

Rating Rationale

March 31, 2023 | Mumbai

Aragen Life Sciences Limited

Rating outlook revised to 'Positive'; Ratings Reaffirmed

Rating Action

Total Bank Loan Facilities Rated	Rs.434.8 Crore
Long Term Rating	CRISIL AA-/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)
Short Term Rating	CRISIL A1+ (Reaffirmed)

Rs.225 Crore Non Convertible Debentures	CRISIL AA-/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)
Rs.75 Crore Non Convertible Debentures	CRISIL AA-/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)
Rs.50 Crore Commercial Paper	CRISIL A1+ (Reaffirmed)

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1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has revised its outlook on the long-term bank facilities and non-convertible debentures (NCDs) of Aragen Life Sciences Limited (Aragen Life) to **'Positive'** from 'Stable', while reaffirming the rating at **'CRISIL AA-'**. The rating on the short-term bank facilities and commercial paper programme has been reaffirmed at 'CRISIL A1+'.

The outlook revision reflects the expectation of sustained strong operating performance of the company with double-digit revenue growth and high profitability which will lead to healthy cash accruals. Aragen Life benefits from its diversified clientele, medium-to-long-term contracts with customers and continued client addition, which supports revenue growth and widens the clientele. Improving cost-competitiveness vis-a-vis Chinese players and increased focus of global pharmaceutical (pharma) players on outsourcing research and development led to revenue growth of around 22% on-year in fiscal 2022 and 25% in the first nine months of fiscal 2023 (on annualised basis). Furthermore, continued healthy demand in the discovery services segment and capacity addition across businesses should aid in healthy revenue growth over the medium term.

Operating profitability remained strong at 29.4% in fiscal 2022 and ~28% in the first nine months of fiscal 2023 (against 28.2% in fiscal 2021 and 25.2% in fiscal 2020), driven by sizeable contribution from the high-margin discovery services

segment and rapidly growing scale of operations. Operating margin is likely to remain healthy at 28-30% over the medium term.

The financial risk profile is healthy, with tangible network of over Rs 1,000 crore as on December 31, 2022. Gearing was comfortable at 0.58 time as on March 31, 2022, and interest coverage ratio healthy at over 16 times in fiscal 2022. Aragen Life has stepped up its organic capital expenditure (capex) to ~Rs 400 crore annually, which could be partly debt-funded and may result in some moderation in credit metrics in the near term. Nonetheless, gearing is expected at below 0.6-0.7 time going forward. In January 2023, the company's board has approved raising capital through an initial public offering (IPO). However, the timeline of the IPO and quantum of fund raise is yet to be finalised by the management and will remain a monitorable.

Thus far, Aragen Life has remained ring-fenced from the GVK group and has not provided any temporary or permanent financial support to GVK group companies. CRISIL Ratings is given to understand that the status quo will be maintained by Aragen Life given the presence of Mr Davinder Singh Brar and his family members, with equal stake, and the presence of the private equity investor, Goldman Sachs group, with a significant minority stake. CRISIL Ratings has also noted that in case of another company of the GVK group, the regulatory authorities are investigating the company and its directors, alleging financial irregularities. CRISIL Ratings has been informed that this development has had no impact on the operations of Aragen Life and will continue to monitor any development in this regard.

The ratings continue to reflect the strong market position of Aragen Life in the contract research industry, based predominantly on full-time equivalent (FTE) and fee-based contracts, and healthy financial and liquidity risk profiles. These strengths are partially offset by susceptibility to regulatory changes and increasing competition and high geographic concentration risk.

Analytical Approach

CRISIL Ratings has combined the business and financial risk profiles of Aragen Life and its wholly owned overseas subsidiaries. The entities, collectively referred as Aragen Life herein, have the same management, financial linkages and similar businesses.

Please refer Annexure - List of Entities Consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description
Strengths

Strong market position in the contract research industry: Aragen Life is one of the largest contract research organisations (CROs) in India, with a large clientele that includes several global pharma players. It offers integrated services across the drug discovery and development value chain and provides research services in medicinal chemistry and biology to innovator pharma companies. The company's strong market position is reflected in its large clientele of over 450 companies. Drug discovery services (including the biologics segment) is the major revenue contributor, accounting for ~65% of the company's revenue in fiscal 2022. This division synthesises compounds and does biology studies and the company, with its strong track record, has continually obtained new projects under the division.

