



## 3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✗	✓	✗

+ Positive = Neutral - Negative

## What has changed in 3R MATRIX

	Old		New
RS	✗	↔	✓
RQ	✗	↔	✓
RV	✗	↔	✗

## Reco/View

	Change
Reco: Buy	↔
CMP: Rs. 3,711	
Price Target: Rs. 4,175	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

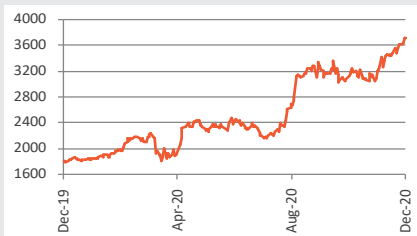
## Company details

Market cap:	Rs. 98,525 cr
52-week high/low:	Rs. 3,760/1,633
NSE volume: (No of shares)	13.8 lakh
BSE code:	532488
NSE code:	DIVISLAB
Free float: (No of shares)	12.8 cr

## Shareholding (%)

Promoters	52.0
FII	18.9
DII	18.8
Others	10.35

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	16.2	15.0	53.3	105.0
Relative to Sensex	5.2	-2.5	20.7	94.6

Sharekhan Research, Bloomberg

## Divis Laboratories Limited

### Adding muscle to race on growth path

Pharmaceuticals

Sharekhan code: DIVISLAB

Company Update

## Summary

- Divis Laboratories Limited (Divis) is witnessing strong demand in both the API as well as custom synthesis businesses.
- Divis is in the midst of an massive capacity expansion plan. In addition to the earlier capex plan of Rs 1800 crore, it shall be investing Rs 400 crore in the custom synthesis business.
- Divis has also commenced work on the Kakinada greenfield plant at an investment of Rs 1500 crore with phase I likely to commence operations in the next 18 months.
- We believe Divis could also benefit from backward-integration initiatives and has planned launch more products. We retain our Buy recommendation on the stock with a revised PT of Rs. 4,175.

Divis Laboratories Limited (Divis) is witnessing a strong demand environment across both its active pharmaceutical ingredients (API) as well as custom synthesis business. There are immense opportunities that have emerged for API players such as Divis, and we expect it to benefit from a structural shift in global supply chains, which are likely to favour Indian API companies, with a significant potential for market share gains. Anticipating strong demand traction, the company had already embarked on a capacity expansion plan, which is expected to be completed by FY2021 and would start contributing to the topline by FY2022, which provides ample visibility to cater to the surging demand. Moreover, the company has received clearance for its Kakinada plant and has commenced construction work at the site. Divis shall be investing Rs. 1,500 crore (to be funded through internal accruals) towards setting up its unit III facility and expects Phase I of the Greenfield to commence operations in the next 18 months. Backed by sturdy project inflow (these projects are high-value projects and, hence, offer better growth visibility) for the custom synthesis business, Divis is investing Rs. 400 crore towards capacity expansion so as to capitalise on the opportunity. Divi's strict adherence to IPR norms, proven delivery capability through the development cycle, commercial supply track record, and strong relationship with pharma majors are key advantages. The fact that the company has lined up substantial investments towards capacity expansions points towards strong growth visibility. We believe Divis could also benefit from its backward-integration initiatives and has planned new product launches. Sales and profit are expected to post at a sturdy 24% and 33% CAGR, respectively, over FY2020-FY2023.

