Divi's Laboratories Limited

March 31, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings	Rating Action
Long Term Bank Facilities	30.00	CARE AA+; Stable (Double A Plus; Outlook: Stable)	Reaffirmed
Long Term / Short Term Bank Facilities	357.00 (Enhanced from 355.00)	CARE AA+; Stable / CARE A1+ (Double A Plus; Outlook: Stable/ A One Plus)	Reaffirmed
Total Bank Facilities	**387.00 (Rs. Three Hundred Eighty-Seven Crore Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the enhanced bank facilities of Divi's Laboratories Limited (DLL) derives strength from increased operating income coupled with healthy profitability margins during FY20 (refers to the period April 01 to March 31) and during 9MFY21, comfortable capital structure as on March 31, 2020 and strong debt coverage indicators. The ratings also factor in experience of the promoters and management team, established track record in Contract Research and Manufacturing Services (CRAMS) segment with reputed clientele and strong research and development capabilities and favorable industry outlook. The ratings are, however, tempered by product and customer concentration risk and exposure to forex risk on account of exports.

Rating Sensitivities

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

- Ability to achieve PBILDT margin of more than 40% on a sustainable basis.
- Sustained ROCE of about 28%

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

- Elongated working capital cycle of beyond 300 days
- Product concentration (from top 5 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). Dr. Divi is supported by group of experienced professionals in different departments. 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.

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 FY2020 Divi's set up two new units-

- One unit(DC-SEZ) at site 1 commenced operations in February 2020 and
- Another unit (DCV SEZ) at Site 2 commenced operations in March 2020.

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 power 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 development of processes for both new compounds and improvement of processes for compounds on the market. R&D expenses during the year FY20 amounted to Rs. 39.46 crore as against Rs. 37.94 crore during FY19. During the year USFDA carried out inspection of Unit I and Unit II in November 2019 and January 2020 respectively and no critical observations made. Inspection was also conducted by HPRA (Ireland) and JAZMP (Slovenia) at Unit II in August 2019 and no critical observations made.

Increase in total operating income and healthy profitability margins

The company's total operating income grew by 8.9% and stood at Rs. 5482.24 crore during FY20 as against Rs. 5030.98 crore during FY19. The growth in topline is moderate during FY20 with export turnover contributing to 86.9% vis-à-vis 88.1% in FY19.

During FY20, DLL registered a healthy PBILDT margin of 36.32% against 39.81% in FY19. The slight decline in PBILDT margins is due to change in product mix which resulted in change in raw material cost composition. The other reasons attributing to lower PBILDT is due to increase in operational expenses.

During 9MFY21, the company has generated revenue of Rs. of Rs.5123 crore. The PBILDT margin and PAT margin stood at 42.18% and 28.63% respectively.

Comfortable leverage and debt coverage indicators

DLL continues to maintain comfortable leverage position with low debt levels represented by overall gearing ratio of 0.02x as on March 31, 2020 (same as on March 31, 2019) and satisfactory debt protection metrics with total debt/GCA of 0.10x of as on March 31, 2020 (0.07x as on March 31, 2019).

Strong liquidity profile

DLL holds strong liquidity position represented by current ratio of 5.09x as on March 31, 2020 as against 5.46x as on March 31, 2019. Further, Divi's has cash and liquid investments to the tune of Rs.999.23 crore (cash and bank balance of Rs.27.88 crore and current investments in mutual funds of Rs.971.35 crore) as on March 31, 2020 (Rs. 1,401.28 crore as on March 31, 2019). The total debt of the company comprises of only working capital limits in the form of Cash credit and overdraft. During last 12 months ending August 2020, the company has not utilized any cash credit limits.

Diversified market presence with major share of revenue from regulated markets

Total exports accounts for 86.9% of gross sales in FY20 (88.1% of gross sales during FY19) out of which majority of revenue is streamed from Europe and North American markets. Revenue from these regulated markets accounts for 71.4% of gross sales in FY20 (72.7% of gross sales in FY19). Exports to Europe market has the highest percentage share in FY20 which contributed about 48% of the gross sales (against 45.90% in FY19) followed by America which contributed 23.4% of the gross sales in FY20 (against 26.85% in FY19). DLL's clientele includes top global innovator pharmaceutical companies. Revenue of DLL is well spread among its client portfolio with top five customers contributing around 36% of sales in FY20 (against 37% of sales during FY19).

