Larry and Barry present royalties to a practical owner of a successful business©

Business owner: Ok, I will listen to you but understand I've seen all the deals, which are supposed to make me more money and usually cost me money upfront.

Larry: May I ask why are you in business? You own and have created a successful business. You are respected in the community. You may have family members employed and doing a good job in the business. Is it because you derive satisfaction from seeing it all work? If so, my basic question is if you could get additional capital to increase the size of your business or to acquire another company, perhaps a competitor, would that appeal to you if it did not require you to share in the ownership of the business?

Business owner: Sure, I like to see the business operate well, grow and give good jobs to my people and provide benefit to both my customers and the community. It is satisfying and has taken a lot of work for many years.

Barry: Then you agree that if it were good now it would be even better if you had additional capital on fair terms, with which you could expand and which didn't require you to sell shares of the company to anyone?

Business owner: Sure, but how do the owners of this new bunch of money benefit? What is their motive? They don't know me and do not want to just help me grow the business bigger and faster.

Larry: The new money would come from investors who could be interested in buying a share of your company's revenues. It's called a revenue royalty. The investors wouldn't be or become owners of the business, just a percentage of the revenues of the business. They do not have any interest in that which you report as profit and if you hit a dry spot, they have no share of the losses. All they care

about and expect is that with the new money you will be able to have increased revenues.

Barry: Larry's right but failed to mention that sometimes the revenue royalties could only be for a percentage of the revenues you created after the closing of the deal, when it is assumed your company would benefit from the use of the new money.

Business owner: Ok, let's say I was interested in, at least discussing the terms of a deal, how do I go about it? Is your company ready to buy such a royalty from my company?

Larry: No, but we advise a royalty income fund which is owned by investors and this fund could well be interested in having such a discussion with you.

Barry: The royalty income fund has an objective of achieving an Internal Rate of Return over the course of up to 20 years of a minimum of 20% per annum.

Business owner: Whoa, stop, I have no interest in paying a 20% interest rate for money. If that's the deal it no good for me.

Larry: I agree and wouldn't either pay or charge anyone 20% interest for growth capital. That is not the deal. Royalties are an agreed percentage of what are assumed to be growing revenues. In many straight royalty deals it takes from 5 to 7 years for the royalty payments to equal the amount paid to the company for the royalty. Then, as the revenues increase, the owner of the royalty benefits, as the percentage of the royalty can be either fixed or variable based on the cumulative amount of royalty payments, which have been paid.

Barry: Yes, for example, if once the royalty income fund or investors have received three times their money back perhaps the royalty rate could decline by 35% or whatever decline was negotiated, depending on how long it took for the royalty payments to reach that

level. Then, if the cumulative royalty payments reached another level, which you agreed to, the royalty rate could drop again.

Larry: This could be a case where a 20-year, with a 5% royalty on the revenues could decline in rate of participation significantly, as a result of cumulative royalty payments received by the fund.

Barry: We should have mentioned, royalty payments by the company issuing the royalty are tax deductible for American tax paying companies. The royalty payments are tax-free for the American royalty owners until the royalty payments have equaled the amount paid to the company, by the investor and thereafter are considered to be ordinary income to the investor.

Business owner: So the company could only pay a percentage on the revenues exceeding the revenues achieved before the closing of the transaction and even that percentage could be reduced over the years if we are successful. What happens if we make mistakes and the revenues do not increase as expected?

Barry: If the revenues are disappointing then the royalty owner will be disappointed and not have made a good investment/ Of course, the fund may want there to be a minimum royalty to be paid, one which would assure a return of the amount invested in an agreed number of years. The investor may also have negotiated a royalty, which extended for a longer time if the revenues achieved were an agreed percentage lower than the revenues your company projected when negotiating the transaction.

Larry: Of course, the other possibility is the revenues are greater than those projected for a number of years and then there could be an improvement in the terms of the royalty reflecting the better than expected results. It is a carrot for being conservative in making the revenue projections and a stick in the case of the revenues being less than projected.

Barry: royalties are fully negotiable as to; amount paid to the royalty issuing company, the royalty payment period, the royalty rate or

percentage of revenues and the means of assuring the royalty investor the company will adhere to the terms of the contract.

Business owner: Ok I understand the first three things; amount period and rate but what is this assurance thing?

Barry: The company agrees to pay all of its revenues into one or two banks and either the banks or an independent party has the irrevocable authority from the company to remove from the company's bank account the agreed percentage of revenues whenever they are received. You and the other controlling shareholders have to personally attest that all revenues are deposited in these agreed bank accounts. Please note that you are not being asked to guarantee anything other than the fact that all of the company's revenues are deposited in the agreed banks and that the royalties will be paid

Larry: Further, the company and the fund or representative of the royalty investors will identify and negotiate how the critical assets of the business will be liened or transferred to a mutually agreed third-party, who will act like a trustee, holding the identified assets until an agreed time. The third-party will grant the company an exclusive international license to use the assets without charge for so long as the company is in compliance with its obligation to make the agreed royalty payments. Once an agreed period of time or cumulative level of payments has been reached the ownership of the assets will be returned to the company, which will never had lost the use of the assets.

