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PERSONAL BUSINESS

HOW TO PLAY IT | DRUGMAKERS

HEALTH REFORM | STUMBLING BLOCKS STILL REMAIN

By Aaron Pressman

As Barack Obama closed in on the Presidency last year, investors got increasingly skittish about drug stocks. Johnson & Johnson fell 18% in the two months before the election, Schering-Plough dropped 23%, and Eli Lilly tumbled 28%. Investors had good reason to be worried. Obama's health-care reform plan is likely to include letting

Medicare negotiate lower drug prices, overturning a ban on government-driven discounts that was in the original 2003 "Part D" program.

But Medicare pricing is only part of the story for drugmakers, several health-care fund managers argue. Investors may be overlooking substantial benefits to pharmaceutical companies because Obama is also likely to get the Food & Drug Administration moving again, says Sam Isaly, co-manager of Eaton Vance Worldwide Health Sciences Fund. "In the end, pricing may or may not come out negative, but change at the FDA will be very positive," he says.

The FDA has been widely criticized for weak oversight and inefficiency, and its congressional overseers have had a testy relationship with the agency. Isaly says few drugs of "consequence" have been approved in the past few years as the agency shied away from anything controversial. "There's an opportunity for a major shift there." Add the stocks' low valuations and high dividend yields, and many drug stocks look appealing.

Isaly favors Novartis and Bristol-Myers Squibb among major pharma companies.

Alger's Ott says Mylan and Teva are well-positioned



OrbiMed's Isaly likes Novartis and Bristol-Myers Squibb



Novartis faces the loss of patent protection for Diovan, its blood pressure medication, in September 2012. But the company is moving ahead quickly with several other promising drugs in development to treat kidney cancer, meningitis, and multiple sclerosis. Bristol-Myers' patent on best-seller Plavix, which is used to prevent blood clots, expires in 2011. So the company is slashing expenses by \$2.5 billion while it scouts for promising smaller drugmakers to acquire.

Health-care reform is also likely to improve prospects for generic drugmakers. With patents on drugs representing \$25 billion in annual sales set to expire by 2012, the generic industry is already sitting pretty. The new Congress is planning to revisit the question of allowing generic versions of biologic drugs (those developed from living cells rather than chemical components, which is currently illegal). Rosanne Ott, co-manager of Alger Health Sciences Fund, says Teva Pharmaceutical Industries and Mylan are best-positioned to benefit for the next two years. Ott says Teva is moving ahead in integrating Barr Pharmaceuticals, which it bought last year. And Mylan is likely to beat investors' expectations in 2009 after digesting Merck's generic lines, which it acquired in 2007 and '08.

Predicting all of the winners and losers from health-care reform is almost impossible at this stage. And the stocks may suffer tremendous volatility. That's what happened at the start of the Clinton Administration, when leaks and rumors about different pieces of its health-care reform proposal alternately battered and bolstered shares of many health-care players. Isaly says he may resort to a simple strategy that helped him beat rival funds back then: dump U.S. stocks and go abroad. "We may have to dust off the old playbook," he says. "There are more things to delve into around the world than just paying attention to Washington." | BW |