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# EDITED TRANSCRIPT

BAYN.DE - Full Year 2014 Bayer AG Earnings Call

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**OVERVIEW:**

BAYN reported full-year 2014 sales of EUR42b. 4Q14 group sales were EUR11b and core EPS was EUR1.19. Expects full-year 2015 sales to be EUR46b.



## CORPORATE PARTICIPANTS

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**Marijn Dekkers** Bayer AG - CEO

**Johannes Dietsch** Bayer AG - CFO

**Liam Condon** Bayer AG - CEO, CropScience

**Olivier Brandicourt** Bayer AG - Chairman, Bayer HealthCare

**Patrick Thomas** Bayer AG - CEO, Bayer MaterialScience

## CONFERENCE CALL PARTICIPANTS

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**Fabian Wenner** Kepler Cheuvreux - Analyst

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**Florent Cespedes** Societe Generale - Analyst

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## PRESENTATION

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### Operator

Ladies and gentlemen thank you for standing by. Welcome to Bayer's investor and analyst conference call on the full year and fourth quarter 2014 results. Throughout today's recorded presentation, all participants will be in a listen-only mode. The presentation will be followed by a question-and-answer session. (Operator Instructions)

I would now like to turn the conference over to Mr. Alexander Rosar, Head of Investor Relations at Bayer AG. Please go ahead, sir.

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### Alexander Rosar - Bayer AG - Head of IR

Thank you, Kleo. Ladies and gentlemen, good afternoon and welcome also on behalf of my colleagues to our fourth quarter conference call. Today, we'd like to review our 2014 numbers with you and we will also provide you with our 2015 financial outlook.

With me on the call are Marijn Dekkers, our CEO and Johannes Dietsch, our CFO. Healthcare is represented by Olivier Brandicourt, CropScience by Liam Condon and MaterialScience by Patrick Thomas.

Marijn will start off with an overview of the highlights in 2014, give a brief summary of the developments in the fourth quarter and he will then elaborate on our outlook for 2015. We assume you have all received and reviewed the briefing document and the presentation slides so Marijn can focus his presentation on the main points.

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



Thank you. Marijn?

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**Marijn Dekkers - Bayer AG - CEO**

Thank you, Alexander. Good afternoon, ladies and gentlemen. It gives us great pleasure to welcome you to our conference call. 2014 was a very successful year for Bayer. What made this year successful is first of all, strong operational performance but also we made significant strategic progress. All our subgroups contributed to our business expansion, allowing us to post new records in terms of sales and earnings and we were particularly pleased that our product innovation showed continued good growth momentum.

Operationally, we have exceeded the targets that we have set out for ourselves at the beginning of 2014. Our portfolio transformation into a pure life science company and the integration of our acquired businesses remain on track.

Against this background, we are proposing a dividend of EUR2.25, which represents a 7% increase over the prior year. The resulting payout ratio of 37% falls within our 30% to 40% dividend payout target. We remain optimistic about future developments. Our financial outlook for 2015 projects further growth and a significant improvement in earnings.

Let me briefly review some of the key figures underlying the performance in Q4. Group sales increased organically by 7% over the prior year to EUR11 billion driven by the business expansion in all of our sub-groups. Reported EBIT dropped by 14% to EUR561 million due to the special charges in the context of the disposal of goodwill, provisions for litigation and expenses for integrating acquired businesses. Adjusted EBITDA of EUR1.8 billion was 4% above the previous year mainly due to higher volumes within all sub-groups. Earnings were diminished by higher expenses for marketing and sales as well as research and development. Core earnings per share in the quarter increased by 8% to EUR1.19.

Moving to slide 5, let's take a look at some key fourth-quarter figures for the individual businesses. And please when I am referring to sales growth, note that this is portfolio and currency adjusted data.

Our pharma segment sales grew 10% with our recently launched products driving this impressive performance and I'll elaborate more on that in a couple of slides. At pharma EBITDA before special items increased by 14% to EUR939 million, primarily due to the strong sales growth of our newer products, and this was partially offset by higher expenses for marketing and sales, R&D and negative currency effects in the order of approximately EUR50 million.

Consumer health sales advanced by 4% versus the prior year. This performance was driven by our consumer care division which grew 9% in the fourth quarter on the back of strong performance of our key brands. The acquired Merck business contributed EUR289 million.

In animal health, sales declined 1% compared to the prior year due to slower tick and flea season and generic pressure for Baytril. In our medical care business, sales were overall flat.

EBITDA before special items of consumer health fell by 5% to EUR487 million. This was due to declines in earnings at medical care and animal health. In addition, we invested in new product launches at consumer care.

CropScience delivered strong growth with sales gains of 8% contributing EUR2.2 billion in the quarter. This performance was driven by higher volumes and improved pricing. Crop protection grew 8% with a significant contribution from Latin America. Seeds grew a remarkable 17%, driven by strong developments in vegetables, cotton and soybean. EBITDA, before special items, rose by 16% to EUR369 million. The contribution stemmed from significantly increased sales volumes at crop protection and seeds, higher selling prices as well as a positive currency effect. This was partially offset by higher selling expenses.

MaterialScience sales increased by 5% to EUR2.9 billion. This increase was due to higher sales volumes in Polycarbonates; Polyurethanes; and Coatings, Adhesives, and Specialties. The subgroup achieved growth in all major regions except Europe where volumes were broadly flat in Q4. EBITDA, before special items, fell 13% to EUR217 million mainly due to higher raw material and energy costs, as well as higher fixed costs.

