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In the Matter of Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding	Docket No. 2006-3 CRB DPRA

THE WRITTEN DIRECT STATEMENT, WITNESS STATEMENTS & EXHIBITS OF NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC., THE SONGWRITERS GUILD OF AMERICA, AND THE NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL

VOLUME XVIII

Filed on April 10, 2007

EXHIBIT CO 0931

control

PolyGram

annual report 1998

introduction

This report reads in two directions.
You're now reading the 'control' side.
If you want to see some of our artists' creativity, simply turn the report over and read it the other way.
You see, we know that you must have creativity but you also need control.
You can't have one without the other.

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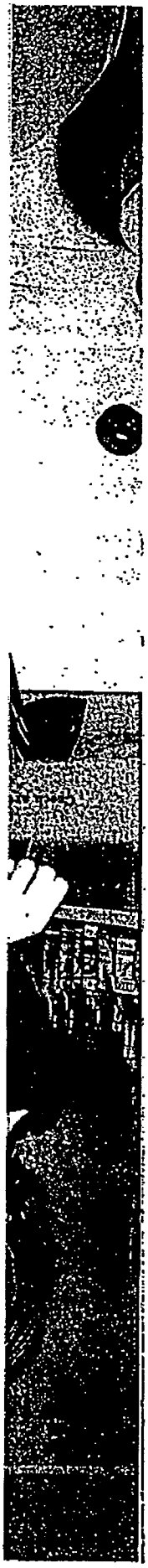
Czech artists MC Erik and Barbara have contributed significantly to PolyGram's increased market presence in eastern Europe.



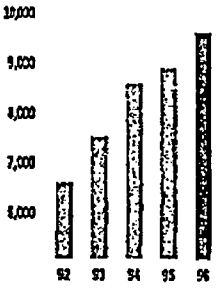
financial highlights

in millions of Netherlands Guilders, unless stated otherwise

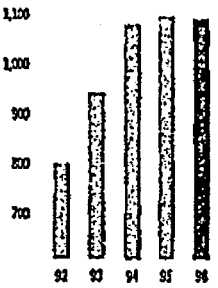
Income statement data	1996	1995	% change
Net sales	9,488	8,798	+8
Income from operations	1,078	1,084	-1
Net income before extraordinary result	722	741	-3
Extraordinary result after tax	(114)	–	–
Net income after extraordinary result	608	741	-18
Net income per share before extraordinary result (NLG)	4.01	4.12	-3
Net income per share after extraordinary result (NLG)	3.38	4.12	-18

Balance sheet data			
Total assets	9,409	8,201	+15
Shareholders' equity	3,302	2,735	+21
Gross cash flow	1,626	1,533	+6

Net sales

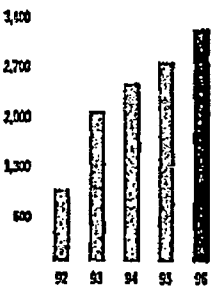


Income from operations



Net income per share before extraordinary result (NLG)

Shareholders' equity

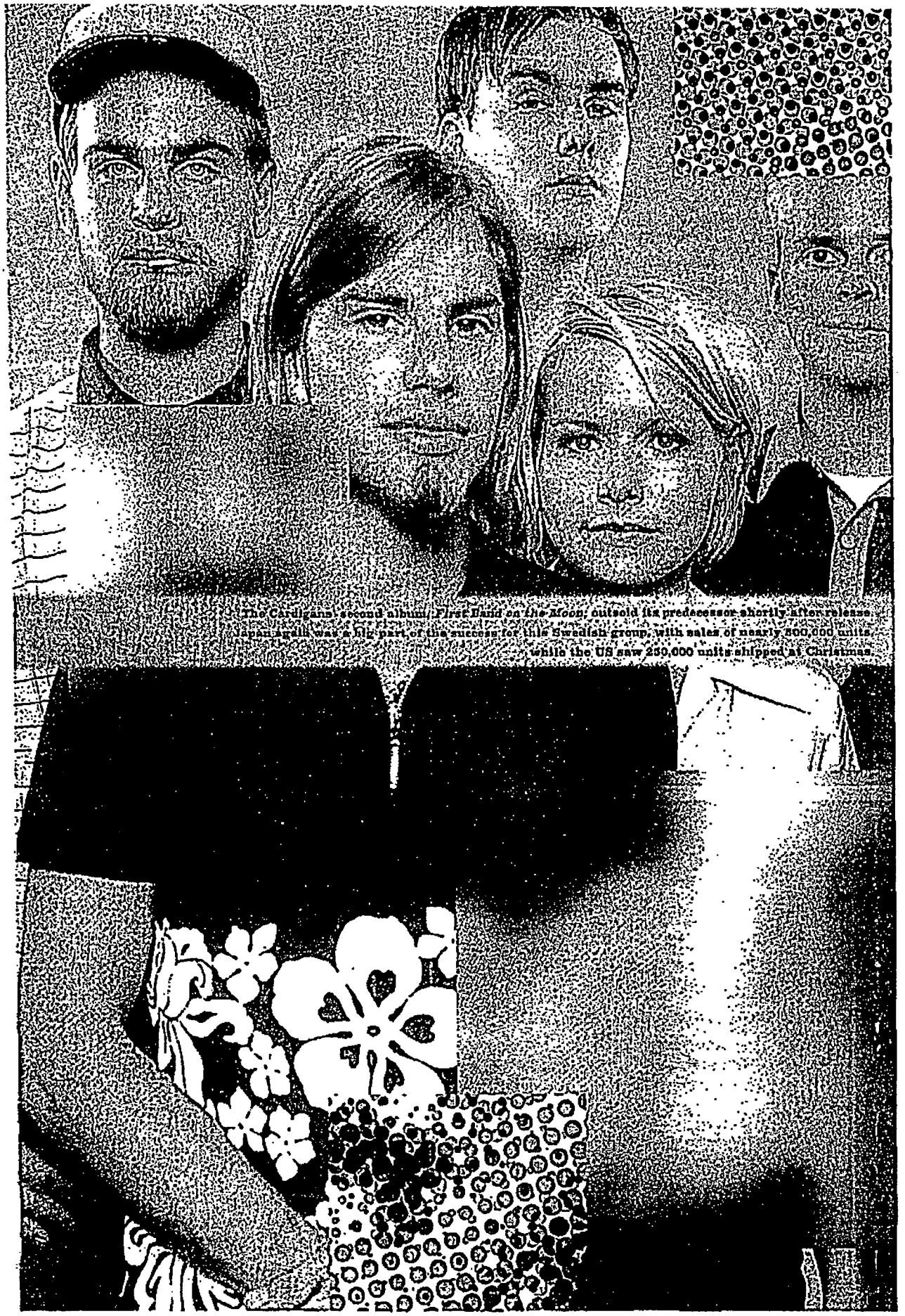


key events of 1996

PolyGram remained the number one record company worldwide

34 albums sold more than 1 million units

PolyGram films won 3 Oscars®



The Cardigans' second album, *First Band on the Moon*, outsold its predecessor shortly after release. Japan again was a big part of the success for this Swedish group, with sales of nearly 500,000 units, while the US saw 250,000 units shipped at Christmas.

president's statement

Alain Lévy
President and Chief
Executive Officer

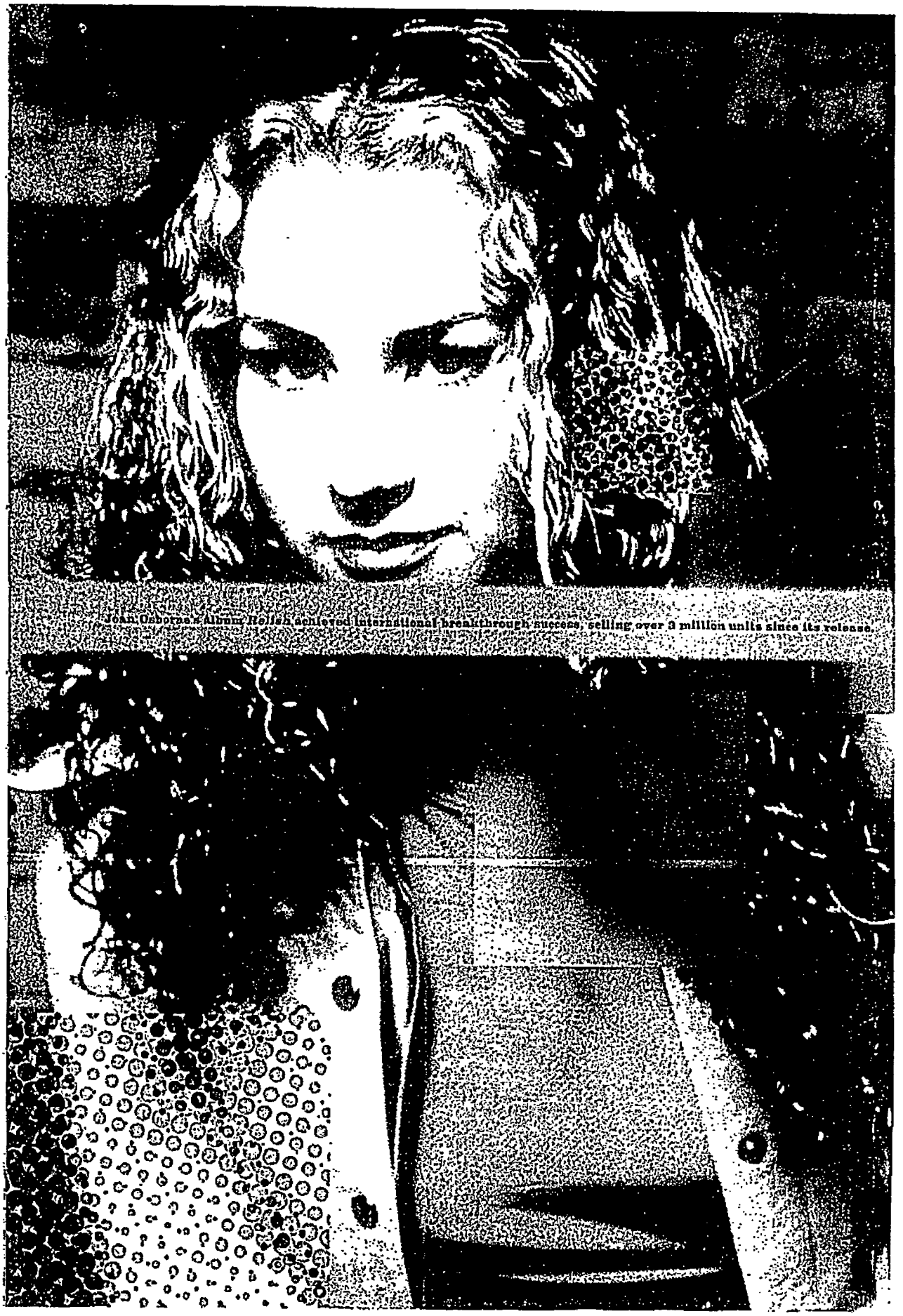
In 1996, PolyGram remained the number one record company in the world and creatively we were as active as usual in finding and developing the big acts of the future. The breadth of our repertoire, internationally and within each region, provides the strong base from which we believe future growth will come. Music as a whole remains an important and growing part of the total entertainment budget and has seen a decade of unprecedented growth, up 12% per annum on a compound basis since 1986.

Sudden shifts in consumer tastes and an upheaval in music retailing in major territories were among the changes which had widespread repercussions for our business in 1996, making it a year of unexpected challenges. Not only PolyGram but the whole industry faced the need to adapt rapidly to new conditions.

Despite disruptions to the music market place PolyGram produced successes in many areas. There were strong performances from national repertoire and in individual country markets, while in film, five years of steady artistic and commercial achievement at PolyGram Filmed Entertainment (PFE) have confirmed that we are now the leading European film company.

We adapted to the changing circumstances and responded with a one-off worldwide restructuring drive. We have begun re-organising our classical music activities, our US operation and our European music distribution and marketing operations to respond to new market conditions. At Motown we are in the process of completely restructuring the label to adapt it to current R&B music trends. This is a costly investment in the short-term but one which we believe will provide significant long-term returns in one of the most vibrant parts of the music business.

National repertoire has moved up the charts and attracted audiences who once bought mainly American or British pop music. In our review of the year, you will find not only familiar names like Bryan Adams, Sheryl Crow and Elton John, but also artists like Seiko Matsuda and Grupo Limité, often little known outside their own markets but who were part of local success stories for the Group last year. We have continued to invest actively in national repertoire in 1996, which produced outstanding successes in Japan and in Brazil, where we have significantly raised our market share. In Europe, PolyGram France was one of our biggest successes of the year, generating hits and an increase in market share, while results in Italy and Spain reflected our ability to combine good new management with a strong creative performance. In a vibrant and competitive UK



Joan Osborne's album *Relish* achieved international breakthrough success, selling over 3 million units since its release.

market we performed well, maintaining our leading position. In North America, we achieved breakthrough success with new artists such as Cake, Jann Arden, Foxy Brown, 311 and Joan Osborne.

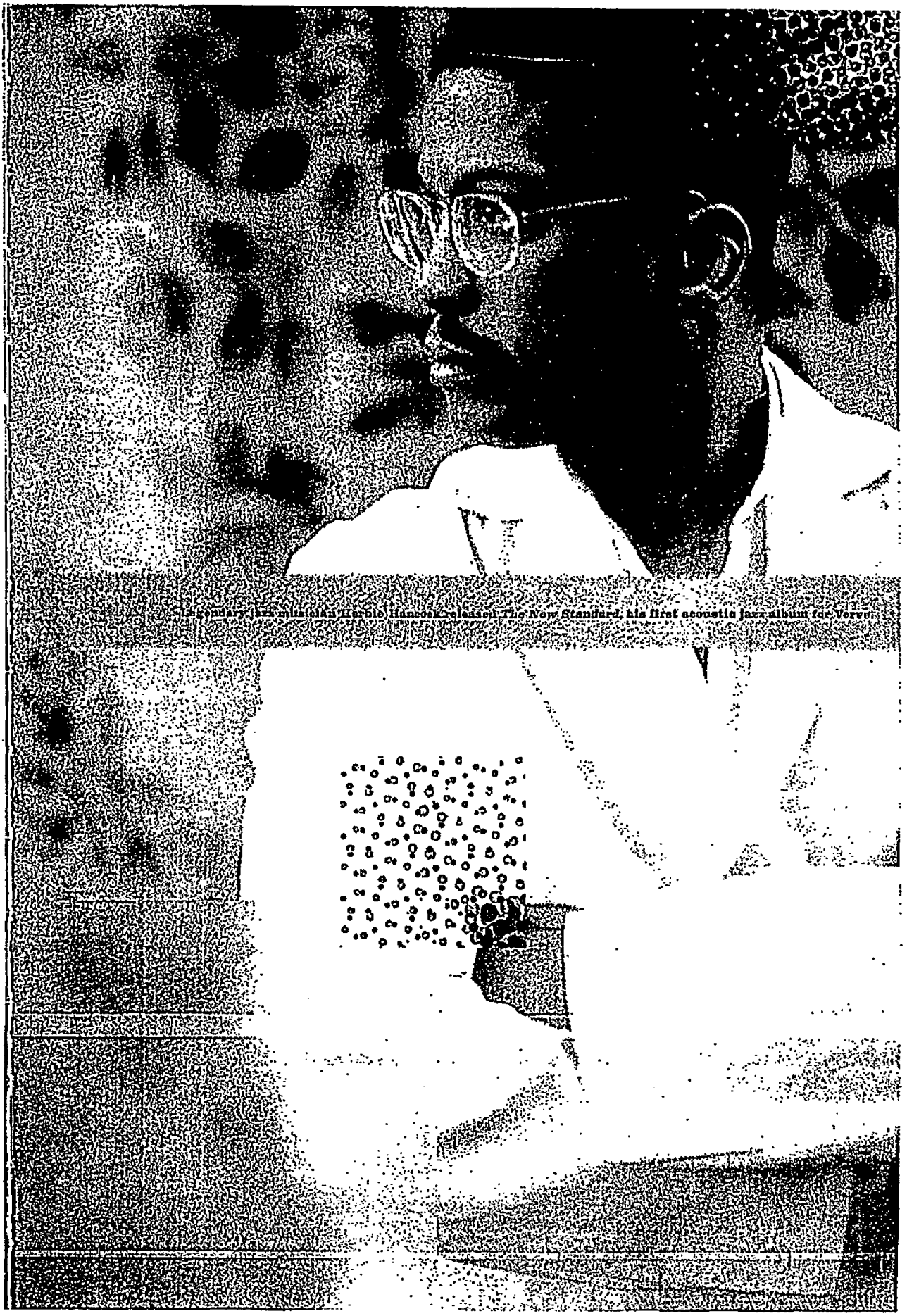
The breadth and strength of PolyGram's creative repertoire is reflected in the continuing success of our music publishing business which celebrates the tenth anniversary of its revival this year. We now have a catalogue of 375,000 titles worldwide across the music spectrum, including songs recorded by Abba, Elton John, Celine Dion and the Spice Girls. An important new deal in the US gave us the rights to administer the Roy Orbison catalogue. PolyGram music copyrights featured on the soundtracks of a number of major films including *Mission: Impossible*, *Twister* and *Shine*. Music publishing achieved a number one market share in the UK during the third quarter.

In filmed entertainment, we are now close to fulfilling the first stage of what we set out to do when we established PFE five years ago. Not only have we succeeded where others have failed but we have done it while keeping to our original script of careful step by step expansion. We are able to attract top artistic talent, and the deals we have secured with broadcasting networks are evidence of the strength of our growing film assets. We believe we will continue to gain share in a market which is expected to grow at a double digit rate for the foreseeable future.

We will continue to develop PFE using the label system of separate and distinctive production units. Our 1997 release schedule will confirm our ability to generate a number of mainstream films as well as smaller releases. Our readiness to expand PFE into US distribution is another sign of our confidence in the business.

In a difficult year when the industry saw many growth expectations dashed, we have produced real success stories in different businesses throughout the world. Most importantly, we have maintained PolyGram's creativity which is the foundation of our long-term success. PolyGram's 12,545 staff around the world are the basis for managing that creativity. I thank them all for their efforts in 1996.

Alain Lévy
President
February 7, 1997



Legendary jazz musician Herbie Hancock released *The New Standard*, his first acoustic jazz album for Verve.

Cross-border PolyGram European music successes in 1996 (in units)

Artist	Country of Origin	Domestic sales	Foreign sales
Abba	Sweden	10,000	1,500,000
Andrea Bocelli	Italy	N/A	1,400,000*
Boyzone	Ireland	50,000	1,400,000
Zucchero	Italy	900,000	1,100,000
Vangelis	Greece	N/A	900,000**
The Cardigans	Sweden	50,000	800,000

*All rights outside Italy
**All rights outside USA and Greece

Top selling PolyGram albums in France in 1996

Artist	Album	Units
Florent Pagny	Bienvenue Chez Moi	1,050,000
Mylène Farmer	Anamorphosis	500,000
The Cranberries	To the Faithful Departed	500,000
Johnny Hallyday	Lorada Tour	450,000
Eddy Mitchell	Mr Eddy	400,000

Top selling PolyGram albums in the UK in 1996

Artist	Album	Units
The Beautiful South	Blue is the Colour	1,100,000
Lighthouse Family	Ocean Drive	950,000
Boyzone	A Different Beat	700,000
East 17	Around the World	600,000
Bryan Adams	18 Till I die	500,000

A look at the pop music charts in Europe in the summer of 1996 told an interesting story. In four countries – Belgium, The Netherlands, Germany and France – one artist had two hit albums in succession, with both English and Italian versions. The artist was Zucchero, one of Italy's leading recording stars, who followed his platinum successes at home with a greatest hits album in both languages.

In a year which saw fewer major international music hits than usual, names like The Cardigans from Sweden and Zucchero not only had hits in their local markets but established a new trend of cross-border musical successes.

At the same time, individual markets, such as France, the UK and eastern Europe produced strong results based on their exploitation of local repertoire. Finding, developing and popularising local acts is an integral part of the international music business. In The Netherlands for example, national pop music now accounts for nearly a quarter of total sales, up from 15% five years ago.

The ability to consistently spot and nurture new local artists has always been one of PolyGram's strengths. In 1996 it was our success in this field, as well as the efforts of new management teams with a strong local focus, which produced good results and helped offset both difficult economic conditions in many European countries and the lack of international hits.

In France, the success of Florent Pagny, Mylène Farmer and new acts like Zâzie and Noir Desir helped build on PolyGram's strong position and increased market share to a record 34%.

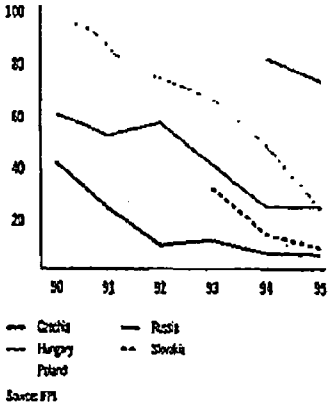
The UK market, fuelled by a creative revolution, experienced another year of growth. Boyzone, who had two number one singles in the UK and a number one album with *A Different Beat*, was one of the biggest selling acts to emerge from Ireland in 1996. New local acts emerged, such as Cast and Lighthouse Family, reviving Polydor's reputation as one of the most vibrant labels for new artists in the industry.

While Germany was particularly affected by the absence of international success stories, it gave rise to promising new acts like Rammstein and Masterboy and to artists like Mark 'OH' and U96.

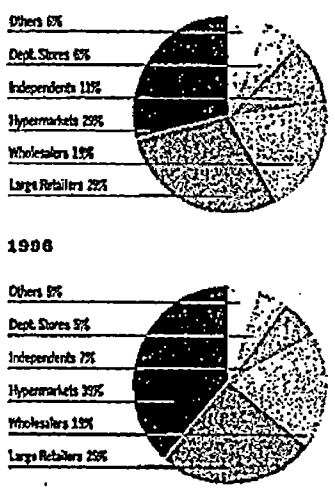
In eastern Europe, where music sales are expanding rapidly, the same trend towards local music is apparent: names like Alice Springs in Slovakia, Kasia Kowalska in Poland and MC Erik and Barbara in Czechia are as important as international acts. PolyGram's aim is to be a major player in these markets, and we have dedicated management time and effort in breaking new acts and opening the

PolyGram achieved a significant turnaround in Spain, aided by the local successes of Ketama and Nino Bravo.

Evolution of piracy in eastern Europe 1990-1995 %



Split of music retail sales in France in 1996 versus 1992



Top selling PolyGram albums in Germany in 1996

Artist	Album	Units
Andrea Bocelli	Bocelli	650,000
Various Artists	Best of Rock	600,000
Metallica	Load	550,000
Various Artists	Just the Best Vol.10	450,000
Various Artists	Just the Best Vol.8	400,000

market up to international repertoire. So far this has meant that PolyGram's profitable business in eastern Europe is growing faster than the market itself.

While 1996 was a year dominated by local European successes, it also saw a number of artists with hit records in more than one market place, despite language and cultural barriers. Italian artist Zucchero sold 500,000 copies of his greatest hits album outside Italy while his compatriot Andrea Bocelli's *Bocelli* sold nearly one million copies in Germany, The Netherlands and Belgium.

The Cardigans' new album *First Band on the Moon* established them as an international act which also succeeded in penetrating difficult foreign markets like the US and Japan, and confirmed Sweden as a major supplier of English language repertoire.

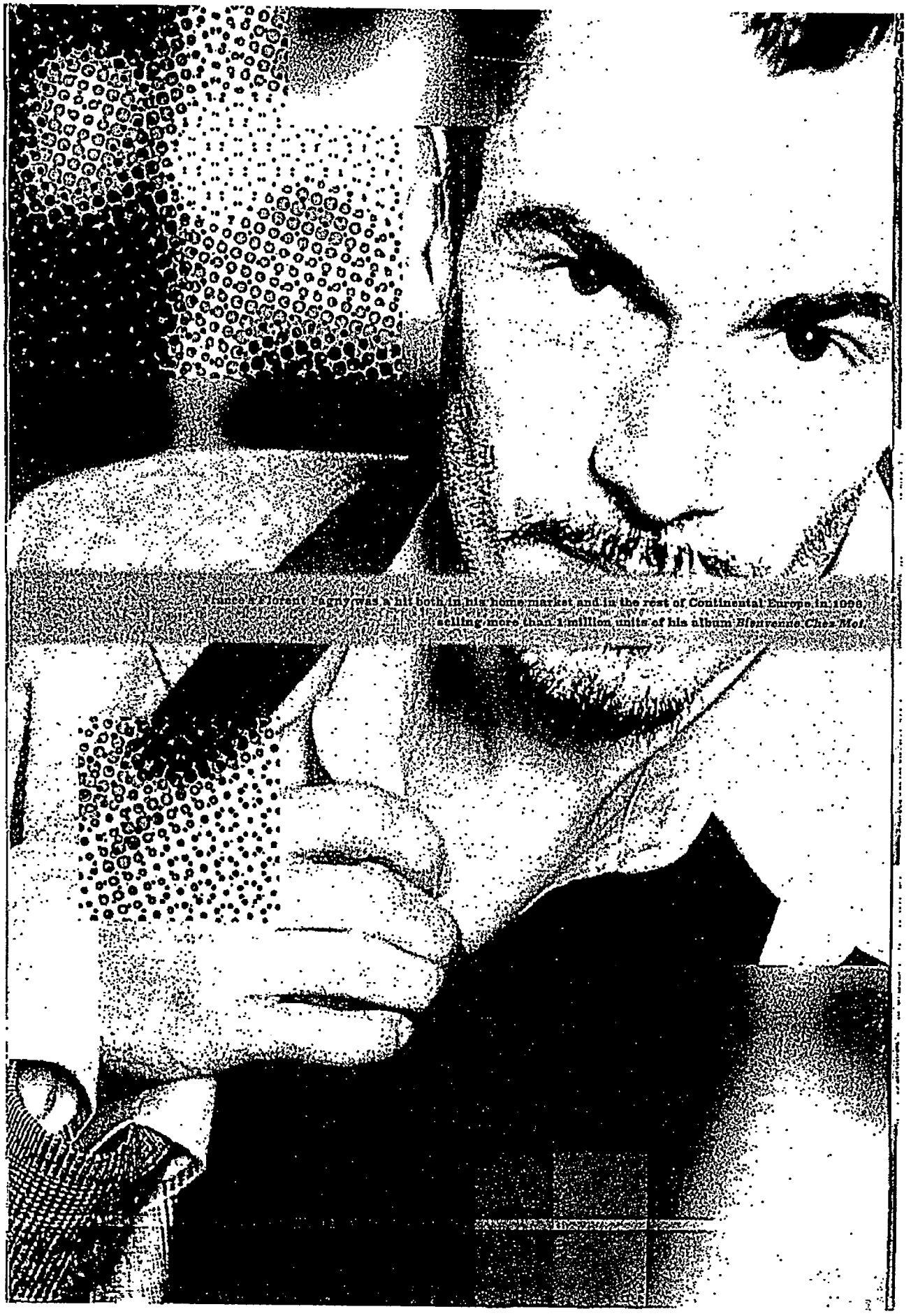
These developments in repertoire brought new challenges to marketing and promotion. This, in addition to the changing face of retailing, especially on the continent, requires new initiatives from our selling and distribution operations. Large retail chains with pan-European purchasing power are increasingly dominating music sales. Hypermarkets typically offer competitive prices and a much narrower range of recordings, based on the hit charts. As a result, promoting new artists and recordings and ensuring sales of our large back catalogue in both pop and classical music has become more difficult.

In France, for example, hypermarkets and the FNAC/Virgin chain already account for nearly two thirds of retail sales. There is a similar trend in Spain where stores carrying limited stocks of perhaps 400 pop and 100 classical titles have already captured half the market from independent retailers, compared with just 15% 10 years ago.

PolyGram has responded to the expansion of large retail chains across traditional European borders and the growth of hypermarkets offering a more narrow range of selections by reviewing our selling approach to make us more focused on the changing needs of retailers and better able to respond to trends in the market. This, together with the re-organisation of our European distribution operations, should give us the most effective organisation for each local market, efficient international distribution of product and allow us to reduce our cost structure.

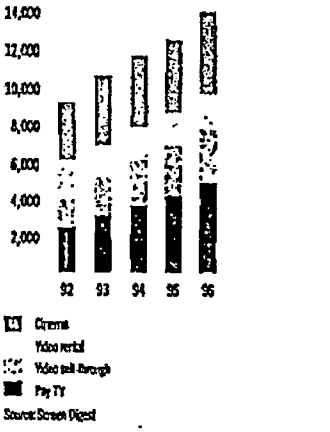
> 'In Europe there is a great deal of identification with specific cultural groups and that is also true musically'
> Rick Dobbis, President PolyGram Continental Europe

In Germany, for example, we were faced with a flat economy and a stagnant market share. Changing music tastes and a new electronic method of compiling the pop charts contributed to the uncertainties of the market place. We reacted by expanding the scope of our extremely successful two year old Motor Music label, now the market leader in dance and jazz, closing our smallest label Metronome Musik and reorganising our sales force, as well as reducing overhead.

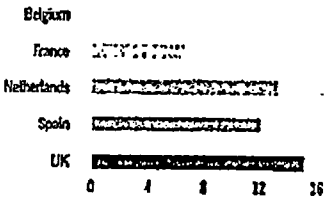


Franco Florent Fagny was a hit both in his home market and in the rest of Continental Europe in 1998, selling more than 1 million units of his album *Bienvenue Chez Moi*.

European movie expenditure 1992-1996 in US$ millions



PolyGram share of major European video rental markets in 1996 %



PFE European activities

Production

Country	
UK	Working Title
	Revolution Films: First look deals
	Specific Films: First look deals
France	PolyGram Division Audiovisuel
	Cinéa (50%)
	Pan Européenne
Benelux	Meteor Film

Distribution

Country	Theatre	Video	Pay per view	Pay TV	Free TV
UK	Own	Own	–	Sky	Ch.4
France	Own	Own	Canal+	Canal+	Package deals
Benelux	Own	Own	Film Net	Film Net	–
Germany	Own	Own	Beta Taurus	Beta Taurus	Tele-München
Spain	Own	Own	–	Canal+ Spain	Antena 3

Our German warehouse has been integrated into our International Supply Centre in Hannover. These actions should also improve the efficiency of our German operation overall.

The challenge for PolyGram's classical music labels has been to diversify their repertoire to appeal to a wider audience. Following the boom conditions of the early nineties and the subsequent slowdown in catalogue sales, the need to expand the horizons of classical music has become apparent throughout the industry.

PolyGram has responded with a careful and comprehensive review of its three major classical labels. The key objective was to sharpen the focus of each label's marketing and artist investment strategies. One of the results of this approach will be a reduction in the overall number of recordings and releases and the reorganisation of the recording studios.

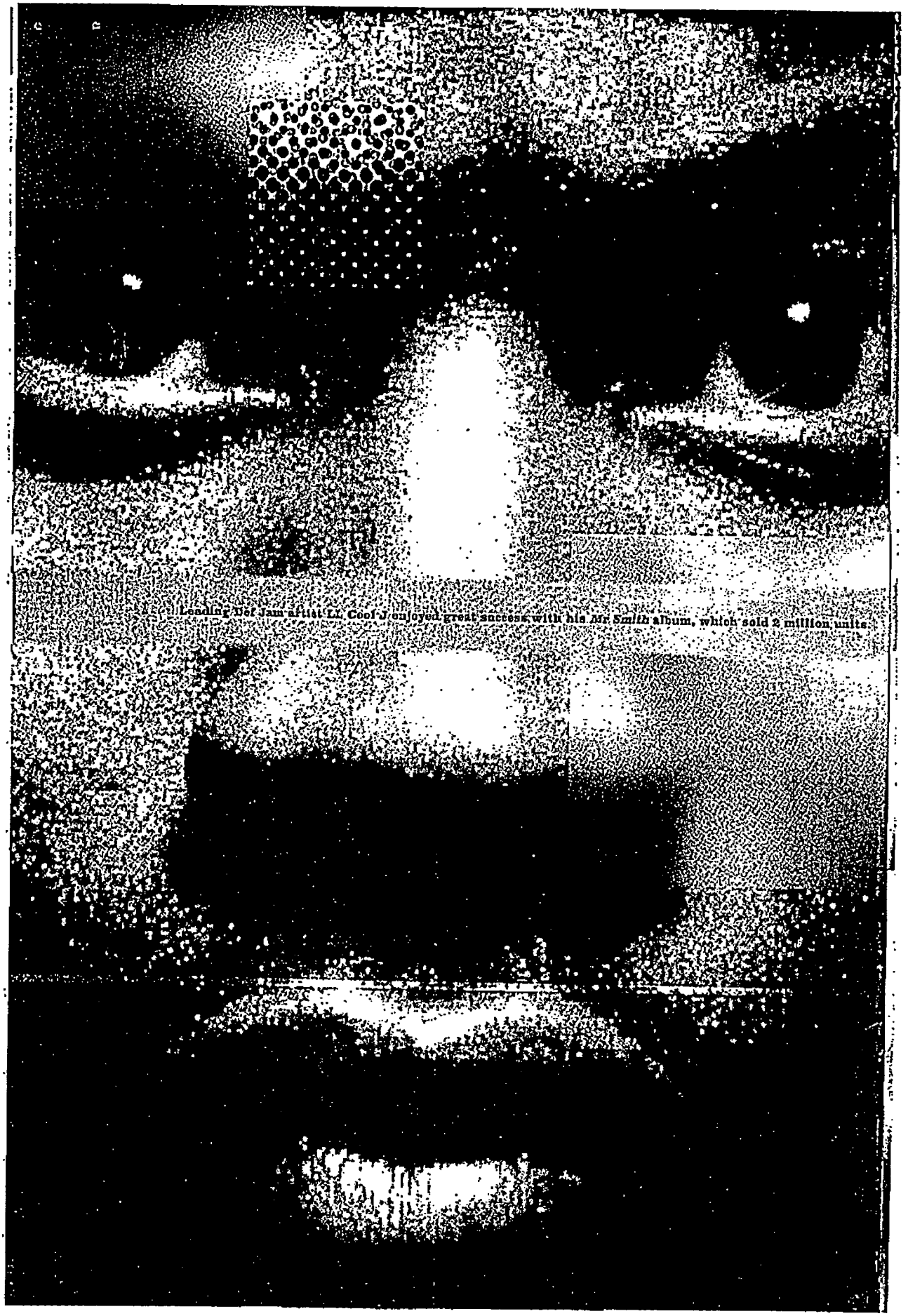
Deutsche Grammophon will concentrate on a more defined range of traditional European music including early music recordings and will also look for opportunities to widen the appeal of its star artists. The highly successful album of Rodgers and Hammerstein songs *Something Wonderful* recorded by Welsh tenor Bryn Terfel is a good example of this.

The newly formed Philips Music Group which unites Philips Classics and creative new labels such as POINT and Imaginary Road, will combine core classical music with more contemporary repertoire and crossover artists from popular music.

Decca will continue to build upon its reputation as the number one opera and vocal label with stars like Luciano Pavarotti and Cecilia Bartoli. Last year, it launched debut albums from two new young sopranos, the Romanian Angela Gheorghiu and American Renée Fleming. Soundtracks will also continue to play a major role in Decca's investment and marketing strategy. Its main soundtrack success from the film *Braveheart* has sold over 1.5 million units to date.

In Europe, nowhere has the force of market changes been more dramatic than in film. Here PolyGram Filmed Entertainment (PFE) was a major beneficiary of the increase in film values as a result of intense competition for programming among Europe's rapidly expanding television distributors.

PFE proved it was able to command top prices for both its growing library and production slate of English language titles such as *Trainspotting*, while also delivering local language films like *The Eighth Day* (*Le Huitième Jour*), a prize winning French film produced and distributed by PolyGram, which was the number one film for 21 weeks in Belgium. Films like this and *Ridicule*, which won the French César Awards for Best Picture and Best Direction, and was nominated for the Best Foreign Film Oscar®, have helped secure sales at prime rates to networks like Canal+ in France, the Kirch Group (pay television) and Tele-München (broadcast television) both in Germany.



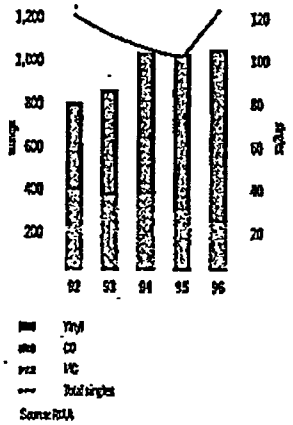
Leading Def Jam artist LL Cool J enjoyed great success with his *Mr Smith* album, which sold 2 million units.

Top selling PolyGram albums in the United States in 1996

Artist	Album	Label	Units*
Shania Twain	The Woman in Me	Mercury Nashville	2.8
311	311	Capricorn/ Mercury	1.5
The Cranberries	To the Faithful Departed	Island	1.3
Joan Osborne	Relish	Mercury	1.2
LL Cool J	Mr Smith	Def Jam	1.2

Source: Soundscan
*In millions

US music industry unit sales 1992-1996 (millions)



Source: RIAA

In fashion terms it was as if short skirts had stopped selling. The music business could no longer rely on its traditional mainstays. Predictability was past, replaced by a new and less certain environment. Creatively and commercially PolyGram had to match this new mood.

Among established artists, The Cranberries were PolyGram's top selling act with over four million units of *To the Faithful Departed*, and Bryan Adams' latest release *18 til I die* sold over 3.6 million copies worldwide. The year also belonged to newcomers like Joan Osborne, Shania Twain, Cake and 311, who produced a series of exciting breakthrough albums. Sheryl Crow's self-titled second album for A&M built sales gradually but finished the year strongly, establishing her as one of PolyGram's most successful international artists.

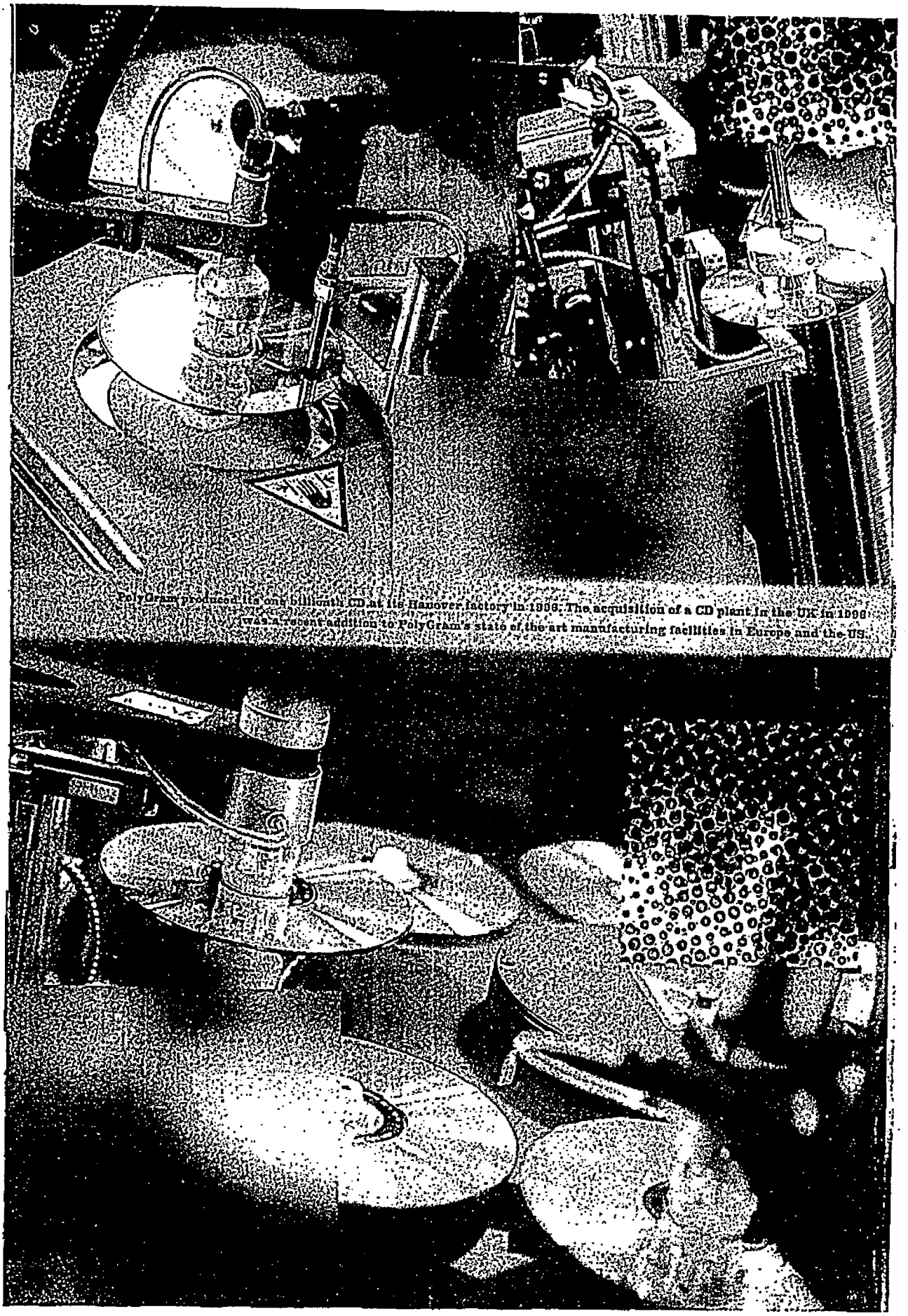
In a saturated and lacklustre US market, experiencing its worst conditions for 15 years, it was not only some artists who felt the effects of slow sales. As a result of over-expansion and a national price war, three US record store chains filed for Chapter 11 protection with others on the brink. Those stores which remained, stocked a more limited number of catalogue recordings and took a more selective and disciplined approach to ordering new releases.

PolyGram responded with label and distribution changes to reflect the tougher conditions in the US music business. These conditions are expected to continue throughout 1997.

PolyGram Group Distribution (PGD) was voted best music distributor of the year for the third year running. Responding to retailers' problems, PGD was reorganised to provide closer contact with customers and better support for both developing artists and those in specific music categories such as jazz, country and classical.

Mercury has reaped benefits from its new management team who have invested in new and developing acts. In 1996, Mercury nearly doubled its market share to over 4% as a result of a series of imaginative artist signings and strong album releases. A joint venture with Capricorn Records produced two major hits: 311 who sold nearly two million albums worldwide and Cake who achieved gold with their debut album *Golden Nugget*. Mercury has also expanded its repertoire through a series of other joint ventures which have included Triloka, Scratchie Records and Mouth Almighty.

Other Mercury successes included Joan Osborne who received six Grammy nominations and John Mellencamp who sold one million units worldwide with *Mr Happy Go Lucky*. Shania Twain's *The Woman in Me* released on Mercury Nashville in 1995, stayed at number one in the country album charts for 29 weeks, selling eight million units worldwide and holds the record as the best selling country album in history by a female artist.



PolyGram produced its one billionth CD at its Hanover factory in 1996. The acquisition of a CD plant in the UK in 1996 was a recent addition to PolyGram's state of the art manufacturing facilities in Europe and the US.

PolyGram US music publishing in 1996

Current bestsellers

Celine Dion	'It's all coming back to me now' written by Jim Steinman
Joan Osborne	'Relish'
Tonyl Tonil Tonél	'House of Music'

Catalogue bestsellers

Abba	'Gold'
The Phantom of the Opera	
Bob Marley	'Legend'
Bon Jovi	'Cross Road'
Elton John	'Love Songs'

Acquisitions/Deals

Desmond Child and Ellie Greenwich/Jeff Barry catalogues
Administration of Roy Orbison catalogue

US box office market shares in 1996

Distributor	No. of films	Gross Revenue (mill. of $)	% change from '95	Market share %
Buena Vista	38	1,202.0	+18.5	20.9
Warner Bros.	31	902.0	+3.4	15.7
Paramount	24	725.5	+33.5	12.6
Fox	14	718.2	+75.6	12.5
Sony	41	598.0	-6.2	10.4
Universal	19	455.0	-27.7	8.4
MGM/UA	19	296.4	-10.1	5.1
New Line	23	285.5	-19.7	5.0
Miramax	40	250.3	+31.8	4.3
Gramercy	15	84.8	+41.7	1.5
Orion	12	48.4	NA	0.8
Sony Classics	19	43.4	+70.7	0.7
Other*	130	119.8	+3.3	2.1

*None greater than 0.4%
Source: Variety Inc. ©1997

PolyGram's major international film production labels worldwide

Fully Owned	Productions per annum
Interscope	4-5
Working Title	3-4
Propaganda	3-4
Island Pictures	2-3

First look deals:
Jodie Foster's Egg Pictures
Tim Robbins' Havoc Inc.
Russell Simmons' Def Pictures
Jason Patric
Act III

Def Jam, now part of the Mercury label, had a good year with breakthrough artist Foxy Brown heading for platinum with her first album which achieved the highest debut for a female rap artist and followed four gold selling singles. Rap superstar LL Cool J achieved double platinum with his sixth album *Mr Smith*.

At A&M, the biggest selling artists were Soundgarden, Sheryl Crow, Sting and Bryan Adams. A&M also enjoyed breakthrough success with Jann Arden and Dishwalla. At Island, highlights for the year included The Cranberries and soundtracks, such as *Don't Be a Menace*.

1996 saw unprecedented success in soundtracks. The biggest sellers included *The Nutty Professor*, *Get Shorty*, *Mission: Impossible* and the re-issue of *Grease*.

Motown presented PolyGram with the most urgent example of where creative change was needed. Despite its impressive brand name and library of hits from artists like Diana Ross and Marvin Gaye, the label required radical action to rejuvenate it as the home of R&B and the powerhouse of African-American music.

The aim is not only to overhaul Motown's artist base but change the entire structural and cultural fabric of the label. As part of this plan, the company was relocated from the West Coast to New York where it will benefit from a larger pool of R&B talent. Under a new management team, Motown has expanded the number of signed artists during 1996 in an effort to underline its credibility as a mainstream record label.

The pace of change has been rapid, and we continue to monitor Motown's progress carefully. We expect to see the first results of the actions we have taken when albums from new artists such as 98 Degrees, Taral Hicks and Ronnie Hanson are released in 1997.

'In a competitive market like the US, our focus must be to spend more time breaking artists and continually revitalising our roster'
Roger Ames, President PolyGram Music Group

We have also taken steps to develop the label brand name further through the development of the Motown Café themed restaurants. In conjunction with Boston Ventures, PolyGram has a direct equity participation in the Cafés. Currently there are locations in New York and Las Vegas and expansion plans include sites in Orlando, London and the Far East.

In jazz the year was an unqualified success. Verve achieved a significant increase in sales. Its A&R operations are now centralised in New York but our jazz activities will also continue to focus on local artist signings. Four Verve albums achieved sales of 200,000 or more, including debut Verve releases by both Van Morrison and Herbie Hancock.

In contrast to the uncertain conditions in much of the music industry, the market for filmed entertainment saw further significant expansion. The growth in the number of cinema screens,

Taiwanese sensation Mavis Fan sold nearly 1 million units of her album *Songs of Cartoon* in 1996.

PolyGram's 1996 box office hits

Film	Worldwide Gross Box Office*
Sleepers	106
Mr Holland's Opus	103
Dead Man Walking	84
Trainspotting	79
Fargo	43
The Eighth Day	38
Eddie	37

*Figures are in US$ millions

Top video sell-through titles in 1996

Title	Units*
Mr Bean Series	3,000
Lord of the Dance	1,500
Barney Series	650
Trainspotting	550**
Bananas in Pajamas	550

*Worldwide sales in '000 units.
**released in the UK only

Top video rental titles in 1996

Title	Units*
Dead Man Walking	330
Usual Suspects	300
Fargo	250
Barb Wire	200
Home for the Holidays	180

*Worldwide sales in '000 units

the popularity of video, boosted by the arrival of digital technology (DVD) and increased demand for film programming by broadcast networks are expected to produce strong growth in this area over the next few years.

PolyGram Filmed Entertainment (PFE), while still loss making, reached break even in the second half of the year and proved it has the creative resources and organisation in place just as the industry is beginning to exploit ever increasing foreign revenue opportunities.

With a slate of 20 films given a multi-territory release in 1996, critical and box office success began early in the year with *Fargo* and *Dead Man Walking* for which Susan Sarandon won the Best Actress Oscar® and finished on a strong note with *Sleepers*, starring Robert De Niro, Brad Pitt, Dustin Hoffman and Jason Patric.

We have established a unique collection of production labels such as Propaganda (*Portrait of a Lady* and the forthcoming *A Thousand Acres* starring Michelle Pfeiffer and Jessica Lange) and Working Title (*Dead Man Walking* and *Fargo*) and ongoing relationships with others such as Figment Films (*Trainspotting* and *A Life Less Ordinary* with Holly Hunter, Ewan McGregor and Cameron Diaz in 1997).

We are now building an international distribution organisation which currently covers seven of the top 10 film markets worldwide.

In the process of building our film business we have created a quality catalogue. This is reflected in a number of premium priced television deals for PFE films last year. We have established a reputation for being creatively driven and talent friendly which attracts the top artists in the industry. Our original commitment to lean management, low overheads and careful expansion has not wavered, laying strong foundations for the future.

'FILM IS ONE OF THE MOST IMPORTANT GROWTH ENGINES FOR THE NEW WORLD OF DIGITAL ENTERTAINMENT AND WE ARE WELL PLACED AND DETERMINED TO GET OUR SHARE OF IT'
MICHAEL KUHN, PRESIDENT POLYGRAM FILMED ENTERTAINMENT

We will enter US mainstream film distribution at the end of 1997. While this will mean additional expenditure it will enable us to earn substantial additional revenues from box office successes and reinforce our access to major talent.

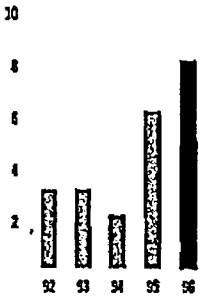
Much of the success of the recent slate of film releases has been mirrored in the performance of PolyGram Video which increased sales and market share in the rental sector with titles like *Dead Man Walking*, *Usual Suspects* and *Fargo*. *Mr Bean* videos sold over 1.3 million units in their first year of release in North America and will be boosted by a feature film *Bean* in 1997.

Through the Sundance Channel, our joint venture in themed television with Robert Redford and Viacom, we have developed another successful outlet for PolyGram film products. Sundance had approximately 1.1 million subscribers in the US by the end of 1996.

The songs of The Carpenters were featured in a popular Japanese TV series, causing a resurgence of interest in the duo. Their *Greatest Hits* album has sold over a million copies in Japan since release.

asia review

Market share in fully owned national repertoire in Japan 1992-1996 %



Top selling PolyGram artists in Asia in 1996

Artist	Source	Units
Jacky Cheung	Hong Kong	2.5 million
The Carpenters	USA	1.6 million
Spitz	Japan	1.5 million
Glay	Japan	1.0 million
Kyosuke Himuro	Japan	1.0 million

One of the outstanding success stories of PolyGram in 1996 came from Japan. Two years ago a new team led by local managers moved in. It concentrated its creative efforts and investment on Japanese pop music artists in addition to marketing international recording stars. It set about finding new acts to meet a growing taste in national music, attracted established stars and changed the local image of PolyGram. The results of this effort came through spectacularly last year. In quick time, PolyGram increased sales of Japanese repertoire, which is up 245% in two years, delivered a number of million selling singles and album releases, and established a reputation as one of the most fashionable and dynamic entertainment companies in the country.

Seiko Matsuda, a well-known local artist, signed by Mercury towards the end of 1995, has seen her career relaunched with her first single for the label reaching number one, and generating more than a million unit sales. Kyosuke Himuro, another new signing, also delivered two chart topping singles and his first million selling album in December.

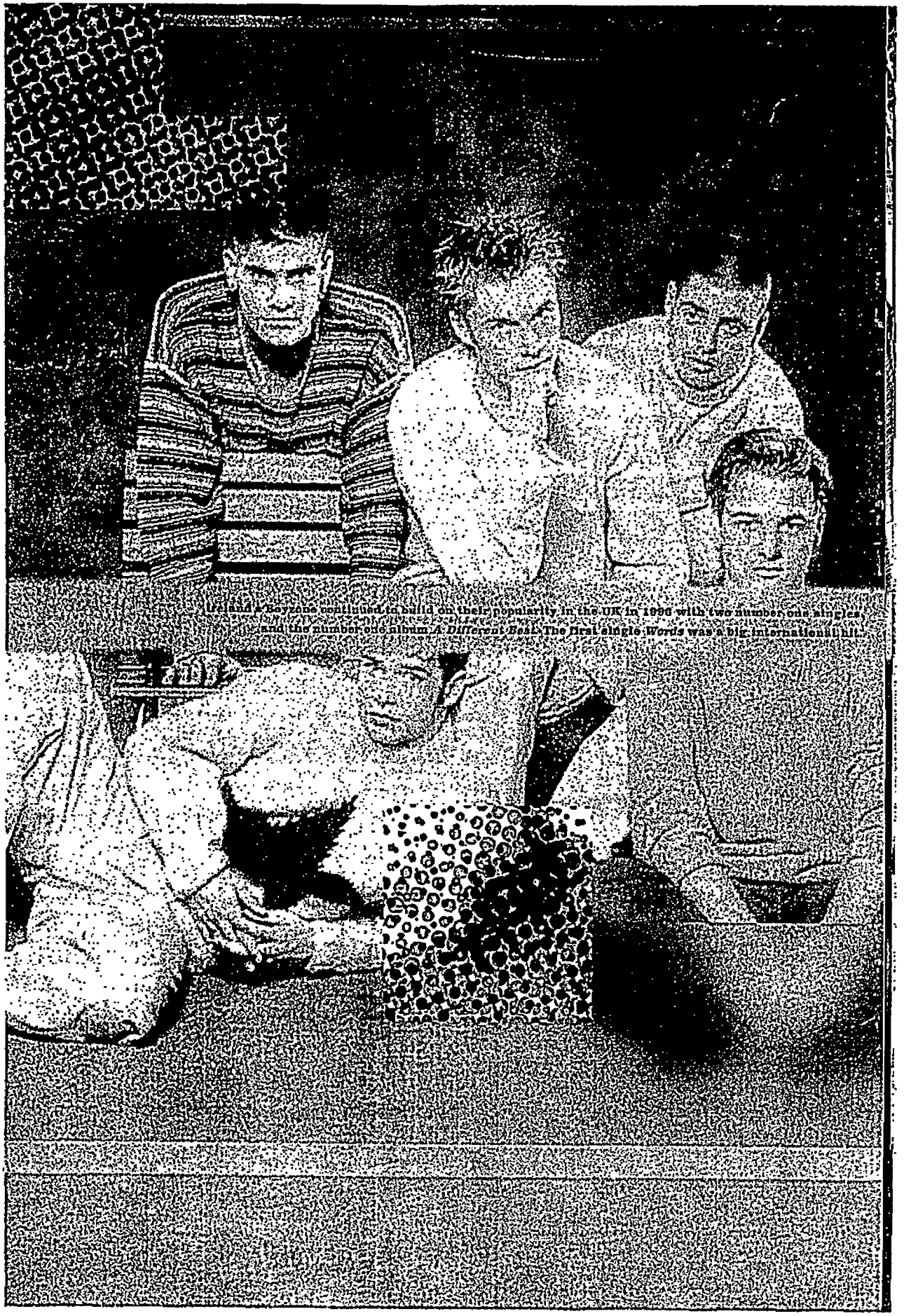
'FOR AN ORGANISATION TO ACHIEVE SUCCESS IN THE ENTERTAINMENT INDUSTRY IT MUST HAVE GOOD LOCAL MANAGERIAL AND CREATIVE TALENT. YOU CANNOT DO WITHOUT IT'
JAN COOK, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

Among the newer artists PolyGram has developed, Spitz has emerged as one of the best selling acts for the Group in Japan, with two million selling number one singles and an album which sold 1.5 million copies. Glay, the biggest breakthrough act for 1996, had three hit singles and two albums, one of which, *Beloved*, was a million seller.

PolyGram's performance reflects its ability to break new acts, and promote existing artists imaginatively, including international artists like Bon Jovi, The Cardigans, The Carpenters and Vanessa Williams who had strong sales in Japan. Not only did we outperform a moderate market last year but we were also able to increase profitability and establish a position at the forefront of the market.

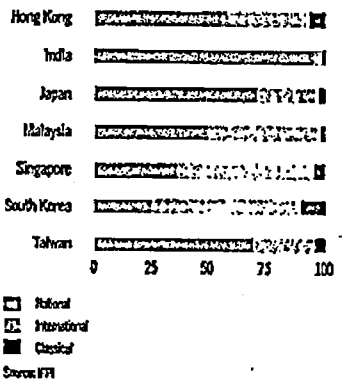
The story was similar in classical music where the Saito Kinen Orchestra and local violinist Akiko Suwanai outperformed many international classical recordings.

The potential of the large south-east Asian market was dramatically illustrated by two successful artists in Taiwan.

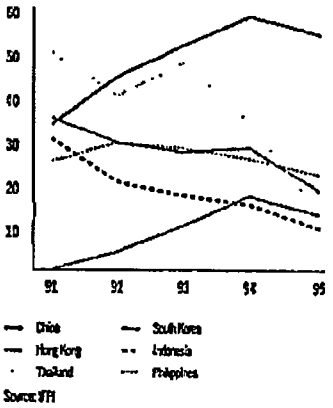


Ireland's Boyzone continued to build on their popularity in the UK in 1996 with two number one singles and the number one album *A Different Beat*. The final single *Words* was a big international hit.

Split of music sales for Asia in 1996 (%)



Development of pirate sales as a % of unit sales in parts of Asia 1991-1995



Jacky Cheung on Polydor sold over 2.5 million units in south-east Asia of which one million copies were sold in Taiwan – a performance which would be equivalent to five platinum discs in the much larger retail market of the US. Decca's new artist Mavis Fan achieved the same distinction, selling nearly a million copies of her 1996 release, *Songs of Cartoon*.

From its success in Taiwan and Hong Kong, PolyGram is building a strong position in both Mandarin and Cantonese music recordings. The fact that PolyGram releases albums by artists in both languages contributes to our strength in the region. During the year we also expanded our presence in Indonesia, Thailand and the Philippines.

China remains a massive music market which is still largely undeveloped. It is expected to grow tenfold to US$ 2 billion in the next few years, but would even then be only a fraction the size of the European industry.

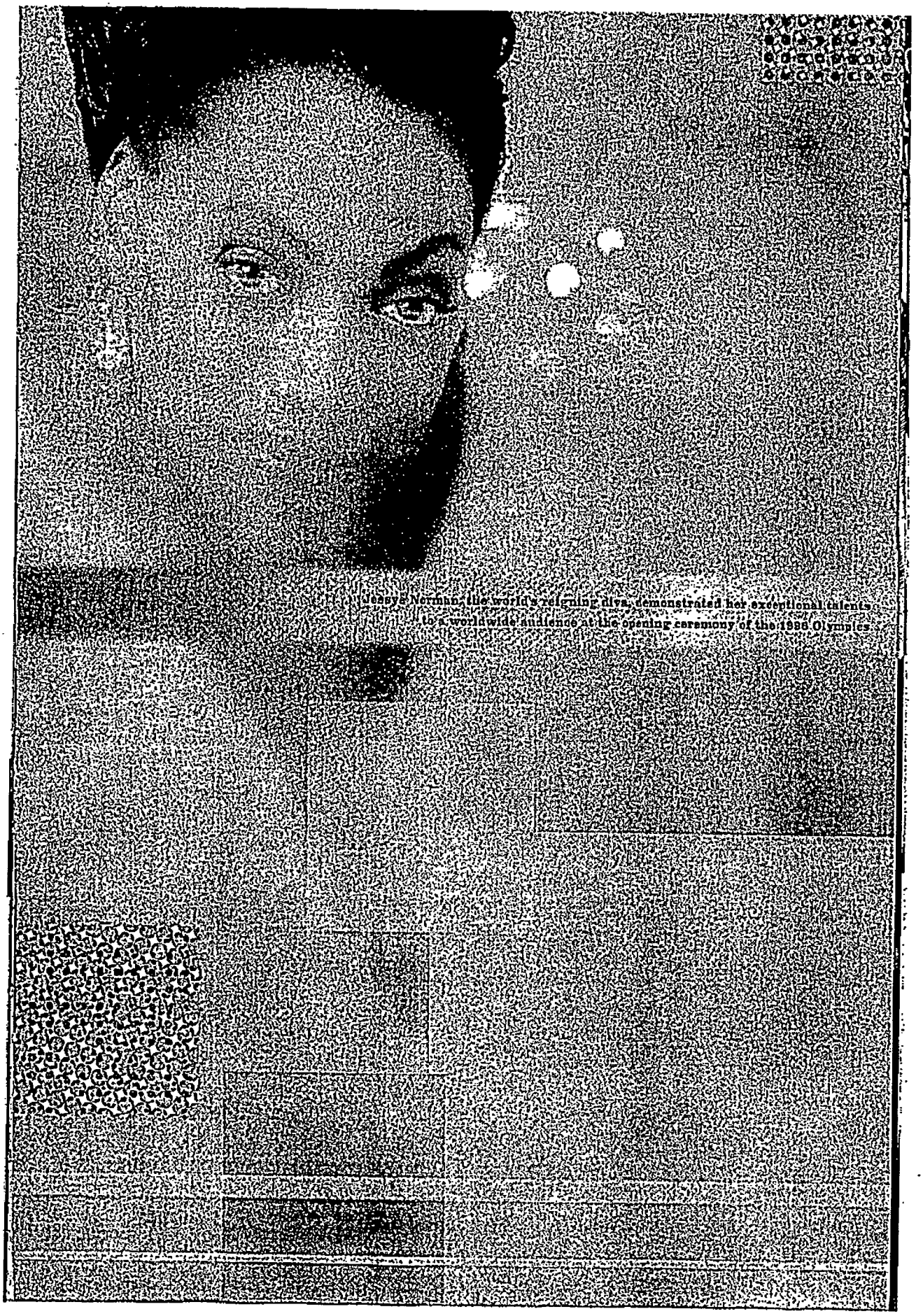
Difficulties with distribution and censorship are hampering its short-term development, but by far the biggest problem for the music business in China is the growing tide of cheap pirate music sales. Piracy is a worldwide problem but according to IFPI figures, China currently accounts for more than 40% of total global pirate audio CD sales. Efforts are underway by PolyGram in co-ordination with other record companies and the Chinese authorities to curb piracy. More work still needs to be done in particular provinces to strengthen enforcement of copyright law.

'THE MAIN REASON FOR OUR SUCCESS IN JAPAN THIS YEAR HAS BEEN NATIONAL REPERTOIRE. WE DECIDED TO CONCENTRATE AS AGGRESSIVELY ON LOCAL ARTISTS AS ON INTERNATIONAL RECORDINGS, AND WE HAVE BEEN SUCCESSFUL IN A SHORT TIME SPAN'
NORMAN CHENG, PRESIDENT POLYGRAM FAR EAST

The handover of Hong Kong this year to China is not expected to increase the piracy problem, but any relaxation of border controls after July or failure to implement existing British copyright legislation particularly on parallel imports would be seen as a threat to business.

In India, a market with enormous consumer potential, cassette sales dominate and CD penetration is still just 1% of sales. PolyGram's efforts to re-enter the local repertoire market a few years ago produced a hit release in 1996 with the *Kamoshi* soundtrack which sold 2.5 million units.

Similarly in Indonesia and Thailand where we have new companies, there is significant upside from the eventual switch to CD in such large population markets.



Jessye Norman, the world's reigning diva, demonstrated her exceptional talents to a worldwide audience at the opening ceremony of the 1996 Olympics.

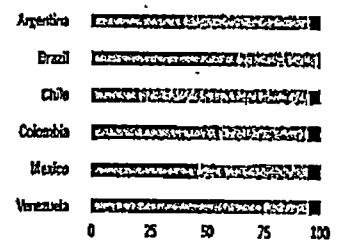
rest of the world review

IFPI ranking of top 10 world music markets in 1995

	Retail Value*	% Share
1. USA	12,102	30.5
2. Japan	7,552	19.0
3. Germany	3,270	8.2
4. UK	2,572	6.5
5. France	2,392	6.0
6. Canada	1,113	2.8
7. Brazil	1,053	2.7
8. The Netherlands	717	1.8
9. Australia	681	1.7
10. Italy	583	1.5
Total	32,033	80.7

*Figures in US$ millions
Source: IFPI

Split of music sales for Latin America in 1996 (%)



Source: IFPI

Latin America, with a population of 479 million, has more people than either the United States or Europe, and a diverse musical genre that is instantly recognisable. In Brazil, it has one of the world's largest and fastest growing music markets.

Since 1992, PolyGram has expanded its Latin American operations, building credibility within the artistic community, reorganising local management and improving profitability and market share.

The result is a business that reached new heights in 1996 and where PolyGram now has the number two position with a 16% market share. In Brazil, where we are already the market leader, we achieved an all-time sales record. The Argentine and Mexican economies have shown signs of recovery, with all Latin American music markets except Venezuela showing growth in 1996. Best-selling local artists included É o Tchan from Brazil, who sold over 2 million units, and Grupo Limité from Mexico who sold over 1 million units.

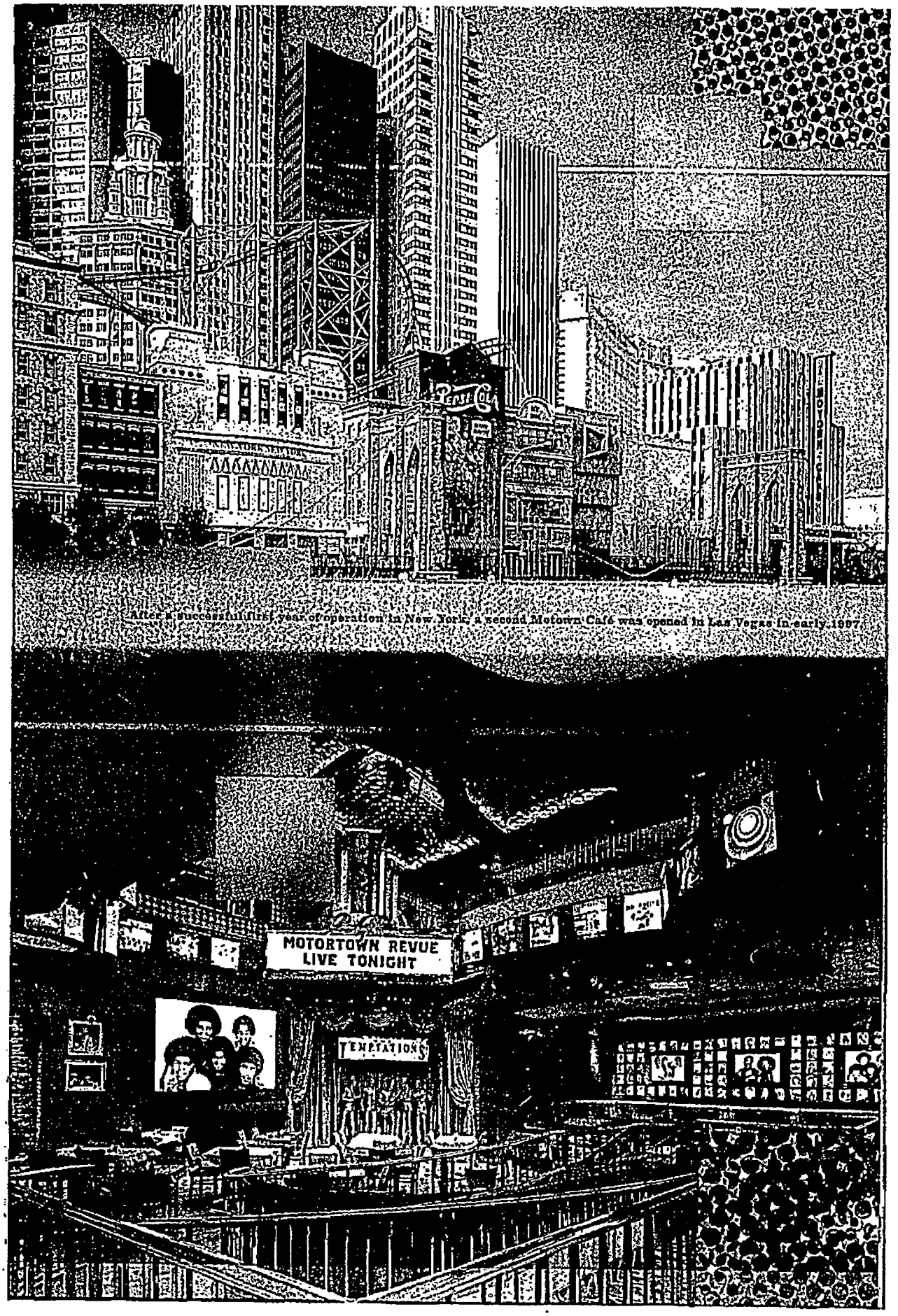
> 'THE FUSION OF ETHNIC AND POP MUSIC COULD MAKE LATIN AMERICA A SOURCE OF INTERNATIONAL PRODUCT'
> MANOLO DIAZ, PRESIDENT POLYGRAM LATIN AMERICA

In spite of the region's reputation as an economic roller coaster, we believe that PolyGram is well equipped to take advantage of the potential future growth of Latin America.

In South Africa, the main international artists who sold well were Bryan Adams and Def Leppard. Considerable local success was also achieved with Chicco and Bobby Hendriks.

In New Zealand, the single released by new local act OMC which went to number one in both New Zealand and Australia, proved to be a strong international hit, reaching the top 5 in UK and European charts. Toni Childs, a local signing in Australia topped the charts for four weeks with her album which sold 150,000 copies. Other good performances in Australia were from Powderfinger, Spiderbait and Anthony Warlaw.

PolyGram Filmed Entertainment successfully began its first operation in the pacific region, by opening a distribution company in Australia. Successful releases included *Dead Man Walking*, *Sleepers* and *Trainspotting*.

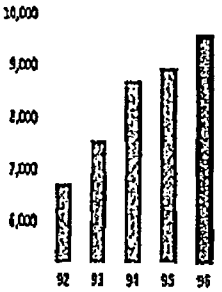


After a successful first year of operation in New York, a second Motown Café was opened in Las Vegas in early 1997.

report of the board of management and financial review 1996

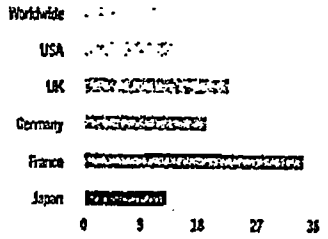
Jan Cook
Executive Vice President
and Chief Financial Officer

Net sales in NLG millions



92	6,617
93	7,416
94	8,803
95	8,708
96	9,488

PolyGram music market share in 1996 (%)



In 1996, PolyGram posted net sales growth of 8% in Netherlands Guilders (NLG), however, operating income and net income before extraordinary results were down 1% and 3% respectively due to modest music industry sales, increased A&R investment in the United States and fewer major music hits. PolyGram was affected by the sluggish conditions in some major music markets in 1996. This was mainly due to rapidly changing music tastes and major upheaval in the retail environment. PolyGram analysed the changed environment and reacted with a re-organisation drive throughout its worldwide music activities. Related to this re-organisation was a one-off pre-tax charge of NLG 160 million. This covered three main areas:

- restructuring PolyGram's US business, particularly Motown.
- re-organising Europe's music distribution and marketing operations.
- restructuring the classical music activities including moving labels to new creative centres and realigning recording facilities.

PolyGram remained the number one record company worldwide and made further progress in establishing a worldwide film production and distribution organisation.

Income Statement

Net Sales

Net sales increased 6% in local currency terms and were up 8% in NLG to NLG 9,488 million, helped by a recovery of the US dollar and Sterling, partly offset by a weaker Yen.

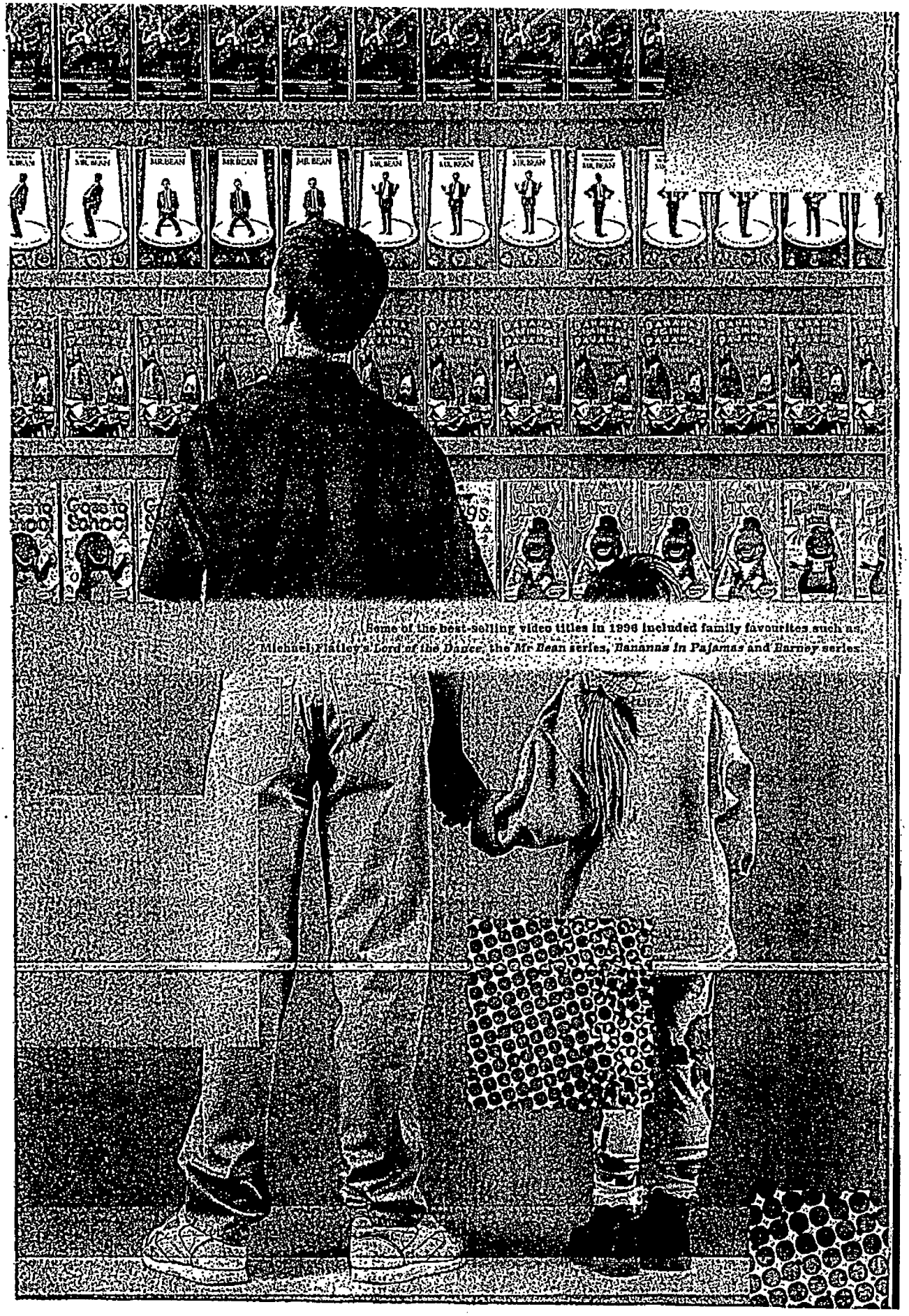
Acquisitions, new consolidations and operations

Of the 6% local currency sales growth, 1% was from new consolidations. The total payment for acquisitions, net of cash acquired was NLG 113 million in 1996 (NLG 419 million in 1995). In music, we increased our stake in leading rap label Def Jam from 50% to 60% (effective June 1, 1996), formed a joint venture with Capricorn Records, USA (effective May 1, 1996) and took full control of Gol Discs (from 49% to 100%, effective September 1, 1996). Effective January 1, 1996, we purchased a CD manufacturing facility in the UK from Philips. At the end of 1996 we increased our stakes in our companies in Indonesia (from 49% to 80%) and the Philippines (from 30% to 51%), to be effective from January 1, 1997. In filmed entertainment, PFE Australia was established January 1, 1996 and we took full control of Gramercy, our US specialist film distributor and Interscope, a US film production label (both effective January 1, 1996). In 1996, PolyGram closed its German, Italian and Dutch joint venture Direct Marketing companies. This was partly in reaction to restrictive conditions imposed by the European Commission.

Performance by Segment

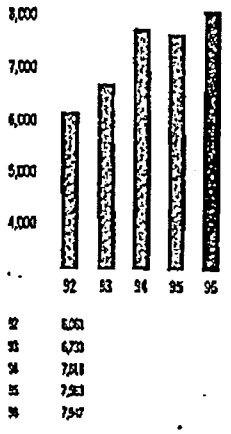
Music

Music sales increased by 5%, whilst operating income declined 3%. The decline in operating income and margin was due to difficult retail conditions in the US and parts of Europe, a relative lack of major selling international albums and sizeable investments in new artists which, in line with our accounting principles, are expensed as they are incurred.

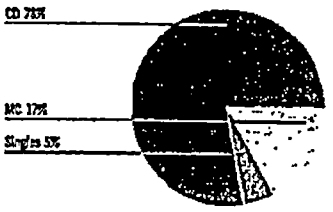


Some of the best-selling video titles in 1996 included family favourites such as, Michael Flatley's *Lord of the Dance*, the *Mr Bean* series, *Bananas In Pajamas* and *Barney* series.

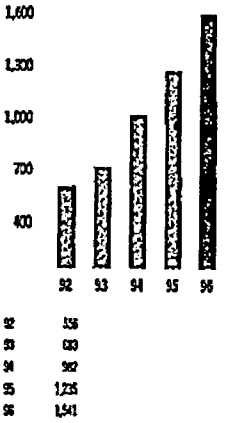
Music sales in NLG millions



1996 net music unit sales by carrier



Film sales in NLG millions



Pop

The relative lack of major international successes in 1996 was partly offset by strong national product, particularly in France, Italy, Spain and Japan. Overall, pop sales increased 2% and 34 albums sold more than one million units compared to 31 in 1995.

Classics & Jazz

As a result of difficult retail conditions in some of the major markets, PolyGram's classics and jazz sales were up just 1%. In reaction to this tough environment, PolyGram is restructuring its classical music activities, under a new management team.

Other music

Other music includes music publishing, third party manufacturing and licence and fee income. Sales increased an impressive 27%. Music publishing had another good year.

Film

Film sales increased 25% to NLG 1,541 million. The operating loss was reduced significantly to NLG 35 million (NLG 69 million in 1995), helped by an improved success rate of our films and a gradual build-up of our catalogue and distribution activities. PolyGram Filmed Entertainment now accounts for 16% of total sales, compared to 14% in 1995.

Performance by Geographic Region

Europe

European sales increased 7%, helped by strong national and UK repertoire. However, operating income declined 2%, which resulted in a margin decline. The decrease in operating margins to 13.1% (14.3% in 1995) was mainly due to stagnant market conditions in some major countries and an increased proportion of sales going through hypermarkets which are higher-volume lower-margin sales.

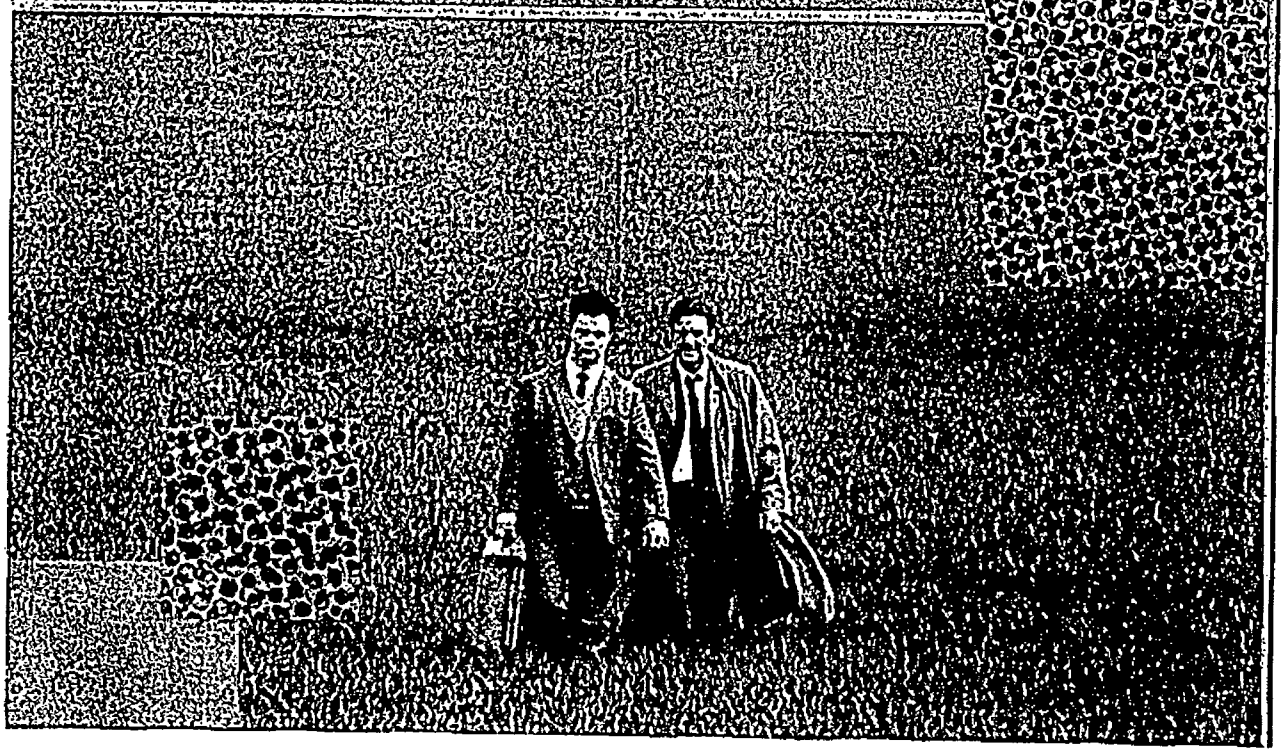
North America

North American sales increased 7% in 1996, whilst operating income declined 42%. The decline in operating margin to 3.2% (5.9% in 1995) was due to disappointing sales volumes on some major music releases, the relatively weak release schedule from some of the US labels in the important Christmas period, a decline in catalogue sales, increased bad debt provisions and lower initial ordering due to the difficult retail environment.

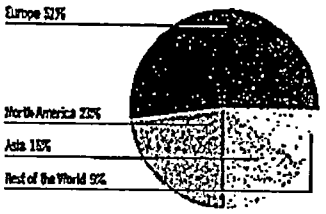
Asia

Sales in Asia were down 3% in NLG, but up 4% in local currency terms in 1996 despite mixed market conditions in the region. We achieved continued strong growth in our own national repertoire in Japan, which was partly offset by a further deliberate decline in low margin third party distributed product and Yen weakness. This achievement is reflected in the strong improvement in operating income, up 6% in NLG and 11% in local currencies, and operating margin to 15.7% (14.5% in 1995). In Hong Kong, total sales were put under pressure from piracy in karaoke CDs which has caused them to decline from nearly one third of total Hong Kong sales a few years ago to virtually nothing. We expect that piracy will continue to be a problem in this region for a number of years, however, in the long-term we remain hopeful of progress. In the rest of south-east Asia, growth was generally at moderate levels.

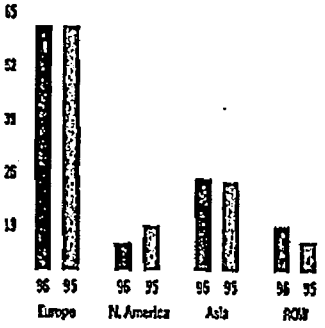
The Eighth Day (Le Huitième Jour) directed by Jaco Van Dormael and starring Daniel Auteuil and Pascal Duquenne was a box office success – taking over US$ 23 million in France alone.



1996 net sales geographical source

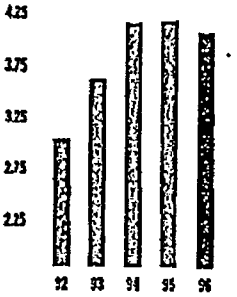


Income from operations by geographical source in %



	96	95
Europe	62	60
North America	5	13
Asia	25	22
Rest of the World	11	7

Net income per share before extraordinary result (NLG)



92	2.59
93	3.58
94	4.16
95	4.12
96	4.01

Rest of the World

Sales increased an impressive 47%, due to some very successful national artists, especially in Brazil and Mexico. Overall operating income increased 58%. The operating margin increased strongly to 14.6% (13.6% in 1995).

Gross income

Gross income increased 7%. The slight decline in gross margin for the Group to 48.2% (from 48.4% in 1995) stems from increased film sales, which have a higher proportion of direct costs, and a lack of major international hits.

Income from operations

Operating income declined by 1%, resulting in a fall in the operating margin to 11.4% (12.3% in 1995). Selling expenses increased from 26.9% to 27.0% of sales, mainly due to increased marketing costs and partly offset by better stock control. General and administrative expenses were higher at 9.6% of sales (9.2% in 1995), mainly due to new consolidations and start up operations. Goodwill amortization was NLG 45 million (NLG 39 million in 1995), with new charges for our additional 10% in Def Jam, Go! Discs and joint venture label Capricorn Records.

Financial income and expense

Financial income and expense increased to a net cost of NLG 8 million, versus NLG 2 million in 1995. Lower interest income was partly offset by exchange gains.

Taxation

The effective income tax rate increased to 29% (28% in 1995). We expect that the tax rate will increase again in 1997 due to a change in the mix of results from countries with low to high tax rates and the lower availability of tax losses.

Non-consolidated companies

The main reason for the increased loss in the non-consolidated companies line to NLG 24 million (NLG 11 million in 1995) was a full year of losses relating to our stake in MTV Asia, established in May 1995.

Third Party Interests

Third party interests declined to NLG 14 million (NLG 27 million in 1995) mainly due to lower financing charges relating to our sub-ordinated notes of NLG 16 million (NLG 22 million in 1995).

Net income and Earnings per share

Net income before extraordinary result was NLG 722 million (NLG 741 million in 1995) and NLG 603 million after extraordinary result. This represents net income per share of NLG 4.01 before extraordinaries (NLG 4.12 in 1995) and NLG 3.36 after extraordinary result.

Gross Cash Flow per share

Gross cash flow from operating activities increased to NLG 9.03 per share (NLG 8.52 per share in 1995), up 6%.

Dividend

PolyGram is proposing to maintain the dividend at NLG 0.95 per share, payable in April 1997.

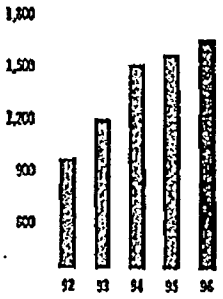
Balance Sheet

Shareholders' equity

Shareholders' equity recorded a net increase of 21%. This was helped by earnings, net of dividend, of NLG 437 million and translation gains of NLG 226 million, offset by the acquisition of own shares of NLG 85 million and other changes of NLG 11 million.

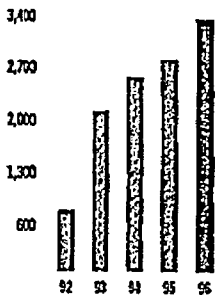
Japan's Gilt broke through in 1988, with three hit singles and two albums, one of which was a million seller.

Gross cash flow in NLG millions



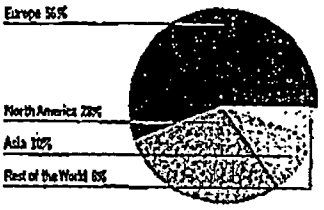
92	931
93	1,159
94	1,471
95	1,513
96	1,626

Shareholders' equity in NLG millions



92	807
93	2,023
94	2,408
95	2,775
96	3,312

1996 geographical split of employees



Working capital requirements

Music inventories remained stable at NLG 471 million (NLG 472 million in 1995) despite positive currency movements and higher sales. Film inventories increased by NLG 294 million to NLG 745 million (NLG 451 million in 1995). Roughly 17% of this increase was due to currency movements. The remainder related to the capitalised costs for unfinished films and increased costs for prints and advertising. The US$ 200 million film lease facility was fully drawn down at the end of October 1996. A new US$ 300 million film lease facility was signed at the beginning of December 1996.

Split of assets

Total assets were NLG 9,409 million (NLG 8,201 million in 1995), of which NLG 1,631 million (NLG 1,266 million in 1995) were identifiable as film assets and NLG 7,778 million (NLG 6,935 million in 1995) related to music. The increase in film assets was due to increased capitalised costs for unfinished films, increased prints and advertising and positive currency movements. Music assets increased mainly due to acquisitions and currency movements.

Fixed asset investments

Capital expenditure increased 15% to NLG 240 million in 1996 (NLG 209 million in 1995) mainly due to the acquisition of the UK CD factory, the acquisition of a recording studio in Japan and the upgrading of our manufacturing facilities.

Liquid assets and liabilities

Long-term liabilities reduced to NLG 285 million (NLG 319 million in 1995), whilst short-term borrowings decreased to NLG 86 million (NLG 115 million in 1995). Taking liquidity of NLG 414 million (NLG 807 million in 1995) minus total long-term and short-term bank debt, PolyGram was again cash positive at the end of December 1996.

Employees

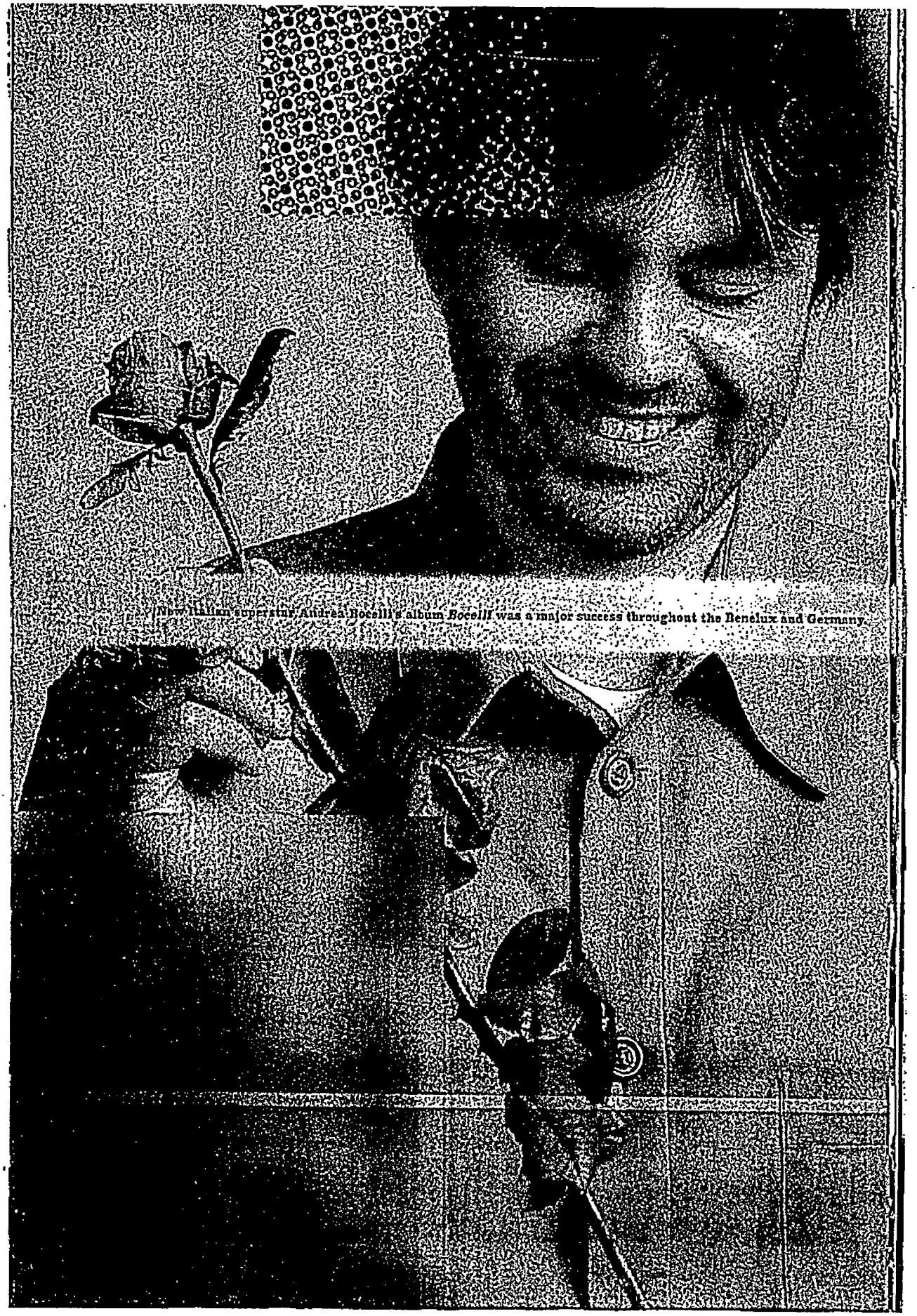
PolyGram's total number of employees at the end of 1996 was 13,545. This includes employees from new consolidations and our growing film operations. Over one third of the total headcount reduction of around 550 people targeted as part of the restructuring charge, was realised in 1996. Around 250 of the 550 relate to employees in the distribution and logistics areas.

Outlook

No major acquisitions or further restructurings are anticipated at this time. Based on current difficult market conditions, we remain cautious for the growth prospects in our core music business. However, we expect that the announced restructuring will better position us for the challenges ahead. In film, we will continue our steady expansion and look forward to the next step which will be to set up US theatrical distribution of mainstream films in the fourth quarter of 1997.

We are pleased to announce our move to quarterly reporting in 1997.

February 7, 1997
The Board of Management



New Italian superstar Andrea Bocelli's album *Bocelli* was a major success throughout the Benelux and Germany.

consolidated statements of income of the PolyGram Group

note	in millions of Netherlands Guilders, except per share data and share amounts	years ended December 31 1996	1995
1	Net sales	9,488	8,798
2	Direct cost of sales	(4,917)	(4,542)
	Gross income	4,571	4,256
2	Selling expenses	(2,565)	(2,363)
2	General and administrative expenses	(928)	(809)
3	Income from operations	1,078	1,084
4	Financial expense	(8)	(2)
	Income before tax	1,070	1,082
5	Income tax	(310)	(303)
	Income after tax	760	779
	Equity in net loss of non-consolidated companies	(24)	(11)
	Group income	736	768
	Third party interests	(14)	(27)
	Net income before extraordinary result	722	741
6	Extraordinary result after tax	(114)	-
	Net income after extraordinary result	608	741
	Average number of shares (par value NLG 0.50) outstanding during the year	180,000,000	180,000,000
	Net income per share before extraordinary result	NLG 4.01	NLG 4.12
	Net income per share after extraordinary result	NLG 3.38	NLG 4.12
	Proposed dividend per share	NLG 0.95	NLG 0.95

Susan Sarandon won the Best Actress Oscar for her role in *Dead Man Walking*, co-starring Sean Penn.

consolidated balance sheets of the PolyGram Group

after proposed distribution of income,
in millions of Netherlands Guilders

	Assets		1996		1995
					as at December 31
	Fixed assets				
7	Intangible fixed assets	2,593		2,339	
8	Tangible fixed assets	801		672	
9	Non-consolidated companies	288		221	
	Other non-current financial assets	110		137	
	Total fixed assets		3,792		3,369
	Current assets				
10	Inventories	1,216		923	
11	Receivables and prepaid expenses	3,987		3,402	
	Cash	414		607	
	Total current assets		5,617		4,932
12	**Total**		9,409		8,201

Group Equity and Liabilities

	Group equity				
13	Shareholders' equity	3,302		2,735	
14	Other group equity	216		286	
	Total group equity		3,518		3,021
15	**Long-term provisions**		904		753
16	**Long-term liabilities**		286		319
15	**Short-term provisions**		608		532
17	**Current liabilities**		4,093		3,576
	Total		9,409		8,201

3LL, an American band, achieved breakthrough success with their self-titled debut album. At year end sales were approaching 2 million units.

consolidated statements of cash flow of the PolyGram Group

In millions of Netherlands Guilders		1996		1995
			years ended December 31	
Cash flow from operating activities				
Net income after extraordinary result		608		741
Adjustments to reconcile net income to gross cash provided by operating activities				
Depreciation on film inventory	528		368	
Depreciation and amortisation on tangible and intangible assets	175		152	
Provision for losses on receivables and prepaid expenses	257		233	
Equity in income/loss of non-consolidated companies (net of dividends)	44		12	
Third party interests	14		27	
		1,018		792
Gross cash provided by operating activities		1,626		1,533
Change in assets and liabilities, net of effects from acquisitions				
Decrease (increase) in assets:				
Receivables and prepaid expenses	(528)		(361)	
Long-term receivables	37		(47)	
Film inventories	(769)		(398)	
Other inventories	35		(47)	
Other assets	1		3	
Increase (decrease) in liabilities:				
Accounts payable	(70)		(59)	
Other current and accrued liabilities	203		298	
Provisions	123		73	
Other liabilities	(103)		(22)	
Total adjustments		(991)		(561)
Net cash provided by operating activities		635		972
Cash flow used in investing activities				
Payments for acquisitions, net of cash acquired	(113)		(419)	
Net payments for tangible and intangible assets	(254)		(198)	
Net payments for non-consolidated companies	(113)		(39)	
Net cash used in investing activities		(480)		(656)
Cash flow from financing activities				
Payables to banks	(75)		(271)	
Long-term debts (including to Philips)	1		9	
Payments to third party interests	(16)		(22)	
Redemption of subordinated notes	(98)		-	
Dividend paid	(171)		(153)	
Net cash provided by (used for) financing activities		(359)		(437)
Net increase (decrease) in cash		(204)		(121)
Translation differences		11		(25)
Cash as at January 1		607		753
Cash as at December 31		414		607
Interest paid		57		57
Income tax paid		248		253

The Guitar Trio – Paco de Lucia, Al Di Meola and John McLaughlin – was one of the best-selling jazz releases in 1980 and a particularly big hit in Europe.

Consolidated Financial Statements of the PolyGram Group

The consolidated financial statements of the PolyGram Group include the accounts of PolyGram N.V. and its subsidiaries (the "PolyGram Group").

The PolyGram Group includes businesses around the world which are involved in the acquisition, production and marketing of repertoire, the manufacture, sale and distribution of pre-recorded sound carriers, such as compact discs, music cassettes and records, and the production and distribution of films and television programming. In addition PolyGram is engaged in activities with respect to music video and music publishing.

Presentation

All amounts are expressed in millions of Netherlands Guilders (NLG) unless otherwise stated. Unless specifically mentioned otherwise, all items in the financial statements are valued at face value. The comparable figures are reclassified to conform to currently adopted presentation methods where necessary.

The financial data of PolyGram N.V. are included in the consolidated financial statements of the Group. Therefore, in accordance with Article 402, Book 2 of the Dutch Civil Code, the non-consolidated statements of income of PolyGram N.V. report only the net income from participations and other income after tax.

Related Party Transactions

Effective January 1, 1996, PolyGram acquired the CD factory in Blackburn, UK from Philips for a consideration of NLG 5 million.

Accounting Policies

Policies of Consolidation

The consolidated financial statements include all of the subsidiaries in which a controlling interest is held by PolyGram N.V., or through any of its subsidiaries directly or indirectly. These companies are included in full in the consolidation; the aggregate of interests of third parties are disclosed separately.

Policies followed in Valuation and Income Recognition

Historic Cost Convention

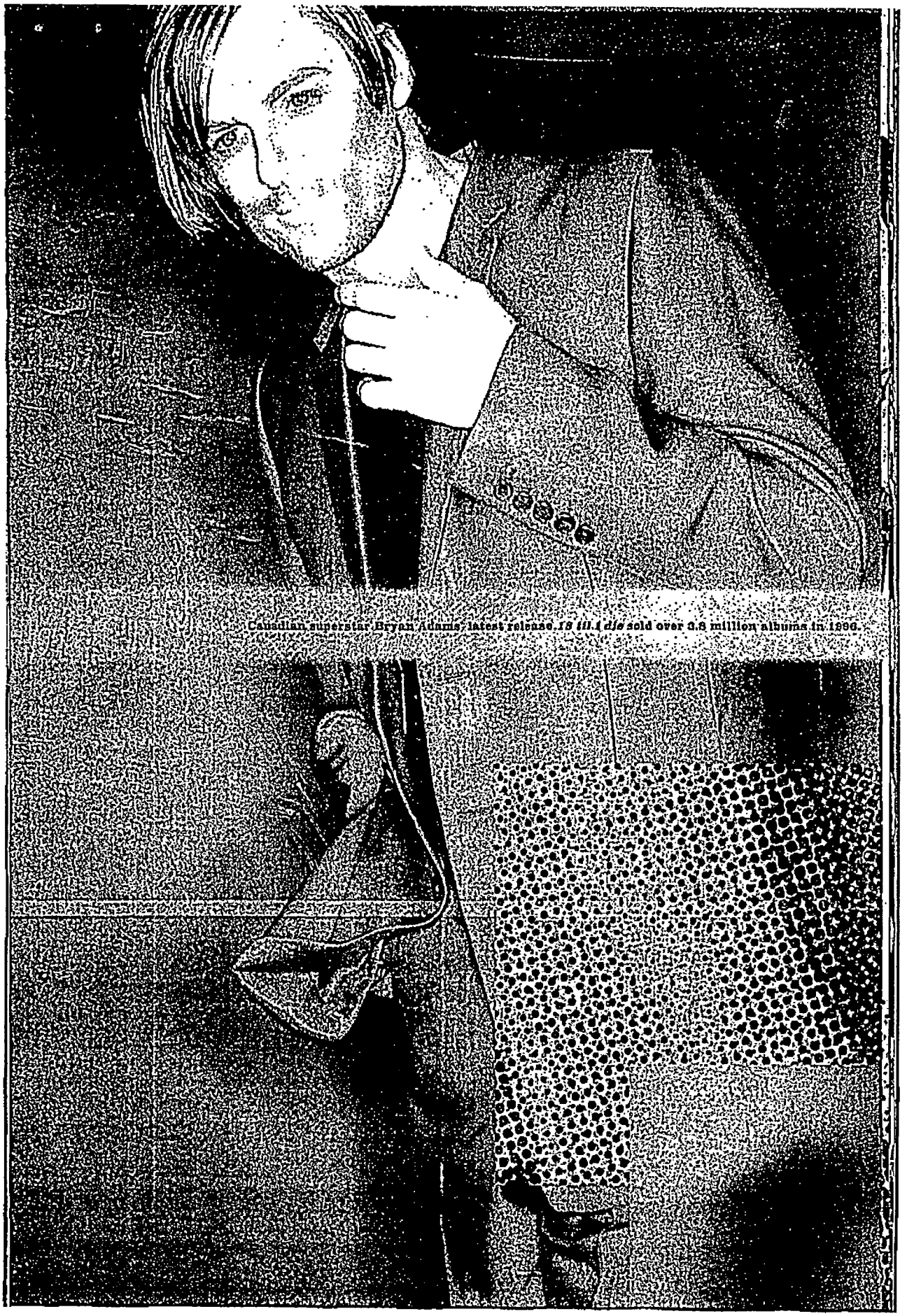
The valuation as well as the depreciation, amortisation and/or consumption of fixed assets and inventories, is based on the historic cost convention.

Foreign Currencies

All foreign currency amounts in the balance sheets have been translated into Netherlands Guilders at the official exchange rates at the respective balance sheet dates. Gains and losses resulting from foreign currency transactions are included in the consolidated statements of income. Exchange differences due to the translation into NLG of investments in foreign subsidiaries, including financing considered a hedge towards those investments, have been accounted for as translation differences in shareholders' equity.

In the case of entities in highly inflationary economies (hyper-inflation countries) the valuation of assets and also depreciation, amortisation and/or consumption is recorded in a functional currency, generally the US Dollar.

In the consolidated statements of income, amounts in foreign currencies have been translated into NLG based upon the applicable rates of exchange for the periods involved.



Canadian superstar Bryan Adams' latest release, *18 till I die* sold over 3.8 million albums in 1996.

Balance Sheets

Intangible Fixed Assets

Catalogues of recorded music, music publishing rights, film rights and theatrical rights are considered intangible assets if they are purchased as part of a major acquisition and are valued based upon the actual amounts paid to third parties upon acquisition or the present value of expected income, whichever is lower. They are amortised if and to the extent that the present value of the expected income generated by the acquired catalogues falls below their book value.

Amounts paid in excess of the net asset value for acquisitions (goodwill) made after January 1, 1993 are capitalised and systematically amortised over the economic life of the business acquired, a period not exceeding 40 years. Prior to 1993, goodwill was charged directly to shareholders' equity.

Tangible Fixed Assets

Tangible fixed assets are valued at their acquisition cost less depreciation. Depreciation is calculated on a straight-line basis taking into account the assets' economic lives.

Non-Consolidated Companies

Investments in non-consolidated companies in which a significant influence is exercised over the business and financial policies are valued at their net asset value. The valuation of assets, liabilities and equity and the recognition of income of these non-consolidated companies reflects, in all material aspects, the accounting policies governing these consolidated financial statements. Non-consolidated companies in which no significant influence is exercised are valued at the lower of cost and net realisable value. In general, a significant influence is considered to exist if more than 20% of the voting rights are held.

Other Non-Current Financial Assets

Other non-current financial assets are valued at the lower of cost and net realisable value.

Inventories

Recording costs are valued at cost less depreciation, which is based on the average economic life.

Films are valued at the lower of cost and net realisable value. The cost of a film includes the direct costs of production, an allocation of studio production overhead, interest capitalised during the production period and print and advertising expenditure. The cost of each individual film is amortised in the proportion that revenues earned in the accounting period bear to the estimated total revenues. Estimates of expected total revenues are reviewed periodically and amortisation is adjusted accordingly.

When PolyGram acts as distributor, income is recognised as the films are exhibited. Revenues from licensing agreements are recognised when the product is first available for release provided certain conditions of sale have been met.

Other inventories are valued at purchase price or cost of manufacture, based on the first-in first-out method, reduced by a provision for the risk of obsolescence. Cost of manufacture includes direct costs and the appropriate proportion of overhead, taking into account the stage of completion. Income derived from intercompany transfers of goods and materials is eliminated.

Receivables and Prepaid Expenses

Trade accounts and other receivables are valued at face value less an allowance for the risk of doubtful accounts.

Advances to artists and repertoire owners are appraised individually and the recoverability of the unrecouped portion is determined by the prospect of future recoupment taking into account current popularity and recent sales.

Included in receivables are net deferred tax assets recognised for temporary differences between the financial and tax bases of assets and liabilities that result in tax deductible amounts in future years, and deferred tax assets recognised for tax loss carry-forwards and tax credits. A valuation allowance is recognised if, based on the weight of the available evidence, it is more likely than not that all or some of the deferred tax assets cannot fully be realised.

Other Group Equity

Other group equity represents third party interests in the total equity of consolidated companies which are shown at net asset value, calculated in accordance with the accounting policies governing these consolidated financial statements.

Mexican band, Grupo Limite, sold nearly 1 million units of their debut album *Por Puro Amor*.

Liabilities

Provisions are not associated with specific assets, but are created to cover certain business obligations and risks. Provisions are stated at face value, with the exception of provisions for employee pension obligations and severance payments, and provisions for earn-outs, which are stated at the present value of the future obligations.

The provisions for pension obligations are based mainly on actuarial calculations and relate to those obligations that are not funded by separate pension funds or by third parties. The total pension coverage provided by these provisions together with the various separate pension funds is equal to at least the present value of existing pension obligations based upon the number of prior years of employment with PolyGram.

Included in provisions are net deferred tax liabilities recognised for temporary differences between the financial and tax bases of assets and liabilities that result in taxable amounts in future years.

Statements of Income

Net sales represent the revenues derived from products delivered to, and services performed for, third parties, net of returns.

The recognition of other income and expenses is closely related to the valuation principles for assets and liabilities.

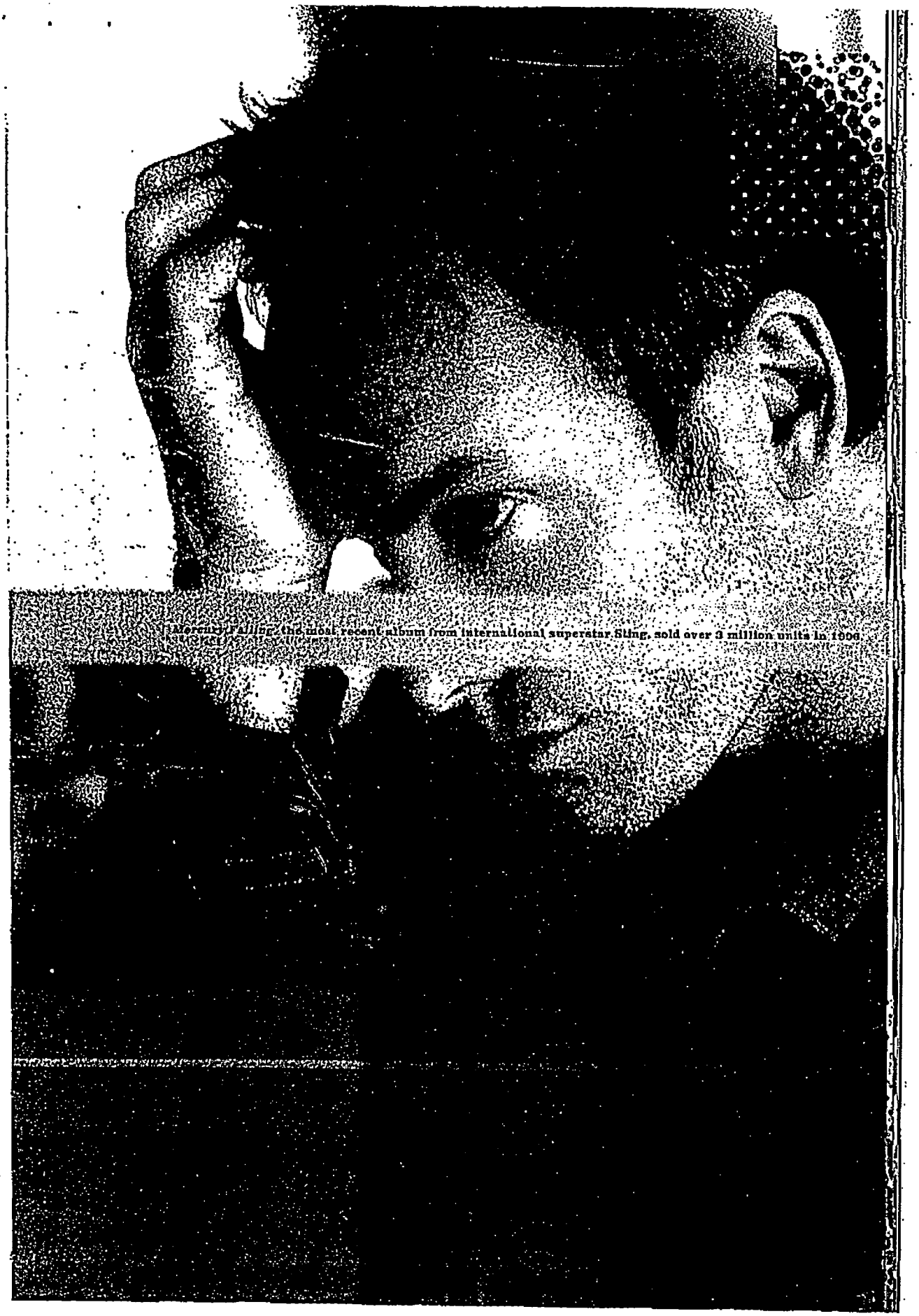
Equity in the net income of non-consolidated companies in which a significant influence is exercised has been recognised, in all material aspects, in accordance with the accounting policies governing these consolidated financial statements. Where no significant influence is exercised in a non-consolidated company, dividends received are recognised as income.

Extraordinary results are income and costs not resulting from the ordinary operations of the Group, which are incidental in nature and have in aggregate a material impact on the PolyGram organisation and results for the year.

Statements of Cash Flow

The consolidated statements of cash flow have been drawn up by the indirect method. For a number of reasons, mainly the effects of translation differences and acquisitions during the year, certain items in the statements of cash flow do not correspond to the differences between the balance sheet amounts for corresponding items. Cash flows in foreign currencies have been translated into NLG based upon the applicable rates of exchange for the periods involved.

Payments for acquisitions, net of cash acquired, include amounts paid during the year for prior year acquisitions.



Mercury Falling, the most recent album from international superstar Sting, sold over 3 million units in 1996.

note 1

Net Sales by Geographical Area

	1996	% of total	1995	% of total
Europe	4,919	52	4,586	52
North America	2,202	23	2,053	24
Asia	1,563	16	1,613	18
Rest of the World	804	9	546	6
Total	9,488	100	8,798	100

Net Sales by Business Segment

	1996	% of total	1995	% of total
Music	7,947	84	7,563	86
Filmed Entertainment	1,541	16	1,235	14
Total	9,488	100	8,798	100

note 2

Cost of Sales

	1996	1995
Direct cost of sales	4,917	4,542
Selling expenses	3,565	2,363
General and administrative expenses	928	809
Total	9,410	7,714

Salaries and wages

Included in cost of sales are salaries and wages amounting to NLG 1,062 million (1995: NLG 938 million). The costs for related social security and similar benefits totalled NLG 238 million (1995: NLG 212 million). Included in the costs for social security are the costs for pension plans totalling NLG 40 million (1995: NLG 41 million). In 1996 remuneration of members and former members of the Board of Management paid by the Group totalled NLG 19.8 million (1995: NLG 18.3 million), and for the Supervisory Board NLG 0.2 million (1995: NLG 0.2 million).

Employees by Geographical Area

	Average number of employees 1996	1995
Europe	7,044	6,647
North America	3,490	3,459
Asia	1,251	1,140
Rest of the World	764	660
Total	12,549	11,906

Fargo, released in February 1996, was nominated for 7 Oscars®, received the Directors Prize at the Cannes Film Festival and has since been named Best Film by the Australian Film Industry, the New York Film Critics Circle and the Broadcast Film Critics Association among others.

note 3 **Income from Operations by Geographical Area**

	1996	1995
Europe	644	654
North America	71	122
Asia	246	234
Rest of the World	117	74
Total	1,078	1,084

Income (Loss) from Operations by Business Segment

	1996	1995
Music	1,113	1,152
Filmed Entertainment	(35)	(68)
Total	1,078	1,084

note 4 **Financial Income (Expense)**

	1996	1995
Interest expense	(42)	(40)
Interest income	31	34
Exchange gains and losses	10	8
Other financial expenses	(7)	(4)
Total	(8)	(2)

note 5 **Income Tax**

Total income tax amounted to NLG 264 million (1995: NLG 303 million) resulting in an effective tax rate of 29% (1995: 28%). Income tax was reduced by NLG 21 million (1995: NLG 86 million) due to the utilisation of tax losses carried forward and tax credits. At December 31, 1996 accumulated tax losses carried forward and tax credits were approximately NLG 856 million (1995: NLG 742 million) of which approximately NLG 127 million (1995: NLG 146 million) will expire within 5 years.

Withholding tax relating to the income of subsidiaries to be distributed as dividends in the near future is generally charged to income in the year in which the income is generated.

PolyGram's operations are subject to income tax with different statutory tax rates in various jurisdictions. The weighted average statutory tax rate reflected in the following table is computed by applying the applicable statutory tax rates to PolyGram's earnings in each country.

Reconciliation of income tax rate	1996 (%)	1995 (%)
Weighted average percentage, based on statutory tax rates	38	40
Tax effect of tax losses carried forward utilised	(2)	(5)
Tax effect of current losses not recognised	-	2
Tax effect of changes in the valuation allowances for deferred tax assets	(2)	1
Tax effect of exempt income and non-deductible expenses	(6)	(5)
Other tax effects	1	(5)
Effective tax rate	29	28

note 7

note 6

note 5

Our success with soundtracks took another leap forward in 1996, with *Braveheart*, *The Nutty Professor*, *Mission: Impossible* and the re-issue of *Grease* all selling over a million albums each.

note 5 Income Tax (continued)

The net deferred tax assets or liabilities are determined per fiscal entity. Offsetting deferred tax assets and deferred tax liabilities within the same fiscal entity is restricted to deferred tax assets and liabilities which reverse in the same period.

Current and non-current deferred tax, net of valuation allowances, is included in receivables in the event and to the extent that, per fiscal entity, total deferred tax assets exceed total deferred tax liabilities. Conversely, current and non-current deferred tax liabilities are included under provisions in the event and to the extent that, per fiscal entity, the deferred tax liabilities exceed the net deferred tax assets.

Analysis of income tax positions	1996	1995
Balances as at January 1	(448)	(453)
Income tax accrued	(310)	(303)
Income tax on extraordinary result	46	-
Income tax paid	248	253
Other changes (including translation differences)	24	55
Balances as at December 31	(440)	(448)

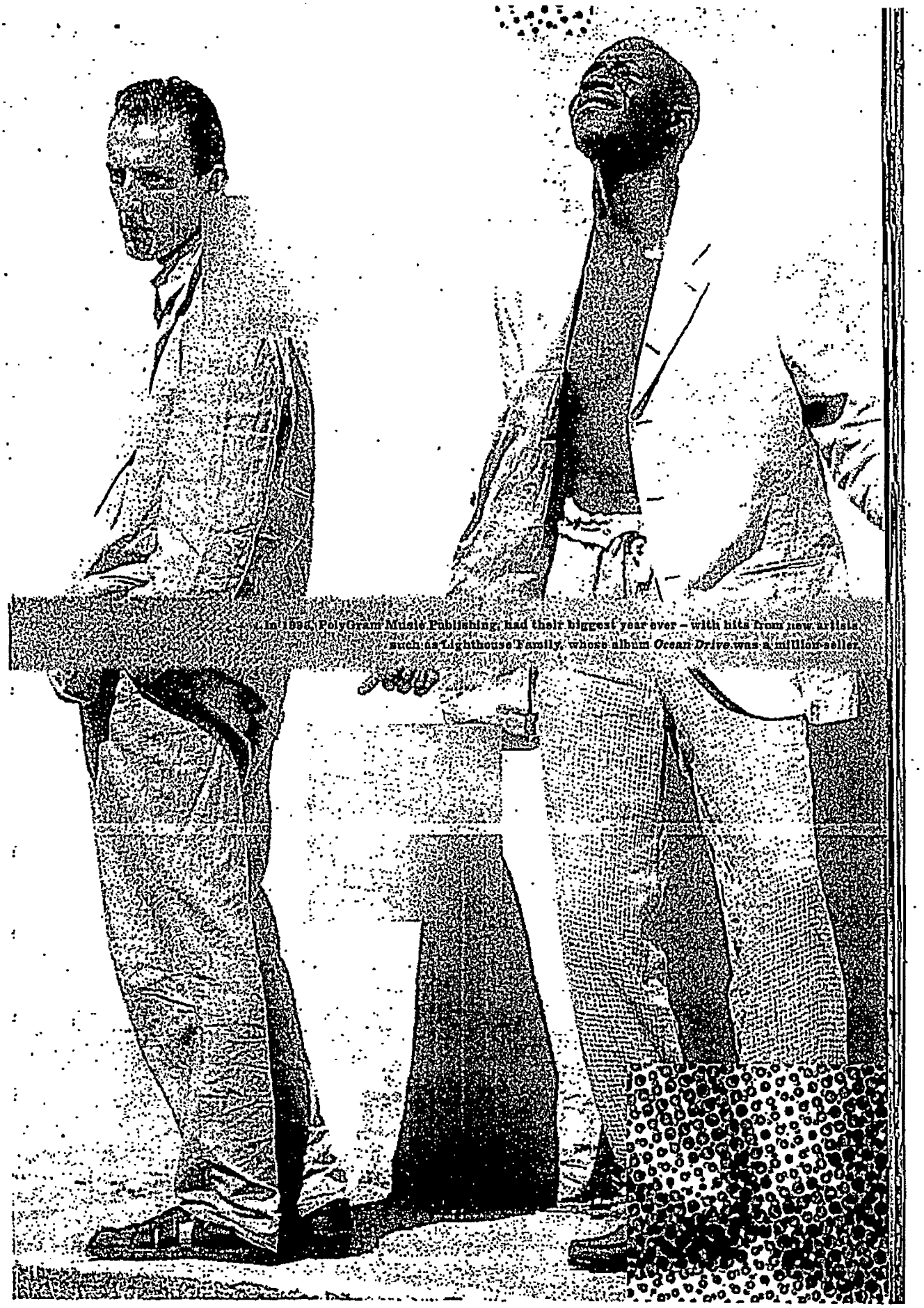
These amounts are included in the following accounts:		
Deferred tax assets (net of valuation allowances of NLG 261 million; 1995: NLG 274 million)	279	207
Deferred tax liabilities	(659)	(560)
Income tax payable, net	(60)	(95)

note 6 Extraordinary result after tax

	1996	1995
Reorganisation costs	160	-
Tax thereon	(46)	-
Extraordinary result after tax	114	-

note 7 Intangible Fixed Assets

	Total	Goodwill	Catalogues of Recorded Music	Music Publishing Rights	Catalogue of Film Rights
Gross value as at January 1, 1996	2,303	629	1,236	318	120
Accumulated amortisation	(64)	(64)	-	-	-
Book value as at January 1, 1996	2,239	565	1,236	318	120
Investments	191	123	4	64	-
Amortisation	(45)	(45)	-	-	-
Translation differences	208	49	127	22	10
Book value as at December 31, 1996	2,593	692	1,367	404	130
Gross value as at December 31, 1996	2,707	806	1,367	404	130
Accumulated amortisation	(114)	(114)	-	-	-



In 1996, PolyGram Music Publishing, had their biggest year ever – with hits from new artists such as Lighthouse Family, whose album *Ocean Drive* was a million seller.

note 8 · **Tangible Fixed Assets**

	Total	Land and buildings	Machinery and equipment	Other depreciable assets	Assets under construction
Gross value as at January 1, 1996	1,193	461	408	292	32
Accumulated depreciation	(521)	(120)	(233)	(168)	–
Book value as at January 1, 1996	672	341	175	124	32
Investments	208	68	78	60	2
New consolidations	32	18	10	4	–
Depreciation	(130)	(20)	(61)	(49)	–
Sales	(14)	(2)	(3)	(9)	–
Other	33	18	10	4	1
Book value as at December 31, 1996	801	423	209	134	35
Gross value as at December 31, 1996	1,439	563	512	329	35
Accumulated depreciation	(638)	(140)	(303)	(195)	–

As at December 31, 1996, the book value of tangible fixed assets acquired under financial lease arrangements amounts to NLG 39 million (1995: NLG 36 million).

note 9 **Non-Consolidated Companies**

	Total	Investments	Loans
Balances as at January 1, 1996	221	217	4
Net investments and additions	113	67	46
Equity in net income (loss)	(24)	(18)	(6)
Dividends	(20)	(20)	–
Other	(2)	(8)	6
Balances as at December 31, 1996	288	238	50

As at December 31, 1996 investments in non-consolidated companies include catalogues of theatrical, publishing and recorded music rights valued at NLG 141 million (1995: NLG 118 million).

note 10 **Inventories**

	1996	1995
Films, net of amortisation	739	451
Finished goods	315	213
Recording costs	209	212
Raw materials	53	47
Total	1,316	923

During 1996, interest capitalised in films amounted to NLG 9 million (1995: NLG 13 million).

Now rap superstar Foxy Brown broke through in 1996, selling over 900,000 units of her self-titled debut album.

note 11 **Receivables and Prepaid Expenses**

	1996	1995
Trade accounts	2,278	2,015
Advances and loans to artists and repertoire owners	871	649
Prepaid expenses and accrued income	303	285
Net deferred tax assets	279	207
Non-consolidated companies	7	22
Philips	5	6
Other receivables	244	218
Total	3,987	3,402

The receivables from non-consolidated companies are mainly trade debts. In accordance with industry practice, advances and loans to artists and repertoire owners with an estimated life in excess of one year (NLG 340 million; 1995: NLG 261 million) have been included in the above.

note 12 **Total Assets by Geographical Area**

	1996	1995
Europe	4,699	3,954
North America	3,456	3,107
Asia	802	808
Rest of the World	452	332
Total	9,409	8,201

Total Assets by Business Segment

	1996	1995
Music	7,778	6,935
Filmed Entertainment	1,631	1,266
Total	9,409	8,201

note 13 **Shareholders' Equity**

	1996
Balance as at January 1, 1996	2,735
Net income	608
Proposed dividend	(171)
Goodwill	8
Transactions in PolyGram N.V. shares, on balance	(104)
Translation differences	226
Balance as at December 31, 1996	3,302

Adjustments to goodwill arising from acquisitions prior to January 1, 1993 are accounted for directly in shareholders' equity.

Trainspotting, one of the most critically acclaimed and commercially successful smaller budget British films for many years, was also a major hit on video.

note 14 **Other Group Equity**

	1996
Balance as at January 1, 1996	286
New consolidations/deconsolidations	(7)
Share in group income	14
Payments to third party interests	(18)
Subordinated notes to be redeemed	(76)
Other movements	14
Translation differences	1
Balance as at December 31, 1996	216

Included in other group equity are US$ 97 million (1995: US$ 142 million) of subordinated notes ("the notes") issued by PolyGram Finance B.V., a group company of PolyGram N.V. The notes are mandatorily exchangeable into non-voting redeemable preference shares of PolyGram Luxembourg Finance S.A. The notes and the preference shares are only redeemable at the option of PolyGram and carry a financing rate at December 31, 1996 of 10.3%, which is subject to periodic adjustment. Financing charges amounting to NLG 24 million and tax benefits thereon of NLG 8 million (1995: NLG 35 and 13 million respectively) are recorded under third party interests in the consolidated statements of income. In 1996 the Company decided to redeem US$ 45 million of the notes in January 1997.

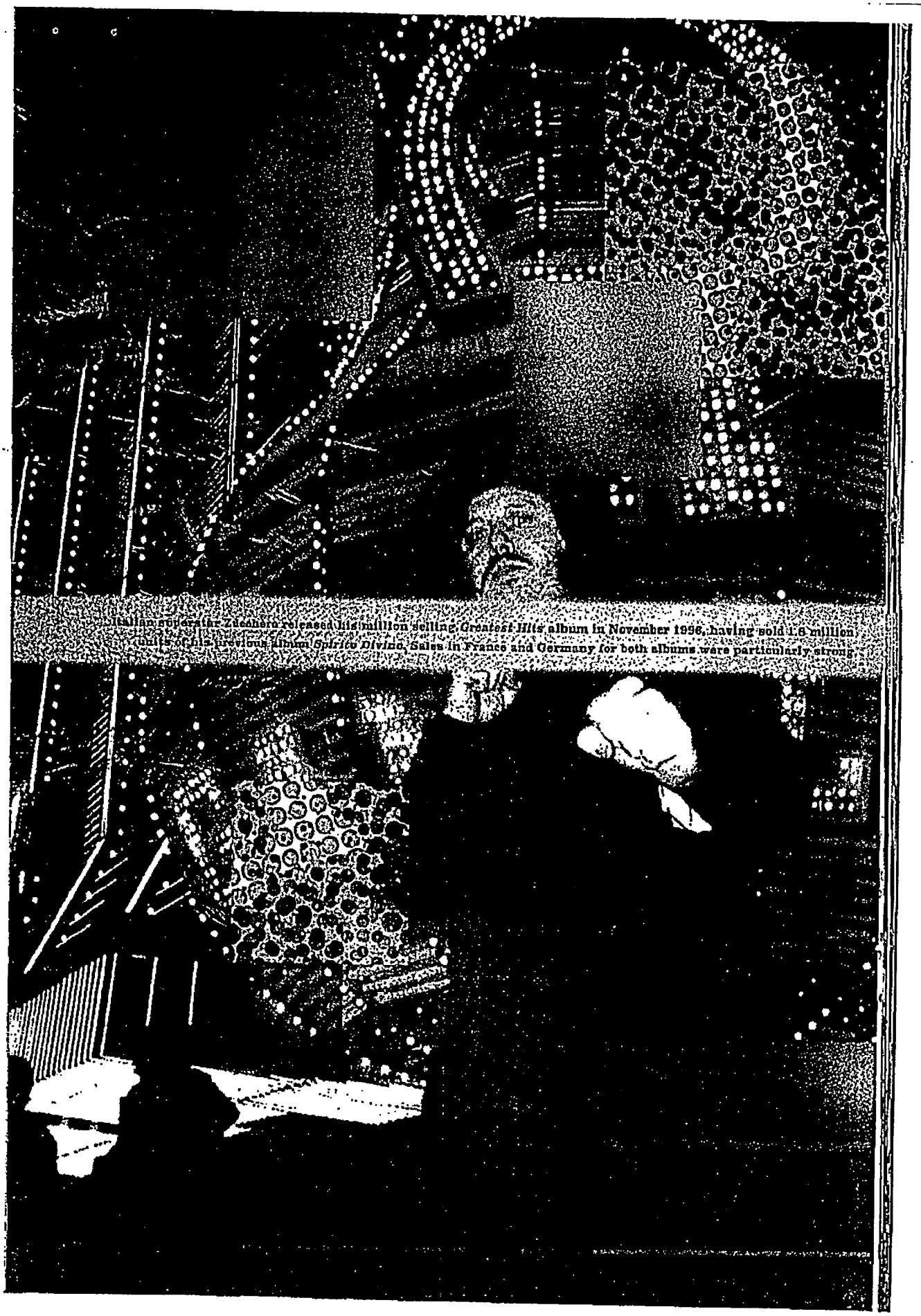
note 15 **Provisions**

	1996		1995	
	Long-term	Short-term	Long-term	Short-term
Pensions	246	8	241	8
Net deferred tax liabilities	582	77	440	120
Returns	-	209	-	193
Reorganisation costs	-	120	-	-
Other obligations and risks	76	192	72	211
Total	904	606	753	532

PolyGram has several pension plans covering its employees. Employee pension plans have been established in many countries in accordance with the legal requirements, customs and the local situation in the countries involved. The pension obligations have, in most cases, been transferred to separate pension funds or to third parties, which limit any further obligations of the PolyGram Group to the beneficiaries.

The provision for pensions covers the pension plan for PolyGram employees in Germany (1996: NLG 229 million; 1995: NLG 224 million). The remaining amount (1996: NLG 25 million; 1995: NLG 25 million) relates to pension plans in other countries. The provision is calculated by using an average discount rate of 6.0% (1995: 6.0%).

The provision for returns covers the cost of expected returns of goods sold. Expected returns are estimated on the basis of past experience as well as current sales.



Italian superstar Zucchero released his million selling *Greatest Hits* album in November 1996, having sold 1.6 million units of his previous album *Spirito Divino*. Sales in France and Germany for both albums were particularly strong.

note 1

note 1

note 16 **Long-term Liabilities**

	1996	1995
Bank loans	160	174
Financial leases	59	62
Philips	2	1
Other long-term debts	64	82
Total	285	319

The average interest percentage of long-term liabilities at December 31, 1996 is 6.6% (1995: 6.3%). Long-term debts at December 31, 1996 with a lifetime in excess of five years are NLG 49 million (1995: NLG 44 million). Long-term bank loans have generally been guaranteed by PolyGram N.V.

note 17 **Current Liabilities**

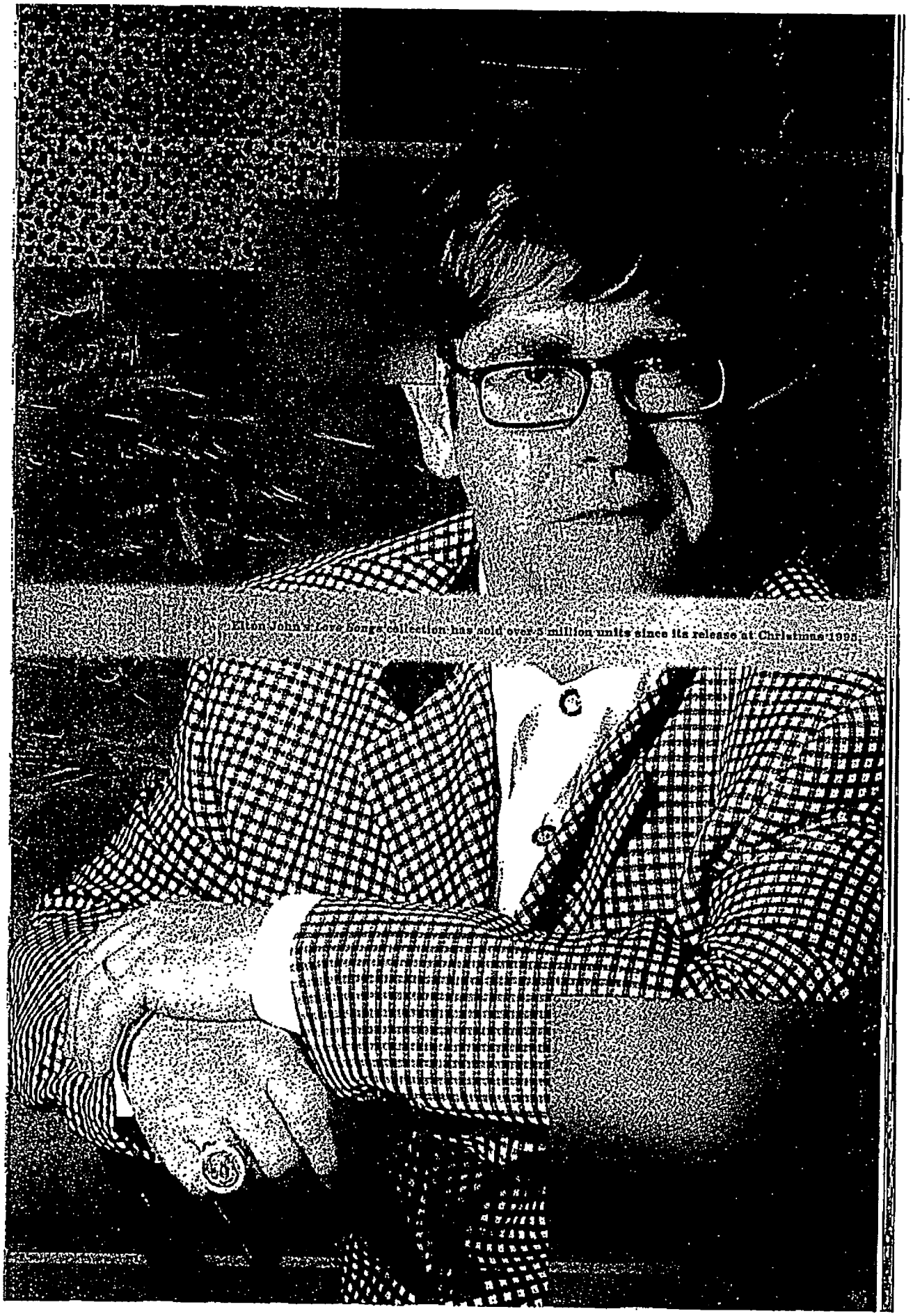
	1996	1995
Accrued licence fees payable	1,581	1,301
Accounts payable to trade creditors	784	707
Proposed dividend	171	171
Bank loans	86	115
Income tax payable	82	116
Subordinated notes to be redeemed	76	98
Philips	33	20
Accounts payable to non-consolidated companies	10	10
Other accrued expenses	976	720
Other debts payable	295	318
Total	4,096	3,576

PolyGram has a committed US$ 650 million, or its equivalent in other currencies, multi-currency revolving credit facility agreement with a syndicate of banks expiring in December 1999. Draw downs are guaranteed by PolyGram N.V. Included in the amount is a swingline facility of US$ 120 million which would allow the facility to be used to support a US commercial paper programme if required in the future. The minimum draw down under the facility is US$ 10 million. As at December 31, 1996 no amount has been drawn down under this facility (1995: nil).

In December 1996, PolyGram Filmed Entertainment Distribution Inc. (PFED) entered into a committed US$ 300 million lease agreement with a syndicate of banks. Under this agreement, the banks will purchase completed films from PFED and lease them back for a period of three years. PolyGram has the option to regain ownership of each film at the end of the lease. During the first two years, the portion of the facility not used for film leasing may be used for funding film productions. The agreement terminates in December 2001. At December 31, 1996, US$ 26 million of the lease has been used. The US$ 200 million operational lease agreement that PolyGram Film Productions B.V. (PFP) had with a syndicate of banks has been fully utilised. PolyGram N.V. guarantees the lease payments.

PolyGram has a NLG 250 million Dutch commercial paper programme in place to provide both an alternative and an additional source of funds to existing uncommitted credit lines. As at December 31, 1996, no amount has been drawn down under this facility (1995: nil).

The PolyGram Group has several other uncommitted credit lines with banks in a number of countries. The unused portion of these credit lines was NLG 1,686 million at December 31, 1996 (1995: NLG 1,543 million).



Elton John's *Love Songs* collection has sold over 5 million units since its release at Christmas 1995.

note 18 Commitments and Contingencies

Leases

The company rents facilities and equipment in the normal course of business. Expenses under these operating leases were NLG 157 million in 1996 (1995: NLG 173 million).

Future minimum rental commitments relating to operational leases at December 31, 1996, amount to:

Years ending December 31,	1997	98
	1998	158
	1999	82
	2000	52
	2001	46
	thereafter	331
Total		767

Guarantees	1996	1995
Guarantees on behalf of non-consolidated companies and third parties	23	17
Guarantees to artists and repertoire owners	596	538

NLG 252 million (1995: NLG 261 million) of the guarantees to artists and repertoire owners is estimated to become payable within one year.

Legal proceedings

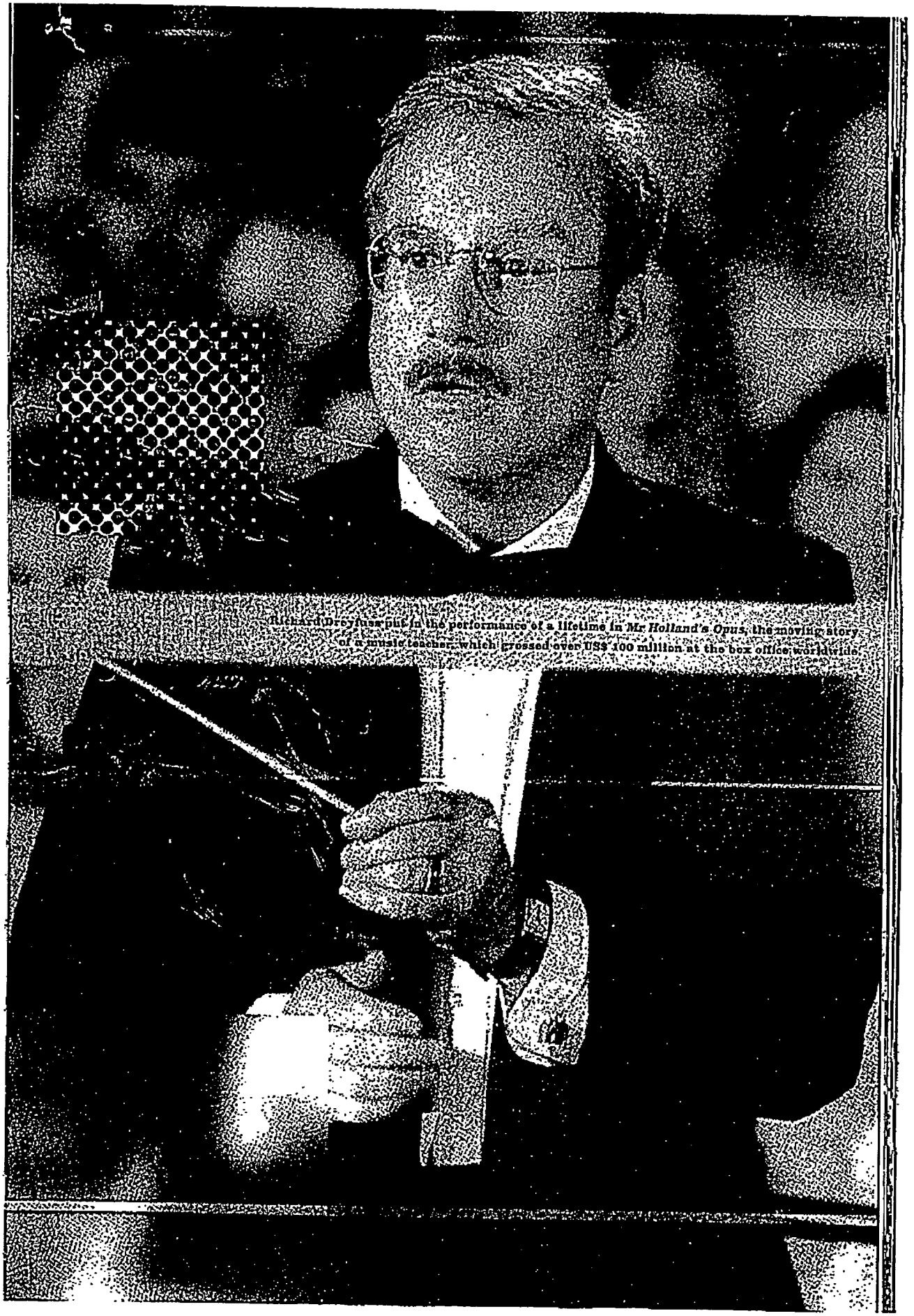
PolyGram has extensive international operations, and is subject to a number of legal proceedings incidental to these operations. PolyGram does not expect that the outcome of currently pending proceedings will, either individually or in the aggregate, have a material adverse effect upon the financial condition, results from operations or cash flow of the PolyGram Group.

Other

In recent years PolyGram has acquired several companies with (minority) interests still held by the vendors. Options have been granted to some vendors which may require PolyGram to acquire the outstanding shares of such companies at a fair market value based on certain conditions.

Financial instruments and risk management

The Group enters into forward foreign exchange contracts, put options and foreign currency swaps with well established commercial banks to hedge currency exposures as a result of transactions denominated in foreign currencies that arise in the normal course of business and as a result of acquisitions of companies. Occasionally, interest rate swaps are entered into to convert floating interest rates to fixed interest rates or vice versa. PolyGram does not enter into speculative positions. Therefore the timing of recognising related gains and losses is matched with the underlying positions being hedged.



Richard Dreyfuss put in the performance of a lifetime in *Mr. Holland's Opus*, the moving story of a music teacher, which grossed over US$ 100 million at the box office worldwide.

financial statements of PolyGram N.V.

Non-consolidated Balance Sheets of PolyGram N.V.

after proposed distribution of income, in millions of Netherlands Guilders

note	Assets	as at December 31 1996	1995
	Non-current financial assets		
A	Participations	2,707	2,271
	Current assets		
	Receivables from participations	766	635
	Total	3,473	2,906

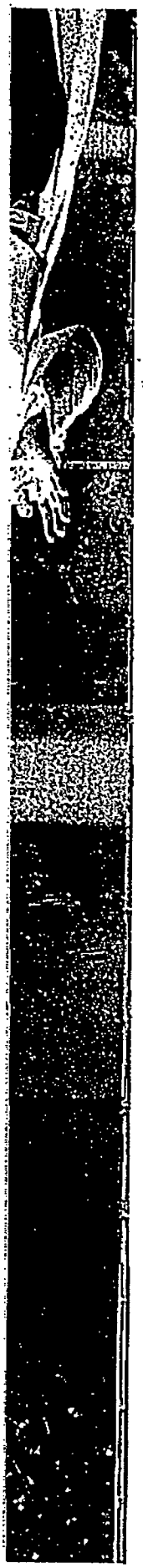
	Shareholders' Equity and Liabilities	1996	1995
	Shareholders' equity		
B	Share capital, issued and paid	90	90
C	Reserves	3,212	2,645
	Total shareholders' equity	3,302	2,735
	Proposed dividend	171	171
	Total	3,473	2,906

Non-consolidated Statements of Income of PolyGram N.V.

in millions of Netherlands Guilders

	years ended December 31 1996	1995
Net income from participations	593	726
Other income after tax	15	15
Net income	608	741

Luciano Pavarotti, the world's greatest tenor, who joined by pop superstars such as Elton John, Bryan Adams, Eric Clapton, Liza Minelli and Joan Osborne in two live recordings for his War Child Charity concerts.



notes to the financial statements of PolyGram N.V.

All amounts are expressed in millions of Netherlands Guilders, unless otherwise stated.
For the accounting policies with regard to valuation and income recognition see pages 21 to 23 of the consolidated financial statements of the PolyGram Group, which form part of these notes.

note A Participations

Participations are valued at their net asset value in accordance with the aforementioned accounting policies.

A list of participations, drawn up in accordance with the relevant legal requirements, is available at the Trade Register office in Amersfoort, The Netherlands.

	1996
Balance as at January 1, 1996	2,271
Equity in net income	593
Goodwill	8
Dividend paid	(306)
Transactions in PolyGram N.V. shares, on balance	(85)
Translation differences	226
Balance as at December 31, 1996	2,707

With regard to the financial statements of the majority of the Dutch private limited liability companies included in the consolidated financial statements, the exemption is applied as referred to in Article 403, Section 1, Book 2 of the Dutch Civil Code.

note B Share Capital, Issued and Paid

At December 31, 1996 the share capital, issued and paid, amounted to NLG 90 million and consisted of 180 million shares with a par value of NLG 0.50 per share. Of the shares, 75% is held by Philips.

