# Merck & Company (MRK)

*Updated May 2nd, 2021 by Nathan Parsh*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $75 | **5 Year CAGR Estimate:** | 13.5% | **Market Cap:** | $189 billion |
| **Fair Value Price:** | $99 | **5 Year Growth Estimate:** | 5.0% | **Ex-Dividend Date:** | 6/11/2021[1] |
| **% Fair Value:** | 76% | **5 Year Valuation Multiple Estimate:** | 5.6% | **Dividend Payment Date:** | 7/7/2021[2] |
| **Dividend Yield:** | 3.5% | **5 Year Price Target** | $126 | **Years Of Dividend Growth:** | 10 |
| **Dividend Risk Score:** | B | **Retirement Suitability Score:** | A | **Last Dividend Increase:** | 6.6% |

## Overview & Current Events

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 73,000 people around the world and generates annual revenues of ~$52 billion. On 2/5/2020, Merck announced that it was spinning off its women's health, legacy brands and biosimilar products into a separate company. These businesses represent ~$6.5 billion of revenues. The transaction should be completed in the first half of 2021.

On 3/11/2021, Merch announced that it was spinning off Organon, its women's health and biosimilar portfolio. The transaction is expected to take place on 6/2/2021.

Merck announced first quarter earnings results on 4/29/2021. Revenue increased 0.2% to $12.1 billion, but missed expectations by $570 million. Adjusted net income of $3,556M, or $1.40 per share, compared unfavorably to adjusted net income of $3,851M, or $1.50 per share, in the prior year. Adjusted earnings-per-share was $0.22 below estimates.

As with prior quarters, COVID-19 was a headwind to results. The company estimates that the pandemic reduced pharmaceutical revenue by ~$600 million. Pharmaceutical revenues were flat compared to the previous year, with currency exchange a 1% drag on results. *Keytruda*, which treats cancers such as melanoma that cannot be removed by surgery and non-small cell lung cancer, continues to perform well, with sales higher by 19% to $3,899M. The product eclipsed the $14 billion mark for revenue in 2020. Increased demand for *Keytruda* in the use of treatment in non-small-cell lung cancer indications continues. COVID-19 did reduce the number of new patient starts, but *Keytruda* is experiencing strong uptake rates for treatment of several cancers, including melanoma and bladder. Sales for Merck's HPV vaccine *Gardasil* fell 16% to $917 million due to U.S. buying patterns and the timing of shipments to China. *Januvia/Janumet*, which treats diabetes and is Merck's second highest grossing product, showed some signs of stabilization as revenue was higher by 1%. Animal Health improved 17% to $1,418M due to strength in demand for companion animal products, such as the parasiticide line, and companion animal vaccines.

Merck reaffirmed prior guidance and expects adjusted EPS of in a range of $6.48 to $6.68 and revenue of $51.8 billion to $53.8 billion for 2021.

## Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $3.77 | $3.82 | $3.49 | $3.49 | $3.59 | $3.78 | $3.98 | $4.34 | $5.19 | $5.94 | ***$6.58*** | ***$8.40*** |
| **DPS** | $1.52 | $1.68 | $1.72 | $1.76 | $1.80 | $1.84 | $1.88 | $1.99 | $2.20 | $2.48 | ***$2.60*** | ***$3.32*** |
| **Shares[3]** | 3041 | 3027 | 2928 | 2838 | 2781 | 2749 | 2697 | 2650 | 2603 | 2536 | ***2536*** | ***2450*** |

Merck's earnings declined during the last recession and it took the company several years to return to growth. In fact, Merck has had earnings-per-share grow by about 5% per year over the past ten years. Merck has struggled to grow earnings as patents for drugs have expired, but *Keytruda* has shown very high rates of growth in recent reporting

[1] Estimated ex-dividend date
[2] Estimated dividend date
[3] In millions of shares

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periods. *Keytruda* has patent protection in the U.S. until 2028, in the European Union until 2030, and in Japan until 2032. Due to this strength, as well as growth in other drugs, we estimate that Merck can grow earnings-per-share by at least 5% through 2026. Merck paused its dividend from 2005 through 2011, but announced a 6.6% dividend increase for the 4/7/2021 payment date.

