DRI Healthcare Trust

DRI Healthcare Trust Q1 2024 Earnings Call

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PRESENTATION

Operator

Good morning, everyone. Welcome to DRI Healthcare Trust's 2024 First Quarter Earnings 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 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 Healthcare Trust's 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.

Today's presentation also references non-GAAP measures, including total cash receipts, normalized total cash receipts, total cash royalty receipts, and Adjusted EBITDA, and certain non-GAAP ratios, included Adjusted EBITDA margin and adjusted cash earnings per unit. These measures and ratios are not recognized measures under IFRS and do not have standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures disclosed by other issuers. Rather, these

measures and ratios are provided as additional information to complement those IFRS measures by providing a further understanding of DRI Healthcare Trust's financial performance from Management's perspective. Accordingly, these measures should not be considered in isolation nor as a substitute for analysis of financial information reported under IFRS.

Please note that all dollar amounts discussed today are in U.S. currency unless otherwise specified.

I want to remind everyone that this conference call is being recorded today, May 7, 2024.

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, Operator, and good morning, everyone. Thank you for taking the time to join us today.

You can find our quarterly results, press release, and the slides of today's call on the Investor page of our website at drihealthcare.com.

With me today are Chris Anastasopoulos, our Chief Financial Officer, Ali Hedayat, Board Trustee and a member of our Investment Committee, and Navin Jacob, our Chief Investment Officer.

On the call this morning, I will be taking you through some general materials. Ali will then take you through our capital markets activities; Navin will discuss the Omidria transaction, market conditions, and our pipeline of deals; and Chris will discuss our financial results.

In the first three months of the year, our team continued to do an impressive job executing on all aspects of our strategy.

In February, we deployed $115 million, plus up to $55 million in potential milestone payments, to expand our royalty entitlement on Omidria. We now receive a 30 percent royalty on all U.S. net sales, which replaced the structured annual caps in our original Omidria deal. This transaction brought our total capital deployments since going public to $881 million in 12 royalty transactions.

In April, we took an important step to simplify our capital structure, retire a significant number of units, and drive down our cost of capital, and last night, we declared a quarterly dividend of $0.085, which is payable on July 19 to unitholders of record on June 30. Recall that in the previous quarter, we increased the distribution from $0.075, representing a 13 percent increase.

As Chris will discuss in further detail, we posted strong financial results for the quarter. We recorded $63.5 million in normalized total cash receipts, 154 percent increase over the same quarter in 2023. Normalized total cash receipts include milestones, but exclude other items that would be considered non-repeating. There were no adjustments required to normalize cash receipts for the three months ended March 31, 2024.

We recorded $42.1 million in total income, a 49 percent increase over the same quarter in 2023, and we recorded $55.1 million in Adjusted EBITDA, 157 percent increase over the same quarter in 2023. This translates to an Adjusted EBITDA margin of 87 percent.

Finally, we delivered $0.47 in basic adjusted cash earnings per unit and declared cash distributions of $0.085 per unit.

The table on Slide 5 shows the individual royalty receipts for the first quarter of 2024 compared to the same quarter in the previous year, as well as to Q4 2023. As regular biotech and pharma investors will know, when you have a portfolio of growth-oriented assets, you will often see some degree of seasonality as these drugs ramp to maturity. This is both due to the normal buying patterns in the pharmaceutical and biotech industries and the growth profile of our assets.

Our portfolio performed well in the quarter, with total cash royalty receipts increasing by 22 percent in Q1 2024 compared to Q4 ‘23 and by 172 percent year-over-year. The increase was driven by royalties on the sales of Orserdu, Vonjo, Omidria, Zejula, as well as Rydapt.

Orserdu continues its strong launch and is performing well relative to our expectations. Like most launching products, we expect that Orserdu royalties will grow as its sales ramp continuous. Our total Q1 receipts included $21 million in milestone royalty cash receipts. This presents us with significant additional capital to redeploy into further accretive deals.

Our royalties on the sales of Vonjo performed well, as the drug continues to be adopted by physicians and patients in the United States. Based on this performance, we received a $5 million

milestone payment in the quarter as part of our second Vonjo royalty transaction based on achieving certain sales milestones for the year ended December 31, 2023. We believe Sobi's acquisition of CTI will continue Vonjo's success. Sobi recently reported that March sales were 29 percent higher than the average for January and February. Sobi is looking to expand Vonjo outside of myelofibrosis with ongoing studies in the hematologic malignancies and hemato inflammatory diseases.

As Navin will discuss, the expansion of the Omidria royalty removed the annual caps and replaced them with a 30 percent royalty on all U.S. net sales, leading to 163 percent growth over both the prior year and previous quarter. There were some mild softness in the sales of the drug in January. However, that has corrected itself in February and March. Overall, the asset is performing in line with our expectations and we anticipate that it will be a significant contributor to the portfolio through to the end of the decade.

