FINAL TRANSCRIPT

DRI Capital Inc.

DRI Healthcare Trust Third Quarter Earnings Call

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CORPORATE PARTICIPANTS

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Chris Anastasopoulos
DRI Healthcare Trust — Chief Financial Officer

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CONFERENCE CALL PARTICIPANTS

Greg Fraser
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Adam Buckham
Scotiabank — Analyst

Doug Miehm
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PRESENTATION

Operator

Good morning everyone and welcome to the DRI Healthcare Trust Third 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 Harbor 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 exceptions 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 security 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 the IFRS and do not have 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's financial performance from Management's perspective. Accordingly, these measures should not be considered in isolation nor as a substitute for analysis or 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, Tuesday, November 9, 2021.

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

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you very much, Operator, and good morning everybody, and thank you very much for taking the time to join us today. Joining me today is Chris Anastasopoulos, our Chief Financial Officer, and Stewart Busbridge, our Chief Operating Officer. We are excited to be sharing both our third quarter results as well as reviewing some of the important milestones that DHT has achieved.

On our call today, I will go over recent highlights before turning things over to Chris to discuss our financial results, followed by Stewart who will discuss our portfolio performance and some of our recent activity, and then I will comment on our outlook before we open the call to questions.

During the course of the third quarter as well as in the weeks following the end of the quarter, our team did a marvelous job achieving some of the key priorities that we had set out for ourselves at the time of our IPO back in February. First, we completed two transactions which have resulted in almost $100 million in acquisitions, and with the impending approval of pacritinib would result in the accretive deployment of up to $185 million. As part of these two transactions, we acquired royalties on four products, including Oracea, which is a treatment for papulopustular rosacea, and pacritinib which, if approved, would be a groundbreaking therapy for myelofibrosis patients.

Second, on October 22 we entered into a new credit agreement with a syndicate of banks for $200 million in revolving facilities on attractive terms. Following the repayment of our existing secured notes, the remainder is available to fuel the continued growth of the Company.

Finally, last night we announced that we are doubling the quarterly cash distribution commencing with Q4 2021 to $0.075 per unit. This will be payable on January 20, 2022 to unit holders of record on December 31, 2021. While this is not a change to our overall policy of distributing between 20 and 30 percent of our cash flow to our unit holders, it does demonstrate our confidence in the sustainability of our cash flow in part due to our recent activity as well as providing unit holders with a more competitive and meaningful regular distribution. As we have previously disclosed, a component of our distribution policy also includes an additional special cash distribution that we intend to pay in January in an amount to be determined prior to the end of the year.

Our new and existing assets have continued to perform well in the quarter, generating $22.9 million in royalty income. We achieved $12.4 million in Adjusted EBITDA, or $17.1 million when we include certain receipts that were received subsequent to the quarter end, which we will discuss shortly. In the quarter, we generated adjusted cash earnings per unit of $0.48.

I will now turn it over to Chris to discuss the balance sheet and the financial results. Chris?

Chris Anastasopoulos — Chief Financial Officer, DRI Healthcare Trust

Thank you Bezhad. We have a very strong balance sheet and are well positioned to fund our growth plans. As at September 30, we had cash and cash equivalents of $33.8 million, along with $7.4 million of funds held in trust. After our principal repayment of $4.2 million on the trust secured notes in mid-October, the remainder of the funds held in trust were released to cash. In addition, at quarter end we had $44 million of royalties receivable in upcoming quarters.

On September 30, the net book value of our royalty assets was $306.6 million and we held the CTI loan receivable of $50 million. As mentioned earlier, we recently entered into a $200 million credit agreement. This consisted of a $475 million credit facility and a $25 million revolver. The proceeds from the initial draw on the facility were used to fully repay and retire the remaining balance of the secured notes that we had assumed at the time of our IPO. Combining our cash on hand, the cash we generate each quarter, and our new credit facility, we have significant resources to deploy in growing our portfolio.

