

**SELL**

TP: Rs 2,800 | ▼ 20%

**DIVI'S LABS**

| Pharmaceuticals

| 06 November 2023

**Growth remains elusive; cut to SELL**

- Dull Q2 with EBITDA/PAT plunging 21%/29% YoY, missing consensus by a wide margin
- Gross/EBITDA margins contracted 600bps/780bps YoY amid price erosion, inventory write-off and product mix change
- We cut FY24/FY25 EBITDA margin forecasts 300-400bps and downgrade from HOLD to SELL with revised TP of Rs 2,800 (vs. Rs 3,200)

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**Modest revenue growth:** DIVI reported modest revenue growth of 3% YoY (+7% QoQ) to Rs 19.1bn, coming in 2% below Bloomberg consensus. Per management, excluding Covid-led growth from both the year-ago base and current quarter, consolidated revenue grew in double digits. On a reported basis, generic APIs grew just 5% YoY (+6% QoQ) to Rs 9.4bn and custom synthesis declined 4% (+7% QoQ) to Rs 7.6bn, while nutraceuticals posted a strong 26% uptick (+15% QoQ) to Rs 2.1bn.

**Pricing pressure, inventory write-off and poor product mix sap margins:** Gross/EBITDA margins contracted 600bps/780bps YoY to 57.6%/25.7% due to a product mix change towards generics, pricing pressure in generic APIs and inventory write-off for Covid products (~Rs 200mn). With the likely commencement of Unit-3 by FY25, the company expects opex to rise in tandem, making margin recovery elusive, in our view.

**Earnings call highlights:** (1) DIVI's generic-to-custom synthesis revenue breakup was at 60:40 in Q2. (2) Forex gain stood at Rs 110mn vs. Rs 310mn in the year-ago quarter. (3) Exports formed ~87% of revenue with sales to Europe/US at ~68% of the revenue. (4) DIVI capitalised assets worth Rs 910mn/Rs 1.2bn in Q2/H1. (5) CWIP was ~Rs 5bn, including Rs 2.6bn for Kakinada. (6) As of 30 Sep 2023, the company had cash on books of Rs 36bn, receivables of Rs 18.6bn and inventory of Rs 29.7bn.

**Downgrade to SELL:** We lower our FY24-FY25 revenue estimates by 8% each and cut our EBITDA margin assumptions by 300-400bps in light of the weak H1FY24 performance. The guidance of higher opex in FY25 upon commercialisation of Unit-3 reinforces our expectations of added margin pressure. DIVI is trading at FY24E/FY25E EV/EBITDA valuations of 33x/28x which appear rich. We continue to ascribe an FY25E EV/EBITDA multiple of 22x to the stock, which is a 25% discount to the 5Y average multiple. Based on our revised estimates, our TP is reset to Rs 2,800 (vs. Rs 3,200) and carries 20% downside – we thus downgrade the stock to SELL from HOLD.

**Key changes**

Target	Rating
▼	▼

Ticker/Price	DIVI IN/Rs 3,507
Market cap	US\$ 11.3bn
Free float	48%
3M ADV	US\$ 18.4mn
52wk high/low	Rs 3,935/Rs 2,730
Promoter/FPI/DII	52%/15%/22%

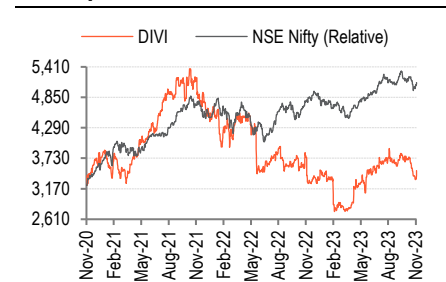
Source: NSE | Price as of 6 Nov 2023

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	77,675	82,391	92,119
EBITDA (Rs mn)	23,678	26,908	31,467
Adj. net profit (Rs mn)	16,937	19,773	20,824
Adj. EPS (Rs)	63.8	74.6	78.4
Consensus EPS (Rs)	63.8	71.0	89.0
Adj. ROAE (%)	13.8	15.2	15.0
Adj. P/E (x)	55.0	47.0	44.7
EV/EBITDA (x)	38.3	33.3	28.2
Adj. EPS growth (%)	(42.0)	17.0	5.1

