

October 09, 2023

Aurigene Pharmaceutical Services Limited: [ICRA]AA+(CE)(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based – term loan	380.00	[ICRA]AA+(CE)(Stable); assigned
Total	380.00	

Rating Without Explicit Credit Enhancement

[ICRA]BBB+

*Instrument details are provided in Annexure-I

Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. This rating is specific to the rated instrument/facility, its terms and its structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The last row in the table above also captures ICRA's opinion on the rating without factoring in the explicit credit enhancement

Rationale

For the [ICRA]AA+(CE)(Stable) rating

The rating for the term loan facility of Aurigene Pharmaceutical Services Limited (APSL) is based on the credit profile of the company as well as its parent Dr. Reddy's Laboratories Limited (DRL; rated [ICRA] AA+(Stable)). Further, ICRA's assessment of the strength of the linkages between DRL and APSL, including the corporate guarantee furnished by DRL to APSL for the rated facilities, is a key driver of the rating. The Stable outlook on this rating reflects ICRA's outlook on the rating of the guarantor, DRL. The rating reflects ICRA's expectations that APSL shall continue to maintain its standalone credit profile over the near to medium term, aided by a meaningful scale-up in discovery services, as well as contract development and manufacturing operations (CDMO).

Adequacy of credit enhancement

The rating of the instrument is based on the credit substitution approach, whereby the rating of the guarantor has been translated into the rating of the said instrument. The guarantee is legally enforceable, irrevocable, unconditional, covers the entire amount and tenor of the rated instrument and has a well-defined pre-default invocation and payment mechanism. Given these attributes, the guarantee provided by DRL is adequately strong to result in an enhancement in the rating of the said instrument to [ICRA]AA+(CE) against the rating of [ICRA]BBB+ without explicit credit enhancement. In case the rating of the guarantor is to undergo any change in future, the same would reflect in the rating of the aforesaid instrument as well.

Salient covenants of the rated facility

- » If change of control occurs in respect of the borrower, it will be an event of default and repayment of the loan might be accelerated
- » Financial covenants (applicable to DRL; consolidated) – Minimum DSCR of greater than or equal to 1.2 times and debt/EBIDTA of less than 4.5 times

For the [ICRA]BBB+ rating

The unsupported rating factors in the company's standalone business and financial risk profiles, along with its financial support as a step-down subsidiary of DRL. APSL has established relationships with reputable global innovator pharmaceutical companies, which provides it with a continued revenue visibility. Moreover, it is setting up another facility in Genome Valley, Hyderabad for R&D and small-scale GMP (good manufacturing practices) manufacturing of large molecules which shall provide APSL with a significant growth opportunity over the medium to long term. APSL continues to maintain a healthy order book supported by recurring contracts executed for its key customers and Group companies.

The rating is, however, constrained by APSL's moderate scale of operations having registered a revenue of Rs. 330.7 crore in FY2023 and Rs. 361.1 crore in FY2022. ICRA also notes that the movement of projects to the commercialisation stage has a long gestation period associated with a lengthy discovery and development process with low rates of success and the long-term growth of the company shall depend on successful commercialisation of its projects. As a large number of innovator and biotech companies are based in regulated markets, especially the US, these markets continue to contribute significantly to APSL's revenues. In FY2023, the US drove 61.6% of APSL's revenues, which is in line with the trend in the industry.

The rating also factors in APSL's weak financial profile characterised by high debt level and negative net worth. The outstanding term loan of Rs. 380.0 crore is repayable in a single tranche in FY2027, and in case APSL's accrual generation does not scale-up materially by then, ICRA expects the repayment to be partly refinanced or funded through support from its parent. APSL's net worth is negative on account of adjustment of the goodwill of the acquired CDMO business in the reserves and surpluses. However, comfort can be drawn from the strong financial flexibility of its parent which continues to provide support to APSL. The company also faces increasing competition as global companies are increasing their presence in discovery services and CDMO. Considering a significant portion of its business is driven by overseas markets, APSL also remains vulnerable to forex fluctuations.

Key rating drivers and their description

Credit strengths

Explicit support in the form of corporate guarantee from DRL – The rating derives comfort from the irrevocable and unconditional corporate guarantee extended to APSL by the guarantor, DRL. While the guarantee has a well-defined payment mechanism in place to ensure the timely payment of the interest and principal obligations of the term loan, adherence to the timelines of the payment structure by the borrower and the lender shall be a key monitorable for the rating.

