

# Divi's Laboratories

<b>BSE SENSEX</b>	<b>S&amp;P CNX</b>
40,248	11,917
<b>Bloomberg</b>	<b>DIVI IN</b>
Equity Shares (m)	265
M.Cap.(INRb)/(USDb)	447.9 / 6.3
52-Week Range (INR)	1776 / 1421
1, 6, 12 Rel. Per (%)	-3/-4/0
12M Avg Val (INR M)	1130
Free float (%)	48.0

## Financials & Valuations (INR b)

Y/E Mar	2019	2020E	2021E
Net Sales	49.5	55.8	64.5
EBITDA	18.7	19.8	24.1
PAT	13.3	14.2	17.8
EPS (INR)	50.0	53.6	67.2
Gr. (%)	55.0	7.2	25.2
BV/Sh (INR)	262.0	304.4	357.8
RoE (%)	20.6	18.9	20.3
RoCE (%)	20.4	18.8	20.1
P/E (x)	33.6	31.3	25.0
P/BV (x)	6.4	5.5	4.7

Estimate change

TP change

Rating change



**CMP: INR1,687 TP:INR1,655 (-2%)**

**Neutral**

## Sales impressive, higher RM cost hurts margins

- **Highest-ever quarterly revenue run-rate:** DIVI's sales were up 9.2% YoY to INR14.5b (our estimate: INR13.5b) in 2QFY20, led by 13% YoY growth in the CRAMS segment (59% of sales) and supported by strong 43% YoY Nutraceutical sales to INR1.6b. However, Customer Synthesis segment grew moderately by 4% YoY (41% of sales), impacting overall growth. Change in the product mix with a shift toward generics (59% v/s 57% YoY) and increased RM cost led to gross margin contraction of 390bp YoY to 59%. DIVI incurred non-recurring operational expense of INR200m related to power & fuel, consultancy and other regulatory costs. Adjusting for this, the EBITDA margin shrank 410bp YoY to 35.3% (our estimate: 34.2%). Accordingly, EBITDA declined 2% YoY to INR5.1b (our estimate: INR4.6b). DIVI had a forex gain of INR132m for the quarter. Adjusting for the same, PAT was down marginally by 1% YoY to INR3.6b (our estimate: INR3.4b). For 1HFY20, sales/EBITDA/PAT grew 12.5%/1.3%/ 1% YoY to INR26b/INR9b/INR6.4b. **Key highlights:** (1) Strong ramp up in Nutraceutical sales led by the start of second-line operations. (2) Inventory build-up is largely to secure RM availability. (3) Backward integration to manufacture key starting materials/intermediates is on track and the benefit would accrue from 4Q.(4) DIVI is progressing well on brownfield expansion with INR2b spent in 1HFY20 and INR9.4b towards CWIP. (5) Post capex, DIVI would take 6-9 months for regulatory validation before beginning commercial operations. **Valuation and view:** We lower our earnings estimate by 5% for FY20 to factor in higher RM cost, impacting profitability over the near term. However, we maintain our FY21 estimates as the benefit of backward integration would accrue gradually 4QFY20 onwards. We roll to 23x (unchanged) 12M forward earnings and arrive at a TP of INR1,655 (prior INR1,590). With the strong chemistry skillset in place, DIVI remains on track to benefit from the CRAMS (contract research and manufacturing services) opportunity. It also on track in terms of capex to cater to future needs of customers, providing visibility of robust growth in earnings. However, the current valuation largely factors in the positives. Maintain **Neutral**.

