

India

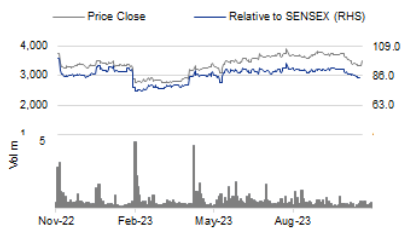
**REDUCE** (previously HOLD)

Consensus ratings\*: Buy 4 Hold 8 Sell 13

Current price:	Rs3,507
Target price:	Rs3,150
Previous target:	Rs3,754
Up/downside:	-10.2%
InCred Research / Consensus:	-3.7%

Reuters:	
Bloomberg:	DIVI IN
Market cap:	US\$11,187m
	Rs930,919m
Average daily turnover:	US\$17.8m
	Rs1482.6m
Current shares o/s:	265.5m
Free float:	48.1%

\*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(5.8)	(6.4)	(6.4)
Relative (%)	(4.3)	(4.9)	(11.8)

Major shareholders	% held
Promoters	51.9
SBI MF	8.3
LIC	6.0

Analyst(s)



**Praful BOHRA**

T (91) 22 4161 1552  
E praful.bohra@incredcapital.com

**Kashish THAKUR**

T (91) 22 4161 1549  
E kashish.thakur@incredcapital.com

# Divi's Laboratories

## Margin recovery baked in; rich valuation

- 2QFY24 EBITDA was a big miss (-12% below expectations) because of a sharp 370bp QoQ decline in gross margin.
- Revenue growth to pick up pace from FY25F, with capacities in place. The pace of margin recovery is key.
- We cut FY24F/25F EPS by 17%/15%, respectively. Downgrade our rating on the stock to REDUCE (HOLD earlier), with a lower target price of Rs3,150.

### Revenue growth steady in 2QFY24, but a big miss on margins

The 2QFY24 revenue of Divi's Laboratories (DLL) were broadly in line, with a sequential 6%/7% recovery in the generics and CCS business, respectively, while the nutraceuticals business rose by a sharp 15% QoQ (+26% YoY). In constant currency or CC terms, the overall revenue declined by 1% YoY. Excl. Covid products, DLL stated that its base business grew in double digits in 2Q as well as in 1HFY24. However, the sharp drop in gross margin (-370bp QoQ) was surprising. Management attributed the fall in gross margin to a change in the product mix, higher pricing pressure and a Rs200m inventory write-off.

### Conference-call highlights

a) Not working with start-ups and small biotech companies and hence, not seeing any slowdown due to this. b) Contrast media – currently has two iodine-based products and will be adding more. c) Commercialization of gadolinium-based products likely to start from FY25F. d) The company believes that GLP-1 peptide products can be a good opportunity, with no major supplies outside of China.

### Kakinada plant capex on track

The construction of Unit-3 is on track with an investment of Rs15bn for phase-I capacity. This unit will manufacture KSMs, a few nutraceuticals' active pharmaceutical ingredients or APIs, advanced intermediates, and complex chemistry APIs, thereby freeing up the Unit-1 and Unit-2 facilities for new opportunities in CCS and generic products. DLL has a CWIP of Rs4.9bn as of 2QFY24-end, of which the Kakinada project accounts for Rs2.6bn.

### Margin recovery is key

While DLL has been giving guidance of an improvement in margins over the last couple of quarters, the same has remained elusive so far, especially when most peers have witnessed a very sharp recovery since 4QFY23. We acknowledge DLL has the building blocks in place - backward integration in large products, a better product mix with faster growth in CCS business, better traction from niche segments like contrast media, operating leverage benefits, etc. – but would be more excited only when we see tangible expansion in margins. Street as well as our estimates build in a margin recovery (+400bp YoY in FY25F) and Kakinada-related costs are likely to hit the P&L from CY25F; thus, we believe the risk on the downside is higher, especially as multiples are elevated. Downgrade our rating on DLL to REDUCE (HOLD earlier) with a lower target price of Rs3,150. Faster-than-expected recovery in margins is a key upside risk.

