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Research Update:

French Health Care Software And Services Group Cegedim Upgraded To 'BB' On Bond Repayment; Outlook Stable

Primary Credit Analyst:
Remi Bringuier, Paris +33(0)1 44 20 67 96; remi.bringuier@standardandpoors.com

Secondary Contact:
Nicolas Baudouin, Paris (33) 1-4420-6672; nicolas.baudouin@standardandpoors.com

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Overview

- On April 1, 2016, French health care software and services group Cegedim S.A. repaid its 2020 bond, using a mix of the cash proceeds from the disposal of its historical division and a drawing from its newly issued revolving credit facility.
- Consequently, Cegedim's financial metrics have strongly improved, prompting us to revise upward our assessment of the group's financial risk profile.
- We are therefore raising our long-term rating on Cegedim to 'BB' from 'BB-'.
- The stable outlook reflects Cegedim's markedly enhanced financing cost structure, which should free up a significant amount of cash for the group to deleverage further.

Rating Action

On April 28, 2016, Standard & Poor's Ratings Services raised its long-term corporate credit rating on French health care software and services group Cegedim S.A. to 'BB' from 'BB-'. The outlook is stable.

We also have withdrawn our 'BB-' issue and '4' recovery ratings on Cegedim's redeemed €425 million senior unsecured notes originally due in 2020.

Rationale

The upgrade primarily reflects the significant decrease in Cegedim's leverage, following its repayment of its 2020 bond with cash from the spin-off of its historical division one year ago. Cegedim's use of the substantial cash proceeds of €396 million for debt reduction has enabled it to significantly deleverage its financial structure. In January 2016, the group put in place a €200 million revolving facility (RCF) paying 90 basis points (bps) above the one-month Euribor rate (currently floored at 0%), under which it drew down 80% of the facility to contribute to repaying the 2020 bond.

We expect Cegedim will a ratio of reported debt to EBITDA of less than 2.5x in 2016 (based on our calculation of the average of the three upcoming fiscal years), which is commensurate with an intermediate financial risk profile. Moreover, most of our other ratios for Cegedim, such as Standard &

Poor's-adjusted funds from operations (FFO) to debt, EBITDA to interest coverage, and free operating cash flow (FOCF) to debt, are now in line with the intermediate category. We have therefore raised our assessment of the group's financial risk profile to intermediate from significant. The cost of debt should decrease from €40 million in 2015 to less than €5 million in 2017, leading to a sizable increase in the group's free cash flow generation that will allow further deleveraging.

The rating on Cegedim reflects our assessment of the group's business risk profile as weak even after its recent disposal. Still, group revenues are relatively well diversified, with a granular customer base, including British and French pharmacists and practitioners, as well as companies operating outside the health care sphere, for which Cegedim has successfully developed a human-resource management offering and e-business solutions. The group's latest acquisitions in 2015 in the U.K. and U.S. will enable it to penetrate these markets through its "SaaS/Cloud" solutions. Under these, the group provides its unique expertise in developing software that offers an enhanced user experience (easy to use web access), combined with a broader range of functionalities (automated updates and multi-devices platform) through migration from a license-based model to SaaS/Cloud technologies.

Cegedim is a key player in data transfer between private health insurers ("mutuelles"), pharmacists, and the French health care system. The group could benefit from additional volumes of activity, since the French government is contemplating banning cash payments to the doctors. Moreover, the government's recent announcement to withhold tax directly at the employer level could boost the group's revenues. Cegedim is one of a few French health care companies with the expertise and the technology to be able to rapidly deploy an effective data solution to the market, but it will first need to win tender offers launched by the French government.

As we anticipated, in addition to repaying the 2020 bond, Cegedim also used portion of the disposal proceeds to reimburse its €63 million bond maturing in July 2015. The improved financing conditions linked to the newly signed RCF used as part of the repayment will trigger a pronounced decrease in the group's average cost of debt. We forecast a reduction of more than 400 bps to less than 2% in 2017 from 6.7% in 2014. In addition, the maturity of the group's €45 million shareholder loan has been extended to 2021, and margin revised downward from 5.5% to 2.9%. Cegedim's financial metrics have soundly improved, with FOCF to debt at 18.5% on a weighted average basis.

