

Divi's Laboratories (DIVI IN)

Set to benefit from Chinese supply disruptions

14 September 2018

INDIA | PHARMACEUTICALS | Company Update

We recently met DIVI's management. Here are the key highlights:

Spots multi-year business opportunity from China's supply disruptions: While the global pharma industry is worried about ongoing supply disruptions and inflationary pressures in drug prices in the wake of ongoing environmental concerns in China, DIVI (being one of the leading global manufacturers of APIs and intermediates) finds great business opportunities from such developments. Its management is confident about leveraging its capabilities in process chemistry, cost-effective manufacturing, and API portfolio (focused), for building sustainable long-term supply relationships with the global customers and for maintaining its strong position of "supplier of choice". DIVI believes this as a multi-year opportunity, as it considers the ongoing Chinese developments as non-reversible.

India/World sources ~65%/20% of APIs/intermediates from China: China is the world's leading producer (over 2,000 APIs) and exporter of APIs by volume, accounting for 20% of total global API output. India is more dependent on China, with 65% of the country's requirement of API/intermediates coming from the red giant.

Pharma imports from China jumped 38% in H1CY18 and 25% were price led: India's import API/intermediates rose by 8% to US\$ 1.26bn in CY17, but jumped 38% to US\$ 825mn in H1CY18 –led by 13% increase in volume (to de-risk the supply uncertainties) and 25% jump in prices (caused by cost escalation and shortages due to the clamp down).

Well-placed with ready capex to grab opportunity from Chinese concerns: DIVI capitalised assets worth Rs 5.86bn in FY18, which includes growth capex of ~Rs 3bn that remains unutilised. It has set up two manufacturing blocks with an investment of Rs 1.80bn in Unit I, out of which it capitalised one in Q1FY19 and expects to capitalise the second one soon. Additionally, it is undertaking a brownfield expansion with an investment of Rs 4bn in Unit II (enhanced from Rs 3bn earlier) and expects to commission this expansion by the end of FY19. Hence, with the almost ready capex of Rs 8.80bn, DIVI is all prepared to benefit from the opportunity flowing in from China.

Green signal for Kakinada project: DIVI has turned optimistic about its Rs 7bn Kakinada Greenfield project; it believes this is on the verge of getting environmental clearance soon (after a two-year effort). It sees land issues sorting out soon and visible project execution.

Sees steady custom synthesis growth; to remain concentrated in top-10 global innovators: DIVI, one of the most successful CRAMS partners from India for global innovators, expects to maintain steady growth in this business, led by its proven capabilities in process chemistry, cost-effective manufacturing, and strong innovators client base. Conducive outlook for pharma outsourcing emerging from price challenges for innovative drugs, reduced R&D productivity, and increased regulatory requirements should ensure sustained growth. Also, DIVI's management believes that CCS will remain concentrated in top-10 global innovators.

Other Key takeaways from the management meet

- Since most of the supply deals are with leading global players, DIVI passes on most benefits flowing from currency depreciation; hardly gains from INR depreciation.
- To build a robust operating system, in terms of processes and compliance, DIVI has added about 1,000 people in FY18.
- Although it is developing selective new products, the company still sees steady growth in its matured/established product basket.

Upgrade to BUY with a revised target of Rs 1,550: In order to capture the supply opportunity in the near future, we have raised our FY20 EPS expectations by 5% to Rs 52 but find it difficult to build the multiyear opportunity flowing from China due to lack of information. Hence, we believe DIVI should be rerated and value it at Rs 1,550 (30x FY20 EPS) vs. Rs1,200 earlier (24x FY20 EPS). Our target multiple is at a discount to the industry average of 34x (factoring Syngene, Wuxi Apptec, Wuxi Biologics). Upgrade to BUY from Neutral.

