DIVI'S LABORATORIES LIMITED

LAKEWATER
Nurturing Visions and Values

CMP: INR 3,650

SEPT 23, 2022

HIGHLIGHTS

- The top line of the Company has consistently been improving registering a CAGR of 23.70% over the last five years.
- 42 patents processed till 2022 with an R&D team of ~ 400 members.
- Return on Net Worth is 25% in FY2022 as compared to 21% in FY2021.

STOCK QUOTE AND CHART (CURRENCY: INR)

52 WK HIGH/LOW	5,425.10/ 3,365.55	MARKET CAP	97.92TCr
VOLUME (MM)	0.76	SHARES OUT. (MM)	265.5
BETA 5Y	0.32	FLOAT %	47.7%
		DILUTED EPS	116.97

INDUSTRY OUTLOOK

- **Global Pharma Sector**

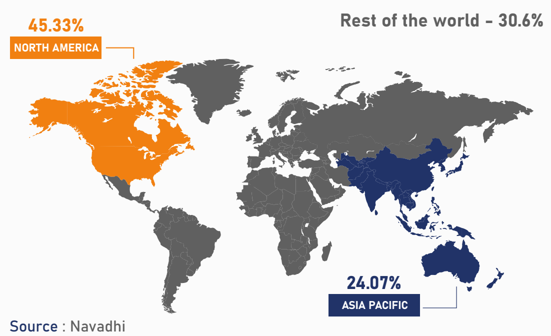
Based on a recently concluded study by IQVIA (NYSE listed pharma analytics research agency), the international medicine market is expected to continue its growth at close to a 5% CAGR rate till 2026. The market size is expected to reach an all-time high of $ 1.8 trillion by 2026 after incorporating the spending on account of Covid 19 pandemic. In line with the last five year's launches, about 290-315 New Active Substances are expected to be launched during this period with an annual average of 54-63 launches.

The top segments is expected to comprise of research and medicines in immunology, neurology, anti-coagulants, oncology, Anti-diabetics, cardiology, and respiratory & pain segments. Over the next five years, the main drivers of growth would be patent expiries, adoption of more modern treatments, and heightened competition in the generic segment. The major markets comprise of US market (expected CAGR of 0-3%), European Union (expected to increase by $51 billion), Japan (expected a negative growth rate), and China (expected to exceed $205 billion). Other 'Pharmerging' centres like India are expected to contribute growth by $128 billion.

- **Indian Pharma Sector**

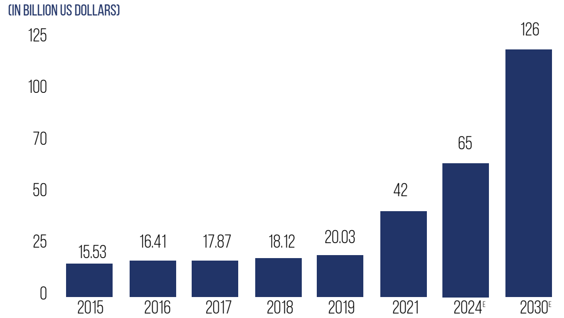
The Indian pharma sector has come a long way as it registered a growth of 103% from INR 90,415 cr in 2013-14 to INR 1,83,422 cr in 2021-22. The export performance has been remarkable over the last 8 years with a growth of almost $10 billion during that span. India is considered a preferred destination for complex APIs, hence witnessed a significant FDI, especially over the last two years. With the commissioning of capital expansion and Capex targeting backward integration to APIs, India poises to garner more control and become a strategic player in the segment. Some of the players in this segment include Dr. Reddy, Abbot India, Lupin, Glaxo.

EXPECTED GLOBAL PHARMACEUTICAL MARKET 2023



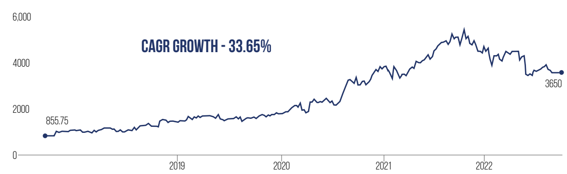
Source : Navadhi

ANNUAL TURNOVER OF INDIAN PHARMACEUTICAL MARKET FROM 2015 TO 2021, WITH ESTIMATES UNTIL 2030



Source : Statista

NSE DIVISLAB : SHARE PRICE (INR)

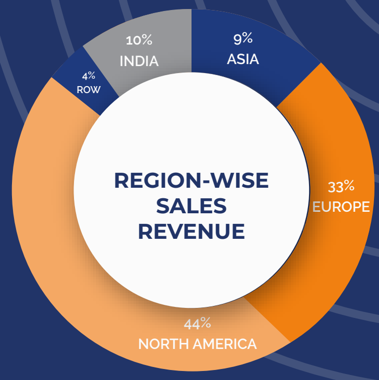


BUSINESS DESCRIPTION

Incorporated in 1990 and headquartered in Hyderabad, Divi's Lab is into manufacturing, marketing, and selling generic medicines, APIs, nutraceutical ingredients, and other intermediates. The Company has further increased its product portfolio by adding custom synthesis of APIs, a range of carotenoids, and a supply of multivitamins to the food, nutritional, and feed industries.

