Technology Transfer Tactics™

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Royalty monetization: High-profile deals generate excitement among TTOs

If you had the opportunity to exchange the potential of a lucrative long-term royalty stream for a huge windfall right now, would you take it? An increasing number of TTOs and the organizations that support them are entertaining just such a proposition, and quite a few of them are opting for the sure money. Why? The universities involved may face pressing financial obligations or wish lists, and others are opting for the less risky approach, taking a guaranteed payout now rather than betting on future royalties for IP that could fail to meet financial expectations or face new competition down the road. The reasons for choosing to monetize a valuable royalty stream vary widely, but there

The case for royalty monetization

Universities and other research institutions that opt to sell all or part of their most lucrative royalty streams do so for four primary reasons, according to **John Gourary**, a partner in the New York City office of **Covington & Burling LLP**, and a key advisor to both Emory and Northwestern when they monetized royalties associated with the blockbuster drugs Emtriva and Lyrica, respectively:

- The first and primary reason why organizations consider royalty monetization is because it diversifies risk, stresses Gourary. "Selling the rights to a royalty stream or a portion of the stream in exchange for a lump sum payment reduces exposure to the particular product or the field, or even the industry within the university's overall portfolio," he says.
- The second and perhaps most obvious reason is because royalty monetization provides immediate access to funds. Universities may need capital to upgrade lab facilities, provide scholarships, or even just to meet current financial obligations.
- A third reason is that large royalty monetization deals, such as Emory's $540 million deal and Northwestern's $700 million transaction, can provide a research organization with a huge boost from positive publicity. "It demonstrates that exciting things are happening on campus, and sort of raises the international profile of a college or university," says Gourary.
- The fourth consideration is that monetizing a royalty stream may be important to the inventors involved, since they share in the proceeds and may be anxious to cash in on their innovations.

Once you decide to pursue a royalty monetization deal, Gourary emphasizes that there are typically three internal constituencies that must come together: the TTO which is monitoring the license and is probably most familiar with the asset, the financial office, and the office of the general counsel, which is responsible for looking out for the organization's legal interests.

Consider outside expertise

To make a deal work, Gourary says most organizations will need to seek outside expertise. "It is really important to have someone who is experienced in these kinds of transactions … who can anticipate concerns that buyers might raise and steer the university through this kind of exercise -- because [these deals] don't come along day in and day out," he says. "If there are any issues or ambiguities, it is a lot better to resolve them before there is a sale. There is a lot of preparation involved."

Also, depending on the size of the deal, many universities bring in consultants to estimate the value of their asset, and investment bankers are typically retained to solicit bids for the asset and handle the auction process.

While needs will vary based on the unique characteristics of the asset involved and the resources available within the seller's organization, Gourary always advises clients to establish a dedicated, day-to-day team to manage the transaction and facilitate decision-making. "You don't want to lose momentum, and you don't want people to think there are problems," he says, noting that these transactions tend to be very complicated and can take as long as two to three months to complete even after a deal is struck. "Once you announce the sale and your timetable, you want to stick to that timetable because if you don't, people will worry about what is causing the delay."

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is no question that interest in this approach is rising among both buyers and sellers.

To be sure, only a select number of high-value innovations are ripe for this type of transaction. But experts tell *TTT* that such agreements are becoming increasingly sophisticated to suit all the parties involved. And while royalty buyers clearly favor innovations with established revenue streams, they are beginning to take an interest in earlier stage innovations as well.

Data show a 10-fold increase

Royalty monetization transactions have taken place in a number of different industries. However, there is particular interest in this type of arrangement in the medical device and pharmaceutical arenas. Further, there is ample evidence that both the frequency and size of these transactions are accelerating.