Barry: The more assured the investor is that he will have a good deal with minimal risks, the lesser will be his requirement for a high level of royalty payment.

Larry: There may even be an assurance policy, which in some countries, royalty issuers will be able to purchase from an independent company, which would allow for an assured payment of the amount paid for the royalty to be received during the royalty payment period by the investors. This assurance policy means there

is little of no risk of principal and only a risk of loss of income and therefore the company can negotiate a likely better deal.

Business owner: Ok, what are the other costs for this non-equity dilutive royalty? In principle, it is interesting and could be workable.

Larry: Good. We believe it is fair and in the best interests of both the companies getting the growth capital and the investors purchasing and owning the royalties.

Barry: There will have to be an annual audit of revenues as the definition of revenues may include credits for discounts and returns. The royalty issuing company will have to advise the royalty holders of revenues and factors known to management, which will or could impact the projected levels of revenues. We'd like the senior executives to participate in a one-day session with other senior executives of royalty issuing companies and investors in the royalties. This annual event will be located in a city having good transportation characteristics and pleasant weather.

Larry: Though not owners of the companies having sold royalties to the fund or other investors the holders of the royalties are naturally motivated to help the company expand revenues and want to be thought of as team members.

Barry: Also, please remember that royalty holders do not vote and have no ability or desire to influence managements. Royalty holders are not interested in executive compensation company policies and practices regarding customers and are only interested in the growth of revenues.

Business owner: How does the fund decide on the amount they will pay for the royalty?

Barry: This will usually be dependent on the type of business, the history of the business and the use of proceeds. Only companies with good profit margins should consider the sale of royalties. Investors in royalties are like all other investors and capital

preservation is of great importance. Next is an assessment of the likelihood of the company being able to attain the projected revenues within the anticipated period. If the company has had a steady record of revenue increasing success then it is reasonable to assume that 50% of revenues could be paid for a royalty of reasonable rate. Again, remember the royalty investor expects to be able to earn an Internal Rate of Return of at least 20% per annum over the course of the royalty payment period, not necessarily in the early years of the royalty.

Larry: You can see exactly what the results will be on the achievement of revenue projections at the websites we have developed www.REXRoyalties.com, www.REXdebt-shareRoyalties.com, www.REXComparator.com and www.REX-PV.com. In the www.REX-PV.com website the calculator shows the result of an investor selling royalties owned at various times to other royalty investors. The logical time for such a sale is when the royalty payments have been sufficient for the investor to have a zero cost basis and to begin to be paying income tax on the royalties received. The investor should be able to sell the remaining years of the royalty for a premium sufficient to provide the sought for Internal Rate of Return over the period of time the royalty was held. All this is spelled out at www.REX-PV.com, including how long it will take the new owner to recapture the capital and the rates of return to be experienced.

Barry: As we have suggested, royalty purchasers usually structure deals where the IRR desired is more than a 20% annual return assuming the projected revenues are achieved. Also, royalties can have minimums as well as caps and can even, in certain circumstances, be convertible into equity. Also royalties can be at different rates during different periods or change when the cumulative royalties paid reach agreed minimums. Finally, royalties can have a range of third-party assurances, which reduce both risk and return.

Business owner: Are the royalties purchased by the fund saleable to others and how can I terminate the royalty if either business looks

like to is going to be much better than we projected or I want to sell the company or go public?

Larry: Royalties are negotiable and can be sold. Also, we are trying to establish royalty sections on various stock and commodity futures exchanges and may possibly start a royalty exchange.

Barry: The royalties can contain a redemption clause whereby the company has the right to buy-back the royalties on terms which will be the worst case for the company, as the company can, at any time, deal directly with any of the owners of the royalties or make a tender offer for all of the royalties or use other techniques to obtain the royalties on more attractive terms than that contracted for in the negotiated redemption right.

Larry: There is also an approach, which we favor for many companies and that is best described at the www.REXdebt-shareRoyalties.com website. In this approach the company enters into a relatively standard loan with the Investor becoming initially a lender with a modest rate royalty commencing on the loan's repayment and running for an agreed number of years, as an inducement to make the loan. This works well as the loan terms can be fit to the needs of the borrower as to amortization, collateral, interest rate levels and maturity. The royalty rate will be less than would be the case without the loan or its repayment as the Investor will not have any principal risk, as the loan has been repaid when the royalty commences.

Business owner: You have convinced me that we should study the websites and have another meeting as it seems, from what you have said, that we and many other business owners could well benefit from this new approach to business financing. Thanks for taking the time to visit with me.

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Lawrence (Larry) Lion and Bernard (Barry) Beaver have been used by Arthur Lipper to illustrate the reactions of typical growth oriented entrepreneurs. Larry and Barry first appeared in the monthly column of Arthur Lipper, as Chairman and Editor-in-Chief of Venture, The Magazine for Business Owners. Arthur Lipper's latest book is The Larry and Barry Guide to Entrepreneurial Wisdom has also been published by CITIC in Chinese and has sold well in China.