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Fresenius SE & Co.KGaA

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David Adlington: Good morning, good afternoon, everybody. This is David Adlington from the J.P. Morgan MedTech team in Europe. My pleasure this morning to start off with Stephan Sturm, CEO of Fresenius. Stephan is going to make some brief introductory comments, and then we're going to head into Q&A.

Thanks for joining us today, Stephan, and over to you for those [inaudible] .

Stephan Sturm: Thank you, David. Thank you. Good morning, everyone. Your interest in Fresenius is appreciated, as always. Happy New Year, even though 2021 has already started.

Very briefly, we have had a different and a difficult 2020 by normal Fresenius's standards. We had a good Q1 but had a trough in the second quarter, where in particular the lack of elective surgery at our hospital businesses were felt.

We were saying at the time that we were convinced that Q2 would mark the trough in this past year. We went on to a solid third quarter. It is now too early to talk about the fourth quarter in the detail that you are used to.

We are looking to releasing our Q4 and full-year earnings on February the 23rd. As so often in these past years, I would be surprised and you should be surprised if the full-year guidance that we slightly adjusted as part of our Q2 earnings call would be missed.

We would work on the assumption that our Q4 has been trending in line with expectations. To remind you, that would still foresee for the full year revenue growth, albeit in the low to mid-single digits, and earnings growth more towards the lower end of a range of -4 to +1 percent at constant currency.

All in all, I would say that hadn't it been for COVID, 2020 would have been a year of solid earnings growth, but as we all know, COVID is a reality and is going to weigh on us for a little longer. Notwithstanding that, given the circumstances, I am reasonably OK with the way 2020 has worked for Fresenius as a company.

Thank you, David. Happy to take your questions.

David: Great, Stephan. I will just keep an eye on the lines just to [inaudible] everything coming in, but I've got some prepared questions here. We've had an ongoing discussion now for probably the last two or three years around the bigger picture for Fresenius SE. Is it growth, value, defensive?

I know you firmly see it as growth. I'm not sure the Street necessarily totally agrees with you. Maybe it would be just worth touching on the growth drivers you see across the businesses, how they've played out top line versus bottom line over the last couple of years, and how you see the dynamics over the next two to three years.

Stephan: David, you're right. That is a discussion that we're leading with the buy side also. Therefore, it is an absolutely fair question. My observation would be that over the last years, fairly consistently -- 2020 is no meaningful exception to that -- the group as a whole as well as the business segments have continued to generate organic top-line growth.

Over the years, we have capitalized and tried to capitalize on non-organic growth opportunities, not so much to broaden the spectrum of the group but rather to capitalize on consolidation opportunities.

I believe where the debate is coming from is that over the last two years, unfortunately, the bottom line has decoupled from the top line. That, first and foremost in my mind, has been driven by conscious investments that not only have gone through the balance sheet but also through our P&L.

They were affecting, by and large, all of our businesses, be it home dialysis or the rollout of dialysis service in China, be it biosimilars for Fresenius Kabi, or be it clustering and alternative business models, risk prevention, at Fresenius Helios.

What I believe, against the backdrop of the major disappointments that we created for our investors at the back end of 2018, we need to do is to demonstrate over an extended series of quarters that those investments have been worth our while. Therefore, we need to demonstrate that we can also grow our bottom line.

Hence my comment a minute ago saying hadn't it been for COVID, I believe that we should have tracked at least at the top end of our original guidance for 2020. We could have shown that return to earnings growth. We now have got to watch how the early signs for 2021 stack up and whether 2021 is going to be the year where we can show some earnings growth and the end of that decoupling.

David: You mentioned inorganic growth there. Are there any parts of the business we're more or less likely to see M&A in, in the next couple years?

Stephan: I would be surprised if we didn't see M&A. When organic growth has been the lead driver of the overall growth of the group, we have always complemented that with selective and, ideally, bolt-on acquisitions. I would like to continue that routine also going forward.

As of now, when we are tracking more towards the upper end of our self-imposed leverage target corridor, I'm hesitating to do anything of size. Once we have grown or de-grown back more convincingly into that three to three and a half times target range. I would be open also for some larger consolidation steps.

