Royalty Pharma

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David Risinger: Great. So good morning, and thank you, everybody, for joining us for our session with Royalty Pharma. My name is Dave Risinger. I cover both major and specialty pharmaceuticals. And it's my pleasure to welcome Royalty Pharma. And I just need to refer you to disclaimers first.

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So it's very much my pleasure to welcome Pablo Legorreta, who is the Founder and CEO of Royalty Pharma. He founded the company in 1996, and built it into one of the largest dedicated life sciences investment companies in the world. Prior to founding Royalty Pharma, he was an investment banker at Lazard. Terry Coyne is also with us. He is the company's CFO. He joined Royalty Pharma in 2010. Previously he was a biotechnology analyst at J.P. Morgan and Rodman and Renshaw. And he began his career at Wyeth Pharmaceuticals.

So congratulations on a very successful IPO, Pablo. I thought it would be great to turn it over to you for some prepared remarks, and then we'll go into the discussion.

Pablo Legorreta: Sure. Thank you. Good morning. Good morning, David, and good morning, everyone. And it's a real pleasure for me to be here this morning at my first investor conference following our IPO in June. And Terry and I felt that because Royalty Pharma is a new public company, that it would be useful if I just spent about five minutes giving our investors and the participants on this call a little bit of background on Royalty Pharma.

So as Dave mentioned, it's a business that I started about 25 years ago, in 1996, having recognized the very large opportunity, sort of untapped opportunity to monetize the rapidly growing universe of pharmaceutical royalties. And maybe just a little background here, as obviously what's happened in this country and the life sciences is that Congress's decision to fund medical research after World War II through NIH and then NIH providing billions of dollars of capital to the incredible network of US academic institutions, research hospitals that do research, generated this -- completely transformed the R&D ecosystem in life sciences, and shifting a lot of the innovation to these participants, academic institutions and hospitals. And that resulted in these institutions ending up owning royalties on products.

So I started to realize this about 30 years ago, and I left Lazard and started Royalty Pharma with a small amount of capital, with this idea to assemble a portfolio of royalties. Now Royalty Pharma over two decades has evolved a lot, and we've always innovated in many ways the structure of the business going from private business that was funded with private equity from private investors at the beginning, to a business that started to issue debt in 2003, backed by our portfolio of royalties, which essentially lowered our cost of capital so much back in 2003, being able to issue debt at 3-4%, that it really opened up the market of academic royalties to us. Prior to that, I tried to buy royalties from institutions, but my cost of capital was high, because it was capital from private investors from equity. And once we transformed the way we funded the business, it opened up dramatically the universe of academic royalties.

We had a second transformation in 2012, where we decided to start to invest in unapproved products and really fund the industry, as we're doing today. And that really opened up now the market of potential royalties to us, not only the royalties that existed in the hands of the original innovators: universities, hospitals that had made the initial discovery; but also biotech companies that have products in clinical development. So the business has transformed.

Our new phase is us as a public company. We achieved that this year in June. And I think maybe just also we can talk a little bit about the business. We view Royalty Pharma as a new kind of biopharma company. And if you ask yourself the question, what drives the performance of Royalty Pharma, the answer is very simple. It's sales of pharmaceutical products. So if you think about it, what Royalty Pharma has is a royalty, which is a percentage of the top line of the sales of products. So it's no different than what drives the performance of the big pharmas and biotech companies that are marketing the drugs.

Now the benefit we have is that given our business model, we capture the positives, the upside, new indications, patent protection; but we do not have at Royalty Pharma the big expense, significant big expense that many of these companies have, which is manufacturing costs, R&D expenditure, sales forces. So that results in a very efficient economic model for us where we have 90%+ EBITDA margins and 70%+ of net income margins, and a business that has been able to perform consistently over two decades with very attractive growth.

And if I talk about our growth over the last two decades, there's really three things that stand out when you think about growth. One is the magnitude of growth of which historically it has been about teens growth consistently over the years. And we believe that in the future, given the portfolio we have which is running very nicely in new investments, we are going to be able to grow at higher growth than the big companies in life sciences, superior growth rates. So magnitude of growth stands out.

