The Larry and Barry Guide to Understanding Royalties©

By Arthur Lipper

Lawrence "Larry" Lion and Bernard "Barry" Beaver are characters I created and used in my monthly Chairman's Comment column in Venture, The Magazine for Business Owners and Entrepreneurs, as a means of giving life to instructional dialogue.

LARRY: "These, of course, are only our minimum projections."

Larry is the extrovert, marketing, outside partner and Barry is the more contemplative Chief Operating Officer-type. They are a good team.

There is one other image I wish to impress on you, on the next page.

Balanced Vision
Royalties are the better way of investing in and financing privately owned companies.

I developed this justice scale to use as a logo for myself and my work as a balancing of risk and reward or pain and pleasure, or good and bad – with an attempt to peer into the future, using the image of a telescope -- signifying that which can be achieved through the use of royalties.

Following are the dialogues. Please let me have any questions which the questions and or answers engender and I will do my best to respond/ Chairman@REXRoyalties.com will get to me.

Session 1 – Amount of Investment and Issuer's Potential

Larry and Barry, As Royalty Buyers, Assess Potential for Royalty Seeking Company©

Larry: So the product looks like it could be a real winner, and if so the royalty deal could be a great investment.

Barry: Sure, but first we want to determine who else has similar products and how good the IP protection is, that the company holds. Do they have patents pending or issued?

Larry: Ok, let's assume they have the IP area covered. It's the size and projected growth of revenues they project which interests me. Also, the projections were only for the U.S. and the international market could be as big.

Barry: Ok. Neither you nor I are likely users of the product so let's go meet and talk to a likely customer to see just how excited they are about the product and what they have to say about competitive products. Also, we need to have some advice as to the likely growth of the industry. We don't want to be investing in the revenues of a better buggy whip.

Larry: So where do we get an industry perspective?

Barry: There may be an industry association and certainly will be a professor at the university who has a view on the industry. However, again, it is the potential users who might also have a realistic view of the potential for the industry in which they compete.

Larry: So if the IP is good, the product good and industry outlook good -- what else do we need to research?

Barry: We need to understand the company itself and the pricing of the product. Can we count on the company being able to produce the product, and how will they price it?

Larry: Of course, they will price it to make a profit and we do not share in profits, only revenues.

Barry: My concern is if they try to make too high a profit at first. If they do, the price will invite competitors to both try to copy it, and to drop their prices. Being greedy is not good business, but delivering value is. Therefore, I'd rather see them price it for a fair profit and gain broad market acceptance, especially as we would be revenue focused, not profit dependent.

Larry: What else should we be checking on?

Barry: We should become aware of the relative size of the company vis-à-vis their competitors and if the use of their product will improve the performance of their customers. If so, that's a real win.

Larry: What else?

Barry: Lastly we want to be sure the amount they want for the royalty is not too high a percentage of their present sales. It is possible the new product doesn't have the customer appeal they believe and that we will have to get our money back from much lower sales growth than projected. If this is a bet essentially on the single new product we want a higher return than if the success will be incremental. Usually, it seems that 40% of present revenues is a good amount to pay for the royalty if one is really enthusiastic about the prospects for the company.

Larry: Of course, in the case of pre-revenue companies the deal has to be better than for companies already in business and having customers.

Barry: You got it.

Session 2 – Royalty Rate and Internal Rate of Return

Larry and Barry, As Prospective Royalty Buyers, Considering the Royalty Rate and IRR©

Larry: Ok, so the company has a really good business opportunity with its product line and the growth of its customers. Now what's a fair deal?

Barry: Well, what's the best realistic return we can earn on money without taking all-or-none sort of risks?

Larry: 15% a year compounded, doubles in a little less than five years, so let's say 20% on the money we continue to have invested in the company without making an assumption of a return on the money paid to us in royalty payments.

Barry: Ok, then let's try to do a deal where if the projected revenues are achieved we will get at least a 20% Internal Rate of Return (IRR) over the course of the royalty payment period.

