Richter Gedeon Nyrt.
Hungary, Pharmaceuticals

SCOPE BBB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	Net interest income		Net interest income	
Scope-adjusted debt/EBITDA	0.0x	0.0x	0.1x	0.0x
Scope-adjusted funds from operations/debt	>100%	>100%	>100%	>100%
Scope-adjusted free operating cash flow/debt	>100%	>100%	>100%	>100%

Rating rationale

The issuer's rating is supported by the increasing exposure to speciality pharmaceuticals, including neuropsychiatry through the growth in Vraylar royalties and the successful launch of Cariprazine in several markets.

Credit metrics reflects a near net cash position supported by recurring cash inflow from Vraylar royalties. Robust cash generation will allow Richter to acquire mature assets that will complement its portfolio and establish a sustainable business model, even beyond the anticipated loss of exclusivity of Vraylar in 2029.

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 if the group's financial policy turned aggressive. It could also follow a deterioration in credit metrics, e.g. if Scope-adjusted debt/EBITDA increased towards 1.5x on a sustained basis as a result of a large acquisition or lack of replacement for Caprizane in the medium term.

A positive rating action is currently remote, given the issuer's significant exposure to a high-risk country (Russia) and past domestic regulatory intervention, which remain difficult to predict. However, a positive rating action could be warranted if the innovative business expands, increasing diversification while perceived risk associated with (i) regulatory intervention or (ii) the company's exposure to Russia softened.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
23 April 2024	Affirmation	BBB+/Stable
26 April 2023	Affirmation	BBB+/Stable
3 May 2022	Affirmation	BBB+/Stable
26 May 2021	New	BBB+/Stable

Ratings & Outlook

Issuer	BBB+/Stable
Senior unsecured debt	BBB+

Analyst

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

Related Methodologies and Related Research

General Corporate Rating Methodology, October 2023

Pharmaceutical Companies' Rating Methodology, April 2024

ESG considerations for rating pharmaceutical companies, March 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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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 while perceived risk associated with (i) regulatory intervention or (ii) the company's exposure to Russia softened.	• 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	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	Net interest income			Net interest income		
Scope-adjusted debt/EBITDA	0.2x	0.0x	0.0x	0.1x	0.0x	Net cash
Scope-adjusted funds from operations/debt	>100%	>100%	>100%	>100%	>100%	Net cash
Scope-adjusted free operating cash flow/debt	-2%	>100%	>100%	>100%	>100%	Net cash
Scope-adjusted EBITDA in HUF m						
EBITDA	183,345	221,985	245,923	233,285	248,044	254,878
Other items[1]	-1,382	43	-11,415	-500	-500	-500
Scope-adjusted EBITDA	**181,963**	**222,028**	**234,508**	**232,785**	**247,544**	**254,378**
Funds from operations in HUF m						
Scope-adjusted EBITDA	181,963	222,028	234,508	232,785	247,544	254,378
less: (net) cash interest paid	2,165	6,040	9,964	9,864	10,189	10,422
less: cash tax paid per cash flow statement	-8,136	-14,290	-9,744	-24,250	-26,844	-27,010
add: Other non-operating charges before FFO	8,648	3,508	-24,471	0	0	0
Funds from operations (FFO)	**184,640**	**217,286**	**210,257**	**218,399**	**230,889**	**237,790**
Free operating cash flow in HUF m						
Funds from operations	184,640	217,286	210,257	218,399	230,889	237,790
Change in working capital	-40,280	-42,058	-66,522	23,174	-9,359	-14,035
Non-operating cash flow	-1,425	22,078	5,405	±0	±0	±0
less: capital expenditure (net)	-141,440	-68,772	-91,582	-112,555	-115,825	-118,974
less: lease amortisation	-2,055	-4,437	-4,428	-3,525	-3,525	-3,525
Free operating cash flow (FOCF)	**-560**	**124,097**	**53,130**	**125,494**	**102,180**	**101,256**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	2,287	6,162	10,319	10,219	10,544	10,777
less: interest expense pensions	-122	-122	-355	-355	-355	-355
Net cash interest received (+) / paid (-)	**2,165**	**6,040**	**9,964**	**9,864**	**10,189**	**10,422**
Scope-adjusted debt in HUF m						
Reported gross financial debt	87,317	86,451	89,652	86,599	84,699	82,799
less: cash and cash equivalents	-59,856	-79,719	-80,493	-66,647	-89,961	-111,974
add: non-accessible cash	0	0	0	0	0	0
add: pension adjustment	1,912	1,418	1,937	1,755	1,703	1,798
Scope-adjusted debt (SaD)	**29,373**	**8,150**	**11,096**	**21,708**	**-3,559**	**-27,376**

