

HOLD

TP: Rs 3,450 | ▲ 1%

DIVI'S LABS

| Pharmaceuticals

| 09 November 2022

Disappointing quarter

- Q2 revenue fell 7% YoY to Rs 18.5bn, weighed down by a decline in custom synthesis business
- Weaker product mix and continued input cost pressures pulled EBITDA margin down 770bps YoY to 33.5%
- We cut FY23/FY24 EBITDA 17%/13% and lower our EV/EBITDA multiple to 24x, yielding a new TP of Rs 3,450 (vs. Rs 4,250); retain HOLD

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Slowdown in custom synthesis business: DIVI's Q2FY23 revenue decreased 7% YoY to Rs 18.5bn owing to a 26% decline in the custom synthesis business which offset the 20% growth in generic APIs (active pharma ingredients). Sequentially, custom synthesis revenue fell 33% due to the absence of Covid product sales (Molnupiravir), whereas growth in generic APIs was muted at just 2% QoQ.

Generic business guided to ramp up from FY24: DIVI's generic pipeline is based on patents expiring over FY23-FY25 (~US\$ 20bn market) and is guided to start contributing from FY24 onwards. The company has received several phase-2/3 contracts in the custom synthesis business and expects good results from these as well as from a few fast-tracked projects in coming quarters.

EBITDA margin contracts: Q2 gross margin contracted 340bps YoY to 63.6% (stable QoQ) due to a substantially lower contribution from the high-margin custom synthesis business and elevated material costs. EBITDA margin dropped 770bps YoY to 33.5% on the back of continued inflationary pressure and negative operating leverage which pushed up power, fuel and transport costs as a percentage of sales.

Earnings call highlights: (1) DIVI's generic/custom synthesis product mix stood at 57%/43% in Q2. (2) Nutraceutical revenue was at Rs 1.6bn. (3) Assets worth Rs 890mn/Rs 2bn were capitalised in Q2/H1. (4) Overall capacity utilisation stood at 80-83% (80% for nutraceuticals). (6) In constant currency terms, Q2/H1 revenue fell 13%/2%. Forex gain for these periods totalled Rs 308mn/Rs 872mn.

Maintain HOLD; TP cut to Rs 3,450: Given the high base of FY22, strong ~83% capacity utilisation, delays at new plants, reduced margins, and the absence of abnormal pandemic-driven growth, we cut FY23/FY24 EBITDA estimates by 17%/13%. Further, to reflect the lack of immediate triggers, we lower our FY24E EV/EBITDA multiple to 24x (from 26x) – in line with stock's 5Y average. This yields a revised TP of Rs 3,450 (vs. Rs 4,250). Maintain HOLD on limited upside potential.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	DIVI IN/Rs 3,415
Market cap	US\$ 11.1bn
Free float	48%
3M ADV	US\$ 25.4mn
52wk high/low	Rs 5,093/Rs 3,366
Promoter/FPI/DII	52%/21%/16%

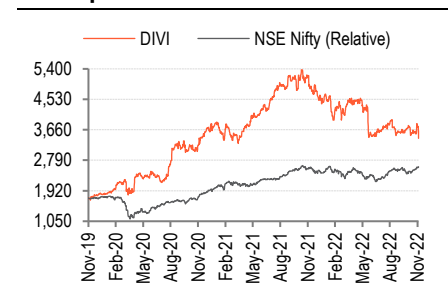
Source: NSE | Price as of 7 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	89,598	86,077	94,685
EBITDA (Rs mn)	38,819	31,891	36,974
Adj. net profit (Rs mn)	29,199	23,577	26,664
Adj. EPS (Rs)	110.0	88.8	100.4
Consensus EPS (Rs)	110.0	93.0	100.0
Adj. ROAE (%)	27.8	19.6	20.3
Adj. P/E (x)	31.0	38.5	34.0
EV/EBITDA (x)	22.9	27.6	23.5
Adj. EPS growth (%)	47.2	(19.3)	13.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	18,545	19,875	(6.7)	22,545	(17.7)	41,091	39,482	4.1
EBITDA	6,210	8,181	(24.1)	8,467	(26.7)	14,677	16,701	(12.1)
Depreciation	857	774	-	837	-	1,694	1,506	-
EBIT	5,353	7,407	(27.7)	7,630	(29.8)	12,984	15,195	(14.6)
Interest	2	2	-	1	-	3	5	-
Other Income	493	191	-	320	-	812	354	-
PBT	5,844	7,596	(23.1)	7,949	(26.5)	13,793	15,545	(11.3)
Less: Taxation	1,216	1,532	-	1,493	-	2,709	4,105	-
Less: Minority Interest	0	0	-	0	-	0	0	-
Recurring PAT	4,628	6,065	(23.7)	6,456	(28.3)	11,084	11,439	(3.1)
Exceptional items	308	0	-	564	-	872	196	-
Reported PAT	4,936	6,065	(18.6)	7,020	(29.7)	11,956	11,636	2.8
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	63.6	67.1	(343)	64.0	(36)	63.8	67.1	(333)
EBITDA Margin	33.5	41.2	(767)	37.6	(407)	35.7	42.3	(658)
Tax / PBT	20.8	20.2	-	18.8	-	19.6	26.4	-
NPM	25.0	30.5	-	28.6	-	27.0	29.0	-
EPS (Rs)	17.4	22.8	-	24.3	-	41.8	43.1	-

