Merck & Company (MRK)

Updated February 6th, 2022 by Nathan Parsh

Key Metrics

Current Price:	$79	**5 Year CAGR Estimate:**	10.1%	**Market Cap:**	$198 billion
Fair Value Price:	$88	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	3/14/2022
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.1%	**Dividend Payment Date:**	4/7/2022
Dividend Yield:	3.5%	**5 Year Price Target**	$112	**Years Of Dividend Growth:**	11
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	6.2%

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 ~$57 billion.

On 6/2/2021, Merck completed its previously announced spinoff of its women's health and biosimilar portfolio into Organon & Co (OGN).

On 9/30/2021, Merck agreed to buy Acceleron Pharma (XLRN) for $11.5 billion in cash.

On 10/1/2021, Merck announced that its antiviral drug, Molnupiravir, was effective in reducing the risk of hospitalizations and deaths by 50% for patients with COVID-19. The company expects to deliver as many 20 million doses in total by the end of 2022. The drug is currently only available in the U.S., U.K, and Japan.

Merck reported fourth quarter and full year 2022 earnings results on 2/3/2022. For the quarter, revenue grew more than 23% to $13.5 billion, beating estimates by $380 million. Adjusted net income of $4.6 billion, or $1.80 per share, compared favorably to adjusted net income of $2.5 billion, or $0.98 per share, in the prior year. Adjusted earnings-per-share was $0.28 better than expected. For the year, revenue grew 17.3% to $48.7 billion. Adjusted net income of $15.3 billion, or $6.02 per share, compared to $11.5 billion, or $5.94 per share, in the prior year.

Pharmaceutical revenue increased 23% to $12 billion for the quarter, with Molnupiravir sales adding $952 million. *Keytruda*, which treats cancers such as melanoma that cannot be removed by surgery and non-small cell lung cancer, remains the key driver of growth for the company, with sales growing 16% to $4.6 billion for the quarter. The product eclipsed the $17 billion mark for revenue in 2021, a 20% improvement from the previous year. *Keytruda* continues to see gains in market share across a number of indications. Sales for Merck's HPV vaccine *Gardasil* improved 50% to $1.5 billion due to high demand in China, but was partially offset by weakness in the U.S. due to the timing of public sector purchases. *Januvia/Janumet*, which treats diabetes, gained 5% to $1.4 billion. This product benefited from favorable rebate adjustment in the U.S. and higher demand internationally. Animal Health increased 8% to $1.3 billion due once again to strength in all geographies and species.

Merck provided an outlook for 2022 as well. Adjusted earnings-per-share is projected to be in a range of $5.76 to $5.91 with revenue in a range of $56.1 billion to $57.6 billion for the year. We have initiated our 2022 forecast accordingly.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$3.82	$3.49	$3.49	$3.59	$3.78	$3.98	$4.34	$5.19	$5.94	$6.02	***$5.84***	***$7.45***
DPS	$1.68	$1.72	$1.76	$1.80	$1.84	$1.88	$1.99	$2.20	$2.48	$2.64	***$2.76***	***$3.52***
Shares[1]	3027	2928	2838	2781	2749	2697	2650	2603	2536	2535	***2535***	***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 just over 5% per year over the past ten years. Merck has struggled to grow

[1] In millions of shares

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earnings as patents for drugs have expired, but *Keytruda* has shown very high rates of growth in recent reporting periods. *Keytruda* has patent protection in the U.S. until 2028, in the European Union until 2030, and in Japan until 2032. In addition, the company's spinoff of Organon should allow for a higher growth as Merck focuses on its pharmaceutical, vaccines and animal health businesses. For now, we maintain out estimate of 5% earnings growth over the next five years. Merck paused its dividend from 2005 through 2011, but has increased its dividend for 11 consecutive years, including a 6.2% raise for the 1/7/2022 payment date.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	10.8	13.3	16.4	15.8	15.2	15.6	14.8	15.9	13.6	12.7	***13.5***	***15.0***
Avg. Yld.	4.1%	3.7%	3.1%	3.2%	3.2%	3.0%	3.0%	2.7%	3.0%	3.4%	***3.5%***	***3.2%***

Shares of Merck have decreased $9, or 10.2%, since our 10/31/2021 update. Based off of guidance for the current year, the stock has a forward price to earnings multiple of 13.5. Merck's long-term average price-to-earnings ratio is 14.4. Due to growth rates of key products, particularly *Keytruda*, we believe shares could trade with a price-to-earnings ratio of 15 by 2027. If shares were to revert to this target by 2027, then valuation would be a 2.1% tailwind to total annual returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