Low-risk business model, predominantly based on FTE and fee-based contracts: The company follows a low-risk business model, which involves billing on an FTE basis as well as fee-based contracts. Contracts are typically renewable annually, resulting in stable revenue. The company has a large clientele and has retained 75-80% of customers over the past several years. It has long-term relationship with clients, resulting in multiple assignments and higher revenue contribution. Also, through diversification of its clientele, the company has reduced customer concentration risk, with the share of the top 10 customers to the revenue almost halving in the past 4-5 years and contributing 38% of total revenue in fiscal 2022.

Healthy operating profitability: Operating efficiency, cost-reduction initiatives and high share of the profitable drug discovery services have enabled Aragen Life's operating margin to improve to 29.4% in fiscal 2022 and ~28% in the first nine months of fiscal 2023 from 25.2% in fiscal 2020. Streamlining of operations, better utilisation of capacities and commercialisation of ongoing capex would support steady profitability of 28-30% over the medium term.

Healthy financial risk profile: Financial risk profile is healthy, backed by healthy cash accrual and prudent capital structure with gearing comfortable at 0.58 time as on March 31, 2022. Given the partial debt-funded acquisition of Intox Pvt Ltd, a pre-clinical CRO, in December 2021, debt/earnings before interest, taxes, depreciation and amortisation (Ebitda) increased to 1.3 times in fiscal 2022 (from 0.8 time in fiscal 2021). However, with healthy profitability and successful integration of the acquired business, the debt/Ebitda improved to 1.1 times in the first nine months of fiscal 2023. Interest coverage ratio was robust at over 16 times in fiscal 2022 and ~12 times in first nine months of fiscal 2023. The company has stepped up its organic capex to ~Rs 400 crore annually, which could be partly debt-funded and may constrain the credit metrics in the near term. Nonetheless, gearing should remain below 0.6-0.7 time and peak debt/Ebitda below 1.5-2.0 times going forward. The company has sizeable contingent liabilities of ~Rs 123 crore related to tax claims that are being contested; a negative verdict requiring large payout by the company will remain a monitorable.

The private equity firm, Goldman Sachs group, holds ~31.3% stake in the company. CRISIL Ratings understands that there is no obligation on Aragen Life or the promoter family to provide an exit or assured return to Goldman Sachs on its investment, and Goldman Sachs may evaluate exit through the planned IPO.

Weaknesses:

Susceptibility to regulatory changes and increasing competition: The CRO industry is highly fragmented owing to low entry barriers. Several large global pharma players are outsourcing contract research activities to India. Hence, more CROs may enter the fray, increasing competition and constraining the pricing flexibility of strong players such as Aragen Life. Additionally, the company faces competition from CROs based in China and Eastern Europe, which may have a broader portfolio of services. Nevertheless, the company benefits from its wide range of service offerings and strong clientele. The company is also exposed to stringent regulatory requirement.

High geographical concentration risk: In fiscal 2022, Aragen Life derived around 56% and 21% of its revenue from the US and Europe, respectively, exposing it to region-specific regulatory and political developments. Large portion of the revenue is expected to come from the US market going forward as well, in line with the current trend. However, upfront and milestone-based payments from customers should mitigate this risk. Revenue is also susceptible to regulatory and political developments in countries in which its customers are located. As the company derives over 90% of its revenue from the overseas market, its revenue and operating margin remain susceptible to any adverse foreign exchange (forex) movements. However, the company hedges majority of its open forex exposure as per its hedging policies, thus mitigating the risk.

Liquidity: Strong

Consolidated cash accrual expected at over Rs 300-350 crore annually in fiscals 2023 and 2024 will comfortably cover the yearly debt obligation of Rs 30-70 crore and partly fund the capex. With gradually increasing cash accrual, CRISIL Ratings expects the company to also be comfortably able to meet its NCD repayment of Rs 200 crore in February 2025. Utilisation of the fund-based bank limit was less than 30% (on average) for the 12 months through December 2022. The company has also steadily built up its liquid surplus, which stood at Rs 262 crore as on December 31, 2022. Dividend payout has been moderate at 25-40% of the net profit over the past few years and is expected to continue at 30% of PAT.

