Music royalties: a surprisingly tangible investment

By Mike Pinggera, Head of Multi-Strategy

While there's nothing quite like hearing one of your favourite songs on the radio, imagine if you also got paid every time a classic hit received airtime? This is one of the reasons we invest in music royalties within the Sanlam Real Assets Fund.

Although music royalties may not be thought of as a real asset like a road or building, there is something strangely tangible about hearing a well-known song and realising you own the rights to it.

We have exposure to this relatively young asset class via the Hipgnosis Songs Fund Limited, which listed on the London Stock Exchange in July 2018. It has so far acquired 1,230 songs, which have achieved 1,646 top 10 chart positions across the world. These include the English language version of Despacito featuring Justin Bieber, as well as Single Ladies, Rapper's Delight and Umbrella.

Hipgnosis are paid every time these songs are performed, regardless of the artist, streaming platform or media. Funds like Hipgnosis buy catalogues of songs and effectively own the writer's share of the songs. Although it is early days, Hipgnosis is targeting an attractive yield of 5% per annum – which is quite compelling in today's low interest rate environment.

From an asset allocation standpoint, music royalties provide an interesting means of diversifying away from other alternative investments and traditional asset classes. Brexit news flow and Donald Trump's tweets can influence the direction of equity and bond markets, but these factors are unlikely to dictate whether a song gets played or not.

The investment case for music royalties is also supported by an increasingly positive backdrop for the industry. Of course, the sector did experience a challenging period over the first 10 to 15 years of the 21st century, after the internet became a gateway for illegal downloading and file sharing. This led to a decline in revenues, which put significant pressure on businesses. In addition, copyrights became attractively priced, prompting an increased willingness amongst writers to sell their material.

The tide began turning in 2015 when global recorded music revenues increased for the first time since 1999, largely driven by technological disruption.

Since then, revenues and royalty income have continued to rise, buoyed by the growth in music streaming services.

The global proliferation of smartphones has played a key role in this turnaround by increasing the availability and ease of legal music consumption, most notably in emerging markets. Meanwhile, the introduction of ad-funded free streaming in developed markets helped to dramatically reduce piracy rates.

Streaming revenues surpassed CD and vinyl sales for the first time in 2017, marking the third straight year of growth in music revenues. The likes of Spotify and Apple Music have played a key role in the expansion of streaming revenues and it is no surprise that other big companies are also tapping into this space. For example, subscription streaming service YouTube Music launched last June, while Tencent Music raised $1.1 billion after listing on the New York Stock Exchange in December. These developments denote a big vote of confidence for the music industry.

We view music royalties as a welcome addition to a diversified real assets portfolio and its attractive yields quality satisfies one of the fund's aims of providing a stable and attractive income stream. It is an area that we will continue to explore for further investment opportunities.

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The Fund may invest in derivatives for the purposes of efficient portfolio management and hedging only . There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The Fund's expenses are charged to capital. This has the effect of increasing dividends while constraining capital appreciation.

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