
SPECIALTY PHARMACY NEWS

2011 Outlook

Specialty Pharmacy's Investor Interest Should Continue Into '11

Following dismal merger and acquisition (M&A) activity in specialty pharmacy in 2009, the sector rebounded in a big way last year, more than doubling the prior year's deals. And that performance, experts say, will continue into 2011 due to multiple factors.

In 2009, six specialty pharmacy deals were completed, a sharp drop from the 12 to 17 deals done over the previous few years (see table, p. 7). "There was a big fall-off in 2009, likely due to fears about the economy," says Dexter Braff, president of The Braff Group, an investment banking firm specializing in home health sectors.

But through the end of the third quarter of 2010 — the most recent data available — The Braff Group has identified 12 specialty pharmacy deals, Braff tells *SPN*. "Over the same period last year, there were four" specialty deals, he says. "That's a very big difference."

He adds that there was another notable aspect to the 2010 specialty pharmacy M&A climate: the number of platform deals, which are when private-equity companies make an initial acquisition in a segment upon which they'll base a business strategy. Platform deals are usually trailed by follow-on transactions to grow the business. Previously, 2007 saw the largest number of platform deals within the specialty pharmacy sector, with three, Braff says. But through the end of the 2010 third quarter, there were five such deals, and his company has identified at least two more from the fourth quarter.

"We know we'll wind up the year with at least seven of these deals," he notes. In specialty pharmacy, 2010 has "seen more investment in private-equity platform acquisitions than any other year by far."

And those seven deals "portend extremely well for a surge in follow-on transactions," Braff asserts. "The rebound in activity seen in 2010 is going to have greater legs than other periods where we saw a surge," he adds, pointing to the "geometric" pattern of platform transactions prompting follow-on transactions.

Because of the "unique expertise" required for specialty pharmacy, "the easiest way to grow is to acquire companies," he says. "There is a great synergistic economic incentive to do follow-on transactions. Specialty really can boost economies of scale." Once a firm has a

base company, it can "layer on another revenue stream" fairly easily, he explains.

"Looking into 2011, we expect to see continued consolidation and investment throughout the specialty pharmacy sector," says Michael Patton, managing director at Provident Healthcare Partners. "Similar to 2008 when we saw Omnicare, a traditional institutional pharmacy, expand into the specialty market with their acquisition of Advanced Care Scripts, we continue to see outside-the-box buyers looking for opportunities to expand outside their typical service lines and bring in-house a specialty platform" (*SPN 8/08, p. 12*).

Patton also points to "a considerable amount of interest" in specialty pharmacy within the private-equity community and cites examples such as Enhanced Equity Fund's deal for Specialty Therapeutic Care (see brief, p. 12) and H.I.G. Capital LLC's purchase of Allion Healthcare, Inc. (*SPN 11/09, p. 1*).

"The main differentiator between the two buyer pools has less to do with up-front cash valuations, but the longer term play," Patton tells *SPN*. "With a strategic acquirer, they will be looking into synergies which can be leveraged for cross-sell potential and structure multiyear earnouts to continue to reward shareholders with the increased profits.

"For private-equity groups, the hook is to remain a stand-alone platform with a strong and experienced capital backing and to experience a second liquidity event years down the road; however, most growth achieved will be through organic or acquisition methods. While both groups look to structure their transactions in differing fashions, each is aggressive in valuation multiples and very interested in working to get deals done."

Interest in the specialty pharmacy sector can be attributed to "basic things and comparative things," says Braff. "Essentially, when health care reform passed, there was a general lift in the notion of the greater use of pharmaceuticals. The expectation is that we'll see increased utilization." And with this boost in utilization "will be the increased need to keep costs down. Specialty pharmacy is a cost-saving model," he contends. "Specialty pharmacy is considered not only an area that will grow," he explains, but there will also be

“gravitation toward it because of cost-effectiveness” concerns.

According to Braff, “although margins may not be as high” among specialty pharmacies compared with other health care services, “they generally have high revenues with extremely high growth rates. They’re attractive [to potential buyers] because of their high profile, high revenues and high growth.”

In addition, because the specialty pharmacy sector “benefits from not being in the bull’s-eye” of margin pressure, in which other areas such as Medicare home health are finding themselves, this has boosted interest in companies within the industry, says Braff. The Medicare home health sector has been averaging four or five platform deals per year since 2006, he points out, but had only one through the third quarter of 2010.

“People are getting skittish about Medicare,” so there has been a refocusing of attention from Medicare-reimbursed services to non-Medicare-reimbursed services, he maintains.

