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## Initiating coverage

## Pharmaceuticals

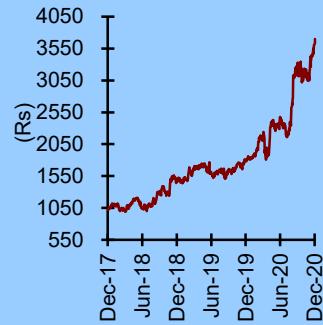
Target price: Rs3,960

## Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	52.0	52.0	52.0
Institutional investors	34.7	35.0	37.1
MFs and others	14.7	15.6	14.8
Banks / FIs	0.9	1.2	3.7
FII	19.1	18.2	18.6
Others	13.3	13.0	10.9

Source: BSE India

## Price chart



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## Divi's Laboratories

## Sustainable strong growth play

Rs3,689

Divi's Laboratories (Divis) is one of the largest generic API manufacturers globally and has a successful track record of executing custom synthesis business for innovator customers. Strong positioning of Divis will help in monetising the growth opportunity in API and CRAMS space given its stellar execution track record and being one of the preferred suppliers. Further, recent and planned capex of ~Rs22bn reinforces our view as Divis is known for expanding capacities with very high business visibility. Key moats of the company have been continuous process innovation, low cost production, talent retention and long-standing relationships with customers. Our reverse DCF calculation suggests that OCF (operating cash flow) would grow strong at ~24% CAGR over next ten years, assuming 12% WACC and 4% terminal growth. Initiate with an ADD rating.

- ▶ **Strong positioning will aid monetisation of growth opportunity in API and CRAMS:** Considering the strong execution track record and process chemistry skills, we believe, Divis is well placed to monetise growing global API (~US\$180bn market) and CRAMS (~US\$74bn market) business opportunities. It commands sizeable (>50%) market share in its top products like *Naproxen*, *Dextromethorphan*, *Gabapentin*, etc. The company only manufactures select APIs (~30) and is globally the largest API manufacturer for more than 10 of them. Focus on few products and bringing cost advantage through process chemistry skills with presence only in API/intermediates work as key moats for Divis to be partner of choice. The company is also a large player in custom synthesis (CRAMS/CDMO) with strong relationship with six of the top 10 big pharma companies. This is a very profitable business (~50% EBITDA margin). We expect generic APIs, carotenoids and custom synthesis businesses to grow at 23.1%, 18.0% and 19.3% over FY20-FY23E, respectively.
- ▶ **Capex of ~Rs22bn ensures growth visibility:** Divis announced capex plan of ~Rs18bn in FY19 of which ~Rs16bn has already been capitalised as on H1FY21 and the remaining would be capitalised by FY21 end. The company also announced an additional capex of Rs4bn towards the custom synthesis capacity which will complete in next 6-9 months with immediate commercialisation. The company has managed a gross fixed asset turnover of ~1.8x over FY11-FY20. This would imply an additional revenue of ~Rs40bn from this new capex over the next few years.
- ▶ **Strong and consistent financial metrics:** Divis registered 17%/14% revenue/PAT CAGR over FY11-FY20 with industry leading EBITDA margin of 35-40% and RoE/RoCE above 20%. We estimate revenue/EBITDA/PAT CAGR of 21%/28%/26% over FY20-FY23E with higher demand for API/CRAMS, growth visibility based on planned capex and stable margin profile. Divis has consistently generated positive FCF over the years and we expect ~Rs37bn FCF over FY21E-FY23E.
- ▶ **Initiate with ADD:** We initiate coverage on Divis with an **ADD** rating and target price of Rs3,960/share based on 40xDec'22E EPS. Key downside risks: Higher competition in API space, currency fluctuation and regulatory hurdles.

Market Cap	Rs979bn/US\$13.3bn	Year to March	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	DIVI.BO/DIVI IN	Net Revenue (Rs mn)	53,944	68,654	81,549	95,174
Shares Outstanding (mn)	265.5	Net Profit (Rs mn)	13,765	19,308	23,109	27,324
52-week Range (Rs)	3760/1633	Dil. EPS (Rs)	51.9	72.7	87.1	102.9
Free Float (%)	47.0	% Chg YoY	1.8	40.3	19.7	18.2
FII (%)	18.6	P/E (x)	71.1	50.7	42.4	35.8
Daily Volume (US\$'000)	57,841	CEPS (Rs)	58.9	81.8	97.6	115.0
Absolute Return 3m (%)	18.9	EV/EBITDA (x)	53.2	35.1	29.2	24.5
Absolute Return 12m (%)	107.5	Dividend Yield (%)	0.9	0.4	0.5	0.6
Sensex Return 3m (%)	18.8	RoCE (%)	18.5	23.0	22.9	22.5
Sensex Return 12m (%)	12.7	RoE (%)	19.3	23.9	23.6	23.2

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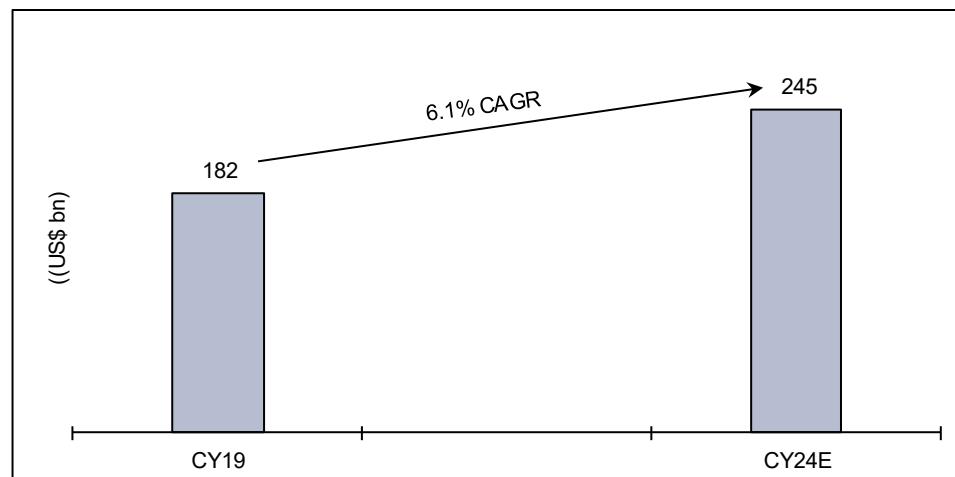
## Investment rationale

### In sweet spot for growing API/CRAMS opportunity

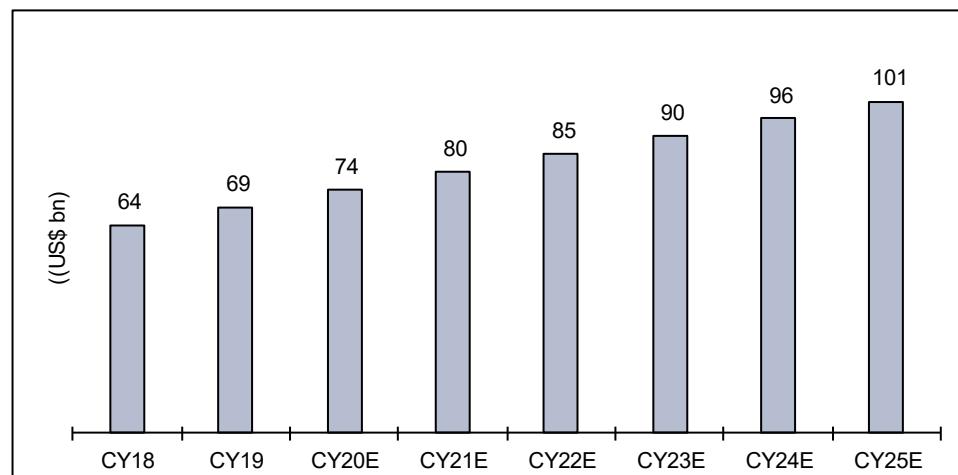
Global API market is valued at ~US\$180bn and CRAMS (API/bulk drugs) is valued at ~US\$74bn and both the industries are expected to grow at 6-7% CAGR till CY25. API exports from India stood at ~US\$4bn in FY20 and are estimated to grow at 7.1% CAGR over FY20-FY25 to US\$5.5bn. We believe there is potential for higher growth in API business opportunity in India with rising preference for manufacturing in India as a part of global supply chain shift in post-COVID era. This is also visible from very strong growth reported by Indian API companies in H1FY21. We also believe Divis is positively placed to garner this growth opportunity considering:

- Potential market share gains in existing products with likely shift of manufacturing to India and aided by capacity addition
- Focus on limited products (~30 commercialised APIs) with continuous process improvement strategy providing scale benefit and cost advantage
- New product launches (~10 products in pipeline) with similar strategy of garnering meaningful market share and process improvement
- Strong track record of meeting customer satisfaction level in terms of timely order supply, maintaining quality standards and zero rejection
- Relatively clean regulatory track record with last inspection at both Unit-I and Unit-II concluding with zero 483 observations

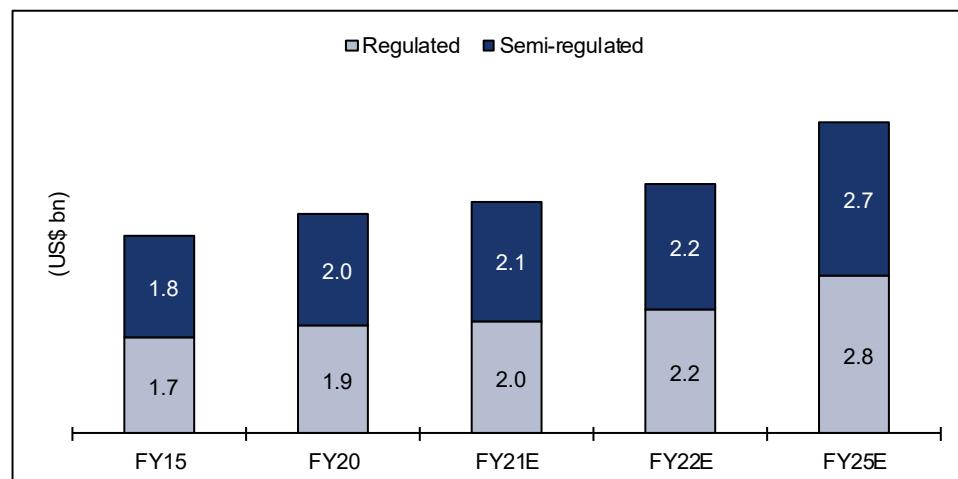
**Chart 1: Global API market size (incl. CRAMS API)**



