

M&A Sector Report

Independent Market
Research from
The Braff Group
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The Braff Group is a leading middle market merger and acquisition firm that specializes in the home infusion therapy, specialty pharmacy, home health care, hospice, home medical equipment, and staffing market sectors. We provide merger and acquisition representation, strategic planning, and valuation services.

M&A Market Watch: Home Infusion Therapy and Specialty Pharmacy Services

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Home Infusion Therapy vs. Specialty Pharmacy Services

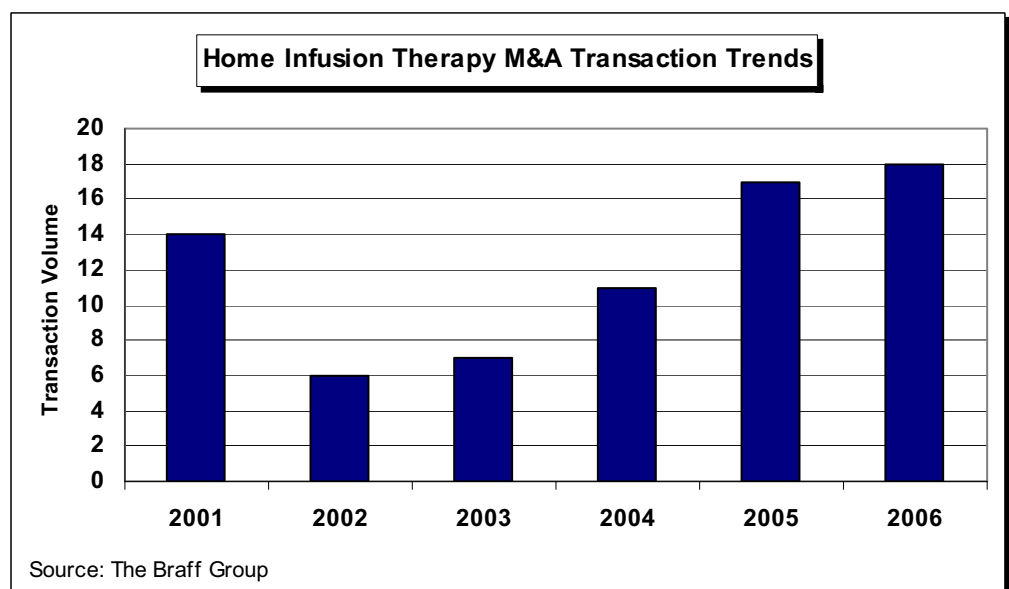
Although home infusion therapy and specialty pharmacy service providers are often grouped together, they are quite different in terms of product lines, clinical oversight, distribution, etc. As such, from a merger and acquisition perspective, each have varying M&A dynamics.

For the purposes of our discussions, home infusion therapy providers (IV) are those firms that provide a broad range of intravenous therapies including total parenteral nutrition, antibiotics, pain management medications, chemotherapy, and others, generally within a limited geographic territory. Specialty pharmacy service providers (SPS), on the other hand, tend to focus on providing a limited number of specialty drugs, including growth hormone, blood factor, intravenous immune globulin, synagis, remicade, oral oncology medications, treatments for multiple sclerosis, HIV/AIDS, hepatitis C, and others, frequently to chronic populations, and often over many states from a single infrastructure. As such, traditional IV therapy tends to have a greater service component, while specialty pharmacy is more akin to high-end distribution, albeit with all the billing and customer service components similar to home health care.

Note that with a substantial portion of the specialty pharmacy pipeline expected to be infusible drugs that require "higher touch" clinical interventions, the line between SPS and IV is increasingly blurring — giving rise to Specialty Infusion hybrid providers. For the purposes of our discussion however, with acquisition strategies and buyers typically focused more toward one sector vs. the other, we will address the industry accordingly.

Home Infusion Therapy

As we can see from the chart below, 2006 was an outstanding year for M&A activity in home infusion as the sector set a new record for transaction volume with 18 deals. More importantly though, are the numbers behind the numbers. In 2005, with Option-



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funded companies, while in 2006, there were seven transactions completed by four private equity sponsors. With acquisition demand for home IV being driven by a larger and broader array of strategic and financial buyers, the sector is extremely well positioned for a robust M&A market in 2007.

