DRI Capital Inc.

DRI Healthcare Trust 2022 Second Quarter Earnings Call

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CORPORATE PARTICIPANTS

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Adam Buckham
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PRESENTATION

Operator

Good morning, everyone, and welcome to the DRI Healthcare Trust 2022 Second 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 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 presentation today also references certain non-GAAP measures, including total cash receipts, total cash royalty receipts, and Adjusted EBITDA, and certain non-GAAP ratios, including

Adjusted EBITDA margins, and adjusted cash earnings per unit. 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, Thursday, August 4, 2022.

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

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you, Operator, and good morning, everyone, and thank you for taking the time to join us today. We very much appreciate it.

With me today are Chris Anastasopoulos, our Chief Financial Officer, and Stewart Busbridge, our Chief Operating Officer. We're excited to share our second quarter results and update you on our key priorities for 2022.

As many of you know, our strategy is to purchase royalty streams on pharmaceutical products that will generate sustainable growth for our investors. Consistent with our strategy, we were very pleased to announce the completion of a transaction to purchase royalties on the worldwide sales of Empaveli, for $24.5 million, combined with an option to deploy more capital to purchase a greater portion of the royalties in the future. Empaveli is approved for the treatment of PNH, a rare blood disorder, and is currently under review for the treatment of other indications, including geographic atrophy, also known as GA. GA is an ophthalmic condition for which there is no effective treatment, and should it get approved, Empaveli will be the first treatment for this condition. Stewart will discuss the transaction in more detail a bit later on through our presentation.

It is expected to provide approximately 10 years' cash flow, and the addition of the transaction extends the duration of our portfolio back up to nine years as of June 30, 2022. As we mentioned on last quarter's call, in April, we enhanced our ability to act on the significant opportunities for additional royalty transactions when we increased the size of our credit facility to $350 million. Currently we have capacity of $283 million on the facility and, combined with our free cash flow, we are well positioned to act on our active pipeline, which sits at about a billion dollars across eight different potential transactions. Importantly, we look forward to the possibility of announcing new deals in the near term.

Finally, we continue to deliver unitholder returns and, last night, declared a $0.075 per unit distribution for the quarter. Not considering any special distributions, this represented an annualized distribution of $0.30 per unit at a current yield of over 4 percent.

Our portfolio continues to perform well, generating $21.3 million in royalty and interest income, total cash receipts of $25.3 million, and $21.4 million in Adjusted EBITDA. We generated adjusted cash earnings per unit of $0.43 in the quarter.

I will now turn it over to Stewart to discuss our recent asset performance.

Stewart Busbridge — Chief Operating Officer, DRI Healthcare Trust

Thank you, Behzad.

I'll start by discussing our recent transaction to acquire a royalty on Empaveli. Empaveli is used to treat paroxysmal nocturnal hemoglobinuria, or PNH, a rare, chronic, life-threatening genetic disorder characterized by the destruction of red blood cells. About half of patients with PNH currently require regular transfusions. The median survival rate is cited as being 10 years after diagnosis.

The FDA and European Medicines Agency approved Empaveli for the treatment of adults with PNH in 2021, and it is available in the U.S. and the EU. In the EU, it is marketed under the brand name Aspaveli.

This transaction entitles us to a royalty of a little under 1 percent on the worldwide net sales of all formulations of Empaveli, up to an annual cap of $500 million. The transaction further demonstrates our ability to structure and execute flexible transactions. As part of this deal, DRI had the option to increase the sales cap from $500 million to $1.1 billion for an additional one-time payment of $21 million, giving us the flexibility to increase our exposure to Empaveli, should we choose to do so.

We will receive royalty payments quarterly for all sales of Empaveli, beginning from this past January, and expect that there will be a three-quarter lag between sales and the resulting royalty receipts. We anticipate receiving our first royalty on Empaveli in Q4 of this year.

Our royalty entitlement will step down as patents expire in each jurisdiction, and, ultimately, the royalty term is expected to expire in the U.S. in the fourth quarter of 2031 and in Europe in the second quarter of 2032. As Behzad mentioned, this transaction extends our portfolio duration to about nine years.

We are also excited with the potential for Empaveli to be approved for the treatment of other indications. It has been granted priority review by the FDA for the treatment of geographic atrophy, or GA, an advanced form of dry, age-related macular degeneration, with a PDUFA target date of November 26, 2022. If approved, it would be the first drug approved for the treatment of GA. There are also Phase III trials underway for the use of Empaveli in treating cold agglutinin disease, a rare autoimmune disorder, and C3 glomerulopathy, a rare kidney disease.

