

Divi's Laboratories Ltd.

Near term headwinds to continue...

Divi's lab missed the earnings estimate and reported revenue degrowth of 31.5% YoY and 7.9% QoQ to Rs. 17,077 mn. The decline was due to lower revenue from custom synthesis business which had high base of molnupiravir in Q3FY22. The company has reported lowest ever gross margin since 16 quarters which was a disappointment. The higher input cost price pressure, unfavourable product mix and increased pricing pressure in generics business. EBITDA declined by 62.8% YoY and 34.3% QoQ at Rs. 4,083 Mn mainly due to lower gross margin accompanied with higher other expenses. EBITDA margins contracted by 2010 bps YoY and 958 bps QoQ to 23.9%. The headwinds in the generics business will continue for the next 4-5 quarters, hence we cut our revenue estimates for FY24 and FY25 by 9.8% and 10.2% respectively. Due to cut down in our earnings estimate, we change our rating from accumulate to reduce.

Custom Synthesis – Divi's 87% of the revenue comes from export business, where the export to regulated markets contributes 68% of the total export. In Q3 FY23 the custom synthesis segment, which is a high margin business, accounted for 40% of total revenue, witnessed decline of 54% YoY and 37% QoQ to Rs. 6,830 mn in Q3 FY23 due to high base of Merck's oral covid pill – molnupiravir in FY22. Custom synthesis business is expected to rebound in Q2FY24 backed by strong orderbook. **On the two fast-tracked projects, Divi's highlighted that both are in the commercial stage and expects them to start contributing to the topline from Q1FY24.**

Generic – The generic segment accounted for 44% of total revenue. Revenues grew by 5% YoY and 4.3% QoQ to Rs. 8,746 mn in Q3 FY23 as compared to Rs. 8,388 mn in Q2 FY23 and Rs. 8,323 mn in Q3 FY22. Higher DMF filings and patent expiries of new molecules in FY24 will add more revenue growth going ahead. High margins of the majority of the new generic products are expected to be value accretive. The company is expecting that in FY23-FY25 USD, USD 20 bn worth of drugs will be going off patent which will create huge opportunities for APIs companies. **Market share gains in key molecules such as carbidopa, levodopa and mesalamine where company has high market share of 20-30% will lead to higher revenue visibility.**

Margin – The higher prices of intermediates, solvents and unfavourable product mix impacted the gross margin in Q3 FY23 which slipped by 996 bps YoY and 693 bps QoQ to 56.7%. EBITDA margins decreased by ~2010 bps YoY and by ~958 bps on sequential basis to 23.9% due to a significant increase in the other operating expenses (from 18.8% of revenue in Q3 FY23 to 17.6% in Q2 FY23). The higher operating costs was mainly due to increased power & fuel prices which are impacted due to geo-political tensions. Divi's has expanded capacity to meet higher demand. **Debottlenecking and backward integration also helped it achieve scale and de-risk its dependence on external supply. Higher capex spending, launch of new products and volume growth across offerings remain key growth drivers.**

Valuation:

The long-term growth story is intact as Divi's focus on custom synthesis segments, and its ability to win repeat, high-tonnage business is clear evidence of its specialization. The company is structurally well positioned in customs synthesis and API even after flattish year ahead on a high base in FY22. Due to the near-term margin pressure which is transitory in nature, we forecast Revenue / EBITDA / PAT CAGR during FY23- 25E at 13.4% / 15 %/22.8%. **We value the stock based on SOTP valuation strategy on FY25E earnings and arrive at a target price of INR 2,819. Reduce.**