Larry: Of course, it's going to take something like 5 years of royalty payments for us just to get our money back so we won't have any positive IRR until we recapture all of our principal.

Barry: Correct, but in the period in which we are being made whole, the revenues of the company should be increasing according to the revenue projections. Therefore, the level of royalty payment will be much higher then than now, and we should start to see some good level IRRs then -- and even more for each year in the future, again according to the revenue projections.

Larry: Yes, these deals all depend on the growth of revenues which the company is projecting. Of course, I would agree that it is easier to predict a Compound Annual Growth Rate for revenues than it is to guess at what per-share profits will be.

Barry: Right, that why I like royalties, as there is less guesswork and greater assured income. Also, there is that website REXRoyalties.com where we can see precisely what our returns will be if the revenue projections are achieved. We can adjust the projected revenues to a lower rate of growth than the company projects, just to be more conservative.
Larry: Are there other websites we can use once we are more experienced?

Barry: There sure are and they are: REXdebt-shareRoyalties.com which shows how to combine debt and a royalty for a better long term deal for both us and the investors. There is also REXComparator.com which allows a comparison between two deals, using the same projected revenues but different deal terms such as royalty rate, maturity and amount paid for the royalty.

Larry: Are there any others?

Barry: Yes there are two more. One of them, REX-PV.com shows the details of transactions if and when the original buyer of a royalty wishes to sell it. The PV means Present Value and the website shows how much the new buyer has to pay the seller for the seller to achieve their target IRR. It also shows the amount the new owner has to receive in royalty payments to break-even on cost and the IRR which will be earned if the projected revenues are achieved.

Larry: What's the last one?

Barry: The final one, REXScaledRoyalties.com, has just been released and it is great as it does what really happens in a royalty transaction negotiation. The users set trigger points for over and under achievement of projected revenues and royalty issuer hving made the projections gets agreed benefits or penalties based on the results in a user selected annual time period, the Selected Adjustment Period. It is really a game changer for royalty transaction negotiation.

Larry: Sure, but if the company does better than the projected revenues, then our returns will be much higher.

Barry: But if that happens the company will want to buy out our royalties and that would be fine, if the price is fair. They will do this by using a redemption clause in our agreement, direct negotiation with us or by tender.

Larry: We can always sell the royalty, right?

Barry: Yes, and we possibly should sell once we get our money back and have to start paying taxes on the royalty payments. The logical buyer of a seasoned royalty could be a tax-exempt institution, as they need the increasing income and don't pay taxes. So they'd pay us a premium for the remaining years of royalty payment. This is all demonstrated in the REX-PV.com website calculator.

Session 3 – Maturity or term of royalty payment period

Larry and Barry, As Business Owners, Discuss Maturity and term of Royalty Payment Period ©

By Arthur Lipper

Larry: So for how long do we have to pay this royalty?

Barry: They use 20 years as a standard time period.

Larry: What happens if we want it to be much shorter?

Barry: Then we would most likely have to pay a much higher royalty rate. The investors have an IRR objective -- how much they want to earn for the risk they believe they are taking -- in achieving the revenues we project. The longer the term of the royalty, the lower the rate can be.

Larry: So couldn't we do a deal where if we pay them an agreed amount in cumulative royalties within an agreed period, then we can cancel the royalty?

Barry: It is all negotiable and we could make such a proposal. The problem is that their counter offer would likely be -- "Then give us a guarantee of a minimum amount of royalty payments during the same period."

Larry: We really need to compare a number of possible deals using the same projected revenues to see which works best for both of us.

Barry: They have a website calculator called REXComparator.com which allows a user to do exactly as you suggest.

Larry: I'd sure like to have a shorter period.

Barry: Yes, me too -- and my guess is that we will buy back the royalties we sell through a redemption to accomplish that result.

Session 4 - Contractual compliance

Larry and Barry, As Prospective Buyers of a Royalty, Worrying About Contractual Compliance ©

Larry: So how do we know these guys will do what they say they will do?

