Richter Gedeon Nyrt.
Hungary, Pharmaceuticals

SCOPE BBB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	Net interest income		Net interest income	
Scope-adjusted debt/EBITDA	0.2x	0.0x	0.2x	0.2x
Scope-adjusted funds from operations/debt	>100%	>100%	>100%	>100%
Scope-adjusted free operating cash flow/debt	-1%	>100%	>100%	>100%

Rating rationale

The issuer's rating is supported by the group's efforts to strengthen its exposure to speciality pharmaceuticals, including in neurology through the growth in Vraylar royalties and the successful launch of Cariprazine in several markets. The women's healthcare portfolio continues to contribute the most to the pharmaceutical business, representing more than one-third of sales. Richter aims to become European leader in women's healthcare in the next few years.

The recurring cash inflow from Vraylar royalties since 2020 has ensured robust cash generation. This will allow Richter to invest in a new pipeline and continue its transition to a specialty innovative pharmaceutical group. The group aims to acquire mature assets that complement its portfolio, especially in women's healthcare. However, no target acquisition is on the horizon.

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 in credit metrics, e.g. if Scope-adjusted debt/EBITDA were sustained at towards 1.5x.

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

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
26 Apr 2023	Affirmation	BBB+/Stable
03 May 2022	Affirmation	BBB+/Stable
26 May 2021	New	BBB+/Stable

Ratings & Outlook

Issuer	BBB+/Stable
Senior unsecured debt	BBB+

Analyst

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Related Methodologies and Related Research

General Corporate Rating Methodology, July 2022

Pharmaceuticals Rating Methodology, January 2023

ESG considerations for rating pharmaceutical companies, March 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Almost net cash position • Significant growth potential thanks to Vraylar royalties • Protection afforded by speciality pharma focus • High profitability despite inflation • High efficiency in product innovation and development providing a constant flow of new products that foster human health and well-being (ESG driver)	• Product concentration, specifically an earnings reliance on one product • Execution risk related to pipeline delivery and inorganic growth • Costs associated with transition towards speciality products • Macroeconomic and supply chain challenges • Pharmaceutical industry's reputational and regulatory risks (ESG factor)

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

Corporate profile

Richter Gedeon Nyrt. (Richter) is a Hungarian pharmaceutical company that was founded in Budapest, Hungary in 1901 by Gedeon Richter, a Hungarian pharmacist. Today, the company is one of the largest pharmaceutical manufacturers in Central and Eastern Europe, with operations in more than 40 countries. Richter has two segments: i) pharmaceuticals, comprising research and development, manufacturing, and the sales and marketing of pharmaceutical products; and ii) the wholesale and retail distribution of these products. Richter focuses on areas in which it has specialised knowledge: central nervous system disorders in original research, women's healthcare, and biosimilars product development.

