UNIVERSAL

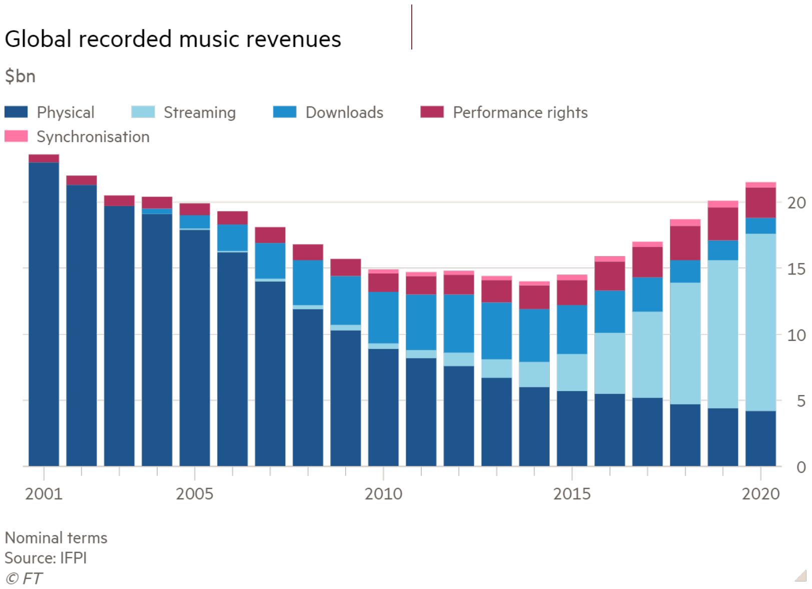
UNIVERSAL MUSIC

There are few things surer than the predilection of humanity for music. It is the shorthand of emotion, as Tolstoy once quipped. All societies throughout history have developed their own musical language; whether it stemmed from the lyre (ancient Greece), the lute (medieval Europe) or the well-tempered clavier (an absolute game-changer that gave birth to the modern piano and in a way, all music that came after it). Warren Buffett's case for investing in Gillette was famously simple: most men shave, and most men will continue to shave 'til day dot. Our thesis on UMG is simple: **Music is Universal**.

We quite deliberately own both ends of the transaction. Investors in the Elevation Capital Global Shares Fund own UMG via a direct holding, but also through our ownership of Tencent (the Chinese technology stalwart that owns 20% of UMG), and Vivendi, which spun-off UMG in 2021 and continues to hold a 10% stake). We also own Spotify (and we published research on it in April 2020 and an update in July 2020).

Why do we own both sides of the transaction?

The reason is quite simple. The two are correlated; the more people who stream music, the more royalties UMG will receive.



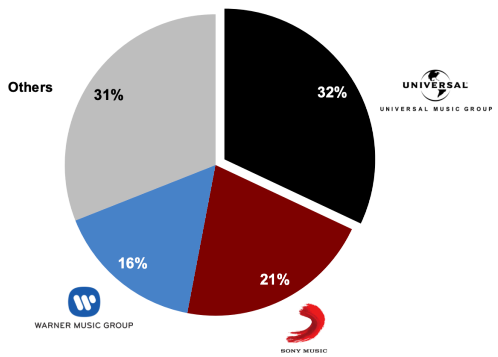
The music industry has gone through two major disruptions in the last twenty years. The first is the "death" of the physical format - the CD - and the ascent of downloaded music. The second was the "death" of downloaded music and the ascent of streaming. Something happened between the 2000s and years following; total revenues declined, hitting their nadir in 2014. It's important to review what happened to understand what occurred next: in effect, the record companies didn't know how to pivot towards a new digital era. Pirating of music was rife but also downloading music is a laborious process compared to a streamer, where millions of songs sit at your fingertips. The industry had continued to pour the bulk of its efforts towards the physical format (CD's), which was a dying format – the iPod had seen to that. Secondly, the music industry couldn't quite profit from downloads enough. The frequency wasn't great enough.

Streaming changed this. Music industry revenues have now recovered to their early 2000s heyday directly proportional to the number of users on the various streaming platforms – Spotify, Apple Music, Tidal, YouTube Music, Amazon Music, etc. The secret is the increase in frequency – whilst streams pay mere fractions of a cent per song play to the record company, the frequency is much greater. This bears many similarities to the co-dependent relationship of recorded music and radio which occurred at the advent of the medium. In other words, it's full circle: streaming is the new radio, and the two are highly correlated.