Barry: First of all, they only have to pay us the agreed percentage of their revenues, when they receive the revenues, for the royalty payment period.

Larry: What happens if there are no revenues?

Barry: Then we'd lose all that we had invested, unless there was a minimum payment agreed to, or the value of the assets of the company that we had rights to could be sold.

Larry: What if the company was refinanced and reorganized?

Barry: Then the party holding the assets on behalf of the royalty owners would license the new company to use the assets on the same terms as the original royalty issuer.

Larry: How do we know the company is going to deposit all of its revenue in the bank where we have an arrangement for deducting the amount of agreed royalty?

Barry: In the case of privately owned companies, owners of at least 60% of the equity will have to personally affirm that all revenues are, and have been, deposited in the designated bank.

Larry: Will all banks agree to deduct the agreed royalty automatically on receipt of a deposit?

Barry: No, not all banks will provide such a service and there may have to be a service provider who is empowered to take the necessary actions to conform to the agreement.

Larry: If the royalties are collected on a daily basis how often do we get our royalty payments?

Barry: Normally it would be quarterly.

Larry: What information is the royalty-issuing company obliged to give us and when?

Barry: That is all in the royalty agreement. Normally, there will be an annual audit of at least revenues and more probably a full audit provided to us within 120 days of the closing of the company's fiscal year. Of course, the revenues will be known much earlier and we will know how much we have collected, so we will really already know the amount of revenues.

Larry: Yes, but it will be good to have the audit. How about projection updates?

Barry: Again, that is a matter to be negotiated in the royalty agreement. In some cases the companies will want to issue quarterly reports and will want to keep their royalty holders informed, and in other cases they will only do the minimum. If and when royalties become traded on exchanges, companies will be encouraged by the exchanges to be forthcoming with advice as to any change in anticipated revenues.

Larry: So it is the old story -- the more complex the contract, the greater the need for legal documentation.

Barry: Correct.

Session 5 – Redemption or termination of royalties

Larry and Barry, As Business Owners, Learn AboutTerminating Royalties ©

Larry: Ok, so we like the idea of being able to sell a percentage of our revenue, but if we actually make our projected revenues the royalties we will be paying will be enormous. How do we get rid of this thing?

Barry: A great problem to have. Then we'll need to negotiate with the royalty owners.

Larry: Sure but by then they will be getting such a good deal they won't want to give it up.

Barry: You are right and that is why there is why we will want a redemption right, which can be negotiated before we reach a final agreement.

Larry: How does it work?

Barry: The royalty buyers agree that within an agreed time period, the company can redeem the royalty contract for an agreed amount. This amount will include the cumulative value of the royalties they have received.

Larry: How much will the redemption value be?

Barry: Depends on the negotiation but probably enough to give the royalty owners at least the Internal Rate of Return (IRR) they targeted at the time of the royalty purchase.

Larry: So how much?

Barry: If redeemed in the first ten years, probably somewhere between 5 and 10 times what they paid.

Larry: That's pretty rich.

Barry: Yes, and we don't have to redeem the royalties as the payments are fully tax deductible to us and we may be able to pay less than the agreed redemption value.

Larry: How can we do that honestly and legally?

Barry: There are a number of ways. For starters, we can contact and negotiate with any or all of the royalty owners and offer them less than the redemption level. We could sweeten the deal by adding some stock, or warrants to buy stock in the company. If we were reasonable we'd probably get some of them to agree to the offer.

Larry: How else can we redeem the royalties and stop paying the full amount, which is a big share of pre-tax profit?

Barry: We could make a tender to all of the royalty holders, offering the deal we thought fair and attractive, but less than the original redemption value.

Larry: But why would they take less than the redemption value?

Barry: Because we are not required to redeem. It's our call.

Larry: What's another way?

Barry: We can do a Dutch auction where we put up an amount that we are willing to pay for the least expensive royalties we can buy. That way we pick the low hanging fruit and can always redeem the balance any time we want.

