

SELL

TP: Rs 5,253 | ▼ 12%

DIVI'S LABS

| Pharmaceuticals

| 10 November 2024

Healthy Q2; rich valuations

- DIVI reported healthy 2QFY25 earnings which was a beat on our estimates. Exports contributed 87% of sales and the US 71%
- EBITDA margin increased 500bps YoY to 30.6% in 2Q. We expect EBITDA margin to climb to 38% by FY27 on the GLP opportunity
- We maintain SELL and ascribe a higher P/E of 52x (five-year mean of 32x) and roll forward to Sep'26, with new TP of Rs 5,253 (from Rs 3,000)

Earnings exceed our estimates on all fronts: DIVI's earnings beat our estimates on all fronts where sales grew by 22% YoY to Rs 23.3bn (6.5% ahead of our estimate), EBITDA by 46% YoY to Rs 7.1bn (8.7% ahead of our estimate) and PAT by 42% YoY to Rs 5.1bn (12% above our estimate).

Custom synthesis drives growth, generics witness pricing pressure: DIVI's Q2 revenue growth was driven by higher interest and customer engagements. During the quarter, Custom Synthesis to Generics contribution sustained at 51%:49%. In generic APIs, DIVI reported 4% YoY growth despite facing price erosion pressure across the portfolio, which was offset by volume growth.

Margins increase amid elevated logistic costs: During Q2, raw material costs increased by 20% YoY and 14% QoQ due to the delay in transit days from 45 days to 70 days. However, it was offset by healthy CS sales and marginal decline in other expenses due to backward integration and better production efficiencies which resulted in EBITDA margin increasing by 500bps YoY and 130bps QoQ to 30.6%.

To participate in GLP opportunity in fragmented manner: Currently DIVI has 500 litres of reactors capacity in the qualification stage to participate in the GLP opportunity. It was supplying to innovator drug through liquid phase, however has now started investments for oral phase. DIVI is to supply only to innovator, and not generic, companies post patent expiry.

High demand for supply of peptides: DIVI is facing much demand for the supply of peptides and is working with customers whose products are in Phase 2 and 3 stages of development. DIVI has a decent order pipeline and expects to be a major player in this segment in the long term.

Maintain SELL: DIVI's generics segment is facing price erosion pressure and expects to supply GLP products in fragments, thereby margins unable to reach its peak of 40%. Hence, we maintain SELL, however ascribe higher P/E of 52x and roll forward our valuations to Sep'26, with a new TP of Rs 5,253 (from Rs 3,000).

Foram Parekh

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Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	DIVI IN/Rs 5,950
Market cap	US\$ 18.7bn
Free float	48%
3M ADV	US\$ 43.8mn
52wk high/low	Rs 6,276/Rs 3,350
Promoter/FPI/DII	52%/15%/22%

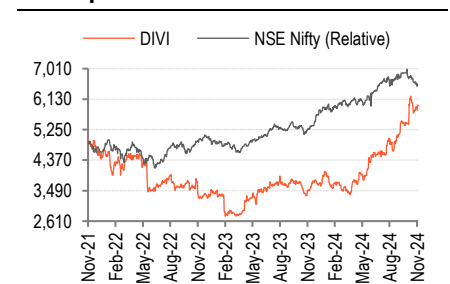
Source: NSE | Price as of 8 Nov 2024

Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	78,450	89,779	101,568
EBITDA (Rs mn)	22,050	28,289	34,035
Adj. net profit (Rs mn)	15,700	18,790	22,914
Adj. EPS (Rs)	59.1	70.8	86.3
Consensus EPS (Rs)	59.1	75.9	95.0
Adj. ROAE (%)	11.9	13.7	15.6
Adj. P/E (x)	100.6	84.1	68.9
EV/EBITDA (x)	69.9	54.4	45.4
Adj. EPS growth (%)	(7.6)	19.7	21.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

Custom synthesis

- Currently contributes 51% of DIVI's total sales.
- Witnessing increased interest and engagements from existing as well as new clients. Number of orders from existing and new clients is steadily increasing.
- DIVI continues to have a collaborative approach to this segment.

Generics

- Key products like Naproxen and Gabapentin are facing price erosion pressure. Prices are expected to stabilise in the next 6-12 months.
- Witnessed volume growth amidst pricing pressure in small and large molecules.
- DIVI has increased market share across small and large molecules. It will sustain 49% contribution to sales going forward.
- Future pipeline is robust. Many products are progressing towards the filing stage and those products are expected to go commercial in FY26.

