

Universal Music Group Out into the Wild: the Story Behind its IPO

Introduction

On September 21st, Universal Music Group (UMG), the world's biggest music label, went public via an IPO on Amsterdam's Euronext exchange. Universal's shares surged at the start of trading on Tuesday, as owner Vivendi VIV.PA spun off the record label in the biggest European listing of the year. Recently, Vivendi sold a further 2.9% of Universal's shares to Pershing Square Holdings, increasing their stake to 10%. Tencent, the Chinese internet conglomerate, bought a 20% stake in the French-controlled music group last year. Universal Music Group at the end of Tuesday was trading at €25.61 up by around 38% compared to its reference price of €18.50, giving the world's biggest music label a market value of €45bn.

UMG is betting on the boom in music streaming, led by Spotify. The trend has fuelled revenue and profit growth for several years now. The music industry, with the likes of Warner, Sony Music, and Spotify, will rely on that bet materializing. The listing will mark the end of Vivendi's two-decade-long control over the company, which started in 2000 when the French company bought the Universal assets from Seagram and its controlling Bronfman family.

Universal Music Group

Universal Music Group's origins began in 1962 when the US-based MCA Inc. merged with American Decca. MCA, now known as Universal Pictures, owned a music division as well as a movie company and was sold to Japan's Matsushita Electric for \$6.59bn in November 1990. In April 1995, Seagram acquired a controlling, 80% stake in MCA from Matsushita for \$5.7bn. The following year, in December 1996, MCA was renamed Universal Pictures, while its music division was relaunched as Universal Music Group. Then, in May 1998, Seagram acquired music company PolyGram for \$10.6bn. A year later, Seagram merged PolyGram into Universal Music Group. Vivendi acquired Seagram in a \$34bn all-stock transaction in 2000. Then, in February 2006, Vivendi struck a \$1.154bn deal to buy Matsushita Electric's 20% stake in UMG – giving the French company full ownership of the music firm. Then, as mentioned earlier, share sales to Tencent and Pershing Square followed. After the IPO, a 60% stake of Universal has been distributed to its shareholders, leaving Vivendi with only a 10% stake.

UMG owns and operates frontline record companies including Capitol, Decca, Def Jam, and Deutsche Grammophon. But UMG's primary business is the Universal Music Publishing Group, which is led by Chairman & CEO, Jody Gerson. UMG, which operates in more than 60 countries, completed the acquisition of EMI Music in September 2012 for £1.2bn. UMG had agreed on the buyout of the British music company from then-owner Citigroup in the prior year.

UMG is seen by analysts as the overwhelming winner in new markets because it produces more stars and hit songs than its rivals, Sony Music Entertainment and Warner Music Group. UMG controls about 40% of the industry and that success facilitates the luring of the next generation of talent. Nine of the top 10 selling musicians worldwide last year came from UMG, according to the global industry body IFPI. The challenge for UMG will be to keep its pole position when a new generation of smaller, digital-focused competitors are trying to draw artists away from the majors by giving them more control and more choice on which label services to use. UMG has ratcheted up

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spending on new musicians and songwriters in the past two years as that competitive environment inflates talent costs.

Vivendi

Vivendi is a French media conglomerate with over 44,000 employees headquartered in Paris, France. Vivendi traces its roots to a water company under the name Compagnie Générale des Eaux (CGE) in 1853. In 1983 CGE helped to establish the first pay-TV channel in France, Canal+. Following expansions into telecommunications and mass media, the firm changed its name to Vivendi in 1998.

The firm can be divided into two broader divisions: Canal+ Group accounting for 51% of revenue, and Universal Music Group which accounted for 47% of revenue. The company recently posted revenues of €8.2bn for the first half of 2021, up 11.9% compared to 2020 and a net income of €724m, up 24.1% compared to the same period in 2020. Other business endeavours include its minority stakes in telecom giants such as Telecom Italia and Telefonica.

Since 2014, Vivendi has built a world-class media, content, and communications group. The group owns Canal+ and operates in other sectors, including publishing, gaming, live entertainment, and ticketing. It also owns a global digital content distribution platform, Dailymotion. Vivendi's various businesses cohesively work together as an integrated industrial group to create greater value. Vivendi is committed to the environment and aims at being carbon neutral by 2025.

Music Industry

The scourge of digital piracy has shot down the music industry in the past years. According to Quartz, global music sales decreased 30% from 2004 to 2009. Thanks to the success of paid streaming services and the improvement in anti-piracy tech, major record labels like Spotify and Apple Music finally saw a boost in revenue. Consequently, the biggest music companies such as Universal Music, Sony Music and Warner Music, which hold the copyrights to most of the world's songs, started to grow again. According to Wedbush Securities, while many thought the industry was close to be dead a decade ago, especially with piracy and a lot of the issues facing the music industry, now they have changed their mind: there has been a massive turnaround that very few predicted would happen with Universal, Warner Music and overall streaming with Apple Music and Spotify. More than half of last year's sales of \$22bn went to the three above mentioned major labels. Sony Music is owned by the Sony Group Corporation, while Warner went public last June and its value is half the size of Universal Music. This means that Universal's IPO represents a unique chance for investors to enter the booming space of music.

