



## SPECIALTY PHARMACY

## SECTOR REPORT





Dear Valued Colleagues:

Specialty pharmacy and pharmacy support services continue to play an increasingly important role in the healthcare continuum. In this 2017 Specialty Pharmacy Report, we highlight today's growth areas and opportunities, with an aim to provide insight into current trends and business drivers.

This report explores the shifts taking place within the industry to enable stakeholders to formulate better decisions and strategies. Our overarching goal is to ensure that independent specialty pharmacy owners and operators remain well-positioned to maximize opportunity and returns.

2017 is uniquely divergent as the industry is pushed to manage unprecedented volume, increasingly complex drug therapies, continued consolidation and PBM dynamics, all against the backdrop of legislative reform. Now, we as operators, investors, and a nation of consumers, are amidst the most significant wave of transformation in the history of specialty pharmacy.

Pharmacy businesses that can efficiently innovate, possess the opportunity to increase both market share and returns. These opportunities remain unbounded. Through the adoption of new service models and technology, the face of modern pharmacy continues to evolve. While campaigns for compelling innovation are being driven by well financed PBMs, payers and large health providers – innovative disruption continues amongst smaller independent operators.

As always, we look forward to continuing our dialog and our work with specialty pharmacy and healthcare stakeholders.

Cordially,

A handwritten signature in black ink, appearing to read "Thomas Bird".

Thomas Bird



### State of the Industry

#### Hepatitis C

- Gilead Sciences 2017 Hep C sales forecast down 35% vs prior year

#### PCSK9: Blockbuster Drug

- PCSK9 anti-cholesterol drugs anticipated as the next Hep C tsunami, but spending on the first entries in the class has been light to moderate
- Cardiologists waiting for outcomes data

#### DIR Fees

- Broad expansion and lack of transparency create growing profit risks for independent pharmacies

#### Consolidation

- Number and size of organizations entering the specialty market continues to increase (Payers, SPPs, Pharma)

#### Regulatory / Compliance

- Some RFPs now seeking dual accreditation and Certified Specialty Pharmacist designation

### Market Drivers

- 10,000 adults aging into Medicare daily
- By 2020, global biologic sales are estimated to exceed \$390B
- Demand for outcomes data – justification of costs
- Diversification of specialty pharmacy competitors
- Patients living longer with complex, multiple chronic conditions – critical need for highly qualified pharmacies to manage exacting medication needs
- Limited distribution networks, particularly in oncology, are increasingly being used by manufacturers

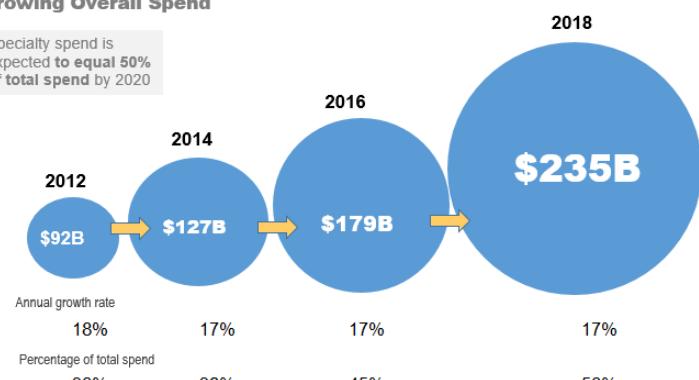
### Specialty Pharmacy Opportunities

- US drug spending increased 3.8% in 2016
- One of every five dollars spent on prescription drugs is for diabetes or specialty inflammatory conditions
- Breakthrough advances in new medications
- Manufacturers' pipelines focused on rare diseases
- Explosive growth from new specialty drug segments including Oncology and Inflammatory therapeutics
- Improvements to be made with distribution, clinical expertise, specialized regional coverage, therapy management programs, and information technology
- Infusion services remain a highly fragmented segment
- Strong capital market sentiment

