Divi's Laboratories Limited

September 12, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	30.00	CARE AA+; Stable	Reaffirmed
Long Term / Short Term Bank Facilities	485.00	CARE AA+; Stable / CARE A1+	Reaffirmed

Details of instruments/facilities in Annexure-1.

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. CARE Ratings notes the moderation in total operating income during FY23 is on account of absence of one-time opportunity that the company had to manufacture a Covid drug during FY22 from where it has derived substantial revenue, nevertheless the revenue stream from its existing products continues to remain intact. Further attenuation in profitability margins during FY23 is primarily attributed to rise in raw material prices, increase in freight costs and pricing pressure. The financial performance of the company, however, remains strong with healthy profitability margins, 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 albeit reduced during FY23 as against FY22, 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) expects improvement in total operating income along with expansion in PBILDT% on account of easing of raw material prices and softening of fright charges.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- To diversify the revenue concentration risk from top 5 products to less than 30%.
- To exhibit consistent revenue growth of about 10% to 15%.
- Sustained ROCE of about 28%.

Negative factors

- Increase in revenue concentration risk from top 5 products beyond 65%.
- Any large debt funded capex or acquisition leading to weakening of credit risk profile of the company.
- Elongation in working capital cycle beyond 300 days.

Analytical approach:

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.

Outlook: Stable

The Stable outlook reflects that the rated entity is likely to maintain its established market position and would have comfortable liquidity profile

Detailed description of the key rating drivers:

Key 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

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

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, 2023, DLL has a total of 40 drug master files (DMFs) with US-FDA, 26 DMFs with Health Canada, 26 CEPs (Certificates of Suitability) issued by EDQM authorities, 7DMFs with PDMA Japan. 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 OHSAS18001 (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. 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 and FY23.

Moderation in total operating income and profitability margins during FY23:
During FY23, total operating income of the company has marginally decreased from Rs.9,000.41 crores in FY22 to Rs.7,897.18 crores indicating a de-growth of 12.3%, however the same is on account of contraction in demand for Covid drugs and change in product portfolio. During FY22, company has manufactured and supplied APIs pertaining to Molnupiravir (an antiviral drug meant to treat Covid 19) for a global player named Merck which contributed revenue of about Rs. 2,500 crores to 3,000 crores, which in turn led to significant growth during FY22. CARE Ratings notes that in the absence of this one time opportunity during FY23, the TOI has moderated during FY23. CARE Ratings expects growth in future years on account of increased capacity of the manufacturing facilities, expanded Sartan portfolio (Hypertension) and enhancing its focus on Contrast media (Radiology).
During the year FY23, PBILDT margin has decreased from 43.6% during FY22 to 31.7% on account of increase in cost of raw material consumption by 17.1%, power and fuel cost by 44.2%, freight cost by 8.5% and employee cost by 17.4% compared to FY22. However, on account of softening of raw material prices and freight costs, CARE ratings expect growth in the margins in future years. During Q1FY24, company has reported total operating income of Rs.1,778.00 crores with PBILDT margin of 28.34%.

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, 2023. Tangible net worth of the company has improved to Rs. 12,761 crores as on March 31, 2023, as against Rs. 11,721 crores as on March 31, 2022. Higher net worth coupled with low debt levels have resulted in comfortable overall gearing of 0.00x (as same as previous year) as on March 31, 2023.
However, Gross cash accruals (GCA) of the company during FY23 has decreased to Rs. 2,272.6 crores (PY: Rs. 3,351.0 crores) on account of decreased total operating income and EBIDTA, nonetheless, the same is satisfactory which results in satisfactory debt protection metrics as on March 31, 2023. The company continue to undertake capex projects through internal accruals without any dependence on external borrowings.