The "Big Three"

Universal Music Group (UMG) is one of the "big three" music publishing companies (the other two are Warner Music and Sony). Like its brethren it is the result of decades of industry consolidation and hence it is a diverse collection of assets which management has pieced together into a coherent whole (whilst UMG's origins stretch back to Decca Records, in 1934, its various assets has, at points, been owned by Panasonic and prior to that Seagrams, the distiller). UMG now holds a 32.1% market share globally, which makes it the largest in the industry. It also is the only publisher to have consistently grown its revenues from 2018-2021, largely due to its embrace of streaming and modern mediums of music consumption (Spotify and the other streamers, TikTok, music licensing on memes and so on). We like industries which have been subject to consolidation, especially ones that are progressing towards an oligopolistic structure. Industries at their birth are often dense with competition. In 1896, when the bicycle became popular there were 140 publicly listed companies engaged in the manufacture of bicycles; by 1901, 40 of those had gone bankrupt and over the next ten years another 60 had gone out of business. The invention of the bicycle was a significant advance in technology (in some ways, it was the most egalitarian advance in technology since the printing press – no fuel needed and relatively cheap and accessible).

UMG commands the largest market share



Yet a significant new technology is no guarantee of a successful business. The more businesses engaged in a new technology, the more competition, and the less chance the business will produce what we are all interested in at the end of the day – significant cash flows.

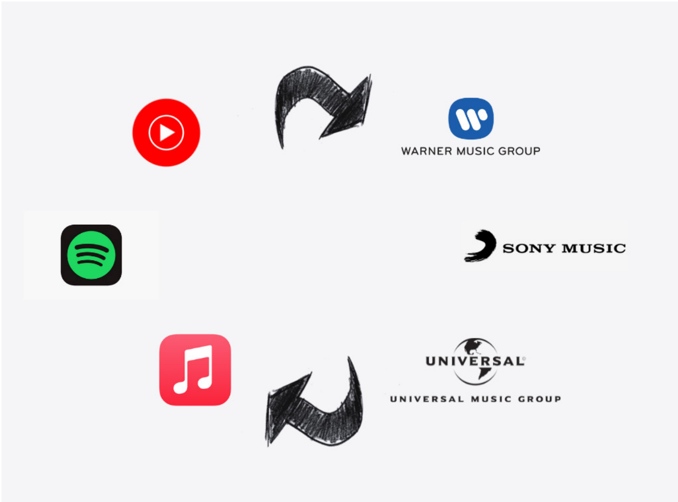
The catalyst for the recorded music industry were the twin inventions of the radio and recorded sound (first on wax cylinders which quickly evolved to vinyl discs). The two were bound together tightly; recorded sound allowed for the first time in history for music to exist outside of the present. Radio allowed for the effective "streaming" of it in a way which allowed almost unlimited distribution. The fortunes of the two industries were, for a time, linked at the hip. There were numerous recorded music companies and numerous radio companies. Both industries consolidated; for instance CBS transitioned from a radio station operator to a TV company, as did NBC. Decca (the historical precursor to UMG) merged with Universal-International and later MCA. Now the music industry has consolidated further resulting in the "Big 3" and the other side of the transaction – now streamers, not radio – are consolidating, too. There are therefore two catalysts that inform our view of UMG: the wider consolidation that has largely resulted in oligopolistic market structure, and the virtuous nature of the other side of the transaction - streamers - and industry consolidation continuing amongst these players.

A virtuous cycle

There are two sides to a music transaction; the ownership of it and the distribution. The ownership of the song/track by the record company (often in tandem with the musician's own company) is broken into two parts - the "master" rights and the "publishing" rights. The record owner of the rights receives royalties in three ways: mechanical royalties (.ie. the reproduction of the work; this is where revenue from streamers occurs), public performance royalties and synchronisation license fees (i.e. when a work is used in any derivative fashion; think of the sample in Vanilla Ice's "Ice Ice Baby" which is taken from Queen's "Under Pressure" - every time "Ice Ice Baby" is played, the owner's of "Under Pressure" get a royalty too).

Streamers, like Spotify, which investors in the Elevation Global Shares Fund own a share of, receive revenue from their subscribers; in turn Spotify pays a proportionate royalty to the rights owner; often this is UMG. This is counted as a 'mechanical royalty'. Other popular apps - like TikTok - pay a performance royalty when users make content which uses a song.

