



"A Premier Short"

/ STRONG SELL OPINION /

Premier, Inc. | NASDAQ:PINC



SPRUCE POINT
CAPITAL MANAGEMENT

INVESTMENT RESEARCH REPORT

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Executive Summary

Short PINC: Spruce Point Sees 55%-75% Downside To \$8-\$15 Per Share

Premier, Inc. (“PINC” or “the Company”) is a group purchasing organization (GPO) which, due to a unique pre-IPO restructuring agreement, is temporarily generating twice the earnings which its business model can sustain organically. In exchange for rights to Premier equity, its “member owner” hospitals agreed to five or seven-year contracts through which they would accept administrative fee rebates (“sharebacks”) roughly half what they could get from competing GPOs. Those contracts are nearing expiration. Complacent sell side analysts, satisfied by Premier’s historical renewal rates among member owner hospitals accepting below-market sharebacks, forecast Premier earnings as though its prevailing economics are sustainable in perpetuity. However, with most member owner equity now having vested, hospitals with expiring contracts are far less incented to remain with Premier at sub-market shareback rates. Premier’s two largest members, whose below-market contracts are set to auto-renew on Oct 1, 2019, could announce their intention to opt out by next week (effective Oct 1, 2020), with remaining member owners set to announce the same as soon as Oct 1, 2020 (effective Oct 1, 2021). This would cause Premier to underperform FY22-23 consensus revenue by >26% and EBITDA by >50%.

- Unique Pre-IPO Restructuring Skews Company Economics: Premier was mutually owned by its member owner hospitals prior to its 2013 IPO. To free up cash for Premier to invest in ancillary services, these hospitals agreed to accept sharebacks of 30% – less than half the market rate of 60-75% – in exchange for equity in Premier and modest tax-related distributions. These agreements were structured to last only five or seven years. While most member owners signed to five-year deals renewed their agreements on similar terms, they most likely did so to avoid having to forfeit their as-yet unvested equity (~30% of their respective equity allocations at the time). Premier’s two largest GPO members, whose seven-year contracts expire on Oct 1, 2020, will have no unvested equity remaining by the time their deals are scheduled to expire, and therefore have far greater incentive not to renew their Premier-friendly deals on the Oct 1, 2019 opt-out deadline. As admin fees carry 100% incremental margins, changes in net admin fees have an overwhelming impact on Premier’s bottom line. The loss of Premier’s two largest GPO members or the restructuring of their agreements could cut Premier’s FY21 EBITDA by 9-17%.
- Increased Shareback Could Be Highly Material To Hospitals With Expiring Deals: Greater New York Hospital Association (GNYHA), Premier’s largest GPO member and a 10% Premier customer, is one of the hospitals whose contract is set to auto-renew next week. By analyzing tax filings, Spruce Point has found that, by receiving a market-rate shareback, GNYHA’s total income could increase by 33%. We believe that GNYHA may have a responsibility to its member hospitals to seek sharebacks more in-line with market rates, and anticipate that it may not renew its current agreement.
- More Opt-Outs Likely To Follow: Member owners which renewed their five-year agreements in Oct 2017 can opt out once again as soon as Oct 1, 2020 (effective Oct 1, 2021) without losing unvested equity. Should all member owners receive market-rate sharebacks of 60-75%, Premier’s FY22-23 EBITDA would be cut by more than half.
- Complacent Sell-Side Assumes Favorable Economics Can Last Forever: Premier’s ~95% renewal rate during its 2017 renewal cycle appears to have convinced the sell side that renewal risk is near-nonexistent. It ignores the fact that, unlike the 2017 renewal class, member owners whose contracts are due to auto-renew next week will have no remaining unvested Premier shares, and will therefore no longer have to accept below-market sharebacks for access to Premier equity. Analysts also appear to underestimate the prevailing market shareback rate by benchmarking against MedAssets. MedAssets, a GPO which was until recently public, reported superficially below-average sharebacks due to its practice of bundling GPO agreements with ancillary services. Our market intel confirms that the market-level shareback is 60-75% and rising.
- Emerging Signs That Hospitals Are Prepared To Exit: Member owners are divesting of Class B shares at an accelerating pace, perhaps reflecting their knowledge that Premier’s economics are set to correct in the near future. Large hospitals such as Johns Hopkins Medicine have already exited, sacrificing some of their unvested Class B shares to do so. New language introduced in Premier’s most recent 10-K (filed Aug 2019) suggests that renewal risk is rising.
- PINC Shares Valued As Though Current Economics Are Sustainable: PINC trades at a 6.6x FY22 EV/EBITDA multiple based on the sell-side’s inflated future earnings estimates. Reverting member owner hospitals to sustainable market-level sharebacks would cut consensus FY22 EBITDA in half. PINC should also trade at a lower EBITDA multiple, as Premier’s true underlying economics are worse than the market believes. Valuing PINC shares at 4-5x FY22 EBITDA on an estimate of EBITDA >50% below the Street would imply that PINC shares are worth \$8-\$15, 55%-75% below current levels. Losing hospitals to competing GPOs could result in even more downside.

Case Study: Premier Closely Mirrors Spruce Point's Successful Call On 2U

Spruce Point believes that the circumstances facing Premier are extremely similar to those faced by education technology provider 2U (NASDAQ: TWOU) through 2018-19. In July 2018, Spruce Point published a "Strong Sell" recommendation on 2U, Inc. (NASDAQ: TWOU) which showed that the company's tuition "take rate" (i.e. revenue share) on its online degree programs was under significant pressure: while 2U claimed historical take rates of over 60%, our FOIA requests demonstrated that intense competition had brought the market rate down to ~40%. Sell-side analysts nonetheless continued to assume that 2U could maintain its historical take rate until only recently, when management admitted on its Q2 earnings call that its core business was under fundamental pressure. The stock fell more than 60% the following day. Spruce Point believes that the circumstances facing Premier are very similar: while the sell side believes that Premier's above-market shareback rates can last indefinitely into the future, Spruce Point finds evidence that near-term catalysts could force Company economics back in-line with the rest of the market.

Spruce Point
Claims on 2U
July 2018

- 2U take rate under heavy pressure with intensifying competition
- Margin pressure with continued shift towards short-course programs
- Sell side inappropriately modeling 2U economics as though historical margins were sustainable

TWOU CEO
July 2019
Q2 Earnings Call

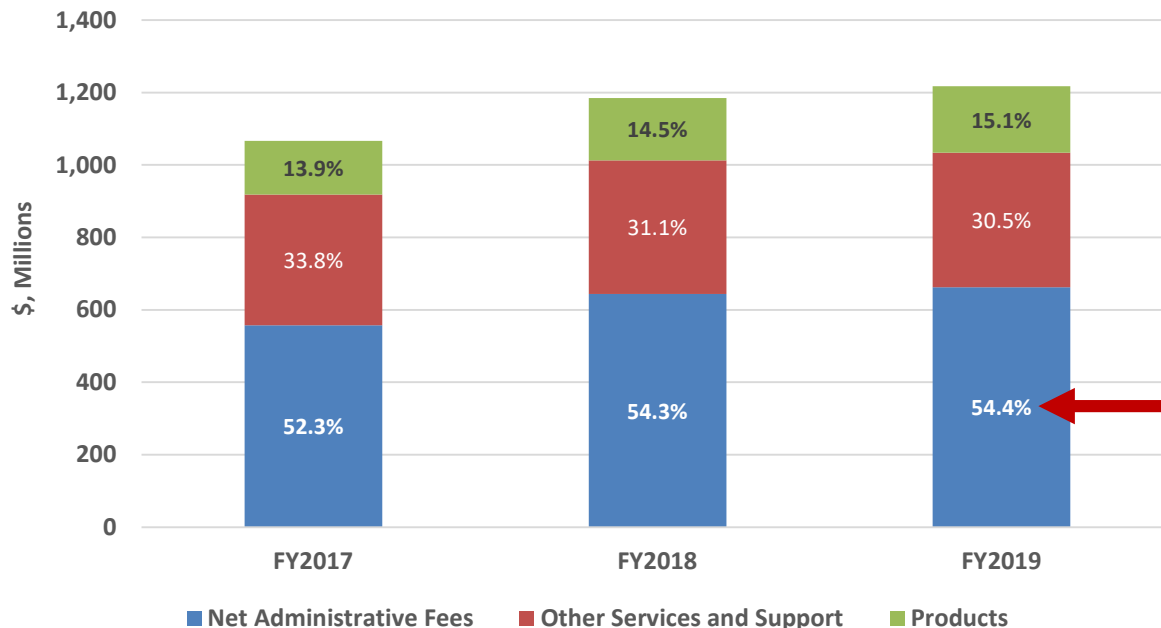
*"...we're adjusting our executional model against the dynamic of this mainstreaming of online education in a way that meets this new market dynamic. **Competition for students has increased. Programs will be slightly smaller than they were in the past.**"*



A Brief Primer On GPO Economics

As a group-purchasing organization (GPO), Premier secures vendor discounts for its hospital members through the force of their collective purchasing power: per its 10-K, Premier represents more than 4,000 U.S. hospitals and health systems and over 175,000 other organizations as a GPO. As do other GPOs, Premier also generates revenue of its own by charging vendors an “administrative fee” of roughly 1.0% to 3.0% on product purchases. After returning a percentage of these fees to member hospitals as a “shareback,” or revenue sharing payment, the remainder is retained as GPO revenue. Premier also generates revenue through various other channels, including supply chain management, SaaS informatics offerings, and other consulting services (and, until recently, specialty pharmacy). Even then, following the recent divestiture of its specialty pharmacy business, administrative fees represent Premier’s most significant source of revenue by a meaningful margin, driving over 50% of sales ex-specialty pharmacy.

Premier Revenue by Segment



Administrative Fees regularly represent over 50% of Premier revenue (after adjusting for discontinued specialty pharmacy business)

Source: PINC FY19 10-K. Historical financials presented as restated in FY19 following discontinuation of specialty pharmacy business.

