Sector in Focus **November 2025**

Pharmaceutical Industry Faces Headwinds

To provide a better understanding of how we think about various credit sectors, we are producing a series of pieces that outline significant issues impacting sectors including domestic banks, pharmaceuticals, technology, and aerospace and defense. Part one of this series focused on domestic banks. In part two, Winnie Cheng, CFA, Vice President and Principal Credit Analyst, will discuss some of the major issues facing the pharmaceutical space.

A Quick Sector Overview

There are recent changes in law, regulation, and government policies that may have negative implications for pharmaceutical companies, ranging from drug approval and recommendation to pricing. Some of the biggest issues facing the pharmaceutical industry include:

Medicare Drug Price Negotiations. The Inflation Reduction Act that was passed in August 2022 requires the federal government to negotiate lower prices for drugs covered under Medicare Part B and Part D that represent significant Medicare expenditures and lack generic or biosimilar competition. Price negotiations for the first ten prescription drugs resulted in reimbursement rate reductions between 38% to 79% less than current list prices according to the Centers for Medicare & Medicaid Services. While the lower negotiated rate is significant, it does not reflect the difference in already discounted prices Medicare currently pays on those medicines. The actual prices paid are not public so the new discount impact on revenues is not known at this point. We note that some of the drugs affected by the new pricing will lose patent protection around the same time so the impact from the change in Medicare reimbursement may be masked by potential overall reduction in revenue from generic or biosimilar competition. The reduced reimbursement rates go into effect in 2026. The second round of price negotiations occurring now will go into effect in 2027 for 15 drugs. We anticipate the price discounts will be similar for the next group of drugs.

Patent Cliffs. We are tracking the patent expirations of our approved companies' blockbuster (over $1 billion annual sales) and near blockbuster status (over $750 million annual sales) drugs for potentially high revenue declines from loss of exclusivity. Some companies have an outsized percentage of their current revenues tied to drugs that may face competition from generic manufacturers when they lose patent protection over the next three years. We weigh that against the sales growth trajectory of its newer portfolio and drug development pipeline to determine credit risk in the near

and intermediate term. Companies with large pending patent cliffs often shop for acquisitions to quickly build revenues, drug portfolios, and pipelines ahead of large sales declines. We assess the effect acquisitions will have on credit metrics, including quality, size of revenues and cash flow, and leverage impact from debt financing.

Most Favored Nation Pricing. President Donald Trump is demanding that pharmaceutical companies lower drug prices to match the lowest price given to other countries in what is coined “most-favored-nation” (MFN) prescription drug pricing. An executive order was issued directing the U.S. Trade Representative and Secretary of Commerce to ensure foreign countries are not engaged in practices that undercut market prices and drive price hikes in the U.S. The president sent letters to 17 of the world’s largest pharmaceutical companies insisting they slash U.S. prices on new drugs to the lowest amount paid by certain other countries. The Secretary of Health and Human Services is to establish a mechanism through which American patients can buy their drugs directly from manufacturers at most favored nation prices. In addition, President Trump demanded companies immediately lower what they charge Medicaid for existing drugs and guarantee that future medicines be launched at prices on par with what they cost overseas. The administration would use trade policies to support manufacturers to raise prices internationally but insists that higher foreign revenues must be reinvested directly to lowering prices for U.S. patients and taxpayers.

There are no details on how many aspects of the plan will be carried out, and we are unsure of the legal standing to enforce corporate compliance on various parts. We view it as a negotiation tactic. The reason drug prices vary around the world, but are generally lower than in the U.S., is that drugs prices are negotiated at a national government or trading block, such as the European Union, level, whereas the U.S. has a fragmented health care system of multiple payers, including federal healthcare reimbursement programs, Medicare and Medicaid, and commercial insurers, that each negotiate their own prices.

