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BAYN.DE - Bayer AG To Discuss The Planned Demerger Of MaterialScience

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OVERVIEW:

On 09/18/14, Co. decided to demerge MaterialScience business and transform Co. into a pure life science player. Co. plans to exit MaterialScience business by way of a stock-market listing, which should take place within next 12-18 months.

CORPORATE PARTICIPANTS

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Marijn Dekkers *Bayer AG - CEO*

Werner Baumann *Bayer AG - CFO*

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Saba Hekmat *New York Life Investors - Analyst*

Jeffrey Holford *Jefferies & Co. - Analyst*

PRESENTATION

Alexander Rosar - ***Bayer AG - Head ? IR***

Ladies and gentlemen, good afternoon and welcome, also on behalf of my colleagues, to our conference call on the occasion of the demerger of our MaterialScience business.

With me on the call are Marijn Dekkers, our CEO; and Werner, Baumann, our CFO. We really appreciate that you could join our call on such short notice. I hope you have had a chance to read our press release and see our presentation, which is available on our website and also during this call.

In a minute, Marijn will outline the rationale for the division to exit the MaterialScience business and transform Bayer into a pure life science company. We will then open the line for Q&A. We will close the call at 5:15, and ask for your understanding that we will limit the Q&A session to two questions per person.

Before handing over to Marijn, I'd like to draw your attention to the Safe Harbor statement. *(See "Disclaimer" chart at the end of this transcript).*

Thank you. Marijn?

Marijn Dekkers - ***Bayer AG - CEO***

Yes, thank you, Alexander. And ladies and gentlemen, good afternoon. Thank you for taking the time to dial in on such short notice. We would like to give you the opportunity to discuss today's announcement with us firsthand.

We decided today to demerge the MaterialScience business and transform Bayer into a pure life science player. Going forward, Bayer will focus its strategy on being a global leader in the life sciences. We plan to exit the MaterialScience business by way of a stock market listing, which should take place within the next 12 to 18 months.

MaterialScience is a world-class business, and we are convinced that it has the potential to create significant long-term value on a standalone basis. As a separate company, MaterialScience will be the fourth-largest European chemicals players, with excellent prospects for sustainable success in its markets.

The transaction will make MaterialScience better able to fund the investment needed to develop its portfolio. The demerger will enable Bayer to concentrate its resources on the healthcare and crop science businesses, thereby creating a global leader in the life sciences, with extensive experience in science and innovation, and the capability to leverage this expertise to improve human, animal, and plant health.

We therefore expect this portfolio decision to be beneficial for both entities, both Bayer and MaterialScience. So why have we decided to take this step, and why now?

The life science activities already clearly dominate Bayer's portfolio, accounting for more than two thirds of group sales, and almost 90% of earnings. Back in 2007, healthcare and crop science generated 66% of Bayer group sales. Last year the figure had risen to 71%.

And while the two businesses contributed 76% to our adjusted EBITDA six years ago, last year they achieved 88% of Bayer's earnings.

Important developments in recent years have taken the life science businesses to where they span today. Looking back at 2010, our pharma business was boasting rather moderate growth rates, but had a very promising pipeline, but one that still had to score success in the clinical and regulatory development, and in the respective market introductions.

The five products we have launched in recent years, Xarelto, Eylea, Adempas, Stivarga and Xofigo, turned out to be transformational for our pharma business, and have turned us into one of the fastest-growing pharma companies worldwide. And we expect to continue growing above market in the future.

Significant progress is also visible in our OTC business. Four years ago, our challenge was to remain among the leaders in a highly fragmented OTC market at the time of ongoing industry consolidation. Strong execution of our emerging market focus strategy in Russia, Brazil and China, and the successful leveraging of our brands' reputation have resulted in continued market share gains.

It was at that time when we formulated our aspiration to become the world's number-one OTC company. And in this context, we continue to invest in the organic growth of the business, and also concluded a series of attractive acquisitions, including of course, this year's announced acquisition of Merck and Company Consumer Care business.

This transaction means we overtake J&J and take up a strong number-two position right behind the newly-formed Novartis-Glaxo joint venture.

In crop science, we had not previously been able to transform our superior product portfolio into market share gain. We were actually losing share. So we developed and executed a new go-to-market approach with a new management team, in order to more effectively transform our R&D capabilities into sales.

We also invested in the expansion of our seeds business, our activities in biologicals and our technology platform. And the success of this approach is now evident from three and half years of straight, almost double-digit organic sales growth. And there are now indications that we are actually gaining share.

