

Why We Own Eli Lilly: From Trial Result to Treatment at Scale

For a person living with obesity, the decisive question is not whether a molecule can produce an impressive headline. It is whether treatment reaches the pharmacy, remains affordable, can be tolerated and delivers enough benefit to justify continuing it.

That is also a useful way to understand Eli Lilly as an investment. The company has helped turn a large and often poorly treated chronic-disease burden into measurable clinical outcomes. But value will be created only if Lilly can convert those outcomes into reliable supply, sustained access and attractive returns while retaining the trust of patients, clinicians, regulators and payers.

A structural need, not a short-lived category

The demand begins with disease prevalence. The World Health Organization says that one in eight people worldwide lived with obesity in 2022, including 890 million adults. It describes obesity as a chronic, relapsing disease shaped by biological, behavioural and environmental factors.

That distinction matters. This is not simply a consumer trend. Obesity is associated with diabetes, cardiovascular disease, sleep apnoea and other health burdens. Better diagnosis and treatment can therefore create value for patients and health systems as well as medicine developers. The market opportunity is large, but prevalence alone does not guarantee profitable growth: people need clinical eligibility, a prescriber, payer approval, supply and support to remain on treatment.

Lilly's advantage is an operating system, not just a molecule

Lilly's central products in this market are Mounjaro for type 2 diabetes and Zepbound for chronic weight management and certain related indications. Both contain tirzepatide, which acts on GIP and GLP-1 receptors. The underlying advantage, however, is wider than a single product. It combines research and clinical-development capability, regulatory experience, intellectual property, manufacturing know-how and commercial relationships with clinicians and payers.

Clinical evidence provides the starting point. In the company-sponsored, randomized SURMOUNT-1 trial, 2,539 adults with obesity or overweight and at least one weight-related complication, but without diabetes, received tirzepatide or placebo. At 72 weeks, mean weight reduction was 15.0%, 19.5% and 20.9% for the three doses, compared with 3.1% for placebo. The most common adverse events were gastrointestinal, and some participants discontinued treatment.

An indication-specific outcome makes the benefit more tangible. In 2024, the US Food and Drug Administration approved Zepbound for adults with obesity and moderate-to-severe obstructive sleep apnoea. The decision drew on two randomized, placebo-controlled studies involving 469 adults. At 52 weeks, participants receiving Zepbound had a clinically meaningful reduction in breathing interruptions during sleep, and more reached remission or mild disease with resolution of symptoms.

These are trial outcomes, not proof of universal real-world impact. The studies have defined populations, treatment protocols and time horizons. Affordability, adherence, safety monitoring and continued access determine how much of that efficacy becomes durable benefit outside a trial.

Where Lilly fits

Human Advancement is Lilly's primary Delta theme because the investment case begins with improved health outcomes and the systems required to deliver them. Climate Action and Nature Innovation remain relevant secondary lenses: pharmaceutical manufacturing uses significant energy, water and materials, so operating efficiency and responsible sourcing affect resilience and external cost. They do not replace the clinical purpose of the business, and they do not excuse a weak financial or governance case.

How clinical advantage becomes earnings

The commercial mechanism is now visible. In the second quarter of 2026, Lilly reported revenue of \$22.97 billion, up 48%. Mounjaro revenue rose 91% to \$9.94 billion, while Zepbound rose 46% to \$4.93 billion. Company-wide volume increased 60%, offset in part by a 13% decline in realised prices. Lilly raised its full-year revenue guidance to \$85 billion-\$87 billion and increased its performance-margin outlook.

The causal chain is straightforward: a growing burden of chronic metabolic disease creates demand for effective treatment; differentiated clinical evidence and a broad development engine support approvals and prescribing; manufacturing capacity and payer access turn prescriptions into supplied doses; volume and product mix then drive revenue, margin, cash flow and reinvestment.

Each link can fail. Lilly and its competitors are investing heavily in capacity because constrained supply can leave eligible patients untreated and cap revenue. Lilly has committed an additional \$4.5 billion to manufacturing sites in Indiana. That can deepen its advantage if new capacity improves availability and lowers unit costs. It can destroy value if demand is overestimated, facilities arrive late or capital returns disappoint.

A financially strong business, not just a good story

A compelling clinical story only matters if the company behind it can fund the next generation of trials, manufacturing capacity and launches, year after year. A business that cannot protect its margins or convert growth into cash will struggle to keep discovering and delivering new medicines, however promising its pipeline looks. So before we get carried away with the tirzepatide story, we ask a simpler question: is this a genuinely well-run, profitable company? On the numbers, the answer is emphatically yes.

Profitability. Lilly earns exceptional and rising profits on the capital invested in the business. Return on shareholders' equity - essentially, how much profit it generates for every dollar shareholders have invested - rose from 48.2% in 2023 to 74.2% in 2024 and 77.8% in 2025, a level of profitability matched by very few large companies anywhere in the market, let alone in pharmaceuticals. Margins have moved in the same direction: the operating margin rose from 30.3% in 2023 to 37.8% in 2024 and 45.6% in 2025, guided toward around 49% for 2026, while a broader measure of profitability, adjusted EBITDA margin, has nearly doubled, from 23.7% to 42.5%, over the same three years. Return on invested capital tells the same story, rising from 22.7% in 2023 to 36.7% in 2025 and guided higher still for 2026 - comfortably clear of the cost of capital we hold pharmaceutical businesses to.

