

Divi's Laboratories (DIVI IN)

Well on track

INDIA | PHARMACEUTICALS | Quarterly Update

2 November 2015

Top takeaways from Q2FY16

- ✓ Surprising 19% yoy growth in generics sales despite a high base effect resulted in 5% higher than expected sales
- Brownfield capex of about Rs 3bn in H1 has supported q2 sales growth.
- ✓ In spite of higher sales contribution from generics (50% of sales), a 100bps margin surprise (supported by better INR realisation) led to 9% higher than expected (our/consensus) earnings

Key highlights: Both custom synthesis and carotenoid sales were below expectation. However, there the margin surprise resulted in 23%/26% growth in EBITDA/adjusted PAT, which was 7%/9% above our estimates.

Management call takeaways

- ✓ In Q2, generics sales saw 19% yoy growth to Rs 4.84bn (50% of sales) and custom synthesis sales rose 13% to Rs 4.34bn (45% of sales). Carotenoid sales were muted — 5% growth to Rs 460mn (5% of sales).
- ✓ Brownfield capex of about Rs 3bn in H1 created extra capacity. Thus, effective utilisation of its facilities is currently 85-87% (vs. >92% earlier).
- ✓ Divi's proposed greenfield facility with an investment of Rs 5bn in the Kakinada SEZ is undergoing the approval process and construction work could begin by December 2015. Management guides incremental sale from intermediate manufacturing from the new unit by H2FY17.
- ✓ Management maintained FY16 sales growth guidance at 15-20% with margins of 37-38%. It expects similar sales growth in FY17 with incremental revenue from its proposed greenfield expansion.

Outlook and valuation: While earnings were higher than we expected, H1 performance is almost in line with our FY16 expectations. Hence, we have maintained our estimates for FY16/17 and continue to value the company at Rs 1045 (22x FY17 earnings), implying 9% downside. However, we remain optimistic on the global pharma outsourcing opportunity for Divi's and we maintain our Neutral recommendation.

Neutral (Maintain)

CMP RS 1150/TARGET RS 1045 (-9%)

COMPANY DATA

O/S SHARES (MN) :	265
MARKET CAP (RSBN) :	297
MARKET CAP (USDBN) :	4.6
52 - WK HI/LO (RS) :	1242 / 787
LIQUIDITY 3M (USDMN) :	11.1
PAR VALUE (RS) :	2

SHARE HOLDING PATTERN, %

	Jun 15	Mar 15	Dec 14
PROMOTERS :	52.1	52.1	52.1
FII / NRI :	20.2	20.5	20.7
FI / MF :	14.8	14.4	13.4
NON PRO :	1.7	1.8	1.8
PUBLIC & OTHERS :	12.3	12.4	13.1

Key Financials

Rs mn	FY15	FY16E	FY17E
Net Sales	31,149	37,597	44,330
EBITDA	11,652	14,287	17,067
Net Profit	8,622	10,542	12,606
EPS, Rs	32.5	39.7	47.5
PER, x	35.4	29.0	24.2
EV/EBITDA, x	26.2	21.4	17.7
ROE, %	24.4	24.9	24.4
Debt/Equity (%)	0.8	2.2	2.1
BLM Cons EPS, Rs	20.3	25.0	37.6

CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY16E	FY17E	FY16E	FY17E
Revenue	37.6	44.3	0.0	0.0
EBITDA	14.3	17.1	0.0	0.0
Core PAT	10.5	12.6	0.0	0.0
EPS (Rs)	39.7	47.5	0.0	0.0

