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To Fellow Shareholders of Hipgnosis Songs Fund (“**SONG**”, the “**Company**”)

Asset Value Investors (“**AVI**”) manages a 5% stake in SONG on behalf of institutional clients, having first invested in the Company in 2020. Shareholders face two crucial decisions ahead of the upcoming AGM and EGM scheduled for 26 October 2023:

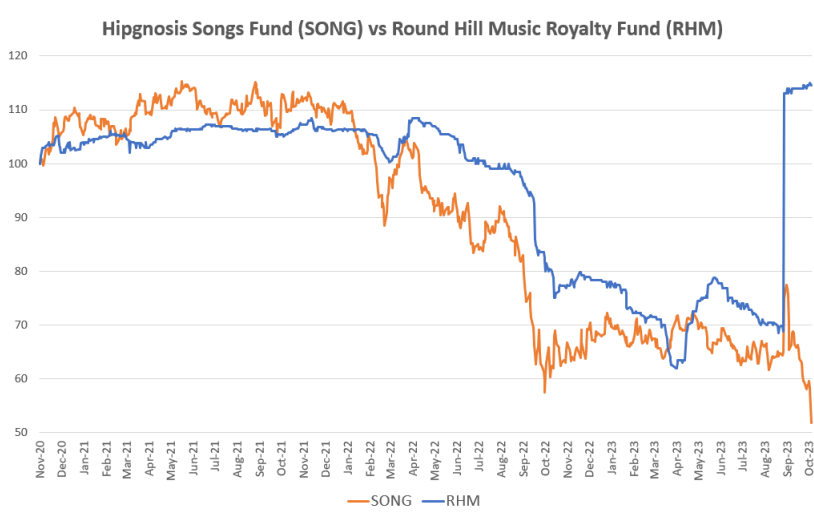
1. Whether to vote for continuation of the Company (Resolution 12 at the AGM, the “**Continuation Resolution**”)
2. Whether to approve the proposed asset sale to a related party of Hipgnosis Songs Management (“**HSM**” or the “**Manager**”) (Resolution 1 at the EGM, the “**Proposed Transaction**”)

Over the course of the last several weeks, we have spoken with a majority of the share register. Not one of those shareholders is in favour of an immediate sale of the portfolio, yet we believe many will vote against continuation. We urge undecided shareholders not to be swayed by a misleading narrative that a failure to pass the Continuation Resolution results in a wind up of the Company or a fire sale of assets.

Voting against continuation should not be perceived as a negative stance to take. On the contrary, we remain excited by the prospects for the Company’s assets, with continued and accelerating industry tailwinds from growth in the adoption of streaming; the likelihood of more systematic price increases from the DSPs<sup>1</sup> with music streaming subscriptions still representing extraordinary value relative to other forms of entertainment; potential for greater shares of revenues accruing to songwriters; and more widespread adoption of artist-centric streaming payment models. We are also excited at the prospect of these positives being better reflected in shareholders’ returns than they have to date.

The Company has a bright future. And that may well be with the current Manager on revised terms should a new Board decide so following consultation with shareholders. But we do, however, strongly believe that a reset is urgently required.

A comparison of the returns enjoyed by shareholders of Round Hill Music Royalty Fund (RHM), the other listed music rights investment company on the London market (recently subject to a bid), and those of SONG’s shareholders highlights very starkly the staggering amount of trapped value in our company’s shares<sup>2</sup>.



<sup>1</sup> Digital Service Providers, e.g., Spotify, Amazon Music, Apple Music etc.

<sup>2</sup> Share prices of RHM and SONG rebased to 100 and in USD from the date of RHM’s IPO to 9.30am on 16 October 2023

## Withdrawal of Proposed Interim Dividend

This morning, the Company announced<sup>3</sup> the withdrawal of the proposed interim dividend declared on 21 September 2023 “in order to ensure compliance with its revolving credit facility’s Fixed Charge Cover Ratio covenant”. This apparently follows the Board being notified by the Independent Portfolio Valuer of materially reduced expectations for retro-active royalty payments in relation to a settlement known as “CRB III”.

The chart above incorporates the impact of this morning’s share price fall, with the shares down 11% at the time of writing from already depressed levels. We note the shares had already traded ex-rights to this dividend, and we are seeking urgent clarification from the Company on certain matters in relation to this announcement.

This raises yet more questions around the way in which our Company is being managed, and we expect shareholders will take this latest development into account when casting their votes at the upcoming meetings.

## Continuation Resolution

We are concerned that a dangerous misleading narrative has been allowed to develop as to what happens if the Continuation Resolution is not approved by shareholders.

It is emphatically NOT the case that it would automatically trigger a wind-up of the Company, any asset sales, nor any course of action whatsoever other than requiring the Board to consult with shareholders on the future direction of the Company. The eventual outcome could be continuing with the same Manager under different terms, continuing with a new manager, and/or exploring an asset sale at a time of shareholders’ choosing.