This slide shows the breakdown of cash royalty receipts by asset for Q2 2022, compared to Q2 2021 and Q1 2022. Cash royalty receipts from our core portfolio decreased by 9 percent to $23 million for the quarter, compared to Q2 2021. This decline was primarily driven by a decrease in royalty entitlements from Eylea I, as the stream reached the anticipated contractual step-downs starting last quarter, as well as the impact on Spinraza over the past year of competitive products, an impact that seems to be stabilizing, as seen by the growth of 7 percent for Spinraza receipts over Q1 of this year.

Royalty entitlements for Rydapt also declined due to a one-time positive adjustment in the second quarter of last year that caused the comparative to be unusually large. As expected, royalty receipts from the mature products continue to decline due to the expiry of royalty entitlements from the rilpivirine portfolio in Q2 of last year and the continued expirations of royalty entitlements in certain geographies in the autoimmune portfolio.

Going forward, we expect to realize growing royalty receipts from Vonjo, our acquisition from Q1 of this year, and our first royalty receipt from Empaveli in Q4 2022, as well as cash flows resulting from the execution of acquisition opportunities in our pipeline.

I will now turn the call over to Chris to discuss our financial status.

Chris.

Chris Anastasopoulos — Chief Financial Officer, DRI Healthcare Trust

Thank you, Stewart.

We continue to generate strong cash flows from our assets. In the first half of 2022, our total cash receipts were $46.2 million, including total cash royalty receipts of $43.7 million and interest receipts of $2.5 million on the loan to CPI.

Applying operating expenses and Management fees totalling $6.9 million over the same period results in an Adjusted EBITDA of $39.3 million for the year to date and an Adjusted EBITDA margin of 85 percent. For the six months ended June 30, we generated $0.91 in adjusted cash earnings per unit.

As at June 30, we had cash and cash equivalents of $43 million, along with $27 million in royalties receivable. As a result of this substantial cash position, we were able to close the Empaveli transaction using cash on hand. As mentioned, our credit facility was expanded in April through the addition of the delayed draw term loan tranche of $150 million, and now stands at a total size of $350 million. As of June 30, we had drawn $67 million on the facility, resulting in $283 million of capacity available to fund our growth. Combining our cash on hand, the cash we generate each quarter, and the funds available from our credit facility, we have significant resources to deploy to continue to grow our portfolio.

I will now turn the call back over to Behzad.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you, Chris.

I'll now sum up our key priorities.

First, growing our asset base. We are poised for growth with a pipeline of targets with attractive royalty streams. Our cash on hand, available credit, and rigorous due diligence processes keep us well positioned to capitalize on the right opportunities. I'll add that our extensive, one-of-a-kind, proprietary database and ability to create transactions that are beneficial to all parties makes us a very attractive partner in the biotech and pharmaceutical industries. We have completed three transactions to date and are on pace to meet or exceed our target of making between $650 million and $750 million of royalty acquisitions over the first five years as a public issuer.

Second, achieving accretive growth. Our acquisition strategy focuses on targets with the potential to generate long-term royalty revenue from medically necessary products with long patent lives, and potential for expansion through new indications or geographies.

Finally, we are committed to providing solid and reliable unitholder returns by distributing between 20 percent to 30 percent of our available cash flows.

With this, I'll now turn it over for your questions. Thank you very much.

Q & A

Operator

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

Adam Buckham — Analyst, Scotiabank

Good morning, thanks for taking my questions.

Maybe to start, I was hoping to get an update on the pipeline; any colour you can provide in terms of number of deals, stage and size would be helpful.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Morning, Adam, thank you very much for the question and appreciate you taking the time to join the call.

Our pipeline continues to develop quite well. As you know, we sort of divide our pipeline into near-term and later-stage deals, meaning deals that we're going to look at later on this year and early next year. Our near-term pipeline is comprised of about 13 or so different transactions right now, and over a billion and a half in size, in total, obviously factoring out the Empaveli transaction that we had recently closed. Those transactions, in total, first of all, meet our investor criteria, meet our financial criteria, so they're down the middle of the fairway in terms of the kinds of assets that we like to look at.

We have about three transactions that are at or near exclusivity that we hope to be able to close in the near term, and then we have another four transactions that we're working hard on, sort of in the middle process of our diligence, and then the balance of the transactions that we're looking at are in the earlier stages of our diligence.