Now we must focus to sustain our strong strategic and operational progress in the life science businesses, and thus maintain our positive momentum. However, going forward, we feel it will become increasingly difficult to adequately resource both the businesses, life science and MaterialScience in one group. And let me explain why.

We have already demonstrated the transformational nature of our pharma pipeline, and we want to continue exploiting our research efforts. And that means, among others, increasing our R&D spend. Robust market growth in our life sciences businesses will also entail the expansion of capacities. As we are now, for instance, seeing with the significant investment being made for the new Factor VIII plant in Germany.

And lastly, we will continue to complement organic growth with targeted bolt-on acquisitions. For example to gain scale or to fill gaps in our portfolio.

On the other hand, MaterialScience also has significant investment needs, if it is to keep pace with the competition. The chemicals and polymers industries have changed structurally in recent years. New competitors have emerged. Huge amounts have been invested in state-of-the-art production plants. And the shale gas boom in the US is transforming industry structure.

With the market environment changing so rapidly, MaterialScience will need to take appropriate measures to remain ahead of the competition. These changes will require substantial investment in capacity expansion projects, process improvement, and more active portfolio management.

Now keeping both businesses in one Bayer group company poses a tremendous challenge for the MaterialScience business. Because it always has to compete with the life science businesses for investment funding. And those businesses offer consistently better returns. And that's why we decided to separate MaterialScience from Bayer, and make it an independent company.

We are convinced that, equipped with more flexibility and independent access to capital, MaterialScience can successfully develop its portfolio, and emerge as an even stronger player in the future.

We believe MaterialScience is an excellent position from the start. And managing its own business outside the Bayer group will enable the new company to build on its strong fundamentals and leverage its competitive position.

MaterialScience is a leader in its markets, thanks to significant investments in recent years that can benefit from one of the most modern state-of-the-art global production networks, and from the cost leadership and customer proximity this network provides.

All this now puts MaterialScience in a position to operate as an entity separate from the Bayer group. There are several reasons why its business can be better leveraged in a standalone scenario. First, MaterialScience would have the ability to further shape and develop its portfolio.

The planned capital market exit would allow for autonomous funding to finance imperative investment needs. In an independent setting, our MaterialScience colleagues would have the opportunity to develop a culture that optimally fits with that business.

Business processes in terms of systems could be tailored to steer the business as efficiently as possible, and bring the new company more in line with its industry peers in this respect.

The planned capital market exit is intended to put MaterialScience in a position in which the business can create long-term value for all its stakeholders.

Let me now briefly explain how to anticipate the structure and timing the capital market exit from our side. We expect the exit to take place during the next 12 to 18 months. The exact timing and structure of the exit will be decided at a later state. Both will depend on the future business and capital market environment.

During the remainder of this year and into next year, we will prepare and execute a legal carve-out of the MaterialScience business. We will draw up pro forma financial statements for both companies, Bayer healthcare and crop science combined, and MaterialScience new, and have them audited. We will also design a detailed company setup for MaterialScience to ensure it's fully sustainable as a separate entity.

We expect to use any potential proceeds mainly for investing in the further development of our life science businesses and/or for reducing net debt, so that we deleverage the balance sheet, following our recent acquisitions of Algeta and Merck Consumer Care.

Please be assured that all of our businesses will continue to operate as normal while we are preparing for the capital market exit. Both entities are expected to be very significant players in their respective markets. The companies of the future Bayer group have pro forma sales of approximately EUR29.3 billion, and EBITDA margin pre-special items of 24.8% in 2013. They will employ nearly 99,000 people, including about 29,500 in Germany.

Following the intended floatation, MaterialScience will generate global sales of approximately EUR11.3 billion, based on pro forma 2013 figures, and an EBITDA margin pre-special items of 9.1%. The new company is planned to have a global workforce of roughly 16,800 people, including about 6,500 in Germany.

So to sum it up, we are convinced that today's strategic decision will benefit both businesses, and enable them to create value in the long term. Bayer will be in an innovation and life science company that is recognized for 150 years of success in science and innovation, and on which we can continue to build.

Our life science businesses operate in markets that are attractive in terms of growth and profitability. We will leverage our broad product portfolio, along with the strong brand's reputation and focus our entire management team on the successful development of the life sciences business.

MaterialScience will be at a clear advantage as it sits about leveraging its competitive edge outside the Bayer group. In recent years, the business has been suitably equipped for the standalone case, and will have the knowhow for successful operation as a separate company.

As Europe's fourth-largest chemicals company, and with autonomous access to capital to fulfill its investment needs, MaterialScience new will continue its operations as a market leader in high tech polymers under new ownership.