The Company has an executive share option plan for senior management. The movements in the number of share options outstanding can be summarised as follows:

	1996	1995
Outstanding as at January 1	3,005,117	2,550,517
Granted	857,934	1,249,750
Lapsed	(7,700)	(49,000)
Exercised	(586,850)	(746,150)
Outstanding as at December 31	3,268,501	3,005,117

The outstanding options at December 31, 1996 for 3,268,501 PolyGram N.V. shares have been granted at a weighted average subscription price of NLG 74.62 (ranging from NLG 30.70 to NLG 103.45) and unless previously exercised will expire at various dates between April 30, 1997 and February 4, 2006.

If all the outstanding share options as at December 31, 1996 were exercised, this would not result in an earnings dilution (1995: a dilution of NLG 0.02 per share, reducing earnings per share to NLG 4.10).

Following the phenomenal breakthrough success of *Tuesday Night Music Club*, Sheryl Crow's self-titled second album sold over 2.8 million units by the end of 1996.

note C Reserves	Total	Share premium	Other reserves
Balances as at January 1, 1996	2,645	1,000	1,645
Net income	608	–	608
Proposed dividend	(171)	–	(171)
Goodwill	8	–	8
Transactions in PolyGram N.V. shares, on balance	(104)	(19)	(85)
Translation differences	226	–	226
Balances as at December 31, 1996	3,212	981	2,231

Mainly in connection with the executive share option plan, PolyGram acquired 1,580,725 shares in 1996 with a nominal value of NLG 0.50 each for an average price of NLG 81.15, and sold 605,670 shares with a nominal value of NLG 0.50 each for an average price of NLG 98.23.

At December 31, 1996 the Group holds 1,233,130 PolyGram N.V. shares, the value of which is deducted from other reserves (NLG 110 million).

Baarn, February 7, 1997

The Board of Management
A. Lévy, President
J. Cook, Executive Vice President
C. Blackwell
Dr. W. Hix
M.A. Kuhn
R.A.E. Stuyt

The Supervisory Board
D.G. Fine, Chairman
C. Boonstra
L.P.H. Das
W. Hulton

other information regarding PolyGram N.V.

Auditor's Report

Introduction

We have audited the 1996 financial statements of PolyGram N.V., Baarn. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and the results of its operations for the year then ended in accordance with accounting principles generally accepted in The Netherlands and comply with the financial reporting requirements included in Part 9, Book 2 of the Dutch Civil Code.

Amsterdam, February 7, 1997
KPMG Accountants N.V.

A recent addition to PolyGram's roster, Cake broke through in 1996 selling nearly 1 million units of their debut album *Fashion Nugget*.

Distribution of Income According to the Articles of Association of PolyGram N.V.

Upon proposal of the Board of Management, which proposal must be approved by the Supervisory Board, the General Meeting of Shareholders of PolyGram N.V. may decide to make distributions in cash or in shares of PolyGram N.V. payable out of distributable income, other reserves and/or share premium account, as shown in the financial statements.

Proposed Distribution of Income

In view of the stipulation of Article 36 of the Articles of Association, it has been proposed that a dividend of NLG 171 million (NLG 0.95 per share) be paid and the remaining amount of net income of NLG 437 million be added to other reserves.

report of the Supervisory Board of PolyGram N.V.

PolyGram N.V.'s financial statements for 1996 have been audited by KPMG Accountants N.V., independent public auditors. We ask you to adopt these statements in accordance with the recommendation of the Board of Management and to accept the proposal to declare a dividend of NLG 0.95 per share in respect of 1996.

At the General Meeting of Shareholders to be held on April 2, 1997 Mr. F.W. Hulton will retire by rotation as a member of the Supervisory Board and has not offered himself for re-appointment. We wish to thank Mr. Hulton for his valuable contribution to the Company.

The performance of the Group this year has been affected by a number of issues which are referred to in this annual report. As a result of these factors and with our support, PolyGram management have taken action to restructure certain parts of their music operations. This has resulted in an extraordinary charge of NLG 160 million against 1996 income.

Baarn, February 7, 1997
The Supervisory Board

application of generally accepted accounting principles in the USA

The accounting policies followed in the preparation of the consolidated financial statements differ in certain significant respects from those generally accepted in the United States of America (US GAAP).

Those differences which have a material effect on net income and/or shareholders' equity are as follows:

a Goodwill arising from a difference between the purchase price including contingent consideration and net asset value of newly acquired companies and participations is accounted for directly in shareholders' equity up to January 1, 1993. Thereafter goodwill is capitalised and amortised over a period not exceeding 40 years. For US GAAP purposes, all goodwill has been recorded as an asset and is being amortised over a period not exceeding 40 years. Under US GAAP, contingent consideration is not recognised at the date of acquisition, but instead is recognised as additional goodwill at the date the contingency is resolved and the additional consideration is payable.

b Intangible assets other than goodwill are amortised if and to the extent that the present value of the expected income generated by each category of asset is less than the book value. For US GAAP purposes, catalogues of recorded music are amortised straight-line over 25 years, the catalogue of film rights straight-line over 20 years and the catalogues of music publishing and theatrical rights straight-line over 15 years.

c Effective January 1, 1996, PolyGram acquired a CD factory in Blackburn, UK from Philips and valued the assets and liabilities at fair value on the acquisition date. For US GAAP purposes the purchase would be recorded using Philips' historical cost, the difference in the purchase price being treated as a capital contribution.

Asian superstar Jacky Cheung's latest album sold nearly 2.5 million units in 1996 and was one of many national music successes for PolyGram during the year.

The calculation of net income after extraordinary result and shareholders' equity, substantially in accordance with US GAAP, is as follows:

in millions of Netherlands Guilders	years ended December 31 1996	1995
Net income after extraordinary result as per consolidated statements of income of the PolyGram Group	608	741
Adjustments to reported income:		
a amortisation of goodwill	(28)	(27)
b amortisation of intangible assets other than goodwill	(96)	(84)
c transactions with Philips	(7)	–
– other	(6)	(1)
– tax effects of US GAAP adjustments	36	20
Approximate net income after extraordinary result in accordance with US GAAP	507	649
Approximate net income after extraordinary result per share in accordance with US GAAP (in NLG)	2.82	3.61

	as at December 31 1996	1995
Shareholders' equity as per consolidated balance sheets of the PolyGram Group	3,302	2,735
Adjustments to reported equity:		
a goodwill	1,021	985
b intangible assets other than goodwill	(549)	(404)
– other	(14)	(8)
– tax effects of US GAAP adjustments	116	71
Approximate shareholders' equity in accordance with US GAAP	3,876	3,359

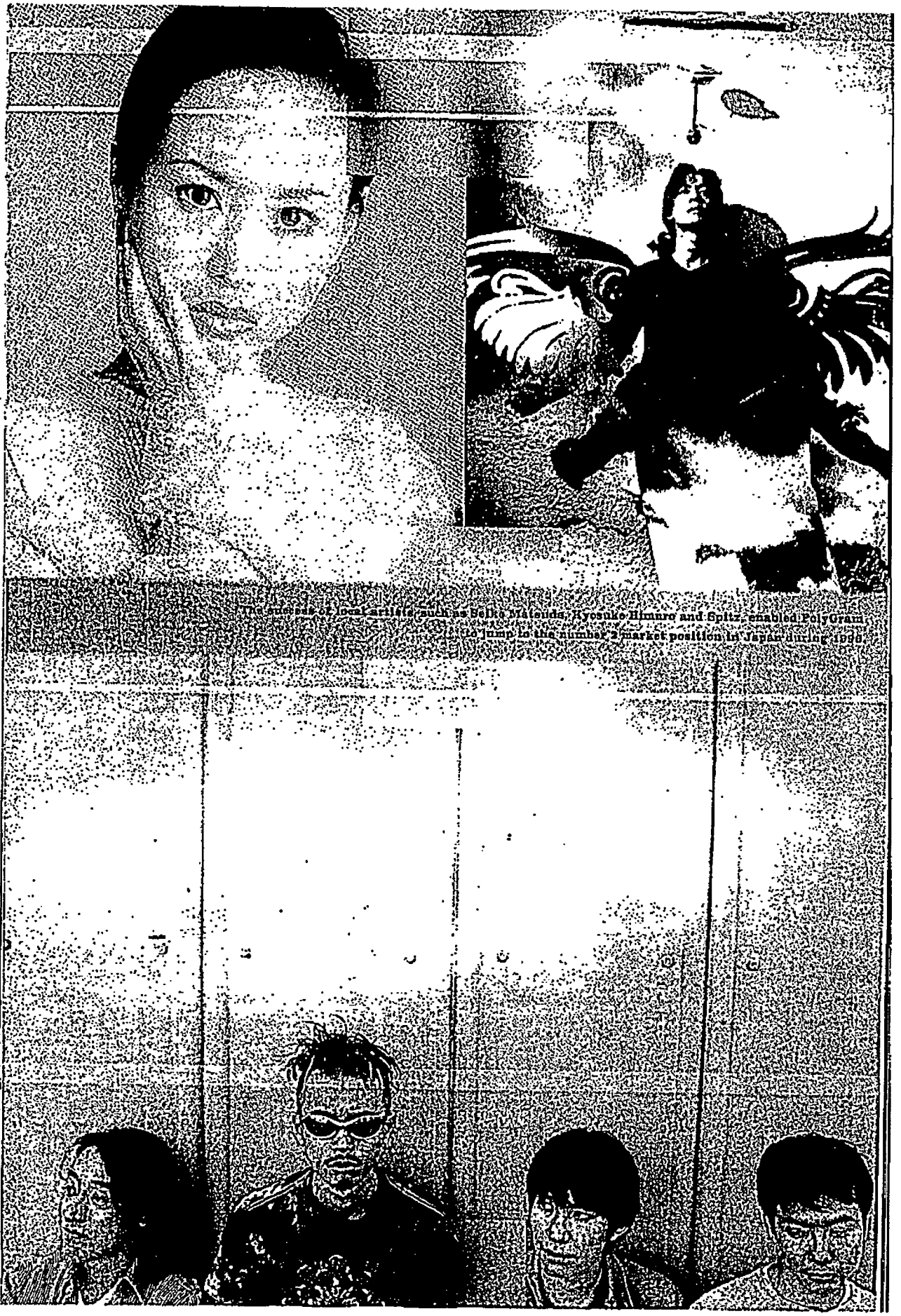
The company accounts for stock options in accordance with Dutch GAAP. By following Dutch GAAP, the accounting also conforms with a US accounting methodology prescribed by the Accounting Principles Board's Opinion No. 25 "Accounting for Stock Issued to Employees". Using a pricing model to determine compensation cost for the company's stock option plan under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation", the company's net income after extraordinary result under US GAAP would have been reduced by NLG 0.05 per share (1995: NLG 0.04 per share). For an overview of options granted under the stock option plan see note B of the financial statements of PolyGram N.V.

During the year, Shania Twain's *The Woman in Me* became the best-selling female country album of all time, with total sales of over 8 million units.

summary of financial statements of the PolyGram Group in US Dollars*

in millions of US Dollars, except per share amounts	1996
Income statement data	
Net sales	5,453
Direct cost of sales	(2,826)
Gross income	2,627
Selling, general and administrative expenses	(2,007)
Income from operations	620
Financial expense	(5)
Income before tax	615
Income tax	(178)
Income after tax	437
Equity in net loss of non-consolidated companies and third party interests	(22)
Net income before extraordinary result	415
Extraordinary result after tax	(66)
Net income after extraordinary result	349
Net income per share before extraordinary result	2.31
Net income per share after extraordinary result	1.94
Balance sheet data (at period end)	
Total fixed assets	2,179
Total current assets	3,228
Total	5,407
Shareholders' equity	1,898
Other group equity	124
Total group equity	2,022
Long-term provisions	519
Long-term liabilities	164
Short-term provisions	348
Current liabilities	2,354
Total	5,407
Shareholders' equity per share	10.54

*Merely for the convenience of the reader, Netherlands Guilder amounts have been converted to US Dollars at a rate of US$ 1 = NLG 1.74, being the rate which was applied for the conversion of US Dollar amounts in the consolidated balance sheet as per December 31, 1996.



The success of local artists such as Seiko Matsuda, Ryosuke Himuro and Spitz, enabled PolyGram to jump to the number 2 market position in Japan during 1998.

PolyGram management

Executive Management
Alain Lévy
President and Chief Executive Officer
Jan Cook
Executive Vice President and Chief Financial Officer
Michael Kuhn
Executive Vice President, and President, PolyGram Filmed Entertainment
Roger Ames
President, PolyGram Music Group
Norman Cheng
President, Far East
Rick Dobbis
President, Continental Europe
Eric Kronfeld
President and Chief Operating Officer, PolyGram Holding Inc., USA

Corporate Officers
Jan Bolger
Vice President, Treasury
Peter Douwens
Senior Vice President, International Manufacturing and Logistics
Richard Constant
General Counsel
Manolo Diaz
President, Latin America
David Hockman
Chief Executive, Music Publishing
Jonathan Smilansky
Senior Vice President, Human Resources
Geoff Lawlan
Vice President, Tax
Peter Matthews
Senior Vice President F&A, Regional Operations
Marc Meyer
Senior Vice President, Strategic Planning and Business Development
David Munns
Senior Vice President, International Pop Marketing
Helen Murphy
Senior Vice President, Investor Relations
Jos de Raaij
Corporate Controller
Christopher Roberts
President, PolyGram Classics and Jazz

Operational Management
Alain Lévy
Chief Executive Officer, PolyGram Holding Inc., USA
Roger Ames
Chairman and Chief Executive Officer, PolyGram Music Group, USA
Clarence Avant
Chairman, Motown Records
Chris Blackwell
Chairman, Island Entertainment Group
Al Cafaro
Chairman and Chief Executive Officer, A&M Records, USA
Wolf-D Gramatke
President and Chief Executive Officer, PolyGram GmbH, Germany
Andre Harrell
President and Chief Executive Officer, Motown Records
Keiichi Ishizaka
President, PolyGram K.K., Japan
John Kennedy
Chairman and Chief Executive Officer, PolyGram UK
Dr. Johannes Kinzl
President, Philips Music Group, The Netherlands
Roger Lewis
President, Decca International, UK
John Nelligan
President, PolyGram Direct Marketing and Chairman, Britannia Music Co.
Alain Rebillard
President and Chief Executive Officer, PolyGram S.A., France
Russell Simmons
Chairman and Chief Executive Officer, Def Jam
Stewart Till
President, International Division, PolyGram Filmed Entertainment
Karsten Witt
President, Deutsche Grammophon GmbH, Germany

Board of Management, PolyGram N.V.
Alain Lévy, President
Jan Cook, Executive Vice President
Chris Blackwell
Dr. Wolfgang Hix
Michael Kuhn
Robert A.E. Stuyt

Supervisory Board, PolyGram N.V.
David G. Fine
Chairman
Cornelis Boonstra
President, Philips Electronics N.V.
Lourens P.H. Das
Formerly Group Director, Mergers & Acquisitions, Philips Electronics N.V.
William Hulton
Director of Botts & Co. Ltd.

Responsibility for the management of PolyGram is with the Board of Management; it is accountable to the Supervisory Board and the shareholders.

Starring Brad Pitt, Robert De Niro, Dustin Hoffman, Jason Patric, Kevin Bacon and Minnie Driver, *Sleepers* was one of PolyGram's most successful films in 1996, taking over US$ 100 million at the box office worldwide, with many territories releasing the film in 1997.

PolyGram worldwide 1996

The Netherlands
PolyGram N.V.
PolyGram International Holding B.V.
PolyGram International Music B.V.
PolyGram Manufacturing & Distribution Centres B.V.
PolyGram Nederland B.V.
Mercury Records B.V.
Polydor B.V.
Wisseloord Studio's B.V.
PolyGram Film Productions B.V.
Philips Classics Productions
PolyGram Filmed Entertainment B.V.

Europe excluding The Netherlands
Austria
PolyGram Ges.m.b.H.
Belgium
N.V. PolyGram S.A.
Czech Republic
PolyGram S.r.o.
Denmark
PolyGram Records A/S
Finland
PolyGram Finland Oy
France
PolyGram S.A.
PolyGram Manufacturing & Distribution Centres S.A.
Island Entertainment Group S.A.
PolyGram Music S.A.R.L.
D.I.A.L. – Diffusion Internationale d'Arts et Loisirs S.A.
PolyGram Audiovisuel S.A.
Germany
PolyGram Holding GmbH
PolyGram GmbH
Deutsche Grammophon GmbH
Mercury Records GmbH
Polydor GmbH
PolyGram Songs Musikverlag GmbH
Karussell Musik & Video GmbH
PolyGram Manufacturing & Distribution Centres GmbH
PolyGram Filmproduktion GmbH
Motor Music GmbH
PolyGram Filmed Entertainment GmbH
Greece
PolyGram Records S.A.
Hungary
PolyGram Records Hungary Ltd.. 51%
Ireland
PolyGram Ireland Limited
Italy
PolyGram Italia S.r.L.
Luxembourg
PolyGram Luxembourg Finance S.A.
Norway
PolyGram A/S
Poland
PolyGram Polska Ltd.
Portugal
PolyGram Portugal S.A.
Russia
PolyGram A/O.....51%
Slovakia
PolyGram Slovensko S.r.o.
Spain
PolyGram Iberica S.A.
Sogepaq Distribucion S.A.....50%
Sweden
PolyGram AB
Sweden Music Förlags AB
Stockholm Label Group AB
Switzerland
PolyGram (Switzerland) AG
United Kingdom
PolyGram (UK) Holdings Plc
PolyGram Leisure Ltd.
PolyGram UK Ltd.
PolyGram International Ltd.
PolyGram International Music Publishing Ltd.
Go! Discs Ltd.
Island Entertainment Group Ltd.
Mercury Records Ltd.
Polydor Ltd.
PolyGram Record Operations Ltd.
A&M Records Ltd.
Britannia Music Company Ltd.
The Decca Record Company Ltd.
PolyGram Video International Ltd.
Dick James Music Ltd.
PolyGram Filmed Entertainment (UK) Ltd.
Really Useful Holdings Ltd. 30%
Working Title Films Ltd.
PolyGram Film International Ltd.
ITC Entertainment Group Ltd.
PolyGram Manufacturing & Distribution Centres Ltd.

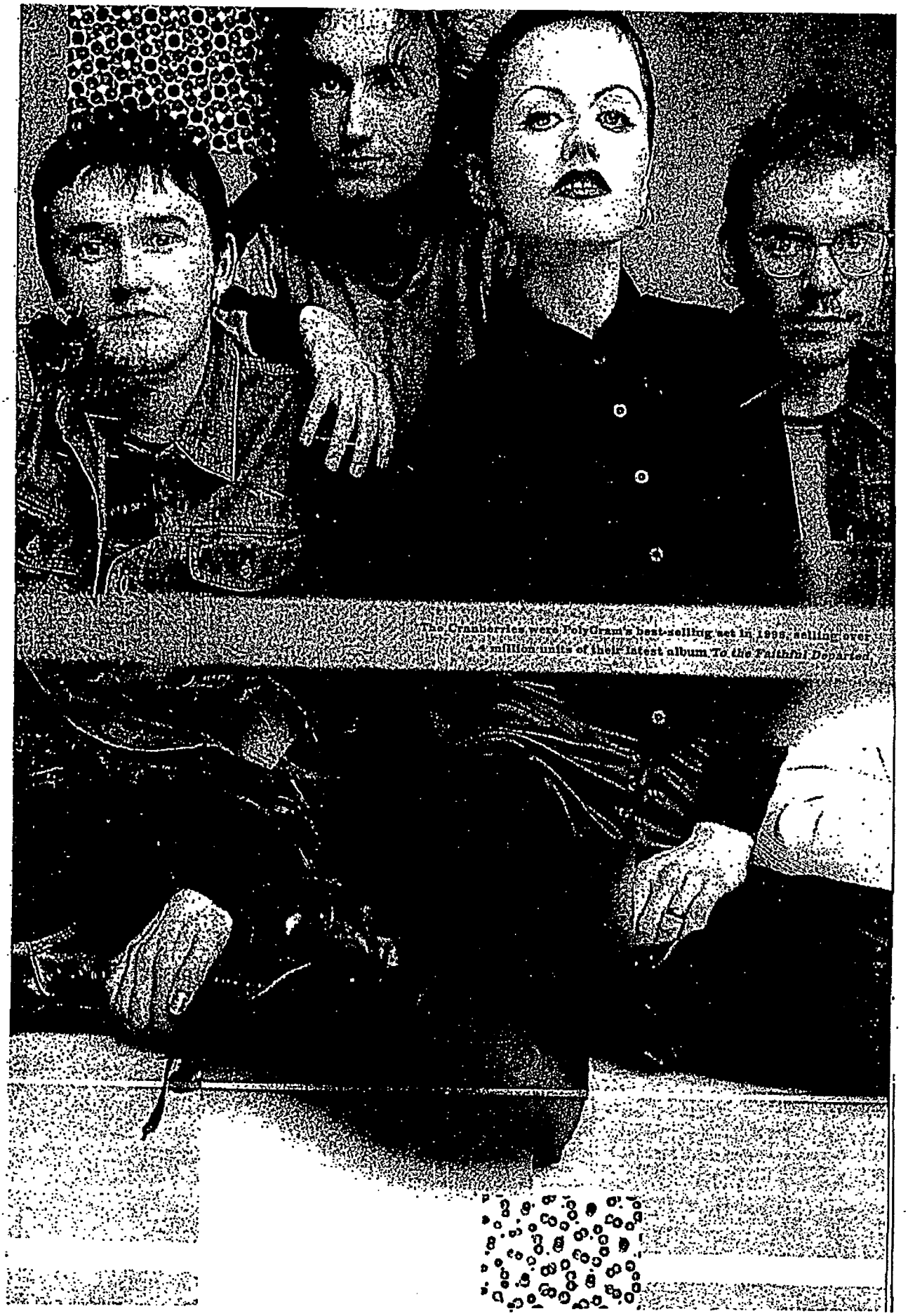
Africa
South Africa
PolyGram South Africa 67%

North America
Canada
PolyGram Group Canada Inc.
Island Records of Canada Ltd.
United States of America
PolyGram Holding, Inc.
PolyGram Records, Inc.
PolyGram Group Distribution, Inc.
PolyGram Merchandising, Inc.
Island Entertainment Group, Inc.
Motown Records Company L.P.
PolyGram International Publishing, Inc.
A&M Records, Inc.
Propaganda Films, Inc.
Interscope Communications, Inc.
PolyGram Manufacturing & Distribution Centers, Inc.
PolyGram Filmed Entertainment Distribution, Inc.
Gramercy Pictures Inc.
Def Jam Records, Inc.....60%
Island Pictures Corporation
Motown Café, LLC.....25%
GTS Records 51%
Capricorn Records, Inc.....51%

Latin America
Argentina
PolyGram Discos S.A.
Brazil
PolyGram do Brasil Ltda.
Chile
PolyGram Discos Limitada
Colombia
PolyGram Colombia S.A.
Costa Rica
PolyGram de Centro America S.A.
Mexico
PolyGram Discos S.A. de C.V.
Venezuela
PolyGram Records S.A.

Asia
Hong Kong
PolyGram Records Ltd.
PolyGram Music Publishing Hong Kong Ltd.
India
PolyGram India Ltd. 51%
Indonesia
PT. Suara Sentral Sejati.....49%
Japan
PolyGram K.K.
Polydor K.K. 99%
Mercury Music Entertainment Co., Ltd.
K.K. Kitty Enterprise
Taurus Records Inc.....51%
PolyGram Music Japan Inc.
Malaysia
PolyGram Records Sdn. Bhd.
Philippines
Polycosmic Records, Inc.....30%
Singapore
PolyGram Records Private Ltd.
MTV Asia LDC 50%
South Korea
PolyGram Ltd.....80%
Taiwan
PolyGram Records Ltd.
Decca Records Taiwan Ltd 60%
PolyGram Music Publishing Ltd.
Thailand
PolyGram Records (Thailand) Ltd.....74%

Australia and New Zealand
Australia
PolyGram Pty. Ltd.
PolyGram Music Publishing Australia Pty. Ltd.
New Zealand
PolyGram Records Ltd.



The Cranberries were PolyGram's best-selling act in 1995, selling over 4.4 million units of their latest album *To the Faithful Departed*.

investor information

Annual Meeting

The Annual General Meeting of PolyGram N.V. will be held at The Grand, Oudezijds Voorburgwal 197, Amsterdam, The Netherlands on Wednesday, April 2, 1997 starting at 2.30 p.m.

Shareholder Information

Shareholders needing information relating to their shareholdings in PolyGram N.V. should contact the Shareholder Information Department, PolyGram N.V., Gerrit van der Veenlaan 4, 3743 DN Baarn, The Netherlands. Shareholders who purchased shares on the New York Stock Exchange may contact the Company's US Transfer Agent and Registrar, Citibank – WWSS – Investor Services, c/o Citicorp Data Distribution, Inc., P.O. Box 308, Paramus, N.J. 07653. Attention: Shareholder Services. Tel: (800) 422 2066.

Provisional reporting dates of 1997 Interim Results

1st quarter: April 22; 2nd quarter: July 23; 3rd quarter: October 22.

Investor Information

Investors desiring further information about PolyGram or who want to receive a copy of our Annual Report on Form 20-F, which will be filed with the US Securities and Exchange Commission, should contact the Corporate Investor Relations Department at:

PolyGram International Ltd.	or	PolyGram Holding Inc.
8 St James's Square		Worldwide Plaza
London SW1Y 4JU		825 8th Avenue
England		New York, NY 10019, USA
(0171) 747 4000		(212) 333 8000

This report will be available on PolyGram's Corporate Information web site www.polygram.com.

The Evolution of PolyGram

The beginnings of PolyGram can be traced back nearly a century to 1898 and the founding of **Deutsche Grammophon Gesellschaft**, one of the world's pre-eminent classical music labels. In the 99 years since then, thousands of renowned popular and classical artists have recorded on the labels that today constitute the PolyGram Group.

PolyGram itself began operations in 1962 as a joint venture between **N.V. Philips' Gloeilampenfabrieken** (now **Philips Electronics N.V.**) and **Siemens AG**. Under the joint venture, Siemens assigned to Philips 50% of its subsidiary **Deutsche Grammophon Gesellschaft**, in return for 50% of **Philips Phonographische Industrie**, a subsidiary founded in 1950.

The subsidiaries were reorganised in 1972 as PolyGram, and in transactions in 1985 and 1987, Philips purchased Siemens' 50% interest. In December 1989, PolyGram became a public company when Philips sold approximately 16% of its interest and PolyGram offered newly issued shares in an initial public offering. In September 1993, PolyGram successfully completed an international offering of 10 million new shares. Philips currently hold 75% of PolyGram's shares.

Today, PolyGram is a global entertainment company and one of the three largest recorded music producers and publishers worldwide. In addition to its founding company Deutsche Grammophon, its world famous labels include Motown, Mercury, Polydor, Vertigo, Fontana, A&M, Island and Def Jam for popular music, Verve for jazz and Decca/London and Philips Classics for classical music. PolyGram's principal activity is the creation, acquisition and production of recorded music which it markets and distributes through its network of subsidiaries in over 40 countries and licensees elsewhere worldwide.

In recent years PolyGram has also been expanding its production and distribution presence in filmed entertainment. In filmed entertainment, PolyGram's production labels include Propaganda, Working Title, Interscope and Island Pictures.

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This report has been printed on chlorine free paper sourced from sustainable forests.

This report reads in two directions. You are now reading the first page of the creative side. Turn it over and you'll read about the other side of PolyGram, which is control. You can't have one without the other.

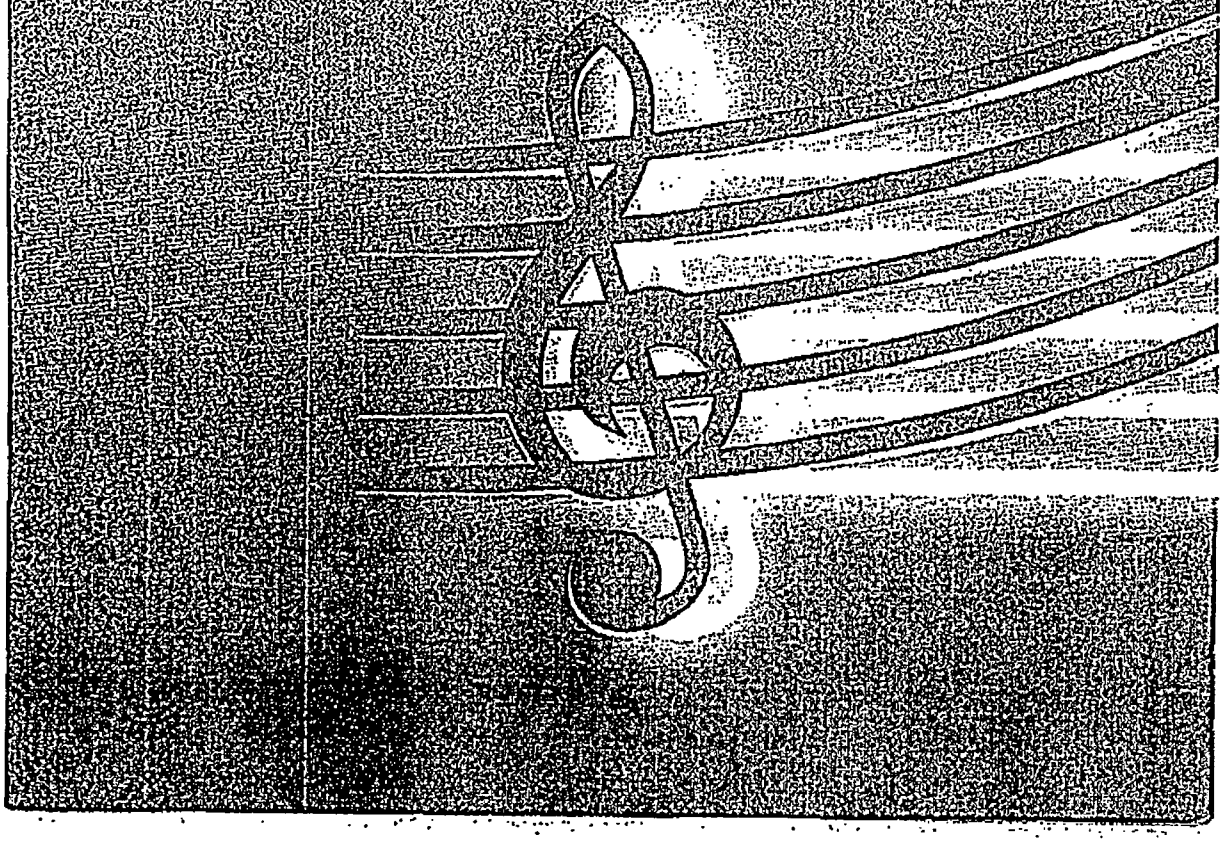
CREATIVITY

PolyGram

EXHIBIT CO 0932

PolyGram

ANNUAL REPORT 1987



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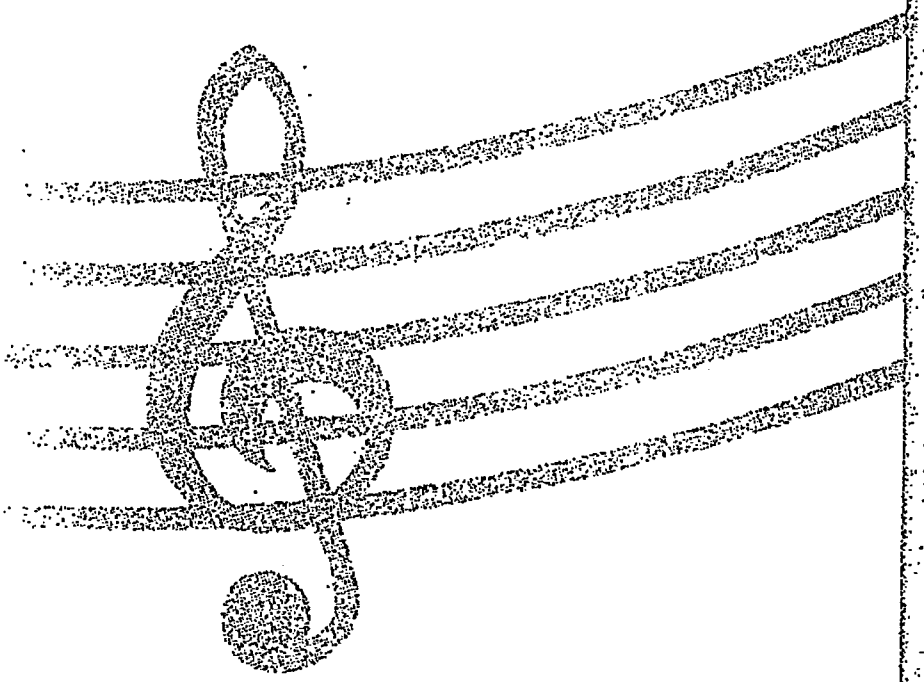


MERCURY

LONDON

Velus

VERTIGO

PHILIPS

Dalvador

Pickwick

DECCA

PHILIPS

PROFILE

PolyGram's business is the creation and acquisition of recorded music, its production, marketing and distribution world-wide.

PolyGram is engaged in music publishing, in audio visual entertainment and programme development for the expansion of planned optical disc formats.

PolyGram is dedicated to excellence of artistic and recording quality excellence as exemplified in its pioneering of the Compact Disc market.

PolyGram occupies a significant position in popular music, and is a world leader in classical music.

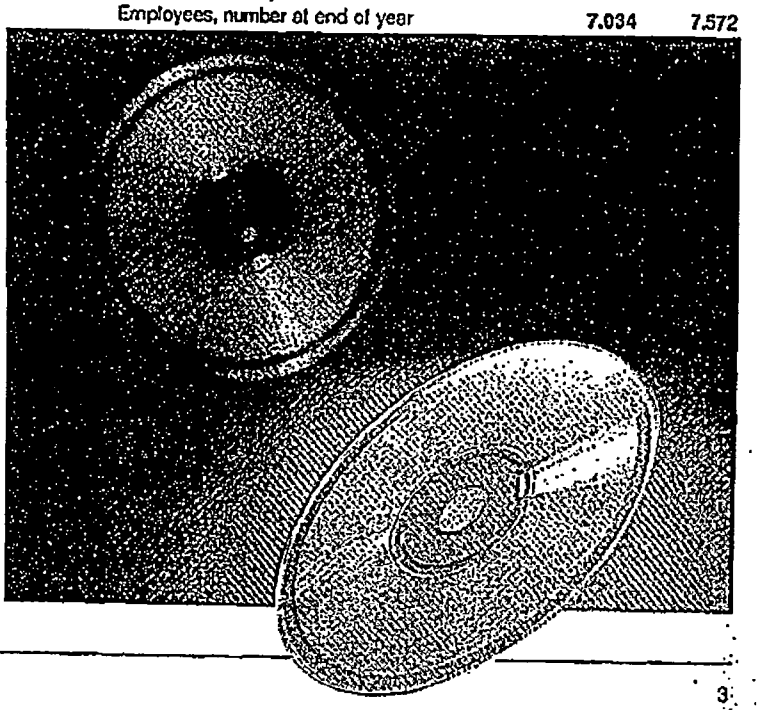
PolyGram employs some 7,000 staff and has subsidiaries in 28 countries while licensees and distributors service customer requirements in other markets.

The principal office of PolyGram N.V. is in The Netherlands. PolyGram is majority owned by N.V. Philips' Gloeilampenfabrieken.

KEY FIGURES

All amounts in millions of Netherlands Guilders unless stated otherwise.

	1987	1986
Net Sales	2,924	2,938
percent increase over previous year	(0.4)	1.6
same excluding currency fluctuations	8.0	15.0
Income from operations	272	239
in percent of net sales	9.3	8.1
in percent of capital employed	11.8	12.0
Income after taxes	204	171
in percent of net sales	7.0	5.8
Net Income	191	316
in percent of shareholders' equity	44.4	163.7
Total capital employed	2,307	1,988
Shareholders' equity	550	310
per common share, par value NLG 1.00 (in Guilders)	6.88	5.64
Inventories	223	261
in percent of net sales	7.6	8.9
Average collection period or trade accounts receivable in months	2.2	2.3
Total liabilities and provisions		
in percent of capital employed	74.9	83.4
Employees, number at end of year	7,034	7,572



PRESIDENT'S REVIEW

I am pleased to be able to present record results for the financial year ended 31st December 1987. The worldwide turnover of NLG 2.9 billion produced income before taxes of NLG 300 million which is the highest ever achieved by the company.

MUSIC MARKET

PolyGram consolidated its position as one of the three largest multinational recorded music organisations within a world music market that has shown remarkable expansion in 1987. Whilst the LP has continued its steady decline, CD sales have grown from some five million units in 1983 to over 250 million units last year. Tape cassettes, however, remain the largest volume sound-carrier, growing in unit terms by some thirteen percent in 1987.

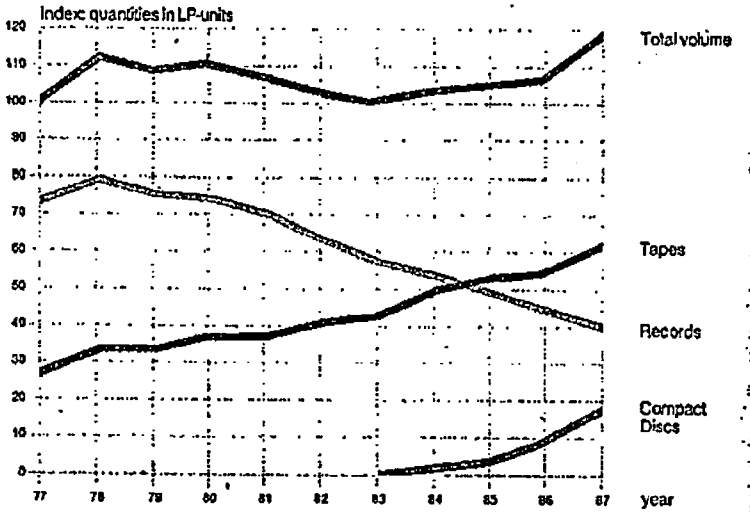
REPERTOIRE

We are encouraged and proud to have an artist roster which we believe to be stronger than in many years. PolyGram's popular music bestseller list of 1987 is led by the US group Bon Jovi whose *Slippery When Wet* album reached sales of some 12 million copies. Other great recording artists who made their mark in 1987 were Def Leppard, John Cougar Mellencamp, Level 42, and the musical phenomenon *Phantom of the Opera*. We maintained our leading position in the classical music market. Decca celebrated Sir Georg Solti's 75th birthday and 40th anniversary with the label by a further extension of his contract. Deutsche Grammophon continued to develop the remarkable career of Vladimir Horowitz who was awarded four Grammys for his recording achievement and the label prepared a CD-edition of "100 Masterpieces" for Herbert von Karajan's eightieth birthday in 1988. Philips Classics crowned the success of Jessye Norman with a world-wide audio and TV spectacular prepared for the Christmas season. In 1987 we promoted CD Video at major exhibitions in Chicago, Berlin and Tokyo in anticipation of an international launch in 1988. We actively pursued further opportunities for optical disc technology and additional investments were made in interactive optical disc software design and programming in the belief that CD interactive will have a role to play in education, information and entertainment. We also extended our music publishing catalogues with selected acquisitions.

EVENTS

1987 closed with the purchase of CBS Records by Sony, the first major entry by a Japanese corporation directly into an international repertoire source.
The press published views and counterviews of the new technology of Digital Audio Tape (DAT), and the feasibility or otherwise of anti-copying devices.
Our business, and the livelihood of our artists, depends on proper protection of the musical works in sound and audio-visual recordings which we control. Legislation, in most countries still falls short of providing the protection that enables the creative community to prosper, or, in some cases, merely to survive. The problems of home taping and piracy continue to plague our industry. We have continually campaigned for proper legislation to protect our rights and those of our artists and we will continue to do so.
Philips announced its intention to float 20% of the PolyGram equity on NASDAQ (the over-the-counter trading market in the USA). The original timing of this event was to have been November 1987, but the dramatic events on the world stock exchanges made our parent company delay the floatation.

DEVELOPMENT WORLD MUSIC MARKET



From left to right: Executive Vice Presidents Jan Cook, Tim Harrold; President David G. Fine; Executive Vice President Aart Dalhuisen; Senior Vice Presidents D. Bruce Mackenzie, Michael A. Kuhn.

STRUCTURE

After a period of three to four years reorganising and then consolidating the corporate structure, we experienced several important personnel changes. When I assumed the position of President of PolyGram in September 1987, I took over a chair vacated by a man, who while not long in the music business, became a most respected industry leader. Jan D. Timmer, in the latter part of 1987, was invited to join the Philips Group Management. As President from 1983, he was the architect of PolyGram's restructuring and he enlightened the music industry in new and exciting technological opportunities. His vigorous promotion of the Compact Disc Digital Audio system was a key factor in its unprecedented success.

Bruce Mackenzie joined Executive Management as Senior Vice President, Regional Operations; previously he achieved the successful turnaround of PolyGram Australia as Managing Director.

Richard Busch, after 40 years with Siemens and PolyGram retired as President of PolyGram Germany, but has agreed to remain as a member of the Supervisory Board there. His successor Ben Bunders was previously President of PolyGram, The Netherlands.

PolyGram Management is committed to the continued development of our company in recorded music, music publishing and in allied fields of packaged audio visual entertainment. I am appreciative of the skill, experience and enthusiasm of colleagues and staff who have made such a major contribution to the organisation and whose role will be so vital in the future.

David G. Fine
President

April 28, 1988

REPORT OF THE SUPERVISORY BOARD

The financial statements of PolyGram N.V. for 1987 have duly been examined by KPMG Klynveld Kraayenhof & Co, independent public accountants. Their statement appears on page 35 of this Annual Report.
Significant corporate events during the year included a restructuring of the company on September 30, 1987 pursuant to which PolyGram, hitherto a Netherlands private limited liability company, was converted into a public limited liability company. The restructuring included a change in the share capital to 80,000,000 shares of NLG 1 each. This restructuring was made in connection with the decision to float 20% of PolyGram N.V.'s equity on NASDAQ, the United States over-the-counter trading market. It is felt that the nature and the global scope of PolyGram's activities as well as its growth strategy justified a more independent position. Philips, however intends to maintain its involvement in the software music industry through PolyGram and, therefore, believes it is of strategic importance to retain a controlling interest in PolyGram N.V. Due to the upheavals in the equity markets in the latter part of the year, the floatation was postponed although it still remains the intention to proceed with an offering when the markets are in a more favourable condition. On December 31, Philips sold 10% of its interest in PolyGram N.V. to a financial institution.
On the personnel side, 1987 saw the departure of Jan D. Timmer in September for a senior position in Philips and his replacement as President of the Board of Management of the company by David G. Fine.
Following his move, Jan Timmer was appointed to the Supervisory Board of PolyGram N.V. On September 21, 1987 Dr. Wolfgang Hix was appointed to the Board of Management of PolyGram N.V. at the same time as Messrs. G.L.R. Kelder and G.H.M. Rooyackers retired from the Board.
We wish to express our thanks and appreciation to David Fine, the other members of the Board of Management and to all of PolyGram's employees for their dedication on behalf of the company in 1987.
A special thank you is also due to Jan Timmer, for his achievements with the company since 1983. We look forward to further progress in 1988.

Baarn, April 28, 1988
The Supervisory Board

REPORT OF THE BOARD OF MANAGEMENT

SALES AND INCOME

Net sales of PolyGram in 1987 amounted to NLG 2,924 million, NLG 14 million below 1986. The decrease results from negative effects of currency fluctuations, mainly the U.S. Dollar, which account for NLG 220 million, offset by an increase in sales of NLG 206 million. After elimination of currency differences, the growth in net sales was 8%.
1987 saw a further decline of conventional vinyl records – both singles and long play formats – and an advancement of the Compact Disc. In 1987 PolyGram's Compact Disc sales for the first time exceeded NLG 1 billion and amounted to 40% of the sales of recorded music.
Income from operations reached a new high of NLG 272 million and was NLG 33 million above 1986. Gross income improved as direct costs of sales decreased due to declining costs of the Compact Disc and a decrease of license costs.
In the course of 1987 PolyGram identified and developed new business opportunities, particularly in the area of new technologies such as CD Video and CD Interactive; the costs were fully absorbed within income from operations.
Financial income and expenses improved by NLG 14 million due to increased interest earnings generated by a positive cash flow.
The effective income tax rate was held at the low level of 32% by utilizing prior year loss carryforwards.
Net income from normal business operations was NLG 191 million and exceeded the comparable 1986 figure by NLG 21 million. Net income of NLG 191 million was NLG 125 million lower than 1986 net income which included a profit from an extraordinary item of NLG 146 million.

EMPLOYEES

PolyGram's total number of employees decreased from 7,572 at the end of 1986 to 7,034 at the end of 1987. Major reductions were due to the discontinuation of factories in Louviers, France and in Madrid, Spain.

FINANCIAL STRUCTURE AND FINANCING

As of September 30, 1987, the capital structure of PolyGram N.V. was altered as follows:

- the issued preferred share capital was converted into common share capital;
- the par value of all shares was changed to NLG 1. As a result the issued share capital consisted of 55 million shares;
- the authorized share capital was increased from NLG 100 million to NLG 250 million;
- a stock dividend of NLG 21 million was distributed to the shareholder;
- 4 million shares were issued to Philips at the rate of NLG 32.50 per share.

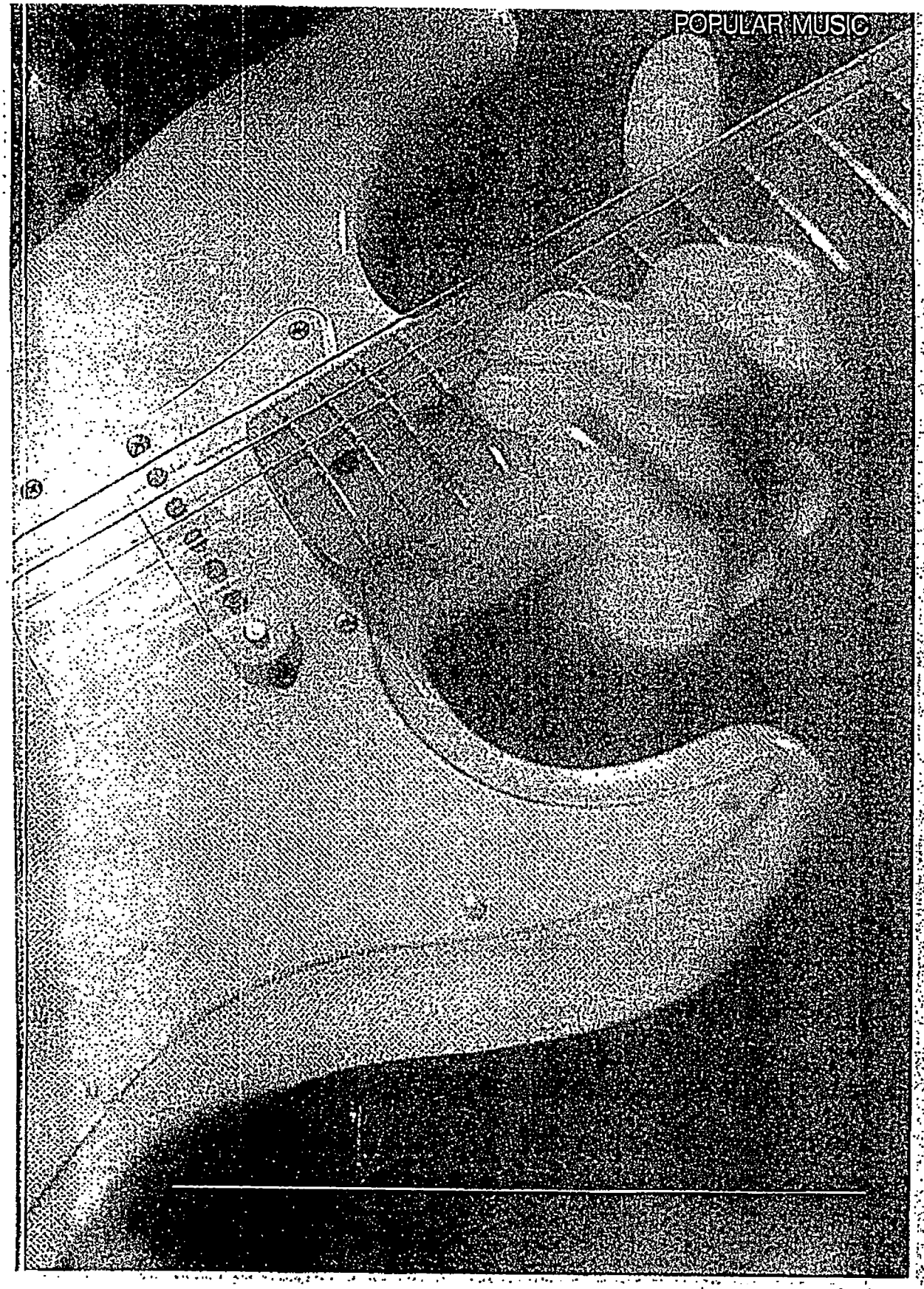
After these transactions, issued and paid share capital amounts to NLG 80 million and the share premium account amounts to NLG 126 million.
Shareholders' equity increased in 1987 from NLG 310 million to NLG 550 million. Increases stem from the capital restructuring, NLG 130 million, distribution of income, NLG 161 million and other changes, NLG 3 million. Equity decreased by NLG 54 million due to negative foreign currency translation differences.
Distribution of income results from net income of NLG 191 million less a proposed dividend distribution of NLG 30 million.
The 1987 net income, the capital restructuring and the decrease of the invested capital excluding finance accounts contributed to a substantial strengthening of PolyGram's cash position.
Bank loans were reduced by NLG 32 million while deposits with Philips were increased by NLG 270 million to NLG 419 million and liquid assets increased by NLG 171 million to NLG 352 million.

OUTLOOK

PolyGram plans to maintain its market share in 1988. Disregarding the value of the U.S. dollar, sales are expected to increase slightly over the 1987 figure.
In 1988 the CD Video hardware and software is, or is planned to be, marketed in Japan, North America and major European markets. This new product is not expected to have a material impact on PolyGram's 1988 sales.
A further expansion of the music publishing activities may be foreseen as the acquisition of catalogues is actively pursued.
In line with PolyGram's policy to adapt its manufacturing capacity to the diminishing demand for conventional records the factory in the U.K. will be closed in 1988, causing a further staff reduction of 300.
Investments in tangible fixed assets amounted to NLG 54 million in 1987 and are expected to be slightly lower in 1988.
Investments in classical and popular recording costs and films together with payments of advances to artists and repertoire owners are planned at approximately the 1987 level for 1988.
Significant changes in the structure or organisation of PolyGram are not expected.

Baarn, April 28, 1988

The Board of Management



POPULAR MUSIC

PolyGram puts a continuous and profound emphasis on artist development, and the provision of a creative environment in which national and international talent can flourish.

1987 was an exciting year for the popular music activities – with new artists like The Fat Boys, Cinderella, Robert Cray, Swing Out Sister, Zucchero and Curiosity Killed The Cat adding to the company's history of million sellers; and with many Silver, Gold or Platinum album awards attesting to PolyGram artists' and labels' sales successes.

PolyGram maintained its prominent position in the popular music market in Europe whilst continuing to increase, for the third consecutive year, its share of the popular music market in the United States.

PolyGram Records Inc. also made a major contribution to sister companies around the world by providing internationally important repertoire: US signings such as Bon Jovi, John Cougar Mellencamp, Cinderella, Robert Cray, and Kiss all achieved substantial international success in 1987.

PolyGram US's outstanding popular music success was the New Jersey group, Bon Jovi. Their most recent Mercury-label album, *Slippery When Wet* accumulated sales of 12 million copies world-wide and achieved Platinum status in the United States, eight times over.

John Cougar Mellencamp is a US signing whose highly acclaimed album, *The Lonesome Jubilee* went double Platinum in the United States in 1987.

US blues guitarist Robert Cray released his first PolyGram album, *Strong Persuader*, early in 1987 – and sold over 1.5 million copies world-wide.

The US rock band KISS achieved substantial international success with their album, *Crazy Nights*. The single, *Crazy Crazy Nights*, outsold all of their previous singles put together in the UK.

Attracted from Philadelphia club-land to sign with Mercury, Cinderella have more than lived up to PolyGram's long tradition of launching hard rock bands. Their debut album, *Night Songs*, crashed into the charts... and went on to sell more than two million.

1987 saw the European release of the latest album by legendary supergroup Deep Purple on Polydor. *The House Of Blue Light* went straight to Top Ten positions in eleven European countries, including five Number One's.

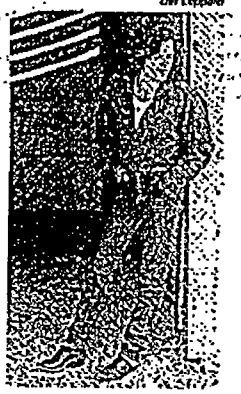
Signings by PolyGram's UK record companies: London, Phonogram and Polydor again proved to be the main source of repertoire for PolyGram companies world-wide.

In 1987 UK band Def Leppard delivered another multi-

Bon Jovi

Def Leppard

Robert Cray



John Cougar Mellencamp

Dire Straits Level 42

million selling album, *Hysteria* – a 63 minute, high-tech masterpiece, recorded at PolyGram's Wisseloord, Netherlands studio. This "heavy metal" album achieved triple Platinum status in the US.

UK signing Level 42, after seven high-charting albums in six years achieved global success with their latest album, *Running In The Family*, selling over two million units.

In 1987 Swing Out Sister carved a niche for themselves in many international markets with their fresh, breezy pop sound. Their debut single, *Breakout*, reached the Top 10 in the United States and some European countries and their first album, *It's Better To Travel*, achieved Gold status in many territories.

The most successful female group of all time is the result of dedicated talent development work, coupled with singular musical ability. Britain's Bananarama, on the London label, notched up 11 hit singles and one was nominated for Best Single of the Year in the UK.

Los Lobos generated 24 No. 1 chart entries for the single *La Bamba* and 7 No. 1's for the LP. The soundtrack gathered over twenty Silver, Gold and Platinum awards.

The 1987 award for 'staying power' must go to Phonogram UK act, Dire Straits. Their album, *Brothers In Arms*, has not been out of the major markets' album charts since it was released in 1985. It has now sold over *ten* million copies outside the US and has achieved Platinum status ten times over in the UK!

A phenomenon of 1987 was – and continues to be – the *Phantom of the Opera* UK cast album. Having charted in the UK even before the stage premiere, sales exceeded one million double albums at year's end; following the show's Broadway opening, *Phantom* entered the US charts and stood to repeat its UK success.

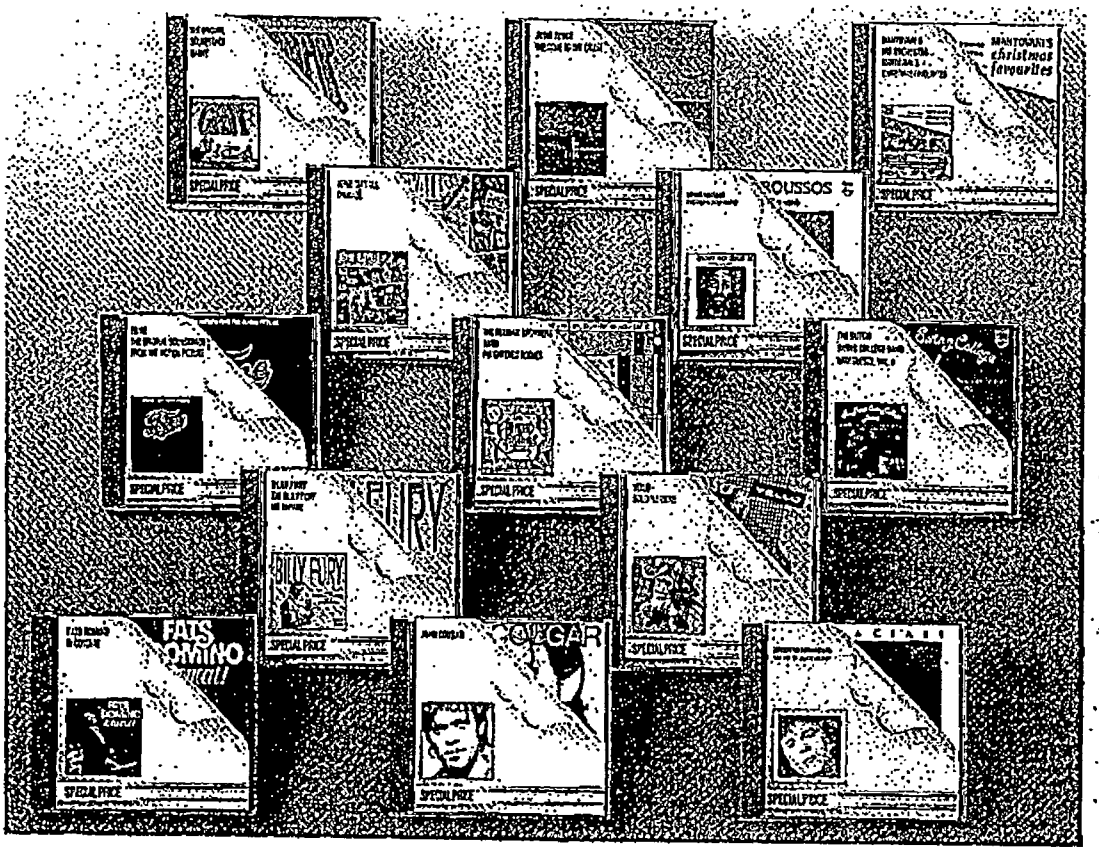
After more than 25 years on the Philips label, Nana Mouskouri is a familiar name all over the world. In 1987 she undertook extensive tours of Europe, Canada, the Far East and still found time to record new albums in Italian, Spanish, English, German, Portuguese and French.

French signing, 15 year old Vanessa Paradis, made her Polydor debut in 1987 with the single *Joe Le Taxi* – and held the Number One position in France for eleven weeks achieving sales above the million mark.

PolyGram Dischi's new signing Zucchero sold over one million *Blue's* albums in his native Italy; the Polydor record was promoted to critical acclaim in Europe early in 1988.

Freddy Mercury, lead singer of Queen was signed by PolyGram International and his first single *Barcelona*, a duet with Montserrat Caballé, was an immediate hit in Europe.

In 1987, PolyGram pioneered the mid-price segment of



the CD market with the launch of the "Special Price" series. This enabled the company to take full advantage of its extensive catalogues and to further stimulate consumer demand for CDs.

A&M AND POLYGRAM

The association began in 1985, when PolyGram licensed from A&M its important catalogue of prestigious artists for continental Europe. Recently extended, the contract also includes Latin America and South East Asia, thus providing PolyGram with a valuable addition to its own popular music repertoire. A&M artists with chart success in Europe in 1987 include Sting, Suzanne Vega, Black and Chris de Burgh.

"CAPTAIN FANTASTIC" ELTON JOHN

and Phonogram, in their ten-year partnership, produced a multitude of memorable hits.
His latest album *Live in Australia*, recorded with the Melbourne Symphony Orchestra and received with enthusiasm in the market, contains the track *Candle in the Wind*. The single entered the charts late in 1987, to begin a steady climb.

A&M RECORDS

MUSIC PUBLISHING

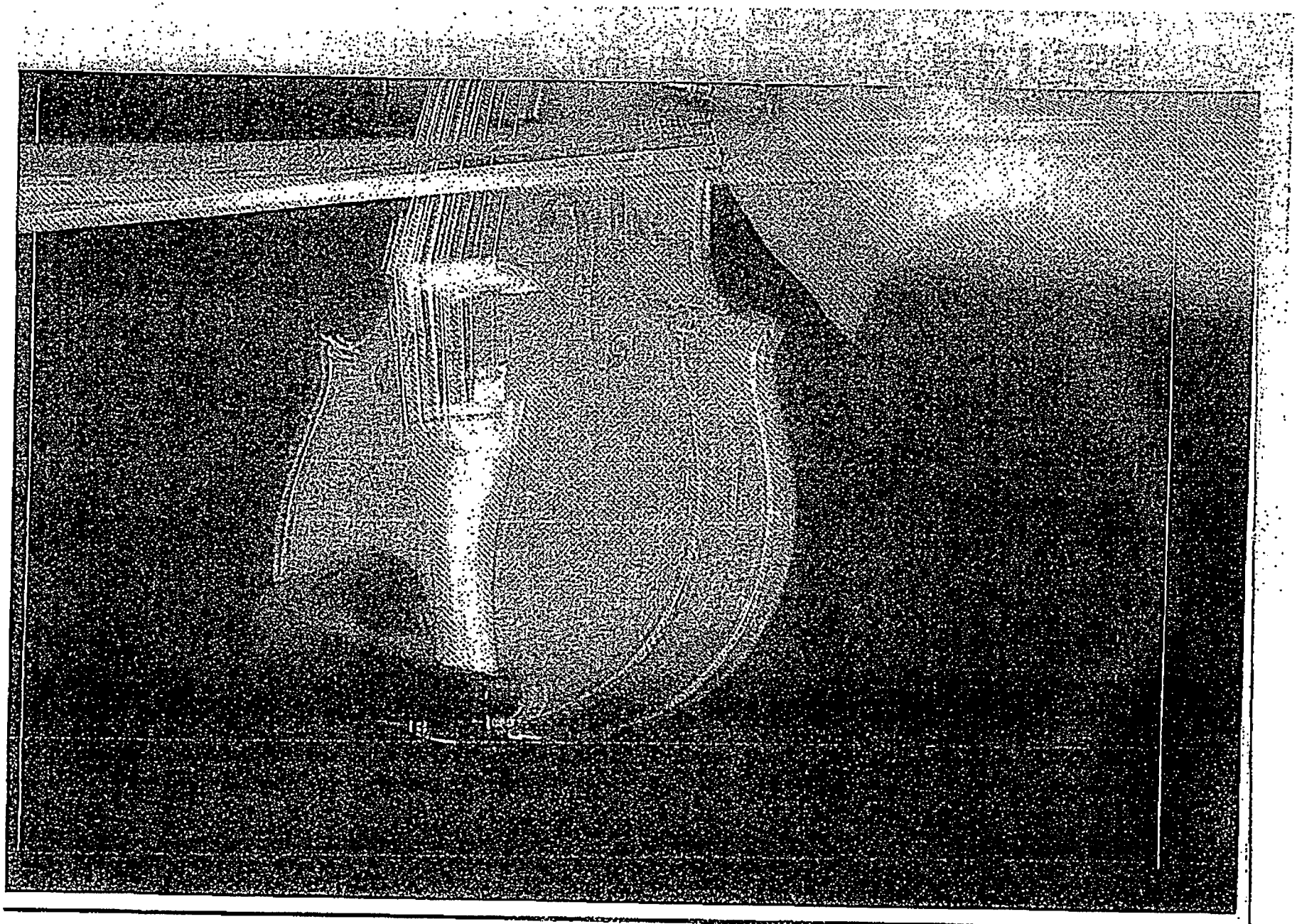
PolyGram's Popular Music Division is committed to expanding its music publishing through the acquisition of existing companies and catalogues which contain proven copyrights – and by signing and developing its own writers and composers.

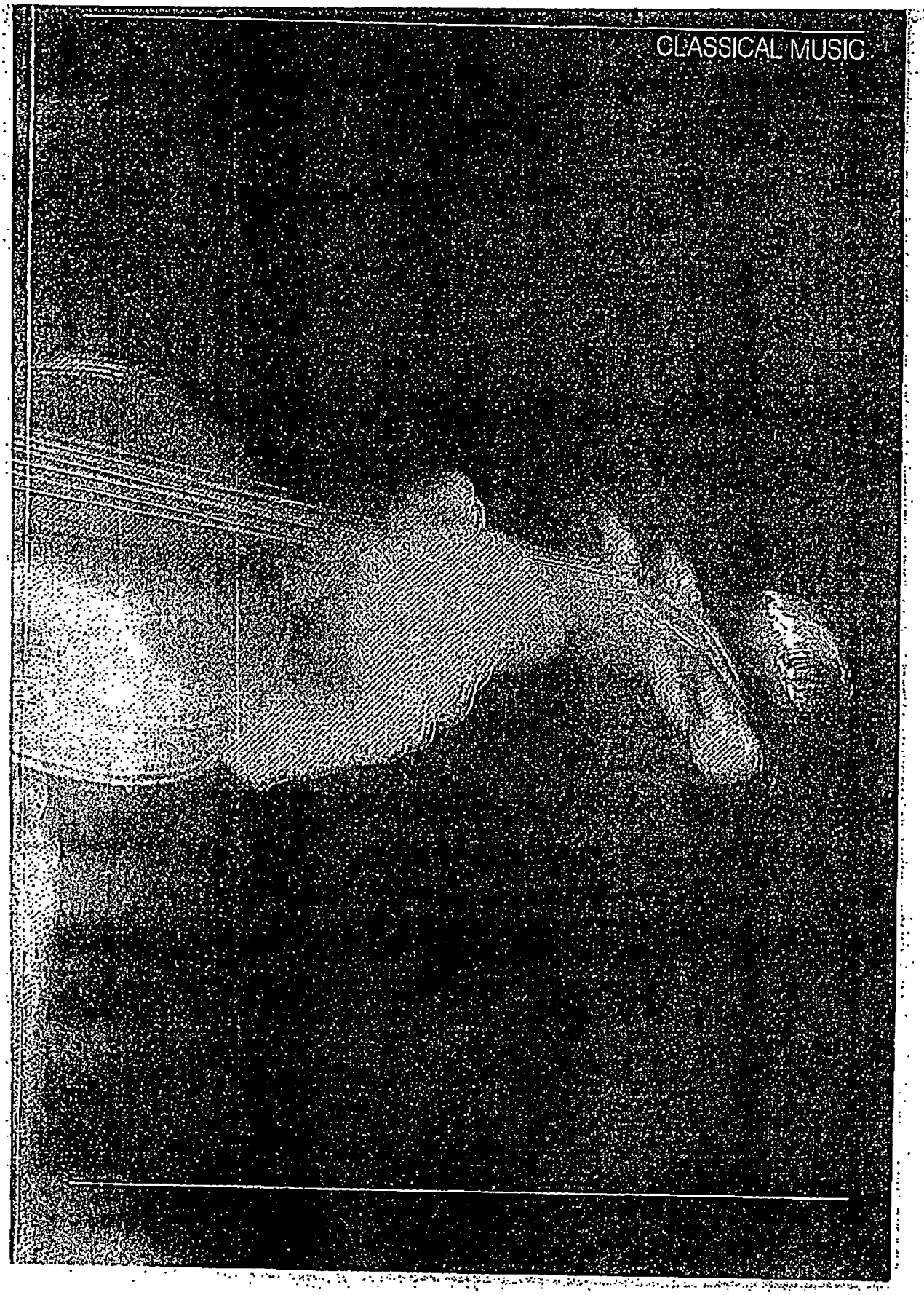
In 1986, PolyGram acquired the catalogue of independent UK publisher, Dick James Music (DJM) – a move which gave it world-wide rights to many successful songs of Elton John and lyricist Bernie Taupin, as well as the works by other leading British songwriters.
In October 1987, PolyGram obtained the music catalogue of Nashville-based Musiplex, from US singer/songwriter Mel Tillis. PolyGram now has the world-wide rights to several important catalogues that include international hits like *Ruby Don't Take Your Love To Town*, *Tobacco Road* and *Crying My Heart Out Over You*. The combination of Musiplex, DJM and the successful US songwriters and catalogues signed directly to PolyGram Music USA, raised PolyGram Music Publishing's presence in the American market in 1987. Songwriters represented by PolyGram include Bon Jovi, Cameo and Curiosity Killed The Cat.
Early in 1988, PolyGram signed a world-wide agreement with the noted US composer Marvin Hamlisch.

Marvin Hamlisch

Mel Tillis

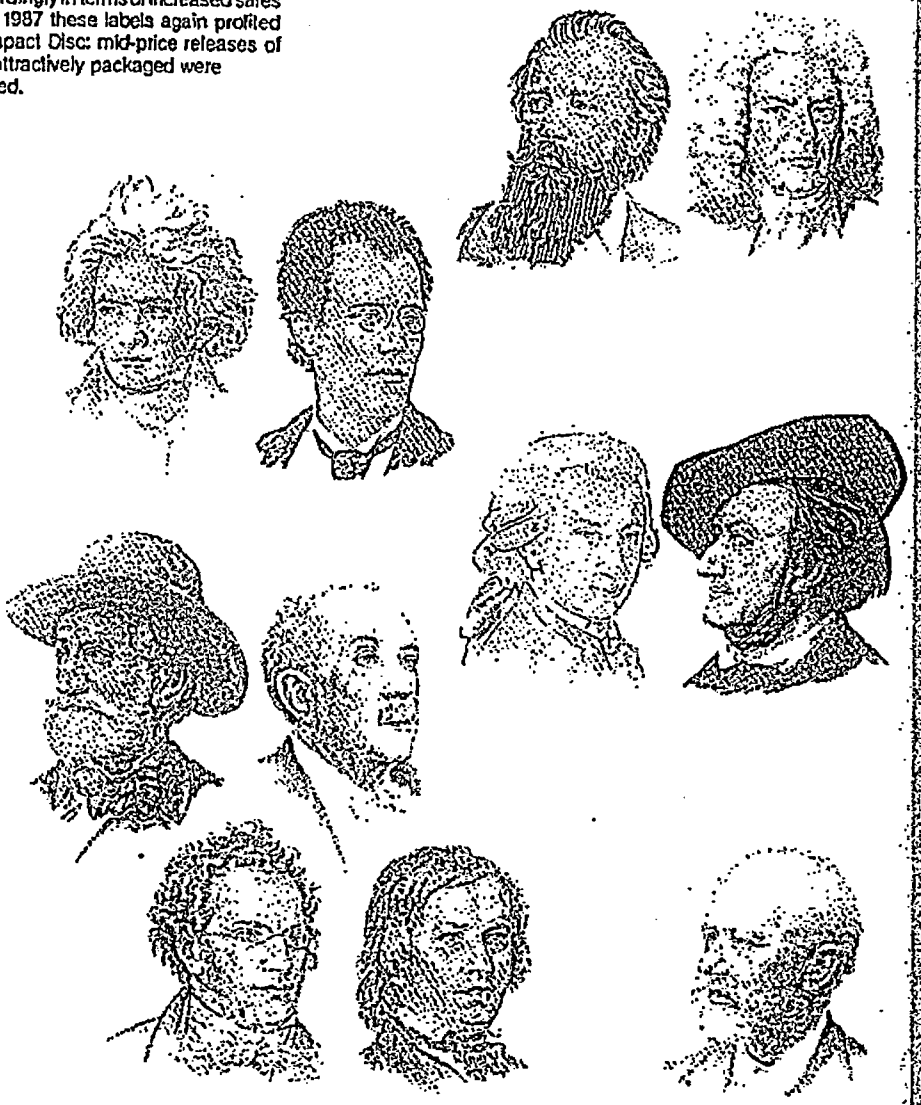
Elton John





CLASSICAL MUSIC

PolyGram leads the world market in the classical music sector; a result of operating three major international classical labels: Deutsche Grammophon (based in Germany), Philips Classics (based in The Netherlands), and UK-based Decca (known as London in North and South America and Japan). Between them, these catalogues contain some 9,000 recordings of the world's foremost artists, conductors and orchestras. This repertoire played a pioneering role in the 1982-83 launch of the Compact Disc system and PolyGram labels benefitted accordingly in terms of increased sales and market share. In 1987 these labels again profited from a "first" on Compact Disc: mid-price releases of valuable recordings attractively packaged were successfully introduced.



DECCA

In 1987, Decca mounted a concerted campaign to celebrate Sir Georg Solti's 75th birthday and his forty continuous years with the label as an exclusive recording artist. Major sales and media campaigns were mounted around the world to promote his three anniversary releases: *Lohengrin* (with which Sir Georg completed his cycle of all Wagner operas), Beethoven *Symphony No. 9*, and Haydn *Symphonies No. 93 and 99*. The Orchestre symphonique de Montréal embarked on a rave-review European tour which included 20 concerts in 15 major cities. The tour marked the 10th anniversary of Charles Dutoit's music directorship of the orchestra. During that time, he has recorded some 30 major works for Decca – and has made his orchestra one of the most highly regarded in the world.

Dame Kiri Te Kanawa again achieved chart success with the new recording of *My Fair Lady* in which she sang the part of Eliza Doolittle. The all-star cast included Jeremy Irons, Sir John Gielgud and Warren Mitchell.

Following the huge world-wide sales success of *Mama*, Luciano Pavarotti released *Volare* – a collection of popular Italian songs produced by Henry Mancini. A live recording of Pavarotti's Carnegie Hall recital in November 1987 can be expected in 1988. New Decca signings have a strong American emphasis. They include the 20 year old violinist Joshua Bell, the San Francisco Orchestra under Herbert Blomstedt, and Christoph von Dohnanyi with the Cleveland Orchestra. All of these debut recordings are scheduled for release early in 1988.

Dame Kiri Te Kanawa

Luciano Pavarotti

Sir Georg Solti

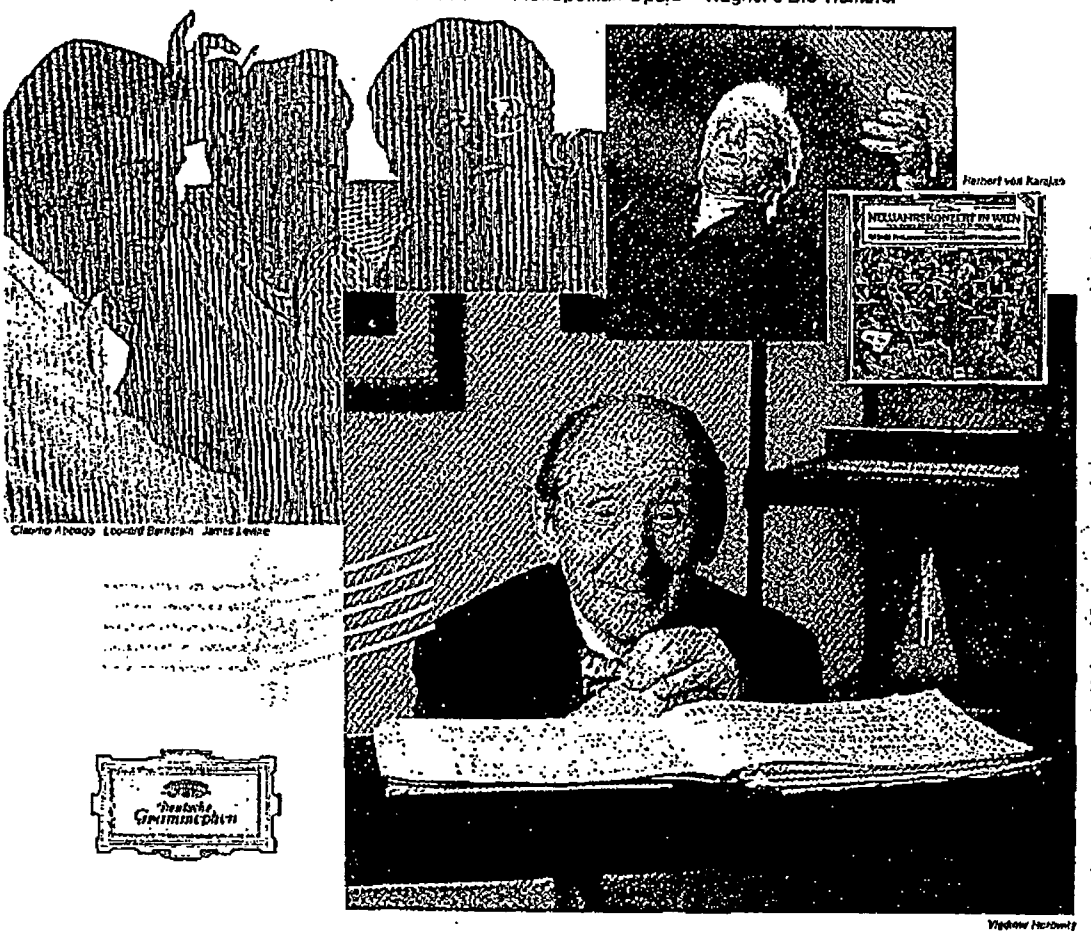
DEUTSCHE GRAMMOPHON

Herbert von Karajan and Vladimir Horowitz consistently scored high on the international classical bestseller lists with their Deutsche Grammophon recordings. The broadcast of Herbert von Karajan's first *New Year's Concert* in Vienna was enjoyed by 700 million people world-wide and the recording of the event became an immediate success.

In the final months of 1987, Vladimir Horowitz's fourth Deutsche Grammophon release in two years confirmed the artist's market appeal – Mozart's *Piano Concerto No. 23 (K.488)* entered the "Billboard" charts in November and moved to the top slot in December. Earlier in the year, four of the ten classical Grammys went to Horowitz's *Studio Recordings: New York 1985* for Deutsche Grammophon.

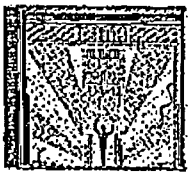
The year was also marked by major releases from Claudio Abbado, who launched a complete Beethoven cycle with the Vienna Philharmonic Orchestra; from James Levine, in his first recordings with the Berlin Philharmonic Orchestra; and from Giuseppe Sinopoli, whose recording of Verdi's *La Forza del Destino* took "Gramophone" magazine's Opera of the Year Award. Archiv Produktion, the label for Early Music, celebrated its 40th anniversary in October. Recordings from Trevor Pinnock and the English Concert, from John Eliot Gardiner and his Monteverdi Choir and English Baroque Soloists, from Musica Antiqua Köln and from Helmut Walcha appeared on the silver label disc.

In 1988, Deutsche Grammophon strives to enhance its position as a leading label for opera, with five major projects: Abbado conducts *Wozzeck*, with the Vienna State Opera; Bernstein conducts *La Bohème*, with a young, all-American cast; Sinopoli conducts *Madama Butterfly*; and Levine conducts *Eugene Onegin*, and the first release in a historical "Ring"-project with New York's Metropolitan Opera – Wagner's *Die Walküre*.



PHILIPS Classics

John Williams



Riccardo Muti

Jessye Norman

PHILIPS CLASSICS

The label's outstanding recording of 1987 was Jessye Norman's *Christmastide*. The album's 17 carols are joined in a *Christmas Symphony* by Donald Fraser. The world premiere of this symphony for soloist, choirs and orchestra – based on the Philips Classics recording – was televised in both the United States and Britain at Christmas.

After making his mark with such extraterrestrial films as *ET*, *Superman* and, appropriately, a Philips Classics release of Holst's *The Planets*, John Williams' album *By Request... the Best of John Williams and the Boston Pops*, topped the Billboard cross-over chart.

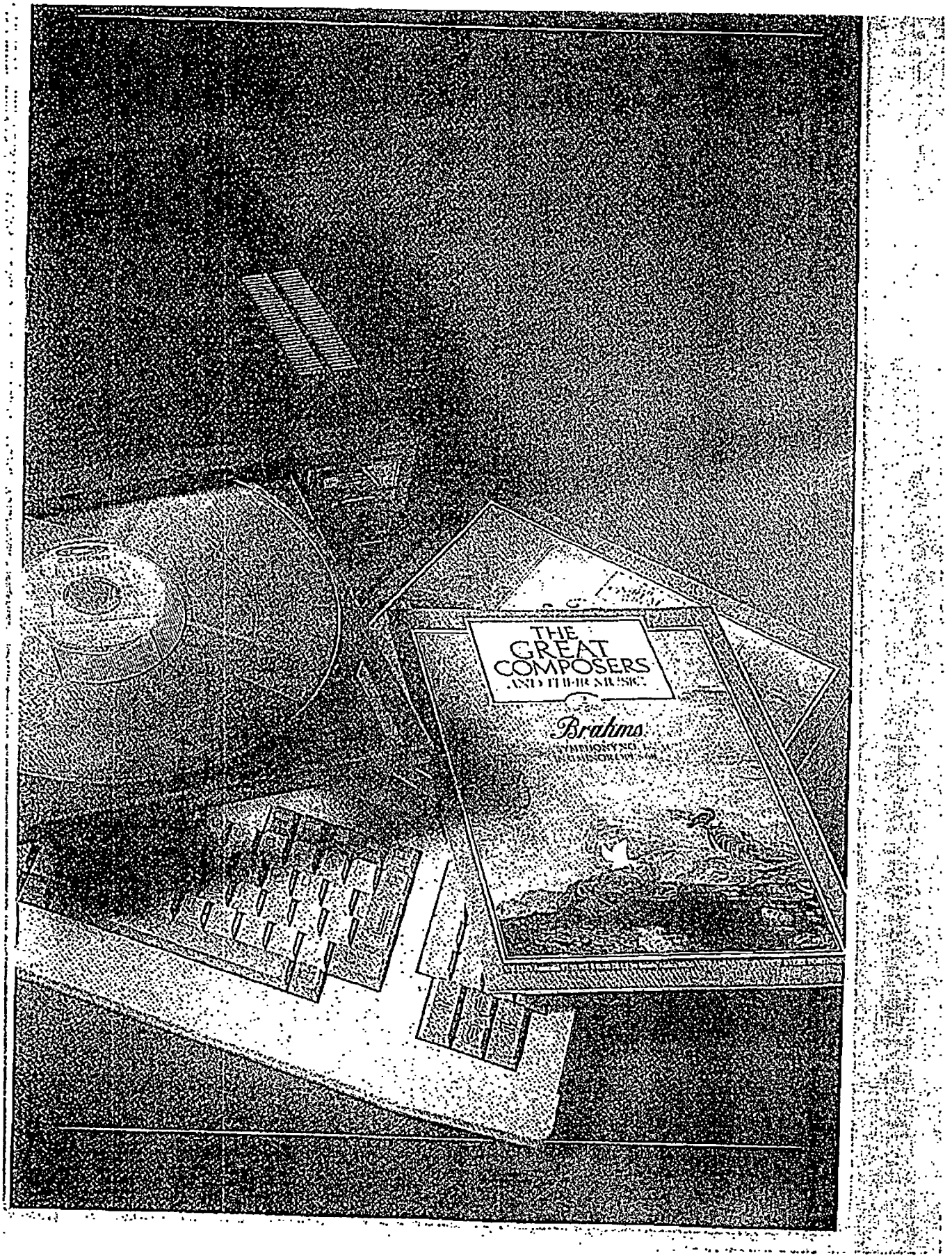
Highlight of 1987 was the signing of a major new contract with Riccardo Muti, music director of both the Philadelphia Orchestra and La Scala, Milan. I Musici – one of Philips Classics' top-selling artists for over 30 years – also extended their contract.

In 1987, Claudio Arrau finished recording the Beethoven piano concerto cycle with the Dresden Staatskapelle, conducted by Sir Colin Davis. The complete set is planned for release in 1988.

Alfred Brendel's recording of the Brahms *Concerto for Piano and Orchestra No. 1* with the Berlin Philharmonic Orchestra under Claudio Abbado was presented at the Salzburg Summer Music Festival; it received the Japan Academy Award.

Other projects included: Semyon Bychkov's first recording of Shostakovich's *Symphony No. 6* with the Berlin Philharmonic Orchestra, followed by Tchaikovsky's complete ballet *The Nutcracker*, and Viktoria Mullova's brilliant performance of the Tchaikovsky and Sibelius *Violin Concertos* with the Boston Symphony Orchestra under Seiji Ozawa. Her second Philips disc, Vivaldi's *Four Seasons* with the Chamber Orchestra of Europe under Claudio Abbado, was one of the high points of 1987.

Bernard Haitink completed recording the Beethoven *Symphonies* with the Amsterdam Concertgebouw Orchestra for a planned release upon the orchestra's and building's 100th anniversary in 1988.


THE
GREAT
COMPOSERS
Brahms

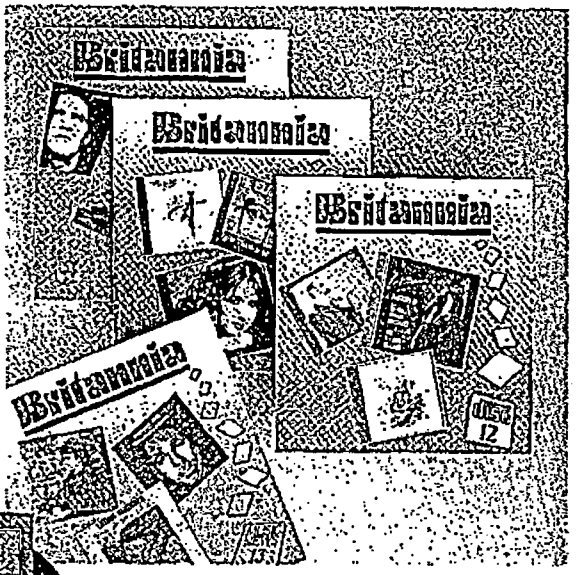
DIRECT MARKETING

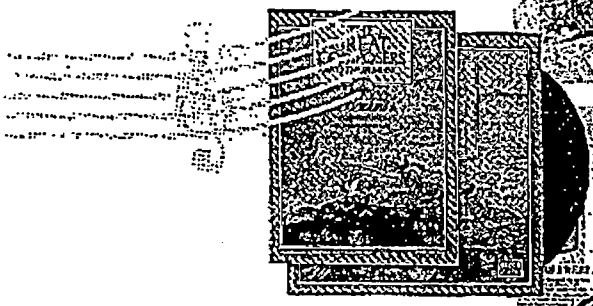
PolyGram operates mail order clubs in the UK (Britannia) and France (D.I.A.L.). These clubs sell product from major record labels and are not restricted to PolyGram repertoire.

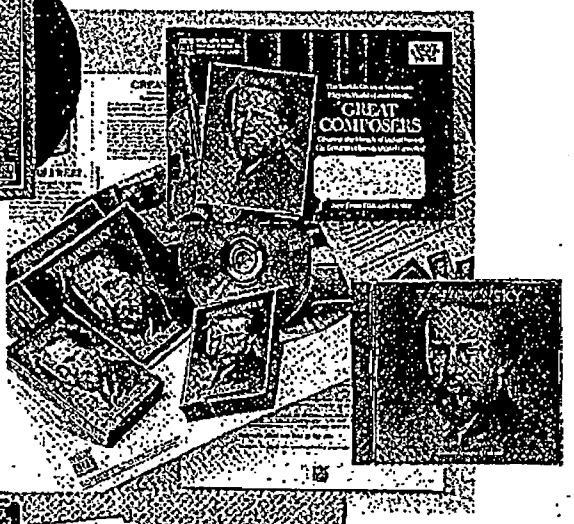
Since 1982, the UK company, Britannia Music, has more than doubled its membership and sales. In 1987, the market leader Britannia exceeded its 1986 sales significantly.

SPECIAL PROJECTS

PolyGram's Special Projects activity is responsible for exploiting the company's extensive music catalogues through non-traditional sales outlets. This includes the licensing of repertoire and sale of sound carriers to third party organisations such as record clubs, mail order companies, part-work publishers and organisers of premiums and incentive promotions. This provides a valuable and relatively stable source of additional revenue.







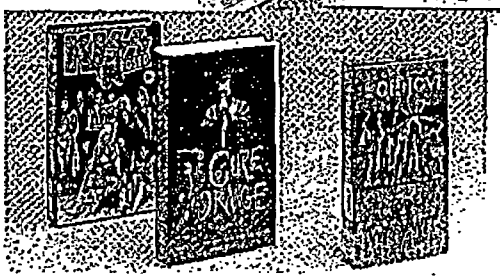
MUSIC VIDEO

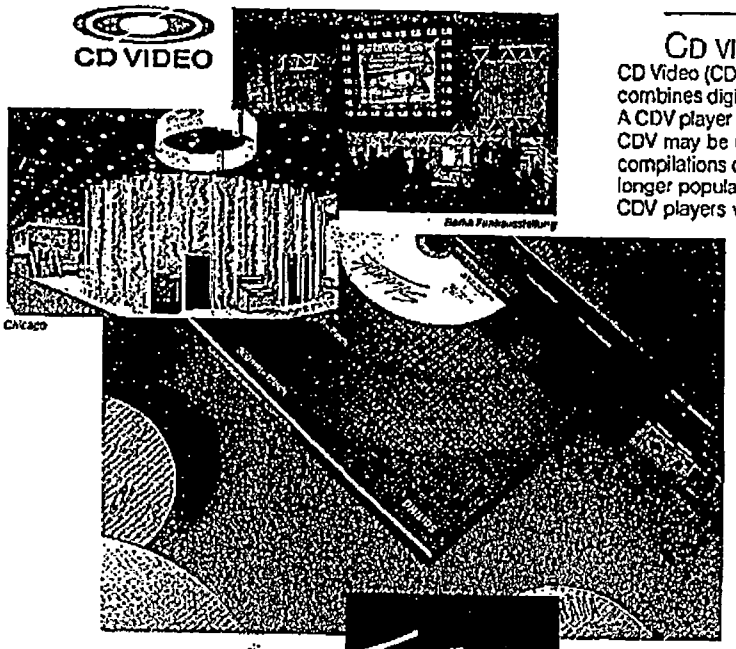
PolyGram is applying the creative skills and marketing expertise gained in the recorded music business to another sector of the home entertainment market: pre-recorded video cassettes.

In the US, two PolyGram Music Video (PMV) releases went platinum: *Kiss eXposed* and Bon Jovi's *Slippery When Wet: The Videos*, while Cinderella's *Night Songs: The Videos* went gold. Bon Jovi's earlier *Breakout* video was the largest selling music video product of 1987, holding the No. 1 position in BILLBOARD's video chart for half the year.

PMV in the UK has built up a significant catalogue. Major music releases in 1987 included: The Cure's "live-in-concert" film, *The Cure In Orange*, *KISS eXposed* and *Eurythmics Live*.

Through its Channel 5 joint venture, PolyGram UK also participates in the "sell-through" market – in which low-priced pre-recorded video cassettes are sold to consumers through "High Street" retail multiples.





Berlin Funkausstellung

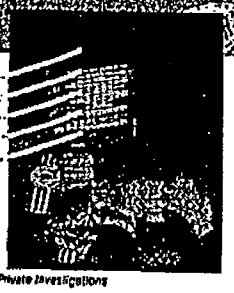
Chicago

CD VIDEO

CD Video (CDV) is a Compact Disc development which combines digitally encoded sound and analogue video. A CDV player can also play standard "audio-only" CDs. CDV may be used for music video clips, special compilations of video clips, full-length feature films and longer popular and classical performances.

CDV players were presented by Philips and others in 1987, for a proposed launch in the major European markets in 1988. At least eight other hardware manufacturers – including the major Japanese brands – are expected to launch CDV players in 1988. The launch in Japan and the US took place late in 1987.

PolyGram and Philips are co-operating closely in the creation and marketing of programming for CD Video. In 1987, PolyGram actively promoted CDV to the recorded music industry, retail trade and the public. Major exhibitions, such as the Chicago Consumer Electronics Show, Berlin Funkausstellung and the Tokyo Audio Fair provided platforms for gathering industry support for the world-wide launch.



Private Investigations

CD INTERACTIVE

After CDV, CD Interactive (CDI) is foreseen as the next generation of CDs. The multi-media technology combines digital audio with digital visuals – with the added feature of interactivity for the user.

PolyGram is currently developing programming for CDI which will merge the record/audio industry, film/video industry and text and database industries in new ways. By combining text, visuals and commentary, it is planned to use CDI for a multitude of home entertainment purposes (such as adventure video games, "teach yourself" programmes, works of reference, musical biographies and more).

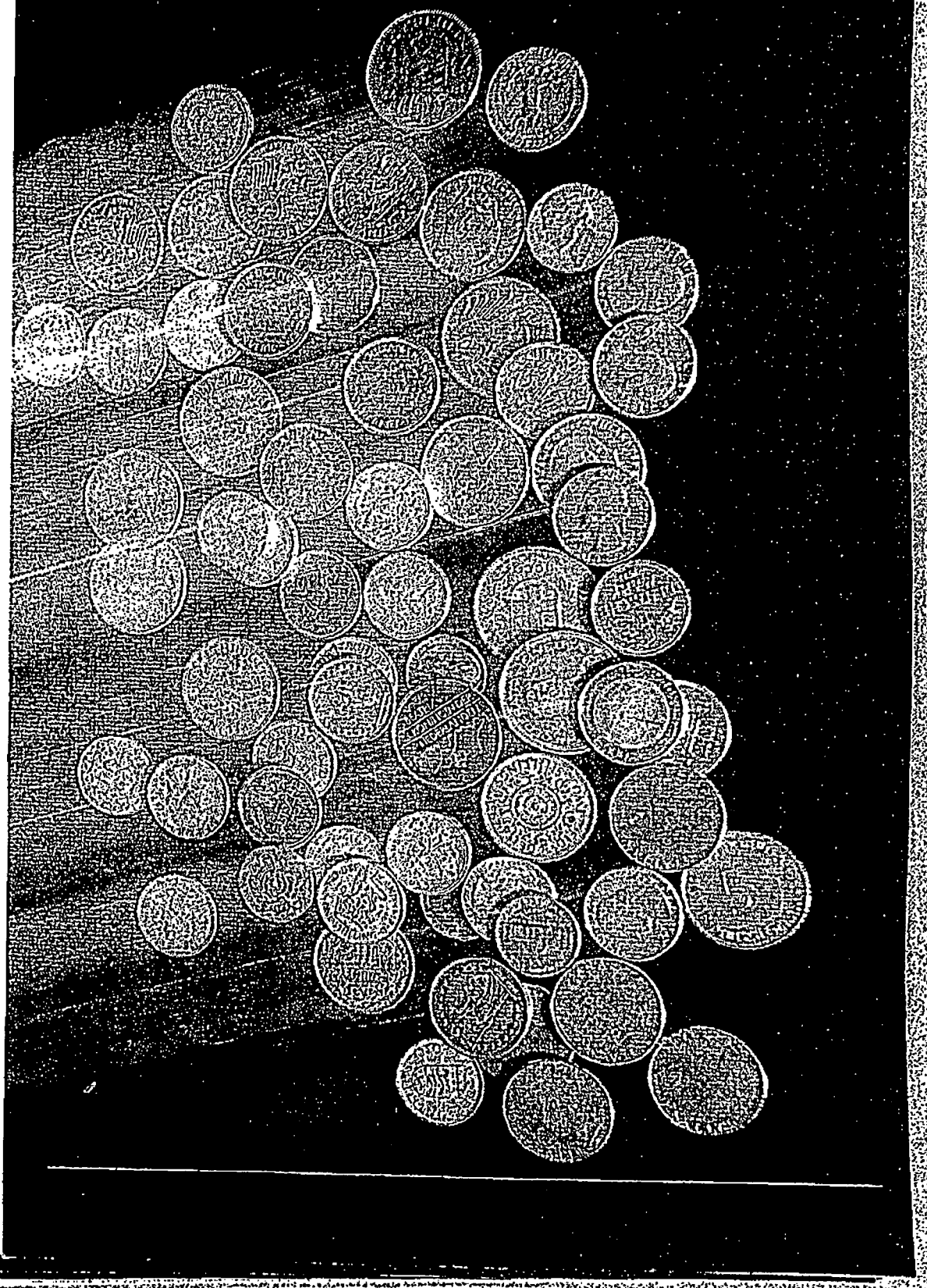
Blue Iguana

FEATURE FILMS

PI – Private Investigations – was released in 1987. This fast-paced action-thriller includes an album soundtrack with music from PolyGram's top bands: Bon Jovi, Level 42, Bananarama, Big Country, and Tears for Fears. *Blue Iguana*, shot on location in Mexico is scheduled for release in 1988. The film was directed by John Lafia and features *Hamburger Hill* star, Dylan McDermott, James Russo and Dean Stockwell. These two low budget movie productions underline PolyGram's commitment to explore a broad range of entertainment programming – particularly where there is a music synergy. The fact that both obtained distribution by major movie studios has encouraged PolyGram to continue this activity. The third movie went into production in New York in 1988.

Not all artists/recordings mentioned are distributed by all PolyGram companies.

FINANCIAL DATA



ACCOUNTING POLICIES

CONSOLIDATED FINANCIAL STATEMENTS OF THE POLYGRAM GROUP

The consolidated financial statements of the PolyGram Group include the accounts of PolyGram N.V. (formerly PolyGram B.V.) and its subsidiaries (the "PolyGram Group").
The PolyGram Group includes businesses around the world which are chiefly involved in the acquisition, production and marketing of repertoire as well as the sales and distribution of pre-recorded sound-carriers, such as records, cassettes, and Compact Discs. In addition PolyGram is engaged in activities with respect to home video and music publishing. Some group companies are also involved in the development of new software applications for Compact Discs.

CHANGE OF NAME AND STATUS

Through an amendment of the Articles of Association, as of September 30, 1987, the legal status of PolyGram B.V. changed from a private limited liability company into a public limited liability company. The name was thereby changed to PolyGram N.V.
In 1987 N.V. Philips' Gloeilampenfabrieken (Philips), holding 90% of the shares of PolyGram B.V., acquired the remaining 10% of the shares which were held by Siemens A.G.. On December 31, 1987, Philips sold 10% of its interest in PolyGram N.V. to a financial institution.

POLICIES OF CONSOLIDATION

The consolidated financial statements include all of the subsidiaries in which more than 50% of the issued share capital is held by PolyGram N.V., or through any of its subsidiaries directly or indirectly.
These companies are included in full in the consolidation; the aggregate of minority interests of third parties are disclosed separately.
With regard to the financial statements of the majority of the Dutch private limited liability companies, included in the consolidated financial statements, the exemption is applied as referred to in article 403, section 1, Book 2 of the Civil Code.

POLICIES FOLLOWED IN VALUATION AND INCOME CALCULATION

Historic cost convention
The valuation as well as the depreciation and/or consumption of tangible fixed assets and inventories, is based on the historic cost convention with the exception of entities in highly inflationary economies (hyper-inflation countries) where the valuation of these assets and also depreciation and/or consumption are based on current value.

Foreign currencies
All foreign currency amounts in the balance sheets have been translated to Dutch guilders ("NLG") at the official exchange rates at the balance sheet date.
Gains and losses resulting from foreign currency transactions are included in the consolidated statements of income.
Exchange differences due to the translation into Dutch guilders of financial statements of foreign subsidiaries have been accounted for as translation differences in shareholders' equity.
In the consolidated statements of income, the amounts stated for sales, expenses and results of foreign participations have been translated to Dutch guilders based upon the rates of exchange for the periods involved.

Face value
Unless specific valuation rules are mentioned all items in the financial statements are valued at face value.

ACCOUNTING POLICIES
(CONTINUED)

BALANCE SHEETS

Intangible fixed assets
Music publishing rights are valued based upon either the actual amount paid to third parties or the present value of future revenues, whichever is lower. Such assets are amortized on a straight line basis over the expected economic life.

Tangible fixed assets
Tangible fixed assets are generally valued at their acquisition cost less depreciation.
Depreciation is calculated on a straight line basis taking into account the assets' economic life.

Non-consolidated companies
The valuation of investments in non-consolidated companies is based on net asset value. The valuation of assets, liabilities, equity and income of non-consolidated companies reflects, as much as possible, the accounting policies established for the consolidated financial statements.

Other non-current financial assets
Securities are valued at acquisition price or realizable value, whichever is lower. Other receivables are stated at face value less an allowance for the risk of doubtful accounts.

Inventories
Recording costs are valued at cost less depreciation, which is based on the average economic life.
Films are valued at cost or the estimated net realizable value, whichever is lower.
Other inventories are valued at cost, based on a first in first out method, reduced by a provision for the risk of obsolescence. Any income derived from intercompany transfers of goods and materials has been eliminated.

Receivables and prepaid expenses
Trade accounts and other receivables are valued at face value less an allowance for the risk of doubtful accounts.
For advances to artists and repertoire owners each contract is appraised individually and the value of the unrecouped portion is determined by the prospects of future recoupment taking into account current popularity and recent sales.

Minority interests
Minority interests in total equity of consolidated companies are shown at net asset value, calculated in accordance with the policies established in the preparation of the consolidated financial statements.

Liabilites
Provisions are not associated with specific assets, but are created to cover certain business obligations and risks. Provisions are stated at face value, with the exception of provisions for employee pension benefits and severance payments, which are stated at the present value of the future obligations.
The provision for employee pension benefits is based on actuarial calculations and relates to those pension obligations that are not funded by separate pension funds or by third parties. Past service liabilities are, in general, covered to the retirement dates of the employees concerned. The total pension coverage provided by this provision together with the various separate pension funds is equal to at least the present value of existing pension benefits based upon the number of prior years of employment with PolyGram.
Deferred income taxes, which are determined for each fiscal entity, include the deferred income taxes arising from timing differences between book (commercial) and taxable (fiscal) income. In the event that the deferred income tax benefits exceed the deferred income tax liability for a given fiscal entity, the net income tax benefit is shown as an asset.

STATEMENTS OF INCOME

Net income is determined taking into account the following accounting policies:
Net sales represent the revenues derived from products delivered to, and services performed for third parties, net of returns.
The costs related to the products and services sold are calculated on the basis of historic cost, including write-downs of any inventories or tangible fixed assets.
Equity in net income of non-consolidated companies has been recognized, in all material aspects, in accordance with the accounting policies followed in the preparation of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME OF THE POLYGRAM GROUP

in millions of guilders

	1987	1986
Net sales	2,924	2,938
Direct costs of sales	(1,618)	(1,681)
Gross income	1,306	1,257
Selling expenses	(677)	(674)
General and administrative expenses	(357)	(344)
Income from operations	272	239
Financial income and expenses	28	14
Income before taxes	300	253
Income taxes	(96)	(82)
Income after taxes	204	171
Equity in net income (loss) of non-consolidated companies	(5)	3
Group income	199	174
Minority interests	(8)	(4)
Net income from normal business operations	191	170
Extraordinary items after taxes	–	146
Net income	191	316

CONSOLIDATED BALANCE SHEETS OF THE POLYGRAM GROUP

after proposed distribution of income

in millions of guilders

AS OF DECEMBER 31		1987		1986
ASSETS				
Fixed assets				
Intangible fixed assets	29		24	
Tangible fixed assets	115		94	
Non-consolidated companies	15		15	
Other non-current financial assets	31		23	
Total fixed assets		190		156
Current assets				
Inventories	223		261	
Receivables and prepaid expenses	1,542		1,390	
Liquid assets	352		181	
Total current assets		2,117		1,832
Total		2,307		1,988

GROUP EQUITY AND LIABILITIES

		1987		1986
Group equity				
Shareholders' equity	550		310	
Minority interests	30		20	
Total group equity		580		330
Long-term provisions		211		242
Short-term provisions		274		256
Long-term liabilities		40		38
Current liabilities		1,202		1,122
Total		2,307		1,988

STATEMENTS OF CHANGES IN THE FINANCIAL POSITION

In millions of guilders

	1987		1986	
Sources of funds				
Net income from normal business operations	191		170	
Extraordinary items after taxes	–		146	
Amortization of intangible fixed assets	4		1	
Depreciation of tangible fixed assets	20		26	
Other changes	(58)		36	
Cash flow		157		379
Dividend received from non-consolidated companies*		–		2
Changes in working capital		(5)		(19)
Total resources from normal business operations		152		362
Share capital, issued and paid, including share premium	130		–	
Changes of long-term liabilities	2		(258)	
Total external resources		132		(258)
Total sources of funds		284		104
Uses of funds				
Investment in intangible fixed assets	9		25	
Investment in tangible fixed assets	54		10	
Changes in other non-current financial assets	8		(2)	
Reduction of long-term provisions	31		38	
Total uses of funds		102		71
Changes in liquid assets				
Liquid assets	171		21	
Payables to banks	11		12	
		182		33

in millions of guilders

NET SALES PER GEOGRAPHICAL AREA

Geographical area	1987 net sales	1987 in % of total	1986 net sales	1986 in % of total
The Netherlands	133	5	110	4
Europe excluding The Netherlands	1,669	57	1,697	58
U.S.A. and Canada	603	21	574	19
Asia	365	12	367	12
Rest of world	154	5	190	7
Total	2,924	100	2,938	100

NUMBER OF EMPLOYEES PER GEOGRAPHICAL AREA

Geographical area	number of employees as of Dec. 31, 1987	number of employees as of Dec. 31, 1986	average number of employees in 1987
The Netherlands	833	815	836
Europe excluding The Netherlands	3,792	4,420	3,981
U.S.A. and Canada	1,094	960	1,010
Asia	507	520	508
Rest of world	808	857	842
Total	7,034	7,572	7,177

GROUP COMPANIES AND NON-CONSOLIDATED COMPANIES OF IMPORTANCE IN INDIVIDUAL COUNTRIES

A list of the group companies and non-consolidated companies, drawn up with due observance of the relevant legal regulations, is available at the Trade Register office in Amersfoort, The Netherlands. The following list includes the significant group companies and non-consolidated companies in each country. Percentages of participation are mentioned for those companies in which the participation is less than 100%.

THE NETHERLANDS

PolyGram International Holding B.V.
Baarn

PolyGram International Music B.V.
Baarn

Phonogram B.V.
Hilversum

Polydor B.V.
Hilversum

PolyGram Record Service B.V.
Baarn

PolyGram Nederland B.V.
Baarn

Wisseloord Studios B.V.
Hilversum

EUROPE EXCLUDING THE NETHERLANDS

Austria
PolyGram Ges.m.b.H.
Vienna

Belgium
PolyGram Records S.A.
Brussels

Denmark
PolyGram Records A/S
Copenhagen

Federal Republic of Germany
Polydor International G.m.b.H.
Hamburg

Deutsche Grammophon G.m.b.H.
Hamburg

Phonogram G.m.b.H.
Hamburg

Metronome Musik G.m.b.H.
Hamburg

PolyGram G.m.b.H.
Hamburg

Grammophon Production International G.m.b.H.
Hamburg

PolyGram Record Service G.m.b.H.
Langenhagen

France
Barclay – Phonogram S.A.
Paris

Polydor S.A.
Paris

Impact S.A.
Antony

D.I.A.L. – Diffusion Internationale d'Arts et Loisirs S.A.
Antony

PolyGram S.A.
Paris

Compagnie Générale Européenne de Distribution et d'Editions Phonographiques
Cogedep – S.A. Paris 38%

Greece
PolyGram Records S.A.
Athens

Ireland
PolyGram Records Ltd.
Dublin

Italy
PolyGram Dischi SpA
Milan

Norway
PolyGram Records A/S
Oslo

Portugal
PolyGram Discos S.A.
Lisbon

Spain
PolyGram Iberica S.A.
Madrid

Sweden
PolyGram A.B.
Bromma

Switzerland
PolyGram Records A.G.
Schlieren

United Kingdom
PolyGram Leisure Ltd.
London

PolyGram International Ltd.
London

PolyGram International Music Publishing Ltd.
London

PolyGram UK Ltd.
London

Phonogram Ltd.
London

Polydor Ltd.
London

Britannia Music Company Ltd.
London

London Records Ltd.
London

The Decca Record Company Ltd.
London

PolyGram Musicvideo Ltd.
London

Dick James Music Ltd.
London

U.S.A. AND CANADA

Canada
PolyGram Inc.
Montreal

United States of America
PolyGram Records Inc.
New York N.Y.

American Interactive Media Inc.
Los Angeles C.A.

LATIN AMERICA

Argentina
PolyGram Discos S.A.
Buenos Aires

Brazil
PolyGram do Brasil Ltda.
Rio de Janeiro

Fonobras – Distribuidora Fonografica Brasileira Ltda.
Rio de Janeiro *50%*

Mexico
PolyGram Discos S.A. de C.V.
Mexico City *99%*

AFRICA

Kenya
PolyGram Records Ltd.
Nairobi

Nigeria
PolyGram Records Ltd.
Lagos *60%*

ASIA

Hong Kong
PolyGram Records Ltd.
Kowloon

India
Music India Ltd.
Bombay *40%*

Japan
Polydor K.K.
Tokyo *51%*

Nippon Phonogram Co. Ltd.
Tokyo *50%*

Malaysia
PolyGram Records Sdn. Bhd.
Kuala Lumpur

Singapore
PolyGram Records Pte. Ltd.
Singapore

AUSTRALIA AND NEW ZEALAND

Australia
PolyGram Records Pty. Ltd.
Sydney

New Zealand
PolyGram Leisure Ltd.
Wellington

MANAGEMENT DIRECTORY

BOARD OF MANAGEMENT, POLYGRAM N.V.

David G. Fine, *President*
Jan Cook, *Executive Vice President and Chief Financial Officer*
Dr Wolfgang Hix
Robbert A.E. Stuyt

EXECUTIVE MANAGEMENT MEMBERS:

Aart Dalhuisen, Executive Vice President, Popular Music, Music Publishing

Tim Harrold, Executive Vice President, Classical Music

Michael A. Kuhn, Senior Vice President, New Business

D. Bruce Mackenzie, Senior Vice President, Regional Operations

OFFICERS OF POLYGRAM'S MAJOR NATIONAL ORGANISATIONS:

M. Richard Asher, Chief Executive Officer, PolyGram Records Inc, New York

Ben Bunders, Chief Executive Officer, PolyGram G.m.b.H., Hamburg

Alain Lévy, Chief Executive Officer, PolyGram S.A., Paris

Terumi Mizuta, President, Polydor K.K., Tokyo

Maurice L. Oberstein, Chief Executive Officer, PolyGram UK Ltd., London

SUPERVISORY BOARD, POLYGRAM N.V.:

Jan D. Timmer, *Chairman*
Member of Philips Group Management, Chairman and Chief Executive Officer, Philips Consumer Electronics Division

Laurens P.H. Das
Director, Corporate Bureau Participations, Philips International

Johan A. Rutgers
Senior Director, Corporate Legal Affairs; Secretary, Philips International

Responsibility for the management of PolyGram lies with the Board of Management; it is accountable to the Supervisory Board.

STATEMENT FROM THE AUDITOR

The information included in this report under "Financial Data" has been taken from the 1987 consolidated financial statements of the PolyGram group, issued under separate cover, on which we have issued an unqualified report.

Amsterdam, April 28, 1988

KPMG Klynveld Kraayenhof & Co.

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Photographers:

*Arthur Umboh, Christian Steiner, Christina Buidon, Doug McKenzie,
G. Schuchmes (Sygma), Joost van Velzen, Leitl & Masolit,
Siegfried Lauterwasser, Lord Snowdon, Zoë Dominic.*

Printed in The Netherlands

WE GIVE OUR ARTISTS THE WORLD

EXHIBIT CO 0933

PolyGram Report 1980/81

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RECORDED MUSIC

MUSIC PUBLISHING

MOTION PICTURES

TELEVISION

VIDEO

DIRECT MARKETING

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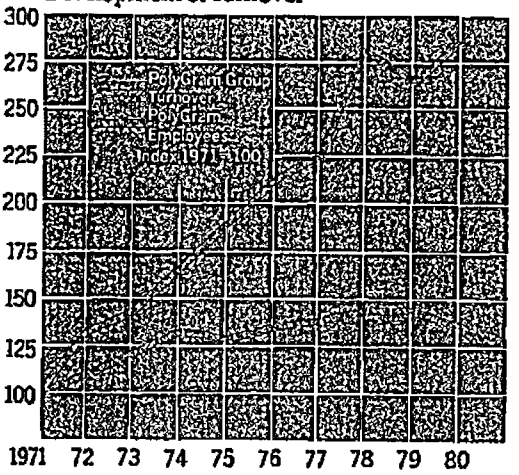
FIGURES

Personnel		
As at 31 December each year	1979	1980
Number of employees	13,785	13,182
Person. expendit. in million DM	511	579
PolyGram Group		
In million DM	1979	1980
Turnover	2,275	2,417
Capital assets	645	829
Current Assets	1,342	1,534
Capital and reserves	474	443
Balance sheet total	1,987	2,363

POLYGRAM GROUP
Development of Turnover



PROFILE

POLYGRAM'S activities are spread across the entertainment, cultural and communication businesses of the world. In the creation, manufacture, marketing and distribution of recorded music in all its forms. In music publishing. In motion pictures and television. In video. In direct marketing and trading.

Some 13,000 employees in 29 countries represent PolyGram around the globe.

The PolyGram Group has five divisions: Record Operations, Publishing, Film and Television, Video, and Direct Marketing and Trading. National and Regional organizations have responsibility for the Group's activities in Africa, Australia/New Zealand, Austria, the Far East, France, Great Britain, The Netherlands, Scandinavia and the United States. PolyGram has over 130 operating companies around the world.

PolyGram's largest division, Record Operations, guides the Group's recorded music activities through Phonogram International, Polydor International, Decca International and PolyGram's associate labels.

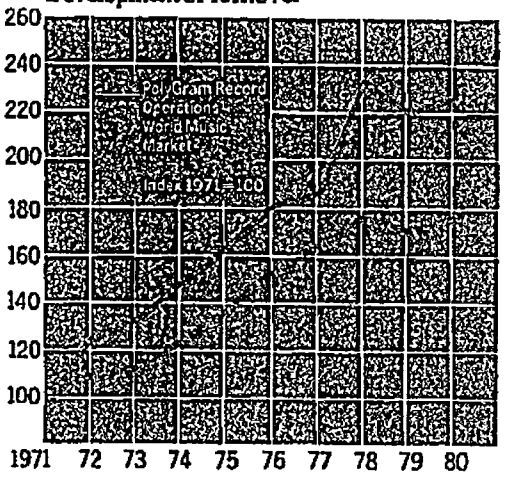
The Group's flagship labels–Polydor, Mercury, Philips, Deutsche Grammophon, Archiv Produktion, Decca and London–have become synonymous with artistic excellence and high technical quality.

PolyGram's major partners are the Robert Stigwood Group–with its RSO label–and the French based Barclay Group. In many markets, PolyGram is also a manufacturing and distribution associate for other leading labels.

PolyGram is a joint subsidiary of N.V. Philips' Gloeilampenfabrieken and Siemens AG. Their co-operation in the music business dates back to 1962, when they exchanged 50 percent of their respective shares in N.V. Philips' Phonographische Industrie, founded by Philips in 1950 and Deutsche Grammophon Gesellschaft mbH, whose history dates back to 1898. PolyGram was formed as a management and holding company in 1972.

The PolyGram Group has international headquarters in Baarn (The Netherlands) and Hamburg (Federal Republic of Germany). Group Management operates from the Hamburg office.

POLYGRAM RECORD OPERATIONS
Development of Turnover



Notes:
1) PolyGram Record Operations: million DM Net Turnover.
2) World Music Market: million DM Retail Value actually paid.

MANAGEMENT REPORT

IN 1980, the worldwide turnover of the PolyGram Group totalled DM 2,400 million, a 6% increase on the Group's 1979 performance.

After a period of uninterrupted growth and profitability, PolyGram–for the second consecutive year–suffered a downturn in earnings in 1980. The Group's results were influenced by the effects of the worldwide economic recession, rising costs and growing piracy and home taping on the music market, the mainstay of our business.

In addition, as the year progressed, the U.S. music operations of our European-based Group were faced with an increasingly difficult trading situation. During this time, important personnel changes went into effect and the new senior management has already achieved a marked improvement in our U.S. business.

In line with overall Group performance, the turnover of PolyGram Record Operations, including the consolidated companies Casablanca, Decca and PolyStar Japan, marginally exceeded that of 1979.

As part of its continuous efforts towards the improvement of sound reproduction, PolyGram has invested considerably in the development, with Philips, of the Compact Disc Digital Audio System (CD). To date, the Group has played a major role in the development of the laser-read digital record for this revolutionary new system.

The Publishing Division again performed excellently in 1980, with turnover substantially above the 1979 previous sales peak. Strong repertoire acquisitions were a significant factor in the Division's fine result.

The Direct Marketing and Trading Division also surpassed the turnover of 1979, and sales in its main activity, mail order clubs, were higher than ever before.

PolyGram confirmed its confidence in the long-term future of the entertainment market by substantially expanding its audio-visual activities in 1980.

New operations, PolyGram Pictures and PolyGram Television, were established in Los Angeles during the year. PolyGram Pictures gives the Film and Television Division its own base for major film projects and, together with PolyGram Television, now reinforces that Division with production and exploitation capability in the American markets and internationally.

The home video market continued to accelerate in many countries throughout 1980, with the launch of the videodisc in the United States, and its forthcoming introduction in the U.K., increasing system options.

The PolyGram Video Division is geared to provide high quality program software for the videodisc and the established videocassette markets. The Division plans a controlled expansion in these fields.

In line with the Group's policy of increasing the functions and responsibilities of national PolyGram organizations–a step aimed at preparing them to adapt to ever-changing conditions in their territories–PolyGram Nederland B.V. was established in 1980 with responsibility for the Group's Dutch operations.

In the period covered by this report, a number of changes were effected in PolyGram's corporate management. Pieter R. Schellevis was appointed PolyGram Delegate to Australia and New Zealand, following Tony van de Haar who has reached the mandatory retirement age. Mr. Schellevis was succeeded as President of Phonogram International by Henk Th. Holsbergen. Richard Busch was appointed Deputy President, PolyGram Record Operations (PRO) and Tim Harrold became President, Polydor International.

When, on January 1 of this year, I assumed the position of President and Chief Executive Officer of the PolyGram Group, I took over a chair vacated by one of the industry's most respected and able men, Coen Solleveld. His contribution has been vital to the development of the Group and we are deeply grateful to him.

PolyGram's Group Management are committed with resolve and dedication to the continued development of the Group, in the knowledge that we are accompanied by skilled and experienced colleagues and staff, and backed by the trust and confidence of PolyGram's shareholders.

Dr. Wolfgang Hix
President and
Chief Executive Officer

ORGANIZATION

GROUP

Dr. Wolfgang Hix
President and Chief Executive Officer
Kurt Kinkele
Executive Vice President
Dr. Hermann Franz
Executive Vice President
Karl-Heinz Busacker
Executive Vice President

DIVISIONS

Dr. Werner Vogelsang*
President.
PolyGram Record Operations
Heinz T. Voigt*
President. Publishing Division
Willem L. Zalsman*
President. Video Division
Dr. Eckart Haas*
President.
Film and Television Division
George H. Baenge*
President. Direct Marketing
and Trading Division

*Vice President PolyGram Group

NATIONAL AND REGIONAL ORGANIZATIONS

Harvey L. Schein*
President and Chief Executive Officer.
PolyGram Corporation U.S.A.
David G. Fine
Chief Executive.
PolyGram Leisure Ltd. Great Britain
Louis Hazan
Chief Executive.
PolyGram S.A. France
J. Dieter Bliersbach
President. PolyGram Far East
Pieter R. Schellevis
PolyGram Delegate
to Australia and New Zealand
Henk Th. Hoksbergen
President and Chief Executive Officer.
PolyGram Nederland B.V.

OPERATING COMPANIES

The operating companies in 29 countries form the foundation of the Group's activities. For names and addresses see pages 25 to 27.

Dr. Wolfgang Hix

Kurt Kinkele

Dr. Hermann Franz

Karl-Heinz Busacker

Dr. Werner Vogelsang

Heinz T. Voigt

Willem L. Zalsman

Dr. Eckart Haas

George H. Baenge

Harvey L. Schein

POLYGRAM RECORD OPERATIONS

IN a difficult year for the music industry in every country where records are sold, 1980 was, for PolyGram's record business, a year of consolidation and creditable achievement.

PolyGram maintained its share of the world music market with a small improvement in turnover on 1979, matching the industry's marginal worldwide growth.

Market Trends

There is no denying that the music industry as a whole was unprepared for the down-turn in volume and sales of the last two years. The immediate problems are all too apparent: spiralling manufacturing and trading costs, the lack of a new supersound, worldwide inflation, recession. The combined effect of these is to deprive the industry's major market segment, the young, of the cash–and the will–to buy recorded music as frequently as in the booming Seventies.

The situation is aggravated by the additional problems the music business faces: un-sold record returns, home taping, counterfeiting and piracy–all eating away at turnover and profitability.

It has been seen before in the music business, and PolyGram's own development confirms this, that a slackening in growth, such as currently being experienced, does not materially affect the ultimate upward pattern.

In the decade to 1980, volume sales of the world music market increased by almost 80 percent, this despite slow progress in the early Seventies and the current sales recession (See Fig. page 3). PolyGram's own growth during this period–reflecting its emergence as an industry leader–was even bigger, at almost 130 percent.

The reasons for continued confidence in the growth potential of the world market are underlined by the fact that, in Western nations, still only 70 percent of households own record playing equipment. Also, until now, the music market in the developing countries has remained largely untapped.

Further impetus is likely as a result of technical innovations. The new breed of portable, miniaturized tape players is already adding another dimension to listening habits. Videocassettes and videodiscs, high quality digital recordings, and the advanced Compact Disc, will all be major influences on the way people receive music in the future.

Yet, while these factors are significant, they will not, in themselves, sell more music. The future is not in gadgetry or marketing statistics, it is in music itself.

The absence of a worldwide music trend certainly contributed to the relatively lean years of 1979 and 1980. The world repertoire of pop music became much more varied in these years and this reflected in a general instability in national markets.

The lack of an international supersound bore heavily in 1980 on those countries without a strong national artist base, yet those with broad local talent rosters often defied the global sales trend by achieving increases in their market volume.

The diversification of demand in markets around the world provides particular opportunities for PolyGram Record Operations (PRO) companies. Guided by its conviction that the successful national acts of today can be the international stars of tomorrow, the Group has always strongly encouraged the development of local talent. PolyGram follows this philosophy wherever it is active, and it is producing results.

Much of the success PRO achieved in the market for single-play records over the years 1978 to 1980 came from new acts. Although singles volume last year decreased marginally against 1979, it was nevertheless impressive by pre-1978 standards. And when the early months of 1981 saw PolyGram scoring strongly in singles and album markets in many countries, it was proof of the benefits to be gained by the careful development of new talent.

PolyGram's renowned classical music catalogs also performed well in 1980, making a substantial contribution to PRO's turnover. The classical sector held up comparatively strongly in the soft overall market and PolyGram, with its famed Deutsche Grammophon and Philips labels now augmented by Decca, is in an excellent position to turn this trend to advantage.

Marketing Activities

The requirement for effective, cost efficient marketing of records was greater than ever in 1980. Responding to the challenge, PolyGram marketing and promotion teams around the world worked with skill and flair to mount high impact campaigns throughout the media, gaining added visibility for the Group's products.

The use of television advertising was extended in 1980 with notable success in many countries. PRO created separate TV merchandising units in Britain and The Netherlands specifically for that purpose. PolyGram's experience has shown that

this medium, in which efficient airtime buying and creative strength are crucial to success, is most suited to the promotion of repertoire compilation albums of established artists and hits.

Other marketing campaigns involved national newspapers, billboards, magazines and radio; each designed to achieve maximum low cost impact in a music market whose inconsistency put big demands on the spread of company promotional budgets.

PolyGram's contacts with the buying public were further improved by providing strong support for campaigns at retail level through in-store promotions and powerful displays. A general strengthening of back-up and service characterized dealings with the trade around the world as PRO companies joined forces with dealers to attract customers into record shops.

National Performances

The industry's general instability in 1980 was typified by the important North American market; while record sales elsewhere remained static or continued to drop, the U.S.A. slowly recovered from the slump of 1979, due mainly to a resurgence of activity from established superstars.

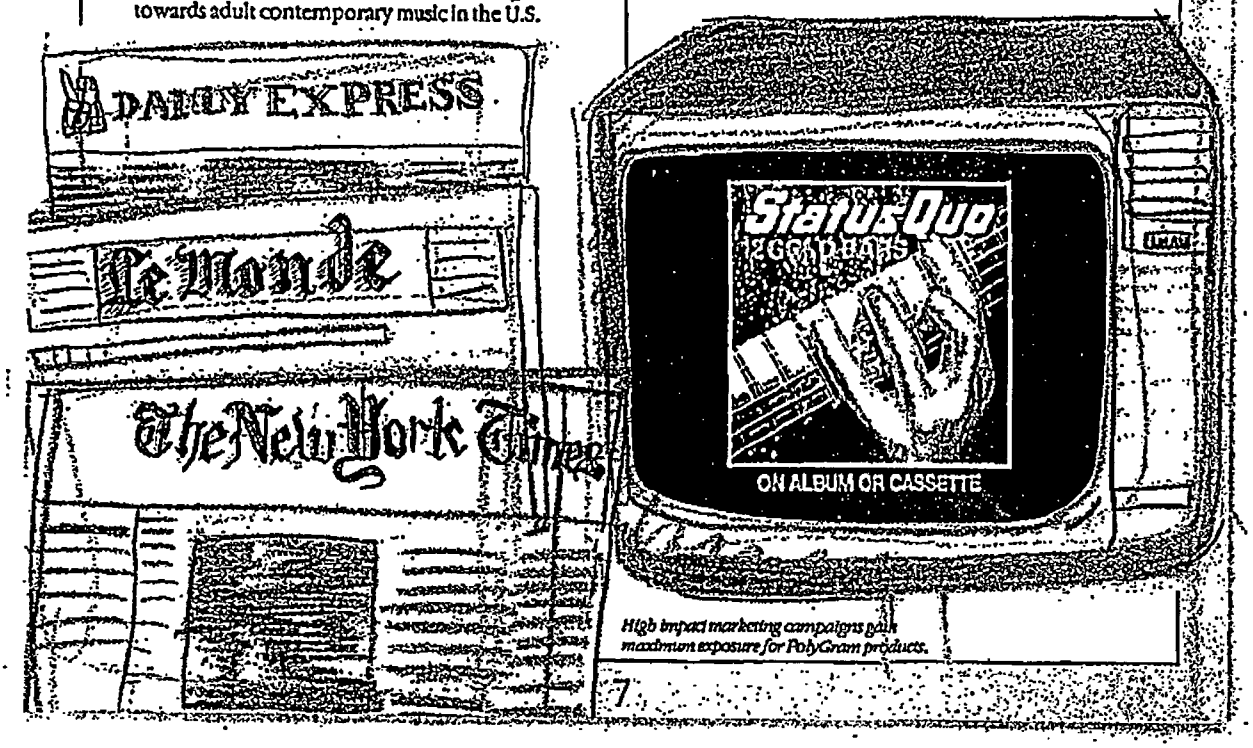
All PolyGram record activities in the United States were consolidated in one unit, PolyGram Records Inc. in January 1981. It combines the operations of Polydor, Phonogram and Casablanca, and of the Group's classical labels Deutsche Grammophon, Philips and London.

PolyGram Records identified the swing towards adult contemporary music in the U.S. and gained success by breaking cross-over acts and developing respected artists in this category. A new returns policy was initiated to combat one of the biggest problems in the record business. PolyGram gave whole-hearted support to the industry "Gift of Music" campaign.

The music market in Canada continued downward and PolyGram suffered from returns along with its competitors. With promising trends towards Black and New Wave music not yet fulfilling potential, the success story of the year in Canada was in the classical sector, with all PolyGram labels increasing sales to high levels.

Europe is increasingly regarded as one music market and in this sense is the largest market in the record industry. In this highly important area, where PolyGram originates, the music business performed below par. A number of countries showed a decrease in unit sales, a trend which has continued into 1981. As a consequence, PolyGram, although maintaining its leading market position, failed to achieve all its 1980 turnover targets.

In Britain, despite intensified price cutting, singles and album volumes dropped due to the poor state of the economy and growing



High impact marketing campaigns gain maximum exposure for PolyGram products.

problems from home taping. Polydor and Phonogram suffered in line with the rest of the industry, but had strong positions on the bestsellers chart and made valuable acquisitions in the vibrant teenage repertoire market. And 1981 started well with PRO taking the leading shares of both singles and album markets in the U.K. for the first quarter.

Following the setting up of the national PRO structure in 1979, the Polydor and Phonogram classical departments in the U.K. were merged to form PolyGram Classics in 1980. The PolyGram labels had outstanding success in the classical sector during the year.

PolyGram Records Ireland did well in 1980 to increase its share in a static market.

The market in France was stable, but was subject to heavy competitive activity, particularly at dealer level. The PolyGram record companies maintained their strong market shares and achieved 34 gold and platinum bestsellers in a country where national repertoire continued to be of major importance.

In the Benelux countries, record sales showed a negative trend; marginal in Belgium, but substantial in The Netherlands. There, Polydor's performance suffered from the lack of international repertoire, but Phonogram, despite the market trend, completed a successful year on the strength of its excellent national roster. PolyGram Records led the Belgian market once again, with nine of its top 11 LP's being TV-advertised product.

Sales value of the German market increased by four percent in 1980, just sustaining its steady upward curve. Deutsche Grammophon Gesellschaft remained overall market leader and improved its share of the classical sector. Phonogram mounted a variety of successful marketing campaigns, and Metronome Musik achieved good results during the year through acquisitions of top talent and development of new repertoire areas.

In Austria, the market lacked vitality; Phonogram suffered from a lack of national repertoire, and Polydor from the absence of international hits, but both exploited their traditional catalogs. Amadeo restructured its repertoire base and performed well in a transitional year.

In Switzerland, PolyGram Records scored success with top national talent in a market that was generally dormant.

PolyGram Dischi in Italy fought to overcome countrywide falling sales and had hits with strong national releases.

In Greece, big selling local artists also made a major contribution to PolyGram's continued leadership of a market not without its problems.

In Spain Fonogram, faced with similar market lethargy, stepped up back catalog promotion and won gold and platinum awards with this initiative. Strong efforts were also made to develop national repertoire with the aim of increasing the market share of this category.

PolyGram Discos Portugal turned in an excellent performance in 1980, boosting turnover and album sales far above 1979 levels.

In Scandinavia, PolyGram Records Denmark battled a declining market and received powerful support from big international hits. Strong bestsellers in the last quarter saw PolyGram Records Norway achieve target despite the negative market trend. Falling sales in Sweden affected PolyGram Records, but the company had success with children's and other specialist catalogs.

In Asia, sales on the Japanese market rose five percent, with national product taking a stronger hold. A good year for Polydor, particularly in the classical sector, was marked with numerous awards for its artists. PolyStar joined the Group in the second half of 1980 and achieved notable chart success with national repertoire. In Singapore, the turnover of PolyGram Records reflected a market beset by piracy and falling sales. The performance of PolyGram Records Hong Kong remained strong with many local hits.

The PRO companies in Australia and New Zealand countered the familiar problems of inflation, piracy and home taping with aggressive marketing activity. In these countries, an impressive collection of gold and platinum awards were gained, 37 in Australia alone. The year in both countries was characterized by the strong emergence of local talent.

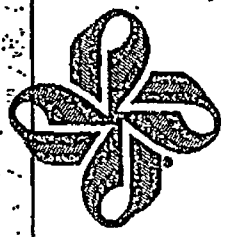
Economic pressures continued to affect PRO companies in Africa. PolyGram Records in Kenya added important ethnic artists to be well positioned for the growth potential of this market. The Nigerian company was plagued with the problems of counterfeiting and piracy.

In Latin America, the economies of most countries suffered from high inflation rates and PRO companies experienced mixed fortunes. Argentina saw a tremendous increase in musicassette business which reflected in PolyGram's results. The markets in Brazil and Venezuela declined, whereas in Mexico PolyGram capitalized on the growth of the market.

Piracy and Home Taping

The spectres of piracy and home taping loomed large over the world music business in 1980 and the industry intensified its efforts and resolve to reduce the revenues lost to these activities.

Piracy has infiltrated markets on every continent. However, in 1980 successful legal actions were fought in Canada, Belgium, Singapore and Australia. In the U.S.A., $55 million worth of counterfeit records and tapes were seized by law enforcement agencies. Effective consumer/dealer campaigns against pirate product are already operating in Norway and Germany. Despite these successes, the basic worldwide problem is still not under control and the full support of law is crucial if piracy is to be contained.



Give the gift of music.

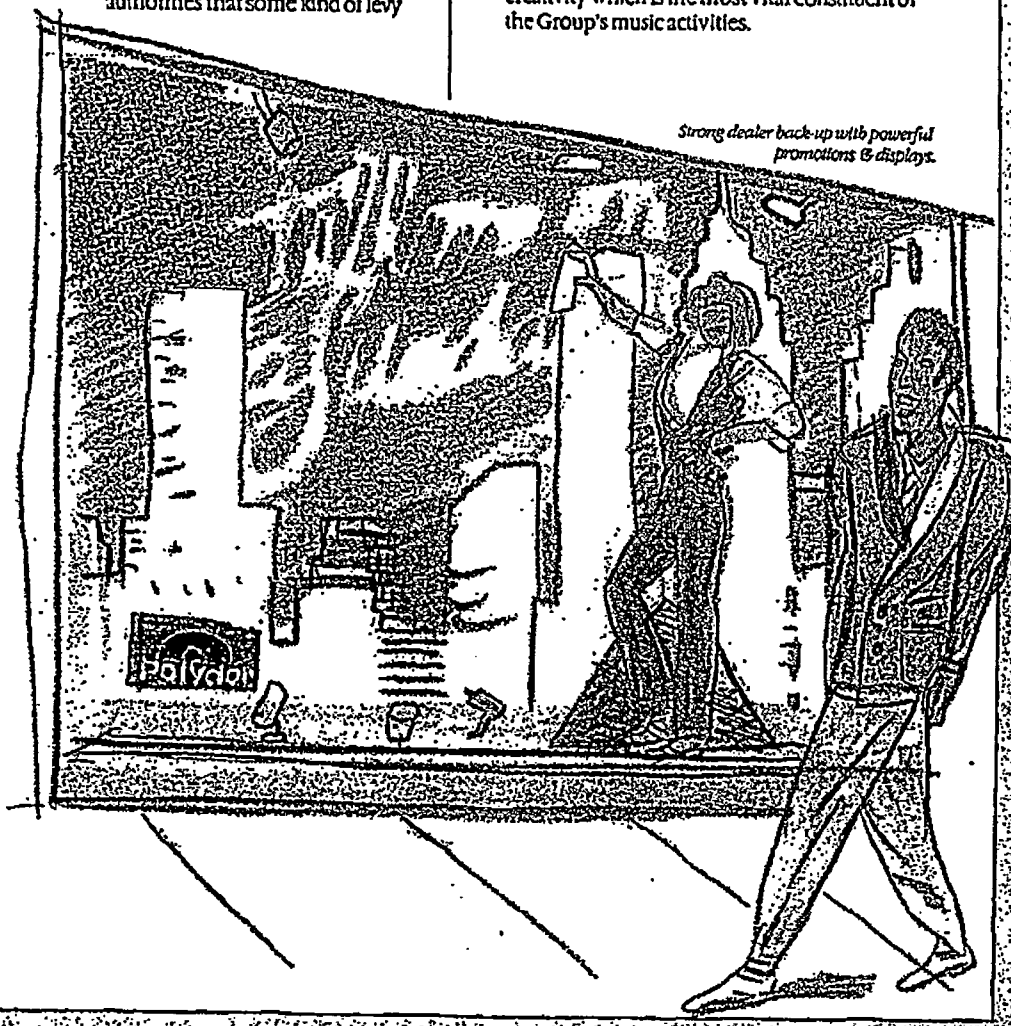
Home taping was rampant, with sales of blank tape increasing dramatically everywhere; in the U.S.A. alone it is estimated that $700 million worth of potential business is now lost annually to this activity. However, progress was made with governments around the world to recognize the enormity of the problem and to convince authorities that some kind of levy on blank tape is necessary. In 1980 Austria became the first country in the world to pass legislation imposing a statutory levy on blank cassettes.

PolyGram remains convinced that a concerted effort by the entire industry, through its international federations, is essential if the twin threats of piracy and home taping are to be challenged and overcome during the Eighties.

PolyGram's share of the world's music market will always be determined by the excellence of its repertoire, and the development of this property will be its most important task in the coming years.

PolyGram has great artists and it will have more. It has recording skill and manufacturing quality, promotion drive and distribution strength, to reach out to the public on every continent.

PolyGram believes in music, in the music makers, and in its ability to harness and guide the creativity which is the most vital constituent of the Group's music activities.



Strong dealer back-up with powerful promotions & displays.

PHONOGRAM INTERNATIONAL

THE slogan of Phonogram International is "a world where talent feels at home." And this is reflected not only in the broad spectrum of artists who have long been with the company, but also by the other talented performers newly attracted to Phonogram and the partnership it offers.

Popular Music

On the Pop side in 1980, in keeping with this tradition, Phonogram eyed the potential of the adult contemporary market and signed a long-term worldwide contract with the popular Dr. Hook, a group long famous for hits; they have since released two excellent albums. Also signed was the highly promising newcomer Florence Warner, previously heard only on the Demis Roussos hit "Lost in Love," and she has now recorded her first LP.

Another aspect of Phonogram's music spectrum was the great success in 1980 of its traditional rock and heavy rock music acts, such as Black Sabbath and Kiss.

The group Kiss was added to the Phonogram roster in a number of major territories and signed a new worldwide album contract. Both Black Sabbath and Kiss released top selling albums, respectively "Heaven and Hell" and "Unmasked," and both made successful tours, Kiss electrifying audiences in Europe and Australia with the sheer impact of their unique stage performances.

Another major success was scored by Lipps Inc., whose single "Funky Town" and album "Mouth to Mouth" were huge sellers throughout the world.

Early in the year, Status Quo renewed its contract with Phonogram International. The latest album from this great rock band, "Just Supposin'," went to the top of the bestseller charts in many countries.

The popular heavy rock band Nazareth also finalized a new agreement with Phonogram International in 1980.

Dire Straits, a Phonogram U.K. signing, built on their spectacular debut year of 1979 by gaining strong international success in 1980. The group's album "Making Movies" went gold in most territories within a few weeks of release.

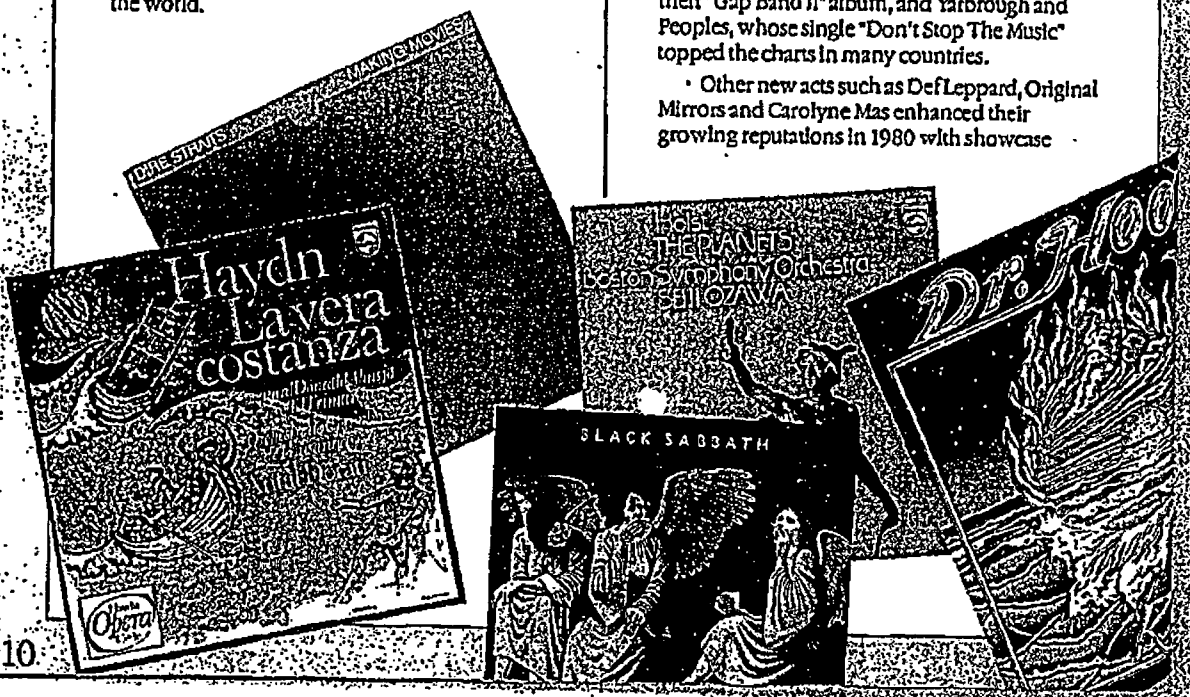
Rocket Records and Charisma Records extended their associations with Phonogram International during the year. Rocket's biggest star is the incomparable Elton John who made successful tours in the U.S.A., Australia and New Zealand in 1980, and rising stars on the Rocket roster include The Lambretas and Judy Tzuke.

For Charisma, the major triumph of 1980 came from Peter Gabriel, a former member of their biggest act Genesis. His third album, titled simply "Peter Gabriel," was praised by the media and charted around the world.

While consolidation of established artists remained fundamental to Phonogram policy in 1980, the company moved to combat the market's general passivity and to secure the future by breaking new acts with considerable effect.

By early 1981 big cross-over successes had been scored around the world by American Rhythm and Blues artists The Gap Band, with their "Gap Band II" album, and Yarbrough and Peoples, whose single "Don't Stop The Music" topped the charts in many countries.

• Other new acts such as Def Leppard, Original Mirrors and Carolyne Mas enhanced their growing reputations in 1980 with showcase



tours which won enthusiastic response from both the media and public. And following their debut in 1980, great things are predicted for the new English group The Teardrop Explodes.

Strong national artists are the cornerstone of Phonogram International's rosters around the world and they made important contributions during 1980.

In the U.S.A., Kool & The Gang had phenomenal success with their album "Ladies Night" and single "Celebration." In Brazil, Maria Bethânia scored a double-platinum LP and Gal Costa a gold.

In The Netherlands B.Z.N. collected no less than three platinum albums and in Belgium, Urbanus Van Anus in one month sold the equivalent of five gold albums with his latest LP.

Johnny Hallyday in France continued his amazing run of success by topping the charts, as did Serge Lama. In Britain, The Boomtown Rats and Thin Lizzy sold strongly throughout the year.

Classical Music

Phonogram International's sales performance in the Classical sector in 1980 showed encouraging growth over 1979. It was also a year of many major honors.

Major awards for Philips recordings included an American Grammy for Benjamin Britten's opera "Peter Grimes" conducted by Colin Davis, who was knighted early in the year by Queen Elizabeth of England. The top citation from the International Record Critics was won by Schoenberg's "Gurre-Lieder," with Seiji Ozawa conducting the Boston Symphony Orchestra, and the German Record Critics prize went to Verdi's "Stiffelio."

Bernard Haitink's interpretation of Debussy's "Nocturnes" and "Jeux," with the Concertgebouw Orchestra, Amsterdam received three awards in 1980, two from the prestigious British magazine The Gramophone and a Grand Prix International du Disque.

The Beaux Arts Trio celebrated their Silver Anniversary in 1980 by also winning major international awards.

In 1980, Phonogram International signed The Boston Pops Orchestra, led by their new conductor John Williams. Their first album on the Philips label "Pops in Space" became a big success, selling thousands of copies in the first weeks of release in the U.S.A.

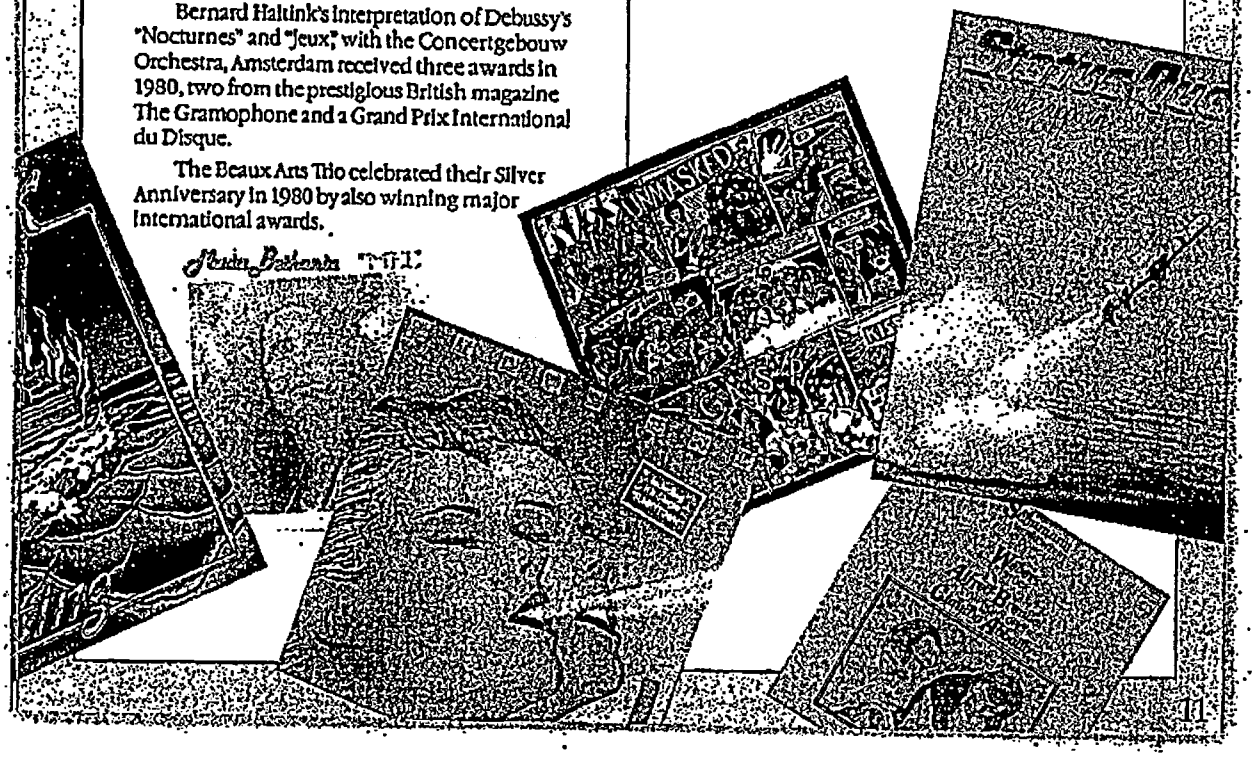
Leonard Bernstein started recording Wagner's opera "Tristan und Isolde" for Philips. Verdi's opera "Falstaff," the first release on the label from Herbert von Karajan and Philips' first digital operatic issue, received critical acclaim worldwide.

