

Divi's Laboratories

Estimate change 

TP change 

Rating change 

CMP: INR3,730

TP: INR3,430 (-8%)

Neutral

Margin recovers; sales yet to pick up

Work-in-progress for greenfield project at Kakinada

- The operational performance of Divi's Laboratories (DIVI) missed our estimates marginally in 1QFY24, due to lower sales in generics and custom synthesis. However, EBITDA margin expanded sequentially owing to lower raw material/logistics costs.
- We reduce our earnings estimates for FY24/FY25 by 3%/5% to account for a gradual off-take in custom synthesis/nutraceutical sales in the near term and extended benefits of cost management activities. We value DIVI at 35x 12M forward earnings to arrive at a TP of INR3,430.
- DIVI continued to add capacity for product development/manufacturing and strengthen its capability in the contrast media space as one of the key levers of growth over the next 3-5 years. Further, being a leader in the core generic portfolio with the lowest cost, DIVI is in a good stead to see better growth than the market in respective molecules. However, we maintain our **Neutral** rating as we believe the valuation adequately factors in the earnings upside over the next two years. It is trading at 15%/48% premium to its 5-year/10-year average PE multiple.

Product mix/lower RM cost drives profitability QoQ

- Revenue declined 21% YoY to INR17.8b (est. INR19.8b).
- Gross margin contracted by 270bp YoY to 61.3% due to a change in the product mix.
- EBITDA margin contracted at a higher rate by 920bp YoY to 28.3% (est. 26.4%) largely due to lower GM and higher employee costs/other expenses (+390bps/260bp as a % of sales).
- As a result, EBITDA was down 41% YoY at INR5b (est. INR5.2b).
- The tax rate was 27.5% in 1QFY24 vs. 17.5%/31.2% in 1QFY23/4QFY23.
- Adjusted for INR30m in forex gains, PAT was down 46% YoY at INR3.6b (est. INR3.9b).

Highlights from the management commentary

- The generics:CS sales ratio was 60:40 for 1QFY24. Nutraceutical sales stood at INR1.8b.
- DIVI continues to work on contrast media API registrations in various geographies. The validations by customers are also underway. DIVI intends to capture the gadolinium-based contrast media opportunity FY25 onward.
- Manufacturing capacity for Unit III would comprise key starting material, nutraceutical APIs, advanced intermediates and certain complex products.
- A decline in logistics cost aided profitability to some extent.



Bloomberg	DIVI IN
Equity Shares (m)	265
M.Cap.(INRb)/(USD\$b)	990.6 / 11.9
52-Week Range (INR)	3949 / 2730
1, 6, 12 Rel. Per (%)	2/25/-10
12M Avg Val (INR M)	1929

Financials & Valuations (INR b)

Y/E MARCH	FY23	FY24E	FY25E
Sales	77.7	79.9	93.0
EBITDA	23.7	23.3	29.4
Adj. PAT	17.2	17.6	23.0
EBIT Margin (%)	26.1	24.8	27.9
Cons. Adj. EPS (INR)	64.9	66.2	86.5
EPS Gr. (%)	-41.2	2.0	30.7
BV/Sh. (INR)	481.0	526.7	586.4

Ratios

Net D:E	-0.3	-0.3	-0.3
RoE (%)	14.1	13.1	15.5
RoCE (%)	14.1	13.1	15.5
Payout (%)	29.8	31.0	31.0

Valuations

P/E (x)	57.5	56.3	43.1
EV/EBITDA (x)	40.0	40.4	32.0
Div. Yield (%)	0.5	0.5	0.6
FCF Yield (%)	1.7	0.8	0.5
EV/Sales (x)	12.2	11.8	10.1

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	51.9	51.9	51.9
DII	21.2	21.1	20.0
FII	14.7	14.7	16.5
Others	12.1	12.3	11.6