The cycle of streamers and music rights owners



Evergreen IP

We agree wholeheartedly with the Sumner Redstone's dictum -- Content is King[1]. Investors in the Elevation Capital Global Shares Fund own shares in a number of the world's top content producers – AT&T, Discovery and Paramount. To paraphrase Redstone - one doesn't listen to music, one listens to Taylor Swift or Bach or The Fall. One doesn't watch TV, one watches a show. UMG's artist roster is first-class: Kanye West, Taylor Swift, Bob Dylan, Lady Gaga and Queen all feature.

Music is evergreen IP. It is inherently recyclable and adaptable and cross-generational. We table a couple of examples to illustrate this. Consider first a small oddity of the stock market – Mills Music Trust (MMT). MMT is owned primarily by former Beatle and argubaly the most famous living musician in the world -- Paul McCartney. It is a very simple business: it owns the rights to a lot of songs and pays a cash dividend every year. That is the entire business. The interesting and perhaps surprising thing to note here is the songs the Mills Music Trust owns. The top grossing song for 2020 was Sleigh Ride, written in 1950 (it earned $804,009.81); its second highest grossing song was Little Drummer Boy (1958) – it earned $496,199.50. A recent piece in The Atlantic suggests that music from the 70s and 80s is the new "evergreen" IP. The recent popularity of Fleetwood Mac's 1977 hit "Dreams" on TikTok is testament to this. UMG, through its extensive back catalogue, reaps the benefits of such "evergreen" catalogues whilst essentially not spending further capital.

The second example which furthers the case for evergreen IP are the recent blockbuster acquisitions of back catalogues, as seen overleaf - since 2019 there has been a flurry of interest in acquiring the back catalogues of musicians. The recording rights have been either bought by the big three or by private-equity backed vehicles, like the Hipgnosis Songs Fund (backed by Blackstone) - a listed entity which has acquired the rights to 50% of Neil Young's catalogue and the full rights to the catalogues of musicians like Debbie Harry, Barry Manilow and Jack Antonoff. Hipgnosis also owns the rights to a number of lesser-known artist's catalogues (as does UMG); making the assertion – much like Mills Music Catalogue does – lesser-known catalogues can represent good value as they are increasingly used for ads, movie and television content and short-form content (ie. TikTok).

Valuing a catalogue is like valuing a bond: the catalogue will produce royalties (yield) year after year, until the rights to the music move into the public domain. When it moves into the public domain it is dependant on each country's respective copyright laws; in the US works written after 1978 retain copyright for 70 years after the author's death. For works pre '78, the total copyright is 95 years from when the work was written. For instance, Prince's Purple Rain was written on August 1983. Prince died in 2016. Therefore the copyright for Prince's work will last until 2076, or another 54 years. Hence the "yield" on Purple Rain is calculated on a 54 year basis.

The royalties of music catalogues are the beneficiaries of significant tailwinds. The first – as we have discussed – is the increasingly symbiotic relationship between streamers and labels which has returned music revenues to their early-2000s peak and appears to be growing. The second is the longer "shelf life" of music which is partially why catalogues are commanding a premium. The third is the increasing use of music in a licensed context; this may be in a traditional way (i.e film, television) or it may be via increasingly user-generated means, such as TikTok. A salient point to note here is that unlike in the past, where radio stations could easily bypass paying royalties and/or underreported plays, algorithms and the connected nature of the internet make underreporting of IP use almost impossible. The content owner gets paid every time.

In effect, then, the bond-like nature of owning the rights to a piece of music has increased in value due to these factors. Because streaming is accessible and can be accessed for a nominal cost every month, the Total Addressable Market (TAM) is almost 100% of the internet-enabled world. We suggest that UMG and its peers landed very attractive deals acquiring the rights to catalogues during the COVID-19 Pandemic, because artists needed revenue in a time when they couldn't tour.

