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MRK - Merck & Co Inc at Cowen HealthCare Conference

EVENT DATE/TIME: MARCH 03, 2020 / 5:00PM GMT



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PRESENTATION

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Well, hello once again. We're very, very happy to have Merck with us at the Cowen Conference again this year. Representing the company is Rob Davis, Chief Financial Officer; as well as Peter Dannenbaum, who heads up the Investor Relations effort.

So thank you so much for being with us today.

QUESTIONS AND ANSWERS

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So given the fact that it's Super Tuesday, I thought I would start out with a bit of a pricing question, and maybe you could just articulate for us how pricing has trended over the last 3 years, how you look at it over the next 3 years, and does it change -- does the answer changes Bernie Sanders isn't expecting?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Well, if you look at where we've been, and we've talked about this in the past, obviously, the pricing pressure continues to be there and continues to impact our business. But probably the way it's evolved the most, we fixed pressure outside the United States for quite some time now. What really has evolved is the fact that today, we largely don't see the benefit from pricing in the United States. And as we look forward, we've actually built in expectations to our long-range plan that you're going to see price declines both globally and within the U.S. as well. We don't know what form it necessarily will take, but we definitely believe that there will be continuing pressure as we move forward.

And as we think about how the political situation could change that, it's really hard to say because obviously, if we look at a Democratic president, it's also very important to understand what happens in the House and the Senate, and in many ways, what happens in the House and the Senate is as important, if not more important than what happens with the presidential race.

So how the dynamic at all that plays out, it's unclear to us, but what is clear is that continuing pressure is going to be there. And that's why you saw us take the actions we took strategically to continue from a position of strength to try to reposition the company to ensure that we are best positioned to have sustainable and strong growth regardless of the environment we face.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

By the way, at any point, if you have a question, please raise your hand, and I'll call upon you.

So let's move to a different topic, and that is that -- and I realize you don't have clarity on this yet because the abstracts haven't been issued yet, but what can we look forward to at the major medical meetings, particularly AACR and ASCO, relative to potential data from Merck?

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Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Yes. Well -- and it's, frankly, a little too early to give specific guidance on those conferences. We will have some important readouts there and more to come as we get closer, so I don't want to get ahead of our scientific team on releasing that information.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Okay. There's a perception, and I confess, it is a perception that I have as well, that the Merck pipeline is on the weaker end of the equation, that KEYTRUDA is a phenomenal asset, and gefapixant is an interesting concept, and HIV is an area where you have some interesting assets. But beyond that, the pipeline needs to be broadened. Now that could just be based on what the company articulates publicly or it could be a reality. So the question is, of all the kind of Phase I and II assets within the Merck pipeline, how many are publicly revealed?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Yes. Yes. Well, I don't want to get into the specifics of that. Obviously, we tend to be conservative in talking about the earlier phases of our pipeline. But maybe just to give you a sense of context from my own experience within the company. It was interesting, going back a few months ago, I actually sat down and spent a full day going through with the heads of our discovery operations the entirety of the pipeline really to get a sense of what was there.

And a couple of comments I would give you with just coming out of that review. One, I was surprised and encouraged by the breadth of the therapeutic areas represented in the pipeline. Obviously, we continue to have a meaningful presence in oncology and continue to prosecute a lot of opportunities, both late stage and early stage in that area. But I would say, we also are seeing some growing opportunities in the CNS space, in the cardiometabolic space is another area where we have a lot of opportunities. Vaccines continues to be an important area of development and discovery for us as well. So I was very pleased with both the breadth of the therapeutic areas covered and the number of modalities covered as well.

So the thing I commented internally to some folks when I left that meeting was in the almost 6 years since I've been at Merck, I was surprised and pleased at the swagger and the confidence that the discovery leaders were carrying themselves with. There clearly is a sense of confidence and belief in what we have and the robustness of the early-stage pipeline. And importantly, I think we've done a nice job augmenting that.

You mentioned some areas. One you didn't mention was vaccines. We continue to believe we have the best vaccines pipeline in the industry, not only because of what we have with V114 and our broader program in pneumococcal disease, but also with CMV, with dengue, with RSV.

