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Research Update:

Fresenius Medical Care AG Outlook To Stable From Negative On Solid Deleveraging Prospects; 'BBB-/A-3' Ratings Affirmed

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Rating Action Overview

- Fresenius Medical Care AG (FME) exceeded our expectations at the end of 2023, reducing adjusted debt to EBITDA to 3.7x and being on track to reduce leverage further during 2024. Despite ongoing macroeconomic challenges, we anticipate that FME will sustainably improve its credit metrics to comfortably below 4x this year.
- Dialysis patient volumes are predicted to gradually increase in the U.S. market, which we see as key to profitability and cash flow. Combined with FME's cost-cutting strategy (FME25) and a prudent financial policy, this should support stronger credit metrics over the next two years.
- We therefore affirmed our 'BBB-/A-3' long-and short-term ratings on the company and revised the outlook to stable.
- The stable outlook is based on FME's ability to sustain stronger EBITDA margins and maintain debt leverage of 3x-4x in the next 12-24 months. We expect FME's EBITDA margins to improve toward 17%-18% during 2024, from 16.7% in 2023, mainly because of better volume dynamics in both the U.S. and international markets. The company has also been able to offset inflationary pressures through its cost-efficiency program and has stuck to its publicly stated financial policy.

Rating Action Rationale

S&P Global Ratings considers 2023 to have been a transitional and transformative year for FME. After changing its legal form, the company was deconsolidated by Fresenius SE and effectively separated. We believe it will now be able to deliver on its plans for profitable growth while maintaining leverage at 3x-4x. S&P Global Ratings-adjusted leverage for FME stood at 3.7x in 2023, while free operating cash flow (FOCF) to debt was 16.7%. The company has therefore outperformed our forecast (leverage of 4.2x-4.3x and FOCF to debt of 8.8%). FME's improved results demonstrated its commitment to operational efficiency. It executed its FME25 cost-cutting strategy and was able to deliver cost optimization and savings ahead of plan. Although 2023's top-line results were lower than expected, this was mainly because of foreign exchange translation effects. Our adjusted measure of EBITDA was €3,256 million, well above the €2,985 million we had forecast, signifying that FME achieved higher cost savings and lower administrative expenses than we anticipated.

FME is now expected to maintain its good growth momentum, with organic revenue growth in 2024 of about 0.5%-1.0%, accelerating to 2%-3% in 2025. We anticipate that EBITDA margins (after special items) will remain about 16%-17% in 2024 and grow to 18%-19% in 2025. Combined with FOCF of €1.8 billion-€2.0 billion per year, this should enable the company to sustainably decrease adjusted debt to EBITDA to 3x-4x over the next two years. Over the same period, we expect FOCF to debt to average 16%-18%. FME's forecast metrics for 2024 and 2025 are based on an overall improvement in volumes. As excess mortality linked to COVID-19 annualizes out, especially in the U.S., the size of the patient pool and thus the size of the treatment market for chronic kidney disease (CKD) and end-stage renal disease (ESRD) will recover. The industry has experienced difficulties in sourcing sufficient qualified care staff in recent years, but FME has reduced the shortfall and continues to seek cost efficiencies to offset the increase in wages.

We expect FME to maintain its focus on organic revenue growth, cost savings, and portfolio optimization, despite the tough economy. Its business fundamentals are strong enough that it can deliver on its operating strategy while maintaining its leadership position in the highly profitable U.S. market. FME currently has a market share of about 37% in the U.S. The company is well-prepared to adapt to longer-term trends in the market, such as an expansion in home dialysis and the shift toward a more value-based health care model. As we move further into the year, we expect treatment volumes to gradually grow as the dialysis patient pool expands. In part, this reflects the easing of the effect of COVID-19 on excess mortality. However, we remain conservative about market treatment growth trends in 2024; we expect to see volume growth of about 0.5%-1.0% in 2024 so that treatment volumes reach pre-pandemic levels only in 2025.

The company's growth strategy incorporates the potential future contribution of high-volume hemodiafiltration (HVHDF) treatments, which have recently been approved in the U.S. This technology offers a more-efficient way of treating dialysis patients and is already transforming dialysis in many markets globally. It reduces the mortality rate by 23% compared with traditional high-flux hemodialysis. FME expects to launch HVHDF commercially in the U.S. during 2025. It is likely to contribute to the organic growth and profitability of the company's care enablement business line.

That said, FME will still rely on its FME25 plan to support EBITDA growth in 2024 and 2025. We still see considerable scope for optimization in the company's business, especially in the care enablement segment. FME has invested heavily in FME25 since 2021 and we estimate that the cumulative annual savings by the end of 2024 will reach about €450 million-€550 million, and could rise toward €650 million by the end of 2025. Most of the savings will be concentrated in general and administrative expenses--these are expected to contribute about 50% of the savings by 2025. Optimization of the manufacturing footprint and improvements to labor efficiency could comprise 40% of the savings, with the remainder coming from efficiencies in the clinic business.

