



FLAGSHIP

A S S E T M A N A G E M E N T



Quarterly Telescope Q2 2024

Flagship Asset Management • Constantia, Cape Town • +27 (0)21 794 3140 • info@flagshipsa.com

01

We are a global specialist investment boutique

Flagship is a specialist global asset manager founded in 2001.

We are 100% independent and fully owned by staff and directors.

Our mission is to be the navigators and global authority of your complete investment future, wherever it may lead.

02

We manage global portfolios in three distinct strategies

Global Flexible | Global Fund of Funds | Global Equity

We believe in a focused approach to fund management

Our longest running Funds have track records spanning over two decades

03

We are long term investors who manage diversified portfolios

We use a dynamic investment strategy and active risk management to build robust, diversified equity portfolios.

Our unconstrained approach allows us to navigate diverse market conditions and identify opportunities wherever they arise.



Contents

Page

• The Flexible Funds Fit	1
• Mind the (I.T.) Gap!	3
• Strategy Performance	6
• GLP-1s Promise to be a Panacea	7
• Stock Profile: Novo Nordisk	12
• Concluding Thoughts	16

The Flagship Global Investment Team



Philip Short BSc (Maths), CFA

Philip is a fund manager of the global funds at Flagship and brings specialist macroeconomic expertise to the global team. Philip has gained 20 years' experience in the industry at JP Morgan, Fairtree Capital and Old Mutual as an analyst and portfolio manager. He completed his Bachelor of Science in Mathematics at the University of Pretoria and is a CFA charter holder.



James Hayward BEng (Civil), CFA

JD is a fund manager of the global funds at Flagship, having joined in 2021 as an equity analyst. At the completion of his degree, JD worked in the engineering and fintech start-up industries while pursuing further studies in investments. JD holds an Engineering degree from Stellenbosch University and is a CFA charter holder.



Paul Floquet CA (SA), CFA

Paul is a fund manager of the global flexible strategies at Flagship, as well as portfolio manager of the Flagship IP Balanced Fund. He qualified as a chartered accountant in 1995 with Deloitte and Touche and gained international investment experience with JP Morgan and Merrill Lynch. He became a portfolio manager and director at Flagship in 2004. Paul is a CFA charter holder.



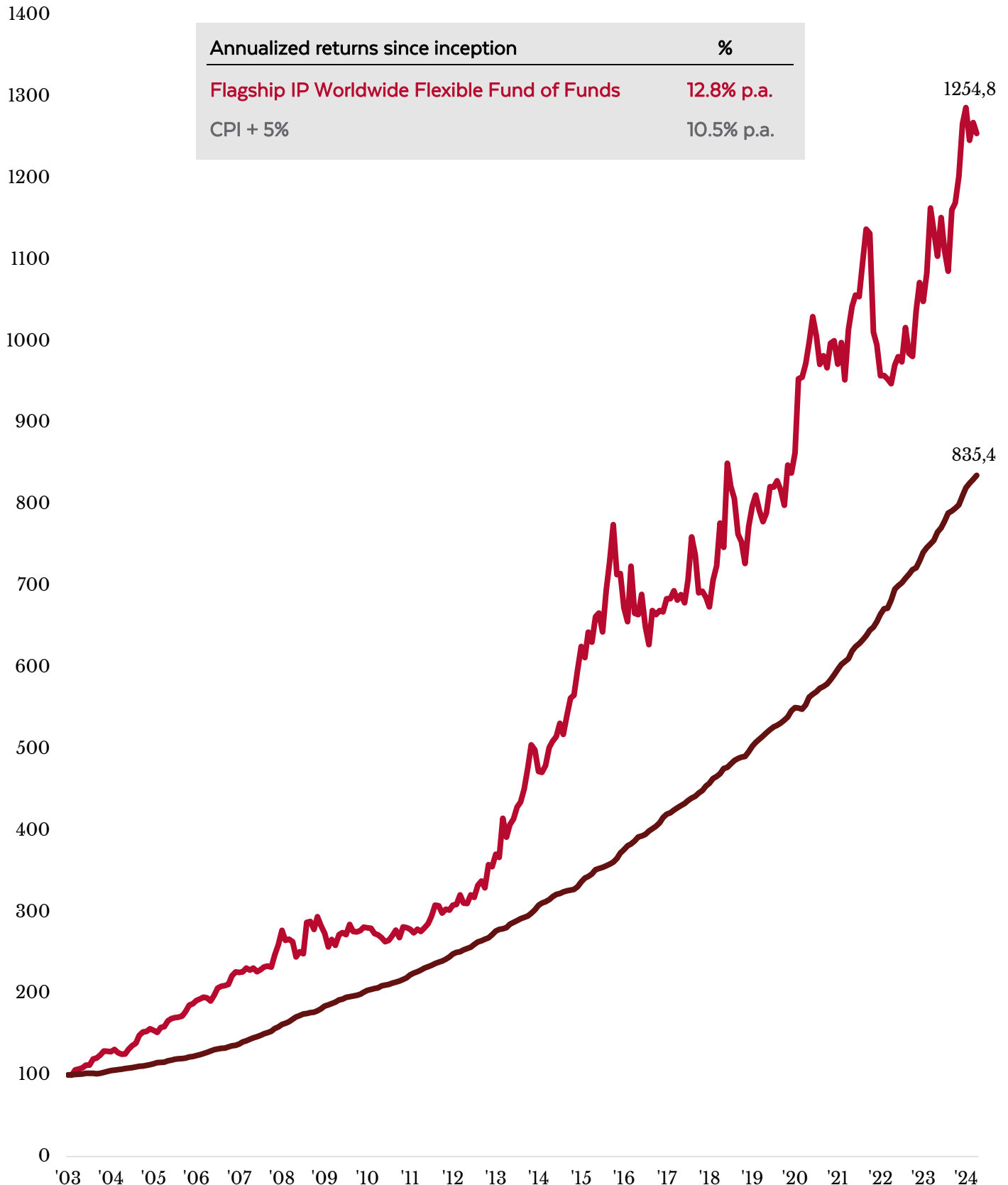
Gerhard Janse van Vuuren BCom (Hons)

Gerhard is an equity analyst for the global team at Flagship, having joined in 2022 via the internship program. Gerhard completed several investment internships while concluding his degree in Investment Management at Stellenbosch University. Gerhard has passed the CFA Level II exam and has completed his Honours degree in Finance at the University of Cape Town.

The Power of Long-term Compounding

The **Flagship IP Worldwide Flexible Fund of Funds** (net of all fees) vs. SA CPI +5%

from 3 April 2003 to 30 June 2024 (21 years, 3 months)



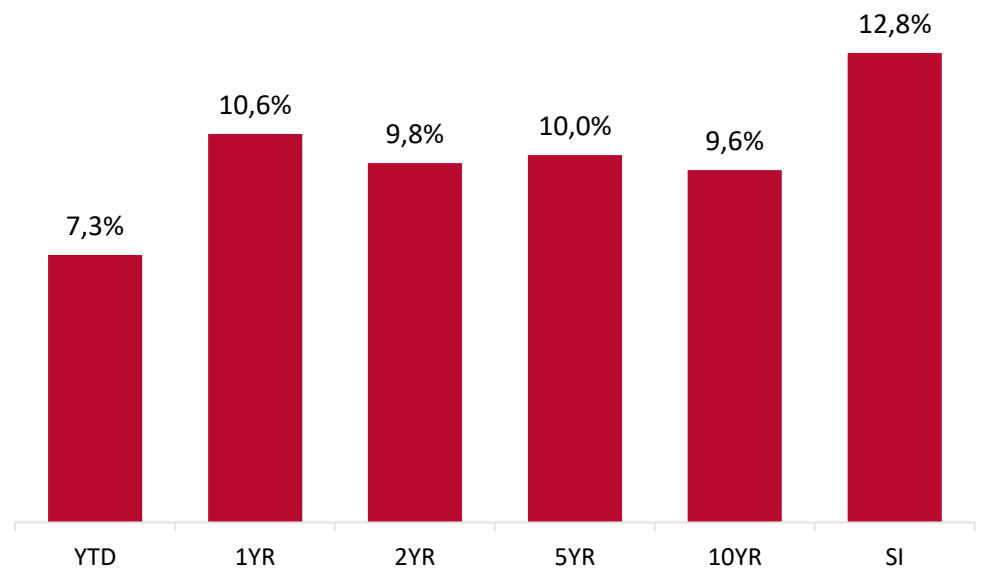


The Flexible Funds Fit

Why are Flagship's Flexible funds well suited for retail investors and Independent Financial Advisors (IFAs)?