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Custom Synthesis	7,975	10,733	(25.7)	11,949	(33.3)	19,923	20,536	(3.0)
Generic APIs	8,941	7,463	19.8	8,736	2.3	17,677	15,886	11.3
Nutraceuticals	1,630	1,680	(3.0)	1,860	(12.4)	3,490	3,060	14.1
Total	18,545	19,875	(6.7)	22,545	(17.7)	41,091	39,482	4.1

Source: Company, BOBCAPS Research

Valuation methodology

Given the high base of FY22, strong ~83% capacity utilisation, delays at new plants, reduced margins, and the absence of abnormal pandemic-driven growth, we cut our FY23/FY24 EBITDA estimates by 17%/13%. Further, to reflect the lack of immediate triggers and delay in Kakinada capex, we lower our FY24E EV/EBITDA multiple to 24x (from 26x) – in line with stock’s five-year average. This yields a revised TP of Rs 3,450 (vs. Rs 4,250). Maintain HOLD on limited upside potential.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	86.1	94.7	98.1	109.0	(12.2)	(13.2)
EBITDA	31.9	37.0	38.3	42.5	(16.7)	(13.1)
EBITDA Margin (%)	37.0	39.0	39.0	39.0	(197bps)	3bps
EPS (Rs)	88.8	100.4	103.3	115.1	(14.0)	(12.7)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY22A	FY23E	FY24E
Generic API	30.4	34.1	37.5
Custom Synthesis	52.9	44.9	49.4
Nutraceuticals	6.3	7.0	7.7

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (x)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
DIVI	DIVI IN	HOLD	3,450	(2.4)	27.7	23.9	24.5	26.5	24
LAURUS	LAURUS IN	HOLD	540	14.9	16.3	14.2	26.3	26.4	16

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.

Key downside risks are:

- demand uptick in Molnupiravir in case of Covid escalation,
- softening of input costs,
- easing pressure on API pricing, and
- fast-track business from custom synthesis customers.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.0	1,246	1,470	HOLD
Alembic Pharma	ALPM IN	1.5	628	770	HOLD
Alkem Labs	ALKEM IN	4.7	3,227	3,220	HOLD
Aurobindo Pharma	ARBP IN	4.0	557	695	BUY
Cipla	CIPLA IN	11.2	1,131	1,320	BUY
Divi's Labs	DIVI IN	11.1	3,415	3,450	HOLD
Dr Reddy's Labs	DRRD IN	9.1	4,485	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	718	970	BUY
Glenmark Life Sciences	GLS IN	0.7	437	535	BUY
Laurus Labs	LAURUS IN	3.0	464	540	HOLD
Lupin	LPC IN	4.0	710	600	SELL
Sun Pharma	SUNP IN	30.2	1,028	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 7 Nov 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	53,944	69,694	89,598	86,077	94,685
EBITDA	18,221	28,599	38,819	31,891	36,974
Depreciation	1,862	2,556	3,115	3,547	3,872
EBIT	16,359	26,044	35,704	28,344	33,102
Net interest inc./(exp.)	(61)	(9)	(8)	0	0
Other inc./(exp.)	1,896	626	733	1,500	650
Exceptional items	0	0	0	0	0
EBT	18,194	26,660	36,429	29,844	33,752
Income taxes	4,406	6,818	7,231	6,267	7,088
Extraordinary items	821	0	406	872	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	14,610	19,843	29,604	24,449	26,664
Adjustments	(821)	0	(406)	(872)	0
Adjusted net profit	13,789	19,843	29,199	23,577	26,664

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	5,907	7,632	7,957	8,140	8,706
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	1,22,537	1,39,556
Shareholders' fund	72,213	92,946	1,17,282	1,23,068	1,40,087
Total liab. and equities	84,471	1,07,772	1,33,747	1,39,709	1,57,292
Cash and cash eq.	1,252	21,704	28,189	43,090	56,594
Accounts receivables	14,134	16,765	24,239	19,696	21,666
Inventories	18,639	21,452	28,286	23,892	26,281
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
Total assets	84,471	1,07,772	1,33,747	1,39,709	1,57,292