## Our Call

**Valuation – Maintain Buy with a PT of Rs. 4,175:** Divis is witnessing improved demand traction across its segments of API and custom synthesis business. To capitalise on these opportunities, the company is expanding its capacity across both these segments. Divis is in the midst of a recently announced Rs. 400 crore capex plan for the custom synthesis segment, backed by strong orders from its customers, especially in the European region. Furthermore, these projects are high-value projects and, hence, augur well for the company. In addition to this, Divis is also implementing a Rs. 1,800 crore capex plan, which involves de-bottlenecking of existing plants as well as setting up of two new units. The expanded capacities are expected to contribute to the topline from FY2022. Moreover, Divis has commenced work on its Kakinada Greenfield and expects phase I of the facility to commence operations within the next 18 months. The Kakinada plant would entail an investment of Rs. 1,500 crore, which would be funded internally. A sturdy capex plan backed by strong demand scenario, provides ample growth visibility. We expect Divis to reap benefits of backward integration, capacity expansion, and emerging opportunities in the API and custom synthesis space. Strong earnings visibility, almost zero debt, and strong return ratios bode well from a growth perspective. Moreover, the company does not have any pending regulatory hurdles, which is a key positive. At the CMP, the stock trades at rich valuations of 39.3x and 32x its FY2022E / FY2023E EPS, respectively; and given the strong growth prospects, we expect the rich valuations to sustain. We retain our Buy recommendation on the stock with a revised PT of Rs. 4,175.

## Key Risks

1) Adverse regulatory changes; 2) Delay in completion of capex plans.

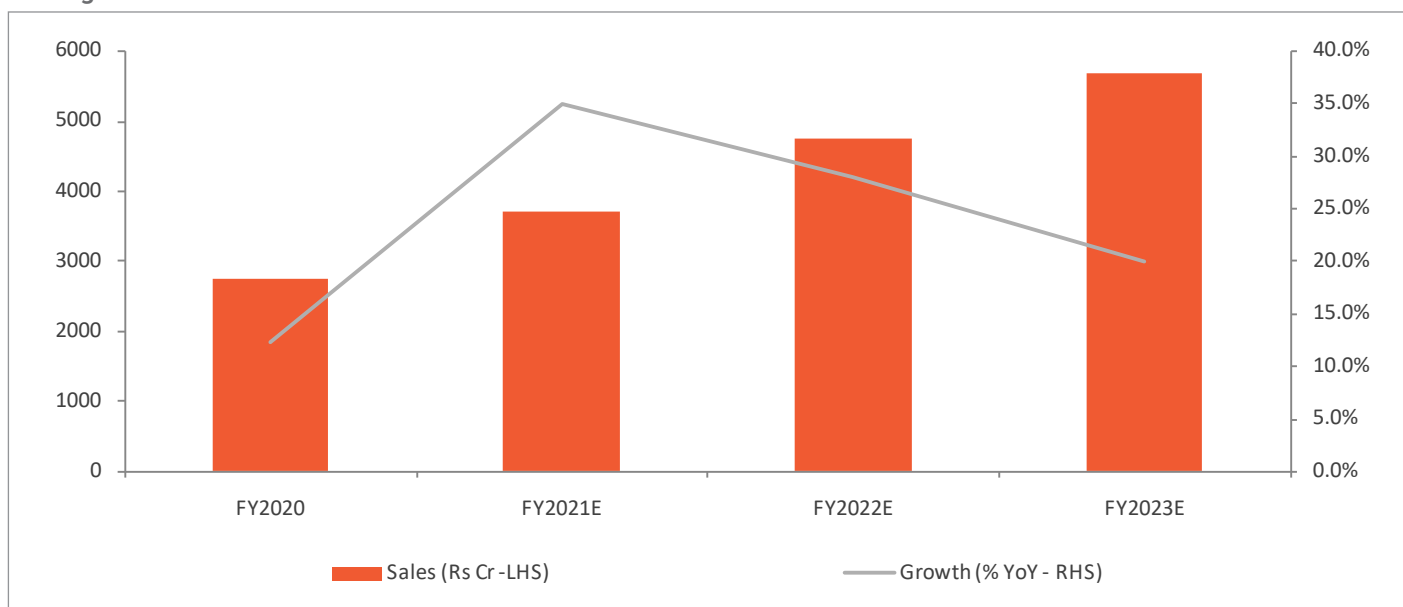
## Valuation (Consolidated)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	4946.3	5394.4	6795.2	8554.1	10168.6
Operating Profits	1871.8	1822.2	2684.1	3421.6	4118.3
OPM (%)	37.8	33.8	39.5	40.0	40.5
PAT	1321.7	1294.5	1919.6	2506.5	3074.6
EPS (Rs)	49.8	48.8	72.3	94.4	115.8
PER (x)	74.5	76.1	51.3	39.3	32.0
EV/EBITDA (x)	49.4	51.1	34.8	27.1	22.0
ROCE (%)	24.9	22.6	27.9	29.1	28.5
RONW (%)	19.0	17.7	21.7	22.8	22.4

