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 the sales and marketing of pharmaceutical products; and ii) the wholesale and retail distribution of these products. A group of Richter companies provides auxiliary services for the two core segments. Richter focuses on areas in which 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	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	Net interest income positive		Net interest income positive	
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	Net cash	0.2x	0.3x	0.3x
Scope-adjusted funds from operations/SaD	Net cash	>100%	>100%	>100%
Free operating cash flow/SaD	Net cash	-1%	85%	49%
Liquidity	>200%	>200%	>200%	>200%

Rating rationale

Scope Ratings GmbH (Scope) has today affirmed the BBB+/Stable issuer rating of Richter Gedeon Nyrt. (Richter). Scope has also affirmed the BBB+ senior unsecured debt rating.

The rating affirmation mainly reflects the group's excellent financial risk profile with a close to net cash position, its solid competitive position in speciality innovative pharmaceuticals, and good prospects for growth and cash generation despite potential disruption from the Russian and Ukrainian business.

As regards Richter's business risk profile (assessed at BBB-), the group continues to reinforce its exposure to specialty pharmaceuticals with an increasing contribution from Vraylar royalties and the successful launch of Cariprazine in a number of markets. The women's healthcare portfolio remains the most important component of the pharmaceutical business, with a sales contribution exceeding one third.

Revenue and gross profit ambitions are growing, with additional budgets secured for launches. Richter continues to make R&D investments in its major biotechnology and central nervous system projects, reaching significant pre-clinical and clinical milestones. Dependence on central nervous system drug Cariprazine is still significant as the product is providing further sales including Vraylar royalties.

Russia is Richter's second largest market in terms of sales. While this may raise some concerns, the group is taking countermeasure to limit losses. Richter has been gradually working to curb its exposure to the Russian market with an expansion drive in Western markets.

Ratings & Outlook

Corporate rating	BBB+/Stable
Senior unsecured rating	BBB+

Analyst

Azza Chammem
+49 30 27891-240
a.chammem@scoperatings.com

Related Methodologies

Corporate Rating Methodology, July 2021

Rating Methodology European Pharmaceuticals January 2022

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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We expect Richter's top line growth to be increasingly supported by royalties from Vraylar, EU launches of Cariprazine, the expansion of its top products and new launches in further markets. All of this would mitigate the potential negative consequences from the war. We expect Richter's operating profitability to stagnate this year. Here, the Scope-adjusted EBITDA margin improvement in 2021 is likely to be offset by potential losses in Russia and Ukraine as well as further investment in marketing to support new launches products.

Richter's financial risk profile (assessed at AA) continues to be the strongest driver of its issuer rating. 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 specialty innovative pharmaceutical group. The group aims to acquire mature assets that will complement its portfolio, especially in women's healthcare. However, there is no target acquisition on the near horizon.

Liquidity continues to be adequate, as reflected by the close to net cash position and annual cash flow of above HUF 130bn.

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 SaD/Scope-adjusted 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.

Rating drivers

Positive rating drivers	Negative rating drivers
• Close to net cash position • Significant growth potential thanks to Vraylar royalties • 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 • Costs associated with transition towards speciality products • Pharmaceutical industry's reputational and regulatory risks (ESG factor) • Impact of Russia-Ukraine war on Richter

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/Scope-adjusted EBITDA increasing towards 1.5x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	Net interest income positive		Net interest income positive	
SaD/Scope-adjusted EBITDA	Net cash	0.2x	0.3x	0.3x
Scope-adjusted funds from operations/SaD	Net cash	>100%	>100%	>100%
Free operating cash flow/SaD	Net cash	-1%	85%	49%
Scope-adjusted EBITDA in HUF m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	154,935	180,754	159,252	174,156
Other	-	-	-	-
Scope-adjusted EBITDA	**154,935**	**180,754**	**159,252**	**174,156**
Scope-adjusted funds from operations in HUF m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	154,935	180,754	159,252	174,156
less: (net) cash interest as per cash flow statement	284	2,287	975	975
less: cash tax paid as per cash flow statement	-7,515	-8,136	-10,412	-11,434
less: pension interest	0	-122	-122	-122
add: dividend received from @equity	2	9	0	0
Scope-adjusted funds from operations	**147,706**	**174,792**	**149,694**	**163,575**
Free operating cash flow in HUF m	**2020**	**2021**	**2022E**	**2023E**
Cash flow from operations	134,437	143,057	142,459	151,506
less: capital expenditure (net)	-66,206	-141,440	-100,000	-120,000
less: lease payments	-3,143	-2,055	-4,000	-4,000
Free operating cash flow	**65,088**	**-438**	**38,459**	**27,506**
Scope-adjusted debt in HUF m	**2020**	**2021**	**2022E**	**2023E**
Reported gross financial debt	14,556	87,317	84,722	82,722
less: cash and cash equivalents	-142,068	-59,856	-43,248	-30,645
add: pension adjustment	4,350	3,824	3,824	3,824
Scope-adjusted debt	**-123,162**	**31,285**	**45,298**	**55,901**

