



The
**RESEARCH
JOURNAL**

FOR USE BY INSTITUTIONAL INVESTORS ONLY. NOT FOR USE WITH THE GENERAL PUBLIC.

WEIGHING UP THE EFFECT OF WEIGHT-LOSS DRUGS

Pre-extract from The Research Journal, Issue 14.

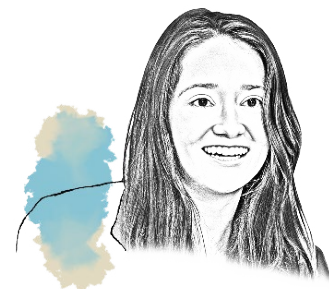
Novo Nordisk and Eli Lilly's ground-breaking anti-obesity drugs look set to be transformational for millions of individuals worldwide so what about the likely consequences for other companies in healthcare and beyond?



LINDSAY SCOTT
Investment Manager



MAX SKORNIAKOV
Investment Manager



DR ORIANA BEAUMONT
Investment Analyst

In September 2023, the previously low-key Danish healthcare company Novo Nordisk became Europe's most valuable company by market capitalisation. In December, the company's largely unheard-of CEO Lars Fruergaard Jørgensen, was crowned the FT's Person of the Year.

Novo may have been founded all the way back in 1923 but 2023 was the year the company and its GLP-1 treatments, Ozempic and Wegovy, became household names. Discussion around these treatments and the resultant weight loss spread from the medical and financial press to tabloid and celebrity magazines and, of course, social media.

Alongside Novo Nordisk, Eli Lilly's GLP-1 treatments have also taken a lead in this market. Mounjaro and Zepbound might not yet have the same name recognition, but Eli Lilly's financial performance and its share price have followed a similar trajectory over the past year.

Novo Nordisk and Eli Lilly have a virtual duopoly on GLP-1s (*glucagon-like peptide 1 receptor agonists*). Novo markets its GLP-1, semaglutide, as Ozempic for type-2 diabetes and Wegovy for weight loss. Meanwhile, Lilly's GLP-1, tirzepatide, is marketed as Mounjaro for diabetes and Zepbound for obesity. Whilst both Ozempic and Mounjaro are diabetes treatments, they do also result in weight loss and so are often mistakenly referred to in the media, and particularly across social media, as anti-obesity treatments.

The importance of these treatments cannot be underestimated. It isn't only the size of this market – by 2030 obesity will affect an estimated one billion people worldwide¹ – but also the public health benefits. As investment manager Lindsay Scott explains, "it is

hard to think of another drug with so many important and positive effects, both for the patient and for society at large. For morbidly obese patients, whose quality of life has been poor, GLP-1s are proving life-changing."

SEPARATING THE WISHFUL THINKING FROM THE REALISTIC POTENTIAL

As relatively new treatments, there isn't yet robust clinical evidence on either the very long-term results or side effects but, given the potential magnitude of the take-up of these treatments, early studies have been seized upon and attention has unsurprisingly turned to second-order effects. If these treatments are the winners, who and what loses?

Much has been made of initial evidence, mainly from self-reported surveys, that GLP-1s might dampen the desire to drink alcohol and reduce cravings for sweet and salty snacks, highly processed foods and carbonated drinks. Without much evidence at all, some have then extrapolated those possible signs to suggest that a desire to gamble or scroll social media might also be limited, and in effect controlled, for those taking these treatments.

On the merry-go-round of quarterly earnings calls, companies across healthcare as well as food and beverage industries have in turn faced a litany of questions on how worried they are and what they are doing to address the potential impact of GLP-1s.

But, as observed by investment analyst, Dr Oriana Beaumont, answering these questions with any degree of confidence or legitimacy today is very difficult. "Whilst we have trial data to show that these treatments work, studies of the resultant side-effects are less robust at this stage".

Oriana joined Walter Scott's Research team in the summer of 2023, having successfully completed a degree in medicine. Putting her years of reading medical literature and assessing clinical

evidence to almost immediate use, she has spent considerable time looking at the evidence. "My goal was to get back to the basics. What is hard evidence? What is hysteria? And, taking that evidence, how might that fit into the real world? Not only are most of the current studies small in size but we just don't yet have data on real-world patient groups. Access to these treatments to date has been mainly through self-pay or insurance, which skews the data. We don't yet have sufficient data on patients achieving significant weight loss and who perhaps don't have the support of dietitians or fitness coaches alongside these treatments," she said.

