CORPORATE PARTICIPANTS

Stephan Sturm, Fresenius SE & Co. KGaA – CEO
Rachel Empey, Fresenius SE & Co. KGaA – CFO
Markus Georgi, Fresenius SE & Co. KGaA – SVP IR

CONFERENCE CALL PARTICIPANTS

Veronika Dubajova, Goldman Sachs
Michael Jüngling, Morgan Stanley
Thomas M. Jones, Berenberg

PRESENTATION

Markus Georgi: Thank you, and good morning to everyone joining us on the line today. I am joined on the call today by Stephan Sturm, our CEO, and by Rachel Empey, our CFO. We will start the call with some prepared remarks and then proceed to Q&A. For the Q&A session, I would like to ask you to limit your questions to one per person to allow us to take as many questions from as many participants as possible. As always, before we begin, I would like to remind you that forward-looking statements and the disclaimer are on Page 2 of today's presentation. And with that, I will pass the call to Stephan.

Stephan Sturm: Thank you, Markus. Good morning, good evening, or good afternoon, depending on your time zone, a warm welcome. We very much appreciate you being available for today's call at such short notice. Markus has already pointed out the safe harbor language to you. So I'd like to focus today's call on the news release we sent out last night. And I'll try to be brief, so to leave time for your questions following my prepared remarks.

So why are we holding this call? We are currently discussing internally our expectations for 2019 and the medium term. That is the year 2020 and beyond. And based on the current status of these discussions, given our commitment to reliability and transparency, we feel it is appropriate to provide you with an interim update.

Having said that, we will provide the regular and more detailed update as part of our full year 2018 results release on February 20 next year. And so please view the still rather broad expectation ranges at this point as preliminary.

So let's get to it, 2019 first, and I'll come to the medium term, that is starting in 2020, later. Based on our narrowed group guidance for this year, we currently expect mid-single-digit organic sales growth for the full year of 2019. At the same time, and that needs a bit more explanation, group net income is expected to remain broadly stable over that of 2018.

For us, 2019 is a year of investing in both infrastructure and capabilities. And that means increased CapEx and OpEx across our businesses to drive future growth and further business development. It just so happens that we have such an investment point across virtually all of our businesses at the same time.

Let me take you through the business segments and add some color to our current expectations for the group next year. A few words on Fresenius Medical Care first. For 2019, FMC currently assumes comparable sales to show solid growth and the comparable net income to be around this year's level. Why is that? FMC expects its 2019 earnings to be impacted by expenses for the further development of their recently or to be acquired businesses, such as NxStage, Humacyte, Xenios, as the company continues to invest for the future. In addition, FMC plans to increase its sales and marketing expenses, particularly in China, to expand its PD business there.

Moving onto Fresenius Kabi, where on the back of a truly outstanding 2018 we currently expect for next year mid-single-digit organic sales growth and low to mid-single-digit EBIT growth in constant currency. Fresenius Kabi is also investing massively into its future and some of its strongest growth areas, such as IV generics, enteral nutrition, and infusion therapy, primarily in North America and Asia, but also in Europe.

In addition, Fresenius Kabi expects meaningful investments in OpEx, for example, the continuing investments into the further development of our biosimilars business, again investments to take advantage of major growth opportunities of the next decade and beyond.

At the same time, and frankly as usual, our current expectations assume some of the 2018 tailwinds to fade away. Specifically, we are yet again modeling a gradual easing of the drug shortage situation in North America in 2019 and continuing over time.

Onto Fresenius Helios, where we expect low to mid-single-digit organic sales growth. Within that aggregate rate, we continue to expect Quirónsalud to grow faster than Helios Germany. And for EBIT, again on a combined basis, we currently expect a low to mid-single-digit contraction. As we have already seen earlier this year, the strong development of Helios Spain will not fully offset the current headwinds at Helios Germany. And given our commentary on the drivers of Helios's underperformance in Germany in Q3 and that it would take us a few quarters to counter them, that shouldn't come as a major surprise.

A few more details on the expected development at Helios Germany: as you know, in the interest of superior medical quality and patient outcomes, but also in light of expected regulatory changes, we launched various initiatives in Q4 last year. And also, these initiatives can be considered as necessary investments into the medium- to longer-term wellbeing of our German hospital business. Unfortunately though, in the short term, they are earnings dilutive.

