August 03, 2023

Aurigene Oncology 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 loans#	150.00	150.00	[ICRA] AA (Stable); reaffirmed
Total	**150.00**	**150.00**	

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

Rationale

The reaffirmation of the rating of Aurigene Oncology Limited (Aurigene) factors in its strong parentage, being a wholly-owned subsidiary of Dr. Reddy's Laboratories Limited [DRL; rated [ICRA]AA+ (Stable)] The rating also factors in Aurigene's established presence in the drug discovery industry and its established relationships with its key customers, including several reputed global pharmaceutical companies. Moreover, the company's credit profile continues to remain supported by its comfortable capital structure and coverage metrics due to its debt free position, steady cash accruals and adequate liquidity profile.

However, Aurigene's rating remains constrained by the company's moderate scale of operations with an operating income of Rs. 272.7 crore in FY2023 against Rs. 290.0 crore in FY2022. Milestone-based payments continue to be a significant part of the revenue and, accordingly, the revenue continues to remain non-linear, dependent on activation of any milestones during the year. Coupled with increased R&D expense towards ongoing drug discovery programmes, this has led to moderation in the operating margins in recent years. The rating also takes into account Aurigene's high customer and geographical concentration risks. Moreover, considering a significant portion of its revenue and margin comes from exports, it remains exposed to forex fluctuations. However, the risk is mitigated to an extent by the company's hedging policy.

The Stable outlook on the rating reflects ICRA's opinion that Aurigene's credit profile will continue to be supported by its strong parentage, established relationships with its reputed customer base, resulting in steady accrual generation; and its debt-free status.

Key rating drivers and their description

Credit strengths

Strong parentage as 100% subsidiary of DRL – Being a wholly-owned subsidiary of DRL, Aurigene continues to draw comfort from the strong credit profile of its parent entity [rated [ICRA]AA+ (Stable)]. However, with healthy cash accruals and an adequate liquidity position expected to remain sufficient for funding its R&D requirements, any need of financial support from DRL remains unlikely. ICRA also notes that Aurigene is guided by DRL's key management personnel at the board level.

Strong track record in drug discovery and reputed client base – Being established in 2001, Aurigene has a strong vintage in the drug discovery segment with established relationships with reputable customers comprising global pharmaceutical players like Exelixis, Curis Inc. and Orion Pharma. Aurigene's research capabilities are supported by a strong base of more than 425 scientists, with more than 80 integrated drug discovery projects, 19 programmes in clinical development and more than 200 new chemical entity (NCE) patents.

Comfortable capital structure and coverage metrics owing to continued debt-free status – Aurigene's capital structure and coverage metrics continue to remain robust in the absence of any debt (except lease liability of Rs. 0.6 crore as on March 31, 2023). The company is expected to remain debt free over the near to medium term supported by steady accrual generation and adequate liquidity position to fund its capex and R&D initiatives.

Credit challenges

Moderate scale of operations – Aurigene's scale of operations remains moderate with an operating income of Rs. 272.7 crore in FY2023 and Rs. 290.0 crore in FY2022. Its operating income has remained in the range of Rs. 200-300 crore over the last five years and the transfer of research services division to its Group entity, Aurigene Pharmaceutical Services Limited (APSL), further moderated the revenue. The drug discovery sector is characterised with uncertainty of success of the drug discovery programmes, which are necessary for scaling up revenues. Currently, Aurigene has 19 programmes in clinical development (including two programmes in their third phase of clinical trials). The success of these programmes would remain one of the key factors in improving Aurigene's scale. The company also remains exposed to pricing pressure from other reputed players, which constraints its pricing flexibility. 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 risks – In FY2023, Aurigene's top two customers generated ~87% of its revenue (against ~94% in FY2022), exposing it to customer concentration risk. However, its long-standing relationships with reputed customers mitigate the risks to a certain extent. Curis Inc., a key customer, continues to remain loss making and its ability to fund the ongoing programmes will remain a key factor for Aurigene's revenue visibility. Moreover, the US market drove ~82% of Aurigene's revenues in FY2023 (against ~90% in FY2022), exposing it to risks related to region-specific regulatory and political developments.

Revenues and margins remain susceptible to forex fluctuations – As Aurigene derived 99.0% and 95.1% of its revenues from overseas markets in FY2022 and FY2023, respectively, its revenues and margins remain susceptible to adverse forex movements. However, the risk is mitigated to an extent by its hedging policy. Additionally, the revenues are also susceptible to regulatory and political developments in its key export markets.

Liquidity position: Adequate

Aurigene's liquidity position is adequate, characterised by steady cash flow from operations and no debt repayment liability. It has moderate capex plans of Rs. 50-60 crore in FY2024, which are likely to be funded by internal accruals and cash and cash equivalents of Rs. 71.9 crore as on March 31, 2023. Moreover, ICRA expects Aurigene to remain debt-free in the near term, as it can comfortably fund its research requirements from its internal accruals, and cash and liquid investments.

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 on a sustained basis could also 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 (erstwhile Aurigene Discovery Technologies Limited) 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 at Bangalore (over 200,000 sft) and Kuala Lumpur, Malaysia. It employs more than 300 scientists.

Aurigene'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. The company has retained the discovery and collaboration segment. During FY2021, Aurigene had extended intercorporate loans of Rs. 160.0 crore to its wholly-owned subsidiary, APSL. The scheduled repayment of the loan is due in FY2026.

Key financial indicators (audited)

AOL – Standalone	FY2021	FY2022	FY2023
Operating Income (Rs. crore)	306.2	290.0	272.7
PAT (Rs. crore)	125.1	68.8	34.7
OPBDITA/OI (%)	52.9%	30.1%	16.0%
PAT/OI (%)	40.8%	23.7%	12.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.6	0.6
Total Debt/OPBDITA (times)	0.0	0.0	0.0
Interest Coverage (times)	3,237.0	1,247.9	241.7

Source: Company, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2024) Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2023 (Rs. crore)	Date & Rating Aug 3, 2023	Chronology of Rating History for the Past 3 Years: Date & Rating In FY2023 May 30, 2022	Date & Rating In FY2022 -	Date & Rating In FY2021 Mar 30, 2021
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
Fund-based – Term Loans	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: Click Here

Annexure I: Instrument details

ISIN No	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 II: List of entities considered for consolidated analysis – Not Applicable

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