Over the next 12 months, we expect uncertainty regarding labor and macroeconomic changes to present challenges. The health care services industry, including the dialysis market, has faced significant staffing shortages in the aftermath of the pandemic and wage pressures are still a concern. There have been significant improvements, in particular the return of nurses to FME and better retention of qualified staff, but staffing is still difficult to maintain. The company had more than 5,000 net open positions in September 2022; by the first quarter of 2024, it had reduced this to about 3,500. Although FME's open positions have yet to reach a normalized level (about 2,500-3,000 open positions), we expect a gradual improvement over 2024 and 2025.

The company has limited scope to pass through inflation-related increases in costs. In particular, the services side of the company is partially reliant on public reimbursement. The increase in Medicare payment rates is still well below the inflation rate; for example, the ESRD reimbursement rate for 2024 was up just 2% on last year.

Our 'BBB-' ratings on FME reflect the company's prudent discretionary spending and adherence to a self-imposed net financial leverage corridor of 3.0x-3.5x (after leases). During 2023, FME cut its discretionary spending, so that gross capital expenditure (capex) dropped to about €685 million, well below the €828 million assumed in our base case. It also reported another year of minimal outflows linked to acquisitions. Acquisition outflows were about €35 million in 2023 and about €59 million in 2022, which is substantially lower than the €250 million-€430 million over 2020-2021. In our view, the company has thus demonstrated its commitment to preserving cash flow, in light of difficult operating conditions. Although we believe the company will resume capital spending and M&A activity in 2024 and 2025, we remain convinced that the company will prioritize maintaining leverage around 3.0x-3.5x despite its higher discretionary spending.

We also view as positive the company's efforts to close divestments of margin-dilutive and noncore assets. Notably, FME closed about 72 clinics in the U.S. (net) and exited operations in Argentina, Chile, Hungary, Sub-Saharan Africa, Turkiye. It also divested Cura Day Hospitals Group in Australia (Cura Day Hospitals Group) and National Cardiovascular Group (NCG) in the U.S. over the course of 2023 and the first quarter of 2024. This is part of its strategy of exiting challenging and unattractive international markets, especially in Latin America. Other announced divestments are planned to take place in Brazil, Colombia, Curacao, Ecuador, Guatemala, and Peru. We understand the proceeds from these divestments are being used to pay down debt.

In our base case, we assume overall group dividend distributions (including minority shareholders) of about €600 million per year in 2024 and close to €700 million in 2025. This translates to discretionary cash flow (after lease payments) of €1,200 million-€1,400 million, on average. Again, this supports adjusted leverage of 3.0x-3.5x for FME, and is commensurate with our 'BBB-' rating.

Outlook

The stable outlook indicates that we expect a gradual recovery in treatment volumes as the impact of the pandemic on the dialysis population dissipates, together with a solid operating performance despite ongoing inflationary pressures. Adjusted debt to EBITDA is predicted to remain comfortably within 3x-4x in 2024 and 2025 and FOCF to debt is likely to average a healthy 16%-18% in this period. FME has achieved its position through solid cost savings and a portfolio optimization program that will continue to contribute to profitability, as well as by being prudent with regard to discretionary spending.

Downside scenario

We could consider lowering the rating on FME if we saw leverage as likely to rise above 4.0x for a prolonged period. This could occur if:

- Lower-than-expected volume recovery, particularly in the U.S., and depressed reimbursement rates that weigh on revenue and EBITDA generation expectations.
- Persistent inflationary costs and a difficult labor market, such that the company remains reliant on costlier temporary staff and is unable to offset the hit through its cost-saving initiatives.
- Failure to maintain prudent discretionary spending, and continue to pursue a reduction in leverage.

Upside scenario

We would consider raising the rating if the company significantly outperformed our base case, such that adjusted debt to EBITDA was comfortably below 3.0x on a sustained basis and FOCF to debt was comfortably maintained at about 15%-25%. This would likely occur if treatment volume recovery in the U.S. was faster than expected and EBITDA margins saw further improvements from the ongoing implementation of the FME25 strategy. An upgrade would also be contingent on the company adopting a more-conservative financial policy to maintain these credit metrics.

Company Description

Fresenius Medical Care AG (FME) had a global network of close to 4,000 clinics on Dec. 31, 2023, and is the world's leading provider of dialysis services. It serves approximately 330,000 patients (an estimated 8% of the global patient population pool) around the globe who are suffering from end-stage renal disease (ESRD), an irreversible and advanced state of kidney impairment that requires a kidney replacement therapy; that is, either a kidney transplant or dialysis. In-center and home dialysis patients must receive their life-saving dialysis treatment several days a week for three to four hours at a time. This division is called Care Delivery and represents 80% of the group's revenue.

FME is also the world's leading provider of dialysis products, such as hemodialysis machines, dialyzers, and related disposable products--the products business (Care Enablement) represents about 20% of total revenue.

In 2023, FME reported total revenue of €19.5 billion (about €19.4 billion in 2022) and S&P Global Ratings-adjusted EBITDA of about €3.3 billion (€3.4 billion in 2022). In geographical terms, the U.S. accounted for about 81% of the Care Delivery segment's revenue (close to 65% of total revenue) and the rest of the world (international) accounted for the remaining 19% in the Care Delivery segment, and approximately 15% of total revenue.

