

Top Research Picks

➔ Divis Laboratories: Import alert shocker at Vizag; downgrade to HOLD

22 March 2017



21 March 2017

HOLD

TP: INR 600.00

▼ 5.4%

Divis Laboratories

DIVI IN

Import alert shocker at Vizag; downgrade to HOLD

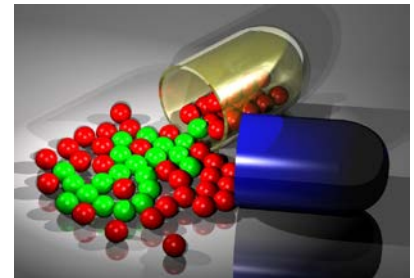
The USFDA has issued an import alert at DIVI's Unit-II Vizag plant, albeit with some product exemptions. While this is better than a full import ban, we worry about the potential cascade of structural issues such as order cancellations, loss of customer confidence and rigorous inspections by other regulators. Accordingly, we cut FY18/FY19 earnings estimates by 36%/40%, downgrade the stock from BUY to HOLD and lower our Mar'18 TP to Rs 600 (from Rs 1,120) as we reset our target FY19E P/E multiple to 16x from 18x.

- ➔ **Import alert at Vizag:** The USFDA has issued an import alert to DIVI's Unit-II plant at Vizag, albeit with exemptions for 10 drugs including *Naproxen Sodium*, *Levetiracetam*, *Gabapentin*, *Lamotrigine*, *Capecitabine*, *Raltegravir Potassium* and *Atovaquone*, along with a few intermediates – 26U90 (chloropurine), BOC core succinate and 2,4-wing active ester. The exempt products contribute a lion's share of the US business (we believe 50-60%), but may have been temporarily left off to prevent near-term product shortages – we see a risk of regulatory oversight if rivals ramp up supplies.
- ➔ **Impact beyond financials:** More than the immediate financial impact, we believe the import alert can damage customer confidence, drive up order cancellations and prompt a slew of rigorous inspections by other regulators, which could structurally affect the business. Further, in the absence of a warning letter, DIVI may be unable to immediately undertake remediation actions (as seen with IPCA).
- ➔ **Downgrade to HOLD:** Around 23% of DIVI's overall sales come from Vizag Unit-II. With 40-50% of the drugs manufactured here covered by the import alert, we cut FY18/FY19 earnings estimates by 36%/40% to build in revenue losses, remediation costs and order cancellations. Fresh capacity addition is likely to be delayed given the ongoing farmer agitation at Vizag and Kakinada, and with Unit-I operating at 85%+, DIVI could find it difficult to shift key products. Given all these constraints, we downgrade the stock to HOLD with a revised Mar'18 TP of Rs 600 (from Rs 1,120).

Financial Highlights

Y/E 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue (INR mln)	31,149	37,764	42,154	40,889	44,160
EBITDA (INR mln)	11,681	14,138	15,470	12,430	13,557
Adjusted net profit (INR mln)	8,515	11,118	11,557	9,022	9,957
Adjusted EPS (INR)	32.1	41.9	43.5	34.0	37.5
Adjusted EPS growth (%)	10.1	30.6	3.9	(21.9)	10.4
DPS (INR)	10.0	10.0	10.0	12.0	14.0
ROIC (%)	25.6	27.1	23.4	15.7	16.3
Adjusted ROAE (%)	26.4	28.6	24.6	16.8	16.8
Adjusted P/E (x)	19.8	15.1	14.6	18.7	16.9
EV/EBITDA (x)	14.0	11.4	10.3	12.4	11.3
P/BV (x)	4.8	3.9	3.3	3.0	2.7

Source: Company, Bloomberg, RCML Research



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PRICE CLOSE (21 Mar 17)

INR 634.45

MARKET CAP

INR 209.9 bln

USD 3.2 bln

SHARES O/S

265.5 mln

FREE FLOAT

48.0%

3M AVG DAILY VOLUME/VALUE

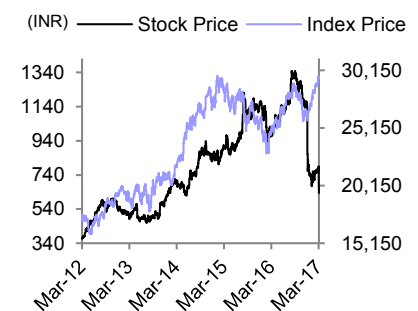
2.7 mln / USD 31.7 mln

52 WK HIGH

INR 1,381.60

52 WK LOW

INR 671.50



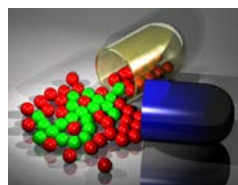
HOLD

TP: INR 600.00

▼ 5.4%

Divis Laboratories

DIVI IN



Company Update

INDIA

PHARMACEUTICALS

Per Share Data

Y/E 31 Mar (INR)	FY15A	FY16A	FY17E	FY18E	FY19E
Reported EPS	32.1	41.9	43.5	34.0	37.5
Adjusted EPS	32.1	41.9	43.5	34.0	37.5
DPS	10.0	10.0	10.0	12.0	14.0
BVPS	131.7	161.5	193.0	212.6	233.3

Valuation Ratios

Y/E 31 Mar (x)	FY15A	FY16A	FY17E	FY18E	FY19E
EV/Sales	5.2	4.3	3.8	3.8	3.5
EV/EBITDA	14.0	11.4	10.3	12.4	11.3
Adjusted P/E	19.8	15.1	14.6	18.7	16.9
P/BV	4.8	3.9	3.3	3.0	2.7

