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CREDIT OPINION
27 April 2023

Update

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RATINGS

Cheplapharm Arzneimittel GmbH

Domicile	Germany
Long Term Rating	B2
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Cheplapharm Arzneimittel GmbH

Update following B2 rating affirmation, outlook remains stable

Summary

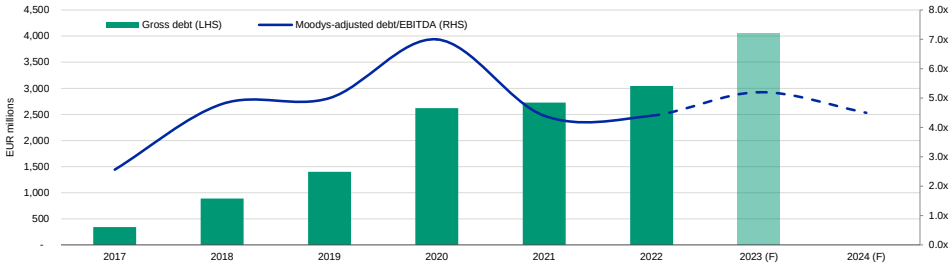
Cheplapharm Arzneimittel GmbH's (Cheplapharm) B2 corporate family rating (CFR) is supported by the company's good therapeutic and geographical diversification; good track record in the timely transfer of marketing authorisations from pharmaceutical companies for products acquired; and strong cash flow from operations (CFO) and free cash flow (FCF), supported by its asset-light business model.

However, the B2 rating is constrained by the structural earnings decline in Cheplapharm's existing off-patent branded product portfolio, prompting it to make product acquisitions to maintain or grow revenue; the company's relatively short track record of working with well-recognised pharmaceutical companies; its aggressive financial policy, with multiple debt-funded acquisitions undertaken in recent years, which increased its Moody's-adjusted gross debt sharply to €3.0 billion as of year-end 2022 from €0.9 billion as of year-end 2018.

Exhibit 1

Cheplapharm's leverage is likely to remain well within the 4.5x-5.5x range

Moody's-adjusted debt (€ million) and gross debt/EBITDA



2023 only includes six months of Zyprexa, assuming closing on 30 June 2023.
Source: Moody's Investors Service

Credit strengths

» Good therapeutic and geographical diversification

» Track record of timely transfer of marketing authorisations from pharmaceutical companies

» Strong cash flow generation, supported by the company's asset-light business model

Credit challenges

» Structural earnings decline in its existing off-patent branded product portfolio, which prompts the company to make product acquisitions

» Relatively short track record of working with well-recognised pharmaceutical companies

» Aggressive financial policy, with multiple debt-funded acquisitions that have substantially increased gross debt in recent years

Rating outlook

The stable rating outlook reflects our expectation that Cheplapharm will successfully execute its announced acquisitions in the next 12-18 months and continue to generate strong CFO, which will offset rising debt and position the company solidly in its rating category.

Factors that could lead to an upgrade

Positive rating pressure may develop over time if:

» Cheplapharm maintains its Moody's-adjusted (gross) debt/EBITDA below 4.5x and its CFO/debt above 15% on a sustained basis

» the company demonstrates commitment to more moderate acquisitions in terms of size and their financial impact, and greater predictability over the potential evolution of its credit metrics in the long term

Factors that could lead to a downgrade

We may downgrade Cheplapharm's rating if it does not maintain Moody's-adjusted debt/EBITDA comfortably below 5.5x, or if its CFO/debt declines below 10% for a prolonged period.

The failure to maintain adequate liquidity, including a well-spread debt maturity profile, or a significant deterioration in interest coverage metrics could also strain the rating.