David: You added the Eugin fertility business at the end of last year. Not massive, but maybe you could add some color to what, first of all, you've done since that. Maybe just add some color on the opportunity you saw there and what the business brings. Is it a platform for a wider move into fertility?

Stephan: I believe that fertility medicine is an area that bodes well as far as sustainable growth is concerned. All the demographics point into that direction. Secondly, we have, as Helios and even more so Quironsalud, a foothold in that business already even though it has been dispersed across our various hospitals in Germany and in Spain. We know what we're talking about.

Thirdly, fertility is a business area that is fragmented and offers all the right ingredients for a roll-up, at least a scale-up.

Fourthly, I believe that with our quality approach there is something that can be done in terms of convincing patients -- we shouldn't be calling the patients -- customers to turn to us to get a high-quality, reliable service that leads them to the result that they are looking for.

Fifthly, that is an area that overall also lends itself to a more digital approach very consistently with the approaches that we have taken in our more legacy businesses within Helios. We will try our utmost to add our digital expertise to what Eugin and our pre-existing businesses have to offer already now.

All in all, I'm very excited about this business opportunity. I think it can be, from a small base, a meaningful growth driver going forward.

David: Just to conclude on the big picture here, if we put all that together, how are you thinking about the top-line and bottom-line growth over the medium term for the business?

Stephan: David, I think that is an implicit question about our medium-term targets. The answer is we are still, as we should, going through a very thorough bottom-up exercise to validate our initial thinking on the 2021 guidance. As part of that, we would also validate our medium-term targets.

We will be definitive as part of our February 23 statement, but as of today, I have no reason to withdraw or put any doubt over the validity of these medium-term targets. Therefore, I continue to believe in mid-single-digit organic revenue growth. Ideally, our earnings growth should beat that at least marginally.

We are going to be, as far our medium-term targets are concerned, back end-loaded, but that is no surprise. That has been clearly communicated, right from the time when we first talked about these medium-term targets. That is driven by the expected market launch of biosimilars in the all-important US market.

As far as our biosimilars activities are concerned, I have nothing to complain about. Much rather, I am fairly satisfied with the performance that we've seen. I take that also as a factor that is underpinning our medium-term targets.

David: Then you touched on it in your opening statement. In terms of the disconnect between the Street and your own growth assumptions, at least in terms of you not getting full value for the expected growth, as a management team and a board, how do you discuss how you might change the Street's perception of the business?

You talked about consistent delivery, particularly bottom line. Is there anything else that you've contemplated in terms of exposing the value?

Stephan: Share price development and share price performance or underperformance, unfortunately, is a standard feature, unfortunately, of management board meetings. We even go as far as discussing analyst reports from time to time, including yours, David.

I believe our conclusion for now is that we have to extend a series of meeting investor expectations to reinvigorate trust in us as a management team and in our ability to grow also the bottom line.

Over and above that, I believe that the Street is focused on only a few parts of the Fresenius business overall. For 2021, what we would like to do is to make our investors, buy-side/sell-side analysts more familiar with very valuable parts of the overall Fresenius group that do not get the attention that they deserve. More to that, I guess, as far as part our February 23 presentation.

David: I won't push you at this point then. Maybe if we look at 2020, most of the companies we cover walked away completely from guidance back in March/April given what was going on with COVID. You updated guidance. Didn't really make a lot of changes to the original guidance you gave this time last year. You stuck with that.

It sounds like you're happy with coming line with that guidance when you report in February. I know when you stood up in San Francisco this time last year, people thought you were going to be very conservative with your guidance. I wouldn't say it was super-conservative.

In terms of having to make very limited changes, was that because the guidance was conservative, because, like you say, you needed to live on those expectations, or have you been able to mitigate a lot of the headwinds?

Stephan: It was by no means a super-conservative guidance. Of course, we got to meet expectations. At the same time, already, when you issue a guidance, you've got to meet certain expectations.

Therefore, I believe the guidance that we issued about a year ago broadly met expectations. We were off to a good start pretty much across our businesses and pretty much across all the geographies. Then came COVID.

I guess at some point in time, people were even wondering whether net-net we wouldn't be a beneficiary of the pandemic. That clearly hasn't been the case. We communicated, in a very transparent way, what were puts, what were the takes.

