



Pharma Supply Chain & Digital Health

LillyDirect Highlights Opportunity for Pharma, Shortcomings of Pharma Supply Chain

While uptake of next generation GLP-1s over the last 18-months has been impressive, it has come despite significant access constraints that extend beyond payor utilization management to pharmacy reluctance to stock what are in many instances unprofitable products and patient difficulty finding providers and developing treatment plans. In response, Lilly launched a new DTC program earlier this week combining digital pharmacy capabilities and telehealth offerings to expand access for consumers and potentially develop direct-to-consumer brand value in competitive categories with multi-product pipelines. While others have experimented at the edges, LillyDirect represents the first time a major brand manufacturer has put their name and reputation on the line with a branded digital solution. It is our view that this launch reflects both an opportunity for pharma manufacturers and shortcomings of the pharma supply chain that must be addressed by traditional pharmacies, distributors and PBMs.

Pharma Brand Opportunity: Near-term channel for customer acquisition + Mid-term user experience as competitive differentiator in high priority therapeutic categories.

- **Expand access for products with significant unmet demand:** New channel for onboarding customers at relatively low customer acquisition cost (CAC) compared to traditional market access and marketing expenditures for large retail franchises. This access benefit is more pronounced for GLP-1s than perhaps any product in recent memory given difficulty accessing providers at the scale needed for obesity and reluctance of retail pharmacies to stock what are unprofitable product in many instances (LillyDirect will prove far cheaper for Lilly than adding 200bp of supply chain discounts on \$10-\$15bn of GLP-1 sales to drive retail uptake).
- **Expand access to providers and build DTC brand value:** New channel for connecting patients to providers and far better user experience than traditional retail or mail pharmacy. The improved user experience could drive loyalty to the Lilly brand in diabetes, obesity and migraine, extending patient lifetime value (LTV). If user experience is superior to peer products that are reliant on retail and mail pharmacy and provides greater cost/discount transparency to patient and employer, a manufacturer may secure an advantage when launching new products or countering new competition though Novo and new GLP-1 entrants may seek to replicate the program.

Supply Chain Risk: Near-term sidestep of traditional pharmacy + Mid-term sidestep of distribution + Long-term DTC can help manufacturers enable new PBM models.

- **Sidestep of traditional retail pharmacy model:** Recognizing direct programs will be deployed selectively and at first will represent a complementary extension of access, not a massive disruption of the current model, such **programs will siphon volume from retail and mail pharmacies** as they expand and LillyDirect appears designed to address **both the cash and commercial markets**. While pharmacies may not be upset to forego unprofitable GLP-1 scripts near-term, if manufacturers can address access issues directly, they have no incentive to improve pharmacy economics. Given high fixed-cost bases, retail pharmacies cannot afford to be excluded from future growth.

Please see important disclosures at the end of this report.

JANUARY 5, 2024

Pharma Supply Chain & Digital Health

Eric Percher

646-876-0115
eric@nephronresearch.com

Dolph Warburton, CFA

646-876-0118
dolph@nephronresearch.com

Simon Mach

646-876-0117
simon@nephronresearch.com

LillyDirect Highlights Opportunity

Supply Chain Risk Continued

- **Sidestep of traditional drug distribution model:** From a distributor perspective, the near term impact is again limited as manufacturers will deploy direct programs selectively at first. However, we expect **manufacturers will establish direct distribution agreements with digital pharmacies such as Truepill** as volumes grow to reduce the discounts provided to the supply chain relative to those offered when a distributor is serving 60,000 pharmacies. For now, we note that Truepill is serviced by McKesson who has stated a strategic focus on supporting the development of the digital pharmacy channel.
- **Sidestep of PBM fulfillment and traditional rebate models:** The potential impact to payors and PBMs is more nuanced than that to pharmacies and distributors. The NPS scores of mail and specialty pharmacies run by the PBMs are no better than those of retail pharmacy. Direct manufacturer programs represent a modest threat to **PBM fulfillment capabilities** but the far more interesting threat is to the **current rebate for market access model**. While PBM contracts historically limit manufacturers' ability to contract directly with employers, development of direct to consumer capabilities could position manufacturers to engage with **next gen PBMs** such as Capital Rx, Emsana and Prescriptive to develop models with far greater transparency around discounts than is afforded by traditional PBM models.

