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A Closer Look: COVID-19 Script Declines Represent an Acute, Not Chronic, Problem

We believe the implications of recent declines in new scripts on the outlook for mid- to late 2020 script growth are being misconstrued. Yes, retail scripts declined -13% y/y the week ending May 1st, but the decline was driven by a -25% shelter-in-place drop in acute scripts which will rebound with reopening whereas the more significant metric of chronic scripts was down just -7% inclusive of a destocking effect we put at 400-500bp. The decline in chronic is far less than the headline suggests and should be in no way surprising given the March pull forward was driven entirely by chronic scripts. While the short-term decline in acute scripts will weigh on June Q pharmacy and distributor results, the relative strength of chronic scripts suggests this is an 'acute' not 'chronic' headwind. We expect retail volume will be depressed by -8.2% in the June Q but will face only a -1.3% headwind in 2H2020.

We estimate panic buying pulled forward 14mn chronic scripts in March. Panic buying was driven by chronic scripts. We project the pull forward at 14mn in March and the destock at 11mn March 28 to May 8th. **As such, we expect chronic scripts will stabilize at down ~3% y/y over the next 2-3 weeks.**

Social distancing and healthcare system avoidance reduced acute scripts by 25%. Acute scripts declined -25% y/y the week of April 10th and have yet to recover though w/w trends inflected from contraction to expansion May 1st. **Our initial read of May 8th data suggests new scripts increased +5.1% w/w as physicians expanded hours and states began to open.**

Chronic scripts account for 69% of total. Segmenting Total Rx (TRx) between treatments for chronic disease on an ongoing basis and treatments for acute conditions we find chronic scripts make up 69% of total and refills compose 77% of total scripts. **The impact of shifts in chronic scripts are more than double the impact of acute and closer to 6-12x on an annual basis.**

New Therapy Starts account for only 19% of scripts, most of which are acute. The category of 'New Rx (NRx)' is somewhat of a misnomer as it includes New Therapy Starts as well as Switch/Add-on Scripts and New Script Refills. **Most important, the New Therapy Starts most likely to be impacted by a decline in physician office visits and screening activity represent only 19% of total scripts and just 12% of chronic scripts.**

In sum, we believe the relative trend in chronic scripts is better than appreciated and the decline in acute scripts will prove temporary in nature. Although the impact of an -8.2% reduction in June Q volume will be significant for pharmacies, distributors and PBMs, the supply chain should prove far more insulated than other areas of healthcare services and retail with full year projected retail volume down only -2.1%. We see Buy rated **Amerisource** as most insulated followed by **McKesson** and **CVS Health**. We are constructive but remain at a Hold rating on **Cardinal Health** and **Walgreens**.

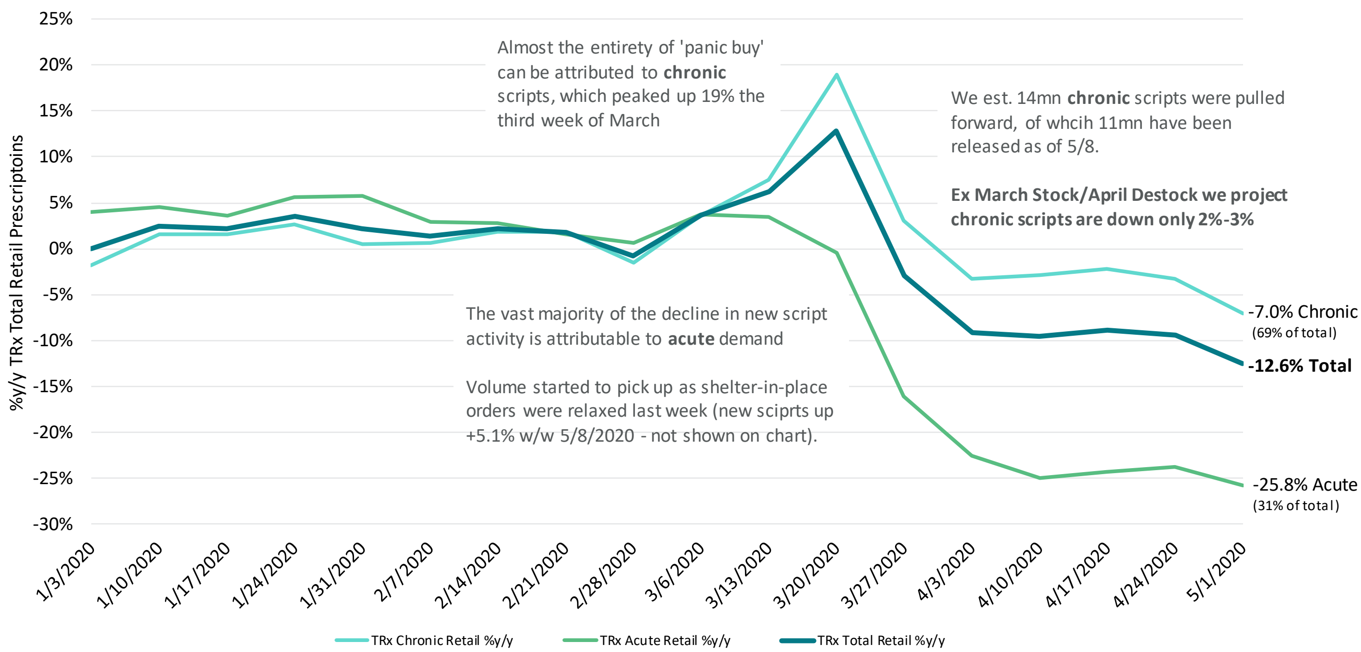
Script Declines Represent an Acute, Not Chronic, Problem

