Application Study: European Pharmaceuticals

This study assesses the credit quality of European pharmaceutical corporates, following the release of Scope's Rating Methodology for European Pharmaceutical Corporates on 16 January 2016. Seventeen corporates were selected from a wider peer group and represent a cluster of 'innovative' and 'generic' types, as well as different company sizes. None of these companies have been rated by Scope, therefore it has derived indicative credit assessments based on public information and without projecting into the future.

Scope Ratings expects the credit quality of most European pharmaceutical companies to continue to be at least stable over the coming two years. This is based on an increasingly positive 'innovative balance' (ability to replace negative patent expiry effects with newly approved products) as well as our perception of the good chances of realising above-GDP growth for the innovative arm. As already visible in 2015, late-stage pipelines continue to deliver on innovative content, enabling innovators to maintain high selling prices, at least in the US. Our positive view also reflects our belief that most larger companies have reasonable financial policies, which enable management to realise potential acquisitions, without jeopardising the rating.

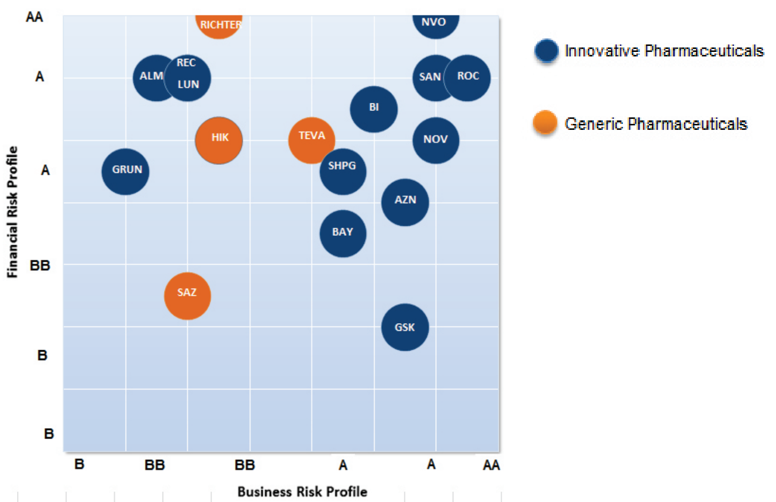
In the case of the generic segment, we see more challenges compared to the innovative, as pricing pressures persist and players need to find profitable niches, or get ready for the 'biosimilars' opportunity, to stem the industry trend towards commoditisation.

Credit quality of assessed corporates

The credit quality of the corporates assessed varies widely, differing by the quality and protection of business risk profiles as well as by financial policy definitions. While large multinational pharmaceutical corporates can still attain very high ratings, smaller and less protected companies remain in the non-investment grade territory. Financial risk metrics are fairly independent from companies' relative sizes, although the larger ones are generally more profitable and cash-rich.

Figure 1 shows Scope's indicative assessment of the credit quality of selected European pharmaceutical corporates. Business and financial risk profiles are combined depending on the rating level (business risk profiles are weighted more for investment grade and vice versa), and finally determined by the rating committee.

Figure 1: Indicative credit assessment of selected corporates in wider peer group



Source: Scope Ratings

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Related Research

Rating Methodology: European Pharmaceuticals
January 2016

European Corporate Outlook,
February 2016

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Bloomberg: SCOP

Main geographic focus	Europe
Inhouse specialist expertise	Yes
Production/distribution	EUR
First-to-file history	No
Products launched	23
Regulatory track record	good

Gedeon Richter plc ('Richter') is a generic company, but strongly committed to R&D and innovative drugs. It is the largest pharma company in Central and Eastern Europe (CEE). As a relatively small player on a global scale, Richter has a flexible approach between inhouse developed and in-licensed products. The business model focuses on only three treatment areas. Richter is the third-largest supplier with about 5% of the Hungarian pharma market, and is a significant player in female healthcare. The company also has a small wholesale and retail pharma business.

Business risk profile

Company in transition

Based on management's stated strategy, Richter sees itself as innovation-driven. This is reflected in the existing clinical pipeline and the recent approval of its anti-schizophrenia drug, VRAYLAR, in the US. However, its main commercial exposure is to off-patent generic products and the company is currently developing two biosimilars. Thus, judged by its present structure, we allocate Richter to the generic industry, although it is by no means a pure play. Based on our reasoning below, we view its business risk profile at a BBB.

Focused European/CIS player, diversified pharma company

Richter is CEE's biggest pharma. With about one-third of group sales in 2015, the CIS region continues its prominence. Western Europe and CIS accounted for almost 85% of group sales, while the US, Asia and emerging markets are underrepresented. Its product portfolio focuses on three important areas: gynaecology, CNS and cardiovascular, which account for about 70% of group sales combined. Richter's diversified group structure (innovative, generic, wholesale) provides another benefit from a rating assessment view.

Thin pipeline – flexible R&D approach

In 2015, R&D spend was below 10% of revenues. We view this as in line with a generic company, but regarding its strategy to focus on innovation, it compares unfavourably to peers, in our view. The clinical pipeline appears to be thin, with 2 NMEs in late-stage development. However, it has led to the recent approval of a schizophrenia drug, a rather specialised treatment area. From a ratings point of view, we view positively the inhouse development of two biosimilar drugs, as competitive pressure is much less severe in this area compared to traditional generics. In 2014, Richter launched 23 new products, which compares unfavourably to peers.

Good profitability

Richter generated a relatively high EBITDA margin of 27% in 2015, strongly improving over 2014. If sustainable, we believe this will give strong support from a ratings point of view and compare favourably to peers.

Financial risk profile

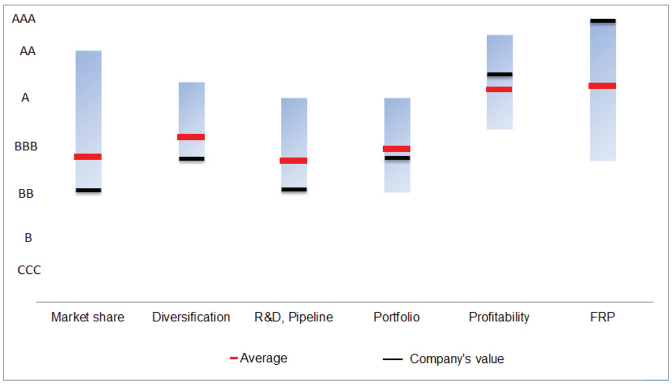
Excellent debt protection measure s

The company continues to have a net cash position due to consistent, and even increasing, free cash flow generation over time, yielding a financial risk profile in the AAA category.

Scope's credit quality assessment

Figures in HUF m	2012	2013	2014	2015	in EUR m
Revenues	326,702	351,424	353,709	365,220	1,179
EBITDA	75,979	75,524	67,110	98,665	318
EBITDA margin	23.3%	21.5%	19.0%	27.0%	
Funds from operations (FFO)	73,182	76,253	60,066	92,022	297
Free cash flow (FCF)	12,604	15,278	24,131	66,511	215
Net debt	-28,194	-44,721	-39,260	-88,663	-286
FFO/net debt	-260%	-171%	-153%	-104%	
Net debt/EBITDA	0	-1	-1	-1	
FFO-interest cover	75,979	75,524	67,110	98,665	

Source: Gedeon Richter, Scope Ratings



Source: Scope Ratings

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