



Metage Capital recommends voting against three Directors at Hipgnosis Songs Fund

19 October 2023

Dear Fellow Shareholder,

'Toxic'¹ - time for a change in leadership

Metage² is a Shareholder in Hipgnosis Songs Fund Limited ('Hipgnosis' or the 'Company'), and following Monday's dividend cut and today's announcement of a strategic review, we have run out of patience with the ongoing turmoil at the Company. Unfortunately, these are only the latest in a series of self-inflicted wounds which include an inadvertent breach of leverage limits in 2021, the dissolution of subsidiaries whilst holding rights and a terribly received proposed sale of assets (the "Proposed Transaction³").

It is time for a clean break. The Directors bearing most responsibility for this situation need to be removed at the Annual General Meeting on 26 October 2023 and a genuine consultation with the Company's Shareholders over who should replace them initiated. Metage has therefore voted against Mr Andrew Sutch, Mr Andrew Wilkinson and Mr Paul Burger and encourages all Shareholders to do the same.

'I Predict A Riot'⁴ – what you don't know can hurt you...

On 16 October 2023⁵ the Company announced that it was cutting its '1.1325' (SIC) pence per share dividend, due to be paid on 27 October 2023. Abnormally, this was despite the shares having traded ex-dividend on 28 September 2023. The cause cited in the RNS was that Citrin Cooperman had reduced its expectations of historic royalties payable to songwriters and that the Board was therefore required to not pay the dividend to ensure "*...compliance with the...Fixed Charge Cover Ratio covenant*".

This is extremely disappointing for several reasons. There had already been a breach of the Company's borrowing restriction in March 2021⁶. Normally this triggers a tightening of the process for reviewing covenants to ensure that future breaches do not inadvertently occur. This typically involves the preparation of cash flow forecasts which are then reviewed and approved by both the audit committee and the full Board. Indeed, it appears that Hipgnosis follows this practice as the 2023 full year accounts refers to having "*...reviewed cash flow forecasts prepared by the Investment Adviser which are based in part on assumptions about the future purchase and returns from existing Catalogues of Songs and the annual operating cost...⁷*"

¹ Britney Spears and Christian Karisson

² Metage Capital Limited manages Metage Funds Limited, which is a Shareholder in Hipgnosis

³ Circular relating to Notices of Extraordinary General Meeting and 2023 Annual General Meeting and Proposed Related Party Transaction dated 28 September 2023.

⁴ Kaiser Chiefs

⁵ <https://polaris.brighterir.com/public/hipgnosis/news/rns/story/xen6lnx>

⁶ Annual Report 2021; Page 32; Debt section

⁷ Annual Report 2023; Page 128; 2. Accounting policies; b) Going concern

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In the March 2023 full year accounts the Company reported a “Fixed charge coverage of 1.3x”⁸. Fixed charges are typically defined as the “...*Measurement of a firm’s ability to satisfy fixed financing expenses, such as interest and leases*”⁹ and are calculated relative to a measure of earnings, such as EBITDA. Critically it does not normally include payments which are at the discretion of the board, such as dividends. Not unreasonably, the reported ratio appears to have been interpreted as unlikely to result in a covenant breach by Shareholders. This is part of a wider pattern of limited disclosures at Hipgnosis.

This also forms part of a history of significant changes to accruals. In the 2023 full year accounts¹⁰ the catalogue bonus provision was reported as moving from only \$1.3 million at 31 March 2022 to \$45 million at 31 March 2023. Now the CRB III retroactive accrual has been cut from \$21.7 million at 31 March 2023 to \$9.9 million. This accrual was only introduced for the first time in the last financial year. Numberwang accounting at its best. Investors need clear, reliable financial information and a Board that can pay dividends predictably. This one appears incapable of doing either.

‘Give it away’¹¹ – ownership of the Company’s assets

One of the most fundamental obligations of any investment company is to ensure the safe custody of shareholders’ assets. In the Circular dated 28 September 2023 (‘Circular’), there was a representation relating to the restoration of certain dissolved companies¹², which led to the suspicion that subsidiaries had been dissolved, whilst still legally having title to rights. Further discussions with Mr Sutch and Mr Burger confirmed that Hipgnosis had indeed dissolved subsidiaries containing rights beneficial to the Company. This had been discovered in the due diligence undertaken as part of the Proposed Transaction.

