Ways You Can Benefit By Using Revenue Royalties

As a business owner:

You can obtain additional expansion permitting working capital, without losing any ownership of your business. A revenue royalty (royalty) is a non-equity dilutive contract for an agreed number of years, in which you agree to pay an investor a percentage of your company's defined revenues. Royalties can be terminated at any time within the agreed royalty payment period on pre-negotiated terms.

The privately-owned company royalty investor is risk-averse and seeks to earn increasing income based on the growth of your business. Therefore, the investor will want a realistic projection of revenues your company will be able to generate if the company has the benefit of using the investor's money.

The royalty investor wants to be paid the agreed percentage of revenues when the revenues are received by the company and wants to be assured the company will honor its obligations to the investor.

The royalty investor is not concerned by your executive benefits or other company matters which an equity investor would, as the royalty investor is not concerned with the valuation of your company, or even directly with its profitability. All the royalty investor is concerned with is the continued sustainability of your company and its growth of revenues.

If the royalty investor is assured of both the achievement of the projected revenues and the resulting royalty payments, you will be able to negotiate more favorable terms. The investor's risk reducing assurances can be through a company minimum payment obligation or by an independent guarantor.

The longer the royalty payment period, the lower can be the justified royalty rate. Therefore, 10- to 20-year royalties are recommended. However, it is likely that successful royalty issuing companies will be interested in shorter period royalty terms. Therefore, the terms of the issuer's right of early redemption is an important aspect of the agreement to be negotiated.

Just think of the good and big things you could accomplish if you had the capital to take the necessary actions. Acquisitions, opening branches, increasing marketing programs, developing new products, etc.

As a royalty Investor:

Investing in royalties issued by privately-owned companies can be highly rewarding, socially constructive and fun.

Financial institutions, such as banks, insurance companies and traditional investors and lenders are usually uninterested in providing financial assistance to privately-owned companies, unless accompanied bypersonal guarantees of the company's primary shareholders. Venture capital investors tend to be both greedy and desirous of having significant influence, if not control, over the companies in which they invest.

Investors focusing solely on the sustainability of the business and the likely growth of its revenues are in a position to benefit when its customers find the product or service offered beneficial and as a result buy increased amounts.

It is easier for investors to research and determine likely revenue trends than estimating likely company profitability levels. Also, in royalty investing company revenues mean royalty payments, even when or if not as high as the rate of growth projected.

It is also important for royalty investors to recognize that royalty issuing companies are likely to want or need to redeem outstanding royalties due to being the target of an acquisition or wishing to be involved in a subsequent financing, which could be a public offering, and that the terms of royalty redemption will be satisfactory to the investor as previously negotiated.

The nature of royalties is such that investors can consider leveraged investing with less risk than is the case with stock investing. This is true as there are so many things which can interfere with company management's profit expectations.

As a guarantor of royalty issuers:

The royalty rate negotiated by a business owner with a royalty investor is dependent on the ability of the royalty issuing company to convince the investor that what is promised will be delivered.

The primary concern of the investor is loss of capital. Therefore, the greatest need of the royalty issuing company is for assurance to be provided to the investor that they will not lose any of their original capital by buying the company's royalty. The company will pay the guarantor a fee at the time the company receives payment for the royalty. The guarantee fee we recommend is 5% of the amount paid for the royalty, the investor's amount which is at risk. The company will also assure by indemnification, that the guarantor will suffer no loss. The guarantee is that by an agreed date the investor will have received at least the amount invested. This creation of investor risk offset should allow for a significant justification of a lower royalty rate than absent the guarantee.

There are two ways the guarantor can accept the risk of the guarantee. The first is simply to make up the difference to the investor of their cost versus the cumulative amount of royalty payments received. The other way is to agree to buy the royalty from the investor for the differential between the cost of the royalty and the royalty payments received. Assuming it is the second approach which is used, the guarantor then has, for the cost of the investor's shortfall of royalty payments, the ownership of the royalty, entitling the guarantor a percentage of revenues for the balance of the royalty payment period.

In the second approach it is probable the royalty issuer's money-back offer of selling the royalty at their cost will not be exercised if the company is generating any significant revenues, as the entitlement for the balance of the royalty payment period would be lost for only getting even.

The royalty investor is going to want to to be made comfortable that the guarantor has and will have the financial assets to honor its obligation a number of years in the future.

If the royalty issuer is an established company with existing and probably growing revenues, the guarantor's assessment of risk is much easier than in the case of a pre-revenue issuer. Clearly, in the case of early-stage companies the indemnification may have little value, but the intellectual property and whatever other assets which had been transferred or pledged by the royalty issuing company will fall to the guarantor.

Being a guarantor will require some research and an understanding of the royalty issuing company, as well as of the terms of the royalty agreement. It is also a situation where the guarantor is being paid to play with the first liability being years into the future. The liability is also likely to be significantly less than the investor's cost of the royalty due to interim payments.

All three of the players have roles
to play and benefits to be earned?

The business owner obtains non-equity dilutive capital with which to grow his or her business.

The investor enjoys the benefit of getting higher levels of income with less risk than is usually associated with such levels of return.

The guarantor is the compensated risk acceptor and must await the payment of royalties by the issuer to the investor to know if the guarantee fee received was an assurance premium or an offsetting reduction in payment on a royalty issued by a company in the future, that has disappointed both the issuer and the investor.

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