### Financial Summary

	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
Revenue (Rsm)	69,694	89,598	77,675	79,168	88,738
Operating EBITDA (Rsm)	28,599	38,819	23,669	22,047	28,213
Net Profit (Rsm)	19,843	29,605	18,225	15,819	20,275
Core EPS (Rs)	74.7	111.5	68.7	59.6	76.4
Core EPS Growth	44.2%	49.2%	(38.4%)	(13.2%)	28.2%
FD Core P/E (x)	46.91	31.45	51.08	58.85	45.91
DPS (Rs)	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0.00%	0.00%	0.00%	0.00%	0.00%
EV/EBITDA (x)	31.80	23.24	37.52	40.02	31.14
P/FCFE (x)	32.28	29.93	20.94	32.75	38.89
Net Gearing	(23.2%)	(24.0%)	(33.0%)	(35.3%)	(34.9%)
P/BV (x)	10.02	7.94	7.29	6.87	6.30
ROE	23.9%	28.2%	14.9%	12.0%	14.3%
% Change In Core EPS Estimates				(17.40%)	(14.55%)
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 1: Result snapshot**

(Rs m)	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	Y-o-Y (%)	Q-o-Q (%)
Revenue	18,545	17,077	19,508	17,780	19,090	3%	7%
Consumption of raw materials	6,746	7,396	8,276	6,880	8,100	20%	18%
<i>as % of sales</i>	<i>36.4%</i>	<i>43.3%</i>	<i>42.4%</i>	<i>38.7%</i>	<i>42.4%</i>		
Employee costs	2,321	2,389	2,576	2,630	2,660	15%	1%
<i>as % of sales</i>	<i>12.5%</i>	<i>14.0%</i>	<i>13.2%</i>	<i>14.8%</i>	<i>13.9%</i>		
Other expenditure	3268	3210	3780	3230	3540	8%	10%
<i>as % of sales</i>	<i>17.6%</i>	<i>18.8%</i>	<i>19.4%</i>	<i>18.2%</i>	<i>18.5%</i>		
EBITDA	6,210	4,083	4,876	5,040	4,790	-23%	-5%
<i>Margins (%)</i>	<i>33.5%</i>	<i>23.9%</i>	<i>25.0%</i>	<i>28.3%</i>	<i>25.1%</i>		
Depreciation	857	868	870	930	950		
Other income	801	1,143	662	810	860		
Interest	2	1	2	0	10		
PBT	6,152	4,356	4,665	4,920	4,690	-24%	-5%
Total tax	1,216	1,288	1,455	1,360	1,210		
<i>Tax Rate (%)</i>	<i>19.8%</i>	<i>29.6%</i>	<i>31.2%</i>	<i>27.6%</i>	<i>26.0%</i>		
PAT before MI	4,936	3,068	3,210	3,560	3,480	-29%	-2%
Minority Interest (MI)	0	0	0	0	0		
Adj. PAT before extraordinary items	4,936	3,068	3,210	3,560	3,480	-29%	-2%
Extraordinary expenses	0	0	0	0	0		
Reported PAT	4,936	3,068	3,210	3,560	3,480	-29%	-2%
No. of shares	265.5	265.5	265.5	265.5	265.5		
EPS	18.6	11.6	12.1	13.4	13.1		

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 2: Margin profile**

Margins (%)	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	Y-o-Y (%)	Q-o-Q (%)
Gross	64%	57%	58%	61%	58%	-10%	-6%
EBITDA	33%	24%	25%	28%	25%	-25%	-11%
Adj. PAT	27%	18%	16%	20%	18%	-32%	-9%
Effective Tax rate	20%	30%	31%	28%	26%	32%	-6%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 3: Revenue contribution**

