Spotlight on music copyright royalties

Why active song management is key to hitting the high notes

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The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested. Where past performance is shown, please note that this is not a guide to future performance.

In this piece, we provide an insight into what we believe to be a growing investment opportunity in music copyright royalties. This innovative asset class is steadily gaining recognition as an investable market with potential long-term growth prospects underpinned by structural growth drivers, such as music streaming. We also explain why we believe taking an active approach to song management could be key to capturing the opportunity, and talk about an investment example we have made in this area.

Are royalties ready for the big time?

Music is always being consumed, it surrounds us wherever we go and technological advances are helping to change the way we consume music.

In the past, we purchased physical recordings, listened to the latest hits on the radio, watched music TV or listened to music played on-stage. While we still do all of those things, we can also consume music online, either by downloading or streaming music to our devices. The more ways there are to consume music and the easier it is to consume; the more consumption grows. Additionally, mobile device ownership and usage is increasing, helping to boost music consumption. The penetration of mobiles in emerging markets is forecasted to grow significantly in the coming years, a key driver of structural growth.

COVID-19 has also impacted the way we consume music. With people confined to their homes, the restrictions on live music performances and fewer new album releases has boosted the online consumption of existing music catalogues, as UK industry figures in 2020 indicate[1].

These structural shifts are certain to continue, we believe. With the potential for significant revenue growth driven by music streaming and the constant evolution of new media platforms that combine audio, visual and social content, there are interesting opportunities for investors who can build diversified portfolios of music copyrights.

Music copyright royalties could offer underlying investors attractive risk-adjusted returns and annuity-like cashflows. If investors including asset managers, who deploy capital by purchasing music copyrights, establish a management platform with the necessary capabilities – by teaming up with music industry professionals – there is also potential to add value to song catalogues through active management and boost revenue through alternative uses of the copyrights, like placement of songs in TV, films, advertisements and video games or in covers or samples recorded by new artists. These management platforms typically comprise a group of professionals working together to add value to catalogues, and in some cases, these platforms can be structured as a separate company that works exclusively with an investor.

Structural growth drivers – Streaming is here to stay

When a song is written or recorded a new music copyright is created. As long as the copyright is correctly registered with the relevant global agencies, every time a song is downloaded, streamed, played, performed or otherwise used it generates royalty income. There are two basic types of music copyrights that can generate income:

- Master copyrights ('Master Rights') – A right to income that attaches to a particular recording of a song
- Publishing copyrights ('Publishing Rights') – A right to income that attaches to the song composition generally, rather than a particular recording.

Master Rights and Publishing Rights receive different shares of the income that is generated when a song is used.

[1] BBC News, "UK music streaming hits a high note amid the lows of Covid", 4 January 2021.

There are three basic types of use that can generate income:

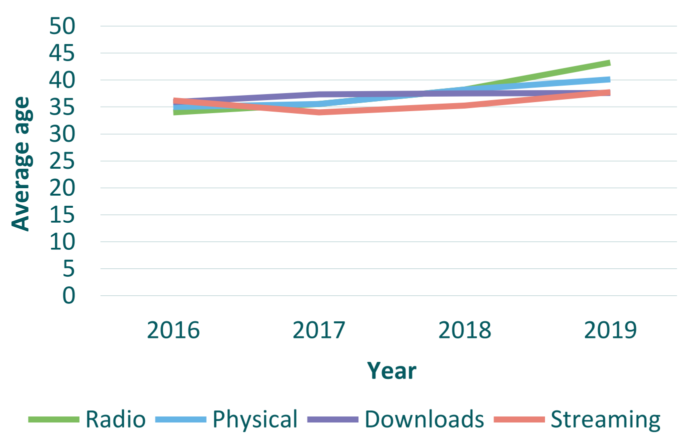
- Mechanical use – Triggers a payment when a copy of a song is made, either in a physical form (CD, vinyl etc.) or a digital form (downloading or streaming to a device)
- Performance use – Triggers a payment when a song is performed live, played in a public place, broadcast on TV or on the radio, or when a song is streamed online
- Synchronisation use ('sync') – Triggers an extra payment/licencing fee when a song is licenced for use in combination with any visual medium, including film, TV or online media.

The more music is consumed, the greater potential for royalty earnings. Although it's worth noting that actual royalty income collected also depends on how music is consumed as much as how often its consumed, given different royalty rates attached to different formats and mediums.

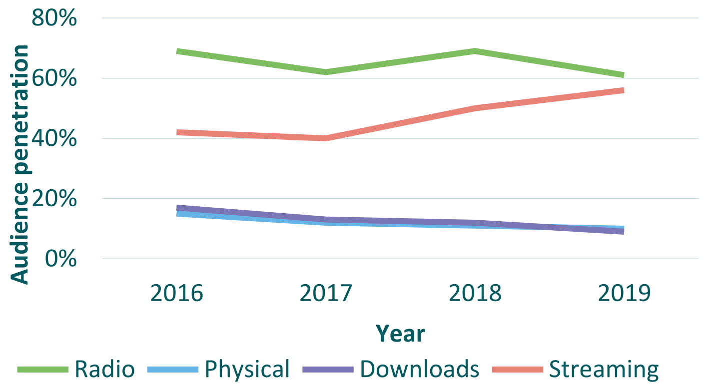
Consumption of music is changing, with the growth of streaming the biggest trend. Consumers are increasingly looking to rent music – rather than buy and own – with a range of subscription streaming options with multiple price points that cater for consumers willing to pay for better access and convenience, and offer a personalised listening experience.