Young conductor Riccardo Chailly made his first recordings for Philips, conducting Mendelssohn's Second and Third Symphonies.

Major digital recordings in 1980 included Brahms' "Deutsches Requiem" by the Vienna Philharmonic Orchestra under Bernard Haitink; Haydn's "The Creation" and "The Seasons" by the Academy of St. Martin-in-the-Fields conducted by Neville Marriner; and Beethoven's Ninth Symphony played by the Concertgebouw Orchestra, Amsterdam under Bernard Haitink.

Recording agreements were reached with the Pittsburgh Symphony Orchestra and its musical director and conductor André Previn. Russian-born violinist Gidon Kremer and recorder soloist Michala Petri also signed contracts with the Philips label. Early in 1981, the recording association with the Academy of St. Martin-in-the-Fields and Neville Marriner was renewed on a long-term basis.

Their talents, and those of the many other artists signed to Phonogram International, will serve to ensure its continued development as a force in world record markets.



POLYDOR INTERNATIONAL

THE principle of balancing artistic creative flair with commercial know-how finds enthusiastic followers at Polydor International. In its music activities around the world, the aggressive and effective marketing of excellent product has become second nature.

Popular Music

In the Pop sector, 1980 saw Polydor International reinforcing its status, with established stars collecting gold and platinum awards and achieving high chart rankings worldwide.

Roxy Music's superb "Flesh and Blood" album, supported by a world tour, went straight to the Number One chart position in the U.K. scoring platinum, plus gold in Australia, Belgium, The Netherlands and New Zealand. The Roxy single "Jealous Guy," a tribute to the creative genius of John Lennon, also topped the British charts.

James Last had his first American hit single in 1980 with "Seduction," and his worldwide tally of gold albums on Polydor, which now exceeds 150, is testimony to the remarkable talent and staying power of this fine artist.

The Abba phenomenon continued: the "Super Trouper" album enjoyed vast shipments on release on Polydor in Central Europe and South East Asia, and went on to win gold awards.

Frank Mills struck gold in Canada and received the country's top music award. There were many gold and platinum citations for Barclay James Harvest, including gold for their LP "Live Tapes."

The Jam firmly established themselves as New Wave leaders in 1980, being voted top group for the second year running by a leading British magazine. Their single "Going Underground" was the first for seven years to enter the British charts at Number One, and at one time they had simultaneous U.K. chart placings for no less than seven singles. The Jam album "Sound Affects" also did well in international markets.

Rainbow embarked on sell-out tours of Europe and Japan and achieved their biggest sales ever in the U.K. with the single "All Night Long." Legendary rock group The Who renewed their contract with Polydor during the year, and gained a high U.K. chart position early in 1981 with their new album "Face Dances."

Film soundtracks generated substantial sales in 1980. The Polydor releases "American Gigolo" and "McVicar," and RSO's "Times Square," "The Empire Strikes Back" and "Fame" all produced excellent response. "Fame" also won two of the coveted Hollywood Oscars for Best Song and Best Original Score of 1980 in Motion Pictures.

One of Polydor's most interesting signings in 1980 was the famous instrumental group The Shadows, currently experiencing a renaissance following a successful European tour.

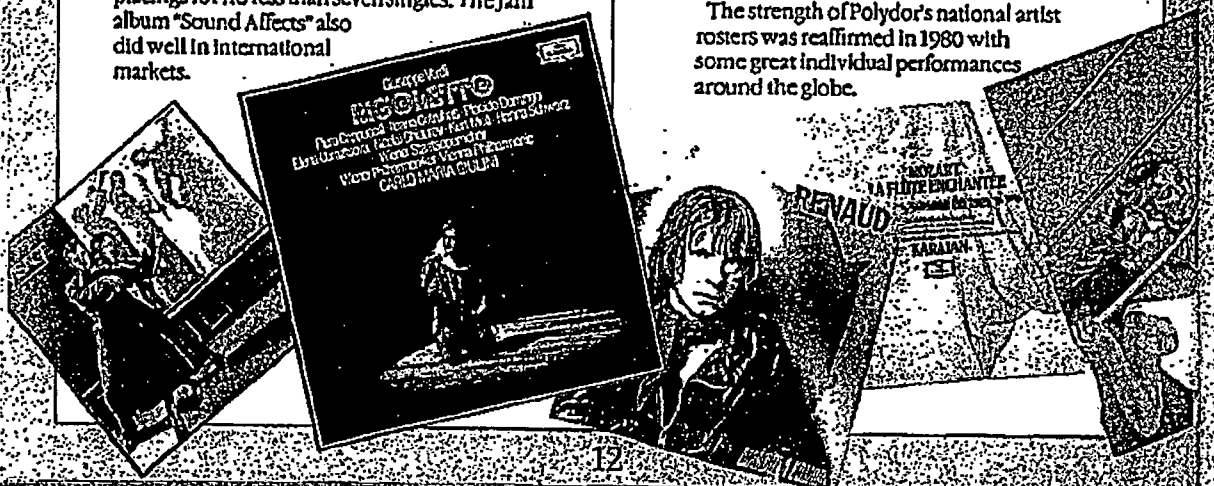
During the year other top signings directly influenced Polydor's success. These included the Polydor U.K. signing of the hit-making Jon and Vangelis team, and acquisition of the rights to the Andrew Lloyd Webber musical "Tell Me On A Sunday" that gave Marti Webb a big selling debut album. Her follow-up album "Won't Change Places" was also a best seller.

It was a good year for newcomers, confirming Polydor's insistence on the development of talent as a prime factor for future growth.

Breakthroughs were made with American artists La Toya Jackson and Benny Mardones, whose debut releases achieved high U.S. chart positions. New British acts The Cure and Visage did well, the Visage single "Fade to Grey" gaining the Number One spot in almost every country it was released.

A big impact was also made by Canadian rock sensation Saga, and by other newcomers Sweet People, whose single "Les Oiseaux Chantaient" won two platinum awards in Canada and high chart placings throughout Europe.

The strength of Polydor's national artist rosters was reaffirmed in 1980 with some great individual performances around the globe.



In Australia, Jon English delivered gold and platinum albums, and in The Netherlands the instrumental group Flairck mirrored this achievement. In the U.S.A., Ray Goodman & Brown were prime movers in the Rhythm and Blues explosion with a gold single and album, as were Peaches and Herb who achieved gold with their album "Twice the Fire."

Martha & The Muffins established themselves instantly in Canada with a gold single and album, and are now heading for international success. Kilby & Caroline achieved their third successive platinum LP in Switzerland, and in France, Renaud had a great year with two huge albums including "Marche à l'Ombre," his biggest yet.

Keiko Mizukoshi confirmed her status as one of Japan's top artists with big selling album and single releases. Best sellers were recorded in Spain by Miguel Rios, and in Ireland by Bagatelle, a new group with a very promising future.

Classical Music

In spite of the soft world market situation, Polydor International's Classical labels succeeded in consolidating their position in 1980, and gained ground in a number of important markets.

The year's best-selling classical release was the new recording of Beethoven's Nine Symphonies by Leonard Bernstein and the Vienna Philharmonic Orchestra. It enjoyed concentrated promotion through TV, radio and the press.

The digital recording premiere on the Deutsche Grammophon label was Herbert von Karajan's new recording of Mozart's "The Magic Flute" which, with later recordings of "Tosca" and "Parsifal," added to his contribution to the label's opera catalog.

After a ten-year absence, Carlo Maria Giulini made a sensational return to the world of opera: Press and public heartily welcomed his studio recording of "Rigoletto."

Good classical chart positions were achieved by Arturo Benedetti Michelangeli playing Beethoven's First Piano Concerto on a live recording with Carlo Maria Giulini conducting the Vienna Symphony Orchestra, and Carlos Kleiber conducting the Vienna Philharmonic Orchestra in Brahms' Fourth Symphony.

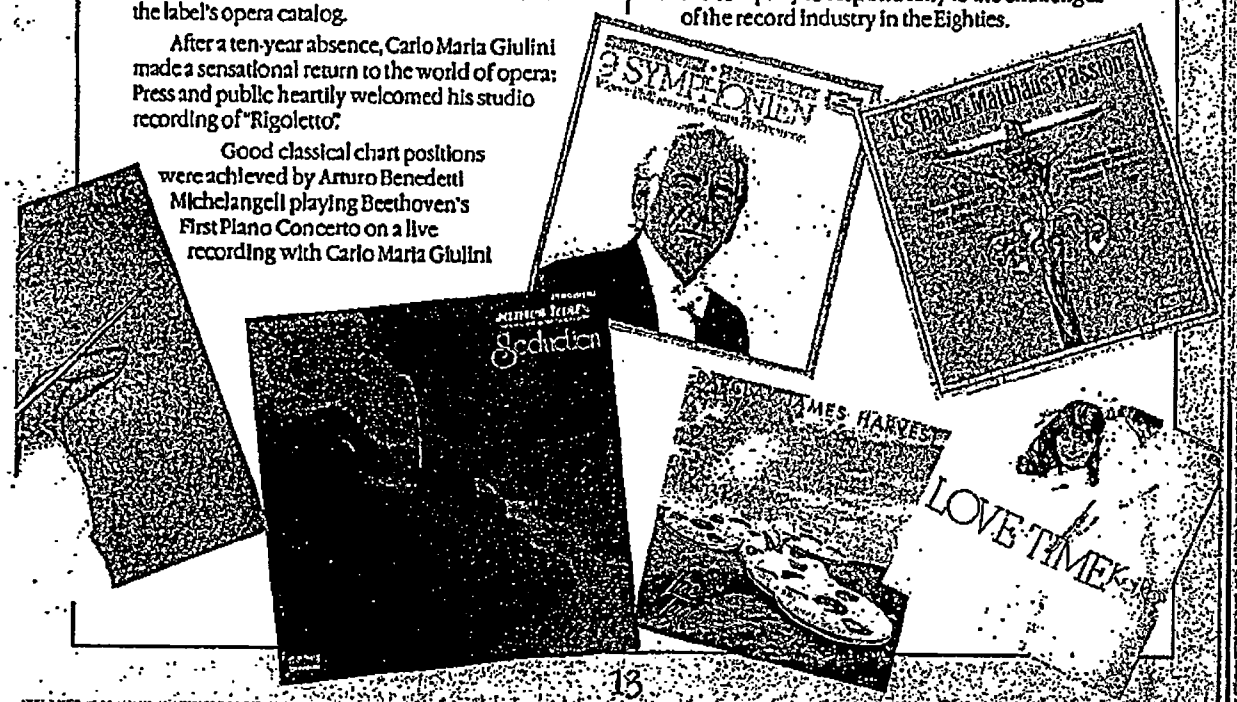
A new exclusive contract with the pianist Maurizio Pollini guaranteed the continuation of his successful association with Deutsche Grammophon.

Conductor Lorin Maazel celebrated his renewal of an earlier association with the Deutsche Grammophon label with recordings of Verdi's "Luisa Miller" performed in London, Tchaikovsky's Violin Concerto with Gidon Kremer, and the Vienna Philharmonic's New Year's Concert.

Archiv Produktion presented a new recording of the St. Matthew Passion by Karl Richter, who had recorded the same work years earlier. This great conductor died early in 1981 but his work lives on.

A total of 30 international awards were made to the Deutsche Grammophon and Archiv Produktion labels in 1980 for new releases from the 1979/80 season. Three Grammy awards were presented to the Paris production of "Lulu" including Best Classical Album and Production of the Year, and a Grammy was also awarded for the production of the Berg and Stravinsky Violin Concertos, played by Itzhak Perlman with the Boston Symphony Orchestra conducted by Seiji Ozawa.

In both its pop and classical operations, Polydor International will continue with the blend of artistic talents and potent marketing that characterized its activities in 1980, positioning the company to respond fully to the challenges of the record industry in the Eighties.



DECCA INTERNATIONAL

THE integration of Decca into the PolyGram family in 1980 ensures the continuity of the Decca reputation for technical excellence, enhanced by top performers in both the pop and classical areas.

Popular Music

On the Pop side, Decca's re-releases during the year of Rolling Stones material sold well, as did re-released material by Tom Jones and Engelbert Humperdinck.

One of Decca's most respected and prolific recording artists, Mantovani, passed away in 1980, and this has led to an increased demand for his work.

The supergroup The Moody Blues continued to justify the reputation made with their past albums and the latest, "Long Distance Voyager," is certain to be one of the major pop releases of 1981.

Camel undertook a massive European tour to promote their new album "Nude," and saw it make the charts in several countries.

New Wave acts signed by Decca, such as the Mo-Dettes and Splodgenessabounds have already achieved chart success in the U.K.

Classical Music

In the Classical field, the success of the great opera tenor Luciano Pavarotti was phenomenal. All four of his recital records reached Number One in the American classical charts.

Vladimir Ashkenazy's artistic development as a conductor was reflected in his recorded works, most notably the beginning of complete cycles of the Sibelius Symphonies, with the Philharmonia Orchestra in London, and of the Rachmaninov Symphonies, with the Concertgebouw Orchestra, Amsterdam.

During 1980 Decca also made its first recording with the New York Philharmonic Orchestra and its conductor Zubin Mehta, who has already made a number of digital recordings for Decca with the Israel Philharmonic Orchestra.

The recording by young Korean violinist Kyung Wha Chung of the Beethoven Violin Concerto, with the Vienna Philharmonic Orchestra, was a major event.

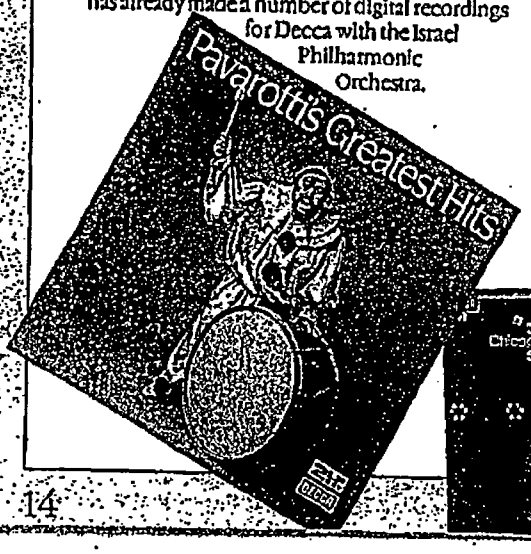
In addition to other digital opera recordings in 1980, the world premiere recording of Massenet's "Le Roi de Lahore" with Dame Joan Sutherland, and Decca's first recording of Janáček's "From the House of the Dead" with the Vienna Philharmonic conducted by Sir Charles Mackerras, were released. The Janáček recording was honored with The Gramophone Record of the Year Award.

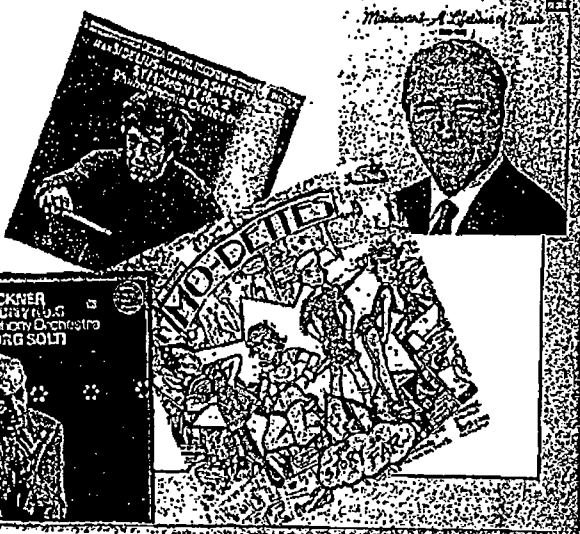
In the U.S.A., Sir Georg Solti won a Grammy award for his recording of Bruckner's Sixth Symphony with the Chicago Symphony Orchestra. He has now won seventeen Grammy awards, more than any other classical or pop artist. The London label was, once again, Best Classical Label in the U.S.A.

In France, soprano Hildegard Behrens won a Grand Prix du Disque for her contribution to the Solti digital recording of "Fidelio."

Period music played on original instruments is increasing in popularity. Florilegium Series recordings by Christopher Hogwood and The Academy of Ancient Music won chart placings in many territories and were honored with major record awards in Austria, Belgium and The Netherlands. Recordings by the Philip Jones Brass Ensemble and by Peter Hurford contributed greatly to the widening international appeal of the Argo label.

Reconfirmation of the PolyGram creed of discovery and cultivation of new and exciting talent came from the addition to the Decca classical roster of striking artists of the younger generation: violinist Boris Belkin, guitarist Carlos Bonell, conductors Riccardo Chailly and Charles Dutoit, 'cellist Lynn Harrell, and pianist Andras Schiff.





ASSOCIATE LABELS

A significant contribution to PolyGram Record Operations' performance was provided by the catalogs of associate labels such as RSO, Barclay, Charisma, De-Lite, EG Records and Rocket Records, as well as a number of licensing deals made worldwide or for specific regions with Carrère, ECM, Francis Dreyfus, Hansa, MCA, Pablo, Polar Music, Spheric BV and The Who Group Ltd.

RSO

For RSO Records, part of the Stigwood Group of Companies, 1980 signalled further accomplishments in the field of film soundtracks. There was a clean sweep of the Academy Awards with Oscars for the title single and platinum soundtrack album from "Fame." "The Empire Strikes Back" soundtrack went platinum, and the exciting score from the RSO movie "Times Square" continued to gain momentum.

RSO's line-up of established international artists further developed their careers in 1980. Eric Clapton completed a very successful Scandinavian tour and released his latest LP "Another Ticket." Robin Gibb of the Bee Gees wrote and produced an RSO album for Jimmy Ruffin. Andy Gibb followed his hit album "After Dark" with major TV appearances around the world.

New names on the RSO roster that came to the fore included Irene Cara from "Fame," The Kingbees and Shot In The Dark.

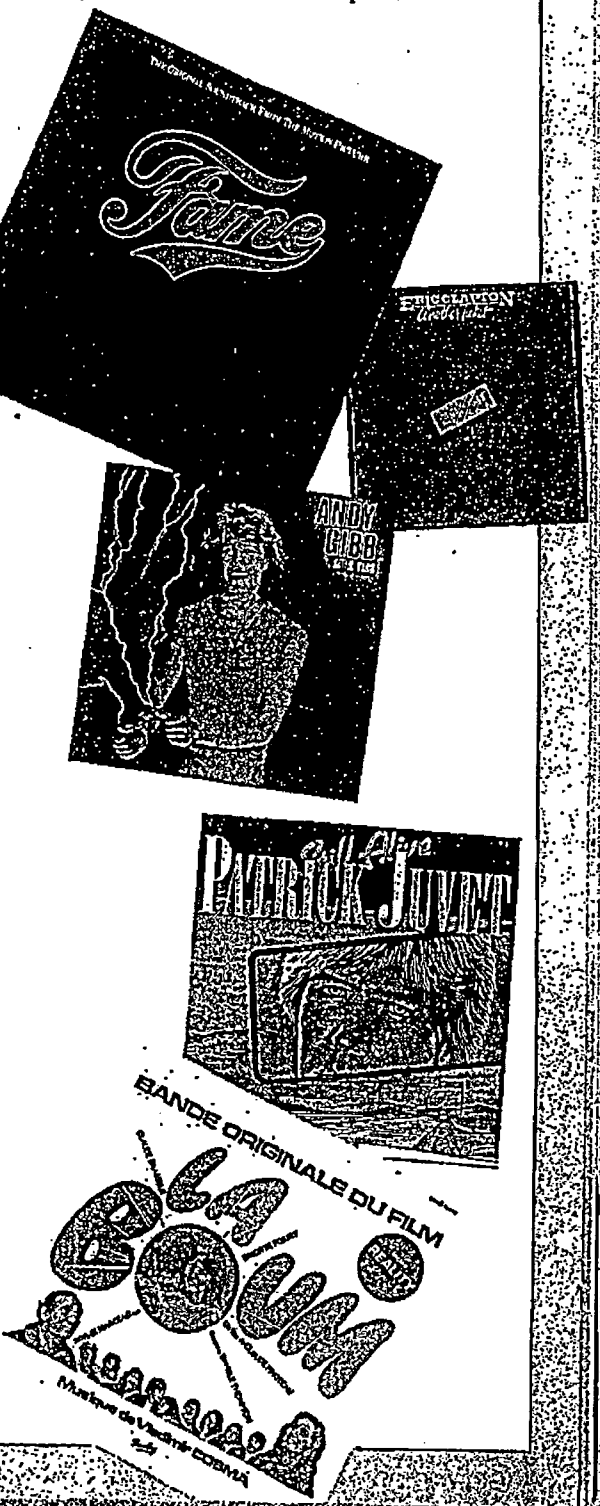
RSO launched a long-term association with Nicky Chinn and Mike Chapman's Dreamland Records in 1980; numbered among this label's quality roster are Suzi Quatro and Spider.

BARCLAY

1980 marked a year of intense artistic and recording activity for the French-based Barclay Group. Many successes were scored by its roster of big French stars, including hits from Antoine, Charles Aznavour, Daniel Balavoine, Patrick Juvet, Raymond Lefèvre, Bernard Lavilliers and Claude Nougaro. Newer talents increased their popularity and gained added exposure with foreign tours and recordings.

One of Barclay's major achievements was the acquisition of the original soundtrack of the film "La Boum" when other French recording companies were predicting little success for this music. Barclay's confidence in the potential of "La Boum" was rewarded with gold and platinum album and single releases as the soundtrack became a top-seller in France in 1981.

Barclay completed agreements for the distribution of the important foreign catalogs Rough Trade and Passport in 1980.



Technical Activities – Distribution

Recording

PolyGram's dedication to the principle of constantly improving quality in its technical operations was enhanced in 1980 with the introduction of a new revolutionary technology, the digital recording.

The Group has studied this technology since its earliest beginnings and took a leading role in the introduction and adaptation of equipment that was initially available for studio use and location recording. The merging of Decca's expertise in the new field of digital recording with PolyGram's own efforts and experience has produced advances in the related technologies that give the Group a strong edge in the development of this recording process.

1980 saw the first major digital concert and opera recordings on the Deutsche Grammophon and Philips labels, as Decca continued their successful series of digital releases. Another milestone was achieved with the production of Wagner's opera "Parsifal", the first ever major classical project recorded in digital multi-channel.

Manufacturing

Overall, the technical operations of PolyGram in 1980 were influenced by the generally depressed state of world record markets, but effective monitoring of manufacturing and delivery capacities kept overheads well under control.

PolyGram factories around the world produced in 1980 some 228 million record units (two percent more than 1979) and 49 million musicassette units (three percent below 1979).

Reflecting national developments in the music market, musicassette operations were started in Kenya and a new factory was built in Nigeria replacing the existing unit. During the year one of the Group's manufacturing centers, in Hanover, celebrated the unique distinction of producing its 100 millionth musicassette, just fifteen years after PolyGram introduced the very first musicassette onto the world market.

Distribution

In a number of countries, substantial investments were made last year in the warehousing sector. These further increased distribution efficiency, and ensured the rapid integration of the Decca catalog into the Group's supply system.

Significant improvements were achieved in the speed and quality of order handling, thereby maximizing the availability of PolyGram's products, and underlining the Group's commitment to retailer service in every part of the world.

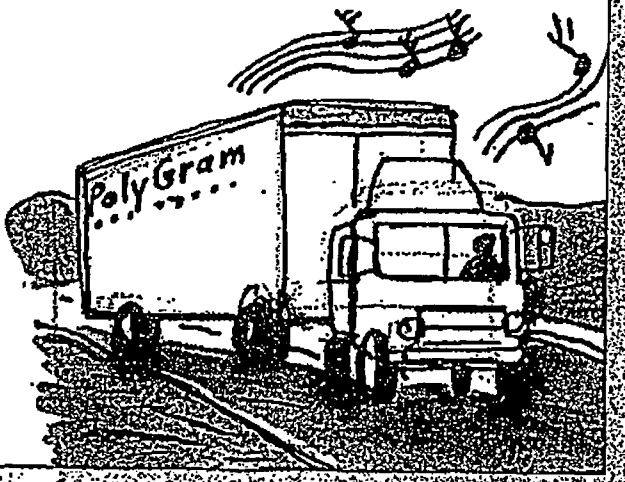
Development

In the development sector, PolyGram achieved further advances during 1980 in the direct-printed label technique for long-playing records, which is one effective deterrent against piracy. Also, in the area of quality control for twelve-inch records, a highly sensitive weak-point analysis system was instituted.

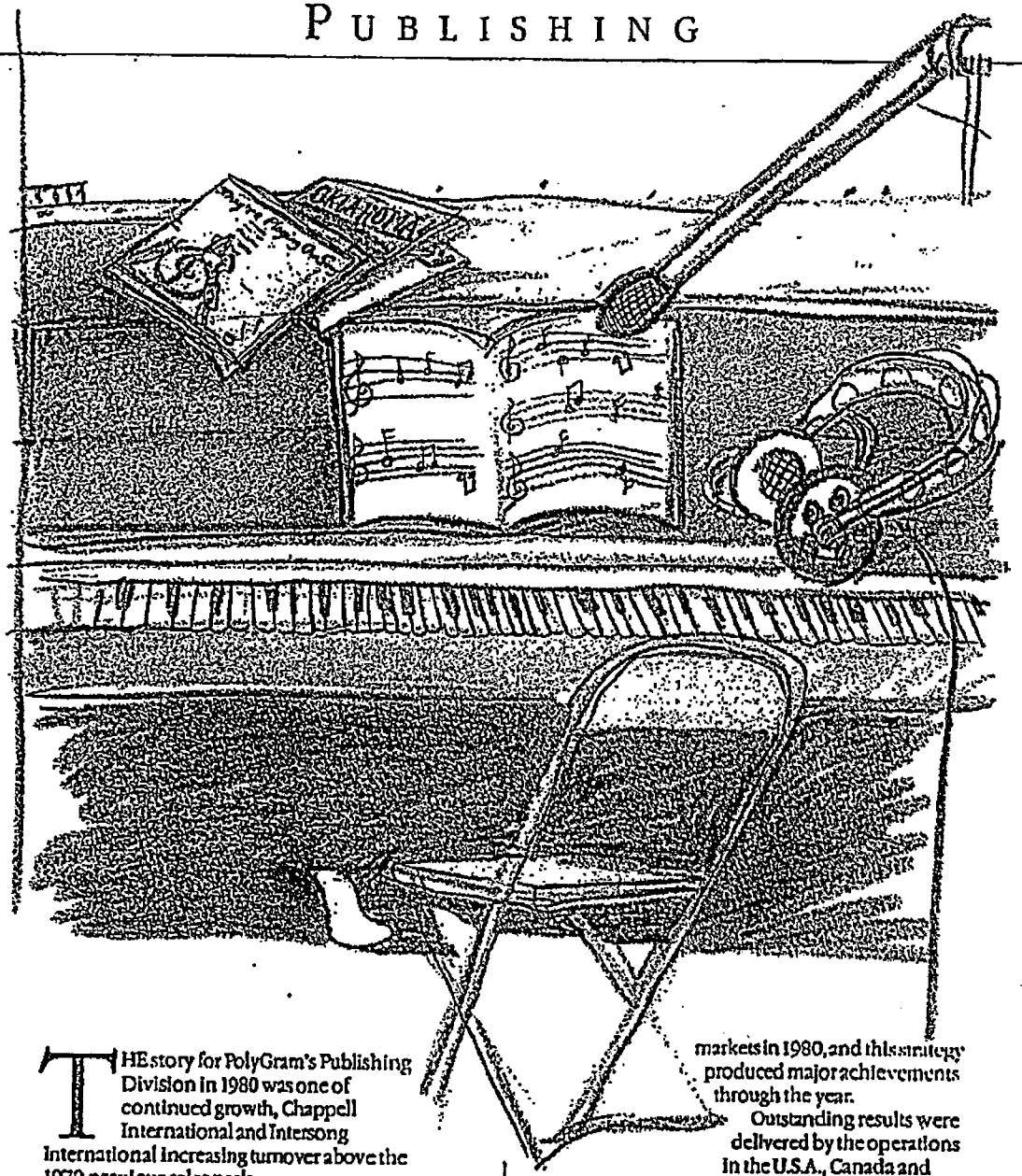
Musicassette production took important steps forward in 1980. Duplication equipment was considerably improved, and a major advance was the introduction of chromium dioxide tape (CrO_2) for digitally recorded classical product.

In the field of optical discs, PolyGram's accumulated know-how was made available to Philips in their European Video Long-Play (laservision disc) operations.

Additionally, having contributed to the successful introduction of the Compact Disc Digital Audio system, PolyGram is continuing to cooperate with Philips in the establishment of this new sound carrier.



PUBLISHING



THE story for PolyGram's Publishing Division in 1980 was one of continued growth, Chappell International and Intersong International increasing turnover above the 1979 previous sales peak.

The reasons are not difficult to find; the Division is concerned with the very lifeblood of the music industry, the writers and composers. Revenue comes not just from hit records, but also from standard catalogs, from radio and television, films and the stage, from live performances and from printed music sales.

Chappell and Intersong strengthened national and international repertoire across all these markets in 1980, and this strategy produced major achievements through the year.

Outstanding results were delivered by the operations in the U.S.A., Canada and Australia, with Chappell and Intersong catalogs winning 15 country music awards in the U.S.A. Chappell achieved Number One corporate publisher status in the U.K., and in Australia, Chappell/Intersong were recognized as the leading publishers, as were Intersong in Brazil.

Record Market

For Chappell, the worldwide acquisition of the Pink Floyd and Neil Diamond catalogs reaped immediate rewards. The Pink Floyd

chappell international

INTERSONG INTERNATIONAL

album "The Wall" and its accompanying single dominated charts around the globe to be nominated best records of 1980 in many territories. At year-end the Neil Diamond "Jazz Singer" album and "Love on the Rocks" single proved the megastar power of this great artist. Both catalogs will provide a rich vein of income in the years to come.

In the U.S.A., Chappell Inc. signed a deal with Virgin Music Publishing to represent a large number of Virgin Records' artists, including Devo and the vastly popular Police. In the U.K., Chappell signed Steve Hackett and Siouxsie and the Banshees, and in Germany, a new addition was Garland Jeffreys, whose single "Matador" was an enormous hit. Chappell Spain scored their biggest ever hit single with "Santa Lucia" by Miguel Rios.

Intersong started the year with the hit "Funky Town" by Lipps Inc. topping the charts around the world, and a major coup was achieved by Intersong U.K. with the acclaimed Bruce Springsteen hit "The River."

Intersong's wide range of pop repertoire was augmented by the acquisition of sub-publishing rights to Black Sabbath, Split Enz and Ray Davies of The Kinks, and agreements with the Doobie Brothers, Chick Corea and Wishbone Ash were extended. Fleetwood Mac scored again with their "Live" album, while the emergence of Matchbox and Bad Manners re-inforced the relationship with Magnet Music.

Other Intersong artists broke new ground in 1980; the group Sky introduced a new style of music to massive audiences around the world. Pat Benatar proved that France could be won by international artists with a big hit there, and The Kinks' old hit "Lola" surfaced again to renewed enthusiasm, going to the Number One chart position in The Netherlands.

The purchase of Decca Records gave Intersong the administration of the valuable Burlington and Palace catalogs, and the company was further strengthened by integration of the Barclay Publishing catalog.

PolyGram's association with RSO Publishing again proved extremely fruitful in 1980. The Barbra Streisand album "Guilty" and single "Woman in Love", both written and co-produced by Barry Gibb, achieved enormous success around the world.

Other Publishing Markets

The development of standard catalogs continued to make a major contribution to the Division's performance. Film soundtracks were a prominent source of revenue, with music from Twentieth Century Fox and Paramount Pictures. In particular, extension of the long-standing relationship between Chappell and Paramount's Famous Music allowed the exploitation of existing valuable material. There were important new soundtracks like "American Gigolo", with its giant international hit for Blondie, "Call Me", a copyright shared with Intersong.

Stage musicals enjoyed a spectacular revival; "Camelot" and "My Fair Lady" toured the U.S. with their Broadway stars, and London saw stagings of the latter along with new versions of other classics like "Oklahoma", "The King and I" and "Pal Joey." The greatness of modern Chappell writers Marvin Hamlisch and Carole Bayer Sager was confirmed when their new musical "They're Playing Our Song" packed theatres in London and New York.

The Publishing Division's representation in television was strengthened by Chappell's contract with the internationally renowned cartoon producers Hanna Barbera; and by Intersong's associations with the Mary Tyler Moore production company and Spelling/Goldberg, whose catalogs include music from such TV series as "Hart to Hart", "Charlie's Angels" and "Starsky and Hutch."

Worldwide sales of printed music flourished in 1980, with impressive revenue development adding significantly to overall performance. The Division believes this sector of music publishing offers real scope for continued growth, particularly in the educational field. The purchase by Chappell, late in the year, of a substantial interest in the major U.S. printed music company Hal Leonard Publishing, provides excellent facilities to tap this future potential.

The strength of the Publishing Division lies in the breadth and quality of its catalogs. With its practised ear for talent, the Division expects to make a telling contribution to the Group effort for many years to come.

Direct Marketing and Trading

Mail Order

An interesting and encouraging phenomenon characterized the main business activity of the Direct Marketing Division in 1980.

At a time when conventional music retailers in many countries had to contend with low demand due to recession, all PolyGram mail order clubs around the world increased their memberships, and total sales for the year were higher than ever before.

This achievement was possible because of the value of the Division's offers, the quality of its product and the efficiency of its direct marketing distribution.

In Great Britain outstanding success was achieved by Britannia Music against a background of fierce price-cutting at retail level.

In France, D.I.A.L., the largest music club in Europe, reinforced its Number One position, expanding its classical series with great success.

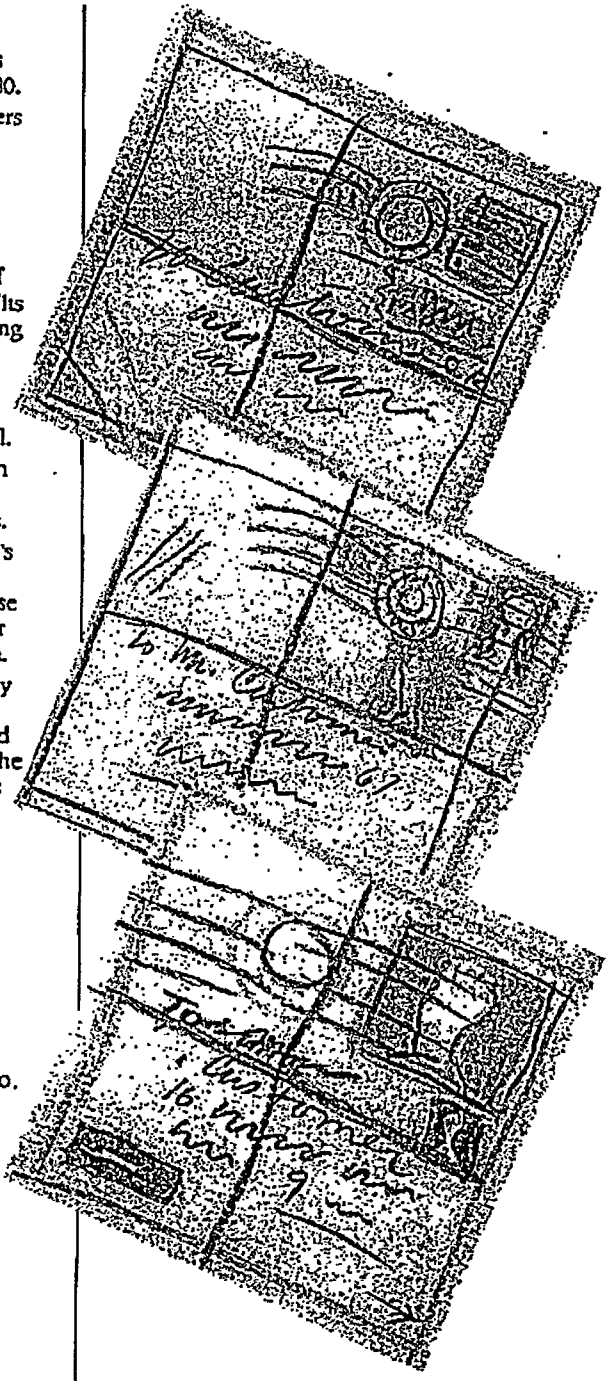
Despite increased competition, PolyGram's Scandinavian clubs also maintained their leadership. The new Prestige AB operations base at Malmö proved that technology is the answer to the needs of rapid, high volume distribution.

New classical club markets were entered by the Division's companies in Australia and New Zealand. PolyGram Direct Marketing continued to develop one of the largest classical clubs in the United States. Even in inflation-beset Brazil, the company's new music venture attracted thousands of orders in its first full year of operations.

Trading

In the trading sector, which covers PolyGram's retail, wholesale and rack-jobbing activities, the effects of the weakened retail market were reflected in depressed sales.

The future for the Division however is highly promising. The immediate advantages to postal trading of new technologies such as the Compact Disc are obvious, and PolyGram is already primed to meet the growing consumer demand for direct purchasing.



dial

PRESTIGE AB

Britannia Music

FILM AND TELEVISION

IN 1980, PolyGram's Film and Television Division continued to develop its plans for expansion in the motion picture and television industries.

The Division's main objective during the year was to establish its position in the United States–the world's biggest national market and the biggest exporter of audio visual productions–and this was achieved with the inception, in March 1980, of PolyGram Pictures and then, in October, of PolyGram Television. Both companies are based in Los Angeles.

PolyGram Pictures

Formed from the successful film activities of Casablanca Record and FilmWorks, PolyGram Pictures provides the base for the funding and development of major motion picture projects.

Five motion pictures were completed in 1980 or are in post-production. All are scheduled to be released in 1981.

Franco Zeffirelli, who brought to the screen such classics as "Romeo And Juliet," "Jesus Of Nazareth" and "The Champ," directs Brooke Shields and newcomer Martin Hewitt in "Endless Love," a story based on the bestselling novel by Scott Spencer about two teenagers whose all-consuming love threatens to destroy them.

Ernest Borgnine stars in "Deadly Blessing," a suspense thriller directed by Wes Carven and set in an isolated farming community controlled by religious extremists. "King Of The Mountain," an action film directed by Noel Nossek and starring Dennis Hopper and Richard Cox, was PolyGram Pictures' first release in 1981.

The PolyGram commitment to movies with international appeal has been enhanced by its financing of "An American Werewolf In London" directed by John Landis, who brought to the screen such successes as "Animal House" and "The Blues Brothers."

PolyGram's current production plans include: "Captured," directed by Ted Kotcheff, starring Karen Allen and Peter Fonda, and "Pursuit," the true story of an airplane hijacker who escaped by parachute, which stars Robert Duvall and Treat Williams, directed by Buzz Kulick.

In pre-production are "Six Weeks," directed by Deryl Duke and starring Dudley Moore, who will also star in another PolyGram film titled "Dangerously."

PolyGram will produce for Universal the highly respected Greek director Costa Gavras' film "Missing And

PolyGram Pictures

PolyGram Television ITF

Presumed Dead" with Jack Lemmon and the 1980 Oscar winner, Sissy Spacek. Also, "Contact" by Carl Sagan the distinguished space scientist and Pulitzer Prize winner, who produced the successful TV space exploration series "Cosmos."

Other projects in development include "Batman," to be produced for Warner Brothers.

PolyGram Television

The establishment of PolyGram Television is a major step towards gaining a share of a lucrative and fast-growing business: worldwide program production and distribution for television.

PolyGram Television's strategy for capturing a share of this large potential market is to own and control copyrights to a catalog of video material both for free and pay television, and supplementary markets including consumer home video.

Specifically, PolyGram Television has recently acquired worldwide distribution rights to several made-for-television movies, including:

"The Shadow Box," directed by Paul Newman, starring Joanne Woodward and Christopher Plummer. Based on the Pulitzer Prize and Tony award-winning play, the two-hour drama also won the coveted Golden Globe award for best television movie of the year following its airing on the ABC network.

"Skokie," a compelling two-and-a-half hour drama starring Danny Kaye, produced by Herbert Brodkin, who made "Holocaust," "Pueblo" and "Missiles Of October."

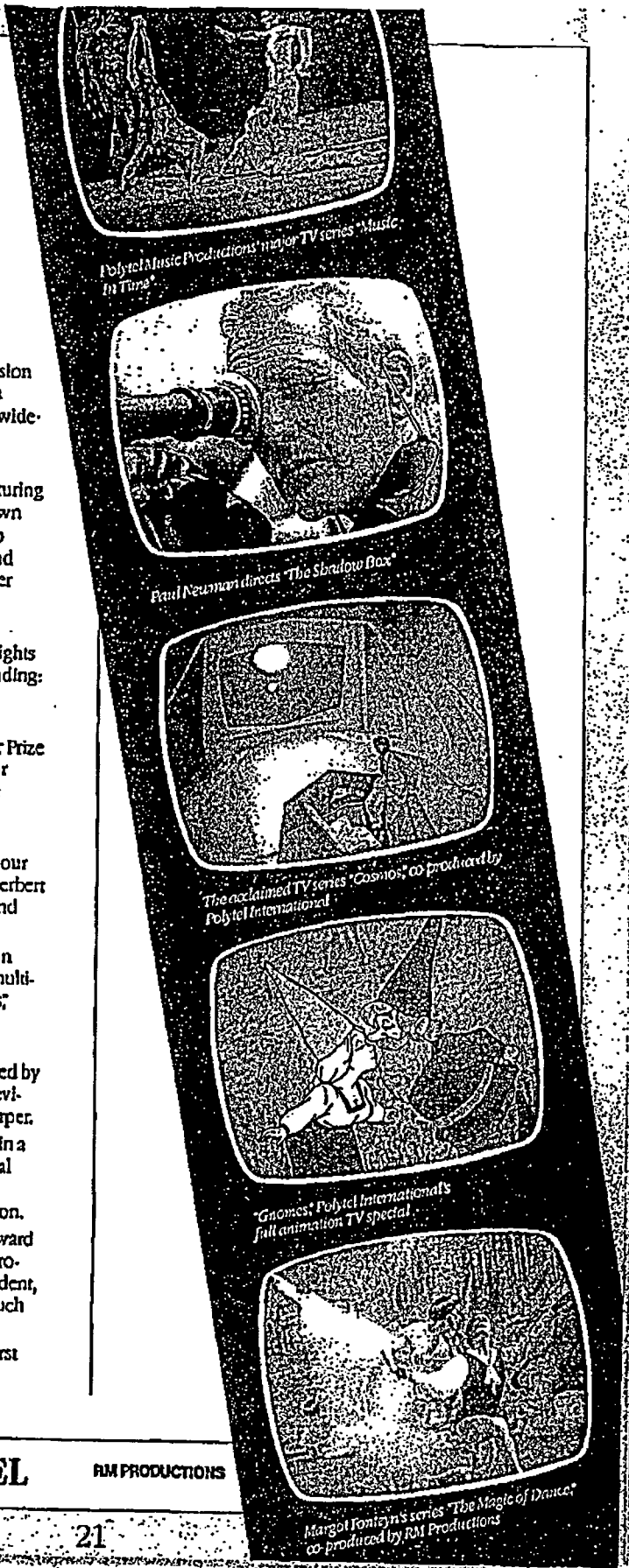
"The Choice," a two-hour drama aired on CBS Television, produced and directed by multi-Emmy award winner David Greene ("Roots," "Rich Man, Poor Man," "Friendly Fire") and starring Susan Clark.

"The Day The Loving Stopped," produced by Paul Monash and Jerry Zeitman for ABC Television, starring Dennis Weaver and Valerie Harper.

"The Five Of Me," starring David Birney in a tour de force performance based on an actual multiple personality, and produced for CBS Television by the Factor-Newland Corporation.

"People vs. Jean Harris," starring Oscar award winners Ellen Burstyn and Martin Balsam, produced for NBC Television by its former President, Paul Klein, and based on the riveting and much publicized murder trial of the same name.

Original program pilots produced for first run syndication include: Eric Sevareid's "Chronicle," featuring the insights and



Polytel Music Productions' major TV series "Music In Time"

Paul Newman directs "The Shadow Box"

The acclaimed TV series "Cosmos," co-produced by Polytel International

"Gnomes," Polytel International's full animation TV special

Margot Fonteyn's series "The Magic of Dance," co-produced by RM Productions

polytel music productions SATEL RM PRODUCTIONS

observations of this much respected journalist, and offered as a weekly news magazine.

Also, "For The Honor Of Our Country," produced by Bud Greenspan whose credits include "The Olympiad," "Numero Uno" and "Wilma." The 26-episode series concentrates on 26 nations, their athletes and their attitudes, and outlines the preparation for the 1984 Olympics.

PolyGram Television has assembled a tightly-knit staff of talented professionals and intends to establish itself as a major presence in the worldwide television marketplace.

European Operations

As in the U.S.A., activities in Europe made a substantial contribution to the Film and TV Division's progress in 1980.

RM Productions in London and Munich again participated in numerous prestigious co-productions in the arts field. "A Time There Was...A Profile Of Benjamin Britten," a co-production of London Weekend Television and RM Productions, directed by Tony Palmer, won the coveted Prix Italia. Athol Fugard's "Marigolds In August" won the 1981 Berliner Bär award at the Berlin Film Festival, and the Uzbek prize at the Tashkent Film Festival in Russia.

Satel's outstanding production of 1980 was the motion picture "Schüler Gerber," based on the famous novel by Friedrich Torberg. It was awarded the rating "besonders wertvoll" in Austria, and won two "Bundesfilmband in Gold" prizes in Germany.

ITF Polytel Italiana of Rome started principal photography on a major six-part serial, "Chartreuse de Parme," which is co-produced with German, French and Italian partners.

The other Polytel companies also embarked on important TV projects in 1980. Polytel International's top-selling series of the year was Carl Sagan's acclaimed 13-part space exploration series, "Cosmos," co-produced with KCET Los Angeles and the BBC. The series is scheduled for broadcast in 33 countries.

"...A Profile Of Benjamin Britten," winner of the Prix Italia.

Danny Kaye stars in "Skokie."

Among current Polytel International major productions is Folco Quilici's "The Age Of Baroque," a co-production with RAI Rome, Antenne 2 Paris and ZDF Germany.

Polyphon Germany reached its highest ever production level in 1980, and continued its successful prime-time variety shows for German television. Production highlights for the year included "Zubin Mehta," a portrait of the famous conductor, and "Holiday Song," a co-production with Trebitsch Production International (TPI), based on the novel by Paddy Chayefsky, author of "Network."

In France, Télécip further expanded its position as a leading producer of period and contemporary drama with the completion of six series, including the highly praised "Salut Champion." Set in the fascinating world of modern sport, this 13-part film follows a leading sports journalist, played by French actor Jacques Charrier, as he covers top events around the globe.

Currently in production is a major five-part dramatization of Mozart's life directed by Marcel Bluwal, and co-produced with partners in six countries.

Polytel Music Productions recorded many outstanding musical performances for TV during the year. Among the artists performing for the company were pianist Vladimir Ashkenazy, violinists Gidon Kremer and Shlomo Mintz, and young German pianist Alexander Lonquich.

Several productions were taped with conductors Daniel Barenboim in Tokyo, Carlo Maria Giulini in Paris and Lorin Maazel in Los Angeles. Now in production is "Music In Time," a major 16-part series directed by Derek Bailey on the history of music, to be introduced by world famous flautist James Galway.

The 1980's will see further significant advances in the audio visual field, with more media and technical innovation opening up a whole range of new markets. The Film and Television Division is confident that with the creativity of its personnel and with the quality and variety of its products it will play a dominant role in the development of these markets.

Eric Sevareid's "Chronicle," co-produced by PolyGram Television.

POLYSCOPE Télécip POLYTEL INTERNATIONAL POLYTEL FILM LTD POLYPHON

VIDEO

THE world has entered the video age and 1980 saw the PolyGram Video Division accelerating its drive to capture major segments of the fast growing home and professional markets.

Few organizations have PolyGram's advantages. The Group has a worldwide distribution network, close family links with the worlds of television and film production, a roster of artists that reads like an entertainment "Who's Who," and is directly associated with the makers of the finest video equipment.

In-Home Market

PolyGram's approach to the vast potential of the home video market is to introduce programs on videocassette and videodisc when and where the quality and availability of hardware systems justifies this.

In the major markets of Europe and the U.S.A., 1980 saw tremendous advances in quality systems establishment. In Europe the video 2000 cassette system, jointly developed by Philips and Grundig—with its advantage of doubled cassette playing time—gained much favor with consumers.

The Philips videodisc system was successfully launched last year by Magnavox throughout the U.S.A., and it will be introduced by Philips to the U.K. soon.

Launched in 1980—the videodisc.

With major developments in video hardware, the video pre-recorded program market took off in 1980 and PolyGram's Video Division responded immediately to the opportunities—and the challenge.

From the Division's initial videocassette releases in 1979 on the Spectrum label in the U.K., fully-fledged video program marketing operations were launched in that country and France in 1980. Germany followed early in 1981, Japan will follow shortly.

The scope of these operations is underlined by the fact that over 100 program titles will be available on cassette in the U.K., France and Germany in 1981, with a further major release of videodisc titles in the U.K. as the system becomes available during the year.

The Video Division is vigorously engaged in the acquisition of program material for home video exploitation, both from outside sources and by close co-operation with PolyGram's Film and TV Division.

Professional Market

The video revolution is universal and in the business world, fast adapting to new information technologies, the Group's PolyMedia companies are primed to satisfy the growing demand for video-based training programs.

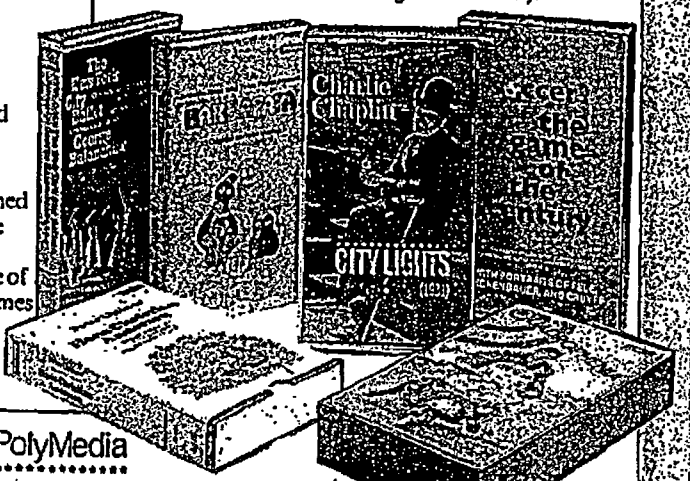
Training programs for business markets.

For PolyMedia, 1980 was another year of development and growth. As industry placed increasing emphasis on cost management, vital training projects were mounted in the fields of data processing and manufacturing control.

Rental contracts, the main source of PolyMedia's revenue, produced improved income throughout the year in all operations, and major new warehousing facilities were opened to service the growing numbers of customers.

PolyMedia's operations were further reinforced early in 1981 when a co-operative agreement was made with the American publisher McGraw-Hill. This allows both organizations to market their respective products in all countries in which they are active, and with the added weight of its PolyThek Catalog of training programs, the new alliance places PolyMedia in a very strong position.

For PolyGram's Video Division, the opportunities of tomorrow are being realized today.



PolyGram's videocassette releases cover a wide variety of interests.

PolyGram Video spectrum PolyMedia

WORLDWIDE

PolyGram's reputation is built on its entertainment tradition, international strength, and expert knowledge of the local markets in which it operates around the globe.

ARGENTINA
Record Company
Manufacturing
Studio
Music Publishing

AUSTRALIA
Record Company
Music Publishing
Direct Marketing
and Trading

AUSTRIA
Record Companies
Manufacturing
Studio
Music Publishing
Film and TV Company

BELGIUM
Record Company
Music Publishing
Direct Marketing

BRAZIL
Record Company
Manufacturing
Studio
Music Publishing
Direct Marketing

CANADA
Record Company
Manufacturing
Music Publishing
Trading

DENMARK
Record Company
Music Publishing

FRANCE
Record Companies
Manufacturing
Studio
Music Publishing
Film and TV Company
Direct Marketing
Video Company

GERMANY (FEDERAL REPUBLIC)
Record Companies
Manufacturing
Studios
Music Publishing
Film and TV Companies
Video Companies
Trading Companies

GREAT BRITAIN
Record Companies
Manufacturing
Studios
Music Publishing
Film and TV Companies
Direct Marketing

GREECE
Record Company
Manufacturing
Music Publishing

HONG KONG
Record Company
Studio
Music Publishing

IRELAND
Record Company

ITALY
Record Company
Manufacturing
Studio
Music Publishing
Film and TV Company

JAPAN
Record Companies
Manufacturing
Studios
Music Publishing

KENYA
Record Company
Manufacturing
Studio

MALAYSIA
Record Company

MEXICO
Record Company
Manufacturing
Studio
Music Publishing

THE NETHERLANDS
Record Companies
Manufacturing
Studio
Music Publishing
Film and TV Company
Video Division

NEW ZEALAND
Record Company
Manufacturing
Music Publishing
Direct Marketing

NIGERIA
Record Company
Manufacturing
Studio

NORWAY
Record Company
Manufacturing
Studio
Direct Marketing

PORTUGAL
Record Company

SINGAPORE
Record Company
Manufacturing
Studio
Music Publishing

SPAIN
Record Companies
Manufacturing
Studio
Music Publishing

SWEDEN
Record Company
Distribution Company
Music Publishing
Direct Marketing
Video Company

SWITZERLAND
Record Company
Music Publishing

U.S.A.
Record Company
Distribution Company
Music Publishing
Film and TV Companies
Direct Marketing

VENEZUELA
Record Company
Manufacturing

NAMES AND ADDRESSES

POLYGRAM GROUP

Dr. W. Hix
President/Chief
Executive Officer

K. Kinkele
Executive
Vice President

Dr. H. Franz
Executive
Vice President

K.-H. Busacker
Executive
Vice President

Dr. W. Vogelsang
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Vice President

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Vice President

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Explanation of Direct Dial Codes
Telephone numbers in countries which can be called directly are preceded by a "+". This represents the number code which must be added and dialed in a particular country to obtain a line for a foreign call. These code numbers vary from country to country.
The first set of digits represents the respective country code followed by area or city code in brackets and telephone number of the individual subscriber.

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SONY

Consolidated Financial Statements

For the year ended March 31, 2006

Sony Corporation

TOKYO, JAPAN

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Management
Investor Information

Sony's Corporate Governance Practices

For an explanation as to the significant differences between the New York Stock Exchange's corporate governance standards and Sony's corporate governance practices, please visit us on the Internet at:
http://www.sony.net/SonyInfo/IR/NYSEGovernance.html

Cautionary Statement

Statements made in this release with respect to Sony's current plans, estimates, strategies and beliefs and other statements that are not historical facts are forward-looking statements about the future performance of Sony. Forward-looking statements include, but are not limited to, those statements using words such as "believe," "expect," "plans," "strategy," "prospects," "forecast," "estimate," "project," "anticipate," "aim," "may" or "might" and words of similar meaning in connection with a discussion of future operations, financial performance, events or conditions. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. These statements are based on management's assumptions and beliefs in light of the information currently available to it. Sony cautions you that a number of important risks and uncertainties could cause actual results to differ materially from those discussed in the forward-looking statements, and therefore you should not place undue reliance on them. You also should not rely on any obligation of Sony to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Sony disclaims any such obligation. Risks and uncertainties that might affect Sony include, but are not limited to (i) the global economic environment in which Sony operates, as well as the economic conditions in Sony's markets, particularly levels of consumer spending; (ii) exchange rates, particularly between the yen and the U.S. dollar, the Euro and other currencies in which Sony makes significant sales or in which Sony's assets and liabilities are denominated; (iii) Sony's ability to continue to design and develop and win acceptance of its products and services, which are offered in highly competitive markets characterized by continual new product introductions, rapid development in technology and subjective and changing consumer preferences (particularly in the Electronics, Game and Pictures segments, and Music business); (iv) Sony's ability to implement successfully personnel reduction and other business reorganization activities in its Electronics segment and Music business; (v) Sony's ability to implement successfully its network strategy for its Electronics and Pictures segments, All Other and the Music business, and to develop and implement successful sales and distribution strategies in its Pictures segment and Music business in light of the Internet and other technological developments; (vi) Sony's continued ability to devote sufficient resources to research and development and, with respect to capital expenditures, to correctly prioritize investments (particularly in the Electronics segment); (vii) shifts in customer demand for financial services such as life insurance and Sony's ability to conduct successful Asset Liability Management in the Financial Services segment; and (viii) the success of Sony's joint ventures and alliances. Risks and uncertainties also include the impact of any future events with material unforeseen impacts.

Financial Highlights

Sony Corporation and Consolidated Subsidiaries – Fiscal Year Ended March 31

Operating Results

	Yen in billions except per share amounts and number of employees		Percent change	Dollars in millions except per share amounts
	2005	2006	2006/2005	2006
FOR THE FISCAL YEAR				
Sales and operating revenue	¥7,159.6	¥7,475.4	+4.4%	$63,893
Operating income	113.9	191.3	+67.9	1,635
Income before income taxes	157.2	286.3	+82.1	2,447
Net income	163.8	123.6	-24.5	1,057
Per share of common stock:				
Net income				
– Basic	¥ 175.90	¥ 122.58	-30.3%	$ 1.05
– Diluted	158.07	116.88	-26.1	1.00
Cash dividends	25.00	25.00	—	0.21
AT FISCAL YEAR-END				
Stockholders' equity	¥2,870.3	¥3,203.9	+11.6%	$27,383
Total assets	9,499.1	10,607.8	+11.7	90,665
Number of employees	151,400	158,500		

Notes:

1. *U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥117 = U.S. $1, the approximate Tokyo foreign exchange market rate as of March 31, 2006.*
2. *In July 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts". SOP 03-1 requires insurance enterprises to record additional reserves for long-duration life insurance contracts with minimum guarantee or annuity receivable options. Additionally, SOP 03-1 provides guidance for the presentation of separate accounts. This statement is effective for fiscal years beginning after December 15, 2003. Sony adopted SOP 03-1 on April 1, 2004. As a result of the adoption of SOP 03-1, Sony's operating income decreased by ¥3,156 million for the fiscal year ended March 31, 2005. Additionally, on April 1, 2004, Sony recognized ¥4,713 million charge (net of income taxes of ¥2,675 million) as a cumulative effect of an accounting change.*
3. *In July 2004, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share". In accordance with Statement of Financial Accounting Standards ("FAS") No.128,"Earnings per Share", Sony had not previously included in the computation of diluted earnings per share ("EPS") the number of potential common stock issuable upon the conversion of contingently convertible debt instruments ("Co-Cos") that had not met the conditions to exercise the stock acquisition rights. EITF Issue No. 04-8 requires that the maximum number of common stock that could be issued upon the conversion of Co-Cos be included in diluted EPS computations from the date of issuance regardless of whether the conditions to exercise the stock acquisition rights have been met. EITF Issue No. 04-8 is effective for reporting periods ending after December 15, 2004. Sony adopted EITF Issue No. 04-8 during the quarter ended December 31, 2004. As a result of the adoption of EITF Issue No. 04-8, Sony's diluted EPS of income before cumulative effect of an accounting change and net income for the fiscal year ended March 31, 2004 were restated. Sony's diluted EPS of income before cumulative effect of an accounting change and net income for the fiscal year ended March 31, 2005 decreased by ¥7.26 and ¥7.06, respectively, as a result of adopting EITF Issue No. 04-8.*

Operational Review

Consolidated Results for the Fiscal Year Ended March 31, 2006

Unless otherwise specified, all amounts are on the basis of Generally Accepted Accounting Principles in the U.S. ("U.S. GAAP").
U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥117=U.S.$1, the approximate Tokyo foreign exchange market rate as of March 31, 2006.

Sales and operating revenue ("sales") increased 4.4% compared with the previous fiscal year; on a local currency basis sales increased slightly. (For all references herein to results on a local currency basis, see Note i on page 11.)

Sales within the Electronics segment increased 1.7% (a 3% decrease on a local currency basis). Although there was a decrease in sales particularly of CRT and plasma televisions, sales of LCD and LCD rear projection televisions increased. In the Game segment, sales increased by 31.4% primarily as the result of the contribution from PSP® (PlayStation® Portable) ("PSP"). Sales in the Pictures segment increased 1.7% compared with the previous fiscal year (a 4% decrease on a U.S. dollar basis). In the Financial Services segment, revenue increased by 32.6% compared to the previous fiscal year mainly due to an improvement in gains and losses on investments at Sony Life Insurance Co., Ltd. ("Sony Life").

Operating income increased 67.9% (a 23% increase on a local currency basis) compared with the previous fiscal year. This includes a one time net gain of ¥73.5 billion ($628 million), which resulted from the transfer to the Japanese Government of the substitutional portion of Sony's Employee Pension Fund. Of this, a gain of ¥64.5 billion ($551 million) was recorded within the Electronics segment. In addition, restructuring charges, which were recorded as operating expenses, amounted to ¥138.7 billion ($1,185 million) compared to ¥90.0 billion in the previous fiscal year. In the Electronics segment, restructuring charges were ¥125.8 billion ($1,075 million) compared to ¥83.2 billion the previous fiscal year.

In the Electronics segment, although there was a decrease in sales to outside customers, an increase in loss on sale, disposal or impairment of assets and a deterioration in the cost of sales ratio associated with a decline in unit selling prices, the amount of operating loss decreased as a result of a gain resulting from the abovementioned transfer to the Japanese Government of the substitutional portion of Sony's Employee Pension Fund and the depreciation of the yen. In the Game segment, there was a significant decline in operating income primarily resulting from an increase in research and development costs associated with PLAYSTATION® 3 ("PS3"). In the Pictures segment, operating income decreased significantly primarily due to lower worldwide theatrical and home entertainment revenues on feature films. In the Financial Services segment, there was a significant increase in operating income mainly attributable to the increase in gains on investments at Sony Life.

Income before income taxes increased 82.1% compared to the previous fiscal year. There was an improvement in the net effect of other income and expenses compared to the previous fiscal year primarily due to the recording of a gain on change in interest of ¥60.8 billion ($520 million), compared to the ¥16.3 billion recorded in the previous fiscal year. During the fiscal year, Sony recorded a gain of ¥21.5 billion ($184 million) on the change in interest in

subsidiaries and equity investees resulting from the initial public offering of Sony Communication Network Corporation ("SCN"), a gain of ¥20.6 billion ($176 million) on the change in interest resulting from the sale of a portion of stock in Monex Beans Holdings, Inc., and gains of ¥12.0 billion ($102 million) and ¥6.6 billion ($57 million) respectively on the change of interest at So-net M3 Inc., a consolidated subsidiary of SCN and at DeNA Co., Ltd., an equity affiliate of SCN accounted for by the equity method.

Income taxes: Compared to an effective tax rate of 10.2% in the previous fiscal year, the effective tax rate was 61.6% in the current fiscal year. This effective tax rate exceeded the Japanese statutory tax rate primarily due to the recording of additional valuation allowances against deferred tax assets by Sony Corporation and several of Sony's domestic and overseas consolidated subsidiaries due to continued losses recorded at these businesses and the recording of an additional tax provision for the undistributed earnings of foreign subsidiaries. The effective tax rate was significantly lower than the Japanese statutory rate in the previous fiscal year as a result of the reversal of valuation allowances at Sony's U.S. subsidiaries associated with an improvement in operating performance.

Equity in net income of affiliated companies decreased by 54.6% compared to the previous fiscal year. Equity in net income of affiliated companies for the previous fiscal year included the recording of ¥12.6 billion as equity in net income for InterTrust Technologies Corporation. This amount reflected InterTrust's proceeds from a license agreement arising from the settlement of a patent-related suit. In the current fiscal year, Sony Ericsson Mobile Communications AB ("Sony Ericsson") contributed ¥29.0 billion ($248 million) to equity in net income, an increase of ¥11.6 billion compared to the previous fiscal year. Sony recorded equity income of ¥5.8 billion ($50 million) for SONY BMG MUSIC ENTERTAINMENT ("SONY BMG"), compared to an equity loss of ¥3.4 billion in the previous fiscal year. However, Sony recorded an equity in net loss of ¥7.2 billion ($61 million) for S-LCD Corporation ("S-LCD"), a joint-venture with Samsung Electronics Co., Ltd. for the manufacture of amorphous TFT LCD panels and equity in net loss of ¥16.9 billion ($144 million) for Metro-Goldwyn-Mayer Inc. ("MGM")*. The equity in net loss for MGM includes non-cash interest of ¥6.0 billion ($51 million) on cumulative preferred stock.

**On April 8, 2005, a consortium led by Sony Corporation of America and its equity partners completed the acquisition of MGM. As part of the acquisition, Sony invested $257 million in exchange for 20% of the total equity. However, based on the percentage of common stock owned, Sony records 45% of MGM's net income (loss) as equity in net income (loss) of affiliated companies.*

Net Income, as a result, decreased 24.5% compared to the previous fiscal year.

Operating Performance Highlights by Business Segment

Note: As of August 1, 2004, Sony and Bertelsmann AG combined their recorded music businesses in a joint venture. The newly formed company, Sony BMG, is 50% owned by each parent company. Under U.S. GAAP, Sony BMG is accounted for by Sony using the equity method and, since August 1, 2004, 50% of net profits or losses of this business have been included under "Equity in net income (loss) of affiliated companies."

In connection with the establishment of this joint venture, Sony's non-Japan based disc manufacturing and physical distribution businesses, formerly included within the Music segment, have been reclassified to the Electronics segment to recognize the new management reporting structure whereby Sony's Electronics segment has now assumed responsibility for these businesses. Effective April 1, 2005, a similar change was made with respect to Sony's Japan based disc manufacturing business. Results for the fiscal year ended March 31, 2005 in the Electronics segment have been restated to account for these reclassifications.

Effective April 1, 2005, Sony no longer breaks out its Music business as a reportable segment as it no longer meets the materiality threshold. Accordingly, the results for Sony's Music business are now included within All Other and the results for the fiscal year ended March 31, 2005 have been reclassified to All Other for comparative purposes. Results for the fiscal year ended March 31, 2006 in All Other include the results of Sony Music Entertainment Inc.'s ("SMEI") music publishing business and Sony Music Entertainment (Japan) Inc. ("SMEJ"), excluding Sony's Japan based disc manufacturing business which, as noted above, has been reclassified to the Electronics segment. However, results for the same periods of the previous fiscal year in All Other include the consolidated results for SMEI's recorded music business for the period through August 1, 2004, as well as the results for SMEI's music publishing business and SMEJ excluding Sony's Japan based disc manufacturing business.

Electronics

Fiscal Year Ended March 31

	Yen in billions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue	¥5,066.8	¥5,150.5	+1.7%	$44,021
Operating loss	(34.3)	(30.9)	—	(264)

Unless otherwise specified, all amounts are on a U.S. GAAP basis.

Sales increased by 1.7% compared to the previous fiscal year (a 3% decrease on a local currency basis). Sales to outside customers decreased 0.9% compared to the previous fiscal year. There was a decline in sales of CRT televisions, due to a continued shift in demand towards flat panel televisions, and plasma televisions, where new product development has been terminated. However, there was an increase in sales of LCD televisions, including the new BRAVIA™ models, which saw increased sales in all geographic areas, and LCD rear projection televisions, which saw increased sales particularly in the U.S.

Operating loss declined by ¥3.3 billion compared with the previous fiscal year. Despite a decline in sales to outside customers, an increase in loss on sale, disposal or impairment of fixed assets, and a deterioration in the cost of sales ratio as a result of a decline in unit selling prices, the amount of operating loss decreased as a result of the ¥64.5 billion ($551 million) net gain resulting from the transfer to the Japanese Government of the substitutional portion of Sony's Employee Pension Fund, as well as favorable exchange rates. With regard to products within the Electronics segment, there was an increase in operating income for such products as "Handycam®" video cameras, which experienced an increase in sales of DVD and high definition video cameras, and "VAIO" PCs, where favorable sales of notebook PC were recorded. On the other hand, there was a deterioration in the profitability of CRT televisions, where sales decreased, as well as in that of Image Sensors and LCD televisions, which both experienced a decline in unit selling prices.

Inventory, as of March 31, 2006, was ¥665.7 billion ($5,690 million), a ¥151.3 billion, or 29.4%, increase compared with the level as of March 31, 2005 and a ¥66.9 billion, or 11.2%, increase compared with the level as of December 31, 2005. This increase was primarily a result of increased semiconductor inventory in preparation for the PS3 launch and increased LCD television inventory in preparation for the launch of new models.

Operating Results for Sony Ericsson Mobile Communications AB

The following operating results for Sony Ericsson, which is accounted for by the equity method, are not consolidated in Sony's consolidated financial statements. However, Sony believes that this disclosure provides additional useful analytical information to investors regarding operating performance. In addition, please note that the operating results of Sony Ericsson discussed below are reported on an International Financial Reporting Standards basis, and thereby differ from the operating results reported on a U.S. GAAP basis contained within Sony's equity in net income (loss) of affiliated companies.

Sony Ericsson recorded sales for the one year period ended March 31, 2006 of Euro 7,972 million, a Euro 1,497 million or 23% increase compared to the same period of the previous year. Income before taxes was Euro 595 million, a Euro 135 million increase compared to the same period of the previous year, and net income of Euro 433 million was recorded, a Euro 166 million increase compared to the same period of the previous year. Results were boosted by sales of hit models such as camera phones and "Walkman®" phones. As a result, equity in net income of ¥29.0 billion ($248 million) was recorded by Sony.

Game

Fiscal Year Ended March 31

	Yen in billions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue	¥729.8	¥958.6	+31.4%	$8,193
Operating income	43.2	8.7	-79.7	75

Unless otherwise specified, all amounts are on a U.S. GAAP basis.

Sales increased 31.4% compared with the previous fiscal year (a 27% increase on a local currency basis).

Hardware: There was a significant increase in sales, mainly in Europe and the U.S., primarily due to a significant contribution to sales from PSP, which experienced favorable growth in all geographic areas. In addition, PlayStation 2 ("PS2") sales were on a par with those in the previous fiscal year.
Software: Although PS2 software sales decreased, as a result of the contribution to sales from PSP software, sales in Japan, the U.S. and Europe were relatively unchanged compared to the previous fiscal year.

Operating income of ¥8.7 billion ($75 million) was recorded, a decrease of ¥34.4 billion or 79.7% compared to the previous fiscal year. Although profits from the PS2 and PSP businesses exceeded those in the previous fiscal year, this decrease was mainly the result of continued high research and development costs associated with PS3, as well as the recording of charges associated with preparation for the launch of the PS3 platform.

Worldwide hardware production shipments*:

- → PS2: 16.22 million units (an increase of 0.05 million units)
- → PSP: 14.06 million units (an increase of 11.09 million units)

Worldwide software production shipments*:

- → PS2: 223 million units (a decrease of 29 million units)
- → PSP: 41.6 million units (an increase of 35.9 million units)

Production shipment units of hardware and software are counted upon shipment of the products from manufacturing bases. Sales of such products are recognized when the products are delivered to customers.

Inventory, as of March 31, 2006, was ¥113.4 billion ($969 million), a ¥35.9 billion, or 46.3%, increase compared with the level as of March 31, 2005 and a ¥9.4 billion, or 9.1%, increase compared with the level as of December 31, 2005. This increase was primarily a result of the world-wide full-scale introduction of the PSP platform to U.S. and European markets in addition to Japan during the fiscal year.

Pictures

	Fiscal Year Ended March 31			
	Yen in billions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue	¥733.7	¥745.9	+1.7%	$6,376
Operating income	63.9	27.4	-57.1	234

The results presented above are a yen-translation of the results of Sony Pictures Entertainment ("SPE"), a U.S. based operation which aggregates the results of its worldwide subsidiaries on a U.S. dollar basis. Management analyzes the results of SPE in U.S. dollars, so discussion of certain portions of its results are specified as being on "a U.S. dollar basis."

Sales increased 1.7% compared with the previous fiscal year (4% decrease on a U.S. dollar basis) due to the depreciation of the yen. Sales, on a U.S. dollar basis, decreased primarily due to lower worldwide theatrical and home entertainment revenues on feature films, partially offset by an increase in television product revenues. The lower theatrical and home entertainment revenues primarily resulted from the strong performance of *Spider-Man 2* in the prior fiscal year coupled with the disappointing performance of certain films in the current fiscal year film slate, particularly *Stealth*, *Zathura* and *The Legend of Zorro*. The increase in television product revenues is due to higher advertising and subscription sales from several of SPE's international channels, higher sales of television library product and the extension of a licensing agreement for *Wheel of Fortune*.

Operating Income decreased ¥36.5 billion to ¥27.4 billion ($234 million), compared with the previous fiscal year. The large decrease was due to the same factors contributing to the decrease in feature film revenue discussed above. Operating income from television increased due to the same factors noted above for revenue.

Financial Services

	Fiscal Year Ended March 31			
	Yen in billions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Financial Services revenue	¥560.6	¥743.2	+32.6%	$6,353
Operating income	55.5	188.3	+239.4	1,610

Unless otherwise specified, all amounts are on a U.S. GAAP basis. Therefore, they differ from the results that Sony Life discloses on a Japanese statutory basis.

Financial Services revenue increased by 32.6%, compared with the previous fiscal year, to ¥743.2 billion ($6,353 million) mainly as a result of an increase in revenue at Sony Life. Revenue at Sony Life was ¥645.0 billion ($5,513 million), a ¥170.8 billion, or 36.0% increase compared with the previous fiscal year. The main reasons for this increase were an improvement in gains and losses from investments as a result of favorable Japanese domestic stock market conditions and an increase in revenue from insurance premiums reflecting an increase of insurance-in-force.

Operating income was ¥188.3 billion ($1,610 million), a ¥132.8 billion, or 239.4% increase compared with the previous fiscal year, mainly as a result of a significant improvement in gains and losses on investments in the general account at Sony Life, primarily resulting from an improvement in valuation gains from stock conversion rights in convertible bonds resulting from favorable Japanese domestic stock market conditions. As a result of the abovementioned factors, operating income at Sony Life increased by ¥127.4 billion or 208.8% to ¥188.4 billion ($1,611 million).

All Other

Fiscal Year Ended March 31

	Yen in billions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue	¥459.9	¥408.9	-11.1%	$3,495
Operating income	4.2	16.2	+286.4	138

Unless otherwise specified, all amounts are on a U.S. GAAP basis.

Sales decreased 11.1% compared with the previous fiscal year reflecting the fact that the results for the first four months of the previous fiscal year in All Other incorporated the results for SMEI's recorded music business, which, as noted above, was combined with Bertelsmann AG's recorded music business to form the SONY BMG joint venture which is accounted for by the equity method (please refer to Note to Operating Performance Highlights by Business Segment on Page 5).

Sales at SMEJ were relatively unchanged compared with the previous fiscal year. Best selling albums during the fiscal year included *Ken Hirai 10th Anniversary Complete Single Collection '95-'05 "Uta Baka"* by Ken Hirai, *NATURAL* by ORANGE RANGE and *BEST* by Mika Nakashima.

Excluding sales recorded within Sony's Music business, there was an increase in sales within All Other. This increase was mainly due to strong sales at a business engaged in the production and marketing of animation products, favorable sales both at SCN and its subsidiaries, as well as an increase in sales recorded at an imported general merchandise retail business.

Operating income of ¥16.2 billion ($138 million) was recorded, an increase of ¥12.0 billion compared with the previous fiscal year. This improvement was mainly the result of the fact that the results for SMEI's recorded music business, which recorded an operating loss in the previous fiscal year, are now recorded as part of the results of the SONY BMG joint venture, and the continued strong performance at SMEJ. Operating income at SMEJ increased significantly compared to the previous fiscal year mainly due to an improvement in the cost of sales ratio and the recording of a gain resulting from the transfer to the Japanese government of the substitutional portion of the Employee Pension Fund.

Excluding the operating income recorded in the Music business, a loss was recorded within All Other mainly as the result of an asset impairment write down associated with the sale of a U.S. entertainment complex. This was offset to

some extent by cost reductions at network related businesses within Sony Corporation.

Operating Results for SONY BMG MUSIC ENTERTAINMENT

The following operating results for SONY BMG, which is accounted for by the equity method, are not consolidated in Sony's consolidated financial statements. However, Sony believes that this disclosure provides additional useful analytical information to investors regarding operating performance.

SONY BMG recorded sales revenue of $4,283 million, income before income taxes of $150 million, and net income of $95 million during the one year period ended March 31, 2006. Income before income taxes includes $186 million of restructuring charges, a year-on-year reduction in restructuring charges of $104 million. Income before incomes taxes also benefited from the realization of incremental cost savings. As a result, equity in net income of ¥5.8 billion ($50 million) was recorded by Sony. Best selling albums during the fiscal year included Kelly Clarkson's *Breakaway*, Il Divo's *IL Divo* and *Ancora*, System of a Down's *Mezmerize*, the Foo Fighters' *In Your Honor*, and Shakira's *Fijacion Oral Volumen I*.

Cash Flow

The following charts show Sony's unaudited condensed statements of cash flows on a consolidated basis for all segments excluding the Financial Services segment and for the Financial Services segment alone. These separate condensed presentations are not required under U.S. GAAP, which is used in Sony's consolidated financial statements. However, because the Financial Services segment is different in nature from Sony's other segments, Sony believes that these presentations may be useful in understanding and analyzing Sony's consolidated financial statements.

■ Cash Flow - Consolidated (excluding Financial Services segment)

Fiscal Year Ended March 31

Cash flow	Yen in billions 2005	Yen in billions 2006	Change 2006/2005	Dollars in millions 2006
- From operating activities	¥485.4	¥252.0	¥-233.5	$2,154
- From investing activities	(472.1)	(296.4)	+175.7	(2,533)
- From financing activities	(95.4)	74.6	+170.0	637
Cash and cash equivalents at beginning of the fiscal year	592.9	519.7	-73.2	4,442
Cash and cash equivalents at end of the fiscal year	519.7	585.5	+65.7	5,004

Operating Activities: During the fiscal year ended March 31, 2006, although there was an increase in inventory, primarily semiconductor inventory for use in PS3 and inventory of new LCD television models, net cash was generated primarily after taking account of depreciation and amortization.

Investing Activities: During the fiscal year ended March 31, 2006, Sony purchased fixed assets mainly within the Electronics segment consisting primarily of semiconductor manufacturing facilities. On the other hand, Sony carried out the sale of a portion of stock resulting from the initial public offering of SCN and the sale of securities investments. In the previous fiscal year, in addition to investment in semiconductor manufacturing facilities, Sony also made an investment in S-LCD in association with its establishment.

As a result, the total amount of cash flow from operating activities and from investing activities during the fiscal year was a use of cash of ¥44.4 billion ($379 million).

Financing Activities: During the fiscal year ended March 31, 2006, although Sony redeemed long-term debt including bonds, financing was carried out through the issuance of straight bonds in order to redeem bonds maturing during the fiscal years ending March 31, 2006 and March 31, 2007.

Cash and Cash Equivalents: In addition to the aforementioned information, the total balance of cash and cash equivalents, accounting for the effect of foreign currency exchange rate fluctuations, increased ¥65.7 billion compared to March 31, 2005, to ¥585.5 billion ($5,004 million) as of March 31, 2006.

■ Cash Flow - Financial Services segment

Fiscal Year Ended March 31

Cash flow	Yen in billions 2005	2006	Change 2006/2005	Dollars in millions 2006
- From operating activities	¥ 168.1	¥ 147.1	¥ -20.9	$ 1,257
- From investing activities	(421.4)	(563.8)	-142.4	(4,818)
- From financing activities	256.4	274.9	+18.5	2,349
Cash and cash equivalents at beginning of the fiscal year	256.3	259.4	+3.1	2,217
Cash and cash equivalents at end of the fiscal year	259.4	117.6	-141.7	1,005

Operating Activities: Net cash from operating activities was generated mainly due to an increase in revenue from insurance premiums, reflecting primarily an increase in insurance-in-force at Sony Life.

Investing Activities: Payments for investments and advances exceeded proceeds from maturities of marketable securities, sales of securities investments and collections of advances primarily as a result of investments in mainly Japanese fixed income securities carried out at Sony Life, as well as an increase in advance payments for mortgage loans and investments in marketable securities at Sony Bank Inc.

Financing Activities: Net cash from financing activities was generated as a result of an increase in policyholders' accounts at Sony Life and an increase in deposits from customers in the banking business.

Cash and Cash Equivalents: As a result of the above, the balance of cash and cash equivalents was ¥117.6 billion ($1,005 million) as of March 31, 2006, a decrease of ¥141.7 billion compared to March 31, 2005.

Notes

Note I: During the fiscal year ended March 31, 2006, the average value of the yen was ¥112.3 against the U.S. dollar and ¥136.3 against the Euro, which was 5.1% lower against the U.S. dollar and 2.0% lower against the Euro, compared with the average rates for the previous fiscal year. Operating results on a local currency basis described herein reflect sales and operating income obtained by applying the yen's average exchange rate in the previous fiscal year to local currency-denominated monthly sales, cost of sales, and selling, general and administrative expenses in the fiscal year. Local currency basis results are not reflected in Sony's financial statements and are not measures conforming with U.S. GAAP. In addition, Sony does not believe that these measures are a substitute for U.S. GAAP measures. However, Sony believes that local currency basis results provide additional useful analytical information to investors regarding operating performance.

Note II: "Sales and operating revenue" in each business segment represents sales and operating revenue recorded before intersegment transactions are eliminated. "Operating income" in each business segment represents operating income recorded before intersegment transactions and unallocated corporate expenses are eliminated.

Business Segment Information

Fiscal Year Ended March 31

	Yen in millions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue:				
Electronics –				
Customers	¥4,806,494	¥4,763,555	-0.9%	$40,714
Intersegment	260,339	386,922		3,307
Total	5,066,833	5,150,477	+1.7	44,021
Game –				
Customers	702,524	918,251	+30.7	7,848
Intersegment	27,230	40,368		345
Total	729,754	958,619	+31.4	8,193
Pictures –				
Customers	733,677	745,859	+1.7	6,375
Intersegment	—	—		—
Total	733,677	745,859	+1.7	6,375
Financial Services –				
Customers	537,715	720,566	+34.0	6,159
Intersegment	22,842	22,649		194
Total	560,557	743,215	+32.6	6,353
All Other –				
Customers	379,206	327,205	-13.7	2,797
Intersegment	80,688	81,676		698
Total	459,894	408,881	-11.1	3,495
Elimination	(391,099)	(531,615)	—	(4,544)
Consolidated total	¥7,159,616	¥7,475,436	+4.4%	$63,893

Electronics intersegment amounts primarily consist of transactions with the Game, Pictures and All Other.
All Other intersegment amounts primarily consist of transactions with the Electronics and Game segments.

Fiscal Year Ended March 31

	Yen in millions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Operating income (loss):				
Electronics	¥ (34,273)	¥ (30,930)	—%	$ (264)
Game	43,170	8,747	-79.7	75
Pictures	63,899	27,436	-57.1	234
Financial Services	55,490	188,323	+239.4	1,610
All Other	4,188	16,183	+286.4	138
Total	132,474	209,759	+58.3	1,793
Corporate and elimination	(18,555)	(18,504)	—	(158)
Consolidated total	¥113,919	¥191,255	+67.9%	$1,635

Commencing April 1, 2005, Sony has partly realigned its business segment configuration. Results of the previous year have been reclassified to conform to the presentations for the current year (see Notes 25 on page F-77).

Electronics Sales and Operating Revenue to Customers by Product Category

Fiscal Year Ended March 31

	Yen in millions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue:				
Audio	¥ 571,864	¥ 536,187	-6.2%	$ 4,583
Video	1,036,328	1,021,325	-1.4	8,729
Televisions	921,195	927,769	+0.7	7,930
Information and Communications	816,150	842,537	+3.2	7,201
Semiconductors	246,314	240,771	-2.3	2,058
Components	619,477	656,768	+6.0	5,613
Other	595,166	538,198	-9.6	4,600
Total	¥4,808,494	¥4,763,555	-0.9%	$40,714

The above table is a breakdown of Electronics sales and operating revenue to customers in the Business Segment Information on page 12. The Electronics segment is managed as a single operating segment by Sony's management. However, Sony believes that the information in this table is useful to investors in understanding the product categories in this business segment. In addition, commencing April 1, 2005, Sony has partly realigned its product category configuration in the Electronics segment. Accordingly, results of the previous year have been restated. (See Note 25 on page F-77).

Geographic Segment Information

Fiscal Year Ended March 31

	Yen in millions		Percent change	Dollars in millions
	2005	2006	2006/2005	2006
Sales and operating revenue:				
Japan	¥2,100,793	¥2,168,723	+3.2%	$18,536
United States	1,977,310	1,957,544	-1.0	16,732
Europe	1,612,536	1,715,704	+6.4	14,664
Other Areas	1,468,977	1,633,365	+11.2	13,961
Total	¥7,159,616	¥7,475,436	+4.4%	$63,893

Classification of Geographic Segment Information shows sales and operating revenue recognized by location of customers.

Condensed Financial Services Financial Statements (Unaudited)

The results of the Financial Services segment are included in Sony's consolidated financial statements. The following schedules show unaudited condensed financial statements for the Financial Services segment and all other segments excluding Financial Services. These presentations are not required under U.S. GAAP, which is used in Sony's consolidated financial statements. However, because the Financial Services segment is different in nature from Sony's other segments, Sony believes that a comparative presentation may be useful in understanding and analyzing Sony's consolidated financial statements.

Transactions between the Financial Services segment and Sony without Financial Services are eliminated in the consolidated figures shown below.

■ Condensed statements of income

Financial Services

Fiscal Year Ended March 31	Yen in millions 2005	Yen in millions 2006	Percent change 2006/2005	Dollars in millions 2006
Financial service revenue	¥560,557	¥743,215	+32.6%	$6,353
Financial service expenses	505,067	554,892	+9.9	4,743
Operating income	55,490	188,323	+239.4	1,610
Other income (expenses), net	10,204	24,522	+140.3	209
Income before income taxes	65,694	212,845	+224.0	1,819
Income taxes and other	25,698	80,586	+213.6	689
Income before cumulative effect of an accounting change	39,996	132,259	+230.7	1,130
Cumulative effect of an accounting change	(4,713)	—	—	—
Net income	¥ 35,283	¥132,259	+274.9%	$1,130

Sony without Financial Services

Fiscal Year Ended March 31	Yen in millions 2005	Yen in millions 2006	Percent change 2006/2005	Dollars in millions 2006
Net sales and operating revenue	¥6,632,728	¥6,763,907	+2.0%	$57,811
Costs and expenses	6,575,354	6,762,375	+2.8	57,798
Operating income	57,374	1,532	-97.3	13
Other income (expenses), net	40,639	71,952	+77.1	615
Income before income taxes	98,013	73,484	-25.0	628
Income taxes and other	(37,043)	82,127	—	702
Net income (loss)	¥ 135,056	¥ (8,643)	—	$ (74)

Consolidated

Fiscal Year Ended March 31	Yen in millions 2005	Yen in millions 2006	Percent change 2006/2005	Dollars in millions 2006
Financial service revenue	¥ 537,715	¥ 720,566	+34.0%	$ 6,159
Net sales and operating revenue	6,621,901	6,754,870	+2.0	57,734
	7,159,616	7,475,436	+4.4	63,893
Costs and expenses	7,045,697	7,284,181	+3.4	62,258
Operating income	113,919	191,255	+67.9	1,635
Other income (expenses), net	43,288	95,074	+119.6	812
Income before income taxes	157,207	286,329	+82.1	2,447
Income taxes and other	(11,344)	162,713	—	1,390
Income before cumulative effect of an accounting change	168,551	123,616	-26.7	1,057
Cumulative effect of an accounting change	(4,713)	—	—	—
Net income	¥ 163,838	¥ 123,616	-24.5%	$ 1,057

■ Condensed balance sheets

Financial Services

March 31	Yen in millions 2005	Yen in millions 2006	Dollars in millions 2006
ASSETS			
Current assets:			
Cash and cash equivalents	¥ 259,371	¥ 117,630	$ 1,005
Marketable securities	458,130	532,895	4,555
Other	274,690	200,929	1,717
	990,191	851,454	7,277
Investments and advances	2,378,866	3,128,748	26,741
Property, plant and equipment	38,551	37,422	320
Other assets:			
Deferred insurance acquisition costs	374,805	383,156	3,275
Other	103,004	164,827	1,409
	477,809	547,983	4,684
	¥3,885,517	¥4,565,607	$ 39,022
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	¥ 45,358	¥ 136,723	$ 1,169
Notes and accounts payable, trade	7,099	11,707	100
Deposits from customers in the banking business	546,718	599,952	5,128
Other	109,438	169,956	1,452
	708,613	918,338	7,849
Long-term liabilities:			
Long-term debt	135,750	128,097	1,095
Accrued pension and severance costs	14,362	13,479	115
Future insurance policy benefits and other	2,464,295	2,744,321	23,456
Other	142,272	173,354	1,481
	2,756,679	3,059,251	26,147
Minority interest in consolidated subsidiaries	5,476	4,089	35
Stockholders' equity	414,749	583,929	4,991
	¥3,885,517	¥4,565,607	$ 39,022

Sony without Financial Services

March 31	Yen in millions 2005	Yen in millions 2006	Dollars in millions 2006
ASSETS			
Current assets:			
Cash and cash equivalents	¥ 519,732	¥ 585,468	$ 5,004
Marketable securities	4,072	4,073	34
Notes and accounts receivable, trade	952,692	973,675	8,322
Other	1,116,353	1,393,306	11,909
	2,592,849	2,956,522	25,269
Film costs	278,961	360,372	3,080
Investments and advances	445,446	477,089	4,078
Investments in Financial Services, at cost	187,400	187,400	1,602
Property, plant and equipment	1,333,848	1,351,125	11,548
Other assets	1,189,398	1,059,786	9,058
	¥6,027,902	¥6,392,294	$ 54,635
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	¥ 204,027	¥ 225,082	$ 1,924
Notes and accounts payable, trade	801,252	804,394	6,875
Other	1,132,201	1,299,809	11,109
	2,137,480	2,329,285	19,908
Long-term liabilities:			
Long-term debt	627,367	701,372	5,996
Accrued pension and severance costs	338,040	168,768	1,443
Other	263,520	352,457	3,012
	1,228,927	1,222,597	10,450
Minority interest in consolidated subsidiaries	18,471	32,623	279
Stockholders' equity	2,643,024	2,807,789	23,998
	¥6,027,902	¥6,392,294	$ 54,635

Consolidated

March 31	Yen in millions 2005	Yen in millions 2006	Dollars in millions 2006
ASSETS			
Current assets:			
Cash and cash equivalents	¥ 779,103	¥ 703,098	$ 6,009
Marketable securities	460,202	536,968	4,589
Notes and accounts receivable, trade	1,025,362	985,508	8,424
Other	1,291,504	1,543,950	13,196
	3,556,171	3,769,524	32,218
Film costs	278,961	360,372	3,080
Investments and advances	2,745,689	3,519,907	30,085
Property, plant and equipment	1,372,399	1,388,547	11,868
Other assets:			
Deferred insurance acquisition costs	374,805	383,156	3,275
Other	1,171,075	1,186,247	10,139
	1,545,880	1,569,403	13,414
	¥9,499,100	¥10,607,753	$90,665
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	¥ 230,266	¥ 336,321	$ 2,874
Notes and accounts payable, trade	806,044	813,332	6,952
Deposits from customers in the banking business	546,718	599,952	5,128
Other	1,226,340	1,450,623	12,398
	2,809,368	3,200,228	27,352
Long-term liabilities:			
Long-term debt	678,992	764,898	6,538
Accrued pension and severance costs	352,402	182,247	1,558
Future insurance policy benefits and other	2,464,295	2,744,321	23,456
Other	299,858	475,106	4,061
	3,795,547	4,166,572	35,613
Minority interest in consolidated subsidiaries	23,847	37,101	317
Stockholders' equity	2,870,338	3,203,852	27,383
	¥9,499,100	¥10,607,753	$90,665

■ Condensed statements of cash flows

Financial Services

Fiscal Year Ended March 31	Yen in millions 2005	Yen in millions 2006	Dollars in millions 2006
Net cash provided by operating activities	¥ 168,078	¥ 147,149	$ 1,257
Net cash used in investing activities	(421,384)	(563,763)	(4,818)
Net cash provided by financing activities	256,361	274,863	2,349
Net increase (decrease) in cash and cash equivalents	3,055	(141,741)	(1,212)
Cash and cash equivalents at beginning of the fiscal year	256,316	259,371	2,217
Cash and cash equivalents at end of the fiscal year	¥ 259,371	¥ 117,630	$ 1,005

Sony without Financial Services

Fiscal Year Ended March 31	Yen in millions 2005	Yen in millions 2006	Dollars in millions 2006
Net cash provided by operating activities	¥ 485,439	¥ 251,975	$ 2,154
Net cash used in investing activities	(472,119)	(296,376)	(2,533)
Net cash provided by (used in) financing activities	(95,373)	74,600	637
Effect of exchange rate changes on cash and cash equivalents	8,890	35,537	304
Net increase (decrease) in cash and cash equivalents	(73,163)	65,736	562
Cash and cash equivalents at beginning of the fiscal year	592,895	519,732	4,442
Cash and cash equivalents at end of the fiscal year	¥ 519,732	¥ 585,468	$ 5,004

Consolidated

Fiscal Year Ended March 31	Yen in millions 2005	Yen in millions 2006	Dollars in millions 2006
Net cash provided by operating activities	¥ 646,997	¥ 399,858	$ 3,418
Net cash used in investing activities	(931,172)	(871,264)	(7,447)
Net cash provided by financing activities	205,177	359,864	3,076
Effect of exchange rate changes on cash and cash equivalents	8,890	35,537	303
Net decrease in cash and cash equivalents	(70,108)	(76,005)	(650)
Cash and cash equivalents at beginning of the fiscal year	849,211	779,103	6,659
Cash and cash equivalents at end of the fiscal year	¥ 779,103	¥ 703,098	$ 6,009

Five-Year Summary of Selected Financial Data

Sony Corporation and Consolidated Subsidiaries – Fiscal Year Ended March 31

	Yen in millions except per share amounts					Dollars in millions except
	2002	2003	2004	2005	2006	2006
FOR THE FISCAL YEAR						
Sales and operating revenue	¥7,578,258	¥7,473,633	¥7,496,391	¥7,159,616	¥ 7,475,436	$63,893
Operating income	134,631	185,440	98,902	113,919	191,255	1,635
Income before income taxes	92,775	247,621	144,067	157,207	286,329	2,447
Income taxes	65,211	80,831	52,774	16,044	176,515	1,508
Income before cumulative effect of an accounting changes	9,332	115,519	90,628	168,551	123,616	1,057
Net income	15,310	115,519	88,511	163,838	123,616	1,057
Per share data:						
Income before cumulative effect of an accounting changes						
– Basic	¥ 10.21	¥ 125.74	¥ 98.26	¥ 180.96	¥ 122.58	$ 1.05
– Diluted	10.18	118.21	89.03	162.59	116.88	1.00
Net income						
– Basic	16.72	125.74	95.97	175.90	122.58	1.05
– Diluted	16.67	118.21	87.00	158.07	116.88	1.00
Cash dividends	25.00	25.00	25.00	25.00	25.00	0.21
Depreciation and amortization*	¥ 354,135	¥ 351,925	¥ 366,269	¥ 372,865	¥ 381,843	$ 3,264
Capital expenditures (additions to property, plant and equipment)	326,734	261,241	378,264	356,818	384,347	3,285
Research and development expenses	433,214	443,128	514,483	502,008	531,795	4,545
AT FISCAL YEAR-END						
Net working capital	¥ 778,716	¥ 719,166	¥ 381,140	¥ 746,803	¥ 569,296	$ 4,866
Stockholders' equity	2,370,410	2,280,895	2,378,002	2,870,338	3,203,852	27,383
Stockholders' equity per share attributable to common stock	¥ 2,570.31	¥ 2,466.81	¥ 2,563.67	¥ 2,872.21	¥ 3,002.85	$ 27.36
Total assets	¥8,185,795	¥8,370,545	¥9,090,662	¥9,499,100	¥10,607,753	$90,665
Number of shares issued at year-end (thousands of shares)						
Common stock	919,744	922,385	923,950	998,092	1,000,939	

** Including amortization expenses for intangible assets and for deferred insurance acquisition costs*

Notes:

1. *U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥117 = U.S. $1, the approximate Tokyo foreign exchange market rate as of March 31, 2006.*
2. *In July 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts". SOP 03-1 requires insurance enterprises to record additional reserves for long-duration life insurance contracts with minimum guarantee or annuity receivable options. Additionally, SOP 03-1 provides guidance for the presentation of separate accounts. This statement is effective for fiscal years beginning after December 15, 2003. Sony adopted SOP 03-1 on April 1, 2004. As a result of the adoption of SOP 03-1, Sony's operating income decreased by ¥5,156 million for the fiscal year ended March 31, 2005. Additionally, on April 1, 2004, Sony recorded a ¥4,713 million charge (net of income taxes of ¥2,675 million) as a cumulative effect of an accounting change. In addition, the separate account assets, which are defined by insurance business law in Japan and were previously included in "Securities investments and other" in the consolidated balance sheet, were excluded from the category of separate accounts under the provision of SOP 03-1. Accordingly, the assets previously treated as separate account assets are now treated within general account assets.*
3. *In July 2004, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share". In accordance with Statement of Financial Accounting Standards ("FAS") No.128, "Earnings per Share", Sony had not previously included in the computation of diluted earnings per share ("EPS") the number of potential common stock issuable upon the conversion of contingently convertible debt instruments ("Co-Cos") that had not met the conditions to exercise the stock acquisition rights. EITF Issue No. 04-8 requires that the maximum number of common stock that could be issued upon the conversion of Co-Cos be included in diluted EPS computations from the date of issuance regardless of whether the conditions to exercise the stock acquisition rights have been met. EITF Issue No. 04-8 is effective for reporting periods ending after December 15, 2004. Sony adopted EITF Issue No. 04-8 during the quarter ended December 31, 2004. As a result of the adoption of EITF Issue No. 04-8, Sony's diluted EPS of income before cumulative effect of an accounting change and net income for the fiscal year ended March 31, 2004 were restated. Sony's diluted EPS of income before cumulative effect of an accounting change and net income for the fiscal year ended March 31, 2005 decreased by ¥7.28 and ¥7.06, respectively, as a result of adopting EITF Issue No. 04-8.*
4. *In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities - an Interpretation of Accounting Research Bulletin ("ARB") No. 51". FIN No. 46 addresses consolidation by a primary beneficiary of a variable interest entity ("VIE"). Sony early adopted the provisions of FIN No. 46 on July 1, 2003. As a result of adopting the original FIN No. 46, Sony recognized a one-time charge with no tax effect of ¥2,117 million as a cumulative effect of accounting change in the consolidated statement of income, and Sony's assets and liabilities increased by ¥95,255 million and ¥97,950 million, respectively.*

These increases were treated as non-cash transactions in the consolidated statement of cash flows. In addition, cash and cash equivalents increased by ¥1,521 million. Sony subsequently early adopted the provisions of FIN No. 46R, which replaced FIN No.46, upon issuance in December 2003. The adoption of FIN No. 46R did not have an impact on Sony's results of operations and financial position or impact the way Sony had previously accounted for VIEs.

5. *On April 1, 2001, Sony adopted FAS No.133, "Accounting for Derivative Instruments and Hedging Activities" as amended by FAS No.138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities – an Amendment of FASB Statement No.133". As a result, Sony's operating income, income before income taxes and net income for the fiscal year ended March 31, 2002 decreased by ¥3,007 million, ¥3,441 million and ¥2,167 million, respectively. Additionally, Sony recorded a one-time non-cash after-tax unrealized gain of ¥1,089 million in accumulated other comprehensive income in the consolidated balance sheet, as well as an after-tax gain of ¥5,978 million in the cumulative effect of accounting changes in the consolidated statement of income. In April 2003, the FASB issued FAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". Sony adopted FAS No. 149 on July 1, 2003. The adoption of FAS No. 149 did not have an impact on Sony's results of operations and financial position.*

6. *In July 2001, the FASB issued FAS No. 142, "Goodwill and Other Intangible Assets". Sony adopted FAS No. 142 retroactive to April 1, 2001. As a result, Sony's operating income and income before income taxes for the fiscal year ended March 31, 2002 increased by ¥20,114 million and income before cumulative effect of accounting changes as well as net income for the fiscal year ended March 31, 2002 increased by ¥18,932 million.*

Consolidated Financial Statements

Sony Corporation and Consolidated Subsidiaries

March 31, 2006

Consolidated Balance Sheets

Sony Corporation and Consolidated Subsidiaries - March 31

	Yen in millions		Dollars in millions (Note 3)
	2005	2006	2006
ASSETS			
Current assets:			
Cash and cash equivalents	¥779,103	¥703,098	$6,009
Marketable securities (Notes 8 and 12)	460,202	536,968	4,589
Notes and accounts receivable, trade (Notes 6 and 7)	1,113,071	1,075,071	9,189
Allowance for doubtful accounts and sales returns	(87,709)	(89,563)	(765)
Inventories (Note 4)	631,349	804,724	6,878
Deferred income taxes (Note 21)	141,154	221,311	1,892
Prepaid expenses and other current assets	519,001	517,915	4,426
Total current assets	3,556,171	3,769,524	32,218
Film costs (Note 5)	278,961	360,372	3,080
Investments and advances:			
Affiliated companies (Note 6)	252,905	285,870	2,443
Securities investments and other (Notes 8, 11 and 12)	2,492,784	3,234,037	27,642
	2,745,689	3,519,907	30,085
Property, plant and equipment (Notes 9 and 12):			
Land	182,900	178,844	1,529
Buildings	925,796	926,783	7,921
Machinery and equipment	2,192,038	2,327,676	19,895
Construction in progress	92,611	116,149	993
	3,393,345	3,549,452	30,338
Less – Accumulated depreciation	2,020,946	2,160,905	18,470
	1,372,399	1,388,547	11,868
Other assets:			
Intangibles, net (Notes 10 and 15)	187,024	207,034	1,770
Goodwill (Note 10)	283,923	299,024	2,556
Deferred insurance acquisition costs (Note 11)	374,805	383,156	3,275
Deferred income taxes (Note 21)	240,398	178,751	1,528
Other	459,732	501,438	4,285
	1,545,880	1,569,403	13,414
Total assets	¥9,499,100	¥10,607,753	$90,665

(Continued on following page.)

Consolidated Balance Sheets

	Yen in millions		Dollars in millions (Note 3)
	2005	2006	2006
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings (Note 12)	¥63,396	¥142,766	$1,220
Current portion of long-term debt (Notes 9, 12 and 14)	168,870	193,555	1,654
Notes and accounts payable, trade (Note 6)	806,044	813,332	6,952
Accounts payable, other and accrued expenses (Notes 5 and 15)	746,466	854,886	7,307
Accrued income and other taxes	55,651	87,295	746
Deposits from customers in the banking business (Note 13)	546,718	599,952	5,128
Other (Notes 21 and 24)	424,223	508,442	4,345
Total current liabilities	2,809,368	3,200,228	27,352
Long-term debt (Notes 9, 12 and 14)	678,992	764,898	6,538
Accrued pension and severance costs (Note 15)	352,402	182,247	1,558
Deferred income taxes (Note 21)	72,227	216,497	1,850
Future insurance policy benefits and other (Note 11)	2,464,295	2,744,321	23,456
Other	227,631	258,609	2,211
Total liabilities	6,604,915	7,366,800	62,965
Minority interest in consolidated subsidiaries	23,847	37,101	317
Stockholders' equity (Note 16):			
Subsidiary tracking stock, no par value –			
2005–Authorized 100,000,000 shares, outstanding 3,072,000 shares	3,917	–	–
Common stock, no par value –			
2005–Authorized 3,500,000,000 shares, outstanding 997,211,213 shares	617,792		
2006–Authorized 3,500,000,000 shares, outstanding 1,001,679,664 shares		624,124	5,334
Additional paid-in capital	1,134,222	1,136,638	9,715
Retained earnings	1,506,082	1,602,654	13,698
Accumulated other comprehensive income –			
Unrealized gains on securities (Note 8)	62,669	100,804	862
Unrealized losses on derivative instruments (Note 14)	(2,490)	(2,049)	(18)
Minimum pension liability adjustment (Note 15)	(90,030)	(39,824)	(340)
Foreign currency translation adjustments	(355,824)	(215,368)	(1,841)
	(385,675)	(156,437)	(1,337)
Treasury stock, at cost			
Subsidiary tracking stock			
2005–32 shares	(0)	–	–
Common stock			
2005–1,118,984 shares	(6,000)		
2006–740,888 shares		(3,127)	(27)
	2,870,338	3,203,852	27,383
Commitments and contingent liabilities (Notes 9 and 24)			
Total liabilities and stockholders' equity	¥9,499,100	¥10,607,753	$90,665

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income

Sony Corporation and Consolidated Subsidiaries – Fiscal Year Ended March 31

	Yen in millions			Dollars in millions (Note 3)
	2004	2005	2006	2006
Sales and operating revenue:				
Net sales (Note 6)	¥6,883,478	¥6,565,010	¥6,692,776	$57,203
Financial service revenue	565,752	537,715	720,566	6,159
Other operating revenue	47,161	56,891	62,094	531
	7,496,391	7,159,616	7,475,436	63,893
Costs and expenses:				
Cost of sales (Notes 18 and 19)	5,058,205	5,000,112	5,151,397	44,029
Selling, general and administrative (Notes 15,17,18 and 19)	1,798,239	1,535,015	1,527,036	13,052
Financial service expenses	505,550	482,576	531,809	4,545
Loss on sale, disposal or impairment of assets, net (Notes 10 and 18)	35,495	27,994	73,939	632
	7,397,489	7,045,697	7,284,181	62,258
Operating income	98,902	113,919	191,255	1,635
Other income:				
Interest and dividends (Note 6)	18,756	14,708	24,937	213
Royalty income	34,244	31,709	35,161	301
Foreign exchange gain, net	18,059	–	–	–
Gain on sale of securities investments, net (Notes 6 and 8)	11,774	5,437	9,645	82
Gain on change in interest in subsidiaries and equity investees (Note 20)	4,870	16,322	60,834	520
Other	34,587	29,447	23,039	197
	122,290	97,623	153,616	1,313
Other expenses:				
Interest	27,849	24,578	28,998	248
Loss on devaluation of securities investments	18,481	3,715	3,878	33
Foreign exchange loss, net	–	524	3,065	27
Other	32,795	25,518	22,603	193
	77,125	54,335	58,542	501
Income before income taxes	144,067	157,207	286,329	2,447
Income taxes (Note 21):				
Current	87,219	85,510	96,400	824
Deferred	(34,445)	(69,466)	80,115	684
	52,774	16,044	176,515	1,508
Income before minority interest, equity in net income of affiliated companies and cumulative effect of an accounting change	91,293	141,163	109,814	939
Minority interest in income (loss) of consolidated subsidiaries	2,379	1,651	(626)	(5)
Equity in net income of affiliated companies (Note 6)	1,714	29,039	13,176	113
Income before cumulative effect of an accounting change	90,628	168,551	123,616	1,057
Cumulative effect of an accounting change (2004: Net of income taxes of ¥0 million 2005: Net of income taxes of ¥2,675 million) (Note 2)	(2,117)	(4,713)	–	–
Net income	¥88,511	¥163,838	¥123,616	$1,057

(Continued on following page.)

Consolidated Statements of Income

	Yen			Dollars (Note 3)
	2004	2005	2006	2006
Per share data (Note 22):				
Common stock				
Income before cumulative effect of an accounting change				
– Basic	¥98.26	¥160.96	¥122.58	$1.05
– Diluted	89.03	162.59	116.88	1.00
Cumulative effect of an accounting change				
– Basic	(2.29)	(5.06)	-	-
– Diluted	(2.03)	(4.52)	-	-
Net income				
– Basic	95.97	175.90	122.58	1.05
– Diluted	87.00	158.07	116.88	1.00
Cash dividends	25.00	25.00	25.00	0.21
Subsidiary tracking stock (Note 16)				
Net income (loss)				
– Basic	(41.80)	17.21	-	-

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

Sony Corporation and Consolidated Subsidiaries – Fiscal Year Ended March 31

	Yen in millions			Dollars in millions (Note 3)
	2004	2005	2006	2006
Cash flows from operating activities:				
Net income	¥88,511	¥163,838	¥123,616	$1,057
Adjustments to reconcile net income to net cash provided by operating activities –				
Depreciation and amortization, including amortization of deferred insurance acquisition costs	366,269	372,865	381,843	3,264
Amortization of film costs	305,786	276,320	286,655	2,450
Accrual for pension and severance costs, less payments	35,562	22,837	(7,563)	(65)
Gain on the transfer to the Japanese Government of the substitutional portion of employee pension fund, net (Note 15)	–	–	(73,472)	(628)
Loss on sale, disposal or impairment of assets, net (Notes 10 and 18)	35,495	27,994	73,939	632
Gain on sale or loss on devaluation of securities investments, net (Notes 6 and 8)	4,707	(1,722)	(5,767)	(49)
Gain on evaluation of marketable securities held in the financial service business for trading purpose (Notes 8)	(4,988)	(5,246)	(44,986)	(384)
Gain on change in interest in subsidiaries and equity investees (Note 20)	(4,870)	(16,322)	(60,834)	(520)
Deferred income taxes (Note 21)	(34,445)	(69,466)	80,115	684
Equity in net (income) losses of affiliated companies, net of dividends	1,732	(15,848)	9,794	84
Cumulative effect of an accounting change (Note 2)	2,117	4,713	–	–
Changes in assets and liabilities:				
(Increase) decrease in notes and accounts receivable, trade.	(63,010)	(22,056)	17,464	149
(Increase) decrease in inventories	(78,656)	34,128	(164,772)	(1,408)
Increase in film costs	(299,843)	(294,272)	(339,697)	(2,903)
Increase (decrease) in notes and accounts payable, trade	93,950	31,473	(9,076)	(78)
Increase (decrease) in accrued income and other taxes	(46,067)	3	29,009	248
Increase in future insurance policy benefits and other	264,216	144,143	143,122	1,223
Increase in deferred insurance acquisition costs	(71,219)	(65,051)	(51,520)	(440)
(Increase) decrease in marketable securities held in the financial service business for trading purpose	369	(26,096)	(35,346)	(302)
Increase in other current assets	(34,991)	(29,699)	(8,792)	(75)
Increase in other current liabilities	44,772	46,545	105,865	904
Other	27,238	67,716	(49,737)	(425)
Net cash provided by operating activities	¥632,635	¥646,997	¥399,858	$3,418

(Continued on following page.)

Consolidated Statements of Cash Flows

	Yen in millions			Dollars in millions (Note 3)
	2004	2005	2006	2006
Cash flows from investing activities:				
Payments for purchases of fixed assets	¥(427,344)	¥(453,445)	¥(462,473)	$(3,953)
Proceeds from sales of fixed assets	33,987	34,184	38,168	326
Payments for investments and advances by financial service business	(1,167,945)	(1,309,092)	(1,368,158)	(11,694)
Payments for investments and advances (other than financial service business)	(33,329)	(158,151)	(36,947)	(316)
Proceeds from maturities of marketable securities, sales of securities investments and collections of advances by financial service business	791,188	923,593	857,376	7,328
Proceeds from maturities of marketable securities, sales of securities investments and collections of advances (other than financial service business)	35,521	25,849	24,527	210
Proceeds from sales of subsidiaries' and equity investees' stocks (Note 20)	–	3,162	75,897	649
Other	6,130	2,728	346	3
Net cash used in investing activities	(761,792)	(931,172)	(871,264)	(7,447)
Cash flows from financing activities:				
Proceeds from issuance of long-term debt	267,884	57,232	246,326	2,105
Payments of long-term debt	(32,042)	(94,862)	(138,773)	(1,186)
Increase (decrease) in short-term borrowings	(57,708)	11,397	(11,045)	(94)
Increase in deposits from customers in the financial service business (Note 13)	129,874	294,352	190,320	1,627
Increase (decrease) in call money and bills sold in the banking business (Note 12)	30,300	(40,400)	86,100	736
Dividends paid	(23,106)	(22,978)	(24,810)	(212)
Proceeds from issuance of stocks by subsidiaries (Note 20)	5,252	4,023	6,937	59
Other	(7,151)	(3,587)	4,809	41
Net cash provided by financing activities	313,283	205,177	359,864	3,076
Effect of exchange rate changes on cash and cash equivalents	(47,973)	8,880	35,537	303
Net increase (decrease) in cash and cash equivalents	136,153	(70,108)	(76,005)	(650)
Cash and cash equivalents at beginning of the fiscal year	713,058	849,211	779,103	6,659
Cash and cash equivalents at end of the fiscal year	¥849,211	¥779,103	¥703,098	$6,009
Supplemental data:				
Cash paid during the fiscal year for –				
Income taxes	¥114,781	¥65,477	¥70,019	$598
Interest	22,571	18,187	24,651	211
Non-cash investing and financing activities –				
Conversion of convertible bonds (Notes 16 and 17)	¥7,977	¥282,744	–	–
Obtaining assets by entering into capital lease	18,298	19,049	¥19,682	$168
Contribution of net assets into the joint venture with Bertelsmann AG (Note 6)	–	9,402	–	–

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Stockholders' Equity

Sony Corporation and Consolidated Subsidiaries – Fiscal Year Ended March 31

	Yen in millions						
	Subsidiary tracking stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock, at cost	Total
Balance at March 31, 2003	¥3,917	¥472,361	¥984,196	¥1,301,740	¥(471,978)	¥(9,341)	¥2,280,895
Conversion of convertible bonds		3,989	3,988				7,977
Stock issued under exchange offering (Note 16)			5,409				5,409
Comprehensive income:							
Net income				88,511			88,511
Other comprehensive income, net of tax (Note 16) –							
Unrealized gains on securities:							
Unrealized holding gains (losses) arising during the period					57,971		57,971
Less : Reclassification adjustment included in net income					(5,679)		(5,679)
Unrealized losses on derivative instruments:							
Unrealized holding gains (losses) arising during the period					7,537		7,537
Less : Reclassification adjustment included in net income					(3,344)		(3,344)
Minimum pension liability adjustment					93,415		93,415
Foreign currency translation adjustments :							
Translation adjustments arising during the period					(129,113)		(129,113)
Less : Reclassification adjustment included in net income					1,232		1,232
Total comprehensive income							110,530
Stock issue costs, net of tax				(53)			(53)
Dividends declared				(23,138)			(23,138)
Purchase of treasury stock						(8,523)	(8,523)
Reissuance of treasury stock			(778)			5,681	4,905
Balance at March 31, 2004	¥3,917	¥476,350	¥992,817	¥1,367,060	¥(449,959)	¥(12,183)	¥2,378,002

(Continued on following page.)

Consolidated Statements of Changes in Stockholders' Equity

	Yen in millions						
	Subsidiary tracking stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock, at cost	Total
Balance at March 31, 2004	¥3,917	¥476,350	¥992,817	¥1,367,060	¥(449,959)	¥(12,183)	¥2,378,002
Exercise of stock acquisition rights		52	53				105
Conversion of convertible bonds		141,390	141,354				282,744
Stock based compensation (Note 17)			340				340
Comprehensive income:							
Net income				163,838			163,838
Other comprehensive income, net of tax (Note 16)—							
Unrealized gains on securities:							
Unrealized holding gains (losses) arising during the period					5,643		5,643
Less : Reclassification adjustment included in net income					(12,924)		(12,924)
Unrealized losses on derivative instruments:							
Unrealized holding gains (losses) arising during the period					(209)		(209)
Less : Reclassification adjustment included in net income					(1,681)		(1,681)
Minimum pension liability adjustment					(769)		(769)
Foreign currency translation adjustments:							
Translation adjustments arising during the period					74,224		74,224
Total comprehensive income							228,122
Stock issue costs, net of tax				(541)			(541)
Dividends declared				(24,030)			(24,030)
Purchase of treasury stock						(416)	(416)
Reissuance of treasury stock			(342)	(245)		6,599	6,012
Balance at March 31, 2005	¥3,917	¥617,792	¥1,134,222	¥1,506,082	¥(385,675)	¥(6,000)	¥2,870,338

(Continued on following page.)

Consolidated Statements of Changes in Stockholders' Equity

	Yen in millions						
	Subsidiary tracking stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock, at cost	Total
Balance at March 31, 2005	¥3,917	¥617,792	¥1,134,222	¥1,506,082	¥(385,675)	¥(6,000)	¥2,870,338
Exercise of stock acquisition rights		931	932				1,863
Conversion of convertible bonds		1,484	1,484				2,968
Conversion of subsidiary tracking stock (Note 18)	(3,917)	3,917					-
Comprehensive income:							
Net income				123,616			123,616
Other comprehensive income, net of tax (Note 16) –							
Unrealized gains on securities:							
Unrealized holding gains (losses) arising during the period					79,630		79,630
Less : Reclassification adjustment included in net income					(41,495)		(41,495)
Unrealized losses on derivative instruments:							
Unrealized holding gains (losses) arising during the period					7,865		7,865
Less : Reclassification adjustment included in net income					(7,424)		(7,424)
Minimum pension liability adjustment					50,206		50,206
Foreign currency translation adjustments:							
Translation adjustments arising during the period					140,473		140,473
Less : Reclassification adjustment included in net income					(17)		(17)
Total comprehensive income							352,854
Stock issue costs, net of tax				(780)			(780)
Dividends declared				(24,968)			(24,968)
Purchase of treasury stock						(394)	(394)
Reissuance of treasury stock				(1,296)		3,267	1,971
Balance at March 31, 2006	-	¥624,124	¥1,136,638	¥1,602,654	¥(156,437)	¥(3,127)	¥3,203,852

(Continued on following page.)

Consolidated Statements of Changes in Stockholders' Equity

	Dollars in millions (Note 3)						
	Subsidiary tracking stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock, at cost	Total
Balance at March 31, 2005	$33	$5,280	$9,694	$12,672	$(3,296)	$(51)	$24,532
Exercise of stock acquisition rights		8	8				16
Conversion of convertible bonds		13	13				26
Conversion of subsidiary tracking stock (Note 16)	(33)	33					-
Comprehensive income:							
Net income				1,057			1,057
Other comprehensive income, net of tax (Note 16) –							
Unrealized gains on securities:							
Unrealized holding gains (losses) arising during the period					681		681
Less : Reclassification adjustment included in net income					(355)		(355)
Unrealized losses on derivative instruments:							
Unrealized holding gains (losses) arising during the period					67		67
Less : Reclassification adjustment included in net income					(63)		(63)
Minimum pension liability adjustment					429		429
Foreign currency translation adjustments:							
Translation adjustments arising during the period					1,200		1,200
Less : Reclassification adjustment included in net income					(0)		(0)
Total comprehensive income							3,016
Stock issue costs, net of tax				(7)			(7)
Dividends declared				(213)			(213)
Purchase of treasury stock						(4)	(4)
Reissuance of treasury stock				(11)		28	17
Balance at March 31, 2006	-	$5,334	$9,715	$13,698	$(1,337)	$(27)	$27,383

The accompanying notes are an integral part of these statements.

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Sony Corporation and Consolidated Subsidiaries

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1. Nature of operations

Sony Corporation and its consolidated subsidiaries (hereinafter collectively referred to as "Sony") are engaged in the development, design, manufacture, and sale of various kinds of electronic equipment, instruments, and devices for consumer and industrial markets. Sony also develops, produces, manufactures, and markets home-use game consoles and software. Sony's principal manufacturing facilities are located in Japan, the United States of America, Europe, and Asia. Its electronic products are marketed throughout the world and game products are marketed mainly in Japan, the United States of America and Europe by sales subsidiaries and unaffiliated local distributors as well as direct sales via the Internet. Sony is engaged in the development, production, manufacture, marketing, distribution and broadcasting of image-based software, including film, video and television product. Sony is also engaged in various financial service businesses including insurance operations through a Japanese life insurance subsidiary and a non-life insurance subsidiary, banking operations through a Japanese internet-based banking subsidiary and leasing and credit financing operations in Japan. In addition to the above, Sony is engaged in the development, production, manufacture, and distribution of recorded music, Internet-related businesses, an animation production and marketing business, an imported general merchandise retail business, an IC card business and an advertising agency business in Japan.

2. Summary of significant accounting policies

Sony Corporation and its subsidiaries in Japan maintain their records and prepare their financial statements in accordance with accounting principles generally accepted in Japan while its foreign subsidiaries maintain their records and prepare their financial statements in conformity with accounting principles generally accepted in the countries of their domiciles. Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform with accounting principles generally accepted in the United States of America ("U.S. GAAP"). These adjustments were not recorded in the statutory books of account.

(1) Newly adopted accounting pronouncements:

Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts -

In July 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts". SOP 03-1 requires insurance enterprises to record additional reserves for long-duration life insurance contracts with minimum guarantee or annuity receivable options. Additionally, SOP 03-1 provides guidance for the presentation of separate accounts. This statement is effective for fiscal years beginning after December 15, 2003. Sony

adopted SOP 03-1 on April 1, 2004. As a result of the adoption of SOP 03-1, Sony's operating income decreased by ¥5,156 million for the fiscal year ended March 31, 2005. Additionally, on April 1, 2004, Sony recorded a ¥4,713 million charge (net of income taxes of ¥2,675 million) as a cumulative effect of an accounting change.

The Effect of Contingently Convertible Instruments on Diluted Earnings per Share -

In July 2004, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share". In accordance with Statement of Financial Accounting Standards ("FAS") No.128, "Earnings per Share", Sony had not previously included in the computation of diluted earnings per share ("EPS") the number of potential common stock issuable upon the conversion of contingently convertible debt instruments ("Co-Cos") that had not met the conditions to exercise the stock acquisition rights. EITF Issue No. 04-8 requires that the maximum number of common stock that could be issued upon the conversion of Co-Cos be included in diluted EPS computations from the date of issuance regardless of whether the conditions to exercise the stock acquisition rights have been met. EITF Issue No. 04-8 is effective for reporting periods ending after December 15, 2004. Sony adopted EITF Issue No. 04-8 during the quarter ended December 31, 2004. As a result of the adoption of EITF Issue No. 04-8, Sony's diluted EPS of income before cumulative effect of an accounting change and net income for the fiscal year ended March 31, 2004 were restated. Sony's diluted EPS of income before cumulative effect of an accounting change and net income for the fiscal year ended March 31, 2005 decreased by ¥7.26 and ¥7.06, respectively, as a result of adopting EITF Issue No. 04-8.

Consolidation of Variable Interest Entities -

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities - an Interpretation of Accounting Research Bulletin ("ARB") No. 51". FIN No. 46 addresses consolidation by a primary beneficiary of a variable interest entity ("VIE"). Sony early adopted the provisions of FIN No. 46 on July 1, 2003. As a result of adopting the original FIN No. 46, Sony recognized a one-time charge with no tax effect of ¥2,117 million as a cumulative effect of accounting change in the consolidated statement of income, and Sony's assets and liabilities increased by ¥95,255 million and ¥97,950 million, respectively. These increases were treated as non-cash transactions in the consolidated statement of cash flows. In addition, cash and cash equivalents increased by ¥1,521 million.

Sony subsequently early adopted the provisions of FIN No. 46R, which replaced FIN No.46, upon issuance in December 2003. The adoption of FIN No. 46R did not have an impact on Sony's results of operations and financial position or impact the way Sony had previously accounted for VIEs.

Exchanges of Nonmonetary Assets -

In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of Accounting Principle Board Opinion ("APB") No. 29". This statement requires that exchanges of productive assets be accounted for at fair value unless fair value cannot be reasonably determined or the transaction lacks commercial substance. This statement is effective for nonmonetary asset exchanges that have occurred in the fiscal periods beginning after June 15, 2005. Sony adopted FAS No.153 on July 1, 2005. The adoption of FAS No.153 did not have a material impact on Sony's results of operations and financial position.

Accounting for Conditional Asset Retirement Obligations -

In March 2005, the FASB issued FIN No. 47, "Accounting for Conditional Asset Retirement Obligations - an Interpretation of FAS No. 143". FIN No. 47 clarifies that an entity is required to recognize a liability for the fair value of a conditional retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. Sony adopted FIN No. 47 on March 31, 2006. The adoption of FIN No.47 did not have a material impact on Sony's results of operations and financial position.

Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds -

In September 2004, the EITF issued EITF Issue No. 04-10, "Applying Paragraph 19 of FASB Statement No. 131, Disclosures about Segments of an Enterprise and Related Information, in Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds". EITF Issue No. 04-10 clarifies how an enterprise should evaluate the aggregation criteria in paragraph 17 of FAS No. 131 when determining whether operating segments that do not meet the quantitative thresholds may be aggregated in accordance with paragraph 19 of FAS No. 131. EITF Issue No. 04-10 is effective for fiscal years ending after September 15, 2005. Sony adopted EITF Issue No. 04-10 during the fiscal year ended March 31, 2006. The adoption of EITF Issue No. 04-10 did not have an impact on Sony's results of operation and financial position.

(2) Significant accounting policies:

Basis of consolidation and accounting for investments in affiliated companies -

The consolidated financial statements include the accounts of Sony Corporation and its majority-owned subsidiary companies, general partnerships in which Sony has a controlling interest, and variable interest entities for which Sony is the primary beneficiary. All intercompany transactions and accounts are eliminated. Investments in business entities in which Sony does not have control, but has the ability to exercise significant influence over operating and financial policies generally through 20-50% ownership, are accounted for under the equity method. In addition, investments in general partnerships in which Sony does not have a controlling interest and limited partnerships are also accounted for under the equity method. Under the equity method, investments are stated at cost plus/minus Sony's equity in undistributed earnings or losses. Consolidated net income includes Sony's equity in current earnings or losses of such companies, after elimination of unrealized intercompany profits. If the value of an investment has declined and is judged to be other than temporary, the investment is written down to its fair value.

On occasion, a consolidated subsidiary or an affiliated company accounted for by the equity method may issue its shares to third parties in either a public or private offering or upon conversion of convertible debt to common stock at amounts per share in excess of or less than Sony's average per share carrying value. With respect to such transactions, where the sale of such shares is not part of a broader corporate reorganization and the reacquisition of such shares is not contemplated at the time of issuance, the resulting gains or losses arising from

the change in interest are recorded in income for the year the change in interest transaction occurs. If the sale of such shares is part of a broader corporate reorganization, the reacquisition of such shares is contemplated at the time of issuance or realization of such gain is not reasonably assured (i.e., the entity is newly formed, non-operating, a research and development or start-up/development stage entity, or where the entity's ability to continue in existence is in question), the transaction is accounted for as a capital transaction.

The excess of the cost over the underlying net equity of investments in consolidated subsidiaries and affiliated companies accounted for on an equity basis is allocated to identifiable assets and liabilities based on fair values at the date of acquisition. The unassigned residual value of the excess of the cost over the underlying net equity is recognized as goodwill.

Use of estimates -

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Translation of foreign currencies -

All asset and liability accounts of foreign subsidiaries and affiliates are translated into Japanese yen at appropriate year-end current rates and all income and expense accounts are translated at rates that approximate those rates prevailing at the time of the transactions. The resulting translation adjustments are accumulated as a component of accumulated other comprehensive income.

Foreign currency receivables and payables are translated at appropriate year-end current rates and the resulting translation gains or losses are taken into income.

Cash and cash equivalents -

Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value because of changes in interest rates.

Marketable debt and equity securities -

Debt and equity securities designated as available-for-sale, whose fair values are readily determinable, are carried at fair value with unrealized gains or losses included as a component of accumulated other comprehensive income, net of applicable taxes. Debt and equity securities classified as trading securities are carried at fair value with unrealized gains or losses included in income. Debt securities that are expected to be held-to-maturity are carried at amortized cost. Individual securities classified as either available-for-sale or held-to-maturity are reduced to net realizable value by a charge to income for other than temporary declines in fair value. Realized gains and losses are determined on the average cost method and are reflected in income.

Equity securities in non-public companies -

Equity securities in non-public companies are carried at cost as fair value is not readily determinable. If the value of a non-public equity investment is estimated to have declined and such decline is judged to be other than temporary, Sony recognizes the impairment of the investment and the carrying value is reduced to its fair value. Determination of impairment is based on the consideration of such factors as operating results, business plans and estimated future cash flows. Fair value is determined through the use of such methodologies as discounted cash flows, valuation of recent financings and comparable valuations of similar companies.

Inventories -

Inventories in electronics and game as well as non-film inventories for pictures are valued at cost, not in excess of market, cost being determined on the "average cost" basis except for the cost of finished products carried by certain subsidiary companies in electronics which is determined on the "first-in, first-out" basis.

Film costs -

Film costs related to theatrical and television product (which includes direct production costs, production overhead and acquisition costs) are stated at the lower of unamortized cost or estimated fair value and classified as non-current assets. Film costs are amortized, and the estimated liabilities for residuals and participations are accrued, for an individual product based on the proportion that current period actual revenues bear to the estimated remaining total lifetime revenues. These estimates are reviewed on a periodic basis.

Property, plant and equipment and depreciation -

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is primarily computed on the declining-balance method for Sony Corporation and its Japanese subsidiaries, except for certain semiconductor manufacturing facilities whose depreciation is computed on the straight-line method, and on the straight-line method for its foreign subsidiaries at rates based on estimated useful lives of the assets, principally, ranging from 15 years up to 50 years for buildings and from 2 years up to 10 years for machinery and equipment. Significant renewals and additions are capitalized at cost. Maintenance and repairs, and minor renewals and betterments are charged to income as incurred.

Goodwill and other intangible assets -

Goodwill and certain other intangible assets that are determined to have an indefinite life are not amortized and are tested for impairment during the fourth quarter of fiscal year on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value below its carrying amount. Fair value for those assets is generally determined using a discounted cash flow analysis.

Intangible assets with finite lives that are determined not to have an indefinite life mainly consist of artist contracts, music catalogs, acquired patent rights and software to be sold, leased or otherwise marketed. Artist contracts and music catalogs are amortized on a straight-line basis over 10 to 40 years. Acquired patent rights and software to be sold, leased or otherwise marketed are amortized on a straight-line basis over 3 to 10 years.

Accounting for computer software to be sold -

Sony accounts for software development costs in accordance with FAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed".

In the Electronics segment, costs related to establishing the technological feasibility of a software product are expensed as incurred as a part of research and development in cost of sales. Costs that are incurred to produce the finished product after technological feasibility is established are capitalized and amortized over the estimated economic life of the product, which is generally three years. Sony performs periodic reviews to ensure that unamortized program costs remain recoverable from future revenue.

In the Game segment, technological feasibility of the underlying software is reached shortly before the products are released to manufacturing. Costs incurred after technological feasibility is established are not material, and accordingly, Sony expenses software development costs for the Game segment as incurred as a part of research and development in cost of sales.

Deferred insurance acquisition costs -

Costs that vary with and are primarily related to acquiring new insurance policies are deferred as long as they are recoverable. The deferred insurance acquisition costs include such items as commission, medical examination and inspection report fees. The deferred insurance acquisition costs for traditional life insurance contracts are amortized over the premium-paying period of the related insurance policies using assumptions consistent with those used in computing policy reserves. The deferred insurance acquisition costs for non-traditional life insurance contracts are amortized over the expected life in proportion to the estimated gross profits.

Product warranty -

Sony provides for the estimated cost of product warranties at the time revenue is recognized by either product category group or individual product. The product warranty is calculated based upon product sales, estimated probability of failure and estimated cost per claim. The variables used in the calculation of the provision are reviewed on a periodic basis.

Certain subsidiaries in the Electronics segment offer extended warranty programs. The consideration received through extended warranty service is deferred and amortized on a straight-line basis over the term of the

extended warranty.

Future insurance policy benefits -

Liabilities for future insurance policy benefits are primarily comprised of the present value of estimated future payments to policyholders. These liabilities are computed by the net level premium method based upon the assumptions such as future investment yield, morbidity, mortality and withdrawals. These assumptions are reviewed on a periodic basis. Liabilities for future insurance policy benefits also include liabilities for guaranteed benefits related to certain non-traditional long-duration life and annuity contracts.

Accounting for the Impairment of long-lived assets -

Sony periodically reviews the carrying value of its long-lived assets held and used, other than goodwill and intangible assets with indefinite lives, and assets to be disposed of, whenever events or changes in circumstances indicated that the carrying amount may not be recoverable. Long-lived assets to be held and used are reviewed for impairment by comparing the carrying value of the assets with their estimated undiscounted future cash flows. If it is determined that an impairment loss has occurred, the loss would be recognized during the period. The impairment loss would be calculated as the difference between asset carrying value and the present value of estimated net cash flows or comparable market values, giving consideration to recent operating performance. Long-lived assets that are to be disposed of other than by sale are considered held and used until they are disposed of. Long-lived assets that are to be disposed of by sale are reported at the lower of their carrying value or fair value less cost to sell. Reductions in carrying value are recognized in the period in which the long-lived assets are classified as held for sale.

Derivative financial instruments -

All derivatives, including certain derivative financial instruments embedded in other contracts, are recognized as either assets or liabilities in the balance sheet at fair value. Changes in the fair value of derivative financial instruments are either recognized periodically in income or stockholders' equity (as a component of accumulated other comprehensive income), depending on whether the derivative financial instrument qualifies as a hedge and the derivative is being used to hedge changes in fair value or cash flows.

In accordance with FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", the derivative financial instruments held by Sony are classified and accounted as below.

Fair value hedges

Changes in the fair value of derivatives designated and effective as fair value hedges for recognized assets or liabilities or unrecognized firm commitments are recognized in earnings as offsets to changes in the fair value of the related hedged assets or liabilities.

Cash flow hedges

Changes in the fair value of derivatives designated and effective as cash flow hedges for forecasted transactions or exposures associated with recognized assets or liabilities are initially recorded in other comprehensive income and

reclassified into earnings when the hedged transaction affects earnings. Changes in the fair value of the ineffective portion are recognized in current period earnings.

Derivatives not designated as hedges

Changes in the fair value of derivatives that are not designated as hedges under FAS No. 133 are recognized in current period earnings.

Sony formally documents all hedging relationships between the derivatives designated as hedges and hedged items, as well as its risk management objectives and strategies for undertaking various hedging activities. Sony links all hedges that are designated as fair value or cash flow hedges to specific assets or liabilities on the balance sheet or to the specific forecasted transaction. Sony also assesses, both at the inception of the hedge and on an on-going basis, whether the derivatives that are designated as hedges are highly effective in offsetting changes in fair value or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge, Sony discontinues hedge accounting.

Stock-based compensation -

Sony applies APB No. 25, "Accounting for Stock Issued to Employees", and its related interpretations in accounting for its stock-based compensation plans and follows the disclosure-only provisions of FAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an Amendment of FASB Statement No. 123". In accordance with APB No. 25, stock-based compensation cost is recognized in income based on the excess, if any, of the quoted market price of the common stock of Sony Corporation at the grant date of the award or other measurement date over the stated exercise price of the award. As the exercise prices for Sony's stock-based compensation plans are generally determined based on the prevailing market price shortly before the date of grant, the compensation expense for these plans is not significant. For awards that generate compensation expense as defined under APB No. 25, Sony calculates the amount of compensation expense and recognizes the expense over the vesting period of the award.

The following table reflects the net effect on net income and net income per share allocated to the common stock if Sony had applied the fair value recognition provisions of FAS No. 123, "Accounting for Stock-Based Compensation", to its stock-based compensation. See Note 17 for detailed assumptions.

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Income before cumulative effect of an accounting change allocated to common stock:				
As reported	¥90,756	¥168,498	¥122,308	$1,046
Deduct: Total stock-based compensation expense determined under the fair value based method, net of related tax effects	(6,334)	(4,690)	(4,182)	(36)
Pro forma	¥84,422	¥163,808	¥118,126	$1,010
Net income allocated to common stock:				
As reported	¥88,639	¥163,785	¥122,308	$1,046
Deduct: Total stock-based compensation expense determined under the fair value based method, net of related tax effects	(6,334)	(4,690)	(4,182)	(36)
Pro forma	¥82,305	¥159,095	¥118,126	$1,010

	Yen			Dollars
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Income before cumulative effect of an accounting change allocated to common stock:				
-Basic EPS:				
As reported	¥98.26	¥180.96	¥122.58	$1.05
Pro forma	91.40	175.92	118.39	1.01
-Diluted EPS:				
As reported	¥89.03	¥162.59	¥116.88	$1.00
Pro forma	82.96	158.10	112.91	0.97
Net income allocated to common stock:				
-Basic EPS:				
As reported	¥95.97	¥175.90	¥122.58	$1.05
Pro forma	89.11	170.86	118.39	1.01
-Diluted EPS:				
As reported	¥87.00	¥158.07	¥116.88	$1.00
Pro forma	80.94	153.58	112.91	0.97

Free distribution of common stock -

On occasion, Sony Corporation may make a free distribution of common stock which is accounted for either by a transfer from additional paid-in capital to the common stock account or with no entry if free shares are distributed from the portion of previously issued shares in the common stock account.

Under the Japanese Commercial Code, a stock dividend can be effected by an appropriation of retained earnings to the common stock account, followed by a free share distribution with respect to the amount appropriated by resolution of the Board of Directors' meeting.

Free distribution of common stock is recorded in the consolidated financial statements only when it becomes effective, except for the calculation and presentation of per share amounts.

Stock issue costs -

Stock issue costs are directly charged to retained earnings, net of tax, in the accompanying consolidated financial statements as the Japanese Commercial Code prohibits charging such stock issue costs to capital accounts which is the prevailing practice in the United States of America.

Revenue recognition -

Revenues from electronics and game sales are recognized upon delivery which is considered to have occurred when the customer has taken title to the product and the risk and rewards of ownership have been substantively transferred. If the sales contract contains a customer acceptance provision, then sales are recognized after customer acceptance occurs or the acceptance provisions lapse.

Revenues from the theatrical exhibition of motion pictures are recognized as the customer exhibits the film. Revenues from the licensing of feature films and television programming are recorded when the material is available for telecast by the licensee and when any restrictions regarding the exhibition or exploitation of the product lapse. Revenues from the sale of home videocassettes and DVDs are recognized upon availability of sale to the public.

Traditional life insurance policies that the life insurance subsidiary writes, most of which are categorized as long-duration contracts, mainly consist of whole life, term life and accident and health insurance contracts. Premiums from these policies are reported as revenue when due from policyholders.

Amounts received as payment for non-traditional contracts such as interest sensitive whole life contracts, single payment endowment contracts, single payment juvenile contracts and other contracts without life contingencies are recognized as deposits to policyholder account balances and included in future insurance policy benefits and other. Revenues from these contracts are comprised of fees earned for administrative and contract-holder services, which are recognized over the period of the contracts, and included in financial service revenue. Property and casualty insurance policies that the non-life insurance subsidiary writes are primarily automotive insurance contracts which are categorized as short-duration contracts. Premiums from these policies are reported as revenue over the period of the contract in proportion to the amount of insurance protection provided.

Accounting for consideration given to a customer or a reseller -

In accordance with EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer or Reseller of the Vendor's Products", cash consideration given to a customer or a reseller including payments for buydowns, slotting fees and cooperative advertising programs, is accounted for as a reduction of revenue unless Sony receives an identifiable benefit (goods or services) in exchange for the consideration, can reasonably estimate the fair value of this benefit and receives documentation from the reseller to support the amounts spent. Any payments meeting these criteria are treated as selling, general and administrative expenses. For the fiscal years ended March 31, 2004, 2005 and 2006, consideration given to a reseller, primarily for free promotional shipping and cooperative advertising programs included in selling, general and administrative expense totaled ¥30,338 million, ¥27,946 million and ¥29,489 million ($252 million), respectively.

Cost of sales -

Costs classified as cost of sales relate to the producing and manufacturing of products and include such items as material cost, subcontractor cost, depreciation of fixed assets, amortization of intangible assets, personnel expenses, research and development costs, and amortization of film cost related to theatrical and television products.

Research and development costs -

Research and development costs are expensed as incurred.

Selling, general and administrative -

Costs classified as selling expense relate to the promoting and selling of products and include such items as advertising, promotion, shipping, and warranty expenses.

General and administrative expenses include operating items such as officer's salaries, personnel expenses, depreciation of fixed assets, office rental for sales, marketing and administrative divisions, a provision for doubtful accounts and amortization of intangible assets.

Selling, general and administrative expenses are expensed as incurred.

Financial service expenses -

Financial service expenses include a provision for policy reserves and amortization of deferred insurance acquisition cost, and all other operating costs such as personnel expenses, depreciation of fixed assets, and office rental of subsidiaries in the Financial Services segment.

Advertising costs -

Advertising costs are expensed when the advertisement or commercial appears in the selected media, except for advertising costs for acquiring new insurance policies which are deferred and amortized as part of insurance acquisition costs.

Shipping and handling costs -

The majority of shipping and handling, warehousing and internal transfer costs for finished goods are included in selling, general and administrative expenses. An exception to this is in the Pictures segment where such costs are charged to cost of sales as they are integral part of producing and distributing the film under SOP 00-2, "Accounting by Producers or Distributors of Films". All other costs related to Sony's distribution network are included in cost of sales, including inbound freight charges, purchasing and receiving costs, inspection costs and warehousing costs for raw materials and in-process inventory. Amounts paid by customers for shipping and handling costs are included in net sales.

Income taxes -

The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Sony records a valuation allowances to reduce deferred tax assets to the amount that management believes is more likely than not to be realized. In assessing the likelihood of realization, Sony considers all currently available evidence for future years, both positive and negative, supplemented by information of historical results for each tax jurisdiction.

Net income per share -

Prior to December 1, 2005, Sony calculated and presented per share data separately for Sony's common stock and for the subsidiary tracking stock by the "two-class" method based on FAS No. 128. As the holders of the subsidiary tracking stock had the right to participate in earnings, together with common stockholders, under this method, basic net income per share ("EPS") for each class of stock was calculated based on the earnings allocated to each class of stock for the applicable period, divided by the weighted-average number of outstanding shares in each class during the applicable period.

The earnings allocated to the subsidiary tracking stock were determined based on the subsidiary tracking stock holders' economic interest in the targeted subsidiary's earnings available for dividends. As defined by Sony Corporation's articles of incorporation, the amount distributable to the subsidiary tracking stock holders was based on the declared dividends of the targeted subsidiary, which might only be declared from the amounts available for dividends of the targeted subsidiary. The targeted subsidiary's earnings available for dividends were, as stipulated by the Japanese Commercial Code, not including those of the targeted subsidiary's subsidiaries. If the targeted subsidiary had accumulated losses, a change in accumulated losses was also allocated to the subsidiary tracking stock. The subsidiary tracking stock holders' economic interest was calculated as the number of the subsidiary tracking stock outstanding divided by the number of the targeted subsidiary's common stock outstanding subject to multiplying by the Standard Ratio (tracking stock : subsidiary's common stock = 1 : 100, as defined in the articles of incorporation). The earnings allocated to the common stock were calculated by subtracting the earnings allocated to the subsidiary tracking stock from Sony's net income for the period.

On October 26, 2005, the Board of Directors of Sony Corporation decided to terminate all shares of subsidiary tracking stock and convert such shares to shares of Sony common stock at a conversion rate of 1.114 share of

Sony common stock per share of subsidiary tracking stock. All shares of subsidiary tracking stock were converted to shares of Sony common stock on December 1, 2005. As a result of the conversion, for the fiscal year ended March 31, 2006, Sony calculated per share data separately for Sony's common stock and for the subsidiary tracking stock by the "two-class" method based on FAS No. 128, but did not present per share data for the subsidiary tracking stock. The earnings allocated to common stock for the fiscal year ended March 31, 2006 were calculated by subtracting the earnings allocated to the subsidiary tracking stock for the eight months ended November 30, 2005.

The computation of diluted net income per common stock reflects the maximum possible dilution from conversion, exercise, or contingent issuance of securities including the conversion of Co-Cos regardless of whether the conditions to exercise the conversion rights have been met.

(3) Recent Pronouncements:

Accounting for Stock-Based Compensation-

In December 2004, the FASB issued FAS No. 123 (revised 2004), "Share-Based Payment" ("FAS No. 123(R)"). This statement requires the use of the fair value based method of accounting for employee stock-based compensation and eliminates the alternative to use of the intrinsic value method prescribed by APB No. 25. With limited exceptions, FAS No. 123(R) requires that the grant-date fair value of share-based payments to employees be expensed over the period the service is received. Sony has accounted for its employee stock-based compensation in accordance with the provisions prescribed by APB No. 25 and its related interpretations and has disclosed the net effect on net income and net income per share allocated to the common stock if Sony had applied the fair value recognition provisions of FAS No. 123 to stock-based compensation as described above in (2) Significant accounting policies - Stock-based compensation. Sony adopted FAS No. 123(R) on April 1, 2006. Sony has elected the modified prospective method of transition prescribed in FAS No. 123(R), which requires that compensation expense be recorded for all unvested stock acquisition rights as the requisite service is rendered beginning with the first period of adoption. As of March 31,2006, the aggregate value of the unvested stock acquisition rights was ¥4,402 million ($38 million). Sony expects the total expenses to be recorded in the future periods will be consistent with the pro forma information shown above in (2) Significant accounting policies - Stock-based compensation.

