Clipping the ticket: the case for investing in global royalty companies

ASX: ROYL

Betashares Global Royalties ETF

Introducing the Betashares Global Royalties ETF

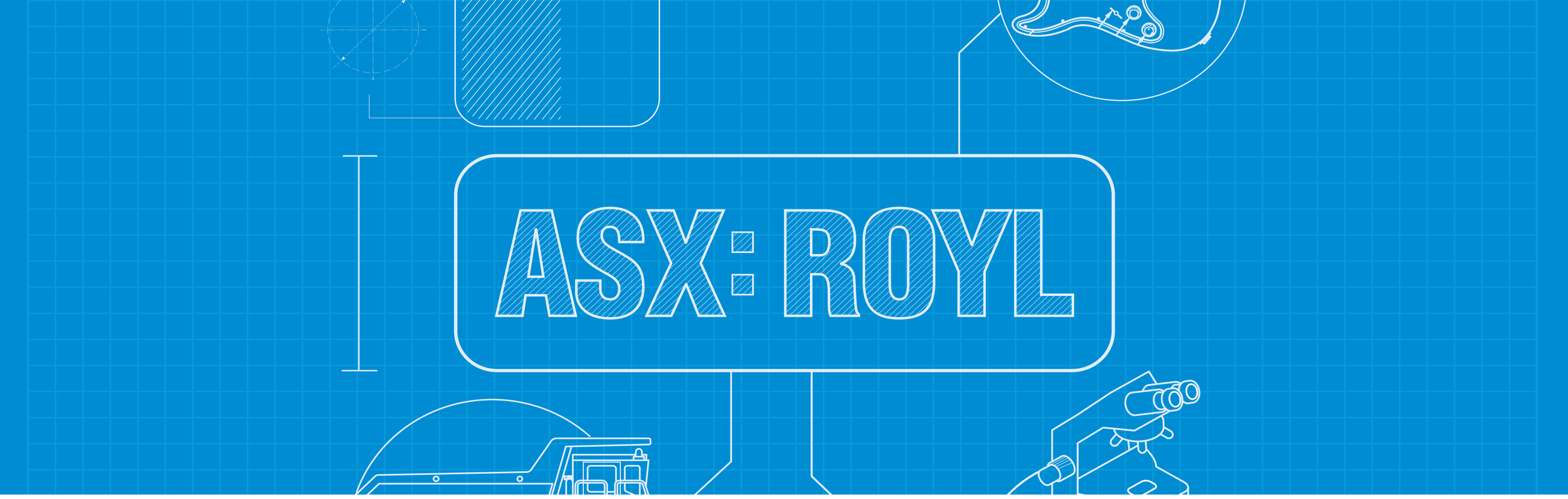
Royalties are an integral, albeit perhaps an 'under the radar' part of the global economy, as they allow the legal sharing of valuable physical and intellectual assets in exchange for due compensation. Royalties are essentially payments made to owners of an asset by others wishing to use it. They were first paid to Kings and Queens for the right to extract deposits from the land they owned – hence the name "royalties".

Royalties historically have been a source of significant value creation. Australia's richest woman, Gina Rinehart, derived a substantial part of her personal fortune from iron ore royalties, while Forbes lists Michael Jackson and Prince as among the highest paid deceased musicians thanks to ongoing royalty income from their work.

These days royalties are paid not just on mining deposits, but also on a range of intellectual property rights such as new drug formulations, patents, trademarks and trade secrets, in technology and even recorded film and music. The growing use of online storage and distribution of intellectual property is increasing the type of royalties that can be collected.

What's more, a number of innovative companies are playing a growing role in creating, acquiring or managing diversified royalty streams on behalf of their investors.

To tap into this unique and attractive source of investment return, Betashares is pleased to introduce the Global Royalties ETF (ASX: ROYL). ROYL is the first ETF in the world to offer investors dedicated exposure to a portfolio of global royalty companies from a variety of industries and sectors. ROYL aims to track an index (before fees and expenses) of companies that earn a substantial portion of their revenue from royalty income and intellectual property income as well as royalty finance and royalty streaming.



Royalties: An attractive risk-return business model

Given royalty payments are typically paid on the revenue earned from the use of an asset, manufacturing of goods or mining volumes, they offer several advantages to investors. For starters, they offer investors exposure to the revenue and growth potential of a company or sector using the asset or producing the end product, without also having exposure to their costs – or the broader operational risks associated with deriving a profit, including a large labour force. Historically, this has been most evident in the mining and energy sectors – where owners of mining royalties benefit from others taking the operational risk of extracting the resource in exchange for a share of the revenue earned.

