

# EQUITY RESEARCH

July 9, 2023

Earnings Update

## DRI HEALTHCARE TRUST

Additional Royalty Interest On VONJO For \$66 Million

### Our Conclusion

DRI Healthcare announced the acquisition of an additional royalty interest on the worldwide sales of VONJO for \$66 million. DRI first acquired a tiered, capped royalty on VONJO in August 2021 that entitled DRI royalties on U.S. VONJO sales up to \$400 million. The newly acquired royalty is tiered and *uncapped*, allowing DRI to further share in the upside of VONJO, a drug that has seen strong growth since its approval in March 2022. Based on our cash receipts estimate, we calculate an IRR of ~15% on the deal with room for substantial upside, as DRI continues to acquire royalties with strong return potential and further establishes itself as a partner of choice for royalty deals of this size. With the deal, DRI expects to hit the upper end of its income guidance with royalty income flat to slightly growing through 2030 and the duration of its royalty portfolio extending to over 10 years. After adding the additional VONJO royalty and a performance fee related to the TZIELD sale to our model, we increase our price target from C\$18.50 to C\$21.

### Key Points

**Transaction Details:** DRI acquired a low-single-digit second tiered royalty (VONJO II) on the worldwide sales of VONJO for a total of \$66 million. VONJO is marketed by SOBI, which recently acquired CTI Biopharma, the drug's original marketer and the seller of DRI's initial VONJO royalty. VONJO is an oncology drug and used in the treatment of myelofibrosis patients. DRI will receive royalties on sales beginning on April 1, 2023, with the first payment expected to be received in Q3/23. DRI is also entitled to receive up to \$107.5 million in milestone payments. Milestone payments will be triggered in the event of regulatory approvals in additional geographies and specified sales thresholds.

**Financial Impact:** With the additional royalty interest on VONJO, management now expects a total income and cash receipt CAGR at the high end of the 7%-9% guidance through 2025 and flat to slightly growing royalty income until 2030. After updating our model for the increased royalty, we calculate ~15% IRR, in line with recent deals and above the trust's typical 12% target. We see significant further upside to the VONJO II IRR if the tiered royalty results in an average royalty greater than the 2% average used in our model. Furthermore, \$107.5 million in potential milestone payments were not factored into the IRR and would also drive further upside.

**Future Deal Capacity:** Following the VONJO II payment of \$66 million and the additional TZIELD performance fee, we calculate leverage at ~2.7x for DRI. DRI is now at the upper limit of management's previously stated comfort level of 2x-3x leverage, but we would not be entirely surprised to see DRI exceed that target in the short term given the strong pipeline. Given the high-margin cash-flowing nature of the business, we have little concern about the trust leveraging up to complete deals and using cash receipts to quickly deleverage.

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### Outperformer

DHT.UN-TSX, Sector: Health Care

Current Price (7/7/23): C\$11.35

Price Target (12-18 mos.): ↑ C\$21.00

Previous: C\$18.50

### CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
Adj. EBITDA(mln)	100.6A	82.4A	93.4E	95.6E
Prior			92.4E	92.7E
FCFPS	2.27A	1.96A	1.34E	2.06E
Prior			1.85E	2.11E

Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2024	23.5E	24.2E	22.4E	25.6E
Prior	23.1E	23.3E	21.6E	24.7E
2023	21.4A	25.1E	20.1E	26.7E
Prior		25.2E	19.6E	26.2E

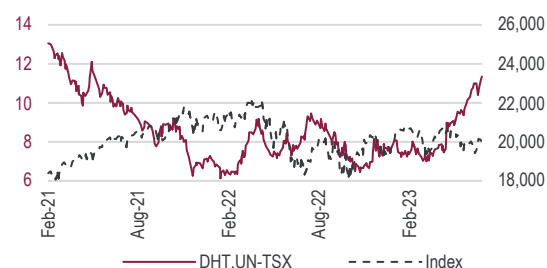
FCFPS	Q1	Q2	Q3	Q4
2024	0.51E	0.52E	0.48E	0.56E
Prior	0.53E	0.53E	0.49E	0.57E
2023	0.31A	0.49E	(0.06)E	0.60E
Prior			0.43E	0.62E

Valuation	2021	2022	2023	2024
EV/EBITDA	6.0x	7.3x	6.5x	6.3x
FCF Yield	26.6%	22.9%	15.7%	24.2%

### Stock Performance and Key Indicators

Avg. Dly. Vol.:	52K	Shares O/S:	37.8M
Market Cap.:	C\$429M	Float:	35.8M
52-wk Range:	C\$6.67 - C\$11.35	Div. / Yield:	C\$0.40/3.51%

### TSX Composite Index vs. DHT.UN-TSX



(Source: FactSet)

All figures in US dollars unless otherwise stated (C\$1.330:US\$1.00).

