



# Compounding Pharmacy Overview

Trends and Best Practices  
for Private Equity

January 2025



# Contents



**01**

**The Compounding  
Pharmacy Market**



**02**

**The Trends and  
Growth Drivers**



**03**

**How Private  
Equity can Shape  
the Industry**



**04**

**Learning from  
Pitfalls and Best  
Practices**





01

# The compounding pharmacy market

# Compounding pharmacies are playing an increasingly important role in fulfilling patient healthcare needs

Examples of commonly compounded drugs today...

**Semaglutide** is being compounded to address national shortages<sup>1</sup>



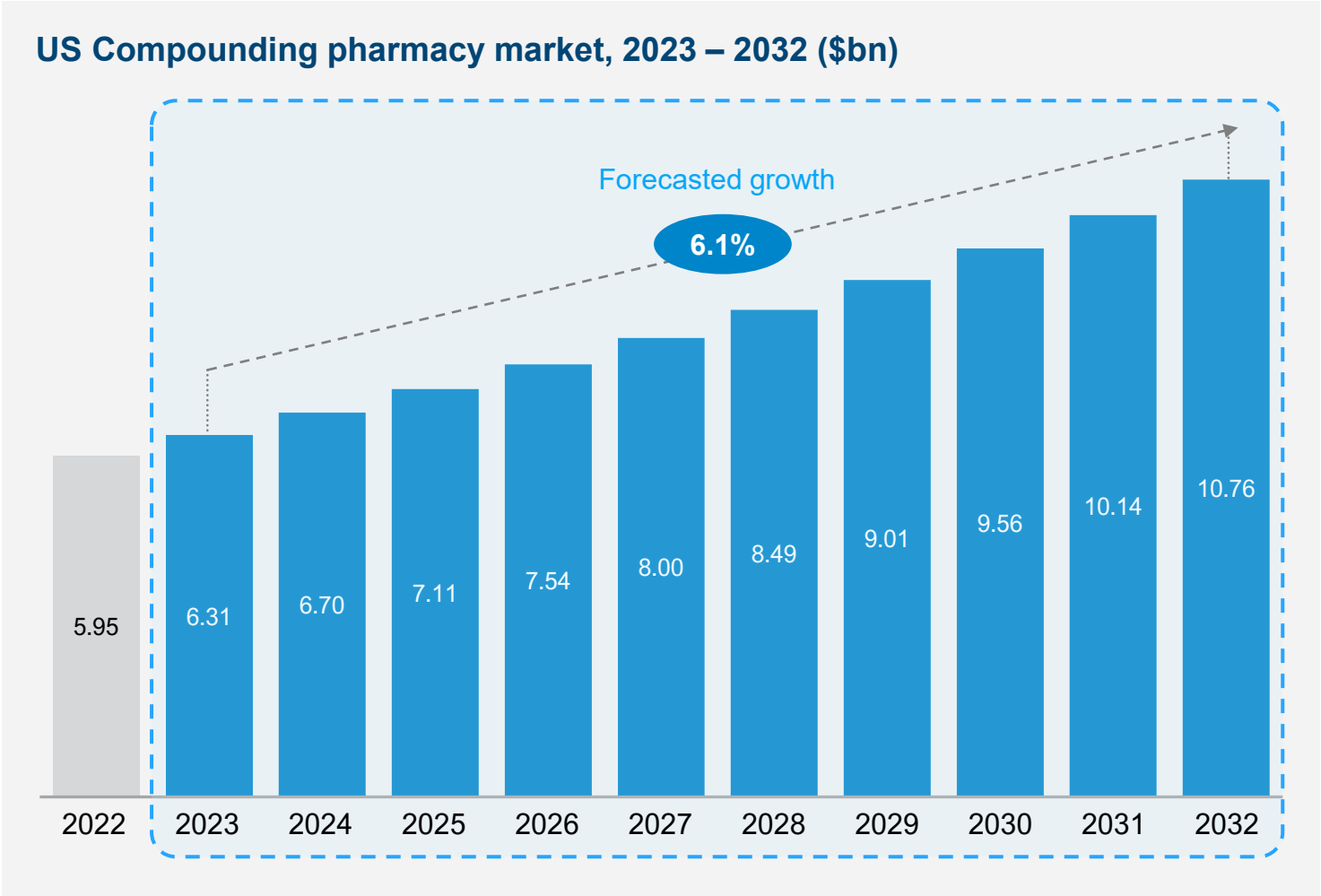
**Hydrocortisone** is compounded to create customized pediatric dosages<sup>2</sup>



**Acne Medication** to meet diverse skincare needs (e.g., allergens)



# The US compounding pharmacy market is ~\$6B with compelling room for growth



Source: BioSpace, Global Market Insights, Mordor Intelligence, American Pharmacists Association

