Current Valuation Methods for Music Publishing Catalogs

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Publishers, songwriters, banks, lenders, and even publishing investment sources such as angel, institutional and hedge fund investors are looking at more accurate ways to value music publishing assets in the new digital economy. The valuators are peering closely at different digital source revenues and how to evaluate the short and long-term effects of those sources on the music publishing catalog. Some examples of this would be YouTube channel ad revenue-sharing income, and direct synch licensing trends with "narrowcaster channels" such as ESPN, who regularly direct licenses the tv synch and performances instead of paying performance fees. Many current valuation experts are trashing the old "NPS" or net publisher's share multiple valuations and moving toward "Regression," "IRR," "Net Cashflow Value" and/or "Current and Future Activity Values" and/or combinations of all of the above to make their valuation decisions.

Even though "Section 115 Download Rates" (as they are called colloquially by some publishers) have been temporarily set at the same rate as physical mechanical royalty rates (9.1 cents), the U.S. is starting to look over the edges of the current digital sales data and trying to predict what income trends lie ahead for them. The current U.S. data appears to show developing trends that are currently the new norm in the UK and Europe. (Traditionally, the UK and Western Europe publishers and performing rights societies have been pretty good precursors to U.S. trends in the music publishing world, so U.S. valuators are watching these trends more closely now when it comes to valuation perspectives.) In the UK and Western Europe, there are not only declining physical sales of records to deal with, but as recent as last semester, there is new data out to support a flattening of digital download sales in the U.K and Europe due to major waves of streaming options available to the general public (including XM, Spotify, Pandora, etc.).

Despite what seems to be a clear diminution in world values related to physical sales of songs on records and a potential flattening of digital download sales now in the UK and Europe, the bright side is that new and old music, as well as the world's catalog of songs in general, is more accessible to the entire world than ever before. The fever of music, no matter the genre, is available and may be caught by anyone who wants to expose themselves to it. Music and "songs as brands" is the new norm. It's much more prevalent to see artists and publishers commercialize their art than before (good or bad). The speed at which record labels and publishers can "break" acts and push huge hits throughout the world's digital systems is unparalleled and the overhead to create and push content is decreasing exponentially each year. Recording costs are declining and digital distribution costs are declining faster and faster. The speed of exposure or exploitation is now virtually as fast as an artist can record it, post it on the web, put up a digital shopping cart, and license it…or not —which is the subject of another article.

With all of these new issues to evaluate, as well as potential changes to the U.S. Copyright Right Act being discussed (again another article), valuators of music catalogs are really forced to evaluate some of their older models and move to accurate valuation models given the new digital trends and the fierce competition in the publishing marketplace. Some of the current methods and models that publishers and valuators are using are:

1. The Multiple of NPS Model

This is a fairly simple method. Add up the publisher's share of non-performance and public performance income (sometimes minus the admin fees, sometimes not, depending on the situation) each year and subtract some unique synch licenses or other anomalies of income, and you divide the total by the number of years of data and that equals the net publisher's share or "NPS" per year. This method is usually good for catalogs with "evergreen" hits that have been played over a period of 10 to 20 years or more and can be fairly accurate. Purchasers typically pay a multiple of the NPS average. (I have seen low multiples of 3 to high multiples of 15 to 20 over the 20 years of my practice in this field; however, many have multiples have hovered in the last few years between the 3 to 8 range, unless it's a special catalog.)

2. The Regression and/or Cash Flow Model

This model is based upon the principal that the first year or two of a hit song's life is pretty much its maximum value and the song's income over time will continue to regress, flatten out or disappear over a long period of time. The total of this regressing income flow is the approximate value. (Sometimes, even more conservative valuators tack on a net present value factor to take into consideration the declining time value of money over time.) An example of how to calculate the potential percentage regression for song income would be as follows. Take a publisher's share sampling (in the same musical genre) of, say, 10 number one hits, 10 top five hits, and 10 top twenty hits over a period of 10 years or maybe even 3 years to look at current trends. (Ideally the larger the sampling the more accurate the model, but this foundational data is not easy to get unless you work regularly with the PRO's or with larger catalogs). The peak quarter or semester's maximum value is the barometer (i.e.100%) and the next period's decline in value is a lower percentage of the peak and so on. Once you have the regressing percentages in place, you can then plug your your songs into the spreadsheet and show an approximation of the amounts to come on your song within this same genre within the next ten, twenty or thirty years, ideally.