Please see "Price Target Calculation and Key Risks to Price Target" information on page 4.  
For required regulatory disclosures please refer to "Important Disclosures" beginning on page 5.

**DRI Healthcare Trust (DHT.UN-TSX) — Outperformer**

Price (7/7/23) C\$11.35 12-18 mo. Price Target C\$21.00

Sector: Health Care

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Key Financial Metrics	2021	2022	2023E	2024E
Net Debt	0	208	188	130
Net Debt/EBITDA	0.0x	2.5x	2.0x	1.4x
Free Cash Flow	90	76	51	78
Per Share Data	2021	2022	2023E	2024E
FCFPS	2.27	1.96	1.34	2.06
Diluted EPS	0.54	0.30	2.30	(0.09)
Adj. EPS Dil.	1.15	1.87	1.51	2.04
Wgt Avg # of Shares	39.8	38.6	37.8	37.8
FD Number of Shares	39.8	38.6	37.8	37.8
Dividends per Share	(0.09)	(0.52)	(0.96)	(0.52)
Income Statement	2021	2022	2023E	2024E
Revenue	82	93	108	108
Tot Operating Exp	60	81	21	111
Adj. EBITDA	101	82	93	96
Adj EBITDA Margin	88.4%	85.7%	87.1%	87.9%
D&A	42	59	79	79
Net Income	22	12	87	(3)
Adjusted Net Income	46	72	57	77
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	92	77	71	95
Acquisit & Invest	(374)	(275)	4	0
Net CFI	(372)	(274)	6	0
Dividends Paid	(4)	(20)	(36)	(20)
Net CFF	342	171	(67)	(37)
Net Cash Flow	62	(25)	11	58
Free Cash Flow	90	76	51	78
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	62	37	47	106
Total Current Assets	92	65	77	134
Net PP&E	294	518	595	516
Receivables - LT	50	50	(5)	(5)
Total Assets	437	633	667	646
Tot Curr Liab	19	50	33	33
LT Int-Bearing Debt	39	210	115	115
Total Liabilities	58	261	239	239
Shareholders' Equity	379	372	429	406
Tot Liab & SE	437	633	667	646

Source: Company reports, FactSet and CIBC World Markets Inc.

**Company Profile**

DRI Healthcare Trust is an open-ended trust that acquires pharmaceutical royalty streams. The royalty portfolio is comprised of approved, medically necessary drugs marketed by leading life sciences companies.

**Investment Thesis**

DHT owns a portfolio of 24 royalties on 20 products that entitle it to a percentage of top-line sales on the underlying products. Our investment thesis is based on 1) Lower-risk exposure to the pharmaceutical and biotech industries; 2) Deep industry expertise and a differentiated niche; 3) Units trading at a notable discount to NAV; 4) Minimal expense profile leading to free cash returns

**Price Target (Base Case): C\$21.00**

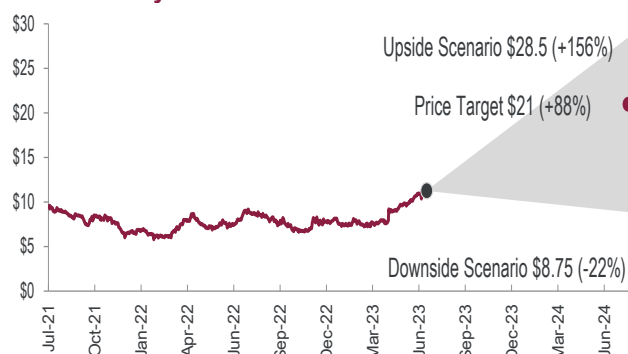
Our base case price target is based on a DCF valuation where we apply an 8% discount rate and 1.0x P/NAV multiple to our cash royalty receipt forecast from DHT's existing royalty assets.

**Upside Scenario: C\$28.50**

In this scenario, we use a 6% discount rate and a multiple of 1.2x P/NAV to reflect both a higher-growth outlook and a lower equity risk premium.

**Downside Scenario: C\$8.75**

In this scenario, we use an 11% discount rate and a multiple of 0.5x P/NAV to factor in a lack acquisition opportunities to replace expiring royalty streams and a higher equity risk premium.