### Growth of Specialty Market

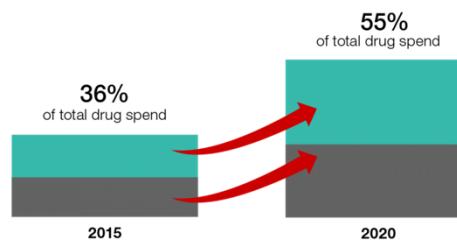
#### Growing Overall Spend

Specialty spend is expected to equal 50% of total spend by 2020



Express Scripts, CVS Health, Gryphon Analytics analysis

#### Total Industry Specialty Spend

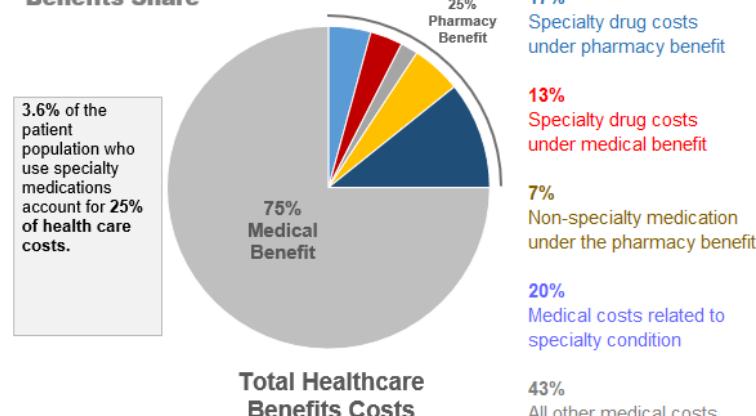


Half of spend is under medical benefit which has limited visibility

Medical Benefit  
Pharmacy Benefit

Data Source: Medicines Use and Spending in the U.S. IMS, April 2016. NHE, Artemetrx, CVS Health Internal Analysis, 2016.

#### Pharmacy & Medical Benefits Share



Express Scripts, CVS Health, Gryphon Analytics analysis

## Role of Information Technology

- New specialty pharmacy technology will play an important role in improving patient outcomes
- New technologies are helping patients better manage their health and make more informed choices about care
- Leading pharmacies have developed a variety of innovative systems, devices and applications to foster greater collaboration and decision-making among care providers, while also engaging patients

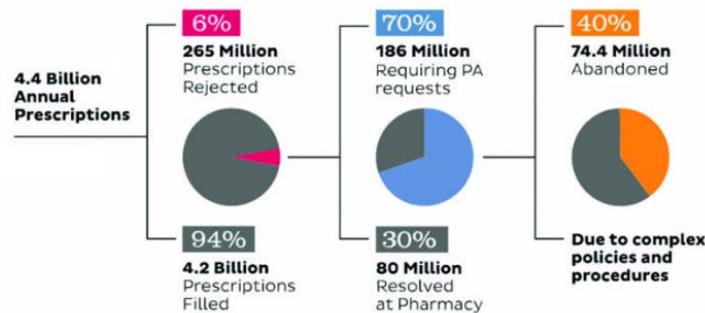
### Pharmacy Drivers

- Lower operational costs
- Measurable ROI
- Adherence / cost reduction
- REMS compliance
- Clinical decision support
- Patient monitoring
- Instant medication history
- Differentiation

### Patient Drivers

- Convenience / refills
- Patient education
- Active engagement
- Mobile apps and tools
- Access to support
- Instant information
- Medication history

### The Prior Authorization Obstacle Course



Hub Services Special Report 2016, Pharmaceutical Commerce

### Does Mobile Technology Matter?

That mHealth Data Trends



71% of nurses are using smartphones at work



62% of physicians are now using tablets, with over half of them using one at point-of-care



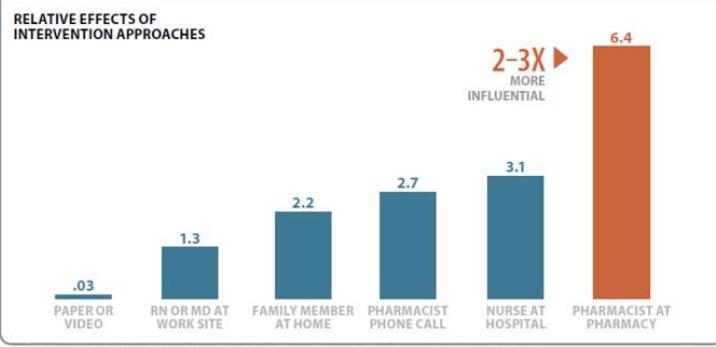
59% of patients in emerging markets use at least one mobile health app or service (compared with only 35% in the developed world).