The second thing is diversity of growth. We have a portfolio that's very, very well-diversified. So not only our top line is diversified, but our bottom line is also diversified. Because of the very low cost structure, whatever we capture in the top line drops down to the bottom line. So in terms of our growth, because of diversity, it's less risky. It's more predictable growth, because it's relying on a very diversified portfolio of products, as opposed to a handful of products. And also the profitability is very predictable.

And the third thing is duration of growth. And here, if you look at the weighted average duration of our portfolio, you weigh our revenues by patent expirations, you will see that it's about 15 years, which is twice as long as many of the big companies in life science. So those three things make our growth stand out.

And let me turn now to talk a little bit about the performance of Royalty Pharma in the recent year or two. So 2020 has been obviously an outstanding year for us, having accomplished this IPO in June. There's another really important thing that we accomplished in the month of August when a lot of people were on vacation that I feel has been missed by many investors. And it is the fact that we restructured our debt, $6 billion of debt outstanding that we used to have as term loan A and term loan B debt at LIBOR plus 150 for the term loan A, 5-year term loan A; and LIBOR plus 2% for the 7-year term loan B. So the weighted average duration that we have in our debt was about less than 7 years. It was 5.5 years when we refinanced our debt in August. But for two decades, it has been always less than 7 years, because we've been using 7-year term loan debt and 5-year term loan debt to fund the business.

The cost of that has been 3% to 4% floating. And we would tend to actually fix the cost of debt with swaps where we would actually enter into a sovereign counterparty and pay 0.5% to maybe 1.25% extra to fix the debt. So we would end up with cost of debt that was more like 3.5% to 4.5% fixed, starting with the floating, 3% to 4%, and 5.5 year weighted average duration. In August of this year, we issued $6 billion of bonds with fixed interest. And we issued a billion, of 3, of 5, of 7, of 10, of 20 and 30-year bonds; so a billion of each one of those maturities, $6 billion with an average coupon of 2.1% and a weighted average duration of 12.5 years, which is very similar to the weighted average duration of the big pharmas: Pfizer, Biogen have; when you look at their debt.

Now importantly, because we did this in August when interest rates are very low. LIBOR is very low, and governments brought down interest rates to extremely low levels. We actually were able to do this at a time where the cost of bonds for us is now 2.1%. And if you look at many other companies in life sciences, they have weighted average cost of debt of more like 3% to 4%. And we are lucky now that we're standing today with a cost of debt of 2%, 2.1%. We also put in place a revolver, $1.5 billion, that is going to allow us to fund acquisitions very efficiently.

And so pretty much what I would say is that we've had a great year, where in addition to accomplishing these two really important things, IPO and debt IPO, which are transformative to Royalty Pharma; we have also invested $1.7 billion this year in very attractive investments, exceeding the target of $1.5 billion per year that we shared with investors in our road show. And we also had a great second quarter, where we reported 24% growth in Adjusted Cash Receipts, the equivalent of our revenue, and 47% growth in Adjusted Cash Flow.

So with that, I'm going to end there, and Terry and I would be very happy to take your questions. Thank you.

David Risinger: Great. Thank you for that overview. That's very helpful, Pablo. So could you go into a little bit more about the culture you've created at the company, the win-win philosophy with customers or partners, and also your carefully curated investment team at Royalty Pharma?

Pablo Legorreta: Sure. So talking about culture, it's obviously tied to the team that we built over the last couple of decades. And I think what I would say is that it's a very young team of really talented men and women, about half and half. Actually, it's very diverse. If you look at the investment group that we have, it's about half female, half male. And also across Royalty Pharma, it's very similar, the entire company.

But it's very talented individuals, all of them with science backgrounds, MDs, PhDs, biochemistry PhDs and those kinds of profiles; with very long -- they've been here for a very long period of time. If I just go through many of them, it's 10 years, 12 years. So it's a team that has stayed in place for a long time, and we've really learned how to work together extremely well as a group. And very open environment where I encourage people to speak up, speak their minds, and to diligence investments and make investments, negotiate investments. The approach we've had for decades is a very consensual approach, where we take everyone's view in consideration, and really sort of test the thesis, the investment thesis, by having open discussions and making sure that everyone feels comfortable.