## Valuation Analysis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 9.1 | 10.8 | 13.3 | 16.4 | 15.8 | 15.2 | 15.6 | 14.8 | 15.9 | 13.6 | ***11.4*** | ***15.0*** |
| **Avg. Yld.** | 4.4% | 4.1% | 3.7% | 3.1% | 3.2% | 3.2% | 3.0% | 3.0% | 2.7% | 3.0% | ***3.5%*** | ***2.6%*** |

Shares of Merck are flat since our 2/9/2021 update. Based off of guidance for the current year, the stock has a forward price to earnings multiple of 11.4. Merck's long-term average price-to-earnings ratio is 14.1. Due to growth rates of key products, particularly *Keytruda*, we believe shares could trade with a price-to-earnings ratio of 15 by 2026. If shares were to revert to this target by 2026, then valuation would be a 5.6% tailwind to total annual returns.

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

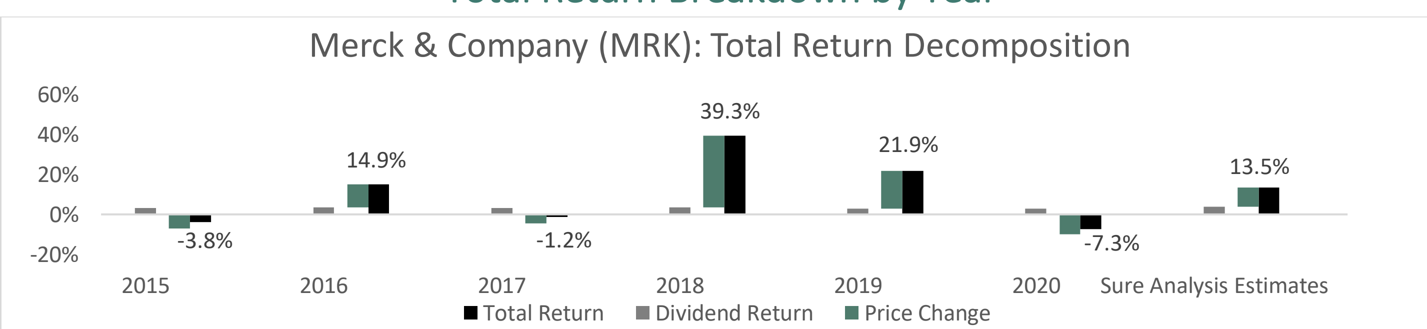
| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 40% | 44% | 49% | 50% | 50% | 49% | 47% | 46% | 42% | 42% | ***40%*** | ***40%*** |

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 declined in 2009 and subsequent long road back to profitability that this is not necessarily true for every healthcare corporation. With that said, Merck's key competitive advantage is that it is seeing strong growth rates in key product areas. While generic competition is putting pressure on certain pharmaceuticals, we find *Keytruda's* growth rate and peak sales expectations very appealing. Merck is also one of the largest pharmaceutical companies in the world, which gives the company size and scale. If needed, the company would likely have the ability to acquire other assets. Merck has also spent heavily (16%-19% of sales) on research and development over the past five years.

## Final Thoughts & Recommendation

We continue to expect Merck & Company to offer an annual return of 13.5% through 2026. This projected return stems from annual expected EPS growth of 5%, a starting yield of 3.5% and a mid-single-digit contribution from multiple expansion. *Keytruda* continues to drive growth for Merck and should be one of the bestselling pharmaceuticals of this decade. Other top grossing products have seen uneven growth rates in the recent term, but we feel that this should smooth out following a recovery from the COVID-19 pandemic. We reaffirm our 2026 price target of $126 and maintain our buy rating on Merck due to projected returns.