Flagship's two Worldwide Flexible funds have a 20-year plus track record of outperforming their benchmarks. In today's world, diversifying your investment portfolio beyond domestic borders is crucial for long-term financial success. Our Flexible Funds offer a comprehensive solution, providing exposure to a carefully curated selection of global assets including equity, fixed income, commodities and real estate. Over time, equities are the best performing asset class, so the funds have a justifiable bias towards equities, allocating between 65% and 85%, and in extreme cases, beyond that.

Chart 1: Flagship IP Worldwide Flexible Fund of Funds performance (annualised)



One of the principal advantages of investing in a flexible fund is that asset allocation decisions for your investments are made by the manager. This means that not only do we manage which underlying securities to add to the portfolios, but also which asset class and which geographies. Should you be holding 80% equities and 20% bonds, or 50% equities, 30% bonds, and 20% cash? The traditional 60%/40% equity/bond allocation was 'problematic' when inflation shot up in early 2022. Knowing that equities and bonds become correlated above a certain level of inflation would have served investors well.

The other major advantage of flexible funds is that they are not limited by regulation as to how much they can invest offshore. Whereas most balanced funds in South Africa, for example, have their offshore holdings limited to 45%, flexible funds can be 100% offshore or 100% local, allowing us to look globally for the best opportunities at any point in time.

While there is a tax benefit (within pension fund investments) in complying with regulations governing South African balanced funds, that benefit is often nullified when the Rand depreciates against global currencies or if your local investment universe doesn't offer you the growth and quality that you can access from global assets.

With markets becoming increasingly volatile and news flow almost overwhelming, it is a full-time job keeping abreast of global macro dynamics, many of which can change quite rapidly.

The other major advantage of flexible funds is that they are not limited by regulation as to how much they can invest offshore.



Our two Worldwide Flexible funds are Rand denominated, allowing clients to quickly and easily invest in global markets without needing to approach SARS for tax clearance.

Looking at a few recent (and one *not* so recent) asset allocation examples that drove investment decisions at Flagship:

1. Two weeks before the South African elections, we increased our allocation to South African holdings. Specifically, we invested 12% of fund in FINI (a South African financial and insurance equity ETF) and JSE Midcap indices. From decision to execution took one day and we allocated to South African stocks we thought stood most to gain from the election, i.e. “SA Inc.”
2. We increased our gold allocation once we saw the global central banks buying the metal, which they had substituted by selling US bonds. We gained confidence in this move due to our ‘deep dive’ analysis on the “US Debt Problem”. As a result, we also decreased the funds’ US bond allocation.
3. We increased overall equity allocation in the funds from 65% to 85% in early 2024 (the S&P 500 has since returned an incremental 14.3%) on the back of:
 - a. Stronger than expected Q4 ‘23 US economic data.
 - b. Stronger fiscal spend by the US government (albeit with longer term ramifications).
 - c. Increased liquidity into the markets by the US Treasury via its Q4 ‘23 Quarterly Refunding Announcement, which issued more shorter-term duration bonds in exchange for longer-term duration.
4. We have, for a long time, had more than 90% of our flexible funds invested offshore. Not only have we benefited from a weaker Rand, but also taken advantage of access to great global companies and sectors not available on the JSE.
5. The ‘not so recent’ example of utilising our fund flexibility was reducing equities to 0% in the Flagship IP Flexible Worldwide Fund of Funds, just before the major market crash in 2008, allowing us to beat the JSE that year by 52%!

The above also demonstrates other characteristics of Flagship’s team and culture:

Globally focused. We are, first and foremost, a specialist global boutique with a double decade history of global knowledge and experience.

Active risk management. Proprietary risk management tools remove the emotion from investing.

Style agnostic. We make use of all investment styles, marrying bottom-up stock selection with top-down asset allocation to create diversified portfolios.

Nimble. As a boutique, we take advantage of lesser-known opportunities in multiple domiciles across the globe.

Our Flexible strategies are uncorrelated with the JSE All Share Index.

Importantly, our two Worldwide Flexible funds are Rand denominated, allowing clients to quickly and easily invest in global markets without needing to approach SARS for tax clearance. These two funds are aimed towards South African investors who reside in South Africa and would like to grow their wealth in real terms, protecting themselves from potential long term Rand depreciation and benefiting from access to global companies and sectors which may enjoy better growth than what can be found on the JSE.

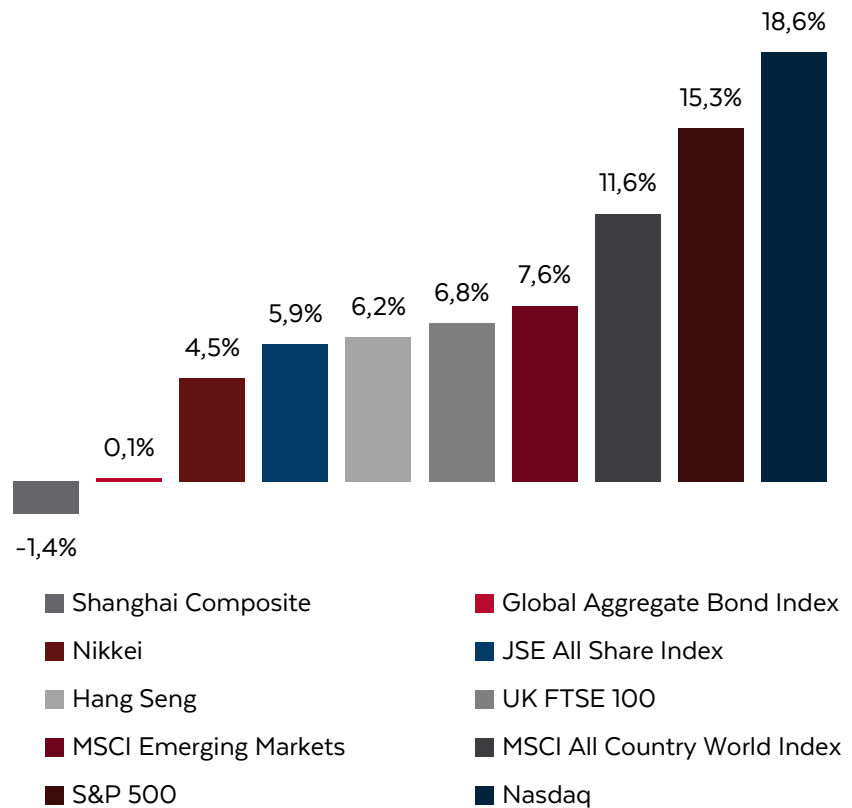


Mind the (I.T.) Gap!

