ROYALTY REPORT: ROYALTY FINANCE TRANSACTIONS IN THE LIFE SCIENCES (2020-2024)

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Introduction

This Royalty Report provides an analysis of publicly reported royalty finance transactions for the last five years (2020 to 2024) in the life sciences sector, focusing on both traditional and synthetic royalty transactions. Traditional royalty transactions encompass monetizations of royalties under existing license agreements. Synthetic royalty transactions involve the sale of a portion of future product sales, rather than the sale of an existing future royalty entitlement.[1]

Methodology and limitations: We analyzed a total of 102 publicly announced royalty transactions over this time period involving the largest and/or most active funds in the space, consisting of the following: Royalty Pharma, HealthCare Royalty Partners (HCRx), Blackstone, OMERS, XOMA Royalty, CPPIPB, Oberland Capital, and DRI Capital.[2] Survey data are based on publicly reported information, including in SEC filings, as well as data from 27 financing transactions executed by Gibson Dunn (representing approximately 30% of the total transactions reviewed during this period).[3] While this is an expansive survey, it does not capture certain transactions that would not have been reported on EDGAR or announced in press releases. Additionally, global pharmaceutical companies are increasingly using clinical funding arrangements (often structured as a type of synthetic royalty financing transaction) to defray development costs and many of these transactions are not sufficiently material to require disclosure. This analysis highlights the growing complexity and dynamism of the pharmaceutical royalty finance market.

Trends and Market Outlook

Key Trends (2020-2024)

- Rising Use of Synthetic Royalties: Emerging as a viable alternative to debt or equity financing transactions, with an average annual growth rate of 33% over the five-year period.
- Increased Activity in Recent Years (2023 and 2024): Driven in particular by high-value deals and late-stage product transactions.
- Milestone-Heavy Transactions: Growing preference for performance-linked payments, allowing buyers to lower their risk profile and allowing sellers to lower their cost of capital.

Factors Driving Market Dynamics

- Economic Conditions: Depressed equity valuations have prompted more companies to seek non-dilutive capital, including through royalty financing. At the same time, a higher interest rate environment has increased discount rates that royalty finance providers apply when valuing royalty streams, which increased the cost of capital, likely moderating the volume of royalty financing transactions.
- Clinical and Regulatory Process: Funds tend to focus on commercial-stage products, though opportunities exist for pre-approval products, in the form of debt, clinical funding arrangements, and/or where positive clinical data bolsters the investment thesis for a particularly de-risked asset.

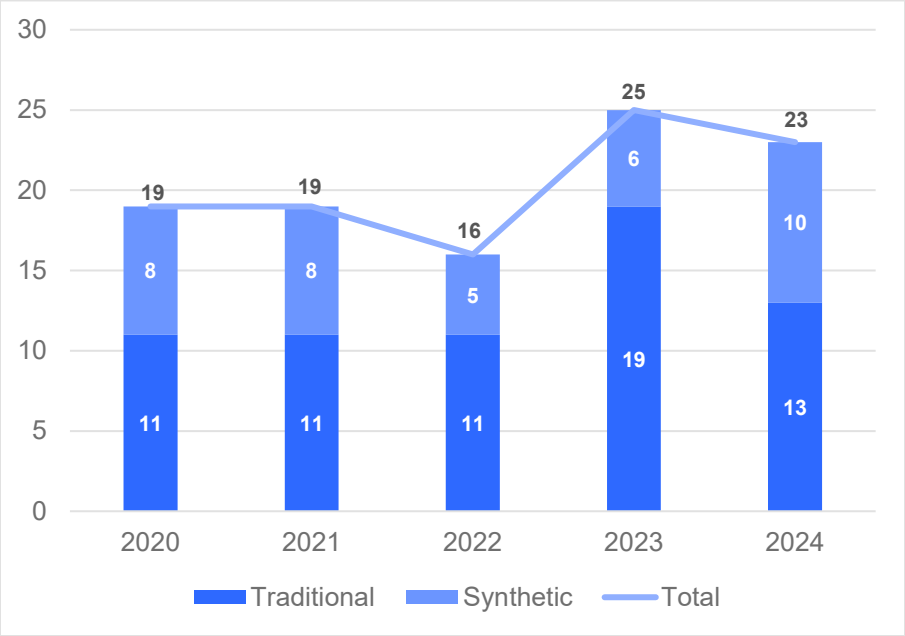
Outlook

- Expect continued growth in both traditional and synthetic royalties as financing tools as companies continue to pursue alternatives to raising non-dilutive capital that provide more flexibility than debt.
- Increased participation from diverse buyers and financial institutions as investors seek to capitalize on innovations in drug development and the steady returns that approved drugs promise.
- Expansion of milestone-linked structures, especially for late-stage pre-approval products in order to offset risks while allowing companies to attract capital at earlier stages.

[1] For purposes of this survey, we have included clinical development funding arrangements as a type of synthetic royal financing. [2] See Appendix 1 for a list of assumptions. [3] During the time period captured by this survey, Gibson Dunn has represented Royalty Pharma, HCRx and XOMA Royalty in royalty financing transactions as well as sellers in 11 transactions.

The Data – Royalty Financing (2020-2024)

Number of Transactions by Transaction Type and Year



102

Total Transactions[4]

Traditional royalty financings, with less risk and more consistent returns, account for the majority of royalty finance transactions across all years. Synthetic royalty financings are leveraged for innovative financing structures with potentially greater upside due to the heightened risk and have been steadily climbing since a dip in 2022, which coincided with the Fed beginning to raise interest rates to moderate inflation, as well as a significant sell-off in biotech stocks.