1.*Redstone first said this in 1974, in Magazine Editing and Production. It was prophetic and has guided the future of media and platforms ever since.*

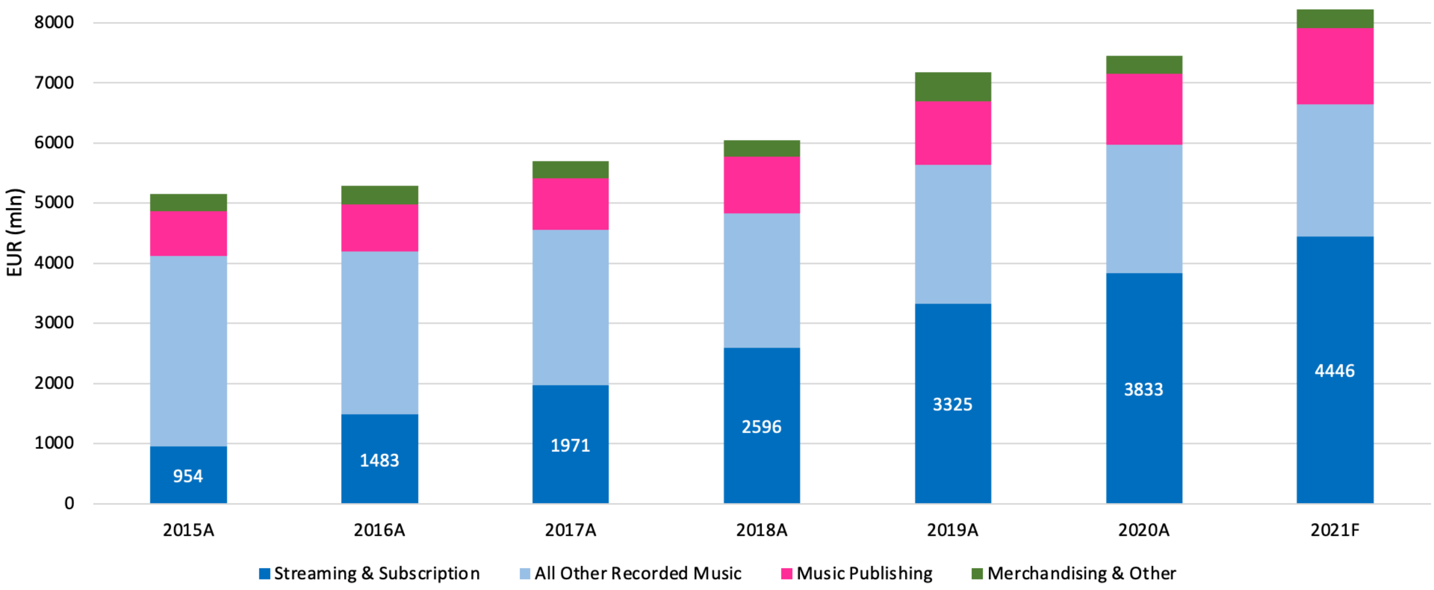
Who’s sold who (a recent history of catalogue aquisitions)

2018	Primary Wave buys part of the rights to Bob Marley’s catalogue for $50 million.
2019	Hipgnosis buys the rights to Timbaland’s catalogue
2019	Primary Wave buys 50% of the rights to Whitey Houson’s songs from her estate.
2020	Hipgnosis buys the rights to catalogues as diverse as that of Barry Manilow and Jack Antanoff.
2021	Neil Young sells 50% of his catalogue to Hipgnosis.
2021	UMG aquires the rights to Bob Dylan’s entire catalogue, the deal is rumored to be +US$400 million.
2021	David Crosby sells entire catalogue to Irving Artists.
2021	UMG spent +US$3 billion on catalogue acquisitions.
2022	UMG buys the rights to Sting’s catalogue in a deal rumored to be worth +US$300 million.