Premier's Pre-IPO Sharebacks At Parity With Market Rates

Before going public, Premier offered its member hospitals administrative fee sharebacks which, according to our research, were generally in-line with the industry's market rate of 60-70%. Prior to the IPO, Premier's non-owner member hospitals were repaid ~66% of the gross admin fees collected on their purchases made through the GPO. Meanwhile, Premier's "member owner" hospitals – the hospitals which collectively owned the Company prior to its IPO – did not receive formal sharebacks, but were nonetheless paid a share of Company income specifically constructed to approximate 70% of the gross admin fees collected on their own purchases, thus putting them in line with market shareback rates.

PINC S-1: Aug 26, 2013

Member Owners

77% of Gross Admin Fees as of
FY13 (\$471M)

~70% Effective Admin Fee
Shareback to Hospital

Following the completion of the Reorganization and this offering, we will be contractually required under the GPO participation agreements to pay each member owner revenue share from Premier LP equal to 30% of all gross administrative fees collected by Premier LP based upon purchasing by such member owner's member facilities through our GPO supplier contracts. In addition, our two largest regional GPO member owners, which represented approximately 17% of our gross administrative fees revenue for fiscal year 2013, will each remit all gross administrative fees collected by such member owner based upon purchasing by such member owner's member facilities through the member owner's own GPO supplier contracts and receive revenue share from Premier LP equal to 30% of such gross administrative fees remitted to us. Historically, we have not generally had a contractual requirement to pay revenue share to member owners participating in our GPO programs, but have paid, and in the case of the six month period ended June 30, 2013 will pay, semi-annual distributions of partnership income, which approximate 70% of the gross administrative fees collected by Premier LP for the fiscal year ended June 30, 2013, based upon purchasing by such member owners' member facilities through our GPO supplier contracts.

Non-Owner Members

23% of Gross Admin Fees as of
FY13 (\$144M, Adj.¹)

66% Admin Fee Shareback to
Hospital

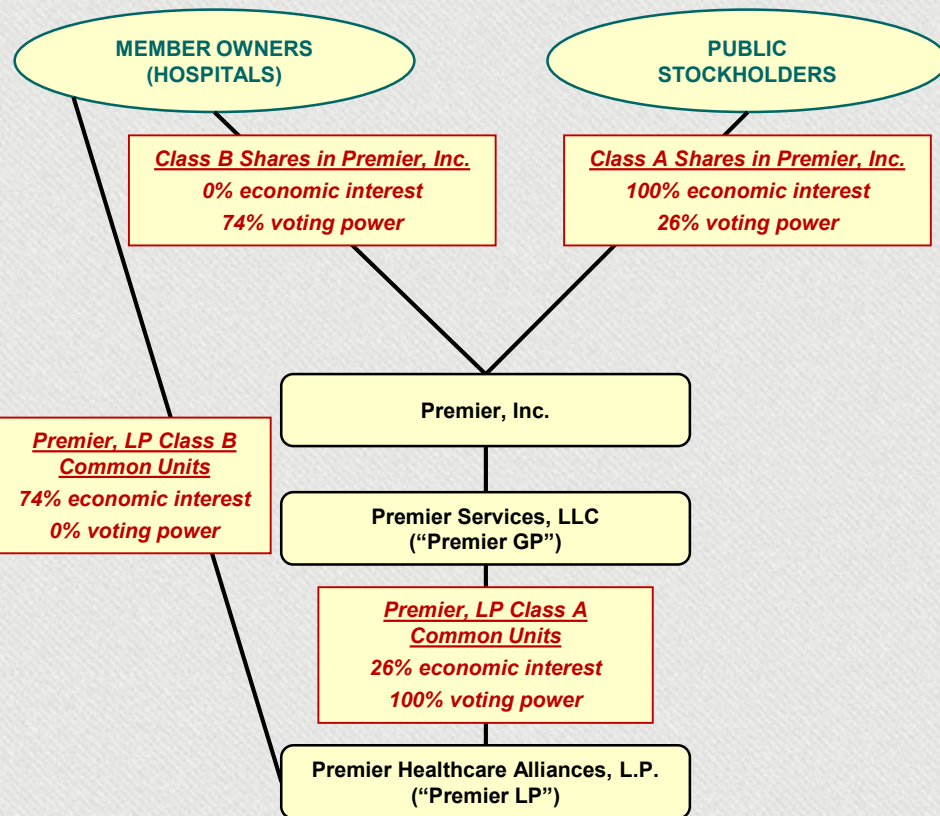
Premier Sharebacks: Non-Owner Member Hospitals	
(\$, Millions)	FY13
Gross Admin Fees (Non-Owner Members)	\$175.4
Less: Innovatix ¹	31.9
(A) Gross Admin Fees (Non-Owner Members), Adj.	\$143.5
Revenue Share (Non-Owner Members)	\$127.2
Less: Innovatix ¹	31.9
(B) Revenue Share (Non-Owner Members), Adj.	\$95.3
Implied Aggregate Shareback, % (Non-Owner Members) ((B) / (A))	66.4%

Source: PINC S-1

Pre-IPO Reorganization And Shareback Reduction

Upon modifying its ownership structure in advance of its IPO, Premier struck five-year (and two seven-year) deals with its member owners, structured to facilitate its expansion into adjacent business lines. To free up capital for Premier to reinvest in itself and further grow the business, member owners agreed to take a reduced 30% shareback of Premier's gross admin fees through the life of these contracts. In exchange, member owners were granted the right to Premier, Inc. Class B shares. One-seventh of each hospital's Class B shares would then vest (i.e. become exchangeable) each year following the reorganization, and the hospital would have the right to exchange them (and their LP units) for publicly-traded Class A shares. Member owners were also granted additional payments tied to anticipated tax benefits resulting from the reorganization.

PINC Reorganization: From 100% Hospital Ownership to Publicly-Traded



Member Owner Terms (Five-Year or Seven-Year Agreements)

Premier Receives...

Member Owner Shareback Cut from 60-70% to 30%

- Member owner hospitals receive 30% of gross administrative fees on purchases made through Premier GPO, versus 60-70% previously
- Frees up capital for Premier to reinvest in itself and diversify into adjacencies (SaaS informatics offerings, etc.)

Member Owners Receive...

Equity Stake in Premier

- Member owner hospitals receive Class B shares in proportion to prior interest in pre-IPO Premier
- One-seventh of allocation of Class B shares vest (i.e. become exchangeable) each year following IPO. Can then be exchanged (with LP units) for publicly-traded Class A shares.

Tax Distribution

- Class B unit holders receive tax distribution to cover potential tax obligation resulting from distribution of Premier LP earnings
- All member owner hospitals receive same tax distribution (in proportion to ownership of Class B shares) regardless of whether the hospital is a non-profit (and therefore not subject to taxes)

Tax Receivable Agreement ("TRA")

- Class B unit holders receive 85% of Premier's realized cash savings due to change in tax basis resulting from initial sale of Class B units
- Payable over 15-year time period following reorganization

Company-Friendly Shareback Shifts GPO Economics Dramatically

As admin fees carry 100% incremental margins, changes in net admin fee revenue flow directly to Premier's bottom line. Accordingly, cutting sharebacks to member owners from 60-70% to 30% has a dramatic effect on Company earnings. Setting member owner shareback rates at par with non-owner shareback rates would have slashed Premier's FY19 operating income by a whopping 86%.

	Actual: Member Owners at 30% Shareback			Pro-Forma: Member Owners at Market Shareback (66%)		
(\$, Millions)	FY17	FY18	FY19	FY17	FY18	FY19
Gross Admin Fees – Member Owners ¹	\$739.6	\$854.2	\$878.9	\$739.6	\$854.2	\$878.9
Rebate – Member Owners ¹	(221.9)	(256.3)	(263.7)	(488.1)	(563.8)	(580.1)
Net Admin Fees – Member Owners	\$517.7	\$597.9	\$615.2	\$251.5	\$290.4	\$298.8
Gross Admin Fees – Non-Owner Hospitals ¹	\$116.9	\$135.0	\$138.9	\$116.9	\$135.0	\$138.9
Rebate – Non-Owner Hospitals (66% Shareback) ¹	(77.1)	(89.1)	(91.7)	(77.1)	(89.1)	(91.7)
Net Admin Fees – Non-Owner Hospitals	\$39.7	\$45.9	\$47.2	\$39.7	\$45.9	\$47.2
Net Admin Fees – Total	\$557.5	\$643.8	\$662.5	\$291.2	\$336.3	\$346.1
Product Revenue and Other Service Revenue	508.8	540.8	555.2	508.8	540.8	555.2
Revenue – Total	\$1,066.2	\$1,184.7	\$1,217.6	\$800.0	\$877.1	\$901.2
COGS	(308.7)	(342.0)	(355.6)	(308.7)	(342.0)	(355.6)
Gross Profit	\$757.5	\$842.7	\$862.0	\$491.3	\$535.1	\$545.6
Operating Expenses ¹	(445.0)	(479.5)	(493.5)	(445.0)	(479.5)	(493.5)
Other Operating Income	5.4	177.2	-	5.4	177.2	-
Operating Income	\$318.0	\$540.4	\$368.5	\$51.7	\$232.8	\$52.1
D&A and Adjustments ¹	180.3	(0.8)	192.5	180.3	(0.8)	192.5
EBITDA, Adj.	\$498.2	\$539.5	\$561.0	\$232.0	\$232.0	\$244.6
Net Admin Fees - % Change	-47.8%	-47.8%	-47.8%	-47.8%	-47.8%	-47.8%
Revenue, Total - % Change	-25.0%	-26.0%	-26.0%	-25.0%	-26.0%	-26.0%
Operating Income - % Change	-83.7%	-56.9%	-85.9%	-83.7%	-56.9%	-85.9%
EBITDA, Adj. - % Change	-53.4%	-57.0%	-56.4%	-53.4%	-57.0%	-56.4%

1. Gross Admin Fees estimated from Company-disclosed blended shareback of ~35%, member owner shareback of 30%, and non-owner shareback of ~66%. Reflects no immediate cost adjustments.