So as we look at it, we think we have a great pipeline there as well as a broad pipeline in oncology. And we've augmented it very recently, both in some of the earlier-stage assets with what we did recently with Taiho, Astex, with the KRAS opportunity, in the later stages with Peloton and with ArQule, with the HIF-2 alpha product and the BTK inhibitor we got in those deals. So as I look at it, we are getting more done than I think people appreciate, both in the strength of what we have inside and how we're augmenting it externally as well.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

And is the company's view that there are assets within the pipeline that have kind of JANUVIA-like potential?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Well, I would say it differently. Do I think that there are other products in our pipeline that are -- that could be blockbuster products? Yes. We do think we have products in there that are blockbusters. We have some more near-term things we think are blockbusters. You mentioned one of

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them, gefapixant, continues to be something we're excited about. As I mentioned, V114 is another area as well. And then we have other products earlier in development. But yes, I do think we have other blockbuster opportunities coming forward.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Questions from the audience? So just want to touch upon JANUVIA. The company has said in the past that there's a team within Merck of 200 people who are working on a successor to JANUVIA. What is the status of this effort? And is it within the realm of possibility that a successor could be available by the time the patent goes?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. And I'm not -- to be honest with you, sure with the specific reference, so I can't comment to whatever was referred to. What I would tell you is we continue to be very excited about the cardiometabolic space in general. And in particular, if you look in that area, as you know, we did execute an option we had with NGM to bring in a NASH compound, which is in Phase II. We think that has some interesting characteristics. We have an early-stage inhaled SGC project that is, I think, going to be promising. We have vericiguat in that space as well.

So as we look at it, the cardiometabolic space is an area we continue to focus on, both in our discovery operations where we built out our discovery position in that space, even here in South San Francisco as well as we continue to focus on it in business development. So that is an area of focus, and I do think you're going to continue to see us -- to continue to prosecute opportunities in that area.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

You mentioned vericiguat. So we know the study was positive. We don't know the data. We've talked to leading CHF experts who, honestly, are not optimistic about the results. Thinking that you probably just crossed over the hurdle that necessary for statistical significance.

Yet, I think Dr. Perlmutter has exhibited a level of enthusiasm for this product that would make us conclude that it's substantially better than just crossing the hurdle. So acknowledging that you're not going to reveal the data today, what can you -- how -- what sort of expectation should we have when we get the data?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Sure. Well, if you look at what vericiguat brings, it is scientifically very important. This is a drug in people with reduced ejection fraction. And importantly, the study that we ran focused on patients with worsening heart failure or who had suffered a recent decompensating event.

So these are sick patients, patients who have been on standard of care therapy and failed on that therapy and are moving into worsening heart failure. This is a population that has really not seen any studies done in recent time and has no on-label products really indicated in this space. So it is a novel mechanism. It's addressing what is an important unmet need. As you mentioned, we did meet our composite endpoint with the drug. We'll obviously bring that data out soon. In fact, I think it's happening at ACC later this month, you will see that data.

So as we look at the scientific importance of this to a clinical unmet need, we think it's meaningful. And given that it's an add-on to standard of care therapy, will be an important addition to the (inaudible).

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

And refresh my memory, on the TRAE trial, was a 20% reduction in risk required for success?

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Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

I know I don't want to get into the specifics of the trial designs. I'll leave that to the scientists.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Okay. Questions from the audience? So let's move to KEYTRUDA. We have physician experts who believe, ultimately, the I-O opportunity will be larger in the adjuvant setting than the metastatic setting. In fact, some have said as much as threefold. And Merck has many, many, many, efforts underway in the adjuvant setting, dozens and dozens of trials. So you seem well positioned to capture this opportunity if it were to materialize.

What does Merck's view about how big this adjuvant opportunity can be?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Well, we see it as large. And for the reason you said, if you look at -- and you really have to go tumor by tumor. But if you look across most tumors, less than half of the potential patient population is in the metastatic setting. So if you think of that, it means you can more than double the potential opportunity if you can move out of metastatic into the adjuvant, neoadjuvant setting and into earlier lines of therapy.

So it is a significant opportunity. And as you mentioned, at Merck, right now, if you look, we have already approved indications in adjuvant melanoma and seeing very good uptake in both the U.S. and around the world with that indication. We have an earlier line of therapy approval in non-muscle invasive bladder cancer we received recently, which is an important area. And obviously, we're excited about what we have in triple-negative breast cancer with KEYNOTE-522, which also will move us into the adjuvant, neoadjuvant space and where we showed statistically meaningful pathologic complete response and need to continue to wait to see event-free survival, but we expect we could see that still this year.

So all of those are products that we're moving for now. Beyond that, we have -- I think it's over 18 now registration-enabling studies across 9 tumor types. And if you look on ClinicalTrials.gov, you'd see that there's over 100 studies underway in the adjuvant, neoadjuvant space, some by us, many by investigators in the field across 11 tumor types.

So it's a very big area for us, and it's an area where we are actually very excited and think we are very well positioned to move into that space as we continue to expand care for the patients.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Questions from the audience? Yes, Michael?

