BRYAN, GARNIER & CO

FOCUS

18th November 2016

Fresenius SE

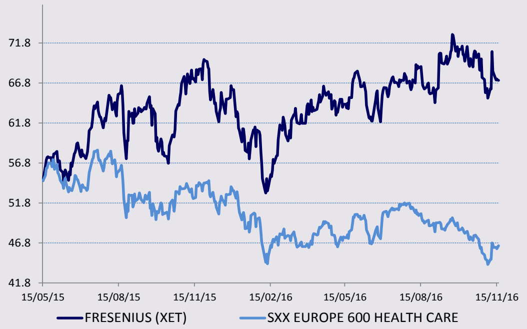
Steady as she goes

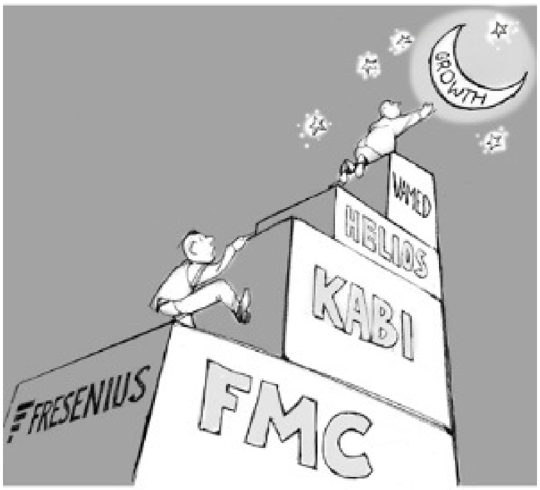
Healthcare

Fair Value EUR78 (price EUR67.13) **BUY-Top Picks**

Bloomberg	FRE GR
Reuters	FREG.DE
12-month High / Low (EUR)	72.9 / 53.1
Market capitalisation (EURm)	36,717
Enterprise Value (BG estimates EURm)	51,911
Avg. 6m daily volume ('000 shares)	1,078
Free Float	64.0%
3y EPS CAGR	13.4%
Gearing (12/15)	118%
Dividend yield (12/16e)	2.90%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	27,626	28,960	33,608	35,919
EBIT (EURm)	3,875	4,289	4,933	5,387
Basic EPS (EUR)	2.50	2.92	3.35	3.73
Diluted EPS (EUR)	2.62	3.00	3.45	3.81
EV/Sales	1.82x	1.79x	1.72x	1.62x
EV/EBITDA	10.1x	9.5x	9.2x	8.5x
EV/EBIT	13.0x	12.1x	11.7x	10.8x
P/E	25.7x	22.4x	19.5x	17.6x
ROCE	3.8	4.4	4.9	5.2





We believe that Fresenius KABI is positioned well to leverage its US hospital channel with the ramp-up of clinical nutrition and strong Gx IV launch pace in 2017 and 2018. US margins are resilient and the negative impact from the normalisation of the US drug shortage situation appears to be a slow process with further delays as an upside. Noise following the US presidential elections does not impact the group. Helios evolves in a stable environment and we continue to believe that synergies with Quirónsalud could be higher than initially anticipated. We reiterate our BUY rating and EUR78 fair value.

- With 50 ANDAs pending with the FDA, the generic IV drug launch pace should at least reach the top end of the group's guidance (6 to 10) over the next two years. Alongside a slower than anticipated resolution of US drug shortages with KABI's marketed product currently designated as in shortage, representing over one third of US generic injectable shortages, we see margins as being resilient in the business.

- In the medium term, we see opportunities from the higher margin prefilled syringe business and the ramp-up of clinical nutrition. Moreover, concerns around drug pricing (investigation for collusion by the US DoJ) and "potential shake-up" of the US healthcare system are overdone in our view as they do not impact Fresenius KABI.

- The stability of both the private and public hospital market environments appears to be sustainable. Quirónsalud's management is on track to achieve 2016 targets which bodes well for 2017's (EUR2.7bn in sales and 19% EBITDA margin). An in-depth review of procurement costs and the patients' management programme could lead to upward revision of the synergies target when Quirónsalud is integrated into the group next year.

- The Conference reinforced our positive stance on the company. We reiterate our BUY rating and EUR78 fair value, offering 16% upside on the current share price. Fresenius SE is in our Q4 2016 Top-Picks list.

