Divi's Laboratories Limited

October 04, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	30.00	CARE AA+; Stable (Double A Plus; Outlook: Stable)	Reaffirmed
Long-term/Short-term bank facilities	485.00	CARE AA+; Stable/CARE A1+ (Double A Plus; Outlook: Stable/A One Plus)	Reaffirmed
Total bank facilities	**515.00 (₹ Five hundred fifteen crore only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of Divi's Laboratories Limited (DLL) continue to derive strength from the extensive experience of the promoters and management team in the pharmaceutical industry, the company's established track record in Contract Research and Manufacturing Services (CRAMS) segment with reputed clientele, its strong research and development capabilities and favourable industry outlook. The ratings also take note of the growing scale of operations marked by considerable improvement in the operating income on year-on-year basis coupled with healthy profitability margins reported during FY22 (refers to the period April 01 to March 31), strong credit metrics characterised by sound capital structure and robust debt coverage indicators. Furthermore, the ratings factor in the healthy liquidity maintained by the company. The ratings are, however, tempered by product and customer concentration risk, working capital intensive nature of operations albeit funded entirely through internal accruals, exposure to the regulatory risk, and forex fluctuation risk on account of majority of the revenue being derived from exports. CARE Ratings Limited (CARE Ratings) notes that one of the major factors that contributed for growth in the total operating income (TOI) during FY22 is on account of deriving benefit from sale of an antiviral drug, i.e., Molnupiravir, which is used primarily for the treatment of COVID-19. CARE Ratings expects that with increase in the cost of raw materials and freight costs, the profitability margins are also expected to attenuate, nevertheless the PBILDT% is expected to remain healthy over 30% to 35% going forward.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- The ability of the company to consistently grow in terms of its scale of operations with PBILDT margin above 40% and return on capital employed (ROCE) above 28% on a continuous basis.
- To reduce the product concentration (from top five products) below 30%.
- To reduce the customer concentration (from top five customers) below 30%.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Elongated working capital cycle of beyond 300 days.
- Product concentration (from top five products) and customer concentration (from top five customers) going beyond 75% on a sustained basis.

Detailed description of the key rating drivers

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Key rating strengths

Experienced promoter, long track record of operations and proven strong R&D capabilities: Incorporated in October 1990, DLL is promoted by Dr Murli K. Divi, a postgraduate in Pharmaceutical Chemistry from College of Pharmacy, Manipal. Dr Divi has over 30 years of experience in the bulk pharmaceutical industry, and prior to venturing on his own, he has worked with Trinity Chemical Corporation, US, Schuylkill Chemical US and Fike Chemicals (as Technical Director & Vice President [R&D] US). Presently, he is the Managing Director (MD) of the company and is supported by a team of experienced professionals in different departments. The Board of Directors of the company consists of seven Independent Directors and five Executive Directors (including the Managing Director), who are all highly qualified individuals with strong professional experience. Since its establishment, the DLL's management has accorded high importance to research and development (R&D), as a result of which, the company has a strong chemistry skill set, product development and process development capabilities for cost efficiency on the existing products. As on March 31, 2022, DLL has a total of 39 drug master files (DMFs) with US-FDA and 25 CEPs (Certificates of Suitability) issued by EDQM authorities. DLL has filed for a total of 41 patents for generic products.

Well-equipped manufacturing facilities accredited by regulatory agencies: DLL has six multi-purpose manufacturing facilities, with two being located at Lingojigudem, Yadadri Bhuvanagiri District (Telangana), while the other four at Visakhapatnam district (Andhra Pradesh). DLL has taken up debottlenecking and backward integration projects at its manufacturing sites, which are fully completed and has contributed to improving the cost efficiency through process optimisation.

The company has triple certifications ISO-9001 (quality systems), ISO-14001 (Environment management system) and OHSAS-18001 (Occupation Health & Safety System) and adhere to cGMP standards. The company has also obtained Food Safety System Certificate (FSSC) 22000 for vitamins and carotenoids, as well as GMP+B2 certification for production of Feed Ingredients. The Company has research centres called as DRC at Hyderabad and process development & support centres (PDSCs) at the manufacturing sites. These centres are involved in the development of processes for both new compounds and improvement of processes for compounds on the market. The R&D expenses during the year FY22 amounted to ₹59.05 crore (0.66% of sales revenue) as against ₹51.26 crore (0.75% of sales revenue) incurred during FY21. USFDA carried out inspection of Unit-I and Unit-II in November 2019 and January 2020, respectively, and no critical observations were made. The inspection was also conducted by HPRA (Ireland) and JAZMP (Slovenia) at Unit-II in August 2019 and no critical observations were made. No inspections were carried out at its manufacturing units during FY22.