Zejula royalty receipts grew by 30 percent year-over-year and 11 percent over the prior quarter driven by continued U.S. performance and growth following the launch of the tablet formulation. Several top line data readouts are expected later this year, potentially leading to additional indications.

We received a nominal amount of royalties on the sales of Empaveli and Syfovre. This is solely due to the timing difference on the payment of royalties and should correct itself over the next quarters.

Oracea royalty receipts grew by 21 percent year-over-year and 8 percent over the prior quarter due to the success of new marketing strategies put in place by Galderma. We are currently co-plaintiffs with Galderma, the marketer of Oracea, and litigation involving the drug. The patents associated with Oracea have been the subject of various disputes and settlements related to generic entry. In one of

these disputes, a lower court recently ruled in favour of the defendants challenging some of the patents that protect Oracea. Galderma has appealed the ruling to a higher court and the case is expected to be heard in early June. A negative decision from the appeal could result in a reduction in cash flows from Oracea. However, this will not have any impact on the revenue guidance that we provided when we reported our full year 2024 results.

Spinraza continues to perform well, bringing in material cash flows even with a moderate decline of 6 percent year-over-year and 13 percent from the previous quarter. Biogen anticipates Spinraza revenue to decrease by low single digits in 2024 largely due to competitive pressures.

Xolair had a strong quarter when adjusted for the seasonality I mentioned earlier, and saw a moderate decline of 4 percent year-over-year and 24 percent quarter-over-quarter. Xolair was recently approved in the U.S. for multiple food allergies, and Roche has noted that there's a lot of excitement in the medical community for the new indication.

Zytiga receipts are only received semiannually in the second and fourth quarter, and, as such, there are no receipts to report for the first quarter.

Over the course of the next three years, we have inbound milestones that we may receive depending on the performance of both Orserdu and Vonjo. These unique and one-time events are not normal course, and when we evaluate the business, we focus on our performance exclusive of these milestones. Importantly, they are not included in our short-term and long-term guidance.

Throughout our history, we have relied on our skilled teams, our disciplined capital allocation, our proactive sourcing, and our strong reputation for execution to deliver results for our unitholders and industry partners. This is our flywheel, and it will continue to help us grow the Company. These advantages help us to outmaneuver the small number of competitors we face and make it challenging for new firms to enter our space.

Completing a successful transaction is a multidisciplinary effort that requires deep scientific, commercial, legal, and financial expertise. Our team's ability to combine these skills sets us apart and is the foundation for delivering success to our unitholders. Our capital allocation strategy remains disciplined, focusing on purchasing royalties on market-leading drugs that will generate significant cash flows for our business. Our dedicated Sourcing team and growing royalty database are invaluable when it comes to uncovering new and interesting royalty opportunities. Our database allows us to analyze potential transactions and to form relationships with royalty holders well in advance of a transaction.

Finally, having evaluated thousands of potential transactions, we have the systems and experience to conduct exhaustive and rapid ground-up diligence on each of the assets we consider, allowing us to provide our counterparties with a certainty of execution that few can replicate. Our goal is to continue to press hard on these competitive advantages as we grow the business for the future.

Looking forward, we remain incredibly excited about the prospects of our business. We will continue to use our industry-leading, 35-year track record of systematic, data-driven sourcing and execution to capitalize on the short-term and long-term tailwinds that we anticipate will lead to a generational growth opportunity in our industry. We have seen success investing in a unique asset class

through multiple periods that deliver returns that are uncorrelated with the broader macroeconomic environment, and we believe our ability to execute within this backdrop will allow us to continue enhancing our leading portfolio and generate high-yielding and high-margin return to our unitholders.

Our performance is built upon decades of relationship building, data aggregation, and specialized expertise that creates strong barriers to entry, resulting in a competitive dynamic that has remained relatively stable over the past 10 years to 15 years.

I will now turn it over to Ali Hedayat, our Board trustee and a member of our Investment Committee.

Ali Hedayat — Board Trustee and Member of Investment Committee, DRI Healthcare Trust

Thank you, Behzad.

We continually seek to optimize our capital structure, and I would like to spend a few moments discussing our recent preferred security refinancing and the resulting benefits to our capital structure on Slide 8.

We first issued preferred securities in February of 2023. The Trust was in a very different position at that time than it is today. The strength of our business has increased considerably since then, and, as such, we have many more options today for raising capital.

