PATENT DEALMAKING

High-level insights into the patent deals marketplace

IAM SPECIAL REPORT

THE DRUG ROYALTY SALES MARKET REACHES NEW HEIGHTS

Some of the highest-value deals in intellectual property today are taking place in the burgeoning marketplace for revenue streams linked to pharmaceutical products

The sale of drug royalty entitlements is providing innovators – especially universities, charities and smaller companies – with valuable new opportunities to receive upfront payments for their patent-protected life sciences innovations, without the need to sacrifice equity or take on debt.

This market has reached new heights in recent years, reflecting the increasing number of royalty streams, a growing awareness among sellers and investors, and more sophisticated dealmaking. However, drug royalty sales remain a niche, highly specialised form of monetisation. Certain kinds of asset are more likely to secure a buyer than others, and there are several potential stumbling blocks to getting a deal over the line.

To help our life sciences readers better navigate this landscape, IAM has taken a deep dive into recent market developments. By speaking to several leading experts, we have identified the most important drug royalty dealmaking trends.

A specialist market goes mainstream

The purchase of drug royalties requires specific expertise to assess the value and reliability of the long-term revenues flowing from IP-protected drugs. As such, a handful of specialist investment teams dominate the market.

However, the remarkable successes of key industry players such as Royalty Pharma are bringing drug royalties to greater prominence and attracting more investors and larger volumes of cash.

Royalty Pharma's 2020 initial public offering (IPO) was a landmark moment for drug royalty sales. Following years of steady growth, the company raised $2.18 billion in the year's largest biotech offering, valuing it at almost $17 billion. Despite the pandemic, it also struck seven deals in 2020, its highest annual total since being established in 1996.

John Gourary,
head of Covington & Burling's
royalty monetisation practice

This momentum continued into 2021, during which Royalty Pharma invested $3 billion (compared to $2.5 billion in 2020) across five deals, including a multilayered royalty transaction worth $2 billion with MorphoSys. It has struck again in the opening days of 2022, agreeing to pay $450 million for a royalty and loan deal with Cytokinetics.

The launch of Blackstone, one of the world's largest investment companies, was another recent milestone. Reflecting the widening appeal of drug royalty sales, in 2020 it agreed to pay $1 billion for half of Alynlam's future licensing income on phase 3 treatment Inclisiran – part of a broader strategic deal, worth $2 billion. Though Blackstone has yet to make another significant investment in pharma royalties, its inaugural life sciences fund raised $4.6 billion in June 2020, suggesting that more deals are likely. Significantly, market experts have told IAM that other large non-specialist investment funds are seriously considering entering the space.

Sagard Healthcare Royalty Partners is also new to the market. Led by industry veterans David MacNaughtan and Ali Alagheband, the team was launched in 2019 and raised $725 million for its first royalty investment fund in February 2021. Following a string of smaller transactions in 2019 and 2020, the company ended 2021 with its largest deal to date: $250 million for AnaptysBio's 8% royalty stake in sales below $1 billion of GlaxoSmithKline's cancer drug Jemperli.

Healthcare Royalty Partners is another significant player. It raised $1.8 billion for its latest royalty investment fund in early 2020 and followed a bumper haul of 10 royalty investments that year with deals in 2021. These included a $200 million purchase for a portion of Regenxbio's royalties on sales of Novartis' gene therapy Zolgensma.

Highly differentiated products with strong IP protection

Not all types of healthcare innovation produce royalties that are attractive to investors. In a recent IAM interview, Sagard's Ali Alagheband explained that deals focus on highly differentiated medically necessary treatments, where potential competitors face high barriers to entry and products have the most reliable long-term revenue streams. "We don't invest in lifestyle products or nutraceuticals," he pointed out. "We will look at some medical devices, but it is harder to do deals in med-tech, because the pace of innovation is much faster." Sagard also steers clear of healthcare IT at present, because of a lack of expertise.

This is elaborated on by Covington & Burling's John Gourary, an experienced and specialist royalty monetisation lawyer. "What makes an asset attractive to a buyer has been consistent over time. The product should be medically necessary, which leads to more predictability in revenue streams." Strong IP protection is also important, he continues. "The third factor is a strong marketer for the product (and a product that is important to the marketer). Lastly, the royalty duration should be five years or more, ideally, which allows buyers more runway to recover their investments."

