Sales remain strong, but rising costs and tightening margins drive distributors to focus on automation, efficiency and managing employee turnover.

U.S. Economy and Distributor Sales
U.S. businesses, including those within the healthcare distribution sector, faced a mixed economic landscape in 2023. The labor market remained exceptionally tight; unemployment levels were at lows not experienced in over 50 years, and wage pressures continued to push companies to raise compensation.

Inflation moderated significantly over the year, falling from 6.4 percent in January to 3.4 percent by December. With the Federal Reserve's interest rate hikes tempering overall economic growth, distributors faced a challenging environment; companies felt pressure to maintain margins amid rising costs and higher borrowing costs.

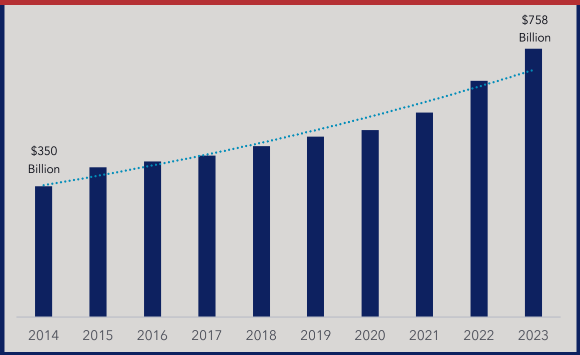
Despite these headwinds, total Rx sales through traditional pharmaceutical distribution grew by 13.7 percent in 2023, following increases of 15.5 and 9.4 percent in 2022 and 2021, respectively. Pharmaceutical distributor sales reached $758 billion, accounting for 95 percent of all prescription drug sales.

Sales by Customer and Category
The overall product mix of healthcare distributors has remained steady over the past several years. However, the composition of prescription drug sales by dollar volume continues to shift increasingly toward specialty drugs. A decade ago, brand name drugs accounted for 64 percent of total sales, while generic drugs made up 14 percent. By 2023, those shares dropped to 53 percent and 6 percent, respectively. In contrast, sales from brand name specialty drugs steadily climbed from 20 percent in 2014 to 38 percent in 2023 — up from 36 percent in 2022.

In 2023, the breakdown of sales across customer types remained mostly consistent, though some notable shifts occurred. Sales to chain drug stores declined from 41 percent in 2019 to 36 percent in 2023. Much of this shift was absorbed by specialty pharmacies, mail-order services and other distributors.

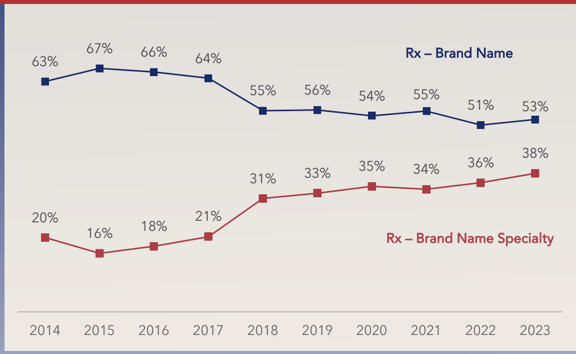
2023
Sales Growth
13.7%

DISTRIBUTOR SALES



9.2% CAGR
Since 2014

PRODUCT TYPES (% OF $)



Margins
Despite the industry's robust sales growth, rising product costs and reduced cash discounts on purchases pushed distributors' gross margins down further in 2023, extending an 11-year trend without improvement. Over that span, the industry's gross margin tumbled from 3.4 percent in 2013 to 1.7 percent in 2023 — the lowest margin in the study's 95-year history. Bottom-line profits also fell back to 0.4 percent, matching 2021 and marking another historic low for profits. As usual, distributors' cost of goods sold exceeded net sales, with profits solely reliant on cash discounts obtained through vendor payment terms. Notably, the cash discount percentage declined from 2.5 percent of sales in 2021 to 2.4 percent in 2022 and 2.3 percent in 2023, mirroring the decrease in gross margins each year.

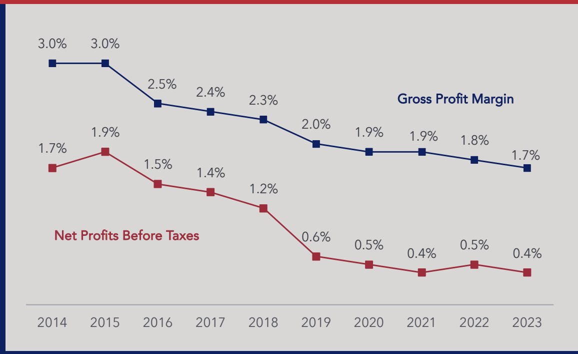
Employees
Labor shortages and employee turnover remained significant challenges in 2023. Baby Boomers continued to exit the workforce, while distributors faced difficulties attracting and retaining qualified workers. According to a 2023 Industry Insights survey of more than 1,000 distributors, most cited an ability to find and retain qualified employees as a main concern.[1]

Employee turnover rates remained elevated in 2023. While there were slight improvements over the previous year, healthcare distributors still saw a turnover rate of approximately 35 percent, with 33 percent of day-shift employees and 46 percent of night-shift employees leaving their jobs. These rates, though slightly improved from 2022, are still significantly higher than pre-pandemic levels. Median turnover for warehouse employees across all distribution sectors was 16 percent, according to Industry Insights' survey of distributors.