## Compounding by the numbers

**32,000+**

US pharmacies describe offering some form of compounding service

**~7,500**

US pharmacies specialize in providing compounding services

**1-3%**

of all US prescriptions are for compounded medicine, with figure expected to increase with patient demand for personalized treatment (e.g., dosing form, dose quantity, allergens)

**323**

Drugs on the active shortage list during first quarter of 2024, a new record high

# Pharmacies operate under two primary segments, each with unique business models, rules, and considerations, though overlap exists

Market Share		503A (Individual Pharmacies)	503B (Outsourcing Facilities)	6.3B	Segment Overlap
Business Model		<ul style="list-style-type: none"><li>▪ B2C: Make or alter drug based on a prescription for a specific patient</li><li>▪ Primarily non-sterile drugs</li></ul>	<ul style="list-style-type: none"><li>▪ B2B: Manufacture in bulk for healthcare facilities, without a prescription required</li><li>▪ Primarily sterile drugs</li></ul>		<ul style="list-style-type: none"><li>▪ ~20% of 503B facilities also own a 503A pharmacy<sup>1</sup></li><li>▪ ~30% of 503A facilities say they also compound sterile preparations</li></ul>
Rules and Regulations		<ul style="list-style-type: none"><li>▪ Regulated at state level through Boards of Pharmacy</li></ul>	<ul style="list-style-type: none"><li>▪ Regulated at federal level through FDA and state Boards of Pharmacies</li><li>▪ Requires submission to regular testing and stability studies</li></ul>		<ul style="list-style-type: none"><li>▪ Both 503A and 503B facilities must acquire state-specific licenses to distribute compounded drugs</li></ul>
Key Considerations		<ul style="list-style-type: none"><li>▪ Limited ability to scale beyond regional geography</li><li>▪ Primarily cash-based businesses due to low insurance coverage</li></ul>	<ul style="list-style-type: none"><li>▪ Greater opportunity to scale and distribute nationally</li><li>▪ Higher cost to meet federal compliance standards</li></ul>		<ul style="list-style-type: none"><li>▪ Perception of lower safety and quality amongst physicians and patients remains a key headwind for growth</li></ul>

503A (Individual Pharmacies)

503B (Outsourcing Facility)

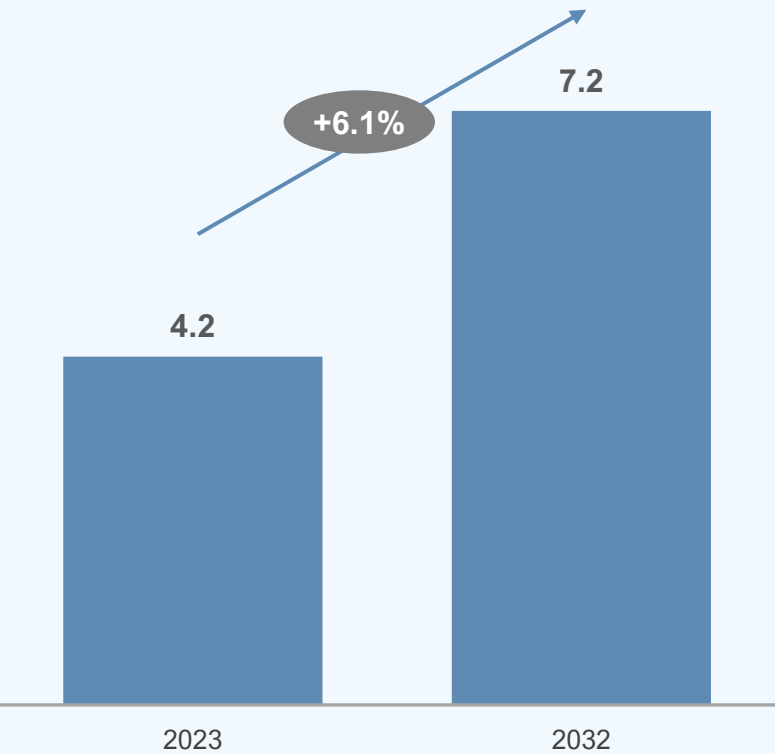
503A (Individual Pharmacies) 503B (Outsourcing Facility)

Source: 1. A&M Analysis of 81 FDA registered 503B compounding pharmacies, 2024 Sterile compounding includes ROAs: Infusions, IVs, pre-filled syringes, and Ophthalmology Non-sterile compounding includes ROAs: pills, powders, creams, nasal injections and tablets

