



## Friday Morning Coffee

### Nr. 137 — “When the going gets tough, the tough get going”

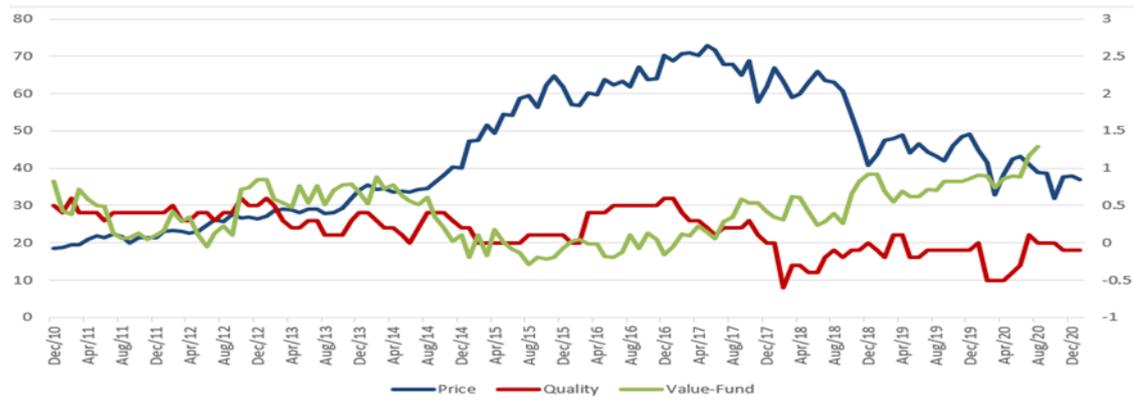
This week we would like to discuss about a market leader, which was already facing tremendous pressure across many of its business channel, but the things got worst in the Covid pandemic. It is the global healthcare conglomerate Fresenius SE. It is active in multiple layers of its niche markets that include providing health services, equipment manufacturing, consumable supplies and project consulting. These activities in combination helps Fresenius defend its market shares in the respective segment and raise switching costs for the customer and support long term recurring revenue. The group Fresenius SE & Co comprises of four operating business segments Fresenius Medical Care, Fresenius Kabi, Fresenius Helios and Fresenius Vamed, all of which are legally independent entities. Shares of the holding company Fresenius SE and Fresenius Medical care are publicly listed.

Fresenius Medical Care (31% owned by the holding company) – This business segment is the world’s largest operator of dialysis clinics and largest manufacturer of dialysis equipment combined with its physician relationships. Operating almost 4000 clinics, FME derives more than 2/3 of its’ revenue and majority of its profits from the US region. Fresenius Kabi is 2nd largest global manufacturer of generic injectable drugs and infusion therapies and the leading provider of infusion and transfusion pumps in Europe. Geographically, Kabi derives c.35% of sales from the EU and the US each, whereas remaining 30% comes from rest of the world. Fresenius Helios - is Europe’s leading private operator with hospital chains in Germany and Spain. Helios has c.4% share of German hospital market out of 17% total share of private hospital operators. Helios derives majority of its’ revenue from Germany. Fresenius Vamed – is project management and consulting business segment providing services to hospitals and other healthcare facilities.

The parent company Fresenius SE and business segment Fresenius Medical care are helmed by extremely competent management teams who have very long association with the group. Up until 2017, the company has created tremendous value for its shareholders by aggressively consolidating then largely fragmented markets in the respective business verticals. In the period post 2017, share prices of both the listed companies started coming under pressure. The cash and growth engine of the group, Fresenius medical care, grew big enough to represent the underlying market itself, whereas the other growth engine, the private hospitals chains, faced headwinds as the PE firms started bidding aggressively in the sector thereby bringing the target multiples at extraordinary levels. In turn, both factors in combination brought down incremental returns on capital. The other issue that added further pressure was the cost base that too largely because of the changes in regulatory standards. Covid pandemic turned the matters worst due to high mortality rates in dialysis patients (each new patient typically brings in 4-5 years of recurring revenue for FME), postponement of high margin selective procedures in the private hospital chains and higher cost of PPE.

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As can be seen in our Quality-Value framework, the Quality of the company never turned negative until 2017 and thereafter it is flirting with zero line. So, what makes us believe that the Quality score would turn positive in the coming period? Apart from Covid-19, which we expect to be a temporary effect, the fact that the underlying dialysis market itself is growing at mid-single digit FME would remain to benefit from the trend given it's share of the market. On top of it, lower penetration of high margin homecare dialysis in the US markets represents big opportunity of FME which was developing quite well up until Covid period. The private hospital chain in Europe will come out stronger post the Covid era as it would have recalibrated its cost base to newer regulatory environment. What we did not discussed earlier are the Kabi and Vamed segments, which are currently doing the heavy lifting and would continue present profitable growth opportunity for the group. At 10.2x one year forward EBIT, Fresenius SE is currently trading at c.10% discount to its own historical average, whereas, closest peers Rhoen Klinikum (focused on chronic disease diagnosis and treatments) & M1 Kliniken (specialising in beauty and aesthetics procedures) are trading at much higher multiples on the current year multiples.

Have a nice weekend,

**Your ECP Team**  
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