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HEADLINE: Q2 2005 **Warner Music Group** Earnings Conference Call - Final

BODY:

OPERATOR: Hello and welcome to **Warner Music Group's** second quarter fiscal ending March 31, 2005 earnings conference call hosted by Jill Krutick, Senior Vice President of Investor Relations and Corporate Development. At the request of **Warner Music Group** today's call is being recorded for replay purposes and if you object you may disconnect at any time.

As a reminder there will be a question-and-answer session following today's presentation. At that time you may press star one if you have a question. You will be prompted to speak your name in order for your question to register.

I would now like to turn this call over to today's host, Ms. Jill Krutick. Ma'am you may begin.

JILL KRUTICK, SVP INVESTOR RELATIONS AND CORPORATE DEVELOPMENT, WARNER MUSIC GROUP, INC.: Thank you very much. Good morning, everyone. I'm delighted to be here to introduce Warner Music Group Corp's first earnings call as a public company.

We have chosen to hold our fiscal second quarter earnings call in tandem with the filing of our 10-Q as we recently emerged from the SEC quiet period. I'll read the Safe Harbor language before Edgar Bronfman, Jr., our Chairman and CEO, shares a few of his visions for the Company and where we are today, and Michael Fleisher, our EVP and CFO provides analysis of fiscal second quarter earnings and explains why we're reporting now and describes our different reporting entities before we turn the call over to Q&A.

This communication includes forward-looking statements that reflect the current views of Warner Music Group about future events and financial performance. Words such as estimates, expect, anticipate, project, plan, intends, believes, forecast, and variations of such words or similar expressions that predict or indicate future events or trends or do not relate to historical matters identify forward-looking statements.

Our expectations, beliefs, and projections are expressed in good faith and we believe there is a reasonable basis for them. However, there can be no assurance that management's expectations, beliefs, and projections will result or be achieved.

Investors should not rely on forward-looking statements because they are subject to a variety of risks, uncertainties and other factors that can cause actual results to differ materially from our expectations.

Now I'll turn the call over to Edgar.

Edgar Bronfman, Jr.: Thank you, Jill. Welcome everyone. Thanks for joining us.

As I'm sure you noticed, when we released WMG Acquisition Corp. earnings last month, we have much good news to report. I'm pleased to reaffirm our Company is operating very well at an exciting stage of transformation in the music industry with many growth opportunities ahead of us.

While I never want to downplay the uncertainty our industry faces, in this period our revenues were stable, the restructuring benefits were evident, digital is becoming an increasingly bigger piece of sales, and we generated significant cash flow.

As this is our first call as a public company I'd like to emphasize that we manage our business for the full year to generate long-term returns for our shareholders. While quarter-to-quarter comparisons for music companies may be accurate, they are not instructive because of the change in release schedules and timing of marketing and promotion expenditures. As a result we will not be providing financial guidance on a going forward basis. Michael will explain this in more detail shortly.

In the 15 months I've been at Warner Music we have built an outstanding management team made up of extraordinary Warner executives and the best from across the industry and they are deeply committed and deeply invested in our Company. This would include our most recent addition last week, Richard Blackstone, the Chairman and CEO of Warner Chapel Music, who most recently ran Zamba Music Publishing. This exceptional management team is now in place and executing our plan.

And now that our restructuring is complete, we have realized approximately $250 million in annualized cost savings. We've managed the consolidation of the Atlantic and Elektra labels, reorganized our international operations in key territories around the world, consolidated and streamlined overhead operations, lowered our variable costs, eliminated more than 1,000 positions, and focused our global artist roster.

Throughout this streamlining process, Warner Music continued to build a strong pipeline of music content across the Company which will be evident especially for Atlantic in our fourth fiscal quarter and beyond, and with this more robust release schedule we expect to be improving revenues and gaining market share beyond the small market share gain we have achieved year-to-date.

We dropped less profitable artists as part of our restructuring effort. As a result, we are spending more A&R in marketing per artist and per release.

We are also developing a new and innovative A&R strategy including our new incubator initiative, which leverages our strong independent distribution network to help identify future major acts at lower cost. For example, Mike Jones, the first artist upstreamed through the incubator system, debuted at number three on the Top 200 Chart in April and has since sold more than half a million albums in the U.S.