Avella, Dispensing Excellence

## Independent Retail Pharmacies : The Sleeping Giant

- There are an estimated 22,000 community pharmacies in the US
- Independent community pharmacies remain a major segment of pharmacy -- a \$81.5 billion marketplace
- Mobilization of the immense independent market will solidify community pharmacies as an ongoing critical component of the specialty supply chain
- Approximately, 1,800 rural independent pharmacies serve as the only pharmacy provider in their community
- One-third of all retail prescriptions are filled thru independent pharmacies
- Independents seeking alternative revenue opportunities
- IRPs engaging their patient populations and building expertise in the space

### Pharmacist Counseling More Than Twice As Effective



### Expanding Capabilities of Independents



According to Rinku Patel of KloudScript, a leading community pharmacy service provider, "The pharmacy industry has a rich history of entrepreneurs and the community pharmacy segment must pivot and adapt to the change to remain successful. As these pharmacies innovate, we should be prepared to see appointment based care models in the pharmacy that addresses not just the dispensing aspects of patient care, but value based services, MTM, adherence solutions, immunization, etc."

Importantly, "Due to the dynamics of, limited networks and limited drug distribution strategies, it is prudent for operators to partner with a service provider that will quickly provide the capabilities necessary to meet stakeholder expectations, shorten time to market, and increase ROI for their specialty program."

**Rinku Patel, PharmD**  
Founder & CEO

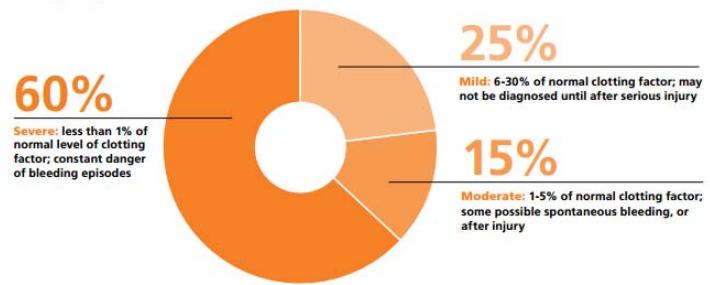


## Therapeutic Spotlight: The third H . . . Hemophilia

Hemophilia is a rare, inherited bleeding disorder in which the blood does not clot properly

- The global market for hemophilia drugs is now worth approximately **\$10 billion a year**
- About **20,000** Americans
- Occurs in **1 of 5,000** male births – affects males almost exclusively
- **8th most costly for** employers for all specialty diseases

Of all people with hemophilia...



Nature Outlook: Haemophilia. A Primer on Haemophilia. Dec 16, 2014

### Therapeutic Drivers

- Patients living longer, normal lifespans
- Inhibitor treatment options escalating treatment costs: the cost for bleeding control bypass agents alone can average \$300,000 per patient per year
- Manufacturers continue to develop new drug advances

### Outcome reporting tools and clinical data

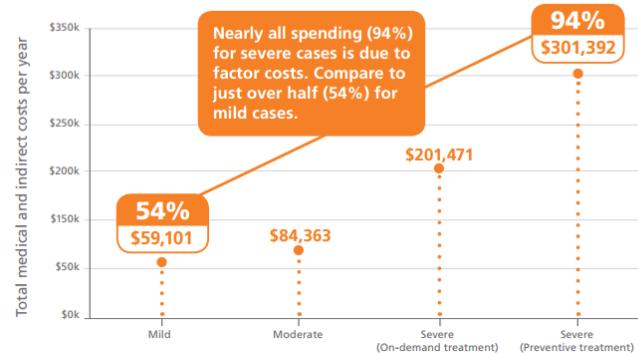
Reporting requirements and clinical data play a critical role in pharmacy operations. According to Dr. Sajal Roy, President and CEO of Factor One Source Pharmacy, “Outcomes reporting is essential to generating both favorable clinical outcomes and getting access to payor specialty contracts. Furthermore, accreditation bodies require this specific reporting as part of a specialty pharmacy’s patient management program. Having the right tools and reports are critical to make this happen in a timely manner.”

