

## Bayer

Price EUR95.41

## Has leverage been overestimated?

Fair Value EUR113 vs. EUR126 (+18%)

NEUTRAL

Bloomberg	BAY GY
Reuters	BAYG.F
12-month High / Low (EUR)	146.2 / 92.8
Market Cap (EUR)	78,899
Ev (BG Estimates) (EUR)	93,402
Avg. 6m daily volume (000)	2,404
3y EPS CAGR	7.1%

With a 6-6.5% CAGR for core EPS over 2015-2020, Bayer appears to stand out less from peers than we thought in terms of PEG ratio. As a consequence, and despite the recent share price correction, we do not see Bayer as a must-have in our universe. We are therefore maintaining our Neutral recommendation.

## ANALYSIS

- Following the FY earnings release and conference call, we have the impression that leverage on operating profitability from top-line growth could be more limited than initially thought even though some elements in Q4 2015 and 2016 are not recurring. Obviously, the influence of FX, including adjustments for currency devaluations (notably for the Brazilian and Argentinian currencies), on EBITDA in Pharmaceuticals and in Crop Science was significant. Equally clear, Bayer acknowledged that revenue synergies from the integration of Merck's business did not materialise as quickly as hoped for in Consumer Care due to under-investment in the brands in the months before the transfer and because of tough market conditions in emerging markets. That said, it is also fair to say that Bayer needs to keep investing in sales and marketing expenses as well as in R&D costs in order to support continuous growth trends and this may limit EBITDA margin expansion, as illustrated by 2016 guidance calling for a near-100bp increase in LifeSciences and which could be reduced further to c. 50bp once Covestro is included.
- Product-wise, the mix effect should improve again in 2016 and beyond, while no update was made to guidance to exceed EUR7.5bn at peak with the "BIG 5" except to say that they should be in excess of EUR5bn in 2016, in line with our estimate of EUR5.2bn. Xarelto will remain a key driver but Bayer mentioned that Eylea and Xofigo are also expected to grow c.20% and c.50% respectively, very much in line with our expectations (BG: +24% and +50% respectively). Xarelto is a clear margin enhancer but its impact is partially offset by high-margin product declines (Yaz, Betaferon).

## VALUATION

- In all, we expect the 50bp group core EBITDA margin improvement on slight top-line growth to translate into limited reported core EPS growth after factoring in a negative financial result of EUR1.2bn. We have cut our core EPS estimate by 4% on average over the 2016-2018 period, with the biggest impact on 2016. We have reintroduced Covestro into the sequence to make our estimates more easy to read when Bayer reports, but we still value it separately from the rest and on the basis of its share price.
- We have also adjusted our numbers to reflect capex assumptions (in fact EUR2.5bn includes EURO.5bn for Covestro, hence our previous estimate). In terms of tax rate, 24% actually means a slight increase vs 23.4% in 2015 unlike our first feeling. Lastly, net debt at the end of 2016 of below EUR16bn is disappointing and we assume this is somewhat cautious.
- As well as guidance, we thought we would have had an update on the Pharma EBITDA margin if only because radiology (which has a 50bp dilutive impact) is added, but Bayer stuck to previous expectations (32-34%) and delayed a potential update until a new MMM (yet to be fixed).
- Currently, Bayer's share is worth EUR108 for the LifeScience business and EUR5 for the 69% stake in Covestro. Hence our new FV of EUR113.
- In view of limited forthcoming newsflow in terms of R&D and with this weak year in terms of growth and despite theoretical upside to our FV, we are maintaining our NEUTRAL recommendation.

## NEXT CATALYSTS

- 26th April 2016: Q1 results

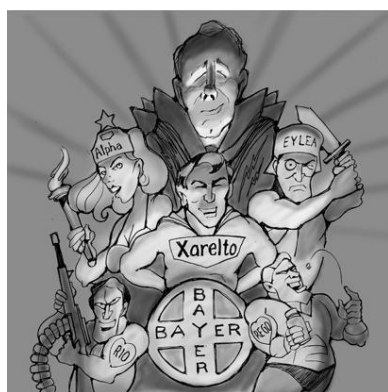
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	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.8%	-23.5%	-19.8%	-17.6%
Healthcare	-6.2%	-12.1%	-8.3%	-11.2%
DJ Stoxx 600	-2.9%	-14.3%	-8.4%	-10.7%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	46,325	46,414	48,200	49,821
% change		0.2%	3.8%	3.4%
EBITDA	10,267	10,527	11,169	11,772
EBIT	8,851	9,296	9,874	10,430
% change		5.0%	6.2%	5.6%
Net income	5,687	5,851	6,515	6,980
% change		2.9%	11.3%	7.1%

	2015	2016e	2017e	2018e
Operating margin	19.1	20.0	20.5	20.9
Net margin	12.3	12.6	13.5	14.0
ROE	25.6	22.9	23.0	22.0
ROCE	11.6	12.4	13.3	14.1
Gearing	71.0	51.4	35.0	20.1

(EUR)	2015	2016e	2017e	2018e
EPS	6.88	7.08	7.88	8.44
% change	-	2.9%	11.3%	7.1%
P/E	13.9x	13.5x	12.1x	11.3x
FCF yield (%)	5.5%	7.8%	8.3%	8.9%
Dividends (EUR)	2.50	2.60	2.70	2.80
Div yield (%)	2.6%	2.7%	2.8%	2.9%
EV/Sales	2.1x	2.0x	1.9x	1.7x
EV/EBITDA	9.4x	8.9x	8.1x	7.3x
EV/EBIT	11.0x	10.0x	9.1x	8.2x



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## Distribution of stock ratings

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SELL ratings 8.9%

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