2018 Expectations

Tim Kosty
R.Ph., M.B.A.

Don Dietz
R.Ph., M.S.

WE SEE TWO MAJOR trends affecting the pharmacy market- place in 2018: generic cost deflation and vertical integration through mergers and acquisitions. Generic cost deflation is a 2017 trend that we expect will continue and perhaps accelerate in 2018. While a few select multisource products have increased in cost to pharmacies, generic drug prices overall have declined and will continue to do so in 2018.

GENERIC DEFLATION

Several reasons that are leading to declining costs for generics include:

- FDA approval for generic drugs, increasing the number of suppliers and encouraging manufacturers to submit additional products for approval.
- The FDA has published a list of drug products that are off patent and off exclusivity, and for which the FDA has not approved an ANDA (abbreviated new drug application) referencing the innovator product. This list can be found at https://www.fda.gov/downloads/Drugs/ResourcesForYou/Consumers/BuyingUsingMedicineSafely/UnderstandingGenericDrugs/UCM564441.pdf.
- Increased competition from international generic suppliers entering the market.
- Several blockbuster brand drugs losing patent protection, creating opportunities for generic suppliers to compete.
- Consolidation in buying power, where three large buying consortiums involving the three major wholesalers are now purchasing approximately 85% of retail generic drug volume.
- Greater transparency in the price pharmacies pay for generic drugs via public availability of NADAC (National Drug Acquisition Cost) and CMS FUL (federal upper limit) prices. The CMS FUL is a transaction price based on the submission of AMP (average manufacturer price) from the manufacturers.

Declining generic drug costs drive the following actions by pharmacists:

- Limit forward purchases of generics and only purchase what will be needed in the short term to avoid holding inventory that has gone down in value.
- Review NADAC pricing, a lagging indicator, to monitor the market for price reductions.
- Evaluate third-party generic reimbursement rates. Perhaps the PBM (pharmacy benefit manager) is aware of the change in market price and has adjusted the MAC (maximum allowable cost) accordingly.
- Regularly monitor wholesaler and GPO (group purchasing organization) pricing to ensure prices are being adjusted downward.
- Compare prices to a secondary wholesaler or distributor — another excellent way to lower costs for generic drugs and monitor market changes.

PBMs are acutely aware of the overall reduction in generic drug costs. Most third-party contracts enable PBMs to adjust their MAC prices for multisource drug reimbursement without prior notification to the pharmacy. Through our ongoing industry monitoring, generic effective rates (GERs) have declined approximately two percentage points in 2017. Based upon the above factors driving generic competition and lower costs in 2018, we expect the PBMs GERs to become more aggressive in 2018.

RETAIL PHARMACY OPTIONS

In the face of competitive market pressure, we have seen little retail pharmacy success in negotiating higher reimbursement rates. There are limited options for retail pharmacies to maintain profitability, but include the following:

- Reduce hours of operation, thereby lowering the labor costs per prescription.
- Acquire other pharmacies, buying their prescription files to leverage the fixed costs of their existing pharmacies at a higher prescription volume.
- Focus on nondispensing activities that generate revenue that exceeds the profit from dispensing prescriptions. Immunizations are the best example of this type of activity.

continued on next page

continued from previous pages

We expect pharmacies to explore and test new nondispensing activities as a strategy to improve profitability in 2018.

VERTICAL INTEGRATION IN THE MARKET

In early December, CVS Health announced that it had agreed to buy Aetna in a $69 billion deal that would combine one of the largest drugstore chains and the number-three health insurer. Aetna has been a client of CVS Health since 2011 through its PBM that manages Aetna's retail pharmacy network and dispenses mail-service and specialty drug prescriptions. Aetna's business represents an estimated 22% of CVS Caremark's PBM revenue.

A cynical view is that the acquisition is locking up an estimated 20 million Aetna members, minimizing business risk when the existing PBM agreement expires in 2020. However, CVS Heath and Aetna management indicate they are intent on creating a new, more cost-effective healthcare model by leveraging CVS's 9,700 pharmacies and 1,100 MinuteClinics to provide unparalleled access for patients. This new model will create an integrated healthcare company that is not built around doctors, but has a more patient-centric focus.

COMMUNITY-BASED HEALTH HUBS

CVS Health and Aetna management project using the CVS pharmacies and MinuteClinics as healthcare hubs for members to access clinical services, resulting in a lower cost than traditional settings. This proposed acquisition will provide vertically integrated care for Aetna's members, while driving additional patient visits into CVS locations. The challenge will be educating members and providing them with financial incentives to use these settings for basic healthcare services. Not discussed has been the impact these new services would have on the existing Aetna provider network and whether this would be an adjunct to or a replacement of that network.

INTEGRATED HEALTHCARE BENEFITS

Highmark Blue Cross Blue Shield recently published a white paper comparing costs for companies that provide integrated pharmacy and medical benefits (carve-in) versus companies that have separate medical and pharmacy benefits (carve out). Companies with carve-in benefits saved an average of $172 per member per year. The Highmark study compared one million members in each group over a three-year period and found reductions in cost for the medical benefit for chronic and complex conditions. Savings were attributed primarily by identifying and responding to gaps in care that were apparent with integrated data. Additional savings were realized for specialty medications by coordinating the patient's benefit between the medical and pharmacy channels.

Bending the cost curve has been the holy grail of healthcare insurers. Treating sick patients has not proven successful, but rather preventing illness appears to be the long-term solution to the cost issue. Theoretically, coordinating care and directing patients to the most cost-effective setting should be the focus of healthcare insurers. However, engaging patients in this process has been challenging. We expect technology solutions to help patients manage these interactions in the future by using home monitoring of vital statistics to assist in determining when to seek professional care.

MERGER MANIA OR NOT

The proposed CVS Health-Aetna merger requires FTC (Federal Trade Commission) approval to move forward. This vertically integrated merger is different from the proposed Anthem-Cigna and Aetna-Humana horizontal mergers the FTC denied in 2017 due to competitive concerns. Furthermore, the impact of the proposed merger on the CVS Health-Anthem PBM deal remains to be seen. It's difficult to see Anthem (the number-two health insurer in the country) leaving its pharmacy business with a direct competitor, even with the proposed corporate firewalls. Time will tell whether the CVS-Aetna transaction is the beginning of a wave of mergers to streamline healthcare delivery.

A Walmart-Humana merger would provide similar strategic benefits, albeit through a smaller store base. Amazon may enter the healthcare market by acquiring a PBM, a retail pharmacy chain, and/or a health insurer. The potential combinations are endless, but all must eventually answer the question: Will the healthcare system be better off or more expensive? 2018 should provide some answers, and likely more questions.

Tim Kosty, R.Ph., M.B.A., is president, and Don Dietz, R.Ph., M.S., is VP of Pharmacy Healthcare Solutions (PHSI), which consults with pharmaceutical manufacturers, PBMs, retail pharmacy chains, and software companies on strategic business and marketing issues. The authors can be reached at tkosty@phsirx.com and ddietz@phsirx.com.