HARBOR HEALTHCARE CONSULTANTS
Mergers & Acquisitions

Market Outlook

2022 LONG-TERM CARE PHARMACY

HOW THE PANDEMIC, PRIVATE EQUITY, FACILITIES AND SPACS IMPACTED LTC PHARMACY VALUES, COMPETITION, AND BEYOND

If you are reading this, you're likely seeking an answer to the popular question: "How has the pandemic impacted the value of my business and how will it affect the industry going forward?" In early 2021, many self-proclaimed soothsayers claimed pandemic impacts would lift in Q2 2021. Then that date was postponed to Q3 2021, then Q4, and so on. Today, most agree that the world we share with this new virus is a world that is here to stay. As the spotlight on healthcare continues to shine brighter than ever, there is no denying the surge in M&A activity demonstrates how competition, Private Equity (PE), and integration are influencing market share and values within the entire LTC subsector.

Looking back, Harbor Healthcare advised on a record setting number of LTC pharmacy transactions in 2021. Pent up demand and low cost of capital contributed to marketplace fever as owners sought to maximize their position in an unprecedented economy. Activity was so strong that the LTC pharmacy sector attracted attention from SPACs and some pharmacy valuations were seen exceeding 45% and beyond previous levels, in some circumstances. Although the financial profiles of many LTC pharmacies were (and many still are) under a COVID cloud, owners still achieved the full enterprise value for their company (pre-COVID level); receiving credit for business that had not yet recovered. While skilled nursing services shouldered the greatest impact and longest recovery from the peak of the pandemic, behavioral health and assisted living experienced a more rapid rebound.

Deal volumes and values in healthcare industries increased between 2020 and 2021 by 32% and 65%, respectively.[4]

> ***LTC pharmacy valuations are significantly higher now than they have been in previous years due to pandemic and market dynamics.***

An understanding of the current LTC pharmacy M&A market requires more than simply transaction and valuation analysis. Now there are added forces at play due to the pandemic, augmenting market complexity. Buyer and seller objectives are more diversified, the desire to complete deals is more urgent, upstream and downstream impacts are greater in caliber (more on that later), and the broader economy is exerting more pressure on strategic mandates.

Healthcare industries saw increased M&A from PE funds that accounted for approximately 49% of deal volume (a 47% YOY increase) and 54% of deal value (a 109% YOY increase) in 2021.[4] A marked increase compared with the average over the previous five years of 33% and 28%, respectively.[4] If an 'unprecedented' pandemic creates 'unprecedented' opportunity for healthcare sellers, record valuations, and buyer activity, then this window of opportunity is not to be missed.

If an unprecedented pandemic creates opportunity for healthcare subsectors that generates record buyer activity and valuations, then this is an opportunity for sellers not to be missed.

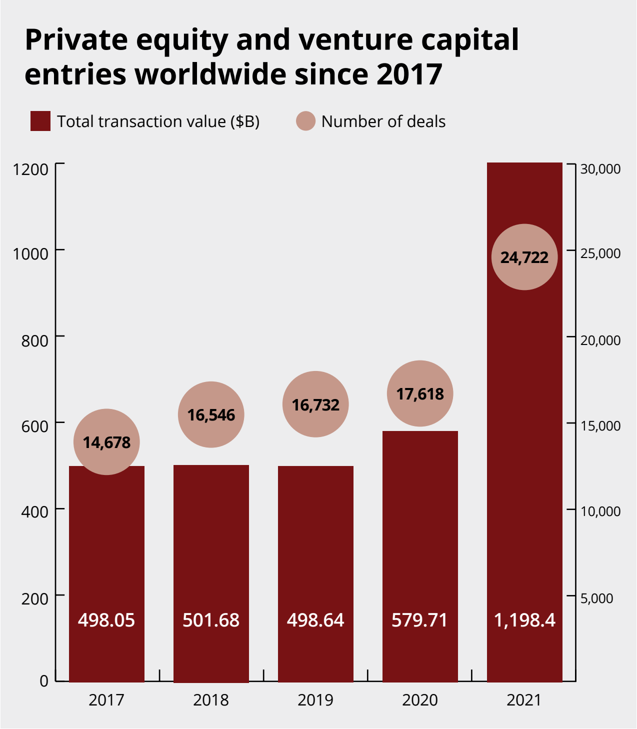

Figure 2- https://www.themiddlemarket.com/news-analysis/deal-valuation-re-visited-how-pe-is-coping-with-high-deal-multiples

> ***For years, there were no pure health services IPOs, but 2020 saw two, and 2021 has seen eight. This count excludes SPAC-backed IPOs, of which there have been at least a dozen in the 12 months through November 15 — two were classified as megadeals.[4]***

Across all sectors of healthcare, the name of the game is integration. Payers continue to integrate vertically, and health systems continue to expand to capture more of the continuum of care. Digital health consolidation impacts patient engagement dynamics and choices about who payers and providers partner with or ultimately acquire. Amazon, Divvydose, Best Buy, Oracle, Mark Cuban; they all want a piece of the action.