BUY (Upgrade)

CMP RS 1273/TARGET RS 1550 (+22%)

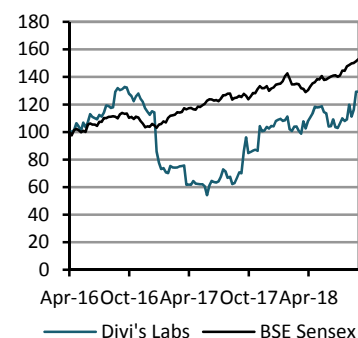
COMPANY DATA

O/S SHARES (MN) :	265
MARKET CAP (RSBN) :	341
MARKET CAP (USD BN) :	4.7
52 - WK HI/LO (RS) :	1331 / 710
LIQUIDITY 3M (USD MN) :	15.5
PAR VALUE (RS) :	2

SHARE HOLDING PATTERN, %

	Jun 18	Mar 18	Dec 17
PROMOTERS :	52.0	52.1	52.1
FII / NRI :	18.4	18.4	17.1
FI / MF :	16.3	15.8	16.7
NON PRO :	2.3	2.2	2.4
PUBLIC & OTHERS :	11.1	11.6	11.7

PRICE VS. SENSEX



CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY19E	FY20E	FY19E	FY20E
Revenue	44.8	52.9	0.0	4.3
EBITDA	15.6	19.0	0.0	4.9
Core PAT	11.0	13.7	0.0	5.1
EPS (Rs)	41.5	51.5	0.0	5.1

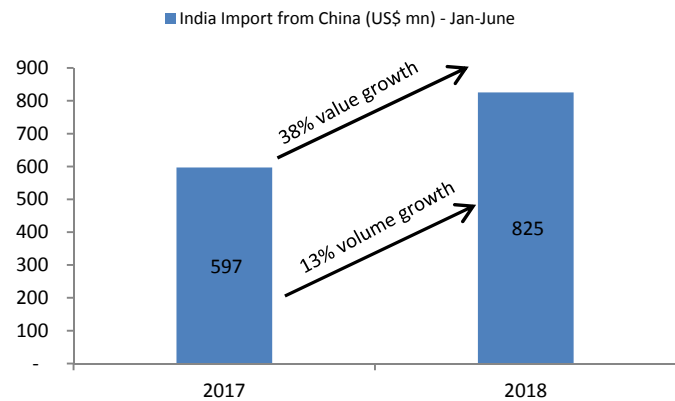
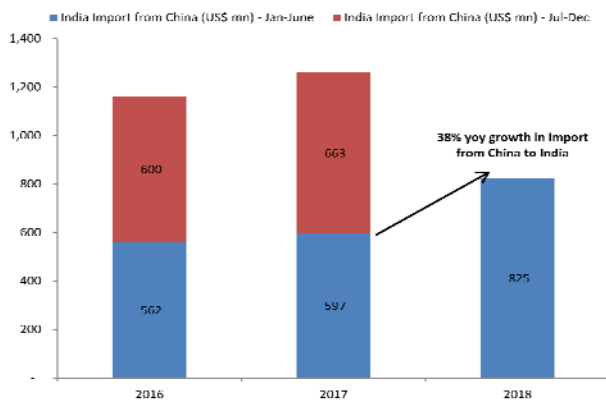
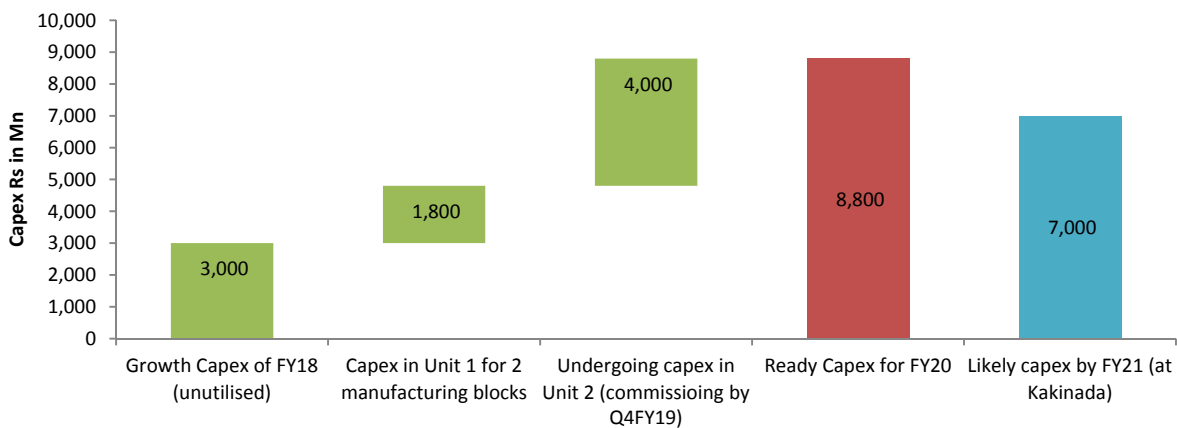
KEY FINANCIALS

