

Divi's Laboratories

BSE SENSEX 18,763	S&P CNX 5,704	CMP: INR1,148	TP: INR1,230	Buy								
Bloomberg Equity Shares (m)	DIVI IN 132.7	Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
52-Week Range (INR)	1,216/695	End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
1,6,12 Rel. Perf. (%)	6/22/42	03/11A	13,071	4,293	32.4	25.7	-	-	25.9	28.2	-	-
M.Cap. (INR b)	152.4	03/12A	18,586	5,333	40.2	24.1	28.6	7.1	27.1	34.1	8.2	22.3
M.Cap. (USD b)	2.8	03/13E	23,023	6,665	50.2	25.0	22.9	6.0	28.6	36.3	6.6	17.3
		03/14E	28,767	8,140	61.3	22.1	18.7	5.0	29.3	37.4	5.3	13.8

Divi's Lab 2QFY13 operational performance in line with estimates. **Key highlights:**

- Divi's Labs reported 33.5% YoY growth in revenues to INR4.72b (estimate of INR4.93b), EBITDA growth of 46% to INR1.85b (v/s estimate of INR1.83b) and 11% growth in Adj PAT to INR1.18b (estimate of INR1.35b). EBITDA margins at 39.1% (up 340bp YoY) were above estimate of 37.2%. Adj PAT growth is lower than the EBITDA growth due to forex losses of INR208m and higher tax rate at 23.6% v/s our estimate of 21%.
- Revenue growth was led by 34% growth in generic APIs and 38% growth for CRAMS business. Neutraceuticals revenues remained flat at INR250m. EBITDA margins are higher than estimates due to better product-mix and partly due to a favorable currency.
- **Lowens guidance:** Management has lowered its 25% top line growth guidance for FY13 to 20-25% growth.

We expect Divi's to be a key beneficiary of the increased pharmaceutical outsourcing from India, given its strong relationships with global innovators and strong chemistry skills. Based on the 2Q performance and the revised guidance, we have lowered our EPS estimates for FY13 and FY14 by 4-5%. We estimate 24% revenue, 27% EBITDA CAGR and 23% EPS CAGR for FY12-14E, led by both generics and CRAMS business segments but partly tempered down by a higher tax rate. We estimate 36-37% RoCE and 29% RoE for the next two years, led by traction in the high-margin CRAMS business, sustained profitability in the generics business and increased contribution from the new SEZ. While the lowering of guidance will be a temporary setback for the stock, we note that the lowered top line growth guidance is a function of some delays in the US FDA inspections rather than any structural problems with the business. Company is targeting a fresh capex of INR1.5-2b for FY13 despite the ~INR4.5b capex undertaken in the past two years. We believe that this reflects management's confidence in future growth as Divi's generally does not undertake capex without adequate visibility of customer orders. The stock trades at 22.9x FY13E and 18.7x FY14E earnings. Maintain **Buy** with a revised target price of INR1,230 (20x FY14E EPS).

Y/E March	Quarterly Performance										(INR Million)	
	FY12				FY13				FY12	FY13E	Estimate	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2Q (%)	Var
Net Op Revenue	3,586	3,541	4,147	7,080	4,684	4,726	5,410	8,203	18,586	23,023	4,932	-4.2
YoY Change (%)	36.1	38.7	33.9	47.9	30.6	33.5	30.5	15.9	42.2	23.9	39.3	
Total Expenditure	2,308	2,279	2,663	4,251	2,780	2,880	3,370	5,176	11,736	14,206	3,100	
EBITDA	1,277	1,262	1,484	2,829	1,904	1,846	2,040	3,026	6,850	8,817	1,833	0.8
Margins (%)	35.6	35.6	35.8	40.0	40.7	39.1	37.7	36.9	36.9	38.3	37.2	
Depreciation	140	152	162	166	175	188	211	253	621	827	198	
Interest	2	6	2	27	4	3	10	17	37	34	8	
Other Income	164	227	284	78	418	-112	105	289	615	699	83	-235.0
PBT	1,299	1,332	1,604	2,714	2,143	1,544	1,924	3,045	6,806	8,656	1,708	
Tax	273	257	341	566	469	364	443	715	1,474	1,991	359	
Deferred Tax	1	14	38	0	0	0	0	0	0	0	0	
Rate (%)	21.0	20.4	23.6	20.9	21.9	23.6	23.0	23.5	21.7	23.0	21.0	
Reported PAT	1,026	1,061	1,226	2,148	1,674	1,180	1,482	2,330	5,333	6,665	1,350	-12.6
Adj PAT	1,026	1,061	1,226	2,148	1,674	1,180	1,482	2,330	5,333	6,665	1,350	-12.6
YoY Change (%)	22.5	47.4	24.5	22.9	63.2	11.2	20.9	8.5	24.2	25.0	27.3	
Margins (%)	28.6	30.0	29.6	30.3	35.7	25.0	27.4	28.4	28.7	28.9	27.4	