FII Includes depository receipts

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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	FY23				FY24E				FY23	FY24E	FY24E 1QE	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE				
Net Sales	22,545	18,545	17,077	19,508	17,780	19,342	20,223	22,541	77,675	79,887	19,838	-10.4
YoY Change (%)	15.0	-6.7	-31.5	-22.5	-21.1	4.3	18.4	15.6	-13.3	2.8	-12.0	
Total Expenditure	14,078	12,335	12,994	14,590	12,740	13,694	14,278	15,848	53,997	56,560	14,601	
EBITDA	8,467	6,210	4,083	4,918	5,040	5,648	5,946	6,693	23,678	23,327	5,237	-3.8
YoY Change (%)	-0.6	-24.7	-62.9	-55.5	-40.5	-9.1	45.6	36.1	-39.0	-1.5	-38.1	
Margins (%)	37.6	33.5	23.9	25.2	28.3	29.2	29.4	29.7	30.5	29.2	26.4	
Depreciation	837	857	868	870	930	878	880	809	3,432	3,497	872	
EBIT	7,630	5,353	3,215	4,048	4,110	4,770	5,066	5,884	20,246	19,830	4,365	-5.8
YoY Change (%)	-2.0	-28.4	-68.5	-60.4	-46.1	-10.9	57.6	45.4	-43.3	-2.1	-42.8	
Interest	0	0	1	2	0	0	0	0	7	0	0	
Other Income	320	492	674	662	810	670	680	404	2,150	2,564	650	
PBT before EO Income	7,950	5,845	3,888	4,707	4,920	5,440	5,746	6,289	22,390	22,394	5,015	
Forex gain /(Loss)	564	308	467	-42	30	0	0	0	1,297	30	0	
PBT	8,514	6,153	4,354	4,665	4,950	5,440	5,746	6,289	23,687	22,424	5,015	-1.3
Tax	1,493	1,216	1,288	1,455	1,360	1,142	1,149	1,170	5,453	4,821	1,103	
Rate (%)	17.5	19.8	29.6	31.2	27.5	21.0	20.0	18.6	23.0	21.5	22.0	
PAT	7,021	4,937	3,066	3,210	3,590	4,298	4,597	5,119	18,234	17,603	3,912	-8.2
Adj. PAT	6,556	4,690	2,738	3,239	3,568	4,298	4,597	5,114	17,222	17,577	3,912	-8.8
YoY Change (%)	2.6	-23.9	-67.2	-61.5	-45.6	-8.4	67.9	57.9	-41.2	2.1	-40.3	
Margins (%)	31.1	26.6	18.0	16.5	20.2	22.2	22.7	22.7	23.5	22.0	19.7	
Adj. EPS	24.7	17.7	10.3	12.2	13.4	16.2	17.3	19.3	64.9	66.2	14.7	

Quarterly Performance

Y/E March	FY23				FY24E				FY23	FY24E	FY24E 1QE
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			
Cost Break-up											
RM Cost (% of Sales)	36.0	36.4	43.3	42.4	38.7	38.6	38.9	39.0	39.3	38.8	42.6
Staff Cost (% of Sales)	10.9	12.5	14.0	13.2	14.8	13.8	13.4	13.0	12.6	13.7	12.7
Other Expenses(% of Sales)	15.5	17.6	18.8	19.2	18.2	18.4	18.3	18.3	17.6	18.3	18.3
Tax rate (%)	17.5	19.8	29.6	31.2	27.5	21.0	20.0	20.3	23.0	21.5	22.0
Gross Margins (%)	64.0	63.6	56.7	57.6	61.3	61.4	61.1	61.0	60.7	61.2	57.4
EBITDA Margins (%)	37.6	33.5	23.9	25.2	28.3	29.2	29.4	29.7	30.5	29.2	26.4
EBIT Margins (%)	33.8	28.9	18.8	20.7	23.1	24.7	25.0	26.1	26.1	24.8	22.0



Key takeaways from the management commentary

- CWIP related to the Kakinada facility was INR1.3b till date.
- Contrast media products, Sartans and near to medium term patent expiry products are key growth driver for DIVI over the next 2-3 years.

