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2015 Outlook: Specialty Pharmacy, Home Infusion Continue to Attract Investor Interest

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As specialty drugs become more high-profile, interest in specialty pharmacy continues to grow, which is spurring an increase in merger and acquisition activity, according to health care M&A company The Braff Group. And while home infusion is still a strong segment, demand for these firms is outpacing supply. While investment in these companies is not without risk, the segments overall hold promise for investors.

Among the various health care services sectors that the company tracks is pharmacy services, which includes specialty pharmacy, infusion and institutional pharmacy. As a whole, that sector was up 71% in 2014 M&A activity through the third quarter compared with the same year-ago period. The increase was driven largely by specialty pharmacy deals, of which there were 15 completed by the end of third-quarter 2014, a 200% boost over the same period in 2013, which saw five transactions (see chart, p. 5). In fact, the 15 transactions completed through the first three quarters of 2014 — which are the most recent data The Braff Group has — beat the 12 specialty pharmacy deals done in all of 2013.

Institutional pharmacy had nine deals through the third quarter last year, up from four for the same stretch of time in 2013. The infusion therapy sector saw five deals through third-quarter 2014, down from the eight it had for the same period the prior year.

The health care services segments are being bolstered by not only health care-specific events — including Diplomat going public — but also external ones, including "improved access to debt,…enthusiasm around" acquisitions and a record-breaking stock market, says Dexter Braff, president of The Braff Group. These factors and more "create an atmosphere of optimism in buyers across all sectors," resulting in "transaction activity increasing over the last 18 months. Deals beget deals," and this enthusiasm has "trickled down to specialty pharmacy, home health" and other health care services sectors. "We're in a giddy market right now that's benefitting sellers in all spaces."

Diplomat IPO Was Big for Buyers

"Suffice to say that we remain very bullish in pharmacy services M&A, particularly in specialty pharmacy in light of the extremely successful Diplomat IPO," says Braff. After almost 40 years of operating as an independent specialty pharmacy, Diplomat went public last summer *(SPN 7/14, p. 1)*. Its IPO, Braff says, "was a very important draw for buyers" because it was "high-profile and successful." So now, "everyone says, 'I can be the next Diplomat.'"

Specialty pharmacy, he contends, is "an interesting phenomenon." It's one of the more attractive health care services sectors with "enormous revenue opportunities." While it's "not necessarily profitable,…the revenue dollars by themselves are alluring." Companies can go from annual revenues of $10 million to $100 million in a year if they can get on a manufacturer's "distribution list and gain access to a high-value drug."

That ability, Braff says, makes the segment one of only a few that can see that kind of growth. "I think that investors are attracted to the meteoric growth opportunities within the space." The growing prices of specialty drugs are "the fuel for the allure. It's that fuel that takes a company from a nice little campfire to a raging fire, and there is no shortage of these opportunities popping up."

'Revenues Carry a Lot of Risk'

It's interesting to note, though, that "while new treatment options for hepatitis C have catapulted many firms, with such high dollars per patient, these revenues carry a lot of risk. So while hep C may be an attractive therapy that companies want to have in their offerings, buyers are nevertheless cautious in evaluating these opportunities."

For one, "margins are an issue" in specialty pharmacy. In fact, "there are many $10 million IV companies that make more profit than a $100 million specialty pharmacy," he notes. But when it comes to mergers and acquisitions, Braff tells *SPN*, "I've come to realize over my career that there is a huge emotional aspect to it. People still act as people.…The fact is that buying decisions are made by people, and if there is excitement around a space, even if the economics are challenging, people will still be drawn to it. All the glamour…is in specialty pharmacy." However, he adds, "I'm not suggesting that specialty pharmacy is not a good business — it's just a hard business," and companies need to "process a lot of scripts…to make a profit."

In specialty pharmacy, "the challenge for buyers and sellers alike is that with such rapid growth in the industry, transactions need to be bigger and bigger to 'move the needle' for a buyer. So a provider with, say, $25 to $50 million in revenues, which would have been an ideal acquisition candidate five years ago, simply isn't big enough to garner interest from some of the most active consolidators," says Braff. "The good news is that on the heels of the Diplomat IPO, we wouldn't be surprised to see some new private-equity groups target providers below $50 million, if for no other reason than to create 'inventory' for the next tier of buyers."

While infusion therapy deals are down, that doesn't mean that there isn't interest in that area, contends Braff. "As for infusion, the sluggish numbers over the recent past do not reflect a change in sentiment toward the sector," he maintains. "Buyers are still very eager to acquire home IV providers and their service-driven margins — if they can find them. Demand far exceeds supply — a development that we do not expect to change much over the near term as the current generation of pharmacy entrepreneurs seem to be drawn to the 'bright lights' of specialty pharmacy vs. traditional IV."