Inventory Costs -

In November 2004, the FASB issued FAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4". This statement requires certain abnormal expenditures to be recognized as expenses in the current period. It also requires that the amount of fixed production overhead allocated to inventory be based on the normal capacity of the production facilities. This statement shall be effective for fiscal years beginning after June 15, 2005, with early adoption during the fiscal years beginning after the date this statement is issued encouraged. The adoption of FAS No. 151 is not expected to have a material impact on Sony's results of operations and financial position.

Derivative Instruments and hedging activities -

In February 2006, the FASB issued FAS No. 155, "Accounting for Certain Hybrid Financial Instruments", an amendment of FAS No. 133 and FAS No. 140. This statement permits an entity to elect fair value remeasurement for any hybrid financial instrument (with changes in fair value recognized in earnings) if the hybrid instrument contains an embedded derivative that would otherwise be required to be bifurcated and accounted for separately under FAS No. 133. The election to measure the hybrid instrument at fair value is made on an instrument-by-instrument basis and is irreversible. The statement will be effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity's fiscal years beginning after September 15, 2006, with earlier adoption permitted as of the beginning of fiscal year, provided that financial statements for any interim period of that fiscal year have not been issued. The adoption of FAS No. 155 is not expected to have material impact on Sony's results of operations and financial position.

Accounting for Servicing of Financial Assets -

In March 2006, the FASB issued FAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140 ". This statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" with respect to the accounting for separately recognized servicing assets and servicing liabilities. This statement shall be effective for fiscal years beginning after September 15, 2006. Sony is currently evaluating the impact of adopting this new pronouncement.

(4) Reclassifications:

Certain reclassifications of the financial statements for the fiscal years ended March 31, 2004 and 2005 have been made to conform to the presentation for the fiscal year ended March 31, 2006.

3. U.S. dollar amounts

U.S. dollar amounts presented in the financial statements are included solely for the convenience of the reader. These translations should not be construed as representations that the yen amounts actually represent, or have been or could be converted into U.S. dollars. As the amounts shown in U.S. dollars are for convenience only, the rate of ¥117 = U.S.$1, the approximate current rate at March 31, 2006, has been used for the purpose of presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

4. Inventories

Inventories comprise the following:

	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006
Finished products	¥405,616	¥534,766	$4,571
Work in process	93,181	123,381	1,055
Raw materials, purchased components and supplies	132,552	146,577	1,252
	¥631,349	¥804,724	$6,878

5. Film costs

Film costs comprise the following:

	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006
Theatrical:			
Released (including acquired film libraries)	¥119,438	¥153,992	$1,316
Completed not released	11,358	13,377	114
In production and development	118,271	156,019	1,333
Television licensing:			
Released (including acquired film libraries)	29,894	36,918	316
In production and development	-	66	1
	¥278,961	¥360,372	$3,080

Sony estimates that approximately 88% of unamortized costs of released films (excluding amounts allocated to acquired film libraries) at March 31, 2006 will be amortized within the next three years. Approximately ¥102,207 million ($874 million) of released film costs are expected to be amortized during the next twelve months. As of March 31, 2006, unamortized acquired film libraries of approximately ¥10,820 million ($92 million) remained to be amortized on a straight-line basis over an average of the remaining life of 4 years. Approximately ¥137,400 million ($1,174 million) of accrued participation liabilities included in accounts payable, other and accrued expenses are expected to be paid during the next twelve months.

6. Related party transactions

Sony accounts for its investments in affiliated companies over which Sony has significant influence or ownership of 20% or more but less than or equal to 50% under the equity method. In addition, investments in general partnerships in which Sony does not have a controlling interest and limited partnerships are also accounted for under the equity method. Such investments include but are not limited to Sony's interest in Sony Ericsson Mobile Communications, AB (50%), SONY BMG MUSIC ENTERTAINMENT ("SONY BMG") (50%), S-LCD Corporation ("S-LCD") (50% minus 1 share), ST Liquid Crystal Display Corporation (50%), InterTrust Technologies Corporation (49.5%),

Metro-Goldwyn-Mayer Holdings Inc. ("MGM") (20%), bit Wallet, Inc (34.6%), and STAR CHANNEL, INC. (17.8%).

Summarized combined financial information that is based on information provided by equity investees is shown below:

	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006
Current assets	¥942,328	¥991,440	$8,474
Property, plant and equipment	361,408	376,155	3,215
Other assets	250,245	903,873	7,725
Total assets	¥1,553,979	¥2,271,468	$19,414
Current liabilities	¥876,430	¥1,009,895	$8,632
Long-term liabilities	115,999	660,504	5,645
Stockholders' equity	561,550	601,069	5,137
Total liabilities and stockholders' equity	¥1,553,979	¥2,271,468	$19,414
Number of companies at end of the fiscal year	58	58	

	Yen in millions Fiscal Year Ended March 31			Dollars in millions Fiscal Year Ended March 31,
	2004	2005	2006	2006
Sales and revenue	¥1,009,005	¥1,473,273	¥2,357,172	$20,147
Gross profit	231,083	477,796	668,226	5,711
Net income	11,323	63,404	32,982	282

S-LCD, a joint venture with Samsung Electronics Co., LTD focused on manufacturing amorphous TFT panel, was established in April 2004 as a joint venture in which Sony has an ownership interest of 50% minus 1 share. Sony invested ¥100,073 million in S-LCD during the fiscal year ended March 31, 2005.

As of August 1, 2004, Sony combined its recorded music business, except for the operations of its recorded music business in Japan, with the recorded music business of Bertelsmann AG in a joint venture. The newly formed company, known as SONY BMG, is 50% owned by each parent company. As a result, the results of the recorded music business, except for the recorded music business in Japan, are no longer consolidated but are accounted for under the equity method.

On April 8, 2005, a consortium led by Sony Corporation of America ("SCA") and its equity partners, Providence Equity Partners, Texas Pacific Group, Comcast Corporation and DLJ Merchant Banking Partners, completed the acquisition of MGM. Under the terms of the acquisition agreement, the aforementioned investor group acquired MGM for $12.00 in cash per MGM share, for a total purchase price of approximately $5.0 billion. As part of this transaction, Sony Pictures Entertainment ("SPE") co-finances and produces certain new motion pictures with MGM as well as distributes MGM's existing film and television content in most markets through SPE's global distribution channels.

MGM continues to operate under the Metro-Goldwyn-Mayer name as a private company, headquartered in Los Angeles, focused on new film production and distribution activities. As part of the acquisition, SCA invested $257 million for 20% of the total equity capital, which includes both common stock and a significant amount of non-voting preferred stock with detachable common stock warrants. Though Sony owns 20% of MGM's total equity on a fully diluted basis as a result of the warrants dilution, Sony owns 45% of the total outstanding common stock and therefore, records 45% of MGM's net income (loss) as equity in net income of affiliated companies.

In September 2005, Sony sold 230,000 shares of Monex Beans Holdings, Inc. As a result of this sale, Sony's ownership interest has been reduced from 20.1% to 10.3%. Therefore, Monex Beans Holdings, Inc. is no longer accounted for under the equity method. The financial position and operating results of Monex Beans Holdings, Inc. as of and for the fiscal year ended March 31, 2006 are not included in the above summarized combined financial information. See Note 20 for more information on this transaction.

The proportionate share in the underlying net assets of the investee exceeded the carrying value of investments in affiliated companies by ¥42,731 million and ¥36,875 million ($315 million) at March 31, 2005 and 2006, respectively. These differences primarily relate to the differences in the carrying value of the net assets contributed by Sony and Bertelsmann AG upon the formation of SONY BMG in August 2004. The contribution of assets to SONY BMG was accounted for at book value. Acquisitions by Bertelsmann AG's recorded music business shortly prior to the formation of SONY BMG resulted in goodwill comprising a significant portion of the assets contributed to SONY BMG by Bertelsmann AG, whereas Sony's contributed assets had a lower historical basis. As a result, Sony's carrying value of the investment in SONY BMG is below its 50% share of the underlying assets of SONY BMG. As the contributions for both Sony and Bertelsmann AG were recorded at historical book value by SONY BMG, there is a basis difference attributable to a non-depreciable asset which is not being amortized. Differences in the carrying value of Sony's other equity investments and the proportionate share of the fair value of underlying net assets primarily relates to unamortizable goodwill.

Affiliated companies accounted for under the equity method with an aggregate carrying amount of ¥17,676 million and ¥4,588 million ($39 million) at March 31, 2005 and 2006, were quoted on established markets at an aggregate value of ¥95,246 million and ¥34,462 million ($295 million), respectively.

Account balances and transactions with affiliated companies accounted for under the equity method are presented below:

	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006
Accounts receivable, trade	¥50,062	¥44,637	$383
Advances	¥16,756	¥15,985	$137
Accounts payable, trade	¥15,225	¥40,507	$346

	Yen in millions Fiscal Year Ended March 31			Dollars in millions Fiscal Year Ended March 31,
	2004	2005	2006	2006
Sales	¥258,454	¥256,799	¥234,636	$2,005
Purchases	¥106,100	¥101,976	¥282,071	$2,411

As of April 1, 2004, Sony Corporation made Sony Computer Entertainment Inc. ("SCE") a wholly-owned subsidiary through a stock for stock exchange pursuant to the provision of Article 358 of the Japanese Commercial Code which does not require the approval of the General Meeting of Shareholders. The stock for stock exchange ratio was determined based on the estimated equity values of SCE and Sony on a consolidated basis. Through the stock for stock exchange, Sony Corporation provided 1,000,000 shares of its common stock to the then Executive Deputy President, Corporate Executive Officer of Sony Corporation who had owned 100 shares of SCE's common stock. This transaction did not have a material impact on Sony's results of operations and financial position for the fiscal year ended March 31, 2005.

Dividends from affiliated companies accounted for under the equity method for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥3,446 million, ¥13,391 million and ¥22,970 million ($197 million), respectively.

7. Accounts receivable securitization programs

In Japan, Sony set up several accounts receivable sales programs whereby Sony can sell up to ¥47,500 million ($406 million) of eligible trade accounts receivable. Through these programs, Sony can sell receivables to special purpose entities owned and operated by banks. Sony can sell receivables in which the agreed upon original due dates are no more than 190 days after the sales of receivables. These transactions are accounted for as sales in accordance with FAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", because Sony has relinquished control of the receivables. The initial sale of these receivables was in March 2005 in which Sony sold a total of ¥10,041 million. Sony sold a total of ¥146,193 million ($1,250 million) of receivables during the

fiscal year ended March 31, 2006. Losses from these transactions were insignificant. Although Sony continues servicing the sold receivables, no servicing liabilities are recorded because costs for collection of the sold receivables are insignificant.

Through May 2005, Sony had set up an accounts receivable securitization program in the United States of America whereby Sony could sell interests in up to $500 million of eligible trade accounts receivable, as defined. Through this program, Sony could securitize and sell a percentage of an undivided interest in that pool of receivables to several multi-seller commercial paper conduits owned and operated by a bank. Sony could sell receivables in which the agreed upon original due dates were no more than 90 days after the invoice dates. The value assigned to undivided interests retained in securitized trade receivables was based on the relative fair values of the interest retained and sold in the securitization. Sony had assumed that the fair value of the retained interest was equivalent to its carrying value as the receivables were short-term in nature, high quality and had appropriate reserves for bad debt incidence. These securitization transactions were accounted for as a sale in accordance with FAS No. 140, because Sony had relinquished control of the receivables. During the period from April 2004 to January 2005, Sony sold a total of ¥80,250 million of accounts receivable under this program. There were no outstanding amounts due at March 31, 2005 relating to the existing undivided interests in the pool of receivables that had been sold. Losses from these transactions were insignificant. This program was terminated in May 2005.

8. Marketable securities and securities investments and other

Marketable securities and securities investments and other include debt and equity securities of which the aggregate cost, gross unrealized gains and losses and fair value pertaining to available-for-sale securities and held-to-maturity securities are as follows:

	Yen in millions							
	March 31, 2005				March 31, 2006			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Available-for-sale:								
Debt securities	¥2,090,605	¥58,161	¥(2,464)	¥2,146,302	¥2,522,864	¥17,021	¥(22,810)	¥2,517,075
Equity securities	107,128	49,350	(814)	155,662	227,079	171,921	(1,589)	397,411
Held-to-maturity Securities	27,431	530	(13)	27,948	33,193	132	(221)	33,104
Total	¥2,225,162	¥108,041	¥(3,291)	¥2,329,912	¥2,783,136	¥189,074	¥(24,620)	¥2,947,590

	Dollars in millions			
	March 31, 2006			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Available-for-sale:				
Debt securities	$21,563	$145	$(195)	$21,513
Equity securities	1,941	1,470	(14)	3,397
Held-to-maturity Securities	283	1	(1)	283
Total	$23,787	$1,616	$(210)	$25,193

At March 31, 2006, debt securities classified as available-for-sale securities and held-to-maturity securities mainly consist of Japanese government and municipal bonds and corporate debt securities with maturities of one to ten years.

Proceeds from sales of available-for-sale securities were ¥397,817 million, ¥613,035 million and ¥524,268 million ($4,481 million) for the fiscal years ended March 31, 2004, 2005 and 2006, respectively. On those sales, gross realized gains computed on the average cost basis were ¥9,525 million, ¥24,080 million and ¥68,096 million ($582 million) and gross realized losses were ¥1,906 million, ¥5,940 million and ¥3,143 million ($27 million), respectively.

Marketable securities classified as trading securities at March 31, 2005 and 2006 were ¥315,946 million and ¥401,561 million ($3,432 million), respectively, which consist of debt and equity securities including short-term investments in money market funds.

In the ordinary course of business, Sony maintains long-term investment securities, included in securities investments and other, issued by a number of non-public companies. The aggregate carrying amounts of the investments in non-public companies at March 31, 2005 and 2006, were ¥48,877 million and ¥59,575 million ($509

million), respectively. Non-public equity investments are valued at cost as fair value is not readily determinable. If the value is estimated to have declined and such decline is judged to be other than temporary, the impairment of the investment is recognized and the carrying value is reduced to its fair value.

For the fiscal years ended March 31, 2004, 2005 and 2006, Sony booked ¥4,988 million, ¥5,696 million and ¥45,092 million ($ 385 million) of net unrealized gain on trading securities primarily in the life insurance business.

The following table presents the gross unrealized losses on, and fair value of, Sony's investment securities with unrealized losses, aggregated by investment category and the length of time that individual investment securities have been in a continuous unrealized loss position, at March 31, 2006.

	Yen in millions					
	Less than 12 months		12 months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Available-for-sale:						
Debt securities	¥1,860,204	¥(22,590)	¥21,250	¥(220)	¥1,881,454	¥(22,810)
Equity securities	266,946	(1,108)	17,495	(481)	284,441	(1,589)
Held-to-maturity securities	20,278	(208)	629	(13)	20,907	(221)
Total	¥2,147,428	¥(23,906)	¥39,374	¥(714)	¥2,186,802	¥(24,620)

	Dollars in millions					
	Less than 12 months		12 months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Available-for-sale:						
Debt securities	$15,899	$(193)	$182	$(2)	$16,081	$(195)
Equity securities	2,282	(10)	149	(4)	2,431	(14)
Held-to-maturity securities	173	(1)	6	(0)	179	(1)
Total	$18,354	$(204)	$337	$(6)	$18,691	$(210)

In evaluating the factors for available-for-sale securities whose fair values are readily determinable, Sony presumes a decline in value to be other-than-temporary if the fair value of the security is 20 percent or more below its original cost for an extended period of time (generally a period of up to six to twelve months). This criteria is employed as a threshold to identify securities which may have a decline in value that is other-than-temporary. The presumption of an other-than-temporary impairment in such cases may be overcome if there is evidence to support that the decline is temporary in nature due to the existence of other factors which overcome the duration or magnitude of the decline. On the other hand, there may be cases where impairment losses are recognized when the decline in the fair value of the security is not more than 20 percent or such decline has not existed for an extended period of time, as a result of considering specific factors which may indicate the decline in the fair value is other-than-temporary.

At March 31, 2006, Sony determined that the decline in value for securities with unrealized losses shown in the above table is not other-than-temporary in nature.

9. Leased assets

Sony leases certain communication and commercial equipment, plant, office space, warehouses, employees' residential facilities and other assets. Certain of these leases have renewal and purchase options.

An analysis of leased assets under capital leases is as follows:

Class of property	Yen in millions March 31 2005	Yen in millions March 31 2006	Dollars in millions March 31, 2006
Land	¥181	¥193	$2
Buildings	11,089	7,437	64
Machinery, equipment and others	33,747	28,870	247
Accumulated depreciation	(18,509)	(14,820)	(128)
	¥26,508	¥21,680	$185

The following is a schedule by year of the future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of March 31, 2006:

	Yen in millions	Dollars in millions
Fiscal Year Ending March 31:		
2007	¥18,322	$157
2008	9,650	82
2009	5,325	46
2010	3,081	26
2011	2,149	18
Later years	4,725	40
Total minimum lease payments	43,252	369
Less - Amount representing interest	4,972	42
Present value of net minimum lease payments	38,280	327
Less - Current obligations	16,966	145
Long-term capital lease obligations	¥21,314	$182

Minimum lease payments have not been reduced by minimum sublease income of ¥10,022 million ($86 million) due in the future under noncancelable subleases.

Minimum rental expenses under operating leases for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥92,649 million, ¥81,391 million and ¥80,014million ($684 million), respectively. Sublease rentals received under operating leases for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥2,923 million, ¥1,933 million and ¥1,350 million ($12 million), respectively. The total minimum rentals to be received in the future under noncancelable subleases as of March 31, 2006 were ¥21,843 million ($187 million). The minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year at March 31, 2006 are as follows:

	Yen in millions	Dollars in millions
Fiscal Year Ending March 31:		
2007	¥47,500	$406
2008	34,715	297
2009	26,529	227
2010	16,320	139
2011	11,541	98
Later years	58,932	504
Total minimum future rentals	¥195,537	$1,671

10. Goodwill and Intangible assets

Intangible assets acquired during the fiscal year ended March 31, 2006 totaled ¥36,237 million ($310 million), which are subject to amortization and primarily consist of acquired patent rights of ¥9,922 million ($85 million) and software to be sold, leased or otherwise marketed of ¥17,653 million ($151 million). The weighted average amortization period for acquired patent rights and software to be sold, leased or otherwise marketed is 8 years and 3 years, respectively.

Intangible assets subject to amortization comprise the following:

	Yen in millions				Dollars in millions	
	March 31				March 31,	
	2005		2006		2006	
	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated Amortization
Artist contracts	¥15,218	¥(11,094)	¥15,218	¥(12,218)	$130	$(104)
Music catalog	65,674	(19,641)	71,921	(24,012)	615	(205)
Acquired patent rights	55,173	(26,139)	67,467	(30,200)	577	(258)
Software to be sold, leased or otherwise marketed	31,807	(16,181)	40,007	(24,194)	342	(207)
Other	27,648	(11,625)	40,978	(15,133)	350	(130)
Total	¥195,520	¥(84,680)	¥235,591	¥(105,757)	$2,014	$(904)

The aggregate amortization expenses for intangible assets for the fiscal years ended March 31, 2004, 2005 and 2006 was ¥28,866 million, ¥24,993 million and ¥28,390 million ($243 million), respectively. The estimated aggregate amortization expense for intangible assets for the next five years is as follows:

	Yen in millions	Dollars in millions
Year Ending March 31,		
2007	¥31,636	$270
2008	24,862	212
2009	18,857	161
2010	15,593	133
2011	9,125	78

Total carrying amount of intangible assets having an indefinite life comprise the following:

	Yen in millions		Dollars in millions
	March 31		March 31,
	2005	2006	2006
Trademarks	¥57,195	¥58,195	$497
Distribution agreement	18,848	18,848	161
	¥76,043	¥77,043	$658

The changes in the carrying amount of goodwill by operating segment for the fiscal years ended March 31, 2005 and 2006 are as follows:

	Yen in millions					
	Electronics	Game	Pictures	Financial Services	All Other	Total
Balance at March 31, 2004	¥52,236	¥110,362	¥70,789	-	¥44,483	¥277,870
Reallocated from Music business to Electronics segment	12,329	-	-	-	(12,329)	-
Goodwill acquired during year	5,872	4,349	5,868	¥441	2,121	18,651
Goodwill contributed to the Joint Venture with Bertelsmann AG	-	-	-	-	(15,626)	(15,626)
Other *	378	29	1,277	-	1,344	3,028
Balance at March 31, 2005	70,815	114,740	77,934	441	19,993	283,923
Goodwill acquired during year	3,337	1,317	947	536	382	6,519
Reallocated from Music business to Electronics segment	634	-	-	-	(634)	-
Impairment losses	-	-	-	-	(534)	(534)
Other *	1,577	207	7,031	-	301	9,116
Balance at March 31, 2006	¥76,363	¥116,264	¥85,912	¥977	¥19,508	¥299,024

	Dollars in millions					
	Electronics	Game	Pictures	Financial Services	All Other	Total
Balance at March 31, 2005	$605	$981	$666	$4	$171	$2,427
Goodwill acquired during year	29	11	8	5	3	56
Reallocated from Music business to Electronics segment	5	-	-	-	(5)	-
Impairment losses	-	-	-	-	(5)	(5)
Other *	14	2	60	-	2	78
Balance at March 31, 2006	$653	$994	$734	$9	$166	$2,556

*Other consists of translation adjustments and reclassification to/from other accounts.

As discussed in Notes 6 and 25, as of August 1, 2004, Sony and Bertelsmann AG combined their recorded music business in a joint venture. In connection with the establishment of the joint venture, assets contributed by Sony included ¥15,626 million of goodwill. In addition, the non-Japan based disc manufacturing and physical distribution businesses, formerly included within the Music segment, have been reclassified to the Electronics segment and accordingly, Sony reallocated ¥12,329 million of goodwill relating to the non-Japan based disc manufacturing and physical distribution business from the Music segment to the Electronics segment. Effective April 1, 2005, a similar change was made with respect to the Japan based disc manufacturing businesses and accordingly, Sony reallocated ¥634 million ($5 million) of goodwill from the Music segment to the Electronics segment. Consistent with the presentation of business segment information in Note 25, the Music segment is included within All Other.

During the year ended March 31, 2006 Sony performed the annual impairment test for goodwill and recorded an impairment loss of ¥534 million ($5 million) in a reporting unit included in All Other. This impairment charge reflected

the overall decline in the fair value of a subsidiary. The fair value of the subsidiary was estimated principally using the expected present value of future cash flows.

11. Insurance-related accounts

Sony's life and non-life insurance subsidiaries in Japan maintain their accounting records as described in Note 2 in accordance with the accounting principles and practices generally accepted in Japan, which vary in some respects from U.S. GAAP.

Those differences are mainly that insurance acquisition costs for life and non-life insurance are charged to income when incurred in Japan whereas in the United States of America those costs are deferred and amortized generally over the premium-paying period of the related insurance policies, and that future policy benefits for life insurance calculated locally under the authorization of the supervisory administrative agencies are comprehensively adjusted to a net level premium method with certain adjustments of actuarial assumptions for U.S. GAAP purposes. For purposes of preparing the consolidated financial statements, appropriate adjustments have been made to reflect such items in accordance with U.S. GAAP.

The amounts of statutory net equity of the subsidiaries as of March 31, 2005 and 2006 were ¥153,228 million and ¥229,543 million ($1,962 million), respectively.

(1) Insurance policies:

Life insurance policies that the life insurance subsidiary writes, most of which are categorized as long-duration contracts, mainly consist of whole life, term life and accident and health insurance contracts. The life insurance revenues for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥437,835 million, ¥426,774 million and ¥453,496 million ($3,876 million), respectively. Property and casualty insurance policies that the non-life insurance subsidiary writes are primarily automotive insurance contracts which are categorized as short-duration contracts. The non-life insurance revenues for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥28,371 million, ¥35,454 million and ¥42,743 million ($365 million), respectively.

(2) Deferred insurance acquisition costs:

Insurance acquisition costs, including such items as commission, medical examination and inspection report fees, that vary with and are primarily related to acquiring new insurance policies are deferred as long as they are recoverable. The deferred insurance acquisition costs for traditional life insurance contracts are amortized over the premium-paying period of the related insurance policies using assumptions consistent with those used in computing policy reserves. The deferred insurance acquisition costs for non-traditional life insurance contracts are amortized over the expected life in proportion to the estimated gross profits. Amortization charged to income for the fiscal years ended March 31, 2004, 2005 and 2006 amounted to ¥50,492 million, ¥47,120 million and ¥42,933 million ($367 million), respectively.

(3) Future insurance policy benefits:

Liabilities for future policy benefits are established in amounts adequate to meet the estimated future obligations of policies in force. These liabilities are computed by the net level premium method based upon estimates as to future

investment yield, mortality, morbidity and withdrawals. Future policy benefits are computed using interest rates ranging from approximately 0.90% to 5.10%. Mortality, morbidity and withdrawal assumptions for all policies are based on either the subsidiary's own experience or various actuarial tables. At March 31, 2005 and 2006, future insurance policy benefits amounted to ¥1,782,850 million and ¥1,901,716 million ($16,254 million), respectively.

12. Short-term borrowings and long-term debt

Short-term borrowings comprise the following:

	Yen in millions		Dollars in millions
	March 31		March 31,
	2005	2006	2006
Unsecured loans, principally from banks:			
with weighted-average interest rate of 2.79%	¥38,796		
with weighted-average interest rate of 3.63%		¥32,066	$274
Secured call money:			
with weighted-average interest rate of 0.01%	-	40,000	342
Secured bills sold:			
with weighted-average interest rate of 0.00%	24,600		
with weighted-average interest rate of 0.01%		70,700	604
	¥63,396	¥142,766	$1,220

At March 31, 2006, marketable securities and securities investments with a book value of ¥119,598 million ($1,022 million) were pledged as collateral for call money and bills sold by a Japanese bank subsidiary.

Long-term debt comprises the following:

	Yen in millions		Dollars in millions
	March 31		March 31,
	2005	2006	2006
Secured loans, representing obligations to banks:			
Due 2005 to 2008 with interest of 2.20% per annum	¥ 1,122	-	-
Unsecured loans, representing obligations principally to banks:			
Due 2005 to 2017 with interest ranging from 0.23% to 5.89% per annum	113,436		
Due 2006 to 2015 with interest ranging from 0.13% to 5.89% per annum		¥128,148	$1,095
Medium-term notes of consolidated subsidiaries:			
Due 2006 with interest ranging from 2.78% to 4.95% per annum	58,755		
Due 2006 with interest of 4.95% per annum		58,698	502
Unsecured zero coupon convertible bonds, due 2008, convertible currently at ¥5,605 ($48) for one common share, redeemable before due date	250,000	250,000	2,137
Unsecured 0.1% bonds, due 2005 with detachable warrants, net of unamortized discount	3,981	-	-
Unsecured 1.55% bonds, due 2006 with detachable warrants	12,000	12,000	103
Unsecured 0.9% bonds, due 2007 with detachable warrants	7,300	7,300	62
Unsecured 0.9% bonds, due 2007 with detachable warrants	150	150	1
Unsecured 1.42% bonds, due 2005, net of unamortized discount	99,998	-	-
Unsecured 0.64% bonds, due 2006, net of unamortized discount	99,996	99,999	855
Unsecured 1.01% bonds, due 2010, net of unamortized discount	-	39,996	342
Unsecured 2.04% bonds, due 2010, net of unamortized discount	49,984	49,987	427
Unsecured 0.80% bonds, due 2010, net of unamortized discount	-	49,991	427
Unsecured 1.52% bonds, due 2011, net of unamortized discount	49,997	49,997	427
Unsecured 1.16% bonds, due 2012, net of unamortized discount	-	39,981	342
Unsecured 1.52% bonds, due 2013, net of unamortized discount	-	34,997	299
Unsecured 1.57% bonds, due 2015, net of unamortized discount	-	29,980	256
Unsecured 1.75% bonds, due 2015, net of unamortized discount	-	24,993	214
Unsecured 2.0% bonds, due 2005	15,000	-	-
Unsecured 1.99% bonds, due 2007	15,000	15,000	128
Unsecured 2.35% bonds, due 2010	4,900	4,900	42
Capital lease obligations:			
Due 2005 to 2019 with interest ranging from 1.55% to 30.00% per annum	40,301		
Due 2006 to 2019 with interest ranging from 1.45% to 16.00% per annum		38,280	327
Guarantee deposits received	23,942	24,056	206
	845,862	958,453	8,192
Less - Portion due within one year	166,870	193,555	1,654
	¥678,992	¥764,898	$6,538

There are no adverse debt covenants or cross-default provisions relating to Sony's borrowings.

A summary of the exercise rights of the detachable warrants as of March 31, 2006 is as follows:

Issued on	Exercisable during	Exercise price Yen	Exercise price Dollars	Number of shares per warrant	Status of exercise
October 19, 2000	November 1, 2001 through October 18, 2006	12,457	106	100 shares of common stock of Sony Corporation	9,224 warrants outstanding
December 21, 2001	January 6, 2003 through December 20, 2007	6,039	52	100 shares of common stock of Sony Corporation	11,459 warrants outstanding

Aggregate amounts of annual maturities of long-term debt during the next five years are as follows:

Fiscal Year Ending March 31	Yen in millions	Dollars in millions
2007	¥193,555	$1,654
2008	32,781	280
2009	285,924	2,444
2010	66,431	568
2011	110,762	947

At March 31, 2006, Sony had unused committed lines of credit amounting to ¥676,449 million ($5,782 million) and can generally borrow up to 90 days from the banks with whom Sony has committed line contracts. Furthermore, Sony has Commercial Paper Programs, the size of which was ¥1,321,940 million ($11,299 million). There was no commercial paper outstanding at March 31, 2006. Under those programs, Sony can issue commercial paper for the period generally not in excess of 270 days up to the size of the programs. In addition, Sony has Medium Term Notes programs, the size of which was ¥587,100 million ($5,018 million). At March 31, 2006, the total outstanding balance of Medium Term Notes was ¥58,698 million ($502 million).

13. Deposits from customers in the banking business

All deposits from customers in the banking business are interest bearing deposits, and are owned by a Japanese bank subsidiary which was established as an Online Internet bank for individuals. At March 31, 2005 and 2006, the balance of time deposits issued in amounts of ¥10 million ($85 thousand) or more were ¥67,387 million and ¥75,459 million ($645 million), respectively.

At March 31, 2006, aggregate amounts of annual maturities of time deposits with a remaining term of more than one year are as follows:

Fiscal Year Ending March 31	Yen in millions	Dollars in millions
2008	¥30,568	$261
2009	20,657	177
2010	200	2
2011	6,637	57
2012	38	0

14. Financial Instruments

(1) Derivative instruments and hedging activities:

Sony has certain financial instruments including financial assets and liabilities incurred in the normal course of business. Such financial instruments are exposed to market risk arising from the changes of foreign currency exchange rates and interest rates. In applying a consistent risk management strategy for the purpose of reducing such risk, Sony uses derivative financial instruments, which include foreign exchange forward contracts, foreign currency option contracts, and interest rate and currency swap agreements. Foreign exchange forward contracts and foreign currency option contracts are utilized primarily to limit the exposure affected by changes in foreign currency exchange rates on cash flows generated by anticipated intercompany transactions and intercompany accounts receivable and payable denominated in foreign currencies. Interest rate and currency swap agreements are utilized primarily to lower funding costs, to diversify sources of funding and to limit Sony's exposure associated with underlying debt instruments and available-for-sale debt securities resulting from adverse fluctuations in interest rates, foreign currency exchange rates and changes in the fair value. These instruments are executed with creditworthy financial institutions, and virtually all foreign currency contracts are denominated in U.S. dollars, euros and other currencies of major countries. Although Sony may be exposed to losses in the event of nonperformance by counterparties or unfavorable interest and currency rate movements, it does not anticipate significant losses due to the nature of Sony's counterparties or the hedging arrangements. These derivatives generally mature or expire within 6 months after the balance sheet date. Sony does not use these derivative financial instruments for trading or speculative purposes except for certain derivatives utilized for portfolio investments such as interest rate swap agreements and bond future contracts in the Financial Services segment. These derivative transactions utilized for portfolio investments in the Financial Services segment are executed within a certain limit in accordance with an internal risk management policy.

Derivative financial instruments held by Sony are classified and accounted for as described below pursuant to

FAS No. 133.

Fair value hedges

The derivatives designated as fair value hedges include interest rate and currency swap agreements.

Both the derivatives designated as fair value hedges and the hedged items are reflected at fair value in the consolidated balance sheet. Changes in the fair value of the derivatives designated as fair value hedges as well as offsetting changes in the carrying value of the underlying hedged items are recognized in income.

For the fiscal years ended March 31, 2004 and 2005, the amount of ineffectiveness of these fair value hedges, that was reflected in earnings, was not material. For the fiscal year ended March 31, 2006, these fair value hedges were fully effective. In addition, there were no amounts excluded from the assessment of hedge effectiveness of fair value hedges.

Cash flow hedges

The derivatives designated as cash flow hedges include foreign exchange forward contracts, foreign currency option contracts and interest rate and currency swap agreements.

Changes in the fair value of derivatives designated as cash flow hedges are initially recorded in other comprehensive income and reclassified into earnings when the hedged transaction affects earnings. For the fiscal years ended March 31, 2004 and 2006, these cash flow hedges were fully effective. For the fiscal year ended March 31, 2005, the amount of ineffectiveness of these cash flow hedges that was reflected in earnings was not material. In addition, there were no amounts excluded from the assessment of hedge effectiveness of cash flow hedges. At March 31, 2006, amounts related to derivatives qualifying as cash flow hedges amounted to a net reduction of equity of ¥2,049 million ($18 million). Within the next twelve months, ¥1,453 million ($12 million) is expected to be reclassified from equity into earnings as loss. For the fiscal year ended March 31, 2006, there were no forecasted transactions that failed to occur which resulted in the discontinuance of cash flow hedges.

Derivatives not designated as hedges

The derivatives not designated as hedges under FAS No. 133 include foreign exchange forward contracts, foreign currency option contracts, interest rate and currency swap agreements, interest rate and bond future contracts, stock price index option contracts, convertible rights included in convertible bonds and other derivatives. Changes in the fair value of derivatives not designated as hedges are recognized in income.

A description of the purpose and classification of the derivative financial instruments held by Sony is as follows:

Foreign exchange forward contracts and foreign currency option contracts

Sony enters into foreign exchange forward contracts and purchased and written foreign currency option contracts primarily to fix the cash flows from intercompany accounts receivable and payable and forecasted transactions denominated in functional currencies (Japanese yen, U.S. dollars and euros) of Sony's major operating units. The majority of written foreign currency option contracts are a part of range forward contract arrangements and expire in the same month with the corresponding purchased foreign currency option contracts.

Sony also enters into foreign exchange forward contracts, which effectively fix the cash flows from foreign currency denominated debt. Accordingly, these derivatives have been designated as cash flow hedges in

accordance with FAS No. 133.

Foreign exchange forward contracts and foreign currency option contracts that do not qualify as hedges are marked-to-market with changes in value recognized in other income and expenses.

Foreign exchange forward contracts and foreign currency option contracts held by certain subsidiaries in the Financial Services segment are marked-to-market with changes in value recognized in financial service revenue.

Interest rate and currency swap agreements

Sony enters into interest rate and currency swap agreements, which are used for reducing the risk arising from the changes in the fair value of fixed rate debt and available-for-sale debt securities. For example, Sony enters into interest rate and currency swap agreements, which effectively swap foreign currency denominated fixed rate debt for functional currency denominated variable rate debt. These derivatives are considered to be a hedge against changes in the fair value of Sony's foreign denominated fixed-rate obligations. Accordingly, these derivatives have been designated as fair value hedges in accordance with FAS No. 133.

Sony also enters into interest rate and currency swap agreements that are used for reducing the risk arising from the changes in anticipated cash flow of variable rate debt and foreign currency denominated debt. For example, Sony enters into interest rate and currency swap agreements, which effectively swap foreign currency denominated variable rate debt for functional currency denominated fixed rate debt. These derivatives are considered to be a hedge against changes in the anticipated cash flow of Sony's foreign denominated variable rate obligations. Accordingly, these derivatives have been designated as cash flow hedges in accordance with FAS No. 133.

Certain subsidiaries in the Financial Services segment have interest rate swap agreements as part of their portfolio investments, which are marked-to-market with changes in value recognized in financial service revenue. Interest rate and currency swap agreements held by certain subsidiaries in the Financial Services segment are also marked-to-market with changes in value recognized in financial service revenue.

Any other interest rate swap agreements that do not qualify as hedges, which are used for reducing the risk arising from changes of variable rate debt, are marked-to-market with changes in value recognized in other income and expenses.

Interest rate and bond future contracts

Certain subsidiaries in the Financial Services segment have interest rate and bond future contracts as part of their portfolio investments, which are marked-to-market with changes in value recognized in financial service revenue.

Stock price index option contracts

Certain subsidiaries in the Financial Services segment have stock price index option contracts as part of their portfolio investments, which are marked-to-market with changes in value recognized in financial service revenue.

Embedded derivatives

Changes in the fair value of embedded derivatives that must be separated from the host contracts and accounted for as derivative instruments under FAS No. 133 are recognized in income. For example, the convertible rights included in convertible bonds held by Sony's life insurance subsidiary, which are classified as available-for-sale debt securities, are considered embedded derivatives and are marked-to-market with changes in value recognized

in financial service revenue.

(2) Fair value of financial instruments:

The estimated fair values of Sony's financial instruments are summarized as follows. The following summary excludes cash and cash equivalents, time deposits, notes and accounts receivable, trade, short-term borrowings, notes and accounts payable, trade and deposits from customers in the banking business that are carried at amounts which approximate fair value. The summary also excludes debt and equity securities which are disclosed in Note 8.

	Yen in millions					
	March 31					
	2005			2006		
	Notional amount	Carrying amount	Estimated fair value	Notional amount	Carrying amount	Estimated fair value
Long-term debt including the current portion	—	¥(845,862)	¥(856,321)	—	¥(958,453)	¥(981,006)
Foreign exchange forward contracts	¥1,545,814	(55)	(55)	¥1,489,213	1,184	1,184
Currency option contracts purchased	428,261	1,646	1,646	457,380	2,540	2,540
Currency option contracts written	146,506	(3,390)	(3,390)	163,746	(2,576)	(2,576)
Interest rate swap agreements	147,024	(2,968)	(2,968)	172,430	(165)	(165)
Interest rate and currency swap agreements	29,643	(1,318)	(1,318)	14,518	(488)	(488)
Interest rate future contracts	136,470	(92)	(92)	—	—	—
Bond future contracts	7,225	45	45	13,934	111	111
Stock price index option purchased	—	—	—	26,650	40	40
Embedded derivatives	405,756	11,894	11,894	411,252	70,712	70,712

	Dollars in millions		
	March 31, 2006		
	Notional amount	Carrying amount	Estimated Fair value
Long-term debt including the current portion	—	$(8,192)	$(8,385)
Foreign exchange forward contracts	$12,728	10	10
Currency option contracts purchased	3,909	22	22
Currency option contracts written	1,400	(22)	(22)
Interest rate swap agreements	1,473	(1)	(1)
Interest rate and currency swap agreements	124	(4)	(4)
Interest rate future contracts	—	—	—
Bond future contracts	119	1	1
Stock price index option purchased	228	0	0
Embedded derivatives	3,515	604	604

The following are explanatory notes regarding the estimation method of fair values in the above table.

Long-term debt including the current portion

The fair values of long-term debt, including the current portion, were estimated based on either the market value or the discounted amounts of future cash flows using Sony's current incremental debt rates for similar liabilities.

Derivative financial instruments

The fair values of foreign exchange forward contracts and foreign currency option contracts were estimated based on market quotations. The fair values of interest rate and currency swap agreements were estimated based on the discounted amounts of future net cash flows. The fair values of convertible rights, which were a majority of embedded derivatives, were estimated based on the market price of stock which will be acquired by the exercise of these rights.

15. Pension and severance plans

Upon terminating employment, employees of Sony Corporation and its subsidiaries in Japan are entitled, under most circumstances, to lump-sum indemnities or pension payments as described below. For employees voluntarily retiring, payments are determined based on current rates of pay and lengths of service. In calculating the payments for employees involuntarily retiring, including employees retiring due to meeting mandatory retirement age requirements, Sony may grant additional benefits.

In July, 2004, Sony Corporation and certain of its subsidiaries amended their pension plans and introduced a point-based plan under which a point is added every year reflecting the individual employee's performance over that year. Under the point-based plan the amount of payment is determined based on sum of cumulative points from past services and interest points earned on the cumulative points regardless of whether or not the employee is voluntarily retiring. As a result of the plan amendment, the projected benefit obligation was decreased by ¥120,873 million.

Sony Corporation and most of its subsidiaries in Japan had contributory funded defined benefit pension plans pursuant to the Japanese Welfare Pension Insurance Law, which consisted of a substitutional portion of the governmental welfare pension program and an additional portion which was established at the discretion of each employer. In June, 2001, the Japanese Government issued the Defined Benefit Corporate Pension Plan Act, which permits each employer and employees' pension fund plan to separate the substitutional portion from its employees' pension fund and transfer the obligation and related assets to the government. In July, 2004, in accordance with the law, the Japanese Government approved applications submitted by Sony Corporation and most of its subsidiaries in Japan for an exemption from the obligation to pay benefits for future employee services related to the substitutional portion of the governmental welfare pension program. In January 2005, the government also approved applications for an exemption from the obligation to pay benefits for past employee services related to the substitutional portion. On September 20, 2005, the benefit obligation for past employee services related to the substitutional portion and the related government-specified portion of the plan assets were transferred to the government. As a result of the transfer to the government of the substitutional portion, as of March 31, 2006, Sony Corporation and most of its subsidiaries in Japan maintain contributory funded defined benefit plans, which were established by succeeding the additional portion established at the discretion of each employer, pursuant to the Corporate Defined Benefit Pension Plan Law.

Under the contributory pension plans, the defined benefits representing the noncontributory portion of the plans, in general, cover 65% of the indemnities under existing regulations to employees. The remaining indemnities are covered by severance payments by the companies. The pension benefits are payable at the option of the retiring employee either in a lump-sum amount or monthly pension payments. Contributions to the plans are funded through several financial institutions in accordance with the applicable laws and regulations.

EITF Issue No. 03-2, "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities", requires employers to account for the entire separation process of a substitutional

portion from an entire plan upon completion of the transfer of the substitutional portion of the benefit obligation and related plan assets to the government as the culmination of a series of steps in a single settlement transaction. In accordance with EITF Issue No. 03-2, Sony recognized a government subsidy of ¥133,322 million ($1,140 million), a derecognition of previously accrued salary progression of ¥40,403 million ($345 million) and a settlement loss of ¥100,253 million ($857 million). The net gain of ¥73,472 million ($628 million) is included in selling, general and administrative expenses for the fiscal year ended March 31, 2006.

Many foreign subsidiaries have defined benefit pension plans or severance indemnity plans, which substantially cover all of their employees. Under such plans, the related cost of benefits is currently funded or accrued. Benefits awarded under these plans are based primarily on the current rate of pay and length of service.

Sony uses a measurement date of March 31 for substantially all of its pension and severance plans.

The components of net pension and severance costs, which exclude employee termination benefits paid in restructuring activities, for the fiscal years ended March 31, 2004, 2005 and 2006 were as follows:

Japanese plans:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Service cost	¥54,501	¥31,971	¥26,561	$227
Interest cost	19,489	21,364	16,504	141
Expected return on plan assets	(22,812)	(16,120)	(17,290)	(148)
Amortization of net transition asset	(375)	(375)	(104)	(1)
Recognized actuarial loss	31,019	20,236	14,393	123
Amortization of prior service cost	(939)	(7,216)	(10,229)	(87)
Gains on curtailments and settlements	—	(876)	—	—
Settlement loss resulting from the transfer of the substitutional portion	—	—	59,850	512
Net periodic benefit cost	¥80,883	¥48,984	¥89,685	$767

Foreign plans:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Service cost	¥11,252	¥6,419	¥6,852	$59
Interest cost	8,566	8,091	8,318	71
Expected return on plan assets	(6,812)	(6,712)	(7,112)	(61)
Amortization of net transition asset	(27)	(18)	21	0
Recognized actuarial loss	1,569	1,637	1,674	14
Amortization of prior service cost	(117)	(114)	(240)	(2)
Losses on curtailments and settlements	5,574	1,713	915	8
Net periodic benefit cost	¥20,005	¥11,016	¥10,428	$89

The changes in benefit obligation and plan assets, funded status and composition of amounts recognized in the consolidated balance sheets were as follows:

	Japanese plans			Foreign plans		
	Yen in millions		Dollars in millions	Yen in millions		Dollars in millions
	March 31		March 31,	March 31		March 31,
	2005	2006	2006	2005	2006	2006
Change in benefit obligation:						
Benefit obligation at beginning of the fiscal year	¥993,542	¥901,726	$7,707	¥155,838	¥153,598	$1,313
Service cost	31,971	26,561	227	6,419	6,852	59
Interest cost	21,364	16,504	141	8,091	8,318	71
Plan participants' contributions	2,111	—	—	873	609	5
Amendments	(120,873)	(11,522)	(98)	286	238	2
Actuarial (gain) loss	1,641	(3,200)	(27)	12,210	20,183	173
Foreign currency exchange rate changes	—	—	—	14,288	17,506	149
Curtailments and settlements	(2,988)	—	—	(628)	(4,485)	(38)
Benefits paid	(25,042)	(18,630)	(160)	(11,639)	(8,670)	(74)
Divestiture	—	—	—	(32,140)	—	—
Transfer of the substitutional portion to the government	—	(291,570)	(2,492)	—	—	—
Benefit obligation at end of the fiscal year	¥901,726	¥619,869	$5,298	¥153,598	¥194,169	$1,660
Change in plan assets:						
Fair value of plan assets at beginning of the fiscal year	¥513,095	¥534,451	$4,568	¥85,662	¥92,025	$786
Actual return (loss) on plan assets	(354)	51,766	442	7,513	11,209	96
Foreign currency exchange rate changes	—	—	—	3,517	5,059	43
Employer contribution	34,581	32,867	281	18,406	5,493	47
Plan participants' contributions	2,111	—	—	873	609	5
Curtailments and settlements	—	—	—	(112)	(4,006)	(34)
Benefits paid	(14,982)	(11,911)	(102)	(11,168)	(5,995)	(51)
Divestiture	—	—	—	(12,666)	—	—
Transfer of the substitutional portion to the government	—	(117,845)	(1,007)	—	—	—
Fair value of plan assets at end of the fiscal year	¥534,451	¥489,328	$4,182	¥92,025	¥104,394	$892

In connection with the establishment of the SONY BMG joint venture with Bertelsmann AG as discussed in Note 6, Sony transferred ¥32,140 million of its benefit obligation and ¥12,666 million of its plan assets which were included in Sony's foreign plans to the joint venture as of August 1, 2004.

	Japanese plans*			Foreign plans		
	Yen in millions March 31		Dollars in millions March 31,	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006	2005	2006	2006
Funded status	¥(367,275)	¥(130,541)	$(1,116)	¥(61,573)	¥(89,775)	$(768)
Unrecognized actuarial loss	322,237	169,915	1,452	37,383	41,587	355
Unrecognized net transition asset	(104)	—	—	7	153	1
Unrecognized prior service cost	(134,440)	(135,733)	(1,160)	(501)	(911)	(7)
Net amount recognized	¥(179,582)	¥(96,359)	$(824)	¥(24,684)	¥(48,946)	$(419)
Amounts recognized in the consolidated balance sheet consist of:						
Prepaid benefit cost	¥1,795	¥2,650	$23	¥1,351	¥1,226	$10
Accrued pension and severance costs, including current portion	(309,957)	(134,849)	(1,153)	(42,934)	(70,986)	(607)
Intangibles	—	—	—	41	157	1
Accumulated other comprehensive income	128,580	35,840	306	16,858	20,657	177
Net amount recognized	¥(179,582)	¥(96,359)	$(824)	¥(24,684)	¥(48,946)	$(419)

The accumulated benefit obligation for all defined benefit pension plan as follows:

	Japanese plans			Foreign plans		
	Yen in millions March 31		Dollars in millions March 31,	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006	2005	2006	2006
Accumulated benefit obligation	¥635,420	¥613,055	$5,240	¥121,176	¥143,031	$1,222

The projected benefit obligations, the accumulated benefit obligations and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were as follows:

	Japanese plans			Foreign plans		
	Yen in millions March 31		Dollars in millions March 31,	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006	2005	2006	2006
Projected benefit obligations	¥898,985	¥817,883	$5,281	¥132,556	¥158,353	$1,353
Accumulated benefit obligations	635,420	612,410	5,234	115,147	139,431	1,192
Fair value of plan assets	533,926	488,588	4,176	86,070	99,798	853

Weighted-average assumptions used to determine benefit obligations as of March 31, 2004, 2005 and 2006 were

as follows:

Japanese plans:

	March 31		
	2004	2005	2006
Discount rate	2.4%	2.3%	2.2%
Rate of compensation increase	3.0	3.3	3.4

Foreign plans:

	March 31		
	2004	2005	2006
Discount rate	5.8%	5.5%	5.1%
Rate of compensation increase	4.0	3.3	3.7

Weighted-average assumptions used to determine net pension and severance costs for the fiscal years ended March 31, 2004, 2005 and 2006 were as follows:

Japanese plans:

	Fiscal Year Ended March 31		
	2004	2005	2006
Discount rate	1.9%	2.4%	2.3%
Expected return on plan assets	4.0	3.2	3.5
Rate of compensation increase	3.0	3.3	3.4

Foreign plans:

	Fiscal Year Ended March 31		
	2004	2005	2006
Discount rate	6.3%	5.8%	5.4%
Expected return on plan assets	8.3	7.8	7.8
Rate of compensation increase	4.1	4.0	3.7

As required under FAS No. 87, "Employers' Accounting for Pensions", the assumptions are reviewed in accordance with changes in circumstances.

To determine the expected long-term rate of return on pension plan assets, Sony considers the current and expected asset allocations, as well as historical and expected long-term rate of returns on various categories of plan assets.

Following FAS No.132(R), "Employers' Disclosure about Pensions and Other Postretirement Benefits", the weighted-average rate of compensation increase is calculated based on the pay-related plans only. The point-based plan discussed above is excluded from the calculation because payments made under the plan are not based on employee compensation.

Weighted-average pension plan asset allocations based on the fair value of such assets as of March 31, 2005 and 2006 were as follows:

Japanese plans:

	March 31,	
	2005	2006
Equity securities	28.0%	38.1%
Debt securities	34.7	47.7
Cash	33.7	6.0
Other	3.6	8.2
Total	100%	100%

Foreign plans:

	March 31,	
	2005	2006
Equity securities	68.3%	69.1%
Debt securities	23.4	20.8
Real estate	4.0	6.8
Other	4.3	3.3
Total	100%	100%

For the pension plans of Sony Corporation and most of its subsidiaries in Japan, the target allocation as of March 31, 2006, is, as a result of our Asset Liability management, 34% of public equity, 56% of fixed income securities and 10% of other. When determining an appropriate asset allocation, diversification among assets is duly considered.

The actual asset allocation as of March 31, 2005 for Sony's principal pension plans did not meet the aforementioned target allocation as the Sony Employees' Pension Fund tentatively held cash to be paid to the Japanese government in relation to the transfer of the substitutional portion of the benefit obligation.

As a result from the transfer of the Japanese Government of the substitution portion of Sony's Employee Pension Fund in September 2005, pension plan assets of the Japanese plans as of March 31, 2006 decreased as compared to March 31, 2005.

Sony makes contributions to its contributory funded defined benefit pension plans as required by government regulation or as deemed appropriate by management after considering the fair value of plan assets, expected return on plan assets and the present value of benefit obligations. Sony expects to contribute approximately ¥33,460 million ($286 million) to the Japanese plans and approximately ¥6,058 million ($52 million) to the foreign plans during the fiscal year ending March 31, 2007.

The future benefit payments are expected as follows:

	Japanese plans		Foreign plans	
	Yen in millions	Dollars in millions	Yen in millions	Dollars in millions
Fiscal Year Ending March 31,				
2007	¥17,336	$148	¥7,262	$62
2008	19,081	163	6,764	58
2009	21,002	180	7,532	64
2010	25,400	217	8,326	71
2011	29,102	249	8,994	77
2012–2016	162,183	1,386	56,418	482

16. Stockholders' equity

(1) Subsidiary tracking stock:

On June 20, 2001, Sony Corporation issued shares of subsidiary tracking stock in Japan, the economic value of which is intended to be linked to the economic value of Sony Communication Network Corporation ("SCN"), a directly and indirectly wholly owned subsidiary of Sony Corporation which is engaged in Internet-related services. The subsidiary tracking stock holders had no direct rights in the equity or assets of SCN or the assets of Sony Corporation.

On October 26, 2005, the Board of Directors of Sony Corporation decided to terminate all shares of subsidiary tracking stock and convert such shares to shares of Sony common stock. All shares of subsidiary tracking stock were converted to shares of Sony common stock on December 1, 2005. As a result of the conversion, the number of shares of Sony common stock to be issued upon conversion was calculated by multiplying the number of shares of subsidiary tracking stock as of November 30, 2005, by 1.114, and the number of shares of Sony common stock to be issued upon conversion was 3,452,808.

(2) **Common stock:**

Changes in the number of shares of common stock issued and outstanding during the fiscal years ended March 31, 2004, 2005 and 2006 have resulted from the following:

	Number of shares
Balance at March 31, 2003	922,385,176
Conversion of convertible bonds	2,944,800
Stock issued under exchange offering	1,088,304
Balance at March 31, 2004	926,418,280
Conversion of convertible bonds	70,765,533
Exercise of stock acquisition rights	27,400
Balance at March 31, 2005	997,211,213
Conversion of convertible bonds	484,200
Conversion of subsidiary tracking stock	3,452,808
Exercise of stock acquisition rights	531,443
Balance at March 31, 2006	1,001,679,664

At March 31, 2006, 58,976,132 shares of common stock would be issued upon conversion or exercise of all convertible bonds, warrants and stock acquisition rights outstanding.

On May 1, 2003, Sony Corporation implemented a share exchange as a result of which CIS Corporation became a wholly-owned subsidiary. As a result of this share exchange, Sony Corporation issued 1,088,304 new shares, and additional paid-in capital increased ¥5,409 million.

On November 20, 1991, Sony Corporation made a free share distribution of 33,908,621 shares in ratios of one share for each ten shares held for which no accounting entry was required in Japan. Had the distribution been accounted for in the manner adopted by companies in the United States of America, ¥201,078 million would have been transferred from retained earnings to the appropriate capital accounts. This has been the only free distribution of common stock where no accounting entry was required in Japan.

Conversions of convertible bonds into common stock are accounted for in accordance with the provisions of the Japanese Commercial Code by crediting approximately one-half of the conversion proceeds to the common stock account and the remainder to the additional paid-in capital account.

The Ordinary General Meeting of Shareholders held on June 20, 2003 approved that Sony Corporation acquire up to a total not exceeding 90 million outstanding shares of its common stock at an amount in total not exceeding ¥400 billion and a total not exceeding 300 thousand outstanding shares of the subsidiary tracking stock at an amount in total not exceeding ¥1 billion. As a result, Sony Corporation had acquired 2 million outstanding shares of its common stock at an amount in ¥8,200 million.

The Ordinary General Meeting of Shareholders held on June 22, 2004 approved to amend the articles of incorporation that Sony Corporation may purchase its own shares by a resolution of the Board of Directors, in accordance with the amendments to the Japanese Commercial Code enacted on September 25, 2003. With the amendment of the articles of incorporation, Sony Corporation may purchase its own shares at any time by a resolution of the Board of Directors up to the retained earnings available for dividends to shareholders. No common stock and subsidiary tracking stock had been acquired by the resolution of the Board of Directors during the fiscal

year ended March 31, 2005 and 2006.

(3) Retained earnings:

The amount of statutory retained earnings of Sony Corporation available for dividends to shareholders as of March 31, 2006 was ¥565,936 million ($4,837 million). The appropriation of retained earnings for the fiscal year ended March 31, 2006 including cash dividends for the six-month period ended March 31, 2006 has been incorporated in the accompanying consolidated financial statements. This appropriation of retained earnings was approved at the meeting of the Board of Directors of Sony Corporation held on May 17, 2006 and was then recorded in the statutory books of account, in accordance with the Japanese Commercial Code.

Retained earnings include Sony's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥2,724 million and ¥13,557 million ($116 million) at March 31, 2005 and 2006, respectively.

(4) Other comprehensive income:

Other comprehensive income for the fiscal years ended March 31, 2004, 2005 and 2006 were as follows:

	Yen in millions		
	Pre-tax amount	Tax expense	Net-of-tax amount
For the fiscal year ended March 31, 2004:			
Unrealized gains on securities -			
Unrealized holding gains (losses) arising during the period	¥89,861	¥(31,890)	¥57,971
Less : Reclassification adjustment included in net income	(7,371)	1,692	(5,679)
Unrealized losses on derivative instruments -			
Unrealized holding gains (losses) arising during the period	11,586	(4,049)	7,537
Less : Reclassification adjustment included in net income	(5,961)	2,617	(3,344)
Minimum pension liability adjustment	162,408	(68,993)	93,415
Foreign currency translation adjustments -			
Translation adjustments arising during the period	(134,312)	5,199	(129,113)
Less : Reclassification adjustment included in net income	1,232	-	1,232
Other comprehensive income	¥117,443	¥(95,424)	¥22,019
For the fiscal year ended March 31, 2005:			
Unrealized gains on securities -			
Unrealized holding gains (losses) arising during the period	¥7,184	¥(1,541)	¥5,643
Less : Reclassification adjustment included in net income	(18,140)	5,216	(12,924)
Unrealized losses on derivative instruments -			
Unrealized holding gains (losses) arising during the period	(2,015)	1,806	(209)
Less : Reclassification adjustment included in net income	(2,848)	1,167	(1,681)
Minimum pension liability adjustment	(1,700)	931	(769)
Foreign currency translation adjustments -			
Translation adjustments arising during the period	76,585	(2,361)	74,224
Other comprehensive income	¥59,066	¥5,218	¥64,284

	Yen in millions		
	Pre-tax amount	Tax expense	Net-of-tax amount
For the fiscal year ended March 31, 2006:			
Unrealized gains on securities -			
Unrealized holding gains (losses) arising during the period	¥125,263	¥(45,633)	¥79,630
Less : Reclassification adjustment included in net income	(64,953)	23,458	(41,495)
Unrealized losses on derivative instruments -			
Unrealized holding gains (losses) arising during the period	14,888	(7,023)	7,865
Less : Reclassification adjustment included in net income	(12,597)	5,173	(7,424)
Minimum pension liability adjustment	88,941	(38,735)	50,206
Foreign currency translation adjustments -			
Translation adjustments arising during the period	143,888	(3,415)	140,473
Less : Reclassification adjustment included in net income	(17)	-	(17)
Other comprehensive income	¥295,413	¥(66,175)	¥229,238

	Dollars in millions		
	Pre-tax amount	Tax expense	Net-of-tax amount
For the fiscal year ended March 31, 2006			
Unrealized gains on securities -			
Unrealized holding gains (losses) arising during the period	$1,071	$(390)	$681
Less : Reclassification adjustment included in net income	(555)	200	(355)
Unrealized losses on derivative instruments -			
Unrealized holding gains (losses) arising during the period	127	(60)	67
Less : Reclassification adjustment included in net income	(107)	44	(63)
Minimum pension liability adjustment	760	(331)	429
Foreign currency translation adjustments -			
Translation adjustments arising during the period	1,229	(29)	1,200
Less : Reclassification adjustment included in net income	(0)	-	(0)
Other comprehensive income	$2,525	$(566)	$1,959

During the fiscal years ended March 31, 2004 and 2006, losses of ¥1,232 million and gains of ¥17 million ($0 million) of foreign currency translation adjustments were transferred respectively from other comprehensive income to net income as a result of the liquidation of certain foreign subsidiaries.

As discussed in Note 6, as of August 1, 2004, Sony and Bertelsmann AG combined their recorded music businesses in a joint venture. In connection with the establishment of the joint venture, the minimum pension liability attributable to employees who were transferred to SONY BMG totaling ¥6,053 million was transferred from other

comprehensive income to the carrying value of Sony's investment in SONY BMG.

17. Stock-based compensation plans

Sony has four types of stock-based compensation plans as incentive plans for directors, corporate executive officers and selected employees.

(1) Warrant plan:

Upon issuance of unsecured bonds with detachable warrants which are described in Note 12, Sony Corporation has purchased all of the detachable warrants and distributed them to selected directors, corporate executive officers and employees of Sony. By exercising a warrant, directors, corporate executive officers and employees can purchase the common stock of Sony Corporation, the number of which is designated by each plan. The warrants generally vest ratably over a period of three years, and are exercisable up to six years from the date of grant.

Presented below is a summary of the activities regarding common stock warrants for the fiscal years shown:

	Fiscal Year Ended March 31						
	2004		2005		2006		
	Number of Shares	Weighted-average exercise price	Number of Shares	Weighted-average exercise price	Number of Shares	Weighted-average exercise price	Weighted-average exercise price
		Yen		Yen		Yen	Dollars
Outstanding at beginning of the fiscal year	3,190,292	¥8,132	3,190,292	¥8,132	2,626,300	¥8,533	$72.93
Forfeited	—	—	(563,992)	6,264	(558,000)	7,167	61.26
Outstanding at end of the fiscal year	3,190,292	¥8,132	2,626,300	¥8,533	2,068,300	¥8,901	$76.08
Exercisable at end of the fiscal year	2,808,292	¥8,416	2,626,300	¥8,533	2,068,300	¥8,901	$76.08

There were no warrants granted or exercised during the fiscal years ended March 31, 2004, 2005 and 2006. At March 31, 2006, there were 1,145,900 and 922,400 shares outstanding under warrants with exercise prices of ¥6,039 and ¥12,457 and average remaining lives of 1.75 years and 0.58 years, respectively. The weighted average exercise price and remaining life of outstanding warrants was ¥8,901 and 1.23 years, respectively. All outstanding warrants were exercisable at March 31, 2006.

(2) Convertible Bond plan:

Sony has an equity-based compensation plan for selected executives of Sony's United States of America subsidiaries using U.S. dollar-denominated non-interest bearing convertible bonds which have characteristics similar to that of an option plan. Each convertible bond can be converted into 100 shares of the common stock of Sony Corporation at an exercise price based on the prevailing market rate shortly before the date of grant. The

convertible bonds vest ratably over a three-year period and are exercisable up to ten years from the date of grant. As the convertible bonds were issued in exchange for a non-interest bearing employee loan and a right of offset exists between the convertible bonds and the employee loans, no accounting recognition was given to either the convertible bonds or the employee loans in Sony's consolidated balance sheet.

Presented below is a summary of the activities regarding convertible bond plan for the fiscal years shown:

	Fiscal Year Ended March 31						
	2004		2005		2006		
	Number of Shares	Weighted-average exercise price	Number of Shares	Weighted-average exercise price	Number of Shares	Weighted-average exercise price	Weighted-average exercise price
		Yen		Yen		Yen	Dollars
Outstanding at beginning of the fiscal year	3,802,700	¥8,870	3,341,700	¥8,852	3,136,400	¥6,861	$58.64
Exercised	—	—	—	—	(484,200)	5,952	50.87
Forfeited	(461,000)	6,943	(205,300)	6,668	(158,700)	7,989	68.28
Outstanding at end of the fiscal year	3,341,700	¥8,852	3,136,400	¥6,861	2,493,500	¥8,133	$69.51
Exercisable at end of the fiscal year	2,614,700	¥7,042	2,923,300	¥6,952	2,493,500	¥8,133	$69.51

There were no shares granted under the convertible bond plan during the fiscal years ended March 31, 2004, 2005 and 2006. All shares under the convertible bond plan were exercisable as of March 31, 2006.

A summary of convertible bond options outstanding and exercisable at March 31, 2006 is as follows:

	Outstanding and Exercisable			
Exercise price range	Number of Shares	Weighted-average exercise price	Weighted-average exercise price	Weighted-average remaining life
Yen		Yen	Dollars	Years
¥5,952~10,000	2,117,200	¥7,229	$61.79	3.98
10,001~13,220	376,300	13,220	112.99	4.08
¥5,952~13,220	2,493,500	¥8,133	$69.51	3.98

(3) Stock Acquisition Rights:

During the fiscal year ended March 31, 2003, Sony adopted an equity-based compensation plan that issues common stock acquisition rights for the purpose of granting stock options to selected directors, corporate executive officers and employees of Sony, pursuant to the Commercial Code of Japan. The stock acquisition rights generally vest ratably over a period of three years and are exercisable up to ten years from the date of grant.

Presented below is a summary of the activities regarding stock acquisition rights plan for the fiscal years shown:

	Fiscal Year Ended March 31						
	2004		2005		2006		
	Number of Shares	Weighted-average exercise price	Number of Shares	Weighted-average exercise price	Number of Shares	Weighted-average exercise price	Weighted-average exercise price
		Yen		Yen		Yen	Dollars
Outstanding at beginning of the fiscal year	2,647,900	¥4,845	5,173,600	¥4,424	7,350,500	¥4,288	$36.65
Granted	2,621,400	4,220	2,433,600	3,998	2,491,600	3,936	33.64
Exercised	—	—	(27,400)	3,896	(364,800)	4,216	36.06
Forfeited	(95,700)	3,896	(229,300)	4,419	(376,600)	4,441	37.96
Outstanding at end of the fiscal year	5,173,600	¥4,424	7,350,500	¥4,288	9,100,700	¥4,351	$37.19
Exercisable at end of the fiscal year	430,900	¥5,291	1,674,000	¥4,652	3,136,200	¥4,629	$39.56

A summary of stock acquisition rights outstanding and exercisable at March 31, 2006 is as follows:

	Outstanding				Exercisable		
Exercise price range	Number of Shares	Weighted-average exercise price	Weighted-average exercise price	Weighted-average remaining life	Number of Shares	Weighted-average exercise price	Weighted-average exercise price
Yen		Yen	Dollars	Years		Yen	Dollars
¥3,782~5,396	9,100,700	¥4,351	$37.19	8.38	3,136,200	¥4,629	$39.56

As the exercise prices for the warrant, convertible bond and stock acquisition rights plans were determined based on the prevailing market price shortly before the date of grant, the compensation expense for these plans was not significant for the fiscal years ended March 31, 2004, 2005 and 2006.

As discussed in Note 2 and 16, all shares of subsidiary tracking stock were converted to shares of Sony common stock on December 1, 2005. As a result of the conversion, all subsidiary tracking stock warrants and acquisition rights were converted to Sony common stock warrants and acquisition rights. In addition to the above tables, 166,643 shares were issued by the exercise of those warrants and acquisition rights. At March 31, 2006, there were no common stock warrants and acquisition rights outstanding which were granted by the conversion.

As a result of the establishment of the joint venture between Sony's recorded music business with the recorded music business of Bertelsmann AG (Note 6), employees of Sony's recorded music business who were granted options under the convertible bond and stock acquisition rights plans prior to the establishment of the joint venture are no longer considered employees of Sony under FAS No. 123 as these individual are now employees of SONY BMG which is accounted for under the equity method. As a result, a compensation charge of ¥340 million was recorded in the fiscal year ended March 31, 2005 based on the fair value method of accounting for stock-based compensation using the Black-Scholes option-pricing model.

The weighted-average fair value per share at the date of grant of stock acquisition rights granted during the fiscal years ended March 31, 2004, 2005 and 2006 were ¥1,413, ¥1,085 and ¥1,585 ($13.55), respectively. The fair value of common stock warrants, convertible bond options and stock acquisition rights granted on the date of grant, which is amortized to expense over the vesting period in determining the pro forma impact, is estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

Weighted-average assumptions	Fiscal Year Ended March 31		
	2004	2005	2006
Risk-free interest rate	2.18%	2.04%	2.90%
Expected lives	3.67years	3.54years	6.14years
Expected volatility	42.83%	35.56%	39.50%
Expected dividend	0.57%	0.62%	0.61%

(4) SAR plan:

Sony granted stock appreciation rights ("SARs") in Japan, Europe and the United States of America for selected employees. Under the terms of these plans, employees on exercise receive cash equal to the amount that the market price of Sony Corporation's common stock exceeds the strike price of the SARs. The SARs generally vest ratably over a period of three years, and are generally exercisable up to six to ten years from the date of grant. Sony uses various strategies to minimize the compensation expense associated with the SAR plans in the United States of America and Europe.

The status of the SAR plans is summarized as follows:

	Fiscal Year Ended March 31						
	2004		2005		2006		
	Number of SARs	Weighted-average exercise price	Number of SARs	Weighted-average exercise price	Number of SARs	Weighted-average exercise price	Weighted-average exercise price
		Yen		Yen		Yen	Dollars
Outstanding at beginning of the fiscal year	2,343,028	¥6,341	1,526,568	¥6,424	865,084	¥7,436	$63.56
Exercised	—	—	(241,134)	3,955	(50,000)	5,020	42.91
Expired or forfeited	(816,460)	5,494	(420,350)	5,855	(628,584)	7,338	62.72
Outstanding at end of the fiscal year	1,526,568	¥6,424	865,084	¥7,436	186,500	¥9,211	$78.73
Exercisable at end of the fiscal year	1,462,391	¥6,421	856,156	¥7,455	186,500	¥9,211	$78.73

There were no SARs granted during the fiscal years ended March 31, 2004, 2005 and 2006. All SARs were exercisable as of March 31, 2006.

A summary of SARs outstanding and exercisable at March 31, 2006 is as follows:

	Outstanding and Exercisable			
Exercise price range	Number of SARs	Weighted-average exercise price	Weighted-average exercise price	Weighted-average remaining life
Yen		Yen	Dollars	Years
¥4,345~7,000	39,650	¥5,819	$49.74	5.91
7,001~10,000	100,525	9,143	78.15	1.73
10,001~14,440	46,325	12,260	104.79	4.19
¥4,345~14,440	186,500	¥9,211	$78.73	3.23

In accordance with APB No. 25 and its related interpretations, the SARs compensation expense is measured as the excess of the quoted market price of Sony Corporation's common stock over the SARs strike price, which is consistent with the accounting treatment prescribed for SAR plans in FAS No. 123. For the fiscal year ended March 31, 2004, Sony recognized ¥105 million of SARs compensation expense. For the fiscal year ended March 31, 2005, Sony recognized a reduction in SARs compensation expense of ¥74 million. For the fiscal year ended March 31, 2006, Sony recognized ¥70 million ($1 million) of SARs compensation expense.

18. Restructuring charges and asset impairments

As part of its effort to improve the performance of the various businesses, Sony has undertaken a number of restructuring initiatives within its Electronics segment, Pictures segment and All Other. For the fiscal years ended

March 31, 2004, 2005 and 2006, Sony recorded total restructuring charges of ¥168,091 million, ¥89,963 million and ¥138,692 million ($1,185 million), respectively. Significant restructuring charges and asset impairments include the following:

Electronics Segment

In an effort to improve the performance of the Electronics segment, Sony has undergone a number of restructuring efforts to reduce its operating costs. For the fiscal years ended March 31, 2004, 2005 and 2006, Sony recorded total restructuring charges of ¥143,589 million, ¥83,227 million and ¥125,802 million ($1,075 million), respectively, within the Electronics segment. In addition to the above charges, the Electronics segment also reflects restructuring costs of ¥2,122 million for the fiscal year ended March 31, 2004, that relate to the non-Japan based disc manufacturing and physical distribution businesses that were part of the restructuring charges of the Music business which is discussed below. These restructuring charges were formerly included within the Music business but were reclassified to the Electronics segment. See Notes 6 and 25 for more information on this reclassification. Significant restructuring activities are as follows:

Downsizing of CRT TV display operations -

Due to the worldwide market shrinkage and demand shift from CRT displays to plasma and LCD panel displays, Sony has begun to implement a worldwide plan to rationalize production facilities of CRT TV display and has been downsizing its business over several years.

As part of its worldwide plan, Sony made a decision in the fiscal year ended March 31, 2004 to discontinue certain CRT TV display manufacturing operations in Japan. Restructuring charges totaling ¥8,478 million consisted of personnel related costs of ¥3,139 million and non-cash equipment impairment, disposal and other costs of ¥5,339 million. Of the total restructuring charges, ¥158 million was recorded in cost of sales, ¥3,139 million was included in selling, general and administrative expenses, and ¥5,181 million was included in loss on sale, disposal or impairment of assets, net in the consolidated statements of income. This phase of the restructuring program was completed in the fiscal year ended March 31, 2004 and no liability existed as of March 31, 2006.

In the fiscal year ended March 31, 2005, as part of this restructuring program, Sony recorded a non-cash impairment charge of ¥7,479 million for CRT TV display manufacturing facilities located in Europe. The impairment charge was calculated as the difference between the carrying value of the asset group and the present value of estimated future cash flows. The charge was recorded in loss on sale, disposal or impairment of assets, net in the consolidated statements of income. This phase of the restructuring program was completed in the fiscal year ended March 31, 2005 and no liability existed as of March 31, 2006.

In the fiscal year ended March 31, 2006, Sony made a decision to discontinue certain CRT TV display manufacturing operations in the U.S. Restructuring charges totaling ¥32,488 million ($278 million) consisted of personnel related costs of ¥1,962 million ($17 million) and non-cash equipment impairment, disposal and other costs of ¥30,526 million ($261 million). Of the total restructuring charges, ¥6,982 million ($60 million) was recorded in cost of sales, and ¥25,506 million ($218 million) was included in loss on sale, disposal or impairment of assets, net in the consolidated statements of income. The impairment charge was calculated as the difference between the carrying value of the asset group and the present value of estimated future cash flows. This phase of the restructuring program was completed in the fiscal year ended March 31, 2006. The remaining liability balance as of March 31, 2006 was ¥3,852 million ($33 million) with a large portion of the liabilities to be paid during the fiscal year ending March

31, 2007.

In the fiscal year ended March 31, 2006, as part of this restructuring program, Sony recorded a non-cash impairment charge of ¥2,856 million ($24 million) for CRT TV display manufacturing facilities located in Southeast Asia. The impairment charge was calculated as the difference between the carrying value of the asset group and the present value of estimated future cash flows. The charge was recorded in loss on sale, disposal or impairment of assets, net in the consolidated statements of income. This phase of the restructuring program was completed in the fiscal year ended March 31, 2006 and no liability existed as of March 31, 2006.

The worldwide plan to rationalize production facilities of CRT TV display was substantially completed during the fiscal year ended March 31, 2006.

Closing of a semiconductor plant in the U.S. -

Due to a significant decline in the business conditions of the U.S. semiconductor industry, Sony made a decision in the fourth quarter of the fiscal year ended March 31, 2003, to close a semiconductor plant in the U.S. This restructuring activity was completed in the fiscal year ended March 31, 2005 and total restructuring charges of ¥4,936 million have been incurred through March 31, 2005. The remaining liability balance as of March 31, 2006 was ¥152 million ($1 million) and will be substantially paid through the fiscal year ending March 31, 2007.

During the fiscal year ended March 31, 2004, Sony recorded net restructuring charges totaling ¥874 million which consisted of the accelerated depreciation and write-down of equipment of ¥1,982 million, gain on disposal of assets of ¥1,962 million, and ¥854 million of other costs including lease contract termination costs. Among these charges ¥1,760 million was recorded in cost of sales, while asset write-down and disposal costs of ¥1,076 million and the gain on asset disposals of ¥1,962 million were included in loss on sale, disposal or impairment of assets, net in the consolidated statements of income.

During the fiscal year ended March 31, 2005, Sony sold the facilities and recorded a gain on disposal of ¥1,794 million. The gain was included in loss on sale, disposal or impairment of assets, net in the consolidated statements of income.

Retirement Programs -

In addition to the restructuring efforts disclosed above, Sony has undergone several headcount reduction programs to further reduce operating costs in its Electronics segment. As a result of these programs, Sony recorded restructuring charges totaling ¥115,149 million, ¥50,960 million and ¥45,116 million ($386 million) for the fiscal years ended March 31, 2004, 2005 and 2006, respectively, and these charges were included in selling, general and administrative expenses in the consolidated statements of income. These staff reductions were achieved worldwide mostly through the implementation of early retirement programs. The remaining liability balance as of March 31, 2006 was ¥19,424 million ($166 million) and will be paid through the fiscal year ending March 31, 2007. Sony will continue to implement programs to reduce headcount by streamlining business operations, including closure and consolidation of manufacturing sites, as well as headquarters and administrative functions.

Pictures Segment

In an effort to improve the performance of the Pictures segment, Sony has undergone a number of restructuring efforts to reduce its operating costs. For the fiscal years ended March 31, 2004 and 2005, Sony recorded total restructuring charges of ¥4,611 million and ¥385 million, respectively, within the Pictures segment. There were no restructuring

charges incurred for the fiscal year ended March 31, 2006. Significant restructuring activities are the following:

Consolidation of Television Operations -

Due to changes within the television production and distribution business, the competition between network owned production companies and other production and distribution companies to license product to the major televisions networks has become more intense. This competitive environment has resulted in fewer opportunities to produce shows for the networks and a shorter lifespan for ordered shows that do not immediately achieve favorable ratings. This trend has resulted in an increase in the number of new programs being distributed yet canceled in their first or second season, which are generally less profitable, and a decrease in the number of network programs that are able to achieve syndication, which are generally more profitable. As a result, in the fiscal year ended March 31, 2002, Sony decided to consolidate its television operations and downsize the network television production business in the Pictures segment. The costs incurred for this program were included in cost of sales in the consolidated statements of income. This restructuring program was completed in the fiscal year ending March 31, 2005, and the total cost of the program from the inception was ¥8,932 million. No liability existed as of March 31, 2006.

Fixed Cost Reduction Program -

During the fiscal year ended March 31, 2004, the Pictures segment implemented a fixed cost reduction program to further reduce its operating costs. This restructuring program primarily related to the reduction of staffing levels and the disposal of certain long-lived assets. This restructuring program was completed during the fiscal year ended March 31, 2005 and the total cost of this restructuring program was ¥4,996 million.

The Pictures segment recorded ¥4,611 million of these costs during the fiscal year ended March 31, 2004. These restructuring charges consisted of personnel related costs of ¥993 million, non-cash asset impairment and disposal costs of ¥1,746 million, and other costs of ¥1,872 million including those relating to the buy-out of term deal commitments. Of the restructuring costs incurred, ¥1,525 million was included in cost of sales, ¥1,340 million was included in selling, general and administrative expenses, and ¥1,746 million was included in loss on sale, disposal or impairment of assets, net in the consolidated statements of income.

During the fiscal year ended March 31, 2005, the Pictures segment completed the fixed cost reduction program and recorded ¥385 million of additional restructuring costs. These restructuring charges consisted primarily of personnel related costs of ¥292 million which were included in selling, general and administrative expenses in the consolidated statements of income. No liability existed as of March 31, 2006.

All Other (Music Business)

Due to the continued contraction of the worldwide music market due to slow worldwide economic growth, the saturation of the CD market, the effects of piracy and other illegal duplication, parallel imports, pricing pressures and the diversification of customer preferences, Sony has been actively repositioning the Music business for the future by looking to create a more effective and profitable business model. As a result, the Music business has undergone a worldwide restructuring program since the fiscal year ended March 31, 2001 to reduce staffing and other costs through the consolidation and rationalization of facilities worldwide excluding Japan. As part of this restructuring program, Sony combined its recorded music business with the recorded music business of Bertelsmann AG to form SONY BMG, a joint venture that is accounted for under the equity method. See Note 6 for more information on this transaction. For the fiscal years ended March 31, 2004, 2005 and 2006, Sony recorded total restructuring charges of ¥10,691

million, ¥3,025 million and ¥129 million ($1 million), respectively, related to the restructuring of the Music business excluding Japan. Of these restructuring charges, ¥2,122 million for the fiscal year ended March 31, 2004, was recorded in the non-Japan based disc manufacturing and physical distribution businesses, formerly included within the Music business but reclassified to the Electronics segment. See Notes 6 and 25 for more information on this reclassification. This worldwide restructuring of the Music business was completed during the fiscal year ended March 31, 2006, and the total cost of the program was ¥52,702 million , which was incurred from the inception of the program through the fiscal year ended March 31, 2006. The restructuring costs within the Music business do not include the restructuring costs of SONY BMG since the establishment of the joint venture. At March 31, 2006, the liability balance was ¥ 1,193 million ($10 million) which is expected to be settled during the fiscal year ending March 31, 2007.

In addition to the above, Sony also recorded restructuring charges of ¥1,291 million, ¥ 803 million and ¥ 346 million ($3 million) for the fiscal years ended March 31, 2004, 2005 and 2006, respectively, in Japan, which were primarily personnel related costs included in selling, general and administrative expenses and loss on sale, disposal or impairment of assets, net in the consolidated statements of income.

Significant restructuring activities included the following:

During the fiscal year ended March 31, 2004, Sony broadened the scope of its worldwide restructuring of the Music business, which resulted in restructuring charges totaling ¥10,691 million. Restructuring activities included the continuation of the shutdown of the CD manufacturing facility in the U.S. as well as the restructuring of music label operations and the further rationalization of overhead functions through staff reductions. The restructuring charges consisted of personnel related costs of ¥5,137 million, lease abandonment costs of ¥1,323 million and other related costs of ¥4,231 million including non-cash asset impairment and disposal costs. Most of these charges are included in selling, general and administrative expenses in the consolidated statements of income. Employees were eliminated across various employee levels, business functions, operating units, and geographic regions during this phase of the worldwide restructuring program.

During the fiscal year ended March 31, 2005, in continuation of the worldwide restructuring program and in connection with the establishment of the joint venture with Bertelsmann AG (Note 6), Sony recorded restructuring charges totaling ¥3,025 million within the Music business. Restructuring activities included the shutdown of certain distribution operations that were no longer required as a result of the recorded music joint venture with Bertelsmann AG as well as the further rationalization of overhead functions through staff reductions. The restructuring charges consisted of personnel related costs of ¥883 million and other related costs of ¥2,142 million. These charges are included in selling, general and administrative expenses in the consolidated statements of income. Employees were eliminated across various employee levels, business functions, operating units, and geographic regions during this phase of the worldwide restructuring program.

During the fiscal year ended March 31, 2006, the worldwide restructuring program was completed and Sony recorded additional restructuring charges totaling ¥129 million ($1 million), primarily consisting of other associated restructuring costs. Restructuring activities included the further shutdown of certain distribution operations that were no longer required as a result of the recorded music joint venture with Bertelsmann AG. These charges are included in selling, general and administrative expenses in the consolidated statements of income.

All Other (U.S. Entertainment Complex)

As part of its efforts to restructure and eliminate certain non-core businesses, Sony reached an agreement to sell a U.S.

entertainment complex in March 2006. As a result, Sony recorded an impairment charge of ¥ 8,522 million ($73 million). The impairment charge was based on the negotiated sales price of the complex, and is recorded in loss on sale, disposal or impairment of assets, net in the consolidated statements of income.

The changes in the accrued restructuring charges for the fiscal years ended March 31, 2004, 2005 and 2006 are as follows:

	Yen in millions			
	Employee termination benefits	Non-cash write-downs and disposals	Other associated costs	Total
Balance at March 31, 2003	¥14,784	-	¥5,787	¥20,571
Restructuring costs	133,367	¥19,170	15,554	168,091
Non-cash charges	-	(19,170)	-	(19,170)
Cash payments	(124,674)	-	(13,686)	(138,360)
Adjustments	1,173	-	333	1,506
Balance at March 31, 2004	24,650	-	7,988	32,638
Restructuring costs	53,563	25,564	10,836	89,963
Non-cash charges	-	(25,564)	-	(25,564)
Cash payments	(61,523)	-	(10,427)	(71,950)
Adjustments*	(1,705)	-	(3,096)	(4,801)
Balance at March 31, 2005	14,985	-	5,301	20,286
Restructuring costs	48,255	76,999	13,438	138,692
Non-cash charges	-	(76,999)	-	(76,999)
Cash payments	(42,152)	-	(7,929)	(50,081)
Adjustments	(1,227)	-	3	(1,224)
Balance at March 31, 2006	¥19,861	-	¥10,813	¥30,674

	Dollars in millions			
	Employee termination benefits	Non-cash write-downs and disposal	Other associated costs	Total
Balance at March 31, 2005	$128	-	$45	$173
Restructuring costs	412	$658	115	1,185
Non-cash charges	-	(658)	-	(658)
Cash payments	(360)	-	(68)	(428)
Adjustments	(10)	-	0	(10)
Balance at March 31, 2006	$170	-	$92	$262

*Adjustments primarily consist of the transfer of the accrued restructuring charges to SONY BMG, a joint venture with Bertelsmann AG (Note 6).

19. Research and development costs, advertising costs and shipping and handling costs

(1) Research and development costs:

Research and development costs charged to cost of sales for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥514,483 million, ¥502,008 million and ¥531,795 million ($4,545 million), respectively.

(2) Advertising costs:

Advertising costs included in selling, general and administrative expenses for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥421,433 million, ¥359,661 million and ¥419,508 million ($3,586 million), respectively.

(3) Shipping and handling costs:

Shipping and handling costs for finished goods included in selling, general and administrative expenses for the fiscal years ended March 31, 2004, 2005 and 2006 were ¥106,590 million, ¥107,983 million and ¥114,500 million ($979 million), respectively, which included the internal transportation costs of finished goods.

20. Gain on change in interest in subsidiaries and equity investees

In January 2004, FeliCa Networks, Inc., whose field of business is Mobile FeliCa IC chip development and production/sales licensing and operation of the Mobile FeliCa service platform, issued 115,000 shares at ¥100,000 per share with a total value of ¥11,500 million in connection with its private offering. As a result of this issuance, Sony recorded a gain of ¥3,364 million and provided deferred taxes on this gain. This issuance reduced Sony's ownership interest from 100% to 60%.

In addition to the above transaction, for the fiscal year ended March 31, 2004, Sony recognized ¥1,506 million of other gains on change in interest in subsidiaries and equity investees resulting in total gains of ¥4,870 million.

In August 2, 2004, Monex Inc., which provided on-line security trading services in Japan, and Nikko Beans, Inc. established Monex Beans Holdings, Inc. by way of share transfer of the then existing shares of Monex Inc. and Nikko Beans, Inc.. At this establishment, 1 share of Monex Beans Holdings, Inc. was allotted to each share of Monex Inc. and 3.4 shares of Monex Beans Holdings, Inc. were allotted to each share of Nikko Beans, Inc.. As a result of this share transfer, Monex Beans Holdings, Inc. issued 2,344,687 shares and Sony recorded a gain of ¥8,951 million and provided deferred taxes on this gain. This issuance reduced Sony's ownership interest from 29.9% to 20.1%.

In September 2004, So-net M3 Inc., which provides medical services via the Internet in Japan, issued 2,800 shares at ¥850,000 per share with a total value of ¥2,380 million in connection with its initial public offering. SCN, a parent company of So-net M3 Inc., sold 3,260 shares of So-net M3 Inc., at ¥790,500 per share with a total value of ¥2,577 million. In October 2004, SCN sold 740 shares of So-net M3 Inc., at ¥790,500 per share with a total value of ¥585 million. As a result of these transactions, Sony recorded a ¥1,823 million gain on issuance of stock by So-net M3 Inc. and provided deferred taxes on this gain. In addition, Sony recorded a ¥2,876 million gain on the sale of its shares of So-net M3 Inc. These transactions reduced Sony's ownership interest from 90.0% to 74.8%.

In January 2005, DeNA Co., Ltd., whose field of business is the operation of on-line auction websites in Japan, issued 14,000 shares at ¥204,600 per share with a total value of ¥2,864 million in connection with its initial public

offering. In March 2005, SCN, which had owned a 27.7% interest in DeNA Co., Ltd., sold 2,000 shares of DeNA Co., Ltd. at ¥204,600 per share with a total value of ¥409 million. As a result of these transactions, Sony recorded a ¥686 million gain on issuance of stock by DeNA Co., Ltd. and provided deferred taxes on this gain. In addition, Sony recorded a ¥76 million gain on the sale of its shares of DeNA Co., Ltd.. These transactions reduced Sony's ownership interest from 27.7% to 24.8%.

In addition to the above transactions, for the fiscal year ended March 31, 2005, Sony recognized ¥1,911 million of other gains on change in interest in subsidiaries and equity investees resulting in total gains of ¥16,322 million.

In June 2005, SCN sold 17,935 shares of So-net M3 Inc., at ¥694,600 ($5,937) per share with a total value of ¥12,458 million ($106 million). As a result of this sale, Sony recorded a ¥11,979 million ($102 million) gain and provided deferred taxes on this gain. This sale reduced Sony's ownership interest from 74.8% to 60.8%.

In June 2005, SCN sold 7,000 shares of DeNA Co., Ltd. at ¥863,040 ($7,376) per share with a total value of ¥6,041 million ($52 million). In March 2006, DeNA Co., Ltd. issued 14,300 shares at ¥314,138 ($2,685) per share with a total value of ¥4,492 million ($38 million) in connection with its private offering. As a result of these transactions, Sony recorded a ¥6,638 million ($57 million) gain and provided deferred taxes on this gain. These transactions reduced Sony's ownership interest from 24.8% to 19.1%.

In September 2005, Sony Corporation sold 230,000 shares of Monex Beans Holdings, Inc. at ¥119,040 ($1,017) per share with a total value of ¥27,379 million ($234 million). As a result of this sale, Sony recorded a ¥20,590 million ($176 million) gain and provided deferred taxes on this gain. This sale reduced Sony's ownership interest from 20.1% to 10.3%. See Note 6 for more information on this transaction.

In December 2005, SCN issued 20,000 shares at ¥320,960 ($2,743) per share with a total value of ¥6,419 million ($55 million) in connection with its initial public offering. Sony Corporation and Sony Finance International Inc., which had owned 82.6% and 17.4% interests in SCN, respectively, sold 66,000 shares and 4,000 shares of SCN, respectively, at ¥320,960 ($2,743) per share with a total value of ¥22,467 million ($192 million). In January 2006, Sony Corporation sold 12,000 shares of SCN at ¥320,960 ($2,743) per share with a total value of ¥3,852 million ($33 million). As a result of these transactions, Sony recorded a ¥21,547 million ($184 million) gain on issuance of stock by SCN and the sale of shares of SCN and provided deferred taxes on this gain. These transactions reduced Sony's ownership interest from 100% to 60.1%.

In addition to the above transactions, for the fiscal year ended March 31, 2006, Sony recognized ¥80 million ($1 million) of other gains on change in interest in subsidiaries and equity investees resulting in total gains of ¥60,834 million ($520 million).

These transactions were not part of a broader corporate reorganization and the reacquisition of such shares was not contemplated at the time of issuance.

21. Income taxes

Income before income taxes and income tax expense comprise the following:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Income (loss) before income taxes:				
Sony Corporation and subsidiaries in Japan	¥(84,571)	¥5,005	¥243,927	$2,085
Foreign subsidiaries	228,638	152,202	42,402	362
	¥144,067	¥157,207	¥286,329	$2,447
Income taxes - Current:				
Sony Corporation and subsidiaries in Japan	¥22,286	¥23,497	¥55,154	$471
Foreign subsidiaries	64,933	62,013	41,246	353
	¥87,219	¥85,510	¥96,400	$824
Income taxes - Deferred:				
Sony Corporation and subsidiaries in Japan	¥(32,845)	¥4,976	¥105,936	$905
Foreign subsidiaries	(1,600)	(74,442)	(25,823)	(221)
	¥(34,445)	¥(69,466)	¥80,115	$684

Sony is subjected to a number of different income taxes. Due to changes in Japanese income tax regulations, a consolidated tax filing system was introduced on April 1, 2002. Sony applied to file its return under the consolidated tax filing system beginning with the fiscal year ended March 31, 2004. Under the Japanese consolidated tax filing system, a 2% surtax was imposed only for the fiscal year ended March 31, 2004. As a result, the statutory tax rate was 43.9% for the fiscal year ended March 31, 2004.

During the fiscal year ended March 31, 2005, a corporation size-based enterprise tax was introduced in Japan and the portion of enterprise tax subject to income was reduced. As a result, the statutory tax rate for the fiscal year ended March 31, 2005 was approximately 41% effective April 1, 2004. The effect of the change in the tax rate on the balance of deferred tax assets and liabilities was insignificant.

Reconciliation of the differences between the statutory tax rate and the effective income tax rate is as follows:

	Fiscal Year Ended March 31		
	2004	2005	2006
Statutory tax rate	43.9%	41.0%	41.0%
Increase (reduction) in taxes resulting from:			
Income tax credits	(2.4)	(0.1)	(1.3)
Change in valuation allowances	6.5	(22.7)	21.6
Increase (decrease) in deferred tax liabilities on undistributed earnings of foreign subsidiaries	(9.2)	(4.0)	4.5
Lower tax rate applied to life and non-life insurance business in Japan	(2.6)	(1.9)	(3.2)
Other	0.4	(2.1)	(1.0)
Effective income tax rate	36.6%	10.2%	61.6%

The significant components of deferred tax assets and liabilities are as follows:

	Yen in millions March 31		Dollars in millions March 31,
	2005	2006	2006
Deferred tax assets:			
Operating loss carryforwards for tax purposes	¥193,212	¥146,206	$1,250
Accrued pension and severance costs	159,610	95,226	814
Film costs	56,746	51,937	444
Warranty reserve and accrued expenses	56,551	52,008	445
Future insurance policy benefits	36,654	24,785	212
Accrued bonus	34,536	27,353	234
Inventory - intercompany profits and write-down	30,270	47,578	407
Depreciation	15,320	34,052	291
Tax credit carryforwards	8,552	39,443	337
Reserve for doubtful accounts	6,574	7,479	64
Impairment of investments	52,501	52,658	450
Deferred revenue in the Pictures segment	12,947	16,713	143
Other	88,077	144,337	1,232
Gross deferred tax assets	751,550	739,775	6,323
Less: Valuation allowance	(89,110)	(150,899)	(1,290)
Total deferred tax assets	662,440	588,876	5,033
Deferred tax liabilities:			
Insurance acquisition costs	(135,083)	(136,919)	(1,170)
Unbilled accounts receivable in the Pictures segment	(57,314)	(49,953)	(427)
Unrealized gains on securities	(41,564)	(63,739)	(545)
Intangible assets acquired through stock exchange offerings	(35,418)	(34,627)	(296)
Undistributed earnings of foreign subsidiaries	(30,865)	(66,719)	(570)
Gain on securities contribution to employee retirement benefit trust	(6,184)	(3,992)	(34)
Other	(58,714)	(65,151)	(557)
Gross deferred tax liabilities	(365,142)	(421,100)	(3,599)
Net deferred tax assets	¥297,298	¥167,776	$1,434

The valuation allowance mainly relates to deferred tax assets of Sony Corporation and certain consolidated subsidiaries with operating loss carryforwards and tax credit carryforwards for tax purposes that are not expected to be realized. The net changes in the total valuation allowance were an increase of ¥11,509 million for the fiscal year ended March 31, 2004, a decrease of ¥38,467 million for the fiscal year ended March 31, 2005 and an increase of ¥61,789 million ($528 million) for the fiscal year ended March 31, 2006. The increase during the fiscal year ended March 31,2006 resulted from a provision for additional valuation allowances due to continued losses recorded by Sony Corporation and certain subsidiaries mainly in the electronics business.

As a result of operating losses in the past, certain consolidated subsidiaries in the U.S. had recognized valuation allowances against deferred tax assets for U.S. federal and certain state taxes. However, because of improved operating results in recent years and a sound outlook for the future operating performance of certain consolidated subsidiaries in the U.S., Sony reversed ¥67,892 million of valuation allowance, resulting in a reduction of income tax expenses for the fiscal year ended March 31, 2005.

Tax benefits which have been realized through utilization of operating loss carryforwards for the fiscal years ended March 31, 2004, 2005 and 2006 were approximately ¥12,000 million, ¥30,000 million and ¥42,000 million ($359 million), respectively.

Net deferred tax assets are included in the consolidated balance sheets as follows:

	Yen in millions		Dollars in millions
	March 31		March 31,
	2005	2006	2006
Current assets - Deferred income taxes	¥141,154	¥221,311	$1,892
Other assets - Deferred income taxes	240,398	178,751	1,528
Current liabilities - Other	(12,025)	(15,789)	(136)
Long-term liabilities - Deferred income taxes	(72,227)	(216,497)	(1,850)
Net deferred tax assets	¥297,298	¥167,776	$1,434

At March 31, 2006, no deferred income taxes have been provided on undistributed earnings of foreign subsidiaries not expected to be remitted in the foreseeable future totaling ¥1,065,809 million ($9,109 million), and on the gain of ¥61,544 million on a subsidiary's sale of stock arising from the issuance of common stock of Sony Music Entertainment (Japan) Inc. in a public offering to third parties in November 1991, as Sony does not anticipate any significant tax consequences on possible future disposition of its investment based on its tax planning strategies. The unrecognized deferred tax liabilities as of March 31, 2006 for such temporary differences amounted to ¥228,546 million ($1,953 million).

Operating loss carryforwards for corporate income tax and local income tax purposes of Sony Corporation and certain consolidated subsidiaries in Japan at March 31, 2006 amounted to ¥121,530 million ($1,039 million) and ¥484,397 million ($4,140 million), respectively, which are available as an offset against future taxable income. Deferred tax asset on the operating loss carryforwards for corporate income tax and local income tax in Japan are calculated by multiplying approximately 28% and 13%, respectively.

Operating loss carryforwards for tax purposes of certain foreign consolidated subsidiaries at March 31, 2006

amounted to ¥173,624 million ($1,484 million).

With the exception of ¥111,265 million ($951 million) with no expiration period, total available operating loss carryforwards expire at various dates primarily up to 7 years.

Tax credit carryforwards for tax purposes at March 31, 2006 amounted to ¥39,443 million ($337 million). With the exception of ¥9,116 million ($78 million) with no expiration period, total available tax credit carryforwards expire at various dates primarily up to 9 years.

Realization is dependent on whether such companies will be able to generate sufficient taxable income prior to expiration of the loss carryforwards and tax credit carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets, less valuation allowance, will be realized. The amount of such net deferred tax assets considered realizable, however, could be changed in the near term if estimates of future taxable income during the carryforward period are changed.

22. Reconciliation of the differences between basic and diluted net income per share ("EPS")

(1) Income before cumulative effect of accounting changes and net income allocated to each class of stock:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31,			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Income before cumulative effect of an accounting change allocated to common stock	¥90,756	¥168,498	¥122,308	$1,046
Income allocated to subsidiary tracking stock	(128)	53	1,308	11
Income before cumulative effect of an accounting change	¥90,628	¥168,551	¥123,616	$1,057
Net income allocated to common stock	¥88,639	¥163,785	¥122,308	$1,046
Net income allocated to subsidiary tracking stock	(128)	53	1,308	11
Net income	¥88,511	¥163,838	¥123,616	$1,057

As discussed in Note 2, the earnings allocated to subsidiary tracking stock are determined based on the subsidiary tracking stockholders' economic interest. The accumulated losses of SCN (the subsidiary tracking stock entity as discussed in Note 16) used for computation of earnings per share attributable to subsidiary tracking stock were ¥1,764 million and ¥1,358 million as of March 31, 2004 and 2005, respectively.

As discussed in Notes 2 and 16, on October 26, 2005, the Board of Directors of Sony Corporation decided to terminate all shares of subsidiary tracking stock and convert such shares to shares of Sony common stock at a conversion rate of 1.114 share of Sony common stock per share of subsidiary tracking stock. All shares of subsidiary tracking stock were converted to shares of Sony common stock on December 1, 2005. As a result of the conversion, the earnings allocated to common stock for the fiscal year ended March 31, 2006 are calculated by subtracting the

earnings allocated to the subsidiary tracking stock for the eight months ended November 30, 2005. The accumulated gains of SCN used for computation of earnings per share attributable to subsidiary tracking stock were ¥8,578 million as of November 30, 2005.

(2) EPS attributable to common stock:

Reconciliation of the differences between basic and diluted EPS for the fiscal years ended March 31, 2004, 2005 and 2006 is as follows:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Income before cumulative effect of an accounting change allocated to common stock	¥90,756	¥168,498	¥122,308	$1,046
Effect of dilutive securities:				
Convertible bonds	2,260	1,209	-	-
Subsidiary tracking stock	-	(0)	(29)	(0)
Income before cumulative effect of an accounting change allocated to common stock for diluted EPS computation	¥93,016	¥169,707	¥122,279	$1,046
	Thousands of shares			
Weighted-average shares	923,650	931,125	997,781	
Effect of dilutive securities:				
Warrants and stock acquisition rights	48	61	915	
Convertible bonds	121,120	112,589	47,468	
Weighted-average shares for diluted EPS computation	1,044,818	1,043,775	1,046,164	
	Yen			Dollars
Basic EPS	¥98.26	¥180.96	¥122.58	$1.05
Diluted EPS	¥89.03	¥162.59	¥116.88	$1.00

Potential common stock upon the exercise of warrants and stock acquisition rights, which were excluded from the computation of diluted EPS since they have an exercise price in excess of the average market value of Sony's common stock during the fiscal year, were 6,796 thousand shares, 7,987 thousand shares and 10,483 thousand shares for the fiscal years ended March 31, 2004, 2005 and 2006, respectively.

Warrants and stock acquisition rights of subsidiary tracking stock for the fiscal year ended March 31, 2004 which have a potentially dilutive effect by decreasing net income allocated to common stock, were excluded from the computation of diluted EPS since they did not have a dilutive effect.

Stock options issued by affiliated companies accounted for under the equity method for the fiscal years ended March 31, 2004, 2005 and 2006, which have a potentially dilutive effect by decreasing net income allocated to common stock, were excluded from the computation of diluted EPS since such stock options did not have a dilutive

effect.

On May 1, 2003, Sony implemented a share exchange as a result of which CIS Corporation became a wholly-owned subsidiary. As a result of this share exchange, Sony issued 1,088 thousand shares. The shares were included in the computation of basic and diluted EPS.

As a result of the adoption of EITF Issue No. 04-8, Sony's diluted EPS of income before cumulative effect of an accounting change for the fiscal year ended March 31, 2004 was restated in the above table (Note 2).

(3) EPS attributable to subsidiary tracking stock:

Weighted-average shares used for computation of EPS attributable to subsidiary tracking stock for the fiscal years ended March 31, 2004 and 2005 were 3,072 thousand shares. At March 31, 2004 and 2005, there were no potentially dilutive securities for net income per subsidiary tracking stock, as tracking stock shares outstanding were increased upon potential subsidiary tracking stocks' being exercised, which resulted in a proportionate increase in earnings allocated to the subsidiary tracking stock. However, they could have a dilutive effect on net income per common stock, as earnings allocated to the common stock would be decreased.

As discussed, all shares of subsidiary tracking stock were converted to shares of Sony common stock on December 1, 2005. As a result of the conversion, earnings per share of the subsidiary tracking stock for the fiscal year ended March 31, 2006 are not presented.

23. Variable interest entities

Sony has, from time to time, entered into various arrangements with VIEs. These arrangements consist of facilities which provide for the leasing of certain property, the financing of film production, the implementation of a stock option plan for Japanese employees and the U.S. based music publishing business. As described in Note 2, the FASB issued FIN No. 46, which requires the consolidation or disclosure of VIEs. The VIEs that have been consolidated by Sony are described as follows:

Sony leases the headquarters of its U.S. subsidiary from a VIE, which has been consolidated by Sony since July 1, 2003. Upon consolidation of the VIE, assets and liabilities increased by ¥25,277 million and ¥27,035 million, respectively, and a cumulative effect of accounting change of ¥1,729 million was charged to net income with no tax effect. Sony has the option to purchase the building at any time during the lease term which expires in December 2008 for ¥29,942 million ($256 million). The debt held by the VIE is unsecured. At the end of the lease term, Sony has agreed to either renew the lease, purchase the building or remarket it to a third party on behalf of the owner. If the sales price is less than ¥29,942 million ($256 million), Sony is obligated to make up the lesser of the shortfall or ¥25,128 million ($215 million).

A subsidiary in the Pictures segment entered into a joint venture agreement with a VIE for the purpose of funding the acquisition of certain international film rights. The subsidiary is required to distribute the product internationally, for contractually defined fees determined as percentages of gross receipts, as defined, and is responsible for all distribution and marketing expenses, which are recouped from such distribution fees. The VIE was capitalized with total financing of ¥47,673 million. Of this amount, ¥1,292 million was contributed by the subsidiary, ¥11,155 million was provided by unrelated third party investors and the remaining funding is provided through a ¥35,226 million bank credit facility. On July 1, 2003, Sony consolidated this entity. Upon consolidation of the VIE, assets and liabilities

increased by ¥10,179 million and ¥10,586 million, respectively, and a cumulative effect of accounting change of ¥388 million was charged to net income with no tax effect. As of March 31, 2006, there were no amounts outstanding under the bank credit facility. Under the agreement, the subsidiary's ¥1,292 million ($11 million) equity investment is the last equity to be repaid. Additionally, it must pay to the third party investors up to ¥2,231 million ($19 million) of any losses out of a portion of its distribution fees. Any losses incurred by the VIE over and above ¥3,523 million ($30 million) will be shared by the other investors. The subsidiary acquired the international distribution rights, as defined, to twelve pictures meeting certain minimum requirements within the time period provided in the agreement.

Sony utilized a VIE to implement a SAR plan (Note 17) for selected Japanese employees. The VIE has been consolidated by Sony since its establishment. With respect to this entity, there was no impact to Sony's results of operations and financial position upon the adoption of FIN No. 46. Under the terms of the SAR plan, upon exercise, Japanese employees receive cash equal to the amount that the market price of Sony Corporation's common stock exceeds the strike price of the plan. In order to minimize cash flow exposure associated with the plan, Sony held treasury stock through the VIE. The VIE purchased the common stock with funding provided by the employee's cash contribution and a bank loan. The SAR plan was terminated during the fiscal year ended March 31, 2006 and there were no amounts outstanding under the bank loan at March 31, 2006.

Sony's U.S. based music publishing subsidiary is a joint venture with a third party investor that was determined to be a VIE. The subsidiary owns and acquires rights to musical compositions, exploits and markets these compositions and receives royalties or fees for their use. Under the terms of the joint venture, Sony has the obligation to fund any working capital deficits. In addition, the third party investor receives a guaranteed annual dividend of up to $7 million and has the option to put its 50% ownership interest to Sony in exchange for a payment of $200 million. At March 31, 2006, the fair value of the third party's 50% interest exceeded $200 million.

VIEs in which Sony holds a significant variable interest but is not the primary beneficiary are described as follows:

As described in Note 6, on April 8, 2005, a consortium led by SCA and its equity partners completed the acquisition of MGM. Sony has reviewed the investment and determined that MGM is a VIE. However, MGM is not consolidated but accounted for under the equity method as Sony is not the primary beneficiary of this VIE as Sony absorbs less than 50% of expected losses and does not have the right to receive greater than 50% of expected residual returns. MGM continues to operate as a private company and continues to engage in the production and distribution of film content. Through its current ownership of MGM's common stock, Sony records 45% of MGM's net income (loss) as equity in net income of affiliated companies.

On December 30, 2005, a subsidiary in the Picture segment entered into a production/co-financing agreement with a VIE to co-finance 11 films scheduled to be released over the following 15 months. The subsidiary will receive approximately $400 million over the term of the agreement. The subsidiary is responsible for marketing and distribution of the product through its global distribution channels. The VIE shares in the net profits of the films after the subsidiary recoups a distribution fee, its marketing and distribution expenses, and third party participation and residual costs. As of March 31, 2006, only one co-financed film has been released by the company. The subsidiary did not make any equity investment in the VIE nor issue any guarantees with respect to the VIE. In May 2006, the subsidiary entered into a second production/co-financing agreement with a VIE to co-finance an additional 11 films to be released over the following 24 months. The subsidiary will receive approximately $330 million over the term of the agreement. Similar to the first agreement, the subsidiary is responsible for marketing and distribution of the product through its global distribution channels. The VIE shares in the net profits of the films after the subsidiary recoups a distribution fee, its marketing and distribution expenses, and third party participation and residual costs.

24. Commitments and contingent liabilities

(1) Commitments:

A. Purchase Commitments

Commitments outstanding at March 31, 2006 amounted to ¥285,774 million ($2,443 million). The major components of these commitments are as follows:

In the ordinary course of business, Sony makes commitments for the purchase of property, plant and equipment. As of March 31, 2006, such commitments outstanding were ¥69,286 million ($592 million).

Certain subsidiaries in the Pictures segment have entered into agreements with creative talent for the development and production of films and television programming as well as agreements with third parties to acquire completed films, or certain rights therein. These agreements cover various periods through March 31, 2008. As of March 31, 2006, these subsidiaries were committed to make payments under such contracts of ¥43,659 million ($373 million).

A subsidiary in the Pictures segment has also entered into a distribution agreement with a third party to distribute, in certain markets and territories, all feature length films produced or acquired by the third party during the term of the agreement. The distribution agreement expires on December 31, 2006 if a minimum of 36 films have been delivered as of that date. If 36 films have not been delivered by December 31, 2006, the distribution agreement expires on the earlier of the delivery of the 36th film or May 25, 2007. It is estimated that the third party will produce or acquire a total of 43 films under the distribution agreement. The subsidiary has the right to distribute the films for 15 years from the initial theatrical release of the film. Under the terms of the distribution agreement, the subsidiary must fund a portion of the production cost and is responsible for all distribution and marketing expenses. As of March 31, 2006, 34 films have been released or funded by the subsidiary. The subsidiary's estimated commitment to fund the production of the remaining films under this agreement is ¥33,077 million ($283 million).

In April 2006, Sony Corporation has entered into a partnership program contract with Fédération Internationale de Football Association ("FIFA"). Through this program Sony Corporation will be able to exercise various rights as an official sponsor of FIFA events including the FIFA World Cup ™* from 2007 to 2014. As of March 31, 2006, Sony Corporation was committed to make payments under such contract of ¥34,639 million ($296 million).

* FIFA World Cup ™ is a registered trademark of FIFA.

The schedule of the aggregate amounts of year-by-year payment of purchase commitments during the next five years and thereafter is as follows:

Fiscal Year Ending March 31,	Yen in millions	Dollars in millions
2007	¥139,130	$1,190
2008	44,538	381
2009	46,966	401
2010	6,003	51
2011	6,553	56
Thereafter	42,584	364
Total	¥285,774	$2,443

B. Loan Commitments

Subsidiaries in the Financial Services segment have entered into loan agreements with their customers in accordance with the condition of the contracts. As of March 31, 2006, the total unused portion of the line of credit extended under these contracts was ¥326,691 million ($2,792 million).

In August 2004, Sony and Bertelsmann AG combined their recorded music businesses in a joint venture. In connection with the establishment of the SONY BMG joint venture, Sony and Bertelsmann AG have entered into a 5 year Revolving Credit Agreement with the joint venture. Under the terms of the Credit Agreement, Sony and Bertelsmann have each agreed to provide one-half of the funding. The Credit Agreement, which matures on August 5, 2009, provides for a base commitment of $300 million and additional incremental borrowings of up to $150 million. As of March 31, 2006, the joint venture had no borrowings outstanding under the Credit Agreement. Accordingly, Sony's outstanding commitment under the Credit Agreement as of March 31, 2006 was ¥26,325 million ($225 million).

The aggregate amounts of future year-by-year payments for these loan commitments cannot be determined.

(2) Contingent liabilities:

Sony had contingent liabilities including guarantees given in the ordinary course of business, which amounted to ¥21,072 million ($180 million) at March 31, 2006. The major components of the contingent liabilities are as follows:

Sony has issued loan guarantees to related parties comprised of affiliated companies accounted for under the equity method and unconsolidated subsidiaries. The terms of these guarantees are mainly within 1 year. Sony would be required to perform under these guarantees upon non-performance of the primary borrowers. The contingent liability related to these guarantees was ¥9,325 million ($80 million) and was not recorded on the consolidated balance sheet as of March 31, 2006.

The European Commission ("EC") has issued the Waste Electrical and Electronic Equipment ("WEEE") directive in February 2003. The WEEE directive generally requires electronics producers after August 2005 to be responsible for financing the cost for collection, treatment, recovery and safe disposal of waste products. In some member states of the European Union ("EU") the directive has been transposed into national legislation subject to which Sony recognizes the liability for obligations associated with WEEE. During the fiscal year ended March 31,

2006, the cost that has been accrued in respect to the above mentioned WEEE responsibilities was not material to Sony's results of operations and financial position. While the cost of this WEEE directive to Sony cannot be determined before the regulation is finally adopted in all individual member states that have to transpose the directive into national legislation, Sony continues to evaluate the impact of this regulation.

Sony has agreed to indemnify certain third parties against tax losses resulting from transactions entered into in the normal course of business. The maximum amount of potential future payments under these guarantees cannot be estimated at this time. These guarantees were not recorded on the consolidated balance sheet as of March 31, 2006.

Sony Corporation and certain of its subsidiaries are defendants in several pending lawsuits. However, based upon the information currently available to both Sony and its legal counsel, management of Sony believes that damages from such lawsuits, if any, would not have a material effect on Sony's consolidated financial statements.

The changes in product warranty liability for the fiscal years ended March 31, 2005 and 2006 are as follows:

	Yen in millions		Dollars in millions
	Fiscal Year Ended March 31,		Fiscal Year Ended March 31,
	2005	2006	2006
Balance at beginning of the fiscal year	¥50,670	¥44,919	$384
Additional liabilities for warranties	33,493	48,471	414
Settlements (in cash or in kind)	(40,358)	(45,162)	(386)
Changes in estimate for pre-existing warranty reserve	(751)	70	1
Translation adjustment	1,865	1,172	10
Balance at end of the fiscal year	¥44,919	¥49,470	$423

25. Business segment information

Effective for the fiscal year ended March 31, 2006, Sony has partly changed its business segment configuration as described below.

As of August 1, 2004, Sony and Bertelsmann AG combined their recorded music businesses in a joint venture. In connection with the establishment of this joint venture, the non-Japan based disc manufacturing and physical distribution businesses, formerly included within the Music segment, have been reclassified to the "Other" category in the Electronics segment. In addition, effective April 1, 2005, a similar change was made with respect to the Japan based disc manufacturing businesses. Results for the fiscal year ended March 31, 2004 and 2005 in the Electronics segment have been restated to account for these reclassifications. As a result of these changes in the Music segment, Sony no longer breaks out the Music segment as a reportable segment as it no longer meets the materiality threshold. Effective April 1, 2005, results for the Music segment are included within the All Other. Accordingly, results for the fiscal year ended March 31, 2004 and 2005 in the Electronics segment and the All Other have been restated to conform to the presentation for the fiscal year ended March 31, 2006.

In July 2004, in order to establish a more efficient and coordinated semiconductor supply structure, the Sony group has integrated its semiconductor manufacturing business by transferring Sony Computer Entertainment's

semiconductor manufacturing operation from the Game segment to the Electronics segment. As a result of this transfer, sales revenue and expenditures associated with this operation are now recorded within the "Semiconductor" category in the Electronics segment. The results for the fiscal year ended March 31, 2004 have not been restated as such comparable figures cannot be practically obtained given that it was not operated as a separate line business within the Game segment. This integration of the semiconductor manufacturing businesses is a part of Sony's semiconductor strategy of utilizing semiconductor technologies and manufacturing equipment originally developed or designed for the Game businesses within the Sony group as a whole.

The Electronics segment designs, develops, manufactures and distributes audio-visual, informational and communicative equipment, instruments and devices throughout the world. The Game segment designs, develops and sells PlayStation, PlayStation 2 and PlayStation Portable game consoles and related software mainly in Japan, the United States of America and Europe, and licenses to third party software developers. The Pictures segment develops, produces and manufactures image-based software, including film, video, and television mainly in the United States of America, and markets, distributes and broadcasts in the worldwide market. The Financial Services segment represents primarily individual life insurance and non-life insurance businesses in the Japanese market, leasing and credit financing businesses and bank business in Japan. The All Other consists of various operating activities, primarily including a business focused on network service business including Internet-related services, an animation production and marketing business, an imported general merchandise retail business, an IC card business, and an advertising agency business in Japan. Sony's products and services are generally unique to a single operating segment.

The operating segments reported below are the segments of Sony for which separate financial information is available and for which operating profit or loss amounts are evaluated regularly by executive management in deciding how to allocate resources and in assessing performance.

Business segments -

Sales and operating revenue:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Sales and operating revenue:				
Electronics -				
Customers	¥4,858,631	¥4,806,494	¥4,763,555	$40,714
Intersegment	228,834	260,339	386,922	3,307
Total	5,087,465	5,066,833	5,150,477	44,021
Game -				
Customers	753,732	702,524	918,251	7,848
Intersegment	26,488	27,230	40,368	345
Total	780,220	729,754	958,619	8,193
Pictures -				
Customers	756,370	733,677	745,859	6,375
Intersegment	-	-	-	-
Total	756,370	733,677	745,859	6,375
Financial Services -				
Customers	565,752	537,715	720,566	6,159
Intersegment	27,792	22,842	22,649	194
Total	593,544	560,557	743,215	6,353
All Other -				
Customers	561,906	379,206	327,205	2,797
Intersegment	100,903	80,688	81,676	698
Total	662,809	459,894	408,881	3,495
Elimination	(384,017)	(391,099)	(531,615)	(4,544)
Consolidated total	¥7,496,391	¥7,159,616	¥7,475,436	$63,893

Electronics intersegment amounts primarily consist of transactions with the Game, Pictures segments and All Other. All Other intersegment amounts primarily consist of transactions with the Electronics and Game segments.

Segment profit or loss:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Operating income (loss):				
Electronics	¥(8,082)	¥(34,273)	¥(30,930)	$(264)
Game	67,578	43,170	8,747	75
Pictures	35,230	63,899	27,436	234
Financial Services	55,161	55,490	188,323	1,610
All Other	(16,225)	4,188	16,183	138
Total	133,662	132,474	209,759	1,793
Elimination	12,658	14,016	13,786	118
Unallocated amounts:				
Corporate expenses	(47,418)	(32,571)	(32,290)	(276)
Consolidated operating income	98,902	113,919	191,255	1,635
Other income	122,290	97,623	153,616	1,313
Other expenses	(77,125)	(54,335)	(58,542)	(501)
Consolidated income before income taxes	¥144,067	¥157,207	¥286,329	$2,447

Operating income is sales and operating revenue less costs and operating expenses.

Assets:

	Yen in millions			Dollars in millions
	March 31			March 31,
	2004	2005	2006	2006
Total assets:				
Electronics	¥3,036,404	¥3,476,465	¥3,548,720	$30,331
Game	684,226	482,037	520,394	4,448
Pictures	856,517	863,056	1,029,907	8,803
Financial Services	3,475,039	3,885,517	4,565,607	39,022
All Other	763,911	577,733	617,868	5,281
Total	8,816,097	9,284,808	10,282,496	87,885
Elimination	(282,057)	(398,074)	(361,392)	(3,089)
Corporate assets	556,622	612,366	686,649	5,869
Consolidated total	¥9,090,662	¥9,499,100	¥10,607,753	$90,665

Unallocated corporate assets consist primarily of cash and cash equivalents, securities investments and property, plant and equipment maintained for general corporate purposes.

Other significant items:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Depreciation and amortization:				
Electronics	¥214,400	¥276,704	¥304,561	$2,603
Game	57,256	16,504	5,087	44
Pictures	7,844	5,598	7,401	63
Financial Services, including deferred insurance acquisition costs	56,586	52,788	47,736	408
All Other	26,066	17,012	12,755	109
Total	362,152	368,606	377,540	3,227
Corporate	4,117	4,259	4,303	37
Consolidated total	¥366,269	¥372,865	¥381,843	$3,264
Capital expenditures for segment assets:				
Electronics	¥253,621	¥312,216	¥328,625	$2,809
Game	100,360	18,824	8,405	72
Pictures	6,013	5,808	10,097	86
Financial Services	4,618	3,845	4,456	38
All Other	12,134	7,928	4,186	36
Total	376,746	348,621	355,769	3,041
Corporate	1,518	8,197	28,578	244
Consolidated total	¥378,264	¥356,818	¥384,347	$3,285

The capital expenditures in the above table represent the additions to fixed assets of each segment.

The following table is a breakdown of Electronics sales and operating revenue to external customers by product category. The Electronics segment is managed as a single operating segment by Sony's management. Effective for the fiscal year ended March 31, 2006, Sony has partly changed its product category configuration. The main change is that the professional-use projector product group has been moved from "Televisions" to "Information and Communications". Accordingly, sales and operating revenue for the fiscal years ended March 31, 2004 and 2005 have been restated to conform to the presentation for the fiscal year ended March 31, 2006.

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Audio	¥675,496	¥571,864	¥536,187	$4,583
Video	949,320	1,036,328	1,021,325	8,729
Televisions	884,600	921,195	927,769	7,930
Information and Communications	878,855	816,150	842,537	7,201
Semiconductors	253,237	246,314	240,771	2,058
Components	623,799	619,477	656,768	5,613
Other	593,324	595,166	538,198	4,600
Total	¥4,858,631	¥4,806,494	¥4,763,555	$40,714

Geographic Information -

Sales and operating revenue which are attributed to countries based on location of customers for the fiscal years ended March 31, 2004, 2005 and 2006 and long-lived assets as of March 31, 2004, 2005 and 2006 are as follows:

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Sales and operating revenue:				
Japan	¥2,220,747	¥2,100,793	¥2,168,723	$18,536
U.S.A.	2,121,110	1,977,310	1,957,644	16,732
Europe	1,765,053	1,612,536	1,715,704	14,664
Other	1,389,481	1,468,977	1,633,365	13,961
Total	¥7,496,391	¥7,159,616	¥7,475,436	$63,893

	Yen in millions			Dollars in millions
	March 31			March 31,
	2004	2005	2006	2006
Long-lived assets:				
Japan	¥1,430,443	¥1,414,632	¥1,449,997	$12,393
U.S.A.	671,534	662,120	757,055	6,471
Europe	211,147	183,620	185,352	1,413
Other	133,640	144,896	159,647	1,364
Total	¥2,446,764	¥2,405,268	¥2,532,051	$21,641

There are not any individually material countries with respect to the sales and operating revenue and long-lived assets included in Europe and Other areas.

Transfers between reportable business or geographic segments are made at arms-length prices.

There are no sales and operating revenue with a single major external customer for the fiscal years ended March 31, 2004, 2005 and 2006.

The following information shows sales and operating revenue and operating income by geographic origin for the fiscal years ended March 31, 2004, 2005 and 2006. In addition to the disclosure requirements under FAS No. 131, Sony discloses this supplemental information in accordance with disclosure requirements of the Japanese Securities and Exchange Law, to which Sony, as a Japanese public company, is subject.

	Yen in millions			Dollars in millions
	Fiscal Year Ended March 31			Fiscal Year Ended March 31,
	2004	2005	2006	2006
Sales and operating revenue:				
Japan -				
Customers	¥2,352,923	¥2,249,548	¥2,253,275	$19,259
Intersegment	2,514,698	2,575,093	3,264,281	27,900
Total	4,867,621	4,824,641	5,517,556	47,159
U.S.A. -				
Customers	2,341,304	2,166,323	2,197,304	18,781
Intersegment	198,450	235,362	279,203	2,386
Total	2,539,754	2,401,685	2,476,507	21,167
Europe -				
Customers	1,647,694	1,524,182	1,575,779	13,468
Intersegment	66,950	52,417	50,400	431
Total	1,714,644	1,576,599	1,626,179	13,899
Other -				
Customers	1,154,470	1,219,563	1,449,078	12,385
Intersegment	813,798	804,721	1,038,827	8,879
Total	1,968,268	2,024,284	2,487,905	21,264
Elimination	(3,593,896)	(3,667,593)	(4,632,711)	(39,596)
Consolidated total	¥7,496,391	¥7,159,616	¥7,475,436	$63,893
Operating income:				
Japan	¥(69,875)	¥(765)	¥199,491	$1,705
U.S.A.	85,290	72,414	11,291	96
Europe	78,822	12,186	(25,171)	(215)
Other	70,543	58,554	41,953	359
Corporate and elimination	(65,878)	(28,470)	(36,309)	(310)
Consolidated total	¥98,902	¥113,919	¥191,255	$1,635

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of
Sony Corporation (Sony Kabushiki Kaisha)

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and changes in stockholders' equity present fairly, in all material respects, the financial position of Sony Corporation and its subsidiaries ("the Company") at March 31, 2005 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2006, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ ChuoAoyama PricewaterhouseCoopers
Tokyo, Japan
May 26, 2006

Management

As of March 31, 2006

Directors

Sir Howard Stringer	Nominating Committee	Sony Corporation Chairman and Chief Executive Officer
Ryoji Chubachi	Nominating Committee	Sony Corporation President and Electronics CEO
Katsumi Ihara		Sony Corporation Executive Deputy President and President of TV & Video Business Group
Akishige Okada	Nominating Committee, Chairman of Compensation Committee	Advisor, Sumitomo Mitsui Banking Corporation
Hirobumi Kawano	Vice Chairman of the Board, Nominating Committee	Senior Vice President, JFE Steel Corporation
Yotaro Kobayashi	Chairman of the Board, Chairman of Nominating Committee	Chairman of the Board, Fuji Xerox Co., Ltd.
Sakie T. Fukushima	Audit Committee	Representative Director & Regional Managing Director—Japan, Korn/Ferry International
Yoshihiko Miyauchi	Compensation Committee	Director, Representative Executive Officer, Chairman and Group CEO, ORIX Corporation
Yoshiaki Yamauchi	Chairman of Audit Committee	Director, Sumitomo Mitsui Financial Group, Inc.
Sir Peter Bonfield		Member of the Board, Telefonaktiebolaget LM Ericsson
Fuco Sumita	Audit Committee	Chief of Sumita Accounting Office
Göran Lindahl	Compensation Committee	Chairman and CEO, Livsafe Group Member of the Board, INGKA Holding B.V.

Corporate Executive Officers

Sir Howard Stringer*	Representative Corporate Executive Officer	Chairman and Chief Executive Officer
Ryoji Chubachi*	Representative Corporate Executive Officer	President and Electronics CEO
Katsumi Ihara*	Representative Corporate Executive Officer	Executive Deputy President and President of TV & Video Business Group
Nobuyuki Oneda	Corporate Executive Officer	Executive Vice President and Chief Financial Officer
Keiji Kimura	Corporate Executive Officer	Executive Vice President, President of Technology Development Group and Officer in charge of Technology Strategies
Nicole Seligman	Corporate Executive Officer	Executive Vice President and General Counsel
Yutaka Nakagawa	Corporate Executive Officer	Executive Vice President and President of Digital Imaging Business Group and Audio Business Group

** They hold their respective offices as Corporate Executive Officers in addition to their offices as Directors.*

Investor Information

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■Sony on the Internet
Sony's Investor Relations Home Pages on the World Wide Web offer a wealth of corporate information, including the latest annual report and financial results.
http://www.sony.net/IR/

■Ordinary General Meeting of Shareholders
The Ordinary General Meeting of Shareholders is held in June.

■Independent Registered Public Accounting Firm
ChuoAoyama PricewaterhouseCoopers
Tokyo, Japan

■Depositary, Transfer Agent, and Registrar for American Depositary Receipts
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4 New York Plaza, New York, NY 10004, U.S.A.

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■Overseas Stock Exchange Listings
New York and London stock exchanges

■Japanese Stock Exchange Listings
Tokyo and Osaka stock exchanges

■Number of Shareholders
(As of March 31, 2006)
718,449

■Information regarding CSR (Corporate Social Responsibility)
Sony's CSR Report and information about Sony CSR and environmental activities can be accessed at the following web site.
http://www.sony.co.net/csr/
Inquiries concerning the aforemontioned activities can be directed to:
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EXHIBIT CO 0935

SONY

FY2006

Second Quarter Consolidated Results
(Quarter ended September 30, 2006)

Sony Corporation Investor Relations

Statements made in this presentation with respect to Sony's current plans, estimates, strategies and beliefs and other statements that are not historical facts are forward-looking statements about the future performance of Sony. Forward-looking statements include, but are not limited to, those statements using words such as "believe," "expect," "plans," "strategy," "prospects," "forecast," "estimate," "project," "anticipate," "aim," "may" or "might" and words of similar meaning in connection with a discussion of future operations, financial performance, events or conditions. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. These statements are based on management's assumptions and beliefs in light of the information currently available to it. Sony cautions you that a number of important risks and uncertainties could cause actual results to differ materially from those discussed in the forward-looking statements, and therefore you should not place undue reliance on them. You also should not rely on any obligation of Sony to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Sony disclaims any such obligation. Risks and uncertainties that might affect Sony include, but are not limited to (i) the global economic environment in which Sony operates, as well as the economic conditions in Sony's markets, particularly levels of consumer spending; (ii) exchange rates, particularly between the yen and the U.S. dollar, the Euro and other currencies in which Sony makes significant sales or in which Sony's assets and liabilities are denominated; (iii) Sony's ability to continue to design and develop and win acceptance of, as well as achieve sufficient cost reductions for, its products and services, which are offered in highly competitive markets characterized by continual new product introductions, rapid development in technology and subjective and changing consumer preferences (particularly in the Electronics, Game and Pictures segments, and music business); (iv) Sony's ability to recoup large-scale investment required for technology development, increasing production capacity and by the Game segment for the development and introduction of a new platform; (v) Sony's ability to implement successfully personnel reduction and other business reorganization activities in its Electronics segment; (vi) Sony's ability to implement successfully its network strategy for its Electronics, Game and Pictures segments and All Other, including the music business, and to develop and implement successful sales and distribution strategies in its Pictures segment and music business in light of the Internet and other technological developments; (vii) Sony's continued ability to devote sufficient resources to research and development and, with respect to capital expenditures, to correctly prioritize investments (particularly in the Electronics segment); (viii) shifts in customer demand for financial services such as life insurance and Sony's ability to conduct successful Asset Liability Management in the Financial Services segment; and (ix) the success of Sony's joint ventures and alliances. Risks and uncertainties also include the impact of any future events with material unforeseen impacts.

Results Overview and Topics Q2 FY06

Results Overview

Consolidated sales grew 8% YoY (+4% on a local currency basis) on contribution from growth in Electronics and Pictures segments, despite declines in Game sales and Financial Services revenue.

A consolidated operating loss of 20.8 bln yen was recorded, compared to an operating income of 74.6 bln yen a year ago. Q2 FY06 operating loss includes a provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program recorded in the Electronics segment, while Q2 FY05 consolidated operating income includes 73.5 bln yen of pension return benefits. Within the Game segment, charges were recorded associated with preparation for the launch of PLAYSTATION®3.

Topics

The positive market reception of DSC-T10, one of the newest additions to our lineup of Cyber-shot™ digital cameras, contributed with other models to very strong quarter for our digital camera business.

Sony Ericsson marked its 5th anniversary with increased market share, in addition to record sales and income before taxes. Major contributors included Cyber-shot and Walkman® phones.

Motion pictures including *Talladega Nights: The Ballad of Ricky Bobby* helped Sony Pictures Entertainment exceed $1 bln in U.S. box office receipts for the fifth consecutive calendar year. Sony Pictures Releasing International also surpassed $1 bln in box office receipts for CY2006, and did so in record time.

Consolidated Results Q2 FY05

(bln yen)

	Q2 FY05	Q2 FY06	Change	Change (LC)*
Sales & operating revenue	1,711.6	1,854.2	+8.3%	+4%
Operating income	74.6**	-20.8***	-	-
Income before income taxes	95.4	-26.1	-	
Equity in net income of affiliates	-2.6	19.7	-	
Net income	28.5	1.7	-94.1%	
Net income per share of common stock (diluted)	27.32 yen	1.60 yen	-94.1%	
Restructuring charges****	32.9	5.3	-27.6	

Sales & operating revenue:	approx. +80.7 bln yen	1 Dollar	110 yen	115 yen
Operating income:	approx. +19.9 bln yen	1 Euro	134 yen	147 yen

* Local currency (LC) basis: change that would have occurred with no year-on-year change in exchange rates
** Q2 FY05 operating income includes 73.5 bln yen of pension return benefits
*** Q2 FY06 operating loss includes a provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program
**** Restructuring charges are recorded as operating expenses

Segments and Affiliates Q2 FY06

(bln yen)

CONSOLIDATED SEGMENTS		Q2 FY05	Q2 FY06	Change	Change (LC*)
Electronics	Sales	1,228.4	1,378.4	+12.1%	+7%
	Operating Income	28.1**	8.0***	-71.4%	-
Game	Sales	214.2	170.3	-20.5%	-23%
	Operating Income	8.2	-43.5	-	-
Pictures	Sales	158.9	178.2	+12.1%	
	Operating Income	-6.6	-15.3	-	
Financial Services	Revenue	175.9	168.1	-4.4%	
	Operating Income	40.0**	24.8	-38.7%	
All Other	Sales	97.3	81.5	-16.3%	
	Operating Income	7.5**	8.5	-14.3%	

* Local currency (LC) basis: change that would have occurred with no year-on-year change in exchange rates
** Includes pension return benefits (54.5 bln yen within Electronics)
*** Includes a provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program

MAJOR EQUITY METHOD AFFILIATES		Q2 FY05	Q2 FY06	Change
Sony Ericsson (mln euros)	Sales	2,033	2,913	+42%
	Income before taxes	151	433	+187%
SONY BMG (mln dollars)	Sales	936	948	+1%
	Income before taxes	-58	-39	-

Sony Ericsson Mobile Communications AB & SONY BMG MUSIC ENTERTAINMENT are 50-50 joint ventures with LM Ericsson & Bertelsmann AG, respectively, both of which are account for by the equity method.

FY06 Consolidated Results Forecast

(bln yen)

	FY05	FY06 Forecast	Change
Sales & operating revenue	7,510.8	8,230	+10%
Operating income	226.4*	50**	-78%
Restructuring charges (included above)	138.7	40	-71%
Income before income taxes	286.3	70	-76%
Equity in net income of affiliates	13.2	40	+204%
Net income	123.6	80	-35%
Capital Expenditures	384.3	460	+20%
for semiconductors (included above)	140.0	170	+21%
Depreciation & Amortization***	361.8	410	+7%
Research & Development	531.8	550	+3%

Foreign Exchange Rates	FY05 Actual	FY06 Assumption (2nd Half)
1 Dollar.	112.3 yen	Approx. 114 yen
1 Euro	138.3 yen	Approx. 145 yen

* Includes 73.5 bln yen of pension return benefits
** Includes a provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program
*** Including amortization expenses for intangible assets and for deferred insurance acquisition costs.

Structural Reform Progress Report Q2 FY06

	Goal (By end of FY07)	FY05 ACT	H1 FY06 ACT	FY05 + H1 FY06 ACT
Consolidated Operating Income Margin*	5%	3.9%	2.0%	-
Electronics Operating Income Margin*	4%	1.4%	4.6%	-
Cost Reduction (bln yen)	200	38	82	120
Manufacturing Sites	11 out of 65	9	0	9
Model Count**	-20%	Base Year	-17%	-17%
Headcount	10,000	5,700	4,400	10,100
Asset Sales (bln yen)	120	78	49	127

On Track to the Original Plan

* Operating income margin, excluding restructuring charges, pension return benefits and the provision for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program.
** Model count reduction comparison based on FY05 (base year)

Electronics Q2 FY06

(bln yen)

Sales & Operating Income

	Change	(LC)
Sales	+12.1%	+7%
Operating Income	-71.4%	-

Q2 FY06 Results

Sales: Increased by 12.1%
(sales to outside customers increased 17%)

- Increase: BRAVIA LCD TVs, VAIO PCs, Cyber-shot digital cameras,
- Decrease: CRT TVs

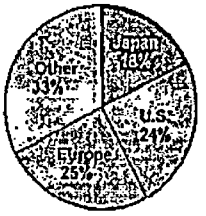
Operating Income: Decreased by 20.1 bln yen

- (-) factors: Absence of pension return benefits recorded in Q2 FY05, SGA increase
- (+) factors: Cost of sales improvement, Decrease in loss on sale, disposal or impairment of assets, Outside sales increase, Foreign exchange rate impact

Restructuring charges: 5.2 bln yen (Q2 FY05: 32.3 bln yen)

Includes intersegment transactions; "LC" is local currency comparison; % under operating income is operating margin

Electronics Sales by Area Q2 FY06

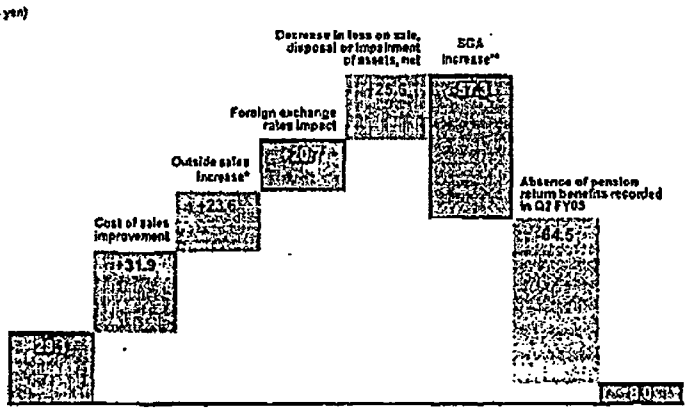


- **Japan: +8%**
  - Increase: LCD TVs, cellular phones
  - Decrease: Video cameras
- **U.S.: +19% (LC +14%)**
  - Increase: LCD TVs, digital cameras
  - Decrease: CRT TVs
- **Europe: +27% (LC +17%)**
  - Increase: LCD TVs, VAIO PCs
  - Decrease: Video cameras
- **Other Areas: +14% (LC +7%)**
  - Increase: LCD TVs
  - Decrease: CRT TVs

Sales to outside customers excluding operating revenue 1,259.8 bln yen, +17% (LC +11%)

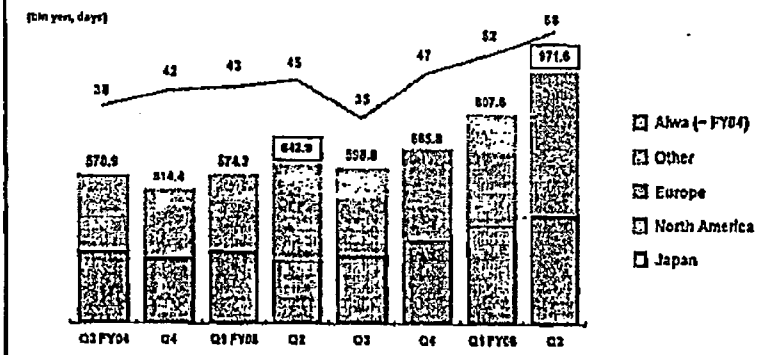
Sales composition is based on customer location (yen basis); Sales are to outside customers and exclude operating revenue; "LC" is local currency comparison

Electronics Operating Income Q2 FY06



* Increase in gross profit from the increase in sales to outside customers.
** Includes a provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program

Electronics Inventory Levels by Area



- 971.6 bln yen – a 328.7 bln yen increase from the end of same period last year, and a 164.0 bln yen increase from the end of June '06.
- Primarily a result of increased LCD television inventory as well as increased semiconductor inventory in preparation for the PS3 launch.

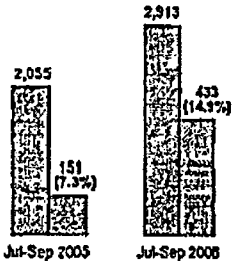
Bar graph: Inventory levels (bln yen)
Line graph: Inventory turnover (average beginning & ending inventory during the quarter divided by average daily sales in the quarter).
From FY05, Aiwa inventory have been divided by region.
Days supply for Q1 FY05 has revised due to the revision of our business segment configuration.

Sony Ericsson Mobile Communications

Equity Method Affiliate

(mln euro)

Sales & Income Before Taxes



	Change
Sales	+42%
Income Before Taxes	+187%

Jul-Sep 2006 Results

Marks 5th anniversary with record quarter

- Unit shipments up 43% YoY to 19.8 mln, outpacing market growth
- Sales and income before taxes both broke records; sales increased 42% to 2,913 mln euro, and income before taxes increased 187% to 433 mln euro
- Contributors to earnings included Cyber-shot phones (K800) and Walkman® phones (W810)

Sony recorded equity in net income of 21.8 bln yen

Impact To Sony

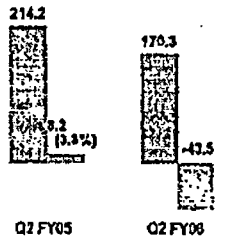
	Jul-Sep 2005	Jul-Sep 2006	Change
Net income (loss)	[illegible]	[illegible]	[illegible]
Equity in net income recorded by Sony (bln yen)	7.0	21.8	+231%

% under income before taxes is OT margin

Game Q2 FY06

(bln yen)

Sales & Operating Income



	Change	(LC)
Sales	-20.5%	-25%
Operating Income	-	-

Q2 FY05 Results

Sales:

- Although PSP software sales increased, overall sales declined primarily due to lower sales of PSP hardware

Operating loss:

- While profit from existing businesses was roughly flat, a loss was recorded mainly due to the recording of expenses for the launch of PS3

Inventory:

- 188.2 bln yen (+84% YoY)
- Increase due to the low level of PSP inventory last year, following the European PSP launch, as well as inventory recorded this year from some PS3-related components

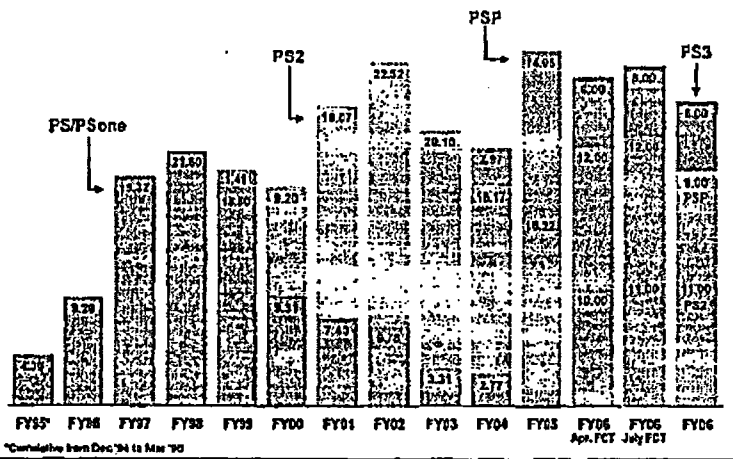
Unit Shipments

		Q2 FY05	Q2 FY06	Change
Hardware (mln units)	PS2	[illegible]	[illegible]	[illegible]
	PSP	[illegible]	[illegible]	[illegible]
Software (mln units)	PS2	[illegible]	[illegible]	[illegible]
	PSP	[illegible]	12.0	[illegible]

Includes intersegment transactions; "LC" is local currency comparison; % under operating income is operating margin

PlayStation Hardware Production Shipments

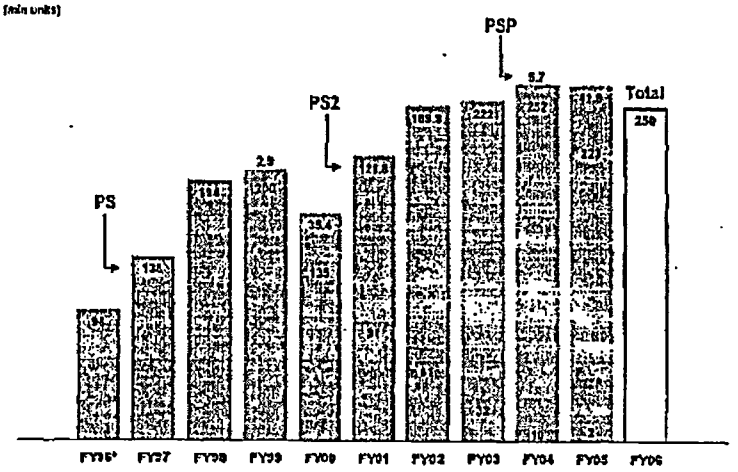
(mln units)



*Cumulative from Dec.'94 to Mar.'96

PlayStation Software Production Shipments

(mln units)

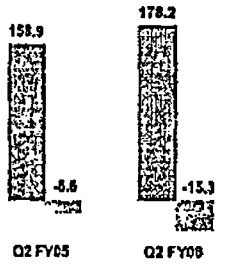


*Cumulative from Dec '94 to Mar '97

Pictures Q2 FY06

(bln yen)

Sales & Operating Income



	Change	(US$)
Sales	+12.1%	+7%
Operating Income	-	-

Q2 FY06 Results

Sales: 12% increase, 7% increase on a US$ basis

(+) factors:

- The greater number of theatrical releases during the quarter, combined with higher theatrical revenue per film
- Major contributors: *Talladega Nights: The Ballad of Ricky Bobby*, *Monster House*, and *Click*

Operating loss: 15.3 bln yen

(-) factors:

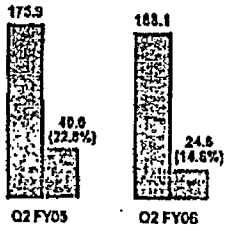
- Motion pictures: adversely affected by higher total marketing expenses resulting from a greater number of theatrical releases and the theatrical underperformance of *Zoom* and *All The King's Men*
- Television: operating income declined due to expenses associated with new network and made-for-syndication TV shows
- However, forecasting full-year profitability due to the planned release on DVD of films released in the first half

Includes intersegment transactions; "US$" is a comparison on the basis of SPE's US dollar consolidated results; % under operating income is operating margin

Financial Services Q2 FY06

(bln yen)

Financial Services Revenue & Operating Income



	Change
Revenue	-4.4%
Operating Income	-38.2%

Q2 FY06 Results

Financial Services revenue: Decreased 4%, mainly due to lower revenue at Sony Life

- Sony Life revenue: 8% lower
  - (-) factor: Lower valuation gains in the general and separate accounts
  - (+) factor: Increase in insurance premium revenue

Operating income: 39% decline mainly due to decreased income at Sony Life

- Sony Life operating income: 35% lower
  - (-) factor: Decrease in valuation gains from investments in the general account, including valuation gains from convertible bonds
  - (+) factor: Increase in revenue from insurance premiums
- Sony Assurance and Sony Bank continued to perform well

Sony Life Results

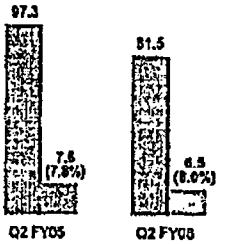
	Q2 FY05	Q2 FY06	Change
Revenue (bln yen)	[illegible]	[illegible]	[illegible]
Operating income (bln yen)	[illegible] 39.7	[illegible] 25.6	[illegible] -35%

Includes intersegment transactions; % under operating income is operating margin

All Other Q2 FY06

(bln yen)

Sales & Operating Income



	Change
Sales	-16.3%
Operating Income	-14.3%

Q2 FY06 Results

Includes SMEI's music publishing business & SMEJ

Sales: Decreased 16%

- Lower sales were mainly due to the sale of Sony retail businesses and lower sales at SMEJ
- SMEJ
  - (-) factor: Lower intersegment sales in association with the transfer of business activity relating to Sony's disc custom press business from SMEJ to other segments within the Sony Group
  - (+) factor: Increase in album and singles sales
  - Best-selling albums and singles included Yuki's *WAVE*, Beyonce's *B'Day* and Shogo Hamada's *The Best of Shogo Hamada vol.1* and *vol.2*.

