Bayer AG

Q2 Earnings Investor Conference Call

5 September 2018

Opening Remarks

Oliver Maier

Head of Investor Relations, Bayer AG

Thank you, Hayley. Much appreciated. I would like to welcome all of you to our second quarter conference call. With me on the call are Werner Baumann, our CEO, Wolfgang Nickl our CFO. And with Dieter Weinand, Heiko Schipper and Liam Condon, the different businesses are represented by the responsible Management Board members.

Werner will start off today's call with presenting some of the highlights of the second quarter 2018. Wolfgang will then go into the financials for the second quarter with some more detail and also cover the performance of the divisions. Werner will then wrap it up with the outlook for 2018, before we go into the Q&A session. So the prepared remarks might be somewhat longer today than normal, but it's obviously also not a normal quarter with the first-time consolidation of Monsanto and all the moving parts that came along with such a transaction and its consolidation.

For the Q&A, I would like to remind everyone of the housekeeping items: to ask two, max three, questions – better two, so that we will have a chance to get through most of the questions within the time available. So, as always, I would like to start the call today by mentioning the cautionary language that is in our safe harbour statement and as well in all the materials that we have distributed today. With no further ado I would like to hand it over to you Werner. The floor is yours.

See disclaimer

Q2 Performance

Werner Baumann

CEO, Bayer AG

All right, so thanks, Oliver, and good afternoon also from my side, ladies and gentlemen. And it's my pleasure to welcome you to our conference call today. Let me preface my talk with one important topic. And that is that, since we offered a separate call on 23 August covering the recent verdict in the Johnson trial and the glyphosate product-liability litigation and given that the transcript of this previous call is available on our website, we do not intend to address that

litigation in today's call. Instead we will be focusing on the second quarter and the first-time consolidation of Monsanto, as Oliver already alluded to. There is only one meaningful development since our call on 23 August, and that is that the court has vacated the 22 October 2018 and 7 January 2019 trial dates in the Missouri glyphosate litigation. A number of trials are currently scheduled beginning in February 2019, but may be subject to change. So the bottom line – there is no further case that is going to be tried for the remainder of the year.

So, with that, let me now focus on the second quarter 2018. In Q2 we finalised the acquisition of Monsanto and, as I mentioned on other occasions, we are really very proud to now finally operate the leading agrochemical and seeds company in the world. The Monsanto business is included in our Q2 numbers from the closing date of 7 June onwards on a pro rata basis. The conditions of the Department of Justice included a 'hold separate' order that remained in place until all of the divestments to BASF had been completed. These divestitures closed on 1 August and 16 August respectively, which allowed us to take full operational control of the Monsanto business as of the later of those two dates. We have started to execute our integration activities right away and we will be fast in implementation. From an operational perspective, our Bayer standalone business performance in the second quarter is fully in line for us to meet the originally announced full-year guidance we gave at the beginning of the year.

Our combined 2018 outlook now reflects all of the impact of the Monsanto acquisition. We confirm our Group outlook for 2018 with the adjustments to reflect the acquisition as of closing date. Due to the typical seasonality of the Monsanto business, the vast majority of its 2018 earnings were realised prior to closing, while the resulting cash flows will be largely coming in in the second half of the year. Consequently, we anticipate reducing our net-debt position to roughly €37 billion by the end of the year. Given the better than originally expected net-debt development and the future growth opportunities of the combined entity, we actually already at this stage want to emphasise our commitment to propose an absolute dividend per share of at least €2.8 per share for the fiscal year 2018.

As mentioned, after the 'hold separate' ended we officially kicked off our joint organisation and integration efforts, and I can tell you there's an awful lot of enthusiasm and excitement in the organisation to finally get going with our combined company. Actually, as a matter of fact, we are now the leading agrochemical and seeds company in the world, with leading innovation capabilities, an excellent and most comprehensive product portfolio across crop protection and seeds and traits and also the most advanced digital platform plus a very strong and experienced team in place. Together, we are fully committed to shape agriculture to benefit farmers, consumers and our environment.

The strong value-creation profile we see for this combination remains fully intact. Let me clearly state that nothing has changed concerning our strategy, the attractive synergy potential and longer-term growth in margin expectations for our combined Crop Science business. We are striving for long-term above-market growth and industry-leading profitability through achievement of our synergy target of $1.2 billion per year on an EBITDA basis as of the year 2022. From a core EPS perspective, the combination will be accretive already in 2019. And we are very optimistic for the future of the business and see it as a 'game-changer' in the industry.

That being said, let me now move on to the highlights in our business in the second quarter. At Pharma, we remain on track to deliver our 2018 fiscal year guidance. Our key growth products will continue to drive our performance, especially Xarelto, for which we see further differentiation potential being supported by the first approval in the CAD/PAD indication. Despite many advances in the area of cardiovascular care, coronary artery disease, CAD, and peripheral artery

disease, so PAD, remain an area of unmet need. The European Commission has approved a regimen of Xarelto twice daily plus Aspirin once daily for the prevention of atherothrombotic events in patients with CAD or PAD at high risk for ischemic events.

We recently submitted the marketing-authorisation application for larotrectinib to the European Medicines Agency. The potential first approval of larotrectinib in the US is expected before the end of this year and would actually mark a paradigm shift in the way we treat cancer by targeting the genomic alteration that is causing the cancer to grow, rather than the site where it originates in the body.

Just a couple of days ago, the FDA approved Jivi for the routine prophylactic treatment of haemophilia A. Jivi's extended half-life allows for twice-weekly initial dosing and may be adjusted to every five days and further individually adjusted to less or more frequent dosing. Approvals in the EU and Japan are expected until year end, being important milestones for our haemophilia portfolio.

At Consumer, the challenging year continues to manifest itself in quarter two, as earlier indicated and expected. For North America it was a difficult first half year primarily due to our important seasonal business. Claritin was impacted by a late start to the allergy season – and so was Coppertone by a late start to the sun-care season. In Europe the supply interruptions continued to weigh on our performance. On a positive note, Asia-Pacific returned to growth driven by our strong nutritional business in China. The OTC version of our product Kang Wang is back in the market in China since late July. In terms of portfolio adjustments, you have seen the sale of our Derm-RX business and the recent close of the US part of that business just yesterday.

