Credit Summary: Perrigo Co. PLC (BBB-, stable)

Stronger credit position grants time to build a durable portfolio.

Morningstar Credit Research
12 October 2017

Contents

Michael Zbinovec
Assistant Vice President
+1 312 346-3136
michael.zbinovec@morningstar.com

Executive Summary

Morningstar Credit Ratings, LLC recently changed the rating outlook for Perrigo Co. PLC to stable from negative after the firm took actions to significantly reduce its debt load over the past year, which should return gross debt leverage to a level prior to its acquisition spree in 2013–15. Despite Perrigo's divestment of its royalty-bearing interest in Tysabri in February 2017 that represented one third of earnings, we anticipate gross leverage around 3 times at the end of 2017 compared with 3.6 times for the trailing 12-month period at the end of the third quarter of 2016 that still included the Tysabri royalties in EBITDA. This leverage improvement has benefited our Cash Flow Cushion and Solvency Score pillars. Perrigo's improved credit position affords the firm time to re-invigorate flagging operational performance through internal investment and corporate pruning. This year may prove to be an inflection point as growth may return in 2018 from momentum provided by new product launches, by our estimates. We anticipate revenue to increase in the low-single digits and EBITDA in the midsingle digits compounded annually from 2017 to 2021, excluding any contribution from Tysabri.

Key Takeaways

- Perrigo is amid executing its operating strategy to build a durable business with an emphasis on innovation. We see a return to growth in 2018 after a brief period of earnings and cash flows volatility as the firm directs capital to internal research and trims its corporate infrastructure.
- Perrigo mitigated our greatest credit concern relating to a potential jump in debt leverage following the divestment of its royalty stream linked to Tysabri sales. The firm's commitment to an investment-grade rating was evident by recent reduction to its debt burden of over $2 billion from cash and divestment proceeds, which slightly exceeded our expectation of $2 billion needed to offset the Tysabri earnings loss and maintain steady leverage measures. This debt reduction positively influenced our Cash Flow Cushion and Solvency Score pillars.
- The firm aims to replace executive management, namely its CEO and CFO, in the near term. While not anticipated, new managers may alter Perrigo's current operating strategy that balances investment to strengthen its innovation engine with maintaining an investment-grade rating.

Companies Mentioned

Name/Ticker	Rating	Outlook	Coupon	Maturity	Price	Yield	Spread
Allergan PLC (AGN)	BBB-	Positive	3.80%	03/15/2025	103.68	3.22%	+103
Shire PLC (SHPG)	BBB-	Positive	3.20%	09/23/2026	98.62	3.38%	+108
Perrigo Co. PLC (PRGO)	BBB-	Stable	4.38%	03/15/2026	103.66	3.85%	+160
Mylan NV (MYL)	BBB-	Negative	3.95%	06/15/2026	101.50	3.74%	+148
Teva Pharma. Industries Ltd. (TEVA)	BBB-	Negative	3.15%	10/01/2026	92.68	4.13%	+184

Source: Interactive Data as of Oct.11, 2017; spread is to the nearest Treasury.

Credit Rating Rationale

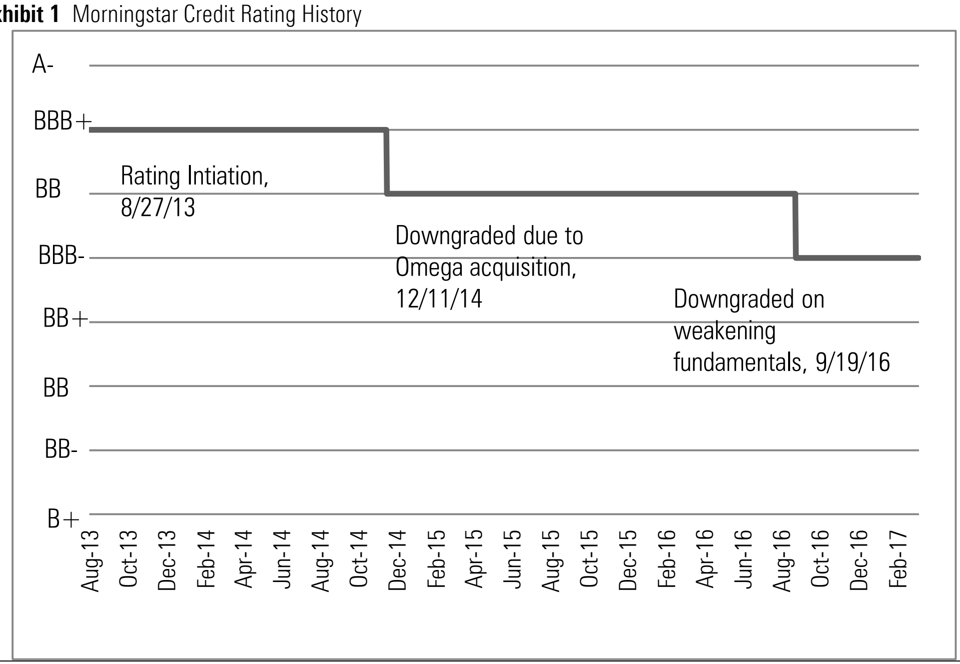
Perrigo faces significant operational headwinds as it carries out its strategy to build a durable business. But, the firm bought some time to execute its business plan after significant debt reduction in fiscal 2017 funded mainly by divestment proceeds that dropped prior elevated leverage into a range consistent with the current rating category, which informs our stable outlook. We think that increased internal investment and corporate pruning to re-invigorate flagging performance will likely create volatility of earnings and cash flows as the company carries out its strategic initiatives. Recent asset sales, notably its royalty stream from sales of Tysabri (multiple sclerosis), have decreased diversification, which along with the loss of its economic moat assigned by Morningstar's Equity Research Group negatively influences our Business Risk pillar. However, this pressure is mitigated by our more favorable view of management from a creditor's perspective given the firm's latest actions to strengthen its balance sheet. Despite greater-than-historical generic drug pricing pressures and choppy operating performance, we anticipate revenue to increase in the low single digits and EBITDA in the midsingle digits compounded annually from 2017 to 2021, excluding any contribution from Tysabri that had represented nearly one third of earnings.

