The Durability of the Specialty Pharmacy M&A Market

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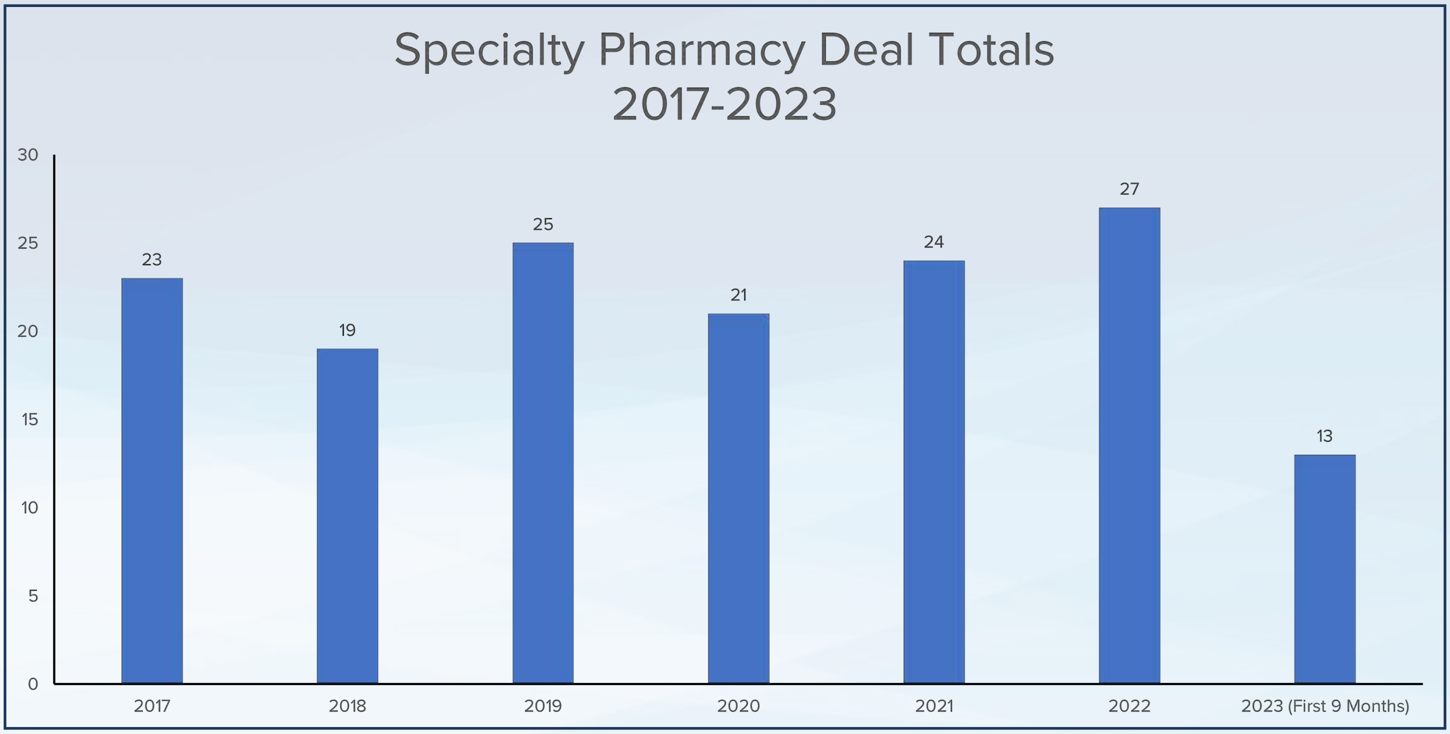
Introduction

The specialty pharmacy market has gone through considerable changes over the last few years; it has faced unmatched demand, but also faced tightening margins and lofty expenses. Despite this, the specialty pharmacy industry is durable.

Specialty pharmacies concentrate on medications that are not found in regular pharmacies. The drugs they manufacture and develop are highly specialized to treat complex conditions and diseases such as cancer, multiple sclerosis, growth deficiencies, hemophilia, HIV/AIDS and cystic fibrosis. The form of medications can range and are often taken orally, but can also be injected or infused.

