PHARMACY OCTOBER 2010

JRx proficies

Welcome to the Spring edition of JR Proficies.

With Spring all is new again including a minority Labor Government hamstrung by the support of independents. Generally you would expect this type of Government to struggle to create meaningful change as disaffected minority interest groups are potentially disproportionately represented.

But while only time will tell if this translates negatively for our National interests it should prove favourable for the Pharmacy Industry as it hopefully will ensure that no new remuneration shrinking initiatives (excluding the "MoU" which was a deal done pre-election) created by bureaucrats are capable of enlisting majority support from a legislative perspective.

And just as well given recent months have seen many retailers including Pharmacies experiencing their worst growth results in memory (JB Hi-FI being one notable exception). While many reasons are cited, including the GFC and the US's inability to recover from it, slowing growth in China and last year's stimulus package not being replaced, there has been very little recognition that customers purchasing decisions are driven by choice just as much as circumstance.

This has been acutely highlighted in a recent edition of Retail Insights published by ACRS (The Australian Centre for Retail Studies) where the following various local and international retail survey results were reported,

JRx pharmacy

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1. 91% of respondents view service as important
2. 58% are willing to pay more for better service
3. 9% is the average of just how much more
4. Over one-third of respondents would buy more online if customer care and advice was as good as that found in-store
5. More than half said the range of products stocked online was better than in-store
6. 86% said the ability to find what they wanted online was better than in-store
7. Aldi hit a 12 month high in customer satisfaction of 91.1% ahead of Coles 86.4%, IGA 85% and Woolworths 84.3% (Pharmacy Brands compared favourably with the top 9 rating between 86.7% and 90.1% based on a recent Roy Morgan Poll).

Translated it means customers will not pay a premium for service(s) levels that do not exceed those of lower priced competitors including those online. Being able to navigate a store and find what they want easily is considered a key component of service. Price differences of over 10% on KVI (known value items) matter and pricing can not be a set and forget exercise.

Moreover it means that consumers are being communicated to through multiple channels and many expect to be able to relate to their product/service providers online and via mobile communication devices. As such Retailers (including Pharmacies) who continue to ignore the web and its relevance to bricks and mortar retail do so at their own peril.

Conversely though if experiences and services provided are highly valued and differentiated from competitors then price rates low in terms of customer focus and decision making priority. Importantly it is these same retailers who then manage to achieve growth.

Of course, achieving real growth (ie customers and items sold) should be every retailer's primary focus. Inside Bruce explores this topic which serves to highlight the importance of engaging the various programs and funding available within the current Guild Government agreement as they become available.

Also to support Bruce's crystal balling activities, Norman takes a look back on some of our 2010 client results to see what was achieved and what it means for future expectations.

Finally we say congratulations to two JR clients (refer back page) who recently won Entrepeneur of the year awards. One is a Pharmacist and one a medical Philanthropist but they have a common business connection through a device I am sure the Industry will be hearing much more about in months to come

Enjoy this edition and please provide any feedback or queries directly back to your JR Pharmacy Partner.

Mark Nicholson

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The year that was...

The 2010 financial year began quite buoyantly however I am certain most of you would agree that the second six months of the year were somewhat flat. Customers have become more selective about when and where to spend their money with the sleeping issue being the on-line options now available to those customers focussed on 1. Convenience and 2. Price.

Trends

The JR Pharmacy client base averages for the year ended 30 June 2010 largely reflect what we were being told anecdotally as the financial year came to a close. A summary of the key performance indicators generated by clients using JR.Bizlink show:

	2010 series (interim)	2009 series	2008 series	Comment
Sales growth	1.75%	0.63%	8.43%	Customer & script driven but FLAT
GP $ growth	2.69%	2.92%	13.44%	Generics driven
Overhead growth	2.34%	13.60%	10.66%	Slowing
Script growth	0.26%	1.04%	5.19%	Aust. Av. Circa 3%
Customer Number growth	(0.88)%	1.83%	3.24%	Switching

The trends are apparent with flat script growth and customer numbers on the downward turn. Recalling my article in the September 2009 edition, growth was strong in the first quarter (and half for that matter) but these results show a sharp decline the latter half of the year. Based on client feedback this seems to have continued into July and August. Certainly a later than usual flu season and a sharp decline in influenza vaccinations has negatively affected the 2010 results compared to 2009.