(Rs m)	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	Y-o-Y (%)	Q-o-Q (%)
Generic business	8,941	8,746	10,010	8,888	9,404	5%	6%
<i>% total revenue</i>	<i>48.2%</i>	<i>51.2%</i>	<i>51.3%</i>	<i>50.0%</i>	<i>49.3%</i>		
Custom synthesis	7,975	6,831	7,998	7,112	7,636	-4%	7%
<i>% total revenue</i>	<i>43.0%</i>	<i>40.0%</i>	<i>41.0%</i>	<i>40.0%</i>	<i>40.0%</i>		
Neutraceuticals	1,630	1,500	1,500	1,780	2,050	26%	15%
<i>% total revenue</i>	<i>8.8%</i>	<i>8.8%</i>	<i>7.7%</i>	<i>10.0%</i>	<i>10.7%</i>		
Total Revenue	18,545	17,077	19,508	17,780	19,090	3%	7%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 4: Actuals vs. Incred and Bloomberg estimates**

(Rs m)	2QFY24A	Incred Estimates	Variation (%)	Bloomberg Estimates	Variation (%)
Revenue	19,090	18,545	3%	19,547	-2%
EBITDA	4,790	5,416	-12%	5,933	-19%
EBITDA Margin (%)	25%	29%	-411bp	30%	-526bp
PAT	3,480	3,877	-10%	4,366	-20%

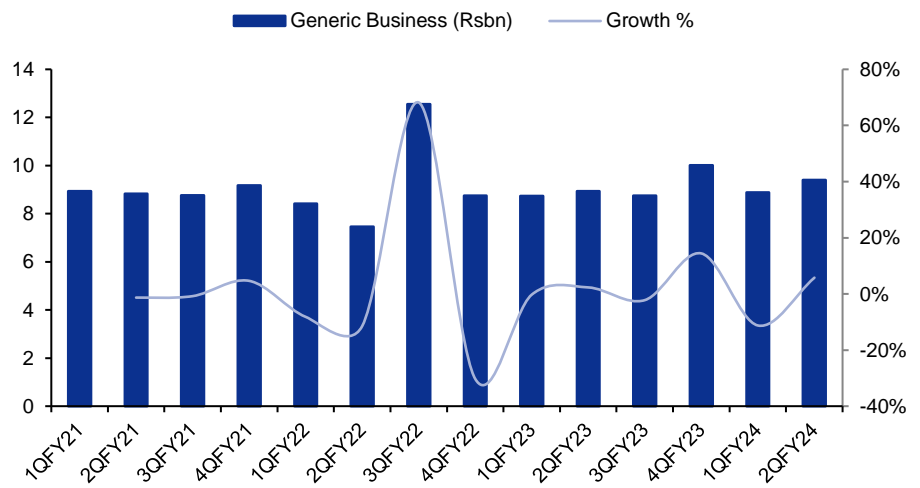
SOURCE: INCRED RESEARCH, COMPANY REPORTS, BLOOMBERG

**Figure 5: Our revised earnings estimates**

(Rs m)	Old Estimates		New Estimates		Change(%)	
	FY24F	FY25F	FY24F	FY25F	FY24F	FY25F
Revenue	81,921	92,327	79,168	88,738	-3%	-4%
EBITDA	26,641	32,871	22,047	28,213	-17%	-14%
EBITDA Margin (%)	33%	36%	28%	32%	-467	-381
PAT	19,152	23,728	15,819	20,275	-17%	-15%

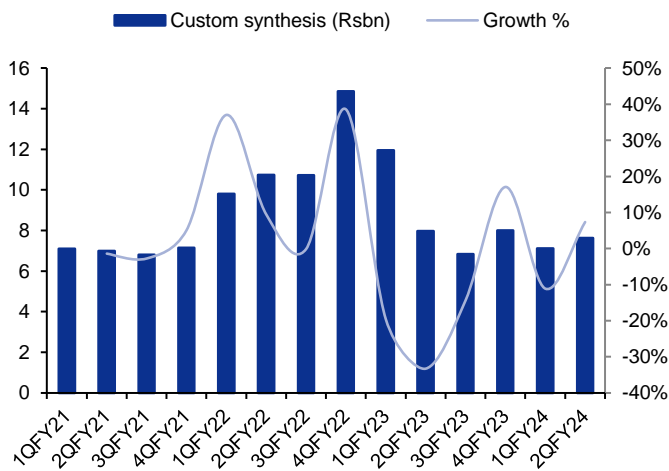
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 6: Generic business impacted in FY23 because of high channel inventory



