

June 5, 2017

Citron provides **New PROOF (post-SALT Conference)
why Mallinckrodt (NYSE:MNK) is on its way to ZERO.**



Express Scripts lets the genie out the bottle!!!!

When Jim Chanos Speaks - Citron Listens.

First Enron, Then Valeant, Now Mallinckrodt.



Mallinckrodt is the most reviled company in the pharmaceutical industry. **Its unsavory business practices have only survived in the “post Valeant” era because of the direct business support of Express Scripts, their “co-conspirator”.**

Two weeks ago at the [SALT conference in Las Vegas](#), legendary short seller Jim Chanos described this unholy alliance, likening the Express Scripts companies' role to Valeant's Philidor.

While Express Scripts was supposed to protect the healthcare system from gouges like Acthar, they were actually distributing the drug through their **CuraScript** division, managing the hub that is tasked with getting approvals for the drug through their **United BioSource** division, and then making very healthy profits dispensing the drug

through their specialty pharmacy **Accredo**.

Acthar's dependence on Express Scripts has been detailed for many years in the press:

Business Insider:

<http://www.businessinsider.com/acthar-drug-shows-flaws-in-drug-pricing-payment-system-2017-2>

New York Times:

<https://www.nytimes.com/2016/12/23/business/drug-price-medicare-mallinckrodt-acthar.html>

Barrons:

<http://www.barrons.com/articles/express-scripts-unit-handles-high-priced-specialty-drugs-1448084792>

Most recently, this alliance re-appears as Express Scripts has been added as a co-defendant in a lawsuit filed by the City of Rockford, Il., which accuses Mallinckrodt and Express Scripts of monopolistic practices and price gouging. The city accused the two of conspiring to charge over \$54,000 a vial for the drug.

http://www.rockfordil.gov/media/pressreleases/2017.04.06_Complaint_FILED.pdf
<http://www.businessinsider.com/rockford-sues-mallinckrodt-over-acthar-price-2017-4>

Express Scripts has been kicked to the curb by their former largest customer, Anthem Healthcare. Worse, it is now being investigated by multiple Attorneys General for representing both the pharmaceutical companies **and** the insurance companies.

In the case of Acthar, while they were supposed to be protecting insurers from system abusers, they were actively obtaining authorizations and selling it through their own "specialty" pharmacies.

Those days are done. This Genie cannot be put back in the bottle.

Express Scripts Has FINALLY changed its stance on Acthar and the effect will send shares of Mallinckrodt to ZERO.

In an investor conference call for Express Scripts hosted by Citi last week, as a reaction to Mr. Chanos comments at the SALT Conference, Express Scripts was forced by analysts to explain their position on HP Acthar Gel.

<https://ir.citi.com/l2GW3%2FspXqa99R2rvpFJS8QKZpf%2BRi62n5DFshd7bPciqQPr7uiAlekB%2FjibEhWR>

All insurance companies and Medicare take notice; these are the words of Express Scripts management, the lifeline of the Acthar cash machine. No more editorializing.

Let's turn it over to Everett Neville, Senior Vice President, Supply Chain and Specialty Pharma:

“I don’t think it’s a very great – it’s a pretty poor drug with a very limited need and certainly Steve could comment.... “

-- Everett Neville, SVP Supply Chain and Specialty Pharma

““Completely, you know, and Steve, you could chime in here too, but I think Steve and I both would agree, and I think everybody in our company would agree, that the product is vastly overpriced for the value...”

-- Everett Neville, SVP Supply Chain and Specialty Pharma

“I personally told their management team their drug is hugely overpriced. I know Steve has as well “

-- Everett Neville, SVP Supply Chain and Specialty Pharma

Then there are the words of Dr. Steve Miller, Chief Medical Officer, Express Scripts:

“If you look at the data, the indications for the drug are really – while it had, in the compendium, it’s listed under a lot of indications, its real use should be very, very limited. ITS AN OLD DRUG . THERE’S BETTER PRODUCTS IN THE MARKETPLACE and so we’re going to continue to be very vigilant in our utilization management.”