Y/E Mar (Rs mn)	Q3 FY23	Q3 FY22	YoY (%)	Q2 FY23	QoQ (%)	Q3 FY23e	Var. (%)
Net sales	17,077	24,932	-31.5%	18,545	-7.9%	19,032	-10.3%
Operating costs	12,994	13,961	-6.9%	12,335	5.3%		
EBITDA	4,083	10,972	-62.8%	6,210	-34.3%	6750	-39.5%
EBITDA Margin (%)	23.9%	44.0%	(2,010) bps	33.5%	(958) bps	16.9%	697 bps
Depreciation	868	799	8.6%	857	1.2%		
Other income	1,143	166	587.4%	801	42.7%		
Interest	1	2	-43.5%	2	-23.5%		
Extraordinary items	0	0	NM	0	NM		
PBT	4,356	10,337	-57.9%	6,152	-29.2%		
Provision for tax	1,288	1,314	-2.0%	1,216	5.9%		
Effective tax rate (%)	29.6%	12.7%	1,686 bps	19.8%	980 bps		
Consolidated PAT	3,068	9,022	-66.0%	4,936	-37.8%	5300	-42.1%

Source: Company, SMIFS research

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Adj EPS	RoE (%)	RoCE (%)	Adj P/E (x)	EV/EBITDA (x)
FY21	69,694	29	28,599	41.0	19,843	44.2	74.7	23.9	23.8	40.7	29.0
FY22	89,598	29	38,819	43.3	29,604	49.2	111.5	28.2	28.2	40.7	31.8
FY23E	75,657	-16	23,010	30.4	18,433	-37.7	69.4	14.8	14.8	41.5	35.4
FY24E	86,492	14	29,116	33.7	18,909	2.6	71.2	13.7	13.7	40.5	28.2
FY25E	97,314	13	34,692	35.6	22,711	20.1	85.6	14.8	14.8	33.7	24.0

Source: Company, SMIFS research estimates



Rating: **Reduce** Upside/(Downside): **-2%**
Current Price: **2,884** Target Price: **2,819**

Earlier recommendation

Previous Rating: Accumulate
Previous Target Price: 3,833

Market data

Bloomberg:	DIVI IN
52-week H/L (Rs):	4,641/2,796
Mcap (Rs bn/USD bn):	765.7/9.34
Shares outstanding (mn):	265
Free float:	48.0%
Avg. daily vol. 3mth (3M Avg.):	0.53 Mn
Face Value (Rs):	2

Source: Bloomberg, SMIFS research

Shareholding pattern (%)

	Dec-22	Sep-22	Jun-22	Mar-22
Promoters	51.9	51.9	51.9	51.9
FII's	15.1	15.4	16.5	18.4
DII's	20.6	20.7	20.0	18.3
Public/others	12.2	11.8	11.5	11.2

Promoters pledged shares (%)

Pledged	0.0	0.0	0.0	0.0
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Source: BSE

Price performance (%) *

YE Mar (R)	1M	3M	12M	36M
NIFTY 50	-2.0	-1.1	1.6	52.5
NIFTY 500	-3.8	-3.3	-1.1	55.0
DIVI IN	-15	-23.7	-32.3	46.3

* As on 3rd Feb 2023; Source: AceEquity, SMIFS research

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Q3FY23 – Key takeaways from the management call

Contrast media: The iodine based contrast media projects have been under implementation over the past few quarters and the company has entered commercialization phase with two of its clients which are expected to contribute from Q1FY24. Divi's has increased its capacity for contrast media products and is working to create new, more effective manufacturing techniques. In contrast Media, the company plans to **enter the MRI segment which requires specialised chemicals such as gadolinium** which helps to improve the clarity of the images or pictures of the body's internal structures.

Generic Pipeline: The company plans to focus on newer API's worth of USD 20 bn which is expected to go off patent in FY23-FY25. This will help the company get more volume growth in FY24.

Base API Portfolio: The Company is committed to expanding its core business, with a focus on increasing market share in new growth compounds like gabapentin, valsartan, mesalamine etc.

Sartans: Divi's anticipate gaining a substantial market share in Sartans based on backward integration strength as **many players are leaving the Sartans industry due to impurity concerns.**

Kakinada's Plant: The company had allocated ~Rs10bn for this project. **The company has received all government clearances for the Unit-3 facility at Kakinada and ~500 acres of land have been handed over to the company.** The company expects construction project to pick-up in full flow over 1-2 quarters and aims to complete the phase-1 of construction in 2-3 years.