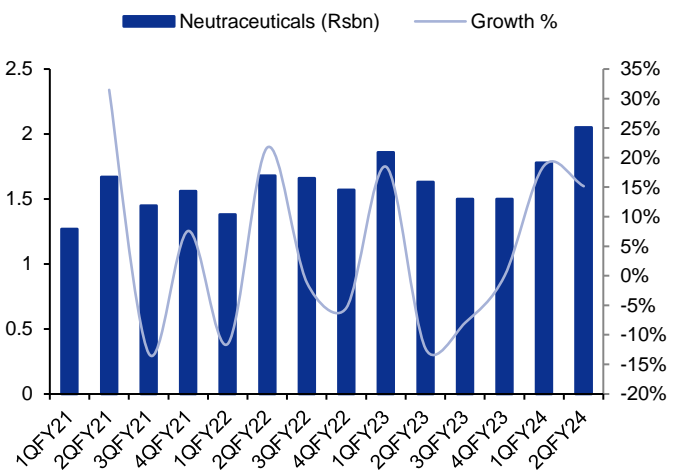
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 7: Custom synthesis business cools off, after a strong FY22, due to supply of a Covid-19 drug



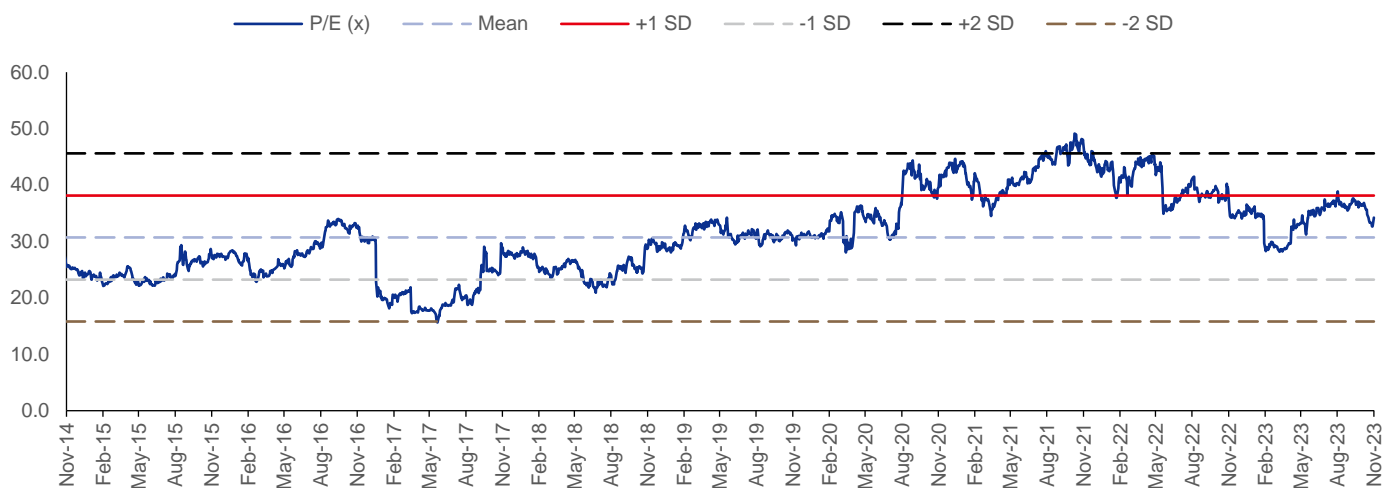
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 8: Nutraceuticals' performance largely steady