As an alternative to a direct investment in the underlying businesses, the royalty business model can be particularly attractive when it comes to more risky and complex business activities such as mining and drug development, with their high capital requirements, operational costs and risks. As evident in the table below, a high percentage of royalties still tends to be derived from these activities. The fact that royalty businesses are mainly exposed to the revenue side alone rather than the associated costs is potentially a significant investor benefit, particularly in a world of high inflation.

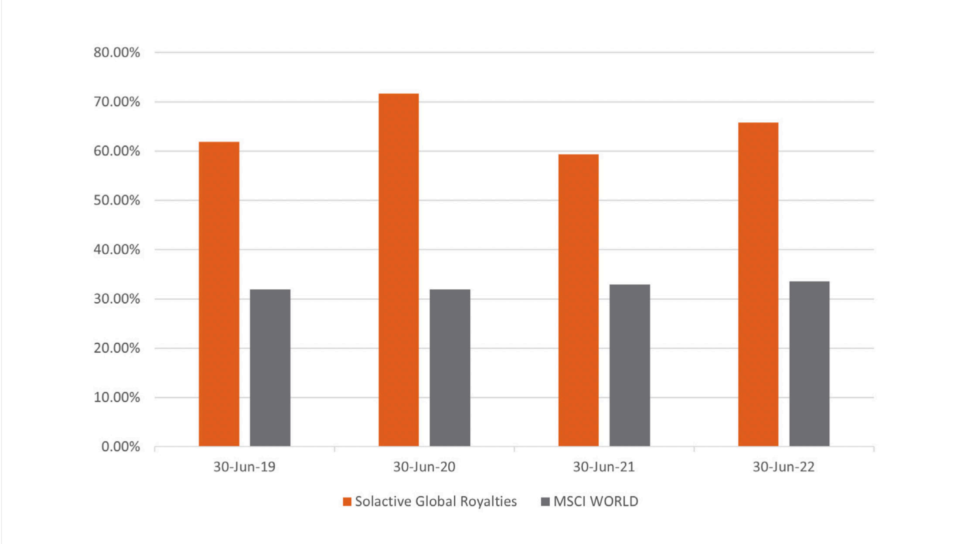
Sector share of royalties for companies in the solactive global royalties index: 31 August 2022

Industry	Weight %
Oil & Gas Royalties	34.7%
Gold & Precious Metals	28.2%
Medical & Biopharma Royalties	15.1%
Music	14.0%
Iron Ore	3.9%
Technology	2.3%
Base Metals	2.0%
Other	0.2%

Source: Bloomberg, Betashares. The Solactive Global Royalties Index is the index which ROYL aims to track, before fees and expenses.

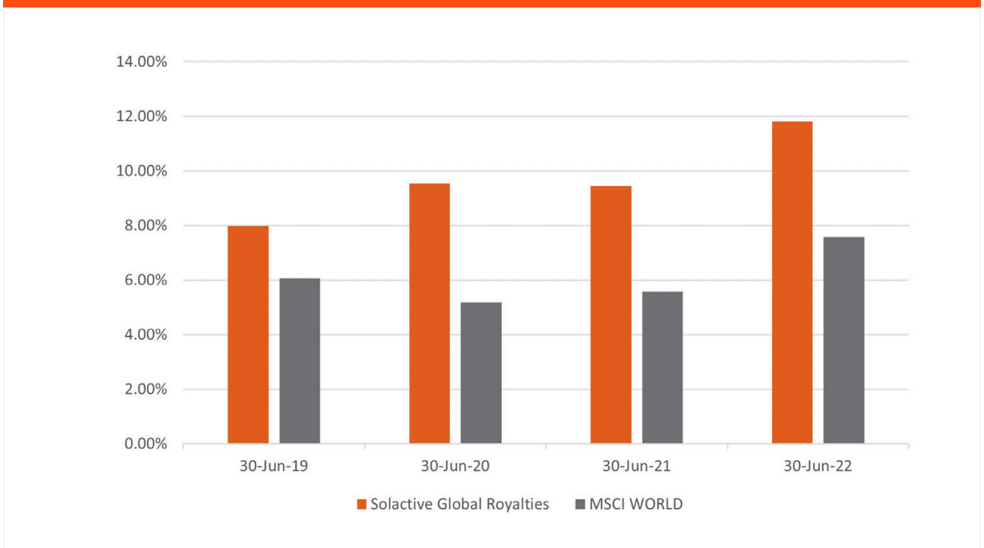
By providing exposure in this way, companies that own and manage royalties tend to have relatively low capital requirements, are able to diversify across different businesses and have generally enjoyed good profitability in recent years. As evident in the chart below, companies covered by the Index which the ROYL ETF aims to track have enjoyed higher gross margins and return on capital than those in a global equity benchmark over the four years to 30 June 2022.