In February 2023, we issued Series A and Series B preferred securities with a face value of $114.76 million, plus approximately 6.37 million warrants for gross proceeds of $95 million. The

securities paid a 7.04 percent coupon on the face value of both classes of preferreds. The securities were issued at a $20 million OID discount, which was a price necessary to access that quantum of capital at that point in time. We calculated an approximate 12 percent total cost of capital on that transaction on the date of issuance.

Even though it was expensive and was a complex financial instrument to execute, it was a beneficial decision for us given we had high visibility into an upcoming deal and confidence in our ability to transact on an accretive opportunity, and within a few short weeks, we deployed those proceeds into the TZIELD acquisition. Since then, our business has grown considerably, and we are now in a strong position to clean up our capital structure with a single class of mezzanine tier securities.

As a result of the transaction, we cancelled the Series A and Series B preferred securities and associated warrants and replaced them with $135.2 million in principal amount of new Series C preferred securities, plus approximately 1.75 million new warrants. The Series C preferred securities pay a cash coupon of 7.5 percent, which escalates to 10 percent in April 2029 and by an additional 1.5 percent annually thereafter if not redeemed up to a specified cap. These securities were issued at par and the transaction extends the coupon step update by 14 months relative to the prior preferred securities.

The 6.37 million warrants from the February 2023 transaction had an exercise price of US$11.62 and recently went in the money. As a result, they would have become part of our fully-diluted share count as of the end of the second quarter of 2024. We have now replaced those with a significantly lower number of out of the money warrants with an exercise price of US$15. Based on the number of

units currently outstanding, this net reduction in warrants reduced potential dilution by over 8 percent. In essence, the transaction allowed us to retire over 4.6 million diluted units.

Not only did this transaction proactively solve a potential overhang on the units, it also cleaned up our capital structure to allow new capital to more easily enter our mezzanine tier. The cost of capital on this transaction was approximately 8 percent after factoring in the cost of the warrants. This is an attractive rate for the mezzanine tier of our capital structure, especially since it is only marginally higher than our bank credit facility, yet substantially subordinated to it. We are prudent with our capital structure, and the net result of this transaction is that it significantly increases our capital flexibility on a go-forward basis as the business continues to scale and we add further assets to the portfolio.

Our competitive advantages are the bedrock upon which we have built a successful business for over 30 years. Now, as a public company with a permanent capital vehicle, we believe we will continue growing at a rapid pace. Our structure as a trust with external management maintains our competitiveness and seeks to optimize unitholder returns in an industry where most firms are structured as tax flow-through entities. The Trust does not have any employees of its own. Salary expenses of the employees of the manager, DRI Healthcare, are compensated directly by DRI Healthcare itself. The Trust pays a management fee to DRI Healthcare equal to 6.5 percent of the cash receipts on our royalty investments and a performance fee pursuant to the terms of the management agreement, aligning incentives for DRI Healthcare and the performance of the Trust itself.

The core of our business model and one of the main reasons why we decided to go public after running three private equity funds is the benefit of reinvesting into the portfolio and compounding for

long-term growth. As you can see on Slide 9, we designed this model to deliver efficient and optimum unitholder value. This model enables regular and reliable distributions to unitholders and the reinvestment of cash flow from royalty proceeds into new assets. The cash generated by the assets currently in the portfolio allows us to redeploy and to fund future acquisitions while growing the portfolio organically and ultimately securing long-term returns for our unitholders. Over time, the intention is that the continued reinvestment compounds and leads to exponential growth. The return profile illustrative of the typical deal based on our historical averages is presented here, and it highlights this power of compounding. As we continue moving forward, we anticipate organic portfolio growth to deliver value for our unitholders.

You can already see the impact of this approach. As of today, our portfolio consists of 25 royalty streams on 19 products. Since going public, we have completed 12 transactions. In just over three years, we are already two years ahead of our initial five-year target as stated at the time of the IPO. We have already deployed more capital in the public trust than we had with any of our three previous private equity funds.

As shown on Slide 11, as of March 31, we had cash and equivalents of $66.6 million and $45.5 million of royalties receivable. Under our recently-expanded credit facility, we had $251.3 million in available credit as at March 31. We are well-capitalized to act on the attractive opportunities that we are seeing in the market.

I will now turn the call over to Navin Jacob, our Chief Investment Officer.

Navin Jacob — Executive Vice President, Investments, and Chief Investment Officer, DRI Healthcare Trust

Thank you, Ali.

As we diligence opportunities in our pipeline and engage with potential counterparties, we apply a consistent and thoughtful approach. We take time to understand the needs of our counterparties and structure bespoke, proprietary, win-win solutions. No two deals are the same, and each is tailored to address both the immediate and long-term objectives of our biopharm partners while seeking to maximize unitholder returns. This approach characterized the recent expansion of our royalty on Omidria, outlined on Slide 12, a drug used in cataract surgery or intraocular lens replacement to maintain pupil dilation and reduce postoperative pain. Omidria is particularly interesting, as it is an attractive, non-opioid choice for physicians. Furthermore, Omidria has been given separate payment status by CMS, which guarantees reimbursement through the end of 2027.