Due to the complicated nature of the medications and rarity of the conditions, specialty pharmacies provide medication administration training, patient monitoring and the patient care services needed with such specific medications. They do this by allowing pharmacists to connect patients directly to the resources needed.

Working alongside the specialty pharmacy market are pharmacy benefit managers (PBM) which act as intermediaries between insurance providers and pharmaceutical manufacturers. PBMs create formularies, process claims, review drug usage, negotiate rebates with manufacturers, create pharmacy networks and, at times, manage mail-order pharmacies. They also frequently own specialty pharmacies.



Source: *Levin ProHC, October 2023*

Statistics

We've compiled statistics of specialty pharmacy mergers and acquisitions to further demonstrate how tailwinds and headwinds impact deal flow. According to data captured in the [LevinPro HC database](), M&A activity in the specialty pharmacy industry has been on a slight, yet steady, escalation since 2018. There were 19 transactions announced in 2018; followed by a jump in 2019 when there were 25 deals reported. Deal volume in 2020 dipped to 21 transactions, but rebounded to 24 acquisitions in 2021 and 26 in 2022.

Yet, in 2023, the deal volume has not lived up to the activity of prior years. Through the first three quarters of 2023, there have been 13 transactions in the specialty, which, annualized, was the lowest annual total over the past five years. This is partially because the market is already so consolidated that there are not as many acquisition opportunities. Companies such as **Express Scripts**, **CVS Caremark** and **OptumRX** are PBMs and control approximately 80% of the market.

Private equity, in contrast to other investors, does not have as large of a presence in the specialty pharmacy market. In 2023, so far, private equity and/or portfolio companies have completed four transactions, or roughly 31% of the sector's year-to-date total activity. Those transactions are **Comvest Partners**' acquisition of Apotheco Pharmacy Group; **ArtesRx**'s purchase of Parkview Health Services; **PharMerica Corporation**'s acquisition of Blake Pharmacy; and **Hildred Capital Management, LLC**'s purchase of AleraCare.

Regarding why PE groups are not flocking to specialty pharmacies, Andre Ulloa, Partner and Executive Advisor at **M&A Healthcare Advisors** had this to say:

"As private equity exits an investment, they expect returns to be enhanced by an increased multiple, or 'multiple arbitrage.' They achieve this by scaling and integrating the portfolio within desirable market sectors that are not overly burdened by regulations which diminish the services (or products) to the constituents utilizing them."

In this, PE, or other investors, are not likely to invest in companies that are losing market share and provide little profit. That being said, Ulloa made it known that there are opportunities in the market for private equity and he is working with "sponsor-backed pharmacy platforms looking to acquire specialty pharmacies."

There were seven transactions completed by pharmacies such as **MDR Specialty Pharmacy**, which specializes in providing fertility treatments. Two of those transactions were completed by retail pharmacies, **Walgreens** (NYSE: WAG) and **CVS** (NYSE: CVS), which were also the only two publicly-traded acquirers. Compared to 2022, the types of acquirers in 2023 were less diverse. In 2022, there was one transaction completed by a biotechnology company and one by a pharmaceutical company. This may indicate how such a consolidated market may not be very accommodating to outsiders.

Disclosed spending in 2023 reached $75.35 million across two deals, which is a significant drop compared to the disclosed spending in 2022 that totals $1.75 billion across three deals. The total purchase prices of 2022 are comparable to those of 2021, which reached $1.55 billion. The deal with the largest purchase price in 2023, so far, is **Belmar Pharma Solutions**' acquisition of **Innovations Group, Inc.** from **UpHealth, Inc.** for $56 million.

There are several different types of specialty pharmacies, each with their own flow of deal activity. Some include long-term care (LTC) pharmacies, digital and infusion pharmacies. It should be noted that some in the industry consider long-term pharmacies to be separate from specialty pharmacies entirely, for the purposes of our data, we consider LTC pharmacies to be another type of specialty pharmacies.

Market Overview

Tailwinds

There are considerable influences contributing to why specialty pharmacy's M&A activity has, for the most part, risen throughout the years. These factors include an increase in FDA approvals, an aging population and increase in demand.

