

# Divi's Laboratories

BSE SENSEX 16,863	S&P CNX 5,087	<b>CMP: INR783</b>	<b>TP: INR882</b>								<b>Buy</b>	
Bloomberg Equity Shares (m)	DIVI IN 132.7	<b>Year End</b>	<b>Net Sales (INR m)</b>	<b>PAT (INR m)</b>	<b>EPS (INR)</b>	<b>EPS Gr. (%)</b>	<b>P/E (X)</b>	<b>P/BV (X)</b>	<b>RoE (%)</b>	<b>RoCE (%)</b>	<b>EV/ Sales</b>	<b>EV/ EBITDA</b>
52-Week Range (INR)	843/582	03/10A	9,416	3,403	25.8	-19.9	-	-	24.7	27.3	-	-
1,6,12 Rel. Perf. (%)	-8/2/35	03/11A	13,071	4,293	32.4	25.7	24.2	5.8	25.9	28.2	8.0	21.1
M.Cap. (INR b)	103.9	03/12E	15,970	4,627	34.9	7.7	22.4	4.9	23.8	30.2	6.5	18.1
M.Cap. (USD b)	2.1	03/13E	19,824	5,851	44.1	26.4	17.8	4.1	25.4	31.5	5.2	13.9

Divi's Lab 3QFY12 operational performance was in line with estimates. Key highlights:

- Divi's Lab reported 34% YoY growth in revenues to INR4.14b (vs est of INR4.1b), EBITDA growth of 27%YoY to INR1.48b (est of INR1.48b) and 25% YoY growth in Adj PAT to INR1.22b (est of INR1.14b).
- Topline growth was led by 41% growth in Generic API revenues to INR2.1b while CCS sales grew by 27% to INR1.83b. Carotenoids revenues grew by 33% to INR200m albeit on a low base
- EBITDA growth at 27% YoY to INR1.48b was in-line with estimates but was lower than topline growth because of higher staff costs. EBITDA margins declined by 200bps YoY to 35.8% vs estimate of 36.3%.
- Adj PAT growth of 25% YoY to INR1.22b was better than our estimate of INR1.14b and was boosted by higher than expected other income at INR284m compared to our estimate of INR116m (mainly due to INR160m of forex gains).

Divi's is well positioned in the CRAMS space, given its strong relationships with innovators, presence across the CRAMS value chain, and its ability to support the innovator in late life-cycle strategies. Unlike other API players, DIVI earns strong margins in this business due to its global cost and market leadership in some APIs (global market share of 50-70%), its ability to increase prices, and strong backward integration. Divi's will be a key beneficiary of increased outsourcing from India. We estimate RoCE and RoE of 25%+ for the next few years, led by traction in the high-margin CRAMS business, sustained profitability in the API business and incremental contribution from the new SEZ. We estimate 23% revenue CAGR for FY11-13 led by both API and CCS business segments and ramp-up in Carotenoids revenues. EPS CAGR will be lower at 17% due to the significant increase expected in the company's tax rate from 9% to 20%. Divi's stock currently trades at 22.4x FY12E and 17.8x FY13E earnings. Maintain **Buy** with a price target of INR882 (20x FY13E EPS).