So Alexander, that concludes my remarks. I think we can now take the questions.

Alexander Rosar - ***Bayer AG - Head ? IR***

Exactly. Henry, can you call for the questions?

Operator

(Operator Instructions) Sachin Jain, Bank of America

Sachin Jain - ***BofA Merrill Lynch - Analyst***

Hi. Afternoon, Sachin Jain from Bank of America. A few questions, please. Firstly, on the capital market exit option, spin versus IPO. I wondered if you could just provide a brief discussion of the pros and cons you see of each approach from your perspective. Is it just down to future market environment, or do you have any particular preference for cash?

Secondly, Werner, I wondered if you had any early discussions with the rating agencies on how they would view this deal.

And then thirdly, again I know it's early days, but in terms of debt and pension liability that could sit within MaterialScience, I wonder if you could give us any color there. Thank you.

Werner Baumann - ***Bayer AG - CFO***

Yes, Sachin. Thanks for the questions. First of all, we are not opposed to taking any cash as part of the separation of BMS. But that's not the overarching objective. The overarching objective is to establish a strong and independently listed market leader in its field, as Marijn has already outlined. And then it will entirely depend on having a capital markets window which allows an IPO.

If that window is not available, we would opt for a spin. So you see that a cash influx is important, but second priority. And so our priority is for and IPO. But if that cannot be done inside of the timeframe the end of which we would go for a spin scenario.

Secondly, we have been working exclusively internally all the way through today towards the endorsement of our supervisory board for the position we had taken in the Board. So no external discussion whatsoever have taken place up until now.

And third, in terms of debt and pension, BMS certainly in Germany will take its own pension obligations as part of the carve-out. We have, of course, internally looked at the debt capacity of BMS new. It's a little bit too early to disclose it because it's done its own 2016 kind of pro forma target financials. And it would not help the discussion.

I can tell you that we are looking at a benchmark debt level and also rating for the new company is going to be investment grade, and then it also depends a little bit on whether it's going to be a spin or an IPO. But really early days. It's too early to tell.

Sachin Jain - ***BofA Merrill Lynch - Analyst***

Thank you very much.

Operator

Jo Walton, Credit Suisse

Jo Walton - ***Credit Suisse - Analyst***

Oh, apologies for that. I lost you there for a minute. I just have a quick question about the corporate costs and how you would envision that. Do you think that there is going to be?we should, when we model this, take the corporate costs and apportion them based on the proportion of profits that you make, or in the proportion of sales that you make?

And the second question is just in terms of the speed of this transaction. What's the gating item? You say 12 to 18 months. But if you think of that, what has to go right to make this happen more quickly? Is it an issue of getting approvals, or is this some sort of legal separation issue? Because I would assume that you could maybe do this more quickly.

Werner Baumann - ***Bayer AG - CFO***

Yes. Thanks, Jo, for the question. Let me start off with answering the first one on corporate cost. Whether you can do it on sales or profit, my answer would be neither/nor. Nor can I give you, at this point in time, kind of a range. And what I can say is that it is not going to be a humongous impact we are going to see. However, we will have some redundancy costs which we will have to deal with after the separation.

The way you should look at it is you should simply look at BMS pro forma and the way we report it right now without corporate center, it is a fairly lean and small organization which we need to enable. It is going to be somewhere in the area of let's say somewhere in mid-double-digit amount of millions that could be envisioned, order of magnitude for the corporate center they will need.

And then on the other side, in Bayer, we will have lower absorption which we will have to address as part of the process after separation of MaterialScience.

In terms of speed, you're absolutely right. We can be fairly quick. However, there are a few stepping stones we have to take. It starts with the internal things we have to do in terms of business design, some legal stuff we have to do in aligning the corporate structure all underneath BMS AG. So a lot of the subs are not owned by AG today. They are depending on whether it's going to be an IPO or a spin, different routes we have to take in terms of boards or even AGM approvals.

And last but not least, it depends on the capital market window we see. That's why we've given you a range. If things go really, really well and fast, it's going to be just about a year, not a lot less, not a lot more either. Depending on capital market's window and a few other considerations, it might stretch out a little bit longer.

Jo Walton - ***Credit Suisse - Analyst***

Thank you.

Operator

Florent Cespedes, Exane BNP Paribas

Florent Cespedes - ***Exane BNP Paribas - Analyst***

(inaudible) gentlemen. Thank you for taking my questions. First of all, for Werner, you say that you want to remain part of the industry consolidation. So could we have an idea of what could be the remaining fire power after the transaction to take part of the potential industry consolidation?

