



# Merck & Company (MRK)

Updated February 15<sup>th</sup>, 2023 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$108	<b>5 Year CAGR Estimate:</b>	6.6%	<b>Market Cap:</b>	\$275 B
<b>Fair Value Price:</b>	\$103	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	03/14/23
<b>% Fair Value:</b>	105%	<b>5 Year Valuation Multiple Estimate:</b>	-0.9%	<b>Dividend Payment Date:</b>	04/10/23
<b>Dividend Yield:</b>	2.7%	<b>5 Year Price Target</b>	\$132	<b>Years Of Dividend Growth:</b>	12
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Hold

## 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 67,000 people around the world and generates annual revenues of ~\$59 billion. On June 2<sup>nd</sup>, 2021, Merck completed its previously announced spinoff of its women's health and biosimilar portfolio into Organon & Co (OGN).

On November 29<sup>th</sup>, 2022, Merck raised its quarterly dividend 5.8% to \$0.73.

On February 2<sup>nd</sup>, 2023, Merck reported fourth quarter and full year results for the period ending December 31<sup>st</sup>, 2022. For the quarter, revenue grew 2.1% to \$13.8 billion, beating estimates by \$140 million. Adjusted net income of \$4.1 billion, or \$1.62 per share, compared to adjusted net income of \$4.6 billion, or \$1.81 per share, in the prior year, but was \$0.08 more than expected. For the year, revenue grew 22% to \$59.3 billion. Adjusted earnings-per-share totaled \$7.48, above the high end of the company's guidance.

Currency exchange reduced revenue results by 6% for the quarter and 4% for the year. On a reported basis, pharmaceutical revenue increased 1% to just over \$12 billion for the quarter. *Agevrio* sales added \$825 million, which was up from \$436 billion in the third quarter of 2022, but down from \$952 million in the fourth quarter of 2021. *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 up 26% to \$5.5 billion. The product generated nearly \$21 billion in 2022, up from \$17 billion in the prior year. *Keytruda* continues to see gains in market share across a number of indications. Sales for Merck's HPV vaccine *Gardasil* decreased 4%, mostly due to currency exchange. *Januvia/Janumet*, which treats diabetes, decreased 34% to \$1.4 billion. This product has lost market exclusivity in the E.U. and had lower demand in the U.S. Animal Health revenue of \$829 million was down 2% to \$1.23 billion, but this was again due to unfavorable currency exchange. Ruminant and poultry products remain in high demand.

Merck provided guidance for 2023 as well. The company expects sales in a range of \$57.2 billion to \$58.7 billion with adjusted earnings-per-share projected to be between \$6.80 to \$6.95. At the midpoint, this would be a decline of 8% from 2022. We have initiated our forecast accordingly.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$3.49	\$3.49	\$3.59	\$3.78	\$3.98	\$4.34	\$5.19	\$5.94	\$6.02	\$7.48	<b>\$6.88</b>	<b>\$8.78</b>
<b>DPS</b>	\$1.72	\$1.76	\$1.80	\$1.84	\$1.88	\$1.99	\$2.20	\$2.48	\$2.64	\$2.76	<b>\$2.92</b>	<b>\$3.73</b>
<b>Shares<sup>1</sup></b>	2928	2838	2781	2749	2697	2650	2603	2536	2535	2548	<b>2545</b>	<b>2530</b>

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 nearly 9% since 2013, though much of this growth has occurred in the near-term. Merck has struggled to grow 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

<sup>1</sup> In millions of shares

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focuses on its pharmaceutical, vaccines and animal health businesses. For now, we maintain our estimate of 5% earnings growth over the next five years. Merck paused its dividend from 2005 through 2011, but has increased its dividend for 12 consecutive years.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	13.3	16.4	15.8	15.2	15.6	14.8	15.9	13.6	12.7	14.8	15.7	15.0
Avg. Yld.	3.7%	3.1%	3.2%	3.2%	3.0%	3.0%	2.7%	3.0%	3.4%	2.5%	2.7%	2.8%

Shares of Merck have increased \$7, or 6.9%, since our October 30<sup>th</sup>, 2022 update. Based off of guidance for the current year, the stock has a forward price to earnings multiple of 15.7. 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 2028. If shares were to revert to this target by 2028, then valuation would be a 0.9% headwind to total annual returns.