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

Business risk profile: BBB-

Increasing focus on speciality drugs

As regards Richter's business risk profile, the commonality among the group's pharmaceutical exposures is their focus on speciality drugs, both in the innovative division (neurology with Vraylar; women's healthcare and contraceptive patch Evra) and the generics division. Some of Richter's generics products have market shares of well above 50% and are thus in no danger of substitution. Management has announced a future focus on innovative drugs, supported by increasing R&D spending on the Richer pipeline. This follows the group's success with neurology drug Cariprazine, outlicensed to AbbVie Inc in North America and generating around USD 1.7bn in revenues for the latter in 2021. Cariprazine is sold under the trademark Vraylar by AbbVie in the US and under the trademark Reagila in Europe and other countries via partners such as Recordati and Hikma.

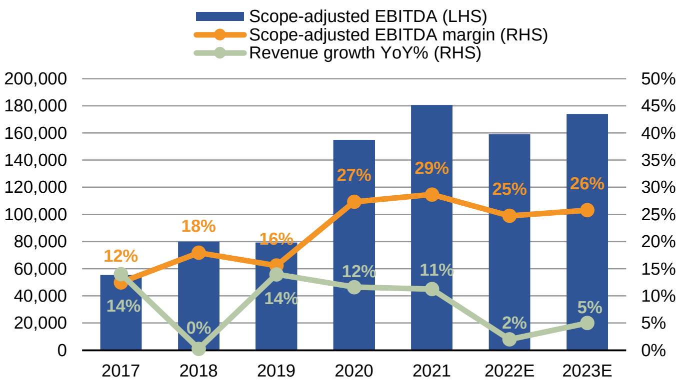
Strong operating profitability for a mid-pharma player

Richter's operating profitability is high for a medium-sized pharmaceutical company, predominantly due to the AbbVie royalties. In 2021, these equated to HUF 101bn, which contributed materially to the sales levels achieved that year. Based on 2021 pharmaceutical sales of HUF 505bn, this translates into a Scope-adjusted EBITDA margin of about 35%. Assuming that the operating margin of the generic activities is below the margin for innovative drugs, the underlying Scope-adjusted EBITDA margin for this segment is probably higher than 35% (the group does not disclose a divisional profit breakdown). We therefore see Richter's profitability as one of the strongest supports for its 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.

Increasing operating expenses post-pandemic

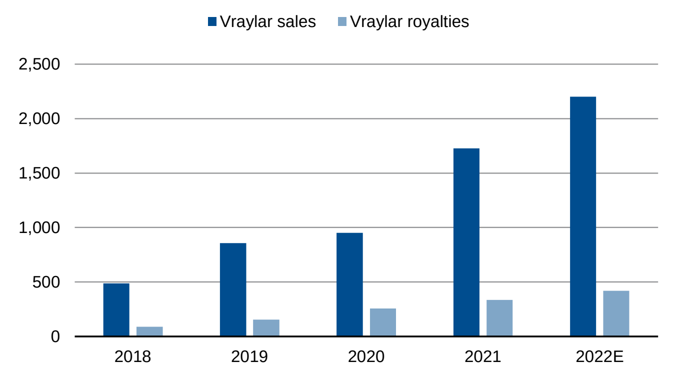
While the pandemic limited selling and marketing expenses in 2020 and 2021, we expect Richter to increase its selling and marketing and R&D expenses to support new product launches and sales in the coming years. We expect the group's Scope-adjusted EBITDA margin to remain relatively flat despite growth from Vraylar. This is due to an increase in operating expenses to support product launches and the direct and indirect impact of the Russia-Ukraine war.

Figure 1: Scope-adjusted EBITDA in HUF m



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 an international context and the concentration rate for its largest product (Cariprazine/Vraylar/Reagila) in relation to speciality pharma sales, already high at 20% in 2021 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. Besides, the main treatment area exposure to neurology and women's healthcare is good for Richter's size.

Potential losses from the Russian and Ukrainian business

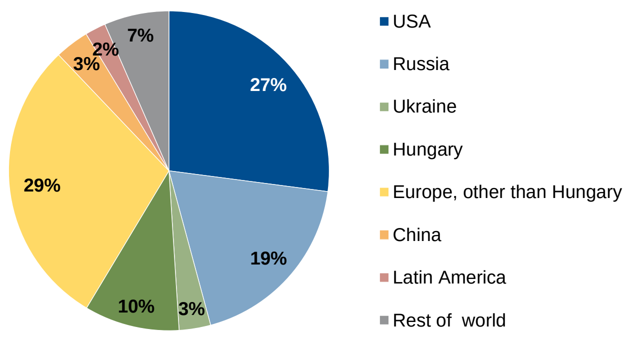
Richter has sales exposure to Russia and Ukraine despite diversifying away from Russia in recent years due to a switch to specialty pharmaceuticals. In 2021, Richter earned a total of about HUF 100bn in revenue in the Russian and Ukrainian markets, which accounted for 19.7% of total pharmaceutical sales and 15.8% of its consolidated sales, compared to 21.9% and 17.6% in 2020, respectively. Richter is taking countermeasure to limit the losses caused by the conflict. However, the depreciation of the ruble and lost sales could lead to a relative decline in Russian sales in 2022, while Ukrainian sales could fall completely. We expect growth in Vraylar, Evra and other products to compensate for the Russian and Ukrainian losses.

