The Ultimate Guide To Buying Music Royalties

Royalty Exchange

Royalties: A New Asset Class

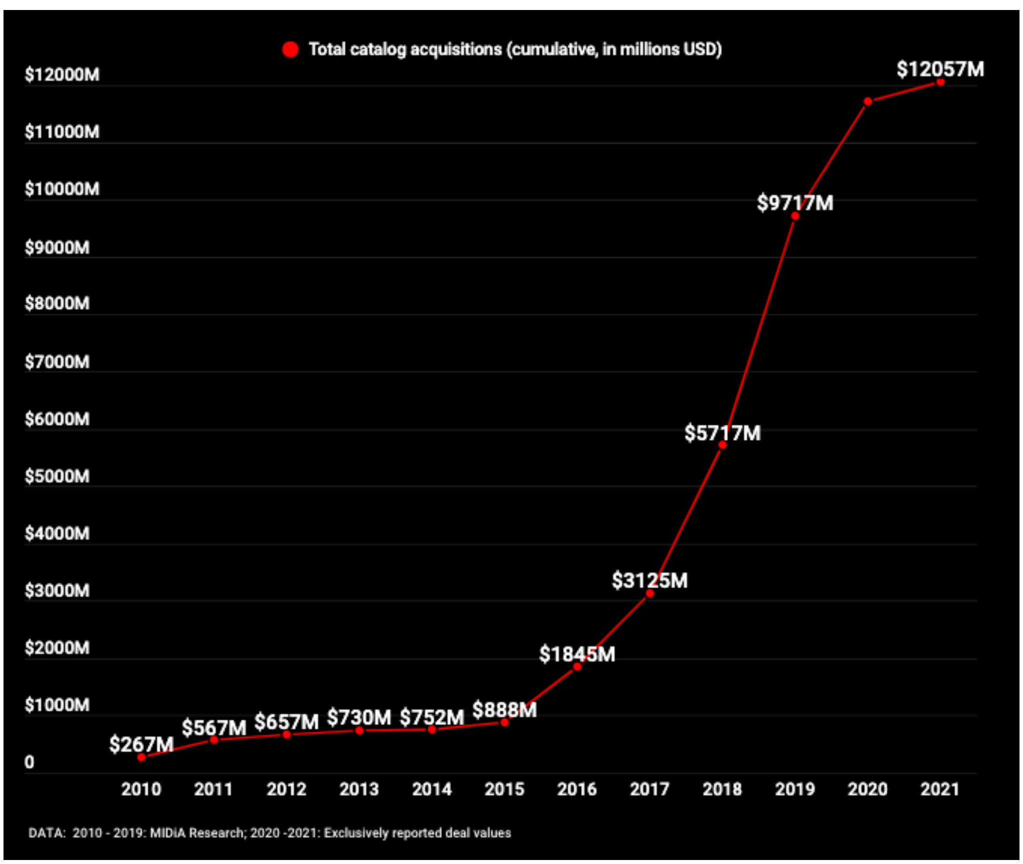
Since the launch of the Royalty Exchange marketplace in 2015, the concept of investing in music royalties has evolved from a relatively obscure idea to one generating mainstream attention.

In fact, the market for music royalties has gotten downright frothy, attracting billions in investment dollars. A few of the more recent, high-profile transactions include:

- Shamrock Capital bought Taylor Swift's master recording catalog for $300 million.
- Vine Alternative Investments paid a reported $100 million for the catalog of dance music producer Calvin Harris.
- Hipgnosis acquired the catalog of Neil Young for $150 million.
- Bob Dylan sold his publishing rights to Universal for $300 million.

Others have included the likes of Fleetwood Mac veterans Lindsey Buckingham, Stevie Nicks, and Mick Fleetwood, along with Latin superstar Shakira, legendary producer Jimmy Iovine and record label exec L.A. Reid.

Forbes Magazine published the following chart tracking the cumulative total of music catalog sales since 2011:



Catalogs sales are not new. Music industry insiders regularly bought and sold music rights between themselves. Private equity funds, public pensions, and other institutional investors were also known to get in the game.

What's different today is the ability for retail investors to gain exposure to this new asset class. As of this writing, there are several funds that raise money by selling publicly traded shares, and use the proceeds to buy music catalogs. Shareholders earn dividends based on the performance of the catalogs these funds own.

Simply put, the word is out. And the financial community is taking notice…

Music royalties are proving a hit for investors (The Economist)

From Bob Dylan to Blondie – why investors are buying up hit songs (The Financial Times)

Investors in Search of Yield Turn to Music Royalty Funds (Wall Street Journal)

Bodak Green: How To Earn Eye-Popping Yields From Music, TV And Movies (Forbes)

The Case For Music Royalties

Investors are always looking for ways to protect their money while maximizing overall returns. Stock and bond markets can be unpredictable and susceptible to macro events, which is why many turn to alternative investments to diversify.

Music royalties provide a great option. Owners of intellectual property get paid every time someone uses their work. They create an asset once, and then collect payment over and over again.

This has the following benefits:

- **Uncorrelated Investment**: Royalty payments, especially music royalties, perform independently of public markets, making them the purest form of alternative investment.
- **Yield Potential**: Royalties have a track record of strong earnings, with the potential to deliver double-digit yields that rival bonds and dividend-paying stocks.
- **Passive Income**: Royalties let you earn money while you sleep. They are a "cut off the top," paid regularly, that put you first in line to receive the cash flows they generate.

Royalty Exchange allows investors to buy a stake in royalties directly from the rightsholders who own them. A rightsholder is a company or individual with a legal claim on income generated from the use of their IP, in this case... music.

Rightsholders could be songwriters, recording artists, labels, publishers, producers, and so on. There are a number of different parties that can have that legal claim on future income. They are paid based on streams, downloads, physical album sales, and other usage depending on exactly which royalty they own.

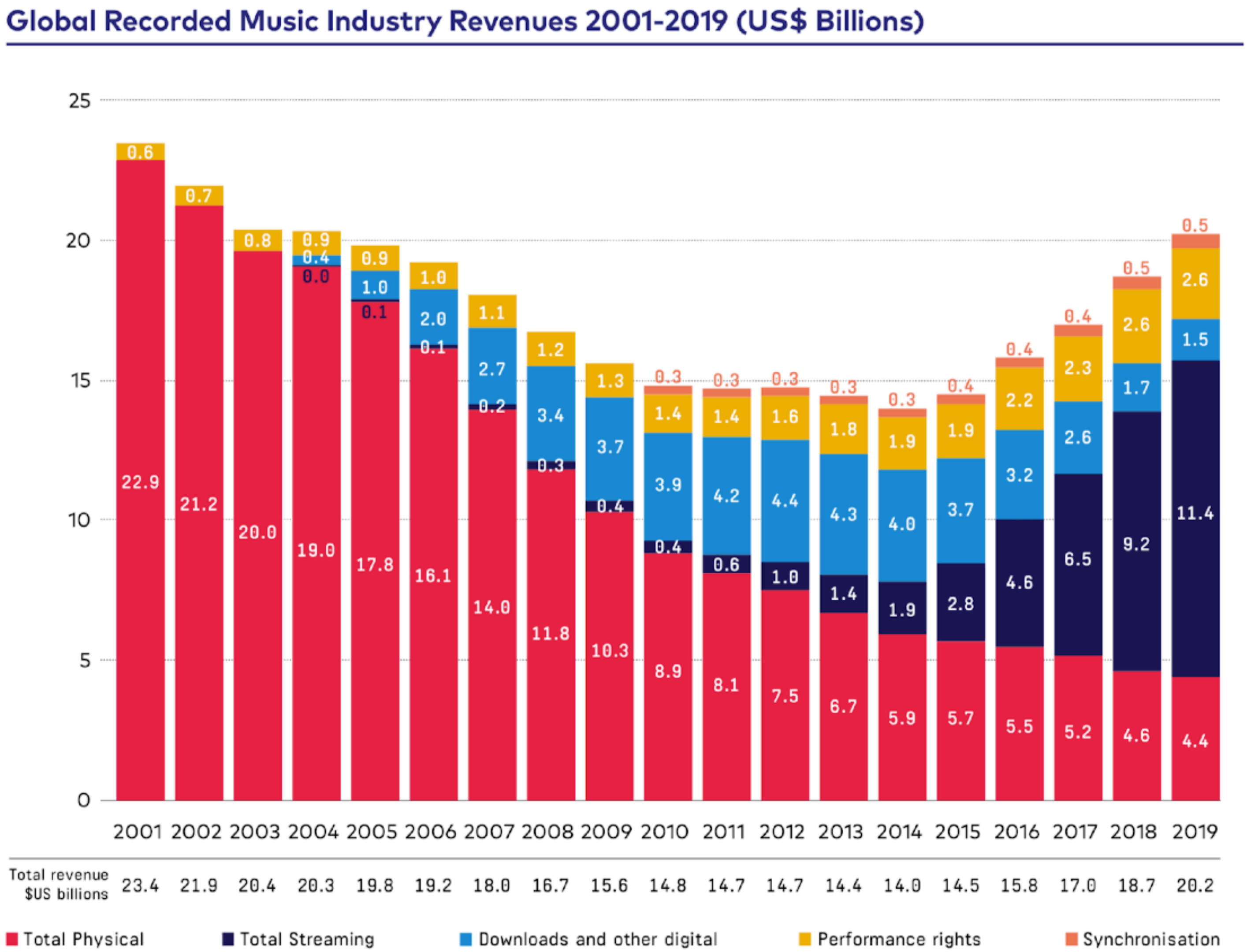
We'll dig more into royalties in general and how music royalties generate income in the following chapters. For now, let's focus on the bigger picture—the music business turnaround and what's driving it.

The Rise of Streaming

Until 2015, the music industry was stuck in a long, brutal bear market for 15 years as a result of:

- Digital Piracy
- Disaggregation of music from physical albums to digital singles
- Mispricing / undervaluation due to lack of transparency

Starting in 2015, things began to turn around thanks to the mainstream adoption of streaming services like Spotify, Apple Music, and others. Subscriptions to digital streaming services have been a game changer for the industry. You can see its impact in the chart below by following the growth of the blue section in each bar, which represents streaming's contribution to overall recorded music revenue.



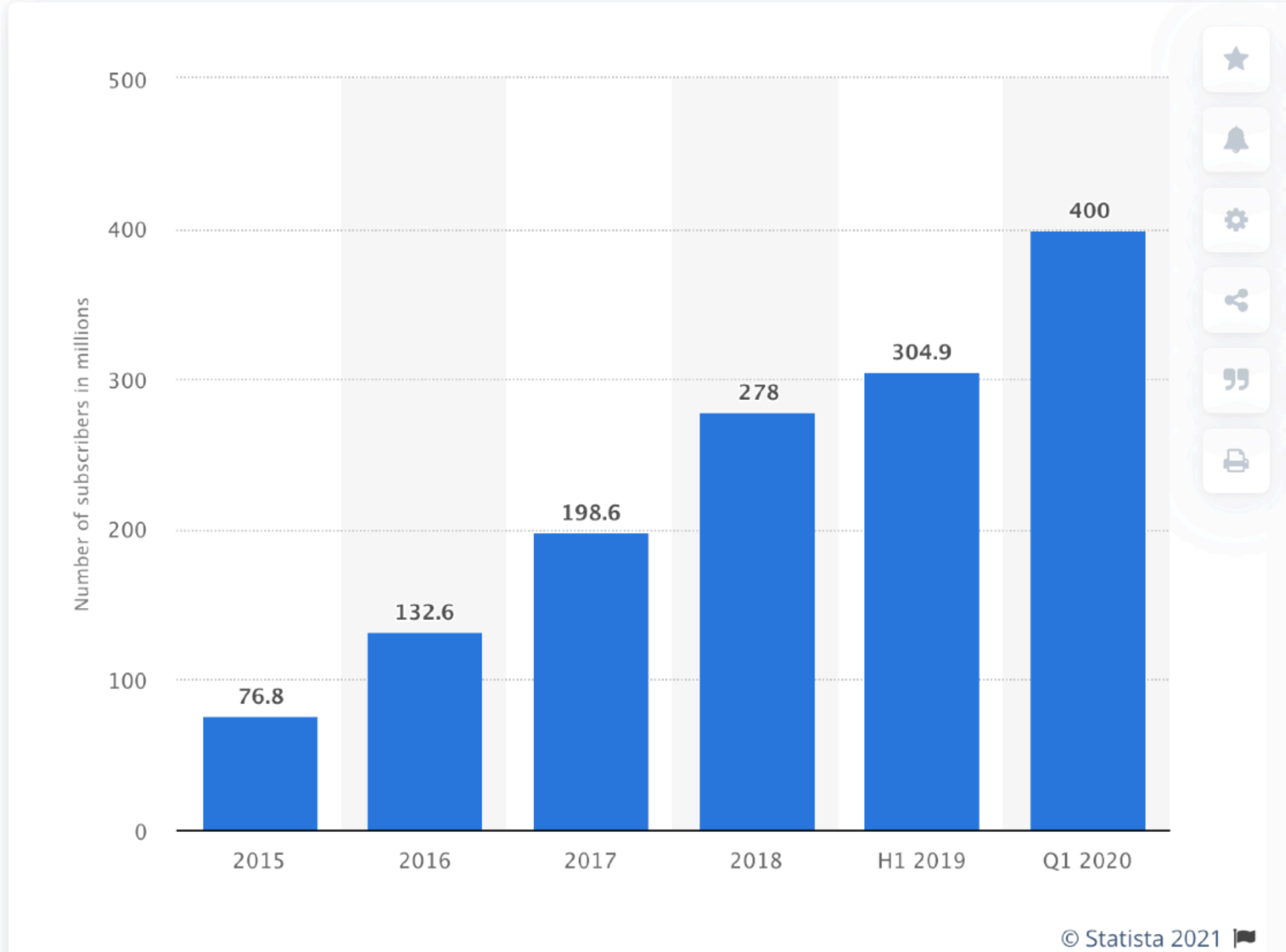
Source: IFPI Global Music Report 2019

As you can see, streaming grew from about $4.5 billion globally in 2016 (then considered a banner year) to $20.2 billion at the end of 2019, according to industry trade group IFPI.