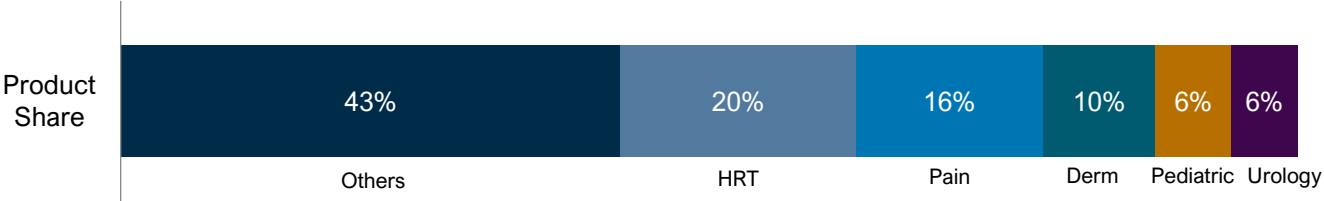
# While the 503A market is larger, it is fragmented, with low product standardization and high variance in dispensing volume

The 503A market size is \$4.2B with a 6% projected growth rate through 2032<sup>1</sup>

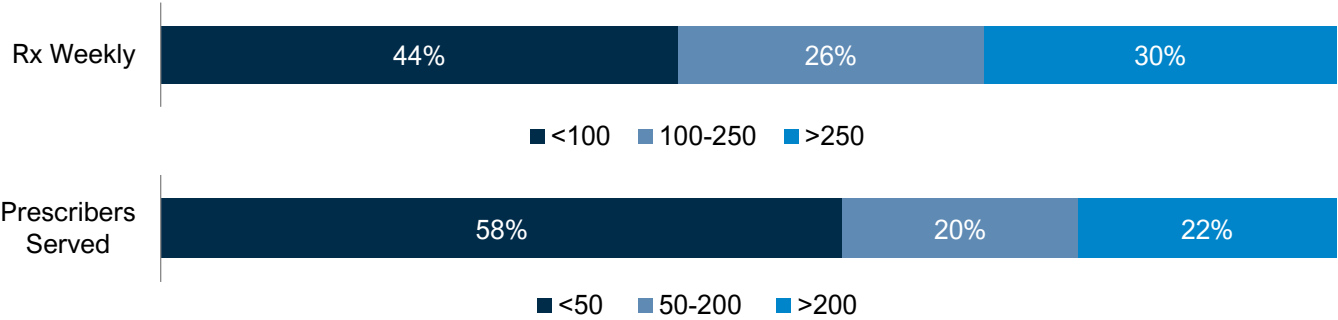
[US Revenue], [\$bn]



The 503A market lacks product standardization with ~40% of sales coming from non-core offerings<sup>2</sup>



503A pharmacies are bifurcated between those with high-volume and large prescriber networks and low volume small prescriber networks<sup>3</sup>



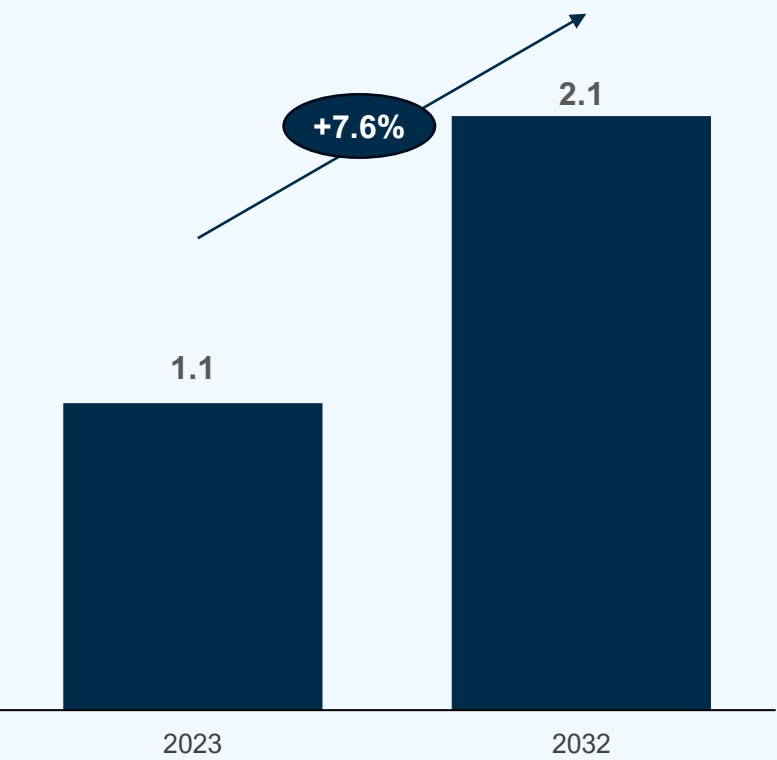
Source: 1. Towards Healthcare, APC 2024 Survey, 2. Towards Healthcare Other includes therapeutic areas such as oncology, hematology, dentistry, etc., 3. N=539 unique 503A pharmacies



