



# Financing Life Sciences

## Royalty Monetization Study 2019-2023

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## Overview

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A biotech company that has developed and out-licensed innovative technology is faced with a pressing question during its lifecycle: what to do with potentially valuable incoming royalty and milestone payments that may stretch far into the future?

If the company wants to accelerate those future payments to invest in its business now, a royalty monetization transaction provides a solution that blends aspects of asset sales and debt financings. Like in an asset sale, a royalty monetization investor purchases an asset from a seller (in this case, the right to receive a future stream of payments under a particular agreement). As in a debt financing, the investor expects to earn a specified return by providing funding up front in exchange for the right to receive future payments. But in a royalty monetization, the seller is typically not responsible for those payments. Instead, the investor looks primarily to the product underlying the royalty stream.

Royalty monetizations are available to companies that have contractual rights to future payments and are not an option for companies at an earlier stage of growth. These transactions permit sellers to raise capital while retaining ownership and control of their businesses without the restrictive covenants you might see in debt financings or the dilution inherent in raising capital through issuing equity.

Because of the limited universe of companies that can engage in these transactions, royalty monetizations remain a smaller and less well understood market than other more conventional forms of financing. In order to shed some light on these transactions, we have reviewed deals of this type involving commitments of at least \$15 million entered into by biotech companies with equity listed on U.S. stock exchanges in the last five calendar years (January 1, 2019 to December 31, 2023). As a separate segment of this market involves sellers that are not public filers (such as universities, non-profit organizations, inventors and private companies), and big pharma companies for which the underlying agreements are not of sufficient materiality for them to be publicly filed, this is necessarily only a snapshot of the market (but one that is generally representative, based on our experience in those other sectors of the market).

In the following pages, we present a summary of our key findings.

## Contacts and Further Information

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If you would like to learn more about the findings in the study, please feel free to reach out to us.

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## Table of Contents

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Summary of Transactions Reviewed.....	3
Approval Status.....	4
Return Caps and Termination Dates.....	5
Geography of Royalties Sold .....	7
Milestones Included.....	7
Royalty Limited to Specific Product.....	8
Requirements to Repay.....	8
Adjustments in Percentage of Royalties Sold.....	9
License Agreement Consents.....	10
Collateral Matters, SPVs and True Sale Considerations.....	11
Patents Licensed to Payor.....	12
Negative Covenants.....	13
Financial Covenants.....	13
Investor Put Rights.....	14
Obligation to Use Efforts to Replace License Agreement.....	14
Representation on Enforceability of License Agreement.....	15
Indemnities.....	16
Seller Buy-Out Right.....	18
Escrow Account Structure.....	19

*This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.*

## Summary of Transactions Reviewed

**39**

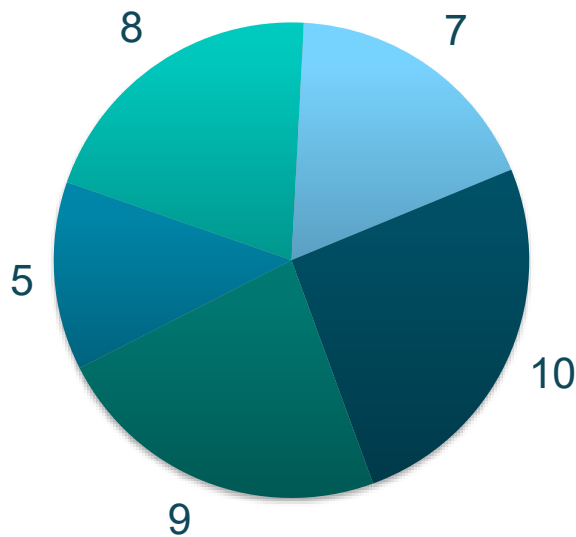
Total Transactions

**14**

Unique Investors

**3**

Investors with Five or More Transactions



■ 2019 ■ 2020 ■ 2021 ■ 2022 ■ 2023

### Key Finding

Transaction volume has generally increased throughout the period.