The Business

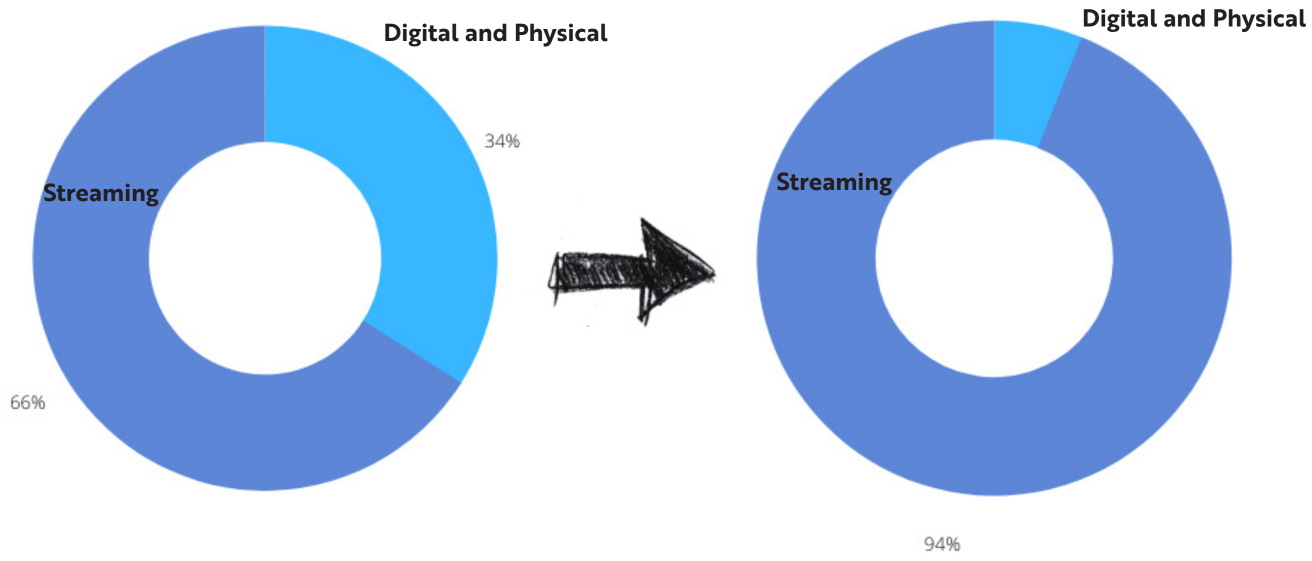
What UMG does is very simple. 80% of UMG's revenue is derived from recorded music (i.e. playing it on Spotify). 16% is derived from publishing. The remainder is derived from merchandise sales. The business is almost wholly determined by recorded music and publishing which provides investors with a high degree of predictability. Hence UMG's revenue has grown at a considerable clip and has been accelerated by streaming. Revenue grew at a pace of +10% in both 2017 and 2018 and +14% in 2019. In 2020, the year of the Pandemic, revenue grew at +5% in spite of this.

Streaming revenue has compounded exponentially



This is consummate with an increase in streaming revenues. In 2015, streaming only accounted for €954 million of UMG's revenue; it now accounts for c. €4.2 billion of revenue – **the bulk of it**. This illustrates the virtuous cycle of music companies and streaming – streaming has grown at a compounded rate of +37% annually and is estimated to grow at a rate of +20% going forward. For every compounded amount of growth in streaming UMG's revenue compounds too.

The symbiotic relationship between streaming and music companies will only increase as streaming grows to account for almost all recorded music revenue. Owning both sides of the relationship is a beneficial position to be in - albeit the UMG side has more pricing power (and why it is a larger part of the Elevation Capital Global Shares Fund's portfolio).



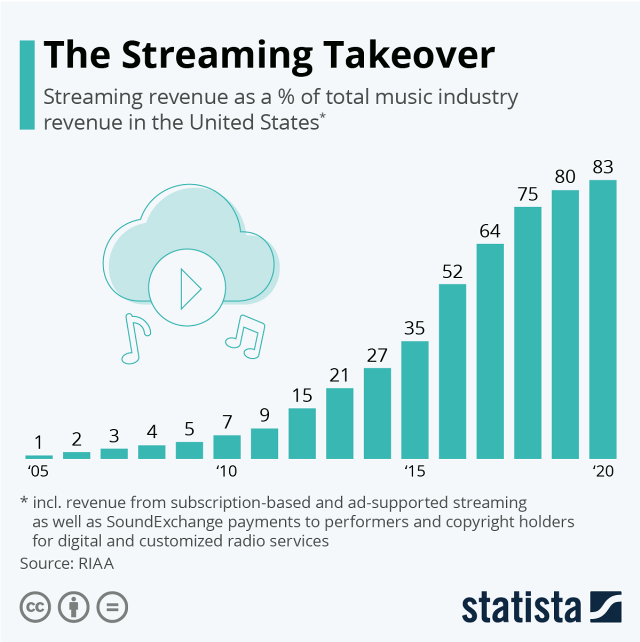
Catalysts

There are two catalysts which are correlated to UMG's growth as a company.

i), The growth and consolidation of streaming.

