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FIRST LIGHT

14 February 2022

RESEARCH

Divi's Labs | Target: Rs 5,250 | +22% | BUY

Remarkable quarter; upgrade to BUY

V-Mart Retail | Target: Rs 4,430 | +24% | BUY

Well placed to capture value fashion opportunity; raise to BUY

BOB Economics Research | IIP

Industrial growth disappoints

SUMMARY

Divi's Labs

- Q3 surpassed expectations on all fronts with revenue/EBITDA growth at 49%/62% YoY, ahead of consensus by 15%/26%
- Operating leverage helped EBITDA margin expand 360bps YoY to 44.6% despite 250bps gross margin correction
- On rollover and rationalising our target FY24E EV/EBITDA to 27x (vs. 31x), we have a new TP of Rs 5,250 (vs. Rs 5,540); raise from HOLD to BUY

Click here for the full report.

V-Mart Retail

- Q3 revenue growth at 47% YoY to Rs 6.9bn, with 83% coming from VMART and 17% from Unlimited stores
- EBITDA up 30% YoY to Rs 1.4bn but margin declined 255bps to 19.6% owing to higher RM and no rental concessions
- We roll valuations to FY24 and reset to 21x EV/EBITDA (vs. 24x), leaving our TP intact at Rs 4,430; upgrade from HOLD to BUY post correction

Click here for the full report.

Daily macro indicators

Indicator	09-Feb	10-Feb	Chg (%)
US 10Y yield (%)	1.94	2.03	9
India 10Y yield (%)	6.81	6.73	(8)
USD/INR	74.81	74.95	(0.2)
Brent Crude (US$/bbl)	91.6	91.4	(0.2)
Dow	35,768	35,242	(1.5)
Hang Seng	24,830	24,924	0.4
Sensex	58,466	58,926	0.8
India FII (US$ mn)	**08-Feb**	**09-Feb**	**Chg ($ mn)**
FII-D	(58.7)	(94.9)	(36.3)
FII-E	9.3	(86.9)	(96.2)

Source: Bank of Baroda Economics Research

BOBCAPS Research
researchreport@bobcaps.in

India Economics: IIP

IIP growth eased to 0.4% in Dec'21 from 1.3% in Nov'21 led by mining (2.6% from 4.9% in Nov'21) and manufacturing output (declined by -0.1% from an increase of 0.8%). Within manufacturing, output of furniture and electrical equipment disappointed the most. Capital goods output contracted to 11-month low of 4.6% in Dec'21. Notably, IIP growth over a 2-year basis (2.6% in Dec'21) is back up to pre-pandemic levels.

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BUY
TP: Rs 5,250 | ⮝ 22%

DIVI'S LABS | Pharmaceuticals | 11 February 2022

Remarkable quarter; upgrade to BUY

- **Q3 surpassed expectations on all fronts with revenue/EBITDA growth at 49%/62% YoY, ahead of consensus by 15%/26%**
- **Operating leverage helped EBITDA margin expand 360bps YoY to 44.6% despite 250bps gross margin correction**
- **On rollover and rationalising our target FY24E EV/EBITDA to 27x (vs. 31x), we have a new TP of Rs 5,250 (vs. Rs 5,540); raise from HOLD to BUY**

Surajit Pal | Saad Shaikh
researchreport@bobcaps.in

Beats consensus estimates by wide margin: DIVI reported standalone Q3FY22 revenue/PAT of Rs 24.7bn/Rs 9.1bn, a beat of 15%/45% over consensus. The custom synthesis business grew 86% YoY and generic API was up 27% YoY. Custom synthesis, generic APIs and nutraceuticals contributed 50%, 44% and 6% of revenue respectively.

Capex yielding fruit in challenging times: In line with the industry, DIVI faced challenges during Q3 such as steep price increases for some raw materials due to the energy crisis in China, but it was able to partly mitigate the headwinds by diversification of procurement sources, long-term contracts with key suppliers, backward integration on key products and selective product offerings. On the logistical front, the company faced limited manpower availability and congestion at ports as well as container shortages, which impacted shipments. However, recent capex for backward integration, debottlenecking and upgrades have minimised supply risk and production disruptions.

Operating leverage aids EBITDA margin gains despite lower gross margin: Gross margin for the quarter dipped to 66.5% (-250bps YoY, -40bps QoQ), but lower staff cost at 10% of revenue (-410bps YoY) and reduced SG&A expense at 12% of revenue (-200bps YoY) aided EBITDA margin expansion of 360bps YoY (+300bps QoQ) to 44.6%.