Do Sell-Side Analysts Believe Post-IPO Economics Will Last Forever?

Sell-side forecasts suggest that analysts see Premier's unique post-IPO economics lasting indefinitely into the future: revenue, earnings, and EPS are all projected to grow steadily through the next several years, with little variation in margins. Recall, however, that its post-IPO contracts featuring reduced shareback rates were structured to last only temporarily, for five or seven years (beginning Sep 2013). Industry experts also report that, excluding temporary contractual barriers, GPO switching costs are generally not high for hospitals. Is it really reasonable to believe that Premier's drastically off-market economics are sustainable when competing GPOs offer sharebacks at least two times higher on average?

Premier Consensus Estimates

(\$, Millions)	FY19A	FY20E	FY21E	FY22E	FY23E
Revenue	\$1,217.6	\$1,255.1	\$1,303.8	\$1,365.8	\$1,464.0
Growth	-	3.1%	3.9%	4.8%	7.2%
Gross Profit	\$862.0	\$893.0	\$931.4	\$951.5	\$1,054.1
Gross Margin	70.8%	71.1%	71.4%	69.7%	72.0%
Operating Profit	\$368.5	\$467.5	\$488.3	\$520.8	\$576.8
Operating Margin	30.3%	37.2%	37.5%	38.1%	39.4%
EBITDA, Adj.	\$561.0	\$575.1	\$599.1	\$630.0	\$686.0
EBITDA Margin	46.1%	45.8%	45.9%	46.1%	46.9%
EPS, Adj.	\$2.66	\$2.83	\$3.02	\$3.28	\$3.67
Growth	-	6.4%	6.6%	8.6%	12.1%

Source: Bloomberg

[PINC S-1: Aug 26, 2013](#)

GPO Participation Agreement

In connection with the Reorganization and this offering, our member owners have entered into GPO participation agreements with Premier LP which will become effective upon the completion of the Reorganization and this offering. Pursuant to the terms of its GPO participation agreement, each member owner will receive cash sharebacks, or revenue share, from Premier LP equal to 30% of all gross administrative fees collected by Premier LP based upon purchasing by such member owner's member facilities through our GPO supplier contracts. In addition, our two largest regional GPO member owners, which represented approximately 17% of our gross administrative fees revenue for fiscal year 2013, will each remit all gross administrative fees collected by such member owner based upon purchasing by such member owner's member facilities through the member owner's own GPO supplier contracts and receive revenue share from Premier LP equal to 30% of such gross administrative fees remitted to us. Subject to certain termination rights, these GPO participation agreements will be for an initial five-year term, although our two largest regional GPO member owners have entered into agreements with seven-year terms.

Sell-side analysts see no change in Premier economics despite contractual cliffs

Spruce Point believes that consensus estimates reflect highly unrealistic assumptions regarding the sustainability of Premier's current economic model. If Premier is forced to adopt shareback rates more in-line with industry standards, future sales and earnings performance will diverge significantly from current Street projections.

Upcoming Expiry Of Long-Term Contracts Could Be The First Crack In The Model

Premier discloses that its two largest member owner hospital groups (GNYHA and Yankee Alliance), which were together responsible for 13% of Premier's gross administrative fees as of FY19, committed to seven-year GPO contracts following the reorganization. These deals are set to expire in Oct 2020. Premier's GPO Participation Agreements state that member owner hospitals can opt out of their deals with one year's advance notice, but that their deals automatically renew under the same terms if they fail to opt out at least one year in advance of their contracts' expiry dates. Accordingly, if these two member owner hospitals fail to opt out by Oct 1, 2019, they will be locked into 30% sharebacks – far below the 60-70% market rate – for another seven years, until Oct 2027. They would be ineligible to opt-out again until at least Oct 2022 (effective Oct 2023).

Impact of Changes Among Top Two Hospitals on Consensus FY21 Results

(\$, Millions)	Consensus	Top Two Hospitals Receive Market Shareback (66%)	Top Two Hospitals Leave PINC GPO	Top Two Hospitals Leave PINC GPO & Other Services ¹
Gross Admin Fees – Top Two Hospital Groups ²	\$141.7	\$141.7	-	-
Shareback	(42.5)	(93.5)	-	-
Net Admin Fees – Top Two Hospitals	\$99.2	\$48.2	-	-
Remaining Revenue Ex-Top Two Hospitals	1,204.6	1,204.6	1,204.6	1,158.5 ¹
Revenue, Total	\$1,303.8	\$1,252.8	\$1,204.6	\$1,158.9
% Change from Consensus	-	-3.9%	-7.6%	-11.1%
COGS	(372.4)	(372.4)	(372.4)	(358.1) ¹
Gross Profit	\$931.4	\$880.4	\$832.2	\$800.3
% Change from Consensus	-	-5.5%	-10.6%	-14.1%
Operating Expenses	(443.1)	(443.1)	(443.1)	(443.1)
Operating Profit	\$488.3	\$437.3	\$389.1	\$357.2
% Change from Consensus	-	-10.4%	-20.3%	-26.8%
D&A and Adjustments	110.8	110.8	110.8	110.8
EBITDA	\$599.1	\$548.1	\$499.9	\$468.0
% Change from Consensus	-	-8.5%	-16.6%	-21.9%

Spruce Point believes that there is a high probability that, come next week, these two hospitals will elect not to renew their current terms beyond Sep 2020, and will instead demand higher sharebacks from Premier or elect for another GPO entirely.

1. Takes only GNYHA, whose total segment-wise revenue contribution is disclosed, into account. Assumes segment-wise revenue growth through FY21 in-line with consensus, and adjust COGS based on adj. gross margin.
2. Assumes Gross Admin Fee growth in line with consensus revenue growth estimates

Investors Lulled To Sleep By The 2017 Renewal Cycle

Why aren't analysts or investors showing signs of concern as the opt-out date approaches? Sell-side notes and event transcripts from throughout 2017 show that, as the Oct 2017 opt-out date for Premier's five-year contracts drew near, analysts were in fact very preoccupied with renewal risk. Premier's strong showing during this renewal cycle, however, appears to have put concerns over renewals to bed: ~95% of member owner hospitals originally signed to five-year deals chose to renew their contracts at the Oct 2017 deadline. Yet analysts forget that member owners locked into five-year deals would have had to forfeit unvested Class B shares (which vest, or become exchangeable, ratably over seven years) had they cancelled their agreements with Premier in 2018. Member owners originally signed to seven-year contracts, whose Class B equity allotments will vest in full on Sep 30, 2020 – one day before their GPO contracts are set to expire – will face no such disincentives to opting out.

PINC S-1: Aug 26, 2013

cash. In the event that a limited partner of Premier LP holding Class B common units not yet eligible to be exchanged for shares of our Class A common stock pursuant to the terms of the exchange agreement (i) ceases to participate in our GPO programs; (ii) ceases to be a limited partner of Premier LP (except as a result of a permitted transfer of its Class B common units); (iii) ceases to be a party to a GPO participation agreement (subject to certain limited exceptions); or (iv) becomes a related entity of, or affiliated with, a competing business of Premier LP, in each case, Premier LP will have the option to redeem all of such limited partner's Class B common units not yet eligible to be exchanged at a purchase price set forth in the LP Agreement. In addition, the limited partner will be required to exchange all Class B common units eligible to be exchanged on the next exchange date following the date of the applicable termination event described above. For additional information regarding the LP Agreement, see "Certain Relationships and Related Party Transactions—Transactions with Member Owners in Connection with this Offering—Amended and Restated Limited Partnership Agreement of Premier LP."

Upon leaving the Premier GPO, member owner hospitals lose their rights to unvested Class B shares.

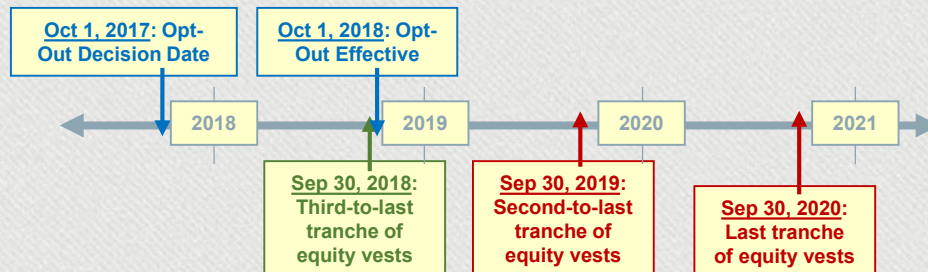
Must exchange unvested shares for "Redemption Amount" of ~\$1.80 per share as of FY19 (implied by cash flow statement).

3.4 Exchange of Class B Common Units. Founding Limited Partners shall only be entitled to exchange Class B Common Units after the one-year anniversary of the last day of the calendar month in which Premier consummates the IPO and such exchange shall be in accordance with the terms of the Exchange Agreement. Further, Founding Limited Partners may only exchange Class B Common Units as follows: (a) each Founding Limited Partner may exchange up to one-seventh of its initial allocation of Class B Common Units (subject to adjustments pursuant to Section 3.9.4) each year (which right shall be cumulative; for example, a Founding Limited Partner that elects not to exchange any Class B Common Units during the first two years after the one-year anniversary of the last day of the calendar month in which Premier consummates the IPO shall be permitted to exchange up to three-sevenths of its initial allocation of Class B Common Units during the third year after the one-year anniversary of the last day of the calendar month in which Premier consummates the IPO) and (b) each Founding Limited Partner may exchange any Class B Common Units acquired by such Founding Limited Partner

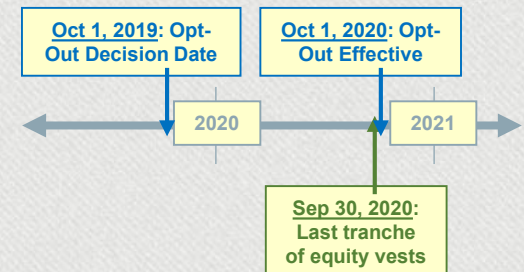
One seventh of each member owner's Class B shares vests every Sep 30, beginning in 2014.¹

The final tranche of Class B shares is due to vest on Sep 30, 2020 – the day before Premier's seven-year contracts expire (perhaps explaining why these hospitals haven't canceled already).