Nursing legislation remains a key topic, as we still don't know the all-important fine print of the new law. Our overall assessment here hasn't changed though. The impact on 2019 looks benign, and 2020, although less clear, still appears manageable. We are actively analyzing the implications of quite a number of possible scenarios and commensurate mitigation initiatives. And as I said, we're also continuing our activities to tackle some of the selective staff shortages that we have seen over the course of the last quarter.

Finally, we are further developing our investment plans into new business models to address the growing trend toward outpatient treatments. I want to be very clear. We see our new outpatient care business models as largely complementary to our inpatient acute care business. We're looking for additional growth, not cannibalization of our legacy business.

Summing up for Helios, we firmly believe that we have initiated the necessary steps to address the current challenges, and we expect to give you a clearer picture as part of our full year 2018 presentation in February next year.

Finally, and to complete the picture for the group, at Fresenius Vamed, we expect very healthy underlying growth rates, similar to those experienced in previous years.

All in all, we view 2019 as a transition year for the group as we invest in our businesses for further growth and to address regulatory challenges. I want to stress again that today's expectations are not final. We're still working on improvements of these current expectations, including potential additional sales growth and cost efficiency measures. Please bear with us until February next year for an update and further details.

Moving onto our expectations for the medium term, looking at what we already know about this year and taking into account our current budget process for 2019, we now believe we won't meet our ambitious 2020 group targets.

Nevertheless, we remain very confident in our growth prospects. Once we have laid the foundations with that 2019 investment year, we expect sustainable organic sales growth in the mid-single digits right thereafter. In 2020 and thereafter, group net income is expected to grow organically slightly faster than sales. That is until our biosimilars business fully takes off. Then we're expecting a further acceleration.

The important word here is also organically. This earnings growth expectation, in contrast to our previous midterm targets, but in line with our budgeting practice, excludes small- and medium-sized acquisitions. Those we'd view as cream on top. And for the avoidance of doubt, inorganic growth but meaningful earnings accretion has been and remains an integral part of our overall growth strategy.

I very much hope that my explanations have been helpful and that last night's news release gives you some more clarity and confidence in how we see Fresenius developing over the next years. With that, Rachel and I are now happy to take your questions. Thank you.

Q&A

Operator: Ladies and gentlemen, we are now starting the question-and-answer session. (Operator Instructions) And the first question is from Ms. Dubajova, Goldman Sachs.

Veronika Dubajova: Good morning, Stephan and Rachel. Thank you for taking my questions. I will keep it to two, please. My first question is on the commentary on Kabi outlook in your press release this morning. Just curious if you can clarify whether you are seeing some unwinding of drug shortages at this stage, or is this just a cautious outlook statement as you think about 2019, and there is nothing that is changing in the injectable generics market at this stage?

My second question is on your decision to exclude bolt-on acquisitions from the medium-term guidance. If I look at your business, it has proven somewhat more difficult to execute on M&A recently. So I'm wondering whether your assessment of the probability of concluding incremental acquisitions has changed at all versus where it would have been 12 or 24 months ago. Thank you.

Stephan Sturm: Thank you, Veronika, and also good morning to you. On your first question, the situation has not changed since we spoke on our Q3 earnings call. And I seem to recall that it was you who was asking me at the end whether there was anything specific that would make me point to a receding drug shortage benefit. And I stick to the answer that I gave at that time. No, there is nothing specific.

All I was pointing to at the time was that, with the level of concentration of drug shortage situation in the markets and the length of time that has lapsed since we saw the trough, then I would see the odds of a trend reversal somewhat higher than a further increase of the number of drug shortage situations.

But as I said in my prepared remarks, this is a standard modeling assumption that we have used over the years. I believe that we have pointed you on various occasions over time to a margin assumption from our perspective that is in the mid-30s or slightly above that we would see once the situation has normalized and us approaching this more normalized margin level that is in -- reflected in those -- in that medium-term expectation that we provided you this morning.

So in a sense, this is the usual modeling exercise that we have gone through also for the purposes of the 2019 budget and our medium-term expectations.

As per your second question, I'd like to differentiate between Helios and the rest of the group. As we have also pointed out to you on numerous occasions, the privatization environment in Germany remains a tough one. We haven't seen any major privatization exercise in a number of years. And as you know, that has been a growth driver over time. With the sheer endless economic cycle, I find it difficult to imagine that that situation is going to change any time soon. It may thereafter. But as I keep on saying, be careful what you wish for. And therefore, that is not part of our assumptions.

