

Bayer

Price EUR93.55

Agreement to buy Monsanto at USD128 per share

Fair Value EUR98 vs. Under Review (+5%)

NEUTRAL

Bloomberg	BAY GY
Reuters	BAYG.F
12-month High / Low (EUR)	126.9 / 84.4
Market Cap (EURm)	77,361
Ev (BG Estimates) (EURm)	95,098
Avg. 6m daily volume (000)	2 562
3y EPS CAGR	6.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-4.6%	7.3%	-6.7%	-19.2%
Healthcare	-3.0%	4.2%	1.1%	-8.7%
DJ Stoxx 600	-2.2%	5.6%	-1.8%	-7.5%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	46,325	46,514	46,189	47,890
% change		0.4%	-0.7%	3.7%
EBITDA	10,334	10,947	10,850	11,435
EBIT	8,851	9,641	9,864	10,421
% change		8.9%	2.3%	5.6%
Net income	5,687	6,085	6,483	6,944
% change		7.0%	6.5%	7.1%

	2015	2016e	2017e	2018e
Operating margin	19.1	20.7	21.4	21.8
Net margin	12.3	13.1	14.0	14.5
ROE	25.6	23.9	23.1	22.4
ROCE	11.6	12.9	13.3	14.1
Gearing	71.0	51.8	37.1	23.3

(EUR)	2015	2016e	2017e	2018e
EPS	6.88	7.36	7.84	8.40
% change	-	7.0%	6.5%	7.1%
P/E	13.6x	12.7x	11.9x	11.1x
FCF yield (%)	5.6%	7.7%	7.9%	8.5%
Dividends (EUR)	2.50	2.60	2.70	2.80
Div yield (%)	2.7%	2.8%	2.9%	3.0%
EV/Sales	2.1x	2.0x	2.0x	1.8x
EV/EBITDA	9.5x	8.7x	8.5x	7.7x
EV/EBIT	11.1x	9.9x	9.3x	8.5x

Bayer has reached an agreement with Monsanto, while slightly increasing its offer to USD128. Largely because the process should take at least 12 months to complete, we keep a NEUTRAL rating on the stock. The deal is not value-creative until 2022. An ex-Monsanto FV of EUR98 is reinstalled.

ANALYSIS

- As rumoured in the last few days, Bayer and Monsanto reached an agreement on September 14th at a final price of USD128 for each Monsanto share to be offered by Bayer in an all-cash transaction. At this level, the offer received full support from Monsanto's Board members and so we now expect the proposed transaction to proceed and to have only one meaningful agreement left to reach: the one from antitrust authorities.
- This aspect was one of the more lengthy addressed during the conference call yesterday. This is in resonance with the current share price of Monsanto that is still, even after yesterday's announcement, far below the offer price (USD106-107 vs USD128). It has not even adjusted by the last increase in the offer price i.e. USD3 per share. It suggests that in investors' mind, the likelihood of a consummated merger has not increased. Of course, it has to be remembered that the share price of Monsanto before the start of the negotiations with Bayer was USD89 and that earnings estimates have been severely cut since then. Considering a break-up fee of USD4 per share, it is like giving the merger a probability of success of no more than 50% still. First very initial feedbacks from discussions with regulators have been described as "encouraging" by Bayer's management, who reiterated several times two reasons to believe in the deal: (i) the strong support to innovation and commitment to invest massively in R&D is perceived very positively; (ii) there is little overlap between the two entities and where there are some (obvious ones), there is a clear commitment to divest anything that is required to get approval.

VALUATION

- This will remain a clear overhang over the two companies and their stocks at least until formal discussions have taken place, starting with European authorities. We have no example of such a big and complex deal not having affected negatively the involved companies and their referenced stock prices. It is hard to see Bayer performing during that long period of time until antitrust authorities give (or not) their green light. This is enough to keep a NEUTRAL rating.
- How should we value this company now and for the year to come? Already a couple years ago, we decided to value it as a pure play company in healthcare because we expected Bayer to come out of Covestro pretty quickly. That's not what has happened. Yet what came out of the conference call yesterday is that the deal should be value accretive as of ... 2022 considering a cost of capital of around 7.7-7.8%.
- In terms of accretion, we lack some pieces of information about financing to challenge Bayer's declared impacts of a small positive in year 1 post-closing (2018) and in double digits in year3 (2020). In particular, the equity part (USD19bn) is unclear. It will be composed of a convertible bond (maturity? coupon? size?) and a subscription right (size? discount to last price?). On the debt side, Bayer will benefit from extraordinary conditions and we expect Co. to be able to raise debt at no more than 3%, which would give an EPS accretion of 1% in 2018 and 13% in 2020, in line with Bayer's guidance. On the same base, EPS would grow 9% on average from 2016 to 2020.
- In terms of valuation, we have decided to move WACC from our so far 7.24% (with beta of 0.95) to 7.53% (beta of 1), closer to Bayer's internal calculation. No reason to be below Co.'s own assumptions. On that base, with 1.8% average LT growth rate and Covestro at market value, with no influence yet of Monsanto, the FV is EUR98. Considering the length of the merger process and some kind of scepticism yet in the market, we decide to reinstall this FV for the time being.

NEXT CATALYSTS

- 19-20 September 2016: Meet The Management meeting in Germany
- [Click here to download document](#)



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NEUTRAL ratings 33,1%

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