Synthetic Royalty and Drug Development Financing Study

2019-2023

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Overview

As highlighted in the preamble to our inaugural study published last year, the cost for research and development of new drugs has continued its exponential climb since the 1950s. To address these growing costs, in addition to more conventional equity, debt and out-licensing transactions, life sciences companies now also turn to the market for "synthetic royalty" and drug development financings.

With equity markets in 2023 virtually grinding to a halt, rising interest rates tempering debt markets, and biotech bankruptcies at an all-time high, last year was challenging. Synthetic royalty and drug development financings were also affected, with the number of transactions down, and completed transactions smaller in size.

In addition, all deals were secured by collateral, including intellectual property and other product assets. This follows the December 2022 Mallinckrodt bankruptcy decision, which as explained in our client alert, exposed the risk in relying on unsecured rights to receive future royalty payments.

With the IPO market beginning to open up, we will see what 2024 brings, but the year got off to a big start with a $500 million synthetic royalty financing in early January, just a few days past the end date for this study.

In the following pages, we present our updated study, which covers the period from January 1, 2019 to December 31, 2023 for transactions involving at least $25 million entered into by public biotech companies.

Although commercially sensitive information was redacted from some publicly filed documents, sufficient information was available to provide a good sense of market terms.

Contacts and Further Information

If you would like to learn more details about our study and this growing market, please feel free to reach out to us.

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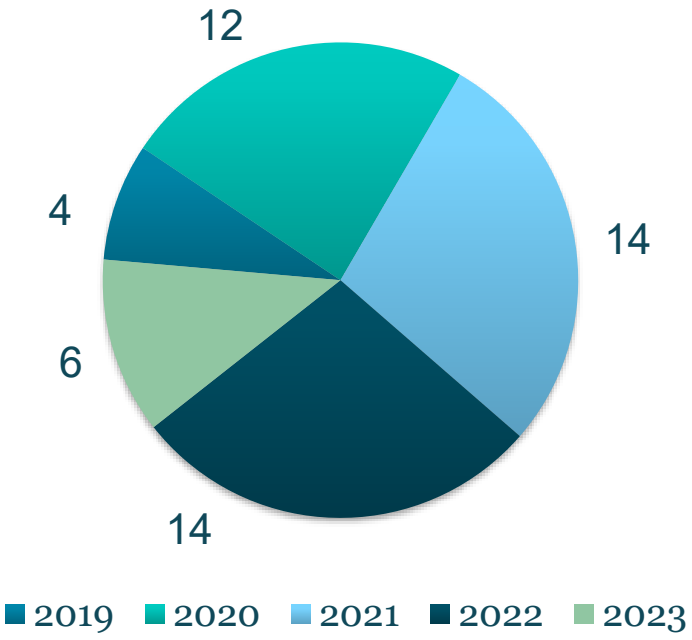
Summary of Transactions Reviewed

50
Total Transactions

23
Unique Investors



Key Finding

While transaction volume was down in line with the rest of the market in 2023, the overall trend was a steady increase from 2019 through 2022, and we see interest in these financings from a growing universe of investors.