[1] Mainly gains/losses on disposal and recurring associate dividend received

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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: from A to A-

Richter has a combination of innovative and generics 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 (neuropsychiatry with Vraylar; women's healthcare and contraceptive patch Evra) and in generics (osteoporosis and rheumatology). 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 by expanding its pipeline. This new strategy follows the success of Richter's neuropsychiatry drug Cariprazine. The drug is licensed to AbbVie Inc in North America under the trademark Vraylar and generated around USD 2.7bn in revenues for AbbVie in 2023. In Europe and other countries, it is sold as Reagila via partners such as Recordati and Hikma.

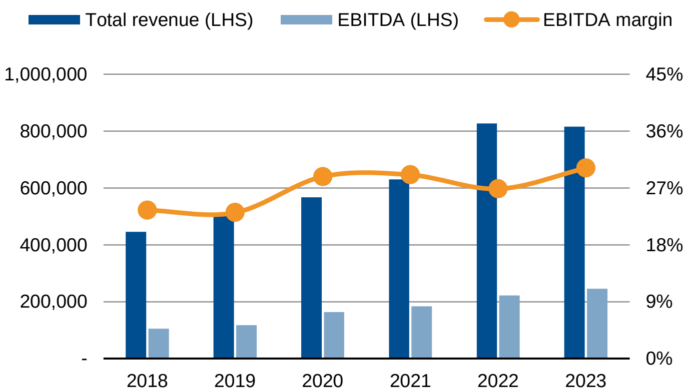
Strong operating profitability for a mid-sized pharma player

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 2023, the royalties equated to HUF 194bn, an increase of 40% YoY. Assuming that the generics operating margin is below that for innovative, the underlying EBITDA margin for innovative is probably higher than 40% (assumed based on the divisional profit breakdown disclosed).

Increasing operating expenses due to inflation

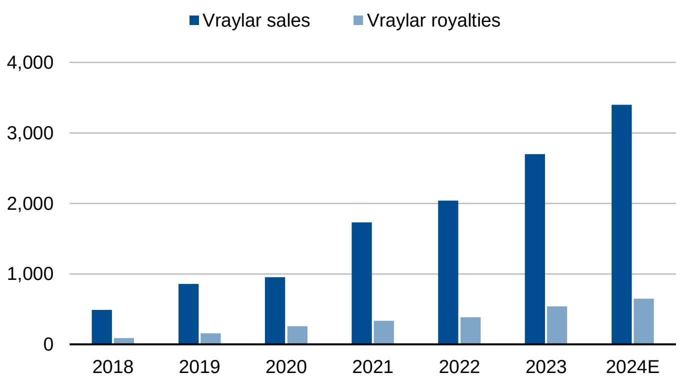
We expect the group's Scope-adjusted EBITDA margin to remain relatively flat despite growth from Vraylar. This will be due to an inflation-induced increase in operating expenses.

Figure 1: Richter revenues in HUF bn



Sources: Richter, Scope

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 (28% of 2023 sales), which is likely to increase further once Vraylar sales peak. On the positive side, the 29% exposure to the US (very likely to grow due to Vraylar) supports diversification. The exposure to neuropsychiatry 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

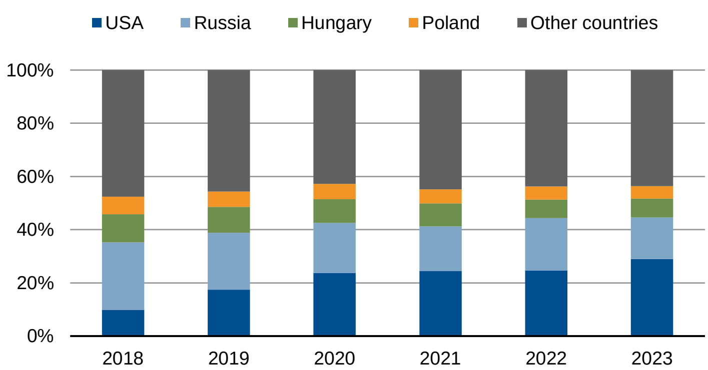
Richter still has a sales exposure to Russia despite diversifying away from Russia in recent years due to the switch to speciality pharmaceuticals. In 2023, Richter earned about HUF 117bn in revenues in Russia, which accounted for 16% of group pharmaceutical sales (20% in 2022). Russia remains Richter's 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. The ruble depreciation negatively affected revenues in 2023 and foreign exchange volatility will continue in 2024.