Financials

Aggregate Transaction Size (billions) by Transaction Type and Year

$24.6 billion

Aggregate Value

$4.92 billion

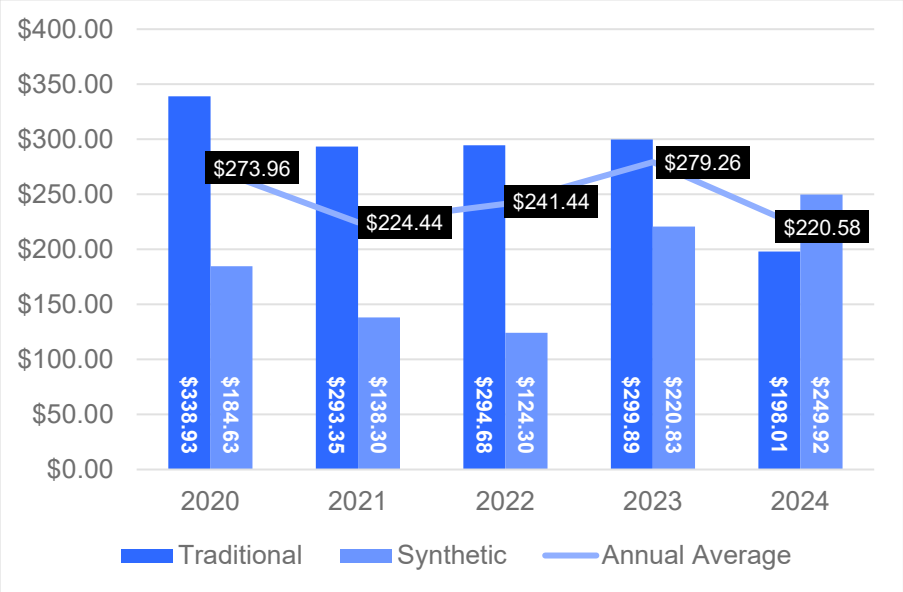
Average Annual Aggregate Value

The aggregate value of traditional royalty financings has been steadily increasing since 2021 but then saw a meaningful dip in 2024.[5] At the same time, the market saw significant growth in synthetic royalty financing transactions, with an average annual growth rate of 33% over the five-year period. The growth in synthetic royalties as a portion of the royalty finance market is a significant trend that we expect will continue in the coming years.

[4] Before excluding certain transactions (where funds acted as the seller/entity receiving financing and add-ons/amendments to prior transactions where there was no up-front or milestone compensation included in such amendments or add-ons) the total transaction count was 106. See Appendix 1 for a list of assumptions. [5] The top five deals in terms of aggregate value (all at least $1 billion) occurred in 2020-2023, which could account for the drop in 2024.

Financials

Average Transaction Size (millions) by Transaction Type and Year

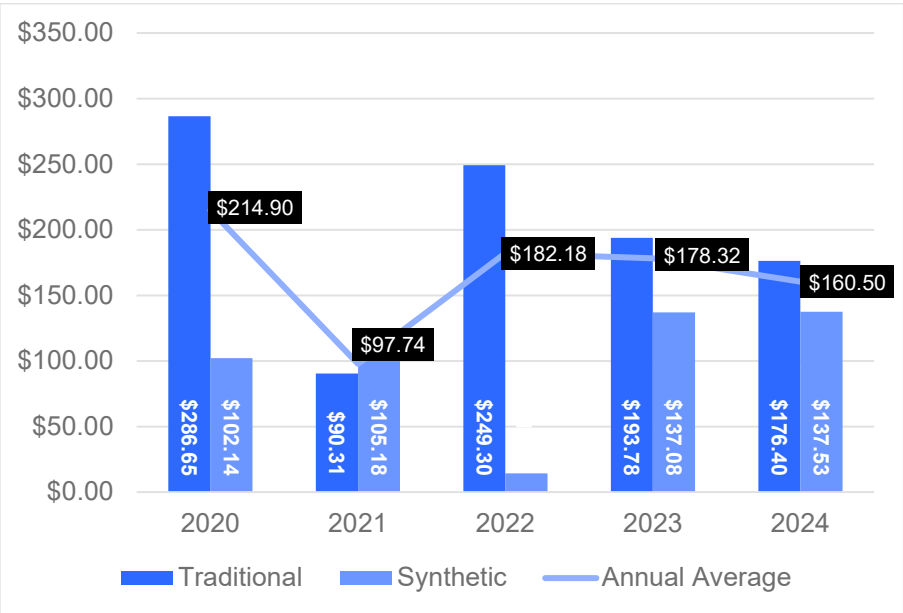


$249 million
Average Transaction Size

$1.2 million to $1.61 billion
Range of Transaction Sizes

Traditional royalty financings historically have accounted for higher average transaction sizes. While the average size of traditional royalties has trended down over this five-year period, we have seen a 14% average annual growth rate in the average size of synthetic royalties.

