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Reason for report:

COMPANY UPDATE



LEERINK SWANN

HEALTHCARE EQUITY RESEARCH

## MERCK & COMPANY, INC.

### Clarifying Confusion Related to Recent Press Reports

• **Bottom Line:** In meetings with MRK management on 12/3, the industry's position regarding healthcare reform, PhRMA's willingness to support healthcare reform, and the public option were discussed. There appears, however, to be some confusion in the press that requires clarification. Our primary takeaway from this discussion was that PhRMA's support for healthcare reform and its pledge to reduce government healthcare spending on pharmaceuticals by \$80B over a decade did not include a broad public option.

• **PhRMA's willingness to support healthcare reform is limited to versions that do not include a broad public option.** MRK's comments during our meeting on 12/3 were consistent with the company's prior comments. It is obvious to us that the industry supports full coverage for the US patient population, which is evident in the industry's willingness to pledge to reduce government healthcare spending by \$80B over 10 years. The industry's concerns with a broad public option specifically relate to free market competition versus mandatory price controls, which stifle innovation. In our opinion, a broad public option would be the first step toward a single-payer system and a negative precedent for the pharmaceutical and biotechnology industry. Recent press reports suggest two major sticking points to forward movement on healthcare reform: (1) abortion and (2) a broad public option.

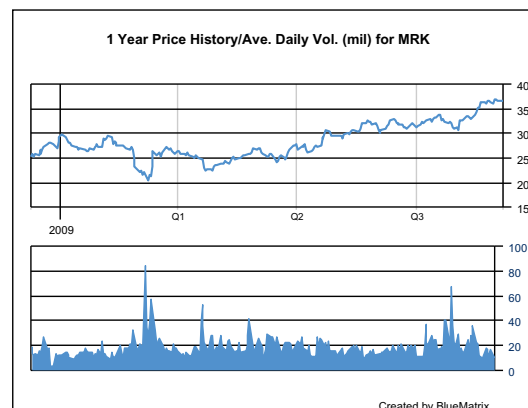
• **We never said that "promises" were made regarding the public option.** It is clear that the White House, Senator Baucus, and other congressional leaders were involved in the negotiations surrounding the \$80B pledge from PhRMA. We do believe that the White House and Congress will "do what is required" to pass healthcare reform. Clearly, PhRMA's support would be helpful in achieving the filibuster-proof 60-vote majority. Today's reports that Senator Dorgan's proposed amendment to allow reimportation and Senator Reid's willingness to introduce the amendment to healthcare legislation is evidence that PhRMA's \$80B pledge was not written in stone. According to theHill.com, Dorgan said that Senators Snowe, McCain, Vitter and Grassley have all pledged to support the amendment. At the same time, support for a broad public option is low and appears to be moving toward either allowing patients to buy in to Medicare starting at age 55, or establishing a network of not-for-profit plans run by the FEHBP.

#### Key Stats:

(NYSE:MRK)

<b>Price:</b>	<b>\$36.70</b>
52 Week High:	\$37.50
52 Week Low:	\$20.05
Shares Outstanding (mil):	3,116.0
Market Capitalization (mil):	\$114,357.2
Book Value/Share:	\$6.48
Cash Per Share:	\$4.66
Net Debt to Total Capital:	47%
Dividend (ann):	\$1.52
Dividend Yield:	4.1%
Est LT EPS Growth:	5%
P/E to LT EPS Growth (FY10):	2.2

*Est LT EPS Growth: CAGR from '10E - '15E - represents combined MRK + SGP cash EPS with synergies*



Dec Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	P/E
2008A	\$5.8	\$6.1	\$5.9	\$6.0	\$23.8	\$0.89	\$0.86	\$0.80	\$0.87	\$3.42	10.7x
2009E	\$5.4A	\$5.9A	\$6.0A	\$8.9	\$26.2	\$0.74A	\$0.83A	\$0.90A	\$0.71	\$3.18	11.5x
2010E	--	--	--	--	\$44.6	--	--	--	--	\$3.33	11.0x

Source: Company Information and Leerink Swann LLC Research  
Results exclude extraordinary items. EPS include options expense. Revenue in \$B.  
Forecasts include SGP as of November 4, 2009.