Figures 1 and 2: The growth of streaming. Average age and penetration of music format audiences, Q4 2016-Q4 2019, US, UK, Australia

Average age of audience



Penetration of audience



Source: MIDiA Research Consumer Surveys Q4 16, Q4-17, Q4-18, Q4-19, n = 4,000. Note: Data refers to CD buyers, download buyers, streaming refers to free + paid, radio refers to audience. Past data is not an indication of future trends.

Music on-demand: Today, music is a key component of all content streaming and has continued to displace radio broadcast – unlimited streaming services can help increase the popularity of newer songs and also allow users to stream music they haven't heard in a long time, potentially increasing the value of older song catalogues. In a report commissioned by M&G, MIDiA Research concluded that streaming is the most important driver of value growth for music catalogues over the medium term. Digital platforms and streaming services are becoming mainstream with growing penetration in both developed and emerging markets set to continue, with the major platforms also looking to expand into new markets. Shifts in streaming user demographics will also shape the evolution of music catalogue consumption. Research from JP Morgan forecasts huge growth in streaming subscriptions, from 200 million today to an estimated two billion worldwide by 2030, as cited in a BBC News article[2].

Don't stop the music

Live music in the COVID-19 era has been severely impacted; the pandemic has forced the postponement or cancellation of music events, concerts and festivals under government guidance. Unable to perform or go on tour and feeling the financial hit, artists are chasing royalties to generate income, particularly from existing back catalogues.

In 2019 in the UK, live music generated £54 million in Performance royalties, an increase of £15 million from 2018[3] boosted by major tours from top recording artists. Similarly, artists can earn royalties when songs are played in public places, like shops, restaurants, pubs and clubs – a revenue source that generated £168.2 million in the UK

[2] BBC News, "Can hit songs be worth more than gold?", 26 June 2019.

[3] BBC News, "Music royalties reach a record high - but a storm is coming", 14 May 2020.

in 2019. In the COVID-19 era, royalty income generated from a rise in online music streaming has helped to partly offset the depressed earnings from the ban on live music performance and lost royalties from the drop in music being played in public venues that have been forced to close due to lockdown restrictions.

Global recorded music revenues look set to grow, with Goldman Sachs forecasting revenues to effectively double by 2030[4]. The advent of paid music streaming over recent years has injected new life into the music industry, after years of dwindling revenue and the existential threat from illegal downloads, and paved a new way to generate royalty income for copyright owners. According to an article by Deloitte, streaming accounted for 80% of overall recorded music revenues in 2019[5]. Moreover, analysts at JP Morgan Cazenove had estimated that streaming can continue to grow music revenues by 10% per annum by 2030[6].

While music streaming in the UK brings in more than £1 billion each year in revenue[7], payments per stream from the major platforms are low. They are received whenever a song is played or 'streamed', with the payment to music rightsholders allocated on a pro-rata model that is based on a song's overall share of streams. Therefore those managers that seek to actively manage the song catalogues by looking to increase a song's popularity and profile, for example, could increase its royalty revenue potential.

What is the opportunity

Acquisitions could target full or partial ownership interest in songs or catalogues, and could target Publishing and/or Master copyrights. This gives the catalogue owner the greatest opportunities for active management and ensures that no matter how music consumption changes in the future, the catalogue owner gains the greatest share of revenue generated. In the US and Europe, copyright interests last 70 years after the death of the song writer or last co-writer (if the song is co-authored), so if artists (song writers, recording artists) sell the copyright during their lifetime then they can monetise the future value of those revenues today.

The availability of (large-scale) song catalogues tends to be limited and subject to auction where purchase prices can be bid upwards due to competition for assets. In its report, MIDiA Research reveals that music catalogue acquisitions have accelerated sharply since 2015 in both value and volume terms. The report also notes that "a catalogue's earnings are evaluated across the history of all the different songs in that catalogue – a whole catalogue will have an average dollar age across all the songs, so the higher dollar age, the more valuable the catalogue." Song catalogues are purchased either because the acquirer assesses the catalogue to be of long-term value or already has a proven commercial worth, or because the acquirer believes the catalogue is undervalued and they can inject new value.

Music royalties is steadily gaining recognition as an investable market with long-term growth prospects underpinned by structural market growth drivers like streaming, as well as opportunities in online media placement and usage to generate additional royalty income from song catalogues relative to the old, physical model of music consumption. Importantly for investors, it may offer them a unique opportunity to access a growing, specialised market with the ability to reach scale quickly.

