S&P Global Ratings

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Ache Laboratorios S.A.

February 14, 2022

Ratings Score Snapshot

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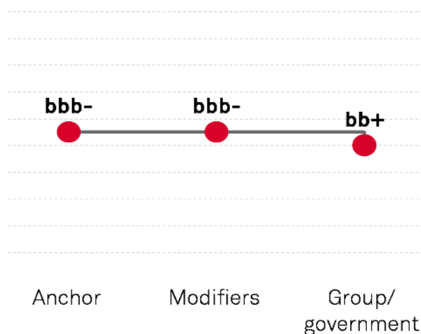
Business risk: **Fair**

Vulnerable Excellent

Financial risk: **Minimal**

Highly leveraged Minimal



BB+/Stable/--

Issuer credit rating

Brazil National Scale

brAAA/Stable/--

Credit Highlights

Overview

Key strengths	Key risks
One of the largest players in Brazil's pharmaceutical market	Operating in a highly fragmented industry.
A sizable pipeline of launches and low leverage.	Geographic concentration.

Familiarity with the regulatory approval process for new drugs.	Rising competition.

Strong cash flows from new drugs and sales recovery. The social-distancing measures imposed by the Brazilian government drastically lowered visits to pharmacies and doctors. This reduced demand for some of Ache Laboratorios Farmaceuticos S.A.'s (Ache's) products in 2020, which weighed on its over-the-counter (OTC) and generics portfolio. In 2021, the company was able to increase visits to physicians and stores by 41% and 17%, respectively. Its multichannel sales force and capillarity lifted productivity, convenience, and coverage. The company's 2021 revenue grew more than 16% from 2020, and we forecast a recurrent and robust cash flow generation in the next two to three years, as the company invests in innovation, installed capacity, international operations, and digital transformation.

Low leverage to remain despite high investments in the new plant. The construction of Ache's new plant in the Brazilian state of Pernambuco was halted for about five months in 2020 due to the government's restrictions to contain the spread of the coronavirus, which postponed investments for that year. As a result, we expect Ache to invest about R$180 million in the new plant in 2022, during which construction should be completed. The company will finance investment mostly through bank loans from BNDES (the Brazilian National Development Bank) and Banco do Nordeste (a public bank in northeastern Brazil, where the plant will be located). Still, we believe Ache's solid cash flows will enable it to continue reporting solid credit metrics, with debt to EBITDA remaining below 0.5x in the next few years.

Outlook

The stable outlook reflects our expectation that Ache will continue increasing its cash flows thanks to its sizable pipeline of new drugs. At the same time, we expect Ache to maintain debt to EBITDA at about 0.5x despite higher debt to finance the construction of the new plant. Additionally, we expect Ache to continue funding its capital expenditures (capex) and dividend payments with internal cash flows.

Downside scenario

We would lower the ratings on Ache if we were to revise Brazil's transfer and convertibility (T&C) assessment downward to 'BB' from 'BB+' due to the sovereign's downgrade. Given that we believe there's a significant cushion between Ache's stand-alone credit profile (SACP) of 'bbb-' and its final issuer credit rating of 'BB+', we would only downgrade the company if its debt to EBITDA is consistently above 3x or if its liquidity weakens. Nevertheless, we could revise downward Ache's SACP to 'bb+' if its debt metric is consistently above 2x or if liquidity weakens because of significant debt increase to fund potential acquisitions or more aggressive dividend distributions. However, we don't forecast these scenarios in the next few years because of the management's very prudent approach to debt. Additionally, in the event of weakened liquidity, we would reassess the extent to which we could rate the company above the sovereign.

Upside scenario

We could raise our ratings on Ache if we upgrade Brazil. This is currently the only upgrade scenario we expect, because we limit ratings on the company to a maximum of two notches above the sovereign rating.

Our Base-Case Scenario

Assumptions

- Brazil GDP real growth: 4.8% in 2021, 0.8% in 2022, and 2.0% in 2023.
- Brazilian inflation rate at 8.2% in 2021, 7.7% in 2022, and 4.0% in 2023.
- During 2021, the volume of prescription drugs remained strong despite negative impacts in volume from a few products such as respiration drugs. Volumes of OTC and generics, on the other hand, plummeted due to suppliers' restrictions and lower

demand for specific drugs during the year. For 2022, we expect demand, particularly for generics and OTC, normalizes, as well as increased sales from the new products launched in 2021.

