



Music Royalty Funds Charm Wealthy Investors

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Music may soothe the savage beast, but it also calms the wealthy fund investors who earn double-digit returns on the rights to some of the world's most famous melodies.

Round Hill Music Royalty Partners, Kobalt Capital and Bicycle Music all offer private equity funds that allow high-net-worth investors to share in the revenue-generating potential of some of the most popular songs ever recorded, across multiple generations and music genres. The investment model is simple and has been used by some of the world's largest pension funds and private equity firms, including the Ontario Teachers Pension Fund and KKR. The funds acquire the rights to catalogs of music and individual songs, which they own for a specified number of years. Every time one of those songs is played, purchased or used for any commercial purpose—anywhere in the world—the fund collects the royalties and investors earn returns.

Multiple sources drive income to the funds. Among them, downloads from Apple's iTunes service, which surpassed 25 billion song purchases in February 2013. A 99-cent download on iTunes generates 9.125 cents to the owner of the song's publishing rights, according to Round Hill CEO and Chairman Josh Gruss.

Income streams also include radio plays, CD purchases, live performances, music-streaming services, cell phone ring tones and even the Muzak played in an elevator. If a filmmaker, television producer, advertiser or video game developer wishes to license a song, it must negotiate a fee with the publishing rights owner, who then receives royalty payments every time the film, TV show or commercial is shown and on every game unit sold.

For example, Round Hill owns the rights to *Land of a Thousand Dances*, written by Chris Kenner and popularized by Wilson Pickett in 1966. The song appears in the movie *Forrest Gump* and various video games, and still receives significant radio play. That one song generates royalties of \$300,000 to \$400,000 a year, according to Gruss.

Those royalties enable music funds to produce "annuity-like cash flow streams," said Gruss, whose \$200 million Round Hill Music Royalty Fund raised \$52 million in its first closing. "Much like an MLP or REIT, we are set up to have the royalty income distributed down to the investor. It's uncorrelated

to the stock market or the price of oil or real estate. It's its own beast and that's why investors are interested," he said.

The Round Hill fund has 15 investors, including limited partnerships, family offices, foundations, and wealthy individuals, Gruss said. The fund's portfolio includes more than 4,000 songs recorded by artists such as Frank Sinatra, Billie Holiday, the Beatles, Aerosmith, and Bruno Mars.

Kobalt Capital started its investment fund in 2011 and has attracted more than \$70 million, mostly from family offices, foundations and ultra-rich investors. The fund owns a catalog of more than 4,000 songs, including popular works by the B52s and Fleetwood Mac, and takes a two-pronged approach to investing in music publishing rights, according to CEO Johan Ahlström.

"We buy copyright catalogs and we also make royalty advances, which effectively become secured loans collateralized by catalogs, so we have great diversification," said Ahlström. "We also have the ability to get active songwriters who have ongoing future music deliveries, which offers some interesting upside," but poses more risk.

Founded By Neil Diamond

Bicycle Music Co.'s pedigree dates back to 1974, when it was founded by Neil Diamond and his business partner, David Rosner. The company changed hands a few times, but, through its investment manager, Alchemy Copyrights, it is currently raising money for its third music royalty investment fund.

Bicycle CEO and Chief Investment Officer Roger Miller declined to disclose the amounts invested in the funds. More than 40 investors, including wealthy individuals, pension plans and insurance companies, are participants, he said. Bicycle's funds have acquired about 100 catalogs of all sizes, including songs by Tammy Wynette, Cyndi Lauper, Marvin Hamlisch, and Nine Inch Nails.

"The primary purpose of the funds is to acquire the underlying rights, primarily publishing rights, but also master recording rights, likeness rights and other rights that underlie classic music that's been around for a while and will continue to be around for a while," said Miller. "We pass through all the net cash to our investors, so it's a true cash-flow product for pension plans and other investors who need income to meet liabilities or cost of living needs."

Returns exceed 10 percent, Miller said. The minimum investment is \$1 million.

Rock Hill's Gruss declined to discuss his fund's returns but noted that industry expectations are in the 10 percent to 13 percent range. "It's a current income vehicle, so we expect a high coupon type of yield," said Gruss. Round Hill distributes all royalty income to investors semiannually, in cash.

Kobalt's Ahlström said his firm offers investors a choice between two share classes. One allows them to stay invested and roll up their value for an exit; the second pays ongoing dividends. The firm

targets an internal rate of return of 12 percent to 14 percent and “high single-digit” ongoing yields. The firm has reopened its fund and is raising capital, with a minimum investment of \$3 million. Ahlström expects the capital raising to close by the end of the third quarter.

In addition to stable income and returns, music royalty funds also offer tax advantages for U.S. investors. “Extremely tax efficient. You can amortize the copyrights over 10 years so the amortization expense shields the royalty income. You defer your tax payments until the time you sell the asset,” Gruss said.

All three firms also try to maximize income by administering the royalty and publishing rights of the songs they control. Each has creative, marketing and accounting teams that seek out licensing opportunities and ensure that all royalties owed are paid. Each firm administers publishing and royalty rights for a roster of artists whose songs are not necessarily owned by the investment funds.

“We’re at a very opportunistic time to get into this space because the digital world is allowing music to go places where it was never distributed before,” Gruss said. “Growth is coming from the international market. Seventy percent of the royalties we earn are from outside the U.S. If you think about a country that 10 years ago maybe had 10 TV stations, today it may have 100. All that programming requires music and we earn a royalty every time one of our songs is used.”

“Music is the engine of the digital world,” he said.