

**SELL**  
 TP: Rs 3,000 | ▼ 18%

**DIVI'S LABS**

| Pharmaceuticals

| 10 February 2024

**Healthy margin recovery, heady valuations**

- Q3 revenue grew 9% YoY on 25% rise in custom synthesis business; API and nutraceuticals stayed soft
- Healthy margin recovery owing to a richer mix, softening raw material costs and low base of last year
- FY24-FY26 EBITDA estimates trimmed 7-13%; on rollover, our TP rises to Rs 3,000 (vs. Rs 2,800) – retain SELL on high valuations

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**Custom synthesis leads growth:** DIVI reported 9% YoY revenue growth in Q3FY24 to Rs 18.6bn, coming in 7% short of Bloomberg consensus. Generic active pharma ingredient (API) as well as nutraceutical business declined both YoY and QoQ, but custom synthesis grew at a healthy 25% YoY (+12% QoQ) as two big projects were commercialised and started supplies during the quarter. Management expects larger benefits in the coming quarters as volumes and shipments scale up.

**Pricing pressure in generic API persists:** Generic API/nutraceutical revenues declined 2%/5% YoY and 10%/25% QoQ due to persistent stress on prices. Management highlighted that the company has maintained market share despite pricing pressure and even gained 300-500bps of share in most high-volume products. DIVI expects the generic business to stabilise over the next 2-3 quarters.

**Margins expand but still short of historical levels:** A higher share of custom synthesis revenue at 46% (vs. 40% each in Q2FY24/Q3FY23) and easing raw material prices enabled gross margin improvement of 400bps YoY (300bps QoQ) to 60.7%. Expansion also came off a low base as the year-ago quarter saw one of the lowest ever margins. The soft base also benefitted EBITDA margin, which climbed 300bps YoY (130bps QoQ) to 27%.

**Earnings call highlights:** (1) DIVI is actively working on GLP-1 building blocks with innovators and envisages a good market opportunity. (2) As of 31 Dec 2023, the company has cash of Rs 39bn on its books. (3) Generic to Custom synthesis revenue breakup was 54:46 in Q3. (4) API business is guided to take a few quarters to normalise.

**Maintain SELL:** Given that DIVI's 9MFY24 EBITDA margin of 27% remains well below historical levels, we scale back our margin assumptions and trim FY24/FY25/ FY26 EBITDA estimates by 12%/7%/6%. The stock is trading at FY25E/FY26E EV/EBITDA valuations of 32x/30x which appear rich. We continue to ascribe the stock a 22x EV/EBITDA multiple (implied P/E of 35x), which is a 10% discount to the 10Y average, and roll valuations over to FY26E. This translates to a revised TP of Rs 3,000 (from Rs 2,800) that carries 18% downside – maintain SELL.

**Key changes**

Target	Rating
▲	◀ ▶

Ticker/Price	DIVI IN/Rs 3,652
Market cap	US\$ 11.8bn
Free float	48%
3M ADV	US\$ 20.6mn
52wk high/low	Rs 4,074/Rs 2,730
Promoter/FPI/DII	52%/15%/22%

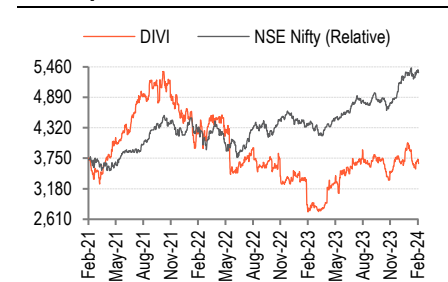
Source: NSE | Price as of 9 Feb 2024

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	77,675	78,114	89,401
EBITDA (Rs mn)	23,678	23,792	29,197
Adj. net profit (Rs mn)	16,990	17,520	19,472
Adj. EPS (Rs)	64.0	66.1	73.3
Consensus EPS (Rs)	64.0	63.6	84.4
Adj. ROAE (%)	13.9	13.6	14.3
Adj. P/E (x)	57.1	55.2	49.8
EV/EBITDA (x)	39.9	39.2	31.6
Adj. EPS growth (%)	(41.8)	3.4	10.9

