

HOLD

TP: Rs 4,250 | ▲ 9%

DIVI'S LABS

| Pharmaceuticals

| 23 May 2022

Strong all-round beat but growth unsustainable – cut to HOLD

- Robust standalone Q4 revenue/EBITDA growth of 45%/57% YoY, ahead of consensus by 11%/17%
- Covid-led growth surge looks unsustainable; inflationary environment, and increased costs likely to sap margins
- We cut FY23-FY24 EBITDA 9-15% and reset to 26x EV/EBITDA (vs. 27x), yielding a new TP of Rs 4,250 (vs. Rs 5,250); downgrade to HOLD

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Growth to rationalise as Covid-led surge ebbs: DIVI reported a 45%/57% YoY increase in standalone Q4FY22 revenue/EBITDA to Rs 25bn/Rs 11bn, beating consensus estimates by 11%/17%. We believe this abnormal growth was derived from Covid-led drugs (similar to last quarter) and is unsustainable going forward with pandemic subsiding all over the world except China. We thus foresee lower growth on a higher base. On the margin front as well, the inflationary environment coupled with a growth taper would weigh on performance.

Q4 growth led by custom synthesis business; generic volumes intact: During the quarter, the custom synthesis business grew 60% QoQ while generic APIs recorded a decline of 66% QoQ. Management highlighted that there was no reduction in volumes or loss of customers in the generics business and expects generic sales to rebound in the next 6-12 months.

Capacity upgrades helping to reduce geopolitical risk: DIVI's recent investments toward capacity upgrades are yielding fruit in terms of securing the supply of intermediates and curbing geopolitical risk. The company plans to further invest Rs 20bn-30bn over the next 2-3 years for capacity expansion/upgrades in order to tap US\$ 20bn worth of molecules that are going off-patent in 3-5 years. Per management, several soon-to-be off-patent molecules are coming from small biopharma companies. DIVI sees large potential in these upcoming molecules and will focus on the ones that offer a long growth runway.

Growth outlook muted; cut to HOLD: Given the current high base, ~85% capacity utilisation, delays at new plants as well as reduced margins and the absence of abnormal growth, we cut our FY23-FY24 EBITDA estimates by 9-15% and lower our target EV/EBITDA multiple from 27x to 26x (implied P/E multiple of 37x) – in line with 5-year average multiple. Our revised TP now stands at Rs 4,250 (Rs 5,250 earlier), offering just 9% upside – downgrade from BUY to HOLD.

Key changes

Target	Rating
▼	▼

Ticker/Price	DIVI IN/Rs 3,898
Market cap	US\$ 13.3bn
Free float	48%
3M ADV	US\$ 24.5mn
52wk high/low	Rs 5,425/Rs 3,789
Promoter/FPI/DII	52%/21%/16%

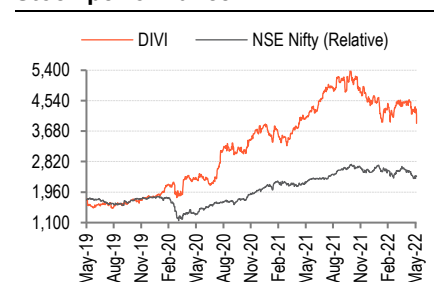
Source: NSE | Price as of 23 May 2022

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	39,246	42,545
Adj. net profit (Rs mn)	29,604	28,202	30,552
Adj. EPS (Rs)	111.5	106.2	115.1
Consensus EPS (Rs)	111.5	108.0	126.2
Adj. ROAE (%)	28.2	23.2	22.6
Adj. P/E (x)	35.0	36.7	33.9
EV/EBITDA (x)	26.2	25.7	23.5
Adj. EPS growth (%)	49.2	(4.7)	8.3

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

Stock performance



Source: NSE



Fig 1 – Quarterly performance (Standalone)

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Net Sales	24,950	17,184	45.2	24,668	1.1	88,798	67,986	30.6
EBITDA	10,960	6,994	56.7	10,999	(0.4)	38,659	28,213	37.0
Depreciation	808	698	-	797	-	3,106	2,546	-
EBIT	10,152	6,295	61.3	10,202	(0.5)	35,554	25,667	38.5
Interest	4	2	-	2	-	10	7	-
Other Income	212	196	-	166	-	733	626	-
PBT	10,360	6,489	59.7	10,366	(0.1)	36,277	26,286	38.0
Less: Taxation	1,827	1,643	-	1,294	-	7,280	6,731	-
Less: Minority Interest	0	0	-	0	-	0	0	--
Recurring PAT	8,533	4,847	76.1	9,072	(5.9)	28,997	19,555	48.3
Exceptional items	293	33	-	0	-	485	(8)	-
Reported PAT	8,826	4,879	80.9	9,072	(2.7)	29,482	19,547	50.8
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	65.2	68.0	(284)	66.5	(134)	66.3	66.7	(35)
EBITDA Margin	43.9	40.7	323	44.6	(66)	43.5	41.5	204
Tax / PBT	17.6	25.3	-	12.5	-	20.1	25.6	-
NPM	34.2	28.2	-	36.8	-	32.7	28.8	-
EPS (Rs)	32.1	18.3	-	34.2	-	109.2	73.7	-

