Six Key Insights into China Biotech's NewCo Model

Authors: Aaron GU | Duzhiyun ZHENG | Matt ZHANG | Franky YU | Shuwen SUN | Ariel YANG[1]

In the age of globalization, Chinese pharmaceutical companies are at the forefront of innovation and collaboration, seizing unprecedented development opportunities. Meanwhile, overseas investors and pharmaceutical companies are also keen to capture investment and development opportunities, and actively looking for new growth areas in the pharmaceutical industry. Against this backdrop, the Spin off-NewCo model (commonly referred to as **"SON"** or **"NewCo"** model), which gained popularity in 2024, has effectively met the needs of all parties involved. This model has set a new trend for Chinese companies expanding internationally, empowering many of them to secure a first-mover advantage in global competition (for practical insights into the "SON" model, please refer to our analysis article: *"Insights into China Biotech's New Approach: Spin-off-NewCo Model"*).

Having advised many NewCo projects, we have gained a deep understanding of their strategic value, commercial opportunities, and associated risk. This article draws on our team's practical experience and provides a concise overview of recent developments in the NewCo model. We analyze key practical aspects of the NewCo model, including strategic considerations for Spin-off, comparisons with traditional out-licensing deals, non-traditional NewCo model, and other factors to consider when establishing a NewCo, aiming to offer valuable insights and encourage discussion within the industry.

Strategic decisions in spin-off and securing a "first-mover advantage"

Spin-off is a critical step in implementing the NewCo model. In most projects, the Spin-off process begins after external investors become involved. In such cases, external investors with a strong interest in specific pipeline assets often require the licensor ("**Licensor**") to fully license the relevant pipeline assets or rights to a NewCo established by the investors or jointly by both parties. This approach aims to maximize resource advantages and drive the development and commercialization of these pipeline assets effectively.

[1] Jingjing XU have contributions to this article.

Recently, we have observed another type of Spin-off strategy, led by the Licensor through internal restructuring within its corporate group. Some biotech companies strategically arrange their internal pipeline layouts, proactively establish NewCos, and allocate relevant pipeline assets in advance. This approach enables them to take greater initiative in subsequent market expansion and international collaboration, maintain effective control over key assets and optimize long-term returns.

These two Spin-off strategies demonstrate the first-mover advantage within the NewCo model, which is leveraged by the leading party in the Spin-off. The choice of a specific Spin-off strategy further depends on the Licensor or investor who makes informed decisions based on their market positioning, resource allocation needs, and risk tolerance.

License model vs. NewCo model: comparisons of revenue pathways and control

Some Licensors, possessing high-quality assets that have made development progresses, may face a choice between the traditional License model and the NewCo model.

In the short term, the traditional License model generates revenue from pipelines more quickly than the NewCo model. Under the traditional License model, the Licensee typically attracts the Licensor by offering substantial upfront payments. This approach enables the Licensor to secure significant income in the short term and alleviate its financial pressure, making the model an appealing option. In contrast, the NewCo model may provide less initial revenue to the Licensor, as the monetization of its assets or rights heavily relies on continued pipeline development and subsequent advancements. As a result, short-term cash flow is relatively slower. However, by effectively integrating resources through the NewCo model, Licensors may achieve significantly higher returns from equity in subsequent license-out transactions, mergers and acquisitions, or public offerings.

For Licensors, the NewCo model offers relative advantages over traditional License model providing greater control over pipeline products and promoting their development and commercialization. In the traditional License model, the Licensee typically holds control over the development of licensed products. Given the potential presence for competing pipelines under development, the Licensee's strategic decisions may introduce uncertainties about further development and commercialization of the licensed products. In the NewCo model, however, the Licensor assumes dual roles as both a shareholder of the NewCo and the grantor of the license. This structure provides the Licensor with greater control over pipeline development compared to the traditional License model. Such control not only facilitates continued product development but also provides Licensor with greater potential for revenue-sharing in the Licensee's future benefits. Particularly after the commercialization of the pipeline, the Licensor stands to benefit not only from milestone payments tied to sales performance but also from long-term equity dividends and appreciation.

In terms of clause design, the focus of the traditional License model and the NewCo model differs significantly. Given the strategic priorities and unique considerations of each party, key provisions – such as diligence obligations, non-compete clauses, termination clauses, and exclusivity clauses – often vary substantially to address specific needs. Therefore, we recommend that companies or investors seek assistance from industry experts, including experienced transactional attorneys and tax professionals,

when crafting such agreements. By aligning contractual terms with strategic objectives and expected outcomes, parties can balance interests effectively and mitigate potential risks.

Breaking stereotypes about the NewCo model: Chinese NewCo and its global expansion

Pharmaceutical companies often face numerous challenges in their globalization process, such as difficulties in financing, fluctuations in cross-border investment regulations, and restrictions on foreign investment and regulatory compliance. The NewCo model inherently offers advantages in addressing these challenges. Specifically, within the commonly used framework of "Dollar Funds + Chinese Assets + U.S. Teams", Delaware in the United States is typically the preferred location for establishing a NewCo due to its favorable tax policies, flexible corporate laws, and investor-friendly protection mechanisms.

However, with the evolution of transactional practices, the NewCo model has become increasingly diversified in its applications. Given its inherent capabilities – such as streamlining pipeline products, spinning off assets, and reducing financing challenges – setting up a NewCo in China has emerged as a new option in transactions where biotech companies act as Licensors and collaborate with Chinese domestic investors or enterprises. This approach not only reduces communication and transaction costs but also significantly shortens project timelines. We have had the experience of participating in projects involving the establishment of NewCos in China, gaining extensive practical experience with this emerging approach.

