2013-14 Economic Report on Retail, Mail, and Specialty Pharmacies

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Pembroke Consulting, Inc., and Drug Channels Institute

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Dr. Fein’s popular and influential Drug Channels website (www.DrugChannels.net) is the go-to source for definitive and comprehensive industry analysis, delivered with a witty edge. He has published hundreds of academic and industry articles, and is regularly quoted in such national publications as The Wall Street Journal, The New York Times, USA Today, Pharmaceutical Executive, and many others. He serves on the editorial advisory boards of Pharmaceutical Commerce and Drug Benefit News.

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Drug Channels Institute (DCI), a division of Pembroke Consulting, Inc., is a leading provider of specialized management education and computer-based training for and about the pharmaceutical industry.

Drug Channels Institute links Dr. Fein’s years of expertise and cutting-edge analysis—such as this 2013-14 Economic Report on Retail, Mail, and Specialty Pharmacies—with online e-learning modules.

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INTRODUCTION AND GUIDE TO THIS REPORT

Over the past year, the $278 billion pharmacy industry has continued to evolve. Generic substitution rates hit new highs, depressing revenue growth but boosting profits. Specialty drugs grew to account for more than 20% of the industry’s dispensing revenues, leading more companies to pursue this fast-growing market. The two largest drugstore chains—CVS Caremark and Walgreens—created or expanded novel generic sourcing operations. Walgreens, which is building a global presence with Alliance Boots, made an unprecedented equity investment in AmerisourceBergen, one of the largest wholesalers. Industry consolidation increased as the largest players continued to acquire smaller competitors and adjacent businesses. Meanwhile, the launch of healthcare reform promised new business, but reduced margins.

Amidst this change, understanding the implications of the industry’s evolution has never been more crucial. The 2013–14 Economic Report on Retail, Mail, and Specialty Pharmacies is the most comprehensive tool available for analyzing the economic and business realities of the U.S. pharmacy industry. It provides an up-to-date, fact-based analysis of the pharmacy channel and its interactions with other participants in our healthcare system. I have synthesized a wealth of statistical data, research studies, financial information, and my own unique business consulting experience into a definitive, nonpartisan resource.

The report is essential for pharmaceutical manufacturers, wholesalers, pharmacists, pharmacy owners, benefit managers, managed care executives, healthcare policy analysts, investors, consultants—anyone who wants to understand and benefit from this ever-changing industry.

After reading the 2013–14 Economic Report on Retail, Mail, and Specialty Pharmacies, you will be able to:

- Describe the U.S. pharmacy industry’s overarching structure
- Identify the largest participants in the pharmacy industry
- Distinguish the different dispensing formats for prescription pharmaceuticals
- Identify key participants in the specialty pharmacy market
- Explain the services specialty pharmacies provide to patients, manufacturers, and payers
- Explain the factors influencing the pharmacy industry’s growth
- Compare growth trends among different dispensing formats
- Describe the relationship between Pharmacy Benefit Managers (PBMs) and pharmacies that participate in a PBM’s network
2013-14 Economic Report on Retail, Mail, and Specialty Pharmacies

- Explain how third-party payers affect a pharmacy’s economics
- Summarize the four primary methods of estimating a pharmacy’s ingredient costs
- Distinguish among services that pharmaceutical wholesalers provide to larger and smaller pharmacies
- Identify typical per-prescription profit margins of generic vs. brand-name prescriptions
- Explain why and how pharmacy profitability from a generic drug varies over its lifecycle
- Distinguish between the profitability levels of retail vs. mail pharmacies
- Define key trends affecting the pharmacy industry’s future

This year’s report has been completely updated, revised, and expanded. It contains the latest financial and industry data, along with detailed information about the strategies and market positions of the largest public companies—CVS Caremark, Express Scripts, Rite Aid, Walgreens, Walmart, and others. The table below highlights the major public companies operating in the pharmacy distribution and reimbursement system.

**Major Public Companies Operating in Pharmacy Distribution and Reimbursement System**

<table>
<thead>
<tr>
<th>Company</th>
<th>Stock Ticker</th>
<th>Primary Role</th>
</tr>
</thead>
<tbody>
<tr>
<td>AmerisourceBergen Corporation</td>
<td>ABC</td>
<td>Pharmaceutical Wholesaler</td>
</tr>
<tr>
<td>Cardinal Health, Inc.</td>
<td>CAH</td>
<td>Pharmaceutical Wholesaler</td>
</tr>
<tr>
<td>Catamaran Corp</td>
<td>CTRX</td>
<td>Pharmacy Benefit Manager</td>
</tr>
<tr>
<td>CVS Caremark Corporation</td>
<td>CVS</td>
<td>Chain Drugstore/Pharmacy Benefit Manager</td>
</tr>
<tr>
<td>Express Scripts, Inc.</td>
<td>ESRX</td>
<td>Pharmacy Benefit Manager</td>
</tr>
<tr>
<td>McKesson Corporation</td>
<td>MCK</td>
<td>Pharmaceutical Wholesaler</td>
</tr>
<tr>
<td>Rite Aid Corporation</td>
<td>RAD</td>
<td>Chain Drugstore</td>
</tr>
<tr>
<td>Walgreen Company</td>
<td>WAG</td>
<td>Chain Drugstore</td>
</tr>
<tr>
<td>Walmart Stores, Inc.</td>
<td>WMT</td>
<td>Mass merchant with pharmacy</td>
</tr>
</tbody>
</table>

