Healthcare distributors boosted productivity and efficiency. Sales surged, though profit margins remain squeezed.

U.S. Economy and Distributor Sales
After two years defined by the COVID pandemic, 2022 brought a hopeful shift toward “business as usual.” The economy, though, brought challenges for most U.S. businesses, including healthcare distributors. Inflation surged during the year (averaging 8 percent), fueled by strong cash positions, supply chain shortages, energy demands from the war in Ukraine and a labor market that offered two open positions for every person looking for work. The highest level of inflation in 40 years far exceeded the 1.9 percent rate averaged over the past decade.

Total Rx sales through traditional pharmaceutical distribution jumped 15.5 percent in 2022, following an increase of 9.4 percent in 2021. Distributor sales reached $666 billion and accounted for an estimated 95 percent of all pharmaceutical sales.

Sales by Customer and Category
Distributors’ mix of products has remained steady over the past several years. However, the types of prescription drugs (in terms of dollar volume) continue to shift more toward specialty drugs and biosimilars. A decade ago, 64 percent of all sales were brand name Rx drugs, though that portion has steadily fallen to 51 percent in 2022. Generic Rx drugs have also fallen from a peak of 15 percent in 2015 to 7 percent in 2022. In their place, sales from brand name specialty drugs have climbed from 23 percent to 36 percent during the same period. Biosimilars came out strong in 2022, accounting for 4 percent of sales.

The portion of sales to each customer type has also held consistent in recent years, though some shifts have taken place over the past 10 years. Nine percent of distributors’ sales were to specialty pharmacies in 2022, compared with just 1 percent in 2013. Chain store sales have risen from 41 percent to 46 percent since 2013, while sales to independent drug stores have gradually fallen from 15 percent in 2011 to 12 percent in 2022.
Orders
Distributors picked more than 10 million units per day in 2022. Each traditional distribution center processed 4,600 orders each business day, and these orders averaged 11 invoice lines and 22 units. The average sale per invoice line was $416. Distributors filled 86 percent of invoice lines for their “raw orders” in 2022, which was down from 93 percent in 2021. The cited reasons for unfilled orders were the manufacturers being unable to ship (69 percent) and distributors being out of stock (31 percent).

Margins
Despite strong sales growth, rising product costs pushed distributors’ gross margins down further in 2022, extending a pattern of 10 consecutive years. The industry’s gross margin fell from 3.4 percent in 2013 to 1.8 percent in 2022, which is the lowest margin in the study’s 94-year history. The industry’s bottom-line profits improved slightly (0.4 percent to 0.5 percent), thanks to reduced relative expenses in areas of buying, warehousing and delivery costs. Distributors’ cost of goods sold again exceeded their net sales. The industry’s profits continue to be solely obtained through cash discounts on purchases, due to vendor payment terms.

Employees
Labor shortages and employee turnover caused major issues for U.S. companies in 2022. Many Baby Boomers exited the workforce during the pandemic, and millions of younger adults paused their careers due to COVID concerns or to help care for their children. Millions more quit their jobs in search of better work-life balance, compensation and culture fit. An Industry Insights survey of more than 1,000 distribution companies listed finding and retaining qualified employees as top concerns.¹

Though their employees had mostly stayed put in 2020 and 2021 as they battled the pandemic, labor turnover became a major issue for healthcare distributors in 2022. More than one-third of day shift employees left during the year, and 54 percent of night shift employees exited. For comparison, the exit rates were just 23 percent and 32 percent, respectively in 2021.

¹Seventy-three percent of respondents relayed that “finding qualified employees” is a main concern, and 48 percent indicated that “retaining employees” is a top concern.
In response to the turnover, tight labor conditions and high inflation, wages jumped again in 2022, with the typical healthcare distributor employee earning $90,000 in total compensation, compared with $77,000 in 2021 and $69,000 in 2020. Each employee also averaged $16,200 of company benefits. Payroll-related costs added pressure to distributors’ profit margins, with costs (as a percentage of gross profits) jumping from 14.1 percent in 2019 to 19.2 percent in 2022. This pattern should flatten out as inflation subsides and employee turnover improves in 2023. Healthcare distributors anticipate salary adjustments of 3 percent to 4 percent for most positions in 2023.

Healthcare distributors’ employees added an eighth consecutive year of productivity gains. Distributors averaged $26 million in net sales ($463,000 of gross profit) for each employee, steadily climbing from $18 million per employee in 2013. Inflation and continued investments in automation and other process improvements allowed for the productivity gains. The portion of companies using automated methods continues to climb (66 percent), and nearly half of their invoice lines were picked by automated methods in 2022.

Asset Management
Distributors decreased the relative size of their balance sheets in 2022, with reductions in cash, inventory and non-current assets. The industry’s asset turnover rate increased to 5.9 times in 2022 from 5.5 times in 2020. A turnover rate of 5.9 means that the industry’s net sales were 5.9 times larger than the book value of its assets. The industry’s asset turns have been consistent, ranging from 5.5 to 6.5 over the past 15 years.

After surging to $450 million in 2021, capital expenditures fell back to $300 million in 2022. Information technology accounted for 60 percent of the new expenditures, followed by “land, buildings and vehicles,” at 31 percent. Machinery and equipment accounted for the remaining 9 percent of capital investments.

Inventory management continued to be a bright spot for healthcare distributors, with companies holding inventory just 24 days in 2022 (the shortest holding period in the study’s history). Distributors made payments on trade accounts after 56 days, on average, during 2022. After two years of an increasing receivables collection period, companies reduced their collection time to 22 days in 2022.
Liquidity and Leverage
Healthcare distributors support their cash flows by collecting receivables in 22 days and paying their accounts payables in 56 days. Despite these steps, the key liquidity metrics (the current ratio and the acid test ratio) remained low, signaling that distributors could be experiencing cash-flow difficulties. The leverage ratio (assets/net worth) reveals how much of the industry’s assets are funded by debt, rather than equity. Following several years of high leverage ratios (98 percent of assets were funded by debt in 2020), distributors improved their net worth positions in 2021 and 2022 (94 percent and 95 percent of assets funded by debt, respectively). The portion of assets currently funded by debt is well above the level carried 10 years earlier.

Note
This summary is focused on traditional distribution.

Source

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