Significant IP due diligence underpins most royalty dealmaking. "We have to ensure that patents were prosecuted properly, we study the file history," Alagheband told IAM. "Depending on the deal and the complexity of the IP estate, we look at the claim construction of the specific IP. Are the claims too broad or too narrow? Can they be attacked by a generic company or other competitors?" Sagard focuses on the composition of matter patents, which are more robust and difficult to design around. "We would not automatically exclude [deals based on formulation or method of use patents], but they are more difficult to make," Alagheband explained.

Orphan drug and oncology revenues are in demand

One of the most pronounced trends in the market is towards investment in revenues flowing from rare disease treatments. This is likely because such drugs are less likely to face commercial competition than other products.

Richard Gervase leads the royalty monetisation practice at Mintz

Of the 20 unique therapies whose revenues Royalty Pharma bought a portion of in 2020 to 2021, 45% focus on the treatment of rare diseases. The sector's first billion dollar-plus deal related to cystic fibrosis drugs. Struck in 2014, the transaction saw Royalty Pharma spend more than $3 billion for orphan drug revenues belonging to the Cystic Fibrosis Foundation. The company has also invested in rare hereditary angioedema treatment revenues owned by Biocryst, in the proceeds of Risdiplam (which treats spinal muscular atrophy), and in orphan drug letermovir.

Other investors have also been drawn to orphan drug royalties. Healthcare Royalty has invested in Zolgensma and Adynovate revenue streams, for example.

Oncology treatments are another key focus. These account for 18% of Royalty Pharma's recent deals and for many of the agreements made by other companies. Last year, Healthcare Royalty Partners agreed to pay up to $325 million in a royalty financing deal based on ADC Therapeutics' antibody drug conjugate Zynlonta. It also committed to pay up to $67.5 million for Aptevo Therapeutics' share of revenues from Pfizer's non-Hodgkin's lymphoma treatment, Ruxience.

Indeed, the value of oncology treatments has tempted investors to abandon their usual requirements for a lack of competition. The Ruxience deal related to a biosimilar. What is more, Sagard was prepared to pay $250 million for a share of the proceeds from cancer treatment Jemperli, despite there being six other PD1 inhibitors already on the market.

Looking back further through the history of royalty transactions, most of the high price-tag deals have related to cancer drugs. The University of California sold its Xtandi revenues for $1.25 billion in 2016, while in 2019 LifeArc was able to secure a $1.297 billion upfront payment for its royalty stream from Keytruda.

Yet the market for royalties is by no means restricted to these two sectors. Major recent investments have been made in immunology, cardiovascular, neurology and infectious disease treatments.

Pre-commercial assets are now attracting deals

Investors have typically been less willing to invest in the future royalties of products not yet on the market. Such revenue streams face profound commercial and regulatory risks. Several companies will not even consider buying these assets. Sagard partner Ali Alagheband explains: "We [Sagard] do not bet on pre-commercialised products. It is not the expertise we have. We look for innovative, commercialised products treating medically necessary conditions. Ideally, we want to see some sales history, but that is not always possible."

Recently, however, there has been a surge of deals relating to pre-approved drugs. In its annual presentation to the JP Morgan Healthcare Conference, Royalty Pharma claimed to have more than doubled its portfolio of development-stage therapies. It stated that these are expected to generate larger percentage returns on average than its royalties on approved drugs.

In its recent deal with Cytokinetics, for instance, the company purchased royalties on investigational drug Aficamten and made a loan against another pre-commercialised product, omecamtiv mecarbil. Royalty Pharma's 2021 agreement with MorphoSys included, among other things, an entitlement to 80% of the company's sales revenue and 100% of its milestones from GlaxoSmithKline's phase three arthritis treatment Otilimab, as well as 60% of future royalties from late-stage antibody Gantenerumab. In late 2020, Royalty Pharma acquired a royalty interest in BioCryst Pharmaceuticals' experimental asset BCX9930. Blackstone also purchased revenues pertaining to developmental assets: its multilayered deal with Alynlam related to Inclisiran, which was yet to come to market at the time.

Synthetic royalty deals have opened up the market

Whereas deals have previously concerned the sale of existing royalty streams from products owned by third

Ali Alagheband, partner at major drug royalty investor, Sagard Healthcare Royalty Partners

parties, a new type of agreement has become more common in recent years. Synthetic royalty deals, in which an organisation creates a new royalty in order to be sold, now account for a significant proportion of drug revenue sales – of the income streams acquired by Royalty Pharma over the past two years, 36% fall into this category.