Telehealth and Digital Pharmacy Opportunity and Risk: It will be interesting to see the extent to which the initial LillyDirect vendors will be able to support expansion. We expect additional telehealth and digital pharmacy providers will be added but see limited opportunity for retail pharmacy partners.

- **Telehealth Opportunity:** The program is clearly designed to drive access to specialist and PCPs and could potentially be expanded to add incremental digital adherence and care management offerings. It is notable that LillyDirect launched not with a single scaled telehealth provider such as Teladoc but with three relatively niche telehealth players that are known for providing superior user experience within specific therapeutic categories (**FORM** in obesity where the company ties patients to PCPs, **gamHealth** in diabetes, **Cove** in Migraine). These players must demonstrate their ability to maintain superior services levels as they scale and we believe it is possible incremental telehealth services could be added both within these therapeutic categories and should any new categories be launched. That said, we view the launch of LillyDirect as a barrier to adoption of existing or contemplated GLP-1 programs from **WW, LFMD, MED, TDOC, HIMS** and **Ro** (at least for the substantial share of the GLP-1 market represented by Lilly, and if Novo and if later entrants follow suit the number of participants in GLP-1 telehealth growth will be constrained).
- **Digital Pharmacy Opportunity:** We expect Lilly chose **Truepill** to support its direct offering owing to the company's high pharmacy service levels, ability to reach all 50 states on a next day basis and commercial coverage capabilities extending to the vast majority of PBMs (again enabling the offering to service both cash and commercial patients). LillyDirect will use **EVERSANA** for onboarding and benefit verification as well as applying manufacturer support program discounts. We see the need to expand digital pharmacy beyond Truepill or EVERSANA as less essential than adding telehealth and care management capabilities. If Lilly does add digital pharmacy vendors it will likely be because they bring specific therapeutic category depth, provider relationships, or enable expansion into specialty categories. As such, we do not expect a vendor like **HIMS** or **Ro** will be added.

Important Disclosures, Disclaimers and Limitations of Liability

Certification. The views expressed herein reflect the personal views of the research analyst(s) on the subject securities or issuers referred to. No part of any Nephron Research LLC ("Nephron") research analyst's compensation is or will be directly or indirectly related to the specific recommendations or views expressed.

This publication has been reviewed by Nephron in order to verify compliance with Nephron's internal policies on timeliness, against insider trading, disclosures regarding ratings systems, conflicts, and disciplinary matters.

As a categorical matter, Nephron Research has a policy of covering all issuers underwritten by NCMG LLC.

No Advice or Solicitation. Nephron is an independent research provider and is not a member of the FINRA or the SIPC and is not a registered broker-dealer or investment adviser. The reader acknowledges the following: (1) you are capable of making your own investment decisions and are not doing so in reliance of the content provided in this document; (2) neither Nephron or any individual author of this material is recommending or selling any securities to you; and (3) the content contained herein has not been tailored to any person's specific investment objectives and is not intended or provided as investment advice.

The information contained herein is not intended to be an inducement, invitation or commitment to purchase, provide or sell any securities, or to provide any recommendations on which individuals should rely for financial, securities, investment or other advice or to make any decision. Information herein is for informational purposes only and should not be construed by a potential subscriber as a solicitation to effect or attempt to effect transactions in securities, or the rendering of personalized investment advice for compensation. Nephron will not render specific investment advice to any individual or company and the content contained herein has not been tailored to the individual financial circumstances or objectives of any recipient. The securities and issuers discussed herein may not be suitable for the reader.

