Divi's Laboratories Limited

September 09, 2019

Ratings

Facilities	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	355.00	**CARE AA+; Stable/CARE A1+ (Double A Plus; Outlook: Stable/A One Plus)**	**Reaffirmed**
Total Facilitates	**385.00 (Rupees Three hundred Eighty Five crore only)**		

Detailed Rationale

The ratings assigned to the bank facilities of Divi's Laboratories Limited (DLL) continues to derive strength from the experience of the promoters and management team, well equipped manufacturing facilities, strong research and development capabilities, comfortable capital structure and debt coverage indicators, strong liquidity position and favorable industry outlook. The ratings also take into account continuing robust financial performance of the company with increase in scale of operations coupled with improved profitability margins during FY19 (FY refers to the period from April 01 to March 31). The ratings are, however, tempered by the ongoing capex programme although the same is being funded by way of internal accruals and available funds, elongated operating cycle, product and customer concentration risk, exposure to regulatory risk and exposure to forex risk on account of exports.

The ability of the company to sustain its growth in total operating income, maintain its profitability margins and capital structure while stringently observing the regulatory compliances are the key rating sensitivities.

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 carries a strong chemistry skill set, product development and process development capabilities for cost efficiency on existing products.

Well-equipped manufacturing facilities

DLL has four multi-purpose manufacturing facilities one located at Lingojigudem, Yadadri Bhuvanagiri District (Telangana) while other three at Visakhapatnam district (Andhra Pradesh). Out of the four units, company operates one EOU and two SEZ units at Visakhapatnam District. 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. All the manufacturing sites of the company have been inspected by US-FDA, EU and other agencies.

Strong research and development capabilities

The company on an ongoing basis incurs capex to augment its manufacturing capacities and upgrade utilities to meet increasing business opportunities in the field of Generic market. This apart, DLL has 3 R&D centers each at Lingojigudem, Hyderabad and Visakhapatnam. R&D expenses during the year FY19 amounted to Rs. 34.89 crore as against Rs. 31.77 crore during FY18.

Healthy growth in total operating income and profitability margins during FY19

The company's total operating income grew by 28.07% and stood at Rs. 5030.98 crore during FY19 as against Rs. 3928.31 crore during FY18. The improvement is at the back of normalized operations after successful closure of audits by USFDA for company's manufacturing units. The company had received an import alert and warning letter for Unit-II at Visakhapatnam, subsequent to inspection of the said unit in November-December 2016. The operations of the company got impacted as DLL needed to set up protocols and procedures for release of export shipments as stipulated in the Import Alert issued by the

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

USFDA in March 2017. During FY18, in view of the import alert, the company had to realign its production programs across its units and also incur additional expenditure for remediation of the deficiencies observed by the FDA and for engaging external regulatory consultants, subject matter specialists and consultants for resolving the issues with the FDA. On account of the aforementioned expenses, the PBILDT margin of the company declined during FY18. However, after lifting of the import alert by USFDA in November 2017, the PBILDT margin of the company improved by 493 Bps and stood at 39.81% during FY19 as against 34.88% during FY18. In tandem with PBILDT margin, the PAT margin of the company improved from during 22.14% FY18 to 26.49% during FY19.

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, 2019 (same as on March 31, 2018) and satisfactory debt protection metrics with total debt/GCA of 0.07x of as on March 31, 2019 (0.06x as on March 31, 2018).

Strong liquidity profile

DLL holds strong liquidity position represented by current ratio of 6.12x as on March 31, 2019 as against 7.11x as on March 31, 2018. Further, current investments in mutual funds stood at Rs. 1945.60 crore as on March 31, 2019 (Rs. 1,889.29 crore as on March 31, 2018). The total debt of the company comprise of only working capital limits in the form of CC and OD wherein OD limits are FD backed. Moreover, during last 12 months ending July 2019, the company has not utilized any cash credit limits.

Diversified market presence with major share of revenue from regulated markets

Major share of total operating income is accounted from exports to regulated markets such as Europe and North American markets. Total exports accounts for 88% of gross sales in FY19 (87% of gross sales during FY18) out of which majority of revenue is streamed from Europe and North American markets. Revenue from these regulated markets accounts for 72.75% of gross sales in FY19 (72.62% of gross sales in FY18). 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 37% of sales in FY19 (against 42% of sales during FY18). Exports to Europe market had the highest percentage share in FY19 which contributed about 46% of the gross sales (against 44% in FY18) followed by America which contributed 27% of the gross sales in FY19 (against 29% in FY18).

Key Rating Weaknesses

Product concentration risk

The revenue concentration from top five products has remained stable over a period of time contributing 47% of sales in FY19 (46% during FY18). Naproxen (an anti-inflammatory drug) contributed about 18% of sales during FY19 (against 15% during FY18). 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 despite increase in the contribution from other products on account of increasing demand in FY19. As on March 31, 2019, DLL has a total of 39 drug master files (DMFs) with US-FDA and 22 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 216 days during FY19 as against 224 days during FY18. 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 July 2019 indicating comfortable liquidity position.

High exposure to forex fluctuation risk

DLL is exposed to forex risk as major revenue of the company is derived from exports. The forex risk is partly mitigated by natural hedge through the imports. 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 FY19, DLL has booked a net forex gain of Rs. 30.92 crore as against a Rs. 24.60 crore in FY18.

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.

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

Divi's Laboratories Limited (DLL) was incorporated in 1990 by Dr. Murli K. Divi as Divi's Research Centre Pvt. Ltd. to carry out process development work for Active Pharmaceutical Ingredients (API) and pharmaceutical intermediates. Subsequently, in 1995, the company changed its name to present nomenclature and started manufacturing API and intermediates in its own unit near Hyderabad. DLL owns four manufacturing units and three R&D Centers spread across Andhra Pradesh and Telangana. To meet growing demand from export markets for generics and custom synthesis, company is constantly augmenting capacities of existing units along with upgrading (modernizing) utilities. DLL is engaged in manufacturing of generic APIs, Nutraceutical, Custom Synthesis (CS) of APIs and Intermediates for innovator companies. Custom synthesis involves development of a non-infringing process and supply of API and intermediates to innovator pharma companies for supporting their drug discovery process. The company collaborates with innovator companies through the early drug development stage to the fermentation stage. 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)	FY18 (A)	FY19 (A)
Total operating income	3928.31	5030.98
PBILDT	1270.24	2002.78
PAT	869.58	1332.65
Overall gearing (times)	0.01	0.02
Interest coverage (times)	598.36	720.42

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

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	-	-	-	355.00	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Cash Credit	LT	30.00	CARE AA+; Stable	-	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)	1)CARE AA+ (06-Oct-16)
2.	Non-fund-based - LT/ ST-BG/LC	LT/ST	355.00	CARE AA+; Stable / CARE A1+	-	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)	1)CARE AA+ / CARE A1+ (06-Oct-16)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities - NA

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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