## Quarterly Performance

Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
<b>Net Op Revenue</b>	<b>2,635</b>	<b>2,553</b>	<b>3,097</b>	<b>4,786</b>	<b>3,586</b>	<b>3,541</b>	<b>4,147</b>	<b>4,697</b>	<b>13,071</b>	<b>15,970</b>
YoY Change (%)	28.0	13.3	57.8	52.4	36.1	38.7	33.9	-1.9	38.8	22.2
Total Expenditure	1,645	1,711	1,927	2,877	2,308	2,279	2,663	2,981	8,156	10,231
<b>EBITDA</b>	<b>990</b>	<b>842</b>	<b>1,170</b>	<b>1,909</b>	<b>1,277</b>	<b>1,262</b>	<b>1,484</b>	<b>1,716</b>	<b>4,915</b>	<b>5,739</b>
Margins (%)	37.6	33.0	37.8	39.9	35.6	35.6	35.8	36.5	37.6	35.9
Depreciation	131	133	135	135	140	152	162	177	534	631
Interest	6	5	6	6	2	6	2	9	22	19
Other Income	59	92	102	112	164	227	284	168	365	844
<b>PBT after EO Income</b>	<b>912</b>	<b>797</b>	<b>1,131</b>	<b>1,880</b>	<b>1,299</b>	<b>1,332</b>	<b>1,604</b>	<b>1,697</b>	<b>4,724</b>	<b>5,932</b>
Tax	71	77	130	126	273	257	341	435	405	1,305
Deferred Tax	3	0	17	6	1	14	38	-53	26	0
Rate (%)	8.2	9.7	13.0	7.0	21.0	20.4	23.6	22.5	9.1	22.0
<b>Reported PAT</b>	<b>837</b>	<b>719</b>	<b>984</b>	<b>1,748</b>	<b>1,026</b>	<b>1,061</b>	<b>1,226</b>	<b>1,315</b>	<b>4,293</b>	<b>4,627</b>
<b>Adj PAT</b>	<b>837</b>	<b>719</b>	<b>984</b>	<b>1,748</b>	<b>1,026</b>	<b>1,061</b>	<b>1,226</b>	<b>1,315</b>	<b>4,293</b>	<b>4,627</b>
YoY Change (%)	40.9	-15.2	45.1	33.9	22.5	47.4	24.5	-24.7	26.1	7.8
Margins (%)	31.8	28.2	31.8	36.5	28.6	30.0	29.6	28.0	32.8	29.0

E: MOSL Estimates

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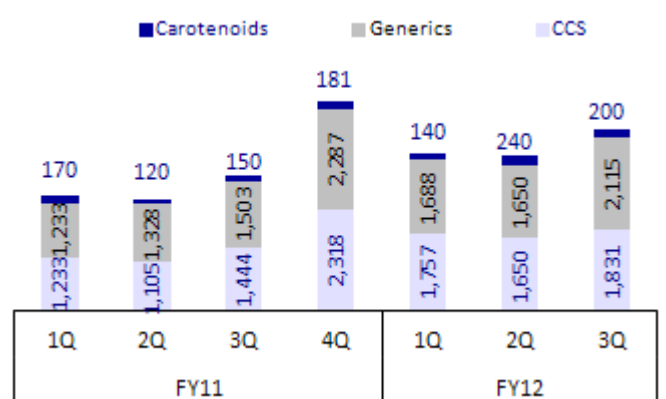
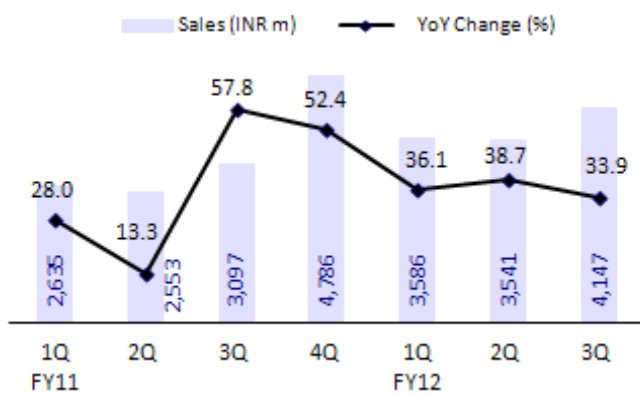
**Revenues boosted by all round performance**

Divi's Lab reported 34% YoY growth in revenues to INR4.14b (vs est of INR4.1b), EBITDA growth of 27%YoY to INR1.48b (est of INR1.48b) and 25% YoY growth in Adj PAT to INR1.22b (est of INR1.14b). While topline & EBITDA performance are in-line with estimates, PAT was boosted by higher other income, mainly due to forex gains of INR160m. However, EBITDA margins at 35.8% were lower than our est of 36.3%.

Topline growth was led by 41% growth in Generic API revenues to INR2.1b while CCS sales grew by 27% to INR1.83b. Carotenoids revenues grew by 33% to INR200m albeit on a low base.