Established relationships with reputable innovator pharmaceutical companies – APSL has been able to maintain a good customer profile with a decreasing customer concentration and a significant contribution from reputed global innovator pharmaceutical companies, which can provide it a recurring order book on account of long-term research contracts. Contribution from the top-10 customers has reduced to 47% of its revenues in FY2023 from 64% in FY2021. However, APSL does have some reliance on biotech startups which have relatively weaker financial profiles and are dependent on the success of a limited number of programmes, which can stretch recovery of dues in case of any unsuccessful results.

Healthy order book; set up of laboratories for large molecules provides revenue visibility over medium to long term – A healthy and increasing outstanding order book provides APSL with a good growth opportunity over the near to medium term. APSL also receives orders from DRL and Aurigene Oncology Limited (AOL) as a part of its recurring business. Moreover, APSL is investing in setting up a new facility in Genome Valley, Hyderabad for R&D and small-scale GMP manufacturing of large molecules which are expected to provide it with healthy growth opportunities over the medium to long term.

Credit challenges

Moderate scale of operations; US contributing to a significant portion of its sales – The scale of operations of APSL continues to be moderate with total operating income of Rs. 330.7 crore in FY2023 and Rs. 361.1 crore in FY2022. The reduction in

revenues over FY2023 was largely driven by discontinuation of some Covid-related products, which contributed materially to revenue in the previous year. The future revenue scale-up for APSL will be supported by commercialisation of successful developments, a healthy order book, reputed customer base, recurring business from Group companies and strong parentage. The US remains a key market for APSL, driving 61.6% of its FY2023 revenues. While this poses some concentration risk for APSL, it is in line with the industry as majority of the global innovator and biotech companies are based in the US.

Weak standalone financial profile with high debt levels and negative net worth – As on March 31, 2023, APSL had a total debt of Rs. 542.9 crore including non-convertible debentures (NCDs) of Rs. 380.0 crore (refinanced subsequently via a term loan of Rs. 380.0 crore), intercorporate loan of Rs. 160.0 crore from AOL and lease liabilities of Rs. 2.9 crore. The term loan is repayable in a single tranche in FY2027, and in case APSL's accrual generation does not scale-up materially by then, ICRA expects the repayment to be partly refinanced or funded through support from its parent. Moreover, the debt metrics are expected to remain moderated in the near term as APSL shall require incremental debt/intercompany loans for funding its ongoing capex plans. APSL's net worth has remained negative on account of the goodwill of the acquired CDMO business, which has been adjusted in its reserves and surpluses (as per Indian accounting standards). However, internal accrual generation has increased in recent years, which is expected to continue going forward.

Vulnerable to forex fluctuations and competitive intensity in the industry – The competitive intensity in the industry is expected to remain high with several global companies increasing their presence in discovery services and CDMO. However, the company's strong parentage, technical capabilities, focus on compliance and safety are likely to mitigate the competitive threats. APSL's revenues and margins also continue to be vulnerable to any adverse forex fluctuations as a large portion of its business is driven by overseas markets.

Liquidity position: Adequate

For the [ICRA]BBB+ rating – Adequate

APSL's liquidity position is adequate, owing to the steady cash flow from operations, no debt repayment liability over the near to medium term, cash and liquid investments of Rs. 35.3 crore and undrawn working capital facilities of Rs. 4.5 crore as on March 31, 2023. The replacement and maintenance capex requirement of APSL is moderate at around Rs. 50-60 crore per annum and its internal accruals are sufficient to fund these requirements. While APSL is expected to incur significant additional capex towards setting up additional laboratories over the next few years, it is expected to continue to receive financial support from its parent/Group companies for funding the capex.

For the [ICRA]AA+ (CE) rating – Strong

DRL's liquidity position remains strong, supported by a healthy generation of cash flow from operations, consolidated unencumbered cash, cash equivalents and liquid investments of Rs. 6,057.7 crore and undrawn working capital limits (standalone) of ~Rs. 5,000 crore as on March 31, 2023. The cash flow generation of the company is also expected to remain strong over the medium term, supported by revenue growth across major geographies. DRL is expected to incur an annual capex of around Rs. 1,200–1,500 crore (excluding that towards any inorganic expansion), which is expected to be funded through internal accruals. Moreover, it is likely to continue to invest in inorganic expansion through acquisitions for further strengthening its core businesses.

