



2021 THE TIDES HAVE TURNED FOR COMPOUNDING PHARMACY M&A

Last year the healthcare sector served as a beacon of hope in the shadowy global economy due to the COVID-19 pandemic. As a subsector of healthcare and an essential business, some pharmacies grew from the pandemic, while others experienced a v-shaped yearly performance; many businesses recovered from part or all of their downtrends by year end. While the worst appears to be over, the surge in M&A demand for healthcare companies, will be a lasting opportunity for pharmacy owners as well.

Many strategic acquirers that experienced a decrease in earnings last year are energetically pursuing acquisitions to improve revenues and diversify their services. Private Equity (PE) groups are also aggressively pursuing pharmacy investments (See Figure 1), increasing demand, boosting valuations and offering unique short and long-term opportunities for sellers. The best part of this heightened interest and activity is, after many years of waiting for the market to shift in their favor, compounding pharmacies are in strong demand.

For much of the last decade, compounding pharmacies encountered headwinds in the M&A markets. A combination of high government scrutiny, a few bad actors, and other challenges, resulted in suppressed demand and valuations. However now, as more companies are disrupting the traditional pharmacy service model and competition grows fiercer, acquirers are diversifying

their integration strategies and expanding their acquisition mandates. Further, the demand for specialty drugs is forecasted to continue rapid growth. In this new landscape, compounding pharmacies are well positioned to capitalize on these new integration strategies and growth.

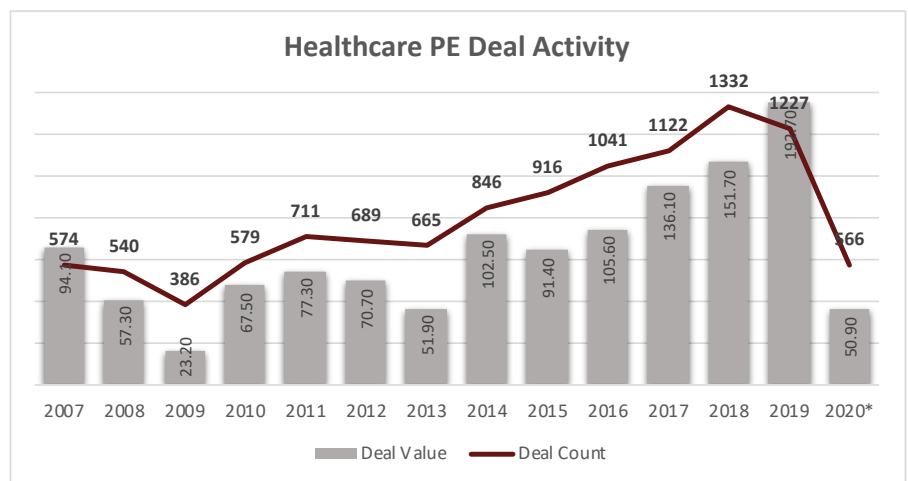
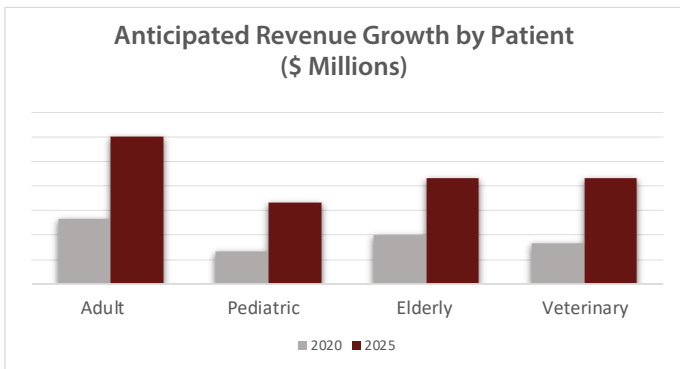


Figure 1 – The Healthcare PE Investment Landscape - Assessing key investment characteristics, capital flows, and performance in a burgeoning space, PitchBook. (September, 2020). Geography: North America & Europe. * As of August 13, 2020

