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MRK - Merck & Co Inc at Goldman Sachs Healthcare CEOs Unscripted: A View from the Top Conference

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PRESENTATION

Jami Rubin - *Goldman Sachs - Analyst*

So I am very delighted to introduce Ken Frazier, CEO, Chairman of Merck and a very, very dear old friend of mine, so I am very, very happy to have you here.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

It's great to be here, Jami.

Jami Rubin - *Goldman Sachs - Analyst*

Happy New Year and all that and thanks to Terry and Justin. So, Ken, I think the last time you were here, it was three or four years ago and what did we talk about? We talked about Tredaptive, the HER2 drug trial, which had just failed. We talked about odanacatib, which was going to be your next big blockbuster. We talked about suvorexant, which just -- just finally got approved and a big part of the narrative was assuring cloud synergy. So it's amazing that just in the last 3 or 4 years how much the Merck story has changed. And I guess that's what, I think, makes this industry so exciting is that these companies are always changing and Merck has certainly changed dramatically since that time.

As you look at the new year, Ken, what do you see as the big opportunities, the big challenges? What keeps you up at night? What are you thinking about?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

So again, thanks for having me and I thank all of you for your interest in being here this morning. I think this is a really exciting time, as we were saying before we got on stage, inside Merck. This is a business that's ultimately based on scientific leadership and how much you can translate that scientific leadership into products that make a difference to people in the world and healthcare systems. And we are on the verge of making some really important contributions.

I will start with the work that's happening in immuno-oncology and I think we are just scratching the surface with what clearly can be a foundational agent with Keytruda. I am extremely pleased with the execution that happened inside the Company over the past two years that allowed us to be on the market already for melanoma, already on the market for second line lung. I think it really shows what happens when people go united around a goal. I think most people would have not expected Merck to have been here.

Jami Rubin - *Goldman Sachs - Analyst*

And for the record, it wasn't even discussed three years ago.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

That's exactly right. And so that's a huge opportunity. I know we are going to have a chance to talk about that later. Our PDUFA date is coming up for our HCV doublet. We are extremely excited. That's a huge, obviously -- huge therapeutic category with huge economics associated with it. More importantly, [300] million people in the world that have HCV virus and 3 million here in the United States, so it's a huge unmet medical need and it's not every day that you have an opportunity to participate with a very competitive regimen in that market.

I'm also excited by the senior team that we've put together at Merck. It took a while to get the right people, people like Roger Perlmutter, Rob Davis have now come to join Adam Schechter and others, and I think what that has really allowed us to do is focus on bringing forward these medically important innovations while at the same time running the Company and changing the culture of the Company so that people are focused on execution; they are focused on the bottom line and fiscal discipline and all of those kinds of things. So it's an exciting time to be inside Merck right now and I think we are on the verge of doing some really great things.

Jami Rubin - *Goldman Sachs - Analyst*

And what are the biggest challenges that you face this year?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I think the biggest challenges that we face continue to be the ones that are external to Merck and external to the industry. A lot of it is the political dialogue around pricing, the pressures that we have. There's some legitimate issues around pricing having to do with consolidation of payors and competition in the marketplace. I'm not really talking about that so much as the headline risk to the industry associated with the fact that we are in the middle of a political season, a presidential season, and people are really now focusing on drug pricing in a way that ignores the value of drugs and actually looks at a few outliers and tries to use those to exemplify an industry, as you just said a few minutes ago, that's doing a lot of good for a lot of people.

Jami Rubin - *Goldman Sachs - Analyst*

Well, we are going to talk about that in a second too, but, Ken, your share price has underperformed your peer group every year for the past several years. I am sure you are abundantly aware of that. Just from a high-level perspective, what is the market missing and what are you doing as the CEO to bridge that valuation gap?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I would say that the number one thing that impacted our stock price last year, as you saw, in about a four or five day period was the [infrared] study.

