the braff group

marketWATCH

PHARMACY SERVICES

DESPITE A SUBSTANTIAL DECLINE IN PHARMACY SERVICES DEAL VOLUME IN 2013, THERE'S REASON TO BE OPTIMISTIC ABOUT 2014

Based upon proprietary data collected and analyzed by The Braff Group, deal volume in pharmacy services – home infusion therapy, specialty pharmacy, and institutional pharmacy – fell 42% in 2013 vs. 2012.

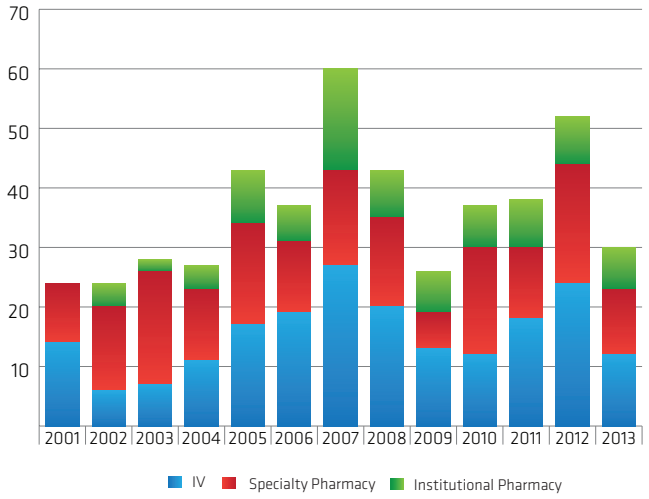
Under most circumstances, a fall-off of this magnitude would suggest a substantial, fundamental, and unfavorable shift in the merger and acquisition dynamics that drive M&A activity in these sectors. While several long-term trends continue to exert downward pressure on the space, there were no new game-changing developments over the year that would undermine long-held consolidation strategies. In fact, a deeper dive into the data suggests that it wasn't as bad of a year as the annual figures suggest.

How so?

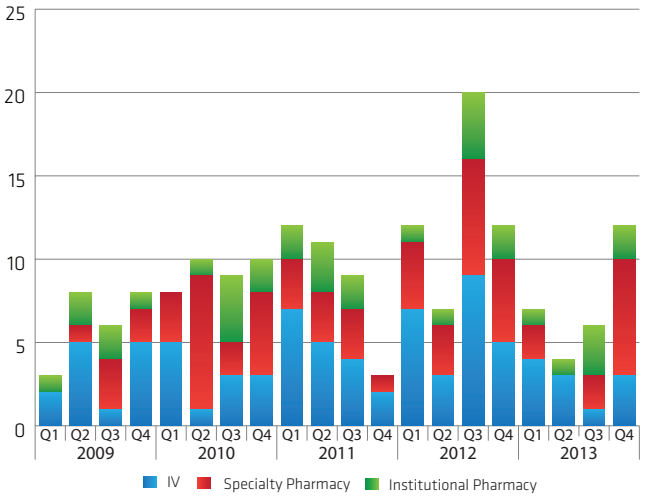
There was a surge in activity in the fourth quarter. While the full year numbers are far from robust, if we examine the quarterly trends (see below), we can see that during the fourth quarter, transaction activity rose to a level consistent with some of the best quarters posted over the past five years.

The "tax effect" inflated volume in 2012 and deflated it in 2013. As we have pointed out throughout the year, deal volume in 2012 was inflated as sellers sought to capture favorable capital gains treatment that was expected to (and did) expire at the end of that year. As such, many deals that would have been completed in 2013 were advanced to 2012, which, in turn, left fewer sellers contemplating an exit in 2013. In fact, if we take the average of the past two years combined, 41 transactions would be amongst the highest recorded since we began tracking activity in 2001.

Pharmacy Services Annual Deal Trends



Pharmacy Services Quarterly Deal Trends



Source: The Braff Group

There were many high profile deals completed in 2013. While the volume of deals closed was comparatively low, some of the deals that did get done made quite a bit of noise. In addition to the blockbuster CVS Caremark-Coram deal, 2013 produced the acquisitions of PharMEDium, Onco360, CarePoint Partners, AxelaCare Holdings, and QoL Meds, the kind of successful, high value deals that characterize a rising market rather than one in decline.