"Never trust a computer you can't throw out the window."

- Steven Wozniak

Chart 2: Global Index returns in USD (December 31, 2023 to June 30, 2024)



Whereas the 1st quarter of 2024 delivered mostly strong equity returns across the board, the 2nd quarter saw a wider variance of returns.

The US market, especially large caps, remained incredibly strong. For the quarter, the S&P 500 returned 4.3%. Most of this return was generated by the constituents that also form part of the tech-heavy Nasdaq, which rallied 8.5% during the quarter. On a year-to-date (YTD) basis, these indices have returned an incredible 15.3% and 18.6% respectively.

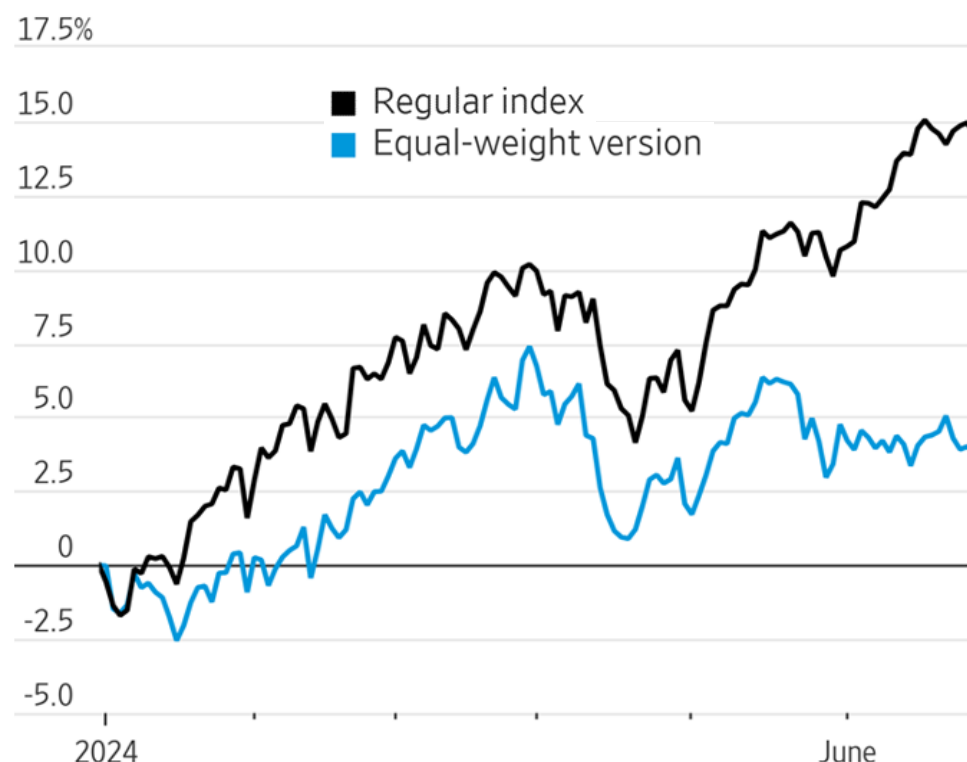
These strong returns have largely been driven by the semiconductor sector (which sits within the technology sector), which gained 23.4% during the quarter – Nvidia still being the posterchild with a 37% return during the period, meaning it has now gained an incredible 149% during the first half of the year. To put into context exactly how important Nvidia has been to the overall market rally, more than a third of the S&P 500 total return YTD can be attributed to the chipmaker. Stated differently, while the S&P 500 gained 15.3% YTD, the S&P 499 (i.e., ex-Nvidia) returned only 9%. The average stock that makes up the index returned only 4.1% this year, underperforming the index by more than 10%. According to Dow Jones Market data, this is the largest underperformance since at least 1990.

More than a third of the S&P 500 total return year-to-date can be attributed to Nvidia.



The FactSet graph below indicates the performance of the regular S&P 500 index, compared to an equal-weighted version, indicating the outsized contribution from the index's mega caps.

Chart 3: S&P 500 Performance (January to June 2024), FactSet



The small-cap Russell 2000 delivered another stark reminder of how narrow the breadth of the market rally has been this year.

The small-cap Russell 2000 delivered another stark reminder of how narrow the breadth of the market rally has been this year. It declined by 3.3% during the quarter and is now only 1.7% in the green for the year to date.

Moving towards Europe, the FTSE 100 returned 3.7% for the quarter, while the Euro Stoxx 50 Index declined by the same percentage. YTD, these indices have now returned 7.8% and 8.2% respectively, in local currency.

In the East, results varied widely, and the fortunes of Japan's Nikkei and Hong Kong's Hang Seng Indices made sharp U-turns from the previous quarter. The Nikkei swung from a 20% gain in Q1, to a 2% decline in Q2 (both measured in Yen) as messaging from the central bank was inconsistent and the Yen continued to weaken against the US dollar. The Hang Seng improved from a 2.7% decline in Q1 to a 9% gain in Q2. YTD, these indices have now returned 19.3% and 6.2% (in local currency), respectively.

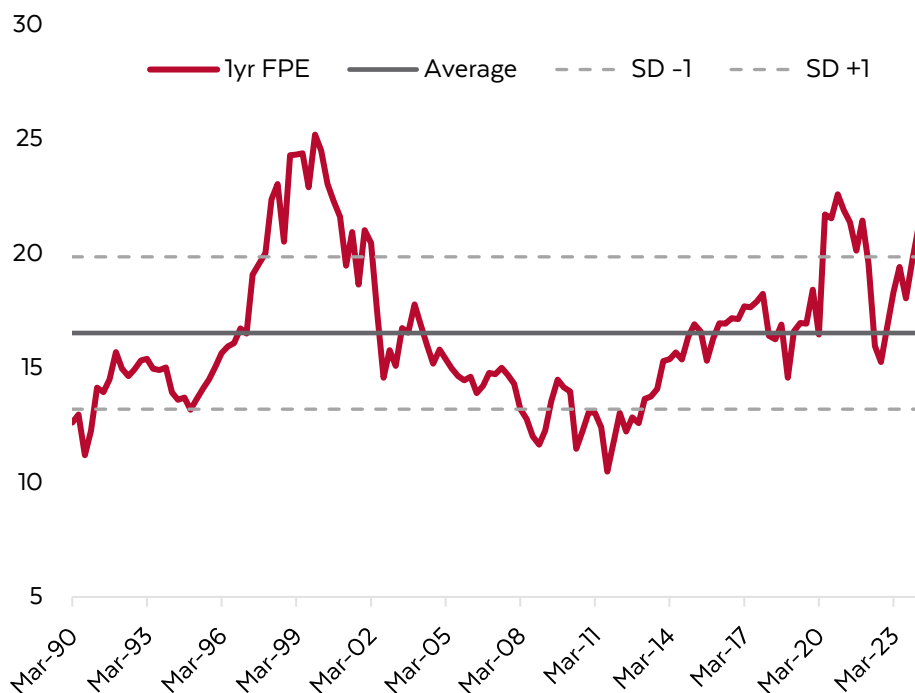
Turning inward, local indices delivered a strong performance, driven by market optimism after the election results and the semi-successful formation of a Government of National Unity. The JSE All Share Index returned 8.2% for the quarter. Coupled with the Rand strengthening by 3.6% over the same period, the index's USD return was an incredible 12.3%. On a YTD basis, the local index has now returned 5.8% in ZAR, erasing losses from the 1st quarter. Special mention must be made of the JSE Financials Index, which returned 20.3% during the quarter. Large losses during Q1, however, means that its YTD gain now stands at 8.9%.