Please refer to Pages 3 - 4 for Analyst Certification and important disclosures. Price charts and disclosures specific to covered companies and statements of valuation and risk are available <https://leerink.bluematrix.com/bluematrix/Disclosure2> or by contacting Leerink Swann LLC Publishing Department, One Federal Street, 37th Floor, Boston, MA 02110.



## INVESTMENT THESIS

**We rate Merck Outperform.** We believe MRK's acquisition of SGP lowers MRK's risk profile while expanding the pipeline and the diversity of its healthcare portfolio. Although MRK faces several near-term risks, including a potential successful challenge (or at risk launch) of Temodar by Teva/Barr in the U.S. and the ongoing JNJ arbitration surrounding the Remicade/Simponi franchise, we believe these risks are largely factored into MRK's current valuation. We believe that MRK is highly likely to retain the rights to Remicade/Simponi via a settlement or an outright victory in arbitration with JNJ, and MRK's substantial late-stage pipeline provides several upside opportunities. In addition, the Merial/Intervet combination represents an attractive medium-term upside opportunity for MRK investors. Our 12-month valuation is \$38-40/share based on our DCF analysis (through 2016E).

## VALUATION

MRK trades at ~11x our 2009 EPS estimate of \$3.18, a discount to BMY but premium to LLY and PFE. We think MRK's stock can trade to approximately \$38-40/share in the next 12 months based on our 2009-2016E discounted cash flow analysis; this assumes the stock achieves an 11-12x multiple on our '10 EPS estimate of \$3.33 for the new MRK. Our previous valuation was approximately \$38/share.

## RISKS TO VALUATION

Risks include greater-than-expected decline in Zetia/Vytorin franchise sales following the ARBITER 6 trial, competition from rivals' pipelines (other late-stage DPP-IV inhibitors, GSK's HPV vaccine, Cervarix, its Rotavirus vaccine, Rotarix, as well as competition to MRK's integrase inhibitor Isentress from GILD as well as GSK) as well as clinical and regulatory risk to key pipeline products (TRA, Tredaptive, V503) and competitive risk to the cholesterol franchise with the entry of Lipitor generics in November 2011.



## Disclosures Appendix

### Analyst Certification

I, Seamus Fernandez, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OP]	74	52.86	7	9.46
HOLD [MP]	61	43.57	2	3.28
SELL [UP]	5	3.57	0	0.00

### Explanation of Ratings

**Outperform (Buy):** We expect this stock to outperform its benchmark over the next 12 months.

**Market Perform (Hold/Neutral):** We expect this stock to perform in line with its benchmark over the next 12 months.

**Underperform (Sell):** We expect this stock to underperform its benchmark over the next 12 months.

The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company

For the purposes of these definitions the relevant benchmark will be the Russell 2000® Health Care Index for issuers with a market capitalization of less than \$2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over \$2 billion.

Definitions of Leerink Swann Ratings prior to October 1, 2006 are shown below:

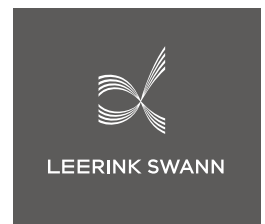
**Outperform (Buy):** We expect this stock to outperform its benchmark by more than 10 percentage points over the next 12 months.

**Market Perform (Hold/Neutral):** We expect this stock to perform within a range of plus or minus 10 percentage points of its benchmark over the next 12 months.

**Underperform (Sell):** We expect this stock to underperform its benchmark by more than 10 percentage points over the next 12 months.

For the purposes of these definitions the relevant benchmark will be the Russell 2000® Health Care Index for issuers with a market capitalization of less than \$2 billion and the S&P 500® Index for issuers with a market capitalization over \$2 billion.

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