

**Rating Action: Moody's affirms Cheplapharm's CFR at B1, outlook changed to negative**

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28 May 2019

Frankfurt am Main, May 28, 2019 -- Moody's Investors Service ("Moody's") has today affirmed the Corporate family rating and Probability of default rating of Cheplapharm Arzneimittel GmbH ('Cheplapharm') at B1 and B1-PD respectively. Concurrently we have assigned a new B1 instrument rating to the proposed €980 million of new senior secured term loan B3 and a B1 rating to the new €310 million of senior secured revolving credit facility (RCF). Moody's would expect to withdraw the legacy instrument ratings of the term loan B1, term loan B2 and revolving credit facility once the proposed transaction will have been closed and the legacy term loans repaid. The outlook has been changed to negative from stable.

**RATINGS RATIONALE**

The affirmation of Cheplapharm's CFR at B1 reflects the company's solid operating performance and cash flow generation during the course of fiscal year 2018 and at the start of 2019. The company's reported EBITDA exceeded budget by 14% in 2018 to reach €167 million and by 23% in Q1 2019 to reach €65 million for the quarter. The acquisitions made since the initial rating in June 2018 have strengthened the group's product and therapeutic diversity, reducing the group's exposure to single off patent legacy drugs that are losing volumes against generic competition over time.

Cheplapharm also managed to continue transferring marketing authorizations of key products acquired over the last two years according to schedule. This is important for the group's future profitability as Cheplapharm can only start implementing its product lifecycle management initiatives once the marketing authorizations have been transferred. The timely transfer of authorizations is also key in establishing a track record of a reliable buyer for large pharmaceutical companies willing to divest legacy off patent products.

The negative outlook is prompted by the very rapid pace of external growth and by the renegotiation of both the net senior secured and total net leverage incurrence test levels in the senior facilities agreement, which is contrary to what Moody's had expected when the rating was set.

Cheplapharm has significantly accelerated its pace of growth over the last 12 months and has further acquisition prospects in the pipeline for the next 6 to 12 months. We believe that this pace of growth might stretch the group's ability to cope with it. We positively note that Cheplapharm has materially increased its headcount across the entire organisation in recent months to ensure the successful transfer of marketing authorization of acquired products across all countries. However this newly hired qualified personnel needs time to get up to speed in a fast growing organisation. . The large number of acquisitions also leads to a lack of deleveraging between the acquisitions and a significant increase in the overall indebtedness of the group.

The renegotiation of the net senior secured and total net leverage incurrence debt with an increase to 4.5x from 4.0x and to 5.5x from 4.75x respectively could signal a departure from the previously more conservative financial policy commitment that strongly underpinned the B1 rating of Cheplapharm. Moody's will closely monitor whether Cheplapharm uses the increased headroom under its facilities agreement to even further accelerate the pace of growth and increase leverage over time.

**LIQUIDITY**

The liquidity profile of Cheplapharm pro-forma of the proposed transaction will be solid. The company had approximately €46 million of cash on balance sheet at 31st March 2019 and will have full access to the undrawn €310 million revolving credit facility (pro-forma of the transaction Cheplapharm will fully repay its RCF). Coupled with a solid operating cash flow generation (pre working capital) this should be more than sufficient to fund modest cash uses mainly consisting of working capital and capex. We would expect Cheplapharm to use its strong liquidity position to grow its business through further product acquisitions.

**STRUCTURAL CONSIDERATIONS**

The pro-forma capital structure of Cheplapharm will mainly consist of senior secured bank debt. The term loan

amounting to €980 million and the €310 million RCF will rank pari passu and be secured over the same security package. There are certain operating subsidiaries of Cheplapharm Arzneimittel GmbH, which are outside of the restricted group. Under the senior facilities agreement, Cheplapharm can give up to €10 million guarantees to these non-restricted subsidiaries, which we have added to our Moody's adjusted debt.

We have also included in our adjusted debt a shareholder loan where Cheplapharm can elect to pay interest in cash to our adjusted debt. The shareholder loan also offers some loss absorption in a default scenario hence we have included it in our waterfall. The small size of this instrument (~€32 million) does not lead to an uplift of the senior secured instrument ratings from the corporate family ratings.

We have used a family recovery rate of 50% despite an all bank debt structure due to the covenant lite package offered to lenders.

#### WHAT COULD CHANGE THE RATING UP / DOWN

Positive rating pressure is not considered in the short term. Positive pressure would build if leverage as measured by Debt/EBITDA would drop towards 3.5x. A higher rating would also require a further diversification of the group's portfolio of drugs coupled with an increase in size of the company.

Negative pressure would build if leverage as measured by pro forma debt/EBITDA would increase sustainably above 4.5x, or if reported debt/EBITDA would remain sustainably above 5.0x (estimated at 5.5x as per 31st December 2018). The continued rapid pace of acquisitions raises the question whether Cheplapharm will ever achieve a reported leverage that would get closer to the pro forma leverage hence our approach to monitor leverage both on a pro forma and reported basis. A deterioration in the group's profitability with EBITDA margins to drop materially and sustainably below 45% could lead to negative pressure on the rating. Beyond quantitative factors any delay in marketing authorization transfers or sharp deterioration in the profitability of products post TSA period indicating that Cheplapharm is not running its business model effectively could lead to negative rating pressure. A deterioration of the group's liquidity profile could also exert negative pressure on the ratings.

#### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Pharmaceutical Industry published in June 2017. Please see the Rating Methodologies page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

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