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SFA Research Corner

Music Royalty ABS — Remastered for Streaming and Beyond

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In 2022, three music royalty ABS transactions were issued for a total of $2.6 billion, according to Finsight, a significant increase over 2021, when one transaction for $304 million came to market. The 2022 bonds are backed by the rights to future income generated by publishing or recording royalties, and in some cases both, of the music of Miles Davis, Otis Redding, James Taylor, Phil Collins, R.E.M, Stevie Nicks, Isaac Hayes, Cyndi Lauper, and Pink Floyd, among many others. Music royalty ABS is not new—indeed David Bowie issued the first in 1997, a $55 million offering that became popularly known as “Bowie Bonds.” Last year’s bonds, which were issued under Rule 144A, come at a moment when more artists or rights-holders wish to raise capital and current music technology makes future cashflows look predictable and promising. KBRA, a leading rating agency for this asset class, expects issuance to top $3 billion in 2023.

In August 2022, Hipgnosis Song Management debuted Hipgnosis Music Assets LP 2022-1, a $222 million securitization. The transaction was backed by a catalog of more than 950 songs across five sub-catalogs and was valued at $341 million on discounted cashflow forecasts by a third-party valuation agent. Structural protections in the transaction include interest and liquidity reserve accounts funded at closing, and debt service coverage thresholds. KBRA, the only rating agency on the single-tranche transaction, rated the bond A-.

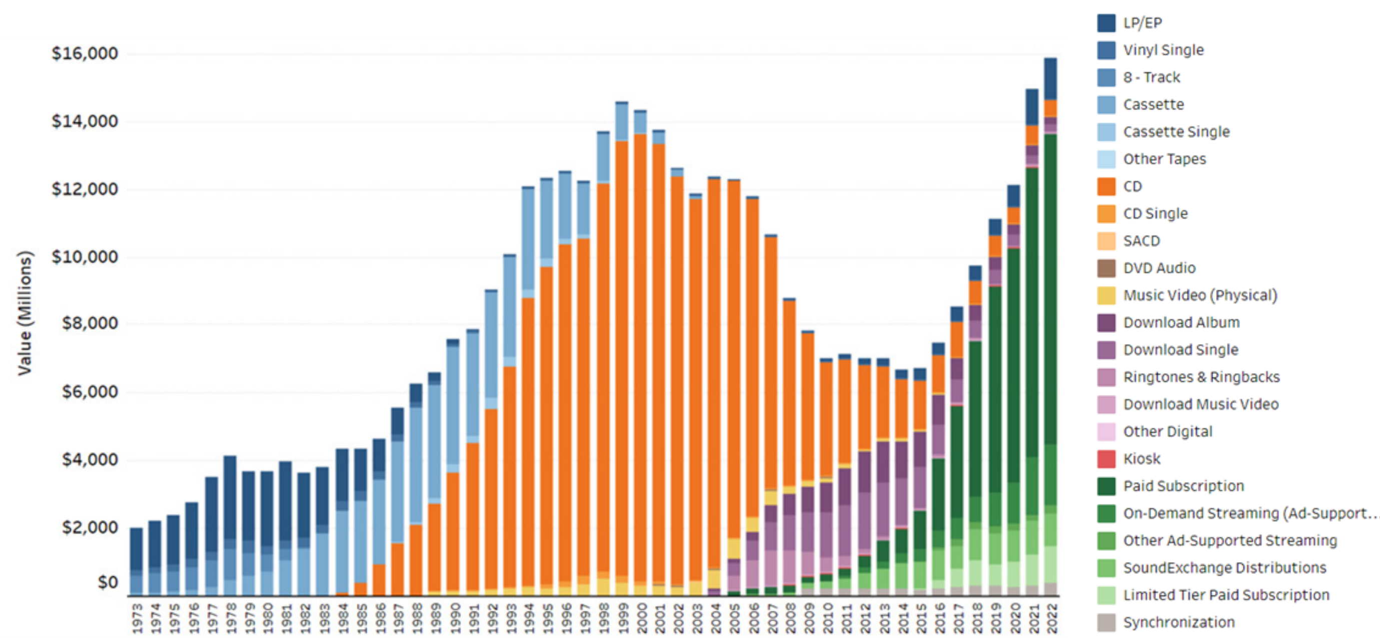
Works by Justin Timberlake were among those behind Hipgnosis Music Assets LP 2022-1. Timberlake earns royalties when other artists perform a song he wrote (his publishing rights) or when one of his recordings (his recording rights) is added to a streaming platform, synchronized to a video or used in other ways protected by his copyrights. In 2022, Timberlake sold the publishing rights to the full catalog of his songs, many of them hits from over a decade ago, to Hipgnosis Song Management, a partnership between Blackstone and long-time music industry icon Merck Mercuriadis. Founder of music IP investment and song management company, Hipgnosis Song Fund, Mercuriadis stated in an interview that, “when a [new] song becomes a proven song, the earnings pattern to it becomes very predictable.”

