

Round Hill Music Royalty Fund

Strong royalty performance

A healthy music-streaming market coupled with Round Hill Music Royalty Fund's (RHMRF's) attractive portfolio resulted in a strong net publisher's share (NPS) performance in 9M22, up 36.1% y-o-y to \$21.8m. Organic NPS growth from the original portfolio was 15.9% over the same period. Since its launch in November 2020, RHMRF has delivered a NAV total return (TR) of c 28.4% and 12.5% annualised (to end-December 2022 in US dollars), above the targeted annualised NAV TR of 9–11%. Rising interest rates have dented sentiment in non-traditional assets and RHMRF's share price retrenched notably in 2022. We believe the quality of the underlying portfolio will continue to be reflected in growing NPS, which in turn should support the NAV, and, ultimately, the share price performance.

RHMRF's TR since launch to 31 December 2022 (%)



Source: Refinitiv, RHMRF. Note: SI (since inception) annualised in US dollars.

Why invest in RHMRF now

Significant music royalty deals continue to be struck on the market, highlighting the inherent value in RHMRF's existing portfolio and pipeline. Manager Round Hill adds incremental value through active management, improving the use of synchronisation for advertising, TV and game trailers, film, television and stage shows. In our view, RHMRF's good revenue growth is supported by a resilient streaming market and formats such as social media, gaming and fitness. The industry agreement on Copyright Royalty Board (CRB) III and IV, setting US royalty rates (see [initiation report](#)), provides further positive impetus.

The analyst's view

RHMRF's NAV TR performance was due to the economic NAV rising to \$1.18 per share (from \$0.98 per share at launch) and dividends. The portfolio is valued using an 8.5% discount rate (page 5), still reasonably conservative despite rising interest rates and in line with peers. Due to the conversion of the 'C' shares in May 2022 (page 5) resulting in an increase in the number of ordinary shares, and a lag in royalty payment receipts from the recently acquired catalogues, dividend cover for the six months to end June 2022 was 0.8x. These revenues should come through from H223, so Round Hill anticipates dividend cover improving for FY22 and FY23.

Discount

The significantly widened discount (c 34% v c 5% 12 months ago) amid FY22's rising interest rate environment could serve as an entry opportunity into this portfolio of quality alternative assets.

NOT INTENDED FOR PERSONS IN THE EEA

Investment trusts
Special situations – music royalties

23 January 2023

Price **\$0.78**
Market cap **\$316.0m**
NAV* **\$480.7m**

NAV per share* \$1.18
Discount to NAV 34.3%

*Economic NAV at 30 June 2022, as reported by the company.

Yield (prospective) 4.5%

Ordinary shares in issue 407.6m

Code/ISIN RHM/GG00BMXNVC81

Primary exchange LSE

AIC sector Specialist – royalties

52-week high/low \$1.09 \$0.75

NAV* high/low \$1.18 \$0.98

Gross gearing** 19%

**As at 30 June 2022, defined as total reported debt to the latest reported economic NAV.

Fund objective

Round Hill Music Royalty Fund's investment objective is to provide investors with an attractive level of regular and growing income and capital returns from investment primarily in high-quality music intellectual property. To achieve this objective, it seeks to invest in a songwriter's copyright interest in a musical composition or song, together with the rights in the recording of these (known as the master recording rights), along with all other rights and assets considered relevant by the manager.

Bull points

- Strong mix of professional music and finance experience in core investment team.
- Relatively high predictability of returns.
- Prospect of more favourable regulation.

Bear points

- Competitive market for assets.
- Risk of overpaying for assets.
- Higher interest rates could undermine value.

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Fund profile: High-quality music royalties specialist

RHMRF listed on the Specialist Fund Segment of the London Stock Exchange (LSE) on 13 November 2020, with the IPO raising \$276.4m. It was the second UK-listed closed-end fund investing in music royalties (following Hipgnosis Songs (SONG), listed in July 2018). On 19 July 2022, the company's ordinary shares were admitted to trading on the Premium Segment of the Main Market of the LSE. The company also introduced an additional market quote for the ordinary shares on the LSE denominated in sterling, satisfying one of the criteria for inclusion in the major UK indices.