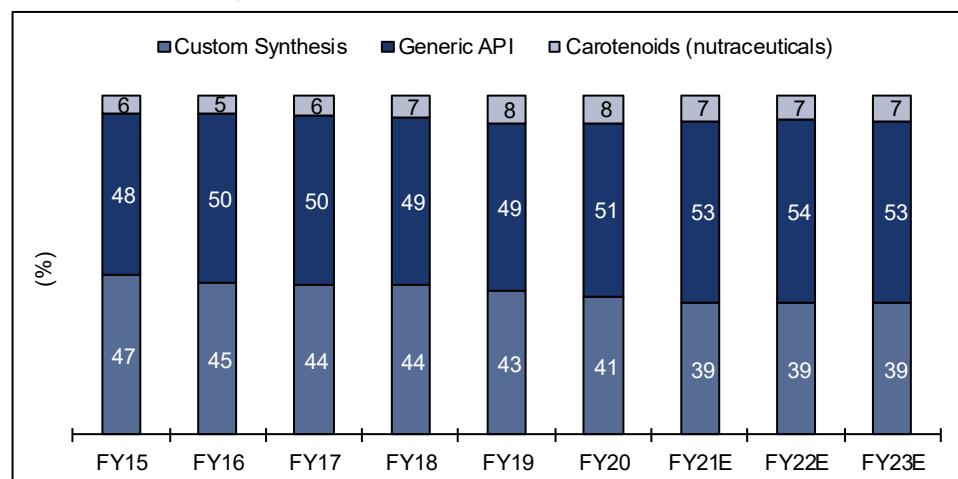
Source: Industry data, I-Sec research

**Chart 2: Global CRAMS (CDMO) market**

Source: Industry data, I-Sec research

**Chart 3: Growth trend in API exports from India**

Source: Industry data, I-Sec research

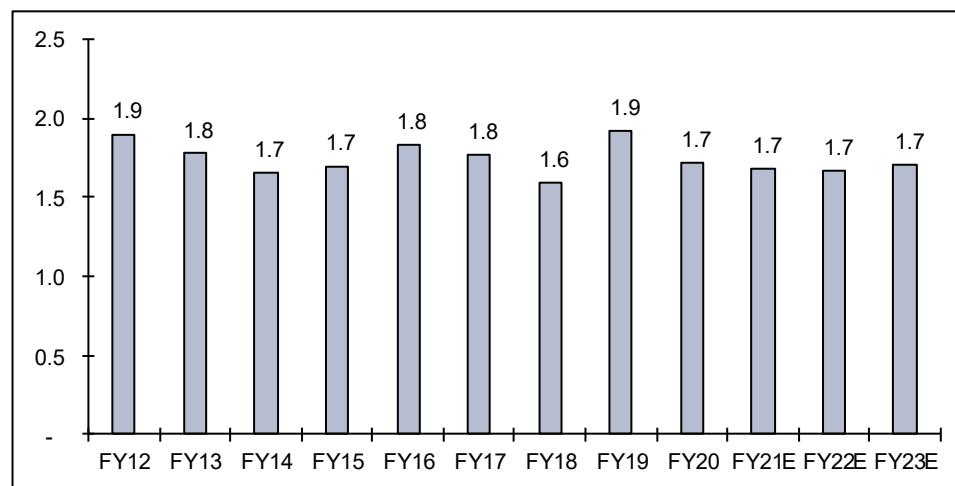
**Chart 4: Divis segmental revenue contribution movement**

Source: Company data, I-Sec research

## Heavy capex ensures high growth visibility in medium term

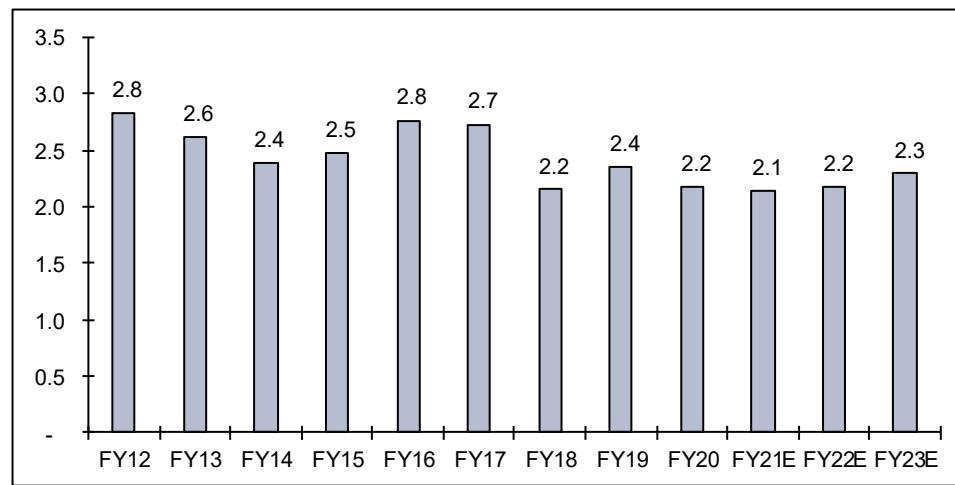
Divis had announced a capex plan of ~Rs18bn in FY19 including two brownfield projects, one each at Unit-I and Unit-II, capacity de-bottlenecking, backward integration and utilities modernisation. Around Rs16bn of this capex has been capitalised as on H1FY21 and we expect the balance by the end of this fiscal. Additionally, the company announced fresh capex of ~Rs4bn for custom synthesis business which will complete in next 6-9 months with immediate commercialisation. We believe asset turns in custom synthesis business will be higher than the overall company average. Overall, the company has managed an asset turnover of ~1.8 (on gross block) over FY11-FY20. This will imply an additional revenue of ~Rs40bn from this new capex over the next few years. Divis also plans to start construction at Kakinada (greenfield plant) in Q4FY21 with a likely capex outlay of ~Rs6bn with an expected commercialisation in FY24-FY25. Post Kakinada, capital infusion at Nellore plant will commence. These two new facilities will aid in maintaining growth momentum beyond FY24. Divis has been judicious in finalising capex plans in past only with strong business visibility and this heavy capex plan reinforces our view of strong growth outlook.

**Chart 5: Gross fixed asset turnover ratio**



Source: Company data, I-Sec research

**Chart 6: Net fixed asset turnover ratio**



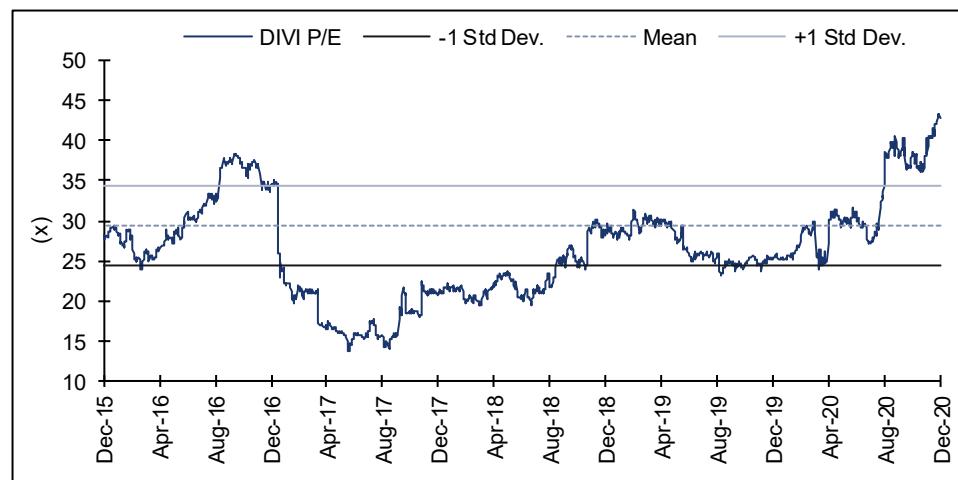
Source: Company data, I-Sec research

## Premium valuation justified

We expect Divis to register earnings CAGR of 25.7% over FY20-FY23E driven by revenue CAGR of 20.8% and 670bps EBITDA margin improvement. We believe revenue growth will be led by market share gain in existing products, new launches (~10 products in pipeline) and growing demand for custom synthesis projects. We expect return ratios to remain strong at RoE and RoCE of 23.2% and 22.5%, respectively, in FY23E despite the ongoing capex programme.

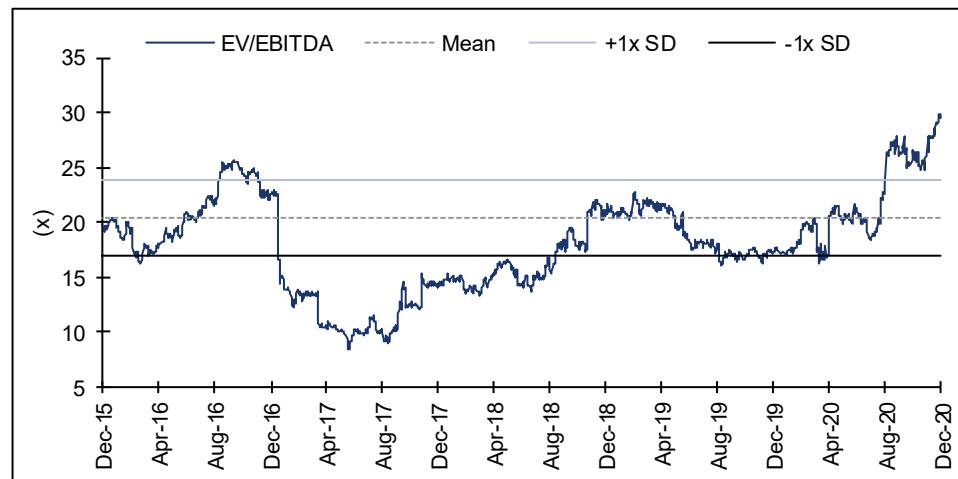
The stock currently trades at valuations of 42.4xFY22E and 35.8xFY23E earnings and EV/EBITDA multiple of 29.2xFY22E and 24.5xFY23E. The stock has traded at premium valuations in the past and the same has improved further recently due to strong growth seen in H1FY21, potential opportunity from shift of API/CRAMS manufacturing to India given China disruptions. We believe premium valuation of the stock is justified and will continue due to its strong execution track record, high growth visibility and superior return ratios. We initiate coverage with an **ADD** rating and value the stock at a target price of Rs3,960/share based on 40xDec'22E EPS.

**Chart 7: 1-year forward P/E chart**



Source: Company data, Bloomberg data, I-Sec research

**Chart 8: 1-year forward EV/EBITDA chart**



Source: Company data, Bloomberg data, I-Sec research

**Table 1: Relative valuations**

Company	CMP (Rs)	Mkt Cap (US\$ mn)	P/E(x)			EV/EBITDA (x)			RoE(%)		
			FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
<b>API/CRAMS players</b>											
Syngene^	605	3,266	60.2	48.7	37.4	34.1	27.5	22.4	15.9	17.0	18.7
Laurus^	333	2,406	20.6	19.7	15.3	13.6	12.1	10.2	38.1	30.7	28.0
Granules^	386	1,291	19.3	16.3	13.7	12.7	10.6	9.0	24.2	23.5	22.5
Aarti Drugs^	790	994	28.1	22.4	17.7	16.7	13.6	12.0	33.1	31.4	31.3
<b>Average</b>			<b>32.1</b>	<b>26.8</b>	<b>21.0</b>	<b>19.3</b>	<b>15.9</b>	<b>13.4</b>			
<b>Large cap Pharma</b>											
Sun Pharma	569	18,425	27.7	24.0	20.9	16.7	14.5	12.4	10.8	11.7	12.2
Dr Reddy's	5,015	11,222	30.1	26.4	18.0	17.4	15.2	10.6	16.6	16.6	21.0
Cipla	766	8,335	26.6	23.4	20.5	14.2	12.6	10.8	13.8	13.9	14.0
Lupin	949	5,802	39.9	26.1	22.4	17.9	13.4	11.6	8.3	11.7	12.4
Aurobindo	896	7,085	16.6	15.5	14.1	10.0	9.4	8.3	17.4	16.0	15.3
Cadila	465	6,426	24.1	22.8	20.3	15.5	14.7	13.2	18.1	17.2	17.5
Torrent Pharma	2,672	6,103	36.3	29.8	25.0	19.6	17.2	15.0	24.1	25.4	26.0
<b>Average</b>			<b>28.8</b>	<b>24.0</b>	<b>20.2</b>	<b>15.9</b>	<b>13.9</b>	<b>11.7</b>			
<b>Divis</b>	<b>3,689</b>	<b>13,216</b>	<b>50.7</b>	<b>42.4</b>	<b>35.8</b>	<b>35.1</b>	<b>29.2</b>	<b>24.5</b>	<b>23.9</b>	<b>23.6</b>	<b>23.2</b>
Company	Mkt Cap (US\$ mn)	P/E(x)			EV/EBITDA (x)			RoE(%)			
		CY20E	CY21E	CY22E	CY20E	CY21E	CY22E	CY20E	CY21E	CY22E	
Lonza^	40,230	40.1	35.2	30.6	25.9	23.2	20.3	14.2	14.7	15.8	
Wuxi AppTec^	38,502	82.4	65.9	50.2	57.9	44.8	35.5	13.1	14.7	16.3	
Catalent^*	15,390	36.5	31.2	25.5	19.5	17.3	15.4	12.9	13.2	14.7	
Celltrion^	50,172	80.6	65.9	59.7	52.9	44.7	39.2	18.6	19.2	18.1	
Samsung Biologics^	53,629	239.6	153.5	116.5	132.4	102.2	83.2	5.8	9.0	10.9	
<b>Average</b>		<b>95.9</b>	<b>70.3</b>	<b>56.5</b>	<b>57.7</b>	<b>46.5</b>	<b>38.7</b>				