The economic cycle is contributing to customers avoiding getting scripts filled. High fuel prices, increases in interest rates, no additional Government hand-outs and job security are all influencing customer spending choices.

Based on the data for the year ended 30 June 2010, generic discounts on average now make up a staggering 43% of EBIT. This may well increase in the current 2011 year as generic deals present, but the flow on price adjustments will eventually be felt through the WADP & MoU implementation.

'Pushing' the overhead button is not the answer to maintaining profitability. In fact it produces the worst result for retail businesses when compared to increasing the average sale per customer. In fact if wages are reduced below optimum efficiency levels there becomes less staff to service customers. This means it becomes increasingly difficult to deliver points of differentiation over EDLP (every day low price) competitors.

Low service levels therefore mean the customer is given little alternative but to shop and compare on price alone.

Where is the growth?

Based on the category data in JR.Spacelink, the major losses in pharmacy were in what I call 'other' retail categories - the front shop lines that customers can get from many other retail channels. These categories were in fact down by 5.5%. Meanwhile, the schedules and general medicines were flat with no growth.

Based on the anticipated growth in script volume in pharmacy over the next 5 years, it is clear that engaging in initiatives that improve medication compliance and assist customers via healthcare programs that form part of key categories will reduce focus on price and determine whether community pharmacy creates "wins" against competition over and above the traditional differentiator of convenience.

Script growth will come from adding value via interventions and compliance programs, whether that be through self initiated processes or Guild endorsed/Government funded programs. Using dispensary traffic as a starting point for customer interaction and not the only point is imperative to fostering the evolution needed to not only survive but successfully grow.

Norman Thurecht

JR Clients Win Entrepenur Awards

Johnston Rorke congratulates its clients Mr Stuart Giles and Dr James Morton who won their respective categories in the Ernst & Young Entrepeneur of the Year awards for the Northern Region. Both now proceed to the National finals.

Interestingly their business interests cross over with Mr Giles operating national hospital pharmacy group APHS and Dr Morton providing specialist Oncology services to some of the centres serviced by APHS. Mr Giles is currently working with Dr Morton's business to trial an innovative device which combines web technology, text messaging and medicine delivery via automated sachets to increase transplant patient's medication compliance.

While Mr Giles' award was received in the Services category recognising the Entrepeneurial contribution of APHS to the Healthcare sector, Dr Morton's was for Social Entrepeneurship.

Dr Morton has over the last seven years spent a considerable amount of his personal time establishing AEIOU which is Australia's largest provider of early intervention care to autistic children. The full-time program is designed to provide autistic children the skills to successfully complete the rest of their education in mainstream schools.

Each centre is staffed with full-time specialist early childhood teachers, speech pathologists, occupational and music therapists. Astonishingly, 70% of children from AEIOU centres transition successfully to mainstream schools, with the majority requiring little or no additional support.

Determined to make AEIOU available to all autistic children, including those from low income families, Dr Morton developed the 10-40-600 fundraising strategy. Currently, there is a $10,000 funding gap for the $40,000 it takes to place a child at an AEIOU centre for 12 months. AEIOU seeks individual and corporate donations to close the gap. The investment provides an average lifetime cost saving of $600,000 for each year a child participates in the program. JR is one of 40 sponsors and have been supporting AEIOU since its inception.

Dr Morton's funding strategy has enabled rapid expansion, with AEIOU opening six regional centres across Queensland in the past five years with further plans to extend this model into NSW in the near future.

Mark Nicholson

The case for growth

Few pharmacy owners and groups are yet to take appropriate steps to protect their businesses from rampant price competition, radically changed consumer behaviour and the future dispensing profitability reductions compliments of WADP (Weighted Average Disclosed Price) adjustments.

I realise many owners have and will continue to ignore these realities because generics profitability has so far covered up lost business and rising overheads. Based on latest JR Pharmacy Services client data the average gross profit dollars received per PBS script has risen to $14 on average compared with $10 five years ago, largely because of generics. With that sort of profit increase it is not surprising that pursuing 'real growth' strategies has not been important.