At Crop Science, the positive Q2 pro forma sales performance was driven by the normalisation of our crop-protection business in Brazil and an improvement in our corn business. We saw double-digit sales growth rates in herbicides, fungicides and insecticides driven by Brazil, EMEA and Asia-Pacific. Our newly acquired business delivered on key metrics with continued adoption of new soybean, cotton and digital technologies. Animal Health improved its performance, with North America, Asia-Pacific and Latin America growing and also benefited from a phasing of Q3 into Q2, particularly driven by double-digit percentage increases in our top line for Advantage and Seresto.

With this quick overview, let me now hand it over to Wolfgang to shed more light on our Q2 performance from a financial perspective. Wolfgang.

Q2 2018 – On Track for FY Guidance

Wolfgang Nickl

Chief Financial Officer, Bayer AG

Thank you, Werner. Ladies and gentlemen, also a warm welcome from my side. I will now guide you through some of our financials as these are a bit more complex due to the first time integration of Monsanto.

Let me dive right into Q2. If you look at the reported sales numbers, they are positively impacted by the inclusion of Monsanto starting on 7 June. Monsanto added €543 million to our top line. However, continued negative FX effects burdened sales by more than €500 million for the quarter. The underlying business looks good. We achieved sales growth on Group level of about 9% organically when adjusting for currency and portfolio effects. Three out of our four businesses grew versus the same quarter last year. In particular, the normalisation of our Crop Science business in Brazil supported this growth.

EBITDA before special items for the Group came in at about €2.3 billion with a contribution from Monsanto of about €70 million. This reflects an increase of about 4% over the same period in the prior year despite a negative FX impact of approximately €130 million and strong incremental investments in R&D of around €160 million. Core earnings per share in the second quarter were up 1% to €1.54, despite the negative currency impact and a higher number of shares. This compares to a consensus of €1.50 per share

With the inclusion of Monsanto we have updated our simulation for the impact of currency fluctuations on our financials. On a full-year pro forma basis, a 1% change of the euro versus our currency basket now impacts sales by about €340 million and EBITDA by about €100 million. Before the acquisition these effects were €250 million and €70 million respectively. Negative FX effects will continue to be a theme for the remainder of the year. On an earnings level, the impact we expect for the second half is approximately the same as the impact of €280 million we saw in the first half of the year.

Sales of pharmaceuticals rose by 3% to about €4.2 billion in Q2. Our key growth products – Xarelto, Eylea, Adempas, Xofigo and Stirvaga – maintained their strong performance overall, with their combined sales rising by more than 13% to now €1.7 billion for the quarter. As for our two highest revenue products, Xarelto sales once again rose significantly at 11%, driven by higher volumes in Europe, Japan and China. Our license revenues in the US also showed a positive development. We also recorded substantial sales gains for Eylea – up 23% primarily due to expanded volumes in Europe, Japan, and Canada. Among other things, the differentiated clinical profile of Eylea had a positive impact. As expected, Pharma's Q2 sales were held back by temporary supply disruptions for some of our established products, such as Adalat and Aspirin Cardio in our supply centre in Leverkusen.

EBITDA before special items in the Pharma business declined by 8% to approximately €1.4 billion. Adjusted for negative currency effects of €54 million, earnings were down by 4%. The decline was mainly attributable to higher R&D and selling expenses, as well as to the effects related to the temporary supply disruptions I just mentioned. We continue to expect the full-year negative effect of these supply interruptions to be unchanged at roughly €300 million at both the sales and EBITDA level. The impact was rather limited in Q2, with the majority still to come in the second half of 2018. Overall, all commitments given to the FDA according to the quality improvement plan are on track.

Now moving on to Crop Science, we achieved a significant year over year improvement in both sales and earnings after a weak prior-year quarter. In May, the DoJ conditionally approved our acquisition of Monsanto. The conditions included a 'hold separate' order that remained in place until all of the divestments to BASF had been completed. These transactions closed on 1 August and 16 August 2018 for a total consideration of €7.6 billion, which finally allowed us also to start the integration on 16 August 2018. In the second quarter's financials, sales and earnings of these divestments were still fully included as part of the Crop Science business. They had a contribution to sales of €468 million. Overall, Crop Science sales increased to a level of about €3 billion in Q2

mainly due to a positive portfolio effect of 25%, or €543 million, from the acquisition of Monsanto. On a pro forma basis this represents a 10% improvement.

For Bayer on a standalone basis, the currency and portfolio-adjusted development showed a 21% growth, particularly due to significantly higher provisions for product returns in Brazil recognised in the prior-year quarter driven by then high channel-inventory levels. Inventories in Brazil have now normalized as a result of the measures that we initiated last year. Crop Science almost doubled its adjusted EBITDA level to €631 million mostly as a result of the recovery of our crop protection business in Brazil, despite negative currency effects of around €50 million. The adjusted EBITDA margin increased also substantially to 21%. The newly acquired business contributed €70 million to earnings. The relatively low EBITDA contribution is a result of the seasonality profile of the seeds business, which I will spend some more time to explain on the following chart.

We show on this next slide, on an illustrative basis, the quarterly seasonality of sales, earnings and cash flow of the Monsanto business for the last four years, normalised to Bayer's definition of fiscal quarters. This chart plays an important role to understand Monsanto's contribution to Bayer in 2018 and going forward. Due to the seasonality of the seeds and crop protection business with a stronger first half, it's very important to realise that around 60% of sales and 80% of profits are on average generated in the first half of our fiscal year. On the other side, about 120% of the cash flow comes in the second half of the year. That is mainly driven by cash collections, which only start after the planting season. These trend patterns also apply for this business in the first half of 2018. This means that for Bayer we will only see limited sales and EBITDA contributions for the second half of 2018 but a very strong cash flow contribution from the acquired business.