So it's worked out extremely well. The culture is one of openness and collaboration. And in terms of the approach that we've had to the markets, it's one where what I've looked to do in every transaction we do is to create win-win situations with our counterparties. Because I always felt that if we created these win-win situations, our business was going to be much bigger, because the companies that we're partnering with would want to do more business with us. And there's many examples of this. Immunomedics was just acquired by Gilead. We actually funded that product -- Immunomedics' product in January of 2018 in a hybrid transaction where we provided $250 million, of which $175 million was for a 4% royalty and $75 million was for equity in the company. So we provided capital to this company, but became also their partner through equity, and funded the drug. And now we have a great outcome, where this company was acquired by Gilead, incredible marketer which we know really well, because we've been getting paid royalties from Gilead on HIV-AIDs for more than a decade. So we think very highly of this company. They're going to do a phenomenal job marketing the product Trodelvy. That is a game-changer for breast cancer patients.

But what's attractive for us is that now the equity piece of our investment is going to result in -- so the $75 million, giving us back about $390 million when we sell the shares to Gilead, 4.4 million shares that we acquired at $17 and are being purchased at $88. And that's going to result in us now getting our capital plus $140 million profit, and essentially the royalty that we own for free. But having supported that management team at times when they needed capital, they needed someone to come in and really invest significant capital to fund the business in a nondilutive way, because they did not issue us much equity as they did because of the royalty component, very accretive. It was a win-win for them and for us.

But I'll stop there, Dave, to make sure we can cover other topics.

David Risinger: Excellent. Well, just to follow on to that, so as a public company, obviously Royalty Pharma is even more visible as an alternative for biopharmaceutical companies to raise capital in a nondilutive fashion. Could you discuss those opportunities ahead? Clearly the Biohaven deal recently was yet another example of that. But how should we think about future opportunities for creative partnerships, and also how would you characterize the future business mix of Royalty Pharma with respect to known royalties versus development-stage royalty deals?

Pablo Legorreta: Of course. And maybe what I'll do is I'll ask Terry, my colleague and partner of many years, to actually answer this question. I don't want to monopolize the conversation. So Terry, can you please go ahead?

Terrance Coyne: Yeah, sure. So yeah, I mean on the Biohaven deal that we announced in August, we think that's a great example of sort of the flexible solutions that we can bring to the industry, and really sort of creative partnering, where we got an additional royalty in Nurtec, a product that we know and like and already have a royalty on. And it's having -- we're very pleased with how the rollout is going there. We're funding development of another product that we like called zavegepant, where we would receive an attractive milestone on FDA approval in migraine, in addition to royalties on that product.

And then we're also providing them what we call commercial launch preferred equity, where we are going to give them $200 million over the next four years or so, to really drive the launch of Nurtec, a product that we have a royalty in. And so we think that -- and in return for that, we're getting an attractive stream of fixed payments that have no commercial risk. So we think when you look at that as a total solution for that company, we think it's really, really attractive, a win-win for them and for us. And I think we're going to continue to try to be creative when we're looking at partnering opportunities with other companies. The commercial launch preferred equity is something new that Pablo thought up fairly recently. And so we're always going to be trying to innovate, trying to think of how we can come up with new ways to partner in the industry. And in that case, drive the sales of a product that we already have a royalty in.

In terms of the pipeline, the mix of approved versus unapproved, it's tough to say. I think over the last few years, we've been much more -- we've seen more opportunities in approved investments. But that could change. Like in 2018, most of what we did was development-stage. We did the Immunomedics deal in 2018, and we did the Biohaven deal in 2018. In 2019 and 2020, it's been much more skewed towards approved products. It's very tough for us to say how it's going to play out over the next year or two. We look at it over multi-year periods. I think we'd expect it to be a healthy mix. Right now we're very sort of under-allocated I would say, to development-stage products. We just don't really have much in the development-stage category. Most of it's approved. And that could change, I think, over the next years. We could find some more attractive development-stage products to invest in. I think we've certainly seen since the IPO, an increase in companies that are viewing -- and not just since the IPO, even before -- that are viewing royalty financing as an attractive way to fund their companies. And I think the Immunomedics is a prime example of a great outcome for them, I think a great outcome for us, where they used royalties at a critical time for that company, where they decided that it was a priority for them to maintain sort of global rights to the product. And I think that our ability to step in and provide capital at scale, helps companies to do that. And obviously it can create significant value in the long run.