Analysts are bullish that this trend will continue. Goldman Sachs has published its Music In The Air report forecasting the music industry's future revenues since late 2016. In its first forecast, it projected streaming revenues would grow to about $14.1 billion by 2030.

Just eight months later, Goldman Sachs doubled its original protection to $34 billion, and later updated it again to $37.2 billion.

Driving this growth is the continued rise of music streaming as the dominant form of music consumption. According to Statistica, music streaming subscribers reached 400 million in the first quarter of 2020, up from just under 305 million at the end of the first half of 2019.



Source: Statistica

Uncorrelated Income

When you own rights or a percentage of a royalty stream tied to a song or catalog of songs, you collect revenue every time they are streamed, played, downloaded, or covered. When a song you own the rights to plays on Spotify, you receive a royalty payment.

Music royalties offer direct exposure to revenue streams generated by music consumption. Neither the consumption nor the royalty payments owed for that consumption are affected by stock or bond price fluctuation. That makes them one of the most uncorrelated assets available to investors today.

The 2020 pandemic provides an example of this. While the music industry suffered from canceled tours and closed bars and restaurants, streaming activity remained a bright spot that kept many in business.

In most markets where Covid-19 resulted in a stay-at-home shutdown, streaming activity initially dropped. According to a study by research group Nielsen Music/MCN titled "Covid-19: Tracking the

Impact On The Entertainment Landscape," less commuting time and more entertainment options were cited as the two leading reasons.

But once music fans settled into their work-at-home environments, streaming shot back up. Spotify, now a public company, reported the following Q2 2020 results during the heart of the pandemic:

- Monthly Active Users increased 29% YoY and 5% over the prior quarter.
- Premium Subscribers increased 27% YoY and 6% over the prior quarter.

Overall, streaming activity in the U.S. set a record in 2020, increasing 17% for the year to over 872 billion streams.

Yield

As any investor is well aware, yield is becoming harder and harder to come by these days. Bond yields are approaching negative territory, and the stock market is growing more and more expensive. So where do you turn to find acceptable yield without taking on an inordinate amount of risk?

The Royalty Exchange Marketplace has proven one such source. That's not just marketing talk. We have actual results to illustrate this point.

Once investors buy a royalty stream on Royalty Exchange, we act as an administrator of ongoing payments. This gives us some insight into the returns our investors have enjoyed. We examined 3418 transactions with at 12 months of returns during the second half of 2020.

The average overall return on investment 10.63%. Respectable by any comparison. But when we filtered the results by more specific types of royalties one can acquire on Royalty Exchange, and the different investing formats available (which we'll detail in the chapters ahead), we found returns as high as 17.60% to no lower than 8.83%.

Averages rarely tell the full story, which is particularly true when examining assets as diverse as music catalogs. But these results illustrate the opportunity that investing in music royalties can provide.

Diversification

It's not stock prices, interest rates, or the Federal Reserve's monetary policy that drove these results. The songs determined the annual return on investment. They will also determine the future revenues produced by these intellectual property assets.

Diversification from the stock market is one of the benefits of music royalty investment. As we've shown, they are largely uncorrelated to the market, and can reduce volatility or even provide greater returns for an investor.

Keep in mind, periods of volatility are also times when alternative investments like royalties grow more popular. Consumers don't stop listening to music if the S&P 500 rises or falls.

That doesn't mean that music is completely recession proof. But music's challenges and risks are more affected by individual industry trends than broader macroeconomic concerns.

Tax Implications

NOTE: Royalty Exchange is not authorized or qualified to offer tax advice. So it is critical that you discuss these issues with your tax advisor to accurately apply them to your unique situation.

Music royalties are a depreciable asset, much like real estate. This means the cost of acquisition can be amortized, offsetting the income produced and reducing overall tax liability.

For royalties acquired directly, the payor of the royalty payment will issue a 1099 for any year royalties are paid greater than $10. From the 1099, you'll have to report the royalty income on your 1040. If you hold the royalties in a business, all income and amortization is reported on your Schedule C. Amortization is calculated and reported on Form 4562.

Unlike real estate, both types of music royalty investments are considered "intangible" assets. Amortization of intangibles is governed primarily by sections 197 or 167 of the Internal Revenue Code. However, section 197 does not apply to the direct purchase of copyrights, or any interest in them. Section 197 only applies to copyrights (or interests of) acquired in connection with the purchase of a trade or business.

So for our purposes, we'll stick with section 167. There are two amortization methods available under section 167.

- Straight-line method: Under this method, simply divide the cost of the royalty by the number of years of its useful life. With royalties, we typically use 10 years.
- Income forecast method: Under this method, each year's depreciation deduction is equal to the cost of the asset, multiplied by a fraction. The numerator of the fraction is the current year's net income, with the denominator the total income anticipated from the royalty through the end of the 10th taxable year after it was acquired. Since the anticipated income may change based on actual results over the time you own the asset, you'll need to update your income forecast every three years.

Conclusion

The growing importance of intellectual property in the global economy, the music industry's recovery, and increasing cash flows that are uncorrelated to stock and bond markets, make media royalties an incredible alternative asset class and one that should be considered for many investment portfolios.

Investing in music royalties today is the opportunity to invest alongside the booming music industry, and experience massive appreciation, collecting royalty income along the way.

Now let's take a closer look at royalties specifically...

How Royalties Work

A Royalty is a payment made to an asset owner for the right to use that asset. A "royalty interest" is the right to collect a share of future royalty payments.

Royalties are a "cut off the top" of revenue earned for the use of the asset. The owner of a royalty gets paid before stockholders, company executives, and so on. Royalty payments are typically made at specified intervals, such as monthly or quarterly.

Music royalties are derived from copyrights, which are a type of intellectual property. Intellectual property is an incredibly valuable asset class and one of the only real competitive advantages left in the world today. The value of all combined intellectual property in the U.S. alone is worth at least $6.6 trillion, according to the U.S. Chamber of Commerce. That is more than the nominal GDP of any other nation.

Intellectual property also includes copyrights (also known as an author's right). "Copyright" is a legal term that describes specific rights held by artists and other creative types over their original works. Copyrights span a broad base of different creative works, including music, literature, artwork, sculpture, and film. They also cover technical drawings, computer programming, personal databases, advertising works, maps, and other business concepts.

U.S. copyright laws give exclusive rights to the creators of original works, and no one can use another's copyrighted works without a license.

In the music industry, the licensing of copyrights are the basis on which royalty payments are made. In the following chapter, we'll describe the specific types of copyrights tied to the music industry and how other parties compensate asset owners for use of their IP.

For now, let's focus on how owning intellectual property rights can provide several key benefits that are attractive to investors.

Income

Music royalties can provide strong income streams over the duration of the music copyright. Music royalties are also not impacted by interest rates set by global central banks or stock market fluctuations.

Royalties are only subject to the global demand of music fans and businesses that use music for personal and professional purposes. A federal statutory standard sets royalty rates for IP holders. This framework is critical to ensuring that IP owners receive their royalties at a standard rate for each use.

These payments depend on the number of times that third parties use the intellectual property in previous periods. Naturally, that can create some large spikes in revenue or smaller lump payments depending on demand.

Capital Appreciation/Upside Potential

On average, music royalties depreciate over time. A typical song enjoys its highest earnings in the first 18-months to three years following its initial release. It usually fades in popularity after that as fans listen to newer music, but it's very rare that a song stops earning altogether. We'll discuss this in greater detail in the "How To Value Royalties" section below.

Typically, royalties are added to our marketplace after that initial window, meaning investors are acquiring royalties that have already experienced that initial drop in earnings. This gives it room to grow again if there is an increased demand from others to use, license, or reproduce it over time.

Strong examples of music that can increase in value are known as "evergreen" songs. These songs are typically always in style. They set a mood and provide listeners with a unique feeling each time they hear it. Not only do they receive regular streams from fans, these songs are immensely popular with advertisers and film producers due to their ability to fit into the narrative of a story or message they are trying to convey.

Longevity

Music created today is protected by copyright laws when the work is "fixed in a tangible medium of expression." Any work produced after January 1, 1978 is protected for the lifetime of the author plus an additional 70 years.

So, if an artist passed away on January 1, 2016, their music would be protected under copyright laws through 2086. Any use or reproduction would require a royalty payment to any entity with an interest in the artist's creative assets.

That makes intellectual property an asset that can be owned for decades, providing returns based on the demand for its use long after its creation and passing of its creators. This is particularly important in the streaming world, where "catalog songs"—music released three or more years ago—represent over half of all total streams.

Some songs can go through many different cycles over time, renewing income streams. After it fades from the radio, a song can find new life as a classic song or throwback tune to the soundtrack of a film or television show. One of the risks and benefits of music intellectual property is that a song's popularity can go in cycles.

Each royalty stream varies according to the duration of the music copyright. As an investor interested in acquiring royalties, it is important to determine the value of your return by how many years you can expect payment based on your ownership rights. Some royalty streams may only have 17 years left on the copyright, while others will likely be much longer. It all depends on the time when the music was published.

Protection

Copyright law ensures significant protections to the holders of the music copyright. The United States has some of the most advanced copyright laws in the world. Over the last 100 years, Congress has amended legislation to benefit the protection of intellectual property and to ensure fair compensation for its use by third parties.

What's more, the music industry has decades-old institutions designed to track, collect, and distribute payment to music royalty owners. We'll discuss them in greater detail in the "Royalty Collection and Distribution" section.

These protections last for the length of the copyright. The chart below breaks down the length of each copyright term depending on the date of publication and the correlating terms protecting the asset.

Date of publication	*Total term of federal protection*
Pre-1925*	Currently in the public domain in the U.S.
1925* – March 1, 1989	Musical compositions published during this period were subject to various formalities. If these formalities were not met, works would enter the public domain. See note on formalities below. See also Copyright Term and the Public Domain in the United States for more detailed information.
March 1, 1989 through 2002	*If created after 1977*: term is life of the author + 70 years and, for works of corporate authorship, the shorter of 95 years from publication or 120 years from creation.
March 1, 1989 through 2002	*If created before 1978* and *first published between March 1, 1989 and on or before December 31, 2002*: term is life of the author + 70 years and, for works of corporate authorship, the shorter of 95 years from publication or 120 years from creation. Copyright shall not expire before December 31, 2047.
After December 31, 2002	Life of the author + 70 years. For works of corporate authorship, the shorter of 95 years from publication or 120 years from creation.

*Musical compositions first registered or published in the United States during this time would receive a maximum term of protection of 95 years from the date of publication. As a result, this date will increase every year moving forward, until reaching works published in 1977.

(source: Ohio State University "When Does Music Enter The Public Domain In The U.S.)

Sound recordings:

Date of publication	*Total term of federal protection*
Pre-1923	Through December 31, 2021
1923 – 1946	100 years from publication
1947 – 1956	115 years from publication
1957 – February 14, 1972	Through February 15, 2067
February 15, 1972 – March 1, 1989	Sound recordings published during this period were subject to various formalities. If these formalities were not met, works would enter the public domain. See the note on formalities below. See also Copyright Term and the Public Domain in the United States for more detailed information.
After March 1, 1989	Life of the author + 70 years. For works of corporate authorship, the shorter of 95 years from publication or 120 years from creation.

(source: Ohio State University "When Does Music Enter The Public Domain In The U.S.)

Alternative Assets / Passive Income

These factors make royalties attractive alternative assets. According to data intelligence firm Preqin, there is $10.31 trillion worth of alternative assets under management today, with $14 trillion expected by 2023.

Driving the increasing interest in alternative investment is, of course, a desire for uncorrelated performance. Royalties fit nicely into this category. In most cases, the underlying copyright is not included in your purchase. You are buying the right to collect income only. This means you don't need to "work" the catalog to ensure continued revenues.

You are simply buying a percentage of the income earned from songs released and managed by music industry professionals, allowing you to benefit from their efforts and expertise without engaging with them directly. This includes the artist, other songwriters, producers, and publishers. They're financially motivated to ensure the asset continues to earn income. That's their job, not yours.

Now let's examine more closely the different types of copyright and royalties in the music business.

