Key Questions

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Should Investors Binge on (or Abstain From) the GLP-1 Craze?

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Over the past year, you have likely encountered numerous headlines touting the new “miracle weight-loss” drugs. While is it is true that these drugs may be good for your waistline, you may be wondering if the companies that develop, manufacture, and market these drugs are also good for your investment portfolio’s bottom line.

While these drugs may appear to be a recent miracle to some, a culmination of decades of research and development led to this moment. In particular, the two companies (Indianapolis-based Eli Lilly (“Lilly”) and Novo Nordisk, headquartered in Denmark) producing this new class of drugs known as GLP-1s have long histories of developing innovative treatments for people with diabetes, the initial application for which these drugs were developed.

What is a GLP-1?

Glucagon-like peptide 1, or better known as GLP-1, is a hormone that tells the body to produce more insulin to help control blood sugar. GLP-1 agonists are the class of drugs that have become extremely popular to help people reach weight-loss goals. Drugs like Ozempic, Monjaro, Zepbound, and Wegovy are in this drug class. While initially developed to help Type-II diabetics manage A1C (a measure of a person’s blood sugar level), studies showed that GLP-1s also helped study participants lose weight. This weight loss occurs as the drug suppresses people’s appetites, causing them to eat less as the movement of food from the stomach to the small intestine is slowed.

In the United States, more than 70% of adults are classified as overweight or obese. When studies showed the opportunities for substantial weight-loss with GLP-1s, investors' ears rightfully perked up sensing large patient need and potentially large patient demand. However, these drugs were intended only for diabetes patients; they had to be resubmitted for approval to have a weight-loss label. But once that occurred (2021 for Novo Nordisk and 2023 for Lilly), investor enthusiasm reached even higher heights.

As of today, there is more demand for these drugs than the companies can supply, which is a very good problem for these companies to have. The work to expand production capacity to meet the growing demand is underway. For Lilly, revenue is expected to grow at a compounded annual rate of nearly 20% over the next 5 years according to analysts’ estimates. Compared to the average of other large cap pharmaceutical companies’ growth of 3%, it is no wonder that Lilly has been an investor favorite of late.

That said, becoming an investor favorite comes with elevated expectations and extended valuations. Lilly currently trades at a price-to-earnings multiple of 60x. This compares to its large cap pharmaceutical peers that trade at an average of 13x and the S&P 500 Index trading at 20x.

On the surface, this may make Lilly seem like an expensive stock. When you consider that its earnings are expected grow at 4 times the rate of its peers, however, Lilly's valuation begins to seem more reasonable.

Over the past year, Lilly's stock is up roughly 140% compared to the S&P 500, which is up 28% over the same time period. This translates to a market capitalization rising from $300 billion to more than $700 billion, making it nearly double the size of the next largest pharmaceutical company in the S&P 500 Index. This rapid price appreciation has also led to Lilly having a large impact on the performance of the healthcare sector and even the S&P 500 as a whole. Over the past year, Lilly has accounted for roughly 50% of healthcare's contribution to S&P 500 returns.

Looking forward, GLP-1s may prove to be even more beneficial, as some smaller studies have shown they can have a positive impact on cardiovascular and kidney health. Conversely, as more of the population use these drugs, negative long-term side effects may become more apparent.

In an era when the large portion of drug development is for rare diseases with small patient populations, this breakthrough for the treatment of obesity stands out even more. However, larger patient populations lead to more opportunities for side effects to be uncovered.

And just as new drugs often come with unanticipated side effects, there is the potential for unanticipated side effects that come from owning stocks that are accompanied by excessive investor enthusiasm. Additionally, competitors have certainly taken notice, and there is a pipeline of similar drugs that may eat into Lilly's market share towards the end of the decade.

For more information, please contact your advisor.

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