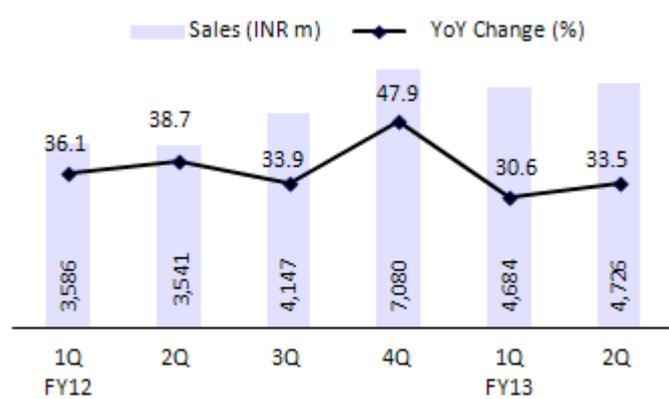
E: MOSL Estimates

2QFY13 EBITDA was in-line with estimates

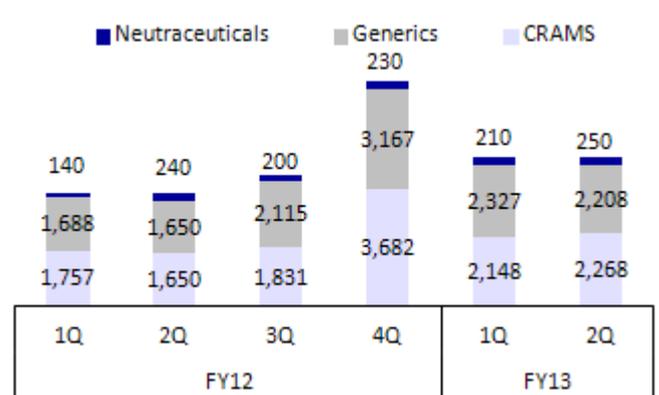
Divi's Labs reported 33.5% YoY growth in revenues to INR4.72b (estimate of INR4.93b), EBITDA growth of 46% to INR1.85b (v/s estimate of INR1.83b) and 11% growth in Adj PAT to INR1.18b (estimate of INR1.35b). EBITDA margins at 39.1% (up 340 bps YoY) were above estimate of 37.2%. Adj PAT growth is lower than EBITDA growth due to forex losses of INR208m and higher tax rate at 23.6% v/s our estimate of 21%.

Revenue growth was led by 34% growth in generic APIs and 38% growth for CRAMS business. Neutraceuticals revenues remained flat at INR250m. EBITDA margins are higher than estimates due to better product-mix and partly due to a favorable currency.

Revenue trend (INR m)

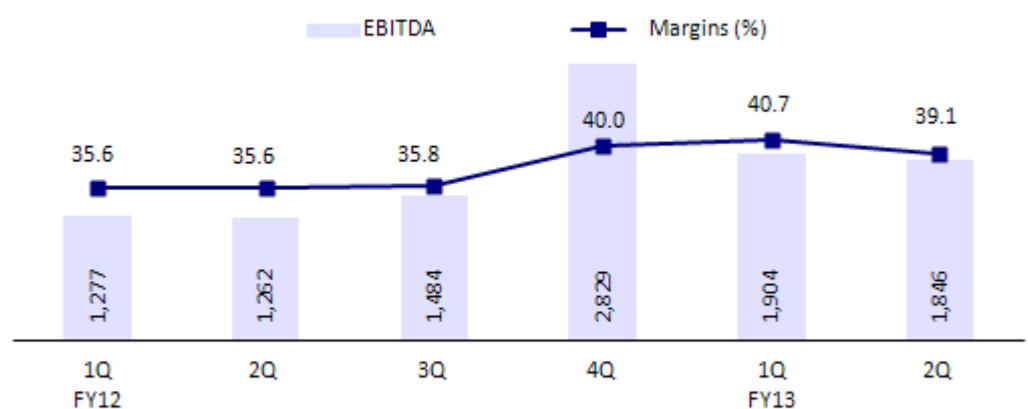


Revenue mix (INR m)