-- Dr. Steve Miller, SVP Supply Chain and Specialty Pharma

Citron notes this comment stands in sharp contradiction to Daniel Yunger, a Mallinckrodt spokesman who told the NY Times 6 months ago, "Acthar is not a drug with no immediate competition."

https://www.nytimes.com/2016/12/23/business/drug-price-medicare-mallinckrodt-acthar.html?_r=0

In the same call Dr. Miller discusses a more responsible and efficient future for Express Scripts:

"Yes. So as you know, we have already told people that we are going after the multiple sclerosis market this next year..... Lots of things, lots of new entrants, but also drugs going generic and other things. We believe this is the perfect time in which we can start reining in this class that's been a real expense driver for our plan sponsors. ."

-- Dr. Miller, SVP Supply Chain and Specialty Pharma

So Express Scripts finally admits in a public forum that the drug is **overprescribed** with **low efficacy** and it is far **too expensive**.

The status quo cannot continue. There is nothing the analyst community can say or do to defend against these statements.

So Why Didn't the Market React?

Incredibly, the transcript for this damning conference call misspelled Acthar ["Aksar"] So the bots, website crawlers indexers, and the AI text analyzers hooked up to algo trading computers never picked it up. That is why you have Citron.



Conference Call Transcript
23 May 2017

...
Liav Abraham: Understood. And any thoughts around another drug that's been somewhat controversial, and that's **Aksar**?
...
Everett Neville: Yes. What, specifically – thoughts about it? What are – maybe you should just ask a question. Thoughts about it in what way?
...
Everett Neville: I don't think it's a very great – it's a pretty poor drug with a very limited need and certainly Steve could comment. He's a doctor and I'm just a really bad pharmacist. But I assume that's probably not what your question was.

Citi Research

How this will Play Out

Express Scripts is the cash lifeline of Mallinckrodt's Acthar franchise. They **will not** be able to maintain both pricing at volumes at their current level.

Mallinckrodt could never replace Express Scripts, because no other PBM would ever tolerate the bad publicity and negative effect on stock price attached to being custodian of the most infamous drug in pharma.

Citron understands that Acthar is not going to disappear overnight, but in a simple model we see that if Acthar revenue, whether through unit volume, pricing or both declines 50%, Mallinckrodt trips all debt covenants and goes bankrupt.

Now a 50% loss in Acthar's contribution to the bottom line is hardly unthinkable. Acthar was generating \$500 million in sales just 5 years ago. At the time, that numbers was considered outrageous. Longtime Acthar observers will remember the N.Y. Times article in 2012 criticizing the drug and its outrageous pricing. At the time it was doing \$500 mil.

<http://www.nytimes.com/2012/12/30/business/questcor-finds-profit-for-acthar-drug-at-28000-a-vial.html>

Here is a simple financial model:

3/31/2017 Adjusted EBITDA (Co. #)	\$	1,536.50
Acthar -- TTM Rev	\$	1,222.50
Assumed EBITDA margin - Acthar		60.0%
Implied Acthar % total EBITDA		47.74%
Acthar EBITDA \$\$	\$	733.5
Current Leverage		3.75
Co. Net Debt	\$	5,769.10
Covenant		5.25
EBITDA for breach	\$	1,098.88
Delta from TTM	\$	(437.62)
% Acthar lost		-59.66%

Prisoner's Dilemma

Mr. Chanos calling out both Mallinckrodt and Express Scripts put the two companies in a classic game theory double-bind known as the Prisoner's Dilemma. Express Scripts decided to "be the rat" and the result will be billions of dollars saved for the US Healthcare system and the destruction of the equity of Mallinckrodt.

Investors must remember that 10 years ago Acthar was priced at \$2,000 per vial and 15 years ago it was \$40 a vial. Now it is over \$40,000 per vial and their distribution partner now admits it is a **"poor drug"** that is overprescribed.

Time for Express Scripts to Back To Work

With a renewed focus on saving their real clients money and assembling formularies that represent 2017 medicine and pricing, Express Scripts should make MNK the first bankruptcy in the "post Valenat" days.

What Does Mallinckrodt have to throw Overboard in order to Save this Doomed Acthar franchise??