Let me now briefly review some of our key figures for the full year 2014 and compare them against our original guidance. I'm pleased to report that we were able to achieve all targets for the full year, with sales growing by 7% to EUR42 billion in line with our raised guidance. We delivered on our earnings promise with adjusted EBITDA rising 5% despite a negative EUR400 million currency effect. We met our mid-to-high single-digit percent guidance on core EPS, achieving 7% growth in 2014. This success was in particular driven by the strong top line performance in pharma and CropScience, both up 11% and then the business expansion of consumer care.



Let me elaborate on these highlights in some more detail beginning with the recently-launched products in pharma. Driven by the continued success of our recently-launched products, as we said, pharma sales advanced 11% in 2014, making it one of the fastest-growing pharma businesses globally. Collectively, these products generated EUR2.9 billion in sales and hence we exceeded our target of EUR2.8 billion that we set for ourselves at the beginning of 2014.

Xarelto ended 2014 with EUR1.7 billion in sales, firmly establishing Xarelto as the leading novel oral anticoagulant achieving 32% global market share in the overall anticoagulant market in December. These most recent IMS figures represent an increase of 8 percentage points over the same period in 2013 and since Xarelto's launch we estimate we have treated more than 10 million patients.

Eylea also gained momentum in 2014 and with sales of EUR759 million for the year we clearly exceeded our target of EUR700 million that we set for ourselves at the beginning of 2014. Impressive gains were achieved in important European markets and moreover in Japan and Australia, we could defend our close to 50% share of the market.

Stivarga finished the year with EUR224 million in sales, up 17% driven by successful roll-outs in various geographies with notable strides in Germany and Japan. Going forward, we believe that we can grow Stivarga in the mid single-digit percentage range with possibility of a significant acceleration if and when new indications can be developed.

Xofigo ended the year weaker than anticipated with EUR57 million in sales due to temporary product shortages during Q4. Since then, this issue has been resolved and patients are now resuming treatment and therefore we expect continued healthy growth in 2015.

Adempas is currently the only drug approved for both PAH and CTEPH and since October 2014 we collaborate with Merck & Company in the development and marketing of Adempas. Sales attributable to Bayer as a result amounted to EUR89 million in 2014.

So now let's turn to consumer health. First, consumer care has also performed well in 2014. The integration of the acquired businesses are running on schedule and impressive progress was achieved in further developing our brands and in building our business in key emerging markets. As you can see on this slide Aspirin sales, including that of pharma were up 5%. Aleve showed substantial growth, up 10% mainly due to product line expansion and Bepanthen achieved a remarkable sales growth of 18% for the year. Strong organic growth was achieved in China, Russia and Brazil, underpinning the successful execution of our emerging market strategy at consumer care.

Then CropScience, driven by the ongoing success of our new commercial strategy, our CropScience business has again shown an exceptional performance and sales there advanced 11% in 2014, driven by higher volumes, were up 9% as well as strong pricing performance with prices up 2%. And we are pleased to report that we are gaining share in 2014. Our new crop protection products normally grew 23%, lending almost EUR1.9 billion to sales in 2014. And then our seeds business with strong sales increases in cotton and oil seeds delivered EUR1.1 billion in sales, which is translating into nearly 20% growth over the prior year. It's also worth mentioning that we could maintain a high EBITDA margin of close to 25% at CropScience. So taken together, I believe we can say that 2014 was a very successful year for our life sciences business.

Now on the next slide, I'd like to give you an overview of our outlook on 2015. Our Group guidance for 2015 is based on December 31, 2014 exchange rate, including a euro-US dollar rate of \$1.21. As stated, we plan to grow sales to about EUR46 billion in 2015 and this corresponds to a currency and portfolio-adjusted growth in the low single-digit percentage range. We aim to raise EBITDA before special items in the low to mid-teens percentage range and core earnings per share in the low teens percentage range.

During 2015, we'll also continue to invest heavily in organic growth for the future. We plan to increase R&D expenditures by about 10% to more than EUR4 billion with the largest proportion invested in our pharma division where we expect important pipeline progress during the next year, year and a half. So we are thus committing to an increase of our pharma R&D budget spend from EUR1.9 billion in 2014 to EUR2.2 billion in 2015 for a EUR300 million increase. In addition to R&D, we are continuing to build new production capacity for our products and fixed asset investments are planned at around EUR2.3 billion and investments in intangible assets of EUR300 million.

Now guidance by sub-group, for healthcare, in 2015 we expect revenue of about EUR23 billion and this translates to a currency and portfolio adjusted increase in the mid-single digit percentage range, and we anticipate EBITDA before special items to increase in the mid-teens percentage range.

So in the pharmaceutical segment, we expect sales to increase organically in the mid to high single-digit percentage range, and we plan to increase in 2015 new product sales towards EUR4 billion -- from EUR2.9 billion last year towards EUR4 billion and to increase adjusted EBITDA in the low teens percentage. We forecast also a slight improvement in the adjusted EBITDA margin.



In the consumer health segment, we plan currency and portfolio adjusted growth in the mid single digit percentage range and EBITDA before special items is expected to increase in the mid to high 20%<sup>s</sup> percentage range.

Then CropScience, after having done four consecutive years of around 10% annual sales growth at CropScience, we believe that we will be faced with a more challenging market environment during 2015. And this particularly pertains to the first quarter which also must be viewed against a very strong quarter start in the season of 2014.

So, we plan to continue to grow above market in our CropScience business and anticipate achieving a turnover of about EUR10 billion and this translates to a currency and portfolio-adjusted increase in the low to mid single digit percentage for the year.

