Sanofi
France, Pharmaceuticals

AA POSITIVE

Corporate profile

Sanofi is one of the largest pharmaceutical companies with a global footprint. The group is a diversified provider of healthcare products focusing on innovative medicines. Its other activities comprise generics, vaccines and over-the-counter products. The group's animal health activities and most of its generics business (Zentiva) have been divested. In the past few years, Sanofi's cooperation with Regeneron has produced very positive results, most notably the development of Dupixent (immunology), which has recently become a blockbuster.

Sanofi was formed in 2004 by the merger of Sanofi Synthelabo and Aventis (including Hoechst of Germany). In 2011, Sanofi acquired US-based rare disease-focused Genzyme Corp. for about USD 18bn and started to build one of the leading rare disease platforms globally.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	28	30	36	49
Scope-adjusted debt (SaD)/EBITDA (%)	1.7	1.1	1.1	0.8
Scope-adjusted FFO/SaD (%)	47	69	81	107
FOCF/SaD (%)	34	47	60	84

Rating rationale

Scope Ratings affirms its AA issuer rating for Sanofi and changes the Outlook to Positive. The short-term rating continues at S-1+ and the senior unsecured debt rating stays at AA.

The affirmation mainly reflects Sanofi's strong operating performance during 2020, as we had expected, based on improving exposure to growth drivers (Dupixent, rare diseases, vaccines) and an enhanced late-stage pipeline. All of this lends itself to good deleveraging potential in the immediate future. In addition, management's drive for efficient resource application has helped improve credit quality, which we reflect in our rating action. We believe that continued good cash generation in the coming years will not be spent on large-scale acquisitions or excessive shareholder remuneration. Therefore, credit metrics should improve further from already-high levels reached in 2020.

Sanofi has become slightly less diversified over the past 24 months and more focused on its core growth drivers. However, the group should eventually stay more diversified than some of its US peers by remaining committed to its consumer healthcare and general medicines exposures.

Ratings & Outlook

Corporate ratings	AA/Positive
Short-term rating	S-1+
Senior unsecured rating	AA

Analysts

Olaf Toelke
+49 69 6677389 11
o.toelke@scoperatings.com

Related Methodology

Corporate Rating Methodology: February 2020

Rating Methodology: European Pharmaceuticals January 2021

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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As regards Sanofi's business risk profile (rated AA-), the group's competitive position is supported by its strengthened focus on vaccines and rare diseases, both areas in which Sanofi is already a leading global player. Immunology (Dupixent) adds to this at a time when Sanofi's former anti-diabetics flagship exposure is continuing to erode following the Lantus patent expiration. In addition, Sanofi's rating also benefits from its improved late-stage pipeline containing 11 new molecular entities (up from eight previously), as well as the further assessment of Dupixent in 10 additional late-stage projects. The drug now has a strong likelihood of generating more than EUR 10bn in revenues in peak sales. Profits are shared with cooperation partner Regeneron. After portfolio restructuring over the last few years and in light of management's new 'play-to-win' strategy, the group has become slightly less diversified with a stronger focus on high-margin pharmaceuticals. A degree of diversification is still provided by critically sized consumer healthcare, general medicines and vaccines exposure. It remains to be seen whether the group will succeed in increasing its market shares in oncology (helped by its two recent acquisitions) as well as in inflammation and immunology around leading drug Dupixent.

The rating is further supported by Sanofi's range of seven blockbusters, boosting profitability. We estimate that the group's underlying innovative pharma EBITDA margin is around 34%, excluding generics and over-the-counter divisions and adjusting for headcount-related restructuring charges. This is equivalent to a high single A category in a big pharma context.

The group continues to be well diversified, in our view. This pertains to: i) its group structure, now resting on the three pillars of innovative pharma, vaccines and consumer healthcare; and ii) diversification in pharma, with significant exposure to six treatment areas including vaccines.

Sanofi's **financial risk profile** (rated AA+) is slightly stronger than its business risk profile from a ratings perspective. We have upgraded Sanofi's financial risk profile as we believe it is likely to improve further, based on significant progress in 2020. Credit metrics strengthened significantly in the past year, thanks to Sanofi's operational progress, described above, as well as the availability of sizeable divestiture proceeds. As a result, discretionary cash flow generation (after M&A and shareholder remuneration) doubled to EUR 6.7bn in 2020, paving the way for considerable deleveraging compared to 2019. As we expected, new management's continuation of the group's historically proven conservative financial policy has contributed to the progress achieved in 2020. This was evidenced by the group spending only about half of the 2020 divestiture proceeds of EUR 11.3bn on acquisitions (Synthorx, Principia) in the year. Thus, Sanofi's credit metrics have recovered significantly from their temporary deterioration in 2018 caused by the patent expiry on Lantus and two acquisitions. Management's financial discipline and focus on the group's operational funding was also supported by the stable dividend and the decision not to allocate funds to share buybacks.