"From 2000 to 2003 there were a total of about $500 million in royalty monetizations. In the last four years, from 2004 to 2007, there have been $5 billion in royalty monetizations – a 10-fold increase," stresses **Louis Berneman**, who was managing director of the Center for Technology Transfer at the University of Pennsylvania from 1995 until 2005, and is now a consultant to New York City-based Paul Capital Healthcare, a group that seeks out royalty streams to purchase. "In fact, I believe royalty monetization is going to increasingly become a post-license value-creating mechanism because institutions frankly can do far better by monetizing a portion of a future royalty stream, and then reinvesting those dollars to recruit new faculty for start-up programs, build out new labs, or launch translational research."

Clearly, that is how Atlanta, GA-based Emory University viewed the approach in 2005 when it cut a $540 million deal with Gilead Sciences and New York City-based Royalty Pharma for 100% of the royalty stream associated with emtricitabine, a blockbuster treatment for HIV which is sold as Emtriva. "Any time one monetizes an asset there is a risk that you'll be receiving less money up front than you would over time," admits **Steve Sencer,** deputy general counsel at Emory. "The imperative for Emory was that this was money we could use now and invest in Emory's programs, and that is what we are doing."

Late last year, Northwestern University inked a deal with Royalty Pharma that was even larger than Emory's. The institution sold a portion of its worldwide royalty interest in Lyrica, a drug manufactured by Pfizer, Inc. that is used to treat nerve pain associated with diabetes and shingles, and to manage pain in fibromyalgia patients. The pact gave Northwestern an immediate payout of $700 million, and since the institution only sold a portion of its royalty interest, it stands to continue to receive some royalties on sales of the drug, although the specifics of the deal have not been made public.

Susie Wuorinen, assistant general counsel at Northwestern, says the school structured the deal this way to maximize benefits to the university while also diversifying risk. "If you look at the industry, there are certain drugs that do really well, and then something occurs [such as introduction of competing products] that creates a reduction in the royalty stream that would come from those drugs," she explains. "At the same time, if you have a blockbuster drug like Lyrica, you might want to retain some of the royalty stream coming in, and Northwestern elected to do that so that it could keep taking advantage of the opportunities presented by the large market for the drug."

Deal structures have evolved

In recent years, financiers have come up with new methods for better meeting the needs of both buyers and sellers when structuring royalty monetization deals. In some cases, for example, the seller may just offer up one tier of the royalty stream, or up front payments may be reduced but supplemented by milestone payments due to the seller when sales reach certain targets.

Royalty monetization firms

Royalty Pharma
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New York, NY 10022
212-883-0200
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Paul Capital Healthcare
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New York, NY 10017
646-264-1100
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DRI Capital, Inc.
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416-863-1865
www.drugroyalty.com

Capital Royalty L.P.
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Houston, TX 77002
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www.capitalroyalty.com

Cowen Healthcare Royalty Partners
177 Broad St.
Suite 1101
Stamford, CT 06901
646-562-1168
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"Both parties now understand that the buyer is going to need to make some money, and the seller is going to have to take a little bit of a discount. So the focus is on structuring a deal that it is fair, and both parties know what they are getting," explains Berneman, noting that such provisions free buyers and sellers from having to focus so much energy on predicting the market for a product.

In addition, some royalty stream purchasers have adapted the royalty monetization concept so that it can also be used for products that are earning revenue but have no related royalty stream. "All a royalty consists of is a percentage of end-user sales, so if you don't have a royalty generating revenue, but you have a product generating revenue, and you want to sell us 5% of end-user sales, that is what we call a synthetic royalty," says **Walter Flamenbaum**, MD, a founding partner of Paul Capital Healthcare. "It has the same economic characteristics as a true royalty."

All of these newer monetization structures should be familiar territory for most TTOs, according to Flamenbaum, because they are based on the license agreement model.