In recent years, Richter has been expanding its operations through strategic partnerships and acquisitions. The company has established joint ventures with other pharmaceutical companies and acquired companies and product lines to expand its portfolio and reach new markets.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	Net interest income			Net interest income		
Scope-adjusted debt/EBITDA	Net cash	0.2x	0.0x	0.2x	0.2x	0.3x
Scope-adjusted funds from operations/debt	Net cash	>100%	>100%	>100%	>100%	>100%
Scope-adjusted free operating cash flow/debt	Net cash	-1%	>100%	>100%	>100%	>100%
Scope-adjusted EBITDA in HUF m						
EBITDA[1]	163,191*	183,345*	221,985	203,032	224,873	233,128
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**163,191**	**183,345**	**221,985**	**203,032**	**224,873**	**233,128**
Funds from operations in HUF mm						
Scope-adjusted EBITDA	163,191	183,345	221,985	203,032	224,873	233,128
less: (net) cash interest paid	284	2,287	6,162	425	375	275
Less: pension interest	0	-122	-122	-122	-122	-122
less: cash tax paid per cash flow statement	-7,515	-8,136	-14,290	-13,300	-15,137	-15,947
add: dividends from associates	2	9	43	0	0	0
Funds from operations (FFO)	**155,962**	**177,383**	**213,778**	**190,034**	**209,989**	**217,333**
Free operating cash flow in HUF m						
Funds from operations	155,962	177,383	213,778	190,034	209,989	217,333
Change in working capital	-21,786	-40,280	-42,058	-16,624	-11,041	-15,505
Non-operating cash flow	261	5,954	25,708	±0	±0	±0
less: capital expenditure (net)	-66,206	-141,440	-68,772	-92,522	-70,000	-70,000
less: lease amortisation	-3,143	-2,055	-4,437	-4,500	-4,500	-4,500
Free operating cash flow (FOCF)	**65,088**	**-438**	**124,219**	**76,388**	**124,448**	**127,329**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	284	2,287	6,162	425	375	275
less: interest expense pensions	0	-122	-122	-122	-122	-122
Net cash interest received (+) / paid (-)	**284**	**2,165**	**6,040**	**303**	**253**	**153**
Scope-adjusted debt in HUF m						
Reported gross financial debt	14,556	87,317	85,226	85,789	86,289	96,789
less: cash and cash equivalents	-142,068	-59,856	-79,719	-43,868	-38,523	-18,630
add: non-accessible cash	0	0	0	0	0	0
add: pension adjustment	4,350	3,824	2,835	2,835	2,835	2,835
Scope-adjusted debt (SaD)	**-123,162**	**31,285**	**8,342**	**44,756**	**50,601**	**80,994**

[1] ** There has been an adjustment to the calculation of Scope-adjusted EBITDA (new information was made available regarding impairments of intangible assets; now excluded from the calculation of Scope-adjusted EBITDA)

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Environmental, social and governance (ESG) profile[2]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Industry related ESG risk

Richter's long record of providing products that contribute to human health and well-being is credit-positive.

However, the high regulatory and reputational risks inherent to the pharmaceuticals sector are credit-negative. The main regulatory risk relates to the potential for large litigation cases, especially in the US. Reputational risk is linked to the perception of unethical pricing and sustainability issues regarding the balancing of patent expiry with new products.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB-

Industry risk profile: A

Richter has a combination of innovative and generics (traditional and biosimilar) businesses. Innovative, consisting of Cariprazine and women's healthcare, has the higher weight in the business split, explained by Richter's drive to expand its innovative business for the near future. The blended industry risk of A is based on a combination of an AA industry risk profile for innovative and a BB for generics.

Increasing focus on speciality drugs

The common factor among the group's pharmaceutical exposures is the speciality focus, both in innovative (neurology with Vraylar; women's healthcare and contraceptive patch Evra) and in generics. Some of Richter's generics products have market shares of well above 50% and are thus in no danger of substitution. Management plans to focus more on innovative drugs and has increased R&D. This new strategy follows the success of Richter's neurology drug Cariprazine. The drug is licensed to AbbVie Inc in North America under the trademark Vraylar and generated around USD 2bn in revenues for AbbVie in 2022. In Europe and other countries, it is sold as Reagila via partners such as Recordati and Hikma.

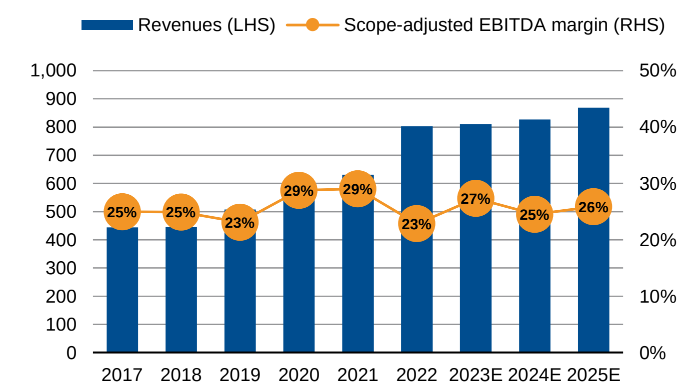
Strong operating profitability for a mid-sized pharma player

Richter's operating profitability is high for a medium-sized pharmaceutical company and the strongest support for the business risk profile. This is predominantly due to the royalties from Vraylar, which contributed materially to group sales and still has significant growth potential. In 2022, the royalties equated to HUF 138bn. Based on 2022 pharmaceutical sales of HUF 656bn, this translates into a Scope-adjusted EBITDA margin of about 35%. Assuming that the generics operating margin is below that for innovative, the underlying Scope-adjusted EBITDA margin for generics is probably higher than 35% (no divisional profit breakdown disclosed).

