

November 8, 2022

Q2FY23 Result Update

☒ Change in Estimates | ☒ Target | ☒ Reco

Change in Estimates

| | Current | | Previous | |
|---------------------|--------------|---------|-------------------|---------|
| | FY24E | FY25E | FY24E | FY25E |
| Rating | HOLD | | ACCUMULATE | |
| Target Price | 3,300 | | 4,140 | |
| Sales (Rs. m) | 91,042 | 105,108 | 103,239 | 117,461 |
| % Chng. | (11.8) | (10.5) | | |
| EBITDA (Rs. m) | 33,911 | 40,308 | 42,441 | 48,803 |
| % Chng. | (20.1) | (17.4) | | |
| EPS (Rs.) | 93.5 | 111.6 | 112.0 | 129.2 |
| % Chng. | (16.5) | (13.7) | | |

Key Financials - Consolidated

| Y/e Mar | FY22 | FY23E | FY24E | FY25E |
|----------------|--------|--------|--------|---------|
| Sales (Rs. m) | 89,598 | 81,144 | 91,042 | 105,108 |
| EBITDA (Rs. m) | 38,819 | 28,721 | 33,911 | 40,308 |
| Margin (%) | 43.3 | 35.4 | 37.2 | 38.3 |
| PAT (Rs. m) | 29,199 | 21,815 | 24,818 | 29,613 |
| EPS (Rs.) | 110.0 | 82.2 | 93.5 | 111.6 |
| Gr. (%) | 47.2 | (25.3) | 13.8 | 19.3 |
| DPS (Rs.) | 35.1 | 35.1 | 37.4 | 42.1 |
| Yield (%) | 1.0 | 1.0 | 1.1 | 1.2 |
| RoE (%) | 27.8 | 17.7 | 18.1 | 19.2 |
| RoCE (%) | 34.0 | 20.4 | 21.7 | 23.2 |
| EV/Sales (x) | 9.8 | 10.7 | 9.5 | 8.1 |
| EV/EBITDA (x) | 22.6 | 30.2 | 25.4 | 21.2 |
| PE (x) | 31.0 | 41.5 | 36.5 | 30.6 |
| P/BV (x) | 7.7 | 7.0 | 6.3 | 5.6 |

Key Data

DIVI.BO | DIVI IN

| | |
|---------------------|----------------------|
| 52-W High / Low | Rs.5,093 / Rs.3,365 |
| Sensex / Nifty | 61,185 / 18,203 |
| Market Cap | Rs.906bn/ \$ 11,065m |
| Shares Outstanding | 265m |
| 3M Avg. Daily Value | Rs.2049.44m |

Shareholding Pattern (%)

| | |
|-------------------------|-------|
| Promoter's | 51.94 |
| Foreign | 16.52 |
| Domestic Institution | 13.85 |
| Public & Others | 17.69 |
| Promoter Pledge (Rs bn) | - |

Stock Performance (%)

| | 1M | 6M | 12M |
|----------|--------|--------|--------|
| Absolute | (8.6) | (18.0) | (34.4) |
| Relative | (13.1) | (26.5) | (35.6) |

Param Desai

paramdesai@plindia.com | 91-22-66322259

Akshaya Shinde

akshayashinde@plindia.com | 91-22-66322490

Divi's Laboratories (DIVI IN)

Rating: HOLD | CMP: Rs3,415 | TP: Rs3,300

Weak CS show; near term challenges

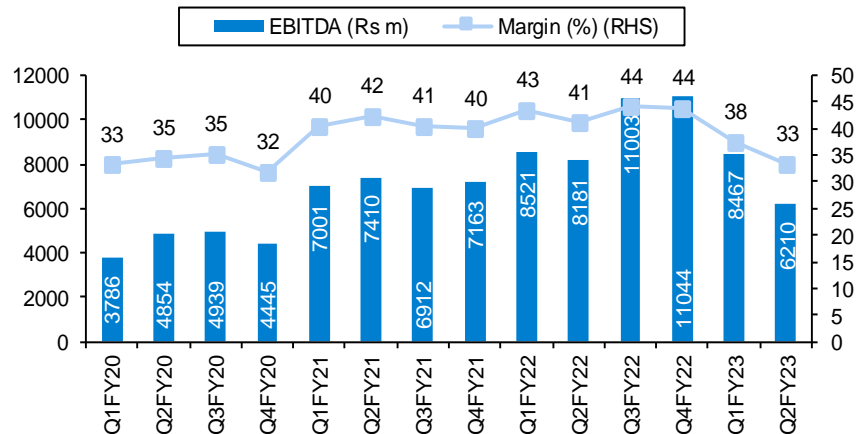
Quick Pointers:

- Generic reported 20% growth, while custom synthesis (CS) declined YoY given high base.
- Outlook for CS segment remains healthy with fast-track projects commencing 2024 onwards.