Unidentified Analyst

How does Merck model with a potential entry of competitors in the front line lung space? We've seen, individually, in lung are future competitors driving this. Could you give us some sort of a depth by level content?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Yes. Well...

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Let me just repeat the question. So Mike is asking about how Merck views entrants into the first-line lung cancer space.

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Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Yes. And so if you look at where we are today, in the United States, for instance, we are facing 6 competitors in the PD-1, PD-L1s today. We can talk about any of the individual, to your point, competitive opportunities that are coming forward. I would rather focus on how is KEYTRUDA positioned, and I think that really speaks to why we have so much confidence.

If you look at KEYTRUDA, we're the only company where we have overall survival across 10 different studies, overall survival in 5 studies in lung cancer, 4 overall survival findings in first-line lung cancer, standard of care in high expressers. If you're a high-expressing PD-1 patient today, you perform best on monotherapy. So why would you not continue with the monotherapy that is working today as standard of care?

As you look at the other lower-expressing patients in KEYNOTE-189 in combination with KEYTRUDA, again, where we improved the risk of survival doubles on KEYTRUDA the benefit that you bring with that product is significant. So as we look at each of these individual areas, the same thing you would see with what we have in squamous non-small cell lung cancer as well.

We think the breadth of our data, the strength of our data, the consistency of it, the fact that most of it is based on overall survival puts us in a very strong competitive position and very well represented in the community space as well as in the academic setting.

So do we expect to see further competition? We do. I don't personally believe you're going to see anything that fundamentally changes the market landscape no different than we haven't so far. And in general, where data has come out, we always find that KEYTRUDA is equal to or generally better. So I think the hurdle we've set is very high. We'll have to see the data, and the world evolves, but we feel very good about our position.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

So we at Cowen believe that KEYTRUDA could do about \$18 billion in 2025. I mean that's only 5 years from now, and \$22 billion. What's the first thing that goes through your mind when you see that number?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Well, I don't want to give specific guidance on where we see the numbers going. But clearly, KEYTRUDA has the potential to be the single largest drug in history and is really foundational in what it's doing in cancer care. And if you look on where we are now and where we're going forward, we're still in the earlier stages of this drug.

We've talked about the fact that if you look forward, while today, we have 23 indications across, I think, it's 15 tumor types now, we have, if you combine it with what we're doing with Lynparza and Lenvima, more than 50 additional indications we're bringing forward. So this truly is a pipeline and a product. And as we think about it in our broader oncology opportunity, it's going to be significant based on, as we talked about just a moment ago, the significant data we have, the strength of the data and the breadth of our offerings make KEYTRUDA not only an important monotherapy but a combination drug of choice, which puts us in a very unique position and one where we feel very bullish about the opportunities long term. And we've been consistent to say that with KEYTRUDA, we think The Street, as you look out to 2024, continues to under-appreciate what we think the potential is with that drug.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Questions from the audience? So KEYTRUDA was granted a rather hefty price cut in Japan earlier this year. Can -- or do you expect KEYTRUDA to grow in Japan in 2020?



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Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

We do. So we do think that despite the 17.5% price reduction that was taken -- and for those of you who don't know the way the Japanese system works, as you see volume accelerate in the market, they have what they termed the huge seller discount that is triggered. And obviously, because of the success we've had with KEYTRUDA in that market, we did trigger a 17.5% price reduction that's taking place in February of this year. And then we actually have triggered another one, which will take place in April of this year, about the same size.

So despite those 2 onetime events, we actually do expect to grow in 2020 in Japan and expect to have continued strong growth on really what is just a great position in the marketplace. We have every major lung cancer indication in the Japanese market, renal cell carcinoma, head and neck cancer, important approvals within MSI High doing quite well, doing well in bladder cancer in that market.

So really across the spectrum of our offerings, we feel very good about where Japan is and the growth potential it holds into the future.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Questions from the audience? Maybe we can move to GARDASIL. Has Merck -- and I apologize if you hadn't, I just don't remember. But has Merck given a dollar number to the incremental sales GARDASIL can generate once the new capacity is online?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

We've not given a specific dollar figure to that, but what I can share, and we have been sharing, is that if you look at where we've been with GARDASIL over the last few years driven really on the base what has become a phenomenal shift in the demand for the product and the demand now that is outpacing our ability to supply as countries around the world really are starting to recognize GARDASIL for what it is, which is a cancer vaccine that can have the opportunity, for instance, to eliminate cervical cancer as well as a growing list of other cancers that the HPV virus is shown to have implications in as well.