**Revenue trend (INR m)**

**Revenue mix (INR m)**

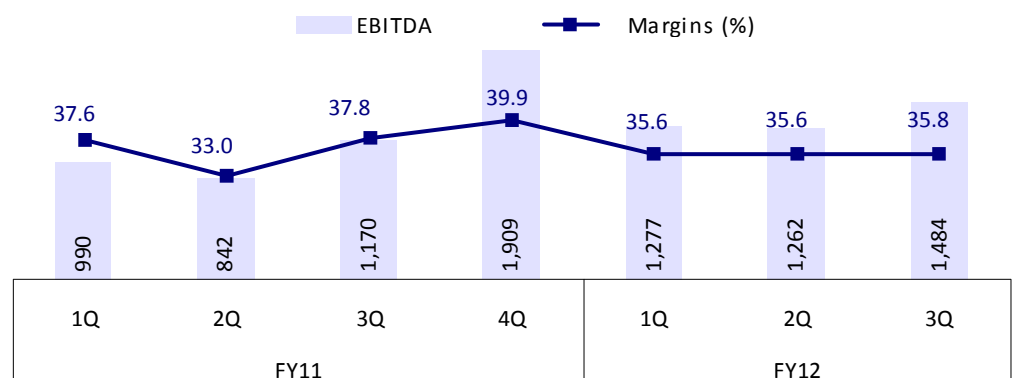


Source: Company

**EBITDA in line with estimates; PAT boosted by forex gains**

EBITDA growth at 27% YoY to INR1.48b was in-line with estimates but was lower than topline growth because of higher staff costs. EBITDA margins declined by 200bps YoY to 35.8% vs estimate of 36.3%. Adj PAT growth of 25% YoY to INR1.22b was better than our estimate of INR1.14b and was boosted by higher than expected other income at INR284m compared to our estimate of INR116m (mainly due to INR160m of forex gains).

**EBITDA Trend (INR m)**



Source: Company

### Retains FY12 & FY13 topline & EBITDA guidance but raises tax guidance

Management has retained its 20-25% and 25% topline growth guidance for FY12 and FY13 respectively on back of better visibility of revenues, ramp up in the production capacities, new CCS projects and incremental revenues from APIs launched in FY11. Further, management has indicated that it will be able to maintain EBITDA margins over the next 2 years. We believe margins may not expand YoY due to new capacities coming on stream in FY12 for which additional expenses will need to be incurred without commensurate revenues. However, it has raised the tax guidance from 20% to 22% for FY12 and from 19% to 20% for FY13.

#### FY12 Guidance

Parameter	Guidance	Remarks
Topline growth (%)	20-25	Recovery in CRAMS business coupled with new launches in API segment, ramp-up in Neutraceuticals to drive top-line growth. We estimate FY12E top-line growth of 22%
EBITDA Margins (%)	Maintain	In the past, management has guided sustaining EBITDA margins at FY11 levels of 37.6%. However, we estimate 35.9% margins based on 9MFY12 performance
Tax rate (%)	22	Our revised estimates factor-in tax rate of 22%
Capex (INR b)	1.75	Resumption of capex implies up-tick in customer sourcing

Source: Company

### Slow ramp-up in Neutraceuticals business so far

Divi's commercialized its neutraceuticals facility in FY09 to target the USD1b carotenoids opportunity (as of now dominated by DSM & BASF). The company has recruited experienced marketing personnel from these companies to source business in the international market. Despite the large opportunity, we believe ramp-up in this business is very gradual with the company recording revenues of INR621m from this opportunity in FY11 and INR580m for 9MFY12. Changing customer preferences to a new supplier is proving to be time-consuming resulting in a very gradual ramp-up in revenues. While management has earlier guided for doubling of revenues to INR1.2b in FY12, we model in a more conservative revenue of INR780m based on the 9MFY12 performance.

### Cutting estimates 2-3%

We have cut our EPS estimates for FY12 and FY13 by 2-3% to model increase in tax rate and slightly lower EBITDA margins. Based on our revised estimates, we expect EPS of INR34.9 for FY12 (up 7.7% YoY) and INR44.1 for FY13 (up 26.4% YoY) resulting in FY11-13 EPS CAGR of 17%.