Source: Company, BOBCAPS Research

Fig 2 – Segmental mix (Standalone)

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Custom Synthesis	19,680	6,703	193.6	12,334	59.6	52,391	27,194	92.7
Generic APIs	3,700	8,922	(58.5)	10,774	(65.7)	30,217	34,842	(13.3)
Nutraceuticals	1,570	1,560	0.6	1,560	0.6	6,190	5,950	4.0
Total	24,950	17,185	45.2	24,668	1.1	88,798	67,986	30.6

Source: Company, BOBCAPS Research

Earnings call takeaways

- **Revenue:** DIVI crossed US\$ 1bn in revenue in FY22. Management refrained from giving out guidance but expects growth to slow down from a high base. The company indicated that it did not lose any customers or volumes in generics during the year, and expects growth to rebound in the next 6-12 months.
- **Revenue mix:** The mix for FY22 stood at 41:59 for the generic and custom synthesis businesses (60:40 in FY21). Exports accounted for 90% of revenue, with the US and Europe contributing 77% of the overall revenue for the year.
- **Capacity utilisation:** Current utilisation is ~80% but varies between 80% and 85%. Unutilised capacity can take on 5-10 large projects.
- **Capacity expansion:** Debottlenecking, backward integration and expansion have helped DIVI reduce reliance on procurement of intermediates and curbed geopolitical risk. Infrastructure upgrades continued in Q4FY22. With capacities in place, the company believes it is poised to take on any opportunity. Its capacities are multi-purpose and can be used to readily produce volumes on short notice.
- **Capex:** DIVI will spend Rs 20bn-30bn in capex over the next 2-3 years, which could be increased to Rs 40bn-50bn as well.
- **Kakinada plant:** The company is awaiting government approval for the Kakinada (Andhra Pradesh) plant.
- **Contrast media:** Management highlighted that there are only two players in the world apart from DIVI in contrast media in five major products. The opportunity is high but entry is difficult. Management expects good improvement in numbers over the next 2-3 years. Iodine prices have surged to US\$ 65-70/kg vs. US\$ 15 earlier.
- **Asset capitalisation:** DIVI has capitalised assets worth Rs 9.4bn in FY22; CWIP stands at 4.7bn.
- **Cash position:** Cash on the company's books is in excess of Rs 28bn.
- **Tax rate:** DIVI had a lower tax rate of 20% in FY22 on account of the commencement of commercial production at new facilities in SEZs.

Valuation methodology

Given the current high base, ~85% capacity utilisation, delays at new plants as well as reduced margins and the expected growth taper, we cut our FY23-FY24 EBITDA estimates by 9-15% and lower our target EV/EBITDA multiple from 27x to 26x (implied P/E multiple of 37x) – in line with 5-year average multiple. Our revised TP now stands at Rs 4,250 (from Rs 5,250 earlier), offering just 9% upside – downgrade from BUY to HOLD.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	98.1	109.0	98.0	113.0	0.1	(3.5)
EBITDA	39.2	42.5	42.9	50.1	(8.6)	(15.0)
EBITDA Margin (%)	40.0	39.0	43.8	44.3	(378bps)	(528bps)
EPS (Rs)	106.2	115.1	114.6	135.1	(7.3)	(14.8)

Source: BOBCAPS Research

Fig 4 – 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 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
DIVI	DIVI IN	HOLD	4,250	14.2	29.7	27.4	87.3	89.4	26.0
LAURUS	LAURUS IN	HOLD	645	11.0	18.7	15.6	26.5	24.6	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	1.9	1,725	2,050	BUY
Alembic Pharma	ALPM IN	1.9	762	770	HOLD
Alkem Labs	ALKEM IN	4.6	2,986	3,400	BUY
Aurobindo Pharma	ARBP IN	4.2	559	850	BUY
Cipla	CIPLA IN	10.1	970	1,100	BUY
Divi's Labs	DIVI IN	13.3	3,898	4,250	HOLD
Dr Reddy's Labs	DRRD IN	9.2	4,275	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	711	970	BUY
Laurus Labs	LAURUS IN	4.0	573	645	HOLD
Lupin	LPC IN	3.6	619	600	SELL
Sun Pharma	SUNP IN	28.5	922	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 23 May 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	53,944	69,694	89,598	98,075	1,09,046
EBITDA	18,221	28,599	38,819	39,246	42,545
Depreciation	1,862	2,556	3,115	3,547	3,872
EBIT	16,359	26,044	35,704	35,699	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	35,699	38,674
Income taxes	4,406	6,818	7,231	7,497	8,121
Extraordinary items	821	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	14,610	19,843	29,604	28,202	30,552
Adjustments	(821)	0	0	0	0
Adjusted net profit	13,789	19,843	29,604	28,202	30,552

