

Divi's Laboratories

Estimate change	↓
TP change	↓
Rating change	↓

Bloomberg	DIVI IN
Equity Shares (m)	265
M.Cap.(INRb)/(USDb)	906.2 / 11.1
52-Week Range (INR)	5091 / 3365
1, 6, 12 Rel. Per (%)	-14/-29/-36
12M Avg Val (INR M)	2303

Financials & Valuations (INR b)

Y/E MARCH	FY22	FY23E	FY24E
Sales	89.6	81.3	92.1
EBITDA	38.8	28.7	34.0
Adj. PAT	29.3	22.3	26.7
EBIT Margin (%)	39.8	31.1	33.2
Cons. Adj. EPS (INR)	110.4	84.0	100.6
EPS Gr. (%)	46.1	-23.9	19.8
BV/Sh. (INR)	441.8	500.8	570.3

Ratios

Net D:E	-0.2	-0.3	-0.3
RoE (%)	27.9	17.8	18.8
RoCE (%)	27.9	17.8	18.8
Payout (%)	32.3	28.9	31.0

Valuations

P/E (x)	30.9	40.6	33.9
EV/EBITDA (x)	22.6	30.1	25.3
Div. Yield (%)	0.9	0.6	0.8
FCF Yield (%)	1.1	1.7	1.1
EV/Sales (x)	9.8	10.6	9.3

Shareholding pattern (%)

As On	Sep-22	Jun-22	Sep-21
Promoter	51.9	51.9	52.0
DII	20.8	20.0	16.4
FII	15.4	16.5	20.7
Others	11.9	11.6	11.0

FII Includes depository receipts

CMP: INR3,414 TP: INR3,250 (-5%) Downgrade to Neutral

Miss in 2QFY23; Growth factors to face softness over medium term

No visibility yet to the start of the Kakinada project

- DIVI delivered an earnings miss in 2QFY23. Reduced traction in Custom Synthesis (CS), coupled with lower operating leverage, resulted in an earnings decline for the first time after 12 quarters of a strong performance.
- We cut our FY23/FY24 estimates by 18%, factoring in: a) a deceleration in the CS business and commercial benefit from certain newer projects on completion of clinical trials (FY24 onwards), b) moderation in the API business, and c) delayed scale-up in the Nutraceuticals business, despite a capacity expansion. We also lower our P/E multiple to 30x from 33x to factor in lower visibility on Kakinada capex, considering capex to be one of the leading growth indicators for DIVI. Accordingly, we arrive at our TP of INR3,250 (from INR4,280 earlier).
- We have downgraded our rating to Neutral, considering the muted outlook (a 4.5% compounded decline in earnings over FY22-24). Valuation is yet to factor in the same.

Inferior product mix and reduced operating leverage drag earnings

- Revenue declined by 6.7% YoY to INR18.5b (est. INR21.8b) in 2QFY23.
- Gross margin contracted by 340bp YoY to 63.6%.
- EBITDA margin contracted at a higher rate (800bp YoY) to 33.5% (est. 37.8%), largely due to lower GM and higher other expenses/employee cost (up 330bp/120bp as a percentage of sales).
- As a result, EBITDA fell 24.7% YoY to INR6.2b (est. INR8.2b) in 2QFY23.
- Adjusted for INR308m of forex gains, PAT fell 24% YoY to INR4.7b (est. INR6.3b).
- Sales rose 4% YoY to INR41b in 1HFY23, while EBITDA/PAT fell 12.5%/10.4% to INR14.6b/INR11.2b.

Highlights from the management commentary

- The share of CS-to-Generics in 2QFY23 revenue stood at 43:57.
- Sales of Nutraceuticals stood at INR1.6b in 2QFY23.
- Assets worth INR890m have been capitalized, and INR5.4b is CWIP.
- The management is awaiting clearance from the state government to kick-start the Kakinada project.
- DIVI's dependence on China has reduced by 20% YoY in 1HFY23.
- Capacity utilization stood at 80-83% in 2QFY23.
- Certain molecules in the CS segment are closer to completing Phase III clinical trials and are near a launch. Meaningful commercial benefits are expected from FY24.
- DIVI has filed multiple DMFs in several regulated markets. The commercial benefit from the same is expected from FY24.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Quarterly Performance