We are surprised that most analyses of script trends have not differentiated between acute and chronic trends

It is our view that the implications of recent *acute* led script declines on the outlook for mid- to late2020 *total* script trends are being misconstrued and the stability of underlying *chronic* script trends is underappreciated.

- **Total retail scripts ended the week of May 1st down 12.6% y/y (Fig. 1).** Total retail scripts jumped from a +2% y/y Jan-Feb run rate to +12% y/y in mid-March before reversing on shelter-in-place orders, declining to -10% y/y as we entered April. Total scripts then took a second step down in late April arriving at -12.6% y/y on May 1st. **The secondary decline in late April appears to have raised investor concerns that chronic scripts were falling alongside acute, suggesting that beyond fewer office visits and screening activity we might be seeing a decline in continuing scripts that could drive a prolonged reduction in total scripts well after the economy reopened and acute activity rebounded.**

Fig. 1: TRx Retail Acute/Chronic Breakdown



Source: Nephron Research, Script data from IQVIA Rx RAPID Weekly, IQVIA Institute, May 8, 2020

It is our view the trend in chronic scripts is better than appreciated and acute scripts will bounce back sharply as the economy reopens

Although retail scripts declined -12.6% y/y the week of May 1, correctly identifying the implications for mid- to long-term script growth requires examining the underlying trend in acute and chronic scripts. **We believe the relative trend in chronic scripts is better than appreciated and the decline in acute scripts will prove temporary in nature.**

- **Acute scripts declined sharply on shelter-in-place orders and have not budged.** It is important to note that Acute scripts saw almost no pull forward in early March (we may have seen some minimal stocking of antibiotics and inhalers) and so have not been impacted by destocking. As such the -25% decline in early April is attributable almost entirely to shelter-in-place orders reducing activity (no one is getting swimmers ear) and socializing (no one is making an office visit for botox or shingles vaccine). **Acute scripts remained down -25.8% y/y for the week ending May 1st but inflected positive in early May as new scripts increased 5.1% w/w the week end May**

8th (not shown on chart) and should rebound significantly as social distancing measures are relaxed even if health system avoidance is slow to ebb.**

- **As Chronic was near 100% of the pull forward it is near 100% of the destock.** Whereas acute scripts declined -25% in early April and remained at -25.8% on May 1st, chronic scripts declined -5% in early April but stepped down to -7.0% on May 1st. A 7% decline in Chronic scripts (which account for 69% of total retail scripts) would hold significant mid to long-term implications for supply chain revenue and profit if sustained, as chronic scripts will be much slower to rebound (only 5-15% of chronic scripts are dynamic in any given year). However, chronic script accounted for near the entirety of March panic buy activity, increasing 19% y/y the week of 3/20/2020. **We estimate that as much as 500bp of the decline is attributable to pull forward, suggesting the underlying decline from fewer new brand scripts is running closer to ~3%, and will decline to -1.3% in the back half of 2020.**
  - Last week we received a lot of incoming questions on other analyst's interpretations of IQVIA data which included expectations for ongoing high-teens declines in total scripts and further chronic script deterioration. As noted above, we expect that the chronic script trend of -7% is likely nearing the nadir and should improve as destocking runs its course over the coming 2-3 weeks.
  - Our conversations with pharmacists and physicians indicate that after the initial panic buying wave, lower volumes at independent and chain pharmacies have provided time for increased outreach on adherence (with mail pharmacies also increasing outreach), doctors and nurse practitioners are conducting fewer new visits but telehealth productivity is increasing and with fewer office visits prescribers have more time on their hands to call in continuing script. **For the week of 5/7, IQVIA data showed that office visits began to expand including in some of the most hard-hit specialties such as ortho, GI and cardio.** The number of handwritten scripts also took back market share from electronic scripts for the first time in five weeks.
  - **The decline in office visits over the past 6-weeks is clearly a much larger headwind for new scripts than for continuing scripts. Specifically, we expect that there will be an ongoing impact from the loss of scripts from asymptomatic patients that are missing screenings and those that require diagnostic tests prior to initiating a new therapy. Given that 'dynamic' chronic scripts represent 5%-15% depending on therapy, we estimate the post destocking headwind at -3.0% and the cumulative impact of missed new scripts April to July at -1.3% in second half 2020 and early 2021.**