We originally purchased a royalty on Omidria in October 2022 for $125 million that was structured with increasing caps on the royalties. Our second transaction on Omidria, announced on February 1, was for $115 million upfront with up to $55 million in potential sales-based milestone payments. The amended agreement removed the caps that were in place in the original Omidria transaction and replaced them with a 30 percent royalty on all U.S. net sales, giving us more upside exposure to growing sales. Omidria is a mature product that has been on the market since 2015 and has a stable sales history with a predictable growth outlook. We expect it'll provide the Trust with reliable cash flows through the end of the decade.

Our pipeline is strong, with approximately $3 billion of potential opportunities and continues to grow. There are three fundamental drivers behind growth in the royalty investing industry, and for DRI Healthcare specifically, which means we have many opportunities to acquire high-quality royalty assets. These drivers can be characterized as long-term, medium-term, and short-term tailwinds. Let me start with long-term tailwinds as outlined on Slide 13.

We're in the early years of what is anticipated to be generational industry growth driven by the development of therapeutics that'll improve the lives of patients worldwide. The number of products developed between Phase 1 trials and registration has increased nearly 50 percent over the past five years, and as of 2022, there will be 1.8 million patients participating in clinical trials. The five-year forward projected revenue from these products in the pipeline has increased by 24 percent over the same timeframe. New modalities rather than conventional small molecules are responsible for more than half of the future projected biopharma revenues.

There have been 68 cell, gene, or RNA-based therapies launched globally to date. Another 45 to 55 are expected to be launched by 2028, with 9 to 11 new products per year on average, up from the average of 5 per year in the past five years. This pipeline is growing in quantity, quality, and diversity due to decades of scientific progress and innovation. In 2023, the FDA approved 55 new drugs, nearly 50 percent more than the previous year and the highest number since 2018. Several of these have the potential to be the first available treatments in their indications.

As a result of this growth, spending on pharmaceutical R&D is forecasted to grow by 15 percent from 2023 to 2028. This is expected to be driven by the pace of innovation, novel modalities, new

targets, and the request from regulators and payers for more extensive clinical and real-world outcomes. These trends in innovation, along with increased life expectancy and improved access in emerging markets, are ultimately expected to drive growth in the worldwide medicine spending from $1.6 trillion in 2023 to $2.2 trillion in 2028. All of this new intellectual property being created by inventors, academic institutions, and biotech companies leads to a greater number of potential royalty opportunities and widens the top tier of our funnel.

This growth comes from across the entire biopharma value chain, with biotechs pushing forward the envelope of innovation. They are responsible for sponsoring the majority of clinical trials and launched more new drugs than the top 16 pharma companies for the first time in 2021. By 2028, biotech will represent 39 percent of drug spending globally and will include both breakthrough cell and gene therapy, as well as maturing biosimilar segment. To keep up with this frenzied pace, large pharma has been continuously increasing its R&D expenditure. This totaled a record $116 billion in 2023, an increase of almost 50 percent since 2018. As a percentage of sales, R&D spending now represents nearly 25 percent for large pharma.

Our focus on drugs that address serious disease areas favours the portfolio towards therapies in areas such as ophthalmology, oncology, immunology, and rare diseases. Sales of these nondiscretionary drugs are uncorrelated with the broader market, and patients continue taking their life-saving medications regardless of the macroeconomic conditions. R&D is concentrated in therapeutic areas with the highest potential, and the therapeutic areas that fit our investment criteria are amongst the ones that attract the most and the highest proportion of capital in the ecosystem.

Clinical trial starts are heavily skewed towards just four therapeutic areas; oncology, immunology, endocrinology, and neurology, representing 79 percent of clinical trials that began in 2023. These therapeutic areas have large addressable markets for approved products and are increasing as we move forward. The two leading global therapeutic areas, oncology and immunology, are forecast to grow 14 percent to 17 percent and 2 percent to 5 percent CAGR, respectively, through 2028. Oncology's projected to add 100 new treatments over five years, contributing to an increasing global spending of $224 billion to a total of more than $440 billion in 2028, and facing limited new losses of exclusivity.