(INR m)

Y/E March	FY22E				FY23E				FY22	FY23E	FY23E	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
Net Sales	19,606	19,875	24,932	25,184	22,545	18,545	19,481	20,773	89,598	81,345	21,812	-15.0
YoY Change (%)	13.3	13.6	46.5	40.8	15.0	-6.7	-21.9	-17.5	28.6	-9.2	9.7	
Total Expenditure	11,086	11,623	13,930	14,140	14,078	12,335	12,838	13,379	50,779	52,631	13,567	
EBITDA	8,521	8,252	11,003	11,044	8,467	6,210	6,643	7,394	38,819	28,715	8,245	-24.7
YoY Change (%)	21.7	9.0	51.7	54.2	-0.6	-24.7	-39.6	-33.0	33.9	-26.0	-0.1	
Margins (%)	43.5	41.5	44.1	43.9	37.6	33.5	34.1	35.6	43.3	35.3	37.8	
Depreciation	733	774	799	810	837	857	840	849	3,115	3,383	833	
EBIT	7,788	7,478	10,204	10,234	7,630	5,353	5,803	6,545	35,704	25,332	7,412	-27.8
YoY Change (%)	21.0	7.5	55.3	58.4	-2.0	-28.4	-43.1	-36.0	35.1	-29.1	-0.9	
Interest	3	2	2	1	0	0	0	-1	8	0	0	
Other Income	163	191	166	212	320	492	510	549	733	1,871	330	
PBT before EO Income	7,948	7,667	10,368	10,446	7,950	5,845	6,313	7,095	36,429	27,203	7,741	
Forex gain /(Loss)	196	-71	-31	312	564	308	0	0	406	872	0	
PBT	8,145	7,596	10,337	10,757	8,514	6,153	6,313	7,095	36,835	28,075	7,741	-20.5
Tax	2,574	1,532	1,314	1,811	1,493	1,216	1,168	1,176	7,231	5,053	1,393	
Rate (%)	31.6	20.2	12.7	16.8	17.5	19.8	18.5	16.6	19.6	18.0	18.0	
PAT	5,571	6,065	9,022	8,946	7,021	4,937	5,145	5,918	29,605	23,021	6,348	-22.2
Adj. PAT	6,391	6,165	8,336	8,413	6,556	4,690	5,145	5,913	29,303	22,303	6,348	-26.1
YoY Change (%)	32.6	16.0	68.8	68.5	2.6	-23.9	-38.3	-29.7	46.1	-23.9	3.0	
Margins (%)	28.4	30.5	36.2	35.5	31.1	26.6	26.4	28.5	33.0	28.3	29.1	

Quarterly Performance

Y/E March	FY22				FY23E				FY22	FY23E	FY23E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
Cost Break-up											
RM Cost (% of Sales)	32.8	32.9	33.4	33.3	36.0	36.4	36.2	35.9	33.1	36.1	36.0
Staff Cost (% of Sales)	11.3	11.3	9.8	10.2	10.9	12.5	12.2	11.3	10.6	11.7	11.2
Other Expenses(% of Sales)	12.5	14.3	12.7	12.7	15.5	17.6	17.5	17.2	13.0	16.9	15.0
Tax rate (%)	31.6	20.2	12.7	16.8	17.5	19.8	18.5	16.6	19.6	18.0	18.0
Gross Margins(%)	67.2	67.1	66.6	66.7	64.0	63.6	63.8	64.1	66.9	63.9	64.0
EBITDA Margins(%)	43.5	41.5	44.1	43.9	37.6	33.5	34.1	35.6	43.3	35.3	37.8
EBIT Margins(%)	39.7	37.6	40.9	40.6	33.8	28.9	29.8	31.5	39.8	31.1	34.0



Key takeaways from management commentary

- The establishment of technology to recover higher amount of Iodine in manufacturing contrast media products has increased the business opportunities for DIVI in this space.
- The backward integration to produce sartans has enabled DIVI to be much more cost competitive compared to peers.
- Two companies may leave manufacturing of nutraceuticals products, thereby providing opportunity for DIVI to scale up its nutraceuticals business.
- Overall, COVID related restrictions in China, energy crisis in Europe has been affecting demand supply situation. Likewise, there is inclination of customers to procure from companies in India. Given DIVI presence across value chain in API/CS space, it stands to gain business opportunities over medium to long term basis.