Key indicators

Exhibit 2

Cheplapharm Arzneimittel GmbH

	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	12-18 months forward view
Revenue (EUR million)	226	315	507	640	1,082	1,279	1500-1600
Debt / EBITDA	2.6x	4.8x	5.0x	7.0x	4.4x	4.4x	4.3x - 4.7x
Cash Flow from Operation / Debt	23%	5%	10%	9%	11%	15%	12% - 15%
Pharmaceutical Cash Coverage of Debt	13%	10%	2%	4%	4%	5%	3% - 4%

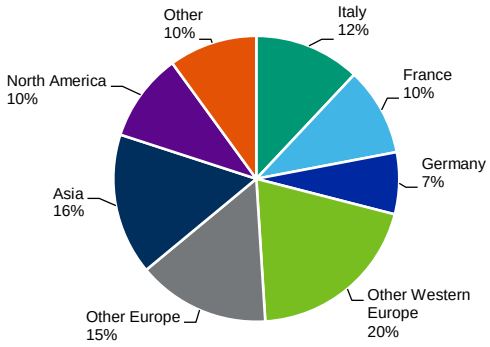
2017-19: Cheplapharm Arzneimittel GmbH audited accounts; 2020-22: Cheplapharm AG audited accounts.
Source: Moody's Investors Service

Profile

Headquartered in Greifswald, Germany, Cheplapharm Arzneimittel GmbH (Cheplapharm) is a family-owned company focused on the marketing of off-patent, branded, prescription and niche drugs. Its business model relies on its good relationships with leading pharmaceutical companies, such as Roche Holding AG (Roche, Aa2 stable) and AstraZeneca PLC (AstraZeneca, A3 stable); its ability to buy products with sufficient earnings potential at the right price; and the outsourcing of its production and distribution to reliable third parties. Cheplapharm's asset-light operations enable it to generate high cash flow, which it reinvests in the acquisition of new products, offsetting the structural earnings decline in its existing portfolio.

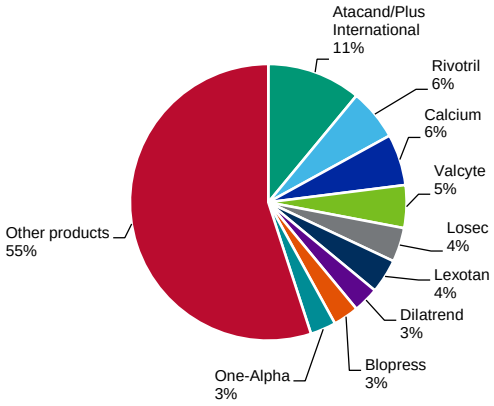
The group owns a portfolio of more than 125 products that it distributes in more than 145 countries. It generated €1,279 million in revenue and €686 million in EBITDA, on a reported basis, in 2022. Cheplapharm is 50:50 owned by co-CEO Sebastian Braun and chief scientific officer Bianca Juha, siblings who took over the company from its founder, Kurt Teubner, in 2003.

Exhibit 3
Revenue breakdown by geography
2022



Source: Company report

Exhibit 4
Revenue breakdown by product
2022



Source: Company report

Detailed credit considerations

Cheplapharm's business model assumes frequent acquisitions to maintain growth, while FCF generation has been positive

Cheplapharm runs an asset-light business model. Instead of developing drugs, it acquires intellectual property rights for legacy or niche branded off-patent products from large multinational pharmaceutical companies, such as Sanofi (A1 stable), AstraZeneca or Roche. After the transfer of the marketing authorisations, Cheplapharm outsources drug manufacturing and — to a large extent — distribution to third parties. This enables the company to minimise costs and generate sizeable cash flow.

The company usually signs transitional service agreements (TSA) with the pharmaceutical companies from which it buys drugs because obtaining the transfer of marketing authorisations can take time. Under a TSA, the seller remains in charge of the drug manufacturing and distribution until the marketing authorisation is transferred. During that period, the seller pays back the profit to Cheplapharm, after deducting a service fee of 5%-9% of revenue. The TSA often states that the seller will supply inventories to Cheplapharm, notably right after the marketing authorisation transfer is approved, to avoid supply disruptions. Cheplapharm generally initiates the transfer of marketing authorisations in the largest markets first. An unexpected delay in the transfer of a marketing authorisation would prevent Cheplapharm from achieving earnings estimated in the business plan, although the company would still receive a share of the seller's earnings.

