CREDIT OPINION
17 December 2024

Update

Send Your Feedback

RATINGS

Cheplapharm Arzneimittel GmbH

Domicile	Germany
Long Term Rating	B3
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 downgrade to B3, outlook remaining stable

Summary

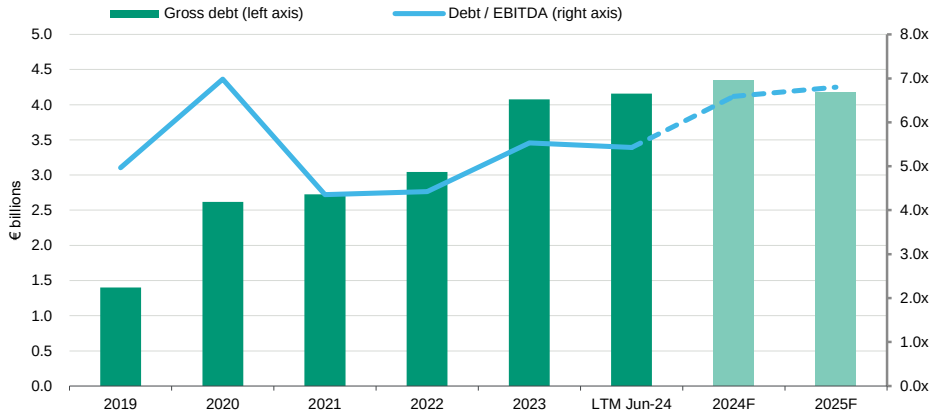
Cheplapharm Arzneimittel GmbH's (Cheplapharm) B3 corporate family rating (CFR) is supported by the company's good therapeutic and geographical diversification; strong cash flow generation, supported by its asset-light business model; and adequate liquidity.

At the same time, the B3 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 execution risks related to the integration of its acquisitions, notably industrial transfers; and its aggressive financial policy, with multiple debt-funded acquisitions in recent years, which increased its Moody's-adjusted gross debt sharply to €4.4 billion as of September 2024 from €0.9 billion as of year-end 2018.

The recent downgrade to B3 primarily reflects the operational issues that Cheplapharm has been facing over the past year and which have recently expanded, resulting in a decline of its EBITDA and significant weakening of its credit metrics.

Exhibit 1

Cheplapharm's leverage increased in 2024 and is likely to remain elevated in the next 12-18 months



2019: Cheplapharm Arzneimittel GmbH audited accounts; 2020-LTM Jun-24: Cheplapharm SE audited accounts.
All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated. LTM = Last 12 months.
Rated entity - Cheplapharm Arzneimittel GmbH, financials under entity Cheplapharm SE.
Moody's forecasts are Moody's opinion and do not represent the views of the issuer.
Sources: Moody's Financial Metrics™ and Moody's Ratings forecasts

Credit strengths

» Good therapeutic and geographical diversification

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

» Adequate liquidity, supported by strong cash flow

Credit challenges

» Widening operational issues due to the company's exceptionally rapid growth in recent years.

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

» Execution risks related to the integration of acquisitions, notably industrial transfers

» 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 be able to stabilise its operating performance over the next 12-18 months while its credit metrics will remain in line with a B3 rating. The stable outlook also factors in our expectation of the company sustaining adequate liquidity.

Factors that could lead to upgrade

We could upgrade Cheplapharm's rating if the company successfully addresses its operational challenges and stabilises its business, thereby reverting to its historical revenue trends, specifically achieving an organic revenue decline of 3%-5% per year. Quantitatively, we would upgrade the rating if Cheplapharm maintains its Moody's-adjusted debt/EBITDA below 5.5x and cash flow from operations (CFO)/debt above 10% on a sustained basis. An upgrade would also require the company to demonstrate a more cautious acquisition strategy.

