PHARMACY MARCH 2013

JRx proficies

Editorial

Welcome to the March 2013 pre APP edition of JRx Proficies. Many of you will be aware that Johnston Rorke affirmed its membership of the Pitcher Partners national accounting network by changing its name to Pitcher Partners on December 1, 2012. Please note however that while there has been a name change there is no change to the ownership of our firm and JR Pharmacy will continue to operate under the same trading name.

AJP March edition featured an article from myself where I held up a crystal ball and made some predictions as to the impact of future medicine price cuts on the average Pharmacy. One key issue noted is that once price reductions cease for many molecules they will be generating less gross profit income than they were before price disclosure commenced in 2007. With the announcement of each round of price cuts (April 1 being the next instalment) concern will heighten for those not achieving sufficient growth to replace each reduction. Inside, Bruce continues with this theme as he highlights the need to understand and respond to the impending loss of income over the next two to three years.

In considering how to develop a winning response for a services centric retail business, Norman introduces us to the SAVE (Solutions, Access, Value, Education) concept as the new and superior alternative to the famous 4 P's (price, product place and promotion). For many Pharmacies an inevitable outcome from formulating a response to price cuts will be the need to take their Pharmacy premises through a refit. This is something I also explore in more detail in this edition.

For those attending APP please be sure to call by our stand and see the latest version of JR.Spacelink and JR.Bizlink reporting tools which can help you grow your business. The Partners and Managers of JR Pharmacy will be there all week-end as well as most of our accountants. If you would like to catch up for a specific meeting please call us to arrange before the start of the conference.

As always we hope you enjoy our insight and will be pleased to attend to any queries you may have arising from the articles inside.

Mark Nicholson

JRx pharmacy a division of Pitcher Partners

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Getting Fitted Out

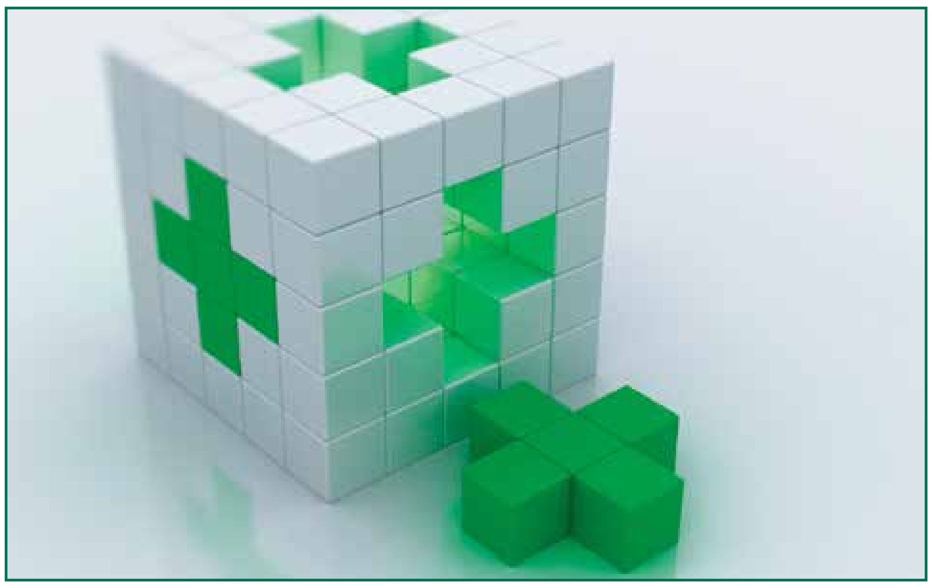
For many owners the necessary response to the ongoing challenges facing Pharmacy (eg deliver services and engage the customer) will be to refit the Pharmacy, join a Brand or do both. The fitout objective of course is to attract more customers, have them use all parts of the store, increase their spend and return more often.

Unfortunately for many owners the process can lead to compromises which produce sub optimal outcomes. Recently I had the opportunity to address this issue with the State managers of a wholesaler pharmacy brand to ensure the process created wins for the owners, staff, brand and most importantly customers. A summary of that discussion follows.

- Usually the fitouts that provide the highest benefits compared to costs occur when
  1. The owner owns the process
  2. The process is collaborative between the designer, owner and where relevant brand/banner representative
  3. The fitout is as a consequence of a business plan for the future and not a replacement for one
  4. Sufficient time is allowed to evolve the fitout plan and then engage with builders/contractors/landlords to minimise costs
- Customer's define service as firstly knowing and stocking what is wanted followed by being able to easily access it in store (including information) and then engaging with friendly knowledgeable staff for assistance and advice.
- As a rule of thumb you should be aiming to improve annual store turnover by ¾ of the cost of the fitout within two years of completing the fitout to justify the cost. Don't forget to consider the cost of doing nothing as sales and customers may actually decline over the same period without a store investment.
- Average retail sale can increase substantially where the dispensary and store layout integrate to efficiently support a Pharmacist engaging with customers in relation to delivery of health solutions and s2/3's.
- Ignoring the dispensary will reduce the fitout costs substantially but can the business deliver Pharmacist services and improve dispensary efficiency without it. Remember the dispensary often accounts for 70%+ of turnover and up to 100% of profit.
- Cash and wraps at the store entrances ensure a customer's transaction isn't completed until they finally leave the store. Studies have shown average retail sale is higher in these store layouts.
- Understand category performance by linear metre and use data to assist with space allocation and category prioritisation/adjacencies.
- Small store formats should not be scaled down large store formats. Focus on allocating appropriate space to key categories first and manage the remainder thereafter.
- Many of the Brands are now offering significant financial and planning support for refits upon joining and interest rates remain historically low.
- Owners generally will reduce costs through involvement in the project management and utilising local labour but in-store construction times may be lengthened if not carefully co-ordinated.