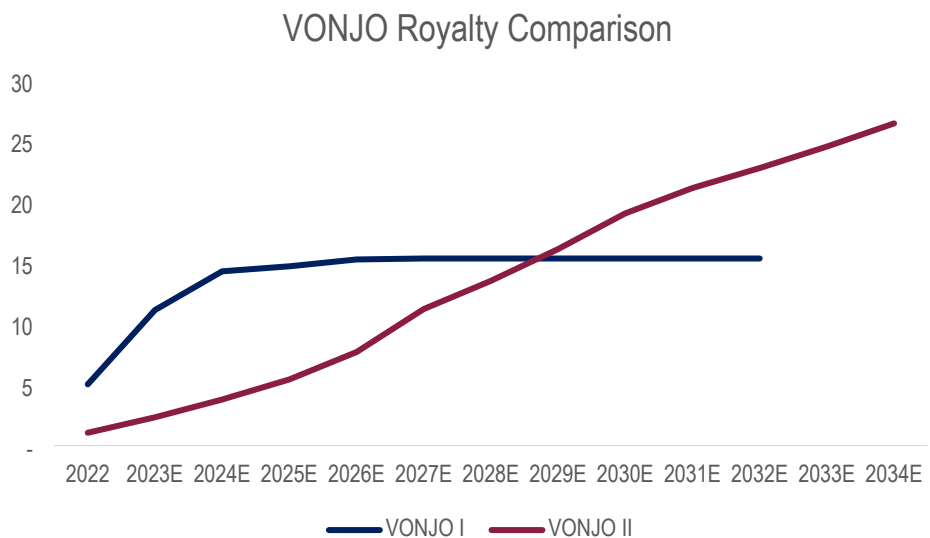
**Scenario Analysis:**

## A Different Royalty Structure Than The Original VONJO Royalty

DRI's new VONJO royalty (VONJO II) differs from the original VONJO royalty acquired in August 2021. VONJO I was a synthetic royalty created between DRI and CTI Biopharma, the marketer of the drug prior to it being acquired by SOBI. At the time VONJO had yet to be approved by the FDA, and DRI provided a \$50 million dollar loan (since repaid by SOBI) and a \$60 million royalty acquisition contingent on the drug's approval. Once approved, DRI's royalty on VONJO was tiered and capped, with the percentage entitlement declining as sales increased before ultimately hitting a cap at \$400 million of U.S. sales.

The VONJO II royalty is also tiered, however the royalty percentage increases as sales grow rather than the declining structure of the original VONJO deal. Additionally, VONJO II is uncapped, which allows DRI to share in VONJO's upside beyond \$400 million in sales. Consensus estimates for VONJO prior to SOBI's acquisition forecast a 25% CAGR through 2034 (when patent protection expires) and peak annual sales of \$1.3 billion. Exhibit 1 illustrates the difference in contribution from VONJO and VONJO II based on consensus estimates, assuming a 2% average VONJO II royalty. At a 2% average royalty, the two royalties do result in a relatively similar cash flow profile; however, there is potential for VONJO II to materially outperform the original VONJO royalty given the progressively increasing tiers and the \$107.5 million in potential milestone payments not factored into our analysis. For context, if the average royalty rate on VONJO was 3%, VONJO II would generate more than 70% greater cash receipts than VONJO I before milestone payment.

**Exhibit 1: DHT.UT - VONJO Royalty Comparison, 2022 -2034E**



Source: Visible Alpha and CIBC World Markets Inc.

## TZIELD Sale Triggers Performance Fee

Within the VONJO press release, DRI Healthcare also included details about additional performance fees it will have to pay to the trust's manager, DRI Capital, in connection with the \$210 million TZIELD royalty sale. DRI anticipates paying between \$17 million to \$20 million in connection with the sale, with the amount payable for the quarter ended June 30, 2023. We have updated our cash receipts forecast and NAV to account for the additional royalty payment at the midpoint of the stated range.

## Price Target Calculation

Our C\$21.00 price target is based on a DCF valuation using our estimate of future cash flows on the existing royalty portfolio less the Trust's 6.5% management fee. Cash flows in our DCF are discounted at a rate of 8.0% and we apply a 1.0x P/NAV multiple to our DCF valuation to arrive at our price target.

## Key Risks To Price Target

Lack of acquisition opportunity to purchase additional royalty streams, regulatory risk related to regulatory approval for underlying pharmaceutical products or product recalls, increased competition for royalty acquisitions, and counterparty risks.

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