Increasing operating expenses due to inflation

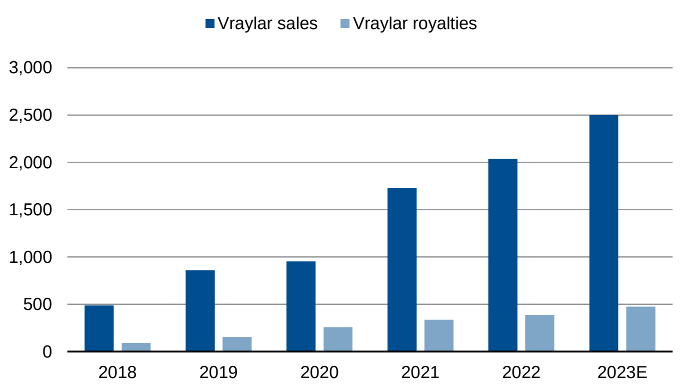
We expect the group's Scope-adjusted EBITDA margin to remain relatively flat despite growth from Vraylar. This will be due to an inflation-induced increase in operating expenses. We note that Hungary's extraordinary tax on the pharmaceutical industry for the years 2022 and 2023 has a limited impact on Richter.

Figure 1: Richter revenues in HUF bn



Sources: Richter, Scope estimates

Figure 2: Vraylar sales evolution in USD m



Sources: Scope estimates, Richter, AbbVie

Strong reliance on Cariprazine

Overall diversification is held back by Richter's small scale in comparison to international peers and the relatively high dependence on its largest product (Cariprazine/Vraylar/ Reagila) in relation to speciality pharmaceutical sales (22% of 2022 sales), that is likely to increase further. On the positive side, the 25% exposure to the US (very likely to grow due to Vraylar) supports diversification. The exposure to neurology and women's healthcare – both representing large addressable markets – are expected to support future sales growth.

US and Russia as the two most important markets

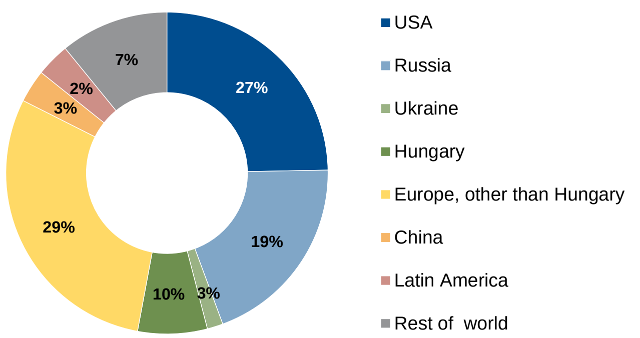
Richter still has a sales exposure to Russia despite diversifying away from Russia in recent years due to the switch to speciality pharmaceuticals. In 2022, Richter earned about HUF 129bn in revenues in Russia, which accounted for 20% of group pharmaceutical sales (17% in 2021). Russia remains Richter's second largest market in terms of sales after the United States. Business in Russia was delayed slighty in the early days of the war between Russia and Ukraine, but shipments have since then broadly returned to the pre-war level. Performance in Russia improved through foreign currency effects, specifically a stronger rouble in parallel with a weaker forint throughout most of the year. The effect was most pronounced when turnover was translated into forint. So far, no sanctions were imposed on pharmaceuticals companies for operating in Russia. Nevertheless, Richter has been reducing its exposure to the Russian market by expanding to Western markets.