Net-net, much rather, we were seeing some downside. Yes, volume demand for many of our services and products were still there. Obviously, we were also helped by some compensation payments, be it for Fresenius Medical Care in the US or be it for our Helios business in Germany.

When I look at the downsides, then it is primarily the effect at our Spanish hospital business in the second quarter, where we had to keep beds free and the fixed-cost clock was still ticking without any government compensation, and also, in Q2 onwards, the lack of elective surgery for both our German and Spanish hospital business and a knock-on effect on our Kabi injectable generics business.

All in all, I'd say moving our earnings guidance down by five percentage points -- you may say it was hardly a move for us -- it was a difficult move to make. Again, I would have preferred strongly to show some earnings growth last year. That will be the task for 2021 now.

David: If we dive into some of the business message. I'm not going to touch on Fresenius medical representatives tomorrow. Just on Kabi, again, bigger pictured question, investors that we talked to starting to think about the generic cliff on the injectables side beginning to roll off over the next two to three years.

How do you think about that and the impact it has on the growth profile at Kabi? How much offset do you think biosimilars would bring to that?

Stephan: In general, I would agree that yes, there is going to be a slowdown of generic launches. I'm hesitating about the word cliff because, in my observation, this is going to be a more drawn-out process. As an insurance policy against such a generics cliff, we bought ourselves the biosimilars business in 2017.

That is actually meant to offset the growth potential that we may be missing going forward. When I look at our ANDA pipeline in the US, then that continues to be filled at a near-record level. Above 50 ANDAs that are waiting for approval. As you know, we have a pretty good track record in terms of turning applications and also into approvals and, subsequently, to launches.

With our typical run rate of, say, somewhere between 10 and 15 new launches per annum, that is going to carry as well for the next three to four years. In any case, it's going to carry us until we can launch IDACIO, our biosimilars version of Humira, then also into the US market.

David: Perfect. You touched on COVID-19 and the impact on Kabi. Elective surgeries got hit, but there were some tailwinds also as well with treating the COVID-19. How did that dynamic pan out, and how are you seeing those evolve with the recent spiking of cases in some markets?

Stephan: Early in 2020, when the treatment regimen was still under discussion and evolving, state-of-the-art was to mechanically ventilate patients right from the beginning. In order to do that, what you needed are sedatives, and our key anesthetic, Propofol, was the product of choice.

Therefore, as far as Propofol is concerned, also as far as infusion pumps were concerned, we saw a spike in demand late Q1, early Q2, then again, more towards late Q2, early Q3. Those spikes were actually spikes and, therefore, very short-lived, and couldn't compensate for the shortfall in elective surgery will knock-on effect on the volume demand in our key product categories.

Over the course of 2020, the treatment protocol has evolved. Mechanical ventilation is now not any longer state-of-the-art. It is being applied only later in the process. Therefore, also the volume demand for Propofol has more normalized over the course of the year. [inaudible] Kabi has suffered from a shortfall of elective surgery, and hence, we had to trim our original guidance.

David: In terms of the spike in recent cases, obviously, referring to now pretty much full lockdown in the UK, various stops on elective procedures in various countries across the world, how is that panning out versus what you saw back in Q2?

Stephan: It is less pronounced because what we were suffering from in Q2 was either a strict imposition of a prohibition of elective surgeries, or at least, a very strong advice only to go about cases that were absolutely necessary.

That meant that in very many hospitals across Europe, and we felt that particularly hard at our Spanish hospitals, we had neither COVID patients nor elective surgery patients. Therefore, over and above the direct impact on the profitability of our hospital's businesses, we had the indirect impact on the lack of volume demand for the largest part of our Kabi portfolio.

That strict prohibition of going after elective surgeries, that is also a trend that has evolved and is not imposed as strictly as it was. Therefore, the effects over the course of Q4 have been more benign than what we had seen in Q2.

David: Geographically, I think we're going to see some evolution through the fourth quarter and first quarter, which is going to be slightly different as well. We're getting the impression that China...We saw that in Q3, that China had rebounded pretty strongly and presumably stayed that way through the fourth quarter.

Is that the right way to be thinking about it? How are you thinking about Europe and the US through the end of the quarter and into the early part of 2021?