Five-Year Opt-Out Decision: Hospital Would Lose 2/7 of Class B Shares



Seven-Year Opt-Out Decision: Hospital Loses No Shares



1. The Oct 31 date referenced in the proxy filing refers to the exchange date (i.e. the date on which vested shares are exchanged, if the holder so elects), not the vesting date. The "anniversary of the last day of the calendar month in which Premier consummates the IPO" (i.e. Sep 30) referenced in the LP Agreement is the vesting date (the date on which Founding Limited Partners become entitled to exchange Class B shares).

Unvested Shares, Not Commoditized Services, The Most Likely Driver Behind 2017 Renewals

As analysts questioned management on the likelihood of a shareback rerating during the 2017 renewal cycle, management repeatedly claimed that its close working relationships with member hospitals and broad offering of ancillary services were enough to convince member owners to continue to accept below-market sharebacks. However, industry experts generally see the GPO industry as a highly-competitive one with low switching costs and few differentiating factors between individual players. Management plays up its new SaaS services as a meaningful draw, but most large GPO offer similar value-added services. Spruce Point believes that, with member owner hospitals accepting lower sharebacks only in return for equity in the first place, the decision to renew among member owners on five-year deals was driven primarily by their desire not to forfeit the ~30% of their Class B shares which had yet to vest. This disincentive is not present for hospitals due to renew on Oct 1, 2019.

Management Claims

“Susan said on the call that the economics [of the renewed contracts] were similar to prior contracts. I think that's the other thing that people are going to really focus on is **are the hospitals coming to you and trying to get a bigger shareback?** So is there any color that you can provide on how things are going on in that front or what your expectations are?”

- James Stockton – Wells Fargo

“Yes. **I think the expectations are similar.** Economics, as has been articulated, again, if the 5-year contracts auto renew, which a lot of our organizations have indicated they will just allow them to auto renew, auto renewals are under the same terms that we have. So what I would tell you is we're saying similar. And the reason we're using the term similar is in the discussions we're having with organizations, **there may be discussions about other things, resources, do they need more -- another additional system in their institution helping them to drive savings and things of that nature, but the core economics around the GPO relationship are not changing as a result of these renewals.**”

- Craig McKasson – CFO, Premier

Source: Wells Fargo Healthcare Conference Presentation (Sep 7, 2017)

Reality

Five-year contracts expire with unvested equity remaining

Seven-year contracts expire with all equity vested

PINC Class B Share Equity Vesting Schedule								
	2013 (IPO)	2014	2015	2016	2017	2018	2019	2020
Class B Shares Vesting By Year, %	14.3%	14.3%	14.3%	14.3%	14.3%	14.3%	14.3%	14.3%
Cumulative Class B Shares Vested, %	-	14.3%	28.6%	42.9%	57.1%	71.4%	85.7%	100.0%
Class B Shares Unvested, %	100.0%	85.7%	71.4%	57.1%	42.9%	28.6%	14.3%	-

With their Class B shares scheduled to vest in full on the final day of their current contracts, the hospitals due to renew or opt out on Oct 1, 2019 have little incentive to continue to accept less than half the shareback dollars that they could receive from another GPO.

Are Analysts Even Aware Of The True Market Shareback Rate?

Some analysts appear to underestimate the true market shareback rate, believing it to be closer to 45% than 60-75%. Spruce Point believes that this stems from their familiarity with MedAssets, which, when acquired by VHA-UHC Alliance (renamed Vizient shortly thereafter) in late 2015 / early 2016, reported a shareback rate of just under 45%. However, MedAssets often bundled its GPO contracts with its software, consulting, and other ancillary services, which would result in these hospitals receiving a lower face-value shareback. Premier does not bundle its GPO services and ancillary offerings in the same manner. We therefore believe that MedAssets' historical shareback rates are not comparable to Premier's on an apples-to-apples basis. This is confirmed by the publicly-searchable details of more recent Vizient contracts, which show Vizient – which no longer offers bundled pricing on GPO sharebacks – agreeing to sharebacks of 60-75%.

MedAssets Shareback Prior to Acquisition by Vizient

(\$, Millions)	FY14
Gross Administrative Fees	\$494,927
Revenue Share Obligation	203,564
Implied Aggregate Shareback, %	41.1%

Bundling as Described on [MedAssets S-4/A \(Oct 3, 2011\)](#)

Revenue Recognition — Multiple-Deliverable Revenue Arrangements

We may bundle certain of our Spend and Clinical Resource Management (“SCM”) service and technology offerings into a single service arrangement. We may bundle certain of our Revenue Cycle Management (“RCM”) service and technology offerings into a single service arrangement. In addition, we may bundle certain of both of our SCM and RCM service and technology offerings together into a single service arrangement and market them as an enterprise arrangement.

Shareback cannot be compared to Premier's shareback on an apples-to-apples basis due to bundling

MedAssets Shareback After Acquisition by Vizient

[Alameda Health System \(Nov 20, 2017\)](#)

68% Shareback

In addition to realizing savings through GPO-negotiated price reductions on product purchases, AHS will also participate in Vizient's Administrative Fee Shared Revenue Program (i.e. Shareback), which is funded by the GPO-contracted vendors. GPO-contracted vendors fall into 2 categories: 1) Suppliers—vendors who make and sell goods at GPO-discounted rates, and 2) Distributors—vendors who for purposes of the GPO provide GPO-discounted distribution/shipping services for delivery of supplies that themselves are not made/provided by a GPO-contracted supplier. Per terms of the proposed renewal agreement, Suppliers pay an average administrative fee to Vizient of 2.65% of the product spend purchased through the GPO by AHS. Distributors pay an average administrative fee to Vizient of 0.5% based on the AHS product distributed through the GPO. The administrative fees are apportioned with AHS receiving 68% of the administrative fees and Vizient receiving the 32% balance.

[Jackson Health System \(Oct 19, 2016\)](#)

60-75% Shareback

MedAssets has prepared two proposals for the Trust to deliver a combined net return of \$29.6M - \$30.7M through savings of \$29.8M, increased shareback in the range of \$4M - \$5.1M (depending on whether Jackson is at 60% or 75% shareback when purchases are made) and fees of approximately \$4.2M. These savings and increases to shareback will be delivered through volume that is incremental to the Trust's current spend and specific to the areas of construction services and equipment standardization through the current slate of capital construction and renovation projects scheduled through 2020.

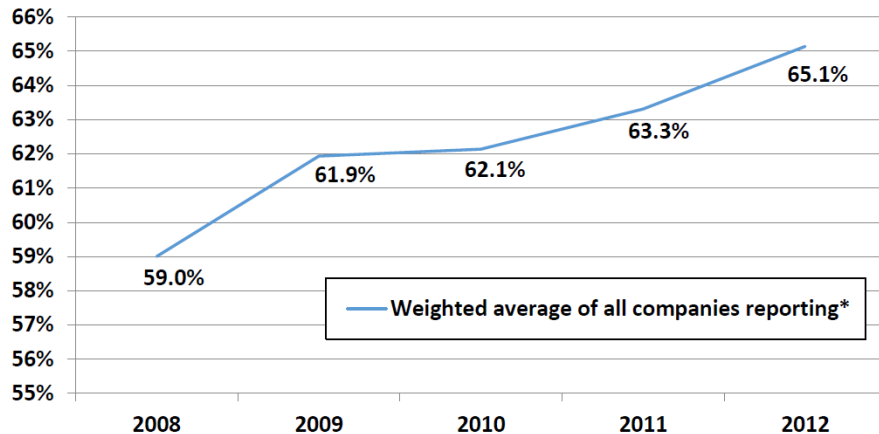
Vizient / MedAssets shareback now 60-75% without bundling

Industry Sources Confirm Market Shareback Rate Of 60-75%

Industry experts and published studies confirm that the market shareback rate is in the 60-75% range. Some experts claim to see shareback rates as high as 80% in some regions. Importantly, they also believe that Premier will experience extreme pressure to match market rates once member owners' existing deals expire.

Applied Policy Research on GPO Shareback Rates (Oct 2014)

Exhibit 1 - Percentage Of Total Fees Received From Vendors That Were Shared With Customers



* Each GPO's percentage of total fees received from vendors that were shared with customers is weighted by that company's share of total fees collected across the five firms.

Expert Commentary

"The average Joes and below – 70 / 30 is what they expect."
- Former Senior Employee, Premier and Vizient

"GPOs are using rebates as the fulcrum to win new business. It will be higher than 65% once [Premier renewals] come up."
- Former Senior Employee, Premier

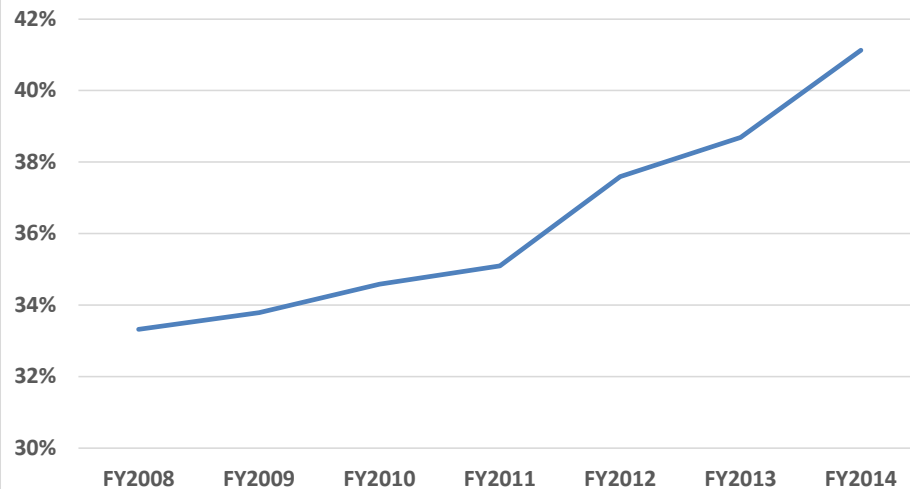
"We need to keep Premier honest. I wouldn't be surprised if we got closer to 80%...."
- Former Senior Employee, Premier

What might average shareback rates look like today given reports that sharebacks have consistently risen through the past several years?