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

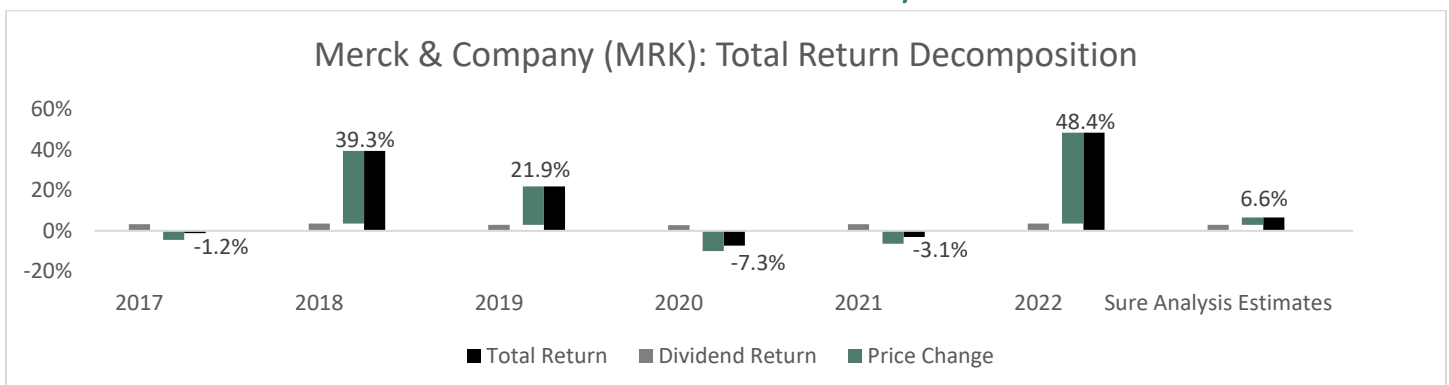
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	49%	50%	50%	49%	47%	46%	42%	42%	44%	37%	42%	42%

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 6.6% through 2028, down from our prior estimate of 9.2%. This projected return stems from annual expected EPS growth of 5% and a starting yield of 2.7%, partially offset by a low single-digit headwind from multiple compression. Once again, *Keytruda* provided strong growth rates that should last for years given its patent protection. Most other top products also showed year-over-year growth as well, though currency exchange remains a headwind. Merck continues to earn a hold recommendation due to projected returns.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	47267	44033	42237	39498	39807	40122	42294	46840	47994	48704
<b>Gross Profit</b>	30821	27079	25469	24564	25777	27210	28785	32728	32509	35078
<b>Gross Margin</b>	65.2%	61.5%	60.3%	62.2%	64.8%	67.8%	68.1%	69.9%	67.7%	72.0%
<b>SG&amp;A Exp.</b>	12776	11911	11606	10313	10017	10074	10102	10615	10468	9634
<b>D&amp;A Exp.</b>	6978	6988	6691	6375	5471	4676	4519	3652	3625	3214
<b>Operating Profit</b>	9877	7665	6683	7547	5499	6797	8931	12241	8483	13199
<b>Op. Margin</b>	20.9%	17.4%	15.8%	19.1%	13.8%	16.9%	21.1%	26.1%	17.7%	27.1%
<b>Net Profit</b>	6168	4404	11920	4442	3920	2394	6220	9843	7067	13049
<b>Net Margin</b>	13.0%	10.0%	28.2%	11.2%	9.8%	6.0%	14.7%	21.0%	14.7%	26.8%
<b>Free Cash Flow</b>	8068	10106	5672	11255	8762	4563	8307	9967	5569	9661
<b>Income Tax</b>	2440	1028	5349	942	718	4103	2508	1687	1709	1521

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	106132	105645	98167	101677	95377	87872	82637	84397	91588	105694
<b>Cash &amp; Equivalents</b>	13451	15621	7441	8524	6515	6092	7965	9676	8062	8096
<b>Acc. Receivable</b>	7672	7184	6626	6484	7018	6873	7071	6778	7851	9230
<b>Inventories</b>	6535	6226	5571	4700	4866	5096	5440	5978	6310	5953
<b>Goodwill &amp; Int.</b>	41217	36102	33378	40325	35467	32467	31357	33621	34842	44197
<b>Total Liabilities</b>	50669	53319	49376	56910	55069	53303	55755	58396	66184	67437
<b>Accounts Payable</b>	1753	2274	2625	2533	2807	3102	3318	3738	4594	4609
<b>Long-Term Debt</b>	20569	25060	21403	26412	24842	24410	25114	26346	31791	33102
<b>Total Equity</b>	53020	49765	48647	44676	40088	34336	26701	25907	25317	38184
<b>LTD/E Ratio</b>	0.39	0.50	0.44	0.59	0.62	0.71	0.94	1.02	1.26	0.87

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	5.8%	4.2%	11.7%	4.4%	4.0%	2.6%	7.3%	11.8%	8.0%	13.2%
<b>Return on Equity</b>	11.5%	8.6%	24.2%	9.5%	9.2%	6.4%	20.4%	37.4%	27.6%	41.1%
<b>ROIC</b>	8.2%	5.7%	16.2%	6.3%	5.8%	3.9%	11.2%	18.9%	12.9%	20.3%
<b>Shares Out.</b>	3027	2928	2838	2781	2749	2697	2650	2603	2536	2535
<b>Revenue/Share</b>	15.37	14.70	14.43	13.90	14.28	14.60	15.79	18.16	18.89	19.19
<b>FCF/Share</b>	2.62	3.37	1.94	3.96	3.14	1.66	3.10	3.86	2.19	3.81

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

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