Custom Synthesis: The custom synthesis business may see muted growth for 3-4 quarters. But the management is confident about its long-term growth. The management said that US and EU does not have enough capacities to produce the newer off patent drugs, this will create immense opportunities for the Indian players going ahead. The demand may remain same at current level.

Divi's expects that business will start recovering on a sequential basis over the coming quarters and has guided double digit topline growth mainly driven by volumes and steady recovery in margins over the medium term driven by cost rationalization and softening of API prices.

Quarterly financials, operating metrics & key performance indicators

Y/E March (Rs mn)	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23
Net Sales	17882	19606	19875	24932	24950	22545	18545	17077
Raw Materials	5814	6421	6548	8316	8689	8120	6746	7396
Employee Costs	2151	2208	2240	2446	2515	2464	2321	2389
Other Expenditure	2755	2457	2906	3199	2787	3495	3268	3210
EBITDA	7163	8521	8181	10972	10960	8467	6210	4083
Depreciation	701	733	774	799	808	837	857	868
Interest	2	3	2	2	0	1	2	1
Other Income	235	360	191	166	505	884	801	1143
PBT	6695	8145	7596	10337	10657	8513	6152	4356
Tax	1675	2574	1532	1314	1827	1493	1216	1288
Tax rate (%)	25.0	31.6	20.2	12.7	17.1	17.5	19.8	29.6
PAT	5020	5571	6065	9022	8830	7020	4936	3068
Adjusted PAT	5020	5571	6065	9022	8830	7020	4936	3068
Y-o-Y Growth (%)								
Revenue	28.7	13.3	13.6	46.5	39.5	15.0	-6.7	-31.5
EBITDA	61.2	21.7	10.4	58.7	53.0	-0.6	-24.1	-62.8
Adjusted PAT	29.3	13.2	16.7	91.7	75.9	26.0	-18.6	-66.0
Q-o-Q Growth (%)								
Revenue	5.1	9.6	1.4	25.4	0.1	-9.6	-17.7	-7.9
EBITDA	3.6	19.0	-4.0	34.1	-0.1	-22.7	-26.7	-34.3
Adjusted PAT	6.7	11.0	8.9	48.8	-2.1	-20.5	-29.7	-37.8
Margin (%)								
RMC/revenue (%)	32.5	32.8	32.9	33.4	34.8	36.0	36.4	43.3
Gross margin (%)	67.5	67.2	67.1	66.6	65.2	64.0	63.6	56.7
Employee cost/revenue (%)	12.0	11.3	11.3	9.8	10.1	10.9	12.5	14.0
Other expenses/revenue (%)	15.4	12.5	14.6	12.8	11.2	15.5	17.6	18.8
EBITDA	40.1	43.5	41.2	44.0	43.9	37.6	33.5	23.9
Adjusted PAT	28.1	28.4	30.5	36.2	35.4	31.1	26.6	18.0

Source: Company, SMIFS research

Fig 1: Key Assumptions

Revenue in Rs. Mn	2021	2022	2023E	2024E	2025E
Generic API	35,892	30,455	35,559	40,893	46,209
% growth	30%	-15%	17%	15%	13%
Custom Synthesis	28,575	52,863	35,732	38,590	42,835
% growth	26%	85%	-32%	8%	11%
Nutraceuticals	5,227	6,280	6,675	7,009	8,270
% growth	38%	20%	6%	5%	18%
Total Revenue	69,694	89,598	77,966	86,492	97,314