13
Investors with Two or More Transactions

8
Investors with Three or More Transactions
(Increased from 6 in the last study)

6
Investors with Four or More Transactions
(Increased from 5 in the last study)

3
Investors with Five or More Transactions
(Increased from 2 in the last study)

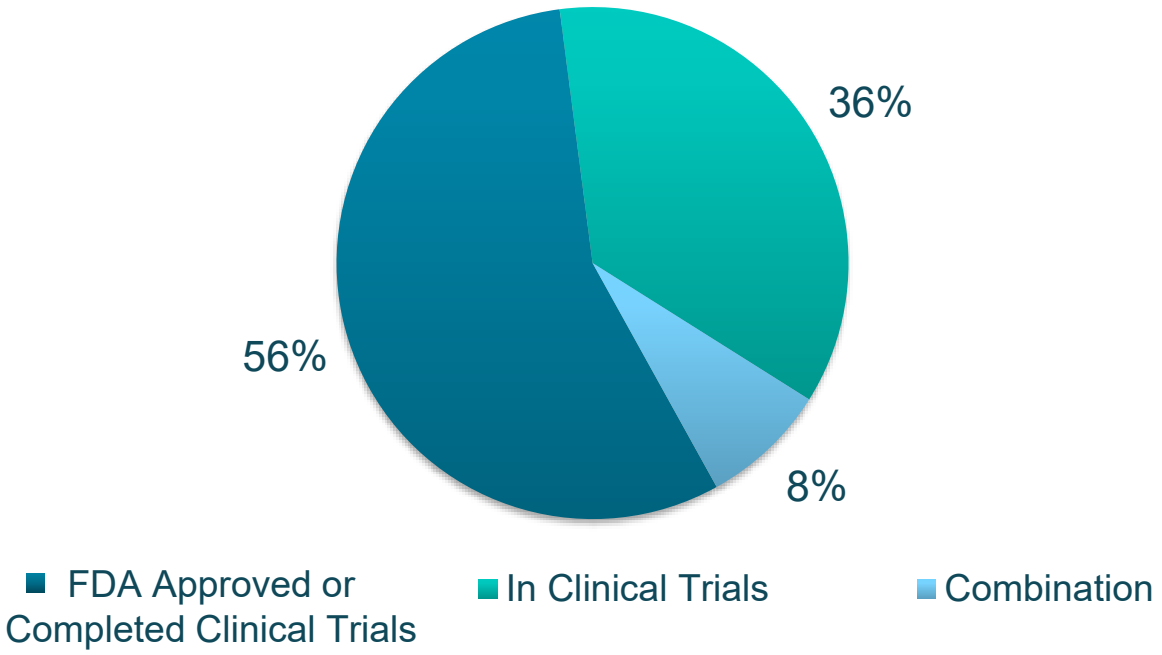
Summary of Transactions Reviewed

$50,000,000
Median Up Front Payment

$120,000,000
Median Total Commitment

$25,000,000
Smallest Total Commitment

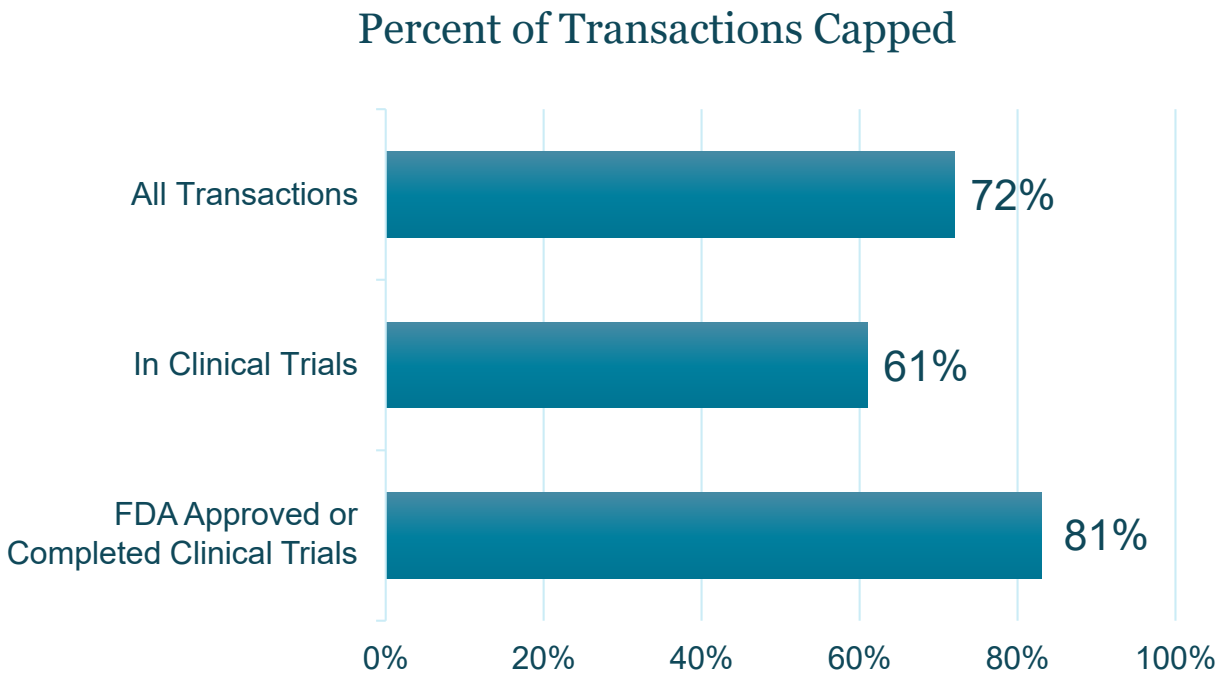
$325,000,000
Largest Total Commitment



Key Finding

Transactions primarily involved drugs either in or starting pivotal trials or already approved by the FDA.

Maximum Return Multiple for Capped Transactions



1.94 Times
Median Return Cap Multiple
FDA Approved or Completed Clinical Trials

4.25 Times
Median Return Cap Multiple
In Clinical Trials

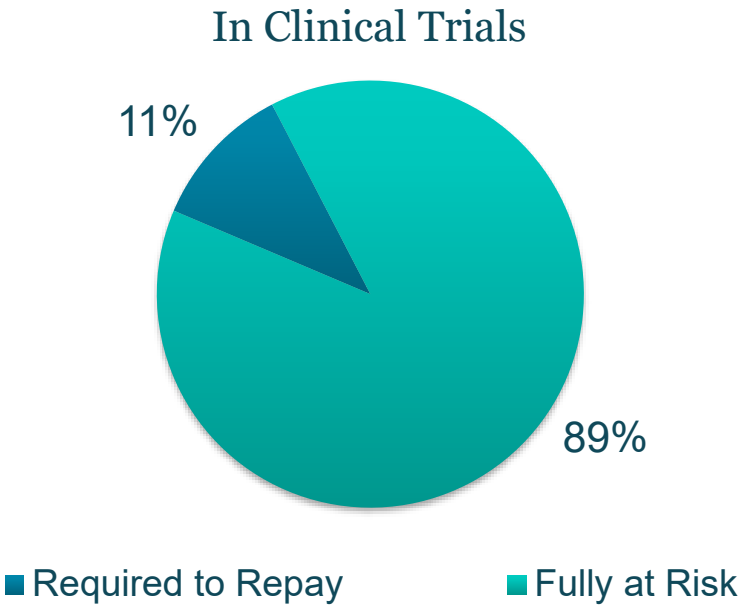
1.55 Times
Return Cap Multiple
Lowest Multiple

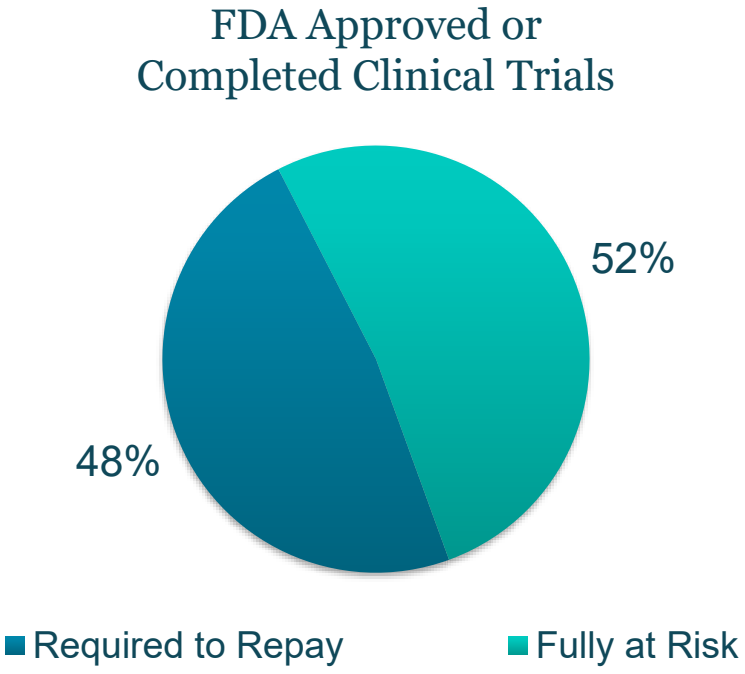
11.14 Times
Return Cap Multiple
Highest Multiple

Key Finding

A significant majority of the transactions capped the return available to the investor at a multiple of the invested amount. The size of this cap was generally inversely related to the stage of regulatory approval of the drug at issue, with debt-like investor returns for established products and equity-like investor returns for riskier products under development.

