

## **Spotlight – Music Royalties**

Related to this quarter’s discussions on the subset of real asset strategies characterized by contractual cash flows (credit-like in nature), one strategy where RockCreek has been focused is music royalties. In this spotlight, we will define investable music assets and their revenues, the various approaches to investing in music assets, and the prevailing market opportunity.

Music royalty strategies are focused on investing in music assets, which may include royalties, interests in royalties, intellectual property, or other contractual rights to receive revenue generated from the sale, distribution, licensing, or exploitation of music assets.

The revenues – cash flow or income – associated with music assets may be generated from either “publishing rights” or “master recording rights.” Publishing rights are formed through a contractual agreement between a songwriter and a music publishing company, which markets the song, collects the income generated, and distributes the income to the beneficial owner(s). The master recording is a copyright associated with the original recording of a song by an artist. The master recording is initially owned by the record label, while the artist receives a royalty. The record label collects the revenues associated with the master recording and distributes income to the relevant beneficiaries.

Publishing rights generate income from three primary sources: (i) performance, (ii) mechanical, and (iii) synchronization. Performance revenues are generated when a song is performed publicly such as during live performances; radio broadcasts; or broadcasts at sporting events, bars, restaurants, and non-interactive formats. Mechanical revenues are generated in exchange for the right to use a song for either physical recording or digital downloads. Synchronization revenues are generated from music used in timed synchronization with media such as movies, television shows, or advertisements. Separately, master recording rights will generate revenues through the physical sales of recorded music – such as CDs or vinyl records – digital downloads, streaming, and synchronization.

Both publishing and master recording rights are protected by statutory law and governed by an original copyright and/or a purchase agreement. The legal life of a copyright is defined as the life of the author plus 70 years, at which point a copyright is expunged and the song enters the public domain. In the case of a sale or transfer of a copyright, US law specifies that the copyright reverts to its original author (the songwriter or artist) 35 years after the date of original transfer. Importantly, an income or revenue stream (a royalty) may be sold separately from a copyright. Royalties do not transfer copyright ownership; they simply compensate the rights-holder for the use of their work. Royalty rights are defined in a purchase agreement, and holders of royalties may perfect their interest by filing lines in specific jurisdictions such as key music centers, or across all 50 states.

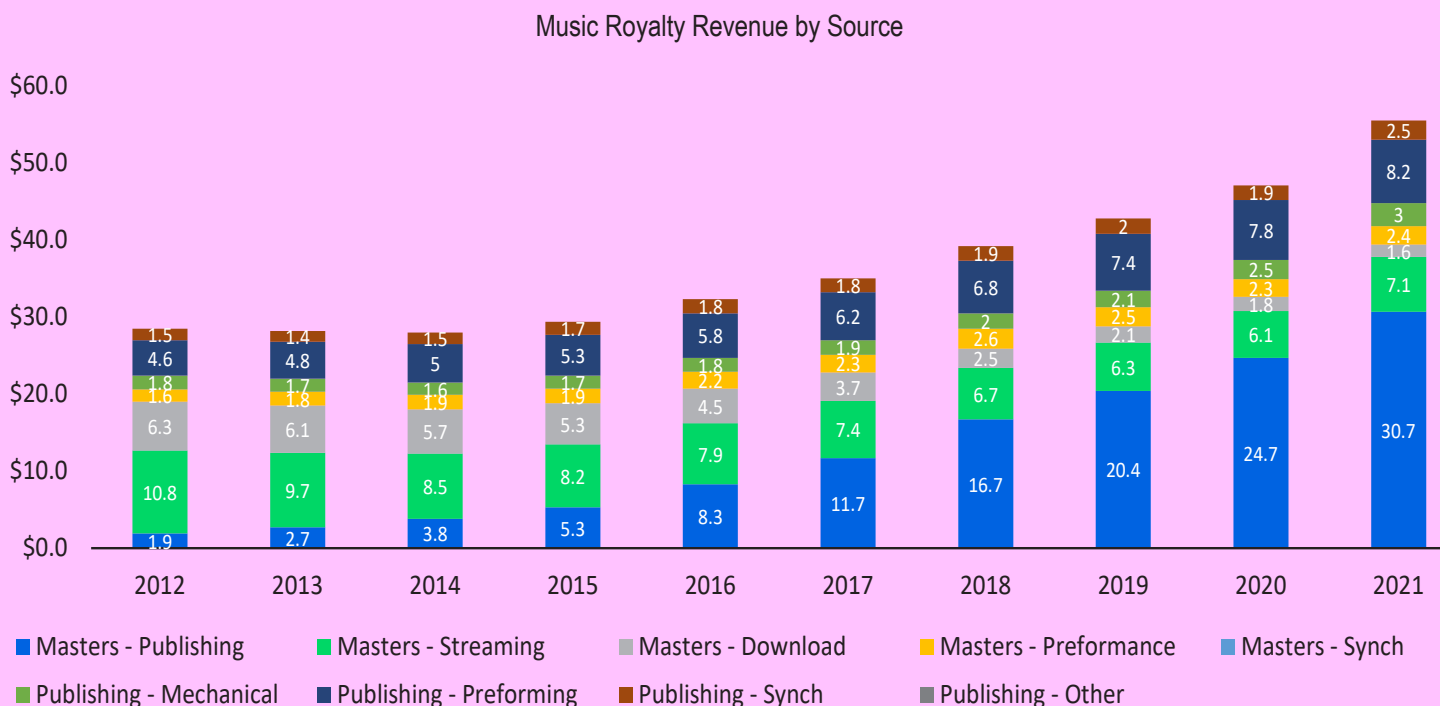
Different participants in the music royalty space will take different approaches to generating investment returns, ranging from being more “financial driven” to being more “music driven.” The former approach tends to be more focused on acquiring stabilized cash-flowing assets that can easily be levered, with value accretion driven primarily by an aggregation or portfolio premium. The firms that execute this strategy tend to be more

capital markets savvy. The latter approach tends to be more operationally intensive, with a focus on creating or acquiring newer assets that should benefit from surging popularity and the ability to grow existing cash flows. The firms that execute this strategy tend to be vertically integrated music platforms with capabilities that include talent acquisition, synchronization, marketing, and servicing.

The investable market for uncorrelated music assets is massive – currently estimated to be between \$30 billion and \$40 billion in aggregate size and growing constantly as new songs are written, recorded, and disseminated through ever-evolving distribution channels. While it’s true that the physical sale of music through CDs, vinyl records, or even digital downloads has declined, technological advances in consumer electronics (especially smartphones) and digital media such as streaming sites and social media are changing global consumer consumption. As explained by the music asset investment firm HarbourView Equity Partners, subscription streaming offers a new value proposition to consumers, distributors, labels, and ultimately content owners by providing immediate access to large libraries of music, increasingly in a personalized and universal offering, as evidenced by the increased market share of Spotify.

Through streaming formats, consumers are experiencing personalized curation driven by data analytics, encouraging longer and more passive listening compared to searching on a title-by-title basis. With penetration increasing across pay-tv, smartphones, wireless broadband, and other platforms that include smart speakers and connected cars, more consumers can enjoy music in more places – and on more devices – than ever before. Streaming has increased not only the amount of time the average consumer spends listening to music but also the total number of consumers using musical composition recordings. Moreover, streaming remains an under-penetrated distribution channel outside the US, offering significant growth potential.

Figure 10. Music royalty revenue has doubled in the last 10 years



Source: Goldman Sachs