I would say, just as a general matter, the pipeline that we have right now is very strong. It's probably one of the strongest iterations of our pipeline that I've seen in many years, and we're being very disciplined about the kinds of deals that we're looking at and making sure that we're looking at quality as we look to expand the asset base.

Adam Buckham — Analyst, Scotiabank

Great, that's fantastic colour. Maybe just moving on to another topic that's come up. So, in the news there's been drug price reform, as of late, that that's been pushed through. I'm just wondering if there's any impact to your portfolio? Then, if it changes the sort of investment criteria of what you guys are looking at, based on that, what's been proposed at this point?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I appreciate the question, and that's something that we've been following pretty closely. As of last night, I'm not sure if it's actually going to happen, given the Senator from Arizona's misgivings about the reform package, but we'll see.

I think the drug price reform bill that has been crafted, first of all, won't really impact our portfolio, and certainly won't impact the assets that we look to acquire, given that the negotiation provisions that the federal government will have in place won't really apply to biologics until 12 years or later after they've been launched into small molecules, eight years or so after they've been launched, which is obviously much later than when we get involved in transactions. We don't think it'll have a particular impact on our acquisition activities and on our portfolio.

We've always been very careful about drug price reform. We've always believed, or for a long time we've believed, that drug price reform was going to happen in the United States. As we underwrite these deals, we tend to factor that in, in our underwriting, so we're not concerned as far as our business is concerned.

Adam Buckham — Analyst, Scotiabank

That's great. Thanks for the questions again, and congrats on the quarter.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you.

Operator

Your next question comes from Paul Stewardson with iA Capital Markets. Please go ahead.

Paul Stewardson — Analyst, iA Capital Markets

Good morning. Just calling in for Chelsea.

Could you give some colour on how the sales ramp of Vonjo is going? If you guys get any sort of look at feedback from prescribers, or any of these sorts of factors that we could look at to see how the uptake is going, beyond the $699,000 of royalty income during the quarter.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Paul, thank you very much for the question, and it's nice to meet you.

We don't get a ton of information other than what's available publicly to everyone. I think that, certainly, the launch of the product was very strong. We believe that that momentum from that launch will continue. We haven't seen any indications in prescription data or anything like that that would suggest any kind of let-up in that.

I'd say that CTI, I believe, is reporting after the close of markets on Monday, so we'll have a much better picture of the performance of the product at that time.

Paul Stewardson — Analyst, iA Capital Markets

Okay, yes, fair enough. The other question is on Natpara. In terms of your new estimate of the fourth quarter in 2025 for reaching the contractual royalty cap, is that assuming that it never returns to the U.S.? Or is that assuming just a later return to the U.S.?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Chris, do you want to take that one?

Chris Anastasopoulos — Chief Financial Officer, DRI Healthcare Trust

Yes, that assumes a later return to the U.S.

Paul Stewardson — Analyst, iA Capital Markets

Okay, and can you give us some colour on, if it doesn't work out and Takeda ends up indefinitely suspending the commercial return to the U.S., what would that kind of take the timeline to for meeting that contractual royalty cap?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I think we'd have to calculate that and get back to you.

Chris Anastasopoulos — Chief Financial Officer, DRI Healthcare Trust

Yes.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I think that we certainly don't expect Takeda to give up on the product, and we believe that they're working on resolving the CRL issues, which we believe is related to the autoinjector, and bringing the drug to market. In the very sort of difficult scenario, or downside scenario, that Takeda does give up on the product, our expectation is that someone will pick up the product and pick up where Takeda left off, and bring it to market themselves. It's an attractive product that addresses a patient population for whom there's not a lot of treatments available, so we think that it'll come to market under another marketer, should Takeda make the decision not to continue with it. But we don't believe that that's going to be the case.

Paul Stewardson — Analyst, iA Capital Markets

Okay. Okay, thanks for taking my questions.

Operator

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

Endri Leno — Analyst, National Bank

Hi, good morning. Thanks for taking my question.

Just a couple for me, but I'll start first with the pipeline. I was wondering if you can give any colour in terms of the composition, especially of the later-stage deal, in terms of therapeutic area or in terms of a commercial launch, whether they've been launched, or whether they're still under FDA or other regulatory (inaudible).

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Endri, thank you very much for taking the time and for the question.

