Sharekhan
by BNP PARIBAS

# Divis Laboratories Limited

## Well Placed to capitalise on industry tailwinds

**Sector: Pharmaceuticals**
**Company Update**

| | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 2,169** | |
| Price Target: **Rs. 2,430** | ↑ |

↑ Upgrade ↔ No change ↓ Downgrade

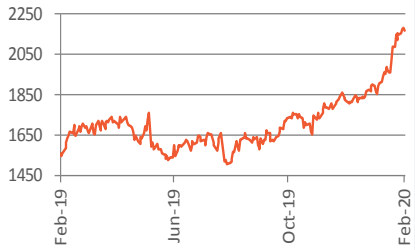
### Company details

| | |
|---|---|
| Market cap: | Rs. 57,576 cr |
| 52-week high/low: | Rs. 2,239/1,467 |
| NSE volume: (No of shares) | 5.1 lakh |
| BSE code: | 532488 |
| NSE code: | DIVISLAB |
| Sharekhan code: | DIVISLAB |
| Free float: (No of shares) | 12.7 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 52.0 |
| FII | 20.3 |
| DII | 15.5 |
| Others | 12.27 |

### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 14.8 | 26.2 | 44.0 | 39.1 |
| Relative to Sensex | 16.5 | 23.5 | 30.1 | 17.7 |

*Sharekhan Research, Bloomberg*

**Divis Laboratories (Divis) is well placed to capitalise on the opportunities in the API space. The company derives around 50% of its sales from the API segment. Off late, API prices have surged sharply (in the range of 20% to 80%) across various products. The surge in the prices could be attributable to possible supply disruption from China following an industrial lock out due to outbreak of Corona virus. This is expected to immensely benefit API focused companies like Divis. Further, the Government of India is also making efforts to boost API production and is in the process of charting a road map for the same. Though plans are at a nascent stage now, once finalized and implemented, they could benefit players such as Divis substantially.**

### Outlook

**API segment to be a key growth driver:** Divis' long-term growth opportunities are intact and the company is well-placed to capitalize on the same. The recent outbreak of Corona virus in China has resulted in a hunt for an alternative sourcing base and global players are looking at India for the same. This augurs well for API focused companies like Divis. Being a leading player in the API space with ample headroom to ramp up the production would enable the company to comfortably cater to the increased demand. We also expect Divis to benefit from backward integration, an aggressive capex plan incurred in the past and outsourcing opportunities. Moreover, the company does not have any pending regulatory hurdles, which augurs well.

### Our Call

**Maintain Buy with a revised PT of Rs 2,430:** Divis is one of the few pharma companies which is in a sweet spot to capitalize on the opportunities in the API space. A strong run up in the API prices in the recent past is attributable to likely supply disruption from China (due to outbreak of the Corona Virus), a leading supplier of API's globally and accounting for 20% of the global output. Further, in order to avoid disruptions going ahead, companies globally are evaluating alternate sources for procurement and this is likely to be a key positive for Divis. Also we expect the company to benefit from backward integration, an aggressive capex plan incurred in the past and outsourcing opportunities. Further The company does not have pending regulatory hurdles which is a key positive and offers visibility for growth going ahead. We expect the sales and PAT to grow CAGR 20% and 24% respectively over FY2020 –FY2022. At CMP, the stock is trading at a reasonable P/E multiple of 33x / 26.8x its FY2021E/FY2022E, which is lower than the long term historical average multiple. We Maintain Buy recommendation on the stock with revised PT of Rs 2,430.

### Key Risks

1) Adverse regulatory change; 2) regulatory compliance risk.

