

Bayer

Germany | Pharma & biotech

22 May 2019

Hold

S&P
Moody's
Fitch
Bloomberg

BBB s
Baa1 n
A- s
BAYN GR

Comment on glyphosate (S&P)

In the agency's view, Bayer has the capacity to withstand the currently known punitive damages related to the glyphosate trials it lost. S&P further clarified its estimate of the group's flexibility, while pointing out that its rating will depend on the future legal costs and potential restrictions on glyphosate-related products.

Capacity to weather known damages

In a bulletin published yesterday, S&P issued its first comment on Bayer after the group's multiple trial losses. The agency started by pointing out that the group's profile offered sufficient financial flexibility to offset the impact of the three litigation cases for which it is required to pay out some EUR2.2bn in punitive damages, including EUR2bn solely for the last case.

It also highlighted the different sources of financial flexibility underpinning the group's current rating, namely: 1) a high FCF generation profile with organic cash flow and disposals (animal health and personal care assets, potentially worth EUR6bn or more); 2) appeal processes in relation to the three cases likely lasting into 2020; and 3) a net debt/EBITDA forecasted at 4x and 3.5x respectively by end-2019 and June 2020, which could potentially go down to 3x relatively quickly if the disposals are executed.

Legal costs factored in as provisioned

The agency also clarified that it did not factor the legal costs into its current base case scenario, but will deduct these costs from its adjusted EBITDA as the company accrues or provisions for it in its accounts. Whether Bayer's rating can withstand the glyphosate costs will depend on the future litigation costs (13,400 litigation claims have been filed against the group) and the potential restrictions on the glyphosate-based products, which make up a large portion of the revenues from Monsanto's legacy business. Within the current rating, S&P estimates that Bayer could absorb an increase in debt of about 0.5-1.0x its adjusted leverage.

Recommendation

We have a Sell recommendation on Bayer, owing to the pending litigation risk related to Monsanto. The performance of Bayer's bonds will be driven by the group's ability to deliver on the expected organic deleveraging (factored into all three agencies' base-case scenarios). The potential payout (with a large tail risk in the event of a worst-case scenario) creates uncertainty on the evolution of the group's credit profile, and will weigh on the bonds. The spread offered does not compensate for this. Our view is different for the shorter hybrid (call 2020), as we think the extension risk is capped by the sizable hybrid curve of the group, while the premium offered is attractive.

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Credit Analyst

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Non-adjusted key financials

FY to 31/12 (EUR)	07/05	2019E	2020E
Sales	39 586	47 197	49 484
EBITDA margin	24.1%	26.4%	28.1%
FCF	4 635	4 491	5 827
Cash & equiv.	4 052	1 800	3 140
ST debt	3 682	3 682	3 682
LT debt	37 712	34 712	32 964
Shareholder's eq.	45 977	53 839	56 694
Net fin.debt	37 342	36 594	33 506

Non-adjusted credit metrics

FY to 31/12 (EUR)	2018	2019E	2020E
Gearing	na	na	na
ND/EBITDA (x)	na	na	na
FFO/Net debt	21.8%	21.9%	27.7%
CFO/Net debt	18.7%	19.5%	25.4%
FOCF/Net debt	12.4%	12.3%	17.4%
DCF/Net debt	6.0%	4.5%	8.8%
RCF/Net debt	15.3%	14.2%	19.1%
EBITDA/Int.(x)	6.7	5.8	7.1
FFO+int./Int.(x)	6.3	5.3	6.3

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Companies mentioned

Stock	ISIN	Currency	Price
Bayer	DE000BAY0017	EUR	56.07

Source: Factset closing prices of 21/05/2019

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Rating ratio Kepler Cheuvreux Q1 2019

Rating Breakdown	A	B
Buy	49%	50%
Hold	34%	33%
Reduce	14%	12%
Not Rated/Under Review/Accept Offer	3%	5%
Total	100%	100%

Source: KEPLER CHEUVREUX
A: % of all research recommendations
B: % of issuers to which material services of investment firms are supplied