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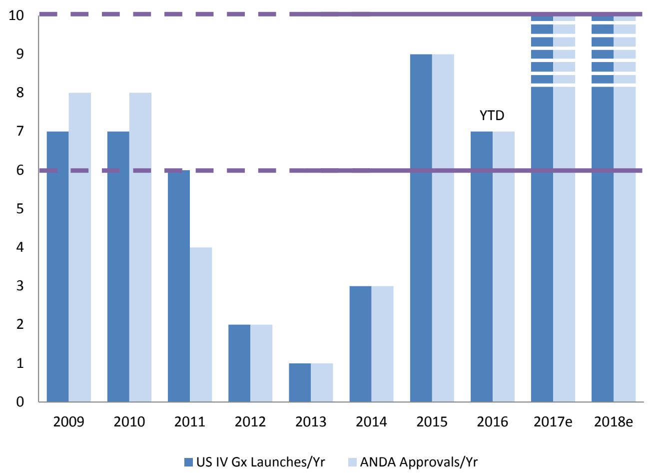
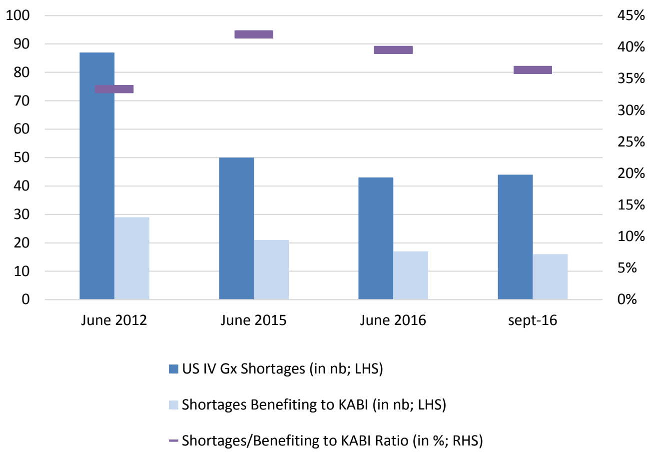
Fresenius SE Major keys to focus on

1. Launch pace keeping-up… Good resilience of margins



■ KABI currently has 50 ANDAs pending in the US which should translate into a robust drug-launch pace 2017 and 2018. While the group reiterated its expectations to reach the high-end of its 6 to 10 generic IV drug launches over the next two years, we do not rule out that the latter guidance could be topped as our projections lead us to 11 launches per year (in 2017 and 2018). So far in 2016, 7 products have been launched including nice add-ons to the portfolio like: 1/ Ketorolac Tromethamine (NSAID; 1m TRx p.a. in the US) which should be made available through the recently-acquired BD's Simplist platform, and 2/ Daptomycin, (Gram-positive infections) a generic of Merck & Co's Cubicin which totalled sales of approx. USD1bn in 2015. Regarding the latter, we believe it holds a potential of close to USD10-15m and USD100m in Q4 2016 and FY2017 respectively (i.e. 5% of the business sales in 2017e). Although several generic drug makers have ANDAs filed with the FDA already, both TEVA and KABI should benefit from first movers position with approvals of their generic on the 15th and 20th of September. Since September, we have not noticed any other ANDA approval for a generic of Cubicin in the US.

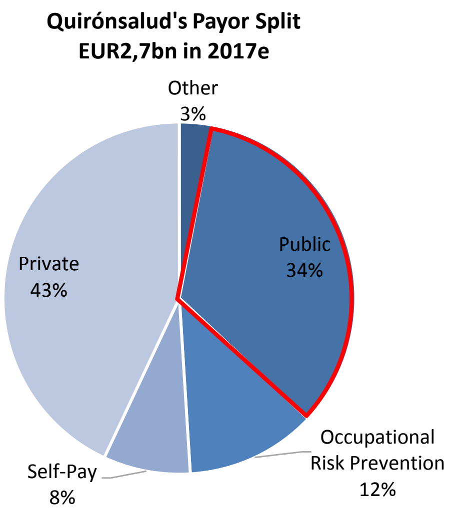


■ Despite a resolution of the US drug shortages, KABI's marketed product, currently designated as in shortage, represents over one third of US generic injectable shortages. Resolution of drug shortages appears to be a slow process as the chart illustrates with 16 KABI marketed products currently designated in shortage vs. 17 at the end of Q2 2016 and 21 in mid-2017.

■ Combined with a healthy pace of launches, this should enable KABI to continue to report resilient US margins in the short term, i.e. north of 40% YTD. As a reminder, normalisation of the shortage phenomenon, which is likely to impact mid-term profitability, is not an unknown. However, we do not believe that delays in the normalisation of KABI's margins would translate into a sharp one when it will happen and see this as an opportunity for the company to find profitability relay(s). Note that management has already shared its expectation of a normalised EBIT margin in the region of the mid 30s; down from north of 40% YTD. In our estimates, we integrate an EBIT margin in North America of 39%, 37% and 35% in 2017, 2018 and 2019 respectively. We see downside risk as limited, further compensated by the longer than expected resilience of margins in the business.

