

BOURNE PARTNERS



MARKET INSIGHT

PHARMACY BENEFIT MANAGEMENT & SPECIALTY PHARMACY

INTRODUCTION – MARKET UPDATE WITH M&A FOCUS

Based on market research and conversations with PBM and specialty pharmacy executives, industry experts, and buyers of businesses in the related subsectors, we highlight a handful of trends we see driving the industry as well as developments we expect will have impact on shaping the future of the category.

The pharmacy benefit management industry remains heavily fragmented. The market is still controlled by a handful of players with the majority of market share fighting for the business of the larger plan sponsors while the numerous smaller companies compete for the relatively smaller employers.

As healthcare expenditures continue to rise, pharmacy benefit managers face increased pressure regarding drug pricing along with other players in the healthcare space. In response to the scrutiny of regulators, PBM pricing models are shifting in favor of transparency over the traditional opaque methods of receiving compensation (administrative fees versus spreads/rebates).

Specialty pharmacy providers are benefitting tremendously from trends in the pharmaceutical industry. As pharma becomes more specialized, the specialty pharmacy market will increasingly grow in size as well as strengths and capabilities.

Overall, the past couple of years have been characterized by consolidation amongst the major health insurance companies. Subsequently, these mergers triggered corresponding consolidation in the PBM and specialty pharmacy space. PBMs have been reluctant to lose leverage as they seek scale in relation to their clients. The recently announced Express Scripts merger with Cigna epitomizes the industry's appetite to make deals. Initial fragmentation also factored into the equation.

As an industry-focused advisor of companies seeking capital markets solutions, such as raising capital or exploring M&A opportunities, we provide value-added insight and transaction services to maximize client value.

Exclusively focused in healthcare, we have a deep track record of transaction success in capital raises and M&A. We hope this market snapshot is a helpful reference and please feel free to reach out with any questions or to discuss ways Bourne Partners may be able to add value to your company. We look forward to hopefully learning more about your strategic priorities and keeping in touch.

INDUSTRY TRENDS & GROWTH DRIVERS

Shift in PBM's Business Models

A greater emphasis on driving value and patient outcomes will be a continual theme moving forward in an endeavor to address rising healthcare costs. In addition, PBMs will maneuver toward more transparent methods of receiving compensation versus historically unclear structures.

Source: *7 Ways Healthcare will Change in 2017* – Express Scripts

Fully transparent PBMs have gone from industry outlier to representing 40% of contracts.

– Derek Daggett,
Senior Sales Executive at SmithRx

Specialty Drug Spend on the Rise

Sticker prices continue to increase for products treating rarer ailments. These less-competitive disease areas have become more attractive as pharma companies seek to maintain leverage in relation to payers. Despite constituting a small fraction of the amount of scripts, specialty drug costs have risen as a percentage of overall healthcare expenditure.

Source: Specialty Pharmacy Times: Top Trends for 2018 in Specialty

Specialty drug costs' share of spending has doubled over the past five years for the largest PBMs.

– Drug Channels: Expert Insights on Pharmaceutical Economics and the Drug Distribution System

Pricing Pressures still on the Rise

Blame for escalating prices has been spread around the industry from big pharma to PBMs. Drugmakers have realized pricing pressure from payers in crowded disease areas where generic alternatives can easily be swapped for more expensive branded products. Pharma companies claim that PBMs encourage higher drug prices in order to receive bigger rebates.

Source: Bloomberg: *Big Pharma Losing Leverage as Payers Raise Pressure on Price*

Further Consolidation

The past few years have been characterized by rapid consolidation across the industry as PBMs and specialty pharmacies seek to ensure greater leverage and negotiating power relative to their clients and drug manufacturers. Vertical integration allows PBMs and insurers to dictate prescription drug prices and pass benefits of discounted drug price surplus to consumer.

Source: GEP: *PBM Industry Witnessing Rapid Consolidation*

Consolidation also protects from the threat of solo market entry by Amazon; the joint alliance of Amazon, Berkshire Hathaway, and JP Morgan; and any other looming disruptive force.

IQVIA (Formerly IMS Health) Annual Review of U.S. Pharmaceutical Market

Overall, IQVIA's report serves as positive reinforcement that the prescription channel is positively positioned as well as providing key insight to acknowledge and address other market concerns. Although the majority of the report dealt with the effects on both branded and generic companies, there are several relevant takeaways for PBMs and Specialty Pharmacies.

In 2017, net brand price growth fell to a pace below the core Consumer Price Index. The previous four years saw net price growth on brands outpace the CPI by approximately 2-3 percentage points on average every year. J.P. Morgan Equity Research asserts that this slowdown is partially driven by various PBM tools such as formulary management and price protection. This could also lessen the ongoing regulatory scrutiny regarding drug pricing and spending.