“Keeping patient’s compliant with their infusion medication, tracking of adverse events and bleeds, and involving patients in their care all lead to superior health outcomes. Payors are most interested the best management of their patient lives and cutting unnecessary costs that can be avoided. It takes time to setup the correct reports and integrate those reports into the patient workflow. Once you have successfully mapped the process, it is amazing how much the data drives decisions.”

Dr. Sajal Roy, President & CEO

### Clotting factor costs

One key cost variable is how much replacement clotting factor a patient needs. Mild and moderate cases require relatively little replacement factor, while severe cases need much more. Patients on preventive therapy use the most replacement factor but also show fewer bleeding episodes and ER visits.



### Inhibitors

Some patients develop a resistance to clotting factor infusions. Essentially, the body develops an allergic reaction to the clotting factors.

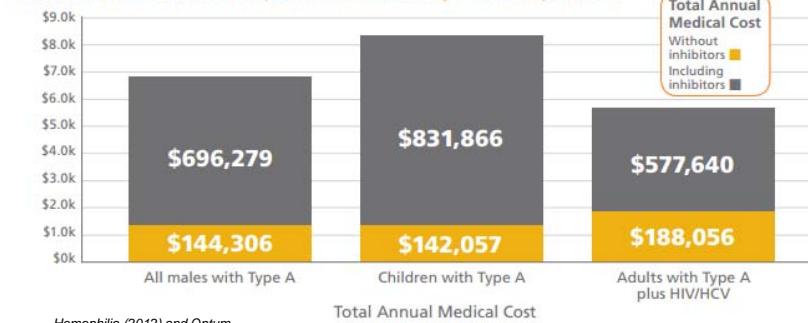
**30%** of patients with severe Type A and up to **5%** of those with Type B develop a resistance after receiving clotting factor infusions over a period of time. About **1,200 Americans** with hemophilia have inhibitors.

When people develop inhibitors it becomes extremely difficult to control their bleeding episodes.

These are some of the most expensive cases to treat.

CDC researchers found that the average yearly health care bill for patients with inhibitors was nearly **five times higher** than for patients without inhibitors.

### Health Care Costs for Hemophilia in Commercially Insured Populations



### Limited Distribution Drugs / Networks

- Each specialty pharmaceutical or biologic may come with unique needs that may change throughout the product life cycle -- **distribution channel decisions are made on a product-specific basis by the manufacturer**
- Limited distribution networks, particularly in oncology, are increasingly being used by manufacturers to reduce costs, improve efficiency and ensure quality control
- Core services include rapid benefits investigation and fast turnaround time for shipments. First-dispensing-time is critical to manufacturers. Specialty pharmacies must demonstrate expertise on these basics to be competitive for LD access

### Benefits to Pharma / Biotech

- Improved access to clinical data
- Improved patient adherence
- Complete traceability down to the patient (serial IDs)
- Commercialization assistance
- Expanded patient training for self administered drugs
- Finding co-payment assistance or alternative coverage for the patient

### Getting In & Staying In

- Failing to deliver all contract requirements will lead to ejection from a network
- First-time-to-fill is decisive and critical
- Every script matters
- Seek barriers to entry through therapy expertise or geographic positioning
- Create collaborative partnerships, deeper relationships
- Increase value to the payers