The streaming industry has grown at a clip of +37% for the last five years. Streaming is the lowest cost form of "essential" entertainment. Spotify costs US$US 9.99 per month. Netflix Standard costs US$15.50 per month. Most streaming services have free ad-supported versions as well which widens the audience significantly. In addition, the CapEx for a streaming service is much lower than a video streaming service (i.e. Netflix). A video streaming service commits to funding content -- Netflix spent US$17 billion in 2021 and that figure is set to only grow as the "streaming wars" continue. A music streaming service doesn't fund its own content (save podcasts, which cost orders of magnitude less to produce). Its capital requirements are relatively bijou while it acts as a conduit for one of the most basic human needs/wants -- music.

Basic math dictates that as the population of the world grows, the "pot" of eligble music listeners will grow too. To refer back to one of our favourites - Charlie Munger - this is a "probable". It is likely those new music listeners will be using a streaming service.



The second catalyst for streaming, and therefore UMG's growth is the consolidation of the streaming industry. Currently the playing field is fractured -- Spotify commands a healthy lead ex-China, yet there are a number of services which compete for market share. The history of television and music suggests strongly that consolidation will occur as the industry matures. With consolidation comes greater pricing power, which suggests higher margins for UMG and the record industry.

ii), The "no shelf life" effect

One of the biggest hits of 2018 was Selena Gomez's "Bad Liar", which interpolated (sampled) Talking Heads' 1977 hit Psycho Killer. The recycling and sampling of older music is commonplace, now, and leads to royalities for both parties (i.e Talking Heads and Selena Gomez). This is an extrodrinary sea change which is often taken for granted -- the idea of a 1950s artist sampling a 1930s artist was unthinkable. Now the recycling of content is standard and has led to music which has no shelf life. A song recorded 50 years ago may generate equivalent royalities of a hit song released six months ago. UMG stands to benefit from the ever-increasing cross-use of music due to its large and valuable catalogue.

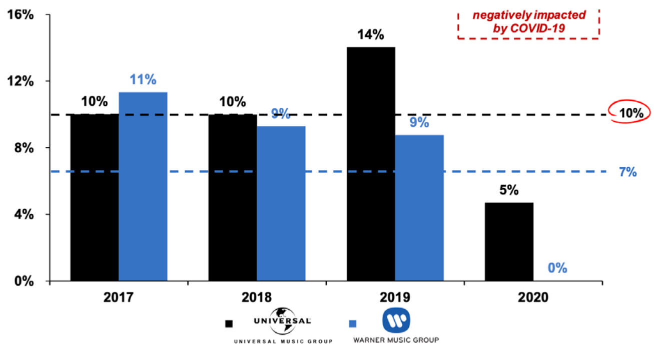
Valuation

UMG's financial performance relative to its closest listed peer, Warner Music, is superior. We think this speaks to the quality of UMG's artists and management - in particular CEO Sir Lucian Grange, who has steered the group soundly through the transition to streaming and has been visionary in the aquisition of "cornerstone" catalogues. UMG's revenue has grown at a rate of +10%, versus Warner's +7%, whilst UMG's operating profit margin sits at +21%, versus Warner's +11%. We believe UMG represents the best company in a very attractive industry.

We think this illustrates the quality of UMG's franchise -- it's +32% market share provides it economies of scale relative to Warner Music or Sony Music (Sony Music is, of course, a unit within Sony).

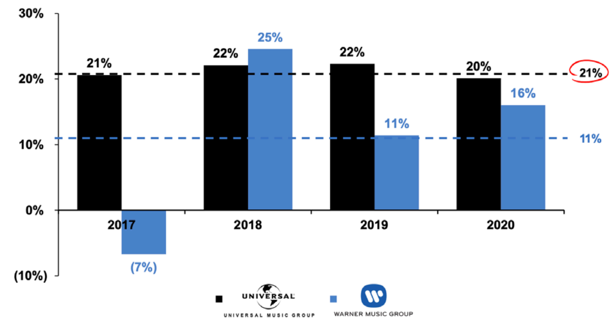
We believe it is likely UMG will continue to reap the benefits of streaming music's maturity. One of the phrases we are fond of repeating at Elevation Capital is "*history doesn't repeat, but it does rhyme*". While music industry revenues as a whole have normalised to early-2000s levels, music industry revenue per capita is still low. At its peak, in 1999, music industry revenue per capita was US$81 (inflation-adjusted). Currently, revenue per capita stands at US$31. This suggests UMG still has plenty of runway ahead as the industry further consolidates.