Jami Rubin - *Goldman Sachs - Analyst*

Right, right.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

And so we are now four months removed from that, and we continue to see no impact on Januvia whatsoever. And it's really important --

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Jami Rubin - *Goldman Sachs - Analyst*

But that's because Jardiance doesn't yet have the updated label.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, that's true, but it's not clear what will happen in terms of an updated label. It's not clear what will happen in terms of guidelines. So the fact of the matter is that's a true statement.

Jami Rubin - *Goldman Sachs - Analyst*

Right.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

We don't know one way or the other what an updated label might look like.

Jami Rubin - *Goldman Sachs - Analyst*

What do you think it's going to look like?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I'm not going to speculate about what the FDA is going to do. I think it is one study. It was not a highly powered study and I think FDA tends to want to think very carefully about whether they get confirmatory outcomes that suggest that this is something that's actually something that physicians ought to think about as a regular part of prescribing, so -- but my point is today you are asking what people are missing. I think people are predicting the demise of this Januvia franchise. We continue to be extremely pleased with the volume growth that we see in the US. As you probably know, half of our sales are outside the US. We are growing even faster outside the United States.

So the first thing I would say is I think people are prematurely deciding that Januvia is in some significant way going to be hindered going into the future. I think the second thing goes back to what I was just saying. I think, for example, in the immuno-oncology field, I don't think people have really gotten their heads around how really big this field could possibly be with additional tumor types. We are studying it in more than 30 tumor types. We have more than 20 registration-worthy studies in 10 tumors going on right now. This could be a very, very big field and I think that Keytruda has already shown in the data that's put out there that it could very well be a foundational element for a lot of different tumor types. I think people are not, again, focusing on how big the HCV field really could be for us and then we have things in our pipeline that are really getting almost no value.

Jami Rubin - *Goldman Sachs - Analyst*

Like?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

(inaudible), for example. If you look at some other competitors, I think people are looking at those macromolecules and saying we ascribe value to the macromolecule. I think we've got really strong human genetics data validating [basis] of mechanism and for whatever reason, that hasn't happened yet. Part of that frankly is the way Merck approaches science and we haven't in any way campaigned for (inaudible) in a way that I think some people might think we ought to do.

But I think those are the things that people are missing and the other thing I think what people don't see and I understand why they don't see it, but it is something that I see and you and I had this conversation when I first became CEO, Jami, is Merck has a real history of scientific leadership. And I think in the long term in all of these companies the success of the companies comes down to the pipelines. And the pipelines in turn have to do with whether or not you can do external science and you can invent internally on a basis where you do better than the average person and that in turn will require that you have the scientific leadership.

One of the first challenges that I had was to make sure that we put in place the kind of scientific leadership that we needed inside Merck and I think we've been able to move in that direction and I think when you said certain things weren't on the radar screen two or three years ago, that's true, but we didn't have the same leadership in place two or three years ago. And that's the part that makes me very excited as a CEO.

Jami Rubin - *Goldman Sachs - Analyst*

The Company has been quiet on the M&A front last year following two bolt-on acquisitions in 2014. You've done the gamut from large transformative deals in the past with Schering-Plough to smaller bolt-on deals. What should we expect from you this year?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I would just say, first of all, we are not at all satisfied with our current complement of assets in our pipeline. So I am very eager to look for opportunities to augment our pipeline. If you haven't seen a lot going on in terms of large deals in the last year, that's just a function of the opportunity set that we have in front of us. Actually, we did more deals last year than we've done in any year that I can remember (multiple speakers). They are not large deals, but again I see that as a function of the opportunity set that's available at a particular point in time.

I would like to do bolt-on acquisitions that actually position us proactively in attractive areas of medicine and we continue to look for those opportunities. By the way, of course, everybody else continues to look for those opportunities and if they are late-stage type compounds, they are highly competitive and so we continue to think that there are opportunities out there, but that goes back to the scientific leadership. Finding those opportunities, particularly earlier on, requires the discernment that I think that we have in place now under Roger Perlmutter's leadership. I am much more confident in the choices that we're going to make. But if I could leave with any message is that we are raring to go with respect to business development.