Cheplapharm generates solid FCF, supported by a high EBITDA margin, which has fluctuated between 50% and 60% in recent years. Although this profit level is possible because the company does not spend on R&D, it also comes from Cheplapharm's lean cost structure, with significantly lower overhead costs than those of large pharmaceutical companies. However, Cheplapharm needs to make acquisitions regularly to offset about 3%-5% annual sales erosion in its off-patent products.

Cheplapharm's business model is not unique in the specialty pharmaceutical industry and has been run by other companies, such as ADVANZ PHARMA Holdco Ltd (B3 positive) and Pharmanovia Bidco Limited (B2 stable). Cheplapharm's product portfolio is centred on legacy branded off-patent products, which generally have very good market acceptance and relatively good visibility into future sales erosion. However, the company's strategy has been more acquisitive than that of its peers.

Cheplapharm's highly acquisitive growth strategy remains a constraint on its rating, although the company has been building a good track record at acquisition execution

During 2020, Cheplapharm signed about €1.5 billion of acquisitions, which were all debt funded. This increased its Moody's-adjusted debt sharply to €2.6 billion in 2020 from €1.4 billion in 2019 and €0.9 billion in 2018. In 2021-22, Cheplapharm undertook fewer and

smaller acquisitions than those undertaken in 2020 and these were mostly funded by the company's internally generated cash flow, resulting in a more limited debt increase to €3.0 billion as of year-end 2022.

2023 will again be a more active year with regard to M&A, with acquisitions worth €1.7 billion already announced. In April 2023, Cheplapharm announced that it will acquire worldwide commercial rights for Zyprexa from Eli Lilly and Company (Lilly, A2 positive) for a total consideration of $1,351 million (about €1.2 billion), which includes a $305 million (about €280 million) deferred purchase price to be paid one year after acquisition closing. This is Cheplapharm's largest acquisition to date and follows the acquisitions of the drugs Xeloda in China and Pulmicort in the US, which both closed in the first quarter of 2023 for a total consideration of about €450 million.

The Zyprexa franchise includes four products with different dosage forms (oral and injectable) indicated for the treatment of schizophrenia and bipolar disorders. Oral forms face generic competition, while the main injectable form, ZypAdhera, does not, but it is likely that it will face increased competition by 2026. We expect sales of acquired products to decline in the low-single-digit percentages over 2023-25, with patients in these indications generally reluctant to switch products and limited additional competition. Pro forma the acquisitions, the Zyprexa franchise will represent about 17% of Cheplapharm's 2022 revenue and about 20% of its 2022 EBITDA, but the company will still maintain a low concentration on a per drug per country basis. The acquisition entails execution risks because of the large number of marketing authorisations (about 300 in 53 countries) and an existing complex supply chain, which Cheplapharm will have to transfer and optimise during the three-year transition service agreement period, but the company has built a good track record at executing such transactions.

The €1.7 billion total consideration for the acquisitions of Xeloda China, Pulmicort US and Zyprexa will be funded through €750 million of new debt, €480 million of shareholder loan, which we treat as equity, €280 million of deferred purchase price, a small drawdown under Cheplapharm's revolving credit facility (RCF) and about €200 million of available cash. Considering these acquisitions, we estimate 2022 pro forma revenue of about €1.7 billion for Cheplapharm, EBITDA of about €980 million and leverage (Moody's-adjusted gross debt/EBITDA) of about 4.2x. Newly raised debt will bear higher funding costs because of the increased interest rates, which, along with increased costs on the company's existing term loan B, will weigh on the company's interest cover.

We expect the company to remain active in acquiring drug portfolios of legacy and niche products because it is key to its strategy to offset the average low to mid single digits, in percentage terms, annual earnings decline in its existing drug portfolio and to grow its business. This entails some uncertainties around the funding mix of such acquisitions, potential integration issues and risks that future earnings from acquired drugs may be lower than Cheplapharm's expectations. Recent acquisitions have also been done at higher revenue and EBITDA multiples than in the past (Zyprexa price represents a revenue multiple of 4.2x and EBITDA multiple of 6.3x). Cheplapharm, which had included in its senior facilities agreement a maximum 3.5x revenue multiple, recently obtained consent to remove this limit. Cheplapharm continues to target acquisitions with a maximum 6.5 years of return on investment.

