

Divi's Laboratories

BSE Code	: 532488
Time Duration	: 18 months
CMP	: ₹2158.95 (as on 27 February 2020)
Target Price	: ₹2590



Our Large Rhino Pick for the month of February 2020 is Divi's Laboratories. It is engaged in the manufacturing of Active Pharmaceutical Ingredients (APIs) and intermediates, custom synthesis of active ingredients and advanced intermediates for pharma MNCs. Further, it produces other speciality chemicals like Carotenoids and complex compounds like Peptides and Nucleotides. The company is amongst the top three API manufacturers in the world. The company's product portfolio includes two broad segments namely, generics including Nutraceuticals and second, custom synthesis of generics, intermediates and speciality ingredients for innovator pharma MNCs. Notably, the company's two generics viz Naproxen (pain management) and Dextromethorphan (cough suppressant) contribute nearly 30 per cent revenue and Divi's enjoys almost 70 per cent of the global market share in these two products.

Well-poised to capitalise opportunities in API segment : Divi's Laboratories is amongst the world's top three API manufacturers. We believe that the recent outbreak of Coronavirus presents enormous opportunities for players like Divi's to grow as China fulfills nearly 20 per cent of the global API output. Due to the outbreak of Coronavirus, China's industrial activity has come to a standstill which has resulted in the supply disruption of input materials for the global pharma industry. Thus, the global pharma players are looking for an alternative solution that can be addressed by Indian players. Due to the supply disruption caused by Coronavirus, the API prices recently have spiked nearly in the range of 20-80 per cent. The curtailment of Coronavirus spread is still a difficult task that would lead to a delay in the beginning of production; as a result, API price may further go up. Notably, Government of India is looking to set up bulk drugs manufacturing parks and faster environment clearance channel to boost API production in the country bodes well for API players.

Expansion to fuel growth engine : In order to cater to the increasing opportunities in the generic and big pharma business, the company is taking up two brownfield projects with an aggregate investment of Rs 1,200 crore. The company is investing Rs 600 crore for expanding SEZ Unit at its Unit-II at Visakhapatnam. Further, Rs 600 crore will be invested in another SEZ Project at Unit-I in Bhuvanagiri-Yadadri (Telangana). The expansion work has already commenced and the projects are expected to be completed by the end of this fiscal year. Besides, the company has also invested Rs 300 crore for debottlenecking programs at Unit-I as well as Unit-II which would create additional capacities for existing products. Considering an enormous opportunity, the expanded capacity is likely to aid revenue growth, going ahead.

No regulatory overhang : In January 2020, USFDA had inspected Unit-II of Divi's, which is the largest facility located at Visakhapatnam. USFDA inspection was concluded with no observations. Apart from this, the same facility was inspected by USFDA earlier in June 2019 without observation. Also, the company's Unit-I was inspected by USFDA in November 2019, which concluded without observation. Notably, this strong track record of regulatory compliance removes regulatory overhang in the near term which lends further confidence in the company.

Focus on Carotenoids to aid revenue growth : Over the years, the company has been focussing on a few research driven niche opportunities. The company commands nearly 70 per cent market share in two generics viz Naproxen (pain management) and Dextromethorphan (cough suppressant) that formed almost 26 per cent of its total sales. Further, the company is also increasing its presence in another niche area of Carotenoids after acquiring requisite capabilities. Carotenoids segment accounted for nearly 7.2 per cent of the total sales of Q3FY20. It has developed various types of Carotenoids including Beta-carotene. The outbreak of Coronavirus in China is likely to accelerate the growth of this segment.

Financial performance : The company's revenue from Rs 3,110.94 crore in FY15 has increased to Rs 4,879.7 crore in FY19, representing an absolute growth of nearly 57 per cent. With a continuous improvement in the margin, its EBITDA during the same period jumped from Rs 1,205.9 crore to Rs 2,006.7 crore. Profit after tax increased to Rs 1,332.7 crore in FY19 from Rs 847 crore, representing 57.3 per cent growth.