Source: Company; Sharekhan estimates

**Divis to benefit significantly from opportunities in API; Capacity expansion provides visibility:** Divis is a leading player in the (API) space and derives around 51% of its FY2020 revenue from the same. Divis has emerged as a dominant, independent API provider globally, with leading market shares globally for 11 APIs, with dominant market share in several high-volume products such as naproxen, which accounts for ~18% of consolidated revenue. There are immense opportunities that have emerged for API players such as Divis, as companies world over look to tide over the pandemic. Supply reliability and quality are factors that have taken precedence over pricing, which pharma companies world over are looking for. Players such as Divis, one of the leading manufacturers of intermediates/APIs, are witnessing strong demand traction and could potentially be one of the key beneficiaries from this. Moreover, substantial capacity expansion plans to be completed by the end of FY2021 provides ample visibility on the company's ability to meet incremental demand, thus pointing towards market share gains. In addition, Divis has been able to develop APIs/intermediates for few COVID-related products (Remdesivir and Favipiravir), which have been attracting strong demand. Although as of quarter ending September 2020, the contribution of these products is not substantial in total revenue, they offer a healthy growth potential as demand is likely to be higher at least in the near to medium term till the time the vaccine is made available to the population at large. We believe recent capacity additions by Divis will enable it to add significant market share across its top-11 products and in a way drive API sales for the company. We expect API sales to report a strong 28% CAGR over FY2020 to FY2023.

