May 30, 2022

Aurigene Discovery Technologies Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund Based – Term Loan#	150.00	150.00	[ICRA]AA (Stable); reaffirmed
Total	**150.00**	**150.00**	

**Instrument details are provided in Annexure-1; #Proposed term loan*

Rationale

The reaffirmation of the rating derives comfort from Aurigene Discovery Technologies Limited's (Aurigene/the company) parentage, as a wholly-owned subsidiary of Dr. Reddy's Laboratories Limited (DRL, rated [ICRA]AA+ (Stable)). The rating also considers Aurigene's established relationships with customers comprising reputed players in the pharmaceutical industry and its established presence across drug discovery and development services. The rating also factors in the company's financial profile characterised by healthy operating margins, nil debt along with robust coverage metrics and comfortable cash flows. This is further cushioned by a cash and liquid investment balance of Rs. 93.0 crore as on March 31, 2022.

The rating, however, remains constrained by the company's moderate scale of operations with ~Rs. 200-300 crore revenue over the last four years. The rating also factors in the high customer and geographical concentration risks of the company. The rating is also constrained by the susceptibility of revenues and margins to foreign exchange fluctuations as Aurigene derives majority of its revenues from overseas markets.

ICRA notes that Aurigene has issued intercorporate loans of Rs. 160.0 crore during FY2021 to its wholly-owned subsidiary, Aurigene Pharmaceutical Services Limited (APSL), which is expected to be repaid in FY2026.

The Stable outlook on the rating reflects ICRA's opinion that Aurigene will continue to benefit from its strong parentage and support from DRL, strong track record of operations, reputed customer base, healthy financial risk profile and commitment to conservative financial policies.

Key rating drivers and their description

Credit strengths

Strong parentage as 100% subsidiary of DRL – Aurigene, with its robust infrastructure and healthy accruals, does not require any financial and operational support from DRL at present. However, it enjoys operational and financial flexibilities through its parentage, which support its business prospects. Further, DRL will provide need-based support. The company is guided at the board level by DRL's key management personnel.

Strong track record in drug discovery segment and reputed client base – The company is an established player in the drug discovery segment. Its research capabilities are supported by a strong base of over 300 scientists. Aurigene's increased focus on internal discovery programmes is expected to provide growth through licencing revenues, going forward. The long-standing relationships with reputed customers comprising global pharmaceutical and biotech players lend revenue stability to the company. Further, Aurigene has some exclusive deals providing upfront payments for research, followed by milestone-based payments and licensing revenues from customers like Exelixis, Curis Inc., Orion Pharma, etc., which support its revenues.

Financial profile characterised by healthy margins and debt-free capital structure – Aurigene's revenues grew by 9.3% in FY2021, despite transfer of its research service business to APSL, supported by healthy revenues from customers across segments such as discovery and collaboration and licensing. In FY2021, Aurigene's operating and net margins also expanded by 920 bps and 830 bps to 52.9% and 40.8%, respectively, supported by its revenue growth and consequent operating leverage. In 9M FY2022, the company reported revenues of Rs. 238.5 crore with healthy operating margins of 38.9%. The capital structure and coverage indicators remained robust as on December 31, 2022, as the company continues to be debt-free. The company's profit margins are likely to remain healthy, going forward, despite expected moderate contraction (on account of further R&D investments in internal drug discovery pipeline) from the 9M FY2022 levels. Going forward, ICRA expects Aurigene to remain debt-free in the near to medium term as the company is capable of funding its research requirements through internal accruals and existing cash and liquid investments.

Credit challenges

Moderate scale of operations – Aurigene, despite being a well-established player in the industry, has relatively moderate scale of operations with revenues at Rs. 306.2 crore (FY2021) and Rs. 238.5 crore (9M FY2022). The high degree of unpredictability of success of the products being developed is a key characteristic of the industry. Aurigene transferred its research services division (41.2% of FY2020 revenues) to APSL in June 2020, which had further moderated the company's revenues. Aurigene also faces intense competition from other large players, which constrains its pricing flexibility to a certain extent. However, Aurigene's association with DRL, its presence in internal discovery programmes and its long-standing relationships with customers mitigate the risk to some extent.

High geographic and customer concentration risks – Aurigene derived 89.7% and 90.9% of its revenues from the US market in FY2021 and 9M FY2022, respectively, exposing it to region-specific regulatory and political developments. Also, it derived 91.8% of its revenues from top-three customers in 9M FY2022 (86.5% in FY2021). While high customer concentration risk exists, the long-standing relationships with reputed customers mitigate it to a certain extent. Going forward, ICRA expects majority of Aurigene's revenues to be derived from the US and the top customers in line with its current trend.

