PITCHER pharmacy

PITCHER PROFICIES

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A publication examining Pharmacy business issues

What's in this issue?

A word from the editor

By Mark Nicholson

Economic Outlook

Welcome to Pitcher Pharmacy's summer edition newsletter. A new Community Pharmacy Agreement combined more recently with a change in Prime Minister has provided a significant boost to Pharmacy's economic outlook.

Improved confidence however needs to be acted upon in order to achieve the potential benefits as it is important to understand that gross profit per script will still decline from its present position over the course of the new agreement. Inside this edition we forecast our expectations for the next five years which put simply means that a 10% -15% decline in GP$ per script will need to be countered by a 10%-15% increase in volume (approximately 3% p.a.) in order to maintain status quo.

Fortunately script volume growth forecast within the 6CPA exceeds this requirement but it remains to be seen whether it will be proportionally spread across all Pharmacies during this period. Delving into the forecasts reveals an expected 35% growth in "under co-pay" scripts which is a category in which we expect to continue to witness aggressive price promoted competition.

Moreover it is against this backdrop that Pharmacy owners must devise a pricing strategy that protects margin but does not compromise volume over the longer term. It will come as no surprise that our long held view remains – that the efficient delivery of services by Pharmacists is key to enhancing relevance/value such that margins and customers are not unnecessarily eroded by warehouse competitors.

Unfortunately the above challenges are potentially amplified by the recent announcement (followed by a subsequent deferral) of an intended up-scheduling of over the counter codeine products. As such it is imperative that all of the above impacts are considered when acquiring a business (or an interest in one) or preparing profit and cashflow forecasts to support business plans.

Inside this edition Norman explores the above in more detail while Felicity overviews both the impact of the recently announced FTA (Free Trade Agreement) with China and the recent "Women In Pharmacy" events Pitcher Pharmacy hosted at Sydney and the Gold Coast.

We have also included a copy of Bruce's recent AJP article "But it's only $1...isn't it?" for those who may have missed it.

As always please call your Pitcher adviser should you have any queries in relation to this newsletter's content.

Why average is not average anymore!

By Norman Thurecht

The recently announced completion of the 6th Guild/Government Agreement is very positive for pharmacy owners, customers and staff as it provides increased trading certainty for the next 5 years.

The 6th Community Pharmacy Agreement has created a level of certainty for community pharmacy over the next 5 years. However, competition for the customer remains high and the impact on dispensary margins needs to be closely managed when combined with:

1. the commencement of the $1 co-payment discount from 1 January 2016,
2. the removal of certain high volume items from the PBS (e.g. Panadol Osteo), and
3. the continual slide in the price of molecules through price disclosure.

Pleasingly, the decision on up-scheduling Codeine has been deferred but if implemented would put further pressure on margins.

Under 6CPA the increased dispense fee and introduction of the AHI fee have assisted in underpinning a fair remuneration/ profit on molecules with a dispensed value of less than $25.

We are however witnessing a disparity in the overall benefits from the 6th Agreement depending on the type/location of a pharmacy. The graph below highlights the monthly movement in GP$ per script as a total (red line) and also separated by type/ location of pharmacy for the period June 2015 to October 2015 (inclusive).

It is evident that all locations experienced an increase in GP$ per script over the period. The benefits of the first few months were then eroded in October with the most recent cycle of price reductions (further outlined below). The net result however is that GP$ per script at October 2015 remained higher than June 2015 (i.e. the last month under the 5th Agreement).

Based on the data, medical centre pharmacies enjoyed the most significant increase in GP$ per script over the period. This outcome is due to the higher proportion of large volume low cost molecules being dispensed in these locations. (Medical centre pharmacies have an average dispensed medicine price at or below $30. Therefore, the removal of the mark-up being replaced with the AHI fee the GP$ increased disproportionately more than the other types of pharmacies.)

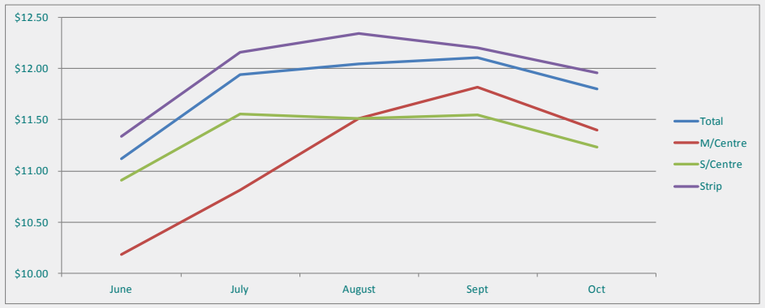
Conversely, strip and shopping centre pharmacies benefited less from the implementation of the 6th Agreement because of the number of higher value molecules being dispensed through their businesses. These pharmacies had an average dispensed medicine price of over $32 for the period, meaning the benefit of the AHI fee flowing into the remuneration mix for low value scripts in these pharmacies was offset by the reduction in mark-up lost on medicines with a dispensed value above $25.