Source: Company, SMIFS research

Fig 2: Quarterly performance

Revenue in INR Mn	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23
Generic API	9,209	8,423	6,876	8,323	6,833	10,089	8,388	8,746
% growth	5.1%	-8.5%	-18.4%	21.0%	-17.9%	47.7%	-16.9%	4.3%
Custom Synthesis	7,332	9,803	11,319	14,959	16,781	10,596	10,753	6,830
% growth	5.1%	33.7%	15.5%	32.2%	12.2%	-36.9%	1.5%	-36.5%
Neutraceuticals	1,341	1,380	1,680	1,650	1,570	1,860	1,714	1,500
% growth	5.1%	2.9%	21.7%	-1.8%	-4.8%	18.5%	-7.9%	-12.5%
Total Revenue	17,882	19,606	19,875	24,932	25,184	22,545	20,855	17,076
% growth	5.1%	9.6%	1.4%	25.4%	1.0%	-10.5%	-7.5%	-18.1%

Source: Company, SMIFS research

Fig 3: SOTP Valuation Metrics for FY25

Segment	Sales in FY25E	% Contribution	PAT in FY25E	Forward P/E	Segment Value	Value per share (Rs)
Generic API	46,209	47.5%	6,478	23	1,49,000	561
Custom Synthesis	42,835	44.0%	14,992	38	5,69,705	2146
Nutraceuticals	8,270	8.5%	1,241	24	29,773	112
Generic API	97,314	100.0%	22,711		7,48,478	2,819

Source: Company, SMIFS Research

Fig 4: Details of molecules where Divi's is expanding its capacity

Molecule	Existing capacities	New Capacities	Total
Naproxen	2,700	810	3,510
Gabapentin	1,250	375	1,625
Levetiracetam	300	300	600
Dextromethorphan	270	200	470
Pregabalin	150	150	300
Valsartan	90	270	360
Contrast Media	3,500	700	4,200
Mesalamine	2,000	200	2,200
Ticagrelor	100	25	125
Lacosamide	50	13	63
Rivaroxaban	42	11	53

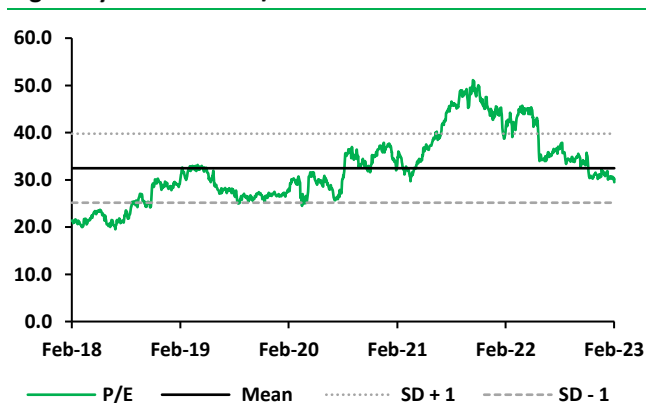
Source: Company, SMIFS Research

Naproxen, Gabapentin, dextromethorphan and pregabalin are its flagship molecules where Divi's has sizeable market share. Two generics, Naproxen (pain management) and Dextromethorphan (cough suppressant) account for ~26% of overall revenues. Divi's enjoys ~70% global market share in these two products. Debottlenecking and addition of new API will fuel the revenue growth in Generic API segment going ahead. However, the high base of molnupiravir in custom synthesis business will lead to muted topline growth for few quarters.