API Segment Sales – Growth trends

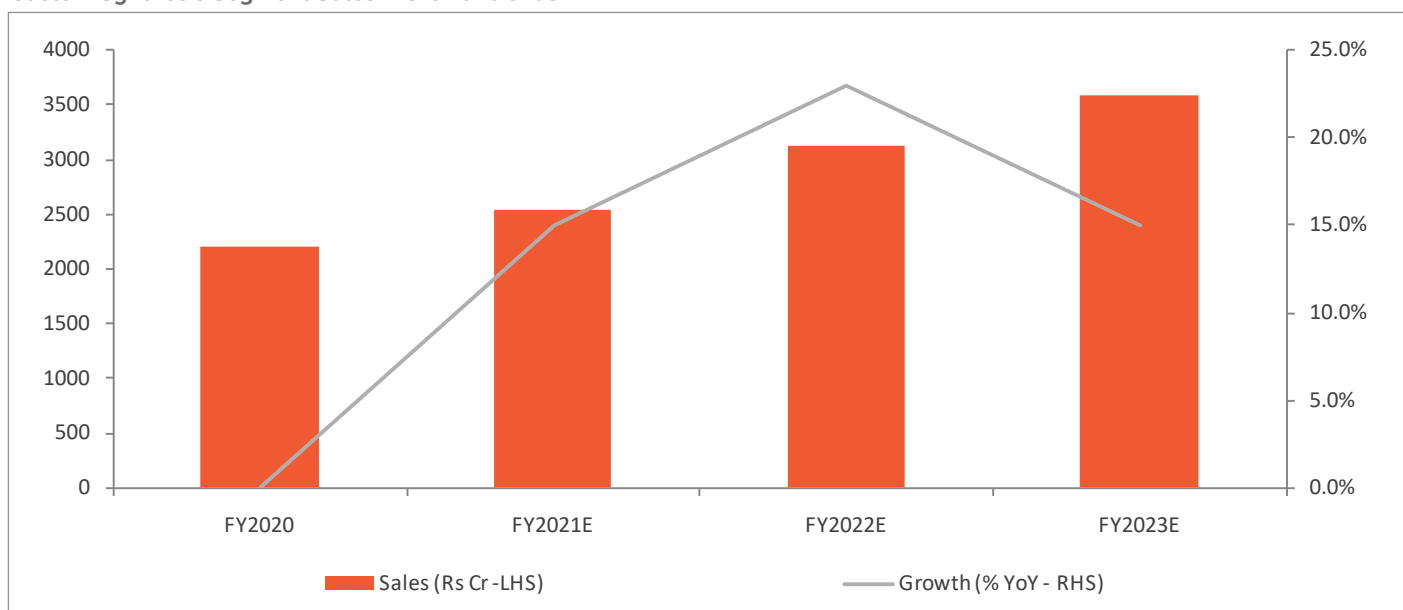


Source: Company, Sharekhan Research

### Custom synthesis segment gaining traction backed by strong demand environment:

Divis, over the year, has emerged as a preferred partner for several of its key customers (which are big global pharma companies) for synthesis projects, with expertise in scaling up high tonnage products. The custom synthesis business is a margin accretive one, but at times it is lumpy in nature. However, as of September quarter, the business showed good recovery on account of an improved business environment. Divis is experiencing strong demand traction, especially from its clients in European region. The company has projects in hand from these customers and, hence, is able to deliver. Strong R&D capabilities and India cost arbitrage along with IP adherence are some legacy strengths, which will drive incremental assignments from MNCs. Management has announced capex of Rs. 400 crore, which it plans to complete in the next 6-9 months. As the company would be putting up block, expanded capacities need not be going through the regulatory approval process and, hence, can commence commercial production up on completion. We expect expanded capacities to start contributing to revenue from FY2022, while full benefit from the same is likely to be reflected in FY2023. Divis' strict adherence to IPR norms, proven delivery capability through the development cycle, commercial supply track-record, and strong relationship with pharma majors are key advantages that would drive growth of the custom synthesis sales. We expect the segment's sales to report a double-digit CAGR over FY2020 to FY2023.

### Custom Synthesis Segment Sales – Growth trends

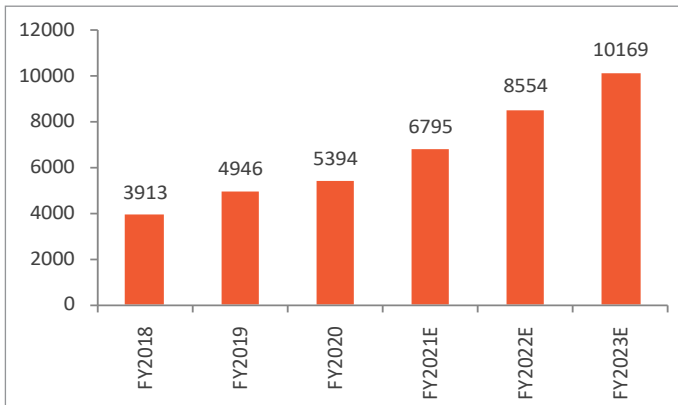


Source: Company, Sharekhan Research

**Capacity expansion plans provide ample visibility on topline growth:** Divis is in the midst of a Rs. 1,800 crore capex plan, which involves de-bottlenecking of existing plants as well as setting up new units. Divis will be investing Rs. 1,200 crore towards setting two units (Rs. 600 crore each). As of 1HFY2021, the company has capitalised Rs. 830 crore, while the balance is likely to be done by the end of FY2021. Of the two units, DCV SEZ is being set up at an already approved facility and, hence, it need not go through the approval process. So, upon completion, the unit can commence commercial production. The second one at DC Sez would be required to go through the regulatory approval process, which could take some time. In addition to the above, Divis has received clearance from the government for Kakinada plant and management looks to start construction work by December 2020 or January 2021 and expects another 2-3 years for the project to go on stream. Continuous capacity expansion plans lined up by the company would enable it to cater to incremental demand. Moreover, anticipating strong demand traction in the custom synthesis business, Divis is investing Rs. 400 crore towards putting up a new block, which is likely to be ready in the next 6-9 months. De-bottlenecking measures being implemented are likely to increase capacity by 25%-30% and are largely completed. Collectively, strong demand traction in place coupled with expanded capacities coming on stream would result in a strong 23% topline CAGR over FY2020-FY2023.