Average Upfront Payment (millions) by Transaction Type and Year



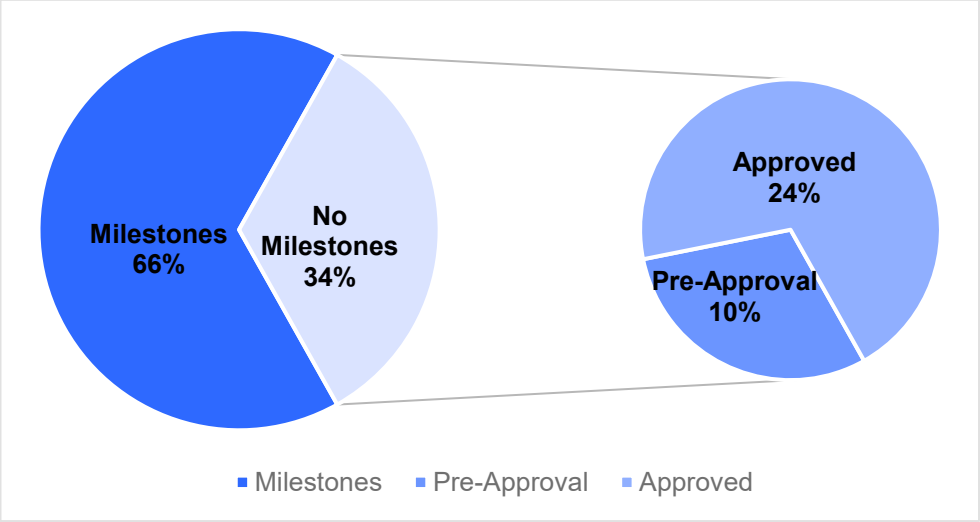
$168 million
Average Upfront Payment

$1.2 million to $1.43 billion
Range of Upfront Payments

Traditional royalty financings are lower risk than synthetic financings, as they tend to relate to more mature commercial products and have lower counterparty risks with marketers that are most often global pharmaceutical companies. In light of this dynamic, traditional royalty financings have typically had significantly higher averages for upfront payments. At the same time, the growth of synthetic royalty financings over the past five years has also resulted in higher average upfront payments, with an average annual growth rate of 193%.

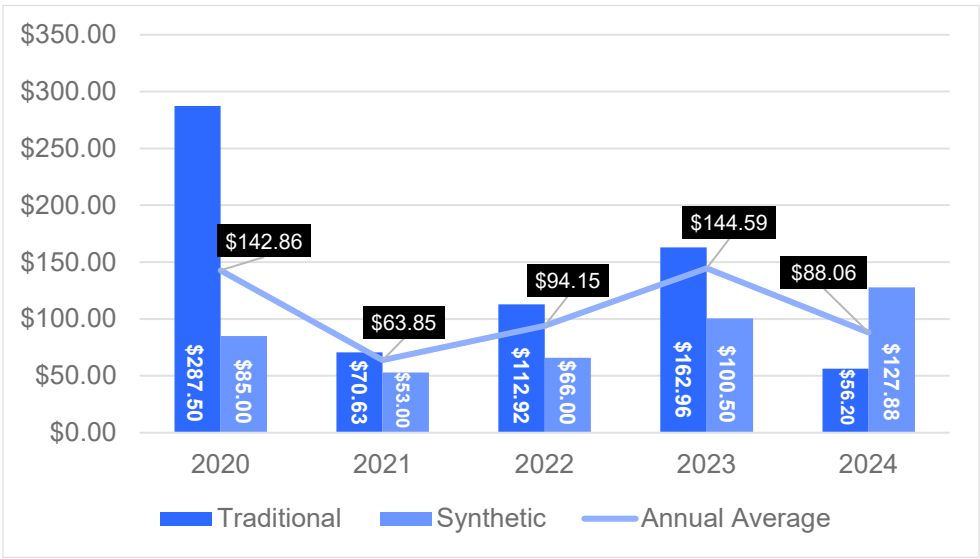
Financials

Existence of Milestones in Transactions



Nearly 2/3 of all traditional and synthetic royalty financings include milestone payments, reflecting a desire for performance-based payment structures tied to sales, approvals, or other predefined metrics, especially with respect to pre-approved products. 71% (24/34) of the transactions where there is solely an upfront payment (i.e., no milestones payments are included) involve an approved product.[6]

Average Milestone Payments (millions) by Transaction Type and Year



$108 million
Average Milestone Payment

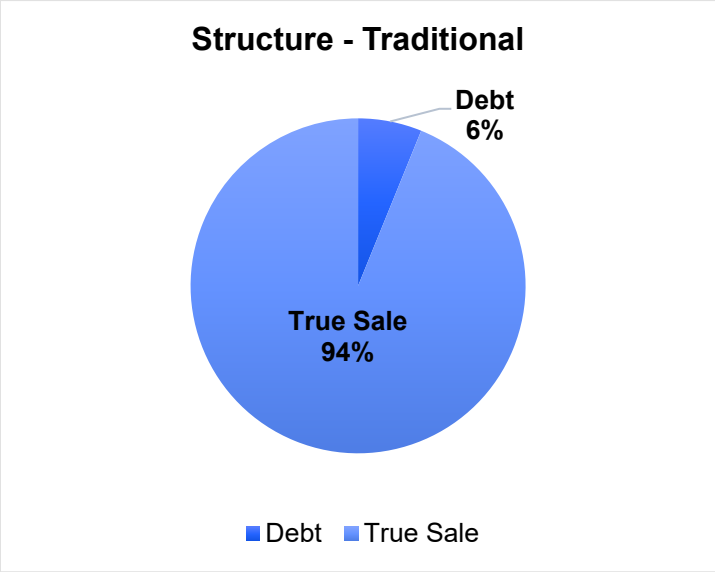
$50 thousand to $625 million
Range of Upfront Payments