RHMRF's IFRS NAV is \$384.2m (as reported in the accounts on 30 June 2022) and the current market capitalisation is \$316.0m. The economic NAV (see the NAV reporting section below) was \$480.7m based on the audited \$1.18 economic NAV per share at 30 June 2022.

The company seeks to invest in music royalties with a proven track record and wide audience appeal. Further details of the investments are given below. It is worth noting that scale is of value in this industry. The more substantial the catalogue, the greater the bargaining power when it comes to negotiating licensing deals.

RHMRF targets an annualised TR to investors of 9–11% over the medium term, after fees and expenses. It also targets an annualised dividend payment of 4.5 cents per share, payable quarterly.

NAV reporting

RHMRF publishes NAVs twice a year as part of its reporting. Under IFRS, the songs in the company's portfolio are classified as intangible assets under IAS 38. The catalogues are held at cost and amortised over their useful life (which is determined at acquisition), less any impairment. The investment manager also discloses the fair value of the portfolio of songs as determined by the independent valuer, Citrin Cooperman (incorporating Massarsky, which we refer to in this report) using a discounted cash flow. This portfolio valuation forms the basis of what RHMRF calls the 'economic NAV' (SONG calls this measure 'operative NAV'). We note that 'economic NAV' might differ from the portfolio value, as the amortised cost has been used in the IFRS NAV in the accounts. In this note we refer to the economic NAV, unless we state IFRS NAV.

On 31 August 2022 the company announced its economic NAV per share of \$1.18 (as at 30 June 2022), up \$0.06 from the \$1.12 audited value reported in RHMRF's FY21 annual report (\$1.07 audited economic NAV per share at 30 June 2021). Massarsky used an 8.5% discount rate (unchanged from the 31 December 2021 valuation). The increase in the economic NAVs between December 2021 and 30 June 2022 was affected due to

- the strength of the portfolio's organic growth in earnings year-over-year, including an increase in the fair value of The Offspring and Eric Carmen catalogues;
- Massarsky's consideration of macroeconomic factors, including the growth of streaming revenue, the global growth of the recorded music industry, and the impact of a post COVID-19 environment in its analysis; and
- an increase in streaming mechanical royalty rates due to the CRB Phono Mechanical III ruling. Agreement was reached in summer 2022 after a successful appeal by songwriters regarding an uplift in historical rates from the 10.5% set for 2013–17 to 15.1% for the years 2018–2022. CRB IV for 2023–27 has been set at 15.35%, still some way short of the ambitious 20% hoped for but nevertheless an uplift over the previous period. RHMRF's investment in its rights administration and automation should give added impetus to the revenues being collected.

As stated in its FY21 report, RHMRF's board believes an economic NAV provides a meaningful alternative performance measure. The directors note that the values of catalogues owned directly by RHMRF are based on fair values produced by the independent valuer.

The company floated at \$0.98 economic NAV per share. The IFRS NAV per share was \$0.94 at 30 June 2022 (\$0.95 at 31 December 2021).

Industry developments

While the frenetic pace of deals in FY21 and early FY22 may have slowed, significant deals continue to be struck on high-profile music assets. Heavyweight private equity funds remain committed to the asset class, including Blackstone through its backing of SONG, Brookfield Asset Management's \$2bn investment in Primary Wave, Apollo Global Management, with its \$1bn investment in HarbourView Equity Partners, KKR & Co, Pimco, Northleaf Capital/Spirit Music Group and Lyric Capital Group. Weight of capital is important as it facilitates scale, with larger, diversified portfolios earning smoother revenue streams.

