2015-16 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors

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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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**ABOUT DRUG CHANNELS INSTITUTE**

**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 combines Dr. Fein’s expertise and cutting-edge analysis—such as this *2015-16 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*—into online e-learning modules that offer a thorough grounding in crucial industry topics, all in 45 minutes or less.

These online learning tools mix the latest industry data and cutting-edge analysis with highly interactive elements that engage and entertain. They educate a wide variety of learners: from sales reps and field teams—who need immediate, easily digestible industry concepts for their key accounts—to internal teams who need to better understand customers and channels.


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INTRODUCTION AND GUIDE TO THIS REPORT

In 2015, the role and functions of the pharmaceutical wholesaling industry continued to evolve along with the U.S. healthcare system. This 2015–16 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors provides an up-to-date, fact-based analysis of the U.S. pharmaceutical wholesale industry 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 2015–16 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors, you will be able to:

- Identify the key participants in the drug wholesaling and specialty distribution industries
- Distinguish between specialty distributors and full-line pharmaceutical wholesalers
- Explain the services that wholesalers and distributors provide to pharmacies, hospitals, physician offices, and outpatient clinics
- Distinguish among the services that various wholesalers provide to larger and smaller pharmacies
- Describe manufacturer channel strategies for working with full-line wholesalers and specialty distributors
- Describe the sources of wholesaler compensation and profits
- Distinguish between the buy-side and sell-side sources of gross margins
- Delineate the sources and uses of cash that wholesalers’ business operations generate
- Define the key industry trends shaping the distribution industry’s future
- Assess differences among the Big Three wholesalers’ business organizations, strategies, and financial performance

2015 Trends

For the first time, U.S. drug distribution revenues at the Big Three public wholesalers—AmerisourceBergen, McKesson, and Cardinal Health— exceeded $300 billion. Other notable developments have occurred since we published our 2014-15 report, including:

- Large pharmacy retailers continue to restructure their wholesale relationships, shifting from self-warehousing to establishing direct-store deliveries from a wholesaler. Some of the largest retail and mail pharmacies are also transitioning generic purchasing to wholesalers. So far, Cardinal Health has been most successful at winning these new relationships, due to its Red Oak generic purchasing joint venture with CVS Health.
Consolidation and acquisitions among pharmacies and payers are pressuring wholesaler margins, especially as the acquiring companies consolidate buying power. These deals are also creating significant volume shifts among the Big Three.

New hepatitis C therapies and other specialty drugs are boosting wholesalers’ revenues but challenging their profits. Payers are shifting specialty dispensing into the largest, payer-owned specialty pharmacies, which offer the smallest margins for wholesalers.

Manufacturers’ channel strategies for specialty drugs are reshaping the distribution industry. For pharmacy-dispensed medications, the expansion of limited specialty networks is reducing the value of the wholesale channel. Genentech’s channel strategy change for three of its provider-administered drugs is boosting wholesalers’ profits and increasing revenues at specialty distribution subsidiaries.

Generic inflation, which had boosted wholesalers’ profits, has begun to slow. The pharmaceutical industry is approaching peak generic substitution rates for traditional drugs. Meanwhile, the first U.S. biosimilar drug launched in September 2015.

The Big Three wholesalers continue to alter their businesses with acquisitions. In 2015, Cardinal Health has been the most active acquirer, buying two smaller distribution companies and further expanding its medical business.

Amid these and other changes, understanding the implications of the industry’s evolution has never been more crucial. The 2015-16 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors—our sixth edition—remains the most comprehensive tool for analyzing the economic and business realities of U.S. pharmaceutical distribution.

Structure of the 2015-16 Report

This year’s report has been updated, revised, reorganized, and expanded. It contains the latest industry and financial data, along with detailed information about the strategies and market positions of the largest public companies: AmerisourceBergen, McKesson, and Cardinal Health.