We reduce our FY24/FY25E EPS estimates by 17%/14% and downgrade to 'Hold' from Accumulate with revised TP of Rs3,300/share (Rs4,100 earlier) valuing at 32x Sept 2024E P/E. Divi's Laboratories (DIVI) reported weak performance in H1FY23, while margins further declined in Q2. Given high COVID base in FY22, we expect flat PAT CAGR over FY22-25E. Yet efforts on backward integration, debottlenecking and utility upgradation will continue to yield better margins, in our view. DIVI remains a preferred play among Indian CRAMS and APIs, given the company's strong execution track record. However, near-term growth will likely remain muted. Downgrade to 'Hold'.

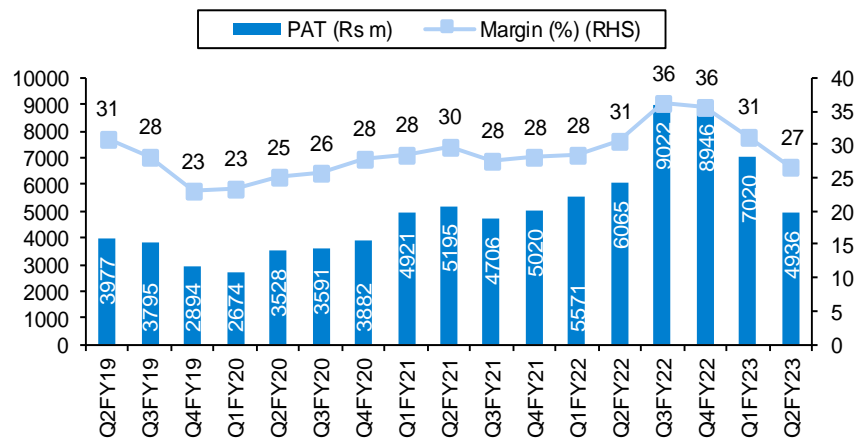
- Weak revenues impacted by CS segment:** Divi's Q2FY23 sales decreased 7% YoY (down 18% QoQ) to Rs18.5bn, lower than our estimates of Rs 21bn. The poor performance was led by decline in custom synthesis (CS) -26% YoY and down 33% QoQ, given high COVID base (reducing sales from Molnupiravir). During Q2FY23 EU and US contributed 68% of revenue. Product mix for generics and custom synthesis in Q2FY23 were at 57% and 47% of revenue, respectively. Nutraceutical business for the quarter was at Rs 1.63bn a decline of 12% YoY. Generics reported robust growth of 20% YoY on low base.
- Margins continue to dip:** GM came in at 64%, down 40bps QoQ. Sharp YoY decline largely on account of increase in the RM prices. Employee expenses grew 4% YoY while other expenses increased by 12% YoY on higher freight, power and energy cost. Resultant EBITDA declined sharply by 24% YoY (down 23% QoQ) at Rs6.2bnvs our est of Rs8bn led by negative operating leverage. OPM came in at 34% (down 410bps QoQ and 770bps YoY). Tax came in lower at 20%. PAT came in at Rs5bn; down 19% YoY vs our estimate of Rs 5.6bn.
- Key concall takeaways:** (1) Company got several opportunities in last six months in CS segment which are mainly in Phase 2 and 3; expects some of them to commercialize in near term (2) Company has filed multiple DMFs in regulated markets in generic API segment and expects most of them to be commercialized as products goes off patent over FY23-25E which has total market size of ~US\$20bn. (3) Company continue to experience price increase in RM and solvent prices along with higher logistic and energy cost. Divi's has reduced its raw material dependency on China by 20% compared to H1FY22. (4) No further progress on Kakinada plant, as company is still waiting for government clearance. (5) During Q2, Rs890mn has been capitalized while Rs5.4bn has been under WIP. As of June2022, net cash stood at Rs34bn (6) Constant currency growth for Q2 declined by 13% given high base, while there was 2% decline for H1FY23. (7) Management expects margins to remain muted over next 2-3 quarters. (8) Overall capacity utilization is ~80-83%. Nutraceutical biz utilization at ~80%; it will continue to work exclusively with few innovators.