Rising interest rates have naturally undermined the relative attractiveness of music royalty revenues compared with other asset classes, but this does not detract from the underlying attractions, particularly with regard to perennial music content. The changed economic backdrop should, at least in theory, change the framework for transaction pricing. However, given the levels of interest in assets – especially the headline-grabbing rights portfolios – the adjustment in transaction values may not be as marked as might be expected in more liquid, shorter-term assets.

The resumption of live music events and tours is a clear positive, reinvigorating sales of legacy content as well as newly released material.

Streaming market update

On 31 October 2022, RHMRF's board noted 'the ongoing supportive market environment for streaming revenues demonstrated by a number of recent industry updates that are anticipated to have a positive impact on company revenues.'

The directors and the investment manager, Round Hill, believe that RHMRF's exposure to positive revenue trends in streaming services is significant, with approximately 50% of RHMRF's revenues derived from digital service providers such as Spotify and Apple Music across master, mechanical and performance royalties.

The company believes that the streaming subscriber growth continues to be the fastest growing area of the music business – the largest streaming service, Spotify grew its premium subscriber base by an extra seven million in Q322, one million above its target. At the end of Q322 it reported 433 million active users, including 188 million subscribers across 183 markets.

RHMRF also noted the recent news by Apple Music to increase its monthly subscription price for its streaming platform in the UK and the US by £1 and \$1, respectively. As the number of subscribers, songs and subscription prices on the streaming platforms increase, it is anticipated there will be a net positive impact on RHMRF's revenues.

These updates follow the positive news announced on 1 July 2022 that the US CRB had upheld the 44% staggered increase in streaming mechanical royalty fees dating back to January 2018, which is expected to result in increased fees payable to RHMRF.

Music as a utility gives defensive characteristic

Given the pressure on household budgets with high inflation and increasing cost of living pressures, the place of music subscriptions in spending will inevitably come under scrutiny. However, music has become akin to a utility as it is a common accompaniment to daily activities. In more economically challenged households, there may be a return to advertising-supported listening, rather than full ad-free subscription. However, we anticipate that the overall streaming market will continue to progress as older age groups become more accustomed to passive music consumption, with household penetration growth slowing in the more mature markets such as the US and UK.

There are other structural concerns, for example, industry commentators have highlighted the large number of music tracks being uploaded onto digital platforms and the advent of swathes of AI-generated content is likely to swell these numbers further. Having a high-quality portfolio weighted to classic tracks, such as that of RHMRF, is therefore a clear advantage in holding and growing share of listening.

Another potential challenge is the proliferation of short-form content, such as that on TikTok where short sections, rather than whole tracks, are used.

NPS trading update for the nine months to 30 September 2022

NPS (see our [initiation report](#) for detail) for the company's portfolio in the first nine months of 2022 was \$21.8m vs \$16.0m for the nine months to 30 September 2021, a 36.1% y-o-y increase.

The NPS from the original portfolio investment was up 9.7% y-o-y, with streaming revenue boosted further by advance licence fee payments from some digital services, which lifted the y-o-y increase to 15.9% organic. Streaming revenues were up 147.7% y-o-y, helped by what management describe as 'a large amount' from Audiam, an interactive streaming mechanical royalty collection agency.

Management reports that catalogues acquired in FY21 and early FY22 (see below) contributed strongly to the improvement. The Carlin collection had a particularly good Q322, after a relatively flat H122.

The nine-month report also highlights a 46.7% uplift in synchronisation revenues, with almost half of the gain generated by the licensing of Eric Carmen's track 'All By Myself' for use in adverts by Adobe and TD Bank.

Portfolio

Acquisitions

Since 29 December 2021, the group has announced six acquisitions of music publishing catalogues, master royalty income, recorded music income, neighbouring rights and publishing rights (for definitions, please see our [initiation report](#)). The investment manager mentions in its 2021 annual report, that its strategy is to acquire vintage catalogues across publishing, recorded music and neighbouring rights. Financial consideration remains key, but Round Hill avoids pure asset gathering without fiscal prudence.