We would like to highlight that the globalization of a Chinese NewCo does not conflict with the traditional overseas NewCo model; they can even proceed concurrently. Furthermore, Chinese NewCo can leverage their inherent advantages to develop Chinese and overseas rights in parallel, creating a "NewCo + NewCo" model. This approach optimizes market expansion mechanisms and facilitates a more comprehensive global strategic layout.

Comparison between traditional and non-traditional NewCo models: the rise of non-traditional NewCo model

In recent years, driven by the evolving landscape of innovative drug development and financing needs, the traditional NewCo model has gradually given rise to more flexible and innovative non-traditional NewCo model, providing the market with diversified solutions. Under the traditional model, funds typically flow with the NewCo paying license fees to the Licensor, with investors participating in project returns indirectly through equity ownership in the NewCo. However, as the NewCo model continues to evolve, new approaches to fund allocation have emerged to meet varying commercial demands.

The key of the non-traditional NewCo model lies in designing fund flows and equity arrangements flexibly based on the specific project requirements. For instance, we assisted in a NewCo transaction where the NewCo was established under the leadership of the Licensor. In this case, investors made direct payments to the Licensor or its affiliated entities in exchange for the option right to acquire the NewCo in the future. This design not only enabled the Licensor to secure funding in the early stages and promote pipeline development but also provided investors with a clear mechanism to lock in returns upon the project

reaching key milestones. Compared with the traditional NewCo model, this structure allows investors to ensure greater certainty by committing more significant financial resources, creating mutually beneficial cooperation conditions for both parties.

The rise of the non-traditional NewCo model demonstrates that the NewCo model is not merely a financing tool but also a strategic approach to resource integration. Looking ahead, companies can develop and choose suitable models flexibly based on their own needs and market conditions, aiming to maximize pipeline value and achieve breakthroughs in international objectives.

Core competitiveness of the NewCo model

The essence of the NewCo model lies in integrating resources from all parties to advance asset development and commercialization with maximum efficiency. Currently, the NewCo model demonstrates strong competitiveness in the global market, driven primarily by investors familiar with overseas markets and management teams experienced in overseas regulatory approvals, clinical trials, and product launches. Leveraging overseas funding and international teams, combined with China's innovative assets, the NewCo model has established a critical position in global drug development and commercialization.

Moreover, in recent years, an increasing number of local teams with international experience have begun to emerge, proving that the success of the NewCo model is not exclusive to foreign investors or teams. With the support of internationally experienced professionals, well-capitalized Chinese investors can achieve significant breakthroughs through the NewCo model. As long as they possess core teams familiar with overseas market regulations, regulatory processes, and product launch operations, Chinese investors can build efficient NewCo structures and serve as a key driver in the globalization of domestic innovative assets.

Currently, the U.S. and other western markets remain the core stages for global pharmaceutical commercialization. Nonetheless, Chinese investors do not need to be confined to traditional paths. By leveraging their capital advantages and recruiting professionals with international backgrounds, they can break through existing paradigms and explore the RMB-dominated NewCo model. This development not only facilitates the internationalization of Chinese assets but also creates a new model of "Chinese capital + international teams", injecting fresh vitality and confidence into the growth of NewCo. We firmly believe that with sufficient funding and a robust reserve of international talent, the Chinese NewCo model will occupy a more significant position in the global pharmaceutical landscape in the future.

The impact of geopolitics on the NewCo model

Geopolitical factors are profoundly influencing the globalization of the NewCo model. Multinational corporations are increasingly cautious in their collaboration with Chinese companies, citing complexities in due diligence and the lack of international credibility as key concerns. As a result, many companies are leaning toward partnerships with overseas entities, such as U.S.-based companies. This trend underscores the global market's emphasis on transaction transparency and compliance, posing new challenges for Chinese pharmaceutical companies (Licensors) in their global collaboration strategies.

To address these challenges, some Chinese companies have begun to adjust their global intellectual property (IP) strategies. For example, they are optimizing group IP arrangements in advance based on the NewCo's location (e.g., Singapore or the U.S.) and considering tax implications. Such adjustments not only enhance the convenience of cross-border cooperation but also mitigate uncertainties arising from geopolitical shifts. Additionally, with China's continuous advancement in high-level, high-quality openness, the cross-border flow of patents and technologies has been significantly invigorated, reducing barriers to pipeline Spin-offs and cross-border technical collaborations in biopharma. This creates new opportunities for Chinese pharmaceutical Licensors to optimize their IP layouts and expand into global markets.

Looking ahead, we recommend that Chinese companies incorporate geopolitical and tax factors into their IP strategy planning and develop specialized global strategies to enhance their international competitiveness. By optimizing the allocation of domestic and overseas resources, Chinese innovative pharmaceutical companies can participate more smoothly in global transactions. Furthermore, leveraging the NewCo model can facilitate more efficient internationalization of innovative assets, ultimately maximizing long-term commercial value.

Conclusion

As the global pharmaceutical market continues to evolve, the NewCo model, as a flexible and forward-looking strategic choice, is garnering increasing attention from the industry. Whether through the steady progression of traditional models or the flexible innovation of non-traditional approaches, the NewCo model provides Chinese pharmaceutical companies and external investors with expanded opportunities in the global market. In the face of geopolitical complexities, cross-border regulatory challenges, and dynamic financing environments, Chinese companies and external investors must adopt a more professional perspective in planning their strategies. By integrating domestic and international resources, optimizing patent layouts, and strengthening collaboration with international teams, they can better navigate challenges and seize opportunities. We firmly believe that the NewCo model will unleash even greater innovative potential in the future, creating broader prospects for the development of innovative pharmaceuticals.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact:

Aaron GU

Tel: +86 21 6080 0505
Email: aaron.gu@hankunlaw.com