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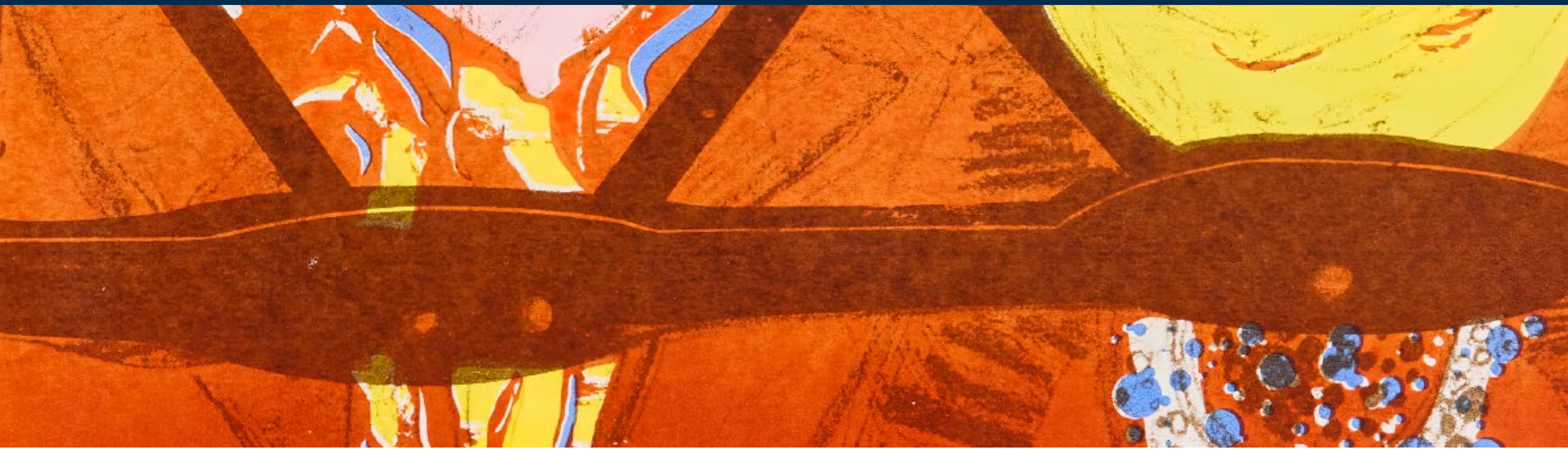

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SHORT-TERM NEWS: LONG-TERM THINKING

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KEY TAKEAWAYS

- Novo Nordisk and Roche have faced scrutiny, but near-term reactions to news are at odds, in our view, with longer-term prospects
- Novo's market position and the long-term dynamics of the obesity market remain unchanged
- Roche has the culture, intellectual capital and financial commitment to continue its legacy of drug development and patient success

Monitoring daily news, quarterly results and other company announcements or peer group activity is very much part of the job within the research team at Walter Scott. But ensuring that we don't overreact or underreact to the latest news is just as important.

In the face of attention-grabbing news headlines and often-transient market fears, it is all-too-easy to be consumed by short-term thinking. Instead, we try hard not to get caught up in fleeting market reactions to short-term misses.

Careful management of consensus estimates can allow a company to 'beat' expectations quarter after quarter. But that isn't always possible. For pharmaceutical companies, gauging the timing and outcome of particular drug trials and managing investor expectations can be just as difficult.

"Businesses do not operate with precise lines of sight"

Financially and strategically, businesses do not operate with precise lines of sight. Missing a particular number or deadline can sometimes lead to dramatic share price declines. In such situations, our job is to go back to our research and understand any news or development in terms of our long-term expectations and the company's stated strategy.

LONG-TERM JUDGEMENT

We had to do just that in December following Novo Nordisk's release of the latest trial data for its next-generation anti-obesity drug, CagriSema.

Whilst there is little doubt about the tremendous growth prospects for anti-obesity treatments given the scale of the world's obesity crisis, investor excitement rose markedly – arguably too far – in 2024. Investors who were unfamiliar with Novo Nordisk's drug pipeline 18 months ago are now well-versed in the merits of both Ozempic and Wegovy. Trial data is followed with vigilance. This level of investor scrutiny, and the volatility in interest that comes with it, is something we have discussed on several occasions with company management. Just as Novo Nordisk's media relations team has had to adapt to the worlds of tabloid journalism and social media, so too the IR team has learned lessons in communicating with a new investor audience.

Results from the latest CagriSema trials showed an average weight loss of 22.7% rather than the 25%+ that the company had previously suggested, and that many investors had therefore assumed. This was taken as disappointing news. The stock fell almost 20% on the day.

AWAITING FULL TRIAL DATA

Speaking to management in the wake of this announcement, there was acknowledgment that the results were disappointing relative to expectations. However, management was also at pains to emphasise that 22.7% weight loss is still significantly higher than the 17% achieved by Novo's current weight-loss drug, Wegovy, and on a par with Zepbound, rival Eli Lilly's obesity therapy. It is also worth remembering that these were headline results. We don't yet have the full trial data. The data that we have, for instance, indicated that only 57% of patients reached the highest CagriSema dose, which is much lower than for other anti-obesity treatments. That was taken as bad news but may instead suggest that patients were happy with the weight loss achieved on the lower dose. Full trial data may answer that question and others.

