Using Revenue Royalties To Acquire and Market Assets ©

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Revenue Royalties are an agreed percentage of revenues received by the royalty issuer during an agreed period.

Royalties are not new, but the use of royalties to finance companies through the acquisition of the asset of cash is growing, as many company owners prefer to avoid incurring debt or suffering equity dilution.

In addition to financing companies through the raising of cash, royalties can be used to acquire companies, and a range of professional practices and other assets. These assets are typically "valued" on the basis of revenues. Valuation can be determined by using either a premium or discount of the revenues recorded during prior periods, or a percentage of future anticipated revenues, or a combination of the two.

A deal for acquiring a practice (medical, legal, consulting) could involve a percentage of revenues for an agreed period, with or without an assured cumulative amount.

Most sophisticated buyers of productive assets, be they businesses or equipment, assess the period over which the invested funds are projected to be earned back. In the case of equipment, which provides increased efficiency, the savings are frequently required to be 18 months while the payback for practices tend to be longer. Although not stated as such, the payouts, as opposed to earn backs, are essentially royalties -- as it is revenues, not profits, which are the measure of payment.

Fees paid by franchisees to franchisors are essentially royalties. The franchisee is benefiting from the profit generation experience and brand recognition of the franchisor's name and method of conducting business.

Royalties are traditionally and broadly used in extractive industries such as oil and gas exploration and production, mineral mining,

forestry, etc. where the sharing of profits as declared by the harvester are not as acceptable to the asset owner as a fee based on the actual production of the property. It is easier, more transparent, and therefore more acceptable to investors, to count the units of production than the declared profits earned on the sale of the commodity.

Publishers commonly compensate authors using royalties. Royalties are used by companies to acquire the rights to use intellectual property and inventions. Royalties can be used to acquire the benefit of performances of artists and athletes. Royalties evolved as a means of the owner of an asset benefitting from the use of the asset by another, without having to know or trust the declaration of profitability by the user of the asset.

The owner of a theatre or medium of electronic distribution is paid rent, as a partial access fee, in the form of a percentage of the sale of admission or other directly related revenue.

The service of executives and other individuals can be compensated, using a percentage of revenues for which they have been responsible. In effect this commission can be thought of as a royalty on the asset of the person’s service. There are tax issues for the user of the person’s service, as to whether the person is an employee or independent contractor. The user of the services would normally prefer the independent contractor designation, and IRS would normally prefer the employee designation.

The weakness of the commission compensation approach is that the recipient of the commission or royalty has no direct interest in the profitability of the transaction, and should therefore never be allowed the ability to set or change the terms of the transaction without management approval. It is possible that management will allow the royalty or commission to be effectively shared with the customer, resulting in a lower price and sales compensation. The royalty paying entity’s benefit is that the expense of the payment is directly linked to a desired financial result.

The bottom line is that revenue sharing payments or royalties can be used to acquire assets, and the assets can be more and other than cash. The contract terms will both differ and have common

characteristics depending on the asset and provider. The common characteristics include a full and complete definition of the asset being acquired; the amount and basis of payment; the period of time the asset will be used and possibly the ability to terminate or extend the time period; the ability of the owner of the asset to terminate the royalty contract, and possibly to penalize the user of the asset if there is a default in the agreed terms of the agreement.

Royalties are the better way of both investing in and financing the use of an asset. The asset can be cash for a company's growth capital, land, equipment, intellectual property and personal service. Royalties are useful in a wide range of commerce.

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March 4, 2017