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Research Update:

Pfizer Inc. Downgraded To 'A+' Following Divestiture Of Upjohn; Outlook Stable

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Research Update:

Pfizer Inc. Downgraded To 'A+' Following Divestiture Of Upjohn; Outlook Stable

Rating Action Overview

- Pharmaceutical maker Pfizer Inc. completed the divestiture of its Upjohn segment, which represents about 20% of 2019 revenues. That business has been combined with Mylan's assets to form a new company, Viatris, in which Pfizer shareholders received a majority ownership. Pfizer also received about $12 billion in proceeds from debt raised by Viatris, which makes this transaction modestly deleveraging for Pfizer.
- S&P Global Ratings views this transaction as negative to Pfizer's business strength, because it weakens therapeutic diversification and scale. This is compounded by the company's plans to fully divest its consumer health business. That said we expect this divestiture will materially increase the company's organic revenue growth to levels above peers', and significantly reduces the need for acquisitions to sustain revenue growth.
- We expect adjusted leverage of 2.6x for 2019 (and 2.8x, as of Sept. 30, 2020) to improve to about 2.4x-2.5x for 2020 (pro forma for the full year impact of the divestiture), and to generally remain below 2.5x going forward.
- We expect substantial COVID-19 vaccine related profits to reduce debt leverage below 2x in 2021, but expect leverage to rise in 2022 once those revenues subside. Moreover, we expect even a moderate level of mergers and acquisitions (M&A) combined with limited discretionary cash flow after the annual dividend, will likely result in leverage rising above 2x.
- We are lowering our ratings on Pfizer, including the issuer credit rating to 'A+' from 'AA-', and removing the ratings from CreditWatch. Our 'A-1+' short-term rating is unaffected.
- The stable outlook reflects the company's very diverse product portfolio, our expectations for mid-single-digit percent revenue growth over the next few years (which is above that of peers), robust EBITDA margins, and only a moderate level of acquisitions. It also reflects our base-case expectation for leverage to generally remain below 2.5x.

Rating Action Rationale

Pfizer's business strength is weakened from the reduction in therapeutic diversification and scale stemming from the divestiture of the Upjohn segment.

Upjohn represented about $10 billion, or 20%, of 2019 revenues (and about $8

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billion of revenues in 2020), with EBITDA margins of about 50%. The business includes drugs that are off patent, several with substantial declines in revenue. The business impact of this divestiture is exacerbated by the company's plan to fully divest its consumer health business over the next few years, following the achievement of certain near term cost-synergies. This is currently held as a 32% stake in a large consumer health joint venture (JV) with GlaxoSmithKline (GSK; A/Stable/A-1) with total 2019 revenues of about $12 billion.

We view the revenues associated with the divested Upjohn assets (as well as those in the consumer health business) as having exposure to different risks than the primary business of on-patent branded drugs and see these businesses as providing some stabilizing benefits. That said, we also view the divestiture, including the significant revenue declines at Upjohn stemming from the recent patent expiration on Lyrica, as improving the organic revenue growth trajectory at Pfizer to levels modestly above big pharma peers'. We believe this meaningfully reduces Pfizer's need for M&A to sustain revenue growth.

We expect research and development (R&D) expenditures to remain largely unchanged in absolute terms following the divestiture, thus increasing as a percentage of revenue from about 14% to about 20%, which is more in line with levels at peers. We view this level of investment in R&D as generally sufficient to sustain organic revenue growth with limited need for acquisitions, which we view as an improved characteristic of the business. We also believe the narrower focus may help management better navigate through the pressures from potential drug price reform in the U.S.

We expect leverage to generally remain below 2.5x, and limited discretionary cash flow available for M&A or debt reduction after accounting for the substantial dividend.

We expect adjusted leverage of 2.5x for 2019 to improve to 2.1x for 2020 (2.4x-2.5x, pro forma for the full year impact of the divestiture), and for leverage to decline well below 2x in 2021, helped by substantial COVID-19 vaccine-related profits. However, we expect leverage to rise in 2022, once the COVID-19-related revenues subside. Moreover, we expect moderate spending on M&A, combined with limited discretionary cash flow after the annual dividend, will likely result in leverage rising above 2x. Thus, notwithstanding the near-term leverage improvement, we expect leverage to rise above 2x, but generally remain below 2.5x going forward. This has been our view on financial policy since the announcement of Array Biopharma acquisition in 2019, which pushed leverage materially above 2x.

Pfizer is a very large, well-diversified, and highly profitable pharmaceutical company.

