

Trends in Specialty Pharmacy Provident Perspectives

As the direct connection between consumers and the rest of the pharmaceutical system, specialty pharmacies are playing an increasingly important role in the rapidly changing healthcare environment. Partnerships with private equity groups and strategic consolidators are two paths independent pharmacies have to compete with the industry giants and accelerate their growth trajectories.





Provident is the leading investment banking firm specializing in merger and acquisition advisory, strategic planning, and capital formation for middle-market and emerging growth healthcare companies.

The firm has a vast network of high-level, senior industry contacts, a thorough knowledge of market sectors and specialties, and unsurpassed experience and insight into the M&A process. Provident uncovers value and opportunities that others often overlook to create transaction premiums for its clients.

INTRODUCTION

Specialty drugs represent one of the fastest growing segments in the healthcare industry, with projections estimating that specialty drugs will represent nearly 40% of total drug spend by 2020, relative to 28% in 2016. This rapid growth, especially within the context of a constantly evolving macro healthcare environment, has created a number of new industry dynamics that have radiated throughout the pharmaceutical supply chain. As the direct connection between consumers and the rest of the pharmaceutical system, specialty pharmacies play a significant role in the management of increasingly expanding patient populations and have therefore experienced new risks and new opportunities as a result of broader industry shifts.

From an investor's perspective, the combination of substantial projected market growth and evolving industry dynamics creates significant opportunities. Although CVS Health Corporation (NYSE: CVS), Express Scripts Holding Company (NASDAQ: ESRX), and Walgreens Boots Alliance (NASDAQ: WBA) account for nearly 60% of industry market share, private equity investors and strategic partners see opportunities to invest in the numerous privately-owned specialty pharmacies to use as a base for increasing the density of their nationwide platforms on a hyperlocal level. Moving into 2018, Provident Healthcare Partners expects buyers to continue consolidating the fragmented specialty pharmacy market as a means of increasing market share, diversifying service offerings, and gaining access to new patient populations. As the owner of an independent pharmacy, recent trends, including private equity interest and a shift toward integrated services, have expanded options when considering an alignment with an outside party.

Sources: Drug Channels 2016 Economic Report

PROVIDENT HEALTHCARE PARTNERS

115+	Deals Closed
20+	Pharmacy and infusion services deals closed
12-15	Landmark Deals Per Year
22	Banking Professionals

- Investment banking services delivered exclusively to companies in the high-growth healthcare industry
- An established track record as one of the most active healthcare investment banks in the country
- Has emerged as an industry leading advisor to pharmacy and infusion services companies
- Experienced advisors to serve the complexities of varied shareholder motivations
- Focus on sell-side mandates resulting in the best long-term partnerships

