In Economically Stressed Times, Investing in Royalties is the Much Better Approach

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How much volatility is enough?

The reason to invest is to earn a profit. Investment profits are earned by buying something, like the stock of a company, at a price and on terms which, at the end of a period can be sold for a higher price. Except in the case where the shares are bought from the company itself, the benefit to the company or society is marginal.

The professional measurement of profit depends on both the amount of time required for a disposition of the acquired asset and the risk of loss accepted by the investor.

For there to be a profit two things must happen. The company's stock must have had an increasing per share earnings, making the company theoretically more valuable, and the market valuation remained at least positive compared with the time of acquisition. Of course, it would be better for the investor if the price/earnings ratio applied by the market also increased.

This means that for the investor to profit, the company's value must have increased, and stock market levels remained at least as high as they were at the time of the stock's acquisition. It can be frustrating for investors if their publicly traded companies do well and market measures are down.

However, for investors to profit from the buying of a royalty, which represents a percentage of a company's revenues, only revenues need to be generated and better yet, increase during the period of revenue sharing entitlement. Of course, it is also necessary for there to be an effective means in place for collecting the agreed royalty and assuring that the royalty issuing company honors its contractual obligations. The mechanism for the royalties we recommend addresses the issues of collecting and paying the agreed amounts covered by the agreement.

In other words, the only condition that needs to be met, in order for the investor to receive a benefit is that the royalty issuing company has revenues, Of course, those revenues must continue for a necessary period and the cumulative revenues reach a desired minimum level. However, neither the company's profitability nor its market valuation is of direct concern to the royalty investor, because it is company sustainability which is necessary for the investor to benefit.

Most investors, especially in the case of privately-owned companies, will be able to more easily reach a decision as to company revenue growth than reported profitability. The revenue growth depends on the relative value of the company's products or service offerings to their customers, not the company's ability to maintain profit margins. Of course, investors will want to hold a view regarding the economic outlook for the company's customers when they develop a forecast for the likely growth of the privately-owned company's revenues. Also, particularly, in privately owned companies, controlling shareholders may prefer the use of tax strategies different than those preferred by other investors.

Therefore, sophisticated investors may prefer to invest a segment of their investment portfolios in high yielding royalties issued by privately owned companies, rather than subject themselves to the stock market's volatility and the challenges of stock picking.

Simply stated, the investor's conundrum is choosing the known risks and benefits of securities speculation versus the higher yield and more predicable outcome of revenue growth investing.

We can help.