These have significant advantages, as royalty transaction specialist Richard Gervase of Mintz comments: "Synthetic royalties are a flexible form of financing. For a company that does not receive royalties (but rather will be commercialising the product itself), synthetic royalty transactions are a good way to raise capital on the basis of the value of a specific asset."

They also open up the market to a larger pool of investors, Gervase continues, "because many investors may not have the mandate to invest in royalty streams directly but may be able to do various types of structured debt financings based on the royalty/revenue stream."

Deals becoming more versatile and tailored

Drug royalty investment deals are becoming more flexible and sophisticated in a range of other ways, too. Deals often include a tiered, tapered or capped royalty structure, with purchasers earning higher or lower percentages based on the size of the income stream and the time it takes to recoup their investment.

This is "often a good way to bridge the gap if the seller has a more bullish view of the asset than the buyer", Alagheband told IAM, following Sagard's purchase of Jemperli royalties from AnaptysBio – a deal that will have included several of these features. "The attractive thing about drug royalty transactions is that there are so many ways to structure these deals. There are many bells and whistles that can be attached to them," he said. "Rather than having a hard cap, you can also have a soft tail: when a certain threshold is reached, the buyer drops to a lower percentage stake."

However, agreements also now increasingly include a royalty purchase alongside other forms of investment relating to equity, corporate debt and additional R&D. One of the clearest indications can be seen in last year's $2 billion deal between Royalty Pharma and MorphoSys. Whereas royalty sellers often use their upfront payment to investment in further R&D, MorphoSys utilised this sale to fund its $1.7 billion acquisition of oncology company Constellation Pharmaceuticals.

In the multilayered transaction, Royalty Pharma agreed to pay $1.425 million upfront to fund the buyout. It also committed to make up to $350 million worth of Development Funding Bonds available to Morphosys, and to pay up to $150 million in additional milestones, as well as buying $100 million worth of MorphoSys shares. In return, Royalty is entitled to 80% of the German biotech's future sales revenues and 100% of its milestone payments from Otilimab. It will receive 60% of the company's royalties from Gantenerumab and a 3% synthetic royalty from all candidates acquired from Constellation.

Blackstone's 2020 agreement with Alynlam is another notable example of sophisticated, tailor-made royalty dealmaking. As well as the purchase of 50% of the company's royalty stake in Inclisiran for $1 billion, the transaction saw $750 million change hands in a secured term loan, $150 million invested in Alynlam's cardiometabolic R&D and a $100 million purchase of common stock.

Indeed, the first royalty agreement of 2022, between Royalty Pharma and Cytokinetics, also falls into this category. That arrangement will see the royalty buyer providing up to $300 million in loans to support the potential commercialisation of omecmtiv mecarbil and the development of aficamten. It also means that Royalty Pharma will acquire a 4.5% synthetic royalty on aficamten sales of up to $1 billion and of 3.5% on sales above $1 billion, in exchange for payment of up to $150 million.

Deeper, longer-lasting partnerships

This is closely related to another development that is reshaping the drug royalty purchase market: the emergence of long-term strategic partnerships between buyers and sellers.

"Now we are becoming more of a financial partner for these companies," commented Alagheband in a more recent interview. "In the past, a deal would be done and then you would move on. These days an initial deal will be struck and then you will work with them over time as their needs change. They may want to make acquisitions. They may need additional capital. Because our solutions are flexible, are bespoke, we can be better partners."

Not only is this reflected in the more complex and tailored agreements that have begun to emerge in the market, but in repeated dealmaking between the same parties. Royalty Pharma, for example, followed up its 2014 deal with the Cystic Fibrosis Foundation by purchasing the remainder of the charity's Vertex royalties in a $650 million agreement in 2020. Its recent Cytokinetics transaction came in the wake of a previous 2017 deal between the two organisations. Royalty Pharma has also agreed repeat deals with BioCryst (2020 and 2021) and Biohaven (2018 and 2020).

So, royalty sales are no longer solely a means to obtain a one-off cash injection in exchange for longer-term income streams. Instead they can offer innovators more meaningful and versatile assistance.

How to approach royalty dealmaking

Despite the growing flexibility of drug revenue transactions, there are of course hurdles to be overcome. However, organisations that seek to monetise their royalties can adopt certain approaches to boost their chances of success.

