FitchRatings

Corporates
Pharmaceuticals
Germany

# CHEPLAPHARM Arzneimittel GmbH

CHEPLAPHARM Arzneimittel GmbH's Issuer Default Rating (IDR) balances Cheplapharm's strong operating and cash flow margins with its modest size, moderate leverage and a scalable asset-light business model that relies on acquisitions to offset the modest yet structural decline of its portfolio of branded off-patent legacy and niche drugs.

The Stable Outlook reflects Fitch Ratings' expectation that the group will continue pursuing its 'buy and build' strategy in a disciplined manner. We expect Cheplapharm to finance acquisitions with internally generated cash flows and additional debt, while maintaining EBITDA leverage of 4.0x-5.0x through to 2026.

## Key Rating Drivers

**Defensive Operations:** The rating is underpinned by Cheplapharm's defensive business profile, characterised by predictable revenue and high margins from a diversified portfolio of branded off-patent drugs, including niche and legacy drugs. The group has a solid record of strong performance, supported by a well-managed intellectual property (IP) portfolio, active product life-cycle management and well-executed acquisitions of drug IP rights.

**Mild Organic Decline:** Cheplapharm relies on constant acquisitions to grow given the structural low single-digit organic decline in sales of its portfolio of off-patent drugs. These acquisitions can be funded internally with the group's strong cash generation. Making acquisitions at disciplined valuation multiples is key and higher interest rates would make debt-financed M&A less attractive.

**Highly Acquisitive in 2023:** Cheplapharm has announced large acquisitions of around EUR2 billion (Fitch estimates) in 2023. These acquisitions include the commercial rights of Xeloda in China and of Pulmicort Flexhaler in the US, combined with the large acquisition of the global commercial rights of the Zyprexa portfolio of Eli Lilly.

Together, these acquisitions will benefit Cheplapharm's business risk profile, broadening its product portfolio and increasing its scale. We see moderate execution risks in the integration of newly acquired targets given Cheplapharm's asset-light business model with fully outsourced manufacturing and distribution.

**Convertible Shareholder Loan Limits Leverage Increase:** Fitch expects recent acquisitions to increase Cheplapharm's EBITDA gross leverage towards 5x in 2023. The increase in leverage was mitigated by the EUR500 million shareholder loan provided to the restricted group by its parent Cheplapharm AG. Fitch treats the shareholder loan as equity but includes the related interest payments in its projections.

This shareholder loan consists of funds raised by Cheplapharm AG from a EUR550 million mandatorily convertible instrument (MCI) maturing in 2029 or when a potential IPO takes place. The MCL was provided by Atlantic Park and GIC, who are expected to own less than 20% of the company after conversion.

## Ratings

**Foreign Currency**

| | |
|---|---|
| Long-Term IDR | B+ |

**Outlook**

| | |
|---|---|
| Long-Term Foreign-Currency IDR | Stable |

**Debt Rating**

| | |
|---|---|
| Senior Secured Debt - Long-Term Rating | BB- |

2035 Climate Vulnerability Signal: 20

Click here for the full list of ratings

## Applicable Criteria

Corporate Rating Criteria (October 2022)

Sector Navigators: Addendum to the Corporate Rating Criteria (May 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (April 2021)

Exposure Draft: Climate Vulnerability in Corporate Ratings Criteria (June 2023) (including rating assumption sensitivity)

## Related Research

Global Corporates Macro and Sector Forecasts (March 2023)

## Analysts


Xavier Taule Flores
+34 93 492 9513
xavier.tauleflores@fitchratings.com

Bekhzod Kayumov
+49 69 768076 173
bekhzod.kayumov@fitchratings.com

**Appropriate Leverage, No Deleveraging:** Cheplapharm's leverage has been moderate compared with private-equity (PE)-owned peers', at around 4x-6x gross debt/EBITDA. We expect the group to continue to favour M&A over deleveraging, resulting in stable gross debt/EBITDA over the next four years at 4.0x-5.0x. We assume that the group will not deviate from its disciplined approach to acquisitions, with established acquisition and investment criteria. Acceptance of higher asset valuations, higher-risk product profiles or weaker integration would be negative for the rating.

**More Debt-Funded M&A Likely:** We expect Cheplapharm to use internally-generated cash, combined with the flexibility under its revolving credit facility (RCF), to prioritise inorganic growth over deleveraging. We estimate that the group would need to invest around 8% of its revenue each year in acquisitions (which we treat as development capex) to offset its organic portfolio decline. This amount can be comfortably funded with internal cash flow generation. Our rating case factors in acquisitions above EUR500 million per year. Larger acquisitions, which would require more funds than committed debt capital, are possible but we treat them as event risk.

**Financial Policy Key to Rating:** Cheplapharm has the ability to deleverage given its strong cash generation, but its strategy has been to prioritise inorganic growth. The decision in 2022 to postpone the planned IPO due to unfavourable market conditions and to instead issue debt to fund inorganic growth was aggressive but fully consistent with its financial policy prior to the IPO announcement. We believe that the recent issuance of a EUR550 million MCI instead of debt demonstrates the willingness of the founding family to continue growing the business while maintaining manageable leverage until a potential IPO takes place.

**Supportive Market Fundamentals:** Cheplapharm benefits from a strong supply of acquisition targets in the market, as innovative pharma companies look to streamline their product portfolios by divesting off-patent drugs to concentrate on their core therapies and implement their capital-allocation strategies. We regard niche specialist pharmaceutical companies, such as Cheplapharm, as firmly positioned to continue capitalising on this sector trend.

