FINAL TRANSCRIPT

DRI Capital Inc.

DRI Healthcare Trust 2021 Fourth Quarter Earnings

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PRESENTATION

Operator

Good morning, everyone. Welcome to DRI Healthcare Trust's 2021 Fourth 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 Annual Information Form, and DRI Healthcare Trust's other filings with the Canadian securities regulators. DRI Healthcare Trust does not undertake to update any forward-looking statements. Such statements speak only as of the date made.

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Accordingly, these measures and ratios 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 US currency unless otherwise specified.

I'd like to remind everyone that this conference call is being recorded today, Tuesday, March 8, 2022.

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 Capital Inc.

Thank you, operator. Good morning, everyone, and welcome to today's call. Joining me today is Chris Anastasopoulos, our Chief Financial Officer, and Stewart Busbridge, our Chief Operating Officer. We are pleased to have this opportunity to discuss our fourth quarter and year end results released yesterday afternoon.

I will begin today's call by going over the objectives for 2021 and how we fared against them, discussing DRI's history and reviewing the state of the biotech and pharma industries and how they are expected to impact our business. Then I will turn it over to Stewart to discuss our portfolio performance and some of our recent activities. Chris will then take us through the financial results and I will close with some concluding comments before opening the call to questions. As usual, please note that all dollar amounts expressed in this presentation are expressed in US dollars unless indicated otherwise.

We had a very successful first year as a public trust, marked by strong performance of our portfolio, demonstrated by generating $116 million of total cash receipts, $101 million in adjusted EBITDA, and $1.85 in adjusted cash earnings per unit. We also delivered on our growth strategy, completing two transactions totalling up to $186 million well ahead of pace to achieve our targeted $650 million to $750 million in transactions in our first five years as a public company. We also enter 2022 particularly well positioned with the volatility in equity markets making the solutions we provide highly attractive to our counterparties. We are poised for growth with a growing pipeline in excess of $1 billion and conversion possibilities among the best in our history as a result of the strong performance of our portfolio and, as we announced last quarter, we were able to double our quarterly distribution to $0.075 from $0.0375 per unit and, over the course of fiscal 2021, returned $21 million to unitholders with cash distributions and unit buybacks, including a special distribution of $0.22 per unit in the fourth quarter.

In 2022 we look to meaningfully advance our objective of generating sustainable growth in cash flows. To reach that objective, we focus on utilizing our high operating leverage in two key ways. First, by successfully managing our existing portfolio of royalties and, second, through the accretive acquisition of additional royalty assets such as we did in 2021 with Oracea and VONJO. These transactions can structured as what are known as traditional royalties transactions where existing royalties that were created through the licensing of intellectual property to entities that are developing a drug are purchased from a variety of counterparties, such as individual inventors, academic institutions, hospitals, and biotech companies, as well as pharmaceutical companies. Historically, we have sourced our assets roughly equally across these various verticals. We also create what are known as synthetic royalties, which biotech companies can use as a non-dilutive funding mechanism where a new royalty is created for DRI's benefit upon the payment of a lump sum that the Company can use to launch products and fund R&D.

The Trust's success is built on DRI's long, solid track record of execution. Since 2006 it has purchased 65 royalty streams on 41 different products that have delivered strong growth and duration of cash flows for the business. The royalty streams that DRI has acquired over its history are on products and include some of the most successful therapeutics in the world.

We continue to see a vast number of opportunities for royalty transactions. There are a number of reasons for this, but I would like to focus on three of them: the increase in the number of drugs approved annually, the continued increase in medical spending worldwide and its impact on research and development investment, and the state of the biotech market, which has seen a boom of new public companies seeking capital in increasingly challenging markets.

Over the last five years there has been an average of 45 new drugs approved by the FDA on an annual basis and our own research shows that more than half of new drugs approved over the last five years have had at least one royalty stream associated with them and many have had multiple royalty streams. These approvals build the top of our pipeline of opportunities.

