

Divi's Laboratories Q2FY21

Financial Results & Highlights

Brief Introduction:

Divi's Laboratories Limited manufactures and sells generic active pharmaceutical ingredients (APIs) and intermediates for in the United States, Asia, Europe, and internationally. The company also undertakes custom synthesis of APIs and intermediates; and supplies a range of carotenoids, as well as markets vitamins to nutritional, pharma, food/beverage, and feed industries. In addition, it exports its products. The company was formerly known as Divi's Research Center and changed its name to Divi's Laboratories Limited in 1994. Divi's Laboratories Limited was founded in 1990 and is headquartered in Hyderabad, India.

Standalone Financials (In Crs)								
	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %	H1FY21	H1FY20	YoY
Sales	1727	1451	19.02%	1728	-0.06%	3450	2617	31.83%
PBT	685	483	41.82%	661	3.63%	1346	849	58.54%
PAT	513	353	45.33%	492	4.27%	1006	620	62.26%
Consolidated Financials (In Crs)								
	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %	H1FY21	H1FY20	YoY
Sales	1763	1493	18.08%	1748	0.86%	3506	2608	34.43%
PBT	694	488	42.21%	661	4.99%	1354	861	57.26%
PAT	520	357	45.66%	492	5.69%	1012	629	60.89%

Detailed Results:

1. Consolidated revenues were up an impressive 18% YoY while profit saw a rise of 46% YoY in Q2.
2. The company saw forex losses of Rs 15.6 Cr in Q2.
3. H1 numbers were very good with consolidated revenues up 34% YoY and profits up 61% YoY. This good H1 performance was mainly due to the stellar Q1 performance and the continued growth momentum in Q2.

Investor Conference Call Highlights

1. The company has capitalized Rs 614 Cr in Q2 for the Capex program which has gotten delayed due to COVID-19. The remaining projects are expected to be completed before the end of the financial year.
2. The company is planning a new Capex of Rs 400 in addition to the planned Rs 1800 Cr.
3. Exports accounted for 87% of sales.
4. The product mix for generics to custom synthesis is at 60% : 40%.
5. Constant currency growth for the quarter has been 18% YoY.

6. Nutraceuticals business amounted to Rs 167 crores for Q2 and Rs 294 crores for H1.
7. The company has received some very fast-tracked projects with a lot of incentivization and high returns due to which they are planning for the new Capex of Rs 400 Cr for the custom synthesis business.
8. The management has refrained from providing any comment on the concerns regarding the case against company officials brought up by SEBI.
9. The company has increased its capacity dramatically from debottlenecking. Its capacity for naproxen has increased by 5000 tons and gabapentin has increased by 2500 tons.
10. The management aims to sell these new incremental volumes without compromising on price.
11. The new projects coming in for custom synthesis are for an organic synthesis reaction and it cannot be confirmed whether it is for COVID or any other therapy.
12. The management has stated that UNIT 1 & 2 have already received USFDA clearance and thus adding additional units to these spaces will not require any more approval as it is to be used for the same product. Thus the company can immediately expand manufacturing in this UNIT and start selling higher volumes out of it.
13. In the medium term, the management expects custom synthesis to lead over generic products but in the long term these divisions should be at 50-50.
14. Some of the Rs 1800 Cr Capex is for debottlenecking which has been completed. Some of it is for backward integration, upgrading utility infrastructure, and the modern wastewater treatment plants at both sites. All of these are keeping in mind the next 10-15 years and preparing for new regulations to come.
15. The Capex of Rs 400 Cr for the custom synthesis projects is expected to be completed in the next 6-9 months and is expected to start production immediately upon completion.
16. The company is waiting on final clearance on the Kakinada site and is expected to start construction on the site in Dec or Jan. The Capex for this site is around Rs 600 Cr.
17. The management is not concerned with the fact that top customers account for 35-36% of sales as they believe that as the company keeps on adding more products and capacity, new customers will come in automatically and the customer concentration will normalize naturally.
18. Sales are expected to start in 203 years for the Kakinada unit with construction expected to be completed in 1-1.5 years.
19. Of the new brownfield expansion for backward integration, the company can use only 25% of the new capacity. The rest is pending approval from regulatory authorities.
20. The company expects sales of Rs 600 Cr in FY21 in the Nutraceutical business. It is expected to maintain a growth rate of 15-18% as the company expands to new markets.
21. The management has stated that in the custom synthesis business, most of the customers are big pharma companies and many are indeed repeat customers.
22. The company has not had to turn down any big orders due to a capacity shortfall so far.

23. The management has admitted that gross margins near 60% are sustainable going forward.
24. There are no instances of customers stocking up in APIs and most of them want delivery to be just in time. Instead many orders in December are getting postponed to January as it is the end of the year for most customers.

Analyst's View:

Divi's Labs has been a celebrated API manufacturer in India for a long time. The company is doing well and differentiating itself from the rest of the Indian Pharma industry by continuing to hone its efforts in maintaining its dominance in the API industry and Custom Synthesis. It had a phenomenal performance in H1 with 34% revenue growth and 61% PAT growth. The management has done well to gain big and high yielding projects in the custom synthesis business which has spurred the company to do additional Capex to expand custom synthesis capacity. It remains to be seen how the company will be able to chart its path in the future by solely relying on its core areas of API and Custom Synthesis while everyone else is diversifying into as many emerging segments as they can and whether the rise in gross margins in last 6 months is sustainable as the management has stated. Nonetheless, given the company's history of excellent performance and its standing in the global API industry, Divi's Laboratories remain a pivotal pharma stock in India, especially given the massive China substitution opportunity.

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