In Sanofi's case, **supplementary key ratings drivers** do not affect the rating. While management's financial policy has clearly proved conservative, we have not applied an explicit uplift for this factor given the group's full distribution of profits in the past. Sanofi is no regular acquirer of large companies. It was quite active in 2018 with mid-sized deals in a pharma context but there was also a disposal (European generics) at the same time.

One or more key drivers of the credit rating action are considered ESG factors. The rating assessment includes a negative rating driver with regard to generally high regulatory and reputational risk in pharma (ESG-related rating driver).

Outlook and rating change drivers

The Outlook is Positive and reflects our expectation that Sanofi will be able to improve credit metrics further from the relatively high levels reached in 2020. This should be supported by more operating progress and the absence of larger-scale acquisitions.

A higher rating could be warranted by the group's credit metrics improving towards a net cash position. Alternatively, a strengthened business risk profile with higher profitability and enhanced diversification (via better product concentration rates) could also result in a positive rating action in future.

A negative rating action, with a return to a Stable Outlook, could result from key credit metrics returning to funds from operations/Scope-adjusted debt (SaD) below 60% and free operating cash flow/SaD of 40% on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Globally leading pharma company • Comparatively diversified player • Credit-supportive underlying industry • Strong free cash generating capability	• Comparatively low operating margins • Leading product Lantus under pressure • Recent acquisitions were dilutive

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Increasing margins and free cash flow • Credit metrics moving towards net cash position	• Future erosion of credit metrics due to further M&A • Inability to maintain at least funds from operations/SaD of 60% and free operating cash flow/SaD of 40%

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	28	30	36	49
Scope-adjusted debt (SaD)/EBITDA (x)	1.7	1.1	1.1	0.8
Scope-adjusted funds from operations/SaD (%)	47	69	81	107
Free operating cash flow/SaD (%)	34	47	60	84
Scope-adjusted EBITDA in EUR m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	10,577	10,249	10,626	12,035
Operating lease payments in respective year	0	0	0	0
Other	0	0	0	0
Scope-adjusted EBITDA	10,577	10,249	10,626	12,035
Scope-adjusted funds from operations in EUR m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	10,577	10,249	10,626	12,025
less: (net) cash interest as per cash flow statement	-287	-278	-210	-160
less: cash tax paid as per cash flow statement	-1,695	-2,051	-1,250	-1,400
add: depreciation component, operating leases	0	0	0	0
Scope-adjusted funds from operations	8,508	7,861	9,081	10,390
Scope-adjusted debt in EUR m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	25,933	23,675	17,000	16,000
less: hybrid bonds	0	0	0	0
less: cash and cash equivalents	-9,427	-13,915	-7,188	-7,529
add: cash not accessible	500	500	500	500
add: pension adjustment	1,172	1,053	861	711
add: operating lease obligations	0	0	0	0
Other	0	0	0	0
Scope-adjusted debt	**18,178**	**11,313**	**11,172**	**9,683**

Business risk profile

Pharmaceutical industry rated at AA

Based on historical sector trends over the last 15 years, the compound average growth rate of revenues in the pharmaceutical industry has been about 4%, with a peak of 10% in 2007 and a trough of -2% in 2012. This compares to global average GDP growth of about 2.5% over the same period. While the pharma market also has periods of cyclicality, they are completely unrelated to macroeconomic indicators. Rather, cycles are due to patent expiry and the development of new, promising medicines. Generally, healthcare markets benefit from an ageing population and the spread of unhealthy lifestyles. We thus assess the sector's cyclicality as low.

High entry barriers/ medium substitution risk

When assessed in accordance with our Corporate Rating Methodology, barriers to entry in the innovative pharmaceutical industry are high. This is based on high capital intensity, including substantial R&D investments, the protected nature of the market via patents, and the consolidated structure of the industry.

We view substitution risk for the pharmaceutical sector as medium.

As per our Corporate Ratings Methodology, the combination of these three industry risk drivers results in an industry risk for Sanofi of AA.

