Divi`s Laboratories Limited (Revised)

October 5, 2021

Ratings

Facilities/ Instruments	Amount (Rs. 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	128.00	CARE AA+; Stable / CARE A1+ (Double A Plus; Outlook: Stable/ A One Plus)	Assigned
Long Term / Short Term Bank Facilities	357.00	CARE AA+; Stable / CARE A1+ (Double A Plus; Outlook: Stable/ A One Plus)	Reaffirmed
Total Bank Facilities	**515.00 (Rs. Five Hundred Fifteen Crore Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & 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 favorable industry outlook. The ratings also take note of the growing scale of operations marked by increase in the operating income on year-on-year basis coupled with healthy profitability margins reported during FY21 (refers to the period April 01 to March 31), strong credit metrics characterized 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 regulatory risk forex fluctuation risk on account of majority of the revenue being derived from exports.

Rating Sensitivities

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

- Ability of the company to sustain the increasing scale of operations with PBILDT margin above 40% and return on capital employed (ROCE) above 28% on a continuous basis

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) going beyond 75% on sustained basis

Detailed description of the key rating drivers

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. Prior to venturing on his own, Dr Divi has worked with Trinity Chemical Corporation, US, Schuylkill Chemical US and Fike Chemicals (as Technical Director & Vice President (R&D) US). Presently, Dr Divi 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 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 existing products.

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

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). During FY20, DLL set up two brownfield projects, namely, DC SEZ unit (Lingojigudem, Telengana) which commenced operations in February 2020 and DCV SEZ unit (Chippada, Visakhapatnam) which commenced operations in March 2020. These projects were completed at an estimated investment of Rs.600 crore each. This apart, DLL has also 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 optimization. Presently, the company has commenced construction of its unit-III facility at Kona Forest, Near Kakinada, Andhra Pradesh, from December 07, 2020 onwards with an estimated investment of Rs.1,500 crore, funded from internal accruals in phased manner. The operations are likely to commence within 12 to 18 months for phase-1 of the Project.

The company has triple certifications ISO 9001 (quality systems), ISO 14001 (Environment management system) and OHSAS (Occupation Health & Safety System) and adhere to cGMP standards. The company has also obtained Food Safety System Certificate (FSSC) 22000 for vitamins and carotenoids in liquid and powder form. The company has Research Centers called as DRC at Hyderabad and Process Development & Support Centres (PDSCs) at the manufacturing sites. These centers are involved in the development of processes for both new compounds and improvement of processes for compounds on the market. R&D expenses during FY21 amounted to Rs.51.26 crore as against Rs.39.46 crore during FY20. USFDA carried out inspection of Unit I and Unit II in November 2019 and January 2020, respectively, and no critical observations were made. 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 FY21.

Increase in the total operating income and healthy profitability margins during FY21

The company's total operating income (TOI) grew by 25% and stood at Rs.6,856 crore during FY21 as against Rs.5,482 crore during FY20. Growth in top line is supported by improved demand for bulk drugs due to COVID-19 pandemic in domestic and export markets during the year. Furthermore, DLL has improved its revenue from contract research to Rs.145.65 crore during FY21 as against Rs.9.01 crore achieved during FY20. During the year FY21, the PBILDT margin has improved to 42.07% (PY: 36.32%) and the PAT margin has improved to 28.51% (PY: 25.04%) as the company has favourable product mix and recently commissioned capex projects like backward integration and debottlenecking projects have reduced dependence on key starting materials and improved cost efficiency through process optimization. During Q1FY22, the company has reported TOI of Rs.1,986 crore, which has improved by 14.93% on y-o-y basis.

Strong credit risk profile marked by sound overall gearing and debt coverage indicators

DLL continues to maintain sound capital structure which is characterized by growing networth due to profit accretion and low debt levels. As on March 31, 2021, the company does not have any outstanding long-term debt and the company's utilization of working capital facilities is also minimal. As a result of this, overall gearing ratio of the company as on March 31, 2021, stood at 0.00x (same as on March 31, 2020). Furthermore, gross cash accruals (GCA) of the company during FY21 has increased to Rs.2,273 crore (PY: Rs.1,611 crore) which resulted in satisfactory debt protection metrics as on March 31, 2021. The company continues to undertake capex projects through internal accruals without any dependence on external borrowings.

Strong liquidity profile

DLL holds strong liquidity position represented by current ratio of 5.56x as on March 31, 2021 as against 5.00x as on March 31, 2020. Furthermore, DLL has cash and liquid investments to the tune of Rs.2,067 crore as on March 31, 2021 (Rs.1,010 crore as on March 31, 2020). The company continues to maintain negative net debt position as the total debt of the company consists of only working capital limits in the form of cash credit and overdraft with no outstanding term debt as on March 31, 2021. During last 12-month period ending July 2021, the company has not utilized any cash credit limits.