## Financial Summary

| (EURm) | 2020 | 2021 | 2022 | 2023F | 2024F | 2025F |
|---|---|---|---|---|---|---|
| Net revenue | 680 | 1,151 | 1,280 | 1,508 | 1,831 | 1,930 |
| EBITDA margin (%) | 51.6 | 54.2 | 53.6 | 52.4 | 51.4 | 50.4 |
| FCF margin (%) | 25.4 | 20.4 | 26.6 | 16.2 | 28.7 | 23.0 |
| EBITDA leverage (x) | 7.0 | 4.4 | 4.4 | 5.0 | 4.4 | 4.3 |
| EBITDA interest coverage (x) | 7.5 | 7.8 | 5.0 | 4.2 | 3.2 | 3.3 |

F = Forecast
Source: Fitch Ratings, Fitch Solutions

## Rating Derivation Relative to Peers

We rate Cheplapharm using our Ratings Navigator Framework for Pharmaceutical Companies.

The IDR reflects Cheplapharm's defensive asset-light business profile with resilient and predictable earnings, as well as high operating margins and strong cash flow generation.

We rate Cheplapharm at the same level as Pharmanovia Bidco Limited (B+/Stable), given that the latter's smaller scale is balanced by but a comparable asset-light scalable business model with strong operating and cash flow margins, in combination with moderate debt/EBITDA of 4.0x-5.0x.

We rate Cheplapharm below Grunenthal Pharma GmbH & Co. Kommanditgesellschaft (BB/Stable). Grunenthal's credit profile reflects its more conservative financial policy with leverage of below 3.0x and strong free cash flow (FCF) margins derived from a portfolio of off-patent and innovative drugs and own manufacturing and distribution capabilities, albeit with lower EBITDA margins of around 20%.

We view Cheplapharm's credit profile as stronger than that of the pharmaceutical company ADVANZ PHARMA HoldCo Limited (B/Stable). Although the latter is involved in bringing new niche, specialist and value-added generics to market through co-development, in-licencing, and distribution agreements, it has smaller business scale and lower operating and cash flow margins, warranting a one-notch difference.

We also regard Cheplapharm as stronger than generics producer Nidda BondCo GmbH (B/Negative), despite its much smaller scale and more concentrated portfolio, which is mitigated by wide geographic diversification within each brand. Nidda BondCo's rating is limited by high EBITDA leverage above 7.0x in 2023, and high refinancing risk, with large maturities due in 2024-2025.

## Rating Sensitivities

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- An upgrade to the ‘BB’ rating category would require a maturing business risk profile, characterised by sustainable revenue, a more diversified product portfolio, as well as resilient operating and strong FCF margins that allow the group to finance development M&A and reduce execution risks
- Conservative leverage policy leading to EBITDA leverage at or below 4.0x on a sustained basis

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Unsuccessful management of individual pharmaceutical IP rights leading to material permanent loss of income and EBITDA margins declining towards 40%
- Positive but continuously declining FCF
- More aggressive financial policy leading to EBITDA leverage sustainably above 5.5x
- EBITDA interest coverage below 3x on a sustained basis

## Liquidity and Debt Structure

**Comfortable Liquidity:** We view liquidity as comfortable based on Cheplapharm’s strong FCF before acquisitions, which we estimate at around EUR400 million a year until 2025. As of end-FY22 the group had EUR150 million in readily available cash in addition to its EUR545 million undrawn RCF. The group benefits from a long-dated debt structure with its term loan B (TLB) and senior secured notes maturing from 2027 to 2030.

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of ‘3’. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch’s ESG Relevance Scores, visit www.fitchratings.com/esg.

## Climate Vulnerability Considerations

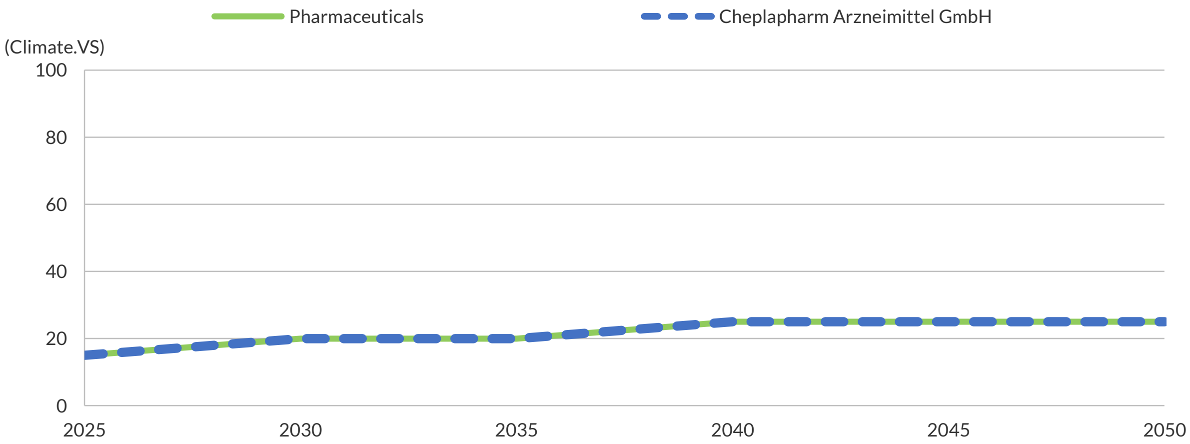
Fitch Ratings has published a Criteria Exposure Draft describing its approach to assessing Climate Vulnerability for Corporates. In this report, we describe our proposal to use Climate Vulnerability Signals (Climate.VS) as a screening tool to identify sectors and Fitch-rated issuers that are potentially most exposed to credit-relevant climate transition risks and, therefore, require additional consideration of these risks in rating reviews. Click here for the Criteria Exposure Draft.

Fitch invites feedback to criteria.feedback@fitchratings.com by 10 July 2023. Fitch will publish on its website any written responses it receives in full, including the name of the respondent, unless the response is clearly marked as confidential.

The FY22 revenue-weighted Climate Vulnerability Signal (Climate.VS) for Cheplapharm for 2035 is 20 out of 100, suggesting low exposure to climate-related risks in that year. For further information on how Fitch perceives climate related risks in the healthcare sector, see Healthcare – Long-Term Climate Vulnerability Scores (February 2023).