While the recording music industry is down year-to-date we continue to outperform. Soundscan numbers through June 5th have U.S. physical unit sales down 7%. Warner Music Group is down only 3%, with a release schedule that through our third quarter reflects the Atlantic restructuring and artist roster reduction and subsequent rebuilding.

The potential of digital distribution is increasingly being reflected in its real world success. Digital revenues were $35 million, or 4.6% of our second quarter revenue. The quarter's $35 million was more than we achieved for digital in all of 2004.

On the physical side, while piracy continues to be a concern, we have seen piracy awareness double over the past year and the illegal P to P usage cut in half. New media products like Rob Thomas' recent number one hit album released as a dual disk, puts us on a path to transition to a DVD-based medium, a much more secure and robust product platform.

As we monetize our musical content across new products and channels, we are in the early stages of the revaluation of the music industry. We saw a similar revaluation in filmed entertainment content over the past 20 years as new channels, together with the explosive DVD format, helped expand the demand for that content.

We expect the same sort of revaluation to occur in the music industry as our channels and products expand exponentially. Given the massive proliferation of players from iPods to wireless to video game consoles and computers, we sit at the center of this new convergence.

For example, we believe we have established the largest mobile footprint of any media company through distribution agreements with carriers that reach 540 million subscribers. This positions us to capitalize on the growth of ring tones and ring backs today, and shortly full track music and full music video downloads among other businesses.

In addition, I should point out that we also have more than 20 years of music video content that we will now begin to monetize.

In the past months we've transformed Warner Music Group through our successful restructuring, innovative business approaches, and energized management team. We believe significant value will be created in the transition of Warner Music Group from a recorded music and song-based company to a multifaceted music-based content company.

The bottom line is, though we will not give financial guidance of specific quarterly estimates, we are confident about this fiscal year taken as a whole and about the future.

Now I'd like to turn this over to Michael to take you through the financials and then we'll open up the call for Q&A.

MICHAEL FLEISHER, EVP, CFO, WARNER MUSIC GROUP, INC.: Thank you, Edgar, and good morning, everyone.

This call is falling at a somewhat unusual time for us given that our third quarter will be ending only two weeks from now on June 30. This morning we filed our form 10-Q for Warner Music Group Corp., the parent entity we just took public and that trades on the New York Stock Exchange under the ticker, WMG.

The timing of the initial filing for Warner Music Group Corp. results from SEC rules which allow a company to file its initial 10-Q within 45 days after going public, instead of the normal 45 days after the end of the quarter. Going forward we will be on a normal reporting timetable.

WMG has three principal companies at the top of its corporate structure, WMG Acquisition Corp., which is 100% owned by WMG Holdings Corp., which in turn is 100% owned by Warner Music Group Corp., the entity that reported today. Notable differences between the two non-parent entities are the levels of cash and debt they hold and the related net interest expense.

More importantly, Warner Music Group Corp. accumulates all the information from the other two entities and will be the topic of our calls each quarter. So in future quarters, though we will make filings for all three entities, we will focus our calls and discussion only on the ultimate parent, Warner Music Group Corp.

Now I'd like to cover some of our key financial highlights, most of which are identical to the operating results reported by WMG Acquisition Corp. last month. First I'll touch on the restructuring briefly as it was substantially complete as of December 31st.

The vast majority of our savings have been captured through the second quarter of this year. This will make costs in the third, or June quarter, versus last year, more of an apples to apples comparison.

We achieved our 250 million in savings as expected and generated a six-month OIBDA through March 31st of 278 million. Our cost savings are also evident as our SG&A expenses fell to 38% of revenue, compared to 43% last year.

Looking at the income statement for the three months ended March 31, 2005, we reported total revenue of 767 million, which was up 4.4% from the same period in 2004, or 1.2% on a currency adjusted basis.

International revenue made up 53% of the total. Digital revenues of 35 million, or 4.6% of total revenues, contributed to our growth.

Total operating income before depreciation and amortization, or OIBDA, was 88 million, up 83% over last year. Excluding FAS 123 charges of 7 million, total OIBDA amounted to 95 million, almost double last year's comparable quarter, helped by our restructuring cost savings.

