Divi's Laboratories Limited

September 13, 2024

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

Ratings assigned to bank facilities of Divi's Laboratories Limited (Divi's) continue to derive strength from the extensive experience of 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 (R&D) capabilities and favourable industry outlook. Ratings factor in strong credit metrics characterised by sound capital structure, robust debt coverage indicators, and healthy liquidity maintained by the company. However, ratings are tempered by product and customer concentration risk despite reduced in FY24 as against FY23, working capital intensive operations, though funded entirely through internal accruals, exposure to the regulatory risk and forex fluctuation risk considering majority of the revenue being derived from exports. Stabilisation of total operating income (TOI) and attenuation in profitability margins in FY24 is primarily attributed to change in product mix, pricing pressure in generics segment, rise in raw material prices and freight costs. CARE Ratings Limited (CARE Ratings) expects improvement in TOI and margins in FY25 considering launch of new products, broadening of customer base, ease of raw material prices, improving demand, addition of capacity with operationalisation of Kakinada plant in second half of FY25, and increase in overall capacity utilisation.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

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

Negative factors

- Increasing revenue concentration risk from top five products beyond 60%.
- Large debt-funded capex or acquisition leading to weakening of credit risk profile of the company.
- Elongating working capital cycle beyond 300 days.

Analytical approach:

Consolidated. CARE Ratings has analysed Divi's credit profile by considering the consolidated financial statements owing to financial and operational linkages between the parent and subsidiaries and the common management. The subsidiaries of Divi's that have been consolidated are mentioned under Annexure-6.

Outlook: Stable

The Stable outlook reflects that Divi's is likely to maintain its established market position and would continue to generate healthy cash accruals and have strong liquidity position over the medium term.

Detailed description of key rating drivers:

Key strengths

Experienced promoter, long track record of operations, and proven strong R&D capabilities

Incorporated in October 1990, Divi's is promoted by Dr Murli K. Divi, a postgraduate in Pharmaceutical Chemistry from College of Pharmacy, Manipal. He 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 company's Managing Director (MD) and is supported by a team of experienced professionals in different departments. The company's Board of Directors consists of five independent directors and five executive directors (including the Managing Director), all highly qualified individuals with strong professional experience. Since its establishment, the Divi's management has accorded high importance to R&D, as a result of which, the company has a strong

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

chemistry skill set, product development, and process development capabilities for cost efficiency on existing products. As on March 31, 2024, Divi's has 41 drug master files (DMFs) with US-FDA, 25 DMFs with Health Canada, 26 CoS (Certificates of Suitability) issued by EDQM authorities, and seven DMFs with PMDA Japan. Divi's has filed for 43 patents for generic products.

Well-equipped manufacturing facilities accredited by regulatory agencies

Divi's has six multi-purpose operational manufacturing facilities, with two at Lingojigudem, Yadadri, Bhuvanagiri District (Telangana), while the other four at Visakhapatnam district (Andhra Pradesh). Divi's 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 ISO 45001 (Occupation Health & Safety System) and adhere to cGMP standards. The company has also obtained Food Safety System Certificate (FSSC) 22000 for vitamins and carotenoids, and 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 developing processes for both new compounds and improving 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 in FY22, FY23, and FY24. In FY25, USFDA conducted a general cGMP inspection at Unit II from July 11, 2024 to July 19, 2024. The inspection was successfully completed with one procedural observation addressed by the company in the stipulated period of time.

Stable TOI and healthy profitability margins

In FY24, the company's TOI stabilised at ₹7,875 crore as against ₹7,897 crore in FY23 majorly due to contraction in demand for COVID-19 drugs, change in product portfolio, and pricing pressure in generic product portfolio. Profit before interest, lease rentals, depreciation, and taxation (PBILDT) margin in FY24 moderated to 28.50% as against 31.66% in FY23 considering increase in the raw material cost consumption by 7.45% and employee cost by 12.23% compared to FY23, while the TOI remained at similar level. CARE Ratings expects growth in revenue and PBILDT margins returning to above 30% in future years due to increased capacity of the manufacturing facilities, growth in custom synthesis segment, expanded Sartan portfolio (Hypertension) and enhancing its focus on Contrast media (Radiology). In Q1FY25, the company has reported an improvement in TOI at ₹2,118 crore (Q1FY24: ₹1,778 crore) with PBILDT margin of 29.37% (Q1FY24: 28.35%).