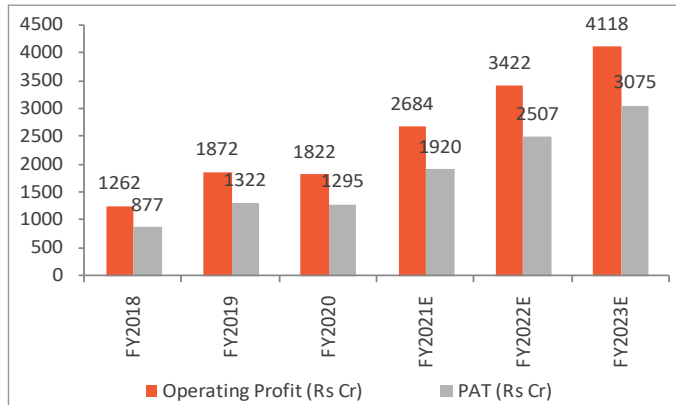
## Financials in charts

### Sales Trends (Rs Cr)



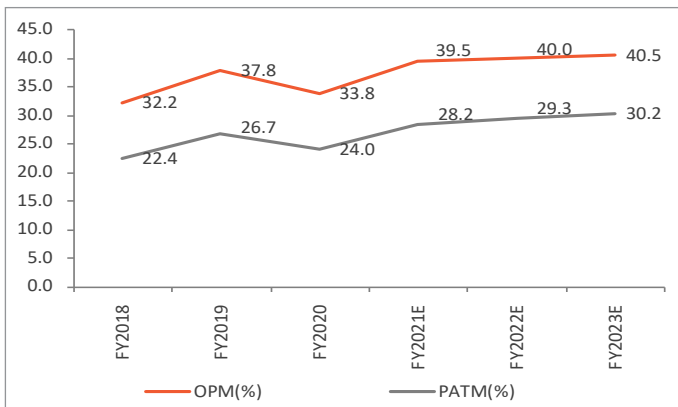
Source: Company, Sharekhan Research

### Operating Profit - PAT Trends



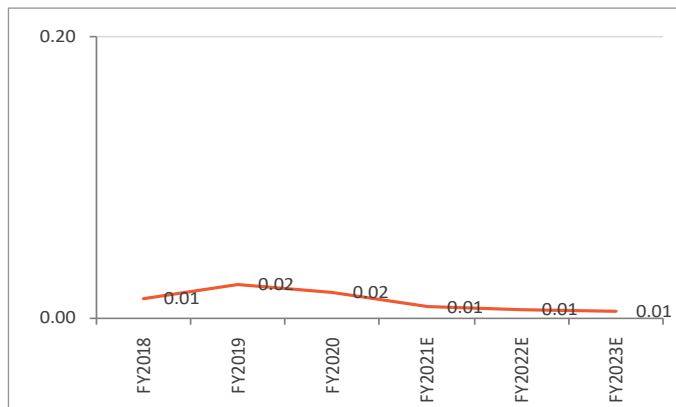
Source: Company, Sharekhan Research

### Margin Trends



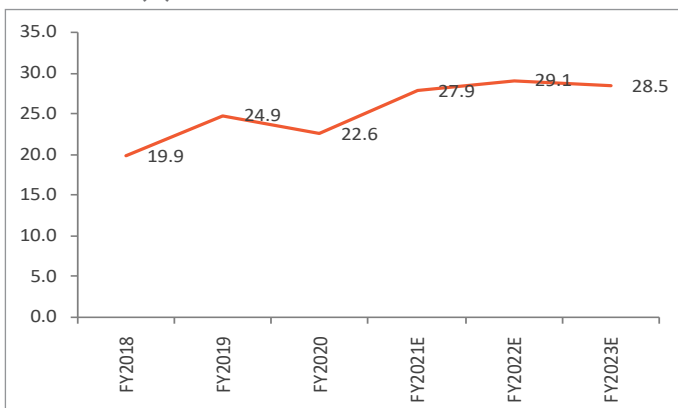
Source: Company, Sharekhan Research