Types of Music Royalties

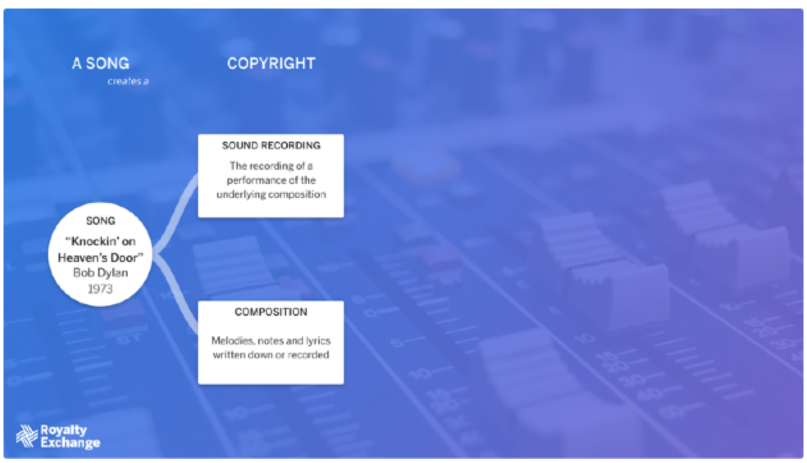
Every song has two copyrights, and the royalties that music earns stems from the licensing that these two copyrights require.

The two copyrights are:

- The Composition: For the song as it is written (think: lyrics & melody)
- The Sound Recording: For the song as it is recorded (what you actually hear)

Take for instance the song "Knocking On Heaven's Door." The musical composition copyright covers the song as written, and it is held by the songwriter. This is the person who wrote the melody, notes, lyrics, etc.

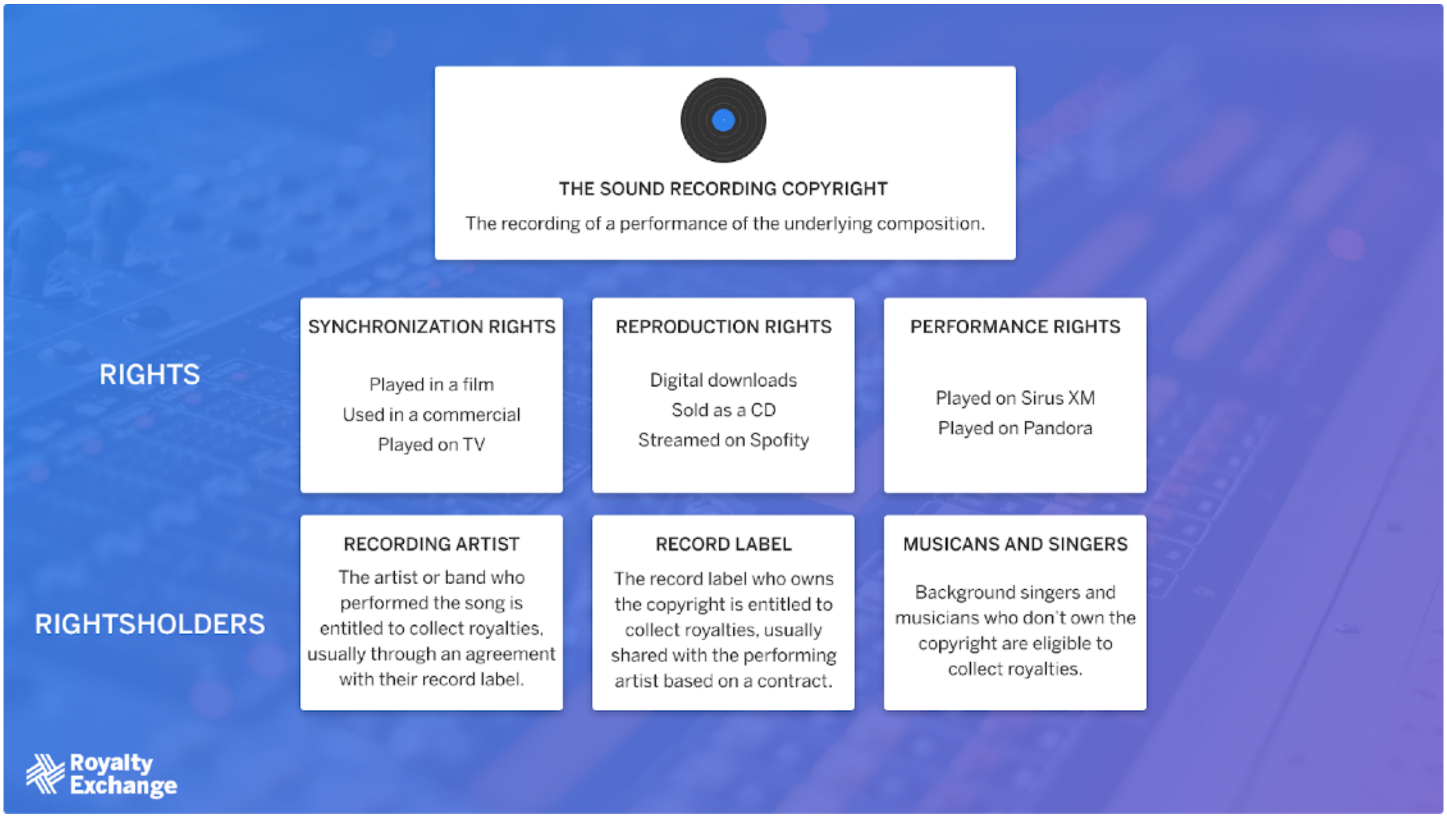
Once that song is recorded, another copyright is generated, called the Sound Recording. The person or band who records the song owns the recording copyright.



In some cases the songwriter and the performer are the same person, as it is in this case. Bob Dylan both wrote and recorded the song. But often, multiple songwriters may assist in writing a song, and all have a royalty interest in the use of the composition copyright.

The granting of the rights included in a copyright is called "licensing." Many different types of rights can be licensed to third parties, thus generating different types of royalties. Let's examine how this works for each type of copyright.

Sound Recording Royalties



Also known as “Master” rights, Recording Rights refer to the master recording captured in the studio and distributed in different formats (physical vinyl or CDs, and digital MP3s or streaming audio). Recording Rights are licensed for such uses as:

Reproduction royalties are paid when the recording of the song is sold (physically or digitally) or streamed. The royalty is paid for each use, and it is a negotiated fee between the rightsholder (typically a record label) and the service provider / retailer.

Performance royalties are paid when the song is played on digital or satellite radio stations. Interestingly, in the U.S., traditional "terrestrial" radio stations do not need to pay a performance license for use of the sound recording, only the composition.

Synchronization royalties are when a song has been licensed for a TV show, film, ad, and so on. It is a one-time, upfront payment for the right to use the song, and the price is negotiated between parties.

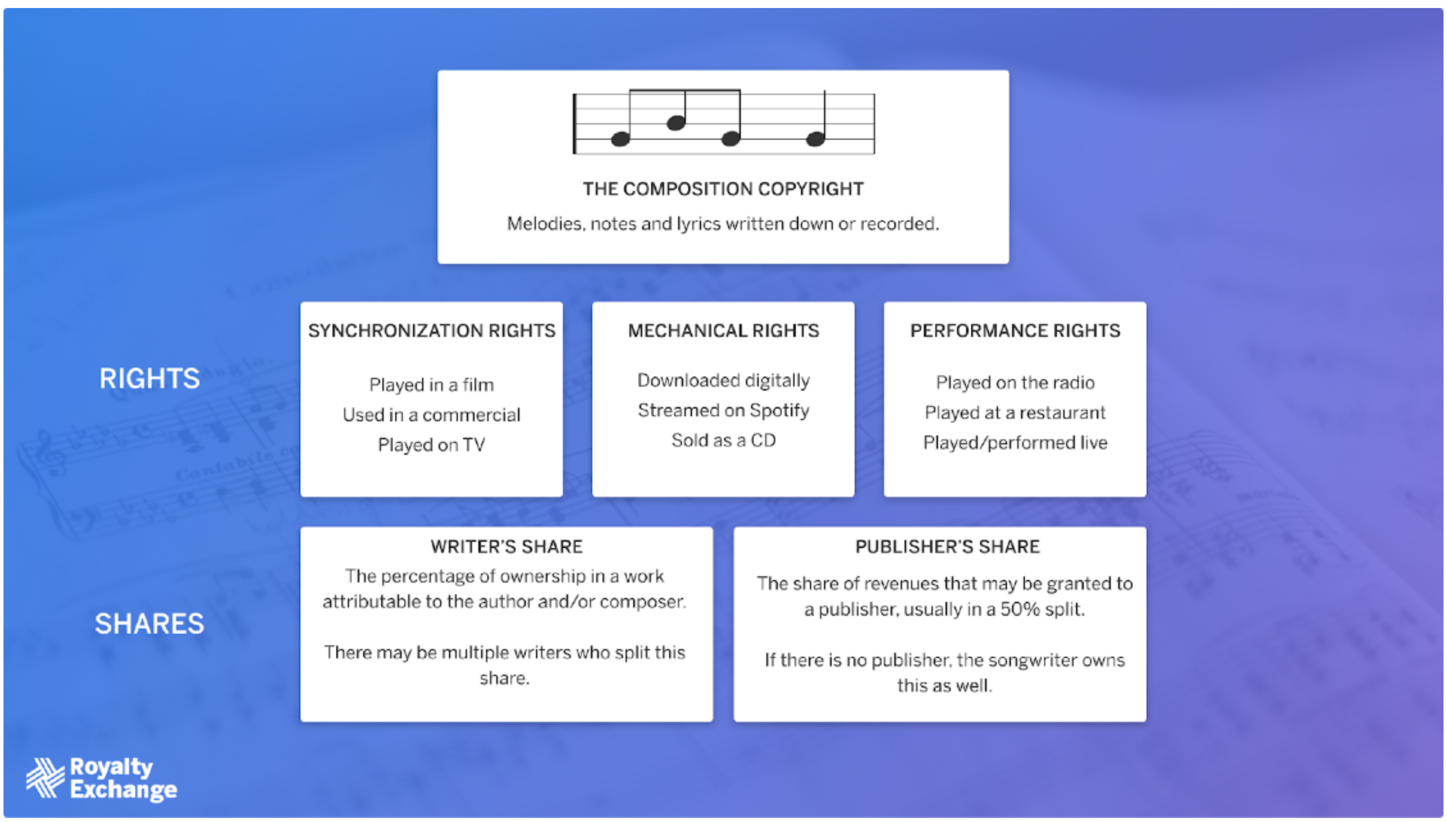
Who retains these rights depends on the types of deals musicians and songwriters make with different entities in the music business.

Typically, recording artists sign a contract with a record label. The label provides an advance and the recording infrastructure for artists to record an album. In return, the label owns the sound recording copyright. Any royalties the sound recording copyright earns are collected by the label, which then pays the artist a percentage of the royalties based on their contract. This can be from 15% to more, but the range varies widely.

Some artists don't work with a record label, taking what's called the DIY route. These artists use digital distribution companies to release their music onto various digital services, and then either conduct their own marketing and promotion, or hire marketing services or consultants. Either way, they collect 100% of the royalties.

Finally, recording artists will hire other musicians not formally part of the band to contribute to the recording. These session musicians and producers may also be awarded a portion of the royalties as compensation for their contribution to the recording.

Composition



The rights to the song's Composition, including the music and accompanying lyrics, are typically called "Publishing Rights."

Publishing rights have similar benefits to Recording rights in that the owners can license their music to third parties. However, some distinct differences exist in the variety of publishing rights and royalties.

Mechanical royalties refer to the right to reproduce and commercially distribute copyrighted songs in physical and digital formats, similar to the Distribution rights of the Sound Recording. Standard mechanical rates are set by a panel of federal judges called the Copyright Royalty Board, which revisits and revises rates every few years.

Once set, they become the price for a "compulsory" license, meaning that any recording artist may record the song without the original songwriter's permission, so long as they pay the Mechanical royalty to the songwriter/publisher for the reproduction.

Performance royalties are a bit more expansive for composition rights. It includes traditional "terrestrial" radio, live performances, music played in public settings like bars and restaurants, and music broadcast on TV or video streaming services.

Performance rates are negotiated on behalf of songwriters and publishers by Performing Rights Organizations, changed with tracking, collecting, and distributing these royalties to songwriters and publishers. More on that in the "Royalty Collection and Distribution" section.