**\$128.4 million**

Median Up Front Payment

**\$177.5 million**

Median Commitment

**\$1.125 billion**

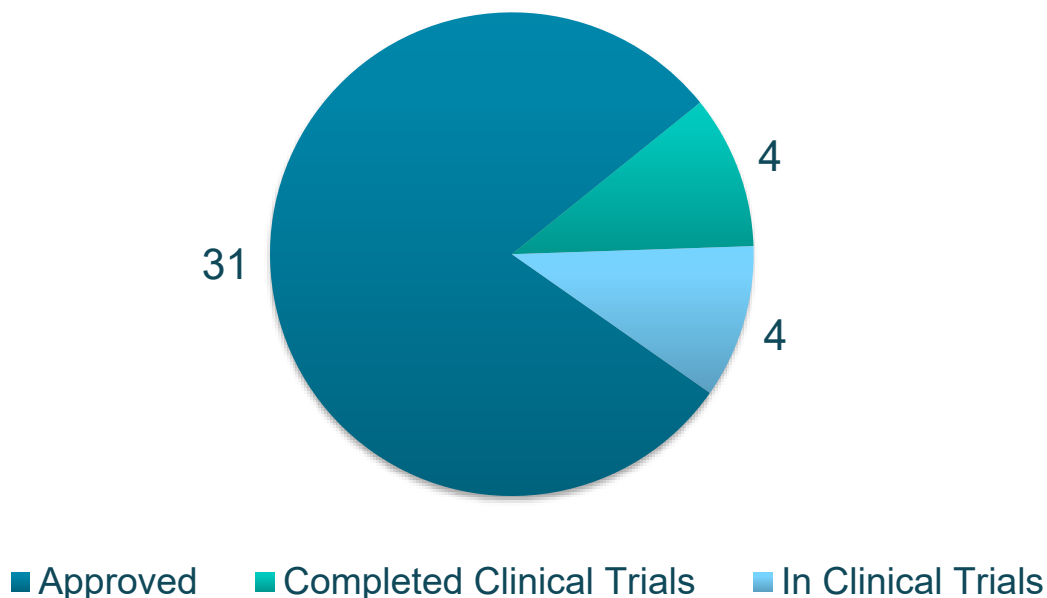
Largest Commitment

**\$17 million**

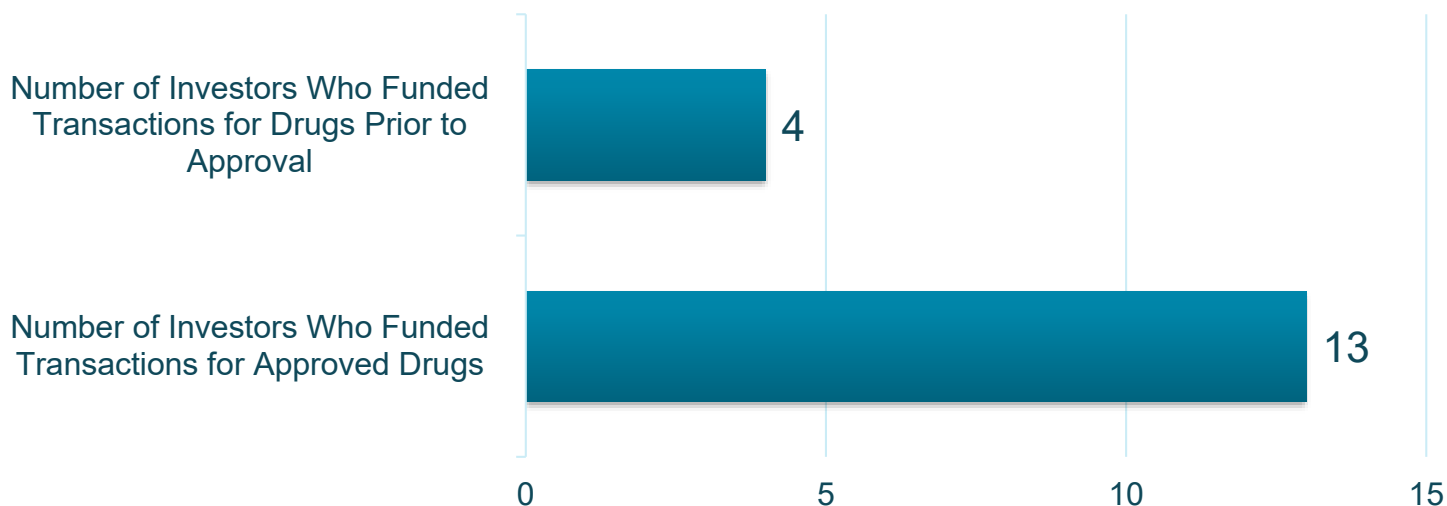
Smallest Commitment

## Approval Status

Drug Approval Status Upon Initial Funding



Unique Investors Who Funded Transactions

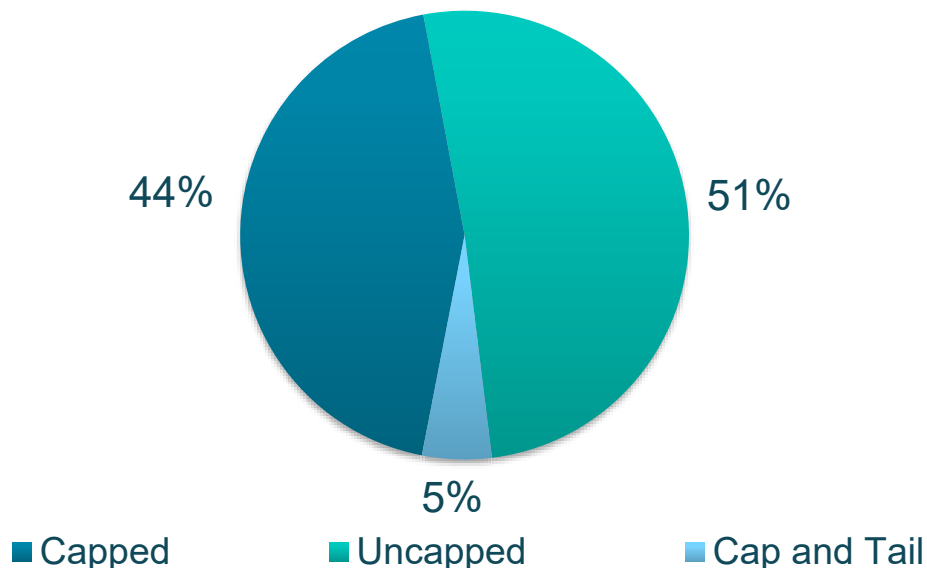


### Key Finding

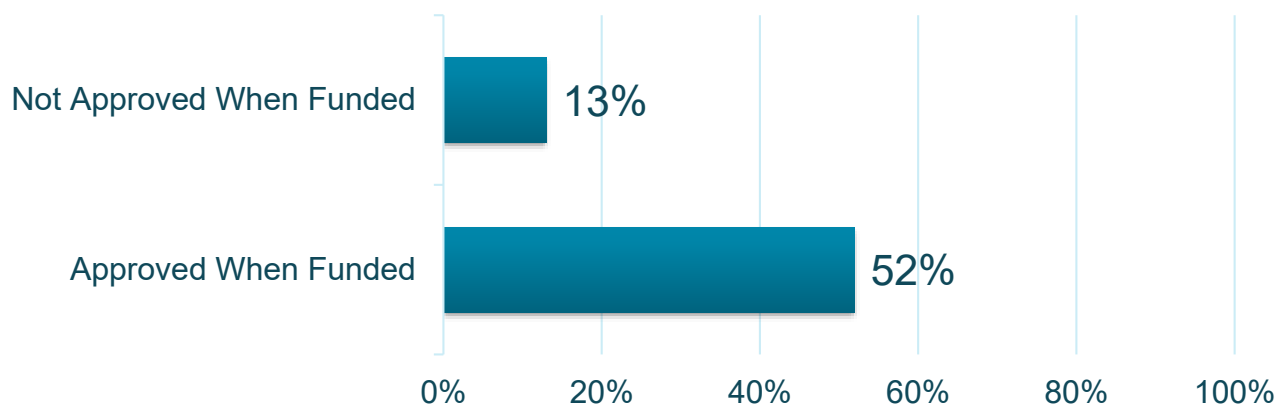
Most of the transactions involved drugs approved in at least one material jurisdiction. Although pre-approval transactions can get done, there are fewer investors interested in that structure, given its greater risk profile.

## Return Caps and Termination Dates

Investor Return Capped<sup>1</sup>



Investor Return Capped – By Drug Approval Status at Funding



### Key Finding

Some transactions involved the purchase of the full amount of a royalty stream, while others had the royalty stream revert back to the seller once a particular return cap was met. Return caps were less common for transactions involving unapproved drugs, where the investment risk was higher.

<sup>1</sup>Note that where this Study lists percentages, we generally excluded transactions in the limited cases where the applicable data was redacted.

## Return Caps and Termination Dates

### Maximum Return Multiple for Capped Deals

**1.3 Times**  
Lowest Multiple

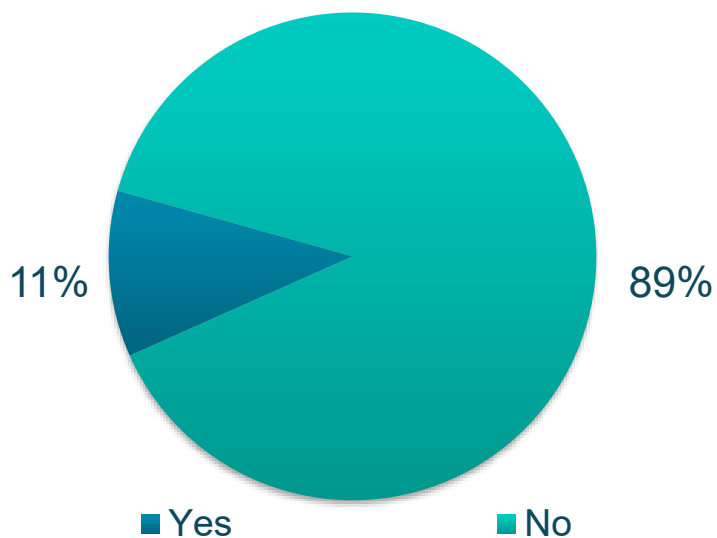
**2.25 Times**  
Median Multiple

**3.4 Times**  
Highest Multiple

#### Key Finding

The return multiples are somewhat similar to those found in our [Synthetic Royalty and Drug Development Financing](#) study for synthetic royalty financings (Median – 1.94x; Lowest 1.55x).

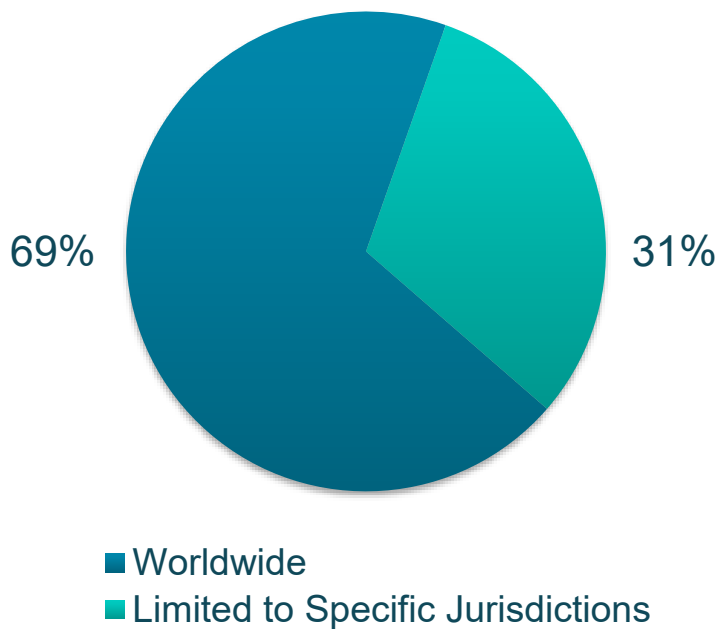
### Fixed Date for Termination of Royalty Payments



#### Key Finding

Although a number of transactions had caps on investor returns, very few fixed the limits for the purchased royalty period.