**Valuation and view**

Divi's is well positioned in the CRAMS space, given its strong relationships with innovators, presence across the CRAMS value chain, and its ability to support the innovator in late life-cycle strategies. Unlike other API players, DIVI earns strong margins in this business due to its global cost and market leadership in some APIs (global market share of 50-70%), its ability to increase prices, and strong backward integration. Divi's will be a key beneficiary of increased outsourcing from India. We estimate RoCE and RoE of 25%+ for the next few years, led by traction in the high-margin CRAMS business, sustained profitability in the API business and incremental contribution from the new SEZ. We estimate 23% revenue CAGR for FY11-13 led by both API and CCS business segments and ramp-up in Carotenoids revenues. EPS CAGR will be lower at 17% due to the significant increase expected in the company's tax rate from 9% to 20%. Divi's stock currently trades at 22.4x FY12E and 17.8x FY13E earnings. Maintain **Buy** with a price target of INR882 (20x FY13E EPS).

## Divi's Laboratories: an investment profile

### Company Description

Divi's Labs is one of the leading players in the CRAMS segment and has one of the strongest CCS pipeline. The company enjoys good relationships with innovator pharmaceutical companies.

### Key investment arguments

- We expect Divi's to be one of the key beneficiaries of increased pharmaceutical outsourcing from India.
- Strong chemistry skills for early-phase work coupled with a strong pipeline of late-stage and commercialized products are likely to augur well for the company's CRAMS business.
- Neutraceuticals business could become big opportunity with limited competition. However, ramp-up in this business will be gradual until new customers are added

### Key investment risks

- The CCS business' success is linked to the fortunes of its MNC customers, especially their drug discovery pipeline.
- Global M&As may lead to rationalization of R&D pipelines which could potentially reduce the number of R&D projects under development thereby affecting CRAMS companies business

- Since the agreements between Divi's and its MNC customers are confidential, there is no visibility on the potential of the CCS business.

### Recent developments

- Commissioning of the new SEZ.

### Valuation and view

- We expect Divi's to be a key beneficiary of the increased pharmaceutical outsourcing from India given its strong relationships with global innovator pharmaceutical companies.
- Valuations at 22.4x FY12E and 17.8x FY13E earnings.
- We maintain **Buy**.

### Sector view

- India is on the threshold of a significant opportunity in the contract manufacturing space. We expect increased outsourcing from India as it offers a unique proposition of low costs coupled with chemistry and regulatory skills.
- High entry barriers will ensure that the top 6-7 players will command a disproportionate share of this opportunity.

### Comparative valuations

		Divis Labs	Dishman	Jubilant
P/E (x)	FY12E	22.4	-43.0	9.0
	FY13E	17.8	5.8	6.2
P/BV(x)	FY12E	4.9	0.5	1.3
	FY13E	4.1	0.4	1.1
EV/Sales (x)	FY12E	6.5	1.3	1.5
	FY13E	5.2	1.1	1.3
EV/EBITDA (x)	FY12E	18.1	7.0	7.2
	FY13E	13.9	5.5	6.4

### Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	52.2	52.2	52.2
Domestic Inst	17.3	17.0	12.7
Foreign	11.0	11.8	17.1
Others	19.6	19.1	18.0

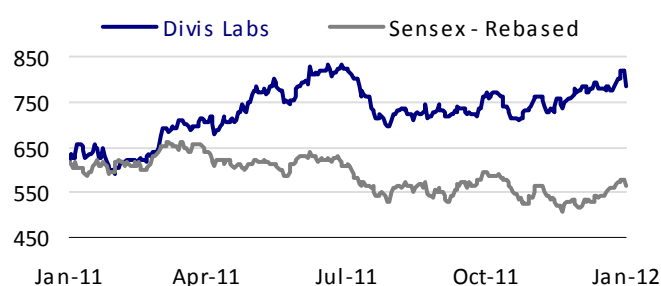
### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	34.9	36.8	-5.1
FY13	44.1	46.1	-4.3