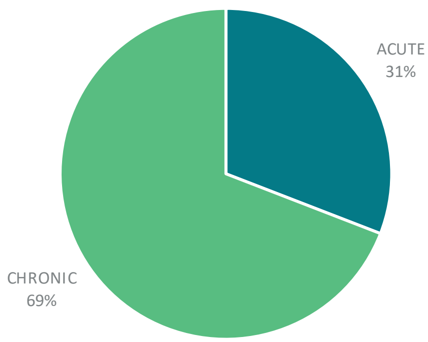
Given that dynamic chronic scripts average 12% of total, a 25% ongoing headwind would represent 3% of chronic scripts

Trends in New Starts, Switches and Refills

Chronic scripts account for 69% of total. Segmenting Total Rx (TRx) between treatments for chronic disease on an ongoing basis and treatments for acute conditions we find chronic scripts make up 69% of total scripts (refills compose 77% of total inclusive of acute refills). **As such, the impact of shifts in chronic scripts is more than double the impact of acute and closer to 6-12x on an annual basis.**

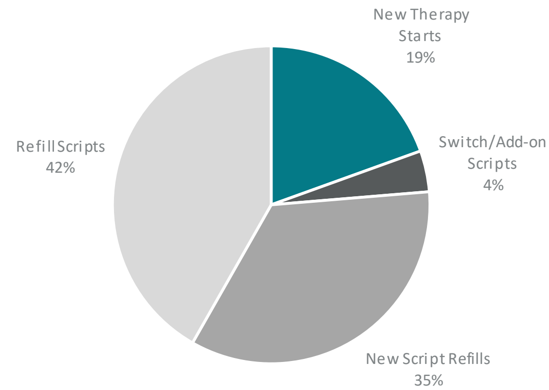
New Therapy Starts account for only 19% of scripts, most of which are acute. As seen in Fig 3 on the following page, the category of 'New Rx (NRx)' is somewhat of a misnomer as it includes New Therapy Starts as well as Switch/Add-on Scripts and New Script Refills. Most important, the New Therapy Starts most likely to be impacted by a decline in physician office visits and screening activity represent 19% of total scripts. **New therapy starts and switches are just 12% of chronic scripts vs 51% of acute.**

Fig. 2: Chronic scripts account for 69% of Total Rx – should prove highly inelastic through pandemic and recession



Source: Nephron Research, Script data from IQVIA "SMART – US Edition", IQVIA Institute