Contrast media

- Witnessed 20-30% YoY volume growth in the quarter.
- Iodine-based products are in the qualification stage currently. Few are expected to advance to the commercial stage, where volume growth can be expected.
- Gadolinium-based compounds are in the qualification stage, and will become commercial in the next one to two years. DIVI is working with many customers for this compound.

GLP opportunity

- DIVI will not participate in end-to-end supply of APIs. It will manufacture in fragments.
- The company is currently in the investment phase of solid base peptide and is setting up 500 litres of capacity.
- On peptides, DIVI is working with several customers with different requirements, and products are in advanced stages, Phase 2 or 3, of development.
- DIVI will not supply peptides to generic players, but only to innovators.

Capex

- As on 2QFY25, DIVI's total capex spend was Rs 10bn and it expects Rs 16bn of total capex in FY25 including the Kakinada plant. Phase 1 of Unit 3 will commence from Dec'24.

Fig 1 – Quarterly financial highlights

(Rs mn)	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)
Net Sales	23,380	19,090	22.5	21,180	10.4
Total Expenses	16,220	14,190		14,960	
(%) of net sales	69.4	74.3		70.6	
Raw material consumed	9,690	8,100	19.6	8,530	13.6
(%) of net sales	41.4	42.4		40.3	
Staff cost	3,040	2,660	14.3	2,920	4.1
(%) of net sales	13.0	13.9	(93)	13.8	
R&D cost	0	0		0	
(%) of net sales	0	0		0	
SG&A	3,490	3,430	1.7	3,510	(0.6)
(%) of net sales	14.9	18.0	(304)	16.6	
EBITDA	7,160	4,900	46.1	6,220	15.1
Depreciation	990	950		970	
EBIT	6,170	3,950	56.2	5,250	17.5
Interest	0	10		0	
Other Income	1,060	860		790	
PBT	7,230	4,800	50.6	6,040	19.7
Less: Taxation	2,120	1,210		1,740	
Less: Minority Interest	0	0		0	
Recurring PAT	5,110	3,590	42.3	4,300	18.8
Exceptional items	0	(110)		0	
Reported PAT	5,110	3,480	46.8	4,300	18.8
Key Ratios (%)			(bps)		(bps)
Gross Margin	58.6	57.6	98	59.7	(117)
EBITDA Margin	30.6	25.7	496	29.4	126
Tax / PBT	29.3	25.2		28.8	
NPM	21.9	18.8		20.3	
EPS (Rs)	19.3	13.5		16.2	

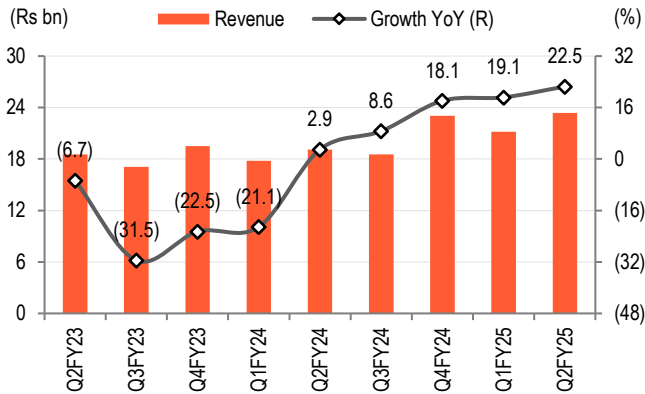
Source: Company, BOBCAPS Research

Fig 2 – Segmental revenue

(Rs mn)	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)
Custom Synthesis	11,456	7,636	50.0	10,378	10.4
Generic APIs	11,924	11,454	4.1	10,802	10.4
Total	23,381	19,090	22.5	21,180	10.4

