DRI Capital Inc. – DRI Healthcare Trust

Q1 2021 Earnings Conference Call

Event Date/Time: May 10, 2021 — 8:00 a.m. E.T.

Length: 26 minutes

CORPORATE PARTICIPANTS

Behzad Khosrowshahi
DRI Healthcare Trust — Chief Executive Officer

Chris Anastasopoulos
DRI Healthcare Trust — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Douglas Miehm
RBC Capital Markets— Analyst

Gregg Gilbert
Truist Securities — Analyst

Adam Buckham
Scotiabank — Analyst

PRESENTATION

Operator

Good morning everyone. Welcome to the DRI Healthcare Trust First Quarter 2021 Results Conference Call.

Listeners are reminded that certain statements made in this earnings call presentation, including responses to questions, may contain forward-looking statements within the meaning of the Safe Harbour provisions of Canadian Provincial Securities laws. Forward-looking statements involve risks and uncertainties and undue reliance should not be placed on such statements. Certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied in such statements.

For additional material information about factors that may cause actual results to differ materially from expectations and about material factors or assumptions applied in making forward-looking statements, please consult the MD&A for this quarter, the risk factors section of the annual information Form and DRI Health care trusts other filings with Canadian Securities regulators. DRI Healthcare Trust does not undertake to update any forward-looking statements. Such statements speak only as of the date made.

This earnings call presentation also makes reference to certain non IFRS measures and industry metrics such as Adjusted EBITDA, Adjusted EBITDA margin, total cash royalty receipts, cash earnings per unit, free cash flow and debt to EBITDA. These measures are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to

similar measures presented by other issuers. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of DRI Healthcare Trust financial performance from management perspective. Accordingly, these measures should not be considered in isolation, nor as a substitute for an analysis of financial information reported under IFRS. Please note that all dollar amounts discussed today are in U.S. currency unless otherwise specified.

I'd like to remind everyone that this conference call is being recorded today, Monday, May 10, 2021.

I would now like to introduce Mr. Behzad Khosrowshahi, Chief Executive Officer of DRI Healthcare Trust. Please go-ahead Mr. Khosrowshahi.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you very much, Operator and good morning everybody, and welcome to our first earnings conference call since DRI Healthcare Trust IPO in February. Thank you very much for taking the time this morning.

Joining me today is Chris Anastasopoulos, our Chief Financial Officer.

On our call today I will review our business model, Chris will then discuss our IPO, our first quarter financial results, portfolio performance, and balance sheet, and then I will comment on our growth strategy and outlook. We will then take your questions.

As many of you already know, we are focused on acquiring and managing a growing portfolio of interests in high quality therapeutics. Our competitive advantages include our 32-year track record in the business, which provides us with a great deal of experience to draw from in executing on our strategy; our reputation as the partner of choice in the biopharmaceutical industry and our exemplary

sourcing and diligence execution. Over that time, we have developed a deep understanding of the pharmaceutical industry. We have formed trusted relationships with individual inventors, academic and research institutions, and corporations worldwide. We have developed and refined a proven and repeatable asset identification, selection and execution process which leverages our significant database of over 6,500 royalties on over 2,000 different products which we mind and add to on a regular basis to identify new opportunities.

We are focused on transactions that range between $25 million and $150 million in size, which we believe is an underserved and difficult to penetrate segment of our market and an arena that allows us to leverage our strengths. In this transaction range, we focus on medically necessary products marketed by industry leaders that benefit from strong regulatory and intellectual property protection. This has been our business model for 20 years and we are hard at work continuing to execute on it for our unitholders.

Now, Chris will discuss our IPO and our first quarter financial results.

Chris Anastasopoulos— Chief Financial Officer, DRI Healthcare Trust

Thanks Bezhad, and good morning everyone. This past February we completed our IPO and together with the concurrent hired pilot placement, we raised $400 million and issued about 40 million units. Approximately $293 million of the proceeds were used to purchase our initial portfolio of royalty assets and working capital, including cash from funds managed by DRI Capital. The balance of the net proceeds after transaction costs plus required cash left the trust with $100 million of cash at the date of acquisition to fund future growth.

