

SELL

TP: Rs 3,000 | ▼ 27%

DIVI'S LABS

| Pharmaceuticals

| 25 May 2024

Strong quarter; rich valuations

- **DIVI delivered a strong quarter with all round beat. EBITDA/PAT beat Bloomberg consensus estimate by 20% each**
- **Company announced a capex of Rs 6.5bn-7.0bn to set up a facility to cater to a new long-term contract from an MNC**
- **We keep our estimates and target multiple unchanged and maintain TP of Rs 3,000. Maintain SELL rating**

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Strong revenue growth driven by custom synthesis business: DIVI posted 18% YoY rise in its fourth quarter revenue to Rs 23bn with a beat of 10% vs Bloomberg consensus estimates primarily on account of strong 47% YoY growth in custom synthesis business due to recent commercialisation of new projects. The company has seen increased enquiries in this segment.

Generic API pricing remains a challenge: Generic API business continues to see pricing challenge which is offset by stable demand and volume gains. Company expects pricing challenges to persist in the near future. The company continues to see strong demand for its key products and benefits from strong backward integration despite the pricing and geopolitical challenges.

Capex announcement for new long-term contract: DIVI announced the signing of a new long-term contract for custom synthesis business with a pharma MNC. As this contract requires specific technology the company needs to invest in a new facility at one of its USFDA approved locations. The company estimates this project needs a capex of Rs 6.5bn-7.0bn and would be commercialised by FY27.

Operational efficiencies drive margin improvement: Company continues to see a decline in raw material costs which were elevated until recently. Gross margin improved 320bps YoY to 60.8%, while remaining flat QoQ. Operating leverage from higher revenue and operational efficiencies drove EBITDA margin expansion of 700bps/480bps YoY/QoQ to 31.7% (above 30% after five quarters). EBITDA for the quarter grew 51% YoY to Rs 7.3bn (beat of 20% over consensus). Net profit jumped 68% YoY to Rs 5.4bn with beat of 20% over consensus.

Maintain SELL: We have kept our FY25/26 estimates largely unchanged and factor in 14% revenue CAGR over FY24-26 and expect EBITDA margin in the range of 32%-34%. DIVI is trading at FY25E/FY26E EV/EBITDA valuations of 37x/31x which appear rich. We continue to ascribe the stock a 22x EV/EBITDA (implied P/E of 35x), which is a 10% discount to the 10-year average, which translates to an unchanged TP of Rs 3,000 with 27% downside after a recent rally. Maintain SELL.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	DIVI IN/Rs 4,122
Market cap	US\$ 13.3bn
Free float	48%
3M ADV	US\$ 22.9mn
52wk high/low	Rs 4,175/Rs 3,295
Promoter/FPI/DII	52%/15%/22%

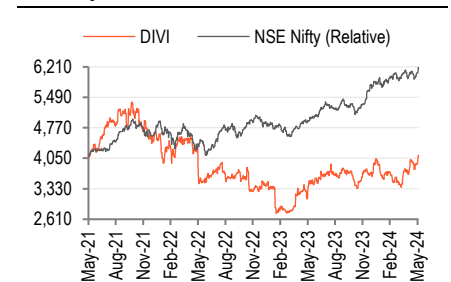
Source: NSE | Price as of 24 May 2024

Key financials

Y/E 31 Mar	FY24P	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)	69.7	58.2	47.8
EV/EBITDA (x)	47.9	37.2	31.1
Adj. EPS growth (%)	(7.6)	19.7	21.9