Not only is the entire biopharma industry expanding at a rapid rate, but also the therapeutic areas with which we have had significant experience and success in are taking up an increasingly large proportion of capital requirements for both R&D funding and end market consumer spending. Over the medium term, we see two different tailwinds driving the royalty financing industry, shown here on Slide 16. Over the next five years, the loss of exclusivity from patent expirees and regulatory loss of exclusivity are estimated to have an impact of $192 billion. As pharma companies face these impending patent cliffs and corresponding drops in revenue, many look to business development transactions to make up this shortfall. As a result of these transactions, new royalties are created that organically restock our long-term pipeline.

Another medium-term tailwind we are seeing is the increased awareness from biotech executives about royalty financing as an option to fund their company's strategic and operational needs. These funding requirements range from R&D projects to launching new drugs or indications to building new manufacturing facilities. Increasingly, biotech executives are seeing the value of royalties as a third tool beyond traditional equity and fixed income for raising capital. This is highlighted in the graph on the

right which shows a strong positive trend in royalty deals, including the strong upward trend in synthetic royalties. DRI Healthcare is uniquely positioned to take advantage of this growing trend given our 35-year history and our focus on creating unique solutions that meet our partners' needs.

The last trend we are seeing is more short-term. In an environment where capital markets remain choppy and interest rates are high, many biotech companies have limited options to secure their next tranche of capital, and therefore, royalty financing becomes an attractive solution. We continue to execute our strategy with a robust pipeline made up of approximately $3 billion in opportunities. As a standard for DRI Healthcare, the deals we are looking at are all high-quality and meet or exceed our qualitative and quantitative investment criteria. Our focus will remain on acquiring royalties on products that have the potential to change and improve healthcare outcomes and quality of life for patients.

We will also require these therapies to be marketed by biopharma companies that can successfully launch and grow the treatments in their target markets. We intend to acquire therapies that benefit from solid and long-lasting intellectual property and/or regulatory protection. This aligns with our target of the weighted average portfolio duration of over 10 years. Our near to midterm pipeline, which includes deals that can close within six to nine months, stands at 11 opportunities. These deals cover a diversified set of disease areas. The backend of our pipeline is comprised of 23 opportunities with similar characteristics. All of these opportunities are on new assets not currently in the portfolio.

While opportunities are growing in the market, there are still significant barriers to entry for potential new entrants, and we hold a solid competitive advantage. The royalty market is complex to access, and complicated ground-up diligence is needed to understand each asset and successfully

execute a deal. Our expertise in clinical trial analysis, sales forecasting, legal diligence, and IP risk analysis is a combination of skill sets that creates a large moat. We have not seen any new firms try to enter the market over the recent months.

I will now turn the call over to Chief Financial Officer Chris Anastasopoulos.

Chris Anastasopoulos — Executive Vice President and Chief Financial Officer, DRI Healthcare Trust

Thank you, Navin.

We continue to generate strong cash flow from our assets as you can see on Slide 19. For the last 12 months ended March 31, 2024, our normalized total cash receipts were $169.7 million, including total cash royalty receipts of $168.1 million and cash interest and other income of $1.6 million.

Our operating expenses and management fees for that time period totaled $22.8 million net of performance fees payable, resulting in an Adjusted EBITDA of $146.9 million and an Adjusted EBITDA margin of 87 percent.

I'll now turn the call back over to Behzad.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you, Chris.

Our skilled team, combined with investment systems and relationships built over decades, has led to strong execution in our short life as a public company and it's propelled us far past the objectives

that we set at the time of the IPO. At the time of the IPO just over three years ago, we said our target was to deploy between $650 million and $750 million over the first five years as a public company. We have already surpassed that goal, having deployed $881 million in royalty transactions with up to $106 million further to be deployed in potential performance-based milestones. Because of our strong pace of deployment, we recently revised our deployment target upwards for the second time in one year to over $1.25 billion over the first five years, ending in 2025.

Our cash flow profile has also changed dramatically since our IPO. Our initial group of assets were declining over the long term, but with the transactions and the growth assets that we have added in the portfolio, we now anticipate high teens royalty income CAGR through to 2025, which is an increase versus our prior guidance of mid teens. In the long term, we expect mid to high single digit CAGR through 2030, which also increased versus our prior guidance of low single digits. This guidance excludes any new transactions we may complete in the meantime.

Built into these gross numbers is our 2024 royalty income guidance. Excluding milestone income and income from any new transactions, we anticipate royalty income between $153 million and $155 million. This compares to 2023 royalty income of $117.5 million on a comparable basis after removing the impact of milestones.

We have also extended the portfolio's duration to over 10 years, in line with our target for 2025.

With last year's two equity offerings and the expansion of our credit facilities, coupled with the increased flexibility from our preferred security refinancing, we have sufficient capital capacity to reach our new targets.

Looking into the next quarter and beyond, we will remain focused on our three key priorities.