### Improving Leverage (D:E)



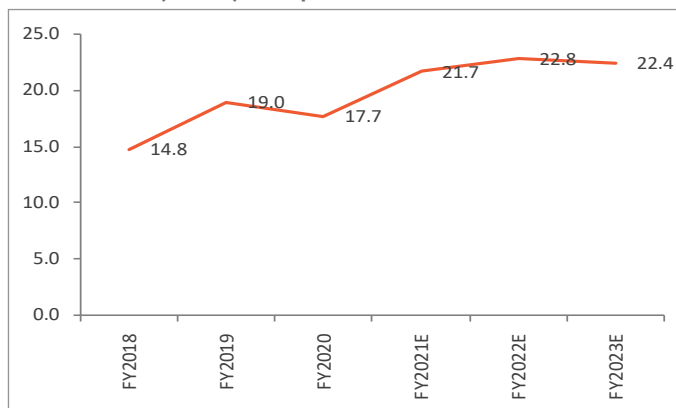
Source: Company, Sharekhan Research

### RoCE Trend (%)



Source: Company, Sharekhan Research

### Return ratios (RoE %) to improve



Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

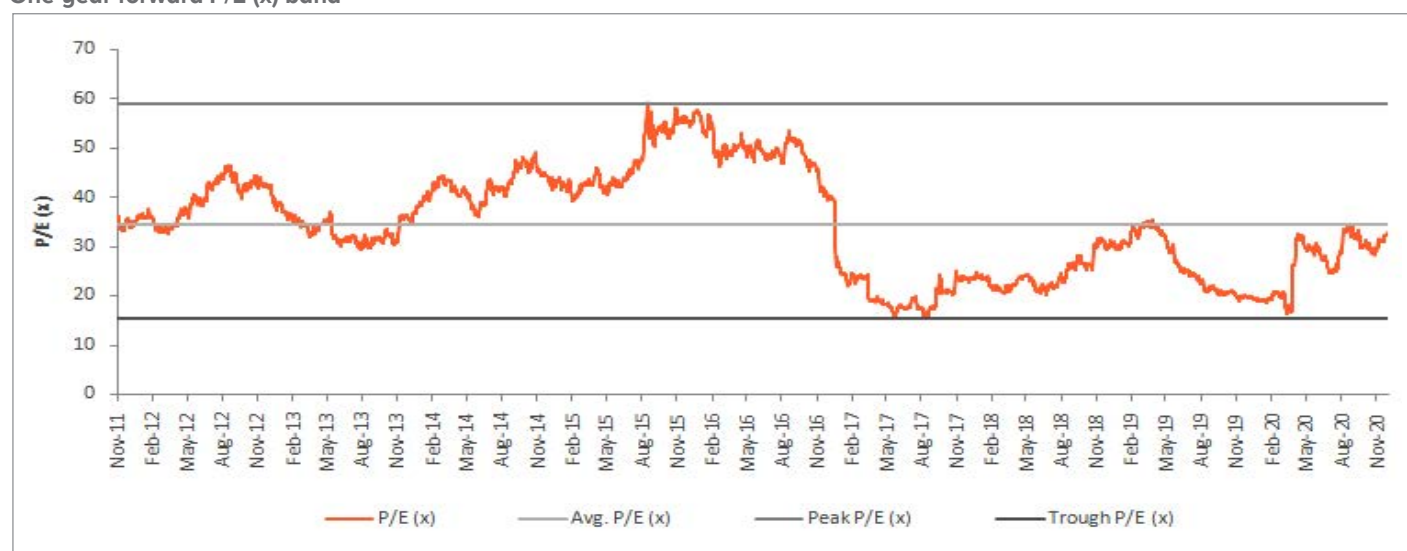
### ■ Company outlook - Robust earnings growth