Operating income: 6.5 bln yen, decrease of 14%

- Primarily the result of the absence of the pension return gains recorded in Q2 FY05 at several businesses including SMEJ. Excluding this, a significant increase in OP
- SMEJ OP relatively unchanged excluding effect of pension return gains and decreased intersegment sales

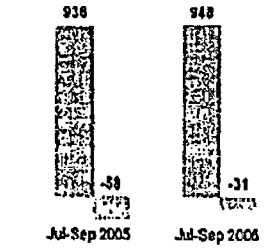
Includes intersegment transactions; % under operating income is operating margin

SONY BMG MUSIC ENTERTAINMENT

(mln dollar)

Equity Method Affiliate

Sales & Income Before Taxes



	Change
Sales	+1%
Income Before Taxes	-

Jul-Sep 2006 Results

Sales increased 1%, loss before taxes was $31 mln

- Sales: increase primarily due to foreign exchange rates impact
- Best selling albums included Justin Timberlake's *Future Sex/Love Sounds*, Beyonce's *B'Day*, and Christina Aguilera's *Back to Basics*
- Loss before taxes: improvement primarily the result of lower legal and restructuring costs
- Loss before taxes includes $39 mln in restructuring charges (Jul-Sep 2005 restructuring charges were $43 mln)

Sony recorded equity in net loss of 2.2 bln yen

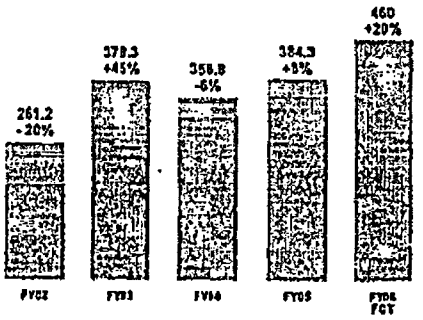
Impact To Sony

	Jul-Sep 2005	Jul-Sep 2006	Change
Equity in net income (loss) recorded by Sony (bln yen)	-3.2	-2.2	

% under Income before taxes is BT margin

FY06 Capital Expenditures Forecast

(bln yen)



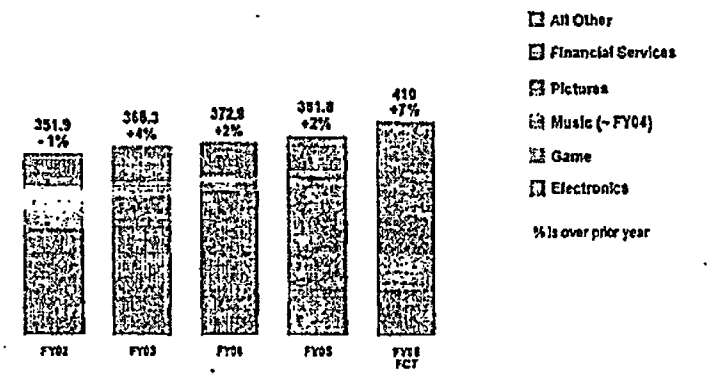
- All Other
- Financial Services
- Pictures
- Music (~FY04)
- Game
- Electronics

% is over prior year

- FY06 (FCT) includes 170 bln yen for semiconductors, compared to 140 bln in FY05
- No change from July forecast

FY06 Depreciation & Amortization Forecast

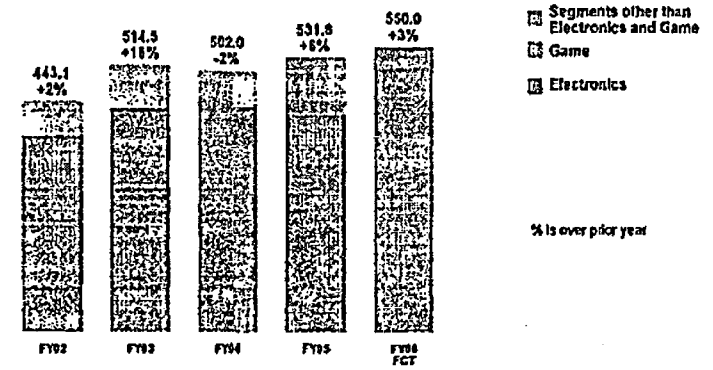
(bln yen)



- FY06 (FCT) includes 340 bln yen for depreciation of tangible assets, compared to 310.5 bln in FY05
- No change from July forecast

FY06 Research & Development Forecast

(bln yen)



- No change from July forecast

Consolidated Results H1 FY06

(bln yen)

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Sales & operating revenue	3,279.8	3,598.4	+9.7%	+5%
Operating income	68.0**	6.2***	-90.9%	-
Income before income taxes	108.3	27.9	-74.2%	
Equity in net income of affiliates	-11.7	23.3	-	
Net income	21.2	34.0	+60.2%	
Net income per share of common stock (diluted)	19.01 yen	32.36 yen	+70.2%	
Restructuring charges****	48.7	16.0	-32.7	

[illegible]	[illegible]	[illegible]	[illegible]
Sales & operating revenue: approx. +160.8 bln yen	1 Dollar	108 yen	114 yen
Operating income: approx. +38.7 bln yen	1 Euro	134 yen	144 yen

* Local currency (LC) basis: change that would have occurred with no year-on-year change in exchange rates
** H1 FY05 operating income includes 73.3 bln yen of pension return benefits
*** H1 FY06 operating income includes a provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program
**** Restructuring charges are recorded as operating expenses

Segments and Affiliates H1 FY06

(bln yen)

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Electronics	Sales	2,357.8	2,659.3	+12.8%	+7%
	Operating income	1.4***	33.4***	+3,848.1%	+[illegible]%
Game	Sales	387.0	292.8	-24.3%	-28%
	Operating income	2.3	-70.3	-	-
Pictures	Sales	303.2	382.9	+26.3%	
	Operating income	-2.4	-11.4	-	
Financial Services	Revenue	329.7	292.2	-11.4%	
	Operating income	62.0**	23.1	-63.0%	
All Other	Sales	190.4	166.6	-10.9%	
	Operating income	12.8**	11.2	-12.4%	

* Local currency (LC) basis: change that would have occurred with no year-on-year change in exchange rates
** Includes pension return benefits (64.8 bln yen within Electronics)
*** Includes provision of 51.2 bln yen for expenses relating to a notebook computer battery pack recall and our voluntary global replacement program

[illegible]	[illegible]	[illegible]	[illegible]
Sony Ericsson (mln euros)	Sales	3,469	5,185	+49%
	Income before taxes	238	644	+171%
SONY BMG (mln dollars)	Sales	1,953	1,820	-7%
	Income before taxes	-97	-104	-

Sony Ericsson Mobile Communications AB & SONY BMG MUSIC ENTERTAINMENT are 50-50 joint ventures with LM Ericsson & Bertelsmann AG, respectively, both of which are accounts for by the equity method.

EXHIBIT CO 0936

DIGITAL MUSIC NEWS

Sony BMG Executive Pegs Digital Sales at 20 Percent

October 5, 2006

Sony BMG digital chief Thomas Hesse pointed to increased online and mobile sales during a Wednesday morning address in Los Angeles. Hesse, one of the most recognized figures in the recent rootkit controversy, noted that twenty percent of the label's US-based music revenues are now coming from digital formats. Other countries like Korea are showing stronger percentages, with over 30 percent, though European nations are displaying weaker gains. Specifically, Italy is showing an 11 percent tally, Germany reported a 4 percent share, and countries like France and the UK fall somewhere in-between, according to Hesse.

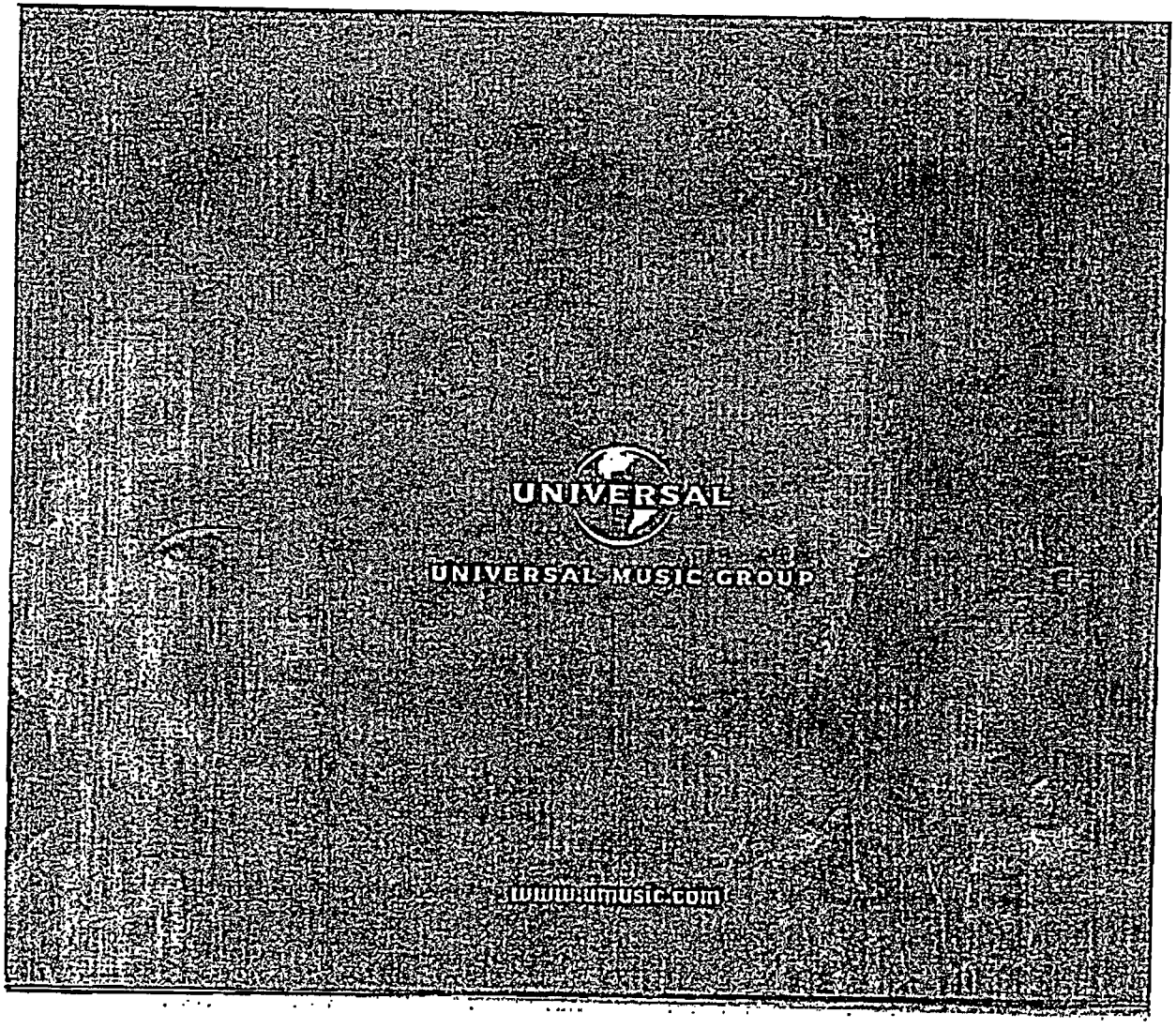
Hesse canvassed across a number of topics, including a recent MP3-based download offering from Jessica Simpson. According to Hesse, that was mostly a promotional play, and not part of a larger strategy. The Simpson offering featured name-customized versions of "A Public Affair," with each retailing for $1.99 on Yahoo Music. Meanwhile, Hesse predicted that global digital sales will likely jump 50-60 percent this year, though CDs will continue to drop. Elsewhere, Hesse pointed to a successful streaming music video initiative called MusicBox, which is now producing 16 million streams a month. "That has really surprised us," he said. In the mobile realm, the executive anticipated strong gains in the over-the-air (OTA) download market, a development that will offer some diversification away from ringtones and ringback tones. The comments were made at Digital Music Forum West, held at the Bel Age in West Hollywood.

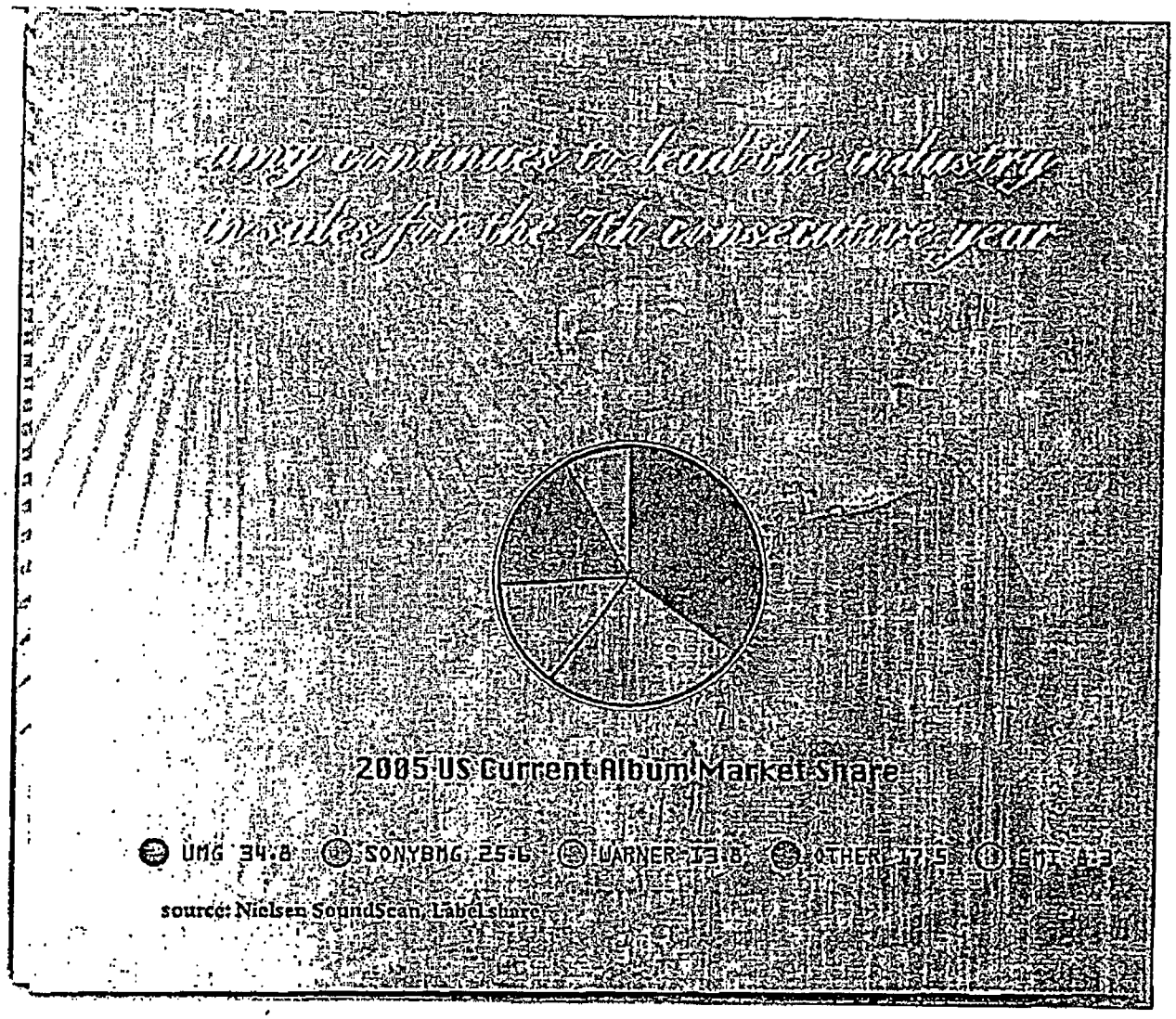
http://www.digitalmusicnews.com/yesterday/october2006#100506hesse

EXHIBIT CO 0937

UNIVERSAL MUSIC GROUP
THE INDUSTRY LEADER

UNIVERSAL MUSIC GROUP


UNIVERSAL
UNIVERSAL MUSIC GROUP
www.umusic.com

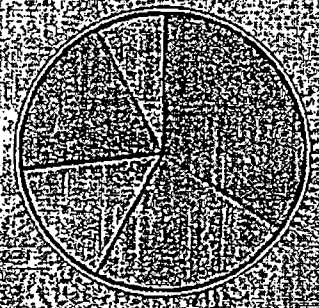

umg continues to lead the industry
in sales for the 7th consecutive year

source: Nielsen SoundScan, Label share

UMG has the most #1 albums

In 2005, UMG artists held the #1 spot on the album chart 50% of the time (26 of 52 weeks)

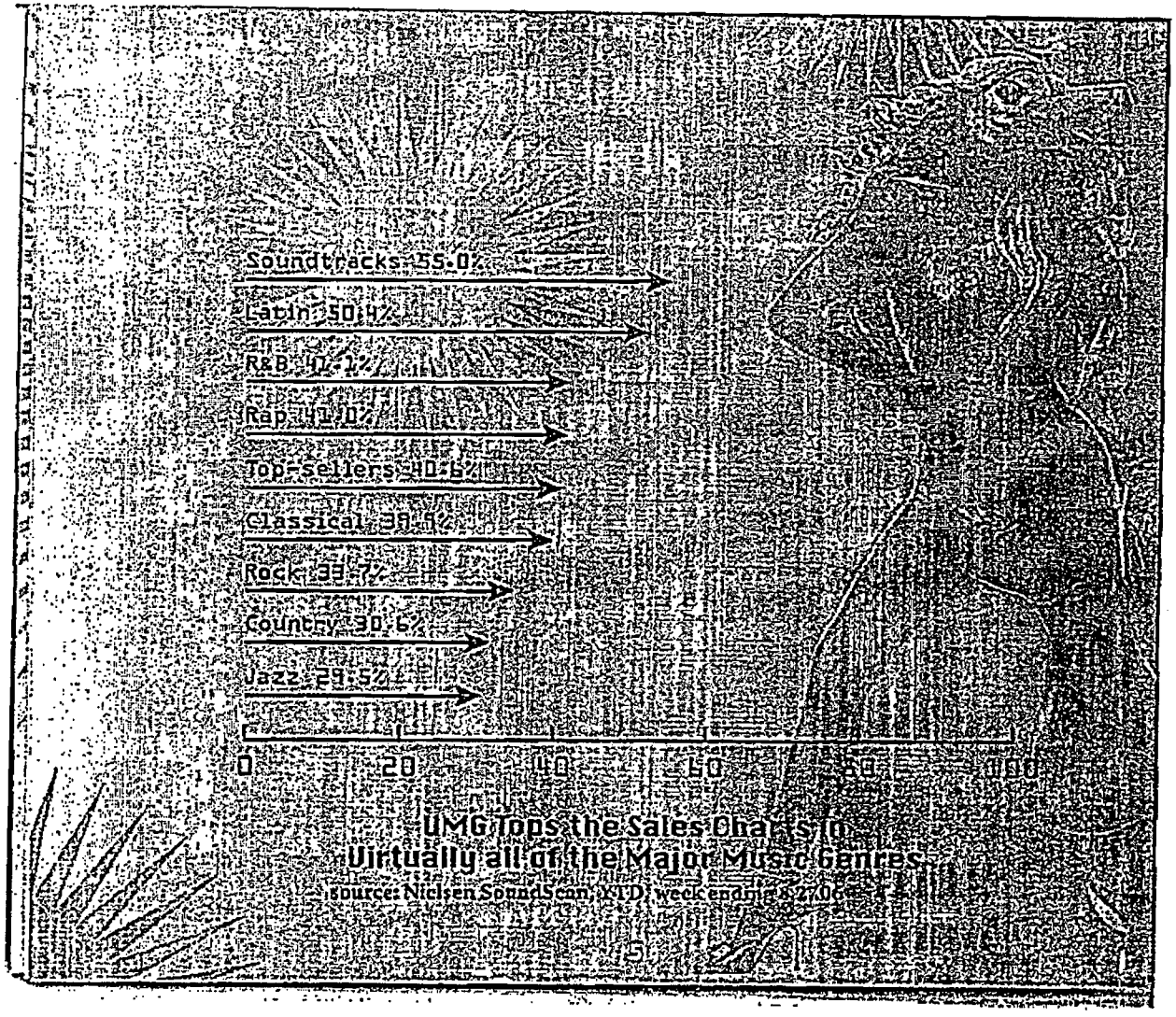
In 2006, UMG artists have held the #1 spot on the album chart 48% of the time (16 of 33 weeks)



2006 US Year-To-Date Current Album Market Share

UMG 34.4 | SONYBMG 29.3 | WARNER 15.5 | OTHER 18.8 | EMI 8.0

Source: Nielsen SoundScan, Label share week ending 8.27.06



UMG Tops the Sales Charts in Virtually all of the Major Music Genres

source: Nielsen SoundScan, CD, weekending 8/27/06

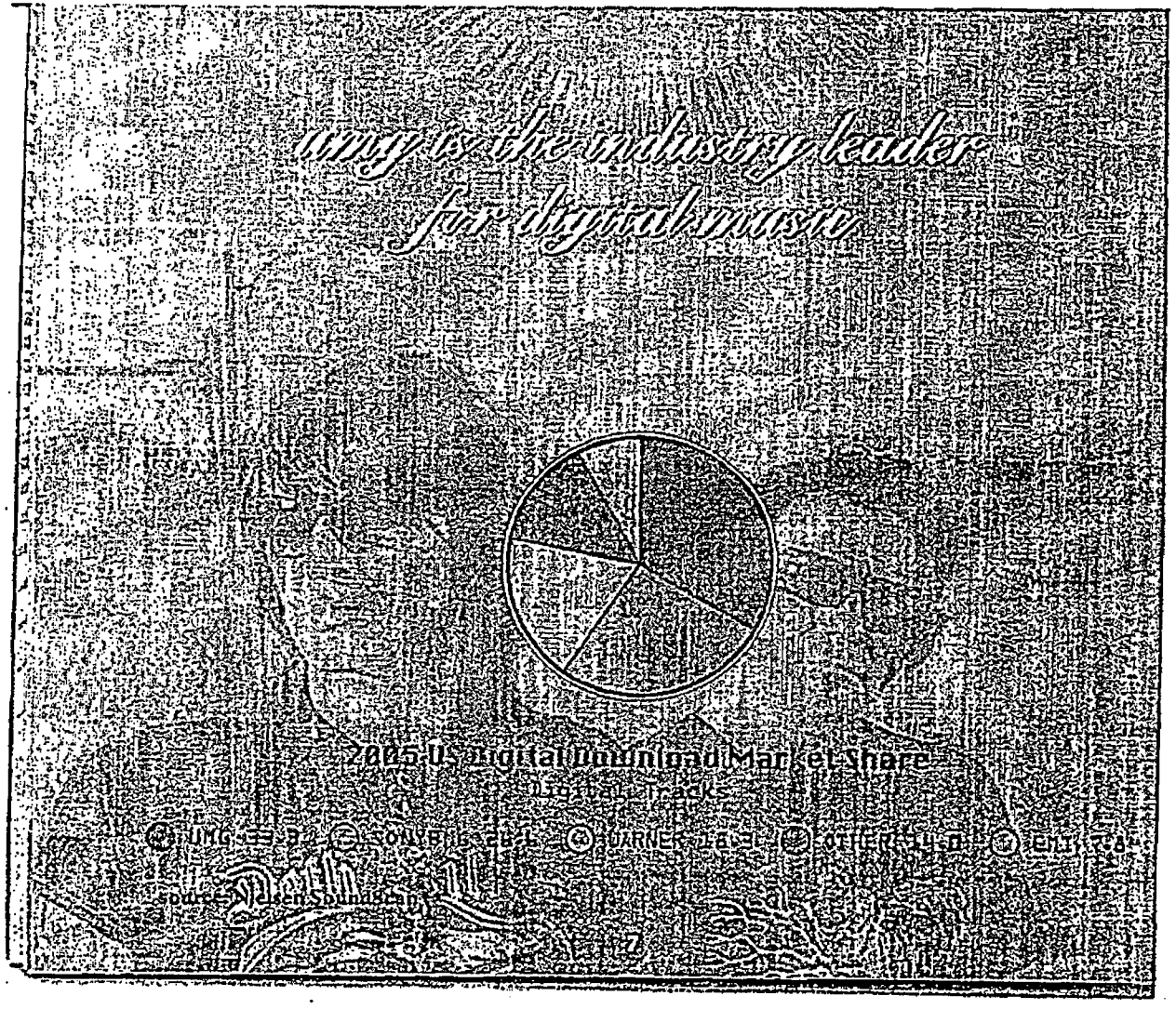
...ung artists lead best sellers chart

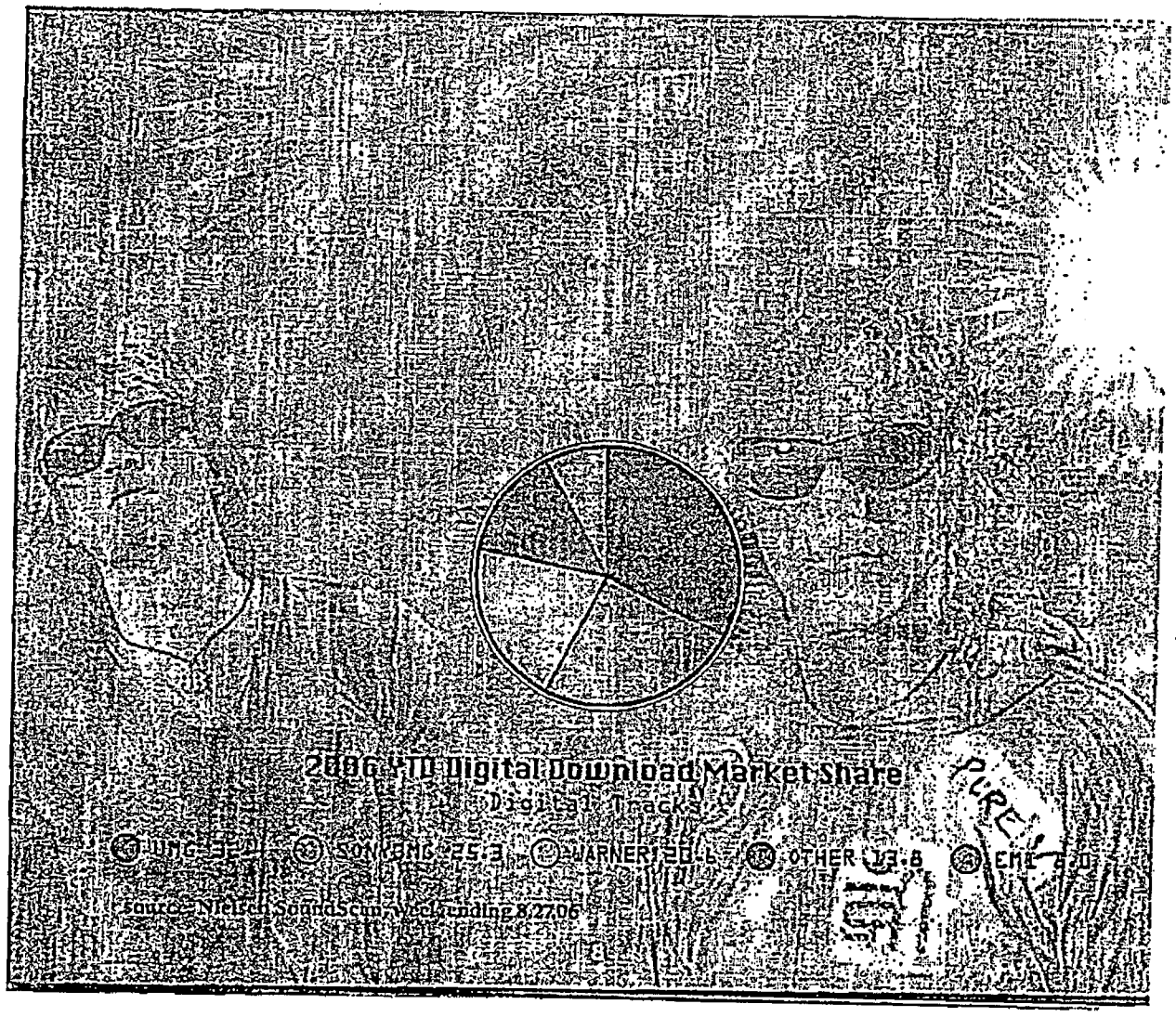
US 2005 Top 10
In millions

Mariah Carey	4.97	1
50 Cent	4.85	2
Kelly Clarkson	3.50	3
Green Day	3.36	4
Black Eyed Peas	3.04	5
Coldplay	2.62	6
Rascal Flatts	2.51	7
Gwen Stefani	2.51	8
Kanye West	2.42	9
The Game	2.28	10

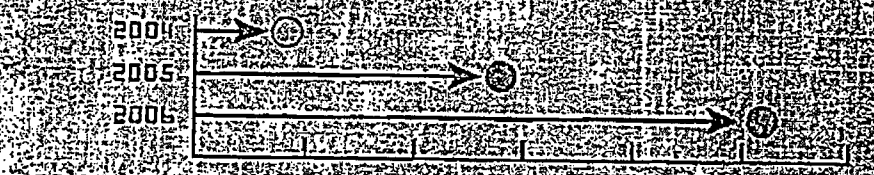
source: Nielsen SoundScan; UMG releases in BLUE

UMG continues to lead the industry in catalog sales, beating the industry in 115 of the past 118 weeks (year-to-year comp...


umg is the industry leader
for digital music
2005 US Digital Download Market Share
Digital Tracks
UMG 33.3
SONYBMG 26.6
WARNER 18.3
OTHER 14.0
EMI 7.8
Source: Nielsen SoundScan
7


2006 YTD Digital Download Market Share
Digital Tracks
UMG 34.1
SONY BMG 25.3
WARNER 20.1
OTHER 13.8
EMI 6.7
Source: Nielsen SoundScan, week ending 8/27/06

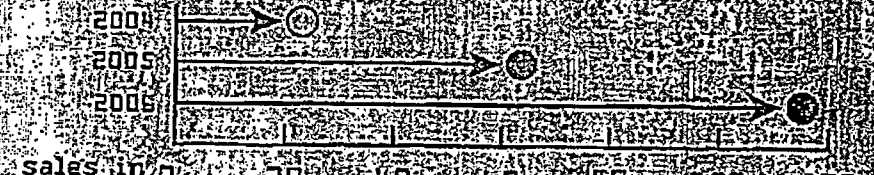
umg = growth in the digital space



US UMG Digital Album Sales (in units)

2004 0.8 2005 2.7 2006 5.2

source: Nielsen SoundScan, week ending 8/27/06/week 34



US UMG Digital Track Sales (in units)

2004 24.3 2005 63.7 2006 118.9

source: Nielsen SoundScan, week ending 8/27/06/week 34

UMG's digital sales surpassed 259 million EUROS in 2005

nearly tripling the 2004 total of 95 million EUROS

UMG Digital Sales (Worldwide)

(2004) 95 million Euros (2005) 259 million Euros

source: UMG

UMG had a 175% increase in global digital sales from 2004 to 2005

	2004	2005	1st half 2006
US mastertones/ringtones	90,919,649	48,719,870	44,492,451
ex-US mastertones/ringtones	12,668,555	59,751,028	41,396,184
total worldwide	103,588,204	108,470,898	85,888,635

UMG Mobile Sales (in units)

source: UMG

UMG had a 385% increase in US mobile sales from 2004 to 2005

UMG leads the industry in US mobile market share with an estimated 33% of the market for January - June 2006.

Gwen Stefani is the first artist ever to sell more than 12 million commercial downloads with "Hollaback Girl."

UMG has 6 of the top 10 selling digital tracks of all time in the US including the Black Eyed Peas' "My Humps" which has sold over 2.4 million units.

UMG is the leader in mastertone sales, receiving 41 mastertone awards by the Recording Industry Association of America (RIAA): **2 multi-platinum, 13 platinum** and **34 gold**.

50 Cent is the top-selling mastertone artist of all time, selling more than 9 million in the US alone.

Chamillionaire's hit single "Ridin" is the most downloaded mastertone to date with US sales in excess of 9 million. It is also the fastest selling mastertone ever with more than 2 million units sold within the first four months of its release.

Rick Ross is the first artist ever to sell 1 million mastertones before the release of his associated album *Port of Miami*.

To date, Universal Music Group leads the industry with over **5 million music videos sold online**.

Top selling songs & artists (digital & mobile)

Top 5 US Digital Track Sales
release-to-date in millions

Black Eyed Peas	"My Humps"	1.48	1
Nickelback	"Photograph"	1.33	2
Weezer	"Beverly Hills"	1.28	3
Fall Out Boy	"Sugar, We're Going Down"	1.25	4
Kanye West	"Gold Digger"	1.18	5

source: Nielsen SoundScan

Top 5 US Mobile (Mastertone) Sales
release-to-date in millions

Chamillionaire	"Ridin'"	3.1	1	RIAA Certified Triple Platinum
Black Eyed Peas	"My Humps"	2.3	2	RIAA Certified Double Platinum
Snoop Dogg	"Drop It Like It's Hot"	1.85	3	RIAA Certified Platinum
Kanye West	"Gold Digger"	1.65	4	RIAA Certified Platinum
50 Cent	"Candy Shop"	1.45	5	RIAA Certified Platinum

source: UMG, RIAA

UMG leads the industry in new business development,

consistently leveraging our core assets to create new revenue streams

Video-On-Demand (VOD)
UMG pioneered the first VOD deal for the global music industry with MSN. Through subsequent deals with the likes of Yahoo!, AOL and hundreds of others, UMG helped create the music VOD marketplace where labels are now compensated for the use of their video content.

Digitization
A multi-year program to digitize UMG's music catalog for distribution on all digital platforms has resulted in UMG offering the most extensive digitized catalog in the world. UMG launched the world's first exclusively digital record label, UMe Digital.

"Shortcodes"
First music company to employ the new cell phone enabled delivery system for digital music products.

New Product Development

A wide variety of digital products including mastertones, ringbacks, alert tones, voicetones, mobile bundles, wallpapers and much more for digital sale.

New Business Models

UMG supports a wide variety of business models including free, ad-supported music sites like Napster, Zango and Musicloads.

Recently, UMG partnered with Spiral Frog, a new ad-supported music download destination which offers legal downloads free of charge to users.

Peer-to-Peer (P2P)

UMG has worked to legitimize P2P websites and is achieving success with companies such as Peer Impact, Snocap and Mashbox.

Tiered Pricing & Innovative Packaging

UMG recently rolled out a series of packaging options with tiered pricing to offer consumers the widest variety throughout Europe.

umg new businesses

Music Publishing

UMG recently entered into an agreement with Bertelsmann AG to acquire BMG Music Publishing, one of the world's great music publishing companies. BMG Music includes such chart-topping artists as Coldplay, Justin Timberlake, Maroon 5, Christina Aguilera, R. Kelly, Linkin Park and Juan Gabriel, an extensive catalog that runs the gamut from The Ycorpions to Barry Manilow, a great music production library, and seminal classical artists such as Puccini and Ravel. This is, of course, subject to the normal regulatory requirements.

IMF: The International Music Feed

A global pop music brand that has a 24 hour cable/satellite TV channel. IMF offers video on-demand, broadband, and mobile content around the world as well as 30 audio channels on [illegible]. IMF programming is also now available on multiple national mobile carriers in the US, the UK, and France. IMF com connects all of The International Music Feed's platforms with music content, program listings, news, and a fast growing social network of bloggers.

UMG's revolutionary 24 hour global music television channel continues to expand with programming from all of UMG's worldwide territories. IMF is available to satellite Dish Network subscribers, Sky Mobile TV, Amp'd Mobile, Sprint Power Vision and AT&T U-verse TV customers.

Globe Productions
UMG's television venture focuses on the development of new television shows and innovative TV platforms for UMG artists.

Universal Music Media
UMG's direct response television venture which produces and distributes full length music and video infomercial programming worldwide.

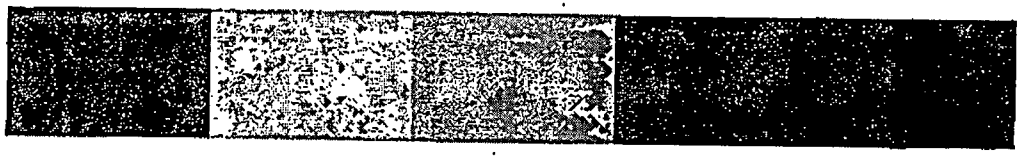
Fontana
Fontana Distribution provides unparalleled sales and marketing support to the thriving independent music community worldwide. Fontana distributes more than 70 labels including Vagrant Records, Telarc, Mad Science, SMC, Upstairs, Rendezvous, Music World, Big Vin, American Gramaphone, Quango, VP, Warcor, DRT and Southern, among many others. In addition, Fontana distributes select projects from UMG labels worldwide.

Vivendi Visual Entertainment
UMG's DVD and home entertainment firm has become a leading choice among independent producers and top independent studios such as Bauer Martinez, bodywisdom media, Code Black, Film Mates, First Independent Pictures, Freestyle Home Entertainment, Lightning Home Entertainment, Melee Entertainment, New Light Entertainment, Palm Pictures, Rising Entertainment, Ruf Nation Films, Trinity Home Entertainment, Uwe Boll Productions, Voy Pictures, Walter Mercado and Xenon Pictures.

EXHIBIT CO 0938

VIVENDI UNIVERSAL *Investor Relations*

> Paris : 8/8/2006 11:41:15am : 26.05 euros e
> NYSE : 8/3/2006 4:00:30pm : 33.37 dollars
> Vivendi Universal Corporate Web Site



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Group Overview > Key Businesses

> Music

Universal Music Group (UMG) is the world's No.1 music company. Its global operations encompass the production and distribution of recorded music on CDs, videos and DVDs, the licensing of music copyrights, music publishing as well as mail-order music/video distribution.

Present in 77 countries, UMG had 25.5% of the worldwide market (source: IFPI): in 2004, more than one out of every four albums sold worldwide was a UMG album – over one in every four in the U.S. and approximately one in every three in France.

UMG is also the world leader in jazz and classical music with approximately 40% of classical music sales worldwide.

UNIVERSAL MUSIC GROUP

http://www.umusic.com

Latest Investor Presentation

- **Universal Music Group presentation** - Investor & Analyst Meeting
  London, October 6, 2005
  Speakers: Mr. Doug MORRIS, *Chairman* ; Mr. Zach HOROWITZ, *President & Chief Operating Officer* ; Mr. Nick HENNY, *Vice Chairman & Chief Financial Officer* ; Mr. Lucian GRAINGE, *Chairman Universal Music International.*

  Listen to the webcast
  Download the slides (1531Ko)

Business Environment

> Canal+ Gr
> Universal I Group
> Vivendi Un Games
> SFR
> Maroc Tele
> NBC Unive

- **Recorded Music**

o **Concentrated market with 4 "majors" (post Sony/BMG merger) and independents:**

	UMG	Sony BMG	EMI	Warner Music	Independents
2004 Global Market Share	25.5%	21.5%	13.4%	11.3%	28.4%

Source: IFPI Market Research: "The Recording Industry in Numbers 2005"

o **Main Labels:**

- **Music Publishing**

Through Universal Music Publishing Group (UMPG), UMG is the third music publisher after EMI and Warner Music Group with over one million owned or administered titles and with some of the world's most popular songs, artists and songwriters. UMPG's licensed music is used in sound recordings, films and commercials.

Strategic Priorities

- **Accelerate transformation into a music entertainment company by leveraging content and brands through innovation and creative new revenue streams**
- **Strengthen both global and local market leadership**
- **Grow digital revenues in every format:** downloads, subscription, or streaming of video and audio content on PC's and mobile devices
- **Expand music publishing revenues**

Key Financials

- **Full Year 2005:**

(in millions of euros)	Comparable basis	% growth at constant currency, except *

Revenues	4,893	+1.5%
Operating Income	480	+20%
Operating margin	9.8%	+1.5 points

Key Operating Metrics

- **UMG's December 31, 2005 YTD Top-10 Selling Artists - Worldwide:**

December 31, 2005 YTD	Million Units
Mariah Carey	7.7
50 Cent	7.5
Black Eyed Peas	6.8
Eminem	5.5
Gwen Stefani	4.2
Kanye West	3.9
Jack Johnson	3.6
The Game	3.2
Nickelback	2.8
NOW20	2.8

Source: UMG

- **2006 Key Music releases:**

Please note that this is a tentative release schedule, subject to change.

2006

- Kaiser Chiefs
- The Game
- Jack Johnson OST
- Nelly Furtado
- Keane
- Toby Keith
- Scissor Sisters
- Gwen Stefani
- Mary J Blige
- G-Unit
- Enrique Iglesias
- Diana Kroll
- Beck
- Sheryl Crow
- D-12
- Dr. Dre
- Snoop Dogg
- Nelly
- No Doubt

Guidance for 2006 financial year *

- **Revenues:** "Slight growth as digital sales more than offset the decline in physical sales *"
- **Operating income margin:** "Same margin rate or slightly above 2005"

* 2005 assumption: €1 = $1.25

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EXHIBIT CO 0939

vivendi press release

Paris, November 16, 2006

Note: This press release contains consolidated unaudited earnings established under IFRS. Vivendi has made changes, as of June 30 2006, to the presentation of its consolidated statement of earnings and its consolidated statement of cash flows as well as the operating performances of its business segments and of the Group. Those changes are detailed in Appendix I.

Vivendi Reports Strong Growth of Adjusted Net Income for the First Nine Months (+16.3%) and the Third Quarter (+28.2%)

First Nine Months of 2006

- **Earnings, attributable to equity holders of the parent, of €3,423 million, an increase of 79.9 %.**
- **Adjusted net income[1], attributable to equity holders of the parent, of €2,109 million, a 16.3 % increase.**
- **Adjusted earnings before interest and income taxes[2] (EBITA) of €3,648 million, an increase of 14.4 % on a comparable basis[3], due to the good performance of all business units, which all have increasing profits.**
- **Increased operating margin.**

Third Quarter of 2006

- **Earnings, attributable to equity holders of the parent, of €1,561 million, an increase of 141.6 %.**
- **Adjusted net income, attributable to equity holders of the parent, of €731 million, a 28.2 % increase.**
- **Adjusted earnings before interest and income taxes (EBITA) of €1,300 million, an increase of 20.9 % on a comparable basis, thanks to the good performance of each business unit.**

Vivendi confirms the guidance for its 2006 adjusted net income, attributable to equity holders of the parent, of at least a 16% increase, with a dividend distribution rate of a minimum of 50% of adjusted net income.
Adjusted net income, attributable to equity holders of the parent, should reach €2.6 billion.

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[1] Adjusted net income, attributable to equity holders of the parent, is detailed in Appendix V.
[2] Adjusted earnings before interest and income taxes (EBITA) is detailed in Appendix I.
[3] Comparable basis essentially illustrates the effect of the divestitures or abandonment of operations that occurred in 2005 and 2006 (mainly NC Numéricâble in 2005 and the Paris Saint-Germain soccer club (PSG) in 2006 at Canal+ Group, and Annuaire Express SFR's phone directory activities in 2005) and includes the full consolidation of states in distribution subsidiaries at SFR as if these transactions had occurred as of January 1, 2005. Comparable basis results are not necessarily indicative of the results that would have occurred had the events actually occurred at the beginning of 2005.

Comments on Vivendi's First Nine Months of 2006 Earnings

Revenues increased to €14,499 million compared to €14,005 million for the first nine months of 2005, representing an increase of €494 million (+ 3.5%).
On a comparable basis, revenues amounted to €14,462 million compared to €13,896 million, an increase of 4.1% (+3.6% at constant currency). All of the Group's businesses contributed to this improvement.

EBITA totaled €3,648 million compared to €3,196 million for the first nine months of 2005. On a comparable basis, EBITA was up €459 million, representing an increase of 14.4% (+14.1% at constant currency), to reach €3,648 million (compared to €3,189 million for the first nine months of 2005). For the first nine months of 2006, each business unit generated positive and growing EBITA.
Operating margin (EBITA on revenues) rate was at 25.2% in 2006 versus 22.8% in 2005.

Income from equity affiliates totaled €245 million compared to €225 million for the first nine months of 2005, representing an increase of €20 million. Income from NBC Universal's earnings amounted to €216 million for the first nine months of 2006 compared to €255 million for the same period in 2005.

Other financial charges and income included an income of €218 million compared to €271 million for the first nine months of 2005, representing a €53 million decrease. For the first nine months of 2006, they mainly included the capital gain on the sale of Veolia Environnement shares (€834 million), offset by the capital losses incurred on the PTC shares (€496 million) and on the sale of the DuPont shares (€98 million). For the same period in 2005, they mainly included the positive impact of the unwinding of InterActiveCorp's interest in VUE (€194 million).

Provision for income taxes resulted in an income of €518 million, compared to a charge of €537 million for the first nine months of 2005. Items included in this amount are the gain related to the settlement of the DuPont litigation (€1,019 million) and the tax savings generated by the Consolidated Global Profit Tax System (€447 million compared to €391 million for the same period in 2005).

Earnings attributable to equity holders of the parent amounted to €3,423 million (basic earnings per share of €2.97 and €2.94 on a diluted basis), compared to €1,903 million for the first nine months of 2005 (basic earnings per share of €1.66 and €1.64 on a diluted basis), representing an increase of 79.9%.

Adjusted net income attributable to equity holders of the parent amounted to €2,109 million (basic adjusted earnings per share of €1.83 and €1.81 on a diluted basis), compared to €1,813 million for the first nine months of 2005 (basic adjusted earnings per share of €1.58 and €1.57 on a diluted basis), representing an increase of 16.3%.
The difference between earnings attributable to equity holders of the parent and adjusted net income attributable to equity holders of the parent is €1,314 million, and mainly includes the gain related to the settlement of the tax dispute on the DuPont shares (€921 million), the capital gain generated on the sale of the Veolia Environnement shares (€834 million), offset by the capital loss incurred on the PTC shares (-€496 million).

Vivendi's Business Units: Comments on First Nine Months and Third Quarter of 2006 EBITA

Universal Music Group (UMG)

First nine months

Universal Music Group's (UMG's) EBITA of €433 million was 18.6% higher than the same period last year as the result of the improved margins from higher sales and a favorable sales mix, as well as the settlement of the Napster litigation and the recovery of a cash deposit in the TVT lawsuit offsetting increased marketing and artist and repertoire (A&R) costs.

Third quarter

UMG's EBITA of €138 million was 11.3% above the same period last year as the result of higher margins and the settlement of the Napster litigation partly offset by an increase in bad debt reserves, primarily in the U.S.

Vivendi Games

First nine months

Vivendi Games' EBITA of €86 million was 186.7% above the same period of the prior year (up 179.2% on a constant currency basis). This significant improvement was driven by growth in revenues, with an increased proportion relating to the higher margin of the *World of Warcraft* business. EBITA was also impacted by start up investments for the Sierra Online and Vivendi Games Mobile divisions.

Third quarter

Vivendi Games' EBITA of €24 million was 118.2% above the same period of the prior year (up 118.0% on a constant currency basis). This significant improvement was driven by growth in revenues, with an increased proportion relating to the higher margin of the *World of Warcraft* business. EBITA was also impacted by start up investments for the Sierra Online and Vivendi Games Mobile divisions.

Canal+ Group

First nine months

Canal+ Group's EBITA was €338 million, up €43 million compared to the same period last year. On a comparable basis[4], EBITA was up €50 million, or 17.4% compared to the same period last year.

This increase reflects the strong growth of pay-TV operations which were up €47 million. Growth of portfolio (subscriptions up nearly 270,000 compared to end of September 2005) and revenue per subscriber has more than offset extra costs linked to the new, exclusive soccer contract.

EBITA from other operations was up €3 million on a comparable basis, mainly due to strong performance of Canal+ in Poland.

[4] Comparable basis mainly illustrates the effect of divestitures at Canal+ Group (mainly NC Numéricâble in 2005 and PSG in 2006), as if these transactions had occurred as of January 1, 2005.

Third quarter

Canal+ Group's EBITA was €148 million, up €51 million compared to the same period last year. This performance (up 52.6% on a comparable basis compared to the same period last year) is due to growth in pay-TV operations in France, which mainly benefited from strong portfolio additions and increased revenue per subscriber. EBITA was also favourably impacted by calendar timing of French Ligue 1 soccer.

EBITA from other operations have been impacted negatively by StudioCanal, mainly due to lower revenues from the Working Title deal.

SFR

First nine months

SFR's EBITA rose by 3.1% to € 2,095 million. EBITA growth mainly reflected a 0.8% growth in network revenues, a 0.7 percentage point reduction in customer acquisition and retention costs to 9.4% of network revenues, as well as a strict control of other costs and despite the increase of the GSM license cost (renewed in April 2006 with a new tax of 1% of revenues).

Third quarter

SFR's EBITA rose by 2% to €706 million due to strong cost controls and despite the increase of the GSM license cost.

Maroc Telecom

First nine months

Maroc Telecom's EBITA amounted to €691 million, increasing by 18.5% compared to the same period in 2005 (+17.7% at constant currency).

This performance was derived from the growth in revenue (11.8% at constant currency) and cost control, in particular acquisition costs in a context of steady growth of the mobile and ADSL customer base[5][6].

This result also includes a €30 million provision, recorded in June 2006, for a new voluntary leave plan (comparable to the provision accounted for at the end of September 2005).

Third quarter

Maroc Telecom's EBITA amounted to €281 million increasing by 21.6% compared to the same period in 2005 (+22.6% at constant currency).

---

[5] Without Mauritel.

[6] The mobile customer base, compliant with the ANRT definition and used by Maroc Telecom in 2006, includes prepaid customers giving or receiving a voice call during the last 3 months and not resiliated postpaid customers.

Important disclaimer

This press release contains forward-looking statements with respect to the financial condition, results of operations, business, strategy and plans of Vivendi. Although Vivendi believes that such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance. Actual results may differ materially from the forward-looking statements as a result of a number of risks and uncertainties, many of which are outside our control, including, but not limited to, the risks described in the documents Vivendi filed with the Autorité des Marchés Financiers (French securities regulator) and which are also available in English on our web site (www.vivendi.com). Investors and security holders may obtain a free copy of documents filed by Vivendi with the Autorité des Marchés Financiers at www.amf-france.org, or directly from Vivendi. The present forward-looking statements are made as of the date of the present press release and Vivendi disclaims any intention or obligation to provide, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ANALYST CONFERENCE

Speakers:

Jacques Espinasse
Member of the Management Board and Chief Financial Officer

Date: Thursday, November 16, 2006
2:30 PM Paris time – 1:30 PM London time – 8:30 AM New York time
Media invited on a listen-only basis

Numbers to dial:

Dial-in (France): +33 (0)1 70 99 42 70
Dial-in (UK): +44 (0)20 7365 1832
Dial-in (US): +1 718 354 1157 and 1 866 239 0753 (toll-free)

Internet: The conference can be followed on the Internet at http://www.vivendi.com/ir
The slides of the presentation will also be available online.
A **replay service** will be available for 14 days.

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APPENDIX I

VIVENDI
ADJUSTED STATEMENT OF EARNINGS AND CONSOLIDATED STATEMENT OF EARNINGS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005
(IFRS, unaudited)

ADJUSTED STATEMENT OF EARNINGS (*)			CONSOLIDATED STATEMENT OF EARNINGS (*)		
	Nine Months Ended September 30,		Nine Months Ended September 30,		
(In millions of euros, except per share amounts)	2006	2005	2006	2005	
Revenues	€ 14,499	€ 14,005	€ 14,499	€ 14,005	**Revenues**
Cost of revenues	(6,984)	(6,988)	(6,984)	(6,988)	Cost of revenues
Margin from operations	7,515	7,017	7,515	7,017	**Margin from operations**
Selling, general and administrative expenses excluding amortization of intangible assets acquired through business combinations	(3,887)	(3,848)	(3,887)	(3,848)	Selling, general and administrative expenses excluding amortization of intangible assets acquired through business combinations
Restructuring charges and other operating charges and income	20	27	20	27	Restructuring charges and other operating charges and income
			(167)	(174)	Amortization of intangible assets acquired through business combinations
			-	(154)	Impairment losses of intangible assets acquired through business combinations
EBITA (*)	3,648	3,196	3,481	2,868	**EBIT**
Income from equity affiliates	245	225	245	225	Income from equity affiliates
Interest	(161)	(167)	(161)	(167)	Interest
Income from investments	51	56	51	56	Income from investments
			218	271	Other financial charges and income
Adjusted earnings from continuing operations before provision for income taxes	3,783	3,310	3,834	3,253	**Earnings from continuing operations before provision for income taxes**
Provision for income taxes	(743)	(623)	518	(537)	Provision for income taxes
			4,352	2,716	**Earnings from continuing operations**
			-	107	Earnings from discontinued operations
Adjusted net income	€ 3,040	€ 2,687	€ 4,352	€ 2,823	**Earnings**
Attributable to:					*Attributable to:*
Minority interests	931	874	929	920	Minority interests
Equity holders of the parent (*)	€ 2,109	€ 1,813	€ 3,423	€ 1,903	**Equity holders of the parent**
	% change: +	*16.3%*	+	*79.9%*	
Adjusted net income, attributable to the equity holders of the parent per share - basic (in euros)	€ 1,83	€ 1,58	€ 2,97	€ 1,66	**Earnings, attributable to the equity holders of the parent per share - basic (in euros)**
Adjusted net income, attributable to the equity holders of the parent per share - diluted (in euros)	€ 1,81	€ 1,57	€ 2,94	€ 1,64	**Earnings, attributable to the equity holders of the parent per share - diluted (in euros)**

(*) Vivendi Management evaluates the performance of the business segments and allocates necessary resources to them based on certain operating indicators (segment earnings and cash flow from operations). Until June 30, 2006, segment earnings corresponded to earnings from operations of each business. As of June 30, 2006, earnings from operations (EFO) were replaced by adjusted earnings before interest and income taxes (EBITA). The difference between EBITA and previously published EFO consists of the amortization of intangible assets acquired through business combinations that is excluded from EBITA. As a result, the definition of adjusted net income has been modified to exclude the amortization of intangible assets acquired through business combinations, as is presently the case for impairment losses of goodwill, or other intangibles acquired through business combinations, that have always been excluded. The reconciliation of earnings, attributable to equity holders of the parent to adjusted net income, attributable to equity holders of the parent is available in the Appendix V.

For supplementary information, please refer to the document "Management Board's Operating and Financial Review and Prospects and Unaudited Condensed Financial Statements for the First Nine Months Ended September 30, 2006" that will be posted on Vivendi's website on November 16, 2006 after the Analyst Conference.

APPENDIX II

VIVENDI
ADJUSTED STATEMENT OF EARNINGS AND CONSOLIDATED STATEMENT OF EARNINGS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005
(IFRS, unaudited)

ADJUSTED STATEMENT OF EARNINGS (*)			CONSOLIDATED STATEMENT OF EARNINGS (*)		
	Three Months Ended September 30,		Three Months Ended September 30,		
(In millions of euros, except per share amounts)	2006	2005	2006	2005	
Revenues	€ 4,883	€ 4,874	€ 4,883	€ 4,874	**Revenues**
Cost of revenues	(2,301)	(2,550)	(2,301)	(2,550)	Cost of revenues
Margin from operations	2,582	2,324	2,582	2,324	**Margin from operations**
Selling, general and administrative expenses excluding amortization of intangible assets acquired through business combinations	(1,319)	(1,237)	(1,319)	(1,237)	Selling, general and administrative expenses excluding amortization of intangible assets acquired through business combinations
Restructuring charges and other operating charges and income	31	(12)	31	(12)	Restructuring charges and other operating charges and income
			(54)	(52)	Amortization of intangible assets acquired through business combinations
			-	-	Impairment losses of intangible assets acquired through business combinations
EBITA	1,300	1,075	1,240	1,013	**EBIT**
Income from equity affiliates	90	53	90	53	Income from equity affiliates
Interest	(46)	(66)	(46)	(66)	Interest
Income from investments	5	14	5	14	Income from investments
			737	31	Other financial charges and income
Adjusted earnings from continuing operations before provision for income taxes	1,349	1,076	2,032	1,045	**Earnings from continuing operations before provision for income taxes**
Provision for income taxes	(280)	(190)	(133)	(152)	Provision for income taxes
			1,899	893	**Earnings from continuing operations**
			-	141	Earnings from discontinued operations
Adjusted net income	€ 1,069	€ 886	€ 1,899	€ 1,034	**Earnings**
Attributable to:					*Attributable to:*
Minority interests	338	316	338	388	Minority interests
Equity holders of the parent	€ 731	€ 570	€ 1,561	€ 646	**Equity holders of the parent**
	% change : +	*28.2%*	+	*141.6%*	
Adjusted net income, attributable to the equity holders of the parent per share - basic (in euros)	€ 0,63	€ 0,50	€ 1,35	€ 0,56	**Earnings, attributable to the equity holders of the parent per share - basic (in euros)**
Adjusted net income, attributable to the equity holders of the parent per share - diluted (in euros)	€ 0,63	€ 0,49	€ 1,34	€ 0,56	**Earnings, attributable to the equity holders of the parent per share - diluted (in euros)**

(*) A reconciliation of earnings, attributable to equity holders of the parent to adjusted net income, attributable to equity holders of the parent is available in the Appendix V.

APPENDIX III

VIVENDI
REVENUES AND EBITA ON A COMPARABLE BASIS BY BUSINESS SEGMENT
(IFRS, unaudited)

Comparable basis essentially illustrates the effect of the divestitures or abandonment of operations that occurred in 2005 and 2006 (mainly NC Numéricâble in 2005 and the Paris Saint-Germain soccer club (PSG) in 2006 at Canal+ Group, and Annuaire Express SFR's phone directory activities in 2005) and includes the full consolidation of stakes in distribution subsidiaries at SFR as if these transactions had occurred as at January 1, 2005. Comparable basis results are not necessarily indicative of the results that would have occurred had the events actually occurred at the beginning of 2005.

(In millions of euros)	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005	% Change	% Change at constant rate
Revenues				
Universal Music Group	€ 3,298	€ 3,211	2.7%	1.4%
Vivendi Games	478	398	20.7%	18.4%
Canal+ Group	2,675	2,462	8.7%	8.4%
SFR	6,497	6,464	0.5%	0.5%
Maroc Telecom	1,554	1,380	12.6%	11.8%
Non core operations and elimination of inter segment transactions	(40)	(17)	-135.3%	-135.3%
Total Vivendi	**€ 14,462**	**€ 13,896**	**4.1%**	**3.6%**
EBITA				
Universal Music Group	€ 433	€ 385	18.8%	17.9%
Vivendi Games	88	30	185.7%	179.2%
Canal+ Group	338	288	17.4%	17.1%
SFR	2,095	2,032	3.1%	3.1%
Maroc Telecom	691	583	18.5%	17.7%
Holding & Corporate	(52)	(133)	60.9%	60.3%
Non core operations	57	24	137.5%	139.6%
Total Vivendi	**€ 3,648**	**€ 3,189**	**14.4%**	**14.1%**
EBITA / Revenues (%)	**25.2%**	**22.9%**		

(In millions of euros)	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	% Change	% Change at constant rate
Revenues				
Universal Music Group	€ 1,098	€ 1,119	-2.1%	0.8%
Vivendi Games	182	158	15.2%	18.0%
Canal+ Group	879	840	4.6%	4.7%
SFR	2,195	2,235	-1.7%	-1.7%
Maroc Telecom	561	503	11.5%	12.3%
Non core operations and elimination of inter segment transactions	(25)	(5)	x5	x5
Total Vivendi	**€ 4,889**	**€ 4,850**	**0.8%**	**1.5%**
EBITA				
Universal Music Group	€ 138	€ 124	11.3%	13.6%
Vivendi Games	24	11	118.2%	118.0%
Canal+ Group	148	97	52.6%	52.5%
SFR	706	692	2.0%	2.0%
Maroc Telecom	281	231	21.6%	22.6%
Holding & Corporate	(32)	(77)	58.4%	58.5%
Non core operations	35	(3)	na*	na*
Total Vivendi	**€ 1,300**	**€ 1,075**	**20.9%**	**21.7%**
EBITA / Revenues (%)	**26.6%**	**22.2%**		

na*: not applicable.

APPENDIX IV

VIVENDI
REVENUES AND EBITA BY BUSINESS SEGMENT AS PUBLISHED
(IFRS, unaudited)

(In millions of euros)	Three Months Ended September 30, 2006	2005	% Change	Nine Months Ended September 30, 2006	2005	% Change
Revenues						
Universal Music Group	€ 1,096	€ 1,119	-2.1%	€ 3,298	€ 3,211	2.7%
Vivendi Games	182	158	15.2%	478	396	20.7%
Canal+ Group	879	863	1.9%	2,712	2,560	5.9%
SFR	2,196	2,236	-1.8%	6,497	6,475	0.3%
Maroc Telecom	561	503	11.5%	1,554	1,380	12.6%
Non core operations and elimination of inter segment transactions	(25)	(5)	x5	(40)	(17)	-135.3%
Total Vivendi	€ 4,889	€ 4,874	0.3%	€ 14,499	€ 14,005	3.5%
EBITA						
Universal Music Group	€ 138	€ 124	11.3%	€ 433	€ 365	18.6%
Vivendi Games	24	11	118.2%	86	30	186.7%
Canal+ Group	149	97	53.6%	338	295	14.6%
SFR	706	692	2.0%	2,095	2,032	3.1%
Maroc Telecom	281	231	21.6%	691	583	18.5%
Holding & Corporate	(32)	(77)	58.4%	(52)	(133)	60.9%
Non core operations	35	(3)	na*	57	24	137.5%
Total Vivendi	€ 1,300	€ 1,075	20.9%	€ 3,648	€ 3,196	14.1%
EBITA / Revenues (%)	26.6%	22.1%		25.2%	22.8%	

na*: not applicable.

APPENDIX V

VIVENDI
RECONCILIATION OF EARNINGS ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT TO ADJUSTED NET INCOME ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT
(IFRS, unaudited)

Vivendi considers adjusted net income, attributable to equity holders of the parent, a non-GAAP measure, as a relevant indicator of the Group's operating and financial performance. Vivendi Management uses adjusted net income, attributable to equity holders of the parent, because it provides a better illustration of the performance of continuing operations excluding most non-recurring and non-operating items.

Following the adoption of EBITA as the key operating performance measure of the business segments, Vivendi Management decided to change the method for calculating adjusted net income, by excluding amortization of intangible assets acquired through business combinations. Adjusted net income, attributable to equity holders of the parent, includes the following items: EBITA, income from equity affiliates, interest, income from investments, including dividends received from unconsolidated interests, as well as interest collected on advances to equity affiliates and loans to unconsolidated interests, as well as taxes and minority interests related to these items. It does not include the following items: impairment losses of goodwill and other intangibles acquired through business combinations, henceforth, the amortization of intangibles acquired through business combinations, other financial charges and income, earnings from discontinued operations, provision for income taxes and minority interests relating to these adjustments, as well as non-recurring tax items (notably the change in deferred tax assets relating to the Consolidated Global Profit Tax System, and the reversal of tax liabilities relating to tax years no longer open to audit or having been settled with the tax authorities).

Three Months Ended September 30,		(In millions of euros)	Nine Months Ended September 30,	
2006	2005		2006	2005
€ 1,561	€ 646	**Earnings, attributable to equity holders of the parent (a)**	€ 3,423	€ 1,903
		Adjustments		
64	62	Amortization of intangible assets acquired through business combinations (a)	167	174
-	-	Impairment losses of intangible assets acquired through business combinations (a)	-	154
(737)	(31)	Other financial charges and income (a)	(218)	(271)
-	(141)	Earnings from discontinued operations (a)	-	(107)
(3)	(1)	Change in deferred tax asset related to the Consolidated Global Profit Tax System	(10)	(5)
(120)	(28)	Non recurring items related to provision for income taxes (b)	(1,186)	(61)
(24)	(9)	Provision for income taxes on adjustments	(65)	(20)
-	72	Minority interests on adjustments	(2)	46
€ 731	€ 670	**Adjusted net income, attributable to equity holders of the parent**	€ 2,109	€ 1,813

(a) As reported in the Consolidated Statement of Earnings.

(b) Corresponds to the reversal of tax liabilities relating to tax years no longer open to audit or having been settled with the tax authorities. For the nine months ended September 30, 2006, this item included mainly the profit related to the settlement of the DuPont litigation (€1,019 million).

EXHIBIT CO 0940

vivendi press release

November 7, 2006

Note to readers: Vivendi provided preliminary, unaudited revenue information for the third quarter and the first nine months of 2006 on an IFRS basis in accordance with European regulatory requirements.

Vivendi Reports First Nine Months 2006 Revenues Up 4.1% on a Comparable Basis

First Nine Months of 2006 Revenues

Vivendi's as published revenues for the first nine months of 2006 amounted to €14,499 million compared to €14,005 million for the first nine months of 2005, an increase of 3.5%.

On a comparable basis[1], first nine months of 2006 revenues amounted to €14,462 million compared to €13,896 million for the first nine months of 2005, **an increase of 4.1% (+3.6% at constant currency).**

Third Quarter of 2006 Revenues

Vivendi's as published revenues for the third quarter of 2006 amounted to €4,889 million compared to €4,874 million for the third quarter of 2005, an increase of 0.3%.

On a comparable basis[1], third quarter of 2006 revenues amounted to €4,889 million compared to €4,850 million for the third quarter of 2005, an increase of 0.8% (+1.6% at constant currency).

[1] Comparable basis essentially illustrates the effect of the divestitures or abandonment of operations that occurred in 2005 and 2006 (mainly NC Numéricable in 2005 and PSG in 2006 at Canal+ Group and Annuaire Express, SFR phone directory activities in 2005) and includes the full consolidation of minority stakes in distribution subsidiaries at SFR as if these transactions had occurred as of January 1, 2005. Comparable basis revenues are not necessarily indicative of the combined revenues that would have occurred had the events actually occurred at the beginning of 2005.

Universal Music Group

First Nine Months:
Universal Music Group's (UMG's) revenues of €3,298 million increased 2.7% from last year driven by strong digital sales growth, higher license income in the U.S., higher music publishing sales and favorable currency movements. At constant currency, sales grew 1.4%.
Digital sales were €348 million with strong growth in all markets and sectors. Digital revenues were more than double last year and represented 10.5% of total revenues.
Best sellers year to date included new releases from Andrea Bocelli, Rihanna and Nelly Furtado, and strong carryover sales from The Pussycat Dolls.

Third Quarter:
UMG's revenues of €1,096 million declined 2.1% versus last year primarily as a result of adverse currency movements and despite very strong growth in the digital sector and higher license income in the U.S. At constant currency, sales grew 0.8%.
Digital sales of €126 million were up 88% versus last year, representing 11.5% of total revenues, with strong growth across both the online and mobile sectors.
Revenues include a net amount of €36 million received in connection with the settlement of the Napster litigation.
Best sellers included new releases from The Killers, Fergie, Scissor Sisters and Ludacris.

Vivendi Games

First Nine Months:
Vivendi Games' revenues of €478 million were 20.7% above the prior year (up 18.4% on a constant currency basis). This increase was primarily driven by the continued worldwide success of *World of Warcraft*, the critically acclaimed subscription-based, massively multiplayer online role-playing game (MMORPG) from Blizzard Entertainment.
Other solid performers included initial launch revenues in North America from the new release *Scarface*, developed internally by Sierra's Radical Entertainment, as well as continuing sales from *Ice Age 2* and *50 Cent: Bulletproof*.

Third Quarter:
Vivendi Games' revenues of €182 million were 15.2% above the prior year (up 18% at constant currency basis). This increase was primarily driven by the continued worldwide success of *World of Warcraft*. Other solid performers included initial launch revenues in North America from the new release *Scarface*, the game based on the classic Universal Studios film.

Canal+ Group

First Nine Months:
Canal+ Group reported revenues of €2,712 million compared to €2,560 million for the first nine months of 2005. On a comparable basis [2], revenues were up €213 million (+8.7% compared to the first nine months of 2005).

This increase reflects the growth of pay-TV operations in France (up 10% on a comparable basis) which benefited from portfolio and revenues per subscriber growth, as well as a higher proportion of digital subscriptions (as of the end of September, Canal+ Le Bouquet represented 57% of total portfolio versus 50% as of the end of September 2005). At the end of September 2006, Canal+ Group's total portfolio was over 8.29 million subscriptions, Canal+

[2] Comparable basis mainly illustrates the effect of divestitures at Canal+ Group (mainly NC Numéricable in 2005 and PSG in 2006), as if these transactions had occurred as of January 1, 2005.

portfolio being just over 5 million subscriptions. As of the end of September 2006, Canal+ Group's total subscription portfolio grew by nearly 270 thousand subscriptions when compared to September 2005.

During the same period, other businesses grew by 3% on a comparable basis, in particular i>TELE, which benefited from advertising revenues growth due to its switch to free-to-air broadcasting over Digital Terrestrial Television (DTT) in October 2005. Polish operations were also up thanks to a strong increase in subscription portfolio.
Revenues for Canal+ Group's movie business decreased slightly.

Third Quarter:
Canal+ Group reported quarterly revenues of €879 million compared to €863 million for same period last year. On a comparable basis[2], revenues increased by €39 million, up 4.6% compared to the third quarter of 2005.
Revenues of pay-TV operations in France grew by 8%, primarily driven by portfolio growth, the increase of revenues per subscriber as well as the higher proportion of digital subscriptions.
Other revenues have been impacted by the decrease in the movie business revenues mainly due to lower revenues from the Working Title deal.

SFR

First Nine Months:
SFR revenues grew by 0.3% to €6,497 million compared to the same period in 2005 (up 0.5% on a comparable basis[3]).

Favorable effects of the increase in customer base along with the growth in "voice" and "data" usage were very largely offset by the strong cut of regulated tariffs at the beginning of 2006 (a 24% cut of mobile voice termination rates and a 19% cut of SMS termination) as well as by the cut in the price charged to customers for the new offers launched in April 2005. SFR ARPU[4] decreased by 5.2% to €463 at the end of September 2006 (versus €488 at the end of September 2005). Excluding the impacts of the regulated tariff cut, SFR revenues would have been up by 4.9%.

For the first nine months of 2006, SFR added 307,000 net new customers, taking its registered customer base to 17.505 million[5], a 6.4% increase versus last year. The contract customer base grew by 9.2% year-on-year to 11.334 million, leading to an improved customer mix of 1.6 percentage point in one year.
Average voice usage of SFR customers (AUPU)[6] continued its strong growth of 13.7% to 323 minutes per month. 3G customers reached 1.925 million as of the end of September 2006 compared to 1.003 million at the end of December 2005.

Net data revenues improved significantly to represent 12.9% of network revenues for the first nine months of 2006, compared to 11.5% in 2005, due to a 18.3% increase in text messaging (SMS) sent by SFR customers (4.6 billion), to the 1.9 time multiplication of MMS sent (123 million) and to the strong increase of other services, in particular in the corporate segment. The latter now represent 32% of total data revenues compared to 29% in 2005.
At the end of September 2006, the data ARPU reached €61, a 6% growth compared to 2005.

This performance highlights the success of SFR "mobile centric" strategy which aims to offer each individual customer greater continuity and personalization of SFR mobile services: two key elements of this strategy being the

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[2] Comparable basis mainly illustrates the full consolidation of minority stakes in distribution subsidiaries and excludes revenues from phone directory activities (Annuaire Express) as of January 1, 2005.
[4] ARPU (Average Revenue Per User) is calculated on a twelve-month rolling period by dividing revenues net of promotions and net of third-party content provider revenues excluding roaming in and equipment sales by average Arcep total customer base for the last twelve months. ARPU is calculated on a comparable basis, excluding revenues from phone directory activities (Annuaire Express).
[5] SFR excluding wholesale customers total base (wholesale customer base reached 367,000 at the end of September 2006).
[6] AUPU (Average Usage Per User) is defined as the incoming and outgoing "voice" volumes divided by average Arcep total customer base for the last twelve months.

launch of the Happy Zone offer, which will consist in unlimited usage of the mobile when at home and the launch, in April 2007, of an ADSL option for SFR customers.

With a view to accelerate the execution of this strategy, SFR signed an agreement[7] to acquire the fixed and ADSL operations of Télé2 France (approximately 300,000 ADSL customers and 3 million fixed line customers to be migrated to ADSL offers) and raised to 40.6% its share in Neuf Cegetel, right before Neuf Cegetel successful IPO.

Third Quarter:
SFR revenues declined by 1.8% compared to the third quarter of 2005 to €2,196 million. Network revenues were stable at €2,105 million.
The strong cut of regulated tariffs as of January 1, 2006 offset favorable effects of the increase in customer base and the growth in "voice" and "data" usage. Excluding the impacts of the regulated tariff cut, SFR revenues would have been up by 2.7% compared to the third quarter of 2005.

Maroc Telecom

First Nine Months:
Maroc Telecom revenues of €1,554 million increased by 12.6% compared to the same period last year (+11.8% at constant currency).

Mobile revenues grew by 17.5% to €1,011 million compared to the same period last year (+16.7% at constant currency).
Revenues increase is the result of commercial success with the sustained growth of the customer base[8] [9] reaching 10.495 million customers (+30.5% compared to the same period last year and a net increase of 2.5 million customers in a year).
The blended ARPU[10], for the first nine months of 2006, stands at €10.6 (-8% compared to the same period last year at constant currency) due to the strong increase of the customer base and the decrease of the average price of communication.
Always innovative in its market, Maroc Telecom introduced new services, on September 1, 2006 with Mobimail (mobile Internet e-mail service) and Mobitalkie (push-to-talk service).

Fixed and Internet revenues grew by 7% to €856 million compared to the same period last year (+6.3% at constant currency).
This good performance was achieved thanks to the dynamism of the public telephony segment (+12%), to the growth of the incoming international traffic (+11.8%), to the continuing success of broadband activity and to a strong growth of data services to enterprises and operators (+22%). The average monthly voice invoice remained stable.
The fixed customer base decreased to 1.267 million of lines (-5.8% compared to the same period last year) while the ADSL customer base[9] experienced a strong growth and almost reached 342,000 lines (+163,000 lines in a year, +91% compared to the same period last year).
To keep its existing customers and attract new ones, Maroc Telecom launched in September new unlimited offers on the fixed telephony segment, named Phony, which allow customers to call all the local and national Maroc Telecom fixed numbers with no limit of time.

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[7] Transaction subject to Competition Authority approval.
[8] Without Mauritel.
[9] The customer base, compliant with the ANRT definition and used by Maroc Telecom in 2006, is calculated as the sum of prepaid customers giving or receiving a voice call during the last 3 months and the number of not resiliated postpaid customers.
[10] ARPU (Average Revenue Per User) is defined as revenues (from incoming and outcoming calls and data services), net of promotions, excluding roaming in and equipment sales, divided by average customer base over the period.

Third Quarter:

Maroc Telecom revenues of €561 million increased by 11.5% compared to the same period last year (+12.3% at constant currency).

Mobile revenues grew by 16.7% to €377 million compared to the same period last year (+17.5% at constant currency) due to the strong increase of the customer base (+ 1.6 million customers in the quarter).

Fixed and internet revenues grew by 5.8% to €296 million compared to the same period last year (+6.6% at constant currency).

Important disclaimer:

This press release contains "forward-looking statements" as that term is defined in the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are not guarantees of future performance. Actual results may differ materially from the forward-looking statements as a result of a number of risks and uncertainties, many of which are outside our control, including but not limited to the risks described in the documents Vivendi has filed with the U.S. Securities and Exchange Commission and with the French Autorité des Marchés Financiers. Investors and security holders may obtain a free copy of documents filed by Vivendi with the U.S. Securities and Exchange Commission at www.sec.gov, the French Autorité des Marchés Financiers at www.amf-france.org, or directly from Vivendi. Vivendi does not undertake, nor has any obligation, to provide, update or revise any forward-looking statements.

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APPENDIX

VIVENDI
REVENUES BY BUSINESS SEGMENT

(IFRS, unaudited)

COMPARABLE BASIS

Comparable basis essentially illustrates the effect of the divestitures or abandonment of operations that occurred in 2005 and 2006 (mainly NC Numéricâble in 2005 and PSG in 2006 at Canal+ Group and Annuaire Express, SFR phone directory activities in 2005) and includes the full consolidation of minority stakes in distribution subsidiaries at SFR as if these transactions had occurred as of January 1, 2005. Comparable basis revenues are not necessarily indicative of the combined revenues that would have occurred had the events actually occurred at the beginning of 2005.

(In millions of euros)	3rd quarter ended September 30, 2006	2005	% Change	% Change at constant rate
Revenues				
Universal Music Group	1,096	1,119	-2.1%	0.8%
Vivendi Games	182	158	15.2%	18.0%
Canal+ Group	879	840	4.6%	4.7%
SFR	2,198	2,235	-1.7%	-1.7%
Maroc Telecom	561	503	11.5%	12.3%
Non core operations and elimination of intercompany transactions	(25)	(5)	x5	x5
Total Vivendi	4,889	4,850	0.8%	1.6%

(In millions of euros)	Nine months ended September 30, 2006	2005	% Change	% Change at constant rate
Revenues				
Universal Music Group	3,238	3,211	2.7%	1.4%
Vivendi Games	478	398	20.7%	18.4%
Canal+ Group	2,675	2,452	9.7%	8.4%
SFR	6,497	6,464	0.5%	0.5%
Maroc Telecom	1,554	1,380	12.6%	11.8%
Non core operations and elimination of intercompany transactions	(40)	(17)	-135.3%	-135.3%
Total Vivendi	14,402	13,898	4.1%	3.5%

AS PUBLISHED (a)

(In millions of euros)	3rd quarter ended September 30, 2006	2005	% Change
Revenues			
Universal Music Group	1,096	1,119	-2.1%
Vivendi Games	182	158	15.2%
Canal+ Group	879	863	1.9%
SFR	2,198	2,235	-1.8%
Maroc Telecom	561	503	11.5%
Non core operations and elimination of intercompany transactions	(25)	(5)	x5
Total Vivendi	4,889	4,874	0.3%

(In millions of euros)	Nine months ended September 30, 2006	2005	% Change
Revenues			
Universal Music Group	3,238	3,211	2.7%
Vivendi Games	478	398	20.7%
Canal+ Group	2,712	2,560	5.9%
SFR	6,497	6,475	0.3%
Maroc Telecom	1,554	1,380	12.6%
Non core operations and elimination of intercompany transactions	(40)	(17)	-135.3%
Total Vivendi	14,439	14,005	3.5%

(a) As they will be published in BALO.

EXHIBIT CO 0941

vivendi press release

July 27, 2006

Note to readers: Vivendi provided preliminary, unaudited revenue information for the first half of 2006 on an IFRS basis in accordance with European regulatory requirements.

Vivendi Reports First Half 2006 Revenues Up 5.8 % on a Comparable Basis

First Half of 2006 Revenues

Vivendi's as published revenues for the first half of 2006 amounted to €9,610 million compared to €9,131 million for the first half of 2005, an increase of 5.2 %.
On a comparable basis[1], first half of 2006 revenues amounted to €9,572 million compared to €9,046 million for the first half of 2005, **an increase of 5.8%** (+4.6% at constant currency).

Second Quarter of 2006 Revenues

Vivendi's as published revenues for the second quarter of 2006 amounted to €4,844 million compared to €4,622million for the second quarter of 2005, an increase of 4.8%.
On a comparable basis, second quarter of 2006 revenues amounted to €4,824 million compared to €4,585 million for the second quarter of 2005, **an increase of 5.2%** (+4.6% at constant currency).

[1]Comparable basis essentially illustrates the effect of the divestitures or abandonment of operations that occurred in 2005 and 2006 (mainly NC Numéricable in 2005 and PSG in 2006 at Canal+ Group and Annuaire Express, SFR phone directory activities in 2005) and includes the full consolidation of minority stakes in distribution subsidiaries at SFR as if these transactions had occurred as of January 1, 2005. Comparable basis revenues are not necessarily indicative of the combined revenues that would have occurred had the events actually occurred at the beginning of 2005.

Universal Music Group

First Half:
Universal Music Group's (UMG's) revenues of €2,202 million were 5.3% higher than last year with strong digital sales growth, increased license income in the U.S. and U.K. and favorable currency movements offsetting lower manufacturing and distribution revenues following the sale of UMG's facilities in Europe and in the U.S.. Digital sales of €222 million more than doubled last year's sales and represented 10.1% of total revenues.

At constant currency, revenues grew by 1.7% versus a very strong first half of 2005 due to an exceptional release schedule that included major releases from 50 Cent, Mariah Carey, The Game and Black Eyed Peas. Best sellers in the first half of 2006 included Andrea Bocelli, Jack Johnson, Ne-Yo and the NOW 21 compilation in the U.S.

In the U.S., UMG's market share of 31.7% was down slightly versus last year's market share of 32%; however, UMG ended the quarter strongly with back to back number 1 albums from A.F.I., Busta Rhymes, Nelly Furtado and India Arie.

Second Quarter:
UMG's revenues of €1,077 million rose 2.2% (up 0.7% at constant currency) compared to last year reflecting strong growth in the digital sector and higher license income in the U.S. and the U.K. as well as favorable currency movements.
Digital sales of €111 million were up 91% versus last year, representing 10.3% of total revenues, with strong growth across all regions and in both the online and mobile sectors.
Best sellers this quarter included new releases from Rihanna, Keane and Nelly Furtado.

Vivendi Games

First Half:

Vivendi Games' revenues of €296 million were 24.4% higher than the prior year (up 18.7% on a constant currency basis). This increase was primarily driven by the continued worldwide success of Blizzard's *World of Warcraft*, the critically acclaimed subscription-based, massively multiplayer online role-playing game (MMORPG).

Other solid performers in the first half of 2006 included the release of Ice Age 2, the game based on Fox movie, and continuing strong sales from backlist products including 50 Cent: Bulletproof and Crash Tag Team Racing.

Second Quarter:
Vivendi Games' revenues of €162 million were 29.6% higher than the prior year (up 27% on a constant currency basis). This increase was driven by the success of Blizzard's *World of Warcraft*, and also by *Ice Age 2*, *50 Cent: Bulletproof* and *Crash Tag Team Racing*.

Canal+ Group

First Half:

Canal+ Group reported revenues of € 1,833 million, up from 1,697 million for the first half of 2005. On a comparable basis[2], Canal+ Group's revenues increased 10.7% compared to the first half of 2005.

Revenues from pay-TV operations in France were up 11%, with all activities achieving revenue growth over the period. This increase was largely driven by Canal+ and CanalSat portfolio growth. The Group's portfolio was over 8.2 million subscriptions, up more than 280,000 compared to June 2005. Compared to the first half of 2005, Canal+ revenues were up 8% thanks to portfolio growth and continuous growth of advertising revenues due to the channel's positive image as well as good audience ratings. At the end of June 2006, Canal+ Le Bouquet represented 56% of the channel's total portfolio versus 49% at the end of June 2005. CanalSat revenues increased mainly due to portfolio growth.

Revenues from pay-TV operations in Poland were up mainly due to the subscriber portfolio growth.

Revenues for Canal+ group's movie business were up 6% benefiting mainly from successful theatrical releases in France, such as *Fauteuils d'orchestre* directed by Danielle Thompson and *Jean-Philippe* directed by Laurent Tuel.

Second Quarter:

Canal+ Group reported revenues of € 934 million, up from € 816 million in the second quarter of 2005. On a comparable basis[2], Canal+ Group's revenues were up 14.3% compared to same period previous year.

Revenues of French pay-television grew 10% compared to the second quarter of 2005 with all of its activities increasing in revenues.

Other business revenues also increased strongly compared to second quarter 2005. Higher revenues from the movie business were due to a favorable timing compared to the second quarter of 2005.

SFR

First Half:

SFR revenues grew by 1.5% versus the same period in 2005 (1.7% on a comparable basis[3]) to €4,301 million.

Favorable effects of the increase in customer base along with the growth in "voice" and "data" usage were partly offset by the strong cut in regulated tariffs as of January 1, 2006 (a 24% cut of mobile voice termination rates and a 19.4% cut for SMS termination) as well as by the cut in the price charged to customers for the new offers launched in April 2005. SFR ARPU[4] decreased by 3.7% to €471 at the end of June 2006 (versus €489 at the end of June 2005). Excluding the impacts of the regulated tariffs' cut, SFR revenues would have been up by 6.1%.

SFR proved ongoing commercial dynamism during the first half, with 216,000 new customers, taking its registered customer base to 17.415 million[5], a 7.4% increase versus last year. The contract customer base grew by 10.7% year-on-year to 11.160 million, leading to an improved customer mix of 1.9 percentage point in one year.

Average voice usage of SFR customers (AUPU)[6] continued its strong growth by 14.5% to 319 minutes per month.

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[2]Comparable basis essentially illustrates the effect of the divestitures at Canal+ Group (mainly NC Numéricable in 2005 and PSG in 2006), as if these transactions had occurred as of January 1, 2005.

[3]Comparable basis mainly illustrates the full consolidation of minority stakes in distribution subsidiaries and excludes revenues from phone directory activities (Annuaire Express) as of January 1, 2005.

[4]ARPU (Average Revenue Per User) is calculated on a twelve-month rolling period by dividing revenues net of promotions and net of third-party content provider revenues, excluding roaming in and equipment sales, by average Arcep total customer base for the last twelve months. ARPU is calculated on a comparable basis, excluding revenues from phone directory activities (Annuaire Express).

[5]SFR excluding wholesale customers total base (wholesale customer base reached 268,000 at the end of June 2006)

[6]AUPU (Average Usage Per User) is defined as the incoming and outgoing "voice" volumes divided by average Arcep total customer base for the last twelve months

3G customers reached 1.574 million as of June 2006 compared to 1.003 million at the end of December 2005. SFR was the first operator to launch HSDPA in France in May 2006 to provide higher debit rates to its customers.
Net data revenues improved significantly to represent 13.1% of network revenues for the first half of 2006, compared to 11.4% in 2005, partly due to a 18.7% increase in text messaging (SMS) sent by SFR customers (3.1 billion), to the 2 time multiplication of MMS sent (83 million) and to the strong increase of other services. The latter now represent 32% of total data revenues compared to 28% in 2005. During the soccer World Cup in June 2006, SFR had more than 120,000 SFR customers registered to the service "Alertes Buts" (Goal Alert) and more than 1 million soccer videos downloaded. At the end of June 2006, the data ARPU reached €62, an 11% growth compared to 2005.

This performance highlights the success of SFR offers, which aim to substitute fixed voice usage for mobile voice usage and to develop new usages for the mobile phone, especially around music, video, TV and games services.

Second Quarter:
SFR revenues declined by 0.4% (up 0.6% on a comparable basis[3]) compared to the second quarter of 2005 to €2,166 million.
On a comparable basis, favorable effects of the increase in customer base and the growth in "voice" and "data" usage were partially offset by the strong cut of regulated tariffs as from January 1, 2006, by the cut in the price charged to customers for the new offers launched in April 2005 as well as by unfavorable calendar effects of approximately 1 percentage point on second quarter revenues growth versus the second quarter of 2005. SFR ARPU[4] decreased by 3.7% to €471 in June 2006 (versus €489 in June 2005).
Excluding the impacts of the regulated tariffs' cut, SFR revenues would have been up by 4.9% compared to the second quarter of 2005.

Maroc Telecom

First Half:

For the first half of 2006, Maroc Telecom revenues of €993 million increased by 13.2% compared to the same period last year (+11.5% at constant currency).

Mobile revenues grew by 18% to €634 million compared to the same period last year (+16.2% at constant currency). This progression was mainly explained by the growth of the customer base[7] [8] with 8.924 million of customers, +24.2% compared to the same period last year, with a net increase of 687,000 customers over the period.
Maroc Telecom launched several innovating offers during the period and reinforced its market leader position: 30 Dh Jawal access (SIM Card + phone number + 10 Dh communication credit), "Twin Jawal" reload plan (10+20 Dh), unlimited calls introduced in postpaid controlled plans.
The monthly ARPU[7] [9] was €10.5 (-7.1% compared to the same period last year) due to the strong increase of the customer base.
The churn rate reaches 16.6% (+6.5 points compared to the same period last year) with the sharp increase of the customer base and the decrease of the access fees.

Fixed and internet revenues grew by 7.7% to €560 million compared to the same period last year (+6.1% at constant currency).
This good performance was achieved thanks to the pricing modifications operated during the last quarter of 2005, the growth of the incoming international traffic (+12.7%) and to the continuing success of the broadband activity. The fixed customer base[7] decreased to nearly 1.310 million of lines (-2.9% compared to the same period last year).
Maroc Telecom stimulated the broadband market over this period with promotions, sharp decrease in price on May 1st from 17% to 33% according to the rates, and migration to the upper rate with no pricing increase for the existing customers.
On May 31, Maroc Telecom launched TV on ADSL, a very first in Morocco, Africa and in the Arabic countries.
The ADSL customer base[7] experienced a strong growth and reached 325,000 lines (+83,000 lines over the period, +140.7% compared to the same period last year).

Second Quarter:
Maroc Telecom consolidated revenues of €510 million increased by 12.3% compared to the same period last year (+11.3% at constant currency).
Mobile revenues grew 18.1% to €334 million compared to the same period last year (+17.1% at constant currency) due to the strong increase of the customer base.
Fixed and internet revenues grew 5.4% to €278 million compared to the same period last year (+4.6% at constant currency) thanks in particular to the success of the ADSL offers.

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[7] Without Mauritel.
[8] The customer base, compliant with the ANRT definition and used by Maroc Telecom in 2006, is calculated as the sum of prepaid customers giving or receiving a voice call during the last 3 months and the number of not resiliated postpaid customers.
[9] ARPU (Average Revenue Per User) is defined as revenues (from incoming and outgoing calls and data services), net of promotions, excluding roaming in and equipment sales, divided by average customer base over the period

Important disclaimer:
This press release contains "forward-looking statements" as that term is defined in the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are not guarantees of future performance. Actual results may differ materially from the forward-looking statements as a result of a number of risks and uncertainties, many of which are outside our control, including but not limited to the risks described in the documents Vivendi has filed with the U.S. Securities and Exchange Commission and with the French Autorité des Marchés Financiers. Investors and security holders may obtain a free copy of documents filed by Vivendi with the U.S. Securities and Exchange Commission at www.sec.gov, the French Autorité des Marchés Financiers at www.amf-france.org, or directly from Vivendi. Vivendi does not undertake, nor has any obligation, to provide, update or revise any forward-looking statements.

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APPENDIX

VIVENDI
REVENUES BY BUSINESS SEGMENT

(IFRS, unaudited)

COMPARABLE BASIS

Comparable basis essentially illustrates the effect of the divestitures or abandonment of operations that occurred in 2005 and 2006 (mainly NC Numéricâble in 2005 and PSG in 2006 at Canal+ Group and Annuaire Express, SFR phone directory activities in 2005) and includes the full consolidation of minority stakes in distribution subsidiaries at SFR as if these transactions had occurred as of January 1, 2005. Comparable basis revenues are not necessarily indicative of the combined revenues that would have occurred had the events actually occurred at the beginning of 2005.

(In millions of euros)	2nd quarter ended June 30, 2006	2005	% Change	% Change at constant rate
Revenues				
Universal Music Group	1,077	1,054	2.2%	0.7%
Vivendi Games	162	125	29.6%	27.0%
Canal+ Group	914	800	14.3%	13.8%
SFR	2,166	2,154	0.6%	0.6%
Maroc Telecom	510	454	12.3%	11.3%
Non core operations and elimination of intercompany transactions	(5)	(2)	-150.0%	-150.0%
Total Vivendi	4,824	4,585	5.2%	4.6%

(In millions of euros)	1st half ended June 30, 2006	2005	% Change	% Change at constant rate
Revenues				
Universal Music Group	2,202	2,092	5.3%	1.7%
Vivendi Games	296	238	24.4%	18.7%
Canal+ Group	1,795	1,622	10.7%	10.3%
SFR	4,301	4,229	1.7%	1.7%
Maroc Telecom	993	877	13.2%	11.5%
Non core operations and elimination of intercompany transactions	(15)	(12)	-25.0%	-25.0%
Total Vivendi	9,572	9,046	5.8%	4.6%

AS PUBLISHED (a)

(In millions of euros)	2nd quarter ended June 30, 2006	2005	% Change
Revenues			
Universal Music Group	1,077	1,054	2.2%
Vivendi Games	162	125	29.6%
Canal+ Group	934	816	14.5%
SFR	2,166	2,175	-0.4%
Maroc Telecom	510	454	12.3%
Non core operations and elimination of intercompany transactions	(5)	(2)	-150.0%
Total Vivendi	4,844	4,622	4.8%

(In millions of euros)	1st half ended June 30, 2006	2005	% Change
Revenues			
Universal Music Group	2,202	2,092	5.3%
Vivendi Games	296	238	24.4%
Canal+ Group	1,833	1,697	8.0%
SFR	4,301	4,239	1.5%
Maroc Telecom	993	877	13.2%
Non core operations and elimination of intercompany transactions	(15)	(12)	-25.0%
Total Vivendi	9,610	9,131	5.2%

na* : not applicable.

(a) As they will be published in BALO.

EXHIBIT CO 0942

VIVENDI UNIVERSAL

March 17, 2004

Note: This press release contains consolidated results established under French Generally Accepted Accounting Principles (French GAAP).

2003 MAJOR EVENTS

- **Investment of €4 billion in SFR Cegetel.**
- **Agreement signed with GE to create, in the second quarter of 2004, NBC Universal.**

2003 CONSOLIDATED FINANCIAL RESULTS

- **Net debt[1] reduced to €11.6 billion at December 31, 2003, after the €4 billion investment in SFR Cegetel.**

- **Adjusted net income[2] (excluding exceptional items and goodwill)**
  - o positive at €349 million, an improvement of €863 million compared with 2002.

- **Asset impairment charge:**
  - o €1.8 billion asset impairment charge, notably at Universal Music Group and Vivendi Universal Games

- **Net loss of €1.1 billion.**

- **Strong growth of operating results on a pro forma[3] basis:**
  - o Operating income of €3,309 million, up 61% on a pro forma basis,
  - o Consolidated cash flow from operations[4] of €4.4 billion, up 64% on a pro forma basis,
  - o Proportionate cash flow from operations[5] of €2.8 billion, multiplied by 3.7 times, on a pro forma basis.

OUTLOOK 2004

- **Very strong growth in adjusted net income.**
- **Strong growth in operating income, excluding VUE, NBC Universal and Telepiù[6].**
- **Stable consolidated cash flow from operations, excluding VUE, NBC Universal and Telepiù[6].**
- **Net debt below €5 billion.**
- **In a position to pay a dividend to our shareholders in 2005.**

Further information is available at: http://finance.vivendiuniversal.com

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[1] French GAAP gross debt less cash and cash equivalents.

[2] For reconciliation of net income (loss) to adjusted net income (loss) please refer to the table in the supplementary schedules attached to this release page 15.

[3] The pro forma information illustrates the effect of the acquisition of the entertainment assets of InterActiveCorp. in May 2002 and the disposition of Vivendi Universal Publishing assets sold in 2003, as if these transactions had occurred at the beginning of 2002. It also illustrates the accounting of Veolia Environnement using the equity method at January 1, 2002 instead of December 31, 2002.

[4] Net cash provided by operating activities net of capital expenditures and before financing costs and taxes.

[5] Defined as cash flow from operations excluding the minority stakes.

[6] Telepiù consolidated until April 30, 2003 ; VUE consolidated until the closing of the transaction ; NBC Universal to be equity accounted.

Paris, March 17, 2004 - Vivendi Universal today announced its financial results for 2003 which are currently being audited and were approved by the Board of Directors.

Comments by Jean-René Fourtou, Chairman and Chief Executive Officer

"I am pleased to announce financial results for 2003 which have exceeded our guidance.

Vivendi Universal's teams have accomplished a lot together in 18 months: we overcame a financial issue, we reduced our debt from approximately €35 billion to €11.6 billion, we divested approximately €10 billion of assets, not counting proceeds from the upcoming VUE transaction.

Today, Vivendi Universal is in good working order. In 2003, Vivendi Universal has invested €1.6 billion of capital expenditures in its core businesses. It has also invested €4 billion for the acquisition of BT's 26% stake in SFR Cegetel.

In addition, we have signed, in October 2003, an agreement with General Electric to combine VUE and NBC. This will give birth to NBC Universal, one of the world's most profitable and fastest-growing media companies, in which we will be an active and long term partner.

Our main commitment was to improve considerably our operating cash flow and Vivendi Universal managers have focused successfully on this matter. As a result, our consolidated cash flow from operations grew 64% in 2003 and our proportionate cash flow from operations increased almost 4 times over the previous year, on a pro forma basis.

We have reversed the trend: cash flow generation in the businesses now contributes to the reduction of the debt, while we maintain capital expenditures to strengthen our operations.

We have eliminated the company's cash drains. The cost of the headquarters has been reduced 50%. For the first time in six years, Canal+ Group records a positive operating income. The Universal Music Group and Vivendi Universal Games are implementing a strong and determined reorganization plan. We have strengthened our relationship with Vodafone for the benefit of SFR and shareholders.

I am proud of the efficiency demonstrated by our teams, both at corporate and the business unit levels. A lot of work still needs to be accomplished this year: closing of the VUE-NBC transaction by the end of the first half, increasing our stake in Maroc Telecom, succeeding in SFR's 3G launch, continuing the process of strengthening Canal+ Group, improving Universal Music Group and Vivendi Universal Games operations, completing our non core assets divestiture program and reducing our net debt.

In 2004, I expect Vivendi Universal to deliver strong growth in its profit, to reach a level of debt below €5 billion at year end and be in a position to distribute dividends to its shareholders in 2005.

On top of an improved financial structure, Vivendi Universal's main objective is to create value for its shareholders in two sectors with strong growth potential: over the long term, Media and Telecommunications have grown significantly faster than the rest of the economy.

In 2005, Vivendi Universal will be a dynamic Media and Telecommunications group, delivering a strong increase in profit with high available cash flow and able to pursue internal growth as well as to invest in select external opportunities."

Comments on the Group's earnings:

Due to substantial scope changes, the straightforward comparison of 2003 versus 2002 results, on an actual basis, may not be meaningful. **This is why the comparisons below are presented on a pro forma basis[3].** For comparison with "as published" statements, see the attached schedules.

Adjusted net income

The 2003 adjusted net income amounted to **+ €349 million.** This compares with a loss of - €514 million in 2002.

This **€863 million improvement** was achieved due to:

+ €1,432 million from the operating income improvement,

+ €393 million from the tax improvement (mainly a consequence of the simplification of SFR's structure i.e., €287 million group share),

and was partially offset by:

- €48 million from the higher financing expenses, reflecting an increased average cost of the debt (4.8% in 2003 versus 4.1% in 2002) offset by a lower average gross debt (€16.4 billion in 2003 versus €22.1 billion in 2002),
- €538 million from higher other financial expenses (mainly due to €228 million of foreign exchange losses in 2003 against €153 million capital gain on Vinci shares in 2002),
- €273 million from higher minority interests (mainly due to the improvement in SFR Cegetel and Maroc Telecom's results),
- €103 million from the decrease in equity earnings or sold affiliates (reduced contribution from Veolia Environnement - €459 million - not fully offset by reduced losses in VUNet, international telecom and Canal+).

The 2003 adjusted net income (excluding exceptional items and goodwill) includes non recurring items. The positive items are the simplification of SFR's structure (€287 million group share) and the reversal of certain provisions (€649 million). They are largely offset by the negative impact of currency movements (€228 million of foreign exchange losses and €121 million from the effect of currency on the operating income) as well as restructuring provisions and various exceptional charges (€510 million).

Goodwill and asset impairment

The company recorded **€1,120 million** in goodwill amortization (versus €992 million in 2002) and impairment losses of goodwill and other intangible assets amounted to **€1,792 million** (versus €18,442 million in 2002). Essentially due to declining market conditions in 2003, impairment losses were recorded on Universal Music (€1,370 million), VUE Universal Parks & Resorts (€188 million), Canal+ Group international assets (€165 million) and VU Games (€61 million).

Financial provisions, exceptional items

The company's 2003 earnings are impacted by a number of exceptional items, although to a much lesser extent than in 2002.

The exceptional gains on divestitures were **€602 million** in 2003, compared to €1,125 million in 2002.

The 2003 financial provisions (net of realized losses) and the charges related to the company's debt restructuring were limited to **€94 million** versus €3,567 million in 2002.

The company benefited from **€1,112 million** of exceptional tax credits in 2003, compared to €1,022 million in 2002 of exceptional tax expenses. The most important swing factor was the reversal of a €477 million reserve (established in 2002 for €534 million for a potential contractual liability for tax indemnification that would have arisen if Vivendi Universal had been unable to secure the refinancing of the bridge loan relating to the VUE Leveraged Partnership Distribution).

[3] The pro forma information illustrates the effect of the acquisition of the entertainment assets of InterActiveCorp. in May 2002 and the disposition of Vivendi Universal Publishing assets sold in 2003, as if these transactions had occurred at the beginning of 2002. It also illustrates the accounting of Veolia Environnement using the equity method at January 1, 2002 instead of December 31, 2002.

Net Loss / Loss per share - basic

Altogether, the company's net loss amounted to - €1,143 million (- €23,301 million in 2002). Vivendi Universal's 2003 net loss per share – basic amounted to - €1.07 (- €21.43 in 2002).

Operating income

Whereas Vivendi Universal's pro forma revenues declined by 10% and 3% at constant currency, pro forma 2003 operating income increased by 61% (and +67% at constant currency) to €3,303 million compared with €2,051 million in 2002.

This strong operating income pro forma performance was achieved through:

+ €542 million improvement at Canal+ Group, which recorded €247 million of operating income in 2003 including some provision reversal early in the year,
+ €510 million from the elimination of the company's cash drains in the non core businesses (VU Net, VTI and Vivendi Valorisation),
+ €470 million from the improved performance at SFR Cegetel Group,
+ €335 million from lower holding and corporate costs,
+ €160 million growth at Maroc Telecom,

and was offset by:

- €486 million decline at UMG,
- €264 million decline at VU Games;
- €15 million decline at VUE (up 39%, on a stand-alone, pro forma, dollar and U.S. GAAP basis)

Cash flow generation

The consolidated cash flow from operations for the year 2003 was €4.4 billion, up 64% compared to €2.7 billion for the same period last year, on a pro forma basis. Approximately €400 million of the consolidated cash flow from operations came from non recurring asset sales, e.g., real estate asset sales at VUE. Also, the working capital requirements of the 4th quarter 2003 have been reduced well below expectations due to positive timing of certain events and through improved cash management.

Proportionate cash flow from operations for the full year was €2.8 billion, 3.7 times the €754 million in 2002, on a pro forma basis.

Access to the cash flows from within the businesses has improved significantly, as the VUE ring fence was eliminated in June 2003 and SFR Cegetel Group has started to distribute dividends in 2003 and adopted a quarterly dividend policy starting in 2004.

The cash flow is now contributing to the reduction of debt, in spite of strong levels of capital expenditures.

Investments

In 2003, Vivendi Universal invested €6.0 billion, of which €4.4 billion in various acquisitions including €4 billion to acquire 26% of Cegetel and €1.6 billion in capital expenditures.

NBC Universal

On October 8, 2003, Vivendi Universal and GE announced the signing of a definitive agreement for the combination of NBC and VUE. The new company, to be called NBC Universal, will be 80%-owned by GE, with approximately 20% held by Vivendi Universal. NBC Universal's assets will include: the NBC Television Network, Universal Pictures, television production studios (NBC Studios and Universal Television), a portfolio of cable networks, the NBC TV stations group, Spanish-language TV broadcaster Telemundo and its 15 Telemundo stations and interests in five theme parks. On a pro forma basis, NBC Universal's 2003 revenues would be more than $13 billion and 2003 EBITDA exceeding $3 billion.

As part of the transaction, GE is expected to pay at closing $3.65 billion of cash consideration, of which Vivendi Universal would receive approximately $3.3 billion, subject to adjustment in the event that InterActiveCorp exercises certain rights it has to participate in the VUE-NBC transaction.

As a result of the deconsolidation of VUE, Vivendi Universal will also benefit from an approximately $3.2 billion reduction in net debt on a consolidated basis. This reduction comes from $1.7 billion related to VUE's debt and the net effect of the deconsolidation of class B preferred shares.

Beginning in 2006, Vivendi Universal will have the option to begin monetizing its ownership interest in NBC Universal at fair market value. Vivendi Universal will hold three out of 15 seats on the Board of Directors of NBC Universal. The transaction had no impact on Vivendi Universal's 2003 accounts.

The completion of the VUE NBC transaction is subject to customary approvals from various regulatory agencies and the defeasance of the covenants of the class A preferred shares. Vivendi Universal currently anticipates completing the VUE NBC transaction in the second quarter of 2004.

Asset divestiture program

The divestiture program is on track, with approximately €3 billion in proceeds generated in 2003 (mainly the Consumer Press division, Canal+ Technologies, InterActiveCorp warrants, Telepiù, Hungary's fixed line, Comareg and VUE real estate), and close to €10 billion in proceeds since July 2002 (excluding the proposed VUE transaction).

Net debt

Vivendi Universal has been able to improve its liquidity and debt situation in 2003 due to improved cash flow generation and the success of its divestiture program.

The net debt of the company was reduced from €34.9 billion in June 2002 to €12.3 billion at the end of 2002 and €11.6 billion at the end of 2003, even if Vivendi Universal invested €6.0 billion in 2003.

The company's Credit Default Swaps (CDS) have improved very significantly, reflecting the turn around of the company's finances. The 5-year CDS measures the risk associated with debt maturing in 5 years time. This indicator declined from 485 points at the end of March 2003 to 275 points at the beginning of June. It decreased further to 185 points in the beginning of September 2003 and to 110 on December 31, 2003.

Since July 2002, Vivendi Universal has restructured and set up €15 billion of debt. During the course of the 2003 financial year, Vivendi Universal was able to obtain new lines of credit allowing it to progressively regain its financial flexibility, to substantially reduce its bank margins, to regain a balance between bank financing and capital market financing and to extend the average maturity of its debt.

At the end of January 2004, following the repayment of the €1.7 billion OCEANE which was maturing in early January, the average duration of Vivendi Universal's debt, including the series A and series B preferred stocks issued by VUE, was approximately 6.7 years compared to 4.5 years at the end of 2002.

Comments on operating income for Vivendi Universal's Media and Telecom businesses:

Media activity *(as fully consolidated at 100%)*

Revenues amounted to €15,725 million in 2003. Operating income was €1,047 million, down 9% on a constant currency and pro forma basis. Media activity has generated €1,920 million of cash flow from operations.

Canal+ Group (100% Vivendi Universal economic interest):

In millions of euros	2003 Actual	2002 Actual	% variation	% variation excluding scope changes
Revenue	4,158	4,833	-14%	+1%
Operating Income	247	(325)	NA	NA

Significant improvement in Canal+ Group's operating income.

In 2003, actual revenues at Canal+ Group declined by 14% (and 12% on a pro forma basis) to €4,158 million resulting from divestitures made in 2003. Excluding all scope changes (primarily Telepiù), Canal+ Group revenues were up 1% versus prior year.

Canal+ Group ended 2003 with the operating income of €247 million compared to an operating loss of €325 million in 2002. Recurring operating income amounted to €99 million. This represented a like-for-like increase of approximately €200 million over 2002. The difference with the actual operating income is explained by non-recurring items, principally a provision reversal impacting Telepiù's operating income for €129 million - this provision on a deal with a channel was reversed when Telepiù reached a high enough number of subscribers to make the contract profitable - and a slightly positive balance between other provision's allowances and reversals.

Revenues from the French pay-TV operations, Canal+ Group's core business, increased 6% to €2,813 million. Canal+ Group ended 2003 with nearly 8.1 million subscriptions to its Canal+ pay-TV offerings in France, representing a net growth of approximately 135,000 subscriptions for the year. With 4.9 million subscriptions at December 31, the Canal+ premium channel significantly limited the forecast decline in its subscriber base to a net of approximately 110,000, primarily due to the sustained level of commitments of new subscribers whose number rose 10% during the year. CanalSatellite continued to grow, ending the year with 2.8 million subscriptions, for a net annual increase of approximately 230,000 subscriptions.
Pay-TV's operating income doubled from the previous year at €128 million. All of the operations (premium channel, theme channels, satellite and cable packages and operations in the French overseas departments and territories) contributed to the increase. The good operating performances were achieved through revenue growth, restructuring efforts and cost savings.

StudioCanal revenues were down 23% to €351 million, in line with the company's strategy to be more selective on its movie investments. StudioCanal's "*Les Nuls l'Intégrule*" ranked number one among France's best-selling videos and DVDs during the holiday season, with nearly one million copies sold, an unprecedented achievement for a comedy DVD in France.
Despite the revenue decline, StudioCanal operating income was positive at €26 million (compared to a €95 million operating loss in 2002) due to the benefits of the company's restructuring, the introduction of a new editorial policy and the decision to discontinue in-house movie production.

Universal Music Group (92% Vivendi Universal economic interest):

In millions of euros	2003 Actual	2002 Actual	% variation	% variation pro forma at constant currency
Revenue	4,974	6,276	-21%	-12%
Operating Income	70	556	-87%	-90%

UMG operating income impacted by a weak market, restructure costs and legal charges

UMG's revenues of €4,974 million were 21% below 2002 due to adverse currency movements, weakness in the global music market and a lower number of releases from global superstars. Revenues declined 12% in constant currency with growth in Japan and the U.K. more than offset by declines in the U.S., Germany, and France. Best sellers included 50 Cent, which was the number one best seller of the year in the U.S. and strong carryover sales from 2002 releases by t.A.T.u. and Eminem. Other major sellers were from Sheryl Crow, Toby Keith, The Black Eyed Peas with very strong sales outside of North America, Sting and Busted, who had two albums in the year selling over 1 million units. UMG estimates that its worldwide market share declined slightly from the record level of 24.3% attained in 2002 but remains higher than 2001 and prior years.

In 2003, operating income at UMG declined 87% to €70 million. This decline reflected the margin impact of the decline in revenue and a higher proportion of lower margin activity partially offset by lower marketing and catalog amortization expenses. Operating income also reflected the costs incurred as a result of a restructuring program commenced in mid-2003 and a charge relating to the cash deposit made with the United States District Court in connection with the Company's appeal of an unfavourable decision after trial in a lawsuit brought by TVT Records and TVT Music, Inc.

Cash flow from operations was down 11% versus last year despite the sharp drop in operating income and the TVT matter, primarily due to a reduction in other working capital requirements, lower artist and repertoire investment and reduced capital expenditures. Also, a large portion of the restructuring charges will not be reduced to cash until 2004.

In a difficult and evolving environment, UMG is pursuing a multi-pronged approach to restore its profitability and revenue growth. These include continuation of the cost-cutting initiatives begun last year, the active

support of legitimate on line services and other efforts to combat piracy, and further adjustment to the North American pricing policy.

Vivendi Universal Games (99% Vivendi Universal economic interest):

In millions of euros	2003 Actual	2002 Actual	% variation	% variation at constant currency
Revenue	571	794	-28%	-16%
Operating Income	(201)	63	NA	NA

Vivendi Universal Games performance suffered a decline.

Vivendi Universal Games revenues, comprised of a balanced mix of original content (45%), licensed properties (40%) and third-party releases (15%), decreased to €571 million for the year, 28% below prior year. On a constant currency basis, revenues were down by 16%.
Operating loss amounted to €201 million compared to operating income of €63 million in 2002 mainly reflecting lower gross margins on declining revenues and the write off of R&D expenses (€54 million). A weaker release schedule compare to the prior year compounded by slippage resulted in lower revenues, higher returns, price protection, and product and advance write-offs.
A new management team has been put in place to stabilize the company and turn it around. 2004 will be a transition year for the company, with the most important titles being released late in the year. The company is focused on significantly enhancing the product portfolio by building off a strong intellectual property base (IP) and alliances, developing new IP for console, expanding into the on-line space and strengthening its market leading PC franchise.

Vivendi Universal Entertainment (86% Vivendi Universal economic interest):

In millions of euros In French G.A.A.P.	2003 Actual	2002 Actual	% variation	% variation pro forma at constant currency
Revenue	6,022	6,270	- 4%	+4%
Operating Income	931	816	+14%	+19%

In millions of dollars In U.S. G.A.A.P.	2003 Actual	2002 Pro Forma[7]	% variation
Revenue	6,622	5,960	+11%
Operating Income	1,008	723	+39%

On a comparable basis (stand alone, pro forma, in dollars and in U.S. GA.A.P.), VUE's operating income increased 39%.

VUE revenues amounted to €6,022 million, down 4%. On a pro forma[7] and constant currency basis, VUE revenues were up 4% and up 10% excluding Spencer Gifts sold in May 2003. On a comparable basis (stand alone, pro forma, in US GAAP and in dollars), VUE revenues increased by $662 million or 11%.
Operating income was up 14% to €931 million and up 19% on a pro forma and constant currency basis.

[7] Pro forma basis as if InterActiveCorp entertainment assets had been consolidated from January 1, 2002, and the results of Universal Studios' international television networks had been reported by VUE instead of Canal Plus Group

On a comparable basis (stand alone, pro forma basis, in US GAAP and in dollars), VUE operating income increased $285 million or 39%. Strong performance at Universal Pictures as well as at Universal Television Production and Distribution were key drivers of the improved results.

Universal Pictures Group operating income increased 47% versus prior year primarily due to the strength of the current year film slate. Significant drivers included strong theatrical and video performances from *Bruce Almighty*, *2 Fast 2 Furious*, *Seabiscuit* and theatrical results from *American Wedding*. 2003 also included strong video performances from *8-Mile*, *Bourne Identity* and *Scarface*.

Operating income increased 8% at Universal Television Group. Operating income at Universal Television Production and Distribution was up 40%, driven by the continued success of the *Law & Order* franchise as well as higher margins on sales of library products. Operating income at Universal Television Networks was flat versus prior year as increases in advertising sales and affiliate fees were offset by investment in acquired and original programming, which is expected to drive future profits.

Universal Parks & Resorts and Other operating income increased 18% over the prior period. Operating income increased 20% at Universal Parks & Resorts, which included a benefit from the 2003 sale of hotel properties located at Universal City. Operating income at Universal Studios Networks, a group of international cable channels, improved by 183%, due to higher affiliate fees and subscribers combined with reduced overhead costs.

Telecom activity (as fully consolidated at 100%)
Revenues amounted to €9,045 million in 2003. Operating income was €2,547 million, up 34% on a constant currency and pro forma basis. Telecom activity has generated €2,749 million of cash flow from operations.

SFR Cegetel (approximately 56% Vivendi Universal economic interest):

In millions of euros	2003 Actual	2002 Actual	% variation
Revenue	7,574	7,067	+7%
Operating Income	1,919	1,449	+32%

SFR Cegetel's operating income grew 32% to €1,919 million, due to good marketing performance and efficient cost management.

SFR Cegetel Group reported an excellent performance in 2003 with consolidated revenue growth of 7% to €7,574 million. Operating income increased by 32% to €1,919 million compared to €1,449 million in 2002 mainly reflecting efficient cost management.

Mobile telephony revenues increased 10% to €6,733 million, driven by significant growth in the customer base and a strong annual rolling ARPU[8]. SFR increased its market share on the French mobile market to 35.3% against 35.1% at the end of December 2002. In 2003 and for the first time ever, SFR (including SRR) became the market leader in net adds with a 38% market share, taking its registered customer base to 14.7 million, a 9% increase against 2002. This good performance was primarily achieved due to strong market share on postpaid net adds (43%). Furthermore, SFR is actively focused on increasing loyalty of postpaid customers resulting in a 7.1 points churn rate decline to reach 13.4% in 2003.
Annual rolling ARPU grew 1.7% to €431, despite the fixed incoming call price decrease of 15% on January 1, 2003. This favorable ARPU trend is explained by an improved customer mix and increased usage: postpaid

[8] Annual rolling ARPU : annual rolling average revenue per user defined as annual rolling mobile (SFR+SRR) revenues excluding roaming-in and excluding equipment sales, net of promotions on yearly average ART (Autorité de Régulation des Télécommunications) total subscriber base.

customer base grew 18% (compared to a 14% market growth), improving the customer mix to 57.7% against 53% at the end of December 2002. Overall voice usage increased 7% year over year to 256 minutes per average customer per month. In addition, the number of multimedia customers more than doubled to more than 2.3 million at the end of December 2003. The growing adoption of multimedia mobile services by SFR customers is confirmed with approximately 330,000 customers (as of December 31, 2003) to the new multimedia service portal Vodafone live! launched in October 2003 (and approximately 410,000 customers at the end of January 2004), 3.3 billion text messages (SMS) and 6 million multimedia messages (MMS) sent in 2003.
Growth in the customer base, strong annual rolling ARPU, declining customer acquisition costs per gross addition resulting from efficient cost management and a strong reduction in bad debt increased operating income by 26% to €1,949 million.

Fixed telephony revenues declined 9% to €841 million mainly explained by the unfavorable impact of year end 2002 voice price decreases and an unfavorable traffic mix. Operating losses decreased by 71% to €30 million mainly due to the improvement of cost management and favorable non-recurring events that more than offset revenue decline. Pro forma of the TD-Cegetel merger, fixed telephony activity, recorded a slightly positive operating income.

Maroc Telecom (35% Vivendi Universal economic interest):

In millions of euros	2003 Actual	2002 Actual	% variation	% variation at constant currency
Revenue	1,471	1,487	-1%	+3%
Operating Income	628	468	+34%	+40%

Maroc Telecom operating income experienced a strong 40% growth to € 628 million, at constant currency, due to the efficient control of costs.

For the full year 2003, Maroc Telecom's revenues amounted to €1,471 million, up 3% at constant currency when compared with the year 2002.
Mobile revenues, representing 46% of 2003 total revenues, were up 8.5% when compared to 2002, thanks to a larger customer base. Mobile customers at year end increased 13% by 617,000 to 5,214,000.
Fixed-line revenues were stable, the increase of incoming mobile calls and internet being balanced by lower national voice traffic and the loss of Meditel's (the mobile competitor) international traffic. Reversing the trend of the previous years, Maroc Telecom's fixed-line customer base increased by 92,000 to reach 1,219,000 customers.
Operating income was up 34% (40% at constant currency) to €628 million mainly driven by strong operational improvement, cost management, impact of 2002 restructuring, lower bad debt, lower mobile acquisition costs and a reduction in selling, general and administrative expenses.

Forward looking Statements:

This annual report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or Exchange Act. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to divestitures, acquisitions, working capital and capital requirements, available liquidity, maturity of debt obligations, business trends and other information that is not historical information. Forward-looking statements can be identified by context. For example, when we use words such as "estimate(s)," "aim(s)," "expect(s)," "feel(s)," "will," "may," "believe(s)," "anticipate(s)" and similar expressions in this document, we are intending to identify those statements as forward-looking. All forward-looking statements, including, without limitation, the launching or prospective development of new business initiatives and products, anticipated music or motion picture releases, Internet or theme park projects, and anticipated cost savings from asset disposals and synergies are based upon our current expectations and various assumptions. Our expectations, beliefs, assumptions and projections are expressed in good faith, and we believe there is a reasonable basis for them. There can be no assurance, however, that managements' expectations, beliefs and projections will be achieved.

There are a number of risks and uncertainties that could cause our actual results to differ materially from our forward-looking statements. These include, among others: satisfaction of the conditions specified in the transaction agreements related to the planned combination of VUE and NBC, including, without limitation, the receipt of required governmental and other third-party approvals of the transaction; changes in the stock market and interest rate environment that affect revenues; general economic and business conditions, particularly a general economic downturn; industry trends; the availability and terms of financing; the terms and conditions of asset disposals and the timing thereof; changes in ownership structure; competition; changes in business strategy or development plans; challenges to, or losses or infringements of intellectual property rights; customer preference; technological advancements; political conditions; foreign currency exchange rate fluctuations; legal and regulatory requirements and the outcome of legal proceedings and pending investigations; environmental liabilities; natural disasters; and war or acts of terrorism.

The foregoing list is not exhaustive and there are other factors that may cause actual results to differ materially from the forward-looking statements. We urge you to review and consider carefully the various disclosures we make concerning the factors that may affect our business. All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this document and are expressly qualified in their entirety by the cautionary statements. We undertake no obligation to publish revised forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

Press Conference
Speakers: Mr. Jean-René Fourtou, Mr. Jean-Bernard Lévy and Mr. Jacques Espinasse
Date: Wednesday March 17, 2004.
10:30 AM Paris time
9:30 AM London time
4:30 AM New York EST

At Vivendi Universal's headquarters in Paris. 42, avenue de Friedland. 75008 Paris.

Webcast details:
The meeting/call will also be webcast at http://www.vivendiuniversal.com

Analyst Conference Call
Speakers: Mr. Jean- René Fourtou, Mr. Jean-Bernard Lévy and Mr. Jacques Espinasse
Date: Wednesday March 17, 2004.
2:30 PM Paris time
1:30 PM London time
8:30 AM New York EST

Media invited on a listen only basis.

Conference Call details:

France: +33 (0)1 70 70 81 78
Or +353 (0)1 247 5109 – Access code: 651177

UK: +44 (0)207 784 1004 –Access code: 337233

US toll free: +1 866 850 2201
US: +1 718 354 1152 – Access code: 337233

Webcast details:
The meeting/call will also be webcast at: http://finance.vivendiuniversal.com

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VIVENDI UNIVERSAL
CONSOLIDATED STATEMENT OF INCOME
(French GAAP, unaudited)

Quarter ended December 31, 2003 As published (a)	Quarter ended December 31, 2002 As published (a)	*(Euros, in millions, except per share amounts)*		Year ended December 31, 2003 As published (a)	Year ended December 31, 2002 With VE accounted for using the equity method	Year ended December 31, 2002 As published (a)
€ 7,215	€ 15,969	Revenues		€ 25,482	€ 28,112	€ 58,150
€ 736	€ 588	**Operating income**		€ 3,309	€ 1,877	€ 3,788
(167)	(357)	Financing expense		(698)	(650)	(1,333)
(124)	321	Other financial expenses, net of provisions		(509)	(3,444)	(3,409)
€ (291)	€ (36)	Financing and other expenses, net		€ (1,207)	€ (4,094)	€ (4,742)
€ 445	€ 552	Income (loss) before gain (loss) on businesses sold, net of provision, income taxes, equity interest, goodwill amortization and minority interests		€ 2,102	€ (2,217)	€ (954)
121	(334)	Gain on businesses sold, net of provisions		602	1,125	1,049
1,253	(1,762)	Income tax expense		408	(2,119)	(2,556)
€ 1,819	€ (1,544)	Income (loss) before equity interest, goodwill amortization and minority interests		€ 3,112	€ (3,211)	€ (2,461)
1	(16)	Equity in earnings of sold subsidiaries	(a)	1	17	17
112	25	Equity in (losses) earnings of unconsolidated companies		71	(99)	(294)
(13)	-	Equity loss in Veolia Environnement impairment	(b)	(203)	-	-
(495)	(364)	Goodwill amortization		(1,120)	(992)	(1,277)
(1,631)	(7,442)	Impairment losses		(1,792)	(18,442)	(18,442)
€ (207)	€ (9,341)	Income (loss) before minority interests		€ 69	€ (22,727)	€ (22,457)
(435)	(420)	Minority interests		(1,212)	(574)	(844)
€ (642)	€ (9,761)	**Net loss**		€ (1,143)	€ (23,301)	€ (23,301)
€ (0.60)	€ (8.98)	**Loss per share - basic**		€ (1.07)	€ (21.43)	€ (21.43)
1,072.7	1,086.4	Weighted average common shares outstanding (in millions)	(c)	1,071.7	1,087.4	1,087.4

(a) In 2002 and 2003, Vivendi Universal applied the option proposed in paragraph 23100 of the French rules 99-02 and presented the equity in (losses) earnings of businesses that were sold during the year on one line in the consolidated statement of income as "equity in (losses) earnings of sold subsidiaries". In 2002 sold subsidiaries included all of the Vivendi Universal Publishing activities excluding: Vivendi Universal Games, publishing activities in Brazil and the Consumer Press Division and Comareg. In 2003 sold subsidiaries included the Consumer Press Division, which was sold in early February 2003.

(b) The impairment loss of €203 million corresponds to Vivendi Universal's 20.4% interest in Veolia Environnement's impairment of goodwill and other intangible assets (i.e., €453 million), after a notional impairment of goodwill initially recorded as a reduction of shareholder's equity of €250 million, as prescribed by French GAAP.

(c) Excluding treasury shares recorded as a reduction of shareholders' equity (that is 4,360 shares as at December 31, 2003). The weighted average common shares outstanding including the potential dilution effect of outstanding convertible bonds and stock options represented approximately 1,209.0 million common shares as at December 31, 2003. The financial instruments with potential dilution effect that were in the money as of December 31, 2003 represented approximately 96.2 million common shares out of 137.9 million common shares to be potentially issued.

VIVENDI UNIVERSAL
REVENUES AND OPERATING INCOME BY BUSINESS SEGMENT
(French GAAP, unaudited)

	AS PUBLISHED					
	Quarter Ended December 31,			Year Ended December 31,		
(Euros, in millions)	2003	2002	% Change	2003	2002	% Change
Revenues						
Canal+ Group	€ 974	€ 1,322	-26%	€ 4,158	€ 4,833	-14%
Universal Music Group	1,691	2,075	-19%	4,974	6,276	-21%
Vivendi Universal Games (a)	254	292	-13%	571	794	-28%
Vivendi Universal Entertainment	1,755	1,828	-4%	6,022	6,270	-4%
Media	€ 4,674	€ 5,517	-15%	€ 15,725	€ 18,173	-13%
SFR Cegetel Group	2,021	1,821	11%	7,574	7,067	7%
Maroc Telecom	370	372	ns*	1,471	1,487	-1%
Telecom	€ 2,391	€ 2,193	9%	€ 9,045	€ 8,554	6%
Others (b)	150	201	-25%	584	813	-28%
Total Vivendi Universal (Excluding VE and VUP assets sold in 2003)	€ 7,215	€ 7,911	-9%	€ 25,354	€ 27,540	-8%
VUP assets sold in 2003 (c)	-	155	na**	128	572	-78%
Total Vivendi Universal (Excluding VE)	€ 7,215	€ 8,066	-11%	€ 25,482	€ 28,112	-9%
Veolia Environnement	-	7,903	na	-	30,038	na
Total Vivendi Universal	€ 7,215	€ 15,969	-55%	€ 25,482	€ 58,150	-56%
Operating Income (Loss)						
Canal+ Group	€ (131)	€ (296)	na	€ 247	€ (325)	na
Universal Music Group	108	371	-71%	70	558	-87%
Vivendi Universal Games (a)	(91)	26	na	(201)	63	na
Vivendi Universal Entertainment	239	91	163%	931	816	14%
Media	€ 125	€ 192	-35%	€ 1,047	€ 1,110	-8%
SFR Cegetel Group	404	243	66%	1,919	1,449	32%
Maroc Telecom	171	153	12%	628	468	34%
Telecom	€ 575	€ 396	45%	€ 2,547	€ 1,917	33%
Holding & corporate	(117)	(411)	na	(330)	(665)	na
Others (b)	153	(130)	na	39	(471)	na
Total Vivendi Universal (Excluding VE and VUP assets sold in 2003)	€ 736	€ 47	na	€ 3,303	€ 1,891	75%
VUP assets sold in 2003 (c)	-	(2)	na	6	(14)	na
Total Vivendi Universal (Excluding VE)	€ 736	€ 45	na	€ 3,309	€ 1,877	76%
Veolia Environnement	-	543	na	-	1,911	na
Total Vivendi Universal	€ 736	€ 588	25%	€ 3,309	€ 3,788	-13%

(a) Vivendi Universal Games was formerly part of Vivendi Universal Publishing (VUP) (includes Kids Activities, e.g., Adi/Adibou in France and JumpStart in the US).

(b) Others correspond to Vivendi Telecom International, Internet, Vivendi Valorisation, Vivendi Universal Publishing (VUP) assets not sold during 2002 and 2003 (Atica & Scipione: publishing activities in Brazil) and the elimination of intercompany transactions.

(c) VUP assets sold in 2003 correspond to the Consumer Press Division sold in February 2003, which was deconsolidated as of January 1, 2003 and Comareg sold in May 2003.

*: not significant
**: not applicable

VIVENDI UNIVERSAL
PRO FORMA REVENUES AND OPERATING INCOME BY BUSINESS SEGMENT
(French GAAP, unaudited)

	PRO FORMA*							
	Quarter Ended December 31,				Year Ended December 31,			
(Euros, in millions)	2003	2002	% Change	% Change at constant rate	2003	2002	% Change	% Change at constant rate
Revenues								
Canal+ Group	€ 974	€ 1,300	-25%	-25%	€ 4,158	€ 4,742	-12%	-12%
Universal Music Group	1,691	2,075	-19%	-11%	4,974	6,276	-21%	-12%
Vivendi Universal Games	254	292	-13%	-1%	571	794	-28%	-16%
Vivendi Universal Entertainment	1,755	1,838	-5%	14%	6,022	6,978	-14%	4%
Media	€ 4,674	€ 5,505	-15%	-5%	€ 15,725	€ 18,790	-16%	-6%
SFR Cegetel Group	2,021	1,821	11%	11%	7,574	7,067	7%	7%
Maroc Telecom	370	372	ns**	3%	1,471	1,487	-1%	3%
Telecom	€ 2,391	€ 2,193	9%	10%	€ 9,045	€ 8,554	6%	6%
Others	150	201	-25%	-20%	584	813	-28%	-22%
Total Vivendi Universal	€ 7,215	€ 7,899	-9%	-2%	€ 25,354	€ 28,157	-10%	-3%
Operating income (loss)								
Canal+ Group	€ (131)	€ (275)	na***	na	€ 247	€ (295)	na	na
Universal Music Group	108	371	-71%	-74%	70	556	-87%	-90%
Vivendi Universal Games	(91)	26	na	na	(201)	63	na	na
Vivendi Universal Entertainment	239	62	na	77%	931	946	-2%	19%
Media	€ 125	€ 184	-32%	na	€ 1,047	€ 1,270	-18%	-9%
SFR Cegetel Group	404	243	66%	66%	1,919	1,449	32%	32%
Maroc Telecom	171	153	12%	16%	628	468	34%	40%
Telecom	€ 575	€ 396	45%	47%	€ 2,547	€ 1,917	33%	34%
Holding & corporate	(117)	(411)	na	na	(330)	(665)	50%	47%
Others	153	(130)	na	na	39	(471)	na	na
Total Vivendi Universal	€ 736	€ 39	na	na	€ 3,303	€ 2,051	61%	67%

* The pro forma information illustrates the effect of the acquisition of the entertainment assets of InterActiveCorp and the disposition of VUP assets in 2003, as if these transactions had occurred at the beginning of 2002. It also illustrates the accounting for Veolia Environnement for using the equity method with a 20.4% ownership interest from January 1, 2002 instead of December 31, 2002. The pro forma information is calculated as a simple sum of the actual results of Vivendi Universal's businesses (excluding businesses sold) and the actual results reported by each of the acquired businesses in each period presented. Additionally, the results of Universal Studios International television networks are reported by Vivendi Universal Entertainment instead of Canal+ Group. This reclassification has no impact on the total results of Vivendi Universal. The pro forma results are not necessarily indicative of the combined results that would have occurred had the transactions actually occurred at the beginning of 2002.

**: not significant

***: not applicable

VIVENDI UNIVERSAL
RECONCILIATION OF NET LOSS TO ADJUSTED NET INCOME (LOSS)
(French GAAP, unaudited)

(Euros, in millions)		Year ended December 31, 2003 as published	Year ended December 31, 2002 With VE accounted for using the equity method		Change
Net loss	(a)	€ (1,143)	€ (23,301)	+	22,158
Adjustments to determine adjusted net income (loss)					
Financial provisions and amortization of financial charges	(b)	(563)	2,786	-	3,349
Realized losses reported in other financial expenses, net of financial provisions taken previously	(b)	503	(1)	+	504
Other non-operating, non-recurring items reported in other financial expenses, net of provisions	(b)	154	782	-	628
Subtotal impact on financing and other expenses, net (see note below)	(b)	€ *94*	€ *3,567*	-	*3,473*
Adjustments on Veolia Environnement reported as for using the equity method	(c)	203	256	-	53
Gain on businesses sold, net of provisions	(d)	(602)	(1,125)	+	523
Goodwill amortization	(a)	1,120	992	+	128
Impairment losses	(a)	1,792	18,442	-	16,650
Income tax expense	(e)	(1,112)	1,022	-	2,134
Minority interests on adjustments		(3)	(367)	+	364
Adjusted net income (loss)		€ 349	€ (514)	+	863

Note:

(a) As reported in the consolidated statement of income.

(b) Details on 2003 impact on financing and other expenses, net:

(Euros, in millions)	Financial provisions and amortization of financial charges	Realized losses	Other non-operating, non-recurring items	Total
InterActiveCorp warrants	454	(329)	-	125
Veolia Environnement and BSkyB redemption premiums	102	(102)	-	-
Amortization of deferred charges related to bonds issuances, facilities and others	(193)	-	-	(193)
Fees related to the implementation of the refinancing plan	-	-	(50)	(50)
Settlement of put options on treasury shares	104	-	(104)	-
Loss on sale of Vinci call options	13	(39)	-	(26)
Other	83	(33)	-	50
Total	€ 563	€ (503)	€ (154)	€ (94)

(c) In 2003, corresponds only to equity loss in Veolia Environnement impairment.

(d) As reported in the consolidated statement of income. In 2003, this item consisted mainly of capital gains on the divestiture of and/or dilution of our interest in the following companies: Telepiù (€215 million), Consumer Press Division (€104 million), Sogecable (€71 million), UGC (€-47 million), Comareg (€42 million) and other various items (€217 million).

(e) Income tax (expense) corresponds to a reversal of a reserve of €477 million (established in 2002 for €534 million for a potential contractual liability for tax indemnification that would have arisen in 2002 if Vivendi Universal had been unable to secure refinancing for the bridge loan relating to the Vivendi Universal Entertainment Leveraged Partnership Distribution), and other provision reversals resulting from the conclusion of tax audit for prior taxable period and income tax (expense) benefit on adjustments.

VIVENDI UNIVERSAL
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(French GAAP, unaudited)

(Euros, in millions)	December 31, 2003	December 31, 2002
ASSETS		
Goodwill, net	€ 17,789	€ 20,062
Other intangible assets, net	11,778	14,706
Fixed assets and investments	10,997	13,727
Total long-term assets	€ 40,564	€ 48,495
Other current assets	11,498	13,543
Cash and cash equivalents	2,858	7,295
Total current assets	€ 14,356	€ 20,838
TOTAL ASSETS	€ 54,920	€ 69,333
SHAREHOLDERS' EQUITY AND LIABILITIES		
Shareholders' equity	€ 11,923	€ 14,020
Minority interests	4,929	5,497
Other equity	1,000	1,000
Other non-current liabilities	5,261	8,054
Gross debt	14,423	19,632
Deferred tax liabilities	5,123	7,857
Other current liabilities	12,261	13,273
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	€ 54,920	€ 69,333

NET DEBT

(Euros, in millions)	December 31, 2003	December 31, 2002	Change
Gross debt	€ 14,423	€ 19,632	- 5,209
Cash and cash equivalents	(2,858)	(7,295)	+ 4,437
Net Debt	€ 11,565	€ 12,337	- 772

NET DEBT MATURITY

(Euros, in millions)	December 31, 2003 TOTAL	Due before one year	Due between one and two years	Due between two and five years	Due after five years
Gross debt	€ 14,423	€ 4,802	€ 473	€ 5,800	€ 3,348
Cash and cash equivalents	(2,858)	(2,858)	-	-	-
Net Debt	€ 11,565	€ 1,944*	€ 473	€ 5,800	€ 3,348

*Of which €1,699 million Oceano was effectively repaid in January 2, 2004.

VIVENDI UNIVERSAL
CONSOLIDATED STATEMENT OF CASH FLOWS
(French GAAP, unaudited)

		Year Ended December 31,		
	(a)	2003	2002 With VE accounted for using the equity method	2002
			(In millions)	
Cash flow - operating activities:				
Net loss		€ (1,143)	€ (23,301)	€ (23,301)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Depreciation, amortization and other operating provisions and allowances		4,759	22,103	24,040
Equity loss in Veolia Environnement impairment		203	-	-
Financial provisions and provisions related to businesses sold		(1,007)	2,786	2,895
Gain on sale of property, plant and equipment and financial assets, net		47	(1,541)	(1,748)
Undistributed earnings from affiliates, net		(13)	356	456
Deferred taxes		(154)	1,589	1,608
Minority interests		1,212	574	844
Changes in assets and liabilities, net of effect of acquisitions and divestitures		(18)	229	(124)
Net cash provided by operating activities		€ 3,886	€ 2,795	€ 4,670
Cash flow - Investing activities:				
Capital expenditures		(1,552)	(1,729)	(4,134)
Proceeds from sale of property, plant and equipment and intangible assets		477	158	158
Purchases of investments	(b)	(4,422)	(2,000)	(4,792)
Sales of investments	(b)	1,408	9,233	10,987
Net decrease (increase) in financial receivables		140	(1,875)	(2,027)
Sales (purchases) of marketable securities		49	322	213
Net cash provided by (used for) investing activities		€ (3,900)	€ 4,109	€ 405
Cash flow - financing activities:				
Net increase (decrease) in short-term borrowings		(7,259)	(3,271)	(5,991)
Notes mandatorily redeemable for new shares of Vivendi Universal		-	767	767
Proceeds from issuance of borrowings and other long-term debt		5,657	369	2,748
Principal payment on borrowings and other long-term liabilities		(1,947)	510	(1,854)
Net proceeds from issuance of common shares		71	68	1,822
Sales (purchases) of treasury shares		(98)	1,973	1,973
Cash dividends paid		(737)	(1,120)	(1,300)
Cash payment to InterActiveCorp		-	(1,757)	(1,757)
Net cash provided by (used for) financing activities		€ (4,313)	€ (2,461)	€ (3,792)
Foreign currency translation adjustment on cash and cash equivalents		(110)	981	1,287
Change in cash and cash equivalents		€ (4,437)	€ 5,424	€ 2,570
Cash and cash equivalents:				
Beginning		€ 7,295	€ 1,871	€ 4,725
Ending		€ 2,858	€ 7,295	€ 7,295

(a) 2002 and 2003 include 100% of Maroc Telecom and Vivendi Universal Entertainment which are controlled by Vivendi Universal with a 51% and 92% voting interest respectively and with a 35% and 86% ownership interest respectively. It also includes 100% of SFR (formerly known as Cegetel Groupe S.A.) which is controlled by Vivendi Universal with an approximately 56% ownership interest as of December 31, 2003.

(b) Purchase of investments and sales of investments include net cash from acquired and divested companies, particularly an investment of €4 billion in SFR Cegetel group (formerly known as Cegetel Groupe SA) on January 23, 2003.

ADDITIONAL INFORMATION

The following compares 2003 actual results with illustrative 2002 income statement that presents Veolia Environnement accounted for as an equity investment.

OTHER FINANCIAL EXPENSES, NET OF PROVISIONS

In 2003, other financial expenses, net of provisions amounted to € 509 million compared to €3,444 million in 2002.

€ million	Included in adjusted net income	2003				
Financial provisions and amortization of financial charges, net of realized losses (including puts)	No	(44)				
Fees related to refinancing plan	No	(50)				
Foreign exchange losses	Yes	(228)				
Other	Yes	(187)				
Of which gain on financial asset sales			20			
Total		(509)				

Financial provisions, net of realized losses were mainly comprised of the assessment of the put option granted to SNCF on Cegetel SAS interest (€85 million) and the SEC indemnity (€40 million), offset by the sale of InterActiveCorp warrants (a €125 million gain after a €454 million provision reversal), the provision reversal following the mark to market of DuPont shares (a €142 million gain), the termination of Lineinvest total return swap (a €97 million gain), and the sale of impaired investment in Softbank Capital Partner (a €29 million gain).

"Other" mainly includes the cancellation of a debt of SFD vis-à-vis SFR-Cegetel for € 200 million. This cancellation was offset by an improvement in SFD's net income and shareholder equity, therefore it has no impact on the adjusted net income.

GAIN (LOSS) ON BUSINESS SOLD, NET OF PROVISIONS

In 2003, gain on businesses sold, net of provisions, of €602 million consisted mainly of capital gains on the divestiture of and/or dilution of our interest in the following companies: Telepiù (+€215 million, including a €352 million provision reversal), Consumer Press Division (+€104 million), Sogecable (+€71 million), UGC (-€47 million), Comareg (+€42 million), Xfera (-€16 million, including a €75 million provision accrual) and Internet subsidiaries (+€38 million). At December 31, 2003, income tax expense and minority interests related to gain on business sold, net of provisions, amounted to €21 million and €11 million, respectively.
In 2002, gain on businesses sold, net of provisions totaled €1 billion.

INCOME TAX EXPENSE

In 2003, the company recorded a tax credit of € 408 million compared to a cost of € 2,119 million in 2002.

€ million	2003	
Total taxes excluded from Adjusted Net Income	**1,112**	
Leverage Partnership distribution	477	
Other provision reversal	211	
Tax asset activation	424	
Taxes included in the Adjusted Net Income	**(704)**	
of which 100% of savings from SFR Cegetel group structure simplification		*515*

In 2003, Vivendi Universal's income tax rate on the adjusted net income in 2003 was reduced to 32% compared to 81% in 2002. However, since SFR Cegetel Group, Maroc Telecom, CanalSatellite and Canal+ SA are not part of Vivendi Universal's consolidated tax group, losses elsewhere in the group are not available to offset profits taxable at those entities. Therefore, this reduced 32% tax rate cannot be sustained in the current structure.

EQUITY IN GAIN (LOSSES) EARNINGS OF UNCONSOLIDATED COMPANIES

€ million	2003	2002	Change
Veolia Environnement	+ 33	+ 235	- 202
VUE subsidiaries	- 26	- 36	+ 10
SFD	+ 98	- 1	+ 99
VTI subsidiaries	- 18	- 175	+ 157
Internet	-	- 74	+ 74
Other	- 16	- 48	+ 32
Total	+ 71	- 99	+170

Excluding impairment losses recorded by Veolia Environnement and the impairment losses recorded in respect to certain VUE affiliates.

PROBABLE ACCOUNTING IMPACT OF THE NBC UNIVERSAL TRANSACTION IN 2004

At December 31, 2003, the fair value of VUE denominated in US dollars exceeded its carrying value also denominated in US dollars. However, due to the evolution of the US dollar/euro exchange rate through December 31, 2003 since the date of Vivendi Universal's acquisition of Universal Studios in December 2000 and the date of Vivendi Universal's acquisition of the entertainment assets of InterActiveCorp in May 2002, a cumulative foreign currency loss is recorded in accordance with French GAAP as a reduction to shareholders' equity through the currency translation adjustment account. The foreign currency loss has no impact on net income in 2003 but will impact 2004 net income (estimated loss at €2.7 billion at December 31, 2003 level of the dollar rate). It will be partially offset by the capital gain in dollars on the transaction.
This transaction has no impact on Vivendi Universal's 2003 accounts.