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

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	FY24	FY23	YoY (%)
Revenue	23,030	19,508	18.1	18,550	24.2	78,450	77,675	1.0
EBITDA	7,310	4,834	51.2	5,000	46.2	22,280	23,594	(5.6)
Depreciation	950	870	-	950	-	3,780	3,432	-
EBIT	6,360	3,964	60.5	4,050	57.0	18,500	20,162	(8.2)
Interest	20	2	-	0	-	30	7	-
Other Income	790	662	-	950	-	3,410	2,150	-
PBT	7,130	4,623	54.2	5,000	42.6	21,880	22,305	(1.9)
Less: Taxation	1,750	1,455	-	1,310	-	5,630	5,453	-
Less: Minority Interest	0	0	-	0	-	0	0	-
Recurring PAT	5,380	3,168	69.8	3,690	45.8	16,250	16,853	(3.6)
Exceptional items	0	42	-	(110)	-	(250)	1,381	-
Reported PAT	5,380	3,210	67.6	3,580	50.3	16,000	18,234	(12.2)
Key Ratios (%)								
			(bps)		(bps)			(bps)
Gross Margin	60.8	57.6	326	60.7	13	60.1	60.7	(57)
EBITDA Margin	31.7	24.8	696	27.0	479	28.4	30.4	(197)
Tax / PBT	24.5	31.5	-	26.2	-	25.7	24.4	-
NPM	23.4	16.2	-	19.9	-	20.7	21.7	-
EPS (Rs)	20.3	11.9	-	13.9	-	61.2	63.5	-

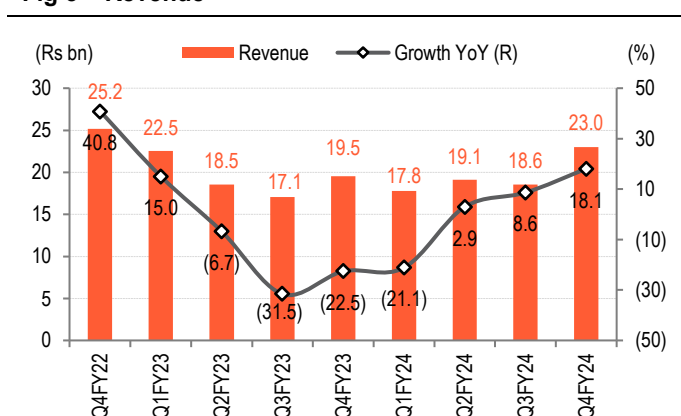
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	FY24	FY23	YoY (%)
Custom Synthesis	11,745	7,998	46.9	8,533	37.6	35,026	34,752	0.8
Generic APIs	9,405	10,010	(6.0)	8,487	10.8	36,184	36,326	(0.4)
Nutraceuticals	1,880	1,500	25.3	1,530	22.9	7,240	6,597	9.7
Total	23,030	19,508	18.1	18,550	24.2	78,450	77,675	1.0

