Larry and Barry, As Investors, Exit Planning for a Royalty ©
REX-PV.com

Arthur Lipper

Larry: Ok, so if the royalty payments were pretty much as expected and the company seemed to be doing well, how could we sell the royalty?

Barry: The website calculator REX-PV.com gives us the answer, of how close we would be to achieving the Internal Rate of Return (IRR) we targeted, and how much we should sell the royalty for.

Larry: Well we wouldn't want to sell the royalty as long as the payments we were receiving would be "return of capital" and income tax free.

Barry: Right, but once we get our money back the royalty payments become ordinary income for tax reporting purposes. Therefore, it could be that selling the royalty to a non-tax consequence buyer, like a pension or endowment fund, would make sense as they would have a higher net return than we would.

Larry: Sure, but they would also be buying a royalty issued by a company that had been performing as expected and was more mature than when we bought the same corporate obligation.

Barry: That's why they should be willing to pay us a premium for the remaining years of the royalty.

Larry: If they paid us enough for us to achieve our target IRR what would be their IRR and would it justify what they had to pay us?

Barry: The website REX-PV.com shows all of that and the buyer would have a great IRR if the company continued to meet its revenue growth projections. Indeed, once we see the potential returns we may change our minds about selling the royalty, even if we have to pay more in income tax.

Larry: So the PV is for Present Value. I get that but it is based upon projected results yet to be achieved.

Barry: Yes, but the returns would be so high that even applying a significant discount to the projected revenues, the royalty would still provide the non-tax paying buyer with a really good return.

Larry: Isn't the royalty issuing company really the logical buyer of the royalty so they wouldn't have to pay us?

Barry: Yes, and it is likely that if the company were doing well they would like to terminate the payments as each dollar paid to us would be a pre-tax profit dollar for them.

Larry: Well, using the REX-PV.com website, we could still see how much the royalty issuer would have to pay us to make an attractive deal.

Barry: Right. Present valuing the royalty based on projected revenues is a useful exercise in determining a fair deal for us as sellers and a buyer, particularly one that is not subject to U.S. taxation.

Larry: If the royalty issuer is not willing or able to pay us the amount we want for the royalty how do we find another possible buyer?

Barry: Perhaps the REX Royalty or Pacific Royalties people can help or we will have to use a financial intermediary to find a prospective buyer.

Larry: Well, if things were really going well for us we could also get an appraisal of the royalty and then donate it to a non-profit of our choice for a large tax deduction.

Barry: Right, there shouldn't be a problem of our benefitting from a royalty issued by a company which has performed well and is experiencing increasing revenues.

Larry: Ok, so now we know how and why we should buy a royalty and with this new website how we should price our exit, so let's do it.

Barry: Agreed.

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