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
783	882	12.6	Buy

### Stock performance (1 year)



## Financials and Valuation

Income Statement						Ratios					
(INR Million)											
Y/E March	2009	2010	2011	2012E	2013E	Y/E March	2009	2010	2011	2012E	2013E
<b>Net Sales</b>	11,803	9,416	13,071	15,970	19,824	<b>Basic (INR)</b>					
Change (%)	14.3	-20.2	38.8	22.2	24.1	EPS	32.2	25.8	32.4	34.9	44.1
<b>EBITDA</b>	5,178	4,053	4,915	5,739	7,460	Cash EPS	35.9	29.7	36.4	39.6	49.5
Margin (%)	43.9	43.0	37.6	35.9	37.6	BV/Share	95.8	114.9	135.6	158.2	188.8
Depreciation	479	515	534	631	722	DPS	3.0	6.0	10.0	10.4	11.6
<b>EBIT</b>	4,700	3,538	4,381	5,108	6,738	Payout (%)	10.9	27.2	36.2	34.9	30.8
Int. and Finance Cha	72	28	22	19	22	<b>Valuation (x)</b>					
Other Income - Rec.	-145	343	365	844	597	P/E			24.2	22.4	17.8
						Cash P/E			21.5	19.8	15.8
PBT before EO Expen:	4,482	3,853	4,724	5,932	7,314	P/BV			5.8	4.9	4.1
PBT after EO Expense	4,482	3,853	4,724	5,932	7,314	EV/Sales			8.0	6.5	5.2
Current Tax	266	408	405	1,305	1,463	EV/EBITDA			21.1	18.1	13.9
Deferred Tax	50	42	26	0	0	Dividend Yield (%)			1.3	1.3	1.5
Tax Rate (%)	7.0	11.7	9.1	22.0	20.0	<b>Return Ratios (%)</b>					
<b>Reported PAT</b>	4,166	3,403	4,293	4,627	5,851	RoE	39.6	24.7	25.9	23.8	25.4
<b>PAT Adj for EO Items</b>	4,166	3,403	4,293	4,627	5,851	RoCE	40.6	27.3	28.2	30.2	31.5
Change (%)	19.9	-18.3	26.1	7.8	26.4	<b>Working Capital Ratios</b>					
Margin (%)	35.3	36.1	32.8	29.0	29.5	Fixed Asset Turnover	2.2	1.6	2.2	2.3	2.4
						Debtor (Days)	82	88	104	100	96
						Inventory (Days)	130	193	160	153	150
						Working Capital Turr	167	204	170	163	159
						<b>Leverage Ratio (x)</b>					
						Current Ratio	3.6	3.1	2.5	2.6	2.6
						Debt/Equity	0.0	0.0	0.0	0.0	0.0
						<b>Cash Flow Statement</b>					
						(INR Million)					
						Y/E March	2009	2010	2011	2012E	2013E
						Op.Profit/(Loss) bef.	5,178	4,053	4,915	5,739	7,460
						Interest/Dividends R	-145	343	365	844	597
						Direct Taxes Paid	-266	-408	-405	-1,305	-1,463
						(Inc)/Dec in WC	-1,855	145	-813	-1,039	-1,540
						<b>CF from Operations</b>	<b>2,912</b>	<b>4,133</b>	<b>4,062</b>	<b>4,239</b>	<b>5,054</b>
						EO Expense / (Income)	0	0	0	0	0
						<b>CF from Operations inc</b>	<b>2,912</b>	<b>4,133</b>	<b>4,062</b>	<b>4,239</b>	<b>5,054</b>
						(inc)/dec in FA	-971	-557	-1,591	-2,844	-1,000
						(Pur)/Sale of Investm	-1,162	-2,695	-844	350	-2,300
						<b>CF from Investments</b>	<b>-2,133</b>	<b>-3,252</b>	<b>-2,434</b>	<b>-2,494</b>	<b>-3,300</b>
						Change in networth	89	285	56	0	0
						Inc/(Dec) in Debt	-334	-198	-98	44	0
						Interest Paid	-72	-28	-22	-19	-22
						Dividend Paid	-456	-925	-1,552	-1,614	-1,801
						<b>CF from Fin. Activity</b>	<b>-773</b>	<b>-865</b>	<b>-1,616</b>	<b>-1,589</b>	<b>-1,823</b>
						Inc/Dec of Cash	6	17	12	155	-68
						Add: Beginning Balan	142	148	165	177	331
						<b>Closing Balance</b>	<b>148</b>	<b>165</b>	<b>177</b>	<b>331</b>	<b>263</b>

E: MOSL Estimates

**N O T E S**

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### Divi's Laboratories

- |   |    |
|---|----|
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| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
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