

EQUITY RESEARCH

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Earnings Update

Scott Fletcher, CPA, CA  
Analyst  
+1 416-956-3229  
Scott.Fletcher@cibc.com

Erin Kyle, CPA  
Associate  
+1 416-313-9851  
Erin.Kyle@cibc.com

DRI HEALTHCARE TRUST

Royalty Portfolio Remains Healthy

Our Conclusion

On the heels of yesterday’s \$130MM Orserdu II acquisition, DRI’s second-quarter earnings were mostly a non-event. Total income was higher than expectations due to one-time fee-related income on the CTI loan receivable repayment and royalty cash receipts were generally in line with our expectations. On the earnings call, management remained very positive on the pipeline and the broader royalty investing space, referring to the current market as a “generational growth opportunity.” While there are clearly a number of attractive opportunities available to DRI, the Orserdu II deal pushes leverage close to the upper end of management’s target range and, as such, we expect a short-term pause in royalty acquisitions, particularly with regards to larger deals that have been more common for DRI in 2023. Despite the expected pause or slowdown in acquisitions, we continue to regard DRI as an attractive investment opportunity, with shares trading at 0.64x our estimate of NAV. We retain our Outperformer rating and C\$20 price target, updated after adding Orserdu II to our model.

Key Points

**Efficiently Adding Follow-on Royalty Streams:** The Orserdu II transaction is DRI’s third follow-on royalty acquisition since IPO, coming after the [VONJO II](#) transaction last month. DRI can more efficiently close additional royalty acquisitions on products already in its portfolio given the majority of due diligence work has already been completed. During the earnings call, management indicated most products have multiple existing royalty streams and DRI is in an advantageous position when it comes to acquiring multiple royalty streams due to its proprietary royalty database. Due diligence work can also lead to identifying attractive royalty opportunities on competitor drugs, adding another layer of efficiency to the acquisition process.

**Expecting A Pause In Acquisitions:** After DRI’s most recent transaction, we calculate pro forma leverage at ~2.6x, above the mid-point of management’s indicated leverage target range of 2x-3x. Given the size of the deals in the near-term pipeline (\$75MM-\$150MM) and the fact that another ~\$40MM in acquisition spending would push leverage up to 3x, we expect DRI to be less active on acquisitions in the short term. Management did comment on the call that it would be willing to push leverage above 3x for the right deal, with cash flow from the portfolio allowing it to deleverage relatively quickly. We view that scenario as somewhat unlikely.

**Pipeline Remains Healthy:** Management noted a healthy near-term pipeline of ~\$1.8B, with deals ranging in size from \$75MM to \$150MM, and indicated the number of opportunities in the market is still growing. We view DRI’s long tenure and strong track record in the industry as competitive advantages, and expect the company to continue to leverage its proprietary database and deep industry relationships to track royalties and continue to grow the business.

Outperformer

DHT.UN-TSX, Sector: Health Care

Current Price (8/15/23): C\$12.75  
Price Target (12-18 mos.): C\$20.00

CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
Adj. EBITDA(min)	100.6A	82.4A	95.8E	103.6E
Prior			112.0E	104.4E
FCFPS	2.27A	1.96A	0.76E	1.60E
Prior			1.14E	1.62E

Adj. EBITDA(min)	Q1	Q2	Q3	Q4
2024	26.3E	25.1E	24.7E	27.4E
Prior			25.0E	27.9E
2023	21.4A	25.1A	21.6E	27.8E
Prior			38.6E	26.9E

FCFPS	Q1	Q2	Q3	Q4
2024	0.40E	0.38E	0.37E	0.44E
Prior			0.38E	0.45E
2023	0.31A	0.07A	(0.07)E	0.45E
Prior			(0.10)E	0.43E

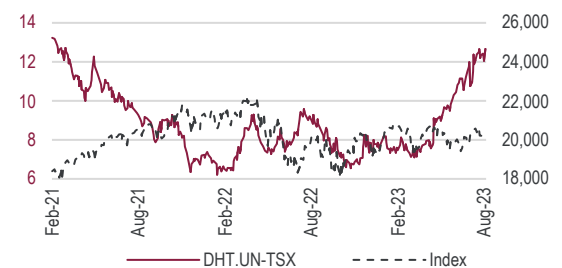
  

Valuation	2021	2022	2023	2024
EV/EBITDA	7.4x	9.0x	7.8x	7.2x
FCF Yield	24.0%	20.7%	8.0%	16.9%

Stock Performance and Key Indicators

Avg. Dly. Vol.: 64K Shares O/S: 46.9M  
Market Cap.: C\$598M Float: 35.8M  
52-wk Range: C\$6.67 - C\$12.75 Div. / Yield: C\$0.40/3.17%

TSX Composite Index vs. DHT.UN-TSX



(Source: FactSet)

All figures in US dollars unless otherwise stated (C\$1.348:US\$1.00).

Please see "Price Target Calculation and Key Risks to Price Target" information on page 3. For required regulatory disclosures please refer to "Important Disclosures" beginning on page 4.

