March 30, 2021

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**	

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

Rationale

The reaffirmation of the rating derives comfort from Aurigene Discovery Technologies Limited's (Aurigene/the company) parentage as it is a wholly-owned subsidiary of Dr. Reddy's Laboratories Limited (DRL, rated [ICRA]AA+ (Stable)). The rating also considers Aurigene's long-standing relationships with a customer base comprising reputed players in the pharmaceutical industry and its presence across drug discovery and development services. The ratings also factor the company's healthy financial profile characterised by strong operating margins, nil debt and robust coverage metrics and comfortable cash flows. This is further cushioned by a cash and liquid investment balance of Rs. 50.0 crore as on November 30, 2020.

Effective June 1, 2020, Aurigene transferred its research services/ discovery services (contract research services, 41.2% of FY2020 revenues) business to Aurigene Pharmaceutical Services Limited (APSL, rated [ICRA]AA+(CE) (Stable)). Aurigene has issued intercorporate loans of Rs. 160 crore to APSL which is expected to be repaid in FY2026. Aurigene has retained Discovery and collaboration segment where in it performs internal drug discovery and collaboration with customers at various stages of the drug discovery and licensing.

The rating, however, remains constrained by the company's moderate scale of operations that has been further impacted due to the sale of research services to APSL. The rating also factors in the high customer and geographical concentration risk 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 the overseas markets.

The Stable outlook on the [ICRA]AA 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 being 100% subsidiary of DRL – With robust infrastructure and healthy accruals, Aurigene does not require financial and operational support from DRL at present. However, it enjoys operational and financial flexibility by virtue of its parentage, thereby supporting its business prospects. Further, need-based support will be available from DRL. The company is guided at the board level by DRL's key management personnel.

Strong track record in the drug discovery segment and reputed client base – Established in 2001, the company is an established player in the drug discovery segment. A 250-strong scientist base supports its research capabilities. Aurigene's increased focus on internal discovery programmes is expected to provide growth through licence revenues going forward. Long-standing relationships with a reputed customer base comprising of global pharma players lends revenue stability to the company. Aurigene also has some exclusive deals providing upfront payments for research followed by milestone payments, licensing and royalty revenues with customers like Exelixis, Curis Inc., Agios Pharmaceuticals Inc., etc, which support its revenues.

Financial profile characterised by healthy margins and debt free capital structure – Aurigene's revenues grew by 32.6% in FY2020, supported by healthy revenues from its customers across segments such as contract research, discovery and collaboration, and licensing. In FY2020, Aurigene's operating and net margins also expanded by 1,160 bps and 1,070 bps to 43.7% and 32.5% respectively, supported by its revenue growth and consequent operating leverage. The capital structure and coverage indicators remain healthy as the company remains debt-free. In 8M FY2021, the company's operating margins remained healthy at 37.7%. 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 cash and liquid investments. ICRA expects the company's profit margins to remain healthy despite expected revenue de-growth in FY2021 (transfer of Discovery services/ research services business to APSL).

Credit challenges

Moderate scale of operations; sale of research services to APSL has further impacted the scale of operations –Although the company is a well-established player in the industry, its scale of operations is relatively moderate at Rs. 280.1 crore (FY2020) and Rs. 156.7 crore (8M FY2021). The high degree of unpredictability of success of the products being developed is a key characteristic of the industry. Aurigene sold its research services division (41.2% of FY2020 revenues) to APSL in June 2020 which has reduced the company's scale of operations. Aurigene also faces intense competition from other large players, constraining pricing flexibility to a certain extent. However, Aurigene's association with DRL, its presence in internal discovery programmes and its long-standing relationships with its customers mitigate the risk to some extent.

High geographic and customer concentration risk – By virtue of its customer profile, Aurigene derived 85.1% and 84.6% of its revenues from the US in FY2020 and 8M FY2021 respectively, exposing it to region-specific regulatory and political developments. Also, it derived 79.3% of its revenues from top three customers in 8M FY2021 (58.7% in FY2020). Going forward, in line with the current trend, ICRA expects majority of Aurigene's revenues to be derived from the US and the top customers.

Revenues and margins remain susceptible to foreign exchange fluctuations – As Aurigene derived 95.5% and 99.7% of its revenues from overseas markets in FY2020 and 8M FY2021 respectively, its revenues and margins remain susceptible to adverse forex movements as it does not have a hedging mechanism. The revenues are also susceptible to regulatory and political developments in countries in which its customers are located. However, the same is partly mitigated by imports.

Liquidity position: Strong

Aurigene's liquidity is strong with 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 cash and liquid investments as on November 30, 2020 stood at Rs. 50 crore. The company is debt-free and has no repayment obligations. ICRA expects Aurigene to remain debt-free in the near term as it will able to fund its research requirements comfortably with its internal accruals and cash and liquid investments. In addition, the company's strong parentage provides the company with 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 could arise with the weakening of support from and linkages with DRL, thereby impacting Aurigene's credit profile, or any deterioration in DRL's 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 Entities in the Pharmaceutical Industry Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	Parent/Group Company: Dr. Reddy's Laboratories Limited 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	The rating is based on the standalone financial statements of the rated entity.

About the company

Established in 2001, Aurigene is a wholly-owned subsidiary of Dr. Reddy's Laboratories Limited. Aurigene is a development stage biotech company engaged in discovery and clinical development of novel therapies to treat cancer and inflammatory diseases. Aurigene is focused on precision- oncology, oral immune checkpoint inhibitors, and the Th-17 pathway. Aurigene currently has several programs from its pipeline in clinical development. Aurigene has also submitted an IND to DCGI, India for a Phase IIb/III trial of CA-170, a dual inhibitor of PD-L1 and VISTA, in non-squamous NSCLC. Additionally, Aurigene has multiple compounds at different stages of pre-clinical development. Aurigene has partnered with many large and mid-pharma companies in the United States and Europe and has 15 programs currently in clinical development. Aurigene has two sites located in Bangalore (over 2,00,000 sft) and Kuala Lumpur, Malaysia. The company's wholly owned Malaysian subsidiary – Aurigene Discovery Technologies (Malaysia) SDN BHD was incorporated with a view to expand its business in Asia. However, the scale of operations of the same remains small currently. The company also has a wholly-owned subsidiary in the US, Aurigene Discovery Technologies Inc, which is currently non-operational. Aurigene has a 250+ strong scientist base.

Effective June 1, 2020, Aurigene transferred its research services/ discovery services (41.2% of FY2020 revenues) business to Aurigene Pharmaceutical Services Limited (APSL, rated [ICRA]AA+(CE) (Stable)). Aurigene has retained Discovery and collaboration segment where in it performs internal drug discovery and collaboration with customers at various stages of the drug discovery and licensing.

Key financial indicators (audited)

Aurigene (standalone)	FY2019	FY2020
Operating Income (Rs. crore)	211.3	280.1
PAT (Rs. crore)	46.1	91.1
OPBDIT/OI (%)	32.1%	43.7%
PAT/OI (%)	21.8%	32.5%
Total Outside Liabilities/Tangible Net Worth (times)	6.6	3.8
Total Debt/OPBDIT (times)	-	-
Interest Coverage (times)	173.7	1,019.5

***Source:** Company, ICRA research; **Note**: PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; RoCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work-in-Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the year)*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Dec 31, 2020 (Rs. crore)	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
					Mar 30, 2021	Dec 9, 2019	Oct 15, 2018	-
1	Term Loan*	Long Term	150.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-

**Proposed term loan*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan*	-	-	-	-	[ICRA]AA (Stable)

Source: *Company; Note: *Proposed term loan*

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.

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