Could The Current Fair-Market Shareback Rate Be Even Higher?

Through the early 2010s, prior to its acquisition by VHA-UHC Alliance, MedAssets' management noted that competitive pressures were driving industry-wide sharebacks up by 100-200 bps per year. As five years have passed since MedAssets was taken over by Vizient (private), market-rate sharebacks could plausibly be 500-1,000 bps higher than they were when MedAssets was acquired in 2014-15, and 600-1,200 bps higher than they were when Premier went public in 2013. Extrapolating this pace of shareback expansion forward to 2019 and applying it to a "non-bundled" shareback rate would suggest that current market-rate sharebacks could potentially be as high as 65-85%.

MedAssets Aggregate Shareback Rate



Source: MedAssets SEC Filings

Maricopa Integrated Health System (Nov 24, 2014)

40% Shareback Rising to 60% Shareback

Shareback: The current agreement with MedAssets stipulates a 40/60 shareback. MIHS receives 40% of the administrative fees from Suppliers while MedAssets retains 60% of the administrative fees. Under the new agreement, MIHS will receive 60% of the administrative fees and MedAssets will retain 40%. Last calendar year MIHS received approximately \$300,000 in shareback dollars from MedAssets. With the new agreement, MIHS should see an increase of 20% in the shareback received or \$60,000 in additional revenue.

Maybe the "gradual" increase in MedAssets' shareback rate wasn't really so gradual on a contract-by-contract basis...

If even MedAssets was offering 60% sharebacks on new contracts shortly before being acquired, this is a much better indicator of the market shareback rate at that point in time than its aggregate blended shareback.

MedAssets Q4 FY13 Earnings Call

"Our gross administrative fees will grow at a faster rate than net admin fees, as we forecast increases in our revenue share obligation due to renewal pricing, shift of fixed fee to shareback agreements, and the impact of performance related fees on the percentage of shareback."

- Mike Nolte – COO, MedAssets

MedAssets Q2 FY15 Earnings Call

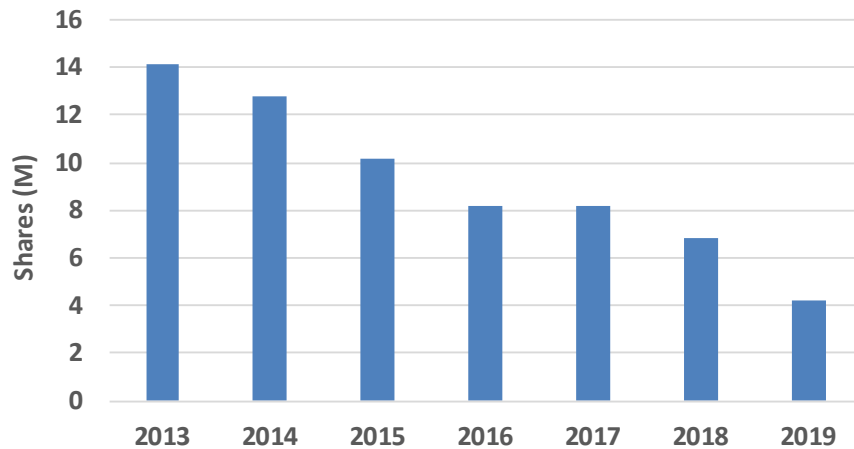
"I know we have discussed this in the past, but we do see continued pressure, as we said, in the 100-basis-point to 200-basis-point range for the revenue share obligation -- that's an industry trend."

- Haley Wise – Chairman & CEO, MedAssets

GNYHA Not A Natural Fit For Premier

Up for renewal in the current cycle is Greater New York Hospital Association (GNYHA), Premier's largest GPO member by gross purchases and the source of over \$71M (11%) of Premier's net administrative fees as of FY18. Industry experts report that GNYHA – with its own sub-GPO under Premier – is not a natural fit for Premier's GPO: Premier works best for mid-sized hospitals and hospital groups which can leverage their software and benchmark tools, of which larger hospital groups like GNYHA have their own. With its own captive GPO, GNYHA has significant product overlap with Premier and thus may sacrifice value by permitting purchases to go through Premier. Similarly large hospital groups like Johns Hopkins Medicine have already left Premier for Vizient – a better steward of large GPO members, per industry experts – even *before* their Premier equity vested in full. We believe that GNYHA's size and potential conflicts make it a strong candidate for choosing not to renew with Premier.

PINC Class B Share Ownership, GNYHA



Source: Premier SEC Filings. 2019 share ownership derived from expected Class B retirements, as disclosed.

Industry experts find it telling that GNYHA is aggressively selling shares despite its relatively stable financial position compared to other member owner hospitals currently selling shares

Vizient Announces Membership Agreement with The Johns Hopkins Health System Corporation

04/16/19

IRVING, Texas

IRVING, Texas--(BUSINESS WIRE)--Vizient today announced that The Johns Hopkins Health System Corporation has joined Vizient as a member with the goal of aligning and accelerating cost and quality performance.

As part of this new agreement, The Johns Hopkins Health System Corporation will join Vizient's group purchasing organization with the expectation of a decrease in its current supply costs. They have the opportunity to join Vizient's pharmacy program, including the company's Novaplus private label program, to reduce pharmacy expenses and minimize the impact of drug shortages on their enterprise. Lastly, they will be deploying Vizient's Clinical Database (CDB) and Operational Database analytics, across all their hospitals with the goal of aligning cost and quality decisions, engaging physicians in utilization and supply choices and improving outcomes.

•• *We are excited to welcome Johns Hopkins Medicine to Vizient and begin working with them on meeting their goal of driving near term and sustainable cost savings as well as improving the quality of care for the patients they serve* ••

[Source](#)

Other large hospital groups leaving Premier for Vizient, which, according to industry experts, is friendlier to large GPO partners



Increased Shareback A Material Benefit To GNYHA

GNYHA's most recent Form 990 made public by the IRS (2017) reveals that the additional income which it stands to gain by moving to a market-rate shareback would be a highly material benefit to the organization. Outside of direct income of \$17M – mostly from investment income – GNYHA's largest source of earnings is its 100% stake in Acurity ([formerly GNYHA Services](#)), its captive GPO. Moving to a market-rate shareback on its purchases made through Premier would increase Acurity income by close to 30%, and total GNYHA income by 20%. If Acurity could eventually bring these purchases entirely in-house, Acurity income would increase by over 50%, and total GNYHA income by 40%.

GNYHA Form 990 (2017)

Form 990 Department of the Treasury Internal Revenue Service	Return of Organization Exempt From Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations) Do not enter social security numbers on this form as it may be made public. Information about Form 990 and its instructions is at www.irs.gov/form990 .	OMB No 1545-0047 2017 Open to Public Inspection
A For the 2017 calendar year, or tax year beginning 01-01-2017, and ending 12-31-2017		
B Check if applicable: <input type="checkbox"/> Address change <input type="checkbox"/> Name change <input type="checkbox"/> Initial return <input type="checkbox"/> Final return/terminated <input type="checkbox"/> Amended return <input type="checkbox"/> Application pending		
C Name of organization GREATER NEW YORK HOSPITAL ASSOCIATION		
D Employer identification number 13-1552496		
% LISA KRIEGER Doing business as		
Number and street (or P.O. box if mail is not delivered to street address) Room/suite 555 WEST 57TH STREET Suite 1500		
City or town, state or province, country, and ZIP or foreign postal code NEW YORK, NY 10019		
E Telephone number (212) 246-7100		
G Gross receipts \$ 29,722,103		

	Prior Year	Current Year
Revenue		
8 Contributions and grants (Part VIII, line 1h)	0	0
9 Program service revenue (Part VIII, line 2g)	5,316,235	5,499,715
10 Investment income (Part VIII, column (A), lines 3, 4, and 7d)	22,608,760	21,648,939
11 Other revenue (Part VIII, column (A), lines 5, 6d, 8c, 9c, 10c, and 11e)	0	1,342
12 Total revenue—add lines 8 through 11 (must equal Part VIII, column (A), line 12)	27,924,995	27,149,996
Expenses		
13 Grants and similar amounts paid (Part IX, column (A), lines 1–3)	0	250,000
14 Benefits paid to or for members (Part IX, column (A), line 4)	0	0
15 Salaries, other compensation, employee benefits (Part IX, column (A), lines 5–10)	1,743,385	3,767,770
16a Professional fundraising fees (Part IX, column (A), line 11e)	0	0
b Total fundraising expenses (Part IX, column (D), line 25) ▶		
17 Other expenses (Part IX, column (A), lines 11a–11d, 11f–24e)	5,362,883	6,096,027
18 Total expenses Add lines 13–17 (must equal Part IX, column (A), line 25)	7,106,268	10,113,797
19 Revenue less expenses Subtract line 18 from line 12	20,818,727	17,036,199

