

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% |

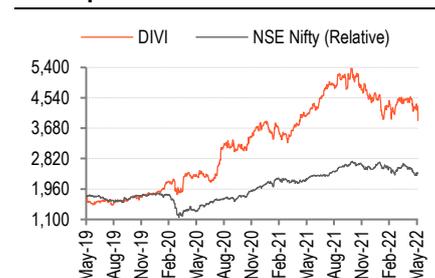
Source: NSE | Price as of 23 May 2022

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%

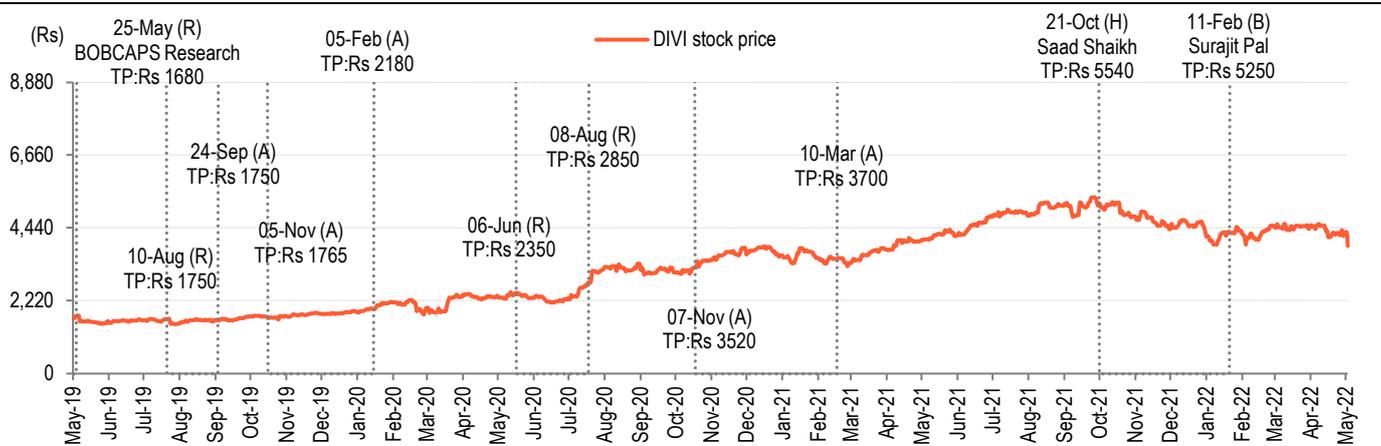
HOLD – Expected return from -6% to +15%

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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