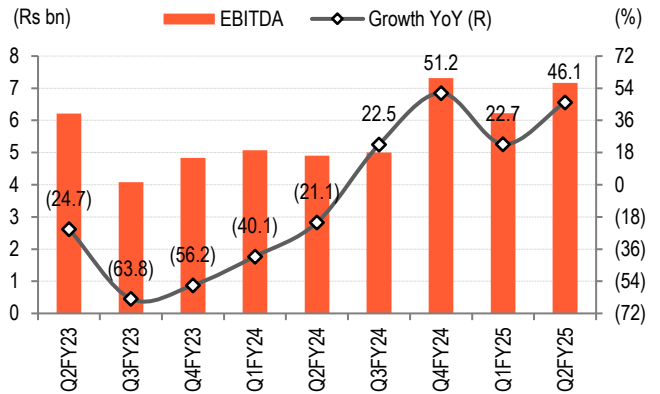
Source: Company, BOBCAPS Research

Fig 3 – Sales growth driven by higher Custom Synthesis sales



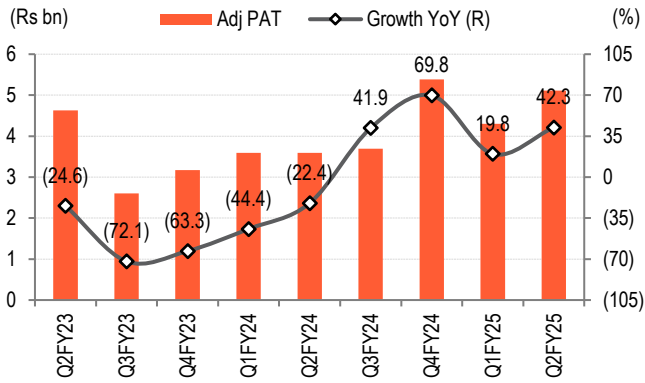
Source: Company, BOBCAPS Research

Fig 4 – EBITDA growth driven by high margin CS sales



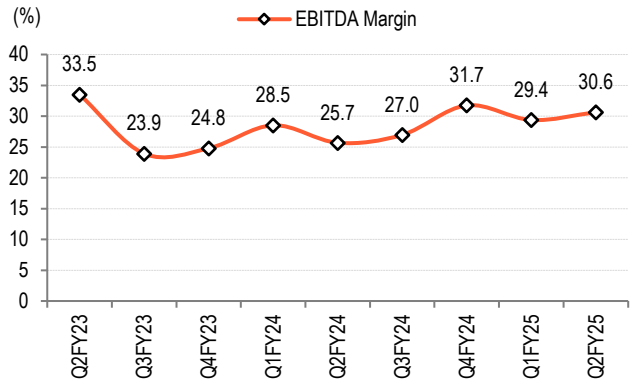
Source: Company, BOBCAPS Research

Fig 5 – Healthy operations led to higher growth



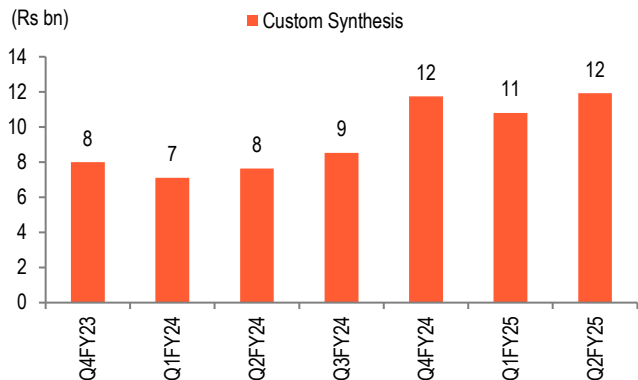
Source: Company, BOBCAPS Research

Fig 6 – EBITDA margin driven by lower other expense and high CS sales



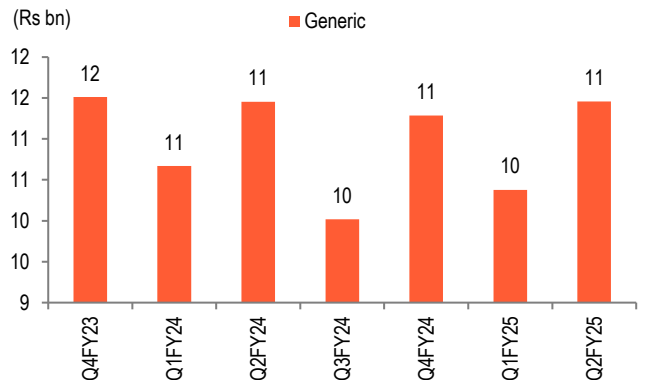
Source: Company, BOBCAPS Research

Fig 7 – CS sales driven by higher interest and engagement from innovator clients



Source: Company, BOBCAPS Research

Fig 8 – Generic sales growth driven by volume amidst pricing pressure



Source: Company, BOBCAPS Research

Valuation methodology

DIVI reported strong earnings and beat our estimates on all fronts despite pricing pressure in the Generic segment (49% of sales). However, there was no volume decline in the Generic segment despite pricing pressure. The Custom Synthesis segment witnessed increasing interest and engagement across customers. The future pipeline is robust for Generics as it continues to witness higher market share in small and large APIs. The Custom Synthesis segment is also witnessing higher numbers of Request for Quote (RFQs) and enquiries across customers, including the GLP opportunity which is to be supplied in fragments. Thus, we expect sales to grow at a CAGR of 15% and earnings at 28% for FY25-27.