Let me now transition over to the Consumer Health business. The second quarter remained challenging. As expected, the top line declined slightly by 1% to approximately €1.4 billion. For North America it was a difficult quarter, impacted by the seasonal categories. The second quarter is always an important quarter for us, as we are key players in allergy with Claritin and in sun care with Coppertone. Both seasons, sun and allergy, started late and therefore impacted our sales levels significantly. In Europe the supply situation continued to weigh on our performance, specifically sales of Canesten and Aspirin. This will remain a substantial headwind for the remainder of the year. In Asia-Pacific, business picked up and returned to growth in the second quarter and, as Werner has already alluded to, we do have the majority of SKUs of the OTC version of Kang Wang back in the market since late July. Driven by lower volumes, unfavourable product mix as well as currency effects and increased investments in Sales and Marketing, the adjusted EBITDA margin declined by 230 basis points to 18.1%.

We divested our prescription dermatology business to LEO Pharma in Denmark. Just yesterday, we successfully closed the sale of the US part. We expect to close the transaction during the second half of 2019 for all other markets. The total consideration we will receive for this business amounts to €613 million, including €55 million for the US business.

Now turning to our Animal Health business, which recorded a strong quarter with both sales and earnings increasing significantly over the prior-year period. Sales, on a currency and portfolio adjusted basis, increased by 8% to €453 million, driven by strong volume expansions. We posted considerable top-line increases in North America that resulted mainly from phasing of demand at the expense of subsequent quarters. US distributors were building up stock to prepare for a packaging change in our Advantage line. We also achieved encouraging sales gains in Asia-Pacific and Latin America. Q2 EBITDA before special items increased by 10% to €128 million. Adjusting for currency effects, earnings would have grown even faster with 19%. This

development was attributable to significantly higher volumes but somewhat mitigated by negative price effects, higher selling expenses and an increase in the cost of goods sold.

So far I have focused on sales and EBITDA before special items. On slide 14 in the deck I would like to now spend a minute to explain how we get from EBITDA before special items of €2.3 billion to a core EPS of €1.54 for the second quarter. We focus on core EPS in order to provide the capital markets with a meaningful non-GAAP measure which usually also provides the base for our dividend proposal. To derive core EPS we exclude special items and non-cash amortisation mainly resulting from former acquisitions. We also adjust for impairment losses and loss reversals from intangible assets. Special items in our EBITDA for the quarter amounted to €318 million mainly driven by our Crop Science business. This included €126 million associated with the sale of acquired inventories that were re-measured at fair value in connection with the preliminary purchase price allocation. Our reported financial result of minus €322 million includes special charges of €106 million, mainly in connection with the bridge financing for the Monsanto acquisition, which we have excluded here. For modelling purposes for the full year you can assume a core financial result of approximately minus €1.3 billion.

The core tax rate of 24.4% was down year on year but is higher than the reported or effective tax rate of 21.0%, mainly due to tax effects related to amortisation and special items. For modelling purposes for the calculation of core EPS for 2018, you can assume the core tax rate to be around 23%.

In the second quarter we have seen two significant equity measures which had an impact on our average weighted number of shares. In April 2018, Temasek of Singapore subscribed to 31 million new Bayer shares, and in June 2018 the capital increase with subscription rights for existing shareholders was implemented, issuing approximately 74.6 million new shares. As the subscription price of the new shares was below the market price of existing shares, this capital increase contained a so-called bonus element pursuant to International Accounting Standard 33. The weighted average number of shares was adjusted to reflect the effect of this bonus element for all periods prior to June 2018. This resulted in an adjustment for the core EPS for 2017 from €6.74 to now €6.64. The weighted share count for Q2 was 916 million shares. For the total number of shares exiting 2018 you can assume approximately 980 million and the average for the full year 2018 is currently estimated at around 941 million shares.

Let me cover two more topics before I hand the call back over to Werner for our outlook for the fiscal year. First, on slide 15 you see the development of gross and net debt during the second quarter as well as the measures we have taken during the quarter to finance the acquisition of Monsanto. During the quarter we issued euro and US dollar bonds, exchanged existing Monsanto bonds into Bayer bonds and drew from the bridge financing bank facilities. Due to higher than expected cash levels at Monsanto on 7 June and better than expected collections, we ended the quarter at a net debt level of about €45 billion. The bridge financing, which stood at €13.6 billion as of the end of June, has declined significantly in August. This was driven mainly due to the proceeds from the divestment of certain Crop Science businesses to BASF for a total purchase price of €7.6 billion.

I am glad to announce that, due to a higher than expected cash position and better than expected cash flows from Monsanto, we do now forecast a net-debt position of around €37 billion at the end of 2018, compared to our original guidance of around €39 billion. In this context I want to emphasise again how important it is for us to de-lever our company further. Let me clearly state that we are strongly committed to get back to a credit rating in the single ‘A’ category in the long term.

I do not want to spend too much time on this chart, chart 16, as you all got some detailed information on the purchase-price allocation with our analyst briefing document this morning. However, I believe it is important to mention that the amortization of intangible assets of €27.1 billion and the depreciation of fixed asset step-ups of €1.1 billion euro, related to the acquired business, are expected to be between €1.7 billion and €2.1 billion on an annual basis. This will be the run rate for about 12 years. Thereafter, the charges will decrease continuously. We have also illustrated in our analyst briefing document how this will affect our EBITDA and EBIT before and after special items. The acquired inventory that has been stepped up to fair values will likely be consumed within the next three quarters. Let me conclude this topic by saying that this information should be considered as indicative only – as the PPA is preliminary, and figures might still change during the finalisation of the entire purchase-price allocation process. Nevertheless we thought this might be helpful to get a good understanding of the moving parts on the technical end of this process.

With that let me hand the call back to Werner, who will cover the outlook and some pro forma illustrative calculations for fiscal year 2018.