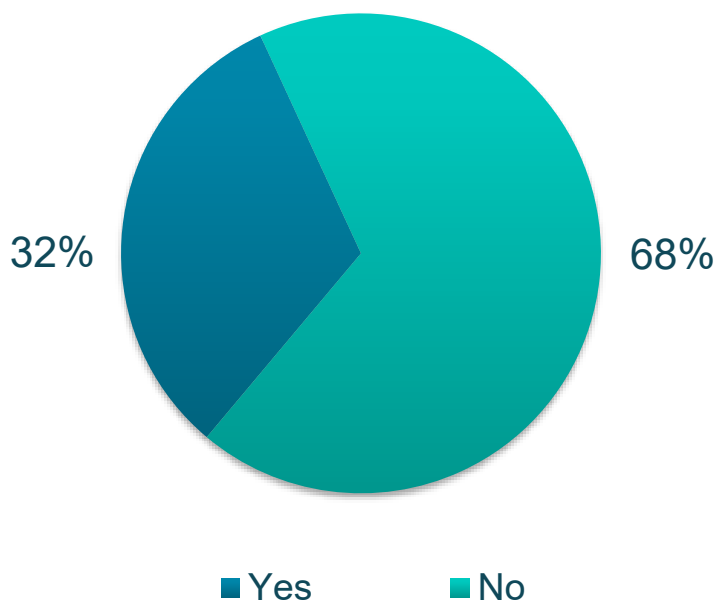
## Geography of Royalties Sold



### Key Finding

Most transactions included a sale of worldwide royalties, but a minority focused on specified jurisdictions.

## Milestones Included

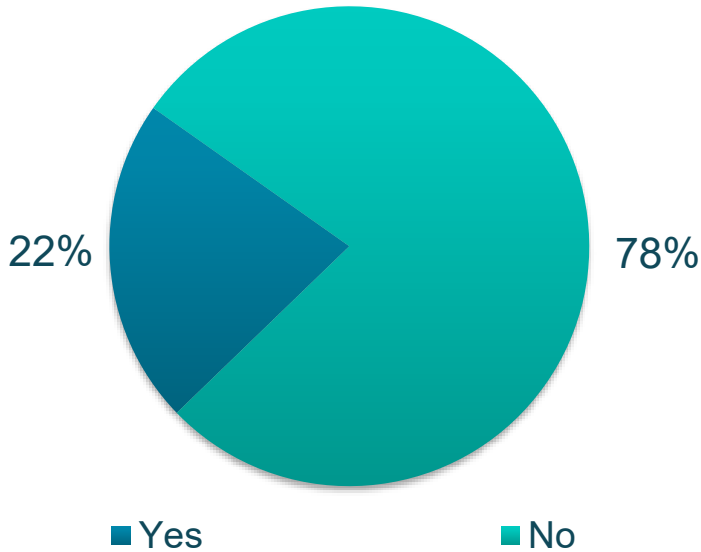


### Key Finding

A minority of transactions included the purchase of milestones, and those that included purchased milestones did not necessarily include all milestones payable under the relevant agreement, highlighting the ability of sellers to retain certain economics.



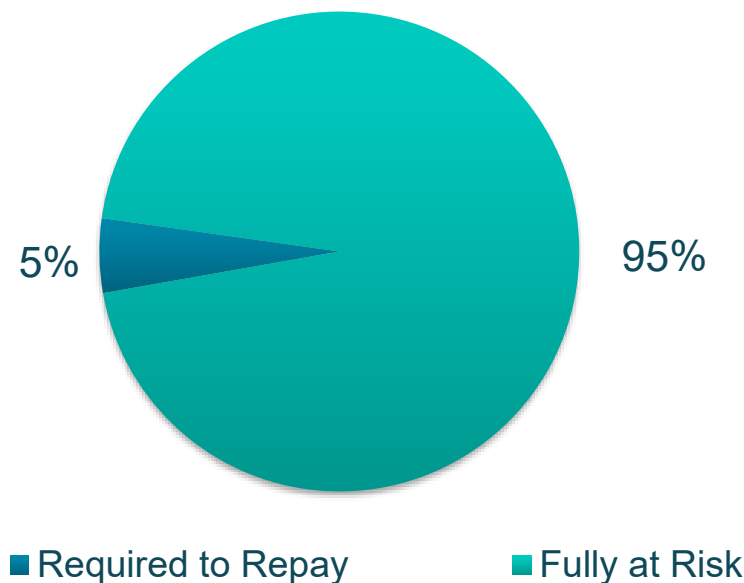
## Royalty Limited to Specific Product



### Key Finding

A significant majority of transactions contemplated (or did not explicitly exclude) royalties in respect of new licensed products under the applicable agreements, rather than confining the royalty stream to a specific product.

## Requirements to Repay

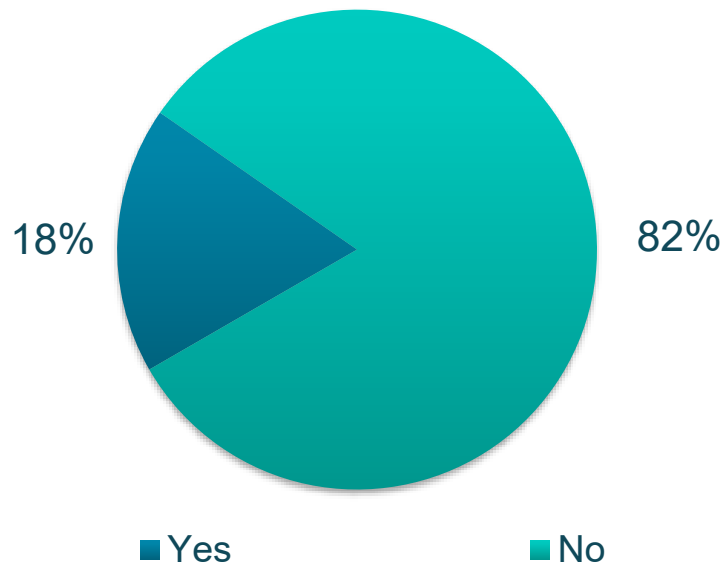


### Key Finding

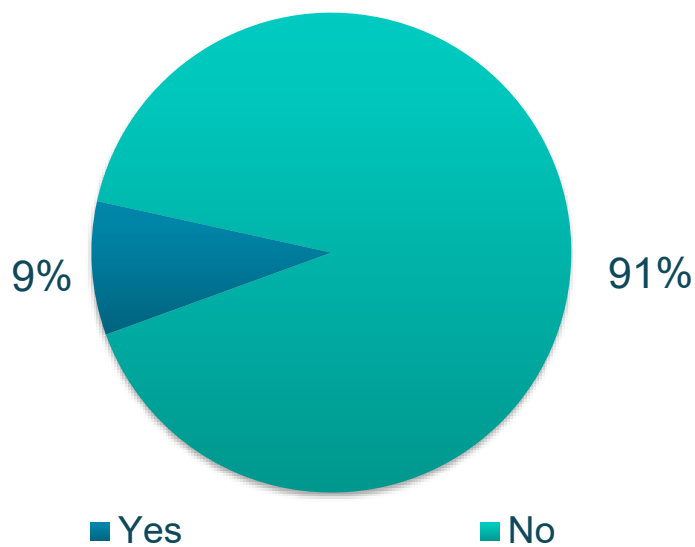
Given that traditional royalty monetizations rely on the royalty stream as a source of repayment, it is not surprising that only in very rare cases do sellers have any fixed obligation to repay any of the advanced funds, regardless of the amount of royalties received. This is an important distinguishing factor of these transactions from debt financings.