FDA Approvals

A major tailwind propelling the specialty pharmacy market forward has been the surge in FDA-approved specialty drugs. In 2016, half of the new drugs approved by the FDA were considered specialty pharmaceuticals. This is a staggering rise from previous decades where only a handful were approved, according to Diplomat's 2016 Specialty Drug Approvals report.

In IQVIA's 2021 report entitled Global Oncology Trends, 17 new drugs to treat rare cancers hit the market in 2020 and in 2021, there were 30 novel oncology medications. While the report did not specify how many were specialty pharmaceuticals, the report did say that in 2020, more than 30% of new medicines were oncology-related and targeted specific genetic mutations. The report also noted that over the last five years, 62 "innovative therapies" were launched across the United States, which have been approved to treat 130 indicators across 24 different tumor types. All of this highlights the impact and attention that specialty drugs have received.

Demographics and Demand

The rise in demand goes hand in hand with an aging population. In 2020, nearly 56 million Americans were 65 years or older. More significantly, approximately 10,000 Americans turn 65 each day, bolstering the number of seniors in the country. With more and more Americans aging, there is a heightened presence of diseases and conditions that may be age related and, thus, a heightened need for medications.

We spoke with Lou Puleo, VP Business Development of **Harbor Healthcare Consultants**, about how an aging population has affected the M&A market. He had this to say:

"An aging population parallels the rise in use of specialty medications. Due to the complex nature of treatments, manufacturers and large specialty pharmacies have increased deal activity to consolidate the market and better control the utilization of the medications."

He also addressed how a consolidated market allows the manufacturers to have better control over how people interact with their medications, allowing for more effective usage of the drugs.

In addition to having an older population, cancer's impact cannot be understated. Cancer, while not an inherently age-related disease, more often appears in older individuals. According to the Cancer Center, approximately 80% of cancer patients are 55 or older. The American Cancer Society projects that there will be almost two million new cancer diagnoses in 2023 and more than 609,000 cancer-related deaths in the country.

Also, in IQVIA's report, oncologists in the United States reported a decline in cancer treatment, but also noted an increased "share of their new patients presented with metastatic cancer during 2020 compared to a baseline period, across a range of large prevalence tumors, particularly for cervical cancer."

In addition to the pervasiveness of cancer, conditions such as multiple sclerosis (MS) have become more prevalent across a myriad of demographics. The numbers of how many Americans have MS vary between sources; the National MS Society estimates around one million Americans, double the number from 1975, while the MS Discovery Forum estimates it to be 400,000, with approximately 200 additional diagnoses each week.

In 2023, Michael Hittle, a PhD student in epidemiology and clinical research at Stanford University, in combination with Jama Neurology, published a study that looked into the demographics behind MS. The study concluded that most patients with the disease are aged 45 to 65 years old. On the growing number of MS patients, Hittle had this to say:

"People are living longer, including people with MS, and there are now effective treatments that slow or halt the course of MS. This results in a higher count of people who currently have the disease."

New pharmaceuticals are in development and going through clinical trials to treat a wider variety of diseases and conditions. Drugs such as Rituximab, an oncology drug, have been proven to help inflammation experienced by those with MS by targeting B-cells. So, in addition to an increased demand, the usage of drugs themselves are being shifted, resulting in wider applications and peeking investor interest.

Headwinds

Yet, while there are many forces pushing the market forward and growing investor interest, there are also headwinds. Factors such as the nicheness of the medications, high cost of drugs, low reimbursement rates, supply chain issues and, of course, the higher cost of capital have limited investor interest in the space.

The medications made by specialty pharmacies are expensive because they cannot be mass produced. According to a 2021 report by AARP, the average annual cost of specialty drugs is $84,000, which is 10 times more than the cost of regular prescription drugs. The report goes on to detail that Zolgensma, which treats spinal muscular atrophy in infants and toddlers, totaled more than $2 million for one dose when it was initially licensed in 2019.

With fewer units/doses being produced, specialty pharmacies are difficult to scale up which limits their profitability, therefore limiting how many investors want to, or can, get involved.