## Quarterly Performance

Y/E March	FY19				FY20E				FY19	FY20E	FY20	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	(%)
<b>Net Op Revenue</b>	<b>9,953</b>	<b>13,239</b>	<b>13,429</b>	<b>12,671</b>	<b>11,628</b>	<b>14,456</b>	<b>14,705</b>	<b>15,007</b>	<b>49,463</b>	<b>55,795</b>	<b>13,493</b>	<b>7.1</b>
YoY Change (%)	21.2	48.7	29.4	16.5	16.8	9.2	9.5	18.4	26.4	12.8	5.0	
<b>EBITDA</b>	<b>3,711</b>	<b>5,215</b>	<b>5,645</b>	<b>4,575</b>	<b>3,932</b>	<b>5,106</b>	<b>5,294</b>	<b>5,476</b>	<b>18,718</b>	<b>19,807</b>	<b>4,614</b>	<b>10.6</b>
Margins (%)	37.3	39.4	42.0	36.1	33.8	35.3	36.0	36.5	37.8	35.5	34.2	
Depreciation	416	424	425	424	438	459	480	502	1,689	1,880	470	
Interest	6	2	25	1	3	38	12	51	35	104	7	
Other Income	221	277	346	408	303	338	390	394	1,248	1,425	330	
<b>PBT before EO Income</b>	<b>3,510</b>	<b>5,065</b>	<b>5,540</b>	<b>4,559</b>	<b>3,794</b>	<b>4,947</b>	<b>5,192</b>	<b>5,316</b>	<b>18,242</b>	<b>19,249</b>	<b>4,468</b>	
Forex gain /(Loss)	267	528	-411	-411	-61	-68	0	0	234	-129	0	
<b>PBT</b>	<b>3,776</b>	<b>5,593</b>	<b>5,129</b>	<b>4,148</b>	<b>3,733</b>	<b>4,879</b>	<b>5,192</b>	<b>5,317</b>	<b>18,477</b>	<b>19,120</b>	<b>4,468</b>	<b>9.2</b>
Tax	911	1,556	1,334	1,228	1,009	1,311	1,298	1,354	5,023	4,971	1,072	
Rate (%)	24.1	27.8	26.0	29.6	27.0	26.9	25.0	25.5	26.8	26.2	24.0	
<b>PAT</b>	<b>2,866</b>	<b>4,037</b>	<b>3,795</b>	<b>2,920</b>	<b>2,724</b>	<b>3,568</b>	<b>3,894</b>	<b>3,965</b>	<b>13,453</b>	<b>14,150</b>	<b>3,395</b>	<b>5.1</b>
<b>Adj. PAT</b>	<b>2,663</b>	<b>3,656</b>	<b>4,099</b>	<b>3,209</b>	<b>2,768</b>	<b>3,618</b>	<b>3,894</b>	<b>3,964</b>	<b>13,283</b>	<b>14,244</b>	<b>3,395</b>	
YoY Change (%)	55.4	72.6	73.4	30.2	4.0	-1.1	-5.0	23.5	55.0	7.2	-5.6	
Margins (%)	28.8	30.5	28.3	23.0	23.4	24.7	26.5	26.4	27.2	25.4	25.2	

Note: 3QFY19 are standalone financials, FY19/FY20 are consolidated financials

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## Operating metrics

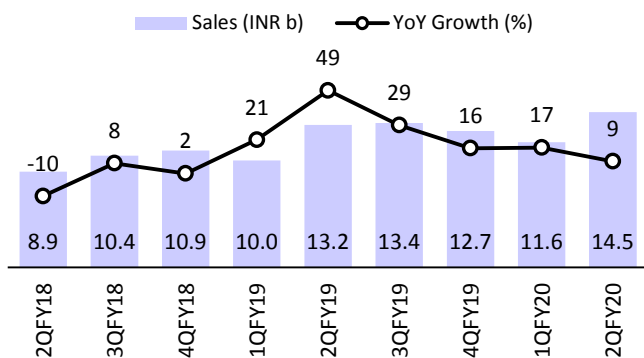
### Exhibit 1: Key Operating Metrics

	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Sales growth (%)	(10.2)	8.1	2.3	21.2	48.7	29.4	15.5	16.8	9.2
Total cost (%)									
Raw material	40.1	39.3	37.5	38.3	37.2	35.8	38.7	38.9	41.1
Staff cost	11.8	11.1	11.6	12.2	10.4	10.2	11.2	10.5	10.5
Other expenses	16.9	16.6	15.4	14.1	13.0	12.0	14.0	15.2	13.2
Tax Rate	25.1	26.5	33.9	25.7	27.8	26.0	29.6	27.0	26.9
Margins (%)									
Gross Margins	59.9	60.7	62.5	61.7	62.8	64.2	60.0	61.1	58.9
EBITDA Margins	31.1	33.0	35.5	35.4	39.4	42.0	34.9	33.8	35.3
EBIT Margins	27.3	29.4	32.0	31.2	36.2	38.9	31.5	30.0	32.1
PAT margins	23.8	22.8	22.7	24.8	27.6	30.5	24.6	23.8	25.0