Perrigo's commitment to an investment-grade rating was best exemplified by its debt tender offer ended in June and repayment of long term debt in May, which decreased its debt load to approximately $3.7 billion at the end of the second quarter from around $5.8 billion at the end of 2016. This debt reduction dropped pro forma gross debt leverage to 3.4 times for the latest 12 months as of June 30, 2017 from 3.6 times for the trailing 12-month period at the end of the third quarter of 2016 (including the Tysabri royalties in EBITDA) that was inflated from heavy acquisition activity between 2013 and 2015, including the large purchases of Elan ($9.5 billion) and Omega ($4.4 billion). The sudden fall in leverage benefited our Cash Flow Cushion and Solvency Score pillars. We see the firm repaying senior notes (about $370 million) due in December 2017 that could further reduce gross leverage to around 3 times. Remaining debt maturities are manageable with free cash flow averaging $700 million through 2021, by our estimates, even after the loss of Tysabri royalties. Perrigo held back on repurchasing shares and pursuing large acquisitions in 2016 to preserve cash for its deleveraging efforts. But, we will remain cautious on Perrigo's capital deployment going forward since the firm saw its new-found financial flexibility as reason for returning to share repurchasing in the second quarter of 2017. In the long run, we would not be surprised to see the firm pursue a transformative acquisition that may once again stress the balance sheet.

Credit Rating History

- In August 2013, our rating on Perrigo was initiated at BBB+.
- After placing Perrigo's rating under review negative in November 2014 following the announcement of its proposed leveraging acquisition of Omega Pharma for about $4.4 billion, we downgraded the rating to BBB from BBB+ in December 2014. The action also considered the firm reaching its debt/EBITDA target of around 2.7 times within 18-24 months of the deal's closure.
- The firm's rating was downgraded to BBB- from BBB in September 2016 in light of stubbornly elevated leverage remaining after heavy acquisition activities in the past years exacerbated by dampened earnings prospects due to Omega integration hiccups and greater-than-historical generic drug pricing pressure in the U.S. We did not expect Perrigo to achieve its debt reduction goal in the mid-2s over our rating horizon.
- In September 2017, Perrigo's rating outlook was revised to stable from negative after the firm significantly reduced its debt load, mainly through the divestment of its royalty-bearing interest in Tysabri for up to $2.85 billion ($2.2 billion upfront with $650 million of milestones in 2018 and 2020), which may return leverage to levels seen prior to an acquisition spree from 2013 to 2015.

Exhibit 1 Morningstar Credit Rating History



Source: Morningstar Credit Ratings, LLC, company filings

Credit Strengths

- Perrigo is committed to maintaining an investment-grade rating, best exemplified by its recent significant debt reduction using proceeds from asset sales. The firm also preserved cash flow through a temporary halt to share repurchasing during 2016.

- The firm's acquisitions have been strategically sound and it has a history of successfully integrating new assets, except for the Omega purchase. Overall, Perrigo's portfolio breadth and geographic reach contribute to a stable Business Risk pillar.
- Strong estimated free cash flow can easily satisfy the firm's long term debt maturities over the next five years, which positively influences our Cash Flow Cushion.

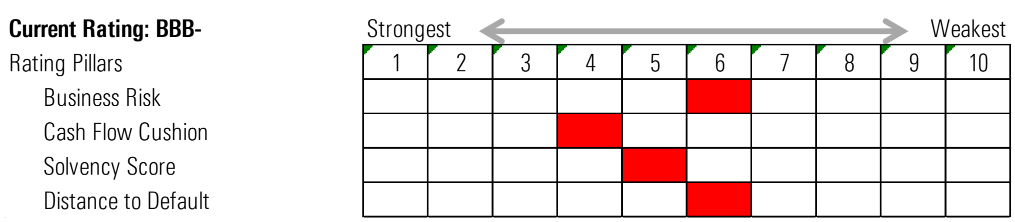
Credit Weaknesses

- Perrigo seeks new executive management, specifically CEO and CFO, who may change the firm's existing operational strategy that balances investment to strengthen its innovation engine with maintaining an investment-grade rating. Perrigo may review strategic options for portions of its corporate structure, especially if new management is hand-picked by private equity firm Starboard that recommended five of the current 11 members of the firm's Board of Directors.
- Earnings and cash flows will likely be volatile as Perrigo attempts to reverse operational declines through increased investment and corporate pruning with 2017 potentially representing a low point.
- Execution risk is high for new product flow, both internally and externally derived, which is needed to reverse pricing pressures, especially for the generic drug portfolio. Results in 2016 were dampened by the lack of significant product introductions that contributed to higher-than-historical pricing declines of 9%-10% in the U.S. market.

