

Divi's Laboratories

BSE SENSEX	S&P CNX
31,028	9,595
Bloomberg	DIVI IN
Equity Shares (m)	265
M.Cap.(INRb)/(USDb)	146.4 / 2.3
52-Week Range (INR)	1380 / 541
1, 6, 12 Rel. Per (%)	-19/-71/-65
Avg Val, INRm	1045
Free float (%)	47.9

Financials & Valuations (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	40.5	40.4	44.7
EBITDA	14.3	13.1	15.0
PAT	10.5	9.5	10.6
EPS (INR)	39.7	35.8	39.8
Gr. (%)	-5.3	-9.7	11.1
BV/Sh (INR)	176.5	196.2	218.1
RoE (%)	23.5	19.2	19.2
RoCE (%)	23.3	19.2	19.2
P/E (x)	13.8	15.3	13.7
P/BV (x)	3.1	2.8	2.5

Estimate change



TP change



Rating change


CMP: INR547 TP: INR600(+10%)
Neutral

Impact of import alert to be visible in FY18

- Revenues declined 3% YoY (~4% miss), while EBITDA of INR3.6b was 7% below our estimate due to lower-than-estimated gross margin of 60.4% (~200bp below est.). EBITDA margin contracted ~250bp YoY to 33.7% due to forex loss of ~INR290m. PAT of INR2.6b (-20% YoY) was ~10% below our estimate. Divis received an import alert at Unit-2 at end-March 2017, the impact of which will be visible 1QFY18 onward. For FY17 sales, EBITDA and PAT stood at INR40.5b (+7.6%YoY), INR14.3b (+1%YoY) and INR10.5b (-5.3%YoY) respectively.
- Proportion of generics remains similar:** API generics (56% of sales) declined 2% YoY to INR6b in 4Q. CRAMS business (44% of sales) declined ~4% YoY. Nutraceuticals reported sales of INR570m v/s INR470m in 4QFY16.
- Guides for minimal impact from Unit-2 import alert:** DIVIS expects loss of <5% of sales due to the Unit-2 import alert. Divis has already hired a third-party consultant to enact remediation measures and help the company to prepare for Unit-1 inspection. We have witnessed with DRRD and SUNP that batch-by-batch testing of products leads to a delay in supplies and an increase in cost.
- Buyback/special dividend could be near-term trigger:** Divis has cash of ~INR17b. There is a possibility of a buyback/ special dividend (like DRRD) in the near term, which could provide near-term support to the stock price.
- Regulatory concerns a big overhang in near term; Maintain Neutral:** We expect the stock to remain range bound in the near term due to uncertainty related to a) impact of current import alert, 2) resolution timeline and 3) unit-1 inspection results. We retain **Neutral** with a TP of INR600. On a going concern basis, large capex addition and delay in commencement of facility are likely to keep growth under check till FY19. However, a strong balance sheet (net cash surplus) and high return ratios (RoE at ~29%) provide valuation cushion.

Quarterly Performance

Y/E March	FY16				FY17E				FY16	FY17	(INR Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			FY17	Var.
Net Op Revenue	8,069	9,619	8,518	10,934	10,060	9,918	9,600	10,631	37,690	40,547	11,030	-3.6
YoY Change (%)	26.1	15.9	8.1	34.2	24.7	3.1	12.7	-2.8	21.5	7.6	0.9	
EBITDA	3,000	3,736	3,212	3,960	4,016	3,680	3,777	3,585	14,064	14,267	3,836	-6.6
Margins (%)	37.2	38.8	37.7	36.2	39.9	37.1	39.3	33.7	37.3	35.2	34.8	
Depreciation	289	301	299	292	301	308	310	314	1,182	1,233	905	
Interest	2	3	2	15	4	4	4	10	23	23	10	
Other Income	360	321	163	193	184	226	215	245	922	870	586	
PBT before EO Income	3,069	3,752	3,074	3,845	3,896	3,595	3,678	3,505	13,781	13,882	3,507	
EO Income	0	0	0	0	0	0	0	0	0	0	0	
PBT	3,069	3,752	3,074	3,845	3,896	3,595	3,678	3,505	13,781	13,882	3,507	-0.1
Tax	617	795	608	623	878	565	996	912	2,662	3,350	617	
Deferred Tax	0	0	0	0	0	0	0	0	21	0	0	
Rate (%)	20.1	21.2	19.8	16.2	22.5	15.7	27.1	26.0	19.5	24.1	17.6	
Adj PAT	2,452	2,957	2,466	3,222	3,018	3,030	2,683	2,593	11,098	10,533	2,891	-10.3
YoY Change (%)	46.0	28.8	11.8	40.8	23.1	2.5	8.8	-19.5	30.6	-5.1	-10.3	
Margins (%)	30.4	30.7	28.9	29.5	30.0	30.5	27.9	24.4	29.4	26.0	26.2	
Reported PAT	2,452	2,957	2,466	3,222	3,018	2,239	2,683	2,593	11,098	10,533	2,891	-10.3