**Valuation** — **Rs cr**

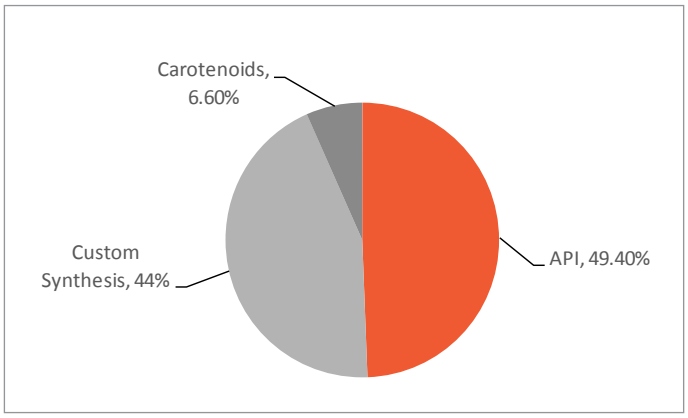
| Particulars | FY2018 | FY2019 | FY2020E | FY2021E | FY2022E |
|---|---|---|---|---|---|
| Net sales | 3912.8 | 4946.3 | 5538.4 | 6578.6 | 7937.1 |
| OPM (%) | 32.2 | 37.8 | 35.1 | 36.3 | 37.0 |
| PAT | 877.0 | 1352.7 | 1404.6 | 1742.6 | 2152.2 |
| EPS (Rs) | 33.0 | 51.0 | 52.9 | 65.6 | 81.1 |
| PER (x) | 65.7 | 42.6 | 41.0 | 33.0 | 26.8 |
| EV/Ebidta (x) | 41.8 | 28.4 | 27.2 | 22.3 | 18.2 |
| ROCE (%) | 19.9 | 25.3 | 22.7 | 23.6 | 24.4 |
| RONW (%) | 14.8 | 19.4 | 17.6 | 18.6 | 19.3 |

*Source: Company; Sharekhan estimates*

**API segment on a strong footing; Divis to benefit significantly from China opportunities:** Divi's is a leading player in the API (active Pharmaceutical ingredients) segment and derives around 50% of the revenues from the same. Off late, API prices have surged sharply in the range of 20% to 80%, attributable to likely supply disruption in China on account of a Corona virus outbreak. China is a major supplier of pharma raw materials including - key starting materials (KSM), intermediates and APIs. The lockdown of industrial activity in China after the outbreak of the corona virus has certainly raised concerns in terms of sourcing of input materials for the global pharma industry, as China is the largest source of intermediates and APIs.(China accounts for 20% of global API output). A cut / low production points at reduced supplies in the near term, which would further spike prices of API's and intermediates. Consequently, players such as Divi's one of the leading manufacturers of APIs could potentially be one of the key beneficiary of Chinese supply disruption, supported by its expanded capacity and backward integration. We expect the company's topline to grow by a 20% CAGR over FY2020-FY2022. Also, the Government of India is taking measures like setting up bulk drugs manufacturing parks and faster environment clearance channel to boost API production in the country. Though the policy currently is at a nascent stage, once finalised and implemented, would be positive for API players.

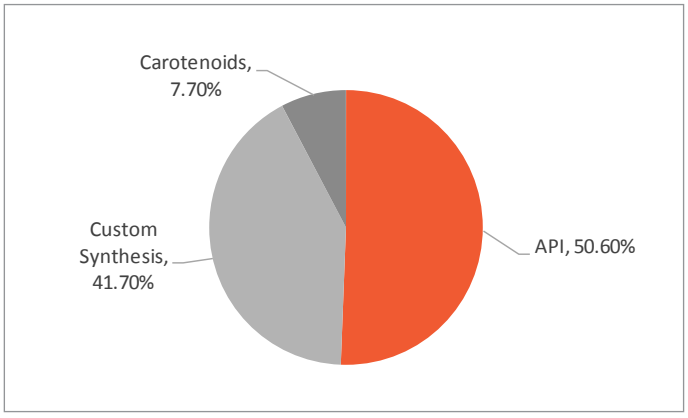
**Strong earnings growth:** Divis' management has guided for a strong 10% revenue growth for FY2020, despite of a high base effect in the previous year. This points at a sharp accelerated growth in Q4FY2020. The company has partly capitalised its backward integration projects and this would start contributing to the topline in Q4FY2020. Divis has already capitalised around Rs. 225 crore capex for YTD FY2020 and has plans to commence a significant portion of the ongoing massive capex of Rs. 1,200 crore in Q4FY2020, the full impact of the same is likely to be reflected in FY2021. The backward integration would also aid operating margin expansion for the company. Cumulatively, a strong doubledigit topline growth coupled with margin expansion would lead to sharp 24% PAT CAGR over FY2020-FY2022.

