

The 2016-17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors

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Pembroke Consulting, Inc., and
Drug Channels Institute

September 2016

Full report available for download at

http://drugchannelsinstitute.com/products/industry_report/wholesale/



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Suggested citation: Fein, Adam J., *The 2016-17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*, Drug Channels Institute, 2016.

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Drug Channels Institute combines Dr. Fein’s expertise and cutting-edge analysis—such as this *2016-17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*—into comprehensive, interactive e-learning modules that offer your team a thorough grounding in crucial industry topics. These online learning tools explain highly complex economic and business data and concepts so you can:

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INTRODUCTION AND GUIDE TO THIS REPORT

In 2016, pharmaceutical wholesalers face a challenging business environment. Consolidation among pharmacies and providers is accelerating, putting downward pressure on wholesalers' sell-side margins. Wholesalers are struggling to profit from the specialty pharmacies that dominate the limited networks now favored by manufacturers and third-party payers. The excess profits that wholesalers earned from the generic inflation bubble are vanishing. Payers are targeting provider-administered specialty drugs with new buy-and-bill reimbursement models and novel channel arrangements.

Meanwhile, manufacturers—driven by new regulations and growing gross-to-net discounts offered to third-party payers—are questioning the structure and composition of their payments to wholesalers. Early evidence suggests that the coming wave of biosimilars may be less beneficial to wholesalers than many expected. Yet we project that amid this profit pressure, U.S. drug distribution revenues at the Big Three public wholesalers—AmerisourceBergen, McKesson, and Cardinal Health—will exceed \$400 billion in 2016 for the first time ever.

This *2016–17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*—our seventh edition—will help you understand this turbulent environment. It remains the most comprehensive tool for analyzing the economic and business realities of U.S. pharmaceutical distribution. This unique resource will benefit pharmaceutical manufacturers, wholesalers, pharmacists, pharmacy owners, hospital executives, buyers, benefit managers, managed care executives, policy analysts, investors, consultants, and more.

This report provides an up-to-date, fact-based analysis of the U.S. pharmaceutical wholesale industry and its interactions with—and services for—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.

This 2016-17 edition also contains the latest financial data and market positions of the largest public companies: AmerisourceBergen, Cardinal Health, and McKesson. It updates our annual analysis of each wholesaler's business segments and underlying business profitability, based upon our proprietary economic models. This information allows you to assess differences among the public wholesalers' business organizations, strategies, and financial performance.

Structure of the 2016-17 Report

This year's report retains the structure that we introduced with last year's edition. *The 2016-17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors* analyzes the industry in three major sections, comprising nine total chapters. Many sections and chapters have been expanded or reorganized to better cover the latest industry developments. A [new Preface section](#) provides an integrated overview of the major themes that recur throughout our analysis. Each theme includes links to relevant chapters and sections within the full report.

Here is a summary of the report’s main sections and chapters.

SECTION I: WHOLESALER AND CUSTOMER INDUSTRY ANALYSIS

- **Chapter 1: Industry 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), and identifies the major industry participants and their revenues.
- **Chapter 2: Channel Role for Retail, Mail, and Specialty Pharmacies** (page 22) analyzes the pharmacy market—the customer group that accounts for the majority of wholesalers’ revenues. It covers wholesalers’ services for smaller pharmacies, wholesalers’ participation in the pharmacy-PBM relationship, and their interactions with pharmacy buying groups. The chapter then separately analyzes how wholesalers work with larger pharmacies. An expanded **Section 2.4** analyzes wholesalers’ role in the distribution of patient-administered specialty drugs dispensed by specialty pharmacies. We also consider the role of wholesaler-owned specialty pharmacies.
- **Chapter 3: Channel Role for Physician Office/Clinics and Hospitals** (page 49) 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 3 has been significantly expanded and reorganized from last year’s edition.

SECTION II: BUSINESS ECONOMICS AND INDUSTRY TRENDS

- **Chapter 4: Wholesaler Profitability** (page 73) delves into the industry’s income statement economics to explain the underlying sources of drug distribution profits. We deconstruct buy-side and sell-side gross margin components, distinguish sell-side profits from specialty and traditional drugs, and explain distribution service agreements (DSAs) with manufacturers. We analyze overall gross margins and operating profits. This chapter also offers an updated explanation of how brand-name and generic drug price inflation affects profits.
- **Chapter 5: Financial Stability and Cash Management** (page 96) 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 108) analyzes 11 key industry trends that will impact the market structure and economics of the pharmaceutical

wholesaling and specialty distribution industries. Eight of these trends are organized and presented based on wholesalers' largest customer groups. This chapter has been significantly revised from last year's edition.

SECTION III: BIG THREE WHOLESALER COMPANY PROFILES

In this section, we analyze the latest financial data and strategies of the largest public companies. Each chapter provides parallel examinations of the Big Three public wholesalers. We scrutinize each company's business history, acquisitions and divestitures, business mix, profitability, largest customers, and company-specific business trends.

- [Chapter 7: AmerisourceBergen Corporation](#) (page 135)
- [Chapter 8: Cardinal Health](#) (Page 151)
- [Chapter 9: McKesson Corporation](#) (page 163)

How to Use the 2016-17 Report

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 300 endnotes, most of which have hyperlinks to original source materials.

Please note that highlighted internal 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:

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As always, I welcome your feedback. Please contact me if you have any questions or comments about *The 2016-17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*.

Adam J. Fein
September 2016

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

<http://drugchannelsinstitute.com/files/2016-17-PharmaceuticalWholesalers-errata.pdf>

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