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

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.

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2014 Specialty Pharmacy M&A Activity Outpaces 2013’s
Pharmacy Service Deal Trends


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