Strong liquidity profile
The company holds strong liquidity position represented by current ratio of 6.3x as on March 31, 2023 as against 3.90x as on March 31, 2022. Further, cash & liquid investments of the company stood at Rs. 4,132 crores as against Rs. 2,742 crores as on March 31, 2022. The total debt of the company comprises of only working capital limits in the form of cash credit and overdraft. During last 12-month period ending July 2023, the company has not utilized any cash credit limits. The company doesn't 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 88% of the gross sales in FY23 (90% of the gross sales during FY22) out of which majority of the revenue is streamed from Europe and North American markets. The revenue from these regulated markets accounts for 70.0% of gross sales in FY23 (76.8% of gross sales in FY22). Exports to Europe has increased to 41% of gross sales (against 32.8% in

FY22) followed by exports to North America market which has increased to 29% (against 23.7% in FY21) (not considered FY 22, as the revenue from North America was 44% on account of supply of anti-covid drugs), majorly on account of increase in the sales of APIs. 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 41% of sales in FY23 as against 54% of sales during FY22.

Healthy growth prospects of the industry:

With a market size of around USD 47-50 billion in FY23 (April 1 to March 31), 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 6-8% during last five years i.e., FY18-FY23 contributed by 8% growth in exports and 6% growth in domestic market while registering a y-o-y growth of 5-3% in FY23, largely driven by higher domestic consumption with growth of 7% and exports grew by just 3% over FY23. Industry is likely to reach USD 57 billion by FY25 with an expectation of growth at 7% to 8% in FY24 – FY25 supported by 6% to 7% growth in exports and 8% to 9% growth in domestic market during the same period.

US Market:

US holds a prominent position as one of the largest export destinations for the Indian Pharma Industry with 30 – 35% of total formulations exports. However, in recent times, US generics market has experienced headwinds on account of significant price corrections due to the consolidation of buyers and distributors. Nonetheless, there are substantial opportunities for Indian Pharma companies to expand its market share as approximately USD 188 billion worth of drugs worldwide are set to go off patent during the period from CY2023 to CY2026.

CRAMS:

CRAMS segment continues to unfold on capex-driven opportunities, further adding to this aggressive capex drives based on "China-plus One" theme is now coming to fore as the post – Covid scenario strengthens the argument in favour of outsourcing with incremental order wins and client additions. CRAMS segment is expected to persist improved trajectory for next 2 years. Strong growth in CRAMS is likely to continue its momentum on the back of strong demand in end-user industries and strong order book.

Key weaknesses

Product and customer concentration risk:

The revenue concentration from top five products has improved to 46% of sales in FY23 (60% during FY22 and 49% in 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. Furthermore, the company visualises new opportunities in the custom synthesis category and 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. 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 41% of sales in FY23 as against 54% of sales during FY22 indicating improvement in the customer concentration risk.

Working capital intensive nature of operations

DLL's working capital cycle remained elongated and stood at 245 days in FY23 as against 208 days during FY22. The working capital cycle is elongated primarily on account of high-cost inventory as at the year end 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. Further, the cash credit limits remained un-utilized during last 12-month period ending July 2023 indicating comfortable liquidity position.

High exposure to forex fluctuation risk

DLL is exposed to forex risk as major revenue (88% of the revenue) of the company is derived from exports. DLL imports around 45% of the raw material consumption (PY: 46%) 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 into 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 hedging transactions as and when it is required. As on March 31, 2023, the company has net foreign currency exposure of Rs. 1,239 crore as against Rs. 1,828 crore as on March 31, 2022). During FY23, DLL has booked a net forex gain of Rs.134 crores as against forex gain of Rs. 38 crore during FY22.

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.