Session 6 – Debt + Share from the perspective of the royalty issuer

Larry and Barry, As Business Owners Consider Debt & Royalties ©

Larry: So is there a way for us to get the most money and pay the least amount to the capital provider?

Barry: Yes there sure is, and it is what they advise most frequently in early stage companies. It's called Debt Plus Share (of revenues) and is explained at REXdebt-shareRoyalties.com.

Larry: How does it work?

Barry: We would borrow the amount of money we need to get to cash flow breakeven and after we pay it back there is a long-term royalty for less than half of what it would be with having borrowed and paid back the money.

Larry: So what's the catch? We are not burdened with those wanting to lend us term money. What's the interest rate, the amortization, the collateral and the ability to prepay?

Barry: Right questions and all are subject to negotiation. The interest they suggest is 10% to 12% per annum. Monthly amortization gives us the lowest interest to pay, but we do not have the full amount due to the amortizations before we are well into operations. The collateral is our intellectual property and anything else they can grab on to, and the loan can be repaid at any time without penalty.

Larry: So we can borrow, without personal guarantees, the amount we need, at a rate only a little higher than we'd have to pay a bank, with monthly repayments of principal and interest, giving up all that is in the company as collateral -- we can repay at any time without a penalty?

Barry: Yes, and the starting royalty, after the loan is repaid, is only 2% of our revenues.

Larry: Do you mean the royalty can be even less than 2%?

Barry: Yes, we can negotiate a reduction in the royalty rate dependent on the cumulative royalty payments we make.

Larry: And is the royalty still redeemable?

Barry: Yes, I believe that it can be negotiated to be redeemable.

Larry: What's wrong with the deal?

Barry: Well we can lose everything if we don't make the loan payments and the loan will have all of the normal negative covenants restricting what we can do with the money.

Larry: So what? We are honest people and will only use the funds for the disclosed purposes, including the payment of our salaries. We also are not promising the projections we are making, even though they seem reasonable to us at this time.

Barry: Right, but still it is taking on corporate debt instead of selling a part of the ownership of the company and you know how I hate debt.

Larry: I don't see the problem. We are getting money almost at bank rates and only giving up a royalty on a modest part of our revenues. Even then we can terminate the deal by paying a known amount.

Barry: Ok. Let's go to the negotiation with an open mind and see how good a deal we can make.

Larry and Barry, As Business Owners, Consider Debt and Royalties From the Investor's Perspective ©

Larry: Isn't this deal too good for the investor buying our royalty?

Barry: Yes, it's a good deal for the investor but also a good one for us, since we have to share only a small percentage of our revenues with the royalty owners once we repay the debt.

Larry: Yes, but once we pay off the loan the investor has gotten his whole investment back and has no skin in the game.

Barry: Yes, that's why we are able to have to give up such a small percentage of our revenues. The investor is able to achieve his IRR very easily from the perspective of having a zero cost. Also the royalty holder is not "in the game" with us as he is only interested in receiving the percentage of the revenues we projected for as long as was agreed.

Larry: So with each amortization payment we make, his risk is reduced and his IRR really increases due to the lessened investment in the benefit he will be receiving once we start to pay a royalty.

Barry: Exactly correct -- which is why he's willing to lend us money now when all the good things we believe will happen are still just hope and projections.

Larry: So you are saying that our risk is the same, which means total and the investor's risk diminishes with our loan repayments -- and in theory his profit potential goes up as we mature and actually create the revenues we have projected.

Barry: Seems like a good deal for both of us.

Larry and Barry Consider Buying a Royalty From an Early Stage Company ©

Larry: How can we consider buying a royalty from a company that doesn't have any revenues now? Isn't that the business of venture capitalists, who will buy a big chunk of the company and then try to help it, sometimes by removing the founder who is running the company?

Barry: Well, we understand the industry in which the company intends to compete and we like the people they have. We also believe that if they can make the product they have invented they should have both good revenue growth and a good profit margin.

