



Warner Music Group

NASDAQ: WMG

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Industry Overview

Record Labels Have An Unparalleled Value Prop to Artists

Meet Caleb, an Aspiring Independent Artist



- Caleb is a Stern student who one day decides to change career paths to become an independent country artist
- He has the passion to record his first album, but **how does he go about actually doing it?**
- Well first, let's look at the Music Industry from his eyes
 - Hyper-competitive
 - Makes less than \$10,000 a year on average
 - Vast majority fail

TLDR, This is a very risky endeavor

Two Options:

1

Go At It Himself

- The process of making a hit song is complex
 1. Need to rent out a studio to record
 2. Hire a producer or a live band
 3. Market the song
 4. Once the song is made, you need someone to distribute it to the DSPs
- **In summary, its risky, expensive, and a headache to go at it alone**

2

"Sell His Soul" to WMG

- Get signed by a music label
 - Financing & connections to other artists
 - Access to world-class producers & publishers
 - Lets him focus on his passion
- **Improves chances of success from 1:10,000 to 1:20 (i.e., Significantly lowers risk)**



Industry Overview

Value chain, major players, stakeholder dynamics

Value Chain Breakdown

Lets go back to our aspiring artist, Caleb



Artist

Through sheer luck or talent, Caleb hits the jackpot, and get signed by WMG

He may begin to write/record his first album

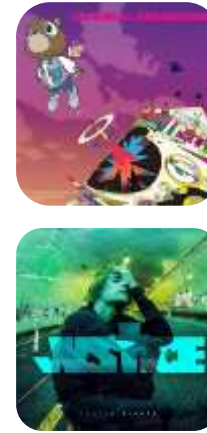


Music Label

WMG does the heavy lifting

Song writers, publishers, distribution, and promotion

Everything needed to make a hit song

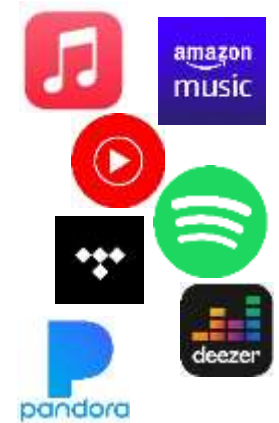


A Hit is Born

The album is a huge hit

All the DSPs release the albums on their platforms

Streaming platforms are competitive, they **need** to add the album



DSPs

DSPs pay WMG fees per stream

Heavily reliant on record labels (i.e., no negotiating power)