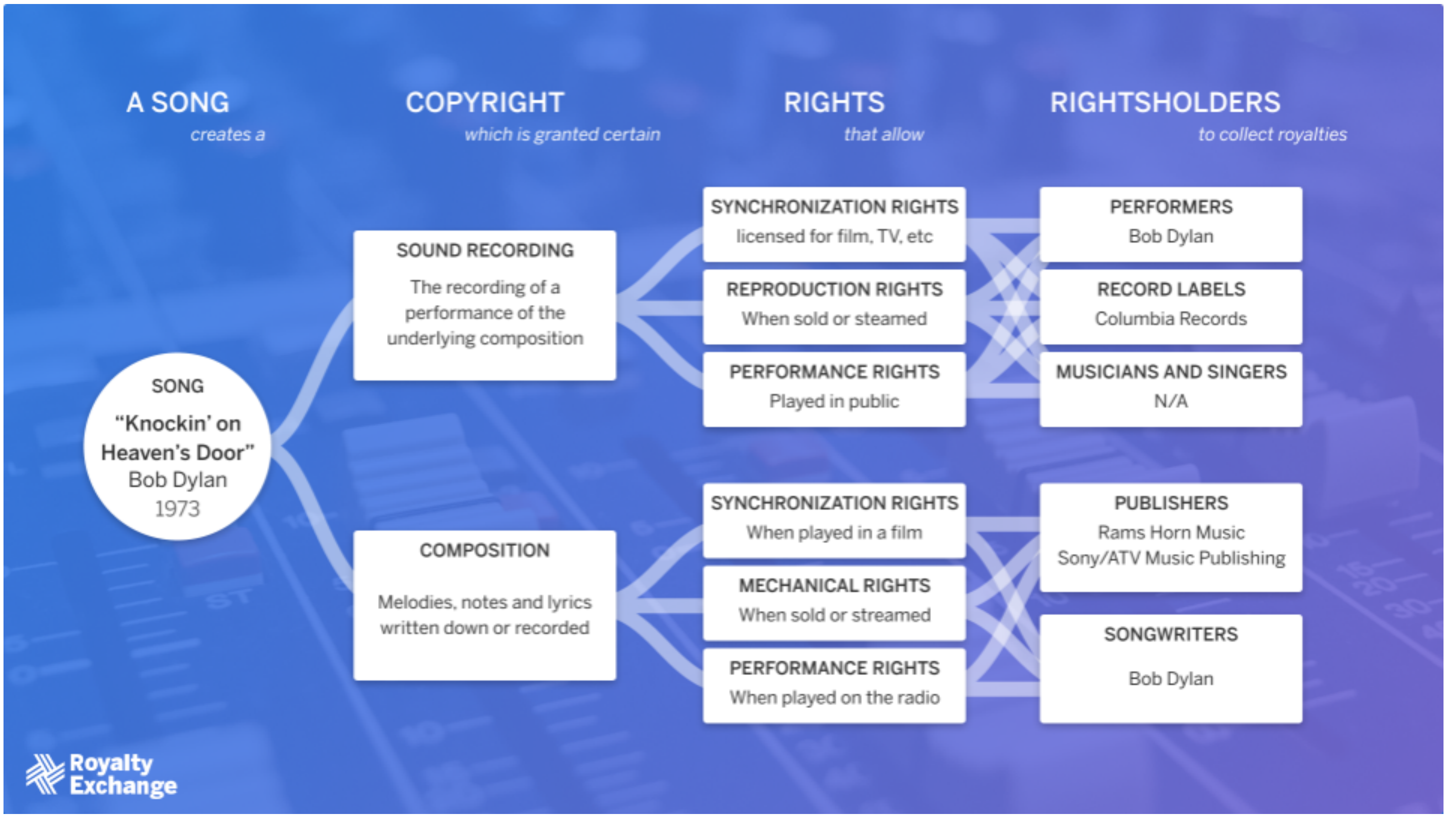
Sync royalties, like with the Sound Recording, are paid when a song has been licensed for a TV show, film, ad, etc. It is the only source of composition royalties that is negotiated on a case-by-case basis. It should be noted that this is a separate, negotiated fee paid for the right to use the song and is distinct from the performance royalty that is paid when an ad/film/TV show airs.

Typically, a songwriter will sign a deal with a publisher in what's called a publishing deal. In these deals, the publisher takes ownership of the copyright, and in return has the task of issuing licenses for the copyright to generate royalties.

All royalties generated from the composition copyright are then split between the publisher and the songwriter, typically 50/50 for performance royalties, but mechanical and sync splits can vary.

Sometimes multiple songwriters work with the same publisher, in which case the publisher keeps 50% of the royalties, and the songwriters split the other 50% among them based on their internal split agreements. Sometimes the songwriter is self-published, and in those cases will collect all the royalties.

Here's a combined overview of the different copyrights and royalties for both the sound recording and the composition:



In the next section, we'll examine more closely the last leg... the entities charged with tracking, collecting, and distributing these royalties.

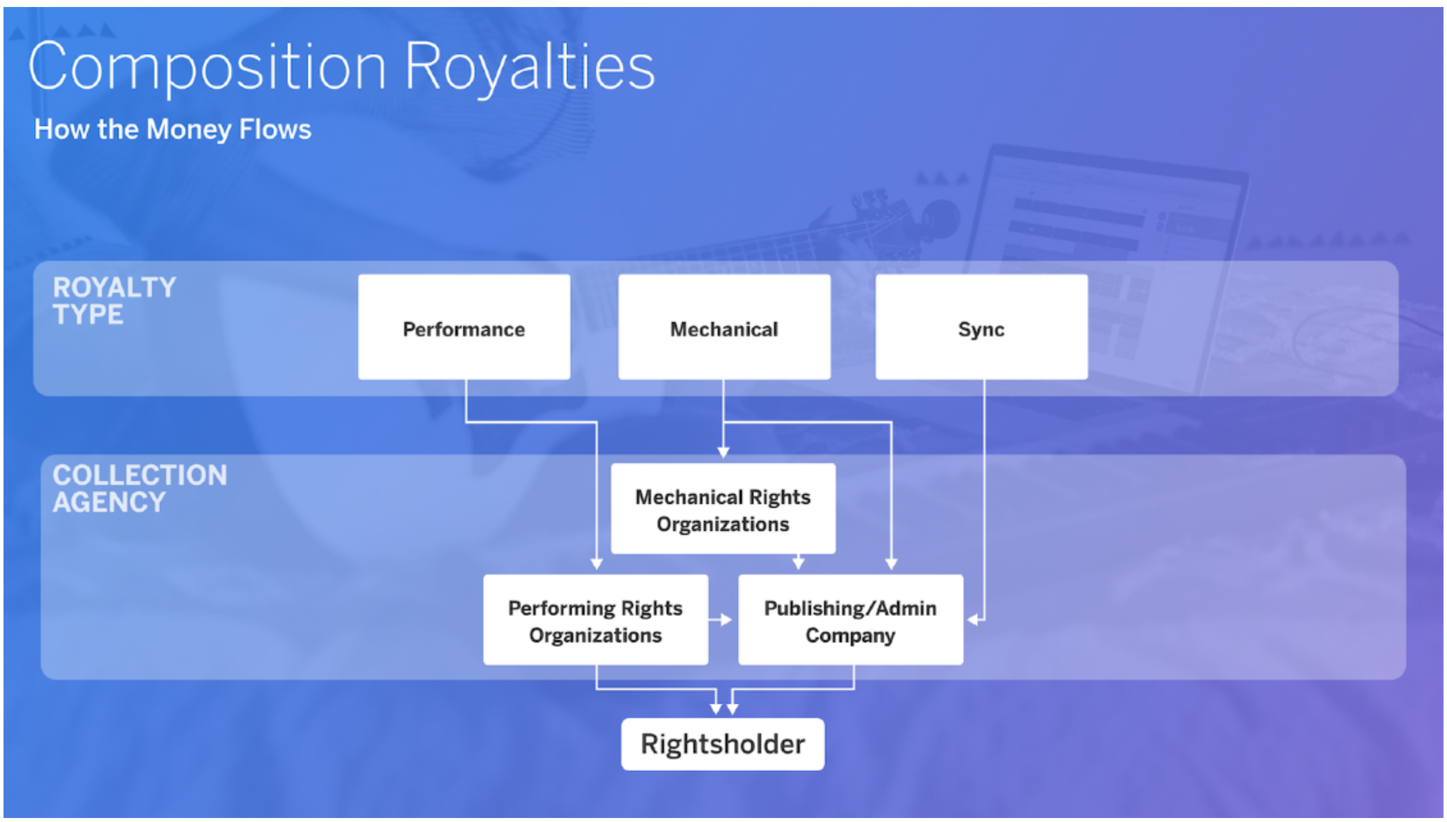
Royalty Collection & Distribution

The flow of royalties from those licensing music to those who own royalty interests in the music has many avenues. In addition to the labels, publishers, songwriters and artists mentioned in the prior chapters, there are also several entities charged with tracking, collecting, and distributing royalties to them based on the different uses and licenses involved.

In this section, we'll examine how owners of intellectual property collect various types of royalty payments for use of these assets.

First, let's review how Composition royalties are collected and distributed...

Composition



As noted in the previous chapter, composition royalties mainly include Public Performance royalties, Mechanical royalties, and Sync royalties.

As noted, songwriters typically sign publishing deals that grant the publisher ownership of the composition copyright in return for the task of exploiting it and collecting the royalties it earns (splitting the proceeds with the songwriter, usually 50/50).

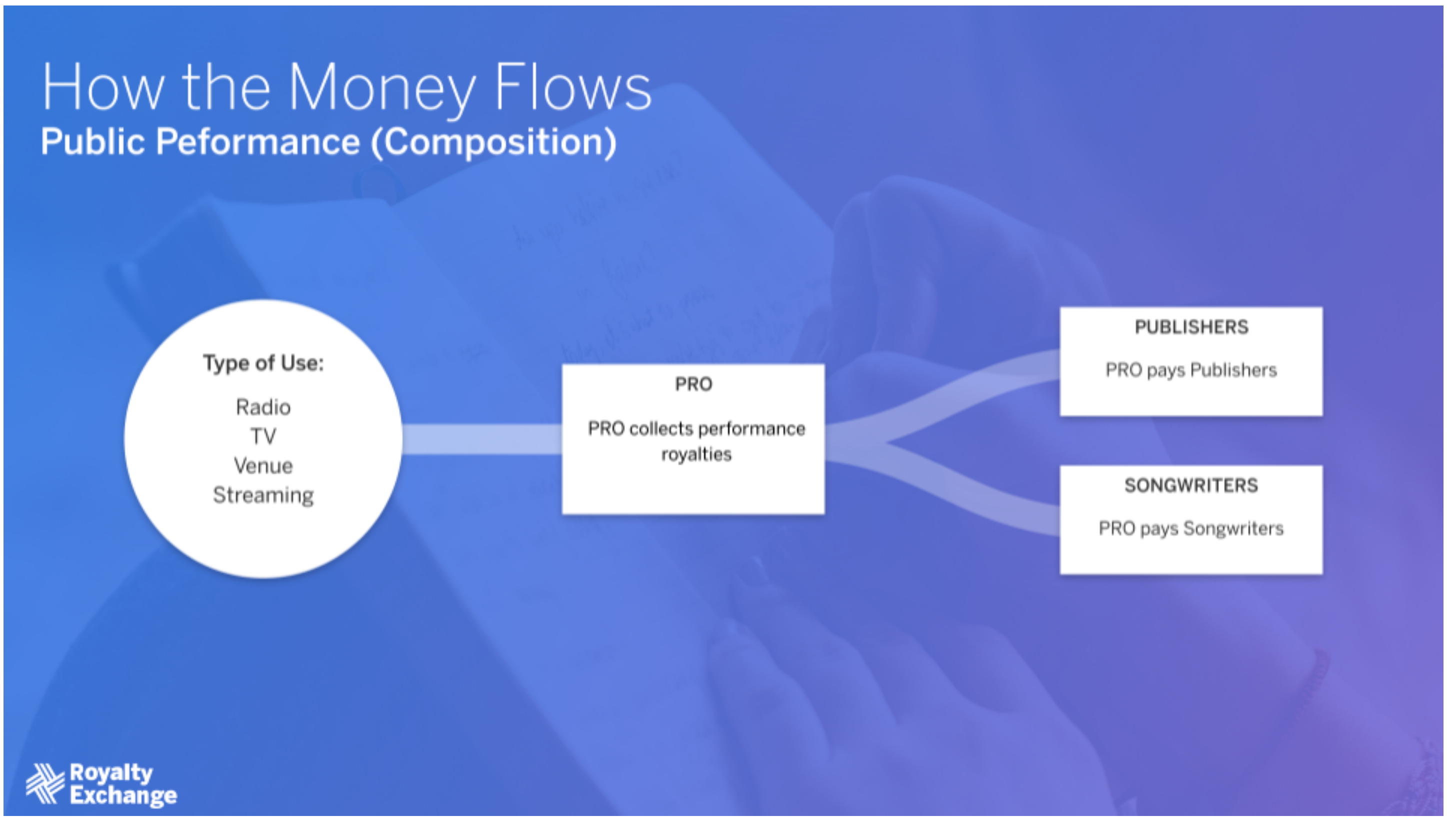
The three major publishers are

- Universal Music Publishing
- Sony Music Publishing
- Warner/Chappell

There are also hundreds of independent music publishers, and many songwriters are also self-published.

Here's how composition royalties are collected/distributed:

Performance royalties are licensed and collected by Performance Rights Organizations (PROs). Songwriters and publishers register with these organizations to collect performance royalties due them whenever a song is played in public. This includes the playing of a song on radio (AM/FM, streaming, or satellite), in a concert hall or in a restaurant, and on television shows and commercials.