- In the medium term first, the group should focus on leveraging its hospital channel. Within its IV Gx business, we see the BD platform and the 10-year exclusive deal as a hidden gem. On one hand, investments made in the platform should allow for more registration of IV drugs for the prefilled syringe format, which allows premium pricing. Moreover, a switch from traditional IV vials to prefilled syringes for key products should not be ruled out. On the other hand, the 10-year exclusive deal agreement gives Fresenius an opportunity to penetrate the US further and leverage its APP portfolio. Leveraging the hospital channel could also be done with the clinical nutrition business and notably the three-chamber bag. Sales of the latter in the US totalled EUR70m YTD. Fresenius' IR team at our conference stated that education still has to be done, i.e. nurse-handling formation and promotion of the product to GPOs.

2. Public and Private hospital market environments are sustainable



- Quirónsalud should be integrated into the group as of February 2017. Management of the recently-acquired Spanish business recently reiterated its 2016 targets which bodes well for 2017 targets of EUR2.7bn in sales and EBITDA in the EUR520-550m range (20% margin vs. 15% at Helios). In the long run, Greenfield projects should not be ruled out to expand the Spanish business.

- As soon as the integration is effective, Fresenius should be able to launch an in-depth review of procurement costs and potentially update on synergy targets which were initially set at EUR50m pre-tax per annum. Considering previous comments from the management as well as the patients' management model that could be duplicated at Helios, we believe that EUR75m of synergies could be reached (please see our note issued on 09/16/2016 here).

- The main point of concern when it comes to Helios is the sustainability of both the German and the Spanish hospital markets. Regarding the German hospital market, the Diagnosis Related Group (DRG), which is revaluated every year, needs to be considered (price mix). While the latter has been set at 2.5% for 2017, we do not see it decreasing for 2018. Not only because of the German Federal elections in September 2017 with candidates not likely to announce a shake-up of the healthcare system while running for the Bundestag but also because 40% of German private hospitals are loss-making, highly relying on the annual revaluation of the DRG. Turning to Spain, Quirónsalud derives 34% of its revenues from hospitals running under a Public-Private Partnership (PPP). These PPPs are planned to last until 2041, with a possibility for the states and Quirónsalud to extend them before their term. Quirónsalud has made significant upgrade investments within these hospitals (radiology equipment amongst others). Should the states decide to end the PPPs before the planned term, it would have to take over the expensive leases on all the equipment.

Please see the section headed "Important information" on the back page of this report.

3. One Sentence
« No issues with the DoJ ».

Following an investigation conducted by the DoJ over the past two years, 12 generic drug makers (including Hikma, TEVA, Sun Pharma and Mylan) could be charged for collusion on price increases by year end. During this investigation, two drugs and their related price increase have been of particular interest (Doxycycline and Dixogin). We note that these two drugs are not manufactured nor commercialised by Fresenius SE and that the company did not received any subpoena by the DoJ. Note also that 95% of FRE's KABI IV Gx sales are made through GPOs at an average price of USD5/vial with pricing down 2-3% this year, away from potential issues around unreasonable price increases.

The new US president-elect Donald Trump has been vocal during his campaign on his intention to repeal Obamacare and give Medicare the right to negotiate prices directly with pharmaceutical companies. Although his position seems to be more nuanced now, it worth noting that Fresenius SE sees no impact for its GPOs and distribution channels. The impact would be directed towards branded products and in the end could translate in an increased use of generics (e.g. positive impact for Fresenius and TEVA for Daptomycin sales on the back of Merc & Co sales of Cubicin).

4. One Figure

4x

Further M&A opportunities for the company. We should be seeing a digestion period following the acquisition of Quirónsalud for EUR5.76bn, until at least mid-2017 when: 1/ the net debt/EBITDA ratio would be back within the 2.5-3.0x targeted range, and 2/ a new CFO would be appointed. Full leverage would allow a 4x ratio, giving Fresenius enough magnitude to engage in any sizeable opportunistic M&A that it would envisage (IV Gx in Asia, infusion pump…?).