Private Equity continues to target pharmacy services. Similar to the referendum on the market that can be drawn from high profile deals as suggested above, private equity investment activity tends to be a good barometer of the go-forward expectations and optimism for a sector. This is particularly the case with new market-entry platform deals, the initial investments intended to support a three to seven year buy-build-exit strategy. And, again, based upon proprietary data compiled by The Braff Group, while PE sponsored platform deals were down compared to a tax-inflated 2012, we did not see a collapse in this leading edge indicator.

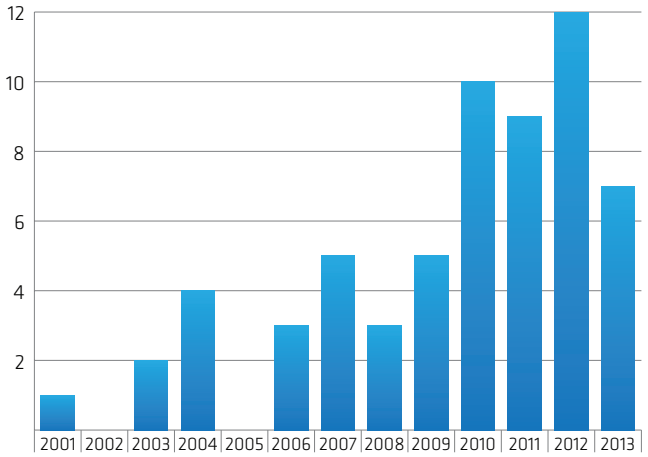
All things considered then, pharmacy services M&A activity is far from the free-fall one might conclude simply by looking at 2013 figures. That said, as alluded to above, several developments that are a long-term in the making, continue to build and exert a drag on pharmacy services M&A.

Dwindling supply of acquisition candidates. Regular readers of marketWATCH have heard this refrain repeatedly over the past several years, and it remains the single greatest impediment to predictable and sustained growth in pharmacy services transaction volume. In sectors with comparatively strong margins that have also produced a period of high profile and successful private equity funded consolidations and exits, we would typically see a wave of new market entrants looking to capitalize on these favorable economics. While this trend has been particularly evident, for example, in hospice, it has been far less so in home infusion therapy, where there have been remarkably few start-ups despite favorable income and exit opportunities. Perhaps this is due to the lure of specialty pharmacy, where firms have grown from startup to tens of millions in revenues in a few short years. Perhaps it's due to a reluctance of would-be IV entrepreneurs to try and steal share in such a high service, high touch, high relationship business. Or, perhaps, it's a function of the options available to newly minted pharmacists to make an attractive living without the hassles of business ownership. Whatever the cause, while demand remains strong, there simply aren't enough acquisition candidates available to keep M&A volumes consistently high.

The size chasing size conundrum. Similar to the supply problems stated above, but for very different reasons, buyers of specialty pharmacy providers are finding it increasingly difficult to identify acquisition candidates that can "move the needle" of revenues and profitability. The issue isn't new start-ups, as we have seen many providers splinter off from other companies to create dynamic firms of their own. The problem here is that with the relentless margin compression facing much of SPS, providers must grow to $50 to $100 million or more in revenues to generate enough raw profit dollars to attract a suitor. And as buyers have turned to increasingly larger acquisition targets, they themselves have bulked up (as margins shrink), forcing them to seek out ever larger providers that are far fewer in number.

The common thread is that buyers still want to buy. But with such a limited, erratic, and unpredictable pool of potential sellers coming to market, we can expect an equally erratic and unpredictable market in pharmacy services M&A for the foreseeable future.

Private Equity Platform Investments in Pharmacy Services



Call us to see how we can put our experience to work for you.

Chuck Gaetano	Reg Blackburn	Ted Jordan	Mark A. Kulik	Nancy Weisling	Pat Clifford	Bob Leonard	Steven Braff
Atlanta	Atlanta	Atlanta	Atlanta	Chicago	Chicago	Ft. Lauderdale	Palm Springs
888-723-9263	866-455-9198	888-290-7080	888-922-1838	888-290-7237	888-922-1834	888-922-1836	888-922-1833

Source: The Braff Group