PITCHER pharmacy
ACCOUNTANTS

PITCHER PROFICIES

WINTER 2016

A publication examining the issues for our clients

What's in this issue?

A word from the editor

By Mark Nicholson

Welcome to the PP Winter 2016 Newsletter; keeping you up to date with industry changes and their future impact on Pharmacy businesses.

As you will be aware, the coalition has been returned to Government by the slimmest of majorities but without control of the Senate. This is potentially a good outcome for Pharmacy businesses and customers as it arguably reduces the risk of any negative policy changes given the likely ongoing need for minor party support (eg. Nick Xenophon who is a strong supporter of Pharmacists). Also it is possible that ministerial shuffling will occur which could translate to a change from the current Health Minister Sussan Ley.

Earlier this year the Australian Pharmacy Professional (APP conference) provided valuable insight into the Government's ongoing influence on Pharmacy's future. Despite Minister Ley's excitement regarding the availability of the 6CPA allocation of $613m (per Appendix B in the CPA) towards Community Pharmacy Programmes with a possible additional $600m, it is now doubtful (given the state of the Country's finances and the projected timelines for trials) that anything close to these combined amounts will be funded within the timeframe of this Agreement.

Significantly, I note the Minister's announcement for the approval of $50m for the Pharmacy Trial Program (which will be applied across three key areas) was already budgeted for over the course of the Agreement. While it is unknown how much of the year 1 budget of $135.1m has been spent to date, I doubt that the Department of Health (driven by the Department of Finance) will allow any shortfall in spend to carry over into later years - and in classic "Yes Minister" style will likely be slow to report and act upon the various trials thereby delaying the proposed remaining spend. As such, it is not unreasonable to think, from a $1.2bn mooted commitment (approx $45k per Pharmacy per annum), the final result may be as little as $25k per Pharmacy per year - on average.

On other matters, Pharmacy cash flow is currently being impacted by the cost and timing of reimbursement for Hepatitis C drugs. While addressing the management challenge this presents, owners should also consider monitoring their KPIs and benchmarks by splitting out high cost/low margin drugs into a separate department to truly understand sales growth and margin performance across the remainder of the dispensary. POS/GP reporting consideration is also required re: the change of NDSS supply arrangements.

Meanwhile if you are looking to purchase a Pharmacy in NSW, the Govt. has now eliminated Stamp Duty on business acquisitions. This may provide added incentive to consider restructuring to trade under a company structure where there may be a range of significant cash flow benefits available to help combat ongoing price cuts.

Speaking of which, inside this edition Norman explores the April 2016 price cuts while also projecting forward to consider the expected October reductions. Both pose challenges for Pharmacy valuations and none more so than negotiations involving partnership changes. We have assisted a number of partnerships recently, to manoeuvre through these challenges to ensure fair and reasonable outcomes for both parties over the life of the partnership. For assistance in these types of negotiations or for more information call myself or Norman.

Also enclosed is a previous article of Bruce Annabel's which summarises how to maximise service income opportunities together with a wrap up of our recent Women in Pharmacy event.

Please call your Pitcher adviser should you have any queries relating to the issues raised in this Newsletter.

Diagnose Your Dispensary to Improve the Health of Your Pharmacy

By Norman Thurecht

Pitcher Pharmacy data has once again highlighted that while there are averages there is no such thing as an average Pharmacy; especially when it comes to measuring GP$ returns from the Dispensary.

With the components of the 6th Agreement now well understood i.e. the introduction of the Administration Handling and Infrastructure (AHI) Fee and improved dispensing fees, the industry mood remains quite positive, comparative to that at the end of the 5th Agreement. This may change, depending upon the impact of the next two-price reductions combined with the ongoing effect of discounting the co-payment and individual Pharmacy pricing practices on molecules as they fall in value and outside of PBS funding.