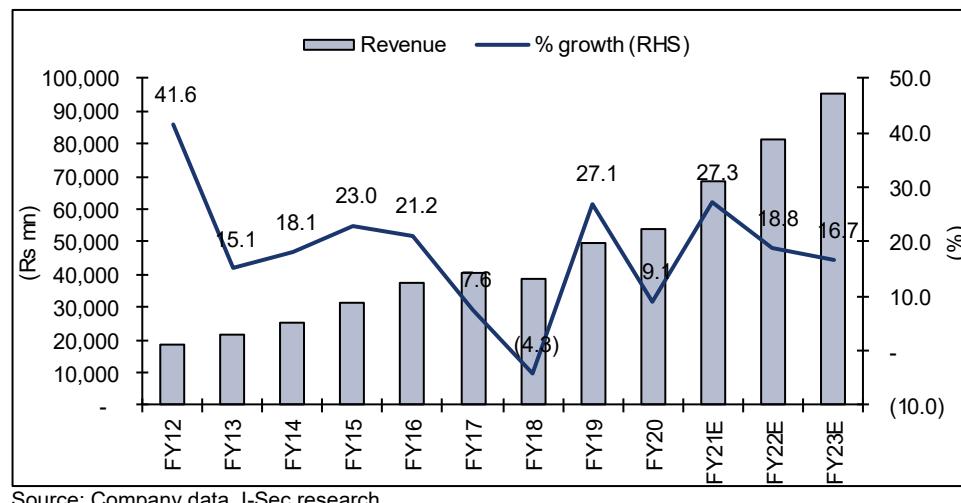
Note: ^ - Bloomberg estimates; \* - FY21-FY23 estimates

Source: Company data, I-Sec research

## High growth visibility across business segments

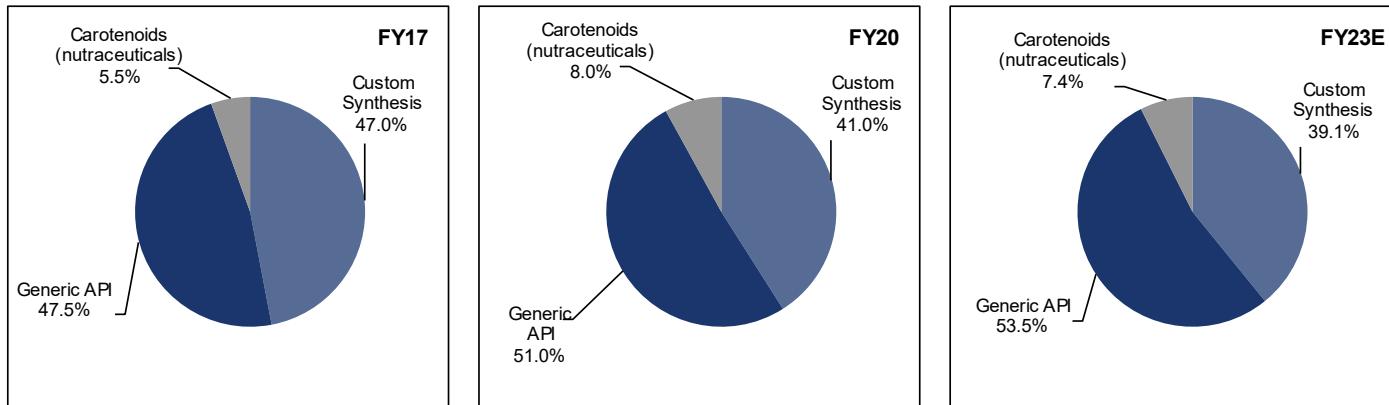
Divis has been a sustainable long-term growth story with 17.0% revenue CAGR observed over FY11-FY20 which is purely organic. Over FY20-FY23E, we expect it to register an even stronger growth of 20.8% considering the recent capacity addition, likely market share gain in existing products backed by cost advantage through continuous process improvement, significant growth uptick in nutraceutical products after COVID-19 and increasing demand for APIs/CRAMS from India with India becoming a preferred destination for manufacturing.

**Chart 9: Revenue growth trajectory**

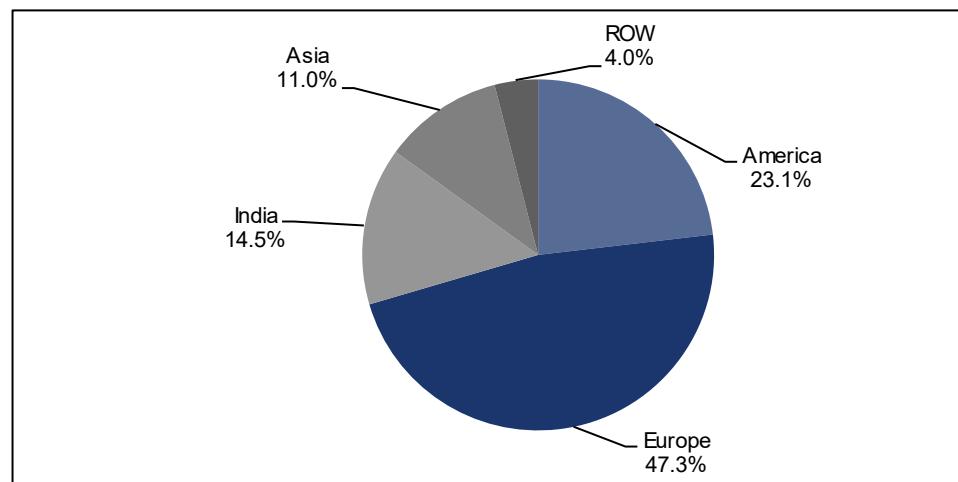


Source: Company data, I-Sec research

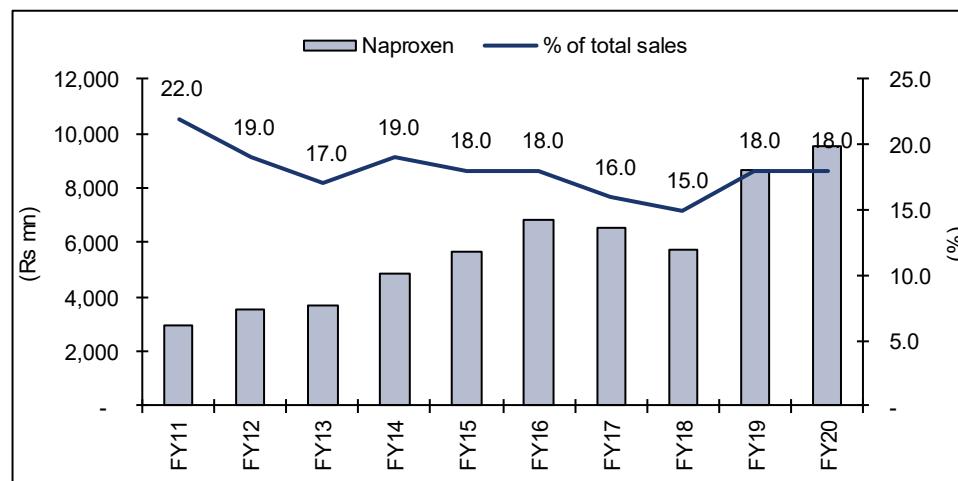
**Chart 10: Movement in segmental revenue contribution**