E: MOSL Estimates; Quarterly numbers are standalone

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- **Unit-1 US FDA inspection is due:** Unit-1 accounts for 35% of total revenue and its exposure to the US market stands at ~11% of total revenues. This plant was last inspected in June 2014, and an inspection is due over the coming few days. It will be critical for the company to come out clear in the USFDA inspection (particularly since the FDA had cited data integrity issues in Unit-2).
- **Negative news flow can continue in future:** There are other regulators (like Health Canada) that rely on inspection results from the US FDA. This increases the risk that DIVI may face a supply ban from these regulators too (resulting in incremental loss of sales). Apart from this, there is a risk of market share loss for existing products and of clients (in EU and other geographies also) shifting business from this plant to peers.

Exhibit 1: Key Operating Metrics

	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Sales growth (%)	24	46.6	14.6	10.4	26.1	15.9	8.1	34.2	24.7	3.1	12.7	-2.8
Total cost (%)												
Raw material	38.9	42.2	40.4	36.5	39.7	40.1	37.3	43.2	38.3	38.8	36.5	39.6
Staff cost	9.4	8.4	9.5	9.7	9.7	8.9	10.7	9.1	9.5	8.7	10.2	9.4
Other expenses	15.4	12.8	14.1	15.4	13.4	12.2	14.3	11.4	12.2	15.4	13.9	17.3
Tax Rate	21.6	21.5	20.6	19	20.1	21.2	19.8	16.2	22.5	15.7	27.1	26
Margins (%)												
Gross Margins	61.1	57.8	59.6	63.5	60.3	59.9	62.7	56.8	61.7	61.2	63.5	60.4
EBITDA Margins	36.3	36.6	36	38.4	37.2	38.8	37.7	36.2	39.9	37.1	39.3	33.7
EBIT Margins	31.1	33	32.4	32.9	33.6	35.7	34.2	33.5	36.9	34	36.1	30.8
PAT margins	26.2	27.7	28	28.1	30.4	30.7	28.9	29.5	30	28.9	27.9	24.4

Source: Company, MOSL

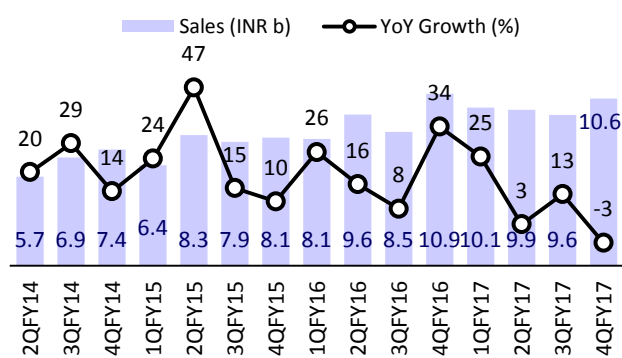
Exhibit 2: Quarterly Snapshot (Revenue Mix)

(INR m)	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17	% YoY	% QoQ
Generics	5,609	5,013	4,230	4,902	5,384	(4.0)	9.8
CRAMs	4,855	4,426	5,058	4,128	4,678	(3.6)	13.3
Neutraceuticals	470	620	630	570	570	21.3	0.0
Total sales	10,934	10,060	9,918	9,600	10,631	(2.8)	10.7

