Contingent Value Rights in Public M&A

Overview, market practices and valuation considerations

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Agenda

- CVR background
- Market context and recent issuance
- Typical structures and key terms
- Valuation frameworks and practical modeling
- Advantages and disadvantages in deal structuring
- Implications and takeaways for financial professionals

What is a Contingent Value Right (CVR)?

- Contractual right granted to target shareholders in the acquisition of a publicly traded company
- Event-driven CVRs provide additional consideration if specified post-closing milestones or events occur
- Public company analog of an earnout for a privately held entity
- Typically documented in a CVR agreement separate from the Purchase and Sale Agreement
- Price protection CVRs are designed to pay out additional consideration in stock-based mergers
- CVRs issued in the past 5 years have been event-driven rather than for stock price protection

Brief History and Evolution

- Late 1980s–1990s: price-protection CVRs tied to acquirer share price
- 2000s: gradual shift toward event-driven CVRs linked to target assets and milestones
- Life sciences companies becomes primary use-case given binary, milestone-driven value
- Increasing use to bridge valuation gaps in smaller, riskier deals
- 2025 demonstrated the use of event-driven CVRs also in large-cap transactions

Market Context and Trends

- About 75 CVRs issued in the past 10 years, with ~30 issued or announced in 2025 only
- Life sciences is now the dominant sector for CVRs – 90% of issues in 2025
- Particularly prevalent in sub-$500m equity value transactions
- Clear acceleration in biotech transactions using CVRs
- 2025 included several large-cap deals

Examples of Recent Transactions

- Hologic / Blackstone + TPG: $76.00 cash plus CVR of up to $3.00 based on breast health segment revenue goals (pending)
- TreeHouse Foods / Investindustrial: CVR sharing upside from long-running antitrust litigation with Keurig Dr Pepper (pending)
- Akero Therapeutics / Novo Nordisk: $54.00 cash plus CVR of up to $6.00 contingent on regulatory approval of lead drug candidate
- 89bio / Roche: $14.50 cash plus CVR of up to $0.90, tied to MASH asset milestones
- Metsera / Pfizer: $65.60 cash plus CVR of up to $20.65 with multiple clinical and regulatory milestones for obesity pipeline
- Walgreens Boots Alliance / Sycamore Partners: CVR contingent on sale or monetization of VillageMD assets

Typical Structural Features

- Triggers for Payout:
  - Clinical milestones
  - Regulatory approval
  - Sales target
  - Litigation resolution
  - Asset sale milestones
- Payout:
  - Normally cash-settled, capped maximum consideration, defined outside dates
- Transferability:
  - In most cases, CVRs are **non-transferable**, with limited permitted transfers, such as estates, to avoid SEC registration requirement as a security
- Efforts standards:
  - Acquirer often subject to "diligent" or "commercially reasonable" efforts with respect to business conduct and milestones, but some agreements actually disclaim any obligation to use efforts

Why Acquirers Use CVRs

- Bridge valuation gaps without paying for all upside upfront
    - **Typically, maximum payout on CVRs represents about 20% of the upfront cash consideration**
- Protect downside for acquirer while remaining competitive in auctions
- Align consideration with the success of high-risk projects, such as a registration clinical trial for a drug
- Positive signaling effects to market
- Conserve balance sheet capacity by deferring contingent payments
- Provides an earnout mechanism that can avoid registration of a new public security, saving expenses and avoiding potential hedge fund shorting of stock

Why Sellers Accept CVRs

- Tool for overcoming information asymmetry between buyer and seller
- Retain upside exposure after solidifying base value at closing
- Improve perceived fairness of a sale in difficult market conditions
- Biotech investors are generally familiar with milestone payment concept
- Monetize contingent assets such as litigation claims or residual programs
- Potentially facilitate board approval where upside is meaningful but uncertain

Valuing CVRs - Overview

- CVRs are unique, illiquid, and not directly hedgeable
- Valuation methods typically used are:
  - Scenario-based expected value
  - Monte Carlo simulation
  - Decision trees
  - Options analysis
  - Implied market value
- Key inputs: milestone definitions, probabilities, timing, payout size
- Discount rate must be carefully chosen (company-specific, industry, or risk-free)
- Important to treat illiquidity and governance risk explicitly in the valuation
- Historical realized value estimated at 54 cents on the dollar, but has been undervalued by market

Scenario-Based Expected Value

- Map each milestone’s timing, probability and conditional payout
- Calculate probability-weighted cash flows and discount to present value
- Pros: intuitive, transparent, flexible for sequential milestones
- Cons: subjective probabilities and discount rate; correlated risks can be hard to capture

Decision Trees and Monte Carlo

- Decision trees for multi-stage structures (e.g., clinical phases, approvals, sales tiers)
- Monte Carlo for sales-based CVRs using stochastic sales paths and simulated payouts
- Facilitates explicit modeling of path-dependence and parameter sensitivities
- Requires careful calibration of sales volatility and scenario assumptions

Options Based Valuation

- Many CVRs resemble digital options or call spreads on revenue or approvals
- Option thinking is useful for understanding convexity and downside
- Full risk-neutral pricing is rarely feasible due to non-hedgeable underlying assets

Implied Market Value

- Where observable, market-implied CVR prices provide useful benchmarks
- Trading in target company shares between merger approval and closing will provide an implied CVR price, where:
    - CVR Implied Value = Share Market Price – Cash Value per Share
- A typical implied value before transaction closing is 15% of potential value
- However, the differential between nominal acquisition value per share and market price can also reflect other risk factors of the transaction not closing or the buyer

Illiquidity, Governance and Efforts Risk

- Non-transferable CVRs carry meaningful illiquidity and holding-period risk
- Conceptually separate the value of a hypothetical marketable claim from a DLOM adjustment
- Governance and information asymmetry: reliance on acquirer's efforts and reporting, with agreement language varying from case to case
- Disputes over efforts standards can be material, as seen in high-profile litigation (e.g., Sanofi's acquisition of Genzyme)

GAAP Accounting Impact

- Most CVRs are classified as liabilities because they are usually cash-settled or do not meet the "fixed-for-fixed" criteria for equity classification
- Fair value of CVR issued is recorded as part of the total consideration paid, thereby increasing goodwill value
- For CVRs classified as liabilities, the acquirer must re-measure the fair value at each reporting period, e.g., quarterly, until the contingency is resolved
- Any changes in the fair value for a CVR (due to shifts in clinical trial success probability, timing, or discount rates) must be recognized as gains or losses in the income statement

Pros and Cons of CVRs

Party	Pros	Cons
Acquirer	Flexibility, bridge value expectations	Complexity, dispute potential, accounting volatility
Seller	Upside potential	Illiquidity, lack of control, credit risk
Investor	Mispricing opportunities	Illiquidity

- Each CVR is bespoke and requires deal-by-deal analysis

Practical Takeaways

- Treat CVR components as separate securities with their own risk-return profile
- Review the CVR agreement rather than relying on high-level deal summaries
- Build disciplined scenario models and be explicit about illiquidity and governance haircuts
- Compare implied pricing with precedent CVRs to calibrate value

Further Reading

- The Re-Emergence of Contingent Value Rights, Harvard Law School Forum on Corporate Governance, June 2025
- Key Components and Trends of CVRs in Life Sciences Public M&A Deals, Harvard Law School Forum on Corporate Governance, June 2023
- Contingent Value Rights: Theory and Empirical Evidence, Chatterjee & Yan, July 2003

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