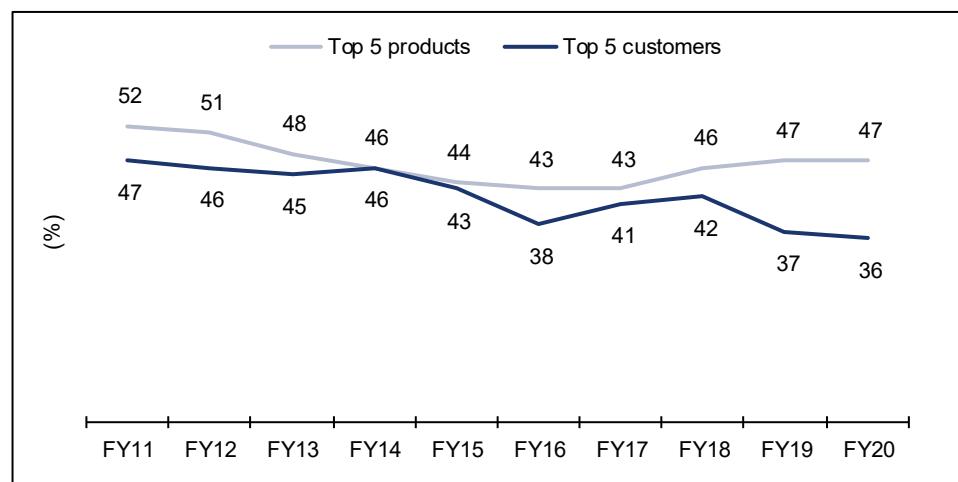
Source: Company data, I-Sec research

**Chart 11: Geographical revenue contribution (FY20)**

Source: Company data, I-Sec research

**Chart 12: Revenue contribution from largest product (Naproxen)**

Source: Company data, I-Sec research

**Chart 13: Revenue contribution from top 5 products and top 5 customers**

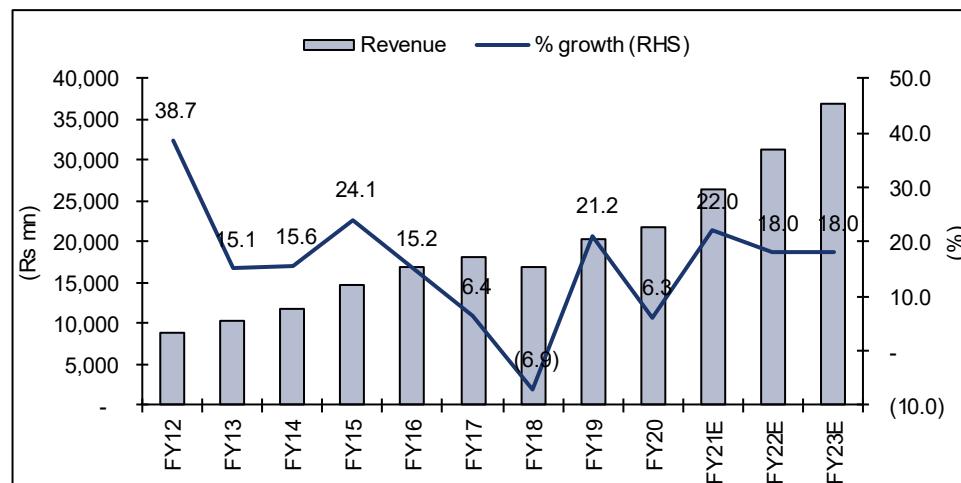
Source: Company data, I-Sec research

## Custom synthesis - strong relationships and high profitability

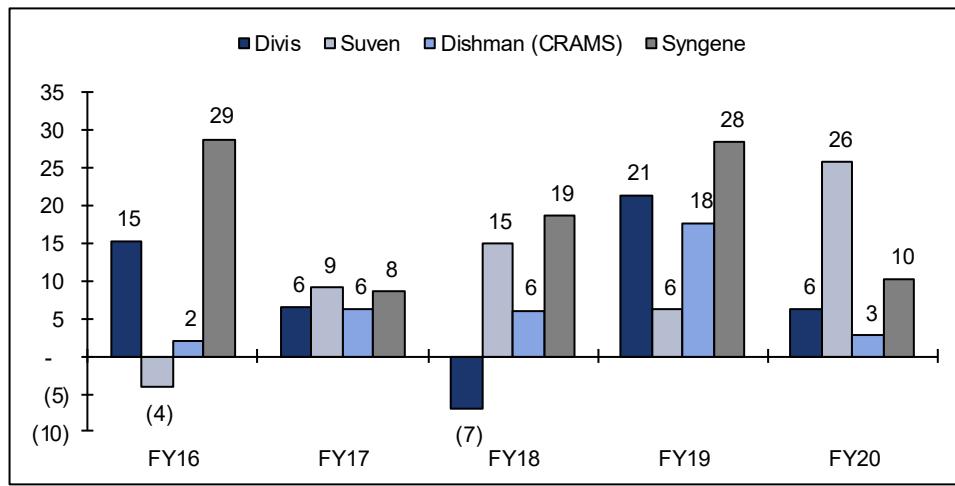
Custom synthesis (CRAMS) is one of the core business areas of the company and contributes ~41% to total revenue. This business primarily includes contract manufacturing services of API and intermediates for global innovators and has diverse product portfolio across therapeutic areas. The company has built strong relationships with six of the top ten big pharma companies. It is associated with twelve of the top twenty big pharma companies for more than ten years in custom synthesis business. Divis has a strong team of 350 scientists who specialise in development of innovative processes and optimisation of same on continuous basis for maintaining competitive position.

This business segment involves taking innovator companies' projects at phase-II or phase-III level and supply materials for trials initially and later commercial quantities if the product is successfully approved and launched. Stickiness is the advantage of this business as innovator customer will want a reliable and quality supplier and won't move away generally as the product would initially be under patent. Hence, if the product is successfully launched, commercial supplies become sustainable in nature. We believe this business provides very high profitability with EBITDA margin of 45-50%. We expect the revenue from this segment to grow at 19.3% CAGR over FY20-FY23E.

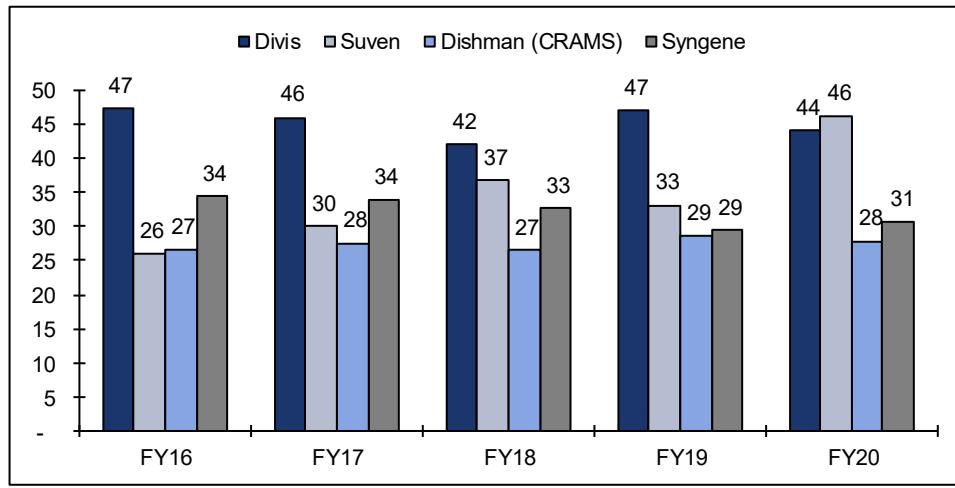
**Chart 14: Revenue growth trajectory in custom synthesis**



Source: Company data, I-Sec research

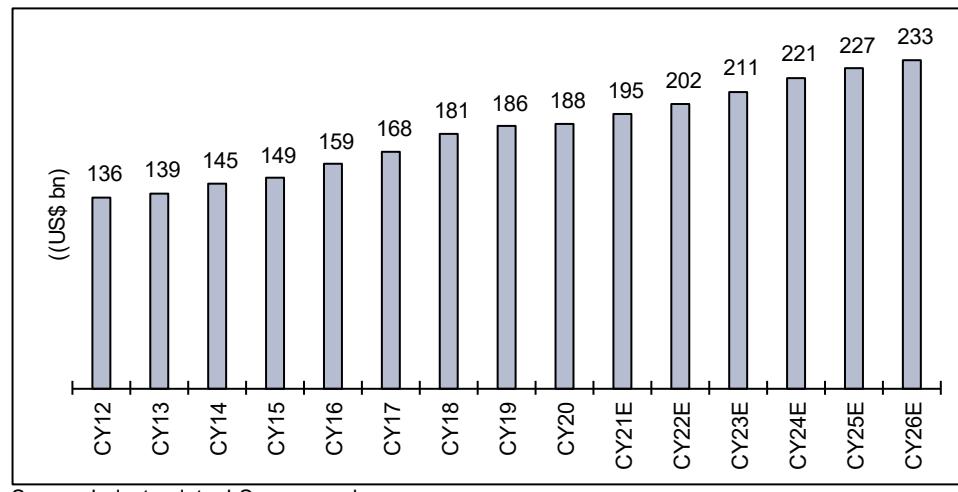
**Chart 15: Revenue growth comparison with peer companies**

Source: Company data, I-Sec research

**Chart 16: EBITDA margin profile comparison with peer companies**

Source: Company data, I-Sec research

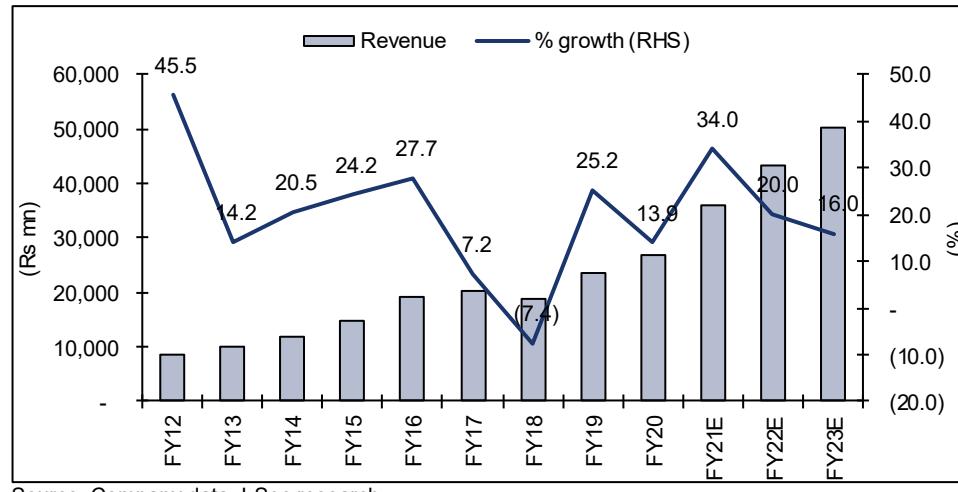
The future growth visibility of this business segment depends upon the R&D spend by the innovators, new product pipeline (NCEs) and innovative product approvals. The global R&D spend has been on rise and as a % to sales has been largely stable. Innovation is a constant feature in pharma and NCE pipeline of new drug development will continue to remain robust.

**Chart 17: Global R&D spend trend**

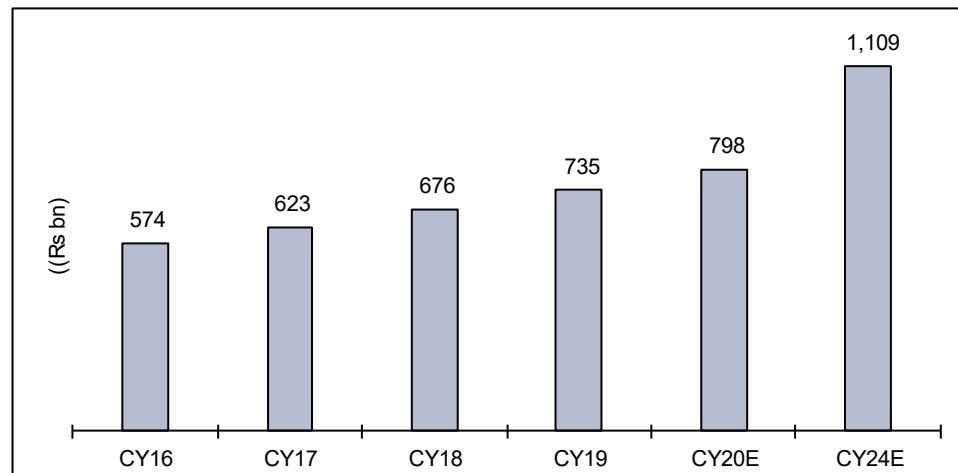
Source: Industry data, I-Sec research

### Generic APIs - strong growth momentum to continue

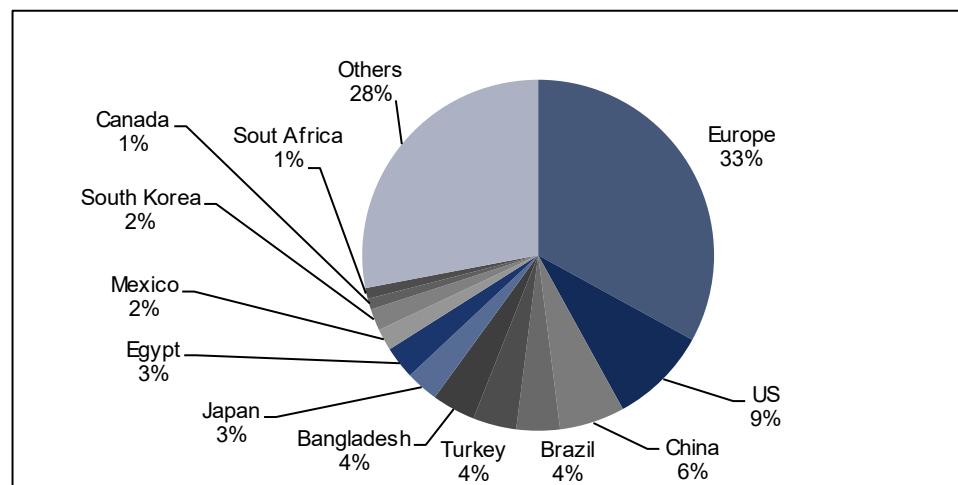
Divis is one of the largest generic API companies in the world particularly in large volume APIs. Divis' strategy has been to focus on limited products, build large capacities to gain scale & sizeable market share, continuous process improvement and robust chemistry skills to gain cost advantage and to have backward integration of intermediates for select products. This strategy has clearly helped the company to witness constant strong growth momentum (18.2% revenue CAGR in generic APIs over last ten years). We expect growth to accelerate over the next three years with 23.1% revenue CAGR driven by the recent capacity addition, market share gain in existing products and likely supply chain shift with India becoming one of the preferred destinations.