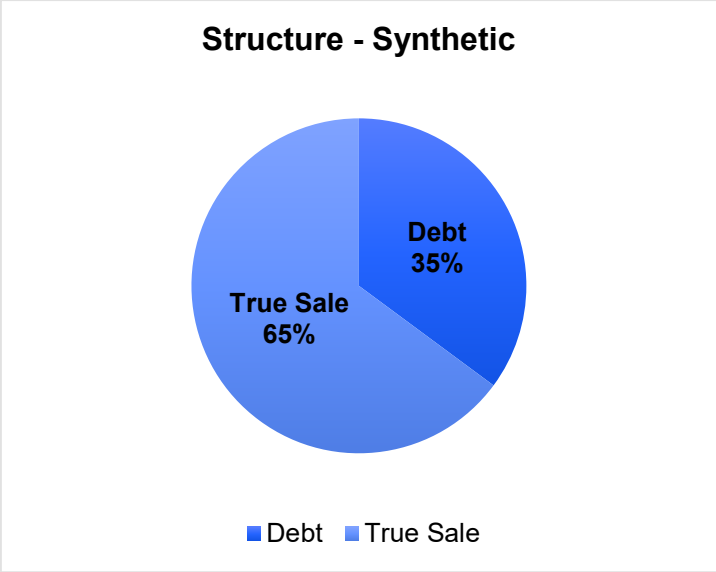
Traditional royalty financings have historically had slightly larger average milestone payments than synthetic financings. However, milestone payments for synthetic financings have been growing robustly while we have seen a slight decline over the same time in milestone payments for traditional royalty financings.[7]

[6] Transactions where there was not sufficient disclosure to determine whether or not the agreement includes milestone payments were excluded from the calculations. [7] Of the traditional royalty financings surveyed for 2020, only two reported any milestones, which accounts for the much higher average in 2020, as it is a sample size of two. Given the small number for 2020, we have disregarded the 2020 data from the trend analysis.

Additional Insights

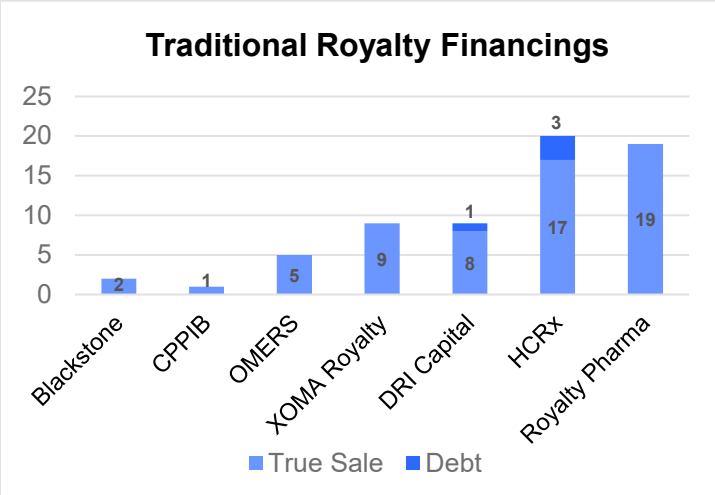
Structure (True Sales vs Debt) by Transaction Type

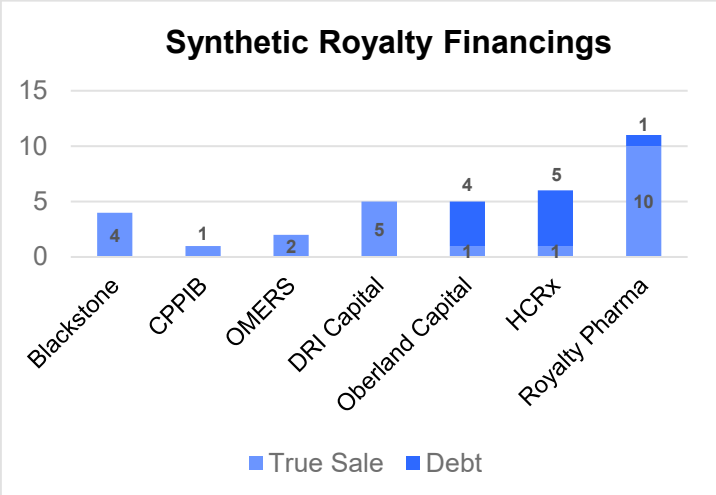




True sale transactions (fully at risk) dominate the market. While it would be expected that debt-based transactions would occur more often under synthetic royalty financings as compared to traditional royalty financings, it is informative that true sale transactions still vastly outnumber debt-based transactions for synthetic royalty financings as well (accounting for over double the number of transactions during this time period).