Taking a more detailed look at the US specifically, the S&P 500 Index is currently trading at a 1 year forward price-to-earnings (1yr FPE) of 21.7x. This is a 31% premium to its 30-year average, and 9% above its standard deviation (SD) over the same period.



The only other times the S&P 500 has traded this high was during the dotcom bubble and the Covid pandemic.

Chart 4: S&P 500 1 year forward PE ratio (March 1990 – 2024)



What is driving this rally? Patently, the technology sector is largely responsible, trading at 28x 1yr FPE. Versus its own history, the technology sector is trading beyond its 90th percentile, and significantly beyond its median value of 18x. Having said that, nearly all the US sectors are trading above their median values.

The two main drivers of this market performance:

1. The strong performance of anything Artificial Intelligence (AI) related. From Nvidia to Microsoft, if a company has an AI angle, its share price is likely to have benefited.
2. Continued US fiscal spend. We touched on this in our last Telescope and have seen no sign of the US government slowing down its propensity to hand out Dollars to the US economy. In what should come as no surprise, the US deficit is now expected to hit \$2 trillion for 2024, up from the earlier guidance by the US Congressional Budget Office of \$1.6 trillion. Deficits are funded by debt with the US government's debt now standing at a staggering \$35 trillion.

We are starting to see some signs of a weaker consumer in the US. Companies within the Consumer Discretionary sector have posted some weak results in quarter 2 this year with a number of company executives citing a “weak consumer” in their earnings calls. In previous Telescopes we estimated that the US consumer would “run out” of savings by quarter 2 of this year, given the starting point and the spending run-rate. This, together with high credit card debt levels, high credit card interest rates (above 20%), and high credit card delinquency rates, suggest that US consumers have (nearly) tapped out that source of spending as well. Given that household final consumption expenditure, i.e. consumer spend, accounts for 70% of US GDP, we are cautious on how much longer strong GDP growth can be sustained, and in turn, high forward PE multiples.

Versus its own history, the technology sector is trading beyond its 90th percentile, and significantly beyond its median value of 18x.



Strategy Performance

The performance of the Flagship strategies over Q2 '24 and 1 year to 30 June 2024, net of fees, is shown below:

Fund of Funds Strategy	Q2 '24	%Δ 1YR
Flagship IP Worldwide Flexible Fund of Funds (ZAR)	-2.5%	10.6%
Flexible Strategy	Q2 '24	%Δ 1YR
Flagship International Flexible Fund (USD)	-2.1%	5.8%
Flagship IP Worldwide Flexible Fund (ZAR)	-4.9%	7.1%
Global Equity Strategy	Q2 '24	%Δ 1YR
Flagship Global Icon Fund (USD)	-2.5%	9.5%
Flagship IP Global Icon Feeder Fund (ZAR)	-6.3%	5.2%

All three strategies delivered disappointing results during the quarter. This was largely due to a low weighting to the technology sector across the strategies, which has been the main driver of global index returns year-to-date.

While the current underperformance is painful for our investors, we are of the view that this sector is too expensive; has become more and more speculative; and the rally is not sustainable. Looking forward, we believe it'll be more beneficial for our investors if we take a cautious approach in the current market environment.

The majority of Flagship's global ZAR denominated strategies hold their assets offshore. With the ZAR strengthening by 3.6% against the dollar during the quarter (due to optimism of an improving SA political outlook), and the inverse correlation between ZAR strength and our global funds' performance, this was a meaningful detractor from performance across our strategies.

The Fund of Funds Strategy declined by 2.5% during the quarter compared to its benchmark of CPI + 5, which returned 1.9%. Annual performance maintained a steady 10.6%. The biggest detractors during the quarter were iShares Japan ETF and Invesco S&P 500 GARP ETF, combined detracting around 1.2% of total performance. The largest contributors were JSE Financials ETF and Guinness Global Innovators Fund, adding 0.6% of performance between them.

Looking at the equity component of the local Flexible strategy, after being one of the main contributors during Q1 '24, Rheinmetall gave up some of its gains to be one of the larger detractors during Q2 '24. We believe the fundamentals of the investment case remain intact, and so we continue to hold the position. Blue Label Telecoms and Walt Disney also gave up some previous gains, delivering negative contributions during the quarter.

The main contributors were the JSE Financials Index and JSE Midcap Index, in which the fund took tactical positions as the election outcome became clearer. Other large contributors were Eli Lilly, Novo Nordisk, and Applovin Corp.

Flagship's Global Equity strategy declined by 2.5% during the quarter, compared to its MSCI ACWI Benchmark which gained 3%. The main detractors during the quarter were Hensoldt, Blue Label Telecoms and Rakuten, while the main contributors were Eli Lilly, Novo Nordisk, Rolls Royce and Applovin.

The ZAR strengthened by 3.6% against the dollar during the quarter and was a meaningful detractor from performance across our global strategies.



GLP-1s Promise to be a Panacea



By Philip Short

- ⇒ Glucagon-like peptide-1, or GLP-1, agonists are a class of medications that can help manage diabetes and obesity.
- ⇒ GLP-1 was first used to treat diabetes in 2005 but since 2021 it has also been used to treat obesity.
- ⇒ GLP-1s have since shown to help a much wider array of ailments and diseases, from cardiovascular health, kidney disease, sleep apnea and more.

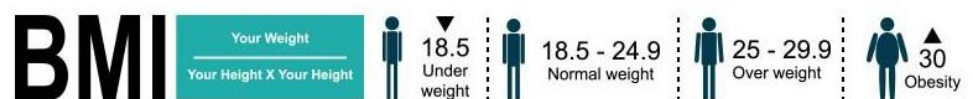
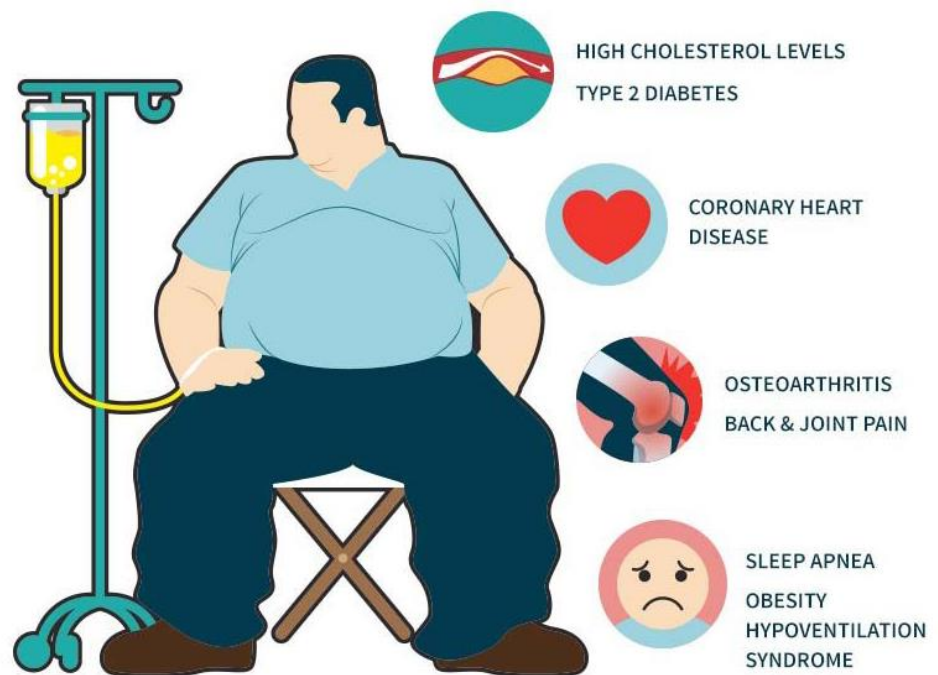
Cue GLP-1s: a natural hormone drug that regulates insulin release and hence blood sugar levels.

