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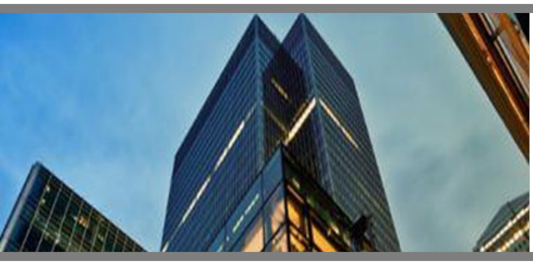
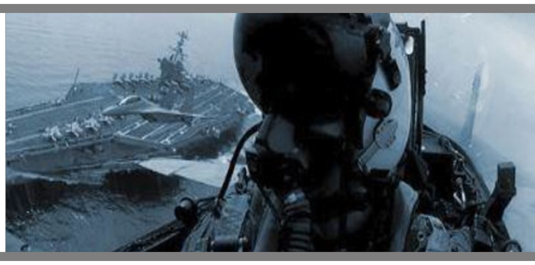
Music ABS: Pool Variations Emerge Amid Constructive Sector View





Collateral Attributes Call for a Nuanced View on Music Securitization

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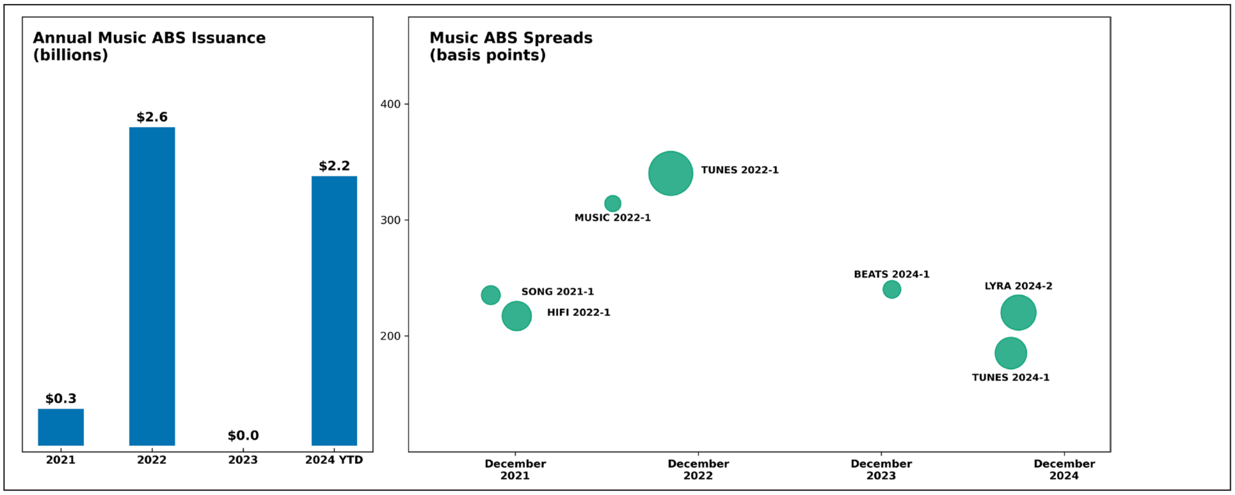
Notable differences in some collateral attributes across recent music royalty ABS transactions suggest deal analysis will become more nuanced, going beyond forming a broad view on the music securitization sector. Secular tailwinds and investor appetite should drive more issuance of music ABS deals. On the supply side, a growing number of artists and other copyright owners that look to monetize their music catalogs via lump sums rather than protracted royalty streams, should provide fresh collateral to securitize. Queen and Pink Floyd selling their music catalogs this year for $1.27 billion and $400 million, respectively, are two recent examples.

On the demand side, investors show increasing interest in esoteric segments, and especially those that may be less correlated with the economic backdrop and other securitized segments.[1] The relative stability and predictability of royalty revenues from streaming services supports both sides of the equation. Issuance picked up this year, reaching $2.2 billion, including two deals that priced in recent weeks (Figure 1). Collateral diversity could allow investors to discriminate in the type of music royalty exposure they add. It can also facilitate intra-sector relative value if spreads gradually reflect collateral differences.

Figure 1. Music Royalties ABS Issuance and Spread Levels

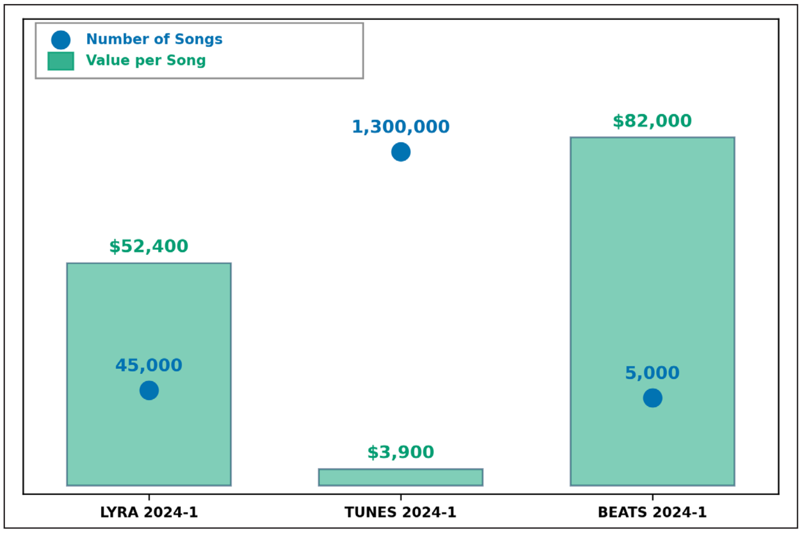


Source: Bloomberg and Academy Securities

1 See "Recovery Bonds: No Need to Closely Watch the Fed or the Economy Here," Securitized Products Special Topics, Academy Securities, November 30, 2022

Pool characteristics reflect sharp valuation differences in music royalty collateral. For example, the number of songs per pool in the three publicly issued transactions this year ranges from 5,000 to 1,300,000, according to deal documents. The respective overall portfolio valuations range from $410 million to $5.05 billion. That pegs values per song at $82,000 or $3,885, on average, depending on the pool (Figure 2).