Our pipeline is pretty varied, and from a therapeutic area standpoint, it's sort of the later-stage assets that we're looking at in our pipeline, spread across autoimmune indications, some oncology indications, some rare disease products. It's pretty broadly spread out in that way. As I mentioned, all of the assets in the pipeline right now meet or exceed our investment criteria, so they're all drugs that have been launched or on the market, generating sales, and have some sales history associated with them or will have some sales history associated with them by the time that we make the purchase. From that perspective, the assets are fairly consistent with the investment criteria that we look at.

Endri Leno — Analyst, National Bank

Okay. That's great to hear. Thank you, Behzad.

The other question for me, on Eylea, I mean, there has been a new competitor launched a few months ago, and they reported positive uptake with the doctors and potential of some market share gains. I was wondering if you can share what your expectations are for Eylea going forward. Thank you.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I think Eylea, it's a little bit of a peculiar deal for us in a certain way, in the sense that, over the course of the next couple years or so, we're going to start hitting the structural cap in those deals, and so our royalties will diminish over that time. Any competitor that comes to market, even if it's wildly

successful, won't really impact the royalties that we're going to be getting and the cash flows of the Trust. But again, Eylea itself has built a dominant position in the space, and we don't think that competitors will be able to materially change that, so we're happy with where things stand for Eylea from a competitive standpoint.

Endri Leno — Analyst, National Bank

Great, thanks. That's it for me. Thank you.

Operator

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

Rahul Sarugaser — Analyst, Raymond James

Good morning, Behzad, Stewart, Chris. Thanks so much for taking our questions this morning.

Really only one for me. You did talk extensively about the pipeline. Recognizing that the landscape is shifting with the current state of the macro and the market, we saw Amgen and Gilead making roughly medium-sized to larger-sized acquisition this morning. Can you just potentially talk about how you are seeing, going forward, the competitive landscape for these deals, given that we're seeing M&A potentially picking up in the space over the next few months?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Rahul, thank you very much for joining the call and for the question.

I think M&A activity in the biotech and pharmaceutical industry, historically, has tended to be a bit of a tailwind for us, in the sense that even when big companies, like Amgen and Gilead, make acquisitions, they sometimes look at selling noncore assets as part of those acquisitions, and royalties are sometimes considered noncore assets. It tends to create opportunities for us, far less so than competition. Obviously, we're in touch with all the big pharmas, and so we'll take a look at these when the time is right. But we're not concerned about M&A activity creating a competitive threat.

Generally speaking, the competitive environment in our business hasn't really changed; we have a few of our day-to-day competitors who are out there fundraising, so we haven't seen them in deals as often, but I expect that they will come back at some point in the future. But our competitive environment hasn't really changed over the course of the past few months.

Rahul Sarugaser — Analyst, Raymond James

Perfect, that's really helpful, and I'll get back in the queue.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you.

Operator

Your next question comes from Tania Armstrong with Canaccord Genuity. Please go ahead.

Tania Armstrong — Analyst, Canaccord Genuity

Good morning, gentlemen, just a couple for me.

First on these, I see the entitlement. We saw a bit of a step-down in the royalty rate, I think just because generics came into the EU market. I'm wondering if this royalty rate is expected to gradually step down over the remainder of the year if there are more generic entrants coming, or if this is kind of a steady state until we see a Japan genericization.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Stewart, you want to take that one?

Stewart Busbridge — Chief Operating Officer, DRI Healthcare Trust

Yes, I think this is on a country-by-country basis, so I expect as the generics are introduced into different countries, the call it weighted average rate that we receive will step down, so there will be some gradual decline there over the next couple years.

Tania Armstrong — Analyst, Canaccord Genuity

Okay. Then secondly, I'm wondering, more on the macro side, if you've seen any changes in the economics of deals closing, just by way of, I guess, interest rates rising and companies may be looking to do different types of transactions to get access to funding. Do you think you'll see any increase or decrease to that 12 percent IRR hurdle rate you're targeting?

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

I think, historically, our hurdle IRRs have gone up or down fairly consistently with long-term interest rates, typically 10-year kind of interest rates. I think that as 10-year interest rates materially increase, then we'll see our hurdle rate go up over time. There is a little bit of a lag between what happens with interest rates and what happens in our market, just given the private nature of the industry in which we participate. But historically, there's been some correlation.

Tania Armstrong — Analyst, Canaccord Genuity

Okay, excellent. Thank you so much. That's all for me.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Thank you.

Operator

Mr. Khosrowshahi, there are no further questions. Please proceed.

Behzad Khosrowshahi — Chief Executive Officer, DRI Healthcare Trust

Well, thank you very much, everybody, for taking the time, we appreciate it, and we look forward to catching up with you 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.