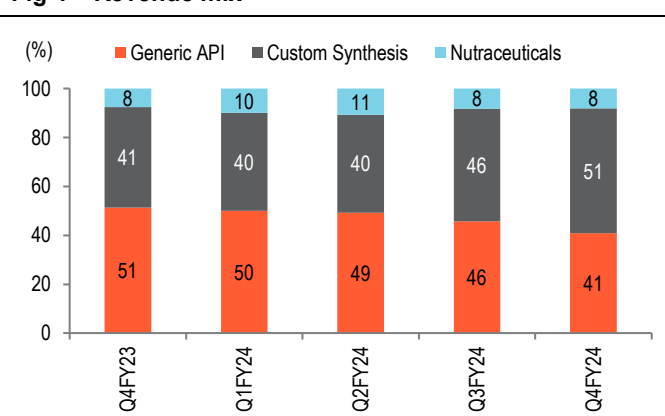
Source: Company, BOBCAPS Research

Fig 3 – Revenue



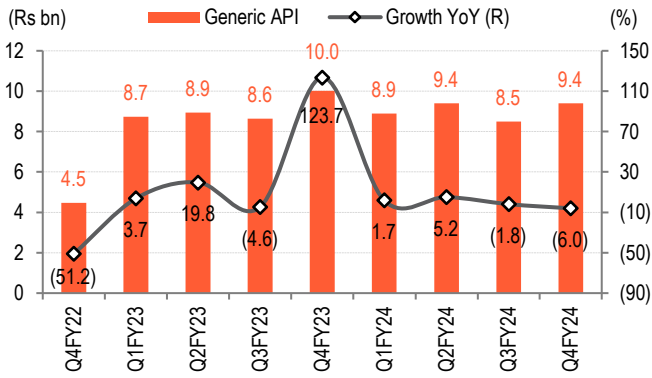
Source: Company, BOBCAPS Research

Fig 4 – Revenue mix



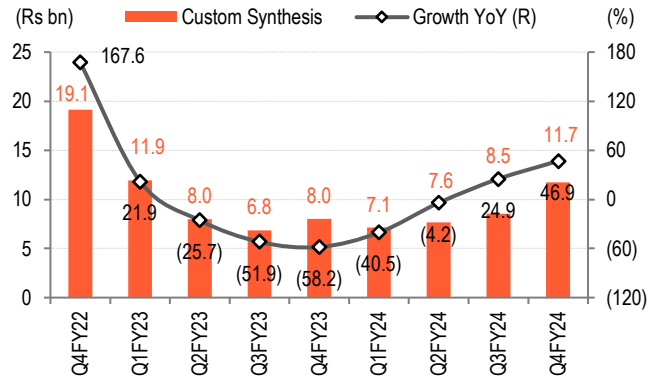
Source: Company, BOBCAPS Research

Fig 5 – Generic API revenue



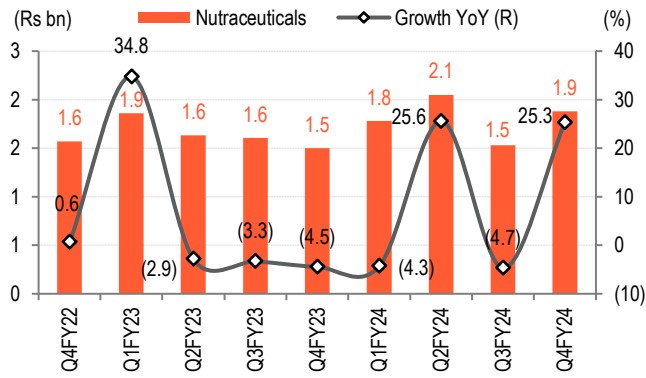
Source: Company, BOBCAPS Research

Fig 6 – Custom synthesis revenue



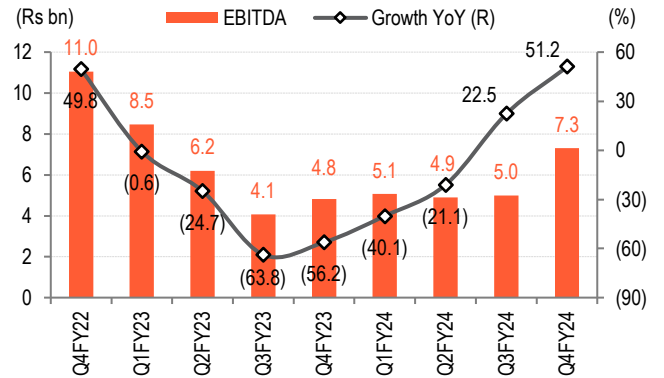
Source: Company, BOBCAPS Research

Fig 7 – Nutraceutical revenue



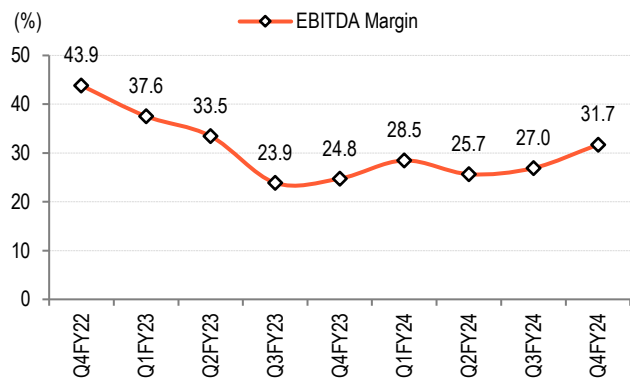
Source: Company, BOBCAPS Research

Fig 8 – EBITDA



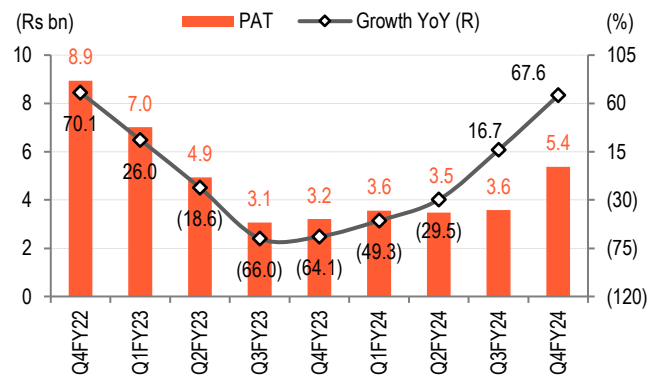
Source: Company, BOBCAPS Research

Fig 9 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 10 – PAT



Source: Company, BOBCAPS Research

Earnings call highlights

Revenue mix

- Q4 revenue split: 49% from generic APIs and 51% from custom synthesis.
- FY24 revenue split: 55% from generic APIs and 45% from custom synthesis.
- Nutraceuticals: Rs 1.9bn in Q4, totalling Rs 7.2bn for FY24.
- Exports were 89% in Q4 and 87% for FY24, with 70% going to the US and Europe for the full year.

Generic API

- Pricing environment: Persistent challenges in both regulated and unregulated markets, exacerbated by geopolitical uncertainties. Prices expected to stabilise eventually.
- API channel inventory: Stabilised at the customer end.
- Volume and market share: Volumes remain strong, offsetting some price declines. Market share remains intact.

New DMF Filings

- All necessary regulatory filings submitted; customers are preparing their filings. Divi's Laboratories aims to be the main supplier once products come off patent, gradually increasing volumes.

Kakinada Plant