Also, along with the acquisition of the wealthy assets, the Trust assumed secured notes with the principal amount outstanding at the time of the IPO, of about $70 million. The payments on these notes

are made quarterly. After the end of the quarter, we made a principal payment of $10.7 million on April 15. We expect to make additional principal payments of $16.3 million for the remainder of this year and fully repay the notes by the end of 2024.

It is important to note that in our consolidated financial statements for the first quarter as per IFRS accounting standards, we are reporting results for the period from February 19, 2021 to March 31, 2021. We generated $12.7 million in royalty income and $3.2 million in net training during this period. It's representing earnings per weighted average unit of about $0.17. All the income of $13.8 million for the period from January 1 to February 18 was recorded as an adjustment to the purchase price of the royalty assets. On a pro forma basis, for the full quarter, the portfolio generated total cash royalty receipts of $30.6 million and recorded pro forma Adjusted EBITDA of $28 million.

The trust has a highly efficient business model that provides exposure to the pharmaceutical sales without the pivotal costs and risks associated with generating those sales. Our Q1 results continue to demonstrate this efficiency.

Our operating expenses, (inaudible) and services fees amounted to $2.6 million for the quarter. Applying this to our pro forma, total cash royalties due to $30.6 million results in a pro forma Adjusted EBITDA of $28 million and the pro forma Adjusted EBITDA margin of 91 percent.

On this slide, you can see the breakdown of cash royalty receipts on a pro forma basis by royalty assets for Q1 2021 compared to pro forma results for Q1 2020. There was a decline of 7 percent in total cash royalty receipts in Q1 2021 compared to the previous year. This was primarily driven by a net 6 percent increase in cash royalty receipts from our core products due to the impact of a decrease in the cash royalty receipts of 4 percent from Spinraza, which was impacted by an increased compensation in

the U.S. market and (inaudible) delays related to the global pandemic. This decline was partially offset by increased sales outside the U.S., driven by patient growth in Europe and in the emerging markets.

There is also an increase of 4 percent in our two-ideal royalties, primarily due to the normalization of treatments globally and the launch of a prefilled syringe formulation outside the U.S.

An increase of 91 percent for FluMist cash royalty receipts, primarily due to increased vaccination programs in the U.S. and the European Union beyond typical levels during the ongoing COVID-19 pandemic, and a sudden increase of 70 percent in net power cash royalties due to the increased sales of the product in Europe. There was a net decrease of 11 percent in mature products, which was primarily driven by the net impact of an increase in cash royalty receipts related to the HIV Portfolio, primarily driven by higher sales in Jamaica, offset by a decrease in the autoimmune portfolio, which was impacted by the expiration of multi entitlement rights in major geographic areas and the continued exploration in other certain geographies.

There's also a decrease in legacy products, primarily due to expired royalty (inaudible) as expected. We should note that there are no cash royalty receipts for Zytiga in Q1 ‘21 and Q1 2020, as this royalty is paid semi-annually in Q2 and Q4 each year. Our portfolio remains diversified across a variety of metrics, including individual therapeutics, marketers, and therapeutic areas.

To summarize, we completed our first quarter as a public company and are well positioned to grow and deliver value to our unitholders. As at March 31, we had cash and cash equivalents of $106 million on our balance sheet. We maintain a prudent approach to debt, which principally consists of $69.9 million in secured notes. As noted previously, after the quarter end on April 15, we made a principal payment of $10.7 million against these notes. The ability to increase our leverage to 2 to 3 times debt EBITDA and then Adjusted EBITDA margins generated free cash flow, we have significant

resources from which to grow. Should we need to raise debt, based on our current track record and quality of our royalty streams, we are confident that we can secure funds on scalable terms.

Behzad will not provide some comments on our growth strategy and outlook.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thanks Chris. As Chris mentioned, we are well capitalized for growth, and there are two distinct avenues that we will pursue to fulfill our strategy. The first is to require royalties on commercialized pharmaceutical products which includes the purchase of existing royalty streams from individual inventors, academic institutions, and research institutions, and biotech and pharmaceutical companies. Second, we will look at investing in synthetic royalty streams. These involve contracting directly with a products marketer to receive a portion of its top line sales in exchange for cash.

