The Drug Industry made a strong recovery in 2017, fueled by a slew of successful new products, a ramp up in R&D spending, a higher number of FDA approvals, and improved operating results. While scrutiny related to drug pricing remained somewhat of an overhang, concerns of increased regulation eased a bit as the year progressed, thanks in part to some reassuring comments made by President Donald Trump. Generic competition also appeared to have less of an impact compared to 2016, and positive sentiment surrounding tax reform provided additional support.

The XLV ETF, which tracks the performance of the broader healthcare industry, increased 20% in value during 2017. This compared to a 24% gain in the Dow Jones Industrial Average and a 26% rise in the S&P 500.

In the following report, we touch on 2017's gainers and laggards, tax reform, a softening generic drug industry, Pfizer's consumer health decision, and a few attractive dividend plays.

Gainers and Laggards

The Drug Industry's strong 2017 campaign was highlighted by double-digit share-price gains from several of the group's top players. North Chicago-based *AbbVie* saw its stock surge more than 50% in value over the 12-month period, as investors applauded development efforts for its top-selling *Humira* franchise. After pulling in roughly $16 billion in sales in 2016, the rheumatoid arthritis treatment (and the world's most lucrative prescription drug) maintained much of its momentum in and is poised to top $18 billion in sales in 2017. Management recently indicated that it expects this figure to balloon to $21 billion by 2020. Other top gainers in the U.S. included *Eli Lilly* (+13%) and *Pfizer* (10%). On the international side, Swiss-based pharmaceutical giant *Novartis* saw its stock increase 15% and Canada's largest drugmaker *Valeant* rebounded 35% after a multi-year run of sharp declines.

On the other hand, the industry had its share of laggards, as well. Beleaguered *Endo International* posted a 50% decline in share price, Botox-maker *Allergan's* stock shed roughly a quarter of its value due to generic concerns tied to a few of its top-selling products, and *GlaxoSmithKline* dipped 10%. While *Merck & Co.* got off to a hot start, sentiment faded in the back half and the stock concluded the year down 6%.

Tax Reform

The recently-passed, Republican-inspired tax legislation is expected to provide a tailwind to pharmaceutical industry earnings in the coming years. Given that the bill was just signed in December, the extent of the benefit is still largely unknown, but we expect to gain further clarity on the upcoming fourth-quarter conference calls. For domestic drugmakers that had been seeking tax inversion deals, where a company reincorporates overseas for tax benefits, this legislation could entice them to remain in the United States.

Generic Softness

Despite an increase in prescriptions, generic drug industry revenues were in steady decline during the course of 2017. Consolidation on the demand side, unsuccessful patent challenges, and a significant increase in competition weighed heavily on top-line results. One of the sector's top players, *Teva Pharmaceutical Industries*, saw its stock price nearly cut in half during 2017. Rival *Mylan's* shares also performed poorly through the first nine months of the year, but a surprise generic approval in the fourth quarter helped fuel a recovery.

INDUSTRY TIMELINESS: 75 (of 97)

Pfizer Mulling Consumer Health Sale

On its third-quarter conference call, *Pfizer* announced that it was reviewing strategic alternatives for its consumer healthcare business. The unit includes lucrative revenue streams like painkiller medication *Advil* and *Centrum* multivitamins. The announcement reflects a shift in strategy as the drugmaker attempts to move away from lower-margin products in order to focus more on innovative pharmaceuticals. Some analysts believe the consumer health unit could fetch as much as $15 billion in a sale, and several industry rivals are said to be in the mix including, *GlaxoSmithKline* and Johnson & Johnson. *Pfizer* is not expected to make a final decision until later in 2018.

Dividends

The Drug Industry currently boasts a handful of high-yielding equities with relatively low-risk profiles. Investors seeking to add current income to their portfolios should consider *GlaxoSmithKline* (5.7%), *Pfizer* (3.8%), *Merck & Co.* (3.4%), and *Novartis* (3.3%).

Conclusion

In terms of Timeliness, the Drug Industry improved significantly during the fourth quarter, gaining 17 spots since our October report. The group currently ranks 75th out of the 97 industries under *Value Line's* coverage. Some attractive year-ahead growth plays in this issue include *Zoetis*, *Eli Lilly*, *AbbVie*, *Merck*, *Pfizer*, and *Novartis*. The sector also offers a strong base of safe, well-established equities with above-average income components.

Michael Ratty