Gross margin

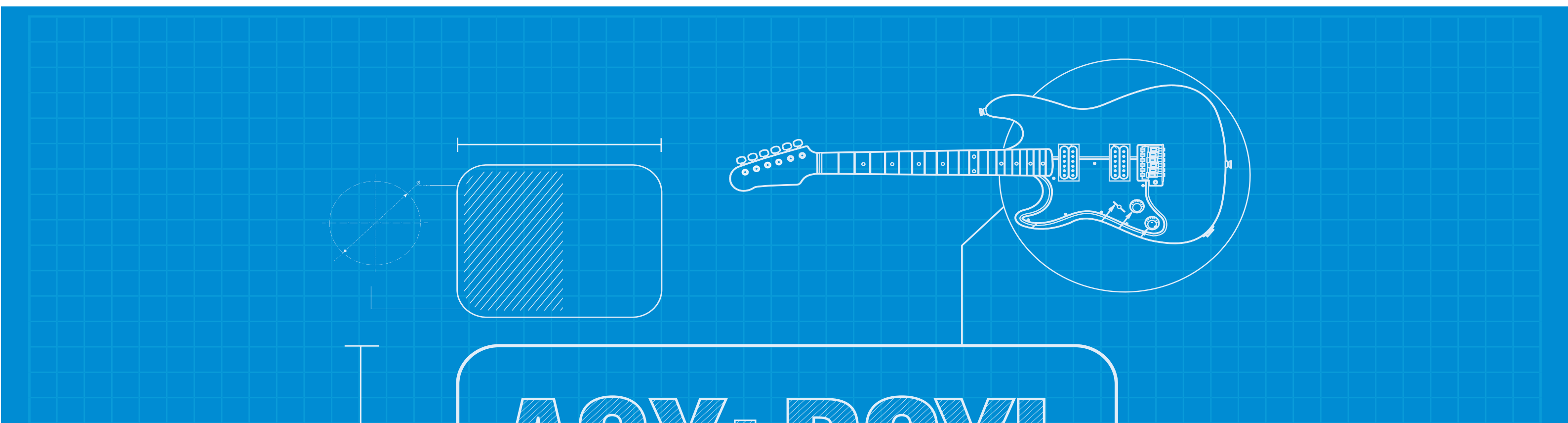


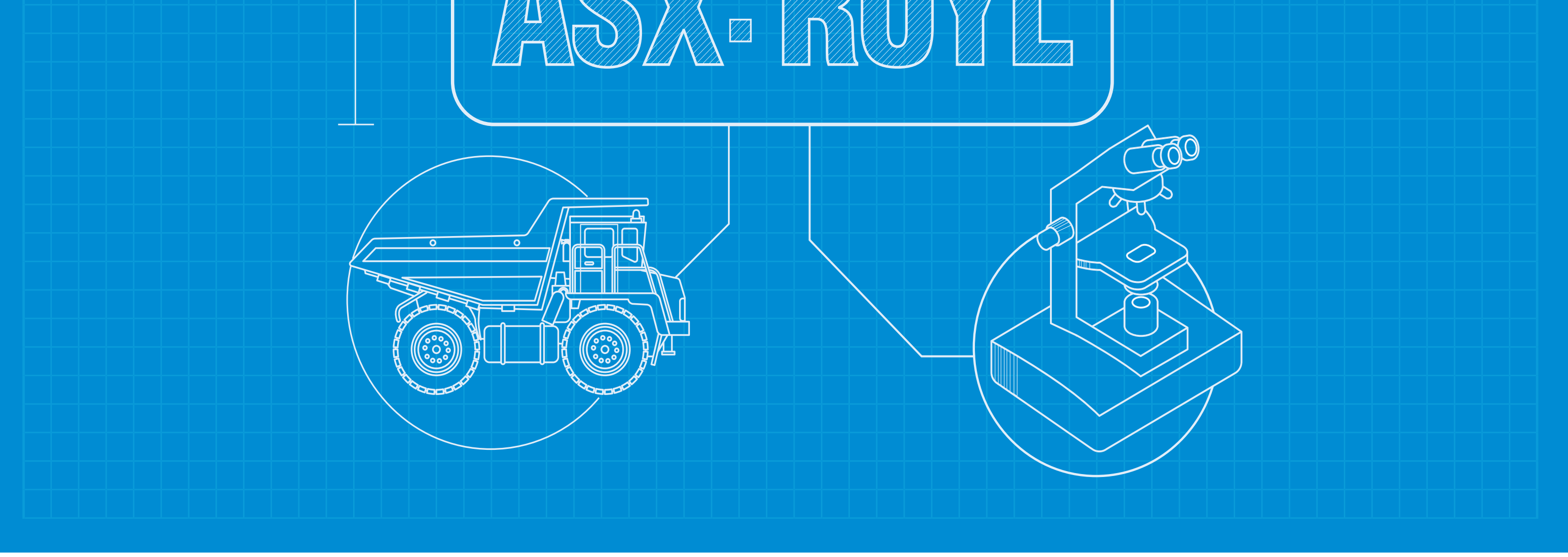
Source: Bloomberg. Past performance is not an indicator of future performance. Gross margin figures are calculated based on the companies in the Solactive Global Royalties Index (the index which ROYL aims to track) as at 30 June each year. You cannot invest directly in an Index. ROYL's inception date was 9 September 2022.

Return on capital



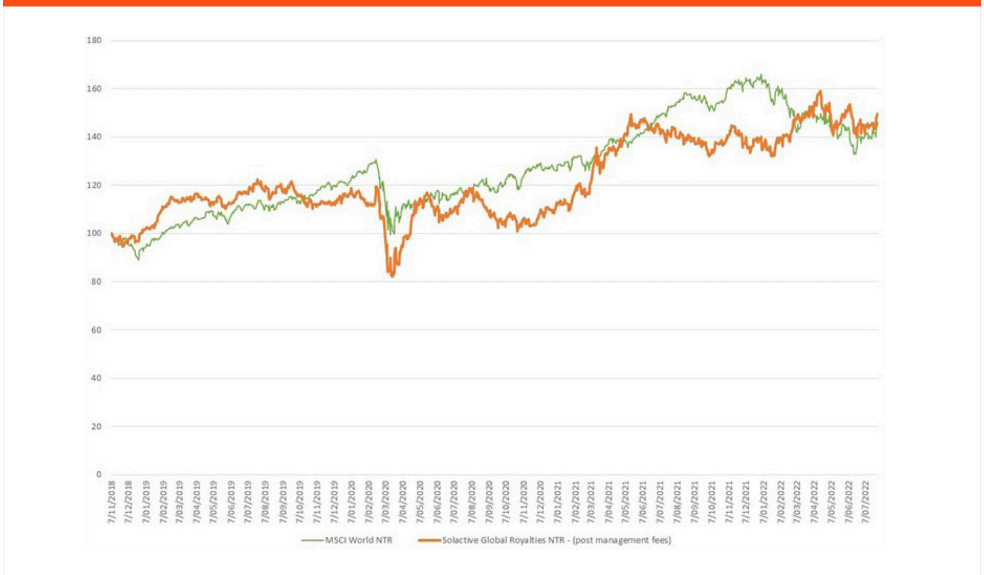
Source: Bloomberg. Past performance is not an indicator of future performance. Return on capital figures are calculated based on the companies in the Solactive Global Royalties Index (which ROYL aims to track) as at 30 June each year. You cannot invest directly in an Index. ROYL's inception date was 9 September 2022.





In terms of sharemarket return, global royalty companies in recent years have enjoyed similar returns to broad global equities, as measured by the MSCI World Index, albeit with a higher level of volatility due their more concentrated exposure.

MSCI world index



Source: Bloomberg. ROYL's inception date was 9 September 2022. Chart shows Index performance (not actual fund performance) after deducting ROYL's management costs of 0.69% p.a. to illustrate the longer-term historical performance of global royalty-earning companies captured by the Index. Past performance is not an indicator of future performance of the Index or ROYL. You cannot invest directly in an Index. ROYL's returns can be expected to be more volatile (i.e. vary up and down) than a broad global shares exposure, given its concentrated sector and industry exposure.