**Chart 18: Strong growth momentum in generic APIs**

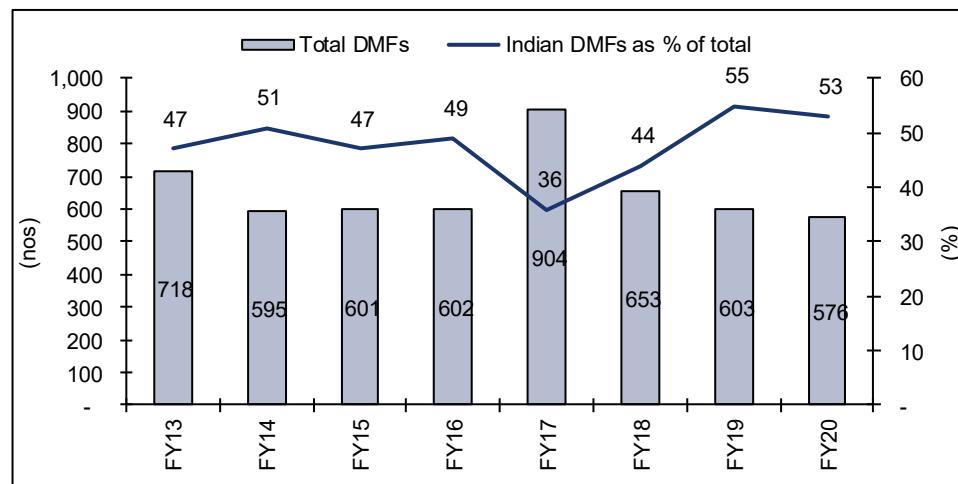
Source: Company data, I-Sec research

**Chart 19: API market size in India**

Source: Industry data, I-Sec research

**Chart 20: Country-wise break-up of API exports from India**

Source: Industry data, I-Sec research

**Chart 21: India's share in global DMF filings**

Source: Industry data, I-Sec research

Divis focusses on very limited number of products but targets to become one of the largest suppliers in the same. Currently, Divis has ~30 commercialised APIs and ~10 products are in the pipeline. As a result of its strategy of gaining meaningful market share in products it commercialises, Divis is now the largest supplier globally in more than 10 of the 30 commercialised APIs and is among the top two manufacturers in 18 of the 30 products. Backward integration of key starting materials, large capacity build-up well ahead of time and dedicated manufacturing blocks for products with large batch sizes have been key ingredients to achieve global leadership position.

**Table 2: Commercialised APIs**

Product	Therapy	Countries
Capecitabine	Antineoplastic	US, EU, Australia, Singapore, Saudi, China, Thailand, Korea, Taiwan
Carbidopa	Antiparkinson	US, EU, Canada, Japan, Korea, Taiwan
Diltiazem HCl	Anti Hypersensitive	US, EU, Canada, China
Dextromethorphan Base	Anti Tussive, Analgesic	US, EU, Japan, Australia, Israel
Dextromethorphan HBr	Anti Tussive, Analgesic	US, EU, Canada, China, Korea, Japan, Taiwan
Gabapentin	Anticonvulsant / Neuropathic Pain	US, EU, Canada, China, Austria, Korea, Japan
Iopamidol	Contrast Medium	US, EU, China, Korea
Irbesartan	Antihypertensive	US, EU, China
Levetiracetam	Anti Convulsant	US, EU, Canada, Australia, Korea, Russia, Japan, Swiss, Saudi
Levodopa	Antiparkinson	US, EU, Canada, Korea, Japan, Taiwan
Mesalamine	Anti inflammatory	US, EU, Iran, Japan
Nabumetone	Anti inflammatory	US, EU, Canada, Korea, Japan, China, Taiwan
Naproxen	Anti Inflammatory, Analgesic, Antipyretic	US, EU, Canada, China, Korea, Saudi, Taiwan
Naproxen Sodium	Anti Inflammatory, Analgesic, Antipyretic	US, EU, Canada, China, Korea
Niacin	Anti Hyperlipidemic	US, Taiwan
Olmesartan Medoxomil	Antihypertensive	US
Phenylephrine HCl	Antitussive	US, EU, Korea, China, Philippines
Pregabalin	Antiepileptic	US, EU, Australia, Uganda, Tanzania, Iran, Korea
Proguanil HCl	Prophylactic Antimalarial	US, EU, Canada
Quetiapine Fumarate	Anti Psychotic	US, EU, Canada, Australia, Korea, China, Taiwan
Telmisartan	Anti Hypertensive	US, EU
Triprolidine HCl	Antihistamine	EU, Canada, Taiwan
Valacyclovir HCl	Anti Viral	US, Canada, Japan, Australia
Valsartan	Antihypertensive	US, EU, Australia, Korea, Japan, Taiwan, Philippines
Venlafaxine HCl	Antidepressant	US, EU
Vigabatrin	Anticonvulsant	US, EU

Source: Company data, I-Sec research

**Table 3: API pipeline to be commercialised**

Product	Therapy	Status
Ranolazine	Anti-Anginal	Validations completed and planning to file DMF
Ticagrelor	Anti-Coagulant	Validations completed and planning to file DMF
Lacosamide	Anti-Convulsant/Anti-Epileptic	Validations completed and planning to file DMF
Iohexol	Contrast Medium	Under Validation
Hydroxychloroquine	Anti-Malarial	Under Validation
Favipiravir	Anti-Viral	Under Validation
Mirabegron	Anticholinergic	Sample Available
Nicotine	Smoking Cessation Aid	Sample Available
Dolutegravir	Anti-HIV	Sample Available
Ibudilast	Anti-Inflammatory	Sample Available
Rivaroxaban	Anti-Coagulant	Sample Available
Tenofovir Alafenamide	Anti-HIV	Sample Available
Vildagliptin	Anti-Diabetic	Sample Available
Brivaracetam	Anti-Convulsant	Early stage development
Dabigatran	Anti-Coagulant	Early stage development
Benserazide	Anti-Parkinson	Early stage development

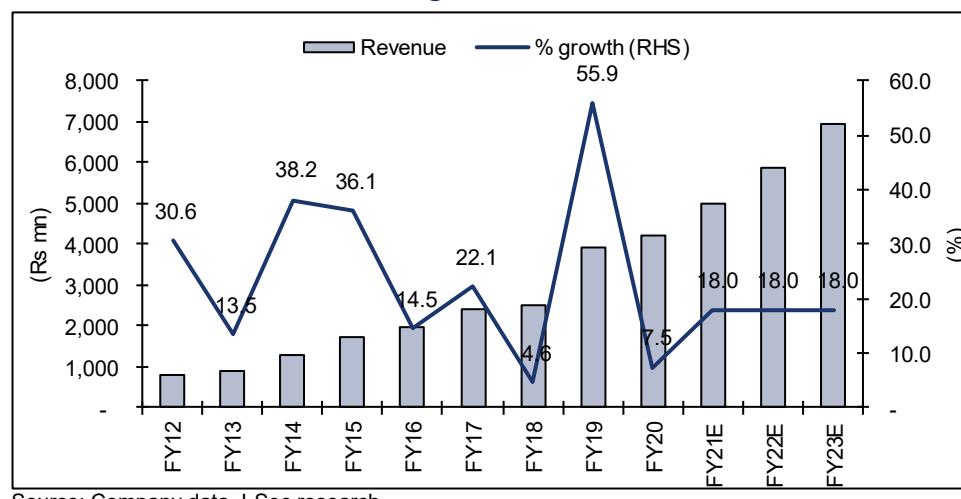
Source: Company data, I-Sec research

## Nutraceuticals - small segment but growing fast

Divis is one of the few nutraceutical ingredient (carotenoids) manufacturers and offers a complete range of products for food, dietary supplements and feed across the world. Its carotenoids product portfolio includes products like *Beta Carotene*, *Astaxanthin*, *Lycopene*, *Canthaxanthin* and also finished forms such as *Lutein*, *Vitamins (A, D3, D2, E Acetate and A Palmitate)*. It also provides customised product solutions in the form of liquid, powder and beadlets. The nutraceutical manufacturing facility is located at Unit-II and manufactures active ingredients as well as finished forms of carotenoids. This plant also includes one R&D, application testing and support facility.

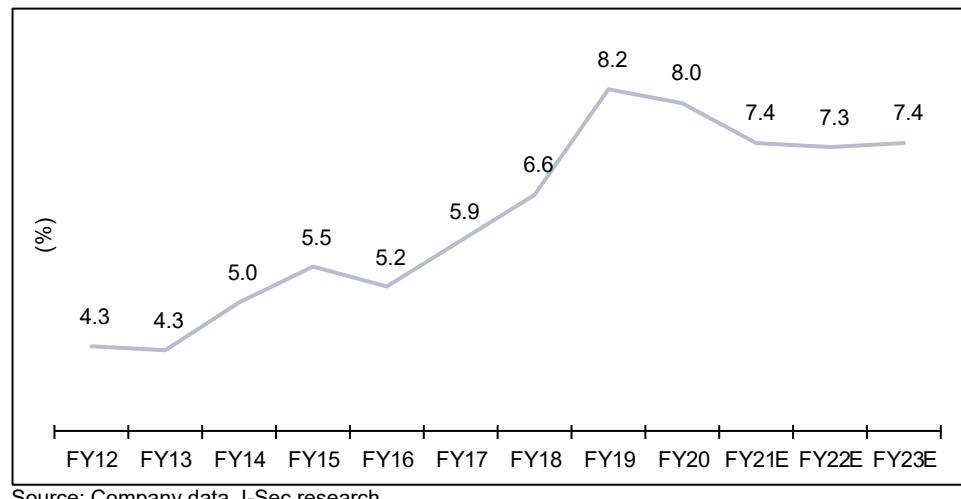
Carotenoids currently contribute ~8% to total revenue and witnessed a strong growth of 23.8% CAGR over FY11-FY20. We expect growth momentum to continue driven by rising demand for nutraceutical products globally after COVID-19 outbreak. We estimate revenue CAGR of 18.0% in this segment, though contribution to total revenue will remain similar.