Outlook

Werner Baumann

All right, so thanks Wolfgang. We have adjusted our Group outlook to account for the sales and earnings contributions from Monsanto since the date of the acquisition, as I already mentioned earlier. Fiscal year 2018 earnings including Monsanto will be lower than we had projected in our February forecast. This is due to the later than anticipated closing and the significant seasonality of Monsanto's business, as Wolfgang alluded to earlier in his presentation. Our outlook takes into account the financing costs for the acquisition of Monsanto shares as well as the higher number of Bayer shares following the capital increases on a pro rata temporis basis. In addition it assumes the absence of the one-time corn licensing benefit of approximately $200 million from the prior year in Monsanto's results. The businesses divested to BASF are no longer taken into account from the date of their respective sale.

The forecasts are based on the exchange rates as of 30 June and adjusted for currency effects to enhance the comparability of operating performance. We now expect Bayer Group sales to be more than €39 billion for 2018, with more than €5 billion attributable to the acquired business. The divestment of selected businesses to BASF will reduce anticipated sales by approximately €1 billion. This forecast now corresponds to a mid-single-digit increase on a currency- and portfolio-adjusted basis. We now anticipate EBITDA before special items to increase by a low- to mid-single-digit percentage. On a currency-adjusted basis, this corresponds to an increase by a high-single-digit percentage. We now expect core earnings per share to come in at between €5.70 and €5.90 per share. On a currency-adjusted basis, this corresponds to a decrease by a high-single-digit percentage.

Prior-year core earnings per share were restated to €6.64 to reflect the bonus element of the capital increase with subscription rights, and this is taken into account here, as Wolfgang already indicated earlier. Realising, now on chart 19, that the reported numbers are hardly indicative for a real underlying performance, we decided to include illustrative information on a pro forma number for full year 2018 in order to underline our statement that Monsanto will as a matter of fact be accretive to core EPS already in year one, assuming that on a pro forma basis 2018 is year one.

Starting from the adjusted core EPS number of around €6.60 for 2018 and based on the various assumptions listed on the left side of the chart, we come to a pro forma EPS for 2018 of about €7, which is an increase, and with that an accretion, for Monsanto of around 5%. The impact from the US GAAP to IFRS conversion, which is actually cash-neutral, reduces that number by 30 cents to about €6.70 – still an accretion versus the starting point of around €6.60. Adjusting for the negative FX effects, the accretion in both cases would be clearly higher. When you think about modelling Bayer and Monsanto now on this basis for 2019 going forward, you can take the pro forma EPS of around €6.70 at current currencies as a starting point and should think about operational performance and incremental cost synergies we might achieve next year as we model 2019.

With that, let me come to chart 20. As mentioned already at the beginning, given the strong cash-flow generation capability of Bayer and Monsanto combined, the lower than expected net-debt level at year end 2018, as well as the exciting future growth opportunities, we will propose a dividend per share for 2018 of at least €2.80 per share. We have decided to deviate from our existing dividend policy of a 30-40% payout ratio of our core EPS, as the core EPS figure for 2018 will be impacted by acquisition timing and technical effects and is therefore not indicative of the underlying earnings power of our company, as we have just discussed.

So, with that, let me conclude my remarks with a view on the upcoming events. On 13 November 2018 we will publish our Q3 figures, and on 5 December we will host our capital markets day in London. The event in December will go way beyond any typical business update, as we intend to have a comprehensive overall strategic overview on the Group, including financial targets for 2022 as well as measures to enhance Group performance further in the future. In addition we will have a deep dive on Crop Science with various workshops in the afternoon as we would envision the understanding of the Crop Science business being the largest lever for our valuation and therefore value-creation going forward. With that, I will hand it back to Oliver.

Questions and Answers

Oliver Maier

Okay, thank you, Werner; thank you, Wolfgang, for your remarks and for the update. Hayley, I think we are now ready to open up the call for Q&A.

Moderator

Thank you. Ladies and gentlemen. At this time, we will begin the question and answer session. If you have a question please press * followed by 1 on your telephone. If you wish to cancel your request please press * followed by 2. Your questions will be answered in the order they are

received. If you are using speaker equipment today, please leave the handset before making your selections. One moment for the first question, please. The first question comes from the line of Mr Michael Leuchten. Please state your name, company name followed by your question.

Michael Leuchten, UBS

Thank you. It's Michael Leuchten at UBS. Two questions, please. I think most of us try to model your divisions by EBITDA. Your 2018 illustrative core EPS number is very helpful, but could you help us with maybe the depreciation number you assume so we can work out an EBIT number or an EBITDA number from here or maybe help us with what the Monsanto EBITDA number was in the first half so we can actually get to an EBITDA number for modelling purposes, because I don't think anybody starts at the EPS number to model a company bottom-up. And then also that EBITDA number would help us then to assess where you are in terms of your trajectory to get to making costs of capital by year four, which you previously stated.

Then my second question is on the warning letter. You did say in Q1 there wasn't much of an impact. You're now saying in Q2 there wasn't any impact. Given that I think your expectation was that this was an inventory issue, a supply disruption issue, how come you still expect there to be an impact on the second have a look if Q1 and Q2 deliver good revenues for those products impacted by the warning letter and the distribution centre?

Werner Baumann

Okay, this is Werner speaking. Thanks for the question, Michael. We can certainly look at what we can provide in addition, but you have certainly for all of the divisions, including now Crop Science, the relevant incremental depreciation and amortisation with the information that we have provided, as far as it relates to the step-up for fixed assets, the purchase-price allocation. And you should also have received a table on an annual basis on how it develops so that you can also clearly distinguish between the one-off that is going to wear itself out over the next nine months by and large for the inventory step-up, and then let us say for the next 12 years on average that is going to come for the D&A. So that should as a matter of fact – if you simply add it on top of the underlying earnings that you can back into – give you a good number to work with for Crop Science. Other than that, I would just ask you to follow up with Oliver and also Jürgen in our IR team if that does not suffice.

Secondly, on the warning letter, we have actually a continued impact looking at some of the trade-off positions we made with our manufacturing and the impacts we have seen so far over the first two quarters. There's a larger part of the impact still to come in the second half of the year. And that is also due to the fact that we do expect another standstill of the production as part of the post audit, the FDA inspection that we are going to have in the second half of the year. So, overall, that is part of the explanation for why we are going to see a sustained impact throughout all quarters of 2018 both from a volume but also, as I say, from a sales and underlying EBITDA perspective – and of course the remediation activities that account for a mid double-digit million amount that is actually stretching across all quarters of the year.