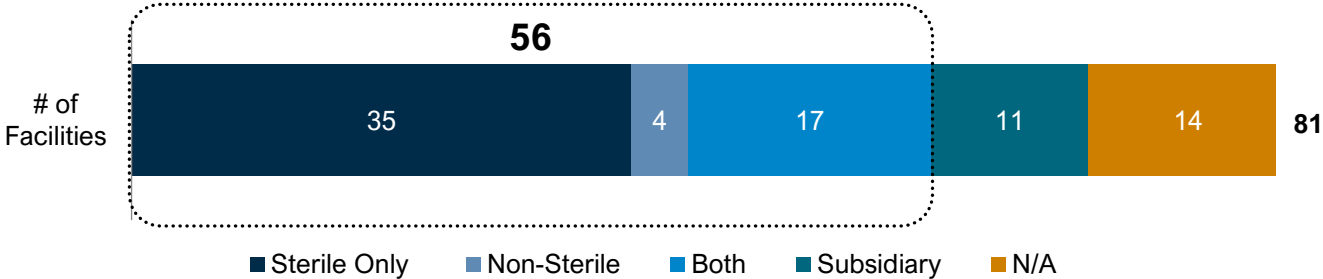
# The 503B market is smaller but faster growing, with greater product standardization in sterile compounding

The 503B market size is \$1B with a 7.6% projected growth rate through 2032<sup>1</sup>

[US Revenue], [\$bn]

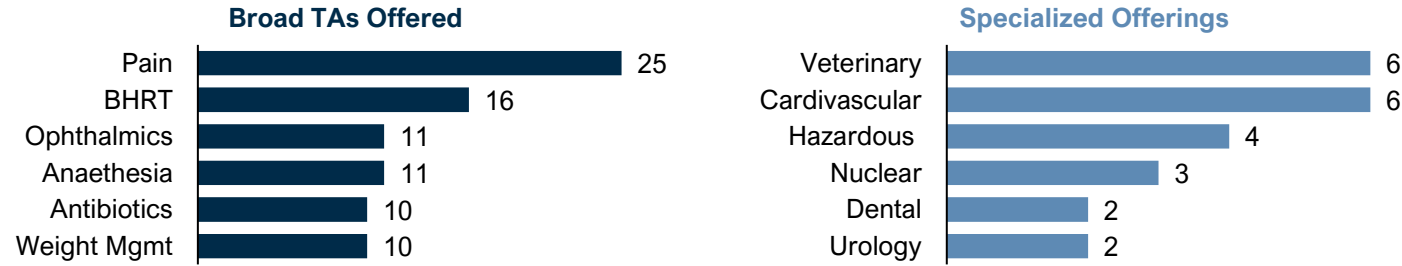


The 503B market is concentrated to 50-60 unique outsourcing facilities, primarily focused on sterile compounding<sup>2</sup>



Most 503B facilities share a similar TA mix, though some provide more specialized offerings<sup>3</sup>

[# of Facilities<sup>4</sup>]



Source: 1. Towards Healthcare, 2. FDA.gov as of August 2024, A&M Analysis N/A includes companies that shutdown, do not have a website, or offer no product information  
Subsidiaries include sites that are an extension of or owned by another 503B entity Sterile compounding includes ROAs: Infusions, IVs, pre-filled syringes, and Ophthalmology,  
3. A&M Analysis, 4. Facilities out of 56 unique companies with available product information





02

# The trends and growth drivers

# Four key factors have led to the importance and growth of compounding in the broader healthcare ecosystem

1

## Personalized Medicine



Increasing patient demand for tailored treatments for preference and convenience

2

## Supply Shortages



Rising number of drugs on FDA shortage list, accelerated by COVID-19 enabled compounding pharmacies to fill the gap left by lack of commercial products

3

## Rising Cost of Drugs



Heightened cost of generics has increased prevalence of cash-only pharmacies, providing catalyst for compounded medicine where insurance coverage is low

4

## TA Expansion



Rapid expansion of compounding into new therapeutic areas such as obesity and hormone replacement therapy



# However, several emerging trends are continuing to shape the compounding pharmacy landscape

## Physician distrust in quality ingredients

Lingering distrust of compounded products remain a barrier for increased physician utilization

## Rise of online pharmacies

Consumer shifts to digital outlets post-COVID have helped online pharmacies quickly gain traction

## Advances in technology

Advancements in compounding techniques allow for more sophisticated formulations and increased quality

## Legal challenges from Big Pharma

Concerns over intellectual property and unfair competition have prompted more pharma manufacturers to file lawsuits