Outlook: Positive

The business risk profile of Aragen Life will continue to improve over the medium term, driven by its strong business model and sustained healthy operating performance. Financial risk profile will remain healthy, supported by steady cash accrual, prudent capital spending and efficient working capital management.

Rating Sensitivity factors

Upward factors

- Sustained high double-digit revenue growth, with operating profitability of at least 25-27% ensuring healthy annual cash accruals
- Sustenance of a healthy financial risk profile and debt metrics at comfortable levels, supported by healthy cash generating ability, while pursuing organic and inorganic expansion plans

Downward factors

- Moderation of revenue growth and operating profitability (below 18-20%) on account of intense competition or impact of any adverse regulatory action
- Higher-than-expected debt-funded capex or acquisitions leading to moderation in the debt metrics, for instance, debt/Ebitda of above 2 times on a sustained basis
- Significant change in shareholding among promoters or large fund outflow to the promoters or promoter companies by way of dividend, capital reduction, share buy-back or any other manner leading to moderation in liquidity
- Material regulatory action against the promoters impacting the operations
- Negative verdict in case of tax exemptions of ~Rs 123 crore being contested

About the Company

Aragen Life, incorporated in 2000, is an integrated contract research and development organisation, which provides drug discovery and development services to pharma, agro chemicals and biotech companies. It provides end-to-end and integrated services across the value chain, from drug discovery to commercial manufacturing. The company provides medicinal chemistry services, biology services, scale-up technologies, formulation and analytical services, process research development and custom chemical synthesis. It also manufactures active pharmaceutical ingredients (APIs) and API intermediates. It has over 450 clients, including 7 of the top 10 global pharma companies. The company has more than 4000 employees, with facilities in Hyderabad, Bengaluru, Pune and Visakhapatnam and in Morgan Hill, California. The company got its current name in December 2020 (it was previously known as GVK Biosciences Pvt Ltd). In January 2023, the company's Board approved conversion into a public limited company. The wholly owned subsidiary, Aragen Bioscience, is a privately held, US-based, pre-clinical CRO specialising in high-value biologics services.

As on December 21, 2022, Mr Davinder Brar, his family members and Reddy Investment Trust directly and indirectly held 33.7% shares each in the company; ~31.3% was held by Goldman Sachs group and the remaining was held by GVK Bio Employee Welfare Trust and others.

For the first nine months of fiscal 2023, the company reported a consolidated profit after tax (PAT) of Rs 156 crore on revenue of Rs 1,301 crore.

Key Financial Indicators

Particulars	Unit	2022	2021
Revenue	Rs crore	1387	1134
PAT	Rs crore	197	168
PAT margin	%	14.2	14.8
Adjusted debt/adjusted networth	Times	0.58	0.32
Adjusted interest coverage	Times	16.25	17.2

Any other information: Not applicable

Note on complexity levels of the rated instrument:

CRISIL Ratings' complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

CRISIL Ratings will disclose complexity level for all securities - including those that are yet to be placed - based on

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For more details on the CRISIL Ratings` complexity levels please visit www.crisilratings.com. Users may also call the Customer Service Helpdesk with queries on specific instruments.

Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Complexity levels	Rating assigned with outlook
NA	Commercial paper^	NA	NA	7-365 days	50	Simple	CRISIL A1+
NA	External commercial borrowing	NA	NA	Oct-23	17.72	NA	CRISIL AA-/Positive
NA	Letter of credit @	NA	NA	NA	47	NA	CRISIL A1+
INE483I07010	Non Convertible Debentures^^	NA	NA	Feb-25	200	Simple	CRISIL AA-/Positive
NA	Non Convertible Debentures^	NA	NA	NA	100	Simple	CRISIL AA-/Positive
NA	Proposed working capital facility	NA	NA	NA	4.22	NA	CRISIL AA-/Positive
NA	Term loan	NA	NA	Mar-24	35	NA	CRISIL AA-/Positive
NA	Term loan	NA	NA	Mar-26	59.06	NA	CRISIL AA-/Positive
NA	Term loan	NA	NA	Nov-26	50	NA	CRISIL AA-/Positive
NA	Term loan	NA	NA	Nov-27	50	NA	CRISIL AA-/Positive
NA	Term loan	NA	NA	Dec-26	50	NA	CRISIL AA-/Positive
NA	Working capital facility	NA	NA	NA	10	NA	CRISIL AA-/Positive
NA	Working capital facility*	NA	NA	NA	111.8	NA	CRISIL AA-/Positive

* Fully interchangeable with letter of credit/buyers` credit/bank guarantee

@ Fully interchangeable with buyers` credit/bank guarantee

^Yet to be placed

^^Rs 200 crore NCD placed, Rs 100 crore NCD yet to be placed

Annexure – List of entities consolidated

Names of Entities Consolidated	Extent of Consolidation	Rationale for Consolidation
Aragen Bioscience Inc	100%	Subsidiary
Aragen Biosciences B.V. Netherlands (earlier GVK Biosciences B.V.)	100%	Subsidiary
Intox Pvt Ltd	76%	Subsidiary

Annexure - Rating History for last 3 Years

Current				2023 (History)		2022		2021		2020		Start of 2020
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund Based Facilities	LT	387.8	CRISIL AA-/Positive		--	07-04-22	CRISIL AA-/Stable	28-09-21	CRISIL AA-/Stable	30-09-20	CRISIL AA-/Stable	CRISIL A+/Positive
			--		--		--	15-01-21	CRISIL AA-/Stable		--	--

Non-Fund Based Facilities	ST	47.0	CRISIL A1+		--	07-04-22	CRISIL A1+	28-09-21	CRISIL A1+	30-09-20	CRISIL A1+	CRISIL A1+
			--		--		--	15-01-21	CRISIL A1+		--	--
Commercial Paper	ST	50.0	CRISIL A1+		--	07-04-22	CRISIL A1+	28-09-21	CRISIL A1+	30-09-20	CRISIL A1+	CRISIL A1+
			--		--		--	15-01-21	CRISIL A1+		--	--
Non Convertible Debentures	LT	300.0	CRISIL AA-/Positive		--	07-04-22	CRISIL AA-/Stable	28-09-21	CRISIL AA-/Stable	30-09-20	CRISIL AA-/Stable	CRISIL A+/Positive
			--		--		--	15-01-21	CRISIL AA-/Stable		--	--

All amounts are in Rs.Cr.

Annexure - Details of Bank Lenders & Facilities

Facility	Amount (Rs.Crore)	Name of Lender	Rating
External Commercial Borrowings	17.72	Citibank N. A.	CRISIL AA-/Positive
Letter of Credit@	47	YES Bank Limited	CRISIL A1+
Proposed Working Capital Facility	4.22	Not Applicable	CRISIL AA-/Positive
Term Loan	35	The Federal Bank Limited	CRISIL AA-/Positive
Term Loan	50	Citibank N. A.	CRISIL AA-/Positive
Term Loan	59.06	Kotak Mahindra Bank Limited	CRISIL AA-/Positive
Term Loan	100	Kotak Mahindra Bank Limited	CRISIL AA-/Positive
Working Capital Facility*	60	Kotak Mahindra Bank Limited	CRISIL AA-/Positive
Working Capital Facility*	51.8	Citibank N. A.	CRISIL AA-/Positive
Working Capital Facility	10	YES Bank Limited	CRISIL AA-/Positive

This Annexure has been updated on 31-Mar-2023 in line with the lender-wise facility details as on 28-Sep-2021 received from the rated entity

@ - Fully interchangeable with buyers credit/bank guarantee
* - Fully interchangeable with letter of credit/buyers' credit/bank guarantee

Criteria Details

Links to related criteria
CRISILs Approach to Financial Ratios

Rating criteria for manufacturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
CRISILs Criteria for rating short term debt
CRISILs Criteria for Consolidation

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