Larry and Barry Considering Selling a Royalty to Finance the Acquisition of a Competitor ©

Arthur Lipper

Larry: I just learned the Johnson Company, our biggest competitor, is negotiating to sell the business.

Barry They should have come to us first as we have the most to gain by acquiring them.

Larry: They probably didn't because we know too much about them and they know we don't have the money necessary to buy them.

Barry: If we bought them there would be a lot of advantages and I would like to see what we could do to raise the cash.

Larry: Well, we know that commercial bank loans are not available to us, with personal guarantees and all sorts of negative covenants.

Barry: Yes and we don't want to have partners in our company or be responsible for investors.

Larry: That leaves royalties, which we have been hearing about.

Barry: Yes, royalties do not vote and do not own any part of the business. Therefore they are not the sorts of nuisance venture capital or Angel money is, with regard to wanting to be on the Board of Directors or declaring optimized profits.

Larry: You're right, and we don't want to have issues with investors with respect to how we handle expenses and executive compensation.

Barry: The acquisition would be great, as with only a slight expansion of our facilities we could handle the increased sales.

Larry: And we wouldn't need many of their labor force except for those who are better than those we already have.

Barry: So, if we sold a 5% royalty for 20 years, with a reduction in the royalty rate every time, within agreed years, we doubled in cumulative royalty payments, this could work.

Larry: And the redemption right in their standard contract allows us to get rid of the royalty by paying a premium within an agreed number of years.

Barry: Yes, and the 60-month money-back guarantee doesn't bother me as it includes credit for cumulative royalties paid.

Larry: We should try to negotiate terms so that we are only paying a royalty on the increase in revenues beginning when we received the payment for the royalty.

Barry: I understand that they are open to linking the royalty payments to the revenues generated after we have the use of the money.

Larry: Yes, and we get to deduct the royalty payments from our federal income tax. Also they only pay a federal income tax on the royalties we pay to them after they get back their cost of he royalty.

Barry: Of course, we have to pay them the agreed percentage of our net defined revenues as soon as we receive payment.

Larry: Yes, and we also have transfer or assign our critical assets to an entity on which we agree to secure our paying the agreed royalty on the agreed revenues.

Barry: But we still have the cost-free use of these assets on an international exclusive basis.

Larry: Seems both fair and reasonable as it allows us to make the acquisition on known terms and we can exercise our right of redemption if we are not able to reacquire the royalties by either direct negotiation with the investor or by tender.

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