First, we plan to continue to invest in our people and continue to help the team build their skills and competencies. DRI Healthcare has been a pioneer and leader in royalty financing for over 35 years, and our team's skill at identifying and closing accretive transactions is vital to that success.

Next, we aim to continue to execute against our robust pipeline, the most active that we've seen in the Company's history. With the current market constraints on biotech financing and the high demand for new and innovative treatments, combined with our skills in sourcing and closing deals, we continue to operate at what we consider peak performance in all aspects of our business and see multiple opportunities to deploy capital. This volume lets us pick high-quality transactions that we believe will deliver long-term, accretive value for our unitholders.

Finally, we continue to be critical partners in advancing innovation in the life sciences sector by providing funding to parties across the value chain, creating win-win situations.

With that, we will now take your questions.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star, one on your touchtone phone. You will hear a three pronged (inaudible) acknowledging your request, and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star, followed by the two. If you are

using a speakerphone, please lift the handset before pressing in any keys. One moment please for your first question.

Your first question comes from Les Sulewski with Truist Securities. Please go ahead.

Les Sulewski – Analyst, Truist Securities

Yes. Good morning. Thank you for taking my question. Navin, I appreciate the thorough analysis of the pipeline. Perhaps maybe just give us a little bit of thoughts on your thinking about the industry dynamics and what buckets are you most interested in. You mentioned long, medium, and short-term, and then any specific disease areas or buckets of growth that you would pursue while you remain agnostic to indication and therapeutic areas, and then I do have a follow-up.

Navin Jacob — Executive Vice President, Investments, and Chief Investment Officer, DRI Healthcare Trust

I'm sorry, Les, I just want to—it wasn't coming through fully. When you asked about medium-term and long-term, what were you asking specifically about the pipeline there?

Les Sulewski – Analyst, Truist Securities

Yes, essentially if you are agnostic to therapeutic areas. You did mention gene and cell therapy that you highlighted, so just wanted to get your idea of what areas are you specifically pursuing?

Navin Jacob — Executive Vice President, Investments, and Chief Investment Officer, DRI Healthcare Trust

Yes, that one's a little bit tough to answer. Les, as you know, we are completely therapeutic area agnostic. However, we did highlight that certain therapeutic areas that we've historically been strong in, ophthalmology, oncology, immunology, are seeing significant investment and will continue to see significant investment by the biopharma industry, and, as such, we are natural investors in those sectors and can help fund those programs whether it's launches or late-stage programs, but I think importantly, as you noted, we are looking at all modalities and therapeutic areas, and, as always, we are focused on our investment criteria and funding assets that we think provide a maximum benefit to society, that have a strong—that are going to have a strong position, a strong IP, and are managed by high-quality biotech developers and marketers. So, it's really a function of the deal at hand, and we look at each individually, and each deal stands on its own, as well as in the portfolio context and what it does for the Trust. Whether it's near-term growth or long-term growth or near-term cash flows, we're looking at all of the above, so it's really tough to give you a specific answer on that, unfortunately, Les.

Les Sulewski – Analyst, Truist Securities

I do appreciate that extra colour. Maybe just, I guess, a follow-up to that would be maybe the pace of (inaudible) across the pipeline. Has that increased, remained steady? Maybe some of your thoughts there, and also specific to the synthetic royalties.

Navin Jacob — Executive Vice President, Investments, and Chief Investment Officer, DRI Healthcare Trust

The pace has increased, and the number of synthetics opportunities in front of us has increased quite a bit as well. I think that's a function of two things. One, the industry as a whole has come to—not has come to, is still growing in its understanding of what royalty investments can do for the sector and why it is a very interesting way of raising capital that's different from equity and fixed income and/or convert. That's number one, and number two, we are out there more, speaking to a lot more companies specifically about this. Now that we have filled the (inaudible) and have guided to growth through the end of the decade, we have a lot of flexibility in the types of companies that we can work with and a lot of strength in the business, which allows us to create more interesting structures and more interesting deals with counterparties.

Les Sulewski – Analyst, Truist Securities

Great. Thank you for that colour.

Operator

Your next question comes from Rahul Sarugaser with Raymond James. Please go ahead.

Rahul Sarugaser – Analyst, Raymond James

Good morning, Behzad, Ali, Navine, and (inaudible). Thanks so much for taking our questions. Perhaps following on from the theme about the pipeline, so we saw the transaction this morning

between Ligand and Agenus for $100 million or $75 million upfront, so a late-stage asset, not approved yet, so could you perhaps comment on sort of the competitive landscape and how far upstream you're looking given sort of the dynamics that we're seeing into potentially preapproved assets?