We anticipate that Cegedim's revenue growth this year will be in line with the 3.4% increase in 2015. We also expect slight improvement in its operating margins as it progressively expands its customer base. We assume that the group will maintain a conservative financial policy and not make any large debt-financed acquisitions or pay large dividends in coming years.

Under our base case for Cegedim, we assume:

- Revenue growth of 3%-4% in the competitive French and U.K. health care market, with stronger growth prospects in the 5%-7% range in newly

entered markets.
- Continued product innovation and increased operating efficiency, following restructuring and the large investment in 2015 to deploy Saas/Cloud solutions, which should widen the group's margins.
- Slightly lower adjusted EBITDA, in the €72 million-€82 million range in 2016 and 2017, compared with our June 2015 forecast, owing the Cegelease division's restatements in line with International Accounting Standard norm IAS 17 and an increasing impact from capitalized development costs.
- Annual capital expenditures (capex) of about €40 million.
- Interest cost decreasing to €15 million in 2016 and about €3 million in 2017, from €40 million in 2015, after the change in the group's capital structure.

Based on these assumptions, we arrive at the following credit measures:
- An adjusted EBITDA margin of 16%-18% over 2016-2017.
- Debt to EBITDA of less than 3.0x in 2016, improving to less than 2.5x in 2017.
- An EBITDA-to-interest coverage ratio of about 5x in 2016, improving to 20x in 2017.
- FOCF to debt of about 5% in 2016, improving to more than 20% in 2017.

Liquidity

We view Cegedim's liquidity as adequate, reflecting our assessment that the company's sources of liquidity will cover its uses by at least 1.2x for the next 12 months.

Principal liquidity sources (as of March 30, 2016):
- Cash and investments of €231.3 million;
- An undrawn €200 million under the new RCF; and
- Cash FFO of about €63 million.

Principal liquidity uses (as of the same date):
- Total debt repayment of €353.8 million at the end of first-quarter 2016;
- Modest working capital outflow of €5.9 million;
- Capex increasing slightly increasing to about €48.5 million, of which just €15 million for maintenance capex; and
- No dividends until 2017 (as discussed with management).

Outlook

The stable outlook on Cegedim reflects its current low debt, following its repayment of the 2020 bond. The outlook also incorporates the group's enhanced financing cost structure, which should free up a significant amount of cash and enable further deleveraging and a ratio of debt to EBITDA in the lower end of the 2x-3x range.

Downside scenario

We could consider downgrading Cegedim if it implemented a radical change in its financial policy, namely through a large debt-financed acquisition that could jeopardize current financial metrics with debt to EBITDA increasing to more than 3x. However, we view this as an unlikely scenario given that the group's biggest shareholder continues to be the founding family. We will closely monitor Cegedim's quarterly performance, which have been subject to profit warnings in the past and remain contingent on the investment budgets of pharmacists and practitioners. A severe operating setback, leading to markedly negative cash flow, could put significant pressure on the current rating.

Upside scenario

We would raise the rating if Cegedim achieved more profitable growth after regaining market share in its health care professionals division. This could occur through successful product launches that enhance the group's portfolio of activities and its size of operation. Any upgrade would also rely on more accretive and sustainable free cash flow generation, in line with peers rated 'BB+'.

Ratings Score Snapshot

Corporate Credit Rating: BB/Stable/--

Business risk: Weak
- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Weak

Financial risk: Intermediate
- Cash flow/leverage: Intermediate

Anchor: bb

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)

Stand-alone credit profile: bb

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013

- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Cegedim S.A.		
Corporate Credit Rating	BB/Stable/--	BB-/Positive/--

Ratings Withdrawn

	To	From
Cegedim S.A.		
Senior Unsecured		
Local Currency	NR	BB-
Recovery Rating	NR	4H

NR--Not rated.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com