### Climate.VS Evolution

As of Dec. 31, 2022




Source: Fitch Ratings

## Liquidity and Debt Maturities

### Cheplapharm Arzneimittel GmbH - Liquidity Analysis

| (EURm) | 2023F | 2024F | 2025F |
|---|---|---|---|
| **Available liquidity** | | | |
| Beginning cash balance | 150 | 1,315 | 1,035 |
| Rating case FCF after acquisitions and divestitures | 292 | 357 | 395 |
| Acquisitions | -1,900 | 54 | -1,100 |
| Rating case FCF after acquisitions and divestitures | -265 | -280 | -38 |
| **Total available liquidity (A)** | **-115** | **1,035** | **997** |
| | | | |
| **Liquidity uses** | | | |
| Shareholder Loan issuance | 500 | 0 | |
| Debt Issuances | 930 | 0 | 0 |
| Debt Maturities | 0 | 0 | 0 |
| **Total liquidity uses (B)** | **1,430** | **0** | **0** |
| | | | |
| **Liquidity calculation** | | | |
| Ending cash balance (A+B) | 1,315 | 1,035 | 997 |
| Revolver availability | 545 | 545 | 545 |
| **Ending liquidity** | **1,860** | **1,580** | **1,542** |
| Liquidity score (x) | Not meaningful | Not meaningful | Not meaningful |

F – Forecast.
Source: Fitch Ratings, Fitch Solutions

| **Scheduled debt maturities** | **Original** |
|---|---|
| **(EURm)** | **31 December 2022** |
| 2022 | 0 |
| 2023 | 0 |
| 2024 | 0 |
| 2025 | 0 |
| 2026 | 0 |
| Thereafter | 3,048 |
| **Total** | **3,048** |

Source: Fitch Ratings, Fitch Solutions

## Key Assumptions

### Fitch's Key Assumptions within our Rating Case for the Issuer

- Sales growth at high single digits in 2023, around 15% in 2024 and high single digits in 2025, with acquisitions offsetting a low-single-digit organic decline
- EBITDA margin to moderate to 50% by 2025 from 54% in 2022
- Capex at around 1% of sales. Moreover, Fitch treats acquisitions equivalent to 8% of sales as capex, as it views them as necessary to offset the organic portfolio decline
- Acquisitions of EUR1,900 million in 2023, EUR600 million in 2024 and EUR600 million in 2025. Fitch treats a portion of these acquisitions as capex, equivalent to the amount required to offset its organic sales decline
- Issuance of EUR500 million shareholder loan in early 2023, treated as equity and resulting in EUR30 million in additional interest paid
- Change in trade working-capital leading to annual outflows of EUR50 million-100 million
- No dividend payments through to 2025

# Financial Data

## CHEPLAPHARM Arzneimittel GmbH

| | Historical | | | Forecast | | |
|---|---|---|---|---|---|---|
| **(EURm)** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** |
| **Summary income statement** | | | | | | |
| Net revenue | 679.8 | 1,150.9 | 1,279.5 | 1,507.9 | 1,831.3 | 1,929.9 |
| Revenue growth (%) | 34.0 | 69.3 | 11.2 | 17.9 | 21.4 | 5.4 |
| EBITDA before income from associates | 350.7 | 623.5 | 685.7 | 790.6 | 941.3 | 972.0 |
| EBITDA margin (%) | 51.6 | 54.2 | 53.6 | 52.4 | 51.4 | 50.4 |
| EBITDAR | 351.1 | 624.0 | 685.7 | 790.6 | 941.3 | 972.0 |
| EBITDAR margin (%) | 51.6 | 54.2 | 53.6 | 52.4 | 51.4 | 50.4 |
| EBIT | 145.5 | 293.2 | 285.8 | 340.6 | 476.3 | 497.0 |
| EBIT margin (%) | 21.4 | 25.5 | 22.3 | 22.6 | 26.0 | 25.8 |
| Gross interest expense | -100.6 | -135.5 | -200.0 | -187.5 | -297.4 | -294.5 |
| Pre-tax income including associate income/loss | 77.9 | 152.7 | 179.2 | 153.7 | 179.4 | 203.0 |
| **Summary balance sheet** | | | | | | |
| Readily available cash and equivalents | 296.9 | 87.3 | 149.9 | 138.8 | 126.1 | 135.2 |
| Debt | 2,453.2 | 2,713.3 | 3,045.0 | 3,945.0 | 4,165.0 | 4,165.0 |
| Lease-adjusted debt | 2,456.4 | 2,713.3 | 3,045.0 | 3,945.0 | 4,165.0 | 4,165.0 |
| Net debt | 2,156.3 | 2,626.0 | 2,895.1 | 3,806.2 | 4,038.9 | 4,029.8 |
| **Summary cash flow statement** | | | | | | |
| EBITDA | 350.7 | 623.5 | 685.7 | 790.6 | 941.3 | 972.0 |
| Cash interest paid | -46.7 | -79.6 | -137.0 | -187.5 | -297.4 | -294.5 |
| Cash tax | -13.6 | -10.9 | -15.7 | -19.8 | -28.2 | -38.9 |
| Dividends received less dividends paid to minorities | 0.1 | 0.1 | 0.2 | 0.0 | 0.0 | 0.0 |
| Other items before FFO | -26.9 | -18.6 | -12.3 | -20.0 | -20.0 | -20.0 |
| Funds flow from operations | 265.9 | 515.0 | 522.2 | 563.9 | 596.2 | 619.1 |
| FFO margin (%) | 39.1 | 44.7 | 40.8 | 37.4 | 32.6 | 32.1 |
| Change in working capital | -40.4 | -215.2 | -78.7 | -193.8 | 76.0 | 0.0 |
| Cash flow from operations (Fitch defined) | 225.5 | 299.8 | 443.5 | 370.1 | 672.2 | 619.1 |
| Total non-operating/nonrecurring cash flow | — | — | — | — | — | — |
| Capex | -52.8 | -65.2 | -102.8 | — | — | — |
| Capital intensity (capex/revenue) (%) | 7.8 | 5.7 | 8.0 | — | — | — |
| Common dividends | — | — | — | — | — | — |
| Free cash flow | 172.7 | 234.6 | 340.7 | — | — | — |
| Net acquisitions and divestitures | -1,114.2 | -448.2 | -497.8 | — | — | — |
| Other investing and financing cash flow items | -227.3 | 211.8 | 3.1 | — | — | — |
| Net debt proceeds | 1,235.2 | 5.7 | 217.2 | 900.0 | 220.0 | 0.0 |
| Net equity proceeds | — | — | — | 500.0 | 0.0 | 0.0 |
| Total change in cash | 66.4 | 3.9 | 63.2 | -11.1 | -12.7 | 9.1 |
| **Leverage ratios (x)** | | | | | | |
| EBITDA leverage | 7.0 | 4.4 | 4.4 | 5.0 | 4.4 | 4.3 |
| EBITDA net leverage | 6.1 | 4.2 | 4.2 | 4.8 | 4.3 | 4.1 |
| EBITDAR leverage | 7.0 | 4.3 | 4.4 | 5.0 | 4.4 | 4.3 |
| EBITDAR net leverage | 6.1 | 4.2 | 4.2 | 4.8 | 4.3 | 4.1 |
| EBITDAR net fixed-charge coverage | 7.8 | 7.8 | 5.1 | 4.2 | 3.2 | 3.3 |
| FFO adjusted leverage | 7.9 | 4.6 | 4.6 | 5.3 | 4.7 | 4.6 |
| FFO adjusted net leverage | 7.0 | 4.4 | 4.4 | 5.1 | 4.5 | 4.4 |
| FFO leverage | 7.9 | 4.6 | 4.6 | 5.3 | 4.7 | 4.6 |
| FFO net leverage | 6.9 | 4.4 | 4.4 | 5.1 | 4.5 | 4.4 |
| **Calculations for forecast publication** | | | | | | |
| Capex, dividends, acquisitions, other items before FCF | -1,167.0 | -513.4 | -600.6 | -2,025.0 | -610.0 | -610.0 |
| FCF after acquisitions and divestitures | -941.5 | -213.6 | -157.1 | -1,654.9 | 62.2 | 9.1 |
| FCF margin after net acquisitions (%) | -138.5 | -18.6 | -12.3 | -109.7 | 3.4 | 0.5 |