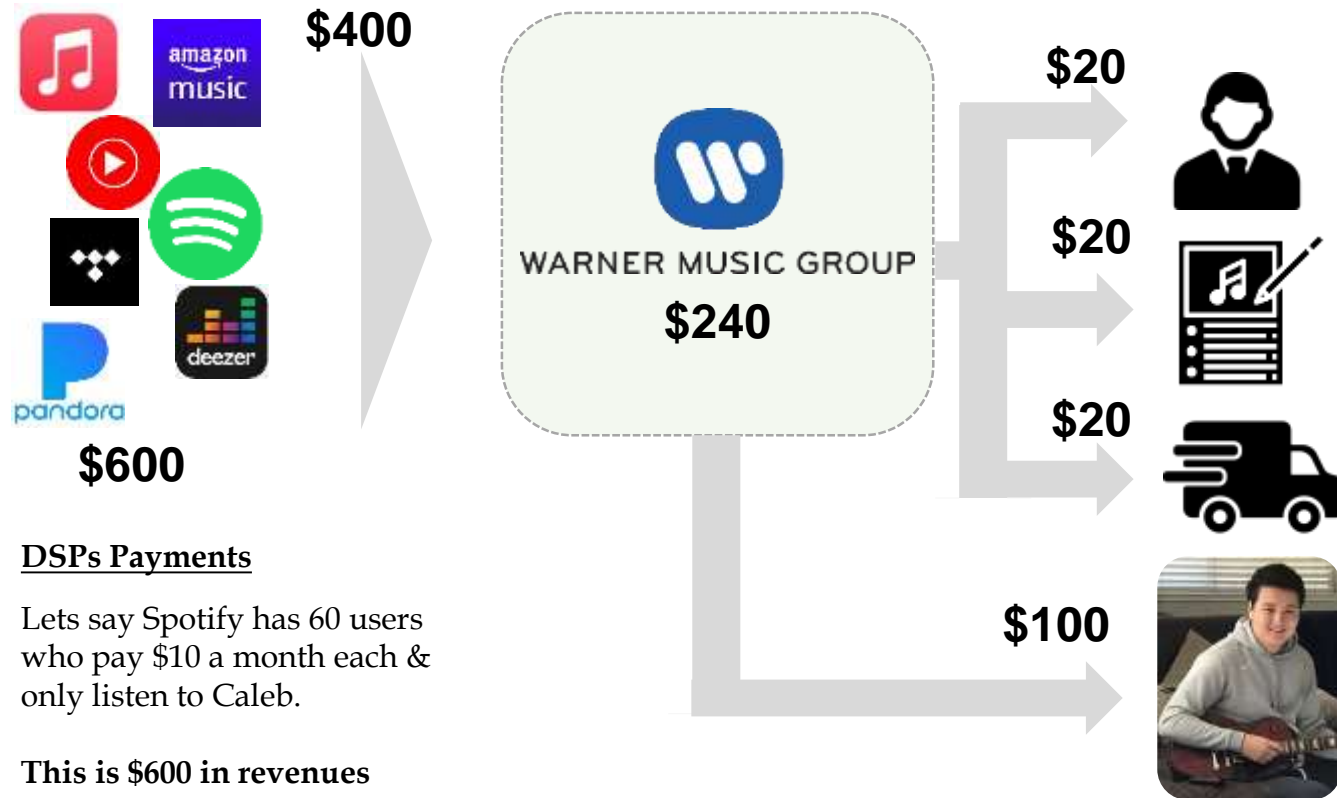


Industry Overview

How capital flows through the value chain

Streaming Revenue Pass-Through Tree

So how does Caleb get Paid?



WMG Payments

WMG retains a fixed % of the fees, in this case it's 60%

WMG pays out intermediaries for their contributions (producers, song-writers, distributors, etc.)

Whatever remains goes to our favorite country star, Caleb

DSPs Payments

Lets say Spotify has 60 users who pay \$10 a month each & only listen to Caleb.

