

26th April 2016

Healthcare

Bayer

Price EUR109.70

Well ahead of its guidance after Q1 but no increase, poor cash-flow

Fair Value EUR110 (0%)

NEUTRAL

Bayer is reporting solid first-quarter earnings this morning, characterised by modest revenue performance overall but by an impressive margin improvement in all divisions, in line with what Covestro already disclosed yesterday for the Chemicals business. Now cash-flow generation was less impressive and despite a good performance in the first three months of the year, the group is not comfortable enough to change its guidance of mid-single digit earnings growth for the full-year.

Bloomberg	BAY GY
Reuters	BAYG.F
12-month High / Low (EUR)	138.4 / 92.8
Market Cap (EURm)	90,716
Ev (BG Estimates) (EURm)	105,153
Avg. 6m daily volume (000)	2 442
3y EPS CAGR	7.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	7.0%	3.7%	-5.8%	-5.3%
Healthcare	6.2%	-2.5%	-7.5%	-7.7%
DJ Stoxx 600	3.5%	3.1%	-8.1%	-5.2%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	46,325	46,611	48,605	50,211
% change		0.6%	4.3%	3.3%
EBITDA	10,267	10,606	11,305	11,905
EBIT	8,851	9,466	9,941	10,496
% change		6.9%	5.0%	5.6%
Net income	5,687	6,015	6,602	7,069
% change		5.8%	9.8%	7.1%

	2015	2016e	2017e	2018e
Operating margin	19.1	20.3	20.5	20.9
Net margin	12.3	12.9	13.6	14.1
ROE	25.6	23.5	23.2	22.2
ROCE	11.6	12.7	13.4	14.2
Gearing	71.0	51.0	34.3	19.2

(EUR)	2015	2016e	2017e	2018e
EPS	6.88	7.27	7.98	8.55
% change	-	5.8%	9.8%	7.1%
P/E	16.0x	15.1x	13.7x	12.8x
FCF yield (%)	4.8%	6.8%	7.3%	7.8%
Dividends (EUR)	2.50	2.60	2.70	2.80
Div yield (%)	2.3%	2.4%	2.5%	2.6%
EV/Sales	2.3x	2.3x	2.1x	1.9x
EV/EBITDA	10.6x	9.9x	9.0x	8.2x
EV/EBIT	12.3x	11.1x	10.2x	9.3x

ANALYSIS

- Q1 2016 was a good quarter for Bayer and numbers look very much like those of Covestro yesterday i.e. a touch light at the top-line level but very solid at the operating margin level and again mixed in terms of operating cash-flows with the same comment of “an increase in cash tied up in working capital”.
- On a division basis, Pharmaceuticals rose a solid 12.2%, driven by the expected Xarelto and Eylea although it is worth noting that first did not fully reflect the good performance registered by its partner J&S in the US in the first-quarter as underlying growth was 28.6% as reported by J&J whereas revenues booked for the US by Bayer are only EUR86m, up 9.9% in CER terms. There is a delay in the recognition of revenues and so there is reserve for the upcoming quarters. Eylea on the contrary remains on a very strong path with a 49% growth Q/Q to EUR372m. Less expected were the good performances of Kogenate, back to a more than decent growth rate of 13.7% although it seems to agglomerate initial Kovaltry sales that may also include some stocking effect and also Gadovist (up 20.2%) with strong growth in the US and in Japan where it has recently been launched. On a less positive tone were Xofigo, Adempas and Stivarga, all below expectations, including more particularly the last one which declined 5.3% in the quarter and more than ever looks in trouble to meet group’s peak sales guidance. Profitability-wise, Pharma division grew 190bp in the EBITDA margin during the quarter where we anticipated only 60bp improvement (and CS 10bp). Bayer is simply mentioning a “very good business performance” but sustainability of this level of profitability and/or growth is the key question for the year and next.
- Same took place in Consumer Health during the quarter as top-line growth was very modest (+2.2%) and below expectations. Bayer mentions tough conditions in Europe and Russia but also decline in the US. Against this unfavourable backdrop, earnings grew and EBITDA margin improved by 150bp, mainly boosted by cost synergies from the integration of the former Merck business.
- And bis repetita with CropScience with disappointing sales numbers, up only 1.2% in CER terms and down 2.2% in reported terms but a 300bp EBITDA margin improvement, this time explained by the joint effect of higher selling prices with lower cost of goods sold.
- All in all, this is a meaningful beat to the consensus numbers that was achieved in Q1 with EBITDA up 15.7% to EUR3.4bn (vs CS: EUR3.05bn, BG: EUR3.13bn) and core EPS up 13.9% to EUR2.37 when CS was expecting only EUR2.15 and although Covestro covers half of the difference.

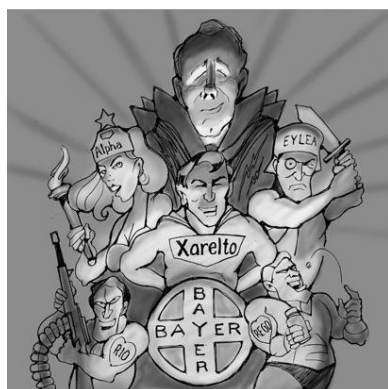
VALUATION

- What happened with working capital within Bayer Group in Q1 2016 is not fully clear to us. It downgraded by 55% so that operating cash flow would have come down despite increasing earnings. This is what clearly prevents us from being really positive about this quarterly set of numbers. And the fact that, despite a clear advance provided by Q1 numbers, the guidance is simply reiterated might suggest that some caution is deserved.

NEXT CATALYSTS

- Today 2pm: Conference Call on Q1 results

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NEUTRAL ratings 0%

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