Merck & Company (MRK)

Updated May 3rd, 2023 by Nathan Parsh

Key Metrics

Current Price:	$119	**5 Year CAGR Estimate:**	4.7%	**Market Cap:**	$302 B
Fair Value Price:	$104	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	06/15/23
% Fair Value:	114%	**5 Year Valuation Multiple Estimate:**	-2.6%	**Dividend Payment Date:**	07/07/23
Dividend Yield:	2.5%	**5 Year Price Target**	$133	**Years Of Dividend Growth:**	12
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Rating:**	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 2nd, 2021, Merck completed its previously announced spinoff of its women's health and biosimilar portfolio into Organon & Co (OGN).

On November 29th, 2022, Merck raised its quarterly dividend 5.8% to $0.73.

On April 16th, 2023, Merck announced that it had agreed to purchase clinical-stage biotech company Prometheus (RXDX) for $10.8 billion in cash.

On April 27th, 2023, Merck reported first quarter results for the period ending March 31st, 2023. For the quarter, revenue decreased 8.9% to $14.5 billion, but beat estimates by $660 million. Adjusted net income of $3.56 billion, or $1.40 per share, compared to adjusted net income of $5.43 billion, or $2.14 per share, in the prior year, but was $0.03 more than expected.

On a reported basis, pharmaceutical revenue decreased 10% to $14.5 billion for the quarter. Currency exchange was a 5% headwind to results. *Lagevrio* sales added $392 million, which was down 88% from the prior year. Excluding currency exchange and the impact of *Lagevrio*, revenue grew 11%. *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 20% to $5.8 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* improved 35% to $2 billion. *Januvia/Janumet*, which treats diabetes, decreased 29% to $880 million. This product has lost market exclusivity in the E.U. and had lower demand in the U.S. due to generic competition. Animal Health revenue of $1.5 billion was up 1% from the prior year. Ruminant and poultry products remain in high demand.

Merck provided updated guidance for 2023 as well. The company expects sales in a range of $57.7 billion to $58.9 billion, compared to $57.2 billion to $58.7 billion previously. Adjusted earnings-per-share are now projected to be in a range of $6.88 to $7.00, up from $6.80 to $6.95 previously. At the midpoint, this would be a decline of 7.2% from 2022. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$3.49	$3.49	$3.59	$3.78	$3.98	$4.34	$5.19	$5.94	$6.02	$7.48	***$6.94***	***$8.86***
DPS	$1.72	$1.76	$1.80	$1.84	$1.88	$1.99	$2.20	$2.48	$2.64	$2.76	***$2.92***	***$3.73***
Shares[1]	2928	2838	2781	2749	2697	2650	2603	2536	2535	2548	***2545***	***2530***

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

[1] In millions of shares

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.

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 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	***17.1***	***15.0***
Avg. Yld.	3.7%	3.1%	3.2%	3.2%	3.0%	3.0%	2.7%	3.0%	3.4%	2.5%	***2.5%***	***2.8%***

Shares of Merck have increased $11, or 10.2%, since our February 15th, 2023 update. Based off of guidance for the current year, the stock has a forward price to earnings multiple of 17.1. 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 2.6% headwind to total annual returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