As I mentioned, beginning with the third quarter, we will begin comparing against a quarter that already has substantial restructuring benefits, resulting in a more normalized year-over-year cost comparison.

Our net income amounted to 4 million, a sizable year-over-year improvement from last year's net loss of 48 million. For the quarter, Recorded Music revenue increased by 4.9% to 621 million, up 1.9% on a currency-adjusted basis.

Digital sales contributed to the growth but they were mostly offset by declines in physical sales. Major sellers in the quarter were Green Day, Michael Buble, TI, and Big & Rich.

Year-over-year Recorded Music OIBDA grew to 72 million from 21 million, as benefits from the Atlantic restructuring initiative and higher margin digital products contributed to our results. Recorded Music OIBDA margin rose to 11.6 versus 3.5% in the same period last year.

In comparison to the same period in 2004, Music Publishing revenue climbed by 3.4% to 154 million, due almost entirely to the benefit from foreign exchange. Increases in performance and synchronization royalties were offset by overall declines in mechanical revenues.

OIBDA improved to 47 million from 45 million, or a margin rate of 30.5%.

We ended the quarter with a cash balance of 447 million, net debt of 2.1 billion, and a $250 million undrawn revolver. Our IPO net proceeds of 517 million, all of which we intend to use along with approximately 57 million of cash on hand to pay down 100% of our WMG Holdings Corp. floating rate notes and PIK notes, as well as 35% of WMG Holdings Corp. discount notes.

Our weighted average cost of debt will drop to an attractive 6.5% when the high-yield debt is redeemed on June 15th.

As previously disclosed, we intend to pay an annual $80 million dividend to shareholders on a quarterly basis. Our 447 million in cash as of March 31st includes cash being used for the IPO concurrent transaction, like the buyback of the Time Warner warrants for 138 million, and the payment of dividends to our stockholders totaling 109 million.

In addition, as previously disclosed at the time of our IPO, our third quarter is expected to have some unusual cost items that result in cash payouts including a 73 million expense for the termination of a management agreement, and approximately 33 million in expenses related to cash payments for employee stock and stock option-related tax issues, and an employee IPO bonus.

Looking at the balance of our 2005 year we remain very encouraged. We have chosen not to provide financial guidance to the investment community as a matter of policy. Quarterly variations are the norm given the rhythm of our music release schedule and our associated marketing and promotion costs.

Having said that, because we are sitting only a few weeks from the end of the third quarter, we thought it appropriate to mention our expectation that second half performance remains strong but will be more fourth quarter weighted. As Edgar mentioned earlier, the Atlantic pipeline in particular is kicking in beginning in our fourth, or the September quarter.

Ahead of this uptick in releases we are expecting our marketing and promotion expenditures to increase in the third quarter, which is set up for our fourth quarter release schedule.

In my five months at Warner Music we have concentrated on improving our financial controls as we have transitioned away from the legacy Time Warner systems. We have enhanced our finance team by hiring a new controller, a new head of internal audit, and other key financial professionals.

We've established an audit committee with Richard Bressler as the audit chair. In addition, we are well on our way to being Sarbanes-Oxley compliant and remain very comfortable with our schedule to meet the September 30, 2006 deadline.

Overall, we believe that Warner Music Group is in the right place at the right time in a world that is undergoing a technological transformation that will make our content available to a much larger audience and a lot more valuable to its investors.

And with that, we'll ask the operator to open up the call for questions.

OPERATOR: Thank you. [Operator instructions] One moment, please, while the questions register. Our first question comes from Anthony Noto, Goldman Sachs.

ANTHONY NOTO, ANALYST, GOLDMAN SACHS: Yes, my first question is really, Edgar, related to a comment you had made. You had mentioned that through June 5th that U.S. music sales, according to Soundscan, were down 7% and Warner Music Group was down 3%, and that's including the fact that you had really pared back some of your artist list. Can you give a sense on a comparable basis what Warner Music would have grown through June 5th year-to-date, backing out the fact that you had pared back some of the music artist list?

And then I have a second question as it relates to some of the new on-line aggregator services that have been launched since you went public.