Source: Company

EBITDA Trend (INR m)



Source: Company

Lowers FY13 topline growth guidance

Management has lowered its 25% topline growth guidance for FY13 to 20-25% growth. The key factors leading to the downgrade is lower than expected ramp-up in Neutraceutical revenues (FY13 sales guidance lowered from INR1.4b to INR1.1b) and delay in US FDA inspection for its new units at Vizag SEZ (now expected in 1QFY14 instead of 2HFY13). It has guided that EBITDA margins will be slightly under pressure due to lower than expected traction in business and the significantly higher power & fuel costs. For 1HFY13, the company has reported EBITDA margin of ~40%. It has also increased its tax rate guidance by 1-2% to 22-23% for FY13.

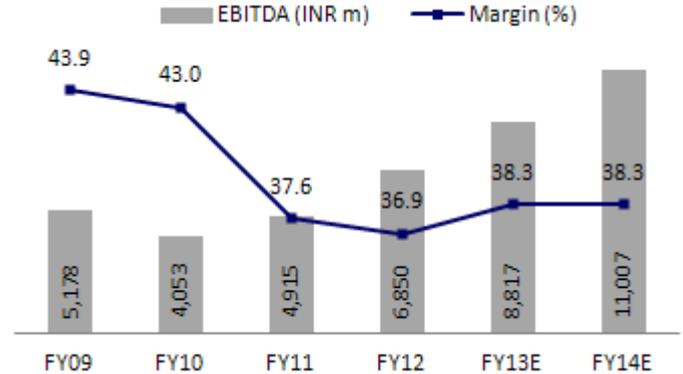
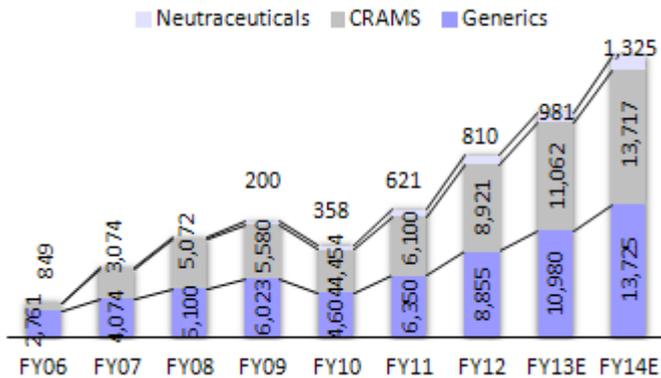
FY13 Revised Guidance

Parameter	Guidance	Remarks
Topline growth (%)	20-25	Lowered from earlier guidance of 25% growth. New contracts for CRAMS business coupled with new launches in API segment, ramp-up in Neutraceuticals to drive top-line growth.
EBITDA Margins (%)	Not specified	Our estimates factor-in EBITDA Margins of 38%
Tax rate (%)	22-23%	Increased from earlier guidance of 20-22%. Our estimates factor-in tax rate of 23%
Capex (INR b)	1.5-2	Higher capex implies up-tick in customer sourcing

Source: Company

Revenue mix (INR m)

EBITDA trend



Source: Company, MOSL

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 generic API players, Divi's earns strong margins due to its global cost and market leadership in some APIs (global market share of 50-70%), pricing power and strong backward integration.
- 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. It has undertaken a large capex at its new SEZ, implying positive prospects for outsourcing business.
- Based on the 2Q performance and the revised guidance, we have lowered our EPS estimates for FY13 and FY14 by 4-5%. We estimate 24% revenue, 27% EBITDA CAGR & 23% EPS CAGR for FY12-14 led by both Generics and CRAMS business segments but partly tempered down by higher tax rate.
- We estimate 36-37% RoCE and 29% RoE for the next two years, led by traction in the high-margin CRAMS business, sustained profitability in the Generics business and increased contribution from the new SEZ.
- While the lowering of guidance will be a temporary set-back for the stock, we note that the lowered topline growth guidance is a function of some delays in US FDA inspections rather than any structural problems with the business. Any correction in the stock price (due to lowering of guidance) should be viewed as a buying opportunity. The company is targeting a fresh capex of INR1.5-2b for FY13 despite the ~INR4.5b capex undertaken in the past two years. We believe that this reflects management confidence in future growth since Divi's generally does not undertake capex without adequate visibility of customer orders.
- The stock trades at 22.9x FY13E and 18.7x FY14E earnings. Maintain **Buy**, with a revised price target of INR1,230 (20x FY14E 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