**Revenue mix FY2018**




*Source: Company, Sharekhan Research*

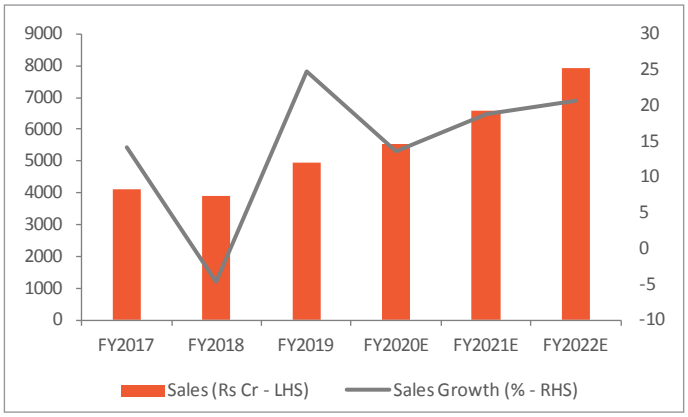
**Revenue Mix FY2020E**




*Source: Company, Sharekhan Research*

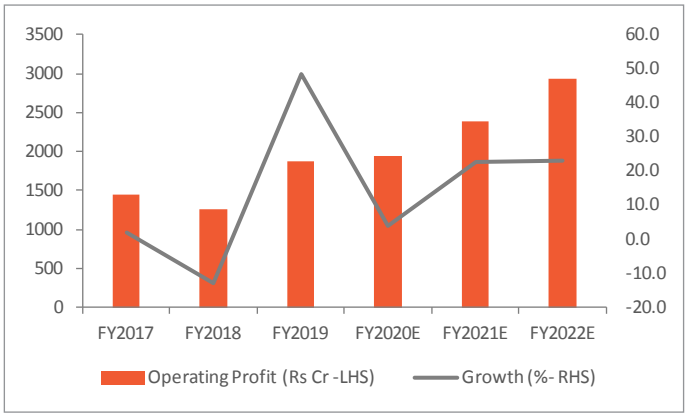
## Financials in charts

### Double Digit revenue growth to sustain



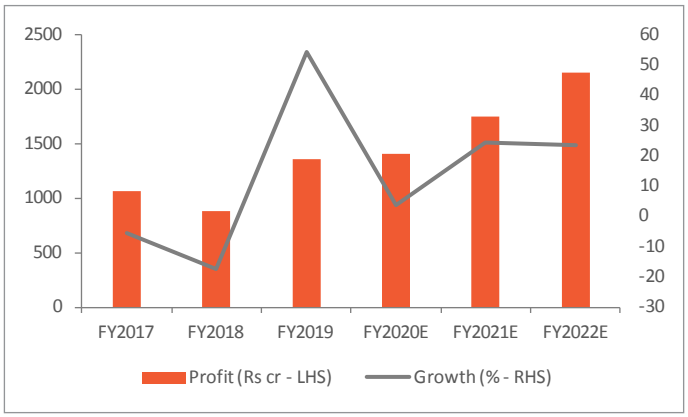

*Source: Company, Sharekhan Research*

### Operating Profit - Growth



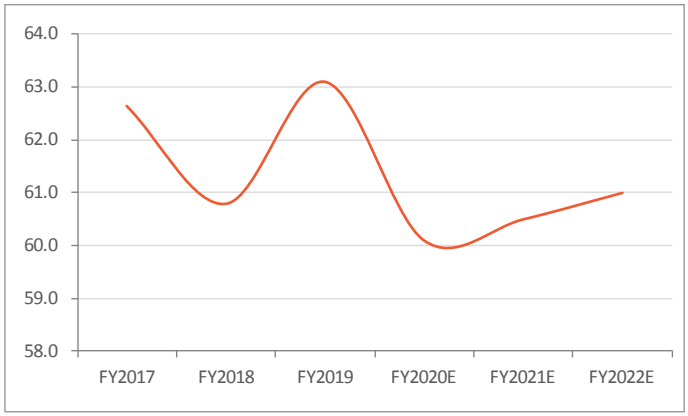

*Source: Company, Sharekhan Research*

### PAT – Growth



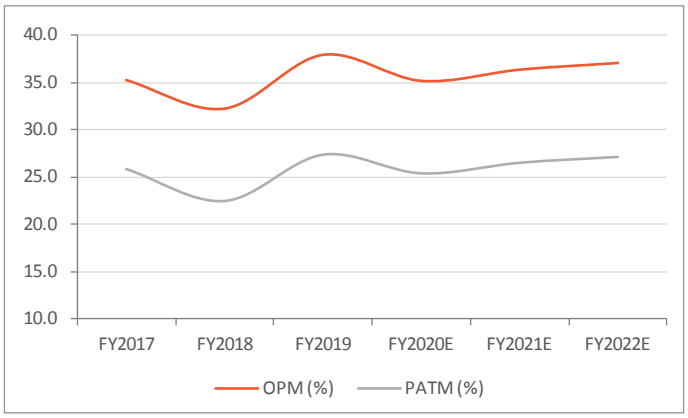

*Source: Company, Sharekhan Research*

### Gross margin trends (%)



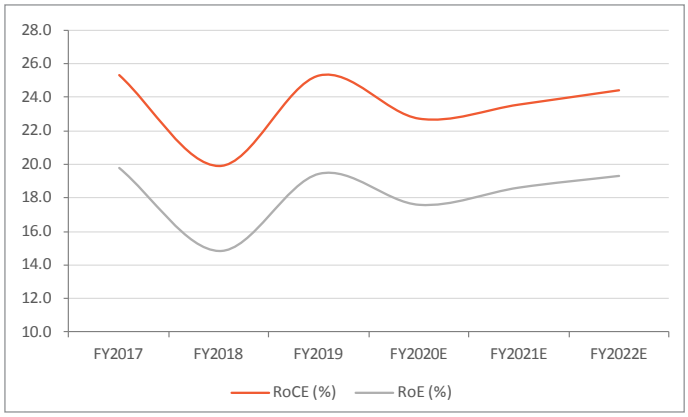

*Source: Company, Sharekhan Research*

### OPM – PAT margin trends (%)




*Source: Company, Sharekhan Research*

### Return Ratios improving (%)

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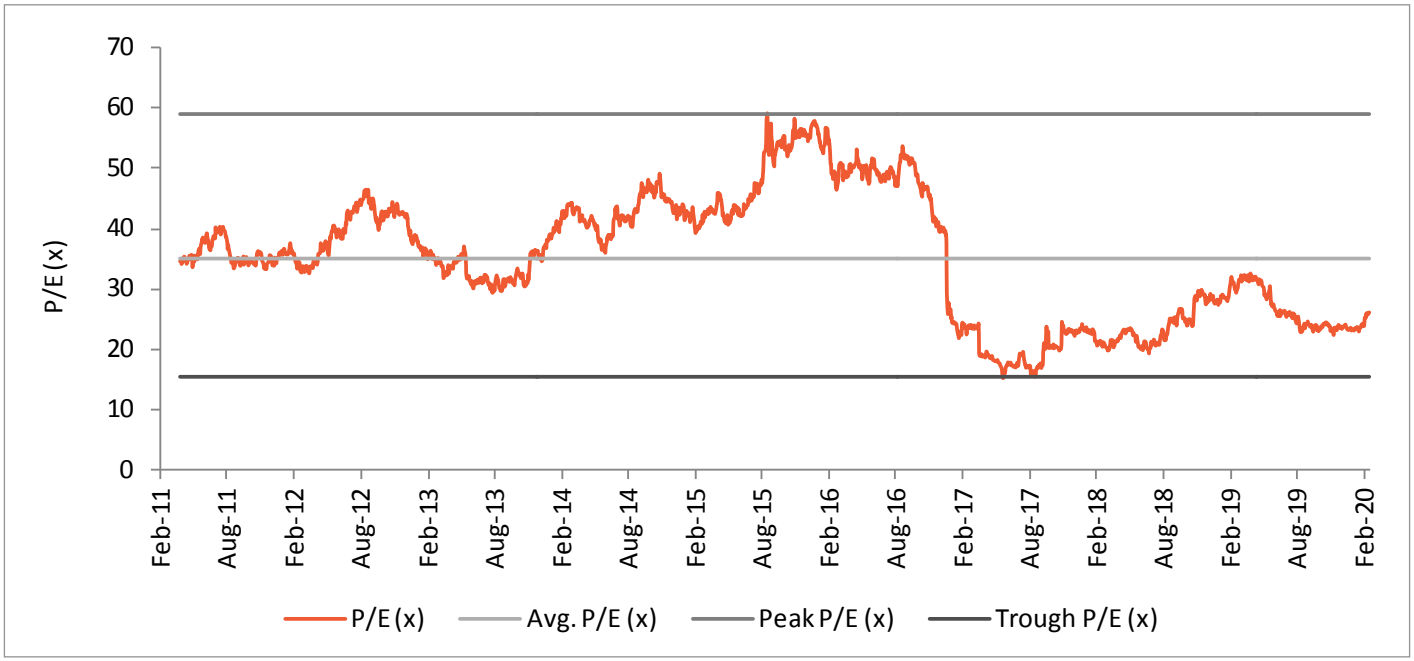