Before I close, I would like to reiterate our strategy and outlook. We seek to generate sustainable growing cash royalty receipts from a diversified asset portfolio much as we have done throughout our history. We expect to make between $650 million and $750 million in royalty acquisitions over the next five years. This will be funded from a combination of cash on hand, the cash generated from the royalty portfolio, and if necessary, additional debt. To ensure reliable and predictable cash flows, we will look to acquire long-life assets such that we maintain and extend the weighted average duration of our portfolio. As stated, we will remain focused on transactions in the range of $25 million to $150 million.

We continue to execute on an active and growing pipeline of interesting opportunities. At this time, our active pipeline is comprised of eight potential transactions. These include acquisition opportunities that were in our pipeline at the time of the IPO and that we have substantially advanced since that time. Going forward, we expect to deliver to unitholders based on our proven long-term track record of executing under accretive transactions.

With that, we will now take your questions.

Q & A

Operator

Your first question comes from the line of Douglas Miehm with RBC Capital Markets.

Doug Miehm — Analyst, RBC Capital Markets

Good morning Behzad and Chris. My questions really have to do with what you just mentioned with respect to those eight products. As we went through the IPO process, you discussed those and three of them were proprietary. My first question, as it relates to those potential acquisitions, are any of them new? Did any fall off? When we think about timing, I think that you'd mentioned maybe four months from the closing of the IPO. Is that still good timing? Then my second question has to do with Spinraza and the new approval of the Roche competitive product in the EU, where you have a little bit more exposure I'd say relative to the U.S. Could you tell us about what you think the dynamics are going to be for that situation? I'll leave it there, thanks.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Doug, thanks very much for the questions and thanks very much for taking the time to attend the call. I appreciate it. I'll go through the questions and I'll do my best to answer them, but if I miss anything, please interrupt me and let me know.

In terms of the deal pipeline and sort of more generally in terms of the market, we see an industry that has just sort of deep and broad financial needs as we saw a few months ago and nothing has

changed in that regard, and we're continuing to see strong interest across all the verticals in which we work. Strong interest from individual inventors, academic institutions, and research institutions as well as biotech and pharma companies, and nothing in our competitive environment or a competitive set has changed materially.

In terms of the pipeline, of the eight products that we discussed in January, four have dropped out of the pipeline and they haven't dropped out because of any sort of issue with the assets that we were looking to acquire or anything like that. It's just a question of timing with the counterparties. In the meantime, we've added four new opportunities into the pipeline that we're working on prosecuting right now.

Most of the deals that are in our pipeline or in sort of low competition and proprietary kinds of situations as we have through our history, and obviously all of the assets that we're looking to acquire are sort of consistent with the criteria that we laid out at the time of the IPO.

In terms of the four months timing, we're obviously pretty comfortable with that and should that change, we will let everybody know and more broadly in terms of the overarching $650 million to $750 million in deployment over the next five years, nothing has changed that would suggest that that is not sort of readily achievable.

In terms of Spinraza, as you know, (inaudible) got approved in the European Union recently. Our point of view on Spinraza is pretty consistent with the analyst community, and we think that SMA is a big market and we think that Spinraza itself has a role to play in that SMA market and will continue as an option for patients, so nothing has changed with respect to our point of view and our point of view is pretty consistent with the analyst community's point of view.

Doug Miehm — Analyst, RBC Capital Markets

Okay. Great, thanks very much.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

No problem Doug.

Operator

Your next question comes from the line of Gregg Gilbert with Truist Securities.

Gregg Gilbert — Analyst, Truist Securities

Good morning. A couple of strategic questions. Your focus is at the smaller end of the deal pie. Does that insulate you from some of the return pressures that might exist at the very large transaction into things, and I guess on the other hand, when I think of smaller transactions, I think about the ability for more entities to try to do them, whether they're dabbling or whether they're sort of committed for the long term. So, maybe you could talk about the balance of those two things.