Pillar Analysis

Perrigo's stable rating outlook implies no immediate catalyst to change the current rating in either direction. Before we consider an upgrade to the current rating, Perrigo would need to stabilize its operational performance and consistently generate EBITDA gains that we see as the main driver of leverage improvement, such that our Solvency Score pillar further improves. On the other hand, if the firm is unable to successfully execute its business strategy and the subsequent pressure on operations negatively influences our Business Risk, Cash Flow Cushion and Solvency Score pillars, then a downgrade may follow.

Exhibit 2 Perrigo Credit Pillar Summary



Source: Morningstar Credit Ratings, LLC

- Business Risk (6): The Business Risk pillar is relatively steadfast at its current level and unaffected by multiple notch moves in any of the factors mentioned below. This pillar has remained consistent despite being stressed by the Morningstar Equity Research Group's recent removal of the firm's economic moat and by the divestment of its royalty stream from sales of Tysabri that has decreased diversification.

However, these pressures are more than offset by our more favorable view of management from a creditor's perspective given the firm's actions to strengthen its balance sheet over the course of 2017.

- Size (7): Despite the divestiture of the Tysabri royalty stream and other assets, the company still generates over $4.5 billion in annual revenue needed to maintain its current size score. We do not expect revenue to increase enough over the next five years to increase this factor.
- Economic Moat (1): Along with the moats of all generic drug manufacturers Perrigo's moat was removed by Morningstar's Equity Research Group in March to reflect the lack of competitive advantages within the industry given the commoditization of the marketplace, notably in the U.S. (the world's largest market).
- Uncertainty (5): Morningstar's Equity Research Group maintains high uncertainty assessment on its cash flows, which changed from medium in 2016 following multiple downward revisions in earnings guidance.
- Product/Customer Concentration (2): The score worsened with the sale of the Tysabri royalty-bearing asset that represented around one third of earnings. Perrigo lost material diversification that helped offset traditional pricing pressures affecting its generic business.
- Management (3): Management's commitment an investment-grade rating was demonstrated by its strengthening of the balance sheet using asset sale proceeds to decrease its debt burden. The firm now holds a middle-of-the-road score as it works to build its research and product portfolios from a better credit position.
- Dependence on Capital Markets (4): Dependency lightened recently after Perrigo's significant debt repayment during 2017 that has left highly manageable long term debt maturities over the next five years.
- Cyclicality (3): The product mix has a degree of seasonality with over-the-counter medicines catering to allergies and coughs/colds.

- Cash Flow Cushion (4): Improvement in the score from 6 directly stemmed from the decrease in the amount maturing debt over the next five years after the firm repaid more than $1.2 billion due through 2021. We see this good rating pillar maintained over the next few years.
- Solvency Score (5): We saw improvement to this factor to 5 from 7 after Perrigo's debt redemption activities in 2017. A further increase of this pillar, which we do not expect in the next few years, would increase the model-driven rating by one notch.
- Distance to Default (6): After a 40% fall in Perrigo's share price during 2016, the firm's equity cushion has been stable during 2017 in conjunction with flat equity pricing.

Financial Projections

As Perrigo executes its strategy to re-invigorate operational growth with internal investment and selective corporate trimming, we think revenue and cash flows may dip in 2017, primarily from the firm's sale of its royalty-bearing interest in Tysabri. Beyond this year though, we anticipate revenue to increase in the low single digits (CAGR = 3%) and EBITDA in the midsingle digits (CAGR = 5%) compounded annually in 2017–21, excluding any contribution from Tysabri that had represented nearly one third of earnings. Margins should benefit from cost initiatives mainly headcount reductions that promise annual savings of $130 million by the middle of 2018. We think that the firm can easily manage coming long-term debt maturities over the next five years of about $1.4 billion (as of June 30, 2017) with solid free cash flow averaging almost $700 million per year. However, we anticipate Perrigo to hold its debt load relatively steady following repayment of senior notes (about $370 million) due in December 2017. So, leverage improvement beyond 2017 may stem from EBITDA growth, in our estimation.

Exhibit 3 Projection Estimates

($s in Millions)	2017E	2018E	2019E	2020E	2021E
Revenues	4,793	4,898	5,052	5,219	5,392
Revenue Growth (y/y)	-9.2%	2.2%	3.2%	3.3%	3.3%
Consumer Healthcare America Growth (y/y)	-3.8%	2.0%	3.0%	3.0%	3.0%
Consumer Healthcare Int'l Growth (y/y)	-12.7%	2.0%	3.5%	4.0%	4.0%
Prescription Pharmaceuticals Growth (y/y)	-10.0%	3.0%	3.0%	3.0%	3.0%
EBITDA	1,062	1,118	1,184	1,232	1,302
EBITDA Margin (%)	22.2%	22.8%	23.4%	23.6%	24.1%
EBITDA Growth (y/y)	-5.1%	5.2%	5.9%	4.1%	5.6%
Operating Cash Flow	611	842	898	903	956
Capital Spending	(134)	(147)	(152)	(157)	(162)
Free Cash Flow	477	695	746	747	794
Gross Debt	3,258	3,203	3,255	3,255	3,165
Gross Debt / EBITDA (x)	3.1	2.9	2.7	2.6	2.4
Net Debt / EBITDA (x)	2.6	2.2	1.7	1.3	1.1
EBITDA / Interest (x)	5.6	8.1	8.5	8.3	8.9

Source: Morningstar Credit Ratings, LLC

Perrigo Overview

Company Description

Perrigo develops, manufactures and distributes over-the-counter and generic prescription pharmaceuticals, nutritional products and active pharmaceutical ingredients (API). Perrigo's strength is derived from its specialization as a key provider of store-branded over-the-counter products. The firm is headquartered in Ireland and markets its products primarily in North America and Europe, as well as in Australia, Israel and China. Perrigo has built its global presence and expanded its product offering through business development, including significant activities in 2013 and 2015, as shown in Exhibit 4. Wal-Mart Stores Inc. (AA-, negative) is Perrigo's largest customer, representing around 13% of overall revenue.