What is 'real growth'?

Generating 'real growth' is vital because warehouse pharmacies and the 'copy cats' are driving customers away from traditional community pharmacies who, in turn, are left with an over-reliance on PBS dispensing with generics propping up the bottom line.

By comparison 'real growth' is about achieving sales and net profit (EBIT) growth by increasing:

- customer numbers;
- script numbers;
- retail (non Rx) sale per customer; and
- gross profit dollars faster than growth of overhead dollars.

The age-old strategies of lowering prices, catalogue promotions and even convenience are no longer enough to guarantee growth and certainly not profitable growth for the majority. Many owners seem to almost assume customers will keep walking in the door.

To achieve 'real growth' a robust and coherent customer focused plan is required which comprises thought-through strategies by owners and key staff. The elements of such a plan I have been writing, discussing and speaking about for many years.

So let's take a closer look at the key challenges and why pharmacists should care about going for 'real growth'.

WADP will reduce generic dollars

Because of the WADP adjustment measure, plus additional price cuts in 2011 and 2012, the average income per script being received now compared with year ending 30 June 2015 is expected to be roughly the same.

However, in the intervening years it can be expected to grow because of major drug patent expiries, such as Crestor and Lipitor, providing pharmacies with additional generic discounts greater than estimated price cuts.

But, beware! In three or four years from now much of the generic largesse will be pulled back by the price disclosure mechanism.

The following table shows the increase/(decrease) in PBS dispensing gross profit dollars and overall pharmacy net profit between year ended 30 June 2010 and year ending 30 June 2015, for four different types of pharmacies. It assumes no growth in script numbers, S2 and S3 and retail, while retail margins are held at current levels.

Pharmacy[1]	2010 v 2015 GP$ growth[3]	Overheads increase[4]	Net profit Impact[5]	Rx growth break even[6]
City suburban strip	$30,000	$139,000	($109,000)	4.1%
City shopping centre	$72,000	$390,000	($318,000)	4%
Regional strip	$84,000	$240,000	($156,000)	3.1%
Rural/provincial[2]	($14,000)	$199,000	($213,000)	3.8%

Therefore in from 2014 onwards (unlike recent years), generics will not be able to rescue traditional community pharmacy bottom lines from falling customer and script volumes nor cover overheads growth which, as usual, continues to grow (particularly in wages and rent).

And let's not forget: when profit falls so does cashflow—the lifeblood of any pharmacy business—particularly for those with large bank debt obligations. Critically, lower profitability usually equates to lower pharmacy values and without script growth the value of the four pharmacies would fall by between $975,000 and $1,987,500!

Pharmacies should do whatever they reasonably can to continue lifting substitution rates without causing customer confusion or concern. But in the meantime, pharmacies that want to maintain financial viability in the longer term must adopt a growth culture and begin implementing a 'real growth' plan now. Becoming dependant on generics as the only profit strategy will end in fast-falling profitability as my calculations demonstrate.

Attracting customers

The other significant factor is shifting consumer behaviour and the impact this has on the market place.

Only a 'real growth' plan will help achieve the required break-even script volume growth of 3.1-4.1% per year for five years. And such a plan must offer consumers with reasons to come that are not price-based.

The starting point is understanding consumer behaviour and what's driving it. The latest Australian Retailers Association Consumer Spending Confidence Report dated August 2010 suggests likely future consumer trends and the key elements of the survey results relevant to pharmacy are:

a) 61% of respondents are uncertain about the times ahead and 65% agreed that saving was more important than spending.
b) 55% shop at a different store based on price rather than convenience.
c) 52% spent a lot of time researching prices online before buying.
d) Over past 12 months respondents reduced their spending across all retail categories.
e) Over the last 12 months 34% reduced their spending on gifts and little will change in the next 12 months.
f) OTC medications and vitamins should see little change during the next 12 months although an interest rate increase will likely lead to a significant reduction in spending.
g) Prescription medication spending will likely be maintained.