- Nil

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 22.9x FY13E and 18.7x FY14E earnings.
- We maintain **Buy** with TP of INR1,230 (20x FY14E EPS)

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)	FY13E	22.9	6.3	10.5
	FY14E	18.7	5.6	6.8
P/BV(x)	FY13E	6.0	0.8	1.4
	FY14E	5.0	0.7	1.2
EV/Sales (x)	FY13E	6.6	1.2	1.3
	FY14E	5.3	1.0	1.1
EV/EBITDA (x)	FY13E	17.3	4.9	6.3
	FY14E	13.8	4.3	5.3

Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	52.2	52.2	52.2
Domestic Inst	15.8	17.2	17.0
Foreign	12.2	11.0	11.8
Others	19.9	19.6	19.1

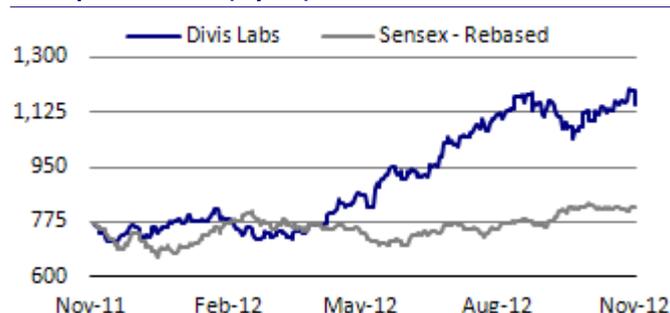
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	50.2	50.5	-0.6
FY14	61.3	62.0	-1.1

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
1,148	1,230	7.1	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
Net Sales	13,071	18,586	23,023	28,767	
Change (%)	38.8	42.2	23.9	24.9	
EBITDA	4,915	6,850	8,817	11,007	
Margin (%)	37.6	36.9	38.3	38.3	
Depreciation	534	621	827	996	
EBIT	4,381	6,229	7,990	10,011	
Int. and Finance Charges	22	37	34	49	
Other Income - Rec.	365	615	699	610	
PBT before EO Expense	4,724	6,806	8,656	10,572	
PBT after EO Expense	4,724	6,806	8,656	10,572	
Current Tax	405	1,474	1,991	2,432	
Deferred Tax	26	0	0	0	
Tax Rate (%)	9.1	21.7	23.0	23.0	
Reported PAT	4,293	5,333	6,665	8,140	
PAT Adj for EO Items	4,293	5,333	6,665	8,140	
Change (%)	26.1	24.2	25.0	22.1	
Margin (%)	32.8	28.7	28.9	28.3	

Balance Sheet		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
Equity Share Capital	265	265	265	265	
Total Reserves	17,710	21,050	25,089	30,028	
Net Worth	17,975	21,315	25,354	30,294	
Deferred liabilities	500	609	609	609	
Total Loans	230	590	590	590	
Capital Employed	18,706	22,514	26,553	31,493	
Gross Block	8,857	10,921	13,519	14,519	
Less: Accum. Deprn.	2,958	3,536	4,396	5,391	
Net Fixed Assets	5,899	7,384	9,123	9,127	
Capital WIP	1,293	1,820	1,820	1,820	
Investments	5,256	4,770	4,000	6,400	
Curr. Assets	10,299	13,592	18,119	22,193	
Inventory	5,717	6,790	9,209	11,507	
Account Receivables	3,674	4,956	6,216	7,767	
Cash and Bank Balance	177	349	852	617	
Loans & Advances	731	1,498	1,842	2,301	
Curr. Liability & Prov.	4,042	5,052	6,509	8,047	
Account Payables	2,424	2,954	3,684	4,603	
Provisions	1,618	2,099	2,825	3,444	
Net Current Assets	6,257	8,540	11,610	14,146	
Appl. of Funds	18,706	22,514	26,553	31,493	

E: MOSL Estimates

Ratios					
Y/E March	2011	2012	2013E	2014E	
Basic (INR)					
EPS	32.4	40.2	50.2	61.3	
Cash EPS	36.4	44.9	56.4	68.8	
BV/Share	135.6	160.6	191.0	228.2	
DPS	10.0	13.0	16.9	20.6	
Payout (%)	36.1	37.6	39.4	39.3	
Valuation (x)					
P/E		28.6	22.9	18.7	
Cash P/E		25.6	20.3	16.7	
P/BV		7.1	6.0	5.0	
EV/Sales		8.2	6.6	5.3	
EV/EBITDA		22.3	17.3	13.8	
Dividend Yield (%)		1.1	1.5	1.8	
Return Ratios (%)					
RoE	25.9	27.1	28.6	29.3	
RoCE	28.2	34.1	36.3	37.4	
Working Capital Ratios					
Fixed Asset Turnover (x)	2.2	2.8	2.8	3.2	
Debtor (Days)	104	98	99	99	
Inventory (Days)	160	133	146	146	
Working Capital Turnover (C)	170	161	171	172	
Leverage Ratio (x)					
Current Ratio	2.5	2.7	2.8	2.8	
Debt/Equity	0.0	0.0	0.0	0.0	

