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Pharma's Challenge: Justifying Price Increases

(Source: an article prepared by Carly Helfand and published by FiercePharma, and the Wall Street Journal)

Merck's CEO Kenneth Frazier knows that with all the scrutiny surrounding the strategy of price increases, Merck is going to have to justify them. As Frazier told The Wall Street Journal, "there's a challenge" surrounding pricing that the pharma industry is "going to have to think through." And that includes finding "new and better ways to link what we charge for the drug to the value that it actually creates in the marketplace," he said.

That's easier said than done according to Frazier. As he pointed out, there are "barriers in the system" to sharing the risk with consumers. Merck, he says, is "actually very eager" to try outcomes based pricing, but "the laws around what we can and cannot do in our pricing model were made for a different environment. They weren't made for performance based contracting or risk sharing or any of those kinds of experimental approaches to pricing." Other drugmakers have managed to enter into "pay for performance" deals with payers, albeit in a small way, and after considerable effort. Frazier didn't say which of Merck's drugs might lend themselves to the idea.

In the meantime, the company plans to keep inching upward on price. But, Frazier promises, the company will continue trying to "be constrained in how we've done it, in a way we think doesn't prevent people from affording our drugs." While Merck hasn't been taking the kind of huge overnight price jumps that have put pharma in the national spotlight lately, *Januvia* and other stalwart drugs have steadily gone up. Januvia's price went up by 93% from 2010 to 2015, a study found last year, as reported by Newsday.

The drug is among a group of products like Novartis' leukemia blockbuster *Gleevec* that have come into the pricing conversation lately. Drugmakers have long used price hikes to offset slower volume growth. And on older drugs, price hikes can create a revenue spike before they fall victim to generic competition. But with all the recent drug pricing controversy coming from Congress, presidential candidates, the public and even doctors, other CEOs have been more proactive about making sure their companies don't get caught in the fray. GlaxoSmithKline's Andrew Witty, for one, has been clear that the company's been bulking up in vaccines and consumer health, two traditionally low margin businesses, to dodge pricing and access pressures that are vexing his Big Pharma peers. Novartis' CEO, Joe Jimenez, recently kicked off a restructuring centered on troubled eye unit Alcon, noting that the company needed to save money on operations if it wasn't going to be able to rely on the pricing power it used to enjoy.

Other drug companies have gotten into "pay for performance pricing," too. However, it's not just Big Pharma experimenting with outcomes based pricing models. Recently a Houston Texas based foundation said it would spend US$7.2 million to a variety of organizations to back research and field pilot projects that test particular setups for this type of a model.

In Brief . . .

- **McKesson** will acquire Canadian drugstore chain **Rexall Health**, including its approximately 470 retail pharmacies, from Katz Group for C$3 billion / US$2.2 billion. The acquisition is expected to strengthen McKesson's position in Canada's pharmaceutical supply chain and expand upon the companies' 20+ years of working together. Like McKesson Canada, the operations of Rexall Health will be part of McKesson's Distribution Solutions segment, which is under the purview of *Paul Julian*, EVP and group president (and IFPW's current vice chairman).
- Japanese wholesaler **Suzuken** reported a 12.2% increase in net sales (to ¥1,655 billion / US$14.6 billion) and a 62.6% rise in operating income (to ¥17,273 million / US$152.2 million) for its fiscal 3rd quarter.
- **American Associated Pharmacies** (AAP) and US wholesaler **H.D. Smith** will combine their respective pharmacy services administrative organizations (PSAOs) into a stand-alone PSAO entity, known as **Arete Pharmacy Network**, servicing more than 2,300 independent retail pharmacies across the United States. PSAOs are crucial but little-known intermediaries that operate between pharmacies and pharmacy benefit managers (PBMs) in the complex U.S. drug channel system. Arete Pharmacy Network will be the 4th-largest PSAO, just behind the PSAOs operated by the Big Three US wholesalers.
- **EBOS Group** (New Zealand) reported revenues of NZ$3.4 billion / US$2.3 billion (up 8.3% overall; with Healthcare up

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New Leadership Announced in Japan's Pharmaceutical Industry

(Source: Pharma Japan)

New leaders will take the reins of major Japanese wholesalers Alfresa Holdings and Suzuken, and drug maker Fuji Pharma as of April 1. They announced changes to their senior management on February 26.

Deputy President Taizo Kubo will become president of Alfresa Holdings to succeed Denroku Ishiguro, who will step aside to become a chairman. Meanwhile, the company's core wholesaling unit, Alfresa Corporation, will be headed by Koichi Masunaga. Incumbent president Hiroyuki Kanome will assume the role of chairman.

Suzuken said that it will promote its vice president, Hiromi Miyata, to president to take over the post from Hiroshi Ota. Mr. Ota will retire as a board member and become adviser upon the company's general shareholders' meeting slated for late June.

Fuji Pharma tapped its business development head Eiji Takemasa to take the helm of the company, which aims to open a new chapter of business after it just marked its 50th anniversary of its inception. Mr. Takemasa will continue to serve in the current post, while incumbent President Hirofumi Imai will become chairman.