Surya Patra & Mehul Sheth

(Rs bn)	Q2FY16	Q2FY15	yoy Ch %	Q1FY16	qoq Ch %	vs. expectations %	Comments
CCS	4,339	3,639	19.2	3,832	13.2	(4.0)	
Generics	4,844	3,998	21.1	4,059	19.3	15.4	Strong growth despite high base
Carotenoids	460	450	2.2	440	4.5	(8.0)	
Net Sales	9,643	8,088	19.2	8,331	15.7	4.6	Strong generics performance
RM cost	3,854	3,205		3,506			
Gross Profit	5,790	4,882	18.6	4,826	20.0	2.9	
Gross Profit margin	60.0	60.4		57.9			
Staff Cost	860	803		695			
Other Expenses	1,170	1,080		1,063			
EBITDA	3,760	2,999	25.4	3,068	22.6	7.0	
EBITDA margin	39.0	37.1		36.8		0.9	Due to higher INR realisation
PBT	3,636	2,835	28.3	2,883	26.1	8.8	
Tax rate (%)	21.2	20.2		21.5			
Forex loss/(Gain)/ EO Loss	(116)	(212)		(43)			
Reported PAT	2,957	2,432	21.6	2,296	28.8	13.5	
Core PAT	2,836	2,211	28.3	2,249	26.1	8.8	
Core EPS (Rs)	10.68	8.33	28.3	8.47	26.1	8.8	

Q2FY16 results

Rs mn	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	QoQ (%)	YoY (%)
Net Sales	6,427	8,331	7,911	8,171	8,088	9,643	19.2	15.7
Material Cost	2,489	3,506	3,186	2,973	3,205	3,854	20.2	9.9
% of Total Sales	38.7	42.1	40.3	36.4	39.6	40.0		
Gross Profit	3,937	4,826	4,725	5,198	4,882	5,790	18.6	20.0
Gross Profit margin	61.3	57.9	59.7	63.6	60.4	60.0		
Staff Cost	602	695	746	789	803	860	7.0	23.7
% of Total Sales	9.4	8.3	9.4	9.7	9.9	8.9		
Other Expenses	984	1,063	1,108	1,079	1,080	1,170	8.3	10.1
% of Total Sales	15.3	12.8	14.0	13.2	13.4	12.1		
Total Expenditure	4,075	5,263	5,040	4,841	5,089	5,883	15.6	11.8
Operating Profit	2,352	3,068	2,871	3,330	2,999	3,760	25.4	22.6
% OPM	36.6	36.8	36.3	40.8	37.1	39.0		
Other Income	113	112	88	125	128	180	40.8	60.2
Interest	4	4	5	6	2	3	54.5	(20.9)
Depreciation & Amortisation	333	293	288	445	289	301	4.0	2.8
PBT	2,129	2,883	2,666	3,004	2,835	3,636	28.3	26.1
Forex loss/(Gain)/ EO Loss	-13.5	-43.2	-111.6	178.7	-212.2	-116.6	(45.1)	169.9
PBT after Forex	2,142	2,927	2,778	2,825	3,047	3,752	23.1	28.2
Taxes	463	630	572	536	615	795		
% of Tax Incidence	21.6	21.5	20.6	19.0	20.2	21.2		
PAT	1,679	2,296	2,206	2,289	2,432	2,957	21.6	28.8
% PAT Margin	26.1	27.6	27.9	28.0	30.1	30.7		
Minority Interest	-	-	-	-	-	-		
Net Profit	1,679	2,296	2,206	2,289	2,432	2,957	21.6	28.8
Adj. PAT (Ex. Forex)	1,661	2,249	2,106	2,511	2,211	2,836	28.3	26.1
Core EPS	6.25	8.47	7.93	9.46	8.33	10.68	28.3	26.1

Segment

(Rs mn)	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	QoQ (%)	YoY (%)
CCS	3,021	3,832	3,639	3,840	3,639	4,339	19.2	13.2
% of Total Sales	47.0	46.0	46.0	47.0	45.0	45.0		
Generics	3,026	4,059	3,902	3,821	3,998	4,844	21.1	19.3
% of Total Sales	47.1	48.7	49.3	46.8	49.4	50.2		
Carotenoids	380	440	370	510	450	460	2.2	4.5
% of Total Sales	5.9	5.3	4.7	6.2	5.6	4.8		
Total Biopharma	6,427	8,331	7,911	8,171	8,088	9,643	19.2	15.7