Larry: They sure liked the idea of selling us 5% of their revenues for the next 20 years. They didn't like the VC and other equity investors who wanted to buy a convertible preferred with a liquidation preference, convertible into a significant percentage of their company at too low a valuation -- were they successful in getting the device to market.

Barry: Yes, a royalty is the better way of both investing in and financing of early stage companies, which are almost always privately owned.

Larry: They think it will take them a year or so to get to market if we supply the capital through buying the royalty. As they won't have any revenues in the first year or so, why not start the 20 years from the time we receive our first royalty payment?

Barry: Yes, that is reality and our agent will own all of the intellectual property presently existing or created to assure contractual compliance. We will let them use the IP, exclusively and without charge, for so long as they do what they have agreed to do.

Larry: If they are successful, our royalty will be worth a lot of money as the entitlement will be to a percentage of a fast growing revenue stream. Can we sell some or all of it to cash in a bit?

Barry: As I read the description of the process, royalties are always free to be sold, even though they are not yet traded on an exchange. We don't pay any income tax on the royalty payments until we are even and then pay tax on ordinary income. The company gets to deduct the payments as an expense of doing business, really as the payment for the funds necessary to make the company successful.

Larry: So what happens if they run out of money and the development takes longer than anticipated?

Barry: The company will probably be reorganized and refinanced and need the IP we own to continue to make it all work. Of course, it could be a flop and there wouldn't be significant royalty payments -- or even zero royalty payments -- then we would have a capital loss for tax purposes.

Larry: How much would we charge for the use of the IP?

Barry: We would only demand to have the royalty agreement honored and for the new company to accept the same deal as the original company had. A nominal fee of $1 per year perhaps, in order to make it a binding contract. This way we continue to hold the old IP and any new IP developed.

Larry: So it is surely not without risk, but a pretty sweet deal and a good way to help get the company started, increase the number of employees and all the good things which come from helping early stage companies to get into business.

Barry: I agree the approach is sound and works for the investors. Now all we would need is for the company to be successful in developing and marketing the device.

Larry and Barry Buying Royalties From Mature Companies ©

Larry: So why would anyone want to buy a percentage of the revenue of a mature company, no longer growing rapidly?

Barry: The attraction of the financial instrument is determined by the risk and the prospective return. Royalties can be structured to have minimum royalty payment levels, and that can be attractive to conservative investors. Also, revenues will probably rise on their own over the years due to inflation.

Larry: Isn't that like a bond in that there is a minimum expectation of a payment like interest?

Barry: No, not at all -- as revenues can rise and royalty payment minimums can also rise, irrespective of revenues. All that happens if someone loans money to a company is they hope to get it back at maturity and receive interest payments until maturity. Royalties are different and can be a much better investment.

Larry: So what would happen if revenues declined?

Barry: The minimum payments are irrespective of revenues.

Larry: There are pension funds and other institutional investors who prefer mature companies and shun early stage companies. Will they be the more important investors in the royalties coming from mature companies?

Barry: Yes, that is a logical expectation. Fiduciaries usually prefer to be comfortable with risk concerns, and pay the price by giving up the potential of significant capital gains.

Larry: How could a mature company make their royalties attractive to those of us who are more gain-focused than income-oriented?

Barry: Your question displays a failure to understand that royalties are transferable, and that with a history of rising royalty payments even a modest rate of revenue growth would increase the royalty payments. This would increase the value of the royalty contract to other investors, so you could still get your gain by selling it.

Larry: Ok. I get it now. That is why the royalties people are so intent on opening and operating a royalties exchange. Then, mature companies would have a robust market for their royalties and competition would bring the royalty rates down.

Barry: Yes, but the royalty issuer can also make the deal more attractive by using the funds to expand their business, thus increasing revenues. They could also use the funds to acquire other companies and be more aggressive than they could have been without the royalty-based funding.

Larry: There is one other thing we could do with a royalty from a mature company that we might be reluctant to do with an early stage company.

Barry: And just what is this genius idea?

Larry: We could more comfortable using borrowed money to buy the royalty, as the royalty will be yielding us much more than we would be paying in interest, especially these days.