The Pharma sector is highly regulated, and given that the Company caters to markets like the USA, Europe, etc., the entire process, from R&D to marketing of products, is well governed. Six manufacturing facilities are located at two units in India, i.e., Hyderabad and Vishakhapatnam. It has also incorporated a subsidiary in USA and Switzerland to improve its customer reach.

Export sales constitute about 90% of the total revenue, of which 77% is accounted for by the developed markets comprising America and Europe. Only about 10% of the top line is generated domestically from India. The segregation of revenue as per primary geography is given alongside.



FINANCIAL ANALYSIS

On the right hand is a quick sneak peek into the financial performance of Divi's Lab over the last 5 years.

The Company's top line has consistently been improving, registering a CAGR of 23.70% over the last five years. The growth is replicated at the bottom line, too, with an EPS of 111.52 for the FY 2022 as against an EPS of 33.04 in FY 2018. This has resulted in considerable improvement in Return on Asset and Equity over these years, reflecting the shareholders' wealth creation achieved by Divi's Lab over these years. The net profit margin is quite comfortable at 33% currently, and based on the LTM (Last Twelve Month's) performance; the 33% net profit margin is expected to continue in the current financial year. The Company's total asset turnover has consistently been at 0.70x over the last five years because of the high asset base. Given the better-fixed asset turnover ratio, it is evident that the asset base is high, not based on fixed assets, as in the case of traditional manufacturing entities. Inventory and receivables constitute a significant chunk of the overall asset base. The liquidity indicators of the Company, as reflected from the current asset and quick ratio, are both exceptionally comfortable and provide a sufficient buffer for the Company to bear any short to medium-term liquidity shocks.

Cash conversion cycle is however, quite high at close to 300 days indicating a stretch in the working capital cycle of the Company. There is considerable scope for improvement on this count. Total debt is insignificant leading to insignificant interest coverage ratio as well. Overall, the Company seems fundamentally strong. Favourable debt matrix and comfortable liquidity position adds to the comfort level.

To conclude, the second table on the right hand side shows the number of Patent Applications which represents total number of companies submitted patent applications pending at Patent Authorities. The pending patent applications may or may not result in the issuance of patents. It includes both domestic & foreign patent applications.

RATIOS

FOR THE FISCAL PERIOD ENDING	2018	2019	2020	2021	2022
PROFITABILITY					
RETURN ON ASSETS %	10.9%	14.4%	12.4%	16.9%	18.5%
RETURN ON EQUITY %	15.5%	21.0%	19.3%	23.9%	28.2%
MARGIN ANALYSIS					
GROSS MARGIN %	58.3%	61.1%	58.4%	64.5%	64.7%
EBITDA MARGIN %	32.6%	37.9%	33.8%	41.1%	43.3%
EBITA MARGIN %	22.5%	27.3%	25.5%	28.5%	33.0%
ASSET TURNOVER					
TOTAL ASSET TURNOVER	0.6X	0.7X	0.7X	0.7X	0.7X
FIXED ASSET TURNOVER	1.9X	2.1X	1.7X	1.7X	1.9X
SHORT TERM LIQUIDITY					
CURRENT RATIO	6.9X	5.5X	5.0X	5.6X	7.0X
QUICK RATIO	4.7X	3.2X	2.8X	3.5X	4.4X
AVG. CASH CONVERSION CYCLE	295.7	306.3	298.9	287.2	296.7
LONG TERM SOLVENCY					
TOTAL DEBT/EQUITY	1.1%	1.5%	0.5%	0.1%	0.0%
TOTAL DEBT/CAPITAL	1.1%	1.5%	0.5%	0.1%	0.0%
EBIT/INTEREST EXP.	NM	NM	295.9X	NM	NM