In the recent quarter of FY20, Divi's Lab reported ~3.5 per cent growth in the net sales to Rs 1,390.5 crore from a higher base of Rs

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1,342.92 crore in Q3FY19. EBITDA for the quarter dipped marginally by 5.1 per cent YoY to Rs 496.9 crore with a corresponding margin contraction of 324 bps. EBITDA margin was at 35.73 per cent. Profit after tax in the quarter was at Rs 360.7 crore down by nearly five per cent from the corresponding quarter of the previous year.

Valuation & outlook : We believe Divi's Lab is well-poised to grow amid the outbreak of Coronavirus in China, which accounts for nearly 20 per cent of the global API production. Also, the company has been investing in the capacity expansion, which would boost its revenue and backward integration helps in improving margin. Despite a higher base, the management has maintained revenue growth guidance of 10 per cent. Notably, the company does not have any pending regulatory hurdles, which further boost a confidence to invest. In terms of return ratios, the company's ROE, ROCE and ROA stand healthy at 20.6 per cent, 28.1 per cent and 15.5 per cent, respectively. In terms of valuation, the stock is currently available at 44.8x P/E on TTM earnings. We recommend a BUY on the stock with a target of Rs 2,590, representing a potential return of 20 per cent.

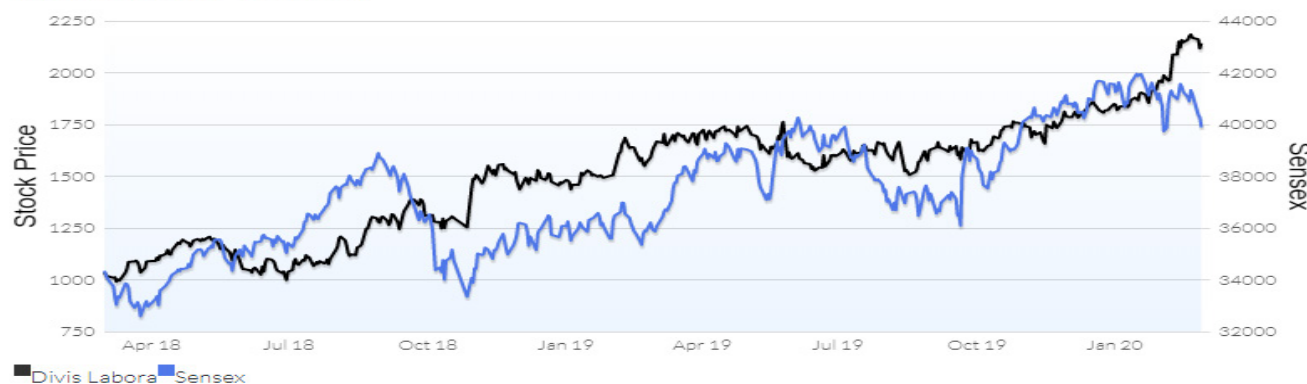
Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201903	201803	201703	201603	201503
Net Sales	4879.66	3815.94	4023.85	3721.33	3084.01
Total Income	5036.24	3928.42	4099.79	3817.25	3126.85
Total Expenditure	3029.59	2564.33	2584.97	2319.91	1920.97
PBIDT	2006.65	1364.09	1514.82	1497.34	1205.88
PAT	1332.65	869.58	1053.27	1110.84	847.06
Dividend %	800.00	500.00	500.00	500.00	1000.00
Adj. EPS(Rs)	50.20	32.76	39.68	41.84	31.91

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201912	201909	Q on Q Var%	201812	Y on Y Var%
Net Sales	1390.49	1403.92	-0.96	1342.92	3.54
Total Expenditure	893.62	918.56	-2.72	819.59	9.03
PBIDT (Excl OI)	496.87	485.36	2.37	523.33	-5.06
PAT	360.73	352.83	2.24	379.49	-4.94
PBIDTM% (Excl OI)	35.73	34.57	3.36	38.97	-8.31
PBIDTM%	38.63	37.95	1.79	41.54	-7.01
PATM%	25.94	25.13	3.22	28.26	-8.21
Adj. EPS(Rs)	13.59	13.29	2.26	14.30	-4.97

Stock vs. Index



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