Figure 2. Music ABS Pool Attributes



Source: Presale reports and Academy Securities

Music Royalty Types May Drive Valuation Differences

Different music royalty types likely explain the stark per-song valuation differences Figure 1 shows. The royalty payments on the 5,000+ songs backing the $266.5 million BEATS 2024-1 deal (Kobalt Music) are all from music compositions and music publishing rights. In turn, recorded music royalties comprise 60% of portfolio payments in the 1.3 million-song catalog backing the $850 million TUNES 2024-1 deal (Concord Music). Only 40% of the revenue in TUNES comes from music publishing royalties. Music publishing royalties are initially owed to songwriters/composers. Recorded music royalties are associated with the recording of music. In the recent catalog sale examples we mentioned above, Queen sold both its publishing and recording rights, according to press reports; Pink Floyd only sold its recording rights.

The catalog valuations we see on music ABS deals suggest royalty revenue from music publishing could be dramatically different from that of recorded music. Of course, the valuation differences can also be a function of the specific songs each catalog contains. Intuitively, hit songs or popular artists stand to generate more royalty revenue. Still, it may be challenging for non-specialists to value precise income streams. Moreover, deal documents appear to try and mask the specific songs in the collateral. We see top songs labeled as “asset 1”, “asset 2” etc.[2] All told, at the very least the varied pool valuations across recent deals show the limitation of using the number of songs in a deal as a value-driver distinguisher.

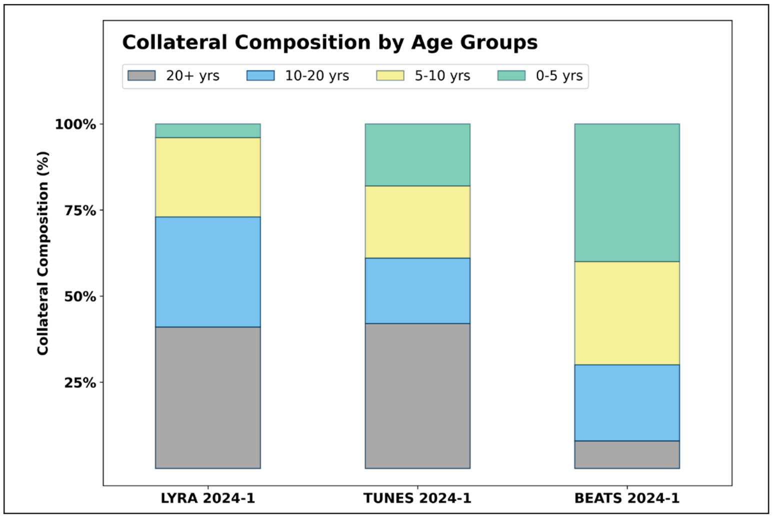
2 Interestingly, the opaqueness of song names we see in music ABS deals echoes the confidentiality on tenant identities in data center ABS, as we discussed in a recent report. In both cases, there could be valid reasons to mask the granular information in publicly issued deals. But the practice can limit the ability of market participants to conduct independent granular underwriting.

Deals Differ in Catalog Vintage and Genre

Catalog vintage and genre breakdowns should also play a role in value differences across music ABS.

- **Competing drivers of vintage value.** High percentage of seasoned music is considered a stronger collateral attribute, according to rating agencies. Royalty cashflows become more stable and predictable over the years since a song is released. On the flip side, song cashflows typically peak within a year or two of its release, subsiding later. There appears to be a trade-off between cashflow amounts and their stability/predictability, based on the song's age. The 2024-vintage music ABS deals feature notable variations in their catalog age composition (Figure 3). Both LYRA 2024-1 and TUNES 2024-1 have over 40% exposure to songs released 20+ years ago. But TUNES have elevated exposure (18%) to new songs, compared to LYRA (4%). In turn, the majority of BEATS 2024-1 catalog is new songs. Such vintage differences again allude to a strong dependence on third-party music valuation agents for cashflow modeling. We expect ABS investors are gradually developing independent views on the nuances of royalty performance drivers.

Figure 3. Music ABS Pool Vintage Breakdown



Source: Presale reports and Academy Securities

- **Music genres feature different cashflow curves.** Stronger music ABS pools have diverse catalogs and multiple music genres, in general. Recent music ABS deals typically highlight the diversity of their catalogs as a credit strength. Still, we cannot immediately see genre breakdowns across deal documents. Different royalty dynamics of various music genres suggest cashflows can vary depending on pool genre composition. For example, country music generates significant revenue from radio, rather than streaming, according to industry participants. Country song revenues can surge post-release, and then drop significantly. In contrast, pop songs may have more sustainable cashflows from streaming. As such, any country-heavy pools may need to be dynamic, with new songs replacing seasoned ones. In other genres, static pools could be stronger given the stability of streaming revenues.

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