



Royalties & Strategies to Protect your Revenue Streams

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Why License?

Licensors

- Generating Cash
- Maximise value of IP portfolio
- Brand Extension
- Access to resources / expertise
- Access to new markets
- Risk sharing
- Market visibility

Licensees

- Expansion of product portfolio
- Access to leading brand
- Access to key Intellectual Property
- Access to innovative R&D
- Risk Management

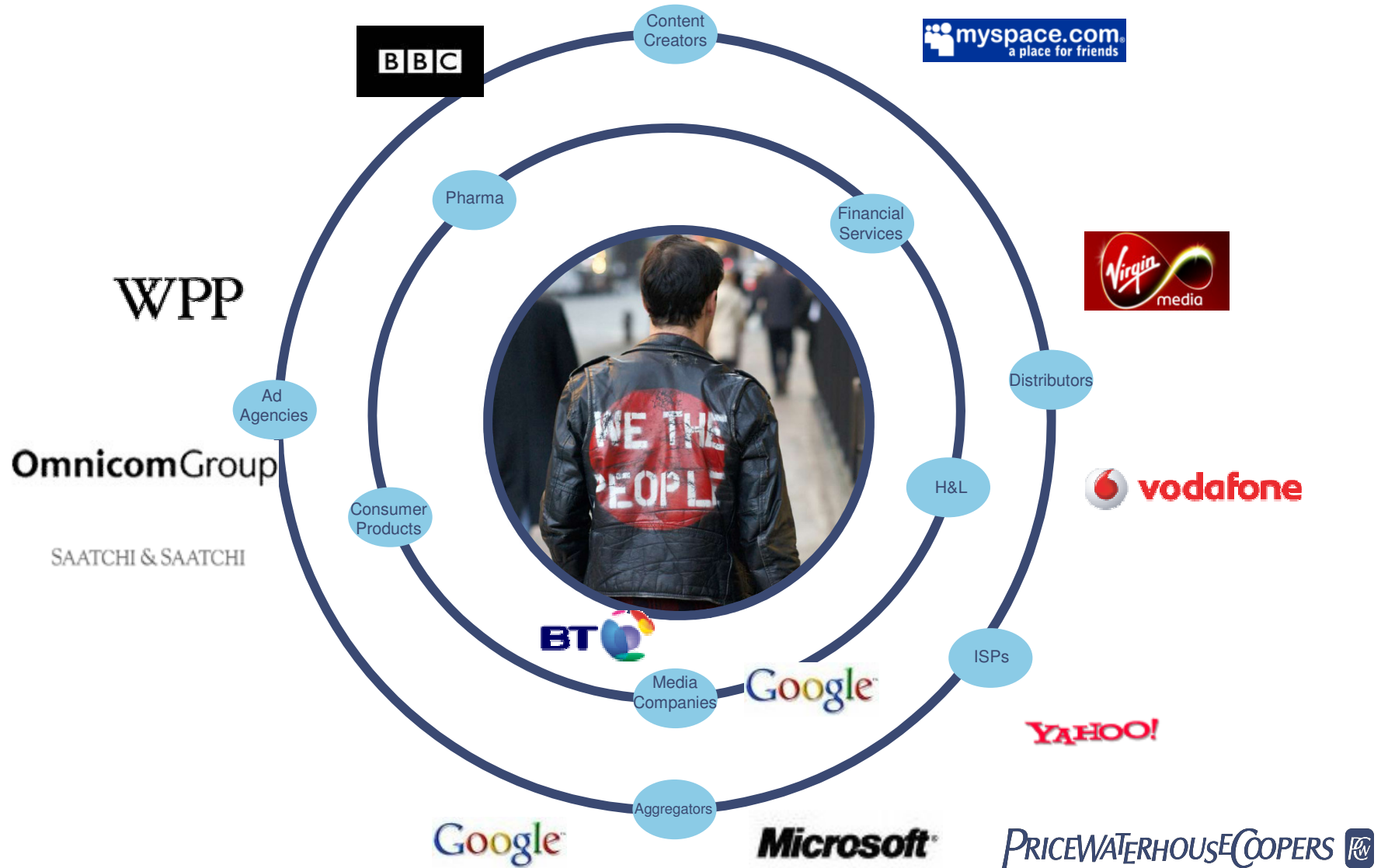
Why License?