These PROs pay both the publisher and the songwriter for their respective share of the performance royalty that they collect. There are three main PROs in the U.S.:

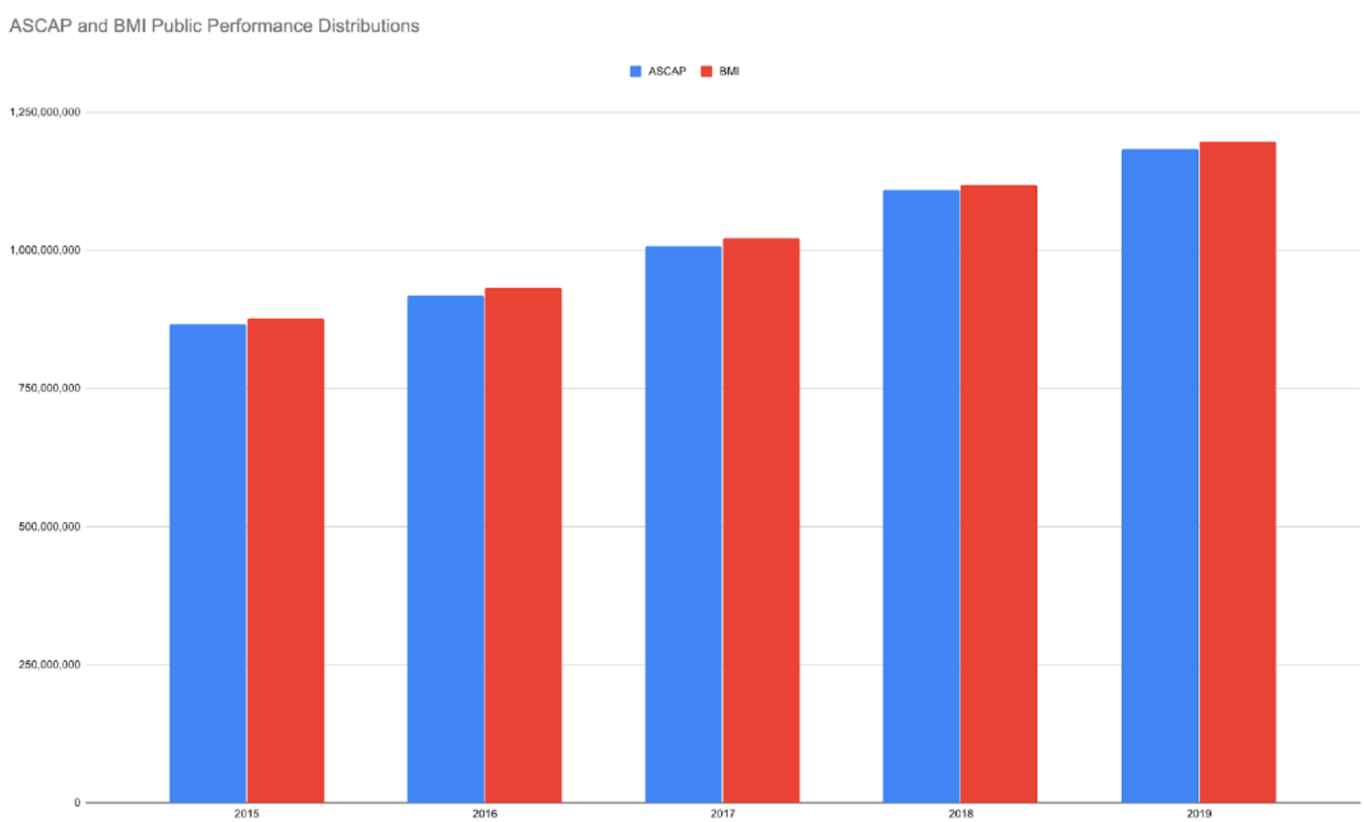
- ASCAP
- BMI
- SESAC

Internationally, PROs examples include:

- PRS For Music (UK)
- GEMA (Germany)
- STIM (Sweden)
- SOCAN (Canada)
- SACEM (France)

SESAC is a private, invite-only organization, while BMI and ASCAP are quasi-governmental organizations operating under legal frameworks known as "consent decrees."

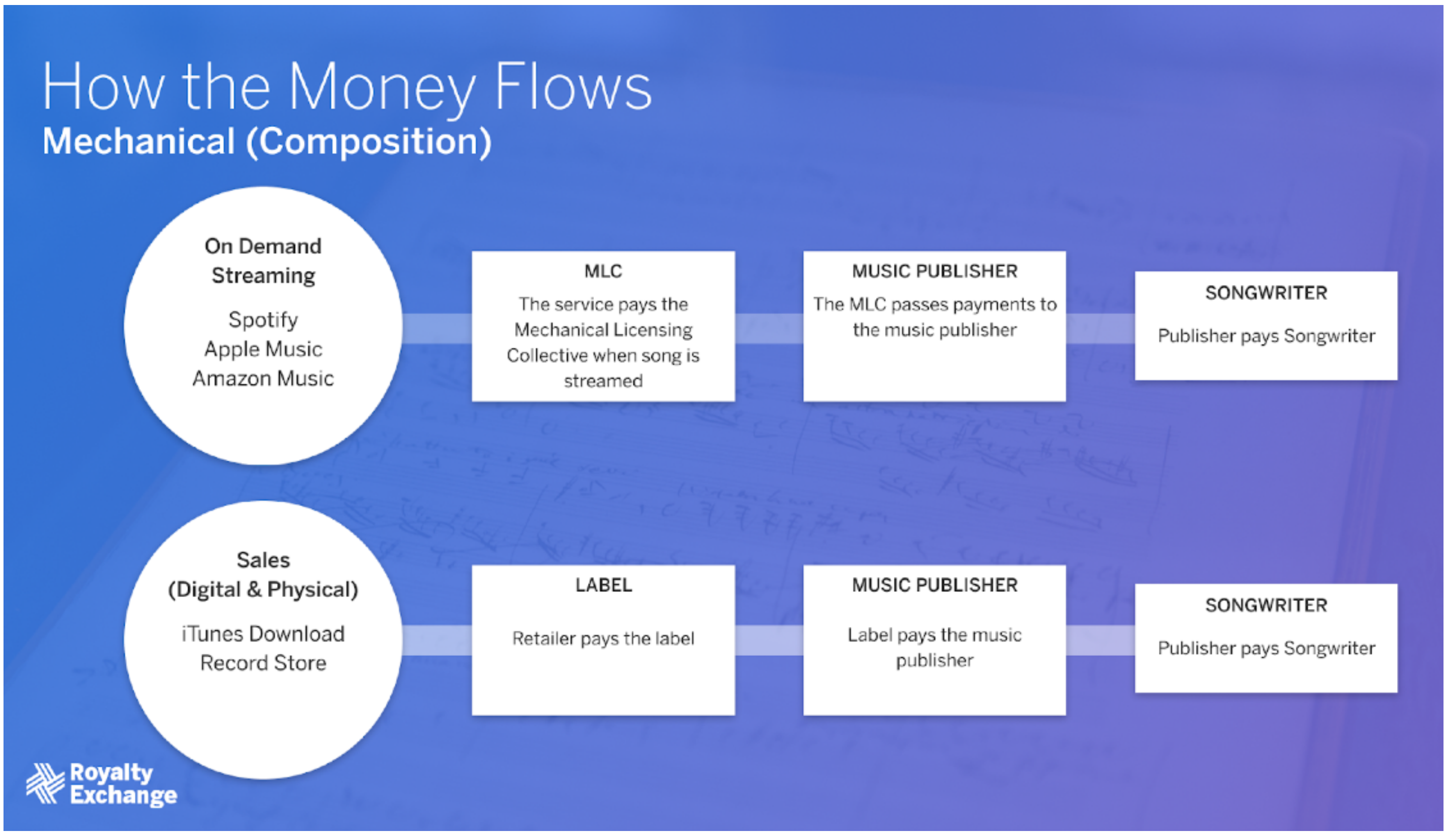
Established by the Department of Justice nearly 80 years ago, the consent decrees state that ASCAP and BMI must offer licenses to everyone on equivalent terms under a blanket license. The rate behind this blanket license can vary based on a variety of factors that differ based on the type of use that triggers it (i.e. radio vs live performance, and so on). BMI and ASCAP both distributed more than $1 billion each in the last year.



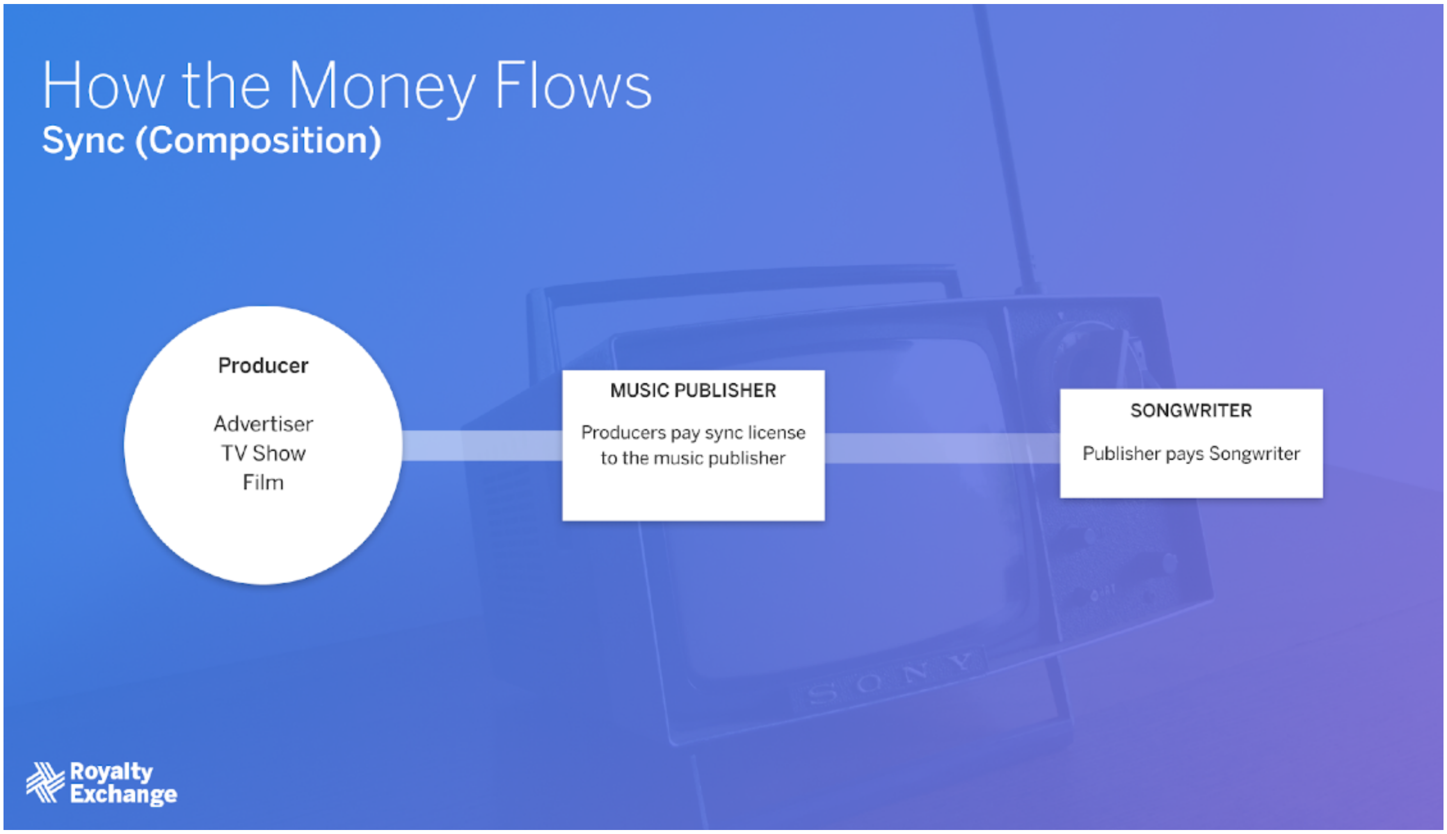
Mechanical royalties are collected in different ways depending on the format. For physical and digital sales, the mechanical royalty is typically passed on to the publisher through the record label after it collects payment from retailers. Internet streaming also triggers a mechanical royalty, as each stream is considered something like a "micro-sale." For digital downloads and streaming mechanicals, there's a new organization called the Mechanical Licensing Collective, launched in early 2021. Streaming music services pay a blanket license to the MLC, who then finds and pays the songwriters and publishers owed.

Mechanical royalty rates are determined by a group of three judges called the Copyright Royalty Board. This board sets rates for a term of several years and hears arguments from both publishers and retailers when making that determination. The mechanical rate is different for each format–9.1 cents for CDs, and a percentage of revenue for streaming, for instance.