## Adjustments in Percentage of Royalties Sold

### Downward Adjustment



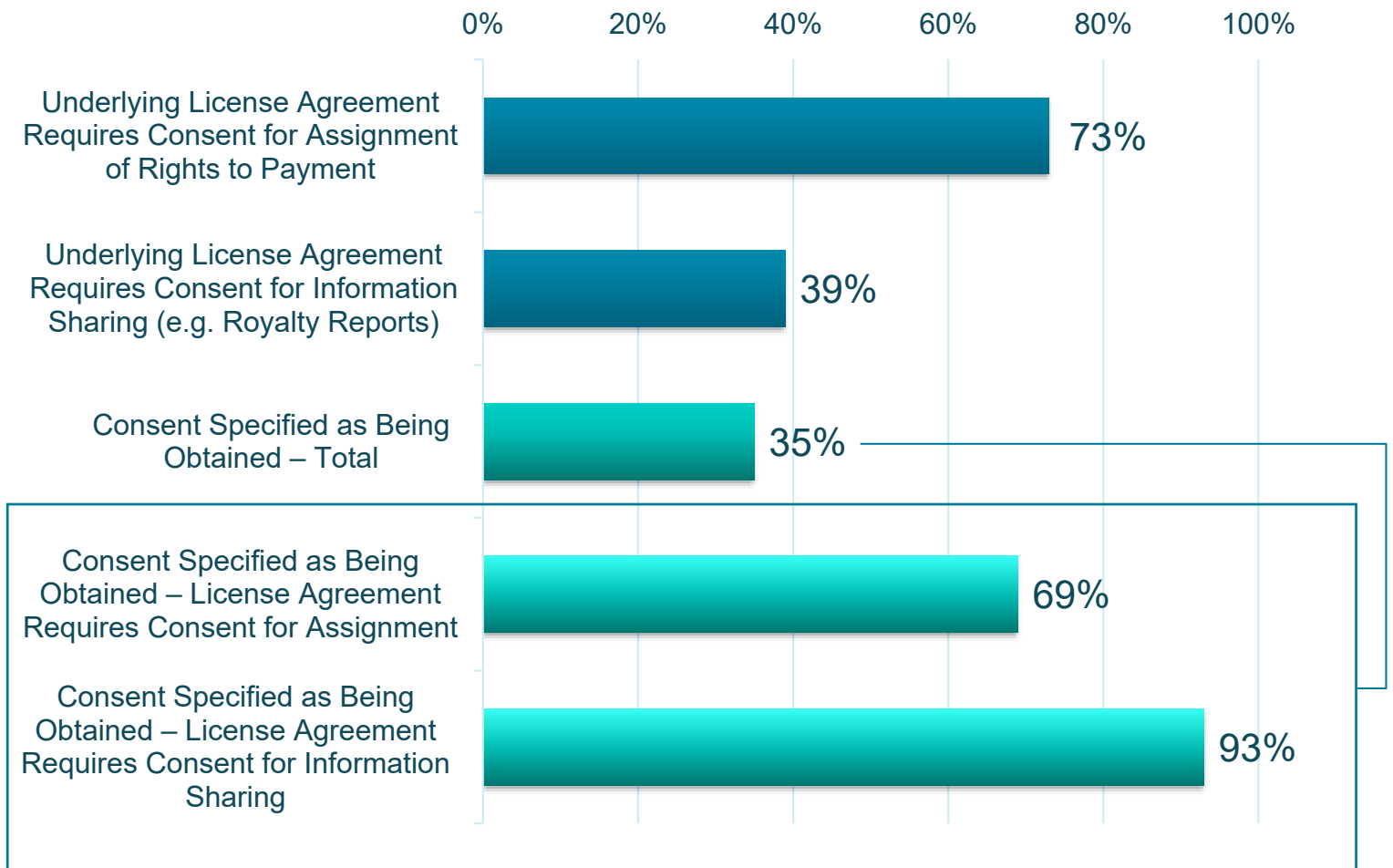
### Upward Adjustment



### Key Finding

A minority of royalty monetization transactions increase the percentage of royalties sold in the event certain metrics aren't met—typically return thresholds as of a specified date. They may also step down based on the achievement of certain economic thresholds. However, most transactions reviewed did not provide for adjustments to the percentage of royalties sold.

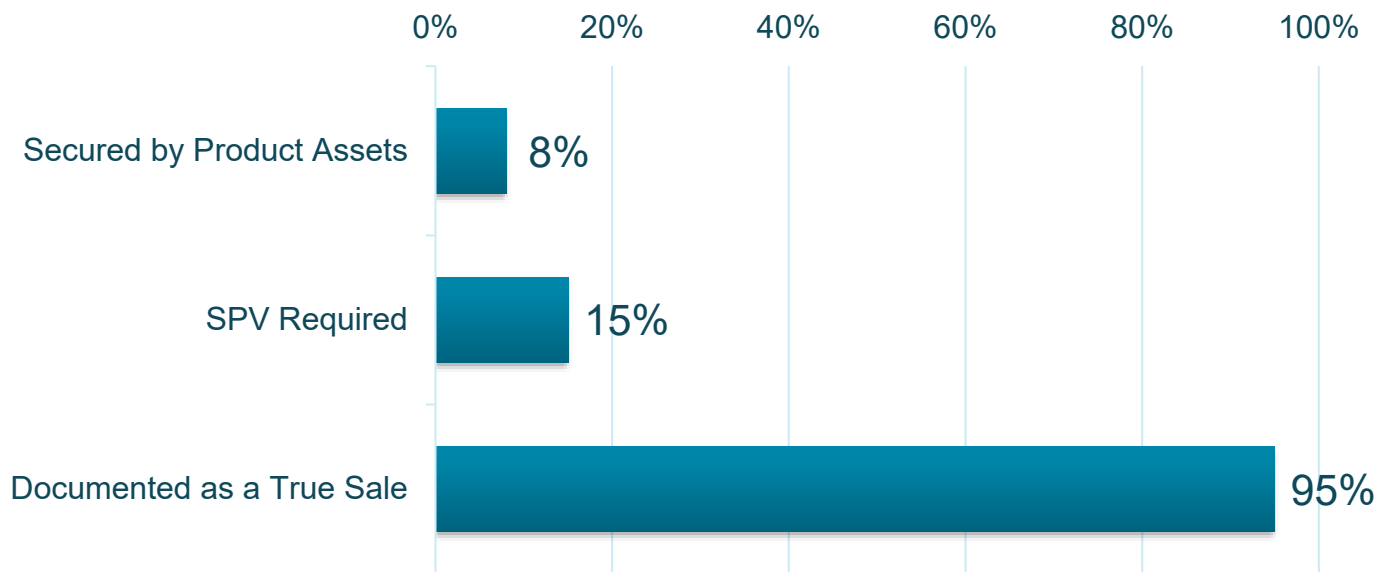
## License Agreement Consents



### Key Finding

While the underlying license agreements under which royalties are paid required consent to assignment in a majority of cases, the data suggests the parties may not have always obtained such a consent. In such circumstances, buyers may rely on a statutory Uniform Commercial Code override (UCC Section 9-406), which provides that contractual restrictions on the assignment of rights to payment are generally ineffective. This override does not apply to other contractual terms (such as confidentiality provisions) however, and therefore to the extent a consent is required for information sharing, such a consent may still be critical to getting a deal done.

## Collateral Matters, SPVs and True Sale Considerations



### Key Finding

Substantially all of the transactions stipulated that they constituted true sales, consistent with the view of these transactions as the sale of contractual rights to payment under the applicable license or other agreements. A subset either required a security interest in assets related to the product or required that a special purpose vehicle be set up to hold the royalty stream and/or related product assets, which can further protect the royalty buyer in the event of a seller bankruptcy.