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
<b>Net Sales</b>	<b>19,090</b>	<b>18,545</b>	<b>2.9</b>	<b>17,780</b>	<b>7.4</b>	<b>36,870</b>	<b>41,091</b>	<b>(10.3)</b>
<b>EBITDA</b>	<b>4,900</b>	<b>6,210</b>	<b>(21.1)</b>	<b>5,070</b>	<b>(3.4)</b>	<b>9,970</b>	<b>14,677</b>	<b>(32.1)</b>
Depreciation	950	857	-	930	-	1,880	1,694	-
<b>EBIT</b>	<b>3,950</b>	<b>5,353</b>	<b>(26.2)</b>	<b>4,140</b>	<b>(4.6)</b>	<b>8,090</b>	<b>12,984</b>	<b>(37.7)</b>
Interest	10	2	-	0	-	10	3	-
Other Income	860	493	-	810	-	1,670	812	-
<b>PBT</b>	<b>4,800</b>	<b>5,844</b>	<b>(17.9)</b>	<b>4,950</b>	<b>(3.0)</b>	<b>9,750</b>	<b>13,793</b>	<b>(29.3)</b>
Less: Taxation	1,210	1,216	-	1,360	-	2,570	2,709	-
Less: Minority Interest	0	0	-	0	-	0	0	-
<b>Recurring PAT</b>	<b>3,590</b>	<b>4,628</b>	<b>(22.4)</b>	<b>3,590</b>	<b>0.0</b>	<b>7,180</b>	<b>11,084</b>	<b>(35.2)</b>
Exceptional items	(110)	308	-	(30)	-	(140)	872	-
<b>Reported PAT</b>	<b>3,480</b>	<b>4,936</b>	<b>(29.5)</b>	<b>3,560</b>	<b>(2.2)</b>	<b>7,040</b>	<b>11,956</b>	<b>(41.1)</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	57.6	63.6	(605)	61.3	(374)	59.4	63.8	(445)
EBITDA Margin	25.7	33.5	(782)	28.5	(285)	27.0	35.7	(868)
Tax / PBT	25.2	20.8	-	27.5	-	26.4	19.6	-
NPM	18.8	25.0	-	20.2	-	19.5	27.0	-
EPS (Rs)	13.5	17.4	-	13.5	-	27.0	41.8	-

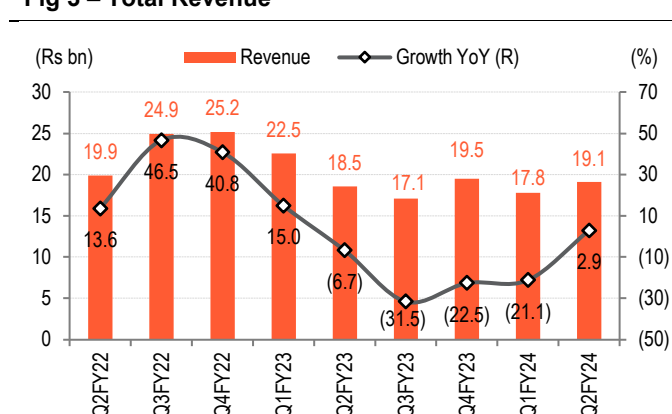
Source: Company, BOBCAPS Research

**Fig 2 – Revenue mix**

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Custom Synthesis	7,636	7,975	(4.2)	7,112	7.4	14,748	19,923	(26.0)
Generic APIs	9,404	8,939	5.2	8,888	5.8	18,292	17,675	3.5
Nutraceuticals	2,050	1,632	25.6	1,780	15.2	3,830	3,492	9.7
<b>Total</b>	<b>19,090</b>	<b>18,545</b>	<b>2.9</b>	<b>17,780</b>	<b>7.4</b>	<b>36,870</b>	<b>41,091</b>	<b>(10.3)</b>