The flatter profit curve achieved by shopping centre pharmacies is also influenced by the ongoing pricing strategies/tactics adopted by various shopping centre pharmacy brands. The success of this strategy/tactic though is defined by whether there is enough volume increase (or protection against volume loss) to justify the more aggressive price position?

As noted earlier, other factors that will have an impact on the total GP$ for the whole industry are the January 2016 option for up to a $1 discount of the co-payment and the removal of some high volume / low cost items from the PBS. The pricing strategy of each pharmacy may therefore impact volume. The questions is whether you have fully considered the financial outcome each of these decisions will have on both the GP$ in the dispensary and retail (OTC) sections of the pharmacy.

It is apparent that dispensary GP$ are now less influenced by the types and volume of molecules dispensed (as they were under the previous Agreement) but more by commercial pricing decisions where flexibility exists. Outlined below is the impact on the GP$ of the 26% price reduction on 1 October on the 40mg Atorvastatin from $8.41 to $6.20. The net into store price on the generic will decrease from about $5.47 to $4.03 assuming the generic manufacturers hold their current percentage discount level.

From the analysis on the right, it is evident that the downward pressure on trading terms continues to impact GP$ per script and will do so until such time as the "net into store" price finds its eventual bottom (which will likely be once supplier discounts settle at 10% or less). At that point there will be little difference in GP$ between dispensing the generic or originator.



In conjunction with the already discussed changes we are also witnessing a 5% to 10% reduction in general script volume as ongoing price reductions force many script prices to fall below co-pay or alternatively customers shift into other script categories in the pharmacy (e.g. concessional, entitlement, private etc).

Buried in the detail of the 6th Agreement is the forecast script growth over the 5 year term of the Agreement. The graph below highlights the forecast overall volume compound growth of approximately 3.75% p.a. While growth is stronger in the latter years script volume nevertheless is forecast to increase annually from FY17 onwards. Of most interest however, is the expected 35% increase in the emerging highly competitive market of below co-pay scripts.

The competitive nature of the market and constant focus on "product at price" promotion is in general, reducing the net profit and cashflow of pharmacy businesses. While there has been a reprieve in the last few months - afforded by the positive changes arising from the 6th Agreement funding arrangements - the impact from the three items mentioned above commencing 1 January 2016 will for some pharmacies erode all recently accrued improvements. As such it is imperative that the likely outcome is projected prior to making or agreeing to any price reducing decisions.

Understanding that for most customers their local pharmacy represents a convenience retailer (hence it is the dominant determinant in the value equation as opposed to price), managing customer health expectations and outcomes must be the most important objective. Getting the customer to shop more often, trafficking through more of the store and buying more as a result of advice and service related to managing their health condition is the only viable solution that will drive growth to replace income from future declining margins.

Atorvastatin 40mg	Pre October 2015 6th Agreement		Post October 2015 6th Agreement	
	Branded	Generic	Branded	Generic
Dispensed Sale				
List Price (PTP)	8.41	8.41	6.20	6.20
Dispense Fee	6.93	6.93	6.93	6.93
PFI	1.72	1.72	1.72	1.72
AHI	3.49	3.49	3.49	3.49
Total Dispensed Sale	**20.55**	**20.55**	**18.34**	**18.34**
GP$				
Dispense Fee	6.93	6.93	6.93	6.93
PFI	1.72	1.72	1.72	1.72
AHI	3.49	3.49	3.49	3.49
Trade Terms (0% for brand & 35% generic)	-	2.94	-	2.17
Total GP$ (assuming no co-pay discount)	**$12.14**	**$15.08**	**$12.14**	**$14.31**
	59.08%	**73.38%**	**66.19%**	**78.03%**

(Assume no trade terms on the originator at end of 5th Agreement and under 6th Agreement as not compliant with volume and no PFI available once 6th Agreement commences)

Downsize admin & build your business

By Annette Ivory-Barker

"Reinvent the Administration Wheel" with Pitcher Pharmacy's External Management Accounting Solution (EMA). PP's External Management Accounting (EMA) Solution is now over two years old and here are just a few of the benefits enjoyed by our progressive group of users:

- Reduction in staff/space requirements
- 24 -7 access via the internet from anywhere
- POS integration for invoice and end of day procedures
- Environment friendly electronic document management
- Knowledgeable helpful support team
- Meaningful monthly/year to date consolidated reports including KPI's and benchmarks
- Monthly "ABA" files for electronic payment of suppliers

Allow us the opportunity to work with you to deliver a change management solution that not only provides savings but streamlines internal processes allowing you to focus on continual business improvement.

