Impact Investing and Revenue Royalties:
A natural convergence for investors

Two growing fields in capital investment are preparing to converge: **impact investing** and **revenue royalties.**

With impact investing, the investor seeks to directly connect values to capital commitments -- optimizing total return first, and then assuring that the invested capital achieves measurable benefits for society.

Impact investing is a new and important **investment style**.

With royalties investing, the investor seeks to maximize current income and achieve efficient liquidity with private company investments, by investing in a percentage of gross revenues rather than in equity or debt.

Royalties investing is an important new **asset class**.

The new asset class of royalties is well-suited to the objectives of the new style of impact investment, for three chief reasons:

1. With royalties, an investor does not seek to influence management through shareholder rights. Management, which possesses the experience (verified by investors in advance) to execute fully on its business plan, retains complete independence to make decisive, fast, long-term decisions, seeking advice when

needed. This comports clearly with the needs of an impact investment company, which is strongly motivated by a clear set of ideas and principles oriented toward social good, where management needs to be free to pursue those purposes without encumbrance or delay. The principle: after full due diligence, trust management to execute on the strategy, and do the right thing.

2. With royalties, a company does not surrender its precious equity in exchange for growth capital, and spend precious time continually planning for and anticipating the terms of the next round. Company management remains fully incentivized to maximize returns for its investors in answer to the question most easily answered: are topline revenues growing as projected?

When management retains its equity, their commitment is continually reinforced, because their natural primary motivation -- to increase the value of their assets -- is aligned perfectly with the motivation of royalty investors. This alignment of focus helps to assure all stakeholders that their impact investment goals will be met.

3. Many companies that deliver social benefit have a difficult challenge in raising capital through current mainstream methods -- equity, debt or a combination of the two. Owning minority shares in a private company provides no liquidity for minority investors, and little control over their investment.

Liquidity for equity holders may arrive one day, in the form of merger, acquisition or public offering, but that exit event may be years in the future for minority shareholders. With commercial debt, there is limited opportunity for term loans on reasonable terms, without accepting high interest, performance penalties and negative covenants, and many impact companies cannot qualify or choose not to submit to the supervision of a commercial bank over their purpose-driven activities.

Royalties, which are far easier to analyze, avoid the valuation conflict, provide immediate incremental liquidity through quarterly revenue collection, and do not incur debt or inflict negative convenants. This new asset class will make it possible for many more impact companies to acquire growth capital, companies that otherwise might be permanantly left on the outside, looking in on capital markets but unable to participate and grow.

For these and other reasons derived from these three primary considerations, revenue royalties and impact investing form a natural partnership; each will help the other to achieve its important goals.

Michael North
Pacific Royalties
7-14-15

michaelnorth@pacificroyalties.com
http://www.pacificroyalties.com

Based on the work and research of Arthur Lipper