Edgar Bronfman, Jr.: Sure. On the first question, Anthony, I'm not sure there's a way to do the calculation of how we would have grown had we not cut any artists. It's fair to say that our overall release schedule is probably half of what it was in the comparable period, sorry, in 2003. So you can see a significant reduction.

Now, again, hard to know what those releases would have done or how that would have impacted sales, but it is a significantly reduced and streamlined release schedule that is essentially, as I said, prior to the rebuilding of the Atlantic schedule, which we expected to take hold in our fiscal fourth quarter, the September ending quarter, we're down, as I said, 3% versus the Soundscan of 7%.

With regard to the new services, we are always pleased to see additional opportunities for consumers to be able to get music and to get it in a way that's commerce enabled and legitimate, and you also, I think it's important for the market to understand that with regard to those services, that there's a significant difference between wholesale pricing and retail pricing. And so we maintain a, we think a strong wholesale price, and there have been a number of services that have introduced at low prices, but those are, we think sort of short-term inducements for consumers on the retail basis, but we have not lowered our wholesale prices in order to allow those retailers to do that. That's something they're doing on their own.

ANTHONY NOTO: One quick follow-up on both of those, Edgar. The number of absolute releases this year versus year ago, is it correct that you said they're down by 50%? You're doing half as many this year as last year through June 5th in terms of absolute releases?

Edgar Bronfman, Jr.: It's actually half as many as through June '03. I don't quite have the number of '04, but it's pretty much a straight line down. But I just don't have the exact number for '04. But if you took basically without being perfect about it, a straight line down, it's, that was how the release schedule declined.

ANTHONY NOTO: Then on the aggregators, Yahoo! obviously has a download product and they have a subscription product and I recognize the fact that regardless of how they price it you're getting your wholesale price. But I was wondering if you could compare and contrast for us the economic differences in the subscription model versus a download model and if you're indifferent or you favor one versus the other? Thanks.

Edgar Bronfman, Jr.: I think we are largely indifferent, Anthony. The margins are very strong for the Company both ways. And we think that the emergence of a robust subscription business will be good for us and good for the industry.

How quickly that takes off is a matter of debate, and I don't know whether consumers will be able to get over the hurdles of theoretically not owning the music that they are paying for, or agree to spend a year, commit to a year's expenditures without knowing how much they would otherwise be spending on a download basis, but we're really frankly indifferent. We do well on either model.

ANTHONY NOTO: Great. Thank you.

OPERATOR: Thank you. Our next question comes from [Aaron Watt], Deutsche Bank.

AARON WATTS, ANALYST, DEUTSCHE BANK SECURITIES: Good morning, gentlemen. Quick clarification question in terms of guidance going forward. Will you be providing annual guidance?

MICHAEL FLEISHER: No.

AARON WATTS: Okay.

MICHAEL FLEISHER: We won't be providing annual or quarterly detailed guidance.

AARON WATTS: Okay. And in terms of sort of your pipeline that you're looking at for your fiscal fourth quarter, can you dig in with any more detail in terms of what artists we might expect or if there's any sort of keynote artist that you're putting out releases on in the next six months or so?

Edgar Bronfman, Jr.: I think we're intent on staying away from trying to identify specific artists, but what I think I can say is that sitting here in the middle of June, you know, we know what we're counting on, we're confident that they will actually be delivered, and we're, as we said, we're confident about the remainder of the year, obviously weighted towards the fourth quarter, but I think we're going to stay away from trying to identify any specific artist or release.

AARON WATTS: Okay.

MICHAEL FLEISHER: Certainly one of the things we will do is, as we report our results we will try and highlight for the previous quarter the big releases that took place in that quarter, who those artists were and how they performed.

AARON WATTS: Okay. Great. And then my last question, just sort of a more macro-based question here. As you look at the competitive landscape as it stands right now, you have two very large music groups out there with two significantly smaller music groups on sort of a current release market share basis. Do you think that puts you at a disadvantage at all in dealing with retailers and, you know, the leverage that you have in those negotiations, or, you know, across the board, how do you look at that environment right now?

Edgar Bronfman, Jr.: I think I would say that there are two fundamental things that record companies do, they identify artists and then they market and promote those artists to consumers. I don't feel that at our current size that Warner Music is at a disadvantage in either of those two fundamental activities.