Good therapeutic and geographical diversification, with modest product concentration

While Cheplapharm remains a small pharmaceutical company, its size has been increasing significantly in recent years. Its 2022 revenue reached €1.3 billion from €0.5 billion in 2019.

Cheplapharm's products are in a wide range of therapeutic areas, with the largest categories being cardiology, and mental and sleeping disorders. Cheplapharm has modest product concentration, with its largest drug, Atacand (for the treatment of high blood pressure), accounting for 11% of total revenue in 2022, followed by Rivotril (for epilepsy) accounting for 6%. Although Rivotril bears a risk of dependency, sanitary and regulatory risks are moderate because the drug has been marketed since 1973.

Europe is still the largest market for Cheplapharm, accounting for 64% of its revenue in 2022, although this share has been declining over recent years. Within Europe, Cheplapharm has good diversification: Italy and France are its largest markets, each accounting for less than 15% of total revenue. A faster-than-expected earnings decline in newly purchased drugs, for instance, because of delisting or market share loss as a result of generic competition, is a key risk for Cheplapharm. This risk varies by country, so the presence of a well-spread geographical revenue base is credit positive. On a per product, per country basis, revenue concentration is not more than 3%-4%.

Moreover, Cheplapharm's reported numbers can distort geographical diversification because some drugs are still subject to a TSA, which implies that the company that sold these products to Cheplapharm still commercialises them. In such cases, the company books sales under the country of origin of the seller and not where they are sold.

Cheplapharm has good supply diversification with reliable manufacturing partners. Large pharmaceutical companies continue to manufacture drugs during the TSA period, so they account for a large portion of Cheplapharm's supplies. Cheplapharm does not dual source its products because of the general simplicity of the active pharmaceutical ingredients used, which reduces the risk of production outage. However, Cheplapharm always applies for two supplier sources in the dossiers for the application of marketing authorisations, which significantly reduces the switching time between suppliers if needed.

Cheplapharm continues to build a successful track record of relationships with leading global pharmaceutical companies

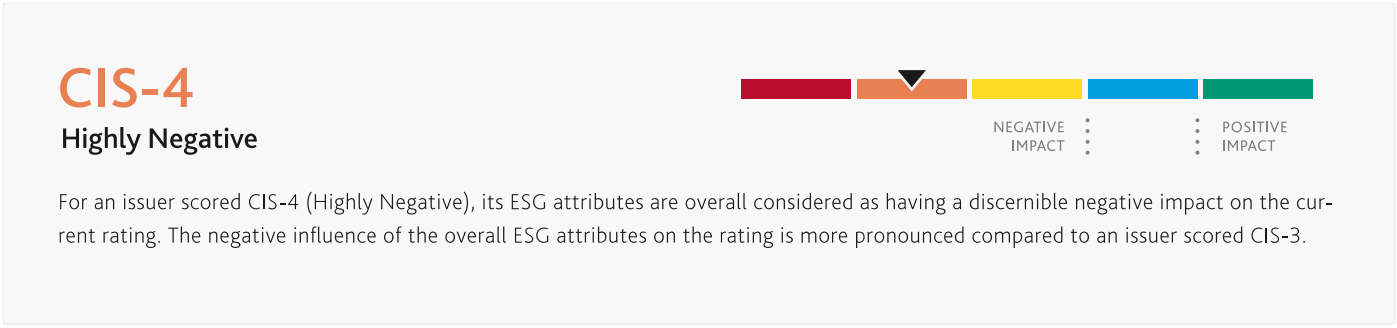
Kurt Teubner founded the company in 1998, which was subsequently acquired by Sebastian Braun and Bianca Juha in 2003. Cheplapharm concluded its first deals with large pharmaceutical companies around 2005. The fact that prominent pharmaceutical companies, such as Roche and AstraZeneca, have partnered with Cheplapharm reflects the quality of its management and medical teams. Cheplapharm's ability to regularly buy drugs from new partners such as Takeda Pharmaceutical Company Limited (Baa2 positive) in 2020 or Lilly in 2023 is credit positive. Large pharmaceutical companies would not sell their products and enter into a TSA with a company that they do not fully trust in light of the reputational risk and the risk that the partner would not obtain marketing authorisations.