Source: MOSL, Company

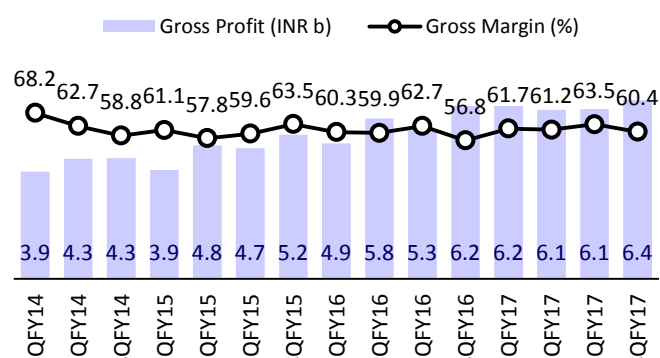
Story in charts

Exhibit 3: Revenue declined by 3% 4QFY17



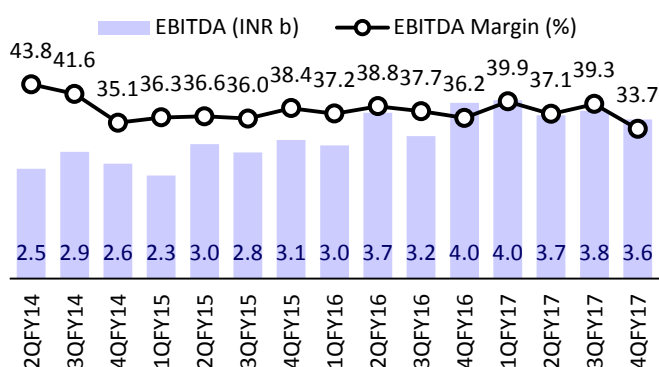
Source: Company, MOSL

Exhibit 4: Gross margins improved ~360bpsYoY



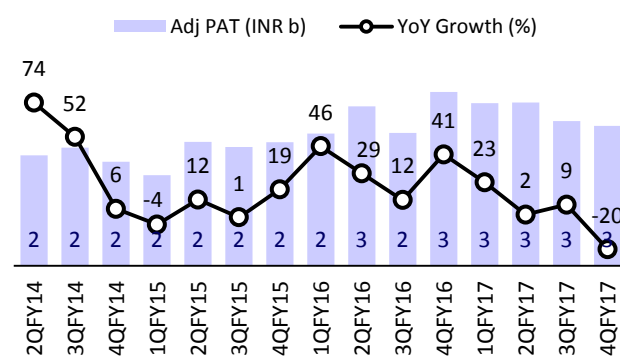
Source: Company, MOSL

Exhibit 5: EBITDA margins contracted due to forex loss



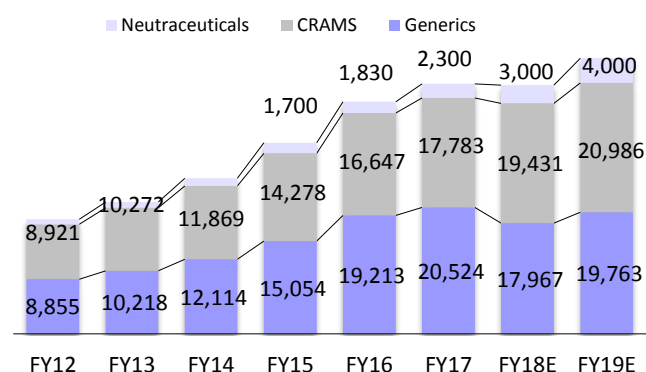
Source: Company, MOSL

Exhibit 6: PAT declined 20%YoY in 4QFY17



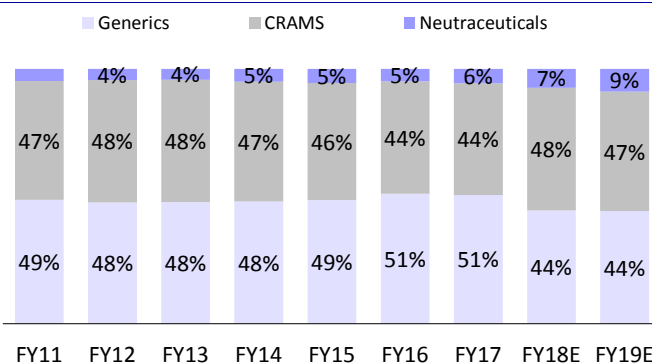
Source: Company, MOSL

Exhibit 7: Annual trend in revenue mix (INR m)



