MONDAY
OCTOBER 19, 2009

BioWorld® Insight
Your Weekly Source for Market and Financial Views

VOL. 17, NO. 42
SPECIAL REPRINT

Even Cash-rich Firms Wade in

Industry Not 'Cowen' to Straits: Royalty Sell-offs a Regal Road

By Randy Osborne
Editor

Raising money through the sales of future royalties isn't just for the desperate anymore, but it remains to be seen whether the ploy will turn out to be good for cash-rich companies that take the increasingly popular route.

Still the poster child for the approach is Cambridge, Mass.-based Vertex Pharmaceuticals Inc., which made news last year when the firm sold royalty rights for two HIV protease inhibitors it helped develop with GlaxoSmithKline plc, of London – Lexiva and Agenerase – for $160 million to **Cowen Healthcare Royalty Partners**. (See *BioWorld Today*, June 4, 2008.)

"Vertex has just been very proactive about financing for many years, to make sure they have money in the bank," said Todd Davis, managing director at Cowen. "You never know when financing windows will close, when they will open, and royalty financing isn't always available either, just like [initial public offering] windows are not always available."

Vertex and GSK partnered on HIV in 1993. The divestment of non-core assets should increase the firm's flexibility and boost development of Vertex's hepatitis C virus portfolio, including the high-profile Phase III protease inhibitor telaprevir.

Selling royalties is "not such a mysterious, unusual approach, and we're seeing a number of very well capitalized companies now approach us," Davis said. "They're simply viewing it as a financial strategy, one driven by financial prudence. Vertex as well as Dyax, one of our other partners, have very proactive financing strategies."

Also of Cambridge, Dyax is doing well for itself despite – and perhaps eventually because of – last week's FDA approval of King of Prussia, Pa.-based CSL Behring's Berinert, which beat would-be competitors to become the first therapy approved by the FDA to treat acute abdominal or facial attacks in adults and adolescents with hereditary angioedema, which afflicts about 6,500 patients in the U.S. (See *BioWorld Today*, Oct. 13, 2009.)

The victory gives CSL seven years of exclusivity protection for Berinert, a C1-esterase inhibitor, under its FDA orphan drug designation in the acute indication. But it also will help broaden awareness that therapy is available. What's more, Berinert is derived from human plasma, given intravenously, and was not cleared for life-threatening laryngeal attacks. This could leave an important space for management of acute attacks, the target of Dyax's DX-88, which bears a Dec. 1 action date at the FDA.

Motives for royalty sell-offs are always different, Davis noted, "but there are certain themes. Sometimes it's risk diversification, where you have one large royalty asset, and the next set [of assets comprises candidates in] Phase I and Phase II, of uncertain futures. You could say they were overallocated, if it was an investment portfolio. So they take a little bit of money off the table for the royalty we have, and put it in the bank for something safe."

While doing the royalty deals carries risk, not doing the deals also does – and sometimes the risk proves fatal. "You might get away with it and you might save a little bit [by spurning a potential royalty deal]," but taking the cash when offered under such an arrangement lets the firm "avoid getting trapped going into the fourth quarter of 2008 with an insufficient amount of capital, and that has killed a number of companies over the past year."

Lately Vertex followed up with another deal, pulling down $155 million in cash including $120 million from issuing notes backed by $155 million in future European telaprevir milestones from Johnson & Johnson, and $35 million for rights to $95 million more in milestones related to the drug's launch overseas. Leerink Swann analyst Howard Liang, in an Oct. 1 research report, called the transaction "unprecedented," and praised the deal.

"While there appears to be a meaningful discount from the potential $250 million in milestones," he wrote, the amount works out to about a 15 percent overall cost of capital, "which we believe is a very reasonable discount considering the alternative of raising equity financing."

Cowen's Davis praised the financing, though it's not the type his firm handles. "I think that was a smart deal for Vertex," he said. "Those milestones aren't without some risk, at least in terms of the timing."

Selling royalties is hardly new. Last year, the former CV Therapeutics Inc. (now part of Gilead Sciences Inc., of Foster City, Calif.) hauled in $175 million, plus another $10 million milestone to come, by selling half its royalty stream on the cardiac stress-testing agent Lexiscan to TPG-Axon Capital. Bridgewater, N.J.-based Enzon Pharmaceuticals Inc. sold 25 percent of its future royalties in PEG-Intron to DRI Capital for $92.5 million in 2007.

And the beat goes on. Cowen, the first outfit to adopt such investments as a core strategy, has been active in the space since the summer of 2008, and so far has done seven deals worth a little over $300 million. Cowen in August raised more than $250 million for a co-investment or "top-up fund."

Deals in the space are growing in complexity and size. The average for Cowen is about $45 million, but the firm is mulling arrangements in excess of $100 million – not university deals (which historically have been big) but pacts with companies.

"We looked at one deal earlier this year that was $600 million," Davis said. "We didn't get it done but we had it fully financed." Others in the works include one valued at around $200 million, and a couple that are worth more than $100 million.

Stamford, Conn.-based Cowen last month established a strategic advisory board that comprises health care industry veterans to help with due diligence and evaluating a bounty of opportunities.

"There are just more royalties available in general in the space, as the venture capital investments of the 1980s and 1990s come to fruition," Davis said. More research and development has been done outside of pharma firms than inside, another major driving force, he added.

"Intellectual property licensing – and therefore royalties – are such a huge economic factor in the industry," he said, and today "established institutional investors who know how to monetize those efficiently," as they deal with more sellers who are more sophisticated, too.

"This is the beginning of a fairly large sector," Davis said.

It all works out well for Cowen, which deploys very little debt to get the deals done and thus dodges the same financial hard times that are spurring drug developers to enter the arrangements.

"It doesn't mean that the other folks who use debt in the space are wrong," he said. "They get a higher return on the asset by using leverage, but that leverage has a cost." While the cost doesn't show up explicitly on the balance sheet, it does become evident in terms of "flexibility, and therefore viability" of the business, Davis said, allowing that "after the deal's been done, a couple of years downstream, we may look at applying debt for various reasons."

Mainly, though, for Cowen, avoiding such leverage means comfort all around. "When we put out a term sheet on a deal, we can speak for all the capital in the term sheet," he said. "We're not trying to raise money to get a deal done." ■