Negative ESG driver reflects risk inherent in pharma industry

We see the pharmaceutical industry as a 'high-risk, high-reward' sector with a high degree of inherent litigation and potential reputational risk, which is negative from an ESG perspective.

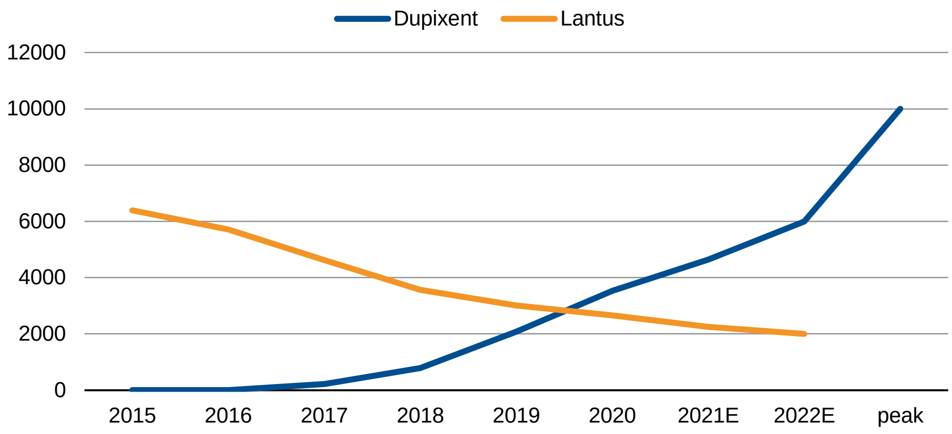
Competitive position

Market shares

Three strong franchises

While Sanofi still has a strong market position in anti-diabetics (mainly through its blockbuster drug Lantus), the group has built sizeable positions over time in two other pharmaceutical segments – rare diseases and vaccines. Sanofi's main progress over the last 12-18 months, however, has been in inflammation/dermatology and its drug Dupixent, which was jointly developed with Regeneron and approved in 2017. It became a blockbuster in 2019 and is likely to generate up to EUR 5bn in revenues this year, with a peak potential of well above EUR 10bn overall. Having recently initiated a new focus on specialty pharmaceutical segments, Sanofi's management has signalled that it will be reducing the focus on its key longstanding diabetes business. Diabetes sales have declined over the last few years for Sanofi in the wake of generic competition and price pressure (mainly in the US, reflecting health care payors' drive for cost efficiency in this large treatment area). At the same time, flagship product Lantus (Sanofi's second-largest product) still generated EUR 2.7bn in revenues in 2020. We believe the new strategy will provide Sanofi with an enhanced growth perspective, as its sizeable exposures to rare diseases, vaccines and immunology/inflammation areas already account for about 40% of the group's pharmaceutical activities.

Figure 1: Dupixent vs. Lantus (EUR m)



Source: Annual reports

Sanofi continues to be a very sizeable global player in rare diseases with annual segment sales of about EUR 3bn following the takeover of US-based Genzyme in 2011. Here, its flagship products are Myozyme for Pompe disease, which became a blockbuster in 2020, and Fabrazyme for Fabry disease, which is only slightly smaller. In vaccines, the group has maintained a number four position globally, based on annual sales of about EUR 6bn in 2020. This division is growing strongly thanks to new innovative products and high demand in emerging markets. As one of only four major vaccine manufacturers worldwide, Sanofi also stands to benefit from significantly increased demand this year in the wake of the coronavirus crisis and most populations' higher safety priorities. This is unrelated, in our opinion, to the potentially successful development of a new Covid-19 vaccine by Sanofi and its partner GSK, which was initially delayed and is now projected to apply for regulatory clearance in the third quarter of 2021.

Outside of classic pharmaceuticals, Sanofi has also reached a critical size in global consumer healthcare. Following the acquisition of Boehringer Ingelheim's activities in 2016, Sanofi became a leading global player in this market, with annual sales approaching EUR 5bn. In 2019, however, GSK announced a joint venture with Pfizer Inc, to create the largest consumer healthcare company by far, with more than EUR 10bn in annual sales.