This is \$600 in revenues

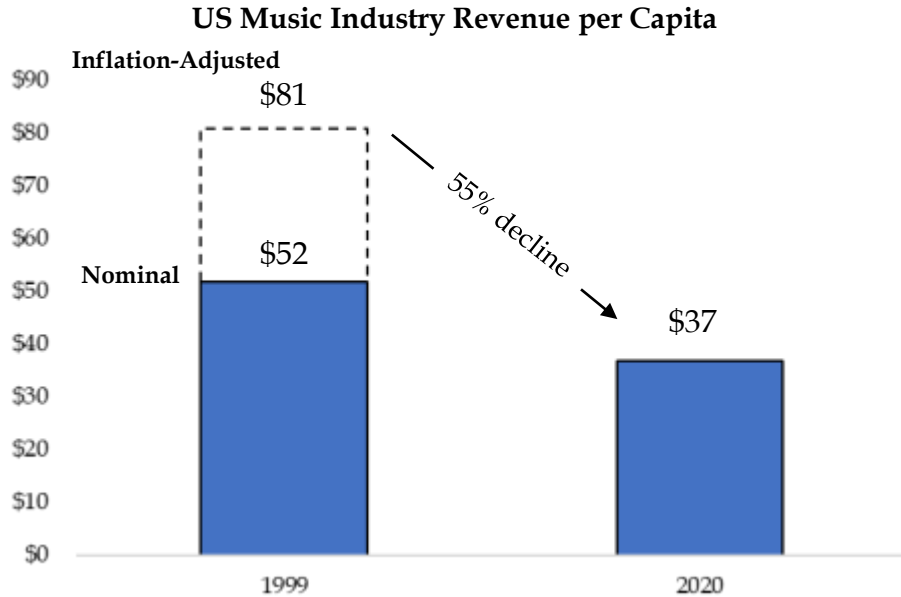
They pay 2/3 of this amount to WMG



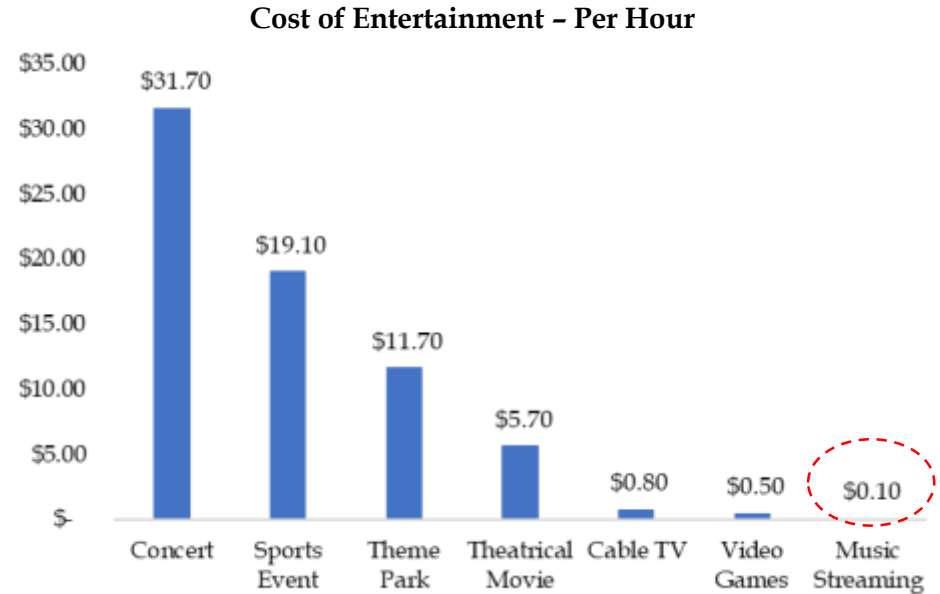
Industry Overview

The music industry is heavily under-monetized relative to both historical levels and current entertainment substitutes.

Music Industry Revenue Below Peak Levels



Cheapest Form of "Essential Entertainment"



Music is still cheaper on average than decades ago (inflation adj.) and is the cheapest form of entertainment.

We think that the drastic under-monetization of the industry represents an opportunity.



Warner Music Group – The Most Attractive Link in the Music Industry

Warner Music Group is one of the “Big 3” record labels and our pick for music industry exposure.

Business Overview

WMG is a leader in the oligopolistic record label industry with a compelling streaming opportunity.

16%

Market Share

65,000

Composers

1mm

Copyrights

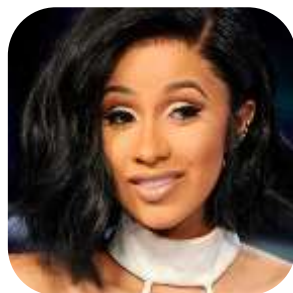
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Artists