Global medical spending, not including the impact of COVID vaccines and therapies, is expected to grow at a compounded annual growth rate in the mid single digits over the next five years and is expected to reach $1.8 trillion in sales by 2026. Growth drivers include increasing life expectancy, population growth, and the development of new treatments with unique mechanisms of action. This demand for innovative therapies increases the need for more medical research. Pharmaceutical R&D reached $198 billion in 2020 and is projected to increase to $254 billion by 2026, driven by the pace of innovation, increasing treatment complexities, and an increasing cost for drug development.

The other side of the equation is the rapid expansion of the biotech market and increased participation of smaller companies in drug development that has resulted in over 500 IPOs in the last 10 years. Over the past 12 months, however, the capital markets have been inhospitable to these same biotech companies, creating an environment where an increasing number of companies are chasing increasingly hard to find capital, creating a need for alternative funding sources.

DRI provides a very attractive financing alternative for these companies. We will work with biotech companies to buy some or all of an existing royalty stream that they own or create a new one while establishing a relationship that could result in a series of transactions over a period of time without diluting the existing equity holders. Our solutions are uniquely tailored to their needs and the profiles of their cash flows and R&D requirements, allowing both parties to benefit from a solution.

The largest areas of growth in medical spending over the next five years are projected to be oncology and immunology, two areas where DRI specializes and has had a long history of success. DRI was an early investor in royalties on oncology and immunology therapeutics with drugs such as Remicade and Keytruda. After both were introduced they were found to be applicable across a range of indications and were introduced into new geographies, resulting in sustained growth in product sales. We expect to benefit from continued increase in spending on oncology and immunology therapies, among others. We have significant expertise and our internal expertise that allows us to discern the most attractive opportunities.

We saw a significant number of opportunities in 2020 and continue to evaluate many attractive potential transactions. As a reminder, DRI's structured deal development process begins with an initial evaluation and then goes to progressively more detailed levels of diligence as a deal develops. In 2021 we performed initial reviews on over 140 opportunities, advanced over 40 of these opportunities to our second level of diligence, submitted five letters of intent, and closed on two transactions. Importantly, many of the transactions that we reviewed in 2021 remain in the front end or later stages of our pipeline and we hope to be able to execute on them as time goes on, with conversion rates enhanced by the turbulence in the biotech equity markets that I spoke of earlier. Going forward, we expect to deliver value to unitholders by executing on the M&A pipeline that we have developed.

I will now turn it over to Stewart to discuss our portfolio and recent activities.

Stewart Busbridge — Chief Operating Officer, DRI Capital Inc.

Thank you, Behzad.

At year end, pro forma for the VONJO royalty transaction that we completed this week, the Trust's assets consisted of 18 royalty assets on 14 products with an average duration of approximately nine years. Our portfolio is well diversified with products in eight therapeutic areas and with a variety of marketers. Five of the drugs generate over $1 billion in annual global sales. The proven cash flow generated by this portfolio enables reliable distributions to our unitholders and provides the resources to acquire additional royalty streams.

I'd like to take this opportunity to review the two transactions we completed in 2021 with an aggregate transaction size of up to $186 million. We believe that these transactions demonstrate our commitment and ability to execute the growth strategy that we have outlined.

In August we closed a transaction with CTI BioPharma, which allowed us to secure a long-term royalty stream on a high-quality product structured with an immediate contribution to cash flow. This transaction also highlighted our ability to structure flexible win-win deals based on our counterparty's funding requirements and unique circumstances. As mentioned last quarter, a key aspect of this transaction is that pacritinib, to be marketed under the brand name VONJO, is not only a high-quality oncology product that meets DRI's acquisition criteria, but it also increases the expected duration of our portfolio to over nine years.

In September we announced the acquisition of a royalty on Oracea, the only branded oral prescription medication for managing papule-pustule rosacea. This was an immediately accretive acquisition of an established high-quality product at the gross purchase price of $50.5 million. As mentioned last quarter, the royalty entitlement is on the worldwide sales of Oracea and is expected to expire in Q1 2028.

These two transactions highlight the balance in our asset acquisition strategy between extending our portfolio duration through growing cash flows and near-term accretion and immediate contribution.

I would like to spend a little more time speaking about our CTI transaction and the way that this highlights our ability to creatively structure transactions to balance the objectives of our counterparties with our commitment to make accretive additions to our portfolio of assets.