Rating sensitivities

Positive factors – The rating would remain sensitive to any change in the credit profile of the guarantor (DRL).

Negative factors – Pressure on APSL's rating could arise in case of weakening of the credit profile of the guarantor (DRL), or weakening in the linkage between the guarantor and APSL. Moreover, pressure on APSL's revenue and margins impacting the earnings stability and/or stretch in its liquidity profile on a sustained basis, could result in a rating downgrade. Additionally,

lack of adherence of terms of payment structure as defined in the Corporate Guarantee deed and addendum can also lead to a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating methodology for Entities in the Pharmaceutical Industry
Parent/Group support	The rating for the term loan of Rs. 380.0 crore is based on the unconditional, irrevocable and continuing guarantee from DRL that covers all the repayment obligations of the term loan
Consolidation/Standalone	Standalone

About the company

Incorporated on September 16, 2019, APSL is a subsidiary of AOL (rated [ICRA]AA (Stable)) and a step-down subsidiary of DRL (rated [ICRA]AA+ (Stable)). Effective June 1, 2020, the CDMO division of the Custom Pharmaceutical Services segment of DRL as well as Discovery Service division of AOL was transferred to APSL.

APSL was formed to service the needs of innovator customers in the areas of medicinal chemistry and biology and contract development and manufacturing services for clinical and commercial needs. DRL intends to position APSL as a global leader in offering end-to-end integrated solutions across discovery, development, and manufacturing. With the consolidation of the Discovery Services and the CDMO divisions, APSL offers end-to-end services to its customers, ranging from discovery, development, scale-up supplies and contract manufacturing. This also enables a flow of projects from drug discovery into development and leads to synergies between the customer base at CDMO division and discovery services, enabling the organisation to be a one-stop shop offering turnkey solutions to its customers.

About the guarantor

DRL was incorporated by its promoter and Founder Chairman, the Late Dr. K. Anji Reddy, as a private limited company on February 24, 1984. The company was subsequently converted to a public limited one on December 6, 1985, and listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) in August 1986, as well as on the New York Stock Exchange (NYSE) on April 11, 2001. As on March 31, 2023, the promoters and the promoter Group held a 26.69% stake in the company.

DRL offers a portfolio of pharmaceutical products and services, including generics, APIs, custom pharmaceutical services, biosimilars and differentiated formulations. It has three divisions — global generics (87% of revenues in FY2023), PSAI (12%) and others (1%). The major therapeutic areas of focus for the company include the central nervous system, gastro-intestinal, oncology, cardiovascular and pain management, with the US, India, West Europe, Russia and the CIS nations being its major markets.

At present, DRL has nine API-manufacturing facilities, of which six are in India, one in Mexico, one in the US and one in the UK. It also has 13 formulations manufacturing facilities in India, and one each in the US and China. In addition, the company has one biologics facility in India and eight technology development and R&D centres in India and across the globe.

For the latest detailed rating rationale of the guarantor, please click [here](#)

Key financial indicators (audited)

APSL – Standalone	FY2022	FY2023
Operating income	361.1	330.7
PAT	32.1	12.8
OPBDIT/OI	28.0%	23.2%
PAT/OI	8.9%	3.9%
Total outside liabilities/Tangible net worth (times)	(1.8)	(1.8)
Total debt/OPBDIT (times)	5.5	7.1
Interest coverage (times)	2.5	1.9

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; all ratios as per ICRA calculations

DRL – consolidated	FY2022	FY2023
Operating income	21,545.2	24,669.7
PAT	2,112.2	4,470.3
OPBDIT/OI	21.8%	26.5%
PAT/OI	9.8%	18.1%
Total outside liabilities/Tangible net worth (times)	0.5	0.4
Total debt/OPBDIT (times)	0.7	0.2
Interest coverage (times)	49.0	45.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. crore; all ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 15, 2023 (Rs. crore)	Current rating (FY2024)		Chronology of rating history for the past 3 years			
				Date & rating in FY2024		Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
				Oct 09, 2023	July 20, 2023	July 28, 2022	July 29, 2021	Jul 07, 2020	Jun 25, 2020
1 Term loans	Long term	380.00	380.00	[ICRA]AA+(CE) (Stable)	-	-	-	-	-
2 NCDs	Long term	-	-	-	[ICRA]AA+(CE) (Stable) Withdrawn	[ICRA]AA+(CE) (Stable)	[ICRA]AA+(CE) (Stable)	[ICRA]AA+(CE) (Stable)	[ICRA]AA+(CE) (Stable)
3 Proposed NCDs	Long term	-	-	-	-	-	-	Provisional [ICRA]AA+(CE) (Stable) withdrawn	Provisional [ICRA]AA+(CE) (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – 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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	June 2023	7.55%	June 2026	380.00	[ICRA]AA+(CE) (Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis- Not applicable

