NATIONAL COMMUNITY PHARMACISTS ASSOCIATION

Executive Summary *and* A Vision for Health Care

The face of *independent* pharmacy

2006

NCPA-Pfizer Digest-In-Brief

NCPA®

November 2006

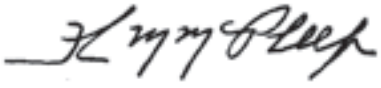
Dear Prospective NCPA Member:

The year 2006 will be remembered as one of profound change for community pharmacy. The implementation of the Medicare Part D prescription drug benefit dramatically changed the practice of pharmacy and patient care—the extent of which we are just beginning to measure and fully understand. While the full impact of the Medicare Modernization Act of 2003 on community pharmacy is still being realized, we recognize that there has been an undeniable shift in pharmacy practice. Since January 1, community pharmacists have been at the forefront of its implementation and have been resilient in making this new federal benefit successful for patients. As with anything new, it is not without its challenges. The profession of pharmacy has truly shined through it all and helped patients across the country benefit from this new program.

What we have seen this year reminds us of the essential role that community pharmacists play in the health care delivery system. Pharmacists are the trusted medication experts that serve their community with their medication needs and provide valuable patient care. As today's medicines continue to allow people to live longer and stay healthier, pharmacists are needed for much more than just dispensing drugs. Pharmacists help the entire health care system by providing patient care at the most accessible point of service. Together, pharmacists and medicines provide an unequaled promise to help keep Americans healthy. Read more about our vision of the future of health care on page 4.

Looking toward the future, a focus on total health care management must become the predominant vision of the health care community. Community pharmacists have long demonstrated that close monitoring of medication therapy can lead to better patient outcomes. Payers, in addition to Medicare's Medication Therapy Management requirement, are now recognizing that continual decreases in reimbursement, higher copays, and shrinking dispensing fees will not lead to better patient outcomes. Pharmacists have proven this year that they have much more to offer the health care system and can provide benefits beyond dispensing medications. It is time to continue the positive momentum and change the health care system to recognize the capability and the contributions medicines and pharmacists make to it.

Pfizer values its relationship with community pharmacists and is pleased to continue its support of the *Digest* again this year. NCPA, with the support of Pfizer, is pleased to continue the *Digest's* long tradition of providing insightful information to the pharmacy marketplace. We are confident that you will find the information contained in the *Digest* an excellent resource and one that will provide value to you throughout the year.



Bruce Roberts, RPh
Executive Vice President & CEO
National Community Pharmacists Association

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Pfizer Inc

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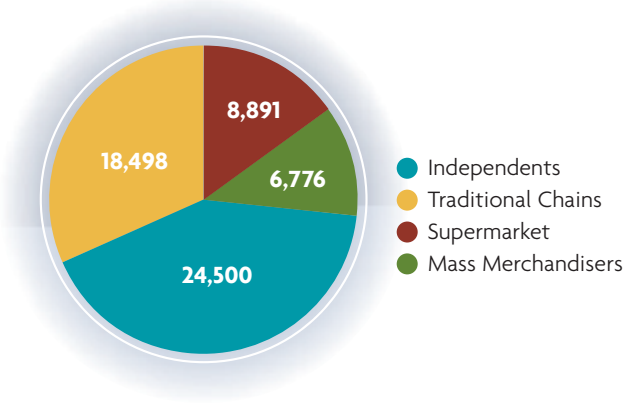
Executive Summary

The *NCPA-Pfizer Digest* provides an annual overview of the value of independent community pharmacy to the health of patients in the United States, including a comprehensive review of the financial operations of the nation's independent pharmacies for 2005. This year's *Digest* findings demonstrate that independent community pharmacy continues to be a dominant force in serving patients with their medications and other health care needs and is a major force in the pharmaceutical marketplace.

Independent pharmacies are all pharmacist-owned, privately held businesses, but they vary in practice setting. They include single-store operations, and other independent, pharmacist-owned operations (such as chain, franchise, compounding, long-term care (LTC), specialty, and supermarket pharmacies) and represent 42 percent of the pharmacy marketplace. In 2005, 21 percent of independent pharmacies had total sales over $6 million, 29 percent with sales between $3.5 and $6 million, 22 percent with sales between $2.5 and $3.5 million, and 28 percent with sales under $2.5 million.