Now in light of the very tough comparator first quarter 2014 as I already mentioned, it might be that first quarter sales growth this year will come a little below this guidance for the full year. And then for the full year 2015, we expect EBITDA before special items to increase in the low to mid single-digit percentage points.

Then MaterialScience, in 2015 we actually expect lower sales as volume growth is over compensated by weaker selling price. However, we expect to see a significant increase in EBITDA before special items and we aim to earn the full cost of capital in 2015. As I mentioned, the planned separation of this business is progressing well allowing us to confirm our original timeline.

So, in summary, we believe 2014 was a very good year. All our subgroups contributed to our growth momentum and operationally we have achieved our set targets. We continue to be optimistic that we can also deliver further growth and higher earnings in the future.

And Alexander this concludes my remarks. I assume we're now happy to take questions.

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

Exactly. Kleo, would you mind opening the Q&A session?

#### QUESTION AND ANSWER

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**Operator**

Thank you very much. Ladies and gentlemen, at this time we will begin the question-and-answer session. (Operator Instructions)

Tim Race.

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**Tim Race - Deutsche Bank - Analyst**

Tim. It's Tim Race here from Deutsche Bank. Just a few questions if I can. First of all, just a very simple housekeeping question, just on tax. Can you discuss what the gains were in the fourth quarter? But then moving on to more interesting questions, could you just discuss we got the Meet Management day coming up very soon and I'm expecting a new mid-term target. Could you just discuss your thinking about healthcare in particular in terms of -- obviously top line is growing very strongly and possibly ahead of where consensus is expecting and what you expect to do with that sort of extra cash that you're generating? Should we look at this as a margin expansion story or is it more R&D going forward beyond 2015, or should it be a compromise of both, just how we should start thinking about that, please?

And then perhaps just a question on CropScience, obviously you've still a very optimistic guidance relative to the market. Could just share whereabouts should we be expecting to take share, which segments and why? Okay, thanks. I'll leave it there.

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**Marijn Dekkers - Bayer AG - CEO**

Okay. Thank you, Tim. We are going to start with your very interesting question about the tax thing. We actually think the tax is a very interesting topic. So, Johannes you want to?



**Johannes Dietsch - Bayer AG - CFO**

Yes. (inaudible) About the tax in the fourth quarter, first of all, we need to say that the earnings before taxes were relatively low in the fourth quarter. And secondly, for the full year we came in with 23.9%, which is at least better than guidance. And in the fourth quarter, technically we had some special items in the tax regulations relating for the full year both here in Germany as well as in the US and given that we had a very low base of systems and translated into tax gains in the fourth quarter. But overall for the full year, they are pretty much in line with our guidance or a little bit better than the 25% we had originally.

**Marijn Dekkers - Bayer AG - CEO**

Okay. Tim, I will take the second question. It's not really fair to ask Olivier to give projections for upcoming years but you can ask him to give projections but not for Bayer. And so I will answer it. And then I think you said it, I mean we will update mid-term targets at the Meet Management meeting in Berlin very extensively. So I don't want to get too much ahead of ourselves there.

But just a general comment, I believe that we have really made a substantial progress in particularly our pharma business over the last few years. And as I mentioned, we are currently the fastest -- one of the fastest growing pharma companies globally, and we are improving our profits and progressing our product development pipeline really nicely. We are convinced that these factors will, over time, bolster our pharma margins and we've already reflected that in 2015 where we've also said that we project mid to high single-digit growth, low teens percent improvement in adjusted EBITDA and also some margin progression.

And I don't know if you picked it up, but in this guidance for 2015, we have an increase of EUR300 million R&D investments to, as I said, to build on our R&D pipeline and our indications for our products going forward, so it's EUR300 million extra in EBITDA R&D cost.

So, we will see more and more top line leverage that will translate into further margin improvement beyond 2015, so in 2016, 2017 and 2018. But in the end this degree of improvement will depend on the progression of our pipeline. I mean, the better we do on the pipeline, the more we will spend on R&D, and it will hold back margins. The worse we do on the pipeline, higher the margins will come out. So, this is a, in that sense, a balance where, yes, we are going to get margin expansion, but how much exactly really depends also on the success of our pipeline and the success of our Phase II trials moving into Phase III, and we will create some more visibility around that in a few weeks in Berlin if that's okay.

Then CropScience, Liam?

**Liam Condon - Bayer AG - CEO, CropScience**

So thanks a lot, Tim. And as you said, overall, we are expecting a soft market environment this year and your question where do we have the optimism and the confidence to continue to grow, I think you could break it down in general terms on the one side into geography and the other into portfolio. So, geographically in soft years in CropScience the two geographies that tend to get hit the hardest are the Americas, North America and Latin America, the big exports commodity impacted geographies. And even in a softer environment for those two geographies, we assume that we can continue to gain market share in a soft environment, but we think they will be particularly soft market developments in those two geographies.

And where geographically what is less impacted from trends and commodity prices and then overall soft outlook in the CropScience world tends to be Europe and Asia-Pacific and we are particularly strong in Europe, so that gives us a degree -- a good degree of confidence that we can maintain a reasonably robust performance even in a soft year.

And then from a portfolio point of view, the big commodity swings nowadays, particularly in the area of corn and soy, the big broad-acre crops and if you look at the breadth of our portfolio, about a quarter of our portfolio sales actually relates to fruit and veg, which doesn't tend to be impacted by the softening of the market. Another quarter is cereals, which is less impacted and then we have the whole area of innovation and new products where at the end of the day, even in this soft markets if a farmer has resistance issues or problems that he can't solve with a lower-priced product then he is going to fall back on innovation to solve his problem and ensure his yield.

