

## **The fourth agreement continues....**

As most of you are aware the Federal Minister for Health and Ageing released the next installment of PBS Reform which could be seen as both the completion of the Fourth Guild/Government Agreement and the bridge to a Fifth agreement which is due for negotiation prior to the election after next.

As it stands, the reform could have been much worse for Pharmacy although key details regarding proposed changes to pharmacy mark-ups and the dispensing fee effective August 1, 2008 yet to be announced.

Clearly any balancing compensation to mitigate the impending loss resulting from discount loss represents a significant win for Pharmacy owners and a giant tick for the Guild administration who orchestrated such a result.

With certain sections of both media and Cabinet negative on Pharmacy's relatively favourable treatment (comparable to manufacturers) the pressure for change will not abate any time soon. A cabinet shake-up, change in leadership or change in Government could all be catalysts for further adjustments. In the meantime the following is my interpretation of the impact attaching to some of the key reform measures:

**Streamlined prescribing of authority prescriptions** from July 1, 2007 will make it easier for Doctors to prescribe certain medicines. This easing should provide some level of increase to historical prescribing volumes in those medicines.

**Creation of separate lists for PBS medicines** to F1 (single brand) and F2 (many brands). F2 will be subject to price reductions of

- 2% per year for 3 years commencing August 1, 2008 for those where price competition between brands is low and
- 25% once-off reduction where price competition between brands is high.

Note that these measures will reduce but not eliminate discounts and are additional to the 12.5% clawback currently in place. This is likely to occur on August 1, 2009 for low price competition medicines and August 1, 2012 for high price medicines as the Government will further adjust prices based on the manufacturer's disclosure of their sale prices to pharmacy.

Essentially the above represent a five and a half year phase-out of generic discounts. The price reductions will see more medicines fall into the non-government funded price category. With reduced discount levels the price variances between warehouse and traditional pharmacies on the medicines in that category should reduce.

**PBS Online incentive** of 40c per script or \$20,000 for the industry's average size pharmacy doing 50,000 scripts per year will be payable from August 1, 2007 which is 1 year before any price reductions filter through. Now that remuneration is confirmed, Pharmacy should embrace the cash flow advantages and commence PBS Online asap. Expect more reform initiatives to follow however once the Health Department commence data mining.

**Pharmacy incentive of \$1.50 per premium-free prescription dispensed.** Note this is not a generic incentive but an incentive to foster the dispensing of "premium-free" drugs. It only applies to F2 medicines and does not apply to 'safety net' prescriptions. Given the F2 medicine list will not be known until August 1, 2007 it is not currently possible to calculate the expected incentive total per pharmacy.

The government is motivated to both increase generics and reduce cost to customer. Brand manufacturers will need to consider their position regarding maintaining brand premiums. There are over 400 brands with a price premium, which a pharmacist must charge the patient and the government is keen to reduce this list. The incentive is payable from August 1, 2008 which accords with the first round of price reductions.

**Changes to pharmacy mark-ups and dispensing fee** are expected to counteract the fall in mark-up dollars resulting from a reduced product cost following price reductions. The changes are yet to be released but are applicable from August 1, 2008.

Similarly, **the CSO funding pool for wholesalers** will be increased to counteract the fall in mark-up dollars resulting from a reduced product cost following price reductions. Changes to volume/loyalty discounts not result as the funding pool is sufficient to cover the expected loss.

### **Summary**

While the impact on profitability is unknown and subject to the mark-up / dispensing fee announcements, pharmacy income will likely achieve a neutral position in the short term thanks to the compensation negotiated. However, anyone purchasing a business during the next 5 years will need to be mindful of the eventual decrease in income because the pricing changes commencing in 2009 will lead to lower dispense incomes.

Do not however expect future pharmacy business values to decline. The market remains hostage to demand exceeding supply and this is likely to continue. Control of significant volume will be required in order to negotiate better than market listed buying terms.

As such the "pharmacy groups" will continue to seek growth and indeed will be presented these opportunities by wholesalers in preference to first time buyers. Reason – good operators known to wholesalers are more likely to grow volume while also allowing wholesalers to reduce their costs through reduced management/distribution costs.

Positively, these changes offer the industry the realistic expectation of a Fifth Agreement. This is because the Government prefers to deal with one distributor representative – in this case the Pharmacy Guild – while implementation of the changes occur.

Negatively, the focus on volume and price will be magnified as time goes on.

Fortunately though, for those who can't/don't want to play the price/volume game there is a reasonable time period to develop customer focused income streams from the provision of healthcare solutions (eg HMR's, weight loss etc).