Pharmacy Profitability – What’s Over the Horizon?

Don Dietz, R.Ph, MS
Vice President, Pharmacy Healthcare Solutions, Inc.
Disclosure

Don Dietz is an employee of Pharmacy Healthcare Solutions, Inc. The conflict of interest was resolved by peer review of the slide content. He declares no other conflicts of interest or financial interest in any product or service mentioned in this program, including grants, employment, gifts, stock holdings, and honoraria.

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Learning Objectives

Following this presentation, attendees should be able to:

1. Describe the existing technology and automation strategies used by pharmacies to maintain pharmacy profitability.

2. Examine the opportunity, feasibility, and challenges to increasing the “pharmacy services” component of retail pharmacy.

3. Identify future solutions for pharmacy to sustain long term profitability via technology, staffing and new revenue streams.
Agenda

• Current Landscape: Profitability and Reimbursement
• Future Outlook
• Challenges
• Questions
Retail Pharmacy Profitability Attributes

- Net profit is stable at 3.0-3.5%
- Cost of prescriptions is increasing
- Reimbursement rates decreasing
- Pharmacy operational efficiencies, including technology, offset declining rates
- Will this trend continue?

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avg. cost of RX</td>
<td>$66.97</td>
<td>$68.49</td>
<td>$71.27</td>
<td>$75.21</td>
<td>$79.43</td>
</tr>
</tbody>
</table>

NACDS Chain Pharmacy Industry Profile 2011-2012; pg. 54
## Net Profit Over Years

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>76.8%</td>
<td>76.8%</td>
<td>76.2%</td>
<td>76.0%</td>
<td>77.1%</td>
<td>76.8%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>23.2%</td>
<td>23.2%</td>
<td>21.8%</td>
<td>24.0%</td>
<td>22.9%</td>
<td>23.2%</td>
</tr>
<tr>
<td>Payroll Expenses</td>
<td>13.7%</td>
<td>13.5%</td>
<td>14.1%</td>
<td>14.5%</td>
<td>13.4%</td>
<td>13.7%</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.4%</td>
<td>6.5%</td>
<td>6.6%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Total Expense</td>
<td>20.2%</td>
<td>20.0%</td>
<td>20.5%</td>
<td>21.0%</td>
<td>20.0%</td>
<td>20.2%</td>
</tr>
<tr>
<td>Net Operating</td>
<td>3.0%</td>
<td>3.2%</td>
<td>3.3%</td>
<td>3.0%</td>
<td>2.9%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

## Walgreens Sales and Earnings

<table>
<thead>
<tr>
<th>Fiscal year ended Aug. 31 (in billions)</th>
<th>Sales</th>
<th>Percent increase/decrease</th>
<th>Earnings (in billions)</th>
<th>Percent increase/decrease</th>
<th>Net Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>$72.20</td>
<td>0.80%</td>
<td>$2.45</td>
<td>15.20%</td>
<td>3.39%</td>
</tr>
<tr>
<td>2012</td>
<td>$71.60</td>
<td>-0.80%</td>
<td>$2.13</td>
<td>-21.60%</td>
<td>2.97%</td>
</tr>
<tr>
<td>2011</td>
<td>$72.20</td>
<td>7.10%</td>
<td>$2.71</td>
<td>29.80%</td>
<td>3.75%</td>
</tr>
<tr>
<td>2010</td>
<td>$67.40</td>
<td>6.40%</td>
<td>$2.09</td>
<td>4.20%</td>
<td>3.10%</td>
</tr>
<tr>
<td>2009</td>
<td>$63.30</td>
<td>7.30%</td>
<td>$2.01</td>
<td>-7.00%</td>
<td>3.18%</td>
</tr>
</tbody>
</table>
Pharmacy Reimbursement Rates

- Trend towards decreasing reimbursement rates and dispensing fees

<table>
<thead>
<tr>
<th>Year</th>
<th>Retail Brand Avg. % AWP Discount</th>
<th>Retail Brand Avg. Dispensing Fee</th>
<th>Mail-Service Brand Avg. % AWP Discount</th>
<th>Mail-Service Brand Avg. Dispensing Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>17.5%</td>
<td>$1.62</td>
<td>23.3%</td>
<td>$2.33*</td>
</tr>
<tr>
<td>2009</td>
<td>16.4%</td>
<td>$1.57</td>
<td>23.7%</td>
<td>$3.19*</td>
</tr>
<tr>
<td>2008</td>
<td>16.1%</td>
<td>$1.73</td>
<td>23.0%</td>
<td>$2.17*</td>
</tr>
<tr>
<td>2007</td>
<td>16.1%</td>
<td>$1.88</td>
<td>22.7%</td>
<td>$1.62</td>
</tr>
<tr>
<td>2006</td>
<td>15.3%</td>
<td>$1.88</td>
<td>21.9%</td>
<td>$0.24</td>
</tr>
</tbody>
</table>

* When a dispensing fee is paid. Only about 20% of employers pay a dispensing fee on mail prescriptions. True average is much lower.

Adapted from Takeda 2010-2011 Prescription Drug Benefit Cost and Plan Design Report

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Growth in Sales and Dispensing

- First time in a decade that dollars spent on prescriptions decreased

Adapted from Center for Healthcare Supply Chain Research/2013-2014 HDMA Factbook; pg. 74
<table>
<thead>
<tr>
<th>Challenges</th>
<th>Technology Solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Need to improve operating efficiency and maintain profits</td>
<td>• IVR</td>
</tr>
<tr>
<td>• Maintain profitability in face of declining reimbursement</td>
<td>• Bar-code scanning</td>
</tr>
<tr>
<td></td>
<td>• Electronic prescribing</td>
</tr>
<tr>
<td></td>
<td>• POS Interface</td>
</tr>
<tr>
<td></td>
<td>• Workflow management</td>
</tr>
<tr>
<td></td>
<td>• Inventory management</td>
</tr>
<tr>
<td></td>
<td>• Website integration</td>
</tr>
</tbody>
</table>
Pharmacy Profitability – What’s on the Horizon?