Moderator

The next question is from the line of Mr Jeff Zekauskas. Please state your name, company name, followed by your question.

Jeff Zekauskas

[Gap in audio] for soybean seeds and traits data. In the second quarter, your sales were down 6.6%, currency and divestiture adjusted, and for the first half they were down 7.8%. Intacta grew and Roundup Ready Xtend grew, and in the United States soybean plantings were flat to down. So I was wondering why was it that revenues were lower. Is that a price issue or a volume issue or something specific to you?

And then, secondly, I think there's an agricultural health study that shows – that looked at 89,000 US farm workers showing glyphosate as a safe chemical, but I don't think that data has ever been published, and I was wondering whether you thought that data would be published in 2018 or 2019 or whether you don't have an opinion on that.

Werner Baumann

So Liam is going to take the first of your questions, Jeff, and then I'm going to comment on the US ag health study, okay?

Liam Condon, Head of Crop Science, Bayer AG

Yes, thanks Jeff. So, as you rightly point out, there has been a very solid increase in market penetration for Roundup Ready Xtend in North America and Roundup Ready 2 Pro in South America, but sales down is primarily due to competitive issues in the US market, which is specifically linked to a very competitive situation on the ground. A lot of this is driven by growers looking for more options now for weed control, and you know that we also had launched, as Bayer, Credenz, a new brand into the market, so that plays in one element. But on the pricing side there is clearly a competitor out there, a state-owned competitor, who has taken a very aggressive stance. Here we accept that we will have some small degree of market-share loss because we want to ensure the innovations we are generating – that we can still maintain the premium pricing in here, but that's the effect that you're seeing. It's basically due to the competitive pricing situation in the US.

Jeff Zekauskas

That's clear, thank you.

Werner Baumann

So, Jeff, now to your second question. To the best of my knowledge, the US ag health study data has been published, but let me elaborate a little bit more. Let me elaborate a little bit more on where the confusion might come from. The IARC assessment did not include the findings of that large, real-life evidence study because it was at the time of the assessment still preliminary and not, let's say, a finished document. And that is why it did not find its way into the IARC assessment. From a scientific perspective, it actually backs up all the other 800 studies now with a real-life evidence study. With 50,000 farmers and then significant others, there is absolutely nothing that has been seen in terms of a statistical signal that there is a cause and effect relationship between the application of glyphosate as a formulated product – so not only the active, but as a formulated product – and the onset of cancer in some individuals, nothing whatsoever.

Jeff Zekauskas

Thank you.

Moderator

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

Sachin Jain, Bank of America Merrill Lynch

– financials, please. Firstly as we sort of think about future earnings power, at the analyst day do you still intend to provide mid-term targets and, if so, what would the format of that be? Is there any intention to give an early look on 19 numbers at the analyst day rather than waiting until March next year?

Secondly, a follow up to Michael's question around thinking about moving parts into 19, Werner, in your introduction you mentioned some drivers of the underlying growth of the business and incremental synergies. I wondered if you could just wrap up. Are there any other factors to think about as we think about pushes and pulls into next year such as a Pharma remediation, any de-leverage, any incremental impact of FX or anything else to think about given the complicated moving parts.

The second question is just on the dividend payout ratio. Should you pay out roughly €2.80 at the midpoint of your guidance, that is close to a 50% payout ratio. Should we think about that as a one-year effect or a more sustainable payout ratio?

Wolfgang Nickl

Yes, I think I can take the first one – this is Wolfgang – on the future earnings power. First of all, as Werner said in December, we want to give a very comprehensive midterm picture of our earnings power, and we are intending to show core EPS all the way to 2022. That is also the year when we have the first time fully achieved the complete synergies for our Crop Science business, so it makes sense to put a stick in the ground for that year.

As it relates to specific guidance for 2019, we intend to do that with the publication of our annual report – and that will be in the February timeframe. But I think in the part that Werner gave you earlier with an illustrative pro forma, if you add the business growth and further progress on synergies, I think you have a good platform to start estimating that well.

Werner Baumann

So, on top of what Wolfgang said, we will not from today's perspective be able to judge what the FX impact is going to be. So you expect that we are going to give a prospect of the midterm aspirations we are going to have, and the year we are going to anchor it around is going to be 2022 on a constant-currency basis – because everything else is going to confuse the hell out of everybody.

Secondly, as Wolfgang already mentioned, as we speak we are already ahead of our deleveraging objectives, because we are starting from quite a bit better than expected place, and that is what Wolfgang also referred to with our year-end net-debt position of about 37 billion, which is better

than the number we gave you earlier for quarter two. We still thought it would be 39. That's actually a significant improvement. And we will of course, going into 2019, continue to focus on deleveraging the company in order to get back to, let's say, our single A target or –A target that we are anchoring our financial policy around.

Relative to payout ratio, if I may deviate a little bit from the prepared remarks and say it in my own words, 2018 is an artefact that is completely useless if you look at year-end guidance, because it includes a fraction of Monsanto in our reported base but it actually includes the full cash flow and it is absolutely meaningless when you then look at the core EPS that is the resulting number that comes out of it. That's why we said we simply have to take a step away from the reported numbers and also from our existing dividend policy that is the 30-40% of core EPS and simply look through it and look at the overall position of the company.

And you will see at least €2.80 next year, which is important in two aspects. First, we want to make sure that our shareholder base continues to benefit from the underlying earnings power of the company. And that is exactly what we do, because Monsanto only paid out one quarterly dividend, and the rest accrues fully to our shareholder base. Secondly, we will continue to increase our earnings based on, let's say, the pro forma number that we have explained and, with that, the dividends will also increase in line with that, assuming that things go on schedule. Dividend continuity and cash returns are very important to our owners – and that is exactly what we are catering to.

Sachin Jain

Thank you.