Contact Annette to find out more about our EMA Solution.

But it's only $1...isn't it?

By Bruce Annabel

The flexible $1 co-payment seems to have a lot of pharmacists confused, so here's what you need to know.

The most discussed topic in pharmacy at the moment is the flexible $1 co-payment, so I have decided this month to write about it instead of the subject flagged in last month's column, 'achieving practice change'. I'll return to that in December.

So, it's only $1 and that doesn't sound like much, right? Wrong, because a small reduction in dispensary income can have a big impact on net profit. So it isn't just a $1!

The conundrum

Not passing on the $1 co-pay discount may lead to some patients defecting to those pharmacies that do, while passing it on will have a significant impact on profit, valuation and cash flow.

The most impact will be on those pharmacies with a high number of concession patients, and/or those operating marginal businesses, and pharmacies with high overhead structures and debt levels. Those within the immediate vicinity of a warehouse pharmacy will be highly susceptible as the warehouse below co-pay concession patient market share is relatively low. Clearly their goal is to attract concession patients away from traditional community pharmacies.

> Those within the immediate vicinity of a warehouse pharmacy will be highly susceptible...

Others likely to embrace the opportunity include the quasi/faux convenience discounters, because they play in the price market and will have little choice but to follow suit.

Upping the ante even further for traditional community pharmacies, I understand that two national banner groups have decided to pass on the $1 co-pay discount in full. While I'm not overly surprised, because both verge on being faux discounters anyway, they display the highest overhead and capital cost structures in the industry meaning many members may suffer as a result of this head office decision.

The reality is that within two months the discount will commence and all pharmacies should have a policy in place by now and inform their most valuable patients well before the 1 January kick off.

Impact

Based on my calculations, if the $1 co-pay discount is passed on in full to both concession and general patients, the impact per script (all scripts) will be around 50c per script on average. Therefore a pharmacy dispensing 60,000 scripts per annum stands to lose about $30,000 pa of net profit and cash flow, while valuation would fall by, say, $150,000 to $167,000 or more depending on the circumstances.

If the reduction is accorded only to concession patients, I estimate the loss would be around 40c per script on average, reducing the effect to $24,000.

Each pharmacy's circumstance will vary which behoves owners to make their own assessment. And now.

On the flip side is the profit impact of losing valuable concession customers if the $1 reduction isn't passed on. Because many of these patients struggle to make ends meet, the reduction, particularly if they have, say, six scripts per month filled, will give them a saving over 12 months of $72. Such a patient generates each year about $2800 total pharmacy sales and $1100 gross profit dollars meaning only 22 such patients need to defect permanently before the pharmacy reaches break-even compared with passing on the $1 only to concession patients. In the case of losing customers with three scripts per month the impact would be $550 loss of GP$ and equivalent to losing 44 patients permanently.

It's possible the $1 co-pay may become another Known Value Item (KVI) like Panamax 100 that customers shop around for and use to assess whether a pharmacy is expensive or not. It's not about the $1 price difference with KVIs so much as the perception of value in comparison with other retailers.

I suspect many owners are feeling emboldened by the short-term profit/cash uplift provided by the 6CPA$3.49 AHI fee since 1 July, believing it provides the financial leeway to pass on the co-pay discount. But, this leeway is temporary because cuts in wholesaler and generic discounts on 1 October plus the cuts coming on 1 April 2016 will remove the great majority of the benefit. Cutting the co-pay by $1 will see all the temporary AHI benefit gone by 1 April 2016. Then, the 1 October 2016 'super cycle' price cuts will remove any balance remaining, plus a lot more.

What should you do?

Not all pharmacies play in the price market and in the case of traditional community pharmacies there are some other options worth considering. Overall it's important to have a systematic and easily understood policy.

1. Do nothing – defence is the best form of attack. These owners believe holding firm may see the loss of one or two patients but overall be far better off while avoiding going with the discount flow.

Some owners I know have made this decision justifiably because in the mind of the patient their offer is so tangibly different and superior to all competition in their market place. They have chosen to dominate in the following four areas which have nothing to do with price:

- Quality premises standing for health;
- Stock the products customers want;
- Health solution service and services delivering patient health outcomes;
- Highly skilled people, with pharmacists 'always out the front' engaging and connecting with patients.

IRI-Aztec shopper view informs us that the top three reasons a patient chooses one pharmacy over another are location convenience, product range and health services. Price is not the overwhelming reason for store choice for the great majority of customers.

2. Don't discount the general co-pay as a rule.

3. Perhaps discount concession co-pays on a selective basis only, although this option may run into trouble due to inconsistency in application.