Product portfolio

Seven blockbuster drugs

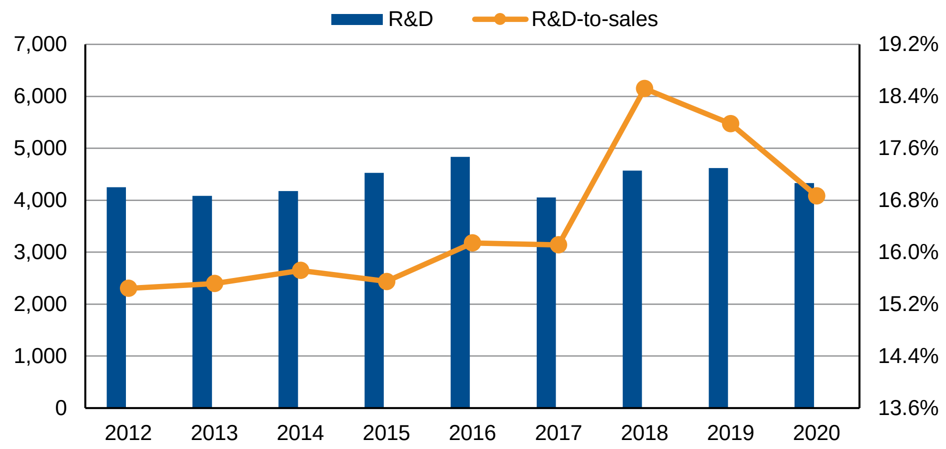
We believe Sanofi's count of seven blockbuster drugs is credit-positive. These major products are typically much more profitable than smaller drugs, as their maturity and lower marketing expenses allow for higher profitability. In addition, Lantus is still likely to remain the most profitable drug for the group for the time being, despite declining sales. Sanofi has a 50/50 profit sharing agreement with Regeneron for Dupixent. In addition to Dupixent and Lantus, Sanofi's other blockbusters include Plavix and Lovenox (cardiovascular), Aubagio (multiple sclerosis) and diabetes drug Toujeo. With seven blockbusters in total, Sanofi compares well to its big pharma peers Pfizer (nine) and GSK (eight).

Pipeline and R&D

Good late-stage pipeline

In our view, Sanofi allocates sufficient resources to R&D, with a ratio of R&D to innovative pharma sales of 15%-20%, which is equivalent to a high A category rating. The group's long, sustained effort in this area has contributed to a strong product portfolio over time.

Figure 2: Continuously high pharma R&D (EUR m)



Source: Sanofi

The group's late-stage pipeline – consisting of 11 molecules at the end of 2020 – is now focused on the newly defined core R&D areas of the group: rare diseases, oncology, vaccines, rare blood disorders, and neurology (mainly multiple sclerosis and immuno-inflammation). Part of the pipeline benefits from the acquisitions of Bioverativ and Ablynx. Sanofi's collaboration with US-based, mid-sized biotech Regeneron has boosted its immunology franchise, consisting of Kevzara (rheumatoid arthritis), Dupixent and Praluent (cardiovascular), which are already marketed. Dupixent in particular has continued to record strong revenue growth for the last two years. With the latest developments, Sanofi's number of new late-stage pipeline assets has recovered from the level reached in 2018. As a side effect, Dupixent is being developed in 10 further late-stage clinical trials.

We expect the impact of patent expiry on Lantus to decrease further in a group context. As there should be no further sizeable patent expiry for the next few years, this paves the way for significant top-line expansion provided by growing sales from newly approved drugs (like Dupixent) or brand new approvals from the pipeline. According to our pharma-specific methodology, if a loss in sales due to patent expiry is likely to be fully offset by sales of new innovative products, this equates to an implied rating of A or higher. We believe Sanofi has significantly improved in this respect over the last two years as total group sales should now be able to expand to about EUR 41bn by 2022, from about EUR 36bn in 2020.

Diversification

Diversification unchanged

Sanofi's credit quality is supported by its corporate structure, as it is still (despite recent divestitures) more diversified than most of its global pharma peers – consolidating top-five positions in four large, global markets (diabetes, rare diseases, vaccines, and consumer healthcare). In innovative pharmaceuticals, exposure to six different major treatment areas (including vaccines) is similarly positive from a credit perspective. Furthermore, the group's geographical breakdown of sales continues to be well diversified, with strong exposures to the still high-margin US market, Europe, and emerging markets (the latter being important for growth potential).

We believe the group's overall diversification has significantly contributed to its historically highly stable operating profits and cash flows, avoiding the negative effects from blockbuster patent expiry that have been more prominent for other peers.

