Richter Gedeon Nyrt
Hungary, Pharmaceuticals

SCOPE BBB+ STABLE

Corporate profile

Richter Gedeon Nyrt. (Richter) is a leading pharmaceutical company in Central and Eastern Europe. Richter has two main segments: i) pharmaceuticals, comprising research and development, manufacturing, and sales and marketing of pharmaceutical products as its core segment; and ii) wholesale and retail distribution of these products. A group of Richter companies provides auxiliary services for the two core segments. Richter focuses on areas where it has specialised knowledge: central nervous system disorders in original research, women's healthcare, and biosimilar product development.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	Net cash	Net cash	Net cash	Net cash
Scope-adjusted debt (SaD)/EBITDA	Net cash	Net cash	Net cash	Net cash
Scope-adjusted funds from operations/SaD	Net cash	Net cash	Net cash	Net cash
Free operating cash flow/SaD	Net cash	Net cash	Net cash	Net cash

Rating rationale

Scope Ratings GmbH (Scope) has today assigned a first-time private issuer rating of BBB+/Stable to Richter Gedeon Nyrt along with a first-time BBB+ senior unsecured debt rating.

The issuer credit rating mainly reflects the group's excellent financial risk profile with a net cash position, solid competitive position in speciality innovative and generic pharmaceuticals, and good prospects for growth and cash generation. The rating also reflects the company's current net cash position and conservative financial policy. As we expect innovative pharma to eventually contribute three-quarters of group profits, the rating mainly reflects this segment's credit characteristics. We also consider the company's wholesale and retail activities to be non-core and have therefore excluded them from our assessment. Richter plans to issue a HUF 70bn senior unsecured corporate bond under the Bond Funding for Growth Scheme of the Hungarian Central Bank later in 2021. The bond will have 10-year tenor with amortisation of 10% in each of the years 7-9 and 70% in year 10. The bond will have annual fixed coupon and the proceeds will be used for general corporate financing.

Outlook and rating-change drivers

The Stable Outlook reflects Richter's ability to grow without its financial risk profile deteriorating significantly, as expressed by a close to net cash position.

A negative rating action could be triggered by a switch to an aggressive financial policy. It could also follow a deterioration of credit metrics, e.g. if SaD/EBITDA were to increase towards 1.5x on a sustained basis.

A positive rating action is remote but could be warranted if the innovative business grows in size, strengthening diversification.

Ratings & Outlook

Corporate rating	BBB+/Stable
Senior unsecured rating	BBB+

Analyst

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Related Methodologies

Corporate Rating Methodology, February 2020

Rating Methodology European Pharmaceuticals January 2021

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Rating drivers

Positive rating drivers	Negative rating drivers
• Net cash position • Significant growth potential thanks to Vraylar royalty • Protection afforded by speciality pharma focus • High profitability • Conservative financial policy	• Product concentration, specifically an earnings reliance on one product • Execution risk related to pipeline delivery and inorganic growth • FX developments (RUB and USD vs HUF) • Costs associated with transition towards speciality products • Pharmaceutical industry's reputational and regulatory risks (ESG factor)