Factors that could lead to downgrade

Conversely, we could downgrade Cheplapharm's rating if the company fails to address its operational challenges and its revenue continues to decline at higher rates than in the past. Quantitatively, we could downgrade Cheplapharm's rating if it fails to maintain Moody's-adjusted debt/EBITDA comfortably below 7.0x or its CFO/debt remains below 5% for a prolonged period. A failure to maintain adequate liquidity, including a well-spread debt maturity profile and timely refinancing of upcoming maturities, or a material deterioration in interest coverage metrics, could also lead to negative pressure on the rating.

Key indicators

Exhibit 2
Cheplapharm SE

(in € billions)	2019	2020	2021	2022	2023	LTM Jun-24	2024F	2025F
Revenue	0.5	0.6	1.1	1.3	1.5	1.6	1.5	1.5
Debt / EBITDA	5.0x	7.0x	4.4x	4.4x	5.5x	5.4x	6.6x	6.8x
CFO / Debt	10.1%	8.6%	11.0%	14.6%	9.1%	4.4%	3.3%	5.3%
Pharmaceutical Cash Coverage of Debt	2.4%	3.7%	3.8%	5.4%	13.3%	7.5%	4.8%	3.8%
EBITDA Margin	55.5%	58.7%	57.9%	53.8%	49.1%	47.7%	44.0%	41.5%
EBITA / Interest Expense	5.2x	4.3x	4.6x	3.4x	3.1x	2.7x	2.3x	2.2x
FCF (before acq. of intangibles) / Debt	9.5%	8.3%	10.7%	14.4%	8.0%	3.6%	2.2%	4.2%
FCF (after acq. of intangibles) / Debt	-42.1%	-35.9%	-7.9%	-5.2%	-28.5%	-28.9%	-14.0%	3.0%

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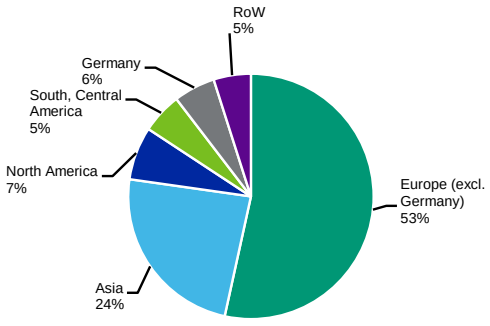
Profile

Headquartered in Greifswald, Germany, Cheplapharm Arzneimittel GmbH (Cheplapharm) is a family-owned company focused on the marketing of off-patent, branded legacy and niche drugs. Its business model relies on 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 strong cash flow, which it reinvests in the acquisition of new products, offsetting the structural earnings decline in its existing portfolio.

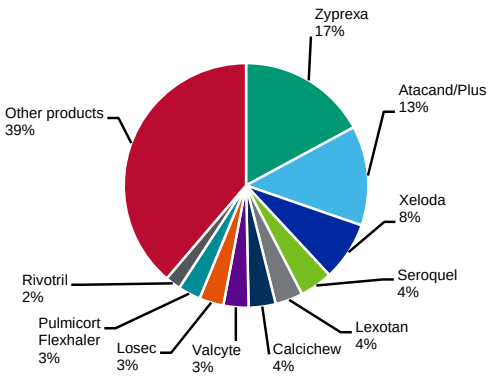
The group owns a portfolio of more than 150 products, which it distributes in more than 145 countries. It generated €1,547 million in revenue and €713 million in EBITDA, on a reported basis, in the 12 months that ended September 2024. Cheplapharm is 50:50 owned by its Co-CEO Sebastian Braun and the chief scientific officer Bianca Juha, siblings who took over the company in 2003.

Exhibit 3
Revenue breakdown by geography (for the 12 months that ended September 2024)



Source: Company filings

Exhibit 4
Company commercial EBITDA breakdown by product (for the 12 months that ended September 2024)



Source: Company filings

Detailed credit considerations

Cheplapharm's business model involves frequent acquisitions to maintain growth; high profitability supports solid operating cash flow

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. 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 the marketing authorisation and industrial transfers 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 to avoid supply disruptions. An unexpected delay in the transfers 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 free cash flow (FCF) before acquisitions, 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 an average 3%-5% annual organic 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 Limited (B2 stable) and Pharmanovia Bidco Limited (B2 stable). Cheplapharm's product portfolio mainly comprises legacy branded off-patent products, which generally have very good market acceptance and relatively good visibility into sales erosion. However, the company's strategy has been more acquisitive than that of its peers.

