Primary Reasons To Accept The Risk of Investing:

- Benefitting From Positive Valuation Change -
or
- Revenue Growth Participation - ©

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Investing is the effort to increase owner benefit through the use of assets. Investing can be done conservatively or speculatively; it can be accomplished on a cash basis or through the use of leverage. Investing allows others to use a range of assets including land, intellectual property, personal talent, equipment and tools, brand names, credit substitution and cash.

For an investor to decide on the approach to be used, there must be an awareness of the amount to be invested relative to the total assets owned, the personal characteristics of the investor, the balance of risk of the investment versus the totality of the assets owned, and the time frame of predicted results. Also, there is the fun and challenge of investing for some, and the fear of loss for others to be considered.

Definitions can be personal, and conclusions will depend on definitions. Does conservative mean avoiding all risk, to the extent possible? No, the word is a relative or comparative term. Does the word speculative mean only "betting the farm" or an all-or-none situation where the gain is large and the risk total? No, speculative means the outcome is not wholly predictable and therefore there is an ever-present possibility for disappointment and a significantly lesser return than was anticipated when the risk was accepted.

Conservative versus speculative can be reflected in the degree to which leverage is used. A conservative investor can buy debt issues in the belief the borrower will be able to meet the obligation as known at the time of investment, whereas a speculator can assume the same obligation using a significant amount of borrowed funds. Investors should clearly define and identify the bet they are making in any investment.

In the purchase of publicly traded equity and equity-related debt or preferred shares, the bet is will there be an increase in market valuation based on either the company's increasing per share profits as reflected in the price/earning ratio, or in the P/E, being the market's assessment of the future change in reported per share profits, or both.

Of course, more so in the past than now, equities were purchased in order to receive the added benefit of rising dividend payments. It was somewhat traditional that companies paid approximately 40% of their earnings to shareholders. Today, because of tax and other considerations, companies that are growing rapidly tend to need to retain their earnings in order to fund the growth of the business, and are less generous in their dividend payment policies.

In the case of privately owned companies, the controlling shareholders frequently choose to embrace legally acceptable policies, which have the effect of reducing reported profitability in order to reduce income tax liabilities. As the controlling shareholders are frequently focused on building a business as large as possible they prefer to delay reporting maximum profits until they are ready to sell the business.

Therefore, the use of royalties -- the payment of an agreed percentage of revenues for an agreed period -- has been found an attractive alternative method of acquiring additional capital. Royalty investors have neither any ownership of the company nor an ability to influence the managers of the business. All the royalty investor is concerned with is the sustainable growth of revenues.

The equity investor primarily focuses on initial valuation, and the possibility of a positive change in valuation. The royalty investor primarily focuses on how well the company is satisfying the needs and wants of customers, and its effectiveness in marketing its wares, as reflected in revenue growth.

Due to the inherent problems of predicting future per-share profitability for any company, especially those with currently or predicted rapidly growing revenues, conservative investors should favor investing in royalties, when available, since the prediction of

revenues is much more focused on the market potential for the company's product or service.

Profits are a measure of management's ability to sell its products for more than its all-inclusive costs. Revenues are a direct measure of how good and important the company's products are to the customer. For total risk assessment of an investment, revenues are easier to anticipate than profits.

Royalties are simply the better way of both investing in and financing of many companies -- especially private companies.

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