So that kind of in a nutshell, gives us the confidence that we can continue to grow solidly in 2015 despite the fact that it will be a soft year.

**Operator**

The next question comes from the line of Mrs. Walker. Please state your name, company name, followed also by your question.

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**Amy Walker - Morgan Stanley - Analyst**

Good afternoon team. It's Amy Walker at Morgan Stanley. I'll try for three as well please. On consumer health, excluding the EUR70 million or EUR73 million contribution from the Merck OTC assets in the pre-exceptional EBITDA line, you saw a decline of 20% in fourth quarter. Marijn you mentioned that higher selling expenses and R&D cost contributed, but could you give us a bit more color on that? Exactly how much was the incremental selling costs do you think those are going to have to continue through the next several quarters? And did medical care decline further sequentially in the fourth quarter versus the third quarter please?

In terms of the pharma pipeline, can you update us on where recruitment is for your Phase IIb trial for regorafenib in Wet AMD and if you still expect completion in early 2016 for that trial? And also could you file on those results or do you need to run a Phase III for that?

And then very last one on CropScience, what would the minus 8% Q4 growth in Europe look like excluding the pull forward of sales into Q3, which you actually have shown positive growth in Europe? And Liam just to your last point about new product introductions, how many new products will we see launched in CropScience this year versus last year? Thanks very much.

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**Marijn Dekkers - Bayer AG - CEO**

Okay. Thank you, Amy. We thought you were going to ask 50 questions. So, we are somewhat pleased that it's only three. We will have Mr. Dietsch start with the OTC question.

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**Johannes Dietsch - Bayer AG - CFO**

The first quarter includes the Merck OTC business where we had the closing as of October 1. We recorded sales of EUR289 million in the segment consumer health and EUR73 million in profits. Beyond that there is additional interest expense of roughly EUR65 million per quarter which translates into our financing costs of average 2.6% [which takes you] certain margin increasing in the core EPS already. Besides that we had one-time expenses on the integration booked off EUR77 million in the fourth quarter.

To see overall performance of consumer health you have to look at the segments medical care, especially the diabetes care business which were substantially below in profitability compared to the quarter before. And also, animal health was lower than the year before because we had recorded a one-time gain in Q4 2013 from TEVA. Then also in consumer care itself has a very good quarter in top line, but also invested heavily in PMI and marketing and sales.

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**Marijn Dekkers - Bayer AG - CEO**

Okay. Olivier, good afternoon. For wet AMD.

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

Yes. So, Amy you know that we have planned a Phase II study. It's not yet recruiting but it's actually very close to recruit and our primary study completion and we mentioned that last time is actually during the first quarter or at the end of the first quarter of 2016, so that's the deadline. That's the timeline.

Regarding the five focus projects or our Phase II project, we are ahead of our plans with copanlisib and we aim to start a Phase III around mid-year, mid-2015. We plan to present Phase II data for Finerenone both in diabetic nephropathy and that's in March at the World Congress of Nephrology. And the second indication worsening chronic heart failure that would be at ESC, which as you probably know is scheduled for August or September of this year. The riociguat Phase IIb data are also planned to be presented at the AHA this year. However, our timelines have changed for two of those five assets. Vilaprisan and Molidustat we are now planning to see our Phase II results by mid-2016.

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**Marijn Dekkers - Bayer AG - CEO**

Okay. Liam, do you want to the CropScience question, minus 8%?



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**Liam Condon** - *Bayer AG - CEO, CropScience*

Yes. Thanks, Amy. As you know there's sometimes big shifts between quarters in the area of CropScience in the sense that we don't work according to the financial calendar, but unfortunately according to the weather and sometimes there's more in one quarter and less in the other. And as you rightly said, we had a very strong Q3 with 13% growth. And I think if you look over the full year with 7% growth for Europe, this was very strong. And I can go into individual countries but I think overall, it's a normal trend for us if we have a very strong quarter the next quarter tends to be weaker. And as this quarter is weak in Europe, what you can expect is the first quarter will then be stronger and we already have indications of that right now. So it's nothing alarming. I would say it's totally within a normal pattern for us and we're very happy about the 7% growth for the full year.

You asked also about the new products in 2015. We will launch two new products in 2015; Sivanto, an insecticide; and Triafamone, a new rice herbicide. I think what's very important to highlight again is big difference with healthcare is of course our life cycles tend to be very long and we build up sales over a very long time period. So what's really benefiting from now in 2014 and 2015 is actually the launches that were made in 2010, 2011 and 2012. They're really starting to kick in. And so we have two this year and we have a nice -- we're basically turning out two new -- at least two new products every year apart from seeds where we have of course multiple varieties throughout the year every year. But two new bigger products where the initial sales will be small and the bigger impact will come from products that were launched in the recent years as opposed to within this year.

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**Amy Walker** - *Morgan Stanley - Analyst*

Thanks. That's very helpful. Just one quick follow-up for Olivier. Olivier that trial in wet AMD with regorafenib just to clarify, can you file in the Phase II or do you have to run a full Phase III as well before you can look to file that product?

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**Olivier Brandicourt** - *Bayer AG - Chairman, Bayer HealthCare*

At this point I can't answer that question but depending on the strength of the data, it may be fileable.

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**Operator**

The next question comes from the line of Mr. Cespedes. Please state your name, company name followed also by your question.

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**Florent Cespedes** - *Societe Generale - Analyst*

Good afternoon, gentlemen. Florent Cespedes from Societe Generale. Three quick product related questions. First on Xofigo manufacturing issue, could this have an impact on the product ramp-up and an impact on the product ramp-up and an impact on the ongoing clinical trials and what is your view on the consensus for this product which tells us that it could reach a blockbuster status in dollars in 2018?

