Considerations and Tools For Royalty Investment ©

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The primary concern of investors should be capital preservation and enhancement, in that order of priority. Not losing capital is of primary importance to most knowledgeable investors.

Decision-making regarding the prospect for capital enhancement should be focused on balancing risk and reward. Of course, the period necessary for reaching a target return on investment is a significant consideration.

In the case of royalties issued by privately owned and established companies, with a record of revenues, the question the royalty investor must address is the likelihood that the revenues will increase, so that the royalty payments will also increase.

Our website calculators each require the royalty issuer to provide projected revenues. These projections are not assured, unless contracted to be so. In REXScaledRoyalties.com the website allows for the parties to identify the percentage of excess revenue justifying an agreed reward, as well as the percentage of under achievement of the projected revenue justifying a penalty for an agreed period. The purpose of creating this website was to encourage prospective royalty issuers to be appropriately conservative in their projection of revenues.

The website REXRoyalties.com is for the simplest arrangement of the parties agreeing to the amount to be invested in the royalty, the term of the royalty and the royalty rate at various times. In almost all cases we believe that royalties should be redeemable by the issuer on terms agreed at the time of royalty issuance.

For early stage companies and some other royalty issuers, the acceptance of debt can reduce the amount to be paid to investors. The website REXdebt-shareRoyalties.com allows a short-term debt, at agreed interest and amortization, with a modest level royalty commencing upon the repayment of the loan. The modest level of the royalty reflects that at the time of receipt the investor no longer has any risk of capital loss as the loan has been repaid.

REXComparator.com is a website allowing the comparison of royalties having different terms but the same issuer projected revenues.

REX-PV is a website allowing royalty investors to understand the result of revenue projections being at least achieved, and the level of premium necessary to be paid the investor for them to obtain a desired level of Internal Rate of Return (IRR), should they wish to sell the remaining period of royalty entitlement. Royalty investors may be prompted to sell royalties at such time as they have recovered their investment and the royalty payments, for American taxpayers, become ordinary income rather than a return of capital.

Both investors and business owners need to consider the "what if's" of revenues being greater or less than projected. Also, we want to provide a significant benefit to the business owner for being extremely conservative in the projections used in the negotiation of royalty terms with prospective investors. Therefore we created REXScaledRoyalties.com In which the parties can agree on a period of time in which projected revenues and therefore royalties are either in excess or less than an agreed amount, with resulting benefits and penalties agreed.

Perhaps the best approach for both royalty issuers and royalty investors can be studied by using REX-RIAR.com. RIAR is the acronym for Royalty Issuer Assured Return. This approach requires the royalty issuer to agree to a minimum royalty payment during an agreed period. The terms and level of assurance are to be determined between the parties, and the level of returns is calculated using a quarterly payment period, rather than the standard annual period, in order to give a more accurate estimate of total return.

As royalties are paid, using our patented approach, at the time of revenue receipt by the royalty issuer, the traditional problem of royalty collection is addressed. Of course, an annual audit of revenues will be required. Also the approach assumes a contractual compliance assurance resulting from a securing by transfer or assignment of ownership of critical assets, without which the royalty issuer's company cannot continue in business. The identification of the critical assets and the terms of transfer and subsequent return are negotiated by the parties.

Of course, royalty contracts can be fully or conditionally endorsed or guaranteed by third parties, including the principals of the issuing companies.

The redemption right of the issuer is important, so the issuer knows the worst case for terminating all royalty payments. The issuer is the most logical buyer of royalties from the investors as each dollar paid in royalties is a dollar of pre-tax profit.

The issuer can contact directly all or any of the royalty investors and attempt to negotiate an acquisition of the royalty. Cash, debt and/or some other asset may be offered in exchange for the royalty.
The issuer can also offer through a tender, perhaps on a Dutch-auction basis, establishing the maximum amount to be paid for the desired amount of royalties to be acquired -- thus assuring that the lowest price offering will be accepted. Finally, the royalty issuer can exercise the redemption right for whatever royalties are still outstanding.

In most cases, for a 20-year royalty I suggest a fair redemption value, assuming exercise is within 10 years, is 10 times the original cost of the royalty, less the cumulative total of royalty payments made. This would result in at least an IRR of 25% per annum for the investor.

I believe that we have addressed the needs of the parties to a royalty transaction. The business owner gets the use of capital with which to increase the revenues of his or her company without any equity dilution or concern about loss of control of the company. The royalty investor has a preferred position, being paid at the time of receipt of revenue "off the top", without any concern for the claimed profitability or market valuation of the business. The royalty holder is solely focused on revenue growth.

Please contact me as below with any questions or comments.

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