S&P Global
Ratings

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Ache Laboratorios Farmaceuticos S.A.

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Table Of Contents

Ache Laboratorios Farmaceuticos S.A.

Business Risk: **FAIR**

Vulnerable — Excellent

Financial Risk: **MINIMAL**

Highly leveraged — Minimal

bbb- **bbb-** **bbb-**

Anchor — Modifiers — Group/Gov't

Issuer Credit Rating

BB+/Stable/--

Brazil National Scale

brAAA/Stable/--

Credit Highlights

Overview

Key Strengths	**Key Risks**
One of Brazil's largest pharmaceutical players	Highly fragmented industry
Familiarity to navigate the regulatory approval process for new drugs	Increasing competition
Very low leverage	A shortfall in discretionary cash flow due to sizable dividends

The company should maintain a sizable pipeline of new drugs launches, enabling increasing cash flows. While we expect Ache Laboratorios Farmaceuticos S.A. (Ache) to continue working on the development of new drugs, we believe it will remain successful in navigating the regulatory approval process. Usually Ache has higher approval levels than the industry average, allowing for the first-to-file status, preventing rework costs, and supporting a strong brand equity.

Ache to generate consistent cash flows, enabling high dividend payments even amid high capex to support construction of the new plant. The construction of the new plant in the state of Pernambuco will likely increase Ache's total capacity by 100% and improve profitability, given that the company will reduce outsourcing of some relevant drug lines.

Pharmaceutical industry in Brazil is less competitive than in mature markets such as in the U.S. and Europe. Still, both domestic and international players have been investing significantly in R&D, with domestic players transitioning to more value-added products such as branded generics and dermocosmetics, while Ache already has a significant position in the first product line.

Outlook: Stable

The stable outlook on Ache reflects our expectation that it will continue generating increasing cash flows from sizable pipeline of new drug launches, even amid slightly weaker profitability in the next few years. The latter will be result of pre-operational expenses during the construction of the new plant and higher FX. We expect Ache to maintain its debt to EBITDA below 0.5x, even amid higher debt to fund the construction of the new plant.

Downside scenario

In our view, a downgrade is unlikely in the next 12 months because the sovereign rating outlook is stable, and we expect the company to maintain stable operating and financial performance. We would lower the ratings on Ache if we were to revise Brazil's transfer and convertibility (T&C) assessment downward to 'BB' due to a sovereign downgrade. Assuming Brazil's T&C assessment remains at 'BB+', we would only downgrade Ache if its debt to EBITDA rises consistently above 3x and/or its liquidity weakens. Nevertheless, we could lower Ache's stand-alone credit profile (SACP) from 'bbb-' to 'bb+' if its debt to EBITDA is above 2x and/or liquidity weakens as result of significant debt increase to fund potential acquisitions or more aggressive dividend distributions. However, we don't foresee these scenarios in the short to medium term because of the management's very prudent approach to debt. Additionally, in the event of weakened liquidity, we would reassess the extent to which the company can have a higher rating than the one on the sovereign.

Upside scenario

We could raise the ratings on Ache in the next 12-18 months if we were to raise Brazil's T&C assessment. We don't expect improvement in Ache's SACP in the same period because we don't expect meaningful rise in the company's scale or geographic and product diversification, all of which will continue to be much weaker than those of global peers.

Our Base-Case Scenario

Assumptions	Key Metrics

Assumptions

- Brazil's GDP growth of 2.4% in 2019 and 2.5% in 2020.
- Inflation rate of 4.3% in 2019 and 4.0% in 2020.
- Brazil's basic interest rate of 7.5% in 2019 and 8.5% in 2020.
- Average exchange rate of R$3.9 per $1.00 in 2019 and R$4.05 per $1.00 in 2020.
- Annual volume growth of 3.5%-6.5% from new drug launches and portfolio maturation. We expect prescription, generic drugs, and dermocosmetics to account for the bulk of volume growth in the next few years.
- Prescription drug price increases of 8% on average in 2018 and 2019, assuming 60% inflation (historical average) plus a 4.5%-6.5% premium to factor in new drug launches, which usually carry higher prices. For the remaining categories (OTC, dermocosmetics, generics), we assume price adjustments aligned with inflation plus 1.5%-2% premium factor on launch of more value added products.
- The combination of volume growth and price increases drive our forecasted revenues of R$3.6 billion in 2019 and R$4.1 billion in 2020.

Key Metrics

	2017A	2018E	2019E
EBITDA margin (%)	29.4	29-31	28-30
FFO to debt (%)	10,887	>400	100-200
Debt to EBITDA (x)	0	0.0-0.3	0.3-0.7

All figures are S&P Global Ratings adjusted. A--Actual. E--Estimate. FFO--Funds from

Base-case projections

We forecast a slight decline in EBITDA margin for the next two years. This is a reflection of higher raw material costs denominated in US dollars, which account for about 40% of total costs, the increasing share of generic drugs sales of total revenue, and some pre-operational costs and expenses for the new plant.

