23rd September 2016

Healthcare

Fresenius SE

Price EUR72.87

Fresenius KABI diluted but short-term outlook still strong

Fair Value EUR78 (+7%) **BUY-Top Picks**

Bloomberg	FRE GR
Reuters	FREG.DE
12-month High / Low (EUR)	72.9 / 53.1
Market Cap (EUR)	39,813
Ev (BG Estimates) (EUR)	55,062
Avg. 6m daily volume (000)	1 033
3y EPS CAGR	12.6%

	1 M	3 M	6 M	31/12/15
Absolute perf.	9.9%	11.2%	17.6%	10.5%
Healthcare	0.8%	2.7%	6.8%	-6.4%
DJ Stoxx 600	2.2%	1.9%	2.2%	-4.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	27,626	28,927	33,694	36,132
% change		*4.7%*	*16.5%*	*7.2%*
EBITDA	4,990	5,407	6,213	6,756
EBIT	3,875	4,250	4,865	5,311
% change		*9.7%*	*14.5%*	*9.2%*
Net income	1,358	1,623	1,864	2,064
% change		*19.5%*	*14.9%*	*10.7%*

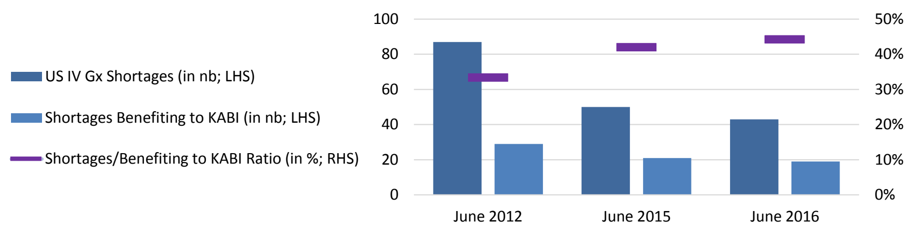
	2015	2016e	2017e	2018e
Operating margin	14.0	14.7	14.4	14.7
Net margin	4.9	5.6	5.5	5.7
ROE	7.2	7.9	8.3	8.4
ROCE	3.8	4.3	4.8	5.1
Gearing	118.4	107.2	101.0	91.6

(EUR)	2015	2016e	2017e	2018e
EPS	2.62	2.97	3.38	3.74
% change	-	*13.6%*	*13.6%*	*10.7%*
P/E	27.9x	24.5x	21.6x	19.5x
FCF yield (%)	1.8%	4.0%	1.8%	4.3%
Dividends (EUR)	1.69	1.93	2.21	2.45
Div yield (%)	2.3%	2.6%	3.0%	3.4%
EV/Sales	1.9x	1.9x	1.8x	1.7x
EV/EBITDA	10.7x	10.2x	9.8x	9.1x
EV/EBIT	13.8x	13.0x	12.6x	11.6x

In an interview given to Manager Magazin, FRE's CEO, Stephan Sturm, said that synergies of more than EUR50m should not be ruled out following the integration of Quironsalud. Also, FRE launched a generic of Cubicin (IV Gx) earlier this week and we believe this could benefit from the short-term outlook for the recently diluted KABI division. This might well enable KABI to keep up with high margin levels (above 40%) despite an easing in the US drug shortage situation.

ANALYSIS

- Following the acquisition of Quironsalud by Fresenius SE, we are reiterating our BUY recommendation and raising our Fair Value to EUR78. As a reminder, we were pleased to see Fresenius' management reinforcing its hospital business (HELIOS), thereby bringing stability and visibility to both sales and earnings at a time when visibility at KABI (mainly a US IV generic business) could be decreasing slightly due to an easing in the drug shortage situation in the US.
- Regarding synergies that could be achieved from the integration of Quironsalud i.e. EUR50m announced, we stressed in our note (please see here) that they could be topped. In an interview given yesterday to Manager Magasin, CEO Stephan Sturm pointed out that this amount should be viewed as a minimum threshold. In the same interview, the CEO mentionned that other M&A deals are still on the agenda. Note that with a net debt/EBITDA ratio that we expected to be back at around 2.5x by mid-2017, bolt-on deals should not be ruled out (KABI's turn?).
- Regarding decreasing visibility at KABI, note that this is due to an easing of the drug shortage situation in the US, which impacted NA growth rate during the second quarter (-6%CC), but has to be nuanced, at least in the short term. Indeed, we highlighted management's ability to **1/** target key drugs (cf chart below) enabling KABI to **2/** increase its EBIT margin in the region i.e. NA EBIT margin +210bp in Q2 to 43.1% of sales. The latter point remains the most important in our view.



- Earlier this week, KABI announced the launch of another IV drug in the US: Daptomycin, an antibiotic indicated in the treatment of serious/complicated blood, skin or bone joint infections. This is the fourth IV drug launch in the US this year (guidance of 6-10 drug launches). As such, we reiterate our view that launch guidance should not be at risk as launches are expected to be back-end loaded towards the end of the year.

  While most of the IV drugs launched in the US by KABI rarely drive more than EUR100m in sales, daptomycin holds greater potential in our view. The drug is marketed under the trade name Cubicin by Merck & Co, following its acquisition of Cubist for USD9.5bn in 2014. US sales of Cubicin amounted to approx. USD1bn in 2015. Now that Cubicin has lost its patent protection in the US (June 2016), TEVA and KABI entered the market on 15th and 20th September respectively. We have identified several other Gx drugmakers that could have an interest in entering this market as they have filed ANDAs (namely Crane, Sagent, Stride, Agila, Hospira, Dr. Reddy and Actavis), KABI and TEVA however should benefit from being the first movers and enjoy a larger market share in coming months. This market share will depend on Merck & Co's defence strategy concerning whether or not it will align with the generic price (~30% discount). Given Merck & Co's statement that it should "lose a significant market share", it is fair to assume that sales are set to decrease by 50-60% in 2017e, due to KABI and TEVA as well as other generic companies, albeit to a lesser extent. Note that GSK's augmentin lost 50% of its sales one year after the introduction of Gx and a further 25% during the second year.

In all, we believe that KABI should derive EUR10-15m and EUR100-125m in sales from daptomycin in Q4 2016 and 2017 respectively (BGe), which should 1/ make the product one of the most important in KABI's portfolio i.e. close to 5% of KABI sales in 2017e and 2/ has the potential to contribute alone to 1/3rd of KABI's 2017e mid-single digit growth.

Once again, this bodes well for our view that FRE's management effectively targets key Gx, which in the short term should continue to benefit KABI margins. As a reminder, KABI's sales and EBIT guidances were raised following Q2 results, from low single digit and roughly flat growth to 3-5% growth for both figures.

VALUATION

- We reiterate our BUY recommendation and EUR78 Fair Value.
- Fresenius SE is in our Q3 Top-Picks list.

NEXT CATALYSTS

- 27th October: Q3 results

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