# Private Company Investing - Equity Versus Royalties ©

**Arthur Lipper**

**The purpose of this column is to highlight the reasons why buying a long-term percentage of a company's revenues is a better deal for investors than buying an ownership interest in the company.**

**Shares of a company are only bought by those anticipating an ability to sell the shares at a profit. Every buyer looks forward to being a seller. Therefore, the buyers must believe that one or  hopefully both of the following: the company's value will increase and the market will believe, at the time of the sale, that continued future growth of value is likely.**

**What is a company really worth? In some industries corporate valuation reflects the appraised value of assets owned. However, this measure presumes the assets will in the future translate into profits. Therefore, it is per-share earnings, which must be the ultimate measure of ownership value. More importantly in terms of the market's appraisal of the appropriate price/earnings ratio, is the trend of per-share earnings relative to other investment opportunities.**

**It is vital that equity investors focus on the per-share results, as in many companies there will have to be equity dilutive financings to achieve the earning growth anticipated. It is not unusual for there to be significant dilution, particularly in privately owned companies where the cost of growth capital is higher than that of publicly traded companies. Frequently, in many of these companies the capital necessary for growth is only available through the sale of equity, as longer-term debt is more difficult for privately owned companies to obtain.**

**Most important is the fact that declaration of maximum profits, requiring the payment of maximum income taxes, is not the objective of the controlling business owners. Therefore, legal options of reporting modest profitability are the preferred path.**

In the case of royalties the investor is only concerned with the level and trend of the company's revenues, not its reported profitability.

Of course, the royalty investor is concerned with an accurate accounting of revenues and the payment of the royalties as agreed. Our patented approach of requiring the agreed royalties to be paid simultaneously with the receipt of revenues addresses this matter.

We also recommend that investors require those controlling the business selling the royalty personally attest that all of the company's revenues will be deposited in designated banks so the process can be automated. Further, there should be an annual audit of at least revenues, and possibly a full audit, to confirm the accuracy of the (perhaps daily), payments to the royalty investors.

Particularly in times of security market volatility the exclusive focus of royalties on a company's revenues can be more predictable, more rewarding and less stressful.

Royalties are the better way of investing in privately owned companies.

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