The biggest holes in this valuation method are obvious: the assumption that all songs regress in value over time. The assumption that songs are similar and don't have unique values and the assumption that the trends in the past will be the same in the future on a macro-level. There are quite a few examples that can poke big holes in this method, such as songs that have an even larger second life with another artist that was unexpected such as, "When You Say Nothing At All," by Keith Whitley which was a big song, that seems to have been outdone by and Allison Kraus's version of the same). Nonetheless this model is used frequently by conservative valuators, which usually include banks and larger institutional publishers.

3. The Internal Rate of Return or "IRR" Method

This method can become overly complex; however, in its simplest terms, the IRR is the percentage rate of return that will eventually pay for the total cost of the asset. The simplest way to explain this is as follows: Hypothetically, if a catalog is priced at $1 million and it is predicted to have an average NPS of $100,000 for 10 years, then the percentage return or IRR on this catalog is 10% over a 10 year period. The IRR method can lead to limitation of risk by buyers over time and can also take a buyer out of the market rate for a catalog pretty quickly. Let's investigate. Say that a large company, like a hedge fund or investment bank, has to have an internal rate of return of 25% to justify a capital purchase, and a smaller publisher needs a 10% rate of return to justify its purchase. The hedge fund could only pay a maximum of $400,000 for the same $1 million dollar catalog above because it would need $100,000 (i.e. 25%) per year to pay off the $400,000, while the smaller publisher could pay the $1 million dollar purchase price because it would need only $100,000 (i.e. 10%) per year to reach its internal rate of return on the asset. (The IRR method is usually adjusted for the cost of funds, so if a publisher has to pay more for the money it uses (i.e. interest), the IRR has to go up too.)

4. Current and Future Activity Model

Due in part to the capital gains treatment of copyright assets sold by songwriters over the years, many publishers are able to purchase fairly new catalogs of songs from songwriters or songwriter publishers and ask for a certain amount of years going forward to be tacked on to the deal. The Current and Future Activity Model is a mixture of one of first three models mentioned above to value previous songs in the catalog, plus a prediction of the future activity of the new or unexploited songs in the catalog (by also using one of the first three methods above). The previously released songs, which can be fairly new or older, have a valuation attached to them that equals either a multiple NPS formula or a remaining pipeline calculation of what income or cash flow is coming over the next few years, then the buyer and seller discuss and/or negotiate what is the best guess of "activity" or cuts within the coming years based upon: 1) previous trackable income histories; 2) average cuts or singles of the songwriter/publisher over the years; 3) new production projects that are in the pipeline; and/or 4) viability of the catalog of old or new songs to be exploited by the new publisher based on the new publisher's passion or connections which differ from the old publisher.

Other Factors to Consider.

While there are other models that differ or from the above, almost all current valuation models other than the above, contain elements of the above 4 models. Two other major outside factors that should be noted which are now important in valuing catalogs are: 1) the recent mergers in the last 7 or 8 years of major publishers resulting in fewer major publisher's in the marketplace (This smaller buyer's pool can artificially drive valuations up with a superstar catalog or writer as there are fewer publishers jockeying for market share and they each know that moving a superstar jockey over from one publisher to another could win the race for market share for a company.); and 2) the entrance of the institutional or investment company into the publisher marketplace. These new players have plenty of money to get in the game and sometimes they need a relevant placeholder or high profile catalog to “sell” to their investors which in turn keeps the monies flowing to their funds. These new players will sometimes spend more to gain the placeholder than a current publisher in the business