HARBOR HEALTHCARE CONSULTANTS
Mergers & Acquisitions

Market Outlook

2019 LONG-TERM CARE PHARMACY

There is another exciting year ahead for the long-term care (LTC) pharmacy M&A market. Before we look into the crystal ball, let's recap the prior year and catch up on current trends. First, consolidation continued among payers and providers. When it will end, nobody knows. What we do know is that companies are seeking to lower costs and minimize risk through this vertical integration. Next, we saw an increased appetite for businesses providing services outside of skilled nursing, particularly behavioral health and assisted living. There are caveats to completing these deals (more on that later) but this demand offers new opportunity for pharmacies and their shareholders, not previously available. Last, technology continued to play a critical role in the LTC pharmacy market. Companies increasingly sought new technology solutions to reduce costs, consolidate data, enhance value, and improve patient outcomes. Now that we are up to speed, let's turn our eyes forward to likely 2019 trends.

As competition grows increasingly fierce and value-based contracts continue to administer reimbursements, corporate strategy will play an increasingly important role in the success of an enterprise. Customer service that goes above and beyond, access to capital for technology and acquisitions (both defensive and growth based), and strategic partnerships are now mandates; no longer just differentiators. The complex framework of the sector makes blue ocean innovation a rarity. Organizations must provide positive outcomes, deploy technology, expand services, anticipate industry changes (i.e. PDPMs, rebates, legislation), and take defensive action against competitive forces, not only to grow market share but to maintain their existing footprint. M&A consolidation in the LTC sector during the past two decades required many mature companies to reinvent their business models to prevent or postpone the premature decline of their business lifecycle. Companies today, must have a comprehensive strategy across the entire C-suite (and beyond) to improve performance drivers. This includes driving down costs and driving up value.

"Any effective enterprise vision must embody the core ideology of the organization, which in turn consists of two distinct parts; core values, a system for guiding principles and tenets; and core purpose, the organization's most fundamental reason for existence."[1]

> ***Companies that enjoy enduring success have core values and a core purpose that remain fixed while their business strategies and practices endlessly adapt to a changing world.[1]***

The M&A activity within larger organizations highlights the priorities that embody today's corporate mandates and strategy. While size does influence dynamics, the fundamentals remain the same, whether evaluating public, private, middle market or large-cap business transactions. The acquisition of Express Scripts by Cigna and BrightSpring to PharMerica (KKR) clearly demonstrates that contracts, pricing models, and patient services are major factors in current strategies.

No longer are larger acquirers seeking pure EBITDA plays. In the current market, an acquisition target must satisfy a swath of performance criteria and synergies for consideration, and to warrant exceptional valuation. At the same time, sellers are seeking a compelling exit scenario, with advantages beyond simple liquidity. Successful LTC pharmacies and related businesses require years to build and extreme attention to detail and service. Owners and their shareholders acknowledge this fact, and are looking for creative and alternative deal structures when they go to market.

In addition to strategy, value-based contracts are playing a pivotal role in the industry. Last year, value-based contracts were anticipated to have a major effect on the market and now those predictions are starting to prove true. As this wave of activity rolls out across the nation, it will afford opportunities to owners and shareholders that previously were not available. As an aside, with more financial sponsors continuing to enter the space, sellers must be cognizant of how platform business transactions can have different dynamics than add-on acquisitions. The clinical and regulatory pieces of a pharmacy transaction are critical, and both buyer and seller must understand how they fit together to achieve a successful close and subsequent integration.

Overall healthcare M&A activity reached record levels in 2018 and it is expected to rise through 2019. Size and quantity of LTC transactions will continue to increase with the overall healthcare M&A activity, as long as reimbursements and legislation do not significantly disrupt the space.

Looking at the economy more broadly, GDP has been on a consistent upward trend since 2009. Fueled by low interest rates, fiscal engineering and stimulus, many economists feel that the economy is approaching recession. While the healthcare sector is generally insulated from economic ebb and flow, the M&A market is not. Access to capital and risk management play a vital role. Private and public debt are at historically high levels and the economy must continue to grow in order to manage these obligations. In fact, many private firms are investing in healthcare as a diversification strategy, to mitigate risk in case of a downturn. If an exit is in an owner's 3-5 year plan, now is a good time to review their options.

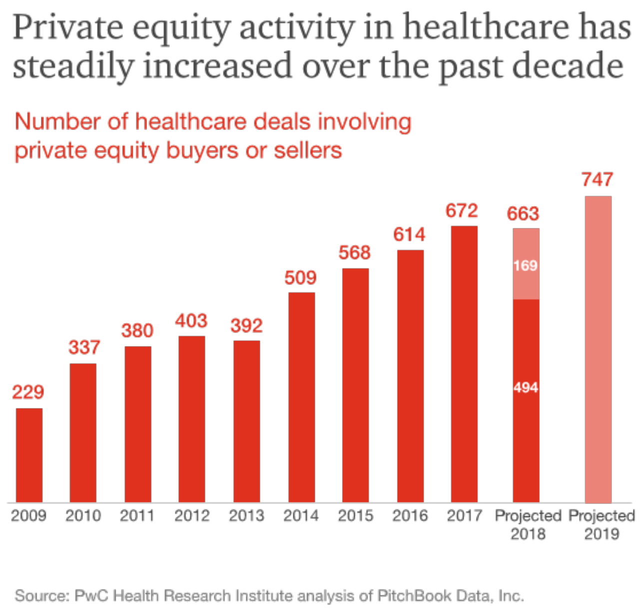

Figure 1 https://www.pwc.com/us/en/industries/health-industries/top-health-industry-issues/pe-in-healthcare.html

[1] (Collins, James and Jerry Porras. "Building Your Company's Vision." *On Strategy*. Harvard Business Review. Vol.1, 2011)

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