# Merck & Company (MRK)

*Updated May 29th, 2018 by Nate Parsh*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $58 | **5 Year CAGR Estimate:** | 4.7% | **Quality Percentile:** | N/A |
| **Fair Value Price:** | $53 | **5 Year Growth Estimate:** | 3.0% | **Momentum Percentile:** | N/A |
| **% Fair Value:** | 109% | **5 Year Valuation Multiple Estimate:** | -1.6% | **Total Return Percentile:** | N/A |
| **Dividend Yield:** | 3.3% | **5 Year Price Target** | $62 | **Valuation Percentile:** | N/A |

## Overview & Current Events

With a current market cap of $157 billion, Merck & Company is one of the largest healthcare companies in the world. Merck manufactures prescription medicines, vaccines, biologic therapies and animal health products. Merck employs 69,000 people around the world and had sales of more than $40 billion in 2017.

Merck released first quarter 2018 earnings on 5/1/2018. Earnings per share came in at $1.05, a $0.05 beat of estimates and a 19% increase from Q1 2017. Revenue of $10 billion, while up 6.5% from the previous year, missed analysts' expectations by $60 million. Pharmaceutical revenues grew 9% year over year to $8.9 billion while Animal Health segment revenue increased 13.4% to $1.1 billion. Merck's drug Keytruda, which treats cancers such melanoma that cannot be removed by surgery and non-small cell lung cancer, had some positive news during the quarter. The drug was found to show a longer survival rate for lung cancer patients when combined with chemotherapy compared to just chemotherapy treatment alone. This should continue to cement Keytruda as a great option to treat this type of cancer.

## Growth on a Per-Share Basis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $3.64 | $3.25 | $3.42 | $3.77 | $3.82 | $3.49 | $3.49 | $3.59 | $3.78 | $3.98 | ***$4.22*** | ***$4.89*** |
| **DPS** | $1.52 | $1.52 | $1.52 | $1.52 | $1.68 | $1.72 | $1.76 | $1.80 | $1.84 | $1.88 | ***$1.92*** | ***$2.12*** |

Merck's earnings declined during the last recession and it took the company several years to return to growth. In fact, Merck has only seen EPS grow by less than 1% per year over the past ten years. Merck has struggled to grow earnings as patents for drugs have expired. Keytruda could help put an end to anemic earnings growth. The drug had more new patient starts than any other immunotherapy drug in the U.S. and saw international sales triple during the first quarter. Annual sales could reach $8 billion by 2020. Thanks to Keytruda, and a few other promising oncology drugs set to be released in the coming years, we forecast that Merck can grow EPS at a rate of at least 3% per year over the next five years.

After pausing its dividend from 2005 through 2011, Merck has increased its dividend at an average rate of just over 2% per year since. The last dividend raise occurred on 11/28/2017, which raised the dividend 2.1%.

## Valuation Analysis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Now | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 10.2 | 9.1 | 10.5 | 9.1 | 10.8 | 13.3 | 16.4 | 15.8 | 15.2 | 15.6 | ***13.7*** | ***12.6*** |
| **Avg. Yld.** | 4.1% | 5.1% | 4.2% | 4.4% | 4.1% | 3.7% | 3.1% | 3.2% | 3.2% | 3.0% | ***3.3%*** | ***3.4%*** |

Merck's long term average price to earnings multiple is 12.6. Based off of the company's midpoint for its updated guidance, shares currently trade at a multiple of 13.7. This is far below the multiple of the S&P 500, but this is evidence of the market not willing to pay up for a very low earnings growth rate.

Merck's dividend yield is well above that of the S&P 500's yield and slightly ahead of the 10-Year Treasury Bond. In a rising interest rate environment, Merck's yield might not be as attractive to income investors to the relatively risk free Treasury Bond.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GP/A | 38.7% | 16.4% | 26.1% | 29.7% | 29% | 25.6% | 25.9% | 24.2% | 27.2% | 31.1% | ***30.4%*** | ***27.4%*** |
| Debt/A | 55.2% | 45.3% | 46.3% | 45.8% | 47.7% | 50.5% | 50.3% | 56% | 57.7% | 60.7% | ***58.8%*** | ***51.5%*** |
| Int. Cov. | --- | 63 | 3.7 | 14.6 | 19.6 | 11.8 | 38.7 | 15.9 | 14.7 | 19.7 | ***20.3*** | ***22.4*** |
| Payout | 41.8% | 46.8% | 44.4% | 40.3% | 44% | 49.3% | 50.4% | 50.1% | 48.7% | 47.2% | ***45.5%*** | ***43.4%*** |
| Std. Dev. | 29% | 31.4% | 18.2% | 22.1% | 16.2% | 13.4% | 14.7% | 17.6% | 14.2% | 17.6% | ***18%*** | ***19.4%*** |

Many investors consider pharmaceutical companies "defensive" stocks because their products are in demand even in a protracted recession. The thinking goes that sick people will seek treatment for illnesses even in poor economic conditions, causing earnings to increase. While this is true for many names in this industry, Merck's earnings decline in 2009, subsequent long road back to profitability and lack of any real growth shows that this isn't true for every company.

Merck's percentage of gross profits to asset ratio has yet to recover above 2008's total, though this ratio has climbed slightly higher over the past five years. The company's debt to asset ratio has also increased in recent years. Even so, Merck doesn't appear to be overleveraged and the dividend can be considered both stable and safe.

As earnings have barely budged over the last decade, Merck did the reasonable thing and paused dividend growth. This helped the company to keep the payout ratio low and allowed Merck to continue to pay its dividend even as earnings stagnated.

## Final Thoughts & Recommendation

We estimate that Merck can offer annualized returns of 4.7% per year through 2023. This estimate is arrived at by a combination of growth (3%), dividends (3.3%) and multiple reversion of (1.6%). At a time when a lot of large cap healthcare companies saw earnings growth, Merck registered very little growth at all. With a rising treasury yield, Merck's dividend yield isn't as attractive as it once was. We think that names like AbbVie (ABBV) and Johnson & Johnson (JNJ) offer investors a better choice in the healthcare sector. These companies offer earnings growth as well as attractive dividend yields.

## Total Return Breakdown by Year