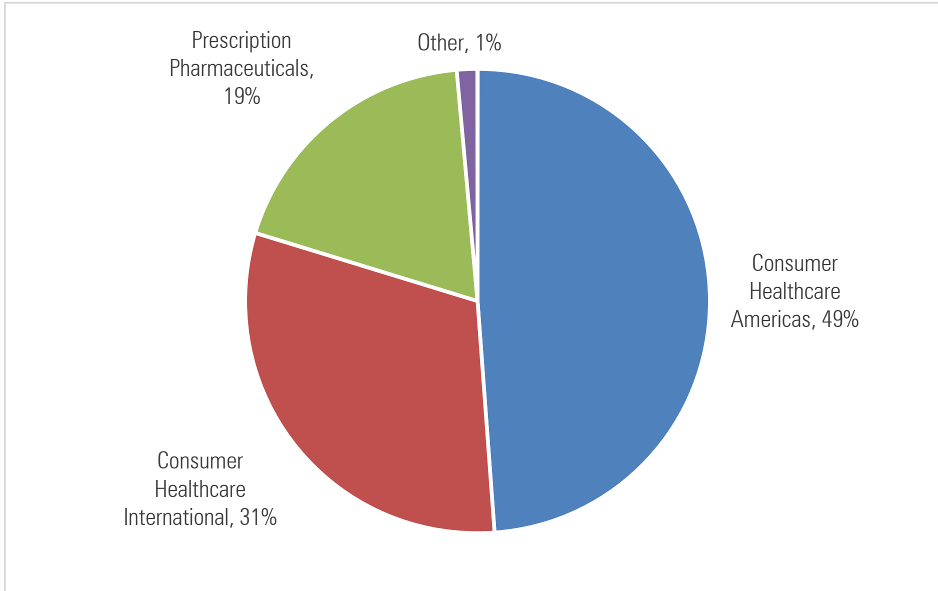
Exhibit 4 Perrigo's Acquisition Activity
($s in Millions)

Target Company	Date	Cost	Year-end Gross Debt	Notes
2016			$5,797	
Generic Benzaclin	Aug-2016	$62		Remaining 60.9% rights from Teva
Generic Retin A	Jan-2016	$416		From Matawan
2015			$5,312	
Entocort	Dec-2015	$380		U.S. rights from AstraZeneca
Naturwohl Pharma	Sep-2015	$150		German nutritionals - Yokebe brand
ScarAway	Aug-2015	$27		U.S. OTC medicines from Enaltus
OTC brands from GSK	Aug-2015	$224		Portfolio of Europe drugs
Gelcaps	May-2015	$38		Mexican softgel manufacturing operations of Patheon
Omega Pharma	Mar-2015	$4,348		International (mainly Europe); assumed $1.4B in Omega debt
2014			$3,234	
Lumara Health	Oct-2014	$83		Women's health portfolio
OTC from Aspen	Feb-2014	$54		OTC in Australia / New Zealand
Methazolomide	Feb-2014	$18		From Fera Pharmaceuticals
2013			$1,974	
Elan	Dec-2013	$9,452		Tysabri and Prialt royalty-bearing assets
Ophthalmic products	Jun-2013	$110		Ointment and solution from Fera Pharmaceuticals
Velcera	Apr-2013	$175		Pet health portfolio, including PetArmor brand
Rosemont Pharmaceuticals	Feb-2013	$283		Oral liquids based in UK
2012			$1,369	
Cobrek Pharmaceuticals	Dec-2012	$52		Bought remaining 81.5% interest; foam technology
Sergeant's Pet Care Products	Oct-2012	$285		U.S. animal health portfolio
CanAm Care	Jan-2012	$39		Diabetes medicines
2011			$893	
Paddock Laboratories	Jul-2011	$546		U.S. generic drugs
2010			$1,344	
PBM Holdings	Apr-2010	$839		Infant and pediatric nutritionals
Orion Laboratories	Mar-2010	$48		Australia/New Zealand OTC brand portfolio

Source: Morningstar Credit Ratings, LLC, company filings ; fiscal year ended in June prior to Jan. 1, 2016

Effective at the beginning of 2017, the firm operates under three main segments: consumer healthcare Americas, consumer healthcare international, and prescription pharmaceuticals. The specialty sciences segment that housed the contribution from the Tysabri royalty stream that was sold in February 2017 has since been dissolved. Perrigo's other business (around 1% of total sales) consists of the firm's API production that caters to both branded and generic pharmaceutical industries. The firm appears to be winding down its API operations with the divestment of its India manufacturing site in April 2017 and the pending sale of its Israel API manufacturing plant.