Exhibit 4: EBITDA, margin: sequential decline due to lower revenues



Source: Company, PL

Exhibit 5: PAT, margin: higher input cost suppress the margins



Source: Company, PL



Cash Flow (Rs m)

| Y/e Mar | FY22 | FY23E | FY24E | FY25E |
|--|----------------|----------------|-----------------|-----------------|
| PBT | 35,712 | 25,263 | 29,838 | 35,685 |
| Add. Depreciation | 3,115 | 3,469 | 4,083 | 4,633 |
| Add. Interest | (8) | (10) | (10) | (10) |
| Less Financial Other Income | 733 | 2,372 | 2,000 | 2,300 |
| Add. Other | 175 | 872 | - | - |
| Op. profit before WC changes | 38,995 | 29,593 | 33,911 | 40,308 |
| Net Changes-WC | (13,467) | 3,996 | (4,949) | (7,033) |
| Direct tax | (6,410) | (5,799) | (7,000) | (8,352) |
| Net cash from Op. activities | 19,118 | 27,790 | 21,962 | 24,923 |
| Capital expenditures | (7,132) | (8,000) | (10,000) | (10,000) |
| Interest / Dividend Income | - | - | - | - |
| Others | - | - | - | - |
| Net Cash from Invst. activities | (7,132) | (8,000) | (10,000) | (10,000) |
| Issue of share cap. / premium | - | - | - | - |
| Debt changes | (4) | - | - | - |
| Dividend paid | (5,309) | (9,318) | (9,939) | (11,181) |
| Interest paid | - | - | - | - |
| Others | (45) | 1,490 | 1,990 | 2,290 |
| Net cash from Fin. activities | (5,357) | (7,828) | (7,949) | (8,891) |
| Net change in cash | 6,629 | 11,962 | 4,013 | 6,032 |
| Free Cash Flow | 11,986 | 19,790 | 11,962 | 14,923 |

Source: Company Data, PL Research

Quarterly Financials (Rs m)

| Y/e Mar | Q3FY22 | Q4FY22 | Q1FY23 | Q2FY23 |
|-----------------------------------|---------------|---------------|---------------|---------------|
| Net Revenue | 24,932 | 25,184 | 22,545 | 18,545 |
| YoY gr. (%) | 46.5 | 40.8 | 15.0 | (6.7) |
| Raw Material Expenses | 8,316 | 8,386 | 8,120 | 6,746 |
| Gross Profit | 16,617 | 16,798 | 14,426 | 11,799 |
| Margin (%) | 66.6 | 66.7 | 64.0 | 63.6 |
| EBITDA | 11,003 | 11,044 | 8,467 | 6,210 |
| YoY gr. (%) | 59.2 | 54.2 | (0.6) | (24.1) |
| Margin (%) | 44.1 | 43.9 | 37.6 | 33.5 |
| Depreciation / Depletion | 799 | 810 | 837 | 857 |
| EBIT | 10,204 | 10,234 | 7,630 | 5,353 |
| Margin (%) | 40.9 | 40.6 | 33.8 | 28.9 |
| Net Interest | 2 | 1 | 1 | 2 |
| Other Income | 135 | 524 | 884 | 801 |
| Profit before Tax | 10,337 | 10,757 | 8,513 | 6,152 |
| Margin (%) | 41.5 | 42.7 | 37.8 | 33.2 |
| Total Tax | 1,314 | 1,811 | 1,493 | 1,216 |
| Effective tax rate (%) | 12.7 | 16.8 | 17.5 | 19.8 |
| Profit after Tax | 9,022 | 8,946 | 7,020 | 4,936 |
| Minority interest | - | - | - | - |
| Share Profit from Associates | - | - | - | - |
| Adjusted PAT | 9,022 | 8,946 | 7,020 | 4,936 |
| YoY gr. (%) | 91.7 | 78.2 | 26.0 | (18.6) |
| Margin (%) | 36.2 | 35.5 | 31.1 | 26.6 |
| Extra Ord. Income / (Exp) | - | - | - | - |
| Reported PAT | 9,022 | 8,946 | 7,020 | 4,936 |
| YoY gr. (%) | 91.7 | 78.2 | 26.0 | (18.6) |
| Margin (%) | 36.2 | 35.5 | 31.1 | 26.6 |
| Other Comprehensive Income | - | - | - | - |
| Total Comprehensive Income | 9,022 | 8,946 | 7,020 | 4,936 |
| Avg. Shares O/s (m) | 265 | 265 | 265 | 265 |
| EPS (Rs) | 34.0 | 33.7 | 26.4 | 18.6 |