By far the most popular M&A subsector of healthcare services is in facilities, as valuations and volume continue to push higher. The activity is expected to continue through 2022 as many believe the subsector has turned a corner. With so much capital entering the space, things are likely to get frothy until interest rates, regulatory action or broader economic pressure create a bottleneck.

With facilities attracting more buyers and consolidation carrying on at a rampant pace, ripples will turn to waves upstream in LTC pharmacy. As the facility subsector consolidates and integrates, contracts for LTC pharmacies will become more challenging to secure. Larger facility chains will continue to make acquisitions and independents will grow fewer and farther between (literally). Chains will exert greater pressure on pharmacy margins as they demand value added services including: advanced technology, multi-state dispensing, and standardized patient services. For independent, single-entity LTC pharmacies, competing for contracts requiring pricing at a loss, will grow more frequent, not less, as competitors swell with economies of scale.

Health services deal volume, value and growth, by target subsector

Volume LTM 11/15/21		Value ($B) LTM 11/15/21	Growth (LTM 11/15/21 vs. 2020)	
			VOLUME	VALUE
374	Other services*	$114.2	53%	315%
102	Labs, MRI & Dialysis	$27.1	62%	374%
445	Long-term care	$18.6	26%	132%
137	Home health and hospice	$12.7	63%	252%
66	Hospitals	$9.2	(16%)	181%
47	Managed care	$7.2	114%	2%
114	Behavioral care	$5.7	56%	103%
407	Physician medical groups	$5.5	119%	55%
81	Rehabilitation	$3.4	145%	408%
1,773		**$203.5**	**56%**	**227%**

Source: LevinPro HC and LevinPro LTC. wwwlevinassociates.com
*Other services includes a broad range of companies such as contract research organizations, ambulatory surgery centers, home infusion services companies, and medical office buildings.

Figure 3 - https://www.pwc.com/us/en/industries/health-industries/library/health-services-deals-insights.html

For many entrepreneurs, a significant portion of their net worth is tied up in their business. The pandemic exposed those owners and shareholders to great potential losses of their business and their net worth. LTC stood at the forefront of those impacts and without government intervention in the form of PPP loans or other COVID relief packages, many companies would have closed. An important lesson, that highlights the need for owners to de-risk their business and their portfolio. The world is no longer in a transient pandemic state. This is the new normal and contingencies are more crucial than ever before. Whether census' return to pre-pandemic levels and when, is anyone's guess. Some LTC pharmacies already returned to previous performance levels (often assisted living and/or IDD) while others experienced greater losses and still have a way to go (aka skilled nursing). What is clear however, is home health, patient-at-home, and new telehealth practices are here to stay. We are watching and experiencing the many ways in which technology creates tidal shifts in pharmacy and it will continue to further disrupt business models.

What happens if a major chain you are servicing pulls their pharmacy services inhouse?

Two of the largest impacts on LTC pharmacy M&A is the surge in Private Equity activity and the expansion of large regional players. The head count for consolidators in LTC pharmacy has increased recently and geographic growth is a crucial driver for these organizations. They cannot grow organically alone and need M&A to achieve their strategic mandates. As these bigger pharmacy chains eat up competition and move across the nation, they ink deals with facility chains that are also swallowing up their independent counterparts. This leapfrog M&A activity between facilities and larger LTC pharmacies will continue to impact independent, single-entity LTC pharmacies: they are more prone to suffer from market share scarcity and feel the squeeze of competitive advantages from larger pharmacies. The pandemic proved that the bigger you are, the more resilient you are and the faster you can recover, allowing you to take advantage of low-interest rates and a booming broader economy.

In summary, the pandemic generated unprecedented buy-side demand and attracted new buyers to healthcare. The drive to treat patients at home shifted the strategic initiatives for many and dramatically increased the significance of digital health. As PE funds seek to capitalize on this landscape, competition for healthcare businesses is fierce, boosting multiples and valuations. Long-term care experienced record activity and valuations in 2021 that will continue through 2022. As facility chains snatch up their competitors through M&A, upstream independent LTC pharmacies are going to experience negative impacts from this rampant consolidation during the next five years. Competition in LTC pharmacy is growing more bloodthirsty and organic growth more challenging. In an era of low interest rates, an advantageous tax environment, and frenzied buyer demand, many sellers are pursuing exits. If an LTC pharmacy owner is considering an exit in the next five years, now is an opportune time to plan their approach.

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