Barry: You are right -- there wouldn't be a lot of risk and the income spread would be significant. Let's do it.

Larry and Barry, As Business Owners, Creating An Investor Pitch and Scaled Royalties

Larry: Ok, so the buyer of a royalty is simply buying a percentage of the revenue projections we present as being realistic.

Barry: Right -- as far as the projections go -- but he is also very concerned that we will use the money as we have said and that we will be sure that he gets paid in royalties what and when he expects.

Larry: We can get some of our customers to say how much they expect to grow over the years. We can also get white papers and research from academics about the probable growth of the industries we serve.

Barry: That would all be good. And of course, we could also guarantee a minimum level of growth in several ways.

Larry: Yeah! They have got all the protection they could want within the terms of the deal.

Barry: You mean the agreement with the bank or an agent of ours to deduct the agreed royalty whenever revenue is deposited. Also, they have a personal affirmation from a majority of the company's owners that all of the revenue has been and will continue to be deposited in the designated banks.

Larry: Yes, and an agent of the royalty owners holds all of our intellectual property and other core assets to assure that we do as we promised. Otherwise, we are not able to use the IP and other assets.

Barry: Yes and we have one more ability to make the royalty investor feel comfortable. This is something new which Arthur Lipper has created and never before revealed or used.

Larry: What is it?

Barry: He calls it a Scaled Royalty and it is great for both the investor and for us, the issuers. See how it works at REXScaledRoyalties.com.

Larry: How does it work?

Barry: We provide projections of revenues and agree that if for any extended period, called a Selected Adjustment Period (SAP), if our revenues are X percent higher than was predicted the royalty rate declines by Y percent for the balance of the contract. A typical SAP would be three years, but this can be modified.

Larry: Who chooses the terms of the variables?

Barry: All of the variables are subject to negotiation. This includes the length of the SAP; the amount of the exceeding revenues needed to trigger the drop of the royalty rate, and the percent the royalty is reduced. This gives us an enormous incentive to be very conservative in making the initial projections, as we get such a big pay-off from beating them.

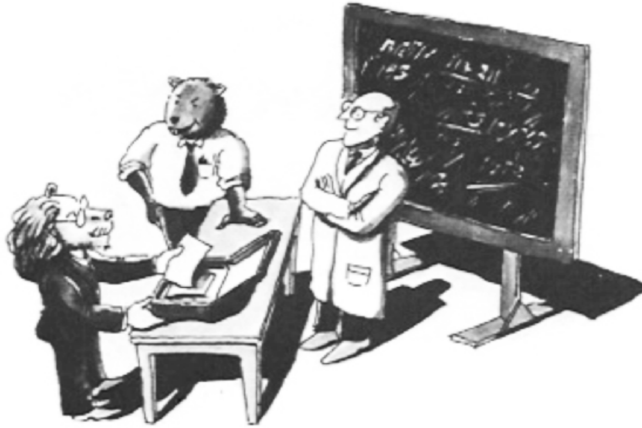
Larry: What's the down side?

Barry: There is also a penalty if we fail to achieve the revenues projected by an agreed percentage for an extended period (a SAP). We have to make up the difference in some way between our deficit and the royalties which would have been earned had we achieved the projected revenues. The make up could be an increase in the royalty rate, an extension of the royalty period, a payment, a note or whatever we all agreed is fair.

Larry: It is a real carrot and stick approach. We benefit if we are conservative in making the projections, and bear the pain if we fail to achieve them. It is diabolical and yet fair. The core motivation -- to increase revenues -- is open, documented, transparent, and shared equally by both the investors and the company.

Barry: Anyone who believes in us and our business will have to like this approach, as it balances the interests of the parties. Of course, the royalties will still be redeemable, so we know the worst-case cost of exercising our right.

Larry: I love it, since I am so sure that we will have great revenue growth, more than the conservative revenues we will now predict. The prospect of giving away less of our profits is very appealing.



BARRY: "Now tell the professor about our scientific advisory board and the stock options."

