Royalties, The better way of both investing in and financing of companies and projects

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Aligning the interests of those having a vested interest in private companies and projects.
What is a royalty?

A royalty is a percentage of defined revenues which has been exchanged by the royalty issuer with a party having an asset the issuer wishes to use.

Royalties can be sold for cash or exchanged for the use of intellectual property, fixed assets, real property, equipment, labor and professional services.
What is a royalty not?

A royalty does not give the holder an ownership interest in the earnings or assets of the royalty issuer.

A royalty does not vote or have an influence on management.

Royalties do not share in profits or losses.
Why are royalties better for the investor?

Royalties are due, irrespective of the declaration of profits or losses by the royalty issuer.

Royalties provide a return to the royalty holder from the revenues of a company or project, even while the company is privately owned.

Royalties are collectible as agreed, including whenever the issuer receives revenues.
Why are royalties better for the entrepreneurs and business owners?

Those buying shares do so primarily with a view to selling the shares at a profit, at a future date. Shareholders therefore want the managers of the company to report the highest profits possible and want those profits to be ever increasing.

Therefore, shareholders are concerned with; executive compensation, expense ratios, Funds invested for longer term results and appearances.
Most shareholders would not favor:

Executive compensation more than “necessary”.
First class travel and other luxuries.
Investing in projects not having an assured or immediate return.
The purchase of non-necessary furnishing or equipment.
The use of legal and acceptable means of reducing the level of reported profitability.
The negotiation of royalties requires experience as the terms can be extremely flexible. Royalties can be for both fixed and varying time periods. Royalties can be for both fixed and variable percentages of revenues. Royalties can be redeemable and also subject to rescission. Royalties can be secured, guaranteed by third parties and convertible into shares of the issuer.
Fiduciary versus seller of revenue participation opportunity

In the sale of any security the company which sells the security assumes a fiduciary relationship with the purchasers and subsequent holders of that security, be they those who bought the security from the company or otherwise. As a fiduciary the company must consider the best interest of the shareholders as being paramount, which at times may not be consistent with the best interests of the founding principals.
The amount to be sought for the sale of the royalty

The amount sought for the sale of a royalty must be reasonable in terms of the potential revenues for the purchaser to be interested.

The amount should also be sufficient to reach a cash flow breakeven point as subsequent financings, if the company is in a negative cash flow position, will be expensive.
The rate or percentage of revenues to be sold

The rate necessary to attract investor interest in early stage, pre-revenue companies, will have to be in the 20% to 30% annual Internal Rate of Return (IRR) range over the course of the royalty payment period.

Of course, royalties can be scaled, capped, secured, convertible and are always negotiable.
The royalty payment period

Royalties can be for either fixed periods of time or for the time period necessary for an agreed amount to be paid. For most early stage companies 3% to 5% of revenues for 20 years should be about right.
What about ending the royalty payment obligation?

Frequently entrepreneurs and business founders want to be able to end their royalty payment obligation. This is because they fear they will be so successful that the royalty holder will be getting “too much” or because they will have an opportunity to sell the company or go public. In either case, the issuer will be worth a lesser valuation to the buyers if the royalty is existing.
Redemption rights

The issuer of a royalty can have a redemption right which will allow the termination of the royalty payment obligation on the payment of an agreed amount. The amount can include the payments made or can be in the form of stock if the stock meets agreed conditions as to value and liquidity.

Determination of the redemption valuation is the most difficult aspect of the negotiation.
When should the royalty holder be paid?

In the relationship format we have patented the issuer agrees to deposit all revenues in designated banks and to authorize the banks, or another agent, to deduct the agreed percentage of each revenue deposit at the time of deposit.
What is the royalty holders guarantee of contractual compliance?

To guarantee performance the issuer is required to transfer to a mutually acceptable third party specific assets of the company, without which the company cannot function. The exclusive international use of these assets are then licensed, without charge, to the Issuer for so long as the issuer is in compliance with their obligations to the royalty holder.

At the end of the royalty payment period the assets are transferred back to the Issuer.
Liquidity

A royalty is a negotiable instrument and can be sold if a buyer can be found. Were there to be an organized market, such as through a stock exchange, where royalties were listed and traded it is logical to believe that royalty purchasers would accept a lower percentage of revenues for the same amount of money as after a series of quarters of increasing revenues the royalties would trade at a premium.
Conclusion for investors

Royalty purchasers can lose money. However, in most cases they are better off than equity holders, unless the company is bought or goes public, in which case they will still profit significantly.

If the royalty issuer is reorganized it is likely those continuing the business will need the transferred assets and will continue the royalty.
Conclusion for the business owners

Royalty holders are only interested in revenues.

Royalty holders do not vote or own equity. The equity stays with the business founders.

Royalties can be structured to accommodate the anticipated business results of the issuer.
Summary

Royalties address the inherent conflict of interest between founders of businesses and investors. Investors are transients by definition, as they only buy with a view of selling.

Royalty purchasers have a longer and more constructive vision of the issuer, one which is more closely associated with that of the owners.
This presentation

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The approach of using royalties in the financing of businesses is patented.

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