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Increasing exposure to innovative products leading to stronger diversification	• A shift towards an aggressive financial policy • SaD/EBITDA increasing towards 1.5x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	Net cash	Net cash	Net cash	Net cash
SaD/EBITDA	Net cash	Net cash	Net cash	Net cash
Scope-adjusted funds from operations/SaD	Net cash	Net cash	Net cash	Net cash
Free operating cash flow/SaD	Net cash	Net cash	Net cash	Net cash
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	79,216	154,935	149,695	178,825
Operating lease payments in respective year	-	-	-	-
Other	-	-		
Scope-adjusted EBITDA	**79,216**	**154,935**	**149,695**	**178,825**
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	79,216	154,935	149,695	178,825
less: (net) cash interest as per cash flow statement	913	893	978	-1,000
less: cash tax paid as per cash flow statement	-7,360	-7,515	-9,901	-11,084
add: other	-2	2	-3	-3
Scope-adjusted funds from operations	**72,767**	**148,315**	**140,769**	**166,739**
Free operating cash flow in HUF m	**2019**	**2020**	**2021E**	**2022E**
Cash flow from operations	99,129	134,243	130,929	152,271
Capital expenditure (net)	-56,636	-66,206	-77,525	-73,000
Free operating cash flow	**42,493**	**68,037**	**53,404**	**79,271**
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	14,025	14,556	80,754	76,952
less: cash and cash equivalents	-128,573	-142,068	-141,737	-177,161
add: cash not accessible	0	0	0	0
add: pension adjustment	2,466	4,350	4,350	4,350
add: contingent provisions	0	0	0	0
Scope-adjusted debt	**-112,082**	**-123,162**	**-56,633**	**-95,859**

Figures are Scope-adjusted and not necessarily in line with reported numbers.

Business risk profile: BBB-

Increasing focus towards speciality pharma

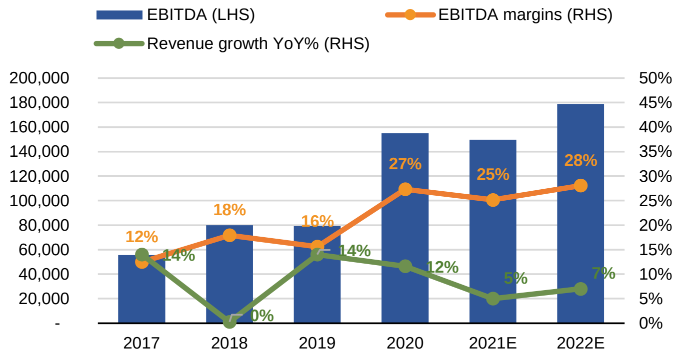
Within the **business risk profile** (assessed at BBB-), the commonality among Richter's pharmaceutical exposures is the focus on speciality drugs, both in the innovative (neurology with Vraylar; women's healthcare and the patch) and generics divisions. Some of its generics products have market shares of well beyond 50% and thus are in no danger of substitution. Management recently stated a future focus on innovative drugs, supported by increasing R&D towards a richer pipeline. This follows the company's success with neurology drug Vraylar (cariprazine), outlicensed to Abbvie Inc in North America and generating almost USD 1bn in revenues in 2020 for the latter.

This is also the reason for Richter's very high profitability, as Abbvie pays a fixed royalty on its North American sales to the company. In 2020, this equated to HUF 79bn which contributed more than half of Richter's group EBITDA in that year. Based on 2020 pharmaceutical sales of HUF 457bn this translates into an EBITDA margin of about 35%. Assuming that the operating margin of the generic activities are below the one for innovative drugs, the underlying EBITDA for this segment is provably higher than 40% (the company does not disclose a divisional profit breakdown). Scope thus believes that the company's profitability level is one of the strongest supports of the business risk assessment. This is even more relevant as sales of Vraylar have significant growth potential and the royalty payments from Abbvie are very likely to increase significantly in the next few years.

Diversification overall is held back by Richter's small scale in an international context and the concentration rate for its largest product (Vraylar) in relation to innovative pharma sales, already high in 2020 at 41% and likely to increase in the near future. On the positive side, the 20% exposure to the US (which is very likely to grow) supports diversification, and its main treatment area exposure (neurology, women's healthcare) is good for Richter's size.