Raise to BUY: Given the impressive 9MFY22 performance (revenue/EBITDA up 26%/31% YoY), we raise our FY22 revenue and EBITDA estimates by 3% each. The stock is trading at 25x/21x FY23E/FY24E EV/EBITDA after correcting 11% in the last three months. Given the current high base, capacity utilisation of ~85%, delays at the Vizag plant as well as easing of the pandemic (affecting Molnupiravir demand), we rationalise our target EV/EBITDA multiple to 27x (31x earlier) – in line with the one-year forward consensus multiple. On moving to FY24 valuations, we have a new TP of Rs 5,250 (Rs 5,540 earlier) and upgrade the stock from HOLD to BUY.

Key changes

Target	Rating
▼	▲

Ticker/Price	DIVI IN/Rs 4,291
Market cap	US$ 15.1bn
Free float	48%
3M ADV	US$ 34.4mn
52wk high/low	Rs 5,425/Rs 3,153
Promoter/FPI/DII	52%/21%/16%

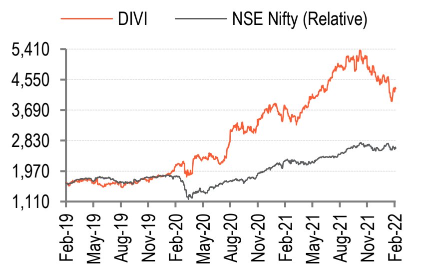
Source: NSE | Price as of 11 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	72,261	86,407	99,475
EBITDA (Rs mn)	31,166	36,975	43,562
Adj. net profit (Rs mn)	22,497	26,125	30,900
Adj. EPS (Rs)	84.7	98.4	116.4
Consensus EPS (Rs)	84.7	93.4	113.1
Adj. ROAE (%)	27.1	26.0	26.2
Adj. P/E (x)	50.6	43.6	36.9
EV/EBITDA (x)	36.1	30.4	25.6
Adj. EPS growth (%)	50.9	16.1	18.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

RESULT REVIEW

BUY

TP: Rs 4,430 | ⮝ 24%

V-MART RETAIL | Retail | 11 February 2022

Well placed to capture value fashion opportunity; raise to BUY

- **Q3 revenue growth at 47% YoY to Rs 6.9bn, with 83% coming from VMART and 17% from Unlimited stores**
- **EBITDA up 30% YoY to Rs 1.4bn but margin declined 255bps to 19.6% owing to higher RM and no rental concessions**
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Ruchitaa Maheshwari
researchreport@bobcaps.in

Revenue at pre-Covid levels on healthy store openings, Unlimited consolidation: Q3 is traditionally a strong quarter backed by festive demand, the marriage season and onset of winter. This coupled with successful integration of 'Unlimited' business in South and West India drove VMART's Q3FY22 revenue up 47% YoY to Rs 6.9bn. The acquisition also contributed positively to overall profitable growth. A like-to-like comparison that excludes Unlimited indicates 22% YoY revenue growth.

Turnaround at Unlimited: Management intends to gradually move Unlimited outlets to VMART branded stores following its 'One Nation One Brand' philosophy, with sharper price points, better quality fabric, improved variety and own private labels. The target is to drive up footfalls, volume growth and store productivity in 2-3 years. Management expects Unlimited to turn profitable over 1-2 years.

Higher RM and rental cost affects margin: Gross margin contracted 30bps YoY to 37% in Q3 with employee cost/other expenses up 65%/86% YoY. VMART posted a 255bps YoY decline in EBITDA margin to 19.6% owing to higher raw material cost and a lack of rental concessions. EBITDA increased 30% YoY to Rs 1.4bn.

Poised for recovery…: We like VMART as a structural long-term story to play the shift from unorganised to modern retail. We expect the company to deliver healthy earnings growth on the back of aggressive store expansion, mid-to-high single-digit SSSg, superior store economics, geography expansion and a healthy balance sheet. Recent acquisition of the Unlimited value retail chain and aggressive store additions in core markets should fuel steady growth, well supported by a lean balance sheet.

…raise to BUY: Given the vast growth opportunity in the value fashion segment and VMART's strong execution capability, we believe the company is well positioned to compete with regional and national players. Post Q3, we raise FY22/FY23 EPS estimates by 98%/3% and also introduce FY24 numbers. Our TP remains at Rs 4,430 as we roll valuations over to FY24 while resetting to 21x EV/EBITDA multiple (vs. 24x earlier on FY23E) compared to its five-year median of 24x. Following the recent 23% correction in stock price from its 52-week high, we upgrade to BUY from HOLD.