And the rise of the mobile internet (smart phones) means customers can research anything, anytime and anywhere it suits them! Not surprisingly, smart retailers, including one well-known warehouse pharmacy group, have already extended their web systems with iPhone capability.

What these findings should mean to you are:

a) Cautious and risk-averse customer are looking to maximise their dollar spend.
b) Low-price retailers do well – supermarkets and warehouse – as long as they can back up the customer strategy with a well-executed low-price operational strategy.
c) There is an online opportunity to promote what the pharmacy stands for while increasing customer convenience.
d) It's no longer purely about the bricks and mortar store.
e) Achieving growth won't happen just by being there.

Future starts today

There are three-to-four years available by the end of which your real growth plan must be firmly entrenched AND working. The big price cuts kick in during 2013/14 and 2014/15 financial years and, in the meantime, customer defection to the competition must be stemmed.

Therefore, it means starting now! Going for real growth is today's imperative if most community pharmacies are to remain relevant and financially viable.

Assumptions re: Table Projections

1. Pharmacies selected from the JR Pharmacy Services client base.
2. Rural/provincial pharmacy substitution rate of 95% is at maximum now.
3. Factors in increasing substitution rate for existing generics, MA price cuts 2011 and 2012, wholesaler trading terms reduction and modelled price reductions caused by price disclosure rules.
4. 2009/10 financial year overheads increase by only 3% pa.
5. Represents between 33% and 50% of 2009/10 pharmacy total net profit.
6. Required prescription growth rate each year for five years compounded to ensure net profit does not fall during the next five years.

Bruce Annabel

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AEIOU 40km Fundraising Walk

Thank-you to those who have supported JR Partners Mark and Nigel towards their 40K walk to raise funds and awareness for the AEIOU Foundation which provides early intervention services for children with autism. Their challenge is to help eliminate the funding shortfall that exists for a child placement in one of their development centres.

Johnston Rorke is a long term supporter of AEIOU and and Mark and Nigel raised over $14 000 for this walk on October 17. If you want to help or know how they are going in the fundraising stakes then please visit the fundraising website at **http://aeiou.org.au/hiker-profile/mark-nicholson-and-nigel-fischer-38**

JR Pharmacy Financial Management Training

The growth in Australian pharmacy retail sales has been patchy for most of the last 12 months. Pharmacy has not been immune to the broader economic cycle now being experienced in Australia. Customers have choice and are exercising that choice on where to spend their money and how to spend including 'bricks and mortar' shopping and 'on-line' options. Price has become a key determinant in how they spend their money and capturing this is requiring more focus by the retail participants. The commencement of the PBS reforms reducing the price of molecules in the dispensary through the 'weighted average disclosure price' mechanism will see the profitability of the dispensary come under attack in the future. Without understanding the ramifications of the externalities affecting pharmacy in the current environment it is difficult to change the strategic and operational approach to running a pharmacy.

To help combat this, JR Pharmacy Services is proud to offer a 2 day training course to owners and managers of Australian retail pharmacies. Run by our own Norman Thurecht, the 2 day course will be delivered in a workshop style format with a mix of lecture, discussion and worksheets to allow attendees to prepare their own calculations. Visit **www.jr.com.au/pharmacy** for further information on the course and to complete an expression of interest form if you are interested in attending one of the sessions we will be running over the next year across the country. Hope to see you there.

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The Future Generation of Pharmacy Owners?

Along with Mark, Norman, and Ian, I have enjoyed spending five weeks in August putting something back into the Pharmacy Profession by presenting lectures and tutorials to over 200 Sydney University 4th year Pharmacy students on essential pharmacy management skills.

We covered a variety of pharmacy specific management topics, including:

- basic accounting skills
- financial and cash flow statements
- financing & KPI's
- space and stock productivity
- mark up and gross profit calculations
- basic valuation principles

The students also taught me something as I now know that "LVR" not only represents "Loan to Valuation Ratio" but also "Left Ventricular Repair".

Thanks to all the students and Professor Lesley White who organizes the subject for their ongoing enthusiasm to prepare themselves for a successful career in business management.

Annette Ivory-Barker

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