We're competitive every day signing artists against Universal or Sony BMG, or EMI, and we're competitive in being able to attractively market and promote those artists. So I feel that at 3 plus billion dollars of revenue we are a big music company and perfectly able to compete in today's marketplace.

AARON WATTS: Okay. Thank you, gentlemen, for the color.

OPERATOR: Thank you. Our next question comes from Michael Savner, Banc of America Securities.

MICHAEL SAVNER, ANALYST, BANC OF AMERICA SECURITIES: Thanks very much. I have a few questions as well. In light of giving no forward guidance, can you at least on a current quarter basis give us a little bit more color on the breakdown of revenue and OIBDA, domestically and internationally, both for Recorded Music and Music Publishing?

Second, I had the same question about the pipeline and if you're not going to give guidance and you're not going to give us a fuller list of what the pipeline looks like over the next few months, what is your recommendation about how investors should think about the business over a six to 12-month time period in terms of expectations?

And then lastly, just kind of a housekeeping question. Can you give a little bit more color about the $33 million special one-time bonuses for the options? Do employees in that include the management group that also received the management termination fee? About how people did that cover? That would be helpful as well.

Michael Fleisher Why don't I start on the last question first, the 33 million. That is primarily made up of key stock issues related to a difference in the price just before IPO time versus the prices that options and stock were granted or sold to employees over the past year. That will be, those payments go to a little over 100 people in round numbers.

They do include some members of the management group that received bonuses in the past, specifically none of those payments are going to Edgar or Lyor, which I think was sort of one of the more detailed questions we've received before, and they are simply to make up for changes in strike price or tax impacts that the change in share value will cause for the employees at that time.

And then in addition there was a $10 million IPO bonus that was paid. That bonus is being paid to all employees of Warner Music Group that are not in some way, shape, or form option holders or shareholders.

MICHAEL SAVNER: Okay.

Michael Fleisher It is not being paid to anyone who is an option or a shareholder.

On the domestic international split, we are going to, we will continue to give everyone on a quarterly basis the global split. It was 53% international, 47% domestic in Q2.

We're not giving a split for Recorded Music versus Publishing, though the Recorded Music business saw pretty similar performance U.S. versus international. Publishing business was a bit stronger internationally than domestic on a revenue basis.

MICHAEL SAVNER: Okay. And then the last question was about how we should think about the business over a period of six, 12 months, you know, in absence of guidance and in absence of a clearer look at your pipeline.

MICHAEL FLEISHER: Yeah, I mean, look, I think you need to look at two things. You need to look at the trailing 12-month performance of the business, largely because quarter-over-quarter on an annual basis are tough comparisons because release schedule changes from one quarter to another quarter. There's obviously seasonality but there's also release schedule changes that impact that.

So I think investors should look at the trailing 12 months, they should look at what we're saying we're going to do. As an example, like we said, a year ago in terms of the restructuring, and then how we execute against that, and then each quarter we'll talk about the releases that we've put out and people can get a sense of how they feel about the artists we have, the roster we have, and our performance going forward.

MICHAEL SAVNER: Okay.

OPERATOR: Thank you. Our next question comes from Richard Greenfield, Fulcrum.

RICHARD GREENFIELD, ANALYST, FULCRUM GLOBAL PARTNERS: Hi. Good morning. Two topics for questions. One, relating to digital. Could you give us some sense of the composition, what are driving those digital revenues or how do they breakdown? And then [inaudible] that, when you sign a new digital contract specifically for content, like for music videos on-line, how do you account for contracts like that?

And then the second topic, just related to returns, you've made some changes in how you run your business that I believe have helped your returns over the last couple of quarters. Could you give us some sense of what those changes are and what type of numbers in terms of how they've benefited you percentage-wise year-over-year? Thanks.

Edgar Bronfman, Jr.: Rich, it's Edgar. I'll do the digital breakdown and then maybe Michael can do how we account for those videos and other kinds of contracts and talk a little about our returns rate, which indeed has come down.

Digital I believe was roundly 60% download, 40% mobile. That we believe mobile will significantly increase as a percentage over time. Of the mobile downloads, excuse me, of the mobile revenues, almost all of that was ring tones, or ring backs.