Second question on Xarelto. Do you see more pressure from your competitors notably from Apixaban on the market? And could you refresh our memory on when we will have the Phase IV results for the new indications that will support the product?

And the last question is on Eylea, could we have more color on the performance in Europe and do you think that it could be possible to achieve the performance you delivered in Japan and Australia in terms of market share? Thank you very much.

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

Okay. Olivier.

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**Olivier Brandicourt** - *Bayer AG - Chairman, Bayer HealthCare*

Xofigo, yes, you have seen that the results for the quarter were very much impacted by the supply situation, but you've also seen our guidance for the product, which is reaching EUR300 million for 2015 in terms of sales. So clearly, we are expecting to do very well in the coming 12 months. And we think that supply situation will not

be a long term -- will not have a long-term impact. We are already working on regaining customer confidence after the drug shortages. We are raising and spending money raising (technical difficulty) awareness of Xofigo, increasing share of voice among target physicians and reviewing our sales force coverage, especially regarding the urologists. So that answers the question for 2015.

And long term we think that Xofigo leads the life cycle we have which you may remember looked at breast cancer and also eventually prolonged treatment up to 12 months versus six, or within six months using higher dosages of (inaudible) then we think we can reach the blockbuster status, which we have in our forecast.

Xarelto, regarding results in so far and how well, you've seen that we've been able to grow very significantly Xarelto during the quarter, more than 80% year-on-year FX adjusted for the full-year. So clearly, we are continuing to build our leading position in this oral anticoagulant area.

For the quarter, we did especially well in the US and in some European countries such as Spain and Poland. For the full year, we grew especially well in France, Germany and Japan, and in the US we basically doubled our sales. Our royalty, which are booked as sales as you know, more than doubled.

Now you need to look, to answer your question, you need to look at the details of market share. You heard Marijn mentioning the 32% versus Eliquis at 10.5%. This is global value as of end of December 2014. When you look more specifically at TRxs and NRxs in the US, Xarelto for the whole anticoagulant market is about 15% and apixaban is about 6%. So, we are competing very effectively and maintaining our position here.

The good news too is the Warfarin stickiness, if you want, is starting to melt and Warfarin was about 60% of the overall TRxs and if you look at February 2013, so almost two years ago, that number was 78%. So that's clearly -- we're seeing a lot of switches from Warfarin and more maybe than we have been used to.

In term of new Rx, Xarelto is at 32%, but here you are talking about only the oral, 32%, Warfarin at 46% and at Apixaban at 18%. So, that's just one example. We mentioned in the past, the results in the cardiology office. YAZ seems also to be stabilized. Xarelto is at 29% and Brxs in cardiology and apixaban at 33%. So the difference is not as important. The same thing in Japan and in Germany.

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**Florent Cespedes - Societe Generale - Analyst**

Eylea?

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

Eylea, you asked a question regarding the market shares in Europe that I can share with you that we're doing pretty well, in Switzerland at 41%, Germany at 37%, UK, 35% and France at 35%. To reach the 50%, which you have seen from Australia and Japan we probably need a new indication and more specifically is DME. We are planning to do very well with DME in Europe and hopefully get to that level of market share.

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**Operator**

The next question comes from the line of Mr. Wenner. Please state your name, company name followed also by your questions.

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**Fabian Wenner - Kepler Cheuvreux - Analyst**

Yes. I presume -- this is me, Fabian Wenner from Kepler Cheuvreux. I hope you can hear me well. Three questions please, first one to Werner or Marijn. I think you said in the past, there is no straightforward strategic buyer for MaterialScience who would be able to buy the whole division in one go due to antitrust issues. Are there any operational or structural hurdles that would prevent except for divestitures of polycarbonates and polyurethanes? That's the first question.

And then the second one for Patrick please. When you look at your current contractual obligations for the feedstocks, when do you think we're going to see the relief from the input costs? Is it going to be in Q1 already, is this more towards Q2, how much do you expect the margins to benefit vis-a-vis the declines in selling prices that you mentioned in the press release? That's the second question.

And then thirdly just quickly for Johannes, again on the taxes. In the 2015 guidance you partly answered this question already, just wanted to make sure there are no one-offs or exceptional things maybe in the tax rate that make the EPS guidance slightly lower than -- relative to the consensus than what you had on EBITDA for



example. So, basically EBITDA guidance seems pretty straight in line with expectations while EPS is very slightly below. Just wanted to make sure there's nothing in there that we don't see. Thank you.

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**Marijn Dekkers - Bayer AG - CEO**

Okay, Fabian, I'll take the first question. It's not easy to separate polyurethane and polycarbonate businesses in MaterialScience because -- for a few reasons. All the plants are in shares facilities. There is a high level of integration operationally and you would actually create when you try to pull those by significant dissynergies I would say. So that is not something that is very feasible and in the end will be value-creating in my opinion, not even when you then would be able to sell the individual pieces to a strategic buyer, who would then have synergies but we would have undone some of those synergies already clearly by the dissynergies of stripping it out.

Patrick, feedstocks.

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**Patrick Thomas - Bayer AG - CEO, Bayer MaterialScience**

Yes, I think the first point we saw feedstocks starting to pull was towards the end of November and that starts to roll through our supply chain in the quarter one and quarter two. Clearly with the falling raw material price, the margins will increase for a period of the year. The ability to hold onto those margins, of course, depends more on the supply and demand balance and that's different in each of the different segments. But, for example, we've seen strong growth in polycarbonates again last year, which is catching up with the long-term growth aspirations that we've seen in polycarbonate and therefore the prices are tending to hold solid even in quarter one. So I'm relatively optimistic.