CTI was seeking capital to prepare for and ultimately execute on the launch of its myelofibrosis therapy, pacritinib. While pacritinib had not yet been approved by the FDA or other regulators, it was in the later stages of that process in the United States; therefore, to provide CTI with the $50 million it needed pre-approval to prepare for the drug's launch, we were able to fund that through a secured loan, which provided DRI with an additional measure of risk mitigation during the pre-approval period.

Second, we agreed to acquire, only after FDA approval on the product was given, a tiered royalty on US sales of pacritinib for $60 million. That approval occurred last week and CTI can now market pacritinib under the brand name VONJO.

Finally, there is a potential for CTI to receive milestone payments of up to $25 million from DRI in the event that VONJO enjoys an accelerated launch that results in sales exceeding certain thresholds by Q3 2023. This more rapid launch would benefit our unitholders as we would be collecting larger royalties earlier than expected.

Our core assets have continued to show strong performance. On a pro forma basis, cash flow royalty receipts from our core portfolio increased by 14% in the fourth quarter of 2021 over the fourth quarter of the prior year. For the year, cash royalty receipts from our core assets grew by 16%. This growth was primarily driven by continued strong demand for Eylea, Rydapt, and Zytiga, each of which showed good growth over both of those periods. In addition, we added Oracea in the third quarter, which contributed to overall growth. These were offset by Spinraza, which continues to face competitive pressures that were anticipated when we acquired the royalty and during the IPO process, as well as some fluctuations in FluMist, which showed a decline for the quarter but a strong increase for the year due to a strong performance in the Q4 2020 and Q1 2021 flu season. Xolair continued as well to decline as our entitlements in certain non-key geographies have expired.

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 of 2021 and the ongoing expiry of entitlements in major geographic areas on products included in the Autoimmune Portfolio.

Our other product segment increased by 30% in the quarter due to contributions from other royalty assets acquired in the Oracea transaction, partially offset by contractual expiries of certain legacy royalty streams.

Our portfolio remains diversified across a variety of metrics, including individual therapeutics, marketers, and therapeutic areas.

We may see some growth opportunities coming from ongoing clinical trials that could lead to expansion of opportunities for several of our core products. These trials range from evaluating the effects of higher dosing regimens for Spinraza or Eylea; the impact of combining Rydapt, Spinraza, and Zytiga with other therapies; expanded indications for Xolair, and the ongoing confirmatory trial for our newest product, VONJO.

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

Chris Anastasopoulos — Chief Financial Officer, DRI Capital Inc.

Thank you, Stewart.

As you can see, our asset portfolio performed very well and delivered solid results. Total royalty income and interest income for the year was $82 million and we generated $116 million in total cash receipts in 2021. We achieved an adjusted EBITDA of $101 million with an adjusted EBITDA margin of 87% for the year. Adjusted cash earnings per unit were $1.85. Total cash returned to unitholders in the year was $21 million through declared distributions, including the quarterly and special distributions paid in January and unit buybacks.

We continued to generate strong cash flows from our assets. For the year ended December 31, 2021 our pro forma total cash receipts were $115.6 million. Applying operating expenses, management fees, and servicer fees totalling $15 million for the year, results in pro forma adjusted EBITDA of $100.6 million and a pro forma adjusted EBITDA margin of 87%. For the year we generated $1.85 in adjusted cash earnings per unit.

As mentioned earlier, due to our strong portfolio performance, we were able to increase our quarterly distribution to $0.075 from $0.0375 per unit in Q4 and we declared a special distribution of $0.22 per unit in December 2021. These distributions were paid to investors in January of 2022.