The robust full track downloads and full music video downloads are a pretty nascent business today, though we think in the calendar fourth quarter of this year we'll begin to see a significant step-up in those revenues.

MICHAEL FLEISHER: Rich, the majority of our digital revenues are accounted for on a cash basis, largely because until we have really good reporting from digital service providers it's hard to do it on an accrual basis.

So largely we wait until we get the money and a breakdown of why we were getting that revenue and then we account for it. There are a few, as we get better and better reporting from the digital service providers where we will actually start to account for them on an accrual basis, but at this point the vast majority of that is done on a cash basis.

In terms of your third question on returns, our returns performance has shown some improvement year-over-year, largely because we're a lot more intense in terms of how we're managing returns. We're very focused on how we're pricing the product up-front, the relationship we have with our physical retailers and making sure that we aren't incenting anyone to sort of order more product than they need. And so because of that I think we're a lot tighter there and generating a little bit better returns rate, and we would expect that performance to continue over the next several quarters.

RICHARD GREENFIELD: And could you just follow up on the cash basis in terms of how you account for those contracts? Were there any contracts that you've been getting for these new types of content deals that you've been signing that have had any up-front payments that have been booked on a cash basis, or are they really spread out in terms of the cash that comes in over time?

MICHAEL FLEISHER: No, it's all spread out over time.

RICHARD GREENFIELD: Thank you.

OPERATOR: Thank you. Our next question comes from Laura Martin, Soleil.

LAURA MARTIN, ANALYST, SOLEIL SECURITIES: Can you hear me okay?

Edgar Bronfman, Jr.: A little louder would be great, Laura.

LAURA MARTIN: Question for Michael just going through the 10-Q. I guess my primary question is related to the $39 million unrealized gain on warrants, and I guess Time Warner said at their annual meeting and you guys disclosed here you've now sold that position, or you're out of that position by buying in their warrants for 138 million. So my questions are two-fold.

First is, starting in fiscal Q4 will we not to have worry about this line item at all, and therefore it will no longer affect diluted EPS and it will no longer be a required line item in your statements?

And then can we presume in the current quarter, having bought out the Time Warner position pretty close in date to the March 31st deadline, or statement date, that you will actually have a realized gain in the current quarter from buying that position from Time Warner?

MICHAEL FLEISHER: No, Laura, the answer to your first question is yes, by the time we get to the fourth quarter the Time Warner warrant will be out for that period, and its associated gains. Obviously it will remain in when we look at the full fiscal year, but for that quarter, it will be out.

In terms of this quarter, the third fiscal quarter, or the June ended quarter, you'll see the sale transaction in that quarter. There won't be a gain because we basically, we booked the gain, the market price, in the second quarter results. So that's the $39 million.

LAURA MARTIN: Gotcha. Okay. That's exactly what I wanted to know. Okay. Yeah. That's it. Thanks.

MICHAEL FLEISHER: Thank you, Laura.

OPERATOR: Thank you. Our next question comes from Bishop Cheen, Wachovia.

BISHOP CHEEN, ANALYST, WACHOVIA SECURITIES: Good morning, Edgar, Michael, and Jill. Couple of questions going to the balance sheet. In the Q, I don't believe there was a pro forma but I just don't want to screw this up because there were so many moving parts. The discount notes that are left in, the accreted value pro forma is something like 169 million, is that correct?

MICHAEL FLEISHER: I don't know that I have the accreted value in front of me, Bishop. It sounds directionally correct.

BISHOP CHEEN: Okay.

MICHAEL FLEISHER: I can tell if you I'm off. That's the 65% remaining.

BISHOP CHEEN: Right. And something like 197 million U.S. sterling at the [inaudible]?

MICHAEL FLEISHER: I'm sorry, Bishop, ask the question again.

BISHOP CHEEN: The sterling notes that were originally issued last summer of 2000 -- or spring of 2004, the sterling notes are still in place?

MICHAEL FLEISHER: Yes, they remain in place.

BISHOP CHEEN: Okay. And then the 250 million revolver that was undrawn of March 31st, in doing all of the special one-time cleanups of the balance sheet, warrants, et cetera, has that revolver been tapped now?