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**Johannes Dietsch - Bayer AG - CFO**

Finally, the guidance on the tax rate for 2015 is again 25%. We aspire for this level or -- of course our mission is to come in slightly below, but you may not expect any unpleasant surprises that we are above the 25%.

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**Operator**

The next question comes from the line of Sachin Jain. Please state your name, company name, followed also by your question.

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**Sachin Jain - Bank of America Merrill Lynch - Analyst**

Hi. It's Sachin Jain from Bank of America. Thanks for taking my questions. Just a few please. Firstly on the pharma R&D. I think 2015 is coming at about 17% of sales, you commented on why you believe that investment is below peer. So I wonder if you could just frame what you view as an appropriate level of investment obviously understanding it's dependent on pipeline success.

And secondly, a related question, I understand you'll give visibility on the mid-term in a couple of weeks, but why don't you just comment as it fits, does the 33% pharma margin target for 2016 still stand given the base that implies roughly 200 basis point inflection from 2015 level?

And then the final question is on the hit in EBITDA and the delay to mid-2016, any color on what's behind that delay, is it more dose ranging work that's been needed? Thank you.

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**Marijn Dekkers - Bayer AG - CEO**

Sachin, thank you for your questions. First, I did not say that we were below peers with our percentage of R&D of sales. You just said it, but I did not. Just to make sure that --

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**Sachin Jain - Bank of America Merrill Lynch - Analyst**

Apologies. That's a quote on Bloomberg, says spend levels below peers. So I'm not sure whether that's correct or not, but that was the quote on Bloomberg.



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**Marijn Dekkers - Bayer AG - CEO**

Okay. I didn't say that either. Why don't I'd say because it's irrelevant. I don't care what our competitors spend much on percentage in sales, the question is what do you do with the money and how good are you doing it and what comes out of it in the end. And I think we have been, if you ask me, relatively modest in our spending with 15% if you do compare it with peers. But we cannot keep that up because we actually have too much success with our currently introduced products for which we need to develop new indications and do new trials, plus we have this pipeline coming through. So we believe that it's justified to increase this percentage of R&D and as I mentioned before, I don't want to say more about it. We will give guidance on 2016, 2017 and 2018 in March 11?

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**Johannes Dietsch - Bayer AG - CFO**

Yes, Meet Management.

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**Marijn Dekkers - Bayer AG - CEO**

In Meet Management in Berlin, but it is a trade off of, yes of course, we are going to get margin expansions in the pharma, but at the same time we have to make sure that when the pipeline develops successfully that we appropriately invest in bringing that all to fruition.

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

On Molidustat, yes I mentioned it was a delay versus our original plan. It's a very complex program. We have three Phase IIb going on plus two Phase IIb line extensions. So five studies going on at the same time and we are falling slightly behind in term of recruitment that explains mainly the delay and you should see those results coming during the first half of 2016.

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**Operator**

The next question comes from the line of Mr. Verdult. Please state your name, company name, followed also by your questions.

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**Pete Verdult - Citigroup - Analyst**

Yes, good afternoon, every. Pete Verdult, Citi. Love to ask Olivier about his plans to Sanofi but realize that this is neither time nor the place. So three Bayer specific questions. Marijn, number one just big picture on the future head of Bayer HealthCare, should we expect an internal candidate or are you looking at external options? Just basically trying to get a sense how quickly the situation might get resolved here to minimize potential disruption.

Secondly, on the pipeline and the comments you've been making about R&D investment, where is Stivarga and (inaudible) if Phase II half yearly data is success, are you planning any changes in the Phase III development program in light of the expected launch and strong adoption of LCZ696? Basically trying to better understand whether you're anticipating issues with respect to the timing of Phase II starts, patient recruitment in an environment where the standard of care is changing, whether you would seek to maybe target more of the preserved segment of the market or seek more data before making what's going to be a very significant Phase III go, no-go decision?

And then quickly and lastly on animal health, Marijn you've always been very candid about the strategic challenges being faced by the business as it currently stands. Any change in view here or new ones since the Meet the Management day in London? And then specifically on chewable formulation of your tick and flea businesses, your competitors are rolling that out. Does Bayer have any plans to do so? Similarly for Advantage, thanks.

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**Marijn Dekkers - Bayer AG - CEO**

Okay, thanks. I will try to answer the first question. You're saying is there a successor for Olivier, yes we announced that Werner Baumann going to succeed Olivier in his role as the CEO of HealthCare. But at the same time, internally we have some time ago initiated the project to look at our structure -- organization structure after the



separation with MaterialScience because we will then have two subgroups left, healthcare and crop, that actually from a business model have quite a lot in common. And the question is, are there further synergies and further streamlining possibilities in the organization to make us more effective and efficient.

So we're looking sort of completely coincidental, but at a time that Olivier is leaving, we're also looking at what -- is there an optimized new organization structure for the life science company that we will be once MaterialScience is separated. And what finally is going to happen will also depend on the outcome of that analysis.

One thing I would like to say though is that it's very unfortunate that Olivier is leaving from a Bayer point of view. But at the same time, if you look at the people who are running the businesses, we have Dieter Weinand running pharma, we have Erica Mann running consumer care, we have Dirk Ehle running animal health and we have Alan Main running medical care and these are four very, very talented highly experienced people who know these businesses extremely well. So from a continuity point of view, we really feel quite confident that we won't miss a beat in 2015 as much as we will miss Olivier of course.