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	5,907	7,632	7,957	8,888	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	1,24,933	1,44,432
Shareholders' fund	72,213	92,946	1,17,282	1,25,464	1,44,963
Total liab. and equities	84,471	1,07,772	1,33,747	1,42,852	1,63,489
Cash and cash eq.	1,252	21,704	28,189	40,158	55,519
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
Total assets	84,471	1,07,772	1,33,747	1,42,852	1,63,489

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	15,473	18,634	19,144	35,591	30,006
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)	(20,020)	(11,053)
Cash flow from financing	(12,704)	1,210	(4,366)	(20,028)	(11,053)
Chg in cash & cash eq.	(573)	20,452	6,484	11,969	15,361
Closing cash & cash eq.	1,253	21,704	28,189	40,158	55,519

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	55.0	74.7	111.5	106.2	115.1
Adjusted EPS	51.9	74.7	111.5	106.2	115.1
Dividend per share	19.9	27.0	40.3	38.4	41.6
Book value per share	272.0	350.1	441.7	472.6	546.0

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	18.8	14.6	11.4	10.3	9.2
EV/EBITDA	55.7	35.6	26.2	25.7	23.5
Adjusted P/E	75.1	52.2	35.0	36.7	33.9
P/BV	14.3	11.1	8.8	8.2	7.1

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	36.4	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
Adjusted ROAE	19.4	24.0	28.2	23.2	22.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	9.1	29.2	28.6	9.5	11.2
EBITDA	(2.7)	57.0	35.7	1.1	8.4
Adjusted EPS	1.9	43.9	49.2	(4.7)	8.3
Profitability & Return ratios (%)					
EBITDA margin	33.8	41.0	43.3	40.0	39.0
EBIT margin	30.3	37.4	39.8	36.4	35.5
Adjusted profit margin	25.6	28.5	33.0	28.8	28.0
Adjusted ROAE	19.4	24.0	28.2	23.2	22.6
ROCE	18.6	23.1	27.1	22.4	21.9
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	1.4	1.5
Current ratio	3.2	4.3	5.2	5.4	6.2
Net interest coverage ratio	269.9	2,993.5	4,463.0		
Adjusted debt/equity	(0.1)	(0.2)	(0.2)	(0.3)	(0.4)

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

Disclaimer

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

BUY – Expected return >+15%

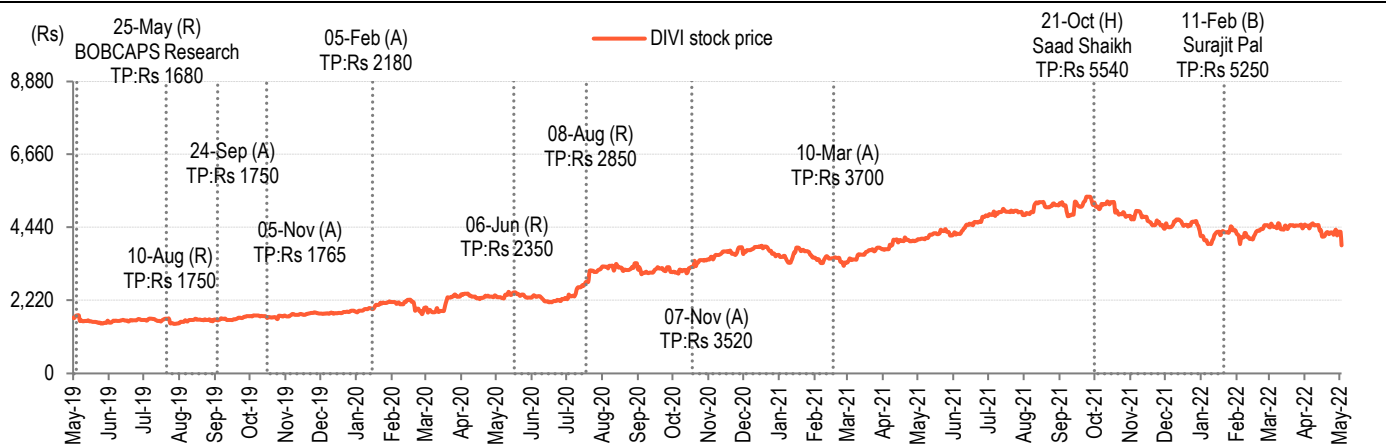
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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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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