12 months rating history

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Company Name	Date	Business Line	Rating	Target Price	Closing Price
Bayer (EUR)	05/06/2018 08:16	Credit Research	Restricted		101.09
	08/06/2018 07:06	Equity Research	Restricted		98.94
	06/07/2018 07:18	Equity Research	Hold	102.35	94.25
	14/08/2018 08:34	Equity Research	Under Review		83.73
	24/08/2018 07:22	Equity Research	Hold	83.00	81.95
	05/09/2018 08:53	Credit Research	Hold		79.83
	24/09/2018 08:25	Equity Research	Buy	84.00	76.52
	20/03/2019 08:11	Equity Research	Under Review	70.00	69.70
	25/03/2019 09:26	Equity Research	Hold	70.00	59.30

Credit research does not issue target prices. Left intentionally blank.

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Buy: The minimum expected upside is 10% over next 12 months (the minimum required upside could be higher in light of the company's risk profile).

Hold: The expected upside is below 10% (the expected upside could be higher in light of the company's risk profile).

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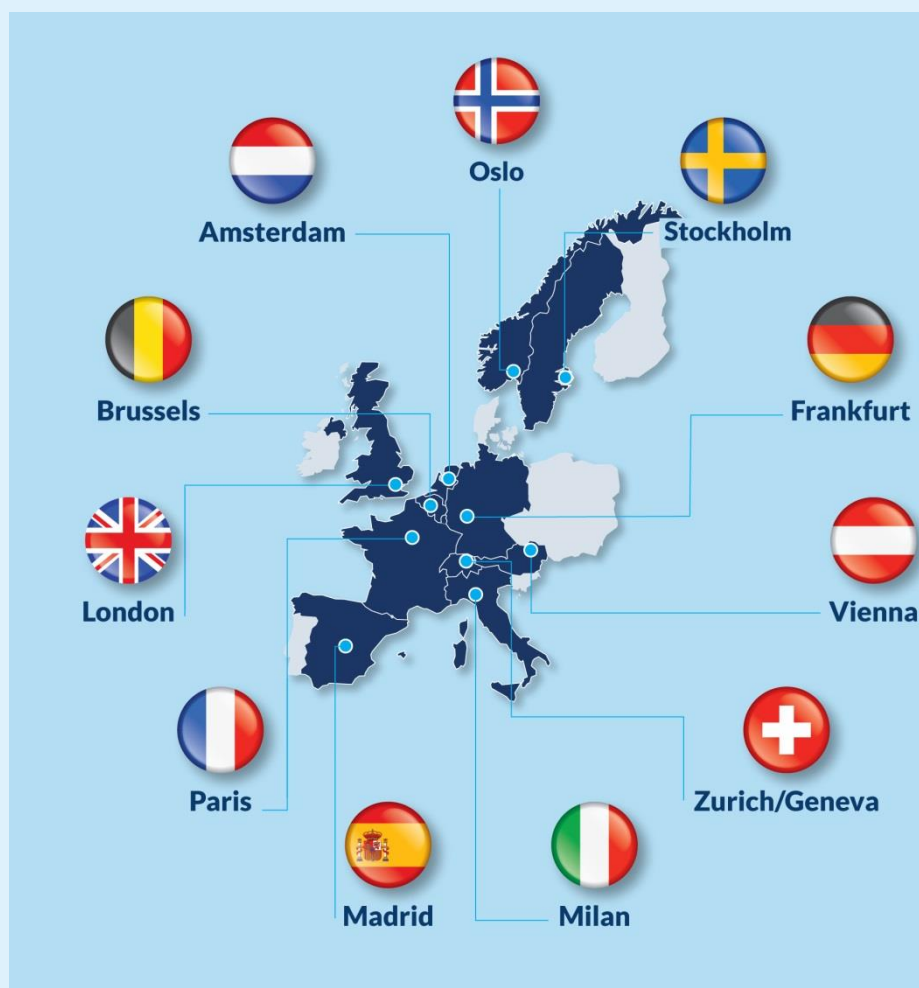
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