- Operations expected to start in Q2-Q3 of the current year.
- Of the Rs 15bn earmarked, Rs 7bn has already been spent. Phase one commercialisation will lead to phase two investments.

Margins

- Raw material prices stabilised after reductions. The company is closely monitoring geopolitical developments to mitigate impacts. Slight increase in custom synthesis mix has supported margins.

Capex

- Expected to be around Rs. 15.0bn-16.0bn in FY25.

New long-term contract

- Rs 6.5bn-7.0bn for a new project involving unique technology. Commercialisation is expected by 2027, to take place in one of the two USFDA-approved facilities.

Valuation methodology

We have kept our FY25/FY26 estimates largely unchanged and factor in 14% revenue CAGR over FY24-26 and expect EBITDA margin in the range of 32-34%. DIVI is trading at FY25E/FY26E EV/EBITDA valuations of 37x/31x which appear rich. Moreover, custom synthesis business which drove the beat in Q4 is a lumpy business and we would like wait to see sustainability in this segment to revise up our estimates specially when generic API pricing challenges persist. We continue to ascribe the stock a 22x EV/EBITDA (implied P/E of 35x), which is a 10% discount to the 10-year average which translates to an unchanged TP of Rs 3,000 with 27% downside after a recent rally. Maintain SELL.

Fig 11 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Revenue	89.8	101.6	89.4	101.2	0.4	0.4
EBITDA	28.3	34.0	29.2	34.0	(3.1)	(0.0)
EBITDA margin (%)	31.5	33.5	32.7	33.7	(115bps)	(15bps)
EPS (Rs)	70.8	86.3	73.3	86.5	(3.4)	(0.2)

Source: BOBCAPS Research

Fig 12 – Key assumptions

Revenue (Rs bn)	FY24A	FY25E	FY26E
Generic API	36.2	39.8	45.8
Custom Synthesis	35.0	42.0	47.1
Nutraceuticals	7.2	7.9	8.7