**One-year forward P/E (x) band**




*Source: Sharekhan Research*

## About company

Divis, based in Hyderabad, India, has two manufacturing units and is among the top pharmaceutical companies in India. Divis is the leading manufacturer of active pharmaceuticals ingredients (APIs), intermediates and registered starting materials offering high-quality products with the highest level of compliance and integrity to over 95 countries. Advanced manufacturing facilities both in Hyderabad and Vizag have been inspected multiple times by USFDA, EU GMP (U.K., Slovenia, German, Irish authorities), HEALTH CANADA, TGA, ANVISA, COFEPRIS, PMDA and MFDS health authorities.

## Investment theme

Long-term growth is likely to remain healthy, led by backward integration, aggressive capacity expansion, outsourcing potentials and opportunities in China, especially in the API space.

## Key Risks

- Adverse regulatory change
- Regulatory compliance risk
- Forex volatility

## Additional Data

**Key management personnel**

| | |
|---|---|
| Dr. Murali K. Divi | Chairman & Managing Director |
| N.V. Ramana | Executive Director |
| Madhusudana Rao Divi | Director of Projects |
| Mr. Kiran S. Divi | Director on Board |
| Ms. Nilima Motaparti | Director on Board – Commercial |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | SBI Funds Management Pvt Ltd | 4.3 |
| 2 | Reliance Capital Trustee Co Ltd | 2.7 |
| 3 | Axis Asset Management Co Ltd/India | 1.97 |
| 4 | GOVERNMENT PENSION FUND - GLOBAL | 1.73 |
| 5 | Norges Bank | 1.73 |
| 6 | PineBridge Investments LP | 1.2 |
| 7 | Goldman Sachs Group Inc/The | 1.09 |
| 8 | BlackRock Inc | 1.08 |
| 9 | Credit Agricole Group | 1.07 |
| 10 | HDFC Asset Management Company | 0.94 |

*Source: Bloomberg*

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