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## Fitch Affirms Ache's IDR at 'BB'; Outlook Negative

Fitch Ratings - São Paulo - 01 Feb 2022: Fitch Ratings has affirmed Ache Laboratorios Farmaceuticos S.A.'s Long-Term Foreign Currency (FC) Issuer Default Rating (IDR) at 'BB', Long-Term Local Currency (LC) IDR at 'BBB' and National Scale Rating at 'AAA(bra)'. The Rating Outlook is Negative for the FC and LC IDRs and Stable for the National Scale Rating.

Ache's ratings reflect the defensive nature of the pharmaceutical industry with low levels of cash flow volatility and the company's leading position in the Brazilian prescription drug segment. The ratings also incorporate Ache's low product portfolio risk, with no relevant exposure to patents or licenses, and the company's commitment to an unleveraged capital structure, while managing its growth plans with its resilient FCF generation before dividends. Ache's sustainable market position, reinforced by its large sales team, gives the company a key competitive advantage in reaching out to the medical community and building brand awareness.

### Key Rating Drivers

**Positive Industry Fundamentals:** The pharmaceutical industry has positive long-term fundamentals, in light of the aging world population and increasing access to health systems. The sector has consistently outperformed the growth of the Brazilian economy. In the last four years, the Brazilian pharmaceutical market reported an average annual increase of 12%, above the rate of Brazilian GDP growth, indicating resilient demand even in adverse macroeconomic conditions.

The higher incidence of chronic diseases and the need to invest in new treatments will continue to boost consumption of medicines in the future. Longer term, increased competition and the maturing of patents may generate some price pressures, as it occurs with generic drugs.

**Solid Business Profile:** Ache has a solid and recognized brand in the Brazilian pharmaceutical industry. The company's diversified product portfolio, leadership in the prescription drug segment and presence in the fast-growing over-the-counter (OTC), generics and dermo cosmetics segments support its sound business profile. Ache is the fifth-largest retail pharmaceutical company in Brazil and has one of the largest sales forces in the domestic market. This gives the company a key competitive advantage over local and international peers, as it allows for extensive outreach to the medical community, a crucial demand driver for prescription drugs.

**Low Product Portfolio Risk:** Ache's operating cash flow is not significantly exposed to license renewals or patent expirations. Similar to other emerging markets pharmaceutical companies, Ache has a narrower R&D product pipeline than those of its multinational competitors and a weaker portfolio of patented products. Positively, the company's exposure to licensing agreements is low, representing less than 8% of revenue. Ache's ability to maintain a sustainable volume of product launches each year

and to increase the share of innovations in its portfolio will be key factors in preserving its competitive position.

**Competition Remains Tight:** Competition with local pharmaceutical companies remains tight with local competitors acquiring brands from multinationals, expanding their generic product reach across segments or therapeutic classes, and with aggressive commercial conditions. Fitch expects Ache's EBITDA margins at 25% in 2021, lower than the 28% average between 2015 and 2019, as the company seeks to defend its position in the prescription drugs segment and to increase its presence on generics, OTC and special care.

**CFFO to Remain Sound:** Ache's pre-dividend FCF will remain robust. Fitch forecasts EBITDA of BRL990 million and cash flow from operations (CFFO) of BRL774 million in 2021, increasing to BRL1.1 billion and to BRL871 million in 2022, and with a growing trend onwards. Base case scenario incorporates capex at BRL804 million in 2021-2023, mostly related to the new plant in Pernambuco, which will lead to around 50% expansion in the company's production capacity. FCF is expected to be negative BRL13 million in 2021 and positive in 2022. Fitch estimates average annual dividends of BRL554 million from 2021 to 2023, corresponding to approximately 75% of net income.

**Unleveraged Capital Structure:** Ache has maintained low leverage ratios and strong credit metrics. Net debt/EBITDA is projected to remain below 0.6x and FFO leverage between 0.8x and 1.1x in the next four years. This scenario already considers investments for the new facility and high dividend pay-outs. In the past four years, the company's average FFO leverage was 0.7x and the net debt/EBITDA ratio was 0.3x.