Navin Jacob — Executive Vice President, Investments, and Chief Investment Officer, DRI Healthcare Trust

I mean, the Company has historically made investments in assets that are approved, but where significant valuation was ascribed to a pipeline indication, and so, for instance, TZIELD, a significant portion of the upfront payment was applied to the protect study in newly-diagnosed patients, which was an indication that was not approved and there was a perceived risk there, but we had done significant diligence into that and felt comfortable with the risk and structured the deal accordingly to manage some of that risk, and so we have historically had a lot of experience in investing in pipeline indications, and that has only increased as we've beefed up the team to be able to assess and analyze pipelines, and so—and we've talked about this before. It won't be too far of a stretch to be investing in a Phase 3 asset.

With that said, that is not going to be what we do every day. It has to be a situation where we think we're adding value to the partner and we see a good opportunity in a very specific asset (audio interference), and that will always be (audio interference) by the overall portfolio (audio interference), assets that are about to be approved (audio interference), and so we look at the risk (audio interference) the entire portfolio and specific to the asset and manage all of that through structuring as well.

Rahul Sarugaser – Analyst, Raymond James

Perfect. That's really helpful, Navin, and just as a follow-up, looking at effectively the book value of the portfolio, where we're sort of seeing the Company's value trading relatively in line, and, of course, you think it should be at a premium, but as we look at the duration on the portfolio, it does sort of still come off as though it's quarter-to-quarter, and that should hopefully stabilize as you continue to build the portfolio, so could you perhaps talk about extension of duration, and perhaps lengthening or lengthening the duration such that the book value delta each quarter should sort of start to iterate downward?

Ali Hedayat — Board Trustee and Member of Investment Committee, DRI Healthcare Trust

Rahul, I'll take that one. It's Ali. I think probably the right way to think about this is when we started life (phon), we started life with a substantially lower portfolio duration that we have today, and I think we have extended that out to plus or minus 10 and a half years now, which is about 2.5 years longer than our duration at the outside of our lives as a public company. I think incremental gains from there in terms of weighted-average portfolio duration are possible, but they get sort of marginally more difficult, so obviously, when you think about what it takes to extend duration much past (audio interference) years, and then you work backwards into patent lives and where a drug is once it exits the FDA process and is in market, you start to get very marginal increases in average duration that are possible at that point.

In terms of sort of stabilizing book value, if you will, we're still at a very early stage of growth in the lifecycle of the business, and I think what you're going to see is a pretty rapid, sustained increase in

book value, because the straight-line amortization on that average life for us is currently well, well below the pace of investment, so effectively, what that means is if you take our book value and you take that average duration, that'll give you a good approximation of what our amortization of book is going to be, and I would say that's below a third of our current investment capacity, so we will be adding substantially more book than we're amortizing, and I think that will continue to be the case until the book value is something in the region of $3 billion to $4 billion, and then we'd probably have a little bit more of a balanced panorama on that front, but that's a decent way away, and I suppose once we get there, will be a good problem to have, so to speak.

Rahul Sarugaser – Analyst, Raymond James

Great. That's exactly the visibility we were looking for. Thanks so much, Ali, so we'll get back in the queue.

Operator

Your next question comes from Scott Fletcher with CIBC. Your line is now open.

Scott Fletcher – Analyst, CIBC Capital Markets

Good morning. Appreciate the details on the refinancing there. Just wondering now that sort of the capital structure's is more in order, if you could update us on how you're thinking about leverage relative to both the credit facility and the preferred securities going forward?

Ali Hedayat — Board Trustee and Member of Investment Committee, DRI Healthcare Trust

Yes, thanks for the question. It's Ali again. I think in terms of our thought process on leverage, I think the right way to look at this is really in terms of the leverage ratios, and it's not our intent to substantially move the ratios of leverage, but obviously, as the business grows, that means the dollars of leverage in each one of those sections of our capital structure can increase, and you've seen that in the past with the bank facility where our terms of EBITDA in terms of bank debt have remained relatively stable in terms of the capacity that the banks are providing us, but obviously, the dollars of leverage have gone up as our EBITDA has gone up, and I think that's something that it's fair to expect will be recurring in the future.

And the mezzanine, part of the intent of this refinancing of the pref security was to essentially create a clean and accessible mezzanine tier for the Company where we can go out and essentially open up that facility from time to time to take in new capital, and again, I think the intent there is that, as a ratio of EBITDA stays relatively constant around maybe a turn, that will, by its nature, be a bit more blocky than our discussions with the banks where I think it's a more fluid dialogue. Obviously, the mezzanine is a bit more of a capital markets' process, and obviously, will depend on various other things that are going on in terms of our pipeline and other bits and pieces of our capital structure, but broadly speaking, I think the intent is to stay in the low threes on a running basis with bank debt and about to turn of mezzanine.