- Average price increase in 2021 reflected mainly the product mix, so for 2022, we expect lower average prices as demand for Ache’s generics and OTC products returns to normal levels.
- Revenue growth of 15% in 2021, 25% in 2022, and 17% in 2023 based on these volume and price changes.
- Somewhat flat EBITDA margins in 2021, returning to pre-pandemic levels of 32% in 2022.
- Dividend payout based on the company guidance, at 80%-85%. Ache has no stated policy of dividends payments, and it has the flexibility to reduce payments, if necessary, to support capex for instance, or other liquidity needs.
- Capex between R$200 million and R$300 million in the next three years, as a significant portion of investments in the Pernambuco plant was shifted to 2021-2022 due to the lockdowns.
- Refinancing of debt in 2021 and 2022 to build liquidity cushion and inventory, and protect the company from the pandemic's potential harsh impacts.

Key metrics

Ache Laboratorios Farmaceuticos S.A.--Key Metrics*

Mil. R$	2019a	2020a	2021e	2022f	2023f
Revenue	3.350	3.477	4.015	5.000	6.700
EBITDA margin (%)	28.9	27.5	26.7	28-31	28-31
Debt to EBITDA (x)	0.5	0.8	0.8	0.3-0.5	0.3-0.5
FFO to debt (%)	147.8	101.4	>100	>100	>100

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

We forecast somewhat flat EBITDA margins in 2021, but they will recover in 2022. Higher expenses related to R&D and digital initiatives, as well as to the transfer of products to the new plant should pressure Ache's margins in 2021. We forecast the company's EBITDA margin to be edge up to about 29% in 2021 from 28% in 2020. We expect margins to start recovering in 2022, returning above 30% thanks to the new plant's full operations.

Solid cash flows allow for sizable dividend payments. We forecast dividend payout to be 80%-85% of previous year's net income in 2022-2023. In our view, Ache's solid operations and rising cash flows, thanks to the pipeline of new drugs and the above-industry-average profitability, allow the company to continue to make such payments. Moreover, we believe dividends are highly discretionary and that Ache could decrease payouts if its liquidity is pressured.

Leverage to remain low. Ache's debt increased in 2020 to finance the new plant, and to strengthen liquidity and inventory amid the pandemic. It reported debt to EBITDA of about 0.8x in 2020 and in the third quarter of 2021. We expect increasing cash flows to strengthen credit metrics with leverage dropping below 0.5x.

Company Description

Ache is one of the largest pharmaceutical companies in Brazil. It has a diversified portfolio in terms of drug categories across the prescription, generic, OTC, and dermatology segments. The company also generates small export revenues through licensing agreements to manufacture and sell pharmaceutical products internationally. Founded in 1966, Ache is headquartered in Sao Paulo, Brazil, and the founding family holds 100% of shares.

Peer Comparison

Hypera S.A. (BB+/Stable/--) is Ache's closest rated peer, because both operate in Brazil and lack international operations. After the recent acquisition of the drug portfolio from Takeda Pharmaceuticals Co. Ltd. (BBB+/Stable/A-2), Hypera has become the largest pharmaceutical player in Brazil, considering sell-out pharmacy purchase price. The company also expanded its presence in the prescription drug segment, increasing competition against Ache. Still, we believe that both companies are well positioned in a fragmented market with room for further growth without jeopardizing their current market shares. Moreover, Ache has maintained a more prudent approach to leverage, with lower debt level than that of Hypera. Our rating on Viatris Inc. (BBB-/Positive/A-3) reflects its large scale, strong product and geographic diversification, record of launching new generic products (including complex generics and biosimilars), and solid margins. However, we believe that COVID-19 will continue to pressure Viatris' results in 2021, but less so than in 2020. Viatris' generics, established brands, and branded products (including EpiPen) are hindered by fewer doctors' visits and elective procedures, and general economic weakness. We expect this impact to lessen in the end of 2021 and beginning of 2022 but believe there could be some lasting effects from tighter government budgets and the behavior of cash-pay patients. Viatris' leverage is higher than that of Ache, because we expect the former company's adjusted debt to EBITDA to remain in the 3x-4x range.

Ache Laboratorios Farmaceuticos S.A.--Peer Comparisons

	Ache	Hypera S.A.	Viatris Inc.
Foreign currency issuer credit rating	BB+/Stable/--	BB+/Stable/--	BBB-/Stable/A-3
Local currency issuer credit rating	BB+/Stable/--	BB+/Stable/--	BBB-/Stable/A-3
Period	Annual	Annual	Annual
Period ending	2020-12-31	2020-12-31	2020-12-31
Mil.	R$	R$	R$
Revenue	3,477	4,089	62,038
EBITDA	957	1,205	14,675
Funds from operations (FFO)	734	1,029	10,049
Interest	65	176	2,631
Cash interest paid	25	166	2,941
Operating cash flow (OCF)	511	1,096	6,759
Capital expenditure	45	1,927	3,538
Free operating cash flow (FOCF)	466	(831)	3,222
Discretionary cash flow (DCF)	(49)	(1,514)	3,181
Cash and short-term investments	284	4,743	4,826
Gross available cash	284	4,743	4,826
Debt	724	984	136,216
Equity	1,831	9,241	119,206
EBITDA margin (%)	27.5	29.5	23.7
Return on capital (%)	35.2	12.5	1.3
EBITDA interest coverage (x)	14.6	6.8	5.6
FFO cash interest coverage (x)	30.2	7.2	4.4
Debt/EBITDA (x)	0.8	0.8	9.3