We have previously highlighted that the molecule mix and substitution levels can create different outcomes in each Pharmacy. What is now evident is that, prescription pricing strategies are creating significant differences in financial performance.

Comparisons to averages are only relevant when you understand your own starting position, the impact of each of the price reductions (April and October each year) and any discounting of the co-payment that may be occurring. Depending on this starting position, the outcomes will vary.

Table 1 below sets out the movements in average sale value per prescription, average cost of goods dispensed and the GP$ per prescription. The following points are evident:

1. The average sale value and cost of goods sold, have increased on balance, since February 2016 with the introduction of some highly specialised and expensive molecules;
2. There are some large variations in the GP$ per prescription both on average and individually across the total sample.

The first point is interesting in that, while there has been an impact upon cash flow, the growth in sale value and cost of goods sold, has had minimal impact on the GP$ per prescription. In fact, the total patient care and solution opportunity, connected to conditions such as Hepatitis C, would suggest that these customers should not be ignored.

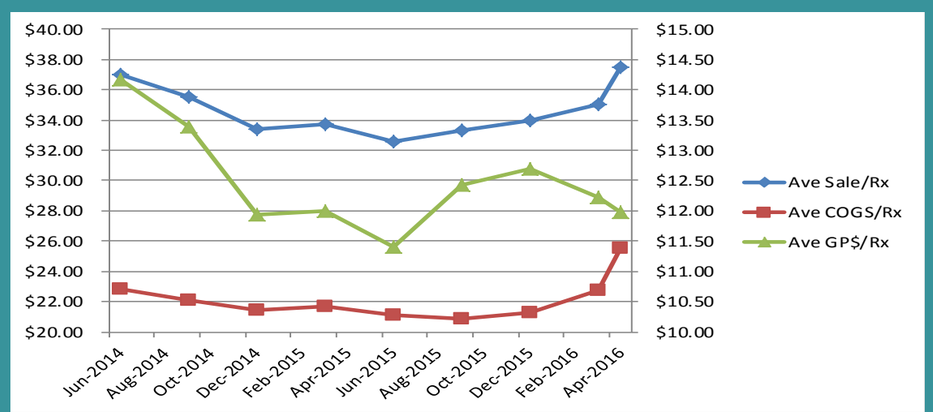
The broader issue surrounding the addition of these high cost molecules to the PBS is that, no new funding has come into the Federal Health Budget and as such, the money for these molecules was merely re-directed from elsewhere. Irrespective of this, with the rising average prescription value, there remains a concern that the Government will at some stage, return their attention to the rising costs of the PBS.

The second point which is occurring in the market is the disparity in returns generated in Pharmacies based on their pricing strategies. For example, the financial benefits from the 6th Agreement can be seen in Table 1, with a rise in GP$ per prescription from 1 July 2015. Price reductions in October 2015 and again in April 2016 however, have seen some of these benefits eroded as Manufacturer and Wholesaler discounts continue to be reduced as the discount is calculated off lower priced molecules.

Importantly, GP$ per prescription is higher now at approximately $12 compared to the month of June 2015 at approximately $11.40. Over the 10 month period ended 30 April 2016, the GP$/Rx was $12.40 compared to the previous full financial year (2015) of $12.15. In other words, this year has seen a rise in the first 6 months before declines in the second half (evidenced Table 1).

The resultant questions are, where is the floor and how do you manage it (given further price reductions) so as to minimise the net profit/cash-flow impact?

TABLE 1



As noted earlier, dissecting different Pharmacies' data reveals significant differences in results. For example, some Pharmacies have seen an increase of over $2 in GP$/Rx since 1 July 2015 while others have experienced a decrease of up to $1 over the same period. Even within National Pharmacy banners, where recommended pricing exists, there are wide variations in GP$/Rx as detailed in Table 2.

TABLE 2

GP$/Rx April 2016 Variation in Performance		
National Banner 1	**National Banner 2**	**National Banner 3**
$14.49	$11.42	$12.05
$11.74	$10.70	$11.85
$10.53	$10.15	$10.83

These results differ by up to 40%. How can this be?