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	15,473	18,634	19,144	37,165	26,743
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
Cash flow from investing	(3,342)	608	(8,293)	(3,593)	(3,593)
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)	(18,663)	(9,646)
Cash flow from financing	(12,704)	1,210	(4,366)	(18,671)	(9,646)
Chg in cash & cash eq.	(573)	20,452	6,484	14,901	13,504
Closing cash & cash eq.	1,253	21,704	28,189	43,090	56,594

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	55.0	74.7	111.5	92.1	100.4
Adjusted EPS	51.9	74.7	110.0	88.8	100.4
Dividend per share	19.9	27.0	40.3	33.3	36.3
Book value per share	272.0	350.1	441.7	463.5	527.6

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	16.4	12.8	9.9	10.2	9.2
EV/EBITDA	48.7	31.2	22.9	27.6	23.5
Adjusted P/E	65.7	45.7	31.0	38.5	34.0
P/BV	12.6	9.8	7.7	7.4	6.5

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	75.8	74.4	80.2	79.0	79.0
Interest burden (PBT/EBIT)	111.2	102.4	102.0	105.3	102.0
EBIT margin (EBIT/Revenue)	30.3	37.4	39.8	32.9	35.0
Asset turnover (Rev./Avg TA)	16.3	18.1	18.5	15.7	15.9
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.1	1.1	1.1
Adjusted ROAE	19.4	24.0	27.8	19.6	20.3

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	9.1	29.2	28.6	(3.9)	10.0
EBITDA	(2.7)	57.0	35.7	(17.8)	15.9
Adjusted EPS	1.9	43.9	47.2	(19.3)	13.1
Profitability & Return ratios (%)					
EBITDA margin	33.8	41.0	43.3	37.0	39.0
EBIT margin	30.3	37.4	39.8	32.9	35.0
Adjusted profit margin	25.6	28.5	32.6	27.4	28.2
Adjusted ROAE	19.4	24.0	27.8	19.6	20.3
ROCE	18.6	23.1	26.7	18.9	19.6
Working capital days (days)					
Receivables	87	81	84	84	84
Inventory	123	105	101	101	101
Payables	94	106	96	96	96
Ratios (x)					
Gross asset turnover	1.3	1.3	1.4	1.3	1.3
Current ratio	3.2	4.3	5.2	5.5	6.3
Net interest coverage ratio	269.9	2,993.5	4,463.0		
Adjusted debt/equity	(0.1)	(0.2)	(0.2)	(0.4)	(0.4)

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

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

BUY – Expected return >+15%

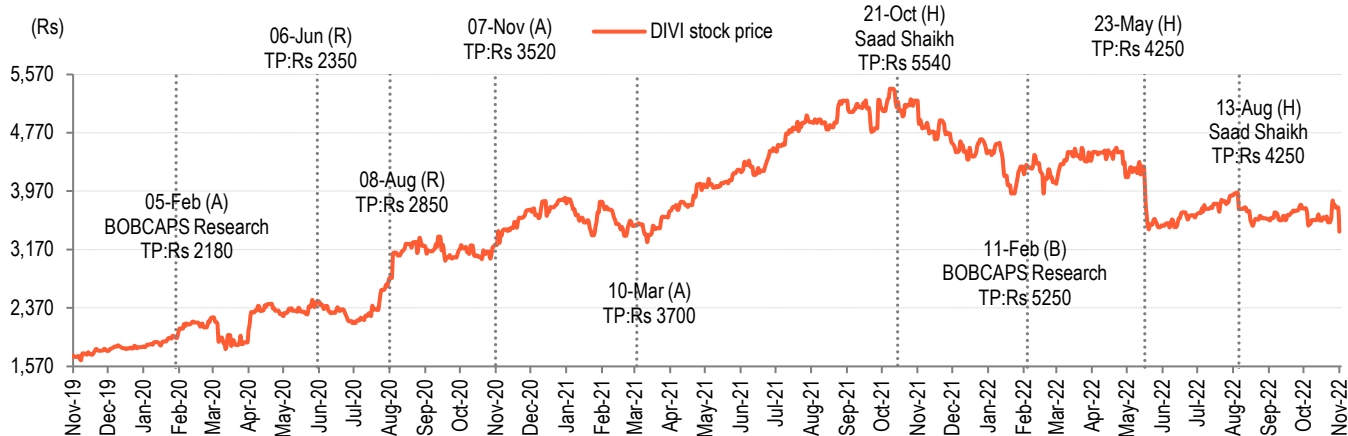
HOLD – Expected return from -6% to +15%

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

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