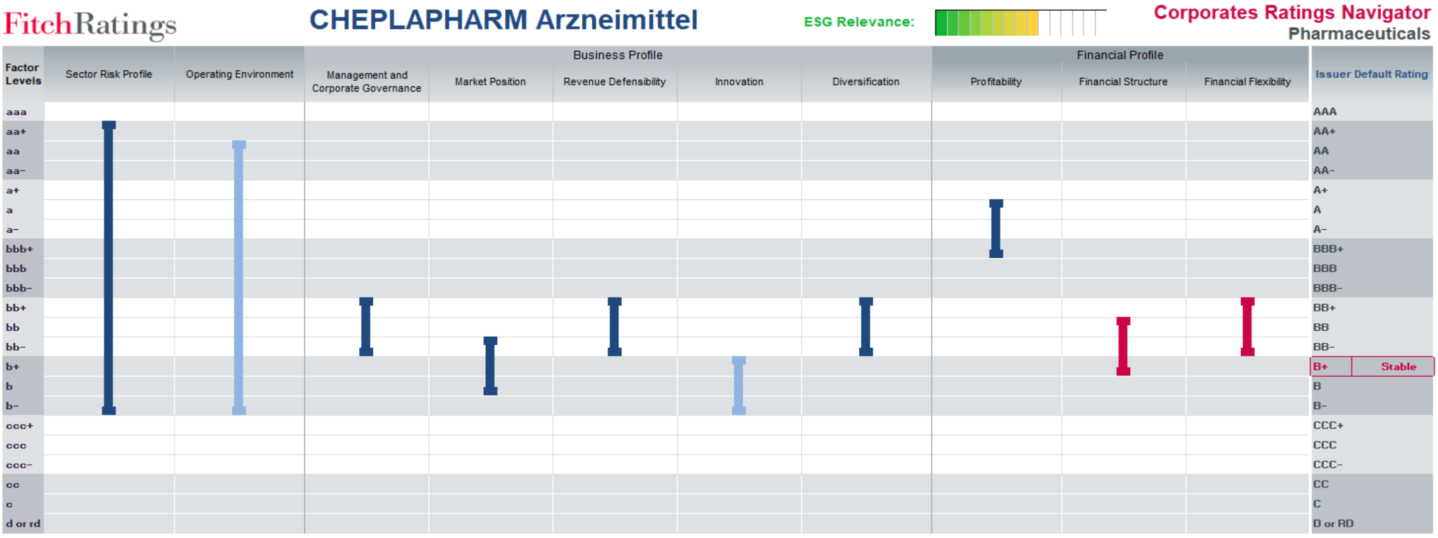
| (EURm) | Historical 2020 | Historical 2021 | Historical 2022 | Forecast 2023 | Forecast 2024 | Forecast 2025 |
|---|---|---|---|---|---|---|
| **Coverage ratios (x)** | | | | | | |
| FFO interest coverage | 6.6 | 7.5 | 4.8 | 4.0 | 3.0 | 3.1 |
| FFO fixed-charge coverage | 6.6 | 7.4 | 4.8 | 4.0 | 3.0 | 3.1 |
| EBITDAR fixed-charge coverage | 7.5 | 7.8 | 5.0 | 4.2 | 3.2 | 3.3 |
| EBITDA interest coverage | 7.5 | 7.8 | 5.0 | 4.2 | 3.2 | 3.3 |
| **Additional metrics** | | | | | | |
| CFO-capex/debt (%) | 7.0 | 8.6 | 11.2 | 6.2 | 12.6 | 10.7 |
| CFO-capex/net debt (%) | 8.0 | 8.9 | 11.8 | 6.4 | 13.0 | 11.0 |
| CFO/capex (%) | 427.1 | 459.8 | 431.4 | 295.6 | 461.4 | 354.2 |

Source: Fitch Ratings, Fitch Solutions, CHEPLAPHARM Arzneimittel GmbH.