Care dominating acquisition activity, the average number of deals completed per unduplicated buyer was 2.43. However in 2006, with a more diverse group of buyers entering the market, the average number of deals per unduplicated buyer dropped to 1.64. Moreover, **in 2005, there were no acquisitions completed by private equity**

We believe there are three primary reasons for the expanded acquisition interest in the home IV arena:

- 1. Comparatively stable and predictable reimbursement.** Unlike other home care sectors such as home health and home medical equipment that are largely dependent on financially stressed federal and state programs for reimbursement (notably Medicare and Medicaid), home infusion therapy is principally reimbursed through numerous local and regional private insurers and private pay. As such, compared to Medicare and Medicaid that can cut pricing across the entire nation or a state with a single change in reimbursement, such “payor risk” is extremely diversified in home IV. And although these payors continue to squeeze margins, with the greatest cuts occurring in the mid-90s, pricing today tends to be “shaved” rather than “slashed”. Taken together then, compared to many other health care service sectors, IV reimbursement is generally more stable and predictable.
- 2. The promise of a revised Part D benefit.** Since the introduction of Medicare Part D in which legislators shoehorned a service intensive IV benefit into a primarily retail and mail-order prescription payment program, infusion advocates have been trying to plug gaps in coverage and payment that make it extremely difficult to provide IV services to such beneficiaries profitably. In July, H.R. 5791, The Medicare Home Infusion Therapy Consolidated Coverage Act, was introduced to the House of Representatives – a bill that would shift the benefit to Medicare Part B which is better suited to cover more complex, multi-faceted, service inclusive therapies. While the bill is moving slowly, it is nevertheless a critical – and credibility enhancing – first step toward righting a benefit that could ultimately be a boon to utilization.
- 3. Home IV is an attractive entry point in home care.** With (a) continued development of complex drug therapies and regimens that require substantial clinical intervention, (b) the home medical equipment sector under substantial and continued reimbursement stress, and (c) Medicare home health currently realizing substantial pricing premiums in the merger and acquisition market, for financial buyers looking to gain entry into the broad home care arena, or existing health care providers looking to diversify their payor or service mix, home infusion therapy is increasingly being seen as a viable acquisition option.

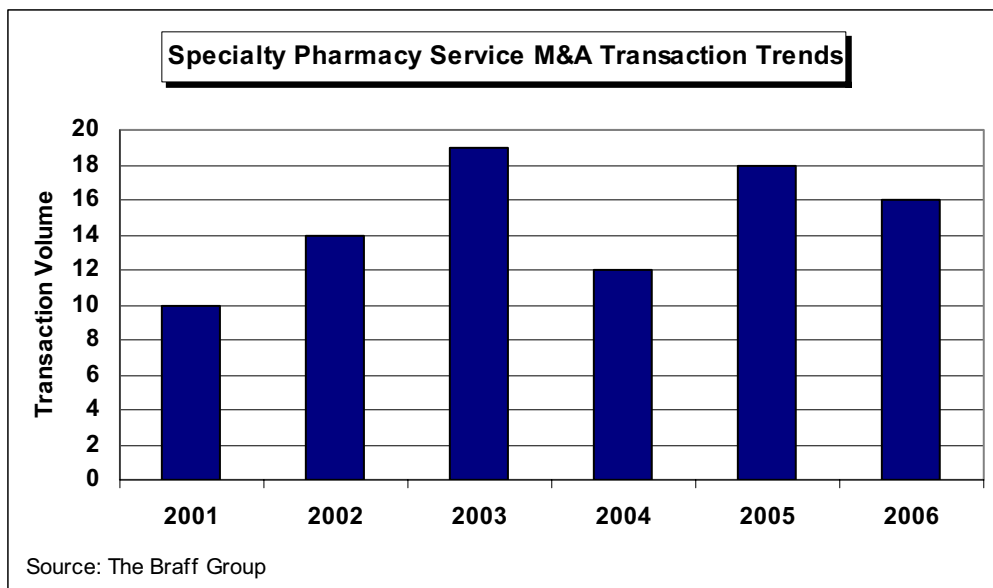
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Specialty Pharmacy Services