Requirement to Repay Financing



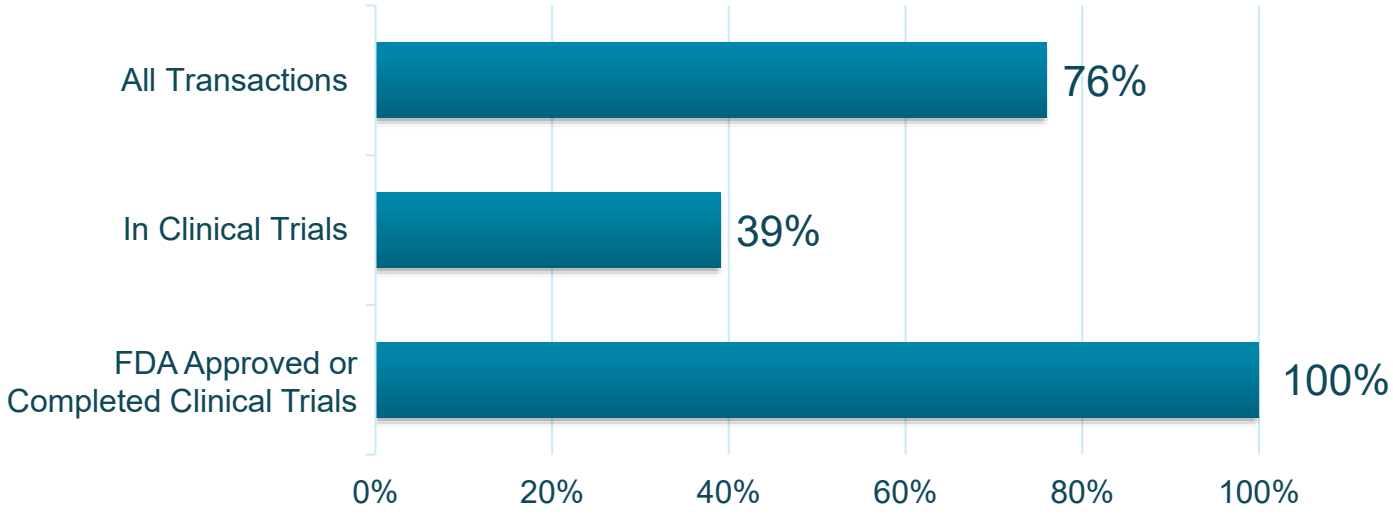


Key Finding

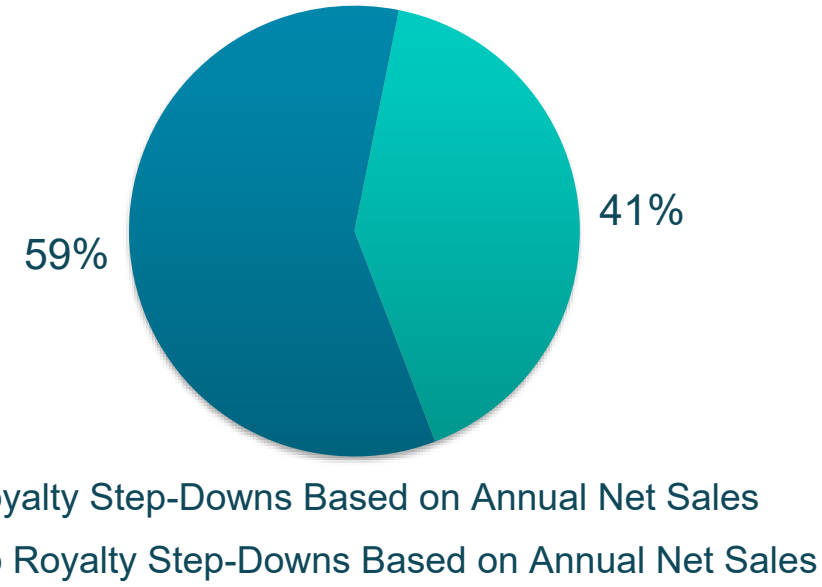
Transactions involving drugs at an earlier stage of development generally did not have any absolute requirement to repay the funded amount, while those involving drugs near or with FDA approval were evenly split between transactions with and without that requirement.

Royalty Rate Economics

Percentage of Transactions with Solely Synthetic Royalty Compensation (No Milestone Success Payments)