Earnings growth. The profit Lilly generates for shareholders has been growing far faster than its already-rapid revenue growth - the clearest marker of quality we look for. Adjusted earnings per share rose from \$6.32 in 2023 to \$12.99 in 2024, up 105.5%, and to \$24.21 in 2025, up 86.3%, against revenue growth of 32.0% and 44.7% in the same two years. That pattern continued into the second quarter of 2026, when revenue rose 48% year on year and non-GAAP earnings per share rose 33% to \$8.38, beating consensus by 27.3% - though the narrower gap between revenue and earnings growth in that specific quarter reflects \$2.8 billion of acquired in-process research and development charges and \$703 million of restructuring and impairment costs tied to an unusually acquisitive quarter, rather than any weakening in the underlying business. Management raised full-year 2026 revenue guidance for the

third consecutive quarter, to \$85-87 billion, and underlying earnings-per-share guidance by \$2.78 at the midpoint - though the reported range was held flat once that quarter's acquisition charges were absorbed, a reminder that headline and reported growth are not quite the same thing this year.

Shareholder returns. Ultimately, none of this matters to an investor unless it shows up in the share price. Reported total-return data show that Lilly's total return - share price growth plus dividends - has compounded at close to 46% a year over the five years to the end of 2025, a run that few large companies of any kind have matched, and one that has continued into 2026 with a further 4% total return year-to-date even as the shares have eased back from their 52-week high. This is not just a promising story about a molecule - it is a demonstrably exceptional business that happens to sit behind one.

None of this is guaranteed to continue - and the very strength of these returns is itself part of the valuation tension we return to below - but it gives us real confidence that Lilly's core profitability and cash generation can keep funding the pipeline investment its impact case depends on.

Leadership we trust, with room to improve

Lilly's governance has real strengths that matter to how far we trust management with growing shareholder capital. Every director stands for re-election annually, giving shareholders a regular and meaningful say over who governs the company. Board tenure is genuinely balanced across new, mid-tenure and long-serving directors, and the board itself reflects a broad mix of scientific, financial, commercial and governance experience, including four female directors. There is only one class of listed stock, so no shareholder carries disproportionate voting power over the rest, and executive pay is weighted heavily toward variable, long-term awards: more than 65% of the Chief Executive's pay is variable and tied to three- to five-year performance metrics, with substantial equity vesting over multi-year schedules that link pay directly to the profitability and returns we test above.

Set against this, our clearest engagement priority is board independence at the top of the house. David Ricks holds both the Chair and Chief Executive roles - a combination we do not see at several of the other companies in this portfolio - and, on our stricter, tenure-based independence test, only six of the board's eleven directors qualify as independent, short of the two-thirds threshold we look for. The Audit Committee itself is not populated solely by independent directors. A Lead Independent Director, Juan Luciano, is in place and provides a real, if partial, structural counterweight, and the board conducts an annual self-assessment of its own effectiveness - though the detailed findings are not made public, only the fact that the process took place.

Capital allocation is a clearer strength. Return on invested capital has risen from 22.7% to 36.7% over the past three years and is guided still higher, and Lilly has funded an unusually acquisitive period - completing four biotechnology acquisitions in the second quarter of 2026 alone, alongside further deals agreed since - from \$15.3 billion of year-to-date business development spending without straining the balance sheet, with net debt of just 1.3 times EBITDA. The dividend has grown every year, rising 15% year on year in the second quarter of 2026 alone, alongside continued share buybacks.

Taken together, this gives us confidence that Lilly is led by a management team that allocates capital with real discipline and pays its people in a way that is tightly aligned with the returns shareholders actually receive, alongside a specific and continuing engagement priority around separating the Chair and Chief Executive roles and broadening board independence.

Evidence before narrative

The measurable outcome is not the size of the market or the number of injections sold. It is the change in a patient's health, documented with an appropriate comparator and a clear boundary. Lilly has strong randomized evidence in obesity and sleep apnoea. The next step is to connect that efficacy to

independently verified real-world access, persistence and outcomes, while testing whether the economics remain attractive after pricing pressure and heavy reinvestment.

Value, decision, and tension

We own Eli Lilly because three things line up, though not without real tension on any of them: a durable, structural source of demand in the under-treated burden of obesity, diabetes and related metabolic disease, met by a company that has combined clinically differentiated medicines with the research, manufacturing and commercial capabilities to deliver them at a scale few competitors can match; a genuinely exceptional financial-quality record, with return on equity, margins and earnings all far ahead of the industry and shareholder returns that have compounded at close to 46% a year over five years; and a leadership team whose capital-allocation discipline we trust, even as we press for further independence at board level and a separation of the Chair and Chief Executive roles.