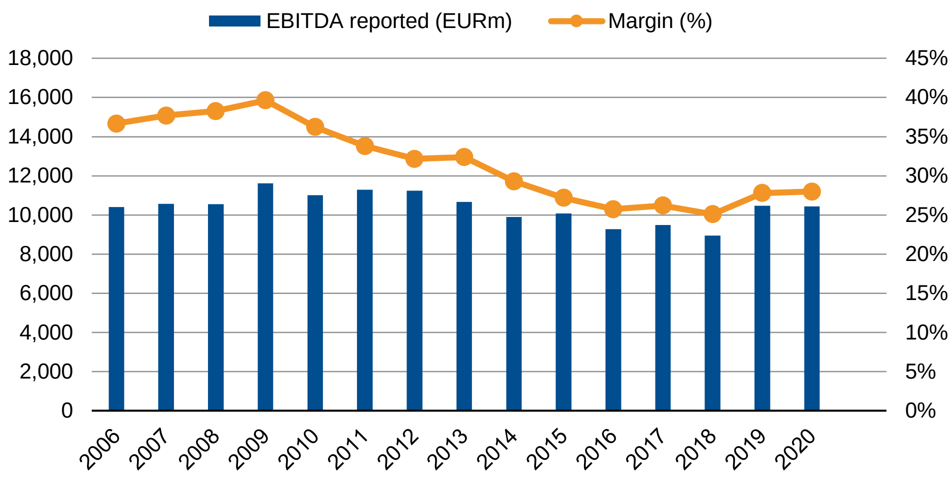
While product concentration rates have been moderating since 2017 linked to Lantus' reduced weight, there has been counter-movement since 2019 due to Dupixent's rapid growth and the larger number of blockbusters versus a year ago. In 2020, the top-three drugs accounted for 27% of total pharma sales (versus 33% in 2019), which is positive for the rating.

Operating margins

Formerly low operating margins have started to increase

Sanofi has low reported operating margins compared with peers, which is surprising given the group's size and positioning. However, reported operating margins include generics and consumer healthcare, which generally have much lower margins than innovative pharmaceuticals. Additionally, the relatively large established products portfolio and emerging markets exposure, with sales of more than EUR 15bn, dilute reported margins further, in our view.

Figure 3: Reported EBITDA – historical trends



Source: Annual reports

While the group's EBITDA margin has thus come down over a long period since 2009, EBITDA and operating cash flows on an absolute scale have been comparatively stable for the last 15 years, given the above, with EBITDA of EUR 9-12bn. The group EBITDA margin started to improve significantly in 2019 (+2.7 basis points) and in 2020 on an underlying basis (to about 29%/30% excluding EUR 1.06bn in restructuring charges in the context of the new structural programme). Attempting to adjust for non-innovative pharma activities, we believe Sanofi's underlying ethical pharma margin (including vaccines) is about 34%.

Business risk profile rated AA-

We continue to assess Sanofi's business risk profile at AA-. This includes the AA category industry risk and our competitive positioning assessment (AA-).

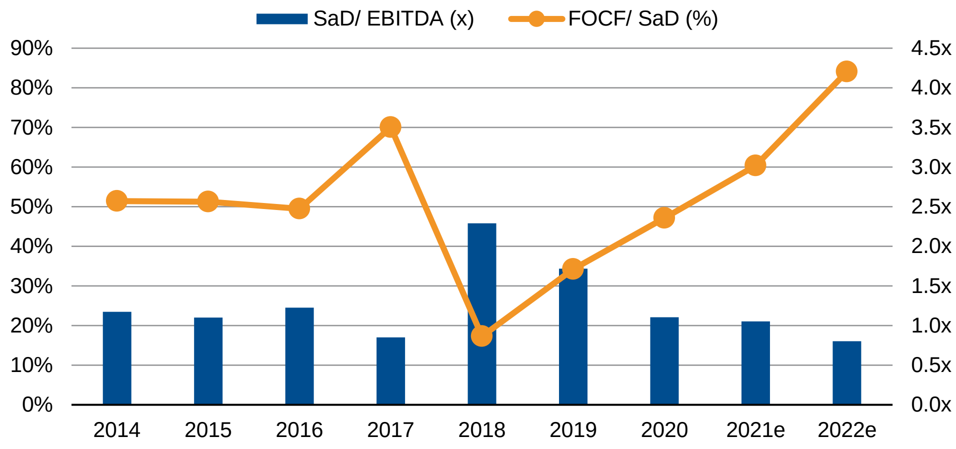
Financial risk profile

Credit metrics

Financial risk profile upgraded to AA+

Sanofi's credit metrics have been stable and strong historically (Figure 4). The unusually sharp deterioration in 2018 was due to about EUR 13bn in acquisitions coupled with the Lantus patent expiry.