Fresenius SE's strategy when it comes to M&A has a proven track record in being oriented towards adding a long-term growth platform with high synergy opportunities (APP in 2008, RHK in 2013, Quirónsalud in 2016). Besides the value added of prefilled generics that could translate into higher profitability for the business, we see a potential use of the Simplist platform for biosimilars. Indeed, Carol Lynch (Sandoz Global Head of Biopharmaceuticals) stated at our Healthcare Conference that the national tender process for biosimilars tends to include more "beyond the pill" services such as ease of use. The Simplist range could fall into this trend in our view. Looking at Novartis' biosimilar business margins, which should reach a 40% within the next few years, Fresenius could see an incentive in being a player in the field. Leverage might hence be used to raise debt to build production lines instead of M&A.

5. How does the Conference impact our Investment Case

The Conference reinforces our positive stance on the company. We believe that Fresenius is positioned well to leverage its hospital channel in the US (Becton Dickinson deal and clinical nutrition) while further delays in the normalisation of KABI's US business is a free upside as the consensus and us have already integrated it. The strong launch pace in 2017 and 2018 could translate into the commercialisation of generics with high sales potential (neostigmine-like). Stability of both the Spanish and German hospital markets is sustainable. Higher than anticipated synergies at HELIOS with the integration of Quirónsalud should not be ruled out.

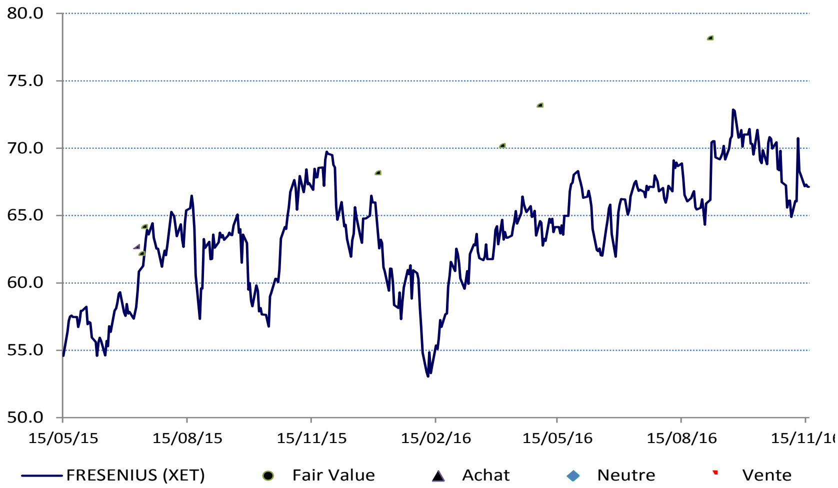
Next Catalysts

Period	Division	Event	Comments
Q4 2016	KABI business	US IV Gx launches	Groups targets high-end of the 6-10 launches
Late 2016/Early 2017 ?	FRESENIUS	CFO to be appointed?	
Feb. 22nd 2017	FRESENIUS	Q4/FY 2016 results	2017 guidance and mid-term targets

Source: Company Data; Bryan, Garnier & Co ests.

Price Chart and Rating History

Fresenius SE



Ratings Date	Ratings	Price
14/07/15	BUY	EUR57.35
18/12/14	NEUTRAL	EUR41.7

Target Price Date	Target price
07/09/16	EUR78
04/05/16	EUR73
06/04/16	EUR70
05/01/16	EUR68
16/07/15	EUR64
14/07/15	EUR62
04/05/15	EUR57
30/04/15	EUR54
18/12/14	EUR42
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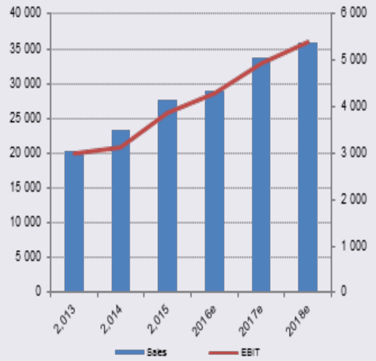
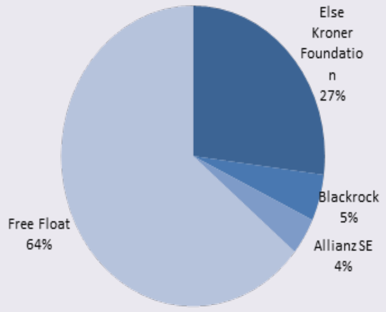
26/11/13	EUR39.27
17/09/13	EUR36.96





Company description

Fresenius is a health care group with international operations, providing products and services for dialysis (Fresenius Medical Care), hospital and outpatient medical care. In 2015, group sales were EUR27.6bn billion. The recent Quirónsalud acquisition strengthened the group's footprint in the hospital business (HELIOS) while its KABI business is benefiting from a good sales momentum notably in the US.