Cheplapharm's highly acquisitive growth strategy and very rapid growth have strained its organisational structure, leading to operational issues

Cheplapharm has been facing widening operational issues over the past year, affecting a broad range of its products and leading to a substantially steeper decline in its EBITDA in Q3 2024, both on a year-over-year and sequential bases. These issues are primarily the result of the company's exceptionally rapid growth through multiple acquisitions in recent years. This rapid growth has strained the company's organisational structure and management resources, and notably led to product availability issues and delays in technical transfers from recent acquisitions.

Cheplapharm has very rapidly expanded its size through multiple debt-funded acquisitions, increasing its revenue sharply to €1.5 billion by 2023 from €0.6 billion in 2020 and its Moody's-adjusted debt to €4.1 billion from €2.6 billion over the same period. Cheplapharm's largest transaction was the acquisition in 2023 of the worldwide commercial rights for Zyprexa from Eli Lilly and Company (Lilly, A1 positive) for a total consideration of $1,351 million (about €1.2 billion).

During the 12 months that ended September 2024, the reduced availability of key products directly hurt Cheplapharm's revenue stream. Integration challenges as a result of the exceptionally rapid growth of the company through multiple acquisitions have further compounded these issues, preventing the company from realising the full benefits of the recent acquisitions. Additionally, the company has faced some market-driven obstacles, such as increased competition and reimbursement losses. The cumulative effect of these issues has led to a significant decrease in EBITDA, particularly pronounced in Q3 2024. Cheplapharm has estimated that these operational issues resulted in a €156 million, or 17%, decline in its adjusted EBITDA in the 12 months that ended September 2024. Such trends will continue to weigh on the company's performance in the next 12-18 months.

The current operational issues that Cheplapharm is facing include a one-year delay in the transfer of the Zyprexa drug production to its contract development and manufacturing organization (CDMO) network and product availability issues with ZypAdhera. The Zyprexa franchise includes four products with different dosage forms (oral and injectable) indicated for the treatment of schizophrenia and bipolar disorders. Oral forms are facing generic competition unlike the main injectable form, ZypAdhera, although it is likely to face increased competition by 2026. In the 12 months that ended September 2024, the Zyprexa franchise represented about 17% of

Cheplapharm's commercial EBITDA (gross profit minus selling and distribution costs). The acquisition entailed significant execution risks because of a large number of marketing authorisations (about 300 in 53 countries) and a complex supply chain.

Remediation of operational issues likely to take time and credit metrics to remain weak in the next 12-18 months

Cheplapharm is still in the process of assessing the full magnitude of these operational issues and has engaged consultancy firms to support this task. While Cheplapharm has started to implement some remediation measures, we expect these to take time to materialise and its credit metrics to remain weak in the next 12-18 months. It also announced in December 2024 that its shareholder and former co-CEO, Sebastian Braun, has returned as co-CEO to focus on the supply chain issues, and that it will adopt a highly selective approach to M&A until its operations stabilise.

Under our current forecasts, we project that Cheplapharm's leverage (Moody's-adjusted debt/EBITDA) will reach about 6.5x in 2024 and stay elevated in the next 12-18 months, at levels in line with a B3 rating. Assuming no new acquisitions, we expect positive FCF in 2025, estimated between €100 million and €150 million.

To counteract the annual earnings decline in its current drug portfolio and to expand its business, the company is likely to resume mergers and acquisitions (M&A) and pursue drug portfolio acquisitions, as these actions are integral to its strategy. Cheplapharm generally acquires drugs at revenue multiples of 2x-4x and it targets acquisitions with a maximum 6.5 years of return on investment.