Growth outlook to moderate over medium term

Custom Synthesis – high base and time-to-scale-up newer project to tone down growth

- In 1HFY23, DIVI's custom synthesis sales declined 3% YoY to INR19b in 1HFY23. Driven by its chemistry skills, manufacturing scale as well as regulatory compliance, and project execution, DIVI has enjoyed a high growth period for custom synthesis business.
- Having said this, the certain newer projects are in the process of completing clinical trials and thus commercial benefit would have gestation period. Further, DIVI had high base of sales in FY22 due to COVID related opportunities.
- Likewise, we expect sales compounded decline of 10% to INR38b over FY22–24.

Generics – China+1/Sartans opportunity to provide impetus to growth

- The Generic API segment grew 13% YoY to INR19b in 1HFY23. Due to macro factors like COVID related lockdown in china and energy crisis in EU, there is a significant opportunity for the Indian API manufacturers and DIVI being a prominent player in the space is poised to benefit from this in the medium to long term.
- The backward integration initiative taken by DIVI over past 15-18M has helped DIVI to protect margin in this segment, despite increase in raw material prices on account of COVID led restrictions in China. Particularly, for Sartans, DIVI is not only gaining traction in existing products, but it also intend to add more molecules in this category to supply.
- DIVI is also working on complex APIs (contrast media/Hi-Po APIs) linked to patent expiries worth USD20b over FY23-25. Subsequently, the dossiers filing is also underway in across geographies.
- Accordingly, we expect DIVI to exhibit 10% revenue CAGR to INR45b over FY22–24.

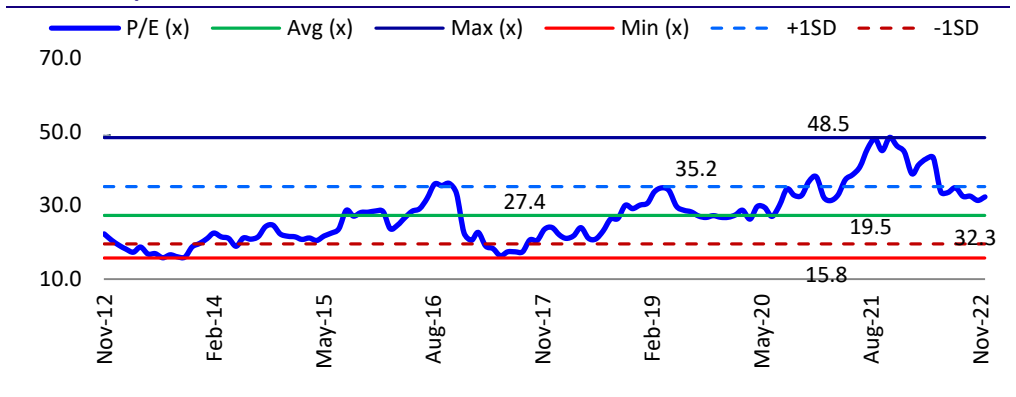
Existing capacities to cater near term requirements; Kakinada project crucial for further growth

- DIVI's has 20% headroom in existing capacities which will drive growth in the near term. At the same time, there are two new capacities commercialized in 1HFY23 which will provide further impetus for growth in both generics as well as CS business.
- However, the progress on Kakinada project remains crucial from major capex perspective.