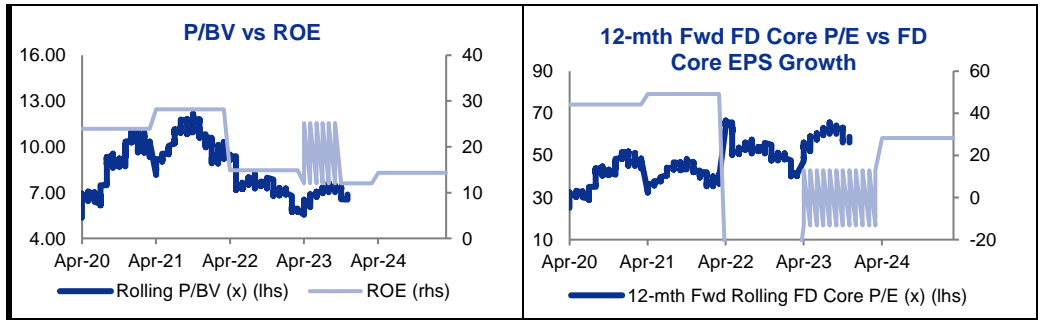
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 9: One-year forward P/E



SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
<b>Total Net Revenues</b>	<b>69,694</b>	<b>89,598</b>	<b>77,675</b>	<b>79,168</b>	<b>88,738</b>
<b>Gross Profit</b>	<b>46,453</b>	<b>59,927</b>	<b>47,138</b>	<b>46,639</b>	<b>55,018</b>
<b>Operating EBITDA</b>	<b>28,599</b>	<b>38,819</b>	<b>23,669</b>	<b>22,047</b>	<b>28,213</b>
Depreciation And Amortisation	(2,556)	(3,115)	(3,432)	(3,830)	(4,300)
<b>Operating EBIT</b>	<b>26,044</b>	<b>35,704</b>	<b>20,237</b>	<b>18,217</b>	<b>23,913</b>
Financial Income/(Expense)	(9)	(8)	(7)	(14)	(14)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	626	1,139	3,447	3,270	3,500
<b>Profit Before Tax (pre-EI)</b>	<b>26,660</b>	<b>36,835</b>	<b>23,677</b>	<b>21,474</b>	<b>27,399</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>26,660</b>	<b>36,835</b>	<b>23,677</b>	<b>21,474</b>	<b>27,399</b>
Taxation	(6,818)	(7,231)	(5,453)	(5,655)	(7,124)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>19,843</b>	<b>29,605</b>	<b>18,225</b>	<b>15,819</b>	<b>20,275</b>
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	<b>19,843</b>	<b>29,605</b>	<b>18,225</b>	<b>15,819</b>	<b>20,275</b>
Recurring Net Profit	19,843	29,605	18,225	15,819	20,275
<b>Fully Diluted Recurring Net Profit</b>	<b>19,843</b>	<b>29,605</b>	<b>18,225</b>	<b>15,819</b>	<b>20,275</b>

Cash Flow

(Rs mn)	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
<b>EBITDA</b>	<b>28,599</b>	<b>38,819</b>	<b>23,669</b>	<b>22,047</b>	<b>28,213</b>
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(2,641)	(13,705)	4,188	1,568	(5,372)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	(6,489)	(5,997)	(3,260)	(5,655)	(7,124)
Net Interest (Paid)/Received	(9)	(8)	(7)	(14)	(14)
Tax Paid	(6,443)	(7,128)	(6,709)	(8,911)	(10,610)
<b>Cashflow From Operations</b>	<b>19,469</b>	<b>19,118</b>	<b>24,597</b>	<b>17,961</b>	<b>15,717</b>
Capex	(9,102)	(7,130)	(4,730)	(7,500)	(7,500)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(1,000)				
<b>Cash Flow From Investing</b>	<b>9,367</b>	<b>11,988</b>	<b>19,867</b>	<b>10,461</b>	<b>8,217</b>
Debt Raised/(repaid)					
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid		(5,309)	(7,964)	(7,964)	(7,964)
Preferred Dividends					
Other Financing Cashflow	1,252	(50)	2,039	3,392	3,499
<b>Cash Flow From Financing</b>	<b>1,252</b>	<b>(5,360)</b>	<b>(5,925)</b>	<b>(4,572)</b>	<b>(4,465)</b>
Total Cash Generated	10,620	6,629	13,942	5,889	3,752
<b>Free Cashflow To Equity</b>	<b>28,837</b>	<b>31,106</b>	<b>44,465</b>	<b>28,422</b>	<b>23,934</b>
<b>Free Cashflow To Firm</b>	<b>28,845</b>	<b>31,114</b>	<b>44,471</b>	<b>28,436</b>	<b>23,948</b>