Cash Flow Statement		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
Op.Profit/(Loss) bef. Tax	4,915	6,850	8,817	11,007	
Interest/Dividends Recd.	365	615	699	610	
Direct Taxes Paid	-405	-1,474	-1,991	-2,432	
(Inc)/Dec in WC	-813	-2,111	-2,567	-2,770	
CF from Operations	4,062	3,880	4,958	6,415	
EO Expense / (Income)	0	0	0	0	
CF from Operations incl EO Ex	4,062	3,880	4,958	6,415	
(inc)/dec in FA	-1,591	-2,523	-2,566	-1,000	
(Pur)/Sale of Investments	-844	486	770	-2,400	
CF from Investments	-2,434	-2,037	-1,795	-3,400	
Change in network	52	14	0	0	
Inc/(Dec) in Debt	-98	360	0	0	
Interest Paid	-22	-37	-34	-49	
Dividend Paid	-1,548	-2,006	-2,626	-3,201	
CF from Fin. Activity	-1,616	-1,670	-2,660	-3,250	
Inc/Dec of Cash	12	172	503	-235	
Add: Beginning Balance	165	177	349	852	
Closing Balance	177	349	852	617	

Disclosures

This report is for personal information of the authorized recipient and does not constitute to be any investment, legal or taxation advice to you. This research report does not constitute an offer, invitation or inducement to invest in securities or other investments and Motilal Oswal Securities Limited (hereinafter referred as MOST) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

Unauthorized disclosure, use, dissemination or copying (either whole or partial) of this information, is prohibited. The person accessing this information specifically agrees to exempt MOST or any of its affiliates or employees from, any and all responsibility/liability arising from such misuse and agrees not to hold MOST or any of its affiliates or employees responsible for any such misuse and further agrees to hold MOST or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays.

The information contained herein is based on publicly available data or other sources believed to be reliable. While we would endeavour to update the information herein on reasonable basis, MOST and/or its affiliates are under no obligation to update the information. Also there may be regulatory, compliance, or other reasons that may prevent MOST and/or its affiliates from doing so. MOST or any of its affiliates or employees shall not be in any way responsible and liable for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

This report is intended for distribution to institutional investors. Recipients who are not institutional investors should seek advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents.

MOST and/or its affiliates and/or employees may have interests/positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

Divi's Laboratories

- | | |
|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issues, and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The research analysts, strategists, or research associates principally responsible for preparation of MOST research receive compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Regional Disclosures (outside India)

This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject MOST & its group companies to registration or licensing requirements within such jurisdictions.

For U.K.

This report is intended for distribution only to persons having professional experience in matters relating to investments as described in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (referred to as "investment professionals"). This document must not be acted on or relied on by persons who are not investment professionals. Any investment or investment activity to which this document relates is only available to investment professionals and will be engaged in only with such persons.

For U.S.

MOST is not a registered broker-dealer in the United States (U.S.) and, therefore, is not subject to U.S. rules. In reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") and interpretations thereof by the U.S. Securities and Exchange Commission ("SEC") in order to conduct business with Institutional Investors based in the U.S., Motilal Oswal has entered into a chaperoning agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo"). Any business interaction pursuant to this report will have to be executed within the provisions of this Chaperoning agreement.

This report is intended for distribution only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the Exchange Act and interpretations thereof by SEC (henceforth referred to as "major institutional investors"). This document must not be acted on or relied on by persons who are not major institutional investors. Any investment or investment activity to which this document relates is only available to major institutional investors and will be engaged in only with major institutional investors.

The Research Analysts contributing to the report may not be registered/qualified as research analyst with FINRA. Such research analyst may not be associated persons of the U.S. registered broker-dealer, Marco Polo and therefore, may not be subject to NASD rule 2711 and NYSE Rule 472 restrictions on communication with a subject company, public appearances and trading securities held by a research analyst account.



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025
Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com