30+%

Stream Growth

A Plethora of Notable Signed Artists and Labels



Sources: Annual Report, Investor Relations

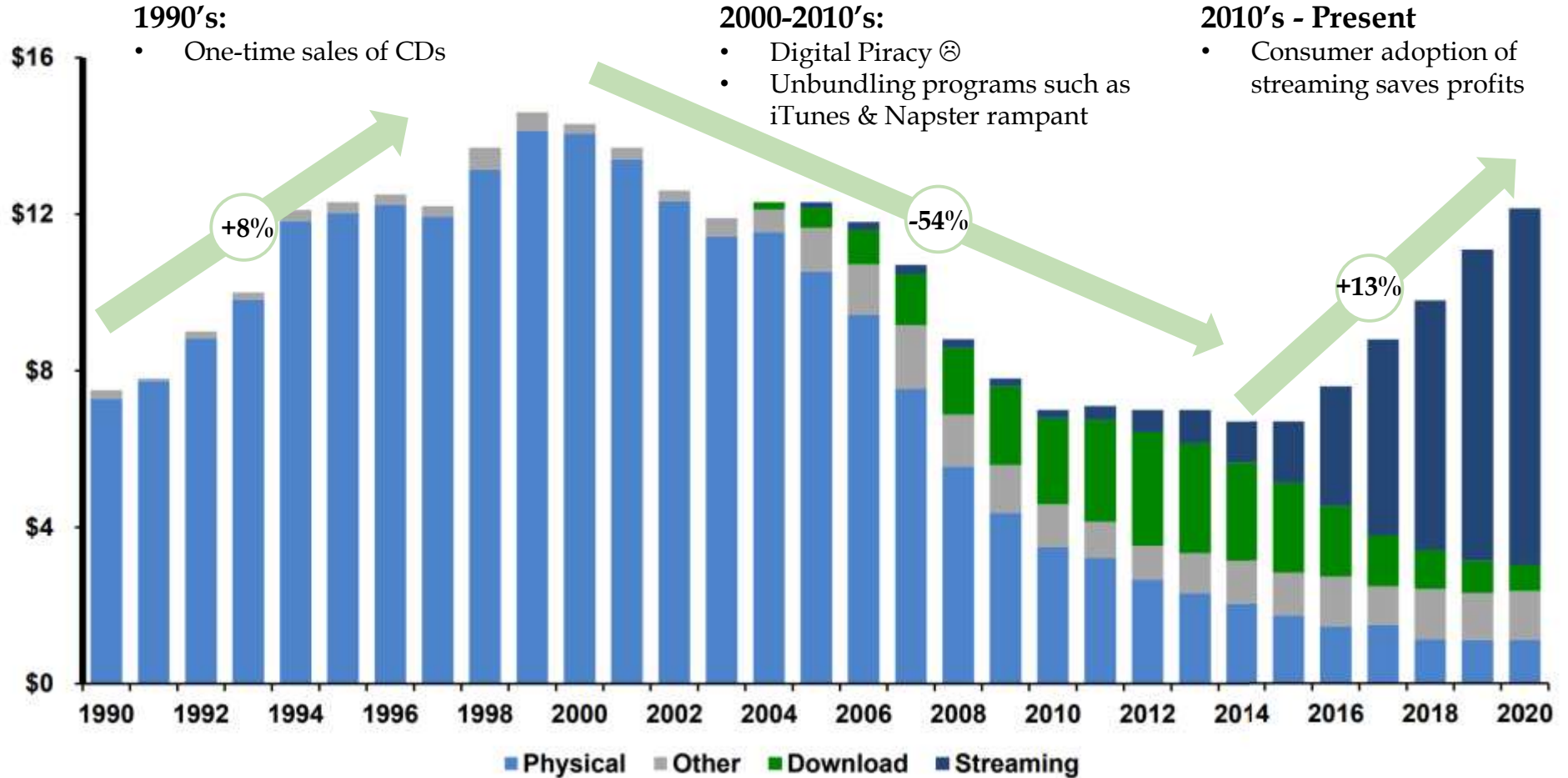


Investment Thesis

Large, Under-Penetrated and Under-Monetized Market

The Reshaping of the Music Industry

U.S. Recorded Music Industry Revenue (\$bn)



Sources: Pershing Square, RIAA



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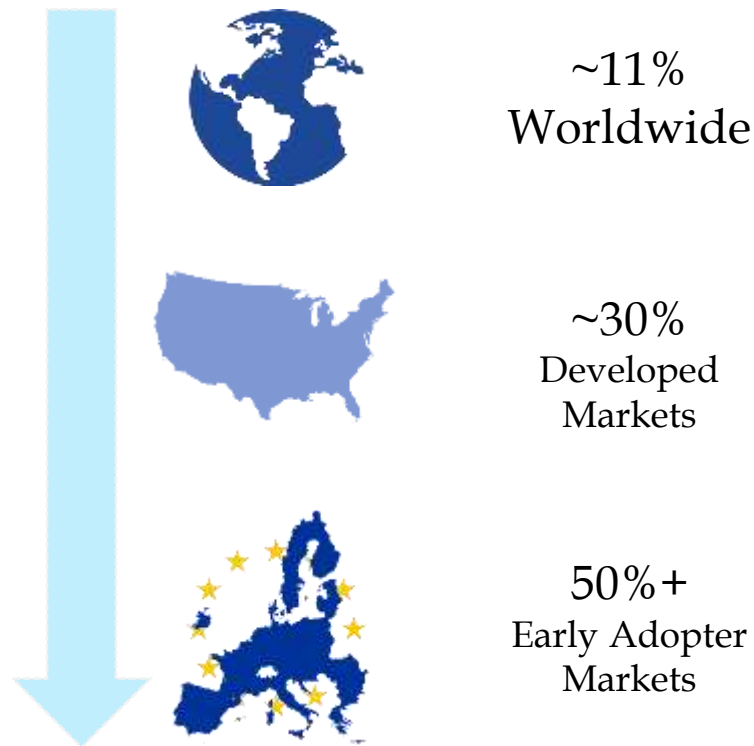
Investment Thesis

Large, Under-Penetrated and Under-Monetized Market

Mobile Streaming Penetration

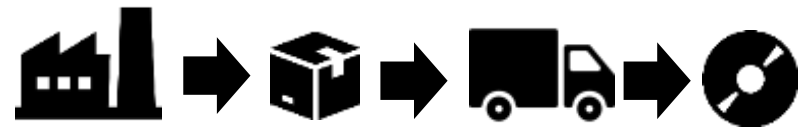
- Streaming represents 61% of WMG's revenues, and this has grown at a 31% 5-yr CAGR
- And there is still more to go...