**How to Interpret the Forecast Presented**

The forecast presented above is based on Fitch Ratings' internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch Ratings to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch Ratings' rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch Ratings' forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch Ratings' own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch Ratings' own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch Ratings may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch Ratings' own internal deliberations, where Fitch Ratings, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch Ratings may update the forecast in future reports but assumes no responsibility to do so. Original financial statement data for historical periods is processed by Fitch Solutions on behalf of Fitch Ratings. Key financial adjustments and all financial forecasts credited to Fitch Ratings are generated by rating agency staff.

## Ratings Navigator




| Bar Chart Legend: | |
|---|---|
| Vertical Bars = Range of Rating Factor | Bar Arrows = Rating Factor Outlook |
| Bar Colors = Relative Importance | ⇧ Positive |
| Higher Importance | ⇩ Negative |
| Average Importance | ⇳ Evolving |
| Lower Importance | ☐ Stable |

FitchRatings

# CHEPLAPHARM Arzneimittel

Corporates Ratings Navigator
Pharmaceuticals

## Operating Environment

| | | | |
|---|---|---|---|
| aa+ | Economic Environment | aa | Very strong combination of countries where economic value is created and where assets are located. |
| aa | Financial Access | a | Strong combination of issuer specific funding characteristics and of the strength of the relevant local financial market. |
| | Systemic Governance | aa | Systemic governance (eg rule of law, corruption; government effectiveness) of the issuer's country of incorporation consistent with 'aa'. |
| b- | | | |
| ccc+ | | | |

## Management and Corporate Governance

| | | | |
|---|---|---|---|
| bbb- | Management Strategy | bbb | Strategy may include opportunistic elements but soundly implemented. |
| bb+ | Governance Structure | bb | Board effectiveness questionable with few independent directors. "Key person" risk from dominant CEO or shareholder. |
| bb | Group Structure | bb | Complex group structure or non-transparent ownership structure. Related-party transactions exist but with reasonable economic rationale. |
| bb- | Financial Transparency | bb | Financial reporting is appropriate but with some failings (eg, lack of interim or segmental analysis). |
| b+ | | | |

## Market Position

| | | | |
|---|---|---|---|
| bb | Revenue | b | $<2 billion |
| bb- | Market Position | b | Weak national and global market positions. |
| b+ | Reimbursement Environment | bb | Negative and/or worsening reimbursement environment. |
| b | | | |
| b- | | | |

## Revenue Defensibility

| | | | |
|---|---|---|---|
| bbb- | % Sales and Profitability at Risk (Innovative) | bb | Significant level of sales and profitability at risk from patent expiry |
| bb+ | Sales Opportunity (Generic) From Expiry | b | Sales opportunities insufficient to sustain near-term growth |
| bb | | | |
| bb- | | | |
| b+ | | | |

## Innovation

| | | | |
|---|---|---|---|
| bb- | Pipeline Profile | b | Sparse and very narrow, requiring a strategic acquisitions to drive profitable growth at a level to remain competitive with its peers. |
| b+ | R&D Productivity (Innovative) | | N/A |
| b | R&D Productivity (Generic) | | N/A |
| b- | | | |
| ccc+ | | | |

## Diversification

| | | | |
|---|---|---|---|
| bbb- | Geographic Diversification | bb | Some presence in one of the following markets: U.S., Europe, Japan and Emerging. |
| bb+ | Top Product Concentration | bbb | Top product: 35%-40% of total sales. |
| bb | | | |
| bb- | | | |
| b+ | | | |

## Profitability

| | | | |
|---|---|---|---|
| a+ | EBITDA Margin | aa | Stable and durably at or above 35% throughout product development and patent expiration cycles. |
| a | EBIT Margin | a | Stable and durably at or above 20% throughout product development and patent expiration cycles. |
| a- | FFO Margin | aa | Stable and durably at or above 25% throughout product development and patent expiration cycles. |
| bbb+ | | | |
| bbb | | | |

## Financial Structure

| | | | |
|---|---|---|---|
| bb+ | EBITDA Leverage | bb | 4.5x |
| bb | EBITDA Net Leverage | bb | 4.0x |
| bb- | FFO Leverage | bb | 5.0x |
| b+ | FFO Net Leverage | bb | 4.5x |
| b | (CFO-Capex)/Debt | bbb | 12.5% |

## Financial Flexibility

| | | | |
|---|---|---|---|
| bbb- | Financial Discipline | bb | Financial policies in place but flexibility in applying them could lead to temporarily exceeding downgrade guidelines. |
| bb+ | Liquidity | bbb | One year liquidity ratio above 1.25x. Well-spread maturity schedule of debt but funding may be less diversified. |
| bb | EBITDA Interest Coverage | bb | 4.5x |
| bb- | FFO Interest Coverage | bb | 3.5x |
| b+ | FX Exposure | bbb | Some FX exposure on profitability and/or debt/cash flow match. Effective hedging in place. |

## Credit-Relevant ESG Derivation

Overall ESG

| CHEPLAPHARM Arzneimittel has 10 ESG potential rating drivers | | | | |
|---|---|---|---|---|
| Water usage in manufacturing process | key driver | 0 | issues | 5 |
| Management of product lifecycle and potential impact on food/water supply; supply chain management - product/APIs | driver | 0 | issues | 4 |
| Wellbeing of clinical trial participants; patient access and affordability | potential driver | 10 | issues | 3 |
| Drug safety & side effects; ethical marketing; data safety in clinical trials; counterfeit drug management | not a rating driver | 2 | issues | 2 |
| Impact of labor negotiations and employee (dis)satisfaction; employee recruitment and retention | | 2 | issues | 1 |
| Pressure to contain healthcare spending growth; highly sensitive political environment | | | | |
| Showing top 6 issues | | | | |

**How to Read This Page:** The left column shows the three-notch band assessment for the overall Factor, illustrated by a bar. The right column breaks down the Factor into Sub-Factors, with a description appropriate for each Sub-Factor and its corresponding category.