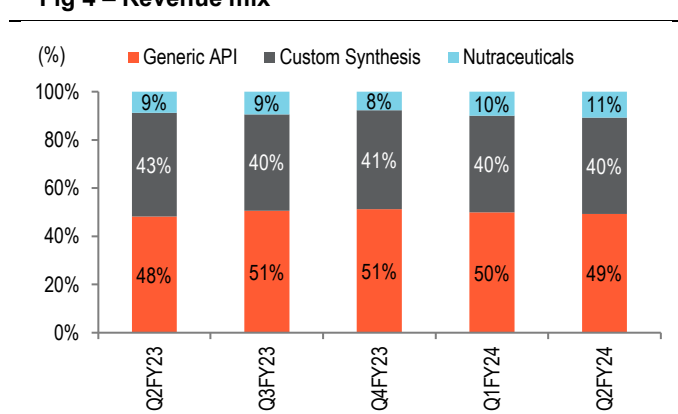
Source: Company, BOBCAPS Research

**Fig 3 – Total Revenue**



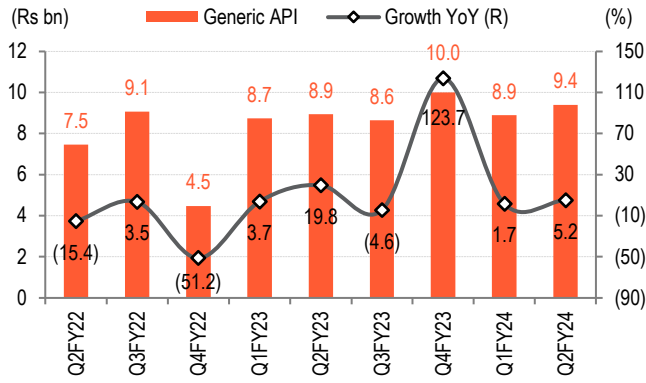
Source: Company, BOBCAPS Research

**Fig 4 – Revenue mix**



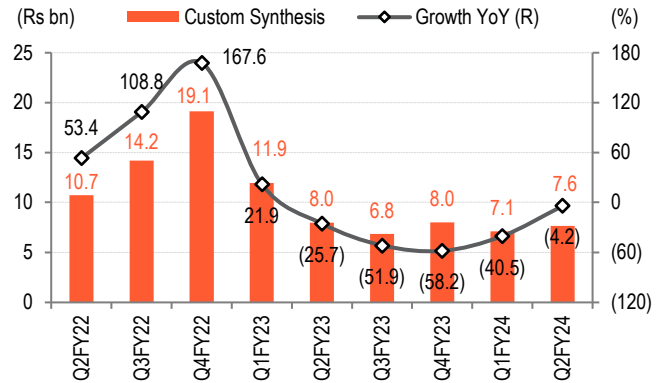
Source: Company, BOBCAPS Research

**Fig 5 – Generic API revenue**



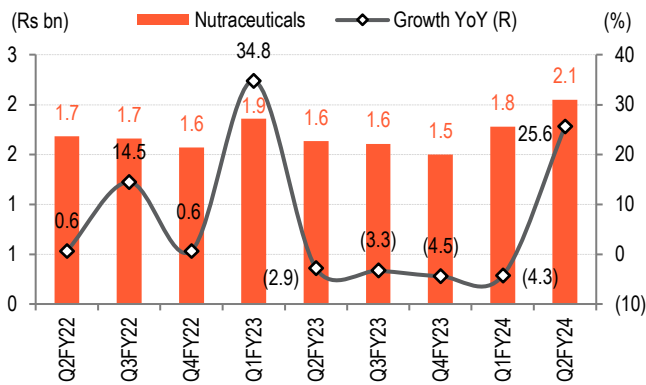
Source: Company, BOBCAPS Research

**Fig 6 – Custom synthesis revenue**



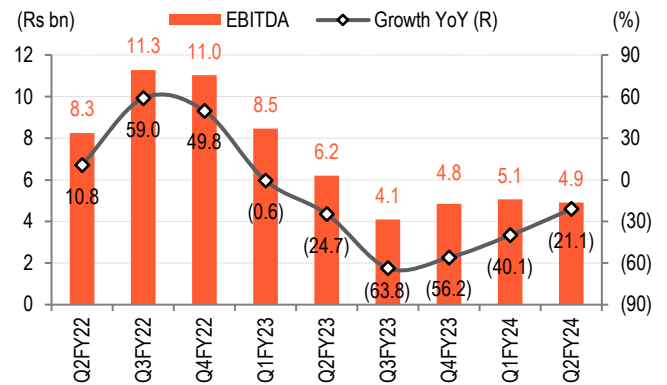
Source: Company, BOBCAPS Research

**Fig 7 – Nutraceutical revenue**



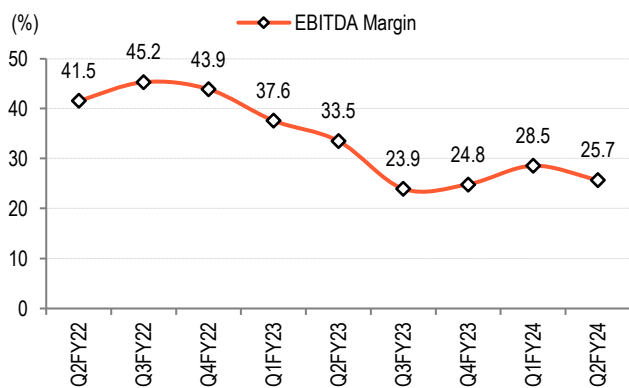
Source: Company, BOBCAPS Research

**Fig 8 – EBITDA**



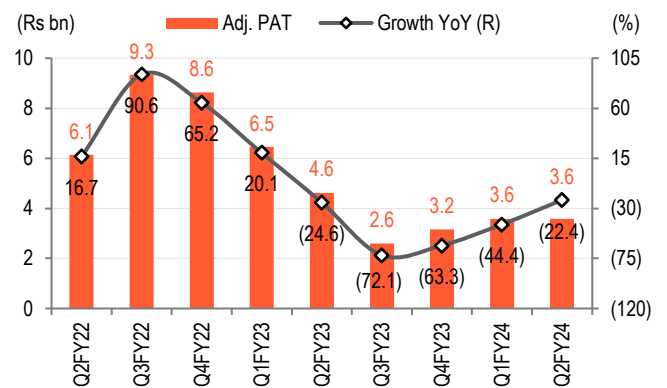
Source: Company, BOBCAPS Research

**Fig 9 – EBITDA margin**



Source: Company, BOBCAPS Research

**Fig 10 – Adj. PAT**



Source: Company, BOBCAPS Research

## Valuation methodology

We lower our FY24-FY25 revenue estimates by 8% each and cut our EBITDA margin assumptions by 300-400bps in light of the weak H1FY24 performance. The guidance of higher opex in FY25 upon commercialisation of Unit-3 reinforces our expectations of added margin pressure.

DIVI is trading at FY24E/FY25E EV/EBITDA valuations of 33x/28x which appear rich. We continue to ascribe an FY25E EV/EBITDA multiple of 22x to the stock, which is a 25% discount to the five-year average multiple. Based on our revised estimates, our TP is reset to Rs 2,800 (vs. Rs 3,200) and carries 20% downside – we thus downgrade the stock to SELL from HOLD.

**Fig 11 – Revised estimates**

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	82.4	92.1	103.0	89.4	100.0	NA	(7.8)	(7.8)	NA
EBITDA	26.9	31.5	36.2	32.7	37.0	NA	(17.6)	(15.0)	NA
EBITDA margin (%)	32.7	34.2	35.2	36.5	37.0	NA	(389bps)	(289bps)	NA
EPS (Rs)	74.6	78.4	90.4	87.8	98.7	NA	(15.0)	(20.6)	NA

Source: BOBCAPS Research

**Fig 12 – Key assumptions**

Revenue (Rs bn)	FY23A	FY24E	FY25E	FY26E
Generic API	36.3	34.5	38.7	43.3
CS	34.8	40.0	44.8	50.1
Nutraceuticals	6.6	7.9	8.7	9.6