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

Price (8/15/23) C\$12.75 12-18 mo. Price Target C\$20.00

Sector: Health Care

Scott Fletcher, CPA, CA +1 416-956-3229 Scott.Fletcher@cibc.com

Key Financial Metrics	2021	2022	2023E	2024E
Net Debt	0	208	262	211
Net Debt/EBITDA	0.0x	2.5x	2.7x	2.0x
Free Cash Flow	90	76	32	75
Per Share Data	2021	2022	2023E	2024E
FCFPS	2.27	1.96	0.76	1.60
Diluted EPS	0.54	0.30	1.52	(0.20)
Adj. EPS Dil.	1.15	1.87	1.32	1.74
Wgt Avg # of Shares	39.8	38.6	42.3	46.9
FD Number of Shares	39.8	38.6	42.3	46.9
Dividends per Share	(0.09)	(0.52)	(0.76)	(0.52)
Income Statement	2021	2022	2023E	2024E
Revenue	82	93	112	123
Tot Operating Exp	60	81	47	133
Adj. EBITDA	101	82	96	104
Adj EBITDA Margin	88.4%	85.7%	87.4%	88.1%
D&A	42	59	83	87
Net Income	22	12	64	(9)
Adjusted Net Income	46	72	56	82
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	92	77	60	103
Acquisit & Invest	(374)	(275)	(128)	0
Net CFI	(372)	(274)	(127)	0
Dividends Paid	(4)	(20)	(32)	(24)
Net CFF	342	171	142	(52)
Net Cash Flow	62	(25)	76	51
Free Cash Flow	90	76	32	75
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	62	37	112	163
Total Current Assets	92	65	142	199
Net PP&E	294	518	720	633
Receivables - LT	50	50	0	0
Total Assets	437	633	863	832
Tot Curr Liab	19	50	27	23
LT Int-Bearing Debt	39	210	262	262
Total Liabilities	58	261	382	378
Shareholders' Equity	379	372	481	454
Tot Liab & SE	437	633	863	832

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 comprises approved, medically necessary drugs marketed by leading life sciences companies.

**Investment Thesis**

DHT owns a portfolio of 25 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; and, 4) Minimal expense profile, leading to free cash returns.

**Price Target (Base Case): C\$20.00**

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.

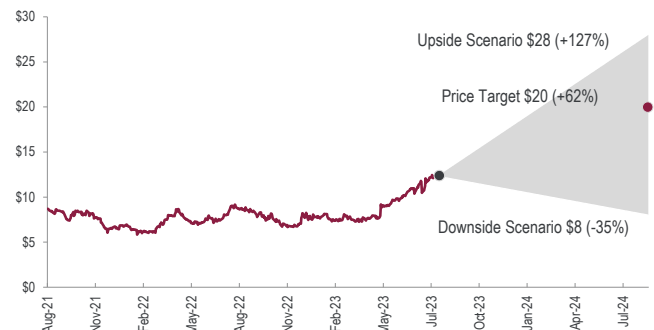
**Upside Scenario: C\$28.00**

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\$8.00**

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:**



## Financial Summary

**Cash Receipts Overview:** DHT reported normalized total cash receipts of \$28.7MM, in line with our estimate of \$28.5MM and up 13% Y/Y. The normalized number corrects for one-time cash inflows and outflows related to the TZIELD sale and loan repayment. The Y/Y increase on the normalized number was driven by the inclusion of newly acquired royalties Omidria, Empaveli and Zejula, and strong performance from Vonjo, partially offset by a decrease in royalty entitlement rates for Eylea I and Eylea II.

**Royalty Income:** DHT's estimate of total income in the quarter was \$28.1MM, up 32% Y/Y and above consensus of \$26.2MM and our estimate of \$26.7MM. The variance to our estimate was driven by higher interest income that resulted from the repayment of the loan to CTI Biopharma. Royalty income of \$23.2MM was 7% below our estimate of \$25.1MM due to the timing of Rydapt royalties expiring in certain geographies and a \$0.75MM litigation settlement included in "Other products" income.

### Exhibit 1: DHT.UT – Financial Summary, Q2/23 (\$MM)

	Q2/23			Q2/22	Y/Y%	Q1/23	Q/Q%
	Actual	CIBCe	Cons.				
<b>Consolidated</b>							
Total Income	28.1	26.7	26.2	21.3	32%	28.2	-1%
Royalty Income	23.2	25.1	NA	20.0	16%	26.3	-12%
Interest Income On Loan Receivable	4.8	1.6	NA	1.3	258%	1.7	181%
Other Interest Income	0.1	-	NA	0.0	940%	0.2	-78%
Total Cash Receipts	28.7	28.5	NA	25.3	13%	25.0	15%
Adjusted EBITDA	25.1	25.0	24.0	21.4	17%	21.4	17%
Adj. EBITDA As % Of Cash Receipts	87.4%	87.8%	NA	84.8%	3%	85.8%	2%
Adjusted Net Income	15.0	18.8	NA	16.5	-9%	18.4	-19%
CFO	20.0	20.0	NA	20.1	0%	20.0	0%

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

## Price Target Calculation

Our C\$20 price target is based on a discounted cash flow (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

Key risks to our price target include: lack of acquisition opportunity to purchase additional royalty streams, risk related to regulatory approval for underlying pharmaceutical products or product recalls, increased competition for royalty acquisitions, and counterparty risks.

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None	NA	Sector rating is not applicable.

Note: Broader market averages refer to S&P 500 in the U.S. and S&P/TSX Composite in Canada.

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