Final Changes Announced Today for Drug System Reform in Ontario

June 7, 2010

The long awaited final changes to the Ontario Drug System Renewal were announced this afternoon by the Ministry of Health and Long-Term Care. We have been on hold since May 15th wondering what would happen. As it turns out, not much - very little impact on the private sector with the minor changes made from what was announced in April, and on the Ontario Drug Benefit (ODB) side - relatively few changes as well.

For those reading this within the capital markets, we don't see an enormous benefit to any of the publicly traded pharmacy chains - there is not much here.

Here is what was announced (all changes effective July 1, 2010 except for Lipitor - **lower pricing for generic Lipitor to change immediately**):

Generic Prices - will stay the same as announced in April (i.e. 25% of brand for government, 50% of brand price for all private sector plan sponsors in Year 1, 35% of brand price effective April 1, 2011, and 25% of brand price from April 1, 2012 until the end of time.)

Some exceptions will be made - for example, single-source generics, non-solid dosage forms, generics of brand products that have been benefits for 10 years or more, generics of brand products that we delisted from the provincial formulary 5 years ago or more, generics for brand drugs that have dropped prices by 20% or more over past 2 years, and three month pricing exceptions for new generics that come to market where generic company has fought to break patent and bring drug to market sooner, etc.

Professional Allowances/Rebates - gone as of July 1 for ODB plan, same 50%, 35%, 25% three-year reduction schedule for private plan sponsors. However, government will allow new "Commercial Terms" (i.e. allow prompt payment discounts, distribution service fees and volume discounts) but apparently will cap these at 10%. How the Government plans to police this is a mystery.... so rebates are out, commercial terms are in, what does that mean? Who knows? This will likely benefit large pharmacy chains who can negotiate better commercial terms. Bottom line: this is still a hit to pharmacy revenues without question, but commercial terms will soften the blow. These Commercial Terms are not new - they were part of the April announcement.

Private Label Generics - still banned on both public and private sector claims. Not great news for Shoppers Drug Mart, Rexall or Jean Coutu.

Bottom line - very little has changes since April announcement for private sector plans outside of some of the generic pricing exemptions. Overall lower generic prices are good news, but as we have discussed, there are a number of ways around these changes that will adversely impact employers (higher mark-ups, higher dispensing fees, etc.)

Some items that impact public sector claims but are of no interest whatsoever to private plans sponsors:

Mark-ups: will stay at 8% on public side for all pharmacies, but they did get rid of the $125 mark-up cap for expensive biological products.

Dispensing Fees: Will increase from $7 to $8, $9, $11 or $12 depending on how far a pharmacy is from another... some minor changes here from April.

Transitional Fee: From the pool of money that was **already allocated** for additional professional services in the April announcement, Government will partially offset blow to pharmacies by having a transition allowance on ODB claims that will provide an additional $1 dispensing fee per prescription in 2010/2011, $0.65 in 2011/2012 and $0.35 in 2012/2013 and $0 thereafter)

Professional Services: Government is expanding its coverage of professional services. It also now start paying pharmacies $60 (up from $50) for a MedsCheck consultation, and has expanded the program for long-term care residents, diabetic patients, and those who are unable to travel outside of home. Government is forming a committee to figure out how to allocate the rest of the $150 million in professional services already allocated back in April announcement - so no details there.

Our take: these are very minor changes to what was announced in mid-April, which is somewhat of a surprise given the delays since May 15.

Good news for private plans: generic price reductions are coming, but the bad news is that there will be a reinforced effort by pharmacy to make up that lost revenue elsewhere given that there was little give-back on ODB side of the business.