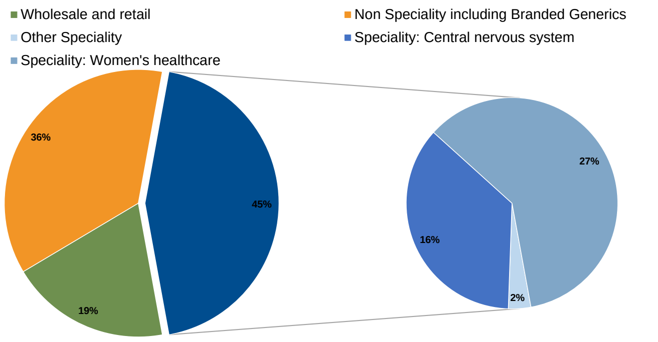
Richter's R&D efforts are good overall (20% of pharmaceutical sales). However, any benefits for our analysis are eroded by Richter's low scores for the breadth of its late-stage pipeline and the number of blockbuster drugs, though both need to be seen in the context of Richter's size. The competitive position assessment benefits from our expectation of very favourable growth, mainly through the revenue potential of Vraylar and other women's healthcare products – as we expect no significant patent expiry in the medium term. Richter's generics division can be assessed as lacking critical scale in the underlying large and very competitive generics market. Scope believes the division's underlying strength lies in the specialist positioning, often accompanied by very high market shares and strong protection due to the dearth of competing products. This also tends to limit pricing pressure for many of Richter's products, in contrast with many other generic products. Thus, Scope estimates the EBITDA margin Richter generates with its generic activities to be significantly higher than the average 25% generated by sizable players. Richter's generics positioning does not meaningfully weaken the credit profile overall as the product portfolio is reasonably protected and geographical diversification is good. Richter has also never had any material regulatory issues in any country, which reflects well on its production and compliance processes. Richter's production and distribution network, often through subsidiaries and partner companies, also appears to service markets well.

Figure 1: Richter evolution in HUF m



Source: Scope estimates

Figure 2: Richter business pillars split based on sales



Source: Scope, Richter

Strong profitability

Richter's operating profitability is thus high for a mid-sized pharmaceutical company, predominantly due to the Abbvie royalties. Its EBITDA margin in 2020 was about 35% overall for pharmaceuticals (excluding wholesale/retail activities) and more than 40% for just the innovative arm (assuming a 25% EBITDA margin on Richter's generics divisions) – which compares favourably even with the majority of big pharma companies.

Financial risk profile: AA

Net cash position driving the financial risk profile

The financial risk profile (assessed at AA) is the strongest driver of the issuer rating. Richter's net cash position has allowed it to self-finance its activities for a few years. The recurring cash inflow from the Vraylar royalty since 2020 is ensuring robust cash generation and will allow Richter to invest into a new innovative pipeline and continue its transition into a specialty innovative pharmaceutical group. The group aims to acquire mature assets that will complement its portfolio, especially in women's healthcare. An example is the recent acquisition of EVRA, a transdermal contraceptive patch, for around HUF 77bn, which will contribute to profits in 2021. Richter's royalty may at least double depending on Abbvie's near-term sales for Vraylar, while our base case scenario assumes single-digit revenue growth. Richter plans to issue a HUF 70bn bond to boost its capacity for acquisitions. The SaD/EBITDA ratio will go up gradually from a net cash position to more than 0.1x in 2023, depending on acquisitions performed in the next three years.

Liquidity is adequate as reflected by the net cash position and the annual operating cash flow of above HUF 130bn.

Conservative financial policy

Among the supplementary rating drivers, financial policy is the most relevant for Richter. While the size of the contemplated bond issuance makes product acquisition likely, management does not appear to be under any time pressure. Thus, a similar transaction like last year's with Johnson & Johnson (EVRA) appears realistic. As the timing and conditions of acquisitions are yet uncertain, Richter's credit metrics have been assessed conservatively, assuming the net cash position is not sustained. We have not applied a downward notch for financial policy, however, as management appears unwilling to take excessive risks on acquisitions.

Richter intends to increase its dividend pay-out in the next years to avoid excess cash accumulation.

Long-term debt rating

Senior unsecured debt has been rated at BBB+, the same level as the issuer rating, reflecting our view of Richter's ability to meet contractual and financial debt obligations as a going concern, on time, and in full out of its operating business.

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