# These dynamics create a complex marketplace but present an attractive entry for opportunistic investors

	Factors Influencing Investment
Physician distrust in quality ingredients	Distrust limits uptake, but increased regulation through USP standards offer an avenue for increased transparency with physicians
Rise of online pharmacies	Increased digitization and decentralization in prescribing provides a framework for scalability
Advances in technology	Improved compounding precision increases quality and TA access, promoting trust among physicians and patients
Big Pharma legal action	Increased scrutiny introduces barriers for entry, but restricts competition for those positioned in non-patented treatments



**The groundwork has been laid, but investors will need to be attentive to the dynamics at play**



03

# How Private Equity can shape the industry



# Compounding pharmacies present an attractive investment for PE investors...

## Cash-based model

57% of pharmacies are cash-only as payer reimbursement varies by ingredients used in medications<sup>1</sup>

## High margin business

72% average gross margin for 503A pharmacies due to low manufacturing cost of APIs<sup>2</sup>

## Strong growth outlook

6% industry CAGR driven by demand for convenience, personalized formulations, and drug shortages<sup>3</sup>

## Fragmented market

80% of 503A compounded pharmacies operate one location<sup>1</sup>

Source: 1. APC Compounding Pharmacy Snapshot, 2024, 2. APC compounding benchmarks, 3. 2022, Towards Healthcare report



# ...and an opportunity to deliver a positive impact to pharmacy owners and their local communities



## Invest to enhance services...

Offered through TA expansion, new technologies, and geographic footprint to maximize convenience for patients and physicians



## Reduce operating costs...

By minimizing overhead and administrative burden, as 30% of independent pharmacies are expected to close by 2025 due to financial hardships<sup>1</sup>



## Expand customer reach...

Through greater marketing investment to increase physician awareness, perceptions of quality, and prescription uptake



## Promote intentional community engagement...

To improve customer LTV, and provide continuation of services from pharmacists, given most have served over 20 years<sup>2</sup>



## Offer pharmacists an opportunity exit...

From their business, knowing their legacy will be preserved and their value realized

# Private equity involvement in compounding pharmacies can address industry challenges and increase patient access

Industry Challenges		Potential Impact of PE Investment
~98 drugs currently on the FDA Drug Shortage list	➤	Increased manufacturing capacity for critical drugs that patients are otherwise struggling to obtain
From 2018 to 2022, FDA-identified compounding incidents have increased from 186 to 340	➤	Greater consolidation and standardization across the compounding market, potentially through increased funding for new compounding technology
Only 40% of compounding pharmacies are licensed in multiple states according to an APC survey	➤	Expanded compounding awareness, use, and prescribing physician network made possible by more concentrated compounding pharmacy groups
Only about 50% of patients in developed countries adhere to full treatment protocols	➤	New opportunities to invest in innovative modes of payment, Rx delivery, and dosage forms that broaden treatment access and encourage increased adherence



# Successful players pull on five primary levers to achieve growth and profitability

## Investment Growth Levers

## Best Practices

### Diversify Revenue Mix



- Balance high-margin services (e.g., HRT) with essential offerings (e.g., generics) to maximize customer LTV
- Balance payer base between commercial and cash-based to reduce overexposure to a single payer

### Focus on Marketing and Branding



- Invest in sales team to boost physician awareness and adoption of pharmacy services
- Emphasize safety, quality, and patient convenience in messaging to physicians

### Scale Sustainably



- Identify tangible cost-synergies from integration, particularly with 503A pharmacies where goodwill makes up significant portion of investment and scalability is more limited
- Consider early therapeutic area (TA) specialization before diversifying to de-risk expansion plan

### Invest in Going Digital



- Leverage digital platform and mail-order pharmacy to remove geographic boundaries and reduce overhead while increasing patient convenience and discretion

### Double Down on Supplier Relations



- Conduct thorough diligence on suppliers to double-down on quality – reputational damage from poor API batch exceeds any discount offered.
- Consider contracting through GPOs to increase scale and improve cost-competitiveness