Rs mn	FY18	FY19E	FY20E
Net Sales	39,128	44,833	52,912
EBIDTA	12,617	15,602	19,048
Net Profit	8,491	11,028	13,671
EPS, Rs	32.0	41.5	51.5
PER, x	39.8	30.6	24.7
EV/EBIDTA, x	26.7	21.5	17.6
P/BV, x	5.7	5.0	4.4
ROE, %	14.3	16.4	17.6
Debt/Equity (%)	1.1	0.7	0.7

Source: Phillip Capital India Research

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Supply uncertainties boost Indian pharma import from China by 38% in H1FY18; 25% jump in prices boosts Chinese import of APIs/intermediates

Well placed with ready capex worth Rs 8.80bn to grab opportunity from Chinese concerns

Product basket of DIVI

Submit Date	List of APIs filed by Divi's Lab	Submit date	List of APIs filed by Divi's Lab
4-Feb-1997	DEXTROMETHORPHAN HYDROBROMIDE USP	15-Jul-2007	BOC COR SUCCINATE (INTERMEDIATE)
27-Nov-1998	NAPROXEN USP	15-Oct-2007	TRYPEPTIDE, DRUG INTERMEDIATE
27-Nov-1998	NAPROXEN SODIUM USP	25-Oct-2007	QUETIAPINE FUMARATE
9-Aug-1999	KETOROLAC ACID	25-Nov-2007	Topiramate
26-Jan-2001	DILTIAZEM HYDROCHLORIDE USP	29-Apr-2008	VIGABATRIN
2-Apr-2001	NABUMETONE USP	5-Oct-2008	KETOENAMINE
31-Jan-2002	5-PHENYLHYDANTOIN	28-Jan-2009	DEXTROMETHORPHAN BASE
3-Sep-2003	SULPHAZINE	28-Jan-2009	VENLAFAXINE HCL
5-Oct-2003	LEVETIRACETAM	10-Mar-2010	SUMATRIPTAN SUCCINATE AND SUMATRIPTAN
19-Sep-2004	METHYLDOPA USP	23-Jul-2010	2-4-WING A ESTER
7-Nov-2004	LORATADINE USP	15-Sep-2010	TRITYL LOSARTAN
20-Nov-2004	CARBIDOPA USP	29-Mar-2011	VALSARTAN USP
3-Dec-2004	LEVODOPA USP	5-May-2012	TELMISARTAN, USP
6-Feb-2005	IOPAMIDOL USP	11-Sep-2012	IRBESARTAN USP
24-Apr-2005	BUPROPION HYDROCHLORIDE USP	28-Jan-2014	OLMESARTAN MEDOXOMIL USP
5-Jul-2005	NIACIN USP	20-Dec-2014	VALACYCLOVIR HYDROCHLORIDE USP (HYDROUS FORM)
17-Jul-2005	VERAPAMIL HYDROCHLORIDE USP	6-Nov-2015	MESALAMINE USP
25-Sep-2005	FOSPHENYTOIN SODIUM USP	8-Jan-2016	LEVETIRACETAM (PROCESS B)
25-Sep-2005	RISEDRONATE SODIUM	1-Aug-2016	PREGABALIN (ALTERNATIVE PROCESS)
25-Sep-2005	ZOLPIDEM TARTRATE USP	29-Jul-2017	VIGABATRIN USP
25-Nov-2005	TAMSULOSIN HYDROCHLORIDE	19-Oct-2003	PHENYLEPHRINE HYDROCHLORIDE USP
4-Dec-2005	GABAPENTIN USP	6-Feb-2005	PROGUANIL HYDROCHLORIDE
17-May-2006	DES Loratadine	27-Oct-2008	CAPECITABINE
4-Sep-2006	SIBUTRAMINE HYDROCHLORIDE MONOHYDRATE	16-May-2014	PREGABALIN
7-Jan-2007	TPE ALCOHOL		