"A seller that wishes to explore a royalty monetisation should plan to do significant preparation work in order to ensure a successful outcome," says Gourary. "It should form a dedicated internal team (in the case of a university or non-profit, this typically includes representatives drawn from the tech transfer office, from finance and from the office of general counsel) and it should also consider engaging external advisors with a track record in royalty monetisations."

These external advisors typically include a financial advisor, as well as an experienced monetisation lawyer who is familiar with this distinctive type of transaction. "Experienced advisors will understand the perspectives of both sellers and buyers, and therefore will help a seller anticipate and proactively address buyer concerns to ensure that the transaction is successfully and efficiently closed."

Gervase echoes this, arguing that sellers should speak to experienced advisors before talking to potential investors. "As a seller, you should make sure you understand the risks of the transaction upfront and structure the transaction to avoid as many of those risks as possible," he suggests. "That is the way you will have the greatest likelihood of success in getting a deal completed in this space."

Gourary also recommends that a seller should examine its asset from the perspective of a royalty buyer. "It will look at the contracts and agreements that give rise to the royalty agreement from the perspective of a buyer and figure out whether there are things that need to be fixed." Any ambiguities involving the economics of the royalty stream should be addressed and resolved before launching a sale, Gourary states. "For example, I have seen ambiguities relating to the duration of the royalty stream and ambiguities in the way certain offsets that may be taken against the royalty are to be calculated." Smart sellers should also check at the beginning of the process as to whether consents need to be obtained for a transaction, in order to avoid derailing a deal partway through. IAM

FURTHER READING

Patent transactions

- Buyer and seller can be pleased with the BlackBerry patent sale's outcome (3 February 2022)
- BlackBerry portfolio sold for $600 million to SPV led by US-based patent market insider (31 January 2022)
- Q3 2021 saw a software surge in US patent sales (7 January 2022)
- Operating companies acquired 70% of transacted US patents in Q2 2021 (8 September 2021)
- Patent dealmaking down in the US during Q1 of 2021 (8 June 2021)
- The 2020 brokered patent market

Patent licensing

- €1.5 billion in IP licensing revenue buoys Nokia profits for 2021 (4 February 2022)
- Ericsson banks $875 million in IP licensing revenues for 2021 (26 January 2022)
- InterDigital reveals financial impact of recent licensing deal with Xiaomi (5 November 2021)
- It's tech, not patents, that makes Qualcomm a royalty-generating machine (23 September 2021)
- Smartphone royalty stack continues multi-year decline, says analyst (6 September 2021)
- Unpacking the royalty stack (1 June 2020)

Drug royalty transactions

- Flexibility crucial to growing appeal of big money drug royalty transactions, says leading deal-maker (1 November 2021)
- Healthcare Royalty Partners' $750 million IPO to be next milestone for a booming market (5 August 2021)
- $2 billion deal shows growing sophistication of drug royalty sales (15 June 2021)
- Five key insights into 2020's drug royalty transactions (16 December 2020)
- There has never been a better time to sell or buy drug royalties, says industry veteran (10 November 2020)
- $1 billion Keytruda deal illustrates value of royalty right sales for research institutes (30 May 2019)

ABOUT IAM

IAM is the leading intelligence platform for the global IP market. Our unrivalled coverage and in-depth analysis of key sectors gives our clients critical information to enable them to maximise the value of their IP assets.

Our unique and timely intelligence, analysis and data service informs high-level corporate decision making, while our extensive connections with senior operators in the corporate, legal, policymaking and investment worlds provide a clear line of sight into market developments before they are widely known.

IAM offers global coverage of the IP value creation environment. Our worldwide team of reporters, researchers and analysts provides unmatched understanding of local markets in North America, Europe and Asia to ensure that IAM is the first to provide the analysis that matters.

Contact us

London
Meridian House
34-35 Farringdon Street
London EC4A 4HL
United Kingdom
T +44 20 7234 0606
info@iam-media.com

Hong Kong
1901, 19/F Dominion Centre
43-59 Queen's Road East
Wan Chai
Hong Kong
T +852 3956 1600
info@iam-media.com

Washington DC
2122 P Street NW
Suite 201
Washington DC 20037
United States
T +1 202 831 4654
info@iam-media.com

IAMSPR_SPCLRPT_Q122