When we delve further into the script data we discover the following items influence the outcome the most:

1. Molecule mix;
2. Number of scripts subject to price competition;
3. Volume of scripts where the co-payment has been discounted by $1;
4. Pricing strategies for acute medications that are below co-payment thresholds.

Although no pharmacy can directly influence the molecule mix, nor can many influence the number of scripts subject to competition, the outcome from the first two items is often influenced by strategies related to the last two points.

Customers are inherently habitual in the way they shop. Most shop on convenience and therefore will tolerate some price elasticity. Therefore managing customer expectations within a price band can influence the GP$/Rx. There is no better example of this than the discounting of the co-payment. The highest achieving pharmacies in the banners above either do not discount the co-payment (despite the banners recommendation to) or do it very selectively while focussing on managing the customer's safety net outcome and relationship.

The clear observation here is the benefit received from the upward adjustment to prices on certain molecules on the overall GP$/Rx.

It is also interesting to note that those pharmacies at the lower end of the GP$/Rx range are not getting exponentially more script volume than any other pharmacy. Therefore, on a cost benefit basis, it may be worth risking a loss of say 5% of script volume for say a 5% increase in prices in order to increase profitability. (I actually do not think you would lose that many customers but a 5% differential in price where possible could make a significant difference in offsetting the coming price reductions).

Importantly, the foundation underpinning dispensing remuneration sustainability (post the next two price cuts) is the indexation growth that was negotiated as part of the 6th Agreement. This is of great benefit to pharmacies that have an increasing numbers of scripts being dispensed throughout the different PBS categories. Unfortunately however, I am seeing most growth in the "General below Co-Pay" and "Private" script categories meaning that indexation benefit will only flow to a reducing percentage of a Pharmacy's existing script volume over the life of the current Agreement.

Therefore, in order for you to contain the effect of the next two rounds of price reductions, it is imperative that each Pharmacy:

1. Understands their current position – script mix and GP$/Rx;
2. Has a considered understanding of what the impact through October 2016 and April 2017 will be; and
3. Have a clear action plan prioritised in order of the items which will deliver maximum benefit.

The last point above has many facets and will differ on a store by store basis. Areas for consideration include

1. Pharmacy branding that matches owners values and professional interests together with customer needs
2. Fit-outs (layout/design) that optimise workflow and customer interaction/store shopability
3. Space requirements that optimise turnover per sqm
4. Strategies for services integration and maximising 6CPA income opportunities as they present
5. Partnerships that deliver business synergies not possible for a sole proprietor
6. Operating structures that maximise cashflow

With the commencement of the new financial year, now is the time to create valuable resolutions. As always we would welcome any opportunity to work with you through this process.

Women in Pharmacy

By Felicity Crimston

On the 13 May, Pitcher Pharmacy together with Symbion hosted our Women in Pharmacy networking evening in Sydney. We were very privileged to have two guest speakers – Linda Miller and Hannah Mann. Linda Miller, a pharmacy business mentor and coach from Pharmacy Profit Secrets, provided tips and strategies on how to motive your staff to sell and be more productive to grow your pharmacy business. Hannah Mann, a co-owner of Kimberley Pharmacy Services, won the 2015 QCPP Pharmacy of the Year, shared her journey and innovative approach to community engagement in an effort to close the gap in health outcomes between indigenous and non-indigenous Australians.

Watch this space for further details of our next event!