Revenues and margins remain susceptible to forex fluctuations – As Aurigene derived 99.8% and 99.3% of its revenues from the overseas markets in FY2021 and 9M FY2022, respectively, its revenues and margins remain susceptible to the adverse forex movements as it does not have a hedging mechanism. The revenues are also susceptible to regulatory and political developments in countries where its customers are located.

Liquidity position: Adequate

The company's liquidity position is **adequate,** characterised by healthy cash flow from operations and no external borrowings. The company has moderate capex plans which is likely to be funded by internal accruals. The company had cash and cash equivalents of Rs 93.0 crore as on March 31, 2022. The company is debt-free and has no repayment obligations. ICRA expects Aurigene to remain debt-free in the near term, as it will be able to comfortably fund its research requirements with the internal accruals and cash and liquid investments. In addition, the company's strong parentage provides healthy financial flexibility, allowing it to raise capital at a short notice.

Rating sensitivities

Positive factors – An upgrade in the rating is unlikely in the near term. However, any change in the credit profile of DRL, might lead to a review of Aurigene's rating.

Negative factors – Pressure on Aurigene's rating could arise in case of a deterioration in DRL's credit profile or if the support and linkage with DRL weakens, thereby impacting its credit profile. Additionally, a deterioration in the company's profitability and any large debt-funded investments impacting the credit metrics could affect the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology](#) [Rating Methodology for Pharmaceutical Industry](#) [Rating Approach – Implicit support from Parent or Group](#)
Parent/Group Support	Dr. Reddy's Laboratories Limited (rated [ICRA]AA+ (Stable)/A1+) The rating assigned to Aurigene factors in the high likelihood of its parent, DRL, extending need-based financial support because of the close business linkages between them. The rating also considers the management support received from DRL in the form of senior board representation. ICRA also expects DRL to be willing to extend financial support to Aurigene to protect its reputation from the consequences of a group entity's distress.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financial statement of the rated entity.

About the company

Established in 2001, Aurigene is a wholly-owned subsidiary of DRL. It is a development stage biotech company involved in discovery and clinical development of novel and best-in-class therapies to treat cancer and inflammatory diseases. Aurigene has partnered with many large and mid-pharma companies in the US and Europe and has 16 programmes at present starting from pre-clinical developments to clinical trials. The company has established relationships with big and medium-sized global pharma and biotech companies. Aurigene has two sites—one each in Bangalore (over 200,000 sft) and Kuala Lumpur, Malaysia. It employs more than 300 scientists.

The company's wholly-owned Malaysian subsidiary, Aurigene Discovery Technologies (Malaysia) SDN BHD, was incorporated to expand its business in Asia. However, at present, the scale of operations of the same remains small. The company also has a wholly-owned subsidiary in the US, Aurigene Discovery Technologies Inc., which is non-operational at present. Effective June 1, 2020, Aurigene transferred its research services (41.2% of FY2020 revenues) business to APSL (rated [ICRA]AA+(CE) (Stable)). The company has retained the discovery and collaboration segment where it performs internal drug discovery and collaboration with customers at various stages of the drug discovery and licensing process.

Key financial indicators (audited)

Aurigene	FY2020	FY2021	9M FY2022*
Operating Income (Rs. crore)	280.1	306.2	238.5
PAT (Rs. crore)	91.1	125.1	97.9
OPBDITA/OI (%)	43.7%	52.9%	38.9%
PAT/OI (%)	32.5%	40.8%	41.0%
Total Outside Liabilities/Tangible Net Worth (times)	3.8	0.4	0.4
Total Debt/OPBDITA (times)	-	-	-
Interest Coverage (times)	1,019.5	3,237.0	7,888.0

**Provisional; NA: Not Available; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; All ratios are as per ICRA calculations*

Source: Company and ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Apr 30, 2022 (Rs. crore)	Date & Rating	Date & Rating In FY2022	Date & Rating In FY2021	Date & Rating in FY2020
					May 30, 2022	-	Mar 30, 2021	Dec 9, 2019
1	Term Loan#	Long Term	150.00	-	[ICRA]AA (Stable)	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)

 # Proposed

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loan	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term Fund Based – Term Loan#	NA	NA	NA	150.00	[ICRA]AA(Stable)

Source: *Company; # Proposed*

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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