As we have discussed Quirónsalud, we have kept on saying that, whilst we are generally very, very happy with this acquisition, the one area of mild disappointment has been the lack of consolidation opportunities in the Spanish market. Maybe sellers have viewed our willingness to spend capital as a signal that it's safe to wait a little longer. In general, I would continue to work on the assumption that more consolidation is going to occur, but for the near term, I'd remain cautious.

As far as Fresenius Kabi is concerned, on the other hand, we remain open in particular to small-, medium-sized acquisitions, but also to portfolio additions, in particular in North America. I've just returned from lovely Delaware, where we have had the Appeal Courts hearing of the Akorn case. I would hope that we can settle this anytime soon. And in particular, once this situation is out of the way, we remain wide open to continue our successful acquisition history.

So the key reason why we have chosen to give you a purely organic growth rate frankly is because that is how our budgeting process works. And we felt that it would also be useful for you to take -- to have a clear untainted view of the underlying organic growth that, from my perspective, is likely to be complemented by further acquisitions in the medium term.

Veronika Dubajova: Excellent. Thank you very much, Stephan.

Stephan Sturm: Thank you.

Operator: The next question is from the line of Michael Jüngling, Morgan Stanley. Please go ahead.

Michael Jüngling: Thank you, and good morning. I have two questions, please. Firstly, for 2020, what level of visibility or comfort do you have that the investment period for 2019 does not creep into 2020, resulting in, let's say, flat earnings development?

And then secondly, on the investment period, can you explain why 2019 has become such an intense investment period when, in the past, it's been fabulous spreading of investments over years, resulting in a very smooth development? Is this perhaps a sign that there was a little bit of underinvestment in the past, and there's a catchup, or is the whole business in need of more investment going forward because the cost of doing business has just become more complex and more expensive? Thank you.

Stephan Sturm: Good morning, Michael, and thank you for your questions. On the first one, obviously, the further out you go, the less visibility you get. But I will -- I want to assure you that we have looked at 2020 with quite some scrutiny. And there are defined business and investment plans for 2019 that come to a well-defined end towards the back end of next year.

There are situations where frankly -- and that is already leading into your second question. There are situations where we just feel that market opportunities do present themselves that we need to capture for the longer-term wellbeing of the group at this point in time.

I want to come back to our commentary at the time when we were announcing the Merck biosimilars acquisition. There are regulatory changes in this part of the business that make this business segment much more attractive than it has ever been before. And therefore, we felt in particular with the transaction structure that we found with Merck to invest into that part of the business now.

It also, when I look across at Fresenius Medical Care, happens that the trend towards home hemodialysis has become much more visible and more pronounced than we had seen before. So we continue to believe, and our view hasn't changed at all from the time when we made the NxStage announcement, that this is a trend that we need to capture. And in order to capture it, we need to make some upfront investments. So that is a large part of the overall story. And as I said in my prepared remarks, I'd view it as a coincidence, and I want to rule out underinvestment.

Let me also talk about Kabi. What you have heard from us over time is that we, given the growing presence in North America, now also want to expand into infusion solutions. We believe that it is a shame that, for an extended period of time, there has been a shortage of as mundane products as infusion solutions in this important market and that therefore it has to be a major investment opportunity for us to also embrace this important market with one of our true legacy products.

Who would've thought, moving on, that we were ever so successful with our enteral nutrition business? Who would've thought that we would also flourish with our initiatives outside our hospital home turf? I had my doubts. I was proven wrong. And therefore -- or my skepticism was proven wrong. And therefore, I also do believe that we're well advised to continue our OpEx investment in these markets. I have alluded to a capacity expansion in Europe. I have alluded to further expansions setting up a manufacturing presence in China. And bear with us. There are a few more projects in our pipeline that I plan to be a bit more explicit on come next February.

So bottom line, Michael, I clearly want to rule out an underinvestment in the past. View it as even more growth opportunities that we do see in the businesses that we're currently active in and that we're trying to capture now.

Michael Jüngling: Great. And can I just ask a quick follow up on restructuring charges? Can I confirm that we should not expect any material or large restructuring charges for '19?