At the same time, the reliance of Cheplapharm's business model on the trust of much larger pharmaceutical companies is credit negative because it increases the risk of possible operating issues, which would hurt not only its earnings but also partners' trust and, therefore, Cheplapharm's ability to source new products.

ESG considerations

Cheplapharm Arzneimittel GmbH's ESG Credit Impact Score is Highly Negative CIS-4

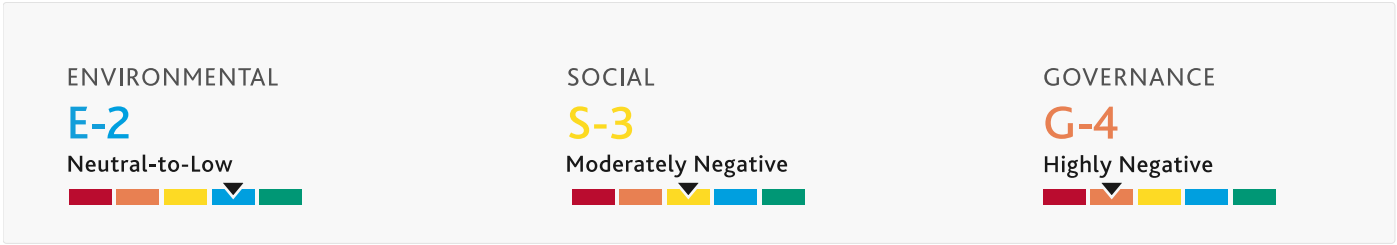
Exhibit 5
ESG Credit Impact Score



Source: Moody's Investors Service

CIS-4. Cheplapharm's ESG Credit Impact Score is Highly Negative (**CIS-4**). This mostly reflects governance-related risks from the company's rapid growth through debt-funded acquisitions with a sharp increase in debt in recent years. Cheplapharm's exposure to environmental risks is neutral-to-low and to social risks is moderate.

Exhibit 6
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

E-2. Cheplapharm's score reflects the neutral-to-low environmental exposures of the pharmaceutical industry, with no significant environmental exposures that are materially different than the industry norm.

Social

S-3. Cheplapharm has a moderate exposure to social risks. Its product portfolio essentially comprises off-patent drugs that have been on the market for many years, which reduces the risk of product safety issues and of abrupt price declines from regulatory changes.

Governance

G-4. Cheplapharm's score reflects financial policies with a tolerance for leverage, and a track record of rapid growth through acquisitions, which has resulted in a sharp increase in debt in recent years. Well-established acquisition criteria and management's experience nevertheless mitigate acquisition integration risk. Cheplapharm has also recently instigated measures to improve its governance through, for instance, the establishment of an external advisory board.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