EVENTUAL ACCOUNTING AND CASH IMPACTS OF THE EXPENSES OF THE CALL OPTION OF VEOLIA ENVIRONNEMENT ON OR BEFORE DECEMBER 23, 2004

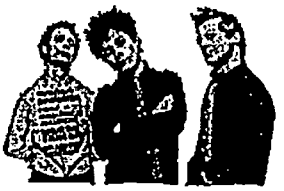
If the call options on Veolia Environnement shares are exercised on or before December 23, 2004, the cash sales of the assets should amount to €2.2 billion and would produce a capital gain without cash tax impact of approximately €2.2 billion.

EXHIBIT CO 0943

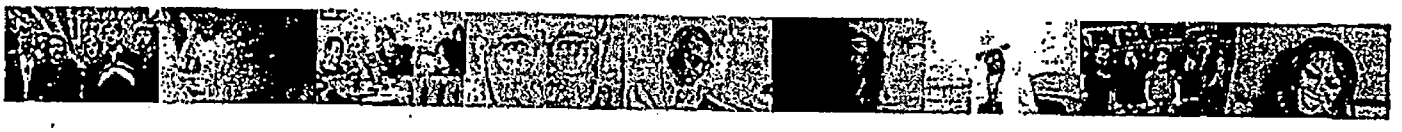
warner | music | group

2005 ANNUAL REPORT

Do you hear it?



Pictured on the cover:
Yi Ping Ho,
Senior Manager, Strategic Planning and Business Development
Listening to *Hung Up* by Madonna



dear | shareholder

This year Warner Music Group has emerged as a leader in the digital music realm, and became the only publicly-traded independent music company in the United States.

Warner Music Group today is a high-performing, innovative and streamlined global company, with an industry-leading management team and some of the world's greatest musical artists.

And this is just the beginning. Our ongoing transformation as a company is geared to seizing the opportunities in the rapidly changing music industry for the mutual benefit of our shareholders, artists and customers.

As we bring you our first annual report, we are proud to share with you some of this year's accomplishments that demonstrate how Warner Music Group is evolving.

LEADING THE RENAISSANCE OF THE MUSIC INDUSTRY

The music industry is undergoing a renaissance driven by converging forces in technology and entertainment. The shift from "physical" sales (of CDs and DVDs) to "digital" sales (of downloads and ringtones) offers great potential to power ever greater consumption of music.

We are highly focused on fully exploiting this growth potential, and we are already beginning to see some of the results. For the twelve months ended September 30, 2005, our growth in key genres and our digital business contributed significantly enough to our domestic recorded music business that we outperformed the industry by 4.0 percentage points, based on year-over-year U.S. SoundScan total album unit sales performance.

We believe that these changes are fundamental and provide a significant source of future growth in the industry.

Why? Because this trend is buttressed by two market-changing developments:

- the rapid growth in portable entertainment devices driven by companies like Apple, Motorola and large consumer electronics companies that provide consumers choice on how and where to connect to the music they love; and
- the increased competition among distributors such as telephone companies, mobile providers, online retailers, broadcasters and cable companies which are all trying to deliver musical content to consumers.

This explosive device growth, supported by a virtually infinite inventory of digital music available in a myriad of combinations, creates a win-win situation for Warner Music Group.

Bolstered by technological, legal and educational advances to combat piracy, the growth of legitimate digital music services is rising. With economic incentive further fueled by the unanimous Supreme Court ruling in MGM vs. Grokster, there are already more than 300 legal online music sites globally providing alternatives to illegal file-sharing.

MORPHING WMG FROM A RECORDS- AND SONGS-BASED COMPANY TO A MUSIC-BASED CONTENT COMPANY

One of the reasons my partners and I invested in Warner Music Group is that we believed we could drive innovation within the industry by making the transition from a records- and songs-based company to a music-based content company.

For us a "music-based content company" is a multifaceted company designed to maximize the potential of our artist-branded content.

We have taken an industry-leading approach to monetize our existing content through the development of new and multiple revenue streams. We are highly focused on extracting the greatest value from all of our content, including music videos, artwork and lyrics. We see this content being exploited across many new product categories—ringtones, mastertones, ringback tones, full track, video and music downloads—and new distribution channels and delivery devices, like MP3-players, mobile phones, online download stores, subscription services, podcasts and satellite radio.

To more fully grasp this market opportunity, we've woven the creation of digital products into all aspects of our business—from "Artists and Repertoire" (A&R) to marketing, promotion and packaging. We are also increasingly "bundling" content, such as bonus tracks, "making-of" videos, and digital booklets with an album, to create premium packages that are attractive to the consumer and derive superior margins and potentially higher sales for us and our artists. These bundling initiatives will remain a key priority as we work towards more variable pricing of music in the digital world.

To best capitalize on the mobile music market opportunity, we believe we have developed one of the largest mobile footprints of any media company today—one that reaches more than half a billion subscribers worldwide. Smart mobile solutions for music will also open up economically viable solutions in emerging markets where piracy remains rampant. In order to take a more active and influential role in shaping new business models and strategic marketing plans in this area, we have established "Chief Experiment Partner" status with many mobile companies.

As part of our ongoing efforts to lead innovation in the digital space, we have trail-blazed a series of "firsts."

To date, we are the first major music company to:

- sell music videos for digital download through a wireless carrier;
- make its music video catalogue available for use in original content developed for wireless platforms; and
- launch a wireless streaming music subscription service in the U.S.

And we're one of the first to make ringback tones available in the U.S.

Our early investments in building a digital music presence have met with great success. Digital has grown to 6% of our revenues for the quarter ended September 30, 2005—a tremendous increase from March 2004 when we bought the company from Time Warner and digital revenues were negligible. What's more, this performance is partially incremental to our physical sales. In fact, we have seen the absolute growth in digital exceed the marginal decline in our physical business for the year ended September 30, 2005 for our U.S. recorded music business. And as the international digital markets become more developed, we expect this digital advantage to spread overseas as well.

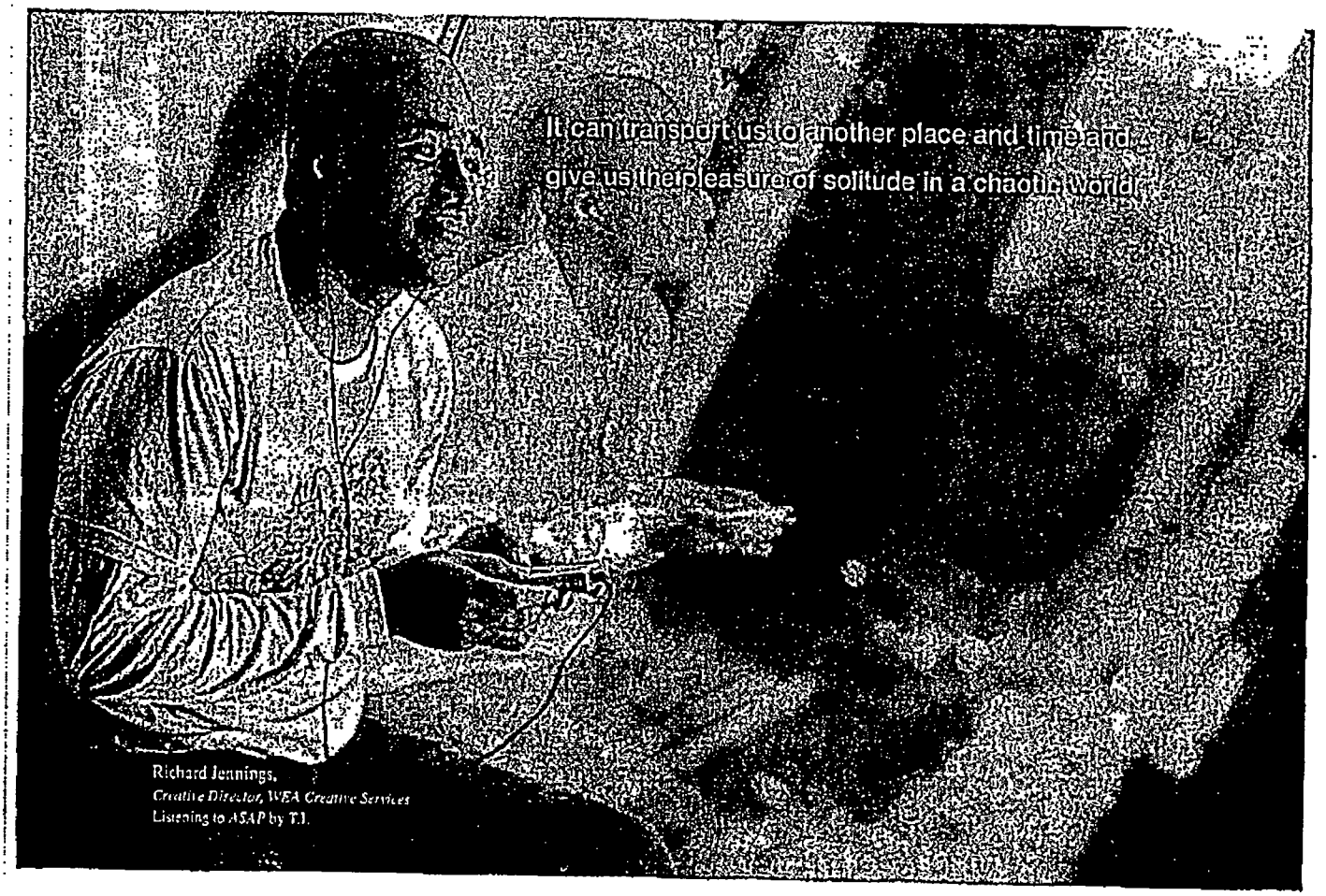
DRIVING SHARE GAINS THROUGH A&R STRATEGY

Through our focused and innovative A&R efforts, we are breaking new acts, building on the potential of our storied, diversified recorded music catalog and publishing businesses, and maximizing our A&R spending efforts. We are carefully investing more A&R dollars in our most promising and profitable artists and applying a rigorous IRR analysis to all major artist signings.

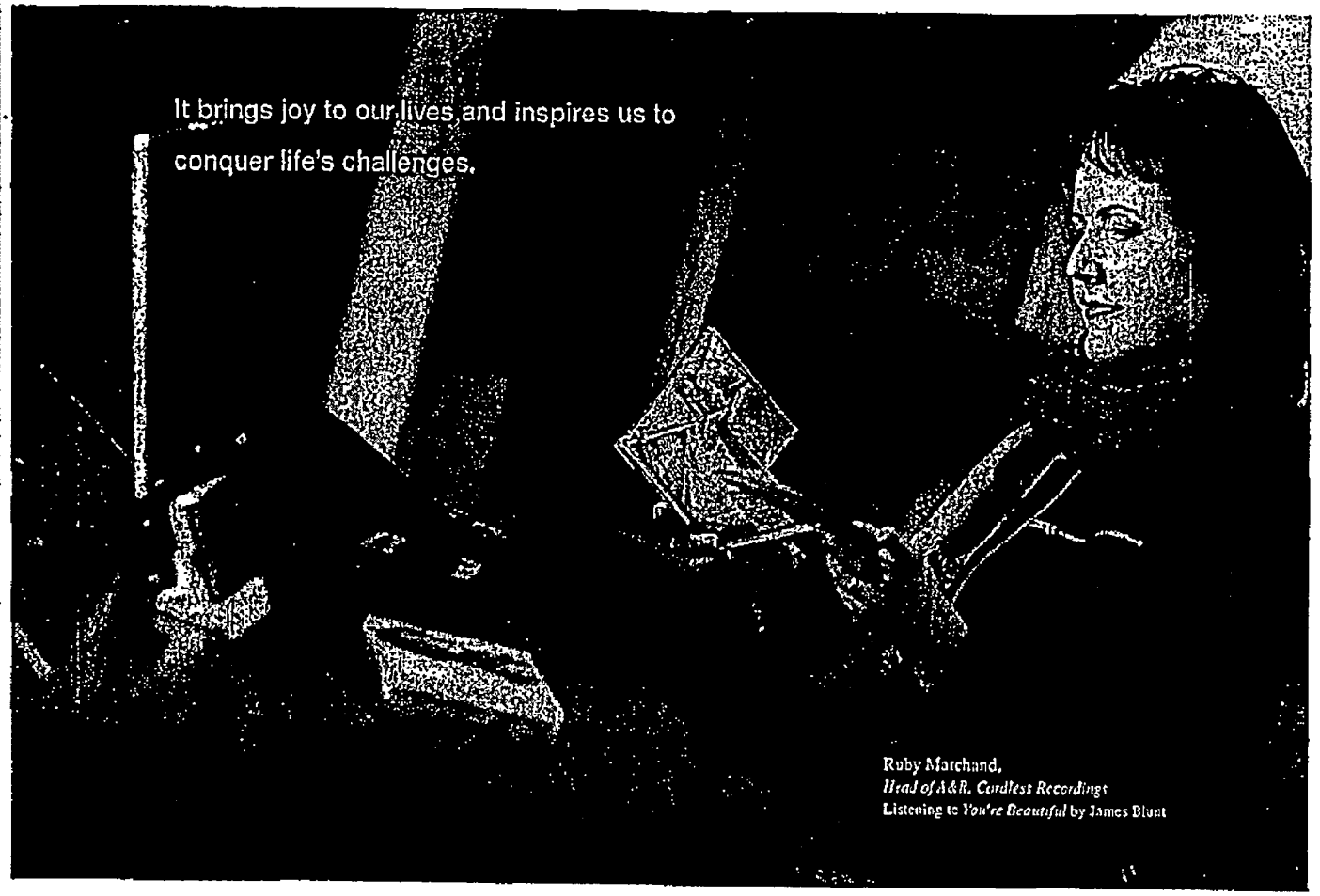
We carefully mine the potential of the artists in our roster. For example, we nurtured James Blunt, a young singer and songwriter, by returning to grass roots artist development with an eye to long-term career advancement. Since his launch in October 2004, he has sold more than 3.5 million albums, becoming the number one UK selling artist in 2005. This is a good example of our carefully honed marketing and promotional strategies designed to drive long-term success.

We also pioneered the incubator model, which is designed to identify future superstars earlier in the A&R process, and at lower cost, by leveraging our strong and industry-leading independent distribution network. To date, we have upstreamed five urban and three rock artists to our major labels, four of whom have debuted in the top 10 on Billboard's Top 200 chart (Paul Wall, Mike Jones, Webbie and Bun-B). Our U.S. SoundScan album share in Rap and R&B music—two of the most significant sales sectors in our industry—surged 11.5 percentage points and 6.0 percentage points respectively year-over-year for the six months ended September 30, 2005.

As part of our digital A&R efforts, we also launched Cordless Recordings, a new "e-label" where artists can develop in a supportive, lower-risk environment. More specifically, an e-label artist is not required to have enough material for an album, only enough to excite our ears. Rather than releasing an album every couple of years, every few months the label will release "clusters"—three or more songs—by an artist. This approach helps maximize our return while giving artists more visibility to consumers.



Richard Jennings,
Creative Director, WEA Creative Services
Listening to *ASAP* by T.I.



Ruby Marchand,
Head of A&R, Cordless Recordings
Listening to *You're Beautiful* by James Blunt

ENSURING PROFITABLE GROWTH THROUGH FINANCIAL DISCIPLINE

As a result of these efforts, our total fiscal year 2005 revenues and operating income amounted to $3.5 billion and $84 million respectively.

To achieve our goal of profitable growth, we've instilled a sense of financial discipline. We restructured and streamlined the company to achieve approximately $250 million in annual cost savings. Going forward, our flexible cost structure—with about 25% fixed and 75% discretionary or variable costs—enables us to be nimble, and the migration to digital further advantages this operating structure. We derive an operating margin advantage in digital given the lack of inventory, distribution and returns expenses. The advantage currently also results from the fact that catalog titles, rather than new releases, make-up two-thirds of our online sales versus one-third for our physical product, as catalog titles have lower marketing costs than new releases.

ENHANCING SHAREHOLDER VALUE THROUGH STRONG CORPORATE GOVERNANCE

To reinforce our culture of corporate integrity, we have instituted strong corporate governance policies, which we view as another key component of the evolution of our company and an important contributor to long-term corporate performance.

GIVING BACK TO THE COMMUNITY

Our company culture is bound by shared values and a strong sense of collaboration. We are committed to philanthropy and working with our communities. In the wake of Hurricane Katrina, hundreds of us joined Habitat for Humanity to build 65 homes for families affected by the hurricane and to raise millions of dollars for hurricane victims.

THIS IS ONLY THE BEGINNING

Thanks to the hard work of our employees and artists, our vision to transform Warner Music Group into the leading music content provider for today's rapidly evolving digital world is quickly becoming a reality.

Our future success will be measured by our ability to continue to identify the most powerful creative voices in music, to create a supportive home for them here that inspires their best work, and to share them with the world, everywhere and in every way—and thus, to return value to you.

We're only at the beginning of this transformation in our industry and for our company.

Thank you for your support.

Edgar Bronfman, Jr.
Chairman and CEO, Warner Music Group
January 2006

RECORDED MUSIC

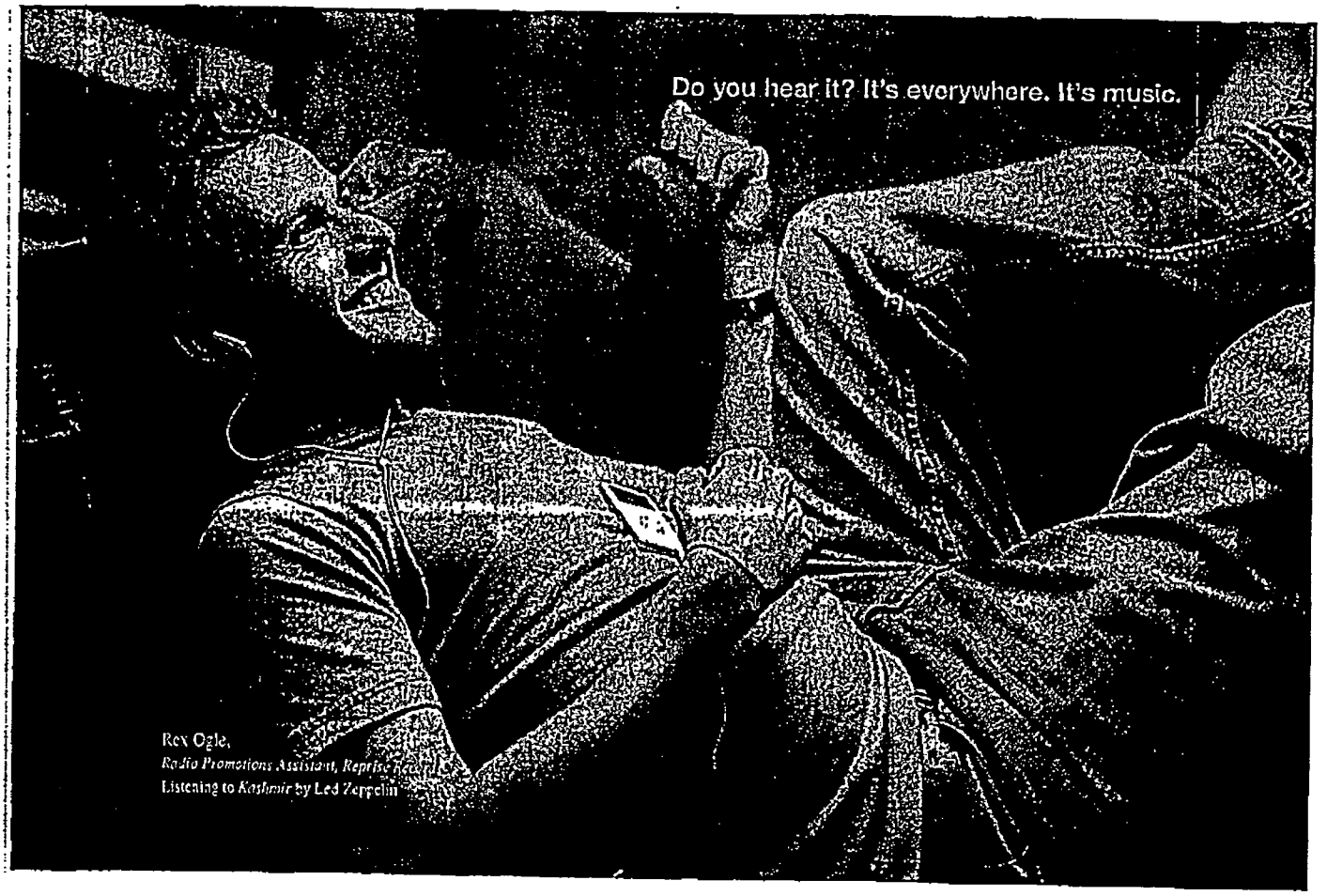
We are home to some of the world's best-known and most successful recording artists, like Eric Clapton, Faith Hill, Green Day, Led Zeppelin, Madonna, Red Hot Chili Peppers, Rob Thomas, and T.I. who are under contract with our record labels, including Asylum, Atlantic, Bad Boy, Cordless, Elektra, East West, Lava, Maverick, Nonesuch, Reprise, Rhino, Sire, Warner Bros. and Word. Warner Music International, a leading company in national and international repertoire, operates through numerous international affiliates and licensees in more than 50 countries. We have one of the largest and most diverse recorded music catalogs, including 28 of the top 100 U.S. best-selling albums of all time, including *The Eagles, Their Greatest Hits, 1971–1975* (the best-selling album of all time), *Led Zeppelin IV* and *Rumours* by Fleetwood Mac.

Our recorded music business represented 83% of our total fiscal 2005 revenues and 72% of operating income (before corporate expenses and eliminations). Recorded music industry revenue is generated when a physical record is shipped or licensed, a digital download is sold through an online retailer or a mastertone through a wireless carrier. In a typical year, approximately 43% of our total revenues come from new album releases, although most of that is more predictable revenue from proven artists and less than 10% is generally derived from artists without an established track record. These new releases feed our high-margin catalog business, which generates approximately 40% of our total revenues in a typical year.

MUSIC PUBLISHING

Warner/Chappell is the world's second-largest music publishing company with over 65,000 songwriters and composers under contract and administers the rights to over one million musical compositions. Our library includes such titles as *Summertime* by George and Ira Gershwin and DuBose Heyward, *Happy Birthday to You* by Mildred and Patty Hill, *Night and Day* by Cole Porter, *Layla* by Eric Clapton and Jim Gordon, *When a Man Loves a Woman* by Calvin Lewis and Andrew Wright, *Winter Wonderland* by Felix Bernard and Dick Smith, as well as more recent popular titles via exclusive agreements with artists/songwriters such as Madonna, Laura Pausini, Green Day, Morrissey, John Rich (of Big & Rich), Dr. Dre, Ligabue, and Nickelback.

Music publishing represented 17% of our total revenues during our fiscal 2005 and 28% of our operating income (before corporate expenses and eliminations). Music publishing revenue is generated when a recording, either in physical or digital form, embodying a Warner/Chappell-controlled song is sold (known as mechanical revenue). Revenue is also generated when a song is performed publicly on radio, television or in live concerts (known as performance revenue) and when a song is synchronized with visual images in movies, video games or television advertisements (known as synchronization revenue).



Rex Ogle,
Radio Promotions Assistant, Reprise
Listening to *Kashmir* by Led Zeppelin

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2005

OR

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

For the transition period from to

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	13-4271875 (I.R.S. Employer Identification No.)
75 Rockefeller Plaza New York, NY 10019 (Address of principal executive offices)	10019 (Zip Code)

Registrant's telephone number, including area code: (212) 275-2000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.001 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

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 if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act.) Yes ☐ No ☒

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

As of March 31, 2005, there was no established market for the registrant's common stock. The aggregate market value of common stock held by non-affiliates as of September 30, 2005 was approximately $603,426,000, using the closing price per share of $18.51, as reported on the New York Stock Exchange as of such date.

As of November 25, 2005, the number of shares of the registrant's common stock, par value $0.001 per share, outstanding was 148,460,662.724.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Part III of this report is incorporated by reference from the registrant's proxy statement to be filed pursuant to Regulation 14A with respect to the registrant's fiscal 2005 annual meeting of stockholders.

WARNER MUSIC GROUP CORP.

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ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

This Form 10-K includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on current expectations, estimates, forecasts and projections about the industry in which we operate, management's beliefs and assumptions made by management. Words such as "may," "will," "expect," "intend," "estimate," "anticipate," "believe," or "continue" or the negative thereof or variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. We disclaim any duty to update or revise any forward-looking statements whether as a result of new information, future events or otherwise. See "Safe Harbor Statement Under Private Securities Litigation Reform Act of 1995."

Our Company

We are one of the world's major music content companies. Our company is composed of two businesses: Recorded Music and Music Publishing. We believe we are the world's fourth-largest recorded music company (third-largest in the U.S.) and the world's second-largest music publishing company. We are a global company, generating over half of our revenues in more than 50 countries outside of the U.S. We generated revenues of $3.502 billion during our fiscal year ended September 30, 2005.

Our Recorded Music business produces revenue through the marketing, sale and licensing of recorded music in various physical (such as CDs, cassettes, LPs and DVDs) and digital (such as downloads and ringtones) formats. We have one of the world's largest and most diverse recorded music catalogs, including 28 of the top 100 U.S. best-selling albums of all time—more than any other recorded music company, including *The Eagles: Their Greatest Hits 1971-1975* (the best-selling album of all time), *Led Zeppelin IV* and *Rumours* by Fleetwood Mac. We also lead all recorded music companies in albums certified as "Diamond" by RIAA, which are those albums that have more than 10 million net shipped units in the U.S., with approximately 30% of the total. Our roster of artists spans all musical genres and includes Led Zeppelin, The Eagles, Madonna, Green Day, Metallica and Fleetwood Mac. Our more recent album successes include artists such as Rob Thomas, Mike Jones, James Blunt, My Chemical Romance, Eric Clapton, T.I., Faith Hill, Death Cab for Cutie, Green Day, Disturbed, Paul Wall, and Big & Rich. Our Recorded Music business generated revenues of $2.924 billion during our fiscal year ended September 30, 2005. The sale of digital content has provided additional revenue streams for our Recorded Music business. Digital recorded music revenue has grown from essentially nothing at the time of our acquisition in 2004 to $137 million during our fiscal year ended September 30, 2005, and represented approximately 6% of recorded music revenues for the fourth quarter of fiscal 2005.

Our Music Publishing business owns and acquires rights to musical compositions, exploits and markets these compositions and receives royalties or fees for their use. We publish music across a broad range of musical styles. We hold rights in over one million copyrights from over 65,000 songwriters and composers. Our library includes titles such as "Summertime" by George and Ira Gershwin and DuBose Heyward, "Happy Birthday to You" by Mildred and Patty Hill, "Night and Day" by Cole Porter, "Layla" by Eric Clapton and Jim Gordon, "When a Man Loves a Woman" by Calvin Lewis and Andrew Wright, "Winter Wonderland" by Felix Bernard and Dick Smith, "Star Wars Theme" by John Williams, "The Wind Beneath My Wings" by Jeff Silbar and Larry Henley and "Frosty the Snowman" by Steve Nelson and Jack Rollins as well as more recent popular titles such as "Cry Me A River" performed by Justin Timberlake, "Smooth" by Itaal Shur and Rob Thomas, "Crazy in Love" performed by Beyoncé Knowles and Jay-Z, "Photograph" performed by Nickelback, "Burn" performed by Usher, "It's Been Awhile" performed by Staind, "Pieces of Me" performed by Ashlee Simpson, "Thank You" performed by Dido Armstrong, "American Idiot" performed by Green Day, "The Reason" performed by

Hoobastank, "Pon DeReplay" performed by Rihanna, "Gold Digger" performed by Kanye West, "We Belong Together" performed by Mariah Carey and "Outta Control" performed by 50 Cent. Our Music Publishing business generated revenues of $607 million during our fiscal year ended September 30, 2005. The sale of digital content has also provided new revenue streams for our Music Publishing business. Digital music publishing revenue has grown from essentially nothing at the time of our acquisition in 2004 to $20 million during our fiscal year ended September 30, 2005, and represented 4% of music publishing revenue for the fourth quarter of fiscal 2005.

Our Business Strengths

While we have recorded net losses on a historical and pro forma basis, primarily due to the decline since 1999 of recorded music sales, increased operating costs, increased competition, and such items as impairment charges and charges related to our initial common stock offering, we believe the following competitive strengths will enable us to continue to generate stable cash flow through our diverse base of recorded music and music publishing assets:

Industry Leading Recording Artists and Songwriters. We have been able to consistently attract, develop and retain successful recording artists and songwriters. Our talented local artist and repertoire teams are focused on finding and nurturing future successful recording artists and songwriters, as evidenced by our recent recorded music album and music publishing successes. This has enabled us to develop a large and varied portfolio of recorded music and music publishing assets that generate stable and recurring cash flows. We believe these assets demonstrate our historical success in developing talent and will help to attract future talent in order to enable our continued success.

Stable, Highly Diversified Revenue Base. Our revenue base is derived primarily from relatively stable and recurring sources such as our music publishing library, our catalog of recorded music and new releases from our existing base of established artists. In any given year, we believe that less than 10% of our total revenues depend on artists without an established track record, with each of these artists typically representing less than 1% of our revenues. We have built a large and diverse catalog of recordings and compositions that covers a wide breadth of musical styles including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, alternative, folk, blues, gospel and other Christian music. We are a significant player in each of our major geographic regions.

High Cash Flow Business Model. We have a highly variable cost structure, with substantial discretionary spending and minimal capital requirements. In October 2003, Time Warner's CD and DVD manufacturing, packaging and physical distribution operations were sold to Cinram, resulting in a significant reduction of our fixed cost base. As part of the sale, we entered into an outsourcing arrangement with Cinram that significantly reduced our exposure to fixed costs and will reduce our future capital expenditure requirements. We spent $30 million in capital expenditures for our fiscal year ended September 30, 2005, $18 million for our ten-month fiscal year ended September 30, 2004 and $51 million for our twelve-month fiscal year ended November 30, 2003. We continuously seek sensible opportunities to convert fixed costs to variable costs. Finally, in addition to our variable cost base and relatively low capital requirements, we have contractual flexibility with regard to the timing and amounts of advances paid to existing recording artists and songwriters as well as discretion regarding future investment in new artists and songwriters, which further allows us to respond to changing industry conditions.

Well Positioned For Growth In Digital Distribution and Emerging Technologies. Through the first three quarters of calendar 2005, our shares of digital recorded music track and album sales in the U.S. as measured by SoundScan were higher than our overall recorded music album share in the U.S., which we believe reflects the relative strength of our content and in particular our catalog content, as well as the success of our recent digital innovation efforts (such as, digital album bundles). In addition, we are highly focused on several new media initiatives: supporting existing and new online services in the U.S. and abroad, working with legitimate peer-to-peer, or P2P, providers and influencing the evolution of new mobile phone services and formats (we have, for example, an agreement between our recorded music and music publishing division for rates on mastertones, ringback tones and other new wireless formats). We have been a leader in mobile music and the use of wireless

technology. We work closely with cellular carriers and device manufacturers to develop mobile music content, including ringtones, ringback tones, artist- branded games, music videos and celebrity non-music personalization products for mobile channels. In the U.S., we have led the music industry with a series of accomplishments in the wireless industry, including being the first major music company to offer a mobile music streaming service and the first major music company to offer full music video downloads through a wireless carrier.

Proven and Committed Management Team. We are led by an experienced senior management team with an average of approximately 20 years of entertainment industry experience. Edgar Bronfman, Jr., our Chairman of the Board and Chief Executive Officer, has extensive and directly relevant experience in the music industry. In 1998, Mr. Bronfman, while President and CEO of Seagram, oversaw the merger of Universal and PolyGram and successfully managed the combined business, the world's largest recorded music company. In addition, Lyor Cohen, who is our Chairman and CEO of U.S. Recorded Music operations, has nearly two decades of experience in the music industry and has previously worked with Mr. Bronfman in his former role as the Chairman and CEO of Universal's Island Def Jam Music Group. Paul-René Albertini, the Chairman and CEO of Warner Music International, is also a music industry veteran with over 20 years of experience. In May of 2005, we hired Richard Blackstone as the Chairman and CEO of our Music Publishing business, Warner/Chappell Music. Mr. Blackstone, who was previously the President and Chief Executive Officer of Zomba Music Publishing, has 15 years of experience in the music publishing business. Our senior management team is very committed to our success. For example, Music Capital Partners, L.P., an investment vehicle controlled by Edgar Bronfman, Jr., owned approximately 9.6% of our equity as of September 30, 2005. The rest of our senior management team owns a meaningful share of our equity through service and performance-based equity plans.

Strong Equity Sponsorship. Thomas H. Lee Partners L.P. and its affiliates (THL), Bain Capital, LLC and its affiliates (Bain Capital), and Providence Equity Partners, Inc. and its affiliates (Providence Equity) are each leading private equity firms with extensive experience in managing investments in entertainment and media assets and a long history of working successfully together. These equity sponsors currently manage entertainment and media companies including Houghton Mifflin Company, ProSiebenSAT.1 Media, American Media and Mountain States Cable. The addition of Edgar Bronfman, Jr., through Music Capital Partners L.P. (Music Capital, and together with THL, Bain Capital and Providence Equity, the Investor Group), brings substantial and directly relevant management experience in the music industry.

Our Strategy

We intend to increase revenues and cash flow through the following business strategies:

Attract, Develop and Retain Established and Emerging Recording Artists and Songwriters. A critical element of our strategy is to find, develop and retain recording artists and songwriters who achieve long-term success. Our local artist and repertoire ("A&R") teams seek to sign talented recording artists with strong potential, whose new releases will generate a meaningful level of sales and increase the enduring value of our catalog by continuing to generate sales on an ongoing basis, with little additional marketing expenditure. We also work to identify promising songwriters who will write musical compositions that will augment the lasting value and stability of our music publishing library. We believe our relative size, the strength of our management team, our ability to respond to industry and consumer trends and challenges, our diverse array of genres, our large catalog of hit releases and our valuable music publishing library will help us continue to successfully build our roster of artists and songwriters. We are constantly looking for new, innovative ways to develop and execute our A&R strategy. For example, in the U.S., we have designed an incubator system, which leverages our strong independent distribution network to identify major acts of the future at a lower cost. At its essence, the incubator system is innovative A&R spending. In addition, we have recently launched Cordless Recordings, an "e-label" that gives its artists the ability to come to market with one or several songs in the digital world without the need to create an entire album. This is another example of ways we are expanding our A&R strategy to adapt to and take advantage of the changing marketplace to find and develop new recording artists and songwriters.

Maximize the Value of our Music Assets. Our relationships with our recording artists and songwriters, our recorded music catalog and our music publishing library are our most valuable assets. We intend to continue to

exploit the value of these assets through a variety of distribution channels to generate significant cash flow from our music content. We believe that the ability to monetize our music content should increase over time as new distribution channels and new formats increase.

- Our Recorded Music business focuses on marketing our artists and catalog in new ways to retain existing fans of established artists and to generate new demand for our proven hits. For example, in 2005, we released a number of successful repurposed catalog compilations, including Ray Charles—*The Ray Soundtrack, Vol 2*, Crosby, Stills & Nash—*Greatest Hits*, and Michael McDonald—*Ultimate Collection*. We also released successful video content such as *George Harrison—The Concert for Bangladesh*. The growing number of legitimate digital distribution outlets allows us to generate incremental catalog sales. From the launch of Apple's iTunes Music Store in the United States in April 2003 through October 2, 2005, catalog sales have represented 54% of our top 200 digital track sales sold on iTunes versus 41% of our physical album sales over the same period.
- Our Music Publishing business seeks to capitalize on the growing demand for the use of musical compositions in media products such as videogames, commercials, other musical works (such as authorized sampling), films, DVDs, mobile phone ringtones and Internet and wireless streaming and downloads by marketing and promoting our libraries to producers of these media in new and innovative ways.

We will seek to exploit the potential of previously unmonetized content in new products and channels from ringtones to full track video and song downloads on mobile phones. For example, we have over 20 years of music videos that we have yet to fully monetize as well as unexploited album art, lyrics, and B-side tracks that that have never been physically released. We are seeking opportunities to create premium-priced album bundles by combining our existing assets with new assets that we are creating such as bonus tracks, music videos and "behind the scenes" footage.

We intend to enhance the value of our assets by continuing to attract and develop new artists and songwriters with staying power and market potential. Additionally, we intend to continually evaluate our artist and songwriter roster to ensure we remain focused on developing the most promising and profitable talent. We will also continue to work with our partners to explore creative approaches and constantly experiment with new deal structures and products to take advantage of new distribution channels.

Focus on Continued Management of Our Cost Structure. We will continue to maintain a disciplined approach to cost management in our business and to pursue additional cost savings. We will also continue to monitor industry conditions to ensure that our business remains aligned with industry trends. For example, subsequent to the acquisition of our company by the Investor Group in 2004, we implemented a broad restructuring plan in order to realign our cost structure with the changing economics of the music industry. The restructuring plan included the consolidation of select business divisions of our Elektra and Atlantic labels, including the legal and business affairs, finance and label sales units, rationalization of our global network, pruning of approximately 30% of our artist roster and an approximately 20% reduction in our global workforce. We completed substantially all of these restructuring efforts in fiscal 2005. In connection with the restructuring plan, we implemented approximately $250 million of annualized cost savings.

Invest in Accordance with an Improved Asset Allocation Strategy and More Efficiently Allocate Capital. We seek to invest in lines of business, geographic locations and individual projects where we believe we can optimize our return on capital. We will also consider the strategic importance of alternative investments in addition to their financial metrics. We believe that as a result of our management processes, analytic techniques and investment discipline, we are well positioned to efficiently deploy our capital. For example, we will continue to seek better returns through a more efficient allocation of our resources by, among other initiatives (1) allocating capital to a smaller number of acts to increase A&R spend per act, (2) reducing our operations in unprofitable geographies and (3) developing initiatives such as our incubator strategy and our new e-label, Cordless Recordings, to identify artists earlier in their careers, allowing us to broaden the scope of our investments in new artists without significant upfront capital.

Develop and Optimize Our Physical Distribution Channel Strategies. We will continue to develop innovative programs with our physical distribution partners to achieve greater sales volume. The physical distribution channels for records are evolving as new outlets develop, the mix of channels and retailers change, new formats for our content are created and pricing models multiply to meet a wide range of needs. Our Recorded Music business will continue to cooperate with its physical distribution channel partners in order to implement forward-looking strategies for our mutual benefit. We will also invest to meet the needs of our channel partners to create more efficient collaboration, such as direct-to-retail distribution strategies and vendor managed inventory.

Capitalize on Digital Distribution and Emerging Technologies. Digital formats should continue to represent new avenues for the distribution and exploitation of our recorded music and music publishing assets. We believe that the development of legitimate Internet and wireless channels for the purchase of music holds significant promise and opportunity for the industry. In particular, new and emerging third-party digital distribution outlets are not only reasonably priced, but also offer a superior customer experience relative to illegal alternatives, as they are easy to use, offer uncorrupted song files and integrate seamlessly with increasingly popular portable music players such as the Apple iPod and its recently released iPod Nano and video versions, the Dell DJ Digital Jukebox and the Creative Nomad. In addition, we believe digital distribution will stimulate incremental catalog sales given the ability to offer enhanced presentation and searchability of our catalog. As networks and phone handsets become more sophisticated, our music is increasingly becoming available on mobile phone platforms through wireless service providers via ringtones, ringback tones, full track downloads and music video downloads. We believe the wireless business offers a more secure environment than does the Internet and thereby reduces our exposure to piracy.

Contain Digital Piracy. Containing piracy is a major focus of the music industry and we, along with the rest of the industry, are taking multiple measures through technological innovation, litigation, education and the promotion of legislation to combat piracy. We will continue to take a leadership role in the music industry's war against piracy, as we did by championing the industry-wide development of the new DualDisc (CD/DVD) physical format, partnering with Apple on its security model for its Macintosh and PC launches of iTunes, and encouraging Microsoft to retool its digital rights management digital media copyright protection technology and include playlist burn limits. In addition, we continue to support the aggressive measures taken by RIAA, IFPI and NMPA, including civil lawsuits, education programs, political lobbying for tougher restrictions on use and international efforts to preserve music copyrights. We believe new technologies geared towards degrading the illegal file-sharing process and tracking the source of pirated music and offer a means to reduce piracy. Furthermore, recent legal actions by our industry, both in and outside the U.S., have been designed to educate consumers that stealing music is against the law and deter illegal downloads. A number of recent decisions, including the U.S. Supreme Court decision in Grokster and the Federal Court of Australia's ruling in a case involving KaZaA have held that P2P networks can be held liable if they induce users to violate copyright laws. The industry has also been working with educational institutions to implement controls to prohibit students from illegally downloading copyrighted material. We believe that consumer awareness of the illegality of piracy has increased as a result of these initiatives. We believe these actions, in addition to the expansive growth of legitimate online music offerings, will help to limit the revenues lost to digital piracy. See "*Industry Overview—Recorded Music—Piracy*".

Company History

Our history dates back to 1929, when Jack Warner, president of Warner Bros. Pictures, Inc., founded Music Publishers Holding Company ("MPHC") to acquire music copyrights as a means of providing inexpensive music for films. MPHC was constructed through the acquisition of M. Witmark & Sons, Remick Music Corp., Harms, Inc. and Advanced Music Corporation. Along with these companies came the beginning of our valuable library of publishing assets, including the works of Cole Porter, Richard Rodgers and Lorenz Hart. Collectively, these assets, as well as numerous others were acquired over the last 75 years, including Chappell & Intersong Music Group acquired in 1987.

Encouraged by the success of MPHC, Warner Bros. extended its presence in the music industry with the founding of Warner Bros. Records in 1958 as a means of distributing movie soundtracks and further exploiting actors' contracts. For over 45 years, Warner Bros. Records has pushed the bounds of the industry both creatively and financially with the discovery of artists such as Neil Young, Grateful Dead and the acquisition of Frank Sinatra's Reprise Records in 1963. Today, Warner Bros. Records is home to such artists as Faith Hill, Red Hot Chili Peppers, Linkin Park, Josh Groban and Madonna.

Atlantic Records was launched in 1947 by Ahmet Ertegun and Herb Abramson as a small New York-based label focused on jazz and R&B. Led by Ertegun, Atlantic had early hits by such artists as Ray Charles, John Coltrane and Aretha Franklin, but quickly broadened its reach and found increasing success with artists such as Bobby Darin, Crosby, Stills & Nash, Buffalo Springfield, Sonny and Cher and Led Zeppelin. Elektra Records was founded in 1950 by Jac Holzman as a folk music label. With an eye to emerging music, Elektra Records signed such artists as Joni Mitchell, The Eagles, The Doors and Jackson Browne. The Atlantic Records Group is home to Elektra Records, Atlantic Records and Lava Records and boasts a roster of acclaimed artists such as matchbox twenty, Led Zeppelin, Phil Collins, Jewel, Kid Rock, T.I., Tracy Chapman, Metallica, Simple Plan, James Blunt and Lil' Kim.

Since 1970, we have operated internationally through Warner Music International ("WMI"). WMI is responsible for the sale and marketing of our U.S. artists abroad as well as the acquisition and development of international artists such as The Darkness, Alejandro Sanz, Maná, MC Solaar and Laura Pausini.

In 2002, we acquired Word Entertainment to expand our presence in the Christian music genre. Word Entertainment boasts a deep roster of Christian artists, including Jaci Velasquez and Randy Travis.

Warner Music Group was acquired by the Investor Group from Time Warner Inc. ("Time Warner") in March 2004.

Warner Music Group became the only stand-alone music company with publicly traded common stock in the United States in May 2005.

Recorded Music (83%, 81% and 84% of consolidated revenues in fiscal 2005, 2004 and 2003, respectively)

Our recorded music operations consist of the discovery and development of artists and the related marketing and distribution of recorded music produced by such artists. In addition to the more traditional methods of discovering and developing artists, we have implemented new initiatives to identify and nurture artists earlier in the development process and reduce development costs by leveraging our independent distribution network. We refer to these new business models as incubator initiatives. Asylum and East West are current incubator labels. In addition, we have also entered into strategic ventures with other record labels.

Our recorded music operations also include a catalog division called Rhino Entertainment ("Rhino"), which was formerly called Warner Strategic Marketing. Rhino specializes in marketing our music catalog through compilations and reissuances of previously released music and video titles, as well as in the licensing of tracks to/from third parties for various uses, including film and television soundtracks.

Our principal recorded music distribution operations include Warner-Elektra-Atlantic Corporation ("WEA Corp."), which primarily distributes our music products to retailers and wholesale distributors in the United States; a 90% interest in Alternative Distribution Alliance ("ADA"), a distribution company which primarily distributes the products of independent record labels to retailers and wholesale distributors; various distribution centers and ventures operated internationally; and an 80% interest in Word Entertainment, whose distribution operations specialize in the distribution of music products in the Christian retail marketplace.

We play an integral role in virtually all aspects of the music value chain from discovering and developing talent, to producing albums and promoting artists and their product. After an artist has entered into a contract

with one of our record labels, a master recording of the artist's music is created. The recording is then replicated for sale to consumers primarily in the CD format, and now, in digital formats. In the U.S., WEA Corp. and ADA market, sell and deliver product, either directly or through sub-distributors and wholesalers, to thousands of record stores, mass merchants and other retailers throughout the country. Our recorded music products are also sold in physical form to Internet physical retailers such as Amazon.com and barnesandnoble.com and in digital form to Internet digital retailers like Apple's iTunes and musicmatch.com.

In the United States, our recorded music operations are conducted principally through our major record labels—Warner Bros. Records and The Atlantic Records Group.

In markets outside the U.S., our recorded music activities are conducted through WMI and its various subsidiaries, affiliates and non-affiliated licensees. WMI produces revenues in more than 50 countries outside the U.S. and engages in the same activities as our U.S. labels: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, WMI also markets and distributes the records of those artists for whom our domestic record labels have international rights. In certain countries, WMI licenses to unaffiliated third-party record labels the right to distribute its records.

Artists and Repertoire ("A&R")

We have a decades-long history of identifying and contracting with recording artists who become commercially successful. Our ability to select artists who are likely to be successful is a key element of our Recorded Music business strategy. Our ability to select artists spans all music genres and all major geographies and includes artists who achieve national, regional and international success. We believe that this success is directly attributable to our experienced global team of A&R executives, to the longstanding reputation and relationships that we have nurtured in the artistic community and to our effective management of this vital business function.

In the U.S., our major record labels identify potentially successful recording artists, sign them to recording agreements, collaborate with them to develop recordings of their work and market and sell these finished recordings to retail stores and legitimate online channels. Our labels scout and sign talent across all major music genres, including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, alternative, folk, blues, gospel and other Christian music. WMI markets and sells U.S. and local repertoire from its own network of affiliates and numerous licensees in more than 50 countries. With a roster of local artists performing in 25 languages, WMI has an ongoing commitment to developing local talent aimed at achieving national, regional, or international success.

We continue to realize significant success in the acquisition of new artists and the development of new content. In 2005, we have already upstreamed five urban and three rock artists to our major labels through our incubator initiative, four of whom have debuted in the top 10 in Billboard's Top 200 chart (Mike Jones, Paul Wall, Webbie and Bun-B). We have also had a number of artists with releases in 2005 that debuted at the #1 spot in the Billboard Top 200 Chart including Staind, Disturbed and Faith Hill. Other artists that have seen success in 2005 include Green Day, Linkin Park, Michel Bublé, Simple Plan, Rob Thomas, Big & Rich, and Shinedown. We also released top-selling albums from other new artists such as James Blunt, The Click Five and My Chemical Romance, and the major-label debuts of artists including Death Cab for Cutie, Rilo Kiley and Cowboy Troy in 2005.

A significant number of our recording artists have continued to appeal to audiences long after we cease to release their new recordings. Our catalog includes the U.S. best-selling album of all time, *The Eagles: Their Greatest Hits 1971-1975*, which has sold 28 million units to date. We have an efficient process for generating continued sales across our catalog releases, as evidenced by the fact that catalog albums generate approximately 40% of our recorded music sales. Relative to our new releases, we spend comparatively small amounts on marketing for catalog sales.

We maximize the value of our catalog of recorded music through our Rhino business unit and through activities of each of our record labels. We use our catalog as a source of material for re-releases, compilations, box sets and special package releases, which provide consumers with incremental exposure to familiar songs and artists. Recent examples include packages such as *"No Thanks!—The 70's Punk Rebellion,"* greatest hits collections from artists such as The Eagles, Crosby, Stills & Nash, Joni Mitchell, Sugar Ray, Rickie Lee Jones, Brandy and Emmylou Harris, box sets by Ray Charles, ZZ Top, Talking Heads, Jerry Garcia, The Faces, Black Sabbath and The Grateful Dead, and DVDs of Live Aid, Led Zeppelin's *"How the West Was Won"*, Ray Charles' *"O—Genio: Ray Charles Live in Brazil, 1963"*, the George Harrison tribute, *"The Concert for George"*, The Ramones documentary, *"End of the Century: The Story of The Ramones"* and The Eagles *"Farewell I Tour—Live From Melbourne"* and the multi-artist box set of 80's songs, *"Left of the Dial: Dispatches from the 80's Underground"*.

Representative Worldwide Recorded Music Artists

Avenged Sevenfold	Cowboy Troy	Green Day	Metallica	Seal
Big & Rich	Damien Rice	David Gray	Luis Miguel	Sean Paul
Bjork	The Darkness	Mike Jones	Missy Elliott	Shinedown
James Blunt	Craig David	Josh Groban	Alanis Morissette	Simple Plan
Boyz N Da Hood	Death Cab for Cutie	Jet	My Chemical Romance	Staind
Michelle Branch	Diddy	Jewel	Muse	Sugar Ray
Michael Bublé	Disturbed	Kid Rock	Notorious B.I.G.	Rob Thomas
Ryan Cabrera	The Eagles	Led Zeppelin	Laura Pausini	T.I.
Tracy Chapman	Enya	Linkin Park	P.O.D.	Twista
Cher	Fabolous	Madonna	Red Hot Chili Peppers	Uncle Kracker
Eric Clapton	Faith Hill	Maná	R.E.M.	Paul Wall
Phil Collins	Fleetwood Mac	matchbox twenty	Rilo Kiley	Westernhagen
The Corrs	Goo Goo Dolls	MC Solaar	Alejandro Sanz	Neil Young

Artists' Contracts

Our artists' contracts define the commercial relationship between our recording artists and our record labels. We negotiate recording agreements with artists that define our right to use the artists' copyrighted recordings in sales and licenses of our recorded music products worldwide. In accordance with the terms of the contract, the artists receive royalties based on sales and other forms of exploitation of the artists' recorded works. We customarily provide up-front payments to artists called advances, which are recoupable by us from future royalties otherwise payable to artists. We also typically pay costs associated with the recording and production of albums, which are treated in certain countries as advances recoupable from future royalties. Our typical contract for a new artist covers a single initial album and provides us a series of exclusive options to acquire subsequent albums from the artist. Royalty rates are often increased for optional albums. Many of our contracts contain a commitment from the record label to fund video production costs, at least a portion of which is generally an advance recoupable from future royalties.

Our established artists' contracts generally provide for greater advances and higher royalty rates. Typically, established artists' contracts entitle us to fewer albums, and, of those, fewer are optional albums. In contrast to new artists' contracts, which typically give us ownership in the artist's work for the full term of copyright, some established artists' contracts provide us with an exclusive license for some fixed period of time. It is not unusual for us to renegotiate contract terms with a successful artist during a term of an existing agreement, sometimes in return for an increase in the number of albums that the artist is required to deliver.

We are also experimenting with other forms of business models with artists to adapt to changing industry conditions. For example, Cordless Recordings, our digital-only e-label will pioneer a new business model allowing for regular release of song "clusters". The label will allow artists to retain masters of their work and copyright ownership in certain cases. Our incubator labels, Asylum and East West, also enter into deals designed to provide a variety of services to labels and artists, such as marketing, distribution and sales services.

Marketing and Promotion

WEA Corp. and ADA market and sell our recorded music product in the U.S. Our approach to marketing and promoting our artists and their recordings is comprehensive. Our goal is to maximize the likelihood of success for new releases as well as stimulate the success of previous releases. We seek to maximize the value of each artist and release, and to help our artists develop an image that maximizes appeal to consumers.

We work to raise the profile of our artists, through an integrated marketing approach that covers all aspects of their interactions with music consumers. These activities include helping the artist develop creatively in each release, strategically scheduling album releases and selecting singles for release, creating concepts for videos that are complementary to the artists' work, and coordinating promotion of albums to radio and television outlets. We are also experimenting with ways to promote our artists through digital channels with such initiatives as experimenting with windowing of content and creating product bundles by combining our existing assets with new assets that are created simultaneously with the album (such as bonus tracks, music videos and "behind the scenes" footage). Through digital distribution channels we have greater marketing flexibility that can be more cost effective. For example, direct marketing is possible through access to consumers via websites and pre-release activity can be customized. When possible, we seek to add an additional personal component to our promotional efforts by facilitating television and radio coverage or live appearances for our key artists. Our corporate and label websites provide additional marketing venues for our artists.

In further preparation for and subsequent to the release of an album, we coordinate and execute a marketing plan that addresses specific retail strategies to promote the album. Aspects of these promotions include in-store appearances, advertising, displays and placement in album listening stations. These activities are overseen by our marketing staff to ensure that maximum visibility is achieved for the artist and the release.

Our approach to the marketing and promotion of recorded music is carefully coordinated to create the greatest sales momentum, while maintaining strict fiscal discipline. We have significant experience in our marketing and promotion departments, which we believe allows us to achieve an optimal balance between our marketing expenditure and the eventual sales of our artists' recordings. We use a budget-based approach to plan marketing and promotions, and we monitor all expenditures related to each release to ensure compliance with the agreed-upon budget. These planning processes are informed by updated reports on an artists' retail sales and radio play, so that a promotion plan can be quickly refined in the event of a commercial success or failure.

While marketing efforts extend to our catalog albums, most of the expenditure is directed toward new releases. Rhino specializes in marketing our catalog through compilations and reissues of previously released music and video titles, licensing tracks to third parties for various uses and coordinating film and television soundtrack opportunities with third-party film and television producers and studios.

Manufacturing, Packaging and Physical Distribution

On October 24, 2003, Time Warner sold its CD and DVD manufacturing, packaging and physical distribution operations ("TW Manufacturing") to Cinram for approximately $1.1 billion in cash consideration. The transaction included the sale of the following businesses: WEA Manufacturing Inc., Warner Music Manufacturing Europe GmbH, Ivy Hill Corporation, Giant Merchandising and the physical distribution operations of WEA Corp. The sales and marketing operations of WEA Corp. remain a part of our business.

At the time of the sale of TW Manufacturing to Cinram, we entered into manufacturing, packaging and physical distribution arrangements with Cinram for our CDs and DVDs in the U.S. and Europe. We believe that the terms of the Cinram agreements reflect market rates and are more favorable than our previous arrangements.

Sales

Most of our sales represent purchases by a wholesale or retail distributor. Our return policies are in accordance with wholesale and retailer requirements, applicable laws and regulations, territory- and customer-specific negotiations, and industry practice. We attempt to minimize the return of unsold product by monitoring shipments and sell-through data.

We generate sales from both our roster of current artists and our catalog of recordings. In addition, we actively repackage and remarket music from our catalog to form new compilations. Most of our sales are generated through the CD format, although we also sell our music through both historical formats, such as cassettes and vinyl albums, and newer emerging digital formats and physical formats, including DVD-Audio and DualDisc.

We sell our recorded music products through a variety of different retail and wholesale outlets including music specialty stores, general entertainment specialty stores, supermarkets, mass merchants and discounters, independent retailers, and other traditional retailers. Although some of our retailers are specialized, many of our customers offer a substantial range of products other than music. We work with our customers to ensure optimal product placement and promotion.

We believe that the Internet has become an increasingly important sales channel. Sales through the Internet include sales of traditional physical formats through both the Internet distribution arms of traditional retailers such as walmart.com or hmv.com and online physical retailers such as Amazon.com and barnesandnoble.com. In addition, there has been a proliferation of legitimate online sites which sell digital music on a per album or per track basis and several carriers are also introducing the capability to download music on mobile devices. We currently partner with a broad range of online digital and mobile providers, such as iTunes, MusicNet, musicmatch, Rhapsody, Sprint, Verizon and Cingular and are actively seeking to develop and grow this business. In digital formats, costs related directly to physical products such as manufacturing, distribution, inventory and return costs do not apply. While there are some digital-specific variable costs and infrastructure investments needed to produce, market, and sell digital products, it is reasonable to expect that we will generally derive a higher contribution margin from digital versus physical sales.

Music Publishing (17%, 20% and 17% of consolidated revenues in fiscal 2005, 2004 and 2003, respectively)

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

Warner/Chappell is 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 65,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative, gospel and other Christian music. Our best-selling songwriter or song owner and song accounted for less than 2.5% and 1% of our music publishing revenues for the twelve months ended September 30, 2005, respectively. Moreover, our music publishing library includes many standard titles that span multiple music genres and has demonstrated the ability to generate consistent revenues over extended periods of time. For example, over the last ten years, our top ten earning songs, which include such titles as "Happy Birthday to You" and "Winter Wonderland" have generally generated average annual revenues of between $0.5 million and $1.5 million per song. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios, including Lucasfilm, Ltd. and Hallmark Entertainment.

Warner/Chappell also previously owned Warner Bros. Publications ("WBP"), which printed and distributed a broad selection of sheet music, books and educational materials, orchestrations, folios, personality books, and arrangements from the catalogs of Warner/Chappell and other music publishers. On May 31, 2005, we sold our printed sheet music business to Alfred Publishing.

Music Publishing Portfolio

Representative Songwriters

Burt Bacharach
Michelle Branch
Andreas Carlsson
Eric Clapton
Bryan-Michael Cox
Sheryl Crow
Dr. Dre
Dido
Fat Joe
George and Ira Gershwin
Green Day
Don Henley
Michael Jackson
Led Zeppelin
Madonna
Nickelback
Pantera
Cole Porter
Radiohead
The Ramones
Alejandro Sanz
John Shanks
Staind
Timbaland
Van Morrison
Barry White
John Williams

Representative Songs

1950s and Prior

Summertime
Happy Birthday to You
Night and Day
The Lady is a Tramp
Too Marvelous for Words
Dancing in the Dark
Winter Wonderland
Ain't She Sweet
Frosty the Snowman
When I Fall In Love
Misty
The Party's Over
On the Street Where You Live
Blueberry Hill

1960s

People
I Only Want to be With You
When a Man Loves a Woman
I Got a Woman
People Get Ready
Love is Blue
Hey Big Spender
For What It's Worth
Sunny
The Look of Love

1970s

Behind Closed Doors
Ain't No Stopping Us Now
For the Love of Money
A Horse With No Name
Moondance
Peaceful Easy Feeling
Layla
Staying Alive
Star Wars Theme

1980s

Eye of the Tiger
Slow Hand
The Wind Beneath My Wings
Endless Love
Morning Train
What You Need
Beat It
Jump
We Are the World

1990s

Unbelievable
Creep
Macarena
Sunny Came Home
Amazed
This Kiss
Believe
Smooth
Livin' La Vida Loca

2000 and After

It's Been Awhile
Photograph
Complicated
You Got It Bad
Crazy in Love
Cry Me a River
White Flag
Dilemma
Work It
Miss You
Burn
American Idiot
The Reason
Save a Horse (Ride a Cowboy)

Our Music Publishing revenues are derived from four main sources:

- *Mechanical:* the licensor receives royalties with respect to compositions embodied in recordings sold in any format or configuration, including singles, albums, CDs, digital downloads and mobile phone ringtones.
- *Performance:* the licensor receives royalties when the composition is performed publicly (*e.g.*, broadcast radio and television, movie theater, concert, nightclub or Internet and wireless streaming).
- *Synchronization:* the licensor receives royalties or fees for the right to use the composition in combination with visual images (*e.g.*, in films, television commercials and programs and videogames).
- *Other:* the licensor receives royalties from other uses such as stage productions and printed sheet music.

Music Publishing Royalties

Warner/Chappell, as a copyright owner or administrator of copyrighted musical compositions, is entitled to receive royalties for the exploitation of those musical compositions as identified below. Often, a copyright owner will transfer "administration rights" to a third party. Administration rights are the rights to license uses of the composition and collect monies derived therefrom.

Music publishers generally receive royalties pursuant to synchronization, mechanical, public performance and other licenses. Throughout the world, each synchronization license is subject to negotiation with a prospective licensee. By contract, music publishers pay a contractually required percentage of synchronization income to the songwriter(s) (or their heirs) and to any co-publishers. In the U.S., music publishers collect and administer mechanical royalties, and statutory ceilings are established by the U.S. Copyright Act of 1976, as amended, for the royalty rates applicable to musical compositions for sales of recordings embodying those musical compositions. In the U.S., public performance royalties are typically administered and collected by performing rights organizations and in most countries outside the U.S., collection, administration and allocation of both mechanical and performance income are undertaken and regulated by governmental or quasi-governmental authorities. *See "Industry Overview—Music Publishing".*

Warner/Chappell acquires copyrights (or portions of copyrights) and administration rights from songwriters or other third-party holders of rights in compositions. Typically, in either case, the grantor of rights retains a right to receive a percentage of revenues collected by Warner/Chappell. As an owner and/or administrator of compositions, we promote the use of those compositions by others. For example, we encourage recording artists to record and include our songs on their albums, offer opportunities to include our compositions in filmed entertainment, advertisements and wireless media, and advocate the use of our compositions in live stage productions. Examples of music uses that generate publishing revenues include:

Mechanical: sale of recorded music in various formats

- Physical recordings (*e.g.*, CDs, cassettes, DVDs, video cassettes)
- Internet and wireless downloads
- Mobile phone ringtones

Performance: performance of the song to the general public

- Broadcast of music on television, radio, cable, satellite
- Live performance at a concert or other venue (*e.g.*, arena concerts, nightclubs)
- Broadcast of music at sporting events, restaurants or bars
- Internet and wireless streaming
- Performance of music in staged theatrical productions

Synchronization: use of the song in combination with visual images

- In films or television programs
- In television commercials
- In videogames

Other:

- Use in toys or novelty items
- Sales of sheet music used by orchestras or individuals (prior to our sale of the printed sheet music business in May 2005)

Composers' and Lyricists' Contracts

Warner/Chappell derives its rights through contracts with composers and lyricists (songwriters) or their heirs, and with third-party music publishers. In some instances, those contracts grant either 100% or some lesser percentage of ownership in musical compositions and administration rights. In other instances, those contracts only convey to Warner/Chappell rights to administer and exploit musical compositions for a period of time without retaining an ownership interest. Our contracts grant us exclusive exploitation rights in the territories concerned (excepting any pre-existing arrangements). Many of our contracts grant us rights on a worldwide basis. Contracts cover the entire work product of the writer or composer for the duration of the contract. As a result, Warner/Chappell typically possesses the administration rights for every musical composition created by the writer or composer during the duration of the contract.

While the duration of the contract may vary, many of our contracts grant us ownership and/or administration rights for the duration of copyright. U.S. copyright law permits authors or their estates to terminate an assignment or license of copyright (for the U.S. only) after a set period of time. In addition, in the U.K., rights transferred by an author of certain works created before June 1, 1957 automatically revert to their author's heirs 25 years after the author's death.

Marketing and Promotion

We actively seek, develop and maintain relationships with songwriters.

We actively market our copyrights to end users such as recorded music companies (including our Recorded Music business), filmed entertainment, television and other media companies, advertising and media agencies, event planners and organizers, computer and video game companies and other multimedia producers. We also market our musical compositions for use in live stage productions and merchandising. In addition, we actively seek new and emerging outlets for the exploitation of songs such as ringtones for cellular phones, new wireless and online uses, digital sheet music and Internet webcasting.

We continually add new musical compositions to our catalog, and seek to acquire rights in songs that will generate substantial revenue over long periods of time.

Digital Sales

We have integrated the sale of digital content into all aspects of our Recorded Music and Music Publishing businesses including A&R, marketing, promotion and distribution. Our new media executives work closely with the A&R departments of our labels to make sure that while a record is being made, digital assets are also created with all of our distribution channels in mind. We also work side-by-side with our wireless and online partners to test new concepts. We believe existing digital businesses will be a significant source of growth for the next several years and will provide new opportunities to monetize our assets and create new revenue streams. As a

music content company, we have assets that go beyond our music catalog and copyrights, such as our music video library, that we now have the opportunity to monetize through digital channels. In addition, we can digitally exploit album art, lyrics and B-side tracks that have never been physically released. For example, we have an agreement with MTV Networks for the use of our music videos in original mobile content and programming. In general, digital music content is sold through two primary channels: online and mobile. The proportion of revenues attributed to each distribution channel varies by region, with digital downloads making up the majority of revenues in the U.S. and mobile music currently representing the majority of digital revenues outside of the U.S, especially in Europe and Asia. However, digital music is in the early stages of growth and we expect these proportions to change as the roll-out of new technologies continues. As an owner of musical 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.

Downloads/Subscription Services

Digital sales of our music content consist primarily of music originally accessed over the Internet or wirelessly through digital download or subscription models, which can then be transferred to a portable music player. We enter into agreements with numerous partners, such as iTunes, MusicNet, musicmatch, Rhapsody, Yahoo! and MSN to provide our content for sale through their music service offerings. Our agreements generally last one to two years. We believe that the short-term nature of our contracts enables us to maintain the flexibility that we need given the infancy of the digital business models. We are also exploring other opportunities to generate revenues through new uses of our content through these developing distribution channels. For example, we have over 20 years of music videos that we have yet to significantly monetize as well as unexploited album art, lyric, and B-side tracks that that have never been physically released.

Mobile

Mobile sales of our music content consists primarily of ringtones, ringback tones and mastertones (a ringtone made from recording by the original artist). We expect the range of products to expand as new technologies continue to be rolled out and to include full track music and full music video downloads, as well as other new businesses from these emerging distribution platforms. We enter into agreements with mobile carriers such as Sprint, Verizon, and France Telecom to provide our content for sale though their music offerings. Our contracts generally last one to two years.

Competition

In both recorded music and music publishing we compete based on price (to retailers in recorded music and to various end users in music publishing), on marketing and promotion (including both how we allocate our marketing and promotion resources as well as how much we spend on a dollar basis) and on recording artist and songwriter signings. We believe we currently compete favorably in these areas. However, there is a threat that the change to the competitive landscape caused by the Universal and Sony BMG duopoly could increase the costs of artist signings and the costs of marketing and promoting records to our detriment. See "*Industry Overview—Recorded Music*" and "*Industry Overview—Music Publishing.*"

Our Recorded Music business is also dependent on technological development, including access to, selection and viability of new technologies, and is subject to potential pressure from competitors as a result of their technological developments. In recent years, due to the growth in piracy, we have been forced to compete with illegal channels such as unauthorized Internet peer-to-peer file-sharing and downloading and industrial duplication. See "*Industry Overview—Piracy.*" Additionally, we compete, to a lesser extent, with alternative forms of entertainment such as motion pictures on home devices (e.g., VHS and DVD) or at the box office and with videogames for disposable consumer income.

Intellectual Property

Copyrights

Our business, like that of other companies involved in music publishing and recorded music, rests on our ability to maintain rights in musical works and recordings through copyright protection. In the U.S., copyright protection for works created as "works made for hire" (e.g., works of employees or specially-commissioned works) after January 1, 1978 lasts for 95 years from first publication or 120 years from creation, whichever expires first. The period of copyright protection for musical compositions and sound recordings that are not "works made for hire" lasts for the life of the author plus 70 years for works created on or after January 1, 1978. U.S. works created prior to January 1, 1978 generally enjoy a total copyright life of 95 years, subject to compliance with certain statutory provisions including notice and renewal. In the U.S., sound recordings created prior to February 15, 1972 are not subject to copyright protection but are protected by common law rights or state statutes, where applicable. Copyright in the European Union has recently been harmonized such that the period of copyright protection for musical compositions in all Member States lasts for the life of the author plus 70 years. In certain European Union countries, such as the U.K., the period of protection for musical compositions was recently extended from 50 years to 70 years, which has restored copyright protection in certain compositions in which our rights lapsed. In the European Union, the term of copyright for sound recordings lasts for 50 years from the date of release.

We are largely dependent on legislation in each territory to protect our rights against unauthorized reproduction, distribution, public performance or rental. In all territories where we operate, our products receive some degree of copyright protection, although the period of protection varies widely. In a number of developing countries, the protection of copyright remains inadequate. The U.S. enacted the Digital Millennium Copyright Act of 1998, creating a powerful framework for the protection of copyrights covering musical compositions and recordings in the digital world.

The potential growth of new delivery technologies, such as digital broadcasting, the Internet and entertainment-on-demand has focused attention on the need for new legislation that will adequately protect the rights of producers. We actively lobby in favor of industry efforts to increase copyright protection and support the efforts of organizations such as the World Intellectual Property Organization ("WIPO").

In December 1996, two global copyright treaties, the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, were signed securing the basic legal framework for the international music industry to trade and invest in online music businesses. The WIPO treaties have been ratified by the requisite number of countries, including the U.S.

The European Union has implemented these treaties through the European Copyright Directive, which was adopted by the EU in 2001. Legislation implementing the Directive in each of the member states is underway. The Directive harmonizes copyright laws across Europe and extends substantial protection for copyrights online. The European Union has also put forward legislation aimed at assuring cross border coordination of the enforcement of laws related to counterfeit goods, including musical recordings.

Trademarks

An important part of our business is our trademarks. Our major trademarks are registered in every country where we believe the protection of these trademarks is important for our business. Our major trademarks include Atlantic, Elektra, Sire, Reprise and Warner/Chappell. We use certain trademarks pursuant to royalty-free license agreements. The duration of the license relating to the WARNER and WARNER MUSIC marks and a "W" logo is perpetual. The duration of the license relating to the WARNER BROS. RECORDS mark and WB & Shield designs is fifteen years from February 29, 2004. Each of the licenses may be terminated under certain limited circumstances, which include material breaches of the agreement, certain events of insolvency, and certain change of control events if we were to become controlled by a major filmed entertainment company. We actively monitor and protect against activities that might infringe, dilute, or otherwise harm our trademarks.

Joint Ventures

We have entered into joint venture arrangements pursuant to which we or our various subsidiary companies manufacture, distribute and market (in most cases, domestically and internationally) recordings owned by the joint ventures. An example of these arrangements is Bad Boy Records, a joint venture between us and Sean "Diddy" Combs.

Employees

As of September 30, 2005, we employed approximately 4,000 persons worldwide, including temporary and part-time employees. None of our employees in the U.S. are subject to collective bargaining agreements, although certain employees in our non-domestic companies are covered by national labor agreements. We believe that our relationship with our employees is good.

Environmental Matters

Our wholly and partially owned pick, pack and ship facilities throughout the world, which are not a significant part of our business, are subject to laws and regulations and international agreements governing the protection of the environment, natural resources, human health and safety and the use, management and disposal of hazardous substances. In particular, our operations are subject to stringent requirements for packaging content and recycling, air and water emissions, and waste management. We believe that we comply substantially with all applicable environmental requirements. Although the costs of maintaining such compliance have not materially affected us to date, we cannot predict the costs of complying with requirements that may be imposed in the future. In connection with some of our existing facilities, we also have been, and may become again, responsible for the costs of investigating or cleaning up contaminated properties. Such costs or related third-party personal injury or property damage claims could have a material adverse affect on our business, results of operations or financial condition.

Financial Information About Segments and Foreign and Domestic Operations

Financial and other information by segment and relating to foreign and domestic operations for each of the last three fiscal years is set forth in Note 23 to the Consolidated and Combined Audited Financial Statements.

INDUSTRY OVERVIEW

Recorded Music

Recorded music is one of the primary mediums of entertainment for consumers worldwide and in calendar 2004, generated $33.6 billion in retail sales.

Recorded music companies play an integral role in virtually all aspects of the music value chain, from discovering and developing talent to producing albums and promoting artists and their product. Revenues are generated through the marketing, sale and licensing of recordings in various physical and digital formats.

The major recorded music companies have built significant recorded music catalogs, which are long-lived assets that are exploited year after year. The sale of catalog material is typically more profitable than that of new releases, given lower development costs and more limited marketing costs. In first three quarters of calendar 2005, 38% of all U.S. physical unit sales were from recordings more than 18-months old, and 25% were from recordings more than three years old. Distribution has been largely stable for the past eight years.

The recorded music industry is highly competitive based on consumer preferences, and is rapidly changing. At its core, the recorded music business relies on the exploitation of artistic talent. As such, competitive strength is predicated upon the ability to continually develop and market new artists whose work gains commercial acceptance. In 2004, the four largest players were Universal, Sony BMG, EMI and WMG, which accounted for approximately 72% of worldwide recorded music sales in 2004. There are many mid-sized and smaller players in

the industry that accounted for the remaining 28%, including independent music companies. Universal was the market leader with a 26% global market share in 2004, followed by Sony BMG with a 22% share. EMI and WMG held a 13% and 11% share of global music sales in 2004, respectively. While market shares change moderately year-to-year, none of these players have gained or lost more than 3 percentage points of share in the last 5 years through 2004 (taking into account combined shares of Sony and BMG for years prior to the formation of Sony BMG in 2004).

The top five territories (U.S., Japan, U.K., Germany and France) accounted for 73% of the recorded music market in 2004. The U.S., which is the most significant exporter of music, is also the largest end-market, constituting 36% of total 2004 recorded music sales. In addition the U.S. and Japan are largely local music markets, with 93% and 72% of their 2004 sales consisting of domestic repertoire, respectively. In contrast, the U.K, German and French markets are made up of a higher percentage of international sales, with domestic repertoire constituting only 51%, 49% and 63% of these markets, respectively.

There has been a major shift in distribution of recorded music from specialty shops towards mass-market and online retailers. Record stores' share of U.S. physical music sales has declined from 53% in 1994 to 33% in 2004. Over the course of the last decade, mass-market and other stores' share grew from 27% to 54%. Online digital distribution currently represents a small portion of overall sales, but is expected to experience significant growth. In terms of genre, rock remains the most popular style of music, representing 24% of 2004 U.S. unit sales, although genres such as rap, hip-hop and Latin music have become increasingly popular.

From 1990 to 1999, the U.S. recorded music industry grew at a compound annual growth rate of 7.6%, twice the rate of total entertainment spending. This growth was driven by demand for music, the replacement of LPs and cassettes with CDs, price increases and strong economic growth and was largely paralleled around the world. The industry began experiencing negative growth rates in 1999, on a global basis, primarily driven by an increase in digital piracy. Other drivers of this decline are the overall recessionary economic environment, bankruptcies of record retailers and wholesalers, growing competition for consumer discretionary spending and retail shelf space, and the maturation of the CD format, which has slowed the historical growth pattern of recorded music sales. Since that time, annual dollar sales of physical music product in the U.S. are estimated to have declined at a CAGR of 4%, although there was a 2.5% year-over-year increase recorded in 2004 (through November 20, 2005 U.S. recorded music sales (excluding sales of digital tracks) are down approximately 7.6% year-over-year, however). Similar declines have occurred in international markets, with the extent of declines driven primarily by differing penetration levels of piracy-enabling technologies, such as broadband Internet access and CD-R technology, and economic conditions.

Notwithstanding these factors, we believe that the music industry could improve based on the recent mobilization of the industry as a whole against piracy and the development of legitimate online music distribution channels. In addition, continued recovery of the world economy and improved consumer expenditures can drive growth in the recorded music industry.

Piracy

One of the industry's biggest challenges is combating piracy. Music piracy exists in two primary forms: digital (which includes illegal downloading and CD-R piracy) and industrial:

- *Digital piracy* has grown dramatically in the last five years, enabled by the increasing penetration of broadband Internet access and the ubiquity of powerful microprocessors, fast optical drives (particularly with writable media, such as CD-R) and large inexpensive disk storage in personal computers. The combination of these technologies has allowed consumers to easily, flawlessly and almost instantaneously make high-quality copies of music using a home computer by "ripping" or converting musical content from CDs into digital files, stored on local disks. These digital files can then be distributed for free over the Internet through anonymous peer-to-peer file sharing networks such as

Limewire, WinMX and KaZaA ("illegal downloading"). Alternatively, these files can be burned onto multiple CDs for physical distribution ("CD-R piracy").

- *Industrial piracy* (also called counterfeiting or physical piracy) involves mass-production of illegal CDs and cassettes in factories. This form of piracy is largely concentrated in developing regions, and has existed for more than a decade. The sale of legitimate recorded music in these developing territories is limited by the dominance of pirated products, which are sold at substantially lower prices than legitimate products. IFPI states that industrial pirated physical music products totaled 1.5 billion units in 2004. IFPI also believes that industrial piracy is most prevalent in Brazil, China, India, Indonesia, Mexico, Pakistan, Paraguay, Russia, Spain and Ukraine.

In 2003, the industry launched an intensive campaign to limit piracy that focused on four key initiatives:

- *Technological:* The technological measures against piracy are geared towards degrading the illegal file-sharing process and tracking providers and consumers of pirated music. These measures include spoofing, watermarking, copy protection, the use of automated webcrawlers and access restrictions. In addition, the industry continues to experiment with new technologies such as DualDisc and DVD-Audio that contain more robust encryption protection.
- *Educational:* Led by RIAA and IFPI, the industry has launched an aggressive campaign of consumer education designed to spread awareness of the illegality of various forms of piracy through aggressive print and television advertisements. Recent surveys confirm the increased consumer awareness of the illegality of piracy. In January 2003, 33% of Americans 10 years of age and older were aware that it is illegal to download copyrighted music for free. By August 2003, that number had risen to 61% and during the latter part of 2004, awareness among Americans 13 years of age and older was measured at 68%.
- *Legal:* In conjunction with its educational efforts, the industry has also begun to take aggressive legal action against file-sharers and is continuing to fight industrial pirates. These actions include civil lawsuits in the U.S. and Europe against individual pirates, arrests of pirates in Japan and raids against file-sharing services in Australia. U.S. lawsuits have largely targeted individuals who share large quantities of illegal music content. RIAA has announced its plans to continue these lawsuits in the U.S. IFPI has brought similar actions in Argentina, Austria, Canada, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Hong Kong, Netherlands, Singapore, Sweden, Switzerland and the U.K. and it may pursue similar actions in other countries. A number of recent court decisions, including the U.S. Supreme Court decision in Grokster and the Federal Court of Australia's ruling in a case involving KaZaA, have also held that one who distributes a device, such as P2P software, with the object of promoting its use to infringe copyright can be liable for the resulting acts of infringement by third parties using the device regardless of the of the lawful uses of the device.
- *Development of online and mobile alternatives:* We believe that the development and success of legitimate online music channels will be an important driver of recorded music sales going forward, as digital sales represent both an incremental revenue stream and a potential inhibitor of piracy. The music industry has been encouraged by the recent proliferation and early success of legitimate online music distribution options. We believe that these legitimate online distribution channels offer several advantages to illegal peer-to-peer sites, including greater ease of use, higher quality and more consistent music product, faster downloading, better search capabilities, and seamless integration with portable digital music players. For example, legitimate online operations such as Apple's iTunes, MusicNet, musicmatch and Rhapsody have been launched since the beginning of 2003 and offer a variety of models, including per-track pricing, per-album pricing and monthly subscriptions. Already, there are more than 300 legal online music sites providing alternatives to illegal file-sharing in markets around the world.

These efforts are incremental to the longstanding push by organizations such as IFPI to curb industrial piracy around the world. In addition to these actions, the music industry is increasingly coordinating with other similarly impacted industries (such as software and filmed entertainment) to combat piracy.

We believe these actions are beginning to have a positive effect. A survey as of May 2005 conducted by The NPD Group, a market research firm, shows that about one-third of Americans aged 13 or older who had ever downloaded music from a file-sharing service stopped using such file-sharing services over the past year, and an additional 27% reduced their downloading activity.

Music Publishing

Background

Music publishing involves the acquisition of rights to, and licensing of, musical compositions (as opposed to recordings) from songwriters, composers or other rightsholders. Music publishing revenues are derived from four main royalty sources: Mechanical, Performance, Synchronization and Other.

In the U.S., mechanical royalties are collected directly by music publishers from recorded music companies or via The Harry Fox Agency, a non-exclusive licensing agent affiliated with NMPA, while outside the U.S., performing rights organizations and collection societies perform this function. Once mechanical royalties reach the publisher (either directly from record companies or from collection societies), percentages of those royalties are paid to any co-owners of the copyright in the composition and to the writer(s) and composer(s) of the composition. Mechanical royalties are paid at a penny rate of 8.5 cents per song per unit in the U.S. (although recording agreements sometimes contain "controlled composition" provisions pursuant to which artist/songwriters license their rights to their record companies at as little as 75% of this rate) and as a percentage of wholesale price in most other territories. In the U.S., these rates are set pursuant to industry negotiations contemplated by the U.S. Copyright Act and are currently increased at two-year intervals. For example, on January 1, 2004, this rate went from 8 cents per song to 8.5 cents per song. On January 1, 2006, this rate will increase again to 9.1 cents per song. Recordings in excess of 5 minutes attract a higher rate. In international markets, these rates are determined by multi-year collective bargaining agreements.

Throughout the world, performance royalties are typically collected on behalf of publishers and songwriters by performance rights organizations and collection societies. Key performing rights organizations and collection societies include: The American Society of Composers, Authors and Publishers ("ASCAP"), SESAC and Broadcast Music, Inc. ("BMI") in the U.S.; Mechanical-Copyright Protection Society and The Performing Right Society ("MCPS-PRS Alliance") in the U.K.; The German Copyright Society ("GEMA") in Germany and the Japanese Society for Rights of Authors, Composers and Publishers ("JASRAC") in Japan. The societies pay a percentage (which is set in each country) of the performance royalties to the copyright owner(s) or administrators (*i.e.*, the publisher(s)), and a percentage directly to the songwriter(s), of the composition. Thus, the publisher generally retains the performance royalties it receives other than any amounts attributable to co-publishers.

The worldwide music publishing market was estimated to have generated approximately $3.6 billion in revenues in 2004 according to figures contained in the March 2, 2005 issue of *Music & Copyright*. We estimate that mechanical royalties are approximately 30% of 2002 industry revenues; performance royalties, 33%; synchronization, 13%; and other, 23%. Geographically, North America is the largest market representing approximately 40% of the global publishing market.

The top five music publishers collectively account for over 65% of the market. Based on *Music & Copyright's* estimates, EMI Music Publishing ("EMI Publishing") and WMG (Warner/Chappell) are the market leaders in music publishing, holding 16.3% and 16.0% shares of the market in 2004, respectively. They are followed by BMG at 13.8%, Universal at 12.5% and Sony/ATV Music Publishing LLC ("Sony/ATV") at 7.4%. Independent music publishers represent the balance of the market, as well as many individual songwriters who publish their own works.

The music publishing market has proven to be more resilient than the recorded music market in recent years as performance, synchronization and other revenue streams are largely unaffected by piracy, and are benefiting

from additional sources of income from digital exploitation of music in downloads and mobile phone ringtones. Trends in music publishing vary by royalty source:

- *Mechanical:* Although the decline in the recorded music market has begun to have an impact on mechanical royalties, this decline has been partly offset by the regular and predictable statutory increases in the mechanical royalty rate in the U.S. (including an increase from 8 cents to 8.5 cents per song in January 2004, and a further increase from 8.5 cents to 9.1 cents per song to occur in January 2006), the increasing efficiency of local collection societies worldwide and the growth of new revenue sources such as mobile phone ringtones and legitimate Internet and wireless downloads.
- *Performance:* According to an April 2004 report from Enders Analysis, performance royalties experienced steady growth from 1999 to 2001. Continued growth is expected, largely driven by television, live performance and online radio streaming and advertising royalties.
- *Synchronization:* We believe synchronization revenues have experienced strong growth in recent years and will continue to do so, benefiting from the proliferation of media channels, a recovery in advertising, robust videogames sales and growing DVD film sales/rentals.
- *Other:* According to Enders Analysis, print revenues grew steadily from 1999 to 2001. Continued growth in this category is expected as well, as more people can afford musical instruments and lessons and online sheet music sales drive incremental revenues.

In addition, major publishers have the opportunity to generate significant value by the acquisition of small publishers by extracting cost savings (as acquired libraries can be administered with little or no incremental cost) and by increasing revenues through more aggressive marketing efforts.

WHERE YOU CAN FIND MORE INFORMATION

We are required to file annual, quarterly and current reports, proxy statements and other information with the SEC. These filings are not deemed to be incorporated by reference in this report. You may read and copy any documents filed by us at the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our filings with the SEC are also available to the public through the SEC's website at *http://www.sec.gov*. Our common stock is listed on the NYSE under the symbol "WMG". You can inspect and copy reports, proxy statements and other information about us at the NYSE's offices at 20 Broad Street, New York, New York 10005. We also maintain an Internet site at *www.wmg.com*. We make available on our Internet website free of charge our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K as soon as practicable after we electronically file such reports with the SEC. In addition, copies of our (i) Corporate Governance Guidelines, (ii) charters for the Audit Committee, Compensation Committee and Executive, Nominating and Corporate Governance Committee and (iii) Code of Conduct which is applicable for all or our employees including our principal executive, financial and accounting officers, are available at our Internet site under "Investor Relations—Corporate Governance." Copies will be provided to any stockholder upon written request to Investor Relations, 75 Rockefeller Plaza, New York, New York 10019, via electronic mail at *Investor.Relations@wmg.com* or by contacting Investor Relations at (212) 275-2000. Our website and the information posted on it or connected to it shall not be deemed to be incorporated by reference into this report.

ITEM 1A. EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth information as to our executive officers as of November 4, 2005, together with their positions and ages.

Name	Age	Position
Edgar Bronfman, Jr.	50	Chairman of the Board and CEO
Lyor Cohen	46	Chairman and CEO, U.S. Recorded Music
Paul-René Albertini	46	Chairman and CEO, Warner Music International
Richard Blackstone	45	Chairman and CEO, Warner/Chappell Music, Inc.
Michael D. Fleisher	40	Executive Vice President and Chief Finaricial Officer
David H. Johnson	58	Executive Vice President and General Counsel
Caroline Stockdale	42	Executive Vice President, Global Human Resources
Alejandro Zubillaga	37	Executive Vice President, Digital Strategy and Business Development

Our executive officers are appointed by, and serve at the discretion of, the Board of Directors. Each executive officer is an employee of Warner Music Group or one of its subsidiaries. Mr. Zubillaga is the brother-in-law of Mr. Bronfman. There are no other family relationships among any executive officers of Warner Music Group. The following information provides a brief description of the business experience of each of our executive officers.

Edgar Bronfman, Jr. has served as our Chairman of the Board and CEO since March 1, 2004. Before joining Warner Music Group, Mr. Bronfman served as Chairman and CEO of Lexa Partners LLC, a management venture capital group based in New York City. Prior to Lexa Partners, Mr. Bronfman was appointed Executive Vice Chairman of Vivendi Universal in December 2000. He resigned from his position as an officer and executive of Vivendi Universal on March 31, 2002, and resigned as Vice Chairman of Vivendi Universal's Board of Directors on December 2, 2003. Prior to the December 2000 formation of Vivendi Universal, Mr. Bronfman was President and CEO of The Seagram Company Ltd., a post he held since June 1994. During his tenure as the CEO of Seagram, he consummated $85 billion in transactions and transformed the company into one of the world's leading media and communications companies. From 1989 until June 1994, Mr. Bronfman served as President and COO of Seagram. Between 1982 and 1989, he held a series of senior executive positions for The Seagram Company Ltd. in the U.S. and in Europe.

Lyor Cohen has served as the Chairman and CEO of our U.S. Recorded Music operations since March 1, 2004. From 2002 to 2004, Mr. Cohen was the Chairman and CEO of Universal Music Group's Island Def Jam Music Group. Mr. Cohen served as President of Def Jam from 1988 to 2002. Previously, Mr. Cohen served in various capacities at Rush Management, a hip-hop management company, which he founded with partner Russell Simmons. Mr. Cohen is widely credited with expanding Island Def Jam beyond its hip-hop roots to include a wider range of musical genres.

Paul-René Albertini has served as President of Warner Music International since 2002 and currently leads Warner Music International, our international division, as Chairman and CEO. From December 2000 until 2002, Mr. Albertini served as President of Warner Music Europe. He joined Warner Music International from Sony Music Entertainment Europe where he held the post of Executive Vice President from 1999. Prior to that he served as President and CEO Sony Music France between 1994 and 1999. In 1991 he became CEO of PolyGram Disques France. In 1983, Mr. Albertini joined PolyGram as International Label Manager before becoming Marketing Director for Barclay Records. He was named Director of Marketing and Promotion for Phonogram in 1989, and was appointed Managing Director Phonogram France. Mr. Albetini graduated from the Institut Superieur de Gestion in Paris in 1982 and attended the International Senior Management Program from Harvard Business School in 1993.

Richard Blackstone has served as Chairman and CEO of Warner/Chappell Music, Inc. since May 28, 2005. Prior to joining Warner Music Group, Mr. Blackstone was the president of Zomba Music Publishing. Mr. Blackstone joined

Zomba in 1989 as Director of Business Affairs, and was later promoted to the dual role of Head of Creative and Head of Business Affairs. Following the purchase of Zomba by BMG Music in 2002 he was named President of Zomba Music Publishing, and was given oversight responsibility for Brentwood Benson Music Publishing.

Michael D. Fleisher has served as our Executive Vice President and Chief Financial Officer since January 1, 2005. Prior to joining Warner Music Group, Mr. Fleisher was Chairman and Chief Executive Officer of Gartner, Inc. Mr. Fleisher joined Gartner in 1993 and served in several roles including Chief Financial Officer prior to being named CEO in 1999. Previous to Gartner, he was at Bain Capital. Mr. Fleisher serves on the Board of Ameritrade.

David H. Johnson has served as Executive Vice President and General Counsel since 1999. Prior to joining Warner Music Inc., Mr. Johnson spent nine years as Senior Vice President and General Counsel for Sony Music Entertainment. He also held several posts at CBS and was an associate in the law firm Mayer, Nussbaum, Katz & Baker. Mr. Johnson received a B.A. in political science from Yale University, a J.D. from the University of Pennsylvania Law School and an L.L.M. from New York University School of Law.

Caroline Stockdale has served as Executive Vice President, Global Human Resources since August 2005. Prior to joining Warner Music Group, Ms. Stockdale was Senior Vice President, Relationship Leader Human Resources, at American Express Financial Advisors/Global Financial Services since 2002. Before joining American Express Financial Advisors in 2002, Ms. Stockdale held a variety of human resources leadership positions at General Electric (GE) Capital Corporation in Europe and the United States beginning in 1997, including Executive Vice President and Global Human Resources Leader at GE Capital Corporation's Aviation Services division. Ms. Stockdale qualified as a chartered accountant and graduated with a B.A. Honors degree from the University of Sheffield in Sheffield, England.

Alejandro (Alex) Zubillaga has served as Executive Vice President, Digital Strategy and Business Development since August 2005. Prior to being designated as Executive Vice President, Digital Strategy and Business Development, Mr. Zubillaga held various positions with Warner Music Group since joining the company in March 2004, including Senior Vice President, Digital Strategy and Business Development and Vice President, Office of the Chairman. Prior to joining Warner Music Group, Mr. Zubillaga served as managing director and co-founder of Lexa Partners LLC. Previously, Mr. Zubillaga was founder and managing partner of E-Quest Partners. Prior to that, Mr. Zubillaga served as founder, chairman and chief executive officer of NETUNO. Mr. Zubillaga graduated from Babson College with a degree in Business Administration.

ITEM 2. PROPERTIES

We own distribution, studio and office facilities and also lease certain facilities in the ordinary course of business. Our executive offices are located at 75 Rockefeller Plaza, New York, NY 10019. In addition, we have a ten-year lease ending on July 31, 2014 for our headquarters at 75 Rockefeller Plaza, New York, New York 10019. We also have a seventeen-year lease ending on December 31, 2020, for office space in a building located at 3400 West Olive Avenue, Burbank, California 91505, used primarily by our Recorded Music business, and an approximately sixteen year lease ending on June 30, 2012 for office space at 1290 Avenue of the Americas, New York, New York 10104, used primarily by our Recorded Music business. We consider our properties adequate for our current needs.

ITEM 3. LEGAL PROCEEDINGS

On September 7, 2004, November 22, 2004 and March 31, 2005, Eliot Spitzer, the Attorney General of the State of New York, served us with requests for information in the form of subpoenas duces tecum in connection with an industry-wide investigation of the relationship between music companies and radio stations, including the use of independent promoters and accounting for any such payments. The investigation was pursuant to New York Executive Law §63(12) and New York General Business Law §349, both of which are consumer fraud statutes. On November 22, 2005 we reached a settlement with the Attorney General in connection with this

investigation. As part of such settlement, we agreed to make $5 million in charitable payments and to abide by a list of permissible and impermissible promotional activities. On July 25, 2005, Sony BMG reached a settlement with the Attorney General in connection with the same industry-wide investigation. Subsequent to the settlement by Sony BMG, TSR Records, an independent label, filed an antitrust suit against Sony BMG alleging that the label's radio promotion activities are anticompetitive. While it is too soon to predict the outcome of these recent developments on us, any litigation we may become involved in as a result of our settlement with the Attorney General, regardless of the merits of the claim, could be costly and would divert the time and resources of management.

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

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

No matter was submitted to a vote of security holders of Warner Music Group Corp. during the fourth quarter of 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Warner Music Group Corp.'s common stock was listed on the New York Stock Exchange under the symbol "WMG" on May 10, 2005. Prior to that time, there was no public market for our common stock. The following table presents the high and low closing prices for the common stock on the New York Stock Exchange during the periods indicated and the dividends declared during such periods:

	High	Low	Dividends Paid
2005:			
Third Quarter (commencing May 10, 2005)	$16.95	$15.23	—
Fourth Quarter	$18.71	$14.75	—
2006:			
First Quarter (ending November 25, 2005)	$18.95	$15.25	$0.13

As of November 25, 2005 there were approximately 35 registered holders of record for the common stock and 148,460,622.724 shares outstanding. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders. The closing price of the common stock on the New York Stock Exchange on November 25, 2005, was 18.05.

Dividend Policy

On October 3, 2005 the Board of Directors of Warner Music Group declared a quarterly dividend of $0.13 per share of common stock, representing an aggregate quarterly dividend of approximately $19.3 million (based on outstanding shares of 148,455,312.724 as of September 30, 2005). The dividend was paid November 23, 2005, to stockholders of record as of the close of business on October 24, 2005. The portion of the dividend with respect to unvested restricted stock of approximately $1 million will be paid at such time as such shares become vested.

As previously announced, we intend to continue paying quarterly dividends on our common stock outstanding in an amount not to exceed $80 million per year in the aggregate. The Board will evaluate whether to pay a dividend on a quarterly basis and will base its decisions on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions and other factors the Board of Directors may deem relevant.

The amounts available to us to pay further cash dividends will be restricted by our subsidiary WMG Acquisition Corp.'s senior secured credit agreement and the indentures governing our outstanding notes, including the indenture governing WMG Holdings Corp.'s outstanding 9.5% Senior Discount Notes due 2014 and the indenture governing WMG Acquisition Corp.'s 7⅜% Senior Subordinated Dollar Notes due 2014 and 8⅛% Senior Subordinated Sterling Notes due 2014. Under Acquisition Corp.'s senior secured credit agreement, generally neither Holdings nor Holdings' subsidiaries may pay dividends or otherwise transfer their assets to us. However, Acquisition Corp.'s senior secured credit agreement permits such restricted payments in an amount not to exceed $10.0 million, subject to increase up to $50.0 million if the leverage ratio is less than 3.5 to 1, and subject to additional increase in an amount equal to 50% of excess cash flow that is not otherwise applied pursuant to Acquisition Corp.'s senior secured credit agreement and allows distributions not in excess of $90 million in any fiscal year to be applied to pay regular quarterly cash dividends to holders of our common stock. The indentures governing the Holdings Notes and the Acquisition Corp. Notes also limit the ability of Holdings, Acquisition Corp. and their subsidiaries to pay dividends to us. Under such indentures, generally our subsidiaries may pay dividends or make other restricted payments depending on a formula based on 50% of consolidated net income. In addition, Acquisition Corp. may also make such restricted payments if, on a pro forma basis after giving effect to any such payment, it has a net indebtedness to adjusted EBITDA ratio of no greater than 3.75 to 1.0 and a net senior indebtedness to adjusted EBITDA ratio of no greater than 2.5 to 1.0, and Holdings may make such restricted payments if, on a pro forma basis after giving effect to any such payment, it has a net indebtedness to adjusted EBITDA ratio of no greater than 4.25 to 1.0. Acquisition Corp. and Holdings may also make restricted payments under the indentures of up to $45.0 million and $75.0 million, respectively, without regard to any such provisions. The Holdings indenture permits Holdings to dividend up to 6% per annum from proceeds of our initial public offering received by Holdings. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition and Liquidity—Liquidity."

Use of Proceeds from Sales of Registered Securities

On May 10, 2005, we registered 37,490,000 shares of our common stock for an aggregate offering price of $897,760,000 in our initial public offering. On May 13, 2005 we closed the sale by us of a total of 32,600,000 shares of our common stock in our initial common stock offering at a price of $17.00 per share in a firm commitment underwritten initial public offering. This offering was effected pursuant to a Registration Statement on Form S-1 (File No. 333-123249), which the Securities and Exchange Commission declared effective on May 10, 2005. Goldman, Sachs & Co. and Morgan Stanley & Co. Inc. were the joint global coordinators and, together with Lehman Brothers Inc. and Deutsche Bank Securities Inc., served as joint book-running managers in the offering. Banc of America Securities LLC and Citigroup Global Markets Inc. acted as joint lead managers in the offering. Of the $554.2 million of gross proceeds raised in the offering:

- approximately $26.3 million was paid to the underwriters in connection with the underwriting discount;
- approximately $10.9 million was used in connection with offering expenses, printing fees, listing fees, filing fees, accounting fees and legal fees; and
- approximately $517 million was used in connection with the redemption of 100% of WMG Holdings Corp.'s Floating Rate Senior Notes due 2011 and Floating Rate Senior PIK Notes due 2014 and 35% of the aggregate principal amount of its outstanding 9.5% Senior Discount Notes due 2014 on June 15, 2005.

Equity Compensation Plan Information

The following table provides information as of September 30, 2005 with respect to shares of our common stock that may be issued under our existing equity compensation plans.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in first column)
Equity Compensation Plans ..... Approved by Stockholders (1)	6,383,629	$6.90	2,089,420

(1) Consists of the 2005 Omnibus Stock Plan, as well as individual LTIP and individual stock option agreements.

LTIP and Individual Stock Option Agreements

In 2004, the Company's board of directors approved a form of LTIP stock option agreement for grants of options to eligible individuals. Eligible individuals include any employee, director or consultant of the Company or any of its affiliates, or any other entity designated by Warner Music Group's board of directors in which the Company has an interest, who is selected by the Company's compensation committee to receive an award. The board authorized the granting of options to purchase up to 1,355,066 shares of our common stock pursuant to the LTIP program. The Company has granted options and may grant additional stock options under the LTIP stock option agreements to certain members of our current or future management. The board also approved the granting of options to purchase 3,701,850 shares of our common stock under stock option agreements with certain members of our management. Individual option agreements and options granted under the LTIP program generally will have a 10-year term and the exercise price will equal at least 100% of the fair market value on the date of the grant. With respect to each option granted pursuant to individual option agreements or a LTIP stock option agreement, one-third of the shares covered by the option generally vest and become exercisable in four equal installments on the day prior to each of first through fourth anniversaries of the effective date of the LTIP stock option agreement, subject to the employee's continued employment. Two-thirds of the shares covered by the option generally vest and become exercisable based on the occurrence of both a service condition (which is the same as the service condition described with respect to the service-based portion of the option) and a performance condition. The performance condition is met if, following an initial public offering or certain other events (including a change in control), a specified investment return is achieved by the investors (one-half of such shares require one return level and the other one-half of such shares require a different return level). The performance-based portion of the option also vests, subject to the employee's continued employment, on the day prior to the seventh anniversary of the effective date of the individual or LTIP stock option agreement and the service condition applicable to the performance-based option will be deemed to have been attained upon certain terminations following or in anticipation of a change in control.

2005 Omnibus Stock Plan

In May 2005, we adopted the 2005 Omnibus Stock Plan, or 2005 Plan, which authorized the granting of stock based awards to purchase up to 3,416,133 shares of our common stock. Under the 2005 Plan, our board of directors or the compensation committee will administer the plan and has the power to make awards, to determine when and to whom awards will be granted, the form of each award, the amount of each award, and any other terms or conditions of each award consistent with the terms of the 2005 Plan. Awards may be made to employees, directors and others as set forth in the 2005 Plan. The types of awards that may be granted include restricted and unrestricted stock, incentive and non-statutory stock options, stock appreciation rights, performance units and other stock based awards. Each award agreement specifies the number and type of award, together with any other terms and conditions as determined by the board of directors or the compensation committee in their sole discretion. Eligible employees include any employee who does not already have any other equity participation in our company. The Company has granted options and may grant additional awards under the 2005 Plan to certain member of our current or future management. Options granted generally have a 10-year term, the exercise price will equal at least 100% of the fair market value on the date of the grant and generally vest in four equal installments on the day prior to each of first through fourth anniversaries of the effective date of the stock option agreement, subject to the employee's continued employment.

ITEM 6. SELECTED FINANCIAL DATA

Our summary balance sheet data as of September 30, 2005 and 2004, and the statement of operations and other data for each of (i) the twelve-month fiscal year ended September 30, 2005; (ii) the seven months ended September 30, 2004, (iii) the three months ended February 29, 2004, and (iv) the twelve-month fiscal year ended November 30, 2003 have been derived from our audited financial statements included or incorporated by reference herein. Our summary statement of operations and other data for each of the ten months ended September 30, 2003 and the five months ended February 29, 2004 have been derived from our unaudited financial statements included or incorporated by reference herein. Our summary balance sheet data as of (i) February 29, 2004 (ii) November 30, 2003 and (iii) November 30, 2002 and the statement of operations and other data for the year ended November 30, 2002 are derived from our audited financial statements that are not included in this annual report. Our summary balance sheet data as of (i) September 30, 2003 and (ii) November 30, 2001 and the statement of operations and other data for the year ended November 30, 2001 are derived from our unaudited financial statements that are not included in this annual report.

The comparability of our historical financial data has been affected by a number of significant events and transactions. These include the acquisition of substantially all of our recorded music and music publishing businesses from Time Warner effective March 1, 2004 for approximately $2.6 billion (the "Acquisition") in 2004, a change in our fiscal year to September 30 from November 30, which was enacted in 2004, and the AOL Time Warner Merger in 2001. For all periods prior to the Acquisition, the recorded music and music publishing businesses formerly owned by Time Warner are referred to as "Old WMG" or the "Predecessor." For all periods subsequent to the Acquisition, the business is referred to as the "Company" or the "Successor." Due to the change in our year-end, financial information for 2004 reflects a shortened ten-month period ended September 30, 2004 and is separated into two pre-acquisition and post-acquisition periods as a result of the change in accounting basis that occurred relating to the Acquisition.

In connection with the Acquisition, a new accounting basis was established for the Company as of the acquisition date based upon an allocation of the purchase price to the underlying net assets acquired. As such, financial information for the twelve months ended September 30, 2004 is separated into pre-acquisition and post-acquisition periods as a result of the change in accounting basis that occurred relating to the Acquisition. That is for the twelve-month period ended September 30, 2004, we have presented our operating results and cash flows separately for the pre-acquisition five-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004. The financial information for the ten months ended September 30, 2004 is separated into the pre-acquisition three-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004.

The split presentation mentioned above is required under GAAP in situations when a change in accounting basis occurs. This is because the new accounting basis requires that the historical carrying value of assets acquired and liabilities assumed be adjusted to fair value, which may yield results that are not strictly comparable on a period-to-period basis due to the different, and sometimes higher, cost basis associated with the allocation of the purchase price.

We believe that this split presentation may impede the ability of users of our financial information to understand our operating and cash flow performance. Consequently, in order to enhance an analysis of our operating results and cash flows, we have presented our operating results and cash flows on a combined basis for the full ten-month period and twelve-month period ended September 30, 2004. The combined presentation for the twelve-month period ended September 30, 2004 simply represents the mathematical addition of the pre-acquisition, five-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004 and the combined presentation for the ten-month period ended September 30, 2004 represents the mathematical addition of the pre-acquisition three-month period ended February 29, 2004 and the post-acquisition seven-month period ended September 30, 2004. These are not intended to represent what our operating results would have been had the Acquisition occurred at the beginning of the period.

The following table sets forth our selected historical financial and other data as of the dates and for the periods indicated.

	Fiscal Years Ended November 30,			Ten Months Ended Sept. 30,	Three Months Ended Feb. 29,	Five Months Ended Feb. 29,	Seven Months Ended Sept. 30,	Ten Months Ended Sept. 30	Twelve Months Ended Sept. 30	Twelve Months Ended Sept. 30,
	2001	2002	2003	2003	2004	2004	2004	2004	2004	2005
	Predecessor						Successor	Combined		Successor
	(unaudited)	(audited)	(audited)	(unaudited)	(audited)	(unaudited)	(audited)	(unaudited)	(unaudited)	(audited)
	(in millions, except per share data)									
Statement of Operations Data:										
Revenues	$ 3,226	$ 3,290	$ 3,376	$ 2,487	$ 779	$ 1,668	$ 1,769	$ 2,548	$ 3,437	$ 3,502
Cost of revenues	(1,731)	(1,873)	(1,940)	(1,449)	(415)	(906)	(944)	(1,359)	(1,850)	(1,850)
Selling, general and administrative expenses	(1,402)	(1,282)	(1,286)	(995)	(319)	(610)	(677)	(996)	(1,287)	(1,301)
Impairment of goodwill and other intangible assets	—	(1,500)	(1,019)	—	—	(1,019)	—	(1,019)	—	—
Depreciation and amortization	(868)	(249)	(328)	(272)	(72)	(128)	(140)	(212)	(268)	(238)
Operating (loss) income	(766)	(1,542)	(1,158)	(197)	(11)	(972)	18	7	(954)	84
Interest expense, net	(34)	(23)	(5)	(5)	(2)	(2)	(80)	(82)	(82)	(182)
(Loss) income before cumulative effect of accounting change	(910)	(1,230)	(1,353)	(201)	(32)	(1,184)	(238)	(270)	(1,422)	(169)
Net (loss) income	$ (910)	$(6,026)	$(1,353)	$ (201)	$ (32)	$(1,184)	$ (238)	$ (270)	$(1,422)	$ (169)
Net income (loss) per common share (1):										
Basic	—	—	—	—	—	—	$ (2.21)	—	—	$ (1.40)
Diluted	—	—	—	—	—	—	$ (2.21)	—	—	$ (1.40)
Average common share (1):										
Basic	—	—	—	—	—	—	107.5	—	—	120.9
Diluted	—	—	—	—	—	—	107.5	—	—	120.9
Segment Data:										
Revenues:										
Recorded Music	$ 2,701	$ 2,752	$ 2,839	$ 2,039	$ 630	$ 1,430	$ 1,429	$ 2,059	$ 2,859	$ 2,924
Music Publishing	547	563	563	467	157	253	348	505	601	607
Corporate and eliminations	(22)	(25)	(26)	(19)	(8)	(15)	(8)	(16)	(23)	(29)
Total revenues	$ 3,226	$ 3,290	$ 3,376	$ 2,487	$ 779	$ 1,668	$ 1,769	$ 2,548	$ 3,437	$ 3,502
Operating income (loss):										
Recorded Music	$ (733)	$(1,206)	$(1,130)	$ (181)	$ (9)	$ (958)	$ 24	$ 15	$ (934)	$ 215
Music Publishing	23	(273)	23	19	17	21	53	70	74	82
Corporate and eliminations	(56)	(63)	(51)	(35)	(19)	(35)	(59)	(78)	(94)	(213)
Total operating income (loss)	$ (766)	$(1,542)	$(1,158)	$ (197)	(11)	$ (972)	$ 18	$ 7	$ (954)	$ 84
OIBDA (2):										
Recorded Music	$ 73	$ 173	$ 116	$ 8	$ 38	$ 146	$ 120	$ 158	$ 266	$ 380
Music Publishing	81	88	107	88	38	57	87	125	145	141
Corporate and eliminations	(52)	(54)	(34)	(21)	(15)	(28)	(49)	(64)	(77)	(199)
Total OIBDA (2)	$ 102	$ 207	$ 189	$ 75	$ 61	$ 175	$ 158	$ 219	$ 333	$ 322
Cash Flow Data:										
Cash flows provided by (used in):										
Operating activities	$ (122)	$ (13)	$ 278	$ 257	$ 321	$ 352	$ 86	$ 407	$ 438	$ 205
Investing activities	(175)	(365)	(65)	(73)	14	17	(2,663)	(2,649)	(2,646)	(54)
Financing activities	227	385	(121)	(151)	(10)	18	2,661	2,651	2,679	(416)
Capital expenditures	(91)	(88)	(51)	(30)	(3)	(24)	(15)	(18)	(39)	(30)

	Fiscal Years Ended November 30,			Ten Months Ended Sept. 30, 2003	Three Months Ended Feb. 29, 2004	Five Months Ended Feb. 29, 2004	Seven Months Ended Sept. 30, 2004	Ten Months Ended Sept. 30 2004	Twelve Months Ended Sept. 30 2004	Twelve Months Ended Sept. 30, 2005
	2001	2002	2003							
	Predecessor						Successor	Combined		Successor
	(unaudited)	(audited)	(audited)	(unaudited)	(audited)	(unaudited)	(audited)	(unaudited)	(unaudited)	(audited)
	(in millions, except per share data)									
Balance Sheet Data (at period end):										
Cash and equivalents	$ 34	$ 41	$ 144	$ 80	$ 471	$ 471	$ 555	$ 555	$ 555	$ 288
Total assets	17,642	5,679	4,484	5,255	4,560	4,560	5,090	5,090	5,090	4,498
Total debt (including current portion of long-term debt)	115	101	120	115	132	132	1,840	1,840	1,840	2,246
Shareholders' equity	14,588	3,001	1,587	2,673	1,691	1,691	280	280	280	89

(1) Net income (loss) per share is calculated by dividing net income (loss) by the weighted average common shares outstanding.

(2) We evaluate segment and consolidated performance based on several factors, of which the primary measure is operating income (loss) before non-cash depreciation of tangible assets, non-cash amortization of intangible assets and non-cash impairment charges to reduce the carrying value of goodwill and intangible assets (which we refer to as "OIBDA"). See "Use of OIBDA" under "Management's Discussion and Analysis of Financial Condition and Results of Operations". Note that OIBDA is different from Adjusted EBITDA as defined in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition and Liquidity—Covenant Compliance", which is presented on a consolidated and combined basis therein as a covenant compliance measure. The following is a reconciliation of operating income, which is a GAAP measure of our operating results, to OIBDA.

Operating income (loss)	$ (766)	$(1,542)	$(1,158)	$ (197)	$ (11)	$ (972)	$ 18	$ 7	$ (954)	$ 84
Depreciation and amortization expense	868	249	328	272	72	128	140	212	268	238
Impairment of goodwill and other intangible assets	—	1,500	1,019	—	—	1,019	—	—	1,019	—
OIBDA	$ 102	$ 207	$ 189	$ 75	$ 61	$ 175	$ 158	$ 219	$ 333	$ 322

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our results of operations and financial condition includes periods prior to the consummation of our acquisition of substantially all of Time Warner Inc.'s recorded music and music publishing businesses and related financing (the "Transactions"). Accordingly, the discussion and analysis of operating results for the ten months and twelve months ended September 30, 2004 do not reflect the full impact that the Transactions have had on us, including significantly increased financing costs. You should read the following discussion of our results of operations and financial condition with the audited financial statements included elsewhere in this Annual Report on Form 10-K for the fiscal year ended September 30, 2005 (the "Annual Report").

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

This Annual Report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical facts included in this Annual Report, including, without limitation, statements regarding our future financial position, business strategy, budgets, projected costs, savings and plans and objectives of management for future operations, are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expect," "intend," "estimate," "anticipate," "believe" or "continue" or the negative thereof or variations thereon or similar terminology. Such statements include, among others, statements regarding our ability to develop talent and attract future talent, to reduce future capital expenditures, to monetize our music content, including through new distribution channels and formats, to effectively deploy our capital, the development of digital music and the effect of digital distribution channels on our business, including whether or not the Internet will become an important sales channel and whether we will be able to achieve higher margins from digital sales, our success in limiting piracy, our ability to compete in the highly competitive markets in which we operate, the growth of the music industry and the effect of our and the music industry's efforts to combat piracy on the industry 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 Annual Report. Additionally important factors could cause our actual results to differ materially from the forward-looking statements we make in this Annual Report. As stated elsewhere in this Annual Report, such risks, uncertainties and other important factors include, among others:

- the impact of our substantial leverage on our ability to raise additional capital to fund our operations, on our ability to react to changes in the economy or our industry and on our ability to meet our obligations under our indebtedness;
- the continued decline in the global recorded music industry and the rate of overall decline in the music industry;
- our ability to continue to identify, sign and retain desirable talent at manageable costs;
- the threat posed to our business by piracy of music by means of home CD-R activity and Internet peer-to-peer file-sharing;
- the significant threat posed to our business and the music industry by organized industrial piracy;
- the impact of our restructuring plan on our business (including our ability to generate revenues and attract desirable talent);
- the popular demand for particular recording artists and/or songwriters and albums and the timely completion of albums by major recording artists and/or songwriters;

- the diversity and quality of our portfolio of songwriters;
- the diversity and quality of our album releases;
- significant fluctuations in our results of operations and cash flows due to the nature of our business;
- our involvement in intellectual property litigation;
- the possible downward pressure on our pricing and profit margins;
- the seasonal and cyclical nature of recorded music sales;
- our ability to continue to enforce our intellectual property rights in digital environments;
- the ability to develop a successful business model applicable to a digital environment;
- the ability to maintain product pricing in a competitive environment;
- the impact of heightened and intensive competition in the recorded music and music publishing businesses and our inability to execute our business strategy;
- risks associated with our non-U.S. operations, including limited legal protections of our intellectual property rights and restrictions on the repatriation of capital;
- the possible unexpected loss of artists and key employees and our market share as a result of our restructuring plan;
- the impact of legitimate music distribution on the Internet or the introduction of other new music distribution formats;
- the impact of rate regulations on our Music Publishing business;
- risks associated with the fluctuations in foreign currency exchange rates;
- our ability and the ability of our joint venture partners to operate our existing joint ventures satisfactorily;
- the enactment of legislation limiting the terms by which an individual can be bound under a "personal services" contract could impair our ability to retain the services of key artists;
- potential loss of catalog if it is determined that recording artists have a right to recapture recordings under the U.S. Copyright Act;
- changes in law and government regulations;
- legal or other developments related to pending litigation or the industry-wide investigation of the relationship between music companies and radio stations by the Attorney General of the State of New York;
- trends that affect the end uses of our musical compositions (which include uses in broadcast radio and television, film and advertising businesses);
- the growth of other products that compete for the disposable income of consumers;
- risks inherent in relying on one supplier for manufacturing, packaging and distribution services in North America and Europe;
- risks inherent in our acquiring or investing in other businesses;
- the possibility that our owners' interests will conflict with ours or yours;
- our ability to act as a stand-alone company;
- increased costs and diversion of resources associated with complying with the internal control reporting or other requirements of Sarbanes-Oxley;

- weaknesses in our internal controls related to U.S. royalties that could affect our ability to ensure reliable financial reports;
- the effects associated with the formation of Sony BMG Music Entertainment; and
- failure to attract and retain key personnel.

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

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

INTRODUCTION

Warner Music Group Corp. (the "Company" or "Parent") was formed by a private equity consortium of Investors (the "Investor Group") on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. ("Holdings"), which is the direct parent of WMG Acquisition Corp. ("New WMG" or "Acquisition Corp."). New WMG is the successor to substantially all of the interests of the recorded music and music publishing businesses of Time Warner Inc. ("Time Warner"). Such predecessor interests formerly owned by Time Warner are hereinafter referred to as "Old WMG" or the "Predecessor." Effective March 1, 2004, Acquisition Corp. acquired Old WMG from Time Warner for approximately $2.6 billion (the "Acquisition").

Warner Music Group Corp. is a holding company that conducts substantially all of its business operations through its subsidiaries. The Company's only asset is its ownership of all outstanding shares of Holdings, and Holdings' only asset is its ownership of all the outstanding shares of Acquisition Corp. The terms "we," "us," "our," "ours," and the "Company" refer collectively to Warner Music Group Corp. and its consolidated subsidiaries, except where otherwise indicated.

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

- *Overview.* This section provides a general description of our business, as well as recent developments that we believe are important in understanding our results of operations and financial condition and in anticipating future trends.
- *Results of operations.* This section provides an analysis of our results of operations for the twelve-month periods ended September 30, 2005 and 2004 and for the ten-month periods ended September 30, 2004 and 2003. 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 twelve-month periods ended September 30, 2005 and 2004, as well as a discussion of our financial condition and liquidity as of September 30, 2005. The discussion of our financial condition and liquidity includes (i) our available financial capacity under the revolving credit portion of our senior secured credit facility and (ii) a summary of our key debt compliance measures under our indenture agreements.

Use of OIBDA

We evaluate our operating performance based on several factors, including our primary financial measure of operating income (loss) before non-cash depreciation of tangible assets, non-cash amortization of intangible

assets and non- cash impairment charges to reduce the carrying value of goodwill and other intangible assets (which we refer to as "OIBDA"). We consider OIBDA to be an important indicator of the operational strengths and performance of our businesses, including the ability to provide cash flows to service debt. However, a limitation of the use of OIBDA as a performance measure is that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in generating revenues in our businesses. Accordingly, OIBDA should be considered in addition to, not as a substitute for, operating income (loss), net income (loss) and other measures of financial performance reported in accordance with U.S. GAAP.

Change in Fiscal Year and Basis of Presentation

In 2004, in connection with the Acquisition, the Company changed its fiscal year-end to September 30 from November 30. As such, we restated our prior quarters starting October 1, 2003, under the new fiscal year format, to enhance comparability between periods. Due to this change in fiscal year-end, our 2004 fiscal year consists of the ten-months ended September 30, 2004, while our 2005 fiscal year is the full twelve-month period ending September 30, 2005. Our discussion of the current twelve-month fiscal year ended September 30, 2005 is presented as the comparison of the twelve-month fiscal year ended September 30, 2005 to the twelve-month period ended September 30, 2004. The twelve months ended September 30, 2004 are unaudited and were derived from the audited fiscal year financial results for the ten months ended September 30, 2004 and the audited fiscal year financial results for the fiscal year ended November 30, 2003. Our discussion of the prior ten-month fiscal year is presented as the comparison of the ten months ended September 30, 2004 to the ten months ended September 30, 2003. The ten months ended September 30, 2003 are unaudited and were derived from the audited fiscal year financial results for the twelve months ended November 30, 2003.

In connection with the Acquisition, a new accounting basis was established for the Company as of the acquisition date based upon an allocation of the purchase price to the underlying net assets acquired. As such, financial information for each of the ten and the twelve months ended September 30, 2004 is separated into pre-acquisition and post-acquisition periods as a result of the change in accounting basis that occurred relating to the Acquisition. That is for the twelve-month period ended September 30, 2004, we have presented our operating results and cash flows separately for the pre-acquisition five-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004. The financial information for the ten months ended September 30, 2004 is separated into the pre-acquisition three-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004.

The split presentation mentioned above is required under GAAP in situations when a change in accounting basis occurs. This is because the new accounting basis requires that the historical carrying value of assets acquired and liabilities assumed be adjusted to fair value, which may yield results that are not strictly comparable on a period-to-period basis due to the different, and sometimes higher, cost basis associated with the allocation of the purchase price.

We believe that this split presentation may impede the ability of users of our financial information to understand our operating and cash flow performance. Consequently, in order to enhance an analysis of our operating results and cash flows, we have presented our operating results and cash flows on a combined basis for the full ten-month period and twelve-month period ended September 30, 2004. The combined presentation for the twelve-month period ended September 30, 2004 simply represents the mathematical addition of the pre-acquisition, five-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004 and the combined presentation for the ten-month period ended September 30, 2004 represents the mathematical addition of the pre-acquisition three-month period ended February 29, 2004 and the post-acquisition seven-month period ended September 30, 2004. These are not intended to represent what our operating results would have been had the Acquisition occurred at the beginning of the period. Reconciliations showing the mathematical combination of our operating results for such periods are included herein.

Though we believe that the combined presentation is most meaningful for the twelve-month period ended September 30, 2004 and the ten-month period ended September 30, 2004, it is not in conformity with GAAP. As

such, we have supplemented our historical operating results for periods, as appropriate, with pro forma financial information and have further highlighted in our discussions that follow any significant effects from the Acquisition to facilitate an understanding of a comparison of our operating results from period-to-period.

OVERVIEW

Description of Business

We are one of the world's major music content companies. Effective as of March 1, 2004, substantially all of Time Warner Inc.'s music division was acquired from Time Warner by us for approximately $2.6 billion.

We classify our business interests into two fundamental areas: Recorded Music and Music Publishing. A brief description of each of those operations is presented below.

Recorded Music Operations

Our Recorded Music business consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists. In the U.S., our operations are conducted principally through our major record labels—Warner Bros. Records Inc. and The Atlantic Records Group. Internationally, our Recorded Music operations are conducted through our Warner Music International division ("WMI"), which includes various subsidiaries, affiliates and non-affiliated licensees in more than 50 countries outside the United States. In addition to the more traditional methods of discovering and developing artists, we have implemented new initiatives to identify and nurture artists earlier in the development process and reduce development costs by leveraging our independent distribution network. We refer to these new business models as incubator initiatives. Asylum and East West are current incubator labels. In addition, we have also entered into strategic ventures with other record labels.

Our Recorded Music operations also include a catalog division named Rhino Entertainment ("Rhino"), formerly known as Warner Strategic Marketing. Rhino specializes in marketing our music catalog through compilations and reissuances of previously released music and video titles, as well as in the licensing of recordings to/from third parties for various uses, including film and television soundtracks.

Our principal Recorded Music distribution operations include Warner-Elektra-Atlantic Corporation ("WEA Corp."), which primarily markets and sells music products to retailers and wholesale distributors in the U.S.; a 90% interest in Alternative Distribution Alliance, an distribution company that primarily distributes the products of independent labels to retail and wholesale distributors in the United States; various distribution centers and ventures operated internationally; and an 80% interest in Word Entertainment, whose distribution operations specialize in the distribution of music products in the Christian retail marketplace.

Our principal recorded music revenue sources are sales of CDs, digital downloads and other recorded music products and license fees received for the ancillary uses of our recorded music catalog. The principal costs associated with our Recorded Music operations are as follows:

- artist and repertoire costs—the costs associated with (i) signing and developing artists, (ii) creating master recordings in the studio, (iii) creating artwork for album covers and liner notes and (iv) paying royalties to artists, producers, songwriters, other copyright holders and trade unions;
- manufacturing, packaging and distribution costs—the costs to manufacture and distribute product to wholesale and retail distribution outlets;
- marketing and promotion costs—the costs associated with the promotion of artists and recorded music products, including costs to produce music videos for promotional purposes and artist tour support; and
- administration costs—the costs associated with general overhead and other administrative costs, as well as costs associated with anti-piracy initiatives.

Music Publishing Operations

Our Music Publishing operations include Warner/Chappell Music, Inc. and its wholly owned subsidiaries, and certain other music publishing affiliates of the Company. We own or control the rights to more than one million musical compositions, including numerous pop music hits, American standards, folk songs and motion picture and theatrical compositions. Our Music Publishing operations also formerly included Warner Bros. Publications ("WBP"), which marketed printed versions of our music throughout the world. On May 31, 2005, we sold WBP to Alfred Publishing. The sale is not expected to have a material effect on our future operating results and financial condition.

Publishing revenues are derived from four main royalty sources:

- *Mechanical:* the licensor receives royalties with respect to compositions embodied in recordings sold in any format or configuration, including singles, albums, CDs, digital downloads and mobile phone ringtones.
- *Performance:* the licensor receives royalties if the composition is performed publicly (e.g., broadcast radio and television, movie theater, concert, nightclub or Internet and wireless streaming).
- *Synchronization:* the licensor receives royalties or fees for the right to use the composition in combination with visual images (e.g., in films, television commercials and programs and videogames).
- *Other:* the licensor receives royalties from other uses such as stage productions.

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

- artist and repertoire costs—the costs associated with (i) signing and developing songwriters and (ii) paying royalties to songwriters, co-publishers and other copyright holders in connection with income generated from the exploitation of their copyrighted works;
- manufacturing, packaging and distribution costs—the costs to manufacture and distribute sheet music and songbooks to retail distribution outlets and schools; and
- administration costs—the costs associated with general overhead and other administrative costs.

Factors Affecting Results of Operations and Financial Condition

Market Factors

Over the past five years, the recorded music industry has been unstable, which has adversely affected our operating results. The industry-wide decline can be attributed primarily to digital piracy. Other drivers of this decline are the bankruptcies of record retailers and wholesalers, growing competition for consumer discretionary spending and retail shelf space, and the maturation of the CD format, which has slowed the historical growth pattern of recorded music sales. While new formats for selling recorded music product have been created, including the legal downloading of digital music using the Internet and DVD-Audio formats and the distribution of music on mobile devices, significant revenue streams from these new markets are just beginning to emerge. As of November 20, 2005, year-to-date U.S. recorded music sales (excluding sales of digital tracks) are down approximately 7.6% year-over-year. The recorded music industry performance may continue to negatively impact our operating results. In addition, a declining recorded music industry could continue to have an adverse impact on the music publishing business. This is because our music publishing business generates a significant portion of its revenues from mechanical royalties received from the sale of music in recorded music formats such as the CD.

Restructuring

Due in part to the development of the new channels mentioned above and ongoing anti-piracy initiatives, we believe that the recorded music industry is positioned to improve over the coming years. However, the industry

may relapse into a period of decline. In addition, there can be no assurances as to the timing or the extent of any improvement in the industry. Accordingly, we have executed a number of cost-saving initiatives over the past few years in an attempt to realign our cost structure with the changing economics of the industry. These initiatives have included significant headcount reductions from the consolidation of operations and the streamlining of corporate and label overhead, exiting certain leased facilities in an effort to consolidate locations and the sale of our manufacturing, packaging and physical distribution operations. We have now completed substantially all of our restructuring efforts and have streamlined the Company to achieve approximately $250 million in annual cost savings.

Transactions with Time Warner and its Affiliates

As previously described, prior to March 1, 2004, Old WMG was owned and operated by Time Warner. As such, in the normal course of conducting our business, Old WMG had various commercial and financing arrangements with Time Warner and its affiliates. In particular, Old WMG purchased manufacturing packaging and physical distribution services from affiliates of Time Warner, and Time Warner funded its operating and capital requirements. See Note 20 to our audited financial statements for a summary of the principal transactions between Old WMG and Time Warner and its affiliates.

Time Warner sold its CD and DVD manufacturing, packaging and physical distribution operations to Cinram at the end of October 2003. Prior to the sale, these operations were under the control of Time Warner and Old WMG's management. As such, pricing for such services was not negotiated on an arms-length basis and did not reflect market rates. As part of the sale, Time Warner and Old WMG entered into arrangements with Cinram, under which Cinram will provide manufacturing, packaging and physical distribution services for our products in the U.S. and Europe at favorable, market-based rates that were negotiated on an arms-length basis.

With respect to the financing arrangements with Time Warner, all cash received or paid by Old WMG was included in, or funded by, clearing accounts or shared international cash pools within Time Warner's centralized cash management system. Some of those arrangements were interest-bearing and others were not. Accordingly, historical net interest expense is not representative of the amounts incurred by us under our new leveraged capital structure created in connection with the Acquisition.

Charges and Payments Relating to Executive Compensation

We determined that certain shares of restricted stock issued in 2004 and early 2005 may have been sold at prices below fair market value on the applicable date of sale and certain options to purchase shares of the Company's stock granted may have had exercise prices below fair market value on the applicable date of grant. As a result, certain U.S. employee holders of the restricted stock who made elections under Section 83(b) of the Internal Revenue Code will be subject to additional ordinary income tax to the extent of the fair market value of the restricted stock received over the purchase price they paid for such stock. In other cases, certain employees who did not make such an election will be subject to higher taxes on their restricted shares at the time of vesting than would have been the case had they purchased the shares for fair market value. In addition, under the provisions of the American Jobs Creation Act of 2004, signed into law in October 22, 2004, U.S. employee option holders whose options vest with exercise prices below fair market value on the date of grant are subject to significant penalties under new Section 409A of the Internal Revenue Code. IRS Notice 2005-1 provides transitional guidance on the application of Section 409A which, among other things, permits options with exercise prices below the fair market value of the underlying stock on the date of grant to be amended or replaced with new options having an exercise price at least equal to the fair market value on the grant date. Non-U.S. employee holders of restricted stock or options may be subject to similar or other related issues. In order for us to address these issues our Board of Directors, based on a re-assessment of fair market values on the applicable dates, approved the actions discussed below.

Restricted Stock. We were authorized to pay each employee, who purchased restricted stock at prices that were below fair market value on the date of purchase, a cash bonus. The cash bonus payable to those employees

who made a Section 83(b) election is an amount equal to the tax liability incurred by the employee as of the date of purchase based on any difference between the re-determined purchase date fair market value and the amount originally paid by the employee, plus an amount necessary to pay the taxes on the bonus. The bonuses that are payable to each of those employees who did not make a Section 83(b) election or the applicable foreign equivalent is an amount reflecting an estimate of the additional tax which would be payable by the employee at the time the restricted stock is scheduled to vest due to that taxable amount being subject to ordinary income rather than capital gains tax rates, and assuming that the re-determined value of the stock remains constant over the vesting period, adjusted down to reflect a present value discount based on the earliest possible vesting dates. We will pay these employees an amount necessary to pay the taxes on the bonus. This will result in total cash payments of approximately $10 million, which the Company has expensed in the fiscal year ended September 30, 2005.

Options. We have revised the exercise prices of certain options to purchase our common stock to prices equal to the applicable re-determined fair market values of the common stock on the dates of the respective grants. To compensate the grantees for the loss of value represented by this adjustment to the option exercise prices, we will pay each affected employee a cash bonus in an amount equal to the excess of the adjusted aggregate exercise price of the employee's options over the original aggregate exercise price of the employee's options, adjusted down to reflect a present value discount based on the earliest possible exercise dates. We have treated the revision of the exercise prices of certain option grants as a modification of such grants. This will result in total cash bonuses paid of approximately $9 million. We have recorded expense of $6 million in the fiscal year ended September 30, 2005 related to this modification of certain grants.

Additional Charges and Payments to Employees

Option Adjustments as a Result of Dividend to Investors. Further, in connection with the $100.5 million cash dividend we declared and paid to holders of our common stock consisting of the Investor Group and certain members of management who held shares of common stock prior to our initial common stock offering, we have made an adjustment to all options outstanding at the time of declaration of the dividend. The adjustment consists of a cash make-whole payment consisting of an amount equal to the pro rata amount that would have been received per share had all outstanding options been exercised at the time of the declaration of the dividend adjusted down to reflect a present value discount based on the earliest possible exercise dates. We have expensed approximately $3 million of expense related to such payments in the fiscal year ended September 30, 2005.

Employee Bonus Plan. We paid a special one-time bonus upon consummation of our initial common stock offering to all or substantially all of our employees, excluding senior management and certain employees with an equity participation in our company. The amount of the award granted to an employee was equal to approximately 4% of the employee's annual salary. We have paid and recorded expense of $10 million in the fiscal year ended September 30, 2005 related to such bonus.

Of the amounts related to restricted stock and options, all but $3 million has been paid as of September 30, 2005.

Initial Common Stock Offering

In May 2005, we completed the initial public offering of our common stock (the "Initial Common Stock Offering"). Prior to the consummation of the Initial Common Stock Offering, we, among other things, renamed all of our outstanding shares of Class A Common Stock as common stock and authorized an approximately 1,139 for 1 split of our common stock. We contributed the net proceeds from the Initial Common Stock Offering of $517 million to Holdings as an equity capital contribution. Holdings used all of such funds and approximately $57 million of cash received through dividends from Acquisition Corp. to redeem its outstanding notes as discussed below.

In addition, in connection with the Initial Common Stock Offering, we among others things, repurchased the warrants issued as part of the initial purchase price consideration for the Acquisition from Time Warner for $138 million, we declared and paid a dividend to our stockholders prior to the Initial Common Stock Offering of $100.5 million, and terminated our management agreement as discussed below.

Holdings Refinancing and Redemption

In December 2004, Holdings issued $847 million principal amount of debt. The $847 million principal amount of Holdings' debt consisted of (i) $250 million principal amount of Floating Rate Senior Notes due 2011 (the "Holdings Floating Rate Notes"), (ii) $397 million principal amount at maturity of 9.5% Senior Discount Notes due 2014, which had an initial issuance discount of $147 million (the "Holdings Discount Notes") and (iii) $200 million principal amount of Floating Rate Senior PIK Notes due 2014 (the "Holdings PIK Notes", and collectively, the "Holdings Notes").

In connection with the Initial Common Stock Offering, we used $517 million of proceeds from the offering along with $57 million of available cash to redeem certain of the Holdings Notes outstanding. As of September 30, 2005, Holdings had $174 million of debt on its balance sheet relating to such securities, net of issuance discounts.

The Holdings Floating Rate Notes were redeemed in full on June 15, 2005. From the issuance date through the redemption date, the notes bore interest at a quarterly floating rate based on three-month LIBOR rates plus a margin equal to 4.375%. Interest was payable quarterly in cash beginning on March 15, 2005.

The Holdings Discount Notes were issued at a discount and had an initial accreted value of $630.02 per $1,000 principal amount at maturity. Prior to December 15, 2009, no cash interest payments are required. However, interest accrues on the Holdings Discount Notes in the form of an increase in the accreted value of such notes such that the accreted value of the Holdings Discount Notes will equal the principal amount at maturity on December 15, 2009. Thereafter, cash interest on the Holdings Discount Notes is payable semiannually at a fixed rate of 9.5% per annum. The Holdings Discount Notes mature on December 15, 2014. The Company redeemed 35% of the Holdings Discount Notes on June 15, 2005.

The Holdings PIK Notes were redeemed in full on June 15, 2005. From the date of issuance through the date of redemption, the notes bore interest at a semi-annual floating rate based on six-month LIBOR rates plus a margin equal to 7%. Interest was accrued in the form of additional PIK notes at the election of the Company. Such amounts were also repaid in connection with the redemption.

In connection with the redemption of the Holdings Floating Rate Notes and 35% of the Holdings Discount Notes, we were required to pay redemption premiums of $10 million and $9 million, respectively, which we paid on June 15, 2005. We also wrote off the remaining balance of debt-issuance costs of $12 million related to the notes redeemed and the remaining unamortized original issue discount of $4 million related to the Holdings PIK Notes. These amounts were recorded as a loss on the repayment of the notes in the consolidated statement of operations for the year ended September 30, 2005.

We were also required to pay all accrued interest as of the redemption date related to the Holdings Notes that were redeemed. This amount consisted of $5 million related to the Holdings Floating Rate Notes, $9 million related to the Holdings PIK Notes, and $4 million in accreted value of the 35% of Holdings Discount Notes redeemed. These amounts have been expensed in the consolidated statement of operations for the year ended September 30, 2005.

Termination of Management/ Monitoring Agreement

As described in Note 20 to our audited consolidated financial statements included herein, we entered into a management monitoring agreement (the "Management Agreement") with the Investor Group in connection with the Acquisition.

Under the Management Agreement, we were required to pay the Investor Group an aggregate annual fee of $10 million per year (the "Periodic Fees") in consideration for ongoing consulting and management advisory services. In addition, in the case of future services provided in connection with any future acquisition, disposition, or financing transactions involving the Company or its subsidiaries, the Management Agreement required the Company, Holdings and Acquisition Corp. to pay the Investor Group an aggregate fee of one percent of the gross transaction value of each such transaction ("Subsequent Fees"). The Management Agreement also requires the Company, Holdings and Acquisition Corp. to pay the reasonable expenses of the Investor Group in connection with, and indemnify them for liabilities arising from, the Management Agreement, the Acquisition and any related transactions, their equity investment in the Company, Holdings or Acquisition Corp., their operations, and the services they provide to the Company, Holdings and Acquisition Corp.

The Management Agreement provided that it would continue in full force and effect until December 30, 2014, provided, however, that the Investor Group could cause the agreement to terminate at any time. In the event of the termination of the Management Agreement, the Company, Holdings and Acquisition Corp. were required by the terms of the agreement to pay each of the Investor Group any unpaid portion of the Periodic Fees, any Subsequent Fees and any expenses due with respect to periods prior to the date of termination plus the net present value (using a discount rate equal to the then yield on U.S. Treasury Securities of like maturity) of the Periodic Fees that would have been payable with respect to the period from the date of termination until December 30, 2014.

The Investor Group terminated the Management Agreement and on May 16, 2005, we paid the Investor Group a $73 million termination fee, which was reflected in our statement of operations for the fiscal year ended September 30, 2005.

Stock-based Compensation

Effective March 1, 2004, in connection with the Acquisition, the Company adopted the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("FAS 123") to account for all stock-based compensation plans adopted subsequent to the Acquisition. Under the fair value recognition provisions of FAS 123, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period.

Prior to the Acquisition, certain employees of Old WMG participated in various Time Warner stock option plans. In accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations, compensation cost for stock options or other equity-based awards granted to employees was recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award over the amount an employee must pay to acquire the stock. Generally, the exercise price for stock options granted to employees equaled or exceeded the fair market value of Time Warner common stock at the date of grant, thereby resulting in no recognition of compensation expense by Old WMG.

We recognized $25 million of stock-based compensation expense in the twelve months ended September 30, 2005, compared to $1 million in the twelve months ended September 30, 2004.

Lava Records Restructuring

The co-chairman of The Atlantic Records Group left our employ in August 2005 and we acquired the remaining interest of the Lava Records joint venture. As a result, in order to streamline our operations, we integrated the Lava operations into the operations of The Atlantic Records Group. In connection with the integration, certain employees were involuntarily terminated and certain artist contracts were terminated, which resulted in the recognition of $7 million in restructuring costs and we also incurred other non-recurring charges of $24 million, specifically related to the departure of the co-chairman of The Atlantic Records Group and the expensing of certain other amounts, in the twelve months ended September 30, 2005. Approximately $20 million of these charges were non-cash.

Settlement

We recorded $5 million of expense related to the settlement of a government investigation into radio promotion practices by New York State Attorney General Eliot Spitzer in the twelve months ended September 30, 2005.

RESULTS OF OPERATIONS

Twelve Months Ended September 30, 2005 Compared to Twelve Months Ended September 30, 2004

The following table summarizes our historical results of operations. The financial data for the twelve months ended September 30, 2005 and the seven months ended September 30, 2004 have been derived from our audited financial statements included elsewhere herein and the financial data for the five months ended February 29, 2004 are unaudited and are derived from the audited financial statements included elsewhere herein. See "Change in Fiscal Year and Basis of Presentation" presented earlier herein for a discussion of the use of financial information for the combined twelve-month period ended September 30, 2004.

	Successor	Combined	Successor	Predecessor
	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004	Seven Months Ended September 30, 2004	Five Months Ended February 29, 2004
	(audited)	(unaudited)	(audited)	(unaudited)
		(in millions)		
Revenues	$ 3,502	$ 3,437	$ 1,769	$ 1,668
Costs and expenses:				
Cost of revenues	(1,850)	(1,850)	(944)	(906)
Selling, general and administrative expenses[1]	(1,301)	(1,287)	(677)	(610)
Impairment of goodwill and other intangible assets	—	(1,019)	—	(1,019)
Amortization of intangible assets	(187)	(201)	(104)	(97)
Loss on termination of management agreement	(73)	—	—	—
Restructuring costs	(7)	(34)	(26)	(8)
Total costs and expenses	(3,418)	(4,391)	(1,751)	(2,640)
Operating income (loss)	84	(954)	18	(972)
Interest expense, net	(182)	(82)	(80)	(2)
Net investment-related gains (losses)	1	(9)	—	(9)
Equity in the losses of equity-method investees, net	(1)	(13)	(2)	(11)
Deal related transaction and other costs	—	(63)	—	(63)
Loss on repayment of Holdings Notes	(35)	—	—	—
Loss on repayment of bridge loan	—	(6)	(6)	—
Unrealized gain (loss) on warrants	17	(120)	(120)	—
Minority interest expense	(5)	(14)	(14)	—
Other income (expense), net	7	(11)	(4)	(7)
Loss before income taxes	(114)	(1,272)	(208)	(1,064)
Income tax expense	(55)	(150)	(30)	(120)
Net loss	$ (169)	$(1,422)	$ (238)	$(1,184)

(1) Includes depreciation expense of: $51 million for the twelve months ended September 30, 2005, $36 million for the seven months ended September 30, 2004, and $31 million for the five months ended February 29, 2004.

Consolidated Historical Results

Revenues

Our revenues increased 2% to $3.502 billion for the twelve months ended September 30, 2005, compared to $3.437 billion for the twelve months ended September 30, 2004. Excluding a $106 million benefit of foreign currency exchange rates, total revenue declined by $41 million. Digital revenues increased significantly from $36 million in the twelve months ended September 30, 2004 to $157 million in the twelve months ended September 30, 2005. The increases in digital revenues resulted from our efforts to build our digital business, including efforts to further monetize existing content through new formats and new distribution channels and the development and increased consumer usage of legal, online distribution channels for the music industry. International operations represented $1.827 billion of consolidated revenue for the twelve months ended September 30, 2005, compared to $1.825 billion of consolidated revenues for the twelve months ended September 30, 2004, comprising 52% and 53% of total revenues, respectively. See "Business Segment Results" presented hereinafter for a discussion of revenues by business segment.

Cost of revenues

Our cost of revenues was $1.850 billion for both the twelve months ended September 30, 2005 and 2004. Expressed as a percentage of revenues, cost of revenues was approximately 53% and 54% for the twelve months ended September 30, 2005 and 2004, respectively. Excluding the negative impact of foreign currency exchange rates, product costs decreased by $8 million, primarily due to the increased usage of digital distribution channels which were more profitable as the absence of certain manufacturing and distribution costs create a better contribution margin. Artist and repertoire costs declined from the prior twelve-month period by $28 million, which was primarily due to pre-acquisition write-offs of advance royalty payments deemed to be unrecoverable, offset by an increase in royalty expense due to changes in product mix and increases in sales. Licensing expense also decreased as a result of declines in certain areas of our Music Publishing business.

Selling, general and administrative expenses

Our selling, general and administrative expenses increased by $14 million to $1.301 billion for the twelve months ended September 30, 2005, compared to $1.287 billion for the twelve months ended September 30, 2004. Expressed as a percentage of revenues, selling, general and administrative expenses were 37% for both of the twelve months ended September 30, 2005 and 2004. The increase in selling, general and administrative expenses relates primarily to certain non-recurring expenses that occurred in 2005, including (i) $29 million in compensation expense, consisting of a $10 million one-time bonus to employees related to the Company's Initial Common Stock Offering and $19 million of one-time payments to holders of the Company's restricted stock and stock options, primarily to compensate them for certain amounts related to stock awards issued at prices that were below fair value at the grant date and (ii) $24 million of expense in the quarter ended September 30, 2005, related to the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of Lava Records. Additionally, our expense related to our stock-based awards increased by $24 million to $25 million for the twelve months ended September 30, 2005, as compared to $1 million for the twelve months ended September 30, 2004. Excluding the impact of the items previously described and the negative impact of foreign currency exchange rates of $29 million, selling, general and administrative expenses in the twelve months ended September 30, 2005 decreased $92 million as compared to the twelve months ended September 30, 2004, and were approximately 34% of total revenues. This decrease in selling, general and administrative expenses related primarily to (i) reductions in sales and marketing costs of $59 million, primarily as a result of our cost-savings initiatives completed in 2005 in connection with our restructuring plan, (ii) reductions in distribution costs of $25 million due to the decline in year over year physical sales as well as the increase in sales through digital distribution methods, lower bad debt expense and the impact of our cost-savings initiatives and (iii) a decrease in depreciation of $16 million due to lower post-Acquisition capital spending and lower depreciation of software development costs in the current year.

Loss on termination of management agreement

Concurrent with our Initial Common Stock Offering, the Investor Group terminated the Management Agreement. Under the Management Agreement, we were required to pay the Investor Group annual fees in consideration for ongoing consulting and management advisory services and transaction based fees for services provided in connection with any future acquisition, disposition, or financing. The Investor Group terminated the Management Agreement on May 10, 2005 and on May 16, 2005, we paid a $73 million termination fee.

Restructuring costs

We recognized $7 million in restructuring costs in the twelve months ended September 30, 2005 compared to $34 million in restructuring costs in the twelve months ended September 30, 2004. The restructuring costs recognized in 2005 related to termination benefits paid to certain employees who were involuntarily terminated and the costs of terminating certain artist contracts. These activities occurred in connection with the integration of Lava Records' operations into the operations of The Atlantic Records Group subsequent to our acquisition of the remaining interest in the Lava Records joint venture. The restructuring costs in 2004 principally related to costs associated with the implementation of a cost-savings incentive compensation plan designed to incentivize management to reduce operating costs.