But, regardless of the lack of robust or definite data, the impact on the share price of several companies has been very real. Some healthcare companies have come under particular scrutiny.

NO MORE BARIATRIC SURGERY OR KNEE REPLACEMENTS?

For medical device companies, it has been widely surmised that these new treatments will in time severely reduce, if not eliminate, the need for certain surgical procedures and medical interventions linked to obesity.

Intuitive Surgical, a leader in robotic surgery, has faced questions on the outlook for bariatric surgery, one of a number of procedures where robotic surgery is particularly effective. The conclusion that such procedures might decline in prevalence seems a reasonable one, but the context and market size is important.

As Lindsay Scott points out, "it is estimated that only 1-2%² of patients eligible for bariatric surgery actually go ahead".

Fellow investment manager Max Skorniakov agrees, "surgery is far from the default option and, as of today, there will continue to be specific circumstances where it is the only option. It should also be remembered

that bariatric surgery is currently estimated to be only about 4-5% of Intuitive's total global procedures."

Medical device company Stryker is another company that has been hit by claims that these drugs will mean a decline in knee replacements, and therefore a collapse in demand for Stryker's knee implants. But, again, the situation is more nuanced, and might even be a positive.

As Max explains, "you often need to lose weight to get a knee replacement so these treatments might actually increase the potential audience for Stryker". He adds that the bigger driver is degenerative disease, "if you live longer and use your knees more, you are more likely to need a replacement. That only 10% of Stryker's sales relate to products and service used in knee replacement procedures must also be remembered."

ResMed is another medical device company that has come in for particular scrutiny, given that around 75% of its revenues come from devices and masks that treat obstructive sleep apnoea, a condition commonly linked to obesity. ResMed's Continuous Positive Airway Pressure (CPAP) device delivers pressurised air to patients, typically through a nasal mask, to prevent collapse of the upper airway during sleep.

But, in its response to what became widespread concern related to GLP-1s, ResMed has presented data³ showing that patients prescribed obesity drugs are more, not less, likely to initiate positive airway therapy treatment. Mask resupply rates were also shown to be higher after one and two years on CPAP therapy for these patients. The results, based on tracked patients using GLP-1s since 2021, were drawn from a dataset of more than 500,000 patients, close to 90% of whom had been prescribed newer GLP-1 drugs.

As Max notes, "as with all studies in this emerging field, these findings will need to be confirmed by longer-term usage as

GLP-1s become more widely available, but they did go quite some way to dispel the view that the new medication was a clear and certain negative for ResMed."

The company has also said that it remains confident that future data will show patients following a course of combined CPAP and GLP-1 therapy are those that will enjoy the most optimal outcomes.

"Sleep apnoea is a widely under-diagnosed condition," stresses Max, "as patients become increasingly aware of the advantages in taking GLP-1s, they are more likely to consult their physicians, and it is their responsibility to diagnose all possible comorbidities, of which sleep apnoea is one of the most common. Relatively few patients are likely to achieve enough weight loss to render solutions such as CPAP machines for sleep apnoea redundant."

POSSIBLE SECOND-ORDER EFFECTS ON FOOD AND BEVERAGE COMPANIES

Few would have anticipated that the success of these GLP-1s and of Novo Nordisk and Elli Lilly would have, in turn, weighed so much on companies outside the healthcare sector. The possibility that these treatments might dampen consumers' desire for certain foods, drinks and possibly behaviours is of course potentially, hugely significant.

But it is far too early to jump to the end conclusion, as many have, heralding the end of fast food and fizzy drinks. As Oriana explains, "there was a study in 2021⁴ that suggested that GLP-1 receptors are expressed on adjacent nerve fibres in the tongue and therefore might impact taste and desire to consume certain types of food. But, as I have said before, we just don't have sufficient data."

Unsurprisingly, Diageo has been on the receiving end of scrutiny as more extreme voices declare the long-term demise of its markets. The team at Walter Scott disagrees. For public health, social and regulatory reasons,

Diageo's strategy has already moved the company from mass-market, mass-consumed alcoholic drinks to more premium products. As Lindsay reminds us, "a strategy that encourages consumers to drink less but drink better is now very much in place at the company, a strategy that should also counter any possible GLP-1 impact, where indications are not a desire to not drink at all, there's just less interest in drinking a lot."