Source: Company, MOSL

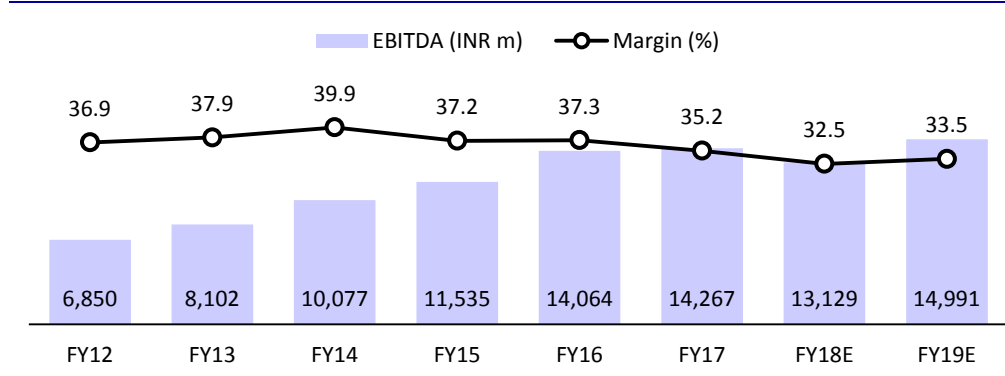
Exhibit 8: Business mix



Source: Company, MOSL

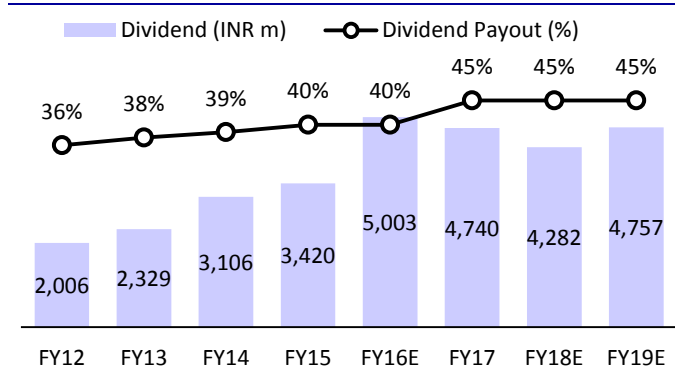
Story in charts

Exhibit 9: EBITDA margin outlook remains modest



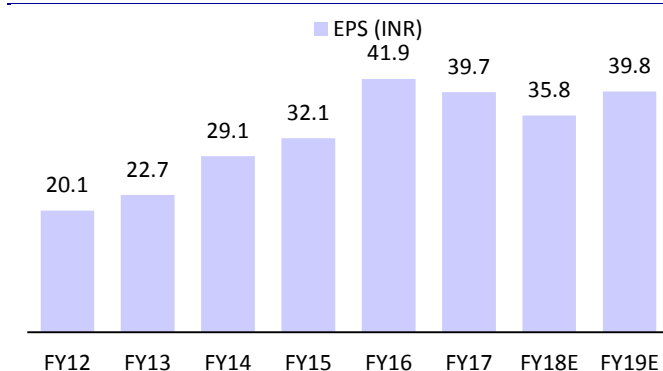
Source: Company, MOSL

Exhibit 10: Dividend payout trend



Source: Company, MOSL

Exhibit 11: EPS to remain subdued



Source: Company, MOSL

Financials and Valuations

Income Statement

(INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Net Sales	18,586	21,399	25,253	31,032	37,690	40,547	40,398	44,749
Change (%)	42.2	15.1	18.0	22.9	21.5	7.6	-0.4	10.8
EBITDA	6,850	8,102	10,077	11,535	14,064	14,267	13,129	14,991
EBITDA Margin (%)	36.9	37.9	39.9	37.2	37.3	35.2	32.5	33.5
Depreciation	621	769	921	1,360	1,182	1,233	2,049	2,274
EBIT	6,229	7,333	9,156	10,175	12,882	13,035	11,081	12,717
Interest	37	18	21	19	23	23	22	22
Other Income	615	497	774	564	922	870	1,379	1,400
Extraordinary items	0	0	0	0	0	0	0	0
PBT	6,806	7,812	9,909	10,721	13,781	13,882	12,438	14,096
Tax	1,474	1,792	2,176	2,206	2,662	3,350	2,923	3,524
Tax Rate (%)	21.7	22.9	22.0	20.6	19.3	24.1	23.5	25.0
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
Reported PAT	5,333	6,020	7,733	8,515	11,119	10,533	9,515	10,572
Adjusted PAT	5,333	6,020	7,733	8,515	11,119	10,533	9,515	10,572
Change (%)	24.2	12.9	28.5	10.1	30.6	-5.3	-9.7	11.1