Session 11 – Features of some royalties

Larry and Barry, As Business Owners, Get Into the Details of Royalties ©

Larry: It's getting confusing. That is why we need an advisor and an attorney to do this royalty thing.

Barry: Agreed, but here are some of the answers. We should specify the rate of exchange to be used if the revenues are in other than U.S. dollars. We should also decide now if we want to make the royalty more attractive to investors by making it convertible into our stock and if so at what valuation.

Larry: Those are both important issues, particularly in the case of non-U.S. revenues. Keep in mind that if we make the royalty convertible into stock, we immediately become fiduciaries and we didn't originally want to do that. As soon as the royalty is convertible into shares it is a security and may be regulated as such. Perhaps the conversion privilege should be only if and when the stock is

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trading publicly, and for a period of time. The royalties could then be convertible as we would already be fiduciaries.

Barry: The tricky question would be the appropriate conversion ratio and the market value, if any, of the royalty. We would want the royalties to be converted then, as each dollar of royalty payment is a Pre-Tax dollar of profit to which a Price/Earning multiplier would be applied to the Net After Tax profit amount – and the stock would go up. We should calculate the benefit of the conversion and offer the royalty holder a conversion that benefits us both.

Larry: As I understand it, the advantage of the Put to buy back the royalty at the value we received, less all royalty payments made, is only exercisable at the end of a 60-month period. This is called a Continental Put, after the European practice of making stock options exercisable at maturity instead of until maturity as is common in the US. The purpose of our making the offer, recognizing that we have no control over the actions of the owner of the royalty, is to allow us to hold in suspense the tax booking of the money we get for the sale of the royalty.

Barry: Right, as we don't know how the IRS is going to characterize the money we received and we want to delay having to address the matter until we know if the royalty holder is going to demand their money back or not.

Larry: But isn't it a bit of a known result, since if we are able to honor the commitment it is unlikely the royalty owner would want to give up the revenues for many years, if we have any revenues?

Barry: Yes, but we have no knowledge or control over the actions of the Put owner, so it is a good argument for waiting until we know if the Put will be exercised.

Larry: What should be the tax treatment?

Barry: Logically, we have sold an asset in the form of a percentage of our revenues for an agreed period. Therefore, the difference between what we received for the asset and our cost in creating the asset should be a profit and we could have a tax to pay on that profit. However, it is up to our attorney and accountant to advise us.

Larry: Of course, the Put is the negotiation offset to the right to redeem the royalty, which we want in case we get a good bid for the company or we can go public at a fair valuation.

Larry: So effectively the royalty owner collects, through an agent, the agreed royalty every time revenue is deposited in the designated bank.

Barry: Yes, and then the royalty owners get the accumulated amounts every 90 days, less the fees and expenses in collecting the payments.

Larry: Also there is a fee to be paid to the trustee-like party holding the critical assets of our business to be sure that they adhere to the contractual obligations. We get to use the assets without cost for as long as we are in compliance.

Barry: Right -- and if we stop paying the royalty, our primary obligation if there are revenues -- then we are effectively out of business, as we need the right to use those assets. It's all a part of the U.S. patent they are licensed to use.

Larry: So we have to agree as to who the holder of the asset will be?

Barry: Correct, and it is even possible that our law firm could be the party or anyone we each agree on. They really have nothing to do unless we get into serious trouble, and then they are supposed to license the assets to the reorganized and refinanced company, on the same terms.

Larry: They seem to have most, if not all, of the issues covered. All we have to do is what we say we are going to do.

Barry: It seems that way to me also, Larry.

Summation

I have tried, in this Larry and Barry dialogue, to answer many of the questions frequently raised regarding the use of royalties. However, there may well be other questions and issues which have not been addressed by Larry or Barry and which I would be most pleased to respond to.

Please contact me at Chairman@REXRoyalties.com.

Arthur Lipper, Chairman
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with assistance from Michael North,
Co-Founder & Managing Member, Pacific Royalties LLC