Smaller players get involved

The size and scope of the Emory and Northwestern deals are unusual for universities, and most TTOs do not have those kinds of assets. However, there is no question that these high-profile deals have prompted tech transfer directors to take a more serious look at royalty monetization and what it could potentially do for their institutions. "Universities are naturally conservative institutions, so it takes some education," explains **Jim Webster**, managing partner of Houston, TX-based Capital Royalty L.P. "It is easier within these academic institutions not to take a risk and not to make a decision. After all, if you don't sell a royalty stream and it goes away, no one is the wiser. If you sell a royalty stream, and for some reason people think it was a mistake, it will become apparent … so there is a risk in making the decision."

Anthony Pirri, PhD, director of the division of technology transfer at Northeastern University, based in Boston, has not been involved with any royalty monetization transactions thus far, but he agrees that going forward with such a pact would not necessarily be a slam dunk at his institution. "It is a very difficult decision to make, and I am not sure how it would be received here," he says. "I would imagine that universities that tend to be strapped for money and looking for resources because they are not rich would find this attractive."

While the approach will not sit well with the philosophies and needs of all institutions, Webster believes TTOs are becoming more knowledgeable and sophisticated about the benefits of royalty monetization. And there is a burgeoning number of potential buyers for royalty streams, many of whom regularly call on universities and research institutions to market their firms and hopefully get first dibs on promising discoveries.

"What we did early on is … put a program in place to visit these institutions and their TTOs so that they would get to know us and understand the proposition we have to offer. We have direct relationships with most of the country's research institutions and their TTOs," explains **Mike Herman**, senior VP of investments at Royalty Pharma, one of the biggest players in the royalty monetization arena. In fact, Herman points out, buyers are often happy to give TTOs an idea of what a particular asset's royalty stream is worth at no charge. "There is no harm in considering a transaction. Just getting a quote or a bid from someone does not require [the TTO] to continue the pursuit of the transaction," he says.

Further, Herman maintains that while deals worth hundreds of millions of dollars get most of the press, smaller transactions can make sense as well. And you don't have to be a major research institution to get in the game. "There is a fair level of serendipity involved in creating or patenting technology that turns out to be a commercial success, so we've seen these assets held by institutions who you might not think may have a patent on a scientifically important technology, but they do," he says. Along with some deals with major research universities, Royalty Pharma has inked deals with smaller institutions such as the University of Cincinnati, Children's Hospital in Boston, and the Philadelphia-based Wistar Institute, Herman reports.

Size matters

However, both small and large players should understand that executing a royalty monetization agreement can take months of work, complex negotiation, and involve multiple experts, some of whom may require a percentage of the deal. For example, when there are multiple suitors for a particular asset, investment bankers are typically utilized to hold an auction and accept bids for the TTO and its sponsoring organization to consider. Given the expense of the process, some smaller deals will not make financial sense for either the buyer or the seller, but market potential is a big factor. "If you have a million dollars coming in per year, it is not going to lend itself to monetization," says Webster. "However, if you have something that is small and will grow to $10 million or $20 million a year, that is a different matter."

Another important consideration has to do with how far along toward commercialization a product is when a university elects to partner with a pharmaceutical company or another outside entity. "The earlier one partners in general, the lower the royalty rate. The later one partners, the more ability you have to control the situation, and the higher the rate," explains Flamenbaum.

He stresses that universities need to understand that most royalty monetization deals will not bring in the kind of revenue that Emory and Northwestern realized from their blockbuster drugs. "Most products are small, and most royalties are small, so please don't look for everybody to do a $600 or $700 million deal, because that is not going to happen."

Nonetheless, all the investment in biotechnology and medical device research that took place in the 1980s and 1990s is now coming to fruition, and this is expected to fuel continued growth in royalty monetization in coming years, according to **Todd Davis**, managing director of Cowen Healthcare Royalty Partners, based in Stamford, CT. "Many of those technologies were born in start-up companies and universities, and as those products have been commercialized, we're seeing more and more royalties -- which means that the total available market of royalties is growing," he says. "That is compounded by the fact that there is growing awareness of [royalty monetization] as an alternative, and a growing level of comfort with this as an alternative."

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