The Drug Industry has performed well in the early stages of 2017. While political backlash related to drug pricing has intensified, the impact seems to have been largely mitigated by solid operating results and encouraging performances from some of the industry's newer assets. Although several branded drugmakers will face significant patent cliffs in 2017, the recent success of the new product cycles appears to have investors focusing more on the long-term stories. CEOs continue to tout the new drugs and play down potential pricing erosion.

The XLV ETF, which tracks the broader healthcare industry has advanced roughly 9% in value year to date, compared to a 5% gain in the Dow and a 6% advance in the S&P 500.

In the following report, we touch on the political landscape, Novartis' capital allocation strategy, notable patent losses and an update on the world's top-selling drug, *Humira*.

Political Landscape

Drugmakers continue to face intense scrutiny on Capitol Hill as a growing number of politicians rally against the industry's pricing practices. President Trump's criticism has been at the forefront, and he recently indicated that the government was paying "astronomical" prices for medicines in its health care programs (Medicare and Medicaid). According to recent data, the United States pays more for drugs than any other developed nation. On a more positive note, President Trump also seems committed to speeding up the approval process for new medicines and easing regulation.

Novartis Announces Massive Share Buyback

Europe's largest drugmaker recently announced that it would be repurchasing $5 billion worth of shares during the course of 2017. The news comes as the company navigates what is expected to be a difficult year on the operating front. With generic competition expected to intensify on a few core franchises, *Novartis* forecasts net sales this year will be broadly in line with 2016 levels. On a separate note, the company is apparently mulling a potential spinoff of its struggling Alcon eye-care unit.

Patent Losses

London-based *AstraZeneca* continues to face significant generic competition on two of its top-3 selling drugs, *Crestor* and *Nexium*. Each has been in free fall since losing exclusivity in most major markets and this trajectory is expected to continue in 2017. The two drugs combine for nearly a quarter of Astra' total sales.

Another overseas drugmaker, *Novartis*, is not targeting much in terms of growth this year due to the patent loss on its blood cancer franchise, *Gleevec*. The drug accounts for a substantial portion of the company's top line and further erosion is expected in the coming quarters. While *Novartis* has several exciting new assets and a well-stocked pipeline, further development will likely be needed to offset *Gleevec* losses. Management indicated that it doesn't anticipate to enter its next growth phase until 2018.

INDUSTRY TIMELINESS: 25 (of 97)

Eli Lilly saw three of its top-six products decline last year, including *Humalog*, *Alimta*, and *Cymbalta*. Patent losses on *Zyprexa* was another drag. With the company's second biggest money maker *Cialis* expected to lose exclusivity later in 2017, the new product cycle will need to accelerate.

HUMIRA Outlook In Question

The world's highest-grossing drug, manufactured by *AbbVie*, generated sales of $16.1 billion in 2016 and growth trends have showed little signs of slowing. However, sales projections for the coming years vary significantly as the long-term outlook is very much in question. While management is confident it can maintain exclusivity until at least the end of the decade, several of its patents are currently being challenged in court. *AbbVie's* growth trajectory will rely heavily on the outcomes. (*Humira* accounts for 63% of the company's total revenue.)

Dividends

Income investors should have little trouble finding attractive options in the pharmaceutical space. Encouragingly, most of these equities also come with relatively low-risk profiles. Top dividend-payers in the issue include *GlaxoSmithKline* (5.5%) and *AstraZeneca* (4.5%). New York-based drug giant *Pfizer* is also solid at 3.7%.

Conclusion

In terms of Timeliness, the Drug Industry has fallen modestly in recent months, losing five spots since our January report. The group currently ranks 25th out of the 97 industries under *Value Line's* coverage. For near-term accounts, *Valeant Pharmaceuticals* and *Endo International* are two equities that hold our top recommendation (1) for year-ahead price growth, however, both investments are considered highly speculative given recent operational challenges. *AstraZeneca*, *Novartis* and *GlaxoSmithKline* represent more stable options that are also pegged to outperform in 2017. The sector offers a strong base of safe, well-established equities with above-average income components, as well.

Michael Ratty