Beyond updating all data and information from previous editions, the 2013-14 report includes many new elements, such as:

- Additional quantitative comparisons of alternative dispensing formats
- New analysis of emerging global generic purchasing organizations
- Expanded information about retail clinics
- Expanded competitive analysis of pharmacies that dispense specialty drugs
- New information on manufacturer copayment offset programs
- New estimates of PBMs’ profitability for handling different prescription types
- Updated discussion of pharmacies' growing role in the 340B discount program
• A list of acronyms and abbreviations used throughout the report (page 167)

This report will help you master the latest facts about the complex interactions within the pharmacy distribution and reimbursement system (pictured below), such as:

• **Product movement**, which traces bulk distribution from pharmaceutical manufacturers to the drug wholesalers that supply pharmacies. A pharmacy marks the final step in which a prescription is dispensed to a patient.

• **Financial flows**, which transfer money from third-party payers to Pharmacy Benefit Managers (PBMs), who in turn reimburse pharmacies. Funds flow to manufacturers via pharmacies, which purchase drugs from wholesalers.

• **Contractual relationships**, which govern the relationships between: 1) payers and PBMs; 2) PBMs and pharmacies; 3) pharmacies and wholesalers; 4) wholesalers and manufacturers; and 5) manufacturers and PBMs.

The U.S. Pharmacy Distribution and Reimbursement System

In the following eight chapters, the *2013-14 Economic Report on Retail, Mail, and Specialty Pharmacies* analyzes the economic relationships between and among the industry’s participants:

• **Chapter 1: Industry Overview** (page 8) defines the industry, explains different pharmacy industry participants, distinguishes among outpatient dispensing
business models, identifies the biggest pharmacies and their national and regional market shares in 2013, and quantifies 2013 market share for pharmacy dispensing of specialty drugs.

- **Chapter 2: Changes in Pharmacy Industry Structure** (page 26) quantifies U.S. spending on outpatient drugs and analyzes the industry’s recent growth trends, including differences among dispensing formats, the surprising resilience of independent pharmacies, the slowdown in mail dispensing, and the expansion of retail clinics and medication therapy management services.

- **Chapter 3: Prescription Prices and Pharmacy Benefits** (page 41) examines trends in third-party payment for prescription drugs, presents average prescription prices for top-selling brand and generic drugs, identifies the key elements of pharmacy benefit design, analyzes consumer copayments and coinsurance, and explains the impact of manufacturer copayment offset programs.

- **Chapter 4: Relationships with Pharmacy Benefit Managers** (page 52) identifies the PBM industry’s key participants, explains the services provided by PBMs to third-party payers, reviews the crucial role of PBMs in pharmacy economics, and describes the relationship between PBMs and pharmacies that participate in a PBM’s network.

- **Chapter 5: Prescription Reimbursement by Third-Party Payers** (page 69) explains the latest methodologies for computing a pharmacy’s revenue from a brand-name, generic, and specialty prescription. This chapter compares and contrasts traditional list price methods with emerging acquisition cost reimbursement approaches. It also explains how prescription reimbursement, formulary rebates, and consumer copayments affect plan sponsor costs.

- **Chapter 6: Relationships with Pharmaceutical Wholesalers** (page 94) explores the interactions of pharmacies with their primary suppliers of drugs. It explains wholesalers’ channel role, identifies the largest wholesale suppliers, distinguishes between the acquisition cost dynamics for smaller pharmacies vs. self-warehousing chains and large mail pharmacies, and analyzes the new relationships between the largest pharmacies and the largest wholesalers.

- **Chapter 7: Pharmacy and Prescription Profitability** (page 109) unites the reimbursement and cost discussion from Chapters 4, 5, and 6 by presenting the latest data on pharmacy and prescription profitability. This section documents overall drugstore profitability, pharmacy margins for prescriptions, the profit
differences between brand and generic prescriptions, and PBM profits from network and mail pharmacies.

- **Chapter 8: Economic Trends and Outlook** (page 121) analyzes five significant trends that will impact the retail, mail, and specialty pharmacies:
  - Healthcare Reform and Prescription Demand
  - The Changing Generic Marketplace
  - The Narrow Network Revolution
  - Capturing the Specialty Opportunity
  - Pharmacy Participation in the 340B Discount Program

As always, I welcome your comments and feedback. Please contact me if you have any questions or comments about the 2013–14 Economic Report on Retail, Mail, and Specialty Pharmacies.

Adam J. Fein
January 2014

P.S. You can find this report’s post-publication errata here:
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