Royalty Investor Due Diligence ©

Arthur Lipper

Royalty investors have two primary concerns regarding the health and revenue growth prospects for the royalty issuing company.

Even though each royalty payment received reduces the investor's principal risk, the sustainability of the royalty issuer is of vital interest to the investor. The securing of the royalty issuer's critical assets to assure contractual obligation compliance is helpful for the investor. However, in the case of a corporate reorganization there may be challenges in some jurisdictions.

Therefore, the royalty investor and the independent asset holding agent must have current information regarding the royalty issuing company to be warned of any approaching adverse event.

The royalty investor is only directly concerned with revenues, specifically the trending of revenues as defined in the royalty payment agreement. The investor only shares in the issuer's revenues and not profits, the due diligence investigation is much different than would be the case were a portion of the royalty issuer's ownership being transferred.

The company seeking growth capital makes revenue projections. The royalty issuing company must share with the investor the assumptions used in preparing the projected results.

Questions for a royalty issuing company:

> When will revenues reach $_____ for a 12 month period?
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> What is the evidence that the above amount can be achieved?
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> Will the revenues be competitively created or will the existence of the product or service create the revenues where none existed previously?

Will the company have the benefit of owning intellectual property, which will reduce competition?

How will the product pricing be established?

Can the early stage pricing and projected revenues be confirmed with customers?

What are the growth characteristics of the industry being served by the company?

What are the barriers to entry for the company in terms of the revenue projections?

Are the direct competitors large or small companies?

How much is budgeted by the royalty issuer for marketing, as a percentage of total revenues?

Are any of the people involved with the issuer veterans of the industry to be served?

Does the company plan to produce the product, or license the intellectual property?

How difficult will it be to circumvent the intellectual property protection?

If early sales are disappointing, what will be done?

If the founders had to sell the company, are there immediately willing buyers?

Which companies would be most hurt by the company's advantages?

Note that all of the questions focus on revenues. An industry specialist will know many more revenue-focused questions.

It is assumed the company will either have or plans to have very good profit margins, so the business owners will want a growth of revenues; there will be significant profit if the revenues are achieved.

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