MICHAEL FLEISHER: We haven't tapped it currently. The revolver is there to sort of help us manage seasonal fluctuations, so we may draw it, but at this point we haven't ever drawn it in the entire time it's been available.

BISHOP CHEEN: And the entire term loan is like 1.45 billion?

MICHAEL FLEISHER: Correct.

BISHOP CHEEN: Fully drawn.

MICHAEL FLEISHER: Correct.

BISHOP CHEEN: Okay. I feel like I got the balance sheet. All right.

And then as you've alluded to, Q3 is going to be bumpy and Q4 is going to be bumpy. Did I misunderstand but the first time that it's going to be the least bumpy is on the expense side for special one-time expenses is going to be Q4 because you're going to show and book in Q3, the June quarter, one-time expense layouts?

MICHAEL FLEISHER: Bishop, I'm not exactly sure what bumpy means, but what I can say is this. In the third quarter we will have a number of one-time charges, both expense items and cash items. We'll obviously detail those out for everyone when we announce the results. We've disclosed all of them in advance.

If you take those aside, the third quarter on a cost basis, expense basis, is the first quarter that we will have a true apples to apples comparison because most of the restructuring work was done last year at the same time, so you are comparing an apples to apples. I think it is fair, to your point though, that our fourth fiscal quarter, the September quarter, will be clean in that it will not have these one-time events and will be also an apples to apples comparison on the expense side.

BISHOP CHEEN: Right. Okay. That is very helpful. And then last question is, is there anything that you can and will be doing to hedge foreign exchange risk, currency risk, since you have a significant part of your economics coming from international?

MICHAEL FLEISHER: We have some, look, we have a natural, some natural hedge in that though we have a good chunk of our revenue coming from foreign jurisdictions, we also have a good chunk of our expenses in foreign jurisdiction. We do some modest hedging in terms of some of the internal movements of capital that we do for tax planning purposes, but besides that, it's really sort of cost prohibitive to be a much more substantial hedger and at the earnings line, the currency fluctuations, even with the dramatic changes we've seen over the last several quarters, haven't had a big earnings impact.

Obviously it impacts our revenues, either positively or negatively, and we'll continue to report both the pre and post foreign currency exchange rate numbers to you so that you can see that impact both positive and negative.

BISHOP CHEEN: Right. So it is a double-edged sword.

MICHAEL FLEISHER: Correct.

BISHOP CHEEN: Okay. All right. I think that's the end of my grand inquisition. Thank you.

MICHAEL FLEISHER: Thanks, Bishop.

OPERATOR: Thank you. Our next question comes from Guy Lamming, Cazenove.

GUY LAMMING, ANALYST, CAZENOVE & COMPANY: Thanks. Two questions if I may. First one is, back in 2000 when the Warner EMI merger was proposed, I think the cost savings promised were around $450 million. Given the size of those savings, what would hold you back from pursuing a merger with EMI?

And the second question is, we've seen some pretty rough trading conditions in continental Europe, particularly France and Germany. Could you give us an update as to how those markets are looking right now, please?

Edgar Bronfman, Jr.: Let me answer the second question first. Continental Europe generally is a little bit softer than we'd like to see through May. I don't have any numbers for the first week of June yet, but through May continental Europe has been somewhat softer than we would have liked to see, similar in a sense to the U.S. Whether this is release-related, as we think it is in the U.S., or has other factors, we're not sure.

And we're hopeful, to get to your second question, that among other things, EMI's release of Coldplay will be a robust international release and we wish them well and that release well, as any strong release is good for the music market.

I think beyond that, I don't think it makes any sense to speculate on merger activity and I think we probably ought to just leave it at that.

GUY LAMMING: Okay. Thanks a lot.

Edgar Bronfman, Jr.: Thank you.

OPERATOR: Thank you. Our next question comes from Larry Hefiter, Pabelli.

LARRY HEFITER, ANALYST, PABELLI: Hi, Edgar. I was just curious as to whether you could give us the breakdown in the digital between domestic and foreign since the mobile has much more developed foreign.

Edgar Bronfman, Jr.: I will try and pull that for you. Of the 60/40 between downloads and mobile, it's going to be very close to domestic and international in that regard, which is the downloads are almost entirely domestic, and mobile is almost entirely international. But I don't have an exact breakdown for you, but it's going to be not far from that 60/40 breakdown.