Further R&D efforts needed to improve speciality exposure

Richter's R&D efforts are good, at above 15% of pharmaceutical sales. However, any benefits for our analysis are eroded by the group's low scores for the breadth of its late-stage pipeline and number of blockbuster drugs, though both need to be seen in the context of Richter's size. Richter is continuing to make R&D investments with its partners in its major biotechnology and central nervous system projects, where it is reaching significant pre-clinical and clinical milestones.

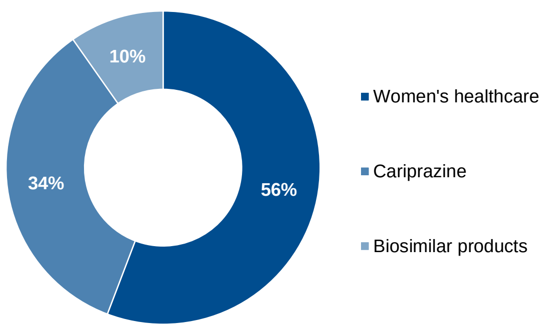
Richter's competitive position assessment benefits from our expectation of very favourable growth, mainly through Vraylar and women's healthcare products, as we expect no significant patent expiry in the medium term.

Figure 3: Geographical split of pharma sales (2022)



Sources: Scope, Richter

Figure 4: Richter speciality business sales split (2022)



Sources: Scope, Richter

Biosimilar focus on rheumatology and osteoporosis

Richter's generics division lacks critical scale in relation to the large and very competitive underlying generics market. The division includes the traditional portfolio, branded generics and biosimilars (which Richter considers part of speciality pharmaceuticals).

During 2022, the company's portfolio of branded generic and traditional products was strengthened with nine product launches and the continued development of generic products. The biosimilars business is focused on the main indications of rheumatology and osteoporosis. Osteoporosis treatment teriparatide/Terrosa reported impressive growth: sales reached HUF 21bn from HUF 13bn in 2021 and global annual sales were in excess of EUR 100m (through Richter and global partners). Richter intends to strengthen its biosimilars portfolio over the coming years with products launched in both osteoporosis and rheumatology after patents expire on the original products. One is a biosimilar of denosumab (Amgen's Prolia and Xgeva) and the other is a tocilizumab biosimilar (Actemra from Roche). Important to note, however, is that biosimilars have significantly higher research and development costs and risks and are more complex to manufacture than small-molecule generics.

Product specialisation limits pricing pressure

We believe the division's underlying strength lies in its specialist positioning, often accompanied by very high market shares and strong protection due to a dearth of competing products. This also tends to limit pricing pressure for many of Richter's products, in contrast with many other generic products. We therefore estimate that the EBITDA margin Richter generates with its generics activities is significantly higher than the 25% average generated by other sizeable players.

Richter's generics positioning does not meaningfully weaken its overall credit profile as its product portfolio is reasonably well protected and its geographical diversification is good. Moreover, Richter has never had material regulatory issues in any country, which reflects well on its production and compliance processes. The group's production and distribution network, often through subsidiaries and partner companies, also appears to service markets well.

Financial risk profile: AA

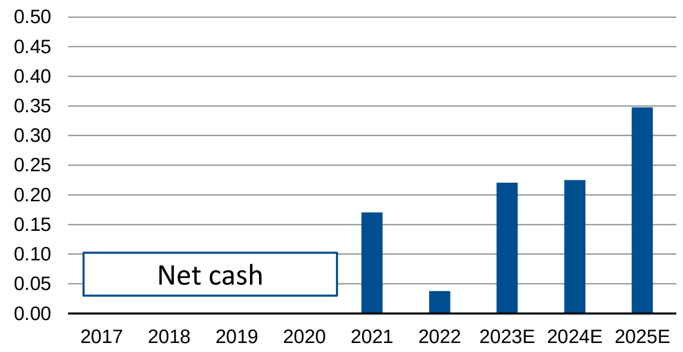
Close to net cash position drives Richter's financial risk profile

Richter's financial risk profile is the strongest driver of its issuer rating. The group's previous net cash position has allowed it to self-finance for a few years. The recurring cash inflow from Vraylar royalties since 2020 has ensured robust cash generation. This will allow Richter to invest in a new innovative pipeline and continue its transition to a speciality innovative pharmaceutical group. The group aims to acquire mature assets that complement its portfolio, especially in women's healthcare. An example is the acquisition of Evra, a transdermal contraceptive patch, for around HUF 77bn at the end of 2020. Richter's royalties may at least double depending on AbbVie's near-term sales of Vraylar.