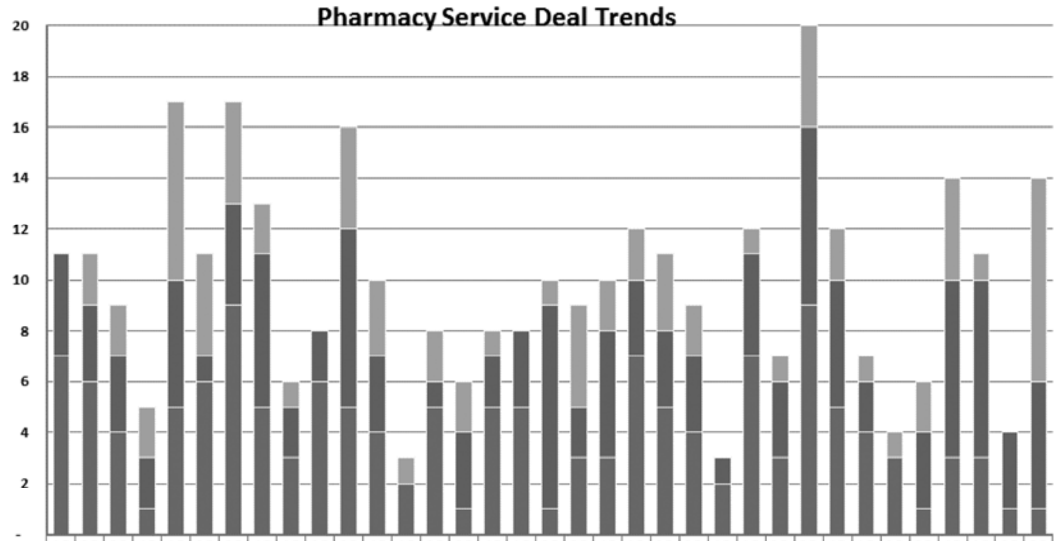
Demand for Infusion Companies Remains

Still, says Braff, "There's no shortage of buyers that want to look at" infusion therapy companies with annual revenues of at least $5 million providing "basic" therapies such as intravenous immune globulin, pain management, total parenteral nutrition and antibiotics. Such firms are the "meat and potatoes of pharmacy services M&A," which is "not different than how it's been for years." But there is a "very limited crop of infusion therapy" companies for buyers to purchase. And "you don't see start-ups in IV therapy," maintains Braff. "I'm sure they're there, but it's not like in other [health care services] segments, where every day there's a new company to add to our database."

BioScrip, Inc. is one company in the space that previously was fairly active in deal making but has been quiet more recently. "One could argue that it's not at all unusual that after a consolidation phase, companies go into a one-to-two-year hibernation period," says Braff. "And they should. If they don't, they can collapse under their own weight." BioScrip in particular went "from adolescence to middle age in one year" and "completely remade themselves" as an infusion services provider, a "massive transformation of the business." The slowdown in activity, he maintains, is "wise. Acquisitions are hard to integrate," and that's without the company's new focus.

Contact Braff at (412) 833-5733.

2014 Specialty Pharmacy M&A Activity Outpaces 2013's



	2006 1Q	2006 2Q	2006 3Q	2006 4Q	2007 1Q	2007 2Q	2007 3Q	2007 4Q	2008 1Q	2008 2Q	2008 3Q	2008 4Q
Institutional Pharmacy	-	2	2	2	7	4	4	2	1	-	4	3
Specialty Pharmacy	4	3	3	2	5	1	4	6	2	2	7	3
IV	7	6	4	1	5	6	9	5	3	6	5	4

	2009 1Q	2009 2Q	2009 3Q	2009 4Q	2010 1Q	2010 2Q	2010 3Q	2010 4Q	2011 1Q	2011 2Q	2011 3Q	2011 4Q
Institutional Pharmacy	1	2	2	1	-	1	4	2	2	3	2	-
Specialty Pharmacy	-	1	3	2	3	8	2	5	3	3	3	1
IV	2	5	1	5	5	1	3	3	7	5	4	2

	2012 1Q	2012 2Q	2012 3Q	2012 4Q	2013 1Q	2013 2Q	2013 3Q	2013 4Q	2014 1Q	2014 2Q	2014 3Q
Institutional Pharmacy	1	1	4	2	1	1	2	4	1	-	8
Specialty Pharmacy	4	3	7	5	2	-	3	7	7	3	5
IV	7	3	9	5	4	3	1	3	3	1	1

SOURCE: The Braff Group. Visit www.thebraffgroup.com.

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Atlantic Information Services, Inc.
1100 17th Street NW, Suite 300, Washington, DC 20036 - **800-521-4323**