Mobile Streaming Penetration by Market



Physical to Digital Switch

- So, not only has the market has grown and will continue to grow, but it comes at higher **incremental margins**
- 1. CD to Digital Streaming boosts GM ~+15%



VS



- 2. Digital Creates High Operating Leverage
 - Think through *increments*
 - i.e., What is the next units margin?
 - Song recording under a digital streaming model involves a high upfront investment, followed by essentially 100% margin streaming revenues

Sources: Annual Report, Pershing Square

Investment Thesis

Market is Backing the Wrong Horse in Spotify vs WMG

What "Bulls" of Spotify Say

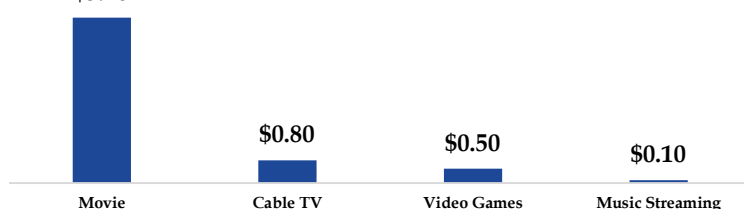
- Spotify is another Netflix story. They will consolidate demand and pressure supply

NETFLIX



- The music industry has been underpriced versus traditional media, giving Spotify a price lever

Cost of Entertainment - Per Hour



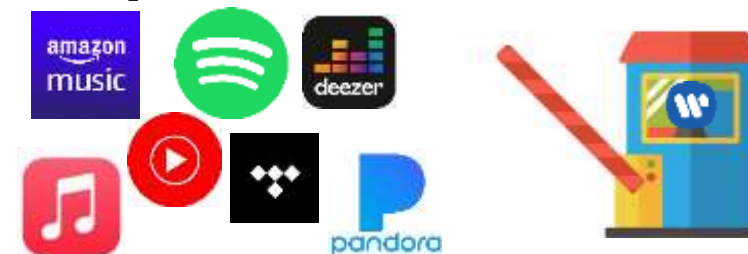
- Spotify is a differentiated product, offering more of an "ecosystem" of music & podcasts

In reality...

- Netflix comparison is silly. The music industry is heavily consolidated (3 players own 70%)
 - Streaming platforms **need** all this content



- Pricing power is within the hands of the music labels. Spotify eats the CAC. Better to be the toll road operator



- Spotify has an undifferentiated stand-alone platform against the deep wallets of tech-giants

WMG wins this equation
We know it... Investors don't know it...
But Spotify's own management knows it!

Sources: Pershing Square, Spotify Annual Reports



Investor Lingo 101

Some basic terminology we'll need to move forward.

What is a Valuation Multiple?

A multiple is essentially the price you're paying for an asset benchmarked to an underlying business KPI.

$$\text{Multiple} = \frac{\text{What you are paying for an asset}}{\text{What you are getting from the firm}}$$

Our Multiple of Choice: Enterprise Value / Adjusted Operating Income (EV/EBITA)

Enterprise Value = Net Debt + Market Capitalization

EBITA = Revenue – COGS – Administrative Costs

Valuation: Predicting the Future

1. Project out WMG's future operating income (profits)
2. Assign an EV/EBITA multiple to that future profit number
3. Subtract out net debt to figure out future market cap.

$$\text{Future EBITA} = \text{Future Sales} * \text{EBITA Margin}$$

$$\text{Future Enterprise Value} = \text{Future EBITA} * \text{Assigned Multiple}$$

$$\text{Future Market Cap.} = \text{Future Enterprise Value} - \text{Net Debt}$$



Valuation Snapshot

Come to Wednesday Workshop and we'll explain everything here.