To have an idea, according to the Recording Industry Association of America, the number of paid music subscriptions in the US reached 75.7m in 2020, which means a 25% increase from 2019. However, along with this boom in the music industry, UK's government ministers are asking whether big music companies are giving artists a fair share of streaming profits. On September 22nd the watchdog was requested to conduct a competition probe into the music industry. According to BBC, under the current regulations, artists receive about 13% of the total income from streams, while record companies receive around 55% and streaming services 30%. As a response, the

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authorities said there "may be value" in this market study but it is up to the CMA (Competition and Markets Authority) to decide whether to pursue it.

IPO Rationale

Speaking about Universal's IPO, Media Research believes that if this deal had been a few years ago, it might have looked riskier because the industry was basically dependent on Spotify. Now the environment is changing, and the new licensing deals opened a new episode for music.

In fact, a decade ago UMG was much less valuable than now; the Japanese SoftBank bid only €7bn for the firm. In hindsight, it is fair to say that Vivendi, the French conglomerate, smartly refused the offer. The listing of Universal represents the end of a process that breaks down the ownership of Vivendi, which has been in control of the label for 20 years. During the last two years, 20% of Universal has been sold to the Chinese group Tencent, and a further 10% stake in the label was bought by Pershing Square, an American hedge fund. Through the Amsterdam listing, a further 60% stake will be transferred from Vivendi to its shareholder. According to the prospectus, the French group opted for the IPO to increase its own valuation. In fact, Vivendi's shareholders have been seeking a spin-off from Universal to reduce conglomerate discounts and allow for an independent valuation of the label. Universal represented more than half of its profits and, listing its biggest money-making asset, the French group will have only 10% in Universal. Following this move, Vivendi plans to takeover French media Lagardere after buying Amber Capital's Stake. According to Reuters, the acquisition of Lagardere will mark the end of France's national industrial champions.

IPO Structure

Vivendi will keep 10% of UMG, while the number of shares distributed represents 59.9% of the capital. The total value of the distribution consists of €5.3bn, equal to €4.89 per Vivendi share, a special dividend from the distribution of reserves and €22.1bn (€20.4) on the interim dividend on profits as of June 30th. It's a major gain for Vivendi's main shareholder, Vincent Bolloré.

Additionally, the New York Stock Exchange-listed Warner Music Group saw its shares increase about 10% in early trading in response to the Universal IPO in Europe. Arguably, investors spotted the unrealised potential in the music sector. Considering that UMG possesses a back catalogue twice as large as Warner Music and controls a significant percentage of the recorded music business, future expansion appears likely. It's worth mentioning, though, that UMG has been investing in signing partnerships with artists in which the artist's copyright ownership is returned to them within a few years. Furthermore, just 56 years after the release of their music, composers in the United States can file an appeal to abolish the practice of publishing copyrights. This rising drive for artists to have more control over their music will undoubtedly affect royalties' revenue in the future.

Market Reaction

Universal Music Group, the American record label spun out from Vivendi that would distribute 60% of its shares to its stockholders, saw a 30% increase in its first day on the Amsterdam Stock Exchange. However, the valuation falls short of the most bullish projections made by Wall Street before the IPO.

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In comparison to the reference price of €18.5, the trading opened at €25.3, representing a 35% increase, and later reached a high of €26.5. The market capitalization increased to €45.5bn from €33.5bn at the time of the placement. Meanwhile, Vivendi, which owns 10% of UMG, is down 65% from the previous session's closing price and 15% from the post-detachment value of UMG shares. The shares of Bolloré Group, through which the billionaire owns his remaining investment in Universal, increased by 2%.

Financial Advisors

The valuations of investment banks have been very different from each other. JPMorgan estimated a value of €54bn. UMG's market valuation was upgraded by Barclays from €38.5bn to €41.4bn (\$48.4 bn). Exane BNP Paribas, as well as Crédit Agricole, CIB, Morgan Stanley, Natixis, and Société Générale, are among the investors advising the IPO. The prospectus lists ten other institutions as “financial co-advisors,” including Bank of America, while Bank of China and Goldman Sachs Bank Europe SE are acknowledged as “other financial advisors.” This broad base of support contrasts sharply with 2018 when Spotify decided to float on the New York Stock Exchange without the help of a single investment bank. However, the worldwide music industry was only three years old at the time.

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