Part IV Identification of Related Organizations Taxable as a Corporation or Trust Complete if the organization answered "Yes" on Form 990, Part IV, line 34 because it had one or more related organizations treated as a corporation or trust during the tax year.									
(a) Name, address, and EIN of related organization	(b) Primary activity	(c) Legal domicile (state or foreign country)	(d) Direct controlling entity	(e) Type of entity (C corp, S corp, or trust)	(f) Share of total income	(g) Share of end-of-year assets	(h) Percentage ownership	(i) Section 512 (b)(13) controlled entity?	(j) Yes No
(1) GNYHA MANAGEMENT CORPORATION 555 West 57th Street NEW YORK, NY 10019 13-1636172	ADMINISTRATION	NY	GNYHA	C CORP	15,922,423	248,614,626	100.000 %	Yes	
(2) ACURITY INC. 555 West 57th Street NEW YORK, NY 10019 13-2903551	Health Care	NY	GNYHA Ventures	C CORP	134,091,973	27,506,675	100.000 %	Yes	
(3) GNYHA VENTURES INC. 555 West 57th Street NEW YORK, NY 10019 13-3465618	Health Care	NY	GNYHA Hgite Corp	C CORP	307,819	69,823,33	100.000 %	Yes	
(4) NEXERA INC. 555 West 57th Street NEW YORK, NY 10019 13-3465618	Health Care	NY	GNYHA Ventures	C CORP	15,197,617	4,825,462	100.000 %	Yes	
(5) Mobile Health INC 555 West 57th Street NEW YORK, NY 10019 27-9915409	Media Technol	NY	GNYHA Ventures	C CORP	0	0	100.000 %	Yes	

Impact of Shareback Adjustments on GNYHA Income

(\$, Millions)	Actual	66% Shareback	In-House
Gross Admin Fees from GNYHA to Premier, SP Estimate ¹	\$101.0	\$101.0	\$101.0
Net Admin Fees to Premier, SP Estimate ¹	70.7	34.3	-
GNYHA Admin Fee Share, SP Estimate (Actual)	\$30.3	\$66.7	\$101.0
Acuity Income (Actual)	\$134.1	\$134.1	\$134.1
Less: GNYHA Admin Fee Share (Actual)	(30.3)	(30.3)	(30.3)
Plus: GNYHA Admin Fee Share (Hypothetical)	30.3	66.7	101.0
Acuity Income (Hypothetical)	\$134.1	\$170.5	\$204.8
Change from Actual	-	27.1%	52.7%
GNYHA Income, All Sources (Actual)	\$182.8	\$182.8	\$182.8
Less: GNYHA Admin Fee Share (Actual)	(30.3)	(30.3)	(30.3)
Less: Class B Share Tax Distribution and TRA Payments ²	-	-	(10.7)
Plus: GNYHA Admin Fee Share (Hypothetical)	30.3	66.7	101.0
GNYHA Income, All Sources (Hypothetical)	\$182.8	\$219.2	\$242.9
Change from Actual	-	19.9%	32.8%

1. 2017 Net Admin Fees (Actual) to Premier estimated from average of FY17 and FY18 Premier net admin fees from GNYHA / Acuity, as disclosed in Premier proxy statements. Associated Gross Admin Fees implied by 30% shareback.

2. Accounts for required exchange of Class B shares following exit from Premier GPO, as per Premier's GPO Agreement. Estimated TRA Payment reflects average of FY17 and FY18 TRA payments to Premier disclosed in proxy statements. Tax Distribution payments estimated from Company-wide tax distributions per Class B share.

Class B “Dividends” Not Sufficient To Encourage GNYHA To Remain With Premier

When questioned about renewal risk in the past, management cited its tax distributions and TRA as sources of member owner stickiness. [As discussed](#), each member owner receives a “tax distribution” covering its pro-rata share of Premier LP tax based on its Class B ownership (regardless of whether it is a for-profit hospital and, therefore, whether it pays taxes at all). Each Class B owner is also given a pro-rata share of 85% of the tax savings realized by Premier due to its change in tax basis stemming from the IPO, per the TRA. Per the LP Agreement, any member owner which leaves the Premier GPO not only forfeits unvested Class B shares, but must exchange its vested Class B shares for Class A shares, which offer none of the benefits provided by Class B shares. However, Spruce Point estimates that the value of the benefits to Class B ownership – which will only fall over time as the 15-year TRA is depleted – pale in comparison to the value of receiving market-rate sharebacks for GNYHA.

Annual Per-Share Benefits To Class B Share Owners, Spruce Point Estimate

Tax Distribution per Class B Share, Spruce Point Estimate		TRA Payments per Class B Share, Spruce Point Estimate		Total Class B Benefits per Class B Share, Spruce Point Estimate	
(Millions, Except per Share Amounts)	FY19	(Millions, Except per Share Amounts)	FY18		Spruce Point Est.
Distributions to Limited Partners of Premier LP ¹	\$57.8	Payments Made to GNYHA Under TRA ¹	\$3.6	Distributions per Share	\$0.80
Class B Shares Outstanding (Period Avg.) ¹	72.4	Class B Shares Held by GNYHA (Period Avg.) ¹	7.5	TRA Payments per Share	\$0.48
Distributions per Class B Share, Annual	\$0.80	TRA Payments per Class B Share, Annual	\$0.48	Total Class B Benefits per Class B Share, Annual	\$1.28

Class B Share Ownership Benefits vs. Value of Reverting to Market Shareback

Total Class B Benefits to GNYHA, Spruce Point Estimate		GNYHA Benefit from Shareback Rerating, Spruce Point Estimate	
(Millions, Except per Share Amounts)	Spruce Point Est.	(\$, Millions)	FY19
Class B Shares Held by GNYHA (Period Avg.) ²	5.5	Net Admin Fees from GNYHA ³	\$73.6
Total Class B Benefits per Class B Share, Annual	\$1.28	Gross Admin Fees from GNYHA (@30% Shareback)	105.1
Total Class B Benefits to GNYHA, Annual	\$7.0	PINC Shareback (@30%)	\$31.5
		Hypothetical Market Shareback (@66%)	69.4
		Hypothetical Gain from Shareback Increase, Annual	\$37.8

While GNYHA receives \$7M in various tax-related distributions from Premier on an annual basis through its ownership of Class B shares, it stands to increase its administrative fee revenue by close to \$40M per year by moving to a market-rate shareback of 66%.

The incentives associated with Class B share ownership are not nearly sufficient to keep GNYHA tied to Premier’s GPO at a 30% shareback rate.

1. LP Distributions from cash flow statement. Year-end Class B shares outstanding from 10-K. Payments Made to GNYHA Under TRA and Class B Shares Held by GNYHA (Avg.) from proxy filings.

2. GNYHA FY19 Class B ownership estimated from year-end FY18 Class B ownership and anticipated Class B divestiture as disclosed in Premier’s proxy filings.

3. FY19 Net Admin Fees from GNYHA estimated from FY18 Net Admin Fees from GNYHA, projected forward at total Net Admin Fee growth rate.



Class B “Dividends” Make Little Difference To Hospitals’ GPO Decision

To the extent that member owner hospitals intend to hold their PINC shares, Class B shares offer superior total returns via the tax distribution and TRA – returns to which they would lose access if they left the Premier GPO and, in turn, were forced to exchange their Class B shares. Our market intelligence indicates that hospitals are nonetheless generally cash-strapped and would prefer to sell their shares rather than receive these marginal benefits, as evidenced by [aggressive selling by GNYHA](#) and [other Class B shareholders](#). However, if GNYHA did, in fact, intend to hold the remainder of its shares, could Premier still get away with offering a shareback rate materially below market due to the added value provided by Class B ownership? Spruce Point estimates that, even taking these “dividends” into account – which, again, will only decrease over time – Premier would still have to offer GNYHA a shareback of at least ~60% to beat the market shareback rate. Transitioning all owner members a shareback rate of 60% would be [nearly as destructive as would transitioning them to the non-owner member rate of 66%](#).

Net Gain To GNYHA From Switching To Another GPO, Spruce Point Estimate

(\$, Millions)	FY19
Hypothetical Gain from Shareback Increase (30% to 66%), Annual	\$37.8
Lost Annual Class B Share Benefits, Total	(7.0)
Net Gain To GNYHA From Switching GPO (@66% Shareback)	\$30.8

See [prior slide](#) for reference calculations

Minimum Premier Shareback To GNYHA For Parity With Market Rate

(\$, Millions)	FY19
Net Admin Fees from GNYHA ¹	\$73.6
Gross Admin Fees from GNYHA (@30% Shareback)	105.1
PINC Shareback (@30%)	\$31.5
Plus: Net Gain To GNYHA From Switching GPO (@66% Shareback)	30.8
Minimum Premier Shareback For Parity With Market-Rate GPO	\$62.3
Implied Shareback %	60%

With GNYHA responsible for 10% of total Premier revenue, Spruce Point believes that GNYHA has significant negotiating leverage against Premier. By threatening to leave, it could plausibly command a market-rate shareback in addition to any Class B benefits it stands to receive, to the extent that it would choose to retain any Class B shares.

As a group, the [wave of hospitals eligible to opt-out in Oct 2020](#) – collectively responsible for ~80% of Premier net admin fee revenue, per our estimates – could wield the same leverage.

1. FY19 Net Admin Fees from GNYHA estimated from FY18 Net Admin Fees from GNYHA, projected forward at total Net Admin Fee growth rate.

Aggressive Class B Share Sales By GNYHA Reveal Limited Effectiveness Of Ownership Incentives

To an untrained eye, a [time series of GNYHA's Class B share count](#) might seem to suggest that it is divesting of its Class B shares only gradually. However, taking its vesting schedule into account paints a different picture. Of its Class B shares which are eligible to be exchanged, GNYHA has never held more than ~25% at one time. Put differently: as soon as its Class B shares become eligible for exchange, GNYHA exchanges (and inevitably sells) the vast majority of them. In fact, in 2015 and 2016, GNYHA had divested of ~99% of its vested Class B shares. This confirms to us that GNYHA is, in fact, an aggressive seller of Class B shares, and that it has little interest in holding its Class B simply for the associated distributions. It's unlikely that these distributions will influence GNYHA to remain a Premier GPO member for the sake of its Class B benefits.

PINC Class B Share Sales By GNYHA							
(Millions)	2013	2014	2015	2016	2017	2018	2019
Class B Shares	14.2	12.8	10.1	8.2	8.2	6.8	4.2 ¹
Vesting Class B Shares	-	2.0	2.0	2.0	2.0	2.0	2.0
Vested Class B Shares, Cumulative	-	2.0	4.0	6.1	8.1	10.1	12.1
Divested / Exchanged Class B Shares	-	1.4	4.0	6.0	6.0	7.3	10.0
% of Vested Class B Shares Divested	-	69.5%	99.6%	98.8%	74.1%	82.6%	82.2%

Source: Premier SEC Filings. 2019 share ownership derived from expected Class B retirements, as disclosed.