Growth to be led by continuous efforts across segments

New molecules/contracts to scale up CS business

- CS sales declined 37% YoY to INR7b, due to a reduction in paxlovid-related contracts.
- DIVI continues to explore opportunities in Sartans and the contrast media space. In Sartans, it is in process of developing/commercializing products with the innovator.
- In the contrast media space, there are a number of Ph-2/Ph-3 compounds lined up for development. Once these molecules are approved by end-FY24, it can cater to huge demand available.
- It is also working on gadolinium-based products and expanding its offering in the contrast media space.
- Since it is a gradual development, we expect CS sales to see a 6% CAGR to INR38b over FY23-25.

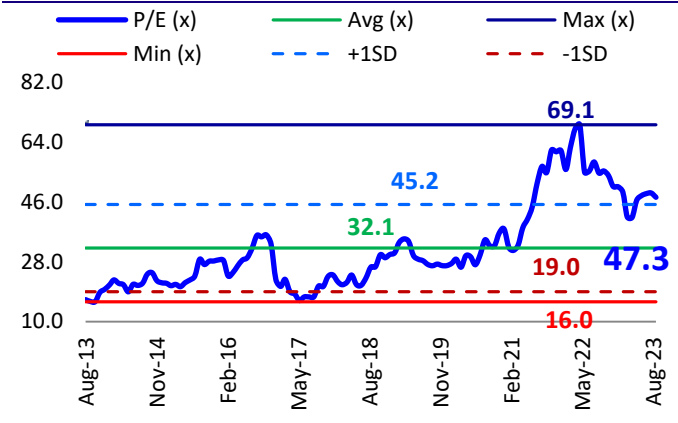
Generics: Demand in core molecules/technology upgradation to drive growth

- In 1QFY24, the generic API segment declined 10% YoY to INR9b, due to inventory pile-up in the channel.
- Being a leader in its core generic portfolio, DIVI is in a good stead to grow better than market in respective molecules.
- Moreover, DIVI is updating its technology in chemistry, leading to a reduction in costs and enabling more production through backward integration. Additionally, new product introductions are expected to drive sales.
- Moreover, DIVI continues to witness a decline in raw material costs, leading to increasing margin in this segment.
- Accordingly, we expect DIVI to post a 12% revenue CAGR to INR47b over FY23-25.

Reiterate Neutral

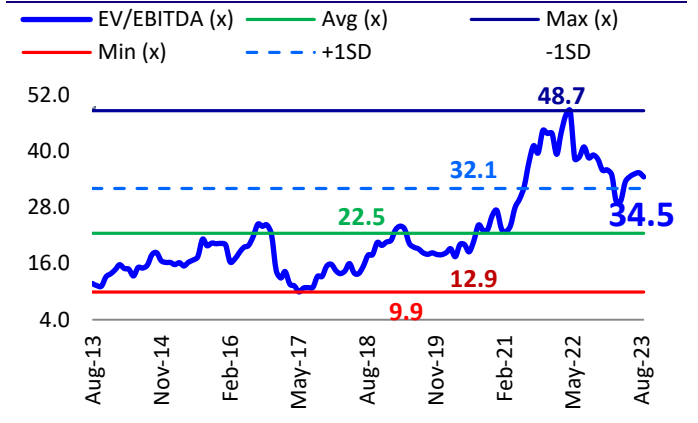
- We reduce our earnings estimate for FY24/FY25 by 3%/5%, factoring in a gradual off-take in custom synthesis/nutraceutical sales over the near term and extended benefits of cost management activities. We value DIVI at 35x 12M forward earnings to arrive at a TP of INR3,430.
- DIVI continues to add product development, manufacturing capacity as well capability in contrast media space key growth levers over the next 3-5 years. Further, being a leader in its core generic portfolio with the lowest cost, DIVI is in a good stead to grow better than market in respective molecules. Having said this, the valuation more than adequately factors the earnings upside over the next two years. It is trading at 15%/48% premium to its 5-year/10-year average PE multiple. Maintain Neutral.