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY17	FY18	FY19E	FY20E
Net sales	41,063	39,128	44,833	52,912
Growth, %	8	-5	15	18
Total income	41,063	39,128	44,833	52,912
Raw material expenses	-15,759	-15,554	-17,485	-20,530
Employee expenses	-4,999	-4,561	-5,111	-5,767
Other Operating expenses	-5,448	-6,397	-6,635	-7,566
EBITDA (Core)	14,857	12,617	15,602	19,048
Growth, %	4.8	(15.1)	23.7	22.1
Margin, %	36.2	32.2	34.8	36.0
Depreciation	-1,233	-1,425	-1,685	-1,858
EBIT	13,624	11,192	13,917	17,191
Growth, %	4.9	(17.8)	24.3	23.5
Margin, %	33.2	28.6	31.0	32.5
Interest paid	-23	-13	-22	-26
Other Non-Operating Income	749	855	1,008	1,311
Pre-tax profit	13,953	12,034	14,903	18,475
Tax provided	-3,349	-3,543	-3,875	-4,803
Profit after tax	10,604	8,491	11,028	13,671
Net Profit	10,604	8,491	11,028	13,671
Growth, %	1.1	(22.8)	29.9	24.0
Net Profit (adjusted)	11,000	8,491	11,028	13,671
Unadj. shares (m)	265	265	265	265
Wtd avg shares (m)	265	265	265	265

Balance Sheet

Y/E Mar, Rs mn	FY17	FY18	FY19E	FY20E
Cash & bank	787	1,125	2,394	4,054
Debtors	9,009	10,144	11,208	13,228
Inventory	13,199	13,507	14,616	16,932
Loans & advances	538	529	448	529
Other current assets	1,681	2,465	2,588	2,717
Total current assets	25,215	27,769	31,254	37,460
Investments	16,307	18,893	20,893	22,893
Gross fixed assets	24,381	30,176	34,383	37,914
Less: Depreciation	-8,789	-10,214	-11,899	-13,756
Add: Capital WIP	4,436	1,198	1,200	3,000
Net fixed assets	20,028	21,160	23,684	27,158
Total assets	61,585	67,832	75,842	87,521
Current liabilities	6,224	5,867	6,227	7,349
Provisions	166	159	159	159
Total current liabilities	6,390	6,026	6,386	7,508
Non-current liabilities	1,621	2,558	2,375	2,456
Total liabilities	8,011	8,584	8,761	9,964
Paid-up capital	531	531	531	531
Reserves & surplus	53,043	58,717	66,550	77,026
Shareholders' equity	53,574	59,248	67,081	77,557
Total equity & liabilities	61,585	67,831	75,842	87,521