Source: MOFSL, Company

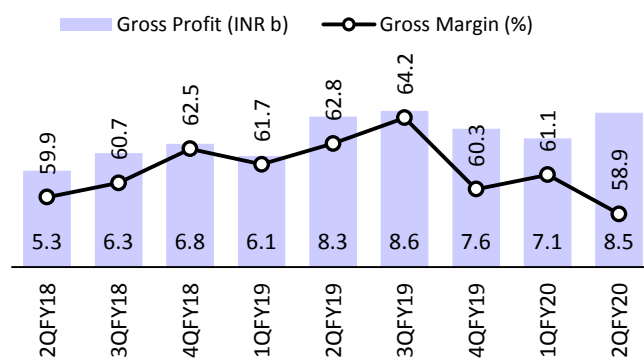
## Story in charts

**Exhibit 2: Revenue growth moderated to 9% YoY**



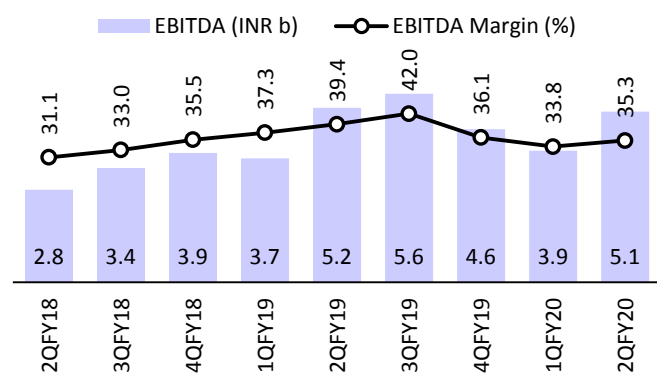
Source: Company, MOFSL

**Exhibit 3: Gross margins shrank 390bp YoY**



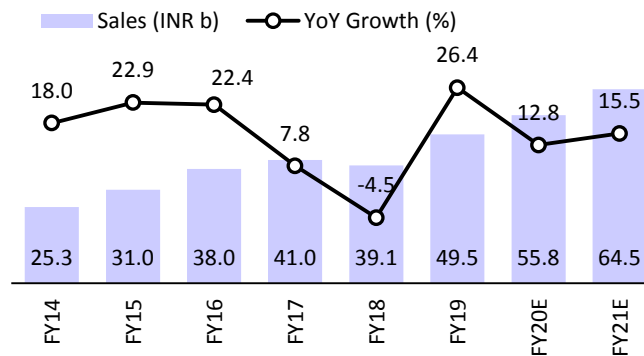
Source: Company, MOFSL

**Exhibit 4: EBITDA margin contracts 410bp YoY**



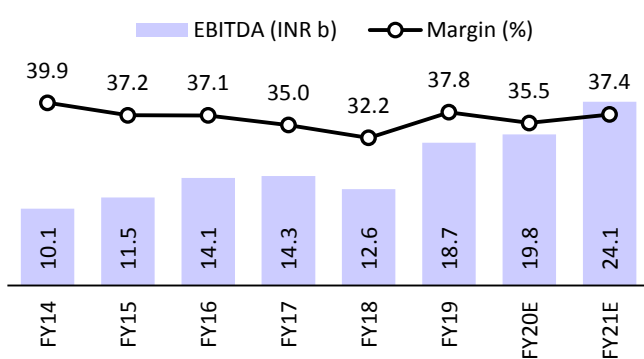
Source: Company, MOFSL

**Exhibit 5: Expect revenue CAGR of ~14% over FY19-21**



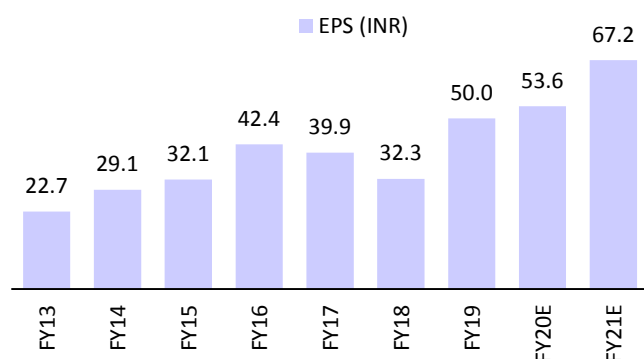
Source: Company, MOFSL

**Exhibit 6: EBITDA margin to remain stable**



Source: Company, MOFSL

**Exhibit 7: Expect EPS CAGR of ~16% over FY19-21**



Source: Company, MOFSL

## Financials and valuations

Income Statement							(INR M)
Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>Net Sales</b>	<b>31,032</b>	<b>37,975</b>	<b>40,952</b>	<b>39,128</b>	<b>49,463</b>	<b>55,795</b>	<b>64,461</b>
Change (%)	22.9	22.4	7.8	-4.5	26.4	12.8	15.5
<b>EBITDA</b>	<b>11,535</b>	<b>14,100</b>	<b>14,350</b>	<b>12,617</b>	<b>18,718</b>	<b>19,807</b>	<b>24,076</b>
Growth (%)	14.5	22.2	1.8	-12.1	48.4	5.8	21.6
Margin (%)	37.2	37.1	35.0	32.2	37.8	35.5	37.4
Depreciation	1,360	1,182	1,233	1,425	1,689	1,880	2,042
<b>EBIT</b>	<b>10,175</b>	<b>12,918</b>	<b>13,117</b>	<b>11,192</b>	<b>17,029</b>	<b>17,928</b>	<b>22,034</b>
Int. and Finance Charges	19	38	23	13	35	104	81
Other Income - Rec.	564	1,048	859	855	1,248	1,425	1,205
PBT	10,721	13,928	13,953	12,313	18,477	19,120	23,158
Current Tax	2,206	2,842	2,852	2,898	4,755	4,971	5,326
Deferred Tax	0	-172	497	645	268	0	0
Tax Rate (%)	20.6	19.2	24.0	28.8	27.2	26.0	23.0
<b>Reported PAT</b>	<b>8,515</b>	<b>11,258</b>	<b>10,604</b>	<b>8,770</b>	<b>13,453</b>	<b>14,148</b>	<b>17,832</b>
<b>Adj. PAT</b>	<b>8,515</b>	<b>11,258</b>	<b>10,604</b>	<b>8,571</b>	<b>13,283</b>	<b>14,244</b>	<b>17,832</b>