Simplified Profit & Loss Account (EURm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**	2019e
Revenues	20,331	23,231	27,626	28,960	33,608	35,919	38,493
Change (%)	*5.4%*	*14.3%*	*18.9%*	*4.8%*	*16.1%*	*6.9%*	*7.2%*
Adjusted EBITDA	3,888	4,051	4,990	5,448	6,277	6,823	7,330
EBIT	2,991	3,114	3,875	4,289	4,933	5,387	5,790
Change (%)	*0.3%*	*4.1%*	*24.4%*	*10.7%*	*15.0%*	*9.2%*	*7.5%*
Financial results	(584)	(602)	(613)	(552)	(695)	(698)	(702)
Pre-Tax profits	2,407	2,512	3,262	3,738	4,238	4,689	5,088
Exceptionals	NM	NM	NM	NM	NM	NM	NM
Tax	(669)	(700)	(965)	(1,065)	(1,208)	(1,336)	(1,450)
Profits from associates	NM	NM	NM	NM	NM	NM	NM
Minority interests	(727)	(745)	(939)	(1,077)	(1,179)	(1,294)	(1,424)
Net profit	1,051	1,086	1,423	1,596	1,851	2,058	2,214
Restated net profit	1,011	1,067	1,358	1,638	1,904	2,106	2,265
Change (%)	*9.2%*	*5.5%*	*27.2%*	*20.6%*	*16.3%*	*10.6%*	*7.5%*
Cash Flow Statement (EURm)							
Operating cash flows	2,320	2,585	3,327	3,746	4,118	4,663	5,041
Change in working capital	68.0	(1,258)	(1,173)	(341)	(1,464)	(727)	(806)
Capex, net	(1,071)	(1,345)	(1,489)	(1,738)	(2,024)	(2,053)	(2,082)
Financial investments, net	(3,603)	(3,351)	(1,494)	(3,016)	(8,607)	(3,104)	(3,019)
Dividends	(491)	(582)	(920)	(1,064)	(1,251)	(1,383)	(1,487)
Other	NM	NM	NM	NM	NM	NM	NM
Net debt	11,940	12,429	13,518	15,195	21,154	21,577	21,503
Free Cash flow	1,520	206	722	1,554	765	1,809	2,002
Balance Sheet (EURm)							
Tangible fixed assets	5,082	6,776	7,428	7,980	8,633	9,222	9,737
Intangibles assets	16,067	21,314	23,033	24,338	30,949	32,026	32,990
Cash & equivalents	864	1,175	1,044	304	(5,655)	(6,078)	(6,004)
current assets	7,972	10,028	10,917	10,506	5,802	6,002	6,766
Other assets	3,637	1,779	1,792	1,792	1,792	1,792	1,792
Total assets	32,758	39,897	43,170	44,616	47,175	49,042	51,286
L & ST Debt	17,896	21,753	22,444	22,137	22,729	22,492	22,479
Others liabilities	1,130	1,980	1,776	1,776	1,776	1,776	1,776
Shareholders' funds	13,732	16,164	18,950	20,703	22,671	24,774	27,031
Total Liabilities	19,026	23,733	24,220	23,913	24,505	24,268	24,255
Capital employed	26,735	32,793	35,761	37,373	39,182	40,882	42,862
Ratios							
Operating margin	14.71	13.40	14.03	14.81	14.68	15.00	15.04
Tax rate	27.79	27.87	29.59	28.50	28.50	28.50	28.50
Net margin	4.97	4.59	4.91	5.66	5.67	5.86	5.88
ROE (after tax)	7.36	6.60	7.16	7.91	8.40	8.50	8.38
ROCE (after tax)	3.78	3.25	3.80	4.38	4.86	5.15	5.28
Gearing	130	135	118	107	100	90.79	83.16
Pay out ratio	66.27	65.33	67.70	66.58	67.49	67.12	67.10
Number of shares, diluted	536	540	544	546	552	552	552
Data per Share (EUR)							
EPS	1.89	1.97	2.50	2.92	3.35	3.73	4.01
Restated EPS	1.96	2.01	2.62	3.00	3.45	3.81	4.10
% change	*8.5%*	*2.5%*	*30.1%*	*14.7%*	*15.0%*	*10.6%*	*7.5%*
BVPS	25.62	29.91	34.84	37.91	41.05	44.86	48.95
Operating cash flows	4.33	4.78	6.12	6.86	7.46	8.44	9.13
FCF	2.84	0.38	1.33	2.85	1.38	3.28	3.62
Net dividend	1.25	1.29	1.69	1.95	2.26	2.50	2.69

Source: Company Data; Bryan, Garnier & Co ests.

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NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

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