We expect earnings decline of -4.5% CAGR over FY22–24

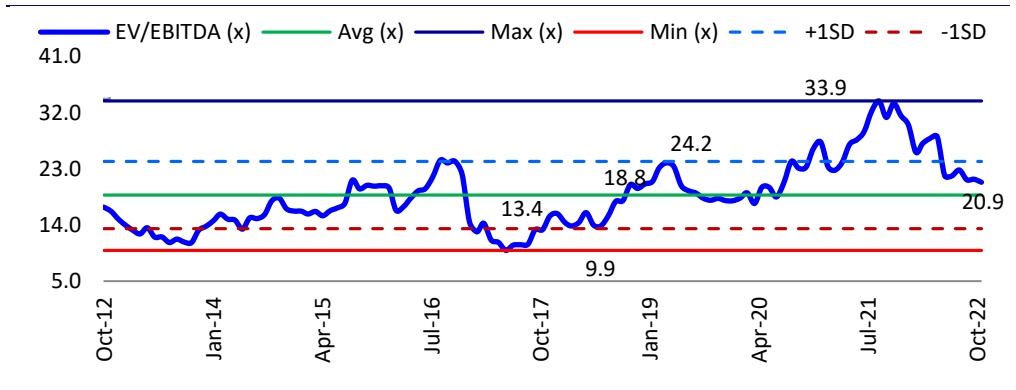
- We cut our estimates by 18% for FY23/FY24, factoring a) deceleration in CS business and commercial benefit from certain newer projects will be post completion of clinical trials (FY24 onwards), b) moderation in API business and c) yet to see scale-up in Nutraceutical business despite capacity expansion.
- We also lower PE multiple from 33x to 30x to factor low visibility on Kakinada capex considering capex to be one of the leading indicator of growth engine for DIVI. Accordingly, we arrive at price target of INR3,250 (from INR4,280).
- We downgrade to Neutral, considering muted outlook (4.5% compounded decline in earnings over FY22-24) and valuation yet to factor the same