Further R&D efforts needed to improve specialty exposure

Richter's R&D efforts are good overall (20% 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 in its major biotechnology and central nervous system projects, where it is reaching significant pre-clinical and clinical milestones.

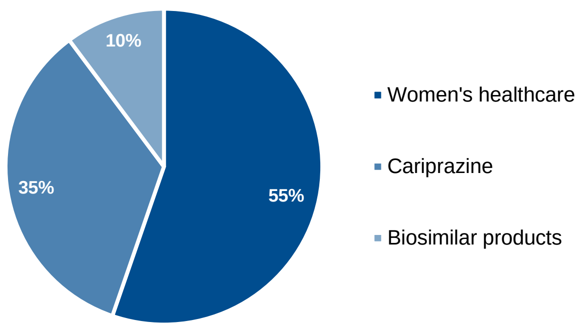
Our assessment of Richter's competitive position benefits from our expectation of very favourable growth, mainly through the revenue potential of Vraylar and other women's healthcare products – as we expect no significant patent expiry in the medium term.

Figure 3: Geographical split of pharma sales (2021)



Sources: Scope, Richter

Figure 4: Richter specialty business sales split (2021)



Sources: Scope, Richter

Biosimilar focus on rheumatology and osteoporosis

Richter's generics division can be seen as lacking critical scale in the underlying large and very competitive generics market. It includes the traditional portfolio, branded generics and biosimilars (which Richter considers as part of specialty pharmaceuticals). Two new products were licensed-in during 2021, keeping the total number of distributed licensed-in generic products at around the level of fifteen. The biosimilar focus is on the main indications of rheumatology and osteoporosis.

Products 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 generic activities is significantly higher than the 25% average generated by sizeable players. Richter's generics positioning does not meaningfully weaken its overall credit profile as its product portfolio is reasonably well protected and 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

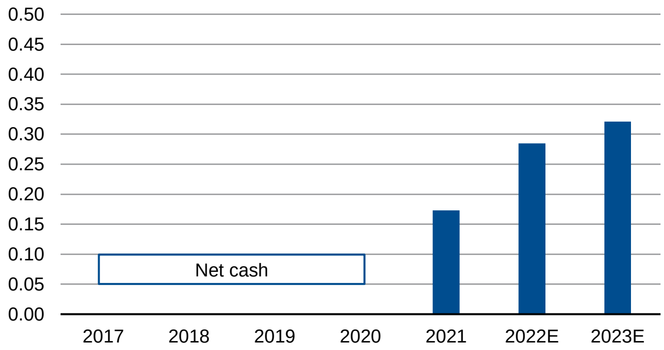
Richter's financial risk profile is the strongest driver of its issuer rating. The group's previous net cash position has allowed it to self-finance its activities for a few years. The recurring cash inflow from Vraylar royalties since 2020 has ensured robust cash generation. This will allow Richter to invest in a new innovative pipeline and continue its transition to a 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 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.

Richter has issued a HUF 70bn bond to boost its capacity for acquisitions. However, there is no target acquisition on the near horizon. The group's SaD/Scope-adjusted EBITDA ratio will go up gradually to around 0.3x in 2023, depending on the acquisitions made in the next three years. We considered the potential consequence of the war in Ukraine on Richter's financials in our base case scenario. Credit metrics remain resilient to shocks given the continuing top line growth.

Adequate liquidity

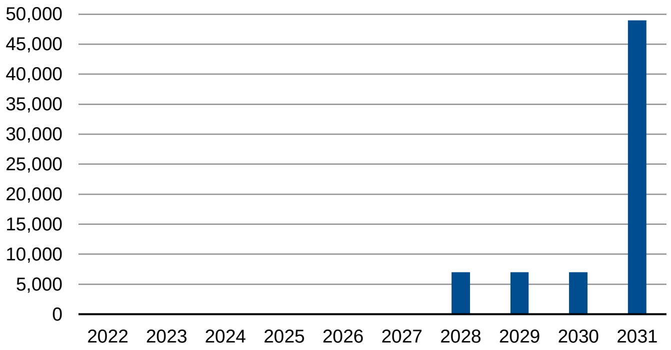
Liquidity is adequate as reflected by the close to net cash position and annual cash flow from operations of over HUF 130bn.

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



Sources: Richter, Scope estimates

Figure 6: Richter debt amortisation schedule in HUF m



Sources: Scope, Richter

Financial policy neutral to 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 targets matured 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 risks on acquisitions.

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

ESG considerations

The rating assessment accounts for the high regulatory and reputational risks inherent to the pharmaceuticals sector, which 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 balancing patent expiry and new products.

Long-term debt rating

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.

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 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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