When it comes to reimbursement, specialty pharmacies work a little differently. According to The American Journal of Managed Care, while traditional reimbursement plans for physician-administered drugs, doctors were reimbursed in full for the medication. With this, there is little incentive for a doctor to care about the price and how that would impact the patient.

Specialty pharmacies 'disrupt' this system as the reimbursement is no longer reliant on the provider supplying the drugs but rather the plan sponsor. This prevents an expensive mark-up for the patient. Yet, this system comes with low reimbursement rates for the sponsor, ultimately limiting the profitability.

Puleo also provided insight into headwinds facing the space. He said, "Reimbursement rates and razor thin margins played major roles in the challenges the market experienced, contributing to why specialty pharmacies were seen as less appetizing to investors."

The drugs used by specialty pharmacies, as they are expensive, are hard to come by for inventory. It can be difficult for pharmacies to maintain stock when getting access to ingredients is disrupted and challenged by labor shortages. While many industries are facing labor shortages, this presents a unique challenge for the specialty pharmacy market because the cost of manufacturing is so expensive that pharmacies may have to choose between paying workers a fair wage and keeping up manufacturing schedules to meet patient demand.

Trends

One trend currently on many minds is the prevalence of PBMs, which have become a major factor in market consolidation and M&A deal activity decline as the vast majority of specialty pharmacies are already owned by PBMs. The Centers for Medicare and Medicaid Services noted that PMBs should help lower drug prices as they are able to negotiate lower rebates for manufacturers. But, PBMs have an incentive to favor expensive drugs over cost-effective ones as they themselves can set the sale price to whatever they see fit.

Data from The Pew Charitable Trusts found that "manufacturer rebates grew from $39.7 billion in 2012 to $89.5 billion in 2016 and played a growing role in partially offsetting increases on list prices, which have risen more quickly than overall retail prescription drug spending."

Ulloa, from M&A Healthcare Advisors, addressed the abundance of PBMs. He noted that when there are high-volume, expensive drugs that are not a challenge to dispense or for the patient to take, PBMs can handle them easily. This is a challenge for many specialty pharmacies, who often lack the infrastructure and capability to cover all drugs, because it forces patients away from independently-owned pharmacies and into PMBs.

Michael Cammeyer, Managing Director of Harbor Healthcare Consultants, also spoke with us about PBMs' impact on the specialty pharmacy industry. He had this to say:

"PBMs have contributed to the decline of independent specialty pharmacies because PBMs control the overwhelming majority of the space; there's limited separation between the two businesses so it's difficult for independent pharmacies to compete with PBM owned pharmacies."

With the limited ability for independent pharmacies to contend with PBMs, it makes sense why investor interest in independent pharmacies has dwindled.

Additionally, another trend in the specialty pharmacy market is the increase of long-term care pharmacies. One of the ways an LTC pharmacy is unique is that their consultants work directly with patients and physicians, whether at their homes or long-term care facilities, and focus on the patient's health as a whole while other specialty pharmacies focus on disease at a time.

In a 2020 interview for Pharmacy Times, Tim Safley and Jon Pritchett, program directors of the Accreditation Commission for Health Care, spoke about long-term care pharmacies accreditation, remarking upon the sector's growth but its challenges.

Safley touched upon about how more LTC pharmacies have become accredited in infusion, as well, which allows them to build distribution systems into more markets. Having multiple accreditations under their belt, pharmacies can provide more services, broadening their customer base. Having more accreditations has allowed pharmacists to overcome the inventory challenge as it, paired with not focusing solely on one drug at a time, has allowed LTC pharmacies to work with more payors.

The multifaceted capabilities of many LTC pharmacies have contributed to their sizable presence in the M&A market. The more "useful" LTC (or any pharmacy) is, the more inclined investors will be to bring them under their umbrella.

Notable Transactions

Now that market conditions have been established, there are several transactions to take a deeper look at as they are good indicators of what the industry has gone through and the future of it.