Companies House makes reference to 18 subsidiaries having been dissolved. In these cases¹³, a written Board Resolution was filed, signed by Mr Sutch, Mr Wilkinson and Mr Burger (see an example in Appendix 1).

The valuation report in the Circular from Citrin Cooperman Advisors LLC explicitly states in its assumptions for the title to the assets “...*to be good and marketable*...”¹⁴ In correspondence with the Board to clarify the situation, we have been told that in fact 21 entities are currently in the process of being restored, to re-secure the affected rights.

These entities have held portfolios including: Poo Bear*, Johnta Austin, Bernard Edwards, Rico Love*, TMS, Dave Stewart, Tricky Stewart, Itaal Shur, Sean Garrett*, Eric Bellinger, Giorgio Tuinfort, Teddy Geiger, Sam Hollander, Ari Levine*, Starrah, Michael Knox, Chrissie Hynde, Steve Winwood, Jamie Scott, Ed Drewett* and Jonny Coffey. The portfolios with an* are included in the Proposed Transaction.

⁸ Annual Report 2023; Page 145; Section 9. Loans and borrowings

⁹ Federal Reserve Bank of Atlanta - <https://www.atlantafed.org/-/media/documents/banking/publications/directors-guide-to-credit.pdf>

¹⁰ Annual Report 2023; Page 133; note 2 (l) Catalogue bonus provision

¹¹ Red Hot Chili Peppers

¹² Circular; Page 25; Section 1 Asset sale and ancillary agreements; (d) Warranties and Indemnities

¹³ See Hipgnosis SFH II Limited <https://find-and-update.company-information.service.gov.uk/company/11465829/filing-history>; “06 Apr 2023 Resolutions” for an example.

¹⁴ Circular; Page 37; Statement of General Assumptions and Limited Condition; Paragraph 1



The Board's response is that the "...hypothetical future risk is to certain administrative and other rights that relate to the song copyrights..." which do not impact the valuation of these assets. Based on the experience of having to tease these issues from the Board and the Investment Advisor, blindly accepting assurances may not be an optimal approach for Shareholders, as behind these statements can lie a murkier picture.

We would highlight that many of these rights need to be enforced by courts in multiple jurisdictions and under different legal systems around the world. Does the Board categorically know the fact that they were de facto without an owner¹⁵ will not have caused any impairment as a result? There is a representation in the Circular that there has been no significant change in the Company's circumstances since the 31 March 2023¹⁶ and a reference to the terms of the Proposed Transaction having a no material adverse change ("MAC") clause¹⁷. Can the Board confirm that the representation remains accurate and that the MAC clause is not expected to be triggered - given the rights in the dissolved subsidiaries and the prevailing issue with the Company's debt covenants?

'Wrecking Ball'¹⁸ - the proposed sale of assets

Much has been written about the deficiencies of the Proposed Transaction, but there are two specific points that we would like to highlight to other investors. Firstly, there is no up to date valuation provided to Shareholders on the assets being sold. Indeed, we note from the Circular that "...the Directors are unable to confirm if there have been any changes to the Fair Value of the First Disposal Assets since 31 March 2023¹⁹" and further that "...providing their advice to the Directors, J.P. Morgan Cazenove have taken into account the Directors' commercial assessment of the First Disposal"²⁰. It appears that no one is providing Shareholders with an independent and robust view on the current fair market value of the assets being sold.

When we met members of the Board, they initially advanced the argument that there was insufficient time to get an updated valuation. However, it appears from the Circular that there was time for the lenders to the Company to receive "...a valuation by Virtu Global Advisors, LLC showing...the fair market value of the First Disposal Assets²¹..." In the absence of an equivalent valuation for Shareholders, we simply cannot know what the impact of this transaction will be on the Company's operative net asset value.