4. Select the most price-sensitive SKUs discriminating between price sensitive chronic medications and less price sensitive acute items.

5. Don't reduce every item by the full $1 choosing to focus on certain lines.

6. Explain to customers that it'll take longer to hit the safety net. For some, this will be a significant consideration and for others they will be happier taking the short-term saving.

7. Assuming you relent and give up the $1, consider how you can make up the loss, for example, keep the patient's scripts on file enhancing adherence and return visits, offering them the opportunity to join your loyalty club; join your script reminder service; make use of MedAdvisor; undertake a MedsCheck; develop the pharmacist's therapeutic support recommendations for script patients and minor ailments and/or adjust pricing of non-sensitive lines particularly S3.

There are no doubt other courses of action that some pharmacists may choose to take, whether or not they choose to give up the $1, and which will be determined by their pharmacy's value offer to their customers. Remember, price is what you pay. Value is what you get. You are the arbiter of that value.[1]

Adding the $1 co-pay cut in a market already dominated by excessive price discounting with major price disclosure cuts in the offing will place even more pressure on bottom lines.

Most owners have reacted by cutting staff hours and pharmacists wage rates making a rod for the collective back of the profession and industry.

So that seemingly innocuous $1 flexible co-pay is anything but just $1.

Reference: 1. Mal Scrymgeour, Zumo Retail

Women in Pharmacy Event - Sydney

By Felicity Crimston

The Women in Pharmacy team, together with Symbion, hosted the inaugural networking event at Darling Harbour, Sydney on the 16th October.

The room was filled with enthusiastic female pharmacists and others in the industry. Our two special guest speakers on the evening were Sarah Cobb, from BforB Australia and Marcela Araneda from Retail Pharmacy. Sarah engaged the audience by providing tips on how to network effectively and how to generate quality referrals with various industry representatives. Marcela shared how Retail Pharmacy has transformed from strength to strength over the years.

For those who are unfamiliar, the women in pharmacy events provide an opportunity for females in the industry to network and learn from each others' experiences in an intimate and friendly environment. A follow up event for Sydney will be confirmed in the new year. To keep up to date with our upcoming events, please 'follow' or 'like' our Facebook and LinkedIn pages.

facebook

LinkedIn

FTA Creams Rx

By Felicity Crimston

Ten years after the Howard government began negotiating the China-Australia Free Trade Agreement (FTA), the government and opposition have now negotiated a deal to pass the agreement that was signed in June 2015.

The introduction of the FTA will benefit both Australia and China as businesses will experience an easing of the incredibly prohibitive barriers and tariffs that currently stifle some sectors of trade between the nations. One such sector is pharmaceutical and health and wellbeing products.

Fuelled by domestic safety scandals and an increasingly affluent and rapidly growing middle class, Chinese demand for international brands offering trusted reputations and quality products is growing exponentially. This is particularly the case for products such as vitamins, supplements and baby formula. However, under the current arrangements, imports of such products into China are largely restricted and limited to unsophisticated traders who can only sell to China's free trade zones, where goods are shipped to warehouses and subsequently sold through an e-commerce platform to avoid tariffs. The existing tariffs and duties that currently add up to 45% to the cost of certain products are to be reduced to a single import value added tax of 10%, which will create opportunities for Australian manufacturers and wholesalers by significantly increasing their competitive position.

Due to the restrictions on manufacturers' ability to sell direct into the Chinese markets, an unsophisticated market has evolved. This has seen opportunistic buyers, Chinese tourists visiting Australia, students studying at the nation's universities and Chinese migrants, snapping up box-loads of vitamins and baby formula in local pharmacies, discount chemists and supermarkets and shipping them direct to China. As a result of this increase in retail consumption, Pharmacies have experienced a significant increase in turnover in these product categories in the past few years.

While this has created a super profit situation for backyard traders and indirectly pharmacies in the short term, the removal of import tariffs and trade barriers between the two countries will soon reduce or eliminate this opportunity in favour of manufacturers. The door now opens for manufacturers like Blackmores who will soon be able to ship products directly into China. As a result the share price of Blackmores has more than doubled since the June signing of the FTA. These changes will inevitably result in a reduction in gross sales for many pharmacies across the country.

For existing or potential pharmacy owners looking to buy, sell or value a pharmacy, there is a need to consider the impact of the historic sales and profit that is attributable to 'abnormal' volume in these product categories given that this volume is likely to either plateau or decline over the next 12 to 18 months. Valuations should be adjusted to normalise these income streams in light of the likely decline over time. While the opportunity should be maximised for as long as it remains available, savvy Pharmacy owners should also factor such declines into forecasting and budgeting and ensure that over performance in these product lines is not masking underperformance in other retail categories.

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