Source: Company Data, PL Research

Key Financial Metrics

| Y/e Mar | FY22 | FY23E | FY24E | FY25E |
|----------------------------|-------|-------|-------|-------|
| Per Share(Rs) | | | | |
| EPS | 110.0 | 82.2 | 93.5 | 111.6 |
| CEPS | 121.7 | 95.3 | 108.9 | 129.0 |
| BVPS | 441.8 | 488.9 | 545.0 | 614.4 |
| FCF | 45.2 | 74.6 | 45.1 | 56.2 |
| DPS | 35.1 | 35.1 | 37.4 | 42.1 |
| Return Ratio(%) | | | | |
| RoCE | 34.0 | 20.4 | 21.7 | 23.2 |
| ROIC | 33.9 | 24.1 | 25.6 | 27.4 |
| RoE | 27.8 | 17.7 | 18.1 | 19.2 |
| Balance Sheet | | | | |
| Net Debt : Equity (x) | (0.2) | (0.3) | (0.3) | (0.3) |
| Net Working Capital (Days) | 182 | 183 | 183 | 183 |
| Valuation(x) | | | | |
| PER | 31.0 | 41.5 | 36.5 | 30.6 |
| P/B | 7.7 | 7.0 | 6.3 | 5.6 |
| P/CEPS | 28.0 | 35.8 | 31.4 | 26.5 |
| EV/EBITDA | 22.6 | 30.2 | 25.4 | 21.2 |
| EV/Sales | 9.8 | 10.7 | 9.5 | 8.1 |
| Dividend Yield (%) | 1.0 | 1.0 | 1.1 | 1.2 |

Source: Company Data, PL Research

Key Operating Metrics

| Y/e Mar | FY22 | FY23E | FY24E | FY25E |
|------------------|--------|--------|--------|--------|
| Generic API | 30,519 | 36,623 | 42,116 | 48,434 |
| Custom Synthesis | 36,495 | 33,940 | 40,728 | 46,838 |
| Cartenoids | 6,210 | 6,831 | 8,197 | 9,837 |

Source: Company Data, PL Research

Price Chart
Recommendation History


| No. | Date | Rating | TP (Rs.) | Share Price (Rs.) |
|-----|-----------|------------|----------|-------------------|
| 1 | 06-Oct-22 | Accumulate | 4,140 | 3,727 |
| 2 | 15-Aug-22 | Accumulate | 4,140 | 3,726 |
| 3 | 07-Jul-22 | Accumulate | 4,300 | 3,659 |
| 4 | 24-May-22 | Accumulate | 4,300 | 3,898 |
| 5 | 08-Apr-22 | Accumulate | 4,750 | 4,448 |
| 6 | 14-Feb-22 | Accumulate | 4,750 | 4,291 |
| 7 | 07-Jan-22 | Accumulate | 4,750 | 4,517 |

Analyst Coverage Universe

| Sr. No. | Company Name | Rating | TP (Rs) | Share Price (Rs) |
|---------|---------------------------------------|------------|---------|------------------|
| 1 | Apollo Hospitals Enterprise | BUY | 5,000 | 4,391 |
| 2 | Aster DM Healthcare | BUY | 234 | 249 |
| 3 | Aurobindo Pharma | Accumulate | 635 | 535 |
| 4 | Cipla | BUY | 1,300 | 1,146 |
| 5 | Divi's Laboratories | Accumulate | 4,140 | 3,727 |
| 6 | Dr. Reddy's Laboratories | BUY | 4,900 | 4,460 |
| 7 | Eris Lifesciences | BUY | 850 | 736 |
| 8 | Fortis Healthcare | BUY | 330 | 266 |
| 9 | Glenmark Pharmaceuticals | Accumulate | 450 | 401 |
| 10 | HealthCare Global Enterprises | BUY | 358 | 291 |
| 11 | Indoco Remedies | BUY | 430 | 336 |
| 12 | Ipca Laboratories | Accumulate | 1,000 | 934 |
| 13 | J.B. Chemicals & Pharmaceuticals | BUY | 1,950 | 1,636 |
| 14 | Krishna Institute of Medical Sciences | BUY | 1,550 | 1,467 |
| 15 | Lupin | Hold | 600 | 721 |
| 16 | Max Healthcare Institute | BUY | 500 | 465 |
| 17 | Narayana Hrudayalaya | BUY | 810 | 715 |
| 18 | Sun Pharmaceutical Industries | BUY | 1,175 | 1,037 |
| 19 | Torrent Pharmaceuticals | BUY | 1,850 | 1,567 |
| 20 | Zydus Lifesciences | BUY | 425 | 409 |