Ache Laboratorios Farmaceuticos S.A.--Peer Comparisons

FFO/debt (%)	101.4	104.5	7.4
OCF/debt (%)	70.6	111.4	5.0
FOCF/debt (%)	64.4	(84.5)	2.4
DCF/debt (%)	(6.7)	(153.8)	2.3

Business Risk

We expect Ache to maintain its significant market position in the Brazilian pharmaceutical industry, with the leading position in main segments of operation, the so called "branded generics" which currently represent about 72% of revenue. The company launched 34 products in 2021 given the perception of quality, efficacy, and safety of its products, even amid the public health crisis, which took a toll on the pharmaceutical industry. Ache will maintain a considerable pipeline of new drugs, while benefitting from experience in navigating through the regulatory approval process. We believe that once the new plant is completed and starts to operate, Ache's profitability should rebound above 30%. In addition, the company's focus on the branded generics, which should continue representing the bulk of its revenue, supports our expectation of higher margins in the future, in contrast to the more commodity-like nature of unbranded generics with lower margins. Ache lacks scale, portfolio, and geographic diversification of large global pharmaceutical players. Still, Ache's consistent operating efficiency with large domestic market share enables sound relationships with distributors and retailers

Financial Risk

We forecast Ache to continue generating solid free cash flows, owing to the new launches and portfolio adjustments over the next few years, despite its sizable capex of about R$300 million in 2022 and R$200 million in 2023 to complete the new plant's construction. Additionally, we expect Ache to continue distributing most of its excess cash to shareholders, while discretionary cash flows remain positive. In September 2021, Ache issued a debenture of R$400 million to refinance existing debt and extend its maturity profile. It was the company’s first market issuance, which combined with the loans to fund the construction of the new plant and amortize previous liabilities, raised debt to EBITDA to 0.9x. This was a leverage peak for a company with a historical net cash position. For the next few years, we expect Ache to issue new debt for refinancing purposes as well. Still, amid increasing cash generation, we forecast debt to EBITDA to drop below 0.5x by 2022. Nevertheless, the new debts have long-term maturities, allowing the company to keep a comfortable capital structure with weighted average maturity of debt of more than three years.

Debt maturities

As of Sept. 30, 2021, Ache's debt maturity profile was as follows:

- Short-term: R$120 million
- 2023: R$146 million
- 2024: R$395 million
- 2025: R$216 million

Ache Laboratorios Farmaceuticos S.A.--Financial Summary

Period ending	Dec-31-2015	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020
Reporting period	2015a	2016a	2017a	2018a	2019a	2020a
Display currency (mil.)	R$	R$	R$	R$	R$	R$
Revenues	2,333	2,686	2,968	3,183	3,351	3,477

Ache Laboratorios Farmaceuticos S.A.--Financial Summary

EBITDA	670	811	871	934	968	957
Funds from operations (FFO)	477	599	647	644	741	734
Interest expense	13	15	16	16	25	65
Cash interest paid	12	11	13	11	22	25
Operating cash flow (OCF)	370	480	695	562	686	511
Capital expenditure	146	108	99	129	187	45
Free operating cash flow (FOCF)	224	372	595	433	499	466
Discretionary cash flow (DCF)	(74)	(80)	45	(31)	15	(49)
Cash and short-term investments	229	134	169	245	145	284
Gross available cash	229	134	169	245	145	284
Debt	0	38	6	138	501	724
Common equity	1,355	1,456	1,525	1,558	1,697	1,831
Adjusted ratios						
EBITDA margin (%)	28.7	30.2	29.4	29.4	28.9	27.5
Return on capital (%)	53.5	54.7	54.9	54.0	44.8	35.2
EBITDA interest coverage (x)	52.6	55.1	53.3	57.8	38.5	14.6
FFO cash interest coverage (x)	39.4	56.9	51.8	59.2	34.6	30.2
Debt/EBITDA (x)	0.0	0.0	0.0	0.1	0.5	0.8
FFO/debt (%)	NM	1,562.1	11,396.9	467.8	147.8	101.4
OCF/debt (%)	NM	1,250.5	12,240.9	408.5	136.8	70.6
FOCF/debt (%)	NM	969.5	10,492.1	314.7	99.5	64.4
DCF/debt (%)	NM	(209.1)	796.1	(22.3)	2.9	(6.7)