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.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	3.7	2,423	2,585	BUY
Alembic Pharma	ALPM IN	2.3	950	970	HOLD
Alkem Labs	ALKEM IN	7.9	5,452	4,800	SELL
Aurobindo Pharma	ARBP IN	8.8	1,235	1,100	HOLD
Cipla	CIPLA IN	14.6	1,486	1,576	BUY
Divi's Labs	DIVI IN	13.3	4,122	3,000	SELL
Dr Reddy's Labs	DRRD IN	11.9	5,866	5,900	HOLD
Eris Lifesciences	ERIS IN	1.5	878	1,200	BUY
Glenmark Life Sciences	GLS IN	1.3	840	790	HOLD
Laurus Labs	LAURUS IN	2.9	439	305	SELL
Lupin	LPC IN	8.9	1,614	1,600	HOLD
Sun Pharma	SUNP IN	43.4	1,487	1,530	HOLD

Source: BOBCAPS Research, NSE | Price as of 24 May 2024

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Total revenue	89,598	77,675	78,450	89,779	101,568
EBITDA	38,819	23,678	22,050	28,289	34,035
Depreciation	3,115	3,432	3,780	3,909	4,183
EBIT	35,704	20,246	18,270	24,380	29,852
Net interest inc./(exp.)	(8)	(7)	(30)	(27)	0
Other inc./(exp.)	733	2,203	3,090	700	700
Exceptional items	0	0	0	0	0
EBT	36,429	22,443	21,330	25,053	30,552
Income taxes	7,231	5,453	5,630	6,263	7,638
Extraordinary items	406	1,297	300	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	29,605	18,287	16,000	18,790	22,914
Adjustments	(406)	(1,297)	(300)	0	0
Adjusted net profit	29,199	16,990	15,700	18,790	22,914

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Accounts payables	7,957	7,625	8,240	8,646	9,517
Other current liabilities	8,192	8,731	10,280	10,280	10,280
Provisions	309	355	440	440	440
Debt funds	8	5	30	20	20
Other liabilities	0	0	0	0	0
Equity capital	531	531	531	531	531
Reserves & surplus	119,438	128,503	134,379	138,835	153,919
Shareholders' fund	119,968	129,034	134,910	139,366	154,450
Total liab. and equities	136,434	145,751	153,900	158,751	174,706
Cash and cash eq.	30,875	43,736	38,999	28,914	32,608
Accounts receivables	24,239	17,925	21,560	22,137	25,044
Inventories	28,286	30,004	31,840	29,516	33,392
Other current assets	4,363	3,970	5,511	5,441	5,441
Investments	720	771	820	820	820
Net fixed assets	43,142	47,142	47,330	58,421	58,238
CWIP	4,699	2,119	7,780	13,441	19,102
Intangible assets	109	84	60	60	60
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	136,434	145,751	153,900	158,751	174,706

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Cash flow from operations	19,144	25,856	14,598	24,948	21,186
Capital expenditures	(7,574)	(4,827)	(9,605)	(20,661)	(9,661)
Change in investments	(719)	(50)	(50)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(8,293)	(4,877)	(9,654)	(20,661)	(9,661)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(35)	(3)	25	(10)	0
Interest expenses	(8)	(7)	(30)	(27)	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(1,637)	(8,108)	(9,676)	(14,334)	(7,830)
Cash flow from financing	(1,679)	(8,118)	(9,681)	(14,371)	(7,830)
Chg in cash & cash eq.	9,171	12,861	(4,737)	(10,085)	3,694
Closing cash & cash eq.	30,875	43,736	38,999	28,914	32,608

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24P	FY25E	FY26E
Reported EPS	111.5	68.9	60.3	70.8	86.3
Adjusted EPS	110.0	64.0	59.1	70.8	86.3
Dividend per share	30.2	30.0	29.8	30.0	29.5
Book value per share	451.9	486.0	508.1	524.9	581.7