Potential growth and diversification

Many royalty companies offer the potential to increase both the level and diversity of their revenue streams in the future, which in turn could further help lower return volatility compared to the underlying businesses from which they generate their revenues.

Note that many royalty companies typically reinvest the bulk of the royalty payments they receive, to generate and fund new opportunities. This means that potential returns to investors in royalty companies can be expected to come primarily in the form of capital growth rather than income.

Although mining and energy still accounts for the majority of global royalty revenues, royalties earned in the areas of entertainment (music and film) and health care (new drug development) continue to expand.

ROYL provides exposure to companies earning royalties in all these areas. Companies included in ROYL's portfolio as at its inception on 9 September 2022 include:

- **Royalty Pharma** – a company which owns a portfolio of pharmaceutical royalties for more than 35 drugs and therapies marketed by leading brands like AstraZeneca, Roche, GSK, Pfizer and Johnson & Johnson. These pharmaceutical drugs are helping treat common, chronic and rare illnesses including diabetes, asthma, migraines and a range of cancers.
- **Universal Music Group and Warner Music Group** – two global music labels which earn royalty income from singers, musicians and other artists. These two companies own the back catalogues of leading artists such as Sting, David Bowie, Bob Dylan and Elvis Presley.
- **Deterra Royalties** – a royalty business that derives its revenue from BHP's Mining Area C – a project that will form the largest operating iron ore hub in the world.
- **Franco-Nevada Corporation** – a gold-focussed royalty and streaming company based in North America.

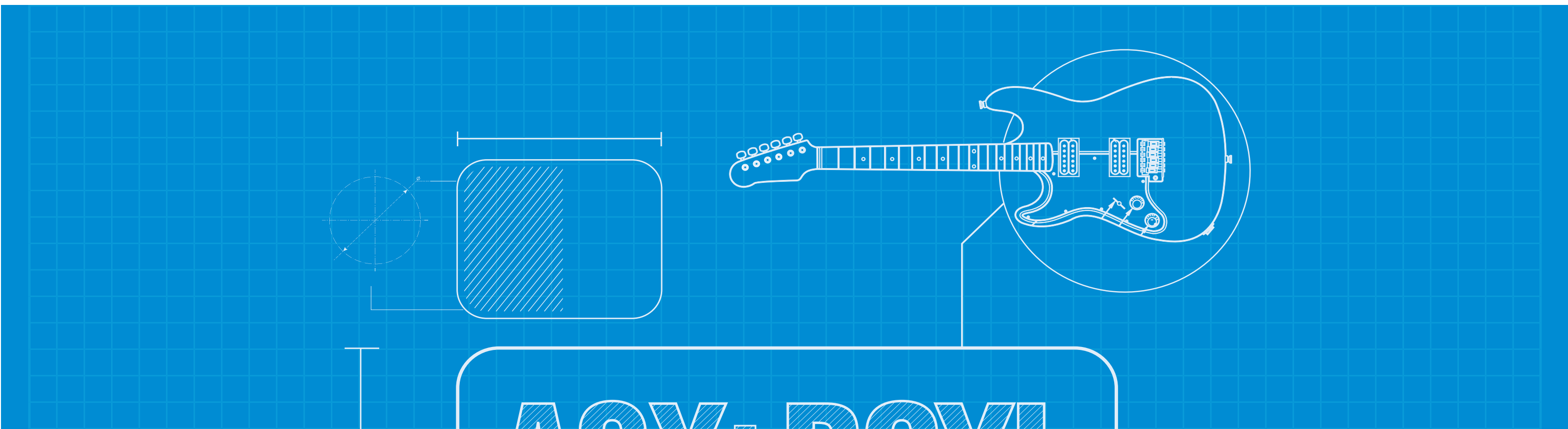
No assurance is given that these companies will remain in ROYL's portfolio or will be profitable investments.