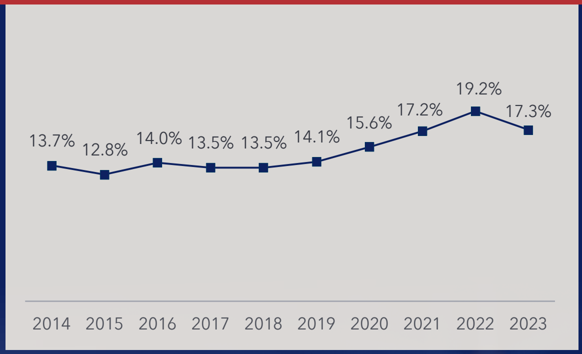
In response to persistent labor market pressures, healthcare distributors have been adjusting compensation. Total compensation per employee in 2023 was $83,000, reflecting a long-term trend of rising wages, which stood at $63,000 in 2017. Each employee also averaged $21,000 in company-provided benefits. Overall employee costs as a percentage of gross margins have also been on an increasing trend, reaching 17.3 percent in 2023 — up from 14.1 percent in 2019.

[1]*Fifty-seven percent of distributors relayed that "finding qualified employees" was a top concern, and 52% cited "retaining employees" was a top concern.*

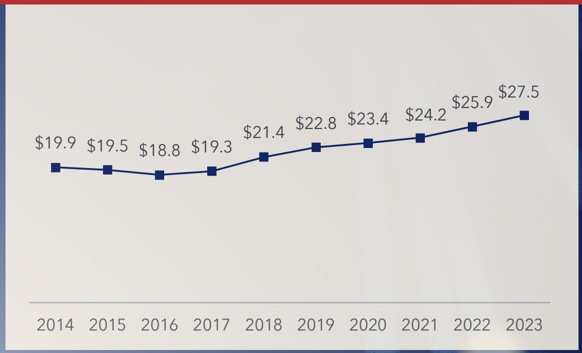
GROSS PROFIT MARGIN



TOTAL COMPANY PAYROLL AS A PERCENT OF GROSS PROFIT MARGIN (%)



SALES PER EMPLOYEE (Millions)



The rising labor costs have placed additional pressure on margins. Most healthcare distributors provided wage increases of 3 percent to 3.5 percent in 2023, with similar adjustments planned for 2024.

Distributors have responded to the increasing labor costs by consistently improving employee productivity. Average productivity increased by 6 percent in 2023, with net sales per employee rising from $25.8 million in 2022 to $27.5 million. This marks another year of steady gains, bolstered by ongoing investments in automation and process improvements. In 2023, 66 percent of companies reported using automated methods, with 47 percent of invoice lines being picked through these automated processes.

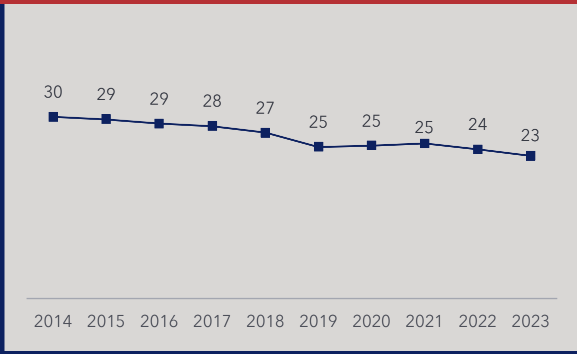
Asset Management

Healthcare distributors further streamlined their balance sheets in 2023, reducing cash, inventory and receivables. This led to an increase in the industry's asset turnover rate, which rose to 6.1 times in 2023, up from 5.9 times in 2022 and 5.5 times in 2020. A turnover rate of 6.1 means that the industry's net sales were 6.1 times the book value of its assets. A higher asset turnover rate indicates more efficient use of assets to generate revenue. The industry's steady range of 5.5 to 6.5 over the past 15 years highlights consistent operational efficiency.