And my second question is on group tax rate. I know it is early days. But could we have an idea of what could be the impact of the Bayer life science tax rate?

Werner Baumann - ***Bayer AG - CFO***

Yes, Florent. On the first question, the technical part, I do?Marijn may want to add something on, let's say, the strategic angle of it. The financial fire power right now is very limited. If you look at the debt level, we have [powered] up as part of the Merck ODC acquisition. So in terms of wiggle room, it is actually very, very limited, absent something bigger which would then lead us to actually raising some equity.

There are no actual plans of doing that. But generically, that's the situation we are in, in terms of fire power, if you want. So smaller things, very small things are part of day-to-day operations. As soon as it becomes mid or big, it will be much more difficult, given where we are today. And we certainly have to de-lever before we can do something debt financed again.

The group tax; that's actually a fairly easy answer. It's either going to be the same, higher or lower. There's nothing else we can say at this point in time. There are other, let's say, complicating issues on top. You may have seen the OECD activities that they are going to take a position by the end of this week in making multinational lives a little bit more difficult. We are working towards our objectives for 2014. Everything else thereafter, also the financial implications in general of the separation, would then much rather be subject of an adjusted guidance going forward. And that's nothing we would do today, nor can we.

Florent Cespedes - ***Exane BNP Paribas - Analyst***

Okay. Thank you.

Marijn Dekkers - ***Bayer AG - CEO***

I would just like to add one comment, maybe just for clarity. This decision to do this is not to create space for Bayer or BMS for that matter, in the very short term. Okay, because this is not a short-term decision. This is a very long-term decision, where we have the strong belief that BMS will develop itself better when it's an independent company outside of Bayer. And that is a 5 to 10-year comment. Not a?the next five weeks or five months comment.

And in the same vein, you should take the comment that we want to continue participate in the industry consolidation that is also a long-term comment, and not?you know, we have plans in the next five weeks to do this or that.

Florent Cespedes - ***Exane BNP Paribas - Analyst***

Okay. That's very clear. Thank you.

Operator

Christian Faitz, Macquarie

Christian Faitz - ***Macquarie Research Equities - Analyst***

Thank you. Actually, all my questions have been answered. And good luck with the spinoff.

Alexander Rosar - ***Bayer AG - Head ? IR***

Thank you. And there's a next question, please?

Operator

Andreas Heine, Barclays

Andreas Heine - ***Barclays Capital - Analyst***

Yes. I just want to know whether a straight sale was ever on the agenda, or whether the long-term value creation by being separate and a standalone company rather than part of a different company were always the only exit route you were looking at.

Werner Baumann - ***Bayer AG - CFO***

Thanks for the question. We of course, as Marijn said earlier, we have analyzed the situation of both the group and BMS in depth, not only over the last month, but over the last years. We have come to the conclusion that we can separate from BMS, creating a separate market leader. We want to do this by establishing a listed company. That is our objective, and that is what we are planning to do.

Operator

Saba Hekmat, New York Life Investors

Saba Hekmat - ***New York Life Investors - Analyst***

Thank you. This is Saba Hekmat from New York Life. A lot of my questions have been answered. But I just wanted to get some clarification on one of the first questions with respect to the rating agencies, and your communication with them, as to what the impact, if any, would be to buyer post the separation of BMS.

Werner Baumann - ***Bayer AG - CFO***

We will engage as we usually do in due time with the rating agencies, and we talk about the target profile of BMS. We certainly do have the objective to not erode our own rating. That's of course understood. How this is going to look like, and I can only repeat what I said earlier. That it depends a little bit on the target profile of BMS new, on its cash generation over let's say the next year or so, when we define the balance sheet structure, the level of debt it can take. And of course it depends on the question of whether it is going to be an IPO or a spin. Because implications for us will be different.

Saba Hekmat - ***New York Life Investors - Analyst***

I understand. But given your commitment to this process and given as you said, your financial flexibility right now is somewhat limited with the Merck acquisition. Would you be willing to sacrifice the rating slightly for this transaction to go through?

Werner Baumann - ***Bayer AG - CFO***

That is not a question we are considering, quite frankly.

Saba Hekmat - ***New York Life Investors - Analyst***

Okay. Thank you.

Operator

Jeffrey Holford, Jefferies

Jeffrey Holford - ***Jefferies & Co. - Analyst***

Hi, it's Jeff Holford from Jefferies. Thanks for doing the call and thanks for taking my questions. Just wondering on the Bayer healthcare side and life sciences side; do you think this could have any future implications for the level of payout that the Company might consider to make it more in line with some of the large cap pharma peers.