Create and keep customers

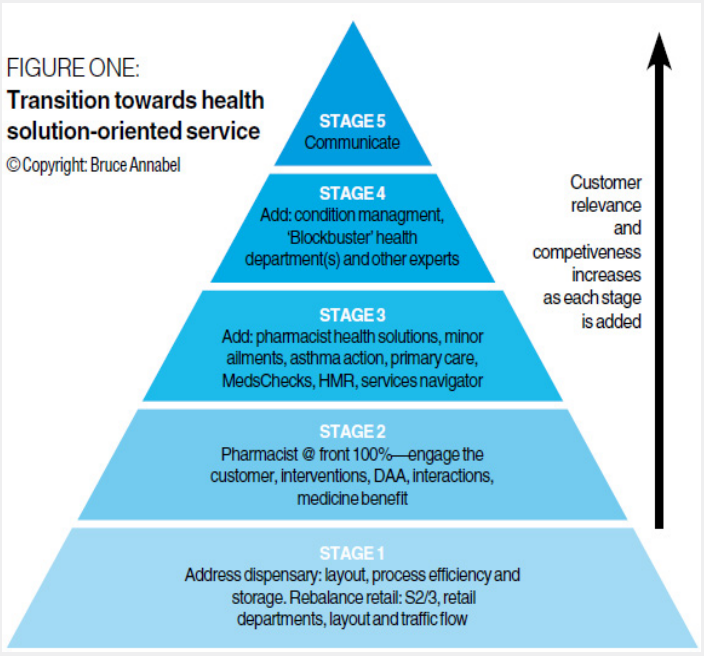
By Bruce Annabel

Creating and keeping customers is essential for pharmacies wanting real growth and an insurance policy against the ravages of disclosed pricing cuts and aggressive competition.

Critical success elements include owners providing leadership and recalibrating pharmacy culture from owner/pharmacist (s) through to part-time assistants.

STAGE 1: First get the physical aspects right to enable the following stages. The dispensary must be designed to speed up prescription processing, save technician time and reduce customer waiting time. It must also facilitate effective and efficient pharmacist-patient engagement at scripts-out and private consulting. Utilise appropriate stock-storage systems to save pick and replenishment time, plus redeploy wall space for S2/3 medicines which is vital. Remove irrelevant retail lines that can't play a part in customer health solutions (eg. gifts, chocolate etc). Ensure a good design so the whole pharmacy is trafficked.

FIGURE ONE:
Transition towards health solution-oriented service



STAGE 2: Move a pharmacist to the scripts-out and medicines section to engage with the customer and deliver basic professional services such as interventions, compliance and so on. Customers love interacting with the pharmacist and give them a reason to return. Dispensary technician(s) swaps with the pharmacist and carries out the processing activities so no extra wages need to be outlaid. Pharmacies of all sizes can do this.

STAGE 3: Ramp it up another level to pharmacist-provided health solutions encompassing a wider range of services and health-giving products, particularly pharmacy's exclusive S2/3 range. The aim is to solve various health problems and delight the customer. Many add another pharmacist at this stage as there are so many opportunities. Recommend services provided in other departments of the pharmacy.

STAGE 4: Pharmacist condition management services are about providing highly specialised services to target customer groups looking for help. Blockbuster formats target specific groups, such as diabetes, wellness, wound care, baby health, sleep apnoea, and usually involve hiring experts such as nurses, nutritionist, naturopath and sleep therapists. Often a fee for service can be charged in addition to maintaining high product margins.

STAGE 5: Tell the market what the pharmacy can do for them, including existing patients and others who are attracted by the offer. Local area marketing and digital are the two vital elements.

Mark Nicholson
Partner
+61 7 3222 8434
mnicholson@pitcherpartners.com.au

Teresa Hooper
Partner
+61 7 3222 8461
thooper@pitcherpartners.com.au

Norman Thurecht
Partner
+61 7 3222 8316
nthurecht@pitcherpartners.com.au

Ian Wessling
Director
+61 7 3222 8315
iwessling@pitcherpartners.com.au

Annette Ivory-Barker
Director
+61 7 3222 8451
aivory-barker@pitcherpartners.com.au

Felicity Crimston
Director
+61 7 3222 8466
fcrimston@pitcherpartners.com.au