As illustrated in the chart below, though slightly off last year’s volume, 2006 was another strong year for M&A activity in the specialty pharmacy services sector with 16 deals announced and/or completed. In addition to the common theme of specialty pharmacy providers acquiring other SPS providers to capture additional product lines and/or geographic reach to leverage existing infrastructures, there were several deals of note during the year that illustrate other notable acquisition strategies in the sector:

- 1. The PBM/SPS Model:** Though still very much in play, the current battle for **Caremark** being waged between **Express Scripts** and **CVS** illustrates the continued interest in blending the transactional fundamentals of prescription benefit management with mail order specialty pharmacy. With \$36B in revenues, about \$12B of which comes from mail order Rx, which includes specialty pharma (with the balance predominately coming from PBM), Caremark is already a blended entity, and is coveted by the buyers to expand these capabilities. With CVS in the mix, another variation on the model emerges as detailed below:

2. Complete Pharmacy Solution Model. Walgreens acquisition of Medmark Specialty Pharmacy Solutions marks yet another aggressive play by the pharmacy giant to expand its reach beyond the retail setting and leverage its strong brand name to create a diversified distribution and service model with capacity to move seamlessly from low touch mail order specialty pharmaceuticals to higher touch home infusion therapy and home medical equipment



3. Multi-Specialty Healthcare Management Model. Finally, we note Magellan Health Services \$285 million dollar acquisition of ICORE Healthcare. The transaction provided Magellan with an entirely new revenue source to augment its core behavioral health management services. We may see more of this type of activity as other focused health care management firms look for new growth engines and opportunities to offer a broader compliment of specialty services.

On the Horizon

Tysabri. After being pulled from the market during trials in 2005 when two patients receiving the drug in combination with Avonex contracted a rare and serious disease of the central nervous system, one of which proved fatal, Tysabri was re-introduced in 2006. Although being administered under extremely tight clinical protocols, the therapy is increasingly gaining momentum. As greater experience with, and confidence in, Tysabri develops, the drug may begin to deliver on its promise for (a) clinical efficacy and (b) substantial utilization.

Oral Oncology Medications. As a result of new and advanced treatment measures, many forms of cancer are becoming more and more like chronic diseases. As such, we are seeing a virtual explosion in the development and utilization of oral oncology medications. While these tend to be high revenue, low margin drugs, they are ideally suited for clinically knowledgeable providers that can efficiently, dose, distribute, and bill for these medications (certain manufacturers are even looking to establish partnerships with providers that can demonstrate their ability to handle these drugs), as well as develop and sustain customer relationships. In other words, it's a perfect product line for SPS and will likely fuel substantial sector growth in the future.

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Emerging Acquisition Candidates. In a comparatively small and young industry, we note that many of the most attractive, “mature” specialty pharmacy candidates divested in the first wave of consolidation that peaked in 2003. While acquisition demand remains high, we sense that a limited supply opportunities has likely contributed to the leveling off of activity since. However, based on our discussions with providers nationwide, we believe there are a large number of aggressive, developing firms — many of whom began to focus on specialty pharmacy in response to the surge of activity from 2001 to 2003 — that are reaching critical mass and will emerge as extremely attractive acquisition candidates over the next 1-3 years. Accordingly, we may see another ramp-up of acquisition activity over the near to mid-term.

About The Braff Group

The Braff Group is a leading middle market merger and acquisition firm that specializes in the home infusion therapy, specialty pharmacy, home health care, hospice, home medical equipment, and staffing market sectors. The firm provides merger and acquisition representation, strategic planning, and valuation services. Since being founded in 1998, The Braff Group has completed more than 90 transactions.

In 2006 the firm was awarded Healthcare Deal of the Year by the M&A Advisor, a leading publication dedicated to middle market merger and acquisition activity, for its representation of Canadian Valley Medical Solutions - the third consecutive year The Braff Group has received this award. The firm was also recognized as a finalist for Boutique Investment Banking Firm of the Year in 2005 and 2006. The Braff Group has also been honored as one of the fastest growing companies in the Pittsburgh Region by the Pittsburgh Business Times.



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