Our cash flow generation continues to demonstrate the efficiency of our business model. In the first nine months of the year, our pro forma total cash royalty receipts were $79.4 million, and we earned interest income of $0.5 million on the CTI loan. Applying operating expenses, management fees, and servicer fees totaling $10.7 million over the same period results in pro forma Adjusted EBITDA of $69.2 million and a pro forma Adjusted EBITDA margin of 87 percent. For the year to date, we generated $1.44 in adjusted cash earnings per unit.

Our pro forma Adjusted EBITDA and margin for the year to date have been impacted by several factors. We received the Eylea cash royalty receipts after the end of the quarter, which reduced our reported cash royalty receipts for the quarter. Had the Trust received those royalties during the quarter, the pro forma Adjusted EBITDA margin would have been 88 percent for the year to date. In addition, our active pursuit of potential transactions resulted in increased research and advisory costs which were not capitalized. In our most recent quarter, other operating expenses also included one-time charges for legal, audit and consulting that are not expected to recur.

I will now turn it over to Stewart.

Stewart Busbridge — Chief Operating Officer, DRI Healthcare Trust

Thank you Chris.

On this slide, you can see the breakdown of pro forma cash royalty receipts by asset for the third quarter and year-to-date 2021 compared to the same periods for 2020. On a pro forma basis, cash royalty receipts from our core portfolio increased by 31 percent. This has been adjusted from our reported cash royalty receipts to include the third quarter royalties associated with Eylea, which were received in the week after the quarter end in both 2020 and 2021, included in the period for reporting purposes. We believe that including these payments provides a more comparable view of the performance of our royalty assets in the quarter.

Third quarter Eylea royalties grew year-over-year by 34 percent as a result of the continued strong performance. Rydapt cash royalties grew by 23 percent over that period because of continued strong demand. Cash royalty receipts for Spinraza fell by 14 percent from the prior year due to lower sales in the U.S. and the EU, which was partially offset by increasing sales outside of those markets. Xolair declined 19 percent as a result of the scheduled expiry of our entitlement in one significant market and a seasonal decline in U.S. sales. Based on Roche’s announcement of Xolair sales subsequent to the first quarter, which drives our Q3 royalty, those U.S. sales appear to have rebounded. Cash royalties received in the quarter also include the royalty that was received on closing of the Oracea transaction and offset a portion of the purchase price.

As expected, royalty receipts from our mature products continued to decline due to the expiry of royalty entitlements from the rilpivirine portfolio in the second quarter and the ongoing expiry of entitlements in major geographic areas, products included in the autoimmune portfolio. Our other products segment, formerly referred to as legacy products, increased slightly due to the inclusion of the two small additional royalties acquired in the Oracea transaction. On a year-to-date pro forma basis, our core assets are up 18 percent over the same nine-month period on a pro forma basis in 2020. Our portfolio remains diversified across a variety of metrics, including individual therapeutics, marketers, and therapeutic areas.

I'd like to take this opportunity to review the transactions we closed in the third quarter, acquisitions that we are very excited about and which demonstrate our commitment and ability to execute on the growth strategy that we have outlined.

In August, we closed a transaction with CTI Biopharma that highlights our ability to structure flexible, win-win deals based on the funding requirements and unique circumstances of our counterparties. On closing, we advanced CTI $50 million in the form of a secured loan to fund commercialization of the drug, pacritinib. The loan bears interest at a minimum rate of 10 percent.

The second component of the transaction, which is conditional on FDA approval of pacritinib, is a purchase of a royalty on pacritinib sales in the United States. Once approved, which is expected at the end of the month, DRI will advance $60 million to CTI. This royalty will entitle us to on an annual basis 9.6 percent of the first $125 million of U.S. sales, stepping down to 4.5 percent on the next $50 million and 0.5 percent on the next $225 million. The royalty is capped at $400 million of annual sales.

The agreement also calls for milestone payments of up to $25 million to CTI should pacritinib enjoy an accelerated launch that results in sales exceeding certain thresholds by Q3 2023. A key aspect of this transaction for us is that the pacritinib royalty increases the expected duration of our royalty portfolio to over nine years.