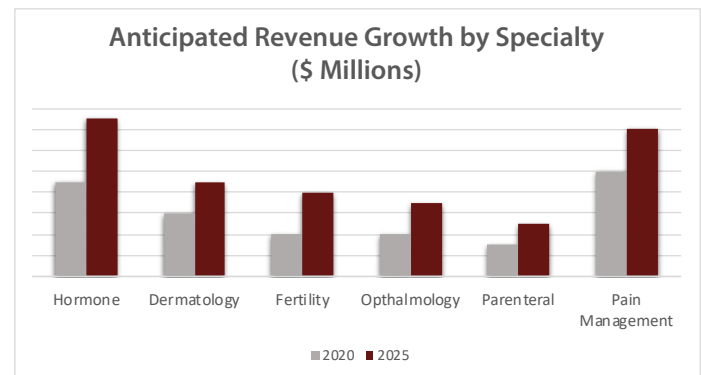
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As with all segments of pharmacy, achieving an attractive exit valuation is not without its challenges. Many factors influence the demand and valuation a compounding pharmacy will fetch in the marketplace. Size, revenue model, drug therapy mix, accreditation, geographic location, contracts and market share are just a few value drivers in a potential sale or partnership. During the peak of the pandemic last year, many businesses that did not experience a performance decline, received very attractive valuations and sold above asking price. Now, demand is still high, taxes are low and capital is inexpensive, but valuation is evaluated more on the merits and long-term growth of the company. Buyers are seeking stability in this new landscape rather than access to a feverish customer base or other defensive corporate strategies.

Strategy plays an important role in any M&A transaction and while the margins and revenue channels in compounding are attractive compared to other segments, they rarely represent pure-play EBITDA acquisitions. With only 7% of independent pharmacies nationwide identifying compounding as their primary operation in 2020¹, buyers and sellers must achieve short and long-term synergies to validate a potential deal. The barriers that historically existed in healthcare between providers and patients due to geography

and location are rapidly disappearing. Telemedicine and digital pharmacy are changing the landscape across all sectors of healthcare, for businesses big and small. Nowadays, no discussion about the future of pharmacy is complete without mentioning the name, Amazon. Larger pharmacies fetch higher multiples and while access to markets and customers generally provide immediate benefits to both buyer and seller, achieving breakthrough success requires a long-term growth plan that may include new specialties, geographic regions, contracts, and licenses. Whether the pharmacy is USP 795/797/800 or 503B, the financial objectives of the deal rationale must not overshadow the strategic objectives, and vice versa.



The US compounding pharmacy market exceeded \$4.8 billion in 2020 and growth in the segment is anticipated to continue above 5% compound annual growth rate (CAGR) for several years². Growth in the space is skewed among different patient groups and specialties. It is no secret that pediatrics and hormone replacement specialties are growing and will continue to do so in the coming years. What is not so certain, is how regulatory criteria may stymie future growth in the segment. Consequently, it is imperative that owners

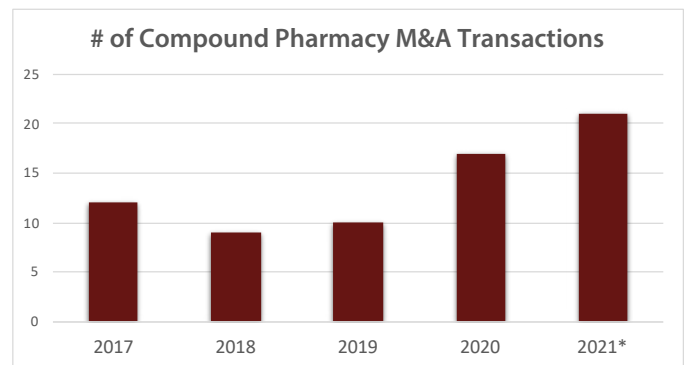
stay ahead of potential pitfalls via adaptation, partnerships, technology, and adding services to their strategic initiatives. For example, while hormone management serves as a strong revenue generator today, pharmacies must diligently pursue markets (veterinary, fertility, ophthalmology, etc.) that will give rise to new, robust revenue channels that can amplify growth and mitigate the risk of industry headwinds through diversification. Compounding is a uniquely fragmented segment of pharmacy, and as such businesses can differentiate themselves more easily to create long lasting opportunities.

The pandemic impacted healthcare and pharmacy in many ways; positive and negative. The methods in which patients receive care changed and some of those changes are here to stay. Retail pharmacy proved resilient to many of the long-term impacts of the pandemic, and once business and patient care return to some semblance of normalcy, the squeeze from big-business competitors will become fiercer than ever. Rapid access to new markets and patients through M&A is a key component to evaluating any strategic acquisition. Healthcare buyers are pursuing horizontal and vertical integration blueprints to multiply their revenues and decrease their expenses. Compounding pharmacies have waited for market demand and growth models to manifest in M&A opportunities, that time has finally arrived.

References

¹ 2020 NCPA Digest Report. National Community Pharmacists Association. (October, 2020).

² U.S. Compounding Pharmacies Market. Global Market Insights. (February, 2021).



*2021 Forecast based on survey of strategic and sponsor activity in compounding pharmacy

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