PL's Recommendation Nomenclature (Absolute Performance)

| | |
|--------------------------|-----------------------------------|
| Buy | : > 15% |
| Accumulate | : 5% to 15% |
| Hold | : +5% to -5% |
| Reduce | : -5% to -15% |
| Sell | : < -15% |
| Not Rated (NR) | : No specific call on the stock |
| Under Review (UR) | : Rating likely to change shortly |



ANALYST CERTIFICATION

(Indian Clients)

We/I, Mr. Param Desai- MBA Finance, Ms. Akshaya Shinde- MBA Finance Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

(US Clients)

The research analysts, with respect to each issuer and its securities covered by them in this research report, certify that: All of the views expressed in this research report accurately reflect his or her or their personal views about all of the issuers and their securities; and No part of his or her or their compensation was, is or will be directly related to the specific recommendation or views expressed in this research report.

DISCLAIMER

Indian Clients

Prabhudas Lilladher Pvt. Ltd, Mumbai, India (hereinafter referred to as "PL") is engaged in the business of Stock Broking, Portfolio Manager, Depository Participant and distribution for third party financial products. PL is a subsidiary of Prabhudas Lilladher Advisory Services Pvt Ltd. which has its various subsidiaries engaged in business of commodity broking, investment banking, financial services (margin funding) and distribution of third party financial/other products, details in respect of which are available at www.plindia.com.

This document has been prepared by the Research Division of PL and is meant for use by the recipient only as information and is not for circulation. This document is not to be reported or copied or made available to others without prior permission of PL. It should not be considered or taken as an offer to sell or a solicitation to buy or sell any security.

The information contained in this report has been obtained from sources that are considered to be reliable. However, PL has not independently verified the accuracy or completeness of the same. Neither PL nor any of its affiliates, its directors or its employees accepts any responsibility of whatsoever nature for the information, statements and opinion given, made available or expressed herein or for any omission therein.

Recipients of this report should be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The suitability or otherwise of any investments will depend upon the recipient's particular circumstances and, in case of doubt, advice should be sought from an independent expert/advisor.

Either PL or its affiliates or its directors or its employees or its representatives or its clients or their relatives may have position(s), make market, act as principal or engage in transactions of securities of companies referred to in this report and they may have used the research material prior to publication.

PL may from time to time solicit or perform investment banking or other services for any company mentioned in this document.

PL is in the process of applying for certificate of registration as Research Analyst under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

PL submits that no material disciplinary action has been taken on us by any Regulatory Authority impacting Equity Research Analysis activities.

PL or its research analysts or its associates or his relatives do not have any financial interest in the subject company.

PL or its research analysts or its associates or his relatives do not have actual/beneficial ownership of one per cent or more securities of the subject company at the end of the month immediately preceding the date of publication of the research report.

PL or its research analysts or its associates or his relatives do not have any material conflict of interest at the time of publication of the research report.

PL or its associates might have received compensation from the subject company in the past twelve months.

PL or its associates might have managed or co-managed public offering of securities for the subject company in the past twelve months or mandated by the subject company for any other assignment in the past twelve months.

PL or its associates might have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.

PL or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months

PL or its associates might have received any compensation or other benefits from the subject company or third party in connection with the research report.

PL encourages independence in research report preparation and strives to minimize conflict in preparation of research report. PL or its analysts did not receive any compensation or other benefits from the subject Company or third party in connection with the preparation of the research report. PL or its Research Analysts do not have any material conflict of interest at the time of publication of this report.

It is confirmed that Mr. Param Desai- MBA Finance, Ms. Akshaya Shinde- MBA Finance Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

The Research analysts for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

The research analysts for this report has not served as an officer, director or employee of the subject company PL or its research analysts have not engaged in market making activity for the subject company

Our sales people, traders, and other professionals or affiliates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest.

PL and its associates, their directors and employees may (a) from time to time, have a long or short position in, and buy or sell the securities of the subject company or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company or act as an advisor or lender/borrower to the subject company or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

US Clients

This research report is a product of Prabhudas Lilladher Pvt. Ltd., which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Prabhudas Lilladher Pvt. Ltd. only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Prabhudas Lilladher Pvt. Ltd. has entered into an agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo").

Transactions in securities discussed in this research report should be effected through Marco Polo or another U.S. registered broker dealer.

Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India | Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

www.plindia.com