Exhibit 1: P/E chart



Source: MOFSL, Company, Bloomberg

Exhibit 2: EV/EBITDA chart



Source: MOFSL, Company, Bloomberg

Story in charts

Exhibit 3: Revenue declined 21% YoY in 1QFY24

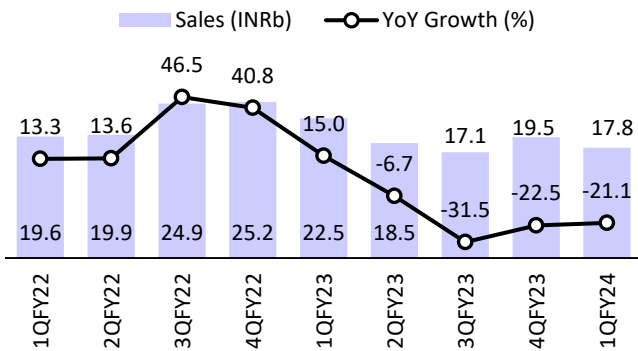


Exhibit 4: Generic API segment contributes 60% to revenue in 1QFY24

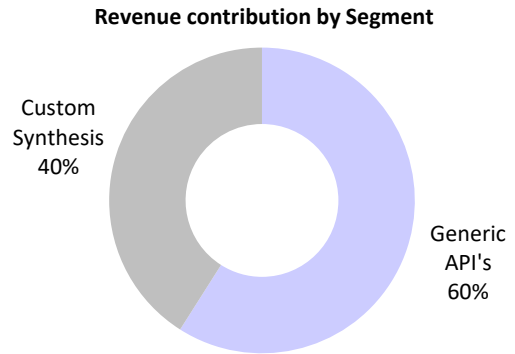


Exhibit 5: Gross margin down 270bp YoY in 1QFY24

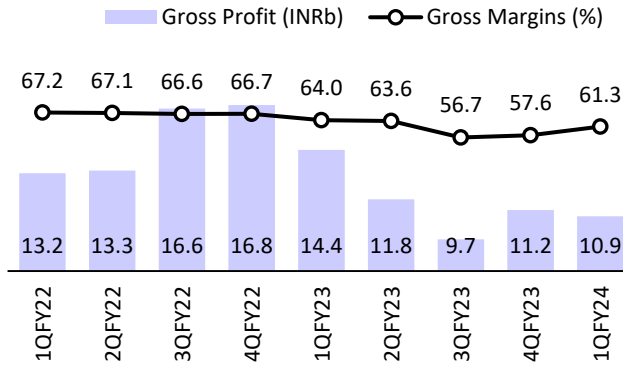


Exhibit 6: EBITDA margin contracts 920bp YoY in 1QFY24

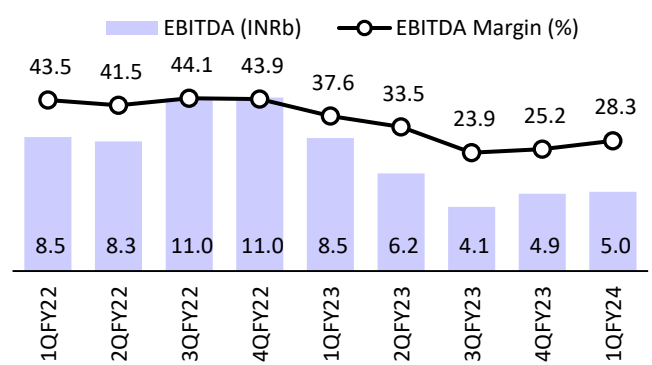


Exhibit 7: Expect ~9% revenue CAGR over FY23–25

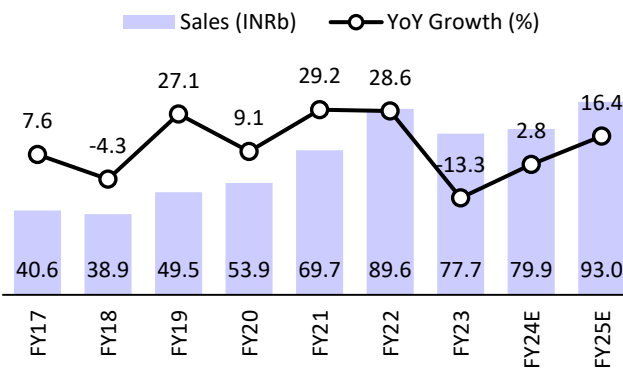


Exhibit 8: Expect margin to expand 110bp over FY23–25

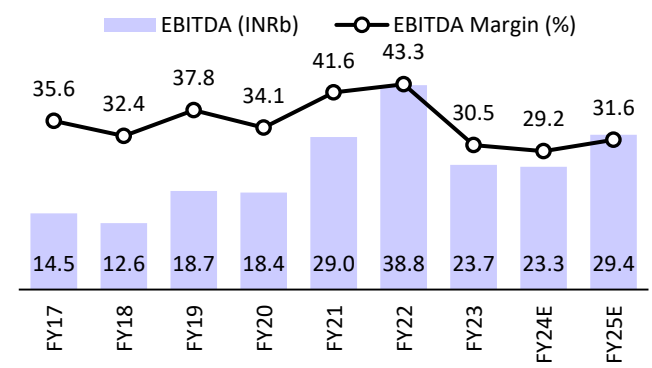


Exhibit 9: Expect 15% earnings CAGR over FY23–25

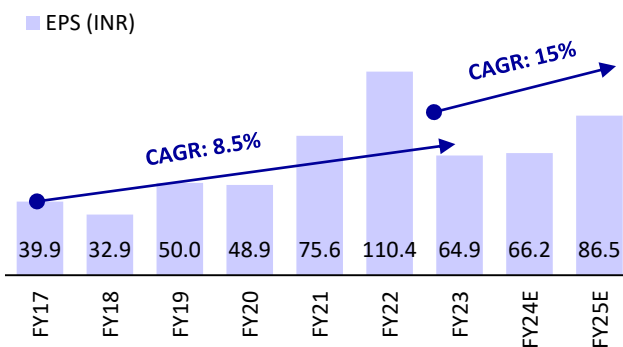
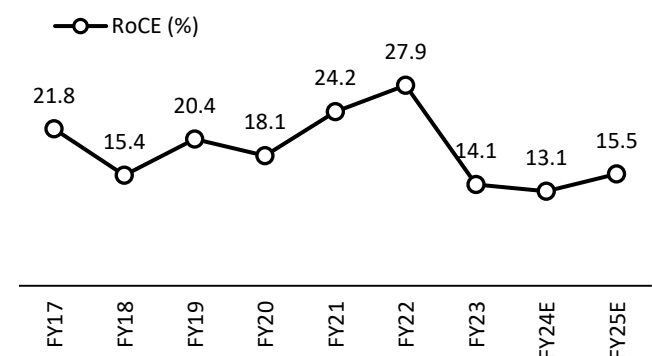


Exhibit 10: RoCE to reach ~16% by FY25



Source: Company, MOFSL

Source: Company, MOFSL

Financials and valuations

Income Statement									(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Total Income from Operations	40,643	38,915	49,463	53,944	69,694	89,598	77,675	79,887	93,023
