Hedging COVID-19 Pandemic Risks in Early-Stage Financings

In recent posts, we reviewed **“down-rounds”** and **hedging COVID-19 pandemic risks in M&A**. This post complements them and focuses on early-stage life sciences companies and their potential investors.

While the customary development timelines for life sciences companies may seem less prone to risks associated with COVID-19, the pandemic still resulted in delays and required adjustment to development plans and budgets, and, consequently, made evaluation of investments challenging.

There are several potential structures that companies can use to get investors “off the fence” and commit funds without lowering their valuation. Companies can offer warrant coverage, to allow investors to purchase shares at the lower price contingent upon additional financing (or failure to obtain it).[1] Alternatively, investors may prefer to spread or stagger their investments, such that capital commitments would be tied to achievement of milestones, which is already common in many life sciences financings, but can be further spread or staggered to address COVID-19 specific concerns. These solutions provide companies with sufficient funds for short-term development runway, and prospective future funds, while allowing investors to validate their evaluations and mitigate risk of overpaying. A similar solution is financing through convertible notes or simple agreements for future equity (SAFEs), with a conversion price or exchange price that is based on future financings and/or contingent upon achievement of milestones. The above alternatives are easier to implement than potential, yet unorthodox means, such as post-Closing price adjustment (which raises anti-dilution concerns).

In addition to mitigation through transaction structures, investors can also seek enhanced discretion with respect to a company’s development plan and budget, access rights and other covenants and rights, or a combination thereof, such that investors could get comfortable without undermining the company’s ability to progress.

Striking the right balance is not always an easy task, in particular during a time of unprecedented uncertainty, but, as long as investors and companies are aligned on the core strategy and goals, there are multiple ways to find it, including those reviewed in this post.

---

[1] Lower price can be accomplished by either offering the right to purchase additional shares of the same class at a lower price for shares in the then-current round or by offering the same price or a discount on the price per share for shares in a future financing with a higher price per share.