Stephan: You are right. At the end of Q2, I was somewhat disappointment with the pace of recovery in China, but over the course of Q3, we saw a recovery almost to pre-COVID levels. That, without going into too much detail, by and large has continued over the course of Q4. I do expect some growth over the course of 2021.

Therefore, China, and ideally also the rest of Asia, are going to outperform the rest of the world as far as Fresenius Kabi's top line is concerned. It remains to be seen what the impact of the lockdown across large parts of Europe does also mean for our Kabi revenues.

David: Moving on from revenues to margins, I mean in the first half they actually held up really well, particularly in the US, 39 percent in the first half. Maybe you just make some comments in terms of, given the competition coming back, the impact on pricing, how sustainable you think those margins are over the medium-term?

Stephan: The margin picture, in particular in the US, actually was a fairly stable one. That notwithstanding the fact that we committed ourselves to price stability against the backdrop of those spikes in demand, in particular for Propofol as I alluded to a bit earlier.

For our largest product, we have some extra demand and we can afford to keep prices stable. That bodes well for the rest of the portfolio and the margin picture that we're seeing there.

In general, what we do need is volume growth to offset the ongoing low single-digit price erosion that we would also expect for this year.

I believe that there is a good chance to see some volume growth, in particular, if the vaccinations that are ongoing lead to a higher degree of elective surgery in the latter parts of this year. Therefore, I believe that there is at least a good basis to expect margin stability going forward.

David: Then just whilst we're on this as well. It came up in the third quarter that you had a couple of quality issues in one of your plants in the US. Just wanted to get any updates around that.

Stephan: The issues actually occurred in the third quarter and we were reporting about them as part of our Q3 call. We detected some of our former employees not sticking to standard operating procedures that we had imposed on that plant. I'm consciously talking about former employees because we had no choice but to make them redundant instantaneously.

We have gone through an extra quality loop. Even though we had no reason to believe that any product was manipulated or that was out of specification, we still wanted to make absolutely sure that no patient could be harmed.

We have completed that quality extra loop without any findings, and therefore, we'll now be working at reducing the back orders that have built over the course of the third quarter and early Q4.

I believe when we were talking about these issues voluntarily and in a very transparent way, the Street reached the consensus conclusion that there was no alternative but for us to receive a warning letter.

I cannot rule out us receiving a warning letter. At the same time, I do not think that there is an automatism. We have not heard back from FDA, but feel good about the remediation action that we have taken.

David: Then maybe just to conclude on Kabi, on the biosimilar side, you mentioned IDACIO biosimilar Humira. I think you've now launched in nine European countries, but we haven't seen a great deal of impact so far and certainly in terms of the top line.

Maybe in terms of where you are versus your original expectations, probably not helped by COVID-19, is that fair to say? I'm just wondering, again, how you expect it to evolve from here?

Stephan: As I said earlier, I'm overall satisfied, but you are also right, David, COVID-19 clearly has not helped. I believe that we have made good progress in the tender markets across Europe, but at the same time, I think I said it already on a previous occasion, just because Fresenius Kabi launches IDACIO, no country government will immediately launch a new tender.

We, in quite a few instances, have to wait for the current tender to expire for a chance for us to compete in a new tender. Those tenders that we have competed in over the second half of 2020 we have been fairly successful. I believe that we have demonstrated our competitiveness. We have won quite a few regions within Italy. We have won certain provinces in the UK.

Yes, we have lost the Hungarian tender, but I would have been surprised if we won everything. Then I would have had to take another close look at our pricing. That actually bodes well.

Why you're not seeing a larger effect on our top line is that, unfortunately, on quite a few occasions, COVID also held back the implementation of those tender results. Therefore, not everywhere where we have won we can now also start to sell.

In the other markets, the prescriber market where we really got to walk from door-to-door and make a case for our IDACIO at individual prescribing doctors, obviously, the lockdowns across Europe have hindered our ability to see doctors and to establish our presence there.

Again, we have a high-quality product. Pricing-wise we can be competitive and are prepared to be competitive. I am working on the assumption that we will be able to demonstrate that once COVID is behind us.

David: Let's just quickly move onto the hospitals business, slightly tailored to cities between Germany and Spain, which you mentioned earlier. Maybe you could just give an update in terms of the...