However, due to higher capex of Rs 16bn expected in FY25, the slower start of unit 3 and fragmented opportunity for GLP products, we believe EBITDA margin will not climb to its earlier levels of 40%. Hence, we maintain our SELL recommendation. However, we ascribe a higher P/E of 52x (five-year average P/E of 32x) due to its leadership position in the CDMO space in India, and roll forward our valuations to Sep'26, with a new TP of Rs 5,253 (from Rs 3,000).

Fig 9 – Key assumptions

(Rs mn)	FY24	FY25E	FY26E	FY27E
Sales	78,450	89,779	101,568	117,757
EBITDA	22,050	28,289	34,035	44,641
PAT	15,700	18,790	22,914	30,731
EPS (Rs)	60.26	70.77	86.31	115.75
EBITDA Margin (%)	28.11	31.51	33.51	37.91
PAT Margin (%)	20.01	20.93	22.56	26.10

Source: Company, BOBCAPS Research

Key risks

Key upside risks to our estimates:

- Earlier-than-expected revival in generic API business
- Reduced inflationary environment
- Higher demand from innovators for the GLP opportunity
- Faster-than-expected progress on delayed facilities

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Total revenue	77,675	78,450	89,779	101,568	117,757
EBITDA	23,678	22,050	28,289	34,035	44,641
Depreciation	3,432	3,780	3,909	4,183	4,367
EBIT	20,246	18,270	24,380	29,852	40,274
Net interest inc./(exp.)	(7)	(30)	(27)	0	0
Other inc./(exp.)	2,203	3,090	700	700	700
Exceptional items	0	0	0	0	0
EBT	22,443	21,330	25,053	30,552	40,974
Income taxes	5,453	5,630	6,263	7,638	10,244
Extraordinary items	1,297	300	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	18,287	16,000	18,790	22,914	30,731
Adjustments	(1,297)	(300)	0	0	0
Adjusted net profit	16,990	15,700	18,790	22,914	30,731

Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Accounts payables	7,625	8,240	8,646	9,517	10,421
Other current liabilities	8,731	10,280	10,280	10,280	10,280
Provisions	355	440	440	440	440
Debt funds	5	30	20	20	20
Other liabilities	0	0	0	0	0
Equity capital	531	531	531	531	531
Reserves & surplus	128,503	134,379	138,835	153,919	174,148
Shareholders' fund	129,034	134,910	139,366	154,450	174,679
Total liab. and equities	145,751	153,900	158,751	174,706	195,840
Cash and cash eq.	43,736	38,999	28,914	32,608	39,133
Accounts receivables	17,925	21,560	22,137	25,044	29,036
Inventories	30,004	31,840	29,516	33,392	38,715
Other current assets	3,970	5,511	5,441	5,441	5,441
Investments	771	820	820	820	820
Net fixed assets	47,142	47,330	58,421	58,238	57,871
CWIP	2,119	7,780	13,441	19,102	24,764
Intangible assets	84	60	60	60	60
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	145,751	153,900	158,751	174,706	195,840

Cash Flows

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Cash flow from operations	25,856	14,598	24,948	21,186	173
Capital expenditures	(4,827)	(9,605)	(20,661)	(9,661)	(9,661)
Change in investments	(50)	(50)	0	0	1
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(4,877)	(9,654)	(20,661)	(9,661)	(9,660)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(3)	25	(10)	0	0
Interest expenses	(7)	(30)	(27)	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(8,108)	(9,676)	(14,334)	(7,830)	131,423
Cash flow from financing	(8,118)	(9,681)	(14,371)	(7,830)	131,423
Chg in cash & cash eq.	12,861	(4,737)	(10,085)	3,694	121,936
Closing cash & cash eq.	43,736	38,999	28,914	32,608	154,544