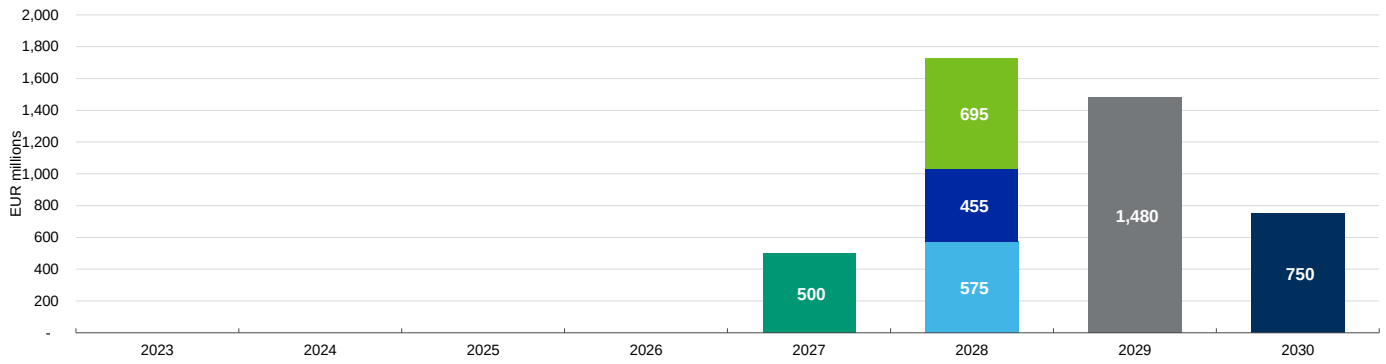
Liquidity analysis

Cheplapharm's liquidity is good, supported by a cash balance of €160 million as of 31 December 2022, access to a senior secured RCF, which was recently upsized to €695 million from €545 million, and solid FCF, which we expect to be about €400 million in the next 12 months. About €200 million of currently available cash and a small RCF drawing of about €35 million will be used to partially fund the Zyprexa acquisition. We expect FCF to be used for acquisitions, and Cheplapharm has also regularly used its RCF to initially fund acquisitions. The company does not face any large near-term debt maturities. The next large debt maturity is the company's €500 million secured notes due 2027.

Exhibit 7

Cheplapharm does not face any large maturity before 2027

Debt maturity profile



€695 million corresponds to the company's RCF.

Source: Company report

Cheplapharm's senior secured RCF has a springing maturity, dependent on the timing of refinancing of existing senior secured notes due 2027 and 2028 and ensuring that the senior secured RCF always matures before the remaining senior secured debt. The earliest maturity date for the senior secured RCF is November 2026. The senior secured RCF is also subject to a springing covenant, which requires the company to maintain net senior secured debt/EBITDA of less than 6.0x if at least 40% of the senior secured RCF is drawn. We expect Cheplapharm to maintain good leeway under this covenant.

Structural considerations

The company's capital structure mostly comprises senior secured debt issued by Cheplapharm Arzneimittel GmbH's level, the main operating entity of the group. This includes a senior secured term loan, senior secured notes and a senior secured RCF. All these debt instruments rank pari passu and have the same security package, which includes a first-priority pledge over Cheplapharm Arzneimittel GmbH's shares and pledges over bank accounts and intercompany receivables. This security package is relatively weak and, therefore, these debt instruments are unsecured in our Loss Given Default analysis. We used a family recovery rate of 50% appropriate for a debt structure comprising bank and bond debts. Cheplapharm's capital structure also comprises a €500 million shareholder loan, which we treat as equity.

In early 2022, Cheplapharm announced its intention to launch an IPO, which was eventually postponed because of unfavourable market conditions. In Q4 2022, Cheplapharm announced that it reached an agreement with two new investors, Atlantic Park and the Government of Singapore Investment Company (GIC), on an investment in the form of a €550 million subordinated convertible instrument that will convert into Cheplapharm AG shares in the event of an IPO or an exit sale, or at maturity. The investment closed in February 2023 and €500 million of the instrument proceeds were downstreamed to Cheplapharm Arzneimittel GmbH, the parent company of the restricted group and the entity to which we have assigned the CFR, through a shareholder loan that we have treated as equity. The remaining €50 million proceeds were transferred to Cheplapharm's current shareholders. The convertible instrument bears annual interest of 12% in the first three years (6% per year thereafter), of which 6% per year can be capitalised. Assuming capitalisation, Cheplapharm Arzneimittel GmbH will have to upstream around €35 million per year to Cheplapharm AG to cover the cash interest payments.

Methodology and scorecard

The principal methodology used in these ratings was our Pharmaceuticals rating methodology, published in November 2021. The B2 rating assigned to Cheplapharm is one notch below the scorecard-indicated outcome based on our forward-looking view, and reflects event risk related to acquisitions and integration risks.