Lenders Are Funding Larger Deals

Another plus for M&A activity is the “lending environment is favoring larger deals,” Braff points out. Unlike home infusion transactions, which tend to involve companies with annual revenues around \$10 million, “specialty pharmacy deals tend to be large

— it’s not uncommon” for these companies’ revenues to be in the \$100 million to \$200 million range, he says. While the “lack of access to debt capital and borrowing” has hampered some activity, more recently the “greatest expansion in the availability of credit...has been with larger-size credit needs....This is a contributing factor in getting deals done,” says Braff. Companies “couldn’t get the debt before but can get it now.”

So what specialty pharmacies are potential acquisition targets? “Any specialty pharmacy doing more than \$50 million annually and has multiple therapies will be an attractive acquisition candidate,” he maintains (see box, p. 5). “Whether they want to sell or not, they will be called on.”

Also stoking specialty pharmacy investment interest is the fact that many of these firms have matured in terms of industry experience and have become the focus of acquisition attempts.

“What often happens in a market when there are not a lot of players” is that “people get drawn into the industry, responding to interest from the investment community and buyers” — which is exactly what happened in the early 2000s, when specialty pharmacy began to capture attention, Braff says. These new companies, though, need time to mature — which is just what the market entrants from the pre-2005 period have done, he contends.

Diversified Offering of Specialty Therapies Attracts Buyers

The evolving theme for 2011 in specialty pharmacy acquisitions is that “buyers are strongly drawn to companies that have developed [expertise in] multiple therapies — not just one or two — and have developed strong contracts,” says Dexter Braff, president of The Braff Group, an investment banking firm specializing in home health sectors — essentially, factors that “help mediate margin compression.”

That said, there are some specific specialty therapies drawing more interest than others:

(1) **IVIg:** There has been “an explosion of interest” in intravenous immune globulin, says Braff. Although IVIg has been available for some time, there is “greater interest now,” he asserts, “perhaps due in some part to elder clinical modalities.” The therapy is being studied in Alzheimer’s patients, which has “caught people’s attention.”

(2) **New drugs for hepatitis C** (see story, p. 1).

(3) **Hemophilia therapies:** Braff tells SPN that he’s seen “some spiking in hemophilia” interest,

most recently in private-equity firm Enhanced Equity Fund’s deal for Specialty Therapeutic Care (see brief, p. 12), a transaction handled by The Braff Group. The margins in hemophilia “can be stable,” but the business model “has been one that a lot of buyers have to get comfortable with,” he adds. “This is definitely the most patient-centric model we’re aware of.”

Because hemophilia is a lifetime disease, the potential revenues “are huge,” with some patients racking up annual claims exceeding \$1 million. “This is a stable population, with high revenues per patient and high customer service,” he says.

One glitch, though, could be reimbursement, as these patients often are covered by Medicaid, and “some states are better than others” in their payments.

These therapeutic areas, says Braff, “are perhaps the oral oncologics of 2011.”

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One industry consultant points to both recent and potential future M&A activity among drug wholesalers as something to keep an eye on.

2010 saw major activity in the oncology services space by two of the three major drug wholesalers. In June, Cardinal Health, Inc. unveiled a deal to purchase Healthcare Solutions Holding, LLC, which has subsidiaries that offer various services across the specialty industry with a large focus on oncology, most notably P4 Healthcare (*SPN 7/10, p. 1*). That was followed by McKesson Corp.'s purchase of US Oncology, a deal that closed Dec. 30 (*SPN 11/10, p. 1*).

"McKesson/US Oncology and Cardinal/P4 may decide to do something different in the marketplace with regard to specialty pharmacy, infusion suites and/or home infusion," says Elan Rubinstein, Pharm.D., founder and principal of consulting firm EB Rubinstein Associates.

He also points out that the third of the big distributors, AmerisourceBergen Corp., "hasn't made a move, but is unlikely to sit on its hands given that

McKesson and Cardinal just made major oncology-centered acquisitions....I'm waiting to see what AmerisourceBergen does and what they all do to gain competitive advantage."

A spokesperson for AmerisourceBergen tells *SPN* that "in 2011, AmerisourceBergen will continue to lead the community oncology and specialty pharmacy markets by delivering innovative programs and services to providers.

"Our national specialty pharmacy, US Bioservices, will continue to provide continuity-of-care services that help patients receive their medications faster and remain on appropriate therapy longer. And our network of community oncology practices, ION Solutions, will continue to implement practical technologies that help physicians manage inventory more efficiently, receive correct reimbursement and work more collaboratively with payers."

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