Number of Transactions for each Fund by Structure and Transaction Type

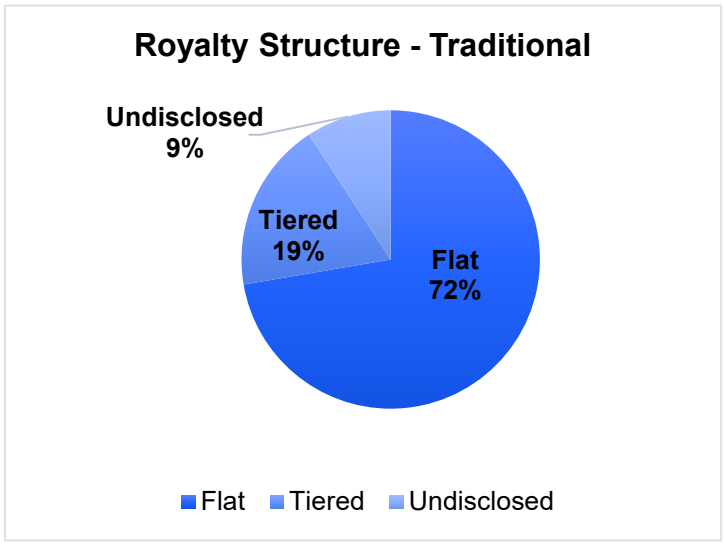


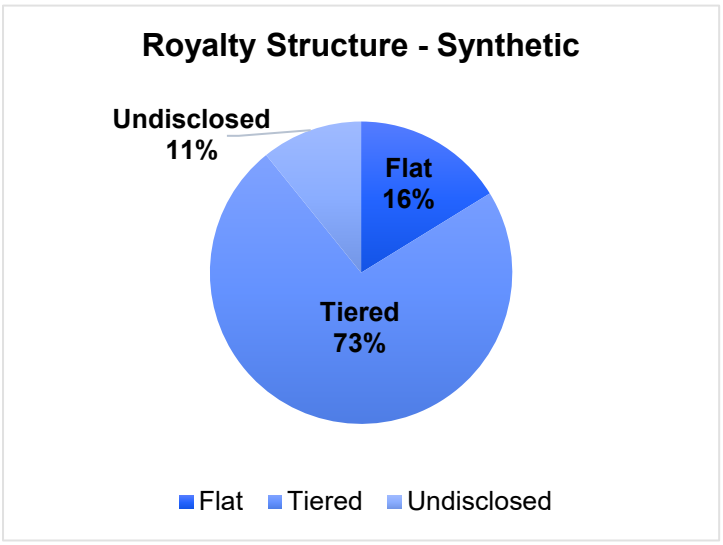


If we break down the number of transactions for each fund by structure (true sale vs debt) and type (traditional vs. synthetic), we can see the transaction preferences for each of the funds.

Additional Insights

Royalty Structure by Type



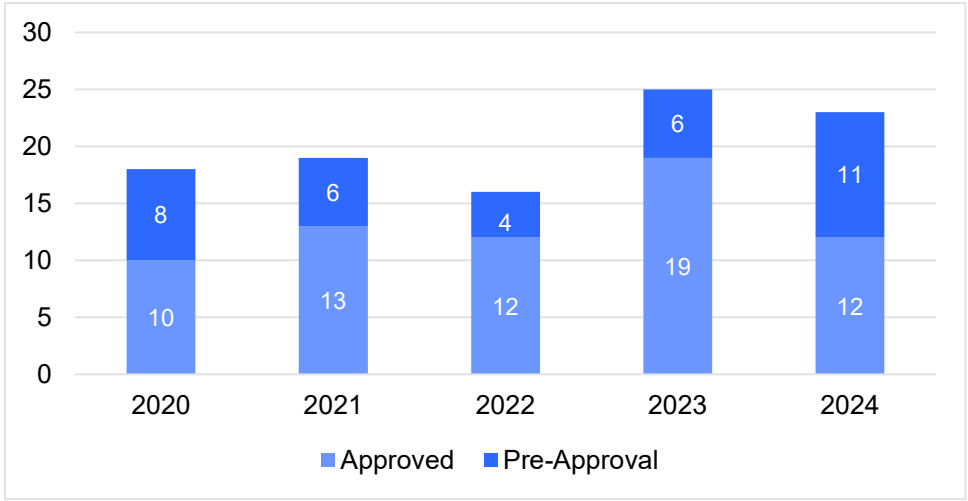


0.75% to 13.8%
Synthetic Royalty Rate Range (royalty as percenter of net sales)

17% to 100%
Traditional Royalty Rate Range (percent of royalty purchased)

As would be expected, synthetic royalty financings have a tiered royalty structure 73% of the time, typically a declining royalty on annual net sales, although we often see a step-up in royalty tiers in later years if a minimum return has not been met within a given period of time. We see the opposite with traditional royalty financings, with a flat royalty structure 72% of the time.

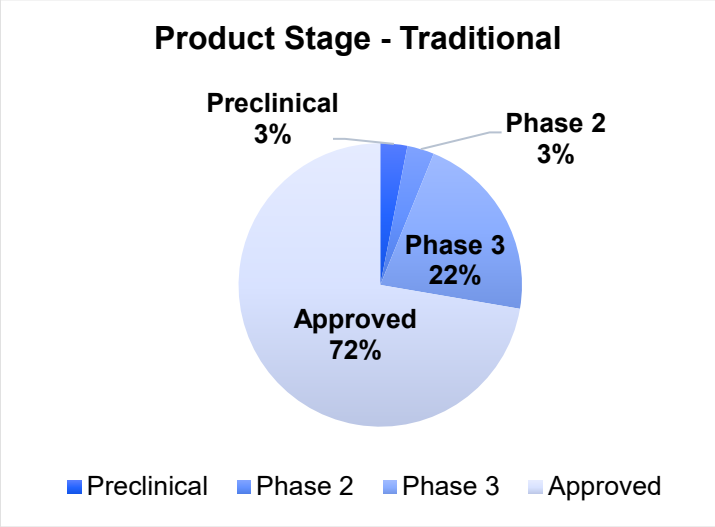
Product Stage by Year

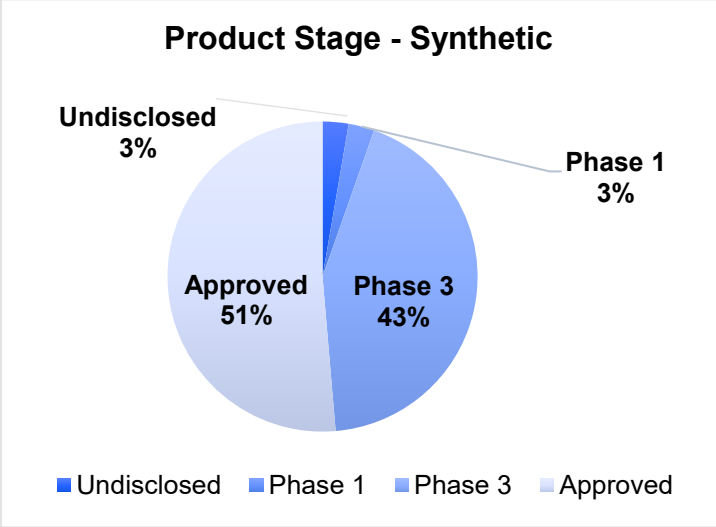


Although there continues to be a steady volume of pre-approval financing transactions (35), the substantial majority of transactions were for approved products (66), reflecting lower risk and faster returns for investors.