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY15	FY16	FY17E	FY18E
Net sales	31,149	37,597	44,330	50,943
Growth, %	23	21	18	15
Total income	31,149	37,597	44,330	50,943
Raw material expenses	-12,132	-14,324	-16,845	-19,104
Employee expenses	-2,904	-3,346	-3,990	-4,483
Other Operating expenses	-4,460	-5,640	-6,428	-7,591
EBITDA (Core)	11,652	14,287	17,067	19,766
Growth, %	14.9	22.6	19.5	15.8
Margin, %	37.4	38.0	38.5	38.8
Depreciation	-1,360	-1,361	-1,582	-1,781
EBIT	10,292	12,925	15,485	17,985
Growth, %	11.6	25.6	19.8	16.1
Margin, %	33.0	34.4	34.9	35.3
Interest paid	-19	-38	-44	-31
Other Non-Operating Income	428	628	721	875
Pre-tax profit	10,721	13,516	16,162	18,829
Tax provided	-2,206	-2,973	-3,556	-4,142
Profit after tax	8,515	10,542	12,606	14,686
Net Profit	8,515	10,542	12,606	14,686
Growth, %	17.4	22.3	19.6	16.5
Net Profit (adjusted)	8,622	10,542	12,606	14,686
Unadj. shares (m)	265	265	265	265
Wtd avg shares (m)	265	265	265	265

Balance Sheet

Y/E Mar, Rs mn	FY15	FY16	FY17E	FY18E
Cash & bank	652	303	3,614	7,006
Debtors	7,416	8,981	10,590	12,311
Inventory	11,626	13,598	15,903	18,273
Loans & advances	1,663	2,857	3,369	4,381
Other current assets	92	92	92	93
Total current assets	21,451	25,831	33,569	42,065
Investments	7,330	8,330	10,330	12,330
Gross fixed assets	19,530	22,689	26,369	29,688
Less: Depreciation	-6,441	-7,803	-9,385	-11,166
Add: Capital WIP	2,182	3,000	1,500	1,500
Net fixed assets	15,271	17,886	18,484	20,022
Total assets	44,051	52,047	62,384	74,416
Current liabilities	4,298	4,177	4,926	5,802
Provisions	3,271	3,367	3,377	3,387
Total current liabilities	7,569	7,545	8,302	9,189
Non-current liabilities	1,528	2,202	2,370	2,027
Total liabilities	9,098	9,747	10,673	11,216
Paid-up capital	265	265	265	265
Reserves & surplus	34,688	42,036	51,446	62,936
Shareholders' equity	34,954	42,302	51,712	63,201
Total equity & liabilities	44,051	52,047	62,384	74,416