Financial Ratios

Y/E 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Profitability & Return Ratios (%)					
EBITDA margin	37.5	37.4	36.7	30.4	30.7
EBIT margin	33.1	34.3	33.7	26.3	26.6
Adjusted profit margin	27.3	29.4	27.4	22.1	22.5
Adjusted ROAE	26.4	28.6	24.6	16.8	16.8
ROCE	25.2	26.6	23.0	15.3	15.2
YoY Growth (%)					
Revenue	23.0	21.2	11.6	(3.0)	8.0
EBITDA	11.0	21.0	9.4	(19.7)	9.1
Adjusted EPS	10.1	30.6	3.9	(21.9)	10.4
Invested capital	17.5	23.2	19.0	7.8	3.6
Working Capital & Liquidity Ratios					
Receivables (days)	86	78	81	87	83
Inventory (days)	123	115	112	122	116
Payables (days)	50	39	36	34	32
Current ratio (x)	3.7	6.1	4.9	4.7	4.8
Quick ratio (x)	1.0	1.6	1.7	1.8	2.0
Turnover & Leverage Ratios (x)					
Gross asset turnover	1.7	1.8	1.8	1.4	1.3
Total asset turnover	0.8	0.8	0.8	0.7	0.6
Net interest coverage ratio	0.0	0.0	0.0	0.0	0.0
Adjusted debt/equity	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)

DuPont Analysis

Y/E 31 Mar (%)	FY15A	FY16A	FY17E	FY18E	FY19E
Tax burden (Net income/PBT)	79.4	80.7	77.0	77.0	77.0
Interest burden (PBT/EBIT)	103.9	106.4	105.7	108.9	110.0
EBIT margin (EBIT/Revenue)	33.1	34.3	33.7	26.3	26.6
Asset turnover (Revenue/Avg TA)	79.1	83.0	78.1	65.2	64.2
Leverage (Avg TA/Avg equities)	121.9	116.9	114.8	116.4	116.1
Adjusted ROAE	26.4	28.6	24.6	16.8	16.8

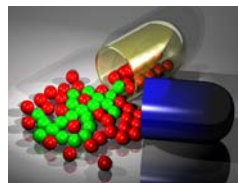
HOLD

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Divis Laboratories

DIVI IN



Company Update

INDIA

PHARMACEUTICALS

Income Statement

Y/E 31 Mar (INR mln)	FY15A	FY16A	FY17E	FY18E	FY19E
Total revenue	31,149	37,764	42,154	40,889	44,160
EBITDA	11,681	14,138	15,470	12,430	13,557
EBIT	10,321	12,956	14,197	10,757	11,759
Net interest income/(expenses)	400	825	811	960	1,172
Other income/(expenses)	0	0	0	0	0
Exceptional items	0	0	0	0	0
EBT	10,721	13,781	15,009	11,717	12,931
Income taxes	(2,206)	(2,662)	(3,452)	(2,695)	(2,974)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	8,515	11,118	11,557	9,022	9,957
Adjustments	0	0	0	0	0
Adjusted net profit	8,515	11,118	11,557	9,022	9,957

Balance Sheet

Y/E 31 Mar (INR mln)	FY15A	FY16A	FY17E	FY18E	FY19E
Accounts payables	2,492	2,583	2,656	2,577	2,783
Other current liabilities	1,806	2,144	2,144	2,144	2,144
Provisions	3,271	164	3,349	3,987	4,624
Debt funds	266	425	425	425	425
Other liabilities	0	0	0	0	0
Equity capital	265	531	531	531	531
Reserves & surplus	34,688	42,345	50,716	55,916	61,413
Shareholders' fund	34,953	42,876	51,247	56,447	61,944
Total liabilities and equities	42,789	48,192	59,821	65,578	71,918
Cash and cash eq.	7,982	8,742	14,824	16,069	19,601
Accounts receivables	7,416	8,809	9,932	9,634	10,405
Inventories	11,626	12,078	13,859	13,443	14,518
Other current assets	1,541	2,986	3,403	3,303	3,563
Investments	0	0	0	0	0
Net fixed assets	13,089	14,388	16,615	22,942	23,644
CWIP	2,396	2,639	2,639	1,639	1,639
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(1,263)	(1,451)	(1,451)	(1,451)	(1,451)
Other assets	0	0	0	0	0
Total assets	42,789	48,192	59,821	65,578	71,918

Cash Flow Statement

Y/E 31 Mar (INR mln)	FY15A	FY16A	FY17E	FY18E	FY19E
Net income + Depreciation	9,875	12,300	12,830	10,695	11,755
Interest expenses	(400)	(825)	(811)	(960)	(1,172)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,338)	(2,800)	(3,248)	735	(1,900)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	8,137	8,676	8,771	10,470	8,683
Capital expenditures	(2,963)	(2,674)	(3,500)	(7,000)	(2,500)
Change in investments	(2,311)	(695)	(5,805)	0	0
Other investing cash flows	428	848	815	964	1,176
Cash flow from investing	(4,846)	(2,521)	(8,490)	(6,036)	(1,324)
Equities issued	0	0	0	0	0
Debt raised/repaid	82	158	0	0	0
Interest expenses	(29)	(23)	(4)	(4)	(4)
Dividends paid	(3,106)	(6,390)	0	(3,186)	(3,823)
Other financing cash flows	0	165	0	0	0
Cash flow from financing	(3,053)	(6,090)	(4)	(3,190)	(3,827)
Changes in cash and cash eq	239	65	277	1,244	3,532
Closing cash and cash eq	652	717	994	2,238	5,771

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Hold	Between 15% and -5%
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