Moderator

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

Emmanuel Papadakis, Barclays

Emmanuel Papadakis from Barclays. A follow-up on Pharma margins, if I may. I just want to check you are reiterating that approximately 300 million EBITDA impact from the disruption. It sounds like you're saying that will now mostly fall in the second half versus prior comments, I think, had called of it to be spread mostly within Q2 and Q3. The second question was around the Consumer margin. You didn't change the full—year guidance. It was clearly a relatively weak quarter. If you could just give us a bit more colour on specifically what was the pressure, the EBITDA level for Consumer and your confidence, therefore, as to why that will be made up to meet that maintained guidance for the full year, that would be very helpful.

Werner Baumann

Okay, Emmanuel, the first question is going to be answered by Dieter Weinand and then Heiko will comment on Consumer.

Dieter Weinand, Head of Pharmaceuticals, Bayer AG

So [inaudible] confirmed our previous guidance of low-single-digit decline or, FX adjusted, a low-single-digit increase. The margin this quarter was impacted by two main things both of equal size. One was currency and the second one increased R&D investment, due to an increase in the [inaudible] in our late-stage pipeline, particularly Finerenone and Vilaprisan. And, again, that was offset by [inaudible] savings in other places and continued growth [inaudible] in our key products. So, going forward, we confirm again our previous guidance.

Heiko Schipper, Head of Consumer Health, Bayer AG

Yes, Emmanuel, if we look at where we are in the first half of the year and now looking forward to the second half, we believe that we can continue to confirm our guidance, which would mean both on growth and on bottom line we will have a better second half. If we look at the second half this year versus last year, we are obviously cycling some one-off effects, particularly the one that we had in China last year. And we also are seeing some underlying dynamics starting to look slightly better. So that's why we feel, for both of these reasons, that growth is starting to look better in Q3 and probably the bottom line will be more toward Q4 and still landing on the guidance for the year.

Emmanuel Papadakis

All right, thank you.

Moderator

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

Peter Verdult, Citi

Thank you. Peter Verdult from Citi. Just a few questions, if I may, for Dieter just on the ARAMIS data later this month. Could you remind us how you hope to position darolutamide given the presence of Erleada and Xtandi in the non-metastatic prostate cancer market? And then just on Xarelto in CAD and PAD, I think in the past you've talked about, on one hand, label-expansion opportunities being around 500 million and on the other a very large patient population of 30 million versus 24 in AS.

So I'm wondering now, as we prepare for the European launch and hopefully the US, whether you are willing to provide any more perspective as to what you think the commercial opportunity there is. A quick one for Liam on glyphosate, could you just talk about the volume price trends experienced to date and confirm there has been no evidence that the recent headlines have had any sort of impact on glyphosate-demand trends around the globe?

And, lastly, if I could push my luck with Wolfgang, I think on the recent litigation call, if I remember correctly, you alluded that you might be in a position to give more information on the level of provisioning for glyphosate, Xarelto and Essure litigation. Are you able to share anything? Thank you.

Werner Baumann

We can start with Wolfgang.

Wolfgang Nickl

Sorry, it was about the provisioning for the legal case. Yes, I think we can there only confirm what we did say on the call – that we have provisions on the books as it is our current practice for the legal costs for three years for the defence in the glyphosate complex. It is not our practice to accrue for damages, and that's also not possible if it's not estimate-able. And if it's not more likely than not, then we believe the probability is not given here and we therefore have not put any provision on the books for potential damages.

Werner Baumann

So let us now switch. Peter, it was actually quite difficult to understand. We understood that one question related to darolutamide and the second one on Pharma was on CAD and PAD, so Dieter is going to try to answer – and if there is one or two things that we miss, just let us know. And then on price trends crop – that is what Liam is going to start with, then.

Dieter Weinand

On darolutamide. There is really nothing new, progressing well. As we said before, with the enrollment, we are actually encouraged by some of the recent data we are seeing with other products that this pathway approach is proven to be efficacious, and we believe we can differentiate the product based on some of the activities against resistant cell lines, as well as the difference in blood-brain barrier penetration, so it's really nothing new and it's progressing well, and we hope to have the data by the end of the year or next year.

So that is darolutamide, so I go to CAD and PAD. Again we are previously [inaudible] opportunity in terms of the patient numbers and we feel that the label that we see in the US – in Europe is a very good label for all PAD and CAD. It is a paradigm shift, as we said previously, in the therapy and we are well prepared to roll out the launches, and we are quite confident in the opportunity this represents, as we have previously stated, so there's nothing really new on that, but the growth potential that we believe will bode well for Xarelto.

Liam Condon

Yes, Peter, thanks a lot for your question. So I can just confirm, related to litigation, that there is no impact we can see whatsoever on demand for glyphosate. And it's of course due to several reasons. One is that there is no change whatsoever in the regulatory status. And this, again, was a jury decision in California. There was no new scientific finding or fact and, with that, no regulatory consequences. And at the end of the day what happens in the field is that farmers decide whether or not to use a glyphosate or indeed any other herbicide based on the situation that they have in the field. And glyphosate has been used and trusted and is well known for its profile for over the last 40 years, and with that we have not seen any change whatsoever.

For your information, sales in the first half of the year for glyphosate for Monsanto were basically flat, as overall for herbicides, and this is also due to the weather situation, particularly in North America, where we had a situation with a cold and wet winter for quite some time and then it went

very quickly into a hot spring or an early summer, so there was simply less time for spraying. That impacted volumes, and in contrast we saw an increase in prices for glyphosate, which is largely due to generic prices increasing because of the increased material costs out of China. So this is a trend that we expect to continue, because the source of the increased material costs from China is due to environmental pressure and clampdowns in China, which is tightening up supply of glyphosate and, with that, increasing overall prices. As we put our prices at a premium to generics, we see a benefit from this as well.

Peter Verdult

That's very helpful, thank you.