“Exploiting IP in a Complex World” – PwC 2007

Executives: How important is IP management to the success of their companies?

- **83% of TICE executives say IP is important (52% saying very important)**
- **“Intellectual property is becoming a critical driver of value. It is still something new and evolving” - Samsung**
- **“Until recently, we tended to keep our patents in a drawers, collecting dust. Now we are beginning to realise they have value beyond what we might see on own business, we are marketing these to other companies. They are very valuable.” - European telecoms company.**
- **IP is a core strategic asset: The focus is shifting from litigation to managing and enhancing its value**

Entertainment & Media Industry Overview



Our Experience

1000

Royalty Examinations

**98% of License Agreements
Royalties are mis-reported**

A Friend with
Significant Experience

Primary Drivers:

- Accounting Mistakes
- Clerical Errors
- Contract Interpretation
- Fraud

Primary Industry Groups:

- Entertainment & Media
- Consumer Products / Luxury Brands
- Pharmaceutical
- Technology / Software

Key Considerations

Quality of Relationship

- Established points of responsibility
- Quality communication and sharing of pertinent information
- Level of trust

Clarity of terms in agreement

- Clearly defined financial terms ie Gross vs. Net
- Use of examples
- Reporting requirements

Accounting systems

- Identification of unique terminology
- Capability to address terms of agreement

Key Considerations

Global Considerations

- Location of partner and access to facilities
- Currency differences
- Sublicensing

Access to books and records

- Inclusion of Audit Clause in agreement
- Access to all relevant books and records

Coordination between corporate departments

- Licensing management should include legal, finance, business development and possibly R&D.
- Is there a formal communication policy between departments?

Accuracy of Royalty Reporting

- Gross vs. Net Sales
- Returns
- Invoiced vs. Collected
- Sales to Affiliates
- Territories
- Other...

Accuracy of Royalty Reporting

Gross vs. Net

Royalty of X% shall be applied to:

Gross sales net of all regular (or reasonable allowances)

Types of Allowances (Define what is “allowed”)

- Trade Discounts
- Volume Discounts
- Settlement Discounts
- Year-end Rebates
- Freight
- Returns
- Bad Debt
- Tax

Accuracy of Royalty Reporting

Invoiced vs. Collected

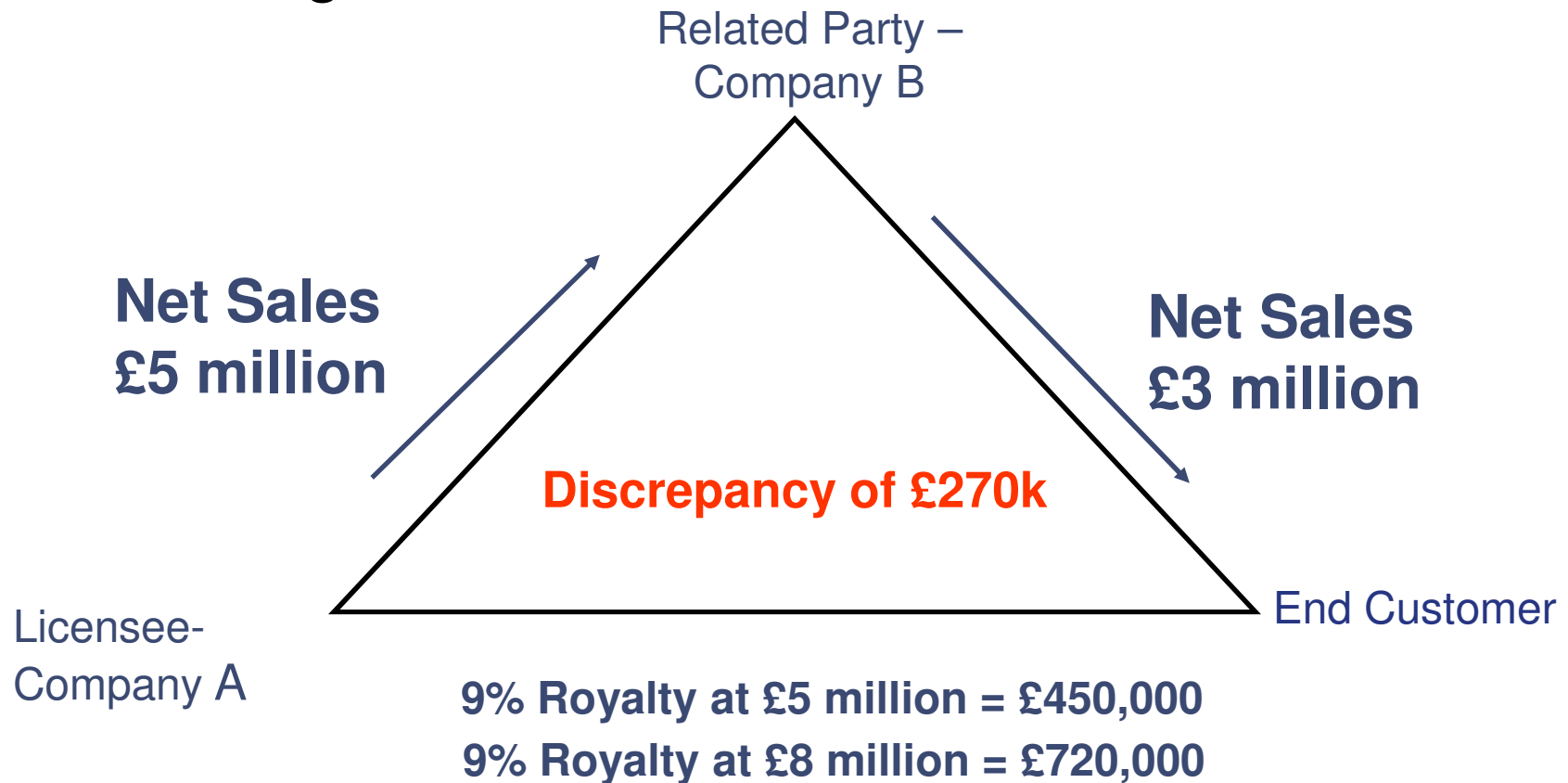
- Royalty based on “Invoice Sales” of “Revenues Collected”