INDUSTRY SPECIFIC

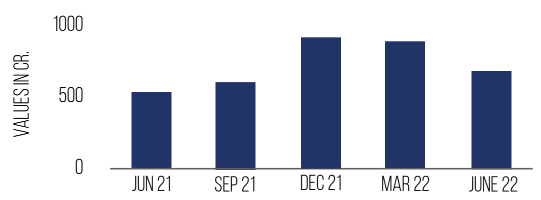
FOR THE FISCAL PERIOD ENDING	2017	2018	2019	2020	2021	2022
PHARMACEUTICAL & BIOTECH ITEMS						
NUMBER OF PATENT APPLICATIONS	34	34	37	37	40	42

CURRENT DEVELOPMENTS AND FUTURE EXPECTATIONS

- **Financials –** The Company's Q4 performance for the year ending March 2022 was above expected performance. The profit surged by 78% on year-on-year basis to INR 895 cr as compared to INR 502.02 cr of reported profit in the same period last year. Subsequently , the results for Quarter 1 of the current financial year has also registered a 15% jump in revenues to INR 2254 cr and a 26% rise in consolidated net profit as INR 702 cr vis-à-vis INR 557 cr in the same quarter last year. The Company continues to be debt free.

With a 5Y monthly Beta of 0.32 the stock is expected to provide average level of diversification benefit for the portfolio of investors. Over the last 90 days, Divis Lab shares have been less volatile as compared to the overall market and the stock's daily price fluctuated less than 98% as compared to the Sensex.

PROFIT AFTER TAX



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- **Business –** With solid support from financials, the business of Divis Lab has also been growing. The Company has a strong product pipeline, and Capex has been planned to ensure portfolio expansion given the rising volume and demand growth. The Company has been achieving economies of scale by debottlenecking and de-risking its dependence on the external supply chain to a great extent. Apart from the already executed Capex plans, the Company now plans to invest another INR 2000-3000 cr over the next three years to install new capacity for emerging custom synthesis projects.

- **Recent Events –** In October 2021, the Company inked a contract with US-based drug major Merck to supply Molnupiravir as an experimental Covid 19 drug. Further, as updated in the latest earning call held in August 2022, the management stated that they have enjoyed an excellent run-on account of molnupiravir and are in talks with the US drug maker for further supply of the same.

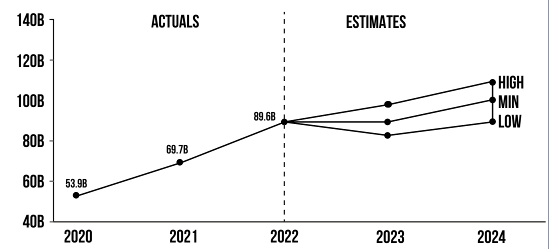
  In early 2021, the Company suffered a setback after its proposed expansion at Kakinada in Andhra Pradesh met with protests from the local population over safety norms. At the same time, the management confirmed that it had received all the clearances from the state and central governments, but on account of accidents at LG Polymers and Visakha Solvents in the recent past, the local people are skeptical about new industries, and hence the protest. The Company had committed INR 500 cr of capital investment, and while the negotiation is still underway, the expansion process is currently at a halt.

- **Future Expectations –** The Company has proved to be a multi-bagger over the last few years. The stock price rose from INR 9 in 2003 to the current levels with an all-time high return of 41,245.56%. The Company's shares rose from INR 635.20 in August 2017 to the current status of INR 3,650 per script, representing a more than 500% jump in return.

  The revenue forecast for the Company is healthy, and the current headwinds are primarily on account of higher crude prices, which are expected to soften gradually. With cost control measures, the absence of debt, quality management, and a robust financial base, the Company is expected to continue its stellar performance over the next few years. Key risk factors include regulatory changes, compliance risks, and forex volatility which the Company needs to mitigate on an ongoing basis.

  The stock has outperformed the benchmark Sensex considerably over the last few years, backed by solid fundamentals such as high-profit margins, low debt levels, and growing dividends. For 2022 the Company declared a 1500% dividend vis-à-vis a 1000% dividend declared for 2021 on a face value of INR 2 per share. The Company's gross margin, as well as its current ratio, has been higher than its industry group average for each of the past five years (Refinitive). The Company's long-term opportunities are intact, and it is well positioned to capitalize on them. The search by international players for alternative procurement sources for APIs and bulk drugs (like the recent case of Molnupiravir) is expected to favour API-centric players like Divis. Reduced dependence on imports and the government's boost to API manufacturing will benefit players like Divis.

DIVISLAB'S ANNUAL REVENUE



	2023	2024
MEAN	89.4B	100.5B
HIGH	98.1B	109.0B
LOW	83.4B	90.1B
FORCASTED GROWTH	-0.30%	12.2%
NO. OF ANALYSTS	21	21

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