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

Divi's continues to maintain sound capital structure, which is characterised by growing net worth and low debt levels. It continues to maintain comfortable leverage levels with no outstanding long-term debt and almost NIL working capital utilisation levels as on March 31, 2024. The company's tangible net worth (TNW) has improved to ₹13,567 crore as on March 31, 2024, as against ₹12,762 crore as on March 31, 2023. Higher net worth and low debt levels have resulted in comfortable overall gearing of 0.00x (as same as previous year) as on March 31, 2024. However, the company's gross cash accruals (GCA) in FY24 has moderated to ₹2,031 crore (PY: ₹2,273 crore) considering stabilised TOI and decline in PBILDT. Nonetheless, the same is satisfactory, resulting in satisfactory debt protection metrics as on March 31, 2024. The company continues to undertake capex projects through internal accruals without dependence on external borrowings.

Strong liquidity profile

The company holds strong liquidity position represented by current ratio of 5.63x as on March 31, 2024 (6.28x as on March 31, 2023). The cash and liquid investments stood at around ₹4,229 crore as on June 30, 2024. The company's total debt comprises only working capital limits in the form of cash credit and overdraft. In last 12-month period ending July 2024, the company has not utilised cash credit limits, and does not have debt repayment obligation for FY25.

Diversified market presence with major share of revenue from regulated markets

The total exports account for 87% of the gross sales in FY24 (88% of the gross sales in FY23), of which majority of the revenue is streamed from Europe and North American markets. Exports to Europe have increased to 52.3% of gross sales (against 40.3% in FY23) followed by exports to North America market which has decreased to 17.1% (against 28.9% in FY23). The revenue contribution in terms of geographies depend upon client requirements from geographies. Divi's clientele includes top global innovator pharmaceutical companies, and its revenue is well spread among its client portfolio with top five customers contributing around 37% of sales in FY24 as against 41% of sales in FY23.

Key weaknesses

Product and customer concentration risk

The revenue concentration from top five products has reduced over the years to 41% of sales in FY24 (60% in FY22 and 46% in FY23). Divi's is one of the world's leading suppliers of Naproxen, which is used in the treatment of osteoarthritis, rheumatoid arthritis, and psoriatic arthritis, among others. The company visualises new opportunities in the custom synthesis category and has strengthened its position in traditional products such as Naproxen (NSAID), Dextromethorphan, Levodopa, Gabapentin (Anti-Epileptic), Nabumetone (NSAID), and others, by increasing capacities at its manufacturing units. Divi's clientele includes top global innovator pharmaceutical companies. The revenue of Divi's is well spread among its client portfolio. However, top five customers contributed around 37% of sales in FY24 as against 41% of sales in FY23 indicating improvement in the customer concentration risk.

Working capital intensive nature of operations

Divi's working capital cycle remained elongated and stood at 241 days in FY24 as against 245 days in FY23. The working capital cycle is elongated primarily considering high-cost inventory as at the year end and collection periods. The company undertakes "campaign production" of large volume products such as 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 per industry norms and to maintain client relationship. The cash credit limits remained un-utilised in last 12-month period ending July 2024 indicating comfortable liquidity position.

High exposure to forex fluctuation risk

Divi's is exposed to forex risk as the company's major revenue (87% of the revenue in FY24) is derived from exports. Divi's imports account for around 45% of the raw material consumption (PY: 45%) which provides natural hedge to an extent. 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 fluctuation in currency exchange rates is shared by both. According to the management, the company continually assesses the impacts of the currency volatility on the cost structure and engages with customers addressing such risks. Also, the company enters hedging transactions as and when it is required. As on March 31, 2024, the company has net foreign currency exposure of ₹1,521 crore as against ₹1,241 crore as on March 31, 2023. In FY24, Divi's has booked a net forex gain of ₹30 crore as against forex gain of ₹130 crore in FY23.

Exposure to regulatory risk

The pharmaceutical industry is highly regulated and requires 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. In FY20, USFDA conducted three inspections of the manufacturing facilities at Unit I and Unit II without observations and no form 483 was issued. No inspections were carried out at its manufacturing units in FY22, FY23, and FY24. In FY25, in July 2024, USFDA conducted a general cGMP inspection at Unit II from July 11, 2024 to July 19, 2024. The inspection was successfully completed with one procedural observation, which the company has addressed in the stipulated period of time.

