

**HOLD**

TP: Rs 4,250 | ▲ 14%

**DIVI'S LABS**

| Pharmaceuticals

| 13 August 2022

## No respite in sight for margins

- Q1 revenue broadly in line with consensus at Rs 22.5bn (+15% YoY/-10% QoQ), but EBITDA 10% below
- Gross/EBITDA margins contracted 320bps/590bps YoY on sustained cost pressure
- Our estimates already bake in margin stress; we retain HOLD and our TP of Rs 4,250 based on 26x FY24E EV/EBITDA

Saad Shaikh

research@bobcaps.in

**Custom synthesis drives growth, generics continue to struggle:** DIVI's Q1 revenue increased 15% YoY, driven by 22% growth in the custom synthesis business. Sequentially, however, custom synthesis revenue fell 38% QoQ due to the absence of Covid product sales (Molnupiravir). In generic APIs, DIVI reported muted 4% YoY growth, though management expects to maintain the generic-to-custom synthesis mix at 50:50. Management guides for double-digit topline growth in FY23 on the back of new products, contrast media and recovery in the generics business.

**Elevated costs continue to strain margins:** Higher raw material and solvent costs led to gross margin contraction of 320bps YoY (-270bps QoQ). Elevated freight and power costs put added pressure on EBITDA margin which contracted 590bps YoY (-630bps QoQ). To mitigate the cost burden, the company is passing on some RM price hikes to customers on a case-by-case basis and is confident in achieving 40% EBITDA margin (including other income) for the year.

**Earnings call highlights:** (1) DIVI has completed capacity expansion in the generic API segment. (2) Management does not expect capex to go beyond Rs 5bn-6bn in FY23. (3) The company is still waiting for a response from the Andhra Pradesh government on the Kakinada plant (4) Company received a contract from big pharma company for 1 contrast media API and is under validation (5) Contrast media to be a major growth engine in next two years.

**Maintain HOLD:** Given the current high base, high ~83% capacity utilisation, delays at new plants, reduced margins, and the absence of abnormal pandemic-driven growth, we maintain our HOLD rating on the stock with an unchanged TP of Rs 4,250, based on an FY24E EV/EBITDA multiple of 26x – in line with the stock's 1Y forward multiple.

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	DIVI IN/Rs 3,726
Market cap	US\$ 12.4bn
Free float	48%
3M ADV	US\$ 26.2mn
52wk high/low	Rs 5,425/Rs 3,366
Promoter/FPI/DII	52%/21%/16%

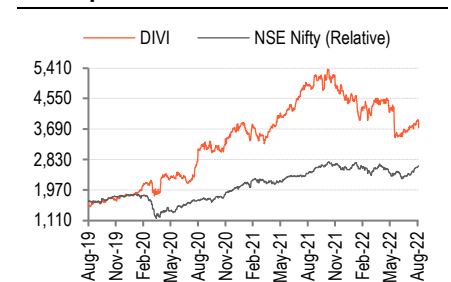
Source: NSE | Price as of 12 Aug 2022

## Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	89,598	98,075	1,09,046
EBITDA (Rs mn)	38,819	38,265	42,545
Adj. net profit (Rs mn)	29,604	27,427	30,552
Adj. EPS (Rs)	111.5	103.3	115.1
Consensus EPS (Rs)	111.5	100.7	114.3
Adj. ROAE (%)	28.2	22.6	22.7
Adj. P/E (x)	33.4	36.1	32.4
EV/EBITDA (x)	25.1	25.2	22.4
Adj. EPS growth (%)	49.2	(7.4)	11.4

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

## Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Sales</b>	<b>22,545</b>	<b>19,606</b>	<b>15.0</b>	<b>25,184</b>	<b>(10.5)</b>	<b>89,598</b>	<b>69,694</b>	<b>28.6</b>
<b>EBITDA</b>	<b>8,467</b>	<b>8,521</b>	<b>(0.6)</b>	<b>11,044</b>	<b>(23.3)</b>	<b>38,819</b>	<b>28,599</b>	<b>35.7</b>
Depreciation	837	733	-	810		3,115	2,556	-
EBIT	7,630	7,788	(2.0)	10,234	(25.4)	35,704	26,044	37.1
Interest	1	3	-	1	-	8	9	-
Other Income	884	360	-	524	-	1,139	626	-
PBT	8,513	8,145	4.5	10,757	(20.9)	36,835	26,660	38.2
Less: Taxation	1,493	2,574	-	1,811	-	7,231	6,818	-
Less: Minority Interest	0	0	-	0	-	0	0	-
<b>Recurring PAT</b>	<b>7,020</b>	<b>5,571</b>	<b>26.0</b>	<b>8,946</b>	<b>(21.5)</b>	<b>29,605</b>	<b>19,843</b>	<b>49.2</b>
Exceptional items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>7,020</b>	<b>5,571</b>	<b>26.0</b>	<b>8,946</b>	<b>(21.5)</b>	<b>29,605</b>	<b>19,843</b>	<b>49.2</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	64.0	67.2	(326)	66.7	(272)	66.9	66.7	23
EBITDA Margin	37.6	43.5	(590)	43.9	(630)	43.3	41.0	229
Tax / PBT	17.5	31.6	-	16.8	-	19.6	25.6	-
NPM	31.1	28.4	-	35.5	-	33.0	28.5	-
EPS (Rs)	26.4	21.0	-	33.7	-	111.5	74.8	-

Source: Company, BOBCAPS Research

## Valuation methodology

Given the current high base, high ~83% capacity utilisation, delays at new plants, reduced margins, and the absence of abnormal pandemic-driven growth, we maintain our HOLD rating on the stock with an unchanged TP of Rs 4,250, based on an FY24E EV/EBITDA multiple of 26x – in line with the stock’s one-year forward multiple.

