

Tortoise QuickTake

Credit Podcast



June 12, 2019

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

John Heitkemper: Thanks for joining this week's Tortoise QuickTake credit podcast. I'm John Heitkemper, portfolio manager for high yield bonds and leveraged loans at Tortoise. May proved to be a challenging month for the high yield market as tariff talk weighed on risk assets, oil prices collapsed and new issue volumes picked up just as retail funds experienced their first monthly outflow of the year. The Bloomberg Barclays U.S. High Yield Index lost 1.19% last month, and aside from the energy sector, which lost nearly 4%, the next weakest industry was Pharmaceuticals, which returned -2.80%. This week, we'll be joined by senior credit analyst Andrew Kim, who will chat about challenges in the Pharma sector, in particular the latest on opioid litigation across the country. Welcome, Andrew!

Andrew Kim: Thanks, John, good to be here.

John Heitkemper: Andrew, can you give a brief background on opioid litigation, particularly as it relates to pharmaceutical companies in the high yield universe? Then we are going to pivot and provide an overall credit opinion on the sector.

Andrew Kim: There has been a significant amount of public attention surrounding opioids as the number of opioid-related drug overdoses has increased significantly over the last several years. According to the Center for Disease Control and Prevention, in 2017, the number of opioid related drug overdoses increased six fold from 1999, and on average, 130 Americans die every day from an opioid overdose.

In one well-publicized lawsuit, the state of Oklahoma is suing several pharmaceutical manufacturers. The state alleges that the pharmaceutical companies falsely and deceptively marketed their opioids, made representations that were false and misleading, and concealed the truth about their campaign. The lawsuit alleges that the conduct of these pharmaceutical companies created a devastating opioid epidemic in Oklahoma. In 2015, 823 fatal drug overdoses occurred in Oklahoma, with opioids contributing to the largest number of these deaths. Two pharmaceutical companies have already settled with the state of Oklahoma: Purdue Pharmaceutical for \$270 million and Teva Pharmaceutical for \$85 million.

In another well-publicized lawsuit, several different lawsuits are consolidating into a multi-district litigation titled the National Prescription Opiate Litigation filed in the United States District Court - Northern District of Ohio. In this lawsuit, plaintiffs allege that the manufacturers of prescription opioids grossly misrepresented the risk of long-term use of those drugs for persons with chronic pain, and distributors failed to properly monitor suspicious orders of those prescription drugs – all of which contributed to the current opioid epidemic. The consolidated cases jury trial will begin on October 21 of this year.

Companies named as defendants in these lawsuits have varying levels of potential liability exposure that will depend on the products that they sold and their conduct. High yield issuer defendants named include Mallinckrodt, Teva and Endo. Insys Therapeutics, which is not a high yield issuer, recently filed for bankruptcy protection after entering into a \$225 million settlement with the government. As part of the settlement, the company admitted to the illegal marketing of Subsys, an opioid painkiller spray.

John Heitkemper: Thanks for that brief background. Are there any unique circumstances with this litigation versus other product liability litigation we have seen?

Andrew Kim: Tobacco product liability litigation was one of the largest and most well publicized settlements. These lawsuits alleged that cigarette manufacturers failed to warn of the health risks and addictive nature associated with smoking. In 1998, several tobacco manufacturers settled with the Attorney Generals of 46 states for more than \$200 billion to be paid over 25 years.

One main difference between tobacco and opioid litigation relates to the marketing of the products. Tobacco companies market cigarettes directly to consumers, while pharmaceutical companies market opioids directly to physicians who then prescribe the drugs to consumers. A County District Judge recently dismissed a lawsuit filed in North Dakota against Purdue Pharmaceutical and stated that “Purdue has no control over its product after it is sold to distributors, then to pharmacies and then prescribed to consumers.” However, this is only one lawsuit and does not address potential liabilities related to the allegations regarding false and deceptive marketing practices by pharmaceutical companies. In the North Dakota case, the Judge cited that “the state did not identify any North Dakota doctor who ever received any specific purported misrepresentation made by Purdue, or who wrote a medically unnecessary prescription because of those alleged statement.”

John Heitkemper: Thanks, Andrew. Can we get our arms around the potential financial liabilities and how impactful they might be to high yield pharma issuers?

Andrew Kim: While there might be some analysis that you can conduct to frame a range of potential liability outcomes, the eventual outcome is still uncertain given the uniqueness of the opioid litigation vs. other product liability litigations. Several analysts have conducted analyses on potential company liabilities, with results varying significantly by billions of dollars, confirming the difficulty in assessing the potential liabilities.

John Heitkemper: How well are pharmaceutical companies prepared to handle the potential financial impact?

Andrew Kim: The ability to absorb the potential financial impact is really company specific. The pharmaceutical companies named as defendants range from investment grade rated companies with AAA bond ratings all the way down to non-investment grade rated companies with CCC bond ratings. The ultimate liability would also depend on the type and amount of opioids sold and the specific conduct of each company.

John Heitkemper: Talk about the other challenges that the sector is facing.

Andrew Kim: The pharmaceutical sector has definitely experienced some headwinds. Some of the challenges facing the sector include generic pricing pressure, public scrutiny regarding elevated branded drug prices, regulatory compliance, and litigation related to opioids, generic price collusion, and other product liabilities.

John Heitkemper: Given all that we have discussed, what is your overall credit opinion on the sector? Is sector investable or should it be left for the distressed players to sort out?

Andrew Kim: Given all the challenges facing the industry, we are taking a cautious view on the sector. While the sector overall is experiencing headwinds, there are certain situations that are investable and we are approaching each investment opportunity on a company-by-company perspective with an overall cautious view on the sector.

John Heitkemper: Thanks, Andrew, we appreciate the insight on this important and evolving topic. Thanks for listening to this week and please tune in for future Tortoise credit podcasts.

Narrator: Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.

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