Jami Rubin - *Goldman Sachs - Analyst*

Can I then infer that you have some more confidence to maybe take on more risk, find earlier stage assets where there is still risk involved? At one time, after Gilead bought Pharmasset, most of the drug industry laughed at that deal. Turns out it was one of the best deals ever done in this industry and I would argue it's because our companies, the large-cap pharma companies, have been to risk-averse. Are you changing your views on risk aversion?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Yes, and I think we have to.

Jami Rubin - *Goldman Sachs - Analyst*

Why, and what gives you more confidence now?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

First of all, when you have a company our size, there's no way we can invent enough stuff to grow a company Merck's size. And this business is always ultimately about risk and historically, if you have followed Merck, about 50% of our sales have always been from externally sourced science. And Merck has always been reasonably good at picking the early things. Januvia is an example of that. I was General Counsel when Ed Scolnick ran in my office and told me I had to get on an airplane and go license some German drug company, this thing called DPP-4. I was like what is that. It turns out to be an important thing for Merck.

So, yes, I am willing to take more risk. There is not always a Pharmasset deal sitting out there with that kind of data in Phase 2 that is -- that that example shows, but we are willing to take more risk and I have confidence in the scientific leadership. I'm willing to write the checks because I have tremendous confidence (multiple speakers).

Jami Rubin - *Goldman Sachs - Analyst*

So that's a change from the last couple years.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

It is. I said it a few minutes ago. Ultimately, in this business, the companies that are successful are successful because they have in place the right scientific leadership. It is a business about making bets, just like your business is. Picking stocks is about making bets. So if you are going to be successful in your business, you have to be right more than the average person is right. Well, how do you get right more than the average -- you just have to have the right people making those judgments. And you asked me what I think people miss about today's Merck and it is that I am completely confident in the leadership that is now in the research labs.

Jami Rubin - *Goldman Sachs - Analyst*

But now you've got to prove that leadership through the kinds of deals that you do.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I think that's right and the kind of execution that we are able to do with our internal assets like Keytruda.

Jami Rubin - *Goldman Sachs - Analyst*

How are you thinking about the shape of your portfolio? Does it make sense to keep -- and every year I ask you this -- but does it make sense to keep the animal health business, and is there a way to lengthen or create a special business unit for your mature brands to eventually spin or sell much like Pfizer has done?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

So we constantly ask ourselves the question of what's the optimal portfolio for a company like Merck, and you have seen us take certain assets and sell them off like consumer. And you've seen us sell off certain therapeutic areas because we didn't think they fit. But we are going to constantly challenge ourselves around what's the optimal constellation of assets that we have. As it relates specifically to animal health, we actually think animal health can actually continue to be a growth driver. We see it as a global business with a very strong global platform. It's growing very well. It's contributing to Merck's overall growth. It's highly innovative.

We've said publicly that, unlike consumer, this is an area where we think that we can invest in as some of our competitors have and get a real good return on invested capital in terms of our animal health business, so really good business. The diversified brands area is something that we constantly look at. There's two sides to that. Obviously, there's some people in the industry who say spinning that off will allow you to have more of a growth company over here and more of a profit company over here. I understand that in theory. In reality, when you are running a company that has as much going on in the pipeline as we do and as much as we are spending on clinical development, etc., it's nice to have some really steady profitable drugs that actually support that. It's also pretty complex surgery to pull out all those plants, etc.

So I'm not saying we won't do it; I'm saying it's a nontrivial exercise. It's the kind of thing that I have to say, on a spreadsheet, makes a lot of sense. In a living, breathing organization, pulling it out and I think that's why sometimes you hear people say we will let you know down the line because it is a nontrivial exercise, as I said.

Jami Rubin - *Goldman Sachs - Analyst*

Right, right. Just back on the animal health business, do you think your shareholders are getting credit for your animal health business? Your stock trades at about a 15, 16 multiple. Zoetis trades at a 26 multiple and I would agree (multiple speakers).