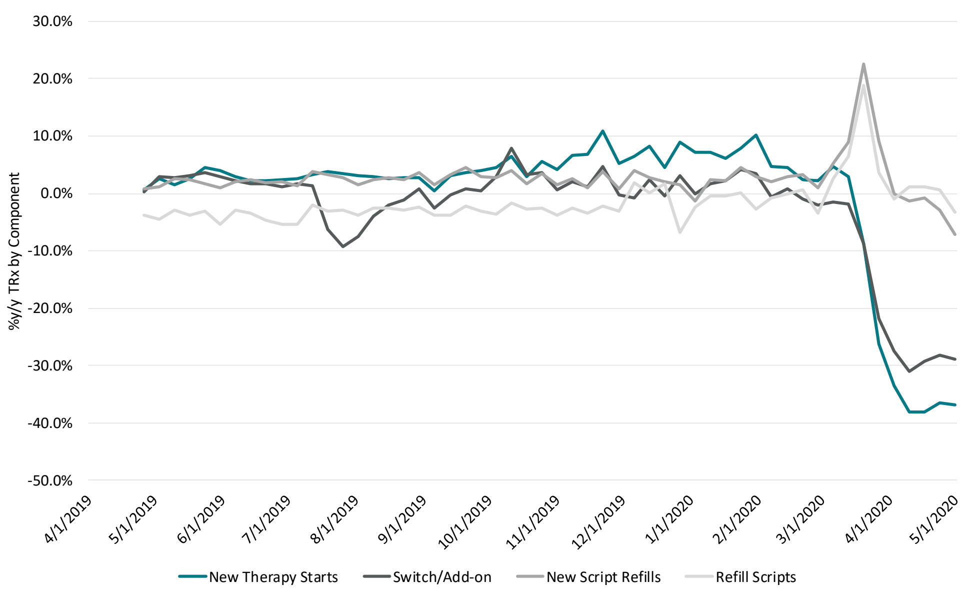
Fig. 3: Refill scripts account for 77% of Total Rx – the new therapy starts most at risk account for 19%



Source: Nephron Research, Script data from IQVIA "SMART – US Edition", IQVIA Institute

Figure 4 makes clear just how sharp the decline in New Therapy starts has been, down 37% y/y showing how steep the decline in acute has been (again, new therapy starts and switches are just 12% of chronic scripts vs 51% of acute). By comparison, refills are down only -3% and new script refills are down only -7%.

Fig. 4: TRx by Component



Source: Nephron Research, Script data from IQVIA Patient Insights Weekly, IQVIA Institute, May 14, 2020

To really understand how much of the downtick in new scripts is attributable to acute vs chronic scripts, we find it is best to look at the absolute numbers over the last 12-months. **Fig. 5 shows new start activity for both acute and chronic scripts.**

Fig. 5: New Start Weekly Volume: The decline in acute volume far surpassed chronic

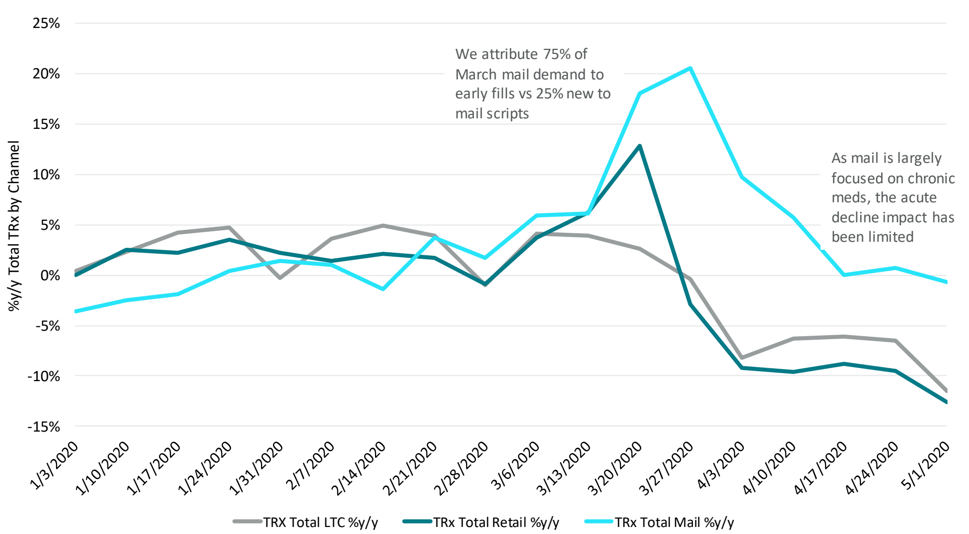
Source: Nephron Research, Script data from IQVIA Patient Insights Weekly, IQVIA Institute, May 14, 2020

Mail vs Retail (and Long-Term Care)

The March increase in mail channel volume appears to be 75+% attributable to early fills and only 25% attributable to new to mail scripts. **Given that the majority of scripts were not true switches and that mail accounts for only 5% of total claims, we size the channel share shift at only 30bp.**

The decline in long term care comes as some surprise as we would expect that patients would still have access to scripts. We assume a portion of this decline is attributable to a decline in census and a portion to the inclusion of broader institutional customers that have been impacted by elective procedures in this channel.