Exhibit 5 Segment Revenue (Six Months 2017)



Source: Morningstar Credit Ratings, LLC, company filings

Consumer Healthcare Americas Segment

Perrigo's largest segment—consumer healthcare Americas—generates nearly one half of the firm's revenue and is primarily focused on the sale of OTC store brand products, which are comparable in quality and effectiveness to national brand names. Store brand products favorably alter the cost equation in the healthcare market due to their low cost to retailers, who can achieve higher profits, and their value to consumers, who pay less than the brand name price for products of similar quality. The consumer healthcare segment markets its medicine chest, which include cough, cold, and allergy treatments, analgesics, gastrointestinal drugs, smoking cessation products, and animal health pharmaceuticals, in the U.S., Mexico and Canada. In addition, Perrigo holds a leading position in the manufacture of store-brand nutritional products, including infant formula and pediatric nutritionals. The firm also markets and distributes pharmaceutical and medical diagnostic products under exclusive agreements in Israel through two departments-- Pharma-Israel and Tayco Diagnostics.

The segment is well-diversified with no therapeutic area representing more than 10% of overall revenue. Perrigo's private-label OTC cough, cold, allergy, and sinus medicines are the largest portion of the segment, collectively generating around 9% to total company sales. While retailers have historically been reliant on Perrigo's low-cost production, consistent supply, and distribution expertise, pricing is a concern as these customers continually look to control procurement costs. To drive growth of this business, Perrigo needs to refresh its private-label portfolio to remain attractive with its core customers, like its recent introduction of an OTC version of the heartburn treatment Nexium 24HR. Perrigo tries to sustain operating margins by constantly fine tuning its segment offering to divest non-core or low-profitable businesses, such as its U.S. vitamins, minerals, supplements product lines sold in August 2016. This corporate pruning has created volatility of segment revenue, but management seeks steady sales growth in the range of 2%–4% over the long term, which we view as attainable.

Exhibit 6 Business Line Revenue (Calendar Year-End 2016)

($s in Millions)	2016 Revenues	% Total Company
Consumer Healthcare Americas	2,507	47%
Cough/Cold/Allergy/Sinus	455	9%
Analgesics	344	7%
Gastrointestinal	335	6%
Infant Nutritionals	427	8%
Smoking Cessation	309	6%
Vitamins, Minerals, and Dietary Supplements	160	3%
Animal Health	144	3%
Other	334	6%
Consumer Healthcare International	1,652	31%
Branded OTC	1,349	26%
Other	303	6%
Prescription Pharmaceuticals	1,043	20%
Other (API)	79	1%
Perrigo Total	5,281	100%

Source: Morningstar Credit Ratings, LLC, company filings; Tysabri royalty stream removed from revenue per restatement in 2017.

Consumer Healthcare International Segment

The consumer healthcare international segment, which includes the legacy branded consumer healthcare segment, significantly expanded throughout Europe with the purchase of Omega Pharma in March 2015. This division also includes operations in the U.K., Australia, and Israel. These businesses develop, manufacture, market, and distribute OTC brands in therapeutic categories such as natural health, cough, cold and allergy, personal care, and pain relief. All together, consumer healthcare international accounts for 31% of total revenue at Perrigo.

The primary focus of Perrigo's cost initiatives is directed to improving the profitability of this segment with an emphasis on Omega. Perrigo has struggled to integrate Omega and the firm currently looks to rightsize the business. In its latest round of restructuring beyond its ongoing supplier consolidation, the firm plans to reduce its workforce by 750 positions, or around 14%, of its employees across the company. Perrigo hopes to achieve annual savings of $130 million by the middle of 2018 through these efforts. Divestments of low-profit business are also expected in this segment akin to the announced sales of its Russian operations and the exit of its distribution agreement in Belgium with EuroGenerics NV (at the end of 2016). The cancellation of the Belgium arrangement will significantly dampen the segment top line in 2017, but we anticipate a return to growth in 2018 after annualizing the end of the agreement and better underlying performance.

Prescription Pharmaceuticals Segment

Products from Perrigo's U.S. prescription medicines business carry the Perrigo brand name sold in the United States. The segment offers treatments for women's health as well as generic versions of difficult-to-manufacture formulations, including the largest dermatology medicine chest in the U.S. with its ointments, gels, and creams. The firm also has the capability of manufacturing other complex drug delivery methods like nasal sprays and injectables. Typically, competition is more limited for more complicated formulas given the technological expertise, regulatory know-how, and increased investment needed to gain marketing approval. Perrigo is also at the forefront of switching prescription medicines to OTC varieties with its brand-name lineup of proton pump inhibitors, or GERD, (Zegerid, Prilosec, and Prevaci) and allergy treatments (Allegra, Xyzal, Zyrtec, and Claritin). The segment represents around 19% of overall revenue.

Over the past year or so, pricing pressure in the U.S. has been greater that the historical rate of decline in the midsingle digits as the generic drug marketplace has been flooded with new competition and third-party payers have taken tougher negotiating stances. Perrigo expects this segment may face pricing declines in the range of 9% to 11% through the end of 2017 and sees pricing eventually normalizing to the traditional level but not likely in 2018. As with any generic drug competitor, Perrigo is tasked to launch new generic drugs to counter this pricing pressure. At its second quarter conference call in August, management noted 21 abbreviated new drug applications (ANDA) presently filed at the FDA, of which six are first-to-file opportunities granted six months of market exclusivity.