UMG's Revenue growth is superior to Warner Music



Source: UMG/ Pershing Square Tontine Holdings

UMG's operating profit is superior to Warner Music

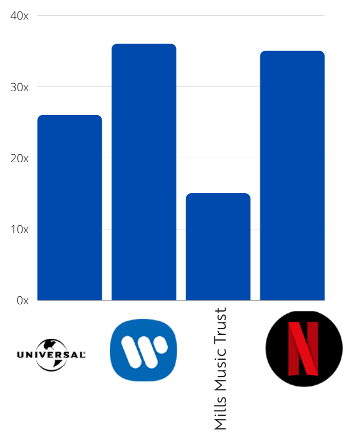


Source: UMG/ Pershing Square Tontine Holdings

FOR SOME COMPANIES, TECHNOLOGY IS THE HIGHEST FORM OF ART; FOR US THE HIGHEST FORM OF ART IS MUSIC. - SIR LUCIAN GRANGE

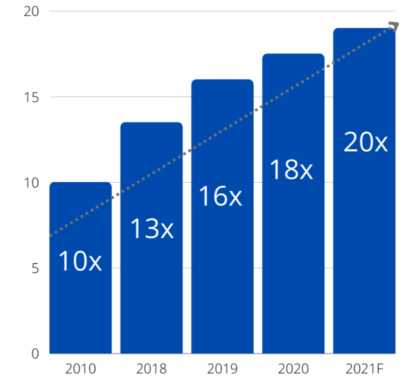
Despite the superior economics of UMG, the business trades at a discount to its compeititors (both direct - Warner Music - and more holistic - Netflix), as of writing. UMG trades at a forward P/E ratio of 26x, whilst Warner Music trades at 36x earnings and Netflix at 35x. Hipgnosis' forward P/E is not comparable at this stage (it trades for ~237x earnings as it is in its infancy) whilst Mills Music Trust's relatively "attractive" P/E ratio is due to the fact that the trust owns a portfolio of expiring assets - many of the songs in their catalogue have less than ten years left before they enter the public domain. *The songs in UMG's catalogue have decades of runway ahead of them.*

UMG's Forward P/E is at a discount to major peers



The true value of UMG lies in its peerless catalogue of music. The market value of a record company is directly correlated to the value and earnings power of its catalogue. The limitations of generally accepted accounting principles ("GAAP") are obvious here, when it comes to valuing exactly *how much the catalogue is worth*. Under GAAP you simply record what you paid for the asset. In many cases, UMG didn't pay *anything* - owning the catalogue or a portion of it was simply part of an artist's contract with UMG. At other times the transaction value was comically low and so long ago the twin powers of inflation and compounding have rendered the sum meaningless (a precursor to Universal - A&M - acquired the rights to The Beach Boys' catalogue for $700,000 in 1969 - a veritable bargain). The effect is that a lot of UMG's catalogue is rendered *invisible* in the eyes of an accountant. Catalogues are also treated as a *depreciating* asset, so the value of them is written off a little every year. This illustrates GAAP's mishandling of music; a music catalogue is an income-earning asset, much like a bond or a stock.

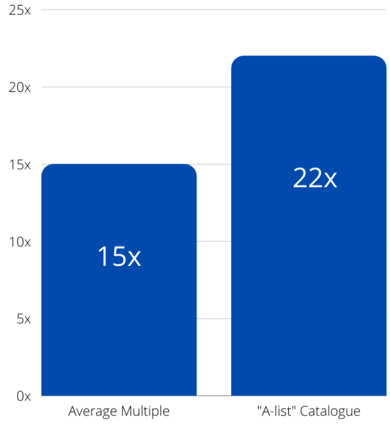
The multiples paid for music catalogues keep rising



Source: Hipgnosis

The end result is that UMG appears to have a catalogue worth €5.54 billion. This accounts for UMG's recent acquisitions but **does not account for the millions of songs UMG holds in its catalogue and has done for many years**. A good way to see the sheer value of UMG's catalogue is to compare it to Hipgnosis Songs Fund (listed on the LSE)- its catalogue acquisitions are so recent that its balance sheet provides us with an insight. Hipgnosis' catalog is worth US$2 billion. From this it generated $US155 million in revenue in 2021. UMG generated €7.3 billion in 2020 (it has yet to report its full year results). Hipgnosis trades for 12.9x revenue/catalogue - *the actual earnings power of its underlying asset.* If we were to extrapolate this to UMG, the value of UMG's catalogue would valued at €95.5 billion and we would expect its market capitalistion to trade in line with that. Catalogues of songs have risen in value in the last decade as their value has been recognised. Hipgnosis' average multiple paid is 15x earnings, whilst the multiple for a "premium" catalog (like Taylor Swift, Bob Dylan, Sting etc) command a multiple of +22x