Change (%)	7.6	-4.3	27.1	9.1	29.2	28.6	-13.3	2.8	16.4
Total Expenditure	26,183	26,298	30,744	35,523	40,711	50,779	53,997	56,560	63,628
% of Sales	64.4	67.6	62.2	65.9	58.4	56.7	69.5	70.8	68.4
EBITDA	14,460	12,617	18,719	18,422	28,983	38,819	23,678	23,327	29,395
Margin (%)	35.6	32.4	37.8	34.1	41.6	43.3	30.5	29.2	31.6
Depreciation	1,233	1,425	1,689	1,862	2,556	3,115	3,432	3,497	3,477
EBIT	13,227	11,192	17,030	16,559	26,427	35,704	20,246	19,830	25,918
Int. and Finance Charges	23	13	35	61	9	8	7	0	0
Other Income	737	1,090	1,220	1,075	626	733	2,150	2,564	2,977
PBT bef. EO Exp.	13,942	12,269	18,215	17,573	27,044	36,429	22,390	22,394	28,895
EO Items	12	44	336	-621	-384	406	1,297	30	0
PBT after EO Exp.	13,953	12,313	18,551	16,952	26,660	36,835	23,687	22,424	28,895
Total Tax	3,349	3,543	5,023	4,429	6,818	7,231	5,453	4,821	5,923
Tax Rate (%)	24.0	28.8	27.1	26.1	25.6	19.6	23.0	21.5	20.5
Reported PAT	10,604	8,770	13,527	12,523	19,843	29,605	18,234	17,603	22,971
Adjusted PAT	10,595	8,739	13,282	12,991	20,062	29,303	17,239	17,580	22,971
Change (%)	-5.7	-17.5	52.0	-2.2	54.4	46.1	-41.2	2.0	30.7
Margin (%)	25.6	21.8	26.2	23.6	28.5	32.4	21.6	22.0	24.7