Additional Insights

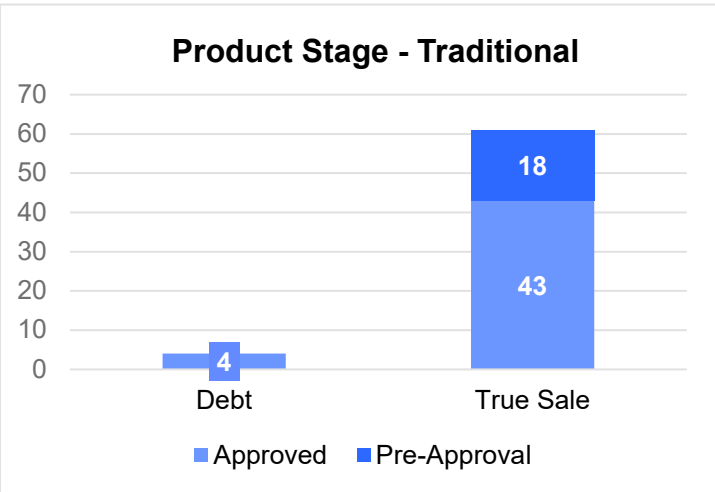
Product Stage by Transaction Type

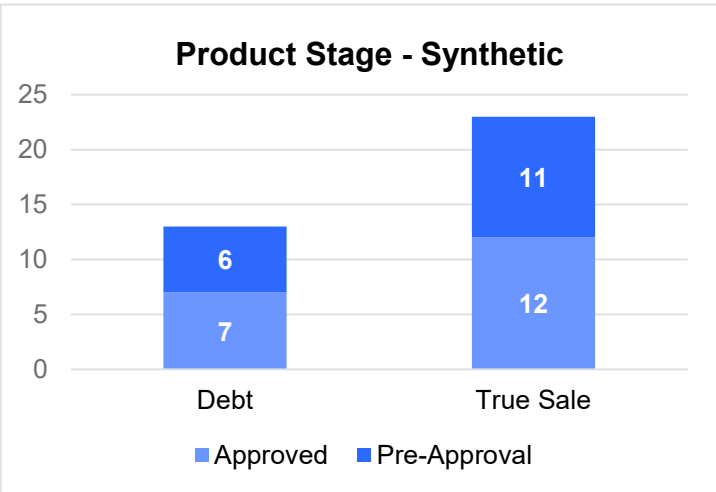




For traditional royalty financings, transactions including approved products significantly outnumbered transactions in which the latest stage product was pre-approval. For synthetic royalty financings, on the other hand, transactions including approved products were nearly the same number as transactions in which the latest stage product was pre-approval. The data for synthetics however is misleading because we group true sale synthetics together with clinical funding arrangements as well as true sale transactions that occur alongside separate debt facilities. Adjusting for this would show 3 pre-approval transactions for true sale synthetics, all of which had delayed closings (and funding) upon approval.

Product Stage by Structure and Transaction Type

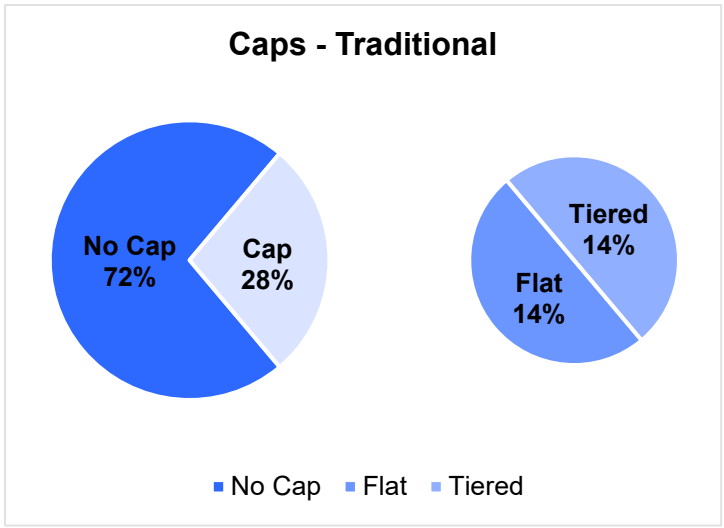


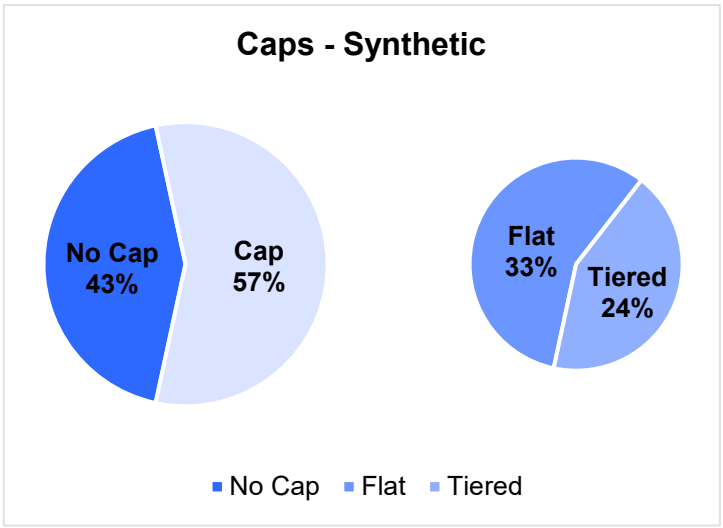


The vast majority of pre-approval transactions for traditional royalties occur with Phase 3 stage products under license with positive data. Debt deals are relatively uncommon in traditional royalties and tend to occur as a royalty-backed loan for commercial products. While we would expect more pre-approval transactions to occur under debt-like structures, the data for synthetics is skewed as discussed above.