Moderator

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

Vincent Andrews, Morgan Stanley

Thank you. It's Vincent Andrews from Morgan Stanley. Just two quick ones. One, if you could just discuss – US seed price cards for next season have come out. They were out and around at Farm Progress, so if you could just sort of discuss your outlook for seed pricing and, you know, maybe you could tie it back to the issues with the soy price competition. And then, separately, could you just give us some insight into where crop-chemical inventory levels are in the key regions, particularly Brazil. Thank you.

Werner Baumann

Okay, thanks for that. So Liam is going to take those questions on seed pricing and crop inventory.

Liam Condon

Yes, thanks a lot Vincent. So bag prices, of course, for our products, Roundup Ready 2 Xtend Genuity, Roundup Ready 2 Yield, Soybeans – they always vary of course by product. So I won't go into any of the details here. We can get back to you on this and what we have as pricing for the different varieties. But ultimately we will have a variety of new releases into the market that will bring incremental value. And with that, as you know, we always share this value with growers. So wherever there is premium potential, we would expect premium prices for the newer products, and then for existing products we simply make adjustments based on the performance-driven value that they deliver to farmers. So overall pricing, we would say, with our new varieties, simply will be increasing in line with the additional value we create and for existing varieties will be based on whatever the current competitive situation is.

On regional inventories around the world, I would say we are not seeing any major anomalies or oversupply. One area where we are concerned to a degree is Europe simply because we have had drought for a very long time now, which means for sure that there will be additional fungicides in the channel. So this is something that we'll be working through basically now in the third quarter, so that's, I would say, a yellow traffic light that's flashing from an inventory-management point of view.

In Brazil, in LATAM, which you referenced specifically, and Brazil, we are very pleased with where channel inventories are now for our products. There has been very, very robust demand, and that led to the situation – we took a lot of measures, as Wolfgang and Werner both mentioned, to basically ensure healthy inventories going into the new season – and we could complete all those measures in the second quarter and – and also based simply on the robust in-market demand that we have seen. And we are expecting ongoing very robust demand out of Brazil simply based on the fact that there will be more soybean acreage planted, and this will for sure drive crop-protection sales, which are for soybeans even higher on average than the seed and trait sales. So there, I would say, versus last year we feel in a very comfortable position.

Vincent Andrews

Thank you very much.

Moderator

The next question comes from the line of Ms Luisa Hector. Please state your name, company name, followed by your question.

Luisa Hector, Exane BNP Paribas

Hello, it's Luisa Hector from Exane BNP Paribas. Thank you for taking my questions. I just wonder whether you could provide, for legacy Bayer crop, the Q2 growth excluding the inventory impacts – I'm getting to around minus 2; it was minus 1, I think, in Q1 – so just to get a sense of that development.

And then, as we look to your two launches in pharma, could you talk a little about the launch costs? Should we see those spanning both 2018 and 2019? So I'm referring to the Long-Acting Factor VIII and Xarelto in the COMPASS indication. And maybe talk a little bit at how you see the Long-Acting Factor VIII ramping up, what we could expect from Kogenate in the face of that line extension. And the same with Xarelto – how soon could we see an inflection in the ex US sales with the COMPASS on the label now? Thank you.

Werner Baumann

Okay. So the first question's on launch cost for Jivi, the impact of Jivi on Kogenate to the overall franchise. And then the CAD/PAD and how it ramps up, and also with the launch cost; that is what Dieter is going to comment on. And then Liam will comment on your question on underlying growth rate, excluding the Brazil inventory effect to the extent possible because there's also been some underlying dynamics that have impacted overall market growth.

Dieter Weinand

And so I'll start with the CAD and PAD launches. You will see the majority of countries – major countries launching still this year for CAD/PAD, followed by the smaller countries next year. We don't have significant – somewhat non-significant incremental regional requirements because we have a full team in place in all countries for [inaudible] support Xarelto. So we've got the care. I don't see a significant impact in terms of the expense base, but I see significant growth opportunity ahead of us with Xarelto.

Similarly with Jivi we have a very significant team in place in the haemophilia market with Kogenate and Kovaltry. And if you correct for the CSL impact you would actually see that we have been going very nicely on the first half of the year for both products, Kogenate and Kovaltry – so [inaudible] was 7%. And again we go 3.2% in the second quarter, so that portfolio is actually evolving very nicely. We believe the team will continue to contribute to that growth in the longer-acting market. So the teams are in place; the resources are in place. There's not significant incremental resource required and we're well-prepared to launch these products in all of these launches.

Werner Baumann

Okay, thanks Dieter. Liam?

Liam Condon

So thanks, Luisa. It's a little bit tricky to simply take out that –the exact stocking effect, because of course, this has happened over multiple quarters and in different ways; there were different provisions built. But maybe to give you a sense of the underlying business, what's happening – if we left out LatAm and Brazil, for example, and look at the other regions, what we can see is, year on year, currency and portfolio adjusted, what we can see is a growth in APAC of 10%, in North America of 2%, and in EMEA we had a slight decline of 3%. The decline in EMEA is primarily due to the drought in Western Europe and in particular a situation in France, where we had the biggest overall decline, where we have a market-leading position.

So of course we have very strong growth in LatAm, in Brazil. A part of that is simply the rebound, but there is clearly underlying growth here. And again, all regions except for EMEA were growing in this first half of the year. So that's just to try and give you a sense of the underlying growth going forward. And I think what you will see now is, as we go into the second half of the year, which is of course heavily dominated by the southern hemisphere and Brazil, LatAm, there we will benefit from the cleaning up of the channel inventories because now we have a much tighter fit between sell in and sell out.

So overall – again, just to give you a sense of what we see as the underlying business going forward.

Werner Baumann

Okay. Thanks, Liam.

Moderator

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

Steve Byrne, Bank of America

Steve Byrne, from Bank of America. Liam, you were talking about your expectations for robust demand for crop chemicals down in South America as their planting season gets underway. My question for you is: what's your commercial strategy to address the very sharp currency declines year over year – Brazil and Argentina? Are you pushing pricing in a local currency basis

commensurately and are you hedging forward any? And then just one additional pricing question on Seeds – are you pushing the Intacta pricing, given the ongoing patent challenge is maybe making that a little more politically challenging?

