

Daniel Hall Presents



Episode 130

How to Earn Royalty Income from Someone Else's Intellectual Property

With PJ Miklus

Hello! Welcome to the RealFastResults.com podcast! PJ Miklus from [Royalty Exchange](#) is today's special guest. Since he works with royalties, he is very knowledgeable about details such as purchasing royalties. So, he's got some great things to cover in this episode. Please welcome PJ to the show...

Promise: How to Invest in Intellectual Properties

Thank you for having me. I think that one thing we really try to portray and make sure that people know is that not only are intellectual and property-based royalties an asset class, but they are arguably one of the purest forms of alternative investments available, given the fact that there is consistent income and cash flow. There's certainly capital appreciation potential because of the fact that the assets are long-term, and there is relative price stability. So, in terms of diversifying an allocation of investments, it definitely makes sense to look at, pursue, and start allocating towards.

Can You Explain More About What You Do?

Royalty Exchange is, of course, a business that can be applied to a number of different forms of media-based intellectual property royalties. We certainly have focused on music, to date, and there have been, obviously, literary deals done in publishing, video, and photography. But we certainly focus on music. We think that now is the opportunity, or now is really the time, that makes the most sense to

look at music because the industry is in a resurgence right now, thanks to digital streaming. It has created a bull market in the music industry that we think is really only its second or third inning. **People that are experiencing and receiving other forms of income undoubtedly find value in looking to these types of royalty streams as they diversify their form of income.**

Just to cover this a little more deeply, Royalty Exchange is a marketplace for buyers and sellers to meet in terms of exchanging these types of royalty assets. There is an auction platform, and we've done over 350 auctions in just under the last three years. We have raised over \$47 million for rights holders. That's mostly been amongst songwriters. Obviously, there are people behind the scenes that don't have as many options as a performing artist may have to leverage their celebrity in different ways.

There are other forms of investing as well. We have private syndicates, which are, basically, private placement offerings. Credited investors can buy units in a high-caliber, multi-million-dollar asset. Based on the amount of units that they buy, they share in the income produced by that. So, we offer a number of different ways to access these type of royalty investments, and fundamentally, serve as the connector between buyers and sellers.

For music royalty, there are two forms of copyrights. There is the writing copyright, which is the composition copyright, and then there is the recording copyright, which is the sound recording, or masters copyright. There are often a number of different rights holders underneath each. So, each one of these individuals can essentially put their part of the royalty rights up for auction.

One thing that I think is important to take note of is that it doesn't have to take up 100% of their revenue stream. We have quite a few songwriters, backup singers, artists, and other forms of right holders, such as producers that will come to us to figure out how to sell 15-20% of the income. Basically, they can bring those payments forward to today, while still receiving the lion's share of the revenue stream that they have been receiving in the first place.

That's where I think a lot of our educational efforts come into play. There is somewhat of a stigma that selling royalties may be bad in terms of someone being in some type of financial trouble, but when you look at it that way, and you look at it in the form of bringing payments forward to today... A dollar today is worth more than a dollar tomorrow, so this can certainly make a lot of financial sense, and we, of course, look to explain and educate people on the options that they have.

Can You Tell Us More About the Finance Options?

We have two types of options on our platform right now. We have the Life of Rights options. **So, if you are an investor and want a Life of Rights option, you are entitled to the revenue from that royalty stream for the life of the last surviving artist, plus 70 years.** If you buy a 10-Year Term Advance, you are basically buying the income produced by that royalty for the next 10 years, at which point the right automatically reverts back to the person who sold it on our platform. So, those are two different types of assets, of course.

It is important to know that just the way that music royalties work is that it's basically the way that the money flows within the music industry. Artists don't really get salaries. They get paid based on the consumption of their creations. Whether it be through streaming or whether it be through buying CDs or records, or listening through different forms of medium, this is how these artists are paid, so if they can diversify that income stream in any way, it can certainly make sense for them.

