

# The 2017-18 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors

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Pembroke Consulting, Inc., and  
Drug Channels Institute

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[http://drugchannelsinstitute.com/products/industry\\_report/wholesale/](http://drugchannelsinstitute.com/products/industry_report/wholesale/)



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Dr. Fein is one of the country’s foremost experts on pharmaceutical economics and the drug distribution system. Top manufacturers call on Dr. Fein’s insights and judgment to create successful commercial strategies and make better strategic decisions in our evolving healthcare environment.

Dr. Fein’s popular and influential Drug Channels website ([www.DrugChannels.net](http://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*, *Forbes*, and many others.

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Drug Channels Institute combines Dr. Fein’s expertise and cutting-edge analysis—such as this *2017-18 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

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In 2017, pharmaceutical wholesalers confronted a deteriorating business environment. Many of the trends that we identified in previous editions of this report culminated in significant profit declines and loss of stock market value. Notable headwinds over the past year include:

- A slowdown in brand-name list price increases—and many manufacturers’ pledges to limit future increases
- Accelerating deflation in generic drug prices and the loss of excess profits earned during the generic inflation bubble
- Intense competition for the business of smaller pharmacies
- Ongoing concentration of dispensing market share for the traditional drugs dispensed by retail pharmacies and for the specialty drugs dispensed by specialty pharmacies
- Declining share of revenues from independent physician offices and clinics
- Lower-than-expected benefits from biosimilar drugs

Wholesalers have been trying to counter these negative trends with new pricing approaches, acquisitions, and other business strategies. Despite the profit pressures, the Big Three public wholesalers—AmerisourceBergen, McKesson, and Cardinal Health—remain among the largest U.S. corporations. We project that U.S. drug distribution revenues for these three companies will reach \$425 billion in 2017.

This *2017–18 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*—our eighth edition—remains the most comprehensive tool for analyzing the economic and business realities of U.S. pharmaceutical distribution. In this definitive, nonpartisan resource, I explore and explain the industry’s interactions with—and services for—other participants in our healthcare system.

In this report, I have synthesized a wealth of statistical data, research studies, financial information, and my own business consulting experience. This unique resource will benefit pharmaceutical manufacturers, wholesalers, pharmacists, pharmacy owners, hospital executives, pharmacy buyers, benefit managers, managed care executives, policy analysts, investors, consultants, and many others.

### Structure of the 2017-18 Report

*The 2017-18 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors* analyzes the industry in three major sections, comprising nine total chapters. It provides an up-to-date, fact-based analysis of this dynamic industry and how it works.

This year’s report retains the structure that we used in last year’s edition, and the chapters correspond to those of previous editions. Some sections and chapters have been expanded or reorganized to better cover the latest industry developments.

Here are some of the notable updates in the 2017-18 report:

- The Industry Overview (Chapter 1) has been reorganized and expanded to provide a more comprehensive introduction to the industry and its major participants.
- Our analysis and data on specialty drugs have been expanded to account for continued growth in this market segment. We have included additional data and analyses of specialty pharmacies operated by physician practices and hospitals.
- New analyses examine the payment relationships between the Big Three wholesalers and each of their larger customers.
- Our deconstruction of wholesaler buy-side and sell-side gross margins for drug distribution of brand-name drugs now includes separate estimates for: (1) wholesalers' largest six pharmacy customers, (2) all other retail, mail, and specialty pharmacy customers, and (3) healthcare providers. The presentation of the generic drug figures now reflects sell-side discounts from published list prices.
- Additional historical trending information has been added throughout the report.
- Chapter 6 offers a more integrated presentation of significant forces of change.

We have updated all market and industry data with the most current information available. The 2017-18 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.

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

[\*\*PREFACE: INDUSTRY TRENDS AND KEY REPORT THEMES\*\*](#) 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.

### [\*\*SECTION I: WHOLESALER AND CUSTOMER INDUSTRY ANALYSIS\*\*](#)

- [\*\*Chapter 1: Industry Overview\*\*](#) (page 7) defines the industry, describes business differences between full-line wholesaling and specialty distribution, summarizes wholesalers' obligations under the Drug Supply Chain Security Act (DSCSA), explains wholesalers' channel roles, discusses and quantifies the products that wholesalers sell, and identifies the major industry participants and their revenues.

- [Chapter 2: Channel Role for Retail, Mail, and Specialty Pharmacies](#) (page 25) 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, including our exclusive analysis of the large generic sourcing consortia between wholesalers and the largest pharmacies. [Section 2.4.](#) (page 49) analyzes wholesalers’ role in the distribution of patient-administered drugs that specialty pharmacies dispense. We also consider wholesaler-owned specialty pharmacies.
- [Chapter 3: Channel Role for Physician Office/Clinics and Hospitals](#) (page 56) 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 expanded and reorganized from last year’s edition.

## **SECTION II: BUSINESS ECONOMICS AND INDUSTRY TRENDS**

- [Chapter 4: Wholesaler Profitability](#) (page 82) 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 explains how brand-name drug price inflation affects wholesalers’ profits.
- [Chapter 5: Financial Stability and Cash Management](#) (page 107) provides a detailed analysis of the key metrics that illustrate wholesalers’ overall financial health. These include 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 120) analyzes key industry trends that will impact the market structure and economics of the pharmaceutical wholesaling and specialty distribution industries. This chapter has been significantly revised and updated 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 151)
- [Chapter 8: Cardinal Health](#) (Page 168)
- [Chapter 9: McKesson Corporation](#) (page 181)

## How to Use the 2017-18 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. The report also includes a list of the [Acronyms and Abbreviations](#) used within it.

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 2017-18 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*.

Adam J. Fein  
October 2017

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

<http://drugchannelsinstitute.com/files/2017-18-PharmaceuticalWholesalers-errata.pdf>

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