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

<b>Balance Sheet</b>					
<b>(Rs mn)</b>	<b>Mar-21A</b>	<b>Mar-22A</b>	<b>Mar-23A</b>	<b>Mar-24F</b>	<b>Mar-25F</b>
Total Cash And Equivalents	21,560	28,189	42,131	48,020	51,772
Total Debtors	16,765	24,239	17,925	19,000	21,297
Inventories	21,452	28,286	30,004	26,917	30,171
Total Other Current Assets	1,969	2,801	3,057	3,167	3,550
<b>Total Current Assets</b>	<b>61,747</b>	<b>83,515</b>	<b>93,117</b>	<b>97,104</b>	<b>106,789</b>
Fixed Assets	44,053	47,875	49,292	52,962	56,162
Total Investments		720	771	771	771
Intangible Assets	92	75	53	53	53
Total Other Non-Current Assets	1,849	1,562	1,155	1,155	1,155
<b>Total Non-current Assets</b>	<b>45,994</b>	<b>50,232</b>	<b>51,270</b>	<b>54,940</b>	<b>58,140</b>
Short-term Debt	11	8			
Current Portion of Long-Term Debt					
Total Creditors	7,632	7,957	7,625	7,427	7,818
Other Current Liabilities	3,481	3,990	3,386	3,249	3,420
<b>Total Current Liabilities</b>	<b>11,125</b>	<b>11,956</b>	<b>11,011</b>	<b>10,677</b>	<b>11,238</b>
Total Long-term Debt		29		136	148
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	3,670	4,481	5,706	5,706	5,706
<b>Total Non-current Liabilities</b>	<b>3,670</b>	<b>4,510</b>	<b>5,706</b>	<b>5,842</b>	<b>5,854</b>
Total Provisions					
<b>Total Liabilities</b>	<b>14,795</b>	<b>16,465</b>	<b>16,717</b>	<b>16,518</b>	<b>17,092</b>
Shareholders Equity	92,946	117,282	127,671	135,526	147,837
Minority Interests					
<b>Total Equity</b>	<b>92,946</b>	<b>117,282</b>	<b>127,671</b>	<b>135,526</b>	<b>147,837</b>

<b>Key Ratios</b>					
	<b>Mar-21A</b>	<b>Mar-22A</b>	<b>Mar-23A</b>	<b>Mar-24F</b>	<b>Mar-25F</b>
Revenue Growth	29.2%	28.6%	(13.3%)	1.9%	12.1%
Operating EBITDA Growth	57.0%	35.7%	(39.0%)	(6.9%)	28.0%
Operating EBITDA Margin	41.0%	43.3%	30.5%	27.8%	31.8%
Net Cash Per Share (Rs)	81.17	106.05	158.70	180.38	194.46
BVPS (Rs)	350.12	441.79	480.93	510.52	556.89
Gross Interest Cover	2,993.51	4,463.04	3,020.51	1,334.61	1,751.87
Effective Tax Rate	25.6%	19.6%	23.0%	26.3%	26.0%
Net Dividend Payout Ratio					
Accounts Receivables Days	80.91	83.52	99.07	85.12	82.88
Inventory Days	314.82	305.93	348.36	319.35	308.97
Accounts Payables Days	106.32	95.88	93.12	84.45	82.51
ROIC (%)	26.0%	28.8%	16.7%	14.7%	17.7%
ROCE (%)	31.3%	34.0%	16.5%	13.8%	16.9%
Return On Average Assets	20.6%	24.5%	13.1%	10.7%	12.8%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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