We see many rights holders that are selling a portion of their royalties through our platform, using the money we've raised through that auction to invest in their career, invest in touring, or invest in some new equipment. There are a lot of different ways that we see these people that are transacting and selling their royalties on our platform putting that money to work. It certainly makes a lot of sense for them when they do so.

Do You See Your Exchange Focusing More on the Literary Market in the Future?

Yeah. You know, we've done a handful of literary royalty deals to date. **We are focused on the music industry today, but there's certainly the ability to scale into that space, given the right opportunity.** We are certainly open to looking at those types of deals as well.

One item that's really interesting about our business model is that it can be easily applied to, whether it would be TV residuals, whether it would be royalties from movies, or whether it would be, as I've mentioned, other types of deals that we've done, such as video, publishing, photography, and trademarks. It's definitely applicable. To be able to look at the track record of the royalty stream's revenue, and see some form of consistency there, and make projections or some type of analysis based on that is what's most important. We do it for music, mostly, today, but it could certainly be applied to other forms of media-based IP.

What's the Process for Bidding on These Rights?

Our website is RoyaltyExchange.com. We have quite a few resources available for people interested in buying royalties, and basically, to learn more about it. There are guides to buying music royalties. They are all under our "Investors" tab. So, I would definitely recommend that listeners go and check that out on RoyaltyExchange.com. There are a number of tabs right at the top of the site where you can find more information.

On our "Listings" tab, we have all of our auctions live there. **To be able to bid on an auction, people need to set up an account with Royalty Exchange.** It takes just a couple of minutes, and then they need to become verified as a verified bidder. That process is usually to speak to me, and it's just a 5 to 10-minute conversation. **Essentially, we just share some insights about the exchange, how it works, and the difference between the Life of Rights and Term Advance options. We want to make sure everyone understands that.**

We'll explain, you know, if you win an auction you do have the highest bid, and you have to deliver the money to us within two days, and then you'll go through the process, after that, for the purchase agreements. We explain that there are some closing documents on taking ownership of the royalties. It's a pretty seamless process. Like I've mentioned, we have done over 350 auctions, and we have over 23,000 investors on our platform. One interesting stat that I would highlight is that 40% of auction winners to date are repeat buyers. So, we've undoubtedly seen people happy with the process and coming back for more to build an allocation in music royalties.

Can You Explain the Secondary “Buy it Now” Option?

Yeah, sure. That's an option that we have provided in the past. **It's basically the ability for an investor that buys an auction to list it for the 12 % premium to the price that they paid for it.** The way that this works is that they will be receiving 10% of the increased purchase price. If someone does transact on that and “buy it now,” the remaining 2% will go to the original seller. We actually don't make money on those “buy it now” auctions, but that, of course, requires a buyer to come in and pay a 12% premium to what the closing price of the auction was. We had some of those deals transacted upon, but that's an option that has been available on our site for a couple of months now.

Of the “buy it now” listings, about 10% or 20% of those have actually transacted, which is interesting. That's not as high of a percentage as we would like, so we've actually put that initiative on hold, and if you look at our site, you'll see that there's no “buy it now” options right now. That's something that we may bring live again shortly, but I guess we are, kind of, retooling that initiative. So, that's just something to keep in mind. If an investor does buy an auction, they don't have the option to list it as a “buy it now” right now, but that is something we will be offering again in the future.

If I Buy an Auction, Is That Asset Alienable?

Yes. You can relist on our marketplace anytime, but you aren't restricted to selling through us. We are, of course, the oldest and largest marketplace for IP-based royalties. So, we will definitely work with whoever would like to sell their rights in a seamless fashion, but they certainly aren't restricted to selling through us.

Can You Tell Me More About Being an Accredited Investor?

You don't need to be an accredited investor to invest in our auction deals. That's basically a classification of investor as defined by the United States, to classify certain investors as sophisticated. The parameters are that you've earned \$200,000 per year in income for each of the last two years, or

with a spouse, you earn a joint income of \$300,000 per year for the last two years, or you have over \$1 million in investable assets outside of your primary residence.