I suppose particularly for Spain which I think most of the investor focus is in terms of reimbursement for those postponed elective procedures and how you're feeling about that. Obviously, the back-end of last year, but again as we go through the first quarter if those cases start to spike.

Stephan: I want to remind everyone when I'm talking about compensation, then what I mean is money received for reserving capacities, whereas reimbursement is receiving monies for actually treating patients.

We've seen a recovery in Q3 of those elective surgeries, more towards the end of Q3. I was talking about that in our Q3 call. Following some catch-up, we were seeing more of a normalization. That was ahead of the second COVID wave really hitting also Spain.

All in all, again, without going into too much detail, I stick by the guidance that we had given for Helios as a whole, but also more specifically for Helios Spain and for Helios Germany.

We still have not received any compensation monies for unutilized beds. I also do not expect that to happen retrospectively for 2020, but also not for 2021.

As far as Germany is concerned, we are still tracking, as far as case number are concerned, below of where we thought we would be pre-COVID, also below the 2019 level.

That was part of our model and part of the guidance. As you know, as we talked about, there is a safety floor that has been installed and that is also giving me some comfort over the course of 2021.

David: Great. Then maybe just finally on Vamed. I've got a couple of questions coming online, so just finally on Vamed. Obviously, that's a business we don't spend a lot of time talking about, but this year the business has been impacted the most, both in terms of percentage but also absolute quantity as well.

Is that business that's lost, is that all just deferred, or is there some of that that's permanently [inaudible] ?

Stephan: I would say both. I would like to believe that most of the delayed orders in our project business are still generally alive. Obviously, those that we have started already are alive and wait for a continuation once the pandemic permits it.

Those project orders that we had been working on and that we were waiting for definitive signatures, some of them will be lost because when it comes to the financial spend in quite a few of the emerging markets, there is going to be a reprioritization. Therefore, I am working on the assumption that some of the projects that we were hopeful for are not going to materialize.

Many others though will. There I believe we continue to be in a very good position to capture them. As far as Vamed's service business is concerned, that also has seen a knock-on effect from the lack of elective surgery, and that's my expectation right now should normalize also over the course of 2021.

As far as the post-acute business is concerned, the very same applies. If you have no elective surgery patients, then you [inaudible] by definition have no post-acute patients. With a bit of time lag, that should also return to some normality over the course, say, of Q3-Q4 of this year.

David: Perfect. I'm just weary of the time, so a couple of minutes left here. This is just in the lines. First question is, "Do you believe that a diversified healthcare company can become a winning model again, or are there some structural issues with the business?"

Stephan: I believe the diversification has served us well over the decades. It is a particularly attractive feature for our lenders. Don't forget, we consciously use leverage to finance our growth. I believe nobody took issue with our diversification, as long as we were able to demonstrate earnings growth. The key task is to demonstrate a return to earnings growth.

If, however, that should not materialize, I don't foresee that, but if that should not materialize, then we also need to be open to look at structural issues.

David: Interesting. Second question. "Are you able to quantify the shortfall in the Spanish compensation not coming through?"

Stephan: I believe that we can quantify that once we have our definitive Q4 results and full-year results. The shortfall relative to the original guidance, that is to the most degree the lack of compensation payments.

David: Final question. "Your ROIC has come down slowly over the past few years. Is that down to M&A? If so, why is more M&A the right path here?"

Stephan: We have seen some outperformance given by mishaps by competitors that were driving our ROIC up. Part of that erosion is also, I would say, a normalization. The caller or the person asking the question is correct.

Large M&A also typically plays a role. In my experience, it always takes three, four, five years before a large strategic acquisition, like for instance, Quironsalud, meets the blended ROIC of the preexisting group. I would still very much say that Quironsalud has been a successful transaction that we're going to reap the benefits from in the short, medium, and long-term.

As I said at the outset, I would be hesitant for various reasons to go after large strategic M&A for the time being, but [inaudible] where we have a near-term synergy potential and that, therefore, are much less, if at all, ROIC dilutive, that should remain on the agenda also in the near-term.

David: Brilliant. Stephan, I'm afraid we're out of time. Thanks very much for joining us again today. I appreciate you taking the time. We'll speak soon. Thanks, Stephan.

Stephan: Thank you, David. Thank you, all. Look forward to speaking...

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