From an investment standpoint, the pharmaceutical sector is an interesting one to navigate. There are many stakeholder interests and they are usually not aligned: company management, employees, competitors and their race for patents, governments, regulators, consumers, lobby groups, ESG policymakers, and the list goes on.

Cue GLP-1s: a natural hormone drug that regulates insulin release and hence blood sugar levels. GLP-1 receptors are found in the digestive tract, the pancreas, and the brain. In addition to signaling the release for insulin, they work to slow the rate at which food passes through the digestive tract. In the brain, they also serve to disrupt some of the dopamine feedback that comes from pleasurable events, such as food intake, and, in this respect, induces satiety. All this results in eating less and feeling fuller sooner, and for longer, hence the weight loss. These drugs were initially developed as diabetic medication, administered via injection. Since the weight-loss effects proved so effective, pharmaceutical companies have modified these drugs and the format in which they are taken, to manage obesity and voluntary weight loss. The current GLP-1 weight loss drugs that have been approved by the FDA have shown weight loss of between 6% and 21% in obese patients (with the definition of obese being a Body Mass Index of over 30).



Obesity-Related Diseases



Novo Nordisk is currently in phase two of its new anti-obesity drug, called Amycretin, which is administered orally as a pill, once daily.

The big moment came in 2021, when the FDA granted approval for Novo Nordisk's GLP-1 based drug Wegovy, for weight loss specifically. Given that the core active pharmaceutical ingredient was the same as for their already-approved diabetic drug, Ozempic, this was a big step, as it meant patients could get a prescription (and thus potentially medical insurance), for weight loss drugs. Eli Lilly's GLP-1 based anti-obesity drugs, Mounjaro and Zepbound, were approved in 2022 and 2023 respectively. These anti-obesity drugs are administered by an injection once a week, with the injection pen needing to be cold-stored.

Pricing for these drugs can be very expensive, depending on where in the world you are. A month's supply of Wegovy, for example, costs \$1,000 in the US, \$168 in Japan, and \$103 in Germany. Mounjaro is just over \$1,000 in the US, \$319 in Japan and \$444 in the Netherlands. Locally, Ozempic costs approximately \$275 (R5,000) per month, depending on your dosage (and if you can get your hands on it due to supply constraints). However, in the US, depending on your health history, your doctor's assessment, and your health insurance, you could end up paying only a fraction for your anti-obesity drugs out of pocket, as your insurer pays a large part of the costs. If your obesity will lead to higher medical expenses for your health insurer down the line, this makes sense.

Innovation

Novo Nordisk is currently in phase two of its new anti-obesity drug, called Amycretin, which is administered orally as a pill, once daily. (There is another anti-obesity pill currently on the market, also by Novo Nordisk, called Rybelsus, but its efficacy is not as desirable as the injections.)



Worldwide adult obesity has more than doubled since 1990, and adolescent obesity has quadrupled.

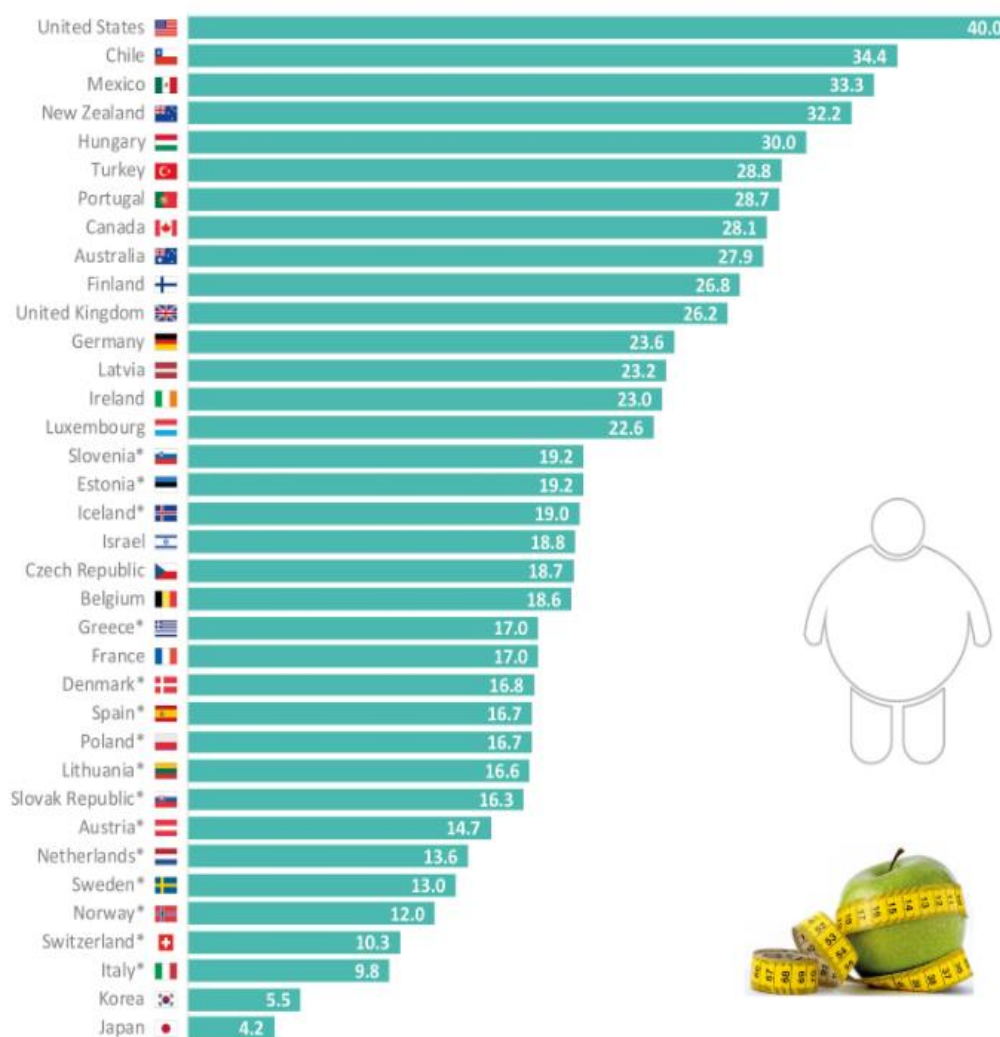
The initial results of Amycretin are also more positive, having the same, if not better, efficacy as that of the injections. Results also indicate fewer side effects and more effective weight loss. As one can expect with these blockbuster drugs, major profits will draw in competition, as well as further innovation.

Total addressable market

This is where it gets really interesting. The anti-obesity drug category was formally established with the approval of Wegovy in 2021, so it's a very nascent market. In the US, the current obesity rate (percent of adult population that is obese) is 40%, while the obese drug penetration rate (percent of the population that is currently on a prescription drug for obesity) is only 1.5%. So, in the US alone, there is still significant runway for these companies to grow. Then, there is still the rest of the world. Key facts from the World Health Organisation:

- In 2022, 1 in 8 (12.5%) people in the world were living with obesity.
- Worldwide adult obesity has more than doubled since 1990, and adolescent obesity has quadrupled.
- In 2022, 2.5 billion adults (18 years and older) were overweight. Of these, 890 million were living with obesity.
- Over 390 million children and adolescents aged 5–19 years were overweight in 2022, including 160 million who were living with obesity.
- In 2022, 37 million children under the age of 5 were overweight.