Additional Insights

Caps and Tails

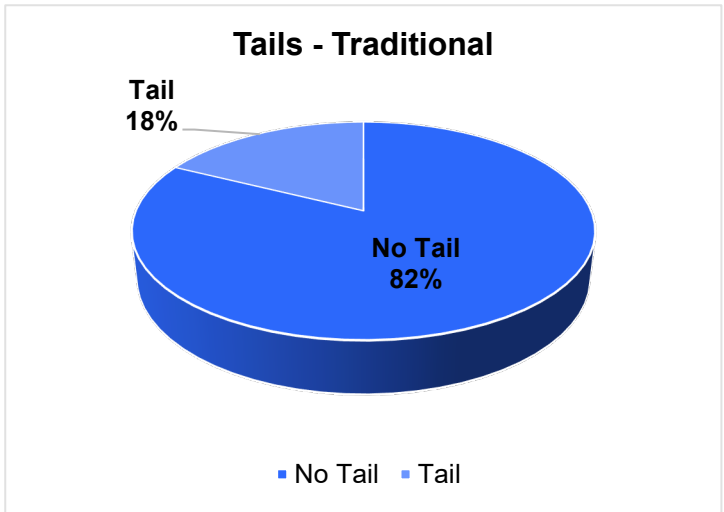


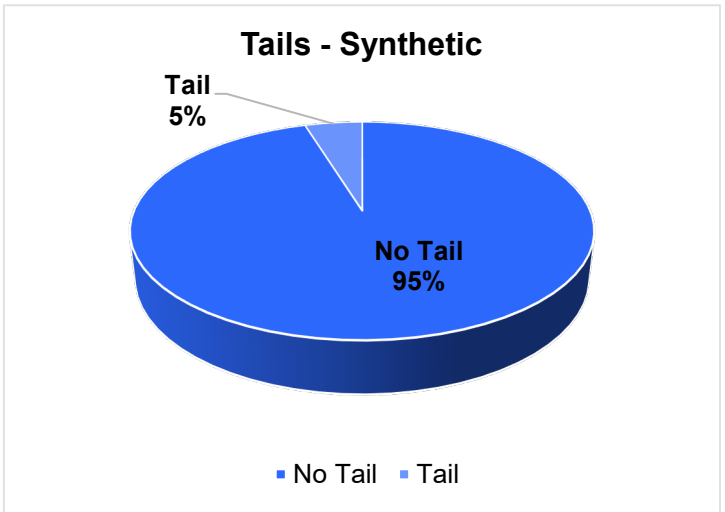


1.8x
Average Cap Multiple

1.12x to 3.33x
Range of Cap Multiples

72% of traditional royalty financings do not include any caps.[8] Whereas about an equal number of synthetic royalty financings included a cap compared to those with no cap. When a cap is present, flat (a single multiple) and tiered (e.g., different multiples tied to the year in which it is reached) caps tends to occur in equal proportions.



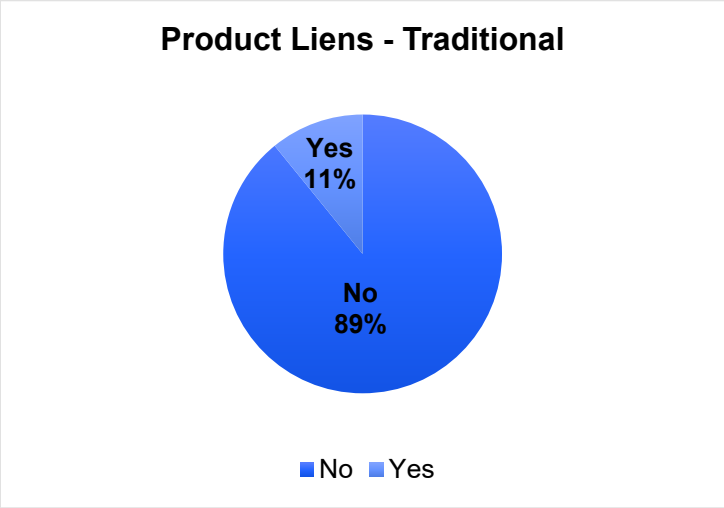


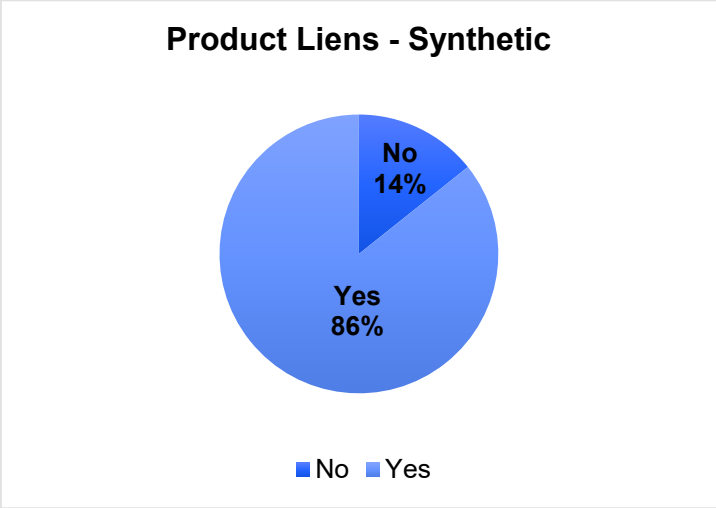
For transactions where caps are included:
- there are typically no tails,[9] and
- traditional royalty financings include tails more than 3x the amount of synthetic royalty financings.[10]

[8] Caps is used to signify capped returns at a multiple of the investment amount. [9] No tail means the entire royalty stream reverts back to the seller after the cap is hit. [10] A tail means that the fund will keep a certain portion of the royalty stream after the cap is hit.