Good therapeutic and geographical diversification, with modest product concentration

Cheplapharm's products are used in a wide range of therapeutic areas, with the largest categories being cardiology, and mental and sleeping disorders. Cheplapharm has modest product concentration: in the 12 months that ended September 2024, its two largest franchises, Zyprexa and Atacand, represented about 17% and 13%, respectively, of its commercial EBITDA.

Europe is still the largest market for Cheplapharm, accounting for 53% of its revenue in the 12 months that ended September 2024, although this share has been declining over recent years and the company benefits from good country diversification within the continent. 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 generally less than 5%.

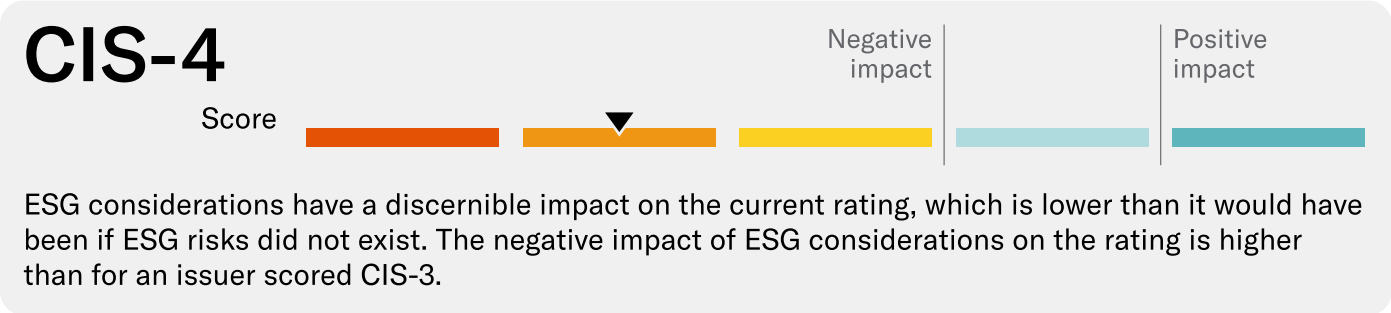
Cheplapharm's reported numbers can distort geographical diversification because some drugs are still subject to a TSA, which implies that the company that sold these products to Cheplapharm still commercialises them. In such cases, the company books sales under the country of origin of the seller and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

In the past year, Cheplapharm has faced operational challenges, including product availability constraints and rising stock prices for several products. Recently, these issues have broadened to encompass delays in transferring manufacturing processes from the seller to Cheplapharm's CDMO network. Cheplapharm's strategy depends on earning the trust of larger pharmaceutical companies to sell their products to it. Persistent operational issues could impair Cheplapharm's reputation, undermining its capacity to source new products. Cheplapharm does not dual-source its products but it can apply for two supplier sources in the dossiers for the application of marketing authorisations, which reduces the switching time between suppliers if needed.

ESG considerations

Cheplapharm Arzneimittel GmbH's ESG credit impact score is CIS-4

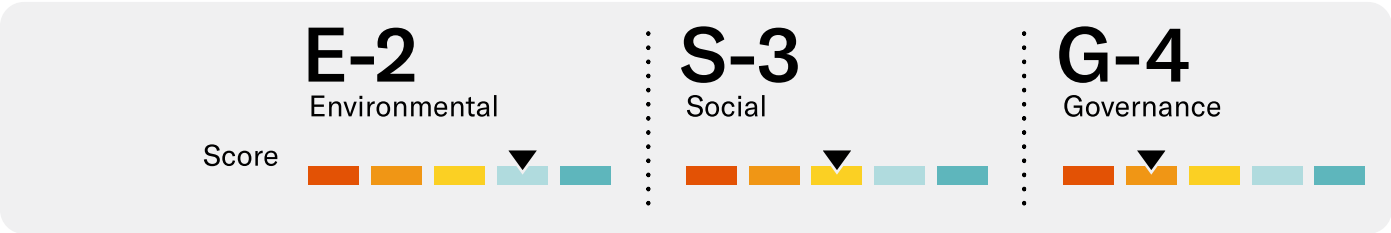
Exhibit 5
ESG credit impact score



Source: Moody's Ratings

CIS-4. Cheplapharm's score indicates the rating is lower than it would have been if ESG risk exposures did not exist. This mostly reflects governance-related risks from the company's rapid growth through debt-funded acquisitions which has resulted in some operational challenges and elevated leverage.