But a high-quality company is not automatically a good investment at any price, and this is where the tension is sharpest. Lilly's shares currently trade at more than 30 times 2026 earnings and near 25 times forward EV/EBITDA, valuations that already assume a great deal of continued execution - a level of optimism that leaves little room for a disappointing pipeline readout, a slower Foundayo launch, or a stumble in the aggressive, acquisition-led strategy management is pursuing to extend the franchise beyond tirzepatide. Nor should adjusted earnings obscure the cost of replenishing the pipeline: Lilly recorded \$2.8 billion of acquired in-process research and development charges in the second quarter of 2026 alone, the visible cost of a strategy that must still prove it earns an adequate return.

The public conclusion therefore needs to be measured. The business has exceptional current momentum, extraordinary profitability and a management team that allocates capital and pays its people with real discipline. But the investment return depends on the price paid, the durability of competitive advantage, the resolution of the governance gaps we continue to engage on, and whether disciplined capital allocation extends to the current wave of dealmaking. Valuation discipline, not the strength of the growth story alone, is what should govern position sizing here.

What could break the chain

- **Product concentration risk.** Mounjaro and Zepbound together generated around two-thirds of quarterly revenue, and the wider incretin franchise is not far behind. That creates sensitivity to competitor data, payer decisions, patent protection, manufacturing execution and any change in safety or regulatory evidence.
- **Pricing and access risk.** Company-wide realised prices fell 13% in the second quarter of 2026 even as volumes rose 60%, and US realised prices fell around 9% on a comparable basis, reflecting structural pricing pressure as self-pay and channel dynamics evolve. Falling prices can be consistent with wider access, but only if volume and mix more than compensate; Lilly states that its medicines reach more than 58 million people worldwide, but that company-reported figure spans the portfolio and is not evidence of affordability, persistence or health outcomes for any individual patient.
- **Competitive intensity risk.** Novo Nordisk is scaling its own oral GLP-1 launch rapidly in some ex-US markets, and generic semaglutide is entering India and Brazil. Lilly's own oral GLP-1, Foundayo, generated only \$98 million in its first reported quarter, below consensus, though management points to a prescriber inflection since.
- **Pipeline, dealmaking and integration risk.** Lilly has become markedly more acquisitive, completing four biotechnology acquisitions in the second quarter of 2026 alone and agreeing further deals since, funded by \$15.3 billion of year-to-date business development spending. Clinical trials fail and acquired research can lose value; the \$2.8 billion of acquired in-process research and

development charges and \$703 million of restructuring and impairment costs recorded in the quarter are the visible near-term cost, and integration risk will rise if the pace of dealmaking continues. Separately, ongoing litigation over whether retatrutide qualifies for a BLA rather than an NDA regulatory pathway remains unresolved.

- Financial-quality durability and valuation risk. The extraordinarily high returns on equity described above are flattered by a still-modest equity base and are expected to normalise toward the mid-30s by 2030 as that base grows - a structural fade, not evidence of deteriorating quality, but one that means today's returns should not simply be extrapolated. Separately, shares trading at more than 30 times forward earnings and near 25 times forward EV/EBITDA leave little margin of safety if execution disappoints even modestly.
- Governance risk. The combined Chair and Chief Executive role, a board that falls short of two-thirds independence on our stricter tenure-based test, and an Audit Committee that includes a non-independent director are gaps we continue to engage on, only partially offset by the presence of a Lead Independent Director.
- Impact-case risk. Trial efficacy in obesity and sleep apnoea is not proof of durable, population-level, real-world outcomes; affordability, adherence, safety monitoring and continued patient access will determine how much of that efficacy becomes lasting benefit outside a clinical trial.

The thesis would weaken materially if the incretin franchise's growth or pricing power deteriorated faster than new indications and products could offset, if the current wave of acquisitions failed to earn an adequate return or diluted margins further than guided, if governance refreshment and independence showed no further progress, or if verified real-world patient outcomes failed to support the efficacy evidence Lilly's trials have generated. It would also weaken if today's valuation already assumed away every one of these risks.

Eli Lilly represents a view that turning molecular science into reliable, accessible treatment at scale can create both human and economic value, when a capable and disciplined organisation stands behind it. The investment case rests on the full causal chain we test everywhere: a large and durable burden of chronic metabolic disease creates structural demand; Lilly's combination of clinical evidence, manufacturing scale and commercial reach converts that demand into supplied doses; volume and mix turn that into revenue, margin, cash flow and reinvestment; a management team we trust to allocate that capital with discipline - while we continue to press for genuine independence at board level - stands behind the numbers; and disciplined valuation, not the pull of the growth story alone, determines whether today's price still rewards shareholders for those risks. That is why Eli Lilly belongs under Human Advancement - for its structural, patient-linked demand, its genuinely exceptional financial quality, and a leadership team whose capital discipline we trust even as its board structure continues to evolve - and why patient outcomes, not product sales alone, remain the final test of impact.

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