Chart 5: Obesity rates as % total adult population (15yrs & older), 2016 or latest year





GLP-1s have a significant growth runway for treating obesity, both in the US and worldwide.

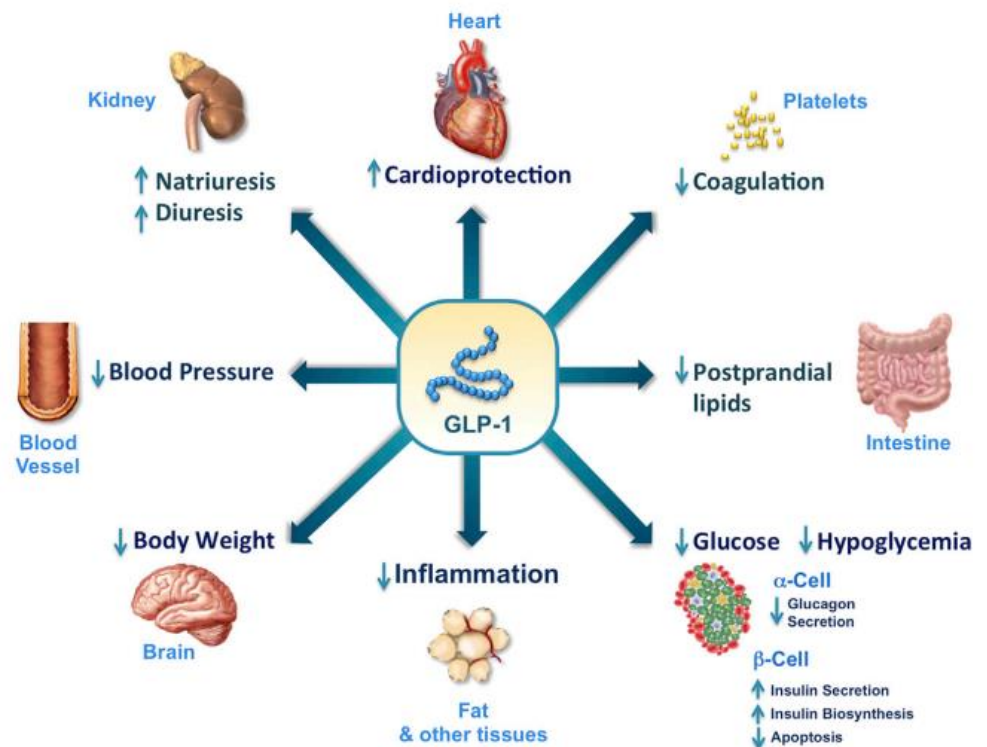
Globally, obesity drugs have only just entered some markets. On 25 June 2024, China approved Wegovy as the first major weight loss drug for its population. China's national obesity rate is lower than the US, but it is growing at a faster rate. A recent study released by "Diabetes, Obesity & Metabolism" showed that 35% of China's population were overweight and 14% were obese.

Summary: GLP-1s have a significant growth runway for treating obesity, both in the US and worldwide.

What has caused further excitement for GLP-1 drug observers is that benefits of these drugs are being seen across a myriad of other ailments; increased cardio vascular health, improvement of sleep apnea, decreased risk of kidney disease with patients who suffer from diabetes (there are 850 million people in the world with some form of kidney disease), and even help with arthritis and Alzheimer's. These positive developments were seen in patients who were suffering from one or more of these conditions, while taking the GLP-1 medication for obesity or diabetes, and who saw improvements in these other conditions before they lost weight, so it is due to the medicine and not the weight loss.

To give you an idea of how big these other markets can be for GLP-1s, Cardio Vascular Diseases (CVDs) are the leading cause of death globally, taking an estimated 17.9 million lives each year (source: World Health Organisation).

Chart 6: GLP-1 modifies CV Risk through direct and indirect actions in multiple organs



It is important to note that the major players, such as Novo Nordisk and Eli Lilly, are in various phases of testing and obtaining approval for their newly adapted GLP-1 drugs, i.e. it is not a given these drugs will be approved. Therefore, the full extent of the upside for these companies is not fully built into investor expectations as yet. Interestingly, from an investment perspective, is Novo Nordisk's observation that many of its patients using Wegovy, who were also smokers or vapers, were "accidentally" quitting; I say accidentally because that was not their intention.



GLP-1s have significant growth potential across a spectrum of other serious ailments which companies have not yet even begun to monetize.

Novo Nordisk found that the scrambling of the dopamine feedback caused by the GLP-1 drugs, which provided satiety when eating food, was also limiting the “reward” signal when smokers/vapers inhaled nicotine. They are now in phase two of clinical trials to produce a GLP-1 drug specifically targeted at quitting nicotine. How big will that market be if they’re successful in making an effective drug to stop nicotine intake, and what does that mean for tobacco and nicotine companies? There are 1.3 billion smokers in the world that could replace their nicotine fix for a GLP-1 tablet.

GLP-1s have significant growth potential across a spectrum of other serious ailments which companies have not yet even begun to monetize. What are the risks with an investment into this space?

- **Supply chains**

Our attention to this sector initially began when we noticed there was a global supply crunch of GLP-1 medication towards the end of 2023. For months, these pharmaceutical companies could not sell their products fast enough. In some geographies, this is still the case. While this indicated strong demand for the product, ongoing supply issues could still result in supply falling behind demand. It’s worth noting that in order to meet GLP-1 demand, Novo Nordisk bought Catalant, a contract manufacturer, for \$16.5bn in February 2024, and is breaking ground on a new \$4.1bn factory this year.

- **Competition**

Novo Nordisk and Eli Lilly have patents until 2031 and 2033 respectively for their GLP-1 drugs. Once these expire, pricing for their drugs will come down quickly. Even before then, other pharmaceutical companies are working to develop their own, unique GLP-1 drugs. So, one has to be prepared for competition, which is the biggest risk to the investment case. Increased competition doesn’t just mean Novo Nordisk and Eli Lilly may lose market share, which they will, but it certainly can and will decrease the profit pool, as competition drives down prices for everyone.

- **Side effects**

As with most medications, there are side effects. Some patients have experienced nausea, vomiting, diarrhea, and depression.

- **Valuation**

Novo Nordisk and Eli Lilly aren’t what some investors would consider cheap, trading on PE multiples similar to Amazon and Adobe. Although, others would argue that those same investors aren’t discounting the correct growth rate inherent in this nascent and fast-growing sector.

- **Regulation**

Regulators are already complaining about the pricing of the weight loss drugs. Regulators have a disproportionate influence on companies when it comes to the healthcare sector.



Investment Case: Novo Nordisk



By Philip Short

- ⇒ The GLP-1 Total Addressable Market (TAM) is larger than most expect, in our view.
- ⇒ Novo Nordisk's operating and financial metrics are best in class.
- ⇒ Novo Nordisk has significantly outperformed the S&P 500 Index since August 2021, when it first traded at a seemingly too high 30x PE multiple, driven by strong earnings growth.

While few will dispute the quality of these companies and the enviable pharmaceutical portfolios they hold, the main questions are: 1) what are these companies worth, and 2) are their earnings sustainable; or, framed another way, how much confidence can I put in that valuation and my earnings' forecasts?