Exhibit 6
ESG issuer profile scores



Source: Moody's Ratings

Environmental

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

Social

S-3. Cheplapharm's score reflects industry-wide risk exposures related to litigation, pricing and high manufacturing compliance standards, but the company's diversified product portfolio which essentially comprises off-patent drugs that have been on the market for many years mitigates 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. Recent widespread operational challenges have stemmed from the company's aggressive M&A strategy, which has strained organisational and management resources, leading to challenges and bottlenecks in integration of recent acquisitions. The **G-4** score also considers the concentrated ownership of the company.

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.

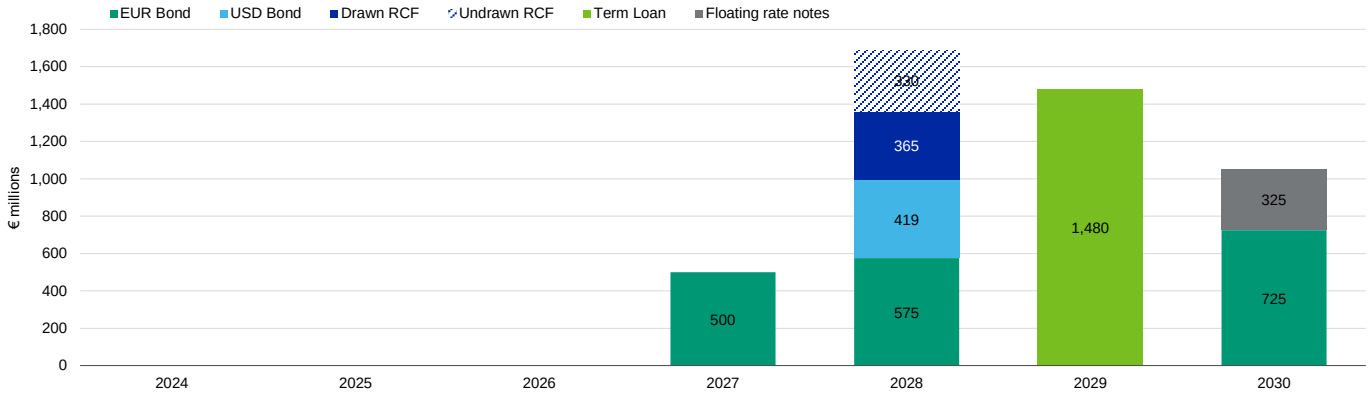
Liquidity analysis

We expect Cheplapharm's liquidity to remain adequate in the next 12-18 months. The company had a cash balance of €399 million as of 30 September 2024, and we expect it to generate FCF of €100 million-€150 million in the next year. Cheplapharm's next large debt maturity is its €500 million senior secured notes due February 2027.

Exhibit 7

Cheplapharm does not face any large maturity before 2027

Debt maturity profile



€695 million corresponds to the company's RCF, of which €365 was drawn as of the end of September 2024.
As of 30 September 2024.
Source: Company filings

Cheplapharm possesses a €695 million senior secured revolving credit facility (RCF) with a springing maturity. This maturity is contingent upon the refinancing timeline of the existing senior secured notes due in 2027 and 2028, ensuring the RCF's maturity precedes that of any 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. The RCF was drawn at €365 million as of 30 September 2024 and the covenant was therefore tested. Cheplapharm is currently within its covenant limit, with a covenant ratio of 5.1x, although its margin for compliance has been narrowing. We expect the company to have adequate liquidity sources to decrease its reliance on the RCF to under 40%. However, a further increase in leverage could restrict its RCF access to only 40% of its total capacity.