Within Solely Synthetic Royalty Compensation Transactions

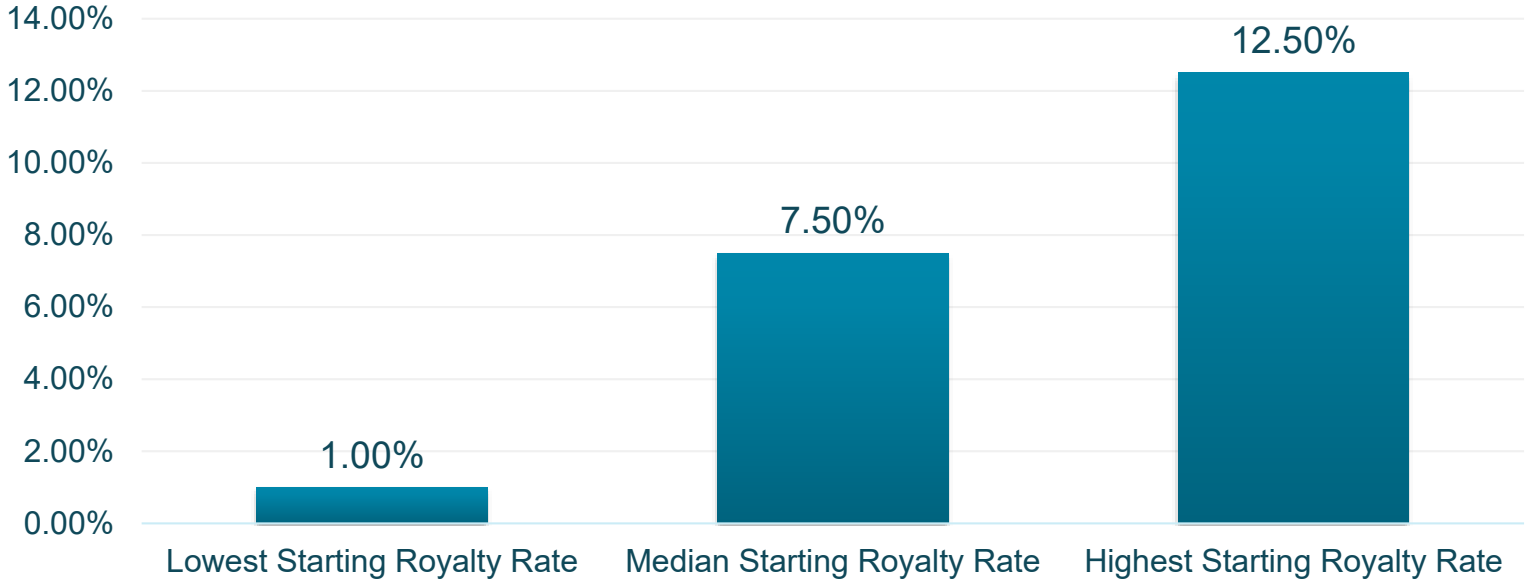


Key Finding

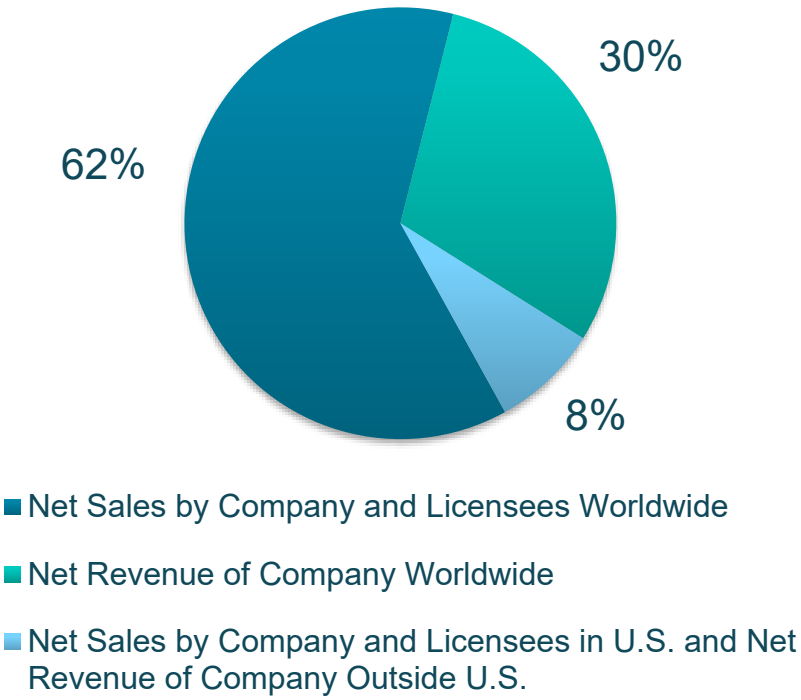
Royalty payment economics in the transactions demonstrated a broad range of structures, with a fully synthetic royalty structure the norm for products that are FDA approved or have completed clinical trials.

Royalty Rate Economics

Within Solely Synthetic Royalty Compensation Transactions



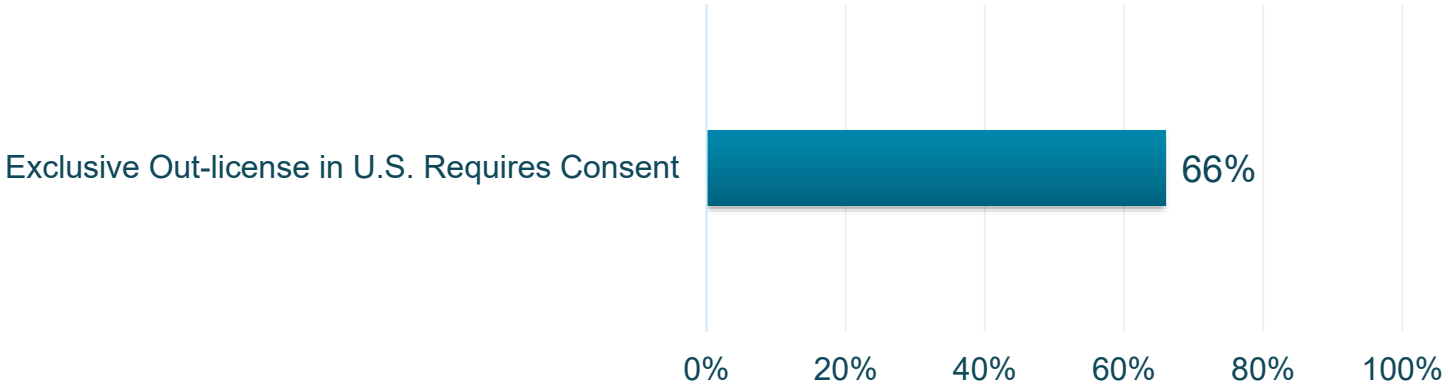
Synthetic Royalties Calculated Based On



Key Finding

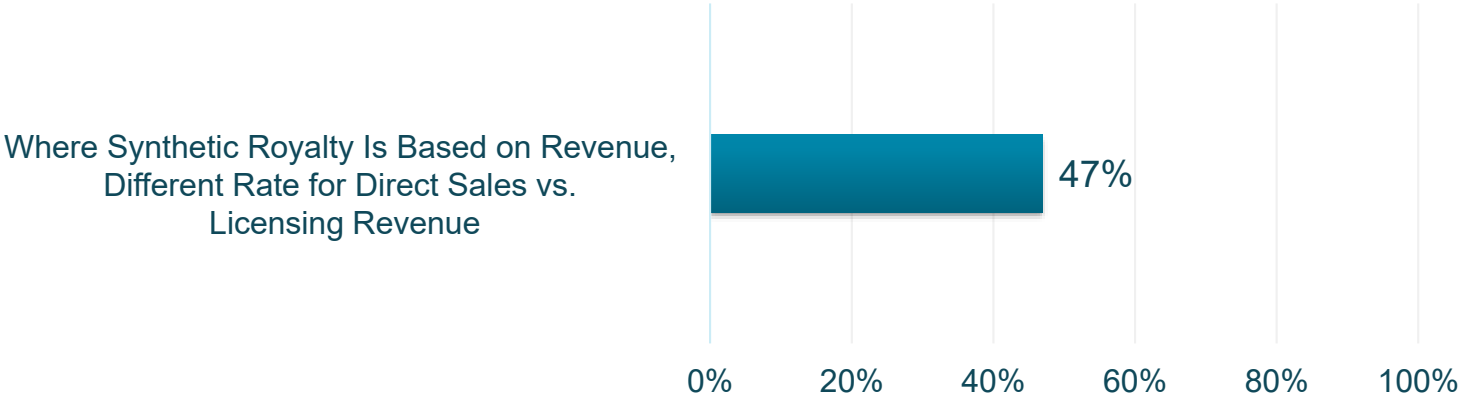
Although a majority of the transactions calculated the synthetic royalty based on net sales by the Company and its licensees, a number of transactions calculated the synthetic royalty solely based on revenue received by the Company, in particular with respect to sales outside of the U.S.