It benefits from high barriers to entry and good pricing power, similar to other branded pharmaceutical company peers. Pfizer also benefits from strong profitability (EBITDA margins of about 40%), at the high end of the range posted by big pharma peers (averaging 30%-40%) such as Eli Lilly & Co. (A+/Negative/A-1+), Merck & Co. Inc. (AA-/Watch Neg/A-1+), Novartis AG

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(AA-/Stable/A-1+), Sanofi (AA/Stable/A-1+), and GSK. These margins however, are below those of biotech peers such as Biogen Inc. (A-/Watch Neg/--), Gilead Sciences Inc. (BBB+/Negative/--), and AbbVie Inc. (BBB+/Stable/A-2), which tend to have margins of about 50%, but with much greater product concentration.

We view Pfizer's business strength more favorably than that of most big pharma peers because of its good scale (about $40 billion of annual revenues pro forma for the divestiture of Upjohn, excluding COVID-19 vaccine revenue) and profitability (about 40% EBITDA margins), and better product and therapeutic diversification. For a more detailed comparison among peers, see "How Business Strength Varies Across The Top Pharma Companies," published Aug. 27, 2020. For a more detailed discussion of the business, see the full analysis published Aug. 27, 2020, on RatingsDirect.

Pfizer could earn billions of dollars in revenues from its vaccine, if successful.

Pfizer partnered with BioNTech SE on the development of an mRNA-based coronavirus vaccine, and recently announced that the first interim analysis of the phase-3 clinical trial for their vaccine (with more than 40,000 participants) found it was more than 90% effective in preventing COVID-19 with no serious side effects observed. The company entered an agreement to supply the U.S. government with 100 million doses for $1.95 billion and for the U.S. to acquire up to another 500 million doses at the same price. The company also has supply contracts with other countries, which provides the company the assurance of revenues even in the face of competing vaccines, albeit contingent on regulatory approval. Although we believe there are still risks to achieve regulatory approval (such as emergency use authorization by the FDA), including the requirement to demonstrate efficacy in reducing severe cases, and a more detailed assessment of the safety profile, at this point we believe approval is more likely than not. As such, we are assuming this product could generate $10 billion in revenues in 2021, in our base case, with margins near corporate average. That said, we view 2021 credit measures as an anomaly for Pfizer, thus failure to achieve regulatory approval would not affect our rating. For more on the vaccine industry, see "COVID-19 May Accelerate Disruption In The Global Vaccine Market," published Aug. 3, 2020, on RatingsDirect.

Outlook

The stable outlook reflects the company's very diverse product portfolio, our expectations for mid-single-digit revenue growth over the next few years (which is above that of peers), robust EBITDA margins, and only moderate level of acquisitions. It also reflects our base-case expectation for leverage to generally remain in the 2.0x to 2.5x range.

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Downside scenario

We could lower the rating if the company pursues significant M&A, which increases leverage to above 2.5x, absent a clear commitment to prioritize deleveraging ahead of other strategic priorities. We estimate the company's capacity within the rating is about $10 billion, depending on future EBITDA acquired and the strength of the commitment to prioritizing deleveraging, and to generally maintain leverage below 2.5x.

Upside scenario

We are not likely to raise the ratings on Pfizer over the next few years unless management demonstrates a firm commitment to preserving a modest financial risk profile, with adjusted debt leverage maintained consistently below 2x.

Company Description

Pfizer is a pharmaceutical company that discovers, develops, manufactures, and markets pharmaceutical and health care products. The company is focused on oncology, immunology, and vaccines, as well as internal medicine, hospital, and rare diseases. It generally focuses on areas of high, unmet medical needs.

The company contributed its consumer health business to a JV with GSK, with Pfizer receiving a 32% stake, as part of an interim step in the plan for an IPO.

Our Base-Case Scenario

Following several years of stagnant organic revenue, we expect organic revenue growth of about 5%-6% over the next few years (excluding divestitures and COVID-19 vaccine revenues). Our base case incorporates the loss of revenue from Upjohn, but assumes $10 billion of vaccine related revenues in 2021, entirely subsiding in 2022.

We expect adjusted EBITDA margins in the low-40% area over the next few years, as potential margin expansion from greater focus and efficiency is offset by price pressure in the U.S. We expect EBITDA margins to decline 120-150 basis points (bps) following monetization of Pfizer's minority interest in the JV with GSK, as that income does not flow through the revenue line. We expect any material impact from legislation on pharmaceutical spending in the U.S. to only take effect in 2022 at the earliest. However, the intensification of political pressure will constrain prices in the interim, as in 2018 and 2019, as industry players including Pfizer seek to maintain good relations with the administration. We assume COVID-19 vaccine margins are near overall company margins.