Structural considerations

Cheplapharm's debt comprises a senior secured term loan B and senior secured notes, as well as a senior secured RCF, all rated B3 in line with the CFR. All these debt instruments have been issued by Cheplapharm, which is also the main operating company of the group, and they share the same collateral, which includes a first-priority pledge over Cheplapharm's shares, as well as pledges over bank accounts and intercompany receivables. We view this security package as relatively weak and therefore consider these debt instruments unsecured in our Loss Given Default analysis. We use a family recovery rate of 50% appropriate for a debt structure comprising bank and bond debts. Cheplapharm's capital structure also comprises €500 million of shareholder loans, which we treat as equity.

Methodology and scorecard

The principal methodology used in these ratings was our Pharmaceuticals rating methodology. The B3 rating assigned to Cheplapharm is one notch below the scorecard-indicated outcome based on our forward-looking view, and reflects the execution risks related to the remediation of the company's current operational issues and the integration of its recent acquisitions.

Exhibit 8

Rating factors

Cheplapharm SE

Pharmaceutical Industry Scorecard	Current LTM Jun-24		Moody's 12-18 month forward view	
Factor 1 : Scale (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue ($ billions)	1.7	B	1.6 - 1.7	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	Ba	Ba	Ba	Ba
d) Pipeline Quality	Caa	Caa	Caa	Caa
Factor 3 : Leverage & Cash Coverage (25%)				
a) Debt / EBITDA	5.4x	B	6.3x - 6.7x	Caa
b) CFO / Debt	4.4%	Caa	4% - 7%	B
c) Pharmaceutical Cash Coverage of Debt	7.5%	B	4% - 7%	B
Factor 4 : Financial Policy (10%)				
a) Financial Policy	B	B	B	B
Rating:				
a) Scorecard-Indicated Outcome		B1		B2
b) Actual Rating Assigned				B3

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Sources: Moody's Financial Metrics™ and Moody's Ratings forecasts

Appendix

Exhibit 9

Peer comparison

Cheplapharm SE

Pharmaceuticals Scorecard	Cheplapharm Arzneimittel GmbH	Grünenthal Pharma GmbH & Co. KG	Theramex (Stars UK Bidco Ltd)	Pharmanovia (Atnahs Pharma UK Limited)	ADVANZ PHARMA Holdco Ltd
Period	Forward view as of Dec-24	Forward view as of Apr-24	Forward view as of Sep-24	Forward view as of Jan-24	Forward view as of Oct-24
Actual Rating Assigned	B3	B1	B2	B2	B2
Indicated Outcome from Scorecard	B2	Ba3	B2	B2	B1
Revenue ($ billions)	1.6 - 1.7	1.8	0.5	0.4 - 0.5	0.9 - 1.0
Product and Therapeutic Diversity	Ba	Ba	Ba	B	Ba
Geographic Diversity	Baa	Baa	Ba	Baa	Ba
Patent Exposures	Ba	B	Ba	Baa	Ba
Pipeline Quality	Caa	Caa	B	Caa	B
Debt/EBITDA	6.3x - 6.7x	3.5x - 4.0x	5.8x - 6.3x	5.4x - 5.6x	5.0x - 5.5x
Cash Flow from Operations/Debt	4% - 7%	13% - 17%	4.5% - 7.5%	10% - 15%	10% - 13%
Parmaceutical Cash Coverage of Debt	4% - 7%	20% - 30%	7% - 12%	5% - 10%	28% - 35%
Financial Policy	B	Ba	B	B	B

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Rated entity - Cheplapharm Arzneimittel GmbH, Theramex and Pharmanovia Bidco Limited, financials under entity Cheplapharm SE, Stars UK Bidco Ltd and Atnahs Pharma UK Limited respectively.
Source: Moody's Financial Metrics™

