

For the most part, stocks in the Drug Industry trended upward in the second quarter. The XLV ETF, which tracks the performance of the broader healthcare industry, has risen roughly 4% in value since March 31st, compared to a 2% increase in the Dow Jones Industrial Average and a 5% uptick on the S&P 500. Still strong macroeconomic indicators and a solid first-quarter earnings season helped fuel the broader market advances, though escalating fears of a trade war resulted in some increased selling in the latter half of June. Rising interest rates are also likely putting some downward pressure on equities, as the Fed hiked its benchmark twice in the first half and is targeting another two increases before year's end.

In regard to the drugmakers, many of the industry's top players beat first-quarter earnings expectations, with a little help from tax reform, and are currently trading higher than their late-March valuations (*Merck*, *GlaxoSmithKline*, and *Eli Lilly* to name a few). Drug pricing remains a hot topic and somewhat of an overhang, as calls for increased regulation on Capitol Hill appear to be gaining steam. On a side note, two of the group's biggest laggards in recent years, *Valeant Pharmaceuticals* and *Endo International*, each rebounded sharply during the second quarter.

In the following report, we touch on patent losses, a notable name change, and highlight a few attractive dividend plays.

Patent Losses

One of the most-talked about patent stories in recent months deals with the world's best-selling drug *Humira*. The rheumatoid arthritis treatment, made by *AbbVie*, pulled in north of \$18 billion in sales last year, and while biosimilar concerns in the U.S. have been put to rest, thanks to an agreement with *Amgen* that delayed its generic launch until 2023, the drug's primary European patent is slated to expire in October. Given *Humira*'s success, a number of companies have been jockeying for position to steal some of these overseas sales. Swiss-based *Novartis* recently received a positive recommendation from European regulators for its candidate adalimumab. An approval would provide a much-needed boost to the company's struggling Sandoz division.

Indianapolis-based *Eli Lilly* has been hit hard by patent expirations over these past few years, losing blockbusters like *Cymbalta* and *Zyprexa*. While strong growth in its new product cycle has helped mitigate some of the impact, the company is expected to face another hurdle when *Cialis*' primary U.S. patent expires in September. The treatment for erectile dysfunction saw its sales decline 7% in the first quarter due to increased competition in Europe, and the erosion is likely to accelerate in the back half of the year. *Cialis* was Lilly's second-highest grossing product in 2017, generating sales of \$2.32 billion.

Across the pond, two of the U.K.'s largest drugmakers are dealing with competitive pressures on some high-profile products. *AstraZeneca* has seen considerable fallout in the cholesterol-fighting *Crestor* franchise, including a 38% decline in sales during the first quarter. *GlaxoSmithKline*'s respiratory drug *Advair* has also posted declines due to pricing and competitive pressures in the U.S., while an expected generic entry later this year is likely to result in further fallout.

INDUSTRY TIMELINESS: 74 (of 97)

Valeant Turns to Bausch

Canada-based *Valeant Pharmaceuticals* recently announced that it was changing its name to Bausch Health Companies. The move was likely motivated by the former name's negative connotation, a result of accounting discrepancies, questionable business practices, and an aggressive growth-through-M&A strategy that ballooned the company's debt to \$30 billion-plus. It also better aligns with the current state of *Valeant's* business, as its Bausch+Lomb eyecare division now accounts for more than half of total revenue. The change is expected to go into effect sometime this month. On a side note, shares of VRX have rebounded more than 50% in price since our April report.

Dividends

The Drug Industry has developed a reputation of paying consistent and relatively generous dividends to its shareholders, specifically within the large pharma space. Several of these equities also maintain strong scores for Safety and Price Stability, which enhances investment appeal for those seeking to reduce risk within their portfolios. At this juncture, *GlaxoSmithKline* (6.3%) stands out, but other attractive, lower-risk income plays include, *Novartis* (4.0%), *Pfizer* (3.7%), and *Merck & Co.* (3.2%).

Conclusion

Based on our Timeliness Ranking System, the Drug Industry has rebounded in recent months, gaining eight spots since our April report. Despite the improvement, the group still ranks in the bottom third of sectors under *Value Line's* coverage (74th out of 97). As a result, the majority of the equities herein are pegged to either track or underperform the broader market averages in the year ahead. A few that currently stand out include *AbbVie*, maker of the world's best-selling drug *Humira*, and *Zoetis*, an attractive option for investors seeking a pure play in animal health.

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