**Chart 22: Carotenoids revenue growth trend**



Source: Company data, I-Sec research

**Chart 23: Revenue contribution of carotenoids to total revenue**



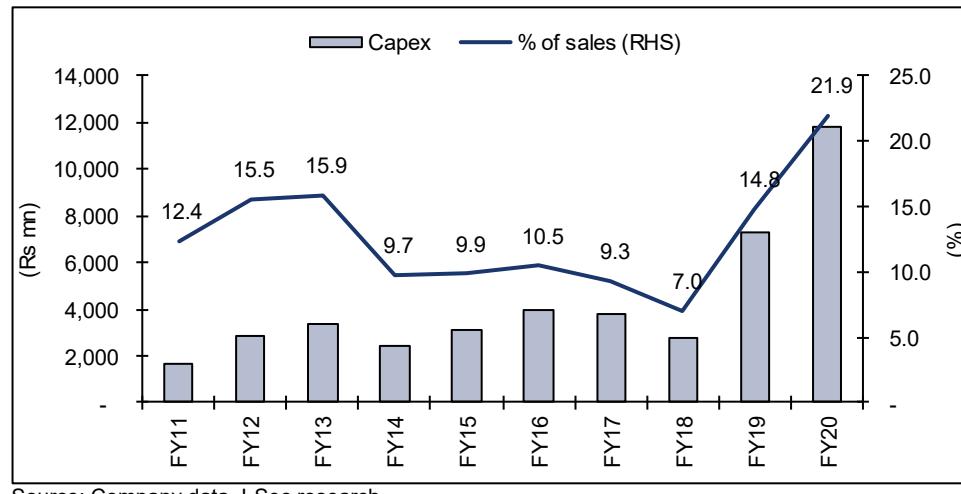
Source: Company data, I-Sec research

## Planned heavy capex ensures growth visibility

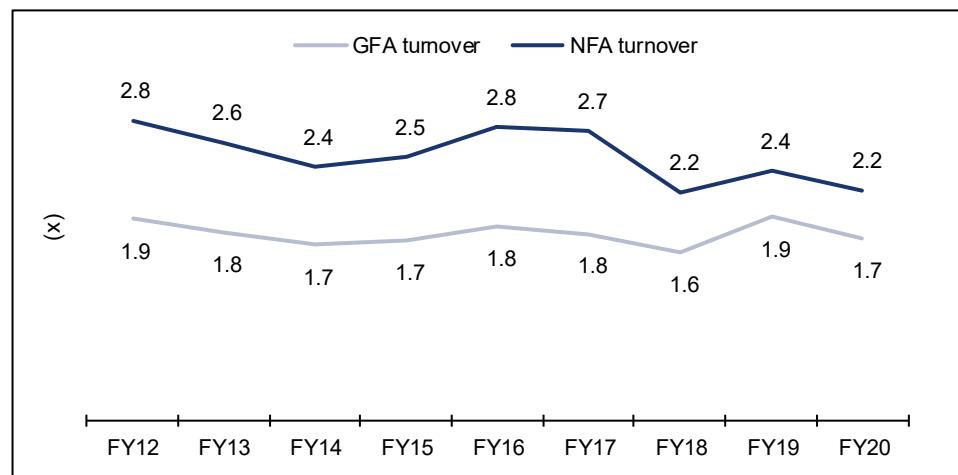
Divis earlier announced a capex plan of ~Rs18bn in FY19 including two brownfield projects, capacity de-bottlenecking, backward integration and plant modernisation. This consists of 1) one brownfield SEZ project at Unit-II, named as DCV SEZ unit near Visakhapatnam, with capex outlay of Rs6bn, 2) another brownfield SEZ project at Unit-I, named Chandra SEZ (DC SEZ) near Hyderabad, with capex outlay of Rs6bn, and 3) remaining for capacity de-bottlenecking at existing units, backward integration and utilities modernisation. Around Rs16bn of this capex has been capitalised as on H1FY21 and the balance will be complete by the end of this fiscal. The company has managed an asset turnover of ~1.8 (on gross block) over FY11-FY20. This will imply an additional revenue of ~Rs40bn from this new capex over the next few years.

Additionally, the company recently announced fresh capex of Rs4bn for custom synthesis business which will complete by Q1FY22 with immediate commercialisation. The company has two more plants that are greenfield projects – Kakinada and Nellore. Construction at Kakinada greenfield plant will commence in Q4FY21 with expected capex outlay of ~Rs6bn. It will take ~3 years for completion of plant and getting necessary regulatory approvals with expected commercialisation in FY25. Post Kakinada, capex at Nellore plant will commence. These two new facilities will aid in maintaining growth momentum beyond FY24. Divis is known for judicious capex planning and invests with very high business visibility and this heavy capex plan reinforces our view of a strong growth outlook.

**Chart 24: Capex trend as % to sales**



Source: Company data, I-Sec research

**Chart 25: Fixed asset turnover ratios**

Source: Company data, I-Sec research

**Table 4: Capacity details**

Name	Location	Unit	Area	Details
Unit I	Bhuvanagiri -Yadadri, Telangana	Existing DC-SEZ	500 acres	13 multipurpose blocks, over 400 reactors and capacity of 2000 cubic meters Investment of Rs6bn with capacity of ~3700 MTPA
		Export oriented SEZ		8 production blocks
Unit II	Vizag, AP	DSN SEZ	450 acres	9 production blocks
		DCV-SEZ		6 production blocks
				Investment of Rs6bn with capacity of ~3700 MTPA
				3 R&D centres with 350 scientists, development of new compounds and improve process of existing products
Research Centres	Hyderabad	DRC		
Unit III	Kakinada		425 acres	To invest ~Rs6bn and commercialisation likely in FY25
Unit IV	Nellore		200 acres	At planning stage, work to start post Kakinada project

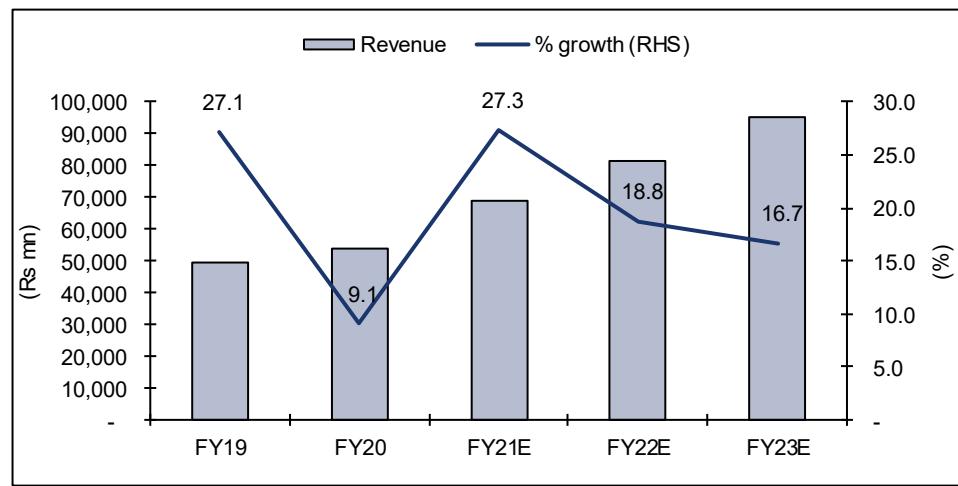
Source: Company data, I-Sec research

## Financial performance

Expect revenue CAGR of 20.8% over FY20-FY23

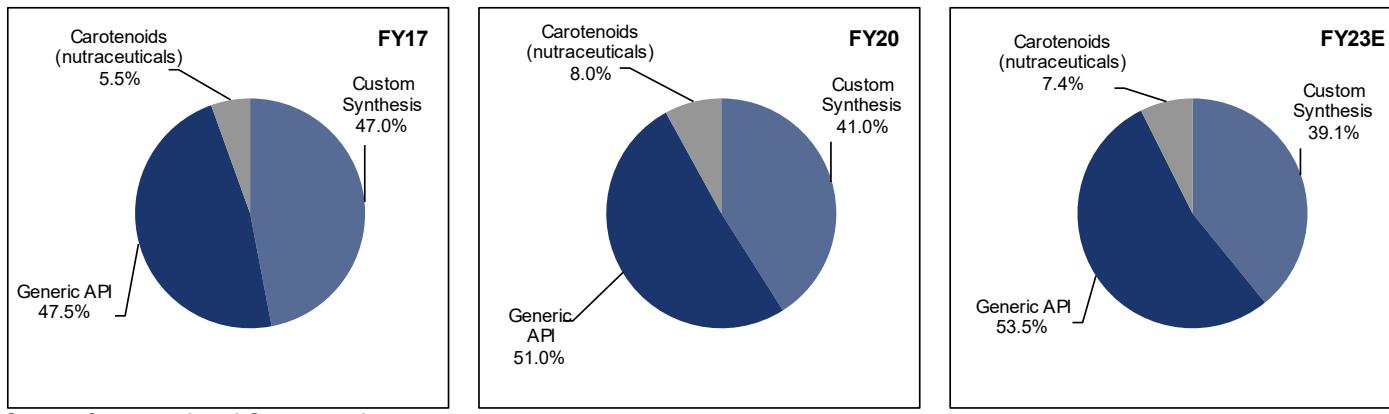
Divis has grown at a CAGR of 17.0% over FY11-FY20 with 14.4% CAGR in custom synthesis segment, 18.2% in generic APIs segment and 23.8% in carotenoids (nutraceuticals) segment. We expect these segments to benefit from market share gain in existing products, new launches (~10 products in pipeline) and growing demand for custom synthesis projects as well as higher demand for nutraceuticals post-COVID. Overall, we expect revenue CAGR of 20.8% over FY20-FY23E.

**Chart 26: Revenue growth trend**



Source: Company data, I-Sec research

**Chart 27: Segment-wise revenue contribution**

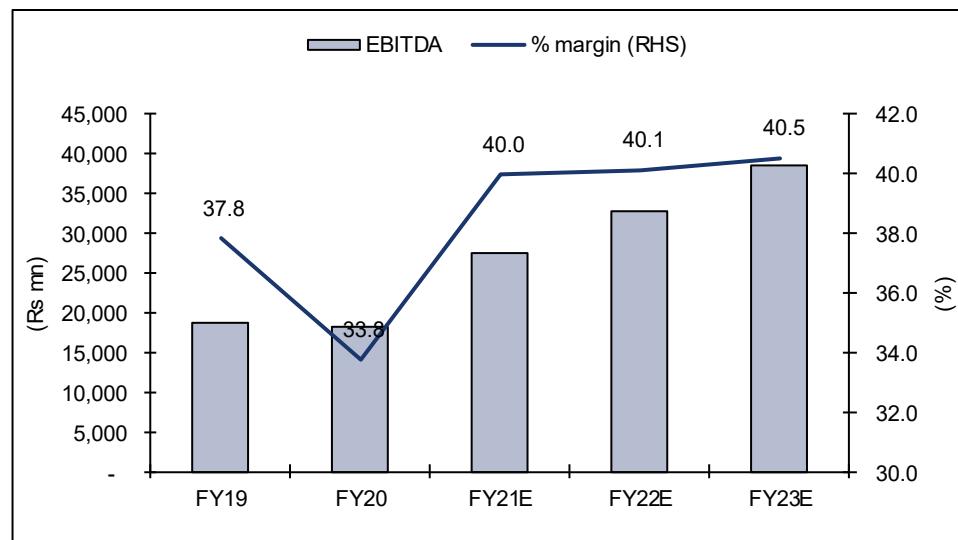


Source: Company data, I-Sec research

## EBITDA margin to remain stable ~40%

We expect Divis to maintain its EBITDA margin at ~40% over FY21E-FY23E despite its high revenue growth since expenses would rise post commercialisation of the announced capex. However, the company's approach of focus on limited products (~30 commercialised APIs) with continuous process improvement strategy provides scale benefit and cost advantage which will help in improvement at the gross margin level. Overall, we expect EBITDA to grow by 28.4% CAGR over FY20-FY23E to Rs38.6bn.