On September 30, we announced the acquisition of a royalty on Oracea, the only branded oral prescription medication for managing papulopustular rosacea. This acquisition is immediately accretive. The net purchase price was $46.4 million after receiving an immediate cash royalty payment attributable to Q2 sales. The royalty entitlement is on the worldwide sale of Oracea and is expected to expire in Q1 2028.

Bezhad will now provide some comments on our growth strategy and outlook.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you Stewart, and thank you Chris.

Turning now to our outlook, our recent activity supports our target of making between $650 million and $750 million in royalty acquisitions over our first five years as a public company. To date, we have made almost $100 million in acquisitions with a further $60 million of acquisitions upon the approval of pacritinib. The transactions that we have closed so far highlight the flexibility we can use to provide differentiated solutions to our counterparties while adding accretive, high quality assets to our portfolio.

Our pipeline of acquisition opportunities remains strong and growing, and we are continually screening deals to complement these opportunities. In addition to closing on two acquisitions, we have added a number of opportunities to our near term pipeline and we continue to evaluate a significant volume of potential deals. Our near term pipeline grew to over $1 billion, comprised of over 10 transactions. In the quarter, we closed on two deals, passed on three deals, and added several new transactions to our pipeline.

With that, we will now take your questions.

Q & A

Operator

Thank you.

Your first question comes from Greg Fraser with Truist Securities. Please go ahead.

Greg Fraser – Analyst, Truist Securities

Good morning folks, thanks for taking the questions. My first one is on Oracea, and based on data from IQVIA, sales have declined on a year-over-year and sequential basis in August and September. Did something happen in August that impacted that, either supply or demand, and how are you thinking about the outlook for that product?

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Greg, it's Bezhad here. Thank you very much for the question, I appreciate it.

There is some fluctuation in the sales of Oracea, and IQVIA data doesn't capture it 100 percent. Based on our view and analysis, we're not concerned that it's posting lower sales than we anticipated or anything has happened that is negative for the prospects of the drug.

Greg Fraser – Analyst, Truist Securities

Got it, okay. Can you comment on how you plan to balance unit buybacks with maintaining liquidity for additional deals?

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Sorry Greg, can you repeat that question?

Greg Fraser – Analyst, Truist Securities

Yes, just curious to hear your thinking about how you plan to balance buying back units with maintaining liquidity for more deals.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I think our focus as an organization is to acquire additional royalty streams and to continue to diversify the portfolio. We have a pretty robust pipeline, so our primary focus is going to be to deploy capital in that effort, in making acquisitions. We will put some small amount of our capital to acquiring units back at the appropriate times, but the majority of our capital will be dedicated to making acquisitions.

Greg Fraser – Analyst, Truist Securities

Got it. Then just a housekeeping question on the Eylea streams, I guess would you anticipate booking two quarter's worth of royalties in the fourth quarter, given the timing of the third quarter royalties?

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Yes, we expect—I mean, we did receive the third quarter royalties in the first week of October, and we expect to receive the fourth quarter royalties in the fourth quarter, so it will be sort of a double payment.

Greg Fraser – Analyst, Truist Securities

Got it, thank you.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

No problem.

Operator

Your next question comes from Adam Buckham with Scotiabank. Please go ahead.

Adam Buckham – Analyst, Scotiabank

Morning, thanks for taking my questions.

Bezhad, you kind of cut out there for a second. I just wanted to clarify on the pipeline. I think you mentioned that it basically sits at 10 transactions currently, which are valued at up to a billion dollars of potential capital deployment. Are you able to—first, is that correct, and then two, are you able to maybe give us an idea of what stage some of those deals are in, and to the extent you can, the cadence of capital deployment over the coming years?

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Absolutely, I'll do my best to give as much transparency in that regard as possible, and sorry that the recording cut out. But just to confirm, there's 10 deals right now in our near-term pipeline that are valued at slightly more than $1 billion right now, so our deal flow pipeline has increased in size quarter over quarter based on the number of deals, as well as the amount or the total value of those deals.