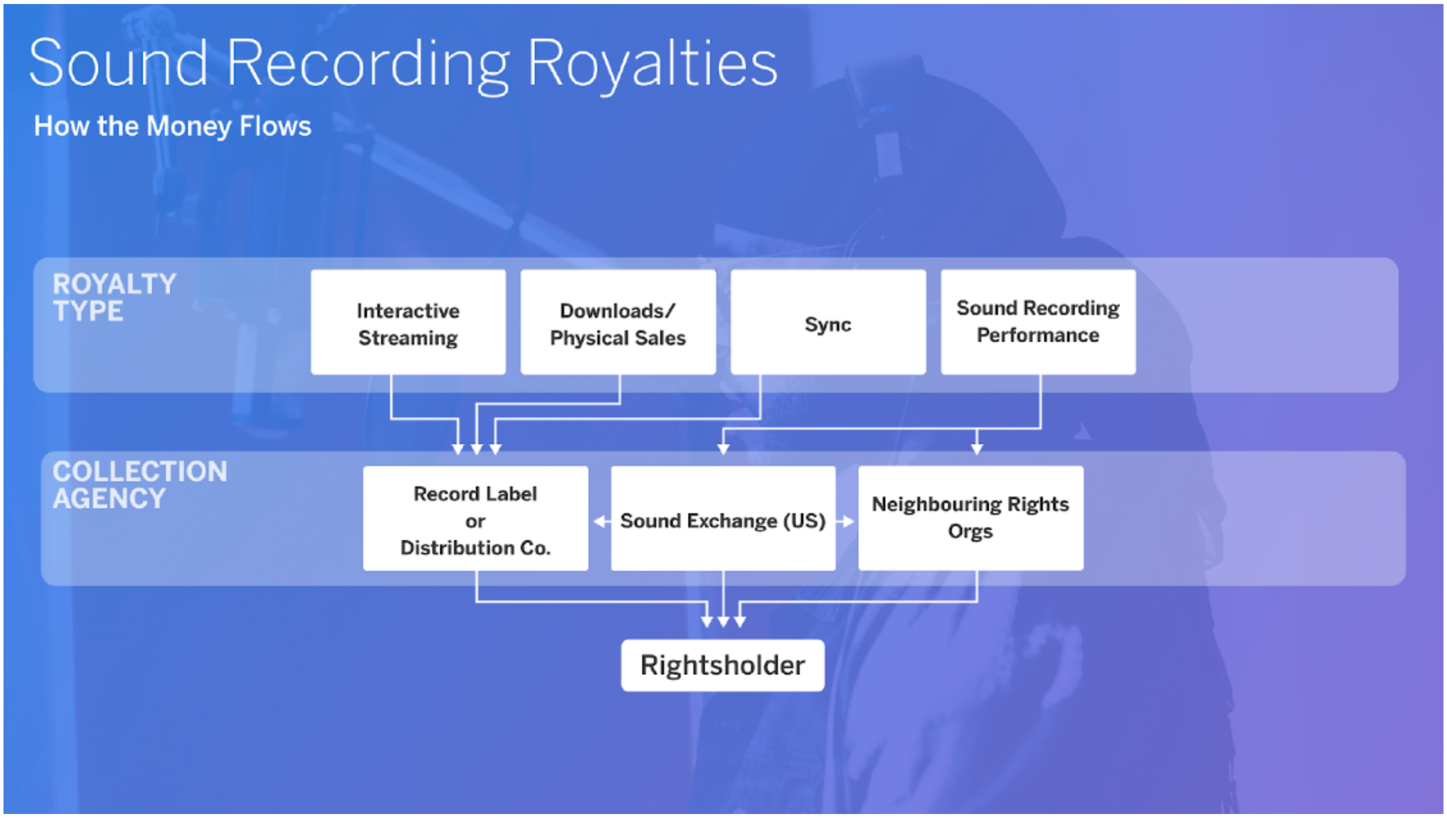
Internationally, mechanical royalties are often collected by that country's PRO, or separate organizations.



Synchronization fees are negotiated between songwriters/publishers and those who wish to use their music in film, TV programs, commercials, or other audiovisual work. They are agreed upon and paid up front directly to the songwriter/publisher, before the audiovisual work is created.



Sound Recording



Sound Recording royalties include those owed for distribution, performance, and sync.

Just as songwriters sign deals with publishers to exploit their copyrights, recording artists often sign deals with record labels. And like publishing deals, recording contracts typically award the recording copyright to the label, in return for their funding, distributing, and promoting any resulting albums or singles. The label then pays the artist a percentage of any royalties earned, after repayment of any advance the artist may have received.

There are both major and independent record labels. Major labels are global in reach, and own both publishing and distribution arms. They aggregate multiple "imprint" labels that do the work of finding, signing, and promoting artists while utilizing the parent company's marketing, distribution, and funding capabilities.

The three major record labels are:

- Universal Music Group
- Sony Music
- Warner Music Group

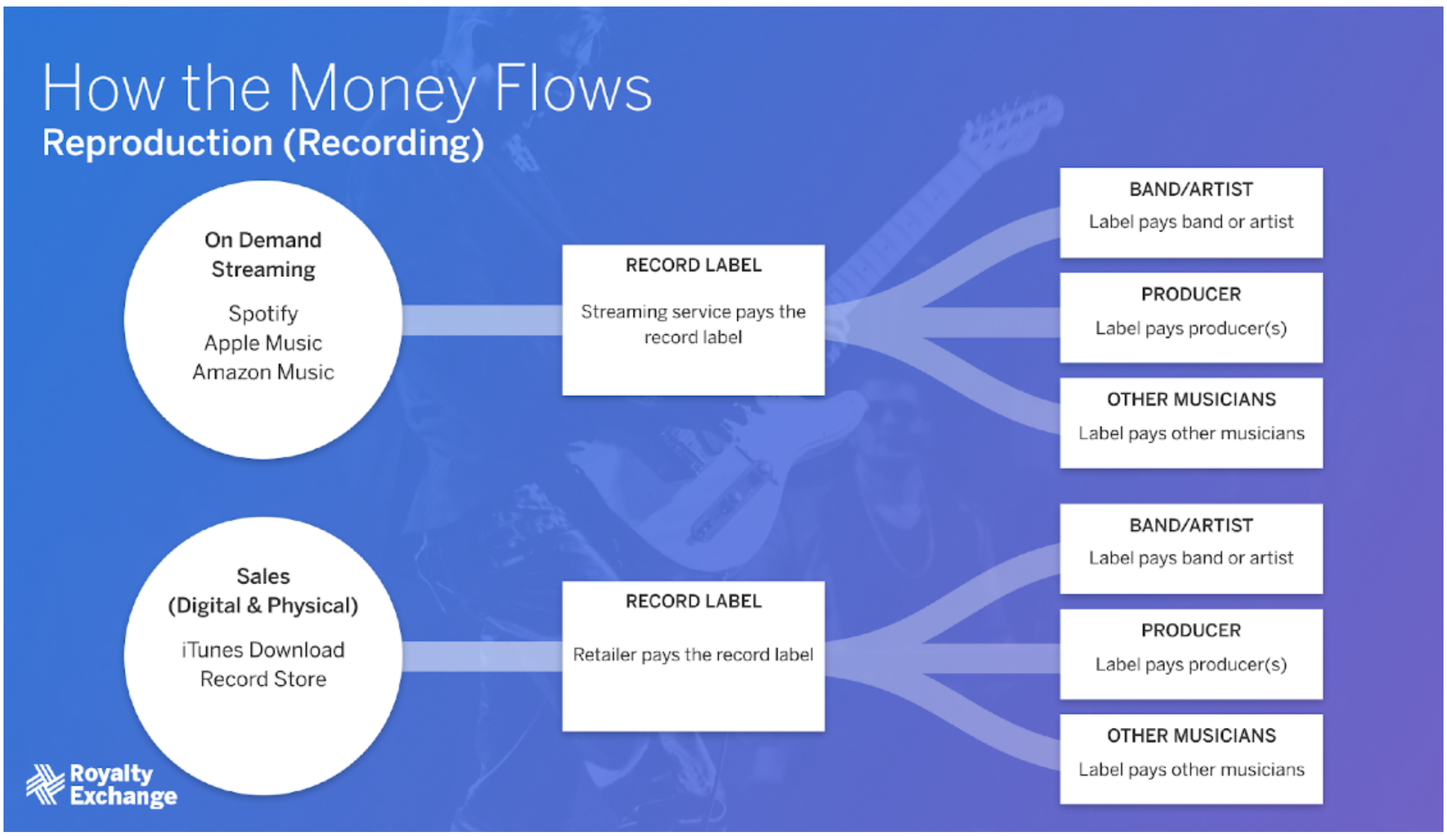
Independent (or "indie) labels are smaller companies that focus on signing artists (often within a specific genre) and partner with other companies to assist with distribution and other services. There are literally hundreds of independent record labels.

Here are the different ways sound recording royalties are collected and paid.

Reproduction royalties are owed when music is sold or streamed. Unlike composition copyrights, these royalties are determined through a negotiation between rightsholders and service providers and retailers.

There are two ways artists can collect these royalties

1. Sign a record label contract, under which the label negotiates and collects licenses on behalf of the artist.
2. Remain unsigned, and rely instead on so-called "DIY" distribution services to place their music with retailers and streaming services to collect royalties.



With the shift from physical distribution to digital, specifically streaming, many digital distribution services have emerged that allow artists to place their music on any music service for a small fee.

Examples include:

- CD Baby
- TuneCore
- DistroKid
- Vydia
- AWAL

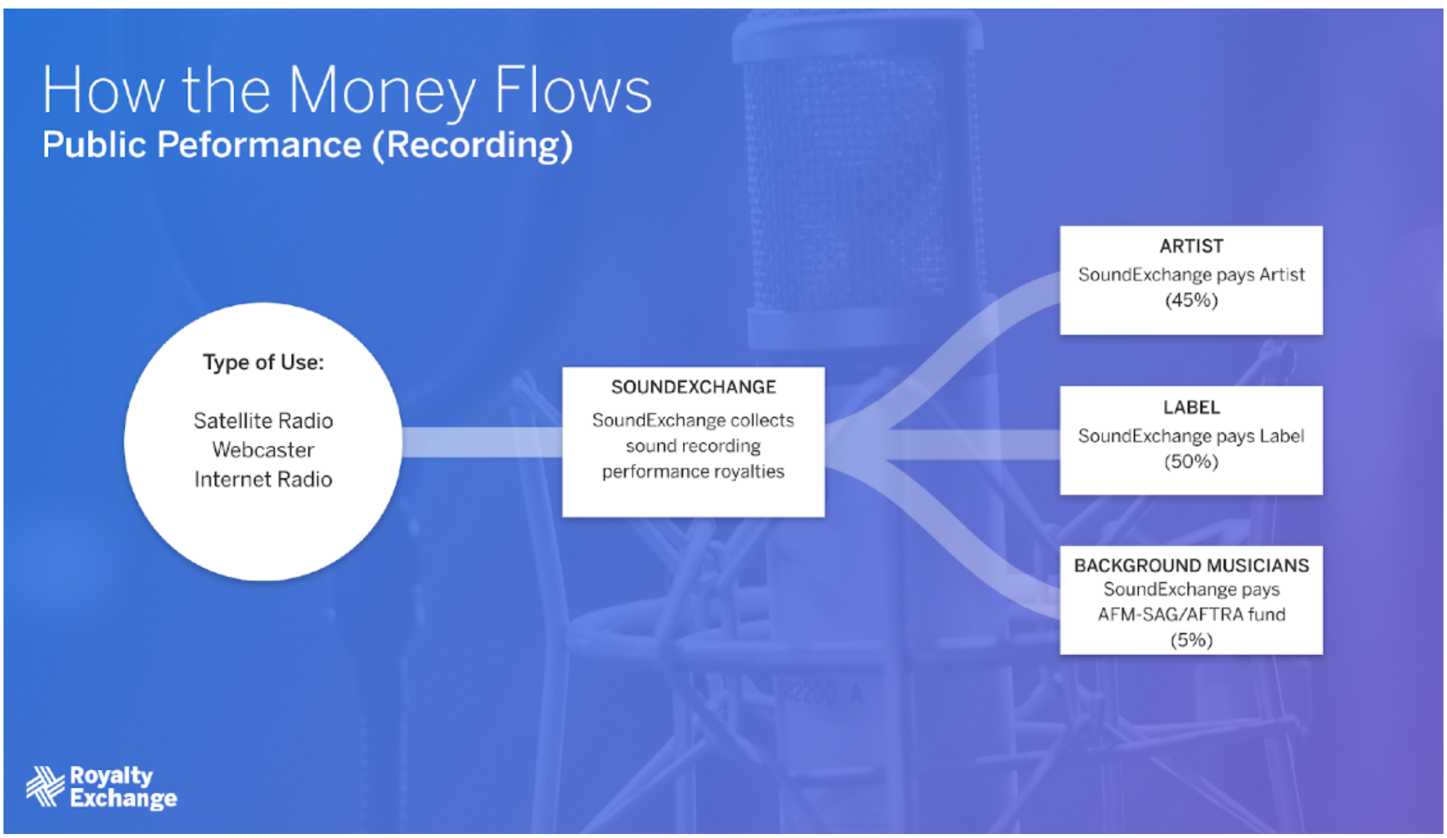
... among many others.

Performance royalties due for the Sound Recording are more limited than with the Composition copyright.

In the U.S., recording artists only collect performance royalties from digital and satellite radio. These digital royalties are collected in two different ways.

One is through SoundExchange, a PRO-like organization charged with issuing blanket licenses to digital music services and collecting the sound recording performance royalty in return. SoundExchange then pays artists directly rather than through their record label.