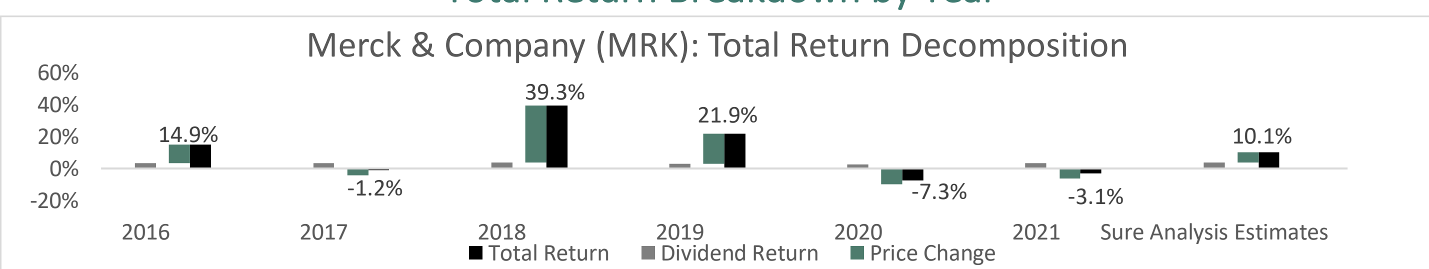
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	44%	49%	50%	50%	49%	47%	46%	42%	42%	44%	***47%***	***47%***

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 suffered a subsequently 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

Merck & Company is expected to offer a total annual return of 10.1% through 2027, up from our prior estimate of 7.1%. This projected return stems from annual expected EPS growth of 5%, a starting yield of 3.5%, and a low single-digit contribution from multiple expansion. *Keytruda* had another outstanding year and should be a source of strength for Merck through the end of the decade. The addition of Molnupiravir has already added meaningfully to the company's business as well. We have raised our 2027 price target $3 to $112 due to EPS guidance and now rate shares of Merck as a buy due to projected returns.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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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	47994
Gross Profit	31176	30821	27079	25469	24564	25777	27210	28785	32728	32509
Gross Margin	64.9%	65.2%	61.5%	60.3%	62.2%	64.8%	67.8%	68.1%	69.9%	67.7%
SG&A Exp.	13733	12776	11911	11606	10313	10017	10074	10102	10615	10468
D&A Exp.	7427	6978	6988	6691	6375	5471	4676	4519	3652	3625
Operating Profit	8976	9877	7665	6683	7547	5499	6797	8931	12241	8483
Op. Margin	18.7%	20.9%	17.4%	15.8%	19.1%	13.8%	16.9%	21.1%	26.1%	17.7%
Net Profit	6272	6168	4404	11920	4442	3920	2394	6220	9843	7067
Net Margin	13.1%	13.0%	10.0%	28.2%	11.2%	9.8%	6.0%	14.7%	21.0%	14.7%
Free Cash Flow	10660	8068	10106	5672	11255	8762	4563	8307	9967	5569
Income Tax	942	2440	1028	5349	942	718	4103	2508	1687	1709

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	91588
Cash & Equivalents	13531	13451	15621	7441	8524	6515	6092	7965	9676	8062
Acc. Receivable	8261	7672	7184	6626	6484	7018	6873	7071	6778	7851
Inventories	6254	6535	6226	5571	4700	4866	5096	5440	5978	6310
Goodwill & Int.	46457	41217	36102	33378	40325	35467	32467	31357	33621	34842
Total Liabilities	48185	50669	53319	49376	56910	55069	53303	55755	58396	66184
Accounts Payable	2023	1753	2274	2625	2533	2807	3102	3318	3738	4594
Long-Term Debt	17515	20569	25060	21403	26412	24842	24410	25114	26346	31791
Total Equity	54517	53020	49765	48647	44676	40088	34336	26701	25907	25317
LTD/E Ratio	0.32	0.39	0.50	0.44	0.59	0.62	0.71	0.94	1.02	1.26

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%	8.0%
Return on Equity	11.5%	11.5%	8.6%	24.2%	9.5%	9.2%	6.4%	20.4%	37.4%	27.6%
ROIC	8.4%	8.2%	5.7%	16.2%	6.3%	5.8%	3.9%	11.2%	18.9%	12.9%
Shares Out.	3041	3027	2928	2838	2781	2749	2697	2650	2603	2536
Revenue/Share	15.53	15.37	14.70	14.43	13.90	14.28	14.60	15.79	18.16	18.89
FCF/Share	3.45	2.62	3.37	1.94	3.96	3.14	1.66	3.10	3.86	2.19

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