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
<b>Net Sales</b>	<b>18,550</b>	<b>17,077</b>	<b>8.6</b>	<b>19,090</b>	<b>(2.8)</b>	<b>55,420</b>	<b>58,167</b>	<b>(4.7)</b>
<b>EBITDA</b>	<b>5,000</b>	<b>4,083</b>	<b>22.5</b>	<b>4,900</b>	<b>2.0</b>	<b>14,970</b>	<b>18,760</b>	<b>(20.2)</b>
Depreciation	950	868	-	950	-	2,830	2,562	-
EBIT	4,050	3,215	26.0	3,950	2.5	12,140	16,199	(25.1)
Interest	0	1	-	10	-	10	4	-
Other Income	950	676	-	860	-	2,620	1,488	-
PBT	5,000	3,890	28.6	4,800	4.2	14,750	17,682	(16.6)
Less: Taxation	1,310	1,288	-	1,210	-	3,880	3,997	-
Less: Minority Interest	0	0	-	0	-	0	0	-
<b>Recurring PAT</b>	<b>3,690</b>	<b>2,601</b>	<b>41.9</b>	<b>3,590</b>	<b>2.8</b>	<b>10,870</b>	<b>13,685</b>	<b>(20.6)</b>
Exceptional items	(110)	467	-	(110)	-	(250)	1,339	-
<b>Reported PAT</b>	<b>3,580</b>	<b>3,068</b>	<b>16.7</b>	<b>3,480</b>	<b>2.9</b>	<b>10,620</b>	<b>15,024</b>	<b>(29.3)</b>
<b>Key Ratios (%)</b>								
Gross Margin	60.7	56.7	401bps	57.6	313bps	59.8	61.7	(191bps)
EBITDA Margin	27.0	23.9	305bps	25.7	129bps	27.0	32.3	(524bps)
Tax / PBT	26.2	33.1	-	25.2	-	26.3	22.6	-
NPM	19.9	15.2	-	18.8	-	19.6	23.5	-
EPS (Rs)	13.9	9.8	-	13.5	-	40.9	51.6	-

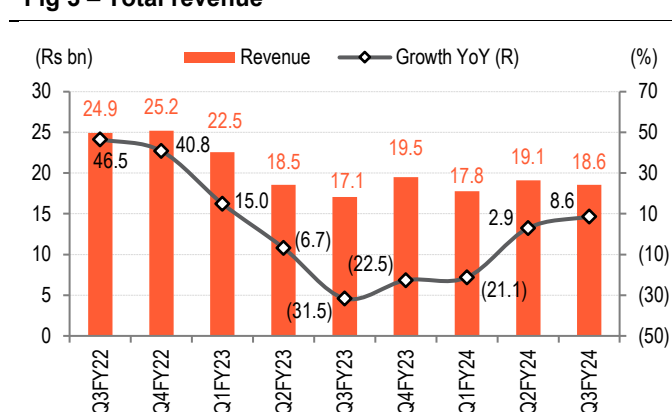
Source: Company, BOBCAPS Research

**Fig 2 – Revenue mix**

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Custom Synthesis	8,533	6,831	24.9	7,636	11.7	23,281	26,754	(13.0)
Generic APIs	8,487	8,641	(1.8)	9,404	(9.8)	26,779	26,316	1.8
Nutraceuticals	1,530	1,605	(4.7)	2,050	(25.4)	5,360	5,097	5.2
<b>Total</b>	<b>18,550</b>	<b>17,077</b>	<b>8.6</b>	<b>19,090</b>	<b>(2.8)</b>	<b>55,420</b>	<b>58,167</b>	<b>(4.7)</b>

