The 2020-21 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors

Adam J. Fein, Ph.D.
Drug Channels Institute

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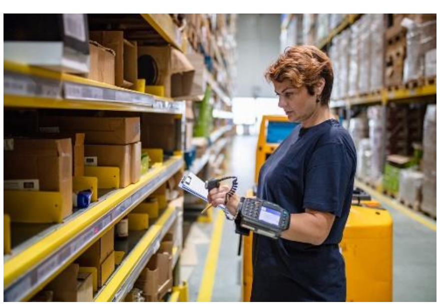
Full report available at https://drugch.nl/wholesale



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ABOUT THE AUTHOR

Adam J. Fein, Ph.D., is the CEO of Drug Channels Institute (DCI), a leading management educator for and about the pharmaceutical industry. DCI is a subsidiary of Pembroke Consulting, Inc.

Dr. Fein is one of the country's foremost experts on pharmaceutical economics and the drug distribution system. He has published hundreds of academic and industry articles. Dr. Fein has contributed to and is regularly quoted in such national publications as *The Wall Street Journal*, *The New York Times*, *The Washington Post*, *Forbes*, and many others.

His popular and influential *Drug Channels* website is a go-to source for definitive and comprehensive industry analysis, delivered with a witty edge. Drug Channels is the only place where you'll find a serious discussion of PBMs, drug pricing, and pharmacy economics, all explained with humor and a healthy dose of pop culture.

Dr. Fein earned his doctoral degree from the Wharton School of Business at the University of Pennsylvania and his undergraduate degree from Brandeis University. He lives in Philadelphia with his wife and business partner, Paula.

Contact information
Adam J. Fein, Ph.D.
Drug Channels Institute
1515 Market Street, Suite 960
Philadelphia, PA 19102
Phone: 215-523-5700
Website: www.DrugChannelsInstitute.com
Email: afein@drugchannels.net

ABOUT DRUG CHANNELS INSTITUTE

Drug Channels Institute (DCI) is a leading provider of specialized management education for and about the pharmaceutical industry.

Drug Channels Institute combines Dr. Fein's expertise and cutting-edge analysis—such as this *2020-21 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*—into interactive e-learning modules that offer your team a thorough grounding in crucial industry topics. Click here to view a module list.

These online learning tools explain highly complex economic and business data and concepts so you can:

- Make better decisions to achieve your business goals
- Improve relationships with key accounts
- Understand your customers, channels, and the economics of the U.S. pharmaceutical industry

Drug Channels Institute also hosts live video webinars during which Dr. Fein discusses trends and policies that affect the pharmaceutical industry and its channels. Click here to view our current and previous video webinars.

To learn more about how Drug Channels Institute can help your business, please contact:

Paula Bader Fein, M.S.Ed.
V.P., Business Development
Drug Channels Institute
1515 Market Street, Suite 960
Philadelphia, PA 19102
Phone: 215-523-5700 x11
Website: www.drugchannelsinstitute.com
Email: paula@drugchannelsinstitute.com

Introduction and Guide to the 2020-21 Report

In 2020, the COVID-19 pandemic disrupted every aspect of the pharmaceutical channel—and our lives. Pharmacy and healthcare provider markets experienced unprecedented volatility. Normally stable patterns of demand became highly unpredictable, as the country's businesses shut down and then began to reopen.

However, this period has also demonstrated the underlying resilience of U.S. distribution channels for prescription drugs. Pharmaceutical wholesalers maintained shipments and operational capacity. Meanwhile, pharmaceutical manufacturers and the federal government partnered in an exceptional effort to develop and launch COVID-19 vaccines. Wholesalers will play a crucial role in distributing these vaccines as they become available.

In the midst of the pandemic, wholesalers must still confront fundamental forces of industry change:

- Wholesalers' retail pharmacy customers are experiencing slowing growth, lower profits, and mounting competitive pressures. The U.S. pharmacy industry has begun a shakeout that will ultimately reduce the number of U.S. pharmacy locations, further concentrating wholesalers' revenues.

- The largest insurers, PBMs, and specialty pharmacies have combined into vertically integrated organizations. They are poised to restructure U.S. drug channels by exerting greater control over patient access, sites of care, dispensing locations, and pricing. Meanwhile, the specialty pharmacy industry has continued to consolidate.

- Wholesalers have adapted their business economics to slower growth in list prices for brand-name drugs. Generic drug prices have stabilized, benefiting wholesalers' profitability. The largest wholesalers made no major acquisitions for the second consecutive year.

- The market for provider-administered biosimilars has expanded significantly. Adoption rates continue to grow and are starting to generate financial benefits for wholesalers.

- Federal and state governments accelerated their efforts to introduce commercial importation of drugs originally intended for foreign markets.

- Wholesalers' potential financial liabilities for the opioid crisis remain uncertain. Litigation regarding their culpability for their role in the distribution of opioids continues.

