
SPECIALTY PHARMACY NEWS

Specialty Pharmacy, Home Infusion M&A Outlook Remains Strong

While most businesses in the U.S. have been impacted by the overall economic turmoil, the issues facing health care services providers, including specialty pharmacy and home infusion companies, will be short-lived, according to one industry expert. Because many of these companies do not rely on lines of credit for their day-to-day operations, they should be able to weather the economic storm. But any that are reliant on borrowed capital to get by may see some rough times ahead.

"The overall economy is certainly a drag on the business world in general, but it's not a substantial drag on health care services providers," says Dexter Braff, president of The Braff Group, a health care mergers and acquisitions (M&A) company. While these businesses' stock prices have been dragged down with the overall market, this is "likely to be short-lived," he says. Although challenges remain, the current economy "doesn't impact the health care services industry the way it affects others," he contends.

"The fundamentals of the past few years are all in place" when it comes to the home infusion and specialty pharmacy industries, says Braff. His firm continues to see "substantial amounts" of M&A interest, activity and demand within these sectors, he tells *SPN*. "There is nothing about this market that says there is a lower need for infusion therapy," he maintains. "The things that have made infusion therapy attractive, none of those dynamics have changed at all." However, private-duty and out-of-pocket home care is an industry that is getting hit, says Braff. This care is "expensive, and patients can't spend as much money" now. "To the extent anyone has exposure to these areas," this is an issue, he asserts.

Overall, Braff contrasts the current economic situation with the downturn of the early 2000s. During that time, he says, technology companies took the brunt of the blow. But "there is a more broad-based issue now," and "anything with a great need for credit" is going to be impacted, he adds. "The real squeeze is on capital."

This bodes well for the health care services industry, as these companies "for the most part" are not "capital intensive," he contends. And while many of these firms have a need for credit, he says, "they are not

relying on credit to get by, to conduct business on a day-to-day basis... Many companies live or die on lines of credit, but that doesn't permeate this industry."

Nevertheless, as lines of credit are being "skinned down," those providers whose lines of credit are coming up for renewal in the short term should expect their renewals to be under "less favorable" terms and "should be hoarding cash," Braff asserts.

Some Private-Equity Firms May Be Affected

Constrained lines of credit may also impact some buyers within the specialty pharmacy and home infusion spaces. "To the extent companies are relying on credit to fund transactions is the extent to which there are greater challenges," says Braff. Private-equity groups have played a "significant role in jump-starting" M&A value in home infusion and specialty pharmacy the past couple of years (*SPN 11/07, p. 5*). For instance, Kohlberg & Co., LLC has been very active in the space (*SPN 2/07, p. 8*), including its finance of the development of Critical Homecare Solutions, Inc. (CHS). MBF Healthcare Acquisition Corp. recently executed a financial commitment to purchase CHS (*SPN 9/08, p. 12*). And in late September, Water Street Healthcare Partners completed an agreement with Gentiva Health Services, Inc. that gave the private-equity firm a controlling interest in CareCentrix (*SPN 10/08, p. 12*).

Private-equity firms make money by investing in companies, building them up and selling them later, Braff points out. "In the financial machinations of private equity, generally speaking, the more debt you can use to finance transactions, the greater your rates of return can be," he explains. By taking this tack, these companies can "enjoy the benefits of leverage."

But now "as debt is constrained, to make transactions work, companies are putting more equity into" deals, he says. And "the more equity they put in, the lower the rates of return that they are generally able to generate. As debt markets become more constricted... to get the returns they are looking for, these companies are now faced with the prospect of preferring to pay less for the companies they are trying to buy. It's interesting because the private-equity guys are beginning to

say, 'We can't afford to pay what we paid in the past because we can't get the rates of return'" that they want.

"It's not that these companies are less valuable, but it's more challenging for these private-equity firms to buy them and get the types of returns they need," Braff says. "To the extent that private equity is a meaningful component of the buying community — which it is — this creates downward pricing pressure."

Still, says Braff, there are "many potential buyers without these mechanisms in the background. They are not trying to create leverage, they have cash on hand, and they are not encumbered by these types of restraints."

And certain private-equity groups may be "open to the notion" of financial deals that predominantly involve equity and then "going back later and recapitalizing the transaction" when the debt markets open up, he says. "By leveraging the investment later [i.e., with borrowed money], after the deal is done, they get the benefits of returns later." Braff adds, however, that this is an "overly simplistic" description of a fairly

complicated approach that not many buyers are choosing now.

Still, he notes that his company has closed more home health care deals in 2008 than it has in any other year, and he expects another three or four more deals before the year is done. "We're adding resources to our organization, not subtracting," he says.

Braff maintains that The Braff Group Composite Index, which measures the stock performances of almost 40 companies in various health care service sectors, is a good indicator of the outlook. "The last time there was a downturn in the economy, the health care service composite index rose dramatically as the market declined. The last bust was formed on technology. People like to retreat to where they are comfortable, and they are comfortable with health care." He says that we may see "another refocus on health care again," although it "may not be as dramatic as what we saw in the flight from technology. Health care is not unexposed, but it is not as exposed as some other industries."

Contact Braff at (888) 922-5169. ✧