Per Share

Y/E 31 Mar (Rs)	FY23A	FY24A	FY25E	FY26E	FY27E
Reported EPS	68.9	60.3	70.8	86.3	115.7
Adjusted EPS	64.0	59.1	70.8	86.3	115.7
Dividend per share	30.0	29.8	30.0	29.5	39.6
Book value per share	486.0	508.1	524.9	581.7	657.9

Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24A	FY25E	FY26E	FY27E
EV/Sales	20.0	19.7	17.1	15.2	13.1
EV/EBITDA	65.6	69.9	54.4	45.4	34.7
Adjusted P/E	93.0	100.6	84.1	68.9	51.4
P/BV	12.2	11.7	11.3	10.2	9.0

DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24A	FY25E	FY26E	FY27E
Tax burden (Net profit/PBT)	75.7	73.6	75.0	75.0	75.0
Interest burden (PBT/EBIT)	110.8	116.7	102.8	102.3	101.7
EBIT margin (EBIT/Revenue)	26.1	23.3	27.2	29.4	34.2
Asset turnover (Rev./Avg TA)	13.8	13.1	14.4	15.2	15.9
Leverage (Avg TA/Avg Equity)	1.1	1.1	1.1	1.1	1.1
Adjusted ROAE	13.6	11.9	13.7	15.6	18.7

Ratio Analysis

Y/E 31 Mar	FY23A	FY24A	FY25E	FY26E	FY27E
YoY growth (%)					
Revenue	(13.3)	1.0	14.4	13.1	15.9
EBITDA	(39.0)	(6.9)	28.3	20.3	31.2
Adjusted EPS	(41.8)	(7.6)	19.7	21.9	34.1
Profitability & Return ratios (%)					
EBITDA margin	30.5	28.1	31.5	33.5	37.9
EBIT margin	26.1	23.3	27.2	29.4	34.2
Adjusted profit margin	21.9	20.0	20.9	22.6	26.1
Adjusted ROAE	13.6	11.9	13.7	15.6	18.7
ROCE	13.1	11.4	13.1	15.0	0.0
Working capital days (days)					
Receivables	99	92	90	90	0
Inventory	137	144	120	120	0
Payables	93	93	95	95	0
Ratios (x)					
Gross asset turnover	1.1	1.1	1.0	1.1	1.2
Current ratio	5.7	5.2	4.4	4.8	5.3
Net interest coverage ratio	3,021.8	609.0	891.5	-	-
Adjusted debt/equity	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)

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

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BUY – Expected return >+15%

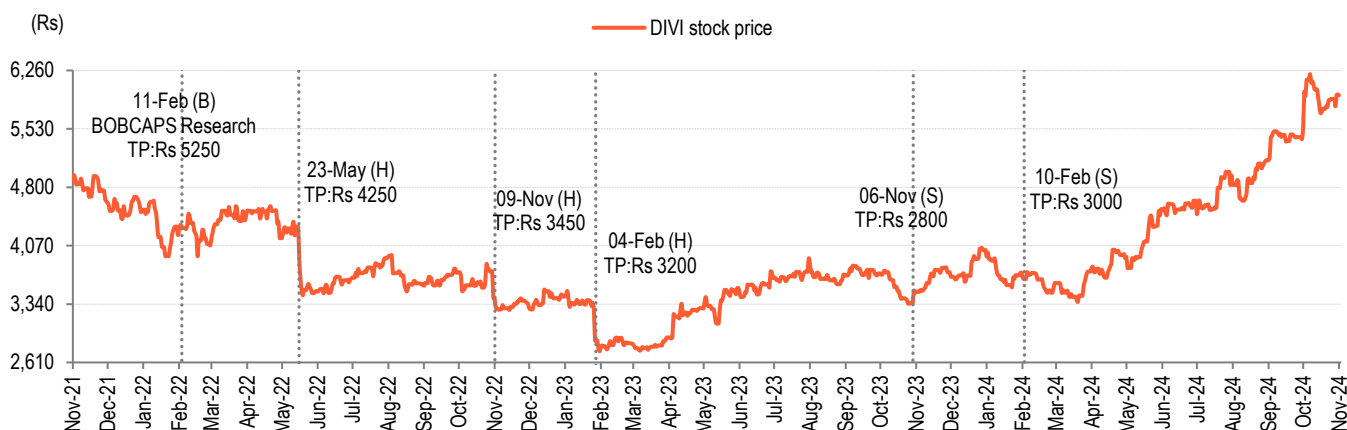
HOLD – Expected return from -6% to +15%

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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