The manager's non-quoted Funds Three and Three Plus have also continued to actively invest over the period and, along with the deals outlined above, a total of over \$200m has been spent on 40 assets. Notable transactions for the private funds have included the catalogue of Nancy Wilson of

Heart and the music royalty interests, including producer royalties and neighbouring rights, of the Canadian producer Bruce Fairbairn.

Exhibit 1: RHMRF's acquisitions since launch

Date of announcement	RHM's name for the catalogue	Number of catalogues	Number of songs	Value* \$m	NPS multiple	Generated revenues \$m	Funding source
Feb-21	Assets of Round Hill Fund One	38	>18,000	282	16.3x	>38m	Pipeline acquisitions
May-21	29.14% minority investment in the RH Carlin portfolio	1	>100,000	c 40	16.2x	Undisclosed	
Dec-21	Niko Moon	1	29	Undisclosed*	Undisclosed*	Undisclosed*	C Share proceeds
Dec-21	Rebellion	1	N/A	Undisclosed*	Undisclosed*	Undisclosed*	
Dec-21	The Richardsons	1	308	Undisclosed*	Undisclosed*	Undisclosed*	
Jan-22	Nancy Wilson	1	N/A	Undisclosed*	Undisclosed*	Undisclosed*	
End-Dec-21	Portfolio	49	>122,000	372**	16.3x	c 27.2***	
Jan-22	David Coverdale	1	N/A	Undisclosed*	Undisclosed*	Undisclosed*	C Share proceeds
Feb-22	Alice In Chains	1	253	Undisclosed*	Undisclosed*	Undisclosed*	
	All acquisitions following the pipeline assets' acquisition up to February 2022	N/A	>5,600	178.2	17.9x	Undisclosed*	
End-Dec-22	Portfolio	51	>123,600	481**	Undisclosed*	To be reported****	

Source: RHMRF. Note: *Due to commercial sensitivities, the company is unable to disclose financial details for each acquisition as it occurs. However, post completion of the investment of proceeds from the C share fund-raise of \$86.5m, together with the remaining undrawn balance of its existing revolving credit facility, the company will make further financial disclosure on the acquisitions. **Fair value as in the annual report to 31 December 2021 and interim report to 30 June 2022. ***Royalty income during FY21. ****Will be reported in 2022 annual report to 31 December 2022.

Conversion of C shares

To finance the acquisitions, listed in Exhibit 1, made between 11 August 2021 and 8 February 2022, RHMRF has fully invested the proceeds from its July 2021 \$86.5m C share issue and drawn down c \$91.7m under its existing revolving credit facility (RCF), using c \$178.2m in total, as announced on 11 February 2022.

Consequently, on 11 May 2022 the company announced the conversion of 77.5m C shares into new ordinary shares (c 19% of the current total ordinary share capital). The current total number of ordinary shares in issue with voting rights is 407.6m. No shares are held in treasury.

Valuations

We note that the NPS multiples, at which RHMRF acquires catalogues, have increased over the life of the fund. While the seed portfolio multiples for two catalogues were 16.3x and 16.2x, the average acquisition multiple has grown to 17.9x (see Exhibit 1).

According to the investment manager Round Hill, active management is often not reflected in underlying multiples. It regards valuations of 16–20x NPS for high-quality, iconic, blue-chip, stabilised catalogues as attractive.

Discount rate

Independent valuer Massarsky built in some margin of safety by using an 8.5% discount rate for the latest portfolio valuation at end-June 2022 and applying a 5.4% risk free rate versus the 3.89% 10-year US treasury rate. It also applied a cost of debt higher than 7% versus RHMRF's interest cost (reported as of end-June 2022) of c 5%. We note that FTI Consulting recently used a 7% discount rate in the H222 securitisation transaction involving RHMRF's closest peer SONG and Blackstone.