### Selected Limited Distribution Manufacturers and Products

**Genentech**



**Pfizer Oncology**

**NOVARTIS ONCOLOGY**

**janssen**

**EMD Serono**

**AVASTIN**  
bevacizumab  
solution for intravenous infusion

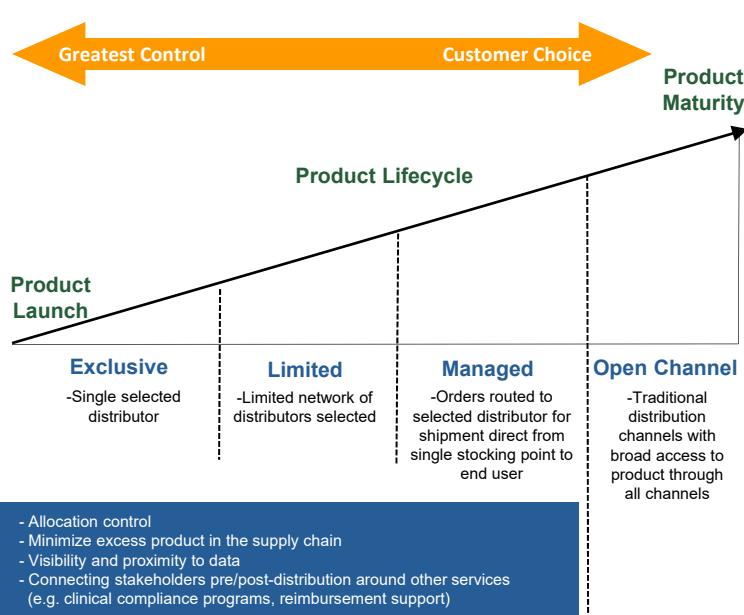
**Otezla**  
(apremilast)  
delayed tablets

**XALKORI**  
crizotinib

**EXJADE**  
Tablets for Oral Suspension  
125 mg | 250 mg | 500 mg

**Zytiga**  
once-daily tablets  
abiraterone acetate

**Serostim**  
[somatotropin (hormone) for injection]



- Success of limited distribution networks and the management of complex patient populations will hinge on **balancing patient access and cost reduction** all while improving clinical outcomes

### Pharmacy Differentiation / Specialization

- Create sticky physician relationships / drive for physician collaboration
- Develop sophisticated support, including specialized sales teams
- Drive and document increased patient adherence – “data is king”
- Establish pharma manufacturer relationships early
- Develop disease specific MTM programs

### Specialty Pharmacy Seller Rationale

- Opportunity to partially de-risk
- Independents seeking partnerships to manage long-term growth
- Growing working capital requirements
- Larger enterprises require investment and development of corporate capabilities
- Declining barriers to entry
- Difficult to access limited distribution networks
- Independents struggling to manage scale

### Acquirers M&A Drivers

- Strategics seeking to fill geographic holes
- Operators strategically managing the therapy mix
- Grocery and retail drugstore chains expanding market presence
- Private equity backed investors acquiring platform investments and tuck-in acquisitions
- Hospital systems, Insurers, and Wholesalers all continue to hunt for specialty pharmacy synergies

### M&A Observations

While valuations continue to trend positively, high premiums have generally been limited to specialized businesses that are well positioned with sustainable competitive advantages. Additionally, acquirers are looking for assets which fill identified geographic holes.

- Diverse base of buyers continue to hunt for growth
- Private equity specialization and speed competing to outmaneuver corporates
- Many acquisitions are immediately accretive, likely benefiting the seller and buyer
- Infusion M&A demand far exceeds supply
- Strong interest in sub \$50M value

Valuations	Enterprise Value / LTM Revenue	Enterprise Value / EBITDA
Specialty Rx		
Mean	0.7x	9.5x
Median	0.6x	8.2x
Infusion		
Mean	1.6x	14.7x
Median	1.5x	11.4x