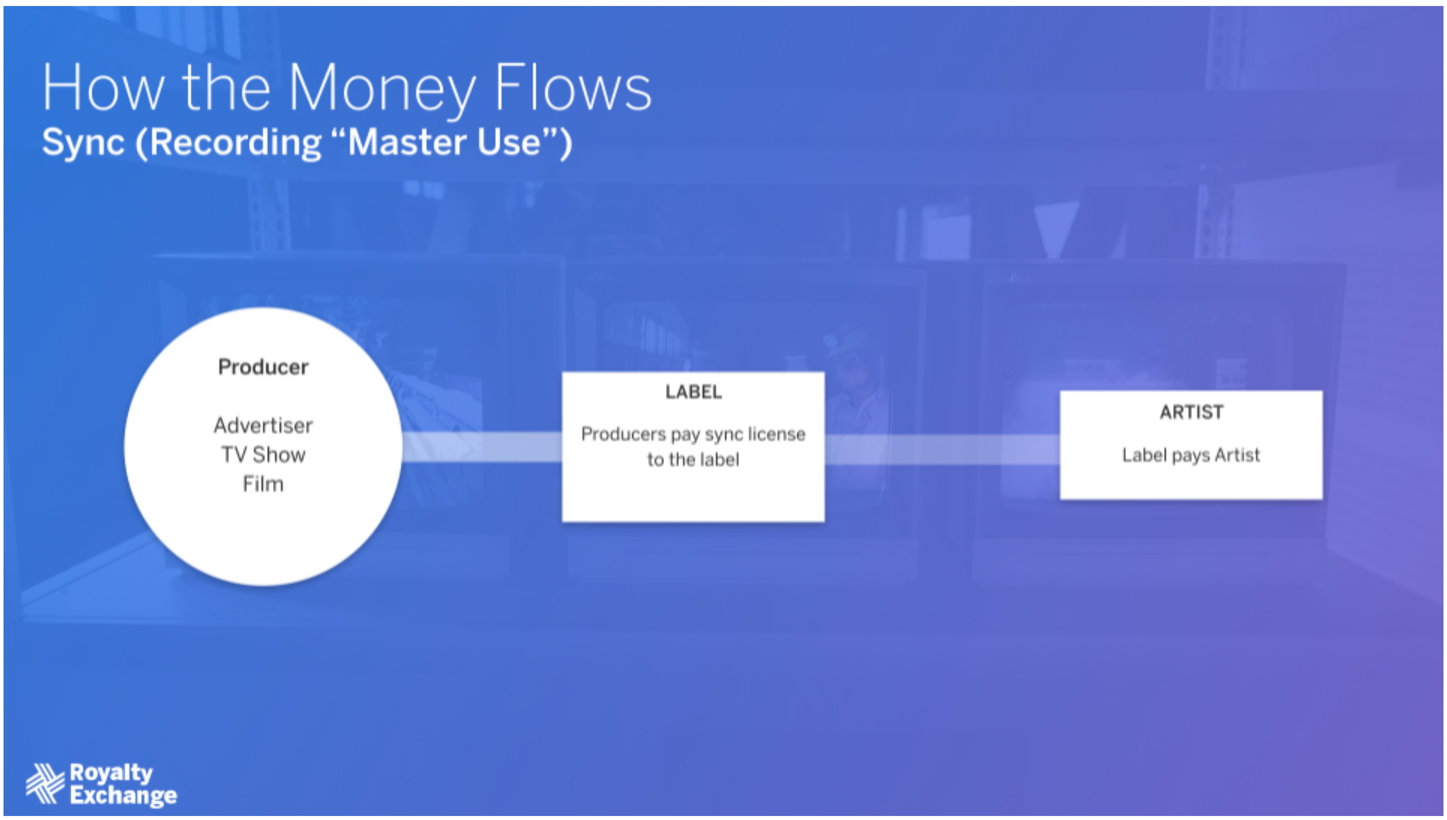
But some digital music services choose to negotiate performance licenses with record labels directly rather than using the SoundExchange license. In these cases, the music service pays the record label and the record label then pays the artist per their contract.



Again, recording artists do not earn performance royalties from terrestrial radio airplay in the U.S. But they do in virtually every other country in the world. Outside the U.S., both digital and radio broadcast performance royalties due to the sound recording copyright owners are called “neighboring rights.”

Neighboring rights are collected by what’s called “neighboring rights collecting societies.” These are often the same entity collecting performance and mechanical royalties for songwriters, but sometimes might be separate organizations. It depends on the country.

Sync royalties are paid to recording artists if the song they recorded is licensed for use in a film, TV show, advertisement, and so on. These royalties are collected by either an artist’s record label, or if unsigned using any of the available online music licensing services.



Valuing Music Royalties

While royalties share many similarities with other popular alternative assets–such as non-correlation to the economy and the ability to diversify risk–music royalties are a brand new asset class for most people.

This makes evaluating risk and determining a valuation challenging. After all, most investors have no experience in the music industry, and can't tell by listening to a song or catalog whether it will prove a good investment or not. Fortunately, you don't have to know anything about music to make smart music royalty decisions. In fact, you don't have to listen to the music at all.

Many investors at first understandably base their risk assessment on qualitative factors that no two catalogs share–like the popularity of the artist or the number of Grammy awards or Billboard chart positions they've earned.

A better approach is to compare catalogs based on measurable similarities... quantitative standard data points all catalogs share, regardless of genre or popularity. It allows investors to better assess the potential risk of unfamiliar catalogs that may still hold value (or to expose the hidden risk of catalogs they recognize).

LTM—Last 12 Months' Earnings

The first such data point is Last 12 Months' Earnings, or LTM. Sales on Royalty Exchange are measured by the multiple over the LTM investors will pay to acquire the royalty available. So if an asset earned $10,000 last year and you pay $50,000 for it, you would have paid a 5x multiple.

When you determine how much you want to spend on an asset, we feel it's helpful to determine at what multiple you're comfortable spending rather than just the dollar amount. Higher quality assets often justify paying higher multiples.

Dollar Age

But how do you determine higher quality assets? We're not in the music business, and can't tell just by listening to music whether it's got a good chance of earning royalties into the future. So we do what all investors do, we examine previous earnings.

This concept is known as the Lindy Effect, defined as:

The future life expectancy of some non-perishable things–like technology, or an idea–is proportional to their current age. Every additional period of survival implies a longer remaining life expectancy.

In other words, the longer something has been around, the longer it is likely to continue to stay around. This is particularly true with music.

Dollar Age is a time-weighted measurement of a catalog's likely stability of earnings based on the revenue produced in the last year, factored against the age of the songs included. For instance, suppose you were evaluating two different catalogs that both earned $50,000 in the last twelve months. One catalog consists of songs that have earned royalties for over 10 years. The other consists of songs that have earned for only 3 years. Even though both earned the same amount last year, the catalog with songs earning for more than 10 years would have the higher Dollar Age and thus would be considered a less risky investment.

So if the LTM earnings are an indicator of the quantity of earnings, Dollar Age is the indicator of the quality of those earnings.

Here's how Dollar Age is factored...

$$\text{Dollar Age} = \frac{\sum_{n=1}^{N} (Age\ of\ Track)_n * (LTM)_n}{TLTM}$$

- ∑ = Sum of
- n = Each track
- Age of Track = Today's date - date of track release (expressed in years)*
- LTM = Last twelve months earnings
- TLTM = Sum of LTM for all tracks

While this may look complicated if you're not familiar with mathematical formulas, it's actually very simple. So here's an example to illustrate the formula more clearly.

Song	Years Earning	LTM $$	Weighted Total
A	3	$2,000	$6,000
B	4	$1,500	$6,000
C	5	$1,200	$6,000
D	6	$1,000	$6,000
	4.21	$5,700	$24,000

(*Age of track means the number of years a track has collected royalties, not necessarily when it was first released. If the date of first payment is unavailable, use the original release data to approximate the age of earnings.)

As you can see, this catalog has four songs, each of which earned a different amount in the last 12 months (LTM), and each has earned for a different period of time.

To calculate the Dollar Age for the entire catalog, simply multiply the LTM of each song by the number of years that song has earned, to generate the weighted total. As you can see, this makes a song that earned $1,000 last year which has earned for six years equal in weighted total value to a song that earned $2,000 last year but has only earned for three years. The combined weighted total ($24,000), is then divided by the total LTM earnings of the entire catalog ($5,700), and the result is the Dollar Age: 4.21.

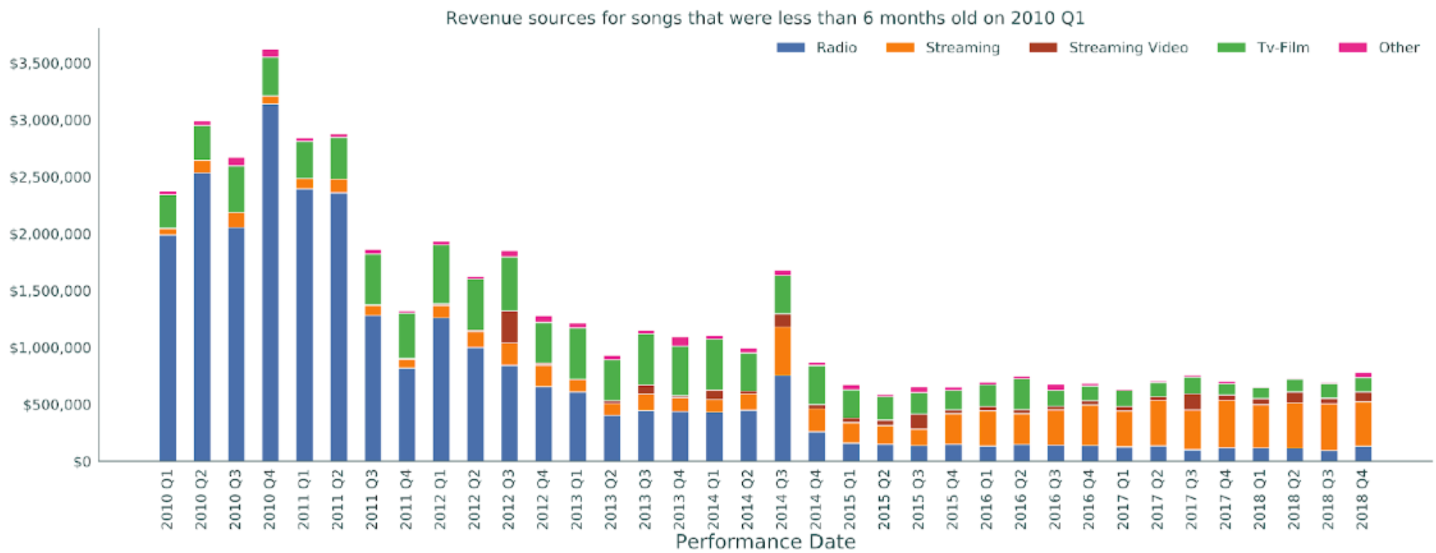
Source of Earnings

By now you've learned that songs earn royalties from multiple sources. Some of those sources are more stable than others. So when evaluating a catalog, it's important to look not only at the total royalties it generates (the LTM), but also the source of those earnings.

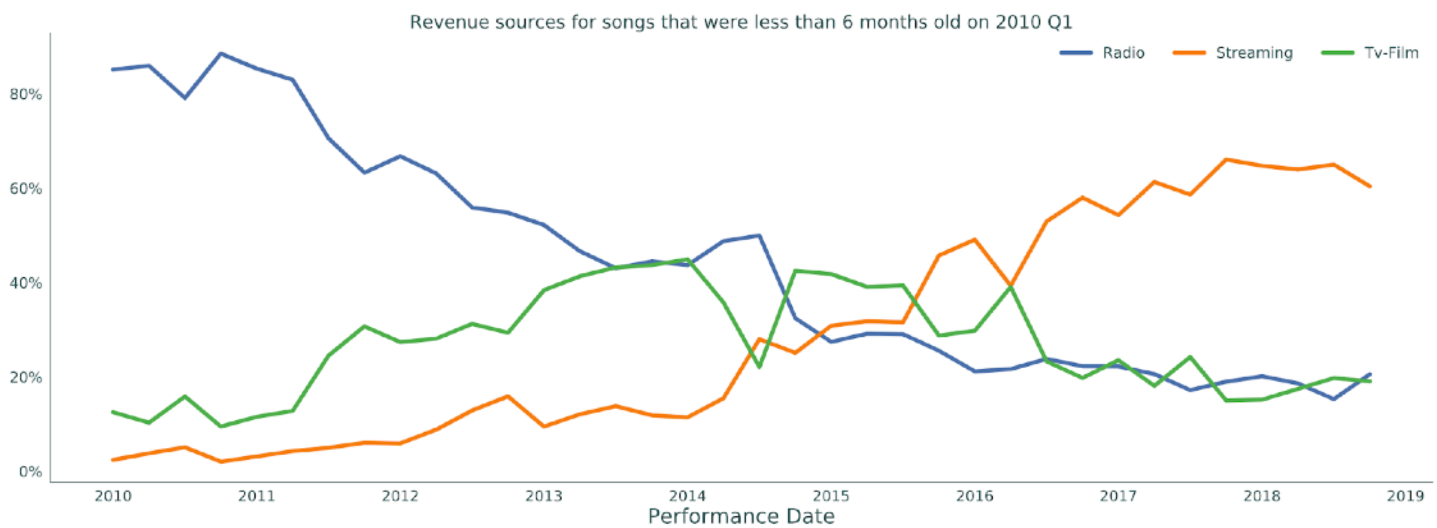
Catalogs that earn primarily from digital streaming are likely more stable than those earning primarily from sync royalties, since sync royalties are one-time payments and difficult to forecast.