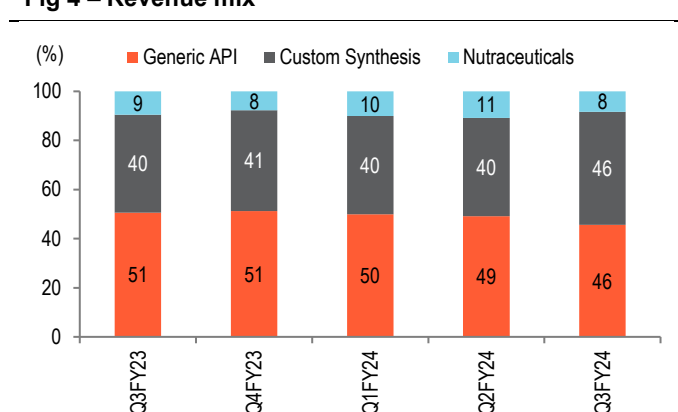
Source: Company, BOBCAPS Research

**Fig 3 – Total revenue**



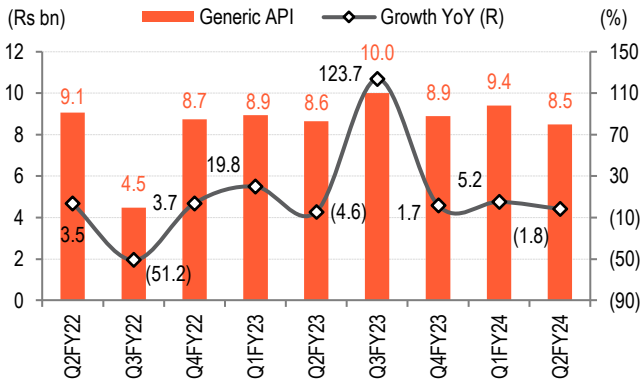
Source: Company, BOBCAPS Research

**Fig 4 – Revenue mix**



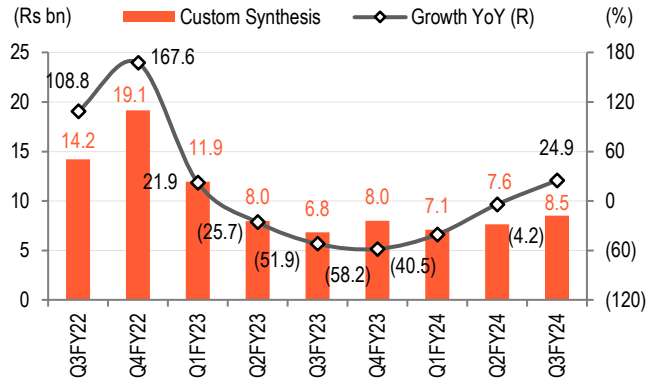
Source: Company, BOBCAPS Research

**Fig 5 – Generic API revenue**



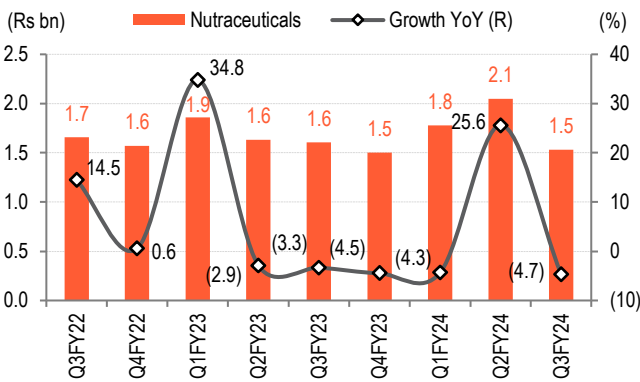
Source: Company, BOBCAPS Research

**Fig 6 – Custom synthesis revenue**



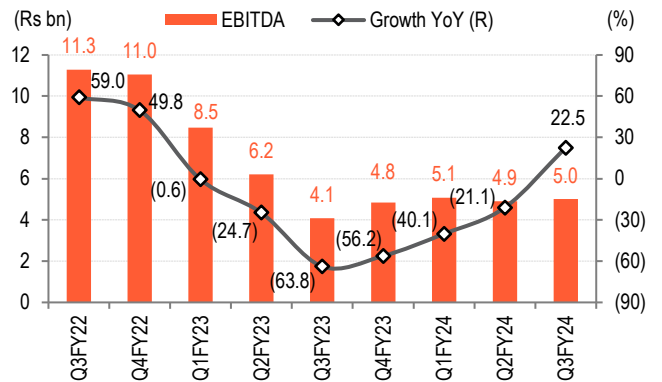
Source: Company, BOBCAPS Research

**Fig 7 – Nutraceutical revenue**



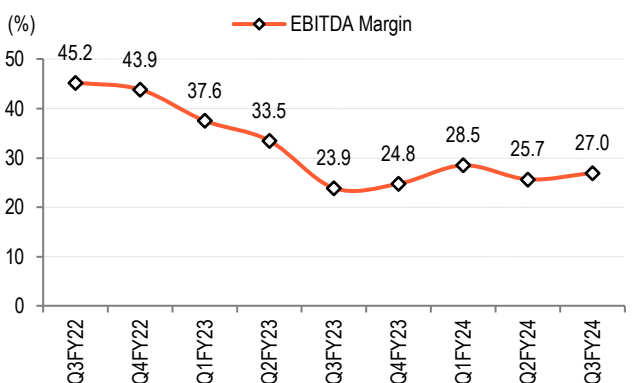
Source: Company, BOBCAPS Research

**Fig 8 – EBITDA**



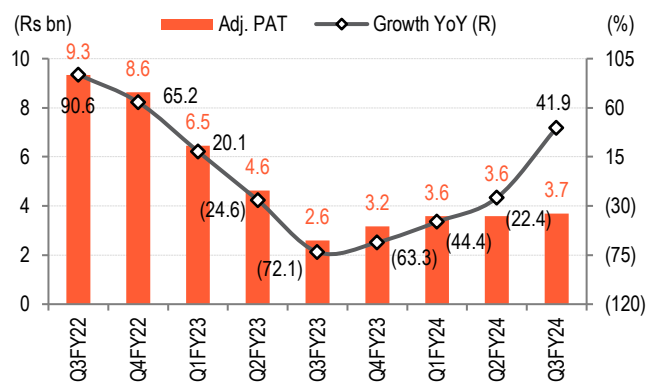
Source: Company, BOBCAPS Research

**Fig 9 – EBITDA margin**



Source: Company, BOBCAPS Research

**Fig 10 – Adj. PAT**



Source: Company, BOBCAPS Research

## Valuation methodology

Given that DIVI's 9MFY24 EBITDA margin remains well below historical levels, we scale back our FY24/FY25/FY26 margin assumptions by 220bps/150bps/150bps and lower EBITDA estimates by 12%/7%/6%. Guidance of higher operating expenses in FY25 upon commercialisation of Unit-3 (Andhra Pradesh) could add to margin pressure, though any surprise from new custom synthesis business as well as declining raw material prices could offer some cushion.

DIVI is trading at FY25E/FY26E EV/EBITDA valuations of 32x/30x which appear rich. We continue to ascribe the stock a 22x EV/EBITDA multiple (implied P/E of 35x), which is a 10% discount to the 10-year average, and roll valuations over to FY26E. Coupled with estimate revision, this translates to a revised TP of Rs 3,000 (from Rs 2,800) that carries 18% downside – maintain SELL.

**Fig 11 – Revised estimates**

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	78.1	89.4	101.2	82.4	92.1	103.0	(5.2)	(3.0)	(1.8)
EBITDA	23.8	29.2	34.0	26.9	31.5	36.2	(11.6)	(7.2)	(6.0)
EBITDA margin (%)	30.5	32.7	33.7	32.7	34.2	35.2	(220bps)	(150bps)	(150bps)
EPS (Rs)	66.1	73.3	86.5	75.0	78.4	90.4	(11.8)	(6.5)	(4.4)

Source: BOBCAPS Research

**Fig 12 – Key assumptions**

Revenue (Rs bn)	FY23	FY24E	FY25E	FY26E
Generic API	36.3	36.0	39.6	45.5
Custom Synthesis	34.8	34.8	41.7	46.7