Walmart's CEO Doug McMillon gave some support to early evidence that consumption of salty, sugary and highly processed foods and drinks might decline. In October 2023, he commented that when looking at customers on GLP-1s, the company had seen "a slight change compared to the total population", with "a slight pullback in the overall basket with less units and slightly less calories"⁵. For Walmart, that isn't necessarily bad news. Basket constituents might change but a higher proportion of higher-margin fresh produce could instead be good news.

For many commentators, making a positive case for Nestlé, seems more difficult. But, with only 15% of global revenues coming from either centre-of-plate or snacking products, the Swiss multinational considers any potential revenue loss to be limited.

In fact, in its third-quarter results call in November 2023, CEO Mark Schneider laid out not only a defence but a case for optimism. He stated that, "recent interest in GLP-1 agonists has underlined the public's desire to combat obesity rates [and] I believe we have important contributions to make. For the time that patients spend on these drugs, and after, we are already developing a number of companion products. The goal will be to address the risk of malnutrition and the loss of lean muscle mass while on the GLP-1 therapy and to avoid or limit weight rebound after the therapy. These innovations are right in our wheelhouse, where we can bring our deep understanding of

nutritional science and appropriate supplementation to the table⁶.”

The risk is arguably more significant for Coca-Cola, given the nature of its products and the fact that North America, which is expected to be the largest market for GLP-1s, is its biggest market. In consumer surveys of people taking GLP-1s, there has been some suggestion that carbonated, sugary drinks is one of the food categories with the greatest reduction in consumption. But, like others, Coca-Cola took the opportunity to address this perceived threat head-on in its communications around its third-quarter results in October 2023⁷. The company stated that it considered itself to be well positioned to provide choice and options for people’s respective motivations and needs, highlighting that 68% of Cola Cola’s products have low or no calories.

Lindsay is confident Coca-Cola has already anticipated the GLP-1 effect: “Whilst much of Cola-Cola’s brand rests upon consistency and heritage, the company has proven itself able to navigate societal change for many decades”. “Just as a recent example, we’ve begun to see a move away from people buying litre bottles of Coke and instead

purchasing more expensive boxes of six mini-cans as a treat. The company may lose sales over time in those large serving sizes, but those smaller cans are highly profitable,” she explains.

In Lindsay’s view, a similar case can be made for McDonalds, a company that has a long track record of adapting to social change and with a phenomenally strong brand. To paraphrase Mark Twain, the team at Walter Scott deems reports of the death of the Big Mac or the “Diet Coke break” are greatly exaggerated.

In attempting to address the global obesity epidemic, Novo and Lilly’s GLP-1 treatments have provoked publicity and understandable hope unlike anything that has been seen before. The potential is unquestionable. However, as Lindsay concludes, “just because Sharon Osbourne has suffered side effects and is talking to *E! News* about it, that isn’t evidence”.

Brand recognition also isn’t evidence. Just because those that have become unofficial ambassadors for these drugs – from Oprah Winfrey to Elon Musk, Kim Kardashian and Jeremy Clarkson amongst many others – have huge

social media followings and, thereby, an ability to turn these treatments into household names almost overnight, it doesn’t mean we have robust data and evidence on likely impacts. Gathering that data both in the clinic and in the real world will take time, and analysing and assessing it will be just as important.

¹World Obesity ‘One billion people globally estimated to be living with obesity by 2030’

²National Library of Medicine ‘Reasons for underutilization of bariatric surgery: the role of insurance benefit design’

³ResMed Q1 2024 earnings call transcript

⁴National Library of Medicine ‘Glucagon-like peptide 1 and taste perception: from molecular mechanisms to potential clinical implications’

⁵Fortune magazine ‘Walmart says shoppers taking Ozempic buy ‘slightly less calories’ as retailers brace for the financial consequences of weight-loss drugs’

⁶Nestlé 2023 nine-month sales conference call transcript

⁷Coca-Cola Q3 2023 earnings call transcript

IMPORTANT INFORMATION

This article is provided for general information only and should not be construed as investment advice or a recommendation. This information does not represent and must not be construed as an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products. This document may not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such an offer or solicitation is unlawful or not authorised.

STOCK EXAMPLES

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.

WALTER SCOTT & PARTNERS LIMITED, ONE CHARLOTTE SQUARE, EDINBURGH EH2 4DR
TEL: +44 (0)131 225 1357 · FAX: +44 (0)131 225 7997
WWW.WALTERSCOTT.COM

Registered in Scotland 93685. Registered Office as above. Authorised and regulated by the Financial Conduct Authority.
FCA Head Office: 12 Endeavour Square, London E20 1JN · www.fca.org.uk