

Bayer

Germany/Pharmaceuticals

7 March 2016

UBS Research

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Bayer, PT cut to €105

- Earnings trimmed post FY15 results
- Covestro lock-up period expires in April
- Presenting new earnings model to reflect restated segment reporting
- Valuation: Price Target cut to €105 from €130

Earnings trimmed post FY15 results

After 3 years (2012-15) of strong (10%) Pharma sales growth, Bayer's pharma sales growth is decelerating to mid-single digit in 2016, as the 5 newly launched products have reached scale (2015 sales of €4.2bn). In subsequent years, we expect Pharma sales growth to decelerate to single-digit, in view of increasing competition for Kogenate, potentially flattening sales for Eylea (competition from new agents in 2018/19) and the Nexavar patent expiration in 2020. 2017 pipeline news flow (more Xarelto outcomes data, ph III data ODN-201) may offset some of this deceleration, but in 2016, pipeline news flow is light. We have updated our Bayer model after FY15 results on Feb 25. Our new Core EPS estimates are 6%, 4%, 2%, and 2% (2016E-19E) below the pre-results consensus.

Covestro lock-up period expires in April

As confirmed by Bayer when the partial IPO was announced, it plans to dispose of its entire Covestro stake in the long term (BBG, 4Sep15) – however, it has not communicated when and how it will exit its 69% stake, though we think a complete exit and de-consolidation of Covestro remains possible in the 2016-17 period. The Covestro lock up period expires in early April, next steps may be announced thereafter. At present, Bayer estimates still include the earnings contribution from Bayer's 69% Covestro holding, but we expect a complete exit to be 4.4%-7% dilutive (2016E-20E).

Presenting new earnings model to reflect restated segment reporting

Our updated earnings model reflects the business unit structure that Bayer will apply going forward. Whilst 2016 targets were issued on this basis, we note that the long-term targets have not yet been adjusted on the new perimeter, and our forecast cannot be compared to the former targets. Due to the CEO transition, Bayer will not hold its traditional Meet the Management meeting in March/ April, where typically such updates were provided.

Valuation: Price Target cut to €105 from €130

Our new price target is based on 13.7x 2017E Core EPS adjusted for Covestro earnings. This is broadly in line with the sector (13.9x), and is underpinned by our NPV/ SOTP value of €102 per share.

12-month rating	Neutral
12-month price target	€105.00
Prior	€130.00
Price	€99.10

Contributing authors: Mark Belsey

Trading data and key metrics

52-wk range	€145.75-92.62
Market cap.	€82.0bn/US\$89.8bn
Shares o/s	827m (ORD)
Free float	100%
Avg. daily volume ('000)	8
Avg. daily value (m)	€0.8
Common s/h equity (12/15E)	€24.3bn
P/BV (12/15E)	3.4x
Net debt / EBITDA (12/15E)	1.8x
RIC	BAYG.F
BBG	BYN GY

Sources: UBS, Bloomberg

EPS (UBS, diluted) (€)

	From	To	% ch	Cons.
12/15E	6.96	6.83	-2	6.83
12/16E	7.44	7.19	-3	7.42
12/17E	8.06	8.12	1	8.10

Definitions of terms and abbreviations are available in the appendix section of this report, and more extensively on internet at www.ubs.com/glossary

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Investment Thesis

Investment Case

After 3 years of strong (10%) Pharma sales growth, Bayer's pharma sales growth is decelerating to mid-single digit in 2016, as the 5 newly launch products have reached scale (2015 sales of €4.2bn) and in subsequent years, we expect Pharma sales growth to decelerate to single-digit, in view of increasing competition for Kogenate, potentially flattening sales for Eylea (competition from new agents in 2018/ 2019) and the Nexavar patent expiration in 2020. 2017 pipeline newsflow (more Xarelto outcome data, phase III data ODN-201) may offset some of this deceleration, but in 2016, pipeline newsflow is light. Bayer is likely to seek to exit its Covestro holdings as fast as possible in coming years, to consolidate its balance sheet, though this exit is earnings dilutive, unless Bayer spends the proceeds on an earnings accretive transaction. Hence, we think investors may value Bayer on a P/E that excludes Covestro contribution. On ex-Covestro earnings, Bayer trades broadly in line with the sector, which seems fair. We lower our €130 PT to €105, a slight discount to the Europe's large cap pharma sector on 2017 Core EPS, and also supported by our €102 SOTP/ NPV valuation.