The same concept was behind David Bowie’s bond in 1997. Consumer preference for his work was predictable and royalties were strong—the artist sold over 1 million records annually for more than twenty years. The transaction was rated A3 by Moody’s and went to a single investor. Market response was favorable and similar bonds from James Brown and the Isley Brothers soon followed. Others might have followed but for the advent of digital music. The first major disruptor was Napster. Notoriously sued by the band *Metallica* for copyright infringement, Napster was a file sharing platform created in 1999 that opened the door to rampant digital piracy. Copying music without permission of or payment to the artists cost the music industry more than $300 million in lost sales according to the Recording Industry Association of America (RIAA), stifling interest in music royalty ABS.

The music industry’s digital revolution began in earnest in 2001 with the creation of the iPod and iTunes, leaving the era of CDs, and falling sales, behind. The RIAA reported that in 2022 revenues for the U.S. music industry grew for the seventh consecutive year—from $7 billion in 2015 to a record high of $15.9 billion. Growth is led by consumer demand.

for digital music—with streaming representing 84% of revenues—which grew from $2.3 billion in 2015 to $13.1 in 2022. KBRA, in their rating of [KKR & Co Inc's](#) HIFI 2022-1—a $733 million securitization backed by 65,000 songs including works of Stevie Nicks, The Weeknd, and Childish Gambino—noted the proliferation of streaming as a positive aspect of the deal. "Consumption is increasing at a subscriber level and the entire music industry is growing as the number of users increase as well as the frequency at which they stream," the report said.

The Rise and Fall of CDs (orange) and the Rise of Streaming (green)
Music Revenues by Format (1973 to 2022)



Source: Recording Industry Association of America ([RIAA](#))

Collateral for future securitizations looks plentiful as a wave of rockers of a certain age cash in their rights to future income streams for lump sums. Neil Young sold 50% of his catalog, song copyrights, and recordings, to Hipgnosis in 2021 for $150 million. Also in 2021, Bruce Springsteen sold his entire catalog for $500 million, Sting followed suit in 2022, selling at $300 million. Classic hits represent approximately [70%](#) of current streaming, making them an attractive acquisition for song management companies and good estate planning for the artists.

Risks to music royalty ABS include legal wrangles over copyright infringement, changes to consumer taste, and discretionary spending. Copyright infringement [damages](#) can be steep and may divert future royalty cash flows. In The Verve vs. The Rolling Stones (1997), for example, in addition to $1.7 million in damages, all publishing royalties were forfeited. Legal risk aside, a consumer swing in preference, for new music over vintage, could impact cashflows of the classic hits in these catalogs and their anticipated royalties. More immediately, macroeconomic headwinds could see consumers cutting back on discretionary purchases and reducing music subscriptions.

Technological development, which disrupted the first wave of music royalty ABS, could actually help more than hinder the second iteration of this asset class. Music [NFTs](#), for example, have the potential to negatively impact revenues of present- day subscription streaming services, but they might also turn to securitization for capital. These unknowns aside, recent transactions lay down the basic tracks and give a window into the opportunities available in this asset class.