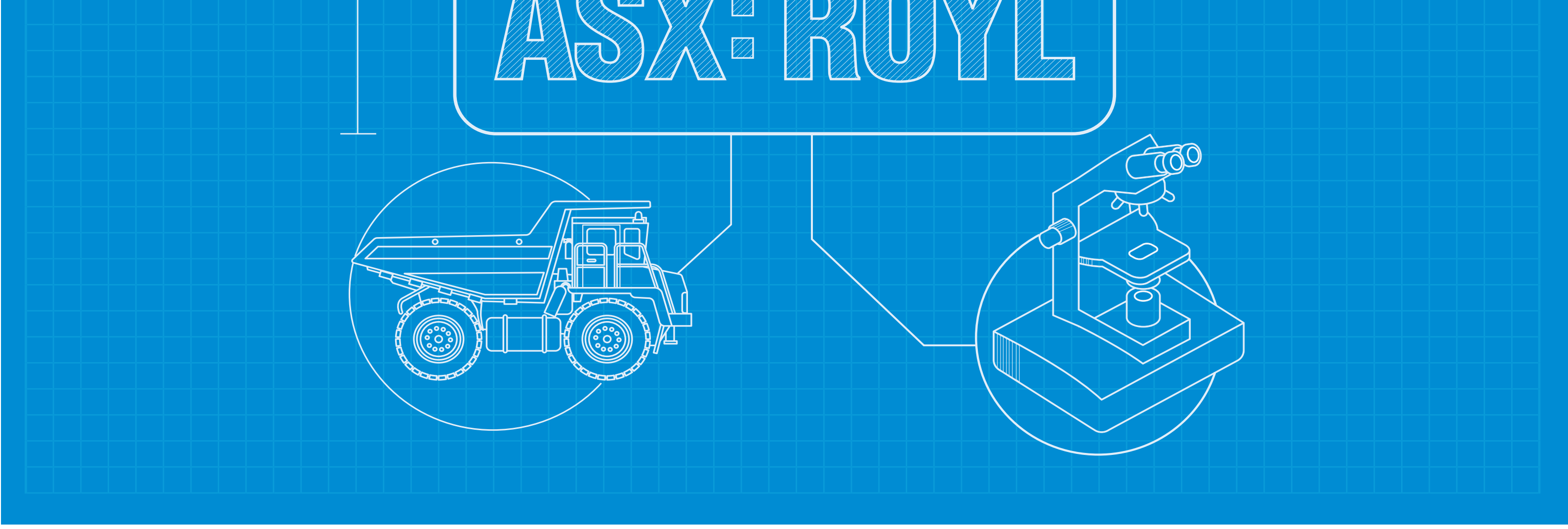
So-called 'royalty finance' has grown in importance in recent years, offering growth and revenue diversification potential for many royalty companies. Under royalty finance agreements, businesses with growth opportunities are able to get up-front financing - without taking on the burden of debt or ownership dilution via new capital - by agreeing to pay a royalty from future revenues. This form of finance is giving rise to royalty revenue streams in not only mining but also the health care sector and beyond.

Advancements in technology and online distribution, moreover, are making it easier to collect royalties for a widening range of activities – such as music, film and industrial patents. According to Research and Markets, for example, the global market for intellectual property rights and royalty management is estimated to grow from US$8.2 Billion in 2020 to US$16.1 Billion by 2026, implying compound annual growth of 12.2% p.a. over this period (actual outcomes may differ materially from forecasts)[1].

As evident in the table below, while companies that derive the bulk of their royalty revenue from mining and energy companies currently account for six of the top-10 holdings in ROYL's Index, also included among the top-10 are companies exposed to health care (Royalty Pharma and Abcellera Biologics) and entertainment (Universal Music and Warner Music).

[1] Research and Markets: Global Intellectual Property Rights and Royalty Management Market Report 2021-2026: Digital Transformation Drive Augurs Well for Future Growth. February 4, 2022.





Top 10 companies in ROYL's index: 31 August 2022	
Security name	**Weight %**
TEXAS PACIFIC LAND TRUST	15.10%
ROYALTY PHARMA PLC-CL A	12.00%
UNIVERSAL MUSIC GROUP NV	8.99%
FRANCO-NEVADA CORP	8.45%
ROYAL GOLD INC	7.39%
WHEATON PRECIOUS METALS CORP	7.28%
PRAIRIESKY ROYALTY LTD	4.93%
WARNER MUSIC GROUP CORP	4.71%
BLACK STONE MINERALS LTD	4.24%
ABCELLERA BIOLOGIES INC	3.05%

ROYL's index is the Solactive Global Royalties Index.