Gryphon Analytics Analyses

### Select Strategic Activity



### CVS/specialty



### Select Private Equity Activity



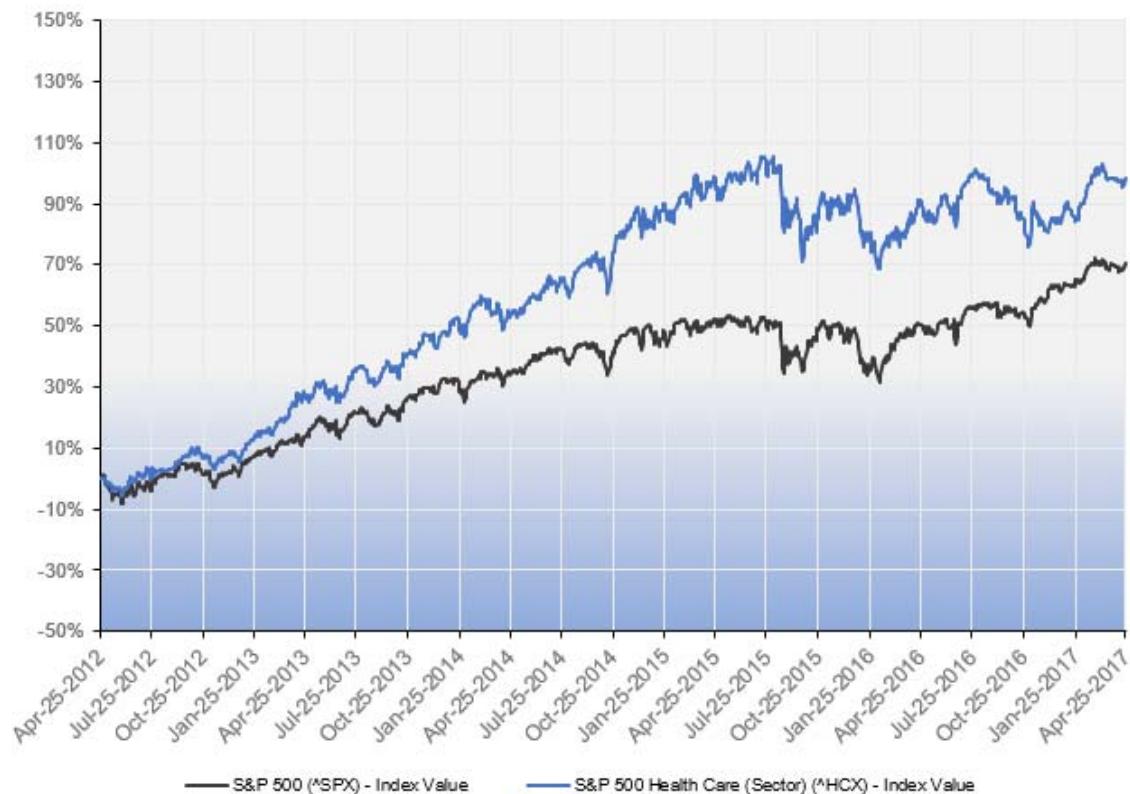
MADISON DEARBORN PARTNERS, LLC



RIORDAN, LEWIS & HADEN | Equity Partners



## Publicly Traded Comparable Companies



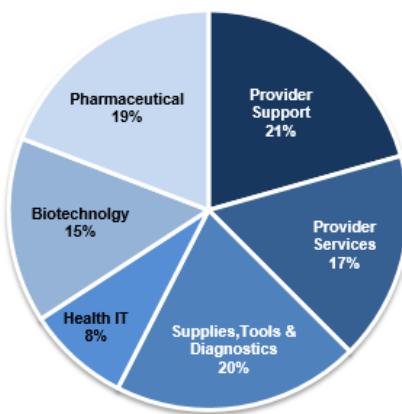
- The healthcare sector remains well positioned for growth
- Healthcare sector gains fueled by the eye-popping returns generated by drug makers launching novel treatments
- The aging population and chronic disease continues to fuel rising demand for specialty care and biopharma therapeutics
- Enterprise value multiples over the past 24 months remain strong

## Healthcare M&A Breakdown

### Healthcare Highlights

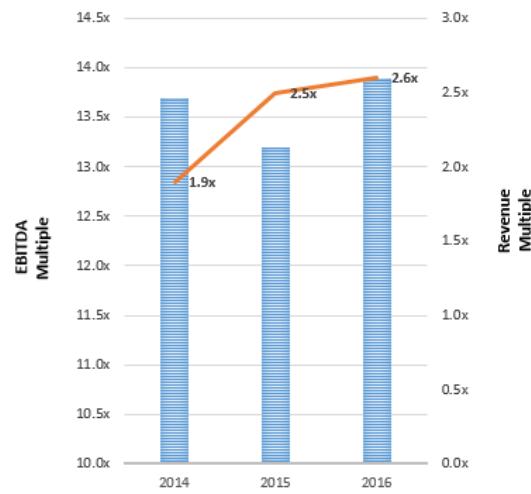
- Three of the industry's top five and six of the top ten highest value acquisitions in 2016 were completed by financial sponsors
- Total transaction volume in 2016 remained comparable to 2015, at 452. This represented a 16 percent rise relative to 2014
- Strategic acquirers represented 80 percent of aggregate volume and 58 percent of value in 2016
- Strategic buyers continue to hunt for acquisition targets

### Healthcare M&A by Sector



Cap IQ and Gryphon Analytics analysis

### Healthcare Valuation Multiples



Cap IQ and Gryphon Analytics analysis



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