Our Base-Case Scenario

Assumptions

- The global macroeconomic cycle will have little effect on overall sales growth, given the protected nature of dialysis services, which are lifesaving.
- Revenue growth of up to 0.5%-1.5% in 2024 and up to 2%-3% in 2025, reflecting a gradual recovery in the patient population and treatment volumes in the U.S.; international divestments; and overall reimbursement pressures, particularly on the public payor side.
- Stable adjusted EBITDA margins of around 17% in 2024 (estimated at 16.7% in 2023), reflecting elevated labor costs and a gradual pickup in treatment volumes in the U.S., as well as the continuing contribution from the FME25 cost-savings program (especially on procurement costs). We expect margins to expand to about 17.5%-18.5% in 2025 on the back of further FME25 efficiencies; normalization of volume trends; and an improved labor market, with lower cost pressures.
- Annual net working capital outflows of up to €100 million in 2024 and €200 million in 2025.
- Capex of about €800 million-€900 million per year, slightly above 2023 levels.
- Lease principal payments of about €500 million-€600 million per year.
- Total dividend distributions (including minority shareholders) of about €500 million-€600 million in 2024, increasing to €600 million-€700 million in 2025, in line with net income trajectory.
- No share buybacks.
- Acquisitions of €300 million per year, in line with pre-pandemic figures.
- Adjusted net debt of about €10.9 billion in 2024 and €10.3 billion in 2025. This includes commercial paper, bonds, bilateral credit lines, accounts receivable facilities, leases, net pension liability, and self-insurance. We net accessible, nonrestricted cash against debt.

Key metrics

Fresenius Medical Care--Key Metrics*

	--Fiscal year ended Dec. 31--				
Bil. €	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**
Revenue	19.4	19.5	19.5-20.0	20.0-20.5	20.5-21.0
Revenue growth (%)	10.1	0.3	0.5-1.0	2.0-3.0	3.0-4.0
EBITDA margin (%)	17.4	16.7	16.5-17.0	18.0-18.5	18.5-19.0
Funds from operations (FFO)	2.7	2.4	2.6-2.8	2.8-3.0	2.9-3.1
Capital expenditure	0.72	0.68	0.85-0.90	0.80-0.85	0.85-0.90
Free operating cash flow (FOCF)	1.4	1.9	1.8-2.0	1.9-2.1	1.9-2.1
Dividends	0.7	0.64	0.6	0.7	0.8
Debt to EBITDA (x)	3.9	3.7	3.0-3.5	close to 3.0	2.2-2.7
FFO to debt (%)	20.5	20.6	24-25	28-29	29.5-30.5

Fresenius Medical Care--Key Metrics* (cont.)

	--Fiscal year ended Dec. 31--				
Bil. €	2022a	2023a	2024e	2025f	2026f
FOCF to debt (%)	11	16.4	16-17	19-20	20-21

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess FME's liquidity profile as adequate, reflecting our view that sources of cash will cover uses by more than 1.2x over the next 12 months, supported by lack of meaningful refinancing needs until 2026. Even if EBITDA were to decline by 15%-20%, we believe that net sources would remain positive. Our assessment is further supported by the group's diverse capital structure; FME is a frequent debt issuer. During 2021, FME refinanced its term loan credit facilities and is no longer subject to any financial maintenance covenants.

Principal liquidity sources over the 12 months from Dec. 31, 2023, include:

- Unrestricted available cash balances of about €1.4 billion as of Dec. 31, 2023;
- Undrawn and committed bank lines of about €3.2 billion equivalent (comprising syndicated bank facility of €2 billion and $531 million U.S. dollar-denominated amounts available under the $900 million accounts receivable program in the U.S.) maturing in August 2024; and
- Our forecast cash funds from operations (after lease payments) of about €2.5 billion-€2.7 billion.

Principal liquidity uses over the same period include:

- About €1.5 billion of short-term debt as of Dec. 31, 2023;
- S&P Global Ratings-forecast annual net working capital outflows of about €200 million-€250 million;
- Total capex of about €840 million-€870 million;
- Overall dividend distributions (including minority shareholders) of about €587 million; and
- No share buybacks and contracted acquisitions.

Issue Ratings - Subordination Risk Analysis

Capital structure

FME's capital structure primarily comprises a mix of commercial paper and accounts receivable facilities, bonds, loans, and revolving credit facilities.

Analytical conclusions

We rate FME's bonds at 'BBB-', in line with the issuer credit rating, supported by the lack of meaningful prior-ranking debt in the capital structure.

Ratings Score Snapshot

Issuer credit rating	BBB-/Stable/A-3
Business risk:	Satisfactory
Country risk	Very low
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb-

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Medical Device Demand To Remain Steady In The Era Of GLP-1s, March 28, 2024

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Fresenius Medical Care AG		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3
Ratings Affirmed		
Fresenius Medical Care AG		
Fresenius Medical Care US Finance II Inc.		
Fresenius Medical Care US Finance III, Inc.		
Senior Unsecured	BBB-	