IQVIA claims that mail script trends are gradually regressing, while J.P. Morgan argues this assessment is questionable due to other data in the public domain. IQVIA's review shows a minimal year-over-year increase, which is hard to take as fact due to Express Scripts and CVS Caremark alone reporting more scripts than IQVIA giving them credit for, let alone the remainder of the market.

Specialty drugs represent an increased 37.4% of spending in 2017 relative to 32.5% in 2016 for retail and mail channels. In terms of non-retail, specialty drugs accounted for around 60% of invoice spending. In summation, specialty drugs jumped from 82% of new brand spend growth in 2017 after representing 69% in 2016. These statistics show the trend in the specialty realm that may continue for years to come.

Among all payor types, Medicare Part D and Medicaid have realized the fastest volume growth. Since 2013, Medicare Part D and Medicaid have compounded annual growth rates of +3.1% and +9.0%, respectively. Cash transactions have steadily decreased while both Medicare Part D and Medicaid continue to increase in total percentage of prescriptions nationwide.

M&A Precedent Transactions

Below is a list of transactions with disclosed deal values within the PBM and specialty pharmacy industries. While larger acquisitions typically have the highest EBITDA multiples given their relative profitability, smaller companies have also been transacting at favorable valuations in terms of revenue over the past few years. Overall, the median enterprise value multiples for this subset of precedent transactions are 1.1x and 12.8x for Revenue and EBITDA, respectively. Typically, Bourne Partners analyzes precedent transactions in any given industry segment in tandem with trading comps. However, due to the lack of public entities in the space that are purely PBMs and/or specialty pharmacies, we find the public comps methodology less reliable and insightful in this category.

Announced Date	Target	Buyer	Geographic Location	Enterprise Value	LTM Revenue	LTM EBITDA	EV / LTM Revenue	EV / LTM EBITDA
Nov-17	National Pharmaceutical Services	Diplomat Pharmacy, Inc.	USA	\$47.0	\$32.0	\$5.4	1.5x	8.7x
Nov-17	Leehar Distributors, Inc.	Diplomat Pharmacy, Inc.	USA	595.6	388.0	41.0	1.5x	14.5x
Jan-16	Helios Comp	OptumRx, Inc.	USA	1,600.0	NA	NA	NA	NA
May-15	AnazaoHealth Corporation	Fagron NV	USA	97.8	NA	16.3	NA	6.0x
Mar-15	Concentra, Inc.	Select Medical Holdings Corporation	USA	1,055.0	1,000.0	NA	1.1x	NA
Mar-15	Catamaran Corporation	OptumRx, Inc.	USA	13,385.5	21,581.9	845.7	0.6x	15.8x
Feb-15	Healthcare Solutions, Inc.	Catamaran Corporation	USA	405.0	NA	35.0	NA	11.6x
Feb-15	Envision Topco Holdings, LLC	Rite Aid Corporation	USA	2,640.1	4,071.4	94.3	0.6x	28.0x
Sep-13	PMSI, Inc.	Helios Comp	USA	408.0	NA	31.9	NA	12.8x
Aug-13	Restat, LLC	Catamaran Corporation	USA	409.5	NA	NA	NA	NA
Jun-13	CarePoint Partners, LLC	BioScrip, Inc.	USA	221.1	140.5	NA	1.6x	NA

Notes:

NA - Not Available

Source: CapitalIQ April 2018

Median	\$409.5	\$694.0	\$35.0	1.3x	12.8x
Mean	1,896.8	4,535.6	152.8	1.2x	13.9x
High	13,385.5	21,581.9	845.7	1.6x	28.0x
Low	47.0	32.0	5.4	0.6x	6.0x

OUR EXPERIENCE

Bourne Partners is an investment banking and private equity firm focused exclusively in the healthcare space covering the pharma, pharma services and distribution chain. We help companies execute M&A (selling their business or buying another) and raising capital to finance growth or recapitalize, taking some chips off the table by bringing in a value-added investor. Below is a snapshot of our most recent deal experience.

FEATURED CASE STUDIES

Cold-EEZE® Case Study

Bourne Partners Value-Add

Bourne Partners provides strategic and financial advisory services to clients throughout the business evolution life cycle. Unlike most investment banks, which simply represent one side of a transaction, our team is made up of experienced investors and operators with a network of resources.

We play an active role in helping businesses grow by creating long-term, profitable relationships that extend beyond single transactions. It is our focus on relationships and results that has yielded us an impeccable track record of client satisfaction.