Upside Scenario

Whilst our expectations for 2016 pipeline newsflow is low, the pipeline may surprise, in case vericiguat looks significantly better in heart failure patient with preserved ejection fraction at the upcoming ACC meeting, and/ or if molidustat p2b data suggest a best in class profile. This may boost or NPV SOTP by c. €5 to c. €110.

Downside Scenario

Underwhelming data on vericiguat in patients with preserved ejection fraction may lead MRK to exit the collaboration and/ or Bayer to abandon the project altogether. The NPV impact would only be c. 1%, though it would leave Bayer more exposed to the Xarelto patent expiration in the next decade. Potassium binders such as Relypsa and ZS9 may remove the key differentiating factor for Finerenone to older MRAs for the treatment of CHF, with a negative impact on our SOTP/ NPV of c. 2%. A hypothetical risk of the Xarelto patent term extension not being granted late this year could reduce our SOTP/ NPV by 5%. The total downside risk from underwhelming pipeline news and the lack of Xarelto patent extension could result in a share price in the mid-nineties.

Upcoming Catalysts

1Q'16 – headline results for molidustat p2b (study completed Dec 15)

April 2-4, 2016 – ACC with p2b data for vericiguat in CHF patient with preserved ejection fraction

Early April 2016 – Covestro lock up expires

May 2016 – Werner Baumann succeeds Dr. Marijn Dekkers as CEO

1H 2016 – Meet the Management, later than usual, due to management transition

2Q'2016 P3 headline results for Stirvaga in 2L Liver cancer

Company Profile: Bayer

Bayer is a diversified German life sciences company, with Pharmaceutical, Consumer and CropScience divisions; Bayer plans to exit MaterialScience (polycarbonates and polyurethanes) in 2016. Pharma (46% of ongoing group EBITDA) has leading franchises in women's health, cardiovascular and specialty pharmaceuticals; key growth products are Xarelto and Eylea. Consumer Health (26% of EBITDA) acquired Merck OTC in 2014 and is the second-largest OTC business globally. CropScience (28%) is mainly crop protection chemicals (c80% of sales), with a smaller seeds business, and an emerging bio-ag business.

Statement of Risk

Risks to Bayer include - in Pharma: Xarelto growth being impacted by increasing competition from Eliquis as well as edoxaban; multiple new/better competitors for Betaseron (multiple sclerosis) and Kogenate (hemophilia) – including Roche's ACE910; failure of the promising phase II pipeline, particularly cardiovascular assets finerenone and vericiguat. In CropScience: weakness in global crop prices leading to a sharper or more prolonged downturn in crop chemicals markets than expected; renewed competition in seeds, or chemicals; greater regulatory oversight leading to increased R&D requirements or litigation. Valuation: our price target is based on 13.7x 2017E Core EPS adjusted for Covestro earnings. This is broadly in line with the sector (13.9x), and is underpinned by our NPV/ SOTP value of €102 per share.

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Highlights (€m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	39,741	40,157	42,239	46,324	47,342	49,701	51,815	53,690
EBIT (UBS)	5,639	5,773	5,944	7,069	7,590	8,527	9,373	10,229
Net earnings (UBS)	4,383	4,643	4,977	5,647	5,943	6,713	7,350	7,962
EPS (UBS, diluted) (€)	5.30	5.61	6.02	6.83	7.19	8.12	8.89	9.63
DPS (€)	1.90	2.10	2.25	2.50	2.80	3.10	3.40	3.65
Net (debt) / cash	(7,837)	(7,369)	(20,007)	(18,075)	(15,425)	(13,456)	(12,215)	(8,953)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	14.2	14.4	14.1	15.3	16.0	17.2	18.1	19.1
ROIC (EBIT) %	16.9	16.9	13.9	13.6	14.6	16.7	18.7	21.0
EV/EBITDA (core) x	7.7	10.0	12.2	10.9	10.4	9.3	8.5	7.8
P/E (UBS, diluted) x	11.2	14.9	17.2	14.5	13.8	12.2	11.1	10.3
Equity FCF (UBS) yield %	5.8	4.6	4.2	5.6	5.9	5.0	5.7	6.2
Net dividend yield %	3.2	2.5	2.2	2.5	2.8	3.1	3.4	3.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied.

Valuations: based on an average share price that year, (E): based on a share price of €99.10 on 04 Mar 2016 20:33 GMT

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	47%	33%
Neutral	Hold/Neutral	42%	34%
Sell	Sell	11%	23%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2014.

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.

