



# Merck & Company (MRK)

Updated November 3<sup>rd</sup>, 2024 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$102	<b>5 Year CAGR Estimate:</b>	10.3%	<b>Market Cap:</b>	\$258 B
<b>Fair Value Price:</b>	\$116	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	12/13/24 <sup>1</sup>
<b>% Fair Value:</b>	88%	<b>5 Year Valuation Multiple Estimate:</b>	2.6%	<b>Dividend Payment Date:</b>	01/08/25 <sup>2</sup>
<b>Dividend Yield:</b>	3.0%	<b>5 Year Price Target</b>	\$148	<b>Years Of Dividend Growth:</b>	13
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## 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 68,000 people around the world and generates annual revenues of more than \$63 billion.

On November 28<sup>th</sup>, 2023, Merck raised its quarterly dividend 5.5% to \$0.77.

On May 29<sup>th</sup>, 2024, Merck completed its \$1.3 billion purchase of EyeBio, which has a pipeline of drug candidates that target retinal diseases.

On October 31<sup>st</sup>, 2024, Merck reported third quarter results for the period ending September 30<sup>th</sup>, 2024. For the quarter, revenue grew 4.4% to \$16.7 billion, which was \$190 million above expectations. Adjusted earnings-per-share was \$1.57 compared to \$2.13 in the prior year and was in-line with estimates.

*Keytruda*, which treats cancers such as melanoma that cannot be removed by surgery and non-small cell lung cancer, continues to be the key driver of growth for the company and had revenue growth of 17% to \$7.4 billion during the period. The product generated \$25 billion in 2023, up from \$20.9 billion in the prior year. Sales for Merck's HPV vaccine *Gardasil* decreased 11% to \$2.3 billion due to lower demand in China, partially offset by gains in the U.S. Animal Health grew 6% to \$1.49 billion due to improved demand for poultry and swine products.

Merck provided updated guidance for 2024 as well. The company now expects sales in a range of \$63.6 billion to \$64.1 billion, up from \$63.4 billion to \$64.4 billion, \$63.1 billion to \$64.3 billion, and \$62.7 billion to \$64.2 billion previously. Adjusted earnings-per-share are now projected to be in a range of \$7.72 to \$7.77 for the year, down from \$7.94 to \$8.04, \$8.53 to \$8.65, and \$8.44 to \$8.59 previously. The reduced adjusted EPS guidance is related to a one-time charge of ~\$0.79 per share related to the acquisition of EyeBio. We have updated our forecast accordingly.

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>EPS</b>	\$3.49	\$3.59	\$3.78	\$3.98	\$4.34	\$5.19	\$5.94	\$6.02	\$7.48	\$1.69	<b>\$7.75</b>	<b>\$9.89</b>
<b>DPS</b>	\$1.76	\$1.80	\$1.84	\$1.88	\$1.99	\$2.20	\$2.48	\$2.64	\$2.76	\$2.96	<b>\$3.08</b>	<b>\$3.93</b>
<b>Shares<sup>3</sup></b>	2838	2781	2749	2697	2650	2603	2536	2535	2548	2533	<b>2541</b>	<b>2530</b>

Merck's earnings declined during the last recession and it took the company several years to return to growth. Excluding last year's unique situation with Prometheus, Merck had earnings-per-share growth of nearly 9% for the 2013 to 2022 period, 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 focuses on its pharmaceutical, vaccines and animal health

<sup>1</sup> Estimated ex-dividend date

<sup>2</sup> Estimated dividend payment date

<sup>3</sup> In millions of shares

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businesses. For now, we maintain our estimate of 5% earnings growth over the next five years. Merck has increased its dividend for 13 consecutive years.

On August 16<sup>th</sup>, 2022, the Inflation Reduction Act of 2022 was signed into law. The law will, in part, require the federal government to negotiate prices for drugs covered under Medicare starting in 2026. This could reduce the profits pharmaceutical companies could collect, but these costs could be shifted to employer sponsored plans, reducing the negative impact on businesses. As such, we maintain our expected growth rates, but will monitor the situation as we get closer to the implementation of the law.

## Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	16.4	15.8	15.2	15.6	14.8	15.9	13.6	12.7	14.8	64.5	13.2	15.0
Avg. Yld.	3.1%	3.2%	3.2%	3.0%	3.0%	2.7%	3.0%	3.4%	2.5%	2.7%	3.0%	2.6%

Shares of Merck have declined \$13, or 11.3%, since our August 3<sup>rd</sup>, 2024 update. Based off earnings estimates for the current year, the stock has a forward P/E ratio of 13.2. Merck's long-term average P/E 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 15.0 by 2029. If shares were to revert to this target by 2029, then valuation would be 2.6% tailwind to total annual returns.