The SPV structure or security interest in product assets (including IP) can help guard against two risks:

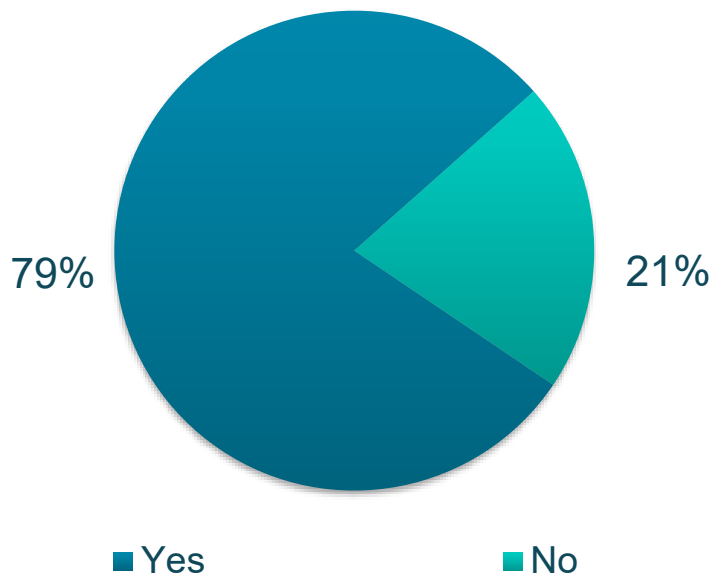
1. A capped deal is susceptible to the risk that it would be recharacterized in a bankruptcy of the seller as a loan – while this risk is somewhat mitigated by the back-up security interest in royalty payments seen in most transactions, if the entire royalty stream is moved to a bankruptcy remote SPV and the SPV sells the capped royalty, the risk can be further limited, as a purchaser would not expect the SPV to file for bankruptcy protection. (Continued)

## Collateral Matters, SPVs and True Sale Considerations

### Key Finding (Continued)

- Even in an uncapped true sale of a royalty stream, there remains a risk that the license agreement under which the royalties are paid is rejected by the royalty monetization seller in a bankruptcy and the seller disposes of the licensed patents to the former licensee under the license, thus potentially impairing the purchaser's rights to the purchased royalty stream.<sup>2</sup> An SPV or security interest in the underlying IP can mitigate against this risk.

## Patents Licensed to Payor



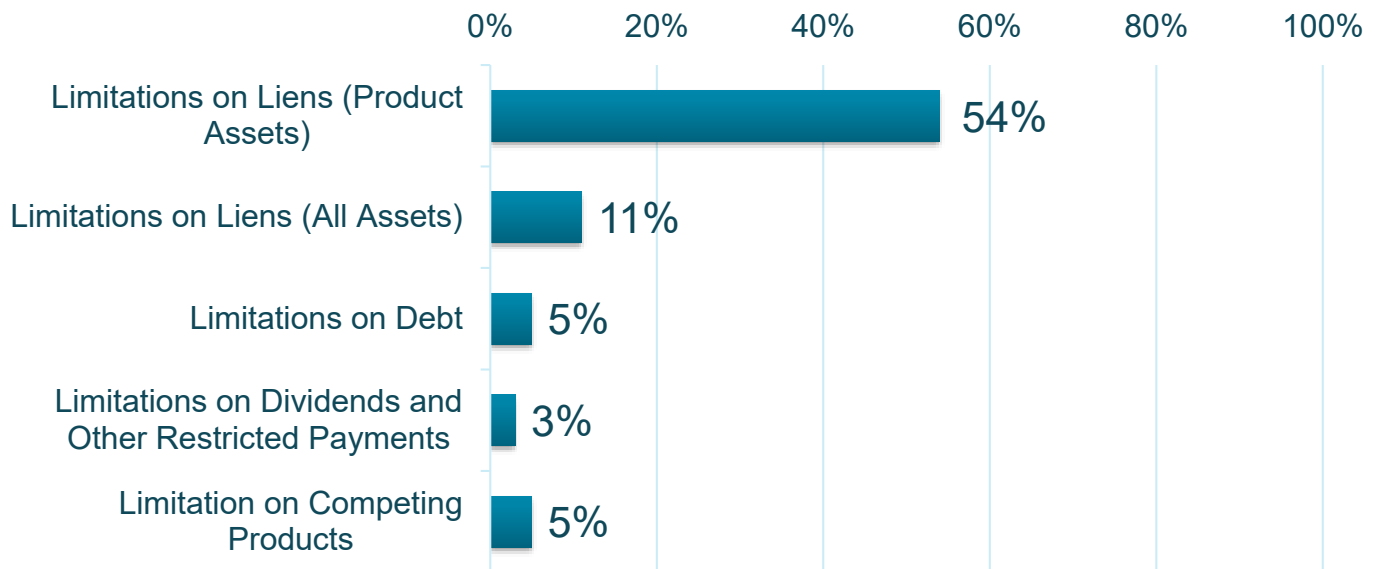
### Key Finding

A majority of transactions involved an underlying licensing arrangement in which the seller licensed patents to a licensee, who is then responsible for paying royalties. The alternative scenario – in which patents were sold, rather than licensed – is more complex, and introduces a risk, in particular where the royalty payor is less credit-worthy, that in a bankruptcy of the royalty payor, the royalty purchaser could be left with an unsecured claim of uncertain value.<sup>3</sup>

<sup>2</sup> We discuss this risk in the following article: <https://www.cov.com/-/media/files/corporate/publications/2024/07/structuring-royalty-monetizations-bankruptcy-and-the-risk-of-contract.pdf>

<sup>3</sup> We discuss this scenario in the following article: <https://www.cov.com/-/media/files/corporate/publications/2023/06/royalty-rights-as-unsecured-claims--banking-law-journal.pdf>

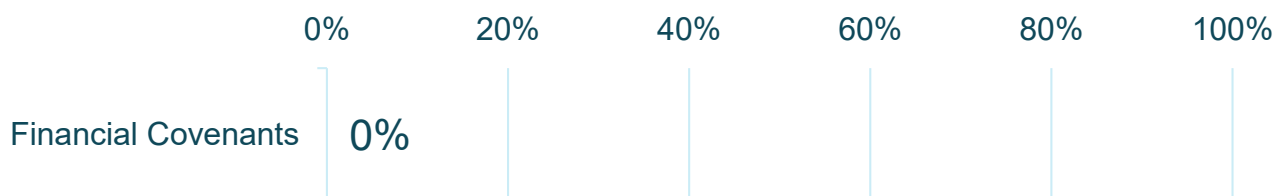
## Negative Covenants



### Key Finding

The negative covenant package for this type of transaction is generally very limited and less restrictive than would be the case in debt transactions or synthetic royalty financings, which reflects the investor's reliance on the royalty stream rather than the seller's ability to pay.

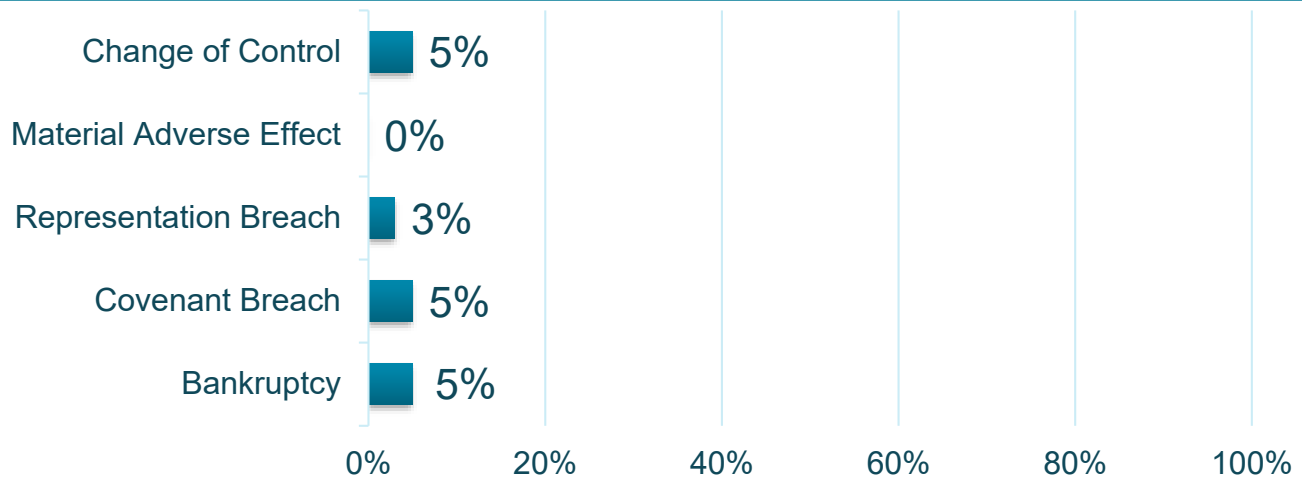
## Financial Covenants



### Key Finding

Financial covenants are generally not included in these transactions, reflecting a focus on the royalty stream rather than the seller's ability to pay.