We finished the year with a strong balance sheet conducive to our continued growth. At year end we had cash and cash equivalents of $61.7 million. In addition, at year end we had $30.1 million of royalties receivable. On December 31, 2021 the net book value of our royalty assets was $293.7 million and we had held the CTI loan receivable with a principal value of $50 million. In October 2021 a subsidiary of the Trust entered into a credit agreement with a syndicate of banks providing for credit facilities of up to $200 million. The initial amounts drawn were used to fully repay and retire the remaining balance of the secured notes that we assumed at the time of the IPO. On December 31, 2021 our credit facility had an outstanding principal balance of $45.5 million, which was subsequently reduced to $15 million with a principal payment of $30.5 million on January 27, 2022. Just yesterday we funded the royalty transaction with CTI, drawing $60 million from our credit facility. Combining our cash on hand, the cash we generate from our assets each quarter, and our new credit facility, we have significant resources to grow our portfolio.

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

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Turning now to our priorities for 2022, we remain focused on growing our asset base, accretively adding high-quality assets to our portfolio, and continuing to provide the distribution policy that reflects our commitment to returning cash to unitholders. Our acquisition pipeline remains strong and growing and our cash on hand and rigorous due diligence processes keep us well positioned for the next right opportunity.

With that, we will now take your questions.

Q & A

Operator

Thank you, sir. Ladies and gentlemen, we will now conduct the question-and-answer session. If you would like to ask a question, press star followed by the one on your telephone keypad. If you would like to withdraw your question, press star two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

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

Greg Fraser — Analyst, Truist Securities

Good morning, folks. Thanks for taking the questions. It sounds like the opportunity set is growing given the volatility for biotech stocks. I'm curious if you're also seeing the return characteristics of potential deals becoming more attractive. And then a question on Oracea. How is that stream performing versus your deal model? Thank you.

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Greg, thanks very much for taking the time and thank you very much for the questions. The opportunity set is definitely growing and, as we mentioned on the earlier part of the call, our pipeline is growing pretty significantly. We're sitting at about $1.6 billion in deals in the early stage of our pipeline, we have about $70 million in deals in exclusivity, and the balance of the pipeline is in late to middle stage sort of diligence in terms of our development process. So the pipeline is sort of solid and growing in the right direction.

I think, given the sort of distress, so to speak, of the biotech segment of our market, we are seeing some degree of sort of ability to set price as opposed to sort of be price takers, and you would see that typically both in discount rates that we may apply to cash flows as well as structures that are more favourable to the buyer than to the seller. So we're definitely seeing a little bit of that in the deal flow that we're looking at.

In terms of Oracea, Oracea is performing fairly consistently with our forecast. I think in the later part or sort of the middle part of Q4 to early part of Q1 it’s been impacted by sort of omicron and issues related to access as a result of omicron, but we think that that should be alleviated soon and we should see a pickup in prescriptions as a result of that. There’s also some degree of seasonality associated with that product and sort of sales and prescriptions tend to increase as the year goes on. So those are sort of the two factors, but generally it’s doing consistently with our expectations.

Greg Fraser — Analyst, Truist Securities

Great. Thanks for taking the questions.

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Thank you.

Operator

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

Adam Buckham — Analyst, Scotiabank

Hey, good morning. Thanks for taking my questions. So the first one, you know, you touched in your opening remarks around the state of the biotech market and a number of companies have come public over the last two years. I’m just wondering, when you look at sort of the transactions that you’ve looked at over the last year, is there a skew towards thinking about pre-approval products or something similar to pacritinib, or is it still sort of that standard approved products within the pipeline?

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Thanks for taking the time and thank you for the question. I think our business is a little bit countercyclical in nature in the sense that we tend to see more deal flow from biotech when biotech markets are choppy or difficult to access, and so we're experiencing that and so we're seeing more deal flow from biotechnology companies. I wouldn't say that there's any particular skew towards earlier-stage deals or more risky investments. And certainly there are some earlier-stage deals in our pipeline, but we're not all of a sudden going to unveil things that we haven't done before. Our focus is on acquiring royalty streams on established products that are commercialized and hopefully will be quickly accretive to the Trust and so nothing has changed in that regard and certainly our pipeline reflects that focus.

Adam Buckham — Analyst, Scotiabank

Okay, great. Thanks for the colour. So the second one for me, in thinking about the later-stage deals that are in the pipeline, you noted about $70 million that's sort of exclusive right now. You know, in looking at the cadence of the year, are you able to share any sort of colour in terms of expectations on that front?

