

Merck & Co., Inc.

US CORE HOLDING*

Recommended since 18.12.15

28.07.2022



Country	US	Market capitalization (bn)	USD	232.4
Sector	Health Care	Free float		99.9%
Factset	MRK-US	Closing price	USD	91.23
ISIN	US58933Y1055	ESG Risk score*	21.8	Medium risk

Perf. since reco. (%)

Merck & Co., Inc. 85.3

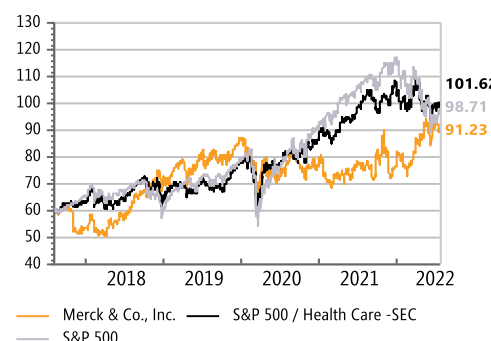
Sector 88.7



*From 2015, B&Cie separates its investment recommendations into Core Holdings (higher organic growth potential, high free cash flow, ROCE in excess of the cost of capital and balance sheet efficiency throughout the cycle) and Satellite Recommendations, which do not meet the above criteria but are likely to outperform in the short-to-medium term.

Profile

Originally the US subsidiary of Merck AG, Merck & Co was established and run by George Merck in 1891. The company became fully independent in 1917. Following the sale of the Consumer Care business in 2014, the company is focused on two areas: (1) pharmaceuticals (90% of sales), dedicated to cardiovascular diseases, diabetes, hepatitis C, HIV, oncology and vaccines, and (2) animal health (10%).



Source: Factset

Market - competition - positions - barriers to entry

Merck & Co is a pharma sector pure player and one of the top five global groups in the sector. Barriers to entry are innovation, with a large R&D budget (17% of sales), the clinical development process, the complexity of molecules, and the regulatory environment.

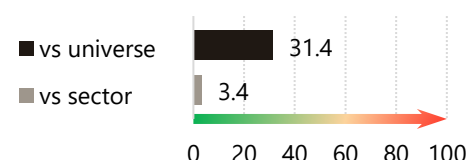
Investment case

- The group's growth profile remains robust in the medium term, buoyed by take-up of Keytruda (an immunotherapy against various forms of cancer – 35% of sales in 2021) as well as favourable trends in its Animal Health division and in vaccines. These last two segments account for 30% of sales and deliver growth averaging between 5% and 10% a year. Meanwhile, Keytruda offers potential sales of \$29bn by 2027 (vs. \$17bn in 2021) and will help significantly improve the group's margins.
- Launched in 2014 as a treatment for melanoma, Keytruda has taken the lead in immuno-oncology, establishing itself as the gold standard treatment in the majority of lung cancers. While these areas will continue to drive growth, Merck also benefits from major indication extensions in renal cell carcinoma (90% of kidney cancers), head & neck, esophageal, uterine cancer, as well as adjuvant in melanoma and triple-negative breast cancer. Developments at earlier stages of the disease (I-III), in adjuvant (administration after first-line treatment to prevent the risk of recurrence) and neo-adjuvant (administration before surgery or first-line treatment) represent opportunities for upward revision, with data in 2022 in renal cell carcinoma and head & neck cancer. In addition, the group is exploring combination therapies with other immunotherapies in development that have a different mechanism of action.
- The recent acquisition of Acceleron for \$11.5bn brings a new late-stage R&D asset, sotatercept (fusion protein therapy), developed for pulmonary arterial hypertension (\$4bn market). The drug offers a promising new mechanism of action, with the potential to be the first to modify disease course.
- Targeted acquisitions (seven of which were completed over the period 2019-2020) and partnerships, designed to boost and diversify the pipeline, will remain at the heart of the capital allocation strategy and are likely to intensify in the medium term in anticipation of the Keytruda patent expiry in 2028.

ESG - risks and key points

- Merck & Co's ESG risk is medium, mainly linked to its presence in the US market (43% of sales), where litigation is more commonplace. The group has in the past been involved in a number of controversies. However, the shift in its business away from its legacy franchises (cardiovascular; primary care) towards oncology tends to mitigate this risk.
- A strong performance on overall management of ESG issues.