Could GNYHA Leave Premier Even Sooner?

By choosing to opt out of its current deal next week and waiting the required one year to move to a new deal at market-level sharebacks (starting Oct 1, 2020), GNYHA would be able to exchange its remaining unvested shares for Class A shares, but its announcement could cause PINC shares to fall by 50% or more if analysts update their forward estimates for a likely Company-wide rerating. By instead choosing to renew its deal under existing terms, GNYHA might preserve PINC's share price for a time, but the stock would nonetheless likely fall by a similar amount on Oct 1, 2020, when the next set of contractual lockups end, but before it can exchange its last tranche for Class A shares. Alternatively, GNYHA could choose to leave Premier immediately, foregoing much of the value of its Class B shares, but gaining an extra year of market-level sharebacks. Spruce Point finds that it may be in GNYHA's best interest to leave immediately and forego its final tranche of unvested equity.

A

GNYHA Leaves Early
Forfeits Unvested Class B Shares

(Millions, Except per Share Values)	FY20	FY21	FY22
Class B Value per Share ¹		\$1.78	
Final Tranche of Class B Shares		2.0	
Value of Class B Share Tranche		\$3.6	
Value at Current Market Price		68.6	
Change in Class B Share Value		-\$65.1	
Increase in Annual Rebate from Move to Market Shareback Rate ²	\$37.8	\$39.0	\$40.1

B

GNYHA Opts Out Oct 1, 2019 and Leaves Oct 1, 2020
Stock Falls 50% Before Remaining Tranche Vests

(Millions, Except per Share Values)	FY20	FY21	FY22
Class B Value per Share		\$16.97	
Final Tranche of Class B Shares		2.0	
Value of Class B Share Tranche		\$34.3	
Value at Current Market Price		68.6	
Change in Class B Share Value		-\$34.3	
Increase in Annual Rebate from Move to Market Shareback Rate ²	-	\$39.0	\$40.1

C

GNYHA Remains
Stock Falls 50% Before Remaining Tranche Vests

(Millions, Except per Share Values)	FY20	FY21	FY22
Class B Value per Share		\$16.97	
Final Tranche of Class B Shares		2.0	
Value of Class B Share Tranche		\$34.3	
Value at Current Market Price		68.6	
Change in Class B Share Value		-\$34.3	
Increase in Annual Rebate from Move to Market Shareback Rate ²	-	-	-

Option A: \$30.7M less stock value for immediate \$37.8M shareback increase

Option B: \$37.8M foregone sharebacks for \$30.7M additional share value

Option C: Worst option due to lost income from below-market sharebacks

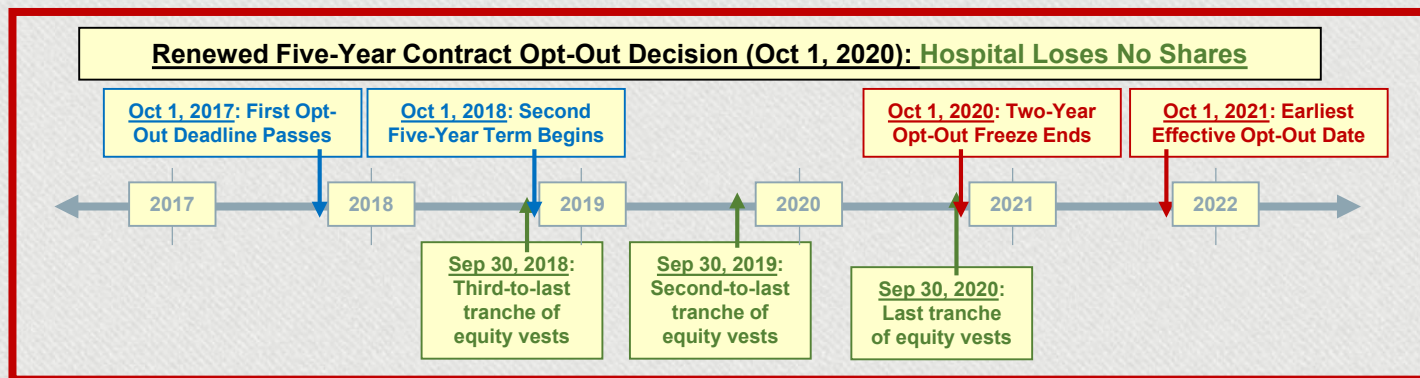
Spruce Point believes that leaving Premier's GPO immediately could be the best option for GNYHA

The Second Cliff: Two-Year Lockup Ends On Renewed Five-Year Contracts

Per Premier's GPO Participation Agreement, member-owner GPO contracts can be terminated with one year's prior notice after having been in effect for at least two years. Oct 1, 2020 marks the two-year anniversary of the beginning of Premier's renewed five-year contracts with the majority of its member owner hospitals. With the remainder of their unvested Class B shares due to vest on Sep 30, 2020, these hospitals will have little incentive to continue to adhere to contracts offering a shareback of only 30% once their renewed five-year deals become eligible for cancellation. Spruce Point anticipates that Premier will experience a wave of cancellations and contract restructurings on Oct 1, 2020, and that, as of Oct 1, 2021, the vast majority of Premier GPO members will receive sharebacks closer to market rates, whether from Premier itself or competing GPOs.

PINC S-1: Aug 26, 2013

Subject to certain termination rights, these GPO participation agreements will be for an initial five-year term, although our two largest regional GPO member owners have entered into agreements with seven-year terms. The agreements will generally be terminable at any time, upon one year's prior written notice, in the event of a change of control of the member owner, and will also be terminable for convenience upon one year's prior written notice, at any time after the second anniversary of the beginning of the applicable term. In either case, the terminating member owner will continue to receive revenue share from Premier LP through the effective date of termination. Under certain circumstances, the GPO participation agreement also will be terminable by either party for cause, including due to a material breach of the terms of the GPO participation agreement. In the event of a termination by Premier LP for cause, Premier LP will retain any collected but unpaid administrative fees otherwise due to the breaching member owner as of the date on which a breach notice is given, but no other damages will be assessed.



By Oct 1, 2021, Premier's 30% shareback will have largely been phased out, and its blended shareback of ~35% will nearly double to 60-75%.

The economics of the business will look radically different than they do today, and radically different from sell-side projections.

Premier Economics Completely Transform Upon Comprehensive FY22 Shareback Rerating

If all of Premier's member owner hospitals were to demand and receive a market-rate shareback beginning in FY22 – the earliest point at which their current terms could be amended – consensus sales estimates for FY22-23 would fall by 26%, and EBITDA estimates would be cut by more than half.

Impact of Changes Among Member Owner Hospitals on Consensus FY22-23 Results

(\$, Millions)	Consensus (At 30% Member Owner Shareback)		Impact of Shareback Rerating to 66%	
	FY22	FY23	FY22	FY23
Gross Admin Fees – Member Owner Hospitals ¹	\$985.9	\$1,056.8	\$985.9	\$1,056.8
Shareback	(295.8)	(317.0)	(650.7)	(697.5)
Net Admin Fees – Member Owner Hospitals	\$690.1	\$739.7	\$335.2	\$359.3
Remaining Revenue	675.7	724.3	675.7	724.3
Revenue, Total	\$1,365.8	\$1,464.0	\$1,010.9	\$1,083.6
% Change from Consensus	-	-	-26.0%	-26.0%
COGS	(414.3)	(409.9)	(414.3)	(409.9)
Gross Profit	\$951.5	\$1,054.1	\$596.6	\$673.7
% Change from Consensus	-	-	-37.3%	-36.1%
Operating Expenses	(430.7)	(477.3)	(430.7)	(477.3)
Operating Profit	\$520.8	\$576.8	\$165.9	\$196.4
% Change from Consensus	-	-	-68.1%	-66.0%
D&A and Adjustments	109.2	109.2	109.2	109.2
EBITDA, Adj.	\$630.0	\$686.0	\$275.1	\$305.6
% Change from Consensus	-	-	-56.3%	-55.5%

With Premier currently structurally overearning the rest of the GPO universe due to its unique post-IPO structure, Company economics will inevitably readjust to reflect market-sustainable terms once member owner hospitals are free to demand market-level sharebacks.

Management Tacitly Revealing Cracks In Its Most Recent 10-K

While management continues to cite its GPO-related savings as a major force behind hospital member stickiness – improperly, in our view – it has increasingly acknowledged that its renewal rates and net administrative fee revenue are at risk to broader industry competition. In fact, management made several additions to its most recent 10-K – filed as recently as Aug 16, 2019 – which suggest that its member hospitals are pressuring the Company to raise its shareback rate. We are not surprised that management made these additions just as the contracts for its two largest member owners approach their respective opt-out dates.

PINC FY18 10-K: Redline to FY19 10-K

“Pursuant to the terms of GPO participation agreements entered into by the member owners (see Note 1 - Organization and Basis of Presentation to the accompanying audited consolidated financial statements for more information), **each of the member owners generally receives revenue share from Premier LP equal to 30% of all gross administrative fees collected by Premier LP** based upon purchasing by such member owner's owned, leased, managed and affiliated facilities through our GPO supplier contracts....

Subject to certain termination rights, these GPO participation agreements have five-year renewable terms, although our two largest regional GPO member owners have entered into agreements with seven-year renewable terms. GPO participation agreements automatically extend for successive five-year or seven-year periods (corresponding to the length of their initial terms) unless the member owner notifies Premier LP, prior to the fourth anniversary (in the case of five-year agreements executed at the time of our IPO), or sixth anniversary (in the case of seven-year agreements executed at the time of our IPO), of the commencement of the then-current term, that such member owner does not want the GPO participation agreement to automatically renew upon the expiration of the then-current term.