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

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

	Successor	Combined	Successor	Predecessor
	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004	Seven Months Ended September 30, 2004	Five Months Ended February 29, 2004
	(audited)	(unaudited)	(audited)	(unaudited)
OIBDA	$ 322	$ 333	$ 158	$ 175
Depreciation expense	(51)	(67)	(36)	(31)
Amortization expense	(187)	(201)	(104)	(97)
Impairment of goodwill and other intangible assets	—	(1,019)	—	(1,019)
Operating income (loss)	84	(954)	18	(972)
Interest expense, net	(182)	(82)	(80)	(2)
Net investment-related gains (losses)	1	(9)	—	(9)
Equity in the losses of equity-method investees, net	(1)	(13)	(2)	(11)
Deal-related transaction and other costs	—	(63)	—	(63)
Loss on repayment of Holdings Notes	(35)	—	—	—
Loss on repayment of bridge loan	—	(6)	(6)	—
Unrealized gain (loss) on warrants	17	(120)	(120)	—
Minority interest expense	(5)	(14)	(14)	—
Other income (expense), net	7	(11)	(4)	(7)
Loss before income taxes	(114)	(1,272)	(208)	(1,064)
Income tax expense	(55)	(150)	(30)	(120)
Net loss	$(169)	$(1,422)	$(238)	$(1,184)

OIBDA

Our OIBDA decreased to $322 million for the twelve months ended September 30, 2005, compared to $333 million for the twelve months ended September 30, 2004. Expressed as a percentage of revenues, total OIBDA

margin was 10% for both the twelve months ended September 30, 2005 and 2004. The decrease in OIBDA was primarily a result of certain one-time items, including (i) the $73 million loss on termination of the Management Agreement described above, (ii) $10 million of one-time bonuses paid in connection with the initial public offering, (iii) $19 million of one-time payments associated with our restricted stock and stock option awards granted at prices below fair value, (iv) $24 million of non-recurring charges incurred in connection with the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of the remaining interest in the Lava Records joint venture, as well as a $24 million increase in stock-based compensation expense. Excluding the one-time items, the increase in stock-based compensation, and a decrease in restructuring costs of $27 million, OIBDA for the twelve months ended September 30, 2005 as compared to the twelve months ended September 30, 2004 increased by $112 million, which was primarily related to the decreases in costs of revenues and selling, general and administrative expenses discussed above and expressed as a percentage of revenues, total OIBDA margin was 14%. See "Business Segment Results" presented hereinafter for a discussion of OIBDA by business segment.

Depreciation expense

Our depreciation expense decreased by $16 million to $51 million for the twelve months ended September 30, 2005, compared to $67 million for the twelve months ended September 30, 2004. The decrease was principally related to lower post-Acquisition capital spending and lower depreciation of software development costs in the current year.

Amortization expense

Our amortization expense decreased by $14 million to $187 million for the twelve months ended September 30, 2005 compared to $201 million for the twelve months ended September 30, 2004. The decrease related to the new basis of accounting recorded in connection with the Acquisition, which resulted in a lower revaluation of the historical cost bases of our identifiable intangible assets. This was offset, in part, by the acquisition of additional recorded music catalog, music publishing copyrights and artist contracts during 2005.

Impairment of goodwill and other intangible assets

We recognized impairment charges to reduce the carrying value of goodwill and other intangible assets of $1.019 billion during the twelve months ended September 30, 2004. Such amounts primarily reflected declines in the valuation of music-related businesses due largely to the industry-wide effects of piracy and were recorded in November 2003.

Operating income (loss)

Our operating income for the twelve months ended September 30, 2005 was $84 million compared to an operating loss of $954 million for the twelve months ended September 30, 2004. This improvement was primarily due to an impairment charge of $1.019 billion, recorded in November 2003, to reduce the carrying value of our goodwill and other intangible assets to fair value. Additionally, the prior twelve-month period reflected an additional $27 million of restructuring costs as compared to the current twelve-month period, as described above. Although our operating income increased as a result of these non-recurring items in the prior twelve-month period, our fiscal year 2005 operating income included the effect of certain one-time items, including (i) the $73 million loss on termination of the Management Agreement described above, (ii) $10 million of one-time bonuses paid in connection with the initial public offering, (iii) $19 million of one-time payments associated with our restricted stock and stock option awards granted at prices below fair value and (iv) $24 million of non-recurring charges incurred in connection with the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of the remaining interest in the Lava Records joint venture, as well as a $24 million increase in stock-based compensation expense. Excluding the one-time items, the increase in stock-based compensation, and the decrease in

restructuring costs and impairment charges previously discussed, operating income for the twelve months ended September 30, 2005 as compared to the twelve months ended September 30, 2004 increased $142 million, which was primarily related to the decreases in costs of revenues and selling, general and administrative expenses discussed above. See "Business Segment Results" presented hereinafter for a discussion of operating income (loss) by business segment.

Interest expense, net

Our net interest expense increased to $182 million in the twelve months ended September 30, 2005, compared to $82 million for the twelve months ended September 30, 2004. The increase in interest expense is due to higher average debt balances in 2005 as compared to 2004, primarily due to the financing of the Acquisition in March 2004, the April 2004 refinancing, the borrowing of an additional term loan in May 2005 and the new debt issued by Holdings of approximately $696 million in December 2004, offset by the subsequent repayment of all but approximately $170 million of the Holdings Notes in June 2005. See "—Financial Condition and Liquidity" for more information.

Net investment-related gains (losses)

We recognized a $1 million investment-related gain for the twelve months ended September 30, 2005 primarily related to the sale of our interest in an equity-method investment. For the twelve-months ended September 30, 2004, we recognized $9 million of net investment-related losses principally related to reductions in the carrying values of certain equity-method investments.

Deal-related transaction and other costs

During the twelve months ended September 30, 2004, in connection with the Acquisition and Time Warner's prior pursuit of other strategic ventures or dispositions, including our businesses, that did not occur, we incurred $63 million of costs. These costs consisted of (i) $23 million of transaction costs, primarily relating to legal, accounting and investment-banking fees, (ii) a $15 million loss in connection with the pension curtailment for employees covered under Time Warner's U.S. pension plans that ultimately occurred upon the closing of the Acquisition and (iii) a $25 million loss relating to certain executive contractual obligations that were ultimately triggered upon the closing of the Acquisition.

Equity in the losses of equity-method investees, net

Our equity in the losses of equity-method investees was $1 million for the twelve months ended September 30, 2005, compared to $13 million for the twelve months ended September 30, 2004. The lower losses principally related to the fact that certain of our former loss-generating investees, such as our former interest in MusicNet, were retained by Time Warner and were not part of the assets acquired by us in the Acquisition.

Loss on repayment of Holdings Notes

In June 2005 we redeemed all of the outstanding Holdings Floating Rate Notes, all of the outstanding Holdings PIK Notes and 35% of the outstanding Holdings Discount Notes. In connection with the redemption, we paid approximately $19 million of redemption premiums and wrote off approximately $12 million related to the carrying value of the unamortized debt issuance costs related to our Holdings Notes and approximately $4 million related to the carrying value of the unamortized discount on the issuance of the Holdings Notes. See "—Financial Condition and Liquidity" for more information.

Loss on repayment of bridge loan

We recognized a $6 million loss during the twelve months ended September 30, 2004 to write off the carrying value of the unamortized debt issuance costs related to our bridge loan, which we repaid in April 2004.

Unrealized gain (loss) on warrants

We recognized a $17 million unrealized gain in the twelve months ended September 30, 2005, compared to a $120 million unrealized loss in the twelve months ended September 30, 2004 on stock warrants issued to Time Warner in connection with the Acquisition. In connection with the Company's Initial Common Stock Offering in May 2005, we repurchased the three-year warrants at a cost of approximately $138 million, which approximated fair value at that date.

Minority interest expense

We recognized minority interest expense of $5 million for the twelve months ended September 30, 2005, compared to $14 million for the twelve months ended September 30, 2004. This expense related to dividends on preferred stock of Holdings that was held directly by the Investor Group and was issued in connection with the initial funding of the purchase price for the Acquisition effective March 1, 2004. The preferred stock was fully repaid in December 2004 from the proceeds of the Holdings Notes.

Other income (expense), net

We recognized other income of $7 million for the twelve months ended September 30, 2005, compared to other expense of $11 million for the twelve months ended September 30, 2004. Other income includes gains and losses related to foreign currency exchange rates movements, associated with inter-company receivables and payables that are not of a long-term investment nature, and as such, are required by U.S. GAAP to be reported in the statement of operations.

Income tax expense

We provided income tax expense of $55 million for the twelve months ended September 30, 2005 compared to $150 million for the twelve months ended September 30, 2004. The income tax provisions are not entirely comparable due to the changes in our tax profile that occurred in connection with the Acquisition. Prior to the closing of the Acquisition, we were a member of the Time Warner U.S. consolidated tax group and were able to recognize deferred tax benefits on U.S. domestic tax losses incurred. However, in connection with the Acquisition, our membership in the Time Warner U.S. consolidated tax group terminated along with our ability to recognize these deferred tax benefits. Accordingly, the income tax expense in 2005 primarily relates to the tax provisions on foreign income. There was no offsetting income tax benefit in 2005 on U.S. and certain foreign jurisdiction tax losses incurred due to the uncertainty of the realization of those deferred tax assets.

Net loss

We recognized a net loss of $169 million for the twelve months ended September 30, 2005, compared to a net loss of $1.422 billion for the twelve months ended September 30, 2004. The decrease in net loss relates primarily to the impairment charge recorded in the twelve months ended September 30, 2004 of $1.019 billion. The twelve months ended September 30, 2005 reflect the effects of certain one-time items, including (i) the $73 million loss on termination of the Management Agreement described above, (ii) $10 million of one-time bonuses paid in connection with the initial public offering, (iii) $19 million of one-time payments associated with our restricted stock and stock option awards granted at prices below fair value, (iv) $24 million of non-recurring charges incurred in connection with the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of the remaining interest in the Lava Records joint venture and (v) the $35 million loss on repayment of the Holdings Notes described above. Excluding the one-time items included in the twelve months ended September 30, 2005, the $24 million increase in stock-based compensation, the $27 million decrease in restructuring, and the effects of one-time items included in the twelve months ended September 30, 2004, which included (i) the impairment charges, (ii) the $6 million loss on repayment of bridge loan described above and (iii) the $63 million of deal-related and other transaction costs described above, net income for the twelve months ended September 30, 2005 as compared to

the twelve months ended September 30, 2004 increased $323 million. This increase is primarily related to the increases in operating income and unrealized gains on warrants and the decrease in income tax expense, all described above.

Business Segment Results

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

	Successor	Combined	Successor	Predecessor
	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004	Seven Months Ended September 30, 2004	Five Months Ended February 29, 2004
	(audited)	(unaudited)	(audited)	(unaudited)
Recorded Music				
Revenue	$2,924	$2,859	$1,429	$1,430
OIBDA[1]	$ 380	$ 266	$ 120	$ 146
Operating income (loss)[1]	$ 215	$ (934)	$ 24	$ (958)
Music Publishing				
Revenue	$ 607	$ 601	$ 348	$ 253
OIBDA[1]	$ 141	$ 144	$ 87	$ 57
Operating income (loss)[1]	$ 82	$ 74	$ 53	$ 21
Intersegment Eliminations				
Revenue eliminations	$ (29)	$ (23)	$ (8)	$ (15)
OIBDA[1]	$ (199)	$ (77)	$ (49)	$ (28)
Operating income (loss)[1]	$ (213)	$ (94)	$ (59)	$ (35)
Total				
Revenue	$3,502	$3,437	$1,769	$1,668
OIBDA[1]	$ 322	$ 333	$ 158	$ 175
Operating income (loss)[1]	$ 84	$ (954)	$ 18	$ (972)

(1) OIBDA and operating income for the twelve months ended September 30, 2005 and 2004 have been reduced by $7 million and $34 million of restructuring costs, respectively. Of such amounts, $7 million related to Recorded Music for the twelve months ended September 30, 2005 and $24 million related to Recorded Music, $1 million related to Music Publishing, and $9 million related to Corporate for the twelve months ended September 30, 2004.

Recorded Music

Recorded Music revenues increased by $65 million to $2.924 billion for the twelve months ended September 30, 2005, compared to $2.859 billion for the twelve months ended September 30, 2004. Recorded Music revenues represented approximately 83% of consolidated revenues for the twelve months ended September 30, 2005 and 2004. The increase in Recorded Music revenue was primarily due to the increase in digital sales of $105 million to $137 million in the twelve months ended September 30, 2005. The increase in revenues from the sale of music in digital formats related to the development and increased consumer usage of legal, online distribution channels for the music industry. For the twelve months ended September 30, 2005, digital sales increased to 5% of Recorded Music revenues. Digital sales in the U.S. increased by $79 million to $105 million or 7% of U.S. Recorded Music revenues, and more than offset the decline in fiscal 2005 U.S physical unit sales. International sales of music in digital formats rose by $26 million to $32 million or 2% of international Recorded Music revenues.

Excluding the increase in digital sales and an approximate $86 million favorable impact of foreign currency exchange rates, physical sales of Recorded Music formats declined by approximately $124 million in the twelve

months ended September 30, 2005 as compared with the twelve months ended September 30, 2004. The decline reflected the continued impact of industry-wide piracy, particularly in our international Recorded Music Business where $111 million of this decline occurred. U.S. Recorded Music experienced a less significant decline in physical sales of $13 million, primarily due to numerous key commercial releases in the twelve months ended September 30, 2005 that sold in excess of one million units, including albums from artists such as James Blunt, Luis Miguel, Michael Bublé, Rob Thomas, Simple Plan, T.I., Faith Hill and Mike Jones.

Recorded Music OIBDA increased by $114 million to $380 million for the twelve months ended September 30, 2005, compared to $266 million for the twelve months ended September 30, 2004. Expressed as a percent of Recorded Music revenues, Recorded Music OIBDA was 13% and 9% for the twelve-month periods ended September 30, 2005 and 2004 respectively. Excluding a $1 million benefit of foreign currency exchange rates Recorded Music OIBDA benefited principally from the revenue increases described above, and from decreases in expenses including (i) a decrease in variable selling and marketing expenses of $58 million as a result of our cost savings initiatives, (ii) a decrease in artist and repertoire costs of $34 million, as the prior year reflected pre-acquisition write-offs of advance royalty payments deemed to be unrecoverable and (iii) a decrease in distribution costs of $25 million due to the decline in year over year physical sales, the increases in sales in digital formats, lower bad debt expenses and the impact of cost-savings initiatives. These benefits were offset by (i) $20 million of one-time compensation expenses related to employee bonuses paid in connection with the Initial Common Stock Offering and payments associated with our restricted stock and stock option awards granted at prices below fair value and (ii) $24 million of non-recurring charges incurred in connection with the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of the remaining interest in the Lava Records joint venture. Excluding these items and a $17 million decrease in restructuring costs, Recorded Music OIBDA increased by $141 million to $431 million and was 15% of Recorded Music revenues for the year ended September 30, 2005.

Recorded Music operating income was $215 million for the twelve months ended September 30, 2005, compared to an operating loss of $934 million for the twelve months ended September 30, 2004. Recorded Music operating income (loss) included the following components:

	Successor	Combined	Successor	Predecessor
	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004	Seven Months Ended September 30, 2004	Five Months Ended February 29, 2004
	(audited)	(unaudited)	(audited)	(unaudited)
OIBDA	$ 380	$ 266	$120	$ 146
Depreciation and amortization	(165)	(181)	(96)	(85)
Impairment of goodwill and other intangible assets	—	(1,019)	—	(1,019)
Operating income (loss)	$ 215	$ (934)	$ 24	$ (958)

The $934 million operating loss in the prior twelve-month period reflects an impairment charge of $1.019 billion recorded to reduce the carrying value of our goodwill and other intangible assets to fair value. Excluding this charge, operating income for the twelve months ended September 30, 2005 improved by $130 million. This improvement related to a decrease in depreciation of $13 million, a decrease in amortization of $3 million, and the $114 million increase in OIBDA described above.

Music Publishing

Music Publishing revenues increased by $6 million to $607 million for the twelve months ended September 30, 2005, compared to $601 million for the twelve months ended September 30, 2004, and represented approximately 17% of consolidated revenues for the twelve months ended September 30, 2005 and

2004. After a benefit from the favorable impact of foreign currency exchange rates of $20 million, Music Publishing revenues declined by $14 million. This decline primarily related to a $15 million decrease in revenues as a result of the sale of our printed sheet music business to a third party on May 31, 2005.

Excluding print revenues through the sale date of $35 million, Music Publishing revenues for the twelve months ended September 30, 2005 consisted of mechanical revenues of $258 million, performance revenues of $192 million, synchronization revenues of $97 million, $20 million of digital revenues and other revenue of $5 million. Music Publishing digital revenues grew by $16 million, to $20 million, as compared to $4 million for the twelve months ended September 30, 2004. Excluding the impact of foreign currency, synchronization revenues increased by approximately $18 million due to favorable market opportunities, such as movie, video game and advertisement deals and continued increases in sales in newer formats. This increase was offset by decreases in performance revenues and mechanical revenues of $16 million and $4 million, respectively. These declines were a direct result of the decline in physical sales, timing of artist and repertoire investments as well as fewer key commercial releases in prior periods.

Music Publishing OIBDA decreased to $141 million for the twelve months ended September 30, 2005, compared to $144 million for the twelve months ended September 30, 2004. Excluding a $2 million benefit from changes in foreign currency exchange rates and $1 million of one-time compensation expenses related to employee bonuses paid in connection with the Initial Common Stock Offering, OIBDA was principally impacted by the revenue decreases explained above, offset by reduced costs as a result of our continued cost-savings initiatives.

Music Publishing operating income increased to $82 million in the twelve months ended September 30, 2005, compared to $74 million in the twelve months ended September 30, 2004. Music Publishing operating income includes the following components:

	Successor	Combined	Successor	Predecessor
	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004	Seven Months Ended September 30, 2004	Five Months Ended February 29, 2004
	(audited)	(unaudited)	(audited)	(unaudited)
OIBDA	$141	$144	$ 87	$ 57
Depreciation and amortization	(59)	(70)	(34)	(36)
Operating income	$ 82	$ 74	$ 53	$ 21

The $8 million increase in operating income related to an $11 million decrease in depreciation and amortization offset by the $3 million decrease in OIBDA described above.

Corporate expenses

Corporate expenses before depreciation and amortization expense increased by $122 million to $199 million for the twelve months ended September 30, 2005, compared to $77 million for the twelve months ended September 30, 2004. Corporate expenses for the twelve months ended September 30, 2005 include (i) a $73 million loss on termination of management agreement, more fully described above, (ii) $8 million of one-time compensation expenses consisting of a one-time bonus to employees related to the Company's Initial Common Stock Offering and one-time payments to holders of restricted stock and stock options primarily to compensate them for certain amounts related to stock awards issued at prices that were below fair value at the grant date and (iii) a $5 million increase in stock-based compensation expense. Additional increases resulted from higher professional and legal costs associated with pending litigation and investigations and Sarbanes-Oxley compliance and higher costs associated with operating as an independent company.

Ten Months Ended September 30, 2004 Compared to Ten Months Ended September 30, 2003

The following table summarizes our historical results of operations. The financial data for the seven months ended September 30, 2004 and the three months ended February 29, 2004 have been derived from our audited financial statements included elsewhere herein. The financial data for the ten months ended September 30, 2003 are unaudited and are derived from the audited financial statements included elsewhere herein. See "Change in Fiscal Year and Basis of Presentation" presented earlier herein for a discussion of the use of financial information for the combined ten-month period ended September 30, 2004.

	Successor	Predecessor	Combined	Predecessor
	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2004	Ten Months Ended September 30, 2003
	(audited)	(audited)	(unaudited)	(unaudited)
		(in millions)		
Revenues	$ 1,769	$ 779	$ 2,548	$ 2,487
Costs and expenses:				
Cost of revenues[1]	(944)	(415)	(1,359)	(1,449)
Selling, general and administrative expenses[1]	(677)	(319)	(996)	(995)
Amortization of intangible assets	(104)	(56)	(160)	(201)
Loss on sale of physical distribution assets	—	—	—	(12)
Restructuring costs	(26)	—	(26)	(27)
Total costs and expenses	(1,751)	(790)	(2,541)	(2,684)
Operating income (loss)	18	(11)	7	(197)
Interest expense, net	(80)	(2)	(82)	(5)
Net investment-related losses	—	—	—	(17)
Equity in the losses of equity-method investees, net	(2)	(2)	(4)	(32)
Deal related transaction and other costs	—	—	—	(7)
Loss on repayment of bridge loan	(6)	—	(6)	—
Unrealized loss on warrants	(120)	—	(120)	—
Other expense, net	(4)	—	(4)	(10)
Minority interest expense	(14)	—	(14)	—
Loss before income taxes	(208)	(15)	(223)	(268)
Income tax benefit (expense)	(30)	(17)	(47)	67
Net loss	$ (238)	$ (32)	$ (270)	$ (201)

(1) Includes depreciation expense of: $36 million for the seven months ended September 30, 2004, $16 million for the three months ended February 29, 2004, $52 million for the ten months ended September 30, 2004 and $71 million for the ten months ended September 30, 2003.

Consolidated Pro Forma Results

As previously discussed, the above table presents our historical operating results separately for each of the pre-acquisition, three-month period ended February 29, 2004 and the post-acquisition, seven-month period ended September 30, 2004. As such, it does not reflect all of the significant effects of the Transactions on our operating results for the entire combined ten-month period ended September 30, 2004. Had the Transactions occurred on December 1, 2003, our pro forma results for the ten months ended September 30, 2004 would have been as follows:

	Pro Forma Ten Months Ended September 30, 2004
	(In millions, unaudited)
Revenue	$2,548
OIBDA	217
Depreciation and amortization	(201)
Operating income	16
Interest expense, net	(112)
Net income (loss)	(286)

A discussion of our consolidated historical results follows.

Consolidated Historical Results

Revenues

Our revenues increased to $2.548 billion for the ten months ended September 30, 2004, compared to $2.487 billion for the ten months ended September 30, 2003. The increase was largely driven by a $20 million increase in Recorded Music revenues and a $38 million increase in Music Publishing revenues.

Recorded Music revenues benefited principally from a $110 million favorable impact of foreign currency exchange rates, and an approximate $30 million increase in revenues from digital sales of Recorded Music product relating to the development and increased consumer usage of legal, online distribution channels for the music industry. These benefits more than offset a decline in physical worldwide music sales due to the continuing industry-wide impact of piracy, lower sales volume associated with a fewer number of key commercial releases that sold in excess of one million units and the effects from our cost-savings initiative to consolidate two of our U.S. record labels. Substantially all of the decline in physical worldwide music sales resulted from lower unit sales volume.

Music Publishing revenues benefited principally from a $33 million favorable impact of foreign currency exchange rates and an aggregate $15 million increase in mechanical, performance and synchronization royalties. These benefits more than offset a $10 million decline in revenues from the sale of print-related products partially relating to the closure of certain of our smaller print operations in connection with our cost-savings initiatives.

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

Cost of revenues

Our cost of revenues decreased to $1.359 billion for the ten months ended September 30, 2004, compared to $1.449 billion for the ten months ended September 30, 2003. Expressed as a percentage of revenues, cost of revenues was approximately 53% for the ten months ended September 30, 2004, compared to 58% for the ten months ended September 30, 2003. The decrease in cost of revenues principally related to approximately $98 million of lower manufacturing costs due, in part, to lower pricing under the new Cinram agreements that went into effect in October 2003, approximately $88 million of lower artist and repertoire-related costs

associated with our lower sales volume and cost savings associated with our restructuring plan that was implemented in 2004 in connection with the Acquisition. These cost reductions were partially offset by an approximate $90 million unfavorable impact of foreign currency exchange rates.

Selling, general and administrative expenses

Our selling, general and administrative expenses were $996 million for the ten months ended September 30, 2004, compared to $995 million for the ten months ended September 30, 2003. Expressed as a percentage of revenues, selling, general and administrative expenses were approximately 39% for the ten months ended September 30, 2004, compared with 40% for the ten months ended September 30, 2003. Selling, general and administrative expenses increased as a result of an approximate $50 million unfavorable impact of foreign currency exchange rates, approximately $6 million of management advisory fees paid to the Investor Group and $43 million of higher corporate expenses as discussed further below, including higher costs associated with operating as an independent company. These increases were offset by decreases due to lower marketing and divisional overhead costs associated with our cost-savings initiatives.

Restructuring costs

We recognized $26 million of restructuring-related costs in the ten months ended September 30, 2004, compared to $27 million of restructuring-related costs in the ten months ended September 30, 2003. The restructuring costs in 2004 principally related to costs associated with the implementation of a cost-savings incentive compensation plan designed to incentivize management to reduce operating costs. The restructuring costs in 2003 principally related to reductions in worldwide headcount, costs to exit certain leased facilities, and costs associated with the restructuring of U.S. and Canadian distribution operations.

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

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

	Successor	Predecessor	Combined	Predecessor
	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2004	Ten Months Ended September 30, 2003
	(audited)	(audited)	(unaudited)	(unaudited)
OIBDA	$ 158	$ 61	$ 219	$ 75
Depreciation expense	(36)	(16)	(52)	(71)
Amortization expense	(104)	(56)	(160)	(201)
Operating (loss) income	18	(11)	7	(197)
Interest expense, net	(80)	(2)	(82)	(5)
Net investment-related losses	—	—	—	(17)
Equity in the losses of equity-method investees, net	(2)	(2)	(4)	(32)
Deal-related transaction and other costs	—	—	—	(7)
Loss on repayment of bridge loan	(6)	—	(6)	—
Unrealized loss on warrants	(120)	—	(120)	—
Other expense, net	(4)	—	(4)	(10)
Minority interest expense	(14)	—	(14)	—
Loss before income taxes	(208)	(15)	(223)	(268)
Income tax benefit (expense)	(30)	(17)	(47)	67
Net loss	$(238)	$(32)	$(270)	$(201)

OIBDA

Our OIBDA increased to $219 million for the ten months ended September 30, 2004, compared to $75 million for the ten months ended September 30, 2003. The increase related to a $150 million increase in Recorded Music OIBDA and a $37 million increase in Music Publishing OIBDA, offset in part by a $43 million increase in Corporate expenses.

Recorded Music OIBDA benefited principally from lower marketing and overhead costs associated with our cost-savings initiatives, approximately $94 million of lower manufacturing costs due, in part, to lower pricing under the new Cinram agreements that went into effect in October 2003, a $1 million favorable impact from foreign currency exchange rates and the absence of a $12 million loss on the sale of physical distribution assets recognized in 2003. These benefits more than offset the loss of margin contributions related to lower worldwide recorded music sales.

Music Publishing OIBDA benefited principally from lower overhead costs associated with our cost-savings initiatives, approximately $18 million of lower advance write-offs and a $4 million favorable impact from foreign currency exchange rates.

Corporate expenses increased due to higher costs associated with operating as an independent company and a change in the allocation of corporate-related costs. As discussed in Note 20 to the audited financial statements, $47 million of corporate-related costs were allocated in 2003 to Time Warner's former CD and DVD manufacturing and printing operations because such operations were managed by Old WMG. Such operations were sold by Time Warner in October 2003, and accordingly, such costs were no longer allocable. The incrementally higher level of costs was partially offset by lower overhead costs associated with our cost-savings initiatives.

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

Depreciation expense

Our depreciation expense decreased to $52 million for the ten months ended September 30, 2004, compared to $71 million for the ten months ended September 30, 2003. The decrease principally related to lower capital spending requirements and lower depreciation of software development costs.

Amortization expense

Our amortization expense decreased to $160 million for the ten months ended September 30, 2004, compared to $201 million for the ten months ended September 30, 2003. The decrease related to the new basis of accounting recorded in connection with the Acquisition, which resulted in a lower revaluation of the historical cost bases of our identifiable intangible assets.

Operating income (loss)

Our operating income increased to $7 million for the ten months ended September 30, 2004, compared to an operating loss of $197 million for the ten months ended September 30, 2003. The improvement in operating income related to a $144 million increase in OIBDA, a $19 million decrease in depreciation expense, and a $41 million decrease in amortization expense, all as previously described above. See "Business Segment Results" presented hereinafter for a discussion of operating income (loss) by business segment.

Interest expense, net

Our net interest expense increased to $82 million for the ten months ended September 30, 2004, compared to $5 million for the ten months ended September 30, 2003. The increase primarily related to the approximately $1.8 billion of debt issued in 2004 in connection with the capitalization of the Company.

Net investment-related losses

We did not recognize any investment-related losses for the ten months ended September 30, 2004. However, for the ten months ended September 30, 2003, we recognized $17 million of net investment-related losses. These losses principally related to reductions in the carrying values of certain equity-method investments.

Equity in the losses of equity-method investees, net

Our equity in the losses of equity-method investees was $4 million for the ten months ended September 30, 2004, compared to $32 million in the ten months ended September 30, 2003. The lower losses partially related to the fact that certain of our former loss-generating investees, such as our former interest in MusicNet, were retained by Time Warner and were not part of the assets acquired in the Acquisition.

Deal-related transaction costs

We did not recognize any deal-related transaction costs for the ten months ended September 30, 2004. However, for the ten months ended September 30, 2003, we recognized $7 million of deal-related transaction costs. These costs primarily related to transaction costs associated with the prior pursuit of other strategic ventures or dispositions of Old WMG's businesses in 2003 by Time Warner that did not occur.

Loss on repayment of bridge loan

We recognized a $6 million loss during the ten months ended September 30, 2004 to write off the carrying value of the unamortized debt issuance costs related to our bridge loan which we repaid in April 2004.

Unrealized loss on warrants

We recognized a $120 million unrealized loss on stock warrants issued to Historic TW in connection with the Acquisition for the ten months ended September 30, 2004. Because the ten-month period ended September 30, 2003 was pre-Acquisition; the stock warrants were not outstanding and no comparable charge was recognized for that period.

Other expense, net

We recognized other expense, net, of $4 million for the ten months ended September 30, 2004, compared to other expense, net, of $10 million for the ten months ended September 30, 2003. The $4 million of costs in 2004 relate to unfavorable foreign currency exchange rate movements associated with intercompany receivables and payables that are not of a long-term investment nature, and as such, are required to be reported in the statement of operations in accordance with GAAP. The $10 million of costs in 2003 primarily related to losses on foreign currency exchange contracts that were used by Time Warner to hedge exposures to changes in foreign currency exchange rates. As discussed in Note 22 to the audited financial statements included elsewhere herein, we are in the process of evaluating our hedging practices and no significant foreign exchange contracts were entered into in 2004.

Minority interest expense

We recognized minority interest expense of $14 million for the ten months ended September 30, 2004. This expense related to dividends on preferred stock of Holdings that was held directly by the Investor Group and was issued in connection with the initial funding of the purchase price for the Acquisition. Because the ten-month period ended September 30, 2003 was pre-Acquisition, the subsidiary preferred stock was not outstanding and no comparable charge was recognized for that period.

Income tax benefit (expense)

We provided income tax expense of $47 million for the ten months ended September 30, 2004, compared to an income tax benefit of $67 million for the ten months ended September 30, 2003. The income tax provisions

and benefits are not entirely comparable due to the changes in our tax profile relating to the closing of the Acquisition. In particular, prior to the closing of the Acquisition, we were a member of the Time Warner consolidated tax return and were able to recognize U.S.-based deferred tax benefits on domestic-source net operating losses incurred. However, upon the closing of the Acquisition, our membership in the Time Warner consolidated tax group terminated along with our ability to recognize similar, U.S.-based deferred tax benefits. Accordingly, the income tax expense in 2004 primarily related to the tax provisions on foreign-source income. There was no offsetting income tax benefit on domestic-source losses recognized in 2004 due to the uncertainty of realization of those deferred tax assets.

Net loss

We recognized a net loss of $270 million for the ten months ended September 30, 2004, compared to a net loss of $201 million for the ten months ended September 30, 2003. As described more fully above, the higher net loss in 2004 principally related to $14 million of higher minority interest charges, $77 million of higher net interest costs, a $114 million higher income tax provision associated with the improvement in pretax losses and $120 million of unrealized losses on the warrants. These losses were offset, in part, by a $204 million increase in operating income (including $60 million of lower depreciation and amortization expense) and $45 million of lower investment-related losses.

Business Segment Results

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

	Successor	Predecessor	Combined	Predecessor
	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2004	Ten Months Ended September 30, 2003
	(audited)	(audited)	(unaudited)	(unaudited)
Recorded Music				
Revenue	$1,429	$630	$2,059	$2,039
OIBDA[1]	$ 120	$ 38	$ 158	8
Operating income (loss)[1]	$ 24	$ (9)	$ 15	(181)
Music Publishing				
Revenue	$ 348	$157	$ 505	467
OIBDA[1]	$ 87	$ 38	$ 125	88
Operating income (loss)[1]	$ 53	$ 17	$ 70	19
Corporate and Revenue Eliminations				
Revenue eliminations	$ (8)	$ (8)	$ (16)	(19)
OIBDA[1]	$ (49)	$(15)	$ (64)	(21)
Operating income (loss)[1]	$ (59)	$(19)	$ (78)	(35)
Total				
Revenue	$1,769	$779	$2,548	2,487
OIBDA[1]	$ 158	$ 61	$ 219	75
Operating income (loss)[1]	$ 18	$(11)	$ 7	(197)

(1) OIBDA and operating income for the ten months ended September 30, 2004 have each been reduced by $26 million of restructuring costs. Of such amount, $17 million related to Recorded Music, $1 million related to Music Publishing, and $8 million related to Corporate. For the ten months ended September 30, 2003, OIBDA and operating income (loss) have each been reduced by $39 million of losses related to restructuring costs and the loss on the sale of physical distribution assets. Of such amount, $36 million related to Recorded Music and $3 million related to Music Publishing.

Recorded Music

Recorded Music revenues increased to $2.059 billion for the ten months ended September 30, 2004, compared to $2.039 billion for the ten months ended September 30, 2003. Revenues benefited principally from a $110 million favorable impact of foreign currency exchange rates and an approximate $30 million increase in revenues from digital sales of recorded music product relating to the development and increased consumer usage of legal, online distribution channels for the music industry. These benefits more than offset a decline in physical worldwide music sales due to the continuing industry-wide impact of piracy, lower sales volume associated with a fewer number of key commercial releases that sold in excess of one million units and the effects from our cost-savings initiative to consolidate two of our U.S. record labels. Substantially all of the decline in physical worldwide music sales resulted from lower unit sales volume.

Recorded Music OIBDA increased to $158 million for the ten months ended September 30, 2004, compared to $8 million for the ten months ended September 30, 2003. The $150 million increase in OIBDA principally related to lower marketing and overhead costs associated with our cost-savings initiatives, approximately $94 million of lower manufacturing costs due, in part, to lower pricing under the new Cinram agreements that went into effect in October 2003, a $1 million favorable impact from foreign currency exchange rates and the absence of $12 million loss on the sale of physical distribution assets recognized in 2003. These benefits more than offset the loss of margin contributions related to lower worldwide recorded music sales.

Recorded Music operating income improved to $15 million for the ten months ended September 30, 2004, compared to a loss of $181 million for the ten months ended September 30, 2003. Recorded Music operating loss included the following components (in millions):

	Successor	Predecessor	Combined	Predecessor
	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2004	Ten Months Ended September 30, 2003
	(audited)	(audited)	(unaudited)	(unaudited)
OIBDA	$120	$ 38	$ 158	$ 8
Depreciation and amortization	(96)	(47)	(143)	(189)
Operating income (loss)	$ 24	$ (9)	$ 15	$(181)

The $196 million improvement in operating loss primarily related to the $150 million improvement in OIBDA discussed above and a $46 million decrease in depreciation and amortization expense. The decrease in depreciation and amortization expense principally related to $29 million of lower amortization resulting from a lower revaluation of the historical cost bases of our identifiable intangible assets in connection with the allocation of purchase price as part of the Acquisition. In addition, depreciation expense declined by $17 million principally relating to lower capital spending requirements and lower depreciation of software development costs.

Music Publishing

Music Publishing revenues increased to $505 million for the ten months ended September 30, 2004, compared to $467 million for the ten months ended September 30, 2003. Revenues benefited principally from a $33 million favorable impact of foreign currency exchange rates, and an aggregate $15 million increase in mechanical, performance and synchronization royalties. These benefits more than offset a $10 million decline in revenues from the sale of print-related products partially relating to the closure of certain of our smaller print operations in connection with our cost-savings initiatives.

The aggregate $15 million increase in royalties noted above consisted of a $4 million increase in mechanical royalties, a $6 million increase in synchronization royalties and a $5 million increase in performance royalties. Mechanical and synchronization revenues increased as a result of our breadth and number of top-performing songs, as well as an increase in sales in newer formats, such as music DVDs and mobile phone ringtones. Performance revenues increased due in large part to an increase in media channels.

Music Publishing OIBDA increased to $125 million for the ten months ended September 30, 2004, compared to $88 million for the ten months ended September 30, 2003. The $37 million increase in OIBDA principally related to lower overhead costs associated with our cost-saving initiatives, approximately $18 million of lower advance write-offs and a $4 million favorable impact from foreign currency exchange rates.

Music Publishing operating income increased to $70 million in the ten months ended September 30, 2004, compared to $19 million in the ten months ended September 30, 2003. Music Publishing operating income includes the following components (in millions):

	Successor	Predecessor	Combined	Predecessor
	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2004	Ten Months Ended September 30, 2003
	(audited)	(audited)	(unaudited)	(unaudited)
OIBDA	$ 87	$ 38	$125	$ 88
Depreciation and amortization	(34)	(21)	(55)	(69)
Operating income	$ 53	$ 17	$ 70	$ 19

The $51 million increase in operating income primarily related to a $14 million decrease in depreciation and amortization expense, and the $37 million increase in OIBDA discussed above. The decrease in depreciation and amortization expense principally related to $12 million of lower amortization expense resulting from a lower revaluation of the historical cost bases of our identifiable intangible assets in connection with the allocation of purchase price as part of the Acquisition.

Corporate expenses

Corporate expenses before depreciation and amortization expense increased to $64 million for the ten months ended September 30, 2004, compared to $21 million for the ten months ended September 30, 2003. Corporate expenses increased due to higher costs associated with operating as an independent company and a change in the allocation of corporate-related costs. As discussed in Note 20 to the audited financial statements, $47 million of corporate-related costs were allocated in 2003 to Time Warner's former CD and DVD manufacturing and printing operations because such operations were managed by Old WMG. Such operations were sold by Time Warner in October 2003, and accordingly, such costs were no longer allocable. The incrementally higher level of costs was partially offset by lower overhead costs associated with our cost-savings initiatives.

Corporate depreciation and amortization expense was $14 million in each period.

FINANCIAL CONDITION AND LIQUIDITY

Financial Condition at September 30, 2005

At September 30, 2005, we had $2.246 billion of debt, $288 million of cash and equivalents (net debt of $1.958 billion, defined as total debt less cash and equivalents) and $89 million of shareholders' equity. This compares to $1.840 billion of debt, $555 million of cash and equivalents (net debt of $1.285 billion) and $280 million of shareholders' equity at September 30, 2004. The increase in debt resulted from the issuance of $697 million of Holdings debt in December 2004, of which all but $170 million was redeemed on June 15, 2005 (carrying value of $174 million as of September 30, 2005), and the borrowing of an additional $250 million of term loans under the Company's senior secured credit facility, offset by our quarterly repayment of our term loans under the senior secured credit facility.

The $191 million reduction in shareholders' equity that occurred during the twelve months ended September 30, 2005 principally related to a return of capital of $422 million paid in December 30, 2004 from the

proceeds of the Holdings Notes, a return of capital of $50 million paid in installments in March and May of 2005, a dividend of $100.5 million paid to our common shareholders immediately prior the Company's Initial Common Stock Offering, a payment of the remaining preference amount of the Class L Common Stock of $8.5 million (after which, such stock converted to Class A Common Stock), the termination of the Management Agreement resulting in a $73 million termination fee and the charges of $35 million incurred in relation to the repayment of certain of the Holdings Notes on June 15, 2005. Such reductions were offset, in part, by the Company's Initial Common Stock Offering, which resulted in additional equity of $522 million.

Cash Flows

The following table summarizes our historical cash flows. The financial data for the twelve months ended September 30, 2005, the seven months ended September 30, 2004 and the year ended November 30, 2003 have been derived from our audited financial statements included elsewhere herein. The financial data for the five and three months ended February 29, 2004 are unaudited and are derived from our interim financial statements. The financial data for the ten months ended September 30, 2003 are unaudited and are derived from the audited financial statements included elsewhere herein. See "Change in Fiscal Year and Basis of Presentation" presented earlier herein for a discussion of the use of financial information for the combined twelve-month and ten-month periods ended September 30, 2004.

	Successor	Combined	Combined	Successor	Predecessor		
	Twelve Months Ended September 30, 2005	Twelve Months Ended September 30, 2004	Ten Months Ended September 30, 2004	Seven Months Ended September 30, 2004	Five Months Ended February 29, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003
	(audited)	(unaudited)	(unaudited)	(audited) (in millions)	(unaudited)	(audited)	(unaudited)
Operating activities ...	$ 205	$ 438	$ 407	$ 86	$352	$321	$ 257
Investing activities ...	(54)	(2,646)	(2,649)	(2,663)	17	14	(73)
Financing activities ...	(416)	2,679	2,651	2,661	18	(10)	(151)

Operating Activities

Cash provided by operations was $205 million for the twelve months ended September 30, 2005, compared to cash provided by operations of $438 million for the twelve months ended September 30, 2004. The $233 million decrease in cash provided by operations resulted primarily from the payment of a $73 million fee as a result of the termination of the Management Agreement and $88 million of higher interest payments associated with our leveraged capital structure. The decrease also reflects cash paid of $10 million to our employees in connection with the our Initial Common Stock Offering and cash paid of $16 million for certain of the other one-time special bonuses paid to certain holders of restricted stock and stock options, as well as the timing of the funding of our working capital requirements.

Investing Activities

Cash used in investing activities was $54 million for the twelve months ended September 30, 2005, compared to $2.646 billion for the twelve months ended September 30, 2004. The decrease in cash used in investing activities primarily related to the cash purchase price of $2.638 billion, including transaction costs, paid in connection with the Acquisition. Cash paid in investing activities for the twelve months ended September 30, 2005 primarily relates to amounts paid to acquire an interest in Bad Boy Records, an additional interest in Maverick, cash paid to fund various investments and to acquire additional music publishing copyrights, offset by the proceeds from the sale of our printed sheet music business. Cash used in investing activities also reflects $30 million of capital expenditures.

Financing Activities

Cash used in financing activities was $416 million for the twelve months ended September 30, 2005, compared to $2.679 billion of cash provided for the twelve months ended September 30, 2004. Cash flows from financing activities are not comparable from period to period. We began operating as an independent company on March 1, 2004. However, prior to March 1, 2004, we were owned by Time Warner and, as such, all of our cash requirements were funded by Time Warner and Time Warner received most of the cash generated by us through a centralized cash management system or use of shared international cash pooling arrangements. Consequently, except for principal payments on capital leases and certain net borrowings of third-party debt, which were not significant, all financing activities for the historical 2004 period related to movement of cash between Time Warner and us.

Cash provided by financing activities for 2004 principally reflected activities to fund the purchase price paid in connection with the Acquisition, settle intercompany receivables and payables for the period preceding the Acquisition, and modify our initial capital structure by returning a portion of the initial capital contributed by the Investor Group. In particular, we borrowed $1.650 billion, which was used primarily to fund a portion of the purchase price paid in connection with the Acquisition (including transaction costs) and to pay $78 million of financing-related debt issuance costs. We also received capital contributions of $1.250 billion from the Investor Group to fund a portion of the purchase price paid in connection with the Acquisition. In April 2004, we refinanced certain of our debt at the Acquisition Corp. level, including the repayment of the remaining balance of the bridge loan of $506 million, the issuance of the U.S. dollar and Sterling denominated notes by Acquisition Corp. for approximately $650 million, and additional term loan borrowings under our senior secured credit facility of approximately $50 million. With respect to the pre-acquisition, five-month period ended February 29, 2004, $290 million of net funding was received by Time Warner and used, in part, to repay $124 million of third-party indebtedness.

Cash used in financing activities for the twelve months ended September 30, 2005 primarily relates to the repayment of a portion of the Holdings Notes for $574 million, quarterly term loan debt repayments of $14 million, the returns of capital and dividends paid to the Investor Group of $917 million, the $209 million redemption of subsidiary preferred stock as part of the Holdings Refinancing, and $138 million paid to repurchase the three-year warrants from Time Warner. These uses of cash were offset principally by $522 million of net proceeds after stock-issuance costs from the Company's Initial Common Stock Offering, $681 million of net proceeds after debt-issuance costs from the issuance of Holdings debt as part of the Holdings Refinancing and $247 million of net proceeds after debt-issuance costs from the additional term loan borrowings under the senior secured credit facility.

Liquidity

Our primary sources of liquidity are the cash flow generated from our subsidiaries' operations, availability under the $250 million (less $4 million of outstanding letters of credit as of September 30, 2005) revolving credit portion of our senior secured credit facility and available cash and equivalents. These sources of liquidity are needed to fund our debt service requirements, working capital requirements, capital expenditure requirements, regular quarterly dividends and the remaining one-time costs associated with the execution of our restructuring plan. We believe that our existing sources of cash will be sufficient to support our existing operations over the next twelve months.

As of September 30, 2005, our long-term debt consisted of $1.430 billion of borrowings (including $17 million of debt that is classified as a current obligation) under the term loan portion of our senior secured credit facility, $642 million of Acquisition Corp. Subordinated Notes and $174 million of Holdings Notes. There were no borrowings under the revolving portion of our senior secured credit facility as of September 30, 2005.

Senior Secured Credit Facility

The senior secured credit facility consists of a $1.430 billion outstanding term loan portion and a $250 million revolving credit portion. During the twelve months ended September 30, 2005 we borrowed an additional

$250 million under the credit facility, which resulted in an increase in the outstanding term loan balance as compared to September 30, 2004. The term loan portion of the facility, including the $250 million of new borrowings, matures in February 2011. We are required to prepay outstanding term loans, subject to certain exceptions and conditions, with excess cash flow or in the event of certain asset sales and casualty and condemnation events and incurrence of debt. We are required to make minimum repayments under the term loan portion of our facility in quarterly principal amounts of approximately $4.2 million through November 2010, with a remaining balloon payment in February 2011. The revolving credit portion of the senior secured credit facility matures in February 2010. There are no mandatory reductions in borrowing availability for the revolving credit portion of the facility through its term.

Borrowings under both the term loan and revolving credit portion of the senior secured credit facility currently bear interest at a rate equal to an applicable margin plus, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Bank of America, N.A. and (2) the federal funds rate plus ½ of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits in the currency of such borrowing for the interest period relevant to such borrowing adjusted for certain additional costs. As of September 30, 2005, the applicable margins with respect to base rate borrowings and LIBOR borrowings were 1.25% and 2.25%, respectively, for borrowings under the revolving credit facility. The applicable margins are variable subject to changes in certain leverage ratios. For borrowings under the term loan facility, the margins with respect to the base rate borrowings and LIBOR borrowings are 1.00% and 2.00%, respectively, but will be 0.75% and 1.75%, respectively if the senior secured debt of Acquisition Corp. is rated at least BB by S&P and Ba2 by Moody's.

In addition to paying interest on outstanding principal under the senior secured credit facility, we are required to pay a commitment fee to the lenders under the revolving credit facility in respect of the unutilized commitments. The initial commitment fee rate was 0.5%. As of September 30, 2005, the commitment fee rate was 0.375%. The commitment fee rate is variable subject to changes in certain of our leverage ratios. We also are required to pay customary letter of credit fees, as necessary.

The senior secured credit facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability and the ability of our subsidiaries to sell assets, incur additional indebtedness or issue preferred stock, repay other indebtedness, pay dividends and distributions or repurchase capital stock, create liens on assets, make investments, loans or advances, make certain acquisitions, engage in mergers or consolidations, engage in certain transactions with affiliates, amend certain material agreements, change the business conducted by us and enter into agreements that restrict dividends from subsidiaries. In addition, the senior secured credit facility requires us to maintain the following financial covenants: a maximum total leverage ratio and a minimum interest coverage ratio, both tested quarterly, and a maximum annual capital expenditures limitation.

Senior Subordinated Notes of Acquisition Corp.

Acquisition Corp. has outstanding two tranches of senior subordinated notes due 2014: $465 million principal amount of U.S. dollar-denominated notes and £100 million principal amount of Sterling-denominated notes (collectively, the "Subordinated Notes"). The Subordinated Notes mature on April 15, 2014. The Subordinated Notes bear interest at a fixed rate of 7⅜% per annum on the $465 million dollar notes and 8⅛% per annum on the £100 million sterling notes. The indenture governing the notes limits our ability and the ability of our restricted subsidiaries to incur additional indebtedness or issue certain preferred shares; to pay dividends on or make other distributions in respect of its capital stock or make other restricted payments; to make certain investments; to sell certain assets; to create liens on certain debt without securing the notes; to consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; to enter into certain transactions with affiliates; and to designate our subsidiaries as unrestricted subsidiaries. Subject to certain exceptions, the indenture governing the notes permits us and our restricted subsidiaries to incur additional indebtedness, including secured indebtedness, and to make certain restricted payments and investments.

Holdings Notes

In December 2004, Holdings issued $847 million principal amount of debt. The $847 million principal amount of Holdings' debt consisted of (i) $250 million principal amount of Floating Rate Senior Notes due 2011 (the "Holdings Floating Rate Notes"), (ii) $397 million principal amount at maturity of 9.5% Senior Discount Notes due 2014, which had an initial issuance discount of $147 million (the "Holdings Discount Notes") and (iii) $200 million principal amount of Floating Rate Senior PIK Notes due 2014 (the "Holdings PIK Notes", and collectively, the "Holdings Notes").

In connection with the Company's Initial Common Stock Offering, we used $517 million of proceeds from the offering along with $57 million of available cash to redeem certain of the Holdings Notes outstanding. As of September 30, 2005, Holdings had $174 million of debt on its balance sheet relating to such securities, net of issuance discounts.

The Holdings Floating Rate Notes were redeemed in full on June 15, 2005. From the issuance date through the redemption date, the notes bore interest at a quarterly floating rate based on three-month LIBOR rates plus a margin equal to 4.375%. Interest was payable quarterly in cash beginning on March 15, 2005.

The Holdings Discount Notes were issued at a discount and had an initial accreted value of $630.02 per $1,000 principal amount at maturity. Prior to December 15, 2009, no cash interest payments are required. However, interest accrues on the Holdings Discount Notes in the form of an increase in the accreted value of such notes such that the accreted value of the Holdings Discount Notes will equal the principal amount at maturity on December 15, 2009. Thereafter, cash interest on the Holdings Discount Notes is payable semiannually at a fixed rate of 9.5% per annum. The Holdings Discount Notes mature on December 15, 2014. The Company redeemed 35% of the Holdings Discount Notes on June 15, 2005.

The Holdings PIK Notes were redeemed in full on June 15, 2005. From the date of issuance through the date of redemption, the notes bore interest at a semi-annual floating rate based on six-month LIBOR rates plus a margin equal to 7%. Interest was accrued in the form of additional PIK notes at the election of the Company. Such amounts were also repaid in connection with the redemption.

The terms of the indentures governing the Acquisition Corp. Subordinated Notes and Holdings Notes significantly restrict Acquisition Corp., Holdings and other subsidiaries from paying dividends and otherwise transferring assets to us. For example, the ability of Acquisition Corp. and Holdings to make such payments is governed by a formula based on 50% of each of their consolidated net income (which, as defined in the indentures governing such notes, excludes goodwill impairment charges and any after-tax extraordinary, unusual or nonrecurring gains and losses) accruing from June 1, 2004 and July 1, 2004, respectively. In addition, as a condition to making such payments to us based on such formula, Acquisition Corp. and Holdings must each have an adjusted EBITDA to interest expense ratio of at least 2.0 to 1 after giving effect to any such payments. Acquisition Corp. may also make a restricted payment prior to April 15, 2009 if, immediately after giving pro forma effect to such restricted payment and any indebtedness incurred to finance such restricted payment, its net indebtedness to adjusted EBITDA ratio would not exceed 3.75 to 1 and its net senior indebtedness to adjusted EBITDA ratio would not exceed 2.50 to 1. In addition, Holdings may make a restricted payment if, immediately after giving pro forma effect to such restricted payment and any indebtedness incurred to finance such restricted payment, its net indebtedness to adjusted EBITDA ratio would not exceed 4.25 to 1.0. Notwithstanding such restrictions, the indentures permit an aggregate of $45.0 million and $75.0 million of such payments to be made by Acquisition Corp. and Holdings, respectively, whether or not there is availability under the formula or the conditions to its use are met. Acquisition Corp.'s senior secured credit agreement permits Acquisition Corp. to make additional restricted payments to Holdings, the proceeds of which may be utilized by Holdings to make additional restricted payments, in an aggregate amount not to exceed $10.0 million (such amount subject to increase to $35.0 million if the leverage ratio as of the last day of the immediately preceding four fiscal quarters was less than 4.0 to 1 and to $50.0 million if the leverage ratio as of the last day of the immediately preceding four fiscal quarters was less than 3.5 to 1), and subject to further increase in an amount equal to 50% of

cumulative excess cash flow that is not otherwise applied pursuant to Acquisition Corp.'s senior secured credit agreement, and, in addition, permits Acquisition Corp. to make restricted payments to Holdings, the proceeds of which may be utilized by Holdings to make additional restricted payments not to exceed $90 million in any fiscal year, provided that the proceeds of such restricted payments shall be applied soley to pay cash dividends on the common stock of Warner Music Group Corp. Furthermore, Holdings' subsidiaries will be permitted under the terms of Acquisition Corp.'s existing senior secured credit agreement, as it may be amended, and under other indebtedness, to incur additional indebtedness that may restrict or prohibit the making of distributions, the payment of dividends or the making of loans by such subsidiaries to Holdings.

Initial Common Stock Offering

In May 2005, we completed the Initial Common Stock Offering. Prior to the consummation of the Initial Common Stock Offering, we, among other things, renamed all of our outstanding shares of Class A Common Stock as common stock and authorized an approximately 1,139 for 1 split of our common stock. We contributed the net proceeds from the Initial Common Stock Offering of $517 million to Holdings as an equity capital contribution. Holdings used all of such funds and approximately $57 million of cash received through dividends from Acquisition Corp. to redeem all outstanding Holdings Floating Rate Notes, all outstanding Holdings PIK Notes and 35% of the aggregate principal amount of the outstanding Holdings Discount Notes, including redemption premiums and interest obligations through the date of redemption.

Dividends

We intend to pay regular quarterly dividends on our common stock outstanding in an amount not to exceed $80 million per year. Any decision to declare and pay dividends in the future will be made at the discretion of our board of directors and will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions and other factors our board of directors may deem relevant.

On October 3, 2005, the Company declared a dividend on its outstanding common stock. The dividend was paid on November 23, 2005, to shareholders of record as of October 24, 2005, at a rate of $0.13 per share, representing a dividend of approximately $19.3 million in the aggregate (based on outstanding shares of 148,455,312.724 as of September 30, 2005). The portion of the dividend with respect to unvested restricted stock of approximately $1 million will be paid at such time as such shares become vested.

Covenant Compliance

Our borrowing arrangements, including the senior secured credit facility, the Holding Notes and the Acquisition Corp. Subordinated Notes contain certain financial covenants which are tied to ratios based on Adjusted EBITDA, which is defined under the indentures governing the notes as "EBITDA." Adjusted EBITDA (as defined in the indentures) differs from the term "EBITDA" as it is commonly used. In addition to adjusting net income to exclude interest expense, income taxes, and depreciation and amortization, Adjusted EBITDA (as defined in the indentures) also adjusts net income by excluding items or expenses not typically excluded in the calculation of "EBITDA" such as, among other items, (1) any reasonable expenses or charges related to any issuance of securities, investments permitted, permitted acquisitions, recapitalizations, asset sales permitted or indebtedness permitted to be incurred; (2) the amount of any restructuring charges or reserves, subject to certain limitations; (3) any non-cash charges (including any impairment charges); (4) any gain or loss resulting from hedging currency exchange risks; (5) the amount of management, monitoring, consulting and advisory fees paid to the Investor Group; and (6) any net after-tax income or loss from discontinued operations.

Adjusted EBITDA is presented herein because it is a material component of the covenants contained within the aforementioned agreements. Non-compliance with those covenants could result in the requirement to immediately repay all amounts outstanding under those agreements which could have a material adverse effect on our results of operations, financial position and cash flow. Adjusted EBITDA does not represent net income or cash flow from operations as those terms are defined by GAAP and does not necessarily indicate whether cash

flows will be sufficient to fund cash needs. While Adjusted 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. Adjusted 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 Adjusted EBITDA in the indentures 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. 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.

The following is a reconciliation of net loss, which is a GAAP measure of our operating results, to Adjusted EBITDA as defined, and the calculation of fixed charge coverage and Net Indebtedness and not senior indebtedness to Adjusted EBITDA ratios under our indentures governing the notes of Acquisition Corp. and Holdings for the most recently ended four fiscal quarters ended September 30, 2005. The terms and related calculations are defined in the indenture (in millions, except ratios).

	Twelve Months Ended September 30, 2005
Net loss of Warner Music Group	$ (169)
Minority interest expense	(5)
Warrant mark-to-market—Warner Music Group Corp.	17
Interest expense—Warner Music Group Corp.	(1)
Net loss of WMG Holdings Corp.	(180)
Loss on repayment of Holdings Notes—WMG Holdings Corp	(35)
Interest expense—WMG Holdings Corp	(35)
Net loss of WMG Acquisition Corp.	(110)
Interest expense, net	146
Income tax expense	55
Depreciation and amortization	238
Management fees(a)	79
Restructuring costs(b)	7
Equity in losses of equity method investees(c)	(1)
Net investment-related gains(d)	1
Non-cash compensation expense(e)	25
Adjusted EBITDA(f)	$ 440
Fixed Charges—WMG Acquisition Corp(g).	$ 111
Fixed Charges—WMG Holdings(h)	$ 121
Net Indebtedness—WMG Acquisition Corp.	$1,824
Net Indebtedness—WMG Holdings Corp.	$1,998
Fixed charges coverage ratio—WMG Acquisition Corp(i)	3.96x
Fixed charges coverage ratio—WMG Holdings(i)	3.63x
Net Indebtedness to Adjusted EBITDA ratio—WMG Acquisition Corp.(j)	4.15x
Net Senior Indebtedness to Adjusted EBITDA ratio—WMG Acquisition Corp.(j)	2.69x
Net Indebtedness to Adjusted EBITDA ratio—WMG Holdings(j)	4.54x

(a) Reflects management fees paid to the Investors for management advisory services.

(b) Reflects costs associated with restructurings.
(c) Represents our share of the net income of investments in companies accounted for using the equity method.
(d) Represents the gain on the sale of an equity method investment.
(e) Reflects costs of stock-based compensation accounted for under FAS 123.
(f) Includes certain non-recurring items, which we are not permitted to add back to net income under the indentures, including (i) $10 million of one-time bonuses paid in connection with the Initial Common Stock Offering, (ii) $19 million of one-time payments associated with our restricted stock and stock option awards granted at prices below the fair market value and (iii) a $24 million incurred in connection with the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of the remaining interests of the Lava Records joint venture.
(g) Fixed charges is defined in the indenture governing the Acquisition Corp. Subordinated Notes as consolidated interest expense excluding certain noncash interest expense.
(h) Fixed charges is defined in the indenture governing the Holdings Notes as consolidated interest expense excluding certain noncash interest expense. Pro forma effect has been given to fixed charges for the Holdings Notes as if they had been issued as of October 1, 2004.
(i) In order to be in compliance with certain debt covenants, the Fixed Charge coverage ratio needs to exceed a 2.0x ratio.
(j) In order for Acquisition Corp. to make certain restricted payments, including payments to Holdings on a pro forma basis after giving effect to such payments, its Net Indebtedness to Adjusted EBITDA ratio needs to be lower than 3.75x, and its Net Senior Indebtedness to Adjusted EBITDA ratio needs to be lower than 2.5x. In order for Holdings to make certain restricted payments, including payments to Warner Music Group Corp., its Net Indebtedness to Adjusted EBITDA ratio needs to be lower than 4.25x. Acquisition Corp. and Holdings may make additional restricted payments using certain other exceptions provided for in the indenture governing the Acquisition Corp. Notes and Holdings Notes, respectively.

The indentures governing the notes, subject to certain exceptions, also require the applicable issuer to have a Fixed Charge Coverage Ratio of at least 2.0 to 1.0 in order to incur additional debt.

Summary

Management believes that future funds generated from our operations and available borrowing capacity will be sufficient to fund our debt service requirements, working capital requirements, capital expenditure requirements, payment of regular dividends on our common stock and the remaining one-time costs associated with the execution of the restructuring plan for the foreseeable future. However, our ability to continue to fund these items and to reduce debt may be affected by general economic, financial, competitive, legislative and regulatory factors, as well as other industry-specific factors such as the ability to control music piracy.

Contractual and Other Obligations

Firm Commitments

The following table summarizes the Company's aggregate contractual obligations at September 30, 2005, and the estimated timing and effect that such obligations are expected to have on the Company's liquidity and cash flow in future periods. We expect to fund the firm commitments with operating cash flow generated in the normal course of business and availability under the $250 million (including $4 million of letters of credit) revolving credit portion of the senior secured credit facility.

	Fiscal years			
Firm Commitments and Outstanding Debt	2006	2007-2009	2010 and Thereafter	Total
	(in millions)			
Term loan facility	$ 17	$ 51	$1,362	$1,430
Acquisition Corp. Notes	—	—	642	642
Holdings Notes	—	—	174	174
Operating leases	34	104	225	363
Artist, songwriter and co-publisher commitments	74	221	74	369
Minimum funding commitments to investees and other obligations	10	38	2	50
Total firm commitments and outstanding debt	$135	$414	$2,479	$3,028

The following is a description of our firmly committed contractual obligations at September 30, 2005:

- Operating lease obligations primarily relate to the minimum lease rental obligations for our real estate and operating equipment in various locations around the world. These obligations have been presented without the benefit of $16 million of sublease income expected to be received under non-cancelable agreements.
- We enter into long-term commitments with artists, songwriters and co-publishers for the future delivery of music product. Aggregate firm commitments to such talent approximated $369 million across hundreds of artists, songwriters, publishers, songs and albums at September 30, 2005. Such commitments, which are unpaid advances across multiple albums and songs, are payable principally over a ten-year period, generally upon delivery of albums from the artists or future musical compositions by songwriters and co-publishers. Because the timing of payment, and even whether payment occurs, is dependent upon the timing of delivery of albums and musical compositions from talent, the timing and amount of payment of these commitments as presented in the above summary can vary significantly.
- We have minimum funding commitments and other related obligations to support the operations of various investments.

MARKET RISK MANAGEMENT

We are exposed to market risk arising from changes in market rates and prices, including movements in foreign currency exchange rates and interest rates.

Foreign Currency Risk

We have significant transactional exposure to changes in foreign currency exchange rates relative to the U.S. dollar due to the global scope of our operations. For the twelve months ended September 30, 2005, approximately $1.8 billion, or 52%, of our revenues were generated outside of the U.S. The top five revenue-producing international countries are the U.K., France, Germany, Japan and Italy, which use the British pound sterling, euro and Japanese yen as currencies, respectively. See Note 23 to our audited financial statements included elsewhere herein for information on our operations in different geographical areas.

Historically, we have used (and continue to use) foreign exchange contracts, primarily to hedge the risk that unremitted or future royalties and license fees owed to our domestic companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. In addition, we hedge foreign currency risk associated with financing transactions such as third party and inter-company debt.

We focus on managing the level of exposure to the risk of foreign current exchange rate fluctuations on our major currencies, which include the British pound sterling, euro, Japanese yen, Canadian dollar, and Australian dollar. Additionally, prior to the closing of the Acquisition, Old WMG and Time Warner used foreign exchange contracts to manage this risk. See Note 22 to our audited financial statements included elsewhere herein for additional information.

The Company also is exposed to foreign currency exchange rate risk with respect to its £100 million principal amount of sterling-denominated notes that were issued in April 2004. These sterling notes mature on April 15, 2014. As of September 30, 2005, these sterling notes had a fair value of approximately $185 million, compared to a carrying value of $176 million. Based on the principal amount of sterling-denominated notes outstanding as of September 30, 2005 and assuming that all other market variables are held constant (including the level of interest rates), a 10% weakening or strengthening of the U.S. dollar compared to the British pound sterling would not have an impact on the fair value of these sterling notes, since these notes are completely hedged as of September 30, 2005.

Interest-Rate Risk

We had $2.246 billion of total debt outstanding as of September 30, 2005, of which $1.430 billion was variable rate debt. As such, we are exposed to changes in interest rates. In order to manage this exposure, and consistent with the requirement under our senior secured credit facility to maintain a fixed-to-floating debt ratio of at least 50% of our actual funded debt though at least April 2007, we entered into interest rate swap agreements to hedge notional debt amounts of $300 million in 2004 and $597 million in 2005. Under these interest rate swap agreements, we agreed to receive floating-rate payments (based on three-month LIBOR rates) in exchange for fixed-rate payments.

Based on the amount of our floating-rate debt and our interest rate swap agreements outstanding as of September 30, 2005, each 25 basis point increase or decrease in interest rates would increase or decrease our annual interest expense and cash outlay by approximately $1.3 million. This potential increase or decrease is based on the simplified assumption that the level of floating-rate debt remains constant with an immediate across the board increase or decrease as of September 30, 2005 with no subsequent change in rates for the remainder of the period. This increase or decrease in rates would partially be mitigated by an increase or decrease in interest income earned on the Company's cash balances, almost all of which are invested in short-term variable interest rate earning assets.

In addition to our $1.430 billion of variable-rate debt, we had approximately $816 million of fixed-rate debt outstanding at September 30, 2005. Based on the level of interest rates prevailing at September 30, 2005, the fair value of this fixed-rate debt was approximately $834 million. Further, based on the amount of our fixed-rate debt and our related $897 million of interest rate swap agreements noted above that were outstanding at September 30, 2005, a 25 basis point increase or decrease in the level of interest rates would increase or decrease the fair value of the fixed-rate debt by approximately $16.6 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.

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

CRITICAL ACCOUNTING POLICIES

The SEC's Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggests companies provide additional disclosure and commentary on those accounting policies considered most critical. FRR 60 considers an accounting policy to be critical if it is important to our financial condition and results, and requires significant judgment and estimates on the part of management in our application. We believe the following list represents the critical accounting policies of us as contemplated by FRR 60. For a summary of all of our significant accounting policies, see Note 3 and Note 4 to our audited financial statements included elsewhere herein.

Purchase Accounting

We account for our business acquisitions under the purchase method of accounting. The total cost of acquisitions is allocated to the underlying identifiable net assets based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, asset lives and market multiples, among other items. In addition, reserves have been established on our balance sheet related to acquired liabilities and qualifying restructuring costs based on assumptions made at the time of acquisition. We evaluate these reserves on a regular basis to determine the adequacy or accuracy of the amounts estimated.

Accounting for Goodwill and Other Intangible Assets

We account for our goodwill and other indefinite-lived intangible assets under Statement of Accountings Standards No. 142, Goodwill and Other Intangible Assets ("FAS 142"). Under FAS 142 the Company no longer amortizes goodwill, including the goodwill included in the carrying value of investments accounted for using the equity method of accounting, and certain other intangible assets deemed to have an indefinite useful life. FAS 142 requires that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques on an annual basis and when events occur that may suggest that the fair value of such assets cannot support the carrying value. Goodwill impairment is tested using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its net book value (or carrying amount), including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. To assist in the process of determining goodwill impairment, we obtain appraisals from independent valuation firms when necessary. In addition to the use of independent valuation firms, we perform internal valuation analyses and considers other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows, market comparisons and analysis of recent transactions. These approaches use significant estimates and assumptions including projected future cash flows (including timing), discount rate reflecting the risk inherent in future cash flows, perpetual growth rate, determination of appropriate market comparables and the determination of whether a premium or discount should be applied to comparables.

We test our goodwill and other indefinite lived intangible assets for impairment on an annual basis in September of each fiscal year. We tested our goodwill and other indefinite lived intangible assets for impairment in the fourth quarter of 2005 and noted that no impairment occurred.

During the fourth quarter of 2003, in connection with Time Warner's agreement to sell us, we recorded a $1.019 billion impairment charge to reduce the carrying value of our intangible assets to fair value based on the consideration to be exchanged in the transaction. The impairment charge is classified as a component of operating loss in our combined statement of operations. The charge consisted of a reduction in the carrying value of goodwill by $5 million, brands and trademarks by $766 million, recorded music catalog by $208 million and other intangible assets by $40 million. Because the 2003 impairment charge was based principally on the difference between the negotiated purchase price of Warner Music Group and the historical book value of the net assets acquired, the amount of the charge was readily determinable.

As of September 30, 2005, Warner Music Group has recorded goodwill in the amount of $869 million, primarily related to the Acquisition. See Note 5 and Note 10 to our audited financial statements included herein for a further discussion of Warner Music Group's goodwill.

Equity Method and Cost Method Investments

For non-publicly traded investments, management's assessment of fair value is based on valuation methodologies including discounted cash flows, estimates of sales proceeds and external appraisals, as appropriate. The ability to accurately predict future cash flows, especially in developing and unstable markets, may impact the determination of fair value.

In the event a decline in fair value of an investment occurs, management may be required to determine if the decline in market value is other than temporary. Management's assessments as to the nature of a decline in fair value are based on the valuation methodologies discussed above and our ability and intent to hold the investment. We consider our equity method investees to be strategic long-term investments; therefore, we generally complete our assessments with a long-term viewpoint. If the fair value of any of our equity method or cost method investments is less than the carrying value and the decline in value is considered to be other than temporary, an impairment charge is recorded to write down the carrying value of the investment to its fair value. Management's assessments of fair value in accordance with these valuation methodologies represent our best estimates as of the time of the impairment review and are consistent with our internal planning. If different fair values were estimated, this could have a material impact on the financial statements.

Revenue and Cost Recognition

Sales Returns and Uncollectible Accounts

In accordance with practice in the recorded music industry and as customary in many territories, certain products (such as compact discs and cassettes) are sold to customers with the right to return unsold items. Under Statement of Accounting Standards No. 48, Revenue When Right of Return Exists, revenues from such sales are recognized when the products are shipped based on gross sales less a provision for future estimated returns.

In determining the estimate of product sales that will be returned, management analyzes historical returns, current economic trends, changes in customer demand and commercial acceptance of our products. Based on this information, management reserves a percentage of each dollar of product sales to provide for the estimated customer returns.

Similarly, management evaluates accounts receivables to determine if they will ultimately be collected. In performing this evaluation, significant judgments and estimates are involved, including an analysis of specific risks on a customer-by-customer basis for larger accounts and customers, and a receivables aging analysis that determines the percent that has historically been uncollected by aged category. Based on this information, management provides a reserve for the estimated amounts believed to be uncollectible.

Based on management's analysis of sales returns and uncollectible accounts, reserves totaling $218 million and $222 million have been established at September 30, 2005 and September 30, 2004, respectively. This compares to total gross receivables of $855 million and $793 billion at September 30, 2005 and September 30, 2004, respectively.

The comparability of the gross dollar value of such reserves has been affected by the inherent seasonality in the music business. That is, the recorded music business historically has generated approximately 35% of its sales in the last three months of the calendar year due to increased consumer demand associated with the holiday season. As such, both gross receivables and related allowances would be at a naturally lower level at September 30, the end of our fiscal year, and at a naturally higher level at December 31, the end of our first fiscal quarter. The ratios of our receivable allowances to gross accounts receivables were approximately 25% and 28% at the end of September 30, 2005 and September 30, 2004, respectively.

Gross Versus Net Revenue Classification

In the normal course of business, we act as an intermediary or agent with respect to certain payments received from third parties. For example, we distribute music product on behalf of third-party record labels.

The accounting issue encountered in these arrangements is whether we should report revenue based on the "gross" amount billed to the ultimate customer or on the "net" amount received from the customer after participation and other royalties paid to third parties. To the extent revenues are recorded gross (in the full amount billed), any participations and royalties paid to third parties are recorded as expenses so that the net amount (gross revenues, less expenses) flows through operating income. Accordingly, the impact on operating income is the same, whether we record the revenue on a gross basis or net basis (less related participations and royalties).

Determining whether revenue should be reported gross or net is based on an assessment of whether we are acting as the "principal" in a transaction or acting as an "agent" in the transaction. To the extent we are acting as a principal in a transaction, we report as revenue the payments received on a gross basis. To the extent we are acting as an agent in a transaction, we report as revenue the payments received less participations and royalties paid to third parties, i.e., on a net basis. The determination of whether we are serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement.

In determining whether we serve as principal or agent in these arrangements, we follow the guidance in EITF 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" ("EITF 99-19"). Pursuant to such guidance, we serve as the principal in transactions where we have the substantial risks and rewards of ownership. The indicators that we have substantial risks and rewards of ownership are as follows:

- we are the supplier of the products or services to the customer;
- we have general inventory risk for a product before it is sold;
- we have latitude in establishing prices;
- we have the contractual relationship with the ultimate customer;
- we modify and service the product purchased to meet the ultimate customer specifications;
- we have discretion in supplier selection; and
- we have credit risk.

Conversely, pursuant to EITF 99-19, we serve as agent in arrangements where we do not have substantial risks and rewards of ownership. The indicators that we do not have substantial risks and rewards of ownership are as follows:

- the supplier (not Warner Music Group) is responsible for providing the product or service to the customer;
- the supplier (not Warner Music Group) has latitude in establishing prices;
- the amount we earn is fixed; and
- the supplier (not Warner Music Group) has credit risk.

Based on the above criteria and for the more significant transactions that we have evaluated, we record the distribution of product on behalf of third-party record labels on a gross basis, subject to the terms of the contract. However, recorded music compilations distributed by other record companies where we have a right to participate in the profits are recorded on a net basis.

Accounting for Royalty Advances

We regularly commit to and pay advance royalties to our artists and songwriters in respect of future sales. We account for these advance royalty payments under the related guidance in Statement of Financial Accounting Standard No. 50, "Financial Reporting in the Record and Music Industry" ("FAS 50"). Under FAS 50, we capitalize as assets certain advance royalty payments that management believes are recoverable from future royalties to be earned by the artist or songwriter.

Management's decision to capitalize an advance to an artist or songwriter as an asset requires significant judgment as to the recoverability of these advances. The recoverability of these assets is assessed upon initial commitment of the advance, based upon management's forecast of anticipated revenues from the sale of future and existing music and publishing-related products. In determining whether these amounts are recoverable, management evaluates the current and past popularity of the artist or songwriter, the initial or expected commercial acceptability of the product, the current and past popularity of the genre of music that the product is designed to appeal to, and other relevant factors. Based upon this information, management expenses the portion of such advances that it believes is not recoverable. In many cases, royalty advance payments to artists or publishers without history of successful commercial acceptability of the product and evidence of current or past popularity will be expensed immediately. All advances are assessed for recoverability continuously and at minimum on a quarterly basis.

We had $380 million and $446 million of advances on our balance sheet as of September 30, 2005 and 2004, respectively. We believe such advances are recoverable through future royalties to be earned by the related artists and songwriters.

Stock-Based Compensation

We account for stock-based compensation issued to employees in accordance with Statement of Financial Accounting Standard No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure" ("FAS 148"), which amends Statement of Financial Accounting Standard FASB Statement No. 123, "Share Based Payment", "FAS 123"). This statement provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. We adopted the expense recognition provision of FAS 123 as of March 1, 2004, the date of the Acquisition, and record stock-based compensation expense for grants on and after that date as provided by FAS 148, and will continue to provide pro forma information for all previous periods in the notes to financial statements to provide results as if FAS 123 had been adopted in those years. Under this provision, we estimate the fair value of our stock-based awards on the grant date and expense the fair value over the service period.

As disclosed in the notes to financial statements, we previously estimated the fair value of options issued at the date of grant using a Black-Scholes option-pricing model, which includes assumptions related to volatility, expected life, dividend yield and risk-free interest rate. In January of 2005 we determined that a binomial method was a more accurate and appropriate method for determining fair value. We have estimated the fair value of our grants made subsequent to January 2005 using the binomial method, which includes assumptions related to volatility, expected life, dividend yield and risk factors. We also award or sell restricted shares to our employees. For restricted shares awarded or sold below market value, the accounting charge is measured at the grant date and amortized ratably as non-cash compensation over the vesting term.

Accounting for Income Taxes

As part of the process of preparing its consolidated financial statements, we are required to estimate income taxes payable in each of the jurisdictions in which it operates. This process involves estimating the actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes", ("FAS 109"), requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. In circumstances where there is sufficient negative evidence, establishment of a valuation allowance must be considered. We believe that cumulative losses in the most recent three-year period represent sufficient negative evidence to consider a valuation allowance under the provisions of FAS 109. As a result, we determined that certain of our deferred tax assets required the establishment of a valuation allowance.

The realization of the remaining deferred tax assets is primarily dependent on forecasted future taxable income. Any reduction in estimated forecasted future taxable income may require that we record additional valuation allowances against our deferred tax assets on which a valuation allowance has not previously been established. The valuation allowance that has been established will be maintained until there is sufficient positive evidence to conclude that it is more likely than not that such assets will be realized. An ongoing pattern of profitability will generally be considered as sufficient positive evidence. Our income tax expense recorded in the future may be reduced to the extent of offsetting decreases in our valuation allowance if such valuation allowances were not established through goodwill at the time of the Acquisition. The establishment and reversal of valuation allowances could have a significant negative or positive impact on our future earnings.

Tax assessments may arise several years after tax returns have been filed. Predicting the outcome of such tax assessments involves uncertainty; however, we believe that recorded tax liabilities adequately account for our analysis of probable outcomes.

New Accounting Principles

In addition to the critical accounting policies discussed above, we adopted several new accounting policies during the past two years. None of these new accounting principles had a material affect on our audited financial statements. See Notes 3 to our audited financial statements included elsewhere herein for a more complete summary.

RISK FACTORS

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

Risks Related to our Business

Increased costs associated with corporate governance compliance may significantly affect our results of operations.

Prior to our acquisition by the Investor Group in 2004, we were a business division of Time Warner. Accordingly, we have limited experience operating as an independent company implementing our own corporate governance practices. We expect the continued evaluation and implementation of corporate governance and securities disclosure and compliance practices in order to comply with these requirements will increase our legal compliance and financial reporting costs. In addition, they could make it more difficult for us to attract and retain qualified members of our board of directors, or qualified executive officers. Finally, director and officer liability insurance for public companies like us has become more difficult and more expensive to obtain, and we may be required to accept reduced coverage or incur higher costs to obtain coverage that is satisfactory to us and our officers or directors. We continue to evaluate and monitor regulatory developments and cannot estimate the timing or magnitude or additional costs we may incur as a result.

Our internal controls over financial reporting may not be adequate and our independent auditors may not be able to certify as to their adequacy, which could have a significant and adverse effect on our business and reputation.

We are evaluating our internal controls over financial reporting in order to allow management to report on, and our independent auditors to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and rules and regulations of the SEC there under, which we refer to as Section 404. Section 404 requires a reporting company such as ours to, among other things, annually review and disclose its internal controls over financial reporting, and evaluate and disclose changes in its internal controls over financial reporting quarterly. We will be required to comply with Section 404 as of September 30, 2006. We are currently performing the system and process evaluation and testing required (and any necessary

remediation) in an effort to comply with management certification and auditor attestation requirements of Section 404. In the course of our ongoing evaluation, we have identified areas of our internal controls requiring improvement, and plan to design enhanced processes and controls to address these and any other issues that might be identified through this review. As a result, we expect to incur additional expenses and diversion of management's time. We cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations and may not be able to ensure that the process is effective or that the internal controls are or will be effective in a timely manner. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, our independent auditors may not be able to certify as to the effectiveness of our internal control over financial reporting and we may be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission. As a result, there could be an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements. In addition, we may be required to incur costs in improving our internal control system and the hiring of additional personnel. Any such action could adversely affect our results.

Our outside auditors have identified weaknesses in our internal controls that could affect our ability to ensure reliable financial reports.

In addition to our evaluation of internal controls under Section 404 of the Sarbanes-Oxley Act and any areas requiring improvement that we identify as part of that process, in connection with our most recent audit, our outside auditors identified a material weakness related to our royalty controls. A material weakness, as defined by the Public Company Accounting Oversight Board, is a significant deficiency that by itself, or in combination with other significant deficiencies, results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Our outside auditors noted that our domestic operations currently use different royalty systems, which has created certain complexities in reconciling royalty payables. While we recognize that additional staff is needed to cope with current requirements in royalty processing until a new system can be developed, we may not be able to hire and train additional staff. While we have begun to take actions to address the issues surrounding our royalty systems, including hiring outside resources to assist our internal personnel with royalties accounting and entering into a joint venture with Universal Music Group, Exigen Group and Lightspeed Venture Partners to build a new uniform royalty system for all U.S. operations, additional measures will be necessary and these measures along with other measures we expect to take to improve our internal controls may not be sufficient to address the issues identified by our outside auditors or ensure that our internal controls are effective. If we are unable to provide reliable financial reports our business and prospects could suffer material adverse effects and our share price could be adversely affected.

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

Illegal downloading of music from the Internet, CD-R piracy, industrial piracy, economic recession, bankruptcies of record wholesalers and retailers and growing competition for consumer discretionary spending and retail shelf space may all be contributing to a declining recorded music industry. Additionally, the period of growth in recorded music sales driven by the introduction and penetration of the CD format has ended. No significant new legitimate audio format has yet emerged to take the place of the CD. The value of worldwide sales (recorded music, excluding sales of digital tracks), as reported by IFPI at fixed 2004 exchange rates, fell as the music industry witnessed a decline of 1.6% from 1999 to 2000, 1.3% from 2000 to 2001, 6.7% from 2001 to 2002, 7.6% from 2002 to 2003 and 1.3% from 2003 to 2004. We cannot assure you as to the timing or the extent of any improvement in the industry or that the evidence of improvement in 2004 based upon U.S. sales through the one-year period ending January 2, 2005 and global sales in the first half of 2004 will continue. For example, as of November 20, 2005, year-to-date U.S. recorded music sales (excluding sales of digital tracks) are down approximately 7.6% year-over-year. A declining recorded music industry is likely to lead to reduced levels of revenue and operating income generated by our Recorded Music business. Additionally, a declining recorded music industry is also likely to have a negative impact on our Music Publishing business, which generates a

significant portion of its revenues from mechanical royalties, primarily from the sale of music in CD and other recorded music formats.

There may be downward pressure on our pricing and our profit margins.

There are a variety of factors which could cause us to reduce our prices and erode our profit margins. They are, among others, increased price competition among record companies resulting from the Universal and Sony BMG recorded music duopoly, price competition from the sale of motion pictures in DVD-Video format and videogames, the ever greater price negotiating leverage of mass merchandisers and big box retailers, the increased costs of doing business with mass merchandisers and big box retailers as a result of complying with operating procedures that are unique to their needs and the adoption by record companies of initially lower-margin formats such as DualDisc and DVD-Audio. See "Risk Factors—We may be materially and adversely affected by the formation of Sony BMG Music Entertainment."

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

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

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

The combined effect of the decreasing cost of electronic and computer equipment and related technology such as CD burners and the conversion of music into digital formats have made it easier for consumers to create unauthorized copies of our recordings in the form of, for example, CDs and MP3 files. A substantial portion of our revenue comes from the sale of audio products that are potentially subject to unauthorized consumer copying and widespread dissemination on the Internet without an economic return to us. We are working to control this problem through litigation, by lobbying governments for new, stronger copyright protection laws and more stringent enforcement of current laws and by establishing legitimate new media business models. We cannot give any assurances that such measures will be effective. If we fail to obtain appropriate relief through the judicial process or the complete enforcement of judicial decisions issued in our favor (or if judicial decisions are not in our favor), if we are unsuccessful in our efforts to lobby governments to enact and enforce stronger legal penalties for copyright infringement or if we fail to develop effective means of protecting our intellectual property (whether copyrights or other rights such as patents, trademarks and trade secrets) or entertainment-related products or services, our results of operations, financial position and prospects may suffer.

Organized industrial piracy may lead to decreased sales.

The global organized commercial pirate trade is a significant threat to the music industry. Worldwide, industrial pirated music (which encompasses unauthorized physical copies manufactured for sale but does not

include Internet downloads or home CD burning) is estimated to have generated over $4.6 billion in revenues in 2004, according to IFPI. IFPI estimates that 1.5 billion pirated units were manufactured in 2004. According to IFPI estimates, approximately 34% of all music CDs sold worldwide in 2004 were pirated. Unauthorized copies and piracy contributed to the decrease in the volume of legitimate sales and put pressure on the price of legitimate sales. They have had, and may continue to have, an adverse effect on our business.

We may not be able to continue to realize the benefits from our restructuring plan and our restructuring plan may adversely affect our business.

In 2005 we substantially completed a restructuring of our business. The scope of our restructuring plan was broad and significant and may cause losses to our business that we cannot predict. Since the time of the Acquisition we have implemented annualized cost savings of approximately $250 million. We cannot assure you that we will continue to realize the benefits of the cost savings achieved.

The primary challenge we face in continuing to realize the cost savings in our restructuring plan is avoiding increased costs required to support our ongoing operations. Specifically, a variety of factors could cause us not to continue to achieve the benefits of the restructuring, or could result in harm to our business, including, among others, the following:

- higher than expected retention costs for employees that have been retained;
- increased operating costs or other unexpected costs associated with supporting the business and meeting financial objectives such as revenue growth;
- loss of revenues and market share due to, among other things, a diminished ability to attract and hire desirable talent;
- unexpected loss of artists or key employees; and
- loss of revenues and market share due to, among other things, a lack of sufficient resources to promote records and albums, and a lack of sufficient resources to attract new artists.

If we fail to continue to realize the benefits of the cost savings achieved through the restructuring plan, our results of operations and financial position may suffer. In addition, we cannot predict the extent to which our restructuring plan may adversely affect our business.

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

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

The recorded music industry is under investigation by Eliot Spitzer, the Attorney General for the State of New York, regarding its practices in promoting its records to radio stations.

On September 7, 2004, November 22, 2004 and March 31, 2005, Eliot Spitzer, the Attorney General of the State of New York, served us with requests for information in the form of subpoenas duces tecum in connection with an industry-wide investigation of the relationship between music companies and radio stations, including the use of independent promoters and accounting for any such payments. The investigation was pursuant to New York Executive Law §63(12) and New York General Business Law §349, both of which are consumer fraud

statutes. On November 22, 2005 we reached a settlement with the Attorney General in connection with this investigation. As part of such settlement, we agreed to make $5 million in charitable payments and to abide by a list of permissible and impermissible promotional activities. On July 25, 2005, Sony BMG reached a settlement with the Attorney General in connection with the same industry-wide investigation. Subsequent to the settlement by Sony BMG, TSR Records, an independent label, filed an antitrust suit against Sony BMG alleging that the label's radio promotion activities are anticompetitive. While it is too soon to predict the outcome of these recent developments on us, any litigation we may become involved in as a result of our settlement with the Attorney General, regardless of the merits of the claim, could be costly and would divert the time and resources of management.

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

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

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

Our business is seasonal. For the fiscal year ended September 30, 2005, we derived approximately 83% of our revenues from our Recorded Music business. In the recorded music business, purchases are heavily weighted towards the last three months of the calendar year, which represent our first quarter under our September 30 fiscal year. Historically, we have realized approximately 35% of recorded music net sales worldwide during the last three months of the calendar year, making those three months (i.e., our new first fiscal quarter) material to our full-year performance. We realized 32% of recorded music calendar year net sales during the last three months of 2004. This sales seasonality affects our operating cash flow from quarter to quarter. We cannot assure you that our recorded music net sales for the last three months of any calendar year will continue to be sufficient to meet our obligations or that they will be higher than such net sales for our other quarters. In the event that we do not derive sufficient recorded music net sales in such last three months, we may not be able to meet our debt service requirements, working capital requirements, capital expenditure requirements, payment of regular dividends on our common stock and other obligations.

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

The industry in which we operate is highly competitive, is based on consumer preferences and is rapidly changing. Additionally, the music industry requires substantial human and capital resources. We compete with other recorded music companies and music publishers to identify and sign new recording artists and songwriters who subsequently achieve long-term success and to renew agreements with established artists and songwriters. In addition, our competitors may from time to time reduce their prices in an effort to expand market share and introduce new services, or improve the quality of their products or services. We may lose business if we are unable to sign successful artists or songwriters or to match the prices or the quality of products and services, offered by our competitors. Our Music Publishing business competes not only with other music publishing companies, but also with songwriters who publish their own works. Our Recorded Music business is to a large

extent dependent on technological developments, including access to and selection and viability of new technologies, and is subject to potential pressure from competitors as a result of their technological developments. For example, our Recorded Music business may be adversely affected by technological developments that facilitate the piracy of music, such as Internet peer-to-peer file-sharing and CD-R activity; by its inability to enforce our intellectual property rights in digital environments; and by its failure to develop a successful business model applicable to a digital online environment, including such channels of distribution as satellite radio. It also faces competition from other forms of entertainment and leisure activities, such as cable and satellite television, pre-recorded films on videocassettes and DVD, the Internet and computer and videogames.

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

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

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

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

In addition, our results can be affected by trends, developments and other events in individual countries. There can be no assurance that in the future other country-specific trends, developments or other events will not have such a significant adverse effect on our business, results of operations or financial condition.

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

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

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

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

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

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

We have positioned ourselves to take advantage of the Internet and wireless as a sales distribution channel and believe that the development of legitimate channels for digital music distribution holds promise for us in the future. However, legitimate channels for digital distribution are a recent development and we cannot predict their impact on our business. In digital formats, certain costs associated with physical products such as manufacturing, distribution, inventory and return costs do not apply. While there are some digital-specific variable costs and infrastructure investments necessary to produce, market and sell music in digital formats, we believe it is reasonable to expect that we will generally derive a higher contribution margin from digital versus physical sales. However, we cannot assure you that we will generally continue to achieve higher margins from digital sales. Any legitimate digital distribution channel that does develop may result in lower or less profitable sales for us than comparable physical sales. In addition, the transition to greater sales through digital channels introduces uncertainty regarding the potential impact of the "unbundling" of the album on our business. While recent studies have indicated that consumers spend more on music in general when they begin to purchase music in digital form than previously, it remains unclear how consumer behavior will change when faced with the prospect of purchasing only their favorite tracks from a given album rather than the entire album. In addition, if piracy continues unabated and legitimate digital distribution channels fail to gain consumer acceptance, our results of operations could be harmed.

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

Mechanical royalties and performance royalties are the two largest sources of income to our Music Publishing business and mechanical royalties are a significant expense to our Recorded Music business. In the U.S., mechanical rates are set pursuant to industry negotiations contemplated by the U.S. Copyright Act and performance rates are set by performing rights societies and subject to challenge by performing rights licensees. Outside the U.S., mechanical and performance rates are typically negotiated on an industry-wide basis. The mechanical and performance rates set pursuant to such processes may adversely affect us by limiting our ability to increase the profitability of our Music Publishing business. If the mechanical rates are set too high it may also

adversely affect us by limiting our ability to increase the profitability of our Recorded Music business. In addition, rates our Recorded Music business receives in the U.S. for, among other sources of income and potential income, the statutory license for eligible non-subscription services to perform sound recordings publicly by means of digital audio transmissions ("webcasting"), the statutory license to make ephemeral recordings of sound recordings for use of sound recordings and the statutory license for use of our content on satellite radio are set by an arbitration process under the U.S. Copyright Act unless rates are determined through voluntary negotiations. If the rates for these and other income sources are set too low through this process, it could have a material adverse impact on our Recorded Music business or our business prospects.

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

The reporting currency for our financial statements is the U.S. dollar. We have substantial assets, liabilities, revenues and costs denominated in currencies other than U.S. dollars. To prepare our consolidated financial statements, we must translate those assets, liabilities, revenues and expenses into U.S. dollars at then-applicable exchange rates. Consequently, increases and decreases in the value of the U.S. dollar versus other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. These translations could result in significant changes to our results of operations from period to period. For the fiscal year ended September 30, 2005, approximately 52% of our revenues related to operations in foreign territories. From time to time, we enter into foreign exchange contracts to hedge the risk of unfavorable foreign currency exchange rate movements. As of September 30, 2005, we have hedged our material foreign currency exposures related to royalty payments remitted between our foreign affiliates and our U.S. affiliates for the balance of the fiscal year.

We may not have full control and ability to direct the operations we conduct through joint ventures.

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

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

California Labor Code Section 2855 ("Section 2855") limits the duration of time any individual can be bound under a contract for "personal services" to a maximum of seven years. In 1987, Subsection (b) was added, which provides a limited exception to Section 2855 for recording contracts, creating a damages remedy for record companies. Legislation was introduced in California to repeal Subsection (b) and then withdrawn. Legislation was introduced in New York to create a statute similar to Section 2855, which did not advance. There is no assurance that New York, California or any other state will not reintroduce or introduce similar legislation in the future. In fact, legislation similar to Section 2855 has recently been introduced in the New York Assembly. The repeal of Subsection (b) of Section 2855 and/or the passage of legislation similar to Section 2855 by other states could materially affect our results of operations and financial position.

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

The U.S. Copyright Act provides authors (or their heirs) a right to terminate licenses or assignments of rights in their copyrighted works. This right does not apply to works that are "works made for hire". Since the effective date of U.S. copyrightability for sound recordings (February 15, 1972), virtually all of our agreements with recording artists provide that such recording artists render services under an employment-for-hire relationship. A termination right exists under the U.S. Copyright Act for musical compositions that are not "works made for hire". If any of our commercially available recordings were determined not to be "works made

for hire", then the recording artists (or their heirs) could have the right to terminate the rights they granted to us, generally during a five-year period starting at the end of 35 years from the date of a post-1977 license or assignment (or, in the case of a pre-1978 grant in a pre-1978 recording, generally during a five-year period starting either at the end of 56 years from the date of copyright or on January 1, 1978, whichever is later). A termination of rights could have an adverse effect on our Recorded Music business. From time to time, authors (or their heirs) can terminate our rights in musical compositions. However, we believe the effect of those terminations is already reflected in the financial results of our Music Publishing business.

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

We may acquire, make investments in, or enter into strategic alliances or joint ventures with, companies engaged in businesses that are similar or complementary to ours. If we make such acquisitions or investments or enter into strategic alliances, we will face certain risks inherent in such transactions. For example, gaining regulatory approval for significant acquisitions or investments could be a lengthy process and there can be no assurance of a successful outcome. We could face difficulties in managing and integrating newly acquired operations. Additionally, such transactions would divert management resources and may result in the loss of artists or songwriters from our rosters. We cannot assure you that if we make any future acquisitions, investments, strategic alliances or joint ventures that they will be completed in a timely manner, that they will be structured or financed in a way that will enhance our credit-worthiness and allow for continued payment of regular dividends or that they will meet our strategic objectives or otherwise be successful. Failure to effectively manage any of these transactions could result in material increases in costs or reductions in expected revenues, or both.

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

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

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

Cinram is currently our exclusive supplier of manufacturing, packaging and physical distribution services in North America and most of Europe. Accordingly, our continued ability to meet our manufacturing, packaging and physical distribution requirements in those territories depends largely on Cinram's continued successful operation in accordance with the service level requirements mandated by us in our service agreements. If, for any

reason, Cinram were to fail to meet contractually required service levels, we would have difficulty satisfying our commitments to our wholesale and retail customers, which could have an adverse impact on our revenues. Even though our agreements with Cinram give us a right to terminate based upon failure to meet mandated service levels, and there are several capable substitute suppliers, it might be difficult for us to switch to substitute suppliers for any such services, particularly in the short-term, and the delay and transition time associated with finding substitute suppliers could itself have an adverse impact on our revenues. In addition, our agreements with Cinram begin to expire in 2006. If we are unable to negotiate renewals of these agreements we would have to switch to substitute suppliers. Further, pricing negotiated with Cinram in future agreements may be more or less favorable than the existing agreements.

We may be materially and adversely affected by the formation of Sony BMG Music Entertainment.

In August 2004 Sony Music Entertainment ("Sony") and Bertelsmann Music Group ("BMG") merged their recorded music businesses to form Sony BMG Music Entertainment ("Sony BMG"). As a result, the recorded music market now consists of four major players (Universal, Sony BMG, EMI Recorded Music ("EMI") and us) rather than five (Universal, Sony, BMG, EMI and us). Prior to the formation of Sony BMG, there was one disproportionately large major, Universal, with approximately 25% market share and four other majors relatively equal in size with market shares ranging between 11% and 14%. Now there are two majors with 2004 global market shares over 25%, Universal and Sony BMG, and two significantly smaller majors, EMI and us, each with less than 15%. There is a threat that the change in the competitive landscape caused by the new Universal and Sony BMG duopoly could drive up the costs of artist signings and the costs of marketing and promoting records to our detriment.

Risks Related to our Leverage

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

We are highly leveraged. As of September 30, 2005, our total consolidated indebtedness was $2.246 billion. We have an additional $250 million available for borrowing under the revolving portion of our senior secured credit facility (less $4 million of current letters of credit).

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

- making it more difficult for us and our subsidiaries to make payments on indebtedness;
- increasing our vulnerability to general economic and industry conditions;
- requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on indebtedness, therefore reducing our ability to use our cash flow to fund our operations, capital expenditures and future business opportunities;
- exposing us to the risk of increased interest rates as certain of the borrowings of our subsidiaries, including borrowings under our senior secured credit facility, will be at variable rates of interest;
- limiting our ability and the ability of our subsidiaries to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions and general corporate or other purposes; and
- limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who are less highly leveraged.

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

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

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

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

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

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

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

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

In addition, under our senior secured credit agreement, our subsidiaries are required to satisfy and maintain specified financial ratios and other financial condition tests. Their ability to meet those financial ratios and tests can be affected by events beyond our control, and they may not be able to meet those ratios and tests. A breach of any of these covenants could result in a default under our senior secured credit agreement. Upon the occurrence of an event of default under our senior secured credit agreement, the lenders could elect to declare all amounts outstanding under our senior secured credit agreement to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders under our senior secured credit agreement could proceed against the collateral granted to them to secure that indebtedness. We have pledged a significant portion of our assets as collateral under our senior secured credit agreement. If the lenders under our senior secured credit agreement accelerate the repayment of borrowings, we may not have sufficient assets to repay our senior secured credit agreement, as well as any unsecured indebtedness.

Risks Related to our Common Stock

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

The Investor Group controls a majority of our outstanding common stock. As a result, we are a "controlled company" within the meaning of the New York Stock Exchange corporate governance standards. Under the New York Stock Exchange rules, a company of which more than 50% of the voting power is held by an individual, a group, or another company is a "controlled company" and may elect not to comply with certain New York Stock Exchange corporate governance requirements, as applicable, including (1) the requirement that a majority of the board of directors consist of independent directors, (2) the requirement that we have a nominating/corporate governance committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities and (3) the requirement that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities. We are and intend to continue to utilize these exemptions while we are a controlled company. As a result, we will not have a majority of independent directors nor will our nominating and corporate governance committee, which also serves as our executive committee, and compensation committee consist entirely of independent directors. Accordingly, you will not have the same protections afforded to stockholders of companies that are subject to all of the New York Stock Exchange corporate governance requirements.

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

The market price of our common stock could decline as a result of sales of a large number of shares of common stock in the market or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. As of September 30, 2005 we had approximately 148.5 million shares of common stock outstanding. Of those shares, the 32.6 million shares sold in our Initial Common Stock Offering in May 2005 are freely tradable. Of the remaining shares, approximately 8.3 million shares represent restricted stock. Of these shares, approximately 1.1 million shares were vested as of September 30, 2005. The approximately 107.5 million remaining shares plus the vested restricted stock will be eligible for resale from time to time, subject to contractual and Securities Act restrictions. The Investor Group, which collectively beneficially own approximately 107.5 million shares, have the ability to cause us to register the resale of their shares and certain other holders of our common stock, including members of our management, will be able to participate in such registration. In addition, notwithstanding the foregoing, we have registered all 8.3 million shares of restricted common stock and approximately 8.4 million shares underlying options issued and that may be issued in the future pursuant to our benefit plans and arrangements on registration statements on Form S-8 and such shares may be sold as provided therein.

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

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

- actual or anticipated variations in operating results;
- changes in financial estimates by research analysts;
- actual or anticipated changes in economic, political or market conditions, such as recessions or international currency fluctuations;

- actual or anticipated changes in the regulatory environment affecting the music industry;
- changes in the retailing environment;
- changes in the market valuations of other music industry peers; and
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives.

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

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

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As discussed in Note 22 to our audited consolidated financial statements for the twelve months ended September 30, 2005, 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 September 30, 2005, other than as described below, there have been no material changes to the Company's exposure to market risk since September 30, 2004.

We are exposed to foreign currency exchange rate risk with respect to our £100 million principal amount of sterling-denominated notes that were issued in April 2004. These sterling notes mature on April 15, 2014. As of September 30, 2005, these sterling notes had a fair value of approximately $185 million, compared to a carrying value of $176 million. Based on the principal amount of sterling-denominated notes outstanding as of September 30, 2005 and assuming that all other market variables are held constant (including the level of interest rates), a 10% weakening or strengthening of the U.S. dollar compared to the British pound sterling would not have an impact on the fair value of these sterling notes, since these notes are completely hedged as of September 30, 2005.

We are exposed to interest rate risk with respect to our floating rate debt. Based on the amount of our floating-rate debt and our interest rate swap agreements outstanding as of September 30, 2005, each 25 basis point increase or decrease in interest rates would increase or decrease our annual interest expense and cash outlay by approximately $1.3 million. This potential increase or decrease is based on the simplified assumption that the level of floating-rate debt remains constant with an immediate across the board increase or decrease as of September 30, 2005 with no subsequent change in rates for the remainder of the period. This increase or decrease in rates would partially be mitigated by an increase or decrease in interest income earned on our cash balances, almost all of which are invested in short-term variable interest rate earning assets.

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

The Company did not enter into any significant foreign exchange forward contracts in October and November 2005.

During the twelve months ended September 30, 2005, the Company entered into additional interest rate swap agreements with a notional face amount of $597 million. Under these interest rate swap agreements, we agreed to receive floating-rate payments (based on three-month LIBOR rates) in exchange for fixed-rate payments. Based on the addition of the new interest-rate swap agreements, each 25 basis point increase or decrease in interest rates would increase or decrease our annual interest expense and cash outlay by approximately $1.3 million. This potential increase or decrease is based on the simplified assumption that the level of floating-rate debt remains constant with an immediate across the board increase or decrease as of September 30, 2005 with no subsequent changes in rates for the remainder of the period.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

WARNER MUSIC GROUP CORP.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Warner Music Group Corp.

We have audited the accompanying consolidated balance sheets of Warner Music Group Corp. (the "Company") as of September 30, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for the twelve months ended September 30, 2005 and for the seven months ended September 30, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Broad (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at September 30, 2005 and 2004, and the consolidated results of its operations and its cash flows for the twelve months ended September 30, 2005 and the seven months ended September 30, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The condensed consolidated financial statements are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

New York, New York
November 15, 2005

/s/ Ernst & Young LLP

Report of Independent Registered Public Accounting Firm

The Shareholders of Warner Music Group Corp.

We have audited the combined statements of operations, group equity, and cash flows of Warner Music Group Corp. ("Old WMG") for the three months ended February 29, 2004 (Predecessor Basis) and for the twelve months ended November 30, 2003 (Predecessor Basis). Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of Old WMG's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of the internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined results of its operations and its cash flows for the three months ended February 29, 2004 (Predecessor Basis), and for the twelve months ended November 30, 2003 (Predecessor Basis), in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The condensed consolidating financial statements are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as whole.

March 10, 2005
New York, New York

/s/ Ernst & Young LLP

Warner Music Group Corp.

Consolidated Balance Sheets

	September 30, 2005	September 30, 2004
	(in millions)	
Assets		
Current assets:		
Cash and equivalents	$ 288	$ 555
Accounts receivable, less allowances of $218 and $222 million	637	571
Inventories	52	65
Royalty advances expected to be recouped within one year	190	223
Deferred tax assets	36	38
Other current assets	39	86
Total current assets	1,242	1,538
Royalty advances expected to be recouped after one year	190	223
Investments	21	8
Property, plant and equipment, net	157	189
Goodwill	869	978
Intangible assets subject to amortization, net	1,815	1,937
Intangible assets not subject to amortization	100	100
Other assets	104	117
Total assets	$4,498	$5,090
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 247	$ 226
Accrued royalties	1,057	1,003
Taxes and other withholdings	23	10
Current portion of long-term debt	17	12
Note payable to shareholders	—	342
Other current liabilities	404	587
Total current liabilities	1,748	2,180
Long-term debt	2,229	1,828
Dividends payable	5	—
Deferred tax liabilities, net	201	265
Other noncurrent liabilities	226	333
Minority interest in preferred stock of subsidiary	—	204
Total liabilities	4,409	4,810
Commitments and Contingencies (See Note 21)		
Shareholders' equity:		
Common stock ($0.001 par value; 500,000,000 shares authorized; 148,455,313 and 107,544,923 shares issued and outstanding)	—	—
Additional paid-in capital	548	512
Accumulated deficit	(480)	(238)
Accumulated other comprehensive income, net	21	6
Total shareholders' equity	89	280
Total liabilities and shareholders' equity	$4,498	$5,090

See accompanying notes.

Warner Music Group Corp.

Consolidated and Combined Statements of Operations

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
	(audited)	(audited)	(audited)	(unaudited)	(audited)
	(in millions, except per share data)				
Revenues[b]	$ 3,502	$ 1,769	$ 779	$ 2,487	$ 3,376
Costs and expenses:					
Cost of revenues[a][b]	(1,850)	(944)	(415)	(1,449)	(1,940)
Selling, general and administrative expenses[a][b]	(1,301)	(677)	(319)	(995)	(1,286)
Impairment of goodwill and other intangible assets	—	—	—	—	(1,019)
Amortization of intangible assets	(187)	(104)	(56)	(201)	(242)
Loss on termination of management agreement	(73)	—	—	—	—
Loss on sale of physical distribution assets	—	—	—	(12)	(12)
Restructuring costs, net	(7)	(26)	—	(27)	(35)
Total costs and expenses	(3,418)	(1,751)	(790)	(2,684)	(4,534)
Operating income (loss)	84	18	(11)	(197)	(1,158)
Interest expense; net[b]	(182)	(80)	(2)	(5)	(5)
Net investment-related gains (losses)	1	—	—	(17)	(26)
Equity in the losses of equity-method investees, net	(1)	(2)	(2)	(32)	(41)
Deal-related transaction and other costs	—	—	—	(7)	(70)
Loss on repayment of Holdings Notes	(35)	—	—	—	—
Loss on repayment of bridge loan	—	(6)	—	—	—
Unrealized gain (loss) on warrants	17	(120)	—	—	—
Other income (expense), net[b]	7	(4)	—	(10)	(17)
Minority Interest expense	(5)	(14)	—	—	—
Loss before income taxes	(114)	(208)	(15)	(268)	(1,317)
Income tax (expense) benefit	(55)	(30)	(17)	67	(36)
Net loss	$ (169)	$ (238)	$ (32)	$ (201)	$(1,353)
Net loss per common share:					
Basic and Diluted	$ (1.40)	$ (2.21)			
Average common shares:					
Basic and Diluted	120.9	107.5			
(a) Includes depreciation expense of:	$ (51)	$ (36)	$ (16)	$ (71)	$ (86)
(b) Includes the following income (expenses) resulting from transactions with related companies (Note 20)					
Revenues	$ 9	$ —	$ 4	$ 35	$ 56
Cost of revenues	(3)	—	(2)	(195)	(239)
Selling, general and administrative expenses	(7)	(10)	(12)	(114)	(144)
Interest income (expense), net	—	—	1	8	10
Other expense, net	—	—	—	(10)	(17)
Minority interest expense	(5)	(14)	—	—	—

See accompanying notes.

Warner Music Group Corp.

Consolidated and Combined Statements of Cash Flows

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
	(audited)	(audited)	(audited)	(unaudited)	(audited)
			(in millions)		
Cash flows from operating activities					
Net loss	$(169)	$ (238)	$ (32)	$(201)	$(1,353)
Adjustments to reconcile net loss to net cash provided by operating activities:					
Impairment of goodwill and other intangible assets	—	—	—	—	1,019
Depreciation and amortization	239	140	72	272	328
Deferred taxes	—	8	(4)	(117)	(19)
Loss on sale of physical distribution assets	—	—	—	12	12
Loss on debt repayment	35	6	—	—	—
Non-cash interest expense	68	19	2	10	11
Net investment-related losses (gains)	(1)	—	—	17	26
Equity in the losses of equity-method investees, including distributions	1	3	2	35	44
Non-cash, stock-based compensation expense	25	—	—	—	—
Unrealized (gain) loss on warrants	(17)	120	—	—	—
Minority interest expense	5	14	—	—	—
Changes in operating assets and liabilities:					
Accounts receivable	(58)	(33)	387	275	(121)
Inventories	(3)	(10)	6	24	12
Royalty advances	—	77	(4)	38	111
Accounts payable and accrued liabilities	10	(23)	(109)	(116)	169
Other balance sheet changes	70	3	1	8	39
Net cash provided by operating activities[a]	205	86	321	257	278
Cash flows from investing activities					
Acquisition of Old WMG[b]	—	(2,638)	—	—	—
Other investments and acquisitions	(78)	(10)	(2)	(43)	(52)
Investment proceeds	54	—	19	—	38
Capital expenditures	(30)	(15)	(3)	(30)	(51)
Net cash (used in) provided by investing activities	(54)	(2,663)	14	(73)	(65)
Cash flows from financing activities					
Borrowings	946	2,348	—	114	114
Financing costs of borrowings	(20)	(99)	—	—	—
Debt repayments	(588)	(631)	(124)	(101)	(101)
Capital contributions	—	—	262	132	132
Proceeds from the issuance of common stock	554	850	—	—	—
Costs to issue common stock	(32)	—	—	—	—
Proceeds from issuance of subsidiary preferred stock	—	400	—	—	—
Repurchase of subsidiary preferred stock	(200)	(202)	—	—	—
Dividends paid on subsidiary preferred stock	(9)				
Proceeds from the issuance of restricted shares	1	3	—	—	—
Cash paid to repurchase warrant	(138)	—	—	—	—
Returns of capital and dividends paid	(917)	—	—	—	—
Loans to third parties	(10)	—	—	—	—
Decrease (increase) in amounts due from Time Warner-affiliated companies	—	—	194	(293)	(195)
Dividends paid to minority interest on subsidiary preferred stock or to Time Warner for predecessor periods	—	(8)	(342)	—	(68)
Principal payments on capital lease	—	—	—	(3)	(3)
Other	(3)	—	—	—	—
Net cash provided by (used in) financing activities	(416)	2,661	(10)	(151)	(121)
Effect of foreign currency exchange rate changes on cash	(2)	—	2	6	11
Net (decrease) increase in cash and equivalents	(267)	84	327	39	103
Cash and equivalents at beginning of period	555	471	144	41	41
Cash and equivalents at end of period	$ 288	$ 555	$ 471	$ 80	$ 144

(a) Net cash used in operating activities for the twelve months ended September 30, 2005 and for the seven months ended September 30, 2004 includes approximately $80 million and $105 million of acquisition-related restructuring payments, respectively.

(b) Excludes $35 million of non-cash consideration issued as part of the purchase price paid to Time Warner in the form of warrants.

See accompanying notes.

Warner Music Group Corp.

Consolidated and Combined Statements of Shareholders' and Group Equity

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Group Equity	Due from Time Warner-Affiliated Companies, net	Total Shareholders' and Group Equity
	Common Shares	Par						
	(in millions, except number of common shares)							
Predecessor								
Balance at November 30, 2002	—	—	$—	$—	$—	$ 3,566	$(565)	$ 3,001
Comprehensive loss:								
Net loss[a]	—	—	—	—	—	(1,353)	—	(1,353)
Foreign currency translation adjustment	—	—	—	—	—	68	—	68
Deferred gains on foreign exchange contracts	—	—	—	—	—	4	—	4
Total comprehensive loss	—	—	—	—	—	(1,281)	—	(1,281)
Reduction in tax benefits on stock options exercised	—	—	—	—	—	(2)	—	(2)
Increase in amounts due from Time Warner-affiliated companies, net	—	—	—	—	—	—	(195)	(195)
Capital contributions	—	—	—	—	—	132	—	132
Dividends	—	—	—	—	—	(68)	—	(68)
Balance at November 30, 2003	—	—	—	—	—	2,347	(760)	1,587
Comprehensive loss:								
Net loss	—	—	—	—	—	(32)	—	(32)
Foreign currency translation adjustment	—	—	—	—	—	21	—	21
Total comprehensive loss	—	—	—	—	—	(11)	—	(11)
Decrease in amounts due from Time Warner-affiliated companies, net	—	—	—	—	—	—	325	325
Capital contributions	—	—	—	—	—	262	—	262
Dividends	—	—	—	—	—	(969)	497	(472)
Balance at February 29, 2004	—	$—	$—	$—	$—	$ 1,629	$ 62	$ 1,691

(a) Net loss for 2003 includes an approximate $1.019 billion impairment charge to reduce the carrying value of goodwill, trademarks and other intangible assets in the fourth quarter of 2003. In addition, net loss for 2002 includes a $4.8 billion impairment charge to reduce the carrying value of goodwill upon the initial adoption of FAS 142 and a $1.5 billion impairment charge to reduce the carrying value of goodwill and other intangible assets in the fourth quarter of 2002 (see Note 10).

See accompanying notes.

Warner Music Group Corp.

Consolidated and Combined Statements of Shareholders' and Group Equity

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Group Equity	Due from Time Warner-Affiliated Companies, net	Total Shareholders' and Group Equity
	Common Shares	Par						
	(In millions, except number of common shares)							
Successor								
Balance at February 29, 2004—Predecessor	—	$ —	$ —	$ —	$—	$ 1,629	$ 62	$ 1,691
Adjustments to record the Acquisition:								
Transfer of excluded net liabilities to Time Warner	—	—	—	—	—	12	(12)	—
Elimination of historical equity balances	—	—	—	—	—	(1,641)	(50)	(1,691)
Capital contribution to fund a portion of the purchase price of Old WMG	107,544,922	—	850	—	—	—	—	850
Balance at March 1, 2004, adjusted to give effect to the Acquisition	107,544,922	—	850	—	—	—	—	850
Comprehensive loss:								
Net loss	—	—	—	(238)	—	—	—	(238)
Foreign currency translation adjustment	—	—	—	—	10	—	—	10
Deferred losses on derivative financial instruments	—	—	—	—	(4)	—	—	(4)
Total comprehensive loss	—	—	—	(238)	6	—	—	(232)
Return of capital	—	—	(342)	—	—	—	—	(342)
Issuance of stock options and restricted shares of common stock	6,570,254	—	3	—	—	—	—	3
Other	—	—	1	—	—	—	—	1
Balance at September 30, 2004	114,115,176	—	512	(238)	6	—	—	280
Comprehensive loss:								
Net loss	—	—	—	(169)	—	—	—	(169)
Foreign currency translation adjustment	—	—	—	—	3	—	—	3
Deferred gains on derivative financial instruments	—	—	—	—	12	—	—	12
Total comprehensive loss	—	—	—	—	15	—	—	15
Return of capital	—	—	(508)	(73)	—	—	—	(581)
Issuance of common stock, net of issuance costs	32,600,000	0.001	522	—	—	—	—	522
Issuance of stock options and restricted shares of common stock	1,740,137	0.001	25	—	—	—	—	25
Other	—	—	(3)	—	—	—	—	(3)
Balance at September 30, 2005	148,455,313	0.001	$ 548	$(480)	$ 21	$ —	$—	$ 89

See accompanying notes.

Warner Music Group Corp.

Notes to Consolidated and Combined Audited Financial Statements

1. Description of Business

Warner Music Group Corp. (the "Company" or "Parent") was formed by a private equity consortium of Investors (the "Investor Group") on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. ("Holdings"), which is the direct parent of WMG Acquisition Corp. ("New WMG" or "Acquisition Corp."). New WMG is one of the world's major music companies and the successor to the interests of the recorded music and music publishing businesses of Time Warner Inc. ("Time Warner"). Such predecessor interests formerly owned by Time Warner are hereinafter referred to as "Old WMG" or the "Predecessor." Effective March 1, 2004, WMG Acquisition Corp. acquired Old WMG from Time Warner for approximately $2.6 billion (the "Acquisition").

On May 10, 2005, the Company sold 32,600,000 shares of its common stock in an initial public offering (the "Initial Common Stock Offering"). In connection with the Initial Common Stock Offering, the Company (i) converted all its formerly outstanding shares of Class L Common Stock into shares of Class A Common Stock, (ii) renamed all of its formerly outstanding shares of Class A Common Stock as "common stock", which had the effect of eliminating from the Company's authorized capital stock the Class L Common Stock and Class A Common Stock and (iii) authorized an approximately 1,139 to 1 split of the Company's common stock.

The Company classifies its business interests into two fundamental areas: recorded music and music publishing. A brief description of those operations is presented below.

Recorded Music Operations

The Company's recorded music operations consist of the discovery and development of artists and the related marketing and distribution of recorded music produced by such artists. In addition to the more traditional methods of discovering and developing artists, the Company has implemented new initiatives to identify and nurture artists earlier in the development process and reduce development costs by leveraging its independent distribution network. The Company refers to these new business models as incubator initiatives. Asylum and East West are current incubator labels. In addition, the Company has also entered into strategic ventures with other record labels.

The Company's recorded music operations also include a catalog division called Rhino Entertainment. ("Rhino"), which was formerly called Warner Strategic Marketing. Rhino specializes in marketing our music catalog through compilations and reissuances of previously released music and video titles, as well as in the licensing of tracks to/from third parties for various uses, including film and television soundtracks.

The Company's principal recorded music distribution operations include Warner-Elektra-Atlantic Corporation ("WEA Corp."), which primarily distributes the Company's music products to retailers and wholesale distributors in the United States; a 90% interest in Alternative Distribution Alliance ("ADA"), a distribution company which primarily distributes the products of independent record labels to retailers and wholesale distributors; various distribution centers and ventures operated internationally; and an 80% interest in Word Entertainment, whose distribution operations specialize in the distribution of music products in the Christian retail marketplace.

The Company plays an integral role in virtually all aspects of the music value chain from discovering and developing talent, to producing albums and promoting artists and their product. After an artist has entered into a contract with one of the Company's record labels, a master recording of the artist's music is created. The recording is then replicated for sale to consumers primarily in the CD format, and now, in digital formats. In the U.S., WEA Corp. and ADA market, sell and deliver product, either directly or through sub-distributors and

wholesalers, to thousands of record stores, mass merchants and other retailers throughout the country. Recorded music products are also sold in physical form to Internet physical retailers.

In the United States, the Company's recorded music operations are conducted principally through its major record labels—Warner Bros. Records and The Atlantic Records Group. In markets outside the U.S., recorded music activities are conducted through our Warner Music International ("WMI") division and its various subsidiaries, affiliates and non-affiliated licensees.

Music Publishing Operations

The Company's music publishing business is focused on the exploitation songs as intellectual property. 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.

Warner/Chappell is the Company's 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. The music publishing library includes many standard titles that span multiple music genres. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios, including Lucasfilm, Ltd. and Hallmark Entertainment.

The Company also previously owned Warner Bros. Publications ("WBP"), which printed and distributed a broad selection of sheet music, books and educational materials, orchestrations, folios, personality books, and arrangements from the catalogs of Warner/Chappell and other music publishers. On May 31, 2005, we sold our printed sheet music business to Alfred Publishing. See Note 6.

Music Publishing revenues are derived from four main sources:

- *Mechanical:* the licensor receives royalties with respect to compositions embodied in recordings sold in any format or configuration, including singles, albums, CDs, digital downloads and mobile phone ringtones.
- *Performance:* the licensor receives royalties when the composition is performed publicly (*e.g.*, broadcast radio and television, movie theater, concert, nightclub or Internet and wireless streaming).
- *Synchronization:* the licensor receives royalties or fees for the right to use the composition in combination with visual images (*e.g.*, in films, television commercials and programs and videogames).
- *Other:* the licensor receives royalties from other uses such as stage productions and printed sheet music.

2. Basis of Presentation

New Basis of Presentation

The accompanying consolidated and combined financial statements present separately the financial position, results of operations, cash flows and changes in equity for both the Company and its predecessor, Old WMG. As described in further detail in Note 5, Old WMG was acquired by a subsidiary of the Company effective as of March 1, 2004. In connection with the Acquisition, a new accounting basis was established for the Company as of the acquisition date based upon an allocation of the purchase price to the underlying net assets acquired.

Financial information for the pre- and post-acquisition periods have been separated by a vertical line on the face of the consolidated and combined financial statements to highlight the fact that the financial information for such periods have been prepared under two different historical-cost bases of accounting.

Old Basis of Presentation

As previously described, the operations of Old WMG were under the control of Time Warner through the end of February 2004. In January 2001, historic Time Warner was acquired by America Online Inc. ("AOL") in a transaction hereinafter referred to as the "AOL Time Warner Merger". The AOL Time Warner Merger was accounted for under the purchase method of accounting. Under the purchase method of accounting, the basis of the historical net assets included in the accompanying combined financial statements was adjusted, effective as of January 1, 2001, to reflect an allocable portion of the purchase price relating to the AOL Time Warner Merger. See Note 5 for additional information.

For all periods prior to the closing of the Acquisition, the accompanying combined financial statements reflect all assets, liabilities, revenues, expenses and cash flows directly attributable to Old WMG. In addition, the accompanying combined financial statements include allocations of certain costs of Time Warner and Old WMG deemed reasonable by the Company's management, in order to present the results of operations, financial position, changes in group equity and cash flows of Old WMG on a stand-alone basis. The principal allocation methodologies are described below. The financial information included herein does not necessarily reflect the results of operations, financial position, changes in group equity and cash flows of Old WMG in the future or what would have been reflected had Old WMG been a separate, stand-alone entity during the periods presented. The income tax benefits and provisions, related tax payments and deferred tax balances have been prepared as if Old WMG operated as a stand-alone taxpayer for the periods presented.

For all periods prior to the closing of the Acquisition, certain general and administrative costs incurred by Time Warner have been allocated to the combined financial statements of Old WMG, including pension and other benefit-related costs, insurance-related costs and other general and administrative costs. These cost allocations were determined based on a combination of factors, as appropriate, including Old WMG's pro rata share of the revenues under the management of Old WMG and other more directly attributable methods, such as claim experience for insurance costs and employee-related attributes for pension costs. The costs allocated to the Company are not necessarily indicative of the costs that would have been incurred if Old WMG had obtained such services independently, nor are they indicative of costs that will be charged or incurred in the future. However, management believes that such allocations are reasonable.

Fiscal Year

In 2004, in connection with the Acquisition, the Company changed its fiscal year-end to September 30 from November 30. As such, financial information for 2004 is presented for a shortened, ten-month transition period ended September 30, 2004. This financial information for 2004 also has been separated into two pre-acquisition and post-acquisition periods as a result of the change in accounting basis that occurred relating to the Acquisition. In order to enhance comparability, financial information for the ten-month period ended September 30, 2004 has been supplemented by the presentation of unaudited financial information for the ten-month period ended September 30, 2003. Based on how the Company's closing schedule occurred in 2003, the information for the ten-month period ended September 30, 2003 consists of 43 weeks, as compared to 44 weeks contained in the ten-month period ended September 30, 2004.

Basis of Consolidation and Combination

Prior to the closing of the Acquisition, the recorded music and music publishing operations of the Company were legally held by multiple subsidiaries and affiliates of Old WMG and Time Warner. As such, the

accompanying financial statements present the *combined* accounts of such businesses for all periods prior to the Acquisition. After the closing of the Acquisition, New WMG acquired the stock or net assets of those predecessor businesses. Accordingly, the accompanying financial statements present the *consolidated* accounts of such businesses for all periods after the closing of the Acquisition. The consolidated accounts include 100% of the assets, liabilities, revenues, expenses, income, losses and cash flows of the Company and all entities in which the Company has a controlling voting interest and/or variable interest entities required to be consolidated in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). All significant inter-company balances and transactions have been eliminated in consolidation and combination.

Recapitalization

As discussed above, on May 10, 2005, the Company sold 32,600,000 shares of its common stock in the Initial Common Stock Offering. In connection with the Initial Common Stock Offering, the Company (i) converted all its formerly outstanding shares of Class L Common Stock into shares of Class A Common Stock, (ii) renamed all of its formerly outstanding shares of Class A Common Stock as "common stock", which had the effect of eliminating from the Company's authorized capital stock the Class L Common Stock and Class A Common Stock and (iii) authorized an approximately 1,139 to 1 split of the Company's common stock, (collectively, the "Recapitalization"). Accordingly, historical financial statements have been restated to reflect the Recapitalization for all periods occurring after the Acquisition that was effective as of March 1, 2004. Such restatement primarily related to common stock and equivalent shares information, net income (loss) per common share computations and stock-based compensation disclosures.

3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated and combined financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates due to, among other factors, the risks inherent in the recorded music and music publishing businesses, including continuing industry-wide piracy. Estimates are used when accounting for certain items such as allowances for doubtful accounts and sales returns, depreciation and amortization, asset impairments (including royalty advances and intangible assets), contingencies, reserves (including certain royalty payables), the value of stock-based compensation and the value of stock warrants issued to Time Warner. In addition, significant estimates were used in accounting for the Acquisition under the purchase method of accounting, and prior to the Acquisition, in allocating certain costs to Old WMG in order to present Old WMG's operating results on a stand-alone basis (see Note 2).

Cash and Equivalents

The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

Foreign Currency Translation

The financial position and operating results of substantially all foreign operations are consolidated or combined using the local currency as the functional currency. Local currency assets and liabilities are translated at the rates of exchange on the balance sheet date, and local currency revenues and expenses are translated at average rates of exchange during the period. Resulting translation gains or losses are included in the accompanying consolidated and combined statement of shareholders' and group equity as a component of accumulated other comprehensive income (loss).

Derivative and Financial Instruments

Effective January 1, 2001, the Company adopted Financial Accounting Standards Board ("FASB") Statement No. 133, as amended by FASB Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133 requires that all derivative instruments be recognized on the balance sheet at fair value. In addition, FAS 133 provides that, for derivative instruments that qualify for hedge accounting, changes in the fair value are either (a) offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or (b) recognized in equity until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

As further described in Note 19, the Company issued, and subsequently repurchased, stock warrants to Time Warner as part of the purchase price of the Acquisition. The stock warrants were derivative financial instruments which the Company accounted for in accordance with the provisions of FAS 133. Accordingly, the warrants were reflected as a liability in the accompanying consolidated balance sheet of the Company at September 30, 2004, at fair value. In turn, changes in the fair value of the warrants were reflected in the accompanying consolidated statement of operations of the Company for the year ended September 30, 2005 and the seven months ended September 30, 2004.

The carrying value of the Company's financial instruments approximates fair value, except for certain differences relating to long-term, fixed-rate debt and other financial instruments that are not significant. The fair value of financial instruments is generally determined by reference to market values resulting from trading on a national securities exchange or an over-the-counter market. In cases where quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques. See Note 14 for the fair value of the Company's debt.

Revenues

Recorded Music

In accordance with industry practice and as is customary in many territories, certain products (such as CDs and cassettes) are sold to customers with the right to return unsold items. Revenues from such sales are recognized when the products are shipped based on gross sales less a provision for future estimated returns. Revenues from the sale of recorded music products through digital distribution channels are recognized when the products are sold by the providers.

Music Publishing

Revenues are earned from the receipt of royalties relating to the licensing of rights in musical compositions, and for the sale of published sheet music and songbooks.

The receipt of royalties principally relates to amounts earned from the public performance of copyrighted material, the mechanical reproduction of copyrighted material on recorded media including digital formats, and the use of copyrighted material in synchronization with visual images. Consistent with industry practice, music-publishing royalties generally are recognized as revenue when received.

Gross Versus Net Revenue Classification

In the normal course of business, the Company acts as an intermediary or agent with respect to certain payments received from third parties. For example, the Company distributes music product on behalf of third-party record labels. Pursuant to Emerging Issues Task Force ("EITF") No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," such transactions are recorded on a "gross" or "net" basis

depending on whether the Company is acting as the "principal" in the transaction or acting as an "agent" in the transaction. The Company serves as the principal in transactions in which it has substantial risks and rewards of ownership and, accordingly, revenues are recorded on a gross basis. For those transactions in which the Company does not have substantial risks and rewards of ownership, the Company is considered an agent in the transactions and, accordingly, revenues are recorded on a net basis.

To the extent revenues are recorded on a gross basis, any participations and royalties paid to third parties are recorded as expenses so that the net amount (gross revenues less expenses) flows through operating income. To the extent revenues are recorded on a net basis, revenues are reported based on the amounts received, less participations and royalties paid to third parties. Either way, the impact on operating income is the same whether the Company records the revenues on a gross or net basis.

Based on an evaluation of the individual terms of each contract and whether the Company is acting as principal or agent, the Company generally records revenues from the distribution of recorded music product on behalf of third-party record labels on a gross basis. However, revenues are recorded on a net basis for recorded music compilations distributed by other record companies where the Company has a right to participate in the profits.

Royalty Advances and Royalty Costs

The Company regularly commits to and pays advance royalties to its artists and songwriters in respect of future sales. The Company accounts for these advance royalty payments under the related guidance in FASB No. 50, "Financial Reporting in the Record and Music Industry" ("FAS 50"). Under FAS 50, certain advance royalty payments that are believed to be recoverable from future royalties to be earned by the artist or songwriter are capitalized as assets. The decision to capitalize an advance to an artist or songwriter as an asset requires significant judgment as to the recoverability of these advances. The recoverability of these assets is assessed upon initial commitment of the advance, based upon the Company's forecast of anticipated revenues from the sale of future and existing music and publishing-related products. In determining whether these amounts are recoverable, the Company evaluates the current and past popularity of the artist or songwriter, the initial or expected commercial acceptability of the product, the current and past popularity of the genre of music that the product is designed to appeal to, and other relevant factors. Based upon this information, the portion of such advances that are believed not to be recoverable is expensed. All advances are assessed for recoverability continuously and at minimum on a quarterly basis.

Royalties earned by artists, songwriters, co-publishers, other copyright holders and trade unions are recognized as an expense in the period in which the sale of the product takes place, less an adjustment for future estimated returns.

Inventories

Inventories consist of CDs, cassettes and related music products, as well as published sheet music and songbooks. Inventories are stated at the lower of cost or estimated realizable value. Cost is determined using first-in, first-out ("FIFO") and average cost methods, which approximate cost under the FIFO method. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost.

Advertising

In accordance with American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") No. 93-7, "Reporting on Advertising Costs," advertising costs, including costs to produce music videos

used for promotional purposes, are expensed as incurred. Advertising expense amounted to approximately $195 million for the year ended September 30, 2005, $94 million for the seven months ended September 30, 2004, $53 million for the three months ended February 29, 2004, and $202 million for the year ended November 30, 2003. Deferred advertising costs, which principally relate to advertisements that have not been exhibited or services that have not been received, were approximately $3 million and $4 million at September 30, 2005 and 2004, respectively.

Concentration of Credit Risk

In the recorded music business, the Company has 15 key customers that generate significant sales volume. At September 30, 2005 each of these customers composed from 1% to 7% of the Company's consolidated gross accounts receivable, and approximately 52% in the aggregate. Based on a history of cash collection, the Company does not believe there is any significant collection risk from such customers. In the music publishing business, the Company collects a significant portion of its royalties from copyright collection societies around the world. Collection societies and associations generally are not-for-profit organizations that represent composers, songwriters and music publishers. These organizations seek to protect the rights of their members by licensing, collecting license fees and distributing royalties for the use of their works. Accordingly, the Company does not believe there is any significant collection risk from such societies.

Shipping and Handling

The costs associated with shipping goods to customers are recorded as cost of revenues. Shipping and handling charges billed to customers are included in revenues.

Investments

In January 2003, FASB Interpretation No. 46, "Consolidation of Variable Interest Entities—an Interpretation of ARB No. 51" ("FIN 46") was issued. FIN 46 requires that the Company first evaluate its investments to determine if any investments in companies in which the Company has significant influence, but less than a controlling voting interest, qualify as a variable interest entity ("VIE"). In determining if an entity is a VIE, FIN 46 requires one to evaluate whether the equity of the entity is sufficient to absorb its expected losses. The evaluation requires the consideration of qualitative factors and various assumptions, including expected future cash flows and funding needs. Even if the entity's equity is determined to be sufficient to absorb expected losses, the rules provide that in certain circumstances there needs to be a qualitative assessment as to whether "substantially all" the benefits of the entity are for the benefit of one of the variable interest holders. In such circumstances, the entity would be deemed a VIE. FIN 46 further provides that the primary beneficiary of a VIE is required to consolidate the VIE's operations.

The Company adopted the provisions of FIN 46 effective as of November 30, 2003. In particular, the Company consolidated four recorded music ventures, which were previously accounted for under the equity method of accounting. The operations of these ventures principally consist of the discovery and development of artists and related music products, which are distributed by the Company. The application of FIN 46 did not have a material impact on the Company's financial statements.

For investments in companies in which the Company has significant influence, but less than a controlling voting interest, that do not qualify as VIE's under the provisions of FIN 46, the Company accounts for the investments using the equity method. This is generally presumed to exist when the Company owns between 20% and 50% of the investee. Should the Company had a greater than 50% ownership interest in an investee and the minority shareholders held certain rights that allowed them to participate in the day-to-day operations of the business, the Company would also use the equity method of accounting.

Under the equity method, only the Company's investment in and amounts due to and from the equity investee are included in the consolidated balance sheet; only the Company's share of the investee's earnings (losses) is included in the consolidated operating results; and only the dividends, cash distributions, loans or other cash received from the investee, additional cash investments, loan repayments or other cash paid to the investee are included in the consolidated cash flows.

Investments in companies in which the Company does not have a controlling interest or is unable to exert significant influence are accounted for at market value if the investments are publicly traded and there are no resale restrictions greater than one year ("available-for-sale investments"). If there are resale restrictions greater than one year, or if the investment is not publicly traded, then the investment is accounted for at cost.

Property, Plant and Equipment

Property, plant and equipment are recorded at historical cost. Depreciation is calculated using the straight-line method based upon the estimated useful lives of depreciable assets as follows: five to ten years for furniture and fixtures, periods of up to five years for computer equipment and periods of up to seven years for machinery and equipment. Buildings are depreciated over periods of up to fifty years. Leasehold improvements are depreciated over periods up to the life of the lease.

Accounting for Goodwill and Other Intangible Assets

In July 2001, FASB Statement No. 141, "Business Combinations" ("FAS 141") and FASB Statement No. 142, "Goodwill and Other Intangible Assets" ("FAS 142") were issued. These standards changed the accounting for business combinations by, among other things, prohibiting the prospective use of pooling-of-interests accounting. In addition, FAS 142 required that goodwill, including the goodwill included in the carrying value of investments accounted for using the equity method of accounting, and certain other intangible assets deemed to have an indefinite useful life, should not be amortized. These new rules also require that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques. The Company adopted the provisions of FAS 142 effective as of December 1, 2001. See Note 10 for further discussion on the adoption of FAS 142.

Internal-Use Software Development Costs

In accordance with AICPA SOP No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use", the Company capitalizes certain external and internal computer software costs incurred during the application development stage. The application development stage generally includes software design and configuration, coding, testing and installation activities. Training and maintenance costs are expensed as incurred, while upgrades and enhancements are capitalized if it is probable that such expenditures will result in additional functionality. Capitalized software costs are depreciated over the estimated useful life of the underlying project on a straight-line basis, generally not exceeding five years.

Valuation of Long-Lived Assets

The Company periodically reviews the carrying value of its long-lived assets, including property, plant and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. To the extent the estimated future cash inflows attributable to the asset, less estimated future cash outflows, are less than the carrying amount, an impairment loss is recognized in an amount equal to the difference between the carrying value of such asset and its fair value. Assets to be disposed of and for which there is a committed plan to dispose of the assets, whether through sale or abandonment, are reported at the lower of carrying value or fair value less costs to sell.

Stock-Based Compensation

Post-Acquisition

Effective March 1, 2004, in connection with the Acquisition, the Company adopted the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("FAS 123") to account for all stock-based compensation plans adopted subsequent to the Acquisition. Under the fair value recognition provisions of FAS 123, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the service period.

Pre-Acquisition

Prior to the Acquisition, certain employees of Old WMG participated in various Time Warner stock option plans. In accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations, compensation cost for stock options or other equity-based awards granted to employees was recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award over the amount an employee must pay to acquire the stock. Generally, the exercise price for stock options granted to employees equaled or exceeded the fair market value of Time Warner common stock at the date of grant, thereby resulting in no recognition of compensation expense by Old WMG. For any awards that generated compensation expense as defined under APB 25, Old WMG calculated the amount of compensation expense and recognized the expense over the vesting period of the award.

Had compensation cost for Time Warner's stock option plans been determined based on the fair value method set forth in FAS 123, Old WMG's net loss for all periods presented prior to the closing of the Acquisition would have been as follows:

	Three Months Ended February 29, 2004 (audited)	Ten Months Ended September 30, 2003 (unaudited)	Year Ended November 30, 2003 (audited)
Net loss:			
As reported	$(32)	$(201)	$(1,353)
Pro forma	$(42)	$(243)	$(1,403)

See Note 18 for further information on employee stock-based compensation.

Income Taxes

Income taxes are provided using the asset and liability method presented by FASB Statement No. 109, "Accounting for Income Taxes" ("FAS 109"). Under this method, income taxes (i.e., deferred tax assets, deferred tax liabilities, taxes currently payable/refunds receivable and tax expense) are recorded based on amounts refundable or payable in the current year and include the results of any differences between U.S. GAAP and tax reporting. Deferred income taxes reflect the tax effect of net operating loss, capital loss and general business credit carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statements and income tax purposes, as determined under enacted tax laws and rates. Valuation allowances are established when management determines that it is more likely than not that some portion or all of the deferred tax asset will not be realized. The financial effect of changes in tax laws or rates is accounted for in the period of enactment.

Prior to the closing of the Acquisition, the taxable results of Old WMG were included in the consolidated U.S. federal, and various states, local and foreign income tax returns of Time Warner or its subsidiaries. Also, in

certain state, local and foreign jurisdictions, Old WMG filed on a stand-alone basis. The income tax provision reflected in the combined statement of operations of Old WMG is presented as if Old WMG operated on a stand-alone basis, consistent with the liability method prescribed by FAS 109. The majority of the temporary differences for pre-Acquisition periods related to non-deductible reserves and adjustments to the carrying value of assets and liabilities established in the accounting for the AOL Time Warner Merger, as well as net operating loss carry forwards in 2002 only.

Comprehensive Income (Loss)

Comprehensive income (loss), which is reported in the accompanying consolidated and combined statements of shareholders' and group 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 deferred gains and losses on financial instruments designated as hedges under FAS 133, which include interest-rate swap and foreign exchange contracts. .

For all periods prior to the closing of the Acquisition, accumulated other comprehensive income (loss) has been presented as a component of group equity and has not been set forth separately due to the complex nature of preparing a *combined* set of financial statements for operations that were legally held by multiple subsidiaries of Old WMG and Time Warner. Such historical accumulated other comprehensive income (loss) balances were eliminated as part of the change in accounting basis that occurred effective on March 1, 2004, in connection with the closing of the Acquisition. The following summary set forth the components of other comprehensive income (loss), net of related taxes, that have been accumulated in shareholders' equity since March 1, 2004:

	Foreign Currency Translation Gain (Losses)	Derivative Financial Instruments Gain (Losses)	Accumulated Other Comprehensive Gain (Losses)
		(in millions)	
Balance at March 1, 2004	$—	$—	$—
Activity through September 30, 2004	10	(4)	6
Balance at September 30, 2004	$10	$(4)	$ 6
Activity through September 30, 2005	3	12	15
Balance at September 30, 2005	$13	$ 8	$21

Other Recently Issued Accounting Standards

Over the past two years, there have been new accounting standards issued, including FASB 123(R), "Share-based Payment (revised)" ("FAS 123R"), which was issued in December 2004. The Company plans to adopt the provisions of FAS 123(R) during the first quarter of fiscal 2006. The adoption of this accounting standard is not expected to have a material impact on the Company's financial statements.

4. Net Loss Per Common Share

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

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

	Year ended September 30, 2005	Seven Months Ended September 30, 2004
Basic and diluted pro forma net loss per common share:		
Numerator:		
Net loss	$ (169)	$ (238)
Denominator:		
Weighted average common shares outstanding for basic and diluted calculation	120.9	107.5
Net loss per common share—basic and diluted:		
Net loss per common share—basic and diluted	$ (1.40)	$ (2.21)

The calculation of diluted net loss per share includes an adjustment to the weighted-average common shares outstanding for the potential dilution that would occur if the Company's stock options or warrants were exercised or the Company's restricted stock had vested. In the periods reported, the effect of the assumed exercise of stock options and warrants and the assumed vesting of restricted shares would have been antidilutive and accordingly, the following share amounts were excluded from the calculation of diluted net loss per share:

	Year ended September 30, 2005	Seven Months Ended September 30, 2004
Stock options	2,298,844	511,810
Restricted stock	6,146,792	4,997,356

See Note 18 for a summary of restricted stock and stock options outstanding during the period and Note 19 for a summary of the terms of the warrants that were issued to Time Warner in connection with the Acquisition.

5. The Acquisition

As previously described in Note 1, effective as of March 1, 2004, a subsidiary of the Company acquired Old WMG from Time Warner for approximately $2.6 billion. The initial consideration exchanged consisted of $2.560 billion of cash and $35 million of non-cash consideration in the form of warrants that gave Time Warner the right, under certain conditions, to purchase up to 19.9% of the capital stock of the Company (see Note 19). In addition, the Company incurred approximately $78 million of transaction costs in connection with the Acquisition.

Pursuant to the terms of the purchase agreement between the Company and Time Warner, the purchase consideration is subject to certain adjustments, generally based on changes in the financial position of Old WMG between the date the purchase agreement was signed and the date the transaction closed. The parties currently are in discussions over the terms of final settlement. Such changes are not expected to be material; however, the purchase price reflected in the accompanying financial statements has been reduced by approximately $12 million to reflect a reimbursement by Time Warner to the Company of a portion of the purchase consideration already agreed to by the parties.

The $2.638 billion cash portion of the purchase price, including transaction costs, was financed by a $1.250 billion initial capital investment by the Investor Group and aggregate borrowings of $1.388 billion. The

$1.250 billion initial capital investment by the Investor Group was comprised of (i) an $85 million contribution in exchange for the issuance of 85,000 shares of Class A Common Stock of the Company, (ii) a $765 million contribution in exchange for the issuance of 9,445 shares of Class L Common Stock of the Company and (iii) a $400 million direct contribution to Holdings in exchange for 40,000 shares of cumulative preferred stock of Holdings. The Company also incurred $262 million of additional indebtedness to pay certain financing-related fees, as well as to fund future working capital requirements that included a portion of the anticipated costs to restructure the business. See Note 14 for a description of the Company's financing arrangements and Note 19 for a description of the returns of capital paid to the Investor Group subsequent to the Acquisition.

The Acquisition was accounted for by the purchase method of accounting for business combinations. Under the purchase method of accounting, the acquisition cost of $2.638 billion, including $78 million of transaction costs and the $12 million reduction in the purchase price described above, was preliminarily allocated to the net assets acquired in proportion to estimates of their respective fair values. The excess of the purchase price over the estimated fair value of the net assets acquired was recorded as goodwill.

The accompanying consolidated financial statements include the following allocation of the purchase price to the net assets acquired: recorded music catalog, $1.216 billion; music publishing copyrights, $808 million; trademarks, $110 million; goodwill, $846 million; other current and noncurrent assets, $1.852 billion; net deferred tax liabilities, $163 million; acquisition-related restructuring liabilities, $275 million; and other current and noncurrent liabilities, $1.756 billion.

Pro Forma Financial Information

The following unaudited pro forma financial information presents the operating results of the Company as if each of (i) the Acquisition and original financing, (ii) the April 2004 Acquisition Corp. Refinancing (as described under Note 14) and (iii) the transactions with Cinram International Inc. with respect to manufacturing, packaging and physical distribution services (as described under Note 6), had occurred at the beginning of each period presented (in millions):

	Pro Forma		
	Ten Months Ended September 30, 2004	Twelve Months Ended September 30, 2004	Year Ended November 30, 2003
Revenue	$2,548	$ 3,436	$ 3,361
Impairment of goodwill and other intangible assets	—	(1,019)	(1,019)
Depreciation and amortization	(201)	(245)	(257)
Operating income (loss)	16	(929)	(1,017)
Net loss	(286)	(1,026)	(914)

2003 Deal-Related and Other Transaction Costs

In connection with the Acquisition and the prior pursuit by Time Warner and Old WMG of other strategic ventures or dispositions involving Old WMG's businesses in 2003 that did not occur, Old WMG incurred approximately $70 million of costs, as follows (in millions):

	Year Ended November 30, 2003
Transaction costs, primarily legal, accounting and investment banking fees	$30
Loss on executive contractual obligations	25
Loss on pension plan curtailment	15
	$70

As part of the Acquisition, the Investor Group and Time Warner agreed that Time Warner would retain its obligations to all employees of Old WMG covered under Time Warner's U.S. pension plans; however, employees of Old WMG would no longer be able to earn additional benefits for future services. Accordingly, Old WMG recognized a $15 million loss in 2003 in connection with the pension curtailment that ultimately occurred upon the closing of the Acquisition. In addition, Old WMG recorded a $25 million loss in 2003 relating to certain executive contractual obligations that were triggered upon the closing of the Acquisition.