Exhibit 10

Moody's-adjusted debt reconciliation

Cheplapharm SE

(in € millions)	2019	2020	2021	2022	2023	LTM Jun-24
As reported debt	**1,385.6**	**2,620.0**	**2,727.0**	**3,046.2**	**4,243.0**	**4,318.3**
Hybrid Securities	-	-	-	-	(168.5)	(159.5)
Non-Standard Adjustments	13.4	-	-	-	-	-
Moody's-adjusted debt	**1,399.0**	**2,620.0**	**2,727.0**	**3,046.2**	**4,074.5**	**4,158.8**

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Source: Moody's Financial Metrics™

Exhibit 11

Moody's-adjusted EBITDA reconciliation

Cheplapharm SE

(in € millions)	2019	2020	2021	2022	2023	LTM Jun-24
As reported EBITDA	**277.7**	**362.1**	**618.9**	**779.1**	**736.4**	**766.6**
Unusual	3.8	13.2	7.4	(90.9)	-	-
Moody's-adjusted EBITDA	**281.5**	**375.3**	**626.3**	**688.2**	**736.4**	**766.6**

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Source: Moody's Financial Metrics™

Exhibit 12

Overview on select historical and forecast Moody's-adjusted financial data

Cheplapharm SE

(in € millions)	2019	2020	2021	2022	2023	LTM Jun-24	2024F	2025F
INCOME STATEMENT								
Revenue	507	640	1,082	1,279	1,498	1,608	1,500	1,480
EBITDA	282	375	626	688	736	767	660	614
EBIT	126	170	296	305	252	203	132	93
BALANCE SHEET								
Cash & Cash Equivalents	26	93	97	160	534	312	201	151
Total Debt	1,399	2,620	2,727	3,046	4,074	4,159	4,349	4,174
CASH FLOW								
Retained Cash Flow	216	259	438	468	536	533	348	327
RCF / Debt	15.5%	9.9%	16.1%	15.4%	13.2%	12.8%	8.0%	7.8%
FCF before acq. of intangibles	133	218	292	438	325	152	95	175
FCF / Debt	9.5%	8.3%	10.7%	14.4%	8.0%	3.6%	2.2%	4.2%
FCF after acq. of intangibles	(589)	(941)	(216)	(157)	(1,162)	(1,203)	(609)	125
FCF / Debt	-42.1%	-35.9%	-7.9%	-5.2%	-28.5%	-28.9%	-14.0%	3.0%
PROFITABILITY								
% Change in Sales (YoY)	61.2%	26.1%	69.2%	18.3%	17.1%	16.3%	0.1%	-1.3%
EBIT Margin	24.8%	26.6%	27.3%	23.9%	16.8%	12.6%	8.8%	6.3%
EBITDA Margin	55.5%	58.7%	57.9%	53.8%	49.1%	47.7%	44.0%	41.5%
INTEREST COVERAGE								
EBIT / Interest Expense	2.3x	1.9x	2.2x	1.5x	1.1x	0.7x	0.5x	0.3x
EBITDA / Interest Expense	5.2x	4.3x	4.6x	3.4x	3.1x	2.7x	2.3x	2.2x
LEVERAGE								
Debt / EBITDA	5.0x	7.0x	4.4x	4.4x	5.5x	5.4x	6.6x	6.8x
Net Debt / EBITDA	4.9x	6.7x	4.2x	4.2x	4.8x	5.0x	6.3x	6.6x

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All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated. LTM = Last 12 months.
Rated entity - Cheplapharm Arzneimittel GmbH, financials under entity Cheplapharm SE.
Source: Moody's Financial Metrics™

Ratings

Exhibit 13

Category	Moody's Rating
CHEPLAPHARM ARZNEIMITTEL GMBH	
Outlook	Stable
Corporate Family Rating	B3
Sr Sec Bank Credit Facility -Dom Curr	B3
Senior Secured	B3/LGD4

Source: Moody's Ratings

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454