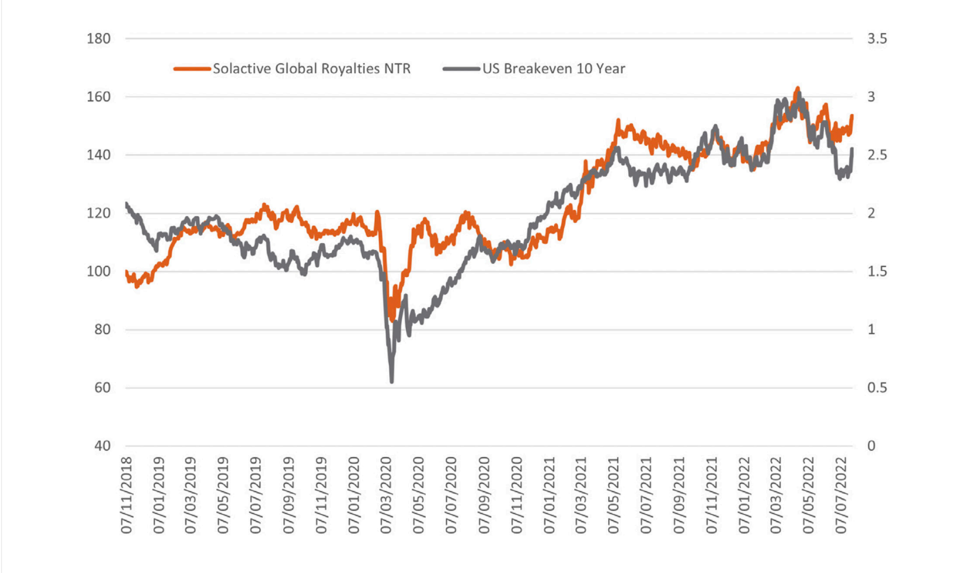
Opportunity to benefit from inflationary environments

Another potential benefit of having exposure to revenues rather than costs is that royalty companies may benefit from inflationary environments. Indeed, to the extent that rising inflation tends to increase prices of commodities and other goods which flow to revenues – this would tend to increase royalty payments based on these revenues. At the same time, many royalty companies are less exposed to the negative impact of inflation in the form of rising input costs.

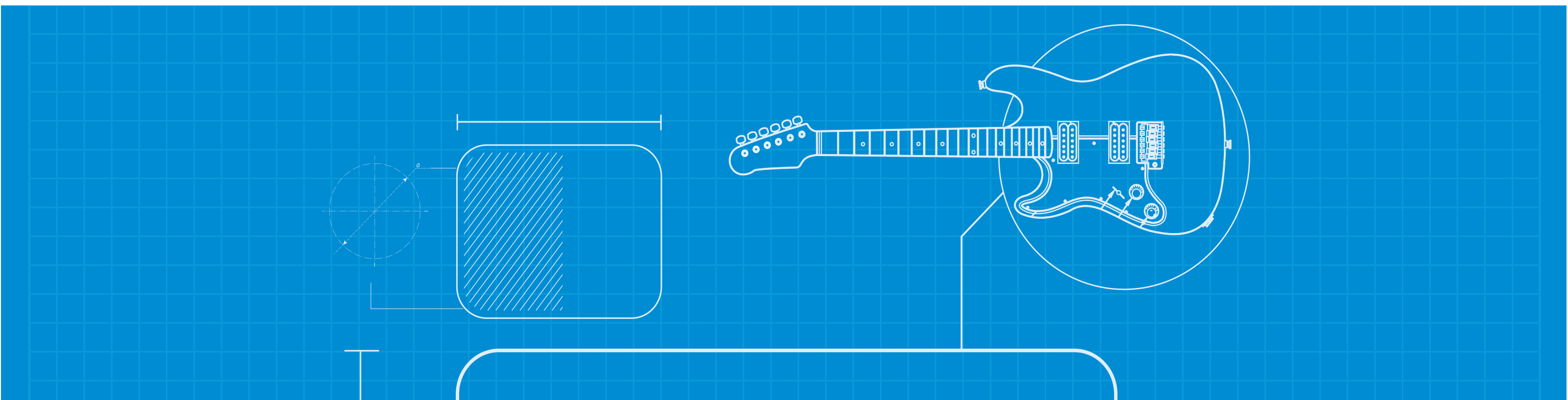
Particularly given today's high level of global inflation – and the risk that inflation could stay higher for longer in the years ahead given disruptions to global supply chains and energy markets – exposure to companies which may benefit from future inflation might be an important consideration for some investors.