Nutraceutical	6.6	7.4	8.1	9.0

Source: Company, BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

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

## 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>78,114</b>	<b>89,401</b>	<b>101,153</b>
EBITDA	38,819	23,678	23,792	29,197	34,047
Depreciation	3,115	3,432	3,772	3,934	4,138
EBIT	35,704	20,246	20,020	25,263	29,908
Net interest inc./(exp.)	(8)	(7)	0	0	0
Other inc./(exp.)	733	2,203	3,340	700	700
Exceptional items	0	0	0	0	0
EBT	36,429	22,443	23,360	25,963	30,608
Income taxes	7,231	5,453	5,840	6,491	7,652
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>18,287</b>	<b>17,618</b>	<b>19,472</b>	<b>22,956</b>
Adjustments	(406)	(1,297)	(98)	0	0
<b>Adjusted net profit</b>	<b>29,199</b>	<b>16,990</b>	<b>17,520</b>	<b>19,472</b>	<b>22,956</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	7,957	7,625	7,827	8,678	9,556
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	127,174	129,876	142,304	156,955
Shareholders' fund	117,282	127,705	130,407	142,835	157,486
<b>Total liab. and equities</b>	<b>133,747</b>	<b>144,421</b>	<b>147,321</b>	<b>160,600</b>	<b>176,129</b>
Cash and cash eq.	28,189	42,449	48,889	54,499	62,307
Accounts receivables	24,239	17,925	18,191	20,819	23,556
Inventories	28,286	30,004	24,611	28,167	31,870
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	51,369	55,435	59,297
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>144,421</b>	<b>147,321</b>	<b>160,600</b>	<b>176,129</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>25,856</b>	<b>26,822</b>	<b>18,074</b>	<b>21,533</b>
Capital expenditures	(7,574)	(4,827)	(5,420)	(5,420)	(5,420)
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>(5,420)</b>	<b>(5,420)</b>	<b>(5,420)</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)	(6,709)	(14,958)	(7,044)	(8,305)
<b>Cash flow from financing</b>	<b>(4,366)</b>	<b>(6,719)</b>	<b>(14,963)</b>	<b>(7,044)</b>	<b>(8,305)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>6,485</b>	<b>14,260</b>	<b>6,440</b>	<b>5,610</b>	<b>7,809</b>
<b>Closing cash &amp; cash eq.</b>	<b>28,189</b>	<b>42,449</b>	<b>48,889</b>	<b>54,499</b>	<b>62,307</b>

### Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	111.5	68.9	66.5	73.3	86.5
Adjusted EPS	110.0	64.0	66.1	73.3	86.5
Dividend per share	40.3	24.9	24.1	26.5	31.3
Book value per share	441.7	481.0	491.2	538.0	593.2

### Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	10.6	12.2	12.0	10.3	9.1
EV/EBITDA	24.6	39.9	39.2	31.6	26.9
Adjusted P/E	33.2	57.1	55.2	49.8	42.2
P/BV	8.3	7.6	7.4	6.8	6.2

### DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	80.2	75.7	75.0	75.0	75.0
Interest burden (PBT/EBIT)	102.0	110.8	116.7	102.8	102.3
EBIT margin (EBIT/Revenue)	39.8	26.1	25.6	28.3	29.6
Asset turnover (Rev./Avg TA)	18.5	14.0	13.4	14.5	15.0
Leverage (Avg TA/Avg Equity)	1.1	1.1	1.1	1.1	1.1
<b>Adjusted ROAE</b>	<b>27.8</b>	<b>13.9</b>	<b>13.6</b>	<b>14.3</b>	<b>15.3</b>

### Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>YoY growth (%)</b>					
Revenue	28.6	(13.3)	0.6	14.4	13.1
EBITDA	35.7	(39.0)	0.5	22.7	16.6
Adjusted EPS	47.2	(41.8)	3.4	10.9	17.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	43.3	30.5	30.5	32.7	33.7
EBIT margin	39.8	26.1	25.6	28.3	29.6
Adjusted profit margin	32.6	21.9	22.4	21.8	22.7
Adjusted ROAE	27.8	13.9	13.6	14.3	15.3
ROCE	26.7	13.3	13.0	13.7	14.7
<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	1.1
Current ratio	5.2	5.6	5.6	6.0	6.5
Net interest coverage ratio	4,463.0	3,021.8	-	-	-
<b>Adjusted debt/equity</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.4)</b>	<b>(0.4)</b>	<b>(0.4)</b>

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

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**BUY** – Expected return >+15%

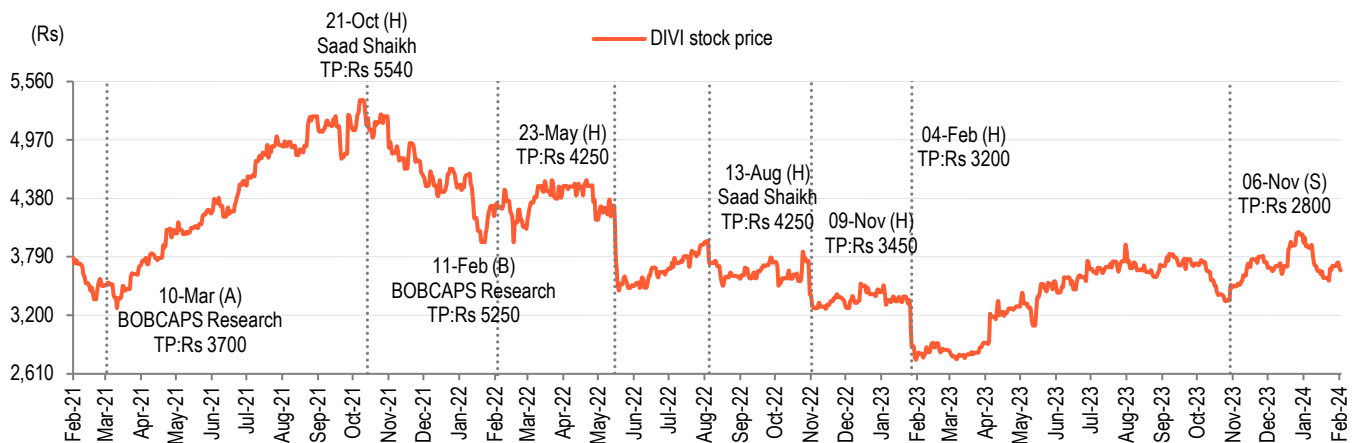
**HOLD** – Expected return from -6% to +15%

**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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