Round Hill highlights in its latest (September 2022) investor presentation that a moderate increase in discount rate does not necessarily mean valuations will have a meaningfully negative impact.

The investment manager argues that future cash flow growth from royalties may offset the impact, such as statutory rate changes, higher streaming subscription prices, alternative platform revenue and other valuation sensitivity factors. Round Hill will continue to monitor the impact of rising

interest rates, inflation and changing market dynamics on the portfolio valuation and will update its shareholders accordingly.

In its interim report to 30 June 2022 Round Hill estimates the potential impact of a 1% increase in the discount rate, leaving all other factors including potentially offsetting ones, mentioned above, unchanged. It estimates that a 1% discount rate increase would reduce the fair value of the catalogues by 14.3%, reducing the economic NAV of the group by \$70.7m, a 14.7% decrease.

Current pipeline assets

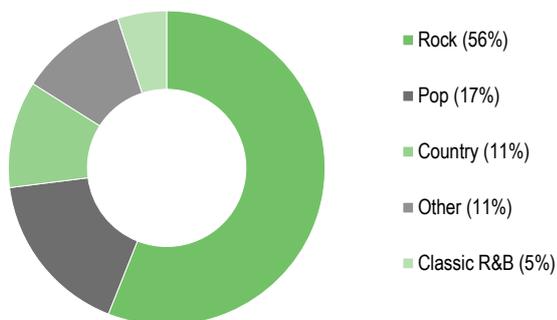
Round Hill has seen significant deal flow emerge from within its existing catalogues (including the pipeline investments) and has a proprietary position on those deals.

Current portfolio positioning

RHMRF’s portfolio has 51 catalogues with over 123,600 songs (at end-June 2022). Exhibits 2 and 3 illustrate how the portfolio is diversified by genre and revenue type, with the catalogues representing a rich mixture across artists, genres, vintages and income composition.

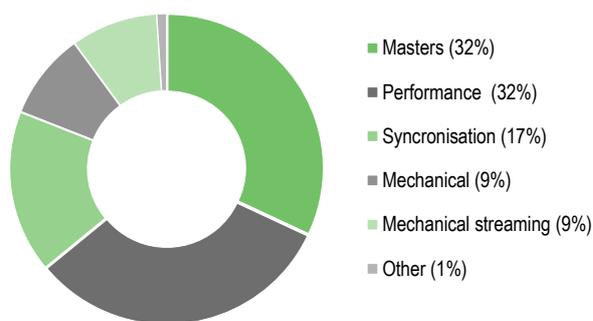
Older genre rock (56%, up from 41% on 30 June 2021) continues to have the largest share, followed by pop (17%) and country (11%). Following the investment manager’s ‘high quality compositions’ approach to primarily acquire songs over 10 years old, more than 90% of all the songs in the portfolio are ‘vintage’, written before 2010. The bias to rock is deliberate, as the attractions cross a wider range of age groups and geographies, with hits having a longer ‘shelf-life’. The portfolio is also diversified by revenue type. Around one third of the portfolio’s revenues in masters’ royalties (32%, up from 27% at February 2022, more than 750 master recordings), perceived by the company, as those with the most stable and higher-quality revenues of all highlighted revenue types (Exhibit 3).

Exhibit 2: Portfolio breakdown by genre*



Source: Round Hill. Note: *As at 30 June 2022.

