



TAYLOR WOODINGS

NEWS FLASH

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Pharmacies under pressure

There have been two recent developments within the pharmacy industry that have placed the traditional pharmacy model under pressure. Firstly, the advent of E-Pharmacy has introduced new competitors to the market and secondly there has been recent changes to the Pharmaceutical Benefits Scheme ("PBS") that decrease the margins in regard to the dispensary side of a pharmacy.

E-Pharmacy

On 1 March 2007 national legislative changes were passed which allowed digitally signed and encrypted prescriptions to hold the same legal standing as physically signed prescriptions in regards to PBS claims. State and Territory Governments across Australia are currently reviewing legislation for the purpose of dispensing digitally signed and encrypted prescriptions with the Northern Territory the first state or territory to trial an E-Pharmacy model.

The impact of this change to the traditional pharmacy is that to be compliant and able to operate utilising the digital signatures significant upgrades are often required to a pharmacies IT infrastructure. This obviously comes at both a financial cost and operational cost (in that training is required and there is an opportunity time cost). Added to this is the fact that there is little or no financial upside for pharmacies adopting this new technology, only downside in that should they not upgrade it will be more difficult to claim under the PBS.

Changes to the PBS

On 1 August 2008 changes to the PBS came into force mainly aimed at forcing the increased take up of generic drugs and streamlining of the operation of the PBS to a automated system. The Pharmacy Guild of Australia is quoted as stating that the changes are the most substantial changes to the PBS system in 60 years and will save the Federal Government \$6 billion over the next 10 years.

Although the changes will mean savings for both government and consumers at least some of these savings will come at the direct expense of individual pharmacies' margins through lower rebates from the PBS system and increased costs through the need to develop better IT systems at pharmacy level.

For example there will be a 25% reduction in PBS rebates in relation to 99 different drugs which are marketed under hundreds of different brands. The reasoning provided by the government for these reductions is to encourage the use of generic drugs which generally have much lower cost prices than their patented equivalents. Australia currently has the lowest take up of generic drugs of any of the Western World countries. As more drugs come off patent in the next few years this will lead to greater savings on the part of both consumers and government (some 100 drugs are due to come off patent in the next ten years).

What do the Changes mean for Pharmacies

The changes to the PBS and associated legislation provide both opportunities and threats for the individual pharmacy.

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For those pharmacies that are able to adapt to a more IT driven operation there are some benefits that can be taken advantage of in the form of moderate incentives offered by the government (mainly a 40 cents rebate for every prescription processed on the PBS on-line system). There are also further incentives available in regard to re-training staff to allow the PBS online system to operate.

In regard to generic drugs there are incentives available in the form of a \$1.50 rebate for each prescription processed where the cost to the customer is no more than the standard co-payment available from the PBS. This incentive is aimed at encouraging a pharmacy to prescribe generic drugs.

However, the threats that exist due to the changes are significant.

Any pharmacy that is not able to process their PBS claims on line faces the risk of delays in receiving their payments (often up to 70% of a pharmacy's revenue). This can have a major cashflow impact on a pharmacy.

Also the reduction in rebates paid under the PBS means that any pharmacy that does have a high generic drugs take up will face severely decreased margins and hence profitability.

How can Taylor Woodings Assist

Taylor Woodings has extensive experience and specialist expertise in the pharmacy industry. With strong relationships with wholesalers, government departments, the Pharmacy Guild of Australia and other industry service providers, Taylor Woodings has been involved with several assignments involving the trading on and sale of pharmacies. Taylor Woodings also has provided consulting services to a number of financiers and large pharmacy groups in relation to various forms of financing (both debt and equity) and operational issues.

Some of these roles include:

- Acting on behalf of secured lenders including financiers and major wholesalers as Receivers & Managers of several pharmacies – both single and multi – site groups. These assignments included the trading and sale of the businesses;
- Acting for financiers and wholesalers as investigating accountants in relation to numerous pharmacies experiencing trading difficulties. Our advice included identifying the formal and informal strategies that could be employed to exit the exposures;
- Conducted a pre-lending review of a franchisor with 25 franchisee members within the pharmacy industry that is rapidly expanding its business nationally via a new business model;
- Advising major wholesalers in relation to difficult trading accounts; and
- Assisting pharmacy owners experiencing difficulties with their trading and developing and implementing turnaround or exit strategies focused on maximising outcomes for all parties.

Through our various assignments we have developed a detailed understanding of the legislative and practical issues associated with formal insolvency appointments and commercial issues associated with the industry.

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