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I think that's also true of Keytruda. If I spin out Keytruda, it would be worth a lot more than the rest of Merck too, Jami. The reality of the world is what we have to do and what we are in the process of doing is focusing on the multiple associated with our human health pharmaceutical business, and I think we are making progress. I'm very excited by the opportunities that we have in 2016. I think we are underestimated. You talk about -- we'll talk about HCV in a few minutes. That's a huge opportunity. How many times do you get to participate in a $20 billion market? And we believe we have a competitive regimen.

A few years ago, I think you probably remember the debate about Victrelis. People thought that that was a drug that wasn't going to be successful. Well, the reality of the world is given an opportunity, Merck is able to succeed in that area. We have a lot of history. With Victrelis, we won in every segment. We won in every geography and I think you probably remember people were saying, well, that might get 10% marketshare at most.

Jami Rubin - *Goldman Sachs - Analyst*

It got more, but then it went away pretty quickly.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well -- but I'm just talking about the fact that I think people underestimated Merck's ability to function in that market and I think we have a competitive drug with respect to HARVONI now.

Jami Rubin - *Goldman Sachs - Analyst*

All right. We're going to talk about the hep C space, but let's talk about Keytruda. Obviously, that's probably the most exciting asset -- the most exciting story at Merck. And you have also said that we are just at the tip of the iceberg, only scratching the surface. You tell me, how big do you think this market is going to be?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I'm not going to project anything because I think you guys are just as good at doing that as us, but if you just look at the fact that we are studying it now for 30 tumor types and the data that we have has shown really robust durable response across many tumor types as monotherapy. I think this drug has really huge upside for a company like Merck and what I am really pleased about, and sometimes I read the commentary and the commentary tends to look at the negative side, the glass-half empty side. They will say things like, well, you know you have a biomarker-oriented strategy that limits the population at the beginning.

The reality of the world is, and other people have different strategies, but we are there now because we took that monotherapy-focused biomarker strategy. We are on the market for second-line lung. We are the leader in melanoma across all classes and I'm extremely, extremely excited by what I see coming in the future with respect to our ability to move into earlier lines of therapy with respect to lung. This KEYNOTE-010 study, which showed overall survival benefits versus docetaxel. I think as you look forward, I see opportunities in other tumor types.

Without putting a number on it, I think having looked at your most recent report, I think most people think it's the most exciting area of medicine going forward. And I like the fact that we were able to leapfrog some of the competitors and get to market. In fact, we got to market first. I don't think anybody saw that coming and I think the folks that did that have other plans up their sleeves and I am very excited by what can happen there.

Jami Rubin - *Goldman Sachs - Analyst*

When you look at the marketplace for PD-1 drugs and PDL-1 drugs, there are a dime a dozen. There are multiple PD-1 drugs in development and you are first on the market, so --.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

There are two on the market now and I think some of the people who are behind us are starting to acknowledge that they don't necessarily have the same quick pathway to the market that --.

Jami Rubin - *Goldman Sachs - Analyst*

Right.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

So it's an important fact that we are able to get there because I think, for the foreseeable future, there are going to be two competitors in that market. We will see if the PDL-1 drugs are really equivalent to the PD-1 drugs. That still remains to be seen.

Jami Rubin - *Goldman Sachs - Analyst*

But there are a number of people who believe that the way to differentiate yourself in this marketplace is through combinations and Merck's strategy has been mostly focused on monotherapy, although you have something like 80 external partnerships or collaborations with outside companies and assets. How is your strategy different from your peer group and is that the right way to think about this that PD-1 drugs, it's becoming a very crowded market. How do you stay at the forefront of this market? How do you stay a leader while there are so many PD-1 drugs in development?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I'm not Roger Perlmutter, but I will repeat something that he says all the time. It comes down to the breadth of the tumors that you work gone and the depth of the data within those tumors, and being in front gives us an opportunity to build that wall of data in those relevant tumor

types. Again, we continue to see monotherapy as having striking benefits for patients. For many, many patients, the optimal therapy from a benefit/risk standpoint is monotherapy. So we have been very focused on demonstrating the value of monotherapy.