Exhibit 3: Portfolio breakdown by revenue type*



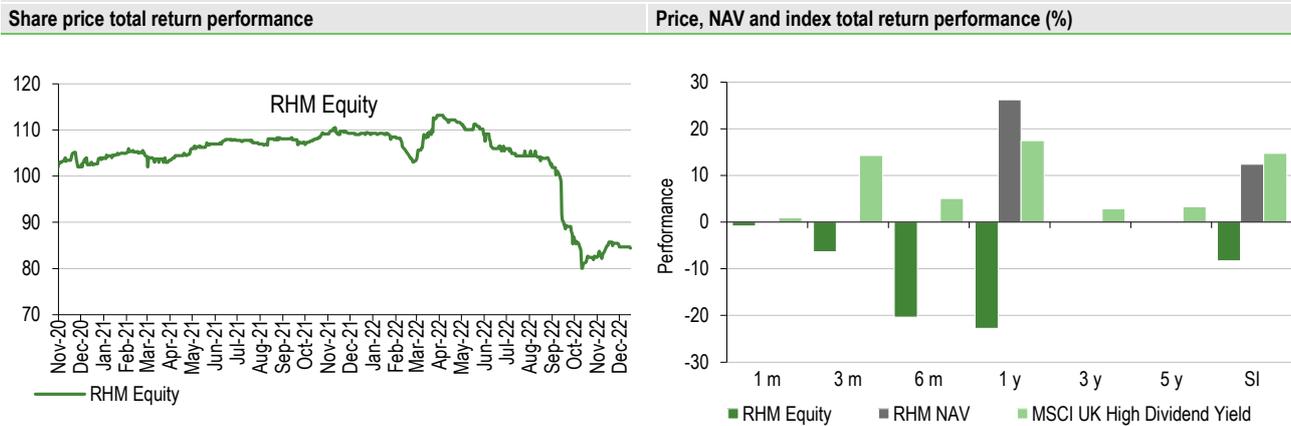
Source: Round Hill. Note: *As at 30 June 2022.

Performance: Trading since 13 November 2020

RHMRF’s performance track record began on 13 November 2020, its first day of trading. RHMRF’s share price is shown in absolute terms in the left-hand chart and in relative terms in the right-hand chart of Exhibit 4, compared to the MSCI UK High Dividend Yield Index. Notably, RHMRF’s NAV outperformed the index over a one-year period on a TR basis and since launch. It is also worth noting that RHMRF’s last 12 months’ NAV TR of 11.1% to end-December 2022 significantly outperformed most major equity indices, such as MSCI World (-17.7% TR) and S&P 500 (-18.1% TR), all TR in dollars.

The share price fell sharply during H122, as rising interest rate concerns dampened general investor sentiment in non-traditional assets. In addition, RHMRF's independent valuation is largely based on a discount rate used to value its assets. Rising interest rates have put extra pressure on RHMRF's share price.

Exhibit 4: Investment trust performance to 31 December 2022



Source: Refinitiv. Note: Three-, five- and SI (since inception) performance figures are annualised.

We compare RHMRF's and SONG's performance in Exhibit 5.

Exhibit 5: Selected peer group as at 31 December 2022*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	SI** of RHM	Prem/disc (cum-fair)	Ongoing charge***	Perf. fee	Gross gearing	Dividend yield
Round Hill Music Royalty	315.9	11.1			28.1	(34.3)	2.1	Yes	19	5.8
Hipgnosis Songs	1,296.7	19.5	54.9		27.6	(46.8)	1.6	Yes	25	6.1
Simple average (2 funds)	806.3	15.3	54.9	N/A	27.9	(40.6)	1.8		22	5.9
RHM rank in peer group	2	2	N/A	N/A	1	1		N/A	2	2

Source: Morningstar, Edison Investment Research. Note: *Performance based on cum-fair NAV. **SI = since launch. ***From RHMRF's and SONG's latest reports. TR = total return in US dollars. Gross gearing is defined as total reported debt to the latest reported economic NAV.

RHMRF has the lower market capitalisation of the two funds. RHMRF's track record is still relatively short, but SONG (launched on 11 July 2018) has a four-year performance track record. In performance terms, since launch RHMRF has slightly outperformed SONG on a NAV TR basis, but we note the still short performance period of just over two years. It is typical for new funds to gain momentum over the first two years as they establish themselves, invest and begin harvesting IPO proceeds, as RHMRF has done. This period largely reflects the set-up stage for RHMRF, as it has now fully invested its IPO proceeds and geared up.