Stephan Sturm: In general, I would confirm that. I want to point you back to my prepared remarks that we're trying to improve our current expectation for '19 not only, but also via cost-efficiency measures. So I cannot rule out completely that we're also going to look at a few cost-saving measures. When you're talking about meaningful restructuring charges, yes, absolutely, very positively, I want to rule that out.

Michael Jüngling: Thank you.

Operator: The next question is from the line of Tome Jones, Berenberg.

Tom Jones: Good morning. Thank you for taking my question. I have just the one, as requested. Stephan and Rachel, I was wondering if you would be so kind as to perhaps try and give us some quantification of what the EBIT growth guidance for both Helios and Kabi would be ex the additional investments you're making in '19. I'm just trying to work out kind of how much of the headwinds are operational issues which you're having to deal with, and how much of it is a result of the additional investment spending that you're making. That would be very helpful. Thank you.

Rachel Empey: Hi, Tom. Good morning. Thank you for your call. Let me try to address your question a little bit. So let's start with Kabi. What you see, what we've guided to is an organic sales growth of mid-single digit as an expectation and an EBIT growth a little bit slower with an expectation of low to mid-single digits.

And I would say that the difference here between the two is coming essentially from two sources that Stephan alluded to. One of them is the debate that Stephan had at length earlier about the easing of those drug shortages in North America. And the second is associated with the ongoing investments that we're doing across the business.

Those investments, specifically to address your question, is of course the biosimilars business, but also as I mentioned when I was talking about 2018 when we met back a few weeks ago on the Q3 call, we are continuing also to invest with a higher level of R&D. And we expect that to further accelerate as we go into 2019 as we also invest in other products development throughout the Kabi group and, of course, the other growth initiatives that we've been driving in terms of investment into infrastructure and capabilities.

So I think those two effects are clearly having a significant impact on the growth that we see at Kabi. And I think that you would more likely see an EBIT growth rate that was more commensurate or even slightly above what you're seeing in sales growth if we were not continuing to make those kind of levels of investment in Kabi.

Tom Jones: Perfect. That's very helpful.

Rachel Empey: If you have a look in Helios, here, I would say it's a little bit more difficult to unravel the interconnection of all of the effects. You're obviously very familiar with what's been happening particularly in the German business. And as Stephan alluded to, we are taking some short-term activities to address some of the challenges that we've seen throughout 2013, particularly in -- sorry, 2018, particularly in the second half year, but also with making more strategic moves in terms of clustering and how we're approaching and managing our business in Germany to address the medium-term trends that we see.

It is more difficult I would say to unravel all of those effects on the Helios Germany numbers. But nevertheless, clearly, the let's say low to mid-single-digit contraction that you are seeing that we have mentioned as our expectation for the whole Helios group is very significantly impacted by those effects. And we would expect more of a growth trajectory for the Helios group if we were not taking all of those activities.

Tom Jones: Okay. Perfect. That's very, very helpful. Thank you very much.

Stephan Sturm: Tom, I want to briefly complement that. And I always hate it when the effect cannot be quantified with some precision. But here, as we alluded to over time, we're absolutely convinced that the German overall system of healthcare provision and also reimbursement is going to turn increasingly into one that is quality based. And the key to quality is going to be concentrating the number of cases where we can then render superior quality.

We've been clear that this is something that is going to cost us a few cases, hence revenue and earnings in the short term. Once the system crystallizes, and I have little to no doubt that it's going to happen -- no doubt that it's going to happen -- we're going to reap the benefits, and patients will come into those places where, given a concentration of cases, we can demonstrate a superior quality.

So it's very difficult to -- as Rachel said, to disentangle what the effects are, and is this an investment, or is it a necessary move to secure our wellbeing? In any case, I believe it is something that we have to do and that, as the leading hospital operator in Germany, we should really set that trend rather than follow it.

I'm being told by Markus that there are no more questions this morning. I hope that our explanations have been helpful. We don't want to make it a routine to get on a call with you in early December, but given quite a number of investor contacts later this month and in particular over the course of January, and given our commitment to be reliable and transparent with you, we felt that this was something that we absolutely should do.

And as I said earlier, please bear with us. We continue to be working on these near-term prospects that will take us then into I would guess -- I would firmly believe a bright future in 2020 and beyond.

So on behalf of also Rachel and the rest of the management team, thank you for being with us this morning. All the best.