Synthetic Royalty Rate Calculation



Key Finding

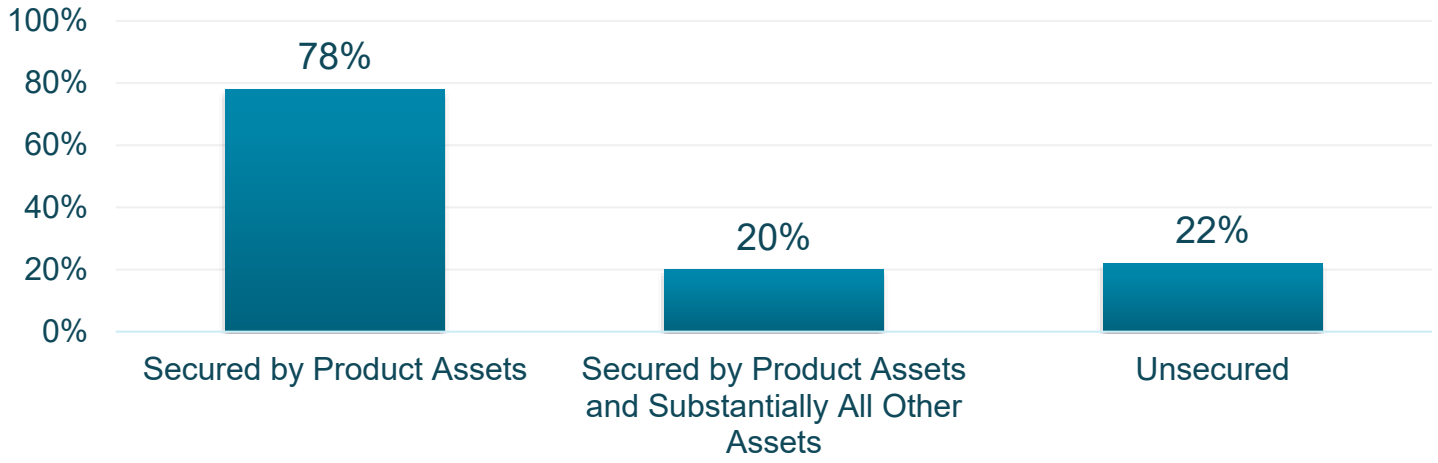
The majority of agreements prohibited exclusive U.S. out-licensing without investor consent.



Key Finding

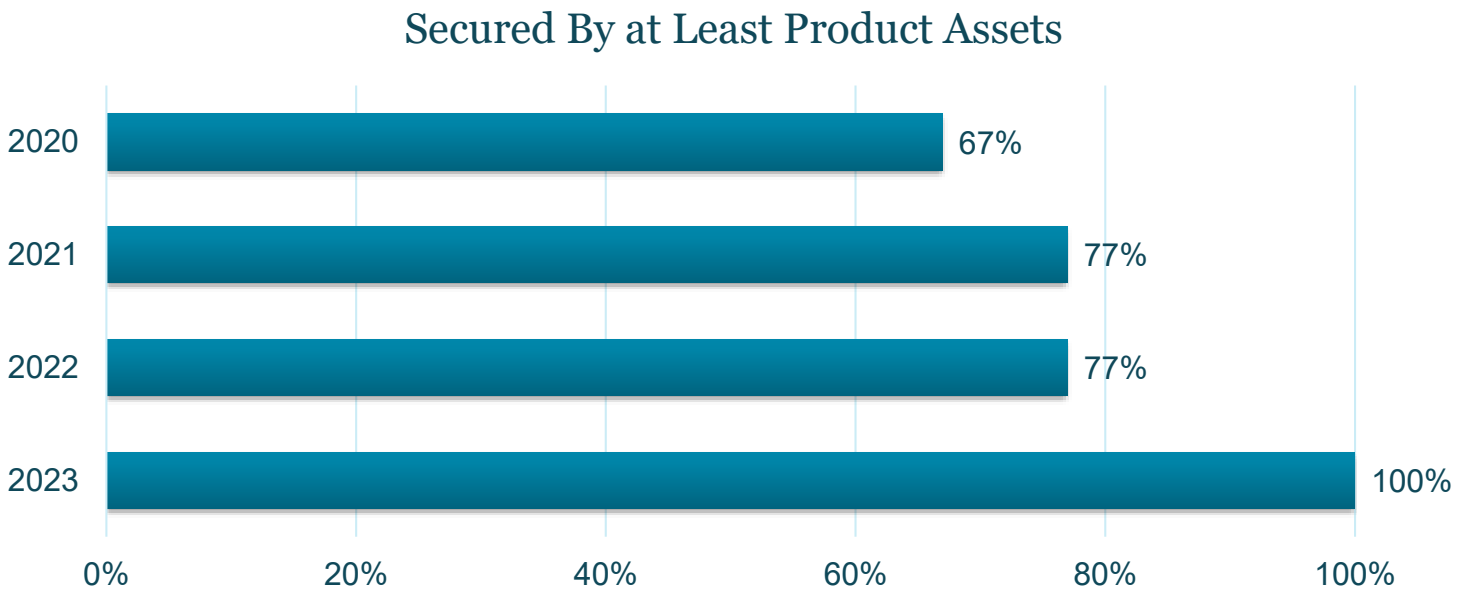
The synthetic royalty rate did not differ in approximately half of the transactions for direct net sales revenue vs. licensing revenue (licensing revenue typically being lower than direct sales revenue). The differing treatment may be due to whether the parties desired differential synthetic royalty rates for sales and licensing revenues or preferred a blended royalty rate.