6. Other Acquisitions and Dispositions

Bad Boy Records LLC Joint Venture

On April 8, 2005, the Company entered into an agreement with an affiliate of Sean "Diddy" Combs to form Bad Boy Records LLC ("Bad Boy"), a joint venture, owned 50% by the Company and 50% by the affiliate. The Company purchased its 50% membership interest in Bad Boy Records LLC for approximately $30 million in cash. The joint venture includes catalog and roster artists such as Notorious B.I.G., Mario Winans, Mase, Carl Thomas, B5, Boyz N Da Hood and Diddy. Mr. Combs is the CEO of the joint venture and supervises its staff and day-to-day operations. The Company provides funding, marketing, promotion and certain backoffice services for the joint venture. The transaction was accounted for under the purchase method of accounting during the third quarter of fiscal 2005 as the Company bears a majority of the financial risks and rewards associated with the venture. The results of operations of Bad Boy are included in the Company's results of operations from its acquisition date. The accompanying consolidated financial statements include the following allocation of the approximately $30 million purchase price to the Company's share of underlying net assets based on their respective fair values: recorded music catalog, $9 million; artists' contracts, $14 million; goodwill, $20 million; and other current liabilities, $14 million.

Sale of Music Manufacturing

In October 2003, Time Warner completed its sale of the DVD and CD manufacturing, printing, packaging, physical distribution and merchandising businesses formerly managed by Old WMG for $1.05 billion in cash to Cinram International Inc. ("Cinram"). The sale included the following businesses: WEA Manufacturing Inc., Warner Music Manufacturing Europe GmbH, Ivy Hill Corporation, Giant Merchandising and the physical distribution operations of WEA Corp.

In addition, Time Warner and Old WMG entered into exclusive, long-term agreements for Cinram to provide manufacturing, printing, packaging and physical distribution of Time Warner's and the Company's DVDs and CDs in North America and Europe at fair market value-based rates. Cinram is currently the Company's exclusive supplier of such services in North America and most of Europe.

As previously noted, the physical distribution operations of WEA Corp., which are included in the accompanying financial statements, were included in the sale. Old WMG recognized a $12 million pretax loss in 2003 in connection with the sale, which has been reflected as a component of operating loss in the accompanying statement of operations. For the year ended November 30, 2003, Old WMG included in its accompanying statement of operations approximately $15 million of revenues; approximately $11 million of operating losses; approximately $4 million of operating losses before depreciation and amortization expense; and an approximate $7 million net loss related to the physical distribution operations of WEA Corp.

Acquisition of Certain Minority Interests in Maverick Recording Company

As of September 30, 2004, the Company had a 50% interest in Maverick Recording Company ("Maverick"). In November 2004, the Company acquired an additional 30% interest in Maverick from its existing partner for approximately $17 million and certain amounts previously owed by such partner to the Company. The transaction was accounted for under the purchase method of accounting during the first quarter of

fiscal 2005. The purchase price was allocated to the underlying net assets of Maverick in proportion to their estimated fair value, principally artist contracts and recorded music catalog. As part of the transaction, the Company and the remaining partner in Maverick entered into an agreement pursuant to which either party can elect to have the Company purchase the remaining 20% interest in Maverick that it does not own by December 2007.

Sale of Warner Bros. Publications

On May 31, 2005, the Company sold Warner Bros. Publications, which conducted the Company's printed sheet music operations, to Alfred Publishing. As part of the transaction, the Company agreed to license the right to use its music publishing copyrights in the exploitation of printed sheet music and songbooks for a twenty-year period of time. No gain or loss was recognized on the transaction, as the historical book basis of the net assets sold was adjusted to fair value in connection with the accounting for the Acquisition. Due to the Company's continuing involvement with Warner Bros. Publications, it was not reported as discontinued operations.

The sale is not expected to have a material effect on the future operating results and financial condition of the Company. For the year ended September 30, 2005, the ten months ended September 30, 2004, and the year ended November 30, 2003, the operations being sold generated revenues of approximately $35 million, $36 million, and $56 million, respectively; operating income (loss) of approximately $1 million, $(7) million, and $1 million, respectively; operating income (loss) before depreciation and amortization expense of $1 million, $(7) million, and $2 million, respectively; and net losses of approximately $1 million, $8 million, and $2 million, respectively.

7. Investments

The Company's investments consist of:

	September 30, 2005	September 30, 2004
	(In millions)	
Equity-method investments	$11	$ 8
Cost-method investments	10	—
	$21	$ 8

In connection with the Acquisition, primarily all of Old WMG's investments were transferred to Time Warner. Significant equity-method investments held by the Company at September 30, 2004 related to the Company's continuing interest in Deston Songs and a new investment made in 2004 in Royalty Services, L.P. (25% owned) to develop a shared royalty system platform with Universal Music Group, Exigen Group and Lightspeed Venture Partners.

In 2005, the Company disposed of its equity-method investment in Deston Songs, and made additional capital contributions to its investment in Royalty Services, L.P., as required by the agreement. Additionally, during 2005 the Company made an investment of $9 million to acquire a 15% interest in Front Line Management, a cost-method investment, and other equity investments of $4 million. Such investments are not material to the Company's overall financial position or operating results.

Net Investment-Related Gains (Losses)

For the year ended September 30, 2005 the Company recognized $1 million of net investment-related gains, primarily related to the disposition of an equity-method investment. There were no significant investment-related gains or losses recognized in either the seven-month period ended September 30, 2004 nor the three-month period ended February 29, 2004.

For the year ended November 30, 2003, Old WMG recognized $26 million of net investment-related losses, principally to reduce the carrying value of certain investments, including Old WMG's interest in Telstar. Of such amount, approximately $17 million of net investment-related losses were recognized by Old WMG in the ten-month period ended September 30, 2003.

8. Inventories

Inventories consist of the following:

	September 30, 2005	September 30, 2004
	(In millions)	
Compact discs, cassettes and other music-related products	$ 84	$ 79
Published sheet music and song books	2	23
	86	102
Less reserve for obsolescence	(34)	(37)
	$ 52	$ 65

The decline in published sheet music and song books relates to the sale of the Company's printed music operations as described in Note 6.

9. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	September 30, 2005	September 30, 2004
	(In millions)	
Land	$ 23	$ 19
Buildings and improvements	107	109
Furniture and fixtures	17	16
Computer hardware and software	91	78
Machinery and equipment	3	3
	241	225
Less accumulated depreciation	(84)	(36)
	$157	$189

10. Goodwill and Intangible Assets

Impairment Charges

During the fourth quarter of the fiscal year ended November 30, 2003, in connection with Time Warner's agreement to sell Old WMG as described more fully in Note 5, Old WMG recorded a $1.019 billion impairment

charge. The charge was necessary to reduce the carrying value of Old WMG's intangible assets to fair value, based on the consideration agreed to be exchanged in the transaction. The impairment charge is classified as a component of operating loss in the accompanying statement of operations. The charge consisted of a reduction in the carrying value of goodwill by $5 million, brands and trademarks by $766 million, recorded music catalog by $208 million and other intangible assets by $40 million. The impairment charge was non-cash in nature and did not affect Old WMG's liquidity.

Goodwill

The following analysis details the changes in goodwill for each reportable segment during the year ended September 30, 2005 and the ten months ended September 30, 2004:

	Recorded Music	Music Publishing	Total
		(in millions)	
Balance at November 30, 2003	$ —	$—	$ —
Acquisition of Old WMG	395	583	978
Balance at September 30, 2004	$ 395	$583	$ 978
Acquisitions	23	—	23
Purchase accounting adjustments	(124)	(8)	(132)
Balance at September 30, 2005	$ 294	$575	$ 869

The acquisition of goodwill primarily relates to the acquisition of a 50% interest in Bad Boy as described in Note 6. The allocation of the Bad Boy purchase price included approximately $20 million of goodwill acquired.

Purchase accounting adjustments relate to changes in the initial estimates of the restructuring costs that arose from the Acquisition and changes to the fair value of assets and liabilities recorded in connection with the Acquisition. These changes were determined in connection with the Company's finalization of the purchase price allocation related to the Acquisition and include the settlement of certain receivables from Time Warner for an amount that is $12 million less than the original amount recorded. The remaining adjustments relate mainly to revisions of the costs to terminate artist contracts and other long-term agreements, and changes to pre-Acquisition deferred tax liability and taxes payable balances.

The Company performs its annual goodwill impairment test in accordance with FAS 142 during the fourth quarter of each fiscal year. 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. The Company conducted its annual goodwill impairment test in September of 2005. The results of the test were that no impairment occurred in 2005.

Other Intangible Assets

Other intangible assets consist of the following:

	September 30, 2004	Acquisitions	Other (a)	September 30, 2005
				(in millions)
Intangible assets subject to amortization:				
Record music catalog	$1,216	$ 33	$ (7)	$1,242
Music publishing copyrights	811	16	(10)	817
Artist contacts	—	31	—	31
Trademarks	10	—	—	10
Other intangible assets	4	—	—	4
	2,041	80	(17)	2,104
Accumulated amortization	(104)			(289)
Total net intangible assets subject to amortization	1,937			1,815
Intangible assets not subject to amortization:				
Trademarks and brands	100			100
Total net other intangible assets	$2,037			$1,915

(a) Other represents foreign currency translation adjustments.

The increase in the Company's gross intangible assets represents the allocation of the purchase price of the Company's acquisition of an additional interest in Maverick to the net assets acquired, principally music copyrights of approximately $17 million and artist contracts of approximately $16 million, and the acquisition of a 50% interest in Bad Boy as described in Note 6, including the acquisition of recorded music catalog of approximately $9 million and artist contracts of approximately $14 million. The increase also relates to the acquisition of approximately $16 million of publishing copyrights during the year ended September 30, 2005.

Amortization

Based on the amount of intangible assets subject to amortization at the end of September 2005, the expected amortization for each of the next five fiscal years is as follows:

	Years Ended September 30,
	(in millions)
2006	$ 188
2007	188
2008	188
2009	187
2010	181
Thereafter	883
	$1,815

The life all acquired intangible assets is evaluated based on the expected future cash flows associated with the asset. The expected amortization expense above reflects estimated useful lives assigned to the Company's identifiable, finite-lived intangible assets established in the accounting for the Acquisition effective as of

March 1, 2004 as follows: ten years for recorded music catalog, fifteen years for music publishing copyrights and fifteen years for trademarks. Artist contracts acquired by the Company have variable estimated useful lives which do not exceed ten years.

Amortization expense included in Old WMG's statement of operations for each of the three months ended February 29, 2004 and the year ended November 30, 2003 was based on different estimated useful lives assigned to Old WMG's identifiable, finite-lived intangible assets. For each of the three months ended February 29, 2004 and the year ended November 30, 2003, estimated useful lives of fifteen years were assigned to both of Old WMG's recorded music catalog and music publishing copyrights. The change in estimated useful lives from 2003 to 2004 was implemented in connection with the valuation of the Company's intangible assets in connection with the Acquisition. See Note 5 for a discussion of the pro forma effects of the Acquisition on the historical operating results of Old WMG, including the effects from the aforementioned changes in estimated useful lives.

11. Restructuring Costs

2005 Restructuring Activities

In August of 2005, Jason Flom, the co-chairman of The Atlantic Records Group left the Company. In an effort to streamline the businesses, the Company merged the operations of Lava Records into the operations of The Atlantic Records Group in September 2005. As a result, certain employee positions at Lava were restructured. In addition to restructuring such employee positions, the Company evaluated its workforce at other affiliates and restructured certain other positions in order to maximize cost-effectiveness. These employee terminations resulted in restructuring charges of $4 million in the year ended September 30, 2005. Additionally, certain artists' contracts were terminated as part of the cost-saving initiative. Such artist contract terminations resulted in $3 million restructuring charges in the year ended September 30, 2005.

Acquisition-Related Restructuring Costs

In connection with the Acquisition that was effective as of March 1, 2004, the Company reviewed its operations and implemented several plans to restructure its operations. As part of these restructuring plans, the Company recorded a restructuring liability of approximately $307 million during 2004. This restructuring liability included costs to exit and consolidate certain activities of the Company, as well as costs to terminate employees and certain artist, songwriters and co-publisher contracts. Such liabilities were recognized as part of the cost of the Acquisition.

Of the total $307 million restructuring costs recorded by the Company, approximately $164 million related to work-force reductions, including employee termination benefits and relocation costs; approximately $75 million related to costs to terminate certain artist, songwriters and co-publisher contracts; and the balance of approximately $68 million related to other anticipated costs to exit certain leased facilities and operations, such as international distribution operations. The number of employees identified to be involuntarily terminated approximated 1,600.

Based on the restructuring plans already implemented, the Company revised its original estimates of restructuring costs during the year ended September 30, 2005. This resulted in an overall reduction in the restructuring costs of approximately $32 million. The Company's restructuring liabilities and goodwill as of September 30, 2005 have been reduced by such amounts. As of September 30, 2005, the Company had approximately $49 million of liabilities for Acquisition-related restructuring costs recorded in its balance sheet. These liabilities represent estimates of future cash obligations for all restructuring activities that had been

implemented. The outstanding balance of these liabilities primarily relate to extended payment terms for long-term lease obligations for vacated facilities or long-term artist commitments. These remaining lease obligations are expected to be settled by 2019. We expect to pay a majority of the remaining costs in fiscal 2006.

	Employee Terminations	Other Exit Costs	Total
	(In millions)		
Liability as of November 30, 2003	$—	$—	$ —
Additions in 2004	164	143	307
Cash paid in 2004	(92)	(13)	(105)
Non-cash reductions in 2004(a)	(1)	(22)	(23)
Liability as of September 30, 2004	$ 71	$108	$ 179
Cash paid in 2005	(53)	(27)	(80)
Non-cash reductions in 2005(a)	—	(18)	(18)
Reversals of PPA liabilities in 2005	(4)	(28)	(32)
Liability as of September 30, 2005	$ 14	$ 35	$ 49

(a) Principally relates to changes in foreign currency exchange rates, the non-cash write-off of the carrying value of advances relating to terminating certain artist, songwriter and co-publisher contracts.

Cost-Savings Incentive Plan

In addition, in connection with the Acquisition, the Company approved a cost-savings incentive compensation plan during 2004 in order to incentivize management to implement the aforementioned restructuring plans and reduce operating costs. Under the plan, key employees of the Company were entitled to earn up to $20 million in the aggregate based on the attainment and maintenance of certain cost-savings targets. Based on the level of cost savings actually generated at the end of September 30, 2004, which exceeded the cost savings targets under the plan, the Company determined that it was probable that eligible employees would vest in the full benefits under the plan. Accordingly, the Company expensed the full $20 million liability under the plan, along with other restructuring-related costs of $6 million, during the seven months ended September 30, 2004. Out of the aggregate $26 million liability, $16 million has been paid during the year ended September 30, 2005. We expect to pay the remaining $10 million in fiscal 2006.

Other Non-Acquisition Related Restructuring Costs

In addition to the costs of restructurings associated with acquisition and merger activities, Old WMG has also recognized restructuring costs that are unrelated to business combinations and are expensed as incurred.

2003 Restructuring Activities

During 2003, in a continuing effort to reduce costs, Old WMG implemented a series of significant restructuring activities. In particular, Old WMG restructured its domestic distribution operations, outsourced its Canadian distribution operations, and continued to reduce its worldwide headcount to adjust to changing economic conditions in various markets. In connection with these initiatives, Old WMG recognized restructuring charges of approximately $35 million in 2003. Of this amount, approximately $22 million related to work-force reductions, including employee termination benefits and relocation costs, and approximately $13 million related to other anticipated costs to exit certain facilities. The number of employees that were involuntarily terminated approximated 365. All restructuring activities were completed by the end of 2003.

As of November 30, 2003, there was approximately $10 million of non-Acquisition related restructuring costs that had yet to be paid, principally relating to severance obligations and long-term lease obligations for vacated facilities. As previously noted, in connection with the Acquisition, Time Warner agreed to assume all unpaid severance obligations from Old WMG. Accordingly, all such liabilities were transferred to Time Warner effective as of March 1, 2004. In addition, in connection with the Acquisition, the Company reevaluated its global facility requirements and further consolidated its real estate holdings. As part of this re-evaluation, the Company remeasured the fair value of its long-term lease obligations for vacated facilities, eliminated the pre-existing $2 million book value of the lease obligations for vacated facilities and recorded the net impact as an addition to goodwill. See prior discussion of Acquisition-related restructuring costs.

The restructuring costs related to each of the Company's business segments, as well as corporate-level employees. Selected information related to the 2003 restructuring plans by business segment is as follows (in millions):

Employee Terminations

	Recorded Music	Music Publishing	Corporate	Total
Additions in 2003	$ 18	$ 3	$ 1	$ 22
Cash paid in 2003	(13)	(1)	—	(14)
Liability as of November 30, 2003	5	2	1	8
2004 activity, primarily adjustments relating to the Acquisition	(5)	(2)	(1)	(8)
Liability as of September 30, 2004	$—	$—	$—	$—

Other Exit Costs

	Recorded Music	Music Publishing	Corporate	Total
Additions in 2003	$ 13	$—	$—	$ 13
Cash paid in 2003	(10)	—	—	(10)
Non-cash reductions in 2003	(1)	—	—	(1)
Liability as of November 30, 2003	2	—	—	2
2004 activity, primarily adjustments relating to the Acquisition	(2)	—	—	(2)
Liability as of September 30, 2004	$—	$—	$—	$—

12. Other Current and Noncurrent Liabilities

Other current liabilities consist of the following (in millions):

	September 30, 2005	September 30, 2004
Accrued expenses	$166	$159
Accrued compensation and benefits	107	93
Deferred income	46	46
Acquisition and merger-related restructuring liabilities	30	90
Other contractual obligations	9	—
Fair value of warrants	—	155
Accrued interest	33	31
Cost-savings incentive plan payable	10	10
Dividends payable	1	—
Other	2	3
	$404	$587

Other noncurrent liabilities consist of the following (in millions):

	September 30, 2005	September 30, 2004
Deferred income	$ 15	$ 25
Accrued compensation and benefits	21	29
Minority interest	9	9
Cost-savings incentive plan payable	—	10
Acquisition and merger-related restructuring liabilities	19	89
Unfavorable and other contractual obligations	132	135
Licensing advance payable	8	8
Other	22	28
	$226	$333

Licensing Advance Payable

Other noncurrent liabilities include an $8 million obligation at each of September 30, 2005 and 2004 to repay an advance received in a prior period under a licensing agreement. Under the terms of the original agreement, such amount was subject to repayment if the advance was not recouped from royalties generated under the agreement by November 30, 2003. In June 2003, the parties entered into an amended agreement whereby, in connection with an extension of the term of the original agreement, the Company agreed to repay the advance over a six-year period ended November 30, 2009. Of the total repayment amount, $2 million was repaid in 2003. The remaining $8 million is repayable as follows: 2006, $0.5 million; 2007, $0.5 million; 2008, $3 million; and 2009, $4 million.

13. Note Payable to Shareholders

In September 2004, the Company declared a $342 million dividend to its shareholders in the form of a note payable. The note payable was interest-bearing at a rate of 10% per annum. The note payable was paid in October 2004 using proceeds received from a return of capital previously invested in Acquisition Corp. Interest paid to the Company's shareholders under the note payable amounted to approximately $1 million.

14. Debt

In connection with the Acquisition, the Company incurred $1.650 billion of indebtedness consisting of (i) $1.150 billion of borrowings under the term loan portion of a senior secured credit facility and (ii) $500 million of borrowings under a senior subordinated bridge loan facility (the "Bridge Loan"). A portion of these borrowings was refinanced by WMG Acquisition Corp., a subsidiary of the Company, in April 2004 (the "Acquisition Corp. Refinancing"). In addition, in December 2004, Holdings incurred approximately $700 million of debt to redeem its outstanding shares of cumulative preferred stock and pay a return of capital to the Investor Group (the "Holdings Refinancing"). A portion of this debt was redeemed in June 2005 (the "Holdings Redemption"). The following summarizes the Acquisition Corp. Refinancing, the Company's debt capitalization as of September 30, 2005 and 2004, the principal terms of the Company's financing arrangements, the Holdings Refinancing.

The Acquisition Corp. Refinancing

In April 2004, the Company incurred $697 million of new indebtedness, consisting of the issuance by Acquisition Corp. of (i) $465 million principal amount of 7.375% Senior Subordinated Notes due 2014,

(ii) 100 million Sterling principal amount of 8.125% Senior Subordinated notes due 2014 (U.S. dollar equivalent of $182 million as of April 2004) and (iii) $50 million of additional borrowings under the term loan portion of the Company's senior secured credit facility.

Together with available cash on hand, such proceeds were used (i) to repay all $500 million of borrowings under the Bridge Loan, (ii) to redeem a portion of the cumulative preferred stock of Holdings in the amount of $202 million and (iii) to pay certain financing-related transaction costs.

In connection with this re-financing, the Company incurred a $6 million pretax loss during the seven months ended September 30, 2004 to write off the carrying value of its unamortized debt issuance costs paid in connection with its borrowings under the Bridge Loan.

Debt Capitalization

As of September 30, 2005 and 2004, the Company's long-term debt consisted of (in millions):

	September 30, 2005	September 30, 2004
Senior secured credit facility:		
Revolving credit facility	$ —	$ —
Term loan	1,430	1,194
	1,430	1,194
7.375% U.S. dollar-denominated Notes due 2014—Acquisition Corp	465	465
8.125% Sterling-denominated Notes due 2014—Acquisition Corp	177	181
9.5% Senior Discount Notes due 2014—Holdings	174	—
Total debt	2,246	1,840
Less current portion	(17)	(12)
Total long term debt	$2,229	$1,828

Senior Secured Credit Facility

Holdings and Acquisition Corp. are party to a senior secured credit facility that was entered into in connection with the Acquisition. The senior secured credit facility consists of a $1.2 billion term loan portion and a $250 million revolving credit portion. The term loan portion of the facility matures in seven years in February 2011. Acquisition Corp. is required to prepay outstanding term loans, subject to certain exceptions and conditions, with excess cash flow or in the event of certain asset sales, casualty and condemnation events and incurrence of debt. Acquisition Corp. is required to make minimum repayments under the term loan portion of the facility in quarterly principal amounts of $4.2 million for the first six years and nine months, with a remaining balloon payment in February 2011.

The revolving credit portion of the senior secured facility matures in six years in February 2010. There are no mandatory reductions in borrowing availability for the revolving credit portion of the facility through its term.

Borrowings under both the term loan and revolving credit portion of the senior secured credit facility bear interest at a rate equal to an applicable margin plus, at the Company's option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Bank of America, N.A. and (2) the federal funds rate plus 1/2 of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits in the currency of such borrowing for the interest period relevant to such borrowing adjusted for certain additional costs. The initial

applicable margin for borrowings under the revolving credit facility and the term loan facility is 1.75% with respect to base rate borrowings and 2.75% with respect to LIBOR borrowings. The applicable margins for borrowings under the senior secured credit facility may be reduced, subject to Acquisition Corp. attaining certain leverage ratios.

In addition to paying interest on outstanding principal under the senior secured credit facility, Acquisition Corp. is required to pay a commitment fee to the lenders under the revolving credit facility in respect of the unutilized commitments. The initial commitment fee rate is .50%. As of September 30, 2005, the commitment fee rate was 0.375%. The commitment fee rate may be reduced subject to Acquisition Corp. attaining certain leverage ratios. Acquisition Corp. is also required to pay customary letter of credit fees, as necessary.

The senior secured credit facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, Acquisition Corp.'s ability and the ability of its subsidiaries to sell assets, incur additional indebtedness or issue preferred stock, repay other indebtedness, pay dividends and distributions or repurchase capital stock, create liens on assets, make investments, loans or advances, make certain acquisitions, engage in mergers or consolidations, engage in certain transactions with affiliates, amend certain material agreements, change the business conducted by itself, its parent company and its subsidiaries, and enter into agreements that restrict dividends from subsidiaries. In addition, the secured credit facility requires Acquisition Corp. to maintain the following financial covenants: a maximum total leverage ratio, a minimum interest coverage ratio and a maximum capital expenditures limitation.

The Company obtained an amendment to its senior secured credit facility in May of 2005 to provide for, among other things, an additional term loan of $250 million which the Company has obtained concurrent with the Initial Common Stock Offering, a reduction in the margin applicable on the term loan, and more flexibility under certain restrictive covenants.

Senior Subordinated Notes due 2014

The Company has outstanding two tranches of Senior Subordinated notes of Acquisition Corp. due 2014: $465 million principal amount of U.S. dollar-denominated notes (the "U.S. Notes") and 100 million principal amount of Sterling-denominated notes (the "Sterling Notes" and collectively, the "Subordinated Notes"). The Subordinated Notes mature on April 15, 2014. Interest is payable on the Subordinated Notes on a semi-annual basis at a fixed rate of 7.375% per annum for the U.S. Notes and 8.125% per annum for the Sterling Notes.

The Subordinated Notes are redeemable in whole or in part, at the option of Acquisition Corp., at any time at a redemption price defined under the indenture governing the Subordinated Notes (the "Indenture") that generally includes a premium. In addition, upon a change of control of Acquisition Corp. and upon certain asset sales as specified under the Indenture, Acquisition Corp. may be required to make an offer to redeem the Subordinated Notes from the holders at a redemption price defined under the Indenture that includes a premium.

The Subordinated Notes are unsecured and subordinated to all of Acquisition Corp.'s existing and future senior indebtedness, including Acquisition Corp.'s obligations under its senior secured credit facility. Each of Acquisition Corp.'s wholly owned domestic subsidiaries that have guaranteed the obligations under Acquisition Corp.'s senior secured credit facility also have guaranteed the Subordinated Notes on a joint, several and unconditional basis.

The Indenture limits Acquisition Corp.'s ability and the ability of its restricted subsidiaries to incur additional indebtedness or issue certain preferred shares; to pay dividends on or make other distributions in respect of its capital stock or make other restricted payments; to make certain investments; to sell certain assets;

to create liens on certain debt without securing the notes; to consolidate, merge, sell or otherwise dispose off all or substantially all of its assets; to enter into certain transactions with affiliates; and to designate its subsidiaries as unrestricted subsidiaries.

Subject to certain exceptions, the Indenture permits Acquisition Corp. and its restricted subsidiaries to incur additional indebtedness, including secured indebtedness.

The Holdings Refinancing

In December 2004, Holdings issued $847 million principal amount of debt consisting of (i) $250 million principal amount of Floating Rate Senior Notes due 2011 (the "Holdings Floating Rate Notes"), (ii) $397 million principal amount at maturity of 9.5% Senior Discount Notes due 2014, which had an initial issuance discount of $147 million (the "Holdings Discount Notes") and (iii) $200 million principal amount of Floating Rate Senior PIK Notes due 2014 (the "Holdings PIK Notes," and collectively, the "Holdings Notes"). The gross proceeds of $696 million received from the issuance of the Holdings Notes were used to (i) redeem the remaining shares of cumulative preferred stock of Holdings at a redemption price of $209 million, including $9 million of accrued and unpaid dividends, (ii) pay a return of capital to Parent Corp. and its shareholders in the aggregate amount of $472 million and (iii) pay debt-related issuance costs of approximately $15 million.

The Holdings Redemption

In June 2005, using proceeds from the Company's Initial Common Stock Offering and approximately $57 million of cash on hand, Holdings redeemed all of the Holdings Floating Rate Notes, all of the Holdings PIK Notes, and 35% of the aggregate outstanding principal at maturity of the Holdings Discount Notes.

The Holdings Floating Rate Notes were redeemed in full on June 15, 2005. From the issuance date through the redemption date, the notes bore interest at a quarterly floating rate based on three-month LIBOR rates plus a margin equal to 4.375%. Interest was payable quarterly in cash beginning on March 15, 2005.

The Holdings Discount Notes were issued at a discount and have an initial accreted value of $630.02 per $1,000 principal amount at maturity. Prior to December 15, 2009, no cash interest payments are required. However, interest accrues on the Holdings Discount Notes in the form of an increase in the accreted value of such notes such that the accreted value of the Holdings Discount Notes will equal the principal amount at maturity on December 15, 2009. Thereafter, cash interest on the Holdings Discount Notes is payable semi-annually at a fixed rate of 9.5% per annum. The Holdings Discount Notes mature on December 15, 2014. The Company redeemed 35% of the Holdings Discount Notes on June 15, 2005.

The Holdings PIK Notes were redeemed in full on June 15, 2005. From the date of issuance through the date of redemption, the notes bore interest at a semi-annual, floating rate based on six-month LIBOR rates plus a margin equal to 7%. Interest was accrued in the form of additional PIK Notes at the election of the Company. Such amounts were also repaid in connection with the redemption.

In connection with the redemption of the Holdings Floating Rate Notes and 35% of the Holdings Discount Notes, the Company was required to pay redemption premiums of $10 million and $9 million, respectively, which the Company paid on June 15, 2005 and recorded as a loss on the repayment of the notes in the consolidated statement of operations for the year ended September 30, 2005.

The Company was also required to pay all accrued interest as of the redemption date related to the Holdings Notes that were redeemed. This amount consisted of $5 million related to the Holdings Floating Rate Notes, $9 million related to the Holdings PIK notes, and $4 million in accreted value of the 35% of Holdings Discount

Notes redeemed. Of such amount, $8 million had been expensed in previous quarters and $10 million was recorded as interest expense in the consolidated statement of operations for the year ended September 30, 2005.

In connection with the redemption of certain of the Holdings Notes, the Company also wrote off the remaining balance of debt-issuance costs of $12 million related to the notes redeemed and the remaining unamortized original issue discount of $4 million related to the Holdings PIK Notes. Such amounts were recorded as a loss on the repayment of the notes in the consolidated statement of operations for the year ended September 30, 2005.

Parent has fully and unconditionally guaranteed the remaining Holdings Discount Notes. The Holdings Notes are unsecured and subordinated to all of Holdings' existing and future secured debt, including Holdings' guarantee of borrowings by Acquisition Corp. under the Company's senior secured credit facility. In addition, the Holdings Notes are structurally subordinated to the Subordinated Notes of Acquisition Corp.

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

Restricted Net Assets

The Company is a holding company with no independent operations or assets other than through its interests in its subsidiaries, such as Holdings and Acquisition Corp. Accordingly, the ability of the Company to obtain funds from its subsidiaries is restricted by the senior secured credit facility of Acquisition Corp., the indenture for the Subordinated Notes issued by Acquisition Corp., and the indentures for the Holdings Notes.

Pre-Acquisition Debt

During 2003, the Company incurred approximately $114 million of indebtedness in connection with a recapitalization of certain wholly owned international subsidiaries. The principal amount of 100 million Euros was owed to Societe General and was repaid in 2004 in connection with the Acquisition.

Interest Expense and Maturities

Total interest expense, including amounts payable to Time Warner and its affiliates for all periods prior to the closing of the Acquisition, was $182 million for the year ended September 30, 2005, $88 million for the seven months ended September 30, 2004, $3 million for the three months ended February 29, 2004, and $47 million for the year ended November 30, 2003. The weighted-average interest rate of the Company's total debt at September 30, 2005 and 2004 was 6.55% and 5.75%, respectively.

Based on the amount of debt outstanding as of September 30, 2005, annual repayments of long-term debt for each of the five years subsequent to September 30, 2005 are approximately $17 million per year.

Fair Value of Debt

Based on the level of interest rates prevailing at September 30, 2005, the fair value of the Company's fixed-rate debt exceeded its carrying value by approximately $10.6 million. Unrealized gains or losses on debt do not result in the realization or expenditure of cash and generally are not recognized for financial reporting purposes unless the debt is retired prior to its maturity.

15. Income Taxes

For the year ended September 30, 2005 and the seven months ended September 30, 2004, the Company is a stand-alone tax filer. However, for all periods prior to the closing of the Acquisition, which includes the three months ended February 29, 2004 and the year ended November 30, 2003, the taxable results of Old WMG were included in the consolidated U.S. federal and various U.S. state and local, and foreign income tax returns of Time Warner or its subsidiaries. Also, in certain U.S. state and local, and foreign jurisdictions, Old WMG filed on a stand-alone basis. The tax provisions and related balance sheet disclosures for the periods prior to the closing of the Acquisition have been prepared assuming Old WMG was a stand-alone taxpayer for the periods presented.

Domestic and foreign pretax income (loss) are as follows (in millions):

	Successor		Predecessor	
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Year Ended November 30, 2003
Domestic	$(194)	$(246)	$(40)	$(1,304)
Foreign	80	38	25	(13)
Total	$(114)	$(208)	$(15)	$(1,317)

Current and deferred income taxes (tax benefits) provided are as follows (in millions):

	Successor		Predecessor	
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Year Ended November 30, 2003
Federal:				
Current	$—	$—	$—	$—
Deferred	—	—	(2)	(36)
Foreign:				
Current(a)	53	21	21	52
Deferred	—	8	(2)	111
U.S. State:				
Current	2	1	—	3
Deferred	—	—	—	(94)
Total	$ 55	$ 30	$ 17	$ 36

(a) Includes cash withholding taxes of $14 million, $9 million, $5 million and $19 million for the year ended September 30, 2005, seven months ended September 30, 2004, the three months ended February 29, 2004, and the year ended November 30, 2003, respectively.

The differences between the U.S. federal statutory income tax rate of 35% and income taxes provided are as follows (in millions):

	Successor		Predecessor	
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Year Ended November 30, 2003
Taxes on income at the U.S. federal statutory rate	$(40)	$(73)	$ (5)	$(461)
U.S. state and local taxes[a]	2	1	—	(59)
Non-deductible impairments of goodwill	—	—	—	2
Foreign income taxed at different rates, including withholding taxes	14	9	6	38
Unrecoverable foreign taxes due to reorganization	—	—	—	46
Current year loss without benefit	86	46	16	44
Non-deductible loss / (Non-taxable gain) on warrant	(6)	42	—	—
Non-deductible loss on minority interest	2	5	—	—
Tax loss carry forward write-off	—	—	—	423
Other	(3)	—	—	3
Total income tax expense	$ 55	$ 30	$ 17	$ 36

(a) U.S. state and local taxes for the year ended November 30, 2003 were net of U.S. federal tax benefit.

During the year ended September 30, 2005, the Company incurred losses in the U.S. and certain foreign territories. The tax benefit associated with these losses was offset by a valuation allowance as the Company has determined that it is more likely than not that these losses will not be utilized. Significant components of the Company's net deferred tax assets/(liabilities) are summarized below (in millions):

	September 30, 2005	September 30, 2004
Deferred tax assets:		
Allowances and reserves	$ 52	$ 4
Employee benefits and compensation	15	34
Other accruals	105	87
Depreciation and amortization	42	14
Tax attribute carryforwards	134	157
Other	11	2
Total deferred tax assets	359	298
Valuation allowance	(323)	(293)
Net deferred tax assets	36	5
Deferred tax liabilities:		
Assets acquired in business combinations	(201)	(232)
Total deferred tax liabilities	(201)	(232)
Net deferred tax assets (liabilities)	$(165)	$(227)

At September 30, 2005, goodwill was reduced by $56 million as a result of the reversal of valuation allowances established at the acquisition date for purchase price liabilities and a determination that it is more likely than not that some portion or all of the deferred tax assets will be realized in certain foreign jurisdictions. Of the total valuation allowance of $323 million at September 30, 2005, $74 million is related to purchased deferred tax assets and when released, will be reversed through goodwill.

At September 30, 2005, the Company has U.S. federal tax net operating loss carryforwards of approximately $110 million, which will begin to expire in fiscal year 2024 and tax net operating losses in certain U.S. state and foreign jurisdictions expiring in various periods. In addition, the Company has foreign tax credit carryforwards for U.S. tax purposes of $19 million, of which $8 million and $11 million will expire in 2009 and 2015, respectively.

U.S. income and foreign withholding taxes have not been recorded on permanently reinvested earnings of certain foreign subsidiaries of approximately $400 million at September 30, 2005. As such, no federal income taxes thereon have been provided for these undistributed earnings. Should these earnings be distributed, foreign tax credits would reduce the additional federal income tax that would be payable. Availability of credits is subject to limitations; accordingly, it is not practicable to estimate the amount of the ultimate deferred tax liability, if any, on accumulated earnings.

16. Pensions and Other Postretirement Benefits

Prior the Acquisition, Old WMG employees in the U.S. and U.K. generally participated in defined benefit pension plans sponsored by Time Warner. As part of the Acquisition, Time Warner agreed to retain its obligations related to such employees of Old WMG; however, those employees are no longer eligible to earn additional benefits for future services. As a result, Old WMG recognized a $15 million loss in 2003 in connection with the probable pension curtailment that ultimately occurred upon the closing of the Acquisition.

Most international employees, such as those in Germany and Japan, participate in locally sponsored defined benefit plans, which are not considered to be material in the aggregate and have a combined projected benefit obligation of approximately $23 million and $40 million as of September 30, 2005 and 2004, respectively. Pension benefits under the Plans are based on formulas that reflect the employees' years of service and compensation levels during their employment period. The Company had an aggregate pension liability relating to these plans of approximately $23 million and $23 million recorded in its balance sheet as of September 30, 2005 and 2004, respectively.

For the year ended September 30, 2005, the seven months ended September 30, 2004, the three months ended February 29, 2004 and the year ended November 30, 2003, pension expense amounted to $6 million, $4 million, $3 million and $21 million, respectively.

Certain employees also participate in pre-tax defined contribution plans. The Company's contributions to the defined contribution plans are based upon a percentage of the employees' elected contributions. The Company's defined contribution plan expense amounted to approximately $2 million for the year ended September 30, 2005, $2 million for the seven months ended September 30, 2004, $2 million for the three months ended February 29, 2004 and $4 million for the year ended November 30, 2003.

17. Minority Interest in Preferred Stock of Subsidiary

As previously described in Note 5, a portion of the $2.6 billion purchase price for the Acquisition was funded by a $400 million direct contribution by the Investor Group to Holdings in exchange for 40,000 shares of

cumulative preferred stock of Holdings ("Holdings' Preferred Stock"). Each share of Holdings' Preferred Stock had a liquidation preference of $10,000 per share plus cumulative accrued and unpaid dividends at a rate of 10% per annum, compounded quarterly.

As previously described in Note 14, the Company redeemed half of the outstanding shares of Holdings' Preferred Stock as part of the April 2004 Acquisition Corp. Refinancing at a redemption price of $202 million, including $2 million of accrued and unpaid dividends. The remaining shares of Holdings' Preferred Stock were redeemed in December 2004 as part of the Holdings Refinancing at a redemption price of $209 million, including $9 million of accrued and unpaid dividends.

As of September 30, 2004, the outstanding shares of Holdings' Preferred Stock had a liquidation preference of $204 million. Such amount has been classified as minority interest in the accompanying consolidated balance sheet of the Company. As noted above, all such amounts were repaid prior to September 30, 2005. Cumulative dividends on the Holdings' Preferred Stock, whether paid or unpaid, were $5 million for the year ended September 30, 2005 and $14 million for the seven months ended September 30, 2004 and are classified as minority interest expense in the accompanying consolidated statement of operations of the Company.

18. Stock-Based Compensation Plans

Post-Acquisition

In connection with the Acquisition, the Company, implemented an equity-based, management compensation plan to align compensation for certain key executives with the performance of the Company. Under this plan, certain key executives were granted a combination of service-based and performance-based stock options or restricted stock. In addition, certain key executives were granted the right to purchase shares of restricted stock in the Company. Similarly, the stock options and shares of restricted stock granted allow such executives to acquire shares of common stock of the Company. A description of each type of equity-based award is described below.

Service-Based Awards

During the year ended September 30, 2005 and the seven months ended September 30, 2004, the Company granted various service-based equity awards to certain key executives of the Company. In the year ended September 30, 2005, these awards consisted of 2,643,233 stock options to purchase shares of common stock of the Company and 583,379 restricted shares of common stock of the Company. The stock options were granted under one of the Company's long-term incentive plans. In the seven months ended September 30, 2004, these awards consisted of 497,893 stock options to purchase shares of common stock of the Company and 796,701 restricted shares of common stock of the Company. The stock option awards become exercisable over a four-year vesting period tied to the executives' continuing employment and expire ten years from the date of grant. Similarly, the restricted shares vest over a four-year period, also contingent upon the employees' continued employment.

Performance-Based Awards

During the year ended September 30, 2005 and the seven months ended September 30, 2004, the Company granted various performance-based equity awards to certain key executives of the Company. In the year ended September 30, 2005, these awards consisted of 2,540,490 stock options to purchase the Company's common stock and 1,156,758 restricted shares to purchase shares of the common stock of the Company. These stock options were granted under one of the Company's long-term incentive plans. In the seven months ended September 30, 2004, these awards consisted of approximately 995,786 stock options to purchase shares of

common stock of the Company and approximately 1,593,402 restricted shares of common stock of the Company. The awards vest over a four-year period tied to the executives' continuing employment and the achievement of certain performance conditions by the Company. In particular, half of the awards have a performance condition based on a 2x liquidity event and the other half of the awards have a performance condition based on a 3x liquidity event (each respectively a "Liquidity Event").

As defined in the underlying plan agreements, a 2x or 3x Liquidity Event generally means the occurrence of an event that implies an aggregate value for the equity held by the Investor Group of 2x or 3x, respectively, of its initial value, as adjusted for prior dividends or other returns of capital received by the Investor Group. Such Liquidity Events include, but are not limited to, an initial public offering of the Company's common stock and a change-in-control transaction under which the Investor Group receives cash and/or marketable securities in exchange for its equity. In connection with the Company's Initial Common Stock Offering in May 2005, the 2x Liquidity Event occurred.

Performance-based stock option awards expire ten years from the date of grant. In addition, to the extent that the performance condition of an award is not satisfied prior thereto, the performance-based award vests on the seventh anniversary of the date of grant as long as the executive is still employed by the Company. Under the Company's LTIP program and its 2005 Omnibus Stock Plan, the Company has an additional 2,089,420 stock options or other stock based awards authorized that have not been awarded.

Purchases of Restricted Stock

During the year ended September 30, 2005 and the seven months ended September 30, 2004, the Company allowed certain key executives to purchase restricted shares of its common stock. To the extent such shares were purchased at a price equal to fair market value at the date of purchase, there was no compensatory element of the transaction. However, to the extent such shares were purchased at a price below fair market value at the date of purchase, the discount has been treated as deferred compensation in the Company's financial statements and is being expensed over the executives' expected service period.

During the year ended September 30, 2005, executives of the Company purchased 1,496,148 restricted shares of the Company's common stock at a cost of $1.04 per share, compared to the weighted-average fair value of the stock of $9.38 per share. The aggregate discount of $12 million will be expensed over the service periods of the awards.

During the seven months ended September 30, 2004, an executive of the Company purchased approximately 3,283,944 restricted shares of common stock of the Company at a fair value of $0.88 per share. Certain other executives of the Company purchased approximately 896,208 restricted shares of common stock of the Company at a cost of $0.88 per share, compared to the weighted-average fair value of the stock of $4.24 per share. The aggregate discount of approximately $3 million will be expensed over the service periods of the awards.

Of the total restricted stock awards granted and restricted stock purchased, 1,095,042 shares were vested as of September 30, 2005.

Assumptions

For purposes of applying FAS 123, the fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option-pricing model, if granted prior to January 2005 and the Binomial model subsequent to January 2005, both of which are based upon several assumptions estimated by the company. The following weighted-average assumptions were used for all grants to the Company's employees in the seven

months ended September 30, 2004 and the twelve months ended September 30, 2005, respectively: dividend yield of 0% and 0%; expected volatility of 50% and 47.8%; risk-free interest rate of 3.07% and 3.80%; and expected term to exercise of 5 years and 6.01 years.

Fair Value of Equity-Based Awards

A summary of the fair value of equity-based awards granted during the year ended September 30, 2005 and the seven months ended September 30, 2004 is set forth below:

	Year ended September 30, 2005			Seven months ended September 30, 2004		
	Number of Shares Granted	Weighted-Average Exercise Price	Weighted-Average Fair Value	Number of Shares Granted	Weighted-Average Exercise Price	Weighted-Average Fair Value
Service-Based Stock Options:						
At-market grants	1,372,988	$17.14	$ 6.92	398,315	$0.88	$0.41
Below-market grants	1,270,245	5.10	7.35	99,578	0.88	4.87
Performance-Based Stock Options:						
At-market grants—2x liquidity event	—	—	—	398,315	0.88	0.41
Below-market grants—2x liquidity event	1,270,245	5.10	7.35	99,578	0.88	4.87
At-market grants—3x liquidity event	—	—	—	398,315	0.88	0.41
Below-market grants—3x liquidity event	1,270,245	5.10	7.35	99,578	0.88	4.87
Total Stock Options	5,183,723	$ 8.29	$ 7.24	1,493,679	$0.88	$1.30
Restricted Stock Grants:						
Service-based awards	583,379	N/A	$10.28	796,701	N/A	$0.88
Performance-based 2x liquidity event awards	578,379	N/A	10.22	796,700	N/A	0.88
Performance-based 3x liquidity event awards	578,379	N/A	10.22	796,701	N/A	0.88
Total Restricted Stock Grants[a]	1,740,137	N/A	$10.24	2,390,102	N/A	$0.88

(a) Excludes 1,496,148 and 4,180,152 restricted shares of common stock of the Company, which were purchased in 2005 and 2004, respectively, by executives of the Company at prices at or below fair market value. The weighted-average purchase price and weighted-average fair value of such shares purchased in 2005 and 2004 were $1.04 and $0.88 per share, respectively and $9.38 and $1.60 per share, respectively.

Compensation Expense

For the year ended September 30, 2005, the Company recognized non-cash compensation expense of $25 million relating to its stock-based compensation plans.

For the seven months ended September 30, 2004, the Company recognized non-cash compensation expense of less than $1 million relating to its stock-based compensation plans.

Summary of Stock Option Activity

A summary of stock option activity is as follows:

	Options Outstanding	Weighted-Average Exercise Price
Balance at November 30, 2003	—	$—
Granted	1,493,679	0.88
Exercised	—	—
Cancelled	—	—
Balance at September 30, 2004	1,493,679	$0.88
Granted	5,183,723	8.29
Exercised	—	—
Cancelled	(298,736)	0.88
Balance at September 30, 2005	6,378,666	$6.90

None of the stock options were exercisable as of September 30, 2004. The following table summarized information about stock options outstanding as of September 30, 2005:

Range of Exercise Prices	Number of Options Outstanding as of September 30, 2005	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number of Options Exercisable as of September 30, 2005	Weighted-Average Exercise Price
Under $5.00	3,696,374	8.90	2.90	398,315	2.90
$ 5.00 - $9.99	970,716	9.22	6.39	—	—
$10.00 - $14.99	338,588	9.51	10.46	—	—
$15.00 and above	1,372,988	9.69	17.14	—	—
	6,378,666	9.15	6.90	398,315	2.90

Payments Relating to Executive Compensation

The Company determined that certain shares of restricted stock issued in 2004 and early 2005 may have been sold at prices below fair market value on the applicable date of sale and certain options to purchase shares of the Company's stock granted may have had exercise prices below fair market value on the applicable date of grant. As a result, certain U.S. employee holders of the restricted stock who made elections under Section 83(b) of the Internal Revenue Code will be subject to additional ordinary income tax to the extent of the fair market value of the restricted stock received over the purchase price they paid for such stock. In other cases, certain employees who did not make such an election will be subject to higher taxes on their restricted shares at the time of vesting than would have been the case had they purchased the shares for fair market value. In addition, under the provisions of the American Jobs Creation Act of 2004, signed into law in October 22, 2004, U.S. employee option holders whose options vest with exercise prices below fair market value on the date of grant are subject to significant penalties under new Section 409A of the Internal Revenue Code. IRS Notice 2005-1 provides transitional guidance on the application of Section 409A which, among other things, permits options with exercise prices below the fair market value of the underlying stock on the date of grant to be amended or replaced with new options having an exercise price at least equal to the fair market value on the grant date. Non-U.S. employee holders of restricted stock or options may be subject to similar or other related issues. In order for the Company to address these issues the board, based on a re-assessment of fair market values on the applicable dates, approved the actions discussed below.

Restricted Stock

The Company is authorized to pay each employee who purchased restricted stock at prices that were below fair market value on the date of purchase a cash bonus. The cash bonus payable to those employees who made a Section 83(b) election is an amount equal to the tax liability incurred by the employee as of the date of purchase based on any difference between the re-determined purchase date fair market value and the amount originally paid by the employee, plus an amount necessary to pay the taxes on the bonus. The bonuses that are payable to each of those employees who did not make a Section 83(b) election or the applicable foreign equivalent is an amount reflecting an estimate of the additional tax which would be payable by the employee at the time the restricted stock is scheduled to vest due to that taxable amount being subject to ordinary income rather than capital gains tax rates, and assuming that the re-determined value of the stock remains constant over the vesting period, adjusted down to reflect a present value discount based on the earliest possible vesting dates. The Company will pay these employees an amount necessary to pay the taxes on the bonus. This resulted in total cash payments of approximately $10 million, which the Company has expensed in the year ended September 30, 2005.

Options

The Company has revised the exercise prices of certain options to purchase its common stock to prices equal to the applicable re-determined fair market values of the common stock on the dates of the respective grants. To compensate the grantees for the loss of value represented by this adjustment to the option exercise prices, the Company will pay each affected employee a cash bonus in an amount equal to the excess of the adjusted aggregate exercise price of the employee's options over the original aggregate exercise price of the employee's options, adjusted down to reflect a present value discount based on the earliest possible exercise dates. The Company has treated the revision of the exercise prices of certain option grants as a modification of such grants under the related guidance and as such, recorded additional expense of $6 million in the year ended September 30, 2005. The cash bonuses that were paid during 2005, or will be paid shortly thereafter, will total approximately $9 million.

Further, in connection with the cash dividends the Company declared and paid to holders of its common stock consisting of the Investor Group and certain members of management who held shares of common stock prior to the Initial Common Stock Offering, the Company has made an adjustment to all options outstanding at the time of declaration of the dividend. The adjustment consists of a cash make-whole payment consisting of an amount equal to the pro rata amount that would have been received per share had all outstanding options been exercised at the time of the declaration of the dividend adjusted down to reflect a present value discount based on the earliest possible exercise dates. The Company has recorded approximately $3 million of expense related to such payments in the year ended September 30, 2005.

Of the amounts related to restricted stock and options, all but $3 million has been paid as of September 30, 2005.

Pre-Acquisition

Prior to the closing of the Acquisition, employees of Old WMG were granted options to purchase Time Warner common stock under various Time Warner stock option plans. Such options were granted to employees of Old WMG with exercise prices equal to, or in excess of, fair market value at the date of grant. Accordingly, in accordance with APB 25 and related interpretations, compensation cost generally was not recognized by Time Warner, nor charged to Old WMG, related to such stock option plans. Generally, the options became exercisable over a four-year vesting period and expired ten years from the date of grant. See Note 3 for a summary of the impact on reported net income (loss) had Old WMG recognized compensation cost for employee stock options.

Time Warner Black-Scholes Assumptions

For purposes of applying FAS 123, the fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants to Old WMG's employees in the three months ended February 29, 2004 and the years ended November 30, 2003: dividend yields of 0% in each period; expected volatility of 35.2% and 52.8%, respectively; risk-free interest rates of 3.1% and 2.6%, respectively; and expected terms to exercise of 1.4 years and 3.1 years, respectively.

Fair Value of Time Warner Equity-Based Awards

The weighted-average fair value of an option granted to the Company's employees was $3.20 and $4.33 for the three months ended February 29, 2004 and the year ended November 30, 2003, respectively.

Summary of Time Warner Stock Option Activity

A summary of Time Warner stock option activity with respect to employees of the Company is as follows:

	Time Warner Options Outstanding	Weighted-Average Exercise Price
Balance at November 30, 2002	29,716	33.72
Granted during 2003	6,341	11.72
Exercised during 2003	(196)	12.21
Cancelled/transferred during 2003(a)	(2,379)	23.79
Balance at November 30, 2003	33,482	30.39

(a) Includes all options cancelled and forfeited during the year, as well as options related to employees who have been transferred out of and into the Company to and from other Time Warner divisions.

Of the approximate 33 million Time Warner stock options held by employees of Old WMG as of the closing date of the Acquisition, approximately 27 million stock options remained outstanding and the balance was cancelled pursuant to the underlying terms of the awards. These stock options remain the obligation of Time Warner and not the Company, and will expire pursuant to the underlying terms of the awards, generally not exceeding three years from the closing date of the Acquisition. In exchange for the cancellation of certain unvested stock option awards as of the Acquisition date, employees of Old WMG received an aggregate $21 million payment funded by Time Warner. This payment was considered in the determination of the fair value of Old WMG's net assets as of November 30, 2003 and, accordingly, has been classified as a component of the impairment charge recognized during the year ended November 30, 2003.

Time Warner Restricted Stock Plans

Time Warner also had various restricted stock plans for employees and non-employee directors of the board. Under these plans, shares of common stock are granted which do not vest until the end of a restriction period, generally between three to five years. During 2003, Time Warner issued approximately 821,000 shares of restricted stock to employees of Old WMG at a weighted-average fair value of $13 per share.

Of the 922,000 unvested shares of Time Warner restricted stock held by employees of Old WMG as of the closing date of the Acquisition, 217,000 shares became vested either pursuant to their original terms or on an accelerated basis, 568,000 shares are still subject to vesting conditions and remain the obligation of Time Warner and the balance was cancelled by Time Warner. Old WMG recognized the cost associated with the vesting of such shares and the anticipated change in employee status of certain executives in 2003 as a component of deal-related transaction and other costs in its statement of operations.

19. Shareholders' Equity

The Company's capital stock formerly consisted of two classes of common stock that were issued in connection with the Acquisition. In addition, as part of the purchase price for the Acquisition, the Company issued warrants that gave Time Warner the right, under certain conditions, to purchase up to 19.9% of the capital stock of the Company. A summary of the terms of these securities is presented below.

Common Stock

In connection with the Acquisition, the Company received (i) a $765 million capital contribution in exchange for the issuance of 9,445 shares of Class L Common Stock and (ii) an $85 million capital contribution in exchange for the issuance of 85,000 shares of Class A Common Stock.

Shares of Class L Common Stock had identical terms as the shares of Class A Common Stock, except with respect to voting rights, liquidation preferences and conversion features, as follows:

- Shares of Class L Common Stock were non-voting, whereas each share of Class A Common Stock is entitled to one vote;
- Each share of Class L Common Stock had a liquidation preference of $81,000 plus an amount equal to accrued and unpaid dividends at a rate of 10% per annum, compounded quarterly. Shares of Class A Common Stock have no liquidation preferences; and
- Each share of Class L Common Stock was convertible into one share of Class A Common Stock plus an additional number of shares of Class A Common Stock determined by dividing the Class L liquidation preference at the date of conversion by the adjusted market value of each share of Class A Common Stock as set forth in the certificate of designation governing such shares.

As more fully described in Note 2, in connection with the Initial Common Stock Offering, the Recapitalization occurred. In connection with the Recapitalization, all shares of Class L Common Stock were converted into shares of Class A Common Stock and, along with all other outstanding shares of Class A Common Stock, were renamed as common stock.

Warrants

A portion of the consideration paid to Time Warner in connection with the Acquisition was in the form of two stock warrants that were issued to Time Warner.

One of the warrants gave Time Warner the right, under certain conditions related to the occurrence of a major music transaction, to purchase approximately 19.9% of the Class A and Class L Common Stock of Parent and 19.9% of the preferred shares issued by Holdings, after taking into account the exercise of the warrant (the "MMT Warrants"). Time Warner could exercise its rights under the warrants only (i) upon the sale to certain music companies of all or substantially all of the recorded music business or music publishing business conducted by the Company or the acquisition by certain music companies of 35% of the outstanding shares of Parent or Holdings; (ii) the acquisition of all or substantially all of the recorded music business or music publishing business of certain music companies; or (iii) a merger with or the formation of a joint venture or other combination of all or substantially all of the recorded music business or music publishing business with that of certain music companies.

The other warrant gave Time Warner the right to purchase approximately 15% of the Class A and Class L Common Stock of Parent and 15% of the preferred shares issued by Holdings, after taking into account the

exercise of the warrant (the "Three-Year Warrants"). Time Warner could exercise its rights under the Three-Year Warrants at any time prior to March 1, 2007, provided that there had not been a public equity offering that results in the common and preferred securities of Parent or Holdings to be outstanding; there had not been a sale of a majority of the then-outstanding common and preferred securities of Parent or Holdings to a third party; or the exercise of the MMT Warrants. Any of those events would cause the term of the Three-Year Warrants to expire.

On May 16, 2005, in connection with the Company's Initial Common Stock Offering, the Company repurchased the Three-Year warrants from Time Warner for an aggregate purchase price of $138 million. The repurchase of the Three-Year warrants had the effect of terminating Time Warner's MMT warrants as of the date of repurchase. As a result, as of September 30, 2005, the warrants were no longer outstanding.

Returns of Capital and Dividends Paid

In September 2004, the Company declared a $342 million dividend to its Class L common stockholders in the form of a note payable. The note payable was paid in October 2004 using proceeds received from a return of capital previously invested in WMG Acquisition Corp.

In connection with the Holdings Refinancing, the Company paid a $472 million return of capital to its Class L common shareholders, of which $422 million was paid in December 2004, $42.5 million was paid in March 2005 and $7.5 million was paid in May 2005.

In connection with the Initial Common Stock Offering, the Company declared a dividend of $8.5 million related to the remaining liquidation preference of its Class L common stock, which was paid on May 16, 2005. The Company also declared a dividend of $100.5 million to its common stockholders immediately prior to the Initial Common Stock Offering, substantially all of which was paid on May 16, 2005. Of the total dividend amount, approximately $7 million related to holders of unvested shares of restricted stock. Of such amount, approximately $1 million was paid on May 16, 2005 and the remaining $6 million will be paid when, and if, such restricted shares vest.

On October 3, 2005, the Company declared a dividend on its outstanding common stock to its shareholders of record as of October 24, 2005. The dividend was paid November 23, 2005, at a rate of $0.13 per share, representing a dividend of approximately $19.3 million in the aggregate. The portion of the dividend with respect to unvested restricted stock of approximately $1 million will be paid at such time as such shares become vested.

20. Related Party Transactions

The nature of the Company's related party transactions has changed as the Company has migrated from a wholly owned operation of Time Warner for all periods prior to the closing of the Acquisition to a stand-alone independent company, effective as of March 1, 2004. Accordingly, the following discussion of related party transactions highlights the significant related party relationships and transactions that existed both before and after the closing of the Acquisition.

Post-Acquisition

Transition Services Agreements

In connection with the Acquisition, the Company entered into a seller administrative services agreement with Time Warner (the "Seller Administrative Services Agreement"). Under the Seller Administrative Services Agreement, Time Warner agreed to provide the Company with certain administrative services, including (i) accounting services, (ii) tax services, (iii) human resources and benefits services, (iv) information technology

services, (v) legal services, (vi) treasury services, (vii) payroll services, (viii) travel services, (ix) real estate management services and (x) messenger services. The obligations for Time Warner to provide those services generally expired on December 31, 2004. The amounts to be paid under the Seller Administrative Services Agreement generally were based on the costs incurred by Time Warner in providing those administrative services, including Time Warner's employee costs and out-of-pocket expenses. For each of the twelve months ended September 30, 2005, and the seven months ended September 30, 2004, the Company incurred $4 million of costs under these administrative arrangements.

Management/Monitoring Agreement

In connection with the Acquisition, the Company entered into a management agreement with the Investor Group for ongoing consulting and management advisory services. Pursuant to this agreement, the Company paid an aggregate of $75 million to the Investor Group under the management agreement in connection with the Acquisition and related original financing. These fees were apportioned between direct costs of the Acquisition (and capitalized as part of the allocation of purchase price) and capitalized debt issuance costs. In consideration for ongoing consulting and management advisory services, the management agreement required the Company to pay (or to cause Holdings or Acquisition Corp. to pay) the Investor Group an aggregate annual fee of $10 million per year ("Periodic Fees"), which was payable quarterly in advance. For both the year ended September 30, 2005 and the seven months ended September 30, 2004, the Company recorded expense of $6 million related to this fee, and such amount has been included as a component of selling, general and administrative expenses in the accompanying statement of operations.

In addition, in the case of future services provided in connection with any future acquisition, disposition, or financing transactions involving Acquisition Corp., the Company or Holdings, the management agreement required the Company to pay (or to cause Holdings or Acquisition Corp. to pay) the Investor Group an aggregate fee of one percent of the gross transaction value of each such transaction ("Subsequent Fees"). The agreement also required Acquisition Corp., Warner Music Group and Holdings to pay the reasonable expenses of the Investor Group in connection with, and indemnify them for liabilities arising from, the management agreement, the Acquisition and any related transactions, their equity investment in Acquisition Corp., Warner Music Group or Holdings, their operations, and the services they provide to Acquisition Corp., Warner Music Group and Holdings.

The management agreement provided that it would continue in full force and effect until December 30, 2014, provided, however, that the Investor Group may cause the agreement to terminate at any time upon agreement of the Investor Group. In the event of the termination of the management agreement, the Company, Holdings and Acquisition Corp. shall pay each of the Investor Group (x) any unpaid portion of the Periodic Fees, any Subsequent Fees and any expenses due with respect to periods prior to the date of termination plus (y) the net present value (using a discount rate equal to the then yield on U.S. Treasury Securities of like maturity) of the Periodic Fees that would have been payable with respect to the period from the date of termination until December 30, 2014.

On May 10, 2005, the Investor Group terminated the Management Agreement, and on May 16, 2005, the Company paid the Investor Group a $73 million termination fee for the termination of the Management Agreement, which was reflected in the Company's statement of operations for the year ended September 30, 2005.

Other Arrangements with the Investor Group and its Affiliates

In the normal course of conducting its business, the Company entered into various other transactions with the Investor Group and its affiliates. As an example, employees of the Investor Group filled management roles on

an interim basis while the Company was transitioning to a permanent management team, including the role of Chief Financial Officer of the Company from June 2004 until December 2004. Such employees did not receive any compensation from the Company for such services; however, a representative cost for such services in the aggregate amount of $280,000 was charged to the statement of operations for the seven months ended September 30, 2004 with a corresponding increase in additional paid-in capital.

Pre-Acquisition

As previously described, the operations of Old WMG were under the control of Time Warner through the end of February 2004. During this period, in the normal course of conducting its business, Old WMG had various transactions with Time Warner and its affiliates, including the CD and DVD manufacturing and printing operations of Time Warner formerly under the management of Old WMG. The following is a summary of the principal transactions between Old WMG on the one hand, and Time Warner and its affiliates on the other hand.

Manufacturing and Printing Services with Time Warner Affiliates

Old WMG had an exclusive arrangement with affiliates of Time Warner to receive manufacturing and printing services in connection with the production of CDs, cassettes and other music-related audio and video products. Amounts included in cost of sales in connection with these services were approximately $216 million for the year ended November 30, 2003. Such costs did not reflect terms negotiated on an arm's-length basis between the units. In connection with the sale of Time Warner's manufacturing and printing operations in October 2003, such services were provided on an arm's-length basis by Cinram, effective with the closing date of the sale (see Note 6).

Distribution Services with Time Warner and Old WMG Affiliates

Old WMG provided distribution services to certain Time Warner affiliates, including Warner Home Video and Time-Life Inc. In addition, Old WMG provided distribution services to other related parties, including companies in which Old WMG had ownership interests therein that allowed for the exercise of significant influence over the operations and financial policies of the investees. Amounts included in revenues in connection with these services were approximately $51 million for the year ended November 30, 2003. Such revenues may not have reflected terms negotiated on an arm's-length basis between the entities. In connection with the sale of Time Warner's manufacturing and printing operations in October 2003, the services for Warner Home Video were provided by Cinram, effective with the closing date of the sale (see Note 6).

Licensing Arrangements with Time Warner and Old WMG Affiliates

Old WMG periodically licensed its masters and rights in owned or administered musical compositions to affiliates of Time Warner for inclusion in certain movie soundtracks, film and television series, music compilations and other forms of entertainment. Amounts included in revenues in connection with these and other licensing arrangements were approximately $2 million for the three months ended February 29, 2004 and $6 million for the year ended November 30, 2003. Such revenues reflect terms resulting from a negotiation between the units that, in management's view, result in a reasonable basis.

Old WMG also entered into sub-publishing or administrative agreements with certain Time Warner affiliates, whereby it exploited or administered rights in musical compositions held by such affiliates. Royalty expenses included in cost of revenues in connection with these arrangements were approximately $2 million for

the three months ended February 29, 2004 and $19 million for the year ended November 30, 2003. Such amounts reflect terms resulting from a negotiation between the units that, in management's view, result in a reasonable basis.

Real Estate and Marketing Arrangements with Time Warner Affiliates

Old WMG utilized and paid for certain office space leased by Time Warner and its affiliates. In addition, Old WMG periodically advertised its products in media produced by Time Warner and its affiliates. Amounts included in costs and expenses in connection with these arrangements were approximately $2 million for the three months ended February 29, 2004 and $26 million for the year ended November 30, 2003. Such amounts reflect terms resulting from a negotiation between the units that, in management's view, result in a reasonable basis.

Financing Arrangements with Time Warner Affiliates

As described in Note 3, Old WMG had agreements with Time Warner, whereby all cash received or paid by Old WMG was included in, or funded by, clearing accounts or international cash pools within Time Warner's centralized cash management system. Some of these arrangements were interest bearing and others were not. Net interest income of approximately $1 million for three months ended February 29, 2004 and $10.8 million for the year ended November 30, 2003 were recognized from Time Warner and its affiliates or other related parties.

In addition, Old WMG participated in Time Warner's foreign currency risk-management program and was allocated its proportional share of foreign exchange contract gains and losses. Net foreign exchange contract losses were immaterial for the three months ended February 29, 2004 and $17 million for the year ended November 30, 2003 and were recognized and are classified in other income (expense), net, in the accompanying statement of operations.

See Note 24 for a description of the Company's participation in Time Warner's accounts receivable securitization program.

Other Costs with Time Warner Affiliates

Employees of Old WMG participated in several Time Warner medical, stock option, pension, deferred compensation and other benefit plans for which Old WMG was charged an allocable share of plan expenses, including administrative costs. The Company also was covered under various Time Warner insurance policies and was charged an allocable share of such costs. Amounts included in expenses in connection with these and other sundry costs, such as communications networking costs, were approximately $8 million for the three months ended February 29, 2004 and $62 million for the year ended November 30, 2003.

Affiliated Management Services

Through February 2004, Old WMG had general management responsibility over substantially all of Time Warner's music operations, including Time Warner's CD and DVD manufacturing and printing operations. Accordingly, certain general and administrative costs incurred in the management of those operations were allocated to Old WMG, including legal, accounting, financial and information technology services. As described previously in Note 2, the allocation of these costs was determined based on Old WMG's pro rata share of the revenues generated by those collective operations. The costs allocated to Old WMG are not necessarily indicative of the costs that would have been incurred if Old WMG had obtained such services independently, nor are they

indicative of costs that will be charged or incurred in the future. However, management believes such allocations are reasonable. Amounts included in expenses in connection with these affiliated management service costs were approximately $2 million for the three months ended February 29, 2004 and $79 million for the year ended November 30, 2003. Such amounts exclude approximately $47 million of costs for the year ended November 30, 2003 that have been separately allocated to Time Warner's former CD and DVD manufacturing and printing operations for comparable management services.

21. Commitments and Contingencies

Leases

The Company occupies various facilities and uses certain equipment under many operating leases. Net rent expense was approximately $37 million in the year ended September 30, 2005, $24 million in the seven months ended September 30, 2004, $13 million in the three months ended February 29, 2004, and $53 million in the year ended November 30, 2003.

At September 30, 2005, future minimum payments under non-cancelable operating leases (net of sublease income) are as follows:

	September 30, 2005
	(in millions)
2006	$ 34
2007	38
2008	34
2009	32
2010	27
Thereafter	198
Total	$363

Guaranteed Minimum Talent Advances

The Company routinely enters into long-term commitments with artists, songwriters and co-publishers for the future delivery of music product. Aggregate firm commitments to such talent approximated $369 million and $345 million as of September 30, 2005 and 2004, respectively. Such commitments are payable principally over a ten-year period, generally upon delivery of albums from the artists or future musical compositions by songwriters and co-publishers.

Other

Other off-balance sheet, firm commitments, which include letters of credit and minimum funding commitments to investees, amounted to approximately $50 million and $65 million at September 30, 2005 and 2004, respectively.

Litigation

The Company was subject to a number of state and federal class action lawsuits, as well as an action brought by a number of state Attorneys General alleging unlawful horizontal and vertical agreements to fix the

prices of compact discs by the major record companies. The parties to the federal action commenced by the Attorneys General have entered into a settlement agreement related to all but two of the related lawsuits. On July 9, 2003, the Court entered a final judgment approving the settlement. In one of the two lawsuits remaining after the settlement, *Ottinger v. EMI Music, Inc., et al.*, the Court entered an order granting final approval of the settlement on January 21, 2004. In the other action, *In re Compact Disc. Antitrust Litig.*, which was brought by individual retailers of compact discs alleging unlawful horizontal agreements to fix the prices of compact discs by the major record companies, on July 29, 2004, the Court denied the parties' motion to grant final approval to the settlement. On August 30, 2004, plaintiffs filed a Second Amended Consolidated Complaint adding additional individual retailers as named plaintiffs in the litigation, which the Company answered, denying all claims, on September 15, 2004. On October 29, 2004, the parties reached an agreement on the terms of a settlement. On February 2, 2005, the Court entered a Stipulation of Dismissal with Prejudice of the entire action. In connection with the aforementioned settlements, Old WMG paid approximately $30 million in cash and product costs in the aggregate during 2001 and 2002. Such amounts did not affect the statement of operations as the settlements were charged against a pre-existing liability relating to these matters.

On September 7, 2004, November 22, 2004 and March 31, 2005, Eliot Spitzer, the Attorney General of the State of New York, served Warner Music Group with requests for information in the form of subpoenas duces tecum in connection with an industry-wide investigation of the relationship between music companies and radio stations, including the use of independent promoters and accounting for any such payments. The investigation was pursuant to New York Executive Law §63(12) and New York General Business Law §349, both of which are consumer fraud statutes. On November 22, 2005 the Company reached a settlement with the Attorney General in connection with this investigation. As part of such settlement, the Company agreed to make $5 million in charitable payments and to abide by a list of permissible and impermissible promotional activities.

In addition to the matters discussed above, the Company is involved with employment claims and other legal proceedings that are incidental to its normal business activities. It is reasonably possible that an adverse outcome on any of these matters could result in a material effect on the Company's consolidated financial statements. Due to the preliminary status of many of these matters, the Company is unable to predict the outcome or determine a range of loss at this time. However, in the opinion of management, it is not likely that the ultimate outcome of these matters will have a material effect on the Company's consolidated financial statements.

22. Derivative Financial Instruments

The Company has exposure to changes in foreign currency exchange rates relating to the cash flows generated by its international operations and exposure to changes in interest rates relating to floating-rate borrowings under its senior secured credit facility. Consequently, the Company uses derivative financial instruments to manage such risks. The following is a summary of the Company's risk management strategies and the effect of those strategies on the Company's financial statements.

Interest Rate Risk Management

The Company uses interest rate swap agreements to manage the floating to fixed-rate proportion of its debt portfolio. In particular, under its senior secured credit facility, the Company is required to maintain a fixed-to-floating debt ratio of at least 50% of its actual funded debt through at least April 2007. The Company enters into interest rate swap agreements in order to hedge the variability of expected future cash interest payments. Under interest rate swap agreements, the Company agrees to receive floating-rate payments (based on

three-month LIBOR rates) in exchange for fixed-rate payments for a fixed term of three years through May 2007. As of September 30, 2005, the Company had total notional amounts hedged under these agreements of $897 million.

The interest rate swap agreements have been designated as a cash flow hedge of the associated variability in future interest payments. As such, the agreements have been recorded at fair value in the accompanying balance sheet and the related gains or losses on the agreements are deferred in shareholder's equity (as a component of comprehensive income). These deferred gains and losses are recognized as an adjustment to interest expense in the period in which the related interest payments being hedged are made 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 amount of the interest payments being hedged, any changes in fair value relating to the ineffective portion of these contracts are immediately recognized in income.

For the year ended September 30, 2005 and the seven months ended September 30, 2004, the Company recognized approximately $4 million and $2 million, respectively, of expense on its interest rate swap agreements, which have been classified as a component of interest expense in the accompanying statement of operations. The Company did not recognize any material gains or losses during the period relating to the ineffective portion of the agreements. At September 30, 2005 the Company had deferred approximately $7 million of gains on its interest rate swap agreements in shareholders' equity, of which approximately $5 million is expected to be recognized to income over the next year.

The Company monitors its positions with, and the credit quality of, the financial institutions that are party to any of its financial transactions. Credit risk related to interest rate swaps is considered low because swaps are entered into with strong creditworthy counterparties and are limited to the net interest payments due/payable for the remaining life of the swap.

Foreign Currency Risk Management

Historically, the Company has used (and continues to use) foreign 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. In addition, the Company currently hedges foreign currency risk associated with financing transactions such as third party and inter-company debt and other balance sheet items.

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 and Australian dollar. Additionally, prior to the closing of the Acquisition, Old WMG and Time Warner used foreign exchange contracts to manage this risk, primarily the exposure to changes in the value of the British pound sterling, Japanese yen and euros. In connection with the anticipated closing of the Acquisition, all positions were unwound as of the end of December 2003. In connection with the discontinuance of such cash flow hedges, Old WMG recognized approximately $5 million of losses during the fourth quarter of 2003.

For royalty related hedges, the Company records foreign exchange contracts at fair value on its balance sheet and the related gains or losses on these contracts are deferred in shareholder's equity (as a component of comprehensive income). 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 income. For hedges of financing transactions and other balance sheet

items, hedge gains and losses are taken directly to the statement of operations since there is an equal and offsetting statement of operations entry related to the underlying exposure. Excluding the aforementioned losses on the discontinuance of cash flow hedges, Old WMG recognized a $694,000 gain in 2003 due to the ineffective portion of certain foreign exchange contracts. Gains and losses on foreign exchange contracts generally are included as a component of other income (expense), net, in the Company's statement of operations.

As of September 30, 2005, the Company had outstanding hedge contracts for the sale of $472 million and the purchase of $248 million of foreign currencies at fixed rates. Further, as of September 30, 2005, the Company had approximately $1.5 million of deferred net gains in comprehensive income related to foreign exchange hedging. The Company had no significant deferred net gains or losses on foreign exchange contracts at September 30, 2004. For the year ended November 30, 2003, Old WMG recognized $12 million in losses on foreign exchange contracts, which were largely offset by corresponding decreases and increases, respectively, in the dollar value of foreign currency royalty payments that have been received in cash from the sale of U.S.-copyrighted products abroad.

Warrants

The Company recorded unrealized gains related to the warrants issued to Historic TW as part of the purchase price of the Acquisition of $17 million for the year ended September 30, 2005. On May 16, 2005, the Company repurchased the Three-Year warrants from Historic TW at a cost of approximately $138 million, which approximated fair value at that date (see Note 19).

23. 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 areas: recorded music and music publishing. Information as to each of these operations is set forth below. The Company evaluates performance based on several factors, of which the primary financial measure is operating income (loss) before non-cash depreciation of tangible assets, non-cash amortization of intangible assets and non-cash impairment charges to reduce the carrying value of goodwill and intangible assets ("OIBDA"). The Company has supplemented its analysis of OIBDA results by segment with an analysis of operating income (loss) by segment.

The accounting policies of the Company's business segments are the same as those described in the summary of significant accounting policies included 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 or combination and, therefore, do not themselves impact consolidated or combined results.

During 2004, in connection with the Acquisition, the Company changed its methodology for allocating certain corporate costs and assets to its business segments. Accordingly, the Company has restated its operating performance and asset measures for all prior periods to reflect its new cost-allocation methodology on a consistent basis.

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(In millions)		
Revenues					
Recorded music	$2,924	$1,429	$630	$2,039	$2,839
Music publishing	607	348	157	467	563
Intersegment elimination	(29)	(8)	(8)	(19)	(26)
Total revenues	$3,502	$1,769	$779	$2,487	$3,376

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(In millions)		
OIBDA[a]					
Recorded music	$ 380	$ 120	$ 38	$ 8	$ 116
Music publishing	141	87	38	88	107
Corporate expenses[b]	(199)	(49)	(15)	(21)	(34)
Total OIBDA	$ 322	$ 158	$ 61	$ 75	$ 189

(a) The comparability of OIBDA by business segment for all periods presented has been affected by certain significant transactions. See *Transactions Affecting the Comparability of Operating Results* presented hereinafter.

(b) Corporate expenses for 2003 were reduced by an allocation of costs to Time Warner's former CD and DVD manufacturing operations that were managed by Old WMG. Such operations were sold by Time Warner in October 2003, and accordingly, no such cost allocations were made for the 2004 periods. See Note 20 for further reference.

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(In millions)		
Depreciation of Property, Plant and Equipment					
Recorded music	$32	$23	$11	$51	$62
Music publishing	5	3	1	6	7
Corporate	14	10	4	14	17
Total depreciation	$51	$36	$16	$71	$86

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(in millions)		
Amortization of Intangible Assets					
Recorded music	$ 133	$ 73	$ 36	$ 138	$ 165
Music publishing	54	31	20	63	77
Corporate	—	—	—	—	—
Total amortization	$ 187	$104	$ 56	$ 201	$ 242

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(in millions)		
Impairment of Goodwill and Other Intangibles					
Recorded music	$—	$—	$—	$—	$ 1,019
Music publishing	—	—	—	—	—
Corporate	—	—	—	—	—
Total impairment	$—	$—	$—	$—	$ 1,019

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(in millions)		
Operating Income (Loss)[a]					
Recorded music	$ 215	$ 24	$ (9)	$(181)	$(1,130)
Music publishing	82	53	17	19	23
Corporate	(213)	(59)	(19)	(35)	(51)
Total operating income (loss)	$ 84	$ 18	$(11)	$(197)	$(1,158)

(a) The comparability of operating income (loss) by business segment for all periods presented has been affected by certain significant transactions. See *Transactions Affecting the Comparability of Operating Results* presented hereinafter.

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(In millions)		
Reconciliation of OIBDA to Operating Income (Loss)					
OIBDA	$ 322	$ 158	$ 61	$ 75	$ 189
Depreciation expense	(51)	(36)	(16)	(71)	(86)
Amortization expense	(187)	(104)	(56)	(201)	(242)
Impairment of goodwill and other intangible assets	—	—	—	—	(1,019)
Operating income (loss)	$ 84	$ 18	$(11)	$(197)	$(1,158)

Transactions Affecting the Comparability of Operating Results

The comparability of OIBDA and operating income (loss) by business segment for all periods presented has been affected by certain transactions, consisting of a management agreement termination fee in the year ended September 30, 2005, restructuring activities in all periods, the sale of Old WMG's physical distribution assets in 2003, and significant impairment charges in 2003 relating to Old WMG's intangible assets. The effect of such transactions that was included in OIBDA and operating income (loss) by business segment is summarized below:

	Fiscal Year Ended September 30, 2005			
	Recorded Music	Music Publishing	Corporate	Total
		(In millions)		
Loss on termination of management agreement	$—	$—	$(73)	$(73)
Restructuring costs	(7)	—	—	(7)
Decrease in OIBDA and operating income	$ (7)	$—	$(73)	$(80)

	Seven Months Ended September 30, 2004			
	Recorded Music	Music Publishing	Corporate	Total
		(In millions)		
Restructuring costs-related decrease in OIBDA and operating income	$(17)	$ (1)	$ (8)	$(26)

	Ten Months Ended September 30, 2003			
	Recorded Music	Music Publishing	Corporate	Total
		(Unaudited) (In millions)		
Restructuring costs	$(24)	$ (3)	$—	$(27)
Loss on sale of physical distribution assets	(12)	—	—	(12)
Decrease in OIBDA and operating income	$(36)	$ (3)	$—	$(39)

	Year Ended November 30, 2003			
	Recorded Music	Music Publishing	Corporate	Total
	(in millions)			
Restructuring costs	$ (31)	$ (3)	$ (1)	$ (35)
Loss on sale of physical distribution assets	(12)	—	—	(12)
Decrease in OIBDA	(43)	(3)	(1)	(47)
Impairment of goodwill and other intangible assets	(1,019)	—	—	(1,019)
Decrease in operating income	$(1,062)	$ (3)	$ (1)	$(1,066)

Total assets and capital expenditures by business segment are presented below:

	September 30, 2005	September 30, 2004
	(in millions)	
Assets		
Recorded music	$2,517	$2,649
Music publishing	1,645	1,754
Corporate [a]	336	687
Total assets	$4,498	$5,090

(a) Primarily includes deferred tax assets and fixed assets.

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(in millions)		
Capital Expenditures					
Recorded music	$22	$11	$ 2	$14	$29
Music publishing	2	1	—	3	3
Corporate	6	3	1	13	19
Total capital expenditures	$30	$15	$ 3	$30	$51

Revenues and total assets relating to operations in different geographical areas are set forth below:

	Successor		Predecessor		
	Year Ended September 30, 2005	Seven Months Ended September 30, 2004	Three Months Ended February 29, 2004	Ten Months Ended September 30, 2003	Year Ended November 30, 2003
			(in millions)		
Revenues[a]					
United States	$1,675	$ 848	$334	$1,211	$1,505
United Kingdom	387	221	111	287	407
Germany	215	124	43	158	210
Japan	170	105	41	144	202
France	241	112	55	154	217
Italy	121	56	37	85	108
Other international	693	303	158	448	727
Total revenues	$3,502	$1,769	$779	$2,487	$3,376

(a) Revenues are attributed to countries based on the location of customer.

	September 30, 2005	September 30, 2004
	(In millions)	
Assets		
United States	$2,597	$3,164
United Kingdom	396	512
Germany	210	269
Japan	192	252
France	225	280
Italy	190	98
Other international	688	515
Total assets	$4,498	$5,090

24. Additional Financial Information

Time Warner Accounts Receivable Securitization Facility

Prior to the Acquisition, Old WMG, through its WEA Corp. subsidiary, participated in one of Time Warner's accounts receivable securitization facilities. Such facility provided for the accelerated receipt of approximately $450 million of cash, in the aggregate, on available accounts receivable. In connection with this securitization facility, Old WMG sold, on a revolving and nonrecourse basis, certain of its accounts receivable ("Pooled Receivables") to a qualifying Special Purpose Entity ("SPE") which, in turn, sold a percentage ownership interest in the Pooled Receivables to third-party commercial paper conduits sponsored by a financial institution. The receivables were sold to the SPE at net realizable value, after any loss due to uncollectibility was recorded by Old WMG. These securitization transactions were accounted for as a sale in accordance with FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," because Old WMG relinquished control of the receivables.

When the receivables were sold to the SPE, Old WMG recorded a retained beneficial interest in the SPE and an intercompany receivable from Time Warner representing the cash portion of the proceeds received by Time Warner on the sale for which there was no obligation to repay. The retained beneficial interest, which was adjusted to reflect the portion of receivables that was not expected to be collectible, accrued interest at a rate that varied with prevailing market interest rates. For this reason, and because the accounts receivables underlying the retained ownership interests that were sold to the qualifying SPE were generally short-term in nature, the fair value of the retained beneficial interest approximated its carrying value at November 30, 2003. The cost of the retained interest, offset in part by the related interest income earned on the retained interest, was borne by Time Warner. In December 2003, in anticipation of the closing of the sale of Old WMG that occurred effective as of March 1, 2004, Old WMG's participation in Time Warner's securitization facility ceased. Accordingly, the receivables sold to the SPE were re-purchased by Time Warner and transferred to Old WMG in satisfaction of the retained interest and intercompany receivable.

Cash Interest and Taxes

The Company made interest payments of approximately $151 million during the year ended September 30, 2005, $56 million during the seven months ended September 30, 2004 and $3 million during the three months ended February 29, 2004. The Company paid approximately $51 million, $31 million and $27 million of foreign income and withholding taxes in the year ended September 30, 2005, the seven months ended September 30, 2004 and the three months ended February 29, 2004, respectively. The Company received $6 million, $2 million and $1 million of foreign income tax refunds in the year ended September 30, 2005, the seven months ended September 30, 2004 and the three months ended February 29, 2004, respectively.

Old WMG made interest payments of approximately $10 million during 2003. Old WMG paid approximately $80 million of foreign income and withholding taxes and received approximately $8 million of foreign income tax refunds in the year ended November 30, 2003. Old WMG did not reimburse Time Warner and its affiliated companies for any payments of federal, state and local income taxes made during the year ended November 30, 2003.

Non-cash Transactions

There were no significant non-cash activities for the year ended September 30, 2005.

Significant non-cash investing activities for the seven months ended September 30, 2004 included the allocation of the purchase price paid in connection with the Acquisition, as more fully described in Note 5. In addition, significant non-cash financing activities for the seven months ended September 30, 2004 included the declaration of a $342 million dividend to the Company's shareholders in the form of a note payable, as more fully described in Note 14.

Significant non-cash investing and financing activities during the three months ended February 29, 2004 included the non-cash recapitalization of certain inter-company receivables and payables between Old WMG and Time Warner, as disclosed in the statement of shareholders' and group equity. There were no significant non-cash investing and financing activities during the year ended November 30, 2003.

25. Subsequent Events

On October 3, 2005, the Company declared a dividend on its outstanding common stock as of October 24, 2005. The dividend was paid on November 23, 2005, at a rate of $0.13 per share, representing a dividend of approximately $19.3 million in the aggregate. The portion of the dividend with respect to unvested restricted stock of approximately $1 million will be paid at such time as such shares become vested.

On November 22, 2005 the Company reached a settlement with the Attorney General in connection with an investigation. As part of such settlement, the Company agreed to make $5 million in charitable payments and to abide by a list of permissible and impermissible promotional activities. Refer to Note 21.

WARNER MUSIC GROUP CORP.

2005 QUARTERLY FINANCIAL INFORMATION
(unaudited)

The following table sets forth the quarterly information for Warner Music Group (in millions, except per share data).

	Three months ended			
	September 30, 2005(a)	June 30, 2005(a)	March 31, 2005(a)	December 31, 2004(a)
Revenues	$ 905	$ 742	$ 767	$1,088
Costs and expenses				
Cost of revenues	(473)	(396)	(400)	(581)
Selling, general and administrative expenses(b)(c)	(359)	(318)	(293)	(331)
Amortization of intangible assets	(47)	(47)	(47)	(46)
Loss on termination of management agreement	—	(73)	—	—
Restructuring Costs	(7)	—	—	—
Total costs and expenses	(886)	(834)	(740)	(958)
Operating (loss) income	19	(92)	27	130
Interest expense, net	(42)	(50)	(52)	(38)
Net investment related gains	—	1	—	—
Equity in the gains of equity-method investees	—	—	—	(1)
Loss on repayment of Holdings Notes	—	(35)	—	—
Unrealized gain (loss) on warrants	—	—	39	(22)
Minority interest expense	—	—	—	(5)
Other income (expense), net	2	1	—	4
Loss before income taxes	$ (21)	(175)	14	68
Income tax expense	(9)	(4)	(10)	(32)
Net loss	$ (30)	$ (179)	$ 4	$ 36
Net Income (loss) per common share				
Basic	$(0.21)	$(1.41)	$ 0.04	$ 0.33
Diluted	$(0.21)	$(1.41)	$ 0.03	$ 0.31
Average common shares:				
Basic	141.2	127.0	107.7	107.5
Diluted	150.2	127.0	123.5	115.3

(a) The Company's business is seasonal. Therefore quarterly operating results are not necessarily indicative of the results that may be expected for the full fiscal year.

(b) The three months ended June 30, 2005 include one-time compensation expense consisting of a $10 million one-time bonus to employees related to the Company's Initial Common Stock Offering and $19 million of one-time payments to holder of restricted stock and stock options primarily to compensate them for certain amounts related to stock awards issued at prices that were below fair value at the grant date.

(c) The three months ended September 30, 2005 include certain non-recurring charges of $24 million incurred in connection with the departure of the co-chairman of The Atlantic Records Group and the expensing of certain amounts paid in connection with the acquisition of the remaining interest in the Lava Records joint venture.

WARNER MUSIC GROUP CORP.

2004 QUARTERLY FINANCIAL INFORMATION

(unaudited)

	Successor		Combined	Successor	Predecessor	
	For the three months ended September 30, 2004(a)	For the three months ended June 30, 2004(a)	For the three months ended March 31, 2004(a)	For the one month ended March 31, 2004(a)	For the two months ended February 29, 2004(a)	For the three months ended December 31, 2003(a)
Revenues	$ 798	$ 726	$ 735	$ 245	$ 490	$ 1178
Costs and expenses						
Cost of revenues	(421)	(393)	(388)	(130)	(258)	(648)
Selling, general and administrative expenses	(304)	(276)	(316)	(97)	(219)	(391)
Impairment of goodwill and other intangible assets	—	—	—	—	—	(1,019)
Amortization of intangible assets	(44)	(45)	(52)	(15)	(37)	(60)
Restructuring Costs	(26)	—	—	—	—	(8)
Total costs and expenses	$ (795)	(714)	(756)	(242)	(514)	(2,126)
Operating (loss) income	$ 3	$ 12	$ (21)	$ 3	$ (24)	$ (948)
Interest expense, net	(35)	(35)	(9)	(10)	1	(3)
Net investment related gains	—	—	—	—	—	(9)
Equity in the gains of equity-method investees	(2)	1	(3)	(1)	(2)	(9)
Deal-related transaction and other costs	—	—	—	—	—	(63)
Loss on repayment of bridge loan	—	(6)	—	—	—	—
Unrealized gain (loss) on warrants	(73)	(47)	—	—	—	—
Minority interest expense	(5)	(6)	(3)	(3)	—	—
Other income (expense), net	(4)	—	—	—	—	(7)
Income (loss) before income taxes	$ (116)	(81)	(36)	(11)	(25)	(1,039)
Income tax benefit (expense)	(21)	(10)	(12)	1	(13)	(107)
Net income (loss)	$ (137)	$ (91)	$ (48)	$ (10)	$ (38)	$(1,146)
Net income (loss) per common share						
Basic	$(1.27)	$(0.85)				
Diluted	$(1.27)	$(0.85)				
Average common shares:						
Basic	107.5	107.5				
Diluted	107.5	107.5				

(a) The Company's business is seasonal. Therefore, quarterly operating results are not necessarily indicative of the results that may be expected for the full fiscal year.

WARNER MUSIC GROUP CORP.

Supplementary Information
Condensed Consolidating Financial Statements

Warner Music Group Corp. (the "Company" or "Parent") was formed by a private equity consortium of Investors (the "Investor Group") on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. ("Holdings"), which is the direct parent of WMG Acquisition Corp. ("New WMG" or "Acquisition Corp."). New WMG is the successor to substantially all of the interests of the recorded music and music publishing businesses of Time Warner Inc. ("Time Warner"). Such predecessor interests formerly owned by Time Warner are hereinafter referred to as "Old WMG" or the "Predecessor". Effective March 1, 2004, Old WMG was acquired from Time Warner by a private consortium of investors for approximately $2.6 billion.

Holdings issued (i) $250 million principal amount of Floating Rate Senior Notes due 2011 (the "Holdings Floating Rate Notes"), (ii) $397 million principal amount at maturity of 9.5% Senior Discount Notes due 2014, which had an initial issuance discount of $147 million (the "Holdings Discount Notes") and (iii) $200 million principal amount of Floating Rate Senior PIK Notes due 2014 (the "Holdings PIK Notes," and collectively, the "Holdings Notes"), which had an initial discount of $4 million. In June 2005, using proceeds from the Company's Initial Common Stock Offering and approximately $57 million of cash on hand, Holdings redeemed all of the Holdings Floating Rate Notes, all of the Holdings PIK Notes and 35% of the aggregate outstanding principal of the Holdings Discount Notes. The remaining Holdings Discount Notes are guaranteed by the Company. These guarantees are full, unconditional, joint and several. The following condensed consolidating financial statements are presented for the information of the holders of the remaining Holdings Discount Notes and present the results of operations, financial position and cash flows of (i) the Company, which is the guarantor of the remaining Holdings Discount Notes, (ii) Holdings, which is the issuer of the remaining Holdings Discount Notes, (iii) the subsidiaries of Holdings and (iii) the eliminations necessary to arrive at the information for the Company on a consolidated or on a combined basis. Investments in consolidated or combined subsidiaries are presented under the equity method of accounting.

The Company is a holding company with no independent operations or assets other than through its interests in its subsidiaries, such as Holdings and Acquisition Corp. Accordingly, the ability of the Company to obtain funds from its subsidiaries is restricted by the senior secured credit facility of Acquisition Corp., the indenture for the Subordinated Notes issued by Acquisition Corp., and the indenture for the Holdings Notes.

Consolidating Balance Sheet
September 30, 2005

	Warner Music Group Corp.	WMG Holdings Corp. (Issuer)	WMG Acquisition Corp.	Eliminations	Warner Music Group Corp. Consolidated
			(In millions)		
Assets:					
Current assets:					
Cash and equivalents	$ 40	$ 1	$ 247	$ —	$ 288
Accounts receivable, net	15	(23)	645	—	637
Inventories	—	—	52	—	52
Royalty advances expected to be recouped within one year	—	—	190	—	190
Deferred tax assets	—	—	36	—	36
Other current assets	—	—	39	—	39
Total current assets	55	(22)	1,209	—	1,242
Royalty advances expected to be recouped after one year	—	—	190	—	190
Investments in and advances to (from) consolidated subsidiaries	43	235	—	(278)	21
Investments	—	—	21	—	—
Property, plant and equipment	—	—	157	—	157
Goodwill	—	—	869	—	869
Intangible assets subject to amortization	—	—	1,815	—	1,815
Intangible assets not subject to amortization	—	—	100	—	100
Other assets	—	4	100	—	104
Total assets	$ 98	$217	$4,461	$(278)	$4,498
Liabilities and Shareholders' Equity:					
Current liabilities:					
Accounts payable	$ 1	$—	$ 246	$ —	$ 247
Accrued royalties	—	—	1,057	—	1,057
Taxes and other withholdings	—	—	23	—	23
Current portion of long-term debt	—	—	17	—	17
Note payable to shareholders	—	—	—	—	—
Other current liabilities	1	—	403	—	404
Total current liabilities	2	—	1,746	—	1,748
Long-term debt	—	174	2,055	—	2,229
Deferred tax liabilities, net	—	—	201	—	201
Dividends payable	5	—	—	—	5
Other noncurrent liabilities	2	—	224	—	226
Total liabilities	9	174	4,226	—	4,409
Shareholder's equity	89	43	235	(278)	89
Total liabilities and shareholder's equity	$ 98	$217	$4,461	$(278)	$4,498

Consolidating Balance Sheet
September 30, 2004

	Warner Music Group Corp.	WMG Holdings Corp. (Issuer)	WMG Acquisition Corp.	Eliminations	Warner Music Group Corp. Consolidated
			(in millions)		
Assets:					
Current assets:					
Cash and equivalents	$—	$—	$ 555	$ —	$ 555
Accounts receivable, net	—	—	571	—	571
Inventories	—	—	65	—	65
Royalty advances expected to be recouped within one year	—	—	223	—	223
Deferred tax assets	—	—	38	—	38
Other current assets	—	—	86	—	86
Total current assets	—	—	1,538	—	1,538
Royalty advances expected to be recouped after one year	—	—	223	—	223
Investments in and advances to (from) consolidated subsidiaries	762	978	—	(1,740)	—
Investments	—	—	8	—	8
Property, plant and equipment	—	—	189	—	189
Goodwill	—	—	978	—	978
Intangible assets subject to amortization	—	—	1,937	—	1,937
Intangible assets not subject to amortization	—	—	100	—	100
Other assets	—	—	117	—	117
Total assets	$762	$978	$5,090	$(1,740)	$5,090
Liabilities and Shareholders' Equity:					
Current liabilities:					
Accounts payable	$—	$—	$ 226	$ —	$ 226
Accrued royalties	—	—	1,003	—	1,003
Taxes and other withholdings	—	—	10	—	10
Current portion of long-term debt	—	—	12	—	12
Note payable to shareholders	342	—	—	—	342
Other current liabilities	140	19	432	(4)	587
Total current liabilities	482	19	1,683	(4)	2,180
Long-term debt	—	—	1,828	—	1,828
Deferred tax liabilities, net	—	—	265	—	265
Other noncurrent liabilities	—	—	333	—	333
Minority interest in preferred stock of subsidiary	—	—	—	204	204
Intercompany	—	(3)	3	—	—
Total liabilities	482	16	4,112	200	4,810
Shareholder's equity (1)	280	962	978	(1,940)	280
Total liabilities and shareholder's equity	$762	$978	$5,090	$(1,740)	$5,090

(1) WMG Holdings Corp. stockholder's equity consists of $762 million of common equity and $200 million of preferred equity. The preferred equity represents a direct contribution from the Investor Group of $400 million in exchange for 40,000 shares of cumulative preferred stock issued as part of the original Acquisition. Prior to September 30, 2004, 20,000 of such shares were redeemed for $200 million. The value of the preferred shares is classified as minority interest on the consolidated balance sheet of Warner Music Group Corp.

Consolidating Statement of Operations
For The Year Ended September 30, 2005

	Warner Music Group Corp.	WMG Holdings Corp. (Issuer)	WMG Acquisition Corp.	Eliminations	Warner Music Group Corp. Consolidated
			(in millions)		
Revenues	$ —	$ —	$ 3,502	$—	$ 3,502
Costs and expenses:	—	—	—	—	
Cost of revenues	—	—	(1,850)	—	(1,850)
Selling, general and administrative expenses	—	—	(1,301)	—	(1,301)
Amortization of intangible assets	—	—	(187)	—	(187)
Loss on termination of management agreement	—	—	(73)	—	(73)
Restructuring costs, net	—	—	(7)	—	(7)
Total costs and expenses	—	—	(3,418)	—	(3,418)
Operating income	—	—	84	—	84
Interest expense, net	(1)	(35)	(146)	—	(182)
Equity in the losses of equity-method investees, net	(185)	(110)	(1)	295	(1)
Net investment-related gains (losses)	—	—	1	—	1
Loss on repayment of Holdings Notes	—	(35)	—	—	(35)
Unrealized gain on warrant	17	—	—	—	17
Other expense, net	—	—	7	—	7
Minority interest expense	—	(5)	—	—	(5)
(Loss) income before income taxes	(169)	(185)	(55)	295	(114)
Income tax expense	—	—	(55)	—	(55)
Net (loss) income	$(169)	$(185)	$ (110)	$295	$ (169)

Consolidating Statement of Operations
For The Seven Months Ended September 30, 2004

	Warner Music Group Corp.	WMG Holdings Corp. (Issuer)	WMG Acquisition Corp.	Eliminations	Warner Music Group Corp. Consolidated
			(In millions)		
Revenues	$ —	$ —	$ 1,769	$—	$ 1,769
Costs and expenses:					
Cost of revenues	—	—	(944)	—	(944)
Selling, general and administrative expenses	—	—	(677)	—	(677)
Amortization of intangible assets	—	—	(104)	—	(104)
Restructuring costs, net	—	—	(26)	—	(26)
Total costs and expenses	—	—	(1,751)	—	(1,751)
Operating income	—	—	18	—	18
Interest expense, net	—	—	(80)	—	(80)
Equity in the losses of equity-method investees, net	(122)	(104)	(2)	226	(2)
Loss on repayment of bridge loan	—	—	(6)	—	(6)
Unrealized loss on warrant	(116)	(4)	—	—	(120)
Other expense, net	—	—	(4)	—	(4)
Minority interest expense	—	(14)	—	—	(14)
(Loss) income before income taxes	(238)	(122)	(74)	226	(208)
Income tax expense	—	—	(30)		(30)
Net (loss) income	$(238)	$(122)	$ (104)	$226	$ (238)

Combining Statement of Operations
For The Three Months Ended February 29, 2004

	Warner Music Group Corp. (a)	WMG Holdings Corp. (Issuer) (a)	WMG Acquisition Corp.	Eliminations	Old WMG Combined
			(in millions)		
Revenues			$ 779		$ 779
Costs and expenses:					
Cost of revenues			(415)		(415)
Selling, general and administrative expenses			(319)		(319)
Amortization of intangible assets			(56)		(56)
Total costs and expenses			(790)		(790)
Operating loss			(11)		(11)
Interest expense, net			(2)		(2)
Equity in the losses of equity-method investees, net			(2)		(2)
Loss before income taxes			(15)		(15)
Income tax expense			(17)		(17)
Net loss			$ (32)		$ (32)

(a) For periods prior to the Acquisition, Warner Music Group Corp. (formerly known as "WMG Parent Corp") and WMG Holdings Corp. did not exist.

Combining Statement of Operations
For The Ten Months Ended September 30, 2003 (unaudited)

	Warner Music Group Corp. (a)	WMG Holdings Corp. (Issuer) (a)	WMG Acquisition Corp.	Eliminations	Old WMG Combined
			(In millions)		
Revenues			$ 2,487		$ 2,487
Costs and expenses:					
Cost of revenues			(1,449)		(1,449)
Selling, general and administrative expenses			(995)		(995)
Amortization of intangible assets			(201)		(201)
Loss on sale of physical distribution assets			(12)		(12)
Restructuring costs, net			(27)		(27)
Total costs and expenses			(2,684)		(2,684)
Operating loss			(197)		(197)
Interest expense, net			(5)		(5)
Net investment-related losses			(17)		(17)
Equity in the losses of equity-method investees, net			(32)		(32)
Deal-related transactions and other costs			(7)		(7)
Other expense, net			(10)		(10)
Loss before income taxes			(268)		(268)
Income tax benefit			67		67
Net loss			$ (201)		$ (201)

(a) For periods prior to the Acquisition, Warner Music Group Corp. and WMG Holdings Corp. did not exist.

Combining Statement of Operations
For The Year Ended November 30, 2003

	Warner Music Group Corp. (a)	WMG Holdings Corp. (issuer) (a)	WMG Acquisition Corp.	Eliminations	Old WMG Combined
			(In millions)		
Revenues			$ 3,376		$ 3,376
Costs and expenses:					
Cost of revenues			(1,940)		(1,940)
Selling, general and administrative expenses			(1,286)		(1,286)
Impairment of goodwill and other intangible assets			(1,019)		(1,019)
Amortization of intangible assets			(242)		(242)
Loss on sale of physical distribution assets			(12)		(12)
Restructuring costs, net			(35)		(35)
Total costs and expenses			(4,534)		(4,534)
Operating loss			(1,158)		(1,158)
Interest expense, net			(5)		(5)
Net investment-related losses			(26)		(26)
Equity in the losses of equity-method investees, net			(41)		(41)
Deal-related transaction and other costs			(70)		(70)
Other expense, net			(17)		(17)
Loss before income taxes			(1,317)		(1,317)
Income tax expense			(36)		(36)
Net loss			$(1,353)		$(1,353)

(a) For periods prior to the Acquisition, Warner Music Group Corp. and WMG Holdings Corp. did not exist.

Consolidating Statement of Cash Flows
For The Year Months Ended September 30, 2005

	Warner Music Group Corp.	WMG Holdings Corp. (Issuer)	WMG Acquisition Corp.	Eliminations	Consolidated
			(in millions)		
Cash flows from operating activities:					
Net loss	$ (169)	$ (185)	$(110)	$ 295	$(169)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					—
Depreciation and amortization	—	—	239	—	239
Loss on repayment of Holdings Notes	—	35	—	—	35
Non-cash interest expense	—	31	37	—	68
Non-cash stock-based compensation expense	—	—	25	—	25
Net investment-related losses	—	—	(1)	—	(1)
Minority interest	—	5	—	—	5
Equity in the losses of equity-method investees	—	—	1	—	1
Equity in the gains (losses) of consolidated subsidiaries	185	110	—	(295)	—
Unrealized gain on warrant	(17)	—	—	—	(17)
Changes in operating assets and liabilities:					
Accounts receivable	—	—	(58)	—	(58)
Inventories	—	—	(3)	—	(3)
Royalty advances	—	—	—	—	—
Accounts payable and accrued liabilities	1	—	9	—	10
Other balance sheet changes	—	1	70	—	70
Net cash provided by (used in) operating activities	—	(3)	208	—	205
Cash flows from investing activities:					—
Investments and acquisitions	—	—	(78)	—	(78)
Investment proceeds	—	—	54	—	54
Capital expenditures	—	—	(30)	—	(30)
Net cash used in investing activities	—	—	(54)	—	(54)
Cash flows from financing activities:					
Issuance of Holdings debt	—	696	—	—	696
Repayment of Holdings debt	—	(574)	—	—	(574)
Additional term loan borrowings	—	—	250	—	250
Financing costs of borrowings	—	(17)	(3)	—	(20)
Debt repayments	—	—	(14)	—	(14)
Capital contributions received (paid)	(590)	517	73	—	—
Proceeds on the sale of restricted shares	1		—	—	1
Proceeds on the issuance of common stock	554		—	—	554
Costs of issuing common stock	(32)		—	—	(32)
Change in intercompany	(7)	18	(11)	—	—
Return of capital	(917)	(1,157)	(742)	1,899	(917)
Return of capital received	1,157	742	—	(1,899)	—
Repurchase of warrants	(126)	(12)	—	—	(138)
Return of capital to preferred shareholders	—	(200)	—	—	(200)
Dividends paid on preferred capital	—	(9)	—	—	(9)
Loans to third party	—	—	(10)	—	(10)
Other	—	—	(3)	—	(3)
Net cash provided by (used in) financing activities	40	4	(460)	—	(416)
Effect of foreign currency on cash	—	—	(2)	—	(2)
Net increase (decrease) in cash	40	1	(308)	—	(267)
Cash and equivalents at beginning of period	—	—	555	—	555
Cash and equivalents at end of period	$ 40	$ 1	$ 247	$ —	$ 288

Consolidating Statement of Cash Flows
For The Seven Months Ended September 30, 2004

	Warner Music Group Corp.	WMG Holdings Corp. (Issuer)	WMG Acquisition Corp.	Eliminations	Consolidated
			(In millions)		
Cash flows from operating activities:					
Net loss	$(238)	$ (122)	$ (104)	$ 226	$ (238)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation and amortization	—	—	140	—	140
Deferred taxes	—	—	8	—	8
Loss on repayment of bridge loan	—	—	6	—	6
Non-cash interest expense	—	—	19	—	19
Equity in the losses of equity-method investees, including distributions	122	104	3	(226)	3
Minority interest	—	14	—	—	14
Unrealized loss on warrant	116	4	—	—	120
Changes in operating assets and liabilities:					—
Accounts receivable	—	—	(33)	—	(33)
Inventories	—	—	(10)	—	(10)
Royalty advances	—	—	77	—	77
Accounts payable and accrued liabilities	—	—	(23)	—	(23)
Other balance sheet changes	—	—	3	—	3
Net cash provided by (used in) operating activities	—	—	86	—	86
Cash flows from investing activities:					
Acquisition of Old WMG	(853)	(1,250)	(2,638)	2,103	(2,638)
Investments and acquisitions	—	—	(10)	—	(10)
Capital expenditures	—	—	(15)	—	(15)
Net cash used in investing activities	(853)	(1,250)	(2,663)	2,103	(2,663)
Cash flows from financing activities:					
Borrowings	—	—	2,348	—	2,348
Financing costs of borrowings	—	—	(99)	—	(99)
Debt repayments	—	—	(631)	—	(631)
Capital contributions	—	850	1,250	(2,100)	—
Proceeds from the issuance of Class C Common Stock	85	—	—	—	85
Proceeds from the issuance of Class L Common Stock	765	—	—	—	765
Proceeds from the issuance of preferred stock	—	400	—	—	400
Repurchase of subsidiary preferred stock	—	(202)			(202)
Proceeds from the issuance of restricted shares	3	—	—	—	3
Return of capital (paid) received	—	210	(210)	—	—
Dividends paid on preferred capital	—	(8)	—	—	(8)
Change in amounts due to parent	—	—	3	(3)	—
Net cash provided by (used in) financing activities	853	1,250	2,661	(2,103)	2,661
Effect of foreign currency exchange rate changes on cash	—	—	—	—	—
Net increase in cash and equivalents	—	—	84	—	84
Cash and equivalents at beginning of period	—	—	471	—	471
Cash and equivalents at end of period	$ —	$ —	$ 555	$ —	$ 555

Combining Statement of Cash Flows
For The Three Months Ended February 29, 2004

	Warner Music Group Corp. (a)	WMG Holdings Corp. (issuer) (a)	WMG Acquisition Corp.	Eliminations	Old WMG Combined
			(In millions)		
Cash flows from operating activities:					
Net loss			$ (32)		$ (32)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation and amortization			72		72
Deferred taxes			(4)		(4)
Non-cash interest expense			2		2
Equity in the losses of equity-method investees, including distributions			2		2
Changes in operating assets and liabilities:					
Accounts receivable			387		387
Inventories			6		6
Royalty advances			(4)		(4)
Accounts payable and accrued liabilities			(109)		(109)
Other balance sheet changes			1		1
Net cash provided by operating activities			321		321
Cash flows from investing activities:					
Investments and acquisitions			(2)		(2)
Investment proceeds			19		19
Capital expenditures			(3)		(3)
Net cash provided by investing activities			14		14
Cash flows from financing activities:					
Borrowings			—		—
Debt repayments			(124)		(124)
Capital contributions			262		262
Decrease (increase) in amounts due from Time Warner-affiliated companies			194		194
Dividends paid			(342)		(342)
Net cash used in financing activities			(10)		(10)
Effect of foreign currency exchange rate changes on cash			2		2
Net increase in cash and equivalents			327		327
Cash and equivalents at beginning of period			144		144
Cash and equivalents at end of period			$ 471		$ 471

(a) For periods prior to the Acquisition, Warner Music Group Corp. and WMG Holdings Corp. did not exist.

Combining Statement of Cash Flows
For The Ten Months Ended September 30, 2003 (unaudited)

	Warner Music Group Corp. (a)	WMG Holdings Corp. (issuer) (a)	WMG Acquisition Corp.	Eliminations	Old WMG Combined
			(In millions)		
Cash flows from operating activities:					
Net loss			$(201)		$(201)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation and amortization			272		272
Deferred taxes			(117)		(117)
Loss on sale of physical distribution assets			12		12
Non-cash interest expense			10		10
Net investment-related losses (gains)			17		17
Equity in the losses of equity-method investees, including distributions			35		35
Changes in operating assets and liabilities:					
Accounts receivable			275		275
Inventories			24		24
Royalty advances			38		38
Accounts payable and accrued liabilities			(116)		(116)
Other balance sheet changes			8		8
Net cash provided by operating activities			257		257
Cash flows from investing activities:					
Investments and acquisitions			(43)		(43)
Capital expenditures			(30)		(30)
Net cash used in investing activities			(73)		(73)
Cash flows from financing activities:					
Borrowings			114		114
Debt repayments			(101)		(101)
Capital contributions			132		132
Decrease (increase) in amounts due from Time Warner-affiliated companies			(293)		(293)
Principal payments on capital leases			(3)		(3)
Net cash used in financing activities			(151)		(151)
Effect of foreign currency exchange rate changes on cash			6		6
Net increase in cash and equivalents			39		39
Cash and equivalents at beginning of period			41		41
Cash and equivalents at end of period			$ 80		$ 80

(a) For periods prior to the Acquisition, Warner Music Group Corp. and WMG Holdings Corp. did not exist.

Combining Statement of Cash Flows
For The Year Ended November 30, 2003

	Warner Music Group Corp. (a)	WMG Holdings Corp. (issuer) (a)	WMG Acquisition Corp.	Eliminations	Old WMG Combined
			(in millions)		
Cash flows from operating activities:					
Net loss			$(1,353)		$(1,353)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Impairment of goodwill and other intangible assets			1,019		1,019
Depreciation and amortization			328		328
Deferred taxes			(19)		(19)
Loss on sale of physical distribution assets			12		12
Non-cash interest expense			11		11
Net investment-related losses (gains)			26		26
Equity in the losses of equity-method investees, including distributions			44		44
Changes in operating assets and liabilities:					
Accounts receivable			(121)		(121)
Inventories			12		12
Royalty advances			111		111
Accounts payable and accrued liabilities			169		169
Other balance sheet changes			39		39
Net cash provided by operating activities			278		278
Cash flows from investing activities:					
Investments and acquisitions			(52)		(52)
Investment proceeds			38		38
Capital expenditures			(51)		(51)
Net cash used in investing activities			(65)		(65)
Cash flows from financing activities:					
Borrowings			114		114
Debt repayments			(101)		(101)
Capital contributions			132		132
Decrease (increase) in amounts due from Time Warner-affiliated companies			(195)		(195)
Dividends paid			(68)		(68)
Principal payments on capital leases			(3)		(3)
Net cash used in financing activities			(121)		(121)
Effect of foreign currency exchange rate changes on cash			11		11
Net increase in cash and equivalents			103		103
Cash and equivalents at beginning of period			41		41
Cash and equivalents at end of period			$ 144		$ 144

(a) For periods prior to the Acquisition, Warner Music Group Corp. and WMG Holdings Corp. did not exist.

WARNER MUSIC GROUP CORP.

Schedule II—Valuation and Qualifying Accounts
Year Ended September 30, 2005
Seven Months Ended September 30, 2004,
Three Months Ended February 29, 2004, and
Year Ended November 30, 2003

Description	Balance at Beginning of Period	Additions Charged to Cost and Expenses	Deductions	Balance at End of Period
		(in millions)		
Year Ended September 30, 2005				
Reserve deducted from accounts receivable				
Allowance for doubtful accounts	$ 58	$ 1	$ (9)	$ 50
Reserves for sales returns and allowances	164	493	(489)	168
Allowance for deferred tax asset	293	86	(56)	323
	$515	$580	$(554)	$541
Seven Months Ended September 30, 2004				
Reserve deducted from accounts receivable				
Allowance for doubtful accounts	$ 69	$ 7	$ (18)	$ 58
Reserves for sales returns and allowances	200	278	(314)	164
Allowance for deferred tax asset	—	293	—	293
	$269	$578	$(332)	$515
Three Months Ended February 29, 2004				
Reserve deducted from accounts receivable				
Allowance for doubtful accounts	$ 67	$ 2	$ —	$ 69
Reserves for sales returns and allowances	224	128	(152)	200
Allowance for deferred tax asset	—	—	—	—
	$291	$130	$(152)	$269
Year Ended November 30, 2003				
Reserve deducted from accounts receivable				
Allowance for doubtful accounts	$ 68	$ 9	$ (10)	$ 67
Reserves for sales returns and allowances	213	585	(574)	224
Allowance for deferred tax asset	21	—	(21)	—
	$302	$594	$(605)	$291

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCE DISCLOSURE

None.

ITEM 9A. 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-15(e) and 15d-15(e) 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

Warner Music Group Corp. became subject to the periodic and other reporting requirements of the Securities Exchange Act of 1934, as amended, on May 10, 2005, the effective date of our registration statement relating to our Initial Common Stock Offering. WMG Acquisition Corp., our wholly owned subsidiary, became subject to the periodic and other reporting requirements of the Exchange Act on February 10, 2005, the effective date of WMG Acquisition Corp.'s registration statement relating to its exchange offer to exchange outstanding unregistered notes for freely tradeable exchange notes that were registered under the Securities Act of 1933, as amended.

SEC 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.

SEC 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.

Internal Controls

In connection with the audit of WMG Acquisition Corp., and subsequently Warner Music Group Corp. for our prior 2004 fiscal year-end, our outside auditors identified a number of significant deficiencies that together constituted material weaknesses in our internal controls. A material weakness, as defined by the Public Company Accounting Oversight Board, is a significant deficiency that by itself, or in combination with other significant deficiencies, results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Our outside auditors identified three material weaknesses as of the prior fiscal year. Specifically, there were certain content issues at our print business, there was a lack of entity level controls present and there were issues related to our royalty systems. In connection with the audit for our current 2005 fiscal year-end, our auditors noted that material weaknesses no longer exist for entity level controls due to the hiring of several key executives, establishing of an internal audit function and other changes in internal controls described below. The control issues of the print business are also no longer relevant since this business was sold during this fiscal year. Our outside auditors did note that our domestic operations continue to use different royalty systems, which has continued to create certain complexities in reconciling royalty expense and payables. While we recognize that additional staff is needed to cope with current requirements in royalty processing until a new system can be developed, we may not be able to hire and train additional staff. See also "Risk Factors—Our outside auditors have identified weaknesses in our internal controls that could affect our ability to ensure reliable financial reports."

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 and as a result of the weaknesses in our internal controls described above and below, our principal executive officer and principal financial officer have concluded that our Disclosure Controls need to be improved so that they will 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. In addition, we continue to review our disclosure controls and procedures during the transition to a stand-alone business with the objective of implementing comprehensive periodic reporting standards as well as addressing the weaknesses in Internal Controls identified by our outside auditors. Since completion of the audit related to our fiscal 2004 year-end, we have taken a number of actions, as set forth below, to remedy the weaknesses discovered in our Internal Controls so that the Company's Disclosure Controls are effective in the future. We will continue to devote resources to improve our controls and remedy weaknesses related to our royalty systems that continued to be identified since the completion of the most recent audit for the 2005 fiscal year-end.

Changes in Internal Control over Financial Reporting

We have already taken a number of actions to begin to address the items identified by our outside auditors and to provide reasonable assurances that the objectives of our Disclosure Controls and Internal Controls will be met including:

- hiring a permanent chief financial officer;
- establishing an audit committee and appointing two independent directors, one of which is a financial expert and the chair of the committee;

- outsourcing our internal audit functions and hiring a director of internal audit;
- hiring internal and external resources to lead our Section 404 evaluation efforts;
- adopting a new code of conduct and hiring outside consultants to assist in the implementation of the new code of conduct;
- adopting a compliance program, appointing a chief compliance officer and hiring a deputy compliance officer;
- hiring other accounting and SEC experienced personnel to enhance the accounting department;
- hiring additional outside resources to assist our internal personnel with royalties accounting and SEC reporting;
- hiring a director of taxation and other tax department members; and
- entering into a joint venture with Universal Music Group, Exigen Group and Lightspeed Venture Partners to build a new uniform royalty system for all U.S. operations.

These actions have resulted in the elimination of the material weaknesses related to entity level controls identified at the time of our fiscal 2004 audit as noted above. We are committed to maintaining high standards of internal control over financial reporting, corporate governance and public disclosure and continue to improve and refine our Internal Controls as an ongoing process and will continue to take corrective actions and implement improvements as appropriate.

Other than as summarized above, there have been no changes in our Internal Controls over financial reporting or other factors that have materially affected, or are reasonably likely to materially affect, our Internal Controls.

Institution of Internal Controls in compliance with Section 404 of Sarbanes-Oxley

As a result of our registration with the Securities and Exchange Commission, we will be required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and regulations promulgated thereunder as of September 30, 2006. We are currently performing the system and process evaluation and testing required (and any necessary remediation) in an effort to comply with management certification and auditor attestation requirements of Section 404. In the course of our ongoing evaluation, we have identified areas of our internal controls requiring improvement, and plan to design enhanced processes and controls to address these and any other issues that might be identified through this review. As a result, we expect to incur additional expenses and diversion of management's time. We cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations and may not be able to ensure that the process is effective or that the internal controls are or will be effective in a timely manner. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance, our independent auditors may not be able to certify as to the effectiveness of our internal control over financial reporting and we may be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission. As a result, there could be an adverse reaction in the financial markets due to loss of confidence in the reliability of our financial statements. In addition, we may be required to incur costs in improving our internal control system and the hiring of additional personnel. Any such action could adversely affect our results. See also "Risk Factors—Our internal controls over financial reporting may not be adequate and our independent auditors may not be able to certify as to their adequacy, which could have a significant affect on our business and reputation."

ITEM 9B. OTHER INFORMATION

Item 9B is not applicable and has been omitted.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

In addition to the information set forth under the caption "Executive Officers of the Registrant" in Part I of this Form 10-K, the information required by this Item is incorporated by reference to our Proxy Statement for the fiscal 2005 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION

The information called for by this item is hereby incorporated by reference to our Proxy Statement for the fiscal 2005 Annual Meeting of Stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information called for by this item is hereby incorporated by reference to our Proxy Statement for the fiscal 2005 Annual Meeting of Stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for by this item is hereby incorporated by reference to our Proxy Statement for the fiscal 2005 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information called for by this item is hereby incorporated by reference to our Proxy Statement for the fiscal 2005 Annual Meeting of Stockholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

The Financial Statements listed in the Index to Consolidated Financial Statements, filed as part of this Annual Report on Form 10-K.

(a)(2) Financial Statement Schedules

The Financial Statements Schedule listed in the Index to Consolidated Financial Statements, filed as part of this Annual Report on Form 10-K.

(a)(3) Exhibits

See Item 15(b) below.

(b) Exhibits

Exhibit No.	Description
2.1(1)	Purchase Agreement, dated as of November 24, 2003 between Time Warner Inc. and WMG Acquisition Corp., as amended
2.2(12)	Settlement Agreement, dated as of July 13, 2005, between Time Warner Inc. and WMG Acquisition Corp.
3.1(2)	Amended and Restated Certificate of Incorporation of Warner Music Group Corp.
3.2(2)	By-laws of Warner Music Group Corp.
4.1(3)	Indenture, dated as of April 8, 2004, among WMG Acquisition Corp., the Guarantors named therein and Wells Fargo Bank, National Association
4.2(3)	First Supplemental Indenture, dated as of November 16, 2004, among WMG Acquisition Corp., Wells Fargo Bank, National Association, as Trustee, WEA Urban LLC and WEA Rock LLC
4.3(7)	Second Supplemental Indenture, dated as of May 17, 2005, among WMG Acquisition Corp., Wells Fargo Bank, National Association, as Trustee, NonZero (since renamed Cordless Recordings LLC) and The Biz LLC
4.4(13)	Third Supplemental Indenture, dated as of September 28, 2005, among WMG Acquisition Corp., Wells Fargo Bank, National Association, as Trustee, and Lava Records LLC
4.5(14)	Fourth Supplemental Indenture, dated as of October 26, 2005, among WMG Acquisition Corp., Wells Fargo Bank, as Trustee, and BB Investments LLC
4.6**	Fifth Supplemental Indenture, dated as of November 29, 2005, among WMG Acquisition Corp., Wells Fargo Bank, as Trustee, and Perfect Game Recording Company LLC
4.7(4)	Indenture, dated as of December 23, 2004, between WMG Holdings Corp. and Wells Fargo Bank, National Association, as Trustee
4.8(12)	Guarantee of Warner Music Group Corp.
10.1(5)	Amended and Restated Credit Agreement, dated as of April 8, 2004, among WMG Acquisition Corp., the Overseas Borrowers from time to time party thereto, WMG Holdings Corp., each lender from time to time party thereto Bane of America Securities LLC and Deutsche Bank Securities Inc., as Joint Lead Arrangers and Joint Book Managers, Lehman Brothers Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Co-Arrangers and Joint Book Managers, Deutsche Bank Securities Inc. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Documentation Agent, and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer.

Exhibit No.	Description
10.2(5)	Amendment No. 1 to the Credit Agreement, dated as of September 30, 2004, among WMG Acquisition Corp., the Overseas Borrowers party thereto, WMG Holdings Corp., the lenders party thereto, Banc of America Securities LLC and Deutsche Bank Securities Inc., as joint lead arrangers and joint book managers and various other parties
10.3(5)	Amendment No. 2 to the Credit Agreement, dated as of December 6, 2004, among WMG Acquisition Corp., the Overseas Borrowers party thereto, WMG Holdings Corp., the lenders party thereto, Banc of America Securities LLC and Deutsche Bank Securities Inc., as joint lead arrangers and joint book managers and various other parties
10.4(6)	Amendment No. 3 to the Credit Agreement, dated as of April 29, 2005 among WMG Acquisition Corp., the Overseas Borrowers parties thereto, WMG Holdings Corp., the lenders party thereto, Banc of America Securities LLC and Deutsche Bank Securities Inc., as joint lead arrangers and joint book and various other parties
10.5(5)	Security Agreement, dated as of February 27, 2004, from the Grantors named to therein to Bank of America, N.A.
10.6(5)	Subsidiary Guaranty, dated as of February 27, 2004, from the Guarantors named therein and the Additional Guarantors named therein in favor of the Secured Parties named in the Credit Agreement referred to therein
10.7(5)	Parent Guaranty, dated as of February 27, 2004, from WMG Holdings Corp. in favor of the Secured Parties named in the Credit Agreement referred to therein
10.8(5)	Company Guaranty, dated as of February 27, 2004, from WMG Acquisition Corp. in favor of the Secured Parties named in the Credit Agreement referred to therein
10.9(5)	Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing (Tennessee) by and from Warner Bros. Records, Inc. to Kay B. Housch in favor of Bank of America, N.A., dated as of February 29, 2004 (20, 24, 26 Music Square East)
10.10(5)	Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing (Tennessee) by and from Warner Bros. Records, Inc. to Kay B. Housch in favor of Bank of America, N.A., dated as of February 29, 2004 (21 Music Square East)
10.11(5)	Deed of Trust, Security Agreement, Assignment of Rents and Leases and Fixture Filing (California) by and from Warner Bros. Records, Inc. to MTC Financial Inc. in favor of Bank of America, N.A., dated as of February 29, 2004
10.12(5)	Trademark Security Agreement, dated as of February 29, 2004, made by the Grantors listed on the signature pages thereto in favor of the Bank of America, N.A.
10.13(5)	Copyright Security Agreement, dated as of February 29, 2004, made by the Grantors listed on the signature pages thereto in favor of the Bank of America, N.A.
10.14(5)	Stockholders Agreement, dated as of February 29, 2004, among WMG Parent Corp., WMG Holdings Corp., WMG Acquisition Corp. and Certain Stockholders of WMG Parent Corp. and WMG Holdings Corp.
10.15(5)	Amendment No. 1 to Stockholder's Agreement, dated as of July 30, 2004, among WMG Parent Corp., WMG Holdings Corp., WMG Acquisition Corp., each Person executing this Agreement and listed as an Investor on the signature pages hereto, each Person executing this Agreement and listed as a Seller on the signature pages hereto, each Person executing this Agreement and listed as a Manager on the signature pages hereto and such other Persons, if any, that from time to time become party hereto as holders of Other Holder Shares solely in the capacity of permitted assignees with respect to certain registration rights hereunder
10.16(7)	Amended and Restated Stockholders Agreement dated as of May 10, 2005 between Warner Music Group Corp., WMG Holdings Corp., WMG Acquisition Corp. and certain stockholders of Warner Music Group Corp.

Exhibit No.	Description
10.17(5)	Seller Administrative Services Agreement, dated as of February 29, 2004, between Time Warner Inc. and WMG Acquisition Corp.
10.18(5)	Amendment No. 1 to Seller Administrative Services Agreement, dated as of July 1, 2004, between Time Warner Inc. and WMG Acquisition Corp.
10.19(5)	Purchaser Administrative Services Agreement, dated as of February 29, 2004, between Time Warner Inc. and WMG Acquisition Corp.
10.20(5)	Management Agreement, dated as of February 29, 2004, among WMG Parent Corp., WMG Holdings Corp., WMG Acquisition Corp., THL Managers V, L.L.C., Bain Capital Partners, LLC, Providence Equity Partners IV Inc. and Music Partners Management, LLC
10.21(7)	Termination Agreement of the Management Agreement dated as of May 10, 2005, between Warner Music Group Corp., WMG Holdings Corp., WMG Acquisition Corp., THL Managers V, L.L.C., Bain Capital Partners, LLC, Providence Equity Partners IV Inc. and Music Partners Management, LLC
10.22(5)	Warrant Agreement (MMT Warrants), February 29, 2004, WMG Parent Corp., WMG Holdings Corp. and Historic TW Inc.
10.23(5)	Warrant Agreement (Three-Year Warrants), February 29, 2004, WMG Parent Corp., WMG Holdings Corp. and Historic TW Inc.
10.24(10)	Warrant Repurchase Agreement, dated as of April 21, 2005, between Warner Music Group Corp. and Historic TW Inc.
10.25(5)	Employment Agreement, effective as of March 1, 2004, between WMG Acquisition Corp. and Edgar Bronfman, Jr.
10.26(5)	Employment Agreement, dated as of January 25, 2004, between WMG Acquisition Corp. and Lyor Cohen
10.27(5)	Employment Agreement, dated as of November 28, 2002, between Warner Music International Services Ltd. and Paul-René Albertini, assumed by WMG Acquisition Corp. on March 1, 2004, as amended by the amendment dated October 21, 2004, and as further amended by the amendment dated December 17, 2004
10.28(5)	Employment Agreement, dated as of March 22, 1999, between Warner Music Inc. and Les Bider, as amended, assumed by WMG Acquisition Corp. on March 1, 2004
10.29(5)	Employment Agreement, dated as of December 15, 1998, between Warner Music Inc. and David H. Johnson, as amended, assumed by WMG Acquisition Corp. on March 1, 2004
10.30(5)	Employment Agreement, dated as of December 21, 2004, between Warner Music Inc. and Michael D. Fleisher
10.31(9)	Employment Agreement, dated as of March 17, 2005, between Warner/Chappell Music, Inc. and Richard Blackstone
10.32(8)	Separation Agreement and Release, dated as of March 31, 2005, between Warner Music Inc. (formerly known as Warner Music Group Inc.) and Les Bider
10.33(5)	Restricted Stock Award Agreement, dated as of March 1, 2004, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and Edgar Bronfman, Jr.
10.34(5)	Restricted Stock Award Agreement, dated as of March 1, 2004, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and Lyor Cohen
10.35(5)	Restricted Stock Award Agreement, dated as of January 28, 2005, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and David H. Johnson
10.36(5)	Restricted Stock Award Agreement, dated as of December 31, 2004, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and Michael D. Fleisher

Exhibit No.	Description
10.47(6)	Restricted Stock Award Agreement, dated as of October 1, 2004, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and Paul-René Albertini
10.38(9)	Restricted Stock Award Agreement, dated as of March 17, 2005, between Warner Music Group Corp. and Richard Blackstone
10.39(5)	Stock Option Agreement, dated as of October 1, 2004, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and Paul-René Albertini
10.40(6)	Deed of Variation to Restricted Stock Award Agreement of Paul-René Albertini, dated as of May 6, 2005, between Warner Music Group Corp. and Paul-René Albertini
10.41(5)	Stock Option Agreement, dated as of September 30, 2004, between Warner Music Group Corp. (formerly known as WMG Parent Corp.) and Les Bider
10.42(5)	Form of WMG Parent Corp. LTIP Stock Option Agreement
10.43(6)	Form of Warner Music Group Corp. 2005 Omnibus Award Plan
10.44(5)	Office Lease, June 27, 2002, by and between Media Center Development, LLC and Warner Music Group Inc., as amended
10.45(5)	Lease, dated as of February 1, 1996, between 1290 Associates, L.L.C. and Warner Communications Inc.
10.46(5)	Consent to Assignment of Sublease, dated as of October 5, 2001, between 1290 Partners, L.P. and Warner Music Group
10.47(5)	Lease, dated as of February 29, 2004, between Historical TW Inc. and Warner Music Group Inc. regarding 75 Rockefeller Plaza
10.48*(5)	U.S. Pick, Pack and Shipping Services Agreement, dated as of October 24, 2003, between Warner-Elektra-Atlantic Corporation and Cinram Distribution LLC
10.49*(5)	U.S. Manufacturing and Packaging Agreement, dated as of October 24, 2003, between Warner-Elektra-Atlantic Corporation and Cinram Manufacturing Inc.
10.50*(5)	International Pick, Pack and Shipping Services Agreement, dated as of October 24, 2003, between WEA International Inc. and Warner Music Manufacturing Europe GmbH Company
10.51*(5)	International Manufacturing and Packaging Agreement, dated as of October 24, 2003, between WEA International Inc. and Warner Music Manufacturing Europe GmbH Company
12.1**	Computation of Ratio of Earnings to Fixed Charges
14**	Code of Ethics
21.1**	List of Subsidiaries
23.1**	Consent of Ernst & Young LLP
31.1**	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended
31.2**	Certification of the Chief Financial Officer pursuant to Rule 13a-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

Exhibit No.	Description
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
(c)	Financial Statement Schedules
	Schedule II—Valuation and Qualifying Accounts

* Exhibit omits certain information that has been filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request pursuant to Rule 406 promulgated under the Securities Act of 1933, as amended.

** Filed herewith

*** Pursuant to SEC Release No. 33-8212, this certification will be treated as "accompanying" this Annual Report on Form 10-K 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, or the Securities Exchange Act, as amended, except to the extent that the registrant specifically incorporates it by reference.

(1) Incorporated by reference to WMG Acquisition Corp.'s Amendment No. 1 to the Registration Statement on Form S-4 (File No. 333-121322).

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

(3) Incorporated by reference to WMG Acquisition Corp.'s Registration Statement on Form S-4 (File No. 333-121322).

(4) Incorporated by reference to Warner Music Group Corp.'s Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-123249).

(5) Incorporated by reference to WMG Acquisition Corp.'s Amendment No. 2 to the Registration Statement on Form S-4 (File No. 333-121322).

(6) Incorporated by reference to Warner Music Group Corp.'s Amendment No. 4 to the Registration Statement on Form S-1 (File No. 333-123249).

(7) Incorporated by reference to Warner Music Group Corp.'s Current Report on Form 8-K filed May 19, 2005 (File No. 001-32502).

(8) Incorporated by reference to WMG Acquisition Corp.'s Current Report on form 8-K filed April 1, 2005 (File No. 333-121322).

(9) Incorporated by reference to WMG Acquisition Corp.'s Current Report on form 8-K filed April 11, 2005 (File No. 333-121322).

(10) Incorporated by reference to Warner Music Group Corp.'s Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-123249).

(11) Incorporated by reference to WMG Acquisition Corp.'s Amendment No. 3 to the Registration Statement on Form S-4 (File No. 333-121322).

(12) Incorporated by reference to Warner Music Group Corp.'s Registration Statement on Form S-4 (File No. 333-126786-01).

(13) Incorporated by reference to Warner Music Group Corp.'s Current Report on Form 8-K filed October 3, 2005 (File No. 001-32502).

(14) Incorporated by reference to Warner Music Group Corp.'s Current Report on Form 8-K filed October 27, 2005 (File No. 001-32502)

SIGNATURE

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, on December 1, 2005.

WARNER MUSIC GROUP CORP.

By: /s/ EDGAR BRONFMAN, JR.
Name: Edgar Bronfman, Jr.
Title: Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)

By: /s/ MICHAEL D. FLEISHER
Name: Michael D. Fleisher
Title: Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities indicated on December 1, 2005.

Signature	Title
/s/ EDGAR BRONFMAN, JR. Edgar Bronfman, Jr.	Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)
/s/ MICHAEL D. FLEISHER Michael D. Fleisher	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
/s/ LEN BLAVATNIK Len Blavatnik	Director
/s/ SHELBY W. BONNIE Shelby W. Bonnie	Director
/s/ RICHARD BRESSLER Richard Bressler	Director
/s/ CHARLES A. BRIZIUS Charles A. Brizius	Director
/s/ JOHN P. CONNAUGHTON John P. Connaughton	Director
/s/ SCOTT L. JAECKEL Scott L. Jaeckel	Director
/s/ SETH W. LAWRY Seth W. Lawry	Director

Signature	Title
/s/ THOMAS H. LEE Thomas H. Lee	Director
/s/ IAN LORING Ian Loring	Director
/s/ JONATHAN M. NELSON Jonathan M. Nelson	Director
/s/ MARK NUNNELLY Mark Nunnelly	Director
/s/ SCOTT M. SPERLING Scott M. Sperling	Director

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-127900) pertaining to the Restricted Stock Agreements of Warner Music Group Corp. and the Registration Statement (Form S-8 No. 333-127899) pertaining to the Stock Option Agreements, 2005 Omnibus Award Plan and the LTIP Stock Option Agreements of Warner Music Group Corp. of our reports dated November 15, 2005 and March 10, 2005, with respect to the consolidated and combined financial statements and schedule of Warner Music Group Corp. included in the Annual Report (Form 10-K) for the year ended September 30, 2005.

December 1, 2005
New York, New York

/s/ Ernst & Young LLP

Exhibit 31.1

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Edgar Bronfman, Jr., Chief Executive Officer and Chairman of the Board of Directors of Warner Music Group Corp., certify that:

1. I have reviewed this annual report on Form 10-K of Warner Music Group Corp. (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and we have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

b) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: December 1, 2005

/s/ EDGAR BRONFMAN, JR.

Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)

Exhibit 31.2

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Michael D. Fleisher, Chief Financial Officer of Warner Music Group Corp., certify that:

1. I have reviewed this annual report on Form 10-K of Warner Music Group Corp. (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and we have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared; and

b) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: December 1, 2005

/s/ MICHAEL D. FLEISHER

Chief Financial Officer (Principal Financial and Accounting Officer)

corporate | information

Board of Directors

Edgar Bronfman, Jr.[2]
Chairman of the Board and CEO, Warner Music Group Corp.

Len Blavatnik[3]
Chairman, Access Industries, Inc.

Shelby W. Bonnie[1]
Chairman and CEO, CNET Networks, Inc.

Richard Bressler[1][4]
Former Executive Vice President and CFO, Viacom, Inc.

Charles A. Brizius
Managing Director, Thomas H. Lee Partners, L.P.

John P. Connaughton
Managing Director, Bain Capital Partners, LLC

Scott L. Jaeckel[4]
Managing Director, Thomas H. Lee Partners, L.P.

Seth W. Lawry[2][3]
Managing Director, Thomas H. Lee Partners, L.P.

Thomas H. Lee[2][3]
Chairman and CEO, Thomas H. Lee Partners, L.P.

Ian Loring[2][3]
Managing Director, Bain Capital Partners, LLC

Jonathan M. Nelson[2][3]
CEO, Providence Equity Partners, Inc.

Mark Nunnelly[2][3]
Managing Director, Bain Capital Partners, LLC

Scott M. Sperling[1][2][3]
Co-President, Thomas H. Lee Partners, L.P.

(1) Co-Presiding Director
(2) Member, Executive, Governance & Nominating Committee
(3) Member, Compensation Committee
(4) Member, Audit Committee

Stock Listing

Warner Music Group Corp. Common Stock is listed on the New York Stock Exchange under the symbol "WMG".

Management Team

Edgar Bronfman, Jr.
Chairman and CEO

Paul-René Albertini
Chairman and CEO, Warner Music International

Richard Blackstone
Chairman and CEO, Warner/Chappell Music, Inc.

Lyor Cohen
Chairman and CEO, U.S. Recorded Music

Michael D. Fleisher
Executive Vice President and Chief Financial Officer

David H. Johnson
Executive Vice President and General Counsel

Caroline Stockdale
Executive Vice President, Global Human Resources

Will Tanous
Senior Vice President, Corporate Communications

Alex Zubillaga
Executive Vice President, Digital Strategy and Business Development

Auditors

Ernst & Young LLP

Transfer Agent/ Shareholder Services

Registered shareholders (who hold shares in their name) with questions or seeking services, including change of address, lost stock certificate, transfer of stock to another person and other administrative services, should contact the Transfer Agent at:

American Stock Transfer and Trust Company
59 Maiden Lane
New York, New York 10038
Phone: 1-800-937-5449
Web site: www.amstock.com
Email: info@amstock.com
Attention: Shareholder Services

Beneficial shareholders (who hold their shares through brokers) should contact the broker directly on all administrative matters.

Corporate Headquarters

75 Rockefeller Plaza
New York, NY 10019
Phone: 1-212-275-2000

Certifications

Warner Music Group has filed with Securities and Exchange Commission as exhibits to its Annual Report on Form 10-K for the year ended September 30, 2005, the certification of each of its Chief Executive Officer and Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act.

Caution Concerning Forward-Looking Statements

This document includes certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and beliefs and are naturally subject to uncertainty and changes in circumstances. Actual results may vary materially from the expectations contained herein due to changes in economic, business, competitive, technological, strategic and/or regularly factors. More detailed information about these factors is set forth in filings by Warner Music Group Corp. with the United States Securities and Exchange Commission, including Warner Music Group Corp.'s most recent Annual Report on Form 10-K and Quarterly Report on Form 10-Q. Warner Music Group is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements, whether as a result of new information, further events or otherwise.

Debt Securities

For a list of the company's debt securities, please refer to the notes summary section of the company's web site at: http://investors.wmg.com/.

Mixed Sources
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warner | music | group

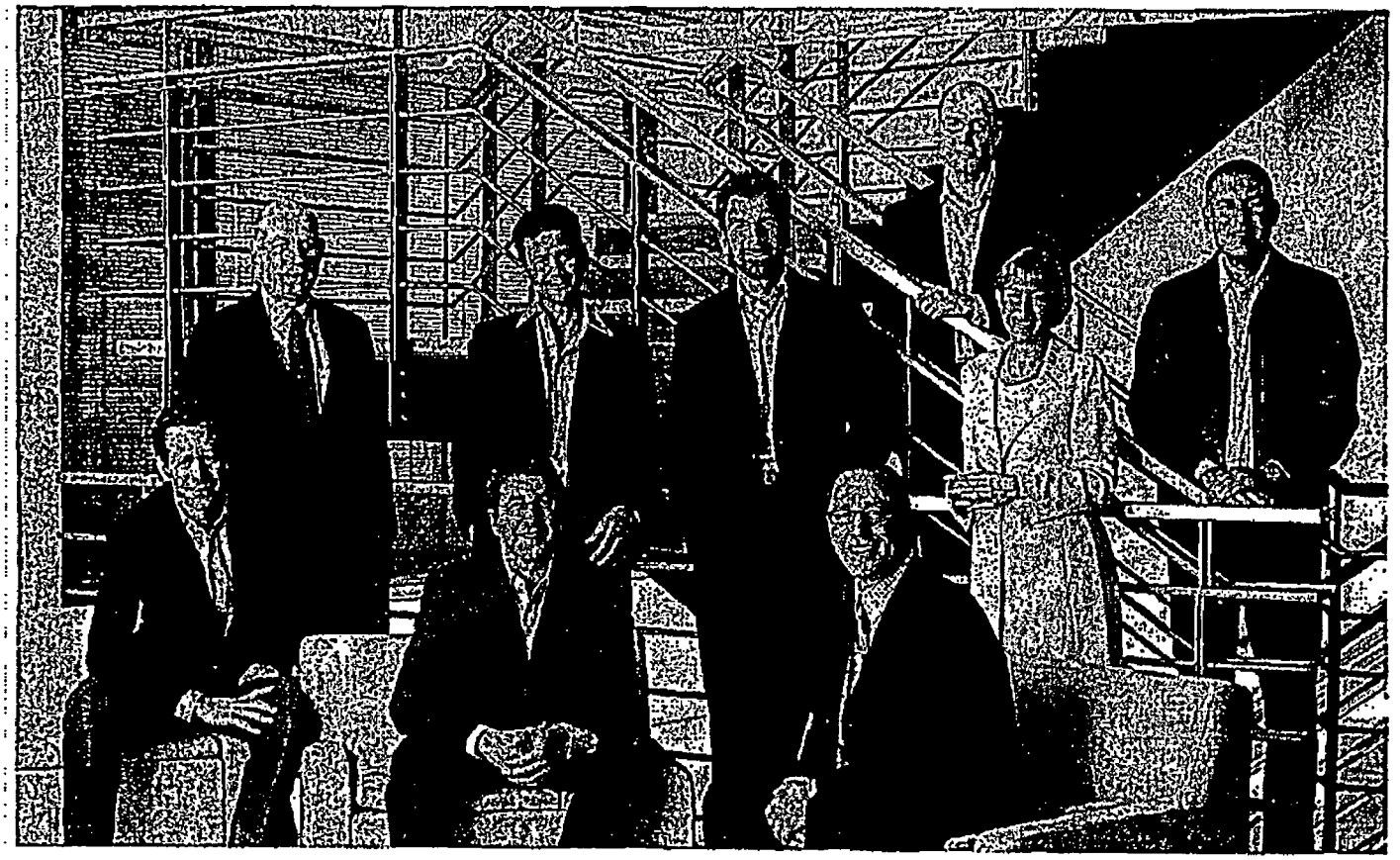
management | team

Standing left to right:

David H. Johnson, *Executive Vice President and General Counsel*
Paul-René Albertini, *Chairman and CEO, Warner Music International*
Edgar Bronfman, Jr., *Chairman and CEO*
Will Tanous, *Senior Vice President, Corporate Communications*
Caroline Stockdale, *Executive Vice President, Global Human Resources*
Lyor Cohen, *Chairman and CEO, U.S. Recorded Music*

Seated left to right:

Alex Zubillaga, *Executive Vice President, Digital Strategy and Business Development*
Richard Blackstone, *Chairman and CEO, Warner/Chappell Music*
Michael D. Fleisher, *Executive Vice President and Chief Financial Officer*



warner | music | group

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