



Do obesity drugs have short legs?

BBH’s portfolio seems to offer stronger fundamentals than the hype elsewhere would suggest...

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Looking through the largest holdings in the **Bellevue Healthcare (BBH)** portfolio reveals what may at first glance seem to be a couple of surprising omissions – no Novo Nordisk or Eli Lilly. Even passive observers of the stock market are likely aware of the waves that the two drug manufacturers have made in the last 18 months. That is the result of diabetes and weight-loss drugs, which have led to a level of hype that seems mirrored today only by the furore surrounding artificial intelligence.

To be fair, there are some meaningful financials behind this. In the first half of this year, profits for Novo Nordisk were up almost 30% year on year to \$5.7bn. Combined with huge inflows into the company’s Copenhagen-listed shares, the currency conversions into Kroner caused by these huge sales have been so large that it has meant the Danish central bank has had to keep rates lower so that the country can maintain its peg with the Euro.

But the level of exuberance we’re seeing doesn’t necessarily reflect reality or the potential returns that the companies selling these drugs can deliver. With regard to the former, there have been reports that investors should reconsider investments in companies that manufacture fast food or confectionary because no one will be eating burgers or buying chocolates anymore. Even more fantastical were claims that airline stocks would perform well because there are going to be fewer fat people, which will in turn lead to less fuel consumption that will then mean better profit margins.

There is a kind of Laputa-esque logic to these claims but they seem unlikely to flow through into reality, with BBH manager Paul Major arguing that a couple of key factors aren’t being accounted for by investors. One is pricing. The drugs that Novo Nordisk and Eli Lilly sell currently cost over \$1,000 per month. Given the huge demand, it is hard not to see more drugs coming to market, driving down prices and reducing profit levels for the two companies.

The other factor is efficacy. These are expensive injectables that you have to keep taking on a monthly basis. This is not like going through a week’s worth of antibiotics to cure your latest bout of tonsillitis – when you stop injecting, your craving for fried chicken and Domino’s pizza is coming right back. And as Paul and his co-manager Brett Darke noted in their August factsheet, there is little research on the long-term efficacy of these drugs. Some of the work that has been done suggest they are not quite what they are cracked up to be. For example, one study covered patients over a two year period and found less than half lost more than 5% of their bodyweight at the start of the period.

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Knowing this, you would expect investors to be erring on the side of caution. In reality the opposite appears to be true. Both Eli Lilly and Novo Nordisk are trading at over 40x forward earnings. So even if they do achieve impressive earnings growth, which is debateable, that appears to be largely priced in already.

Knowing this and then looking at the BBH portfolio can make you feel like reality has been inverted. In October, 13 of the trust’s holdings released earnings updates for Q3 – a not insignificant number given the managers run a concentrated portfolio that has a maximum of 35 stocks. Of those 13 companies, 11 either hit or upgraded their earnings targets for 2023. Only two missed earnings targets.

Despite this and strong subsequent NAV performance, the trust’s discount widened in November to 9.2%. Frustrating though this may be for shareholders, it is not the first time the managers have felt the heat for not owning the ‘right’ stocks. In 2021, Moderna and BioNTech peaked at \$484 and \$447 respectively – both companies that Brett and Paul refused to own. As I write this, they are trading at \$78.93 and \$97.50 per share respectively.



Whether or not history will repeat itself with the two big weight loss drug producers remains to be seen. But as the Germans like to say, lies have short legs. If the fundamentals don't make sense then ultimately share prices follow, for better or worse. That's as true for Novo Nordisk and Eli Lilly as it is for BBH's portfolio.

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