Exhibit 1: P/E chart



Source: MOFSL, Company, Bloomberg

Exhibit 2: EV/EBITDA chart



Source: MOFSL, Company, Bloomberg

Story in charts

Exhibit 3: Revenue growth declined by 7% YoY in 2QFY23

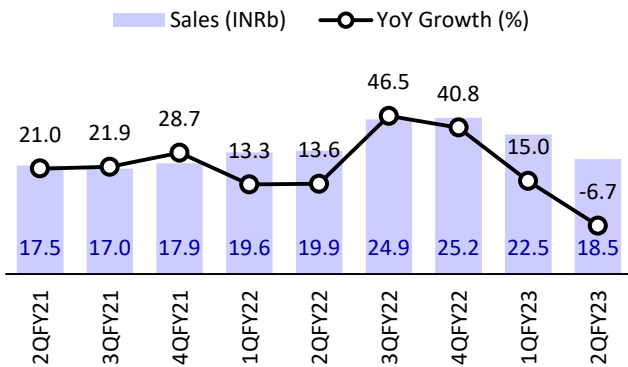


Exhibit 4: Generic APIs segment contributes 57% to revenue in 1QFY23

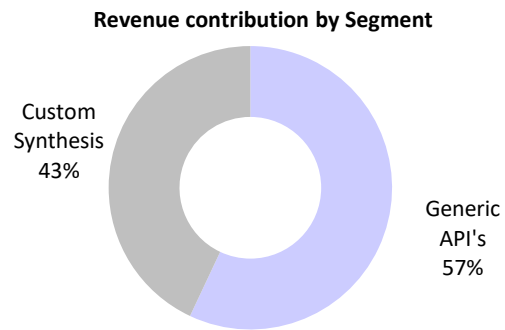


Exhibit 5: Gross margin down 340bp YoY in 2QFY23

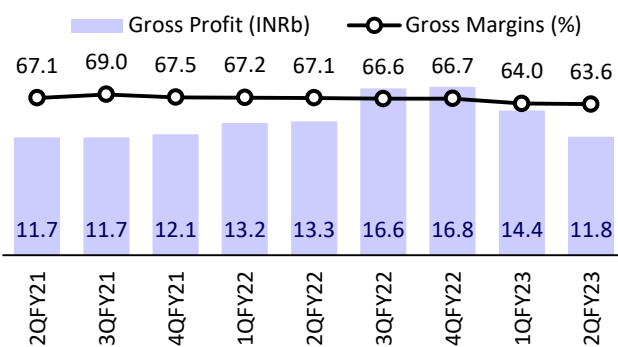


Exhibit 6: EBITDA margin contracts 800bp YoY in 2QFY23

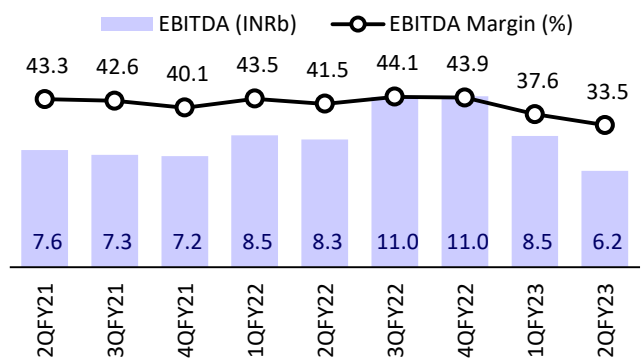


Exhibit 7: Expect ~1% revenue CAGR over FY22–24

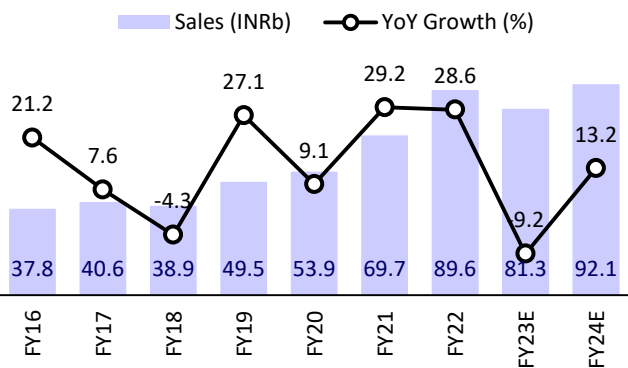


Exhibit 8: Expect margin to contract 640bp over FY22–24

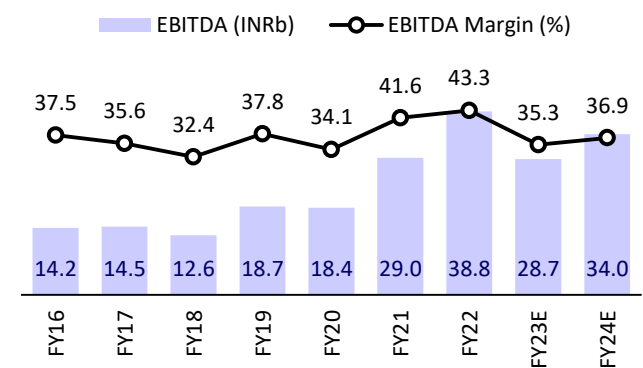


Exhibit 9: Expect 4.5% CAGR earnings decline over FY22–24

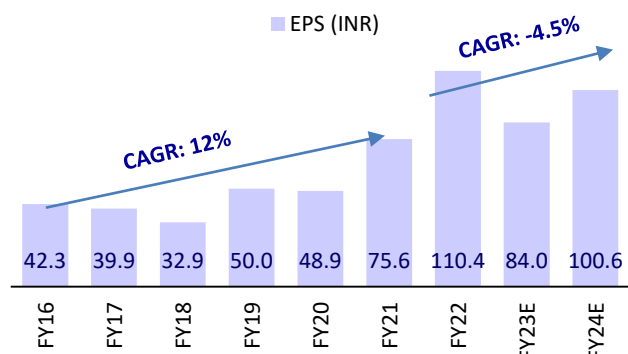
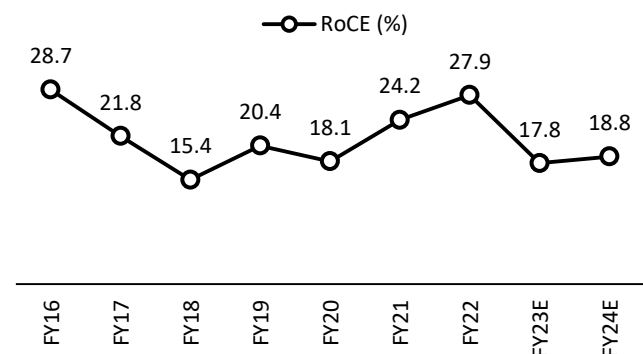