SECTOR EXPERTISE

Unlike generalist firms, we concentrate solely on healthcare investment and transaction advisory



360° APPROACH

As an investor, operator; and advisor, we offer perspectives from a complete spectrum of experiences



MAXIMIZED OUTCOMES

We understand the necessity for the alignment of interest throughout the capital structure



MAXIMIZED OUTCOMES

Objective

ProPhase Labs engaged Bourne Partners to act as its exclusive financial advisor to find an acquirer and maximize shareholder value in the sale of its cold remedy brand, Cold-EEZE®.

Process

Bourne Partners utilized its deep industry relationships and knowledge to market, solicit interest, negotiate, and drive the sale of Cold-EEZE® to a timely close. Within this process Bourne identified a set of financial and strategic buyers, including a group of pharmaceutical companies likely to place high value on the asset.

Result

After running a targeted sale process, Bourne Partners achieved maximum value in its \$50m sale of Cold-EEZE® to Mylan. Under the terms of the agreement, Mylan, through its US OTC subsidiary, purchased substantially all of the assets and other rights relating to the Cold-EEZE® brand. Consistent with industry trends, Mylan was able to justify a purchase price significantly higher than other bidders due to its desire as a pharma company to expand its consumer health presence.

“ I highly recommend Bourne Partners as a sell-side advisor in the consumer health space. Their deep industry knowledge and extensive relationships were critical in maximizing the value of the sale of our flagship brand, Cold-EEZE® cold remedy. ”

- Ted Karkus,
Chief Executive Officer,
ProPhase Labs, Inc.

Transacting Companies



PROPHASE LABS, INC. (NASDAQ: PRPH)

ProPhase Labs' primary business is the manufacturer, distribution, marketing, and sale of OTC healthcare and cold remedy products to consumers through national chain, specialty, local retail stores and e-commerce. Its flagship brand is Cold-EEZE® and its principal product is Cold-EEZE® cold remedy zinc gluconate lozenges, a homeopathic product proven in clinical studies to reduce the duration and severity of symptoms of the common cold.

MYLAN N.V. (NASDAQ: MYL)

Mylan is a global pharmaceutical company committed to setting new standards in healthcare. Working together around the world to provide 7bn people access to high quality medicine. It offers a growing portfolio of more than 2,700 generic and branded pharmaceuticals. Mylan markets its products in more than 165 countries and territories.

CASE STUDY

BOURNE PARTNERS

M&A TRANSACTIONAL ADVISORY



OPTIMAL RESEARCH / ACCELOVANCE, INC.

Optimal Research, a carve-out of Accelovance, Inc., is a Site Management Organization (SMO) providing solutions to pharmaceutical and biotech companies, medical device companies, and contract research organizations (CROs). Accelovance is an award winning, full service clinical Contract Research Organization focused on vaccine, oncology, and general medicine Phase I-IV programs. Accelovance provides global CRO services to pharmaceutical companies, biotech, CROs, and academic institutions, and is based in Rockville, MD with multiple offices in the US, Europe and China.

HOW BOURNE ADDS VALUE

Bourne Partners provides strategic and financial advisory services to clients throughout the business evolution life cycle. We play an active role in helping businesses grow and maximize outcomes by creating long-term, profitable relationships that extend beyond single transactions. It is our focus on relationships and results that has yielded us an impeccable track record of client satisfaction.

OBJECTIVE

Accelovance, Inc. engaged Bourne Partners to identify an acquirer of the company and negotiate a transaction that maximized shareholder value.

PROCESS

Based on the increased M&A activity around SMO's, Bourne Partners and Accelovance chose to run a highly targeted process focusing solely on a handful of the largest CRO's, all known by Bourne Partners to be actively seeking SMO acquisition opportunities. When initial indications were received, it was clear that Accelovance should consider carving out its SMO, Optimal Research, from the Clinical CRO segment of the business.

RESULT

Accelovance ultimately maximized value by carving out Optimal Research. Bourne Partners is currently in the process of selling Accelovance's Clinical CRO business and has signed to sell the remainder of the company to a publicly traded Japanese entity.

“ I highly recommend Bourne Partners as a sell-side advisor in the Clinical CRO and Sites Network space. Their experienced execution team, deep domain knowledge and extensive strategic and PE relationships were critical in maximizing the value of the sale of our Investigative Site Network, Optimal Research.”

- Steve Trevisan, Founder, President & CEO, Accelovance, Inc.

Since 1991, Bourne Partners has been a thought leader in the healthcare investment banking space. Our team is a trusted resource for clients and our track record of success includes raising over \$2 billion in equity and debt capital and executing more than \$5 billion in M&A transactions.

Please contact us to talk about ways we may be able to add value to your company's strategic priorities.



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