Key changes

Target	Rating
◀ ▶	▲

Ticker/Price	VMART IN/Rs 3,583
Market cap	US$ 937.6mn
Free float	54%
3M ADV	US$ 0.9mn
52wk high/low	Rs 4,849/Rs 2,493
Promoter/FPI/DII	46%/21%/32%

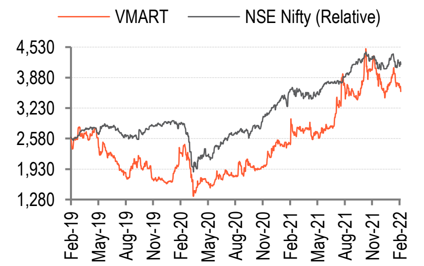
Source: NSE | Price as of 11 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	10,755	17,820	24,499
EBITDA (Rs mn)	1,192	2,042	3,128
Adj. net profit (Rs mn)	(340)	369	988
Adj. EPS (Rs)	(17.2)	18.7	50.1
Consensus EPS (Rs)	(17.2)	19.0	59.2
Adj. ROAE (%)	(5.3)	4.4	10.9
Adj. P/E (x)	(207.9)	191.3	71.5
EV/EBITDA (x)	59.0	33.5	21.3
Adj. EPS growth (%)	(170.0)	(208.7)	167.7

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

IIP

11 February 2022

Industrial growth disappoints

IIP growth eased to 0.4% in Dec'21 from 1.3% in Nov'21 led by mining (2.6% from 4.9% in Nov'21) and manufacturing output (declined by -0.1% from an increase of 0.8%). Within manufacturing, output of furniture and electrical equipment disappointed the most. Capital goods output contracted to 11-month low of 4.6% in Dec'21. Notably, IIP growth over a 2-year basis (2.6% in Dec'21) is back up to pre-pandemic levels.

Madan Sabnavis
Chief Economist
chief.economist@bankofbaroda.com

Jahnavi

IIP growth moderates: Industrial output softened further for the fourth month in a row to 0.4% in Dec'21 from 1.3% in Nov'21. Mining output moderated to 10-month low of 2.6% in Dec'21 compared with 4.9% in Nov'21. Manufacturing output contracted by 0.1% in Dec'21 compared with an increase of 0.8% in Nov'21. The only bright spot was electricity registering a growth of 2.8% in Dec'21 (2.1% in Nov'21). Notably, over a 2-year horizon, IIP index is 2.6% above the pre-pandemic level. Both manufacturing (increase of 2.5% in Dec'21 versus a contraction of -0.8% in Nov'21) and electricity (up by 8.1% in Dec'21 from a 5.7% in Nov'21) have risen above the pre-pandemic levels. Mining production has contracted at a much slower pace (-0.5% in Dec'21 from -0.8% in Nov'21) on a 2-year horizon.

Manufacturing remains under pressure: Within the 23 broad sectors covered, 10 sectors under manufacturing reported contraction in Output in Dec'21. Amongst these, output of electrical equipment, chemical and chemical products, rubber and plastic products, wood and wood products contracted at a much sharper pace. Moreover, output of wearing apparel (6.1% versus 33.4% in Nov'21), basic metals (1.7% versus from 7.3% in Nov'21), and furniture (9.6% in Dec'21 versus 23.1% in Nov'21) moderated in Dec'21. Over a 2-year horizon, 13 out of the 23 sectors reported contraction in Nov'21.

Capital goods-a drag: Within use-based classification, there has been a broad based decline across sectors. Capital goods output has contracted to 10-month low of 4.6% in Dec'21 compared 2% decline see in Nov'21. Output of primary (2.8% from 3.5% in Nov'21), intermediate (0.3% from 2.4% in Nov'21) and infra goods (1.7% from 3.1% in Nov'21) moderated further as they continued to lose momentum in Dec'21. Output of consumer non-durable contracted to a 5-month low of 0.6% in Dec'21 compared with an increase of 0.5% in Nov'21. However, consumer durable output declined at a much slower pace by 2.75 in Dec'21 (5.4% in Nov'21). Over a 2-year horizon also, there has been a broad-based improvement in all the sectors, with exception of infra goods (4.8% from 5.3% in Nov'21).

Sustainable recovery remains a challenge: During Apr-Dec'21, IIP rose by 15.2% compared with a decline of 13.3% in the same period over the previous year. The rapid spread of Omicron (Covid-19 variant) in Jan'21 had posed a challenge with surge in cases across the country resulting in state-wide restrictions. However, with cases now ebbing and states reopening the economy along with budget announcements, we expect improvement and revival to sustain in Q1FY23.

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

BUY – Expected return >+15%

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Note: Recommendation structure changed with effect from 21 June 2021

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