Scott Fletcher – Analyst, CIBC Capital Markets

Okay, thanks. That's extremely helpful, and then just one more question on the 2024 income guidance, you left that unchanged. I mean, if you annualize Q1, obviously, that's above that range. Is there anything outside of conservatism in leaving it unchanged, or is there anything you're seeing for the remainder of the year that would sort of keep it lower than the first quarter annualized?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

No. I mean, I think—it's Behzad, Scott. Thank you very much for the question. I think we were comfortable with the guidance with where it was, and we'll obviously review that on a quarterly basis, but that was the rationale there.

Scott Fletcher – Analyst, CIBC Capital Markets

Okay. Appreciate the answers. Thank you.

Operator

Your next question comes from George Farmer with Scotiabank. Your line is now open.

George Farmer – Analyst, Scotiabank

Hi. Thanks for taking my question. Wanted to, again, press you a bit on guidance, Behzad. I mean, it's the first time you've provided the Street with this sort of guidance. We're just one quarter in, but it looks like you're on track. Is there anything that you're worried about that could maybe trigger a miss

potentially; I don't know, the impact of the Oracea litigation? I know that's just a small fraction of your portfolio, but how should we think about that going forward?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Hi, George, I appreciate the question. I think we're certainly—as I said, we're comfortable with the guidance. We don't see anything on the horizon that could potentially trigger a miss, including anything to do with Oracea, so I think we're generally happy with the direction of the business, and consequently, we're confident in the guidance that we've provided.

George Farmer – Analyst, Scotiabank

Okay, great, and then also thinking about your cash structure, I mean, was there an opportunity maybe to have retired the entire preferred instrument and just go to straight debt, and are you also maybe thinking about, now that you have kind of a clear sight of continuous profitability, thinking about convertible debt?

Navin Jacob — Executive Vice President, Investments, and Chief Investment Officer, DRI Healthcare Trust

I think we intended to basically keep the preferred outstanding given the fact that the leveraging in the bank that was about in line or the leverage capacity in the bank that was about in line with the guidance that I just talked about a couple of minutes ago with regards to what we intend our ratios to be. I think at some point in time that may be replaced with something a little bit more conventional, potentially a term loan or high-yield debt or something of that nature, but there will be a running

subordinated tier in the capital structure, in all likelihood. On a co-forward basis, what that looks like and what the shape or form of that is, I think we will be pretty flexible about it in our thought process.

One obvious marker in the sand there is the coupon step-up date in about five years, and obviously, at that point in time, the instrument as it's currently structured will, in all likelihood, not be outstanding, so I think that's maybe a long stop date on our thought process around that, but for the meanwhile, in terms of cost, the marginal cost of this security was around the 8 percent mark, and I think, compared to our bank debt and other sources of mezzanine funding, that's a pretty reasonable number.

With regards to your question on convertible debt, look, we've toyed around with different forms of financing, and, as I said, as we get potentially closer to the date where we finance out this preferred C, that'll be on the menu of options we consider, but it's not something that we have really thought about right now.

George Farmer – Analyst, Scotiabank

Okay. Thanks very much.

Operator

Your next question comes from David Martin with Bloom Burton. Please go ahead.

David Martin – Analyst, Bloom Burton

Good morning, and thanks for taking my questions. With Lupin launching the Oracea generic at risk and if Galderma's appeal isn't successful, will your royalty rates stay the same on a percentage basis on Galderma sales of the branded drug and main sales of the authorized generic, and what percent of Oracea royalties have historically been derived from the branded and authorized generic products?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

David, thank you very much for the question. Nothing will change with respect to our royalty rates on either branded or the sort of branded generic version of Oracea, and I think that sales have generally been split sort of 50/50 between the brand and the branded generic, so between Galderma's portion and main's portion, but there's been some up and down on that depending on the quarter, but certainly, we don't think—none of the royalty rates will change.

David Martin – Analyst, Bloom Burton

Okay, great, and I don't think any of your other royalty assets face a similar risk of litigation, at risk generic challenges, but is that correct?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Yes, certainly, none of our other royalty assets are subject to any form of litigation around the patents or anything like that, and as you know, launches at risk are pretty far and few in the

pharmaceutical industry, and so we were a little bit surprised by this, but hopefully, we will prevail in the next round of court cases and get this sorted out.

David Martin – Analyst, Bloom Burton

And, when does Galderma expect—or when do you expect Galderma to hear on their appeal?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

By early June.

David Martin – Analyst, Bloom Burton

Okay, great. That's it for me. Thanks.

Operator

There are no further questions at this time. I will now turn the call over to Behzad for closing remarks.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you very much, everybody, for joining the call. We really appreciate it, and have a great day. Take care.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.