Almost all of the forecasted capex for 2019-2020 is slated for the new plant. We forecast annual capex of about R$400 million in 2019 R$ 200 million in 2020,mainly for the development of the new plant and the remainder for operations maintenance. The project's total investment is about R$650 million for 2018-2020. The company will fund the total amount with debt. It has already contracted a R$323 million loan from BNDES (the Brazilian National Development Bank) and a R$324 million loan from Banco do Nordeste (a public bank from the northeastern region, where the plant will be located). The two loans are disbursed gradually, as the project advances, until 2020.

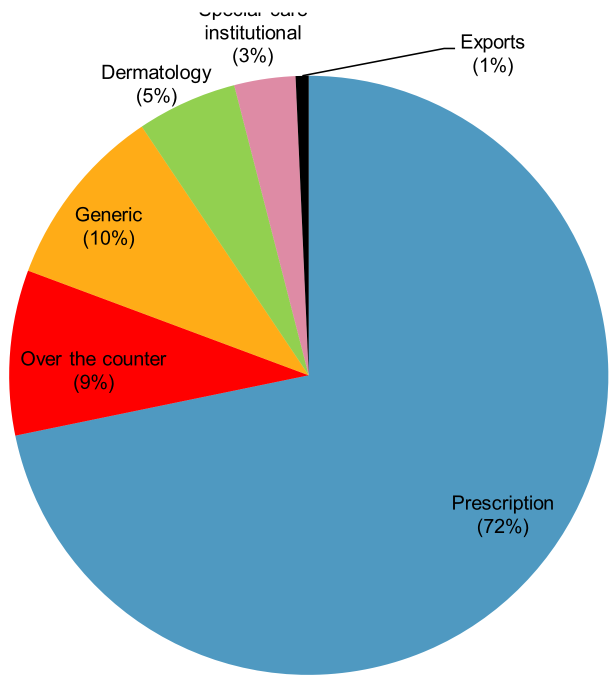
Even amid considerable capex, we expect Ache to generate free operating cash flows. However, discretionary cash flow will remain negative or close to zero due to sizable dividends payments. We forecast payout of 85% of previous-year net income in 2019 and 2020, similar to 2018 level.

Company Description

Ache is one of the largest pharmaceutical companies in Brazil. It has a diversified portfolio in terms of therapeutic classes through the prescription, generics, over the counter (OTC) and dermatology segments. The company also counts with minor export revenues via licensing agreements to manufacture and sell, pharmaceutical products in the Americas, Africa, Japan, the Middle East, Asia, and internationally. Founded in 1966, Ache is headquartered in São Paulo, Brazil, and family founders hold 100% of its shares.

Chart 1

Revenue By Segment



Source: S&P Global Ratings.

Business Risk: Fair

We expect Ache to maintain solid market position in the Brazilian pharmaceutical industry, with its main segment of operation, the so called "branded generics", as having a leading position. The company should keep a sizable pipeline of new drugs while benefitting fro experience in navigating regulatory approval process for new drugs launches.

Ache lacks scale, and portfolio and geographic diversification in comparison with large global pharmaceuticals players. The latter players, in conjunction with other large domestic players, could put pressure on Ache's market share and profitability. Still, Ache's consistent operating efficiency with a large scale in domestic market enables solid relationships with distributors and retailers.

We believe that once the new plant is fully operational, likely by the end of 2021, Ache's profitability should rebound to those in past years of above 30%, given that it will start manufacturing packaging and some relevant drug lines internally, and not rely on third parties anymore.

Peer comparison

Hypera S.A. (BB+/Stable/--) is Ache's closest rated peer, because both operate in Brazil and lack international diversification. Hypera has been increasing the focus on the prescription drug segment, which increases competition for Aché. Still, we believe that both companies are well positioned in a fragmented market, and can grow without jeopardizing their current market shares. Both companies maintain a very prudent approach to leverage, with low debt levels. Mylan N.V. (BBB-/Stable/A-3), which is one of the largest global generic drugs producers, has a larger scale than Ache, but both generate similar profitability levels due to a portfolio that's based on generics. However, Mylan carries much higher leverage than Aché, resulting in only one notch difference in the ratings.