## Environmental (E)

| General Issues | E Score | Sector-Specific Issues | Reference |
|---|---|---|---|
| GHG Emissions & Air Quality | 1 | n.a. | n.a. |
| Energy Management | 2 | Energy use in manufacturing | Profitability; Financial Structure; Financial Flexibility |
| Water & Wastewater Management | 3 | Water usage in manufacturing process | Size and Market Positioning; Profitability; Financial Structure; Financial Flexibility |
| Waste & Hazardous Materials Management; Ecological Impacts | 3 | Management of product lifecycle and potential impact on food/water supply; supply chain management - product/APIs | Size and Market Positioning; Profitability; Financial Structure; Financial Flexibility |
| Exposure to Environmental Impacts | 2 | Manufacturing facilities and inventory exposure to extreme weather events | Size and Market Positioning; R&D Product Pipeline; Profitability; Financial Structure; Financial Flexibility |

| E Scale |
|---|
| 5 |
| 4 |
| 3 |
| 2 |
| 1 |

## Social (S)

| General Issues | S Score | Sector-Specific Issues | Reference |
|---|---|---|---|
| Human Rights, Community Relations, Access & Affordability | 3 | Wellbeing of clinical trial participants; patient access and affordability | Size and Market Positioning; R&D Product Pipeline; Profitability; Financial Structure; Financial Flexibility |
| Customer Welfare - Fair Messaging, Privacy & Data Security | 3 | Drug safety & side effects; ethical marketing; data safety in clinical trials; counterfeit drug management | Size and Market Positioning; R&D Product Pipeline; Profitability; Financial Structure; Financial Flexibility |
| Labor Relations & Practices | 3 | Impact of labor negotiations and employee (dis)satisfaction; employee recruitment and retention | Size and Market Positioning; Profitability; Financial Structure; Financial Flexibility |
| Employee Wellbeing | 1 | n.a. | n.a. |
| Exposure to Social Impacts | 3 | Pressure to contain healthcare spending growth; highly sensitive political environment | Size and Market Positioning; R&D Product Pipeline; Profitability; Financial Structure; Financial Flexibility |

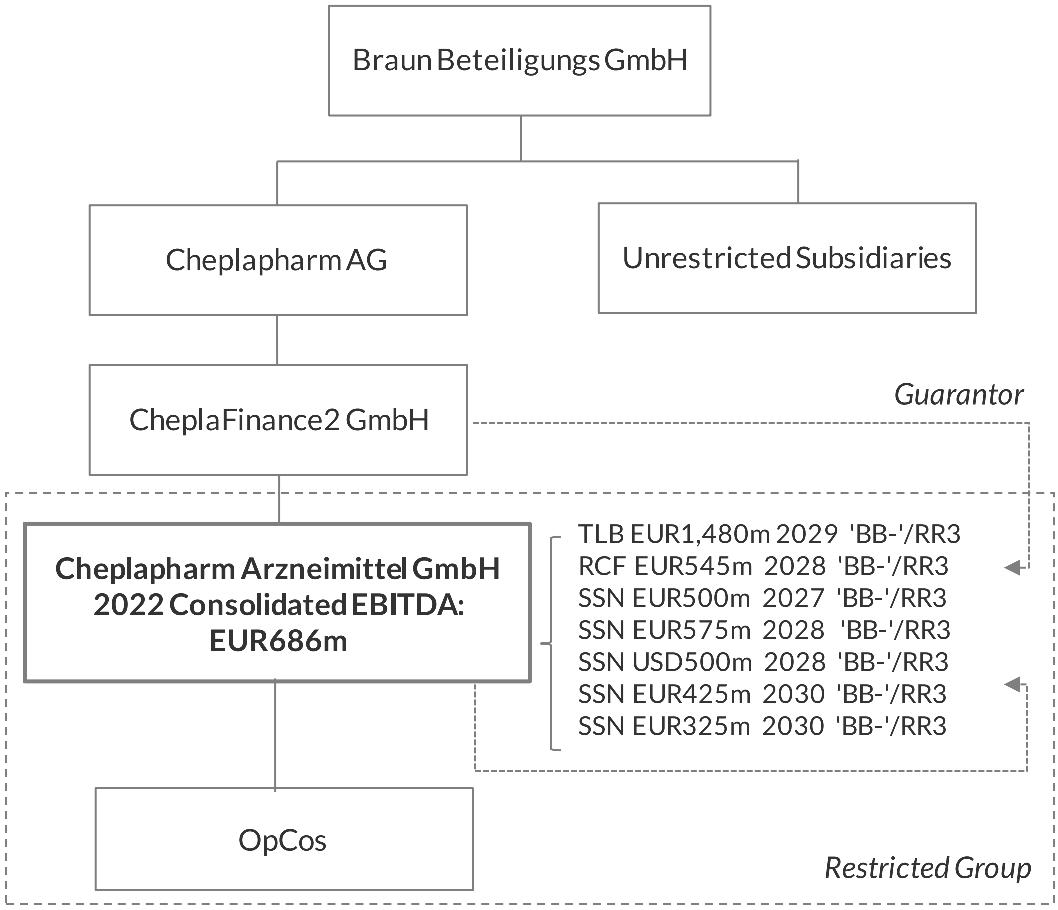
| S Scale |
|---|
| 5 |
| 4 |
| 3 |
| 2 |
| 1 |