ESG risk vs. universe & sector (percentile)*



Source: Sustainalytics

Valuation** in USD

Current price	Value Bordier Scenario
91	102

Our scenario assumes a US risk-free interest rate of 3.50%; sales growth averaging 4.5% a year out to 2027 and a subsequent decline in sales averaging 8% a year towards the end of the period; an EBITDA margin improvement towards 44% in 2024 before returning to 37% to reflect expiry of the Keytruda patent.

***) The theoretical value reflects the company's business model, our baseline growth and profit scenario and market data, exogenous to the company (risk-free rate and equity risk premium). It does not in itself constitute a target price.

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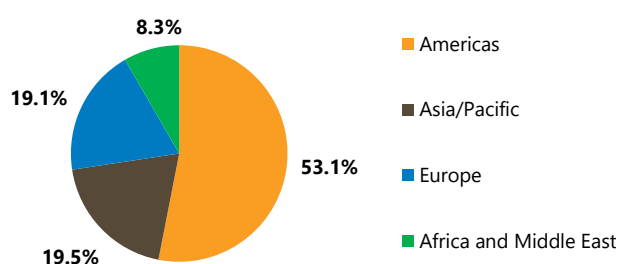
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"Bordier Core Holding" indicators

In millions of USD	2020	2021	2022e	2023e	2024e
Sales revenue	47'994	48'704	56'984	55'559	58'059
Sales growth %	2.5%	1.5%	17.0%	-2.5%	4.5%
<i>o/w organic</i>	4.0%	16.0%	19.0%	-2.5%	4.5%
EBIT adjusted	16'947	17'696	21'798	21'501	23'630
% of sales	35.3%	36.3%	38.3%	38.7%	40.7%
Net income	15'084	15'282	18'342	17'753	19'648
Adjusted EPS	5.94	6.02	7.23	6.99	7.74
Adjusted EPS growth	14.4%	1.4%	20.0%	-3.2%	10.7%
Capex/Sales	9.8%	9.1%	5.0%	4.5%	4.5%
Free cash-flow	5'569	8'674	13'732	18'128	18'425
FCF/Sales	11.6%	17.8%	24.1%	32.6%	31.7%
Dividend per share	2.44	2.60	2.76	2.99	3.36
Dividend yield	3.0%	3.4%	3.0%	3.3%	3.7%
ROCE - WACC	19.9%	18.2%	22.7%	22.9%	24.5%
ROE (%)	59.6%	40.0%	39.6%	32.6%	30.7%
Net debt/Ebitda	178.6%	151.3%	78.4%	28.9%	-16.0%

Source: Factset, Bordier estimates

Sales breakdown - 12/2021



Ratios

	Merck & Co., Inc.	S&P 500 Sector	Market
PE (x)***		Health Care	SP 500
2021	12.7	16.8	21.2
2022e	12.6	16.3	17.8
2023e	13.0	16.4	16.5
P/B (x)***			
2021	5.1	5.0	4.5
2022e	5.0	4.5	3.8
2023e	4.2	4.1	3.5
Beta (2Y, daily) vs market: 0.39			

***) The valuation ratios set out are provided for information only. They do not constitute the criteria based upon which Core Holdings are selected, and may present significant premiums representing the quality of the company's business model.

Governance and ownership structure

Since 2021 - CEO Robert M. Davis

Key shareholders (if any):

100% free float

Agenda

28 Jul. 2022: Q2 results

27 Oct. 2022: Q3 results

Any special characteristics of ownership (multiple voting rights, controlling holding company, shareholders' agreements, etc.):

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Glossary

ESG Risk Score

At B&Cie, we take particular care to ensure that the companies in which we recommend investing are sustainable. Accordingly, our selection process takes account of risks relating to environmental, social and governance (ESG) issues. This approach is underpinned by research from Sustainalytics, the global leader in ESG and corporate governance analysis, whose methodology aims to identify major controversies and risks and assess a company's ESG risks relative to both its sector and the investment universe as a whole. The corresponding score is expressed as a percentile: the lower the overall risk score, the lower the risk within the investment universe.

b-Digital, b-Transition & b-Well

Over and above the conventional geographical and sectoral approaches to asset management, at B&Cie we believe the world of tomorrow is being shaped by structural trends. We have identified three main megatrends: ongoing digital globalisation of the economy; economic transition, particularly in the energy sector; and the quest for wellness. We believe selecting and investing in companies that play an active role in these transformations should lead to more resilient portfolios that generate higher long-term returns. Our investment recommendations in the digital globalisation space are labelled "b-Digital", those in the economic transition space "b-Transition" and those in the wellness space "b-Well". A given recommendation may fall under more than one theme, in which case it will carry the relevant matching labels.

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