And just secondly, you did mentioned recently you were continuing to make a strategic review on the animal health side of the business. Does this separation potentially reflect any of those thoughts that you have and does it help potentially enable the strategy where you might bulk up in animal health? Thank you.

Werner Baumann - ***Bayer AG - CFO***

Yes. Let me answer your first question. This is Werner Baumann speaking. And then Marijn for sure will shed some light on animal health.

We are not reconsidering the current dividend policy because we are still a year away, minimum from the separation of BMS. And I can only repeat what I said earlier. Today we are communicating a strategic position, and the first milestone of a process. A lot of the consequential issues which will arise, also questions in terms dividend payout, what is the right peer group and what have you; those will be answered in due time. Anything which is guidance-relevant, as usual, will be part of our end of February communication, to the extent that it's relevant at that point already.

Marijn Dekkers - ***Bayer AG - CEO***

Yes, this Marijn on our activities. Again, I mentioned, and that's why I did that, is this is a sort of a long-term strategic decision, and not one that we now need to do because we need to raise money for a specific acquisition target. That is not the thinking behind this, and it shouldn't be interpreted this way.

So I really don't want to speculate about potential areas of interest for acquisitions at the moment. If I just look, it's now October 2014. We've already done Algeta. This year we've done Merck OTC. We now have this big decision with MaterialScience. We've been very, very active.

We also need to execute all of these things. So I would say we'll stay focused. And of course, over a longer-term period, when consolidations and opportunities come up for M&A, we will clearly look at them. But it's not on the short-term agenda.

Jeffrey Holford - ***Jefferies & Co. - Analyst***

Thank you.

Operator

(Operator Instructions) Jo Walton, Credit Suisse

Jo Walton - ***Credit Suisse - Analyst***

Just a quick one; under IFRS accounting once you've made a strategic decision to get rid of something, you normally have to put it as a discontinued business. Should we assume that that's how you will be accounting for this from the beginning of next year?

Werner Baumann - ***Bayer AG - CFO***

No, you should not safely assume that, Jo. It really depends. There's some more technicalities involved here. We have to be very, very certain that at the time and point we declare discontinued, we are diluted down below 30% within a maximum of 12 months.

And you're doing that with a higher risk position, only to revert back to reporting it as continued doesn't make sense. So we want to be absolutely sure. So seeing that at the beginning of next year item, will not happen.

Jo Walton - ***Credit Suisse - Analyst***

And a quick second question; you said there were about 16,800 staff to go out of the business. That seems to be a bit more than we've got reported as being part of MaterialScience at the moment. Are there elements of significant numbers of central people that will move out as well?

Marijn Dekkers - ***Bayer AG - CEO***

Yes. I mean that's the right conclusion. About 2500. So they come from the different service organizations, IT, the central engineering unit that we have; some corporate people. That all adds up because that is expertise. A lot of people who are now solely working for MaterialScience anyway will go and join MaterialScience when they go independent.

Jo Walton - ***Credit Suisse - Analyst***

And will these 2,500 people or so already effectively be charged to that business? Or are these the people that make up the mid-double-digit corporate services line that will [get across] as well.

Werner Baumann - *Bayer AG - CFO*

Jo, this is Werner speaking. First, the 2500 people which go over have already today?they are already today fully absorbed in MaterialScience's P&L. And as Marijn mentioned, these are the people in the service companies. We have normal contracts between the service companies and the businesses. They are being charged out on a cost-plus or market price basis. So there's no incremental cost that we would see in BMS, nor as to any relief we would see at our end.

On top of that, the Company is being run by one corporate center. So we have one center tax department, we have one treasury department, we have one IR department, and so on. And all of that now needs to be replicated. And we will not be able to simply split and actually fully populate BMS with our own organization, which means that we have a little bit of redundancy cost here, because we have to re-staff. And on the other side, there is some real incremental organizational structure which needs to be built at BMS. That's where that incremental cost is coming from.

Jo Walton - *Credit Suisse - Analyst*

Thank you very much.

Operator

There are no further questions at this time. Please continue with any other points you wish to raise, Alexander.

Alexander Rosar - *Bayer AG - Head ? IR*

In this case, ladies and gentlemen, also on behalf of my colleagues, I'd like to thank you for being with us on the call. And thank you for your questions. We're now saying good-bye, and hope to see you all at our mid-management conference in London on September 30th. Bye-bye.