Liam Condon

Okay. Thanks, Steve. It's a very important issue for us – is managing the currency risk in the second half of the year. And I guess Wolfgang might want to comment in addition. But let me just explain in general how we overall approach the business in LatAm, and take specifically the example of Brazil, which is by far the biggest market.

So we have to invoice in Brazilian real, but we try and tie the business as tightly as possible to US dollars. So the price lists are basically regularly updated according to the US dollar prices. So whenever there is a change – any kind of significant deviation between the real and the dollar, we try and immediately update the price lists to reflect the latest situation. You can't do this on a daily basis, but we try and do it as often as possible. That's one method of trying to lock in the currency tighter to US dollar, as opposed to being completely exposed to the Brazilian real.

The second element is barter. And, for example, with Crop Science, about 25% of our current business is actually through barter, which again locks into the US dollar-based because at the end of the day, these are commodities that are traded on international markets and in US dollars.

And, of course, we have hedging policies in place, which maybe Wolfgang might want to lead – allude to. But here overall, we of course do have an exposure and our goal is to try and limit it through multiple mechanisms. But we cannot reduce this exposure to zero; that's very clear.

Werner Baumann

Yeah Steve, this is Werner. Maybe I can comment a little bit broader on FX and how we deal with it for both the Crop business, but also for our remaining businesses. So our standard policy is as follows: the anticipated net exposure for our operations business is hedged in the main currencies, as long as it's not prohibitively expensive, at about 50% of the anticipated exposure. Currently, we don't hedge in the real because it's – just simply, it's not economical. It's too expensive.

Secondly, everything that has been booked, the net booked exposure is hedged at 100% level in the main currencies.

And maybe one last word for the combined new company going forward, what the overall sensitivities are that Wolfgang already alluded to – on an annualised basis, so full-year annualised basis, the total FX exposure, if the basket that we operate in moves by 1% up or down, it means a top-line impact by roughly 340 million and a bottom-line impact by about 100 million, and what is included in this impact is actually three things. It is actually the transactional FX impact, the translational impact and then the net delta hedging impact that we see from our hedging operations.

Steve Byrne

Thank you.

Moderator

Next question comes from the line of Mr Richard Vosser. Please state your name, company name, followed by your question.

Richard Vosser, JP Morgan

Hi, Richard Vosser from JP Morgan. Thanks for taking my questions. One question, just thinking about bolt-on pharma M&A and R&D – how are you thinking about pharma bolt-ons, given the demands from cash, as you've alluded to, to deleveraging and potentially for ongoing litigation purposes as well. And tying that into R&D spend – a little bit higher, maybe, seasonally at the moment or this quarter, but we should see a significant reduction in R&D spend as the lifecycle management at Xarelto has officially largely completed now, so just your thoughts on R&D spend and pharma innovation going forward.

Then, just coming back, second question, on to the guidance, Werner, you highlighted moving from the 2018 pro forma. I think synergies are targeted to be about €170-300 million next year. At the upper end, that's about 23 cents. We have 300 million of one-offs this year from the manufacturing. Do you expect those to fully reverse next year? Again, that's about 23 cents. And potentially growth next year, I don't know, of 5-7%, so perhaps you could just maybe talk about some of my maths and where consensus is at 7.78 on a core EPS level for 2019. Thanks very much.

Werner Baumann

Okay, Richard, to start with your last ask first, I will not comment on the 7.78 because there's something that we don't make the consensus or the prospective on 2019. We will give guidance on 2019 at our full-year earnings, as Wolfgang alluded to.

Now coming to your questions, what we always said is that we are going to put ourselves in a position that we can continue to fund all of our businesses that we continue to operate, let's say, as core businesses going forward. That means, of course, also for pharma that there is funding available for external growth. We have been talking about it before. I can only reiterate it. As you've seen with Loxo, if a Loxo opportunity came about, we would of course jump on it and we would certainly have the financial means to secure such an asset. We have also talked about stepping up our efforts in business development and licensing growth going forward in order to further complement our own internal R&D efforts, and, the funding that is needed, it available to the company.

We have a rating that, if you look at the three that are out there – Moody's, Standard & Poor's and also Fitch – it ranges from BBB to A-, which also means that we would have, if need be, a little bit of debt capacity, but clearly our focus is first of all on delevering and, with the free cashflow generation of the combined business, with the incremental synergies coming in on top of the funding that comes from growth, we are well positioned to fund growth and also opportunities in innovation, going forward, in pharma in particular but also in our other businesses.

Having said that, how do we look at, let's say, potential cash out for litigation. First of all, I will just come back to what Liam said. We have provided for our current estimate for the next three years of defence cost for the Glyphosate litigation and that is solidly backed into our financials. The second thing is that we have always said that the financial profile of the company needs to actually mirror the operational risk of a business. If something unforeseen happens, we should be

able to deal with that unforeseen event from a cash funding perspective while at the same time continuing to fund our business operations and the growth opportunities we have. So there is no conflict or trade-off that from today's perspective, we would have to make.

Now, on guidance, first of all, I can confirm that we are for 2019 actually in line with the information that we provided you. We are looking at a net synergy realisation of 20-35% of the $1.2 billion in fiscal 2019. Secondly, the 300 million are an adjustment to our typical 2018 growth profile. What it's going to translate into in terms of what we are going to see coming back in 2019 we will for sure comment on as part of the capital markets day or, at the latest, when we give guidance for 2019. That is something that we would have to look at separately.

Richard Vosser

That's very helpful. Thank you very much.

Werner Baumann

Okay.

Oliver Maier

Hayley, are there any more questions? We are running out of time a little bit so are there any more questions?

Moderator

There are no further questions.

Oliver Maier

Okay, great. Thank you very much everybody for participating in today's call. It was a little longer and a little bit more complex, but I hope we provided all the information necessary. Thank you very much. Talk to you soon.

Moderator

Ladies and gentlemen, this concludes the second quarter 2018 results investment analyst conference call of Bayer AG. Thank you for participating.

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