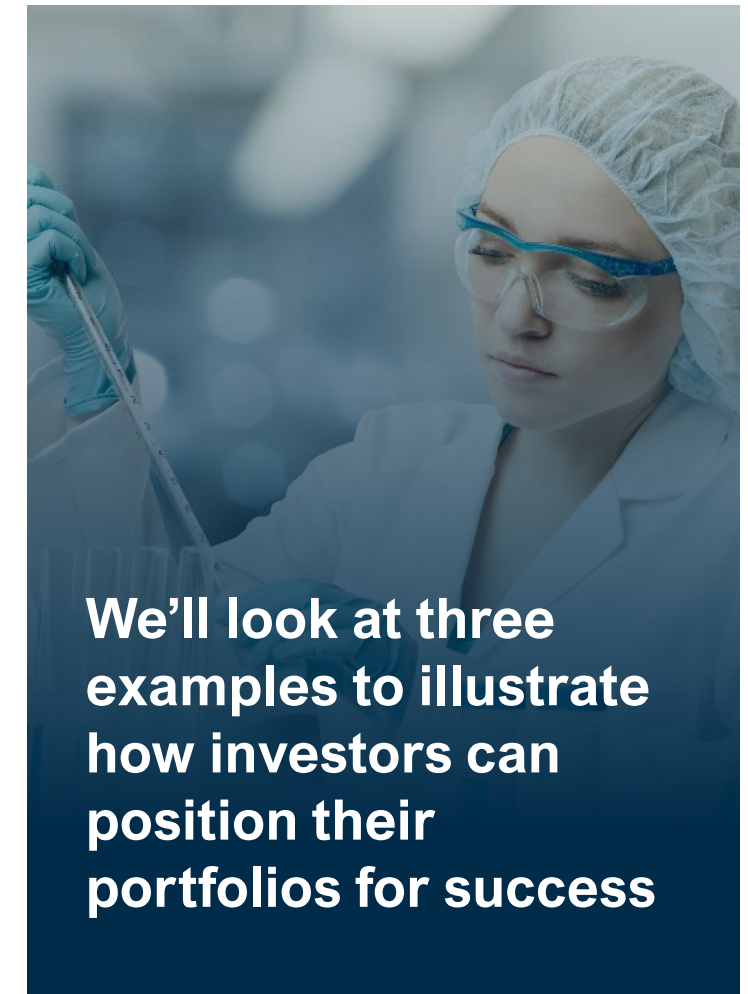
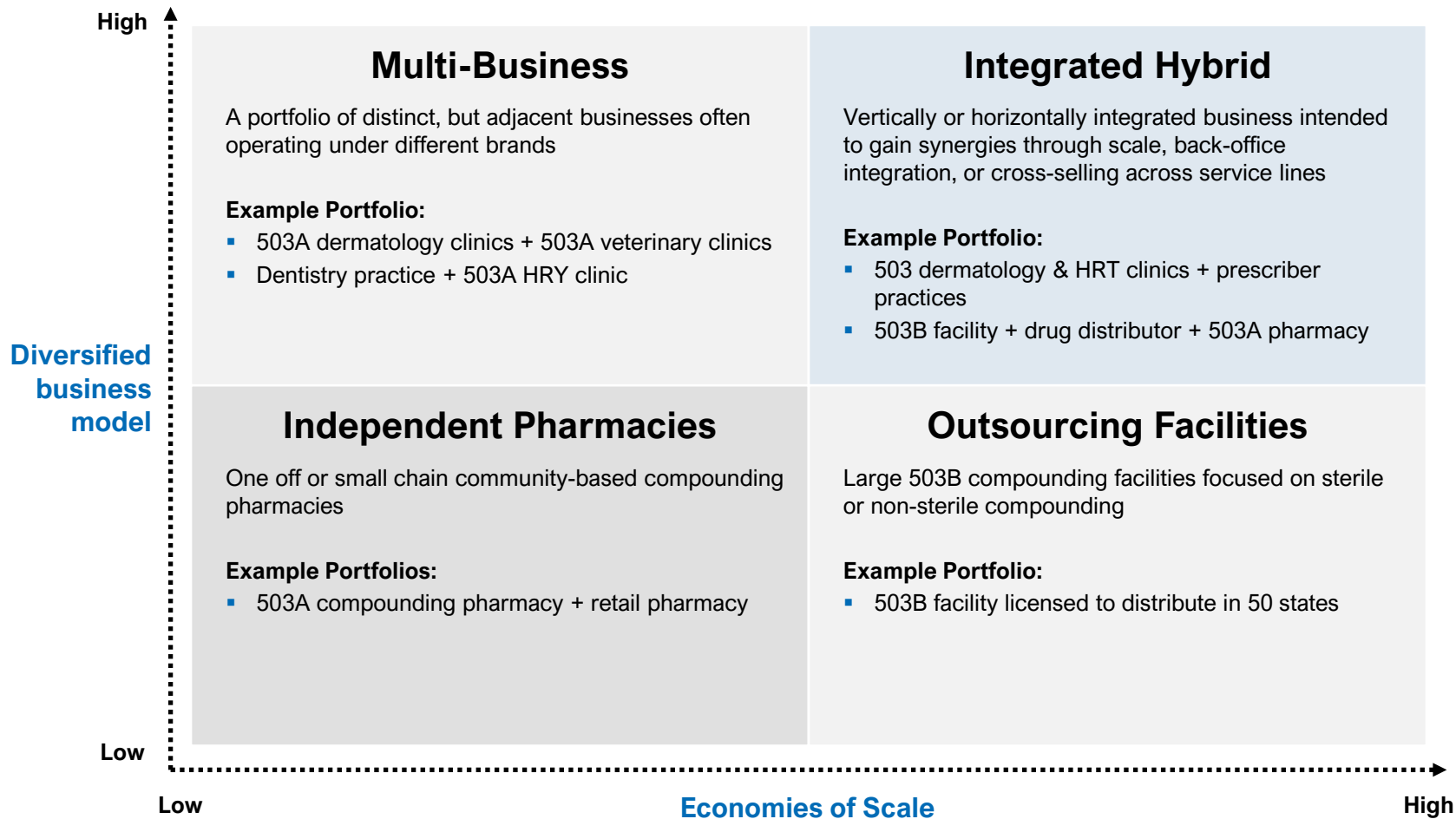
The background of the slide is a photograph of railway tracks. The tracks are made of dark metal rails on wooden sleepers, with gravel ballast between them. They curve from the bottom left towards the top right, where they meet at a crossing. The ground around the tracks is covered with green moss and some dry leaves. The overall lighting is somewhat dim, giving it a moody appearance.