Cash Flow

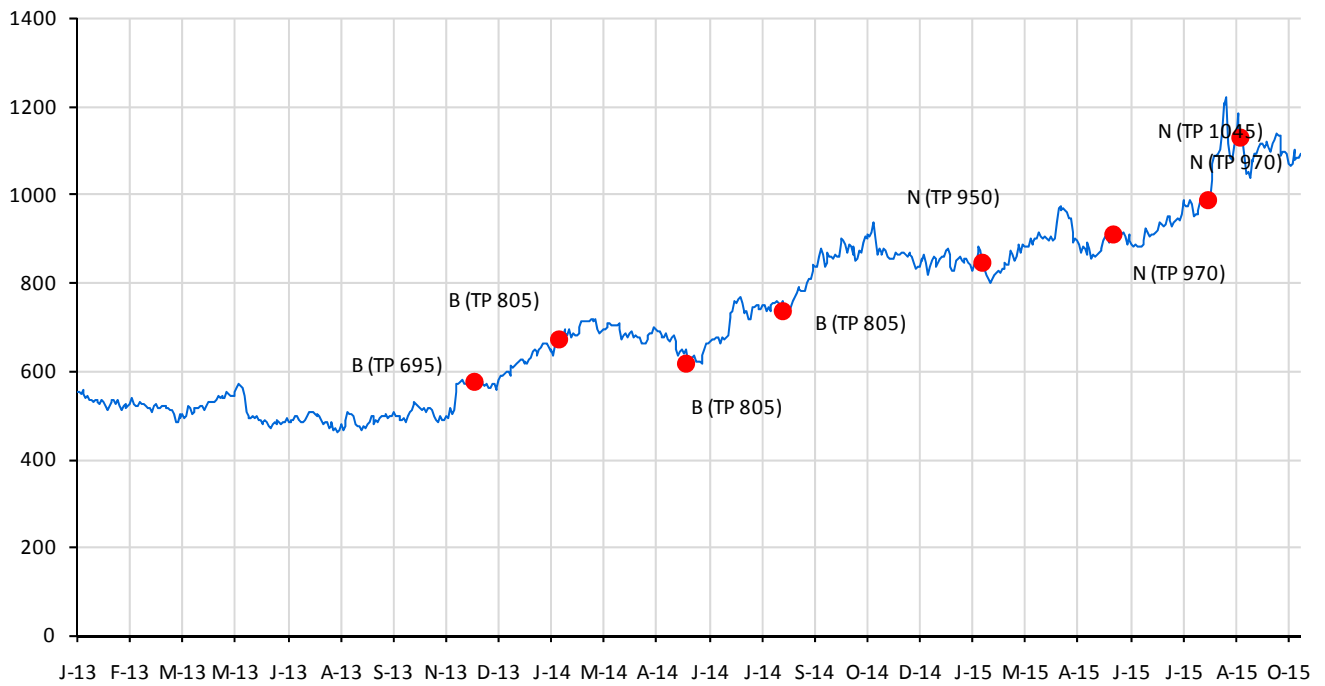
	FY15	FY16	FY17E	FY18E
Pre-tax profit	10,721	13,516	16,162	18,829
Depreciation	1,360	1,361	1,582	1,781
Chg in working capital	-1,348	-4,755	-3,668	-4,217
Total tax paid	-2,093	-2,973	-3,556	-4,142
Other operating activities	0	0	0	0
Cash flow from operating activities	8,639	7,148	10,520	12,250
Capital expenditure	-2,967	-3,977	-2,181	-3,318
Chg in investments	-2,311	-1,000	-2,000	-2,000
Cash flow from investing activities	-5,279	-4,977	-4,181	-5,318
Free cash flow	5,663	0	0	0
Debt raised/(repaid)	82	674	168	-343
Cash flow from financing activities	82	8,022	9,579	11,146
Net chg in cash	3,442	10,194	15,918	18,078

Valuation Ratios

	FY15	FY16	FY17E	FY18E
Per Share data				
EPS (INR)	32.5	39.7	47.5	55.3
Growth, %	17.4	22.3	19.6	16.5
Book NAV/share (INR)	131.7	159.3	194.8	238.1
FDEPS (INR)	32.5	39.7	47.5	55.3
CEPS (INR)	37.6	44.8	53.4	62.0
CFPS (INR)	30.9	24.6	36.9	42.9
Return ratios				
Return on assets (%)	21.0	22.0	22.1	21.5
Return on equity (%)	24.4	24.9	24.4	23.2
Return on capital employed (%)	29.4	30.5	30.0	28.9
Turnover ratios				
Asset turnover (x)	1.0	1.1	1.1	1.1
Sales/Total assets (x)	0.8	0.8	0.8	0.7
Sales/Net FA (x)	2.2	2.3	2.4	2.6
Working capital/Sales (x)	0.5	0.6	0.6	0.6
Receivable days	86.9	87.2	87.2	88.2
Working capital days	193.3	207.3	206.1	209.6
Liquidity ratios				
Current ratio (x)	5.0	6.2	6.8	7.3
Quick ratio (x)	2.3	2.9	3.6	4.1
Interest cover (x)	552.0	343.8	349.3	587.6
Total debt/Equity (%)	0.8	2.2	2.1	1.2
Net debt/Equity (%)	(1.1)	1.5	(4.8)	(9.9)
Valuation				
PER (x)	35.4	29.0	24.2	20.8
PEG (x) - y-o-y growth	2.0	1.3	1.2	1.3
Price/Book (x)	8.7	7.2	5.9	4.8
EV/Net sales (x)	9.8	8.1	6.8	5.9
EV/EBITDA (x)	26.2	21.4	17.7	15.1
EV/EBIT (x)	29.6	23.7	19.6	16.6

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	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

Management

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