MNK has recently announced plans to sell their generics unit. Their generics unit is beyond controversial because of its sales of opiate based painkillers, which have fallen out of favor with doctors, due to the epidemic of addiction to this class of drugs, and the legal system blowback.

https://www.washingtonpost.com/graphics/investigations/dea-mallinckrodt/?utm_term=bf7c6b55a072

We give credit to CFO Matthew Harbaugh for being honest with investors, in disclosing the headwinds for Mallinckrodt's generic business:

"We expect continued pressure on the segment from competitive entrants and market pricing in coming quarters,"

-- Mallinckrodt CFO Matthew Harbaugh

Selling the generics business at any price is just putting a finger in the dam. It will only increase Mallinckrodt's dependency on Acthar for its entire bottom line. Lets us not forget, if MNK receives anything less than \$2 billion for the generics, the leverage actually INCREASES because of the loss of EBIDTA.

Nothing can make up for the extreme leverage taken on by Mallinckrodt when it acquired Questcor for debt at the top of the pharma buyout feeding frenzy.

Mallinckrodt: Pharma's Most Wanted



All the signs of a pharmaceutical company going rogue perpetuated when Mallinckrodt resigned from the Pharmaceutical Research and Manufacturers Association.

This happened because of potential changes to the trade group's bylaws that could **exclude companies that don't spend significant funds on researching and developing new drugs.**

<https://www.wsi.com/articles/mallinckrodt-leaves-pharmaceutical-trade-group-ahead-of-potential-changes-to-bylaws-1491406538>

Conclusion

Express Scripts will continue to earn the vast majority of its profits as a pharmacy-benefit manager. The losses due to curbing Acthar's excesses are just a minor flesh wound to them. But the loss of Express Scripts enabling market access is a fatal blow to Mallinckrodt. The words of Express Scripts management will echo through the halls of Medicare and insurance companies as Acthar has finally met the truth: it is old drug that is way too expensive and not as good as its competition.

While continued prescribing of Acthar will be limited to the narrow niche of infantile spasms diagnosis, whether at a reasonable or inflated cost, the equity of Mallinckrodt will go to 0, as correctly predicted by the same short seller who warned on us on Enron and Valeant.....

Kudos to Mr. Chanos.

Cautious Investing to All

Supplemental Information

According to the Medicare Drug Spending [Dashboard](#) for 2015, **Acthar was the single most expensive drug, per patient, that the government paid for during the course of last year.**

Of the 3,100 beneficiaries using Acthar, Medicare spent an average of **\$162,371 on each one.**

<https://www.nytimes.com/2016/12/23/business/drug-price-medicare-mallinckrodt-acthar.html>

Jim Chanos explanation of MNK Bankruptcy Thesis

<https://www.bloomberg.com/news/videos/2017-05-18/chanos-on-mallinckrodt-express-scripts-and-tesla-video>

Dr. Steve Miller from ESRX understanding the dangers of Mallinckrodt to the system

The biggest problem is not new expensive drugs but re-pricing old ones, and not just ones being purchased by Martin Shkreli or Valeant. **"You have no new research. You have no innovation. You have nothing but increased drug prices,"** says Steve Miller, chief medical officer at Express Scripts.

<https://www.forbes.com/sites/matthewherper/2016/01/20/solving-pharmas-shkreli-problem/#4b1379b86be3>

Mallinckrodt is currently or recently under investigation by the: FTC, SEC, DOJ, DEA, IRS, AG, – every TLA is looking at them except



Congress has had its eyes on ending the Acthar scheme for years

As stewards of taxpayers money, Congress needs to expose why CMS continues to pay for this drug when "Acthar reimbursements have been severely restricted by most large pharmaceutical companies and Tricare has discontinued reimbursement for this drug."

<http://www.businessinsider.com/tim-scott-letter-on-acthar-and-medicare-waste-2017-4>



In case Citron appears on CNBC with the esteemed Scott Wapner, we refer back to our previous interview about Mallinckrodt where Scott asked Andrew Left:

"And what basis do you have that the drug does not work?" - Wapner
<http://video.cnbc.com/gallery/?video=3000501865>

Answer: "Express Scripts Told Me!!"