Nephron recommends that readers independently evaluate each issuer, security or instrument discussed herein and consult any independent advisors they believe necessary prior to making any investment decisions. Investment decisions should be made as part of an overall portfolio strategy and you should consult with professional financial, legal and tax advisors prior to making any investment decision.

For Informational Purposes Only. This publication is provided for information purposes only, is not comprehensive and has not been prepared for any other purpose. All information contained herein is provided "as is" for use at your own risk. The views and information in this publication are those of the author(s) and are subject to change without notice. Nephron has no obligation and assumes no responsibility to update its opinions or information in this publication. The information contained in this publication whether charts, articles, or any other statement or statements regarding market, stocks or other financial information has been obtained from sources that Nephron believes to be reliable, however Nephron does not represent, warrant or guarantee that it is accurate, complete or timely. Nothing herein should be interpreted to state or imply that past results are an indication of future performance.

Rating System. Nephron uses an absolute rating system which rates the stocks of issuers as Buy, Sell, or Hold (see definitions below) backed by a 12 Month price target. Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent identified potential upside/potential downside to each analyst's price target over the same 12-month period. Buy - Current stock price generally represents upside to our 12-month price target of 20%+. Sell - Current stock price generally represents downside to our 12-month price target of 20%+. Hold - Current stock generally represents limited opportunities on both the long and short side over 12-month period.

The entire contents of this publication should be carefully read, including the definitions of all ratings. No inferences of its contents should be drawn from the ratings alone.

Disclaimer Regarding Forward Looking Statements. The information herein may include forward looking statements which are based on our current opinions, expectations and projections. All ratings and price targets are subject to the realization of the assumptions on which analyst(s) based their views. The assumptions are subject to significant uncertainties and contingencies which may change materially in response to small changes in one or more of the assumptions. No representation or warranty is made as to the reasonableness of the assumptions that contributed to the rating or target price or as to any other financial information contained herein. Nephron undertakes no obligation to update or revise any forward looking statements. Actual results could differ materially from those anticipated in any forward looking statements. Nothing herein should be interpreted to state or imply that past results or events are an indication of future performance.

IRS Circular 230 Prepared Materials Disclaimer. Nephron does not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related obligations or penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.

No Warranties. Nephron disclaims to the fullest extent permitted by law any warranties and representations of any kind, whether express or implied, including, without limitation, warranties of merchantability or fitness, for any purpose and accuracy or for any other warranty which may otherwise be applicable or created by operation of law, custom, trade usage or course of dealings. Nephron makes no representation that (i) the content will meet your requirements, (ii) the content will be uninterrupted, timely, secure, or error free, or (iii) the information that may be obtained from the use of the content (including any information and materials herein) will be compliant, correct, complete, accurate or reliable. THERE ARE NO WARRANTIES EXPRESSED OR IMPLIED, AS TO ACCURACY, COMPLETENESS, OR RESULTS OBTAINED FROM ANY INFORMATION.

Disclaimer of Liability. We shall not accept any liability with respect to the accuracy or completeness of any information herein, or omitted to be included herein, or any information provided, or omitted to be provided, by any third party. We shall not be liable for any errors or inaccuracies, regardless of cause, or the lack of timeliness, or for any delay, error or interruption in the transmission thereof to the user. TO THE FULLEST EXTENT PERMITTED BY LAW IN YOUR JURISDICTION, IN NO EVENT SHALL NEPHRON BE LIABLE FOR ANY DIRECT, INDIRECT, CONSEQUENTIAL PUNITIVE, SPECIAL OR INCIDENTAL OR OTHER DAMAGES ARISING OUT OF THE CONTENT.

Reproduction and Distribution Strictly Prohibited. © Copyright Nephron Research LLC. No part of this publication or its contents may be downloaded, stored in a retrieval system, further transmitted, or otherwise reproduced or redistributed in any manner without the prior written permission of Nephron. The contents herein are directed at, and produced for the exclusive use of Nephron clients and intended recipients. No license is granted to Nephron clients and/ or the intended recipient Nephron will not treat unauthorized recipients of this publication as its clients.