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Fresenius Ownership Structure Could Pose Obstacle to Value Creation by Elliott

By: Deane McRobie

While Elliott looms large on Fresenius SE's shareholder register, the company's shareholding structure is an obstacle to immediate value creation, a source familiar with the situation told *CTFN*.

Fresenius, which comprises a 30.8% stake in kidney-treatment provider Fresenius Medical, hospital operator Helios, hospital developer Vamed and pharma unit Kabi, delivered lackluster quarterly results on October 31, reporting growing sales but a 19% year-on-year decline in net income, forecasting that net income will decline this year by about 10%.

Elliott was reported last month to have bought shares in the company, and its stake was reported on October 31 to have grown to over 3% of the company. Fresenius CEO Michael Sen was reported on October 25 to have had a phone call with Elliott.

As part of a "reset" to realize a "new Fresenius", Sen, who has been on the job for just a month, pledged on this week's results call to "look at [our] portfolios at the segment level" and hinted that the company may dispose of certain units. He also said, as reported, the company must rely less on debt-fueled expansion as it returns to its targeted leverage of 3.5x net debt/EBITDA.

Else Kroner Foundation, a non-profit which controls just over 26% of Fresenius, has been a reason for the company's difficulty in getting leverage down, the source said. It has been averse to equity-dilutive expansion, preferring that M&A be paid for by debt, he said.

The company has typically made acquisitions at up to 4x net debt/EBITDA, the source said, but this cannot persist in the current bond market. On this week's earnings call, management noted both the importance of remaining investment-grade and the unsustainability of its debt burden amid higher interest rates, although it has tended to issue fixed-rate notes.

The foundation has also given management a "big cushion" while proving unconcerned with short-term value creation, although Sen appears to be more aggressive than his predecessor, the source said.

Although Fresenius was once a "real innovator in the integrated proposition of everything from consumables to device manufacture to services", with the conglomerate using one segment's cash flow to balance out that of another, now "the foundation is the only thing keeping it together", the source said.

No "silver bullet" exists to reduce the foundation's influence, but Elliott would do well to pursue its agenda regardless and hope that other minority shareholders add to the pressure it applies, he said. Shareholders' views on Fresenius's potential will be taken into account in our ongoing review and analysis, a company spokesperson told *CTFN*.

A playbook for the activist could include pressing the company to dispose of assets more aggressively, the source said, as just about every bit would be worth more to the company in a sale than continuing to operate within it. Fresenius is trading at an EV/EBITDA multiple near 7x, he said, but infrastructure funds tend to pay as much as 12x for hospital assets.

Some pieces are already coming loose. KKR and CVC were reported on October 3 to be interested in Helios subsidiary Quironsalud; the source said other private-equity firms are also interested in that asset. Helios could also make acquisitions as recessions crimp hospital valuations, the source said.

Under pressure from Elliott, Fresenius could force a breakup of Fresenius Medical, he said. Fresenius Medical could easily be segmented, with its European or Asian dialysis businesses each finding their own interested buyers, he said.

As of November 2, Fresenius Medical has a TTM EV/EBITDA of 6x, according to *CTFN* analysis. Bridgepoint is likely to realize 8x EV/EBITDA from its ongoing sale of Diaverum, a similar provider of kidney treatments, for 8x EV/EBITDA, the source said. According to the latest third-party reports, Bridgepoint hired Citi in September to sell the asset. Bridgepoint did not respond to a request for comment.

As for other Fresenius units, "everything is being pitched" by healthcare bankers to potentially interested parties, he said. Interest is most likely to be from financial parties, he said, both because competition issues prohibit most big strategics from taking on the assets and because most other strategics are suffering through share-price slumps of their own.

Kabi is a "premium" asset and the most attractive part of Fresenius, the source said, adding that it, too, comprises many disposable parts. Its subsidiaries include Labesfal, Fresenius Kabi Oncology, Dabur Pharma, APP Pharmaceuticals and Fenwal Holdings. Its closest comparable is Baxter International, and in competition with Baxter it could — instead of shedding components — use M&A to build scale in the US, where the bundling of products like IV and nutrition are key to winning hospital-supply contracts, the source said.

Some parts of Fresenius could prove a tough sell. The company was reported last February to be considering a flotation of Vamed; the source said this is unlikely to be sold, as it is "a basketcase that nobody wants to buy". On the earnings call, the company noted strong headwinds facing the unit.

Another way to create value at the "bloated" Fresenius is to cut operational costs, the source said. The company spends more on R&D than it has to, has avoided layoffs for too long, and could find savings by reducing administrative overhead, he said.

Elliott declined to comment.

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