The increased competition for catalogues has reduced the returns from acquiring large catalogues (asset values over $20 million) and passively managing those assets. Furthermore, recent consolidation of the publishing market via acquisitions of prominent independent music publishers, for example Pulse Music, Big Deal, SONGS, has left an opening in the middle of the market for active copyright management. While acceptable risk-adjusted returns can be achieved from large passive income portfolios, the highest returns are potentially available from targeting smaller catalogues (asset values of $1 million to $20 million) where there is less competition, and using a specialist management platform (comprising experienced music executives and creatives) to actively manage a consolidated portfolio.

What are the benefits for investors?

Music copyrights can offer potentially enhanced risk-adjusted returns and annuity-like cashflows, particularly if investors target smaller, underutilised catalogues and actively manage assets using a specialist team. Such an approach provides a unique risk-return profile and low correlation with the returns of most traditional and alternative asset classes. It could therefore provide an uncorrelated and diversifying source of long-term, stable income.

Music copyrights could provide investors with more resilient income streams against a backdrop of wider economic uncertainty, in part due to the consistent use of music throughout the economic cycle and the forecasted growth in consumption through streaming. Music is widely consumed in various formats and mediums, and

[4] Goldman Sachs Global Investment Research, "Music in the air 2020", as at 2020.

[5] Deloitte, "How streaming is changing the music industry", 10 June 2020.

[6] As cited in the following article, "Music royalties fund Hipgnosis strikes a discordant note", 21 December 2019.

[7] The Guardian, "MPs to examine impact of streaming on future of music industry", 15 October 2020.

streaming services are comparatively lower cost so are relatively resilient to economic disruption and falling household disposable incomes. There is also the potential to grow income levels and achieve capital growth through active management of song catalogues.

How to access this innovative asset class?

We believe investment in music copyrights is well suited to long-term, flexible capital with the objective of building and structuring platforms that not only buy music royalties but also target new revenue opportunities.

Investment is typically via specialist strategies that have the flexibility to invest in private special situations financings and the skills and experience to take a hands-on approach to structuring investments that can unlock value and provide good outcomes for investors.

M&G has developed a track record in investing in both large passive portfolios and smaller, actively managed portfolios. Employing the latter approach, M&G has used its expertise to build its own music copyrights management platform alongside an experienced team of music executives and creatives, forming a company, Seeker Music Group (see 'Music royalties investment in action' section for more details about this investment).

We believe Seeker Music Group has the right management and resources in place to actively promote valuable songs and recordings, and develop strategies to create new opportunities to maximise the earning potential of a song through innovative placement and usage. In addition to experienced music executives, Seeker has built an internal creative licencing team tasked with maximising opportunities to generate higher income from royalties and licence fees. This team also enables Seeker to exercise creative control over assets to boost their synchronisation royalties (greater placement of songs in TV, films, video games and advertisements).

Creative licencing teams are also looking to tap into future growth drivers as well as current opportunities, including digital-first media platforms that combine audio, visual and social content and immersive entertainment (virtual reality, augmented reality), for example. Digital media platforms, such as Instagram, YouTube, Reels and TikTok (user generated content), where music has become a greater part of the business model, are expected to continue to grow and generate incremental revenue streams for copyright owners.

Taken together, we believe these capabilities make Seeker Music Group very well-positioned to benefit from the growth in music consumption and generate potentially attractive returns for M&G's investors via access to specialist strategies that have the flexibility to invest in these types of investments.

Music royalties investment in action: Seeker Music

Investment overview: To partner and build a management platform that buys music copyrights. Joint investment by M&G's Debt Opportunities and Catalyst teams, which form part of the Private & Alternative Assets business at M&G.

The platform will enter into licencing agreements under which it will receive payments attributable to the copyright interests in the songs which it owns. These payments may take the form of royalties, licence fees and/or advance payments, including: mechanical royalties; performance royalties and synchronisation fees.

Diversified musical content strategy

The platform aims to build a high quality, diversified portfolio of songs over time. The platform will selectively acquire song catalogues of numerous song writers and artists across a range of genres. Catalogue acquisitions are expected to have a maximum value of $20 million and be supported by active management, which differentiates the platform from the larger platforms that target larger catalogues and passively collect royalties.

Experienced and well-connected leadership team

After extensive due diligence, a core management team was put in place to source attractive investment opportunities and effectively manage the portfolio. We appointed a CEO, COO and CFO who have proven track records in the acquisition and active management of music copyrights. In turn this executive team has built a creative capability for Seeker Music Group.

Active management – greater creative control over assets

Management has built its own internal creative licensing team that assists with the active management of songs. Given strong structural growth drivers already in place in the market, we believe there is potential for strong revenue growth from paid music streaming and synchronisation of songs in film, TV, advertising and other digital-first content streaming opportunities by taking greater control of the assets and developing new opportunities to extend the earnings lifecycle of each song.

Poised for growth

We would be looking to target a potential mid-teen IRR (internal rate of return) from such an investment, depending on the nature and timing of our exit.

Source: M&G, as at January 2021.

www.mandg.com/institutional

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