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

Animal health.

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**Marijn Dekkers - Bayer AG - CEO**

Yes, I was going to leave that to you (inaudible).

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

The Vericiguat question. Then we start with two Phase IIb, right, one in reduced ejection fraction, one in preserved ejection fraction. And you should see we have planned for primary study completion around May 2015, so it's coming very soon. Therefore, your question is a right question, what do we do in light of the LCZ results. We think that there is still room for improvement despite good results of PARADIGM in CHF, right. So PARADIGM in stable chronic heart failure showed still about 13.3% of mortality in the LCZ arm. So it's definitely a big unmet medical need and we think with riciguat in addition to two other products, of course our partial A1 agonist or Finerenone which is closer to us those products have a very significant role to play in the treatment of CHF.

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**Marijn Dekkers - Bayer AG - CEO**

And then animal health, there is really no update. Our outlook on animal health is the same as what we verbalized in London.

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**Operator**

The next question comes from the line of Jo Walton. Please state your name, company name, followed also by your question.

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**Jo Walton - Credit Suisse - Analyst**

Thank you. Jo Walton from Credit Suisse. I notice that your pension liabilities in your balance sheet have risen quite dramatically from EUR7 billion to EUR12 billion. I wonder how you feel about having such a high level of pension liabilities on your balance sheet and where they're doing something about that -- where that sits in your priority list for any cash that you might receive on getting rid of MaterialScience?

Secondly, on looking at the pharma business, we can see that the ratio was -- the income that you booked for Xarelto from the US and what J&J reports to the end user sales, we've now hit something like an apparent 30% royalty. I wonder if you could confirm whether we have sort of triggered up to the next level and whether this is the level that will be sustainable or whether there is any further increase in royalty rate that we may see?

And finally, could you tell us just a little bit more about the diabetes care business and your plans to try and sort this out because it seems to be a problem for everybody that someone is doing really badly in this business while one of the other players is doing no more than okay. Is this still something that you think that you have a role to play within and you can see a time where profitability improves?



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**Marijn Dekkers - Bayer AG - CEO**

Okay. First pension. Johannes.

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**Johannes Dietsch - Bayer AG - CFO**

Regarding pension liabilities, we are using discount rates to show the net present value in our balance sheet. The year before, we had a rate of 3.8% in Germany or in Euroland, and at the end of 2014, we used 2.0%. That increased dramatically the net present value of our future pension liabilities which on average 17 years in maturity. A very long-term liability discounted to the relatively low discount rate brings us up to the level as you described plus EUR4.9 billion.

We are able to report this in equity, we don't need to ramp through the P&L. But of course it shows up in our balance sheet and unfortunately it is also being the basis for regulation with rating agencies because they look at the total debt, not only financial, but also pension debt.

I am relatively relaxed about that because our returns on the assets on the funded part are substantially higher than the 2.0% because actually last year we had double-digit income from our pension funds and we have a large portion of unfunded pension fee on Germany where we use Bayer's balance sheet and here you saw that our cash flow return on investment is substantially higher than the 2%. Therefore, we are somehow relaxed on that.

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**Marijn Dekkers - Bayer AG - CEO**

Okay. Short answer on Xarelto.

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

We disclosed that we book up to 30% rights in market sales as royalty but we are not giving any details. You also need to know that in addition to royalties, we receive cost of goods, co-promotion fees and potential milestone payments and all of that are booked as Xarelto US sales. So, just for you to know that's the only think I can say.

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**Marijn Dekkers - Bayer AG - CEO**

And then, Joe, I will quickly answer on the diabetes care question. You're right that industry is in quite a lot of flux because prices have come down quite significantly over the last few years. That also gets you -- that always gets you to a point that you want to see what is really the significance of this business in the portfolio. We are in the process of that. I don't really want to comment too much about all the different options there, but one thing I would say is that this business is an enormous cash flow generator for Bayer also because we don't have -- we don't do that much self manufacturing. We do quite a lot of outsourcing of the products. And as a result, the margins may not be all the way up to the average margins of the Bayer, but the cash flow generation is certainly, I would say, cash flow over sales is certainly higher than the average of Bayer. So, it is actually from a cash generation point of view, a very attractive business for us, but stay tuned on that. It's hard to give very clear answers on that now because it is a situation influx.

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**Operator**

(Operator Instructions) The next question comes from the line of Mrs. Holford. Please state your name, company name, followed also by your question.

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**Kerry Holford - Exane**

Thank you. Kerry Holford from Exane. One question from my list, so on Kogenate, it looked particularly strong in Q4. You mentioned in the press release shifts in order patterns and I wonder how those really contributed to Q4 and what we should think about the year ahead and also an update there on the capacity constraints would be useful. Thank you.

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**Marijn Dekkers - Bayer AG - CEO**



Okay. You've seeing that we had a strong quarter specifically coming from the US and that was the result of shifts of achieving region shipments to CSL. In addition to that, we had also some buyings in the US during the last quarter as we introduced in November-December a price increase and we've seen some buy-in in advance. So that's mainly the result of what the drivers of the good quarter.

Related to the supply constraint, we are planning to seeing that same situation during 2015 and we should see some easing during 2016 after we would have the launched our new plasma-free presentation Bayer 81 and we would have seen on the marketplace some switches from Kogenate to this product. But that would happen probably during the second half of 2016.

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**Operator**

The next question comes from line of Mr. Vossler. Please state your name, company name, followed also by your question.

