

Medicare drug benefit: Boon or bust for drug companies?

By THERESA AGOVINO
Associated Press

NEW YORK — At first blush the Medicare drug benefit senior citizens began signing up for on Tuesday seems like a pharmaceutical executive's dream: Millions of people who formerly lacked drug coverage suddenly having the means to buy medicines.

And for the first year or two the benefit, which takes effect in January, should boost sales and profits as health insurers competing for members offer generous drug coverage. Sanford C. Bernstein analyst Richard Evans estimates the benefit could increase earnings in 2006 and 2007 by 2 percent to 3 percent.

But the long-term picture is much murkier. Analysts and some drug-industry executives believe health plans will become much less liberal with drug coverage after they've attracted members and the government uses its considerable clout to rein in pricing. Evans estimates the benefit could lower drug companies earnings by between 3 percent

and 13 percent in 2006 and 2009.

Experts contend the benefit will only add to growing pressure on drug companies to prove their products are more cost-effective than the competition's medicines. During the 1990s, pharmaceutical companies earned billions of dollars by churning out drugs that were very similar to their brethren's products or second generations of their own medicines that were barely distinguishable from the original.

Those days are already fading, but experts say the change will come even faster after the benefit goes into effect because the government will have unprecedented influence on pricing. It will pay for about 41 percent of the drugs purchased in the United States next year.

"A customer that big has enormous negotiating power. If you don't get your product on a government formulary, your product doesn't have a future," said Anthony Hooper, president of the U.S. pharmaceutical division of Bristol-Myers Squibb Co. "Now not only does your product have to work, but the gov-

ernment is going to demand information that differentiates it."

Some drug executives don't see doom because they say managed care has already pushed them to contract prices and prove their drugs are worth the money. Studies which compare competing drugs' outcomes are becoming more common.

It is too soon to predict the benefit's effect because it is unclear how many beneficiaries will enroll and what kind of plans they will select, said Ian D. Spatz, vice president of public policy at Merck & Co. Also, insurers' participation and product offerings will change as they gain more experience.

"This is a learning process," Spatz said. "They'll be a lot of change."

Drug executives hope the Medicare law's ban on government price controls remains a constant, but that could change if costs balloon.

Estimates of the benefit's price tag have already jumped. In February 2004, the White House said it would cost \$511 billion over 10 years, but the figure rose

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AP photo
Mary Spring, 83, from Los Angeles, listens as she is briefed on the Medicare prescription drug benefits program by Jillian Green, an advocacy group field organizer with Medicare Today, during a seniors Medicare drug workshop at the Van Nuys-Sherman Oaks Senior Center in Sherman Oaks, Calif.

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to \$724 billion last February. One reason for the lower estimate is that it included 2004 and 2005, when the government was financing drug discount cards and not the more expensive benefit, while the 2005 estimate was for 2006 through 2016.

"There isn't enough pressure on pricing in the industry," said Carl Seiden, an analyst at UBS, noting that price increases have outpaced inflation for years.

Seiden said the industry's research and development haven't been especially productive in the last decade but price increases have helped prop up earnings.

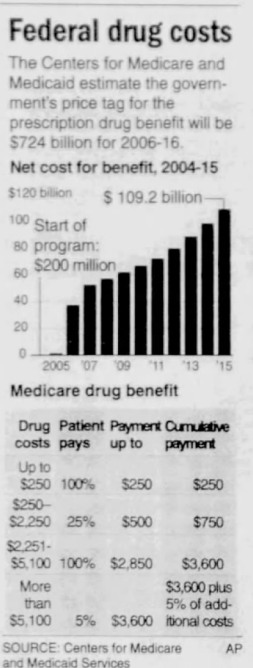
According to pharmacy benefit manager Express Scripts, the average drug price rose 6 percent last year, after jumping 6.9 percent in 2003 and 7.5 percent in 2002.

Higher prices have contributed to a slowdown of the growth in prescriptions written as some people forgo medicines that they can't afford. According to IMS Health, a consulting company which tracks the industry, the number of prescriptions written grew only 2.3 percent last year, its fifth consecutive year of decreasing growth. In 2000, the number of prescriptions rose 6.5 percent.

Analysts note that not all companies will be affected equally. Companies such as Merck and Pfizer Inc., which make a lot of products in crowded markets such as cardiovascular medicines, may suffer more than companies with more specialized products such as Bristol-Myers and The Eli Lilly & Co.

Pfizer and Merck disputed that notion. During a conference call last month, Pfizer CEO Hank McKinnell said the company was well positioned because it reorganized its sales force around the 34 regions the government set up to administer the drug benefit, instead of its previous clustering around high population areas.

This way, Pfizer sales representatives can talk knowledgeably with doctors about which drugs are covered by each insurer's health plan, said Pat Kelly, president of Pfizer's U.S. business. Medicare covers about 42 million people, so it makes sense to cater to such a



large demographic, Kelly said.

Pfizer's top-selling drug, cholesterol-lowering agent Lipitor, may already be under pressure. Express Scripts is recommending clients remove it from the list of preferred drugs next year because competing drug Zocor will lose its patent protection. Generic drugs are 50 percent to 60 percent cheaper than brand names. Pfizer believes doctors and patients will continue to demand Lipitor because of the vast evidence of its effectiveness.

Indeed, experts expect Medicare drug plans to promote the use of generic drugs to hold down costs as private insurers have for years. It will become easier as numerous drugs lose patent protection in the next few years such as Bristol-Myers' cholesterol drug Pravachol and Pfizer's antidepressant Zoloft.

Numerous categories of drugs are already under fire. Bristol-Myers' Hooper said that Medicare drug plans were asking for bigger discounts than commercial plans and in some cases receiving them. For example, Medicare plans were demanding 35 percent discounts on ACE inhibitors, drugs used for high blood pressure, he said. Private health plans receive a 25 percent discount.