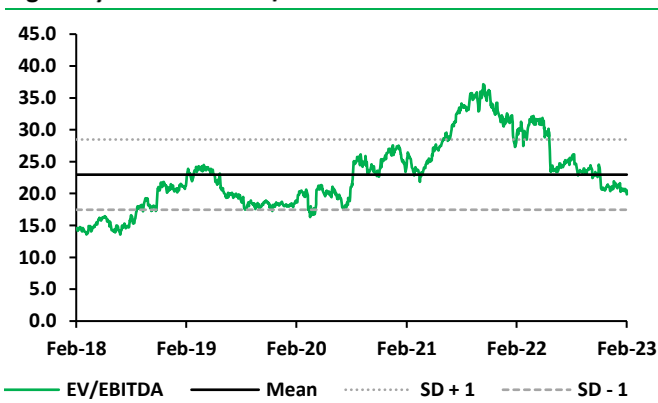
Fig 5: Change in Estimates

Particulars	New Estimates			Old Estimates			Change		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenues	75,657	86,492	97,314	83,299	95,903	1,08,365	-9.2%	-9.8%	-10.2%
Gross Profit	45,962	53,303	60,791	53,049	63,549	72,507	-13.4%	-16.1%	-16.2%
Gross Margin	60.8%	61.6%	62.5%	63.7%	66.3%	66.9%	(293) bps	(464) bps	(444) bps
EBITDA	23,010	29,116	34,692	32,573	39,838	46,628	-29.4%	-26.9%	-25.6%
EBITDA Margin (%)	30.4%	33.7%	35.6%	39.1%	41.5%	43.0%	(869) bps	(788) bps	(738) bps
PAT	18,433	18,909	22,711	23,862	29,403	34,566	-22.8%	-35.7%	-34.3%
EPS	69.4	71.2	85.6	89.9	110.8	130.2	-22.8%	-35.7%	-34.3%

Source: Company, SMIFS Research

Fig 6: 1-year forward P/E


AceEquity, SMIFS research

Fig 7: 1-year forward EV/EBITDA


AceEquity, SMIFS research

Financial Statements

Income Statement					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Revenues	69,694	89,598	75,657	86,492	97,314
Raw Materials	23,241	29,671	29,694	33,189	36,524
% of sales	33.3	33.1	39.2	38.4	37.5
Personnel	8,258	9,462	9,622	10,737	12,036
% of sales	11.8	10.6	12.7	12.4	12.4
Other Expenses	9,596	11,646	13,330	13,451	14,063
% of sales	13.8	13.0	17.6	15.6	14.5
EBITDA	28,599	38,819	23,010	29,116	34,692
Other Income	626	1,139	4,016	668	683
Depreciation	2,556	3,115	3,452	3,514	3,824
EBIT	26,669	36,843	23,575	26,271	31,551
Finance cost	9	8	8	8	8
Core PBT	26,035	35,696	19,551	25,594	30,860
Exceptional Items	0	0	0	0	0
PBT	26,660	36,835	23,567	26,262	31,543
Tax-Total	6,818	7,231	5,134	7,353	8,832
Tax Rate (%) - Total	25.6	19.6	21.8	28.0	28.0
PAT	19,843	29,605	18,433	18,909	22,711
Adjusted PAT	19,843	29,604	18,433	18,909	22,711

Source: Company, SMIFS research estimates

Key Ratios					
YE March	FY21	FY22	FY23e	FY24e	FY25e
Growth Ratios (%)					
Revenue	29.20	28.56	-15.56	14.32	12.51
EBITDA	56.95	35.74	-40.72	26.53	19.15
Adjusted PAT	44.15	49.19	-37.74	2.58	20.11
Margin Ratios (%)					
Gross Profit	66.65	66.88	60.75	61.63	62.47
EBITDA	41.04	43.33	30.41	33.66	35.65
EBIT	38.27	41.12	31.16	30.37	32.42
Core PBT	37.36	39.84	25.84	29.59	31.71
Adjusted PAT	28.47	33.04	24.36	21.86	23.34
Return Ratios (%)					
ROE	23.9	28.2	14.8	13.7	14.8
ROCE	23.8	28.2	14.8	13.7	14.8
Turnover Ratios (days)					
Gross Block Asset Turnover (x)	1.71	1.92	1.62	1.76	1.80
Adj CFO / Adj PAT (%)	98.1	64.6	169.6	91.3	96.9
Inventory	105	115	117	119	119
Debtors	88	90	92	93	93
Creditors	35	40	41	41	41
Cash conversion cycle	157	165	168	171	171
Solvency Ratio (x)					
Debt-equity	0.0	0.0	0.0	0.0	0.0
Net debt-equity	-0.2	-0.2	-0.4	-0.4	-0.4
Gross Debt / EBITDA	0.0	0.0	0.0	0.0	0.0
Current Ratio	5.6	7.0	7.7	7.7	7.9
Interest coverage ratio	3065	4605	2900	3170	3807
Dividend					
DPS	20.0	30.0	20.0	16.0	19.7
Dividend Yield (%)	0.7	0.7	0.7	0.6	0.7
Dividend Payout (%)	26.8	26.9	28.8	22.4	23.0
Per share Ratios (Rs)					
Basic EPS (reported)	74.8	111.5	69.4	71.2	85.6
Adjusted EPS	74.7	111.5	69.4	71.2	85.6
CEPS	84.4	123.3	82.4	84.5	100.0
BV	350.1	441.8	493.8	547.2	611.6
Valuation (x)					
P/E (adjusted)	40.7	40.7	41.5	40.5	33.7
P/BV	8.7	10.3	35.0	34.2	28.9
EV/EBITDA	29.0	31.8	35.4	28.2	24.0
EV/Sales	11.9	13.8	10.8	9.5	8.6
Adj Mcap / Core PBT	30.2	33.0	36.6	27.7	22.7
Adj Mcap / Adj OCF	40.4	61.6	22.9	41.1	31.8