Table 1

Ache Laboratorios Farmaceuticos S.A. -- Peer Comparison

Industry Sector: Pharmaceuticals

	Ache Laboratorios Farmaceuticos S.A.	Mylan N.V.	Hypera S.A.
Rating as of Jan. 21, 2019	BB+/Stable/--	BBB-/Stable/A-3	BB+/Stable/--
	--Average of past three fiscal years--		
(Mil. R$)			
Revenues	2,662.4	37,622.6	3,274.4
EBITDA	784.3	10,681.2	1,113.6
FFO	570.0	8,359.5	1,024.6
Net income from cont. oper.	528.2	2,408.8	701.4
Cash flows from operations	514.8	7,317.6	454.4
Capital expenditures	117.6	2,283.5	179.6
Free operating cash flow	397.2	5,034.1	274.8
Discretionary cash flow	(36.5)	5,034.1	32.8
Cash and short-term investments	177.3	3,274.8	1,875.4
Debt	14.7	43,097.1	586.1
Equity	1,445.0	39,657.1	8,158.9
Adjusted ratios			
EBITDA margin (%)	29.5	28.4	34.0
Return on capital (%)	51.5	6.4	12.4
EBITDA interest coverage (x)	53.7	6.7	4.0
FFO cash interest coverage (X)	48.9	8.0	3.2
Debt/EBITDA (x)	0.0	4.0	0.5
FFO/debt (%)	3,883.4	19.4	174.8
Cash flow from operations/debt (%)	3,507.0	17.0	77.5
Free operating cash flow/debt (%)	2,706.0	11.7	46.9

Table 1

Ache Laboratorios Farmaceuticos S.A. -- Peer Comparison (cont.)			
Industry Sector: Pharmaceuticals			
	Ache Laboratorios Farmaceuticos S.A.	**Mylan N.V.**	**Hypera S.A.**
Discretionary cash flow/debt (%)	(248.5)	11.7	5.6

FFO--Funds from operations.

Financial Risk: Minimal

We forecast Ache to continue generating solid free operating cash flows even amid high capex plan over the coming years. Despite the higher gross debt to fund capex, we believe increasing cash flows from new drugs and portfolio maturation will support low leverage, with debt to EBITDA around 0.5x in the next few years. Given the forecasted free operating cash flows, we continue to expect Ache to distribute excess cash to shareholders, leading to negative or close to zero discretionary cash flows. The new loans to fund the plant's construction have long-term maturities and low cost, allowing the company to maintain a comfortable capital structure.

Financial summary

Table 2

Ache Laboratorios Farmaceuticos S.A. -- Financial Summary					
Industry Sector: Pharmaceuticals					
	--Fiscal year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
Rating history	BBB-/Negative/--	BBB-/Negative/--	BBB-/Stable/--	BBB-/Stable/--	BBB-/Stable/--
(Mil. R$)					
Revenues	2,967.9	2,686.3	2,332.9	2,133.8	1,860.6
EBITDA	871.4	811.0	670.4	739.1	654.7
FFO	617.7	614.0	478.4	553.1	484.6
Net income from continuing operations	566.4	544.3	473.9	475.0	403.2
Cash flow from operations	694.6	479.7	370.1	469.8	311.3
Capital expenditures	99.2	107.8	145.7	88.1	57.4
Free operating cash flow	595.3	371.9	224.4	381.7	253.9
Discretionary cash flow	45.2	(80.2)	(74.4)	(115.6)	(25.9)
Cash and short-term investments	169.0	134.4	228.6	291.1	415.2
Debt	5.7	38.4	0	0	0
Equity	1,524.5	1,455.9	1,354.7	1,140.9	1,263.2
Adjusted ratios					
EBITDA margin (%)	29.4	30.2	28.7	34.6	35.2
Return on capital (%)	52.8	51.9	49.8	56.7	50.3
EBITDA interest coverage (x)	53.3	55.1	52.6	86.8	88.5
FFO cash interest coverage (x)	49.8	58.7	39.6	55.3	35.3
Debt/EBITDA (x)	0.0	0.0	0	0	0
FFO/debt (%)	10,887.0	1,600.6	N.M.	N.M.	N.M.

Table 2

Ache Laboratorios Farmaceuticos S.A. -- Financial Summary (cont.)					
Industry Sector: Pharmaceuticals					
	--Fiscal year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
Cash flow from operations/debt (%)	12,240.9	1,250.5	N.M.	N.M.	N.M.
Free operating cash flow/debt (%)	10,492.1	969.5	N.M.	N.M.	N.M.
Discretionary cash flow/debt (%)	796.1	(209.1)	N.M.	N.M.	N.M.

FFO--Funds from operations. N.M.--Not meaningful

Liquidity: Adequate

Ache's liquidity is adequate, in our view. While we expect the company to maintain high dividend payouts due to strong cash flows, Ache would have the flexibility to reduce them, if needed. Ache is not a frequent issuer in credit markets, but has sound relationships with Brazilian banks (mainly public lenders) and generally prudent financial risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash position of R$153.8 million as of Sept. 30, 2018; • Projected FFO of around R$690 million in the next 12 months from Sept. 30, 2018; and • New debt to be disbursed in the next 12 months of R$56 million.	• Short-term debt maturities of R$46 million as of Sept. 30, 2018; • Projected working capital outflows of about R$120 million in the next 12 months; • Capex of about R$360 million in the next 12 months; and • Dividend payments of about R$150 million in the next 12 months (reduced to 25% from base-case level of 85%, because we believe the company could lower them if needed).