Cash Flow

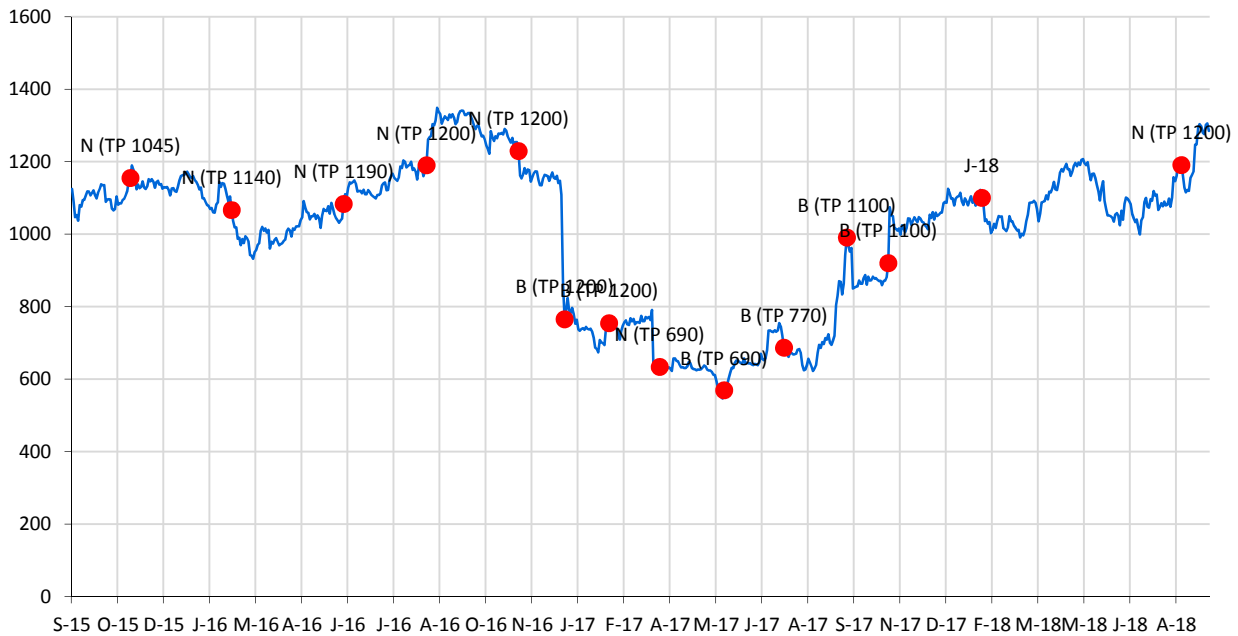
	FY17	FY18	FY19E	FY20E
Pre-tax profit	13,953	12,034	14,903	18,475
Depreciation	1,233	1,425	1,685	1,858
Chg in working capital	288	-2,581	-1,856	-3,424
Total tax paid	-2,879	-2,855	-3,875	-4,803
Other operating activities	0	0	0	0
Cash flow from operating activities	12,596	8,023	10,857	12,105
Capital expenditure	-4,234	-2,557	-4,209	-5,331
Chg in investments	-8,279	-2,586	-2,000	-2,000
Cash flow from investing activities	-12,513	-5,142	-6,209	-7,331
Free cash flow	8,362	5,466	6,647	6,773
Debt raised/(repaid)	-67	274	-183	81
Cash flow from financing activities	10,574	5,948	7,650	10,557
Net chg in cash	10,657	8,828	12,298	15,331

Valuation Ratios

	FY17	FY18	FY19E	FY20E
Per Share data				
EPS (INR)	41.4	32.0	41.5	51.5
Growth, %	1.1	(22.8)	29.9	24.0
Book NAV/share (INR)	201.8	223.2	252.7	292.2
FDEPS (INR)	41.4	32.0	41.5	51.5
CEPS (INR)	46.1	37.4	47.9	58.5
CFPS (INR)	44.6	27.0	37.1	40.7
Return ratios				
Return on assets (%)	19.2	13.1	15.4	16.8
Return on equity (%)	19.8	14.3	16.4	17.6
Return on capital employed (%)	26.0	19.5	21.5	23.1
Turnover ratios				
Asset turnover (x)	1.1	1.0	1.0	1.1
Sales/Total assets (x)	0.7	0.6	0.6	0.6
Sales/Net FA (x)	2.2	1.9	2.0	2.1
Working capital/Sales (x)	0.4	0.5	0.5	0.5
Receivable days	80.1	94.6	91.3	91.3
Working capital days	161.8	193.8	184.3	179.7
Liquidity ratios				
Current ratio (x)	4.1	4.7	5.0	5.1
Quick ratio (x)	1.9	2.4	2.7	2.8
Interest cover (x)	605.5	841.5	620.8	649.8
Total debt/Equity (%)	0.7	1.1	0.7	0.7
Net debt/Equity (%)	(0.8)	(0.8)	(2.9)	(4.5)
Valuation				
PER (x)	30.7	39.8	30.6	24.7
PEG (x) - y-o-y growth	29.1	(1.7)	1.0	1.0
Price/Book (x)	6.3	5.7	5.0	4.4
EV/Net sales (x)	8.2	8.6	7.5	6.4
EV/EBITDA (x)	22.7	26.7	21.5	17.6
EV/EBIT (x)	23.5	28.0	22.5	18.1

Source: Company, PhillipCapital India Research Estimates

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
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SELL	<= -15%	Target price is less than or equal to -15%.

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