Change (%)	10.1	32.2	-5.8	-19.2	55.0	7.2	25.2
Margin (%)	27.4	29.6	25.9	21.9	26.9	25.5	27.7

Balance Sheet							(INR M)
Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Equity Share Capital	531	531	531	531	531	531	531
Total Reserves	34,423	42,402	53,043	58,717	69,041	80,289	94,465
<b>Net Worth</b>	<b>34,954</b>	<b>42,933</b>	<b>53,574</b>	<b>59,248</b>	<b>69,572</b>	<b>80,820</b>	<b>94,996</b>
Deferred liabilities	1262	731	1228	1917	2188	2188	2188
Total Loans	261	419	357	631	1,056	1,056	1,056
<b>Capital Employed</b>	<b>36,477</b>	<b>44,083</b>	<b>55,160</b>	<b>61,796</b>	<b>72,816</b>	<b>84,064</b>	<b>98,240</b>
Gross Block	19,634	21,938	24,339	30,134	32,739	46,934	53,934
Less: Accum. Deprn.	6,545	7,551	8,747	10,172	11,861	13,740	15,782
<b>Net Fixed Assets</b>	<b>13,089</b>	<b>14,388</b>	<b>15,592</b>	<b>19,962</b>	<b>20,878</b>	<b>33,193</b>	<b>38,151</b>
Capital WIP	2,182	2,639	4,436	1,198	4,919	2,000	2,000
Investments	7,330	8,025	16,307	18,894	19,456	16,956	16,956
<b>Curr. Assets</b>	<b>21,451</b>	<b>23,924</b>	<b>25,215</b>	<b>27,769</b>	<b>35,106</b>	<b>39,869</b>	<b>50,300</b>
Inventory	11,626	12,078	13,199	13,507	17,723	20,644	23,851
Account Receivables	7,416	8,809	8,984	10,144	11,634	13,949	16,115
Cash and Bank Balance	652	734	787	1,125	1,153	2,486	7,111
Loans & Advances	1,756	2,303	2,244	2,994	4,597	2,790	3,223
<b>Curr. Liability &amp; Prov.</b>	<b>7,575</b>	<b>4,896</b>	<b>6,390</b>	<b>6,026</b>	<b>7,543</b>	<b>7,954</b>	<b>9,167</b>
Account Payables	4,303	4,759	6,224	5,867	7,400	7,811	9,025
Provisions	3,271	137	166	159	143	143	143
<b>Net Current Assets</b>	<b>13,876</b>	<b>19,028</b>	<b>18,825</b>	<b>21,743</b>	<b>27,563</b>	<b>31,915</b>	<b>41,133</b>
<b>Appl. of Funds</b>	<b>36,477</b>	<b>44,083</b>	<b>55,160</b>	<b>61,796</b>	<b>72,816</b>	<b>84,064</b>	<b>98,240</b>