When you start talking about combinations, let's take a step back and again, I read a lot of stuff about this and I am just astounded by the conclusions that people are able to reach. So the first question is going to be how many patients are optimally treated on monotherapy. So you are going to have to have some way of assessing and stratifying who needs something more than monotherapy, especially given the costs associated with these combinations.

Then the next question is how often, how many combinations provide either additive benefit or synergistic benefit over and above those monotherapies and then what specific agents? Are they traditional agents, are they other checkpoint inhibitors, are they other targeted agents, are they vaccines? There are so many potential combinations that are out there that I think the approach that Merck is taking is, early on, try to investigate as many potential combinations as you possibly can because it doesn't cost you a lot to investigate them early on. And then you can hone in later on on the question of which ones actually look like they have a substantial benefit for a substantial percentage of patients.

I think it's frankly guesswork now to try to decide which of those many, many hundreds of combinations are actually going to be significantly more valuable than monotherapy and I come back to the point it's important to recognize how incredibly beneficial monotherapy is with these patients.

Jami Rubin - *Goldman Sachs - Analyst*

Can you describe your experience with Keytruda in lung cancer, what the competitive dynamic has been? You received an approval before Bristol-Myers in non-squamous and squamous lung cancer. What -- but in a more restricted patient population -- what has been the commercial hurdles with your label, if at all? And what has been the dynamic with Opdivo on the market that has a broader all-comers label?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

So in second line, to be honest, we have taken on the responsibility and the challenge of getting physicians to do the biomarker test as a prerequisite to taking our drug. That's what you meant by saying have a limited patient population.

Jami Rubin - *Goldman Sachs - Analyst*

Right.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

We had to take that challenge on. We are having to get physicians comfortable with it. There are people who are already comfortable with it, but it's a challenge. There is no two ways about it. The all-comers strategy is an easier sell in the first instance. But, again, look at the cost of these drugs, particularly in places like Europe. People are going to want to figure out which patients are most likely going to benefit from these drugs. I think if you look over the long arc -- and I don't think it's that long of an arc -- you are going to see that testing is going to become more and more common, particularly as you move into earlier lines of therapy.

So I think the biomarker in this strategy was the right one for us because, first of all -- I'm going to say it again -- we are there. There are other people that you are going to talk about in a few minutes. You say they are a dime a dozen. You might talk about Roche and you might talk about AstraZeneca, but we are on the market. So it got us there and as we move forward into these earlier lines of therapy and as people begin to wrestle with the cost of these drugs, I think the world is going to move to needing to have some kind of way of deciding which patients are eligible for which drugs at which point in their disease. So right now, what looks like a disadvantage in the short run, I think in the long run becomes something that is very beneficial to us, as well as the healthcare system.

Jami Rubin - *Goldman Sachs - Analyst*

Do you expect that the results from KEYNOTE-010 to significantly help or inflect your revenues in this space going forward?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I think it's extremely helpful to have that kind of demonstrable advantage when it comes to overall survival, and again, what you see is, as I said a few minutes ago, how powerful Keytruda monotherapy is for a very large subset of patients.

Jami Rubin - *Goldman Sachs - Analyst*

Do you think that data set makes it harder for say Roche and AstraZeneca to get their products on the market with response rate data?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

So I have to say that I think that you've heard them say things to that effect, so I don't have an opinion about that. I wish I was someone who has more depth of knowledge. My sense of it is that this is a situation where getting there first and having a substantial amount of data in relevant tumor types in patient populations is a huge advantage because the FDA is not going to give everybody accelerated review.

Jami Rubin - *Goldman Sachs - Analyst*

Right, right. When you look at that whole space, your immediate competitors, Bristol-Myers and Roche, have had a lot more oncology experience than Merck has. It's just a fact. As you've launched Keytruda in melanoma and lung, how have you overcome the perception issues from a commercial standpoint?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, I think it's an interesting question. So first of all, I have to concede that Merck was not a powerhouse in oncology. We had Temodar, we had Emend, but we are not a powerhouse. I think that the past experience is relevant, but there are a couple of things that I think we should keep in mind. First of all, let's look at Januvia. Merck had nothing in diabetes before Januvia. There are certain things that the drug had to do for itself and physicians want to prescribe the best drug for their patients and if you come forward with a drug with a very strong value proposition therapeutically and economically, that's very helpful.

