

For the most part, stocks in the Drug Industry continued on an upward trend during the third quarter. The XLV ETF, which tracks the performance of the broader healthcare industry, has risen roughly 14% in value since June 30th, compared to a 9% increase in the Dow Jones Industrial Average and a 7% uptick on the S&P 500. Equity market gains have been supported by improved corporate earnings, due in part to tax reform, and a still strong U.S. economy, highlighted by rock-solid employment figures and wage growth. These catalysts have thus far been sufficient in offsetting trade war concerns and the Fed's decision to keep raising rates.

In regard to the drugmakers, many of the industry's top players beat second-quarter earnings expectations and are currently trading higher than their late-June valuations. To name a few, domestic heavyweights *Pfizer* and *Merck* saw their stock prices rise 21% and 17%, respectively, during the September period.

Humira and Keytruda

Humira has been the world's best-selling drug for a few years now and continues to grow at a healthy pace, fueled by label expansion and strong uptake trends in both U.S. and international markets. The franchise, which is developed by *AbbVie*, raked in a whopping \$18.4 billion in sales in 2017 (+14.6% versus prior year) and \$9.9 billion during the first half of 2018. While the upcoming loss of a European patent is expected to dampen growth in the coming years, *Humira* is likely to retain its top spot for the foreseeable future. The drug is protected in the all-important U.S. market until 2023.

Another one of the industry's more lucrative medicines is *Merck's* standout cancer asset *Keytruda*. The drug has established itself as the favorite in the high-growth immuno-oncology market and has been on a tear over the past several quarters. With \$3.8 billion in total sales last year, and \$3.1 billion in the first half of 2018, its currently a far cry from *Humira*. However, *Keytruda* is still in its relatively early stages and is growing at a much faster clip (Q2 sales +89% year over year). With time and further development, it could be in the same stratosphere within the next five or so years. While peak sales estimates vary greatly, consensus expectations see *Keytruda* topping \$12 billion by 2024.

Pricing Freeze

The industry has come under intense political scrutiny in recent years due to sky-high drug prices. With the Trump Administration trying to clamp down on healthcare costs, many of the world's top pharmaceutical companies have found themselves caught in the cross hairs. In order to help ease escalating tension on Capitol Hill, several big-name players including *Pfizer*, *Merck*, *Novartis*, and *Eli Lilly* have agreed to halt or delay drug price increases for the remainder of 2018.

IPO Activity

Eli Lilly announced a strategic review of its Elanco animal health business last October and ultimately determined that an IPO was the best way to go (the unit generated sales of \$3.1 billion in 2017, or roughly 14% of total revenue). The offering took place on September

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19th (ticker: ELAN) and represented an ownership stake of just under 20%, with Lilly retaining the rest. In the early going, the IPO has been well received, as shares of ELAN opened at \$24 a share and quickly jumped to the mid-\$30s. The move seems to mirror *Pfizer's* spin-off of its animal health unit *Zoetis* in 2013, and given the success of that transaction (*ZTS* has tripled in price since its IPO), its easy to see why investors are excited.

Meantime, across the pond, Swiss-based *Novartis* recently announced plans to spin off 100% its Alcon eye-care division into a separately traded standalone company. The decision was made after a lengthy strategic review, with management indicating that the move would enable it to increase focus on its core pharmaceuticals business. The spinoff is expected to be completed during the first half of 2019.

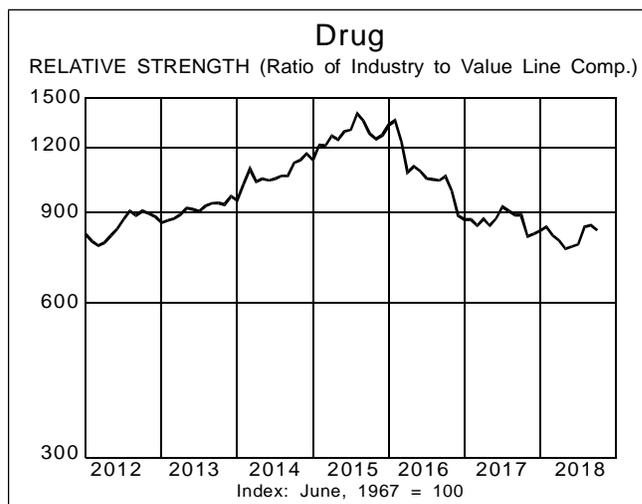
Dividends

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, *Glaxo-SmithKline* (5.0%) stands out, but other attractive, lower-risk income plays include, *Novartis* (3.4%), *Pfizer* (3.1%), and *Merck & Co.* (2.7%).

Conclusion

Based on our Timeliness Ranking System, the Drug Industry has declined in recent months, falling nine spots since our July report. As a result, the group remains in the bottom quartile of sectors under *Value Line's* coverage (83rd out of 97). While the majority of the equities herein are pegged to either track or underperform the broader market averages in the year ahead, there are a few standouts including *AbbVie*, maker of the world's best-selling drug *Humira*, and *Eli Lilly*, owner of blockbuster diabetes franchise *Trulicity*. *Zoetis* is another appealing option for investors seeking a pure play in the increasingly attractive animal health segment.

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