Collateral



Key Finding

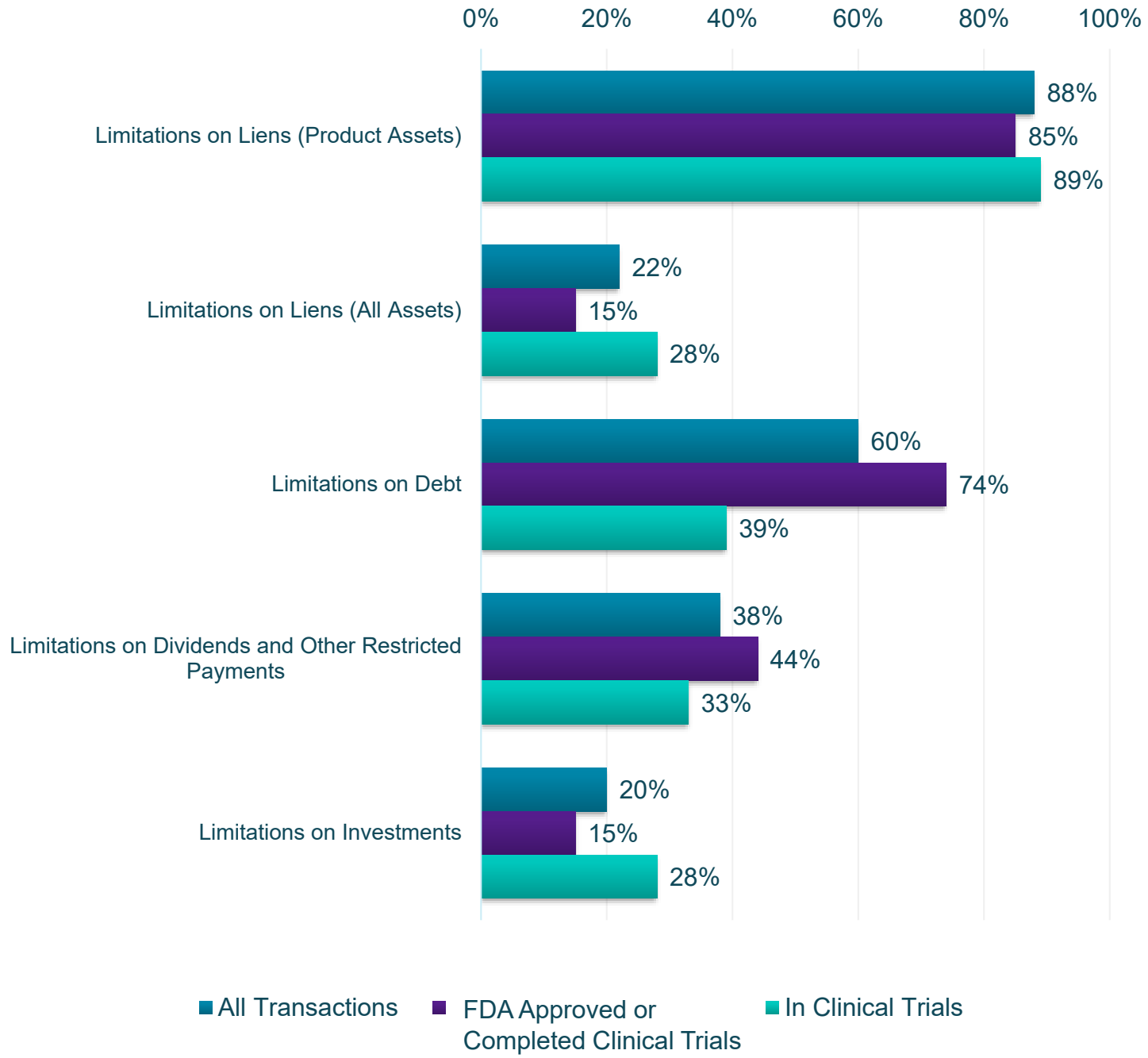
These transactions are often secured by product assets (such as intellectual property, contract rights, and related assets), and in some cases by all assets.



Key Finding

There is a clear trend toward these transactions being secured by intellectual property and other product assets.

Negative Covenants

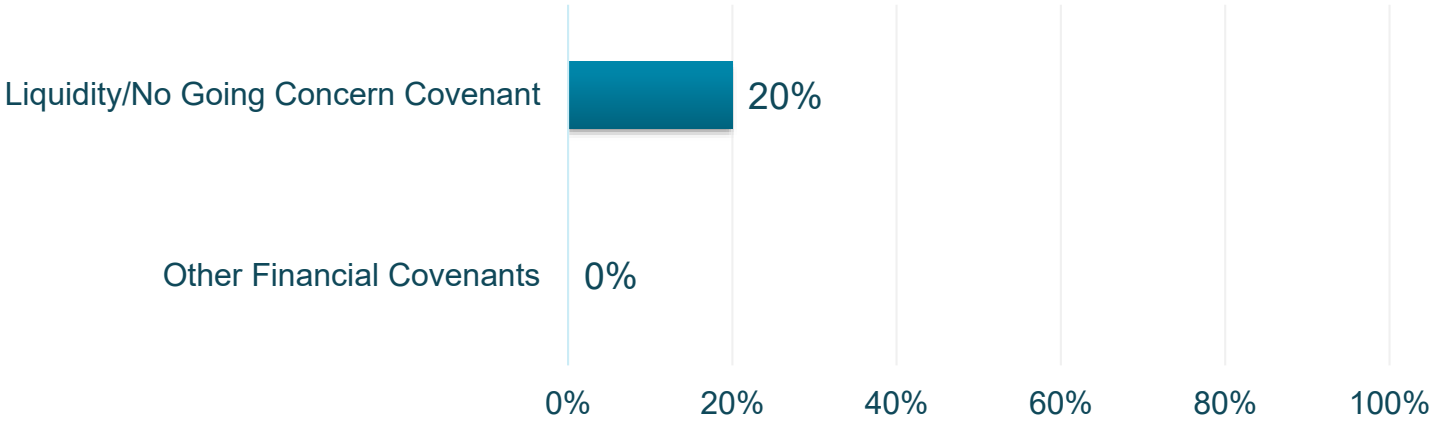


Key Finding

Covenants were generally less restrictive for these transactions as compared to debt transactions.

