

Sector: Pharmaceuticals
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 2,784	
Price Target: Rs. 3,400	↑
↑ Upgrade ↔ No change ↓ Downgrade	

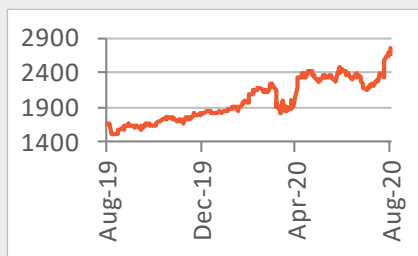
Company details

Market cap:	Rs. 73,913 cr
52-week high/low:	Rs. 2,815/1,467
NSE volume: (No of shares)	7.2 lakh
BSE code:	532488
NSE code:	DIVISLAB
Sharekhan code:	DIVISLAB
Free float: (No of shares)	12.7 cr

Shareholding (%)

Promoters	46.9
FII	19.7
DII	15.6
Others	12.77

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	27.0	23.3	33.4	68.6
Relative to Sensex	23.3	2.3	40.9	64.9

Sharekhan Research, Bloomberg

Divis Laboratories (Divis), a leading API player, reported impressive numbers for the quarter. Consolidated sales stood at Rs 1730 crore up 48.8% y-o-y, largely driven by a volume-led growth across product portfolio. The operating margins at 40.5% expanded sturdily by 665 bps y-o-y on the back of a rise in gross margins and benefits of operating leverage. Adjusted PAT stood at Rs. 487 crore up 75% y-o-y and was ahead of estimates. Amid the COVID-19 pandemic, businesses are witnessing changes, leading to evolution of new business practices. Immense opportunities have opened up for API-centric players such as Divis as companies across the globe are hunting for an alternate source for procurement of APIs / bulk drugs. Moreover, the Indian government's thrust on promoting bulk drug manufacturing is a step ahead in the right direction. Further the ongoing capacity expansion plans, which are expected to be completed by FY2021 provides ample visibility to cater to the expected increase in demand. The fact that company is pursuing a massive Rs. 1,800 crore capex, also points towards strong growth visibility. We believe Divis could benefit from its backward integration initiatives, a slew of planned new product launches and a large capex project, as well as from emerging opportunities in the API space. Moreover, the custom synthesis business has gained traction and is expected to sustain the momentum thus adding to the topline. Sales and profit are expected to grow at a sturdy 23% / 35% CAGR over FY2020-FY2022.

Key positives

- Revenues grew impressively by 48.8% y-o-y aided by a strong volume growth across product portfolio.
- Operating margins have expanded by a sturdy 665 bps y-o-y to 40.5% backed by gross margins expansion and benefits of operating leverage.

Key negatives

- Other income declined by 58.7% y-o-y to Rs 13 crore, which is the lowest in the past eight quarters

Our Call

Valuation – Maintain Buy: Divis is one of the leading players in the API space and also has a presence in the CRAMS segment. Following the supply disruptions in the API space, an array of opportunities have emerged. Companies like Divis Laboratories are best positioned to capitalise on these opportunities. Amidst a strong demand outlook, its expanded capacities are expected to come on stream, which will provide ample visibility on the company's capability to meet the increased demand. The full benefits of expanded capacities are likely to be reflected from FY2022 onwards. Q1FY21 was a phenomenal quarter for Divis, though growth was lumpy. Based on Q1FY21 results, we have revised our earnings estimate upwards for FY2021 / FY2022 and have also introduced FY2023 estimates in this note. At CMP, the stock is trading at 40.8x /31.2x its FY2021 / FY2022 earnings. We expect Divis to benefit from backward integration, capacity expansion and emerging opportunities in the API space. Strong earnings visibility, sturdy balancesheet with almost a zero debt and strong return ratios bode well and provides visibility on P/E multiple expansions. Moreover, the company does not have any pending regulatory hurdles, which is a key positive. We retain Buy recommendation on the stock with a revised PT of Rs. 3,400.

Key Risks

- Adverse regulatory changes;
- Delay in completion of capex plans.