Source: Company, BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- moderation in price erosion in generic APIs,
- ramp-up in custom synthesis revenue faster than expected, being a lumpy business, and
- lower input prices thereby improving margins.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.8	1,817	2,070	BUY
Alembic Pharma	ALPM IN	1.7	731	615	HOLD
Alkem Labs	ALKEM IN	5.6	3,825	3,300	SELL
Aurobindo Pharma	ARBP IN	6.2	874	880	HOLD
Cipla	CIPLA IN	11.8	1,204	1,360	BUY
Divi's Labs	DIVI IN	11.3	3,507	2,800	SELL
Dr Reddy's Labs	DRRD IN	10.8	5,338	5,500	HOLD
Eris Lifesciences	ERIS IN	1.4	861	955	BUY
Glenmark Life Sciences	GLS IN	0.9	619	620	HOLD
Laurus Labs	LAURUS IN	2.4	372	340	HOLD
Lupin	LPC IN	6.6	1,199	800	SELL
Sun Pharma	SUNP IN	33.6	1,150	1,200	HOLD

Source: BOBCAPS Research, NSE | Price as of 6 Nov 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Total revenue</b>	<b>89,598</b>	<b>77,675</b>	<b>82,391</b>	<b>92,119</b>	<b>103,000</b>
EBITDA	38,819	23,678	26,908	31,467	36,213
Depreciation	3,115	3,432	3,883	4,401	4,919
EBIT	35,704	20,246	23,024	27,065	31,294
Net interest inc./(exp.)	(8)	(7)	0	0	0
Other inc./(exp.)	733	2,150	3,340	700	700
Exceptional items	0	0	0	0	0
EBT	36,429	22,389	26,364	27,765	31,994
Income taxes	7,231	5,453	6,591	6,941	7,998
Extraordinary items	406	1,297	98	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>29,605</b>	<b>18,234</b>	<b>19,871</b>	<b>20,824</b>	<b>23,995</b>
Adjustments	(406)	(1,297)	(98)	0	0
<b>Adjusted net profit</b>	<b>29,199</b>	<b>16,937</b>	<b>19,773</b>	<b>20,824</b>	<b>23,995</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	7,957	7,625	8,212	8,942	9,730
Other current liabilities	8,192	8,731	8,731	8,731	8,731
Provisions	309	355	355	355	355
Debt funds	8	5	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	531	531	531	531	531
Reserves & surplus	116,751	127,140	131,280	144,571	159,885
Shareholders' fund	117,282	127,671	131,811	145,102	160,416
<b>Total liab. and equities</b>	<b>133,747</b>	<b>144,387</b>	<b>149,110</b>	<b>163,131</b>	<b>179,234</b>
Cash and cash eq.	28,189	42,415	46,446	52,118	59,759
Accounts receivables	24,239	17,925	19,187	21,452	23,986
Inventories	28,286	30,004	25,959	29,024	32,452
Other current assets	4,363	3,927	3,867	3,867	3,867
Investments	720	771	771	771	771
Net fixed assets	43,142	47,142	53,259	58,857	63,938
CWIP	4,699	2,119	(462)	(3,042)	(5,623)
Intangible assets	109	84	84	84	84
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>133,747</b>	<b>144,387</b>	<b>149,110</b>	<b>163,131</b>	<b>179,234</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Cash flow from operations</b>	<b>19,144</b>	<b>25,802</b>	<b>27,228</b>	<b>20,624</b>	<b>23,741</b>
Capital expenditures	(7,574)	(4,827)	(7,420)	(7,420)	(7,420)
Change in investments	(719)	(50)	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(8,293)</b>	<b>(4,877)</b>	<b>(7,420)</b>	<b>(7,420)</b>	<b>(7,420)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(35)	(3)	(5)	0	0
Interest expenses	(8)	(7)	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(4,323)	(6,689)	(15,773)	(7,533)	(8,681)
<b>Cash flow from financing</b>	<b>(4,366)</b>	<b>(6,699)</b>	<b>(15,778)</b>	<b>(7,533)</b>	<b>(8,681)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>6,485</b>	<b>14,226</b>	<b>4,031</b>	<b>5,672</b>	<b>7,641</b>
<b>Closing cash &amp; cash eq.</b>	<b>28,189</b>	<b>42,415</b>	<b>46,446</b>	<b>52,118</b>	<b>59,759</b>

### Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	111.5	68.7	75.0	78.4	90.4
Adjusted EPS	110.0	63.8	74.6	78.4	90.4
Dividend per share	40.3	24.8	27.1	28.4	32.7
Book value per share	441.7	480.9	496.5	546.5	604.2

### Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	10.2	11.7	10.9	9.6	8.6
EV/EBITDA	23.6	38.3	33.3	28.2	24.3
Adjusted P/E	31.9	55.0	47.0	44.7	38.8
P/BV	7.9	7.3	7.1	6.4	5.8

### DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	80.2	75.6	75.0	75.0	75.0
Interest burden (PBT/EBIT)	102.0	110.6	114.5	102.6	102.2
EBIT margin (EBIT/Revenue)	39.8	26.1	27.9	29.4	30.4
Asset turnover (Rev./Avg TA)	18.5	14.0	14.0	14.8	15.0
Leverage (Avg TA/Avg Equity)	1.1	1.1	1.1	1.1	1.1
Adjusted ROAE	27.8	13.8	15.2	15.0	15.7

### Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>YoY growth (%)</b>					
Revenue	28.6	(13.3)	6.1	11.8	11.8
EBITDA	35.7	(39.0)	13.6	16.9	15.1
Adjusted EPS	47.2	(42.0)	17.0	5.1	15.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	43.3	30.5	32.7	34.2	35.2
EBIT margin	39.8	26.1	27.9	29.4	30.4
Adjusted profit margin	32.6	21.8	24.0	22.6	23.3
Adjusted ROAE	27.8	13.8	15.2	15.0	15.7
ROCE	26.7	13.3	14.6	14.4	15.1
<b>Working capital days (days)</b>					
Receivables	84	99	85	85	85
Inventory	101	137	115	115	115
Payables	96	93	95	95	95
<b>Ratios (x)</b>					
Gross asset turnover	1.4	1.1	1.0	1.0	1.0
Current ratio	5.2	5.6	5.5	5.9	6.4
Net interest coverage ratio	4,463.0	3,021.8	-	-	-
Adjusted debt/equity	(0.2)	(0.3)	(0.4)	(0.4)	(0.4)

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

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**BUY** – Expected return >+15%

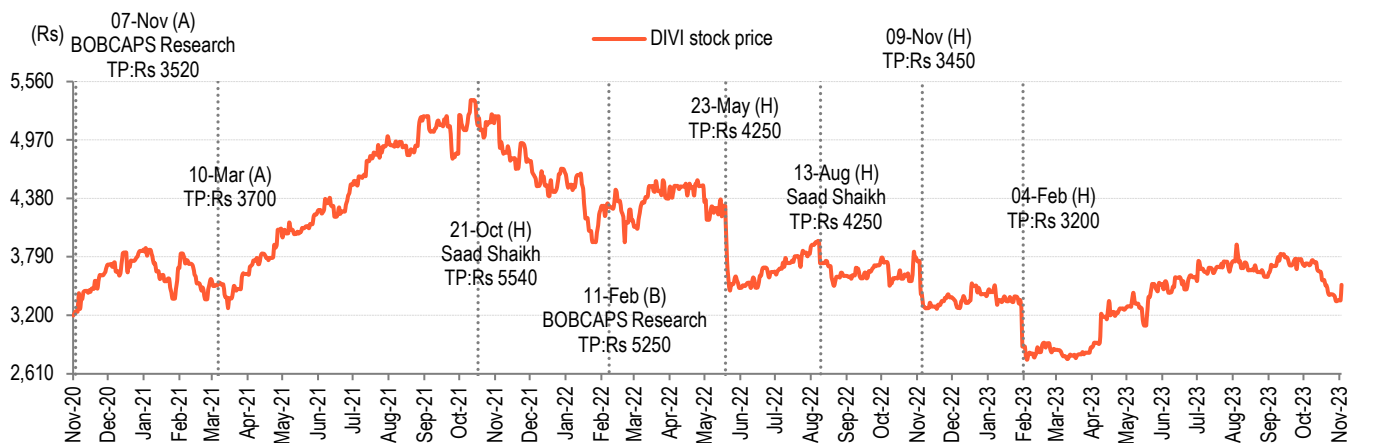
**HOLD** – Expected return from -6% to +15%

**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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