- New cell and gene therapies have been launched, but wholesalers seem likely to play a limited role in certain channel activities for these therapies.

Understanding an Evolving Channel

We project that U.S. drug distribution revenues for the Big Three public wholesalers—AmerisourceBergen, Cardinal Health, and McKesson—will reach $513 billion in 2020. This *2020-21 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*—our 11th edition—remains the most comprehensive, fact-based tool for understanding and analyzing this large and growing U.S. pharmaceutical distribution industry.

This definitive, nonpartisan resource thoroughly updates our annual exploration of the industry's interactions with—and services for—other participants in our healthcare system. The report synthesizes a wealth of statistical data, research studies, financial information, and my own unique business consulting experience. It will aid pharmaceutical manufacturers, wholesalers, pharmacists, pharmacy owners, hospital executives, pharmacy buyers, benefit managers, managed care executives, policy analysts, investors, consultants, and many others.

Our 2020-21 edition contains the most current financial and industry data. We include detailed information about the strategies, market positions, and executive compensation of the three largest companies: AmerisourceBergen, Cardinal Health, and McKesson. The report updates our annual analysis of each wholesaler's business segments and underlying business profitability, based upon our proprietary economic models. The information allows you to assess differences among the public wholesalers' business organizations, strategies, and financial performance. Where appropriate, financial data have been restated based on updated disclosures.

What's New in the 2020-21 Report

The 2020-21 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors retains the structure of last year's edition, and the chapters correspond to those of previous editions. However, certain material has been reorganized to reflect the latest industry developments. We have also expanded information and analysis on various topics.

The most notable new material in this 2020-21 edition comprises three sections that address COVID-19 and its impact on wholesalers:

- Section 6.1.4. examines the potential financial effects on wholesalers of widespread distribution of one or more COVID-19 vaccines.
- Section 6.2.2. highlights the initial effects of COVID-19 on the pharmacy industry and the derivative impact on wholesalers.
- Section 6.3.2. traces how COVID-19 has impacted the buy-and-bill and inpatient drug market and the derivative impact on wholesalers.

This report was prepared during a highly uncertain time, so we expect to revisit this material in future editions. We will also continue to monitor these trends on *Drug Channels*.

Structure of the 2020-21 Report

The 2020-21 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors analyzes the industry in a preface and three primary sections, comprising nine total 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 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, analyzes the products that wholesalers sell, and reviews insurance coverage of these products. This chapter also identifies the major full-line wholesalers and specialty distributors, and it provides the latest data on their market share and revenues.

- **Chapter 2: Channel Role for Retail, Mail, and Specialty Pharmacies** (page 29) 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 via Pharmacy Services Administrative Organizations (PSAOs), and wholesalers' interactions with pharmacy buying groups.

  The chapter also analyzes how wholesalers work with larger pharmacies. We include our proprietary analysis of the large generic sourcing consortia between wholesalers and the largest pharmacies. Section 2.4. (page 53) 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 59) 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. It includes material regarding pharmacy dispensing of buy-and-bill channels that appeared in Chapter 6 of last year's edition.

SECTION II: BUSINESS ECONOMICS AND INDUSTRY TRENDS

- **Chapter 4: Wholesaler Profitability** (page 101) 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, as well as wholesalers' gross profits from brand-name vs. generic drugs. This chapter explains how brand-name drug price inflation affects wholesalers' profits and examines wholesalers' operating expenses and operating profits.

- Chapter 5: Financial Stability and Cash Management (page 129) 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 5 also explains executive compensation at the Big Three wholesalers.

- Chapter 6: Forces of Change for Drug Distribution (page 148) updates our analysis of the key industry trends that will impact the market structure and economics of the pharmaceutical wholesaling and specialty distribution industries. It presents the outlook for the U.S. prescription market, wholesalers' projected revenues, and brand-name and generic pricing. Chapter 6 also contains three new sections related to COVID-19.

  In addition, we examine ongoing trends for importation policies, vertical integration activities by hospitals, and future channels for cell and gene therapies. This chapter also updates the status of and outlook for pharmacy-dispensed and provider-administered biosimilars.

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 187)
- Chapter 8: Cardinal Health (Page 205)
- Chapter 9: McKesson Corporation (page 218)

How to Use the 2020-21 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. After clicking a link, use the following shortcuts to return to your previous location in the document:

- Windows: **ALT+Left Arrow**
- Mac: **Command+Left Arrow**

We offer more than 480 endnotes, most of which have hyperlinks to original source materials. The report also includes a list of the Acronyms and Abbreviations (page 238) used within it.

To search the entire PDF document for every occurrence of a word or phrase, use the following keyboard shortcuts:

- Windows: **Shift+CTRL+F**
- Mac: **Shift+Command+F**

As always, I welcome your feedback. Please contact me if you have any questions or comments about *The 2020-21 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors*.

Adam J. Fein
October 2020

P.S. Click here for post-publication errata.

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