Valuation (Consolidated)

Particulars	FY2018	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net sales	3912.8	4946.3	5394.4	6603.5	8181.5	9633.1
OPM (%)	32.2	37.8	33.8	38.5	39.5	39.9
PAT	877.0	1321.7	1294.5	1813.3	2365.6	2854.9
EPS (Rs)	33.0	49.8	48.8	68.3	89.1	107.5
PER (x)	84.3	55.9	57.1	40.8	31.2	25.9
EV/Ebitda (x)	53.7	37.0	38.3	27.4	21.2	17.4
ROCE (%)	19.9	24.9	22.6	26.4	27.9	27.4
RONW (%)	14.8	19.0	17.7	20.7	22.0	21.6

Source: Company Data; Sharekhan estimates

Stellar performance for the quarter: Divis reported a stellar performance for the quarter, though it reflects an element of lumpy growth. Results are ahead of estimates. Revenues stood at Rs. 1,730 crore, are up by 48.8% y-o-y, largely driven by volume-led growth across product portfolio. Operating margins at 40.5% expanded by an impressive 665 bps y-o-y. Benefits of operating leverage, and expansion in gross margins fuelled OPM expansion. Operating profits at Rs 700 crore, are up 78% y-o-y and ahead of estimates. The other income for the quarter (adjusted for forex gains) is down 58.7% y-o-y to Rs 12.5 crore. Consequently, adjusted PAT for the quarter stood at Rs 487 crore up 75% y-o-y and was ahead of our estimates. Reported earnings for the quarter stand at Rs 492 crore, up 80.6% y-o-y.

API space looks enticing; Divis to benefit significantly from opportunities in API: Divis is a leading player in the API (active Pharmaceutical ingredients) segment and derives around 59% of its revenues from the same. China is a major supplier of pharmaceutical raw materials including - key starting materials (KSM), intermediates and APIs. The COVID-19 related disruption has certainly raised concerns in terms of sourcing of inputs for the global pharma industry, as China is the largest source of intermediates and APIs. Consequently, companies world over are hunting for an alternate source for procurement of APIs. Players such as Divis one of the leading manufacturers of intermediates/APIs could potentially be one of the key beneficiaries of this situation, supported by its expanded capacity and backward integration. Also the company has been successfully able to benefit from few of the Covid related products (HydroxyChloroquine, Remdesivir and Favipiravir) by developing the APIs and intermediates. Though the share of these products was lower in Q1FY21, going ahead they could provide a significant opportunity, if the drugs are in demand. In addition to this, the company has a strong product pipeline. This augurs well for Divis as it would boost the top line. We expect the company's top line to grow by a sturdy 23% CAGR over FY2020-FY2022. Also, the government is providing certain benefits so as to promote API manufacturing in India and in a way reduce dependence on imports. This could be positive for API players such as Divis if they opt for the benefits.

Capacity expansion to be done by FY21: Divis is amid a massive Rs. 1,800 crore capex plan, which involves de-bottlenecking of existing plants as well as setting up new units. The company had announced a capex of Rs. 1,200 crore towards two projects, which were slated to be completed by FY2020. However, capex plans had been deferred and the management expects to complete it by FY2021. Consequently, the full benefits of expanded capacities are expected to be reflected in FY2022 onwards. Divis is expected to be significantly benefiting from capex plans. Through the new capacities, the company would be manufacturing certain key APIs / intermediates, which were earlier imported. This would lead to benefits of backward integration unfolding going ahead. Moreover, the new sites would add to the capacities of existing products and also facilitate the introduction of new products.

Q1FY2021 Concall Highlights:

- ◆ Q1FY21 was a challenging quarter for the company due to the COVID-19 related lockdown. Post relaxing of the lockdown, the company's operations have improved and are now at close to normal levels. Revenues grew remarkably by 48.8% y-o-y on the back of a volume-led growth across all the product portfolio.
- ◆ Divis derives around 74% of its sales collectively from the developed markets of US and Europe. The mix between generic APIs and custom synthesis segments stood at 59:41 for the quarter.
- ◆ The company has invested in Gabapentin to increase current capacities and for backward integrating into its intermediates to reduce dependency on China.
- ◆ Divis Labs is setting up two new units in DC SEZ and DCV SEZ with an investment of Rs 600 crore each. The plants are expected to be ready by the end of FY2021, subject to regulatory approvals.
- ◆ De-bottlenecking measures are likely to increase capacity by 25-30%.
- ◆ Divis sees API supply issues from the Chinese API players, which has resulted in most of the companies in the US and Europe scouting for alternate sourcing destination. This is likely to work to the benefit of Indian companies.
- ◆ As of June 2020, the company has cash of around Rs. 1343 crore on its books, receivables Rs. 1550 crore and stocks amounting to Rs 1742 crore. Gross block addition during the quarter stood at Rs 216 crore