Fig. 6: TRx by Channel



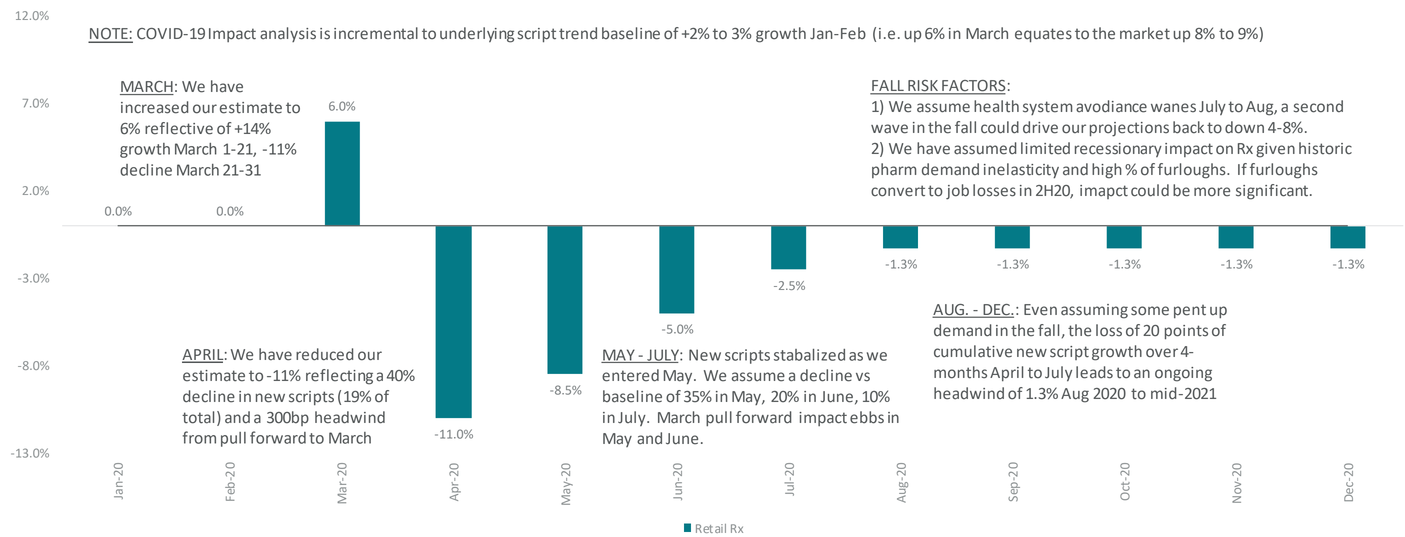
Source: Nephron Research, Script data from IQVIA Rx RAPID Weekly, IQVIA Institute, May 8, 2020

Updated 2020 Retail Script Projections

With the decline in new brand starts stabilizing in late April, we update our projections of COVID-19 impact on retail scripts, arriving at a full year headwind of -2.2%

We have updated our COVID-19 script growth impact analysis to reflect datapoints accumulated from early May pharma supply chain discussions and earnings reports (March Q result up sharply June Q outlooks less negative than expected despite a sharp drop in April) as well as IQVIA weekly script trends. **The level of COVID-19 disruption was greater than we initially modeled with a projected early March 'panic buy' boost of +14% giving way to an -11% downward trend in late March and April. We model this decline was composed of a -40% decline in new scripts (~19% of total) driving an -8% headwind and post panic destocking driving an additional -3% headwind.**

Fig. 7: Our projection of incremental COVID-19 impact on retail scripts has increased to 2.2% from 0.9% in 2020



Source: Nephron Research Projections as of 5/13/2020

Outlook

In sum, we believe the relative trend in chronic scripts is better than appreciated and the decline in acute scripts will prove temporary in nature. Although the impact of an -8.2% reduction in June Q volume will be significant for pharmacies, distributors and PBMs, the supply chain should prove far more insulated than other areas of healthcare services and retail with full year projected retail volume down only -2.2%. We see Buy rated **Amerisource** (we maintain our $102 12-mo target price, 14x FY20 EPS of $7.45) as most insulated followed by **McKesson** (we maintain our $174 12-mo target price, 12.2x our revised, and depressed FY21 EPS estimate of $14.27) and **CVS Health** (we maintain our $84 12-mo target price, 11.9x our FY20 EPS estimate). We are constructive but remain at a Hold rating on **Cardinal Health** (we maintain our $55 12-mo price target, 9.7x our forward 12-mo EPS estimate of $5.65) and **Walgreens** (we maintain our $43 price target, 8.2x FY20 EPS estimate of $5.25).

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