04

# Learnings from pitfalls and best practices



# PE investment in compounding pharmacies comes in four different flavors, balancing diversification and scale



# Outsourcing Facilities | Economies of scale can be unlocked through investments in automation and TA specialization



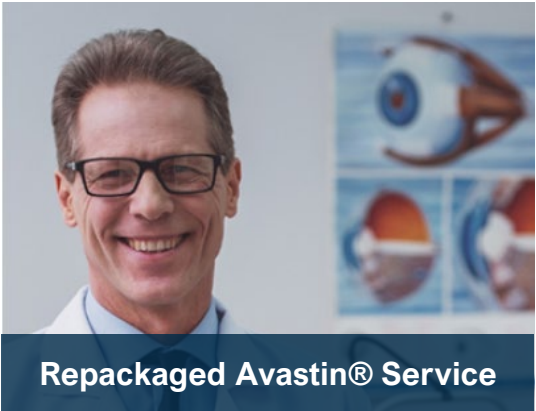
## Situation

In 2015, Frazier Healthcare Partners invested in Leiters Health, a 503B manufacturing facility in Colorado. The company provided a range of sterile offerings, but in 2018 entered the ophthalmic and pain management market to address supply shortages and demand for opioid alternatives in hospitals. After investing significantly in production automation to emphasize quality, they won preferred manufacturing partnerships with Avanos Medical, Eye Connect, and a large hospital GPO.

By 2022, the company acquired another manufacturing facility to boost their capacity and expand their offerings, becoming one of 9 503B companies with more than one site. They obtained licenses to distribute in all 50 states, and contracted with 9 different GPOs to diversify their supplier relationships, achieving 271% revenue growth over a 3-year period.

## Featured Services

Leiters Health specialized in TA offerings based on customer demand, and unlocked cost-savings from automation



Repackaged Avastin® Service



General Ophthalmics

## Lessons from Scaling Manufacturing

Investments in automation, paired with a targeted TA strategy, and strategic re-branding saw explosive growth for a 503B facility

(271%) | 3-Year Revenue Growth



# Integrated Hybrid | Diversification provides a means to capture share across the value chain while bulletproofing the P&L



## Situation

In 2019, Waud Capital invested in Apotheco, a chain of retail dermatology clinics, and began an aggressive expansion that tripled Apotheco’s dermatology locations across the Northeast. By 2022, Apotheco entered the compounding market through a merger with Chicago-based Skin Medicinals, a technology platform that enables prescribers to customize patients’ dermatology medications.

In parallel, Waud capital acquired APDerm, a regional dermatology practice in the Northeast, diversifying their income streams while expanding their footprint across the Dermatology value chain. Waud’s acquisitions centered on providing end-to-end services in Dermatology, realizing revenue synergies from cross-selling on their digital platform, cost-savings from pharmacy integration, and information synergies across their portfolio.

## Lessons from Vertical Integration

Integration of vertically-related businesses diversifies income streams, provides resiliency to macro challenges, & promotes a seamless experience for patients

### The Future of Dermatology

Waud Capital created a stable and sizeable dermatology portfolio before expanding into compounded medicine



No prior authorizations



Prescribe from the skin platform or your EMR



Saving the healthcare industry \$200M+ to date



Delivered to the patient’s doorstep



Access to medications at affordable prices



Trusted by 11,000+ prescribers in all 50 states

+16  
New operating sites

# Multi-Business | Failure to follow these best practices risks greater exposure to adverse events, leading to profit loss & bankruptcy