"Novo now has a more efficacious drug, with a long patent life and a good safety profile"

Viewed in the calm light of day rather than as a knee-jerk reaction, thanks to CagriSema, Novo now has a more efficacious drug, with a long patent life and a good safety profile. The company's market position and the long-term dynamics of the obesity market remain unchanged. While Eli Lilly might have the slightly superior product for now, a successor drug to Zepbound is not expected for a few years and CagriSema, which is widely expected to come to the market in the third quarter of 2026, will provide physicians and patients with an always-welcomed choice with both offering similar weight-loss characteristics.

TOO QUICK TO JUDGE

A recent share price chart of Swiss-based pharmaceutical giant, Roche, also tells a story of disappointed investors quick to judge clinical trial data. In December the company provided an update on the phase two trial of its possible Parkinson's treatment, Prasinezumab. Focus fell on the headline: that there was not sufficient statistically significant evidence that the treatment might delay the progression of this devastating disease. However, the trial did suggest a possible benefit for patients in the early stages of this disease and the drug also continues to be well tolerated with no new safety signals raised in this trial. All of which is encouraging news.

But, with the market focused on the headline disappointment, as with Novo, we went back to our research and our determination to separate short-term noise from long-term prospects. And again, we also sense-checked our beliefs against the views of company management. A recent call with CEO, Thomas Schinecker has added to our confidence.

Whilst he only assumed this position in 2023, his career at Roche began in 2003 and for many years, he was CEO of Roche's diagnostic business. Unsurprisingly given that tenure, his belief in, and commitment to, Roche's culture is clear. But that is not to say he is afraid of change.

He has laid out a strategy that not only preserves, but, he hopes, will raise the bar in Roche's R&D programme. The company's R&D track record remains industry leading but this success has been marred by a rising R&D failure rate. Blaming an easy money environment and not enough commercial rigour with too many projects being launched and not enough being culled, Schinecker is clear that financial metrics matter. So there are now limits on R&D spending, alongside a more rigorous approval process.

DRUG PIPELINE

We also discussed the company's medium-term growth outlook. Recent trial data might have disappointed the market, but there remains real potential in its GYM59 anti-obesity drug, one that also prevents muscle loss, as well as its Parkinson's treatments that use the company's Brain

Shuttle technology to penetrate the blood-brain barrier. That barrier, which restricts molecules moving between the bloodstream and the central nervous system, has been a major obstacle in the development of treatments for neurological diseases so Roche's technology is a significant breakthrough with a multitude of potential benefits.

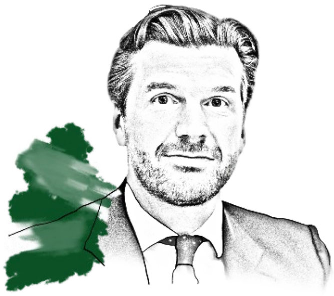
As Schinecker put it, its pharma business will continue to deliver "good growth" until 2028. From that point the company needs new drug launches to kick in but, even without any new launches, the existing portfolio will not decline.

LOOKING THROUGH VOLATILITY

The path towards those new launches will probably continue to be volatile. 2025 will see a number of important phase three trial results: Giredestrant (breast cancer), Fenebrutinib (multiple sclerosis) and Astegolimab (chronic obstructive pulmonary disease). The results from all will be closely watched and, if history repeats, minor misses will be punished. We may see more unwelcome short-term pressure on the share price.

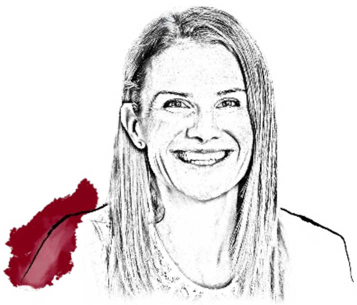
We will, however, continue to judge the company on its long-term prospects, not short-term data flow. The CEO has articulated a compelling plan that should see the company launch two transformational new medicines every year whilst continuing to optimise an industry leading R&D engine and pipeline. Beyond that pipeline, Roche is now through an unfortunate biosimilar window, something that has been a particular issue in recent years. Once a drug patent expires, others can produce biosimilar drugs that are highly similar to the drug that was originally approved. Those biosimilars not only change the supply dynamics but tend to be highly price competitive.

With a number of drugs coming off patent at the same time, Roche had to contend with similar, often highly competitive, drugs coming to market across many of its key franchises. However, as expected, those competitive pressures have now settled and the company will not face further material biosimilar pressures for the rest of the decade. Its diagnostics business is also expected to deliver reasonable growth with the company's long-term objective to double the number of patients tested. It is on that broader picture and long-term outlook that our confidence lies.



DES ARMSTRONG

Des joined the Investment team at Walter Scott in 2004 and is now a senior member of the Research team with leadership and mentoring responsibilities alongside investment and client relationship roles. As befits Walter Scott's global approach, Des has been part of all the regional research teams and has helped lead team-wide research efforts in a variety of sectors. He graduated from the University of Aberdeen with a BSc (Hons) in Pharmacology.



LINDSAY SCOTT

Lindsay is an investment manager at Walter Scott. Prior to joining the firm in 2004, she trained in accountancy at AstraZeneca before focusing on European healthcare within SG Cowen's corporate finance team. Lindsay holds a BSc (Hons) in Biology from the University of Nottingham and an International MBA awarded jointly by the University of Edinburgh and ESADE Business School in Spain.

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