Additional Insights

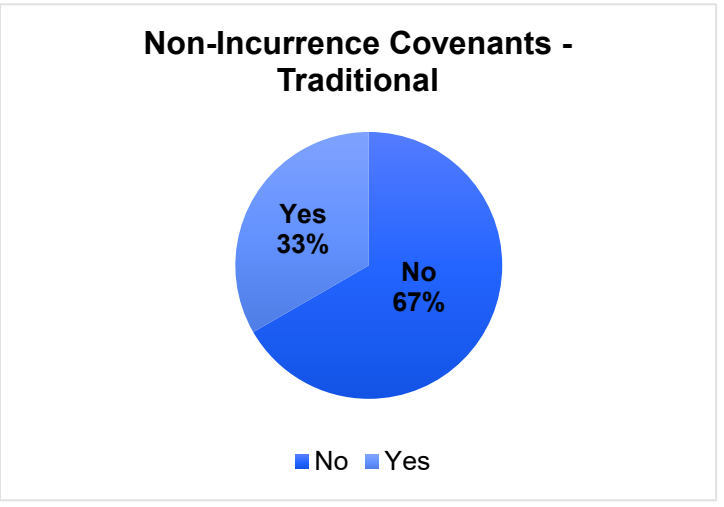
Existence of Product Liens by Type

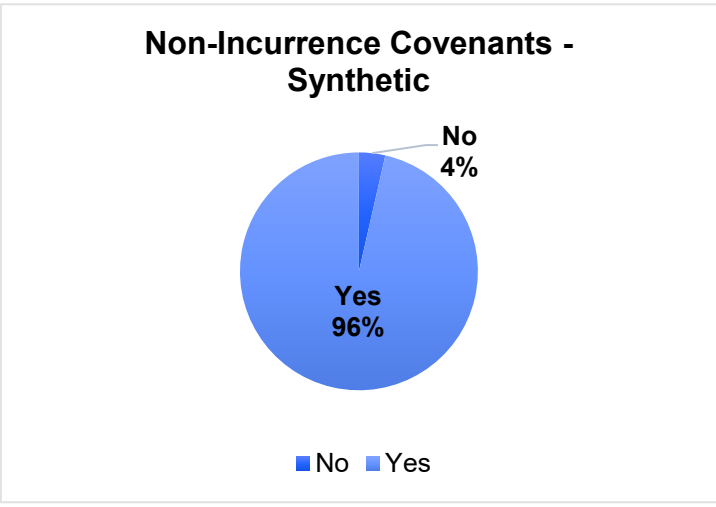




89% of traditional royalty finance transactions do not include liens on product related assets (e.g., patents, regulatory approvals, license agreements, etc.). We see the opposite for synthetic royalty financings, in which 86% include product-related liens. Where a synthetic financing is structured as a loan, a lien on key assets (if not all assets) is to be expected. For synthetic financings structured as true sales, a product-level lien will be expected for all but the largest and most credit-worthy counterparties.

Existence of Non-Incurrence Covenants by Type





67% of traditional royalty finance transactions do not include non-incurrence covenants. We see the opposite for synthetic royalty financings, in which 96% include non-incurrence covenants.[11] Given that traditional royalty financings are almost always documented as true sales, the absence of incurrence covenants is to be expected. Similarly, given the counterparty risks in a synthetic royalty financing, including the risks of recharacterization of a true sale in bankruptcy, leads most finance providers to insist on some sort of debt incurrence covenants.

[11] Non-incurrence covenants limit the seller/borrower from incurring additional debt or imposing liens on product-related assets. Transactions where there was not sufficient disclosure to determine whether or not the agreement includes non-incurrence covenants were excluded from the calculations.

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Key Assumptions

We adhered to the following assumptions when compiling our data:

Exclusion of Certain Transactions: We did not include (i) transactions where the fund acted as the seller or entity receiving financing[12] or (ii) amendments or add-ons to prior transactions where there was no up-front or milestone compensation included in such amendments or add-ons. Thus, the statistics for the total number of transactions are less than they would be if these had been included.

Debt: A deal is considered "Debt" if there is a minimum guaranteed payment or a maturity date.

Multiple Products: For transactions involving multiple products, we extracted the majority of the data based on the product with the most advanced “Product Stage” (i.e., the main product). However, if all products were at the same regulatory stage, we determined the main product based on the product that appeared to “lead” the deal or have the most value.

Purchase Price for Development Funding Arrangements: For development funding arrangements, the upfront payments include any monthly payments made by the Buyer to the Seller, and the milestone payments included options to increase the total funding obligation with respect to those monthly payments.

Tiered Royalty Percentages: The royalty rate calculated for tiered royalty transactions is limited to the percentage from the first tier.

Cap Multiple:

- The cap multiple calculated for tiered caps is limited to the first cap tier.
- For deals involving milestone payments and a cap that is a set dollar amount, the “Cap Multiple” is considered tiered, and the first cap tier is calculated against the upfront payment.
- The cap multiple for royalty-backed notes is determined based on the following equation, unless another cap is specified: (Interest Amount + Size)/Size.

[12] The statistics and reporting are focused on transactions where the funds acted as the buyer/financing party.