Results (Consolidated)

Particulars	Rs cr				
	Q1FY21	Q1FY20	YoY(%)	Q4FY20	QoQ(%)
Net revenues	1730.5	1162.9	48.8	1389.7	24.5
Operating profit	700.1	393.1	78.1	444.5	57.5
Other Income	12.5	30.3	(58.7)	19.7	(36.5)
Interest	0.2	0.3	(28.1)	0.4	(47.7)
Depreciation	56.2	43.8	28.2	49.8	12.9
PBT	656.2	379.3	73.0	414.0	58.5
Tax Expense	168.9	100.9	67.5	82.7	104.2
Adj.PAT	487.3	278.4	75.0	331.2	47.1
Net PAT	492.1	272.4	80.6	388.2	26.7
Margins			bps		bps
OPM	40.5	33.8	665	32.0	847

Source: Sharekhan Research

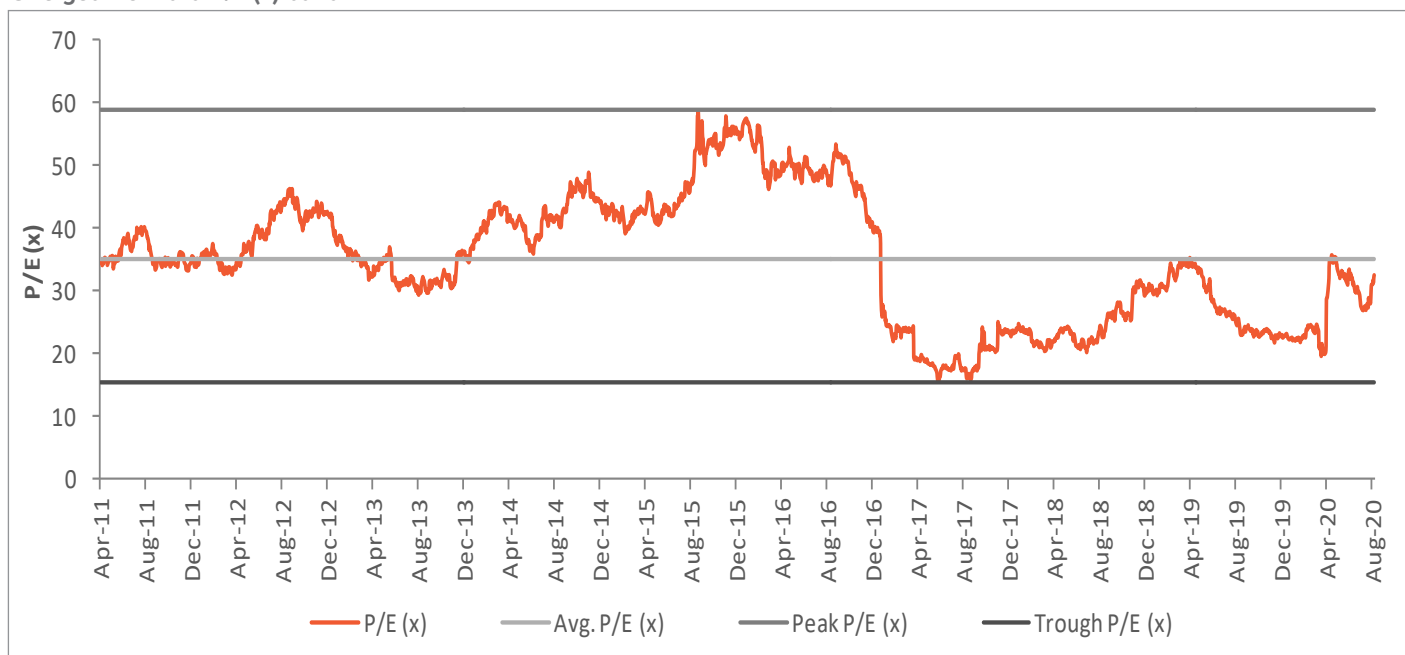
Outlook

Gearing up to grow: Divis long-term growth opportunities are intact and the company is well-placed to capitalise on the same. Immense opportunities lie ahead in the contract research and manufacturing space (CRAMS). Similarly, growth levers in the generic API space too are promising. The hunt by global companies for alternative procurement source for APIs / bulk drugs is expected to benefit API centric players like Divis. Measures taken by the government to boost API manufacturing in India and reduce dependence on imports is likely to substantially benefit companies like Divis. With expanded capacities likely to go in stream by FY2022, Divis would be best placed to cater to the increased demand.