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

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2020									
Company reported amounts	897	1,831	3,477	1,033	897	65	957	511	515	45
Cash taxes paid	-	-	-	-	-	-	(198)	-	-	-
Cash interest paid	-	-	-	-	-	-	(25)	-	-	-
Lease liabilities	111	-	-	-	-	-	-	-	-	-
Accessible cash and liquid investments	(284)	-	-	-	-	-	-	-	-	-

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

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Nonoperating income (expense)	-	-	-	-	16	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	(15)	(15)	-	-	-	-	-
EBITDA: other	-	-	-	(60)	(60)	-	-	-	-	-
Working capital: other	-	-	-	-	-	-	-	11	-	-
OCF: other	-	-	-	-	-	-	-	(11)	-	-
Total adjustments	(173)	0	0	(75)	(59)	0	(224)	0	0	0
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	724	1,831	3,477	957	838	65	734	511	515	45

Liquidity

Ache's liquidity remains adequate, in our view, with sources of liquidity to exceed uses by more than 1.2x for the next 12 months. While we expect the company to maintain high dividend payouts due to strong cash flows, they're discretionary and Ache can reduce them if needed in order to support its considerable capex in the next two years. We assume Ache could reduce the dividend payout ratio to about 25% to maintain adequate liquidity. We don't assess Ache as a frequent debt issuer in credit markets, but it has sound relationship with banks (mainly public lenders) and generally prudent financial risk management, ensuring a consistently comfortable liquidity position. In addition, we believe Ache can absorb high-impact and low-probability events without refinancing, given its ability to adjust capex and dividends.

Principal liquidity sources

Cash position of R$140 million as of Sept. 30, 2021;

Undrawn bank lines of R$300 million; and

Projected funds from operation (FFO) of about R$1100 million in 2021.

Principal liquidity uses

Short-term debt maturities of R$120 million as of Sept. 30, 2021;

Projected working capital outflows of about R$60

million in 2022;

Capex of about R$240 million in 2022;

Dividend payments of about R$570 million in 2022.

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, total liabilities to total assets of a maximum of 75% (only for BNDES's loans), and an EBITDA margin above 18%.

Environmental, Social, And Governance

ESG factors have no material influence on our credit rating analysis of Ache.

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, very few short-term debt maturities, and flexibility to reduce dividends and capex. We consider domestic pharmaceutical entities to be moderately sensitive to Brazil's economy, given the industry's resilience. These factors allow us to rate Ache above the sovereign, but we cap the rating at the 'BB+' T&C assessment on the country, because Ache mainly operates in the domestic market. In a simulated sovereign default scenario, we would expect to see:

- Consolidated net revenue to drop following the 10% contraction in Brazil's GDP, because we expect challenging macroeconomic conditions to reduce volumes sold but no changes in prices.
- Inflation rate would be higher than the double in our base-case scenario, in line with our criteria that assumes "a double of inflation, subject to a minimum of at least the historical peak in inflation rates for that country over a relevant time horizon", which was 12.5% in 2002.
- Inflation would increase COGS and SG&A, resulting in EBITDA in the next 12 months that's 25% lower than in our base-case scenario, somewhat more conservative than the 'ratings above the sovereign' criteria guidance of 15%-20% EBITDA decline for 'moderate sensitivity' industries.
- Doubling the basic interest rate would increase interest expenses, because about 40% of debt is linked to variable interest rate, reducing FFO.
- According to the management, Ache would reduce capex to the minimum of R$70 million for operations maintenance. It would also postpone the capex for the construction of the new plant, as it wouldn't have significant impact on operations, because the products to be manufactured at that facility are currently produced by third parties.
- We assume no dividend payment during the year of default, as according to management it could be postponed in moments of liquidity pressures.
- We assume 10% haircut to the company's bank deposits and 70% of haircut to remaining cash position, which is mainly short-term securities (certificate of deposits from domestic banks).

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

Rating Component Scores

Foreign currency issuer credit rating	**BB+/Stable/--**
Local currency 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-**
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: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (as of February 14, 2022)*

Ache Laboratorios Farmaceuticos S.A.	
Issuer Credit Rating	BB+/Stable/--
Brazil National Scale	brAAA/Stable/--

Ratings Detail (as of February 14, 2022)*

Issuer Credit Ratings History

07-Apr-2020		BB+/Stable/--
12-Dec-2019		BB+/Positive/--
12-Jan-2018		BB+/Stable/--
16-Aug-2017		BBB-/Negative/--
23-May-2017		BBB-/Watch Neg/--
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.

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