Secondly, in a significant transaction, it would be good practice for a board to formally articulate their expectations regarding dividend cover, expected income, cash flow and how a company's lending covenants would be affected. Noticeably the Circular made only one vague statement on the Proposed Transaction on dividends "...As a result, the Board believes that it is in the best interests of Shareholders to reduce leverage in order to improve security over the target dividend²²." This odd wording is not the same as

¹⁵ Technically assets of the Crown or Bona Vacantia for the legal fans

¹⁶ Circular; Page 38; Section 3 Significant Change

¹⁷ Circular; Page 23; Section 1 (b) Conditions and Completion

¹⁸ Sacha Skarbek

¹⁹ Circular; Page 14; Section 5 Principal risks to the First Disposal

²⁰ Circular; Page 21; Section 17 Recommendation

²¹ Circular; Page 39; Section 4(c) Amendment No. 1

²² Circular; Page 15; Section 7 Intended use of Disposal proceeds and the Share Buy Back Programme



expressing a clear view that dividends (and covenants) will all be fully covered following the Proposed Transaction. Shareholders should expect to have clarity on these points before voting, particularly given the issues experienced this week.

If Shareholders are considering voting for the Proposed Transaction in a belief that it will secure the dividend, bluntly we do not know whether this is the case. If a refreshed Board came to the conclusion that assets sales were necessary to de-gear, another, probably smaller sale could be undertaken to address the leverage. We believe that Blackstone are commercially rational – if a potentially smaller deal is needed, they will still be willing to buy the Company's iconic assets at a fair price.

'Blame'²³ – who needs to be held accountable?

In our view, the failures which have occurred span many aspects of the Company's operations including accounting, legal and fundamental commercial judgement. To get an effective Board at Hipgnosis, we believe that it is essential that there is a fast and far-reaching change in its membership. Calling a strategic review does not address the underlying problem. If the responsible Directors remain on the Board during this transition, we fear that they will seek to justify their actions and it will prevent new incoming Directors from undertaking a full autopsy of how we have reached this point. The risk is a Kabuki Theatre of governance, where boxes are scrupulously ticked, but new Directors appointed who will ensure a continuity of mismanagement and a strategic review that decides that the status quo is fine.

Consequently, anyone associated with the Proposed Transaction, dissolution of subsidiaries and failure to comply with the Company's debt obligations cannot be allowed to drive the process for selecting their replacements. Mr Paul Burger sits at the fulcrum of all of these issues. He is a member of the Audit and Risk Management Committee, the Senior Independent Director, Chair of the Portfolio Committee²⁴ and critically Chair of the Nomination Committee. We therefore believe that he should be removed from the Board along with the Chairman, Mr Andrew Sutch and the Chair of the Audit and Risk Management Committee, Mr Andrew Wilkinson. Consequently, Metage recommends that Shareholders vote against their reappointment at the Annual General Meeting on the 26th October 2023 (we recommend voting AGAINST resolutions 5, 6 and 8).

Yours faithfully,

Tom Sharp
Chief Investment Officer, Metage Capital Limited
Email: tom.sharp@metage.com

²³ John Newman

²⁴ Annual Report 2023; Page 101; Purpose and Aim. The Portfolio Committee is responsible for "...determining, in collaboration with its legal, tax or corporate finance advisers, the most appropriate means for disposal of the Catalogues of Songs in the event that such Catalogues of Songs are not directly transferable but are held in an intermediated form (such as a special purpose company, or similar)."

Appendix 1: example of a dissolved subsidiary's written board resolution.

HIPGNOSIS SFH II LIMITED

(Company Number: 11465829)

(the "Company")

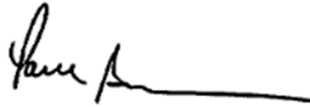
Written Board Resolution

Following due consideration we, being the Directors of the above named Company, for the time being entitled to receive notice and to attend meetings of the Board of Directors hereby resolve the following as written resolution of the Board:

IT IS HEREBY RESOLVED that

- a) the Company is no longer required;
- b) none of sections 1004 and 1005 of the Companies Act 2006 exist in relation to the Company;
- c) application be made to the Registrar of Companies for the Company to be struck off the register, following the completion and signature of Form DS01; and
- d) the Secretary be and is hereby authorised and directed to arrange for the filing with the Registrar of Companies all necessary returns.

Dated the 1st day of April 2020



.....
A Sutch

.....
P Burger



.....
A Wilkinson