As everybody knows, we've closed on two transactions, which obviously dropped out of our pipeline. There was three deals over the quarter that we passed on, mostly for asset quality reasons, so they dropped out of our pipeline, and then we've added six new deals to the pipeline. All of these deals are sort of down the middle of the fairway in terms of the criteria that we have outlined and we use to evaluate transactions, so they're in the $25 million to $150 million size, they meet all of our financial criteria for a transaction, and they're reasonably high quality assets.

We have one deal that is under exclusivity right now that we hope to be able to close in the next couple months or so. We have four deals that are in very late stages of evaluation, so we're doing the heavy lifting on the diligence on those transactions, and then we have another five deals where we're sort of in the middle of our process.

I wish I could tell you what the pace of deployment is going to be and with a lot of accuracy. What I can tell you is that it's a pretty robust market for deals right now and certainly we're seeing a lot of traffic from a deal flow standpoint, and certainly we're confident at a minimum to be able to able to hit that $150 million per year target for 2022, if not exceed that.

Adam Buckham – Analyst, Scotiabank

That’s really great colour, thanks Bezhad. That’s it for me.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

No problem.

Operator

Ladies and gentlemen, as a reminder, should you have any questions, please press star, one.

Your next question comes from Doug Miehm with RBC. Please go ahead.

Doug Miehm – Analyst, RBC Capital Markets

Yes, good morning. Just wondering if you can give us maybe an update on your conversations with CTI with respect to, provided the drug gets approved, if they’ve fine tuned the launch dynamics or approach that you could expand on to any degree.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Doug, good morning. Thank you very much for the question. Unfortunately we can’t give a ton of—make a ton of disclosure around that. We know that at the time that we were doing the deal, during the course of our diligence, that they were pretty well advanced on their planning for their launch, their establishment of the salesforce and all the other bells and whistles that they need to put in place in order to have a successful launch. That was part of the reason we were confident in the company as a marketer, because they had done a professional job in getting things ready, so I expect that their state of readiness has only (inaudible) time. We continue to expect that the drug's (inaudible) PDUFA date at the end of this month and we're excited for the (inaudible) of the drug.

Doug Miehm – Analyst, RBC Capital Markets

Okay, great. Thanks.

Could you talk about the type of deals that you're looking at, this one under exclusivity in four in late stage? I just ask because I think people were a little surprised with the first deal, which while it had very long duration, it was a little different from perhaps what you've done in the past that people were expecting. I'm just wondering if you could provide some basic characteristics around these five deals that you're close on right now.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Yes, absolutely. I can talk a little bit about that.

The five deals that we're close on are all products that are on the market and have been selling, in one case for four or five years now, in another case on the lower side for about a year now. They're all products that are in active marketing globally, so they don't really share the pacritinib characteristics. In terms of marketers for these products, these are marketed by companies that are big name pharmaceutical companies that everybody would recognize if they saw the name, and in terms of size of deal, they sort of range from the bottom end of our range - you know, $25 million on the smaller one, and then up to about $150 million on the larger ones. Then in terms of financial criteria, they're sort of—

as I mentioned earlier, they are sort of down the middle of the fairway in terms of what we look for from a financial criteria standpoint.

I think we're occasionally going to do a deal like the pacritinib deal, and timing was just sort of something that we're not in control of, which was why it was the first deal that we did. But I don't want anybody to take a signal that all of a sudden, we're changing the strategy that we outlined back in February at the time of the IPO. It's going to be something that we do occasionally, but by far more commonly we will be buying royalties or buying interest in drugs that are on the market and have been marketed for some time.

Doug Miehm – Analyst, RBC Capital Markets

Okay, great. Thanks very much.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you Doug.

Operator

There are no further questions at this time. Please proceed.

Bezhad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you very much everybody for taking the time, I appreciate it, and look forward to speaking to you again soon.

Operator

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