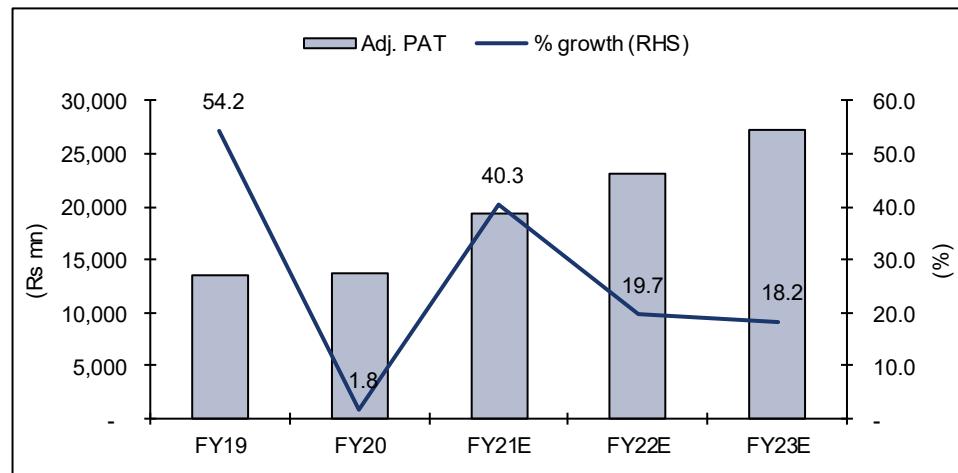
**Chart 28: Movement of EBITDA margin over FY20-FY23E**



Source: Company data, I-Sec research

## Expect adjusted net profit to grow at 25.7% CAGR

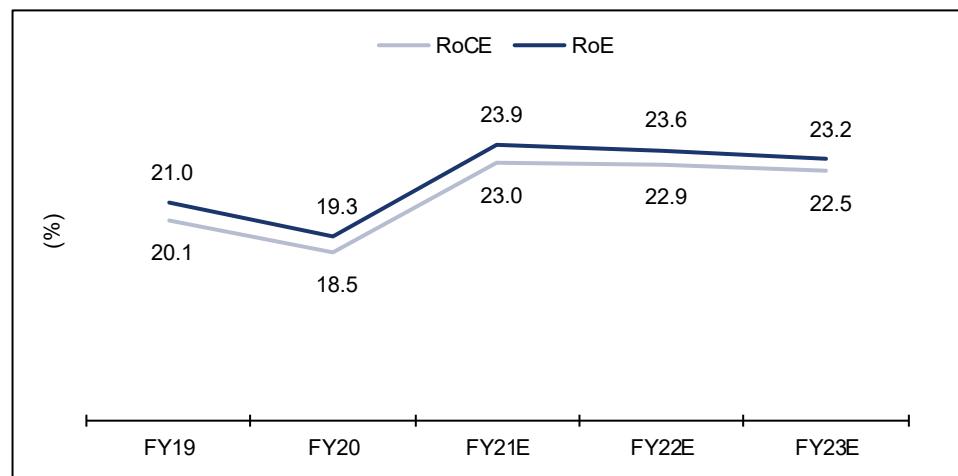
Considering a healthy revenue growth trajectory and stable EBITDA margin, we believe Divis will be able to continue reporting healthy bottomline growth. The increase in depreciation will be due to the expansion the company is undergoing at the moment. We expect the company to register 25.7% adjusted net profit CAGR over FY20-FY23E to Rs27.3bn.

**Chart 29: Adjusted net profit growth trend**

Source: Company data, I-Sec research

### Stable but healthy return ratios

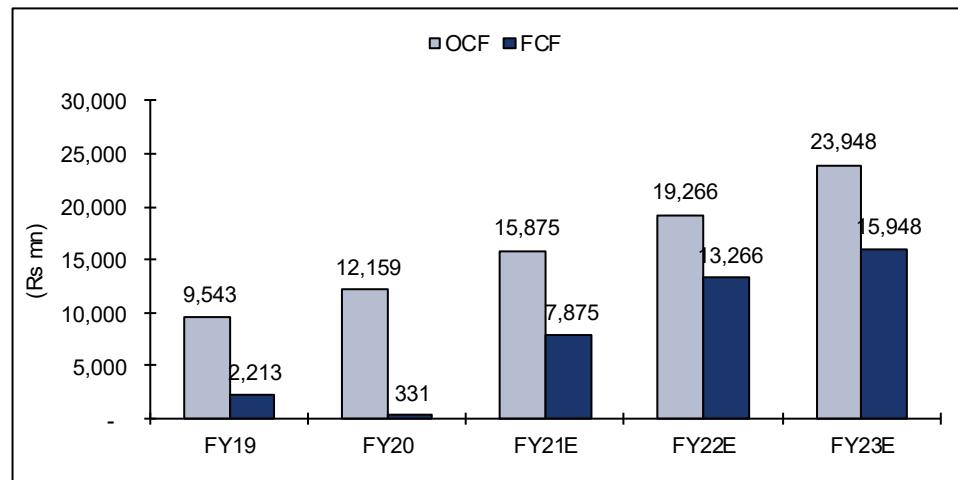
As the company is undergoing a significant expansion phase, we expect the return ratios to remain stable in near to mid-term ratios at ~22-23%.

**Chart 30: Return ratios to remain high**

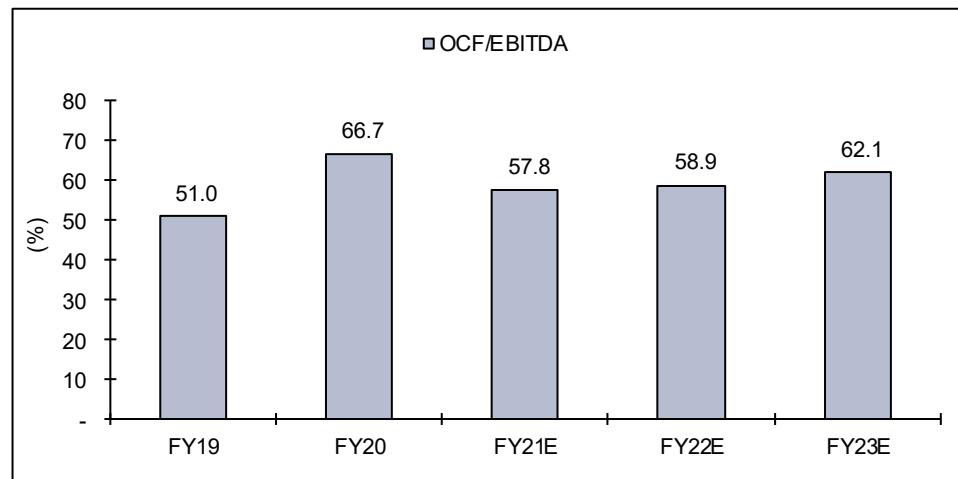
Source: Company data, I-Sec research

### Consistent and strong free cashflow generation

Considering the healthy revenue and profit growth with stable EBITDA margin, we believe Divis will continue to see growth in operating cashflow (OCF) and free cashflow (FCF). We expect OCF to grow at 25.3% CAGR to Rs23.9bn in FY23E and the OCF/EBITDA stable at ~60-62%. The company has announced significant capex plans suppressing FCF at the moment. However, a large part of the capex is already capitalised aiding growth in FCF over the next few years.

**Chart 31: Strong free cashflow generation**

Source: Company data, I-Sec research

**Chart 32: OCF to EBITDA ratio**

Source: Company data, I-Sec research

## Risks

### Regulatory hurdles

Regulatory inspections and observations are recurring events in pharma business and any adverse outcome in terms of warning letter or import alert can have a negative impact. Divis has history of one import alert in FY18; however, it was able to resolve the same in few months as compared to several years in case of most other companies.

### Concentration risk

Currently, Divis has ~30 commercialised APIs and ~10 products are in the pipeline. The top 5 products contribute ~47% to total sales, while the top product can contribute ~18% to total sales. This high concentration has an inherent risk of adverse business impact.

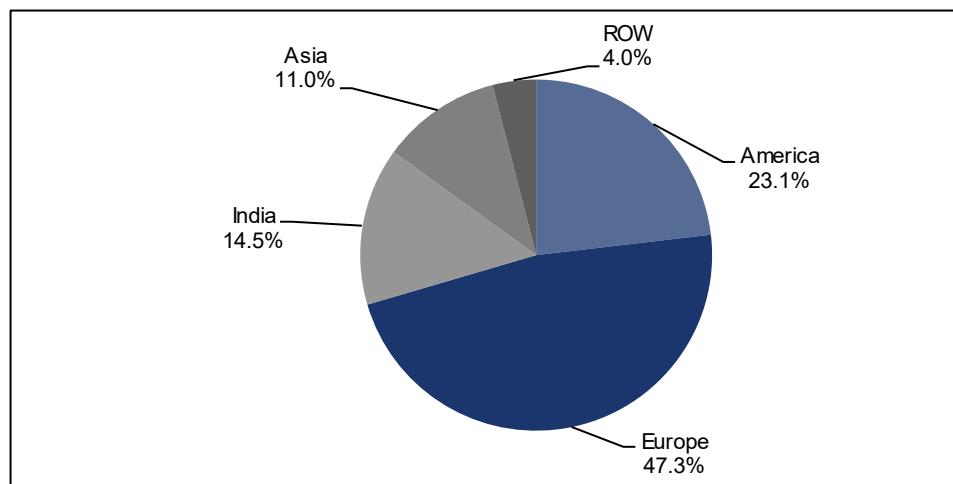
### Currency volatility

Exports sales contribute ~87% to the overall sales which is affected by sharp currency fluctuations.

## Company background and key management personnel

Divis commenced its operations in 1990 under the leadership of Dr. Murali Divi. The firm's focus has always been manufacturing of generic APIs and intermediates as well as offering process development services to manufacturers of APIs and intermediates. Currently, Divis has ~30 commercialised APIs with ~10 products in the pipeline. Backward integration of key starting materials, large capacity build-up well ahead of time and dedicated manufacturing blocks for products with large batch sizes have been key ingredients to achieve global leadership position. As a result of its strategy, Divis is now the largest supplier globally in more than 10 of the 30 commercialised APIs and is among top two manufacturers in 18 of the 30 products.

**Chart 33: Region-wise revenue mix (FY20)**



Source: Company data, I-Sec research

The company has R&D centres in Hyderabad and four multipurpose manufacturing facilities at two sites. Unit 1 in Telangana has 13 commercialised blocks while Unit 2 in Vizag has 23 commercialised blocks. The company is currently in the process of expanding its manufacturing facility.