The numbers in the premium/discount to NAV column in Exhibit 5 are comparable for RHMRF and SONG. We note that SONG's latest economic (or operative) NAV per share was \$1.83 as at 30 September 2022, and RHMRF's latest reported economic NAV per share was \$1.18 at 30 June 2022.

Gearing and RCF

Gearing represented by borrowing is allowed for up to 25% of economic NAV, calculated at the point of drawdown, in accordance with the prospectus. As at 30 June 2022, debt to economic NAV was 18.7% (15.5% at 31 December 2021).

At 30 June 2022, the capacity under the RCF was \$110m, RHMRF had \$12m of cash on hand and circa \$18m of undrawn credit under the RCF. The company had complied (and continues to comply) with all covenant compliances as per RHMRF's RCF.

Dividends and dividend policy

RHMRF's primary objective is to reward its investors with a stable income (it also aims for long-term growth of capital). In its interim report for the six months to 30 June 2022, the board confirmed the 4.5% dividend yield target for the financial period to 31 December 2022. This is in line with RHMRF's long-term annualised dividend yield target of 4.5%, by reference to the IPO issue price of \$1.0.

On 24 November 2022 the company declared an interim dividend of \$0.01125 per share for Q322, paid on 12 December 2022. This followed the payment of the first two interim dividends for FY22, both \$0.01125 per share, totalling \$0.0225 per ordinary share.

The dividend policy is to pay dividends quarterly: declare dividends for the quarterly periods ending March, June, September and December and pay in June, September, December and March, respectively. The aim is to pay dividends out of royalty income, but they can be paid out of capital, if necessary, within the dividend policy.

Dividend cover

As at 30 June 2022, the dividend cover was 0.8x. During the six months to end-June 2022, the company deployed the remainder of the C share capital acquiring the David Coverdale and Alice In Chains catalogues. Once the acquisitions completed, the C shares were converted into new ordinary shares and received a full dividend in relation to the quarter ending 31 March 2022. Due to the lag in receipt of royalty payments, revenues from these catalogues should start to be reflected in the second half of the year, so the investment manager expects the dividend cover to improve for the full FY22 and FY23.

We note that the dividend cover for SONG, using the definition from its interim report for the six months to 30 September 2022, is c 1.2x.

The board

Exhibit 6: RHMRF's board of directors

Board member	Date of appointment	Remuneration in FY21	Shareholdings at end-FY21
Robert Naylor (chairman)	November 2022	N/A	N/A
Trevor Bowen*	October 2020	£118,294	75,000
Audrey McNair	July 2022	N/A	N/A
Caroline Chan	August 2020	£87,673	50,000
Francis Keeling	October 2020	£91,955	20,000

Source: RHMRF. Notes: *Stepped down on 1 November 2022.

RHMRF's board currently consists of four non-executive directors.

On 1 November 2022 the company announced that Trevor Bowen was stepping down from his role as chairman of the board and as a non-executive director of the company with immediate effect. Upon taking on the role of chairman, Trevor's core objective was to obtain a listing on the premium segment of the Main Market of the LSE for the company. Once this had been achieved, he believed it was an opportune time to step aside and hand over his role.

The company simultaneously announced the appointment of Robert Naylor as chairman of the board and non-executive director with immediate effect. Robert has over 25 years' experience in capital markets and investment trusts. A qualified chartered accountant, having started his career with Ernst & Young in 1996, Robert has held various positions within JP Morgan Asset Management, Panmure Gordon (UK) and Cenkos Securities. He is currently CEO of Intuitive Investments Group, an AIM-listed investment company, providing investors with exposure to a

portfolio concentrating on fast growing life sciences businesses. Additionally, he is a non-executive director of Light Science Technologies, an AIM-listed controlled environment agriculture company.

On 20 July 2022, the company announced the appointment of Audrey McNair as a non-executive director with effect from 20 July 2022. Previously, Audrey was global head of business risk at Aberdeen Asset Management.

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