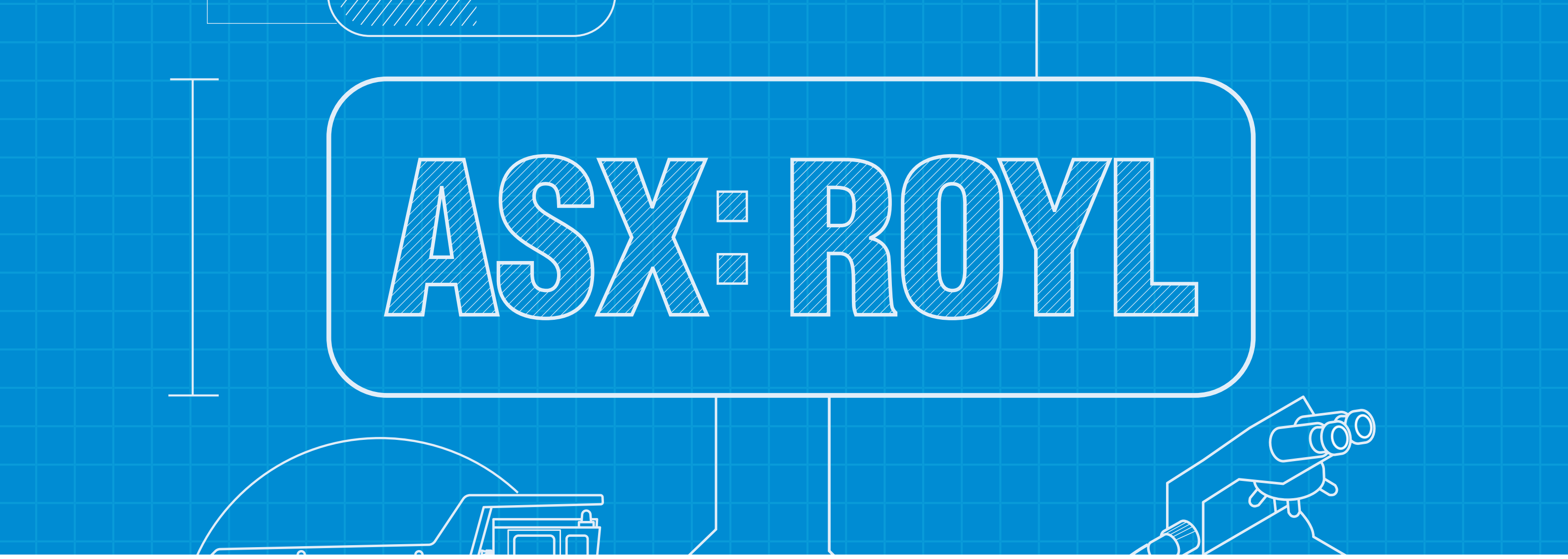
As the chart on the next page shows, the past performance since inception of the Solactive Global Royalties Index, which ROYL aims to track, has shown a strong correlation to the 10 Year Treasury Breakeven rate, a commonly used measure of expected inflation.

Solactive global royalties index



Source: Bloomberg. Past performance is not an indicator of future performance of the Index or ROYL. Chart shows performance of the index which ROYL aims to track, not the actual past performance of ROYL. Index performance does not take into account ROYL's management costs of 0.67% p.a. ROYL's inception date was 9 September 2022.





Summary

Many royalty companies offer an attractive business model in that they are able to benefit from growth in revenues of the underlying companies which their royalty payments come from without taking on the latter's operational and cost risks. Innovative forms of financing and new technologies, moreover, offer the potential for royalty companies to grow and diversify their revenue streams over time. In recent years, global royalty companies have offered attractive returns on capital compared to broad global shares. They may also benefit from inflationary environments in these uncertain times.

The potentially attractive investment opportunity that royalty companies provide has remained 'under the radar' for the majority of investors. With this in mind, Betashares is pleased to offer the ROYL ETF, the first ETF in the world to offer a cost-effective and convenient way to gain dedicated exposure to an entire portfolio of global royalty companies across a range of industries and sectors, delivered via the ease of an ASX-traded ETF.

There are risks associated with investment in the Fund, including market risk, sector risk, royalties related risks, international investment risk and concentration risk. The Fund's returns can be expected to be more volatile (i.e. vary up and down) than a broad global shares exposure, given its more concentrated exposure. The Fund should only be considered as a component of a diversified portfolio. For more information on risks and other features of the Fund, please see the Target Market Determination (TMD) and Product Disclosure Statement, available at www.betashares.com.au.