Healthy growth prospects of the industry

Pharma exports are expected to grow by 8%-10% on a y-o-y basis and the increase in exports will be backed by higher exports to USA, pharmemerging nations, developed nations and other nations. A stabilising price erosion environment is likely to aid pharma exports to USA. Moreover, the need for affordable healthcare in pharma emerging and developed nations is likely to support exports of branded generics to these countries. Also, rising per capita incomes in pharma emerging nations will contribute to the rise in branded generics exports from India. In addition to this, patent expiry or loss of brand exclusivity is also expected to result in higher exports of generic drugs. Besides, the Indian pharma companies are likely to focus on development of specialty medicines or complex generics to augment their portfolio which will help increase the Indian companies to gain share in world exports. On the domestic front, the industry is expected to grow at around 10%-12% and this will be backed by growth in presence of chronic diseases, increasing per capita income, improvement in access to healthcare facilities and penetration of health insurance. These factors are expected to increase the volumes of Indian pharma industry and the volumes are likely to grow faster compared to total domestic market growth rate.

Key Rating Weakness:

Product concentration risk

The revenue concentration from top five products has remained stable over a period of time contributing 47% of sales in FY20 (47% during FY19). Naproxen (an anti-inflammatory drug) contributed about 18% of sales during FY20 in line with the 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. The product concentration from top five products has remained stable over the period. Further, the company visualizes new opportunities in the custom synthesis category. As on March 31, 2020, DLL has a total of 38 drug master files (DMFs) with US-FDA and 23 CEPs (Certificates of Suitability) issued by EDQM authorities. Divi's has filed for a total of 37 patents for generic products.

Working capital intensive nature of operations

DLL's working capital cycle remained elongated and stood at 222 days during FY20 as against 216 days during FY19. 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. Further, the cash credit limits remained un-utilized during last 12 months ending August 2020 indicating comfortable liquidity position.

High exposure to forex fluctuation risk

DLL is exposed to forex risk as major revenue (87% of the revenue) of the company is derived from exports. Divi's imports around 50% of the raw material consumption which provides natural hedge to the tune of around 25% - 29% of the total foreign exchange earnings. Further, 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 into hedging transactions as and when it is required. During FY20, DLL has booked a net forex gain of Rs. 82.04 crore as against Rs. 30.92 crore in FY19.

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.

Liquidity: Strong

DLL holds strong liquidity position marked by strong accruals to the tune of Rs.1611.45 crore during FY20 with nil repayment obligations on tem loans. DLL has cash and liquid investments to the tune of Rs.999.23 crore as on March 31st, 2020 and current ratio stood at 5.09x as on March 31, 2020 as against 5.46x as on March 31, 2019. During last 12 months ending August 2020, 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. Further the company has not availed moratorium provided as a part of RBI Covid-19 regulatory package.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings
Rating Methodology- Pharmaceutical Sector
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology- Manufacturing Companies
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 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 122 products across diverse therapeutic areas, DLL is one of the largest pharmaceutical companies in India. Divi's revenues are derived from custom synthesis of APIs / intermediates for innovator companies, and generic exports.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	5030.98	5482.24
PBILDT	2002.78	1991.33
PAT	1332.65	1372.71
Overall gearing (times)	0.02	0.02
Interest coverage (times)	720.42	283.66

**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	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+

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	30.00	CARE AA+; Stable	1)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)	1)CARE AA+; Stable (29-Sep-17) 2)CARE AA+; Stable (03-May-17)
2.	Non-fund-based - LT/ ST-BG/LC	LT/ST	357.00	CARE AA+; Stable / CARE A1+	1)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)	1)CARE AA+; Stable / CARE A1+ (29-Sep-17) 2)CARE AA+; Stable / CARE A1+ (03-May-17)

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

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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