Pablo Legorreta: Dave, if I can just add to Terry's comment, because the answer he provided is about the future. And I think one -- and the mix of investments. But one thing that is really exciting for me is that very strong tailwind that we benefit from. And I'll illustrate this with some numbers. So over the last five years, there were about a little bit less than 200 biotech companies that went public. And they raised more than $200 billion in IPO transactions and follow-ons. And that gave all of these companies a lot of capital to fund phase 1, phase 2 trials.

But now these companies will require late-stage funding. And one direct point that's also interesting is -- and I think it was one of our underwriters that calculated that for our road show -- that over the next three years, just the US biotech industry, the US biotech companies require about $70 billion of capital to fund their pipeline, to stay in business, to stay as a going concern. And if you think of that $70 billion that is needed over three years, we're going to be there talking to companies to provide some of that capital. So it's a very, very powerful tailwind, the capital that's needed by the biopharma industry to fund itself.

And then one last thing that I wanted to mention, you asked about the team, employees. And one really important thing that I'd like to share that I think differentiates Royalty Pharma from many other businesses is that we are all heavily invested in the business. We used to have incentive compensation that was converted into equity ownership in Royalty Pharma. So we own as a team 17% of the business, and potentially up to an additional 6%, so 23% of shares that we will get based on performance. But the shares will come from the old investors, the investors that owned Royalty Pharma before it went public, the private investors. We will get an additional 6% of their ownership based on performance, so 23% ownership. And we're already there, because the goal was $32 per share. It's at $40. So we're there. So we will own a very significant share of this business.

And I think what I'd like to say is that the way our public investors should look at us is really as fellow shareholders, not as a management team that was brought in to run this business that was given options and owns a small amount of equity. We own a very large share of this business. So obviously we're motivated to make this equity be very valuable over time. And one of the things that occurred to me to do as part of preparing Royalty Pharma to go public was that I asked all of my colleagues at Royalty Pharma, and here it's all employees, to actually commit to not sell 80% of what we own for the next five years after the IPO. So the lockup will expire. The typical underwriter's lockup will expire after six months, so in December. And after that, for another 4 and 1/2 years, all of us: myself, Terry, and all of the employees at Royalty Pharma, are committed to not sell contractually 80% of what we own.

And I would ask you, how many companies go public where management owns so much and which is obviously so much -- it's the vast majority of my net worth, Terry's net worth. And we've committed to not sell for such a long period, because we're really in this for the long run. And I'll stop there. But I thought it was a relevant thing to share with you.

David Risinger: Excellent. That's great additional color. Thank you. So maybe we could just pivot to the current landscape. So innovation is booming, but asset valuations have also risen. And competition for royalty deals has grown. So in light of those considerations, how do you characterize opportunities to generate compelling returns on future deals?

Pablo Legorreta: Sure, thank you. So all of the things you mentioned are correct. There is more competition. Life sciences is such a big part of the US economy and it's obviously one of the sectors or industries where the US is leading the world by a long margin. So it's an incredibly dynamic interesting ecosystem, and one where Royalty Pharma has become a partner of choice of many of the participants in this ecosystem. It's obviously the academic institutions, and research hospitals, foundations. We've done deals with the Cystic Fibrosis Foundation, as you know, biotech, and big pharma. And I think more and more all of these participants recognize the value added we bring to funding this ecosystem.

But if we talk about competition, obviously when you have an attractive large growing market, it attracts competition, and there are new entrants into this market. And what I would say, Dave, is that I think Royalty Pharma is extremely well-positioned to be probably the most successful competitor in life sciences in our business for various reasons. One is the team, we have an exceptional team. And I talked about the team in the past. When I look at this team as a group, I mean there's obviously amazing investors that invest in life sciences, many of which have invested with us. But as a team, together, working together, it's large, it's very smart people; all of them with backgrounds as analysts like you. But they've transitioned to not be only analysts that understand how to analyze an opportunity, but they've become exceptional investors that understand how to assess value, how to assess risk and negotiate really good deals.