Negative Covenants

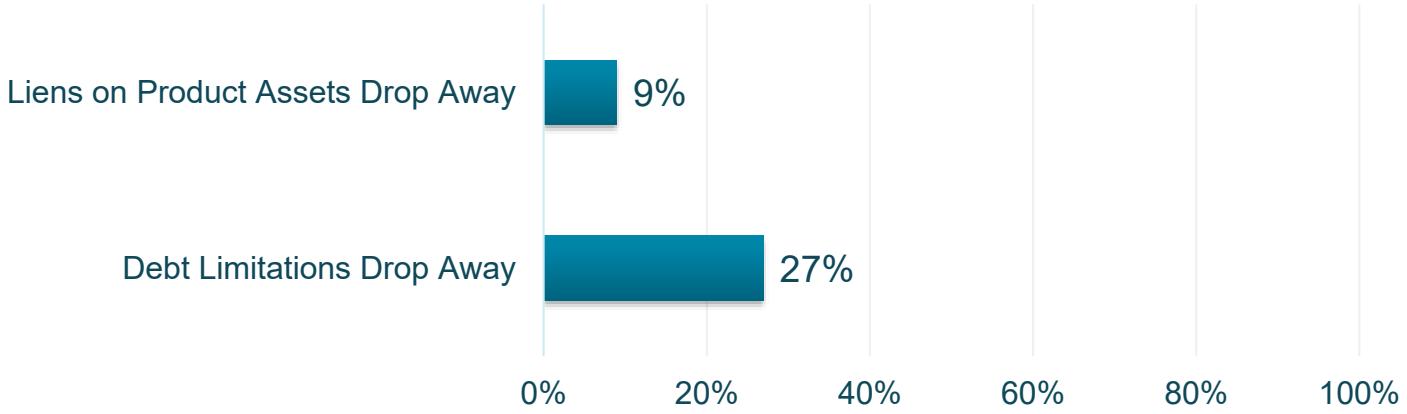
Financial Covenants



Key Finding

Financial covenants were rare in these transactions, and when included were limited to liquidity or related concepts.

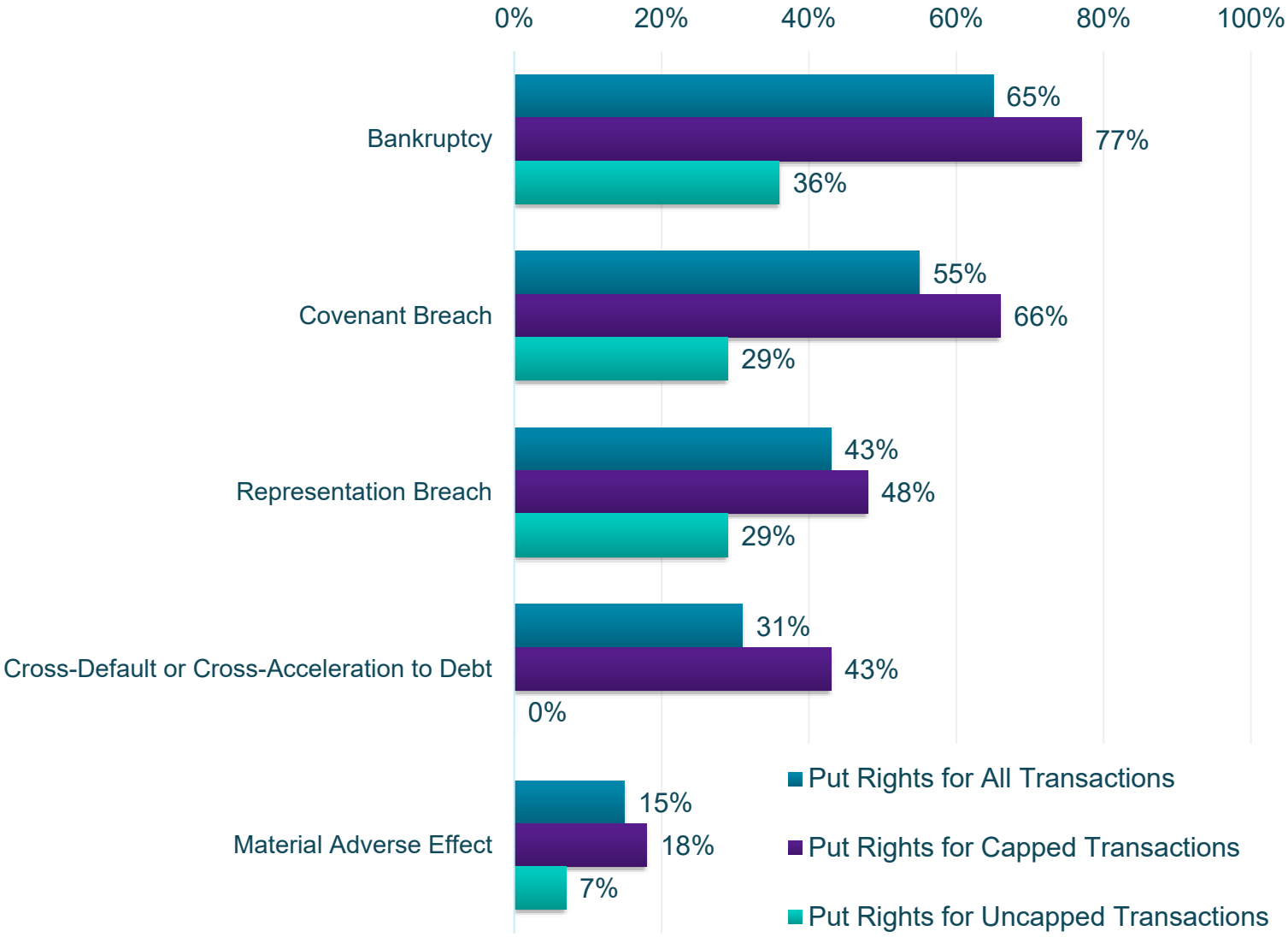
Investor Protections Drop Away on Specified Investor Returns



Key Finding

Some agreements had certain investor protections fall away upon the achievement of specified returns.