Divis' long-term growth opportunities are robust and the company is well-placed to capitalise on the same. Immense opportunities lie ahead in the custom synthesis business. Similarly, growth levers in the generic API space are promising. The hunt by global companies for alternative procurement source for API/ bulk drugs is expected to benefit API-centric players such as Divis. Consequently, the company is in the midst of a substantial capacity expansion plan across its facilities for both the API as well as custom synthesis businesses. With expanded capacities likely to go in stream by FY2022, Divis would be best placed to cater to increased demand.

### ■ Valuation - Maintain Buy with a PT of Rs. 4,175

Divis is witnessing improved demand traction across its segments of API and custom synthesis business. To capitalise on these opportunities, the company is expanding its capacity across both these segments. Divis is in the midst of a recently announced Rs. 400 crore capex plan for the custom synthesis segment, backed by strong orders from its customers, especially in the European region. Furthermore, these projects are high-value projects and, hence, augur well for the company. In addition to this, Divis is also implementing a Rs. 1,800 crore capex plan, which involves de-bottlenecking of existing plants as well as setting up of two new units. The expanded capacities are expected to contribute to the topline from FY2022. Moreover, Divis has commenced work on its Kakinada Greenfield and expects phase I of the facility to commence operations within the next 18 months. The Kakinada plant would entail an investment of Rs. 1,500 crore, which would be funded internally. A sturdy capex plan backed by strong demand scenario, provides ample growth visibility. We expect Divis to reap benefits of backward integration, capacity expansion, and emerging opportunities in the API and custom synthesis space. Strong earnings visibility, almost zero debt, and strong return ratios bode well from a growth perspective. Moreover, the company does not have any pending regulatory hurdles, which is a key positive. At the CMP, the stock trades at rich valuations of 39.3x and 32x its FY2022E / FY2023E EPS, respectively; and given the strong growth prospects, we expect the rich valuations to sustain. We retain our Buy recommendation on the stock with a revised PT of Rs. 4,175.

### One-year forward P/E (x) band



Source: Sharekhan Research

### Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E			EV / EBITDA			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Solara Active Pharma	1,278.0	17.0	4,590.0	39.6	21.0	17.9	19.5	12.4	10.5	10.5	16.6	16.4
Divis Laboratories	3,711.0	26.5	98,525.0	76.1	51.3	39.3	51.1	34.8	27.1	17.7	21.7	22.8

Source: Company, Sharekhan Research

## 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 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, and 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 are promising. The hunt by global companies for alternative procurement source for APIs/bulk drugs is expected to benefit API-centric players such as Divis. Measures taken by the government to boost API manufacturing in India and reduce dependence on imports are likely to substantially benefit companies such as Divis. With expanded capacities likely to go in stream by FY2022, Divis would be best placed to cater to increased demand.

## Key Risks

- 1) Adverse regulatory changes
- 2) Regulatory compliance risk
- 3) Forex volatility

## Additional Data

### Key management personnel

Dr. Murali K. Divi	Managing Director
N.V. Ramana	Executive Director
Dr. Kiran S. Divi	Whole time Director and CEO
Ms. Nilima Motaparti	Whole time Director – Commercial

Source: Company

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Pvt Ltd	4.7
2	Axis Asset Management Co Ltd/India	3.0
3	Norges Bank	1.65
4	GOVERNMENT PENSION FUND - GLOBAL	1.59
5	Reliance Capital Trustee Co	1.47
6	PineBridge Investments LP	1.14
7	Vangaurd Group Inc	1.07
8	BlackRock Inc	1.04
9	UTI Asset Management Company	0.94
10	HDFC Asset Management Company	0.88

Source: Bloomberg

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## Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research



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by BNP PARIBAS

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