And another thing that's important is, at Royalty Pharma, we spend a huge amount of money, capital, resources in diligencing, in really making sure we're doing excellent work to understand the opportunity, and that no stone is left unturned. And we do that because we're making hundreds of millions, billions of dollars in investments. And we have a process that we've applied for decades that it's been honed and refined, of how we're constantly monitoring everything that's out there in life sciences: going to medical conferences and building models that we update every quarter. And then we've identified things that make products -- attributes, the 10 or so criteria that makes a product attractive, sort of our secret sauce. And we've become very disciplined. If the product scores high in 8, 9, 10 of the attributes, we're very interested. If it scores high in less, we're not going to invest, because we've lost money in the past. We've learned from our mistakes. So I think the team is excellent. The process is really great.

Another really important advantage we have is our cost of capital. And becoming public was great, because it has now given us access to the biggest pool of capital in the world, the public equity markets. But I already talked about how we were able to lower our cost of capital on the debt side by a couple points, which is very significant. And during the road show, I was -- the comment I would make is that our cost of capital is somewhere between 5% and 7% when I look at our WACC compared to big pharma. It's very similar, in the same zip code as big pharma. But now with a cost of debt that is even lower, I think we have an advantage there.

But going back to our competitors, which are other investment firms, other players, we actually -- the recent entrants in the market, many of them are set up with structures where they have high return hurdles because they have a high fee structure, sometimes 2 and 20 fee structures. And they don't have access to the debt capital that we have access to. So there's no question that if you look at our cost of capital, we by far have a much lower cost of capital than anyone else in life sciences, businesses like ours.

And then scale is also a huge thing. So we bought for $3 billion, $3.3 billion a royalty in cystic fibrosis of which $2.5 billion we allocated to the products that were not approved. Kalydeco was approved, and we allocated $100 million to that and $2.5 billion to the rest. And I would really like to see other businesses out there willing to invest $2.5 billion in one -- this was a franchise of multiple products, but unapproved. We can do it because of the scale of our business, the value of the assets that are approved, the value is so large relative to the unapproved that we can make those kinds of bets.

And it's important because that's the kind of capital that the industry needs, being able to invest $200 million, $500 million to fund a phase 3 trial which we can do easily. And it doesn't even concentrate us. In the past, if you look, we've invested a little bit more than $6 billion in unapproved. Now it turns out that 90% of those get approved. So right now, as Terry was saying, our allocation to unapproved is low. But I think we're very well structured to be very competitive. And now being public, it's going to put us five years ahead of the competition.

So we're always innovating to always stay ahead of the competition. And in this new phase as a public company, I think we've achieved that in a major way.

David Risinger: Excellent. Well, we are pretty much out of time. Actually, we're a little over time. That was extremely informative. So I appreciate all of those perspectives. Maybe Terry, you could just touch quickly on the 0% corporate tax rate, including the sustainability of the Irish tax structure and the US tax status.

Terrance Coyne: Sure. Sure, Dave. So yeah, I mean this is obviously something that we've spent a lot of time on and it's very important for our structure. So we're really confident in our ability to maintain our tax status. I think it's important to just point out that the discussion on US tax reform relates to US individuals and US corporations. And we are not a US individual or corporation. We're a UK PLC. So from that perspective, it's not relevant to Royalty Pharma, and we're not aware of any changes in UK or Irish tax law that would impact our tax structure. So I think that we're very confident in our ability to maintain our status. We've had virtually the same structure in place for 17 years, since 2003. And we anticipate that nothing is going to change there.

David Risinger: Excellent. Well, that will be an ongoing competitive advantage for Royalty Pharma, so wonderful. Well thank you both so much for your time. I really appreciate your participation, and hope you have a great rest of the conference. Pablo, did you want to finish up with any closing comments?

Pablo Legorreta: Very quick closing comment, just to thank all of our public investors that we've now established a new relationship with, and to just tell them that based on the outlook that I see for Royalty Pharma and the very unique position as the leading funder of innovation in life sciences and what I see as the golden age of life sciences, today I am as excited about the future of Royalty Pharma as I was when I founded this business back in 1996. And with that, Dave, I thank you and also Morgan Stanley for being a great partner of ours in our IPO. I think the work that was done by the Morgan Stanley team was exceptional, helping us achieve a great IPO, also in a recent debt restructuring that we did. So I thank you for the invitation to speak today, and also thank all of our public investors.

David Risinger: Wonderful. Thank you again, Pablo and Terry, and have a great rest of the week. Operator, you can close out.