Executive Turnover

Perrigo is presently experiencing turnover with its key executive management as both its CEO and CFO have made decisions to retire from the company. Most recently, John Hendrickson announced in June that he will retire from his CEO position following the selection of a replacement with an intention to remain on board for up to 60 days to aid in the transition. Hendrickson's tenure at CEO was short-lived given that he held the title since April 2016 after earning positions of increased responsibility within Perrigo starting in 1989. His retirement gives us pause, considering solid execution of his turnaround strategy since taking the CEO position. Further confounding the situation, Perrigo is amid replacing its longtime CFO Judy Brown, who retired suddenly in February 2017 to join Amgen Inc. (A, stable). Ron Winowiecki, senior vice president of business finance since January 2014, now serves as interim CFO until a replacement is hired. Starboard Value LP will likely have a say in Perrigo's hiring decision for the CEO and CFO positions, as the private equity firm owns around 6.7% of Perrigo and recommended five of the current 11 members of Perrigo's board of directors, including the head of Starboard Jeffrey Smith. We suspect that Perrigo's operating strategy, which has been instrumental for its turnaround, may remain intact, supported by a 60-day transition period for a new CEO. We will keep an eye open for any change to the firm's commitment to maintaining an investment-grade rating, though. However, new management may step up asset sales, notably a divestiture of the prescription drug business favored by Starboard, to heighten focus on the more innovative consumer health businesses.

Capital Structure and Liquidity Analysis

Perrigo has substantially strengthened its balance sheet in 2017 after debt leverage had inflated from heavy acquisition activity from 2013 to 2015, including the large purchases of Elan ($9.5 billion) and Omega ($4.4 billion). We are encouraged by the firm's commitment to an investment-grade rating shown by its substantial debt reduction in light of the divestiture of the Tysabri royalty-bearing asset in February 2017. Using divestment proceeds, primarily from the Tysabri asset sale, the firm significantly decreased its debt load to approximately $3.7 billion at the end of the second quarter of 2017 from around

$5.8 billion at the end of 2016, slightly exceeding our initial expectations. Debt reduction included early redemption in May of $600 million in senior notes due in 2018 and a $1.4 billion cash tender offer executed in June. As a result, gross leverage dropped to 3.4 times for the trailing 12 months on a pro forma basis compared with 3.6 times for the trailing 12 months ended Sept. 30, 2016 (including Tysabri earnings in EBITDA). Considering the firm's cash balance of $761 million at the end of the second quarter, adjusted net debt leverage was 2.7 times versus 3.4 times for the trailing 12 months ended Sept. 30, 2016.

Exhibit 7 Capital Structure ($s in Millions)

	June 2017	xEBITDA
Revolving Credit Facility ($1.0B) due 2019	0	
Term Loan due 2019	429	
5.125% senior notes due 2017 (EUR300MM, Omega)	343	
5.0% senior notes due 2019 (EUR120MM, Omega)	137	
3.5% senior notes due 2021	280	
3.5% senior notes due 2021	310	
5.105% senior notes due 2023 (EUR135MM, Omega)	154	
4.0% senior notes due 2023	216	
3.9% senior notes due 2024	700	
4.375% senior notes due 2026	700	
5.3% senior notes due 2043	91	
4.9% senior notes due 2044	304	
Other	12	
Total Debt	3,675	3.4x
Total Cash and Equivalents	761	
Net Debt	2,914	2.7x
Adj. EBITDA (LTM for June 30, 2017)	1,067	

Source: Morningstar Credit Ratings, LLC, company filings; MM = millions, B = billions

We see the firm repaying senior notes (about $370 million) due in December 2017 that could further reduce gross leverage to around 3 times at the end of 2017. Remaining debt maturities after the debt pay down are about $570 million due in 2019 and around $590 million due in 2021, which are highly manageable with annual free cash flow averaging about $700 million through 2021 by our estimates, even though future earnings will be detrimentally affected by the loss of Tysabri royalties. Perrigo held back on repurchasing shares and pursuing large acquisitions in 2016 to preserve cash for its deleveraging efforts. But, we will remain cautious of Perrigo's capital deployment going forward since the firm saw its newfound financial flexibility as reason for recently returning to share repurchasing. At the end of the second quarter of 2017, the firm had $1.4 billion remaining on its 2015 share repurchase authorization that is effective until the end of 2018. In the long run, we would not be surprised to see the firm pursue a transformative acquisition that may once again stress the balance sheet.

Capital-Allocation Policy

Other than its commitment to investment-grade status, Perrigo currently offers no financial target to which it operates. Previously, the firm hoped to reduce gross leverage (total debt/EBITDA) to around 2.7 times within 18–24 months of the completion of the Omega acquisition in December 2014. We thought that it would be difficult for the firm to achieve this goal, which helped support our downgrade of Perrigo's rating to BBB- from BBB in September 2016. But, we now see a path for debt leverage to drop to around 3 times by the end of 2017 as debt reduction greatly exceeds operational pressures.

On Perrigo's second-quarter results conference call, management updated its outlook for 2017 to revise its expectations for revenue to $4.7 billion–$4.85 billion from $4.6 billion–$4.8 billion initially. Revenue may consist of around $2.4 billion (around a 4.5% drop from 2016) from the consumer healthcare Americas segment, about $1.45 billion (a fall of more than 12% from 2016) generated by the consumer healthcare international business, and around $950 million (negative 9% from 2016) coming from the prescription pharmaceuticals division. This increased sales guidance still represents an 11% decline at the midpoint of the range from 2016. The firm also refreshed its outlook for operating cash flow to $600 million from $575 million previously. We see these results as low points over our five-year horizon.

