Fresenius SE

Price EUR64.47

We see room to outstrip FY2016 guidance

Fair Value EUR73 vs. EUR70 (+13%) **BUY-Top Picks**

Bloomberg	FRE GR
Reuters	FREG.DE
12-month High / Low (EUR)	69.8 / 53.1
Market Cap (EURm)	35,198
Ev (BG Estimates) (EURm)	50,496
Avg. 6m daily volume (000)	1 296
3y EPS CAGR	9.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.5%	10.8%	-3.8%	-2.3%
Healthcare	2.6%	-1.5%	-11.6%	-11.1%
DJ Stoxx 600	0.7%	1.9%	-11.3%	-8.3%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	27,626	29,070	30,963	33,250
% change		*5.2%*	*6.5%*	*7.4%*
EBITDA	4,990	5,432	5,799	6,287
EBIT	3,875	4,269	4,561	4,957
% change		*10.2%*	*6.8%*	*8.7%*
Net income	1,358	1,576	1,681	1,843
% change		*16.1%*	*6.6%*	*9.6%*

	2015	2016e	2017e	2018e
Operating margin	14.0	14.7	14.7	14.9
Net margin	4.9	5.4	5.4	5.5
ROE	7.2	7.6	7.5	7.6
ROCE	3.8	4.2	4.3	4.6
Gearing	118.4	107.5	99.2	90.1

(EUR)	2015	2016e	2017e	2018e
EPS	2.62	2.90	3.09	3.39
% change	-	*10.8%*	*6.6%*	*9.6%*
P/E	24.6x	22.2x	20.9x	19.0x
FCF yield (%)	2.1%	4.4%	4.4%	4.6%
Dividends (EUR)	1.69	1.87	2.00	2.19
Div yield (%)	2.6%	2.9%	3.1%	3.4%
EV/Sales	1.8x	1.7x	1.6x	1.5x
EV/EBITDA	9.8x	9.3x	8.7x	8.1x
EV/EBIT	12.6x	11.8x	11.1x	10.3x

A strong start to the year, which was slightly ahead of FRE's internal expectations and reinforced management's confidence in delivering its FY2016 guidance (6-8% organic and 8-12% net income growth), but not to the point of upgrading it. The main reason for this is caution on profitability levels at KABI. We acknowledge that the division will face tough comps starting in Q2, however, we do not see tailwinds fading rapidly. Although our updated numbers are within the company's topline growth guidance range (BGe 7.4%) they are slightly ahead in terms of net income growth (BGe 12.3%). We will monitor closely any changes that could impact KABI's profitability levels. However, there is room for the company to outstrip guidance at this stage.

ANALYSIS

- The main point of interest during yesterday's call on Q1 results was KABI growth prospects for the remainder of the year and the division's ability to deliver/maintain current profitability levels. As a reminder, while organic growth was in line with expectations at EUR1,470m (7% cc and reported) for the first quarter, the good trend in profitability stemmed from multiple sources, which we do not see fading entirely towards the end of the year. Management was pleased by growth, which came from all KABI's businesses and was slightly ahead of internal projections.
- This strong start to the year occurred despite pricing pressure on Neostigmine. Indeed, Hikma's entrance on the market earlier in 2016 led to a 33% price cut for the product. Note also that Fresenius KABI's competitor now holds a 20% market share in the country. Three Gx IV launches in Q1 bodes well with strategy to reach high end of 6-10 product launches guidance in 2016. Our model points to 11 launches this year. In the longer run, it is important in our view to also consider the newly acquired BD plant, which might well help to sustain profitability levels with additional launches of high margin prefilled syringes. Note that at the time of the first launch of a prefilled syringe from this plant in 2013, BD's management mentioned that the division could reach USD100-200m towards 2018. While the previous owner struggled in leveraging its hospital channel to grow this business before deprioritizing it, we believe that Fresenius KABI is in better place to create synergies out of it, once necessary investments would have been made. Hence, we do not rule out that sales of prefilled Gx produced in this plant might well go above the above mentioned numbers (not included in our valuation yet). Finally, a 10 year supply agreement with BD should help to enhance synergies by bringing KABI's legacy products to the US (management di not mentioned if BD was a client before this agreement was inked, which if not might be a free upside).
- We acknowledge that Fresenius KABI will face tough comps starting in Q2 (12.5% organic growth and EBIT margin of 20.4% in Q2 2015). However, we and the consensus have already integrated this, leaving us with a positive risk-reward profile at this stage. While easing the shortage situation needs to be monitored closely, we would highlight that on a sequential basis (Q1 2016 vs Q4 2015), management has been able to at least maintain profitability in the US.
- Turning to Helios which reported 3% organic growth for the quarter (in line with company's guidance of 3-5% organic growth), note that Q1 was impacted by Easter weekend during which physicians are reluctant to take in new patients. From a profitability standpoint, a good performance from former RHK hospitals and Helios led to a 50bp increase in EBIT margin, and our numbers for the year is within the company's range (EUR670-700, BGe EUR690m).

VALUATION

- We have adjusted our tax rate to 28.5% for the year (vs. 29%) as well as our net interest for the year, which are now anticipated at EUR592m vs. BGe EUR633m previously.
- While we were previously in the middle range of the company's net income growth guidance (8-12%) guidance, these small adjustments put our net income growth slightly ahead of it EUR2.94 (+12.3%) vs EUR2.89 (+10.4%) previously.

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