

2020 SPECIALTY & INFUSION - CHALLENGING SEGMENTS WITH RAPID GROWTH

Specialty pharmacy is the fastest growing pharmacy segment and it is estimated that specialty drugs accounted for nearly 70% of prescription-dispensing revenues in 2018. However, even with this strong representation, the past 12-24 months experienced slowing M&A activity. The number of transactions in 2019 for specialty and infusion pharmacies fell by nearly 15% from 2018 levels and by more than 30% from 2017 levels. Acquirers are finding synergies more challenging and a closer look at the space reveals some clear headwinds. First, DIR fees (and now GER fees) continue to plague the space. In fact, 2019 saw a record level of DIR fees totaling over \$9 billion³. Second, payor networks and contracts made competing in the space very challenging. Over 50% of pharmacists reported insurance companies and exclusions from networks, PBMs and PBM practices as their greatest challenge to growth¹⁰. With so many challenges in this competitive segment of pharmacy, is there a guiding light for the space? Luckily, there are a few revenue generators that offer solid margins and opportunities for growth.

The specialty pharmacy and infusion markets grew rapidly during the past several years. Total spending on specialty drugs in 2019 was estimated to be \$446 billion⁸. Although specialty drugs are used by only 2% of the population, its share of spend jumped from 44.7% in 2018 to 47.7% in 2019; nearly half of all spending on prescription drugs. This increased spend resulted from new therapies entering the market with few or no competing drugs to drive down prices⁷. Demand continues to rise for specialty medications that treat specific disease states. Limited distribution drugs (LDDs) and orphan drugs are highly coveted therapies that generate strong revenue for specialty pharmacies. In fact, approximately 80% of new drug approvals are considered specialty⁴. Outcome based contracts (OBCs) have increased more than 50% over the past several years, as they continue to merge with reimbursements, technology, and providers. The results show that patients who exclusively use specialty pharmacies experienced a 60% higher likelihood of achieving optimum adherence compared with retail pharmacy users. Technology is rapidly changing the way in which the sub-sectors function and it will continue to improve distribution, outcomes and costs.

While specialty pharmacy is rapidly increasing, the M&A market is getting squeezed. The differential

Percent of total drug spend by drug type, 2019

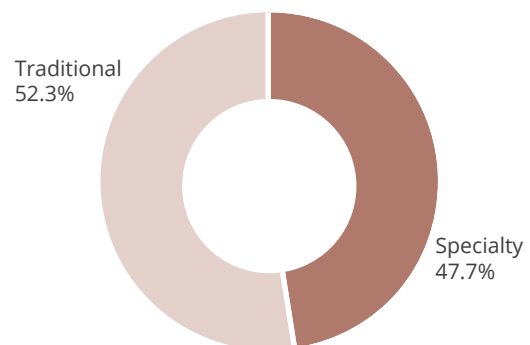


Figure 2: <https://www.express-scripts.com/corporate/drug-trend-report#2019-by-the-numbers>

between larger players and independents grows vastly wider every year, many specialty pharmacy owners are seeking an exit now, if they can, or they are pursuing additional revenue channels to their business. Pharmacies face headaches from PBMs, continued payor and provider consolidation, margin pressure, unethical competition, and DIR fees. Differentiating a business based on service grows more challenging every day. That said, there are still areas of specialty pharmacy that demonstrate strong growth and healthy margins, if deployed properly.

Which Specialties Are Driving Growth?

Asked which specialties were driving growth, specialty pharmacy professionals reported disease states across the board, including in the following:

- Oncology/Hematology (50%)
- Rheumatology (45%)
- Gastroenterology (43%)
- Neurology (38%)
- Gastroenterology (42.9%)
- Infectious Disease (21.4%)
- Rheumatology (45.2%)
- Dermatology (35.7%)
- Immunology (29%)
- Infectious disease (21%)
- Respiratory (14%)
- Pediatrics (5%)
- Other, including cardiology, ambulatory infusion management, infertility, HRT, migraine/osteoporosis, and PCSK9 (14%)