SONG’s own prospectus<sup>4</sup> and the AGM/EGM circular<sup>5</sup> are clear on this:

*“If a Continuation Resolution is not passed, the Directors are required to put forward proposals for the reconstruction, reorganisation or winding-up of the Company to the Shareholders for their approval within six months following the date on which the relevant Continuation Resolution is not passed. **These proposals may or may not involve winding-up the Company or liquidating all or part of the Company’s then existing portfolio of investments and, accordingly, failure to pass a Continuation Resolution will not necessarily result in the winding-up of the Company or liquidation of all or some of its investments.**”*

We note the six-month period is a standard clause for closed-end funds with continuation votes. It exists to protect shareholders, not to create a deadline which in any way compromises their best interests, and it could quite easily be extended with the consent of shareholders.

## Why Vote Against Continuation?

AVI intends to vote against the Continuation Resolution. We are also firmly opposed to an immediate sale of the portfolio or initiation of a wind-up process. In time, against a more accommodating market backdrop, a sale of part of the portfolio or the company, may well be judged to be in the best interests of all shareholders. But that must be a decision made by a newly reconstituted Board of Directors, following extensive consultations with shareholders.

The process behind the Proposed Transaction<sup>6</sup>, its terms, and the way in which it was presented have left a bitter taste in the mouths of shareholders. This follows years of poor disclosure and transparency, including but certainly not limited to contingent bonus liabilities due to artists from whom SONG has acquired catalogues, changes to the Company’s tax status, and this morning’s worrying developments.

In part due to the issues described above, SONG now trades on a discount to NAV in excess of 50%. It is imperative that the focus now is on addressing all impediments to the shares trading closer to fair value.

Voting against continuation would provide a newly reconstituted Board with a blank canvas to take on this task. We understand the Manager has recently bolstered its team with new hires including a new CFO and General Counsel, which we welcome. This should serve them well if the refreshed Board decides to ask the Manager to re-pitch for their role in a beauty parade of potential new managers.

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<sup>3</sup> [Update on CRB III impact and dividend payment - 07:13:27 16 Oct 2023 - SONG News article | London Stock Exchange](#)

<sup>4</sup> [HSFL Prospectus 21012021.pdf \(hipgnosisongs.com\)](#), p72

<sup>5</sup> [Hipgnosis-Songs-Fund-Limited-Circular-28.09.2023.pdf \(hipgnosisongs.com\)](#)

<sup>6</sup> [Asset sales to fund buy backs and reduce debt - 07:00:06 14 Sep 2023 - SONG News article | London Stock Exchange](#)

On the other hand, we fear a vote in favour of continuation provides the current Board and Manager with an implicit endorsement of them and the strategy to date.

While we were pleased to see the Board announce some concessions on 28 September 2023<sup>7</sup>, we are perplexed by the stated intention to serve notice on the Manager if the average discount to NAV over January 2025 exceeds 10%. Firstly, we see no plausible scenario in which the shares are trading at such a tight discount level by that date given the starting point, so the statement can effectively be simplified to saying that the Board intend to serve notice in January 2025.

This then begs the question as to why the Board does not serve protective notice sooner? This notice could be revoked if the discount does meet the January 2025 test whereas, under the Board's approach, notice will be served in January 2025 yet it will be a further twelve months until the Manager has served out their notice period. This will mean shareholders incur an additional year of fees (£8m at the current market capitalisation).

We also note the Board only "intends" to serve notice and that "the Board may withdraw the notice before the effective date of termination if it considers it to be in the interests of shareholders to do so".

### **Proposed Transaction**

On 14 September 2023, the Company announced proposals for the sale of catalogues to Hipgnosis Songs Capital ("HSC"), a partnership between HSM and Blackstone, with the proceeds to be used for a share buyback programme and reducing debt. Although the headline figures suggested the proposed sale would be taking place at a 17.5% discount to NAV, this had climbed to 25-30%<sup>8</sup> by the time readers reached the bottom of the announcement given a series of give-aways, transaction costs, and taxes.

*We are wholly opposed to the Proposed Transaction and will be voting against it. We believe an overwhelming majority of shareholders share our views. We note the Company's share price is down by 29% since the deal was announced, a period over which equity markets are essentially flat<sup>9</sup>.*

We believe it is likely the Board now recognises shareholders are highly likely to vote against the Proposed Transaction but are maintaining their recommendation to vote in favour to avoid triggering a \$6.6m termination fee to HSC. Thus, if there are shareholders still undecided on whether to vote for or against the Proposed Transaction, we urge them to disregard the Board's recommendation when making their decision.