If you satisfy any of those requirements, then you are considered an accredited investor, and you should be able to pass through the verification process that we make every one of our investors go through that plans to invest in the private syndicates. It's through a third-party provider that verifies people as accredited investors. It's through securities regulations that require that for private placement investing.

I would say that's a very interesting business model that we've built out, and the first deal that we did was for the first four studio albums of the alternative rock band, Cage the Elephant. The first four albums that they created, it's a share in the composition copyright from those albums. We closed that back in June.

We just closed our most recent private syndicate a couple of weeks ago. It was for a share in the sound recording revenue from the entire Dire Straits catalogue. That's everything they've done on the sound recording side, and then some solo works from Mark Knopfler and John Illsley, including some movie soundtracks. That was a really interesting deal that was actually oversubscribed by over 85% among our investors.

So, there's unquestionably an incredible appetite for these types of investments, and one thing that I would mention is that these private syndicates are, initially, exclusively available to members of our premium investor membership, the All-Access Investor membership. With the Dire Straits deal, you had to be an all-access investor to access it, and among those premium members is where we got over 85% over-subscribed. So, it wasn't even open to the public. I think that if it had been open to the general public, we would have gotten over-subscribed by much, much more.

Can Tell Us More About This Private Investor Deal?

Basically, we create 1,000 shares of these catalogues. They are multi-million dollar, high-caliber assets that aren't necessarily suitable to list on the exchange because it's hard to imagine people bidding over each other for an asset that might go for \$3 million - \$3.5 million. So, what we do is split it up into units in which investors can decide how many units they want to purchase, and then they will receive the income on a proportional basis, based on how much they invested going forward.

This is a way for accredited investors to get involved at a fixed purchase price. This is a purchase price that we negotiate with the seller. The minimum purchase for the last two deals has been just above \$35,000, and that equates to 10 units. We've seen interest through the roof, with some investors coming in at well over \$500,000 and close to \$1 million, in terms of the type of investment they are interested in.

What Are the Investment Amounts, Typically?

In terms of the average purchase price on the auction platform, it's at about \$60,000. I've been looking at some stats, and that has been relatively consistent over the time that we've had the auction platform up. We've obviously had deals that were well over \$500,000, but we've also had deals that were under \$10,000. So, in terms of multiples of last year's cash flow, I would say that the average multiple at which these deals transact is usually around 5-7 times last year's cash flow range.

I have found that if you look at the deals that transact above the \$100,000 mark (So, once you get into the six digits), you see those multiples that the final bid, or that the auction ends at, come down a little bit, on average. So, that is to say that there seems to be less demand with higher dollar amounts, as you would imagine. I've also seen some lower multiples on some great assets. It's really about watching the platform because we certainly have great multiples that are below the \$100,000 range as well. It's just about, I guess, watching it at the right time.

I also want to mention is that one thing that's extremely interesting about the music industry, and why we see so much opportunity, is that thanks to digital streaming you do see many of these revenue streams growing. There's a lot of revenue that's being picked up. A stat that you might find intriguing is that of all the smartphones in the world today, only about 3% of them have paid streaming music subscriptions associated with them. So, we, along with many analysts in the industry, think that there is plenty of room for growth, in terms of how many people are actually streaming and accessing this music via streaming services. We expect the growth to continue in these revenue streams as sustainable assets. That's what really makes it so exciting, is that there's capital appreciation potential as well here.

Can You Share Any Tips for Getting a Good Deal?

You know, what's great about the music industry is that it's so broad. There have been so many music pieces produced, and there are so many different types of revenue streams and rights holders that are out there. So, it's really about looking at the deals one by one and taking note of what you see as interesting. We have deals that are listed that only have a couple of years of cash flow history, and then we have deals that have over 30, and maybe even over 50, years of cash flow history.