## Financials and valuations

### Ratios

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>EPS</b>	<b>32.1</b>	<b>42.4</b>	<b>39.9</b>	<b>32.3</b>	<b>50.0</b>	<b>53.6</b>	<b>67.2</b>
Cash EPS	37.2	46.9	44.6	37.7	56.4	60.7	74.9
BV/Share	131.7	161.7	201.8	223.2	262.0	304.4	357.8
DPS	10.0	10.0	10.0	10.0	16.0	9.3	11.8
Payout (%)	37.5	28.4	30.1	35.4	36.9	20.5	20.5

### Valuation (x)

P/E	52.4	39.6	42.0	52.0	33.6	31.3	25.0
Cash P/E	45.1	35.8	37.7	44.6	29.8	27.7	22.4
P/BV	12.8	10.4	8.3	7.5	6.4	5.5	4.7
EV/Sales	14.4	11.7	10.9	11.4	9.0	8.0	6.8
EV/EBITDA	38.6	31.6	31.0	35.3	23.8	22.4	18.3
Dividend Yield (%)	0.6	0.6	0.6	0.6	1.0	0.6	0.7

### Return Ratios (%)

RoE	26.3	28.9	22.0	15.2	20.6	18.9	20.3
RoCE	26.1	28.7	21.8	15.1	20.4	18.8	20.1
RoIC	32.1	35.4	30.1	21.5	28.2	24.1	25.2

### Working Capital Ratios

Accumulated Dep/Gross Block (x)	0.3	0.3	0.4	0.3	0.4	0.3	0.3
Fixed Asset Turnover (x)	1.7	1.8	1.8	1.4	1.6	1.4	1.3
Debtor (Days)	86	83	78	91	82	87	86
Inventory (Days)	137	116	118	126	131	135	135
Working Capital Turnover (Days)	156	176	161	192	195	193	193

### Leverage Ratio (x)

Current Ratio	2.8	4.9	3.9	4.6	4.7	5.0	5.5
Debt/Equity	0.01	0.01	0.01	0.01	0.0	0.0	0.0

### Cash Flow Statement

(INR M)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Op.Profit/(Loss) bef. Tax	11,535	14,100	14,350	12,617	18,718	19,807	24,076
Interest/Dividends Recd.	564	1,048	859	855	1,248	1,425	1,205
Direct Taxes Paid	-2,206	-2,842	-2,852	-2,898	-4,755	-4,971	-5,326
(Inc)/Dec in WC	-1,349	-5,070	256	-2,581	-5,792	-3,018	-4,593
<b>CF from Operations</b>	<b>8,545</b>	<b>7,236</b>	<b>12,613</b>	<b>7,993</b>	<b>9,419</b>	<b>13,243</b>	<b>15,362</b>
(inc)/dec in FA	-2,967	-2,762	-4,197	-2,557	-6,326	-11,276	-7,000
<b>Free Cash Flow</b>	<b>5,578</b>	<b>4,474</b>	<b>8,416</b>	<b>5,436</b>	<b>3,093</b>	<b>1,967</b>	<b>8,362</b>
(Pur)/Sale of Investments	-2,199	-695	-8,282	-2,586	-562	2,500	0
<b>CF from Investments</b>	<b>-5,167</b>	<b>-3,457</b>	<b>-12,479</b>	<b>-5,143</b>	<b>-6,889</b>	<b>-8,776</b>	<b>-7,000</b>
Inc/(Dec) in Debt	82	158	-61	274	425	0	0
Interest Paid	-19	-38	-23	-13	-35	-104	-81
Dividend Paid	-3,195	-3,195	-3,195	-3,106	-4,970	-2,900	-3,656
Others	-265	-83	3,198	54	1,844	0	0
<b>CF from Fin. Activity</b>	<b>-3,397</b>	<b>-3,158</b>	<b>-81</b>	<b>-2,791</b>	<b>-2,736</b>	<b>-3,005</b>	<b>-3,737</b>
<b>Inc/Dec of Cash</b>	<b>-18</b>	<b>621</b>	<b>53</b>	<b>338</b>	<b>29</b>	<b>1,333</b>	<b>4,625</b>
Add: Beginning Balance	671	652	734	787	1,125	1,153	2,486
<b>Closing Balance</b>	<b>652</b>	<b>1,273</b>	<b>787</b>	<b>1,125</b>	<b>1,153</b>	<b>2,486</b>	<b>7,111</b>

## NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

\*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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