Figure 4: Scope credit ratios



Source: Scope

Following the release of strong 2020 and first-quarter 2021 performance figures, we expect Sanofi to improve its credit metrics to its upgraded AA+ financial risk profile within two years. This is based on the following trends reflected in our base-case assessment:

- Group revenue growth of about 5% for 2021 and 7% for 2022, reflecting purely organic trends and no further coronavirus-related business restrictions. Assumed 6% growth in 2021 vaccine revenues, with a continued zero expectation for 2022 revenues from a potential approval of a Covid-19 vaccine towards the end of 2021.
- Expectation of continued sales declines in diabetes and cardiovascular/established products segments due to the patent erosion of leading drugs offset by strong likely growth in the specialty care unit (rare diseases, multiple sclerosis, blood disorders and Dupixent)
- Our Dupixent revenue assumptions are EUR 4.6 bn for 2021 and EUR 6bn for 2022, which might prove conservative.
- Only slightly increasing EBITDA margins assumed for the projection period, based on reported 2020 EBITDA margin of 27%, reflecting the ongoing transformation of the group coupled with necessary restructuring expenses as part of the operational excellence programme
- No major acquisitions for the next two years, only EUR 3bn of bolt-ons assumed per year
- 60%-70% of net profits distributed as dividends, translating into stable cash outflows of about EUR 4bn per year
- Assumed discretionary cash flows of around zero in 2021 and EUR 1.3bn in 2022, enabling deleveraging
- No share buybacks assumed

Figure 5: Expected rise in free cash flow in 2020

Free cash flow	2017	2018	2019	2020	2021E	2021E
Funds from operations (unadjusted)	**7,464**	**6,013**	**8,584**	**8,090**	**9,166**	**10,475**
less: capex (net)	-1,559	-1,877	-1,516	-2,114	-2,000	-2,000
Change in working capital	-85	-466	-840	-641	-418	-334
Free cash flow	**5,820**	**3,670**	**6,228**	**5,335**	**6,748**	**8,141**
Dividends	-3,725	-3,787	-3,848	-3,981	-4,000	-4,000
Acquisitions (net)	2,758	-10,831	698	5,815	-3,000	-3,000
Share buybacks (net)	-1,843	-924	162	-619	200	200
Discretionary cash flow	**3,010**	**-11,872**	**3,240**	**6,550**	**-52**	**1,341**

Source: Sanofi annual reports, Scope estimates and adjustments

Sanofi's cash generation is highly likely to increase from the level reached in 2020. This assumption is based on two main drivers: i) annual funds from operations as a proxy for operating cash flows are likely to rise based on a combination of derived growth (Dupixent, rare diseases, pipeline) and efficiency gains; and ii) the continuation of management's sound financial policy to support deleveraging. We believe that management is firmly committed to keeping discretionary spending (M&A, shareholder remuneration) under control during the first few years of the group transformation process, which began in 2020. Thus, we believe that Sanofi's financial profile is likely to approach a net cash position within a few years, given the group's potential for significant operating improvements from its pharmaceutical exposure, as reflected in our base case scenario, coupled with spending discipline and a creditor-supportive financial policy.

Following the application of IFRS16, which brought operating leases onto the balance sheet, the main additional debt constituents are now restricted to pensions (Scope-adjusted, as pension assets cover annual payments by substantially more than our 6x threshold to apply a 50% haircut for the 'gap'). We deduct available cash from our SaD calculation, reserving EUR 500m as a proxy for restricted cash elements.

Liquidity

We view the group's liquidity as adequate for the ratings. Limited short-term debt on Sanofi's balance sheet is covered by an ample cash balance of EUR 6bn-7bn per year, combined with undrawn committed lines of EUR 8bn. The short-term rating is S-1+, in line with the mapping in our rating methodology.

Supportive financial risk profile

Sanofi's financial risk profile is rated AA+ as per our methodology. This is based on our view that the group will continue to deliver high and stable credit metrics in the foreseeable future. Management's financial policy also supports the rating. We do not expect any major additional acquisitions in the remainder of 2020, while the confirmed absence of share buybacks in 2020 is an additional support to the ratings. It remains our understanding that new management is strongly committed to maintaining the ratings.

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid
Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London
111 Buckingham Palace Road
London SW1W 0SR

Phone +44 020 7340 6347

info@scoperatings.com
www.scoperatings.com

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