Exhibit 10: RoCE to moderate over FY22–24



Source: Company, MOFSL

Source: Company, MOFSL

Financials and valuations

Income Statement								(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Total Income from Operations	40,643	38,915	49,463	53,944	69,694	89,598	81,345	92,094
Change (%)	7.6	-4.3	27.1	9.1	29.2	28.6	-9.2	13.2
Total Expenditure	26,183	26,298	30,744	35,523	40,711	50,779	52,631	58,111
% of Sales	64.4	67.6	62.2	65.9	58.4	56.7	64.7	63.1
EBITDA	14,460	12,617	18,719	18,422	28,983	38,819	28,715	33,983
Margin (%)	35.6	32.4	37.8	34.1	41.6	43.3	35.3	36.9
Depreciation	1,233	1,425	1,689	1,862	2,556	3,115	3,383	3,436
EBIT	13,227	11,192	17,030	16,559	26,427	35,704	25,332	30,546
Int. and Finance Charges	23	13	35	61	9	8	0	0
Other Income	737	1,090	1,220	1,075	626	733	1,871	2,026
PBT bef. EO Exp.	13,942	12,269	18,215	17,573	27,044	36,429	27,203	32,572
EO Items	12	44	336	-621	-384	406	872	0
PBT after EO Exp.	13,953	12,313	18,551	16,952	26,660	36,835	28,075	32,572
Total Tax	3,349	3,543	5,023	4,429	6,818	7,231	5,053	5,863
Tax Rate (%)	24.0	28.8	27.1	26.1	25.6	19.6	18.0	18.0
Reported PAT	10,604	8,770	13,527	12,523	19,843	29,605	23,021	26,709
Adjusted PAT	10,595	8,739	13,282	12,991	20,062	29,303	22,303	26,709
Change (%)	-5.7	-17.5	52.0	-2.2	54.4	46.1	-23.9	19.8
Margin (%)	25.6	21.8	26.2	23.6	28.5	32.4	26.8	29.0

Balance Sheet								(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Equity Share Capital	531	531	531	531	531	531	531	531
Total Reserves	53,043	58,717	69,041	72,568	92,415	116,751	132,413	150,844
Net Worth	53,574	59,248	69,572	73,099	92,946	117,282	132,944	151,374
Total Loans	357	631	1,056	389	4	0	0	0
Deferred Tax Liabilities	1,228	1,917	2,188	2,696	3,348	4,069	4,069	4,069
Capital Employed	55,160	61,796	72,816	76,184	96,298	121,351	137,013	155,444
Gross Block	17,940	23,735	26,339	35,143	46,919	56,246	65,005	75,257
Less: Accum. Deprn.	2,348	3,773	5,462	7,324	9,880	12,995	16,378	19,814
Net Fixed Assets	15,592	19,962	20,878	27,819	37,039	43,251	48,627	55,443
Capital WIP	4,436	1,198	4,919	9,197	7,106	4,699	5,940	6,688
Total Investments	16,307	18,893	19,456	9,714	0	720	720	720
Curr. Assets, Loans&Adv.	25,215	27,796	35,106	38,584	63,563	84,933	94,566	106,242
Inventory	13,199	13,507	17,723	18,639	21,452	28,286	28,118	31,046
Account Receivables	9,009	10,144	11,634	14,134	16,765	24,239	21,172	23,213
Cash and Bank Balance	787	1,125	1,153	1,226	21,560	28,189	41,446	47,648
Loans and Advances	2,220	3,021	4,597	4,586	3,786	4,219	3,830	4,336
Curr. Liability & Prov.	6,390	6,053	7,543	9,130	11,411	12,251	12,839	13,648
Account Payables	4,713	4,327	5,320	6,626	7,632	7,957	8,940	9,234
Other Current Liabilities	1,511	1,540	2,039	2,174	3,501	3,986	3,619	4,097
Provisions	166	186	185	329	278	309	280	317
Net Current Assets	18,825	21,743	27,563	29,455	52,153	72,681	81,727	92,594
Appl. of Funds	55,160	61,796	72,816	76,184	96,298	121,351	137,013	155,444