Period	Royalty Rate	Net Sales	Royalty
Invoiced 15/12/06	9%	£5,000,000	£450,000
Cash Recd 31/01/07	4%	£5,000,000	£200,000

- Timing issues (could affect internal reporting and analysis)

Accuracy of Royalty Reporting

Sales through Affiliates



Accuracy of Royalty Reporting

Sales Outside of Territory

- To prevent sales into other licensee's territories
- Territory specific Advances and Minimum Guarantees
- Royalties on "Out" of Territory sales not recoupable from Minimum Guarantee
- Higher royalty rates on sales outside the territory
- Penalties

Accuracy of Royalty Reporting

Other Considerations

- Statements – Information & timing
- Payments - Currency
- Exchange Rate – Source, date
- Late payment interest
- Audit Clause

Protecting Royalty Streams

Questions to consider:

- Do you have a thorough inventory of all IP and License agreements?
- Is there appropriate level of review and oversight over the reports to and from partners?
- Have you been subject to an audit by a partner and what did / can you learn from it?
- Have you exercised the Audit clause? Why not?

Protecting Royalty Streams

Right or Obligation to Appoint Independent Auditor

- *“...may be audited ... but not more than once in each calendar year ...”*
- *“licensee must maintain books and records for at least X number of years”*
- One audit vs. one visit
- Audit fees to be paid by licensee if under reported royalties exceed X%, typically 5%

Protecting Royalty Streams

Compliance Programme - Objectives

- Risk Assessment of license Portfolio
- Manage, monitor and enforce the portfolio
- Forensic based examinations
- Identification of revenue leakage issues
- Consistent message to the market place
- Proactive vs. Reactive

Best Practices to Ensuring Accurate Royalties

- Proactive vs. Reactive
- Clear and concise agreement terms
- Maintaining regular contact with the licensee
- Exercising audit rights regularly
- Access for a thorough and unrestricted royalty examination
- Know your business partner

Licensee Quotes

- *“We were going to tell the licensor about sales into that new territory...we just never got around to it.”*
- *“I know we agreed we would pay 9% but don’t you think that’s too high? We think 3% is much more reasonable.”*
- *“We don’t have the documents from 2003...they burned up in a fire.”*
- *“We don’t have any documents ...they’ve been seized by the government.”*
- *“We can’t schedule the audit next week. We’ve moved our office to a bunker and bombs are going off right now. Maybe in a few weeks time...” [licensee located in Israel]*

Questions ?