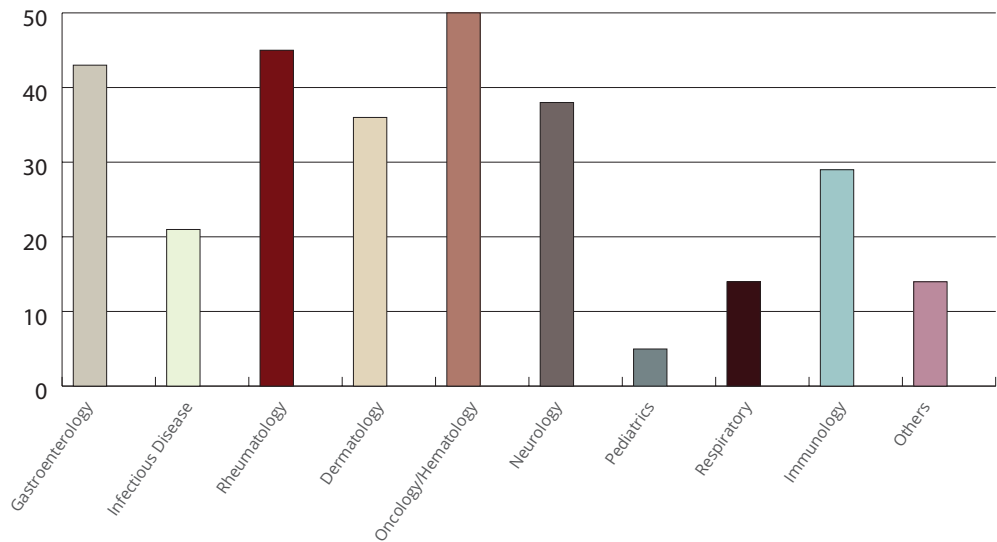


Figure 1: <https://csigroup.net/wp-content/uploads/2019/07/CSI-2019-Industry-Report-Web-compressed.pdf>

Even with the changing landscape, specialty infusion and home infusion therapy (HIT) are still in high demand. The sub-sectors continue to grow, and the HIT market is expected to exceed \$13 billion by 2024 (10% CAGR)¹. Infusion drugs exceed 20% of total specialty pharmacy volume in today's market and significantly contribute to a pharmacy's bottom line. In fact, multiple based valuations for specialty infusion and HIT are still often in the double digits. Pricing factors however, are of critical importance and may include: contracts, payors, disease state serviced and percent of total, patient count, geographic location and footprint, rare patient portfolio, etc. The Cures Act introduced insecurity to the space and whether NHIA will be able to successfully combat CMS' reimbursement remains to be seen. Nevertheless, buyers are actively seeking strategic acquisitions and valuations are near historic peaks. To improve valuations, many pharmacies pursue tough patients (geographically or otherwise) and seek out nursing agencies that have their own contract with the payor. Further, pharmacies try to avoid Part D because many commercial claims through PBMs are sent to vertically integrated specialty pharmacies. Even IVIG is not as profitable as it once was, in fact, many therapies are not.

That said, while some therapies fall out of favor (Milirone, etc.), others gain ground (Remicade, etc.). There are many alternative strategies to running the infusion gauntlet, but it is a race that can be decidedly rewarding to the value of a pharmacy at exit. For more detailed information regarding infusion and growth/valuation strategies please see the fall, [2019 Infusion Market Insight Report](#).

Moreover, 60% of health systems surveyed plan to start offering home infusion services in the next 12 to 24 months.³

Another race in specialty pharmacy is happening around 340B as competition heats up to become a contract pharmacy for covered entities. While the future of the program is not entirely clear and the program itself is a topic of debate, it continues to demonstrate strong growth. Rather than earning a traditional gross profit, 340B pharmacies



On the retail side, investors are continuing to watch the CVS/Aetna deal to see how it unlocks value for patients. By the end of 2021, CVS plans to expand its HealthHUB stores, which provide preventive care, wellness services, and management of chronic conditions like diabetes to Aetna members.⁹

earn based on various negotiated revenue models that can be 3 to 4 times higher than average. It is estimated that up to 10% of all specialty prescriptions are dispensed by 340B contract pharmacies⁶, representing a market size greater than \$44 billion. While most covered entities work with a select group of contract pharmacies, the tremendous activity and growth in 340B provides ample opportunity for independent owners. Demand is high for businesses operating in this profitable and growing niche.

Despite significant growth over the past decade, specialty and infusion pharmacy are reaching points of maturity. As a result, entering the spaces and scaling a business is increasingly difficult. Acquirers are challenged to identify synergies and growth. Many acquisitions among big players are vertical integrations while smaller players seek improved access to contracts and rates, LDDs, and geographic regions. The prevalence of OBCs, DIR fees, rethinking the Stark Law, and overhauling reimbursements created an environment where profits are tucked into efficiencies, technology, leveraging services and economies of scale. No longer are profits found in dispensing fees and service. Pharmacies looking to maximize their value need to exercise discretion and remain highly selective about how they grow their business and the areas in which they focus their efforts. Infusion and 340B are just two examples of strategies that generate attractive revenues and growth, but neither has easy access.

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