Diversified market presence with major share of revenue from regulated markets

Total exports account for 88% of gross sales in FY21 (87% of gross sales during FY20) out of which majority of revenue is streamed from Europe and North American markets. The revenue from these regulated markets accounts for 71.1% of gross sales in FY21 (71.4% of gross sales in FY20). The exports to Europe market has the highest percentage share in FY21 which contributed about 47.4% of the gross sales (against 48% in FY20) followed by America which contributed 23.7% of the gross sales in FY21 (against 23.4% in FY20). 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 34% of sales in FY21 (against 36% of the sales during FY20).

Healthy growth prospects of the industry

The Indian pharmaceutical industry (IPI) is globally ranked third in terms of volume and thirteenth in terms of value. The industry size is estimated at about USD 42 billion in 2020 with domestic and export segment each holding a share of around 50% in industry's revenues. 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 capitalize on the same, Government of India has announced initiatives like development of three Bulk Drug Parks worth Rs.3,000 crore and Production Linked Incentive (PLI) Scheme worth Rs.6,940 crore for 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, growth prospects of Indian pharmaceutical industry remain healthy.

Key Rating Weaknesses

Product concentration risk

The revenue concentration from top five products has remained stable over a period of time contributing 49% of sales in FY21 (47% during FY20). Naproxen (an anti-inflammatory drug) contributed about 20% of the sales during FY21 as against 18% of sales in previous year. DLL is one of the world's leading suppliers of Naproxen, which is used in the treatment of osteoarthritis, rheumatoid arthritis, psoriatic arthritis, etc. Furthermore, the company has significant market share in Dextromethorphan (cough suppressant) and Gabapentin. The product concentration from top five products has remained stable over the period. As on July 31, 2021, the company has an order book of Rs.3,000 crore for various active pharmaceutical ingredients (API). Furthermore, the company visualizes new opportunities in the custom synthesis category. As on March 31, 2021, DLL has a total of 39 drug master files (DMFs) with US-FDA and 24 CEPs (Certificates of Suitability) issued by EDQM authorities. DLL has filed for a total of 40 patents for generic products.

Working capital intensive nature of operations

DLL's working capital cycle although improved has remained elongated and stood at 204 days during FY21 as against 222 days during FY20. 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 unutilized during last 12 months ending July 2021, indicating comfortable liquidity position.

High exposure to forex fluctuation risk

DLL is exposed to forex risk as major revenue (88% of the revenue during FY21) of the company is derived from exports. DLL imported around 44% of the raw material consumption during FY21 (reduced from 50% during FY20), which provides natural hedge to some extent against the forex fluctuation risk related to export income. This apart, the company has entered into contract with major clients for a fixed exchange price, wherein any fluctuation in currency exchange rates is shared by both. The company manages currency fluctuations by having a better geographic balance in revenue mix and ensures a foreign currency match between liabilities and earnings. According to the management, the company continually assesses the cost structure impacts of the currency volatility and engages with customers addressing such risks. As on March 31, 2021, the company has net foreign currency exposure of Rs.1,198 crore (Rs.1,063 crore as on March 31, 2020). During FY21, DLL has booked a net forex loss of Rs.0.77 crore against gain of Rs.82 crore in FY20.

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 as per the country; however, it generally takes 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 of DLL at Unit 1 and Unit II, and the same were cleared with minor observations. During FY21, no inspections were carried out by USFDA.

Liquidity: Strong

DLL holds strong liquidity position marked by strong accruals to the tune of Rs.2,273 crore during FY21 with nil repayment obligations on term loans. DLL has cash and liquid investments to the tune of Rs.2,241 crore as on July 31, 2021. Current ratio as on March 31, 2021 stood at 5.56x as against 5.00x as on March 31, 2020. During the last 12-month period ending July 2021, the company has not utilized any cash credit limits leaving the company with bank lines to the tune of Rs.30.00 crore in case of any exigencies. 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: Standalone

Applicable Criteria

Criteria on assigning Rating Outlook
Rating Methodology- Manufacturing Companies
Rating Methodology - Pharmaceutical Sector
Criteria for Short Term Instruments
Policy on Default Recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities

About the Company

DLL was incorporated in 1990 by Dr Murli K Divi. DLL 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 centers spread across the states of Telangana and Andhra Pradesh. With a portfolio of 130 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 (Rs. crore)	FY20 (A)	FY21 (A)
Total operating income	5,482.24	6,855.92
PBILDT	1,991.33	2,884.15
PAT	1,372.71	1,954.72
Overall gearing (times)	0.02	0.00
Interest coverage (times)	283.67	1,602.31

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: 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	Coupon Rate	Maturity Date	Size of the Issue (Rs. 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 of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Fund-based - LT-Cash Credit	LT	30.00	CARE AA+; Stable	1)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)	1)CARE AA+; Stable (07-Jan-19)2)CARE AA+; Stable (07-Dec-18)
2	Non-fund-based - LT/ ST-BG/LC	LT/ST*	357.00	CARE AA+; Stable / CARE A1+	1)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)	1)CARE AA+; Stable / CARE A1+ (07-Jan-19)2)CARE AA+; Stable / CARE A1+ (07-Dec-18)
3	Non-fund-based - LT/ ST-BG/LC	LT/ST*	128.00	CARE AA+; Stable / CARE A1+				

*Long Term/Short Term

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

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

Sr. No.	Name of the 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 instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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