# Divis Laboratories Limited

May 03, 2017

**Ratings**

| Facilities | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Long-term Bank Facilities | 25 | **CARE AA+; Stable [Double A Plus; Outlook: Stable]** | Reaffirmed |
| Long-term/Short-term Bank Facilities | 243 | **CARE AA+; Stable/CARE A1+ [Double A Plus; Outlook: Stable/ A One Plus]** | Reaffirmed |
| **Total Facilities** | **268 (Rs. Two hundred Sixty Eight 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 Ltd (DLL), continue to factor in well experienced promoters having long track record of operations in the pharmaceutical industry, proven research and development capabilities with a large number of Drug Master Files (DMF) filings, well-equipped manufacturing facilities with the United States Food & Drug Administration (USFDA) and current Good Manufacturing practices (cGMP) certified production units, healthy growth in the revenue coupled with strong profitability margins in FY16 and 9MFY17 (FY refers to the period April 1 to March 31), very low debt levels marked by comfortable leverage position and debt risk coverage, healthy liquidity profile and positive industry outlook. The ratings also factor in the impact of issuance of import alert by USFDA to DLL in the month of April, 2017. The ratings are, however, constrained by revenue concentration from top few products, foreign exchange fluctuation risk and stretched operating cycle period. The ability of the company to diversify the product base along with sustained profitability levels, manage forex exchange fluctuation risk and successful execution of the proposed project without time and cost overrun are the key rating sensitivities.

**Detailed description of the key rating drivers**

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

Dr. Murli K Divi has over 30 years of experience in the bulk pharmaceutical industry. Dr. Divi is supported by a team of experienced professionals in different departments. The company has strong chemistry skill sets, product development and process development capabilities for cost efficiency.

***Well-equipped manufacturing facilities***

DLL has four multi-purpose manufacturing facilities one located at Nalgonda district, Telangana state while other three (one Export oriented unit and other two Special Economic Zone units) at Visakhapatnam district, Andhra Pradesh state. All the units of the company are approved by US FDA and also has various certifications.

***Favourable financial risk profile with significant growth in operating income in conjunction with strong profitability margins and low debt coverage indicators***

DLL's Total Operating Income (TOI) has shown a healthy growth of 22% during FY16 over FY15 driven by growth in its custom synthesis business as well as generic API business. The PBDILT margin and PAT margin of the company has improved and continued to remain robust.

Furthermore, during 9MFY17 (unaudited results), the company has achieved total operating income of Rs.3054.15 crore (Rs.2725.05 crore in 9MFY16) with PAT of Rs.793.98 crore (Rs.788.84 crore in 9MFY16). The financial risk profile of DLL remains favourable with low debt levels.

***Diversified market presence with major share of turnover from regulated markets***

Major share of the revenue is streamed from exports particularly regulated markets like Europe and USA. Revenue of DLL is well spread among its client portfolio with top five customers contributing around 38% of net sales in FY16 (against 43% of net sales during FY15).

**Key rating weakness**

***Impact of Issuance of import alert***

In the month of April 2017, USFDA has issued a warning letter to DLL post import alert issued in the month of March 2017. In import alert issued, USFDA has exempted several products manufactured at the company's unit II-Visakhapatnam, Andhra Pradesh which the company will continue to supply to its customers.

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

*Revenue loss of less than 5% is expected out of this event; hence CARE does not foresee significant impact on the financial position of the company. However, CARE will continue to closely monitor the updates on this event and would hence review the rating as required based on the developments.*

***Product concentration risk***

The revenue concentration from top five products has remained stable over a period of time contribution nearly 42% of net sales in FY16 despite of increase in the contribution from other products during the year. During FY16, the company has focused to strengthen their position for traditional generic products by increasing capacities at manufacturing sites. The company has also launched several new products which are expected to reap revenue in one to two years timeline.

***High exposure to forex fluctuation risk***

DLL is exposed to forex risk as major revenue of the company comes from exports. The forex risk is partly mitigated by natural hedge through the imports. Furthermore, DLL has contract for the fixed exchange price covering 40% of the total sales. During the year, DLL has earned net gain on foreign currency transaction and translations against notional loss in FY15.

***High working capital cycle albeit improved***

The working capital cycle of DLL has remained high though improved y-o-y ending FY16. Improvement in working capital cycle is owing to improved collection period and inventory holding period in FY16. However, the company has trend of high inventory holding period due to large product portfolio and also supply of drugs to innovator companies on need basis.

**Analytical approach:** Standalone

**Applicable Criteria**

- Criteria on assigning Outlook to Credit Ratings
- CARE's Policy on Default Recognition
- Criteria for Short Term Instruments
- Rating Methodology-Manufacturing Companies
- Financial ratios – Non-Financial Sector
- Rating Methodology- Pharmaceutical Sector

**About the company**

DLL was incorporated in 1990 by Dr Murli K Divi. DLL have four manufacturing units and three R&D centres spread across the states of Telangana and Andhra Pradesh. To meet growing demand from export markets for generics and custom synthesis, the company set up a new Special Economic Zone (DSN SEZ) at Vishakapatanam, Andhra Pradesh state, which has become fully operational by end of FY14. DLL is engaged in the manufacturing of generic APIs, Custom Synthesis (CS) of active ingredients for innovator companies and other speciality chemicals like peptides and nutraceuticals.

**Status of non-cooperation with previous CRA: Not Applicable**

**Any other information:** Not Applicable

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

***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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**About CARE Ratings:**

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**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 | - | - | - | 25.00 | CARE AA+; Stable |
| Non-fund-based - LT/ ST-BG/LC | - | - | - | 243.00 | 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 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 | Date(s) & Rating(s) assigned in 2015-2016 | Date(s) & Rating(s) assigned in 2014-2015 |
| 1. | Fund-based - LT-Cash Credit | LT | 25.00 | CARE AA+; Stable | - | 1)CARE AA+ (06-Oct-16) | 1)CARE AA+ (15-Oct-15) | 1)CARE AA+ (07-Oct-14) |
| 2. | Non-fund-based - LT/ ST-BG/LC | LT/ST | 243.00 | CARE AA+; Stable / CARE A1+ | - | 1)CARE AA+ / CARE A1+ (06-Oct-16) | 1)CARE AA+ / CARE A1+ (15-Oct-15) | 1)CARE AA+ / CARE A1+ (07-Oct-14) |

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