Peer Comparison
Specialty drug firms often specialize in only a couple of areas of expertise, rather than playing in a broader range of therapeutic areas, which can lead to product concentration risk and pressures on our Business Risk pillar. Historically, specialty pharmaceutical firms tend to rely more heavily on other means, such as in-licensing or acquiring new products from other entities, to launch new products rather than internal development. Within this sector, Allergan PLC (BBB-, positive) stands alone with its wide moat from Morningstar's Equity Research Group as it depends more heavily on internal development than other specialty pharmaceutical firms. Perrigo's strength lays in its private label (or store brand) businesses that provide low cost OTC medicines for a variety of participants in the healthcare industry, where cost containment remains a top priority.

Consolidation within the specialty pharmaceutical space (including the no-moat generic drug industry) has left relatively high leverage on the balance sheets of Teva Pharmaceutical Industries Ltd. (BBB-, negative), Allergan, Mylan NV (BBB-, negative), Shire PLC (BBB-, positive), and Perrigo. As a result of the higher debt load, our Cash Flow Cushion and Solvency Score pillars are stressed at Teva, Mylan, Shire, and Allergan, in particular. Each of these firms that completed leveraging transactions over the past few years has focused on rapid debt reduction with varying degrees of success reflected in its rating outlooks. For example, Perrigo successfully reduced debt throughout 2017, helped by proceeds from significant asset divestments, which prompted a change in rating outlook to stable from negative. In relation to their peer group, Teva and Mylan operate on the edge of investment-grade territory.

Exhibit 8 Specialty Pharmaceuticals Comparable Table

Ticker	**AGN**	**SHPG**	**PRGO**	**MYL**	**TEVA**
Morningstar LLC Rating	BBB-	BBB-	BBB-	BBB-	BBB-
Outlook (rec)	Positive	Positive	Stable	Negative	Negative
Information from Morningstar Equity Research Group					
Moat	Wide	Narrow	None	None	None
Moat Trend	Stable	Positive	Negative	Negative	Negative
Uncertainty	Medium	Medium	High	Very High	Very High
Pillars					
Business Risk	4	5	6	6	5
Cash Flow Cushion	6	6	4	7	7
Solvency Score	5	6	5	6	7
Distance to Default	5	5	6	6	8
TTM as of Date ($s in millions)	6/30/2017	6/30/2017	6/30/2017	6/30/2017	6/30/2017
Revenues	$14,670	$14,576	$5,025	$12,007	$23,371
Adj'd EBITDA	$6,686	$5,227	$1,067	$3,716	$6,378
Adj'd EBITDA %	46%	36%	21%	31%	27%
Total Debt	$30,238	$21,296	$3,675	$15,052	$35,052
Cash & Investments	$5,826	$264	$761	$613	$599
Net Total Debt/(Cash)	$24,412	$21,032	$2,914	$14,439	$34,453
Market Capitalization	$69,070	$44,150	$12,450	$20,530	$16,000
Enterprise Value	$93,482	$65,182	$15,364	$34,969	$50,453
Debt % of EV	28%	33%	24%	43%	69%
TD/EBITDA	4.5x	4.1x	3.4x	4.1x	5.5x
Net TD/EBITDA	3.7x	4.0x	2.7x	3.9x	5.4x
Adj TD/EBITDAR*	4.5x	4.2x	3.6x	4.1x	5.6x
Interest Expense	$1,184	$621	$206	$569	$834
EBITDA/Interest	5.6x	8.4x	5.2x	6.5x	7.6x
(EBITDA-CapX)/Int	5.4x	7.0x	4.8x	5.9x	6.5x
OCF	$1,177	$3,361	$643	$2,570	$4,097
CapX	($286)	($860)	($81)	($379)	($949)
FCF	$891	$2,501	$562	$2,191	$3,148
FCF/Debt	3%	12%	15%	15%	9%
Share Repurchases	($15,044)	$0	($58)	$0	$0
Dividends	($751)	($235)	($88)	$0	($1,377)
Net FCF	($14,904)	$2,266	$416	$2,191	$1,771

Source: Morningstar Credit Ratings, LLC as of Oct. 11, 2017, *Adjusted TD includes total debt plus underfunded pension liabilities plus 8 times rents."

Appendix

Perrigo's Moat and Trend

The following description comes directly from Morningstar's Equity Research Group: "We're changing our moat rating for Perrigo to none from narrow. We now consider the generic drug industry as a whole as a predominantly no-moat industry, including Perrigo. Barriers to entry remain low, products remain highly commoditized, and the industry remains fairly fragmented despite past consolidation. In its U.S. consumer health operations, we previously thought Perrigo's economies of scale, shelf space management, and unique packaging capabilities helped entrench the firm in customer supply chains. Additionally, we thought manufacturing and regulatory barriers in the prescription topicals segment could support above-average growth and profitability. Now, we think the continual rise of new entrants, particularly from low cost emerging markets, continues to diminish the cost advantage of larger peers like Perrigo. Recent price erosion in Perrigo's prescription topicals unit combined with poor performance of the Omega assets, we have diminished confidence Perrigo can create economic profits over the long-term as the abilities of challengers gradually improve. Historical growth and profitability seen over much of Perrigo's recent past will likely be difficult to sustain going forward.