We had an auction, just recently, and it was the theme song from Merry Melodies, which are, of course, the cartoons. Everybody knows that theme song and being able to own a share in the revenue produced by it, especially considering how often it's syndicated, is very attractive. I would just say to look at each asset as a new opportunity, and if you approach this with some form of discipline...

You know, if you approach it with some sort of idea of what your parameters are, in terms of how much you want to invest and what you think is a reasonable multiple of cash flow for the asset that you're looking at, then you should be in pretty good shape. We definitely have quite a number of deals, and

the number of deals that we are bringing to the platform has grown year over year, and we plan to continue to grow it.

Can You Go Over the Short and Long-Term Options Again?

It's always evolving, but we provide as much information as we can on these types of deals. One piece of information that we try to provide on every deal, and we can really only reasonably provide it for deals that have over three years of earnings history, is a theoretical IRR (internal rate of return). And, we do it for both Life of Rights and for the Term Advance, 10-year types of auctions. If you are looking at a term advance, there are certainly deals that transact well above the 20% theoretical IRR range, which is to say that if that theoretical IRR comes true, then investors would make their money back within 10 years. I'm sorry, within 5 years, and then it would be off to the races after that.

So, that's something to keep in mind. You could take a look at the theoretical IRR, and you should certainly read the listing that we put together. Our account management team, and our relationship management team, really aggregate all of the information that we have. They share as much of that as they can, as they see it as relevant, so that investors can make an informed and educated decision on the assets that they are bidding on. Of course, I'm always a resource. I'm the Head of Investor Relations in music at Royalty Exchange, and I'm happy to take any type of inquiries. People can always write in to me or call me, and the information is on our site, RoyaltyExchange.com, on how you can submit inquiries. We'll get back to you extremely quickly.

Will You Tell Us More About IRR's?

We have proprietary metrics that we look at when we think a royalty and IP-based royalty asset may be valuable, and these may not be applicable to other forms of investment, but we believe that these are to music royalties. There's a model that we use to calculate the theoretical IRR through. These proprietary metrics that we look at include all of the following:

- The Decay Rate – This is the rate at which we project a revenue stream will potential decay over time.
- A Trend Rate – A revenue stream might be growing, and we think that it might grow a certain amount going forward or level off after a certain amount.
- Income Normalization – There may have been a spike in a certain recent period that may skew the numbers, in terms of how much has been earned in the last 12 months, and we want to incorporate that, of course.
- Terminal Value – We look at a terminal value, usually after 10 years, and we try to project what the work would be worth after 10 years.
- Dollar Age – This is probably the most valuable number that we look at. This is a proprietary metric that's time weighted, and it puts a life of the earnings of the catalog, based on the contribution of each song and how long it has been in existence, earning revenue, and how much that contributed to the last year's cash flow.

The dollar age value is basically a way to see a time weighted average for the life of an entire catalogue. These are all incorporated into our model that is used to calculate our theoretical IRRs. I hope that I haven't gone too deep into the weeds, but there is quite a bit of analysis that goes into forming that theoretical IRRs, which we display on our auctions.

If you look at the traditional stream of a catalogue and find that has been sustained over time, there is reason to believe and project that this activity will continue for a certain amount of time. The trend rate may continue, or it may grow, if it's growing, or it may decay, if it's decaying. It's really on an asset by asset basis that you need to evaluate these revenue streams on.

Is There Anything You'd Like to Add?

Thank you for having me and thank you to anyone who tuned in today. **I'd just like to add that intellectual property-based royalties certainly are an asset class, but like I mentioned at the beginning of the podcast, they are also one of the purest forms of alternative investments available for a number of reasons, which I have talked about here, today.** For instance, they are great diversifiers in terms of creating and contributing passive income to a portfolio, and we are certainly available to answer any questions that anybody has. They can just go to [RoyaltyExchange.com](https://www.RoyaltyExchange.com) or reach out to me directly. I'm always willing to hop on the phone or respond to you by email, and I'm looking forward to getting in touch with anyone who wants to learn more.

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