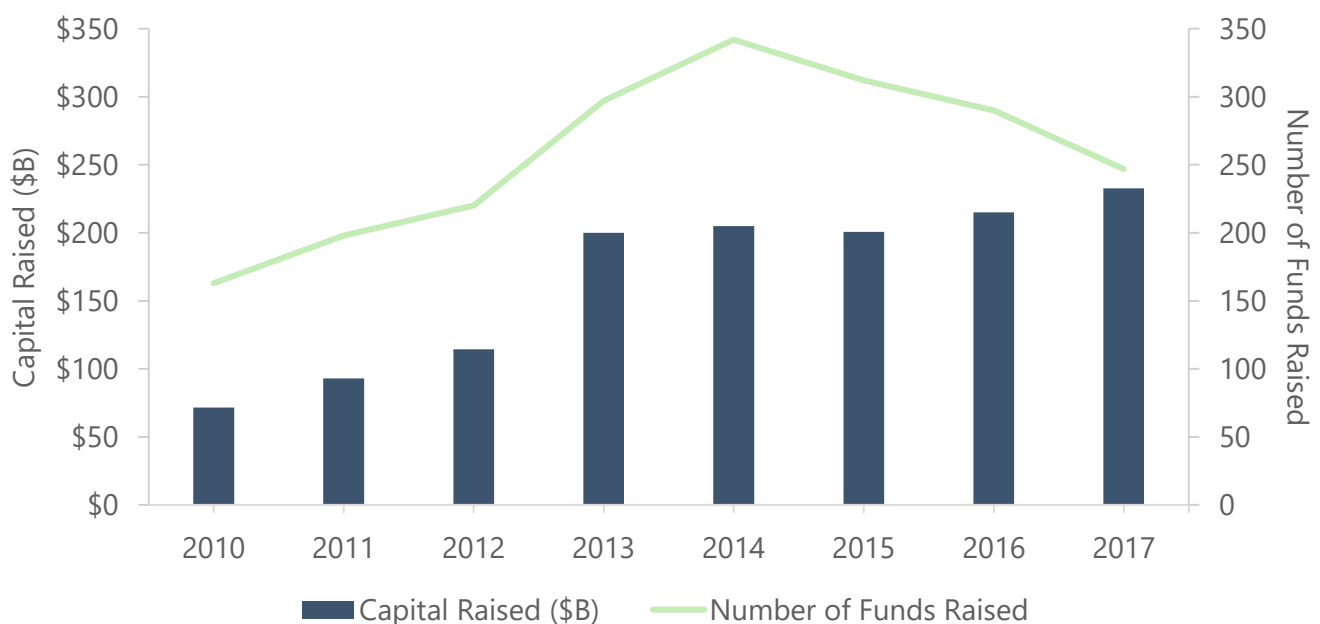
CONSOLIDATION TRENDS

PRIVATE EQUITY INTEREST IN THE SPECIALTY PHARMACY SECTOR

Strong tailwinds for specialty pharmacies have caught the eyes of private equity investors. Increasingly favorable demographics are a key driving force of growth in the industry. An increase in the diagnosis of chronic conditions, such as Amyotrophic Lateral Sclerosis (ALS), Multiple Sclerosis (MS), and Acquired Immune Deficiency Syndrome (AIDS), has led to an increase in specialty drug volume to treat these conditions. Parallel to the increased diagnosis of chronic conditions is an aging population in the U.S. that is more likely to develop such chronic diseases. Indeed, the population of individuals aged 65 years and older is projected to grow by 55% between 2015 and 2030, and prevalence of these conditions is expected to rise by 57% by the year 2020. As private equity groups look to

specialty pharmacies as an investment opportunity, owners of specialty pharmacies are likewise evaluating private equity groups as solutions to industry-specific problems. The rising cost of specialty products, uncertainty surrounding 340B pricing and direct and indirect remuneration (DIR) adjustments, debates over the expansion of Any Willing Provider (AWP) rules, and increased competition for access to new drugs are just some of the challenges independent pharmacies will face in 2018. Often times, these issues can be assuaged and shareholder risk mitigated by gaining size, scale, and access to capital. Having had historically strong fundraising over the past several years, private equity groups have been attractive partners that can help independent pharmacies by deploying capital and adding strategic expertise to navigate competitive pressures.

Private Equity Fundraising Activity



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What independent pharmacies see as roadblocks, private equity groups see as opportunities. Investors bring with them capital and industry experience when they partner with pharmacies, which can be used to develop pharmacy and IT infrastructure, fill staffing vacancies, earn accreditation, and win limited distribution contracts.

A recent example of private equity investment in pharmacy services is Frazier Healthcare Partners' ("Frazier") recapitalization of Southside Pharmacy ("Southside"), a comprehensive pharmacy services provider that serves over 35,000 patients per year. Frazier partnered with Southside in conjunction with the fund's operating partner Amit Jain, formerly of Omnicare's specialty pharmacy division, in order to help expedite the organization's growth into a national platform. Mr. Jain, who allowed Southside's founder to transition into an advisory role by stepping into the CEO position, has also been surrounded by a team of highly experienced executives that Frazier introduced. Collectively, the organization will leverage its newly acquired resources to accelerate growth and strategically position itself as a market leader.

"What independent pharmacies see as roadblocks, private equity groups see as opportunities"

MIDDLE MARKET STRATEGIC CONSOLIDATORS

In addition to private equity investors, strategic entities have been active consolidators of the pharmacy services market as well. In September 2017, BioMatrix SpRx ("BioMatrix"), a nationwide specialty pharmacy, acquired Elwyn Pharmacy Group ("Elwyn"). The acquisition of Elwyn doubles the size of the BioMatrix platform and brings Elwyn's expertise in treating neurological and auto-immune disorders, fertility, and oncology disease states to their portfolio of service offerings. From a strategic standpoint, the partnership has the opportunity to be highly synergistic in that it brings together the therapies of two pharmacies that have very little overlap, yielding a single entity with a comprehensive offering of drugs to patients with a wide range of diseases. In 2018, Provident expects middle market strategic consolidators to continue making acquisitions to increase their service offerings and expand into new geographies.

Another growing trend in the middle market is the integration of specialty pharmacies with pharmacy benefit managers (PBMs). In November, Diplomat Pharmacy Inc (NYSE: DPLO) acquired Pharmaceutical Services, Inc. (doing business as National Pharmaceutical Services), a full-service PBM based in Nebraska. Through the transaction, Diplomat will bolster its clinical and technological offerings. Less than a month later, Diplomat announced that it had completed the acquisition of a second PBM, Leehar Distributors, LLC (doing business as LDI Integrated Pharmacy Services), which includes URAC-accredited mail-order and specialty pharmacies, a national network of retail pharmacies, and clinical programs. With these two

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transactions, Diplomat makes a dramatic entrance into the PBM space and highly diversifies its service offerings.