Investor Put Rights



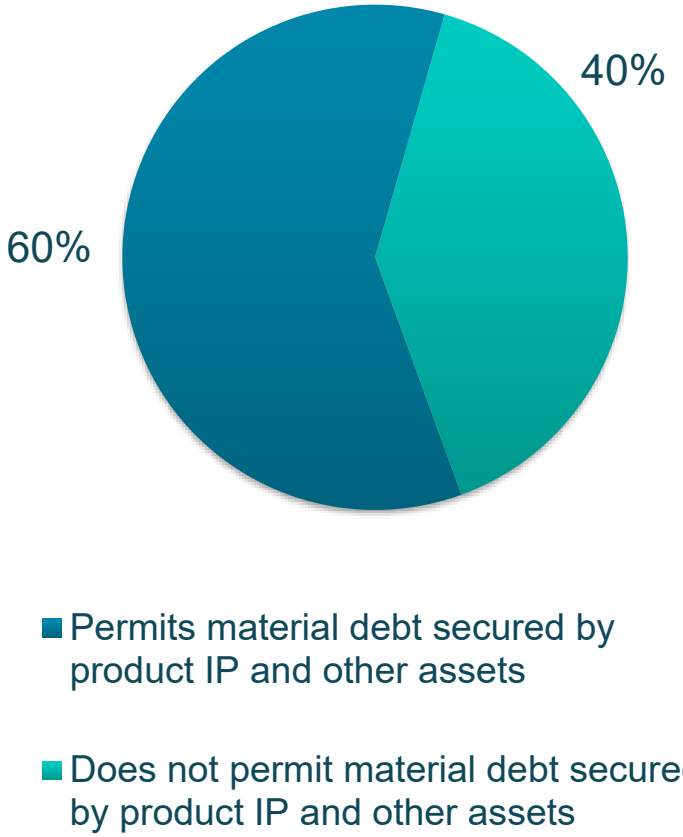
Key Finding

Put rights give the investor a return of their capital plus an agreed multiple upon certain events, which are comparable to events of default in debt transactions.

Absent a put right, the typical remedy for the investor would be an indemnity or breach of contract claim for damages.

Transactions vary widely on their inclusion and details of put rights.

Intercreditor Issues



Key Finding

A majority of the transactions permitted material debt to be secured by product assets. In such cases, there is usually an intercreditor agreement put into place that spells out how the transaction will co-exist with this other debt, in particular if the company encounters financial distress or files for bankruptcy protection.

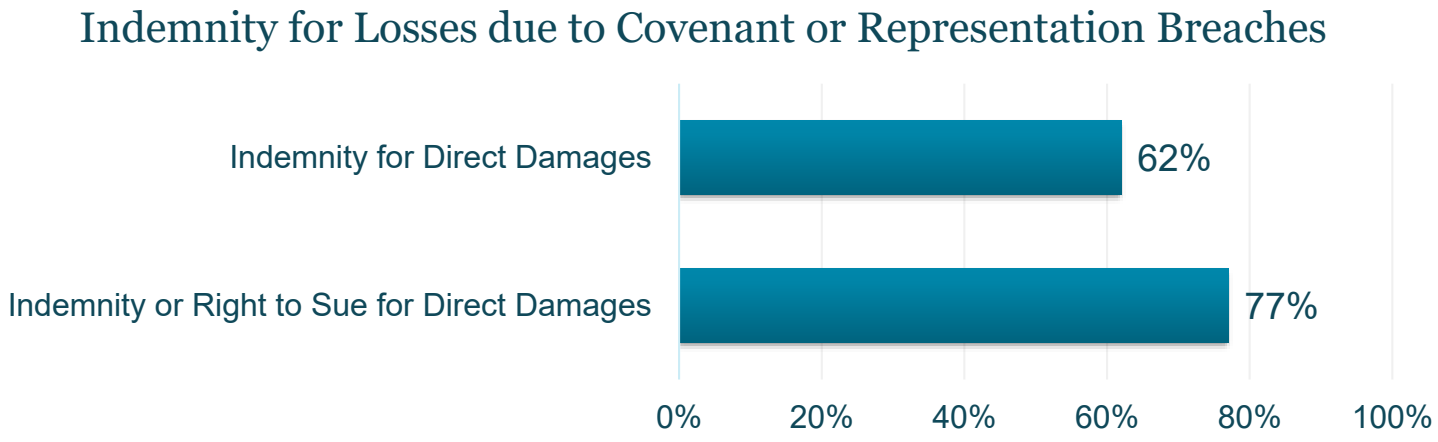
Key Finding

Because intercreditor agreements are not typically publicly filed, there is limited public data on those agreements.

From a business perspective, parties often desire that the investor remain entitled to synthetic royalty and milestone payments, even after an asset sale or bankruptcy.

However, in the event that bankruptcy courts do not honor this desired treatment, intercreditor agreements often provide in the alternative that proceeds from a sale, restructuring or bankruptcy be allocated among the investors and secured lenders according to an agreed waterfall.

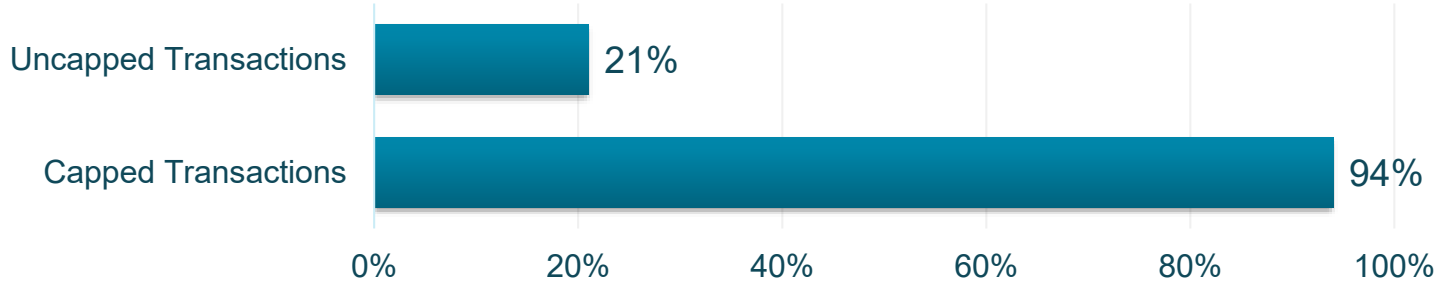
Indemnities



Key Finding

Companies generally agreed to indemnify investors from third party claims caused by breaches, but a majority also indemnified investors for all (not just those from third party claims) losses due to breach. An additional subset contemplated the possibility of suing for damages (even if there was no direct indemnity).

Company Buy-Out Rights



Key Finding

Given that capped transactions set a ceiling on returns, most of these transactions included the ability for the company to terminate the contract early by paying a specified amount. This flexibility is much less common for uncapped transactions, where the upside potential for the investor is greater and a buyout price more difficult to calculate.

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