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**Richard Vossler - JPMorgan - Analyst**

Hi, Richard Vossler from JPMorgan. Thanks for taking my question. Just thinking about the FX rates are obviously are considerably lower at the moment on the euro, just wondering how that would impact the FX benefit that you're thinking about on your guidance for 2015? Thanks very much.

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**Marijn Dekkers - Bayer AG - CEO**

Johannes?

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**Johannes Dietsch - Bayer AG - CFO**

Yes, we gave guidance on year-end rates. At that time the US dollar was at \$1.21 and Chinese renminbi at [CNY7.54] and the Japanese yen at [JPY145]. We still stick to our guidance and to our sensitivity that a 1% change in our currency basket overall will change our EBITDA by EUR70 million. However, it's not only related to US dollar, which accounts only for 37% of the basket, you have to take other currencies into account as well. So, it's not an easy calculation, just the 1% on the overall currency basket.

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**Operator**

The next question comes from the line of Mr. Wendorff. Please state your name, company name, followed also by your question.

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**Daniel Wendorff - Commerzbank - Analyst**

Daniel Wendorff, Commerzbank. Thanks for taking my question and it's actually related to the performance of the Merck & Co. OTC business in the fourth quarter which came in at EUR289 million as you mentioned it. It's slightly below the EUR300 million and EUR350 million you gave at the end of October when you reported Q3 results. And one that what has changed in turn is there was any change or was it a special one-off factor which actually drove this below the wide range you gave us at the end of October? Thank you.

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**Johannes Dietsch - Bayer AG - CFO**

Yes, you are right. The number is lower as you've seen, it's EUR289 million for the quarter. So, we started from a low base after day one and some of Merck consumer care new product launches in the US in 2014 were not successful. So line extension, new products and more specifically amongst them, one product called OXYTROL, which is now discontinued. So that's the main reason. However, again, we are not changing our long-term prospect because we think we're going to -- we are convinced, we're going to deliver both top line and cost synergies in 2017.

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**Operator**



The next question comes from the line of Mr. Evans. Please state your name, company name, followed also by your question.

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**David Evans - UBS - Analyst**

David Evans from UBS. Just one question on the growth of your pharma R&D budget. Is most of this increase related to new Phase III studies or if not, can you point to other areas of R&D that you are in the process of building up and related to that how much clarity do you have by now on how many of your Phase II assets will be moving into Phase III this current year? Are those numbers fixed or do you still have some choices to make for this year? Thanks.

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**Marijn Dekkers - Bayer AG - CEO**

Olivier.

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**Olivier Brandicourt - Bayer AG - Chairman, Bayer HealthCare**

So the R&D budget will increase because of three buckets, right. So, you have a relatively short bucket, which is linked to the different lifecycle plan for the currently new launched products lifecycle plans, and as you know, they are pretty large and especially if you look at the one behind Xarelto. So, that's the first one.

So, second has to do with the end of your question related to the Phase II. You have heard earlier that three are actually moving to Phase III or be Phase III ready in 2015. So 2016 would be the start of those large studies. Cardiovascular, as you know, Phase III studies are large and expensive. So that's a key area.

And the third one has to do with the long-term and how much do we invest in discovery and in large platforms such as, if you want, chemical library, where we are adding a significant investment as we speak. So that's roughly I think that's the answer to your question.

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**Operator**

The last question comes from the line of Mr. Gilbert. Please state your name, company name, followed also by your question.

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**Thomas Gilbert - UBS Chemicals - Analyst**

Thomas Gilbert, UBS Chemicals. A question on CropScience. What do you think is the marginal cost in dollar per bushel of the marginal land in Brazil at the moment? Can you -- does everyone make money at the current price -- at the current crop prices or soy price in real and dollars and is there a significant or only small risk of downtrading reduction in intensity of use per hectare?

Could you at the current situation just talk around the risk for the second half year?

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**Liam Condon - Bayer AG - CEO, CropScience**

Yes. Our assumption today is that basically at the current prices the marginal cost is really at the border, which means if commodity prices were to go down further there would be no additional expansion of acreage in those marginal areas because it's of course much more expensive to farm the marginal areas that haven't been farmed yet.

And where we are today from what we've seen and heard, farmers can still make decent, reasonable money today at even some marginal areas today, but further expansion would be a problem at current commodity prices. So it's going to depend heavily now what happens with soybean commodity prices going forward and that's of course a factor now what the yields will be in Latin America plus how much planting will be done in North America. So, clearly too early to make that call right now but that's what's going to have the biggest influence over time.

And downtrading is always, let's say in a soft year, downtrading at a lower price products is always an issue. But here again, if you look at the nature of some of the diseases in Asian soybean rust and some of the challenges that we're facing particularly with soybeans in the tropical climate, there is still a strong need for innovation and we can supply those products. So we're still -- we have reasonable confidence that also in this soft year that in Brazil, we can continue to grow nicely.



**Thomas Gilbert - UBS Chemicals - Analyst**

Thank you, Liam. Can I just ask you where you think the low cost is, is that \$6, \$6.5 a bushel in Brazil?

**Liam Condon - Bayer AG - CEO, CropScience**

Yes. We would say it's \$6.5, not \$6, \$6.5, yes.

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

Kleo, do we have additional questions? Probably not.

**Operator**

Excuse me Mr. Rosar, you may now continue with any other points you wish to raise. Thank you.

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

Okay. Thank you, Kleo. Thank you, ladies and gentlemen. Thank you for being with us on the call. Thanks for your questions and we all hope to meeting you soon again in Berlin.

**Operator**

Ladies and gentlemen, this concludes the full year and fourth quarter 2014 results investor and analyst conference call of Bayer AG. Thank you for participating. You may now disconnect.



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