Owners of stock in companies with future value can benefit from stock price lows

The market price and trend of quoted shares do not always reflect the good things the company can produce in the future. Frequently, a decline in stock price is the result of an earlier unwarranted high share price. This is often the case with early-stage companies that have benefited from overly optimistic projections.

A significant shrinking of the amount of outstanding equity would greatly benefit the remaining shareholders, assuming the company's objectives are achieved in the future.

Accepting the above observations leads to a question: how could a company, without using funds to bid for outstanding shares, accomplish the objective of concentrating ownership?

The answer is to offer to the owners of a minimum number of shares a revenue royalty exchange for their shares. We can assist companies in the designing of such a share-for-royalty swap.

The terms of the royalty payments can commence when revenues of the company are at agreed levels. The cumulative amount of royalty payments can be limited to a multiple of the share price at the time of the exchange. Depending on circumstance, the multiple could be 5 or 10 times the then-current price of the shares.

What would be the worst result for the shareholder accepting such a revenue royalty? That the company does not reach the assigned commencement level of revenues, and goes out of business. Were this to be the case the investor would have a tax-loss benefit based on the original cost of the shares.

What would be the worst case for the company issuing the royalty in exchange for the shares? If the royalty payments commenced without the company achieving profitability at the higher revenue levels. The presence of the royalty might also limit the company's ability to sell new shares on terms as favorable as would have been the case without the royalty in effect. Of course, the royalty would be for a negotiated period, and one use of additional capital could be for a possible right of redemption of the royalty, which could be one of the terms of the royalty.

The immediate and possibly only cost to the company offering a share-for-royalty exchange would be the legal fees and mechanics necessary in making the offering to shareholders.

This is to be checked with your tax advising accountant and/or attorney, but I believe that US investors will be able to receive royalty payments without incurring a federal tax liability, until they have received payments equal to their cost for the shares, and that thereafter royalty payments will be recognized as ordinary income. Further, I believe that all royalty payments made by the company will be federal tax deductible.

The benefits of a share/royalty swap will be different depending on the company's current situation and future events, but the possibility of such a transaction is worthy of consideration.

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