A Growing Royalty Stream on Mandatory Standardized Testing

Across the country, at the end of every school year, students take standardized tests to measure their academic progress.

Now you can earn a royalty on the copyrighted content used in standardized tests.

These tests, in various forms, have been mandated by the federal government since 1965. The federal government requires the states to conduct and report on the results of these tests. Otherwise, the states can't get federal funding for their schools.[1]

Test makers are strongly encouraged by states to use "authentic,"[2] or previously published and properly licensed, content on the reading portions of these tests.[3] So test makers need to find and license real-world content for the tests every year.

This asset is a large and growing library of authentic, published articles that earns royalties every time a test maker uses the content on a standardized test.

What is this asset?

For the last 50 years, Cricket Media has been publishing children's magazines. You might remember them from your time in school. Magazines with age-appropriate reading material show up in homes, libraries, and classrooms.

[1] To receive a portion of federal funding under Title I, states are required to have a high-quality annual assessment system to measure student progress and demonstrate accountability. (link)
[2] "Authentic" is a term used in evaluating texts for standardized testing, and is understood in the industry to mean the same thing as previously published. This term is contrasted with commissioned passages, which are written solely for the purpose of the test. (link)
[3] "Generally, texts used for assessment should be drawn from previously published materials because these materials have undergone professional review and editing in the publication process." and "Consequently, passage finders should plan to locate authentic texts." (link)

Cricket publishes nine magazines with content covering pre-kindergarten to high school.

Publishing these magazines is Cricket's core business and it makes up most of their revenue. But once the Cricket team publishes the articles for these magazines, they upload that content to online databases where people can license it for use in textbooks, school curricula, and standardized tests.

This asset is the royalty stream generated by the content's use in standardized tests. It's currently paid by the Copyright Clearance Center (CCC), which is a collective licensing organization for text. The CCC is similar to ASCAP and BMI in that they represent publishers like Cricket and issue licenses to various organizations to use their clients' content. Publishers like Cricket, Oxford University Press, and Wiley[4] make their content available under the CCC license. Then companies like Verizon and Eli Lilly pay for a CCC license so they can use that content. [5]

Here's how the standardized testing royalty works:

The states need to test their students every year so that they continue to receive federal funding for their schools. Typically, states will contract with educational testing companies to develop these mandatory assessments.

In essence, Cricket is a subcontractor that provides high-quality content to test makers so they can get their tests approved by the states.

Here's the testing company's process for building these tests:

First, the contractor develops a broad outline for the content to be included in the test based on the individual state's guidelines. Then they develop item

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[4] https://www.copyright.com/media-press-releases/new-features-in-ccc-marketplace-help-publishers-engage-with-leading-medical-communications-professionals/

[5] https://www.copyright.com/wp-content/uploads/2021/02/Case-Study-Verizon.pdf; https://www.copyright.com/wp-content/uploads/2023/03/CCC-Lilly-Case-Study.pdf

specifications to outline specific requirements for each item on the test. These specifications define the skills, knowledge, and processes that the passage should target. They also indicate the desired complexity level, length, and other characteristics of the passage. Assessment specialists then review and select potential reading passages. For example, they may decide to include:

- Two articles about early American history
- One article about the biology of cells
- An article discussing Democracy in Athens
- Three articles that cover geography

Then, because the content used in these tests should be published elsewhere, the testing company searches content databases for authentic texts that cover the targets they want to test, paying particular attention to text complexity, bias, and sensitivity review. They look for grade-appropriate articles that they can use and once they find those articles, they put them into an item bank.

The item bank is a topically organized collection of articles maintained by the testing company.

After the item banks are filled, another team at the testing company reviews those articles and writes questions designed to test students' comprehension of the content and their ability to think critically about it. The combination of the reading passage licensed from CCC and related questions is called a “test item.”

After the test item passes internal review, it is then field-tested with students. Sometimes this is done with focus groups or these experimental test items are included on a standardized test but not counted for scoring the test. The field-testing process is designed to determine whether or not the test item is a good assessment of a student’s comprehension of the material.

After they finish field testing and analyzing the results, the testing company submits the test item (along with a report on the field testing results) to the state’s department of education. The department of education reviews, and either approves or denies, the test item.