My second question is may be premature, but I know it's not your intention to look at preapproval assets for now, but maybe you could talk about what could change that overtime, whether it's a size issue or just what's available issue, thank you.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

No problem Greg. Thank you very much for the questions and thank you to you too for attending the call. You're right, our focus is on sort of a specific component of the market on the $25 million to $150 million segment of the market. As you heard from us during the process of the IPO, we've

deployed or acquired about $1.3 billion worth of assets in that segment of the market over the years, and so it’s an area that we're very familiar with. It's an area where we know all the counterparties, we have sort of deep and longstanding relationships with those counterparties and we're able to sort of thrive in that segment of the market.

In terms of return compression in different segments of the market, we haven't really seen materially better returns over the years in different segments of the market but things have changed a little bit in the sort of bigger sized deals segment of the market. Right now in that segment, you obviously have Royalty Pharma who is competing with a number of the Canadian Pension Plans and that sort of larger deal size segment of the market feels to be a lot more competitive than it used to be. Our segment of the market from a competitive standpoint really not much has changed and our focus is to engage with counterparties very early on in their decision-making process about selling a royalty stream so that we have more information from them so that we can structure a deal appropriately that meets their objectives and that puts us in sort of an advantage position if and when we are sort of facing competitors.

In terms of preapproval deals, I think we'll dabble in that market from time to time, but those kinds of deals have to meet a pretty high standard for us in order to sort of execute on them. We’ve got to make sure that we understand that a number of factors, including we want to make sure that the patient population is readily identified and the clinical data suggests that the drug will get approved, it's something that we may look at from time to time, but I really don't think it's going to be a material portion of our portfolio, at least not in the near term.

Gregg Gilbert — Truist Securities

Thank you.

Operator

Your next question comes from the line of Adam Buckham with Scotiabank.

Adam Buckham — Analyst, Scotiabank

Good morning and thanks for taking my questions. I just wanted to touch on Doug's question a little bit on the pipeline assets. Is it possible at a high level to get an idea of how far along the due diligence process some of the (inaudible) products are?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I can answer that question at a high level and Adam, thank you very much for the question and thank you for taking the time.

Typically as you know, our diligence process is something that takes us, on the short end, something like six or eight weeks, on the long end, three months or sometimes four months or so, and sometimes our diligence process is extended by how quickly or slowly our counterparties move and academic institutions tend to do move a little bit more slower than corporations do, but we go through a very methodical sort of approach to analyzing the deals that we look at and we look at the scientific data that supports a particular drug. We obviously build our own forecasts and do a lot of diligence there. We get IP opinions and things like that, and those are just two or three of the things that we do.

In that universe of eight deals that we're looking at, I'm not trying to be evasive, this is obviously our secret sauce here, I would say three of them are very advanced in our diligence cycle, and the balance, I would say, sort of three of the balance are sort of in the mid stages of our diligence cycle and

a couple of them are early on, and that's sort of where things sort of sit in our pipeline, and that's pretty standard in our pipeline. We've got a few things that we've been working on for a while, and we know and we're getting to know better and stuff like that, and then there's things that are getting introduced in our pipeline all the time, so those new introductions were a little bit earlier stage.

Adam Buckham — Analyst, Scotiabank

That's great colour, thanks. Secondly, I wonder if you can maybe dig in on Spinraza a little more. Something that Biogen noted in their earnings was the demand that they were seeing in emerging markets for Spinraza. During your initial due diligence on that asset, I'm wondering if you could give us a little colour on what sort of runway. I know you probably can't comment in detail, but maybe you can give us some idea of the drivers and emerging markets, and whether the asset has the ability to generate significant growth in those jurisdictions.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Unfortunately, I can’t give you a ton of colour on that. What I would say is that SMA is a patient population that, at least in western markets, is about 40,000 patients, and like a lot of the analyst community, we believe that Spinraza has a role to play for certain segments of that 40,000 patient population and we've seen that role pan out in the United States and in the European Union, and I imagine that certain emerging markets will be consistent with that, so I don't imagine that the dynamic for Spinraza will be any different in emerging markets than what we've seen in Western markets.

Adam Buckham — Analyst, Scotiabank

Great, that’s helpful. Congrats on your first quarter.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you.

Operator

There are no further questions at this time.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Well, thank you very much everybody for taking the time. We appreciate it.

Operator

This concludes today's conference call. You may now disconnect.