"A-list" catalogues command a premium

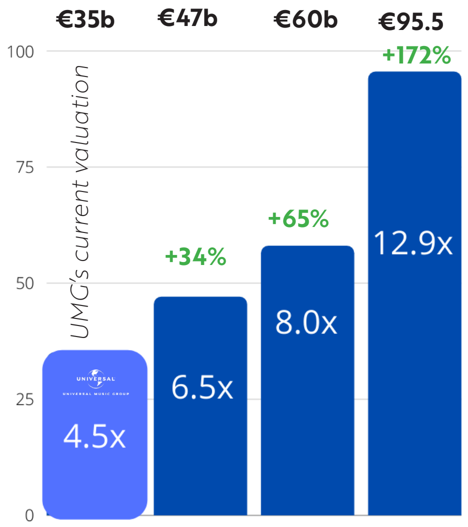


Source: Hipgnosis

Recent investments by Blackstone and KKR targeting the purchase of catalogues have increased the multiples paid considerably - from 10x into 2010 to as much as 22x paid now. Hipgnosis disclosed the multiples they paid in a 2020 article in the New York Times[1]. Even if the multiples paid for catalogues were to halve from our conservative estimate of 12.9x (we consider this unlikely – streaming is too entrenched), **UMG's catalogue would be worth €47 billion - a +37% premium to the current market capitalisation of UMG. Even at a steep discount to the multiples "pure play" peers like Hipgnosis pay for catalogues, UMG's underlying catalogue represents extremely good value for money; buying shares in UMG therefore represents buying a portion of an undervalued and highly monetisable asset.**

UMG's potential market capitalisation - based on Hipgonosis' equivalent multiples

Hipgnosis trades at 12.9x R/C - even at half this multiple UMG is trading at an attractive discount



1 https://www.nytimes.com/2020/12/18/arts/music/merck-mercuriadis-hipgnosis.html

Conclusion

UMG is the best business in an attractive global industry.

UMG owns the catalogues to some of the greatest music of all time and counts ***ten out of the top ten*** artists in the world on its label. It is the undisputed market leader and the largest in the industry. Its revenue base is twice the size of its largest competitor, Warner Music ($US7.4 billion vs. US$3.7 billion) and it holds significant advantages due to its scale -- its net income margins look set to grow as UMG continues to expand.

To own UMG is to earn a royalty on people listening to music. Any type of business where you can earn a royalty on something as essential as music is incredibly compelling. A record company is agnostic to current music trends or where music may go in the next ten years (the zeros generated on a royalty statement are the same regardless, whether the music is Taylor Swift, Bob Dylan or Kanye West).

Whilst we believe UMG is trading at a discount compared to the multiples of its peers (~40% compared to Warner Music). We also believe an investment in UMG represents buying a portion of a high quality company which can compound capital at a superior rate of return over the long-term. **We see UMG as a company one may never sell. It has the rare combination of underlying economics and a compelling set of "probables" that are unlikely to change come judgement day.**

This summary report was written in February 2022.
Any data not referenced was sourced from UMG and Vivendi annual reports and conference calls.

ELEVATION CAPITAL
GLOBAL SHARES FUND

Independent Thinking Disciplined Investing

[In-de-pend-ent Think-ing] indəˈpendənt THiNkiNG verb
Is essential to long-term investment success. We are often contrarian and do not pay attention to index compositions when making investment decisions. We believe that when you're several thousand miles away from Wall Street in a different nation, it's easier to be independent and buy the things that other people are selling, and sell the things that other people are buying.

[Dis-ci-plined In-vest-ing] disciplinəd invesʼting verb
The market presents opportunities every day, but disciplined investing is as much about the opportunities you do not take. We also believe that cash is sometimes the most attractive investment.

MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2017, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2013, NEW ZEALAND

NOMINEE - MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

The Blade L04, 12 St Marks Road, Remuera, Auckland 1050, New Zealand | www.globalsharesfund.co.nz | +64 9 379 6493 | info@elevationcapital.co.nz