The 2015-16 edition not only updates all data and financial information from previous editions, it also includes many new elements, such as:

- Unified market share estimates for the distribution of specialty drugs by full-line wholesalers and specialty distributors
- Analyses of specialty pharmacies (including both outpatient pharmacies and in-office dispensing by oncology practices) and the key market participants
- A revised primer on the relative profitability of brand-name and generic drugs
- Analyses of how the channel strategies of manufacturers and third-party payers are affecting wholesalers’ performance with specialty drugs
A revised Chapter 6, which now analyzes the forces of change separately for pharmacy-dispensed and provider-administered drugs

New analysis and information on biosimilars

Expanded financial and business analysis of the Big Three wholesalers, which are now covered in three separate, company-specific chapters. The new chapters’ parallel structures allow for easy company comparison.

New material on the veterinary distribution market, which complements our analysis of AmerisourceBergen’s expansion into this market

Updated analysis of each wholesaler’s business segments and underlying business profitability, based upon our proprietary economic models

The report analyzes the industry in nine major chapters. **The chapters are self-contained and do not need to be read in order.** We include extensive internal references to help you navigate the entire document and customize it to your specific needs. There are also more than 200 endnotes, most of which have hyperlinks to original source materials.

Please note that highlighted references are clickable hyperlinks in the PDF document. After clicking a link, use the following shortcuts to return to your previous location in the document:

- Windows: ALT+Left Arrow
- Mac: Command+Right Bracket

A guide to the chapters:

- **Chapter 1: Industry and Report Overview** (page 1) defines the industry, describes business differences between full-line wholesaling and specialty distribution, explains wholesalers’ channel roles, summarizes wholesalers’ obligations under the Drug Supply Chain Security Act (DSCSA), identifies the biggest full-line wholesalers and specialty distributors, and explains recent industry growth trends.

- **Chapter 2: Channel Role for Retail, Mail, and Specialty Pharmacies** (page 15) examines the pharmacy market, wholesalers’ services for smaller pharmacies, wholesalers’ participation in the pharmacy-PBM relationship, and changing relationships between wholesalers and larger pharmacies. This chapter also analyzes wholesalers’ role for patient-administered specialty drugs dispensed by specialty pharmacies.

- **Chapter 3: Channel Role for Physician Office/Clincs and Hospitals** (page 32) examines channels for provider-administered medications, explains the buy-and-bill system for drugs administered in outpatient settings, and describes the role and functions that wholesalers perform for hospitals, including hospitals that participate in the 340B Drug Pricing Program. This chapter also provides an in-depth consideration of group purchasing organizations (GPOs) for both hospitals and physician practices.
• **Chapter 4: Wholesaler Profitability** (page 44) delves into the industry’s income statement economics to explain the underlying sources of drug distribution profits. We decompose buy-side and sell-side gross margin components, and explain distribution service agreements (DSAs) with manufacturers. We analyze overall gross margins and operating profits. This chapter also explains how brand-name and generic drug price inflation affects profits.

• **Chapter 5: Financial Stability and Cash Management** (page 65) provides a detailed analysis of the key metrics that illustrate wholesalers’ overall financial health, including capital structures, debt (leverage), balance sheet assets, cash flow, return on invested capital, and stock market valuation and performance.

• **Chapter 6: Forces of Change for Drug Distribution** (page 76) analyzes 11 key industry trends that will impact the market structure and economics of the pharmaceutical wholesaling and specialty distribution industries. These trends are organized and presented based on wholesalers’ largest customer groups.

• **Company Profiles (Chapters 7, 8, and 9):** In these chapters, we outline the common strategies behind the Big Three wholesalers’ drug distribution businesses and connect these strategies to the themes and topics in the report. The company-specific profiles provide parallel examinations of the Big Three public wholesalers. We scrutinize each company’s business history, acquisition and divestitures, business mix, profitability, largest customers, and company-specific business trends.
  
  o  **Chapter 7: AmerisourceBergen Corporation** (page 100)
  o  **Chapter 8: Cardinal Health** (Page 114)
  o  **Chapter 9: McKesson Corporation** (page 125)

As always, I welcome your comments and feedback. Please contact me if you have any questions or comments about the *2015-16 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors.*

Adam J. Fein
September 2015

P.S. You can find post-publication errata here:

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