Number of Pharmacy Outlets



An overview of the average community pharmacy is provided to the right. In general, the percent of prescriptions paid for by a third party increased from 85 percent to 87 percent; and the percent of prescriptions dispensed generic increased to 56 percent. Increasingly, independents are operating multiple pharmacies. Thirty-three percent of independent owners have ownership in two or more pharmacies, and the mean number of pharmacies

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Community Pharmacy **At-A-Glance**

	2005	
Average number of pharmacies in which each independent owner has ownership	1.87	
Value of inventory as cost and as a percentage of sales		
Prescription inventory	7.2%	
Other inventory	1.9%	
Total inventory	9.1%	
Size of area and median sales per square foot		
Prescription sales per square foot	1,003 square feet	$3,993
Other sales per square foot	2,776 square feet	$98
Total sales per square foot	3,779 square feet	$1,207
Percentage of prescriptions dispensed per pharmacy location		
New prescriptions	48%	
Renewed prescriptions	52%	
Total prescriptions	100%	
Number of hours and days per week		
Hours open per week	60	
Days open per week	6	
Sales activity per hour open		
Number of prescriptions dispensed per hour	20	
Percentage of total prescriptions covered by:		
Government programs (Medicaid or Medicare drug discount card)	28%	
Other third-party programs	59%	
Percentage of prescriptions dispensed generically	56%	

A Vision for

Pat Kelly
Pfizer Inc

For better or worse, pharmacists and pharmaceutical manufacturers are on the front lines of the American health care debate, a debate that increasingly centers on questions of cost.

Few would contest that the United States spends an enormous amount on health care, but it is certainly debatable whether we're getting better health for the money we spend.

Although national spending on pharmaceutical medicine represents the same proportion of overall health care spending today as it did 30 years ago, individual Americans are spending more out-of-pocket for their medicines than ever. That's because copays have increased faster than inflation and faster for pharmaceuticals than for other forms of care, leaving patients to bear a greater share of the pharmaceutical cost burden than ever before. Patients need their medicine to stay healthy and productive (and help avoid more costly acute interventions), but the high out-of-pocket cost of prescription medicine makes it less likely that they take advantage of treatment with the potential to save them money later.

Debating costs, as we have for so long, misses the very point of our shared efforts: improving patient health. What we need is a new dialogue, and this year's *Digest* provides us with such an opportunity. And I'd like to begin this new dialogue with a seeming heresy: the cost of health care is not the problem.

The problem is the cost of disease—of failing to help people avoid disease—of not preventing debilitating conditions and poor health. The problem is the cost of providing care when conditions are most dire, when the cost of care is most expensive and when the effect of care is lowest.

The problem is that we don't have a health care system so much today as a "sickcare" system.

A more thoughtful, cost-effective approach to health care would be to provide appropriate and more purposefully organized care along the entire spectrum of health — from prevention to disease management to end-of-life care. In the process, we would generally move the point of greatest intervention upstream, if you will, to produce better health outcomes downstream and at lower costs. We need a new approach that takes the whole patient and the totality of health care into account.

What we need is Total Health Management. A holistic approach like THM, looks across the health continuum and takes a long-term perspective. It recognizes that as popula-

tions change and age, individuals and their families move from "health" to "at-risk" to "chronic illness" and, eventually, to "end of life;" they need support — and different support — at each phase. Such an approach encompasses a strong emphasis on prevention and wellness, but goes further to promote good health at every stage.

To address the risk factors for chronic illness, a THM approach would include health education, information, risk assessments, and coaching services to help individuals take greater control of their health. For those further along the continuum — such as those suffering from chronic conditions — this approach would help them manage their disease and make lifestyle changes that could delay the onset of co-morbid conditions.

Common sense? I think so, but common sense is in increasingly short supply in health care today. A health care system based on avoiding acute care interventions and delivering appropriate care at every point on the health continuum would naturally put the patient, physician, and, importantly, the pharmacist at the center of the health care equation.

The best part about this approach is that it's about improving health and getting more for our health spending. It promises to reduce administrative and clinical waste—estimated at one-third of the $2 trillion we spend annually on health care — while ensuring appropriate consideration of the quality of care…not simply the cost of care.

In fact, with appropriate reimbursement and payment methods — for example, full, first-dollar coverage and payment for preventative and wellness services — a more balanced approach to health care delivery would make possible total patient treatment. Thus effectively addressing not only quality of care but also quality of life and total overall cost.

But to make this approach work, we'll need this or a similar type of reimbursement approach to match it. A THM benefit design would provide increased coverage and payment for the services that prevent disease and improve health over the long term. And, at the center of all decisions about health and treatment would be an informed patient, physician, and pharmacist.

The "sickcare" debate is bleak and unproductive. Better for patients, care providers, and society that we talk instead about managing health and lowering the cost of disease rather than the other way around.

That's a dialogue we're eager to have with our pharmacist colleagues, physicians, policy-makers, and anyone else who cares about a healthier future for patients.

in which each independent owner has ownership is 1.87. This reflects a movement toward consolidation within the pharmacy industry.

Notably, independent pharmacies are now open 60 hours per week on average. This ramp-up in hours of operation indicates that community pharmacists may work longer hours to offset decreasing gross margins.

Since community pharmacy constantly is adapting to the changing dynamics of health care, each year the *NCPA-Pfizer Digest* adds new, in-depth information about the marketplace that is of interest to key stakeholders in independent pharmacy. This year, the *Digest* includes new information on the adoption of electronic prescribing, pharmacy staffing shortages, and a preliminary look at the impact of Medicare Part D on independent community pharmacy. A few highlights of the new information include:

- Almost half of the respondents are connected for electronic prescribing, and 24 percent of respondents already receive electronic prescriptions.
- Thirty-seven percent of respondents indicated they plan to hire a part-time or full-time pharmacist within the year. However, more than 60 percent indicate that they have no plans to hire an additional pharmacist.