Other countries have government or quasi-government bodies that determine what is a fair price and negotiate from that perspective while in the U.S. the drug companies start the pricing process at a price of their own determination. Medicare evaluates the costs to research, develop, and produce the drug when setting prices, but only two of the 11 comparable countries also consider these factors. In addition, eight of the 11 comparable countries use drug prices in other countries as a reference for setting their own prices, while Medicare does not. Given drug price negotiations take place at separate times and regulatory approval for new drug sales also happen at different times, sometimes years apart, it will be difficult to determine the lowest price. Companies may try to circumvent MFN pricing by offering different versions of drugs or delaying launches of drugs in foreign countries.

Changes in Government Vaccine and Preventative Care Policies. Replacement of Centers for Disease Control and Prevention (CDC) vaccine advisory committee members with new members that hold a negative vaccine bias, as well as expectations that U.S. Health Secretary Robert F. Kennedy Jr. will replace the U.S. Preventive Services Task Force’s (USPSTF) 16-member advisory panel, will have repercussions for vaccine and other preventative medications such as HIV prevention drugs. Lower Food and Drug Administration (FDA) approval of vaccines and other preventative medications, and potential changes in commercial and government reimbursement for medications based on modified CDC and USPSTF recommendations will negatively affect future sales and require research and development impairment charges if current research projects are terminated. The current administration ends in 3.5 years, and it is unknown if the next White House will embrace the same policies. Given the number of years needed to develop new drugs (often 10+ years) before it is presented for regulatory approval, we do not expect companies will terminate current vaccine research. Still, sales and reimbursement issues remain an interim concern.

Tariffs. To encourage greater domestic manufacturing, the White House floated multiple potential tariffs on imported pharmaceuticals, with the latest social media post stating that the U.S. government will impose a 100% tariff on any branded or patented pharmaceutical product, unless a company is building their pharmaceutical manufacturing plant in America. “Is building” was defined as breaking ground or under construction by October 1, 2025. Some pharmaceutical companies increased capital investment in domestic manufacturing to support high demand for certain products, such obesity treatment drugs.

Many pharmaceutical companies have pledged additional investment in manufacturing or research and development facilities in the U.S. since the beginning of the year and most began stockpiling inventory in the second quarter in preparation for changes in tariff policy. To date, approximately $325 billion of new investments were announced. Most companies have begun construction at this point.

All American pharmaceutical companies have over half of their manufacturing done in the U.S., but many have a significant percentage of their production facilities in other countries. Some production is for local consumption, but often, for efficiency purposes, certain drugs are mass manufactured in a few factories for sale to the global market. The large international pharmaceutical companies that derive a sizable percentage of revenue from the U.S. do not have significant manufacturing plants in the U.S. and sales are supported by imported products. We expect companies based in the European Union exporting to the U.S. will be subject to the negotiated 15% tariff. No formal tariff agreement has been reached with the United Kingdom or Japan. Given the inventory buildup since April, we expect tariff impact will be low until mid-2026 or later.

Our Outlook

While the sector faces challenges, some challenges may result in smaller consequences than what is suggested in current headlines. Some of the U.S. government demands and policy changes may be mitigated by lawsuits or lack of legal standing for enforcement. We view the pharmaceutical industry as a defensive sector with positive drivers including an increasing demand for medications for an aging global population. The U.S. remains the biggest market with the highest growth for pharmaceutical companies. Changes in government reimbursement programs will negatively affect revenue but given the lack of a uniform pricing system and that most of sales are reimbursed by commercial insurance, U.S. revenues should not go into a free fall.

Artificial intelligence is helping to more swiftly develop new compounds and delivery systems that are increasing efficiency in bringing new products to the market. The well-rated drug companies all have solid credit profiles with high profit margins that support strong profitability, large portfolios of late-stage assets in development that will help to offset older assets' loss of exclusivity, substantial free cash flow, large cash and liquid investment holdings, and well-laddered debt maturity schedules that support their liquidity profile, and modest leverage. We like companies with broad drug portfolios, low revenue concentration risk by product, and high research and development pipeline productivity as these three factors weigh heavily on future profitability.

If you have any questions about this report, please reach out to your relationship manager.

Stay tuned for future commentary on the technology and aerospace and defense sectors.