If the test item is approved, then students will see it on future tests. But if the test item is rejected, then it won't be on the test.

Depending on the state, it costs between $10,000 and $100,000 to develop *a single test item*. If a test item is rejected, the money spent on field-testing is wasted. So there is an incentive for the test makers to use content that is likely to be approved by the state, so as to minimize the risk of their test items being rejected.

And that's where Cricket's content comes in. They have a 50-year track record of publishing compelling and pedagogically sound content. Their content has been approved by more than 30 states and millions of students have seen it on their tests.

The Cricket content is:

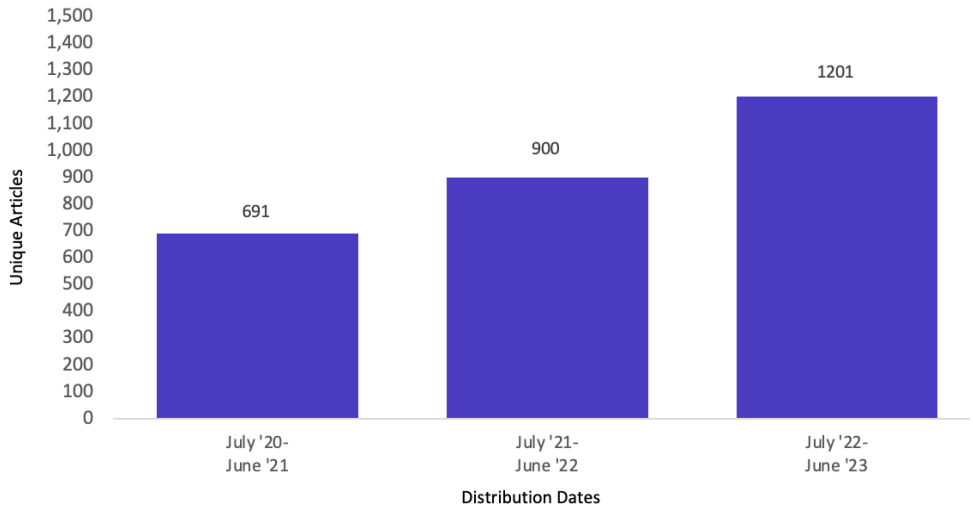
- Tagged for complexity and searchable by complexity. There is a stated level of vocabulary, sentence structure, and content complexity that aligns with the state proficiency standards. This means that test makers can search by difficulty level and easily find content that helps them accomplish their testing goals.
- Short-form magazine content, which means that test makers don't have to make decisions on which section of a longer piece to use in their test item. The content is already written at an appropriate length for plug-and-play use in testing.
- Authentic: written for children by a variety of authors, with engaging text that reflects diverse voices, cultures, and experiences.
- From multiple magazines that provide a variety of content types sought by test makers: informational, literary, scientific or technical, expository, persuasive, and argumentative. Test makers can get every type of short writing piece. If they want the student to assess the quality of an argument in a persuasive essay, Cricket has that content. If they want the student to demonstrate comprehension of a scientific essay, Cricket has that content too.

Choosing Cricket content as the basis for developing test items is a low-risk option for the test makers.

And once the content is approved by the state, there is a strong incentive to use that material for as long as possible. Because so much of the cost of developing a test item is in the selection and review of the text, test makers prefer to use the same source of content that has been approved before.

Safe sources of content, like Cricket, tend to predominate over more experimental or esoteric sources of content for these tests.

This means that publishers like Cricket, with a track record of producing content that is approved by the state, will get more content placed over time. And more content placed means more royalties. This is an example of the Matthew effect – e.g. the rich get richer. Another name for this is preferential attachment. Success leads to more success. And in a risky environment like getting text approved for state tests, the more Cricket's content is approved, the more likely it is to be approved in the future. You can see this play out in the number of unique articles licensed over the last 3 years:



And you can see the result of this in the historical earnings of this income stream: the royalties have been growing 5%+ a year since 2015.