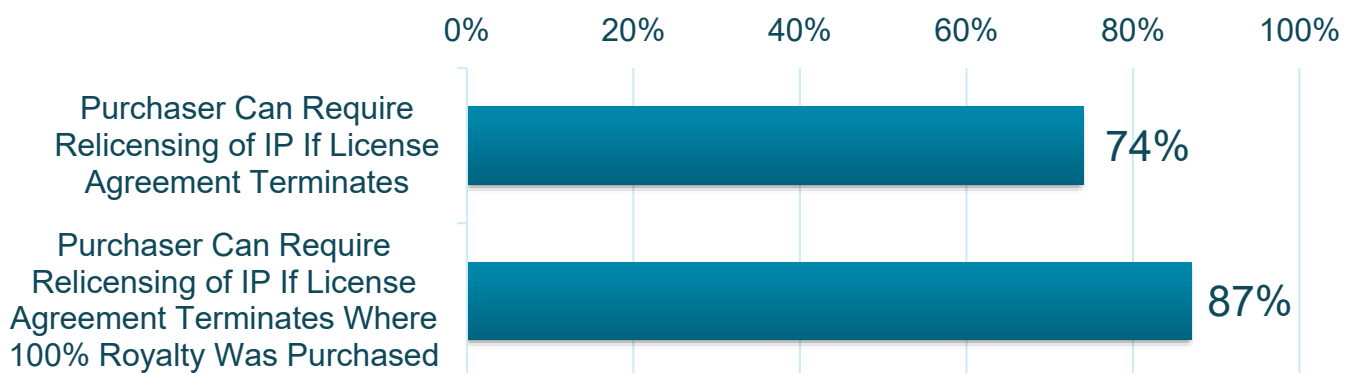
## Investor Put Rights



### Key Finding

As with negative covenant coverage, these transactions rarely included put rights (equivalent to customary events of default in debt deals). This again reflects the investor’s reliance on the royalty stream rather than the seller’s ability to pay.

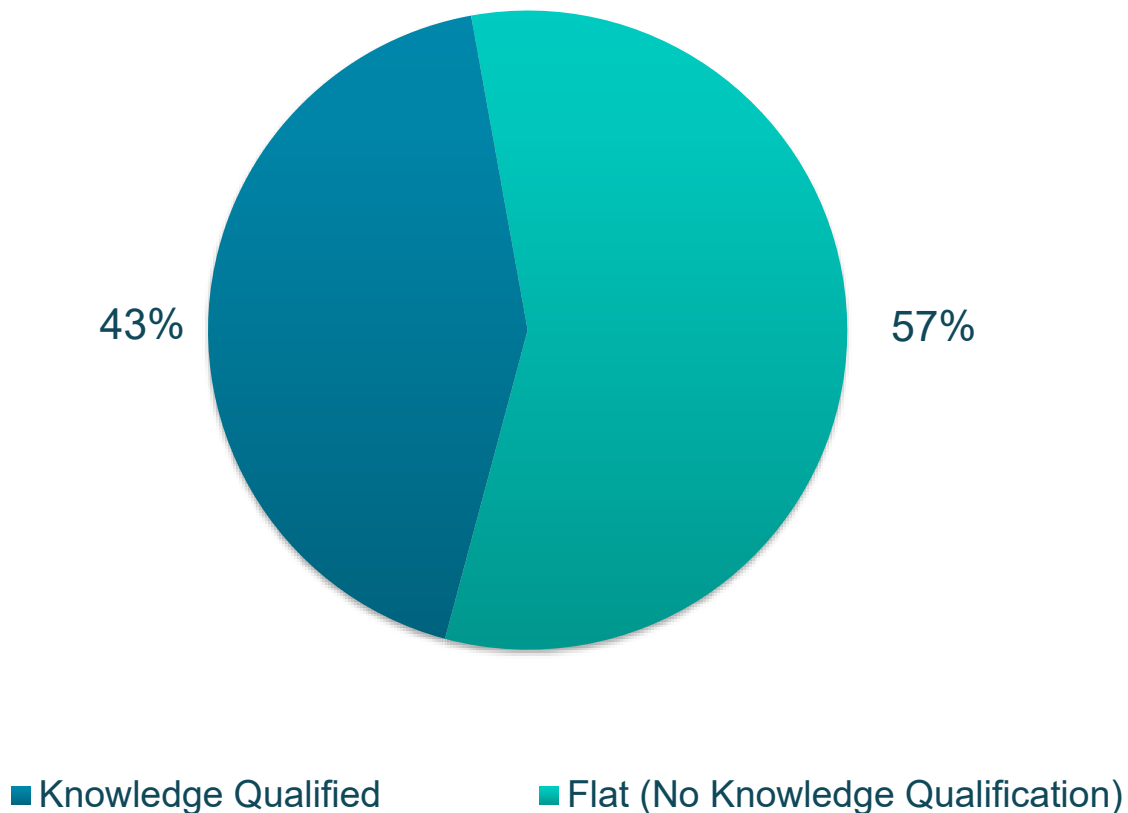
## Obligation to Use Efforts to Replace License Agreement



### Key Finding

Purchasers and sellers can have divergent incentives with respect to establishing a new licensing and royalty relationship if the original license agreement terminates, as the purchaser often has a much larger financial stake in the royalty stream. This is particularly the case where the seller has transferred the entirety of its future royalty stream to the purchaser, in which case purchasers look to contractual mechanisms to protect themselves.

## Representation on Enforceability of License Agreements



### Key Finding

A central due diligence focus in a royalty monetization transactions is the license agreement, and its enforceability is a critical aspect of any such review. For example, intellectual property case law<sup>4</sup> has cast doubt on the enforceability of royalties on licenses of U.S. patents that remain constant after patent expiration.

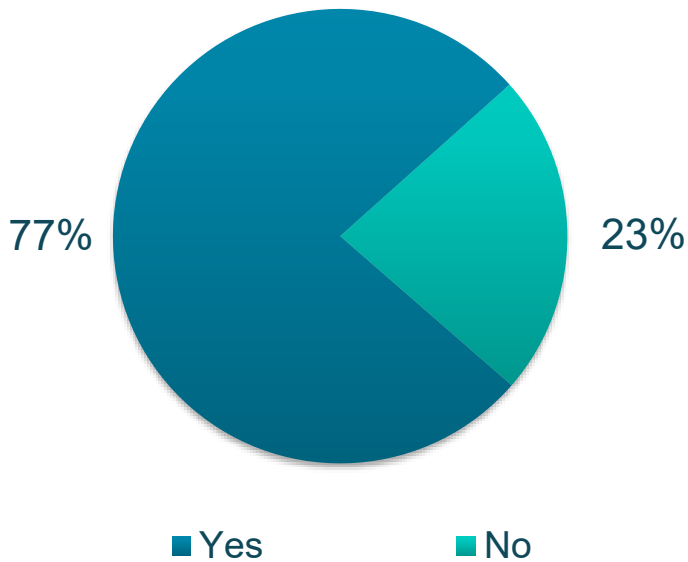
From a buyer's perspective, the royalty stream is the purchased asset, and therefore the enforceability of this agreement is the bedrock of the royalty monetization. However, sellers often argue that they are no better placed than a buyer to make a final evaluation of enforceability against the royalty payor.

<sup>4</sup> See *Brulotte v. Thys Co.*, 379 U.S. 29 (1964) and *Kimble v. Marvel Ent't LLC*, 133 S. Ct. 2401 (2015).