Balance Sheet

(INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Share Capital	531	531	531	531	531	531	531	531
Reserves	21,050	24,740	29,368	34,423	42,346	46,331	51,564	57,379
Net Worth	21,581	25,271	29,899	34,954	42,877	46,862	52,095	57,910
Debt	617	331	179	261	419	261	261	261
Deferred Tax	609	792	1,150	1,262	1,451	1,948	1,948	1,948
Total Capital Employed	22,807	26,394	31,228	36,477	44,747	49,071	54,304	60,119
Gross Fixed Assets	10,921	13,383	17,403	19,634	21,961	25,461	28,961	32,461
Less: Acc Depreciation	3,536	4,296	5,185	6,545	7,573	8,806	10,854	13,128
Net Fixed Assets	7,384	9,087	12,218	13,089	14,388	16,655	18,106	19,333
Capital WIP	1,820	3,034	1,445	2,182	2,639	2,700	2,850	2,850
Investments	4,770	4,078	5,019	7,330	8,025	8,025	8,025	8,025
Current Assets	13,858	15,454	18,688	21,451	24,591	32,392	35,552	41,285
Inventory	6,790	8,357	9,324	11,626	12,078	15,003	14,947	16,557
Debtors	4,951	5,120	7,237	7,416	8,809	10,948	10,907	12,082
Cash & Bank	575	674	671	652	717	4,414	7,678	10,408
Loans & Adv, Others	1,542	1,302	1,457	1,756	2,986	2,027	2,020	2,237
Curr Liabs & Provns	5,025	5,259	6,143	7,575	4,897	10,702	10,230	11,375
Curr. Liabilities	2,927	2,901	2,995	4,303	4,733	5,677	5,656	6,265
Provisions	2,099	2,358	3,148	3,271	164	5,025	4,574	5,110
Net Current Assets	8,832	10,195	12,546	13,876	19,694	21,690	25,323	29,911
Total Assets	22,807	26,394	31,228	36,477	44,746	49,071	54,304	60,119