Secondly, we were able to put together a business unit very quickly and that business unit is composed of a substantial number of people who came to us with the experience that those other companies have because they saw Keytruda. They wanted to work on Keytruda. So that experience that you talk about is portable. We have been able to hire people at very high levels in our oncology business unit who came to us from those companies because they saw Keytruda as a once in a lifetime opportunity.

By the way, bottom line, the first therapeutic area, which was melanoma with no experience, we are the number one agent across all competition. So it shows that you can win if you have a good agent and you have the right people in the right place.

Jami Rubin - *Goldman Sachs - Analyst*

You have been criticized for not pursuing internal combinations as aggressively as your peers, and that I think is a function of what you already have internally. You are not a big oncology powerhouse, so you've looked outside and done partnerships with external partners. But just take [IDO], for example. You don't earn an internal IDO asset, I don't believe, but you do have a partnership with Incyte, which is pretty far along. Both Bristol

and Roche have their own IDOs in-house. By not owning an IDO, does that put you at a commercial disadvantage and when you talk about wanting to pursue M&A, bolt-on acquisitions, are you thinking about acquiring those kinds of assets to have them in-house?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Absolutely. We are thinking about acquiring them. But again, you have to decide which ones make sense to own. So just saying I have two assets doesn't mean that I have a combination that in the marketplace is going to win. So for example, are they both injectable? Are they both synchronized in terms of their administration? Those are the kinds of things you have to think about. Just saying I have an oral drug over here and an injectable over here, that doesn't necessarily confer commercial advantage. So what we are trying to do is work with the market leader, Incyte, to try to evaluate what benefit we could demonstrate that that combination has on top of again a very strong monotherapy.

It's a nontrivial exercise to assign value to both parts of the combination too and I think right now people who own them, they say, well, we own the combination and that sounds really good and if it bears out and you get the right kind of injectable synchronized thing, that's an advantage. But I think there's so much to be learned about this area that it's really premature to start saying, oh, well, these guys have an advantage because they had that.

A few years ago, everybody said, for example, that the fact that we didn't have the earlier checkpoint inhibitor would be a problem for us in melanoma. We took the monotherapy approach. It turns out that's a pretty good approach.

Jami Rubin - *Goldman Sachs - Analyst*

So let me just ask you one last question on Keytruda. What are we going to learn this year?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, we're going to learn a lot. So we have additional tumor types that we intend to bring forward like gastric and head and neck. In the middle of the year, we are going to get first-line data as it relates to lung. I think that's an important -- (multiple speakers).

Jami Rubin - *Goldman Sachs - Analyst*

When during the year?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I would say mid-year, June. I would say that. We continue to get some of our earlier compounds like GITR. We will see data on some of those things. We will continue to see the continued progress that we have in melanoma with the new label and in lung as we move into earlier lines of therapy. So I think it's an exciting time to be in this field. And again, I will say what I said before, which is I think Merck has not gotten a lot of credit for execution and I think if you look at where we were in this field three years ago, two and a half years ago, and you look at where we are now, I think it shows that we have the right leadership in place; and the Company is really united around a few focused areas and to me, that's critical.

Jami Rubin - *Goldman Sachs - Analyst*

Before we move on, I just want to make sure, are there any questions from the audience? Okay. You are obviously brimming with excitement over your doublet hep C product. So Ken, this is something that you will soon be launching to the genotype 1 patient population. Why are you so excited? I think the market's view is that it's a zero-sum game. I think the debates now are around pricing and the size of the tail of the business. How do you plan to compete in an already fairly entrenched marketplace?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, as I said a few minutes earlier, it's not every day you get into a marketplace this large. And we think there's room for multiple entrants in this market. We think we have a compound that you talked about genotype 1, which is the predominant genotype in the US. We believe we can go head to head with HARVONI. And we have a history of success in this area. We know this area. We believe that with the PDUFA date coming up soon that we are going to be able to get into that field with again a highly competitive drug on the merits. And I won't talk about all of our go-to-market and pricing strategy today because I'm sure our competitors would love to know exactly how we intend to come to market, but let me just say that my organization is raring to go in that area.

