Constructing a Portfolio of Royalties Issued By Local Companies ©

Arthur Lipper

It is generally agreed that if some locally owned businesses had more capital they could increase the size of their companies, hire more people and benefit the community. It is also understood that the owners of these businesses do not generally want to dilute their ownership or have new "partners".

From the investors' perspective there is a need to balance the possibility of making a profit with the risk of capital loss.

The traditional approach to financing a business -- buying an interest in the business -- only works if the business owner(s) are interested in selling a share of ownership. In doing so the owners effectively become fiduciaries and have to make all decisions with a view as to what is in the best interest of all of the owners, including the new investors. If there is equity involved in the financing then there is the issue of shareholder voting, etc.

It is clear that both the investors and businesses are better served if the capital raising takes the form of the company selling the investors a percentage of the company's top line revenues, which is a royalty, than a share of ownership.

The royalty is paid irrespective of profit declarations and is simply calculated, collected and distributed if effectively arranged and documented.

First there is the matter of finding businesses which both seek capital and have a realistic prospect of increasing revenues, if the capital is acquired. The investor can make it known locally, perhaps through an attorney or other agent, that funds are available for the purchase of royalties with the following possible characteristics.

Business and owner description **Current financials**
Business financial history

Amount of funds sought Use of proceeds
Projected revenues

This information can initially be presented informally without full documentation. More complete documentation can be required once there is an investor interest in further consideration of the applicant.

The investor will decide to what extent there is a need for a royalty advisor, attorney or accountant involvement in the discovery and analysis of the opportunity.

The investor will also have to decide the level of royalty portfolio diversification required for risk modification. I am a firm believer portfolio diversification for all investments..

Once the investor is convinced the company's revenues will increase and continue to do so as projected by the company there is need to determine which of the several royalty approaches facilitated by the following website calculators is most appropriate for the situation. The website calculators each have instructional text and samples. They are:

REXRoyalties.com The simplest and least complicated.
REXComparator.com Allows a comparing of different deals.
REXdebt-shareRoyalties.com Uses a combination of debt and royalty.
REXScaledRoyalties.com Provides incentive for issuer conservatism.
REX-PV.com Calculates the results of secondary transactions.
REX-RIAR.com Facilitates negotiation of issuer assured results.

The above sites can also be accessed through Royalties.Website,where there is a listing of more than 50 articles and other writings describing aspects of royalty investing.

The royalty agreement defines the percentage of revenues to be paid to the royalty owner, the period of time in which the payment obligation continues, the possible ability of the royalty issuer to redeem the royalty, the payment of royalty on the receipt of revenue, the securing of the company's obligations regarding the royalty and other elements of the relationship.

There must be mechanisms established for the registration of the royalty, recording of any change in ownership of the royalty, the collection of the royalty payments and the distribution of the royalty

payments. There must also be agreement as to the level of company information to which the royalty owner is entitled and whether there must be a full annual auditor just an audit of revenues.

Finally, the investor will have to determine if the services of a royalty advisor is required and the basis of retention. As the procedures recommended are covered by a U.S. patent there will be an annual license fee required to be paid to the patent owner, British Far East Holdings Ltd.

I believe that fair and reasonable royalties can be created in which royalty issuers receive the funds necessary for accelerated growth and investors have comfortably more than a 15% annual Internal Rate of Return over the course of the royalty payment period.

In many cases, the REXdebt-shareRoyalties.com approach will result in the best deal for both the business owner and the royalty investor as at the end of an agreed payment period the lender has received a full repayment of a fair interest bearing loan with there being a relatively modest royalty for an agreed number of years commencing on the loan repayment. Without the loan, using the REXRoyalties.com approach the royalty rate will be higher as the risk is greater.

The samples in the website calculators for both of the approaches are instructive. Both prospective royalty investors and business owners are urged to become familiar with and comfortable in using the website calculators as they are intended to facilitate the open negotiation of royalties, where both parties can envision the accuracy of revenue projections

In closing I note that communities would benefit if an office of local business development were created to coordinate the interests of both business owners and investors.

PacificRoyalties.com, a patent licensee of British Far East Holdings Ltd., is prepared to explore with investors, business owners and communities the possibility of assisting them in advising regarding the above considerations.

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February 16, 2016

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