As always please contact your JR Pharmacy partner for any business planning assistance required.

Mark Nicholson



Use it before you lose it

PBS dispensing profitability (GP dollars per script) is at an all time high including fees, mark-up and supplier discounts. The last ingredient now comprises on average 64% of pharmacy net profit before interest and tax (EBIT) which the government is pulling back through ongoing price disclosure (WADP) cuts.

Using WAMTC the Government utilised another handy tool to reduce drug costs in the form of the 1 December 2012 25% cut to high potency statins (atorvastatin and rosuvastatin) pulling forward some of the WADP cut expected 1 December 2013.

Looking ahead the offset game continues in 2013 with big price cuts again set for 1 April (eg: pantoprozole), 1 August (eg: Simvastatin, Copidogrel) and 1 December 2013 (eg: atorvastatin). Some of the impact should be ameliorated by generic discounts from new patent expiries such as Karvea/Avapro, Atacand for example.

But, a single strategy of maintaining pharmacy net profits intact from and including 2014 purely through patent expiries starts to lose steam as overheads grow (rent and wages) and continual WADP cuts eventually exceed the new generic income benefits. However, a judge's decision re: Astra Zeneca's Crestor (rosuvastatin) has now provided pharmacy a windfall in dispensing income injection during 2013 that will help absorb the 2013 price cuts. That will improve community pharmacy net dispensing income prospects in 2014 deferring the crunch until late that year or early 2015.

If you survived reading and comprehending all that I hope three messages are clear:

1. Relying on generics as the single profit maintenance strategy is not sustainable in the long term.
2. The unprepared pharmacy owner will ultimately see the generics wave turn into a dumper in 2015.
3. Now is the time to start preparing because starting when you're on the dumping wave will be too late as net profit, cash flow and valuation will be impacted.

Therefore, the approach should be to use the short term generic largesse to invest in business transformation now and move from transacting and reacting to a customer centric model delivering valued health solution benefits throughout the pharmacy. The idea is to farm existing income accretive opportunities and build alternate income sources at the same time aiming to build a buffer against the cuts.

Those who do this during the next eighteen months will be swimming to the side of the waves and into the calmer waters of sustainability.

Bruce Annabel

Save for the four P's

For retailers the four P's represent the product, place, price and promotion. These concepts have served retailers well in their pursuit of selling more to the same or new customers. However, modern retail thought leadership suggests that the focus should change from products to Solutions, place to Access, price to Value and promotion to Education. The four P's are morphing into a concept known as SAVE.

A recent article published in the HBR[1] discussed this concept with reference to business to business transactions. However, in my view, the concept of SAVE has specific relevance to specialty health retail, which pharmacy must own as a market segment.

Some would argue that pharmacy is more akin to convenience retailing, hence the product mix is often general with many non-health related products obscuring the health component. The opposing position is to create a specialty health retail destination where 80%+ of the space and stock investment is allocated to the health categories.

To create a **solutions** business, the culture of the pharmacy must change from a transactional business where staff merely complete customer orders to one that focuses on condition, product bundle and customer outcome. Many forward thinking owners are already well on the way to creating this. The largest hurdles are the need to understand both the way the customer shops and the pharmacy remuneration model. The second part is imperative because of the pressure on dispensary margins in the future.

Providing the customer **access** to the solutions means management must develop an integrated cross-channel presence that considers the customer's entire purchase journey. This would also include the layout and design of the pharmacy which Mark refers to in his article. Retail from a customer's point of view is often about speed and ease. Your opportunity is to create that environment to increase customer visits and average spend per customer or script.

Probably the more important facet of the SAVE concept but the most difficult for pharmacy to embrace is that instead of price pharmacy must focus on the **value** to the customer. To do this in a relatively homogenous product environment, the staff must be able to articulate the benefits of a product relative to the price. The next time you are in the pharmacy, listen to the conversation the staff are having with the customers. Do they mirror this product knowledge approach? With constant pressure on retail margins, the value approach is the only way to maintain or grow retail margins.

Education is the last piece of the detailed transition to solutions based specialty retail. Too many promotional dollars are spent on catalogues promoting the same products as the next pharmacy. This does not foster customer loyalty to the store - only the price. Therefore, promotion must transition to education – ie providing customers information to their specific needs at each point of the purchase cycle (remember the integrated cross-channel approach mentioned before?).