It's no secret that, over the past few years, Merck has been very focused, for example, on the cost side of the ledger. We just took $2.5 billion out over and above the synergies that came out of the SP merger. It's time for us to launch drugs. It's our time now. And I think this is a big drug and a big field. It's a field we know. It's a field that we have great confidence in and Gilead is a very fine company with very fine medicine, has made a big difference; but we think we can compete.

Jami Rubin - *Goldman Sachs - Analyst*

Given that you have a next-generation drug in development with the new (inaudible) you just acquired --

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Right, from Idenix.

Jami Rubin - *Goldman Sachs - Analyst*

From Idenix, right, does that -- preserving the value of that, does that have any bearing on how you think about pricing for the doublet that will be launched?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, again, I am not going to get into our pricing strategy right now. I just think that that triplet is a very valuable asset as we move into the future and think about being able to deal pan-genotypically, shorter durations --

Jami Rubin - *Goldman Sachs - Analyst*

How do you expect to differentiate because the data we've seen from Gilead and AbbVie for their next-generation pan- genotypic pill looks similar? So what would you hope to show in your triple combination that will differentiate?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, we will have to see how the data turns out. I do think this is a big field and there's room for multiple entrants.

Jami Rubin - *Goldman Sachs - Analyst*

Okay, good. Let's talk about Merck's commitment to Alzheimer's because, as you said, you've gotten no credit for your base inhibitor. I would agree. Talk about the Company's commitment to the base inhibitor and why you think you are ahead of Lilly, AstraZeneca, Biogen, (inaudible). Why is the

market not giving you credit? How do you think about the risk profile of that asset? How important is Alzheimer's to Merck's future strategy going forward? I mean Lilly just had a three-hour analyst meeting on Alzheimer's and you guys rarely even bring it up.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Right. So again, your question is why is the market sentiment different for Merck and I'm not always in a position to answer that question. Let me just say that we are committed to Alzheimer's. We believe that the base compound has pretty strong foundational human genetics data behind it. We are excited that we have the study underway. It's why we went directly from Phase 1 to Phase 3, which is unusual for a company like Merck. We thought the human genetics data was very compelling.

As Roger Perlmutter has said, he tends to be data-driven and he wants to see the data. But we do have a reason to believe that this is a medicine that could actually make a huge difference in this population and we are very excited. Early next year, I guess it's July of next year, is when this study is supposed to read out -- July of 2017, if it doesn't stop anytime earlier. We have no reason to believe it will. The fact of the matter is we will see whether or not in this mild to moderate population we do have the effect on cognition that we have. We know from human genetics data that people who have this base inclination do not develop Alzheimer's and that's a positive thing. Of course, before that, we had the prodromal study -- earlier in the disease -- it will be later in reading out. We also have the prodromal study. So we are very committed to that.

We also, as you look at our pipeline, we also have another Phase 2 compound in Alzheimer's and so I would say we have a deep program both in disease-modifying agents and symptomatic agents behind that. So we are very committed to Alzheimer's.

Jami Rubin - *Goldman Sachs - Analyst*

Just sort of a P&L-related question, can Merck's operating margins meaningfully improve over the next several years with so many legacy products and upcoming patent expirations? Zetia, Vytorin, for example. Is there room for another major restructuring program? How should we think about operating margins going forward?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, on the plus side, when you have drugs like Keytruda and an HCV drug, that helps a lot with operating margins.

Jami Rubin - *Goldman Sachs - Analyst*

Right, right, right.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

On the other side, when you have drugs going off like Zetia and Vytorin, fortunately those were not huge growth drivers for us, but they were very profitable drugs. That's the other side of the equation.