So as we look at that situation, moving forward, it's important to understand where we've been. We've more than doubled our capacity over the last few years. That's really both driving operating efficiencies in our existing bulk production facilities as well as augmenting our packaging and other fill/finish opportunities. And then as we look forward in 2023 where we're bringing on 2 new bulk manufacturing facilities, we would expect to double our capacity again.

Now how that translates to sales? Just to be clear, I wouldn't double the sales number because, obviously, as we continue to drive broader capacity expansion, we are moving into some of the lower-priced markets. So you'll have to look at the mix of markets as we continue to fulfill the growing need in the developed world as well as to start to address more and more the developing world. But even with the fact that there's differential pricing, it's a meaningful growth opportunity for the next 10 years plus for this company.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

So the company, as it always does, was asked and spoke about M&A on the Q4 conference call. And I guess my impression from listening to what was said is that M&A is a when, not if, and it's going to be significant. That was my impression. I'm wrong a lot. So if that was the wrong impression to garner from those comments, please correct it.

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Well, I think -- clearly, we want to make sure everyone understands is we do have an urgency around needing to augment the pipeline. We do feel very good about what we have internally, as I mentioned, but we also recognize that you can always do better.



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And so if you look at what we did in 2019, we actually did 80 business development transactions. If you include the ArQule deal, we deployed over \$8 billion in 2019 to business development and brought in some meaningful assets like the ArQule asset, like the Peloton asset and others.

So we will continue to have that kind of focus and urgency, and we'll continue to look for the opportunities to augment our pipeline with a focus, first and foremost, on where do we see the best science that we believe can address a meaningful unmet need and then combining that with where we believe there is an opportunity for value creation. We're willing to act and will do so.

So that sense of urgency is clearly what we wanted to communicate and something we're continuing to prosecute against.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Questions? Yes?

Unidentified Analyst

Can you compare and contrast the M&A dollars versus the (inaudible) pipeline dollars as well as where you have one-offs (inaudible) and you're augmenting the pipeline by buying? Or augmenting the pipeline by investing in the earlier stage? Where do you cut them off in the earlier stage?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. So maybe I think that...

Peter Dannenbaum - *Merck & Co., Inc. - VP of IR*

Steve, do you want to repeat?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

I can maybe repeat the question. I think the question is, how do we weigh the decision to invest further in our internal pipeline and make the decisions there relative to how do we augment it externally through business development?

As we look at it, so we run -- if you think about it from a valuation perspective, as we look at what we think is the probability of technical success of our own science and then how we value that internally, we use the exact same modeling external. So we don't treat an internal -- or from an external asset differently in the sense of how we think about value.

Now to the extent we have insights, for instance, on something internally where our scientists have a particular belief and strong conviction, that might change the way you think about the probabilities. Likewise, no different than we would argue as you think about looking in spaces outside the company where our scientists bring specific expertise, that will weigh in on that, but that's how we think about it. And right now, we're in a situation, I would say, a favorable situation, where we have not been forced to say, okay, kill something internally to augment externally.

If we find opportunities in-house that we think are meaningful, we prosecute them. We give stage-appropriate investment. We try to make the right decisions to know when to move forward and when to kill and do appropriate stage gating to do that. But we have not consciously suboptimized the internal for the external or vice versa. We have the capacity and capability to pursue both, which is what we're doing and where we will continue to focus.



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Unidentified Analyst

So just a follow-on. So is it a fair comment that the DCF hurdle rate for internal and external is the same?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Generally, yes. But we look at it almost project by project. So we will make risk adjustments based on the specifics of the projects. But as a broad-based statement, yes.

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Other questions in the audience? Yes?

Unidentified Analyst

Can you talk about the decisions on the NRDL in China when you -- and at what point do you revisit decisions that were made? And how frequently do those discussions happen?

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Decisions on the NRDL in China.

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

Yes. So obviously, we did have discussions with the Chinese government about bringing in KEYTRUDA into the NRDL. As we went those -- through those discussions and looked at what was our own view of value relative to price, we made a determination that we felt that it was better to continue to move forward in the private pay market and focus more on bringing access through our patient assistance programs for the time being, but that's a fluid situation. We're opening to continuing dialogue with the Chinese government. And as we see the broader macro landscape evolve, we'll make determinations of what we think is best given the facts we face at that time. So we are open, and that situation could evolve.

The timing of when NRDL comes, over the last couple of years, it's happened pretty much on an annual basis. Historically, that wasn't the case. So it's unclear when the next NRDL opportunity will come, whether or not it'll be next year or not. But if and when that happens, we'll be in a position to have open discussions with the Chinese government and make the decision that we think is best for the patients and for the company, based on the facts we see at that time.

Unidentified Analyst

How long does that planning cycle take or that discussion cycle?