Increase in the TOI and healthy profitability margins during FY22: During FY22, the TOI of the company increased by 29% to ₹9,069 crore as against TOI of ₹7,027 crore in FY21. The growth in the annual revenues is supported by improved demand for bulk drugs and export markets during the year. During May 2021, the company has received authorisation to manufacture and supply of APIs pertaining to Molnupiravir for a global player named Merck. CARE Ratings notes that one of the major factors that contributed for growth in the TOI during FY22 is on account of deriving benefit from the sale of an antiviral drug, i.e., Molnupiravir. During FY22, the PBILDT margin improved to 44.05% (PY: 41.62%) and profit after tax (PAT) margin improved to 32.64% (PY: 28.24%), as the company has favourable product mix, and the commissioned capex projects like backward integration and debottlenecking projects have reduced the dependence on key starting materials besides achieving productivity and cost efficiency. During Q1FY23, the TOI of the company has improved by 14.99% on y-o-y basis and fell by 10.49% on q-o-q basis to ₹2,255 crore with PAT of ₹702 crore. The PBILDT margin stood at 41.48% in Q1FY23 as against 45.29% during Q1FY22 period. CARE Ratings expects that with increase in the cost of raw materials and freight costs, the profitability margins are also expected to attenuate, nevertheless the PBILDT% is expected to remain healthy over 30% during the near term.

Strong credit risk profile marked by sound overall gearing and debt coverage indicators: DLL continues to maintain sound capital structure, which is characterised by growing net worth and low debt levels. DLL continues to maintain comfortable leverage levels with no outstanding long-term debt and almost NIL working capital utilisation levels as on March 31, 2022. The tangible net worth of the company has improved to ₹11,721 crore as on March 31, 2022 as against ₹9,290 crore as on March 31, 2021. Higher net worth coupled with insignificant reliance on the debt levels has resulted in comfortable overall gearing of 0.00x

(as same as previous year) as on March 31, 2022. Furthermore, gross cash accruals (GCA) of the company during FY22 has increased to ₹3,351 crore (PY: ₹2,305 crore), which results in satisfactory debt protection metrics as on March 31, 2022. The company continues to undertake capex projects through internal accruals without any dependence on the external borrowings.

Strong liquidity profile: The company holds strong liquidity position represented by current ratio of 3.90x as on March 31, 2022 as against 3.89x as on March 31, 2021. Furthermore, cash and liquid investments of the company stood at ₹2,742 crore as on March 31, 2022 as against ₹2,081 crore as on March 31, 2021. The total debt of the company comprises only working capital limits in the form of cash credit and overdraft. During the last 12-month period ending July 2022, the company has not utilised any cash credit limits. The company does not have any debt repayment obligation for the year FY23.

Diversified market presence with major share of revenue from regulated markets: The total exports accounts for 90% of the gross sales in FY22 (88% of the gross sales during FY21) out of which majority of the revenue is streamed from Europe and North American markets. The revenue from these regulated markets accounts for 76.8% of gross sales in FY22 (71.1% of gross sales in FY21). The exports to North America market has increased in FY22, which contributed about 44.0% of the gross sales (against 23.7% in FY21), majorly on account of increase in the sales of APIs. It is followed by Europe, which contributed 32.8% of the gross sales in FY22 (against 47.4% in FY21). The revenue contribution in terms of geographies depend upon the requirements of the clients from various geographies. DLL's clientele includes top global innovator pharmaceutical companies. The revenue of DLL is well spread among its client portfolio with top five customers contributing around 54% of sales in FY22 as against 34% of sales during FY21.