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Global Equity 12-Month Rating Definitions

Buy: FSR is > 6% above the MRA. **Neutral:** FSR is between -6% and 6% of the MRA. **Sell:** FSR is > 6% below the MRA.

Key Definitions

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Exceptions and Special Cases

Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified the Companies Mentioned or Company Disclosure table in the relevant research piece.

Company Disclosures

Bayer	BAYN GR	Neutral (UR)	€98.10	03 Mar 2016
Novo Nordisk	NOVOB DC	Sell	DKr356.40	03 Mar 2016
AstraZeneca	AZN LN	Buy	4,000p	03 Mar 2016
GlaxoSmithKline	GSK LN	Neutral	1,370p	03 Mar 2016
Roche	ROG VX	Buy	CHF251.50	03 Mar 2016
Novartis	NOVN VX	Buy	CHF72.00	03 Mar 2016
Sanofi	SAN FP	Neutral	€71.83	03 Mar 2016
Syngenta	SYNN VX	Neutral	CHF403.10	03 Mar 2016
Company Name	Reuters	12-mo rating	Price	Price date

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

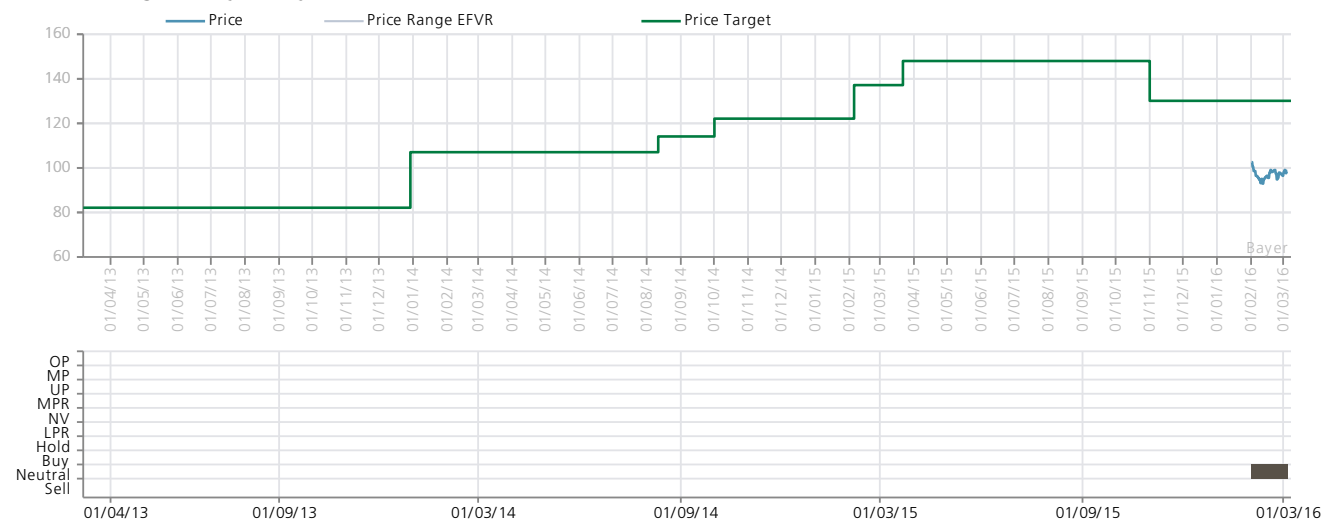
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Bayer 1, 2;

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Global rating history -- Bayer, BAYN GY