I think as I think about operating margin and I hope you have seen my management team has been very focused on operating margins. There's been frankly a 20% increase in our operating margins since I've been CEO. Most people don't point that out. We went from 29% to 35%. That doesn't happen without (multiple speakers).

Jami Rubin - *Goldman Sachs - Analyst*

I will put that in my next note.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, but it doesn't happen without a team that's laser-focused on the bottom line in a period where we didn't have new drugs coming to market. So I am very confident in that. You know we just announced that we have gotten more than $2.5 billion of additional cost reductions out of this Company. Again, post-SP synergies, merger synergies and then we took out another $2.5 billion.

Now as I look at the future, I think the most important thing to understand is that the culture of the Company has changed around continuous productivity and people think about using scarce assets and allocating those scarce assets to where you have the greatest opportunities for growth. So I think going forward we will have this continuous productivity. We may have restructurings as a part of that continuous productivity. I wouldn't sit here today and say we are likely to announce another $2.5 billion like we did a couple years ago, but we could do more restructurings along the line to ensure that we do reach the continuous productivity.

Jami Rubin - *Goldman Sachs - Analyst*

We only have a couple more minutes, but as head of the PRMA, Ken, it surprises me that we are sitting here in a very defensive position like we were 20 years ago with respect to drug pricing given just the significant innovation that we've seen the industry bring to the marketplace. Yet the industry is still finding itself on the defensive. What can the industry -- what should the industry be doing? Isn't there a better way that the industry could be defending its drug pricing practices? And I guess the more important question is where might the industry be vulnerable? It's not just about Turing. It's not just about Valiant. Drug pricing is every other day in the Wall Street Journal or the New York Times there's an article about the high cost of drugs. As head of PRMA, how do you see the pricing debate playing out and how is it going to impact companies like Merck? In one minute, can you answer that question?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

This is deja vu all over again because I joined the industry working for [Roy Bajalos] in 1992 during the so-called (inaudible) period. And it's exactly the same arguments that were being made.

Jami Rubin - *Goldman Sachs - Analyst*

Yes, and think about how much progress has been made since --

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I agree with that.

Jami Rubin - *Goldman Sachs - Analyst*

-- and we are still having the same conversation.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I think there are two main areas of vulnerability for the industry. Number one is I think there isn't as much transparency to the public of the difference between list price and the actual prices that people pay and I spend a lot of time going around trying to get people to understand the difference between -- you don't pay the list price for your car, you don't pay the list price for your drugs. So that's one of the issues that we have. Another and very significant issue is the way in which our insurance system is structured. So you probably know that if you have most insurance plans, you pay

above 20% of your drug cost in terms of your co-insurance and co-pay compared to something like 6% for inpatient care, something like 8% for outpatient care.

Jami Rubin - *Goldman Sachs - Analyst*

That's a lot of money.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

I think benefit design is a big problem and I think people don't realize that the cost to consumers is different because there is, in effect, discrimination against pharmaceuticals and benefit design. So I think those are the two big areas of vulnerability. I think the industry --.

Jami Rubin - *Goldman Sachs - Analyst*

How do they get resolved?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Well, first of all, I believe that people will continue to pay for valuable drugs going forward and I believe that, in Washington, people are smart enough to know that this is one of the few US-based industries that's a global leader. So I am hoping that we won't see any kind of draconian policy.

Jami Rubin - *Goldman Sachs - Analyst*

Do you have confidence though that the people in Washington understand that?

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Yes, I do. I do. I think that we are vulnerable because citizens can't pay for their drugs. It's a real issue. It is not a hypothetical issue. When people go to the counter and they have this 20% of their drug bill as a co-pay and they have to pay $5000 to $10,000 before their insurance kicks in, that's a problem. And we've got to deal with that as a country and we've got to deal with that as an industry.

Jami Rubin - *Goldman Sachs - Analyst*

On that note, thank you very much, Ken.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Thank you, Jami. It's always a pleasure.

Jami Rubin - *Goldman Sachs - Analyst*

Happy New Year.

Ken Frazier - *Merck & Co., Inc. - Chairman & CEO*

Happy New Year to you too.