Valuation

Maintain Buy: Divis is one of the leading players in the API space and also has a presence in the CRAMS segment. Following the supply disruptions in the API space, an array of opportunities has emerged. Companies like Divis Laboratories are best positioned to capitalise on these opportunities. Amidst a strong demand outlook, its expanded capacities are expected to come on stream, which will provide ample visibility on the company's capability to meet the increased demand. The full benefits of expanded capacities are likely to be reflected from FY2022 onwards. Q1FY21 was a phenomenal quarter for Divis, though growth was lumpy and hence we believe the performance is not indicative for the full year. Based on Q1FY21 results, we have revised our earnings estimate upwards. At CMP, the stock is trading at 40.8x /31.2x its FY2021 / FY2022 earnings. We have also introduced FY2023 estimates in this note. We expect Divis to benefit from backward integration, capacity expansion and emerging opportunities in the API space. Strong earnings visibility, almost a zero debt and strong return ratios bode well and provides visibility on P/E multiple expansions. Moreover, the company does not have any pending regulatory hurdles, which is a key positive. We retain Buy recommendation on the stock with a revised PT of Rs. 3,400.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E			EV / EBITDA			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Cipla	729.0	80.6	58,747.0	38.0	26.4	21.2	19.2	15.2	12.8	10.1	13.3	14.5
Torrent Pharma	2,941.0	17.0	49,761.0	48.8	39.3	30.4	27.6	23.0	18.8	14.8	17.5	20.6
Divis Laboratories	2,784.0	26.5	73,913.0	57.1	40.8	31.2	38.3	27.4	21.2	17.7	20.7	22.0

Source: Company, Sharekhan estimates

About company

Divis, based in Hyderabad, India, has two manufacturing units and is among the top pharmaceutical companies in India. Divis is the leading manufacturer of active pharmaceutical ingredients (APIs), intermediates and registered starting materials offering high-quality products with the highest level of compliance and integrity to over 95 countries. Advanced manufacturing facilities both in Hyderabad and Vizag have been inspected multiple times by USFDA, EU GMP (U.K., Slovenia, German, Irish authorities), HEALTH CANADA, TGA, ANVISA, COFEPRIS, PMDA and MFDS health authorities.

Investment theme

Divis' long-term growth opportunities are intact and the company is well-placed to capitalise on the same. Immense opportunities lie ahead in the contract research and manufacturing space (CRAMS). Similarly, growth levers in the generic API space too are promising. The hunt by global companies for alternative procurement source for API's / bulk drugs is expected to benefit API centric players like Divis. Measures taken by the government to boost API manufacturing in India and reduce dependence on imports is likely to substantially benefit companies like Divis. With expanded capacities likely to go in stream by FY2022, Divis would be best placed to cater to the increased demand.

Key Risks

- ◆ Adverse regulatory change
- ◆ Regulatory compliance risk
- ◆ Forex volatility

Additional Data

Key management personnel

Dr. Murali K. Divi	Chairman & Managing Director
N.V. Ramana	Executive Director
Madhusudana Rao Divi	Director of Projects
Mr. Kiran S. Divi	Director on Board
Ms. Nilima Motaparti	Director on Board – Commercial

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Pvt Ltd	4.9
2	Axis Asset Management Co Ltd/India	2.9
3	Reliance Capital Trustee Co Ltd	1.89
4	GOVERNMENT PENSION FUND - GLOBAL	1.68
5	Norges Bank	1.65
6	PineBridge Investments LP	1.19
7	Goldman Sachs Group Inc/The	1.05
8	Credit Agricole Group	1.03
9	BlackRock Inc	0.97
10	HDFC Asset Management Company	0.94

Source: Bloomberg

Data as on 8th June 2020

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.