

Bayer

Price EUR84.42

A value call for a new investor base?

Fair Value UNDER REVIEW

NEUTRAL

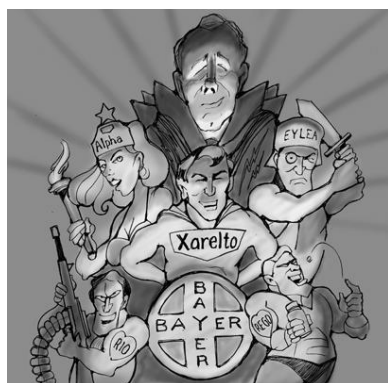
Bloomberg	BAY GY
Reuters	BAYG.F
12-month High / Low (EUR)	137.4 / 84.4
Market Cap (EURm)	69,811
Ev (BG Estimates) (EURm)	86,987
Avg. 6m daily volume (000)	2 758
3y EPS CAGR	6.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-23.5%	-13.1%	-32.7%	-27.1%
Healthcare	-1.9%	2.4%	-10.3%	-9.2%
DJ Stoxx 600	-3.4%	2.7%	-11.5%	-8.0%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	46,325	45,860	47,452	49,008
% change		-1.0%	3.5%	3.3%
EBITDA	10,275	10,653	11,169	11,755
EBIT	8,851	9,274	9,752	10,291
% change		4.8%	5.1%	5.5%
Net income	5,687	5,827	6,399	6,852
% change		2.5%	9.8%	7.1%

	2015	2016e	2017e	2018e
Operating margin	19.1	20.2	20.6	21.0
Net margin	12.3	12.7	13.5	14.0
ROE	25.6	22.9	22.7	21.8
ROCE	11.6	12.4	13.1	13.9
Gearing	71.0	51.8	35.6	20.9

(EUR)	2015	2016e	2017e	2018e
EPS	6.88	7.05	7.74	8.29
% change	-	2.5%	9.8%	7.1%
P/E	12.3x	12.0x	10.9x	10.2x
FCF yield (%)	6.2%	8.6%	9.2%	9.9%
Dividends (EUR)	2.50	2.60	2.70	2.80
Div yield (%)	3.0%	3.1%	3.2%	3.3%
EV/Sales	2.0x	1.9x	1.8x	1.6x
EV/EBITDA	8.8x	8.2x	7.5x	6.8x
EV/EBIT	10.2x	9.4x	8.6x	7.7x



The rationale behind the transaction is strong but it significantly changes the business mix in an unexpected manner that shareholders may need some time to accept. Short-term uncertainties also make it difficult to buy a new story quickly despite an attractive core EPS CAGR. Let's wait.

ANALYSIS

- During two successive conference calls yesterday, Bayer's management tried to convince investors and analysts why they had decided to bid for Monsanto for USD62bn in an all-cash transaction.
- First of all, management reiterated that although people may have been surprised by the nature and size of the deal, it is fully in line with the group's strategy of always looking for opportunities to reinforce Bayer as a Life Science company i.e. in each of its core businesses. Then, over the years, as various combinations with Monsanto have been considered, it became clear that an acquisition and merger of the two entities was the scenario that made the most sense and created the most value in an Agro industry facing increasing opportunities and challenges to close the gap between people's needs (3 billion more inhabitants by 2050) and farmland capabilities (expected to decline). Of course, management also stressed that the two companies have very complementary portfolios with limited overlaps that also make a combination highly attractive. Bayer will indeed strengthen its positions in seeds and traits and from a geographical perspective, significantly grow its exposure to the North American and Latin American regions.
- Hence the level of synergies (USD1.5bn) that could appear high but with which Bayer looks very comfortable although management did not want to break it down between components for obvious reasons (it does not want Monsanto to be given too much). That said, it includes both revenue and cost synergies.

VALUATION

- The most interesting part of the conference call was that concerning the financial aspects of the deal: (i) first, Bayer agreed that key assumptions suggest a leverage above 4x after transaction and current discussions with credit rating agencies drive to a central case of BBB post transaction (from the current A- with negative outlook i.e. two levels of downgrade. However, a third level of downgrade cannot be ruled out. That said, Bayer is not expecting any asset sale to reduce the amount of debt required. However, we do expect Covestro's remaining shares to be fairly quickly divested; (ii) second, Bayer said that NOPAT would exceed cost of capital in the third year post transaction, considering that WACC used for the statement is 7.7% (we are currently using a WACC of 7.2%). Everything else being equal, our FV of Bayer with a WACC of 7.7% would be EUR94; (iii) the core EPS accretion calculation indeed includes subscription rights by existing shareholders but the ratio of subscription vs sale of rights by shareholders is another unknown factor, as well as the discount offered to acquire new shares.
- Let's make some basic assumptions. If we compute and take for granted the USD1.5bn in synergies as follows (USD500m in Y1, USD1bn in Y2, USD1.5bn in Y3), a tax rate of 25%, a EUR/USD parity of 1.12, assume 25% of financing is made through a rights issue at a 5% discount to the last share price (158.5m new shares issued) and the remaining through debt at an average gross rate of 3.5%, then we derive a core EPS accretion of 3% in Y1, 10% in Y2 and 13% in Y3. Note that we do not factor in here any cost for the restructuring programme to deliver the synergies (the cash part should be accounted for). Bayer's annual core EPS growth rate would then be 12.2% on average between 2015 and 2019.
- So, in the end, Bayer could well become an attractive value call, maybe for a different shareholder base as the product mix changes. That said, it is too early to play because Monsanto's statement, the price discount on rights issuance, final credit rating and part of revenue synergies are key components in the equation. Also the fact that Monsanto's price did not adjust to the offer price (USD122) could mean it is far from over. We must wait.

NEXT CATALYSTS

- Upcoming days: Monsanto's answer to the offer - [Click here to download](#)



Analyst :
Eric Le Berrigaud
33(0) 1 56 68 75 33
eleberrigaud@bryangarnier.com

Sector Team :
Mickaël Chane Du
Hugo Solvet

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London	Paris	New York	Munich	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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