A significant transaction from 2022 is **Nautic Partners**, **The Vistria Group** and **General Atlantic**'s acquisition of **PANTHERx Rare** in May 2022 for $1.4 billion. **Centene Corp.** (NYSE: CNC) sold PANTHERx Rare, after having purchased the company in 2020 for $910 million.

General Atlantic is a growth equity firm that, as of December 2021, has $84 billion assets under management, and more than 215 investment professionals worldwide. The Vistria Group is a private investment firm focused on investing in middle market companies in the healthcare, education and financial services sectors. The Vistria Group has raised over $5.1 billion across six funds. Nautic Partners is a middle-market private equity firm with a specialized focus in healthcare. Nautic has completed more than 150 platform transactions and has managed over $3.3 billion in assets.

The new partnership is aimed at accelerating PANTHERx Rare's continued growth as a pharmacy care delivery model for patients living with rare and orphan diseases.

In the press release for the deal, Justin Sunshine, Managing Director at General Atlantic, addressed the increased demand for specialty pharmacies to support rare and orphan disease patients, alluding to how the market is growing.

Sunshine had this to say: "We see a growing market need for a specialized pharmacy model to support rare and orphan disease patients in their healthcare journey and to meet the unique distribution demands of these life-enriching medicines,"

As one of the few transactions completed by private equity buyers, this acquisition emphasizes how private equity may be hesitant to break into a market with tight profit margins. To complete this transaction, three large private equity groups, with years of experience in healthcare and capital, joined together to spread the risk of the acquisition.

Over the last two years, Walgreens has made two significant transactions that demonstrate how the company is trying to break into the specialty pharmacy industry.

In 2021, **Walgreens Boots Alliance**, purchased the remaining 30% stake in **Shields Health Solutions** from **Welsh Carson Anderson & Stowe** in a deal valued at $1.37 billion.

Shields Health Solutions is a specialty pharmacy that represents more than 1 million patients across 30 diseases and is partnered with more than 70 health systems. It is "the premier health system-owned specialty pharmacy integrator in the United States," according to the press release.

Roz Brewer, CEO of Walgreens Boots Alliance had this to say:

"Our full acquisition of Shields will complete another major milestone as part of our consumer-centric healthcare strategy to drive sustainable long-term growth... We can now make further progress on our strategy through Shields' integrated model, increasing our value to health systems, expanding access to payor partners and supporting improved outcomes and lower costs."

Walgreens already owned 70% of Shields (which was purchased through several phases).

In February 2023, Walgreens also purchased **Medly Health**'s pharmacy assets for $19.35 million. This transaction came shortly after Medly Health filed for bankruptcy.

Medly Health was a Brooklyn-based digital pharmacy that operated four full-service digital pharmacies and 21 brick-and-mortar locations. It served more than 20 markets across nine states.

Despite its 2019 partnership with **RxAdvance**, Walgreens is not as well established in the PBM space, partially because RxAdvance is on the smaller side and was never able to outperform the services offered at larger PBMs. Due to this, Walgreens seems to have shied away from acquiring PBMs and, instead, purchased specialty pharmacies that provide niche services. Additionally, there is less for Walgreens to lose, financially, as it took advantage of a bankruptcy and purchased Medly at a discount.

With Shields' nationwide presence and Medly's digital capabilities, Walgreens may be preparing to go up against another retail pharmacy-based PBMs like CVS Caremark.

Future of the Market

Even with considerable headwinds exerting their force onto the market, the specialty pharmacy industry will endure. Yet, in the coming months and into 2024, the headwinds such as the high cost of capital, will catch up to the M&A market. For the rest of 2023, deal volume is not anticipated to increase dramatically, possibly bringing in only several more deals.

Regarding deal activity for the rest of the year, Ulloa had this to say:

"I don't expect an uptick in M&A activity this fourth quarter, but certain indicators suggest that 2024 will be a big year for transactions. There are several portfolio companies which are looking to exit the market and if the PBM strangle loosens…then these pharmacy assets will be more desirable."

Cammeyer echoed this sentiment, noting that while individual deal totals may be lower in 2024 than in previous years, the deals that will be announced will comprise large portfolio transactions, evening out deal activity.

This is something to look forward to.