USD mm	2017	2018	2019	2020	2021E	2022E	2023E
Earnings Model							
Segment Breakdown							
Recorded Music							
Sales	3,020	3,360	3,840	3,810	4,591	5,050	5,656
OIBDA	458	543	642	756	872	960	1,075
EBITA	426	508	597	701	872	1,010	1,414
Music Publishing							
Sales	572	653	643	657	723	741	759
OIBDA	152	159	166	160	25	26	27
EBITA	146	152	161	155	181	185	205
Corporate/Other							
Revenue Eliminations	(16)	(8)	(8)	(4)	(11)	(12)	(13)
OIBDA Eliminations	(124)	(148)	(144)	(171)	(180)	(197)	(220)
EBITA Eliminations	(136)	(161)	(155)	(182)	(197)	(217)	(242)
Total Revenue	3,576	4,005	4,475	4,463	5,303	5,779	6,403
Total OIBDA	486	554	664	745	718	788	881
Total EBITA	436	499	603	674	856	978	1,377

Balance Sheet

Market Cap	NA	NA	NA	15,398	18,609	20,586	22,772
Cash	(647)	(514)	(619)	(553)	(553)	(553)	(553)
Total Debt	2,811	2,819	2,974	3,104	2,245	1,640	671
Investments (RBLX, Dapper, etc.)					(210)	(227)	(245)
Legal Proceeds					(250)	(250)	(333)
OPEB/Pension					43	43	43
WC @ 3% of Sales	107	120	134	134	159	173	192
Total Capitalization	2,271	2,425	2,489	18,083	20,043	21,412	22,547

Multiple and Valuation

Stage 2 Sales Growth	10.0%
Normal EBITA Margin	21.5%
Capital Intensity	1.0%
Tax Rate	27.0%
ROIC	1569.7%
Risk Category	1
Discount	6.5%
Theoretical Multiple	22.25x
EBITA	1,377
EV Out-Year	30,628
(-) Net Debt - Assets	(225)
Equity Value	30,853
Per Share	58.90
Current Price	40.04
IRR	19.69%

Sources: SEC Filings, IAG Projections



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Sanity Check 1 – Public Comparables

We can check what other investors are willing to pay for similar assets to WMG to benchmark our valuation.

	Ticker	TEV	EBITA Margin	NI Margin	TEV/Sales	TEV/EBITDA	TEV/EBITA	TEV/EBIT	P/E	TEV/Sales	TEV/EBITDA	P/E
Streaming Comps												
The Walt Disney Company	DIS	388,737	12.0%	3.9%	6.1x	46.2x	85.4x	120.0x	295.1x	4.8x	25.9x	41.6x
Roku	ROKU	40,915	12.9%	9.6%	17.6x	115.2x	148.4x	184.3x	185.1x	12.4x	111.0x	NM
Discovery	DISC.A	31,202	33.5%	21.1%	2.8x	8.1x	9.0x	13.5x	16.1x	2.5x	8.5x	9.7x
Netflix	NFLX	268,142	22.5%	22.0%	9.7x	42.8x	44.1x	44.1x	60.4x	8.5x	38.8x	54.2x
Average		182,249	20.2%	14.2%	9.1x	53.1x	71.7x	90.5x	139.2x	7.0x	46.1x	35.2x
Median		154,528	17.7%	15.3%	7.9x	44.5x	64.8x	82.1x	122.8x	6.6x	32.4x	41.6x
Music												
Live Nation Entertainment	LYV	22,015	-69.5%	-103.7%	17.1x	NM	NM	NM	NM	2.2x	23.1x	NM
HYBE Co., Ltd.	A352820	9,087	21.2%	15.3%	11.1x	52.5x	61.5x	72.6x	103.1x	6.4x	30.4x	48.8x
Vivendi SE	VIV	45,671	13.7%	11.1%	2.3x	15.3x	19.1x	20.6x	30.2x	2.2x	13.0x	22.1x
Average		25,591	-11.5%	-25.8%	10.2x	33.9x	40.3x	46.6x	66.7x	3.6x	22.1x	35.5x
Median		22,015	13.7%	11.1%	11.1x	33.9x	40.3x	46.6x	66.7x	2.2x	23.1x	35.5x
Asset-Light Royalties												
The Wendy's Company	WEN	8,258	31.8%	23.3%	5.5x	16.9x	20.4x	23.0x	27.4x	4.4x	17.5x	28.0x
Wingstop	WING	5,806	26.7%	23.8%	21.3x	76.4x	86.5x	89.6x	192.0x	18.3x	61.8x	112.4x
Planet Fitness	PLNT	8,013	41.1%	27.6%	18.4x	36.9x	58.6x	66.9x	261.5x	12.5x	31.4x	68.0x
Restaurant Brands International	QSR	34,632	37.6%	34.0%	6.4x	17.3x	18.5x	19.2x	29.2x	5.8x	-	21.6x
Domino's Pizza	DPZ	23,654	19.1%	18.1%	5.4x	27.0x	30.2x	30.2x	40.8x	5.2x	25.3x	34.4x
Rollins	ROL	18,515	22.7%	18.7%	8.1x	30.4x	38.9x	43.3x	54.9x	7.4x	31.9x	51.1x
Yum! Brands	YUM	49,045	36.8%	34.1%	7.8x	20.5x	22.3x	22.9x	29.5x	7.3x	20.4x	27.7x
Hilton Worldwide Holdings	HLT	45,363	35.8%	21.2%	26.7x	62.0x	82.0x	126.4x	NM	6.3x	22.1x	37.6x
Average		25,612	32.2%	25.6%	12.7x	34.9x	44.1x	51.6x	96.4x	7.3x	28.3x	45.4x
Median		21,084	33.8%	23.5%	8.0x	28.7x	37.3x	39.5x	47.9x	6.1x	24.1x	36.0x
Warner Music Group Corp.	WMG	24,118	19.9%	14.3%	4.8x	22.6x	25.7x	33.5x	76.8x	4.3x	22.3x	41.9x