## Indemnities

### Indemnity Caps



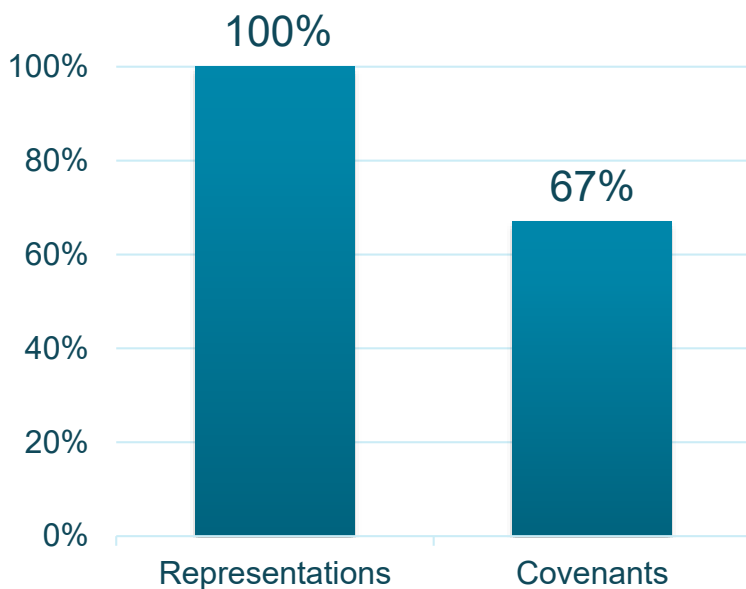
**Lowest Cap**  
**100%**  
of the Purchase Price  
Minus Royalties Received

**Highest Cap**  
**250/330%**  
(Depending on Type of Claim)  
of the Purchase Price  
Minus Royalties Received

#### Key Finding

Most transactions under review included a cap on the indemnity obligations of the royalty seller in the event of a breach of the royalty purchase agreement. 100% of the purchase price minus royalties received was the most common cap, but there was some variation among transactions (including 100% of the purchase price minus royalties received after a certain number of years).

### Indemnity Cap Scope

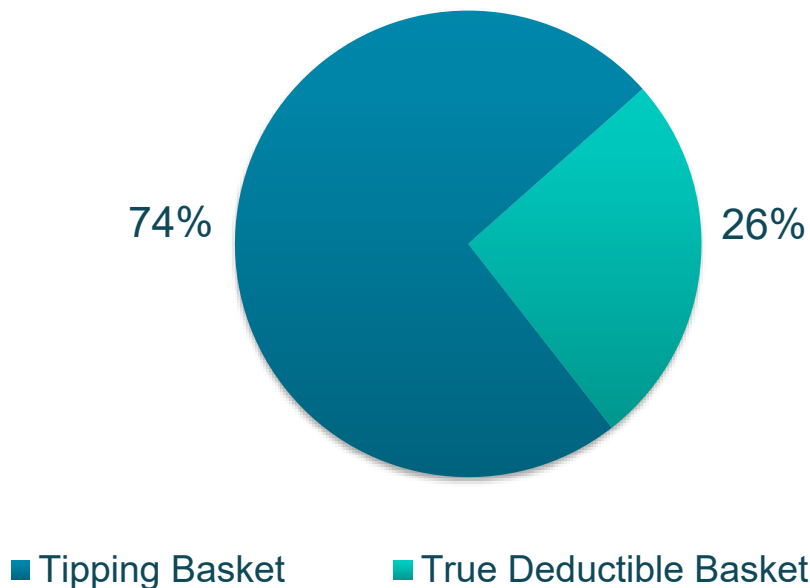
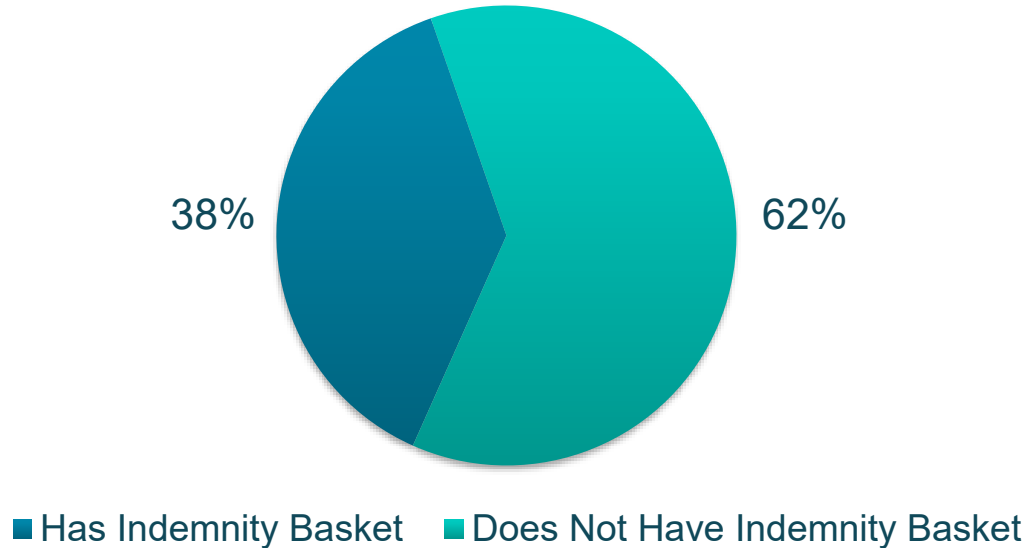


#### Key Finding

A majority of indemnity caps applied to both representations and covenants. That being said, the cap more commonly limited the seller's exposure on representations (where not all facts may be known and some degree of risk allocation may be appropriate), as opposed to covenants, which are more often in the control of the seller.

## Indemnities

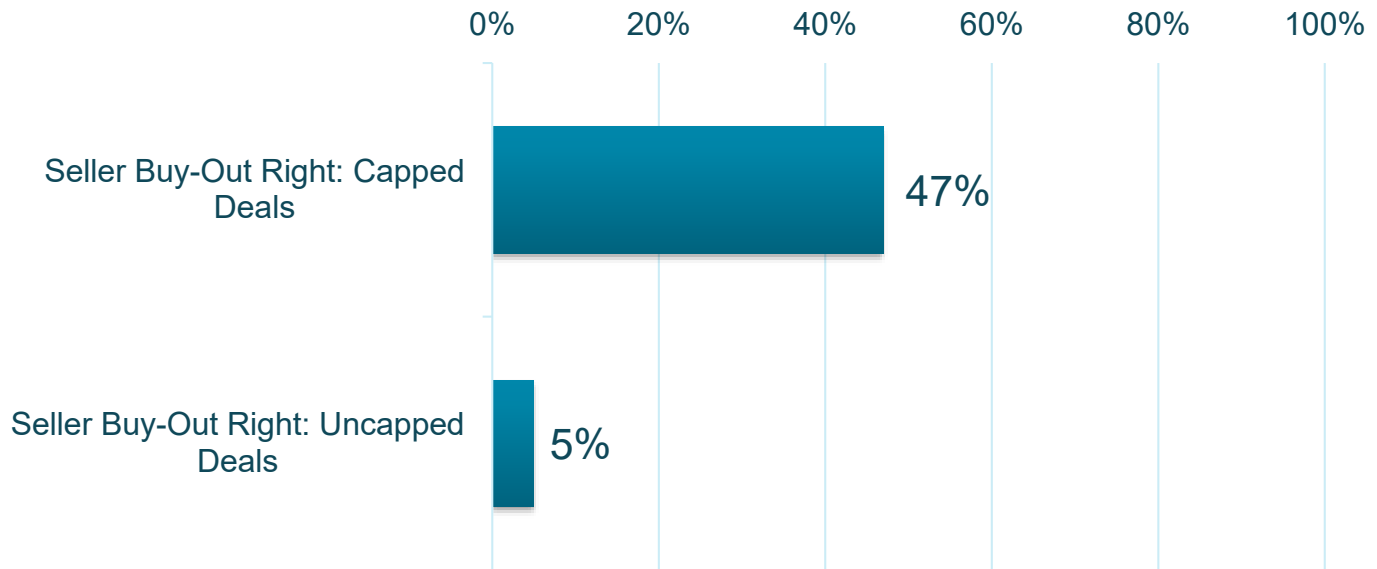
Indemnity Basket



### Key Finding

A significant minority of the deals under review included an aggregate monetary threshold below which an indemnity claim could not be made (the “indemnity basket”). In most transactions, once claims crossed that threshold, the entire set of claims would be indemnifiable (commonly referred to as a “tipping basket”), but some transactions deducted the threshold amount from the amount of the claims (commonly referred to as a “true deductible”).