Balance Sheet									(INR m)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	531	531	531	531	531	531	531	531	531
Total Reserves	53,043	58,717	69,041	72,568	92,415	116,751	127,140	139,271	155,122
Net Worth	53,574	59,248	69,572	73,099	92,946	117,282	127,671	139,802	155,653
Total Loans	357	631	1,056	389	4	0	0	0	0
Deferred Tax Liabilities	1,228	1,917	2,188	2,696	3,348	4,069	5,230	5,230	5,230
Capital Employed	55,160	61,796	72,816	76,184	96,298	121,351	132,901	145,055	160,907
Gross Block	17,940	23,735	26,339	35,143	46,919	56,246	63,653	70,848	81,337
Less: Accum. Deprn.	2,348	3,773	5,462	7,324	9,880	12,995	16,427	19,924	23,401
Net Fixed Assets	15,592	19,962	20,878	27,819	37,039	43,251	47,226	50,924	57,936
Capital WIP	4,436	1,198	4,919	9,197	7,106	4,699	2,119	5,924	6,935
Total Investments	16,307	18,893	19,456	9,714	0	720	771	771	771
Curr. Assets, Loans&Adv.	25,215	27,796	35,106	38,584	63,563	84,933	94,130	100,250	111,051
Inventory	13,199	13,507	17,723	18,639	21,452	28,286	30,004	29,442	33,993
Account Receivables	9,009	10,144	11,634	14,134	16,765	24,239	17,925	18,823	22,682
Cash and Bank Balance	787	1,125	1,153	1,226	21,560	28,189	42,131	47,800	49,502
Loans and Advances	2,220	3,021	4,597	4,586	3,786	4,219	4,070	4,186	4,874
Curr. Liability & Prov.	6,390	6,053	7,543	9,130	11,411	12,251	11,345	12,813	15,786
Account Payables	4,713	4,327	5,320	6,626	7,632	7,957	7,625	8,988	11,331
Other Current Liabilities	1,511	1,540	2,039	2,174	3,501	3,986	3,364	3,460	4,029
Provisions	166	186	185	329	278	309	355	366	426
Net Current Assets	18,825	21,743	27,563	29,455	52,153	72,681	82,785	87,437	95,266
Appl. of Funds	55,160	61,796	72,816	76,184	96,298	121,351	132,901	145,055	160,907