Sources: Capital IQ



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Sanity Check 2: Private Market Values (PMV's)

We can also check our valuation by benchmarking it to the transactions of strategic buyers and other large investors.

Date	Target	Buyer	Tx Size	EV/EBITA	EV/EBITDA	EV/Sales
6/4/2021	UMG (10% equity stake)	Pershing Square Tontine	42,000	25.4x	23.5x	4.7x
4/26/2021	eOne Music	Blackstone Group	385	18.3x	16.0x	3.2x
4/2/2021	Big Machine Label Group	Big Hit Entertainment	1,050	34.1x	27.8x	7.4x
11/16/2020	Taylor Swift's Master Records	Shamrock Holdings	300	-	-	5.5x
3/31/2020	UMG (20% equity stake)	Tencent Consortium	36,800	25.7x	23.7x	4.2x
5/21/2018	EMI Music Publishing	Sony Corporation	4,750	26.2x	19.1x	7.2x
9/22/2017	Carlin Music	Roundhill Music	245	-	-	7.2x
6/2/2017	Imagem Music Group	Concord Bicycle Music	600	-	-	4.9x
1/4/2017	SESAC	Blackstone Group	1,125	-	-	4.5x
3/14/2016	Sony/ATV Music Publishing	Sony Corporation	2,400	-	-	4.8x
9/12/2011	Bug Music	BMG Rights Entertainment	300	28.3x	25.0x	4.3x
9/6/2006	BMG Music Publishing	UMG	2,100	22.7x	20.1x	4.4x
Average			7,671	25.8x	22.2x	5.2x
Median			1,088	25.7x	23.5x	4.8x
IAG's valuation of WMG:			30,628	22.2x	20.8x	4.8x

Our valuation falls a couple turns below that of precedent transactions, adding another layer of conservatism.

Sources: Capital IQ, Investor Presentations, Annual Reports



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Sanity Check 3 – Pricing the Installed Base

If the C-suite all quit and went to the beach, Warner suddenly looks much cheaper.

The Recurring Parts of the Business

Existing Library of Content

Royalties on Library

Marketing/ A&R on Library

Sustainable Earnings Math

1/3 of content is <5 years old

Decay rate of 50% on that content

WMG cuts marketing/ A&R cost

Net net, **sales decline** ~15% next year but **EBITA still almost doubles** from the prior year

New Valuation:

~17x fwd. EV/EBITA multiple

Direct Comp for Music IP



HIPGNOSIS

Hipgnosis is a closed-end fund that employs a similar back-ended music IP strategy. It is a direct comp to Warner excluding the growth reinvestment.

Comparable Valuation:

22x EV/EBITA multiple