As of the date of this Annual Report, approximately 96% of our fiscal 2018 net administrative fees revenue associated with existing members is covered by GPO participation agreements that have been renewed or extended at the same or similar economics, or initially had terms longer than five years. We continue to work with the few remaining member owners with initial five-year terms that have not yet renewed or extended their GPO participation agreements to achieve renewal or extension of those agreements at the same or similar economics on or before September 30, 2018.”

PINC FY19 10-K: Redline to FY18 10-K

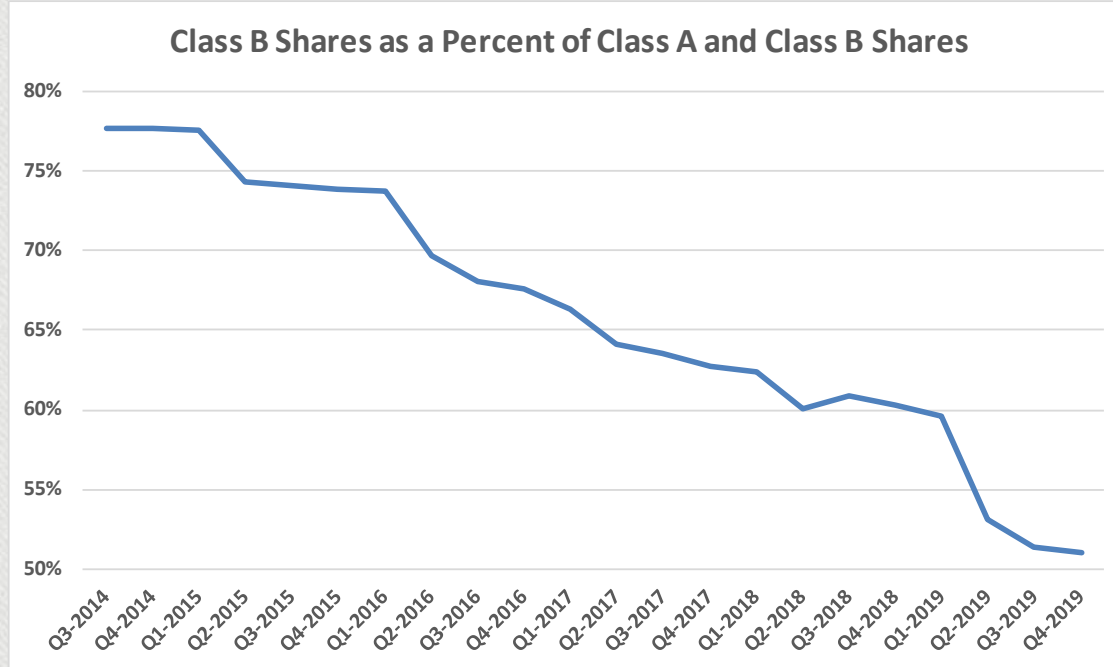
“Pursuant to the terms of GPO participation agreements entered into by the member owners (see Note 1 - Organization and Basis of Presentation to the accompanying audited consolidated financial statements for more information), **the overwhelming majority of our member owners currently receive revenue share from Premier LP equal to 30% of all gross administrative fees collected by Premier LP** based upon purchasing by such member owner's owned, leased, managed and affiliated facilities through our GPO supplier contracts....

Due to competitive market conditions, we have experienced, and expect to continue to experience requests, at times, to provide existing and prospective members increases in revenue share on incremental and/or overall purchasing volume. Subject to certain **early** termination rights, these GPO participation agreements **generally** have five-year renewable terms that initially expire on September 30, 2023, although our two largest regional GPO member owners have entered into agreements with seven-year renewable terms that initially expire on September 30, 2020. **In general,** our GPO participation agreements automatically extend for successive five-year or seven-year periods (corresponding to the length of their initial terms) unless the member owner notifies Premier LP, prior to the fourth anniversary (or September 30, 2022 in the case of five-year agreements), or sixth anniversary (or September 30, 2019 in the case of seven-year agreements), of the commencement of the then-current term, that such member owner does not want the GPO participation agreement to automatically renew upon the expiration of the then-current term.

We are currently working with the member owners with initial seven-year terms to achieve renewal or extension of those agreements.... In addition, some of our GPO participation agreements with member owners have been extended on terms that vary from their original terms.”

Member Owner Hospitals Dumping Shares

Some investors believe that member owner hospitals are strongly incented to remain within the Premier GPO network by the Class B share tax distributions and TRA payments, which Spruce Point estimates to be worth ~\$1.28 per share per year as of FY19, and which member owners would lose upon leaving Premier. We have already noted that these benefits are likely small for a given hospital compared to the potential benefit of receiving market-rate sharebacks. Indeed, they appear insufficient even to deter hospitals from simply selling their shares. The rapid pace of Class B selling among member owner hospitals has only accelerated through the past four quarters, with the Class A share count recently having passed the Class B count for the first time since Premier went public in Sep 2013. Our conversations with experts reveal that hospitals are generally not cash-rich institutions, and would likely prefer to sell rather than sit on their shares for a small “dividend.” Sales of Class B shares should also be interpreted as a form of insider selling, which sends a concerning signal to other Premier investors.



Source: Premier SEC Filings

Note that the pace of Class B sales accelerates each Q1, when another tranche of Class B shares vest. Spruce Point expects sales of Class B shares to accelerate once again this quarter – particularly as member owner hospitals, likely aware of the impending risks to Premier’s economics, look to reduce their exposure ahead of a seismic shift in earnings. Their understanding of these risks only further disincentivizes holding Class B shares, and undercuts the argument that hospitals may wish to remain with Premier to reap the benefits of Class B ownership.

Little Reason For Hospitals To Sit On PINC Shares

Spruce Point notes that PINC shares have been a chronic underperformer since the Company's IPO in Sep 2013, up only 35% since going public – lagging the XHE, XLV, and XHS since that date. The stock has also performed extremely poorly during the Oct-Dec period on a yearly basis since 2016, often declining by 20% in this time period. We believe that recent poor performance may reflect broader questions regarding the longevity of Premier's current economics among some investors. Even then, we question why cash-strapped hospitals would choose to remain invested in PINC shares in hopes of stronger future performance rather than sell.

PINC's Share Underperform Key Benchmarks



Source: Bloomberg

Note: XHS: Healthcare Services, XHE: Healthcare Equipment, XLV: Healthcare Select

PINC's Shares Historically Perform Poorly In October-November



Source: Bloomberg

Misunderstanding Of Premier's Economics Results In Mispriced Shares

With only half of analysts rating PINC a “buy,” the sell side is not overwhelmingly bullish on the stock, but it nonetheless assigns PINC an average price target of \$42.76, 26% above current levels. Spruce Point believes that this reflects the sell side’s lack of understanding of the business’ true underlying economics: analysts’ price targets reflect a level of earnings power which the Company cannot sustain through the long-term. Accordingly, we impute little to no significance to the sell side’s implied upside in PINC shares. Analysts are valuing a business which, we believe, will not exist in its current form in three years’ time.

Broker	Rating	Price Target
Wells Fargo	Outperform	\$47.00
Oppenheimer & Co.	Outperform	46.00
Benchmark Company	Buy	46.00
Baird	Outperform	46.00
Barclays	Overweight	46.00
J.P. Morgan	Neutral	45.00
Jefferies	Buy	43.00
Morningstar, Inc.	Buy	43.00
Nephron Research	Hold	43.00
Raymond James	Outperform	43.00
Credit Suisse	Neutral	42.00
Cowen	Market Perform	42.00
Guggenheim Securities	Neutral	41.00
SunTrust	Hold	40.00
Evercore ISI	In-Line	40.00
Piper Jaffray	Neutral	38.00
Canaccord Genuity	Hold	36.00
William Blair & Co.	Outperform	-
KeyBanc Capital Markets	Sector Weight	-
Average Price Target		\$42.76
% Upside		26%

Spruce Point Sees 55-75% Downside In PINC

In a base-case scenario in which member owner sharebacks gradually rerate close to the average market rate, and in which PINC's FY22 EV/EBITDA multiple contracts by ~35% as the economics of the business are reset, Spruce Point sees close to 70% downside in PINC shares. We believe that PINC shares have anywhere from 55%-75% downside depending on the extent to which the shareback rerates up front. The downside could be far worse should PINC lose member hospitals to competing GPOs in addition to having to raise its shareback to member owners.

PINC FY22 EBITDA and Valuation

(\$, Millions)	Consensus	Bull Case	Base Case	Bear Case
Gross Admin Fees – Member Owner Hospitals ¹	\$985.9	\$985.9	\$985.9	\$985.9
Shareback, %	30.0%	50.0%	57.5%	65.0%
Shareback, \$	(295.8)	(492.9)	(566.9)	(640.8)
Net Admin Fees – Member Owner Hospitals	\$690.1	\$492.9	\$419.0	\$345.1
Remaining Revenue	675.7	675.7	675.7	675.7
Revenue, Total	\$1,365.8	\$1,168.6	\$1,094.7	\$1,020.7
COGS	(414.3)	(414.3)	(414.3)	(414.3)
Gross Profit	\$951.5	\$754.2	\$680.4	\$606.4
Operating Expenses	(430.7)	(430.7)	(430.7)	(430.7)
Operating Profit	\$520.8	\$323.6	\$249.7	\$175.7
D&A and Adjustments	109.2	109.2	109.2	109.2
EBITDA, Adj.	\$630.0	\$432.8	\$358.9	\$284.9
EV / EBITDA Multiple	6.6x	5.0x	4.5x	4.5x
Enterprise Value	\$4,170.8	\$2,164.0	\$1,615.1	\$1,282.1
Net Debt, Adj. ¹	(107.4)	315.5	315.5	315.5
Equity Value	\$4,278.3	\$1,848.5	\$1,299.6	\$966.6
Diluted Shares Outstanding	126.1	126.1	126.1	126.1
Share Price	\$33.94	\$14.66	\$10.31	\$7.67
Downside	-	-56.8%	-69.6%	-77.4%

1. Assumes Gross Admin Fee growth in line with consensus revenue growth estimates. Spruce Point Net Debt includes Operating Leases and TRA liabilities.