Given the depth of opposition to the Proposed Transaction and the near certainty that it is voted down, we do not intend to discuss the details of it exhaustively here. We simply re-iterate that the inherent conflicts in a sale to a related party, the uncompetitive nature of the process given the restrictive terms of the Go-Shop provision, and the lack of an up-to-date valuation or proper fair-and-reasonableness opinion<sup>10</sup>, make it unlikely this will be the best deal for shareholders.

There may be a case for partial asset sales to fund share buybacks but that does not mean shareholders should accept **\*this\*** tainted deal. If shareholder consensus is in favour of such sales, a refreshed Board can pursue this properly in a rigorous, competitive process.

This is a transaction the company did not need to do. Shareholder calls for sales to validate the NAV and raise cash for share repurchases have mutated, via a flawed process, into a deeply discounted transaction that permanently destroys shareholder value and potentially impairs the NAV going forward.

### **Board of Directors**

On 28 September 2023, the Company announced that Andrew Sutch and Andrew Wilkinson would be stepping down as Chair and Chair of the Audit Committee respectively. While Andrew Wilkinson will be leaving the Board before the end of 2023, Andrew Sutch may remain as a director up until the AGM in 2024.

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<sup>7</sup> [Publication of Circular and Notice of AGM & EGM - 11:07:39 28 Sep 2023 - SONG News article | London Stock Exchange](#)

<sup>8</sup> Additional costs over and above the headline 17.5% discount include the Right-to-Income paid away to the buyer, transaction costs, taxes, and potential for additional contingent bonuses up to a cap of \$30m

<sup>9</sup> Share price total return of -29% from 13-Sep-23 to 9.30am on 16-Oct-23 vs +0.1% for FTSE All-Share/-0.2% for MSCI World (all returns in GBP)

<sup>10</sup> While we are told the Board "considers the [Proposed Transaction] to be fair and reasonable" and that they have been advised it is so by J.P. Morgan Cazenove, we are also informed that J.P. Morgan Cazenove have "taken into account the Directors' commercial assessment of the [Proposed Transaction]...in providing their advice to the Directors", a bizarrely circular state of affairs.

The retirement of these directors was a clear acknowledgement that there is dissatisfaction with the Board. These changes should be made as quickly as possible. It is imperative that shareholders have confidence in their replacements, and this is best achieved by their direct involvement in the recruitment process. We - and we expect other shareholders - plan to be in contact with the Board privately to ensure new appointments happen as swiftly as possible.

### **The Manager's Option to Acquire the Portfolio**

SONG's prospectus<sup>11</sup> disclosed that in the event of termination (i.e., twelve months after notice has been served), the Manager then has a six-month period in which to exercise an option (the "**Manager's Option**") to acquire the portfolio at the higher of (i) fair market value as determined by an independent valuer; (ii) an **unsolicited** third-party bid; and (iii) the Company's market capitalisation.

But we note the circular published on 28 September 2023<sup>12</sup> reveals that an amendment was made to the Investment Management Agreement ("**IMA**") on 12 October 2021 following the acquisition by Blackstone of a majority stake in the Manager. This amendment states that:

*"[T]he Investment Adviser agreed that where the Company or a member of the Group purchases any asset from or sells any asset to a member of the Investment Adviser's group the Company or Group member, as the case may be, shall be in no worse position than they would have been in had they effected that transaction in the open market on the best terms available."*

This clearly contradicts key elements of the language used in the prospectus around the Manager's Option. We understand the Company has received initial legal advice suggesting this amendment would give the Board the right, or potentially even oblige the Board, to solicit third party offers which the Manager would need to match when exercising the Manager's Option on termination.

Further, this raises questions of what would happen if a third party were bidding for the Company rather than the portfolio, the former being a far more tax-efficient method of acquiring the Company's assets. Our interpretation is the IMA amendment means the Manager would be required to bid substantially more for the portfolio to match a third party's bid for the Company given the gross-to-net leakage suffered by SONG shareholders in a sale of the portfolio.

We believe the terms of the Manager Option, as described in the prospectus, represent a serious impediment to the Company either trading, or its assets being sold, at full fair value. It is imperative the Board issues a statement confirming that the October 2021 amendment to the IMA has changed the original terms of the Manager's Option in the way we describe above. We encourage our fellow shareholders to press for this clarification to be made expeditiously.

***AVI urges its fellow shareholders to vote AGAINST the Proposed Transaction - a truly dreadful deal for shareholders - and vote AGAINST continuation to take back our company and secure for it a brighter future.***

Yours sincerely,



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<sup>11</sup> [HSFL Prospectus 21012021.pdf \(hipgnosissongs.com\)](#)

<sup>12</sup> [Hipgnosis-Songs-Fund-Limited-Circular-28.09.2023.pdf \(hipgnosissongs.com\)](#)