Liquidity: Strong

The company holds strong liquidity position represented by current ratio of 5.63x as on March 31, 2024. The company's cash and liquid investments stood at around ₹4,229 crore as on June 30, 2024. Its total debt comprises only working capital limits in the form of cash credit and overdraft. In last 12-month period ending July 2024, the company has not utilised cash credit limits. The company does not have debt repayment obligation for FY25. The company has planned for capital expenditure of around ₹1,500 crore for Unit III in Kakinada, out of which it has already incurred around ₹1,000 crore till June 30, 2024, and expecting remaining capital expenditure on it by end of FY25. The company plans to incur total capital expenditure of around ₹1,000 crore each in FY25 and FY26 towards regular maintenance and also capacity augmentation at its existing plants. Considering the past GCA and also the estimated cash accruals of about ₹2,500 crore to ₹3,000 crore, the company plans to incur the capex from its internal accruals without relying on external debt.

Assumptions/Covenants: Not applicable

Environment, social, and governance risks

For the pharma industry the main factor of environment, social, and governance (ESG) affecting the sector is the social aspects like product safety and quality, human capital & development, and access to healthcare. Governance remains a universal concept affecting 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, 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 such as USFDA.
Divi's has implemented and adapted initiatives for sustainability management, which is aimed to reduce carbon footprints (~19,000 tCO2e emissions were reduced in FY24), energy conservation (~164,900 GJ of energy conserved in FY24), water conservation (~130,300 KL water conserved in FY24), waste management (~40 MT plastic waste was reduced in FY24) and green belt development. In FY24, Divi's has installed RO plants in 133 schools benefiting ~11,000 students.

Applicable criteria

Consolidation
Definition of Default
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Rating Watch
Manufacturing Companies
Pharmaceuticals
Financial Ratios – Non financial Sector
Short Term Instruments

About the company and industry

Industry classification

Macroeconomic indicator	Sector	Industry	Basic industry
Healthcare	Healthcare	Pharmaceuticals & Biotechnology	Pharmaceuticals

Incorporated in October 1990, Divi's is a pharmaceutical company engaged in Generic API, Custom Synthesis, and Nutraceuticals. It is promoted by Dr Murli K. Divi. The company is catering to therapeutic segments such as cardiovascular, anti-inflammatory, anti-cancer, central nervous system drugs among others. Divi's currently has seven manufacturing units (one in Kakinada under construction) and three R&D centres spread across Telangana and Andhra Pradesh. With a portfolio of over 160 products across diverse therapeutic areas, Divi's is one of the largest pharmaceutical companies in India.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)	Q1FY25 (UA)
Total operating income	7,897.18	7,875.00	2,118.00
PBILDT	2,499.91	2,244.00	622.00
PAT	1,823.38	1,600.00	430.00
Overall gearing (times)	0.00	0.00	NA
Interest coverage (times)	1,275.46	561.00	

A: Audited UA: Unaudited; NA: Not available; Note: these are latest available financial results

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Detailed explanation of covenants of rated instrument / facility: Annexure-3

Complexity level of 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 and 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 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 2024-2025	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
1	Fund-based - LT-Cash credit	LT	30.00	CARE AA+; Stable	-	1)CARE AA+; Stable (12-Sep-23)	1)CARE AA+; Stable (04-Oct-22)	1)CARE AA+; Stable (05-Oct-21) 2)CARE AA+; Stable (26-Aug-21)
2	Non-fund-based - LT/ ST-BG/LC	LT/ST	357.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (12-Sep-23)	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)
3	Non-fund-based - LT/ ST-BG/LC	LT/ST	128.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (12-Sep-23)	1)CARE AA+; Stable / CARE A1+ (04-Oct-22)	1)CARE AA+; Stable / CARE A1+ (05-Oct-21)

LT: Long term; LT/ST: Long term/Short term

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

Annexure-4: Complexity level of 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 lender-wise details of bank facilities please click here

Annexure-6: List of entities consolidated

Sr No	Name of the entity	Extent of consolidation	Rationale for consolidation
1	Divi's Laboratories USA, Inc	Full	Subsidiary
2	Divi's Laboratories Europe AG	Full	Subsidiary

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