## Derivation Summary

Ache's lack of geographic diversification, smaller scale and relatively narrow research portfolio compared with top pharmaceutical companies constrain its 'BBB' LC IDR, while the concentration of revenues in Brazil together with the lack of operating and financial assets abroad cap its FC IDR at the Brazilian Country Ceiling of 'BB'. Ache's capital structure has consistently been stronger than Fitch's 'BBB' portfolio and is well-positioned in terms of leverage compared with most of the top global pharmaceutical issuers that are rated 'A' or 'AA' by Fitch, with average net leverage below 1.0 x.

Ache's National Scale Rating is the same rating category of Eurofarma Laboratorios S.A (AAA[bra]/Stable), and both companies are well positioned in the Brazilian pharmaceutical market landscape and count on a conservative financial profile. Ache is rated one notch higher than Blau Farmaceutica S.A. (AA+[bra]/Stable). Compared with Ache, Blau has limited operational scale; revenue concentration in a few products with a focus on the nonretail segment. Both companies have strong credit metrics. Ache is positioned two notches higher than Uniao Quimica Farmaceutica Nacional S.A. (AA[bra]/Stable), the later has a good operational scale and diversification, but Ache's capital structure and financial flexibility are stronger.

## Key Assumptions

--Average volume growth of 12% per year from 2021 to 2023;

- Average revenues growth of 15.5% per year from 2021 to 2023;
- Capex of BRL804 million in 2021-2023, which includes investments in the new plant in Pernambuco;
- Dividend pay-out of 75% of the net income per year.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- For the FC and LC IDRs, positive rating actions are limited by Brazil's Country Ceiling of 'BB' and 'BB-' sovereign rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Ache's credit ratios are very strong at the current rating level, but unexpected events that move net debt/EBITDA beyond 2.0x or FFO-adjusted leverage beyond 3.0x could result in negative rating action for the LC IDR;

- Significant market share or brand deterioration;

- Further negative rating action on Brazil's sovereign rating and Country Ceiling could result in negative rating action on Ache's FC and LC IDRs.

## **Best/Worst Case Rating Scenario**

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **Liquidity and Debt Structure**

**Strong Liquidity:** Ache has historically maintained a robust liquidity position. On Sept. 30, 2021 Ache reported BRL131 million of debt maturing up to December 2022 and cash and marketable securities of BRL137 million, reinforced by an undrawn balance of BRL270 million from a BRL300 million revolving credit facility (RCF), a strong pre-dividend FCF generation and flexible dividend payment to manage cash needs. Ache has BRL70 million of debt due in 2023 and BRL231 million in 2024.

Ache's total debt of BRL879 million was comprised of long-term transactions from development banks such as Banco Nacional de Desenvolvimento Economico e Social (BNDES), Banco do Nordeste and others (51%), long-term debentures (45%) and others (3%).

## Issuer Profile

Ache is the fifth-largest pharmaceutical company in the Brazilian retail market, and is a leader in the Brazilian prescription segment with solid brand recognition and a diversified product portfolio. Ache develops, manufactures and commercializes off-patent and locally unpatented products.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

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## Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Ache Laboratorios Farmaceuticos S.A.	LT IDR	BB 	Affirmed	BB 
	LC LT IDR	BBB 	Affirmed	BBB 
	Natl LT	AAA(bra) 	Affirmed	AAA(bra) 

### RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

### Applicable Criteria

[Corporate Rating Criteria \(pub.15 Oct 2021\) \(including rating assumption sensitivity\)](#)

[Metodologia de Ratings Corporativos \(pub.15 Oct 2021\)](#)

[Metodologia de Ratings em Escala Nacional \(pub.22 Dec 2020\)](#)

[National Scale Rating Criteria \(pub.22 Dec 2020\)](#)

### Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 [\(1\)](#)

### Additional Disclosures

[Solicitation Status](#)

## Endorsement Status

Ache Laboratorios Farmaceuticos S.A. EU Endorsed, UK Endorsed

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