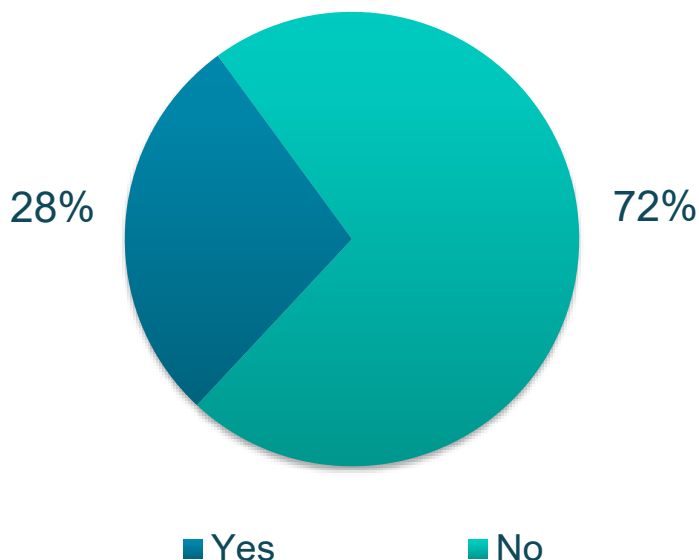
## Seller Buy-Out Right



### Key Finding

Given that capped transactions set a ceiling on returns, many of these deals included the ability for the issuer to pay a fixed amount and terminate the royalty monetization early. This flexibility is much less common for uncapped deals, where the upside potential for the investor is greater and a buyout price more difficult to calculate.

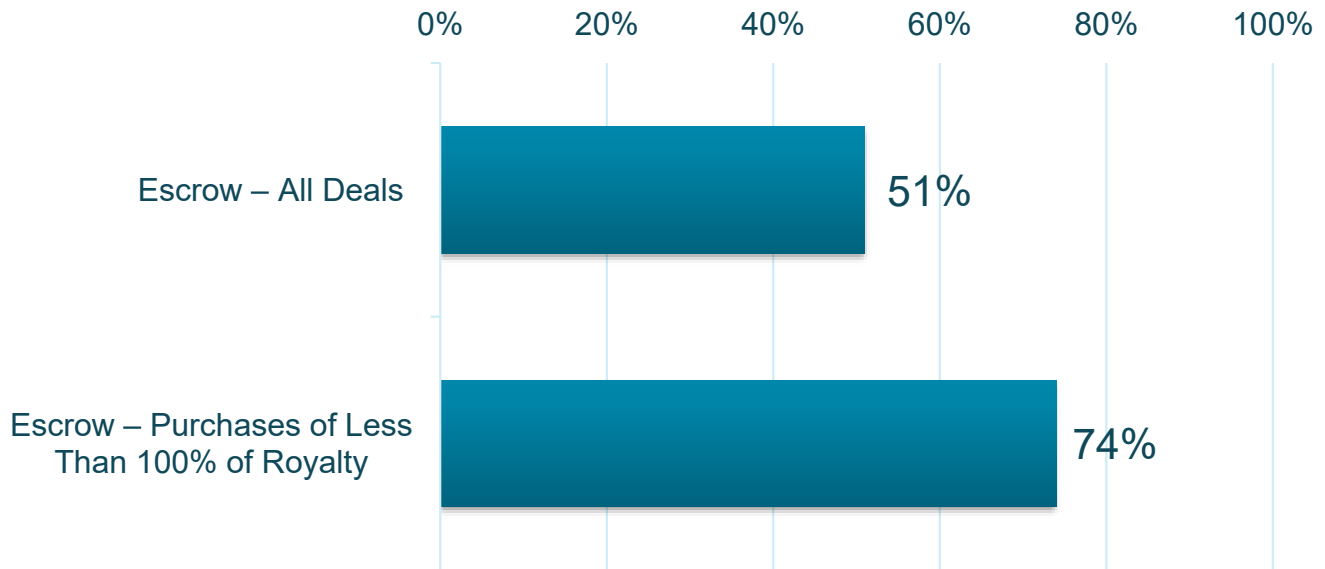
## Royalty Payor Pays Buyer Expenses



### Key Finding

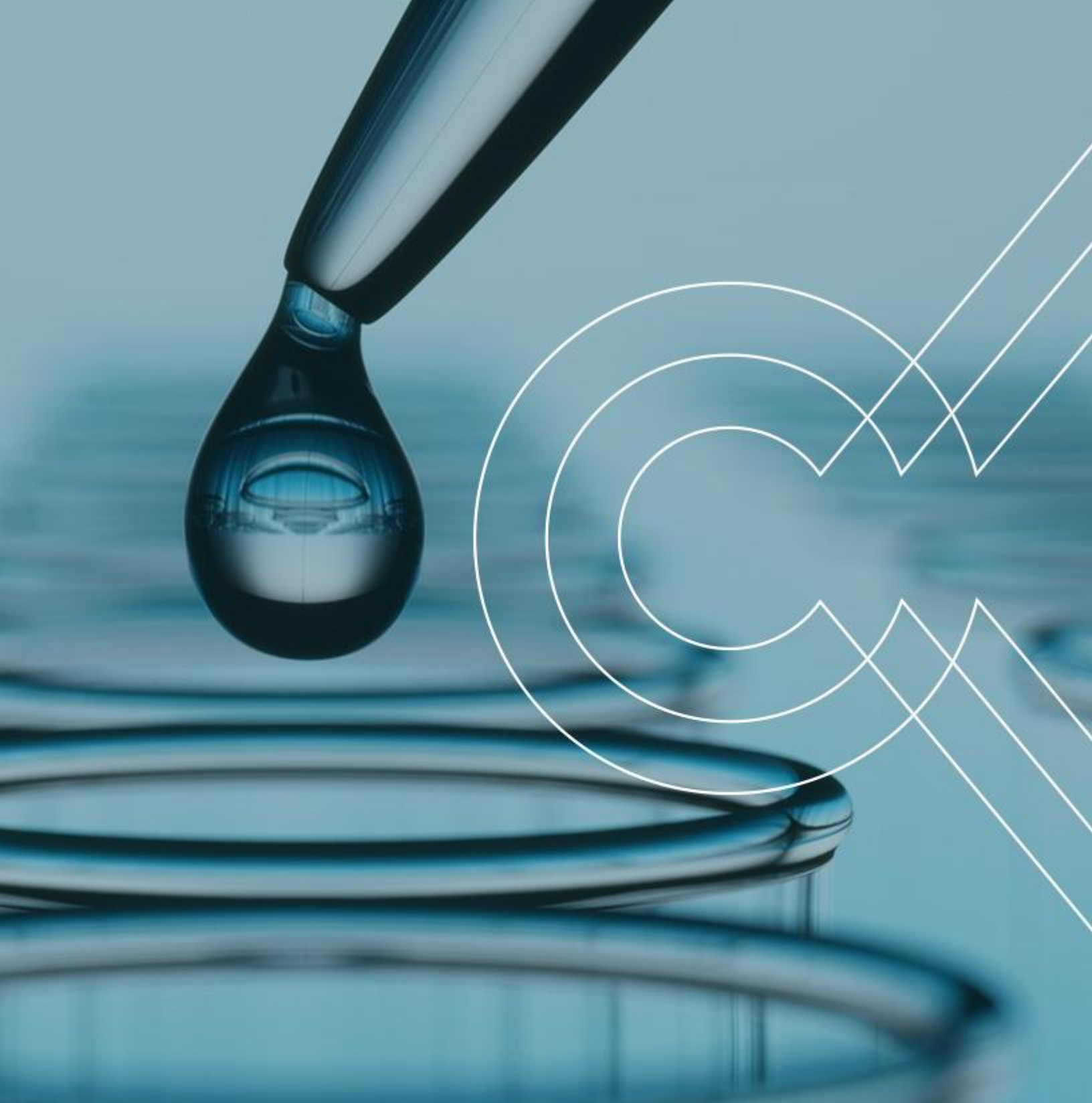
While present in a minority of deals, most transactions did not provide for reimbursement of buyer expenses, similar to most M&A transactions and differentiating these transactions from debt financings, in which borrowers typically pay lender expenses.

## Escrow Account Structure



### Key Finding

A small majority of transactions reviewed included an escrow account structure into which the royalty payor would remit the purchased royalties rather than having payments made directly to the purchaser. These structures can be used in various circumstances, such as where a royalty payor may be unwilling to pay a purchaser directly, where a seller retained a portion of the royalty in question or where other payments to third parties need to be made from the royalty revenues.



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