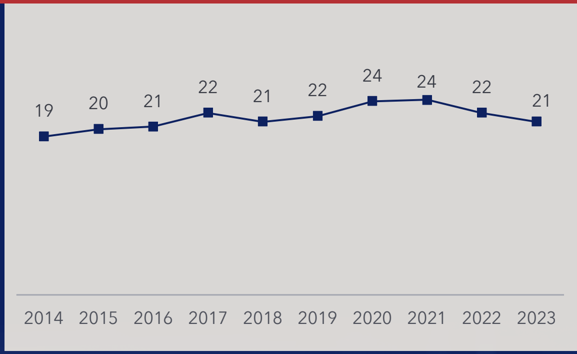
Capital expenditures have fluctuated significantly in recent years. In 2021, the industry increased capital spending to $450 million, primarily to support COVID-19 vaccine distribution. In 2022, capital expenditures dropped to $300 million, of which a heavy focus was on information technology investments to meet serialization requirements. For 2023, capital expenditures rose by 10 percent to $335 million and reflected a more typical level for the industry. "Land, buildings and vehicles" accounted for 44 percent of the total, while information technology made up 40 percent. The remaining 16 percent was allocated to machinery and equipment.

Inventory management remained a bright spot for healthcare distributors in 2023, as companies further streamlined their processes. Inventory was held for 23 days on average, down from 24 days in 2022.

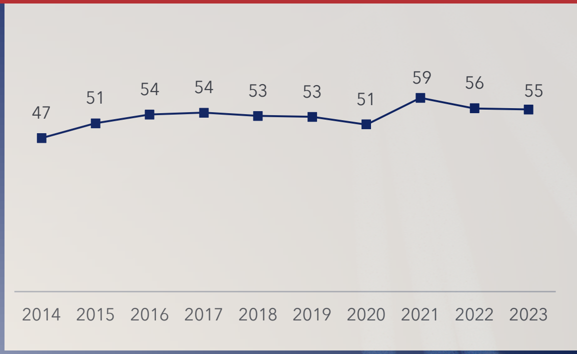
INVENTORY DAYS



RECEIVABLE DAYS



PAYABLE DAYS



Liquidity and Leverage

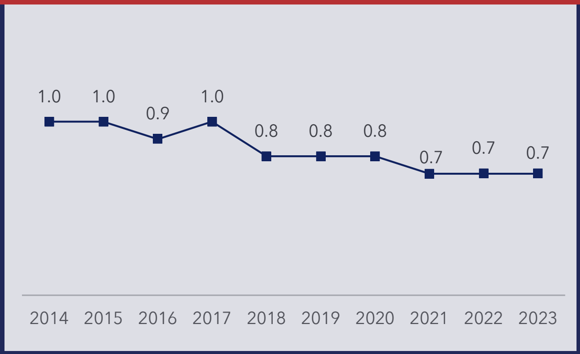
Healthcare distributors support their cash flow by minimizing inventory levels and collecting receivables in 21 days while taking 55 days to pay their accounts payables. Despite these efforts, key liquidity metrics — such as the current ratio and acid test ratio — remained low, suggesting potential cash flow difficulties.

The leverage ratio (assets/net worth) highlights how much of the industry's assets are financed through debt rather than equity. While leverage can be advantageous for seizing high-return opportunities like acquisitions or capital improvements, it also increases financial risk. After two years of modest improvements, distributors' leverage increased in 2023, with 96.5 percent of assets funded by debt — well above levels seen a decade ago. As distributors navigate reduced margins and elevated interest rates, the impact of the industry's unique leverage will be monitored.

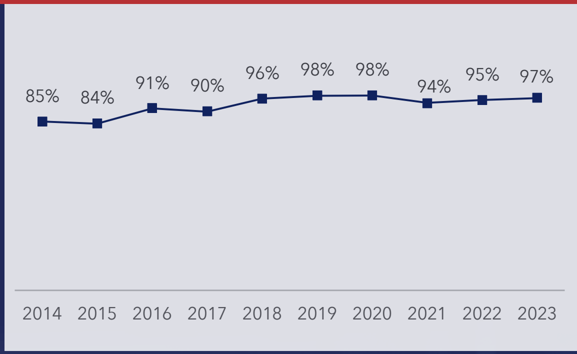
Orders

In 2023, distributors picked more than 10 million units per day. Each traditional distribution center processed an average of 4,200 orders per business day, with each order consisting of 12 invoice lines and 25 units. The average sale per invoice line increased to $432 in 2023, up from $416 in 2022, while the average invoice totaled $5,200. Distributors filled 88 percent of invoice lines for "raw orders," a slight improvement from 86 percent in 2022. The primary reasons for unfilled orders were manufacturers' inability to ship (73 percent) and distributors being out of stock (27 percent).

CURRENT RATIO



PERCENT OF ASSETS FUNDED BY DEBT



Note: *this summary is focused on traditional distribution*

Source:
Industry Insights. *Cross-Industry Compensation and Benefits Survey.* June 2024.

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