Tranched Investments in Troubled Times

Investments in early stage life sciences companies often provide that payments are tranched over time, subject to satisfying agreed milestones. This is normal, but in this abnormal market, stakeholders are approaching tranched investments with more caution.

As a starting point, where milestones and other completion conditions are met, the investor should be contractually obliged to invest the next tranche. To facilitate this, operational milestones should be objective tests and completion conditions should involve clear deliverables for the company. However, unforeseen events may challenge the tranched structure that was originally agreed when the initial investment was made.

In the current climate, R&D-focused business models of life sciences companies are under pressure. Specifically, as the effects of COVID-19 crystallise, there has been an impact the ability to carry out R&D, particularly where it involves third party contractors, laboratory testing and evaluating patients during clinical trials. Where R&D is able to continue, the pace at which it is moving is generally slower. This is particularly difficult for companies that rely on tranched funding from investors linked to satisfying specific milestones.

Consequently, where companies are mid-way through a tranched investment round, parties may consider adjusting them to allow for smaller and more frequent tranches or adjust the associated triggers. In circumstances where a milestone has not been met, an investor may be persuaded to waive the milestone to invest the next tranche earlier than planned. Where a milestone has been met, if the investor does not invest the agreed amount for whatever reason, the company may consider what the ramifications on the investor's preferential rights should be.

Tranched investments are not an option to invest. However, in these times, flexibility may be needed and regular communication between companies and investors as to what is appropriate at the time is essential.