Further R&D efforts needed to improve speciality exposure

Richter's R&D efforts are good, at around 10% 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.

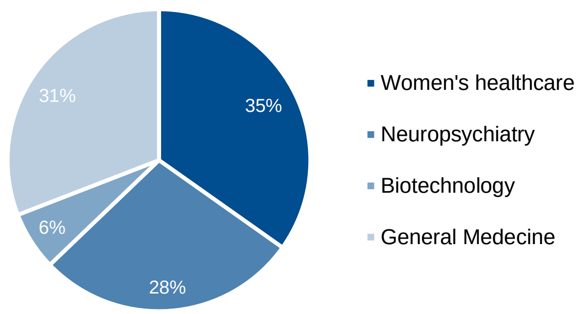
Richter's competitive position assessment benefits from our expectation of very favourable growth, mainly through Vraylar and women's healthcare products, as we expect no significant patent expiry in the medium term.

Figure 3: Geographical split of pharma sales



Sources: Scope, Richter

Figure 4: Richter division sales split (2023)



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. Richter's biosimilars division was renamed Biotechnology while its generics division was rebranded as General Medicine in 2023.

Richter also intends to strengthen its biosimilars portfolio over the coming years through launches in the main indication areas of osteoporosis and rheumatology, upon patent expiry of the originator products. Early 2024, Richter completed the following two deals: (i) in January 2024, Richter became a strategic investor of Formycon AG, a pure play biosimilar company via 9% equity investment and; (ii) in March 2024, Richter agreed to acquire the interest of its partner's, HELM, in all of its German biological assets, resulting in 100% ownership of both Richter-Helm BioLogics and RHT Richter-Helm BioTec. The transaction allows Richter to consolidate its ownership and control over all biological research, development and manufacturing assets in Germany. This deal is a further step on the road towards making the biological business unit sustainably profitable and expanding capacities. 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 is around 15% to 20% with the objective to go above 20%.

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

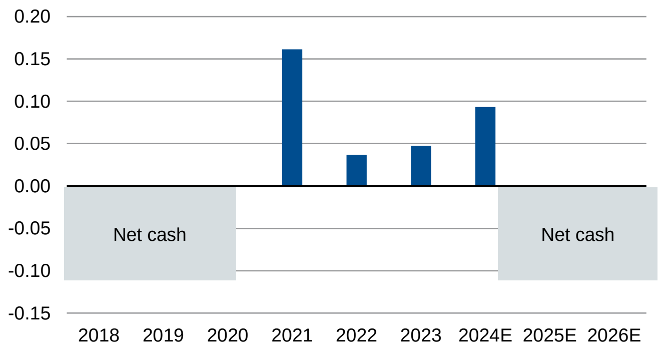
Close to net cash position drives Richter's financial risk profile

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. Richter's royalties may at least double depending on AbbVie's near-term sales of Vraylar. 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.

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% despite the increasing cash outflow associated with building up working capital due to supply chain disruptions. We expect the close to net cash position to remain in place given the absence of large acquisitions and the strong annual cash generation.

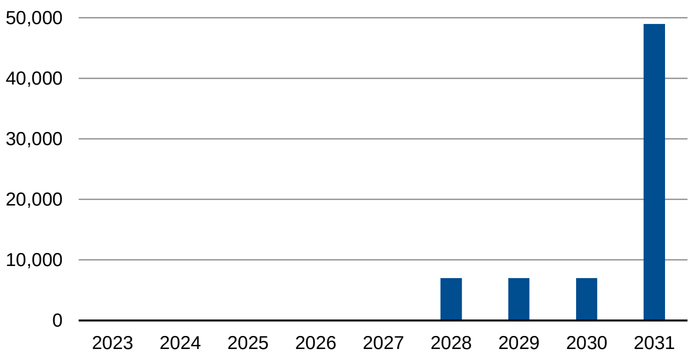
The rating case considers the announced Formycon and Helm deals totalling around HUF 72bn that occurred in Q1 2024 and the remaining HUF 10.2bn share buybacks out of the HUF 40bn programme that started in 2023.

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 80bn at YE 2023), supported by reliable free operating cash flow generation and no significant debt maturing until 2027.

Balance in HUF m	2023	2024E	2025E
Unrestricted cash (t-1)	79,719	80,493	66,647
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	53,130	125,494	102,180
Short-term debt (t-1)	1,225	1,225	975
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 that will complement the portfolio and establish a sustainable business model, even beyond the anticipated loss of exclusivity of Vraylar in 2029.

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 and factoring in possible execution risk. 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 around 40% of net profit for the next few years to avoid excess cash accumulation.

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.

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

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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