Healthy growth prospects of the industry: With a market size of around USD 47-49 billion in FY22), the Indian pharmaceutical industry globally ranks third in terms of volume and thirteenth in terms of value. The industry has exhibited compounded annual growth rate (CAGR) of 8%-9% during last five years, i.e., FY17-FY22, while registering a y-o-y growth of 5%-7% in FY22, largely driven by higher domestic consumption, even as the exports value was stable at USD 24.60 billion in FY22. The growth in the domestic pharma market is expected to be driven by increase in the penetration of health insurance, improving access to healthcare facilities, rising prevalence of chronic diseases and rising per capita income. The export growth is expected to be led by increasing generic penetration in the regulated markets on the back of enhanced focus on the niche and complex product segments, patent expiries, medicine patent pool announcing licensing agreement with pharmaceutical companies and growing demand from semi-regulated pharma markets. Furthermore, supply constraints from China, which is the largest producer of key starting material (KSM) and active pharmaceutical ingredients (API), and diversification efforts from global pharmaceutical players with 'China plus one' strategy has created new growth opportunities for Indian manufacturers. To capitalise on the same, Government of India has announced initiatives like development of three Bulk Drug Parks worth ₹3,000 crore and Production Linked Incentive (PLI) Scheme worth ₹6,940 crore for the promotion of domestic manufacturing of KSMs and APIs in the country. With growing demand from global and domestic markets, supported by expanding manufacturing capabilities and policy initiatives, the growth prospects of the Indian pharmaceutical industry remain healthy.

Key rating weaknesses

Product and customer concentration risk: The revenue concentration from top five products has increased contributing 60% of sales in FY22 (49% during FY21). DLL is one of the world's leading suppliers of Naproxen, which is used in the treatment of osteoarthritis, rheumatoid arthritis, psoriatic arthritis, etc. The product concentration from top five products has increased over the period. Furthermore, the company visualises new opportunities in the custom synthesis category. Furthermore, the company has strengthened its position in traditional products like Naproxen (NSAID), Dextromethorphan, Levodopa, Gabapentin (Anti-Epileptic), Nabumetone (NSAID), etc., by increasing capacities at its manufacturing units. On May 26, 2021, DLL Laboratories had announced that it has been selected by Merck (US-based drug major, which is also known as MSD) as an authorised manufacturer for the active pharmaceutical ingredient (API) of Molnupiravir. DLL has been allowed to supply the API to MSD's VL partners in India. The US government had committed to purchase approximately 1.7 million courses of Molnupiravir upon issuance of

emergency use authorisation or approval by the U.S. Food and Drug Administration. DLL's clientele includes top global innovator pharmaceutical companies. The revenue of DLL is well spread among its client portfolio, however, top five customers contributed around 54% of sales in FY22 as against 34% of sales during FY21 indicating increase in the customer concentration risk.

Working capital intensive nature of operations: DLL's working capital cycle remained elongated and stood at 208 days during FY22 as against 203 days during FY21. The working capital cycle is elongated primarily on account of high inventory and collection periods. The company undertakes 'campaign production' of large volume products like Naproxen, Dextromethorphan and Gabapentin by running the plant at full stream. The company then stocks these products thus freeing the multi-purpose plants for producing other products. Hence, the company in general has a trend of high inventory holding period. The collection period is high since the company needs to allow credit period as per industry norms and to maintain client relationship. Furthermore, the cash credit limits remained un-utilised during the last 12-month period ending July 2022 indicating comfortable liquidity position.

High exposure to forex fluctuation risk: DLL is exposed to the forex risk as major revenue (90% of the revenue) of the company is derived from exports. DLL imports around 46% of the raw material consumption (PY: 44%), which provides natural hedge to the tune of around 25% - 29% of the total foreign exchange earnings. The company manages currency fluctuations by having a better geographic balance in revenue mix and ensures a foreign currency match between liabilities and earnings. The company has entered contract with major clients for a fixed exchange price, wherein any fluctuation in currency exchange rates is shared by both. According to the management, the company continually assesses the cost structure impacts of the currency volatility and engages with customers addressing such risks. Also, the company enters into hedging transactions as and when it is required. As on March 31, 2022, the company has net foreign currency exposure of ₹1,828 crore (₹1,002 crore as on March 31, 2021). During FY22, DLL has booked a net forex gain of ₹38 crore against loss of ₹1 crore in FY21.