**Fig 2 – Key assumptions**

Parameter	FY22A	FY23E	FY24E
Revenue	89.6	98.1	109.0
EBITDA	38.8	39.2	42.5
EBITDA Margin (%)	43.3	40.0	39.0
EPS (Rs)	111.5	106.2	115.1

Source: Company, BOBCAPS Research

**Fig 3 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
DIVI	DIVI IN	HOLD	4,250	4.7	25.1	22.6	27.5	29.9	26.0
LAURUS	LAURUS IN	HOLD	645	21.7	18.2	15.2	27.9	28.5	17.0

Source: BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- earlier-than-expected revival in generic API business,
- reduced inflationary environment,
- continued demand for pandemic-led drugs, and
- faster-than-expected progress on delayed facilities.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.1	1,278	1,500	BUY
Alembic Pharma	ALPM IN	1.6	653	770	HOLD
Alkem Labs	ALKEM IN	4.4	2,957	3,220	HOLD
Aurobindo Pharma	ARBP IN	4.4	593	695	BUY
Cipla	CIPLA IN	10.4	1,027	1,100	BUY
Divi's Labs	DIVI IN	12.4	3,726	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.9	4,261	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	695	970	BUY
Glenmark Life Sciences	GLS IN	0.7	438	560	BUY
Laurus Labs	LAURUS IN	3.8	566	645	BUY
Lupin	LPC IN	3.9	683	600	SELL
Sun Pharma	SUNP IN	27.5	913	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 12 Aug 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Total revenue</b>	<b>53,944</b>	<b>69,694</b>	<b>89,598</b>	<b>98,075</b>	<b>1,09,046</b>
EBITDA	18,221	28,599	38,819	38,265	42,545
Depreciation	1,862	2,556	3,115	3,547	3,872
EBIT	16,359	26,044	35,704	34,718	38,674
Net interest inc./(exp.)	(61)	(9)	(8)	0	0
Other inc./(exp.)	1,896	626	1,139	0	0
Exceptional items	0	0	0	0	0
EBT	18,194	26,660	36,835	34,718	38,674
Income taxes	4,406	6,818	7,231	7,291	8,121
Extraordinary items	821	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>14,610</b>	<b>19,843</b>	<b>29,604</b>	<b>27,427</b>	<b>30,552</b>
Adjustments	(821)	0	0	0	0
<b>Adjusted net profit</b>	<b>13,789</b>	<b>19,843</b>	<b>29,604</b>	<b>27,427</b>	<b>30,552</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	5,907	7,632	7,957	9,146	10,026
Other current liabilities	5,777	6,874	8,192	8,192	8,192
Provisions	230	278	309	309	309
Debt funds	344	43	8	0	0
Other liabilities	0	0	0	0	0
Equity capital	531	531	531	531	531
Reserves & surplus	71,682	92,415	1,16,751	1,24,438	1,43,938
Shareholders' fund	72,213	92,946	1,17,282	1,24,969	1,44,469
<b>Total liab. and equities</b>	<b>84,471</b>	<b>1,07,772</b>	<b>1,33,747</b>	<b>1,42,615</b>	<b>1,62,995</b>
Cash and cash eq.	1,252	21,704	28,189	39,921	55,024
Accounts receivables	14,134	16,765	24,239	22,442	24,952
Inventories	18,639	21,452	28,286	27,222	30,267
Other current assets	3,718	3,704	4,363	4,314	4,314
Investments	9,714	1	720	720	720
Net fixed assets	27,732	36,947	43,142	45,594	47,723
CWIP	9,196	7,106	4,699	2,292	(114)
Intangible assets	87	92	109	109	109
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>84,471</b>	<b>1,07,772</b>	<b>1,33,747</b>	<b>1,42,615</b>	<b>1,62,995</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Cash flow from operations</b>	<b>15,473</b>	<b>18,634</b>	<b>19,144</b>	<b>35,074</b>	<b>29,749</b>
Capital expenditures	(13,083)	(9,105)	(7,574)	(3,593)	(3,593)
Change in investments	9,742	9,713	(719)	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(3,342)</b>	<b>608</b>	<b>(8,293)</b>	<b>(3,593)</b>	<b>(3,593)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(712)	(301)	(35)	(8)	0
Interest expenses	(61)	(9)	(8)	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(11,931)	1,520	(4,323)	(19,740)	(11,053)
<b>Cash flow from financing</b>	<b>(12,704)</b>	<b>1,210</b>	<b>(4,366)</b>	<b>(19,748)</b>	<b>(11,053)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(573)</b>	<b>20,452</b>	<b>6,484</b>	<b>11,732</b>	<b>15,103</b>
<b>Closing cash &amp; cash eq.</b>	<b>1,253</b>	<b>21,704</b>	<b>28,189</b>	<b>39,921</b>	<b>55,024</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	55.0	74.7	111.5	103.3	115.1
Adjusted EPS	51.9	74.7	111.5	103.3	115.1
Dividend per share	19.9	27.0	40.3	37.4	41.6
Book value per share	272.0	350.1	441.7	470.7	544.1