How this Asset Earns Royalties

There are two ways this asset earns royalties:

1. When a testing company puts a piece of content into their item bank which is available for students to access (even if the content is not used). This generates a small "inclusion" royalty. All content items that test makers report as included receive an equal share of this portion of the royalty pool. (This royalty pool is comprised of 20% of the total license fee the test maker pays to the CCC)[6]
2. When the test item gets approved and students see the piece of content on their year-end assessment. This generates a much larger "frequency of use" royalty. (This royalty pool is comprised of 80% of the total license fee the test maker pays to the CCC)[7]

The amount of royalties earned per test item included in assessments is determined by the number of students that see the test item on a test. Thus, larger school districts pay more royalties. The test makers tell the CCC what school districts they are developing tests for, and the CCC charges the test makers a licensing fee based on the number of students in those school districts.

Then the test makers report to the CCC which content they used for their test items. The CCC pays royalties out of the pool based on the pro-rata usage of content. For example, if Cricket's content makes up 50% of the total content usage on a test in a school district, then Cricket would get 50% of the royalties, less CCC's fee.

[6] After CCC's fee
[7] After CCC's fee.

And the larger the school district, the higher the royalties will be. So if Cricket's content is used by the Los Angeles county school district that will earn more royalties than if the content is used by a small school district in North Dakota. Just like music: a song with 1 million streams on Spotify will make more money than a song with 10,000 streams.

Why is Cricket Selling this Asset?

Cricket is selling this asset to raise non-dilutive capital to expand internationally, develop their educational software, and build language-learning products.

The important thing to note is that the content that generates this royalty is created as a by-product of Cricket's much larger publishing and licensing businesses.

The content is created for the print magazines, then uploaded and tagged with metadata for Cricket's non-testing licensing business. There is no additional effort required by them to generate this royalty.

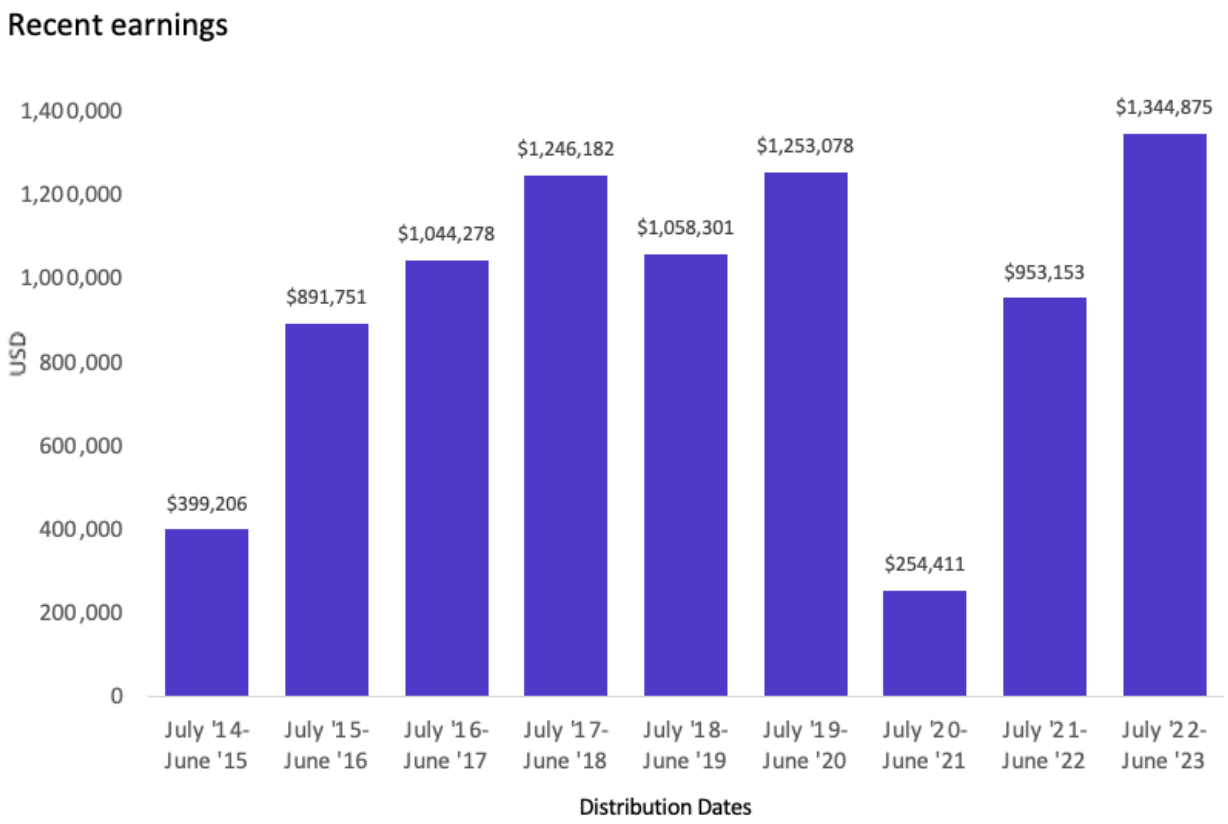
Going forward, Cricket will retain 25% of the royalties generated by any new content published after this asset is sold. The buyer of this asset will receive 75% of the royalties from this new content. So if Cricket writes an article for a classroom magazine in 2025 and that article gets used in a test in 2029, you'll get paid for the usage of the new content.[8]