LARRY HEFITER: And if you were, since you're in the not giving guidance category you don't have any guess as to what mobile revenues will be three years from now that you'd like to share with us, would you?

Edgar Bronfman, Jr.: Well, I don't think any of us have a crystal ball in that regard, but we're pretty confident that the analysts who are suggesting that overall digital revenues will be 20 plus percent of the market by '08, given our progress year-to-date and where we see the percentage of our revenues coming and growing, from all digital sources we think that number is attainable or even one that we can beat. How much of that will be mobile versus downloads, hard to tell, but I would suspect by '08 mobile will represent a larger percentage of revenue than will download.

LARRY HEFITER: And last question. It seems to me Q4 last year was just a terrible period for the industry, and I think your Company. Was that the case?

Edgar Bronfman, Jr.: Q4 last year, are we talking about our fiscal Q4 or the calendar 4?

LARRY HEFITER: The calendar Q4.

Edgar Bronfman, Jr.: Calendar 4 was, I think, a fairly tough quarter last year for the industry generally and we had no significant large releases in calendar fourth quarter. We hope for the industry that it will have a stronger calendar fourth quarter than it did last year and we're very optimistic about our own release schedule.

LARRY HEFITER: Great. Thanks, Edgar. Thanks, Larry.

OPERATOR: Thank you. Our next question comes from Rosalie Mormon, Citigroup.

ROSALIE MORMON, ANALYST, SMITH BARNEY CITIGROUP: Hi. Good morning. Just a very quick question most of them have already been answered. Basically on what's happened to Warner Music in Chile, can you give us a bit more detail about that and what the issues are, the internal controls and the impacts on business there?

Edgar Bronfman, Jr.: No, I don't think there's anything more for us to disclose at this point on that.

ROSALIE MORMON: Okay. Thanks very much.

Edgar Bronfman, Jr.: Thank you.

OPERATOR: Thank you. Our last question comes from Michael Savner, Banc of America Securities.

MICHAEL SAVNER: Thank you for the follow-up. Just to be clear, when you said Warner is down 3% on physical sales, I think you said year-to-date. Just want to confirm that's right, and if so, can you provide that same metric for the second quarter specifically?

And then Edgar, can you maybe just take a second to address on a more macro level your view of the physical market when it flattens out? Obviously down 3% year-to-date is quite respectable given that the trends of the last couple of years. Do you think you've reached that stabilization point now and especially considering that's with a reduced release list, or do you still think there's going to be a fair amount of volatility in the physical market and stability could be a year or two off? Your perspective would obviously be very interesting. Thanks.

Edgar Bronfman, Jr.: Just to confirm I did say down 3% year-to-date. I don't, do we have, and to be clear, that's based on Soundscan information, that's calendar year-to-date.

MICHAEL FLEISHER: Calendar year-to-date. Right.

Edgar Bronfman, Jr.: Do we have a number in the Q? If we have a number, Michael, we'll get that.

MICHAEL SAVNER: Okay.

Edgar Bronfman, Jr.: In terms of my own view of the physical market I think we need to remain somewhat cautious. The market is down 7%. I think that this week Soundscan should see a more robust week, obviously with the release of Coldplay, White Stripes and Black Eyed Peas and others. And given our own release schedule we feel reasonably good about, as we've tried to say, about our fiscal year as a whole, those as we said would be more fourth quarter weighted.

I think though that it's a little early to call a stabilization in the physical market. I would like to say it and I'd like to see it, but I think it's a little early to say.

What I do think is that I think it's unlikely, sitting here today, that the physical market will return to the kinds of declines that we saw when piracy was at its most robust in sort of '01 and '02 and into '03, but whether we're absolutely flat or we tick along at a couple of points down is really very difficult to tell at this point.

MICHAEL SAVNER: Thank you very much.

Edgar Bronfman, Jr.: Okay. Well listen, I'd like to thank everyone for being on the call. We're very, as I said, pleased with where we are in terms of our restructuring completion, getting the management in place, being public, and we're now ready to seize the market opportunities as they develop. Thanks again for your interest.

OPERATOR: Thank you for participating in today's call and have a good day.

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