Terms and Abbreviations

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
1H, 2H, etc. or 1H11, 2H11, etc.	First half, second half, etc. or first half 2011, second half 2011, etc.	1Q, 2Q, etc. or 1Q11, 2Q11, etc.	First quarter, second quarter, etc. or first quarter 2011, second quarter 2011, etc.
2011E, 2012E, etc.	2011 estimate, 2012 estimate, etc.	A	actual i.e. 2010A
ADR	American depositary receipt	ARPU	Average Revenue Per User
AUM	Assets under management = total value of own and third-party assets managed	Avg.	average
bn	Billion	bp or bps	Basis point or basis points (100 bps = 1 percentage point)
BVPS	Book value per share = shareholders' equity divided by the number of shares	CAGR	Compound annual growth rate
Cant Inc/Capita	Cantonal income per capita (Switzerland only)	Capex	Capital expenditures
CF	Cash flow	CFO	1) Cash flow from operations, 2) Chief financial officer
COGS	Cost of goods sold	COM	Common shares
Cons.	Consensus	Core Tier 1 Ratio	Tier 1 capital minus tier 1 hybrid securities
Cost/Inc Ratio (%)	Costs as a percentage of income	CPI	Consumer price index
CR	Combined ratio = ratio of claims and expenses as a percentage of premiums (for insurance companies)	CY	Calendar year
DCF	Discounted cash flow	DDM	Dividend discount model
Dividend Yield (%)	Dividend per share divided by price per share	DPS	Dividend per share
E	expected i.e. 2011E	EBIT	Earnings before interest and taxes
EBIT Margin (%)	EBIT divided by revenues	EBITDA	Earnings before interest, taxes, depreciation and amortization
EBITDA Margin (%)	EBITDA divided by revenues	EBITDA/Net Interest	EBITDA divided by net interest expense
EBITDAR	Earnings before interest, taxes, depreciation, amortization and rental expense	EFVR	Estimated fair value range
EmV	Embedded value = net asset value + present value of forecasted future profits (for life insurers)	EPS	Earnings per share
Equity Ratio (%)	Shareholders' equity divided by total assets	EV	Enterprise value = market value of equity, preferred equity, outstanding net debt and minorities
FCF	Free cash flow = cash a company generates above outlays required to maintain/expand its asset base	FCF Yield (%)	Free cash flow divided by market capitalization
FFO	Funds from operations	FY	Fiscal year / financial year
GDP	Gross domestic product	Gross Margin (%)	Gross profit divided by revenues
H	half year	h/h	Half-year over half-year; half on half
hist av.	Historical average	Interbank Ratio	Interbank deposits due from banks divided by interbank deposits due to banks
Interest Coverage	Ratio that expresses the number of times interest expenses are covered by earnings	Interest exp	Interest expense
ISIN	International securities identification number	K	One thousand
LLP/Net Int Inc (%)	Loan loss provisions divided by net interest income	LLR/Gross Loans (%)	Loan loss reserves divided by gross loans

Bayer

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
LPR	Least Preferred: The stock is expected to both underperform the relevant benchmark and depreciate in absolute terms.	Market cap	Number of all shares of a company (at the end of the quarter) times closing price
m/m	Month-over-month; month on month	mn or m	Million
M and A	Merger and Acquisition	MP	Marketperform: The stocks expected performance is in line with the sector benchmark
MPR	Most Preferred: The stock is expected to both outperform the relevant benchmark and appreciate in absolute terms.	n.a.	Not available or not applicable
NAV	Net asset value	Net Debt	Short- and long-term interest-bearing debt minus cash and cash equivalents
Net DPS	Net dividends per share	NIM or Net Int Margin (%)	Net interest income divided by average interest-bearing assets
Net Margin (%)	Net income dividend by revenues	NV	Neutral View: The stock is expected to neither outperform nor underperform the relevant benchmark nor significantly appreciate or depreciate in absolute terms.
n.m. or NM	Not meaningful	NPL	Non-performing loans
OP	Outperform: The stocks is expected to outperform the sector benchmark	Op Margin (%)	Operating income divided by revenues
p.a.	Per annum (per year)	P/BV	Price to book value
P/E or PE	Price to earnings / Price Earnings Ratio	P/E Relative	P/E relative to the market
P/EmV	Price to embedded value	PEG Ratio	P/E ratio divided by earnings growth
PPI	Producer price index	Prim Bal/Cur Rev (%)	Primary balance divided by current revenue (total revenue minus capital revenue)
Profit Margin (%)	Net income divided by revenues	q/q or QQQ	Quarter-over-quarter; quarter on quarter
R and D	Research and development	ROA (%)	Return on assets
ROAE (%)	Return on average equity	ROCE (%)	Return on capital employed = EBIT divided by difference between total assets & current liabilities
ROE (%)	Return on equity	ROIC (%) or ROI	Return on invested capital
Shares o/s	Shares outstanding	Solvency Ratio (%)	Ratio of shareholders' equity to net premiums written (for insurance companies)
sotp or SOTP	Sum of the parts	Tax Burden Index	Swiss tax index; 100 = average tax burden of all cantons
tgt	Target	Tier 1 Ratio (%)	Tier 1 capital divided by risk-weighted assets; describes a bank's capital adequacy
tn	Trillion	UP	Underperform: The stock is expected to underperform the sector benchmark
Valor	Swiss company identifier	WACC	Weighted average cost of capital
CIO	UBS WM Chief Investment Office	x	multiple / multiplier
y/y or YOY	Year-over-year; year on year	yr	Year
YTD	Year-to-date		

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Version 02/2016.

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