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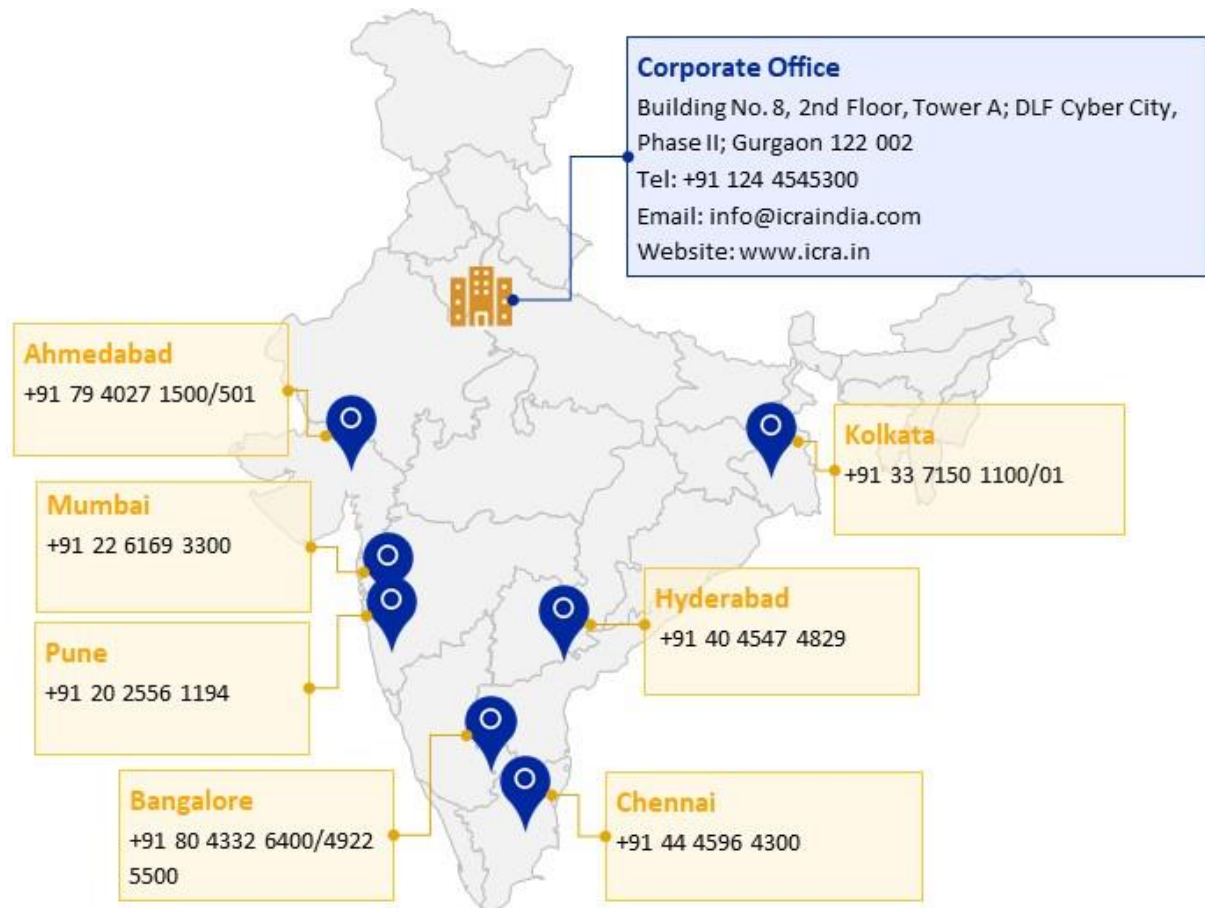
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