

Milestones, royalties and the structure of deals

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The financial terms of a pharmaceutical licence reflect the uncertainty of drug development. Only a small fraction of candidate molecules that enter clinical trials eventually obtain marketing authorisation. The probability of success also differs strongly between therapeutic areas and phases.¹ The parties therefore split the payment into several elements. An upfront payment on signature compensates the licensor for the work done so far. Milestone payments become due when defined events occur, such as the start of a phase of clinical trials, the filing of an application for authorisation, the approval in a major market or the achievement of certain sales thresholds. Royalties, calculated as a percentage of the net sales of the product, finally share the commercial success.

Press releases often announce deals with a "total value" of several billion dollars. Such figures add up all possible milestones and give a misleading impression of what the licensor will actually receive. In most cases the upfront payment represents only a small part of the headline figure. Many milestones will never be paid because the product fails along the way.² For a biotech company in Basel, the distinction between the upfront payment and the contingent payments is crucial for financial planning, because only the upfront payment can be counted on to fund its operations.

Royalty rates depend on the stage of development at which the licence is granted and on the strength of the intellectual property. An early-stage licence from a university may carry a single-digit royalty, while a late-stage product with strong patents may command royalties in the double digits.³ Royalty streams have themselves become a financial asset. Specialised investors buy future royalties from universities and biotech companies in exchange for an immediate payment, which gives the seller liquidity and transfers the commercial risk to the buyer. This market for royalty monetisation has grown into a significant source of non-dilutive financing for biotech companies, including some in Switzerland.⁴

1 Notes

1. On the probabilities of success of clinical development by phase and therapeutic area, see the analyses published by the Biotechnology Innovation Organization (BIO) and others on clinical development success rates. Figures to be verified. ↩
2. On the gap between announced "biobucks" and payments actually received in biopharmaceutical licensing, see the industry literature on deal structures and analyses of licensing databases. To be verified. ↩
3. On typical ranges of royalty rates by stage of development in the life sciences, see the surveys of licensing practice published by professional associations such as the Licensing Executives Society. Figures to be verified. ↩
4. On royalty monetisation and synthetic royalty financing as a source of capital for biotech companies, see the reports of specialised royalty investors and the financial press. To be verified. ↩

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