"Because of the Elan acquisition, Tysabri royalties have historically made up a large portion of Perrigo's bottom line, but management announced the sale of this asset in early 2017.

"We think Perrigo has a negative economic moat trend. We think the company's relatively large exposure to the U.S. OTC generic drug markets threatens to erode the firm's cost advantage over time. Additionally, new competition in the prescription topicals market will likely continue to diminish the firm's history of more stable pricing in this segment."

Morningstar Credit Ratings, LLC | 8 September 2017

Perrigo Company (PRGO)

Corporate Credit Rating N/A

Economic Moat [1]	Moat Trend [1]	Outlook
None	Negative	Review

Sector	Healthcare	Business Risk Rank	6
Industry	Drug Manufacturers - Specialty &	Cash Flow Cushion Rank	4
		Solvency Score Rank	7
		Distance to Default Rank	6

Perrigo Co PLC develops, manufactures and distributes over-the-counter and generic prescription pharmaceuticals, nutritional products and active pharmaceutical ingredients.

All values (except per share amounts) in: USD Millions	2014	2015	2016	Forecast *2017*	*2018*	*2019*	*2020*	*2021*
Income Statement								
Revenue	4,172	5,350	5,281	4,793	4,898	5,052	5,219	5,392
Gross Profit	1,436	2,115	2,052	1,920	2,014	2,124	2,203	2,277
Operating Income	656	764	662	621	706	780	867	951
Adjusted EBITDA	1,015	1,387	1,119	1,062	1,118	1,184	1,232	1,302
Net Income	346	(33)	(4,013)	140	434	507	580	656
Balance Sheet								
Cash + Investments	805	418	622	495	774	1,262	1,651	1,702
Total Debt	3,234	5,990	5,797	3,258	3,203	3,255	3,255	3,165
Total Adjusted Debt	3,510	6,376	6,221	3,695	3,653	3,719	3,733	3,657
Cash Flow Statement								
Cash Flow From Operations	694	1,049	655	611	842	898	903	956
Capital Expenditures	(172)	(167)	(106)	(134)	(147)	(152)	(157)	(162)
Free Cash Flow (CFO-Capex)	522	882	549	477	695	746	747	794
Free Cash Flow / Sales	12.5%	16.5%	10.4%	10.0%	14.2%	14.8%	14.3%	14.7%
Growth (% YoY)								
Revenue	9.8%	28.3%	-1.3%	-9.2%	2.2%	3.2%	3.3%	3.3%
Gross Profit	2.3%	47.3%	-3.0%	-6.4%	4.9%	5.4%	3.7%	3.4%
Operating Income	-0.7%	16.4%	-13.3%	-6.2%	13.6%	10.4%	11.2%	9.7%
Adjusted EBITDA	23.7%	36.6%	-19.3%	-5.1%	5.2%	5.9%	4.1%	5.6%
Profitability (%)								
Gross Margin	34.4%	39.5%	38.9%	40.1%	41.1%	42.0%	42.2%	42.2%
Operating Margin	15.7%	14.3%	12.5%	13.0%	14.4%	15.4%	16.6%	17.6%
Adjusted EBITDA Margin	24.3%	25.9%	21.2%	22.2%	22.8%	23.4%	23.6%	24.1%
Net Margin	8.3%	-0.6%	-76.0%	2.9%	8.9%	10.0%	11.1%	12.2%
Adjusted ROIC	8.9%	6.2%	-0.8%	4.5%	5.5%	5.9%	6.3%	6.8%
Adjusted RONIC	1.1%	4.0%	401.5%	-35.4%	-45.0%	-7.1%	-7.7%	-49.5%
Coverage / Cash Flow								
Adjusted EBITDA / Interest Expense	9.3	7.0	(7.1)	5.6	8.1	8.5	8.3	8.9
(Adj. EBITDA-CapEx) / Int. Exp.	8.0	7.5	4.7	5.4	7.2	7.4	7.3	7.9
Adj. EBITDAR / (Int. Exp. + 1/3 Rents)	9.0	8.0	5.0	5.9	7.6	7.9	7.8	8.3
Dividends / FCF	9%	8%	15%	20%	13%	12%	11%	10%
Share repurchase (issuance) / FCF	0%	55%	-2%	21%	29%	67%	67%	63%
Leverage								
Total Debt / Adj. EBITDA	3.2	4.3	5.2	3.1	2.9	2.7	2.6	2.4
Net Debt / Adj. EBITDA	2.4	4.0	4.6	2.6	2.2	1.7	1.3	1.1
Total Adj. Debt / Adj. EBITDAR	3.3	4.4	5.3	3.3	3.1	3.0	2.9	2.7
EV /Adj. EBITDA	21.8	19.1	15.3	12.7	-	-	-	-
Debt / Capital	27%	37%	49%	36%	35%	35%	35%	34%
FCF / Total Debt	16%	15%	9%	15%	22%	23%	23%	25%

About Morningstar® Credit Research
Morningstar Credit Research provides independent, fundamental equity research differentiated by a consistent focus on sustainable competitive advantages.

For More Information
Gregg Novek
+1 646 560-4529
gregg.novek@morningstar.com

22 West Washington Street
Chicago, IL 60602 USA