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)									
EPS	39.9	32.9	50.0	48.9	75.6	110.4	64.9	66.2	86.5
Cash EPS	44.6	38.3	56.4	56.0	85.2	122.1	77.9	79.4	99.6
BV/Share	201.8	223.2	262.1	275.4	350.1	441.8	481.0	526.7	586.4
DPS	10.0	10.0	10.0	16.0	20.0	29.9	17.0	17.0	22.2
Payout (%)	30.1	36.4	23.7	40.9	32.3	32.3	29.8	31.0	31.0
Valuation (x)									
P/E	93.5	113.3	74.6	76.2	49.4	33.8	57.5	56.3	43.1
Cash P/E	83.7	97.4	66.2	66.7	43.8	30.6	47.9	47.0	37.4
P/BV	18.5	16.7	14.2	13.5	10.7	8.4	7.8	7.1	6.4
EV/Sales	24.4	25.4	20.0	18.3	13.9	10.7	12.2	11.8	10.1
EV/EBITDA	68.5	78.5	52.9	53.7	33.4	24.8	40.0	40.4	32.0
Dividend Yield (%)	0.3	0.3	0.3	0.4	0.5	0.8	0.5	0.5	0.6
FCF per share	29.1	18.9	8.3	1.2	39.1	45.2	69.8	32.2	22.0
Return Ratios (%)									
RoE	22.0	15.5	20.6	18.2	24.2	27.9	14.1	13.1	15.5
RoCE	21.8	15.4	20.4	18.1	24.2	27.9	14.1	13.1	15.5
RoIC	30.3	21.5	28.3	23.7	31.8	36.9	17.7	17.4	21.2
Working Capital Ratios									
Asset Turnover (x)	0.7	0.6	0.7	0.7	0.7	0.7	0.6	0.6	0.6
Inventory (Days)	119	127	131	123	112	115	141	135	133
Debtor (Days)	81	95	86	96	88	99	84	86	89
Creditor (Days)	42	41	39	45	40	32	36	41	44
Leverage Ratio (x)									
Net Debt/Equity	-0.3	-0.3	-0.3	-0.1	-0.2	-0.25	-0.34	-0.3	-0.3

Cash Flow Statement

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
(INR m)									
OP/(Loss) before Tax	13,953	12,313	18,551	16,952	26,660	36,835	23,687	22,424	28,895
Depreciation	1,233	1,425	1,689	1,862	2,556	3,115	3,432	3,497	3,477
Interest & Finance Charges	-32	-30	-40	-6	-564	4	-2,144	-2,564	-2,977
Direct Taxes Paid	-3,017	-2,686	-4,844	-4,452	-6,443	-6,410	-5,453	-4,821	-5,923
(Inc)/Dec in WC	-371	-2,191	-4,998	-2,183	-2,641	-13,705	3,838	1,017	-6,126
CF from Operations	11,766	8,831	10,357	12,174	19,569	19,840	23,360	19,553	17,346
Others	-262	-1,073	-814	-14	-100	-722	0	0	0
CF from Operating incl EO	11,504	7,759	9,543	12,160	19,469	19,118	23,360	19,553	17,346
(Inc)/Dec in FA	-3,767	-2,738	-7,331	-11,829	-9,101	-7,132	-4,827	-11,000	-11,500
Free Cash Flow	7,737	5,021	2,213	331	10,368	11,986	18,534	8,553	5,846
(Pur)/Sale of Investments	-8,289	-2,559	-291	10,336	9,740	-15,990	-50	0	0
Others	659	513	767	658	112	1,173	2,150	2,564	2,977
CF from Investments	-11,396	-4,784	-6,854	-835	751	-21,949	-2,727	-8,436	-8,523
Issue of Shares	0	0	0	0	0	0	0	0	0
Inc/(Dec) in Debt	0	0	776	-612	-333	-4	0	0	0
Interest Paid	-23	-13	-35	-61	-9	-4	-7	0	0
Dividend Paid	0	-3,192	-3,200	-10,241	0	-5,309	-5,432	-5,449	-7,120
CF from Fin. Activity	24	-3,142	-2,459	-10,914	-349	8,676	-6,481	-5,449	-7,120
Inc/Dec of Cash	132	-167	230	411	19,871	5,844	14,152	5,669	1,703
Opening Balance	734	787	1,124	1,153	1,227	21,560	28,189	42,131	47,800
Closing Balance	866	620	1,354	1,564	21,097	27,405	42,341	47,800	49,502
Forex and other adjustments	-79	504	-201	-337	463	784	-210	0	0
Total Cash & Cash Eq	787	1,124	1,153	1,227	21,560	28,189	42,131	47,800	49,502

Investment in securities market are subject to market risks. Read all the related documents carefully before investing

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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