Credit metrics reflects a near net cash position supported in 2023 by the proceeds from the Romanian wholesale business sale. Scope-adjusted debt/EBITDA is still below 0.5x and cash flow cover in terms of Scope-adjusted free operating cash flow/debt is significantly above 100%. Scope expects the close to net cash position to remain in place given the absence of large acquisitions and the strong annual cash generation.

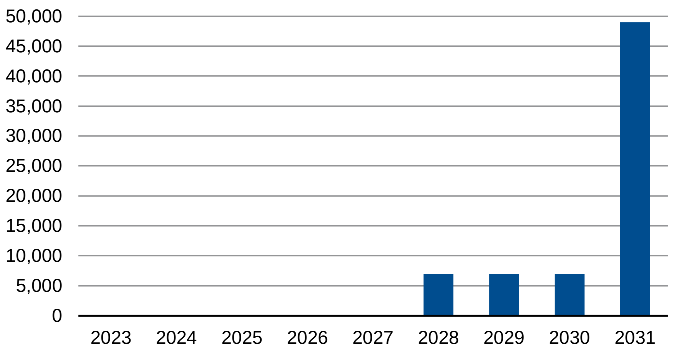
While Richer has no target acquisitions planned in the near term, Scope conservatively assumes acquisitions of HUF 80bn for 2024 and HUF 100bn for 2025. The rating case considers up to HUF 40bn in planned share buybacks in 2023. However, it is important to note that the full amount may not be used if Richter finds an appropriate acquisition target. Scope has also not factored in any major regulatory interventions in its rating case. Richter has issued a HUF 70bn bond in 2021 to boost its capacity for acquisitions. With a recurring cash flow from Vraylar royalties and no large-scale acquisitions on target, Richter will remain in a close to a net cash position.

Figure 5: Scope-adjusted debt/EBITDA (x)



Sources: Richter, Scope estimates

Figure 6: Richter bond amortisation schedule in HUF m



Sources: Scope, Richter

Adequate liquidity

Richter's liquidity profile is adequate thanks to its low balance sheet financial debt and ample available cash (about HUF 60bn at YE 2022), supported by reliable free operating cash flow generation and no significant debt maturing until 2027.

Balance in HUF m	2022	2023E	2024E
Unrestricted cash (t-1)	59,856	79,719	43,868
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	124,219	76,388	124,448
Short-term debt (t-1)	4,595	4,437	4,500
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

Financial policy neutral for the rating

Financial policy is the most relevant supplementary rating driver for Richter. While the size of the HUF 70bn bond issued in 2021 makes product acquisitions likely, management does not appear to be under any time pressure. Management is targeting mature assets. As the timing and conditions of acquisitions are still uncertain, we have assessed Richter's credit metrics conservatively, assuming that the near net cash position will not be sustained. Our assessment of financial policy is neutral, as management appears unwilling to take on the risks stemming from further acquisitions.

Richter has increased its dividend payout to 40% of net profit for the next few years to avoid excess cash accumulation.

Management has decided on a 12-month share buyback programme of up to HUF 40bn. Further programs are also determined by acquisition and licence purchase opportunities, the latter of which could also amount to significant amounts due to upfront payments.

Long-term debt rating

Senior unsecured debt rating: BBB+

Senior unsecured debt has been rated BBB+, the same level as the issuer rating.

In June 2021, Richter issued a HUF 70bn senior unsecured corporate bond, with a 1.75% coupon, under the Bond Funding for Growth Scheme of the Hungarian Central Bank. The bond has a 10-year tenor with amortisation of 10% in each of the years 7-9 and 70% in year 10. The proceeds are used for general corporate financing.

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