## Governance (G)

| General Issues | G Score | Sector-Specific Issues | Reference |
|---|---|---|---|
| Management Strategy | 3 | Strategy development and implementation | Management and Corporate Governance |
| Governance Structure | 3 | Board independence and effectiveness; ownership concentration | Management and Corporate Governance |
| Group Structure | 3 | Complexity, transparency and related-party transactions | Management and Corporate Governance |
| Financial Transparency | 3 | Quality and timing of financial disclosure | Management and Corporate Governance |
| | | | |

| G Scale |
|---|
| 5 |
| 4 |
| 3 |
| 2 |
| 1 |

## Simplified Group Structure Diagram




Source: Fitch Ratings, Fitch Solutions, CHEPLAPHARM Arzneimittel GmbH, as of June 2023

## Peer Financial Summary

| Company | IDR | Financial statement date | Revenue (EURm) | EBITDA margin (%) | FCF margin (%) | EBITDA leverage (x) | EBITDA interest coverage (x) |
|---|---|---|---|---|---|---|---|
| CHEPLAPHARM Arzneimittel GmbH | B+ | | | | | | |
| | B+ | 2022 | 1,280 | 53.6 | 26.6 | 4.4 | 5.0 |
| | B+ | 2021 | 1,151 | 54.2 | 20.4 | 4.4 | 7.8 |
| Pharmanovia Bidco Limited | B+ | | | | | | |
| | B+ | 2022 | 245 | 40.3 | 13.2 | 5.7 | 4.1 |
| | B+ | 2021 | 226 | 44.4 | 33.8 | 5.7 | 6.1 |
| Nidda BondCo GmbH | B | | | | | | |
| | B | 2022 | 3,797 | 22.4 | 2.7 | 6.9 | 2.9 |
| | B | 2021 | 3,250 | 22.2 | 0.2 | 8.6 | 3.0 |
| Roar BidCo AB | B | | | | | | |
| | B | 2021 | 1,043 | 18.6 | 0.9 | 7.5 | 3.7 |
| | | 2020 | 1106,9 | 17.2 | 0.7 | 5.3 | 5.2 |
| Grunenthal Pharma GmbH & Co. Kommanditgesellschaft | BB | | | | | | |
| | BB | 2022 | 1,654 | 25.6 | 13.2 | 2.9 | 9.5 |
| | BB | 2021 | 1,467 | 24.1 | 15.5 | 2.9 | 9.7 |
| Teva Pharmaceutical Industries Limited | BB- | | | | | | |
| | BB- | 2022 | 14,925 | 25.0 | 9.5 | 6.1 | 3.9 |
| | BB- | 2021 | 15,878 | 25.6 | 12.2 | 5.9 | 4.4 |

Source: Fitch Ratings, Fitch Solutions, CHEPLAPHARM Arzneimittel GmbH.

## Fitch Adjusted Financials

| (EURm) | Notes and formulas | Reported values | Sum of adjustments | Corp- lease treatment | Other adjustments | Adjusted values |
|---|---|---|---|---|---|---|
| 31 December 2022 | | | | | | |
| **Income statement summary** | | | | | | |
| Revenue | | 1,280 | | | | 1,280 |
| EBITDAR | | 686 | | | | 686 |
| EBITDAR after associates and minorities | (a) | 686 | | | | 686 |
| Lease expense | (b) | 0 | | | | 0 |
| EBITDA | (c) | 686 | | | | 686 |
| EBITDA after associates and minorities | (d) = (a-b) | 686 | | | | 686 |
| EBIT | (e) | 286 | | | | 286 |
| **Debt and cash summary** | | | | | | |
| Other off-balance-sheet debt | (f) | 0 | | | | 0 |
| Debt[b] | (g) | 3,046 | -1 | -1 | -0 | 3,045 |
| Lease-equivalent debt | (h) | 0 | | | | 0 |
| Lease-adjusted debt | (i) = (g+h) | 3,046 | -1 | -1 | -0 | 3,045 |
| Readily available cash and equivalents | (j) | 165 | -15 | | | 150 |
| Not readily available cash and equivalents | | 0 | 15 | | | 15 |
| **Cash flow summary** | | | | | | |
| EBITDA after associates and minorities | (d) = (a-b) | 686 | | | | 686 |
| Preferred dividends (paid) | (k) | 0 | | | | 0 |
| Interest received | (l) | 1 | | | | 1 |
| Interest (paid) | (m) | -137 | | | | -137 |
| Cash tax (paid) | | -16 | | | | -16 |
| Other items before FFO | | -12 | | | | -12 |
| Funds from operations (FFO) | (n) | 522 | | | | 522 |
| Change in working capital (Fitch-defined) | | -79 | | | | -79 |
| Cash flow from operations (CFO) | (o) | 444 | | | | 444 |
| Non-operating/nonrecurring cash flow | | 0 | | | | 0 |
| Capital (expenditures) | (p) | -5 | -97 | | -97 | -103 |
| Common dividends (paid) | | 0 | | | | 0 |
| Free cash flow (FCF) | | 438 | -97 | | -97 | 341 |
| **Gross leverage (x)** | | | | | | |
| EBITDAR leverage[a] | (i/a) | 4.4 | | | | 4.4 |
| FFO adjusted leverage | (i/(n-m-l-k+b)) | 4.6 | | | | 4.6 |
| FFO leverage | (i-h)/(n-m-l-k) | 4.6 | | | | 4.6 |
| EBITDA leverage[a] | (i-h)/d | 4.4 | | | | 4.4 |
| (CFO-capex)/debt (%) | (o+p)/(i-h) | 14.4 | | | | 11.2 |
| **Net leverage (x)** | | | | | | |
| EBITDAR net leverage[a] | (i-j)/a | 4.2 | | | | 4.2 |
| FFO adjusted net leverage | (i-j)/(n-m-l-k+b) | 4.4 | | | | 4.4 |
| FFO net leverage | (i-h-j)/(n-m-l-k) | 4.4 | | | | 4.4 |
| EBITDA net leverage[a] | (i-h-j)/d | 4.2 | | | | 4.2 |
| (CFO-capex)/net debt (%) | (o+p)/(i-h-j) | 15.2 | | | | 11.8 |
| **Coverage (x)** | | | | | | |
| EBITDAR fixed-charge coverage[a] | a/(-m+b) | 5.0 | | | | 5.0 |
| EBITDA interest coverage[a] | d/(-m) | 5.0 | | | | 5.0 |
| FFO fixed-charge coverage | (n-l-m-k+b)/(-m-k+b) | 4.8 | | | | 4.8 |
| FFO interest coverage | (n-l-m-k)/(-m-k) | 4.8 | | | | 4.8 |