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

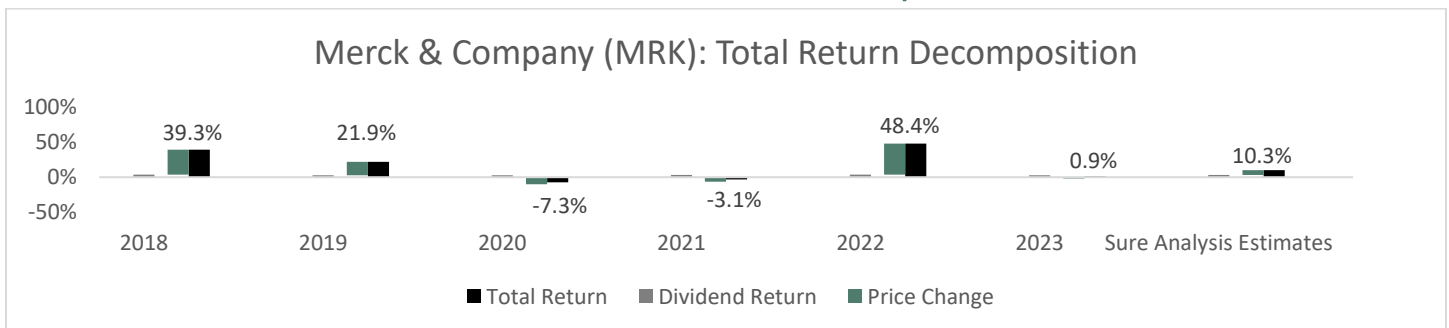
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	50%	50%	49%	47%	46%	42%	42%	44%	37%	175%	40%	40%

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 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% to 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 10.3% through 2029, up from 8.2% previously. This projected return stems from expected earnings growth of 5%, a starting yield of 3.0%, and a low single-digit tailwind from multiple expansion. Merck's top selling products, especially *Keytruda*, continue to produce strong growth rates. We now rate shares of Merck as a buy due to total returns.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Revenue</b>	42237	39498	39807	40122	42294	46840	47994	48704	59283	60115
<b>Gross Profit</b>	25469	24564	25777	27210	28785	32728	32509	35078	41872	43989
<b>Gross Margin</b>	60.3%	62.2%	64.8%	67.8%	68.1%	69.9%	67.7%	72.0%	70.6%	73.2%
<b>SG&amp;A Exp.</b>	11606	10313	10017	10074	10102	10615	10468	9634	10042	10504
<b>D&amp;A Exp.</b>	6691	6375	5471	4676	4519	3652	3625	3214	3909	3872
<b>Operating Profit</b>	6683	7547	5499	6797	8931	12241	8483	13199	18282	2954
<b>Op. Margin</b>	15.8%	19.1%	13.8%	16.9%	21.1%	26.1%	17.7%	27.1%	30.8%	4.9%
<b>Net Profit</b>	11920	4442	3920	2394	6220	9843	7067	13049	14519	365
<b>Net Margin</b>	28.2%	11.2%	9.8%	6.0%	14.7%	21.0%	14.7%	26.8%	24.5%	0.6%
<b>Free Cash Flow</b>	5672	11255	8762	4563	8307	9967	5569	9661	14707	9143
<b>Income Tax</b>	5349	942	718	4103	2508	1687	1709	1521	1918	1512

## Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Total Assets</b>	98167	101677	95377	87872	82637	84397	91588	105694	109160	106675
<b>Cash &amp; Equivalents</b>	7441	8524	6515	6092	7965	9676	8062	8096	12694	6841
<b>Acc. Receivable</b>	6626	6484	7018	6873	7071	6778	7851	9230	9450	10349
<b>Inventories</b>	5571	4700	4866	5096	5440	5978	6310	5953	5911	6358
<b>Goodwill &amp; Int.</b>	33378	40325	35467	32467	31357	33621	34842	44197	41473	39208
<b>Total Liabilities</b>	49376	56910	55069	53303	55755	58396	66184	67437	63102	69040
<b>Accounts Payable</b>	2625	2533	2807	3102	3318	3738	4594	4609	4264	3922
<b>Long-Term Debt</b>	21403	26412	24842	24410	25114	26346	31791	33102	30691	35055
<b>Total Equity</b>	48647	44676	40088	34336	26701	25907	25317	38184	45991	37581
<b>LTD/E Ratio</b>	0.44	0.59	0.62	0.71	0.94	1.02	1.26	0.87	0.67	0.93

## Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Return on Assets</b>	11.7%	4.4%	4.0%	2.6%	7.3%	11.8%	8.0%	13.2%	13.5%	0.3%
<b>Return on Equity</b>	24.2%	9.5%	9.2%	6.4%	20.4%	37.4%	27.6%	41.1%	34.5%	0.9%
<b>ROIC</b>	16.2%	6.3%	5.8%	3.9%	11.2%	18.9%	12.9%	20.3%	19.6%	0.5%
<b>Shares Out.</b>	2838	2781	2749	2697	2650	2603	2536	2535	2548	2533
<b>Revenue/Share</b>	14.43	13.90	14.28	14.60	15.79	18.16	18.89	19.19	23.32	23.60
<b>FCF/Share</b>	1.94	3.96	3.14	1.66	3.10	3.86	2.19	3.81	5.79	3.59

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

### Disclaimer

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