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Yeah, absolutely. I think, you know, when we went public we said that we would endeavour to do about $140 million in deals per year. As Stewart mentioned, we obviously beat that number for 2021. Our expectation and our drive in the organization is to continue to beat that number and I'm hopeful that we'll be able to do that handily in 2022. I don't want to give specifics, it's just tough to do over the course of the next 12 months or so, but we're geared up to be able to try to beat that.

Adam Buckham — Analyst, Scotiabank

Great. Thanks, Behzad.

Operator

Thank you. Your next question comes from Endri Leno with National Bank. Please go ahead.

Endri Leno — Analyst, National Bank Financial

Hi. Good morning. Thanks for taking my questions. A couple for me. (Inaudible) you mentioned that most of the spending (inaudible)…

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Sorry, Endri, we're having a little bit of trouble hearing you. Can you speak up?

Endri Leno — Analyst, National Bank Financial

Yeah. Can you hear me now?

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Yes. Much better.

Endri Leno — Analyst, National Bank Financial

Sorry about that. So you mentioned in the prepared remarks, Behzad, oncology and immunology will likely see the most dollars into 2026 in development. I was just curious if you're seeing the same thing in your deal pipeline or is it a bit more diversified than oncology and immunology.

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Our pipeline has always been a reflection of innovation in the biotech and pharmaceutical industry and so, you know, around 2010, when you had a lot of different immunology products launching in a lot of different segments of the immunology space, our pipeline reflected that. Sort of in 2015 or so when you had the IO products launching, then our pipeline reflected more oncology at that time. And so our pipeline has, as I said, been a reflection of the sort of innovation in our industry, and today we're seeing oncology opportunities, we're certainly seeing autoimmune opportunities, we're seeing a number of rare disease opportunities, some cell and gene therapy opportunities, so it's sort of where innovation exists and our pipeline reflects it.

Endri Leno — Analyst, National Bank Financial

Okay, great. Thank you. And my other question is whether you've seen or whether you expect any impact from the current situation in Eastern Europe. I think some pharma companies had changed some of the sales or even some of the clinical trials they were doing there. Any impact on the royalties on the products that you have?

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Yeah. I mean first of all, I have to say that our hearts break for what's going on in Eastern Europe and certainly it's a tragedy. I think, you know, sales of the products that are in our portfolio, you know, we didn't derive a lot of sales from Russia or Eastern Europe generally. As you can imagine, it's a small segment of the pharmaceutical industry, so if the sales are slowed down or go away it won't have a material impact for us.

I think the impact could be on the industry as a whole where, as I'm sure you know, you have clinical trials that are run all around the world and, in particular, many clinical trials are run in Continental Europe and in Eastern Europe, and so there could be an impact on the time required to complete clinical trials, but that's not going to have as much of a direct impact on what we do.

Endri Leno — Analyst, National Bank Financial

Okay. Thank you for the colour.

Operator

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

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

Doug Miehm — Analyst, RBC Capital Markets

Good morning. My question just has to do with how much cash or lines would you have available to do deals. I can see the 125, but can you give us the other ways that you could raise capital, especially given the discount to NAV right now, in the context of all the potential deals you're looking at? Are there other things that you can do to help the situation? I'll leave it there. Thanks.

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Doug, thanks very much for the question. I think, you know, when we planned our business and when we planned at the time of the IPO, as I mentioned, we were expecting to do $140 million in deals per year and we set up the business in such a way that we could do that with a combination of the amounts raised at the time of the IPO, organic sort of free cash flows from the business, as well as credit facilities, so we're comfortable in having the financing to at least complete $140 million of deals per year. Our banks have been very supportive, the syndicate of banks that Chris talked about have been very supportive about growing the business and potentially growing the size of our bank facilities, and so we think that, in the absence of anything else, we'll be able to grow the business through both cash on hand and available credit.

Operator

Thank you. There are no further questions. Mr. Khosrowshahi, you may proceed.

Behzad Khosrowshahi — Chief Executive Officer, DRI Capital Inc.

Thank you very much, everybody, for taking the time to listen to this call and to ask your questions. We appreciate it. Look forward to engaging with you going forward. Thank you.

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.