McKesson Buys Biologics Inc. and Vantage Oncology

(Source: Barclay Research and Company Data)

McKesson announced a significant expansion of the company's oncology specialty pharmacy (SP) capabilities with the acquisition of Biologics Inc. (a private company) as well as a smaller but still material expansion of its oncology management network with the acquisition of Vantage Oncology (another private company). Barclay expects the majority of the US$1.2 billion attributed to the two transactions went toward Biologics Inc., which they view as a premium asset with strong physician and manufacturer relationships that can be leveraged across the broader McKesson Specialty Health businesses. The combined transactions will be funded by a mix of cash and incremental debt. The deals are expected to close in first quarter FY17.

McKesson possesses leading market share in the Oncology specialty drug (SD) marketplace focused on physician offices and clinics, which Barclay sizes at US$25 billion in 2016. They estimate McKesson's Oncology SD revenue at US$9-US$10 billion, just ahead of AmerisourceBergen. To date, the company has had a more limited role in the Specialty Pharmacy (SP) marketplace focused on serving patients in the home or alternate site, which Barclay sizes at US$19 billion. McKesson's existing SP activity is primarily in support of its network of practice-based physicians, chiefly oncologists. Biologics expands McKesson's Oncology SP offering while providing valuable manufacturer relationships.

Based on comparable companies covered by Barclay, they estimate that Biologics Inc. has annual revenue of roughly US$900 million, derived from dispensing oncology biologics to patients and physician offices as well analytics and services for manufacturers. Barclay's discussions with supply chain participants suggest that Biologics provides a high service model along the lines of Diplomat Pharmacy and has strong penetration of limited distribution and exclusive oncology products. With the acquisition of Biologics, McKesson expands the scope of its SP operation (though still limited to Oncology) while gaining access to limited distribution drugs. Barclay expects the ability to offer manufacturers comprehensive support for oncologists' complete SD and SP needs will expand McKesson's value proposition for biopharma leading to incremental synergy opportunities in the years to come. Barclay anticipates McKesson paid a premium valuation for Biologics, estimated to be 25 times 2015 EBITDA, or US$900 million.

Vantage Oncology extends McKesson's U.S. Oncology Model. Vantage Oncology operates more than 50 cancer centers in a practice management and service model that is similar to McKesson's U.S. Oncology network (USO), which is currently at 350 sites. The primary differences between Vantage and USO appear to be Vantage's focus on radiation oncology and the use of a joint venture (JV) structure with physicians and hospitals, which contrasts with USO's fee for service structure. It is expected that McKesson will leverage its scale and experience with USO to drive growth and create operational efficiencies with Vantage, which has little geographic overlap with the USO network. It will also be interesting to see to what extent Vantage's radiology capabilities can be leveraged to expand the USO network. Vantage is currently a McKesson distribution customer.

Vantage's public filings disclose US$181 million in revenue for the trailing 12-months ending March 31, 2014. Assuming revenue expanded to US$250 million in 2015 and apply a generous EBITDA margin of 10%, Barclay arrive at 2015 EBITDA of US$25 million. Taking into account the total revenue and earnings accretion commentary, they expect McKesson may have paid 12x 2015 EBITDA, or US$300 million for Vantage.

It is believed that the provider aligned clinic model puts McKesson in an advantageous position relative to the development of manufacturer offerings, including exerting formulary power to achieve elevated economics from the coming biosimilar wave.

"McKesson is committed to the success of our community oncology partners and customers and we believe the acquisitions of Vantage and Biologics complement our holistic approach to providing best-inclass care for oncology patients," said John Hammergren, chairman and chief executive officer, McKesson Corporation. "These investments will broaden McKesson's practice management services and solutions that allow oncologists to focus on providing excellent patient care and provide additional support solutions that enhance care delivery for patients. We will also be able to offer additional valueadded services to our manufacturer partners, expand our reach and pharmaceutical distribution scale, and provide care management and care coordination for payers as the industry moves towards valuebased reimbursement models," concluded Hammergren.

In Brief (cont.) . . .

by 8.2% and Animal care up by 10.1%) and EBITDA up 13.3% to NZ$113.7 million / US$75.9 million (with Healthcare up by 12.7% and Animal Care up by 16.3%).

- **IMS Health** reported revenue of US$2.9 billion (+21% on a constant currency basis) and net income of US$417 million, compared with a net loss of US$189 million in the prior-year period which included one-time IPO-related charges, in 2015.
- **Bayer** has named *Werner Baumann* as its new chairman of the management board, succeeding current chief executive *Marijn Dekkers*. Baumann will retain his current role as head of strategy and portfolio management when he takes on the chairman position on May 1.
- **Allergan** PLC's deal-making ways paid off in 2015 as revenue rose 124% to US$15.1 billion and non-GAAPearnings per share grew 78% to US$13.43, due in large part to the acquisition of Allergan Inc. last year and other transactions. Allergan President and CEO *Brent Saunders* said the company will not make any other transformative purchases while its US$160 billion merger with **Pfizer Inc.** is pending but that smaller deals to boost Allergan's main areas of expertise are still likely.

(Source: Drug Channels, Drug Store News, EBOS Group, IMS Health, Marketwired, Scrip and Suzuken)

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