## Total Return Breakdown by Year

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## Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 48047 | 47267 | 44033 | 42237 | 39498 | 39807 | 40122 | 42294 | 46840 | |
| Gross Profit | 31176 | 30821 | 27079 | 25469 | 24564 | 25777 | 27210 | 28785 | 32728 | |
| Gross Margin | 64.9% | 65.2% | 61.5% | 60.3% | 62.2% | 64.8% | 67.8% | 68.1% | 69.9% | |
| SG&A Exp. | 13733 | 12776 | 11911 | 11606 | 10313 | 10017 | 10074 | 10102 | 10615 | |
| D&A Exp. | 7427 | 6978 | 6988 | 6691 | 6375 | 5471 | 4676 | 4519 | 3652 | |
| Operating Profit | 8976 | 9877 | 7665 | 6683 | 7547 | 5499 | 6797 | 8931 | 12241 | |
| Op. Margin | 18.7% | 20.9% | 17.4% | 15.8% | 19.1% | 13.8% | 16.9% | 21.1% | 26.1% | |
| Net Profit | 6272 | 6168 | 4404 | 11920 | 4442 | 3920 | 2394 | 6220 | 9843 | |
| Net Margin | 13.1% | 13.0% | 10.0% | 28.2% | 11.2% | 9.8% | 6.0% | 14.7% | 21.0% | |
| Free Cash Flow | 10660 | 8068 | 10106 | 5672 | 11255 | 8762 | 4563 | 8307 | 9967 | |
| Income Tax | 942 | 2440 | 1028 | 5349 | 942 | 718 | 4103 | 2508 | 1687 | |

## Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets ($B) | 105128 | 106132 | 105645 | 98167 | 101677 | 95377 | 87872 | 82637 | 84397 | |
| Cash & Equivalents | 13531 | 13451 | 15621 | 7441 | 8524 | 6515 | 6092 | 7965 | 9676 | |
| Acc. Receivable | 8261 | 7672 | 7184 | 6626 | 6484 | 7018 | 6873 | 7071 | 6778 | |
| Inventories | 6254 | 6535 | 6226 | 5571 | 4700 | 4866 | 5096 | 5440 | 5978 | |
| Goodwill & Int. | 46457 | 41217 | 36102 | 33378 | 40325 | 35467 | 32467 | 31357 | 33621 | |
| Total Liabilities | 48185 | 50669 | 53319 | 49376 | 56910 | 55069 | 53303 | 55755 | 58396 | |
| Accounts Payable | 2023 | 1753 | 2274 | 2625 | 2533 | 2807 | 3102 | 3318 | 3738 | |
| Long-Term Debt | 17515 | 20569 | 25060 | 21403 | 26412 | 24842 | 24410 | 25114 | 26346 | |
| Total Equity | 54517 | 53020 | 49765 | 48647 | 44676 | 40088 | 34336 | 26701 | 25907 | |
| D/E Ratio | 0.32 | 0.39 | 0.50 | 0.44 | 0.59 | 0.62 | 0.71 | 0.94 | 1.02 | |

## Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | 5.9% | 5.8% | 4.2% | 11.7% | 4.4% | 4.0% | 2.6% | 7.3% | 11.8% | |
| Return on Equity | 11.5% | 11.5% | 8.6% | 24.2% | 9.5% | 9.2% | 6.4% | 20.4% | 37.4% | |
| ROIC | 8.4% | 8.2% | 5.7% | 16.2% | 6.3% | 5.8% | 3.9% | 11.2% | 18.9% | |
| Shares Out. | 3041 | 3027 | 2928 | 2838 | 2781 | 2749 | 2697 | 2650 | 2603 | |
| Revenue/Share | 15.53 | 15.37 | 14.70 | 14.43 | 13.90 | 14.28 | 14.60 | 15.79 | 18.16 | |
| FCF/Share | 3.45 | 2.62 | 3.37 | 1.94 | 3.96 | 3.14 | 1.66 | 3.10 | 3.86 | |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*