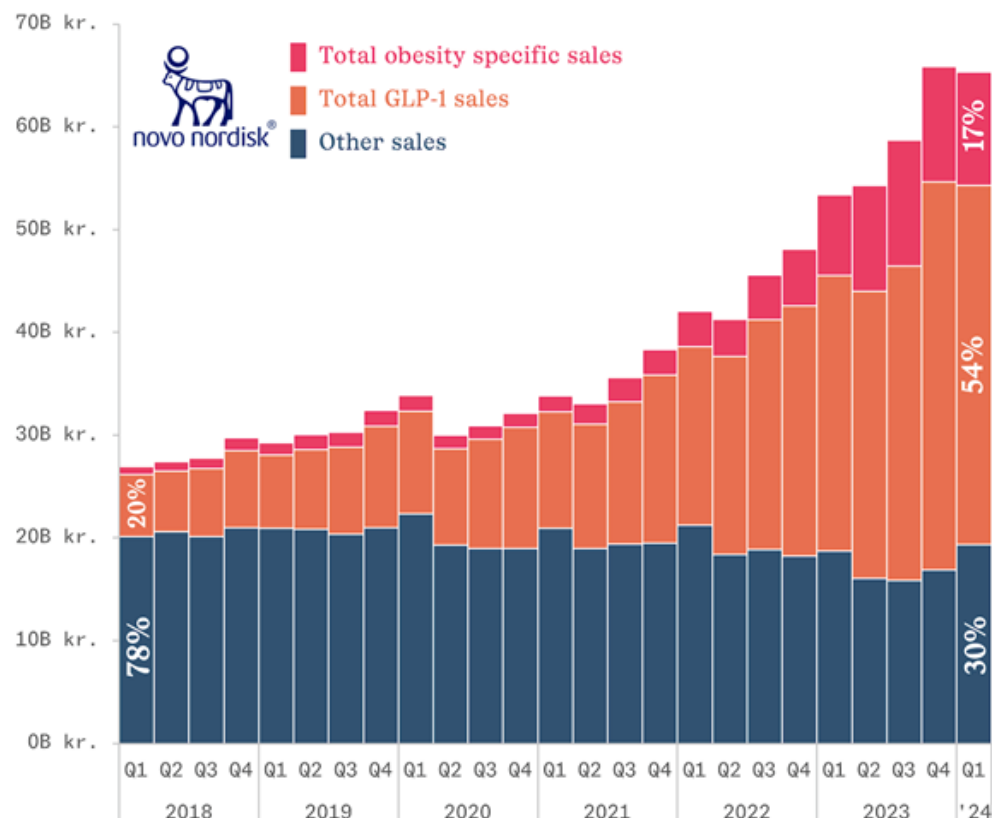
Before I go down the path of discussing how we view these companies, I think it's worth reminding clients that Flagship is style agnostic, meaning we are not beholden to one specific style of investing, such as value, quality or growth. We embrace all styles, which gives us a larger opportunity set to choose from in terms of stock selection, and it allows us to perform well even when a certain style is out of favour (which can mean underperformance for years if one is wedded to one particular style).

While we own both Novo Nordisk and Eli Lilly in the Flagship global funds, I will focus on Novo Nordisk. It's a purer play on obesity, as its obesity portfolio makes up a larger portion of its revenue versus Eli Lilly. It has a less demanding valuation, performs better on quality and return metrics, and has a stronger balance sheet. This is reflected in its larger weighting in Flagship's portfolios.

**Novo Nordisk's
operating and
financial metrics are
best in class.**



Chart 7: Novo Nordisk Sales, by division, Danish Krone bn



If we look at Novo Nordisk, the short-term forward price-to-earnings multiple is rich at 37x. Can it grow earnings into that multiple in the medium term? We think so.

Let's start by looking at what compounded annual growth rates the market expects between 2023-2027 (source: Bloomberg):

- Revenue: 20% per annum
- Earnings per share: 18% per annum

So, the market is expecting Novo Nordisk to double its earnings over the next four years. The Organisation for Economic Co-operation and Development expects global obesity rates to continue growing higher. For the US, that is expected to go from 40% of the population in 2018 to 50% in 2030. Given that the GLP-1 penetration rate in the US is currently 1.5% (i.e. only 1.5% of the 40% are taking weight loss drugs), that growth in penetration has a long way to go in a target market that already exists (the 40% obesity population). Then you also have new markets for anti-obesity drugs, like China, where penetration rates are closer to 0%, but also with a sizable market in terms of obesity rates. On top of that, you have innovation within the obesity category such as Novo Nordisk's Amycretin GLP-1 pill, which will grow the addressable market (not everyone likes to inject themselves), and likely bring pricing down while keeping margins high (pills are cheaper to produce than injectables).

In addition, Novo Nordisk is already progressing well in clinical trials with the new applications for GLP-1s such as Chronic Kidney Disease (CKD), Cardio Vascular (CV) health, Alzheimer's, sleep apnea, smoking cessation, etc. You have a lot of blue-sky opportunities that are not reflected in the current share price.

The short-term forward PE multiple for Novo Nordisk is rich at 37x. Can it grow earnings into that multiple in the medium term? We think so.



Chart 8: Novo Nordisk's current pipeline of clinical trials, BofA Merrill Lynch

Strategy Supporting	Trial Name	Phase	Population	Treatments	Duration	Primary completion
CagriSema	REDEFINE-1	PIII	Obese non-diabetic adults. BMI ≥ 30 or ≥ 27 & ≥ 1 comorbidity	CagriSema v Sema vs Cagri vs Pbo	68 wks	Oct-24
	REDEFINE-2	PIII	Obese diabetic adults. BMI ≥ 27 , Type 2 diabetes, HbA1c 7-10%	CagriSema vs Placebo	68 wks	Dec-24
	REDEFINE-3	PIII	Obese 55+ yo. BMI ≥ 25 , CVD. If T2D, HbA1c 6.5-10%	CagriSema vs Placebo	242 wks	Sep-27
	REDEFINE-4	PIII	Obese non-diabetic adults. BMI: ≥ 30 . Excludes HbA1c $\geq 6.5\%$	CagriSema vs Tirzepatide	72 wks	Aug-25
	REIMAGINE1	PIII	Diabetic adults. BMI ≥ 23 , HbA1c 7.0-9.5%	CagriSema vs Placebo	40 wks	Aug-25
	REIMAGINE2	PIII	Diabetic adults. MET +/- SGLT2. HbA1c 7.0-10.5%	CagriSema v Sema vs Cagri vs Pbo	68 wks	Nov-25
	REIMAGINE3	PIII	Diabetic adults. BMI ≥ 23 . Basal insulin +/- MET	CagriSema vs Placebo	40 wks	Sep-25
	REIMAGINE4	PIII	Diabetic adults. MET +/- SGLT2. HbA1c 7.0-10.5%	CagriSema vs Tirzepatide	68 wks	Nov-25
Sema Alzheimer's	EVOKE	PIII	Early Alzheimer's Disease	Semaglutide vs Placebo	104 wks	Sep-25
	EVOKE+	PIII	Early Alzheimer's Disease	Semaglutide vs Placebo	104 wks	Sep-25
Oral obesity	nm	PII	Diabetic Kidney Disease	INV-202 vs Placebo	16 wks	2H24*
	nm	PII	Obesity & Metabolic Syndrome	INV-202 vs Placebo	16 wks	2H24*
	nm	PI	Obesity	Amycretin (SC OW)	nm	1H25E*
	nm	PII	Type 2 diabetes	Amycretin (SC OW, Oral QD) vs Pbo	nm	2H25/ Early-26*
Ziltivekimab	ZEUS	PIII	CKD, ASCVD, Inflammation	Ziltivekimab vs Placebo	48 mths	Sep-25
	HERMES	PIII	Heart Failure	Ziltivekimab vs Placebo	48 mths	Jul-27
	ARTEMIS	PIII	Acute Myocardial Infarction	Ziltivekimab vs Placebo	25 mths	Sep-26
	ATHENA	PIII	HF w/ reduced/preserved EF & Inflammation	Ziltivekimab vs Placebo	12 mths	May-26
Ocedurenone	CLARION-CKD	PIII	Uncontrolled hypertension & CKD (stage 3b/4)	Ocedurenone vs Placebo	12-52 wks	Early-25E*
	PIII start 25E	PIII	Heart Failure with preserved Ejection Fraction	Ocedurenone	nm	nm
Sema MASH	ESSENCE	PIII	MASH with fibrosis stage 2/3	Semaglutide vs Placebo	72 wks	End-24E*
High-dose Sema	STEP UP	PIII	Obese non-diabetic adults. BMI ≥ 30	Sema 7.2mg v Pbo vs Sema 2.4mg	72 wks	Early-25E*
	nm	PIII	Obese diabetic adults. BMI ≥ 30 , Type 2 diabetes, HbA1c 7-10%	Sema 7.2mg v Pbo vs Sema 2.4mg	72 wks	Early-25E*