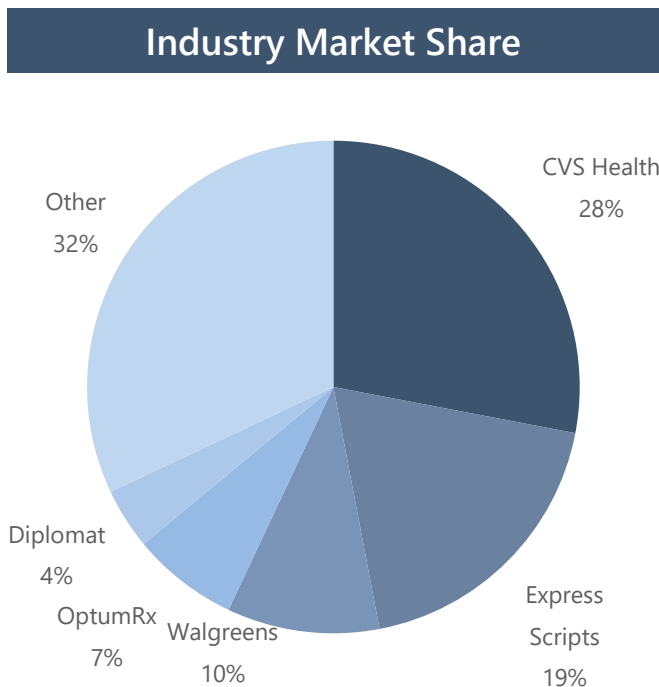
The motivation to expand and differentiate service offerings extends beyond specialty pharmacies acquiring PBMs. In a similar manner to the aforementioned acquisitions, Express Scripts Holding Company (NASDAQ: ESRX) acquired eviCore healthcare (“eviCore”), a provider of medical benefits management (MBM) and administrative services on behalf of commercial health insurers. eviCore manages benefits in several therapeutic areas that are in great need of better cost management, including radiology, cardiology, musculoskeletal disorders, post-acute care, and oncology. Over \$300 billion are spent annually in the treatment of these therapeutic areas, making eviCore an especially attractive platform for Express Scripts as the company looks to build a comprehensive suite of solutions with significant cross-sell opportunities.

LARGE INTEGRATED HEALTHCARE COMPANIES

The pharmacy services M&A landscape has historically consisted of horizontal mergers, such as specialty pharmacies acquiring other specialty pharmacies and PBMs acquiring other PBMs. More recently, acquisitive companies are deciding to integrate vertically to forge deeper into segments outside of their core businesses. Pharmacy services companies will have more patient touchpoints throughout the continuum of care as they broaden their service offerings. With more touchpoints, a fully-integrated provider can better educate patients, monitor medication adherence, and manage diseases.

Companies that can offer a broad array of services will be well-equipped to aggregate and analyze data to optimize care for patients and control costs. Facing cost pressures, healthcare providers across the continuum are forced to seek new ways to drive efficiency. Healthcare companies have found that bringing PBMs in-house is one strategy for reducing the cost of care, as is the case with Anthem’s IngenioRx, UnitedHealth Group’s OptumRx, and CVS’ Caremark.

Similarly, CVS boasts a large network of retail pharmacies, specialty pharmacies, a PBM, and now potentially one of the largest health insurers in the U.S., pending the acquisition of Aetna. The likely next step for CVS and similar organizations is to expand into the service lines that they do not currently offer to move closer to being a fully-integrated healthcare company with a truly comprehensive suite of services.



CONCLUDING THOUGHTS

All providers of healthcare services face increased pressure to reduce cost and increase quality of care. Providers in the specialty pharmacy industry face additional roadblocks as they allocate their limited resources across a wide range of initiatives, such as gaining accreditation and applying for limited distribution drugs. Despite these headwinds, private equity groups and strategic consolidators alike have continued interest in the specialty pharmacy market. These parties see an opportunity to build robust healthcare platforms in a sector with favorable macroeconomic trends by investing in and acquiring independent specialty pharmacies with the goal of helping them maneuver roadblocks and build a growing business.

Members of the Provident Healthcare Partners investment banking group, including Michael Patton, Managing Director and Justin Hand, Managing Director, would be happy to elaborate on any of the trends and insights mentioned in this article or to answer other inquiries regarding healthcare services. They can be reached at (617) 742-9800.

Recent Provident Healthcare Partners Pharmacy Services Transactions



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