## Situation

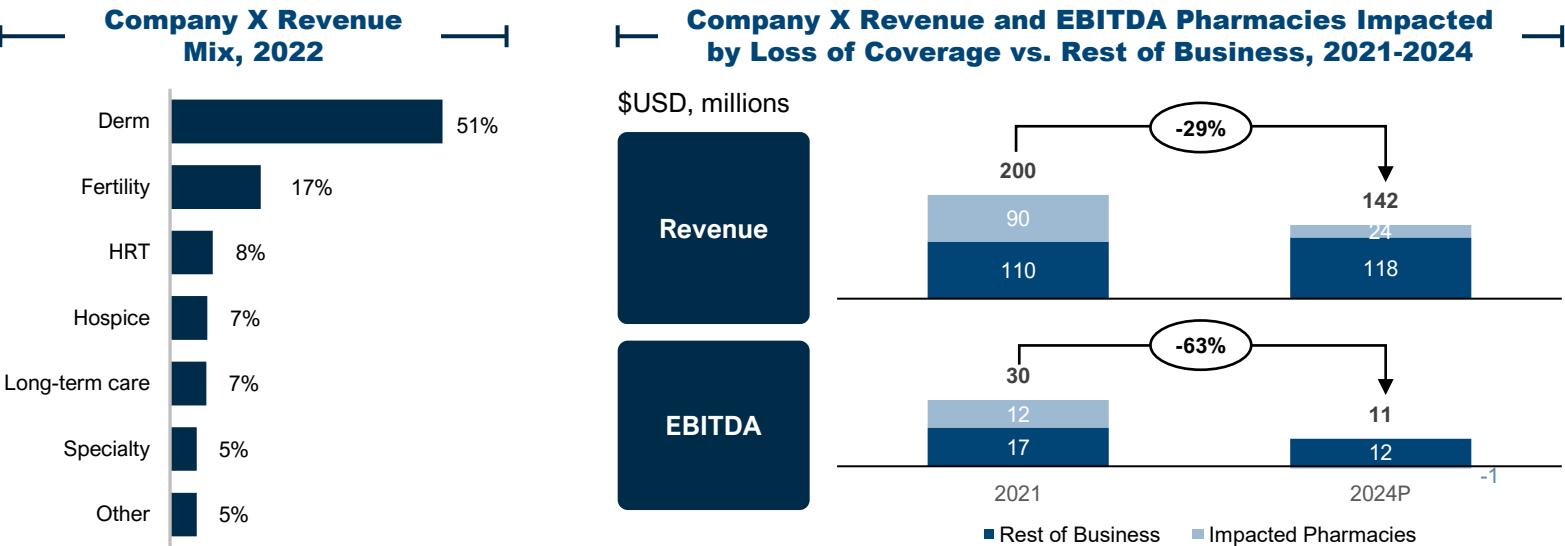
In 2019, a middle-market private equity firm began a diverse roll-up strategy focused on specialty and compounding pharmacies across the US, completing over 20 acquisitions in a two-year span in the dermatology, HRT, and veterinary service sectors.

After two years, the company began experiencing financial headwinds, following a large commercial payer revoking coverage for their top earning retail pharmacies. With no clear organic growth strategy, and no integration related cost-savings, the rest of the portfolio faltered.

## Lessons from Bankruptcy

Over-exposure to single payer, lack of back-office integration, and no clear segmentation strategy led to bankruptcy of national compounding pharmacy group

(\$60M) | Loss of revenue in 3 years



Source: A&M Analysis, Company X Financial Statements

---

2025 remains an  
opportune time for  
investing in  
compounding  
pharmacies, despite  
some challenges

---

## Key Challenges

### Uncertain regulatory landscape

Incoming nominees may increase scrutiny of safety protocols for GMP certification

### Evolving drug shortage list

High demand drugs (e.g., Zepbound) may be removed, putting key revenue streams at risk

### Shrinking Talent Pool

Pharmacists and technicians are more challenging to recruit and retain as total talent pool decreases

---

## Opportunities

### Demand for personalized medicine

Geriatric and pediatric population increasingly seeking customized therapies

### Disruption to PBM model

Shifting preference to alternative pharmacy outlets, as national chains face regulatory scrutiny

### Tightened margins in traditional retail

Well-managed pharmacies can achieve net profits of up to 20% higher than retail

# Thank you





# Authors



**Mark Freitas**

Managing Director  
Boston



**Seth Rogers**

Senior Director  
Boston



**Nick Porter**

Associate  
New York



**Nate Sifuentes**

Associate  
New York

## Acknowledgments

The authors would like to thank the following for their contributions to this report:

Private Equity Performance  
Improvement Group  
**Eric Lorge, Managing Director**

Corporate Transactions Group  
**Kishan Patel, Senior Associate**

External Experts  
**Andy Heno**