That's a lot to digest (yes, pun intended).

Let's look at some of Novo Nordisk's operating and financial metrics for the Financial Year End 2023:

You have a lot of blue-sky opportunities that are not reflected in the current share price.

- 2023 year-on-year sales growth rate: 31%
- Gross margin: 85%
- Operating profit margin: 44%
- Net profit margin: 36%
- Return on Equity (RoE): 88% - for every \$1 the company retains after paying dividends, it can reinvest in the company and generate a profit of 88c on that \$1, annually.
- Return on Invested Capital (RoIC): 67%
- Dividend payout ratio: 50% - it pays half of its profits out in dividends.
- Share buyback: the company is currently buying back its own shares in the open market.
- Net debt: negative - it has more cash on its balance sheet than debt.
- Free cash flow/net income: 102% - it converts all its accounting profit into free cash flow, which is cash post capital expenditures.



In short, the market has underestimated Novo Nordisk's earnings potential.

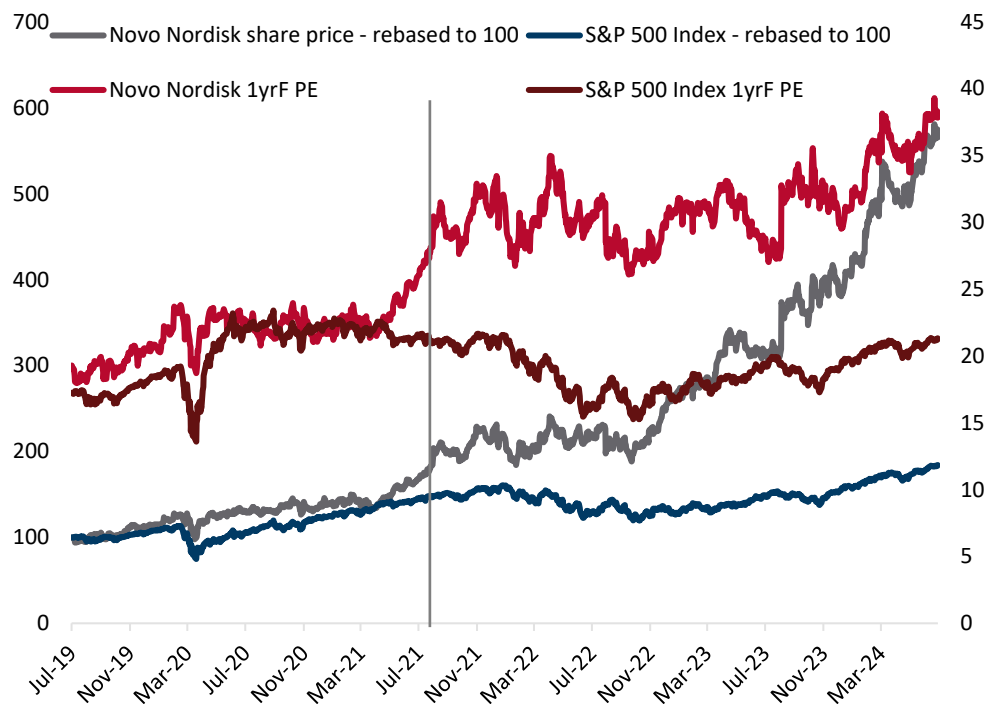
Valuation

Investors usually first have a look at a 1 year forward price-to-earnings multiple (1yr FPE) to get a quick gauge if a company is cheap or not. Some investors rely solely on 1yr FPE's, which is where we feel pure value managers unnecessarily exclude some great companies. Case in point, Novo Nordisk currently trades on a 1yr FPE of 37x. Many would say that's too expensive. Let's dig a bit deeper.

Looking at the chart below, we see Novo Nordisk's 1yr FPE first hit 30x on 5 August 2021, shown by the black vertical line. The S&P 500 at the time was trading on a 21x 1yr FPE – quite demanding relative to its own long-term history. Since August 2021, Novo Nordisk's share price has gained 177% versus the S&P 500 Index's 24%. Over the same period, Novo Nordisk's 1yr FPE expanded from 30x to 37x, meaning that although the share became more “expensive”, its PE multiple explained only a quarter of the 177% share price return; the remaining three quarters came from earnings growth. Over the same period, the S&P 500 PE multiple has stayed flat at 21x.

The market's 1 year forward earnings estimates for Novo Nordisk went from Danish Krone 9.7 in August 2021 to Danish Krone 23.6 today. In short, the market has underestimated Novo Nordisk's earnings potential. And if you have stronger than expected earnings growth, looking at PE multiples is less helpful when it comes to establishing the true value of a business.

Chart 9: Novo Nordisk share price, S&P 500 Index (both rebased to 100) – left axis, versus their respective 1yr FPE's – right axis.



Our investment case is based on the addressable market being larger than what the market is currently pricing in. As Novo Nordisk's operating and financial metrics are already so strong, it would be naïve to think there's further upside to come from those improving. We are aware that competition is coming and will intensify. We are also aware that, at some point, we will need to trim or sell our holdings in these companies, as the upside is not infinite. Our investment in Novo Nordisk has returned 40% in the six months since we bought it. We expect it has further to go.



In conclusion

We write these Telescopes so that our investors know what it is we are doing, and why we are doing it. For many of you, we are the caretakers of your global investments, and we would like to use this opportunity to thank you for the trust you place in us, and emphasize how deeply committed we are to the responsibility you have placed in our hands.

We believe it is of the utmost importance that all clients feel a true sense of the word “Partnership” in how we are aligned. Our portfolio management team reflects this with significant personal investments in the Flagship strategies.

Flagship funds own a selection of businesses that we believe to be of unusually high quality, and will prove to be financially resilient whatever the prospects of the global economy.

We expect the value of these businesses to rise at an attractive rate over the coming years, and that owning these businesses at a discount to what they are worth will make an additional contribution to your returns.

While we believe that Flagship funds will continue to outperform over longer-term periods, there will inevitably be shorter-term periods over which our funds will not outperform. This is the nature of markets – one’s alpha (or excess performance relative to one’s benchmark) is lumpy and doesn’t accrue in a straight line.

Warm Regards,

The Flagship Global Team





Navigate Safely Forward

T +27 21 794 3140

E info@flagshipsa.com

www.flagshipsa.com

Specialist Global Asset Management.

Disclaimer

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