Financials and Valuations

Ratios								
Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Basic (INR)								
EPS	20.1	22.7	29.1	32.1	41.9	39.7	35.8	39.8
Cash EPS	22.4	25.6	32.6	37.2	46.3	44.3	43.6	48.4
Book Value	81.3	95.2	112.6	131.7	161.5	176.5	196.2	218.1
DPS	6.5	7.5	10.0	10.0	16.1	15.3	13.8	15.3
Payout (incl. Div. Tax.)	37.6	38.7	40.2	36.5	45.0	45.0	45.0	45.0
Valuation(x)								
P/E	27.2	24.1	18.8	17.0	13.1	13.8	15.3	13.7
Cash P/E	24.4	21.4	16.8	14.7	11.8	12.3	12.5	11.3
Price / Book Value	6.7	5.7	4.9	4.2	3.4	3.1	2.8	2.5
EV/Sales	7.8	6.8	5.7	4.7	3.8	3.5	3.4	3.0
EV/EBITDA	21.2	17.9	14.4	12.5	10.3	9.9	10.5	9.0
Dividend Yield (%)	1.2	1.4	1.8	1.8	2.9	2.8	2.5	2.8
Profitability Ratios (%)								
RoE	26.8	25.7	28.0	26.3	28.6	23.5	19.2	19.2
RoCE	26.4	25.2	27.8	26.1	28.4	23.3	19.2	19.2
RoIC	35.3	33.0	33.5	32.1	34.8	29.4	24.3	25.6
Turnover Ratios (%)								
Asset Turnover (x)	0.8	0.8	0.8	0.9	0.8	0.8	0.7	0.7
Debtors (No. of Days)	98	88	106	86	84	96	95	94
Inventory (No. of Days)	133	143	135	137	117	135	135	135
Leverage Ratios (%)								
Net Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.2
Cash Flow Statement								
	(INR Million)							
Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Adjusted EBITDA	6,850	8,102	10,077	11,535	14,064	14,267	13,129	14,991
Non cash opr. exp (inc)	615	497	774	564	922	870	1,379	1,400
(Inc)/Dec in Wkg. Cap.	-2,177	-1,263	-2,355	-1,349	-5,753	1,701	-369	-1,858
Tax Paid	-1,474	-1,792	-2,176	-2,206	-2,662	-2,852	-2,923	-3,524
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	3,813	5,544	6,320	8,545	6,570	13,986	11,217	11,010
(Inc)/Dec in FA & CWIP	-2,523	-3,503	-2,105	-2,967	-2,784	-3,561	-3,650	-3,500
Free cash flows	1,290	2,041	4,215	5,578	3,786	10,425	7,567	7,510
(Pur)/Sale of Invt	486	692	-941	-2,199	-695	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-2,037	-2,811	-3,046	-5,167	-3,480	-3,561	-3,650	-3,500
Inc/(Dec) in Net Worth	14	0	0	-355	1,808	-1,808	0	0
Inc / (Dec) in Debt	387	-286	-152	82	158	-158	0	0
Interest Paid	-37	-18	-21	-19	-23	-23	-22	-22
Divd Paid (incl Tax) & Others	-2,006	-2,329	-3,106	-3,106	-4,968	-4,740	-4,282	-4,757
CF from Fin. Activity	-1,643	-2,633	-3,278	-3,397	-3,026	-6,728	-4,304	-4,779
Inc/(Dec) in Cash	133	99	-4	-18	65	3,697	3,263	2,731
Add: Opening Balance	442	575	674	671	652	717	4,414	7,678
Closing Balance	575	674	671	652	717	4,414	7,678	10,408

Corporate profile

Company description

Divi's Labs is one of the leading players in the CRAMS segment and has one of the strongest CCS pipeline. The company enjoys good relationships with innovator pharmaceutical companies.

Exhibit 1: Sensex rebased

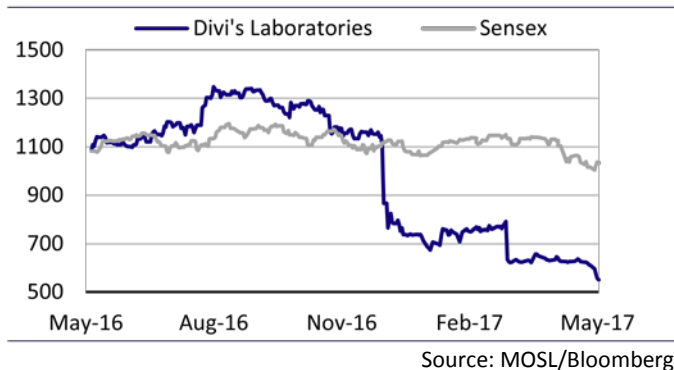


Exhibit 2: Shareholding pattern (%)

	Mar-17	Dec-16	Mar-16
Promoter	52.1	52.1	52.1
DII	14.2	14.6	14.0
FII	17.2	19.8	19.6
Others	16.5	13.6	14.3

Note: FII Includes depository receipts

Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
SBI MUTUAL FUND	4.4
RELIANCE CAPITAL TRUSTEE COMPANY LIMITED	4.0
ICICI PRUDENTIAL MUTUAL FUND	1.7
HDFC TRUSTEE COMPANY LIMITED	1.4
PINEBRIDGE INVESTMENTS GF MAURITIUS LIMITED	1.3

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Murali K Divi	Chairman & Managing Director
N V Ramana	Executive Director
Kiran S Divi	President & Director
P V Lakshmi Rajani	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
Madhusudana Rao Divi	G Suresh Kumar
K V K Seshavataram	Ranga Rao Ravipati
S Sridevi	

*Independent

Exhibit 6: Auditors

Name	Type
EVS & Associates	Cost Auditor
P V R K Nageswara Rao & Co	Statutory
V Bhaskar Rao & Co	Secretarial Audit

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	39.7	45.6	-12.9
FY18	35.8	42.2	-15.1
FY19	39.8	42.9	-7.2

Source: Bloomberg

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