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	18.0	14.0	10.9	9.8	8.8
EV/EBITDA	53.2	34.1	25.1	25.2	22.4
Adjusted P/E	71.7	49.9	33.4	36.1	32.4
P/BV	13.7	10.6	8.4	7.9	6.8

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	75.8	74.4	80.4	79.0	79.0
Interest burden (PBT/EBIT)	111.2	102.4	103.2	100.0	100.0
EBIT margin (EBIT/Revenue)	30.3	37.4	39.8	35.4	35.5
Asset turnover (Rev./Avg TA)	16.3	18.1	18.5	17.7	17.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.1	1.1	1.1
<b>Adjusted ROAE</b>	<b>19.4</b>	<b>24.0</b>	<b>28.2</b>	<b>22.6</b>	<b>22.7</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	9.1	29.2	28.6	9.5	11.2
EBITDA	(2.7)	57.0	35.7	(1.4)	11.2
Adjusted EPS	1.9	43.9	49.2	(7.4)	11.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	33.8	41.0	43.3	39.0	39.0
EBIT margin	30.3	37.4	39.8	35.4	35.5
Adjusted profit margin	25.6	28.5	33.0	28.0	28.0
Adjusted ROAE	19.4	24.0	28.2	22.6	22.7
ROCE	18.6	23.1	27.1	21.8	21.9
<b>Working capital days (days)</b>					
Receivables	87	81	84	84	84
Inventory	123	105	101	101	101
Payables	94	106	96	96	96
<b>Ratios (x)</b>					
Gross asset turnover	1.3	1.3	1.4	1.4	1.5
Current ratio	3.2	4.3	5.2	5.3	6.2
Net interest coverage ratio	269.9	2,993.5	4,463.0		
<b>Adjusted debt/equity</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.4)</b>

Source: Company, BOBCAPS Research | Note: TA = Total Assets

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

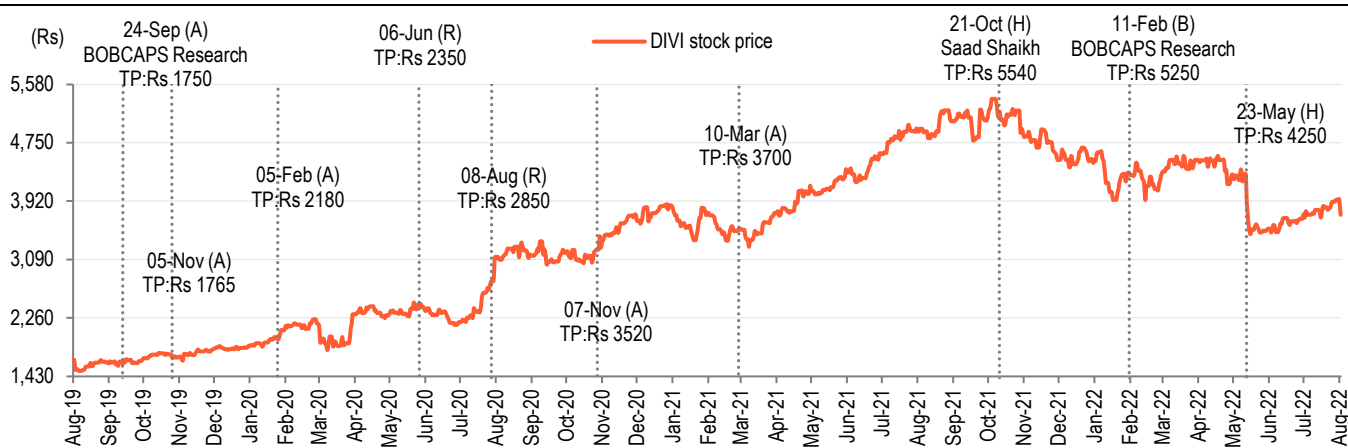
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): DIVI'S LABS (DIVI IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

### Rating distribution

As of 31 July 2022, out of 119 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 71 have BUY ratings, 26 have HOLD ratings, 5 are rated ADD\*, 1 is rated REDUCE\* and 16 are rated SELL. Of these, 2 companies rated BUY and 1 rated ADD have been investment banking clients in the last 12 months. (\*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

### Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

### General disclaimers

BOBCAPS is engaged in the business of Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions 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. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation

or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

#### **Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014**

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company or third party in the past 12 months in connection with research report/activities. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.