In addition to political pressures in the U.S., the ongoing consolidation

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among pharmacy companies, pharmacy benefit managers, and insurance companies provides these customers with more negotiating power (e.g., via formularies), which has been a source of pressure on pharma pricing. We expect this to remain a headwind for industry margins over the next few years.

We expect Pfizer to allocate roughly $8 billion-$8.5 billion of its approximately $10 billion-$11 billion in annual free cash flow toward dividends, leaving limited free cash flow available for share repurchases and acquisitions. We expect the need to supplement the medium-term pipeline to support sustained revenue growth will result in adjusted leverage generally remaining in the 2.0x-2.5x range.

Liquidity

We assess liquidity as exceptional. We expect Pfizer's sources of cash to exceed uses by at least 2x, and we believe it should withstand even severe adverse market conditions over the next two years with sufficient liquidity to meet its obligations. We also believe Pfizer can likely absorb high-impact, low-probability events without refinancing.

Principal Liquidity Sources

- Total cash and equivalents of about $10.5 billion as of Sept. 27, 2020;
- Long-term investments of $3.1 billion, about $1 billion of which we estimate is liquid;
- Roughly $7 billion availability under its revolving line of credit facilities maturing in 2024; and
- Expected funds from operations of about $12.7 billion.

Principal Liquidity Uses

- Annual capital expenditures of about $2 billion;
- Annual dividends of about $8 billion-$8.5 billion; and
- Approaching debt maturities of about $2.2 billion.

We expect the company is using the $12 billion of proceeds from the completed divestiture primarily to reduce the $11 billion commercial paper balance outstanding as of Sept. 27, 2020. We expect the company to generally reduce share repurchases in years of significant acquisitions.

Covenants

The company has no financial maintenance covenants under its credit agreements.

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Issue Ratings - Subordination Risk Analysis

The company's debt is primarily issued by parent Pfizer Inc., though there is about $4 billion outstanding at the Wyeth subsidiary and about $900 million at Pharmacia Corp. Combined, these obligations represent 10% of the capital structure. Although the parent provides a downstream guarantee, there is no upstream guarantee; thus, these obligations are structurally senior to debt issued by the parent, with regard to the assets at these respective subsidiaries. We do not differentiate our issue-level ratings, however, because of the relatively small proportion of debt having a structural advantage, and because that advantage is limited only to the value of the assets at those subsidiaries.

Capital structure

We estimate Pfizer's capital structure consists of about $40 billion of unsecured debt, after incorporating the $12 billion of proceeds of the divestiture being applied to reduce the $11 billion of commercial paper outstanding.

Analytical conclusions

We rate Pfizer's senior unsecured facilities the same as the issuer credit rating because of the low leverage and absence of material priority claims.

Ratings Score Snapshot

Issuer Credit Rating: A+/Stable/A-1+

Business risk: Excellent

- Country risk: Very low
- Industry risk: Low
- Competitive position: Excellent

Financial risk: Intermediate

- Cash flow/leverage: Intermediate

Anchor: a

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Exceptional (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: a+

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Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Pharmaceutical Industry, April 8, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Related Research

- Pfizer Inc., Aug. 27, 2020
- How Business Strength Varies Across The Top Pharma Companies, Aug. 27, 2020
- COVID-19 May Accelerate Disruption In The Global Vaccine Market, Aug. 3, 2020
- Pharma Industry Only Moderately Affected While Helping Mitigate COVID-19 Pandemic Impact, March 16, 2020
- Biosimilar Adoption In The U.S. Will Challenge Some Of Pharma's Biggest Names, March 3, 2020
- Outlook 2020: Pharmaceuticals Negative On M&A, Opioid Litigation, Feb. 18, 2020
- Oncology Is A Major Growth Opportunity For Big Pharma, Injected With Risk, Aug. 1, 2019
- Pfizer Inc. Ratings Lowered And Remain On CreditWatch On Planned Spin Off Of Upjohn Segment, July 29, 2019
- Lessons Learned: What Leads To Rating Changes For Investment-Grade Pharmaceutical Companies, Jan. 22, 2019

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- Which Pharma Company Ratings Could Be At Risk If U.S. Drug Pricing Reforms Become Law?, Oct. 31, 2018

Ratings List

Downgraded; Off CreditWatch; Outlook Action

	To	From
Pfizer Inc.		
Issuer Credit Rating	A+/Stable/A-1+	AA-/Watch Neg/A-1+
Pfizer Inc.		
Pharmacia Corp.		
Wyeth		
Senior Unsecured	A+	AA-/Watch Neg

Short-Term Ratings Affirmed

Pfizer Inc.	
Pfizer Investment Capital PLC	
Commercial Paper	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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