Stephen Michael Scala - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

How long does the planning cycle take?

Robert M. Davis - Merck & Co., Inc. - Executive VP of Global Services & CFO

It varies. It varies. I don't want to give specifics on how we get into the negotiations with the government.

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Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Other questions from the audience? Yes?

Unidentified Analyst

Can I ask about the -- how you look at the KEYTRUDA kind of situation going out? Or you're already in any type of ideas about how you're supposed to extend that?

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Planning for the KEYTRUDA patent expiration.

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. So obviously, we're very focused on it. I would say we have some time. It's 2028, but we are already very focused on it, both in terms of how do we think about augmenting our pipeline through all the things we've talked about with business development, with our internal pipeline as well as looking at KEYTRUDA itself and continuing to look for where is the best way we can improve that asset to help the most patients.

It's interesting, if you look at KEYTRUDA, as important and game-changing as that asset is in the oncology space, there still is only a minority of patients that still ultimately benefit.

So the opportunity to broaden the patient population through continuing to look at combination studies, continuing to look at other learnings that KEYTRUDA gives us, we're pursuing all of those. We believe if we can do that, and we bring real value by broadening the population, it might also bring with it the opportunity to revisit how you think about the lifespan of the product as well. But our focus, first and foremost, is about can we find that unmet need? And that's how we're pursuing it.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Other questions? Yes?

Unidentified Analyst

The market doesn't give you much credit for gefapixant. Why do you think that is? And how does that change?

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Question on gefapixant, and analysts don't give it much credit.

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. Well, anytime you're moving into a new space where it's -- there's -- you're establishing new ground, I think it's hard for people to model because they're trying to understand the potential.



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I will tell you, we continue to be very bullish on what gefapixant can be in the marketplace. Actually, we have 2 Phase III studies underway, as you know, right now. One of those Phase III studies will read out in this year. So you will get a sense of some of the data around that product.

I can tell you that enrollment into our studies continues to go very well, and that gives us a lot of confidence. The speed with which we were able to bring patients in tells you there's an unmet need. It's maybe not an unmet need that's fully appreciated or understood, but you're actually seeing it through the way the study is evolving, which gives us a lot of confidence. So more to come. And I do believe as people get a better sense of that opportunity, they will become more bullish on it over time.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

And the indication for this Phase III study coming this year?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

It's (inaudible).

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

(inaudible) Okay. Are there any other questions? Yes?

Unidentified Analyst

Can you clarify the comment on the margin expansion going forward?

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Clarify comments on margin expansion.

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. So if you look at where we are as a company with the spin-off of NewCo, in the first year that we effectuate that change, you are going to see a slight decrease, about 1 percentage point in our operating margin. And that's because if you look at the assets we're pulling out of the company, we said they carry revenue between \$6 billion and \$6.5 billion. And within Merck, they had an operating margin of about 45%. So obviously, higher than Merck's margin, and there is some initial negative impact.

That is partially offset by the fact in the first year, we are going to achieve the \$500 million -- the first \$500 million of operation efficiencies in Merck of the \$1.5 billion we committed to over 3 years. So net-net, if you net the benefit of the operating efficiencies, less the dis-synergy of the lost margin of those assets, it's about 1 point in the first year. After that, as you look forward, as you get into year 2, and we achieved the second \$500 million of operating efficiencies, so now, cumulatively, \$1 billion, it actually swings to be margin accretive versus if we had not done the transaction at all.



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And as you go forward then into year 3, when you get the third \$500 million, you're now at \$1.5 billion, it becomes even more meaningfully margin accretive than what we would have otherwise had. And all of that is moving us on a pace with the natural mix of our business showing margin growth with that \$1.5 billion layered on top of it is why we said we would be north of 40% by the time you get into 2024 and with a margin higher than we otherwise would have achieved if we had not done the separation because we believe the separation allows us to go after operating efficiencies that we couldn't have done otherwise.

Unidentified Analyst

So is the accretion coming from the second year from the [1%] decline? Or from the margins as they are today?

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

The question was to detail the accretion in the second year.

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. So in the second year, when I say we will be higher, actually, it'll be higher than what we otherwise would have had if we had not done the transaction. So we're growing, and we're growing to a rate higher within 24 months than what we would have had if we had not done the transaction. And then that just continues to grow further after that.

Stephen Michael Scala - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So we are out of time. I want to thank both Rob and Peter, for a very interesting discussion. Thank you very much.

Robert M. Davis - *Merck & Co., Inc. - Executive VP of Global Services & CFO*

Yes. Thank you for having us. Appreciate it. Thank you, everyone.

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