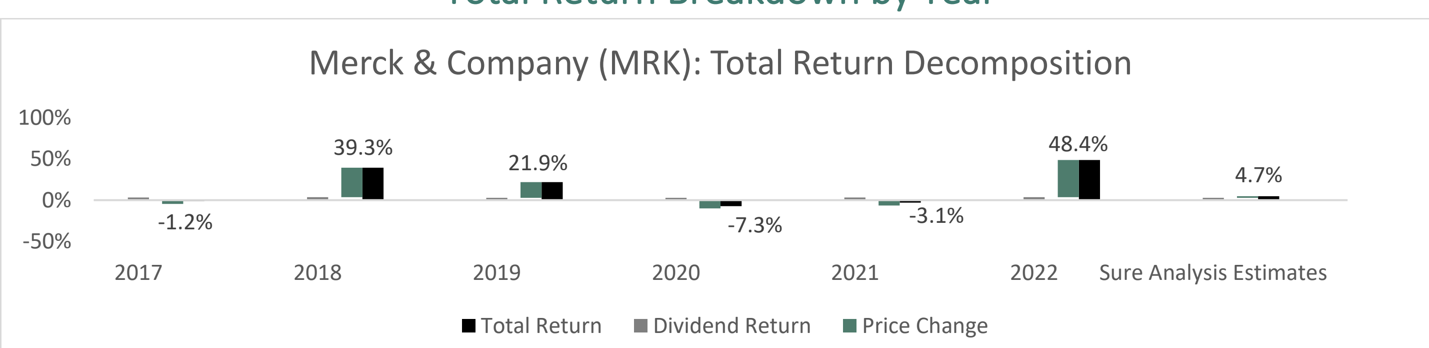
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	49%	50%	50%	49%	47%	46%	42%	42%	44%	37%	***42%***	***42%***

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 4.7% through 2028, down from our prior estimate of 6.6%. This projected return stems from annual expected EPS growth of 5% and a starting yield of 2.5%, 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	44033	42237	39498	39807	40122	42294	46840	47994	48704	59283
Gross Profit	27079	25469	24564	25777	27210	28785	32728	32509	35078	41872
Gross Margin	61.5%	60.3%	62.2%	64.8%	67.8%	68.1%	69.9%	67.7%	72.0%	70.6%
SG&A Exp.	11911	11606	10313	10017	10074	10102	10615	10468	9634	10042
D&A Exp.	6988	6691	6375	5471	4676	4519	3652	3625	3214	3909
Operating Profit	7665	6683	7547	5499	6797	8931	12241	8483	13199	18282
Op. Margin	17.4%	15.8%	19.1%	13.8%	16.9%	21.1%	26.1%	17.7%	27.1%	30.8%
Net Profit	4404	11920	4442	3920	2394	6220	9843	7067	13049	14519
Net Margin	10.0%	28.2%	11.2%	9.8%	6.0%	14.7%	21.0%	14.7%	26.8%	24.5%
Free Cash Flow	10106	5672	11255	8762	4563	8307	9967	5569	9661	14707
Income Tax	1028	5349	942	718	4103	2508	1687	1709	1521	1918

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	105645	98167	101677	95377	87872	82637	84397	91588	105694	109160
Cash & Equivalents	15621	7441	8524	6515	6092	7965	9676	8062	8096	12694
Acc. Receivable	7184	6626	6484	7018	6873	7071	6778	7851	9230	9450
Inventories	6226	5571	4700	4866	5096	5440	5978	6310	5953	5911
Goodwill & Int.	36102	33378	40325	35467	32467	31357	33621	34842	44197	41473
Total Liabilities	53319	49376	56910	55069	53303	55755	58396	66184	67437	63102
Accounts Payable	2274	2625	2533	2807	3102	3318	3738	4594	4609	4264
Long-Term Debt	25060	21403	26412	24842	24410	25114	26346	31791	33102	30691
Total Equity	49765	48647	44676	40088	34336	26701	25907	25317	38184	45991
LTD/E Ratio	0.50	0.44	0.59	0.62	0.71	0.94	1.02	1.26	0.87	0.67

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	4.2%	11.7%	4.4%	4.0%	2.6%	7.3%	11.8%	8.0%	13.2%	13.5%
Return on Equity	8.6%	24.2%	9.5%	9.2%	6.4%	20.4%	37.4%	27.6%	41.1%	34.5%
ROIC	5.7%	16.2%	6.3%	5.8%	3.9%	11.2%	18.9%	12.9%	20.3%	19.6%
Shares Out.	2928	2838	2781	2749	2697	2650	2603	2536	2535	2548
Revenue/Share	14.70	14.43	13.90	14.28	14.60	15.79	18.16	18.89	19.19	23.32
FCF/Share	3.37	1.94	3.96	3.14	1.66	3.10	3.86	2.19	3.81	5.79

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