MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns B2 rating to Cheplapharm's new senior secured term loan

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Paris, February 07, 2022 -- Moody's Investors Service (Moody's) has today assigned B2 ratings to the new senior secured term loan B (TLB) and senior secured revolving credit facility (RCF) issued by Cheplapharm Arzneimittel GmbH ("Cheplapharm", "the company" or "the group"). The outlook is stable.

Cheplapharm intends to issue a new €1,480 million senior secured term loan B due 2029 and will use most of the proceeds to repay its existing €980 million senior secured term loan B4 due 2025. The remaining €500 million proceeds will be used to partially repay RCF drawings, which amounted to €253 million as of 30 September 2021, and partially fund recently signed acquisitions. At the end of 2021, Cheplapharm had closed acquisitions totaling approximately €355 million and signed definitive agreements for investments of €565 million. At the same time, Cheplapharm also intends to refinance its existing senior secured RCF with a new six-year €450 million senior secured RCF.

RATINGS RATIONALE

The assignment of a B2 rating to the new senior secured TLB considers that, pro forma the planned refinancing and recent acquisitions, Cheplapharm's credit metrics will meet the requirements for the B2 rating, which include a Moody's-adjusted (gross) debt / EBITDA between 4.5x and 5.5x.

In 2021, Cheplapharm performed in line with its guidance and continued to successfully integrate acquisitions closed in late 2020 and early 2021. While there continue to be risks associated with integrating acquisitions, Moody's expects the company will grow Moody's-adjusted EBITDA to close to €650 million in 2021 compared with €370 million in 2020, resulting in Moody's-adjusted (gross) leverage of around 4.5x by year-end 2021, down from 7.1x at the end of 2020.

Cheplapharm's B2 rating continues to reflect its good therapeutic and geographical diversity; a good track record in the timely transfer of marketing authorizations from pharmaceutical companies for products acquired; and the generation of strong cash flow from operations (CFO) and free cash flow (FCF), supported by the company's asset light business model.

The B2 rating remains constrained by the company's structural earnings decline in its existing off-patent product portfolio, which prompts the company to make ongoing product acquisitions to maintain or grow revenues; its relatively short track record of working with well-recognized pharmaceutical companies; an aggressive financial policy, with multiple debt-funded acquisitions undertaken in recent years, which increased its gross debt sharply to €2.8 billion at the end of September 2021 from €0.9 billion at the end of 2018.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Cheplapharm will continue to successfully deliver on the integration of its acquired portfolio of drugs in the next 12 to 18 months and operate with credit ratios commensurate with the B2 rating. Moody's also expects that the company will continue to generate strong CFO to offset rising debt levels.

LIQUIDITY

Based on data as of 30 September 2021 and pro forma the refinancing, Cheplapharm would have a cash balance of about €70 million and about €360 million available under its €450 million senior secured RCF. Moreover, Moody's forecasts that Cheplapharm will generate €350 million to €400 million of Moody's-adjusted FCF (before acquisitions) over the next 12 months. Depending on when recently signed acquisitions will be paid, Cheplapharm could still need to raise additional funds to fund its acquisitions. Following the refinancing, the next material debt maturity will be the €500 million guaranteed senior secured notes due 2027.

STRUCTURAL CONSIDERATIONS

Pro forma the refinancing, the company's capital structure comprises a €1,480 million senior secured term loan B, three tranches of €500 million due 2027, €575 million due 2028 and $500 million due 2028 guaranteed senior secured notes, as well as a €450 million 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 as well as pledges over bank accounts and intercompany receivables. Moody's views this security package as relatively weak and therefore considers these debt instruments as unsecured in its loss given default analysis.

Cheplapharm's Moody's-adjusted debt also includes a small shareholder loan (around €30 million) that ranks behind the senior secured instruments in the waterfall.

Moody's uses a family recovery rate of 50%, which is appropriate for a debt structure comprising bank and bond debt.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A positive rating action would require that Cheplapharm maintains its Moody's-adjusted (gross) debt/EBITDA ratio below 4.5x and its CFO/debt ratio above 15% on a sustained basis. An upgrade would also require the company to show commitment to more moderate acquisitions in terms of size and in their financing to ensure that the company limits the impact on its credit metrics.

Conversely, Moody's may downgrade Cheplapharm's rating if it does not maintain a Moody's-adjusted debt/EBITDA ratio pro forma acquisitions comfortably below 5.5x, or if its CFO/debt ratio declines below 10% for a prolonged period. Failing to maintain adequate liquidity, including a well spread debt maturity profile, could also trigger a rating downgrade.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Pharmaceuticals published in November 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1285013 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

COMPANY 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 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 into 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 over 145 countries. It generated €793 million in revenue and €484 million in EBITDA, on a reported basis, in the nine months ended 30 September 2021. Cheplapharm is 50:50 owned by Sebastian Braun (Co-CEO of the group) and Bianca Juha (Chief Scientific Officer).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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