We know that the GP$ per script will fall from the current unprecedented heights. As it decreases there will be a scramble for the customer and the customer's purse. The question is how many pharmacies will get caught in the "repetitive and relatively unproductive" product push environment which continues to put pressure on margins and undermine the health destination status Pharmacy must own.

1 Rethinking the 4 P's HBR Jan 2013 by Richard Ettenson, Eduardo Conrado and Jonathon Knowles which was published in the HBR in January 2013.

Norman Thurecht

Retail Health Insights

As always the devil is in the detail when it comes to reviewing and analysing what departments and products are returning profit to you.

The latest ABS Statistics reporting the sector that includes Pharmacy report a 4.1% decline in turnover over the last 12 months.

By way of comparison we have set out below the growth rates achieved from a cross section of pharmacies utilising our JR.spacelink category management tool.

For dispensary it is now imperative that you focus on GP$$, (as opposed to sales growth) and script growth, given the impact price cuts are having on sales growth.

For retail sectors, concentration should remain in sales, GP$$ and unit volume.

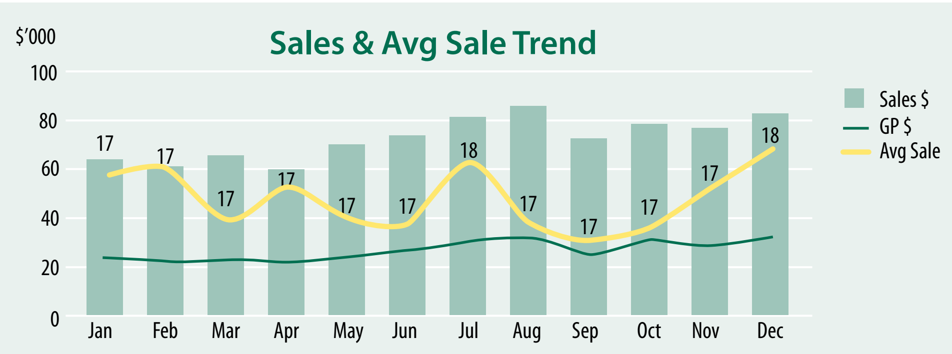
Of equal importance is the focus on Gross profit dollars generated per square metre (GMROS) which allows the pharmacy to optimise space allocation to each Department and, in turn, maximise pharmacy income.

If you would like to know more please visit us at our APP Stand where we can demonstrate the latest technology that allows you to view your pharmacy's performance with ease.

We look forward to seeing you there.

Teresa Hooper

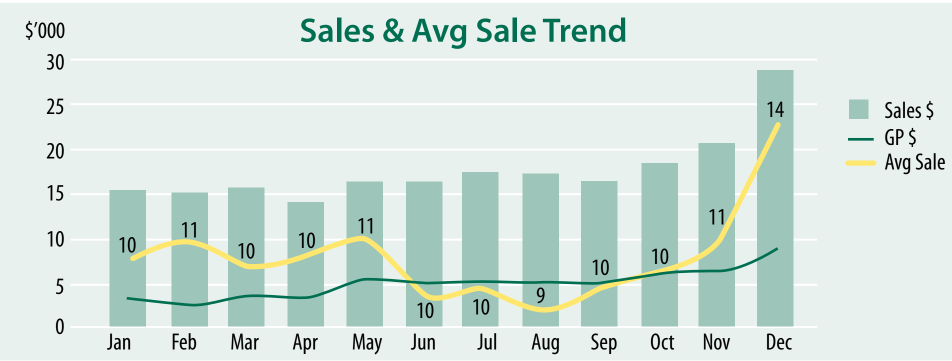
Health Department Trends



Top 5 Health Categories

	Sales	GP$$	GMROS
Disease State Mgt	$9,432	$3,106	$3,016
Pharmacy Only	$230,878	$92,230	$2,407
Analgesics	$58,971	$26,815	$1,664
Cough & Cold	$75,874	$32,229	$1,621
Stomach & Bowel	$25,648	$9,925	$1,159

General Department Trends



Top 5 General Categories

	Sales	GP$$	GMROS
Footwear	$23,188	$7,807	$1,086
Photographics	$1,432	$310	$925
Perfumes - Prestige	$25,957	$8,088	$723
Confectionary	$14,046	$4,447	$625
Cosmetics - Prestige	$36,446	$10,685	$621

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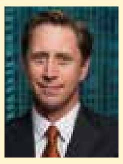

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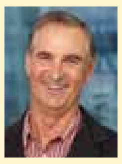

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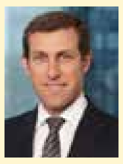

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Pharmacy Performance Overall

	Growth Last 12 Months	
Dispensary	**Sales**	**Gross Profit**
Dispensary	1.60%	7.65%
Middle Health	3.60%	3.49%
General	-7.59%	-6.08%

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