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24P	FY25E	FY26E
EV/Sales	12.0	13.7	13.5	11.7	10.4
EV/EBITDA	27.8	45.1	47.9	37.2	31.1
Adjusted P/E	37.5	64.4	69.7	58.2	47.8
P/BV	9.1	8.5	8.1	7.9	7.1

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24P	FY25E	FY26E
Tax burden (Net profit/PBT)	80.2	75.7	73.6	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	23.3	27.2	29.4
Asset turnover (Rev./Avg TA)	18.3	13.8	13.1	14.4	15.2
Leverage (Avg TA/Avg Equity)	1.1	1.1	1.1	1.1	1.1
Adjusted ROAE	27.4	13.6	11.9	13.7	15.6

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24P	FY25E	FY26E
YoY growth (%)					
Revenue	28.6	(13.3)	1.0	14.4	13.1
EBITDA	35.7	(39.0)	(6.9)	28.3	20.3
Adjusted EPS	47.2	(41.8)	(7.6)	19.7	21.9
Profitability & Return ratios (%)					
EBITDA margin	43.3	30.5	28.1	31.5	33.5
EBIT margin	39.8	26.1	23.3	27.2	29.4
Adjusted profit margin	32.6	21.9	20.0	20.9	22.6
Adjusted ROAE	27.4	13.6	11.9	13.7	15.6
ROCE	26.4	13.1	11.4	13.1	15.0
Working capital days (days)					
Receivables	84	99	92	90	90
Inventory	101	137	144	120	120
Payables	96	93	93	95	95
Ratios (x)					
Gross asset turnover	1.4	1.1	1.1	1.0	1.1
Current ratio	5.3	5.7	5.2	4.4	4.8
Net interest coverage ratio	4,463.0	3,021.8	609.0	891.5	-
Adjusted debt/equity	(0.3)	(0.3)	(0.3)	(0.2)	(0.2)

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

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BUY – Expected return >+15%

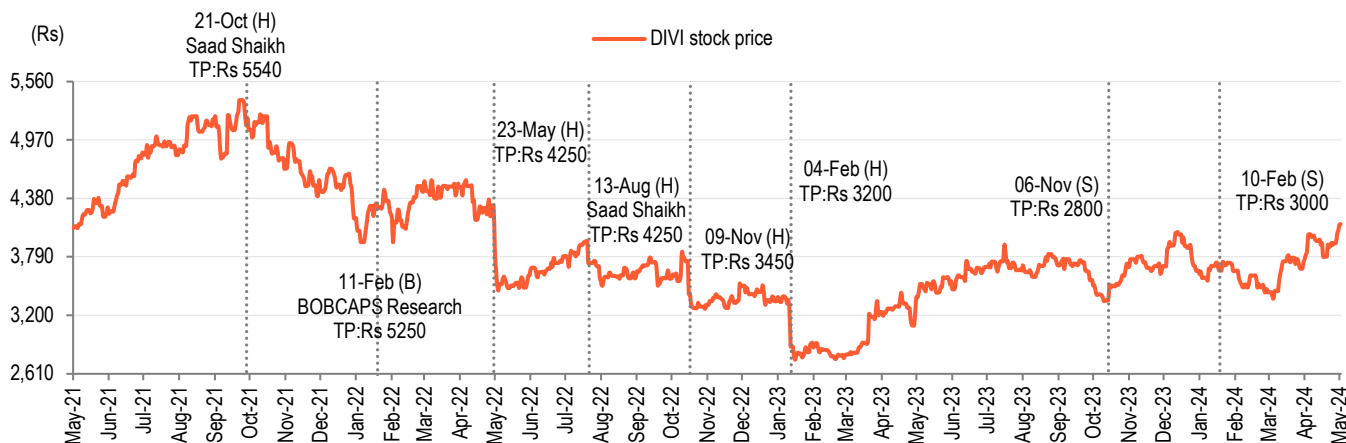
HOLD – Expected return from -6% to +15%

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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