We conducted an analysis of the public performance royalties earned by a group of about 5,000 songs submitted to our platform, from their release in 2010 through 2018. Because public performance royalties are generated by multiple types of uses (such as streaming, radio, TV, live performances, and so on), this examination provides the clearest picture of how different sources of royalties can impact a catalog over time.

The results in the chart below show that the majority of public performance royalties came overwhelming from three sources–streaming, TV/film, and radio. The other sources had a very small impact on the overall royalty income of the catalogs analyzed.



Here's another look at the same data, displayed as a percentage of earnings rather than dollar amounts to better illustrate the overall impact each source of royalties has over time.



The main takeaway is that the way a catalog earns royalties is an important measurement, and those sources will likely change over time depending on the age of the song. Knowing how different types of royalties fluctuate over time will help you evaluate the performance of your individual royalty stream by comparison.

Trend Rate

As part of your assessment, it is important to understand how much income a royalty stream is producing. What was the total income produced in the last year? In the past three years? Looking at the average yearly income is a good starting point for assessing the potential of a royalty. Seeing a longer trail of historical data is terrific.

However, typically the most recent history is likely a better indicator of near-future results than older data.

Royalties on average tend to decline over time. The rate of that decline is worth following. Is that rate decreasing or increasing? We consider a three-year average trend rate of -5% or better to be indicative of a quality catalog.

It's important to note that these valuation methods are just guidelines that we share based on our history and monitoring of the marketplace. Investors should conduct their own due diligence and develop a valuation method that best suits their return expectations and risk profile.

Due Diligence & Risk Mitigation

While Royalty Exchange vets assets listed on the marketplace to check for encumbrances, liens, or disputes prior to listing, investors are responsible for conducting their own due diligence when evaluating assets before placing a bid.

So let's review some resources available to you when investigating any asset under consideration.

Let's start with reviewing the details of each asset contained in each listing.

- Identify the specific royalty stream available. Are they Composition or Sound Recording royalties? Are they Songwriter or Publisher royalties?
- What is the term of the investment? Is it for the lifetime of the copyright or a shorter term? How much time is left on the copyright?
- How many songs are in the catalog? Is it an individual song or a diverse catalog of songs?
- What drives earnings? Are any of the songs licensed for popular movies or TV shows, or are any songs regularly licensed for commercial use?

Beware of letting "social proof" influence your decision making. When bidders see that others are actively bidding on an auction, they feel more confident placing a bid as well. This increases the confidence of others who then bid further. Conversely, when there are few or no other bidders they hesitate and worry that they might be making a mistake.

These are sensible guardrails to inform risk and reward in any bidding decision. When the nominal price (position size) and multiple are low enough relative to the Dollar Age, bidding on an asset can feel like a no-brainer.

For investors who like to dig deeper than what Royalty Exchange listings provide, here are some useful third party resources relevant to music royalty due diligence.

Streaming Data: The major music services will display streaming data that artists receive. This includes subscription services like Spotify and Apple Music, but video platforms like YouTube as well. Checking the stats on all three can provide useful insight.

Billboard Charts: In addition to the flagship Hot 100, Billboard also published genre-specific charts which can provide more granular detail on a song or artist's popularity within a subgroup of fans. Songs that remain on the charts for longer periods are particularly notable.

Analytic Services: Several companies track and aggregate useful music industry data, some free and others for a fee. This data can include tracking social engagement, market penetration, genre-specific data, and much more.

Here are a few of the more notable services:

- Chartmetric
- Nielsen / MRC
- NextBigSound
- AlphaData.fm

Music Industry News: If you'd like to keep track of music industry developments that may affect the earning power of music royalties, here is a list of the more reputable outlets covering the space:

- Billboard.biz
- Music Business Worldwide
- Variety
- Music Ally
- Midia Research

Music Business Associations: The music business has several trade groups that regularly publish both regional and global results worth following. The organizations below serve either record labels (for Recording revenue) or Publishers (for Composition revenue):

- Recording Industry Association of America (RIAA)
- International Federation of the Phonographic Industry (IFPI)
- International Confederation of Societies of Authors and Composers (CISAC)
- National Music Publishers Association (NMPA)
- Association of Independent Music Publishers (AIMP)
- American Association of Independent Music (A2IM)

Risk Mitigation

As with any asset class, you want to understand the key risks associated before investing. The following are the most common, and how Royalty Exchange acts to minimize them in advance.

Risk: Asset Transfer	**Solution**
All transactions carry risk associated with transferring ownership of assets. Will one party walk away? Can the investor pay in a timely manner?	All deals on the Royalty Exchange marketplace are legally binding. Listing agreements with sellers are finalized well before the assets are posted for sale. All investors are verified prior to placing bids and are legally bound to pay if an auction is won or an offer accepted. This verification process ensures that all funds can transfer within 48 hours of deal acceptance and offers the fairest, safest way to transact on the open market. Royalty Exchange facilitates each closing and does not release funds to the seller until the transfer of ownership is confirmed.
Risk: Liens & Disputes	**Solution**
Disputes in the world of royalty assets are not uncommon, especially early in the life of the asset. Similarly, royalty assets are occasionally subject to tax or other liens for various reasons that could result in the garnering of proceeds.	Prior to listing, Royalty Exchange verifies that the asset for sale is capable of being transferred free and clear, checking for encumbrances, liens, or disputes prior to listing.
Risk: Collecting Payment	**Solution**
Collecting proceeds from royalties is complex. Government-regulated entities aggregate payment in an antiquated, disconnected way which can prove complicated when buying various royalty assets from different distributors over time.	Royalty Exchange acts as the administrator for all assets sold on our platform. This provides you with a "one-stop shop" for your royalty payments, royalty auditing, tracking of your returns, and other support/service benefits. The cost of this service is a one-time fee paid at the close of the transaction of 1% of the final price, with a $500 minimum.

Risk: Liquidity	Solution
One of the limitations to royalty investment in the past was a lack of liquidity. Just as royalty investments were once difficult to get into, getting out was equally challenging.	Royalty Exchange allows investors to resell their assets on the Royalty Exchange Marketplace whenever they choose.
Risk: Volatility	**Solution**
While some aspects of royalty income are consistent, with easy to follow trends, others are not. In particular, international income, outlier payments, and one-off legal settlements can distort earnings.	Royalty Exchange excludes or normalizes these payments when calculating list prices. This creates a more accurate valuation for the earning potential of any catalog, while still allowing for the upside of those unpredictable payments.

Ways To Buy Music Royalties

Royalties as an asset class are relatively new to retail and institutional investors.

That's because these yield-generating assets are so valuable that industry insiders restricted access to them for decades. Buying and selling royalty rights was limited to private backroom deals, with little competition and no transparency.

With Royalty Exchange, you can not only access these lucrative assets, but you can seamlessly add them to your portfolio with confidence.

Simply put, we make royalty investing easy. We do this by creating standardized assets made available in familiar investment vehicles.

Investment Horizon

There are three types of investment options available on the Royalty Exchange marketplace. They include...

Term: Life of Rights

Investor collects royalty income for the lifetime of the underlying copyright (Life of the creator PLUS 70 years).

Purchasing a Life of Rights asset gives you the right to collect royalties for the duration of the copyright while you continue to own it. For copyrights created after 1977, that duration is the lifetime of the last living creator plus 70 years.

Because there are fewer opportunities to acquire Life of Rights assets, competition is often fierce. Life of Rights auctions on average attract twice as many bidders and three times as many bids as Term Based auctions.

Term: Temporary

Investor collects royalty income for a fixed period of time (typically 10 or 30 years). Royalty income then reverts to the original seller after the end of the term.

The fixed timeframe of term-based assets is the preferred option for sellers who otherwise resist selling royalties permanently. As a result, you as an investor gain access to both a broader range of royalty investment opportunities, as well as more diverse and higher quality catalogs (and at lower costs).

Fixed Return

Investor collects a fixed dollar amount, which will differ from asset to asset. In this case, the total return is fixed, but the time it takes to collect that total is variable.

Once collected, royalty income reverts to the original seller. These investments function much like advances. The rate of return will depend both on the amount paid and the time it takes to recoup.

Investing Formats

There are three different kinds of listings on Royalty Exchange:

The Auction House

Our online Auction House allows investors like you to find quality royalty investment opportunities and buy directly from the owners themselves. We don't conduct backroom deals or broker private transactions. Instead, we facilitate public auctions on a level playing field where everyone has access to the same information and opportunities.

Each listing includes the details necessary to help investors understand the income stream listed for sale

The eXchange

eXchange listings are static, unlike auctions. Here, you can make an offer directly to the asset owner, either another investor like you who previously bought the asset on Royalty Exchange or a rightsholder listing their catalog for the first time (called a Direct Listing).

Interested investors can make offers directly to the owner, who can accept or reject them through the platform. Owners can also set a "List Price" that dictates the amount they'd consider for an immediate sale.

Auction House and eXchange listings are single-seller, single-buyer transactions. There are no fractional shares. All bids and offers are binding. That means that if you win an auction, or if your offer made in the eXchange is accepted, the seller must transfer the asset and you must pay the agreed-upon price.

Private Syndicates

On rare occasions, we will offer Private Syndicates to accredited investors in our All Access program. Private Syndicate participants can acquire an equity interest in multi-million dollar, top-tier catalogs. Unlike auctions, there is no bidding. The cost of Private Syndicate units are known in advance, providing the flexibility to take a position size in each catalog that best suits your strategy and risk profile.

Though these deals are much less frequent (Royalty Exchange has stringent criteria for what would be offered in a Private Syndicate structure), they can be a unique investment opportunity when available.

Get Started With Royalty Exchange

Using Royalty Exchange to shop for music royalties isn't just easy. It's free.

Anyone can create a free account on Royalty Exchange to view any listing. You don't need to be an accredited investor, and there are no fees to join.

Once your account is created, you can browse all listings and even register to watch an auction. To bid, or make an offer, investors must first complete a one-tine, in-house verification process.

For serious investors, our All Access premium membership program offers:

- monthly Insights reports
- access to financial analysis
- significant discounts on marketplace fees
- priority access to private syndicates

GET STARTED TODAY

[WWW.ROYALTYEXCHANGE.COM](http://www.royaltyexchange.com)

Appendix

Digital Service Providers

Digital Service Providers—also known as “DSPs”—include such services as on-demand streaming services, Internet radio, streaming video, and so on.

Since digital has become the dominant music format of the age, a quick overview of the main services might prove helpful. Below is a short list of the main service of each type, and how they generate royalties differently.

On-Demand Streaming

These services allow fans to select a specific song to play on demand, create playlists, skip or pause songs, and more.

These are also known as “interactive” features, which generate a higher mechanical royalty payment than many of the other options below. All require fans to pay a monthly subscription fee for these capabilities, while some offer a free service tier supported by advertising with slightly limited features.

Services:

- Spotify
- Apple Music
- Amazon Music
- Deezer
- Tidal

Internet Radio

These services range from those that simply stream a programmed radio station over the Internet, to those that stream a more customized/curated stream programmed on the fly by an algorithm attempting to replicate the listener's taste.

The common thread between them all is that they do not allow users to select specific songs, but rather stream songs selected by the service based on their input. There is limited ability to pause or skip songs. These are termed “non-interactive” features and pay a lower “webcasting” royalty rate.

Services:
- Pandora
- iHeartRadio
- SiriusXM
- TuneIn
- Soma.fm

(Note: Many on-demand services like Spotify and Apple also offer Internet Radio services, while Internet Radio services like Pandora also offer on-demand features for a higher price.)

Video

Music and video have gone hand-in-hand since the end of the silent film era, and online video services and apps are no different. In fact, more music is streamed on YouTube every month than on any individual music streaming service. But the way video services pay royalties for this music is much different, thanks to the "safe harbor" protection clause of the Digital Millennium Copyright Act, which is a point of frustration for music rightsholders.

But there are other new video services that the music industry has taken a more aggressive licensing stance with worth noting as well.

Services:
- YouTube
- TikTok
- Vevo
- Twitch

Streaming Economics

For all the simplicity streaming services offer music fans, the way they compensate artists is a little confusing. So let's take a quick look at how streaming revenues flow in the music business.

Streaming services operate what's known as a "pro-rata model." Under this model, services compile the revenue generated by monthly subscription fees and advertising revenue into a big pot. The streaming service keeps around 30% of this revenue, and the remaining 70% goes to songwriters and artists.

That 70% is distributed to rightsholders based on collective listening time. So if an artist commands 3% of the total listening time for a given month, that artist receives 3% of that month's revenue.

That means if you pay $10 a month for Spotify, and only stream music from one artist, that artist will not receive your full $10. Instead, that artist will collect only the share of that month's revenue equal to the total streams received from all listeners.

It's also why it's not possible to determine a "per stream" rate. The per-stream payment will change from month to month based on the total number of streams and the total number of subscribers. The greater the number of streams, the lower the per-stream payment (but likely will result in higher overall total payment).

The more subscribers that music services acquire, the larger that pot gets, and the more revenue there is to share among artists.

Also worth noting is the difference between how recording artists are paid vs. songwriters. For every $100 collected, streaming services pay around $52 to recording artists and around $12 to publishers and songwriters.

STILL HAVE QUESTIONS?

Attend one of our monthly Investor Office Hours sessions–an open Q&A where our staff answer all your questions. You can submit a question in advance, or ask one live.

REGISTER NOW