Source: Company, SMIFS research estimates

Balance Sheet					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Sources of Funds					
Capital	531	531	531	531	531
Reserves & Surplus	92,415	1,16,751	1,30,557	1,44,729	1,61,829
Shareholders' Fund	92,946	1,17,282	1,31,087	1,45,260	1,62,360
Total Loan Funds	48	37	51	52	52
Other Liabilities	3,633	4,481	4,085	4,671	5,255
Total Liabilities	96,627	1,21,800	1,35,224	1,49,982	1,67,666
Application of Funds					
Gross Block	46,671	46,671	46,671	51,671	56,671
Net Block	36,947	43,176	44,972	46,458	47,635
Capital WIP	7,149	4,699	5,400	6,500	7,200
Investments	15	720	15	17	19
Other Non-Current Assets	1,884	1,637	2,193	2,497	2,800
Inventories	21,452	28,286	24,252	28,199	31,727
Sundry Debtors	16,765	24,239	19,070	22,038	24,795
Cash and bank balances	21,560	28,189	49,591	56,013	66,698
Other current assets	1,969	2,801	2,118	2,422	2,725
Total Current Assets	61,747	83,515	95,030	1,08,671	1,25,946
Sundry Creditors	7,632	7,957	8,498	9,716	10,931
Other current liabilities	3,481	3,990	3,889	4,446	5,002
Total Current Liabilities	11,113	11,947	12,387	14,161	15,933
Net Current Assets	50,634	71,568	82,643	94,510	1,10,012
Total Assets	96,627	1,21,800	1,35,224	1,49,982	1,67,666

Source: Company, SMIFS research estimates

Cash Flow					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Operating profit before WC changes	28,553	39,232	27,027	29,784	35,375
Changes in working capital	-2,641	-13,705	9,375	-5,163	-4,536
Income tax Paid	-6,443	-6,410	-5,134	-7,353	-8,832
Cash flow from operating activities	19,469	19,118	31,267	17,268	22,007
Adj OCF	19,461	19,118	31,259	17,260	21,999
Capex	-9,102	-7,132	-5,949	-6,100	-5,700
Adj FCF	10,359	11,986	25,310	11,160	16,299
Cash flow from investing activities	751	-21,949	-5,244	-6,102	-5,702
Debt	-333	-4	14	1	-
Dividend	-	-5,309	-4,240	-4,349	-5,224
Interest and Lease	-9	-4	-8	-8	-8
Cash flow from financing activities	-349	-5,324	-4,621	-4,744	-5,619
Net change in cash	19,872	-8,156	21,402	6,422	10,686

Source: Company, SMIFS research estimates

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