E: MOFSL Estimates

Financials and valuations

Ratios	(INR m)							
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)								
EPS	39.9	32.9	50.0	48.9	75.6	110.4	84.0	100.6
Cash EPS	44.6	38.3	56.4	56.0	85.2	122.1	96.8	113.6
BV/Share	201.8	223.2	262.1	275.4	350.1	441.8	500.8	570.3
DPS	10.0	10.0	10.0	16.0	20.0	29.9	20.8	25.9
Payout (%)	30.1	36.4	23.7	40.9	32.3	32.3	28.9	31.0
Valuation (x)								
P/E	85.7	103.9	68.3	69.9	45.2	31.0	40.7	34.0
Cash P/E	76.7	89.3	60.6	61.1	40.1	28.0	35.3	30.1
P/BV	16.9	15.3	13.0	12.4	9.8	7.7	6.8	6.0
EV/Sales	22.3	23.3	18.3	16.8	12.7	9.8	10.6	9.3
EV/EBITDA	62.7	71.9	48.5	49.2	30.6	22.7	30.2	25.3
Dividend Yield (%)	0.3	0.3	0.3	0.5	0.6	0.9	0.6	0.8
FCF per share	29.1	18.9	8.3	1.2	39.1	45.2	70.6	46.9
Return Ratios (%)								
RoE	22.0	15.5	20.6	18.2	24.2	27.9	17.8	18.8
RoCE	21.8	15.4	20.4	18.1	24.2	27.9	17.8	18.8
RoIC	30.3	21.5	28.3	23.7	31.8	36.9	23.5	26.5
Working Capital Ratios								
Asset Turnover (x)	0.7	0.6	0.7	0.7	0.7	0.7	0.6	0.6
Inventory (Days)	119	127	131	123	112	115	126	123
Debtor (Days)	81	95	86	96	88	99	95	92
Creditor (Days)	42	41	39	45	40	32	40	37
Leverage Ratio (x)								
Net Debt/Equity	-0.3	-0.3	-0.3	-0.1	-0.2	-0.25	-0.3	-0.3

Cash Flow Statement	(INR m)							
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
OP/(Loss) before Tax	13,953	12,313	18,551	16,952	26,660	36,835	28,075	32,572
Depreciation	1,233	1,425	1,689	1,862	2,556	3,115	3,383	3,436
Interest & Finance Charges	-32	-30	-40	-6	-564	4	-1,871	-2,026
Direct Taxes Paid	-3,017	-2,686	-4,844	-4,452	-6,443	-6,410	-5,053	-5,863
(Inc)/Dec in WC	-371	-2,191	-4,998	-2,183	-2,641	-13,705	4,211	-4,665
CF from Operations	11,766	8,831	10,357	12,174	19,569	19,840	28,745	23,454
Others	-262	-1,073	-814	-14	-100	-722	0	0
CF from Operating incl EO	11,504	7,759	9,543	12,160	19,469	19,118	28,745	23,454
(Inc)/Dec in FA	-3,767	-2,738	-7,331	-11,829	-9,101	-7,132	-10,000	-11,000
Free Cash Flow	7,737	5,021	2,213	331	10,368	11,986	18,745	12,454
(Pur)/Sale of Investments	-8,289	-2,559	-291	10,336	9,740	-15,990	0	0
Others	659	513	767	658	112	1,173	1,871	2,026
CF from Investments	-11,396	-4,784	-6,854	-835	751	-21,949	-8,129	-8,974
Inc/(Dec) in Debt	0	0	776	-612	-333	-4	0	0
Interest Paid	-23	-13	-35	-61	-9	-4	0	0
Dividend Paid	0	-3,192	-3,200	-10,241	0	-5,309	-6,645	-8,278
CF from Fin. Activity	24	-3,142	-2,459	-10,914	-349	8,676	-7,359	-8,278
Inc/Dec of Cash	132	-167	230	411	19,871	5,844	13,257	6,202
Opening Balance	734	787	1,124	1,153	1,227	21,560	28,189	41,446
Closing Balance	866	620	1,354	1,564	21,097	27,405	41,446	47,648
Forex and other adjustments	-79	504	-201	-337	463	784	0	0
Total Cash & Cash Eq	787	1,124	1,153	1,227	21,560	28,189	41,446	47,648

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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