Liquidity: Strong

The company holds strong liquidity position represented by current ratio of 6.3x as on March 31, 2023 as against 3.90x as on March 31, 2022. Further, cash & liquid investments of the company stood at Rs. 4,132 crores as against Rs. 2,742 crores as on March 31, 2022. The total debt of the company comprises of only working capital limits in the form of cash credit and overdraft. During last 12-month period ending July 2023, the company has not utilized any cash credit limits. The company doesn't not have any debt repayment obligation for the year FY23. Company has planned for capital expenditure of 1500 crores for Unit III in Kakinada, out of which it has already incurred Rs.500 crores by the end of FY23 and expecting capital expenditure of Rs.1000 crores by FY24. Further the company plans to capital expenditure of about Rs. 1500 crore during FY24 toward regular maintenance and also capacity augmentation at its existing plants. Considering the past gross cash accruals and also the estimated cash accruals of about Rs. 2500 crores to Rs. 3000 crores, the company plans to incur the capex from its internal accruals without relying on external debt.

Assumptions/Covenants: Not applicable

Environment, social, and governance (ESG) risks

For the pharma industry the main factor of ESG affecting the sector is the social aspects like product safety and quality, human capital & development, access to healthcare. Governance remains a universal concept affecting all the sectors and geographies. Amongst the ESG factors, majority of the pharma companies seems to be focusing on product quality & safety and regulatory compliance in governance. Since these companies have exposure to different geographies, each having its own regulatory requirements which are continuously evolving, any non-compliance with regulations or scrutiny process can result in product withdrawals, recalls, regulatory action, declining sales, reputational damage, increased litigation and related expenses. It might also result in regulatory ban on products/facilities (as in the recent cases of import alerts issued by the USFDA to top pharma companies) and may impact a company's future approvals from regulators like USFDA.

Divi's has implemented and adapted various initiatives for sustainability management like which is aimed to Reduce carbon footprints (~15500 tCO2e GHG emissions), Energy Management (~1,58,71,000 KWH of energy conserved), Water Management (~39,000 m^3 water conserved), Waste Management (~49,830 MT hazardous waste processed) and Green Belt development. Company has received Ecovadis Silver, in recognition of sustainability efforts and integrating ESG into daily operations, Divi's Unit 1 received Suraksha Puraskar and Divi's Unit 2 received Prashansa Patra during NSCI awards for occupational health and Safety.

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
Manufacturing Companies
Pharmaceutical
Policy on Withdrawal of Ratings

About the company and industry

Industry classification

Macro-Economic Indicator	Sector	Industry	Basic Industry
Healthcare	Healthcare	Pharmaceuticals & Biotechnology	Pharmaceuticals

Incorporated in October 1990, Divi's Laboratories is pharmaceutical and Biotechnology company engaged in Generic API, Custom Synthesis and Nutraceuticals. It is promoted by Dr Murli K. Divi. Divi's has global leadership position in CRAMS and Generic APIs. It is catering to therapeutic segments like Cardiovascular, Anti-Inflammatory, anti-cancer and Central nervous system drugs.

Brief Financials Consolidated (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	Q1FY24 (UA)
Total operating income	8,917.80	7,759.32	1778.00
PBILDT	3,917.57	2,484.00	504.00
PAT	2,948.54	1,808.15	356.00
Overall gearing (times)	0.00	0.00	0.00
Interest coverage (times)	2,277.66	1,469.82	NA

A: Audited, UA: Unaudited, NA: Not available; Note: 'the above results are latest financial results available'

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: Annexure-4

Lender details: Annexure-5

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 2023-2024	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
1	Fund-based - LT-Cash Credit	LT	30.00	CARE AA+; Stable	-	1)CARE AA+; Stable (04-Oct-22)	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)
2	Non-fund-based - LT/ ST-BG/LC	LT/ST*	357.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (04-Oct-22)	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)
3	Non-fund-based - LT/ ST-BG/LC	LT/ST*	128.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (04-Oct-22)	1)CARE AA+; Stable / CARE A1+ (05-Oct-21)	-

*Long term/Short term.

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

Annexure-4: Complexity level of the various instruments rated

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: Lender details

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

Annexure-6: List of subsidiaries/associates considered for consolidation

Name of companies/ Entities	Shareholding of Divi's as on March 31, 2023
Divi's Laboratories USA, Inc	100%
Divi's Laboratories Europe AG	100%

Note on the 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.

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About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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