Financial Analysis

Annual Royalty Growth

The royalties have grown from $891,751 in 2015-2016 to $1,344,875 in 2022-2023. That's a 5.27% compound annual growth rate.

[8] Sometimes Cricket uses third party content or public domain content in its magazines. This type of content is not eligible for inclusion in this royalty stream.



But what happened in 2020-2021 and 2021-2022?

Because of COVID-19, all public schools shut down in 2020. As part of the federal government's COVID response, the US Department of Education issued a comprehensive waiver that eliminated the required standardized testing for 2020.

Since the CCC royalties reflect the number of students who take the tests, this caused the royalties to drop from $1,253,078 in 2019-2020 to $254,411 in 2020-2021.

In 2021-2022, the royalties recovered but still did not return to the 2019-2020 level of earnings. That's because in 2021, the federal government made

standardized testing optional or allowed states to use other assessment methods to determine their students' progress because of ongoing COVID disruptions. So while the royalties went from $254,411 in 2020-2021 to $953,153 in 2021-2022, the 2021-2022 royalties do not reflect the normal academic year's worth of royalties for this asset.

> The 2022 school year was the first since 2019 that all students were back in the classroom and taking the federally required tests. And the royalties reflect this return to the norm: 2022-2023 royalties were $1,344,875 which was 7.33% higher than pre-pandemic royalties in 2019-2020.

Overall, the annual royalties have grown 50.81% in the last seven years.

Stability of Royalty Payments

This catalog is growing and the payments are relatively stable. Aside from the pandemic-affected 2020 and 2021, there is not a lot of inter-year volatility.

To measure this, we look at the coefficient of variation (CV) to determine the volatility of payments over time. The CV is the standard deviation of royalties earned, divided by the average royalties earned. For this analysis, we excluded the pandemic years of 2020-2021 and 2021-2022.

From 2015-2016 to 2022-2023, the coefficient of variation is 14.86% which indicates a fairly stable stream of income.

The asset is growing and, global pandemics aside, the royalties have been stable.

Diversity of Royalties

This asset does not rely on a handful of articles to generate royalties. It's quite diversified.

In the most recent annual payment, 1201 unique articles earned royalties from usage on standardized tests. Of those articles that earned, the largest earner "Writing It Down" was responsible for just 1% of the royalties.

The top 10 earning articles in that same period earned just 7.95% of the total royalties, and the top 100 earned just 40.6% of the total royalties.

Summary

These royalty payments have been growing at a 5% annual rate since 2015. The annual earnings have grown from $891,751 in 2015-2016 to $1,344,875 in 2022-2023. The royalties are very diversified, with the largest earning title in the last 12 months making up just 1% of the total earnings. You will be entitled to 100% of the royalty payments when Cricket's current content is used in standardized tests and 75% of the royalty payments if Cricket publishes new content that gets licensed for standardized testing. This royalty right will continue as long as the copyright is in place.

Please contact investors@royaltyexchange.com with any questions. You can bid on this asset by clicking this link.