For more than 70 years, pharmacy demographic and financial data have been collected and published in the *NCPA-Pfizer Digest,* providing community pharmacy with an opportunity to look at long-term trends. (Go to www.ncpanet.org for the history of the *Digest*.) While gross margins have fallen sharply over the last 10 years due to non-negotiable contracts from pharmacy benefits managers (PBMs) and government reductions, average sales per pharmacy location have increased annually. However, the actual rates of growth have decreased. For example, 2003 sales were up by 14 percent over 2002. In 2004, sales grew by 10 percent. For 2005, sales were up by 5 percent as shown below.

Table 1 • **Averages of Pharmacy Operations, 10-Year Trends**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Sales	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Cost of goods sold	73.7%	74.4%	75.1%	76%	76.7%	77%	76.5%	76%	77.9%	76.4%
Gross profit	**26.3%**	**25.6%**	**24.9%**	**24%**	**23.3%**	**23%**	**23.5%**	**24%**	**22.1%**	**23.6%**
Payroll expenses	13.6%	13.1%	13.2%	12.8%	12.2%	12.5%	13.1%	13.2%	12.2%	13.4%
Other operating expenses	9.7%	9.4%	8.6%	7.6%	7.9%	6.9%	6.6%	6.8%	6.3%	6.5%
Total expenses	**23.3%**	**22.5%**	**21.8%**	**20.4%**	**20.1%**	**19.4%**	**19.7%**	**20%**	**18.5%**	**19.9%**
Net operating income	**3%**	**3.1%**	**3.1%**	**3.6%**	**3.2%**	**3.5%**	**3.8%**	**4%**	**3.6%**	**3.7%**

Table 1 provides the profitability trends over the past decade, including the following:

- Gross profit decreased in 2004 to its lowest level in the past 10 years after increasing the previous two years. For 2005, average gross profit increased by 1.5 percent to 23.6 percent returning to a level last seen in 2002. This may be due to the introduction of several generic products which typically have higher gross margin percentages but may not have higher gross margin dollars.
- Payroll expenses as a percentage of sales increased 1.2 percent in 2005 to 13.4 percent, their highest level since 1996.
- Operating expenses increased slightly in 2005 to 6.5 percent after reaching a 10-year low, at 6.3 percent of sales in 2004.

With the continued reduction of payment rates to all-time lows and the subsequent long-term falling profit margins documented above, independent pharmacies have responded by expanding and diversifying their businesses to include enhanced patient care services and other valuable community services. Independent pharmacies are the nation's leaders in providing disease management services to patients with chronic health conditions such as diabetes, asthma, hypertension, and hyperlipidemia. In 2006, independent pharmacies have embraced the concept of medication therapy management (MTM) services and have integrated these services into their practices. More information about MTM services will be highlighted in next year's *Digest*. Other pertinent information about the independent pharmacist's professional interactions include the following.

- Independent pharmacists consult with physicians 8.7 times daily on prescription drug therapy. This includes generic product recommendations and therapeutic interchange recommendations. Physicians in turn accept pharmacists' generic product recommendations 87 percent of the time and 74 percent of the time for other therapeutic recommendations.
- The services provided the most by independent pharmacies are nutrition, delivery, and patient charge accounts.

Additionally, community pharmacists across the nation are working with Medicare beneficiaries in their communities to help them afford their medications and use them appropriately. After the prescription drug benefit started, pharmacy staff spent, on average, seven hours per day helping Medicare patients receive medications under their new benefit. Even before Part D started, the average independent pharmacy spent more than 70 hours preparing for Medicare Part D.

However, the service to Medicare beneficiaries has not been without financial hardships to local pharmacies. Another NCPA survey in March 2006 found that 93 percent of independent pharmacy owners said that their cash flow is worse than before the start of Medicare Part D. As a result, 28 percent of independent community pharmacies have sought help from their wholesaler, and an equal percentage have had to take out a line of credit simply to pay for medication inventory and payroll while waiting for the drug plans to issue reimbursement checks.

It is important to note that this year's *Digest* data reflect the marketplace in 2005, prior to the Medicare Part D prescription drug benefit implementation. During 2005, respondents indicated approximately five percent of their prescriptions were covered by a Medicare drug discount card. Preliminary data indicate that significantly more prescriptions will be covered under Medicare Part D than the preceding discount card program. Next year's *Digest* will highlight complete information about the financial impact of Medicare Part D during its first year of implementation.

The results are unmistakable—independent community pharmacies are leading the way in community pharmacy practice. They are laboratories of innovation for the pharmacy profession. They are leaders in providing customer service and overall patient care services. Community pharmacists are civic leaders and patient advocates in their communities. They continue to define the future of pharmacy practice.

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