**Table 5: Key management personnel**

Name	Designation	Background
Dr. Murali K. Divi	MD	Dr. Divi is the Founder and Managing Director of Divi's Laboratories Ltd. He had extensive experience of more than 15 years in the pharma industry before founding Divi's Labs. He currently manages technical and financial operations of the company.
Dr Kiran S. Divi	CEO & Whole time director	He has been a part of the company since the past 15 years and was elevated to the position of CEO in Jan'20. He currently manages corporate functions and operations at manufacturing plants.
Mr N.V. Ramana	Exec. director	He has been a part of Divis for nearly 25 years and is overseeing strategic planning, sales & marketing, CRAMS and nutraceutical divisions. His experience in the industry spans more than 35 years.
Mr Madhusudana Rao Divi	Whole time director (Projects)	He has been a part of Divis for nearly 20 years and heads projects division, managing production, engineering, sustainability and environmental segment along with construction of new projects.
Ms Nilima Motaparti	Whole time director (Commercial)	She joined Divis 5 years ago and administers material sourcing & procurement, corporate finance and investor relation at the company.

Source: Company data

## Financials

**Table 6: Profit and loss statement**

(Rs mn, year ending Mar 31)

	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	48,038	52,912	67,621	80,516	94,141
Other operating income	1,424	1,033	1,033	1,033	1,033
<b>Total Sales</b>	<b>49,463</b>	<b>53,944</b>	<b>68,654</b>	<b>81,549</b>	<b>95,174</b>
<b>Less:</b>					
Raw material cost	18,252	21,085	24,372	29,765	34,738
Employee cost	5,423	6,211	7,701	8,625	9,850
Others	7,069	8,427	9,134	10,434	12,008
<b>Total Operating Expenses</b>	<b>30,744</b>	<b>35,723</b>	<b>41,207</b>	<b>48,825</b>	<b>56,597</b>
<b>EBITDA</b>	<b>18,718</b>	<b>18,222</b>	<b>27,446</b>	<b>32,724</b>	<b>38,577</b>
Depreciation	1,689	1,862	2,409	2,792	3,198
Other income	1,556	1,896	791	979	1,166
<b>EBIT</b>	<b>18,586</b>	<b>18,256</b>	<b>25,829</b>	<b>30,910</b>	<b>36,545</b>
Less: Financial expenses	35	61	16	16	16
Extraordinary Items	-	-	-	-	-
<b>Recurring Pre-tax Income</b>	<b>18,551</b>	<b>18,195</b>	<b>25,813</b>	<b>30,895</b>	<b>36,529</b>
Less: Taxation	5,023	4,429	6,505	7,785	9,205
Less: Minority Interest / Subs. loss	-	-	-	-	-
<b>Reported Income</b>	<b>13,527</b>	<b>13,765</b>	<b>19,308</b>	<b>23,109</b>	<b>27,324</b>
<b>Adjusted Net Income</b>	<b>13,527</b>	<b>13,765</b>	<b>19,308</b>	<b>23,109</b>	<b>27,324</b>

Source: Company data, I-Sec research

**Table 7: Balance sheet**

(Rs mn, year ending Mar 31)

	FY19	FY20	FY21E	FY22E	FY23E
<b>ASSETS</b>					
<b>Current Assets, Loan &amp; Advances</b>					
Current investments	13,983	9,714	9,714	9,714	9,714
Inventories	17,723	18,639	21,544	26,311	30,707
Sundry debtors	11,634	14,134	17,987	21,366	24,936
Cash and bank balances	1,153	1,226	5,224	13,853	24,320
Loans and advances	355	393	404	413	423
Other current assets	4,242	4,193	5,024	5,752	6,521
<b>Total Current Assets</b>	<b>49,090</b>	<b>48,298</b>	<b>59,897</b>	<b>77,408</b>	<b>96,621</b>
<b>Current Liabilities &amp; Provisions</b>					
Current Liabilities	5,552	6,963	8,172	9,935	11,595
Provisions and other liabilities	1,860	1,962	2,496	2,965	3,461
<b>Total Current Liabilities &amp; Provisions</b>	<b>7,412</b>	<b>8,925</b>	<b>10,668</b>	<b>12,900</b>	<b>15,056</b>
<b>Net Current Assets</b>	<b>41,678</b>	<b>39,373</b>	<b>49,228</b>	<b>64,508</b>	<b>81,566</b>
<b>Investments</b>	<b>5,473</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Fixed Assets</b>					
Tangible Assets	20,837	27,783	35,374	38,582	43,383
Intangible assets	41	36	36	36	36
Goodwill	-	-	-	-	-
<b>Total fixed assets</b>	<b>20,878</b>	<b>27,819</b>	<b>35,410</b>	<b>38,618</b>	<b>43,419</b>
<b>CWIP</b>	<b>4,919</b>	<b>9,197</b>	<b>7,197</b>	<b>7,197</b>	<b>7,197</b>
Miscellaneous Expenses not written off	-	-	-	-	-
<b>Total Assets</b>	<b>72,948</b>	<b>76,389</b>	<b>91,835</b>	<b>110,323</b>	<b>132,182</b>
<b>EQUITY AND LIABILITIES</b>					
<b>Shareholders Fund</b>					
Equity share capital	531	531	531	531	531
Reserves and surplus	69,041	72,568	88,015	106,502	128,362
<b>Total Shareholders Fund</b>	<b>69,572</b>	<b>73,099</b>	<b>88,546</b>	<b>107,033</b>	<b>128,892</b>
<b>Borrowings</b>					
Long term	-	45	45	45	45
Short term	1,056	344	344	344	344
<b>Total Borrowings</b>	<b>1,056</b>	<b>389</b>	<b>389</b>	<b>389</b>	<b>389</b>
<b>Deferred Tax Liability</b>	<b>2,188</b>	<b>2,696</b>	<b>2,696</b>	<b>2,696</b>	<b>2,696</b>
<b>Minority interest</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Other long term liabilities</b>	<b>132</b>	<b>205</b>	<b>205</b>	<b>205</b>	<b>205</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>72,948</b>	<b>76,389</b>	<b>91,835</b>	<b>110,323</b>	<b>132,182</b>

Source: Company data, I-Sec research

**Table 8: Cashflow statement**

(Rs mn, year ending Mar 31)

	FY19	FY20	FY21E	FY22E	FY23E
<b>Cashflow from Operating Activities</b>					
PBT	18,551	18,195	25,813	30,895	36,529
Add: Depreciation	1,689	1,862	2,409	2,792	3,198
Add: Interest expense	35	61	16	16	16
Less: Taxes	(4,844)	(4,452)	(6,505)	(7,785)	(9,205)
<b>Operating Cashflow Before WC change (a)</b>	<b>15,430</b>	<b>15,666</b>	<b>21,733</b>	<b>25,917</b>	<b>30,538</b>
<b>Changes in Working Capital</b>					
(Increase) / Decrease Trade & Other receivables	(1,855)	(2,067)	(3,854)	(3,379)	(3,570)
(Increase) / Decrease Inventories	(4,217)	(915)	(2,905)	(4,767)	(4,396)
Increase / (Decrease) Trade Payables	842	939	921	1,511	1,393
Others	(657)	(1,463)	(19)	(17)	(17)
<b>Working Capital Inflow / (Outflow) (b)</b>	<b>(5,887)</b>	<b>(3,506)</b>	<b>(5,857)</b>	<b>(6,651)</b>	<b>(6,590)</b>
<b>Net Cashflow from Operating Activities (a) + (b)</b>	<b>9,543</b>	<b>12,159</b>	<b>15,875</b>	<b>19,266</b>	<b>23,948</b>
<b>Cashflow from Capital commitments (c)</b>	<b>(7,331)</b>	<b>(11,829)</b>	<b>(8,000)</b>	<b>(6,000)</b>	<b>(8,000)</b>
<b>Free Cashflow (a) + (b) + (c)</b>	<b>2,213</b>	<b>331</b>	<b>7,875</b>	<b>13,266</b>	<b>15,948</b>
<b>Cashflow from Investing Activities</b>					
Purchase of Investments	(429)	10,563	-	-	-
Others	906	431	-	-	-
<b>Net Cashflow from Investing Activities (d)</b>	<b>477</b>	<b>10,994</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Cashflow from Financing Activities</b>					
Increase in Share capital	-	-	-	-	-
Proceeds from fresh borrowings	776	(612)	-	-	-
Interest expense	(35)	(61)	(16)	(16)	(16)
Dividend paid including tax and others	(3,200)	(10,241)	(3,862)	(4,622)	(5,465)
<b>Net Cashflow from Financing Activities (e)</b>	<b>(2,459)</b>	<b>(10,914)</b>	<b>(3,877)</b>	<b>(4,637)</b>	<b>(5,480)</b>
<b>Miscellaneous Items (f)</b>	<b>(202)</b>	<b>(337)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Increase / (Decrease) in Cash</b>	<b>28</b>	<b>74</b>	<b>3,998</b>	<b>8,628</b>	<b>10,467</b>
<b>(a) + (b) + (c) + (d) + (e) + (f)</b>					
Opening Cash and Bank balance	1,125	1,153	1,226	5,224	13,853
Closing Cash and Bank balance	1,153	1,226	5,224	13,853	24,320
<b>Increase / (Decrease) in Cash and Bank balance</b>	<b>28</b>	<b>74</b>	<b>3,998</b>	<b>8,628</b>	<b>10,467</b>

Source: Company data, I-Sec research

**Table 9: Key ratios**

(Rs mn, year ending Mar 31)

	FY19	FY20	FY21E	FY22E	FY23E
<b>Per Share Data (Rs)</b>					
EPS	51.0	51.9	72.7	87.1	102.9
Cash EPS	57.3	58.9	81.8	97.6	115.0
Dividend per share (DPS)	10.0	32.0	14.5	17.4	20.6
Book Value per share (BVPS)	262.1	275.4	333.6	403.2	485.6
<b>Growth (%)</b>					
Net Sales	27.1	9.1	27.3	18.8	16.7
EBITDA	48.4	(2.7)	50.6	19.2	17.9
PAT	54.2	1.8	40.3	19.7	18.2
Cash EPS	49.3	2.7	39.0	19.3	17.8
<b>Valuation Ratios (x)</b>					
P/E	72.4	71.1	50.7	42.4	35.8
P/CEPS	64.4	62.7	45.1	37.8	32.1
P/BV	14.1	13.4	11.1	9.1	7.6
EV / EBITDA	51.6	53.2	35.1	29.2	24.5
EV / Sales	19.5	18.0	14.1	11.7	9.9
<b>Operating Ratios</b>					
Raw Material / Sales (%)	36.9	39.1	35.5	36.5	36.5
Employee cost / Sales (%)	11.0	11.5	11.2	10.6	10.3
SG&A / Sales (%)	14.3	15.6	13.3	12.8	12.6
Effective Tax Rate (%)	27.1	24.3	25.2	25.2	25.2
Working Capital (days)	302	308	291	288	293
Inventory Turnover (days)	312	315	301	293	300
Receivables (days)	80	87	85	88	89
Payables (days)	90	94	95	93	95
Net D/E Ratio (x)	(0.2)	(0.1)	(0.2)	(0.2)	(0.3)
<b>Return/Profitability Ratios (%)</b>					
Net Income Margins (Adjusted)	27.3	25.5	28.1	28.3	28.7
RoCE	20.1	18.5	23.0	22.9	22.5
RoE	21.0	19.3	23.9	23.6	23.2
RoIC	27.2	22.4	27.1	28.2	29.6
Dividend Payout	19.6	61.7	20.0	20.0	20.0
Dividend Yield	0.3	0.9	0.4	0.5	0.6
EBITDA Margins	37.8	33.8	40.0	40.1	40.5

Source: Company data, I-Sec research

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