[a] EBITDA/R after dividends to associates and minorities.
[b] Includes other off balance sheet debt.
Source: Fitch Ratings, Fitch Solutions, CHEPLAPHARM Arzneimittel GmbH

## B+ and below Considerations

| Considerations | B+ | B | B- | CCC+ | Trend | Fitch's View |
|---|---|---|---|---|---|---|
| **Business model** | Robust | Sustainable | Intact | Redeemable | ◀▶ | The company has a sustainable business model backed by a record of solid performance, supported by a well-managed IP portfolio and brand management. However, the model relies on constant acquisitions to avoid a structural decline in organic sales and margins, which makes it less attractive in an environment of high interest rates. |
| **Strategy/ execution risk** | Limited | Moderate | Meaningful | Challenging yet achievable | ◀▶ | The company has a solid record of integrating debt-funded M&A to achieve consistently high EBITDA and cash flow margins. |
| **Cash flow** | Consistently positive | Neutral to positive | Volatile | Mostly negative | ◀▶ | We expect it to have large and consistent FCF margins of 25%-30% through to FY25. |
| **Leverage profile** | Clear deleveraging path | Deleveraging capacity | High but sustainable | Significant outlier | ◀▶ | It has relatively modest leverage of 4x-4.5x debt/EBITDA. It has a strong capacity to deleverage given strong FCF generation, but we expect stable leverage due to high M&A expenditure. |
| **Governance and financial policy** | Committed | Some commitment to deleveraging | Aggressive | Ineffective | ◀▶ | The company's financial policy is more prudent that those of most PE-owned companies, with leverage maintained around 4x-5x. It is characterised by family ownership and a willingness to raise equity (envisaged IPO in medium term and recent mandatory convertible loan). This is offset by its strategy of prioritising inorganic growth by spending internally generated FCF on acquisitions. |
| **Refinancing risk** | Limited | Manageable | High | Off-market options | ◀▶ | There is limited refinancing risk given expected EBITDA leverage of around 4.0-5.0x. There are no maturities until 2027-2028. |
| **Liquidity** | Comfortable | Satisfactory | Limited | Minimal headroom | ◀▶ | The company has a good liquidity profile, supported by a committed RCF of EUR545 million. |
| **Conclusion** | B+ | | | | | |

Source: Fitch Ratings

# Recovery Analysis

## Recovery Analysis

| | |
|---|---|
| **Issuer Name** | CHEPLAPHARM Arzneimittel GmbH |
| **IDR** | B+ |
| **Sector** | Pharmaceuticals |
| **Statement Date** | 31 December 2022 |
| **Currency** | EUR |
| **Scale** | (m) |

| **Going Concern Enterprise Value** | |
|---|---|
| Going Concern EBITDA | 550 |
| EBITDA Multiple (x) | 5.5 |
| Additional Value from Affiliates, Minority Interest, Other | - |
| **Going Concern Enterprise Value** | **3,025** |

| **Liquidation value (LV)** | **Book value** | **Advance rate (%)** | **Available to creditors** |
|---|---|---|---|
| Cash | 159.6 | 0 | - |
| Accounts Receivable | 397 | 75 | 298 |
| Inventory | 330 | 50 | 165 |
| Net Property, Plant and Equipment | 35 | 50 | 18 |
| LV of Off Balance Sheet Assets | - | 100 | - |
| Additional Value from Affiliates, Minorities, Other | - | 100 | - |
| **Total Liquidation Value** | | | 481 |

| **Enterprise Value for Claims Distribution** | |
|---|---|
| Greater of Going Concern Enterprise or Liquidation Value | 3,025 |
| Less Administrative Claims | 302.5 |
| **Total Enterprise Value** | **2,722.5** |

**Distribution of Value**

| Priority | Amount | Concession allocation | Value recovered | Recovery (%) | Recovery rating | Notching | Rating |
|---|---|---|---|---|---|---|---|
| Senior Secured Facilities | 4,318.6 | 0 | 2,723 | 63 | RR3 | +1 | BB- |

Source: Fitch Ratings, Fitch Solutions

### Key Recovery Rating Assumptions

In a distressed scenario, we expect Cheplapharm would most likely be sold or restructured as a going concern (GC) rather than liquidated given its asset-light business model.

We estimate post-restructuring GC EBITDA of about EUR550 million, which includes the contribution from the acquisitions scheduled for completion in 2023. Cheplapharm would be required to address debt service and fund working capital as the company takes over inventories following the transfer of market authorisation rights, as well as to make smaller M&A to sustain its product portfolio to compensate for a natural sales decline.

Fitch continues to apply a distressed enterprise value/EBITDA multiple of 5.5x, reflecting the underlying value of the company's portfolio of IP rights.

After deducting 10% for administrative claims, the allocation of value in the liability waterfall results in a Recovery Rating of 'RR3' for the existing senior secured debt, including the EUR545 million RCF, which we assume will be fully drawn prior to distress, indicating a 'BB-' instrument rating with a waterfall-generated recovery computation of 63% (56% previously).

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.