Exhibit 8

Rating factors

Cheplapharm Arzneimittel GmbH

Pharmaceutical Industry Scorecard [1][2]	Current FY 12/31/2022		Moody's 12-18 Month Forward View As of 04/24/2023 [3]	
Factor 1 : Scale (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$1.4	B	$1.5 - $1.6	B
Factor 2 : Business Profile (40%)				
a) Product and Therapeutic Diversity	Ba	Ba	Ba	Ba
b) Geographic Diversity	Baa	Baa	Baa	Baa
c) Patent Exposures	Baa	Baa	Baa	Baa
d) Pipeline Quality	Caa	Caa	Caa	Caa
Factor 3 : Leverage & Cash Coverage (25%)				
a) Debt / EBITDA	4.4x	Ba	4.3x - 4.7x	Ba
b) (Cash Flow from Operation) / Debt	14.6%	B	12% - 15%	B
c) Pharmaceutical Cash Coverage of Debt	5.4%	B	3% - 4%	Caa
Factor 4 : Financial Policy (10%)				
a) Financial Policy	B	B	B	B
Rating:				
a) Scorecard-Indicated Outcome		B1		B1
b) Actual Rating Assigned		B2		

[1] All ratios are based on adjusted financial data and incorporate our Global Standard Adjustments for Non-Financial Corporations. [2] As of 31 December 2022. [3] This represents our forward view, not the view of the issuer.

Sources: Moody's Financial Metrics™ and Moody's Investors Service

Ratings

Exhibit 9

Category	Moody's Rating
CHEPLAPHARM ARZNEIMITTEL GMBH	
Outlook	Stable
Corporate Family Rating	B2
Sr Sec Bank Credit Facility -Dom Curr	B2
Senior Secured	B2/LGD4

Source: Moody's Investors Service

Appendix

Exhibit 10

Peer comparison

Cheplapharm Arzneimittel GmbH

Pharmaceuticals Scorecard	Cheplapharm Arzneimittel GmbH	Grünenthal Pharma GmbH & Co. KG	Theramex (Stars UK Bidco Ltd)	Atnahs (Pharmanovia Bidco Ltd)	ADVANZ PHARMA Holdco Ltd
Period	Forward view as of April 2023	Forward view as of April 2023	Forward view as of July 2022	Forward view as of May 2022	Forward view as of January 2023
Actual Rating Assigned	B2	B1	B2	B2	B3
Indicated Outcome from Scorecard	B1	Ba3	B3	B2	B2
Revenue (USD Billion)	$1.5 - $1.6	$1.8	$0.3 - $0.4	$0.3 - $0.4	$0.7 - $0.8
Product and Therapeutic Diversity	Ba	Ba	Ba	B	Ba
Geographic Diversity	Baa	Baa	Ba	Baa	Ba
Patent Exposures	Baa	B	B	Baa	Ba
Pipeline Quality	Caa	Caa	B	Caa	B
Debt/EBITDA	4.3x - 4.7x	3.3x - 3.8x	5.9x - 6.0x	5.5x - 5.6x	5.0x - 5.5x
Cash Flow from Operations/Debt	12% - 15%	10% - 15%	8% - 9%	10% - 12%	9% - 11%
Parmaceutical Cash Coverage of Debt	3% - 4%	15% - 22%	1% - 2%	4% - 8%	15% - 20%
Financial Policy	B	Ba	B	B	B

Source: Moody's Investors Service

Exhibit 11

Moody's-adjusted EBITDA breakdown

(in EUR Thousands)	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-21	FYE Dec-22
As Reported EBITDA	**178,357**	**277,720**	**362,072**	**618,862**	**779,055**
Operating Leases	718				
Unusual	7,382	3,792	13,187	7,415	-90,850
Non-Standard Adjustments					
Moody's-Adjusted EBITDA	**186,457**	**281,512**	**375,259**	**626,277**	**688,205**

All figures are calculated using our estimates and standard adjustments.
Source: Moody's Financial Metrics™

Exhibit 12

Moody's-adjusted debt breakdown

(in EUR Thousands)	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-21	FYE Dec-22
As Reported Debt	**858,808**	**1,385,613**	**2,619,969**	**2,727,035**	**3,046,159**
Operating Leases	2,154				
Non-Standard Adjustments	27,339	13,406			
Moody's-Adjusted Debt	**888,301**	**1,399,019**	**2,619,969**	**2,727,035**	**3,046,159**

All figures are calculated using our estimates and standard adjustments.
Sources: Moody's Financial Metrics™

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EMEA	44-20-7772-5454