- Continual downward margin pressure
- Many technology improvements already implemented
- Labor cost implications
- Pharmacists gaining status as healthcare providers
- Service model integration with product distribution
## Pharmacy Profitability

**Independent Community Pharmacy Viability**

<table>
<thead>
<tr>
<th>Net Profit as a Percent of Sales</th>
<th>Percentage of Pharmacies</th>
<th>2012 Accumulated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating At a Loss</td>
<td>24.3%</td>
<td>24.3%</td>
</tr>
<tr>
<td>Less Than 2%</td>
<td>18.7%</td>
<td>43.0%</td>
</tr>
<tr>
<td>2% to 4%</td>
<td>15.5%</td>
<td>58.5%</td>
</tr>
<tr>
<td>4% to 6%</td>
<td>13.8%</td>
<td>72.3%</td>
</tr>
<tr>
<td>6% to 8%</td>
<td>11.2%</td>
<td>83.5%</td>
</tr>
<tr>
<td>8% and Over</td>
<td>16.5%</td>
<td>100%</td>
</tr>
</tbody>
</table>

2013 NCPA Digest with Financials, pg. 6
Future Reimbursement Themes

• Aggressive network rates create margin pressure
• Reimbursement based on actual costs
• Efficient providers rewarded
• Limited networks today = reduced rates
• Future incentive networks?
  – Increase dispensing fees
  – Bonus payments
  – Improved reimbursement rates based on performance
New Technology Benefits

• Telepharmacy / Telehealth
  – Telepharmacy: Delivering pharmaceutical care via telecommunications (Skype, Facetime, etc.) to patients that do not have direct pharmacist access
  – Telehealth: using telecommunications to provide clinical healthcare distantly, usually by a physician

• Medication synchronization
  – NCPDP developed new submission clarification codes to signify that a shorted days supply is being dispensed
    • Clarification code 47: Shorted Days Supply Fill
    • Approved Msg Code 23: Prorated copay applied based on days supply
New Technology Benefits

• Track and trace
• Automated prior authorizations
• Medication adherence initiatives
• Apps
• Auto-refills
• Others
Pharmacist Wages - Recent Trends

- Pharmacist wage increases have been slowing in recent years.

![U.S. Average Pharmacist Salary Graph]

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Westbrook, Allison; The Average 10-Year Salary of a Pharmacist; eHow
Pharmacytraining.org; Pharmacist Salary 2012
Pharmacist Employment Outlook

• Student pharmacists facing challenging job market
  - Increase in pharmacy graduates
    • 81 pharmacy schools in 2000 vs. 128 today
  - Oversupply in northeast/demand higher in south
  - Predicted that 20% of new graduates will be unable to find work in 2018

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Pharmacist Employment Outlook

• Reasons for possible oversupply issue:
  – Increased and better use of technology
  – Fewer retirees with the recession
  – Shortage of pharmacists in the 1990’s
    • New pharmacy schools opened to meet the demand
    • Pharmacy school can take 10+ years to get going
    • Pharmacy schools expanded class sizes
    • Increase of H1B visas in the 90’s to fill the need for pharmacists
  – Increased role and use of pharmacy technicians
Contrasting Employment View

• Bureau of Labor Statistics expects 25% increase in pharmacist employment from 2010 to 2020\(^1\)
  – Faster than average increase vs. all employment

• Possibly based on:
  – Increased role of pharmacists in clinical services
  – An improved economy could lead to increased retirement of older pharmacists
  – Newly insured individuals under the Affordable Care Act
Pharmacy Employment Outlook: Salary Implications

- Slower growth or flattening of wages
- Bonuses vs. salary increases
- Lower starting salaries
- Upgrading of pharmacists replacing the “license holders”
- Cuts in compensation (salary and/or benefits)
Service Model Challenges: Rx Dispensing vs. Pharmacy Services

- Prescription gross profit:
  - About $12.50 per prescription
- 15 prescriptions * $12.50 = $187.50 gross profit

- MTM Pharmacist services: $2 per minute
- 1 hour MTM = $120

Approximately 50% greater profit dispensing prescriptions vs. doing MTM work
MTM Challenges

• Reimbursement less for MTM than prescription dispensing
• Episodic cases vs. regular activity
• Competition from other MTM providers
  – Nurses, case managers as low as $0.65 per min
• Pharmacy has not embraced MTM, so payers are skeptical about commitment
Conclusions: Expect to See:

• Up to 10,000 pharmacies closing
• Lower labor costs
• Next generation technology enhancements:
  – Central processing / Central fill
  – Automated prior authorizations
  – Pharmacist portability beyond Rx counter
    • Increased used of tablets
  – Telepharmacy
• New revenue streams
Maintaining Profitability

• Lower labor costs:
  – Increased use of technology
  – Telepharmacy
  – Reduce salaries

• New reimbursement methodologies:
  – Acquisition cost-based reimbursement
  – Dispensing fee that is approximate cost to dispense
New Revenue Streams

• Services like immunizations
  – Need a shorter implementation curve
• Pharmacists gaining healthcare provider status
  – Ability to charge for other services
• Clinical services – albeit at lower profit levels
• Apps
• Others??
Questions?

Don Dietz, R.Ph, MS
Vice President
Pharmacy Healthcare Solutions Inc.

968 Perry Highway
Pittsburgh, PA 15237
(412)-635-4650
ddietz@phsirx.com