Debt maturities

As of September 2018, Ache's debt maturities were as follows:

- 2019: R$45.9 million
- 2021: R$38.9 million
- 2023: R$36.4 million
- 2025: R$36.5 million
- 2026: R$85 million

Covenant Analysis

Compliance expectations

We expect the company to maintain more than a 15% cushion on its financial covenants.

Requirements

Ache's covenants require it to keep net debt to EBITDA at maximum of 3x and total liabilities to total assets of maximum of 75% (only BNDES' loans). In our view, Ache will maintain a large headroom on its covenants calculations.

Rating Above The Sovereign

The global scale rating on Ache is currently two notches above the 'BB-' long-term sovereign foreign currency rating on Brazil because, in our view, there's a considerable likelihood that the company wouldn't default in a hypothetical scenario of sovereign default due to its comfortable liquidity position, with very few short-term debt maturities, and its flexibility to reduce dividends and capex.We consider pharmaceutical entities to be moderately sensitive to Brazil's economy, given the industry's resilience. This factor allows us to rate Ache above the sovereign, but we cap the rating at the country's 'BB+' T&C assessment due to the bulk of Ache's operations in domestic market.

Under a simulated sovereign default scenario, we would expect to see:

- GDP contraction of 10%, doubling of foreign exchange and basic interest rates, compared with our base-case scenario, and an inflation rate of 12.5%.
- GDP decline and high unemployment would Ache's reduce revenues by about 10% due to lower volumes and no price increases.
- Inflation and a weaker foreign exchange rate would increase costs and expenses, leading to an EBITDA decline close to 35%, relative to our base case.
- Doubling of basic interest rates would increase Ache's interest expenses on its floating-rate debt.
- A haircut of 70% on the company's short-term investments and of 10% on its bank deposits.
- Under weaker cash flow generation, we assume the company would reduce capex to maintenance levels of about R$70 million and wouldn't distribute dividends.
- Ache would postpone the construction of the new plant.

Even under this hypothetical scenario, the company's cash sources would be sufficient to cover its short-term needs, given its smooth debt amortization profile.

Reconciliation

Table 3

Reconciliation Of Ache Laboratorios Farmaceuticos S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$)

	--Rolling 12 months ended Sep. 30, 2018--									
Ache Laboratorios Farmaceuticos S.A. reported amounts.										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
	242.8	1,490.4	3,235.9	974.1	911.5	17.4	974.1	576.7	533.6	115.9
S&P Global Ratings' adjustments										
Interest expense (reported)	--	--	--	--	--	--	(17.4)	--	--	--
Interest income (reported)	--	--	--	--	--	--	12.3	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(261.9)	--	--	--
Surplus cash	(153.8)	--	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	10.0	--	--	--	--	--
Non-controlling Interest/Minority interest	--	8.8	--	--	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	--	2.4	2.4	--	2.4	--	--	--
D&A - Other	--	--	--	--	(6.0)	--	--	--	--	--
Working capital - Taxes	--	--	--	--	--	--	--	(178.0)	--	--
Working capital - Other	--	--	--	--	--	--	--	29.8	--	--
OCF - Taxes	--	--	--	--	--	--	--	178.0	--	--
OCF - Other	--	--	--	--	--	--	--	(29.8)	--	--
Total adjustments	(153.8)	8.8	0.0	2.4	6.4	0.0	(264.7)	0.0	0.0	0.0
S&P Global Ratings' adjusted amounts										
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
	89.0	1,499.2	3,235.9	976.4	918.0	17.4	709.3	576.7	533.6	115.9

Ratings Score Snapshot

Issuer Credit Rating

BB+/Stable/--

Business risk: Fair

- **Country risk:** Moderately high
- **Industry risk:** Low
- **Competitive position:** Fair

Financial risk: Minimal

- **Cash flow/Leverage:** Minimal

Anchor: bbb-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb-

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Pharmaceutical Industry, April 8, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	**bbb/bbb-**	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of January 30, 2019)

Ache Laboratorios Farmaceuticos S.A.		
Issuer Credit Rating		BB+/Stable/--
Brazil National Scale		brAAA/Stable/--
Issuer Credit Ratings History		
12-Jan-2018		BB+/Stable/--
16-Aug-2017		BBB-/Negative/--
23-May-2017		BBB-/Watch Neg/--
17-Feb-2016		BBB-/Negative/--
16-Aug-2017	*Brazil National Scale*	brAAA/Stable/--
23-May-2017		brAAA/Watch Neg/--
17-Feb-2016		brAAA/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.