Exposure to regulatory risk: The pharmaceutical industry is highly regulated and requires various approvals, licenses, registrations and permissions for business activities. Each authority has its own requirement, and they could delay or refuse to grant approval, even when a product has already been approved in another country. The approval process for a new product registration is complex, lengthy and expensive. The time taken to obtain approval varies by country, but generally it takes from six months to several years from the date of application. Any delay or failure in getting approval for new product launch could adversely affect the business prospect of the company. Given India's significant share in the US's generic market, the USFDA has increased its scrutiny of manufacturing facilities and other regulatory compliances of the Indian pharma companies supplying APIs and generic drugs to the US. Non-compliance may result in regulatory ban on products/facilities and may impact a company's future approvals from USFDA. During FY20, USFDA conducted three inspections of the manufacturing facilities at Unit-1 and Unit-II. In its latest inspection by USFDA conducted from January 27, 2020 to January 31, 2020, the company has successfully completed the inspection without any observations and no form 483 was issued. During FY22, no inspections were carried out by the USFDA.

Liquidity: Strong

DLL holds strong liquidity position marked by strong cash accruals to the tune of ₹3,351 crore during FY22 with nil repayment obligations on term loans. DLL has cash and liquid investments to the tune of ₹2,742 crore as on March 31, 2022. The current ratio as on March 31, 2022, stood at 3.90x as against 3.89x as on March 31, 2021. During last 12-month period ending July 2022, the company has not utilised any cash credit limits leaving the company with bank lines to the tune of ₹30 crore in case of any emergencies. With comfortable capital structure and low debt levels, the company has sufficient gearing headroom to raise any debt for its capex if required.

Analytical approach: Consolidated. The analytical approach is changed from Standalone to Consolidated. CARE Ratings has analysed DLL's credit profile by considering the consolidated financial statements owing to the financial and operational linkages

between the parent and subsidiaries and the common management. The subsidiaries of DLL that have been consolidated are mentioned under Annexure-6.

Applicable criteria

Policy on default recognition

Consolidation

Financial Ratios – Non financial Sector

Liquidity Analysis of Non-financial sector entities

Rating Outlook and Credit Watch

Short Term Instruments

Pharmaceutical

Policy on Withdrawal of Ratings

About the company

DLL was incorporated in 1990 by Dr Murli K Divi. It is engaged in the manufacturing of generic APIs, Nutraceutical, Custom Synthesis (CS) of APIs and intermediates for innovator companies. DLL have six manufacturing units and three R&D centres spread across the states of Telangana and Andhra Pradesh. With a portfolio of 160 products across diverse therapeutic areas, DLL is one of the largest pharmaceutical companies in India, and its revenues are derived from custom synthesis of APIs/ intermediates for innovator companies and generic exports.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	Q1FY2023
Total operating income	7,027	9,069	2,254
PBILDT	2,924	3,995	935
PAT	1,984	2,960	702
Overall gearing (times)	0.00	0.00	0.00
Interest coverage (times)	1,399.20	2,007.45	7,193.00

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	30.00	CARE AA+; Stable
Non-fund-based - LT/ ST-BG/LC		-	-	-	357.00	CARE AA+; Stable / CARE A1+
Non-fund-based - LT/ ST-BG/LC		-	-	-	128.00	CARE AA+; Stable / CARE A1+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Cash Credit	LT	30.00	CARE AA+; Stable	-	1)CARE AA+; Stable (05-Oct-21) 2)CARE AA+; Stable (26-Aug-21)	1)CARE AA+; Stable (31-Mar-21) 2)CARE AA+; Stable (28-Sep-20)	1)CARE AA+; Stable (09-Sep-19)
2	Non-fund-based - LT/ ST-BG/LC	LT/ST*	357.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (05-Oct-21) 2)CARE AA+; Stable / CARE A1+ (26-Aug-21)	1)CARE AA+; Stable / CARE A1+ (31-Mar-21) 2)CARE AA+; Stable / CARE A1+ (28-Sep-20)	1)CARE AA+; Stable / CARE A1+ (09-Sep-19)
3	Non-fund-based - LT/ ST-BG/LC	LT/ST*	128.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (05-Oct-21)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of rated instruments/facilities - Not Applicable

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Non-fund-based - LT/ ST-BG/LC	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Annexure-6: Subsidiaries being consolidated

Sr. No.	Name of the company	Percentage Ownership Interest
1	Divi's Laboratories (USA) Inc	100%
2	Divi's Laboratories Europe AG	100%

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About us:
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