

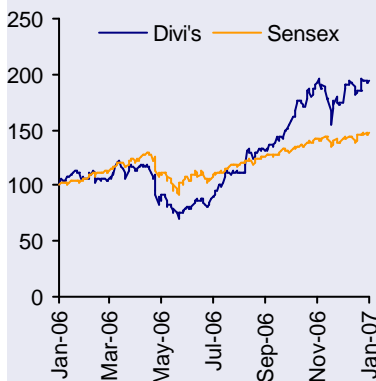
## Divi's Laboratories Ltd (Q3FY07)-Investment Update

<b>Recommendation</b>	<b>HOLD</b>
CMP	Rs3,125
Target Price	Rs3,076
Upside	(1.6)%
52 Week H/L	Rs3,240/1,110
Average Volumes	9,125
Market Cap	Rs40bn
Face Value	Rs10
BSE Code	532488
NSE Code	DIVISLAB
Bloomberg	DIVI@IN
Reuters	DIVI.BO

### Share holding pattern

<b>Dec '06</b>	<b>(%)</b>
Promoters	53.89
Institutions	27.30
Public	11.34
Others	7.47

### Share price chart



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*Divi's Laboratories Limited's (Divi's) Q3 FY07 results were in line with expectations. Sales witnessed a growth of 38.5% Rs1.5bn driven by continued momentum in both generic API & CCS businesses. The sales mix for the quarter stood at 58:42 in favor of generic API. Operating profit margin (OPM) remained flat for the quarter at 28.4% due to higher contribution from generic API and ESOP charges of Rs60mn for the quarter. Lower tax outgo (7.3% vs 33%) due to tax breaks aided a 74% bottom line growth to Rs327mn, translating into an annualized EPS of Rs102 for the quarter. For 9M FY07, Divi's recorded PAT growth of 91% to Rs908mn, translating into an annualized EPS of Rs94.6.*

*YTD FY07 has been a tremendous year for Divi's in terms of business mix and profitability and we believe this momentum will sustain in 2008. Growth over the next two years would be driven by the CCS business through addition of new contracts as well as increasing volume from existing customers. On the generic API front, Divi's is likely to witness strong volume growth which would enable it to maintain its market leadership in key APIs. In addition Divi's has a strong pipeline of difficult to manufacture products expected to be launched over 2007-09. The company is all set to launch neutraceutical (carotenoids) by April 2007, a market worth US\$1.1bn. Increasing contribution from high margin CCS business would lead to earnings CAGR of 52% to Rs1.64bn over FY06-08. The stock has had a dream run on the bourses generating twice the returns as compared to Sensex over the year. At Rs3,125, the stock is trading at 35x FY07E EPS of Rs89.2 and FY08E EPS of Rs128.1. While the growth story looks intact, we believe current valuations adequately factor in higher earnings estimates for the stock and recommend a HOLD. We feel the stock will be re-rated if the earnings momentum sustains post FY08.*

### Financial highlights

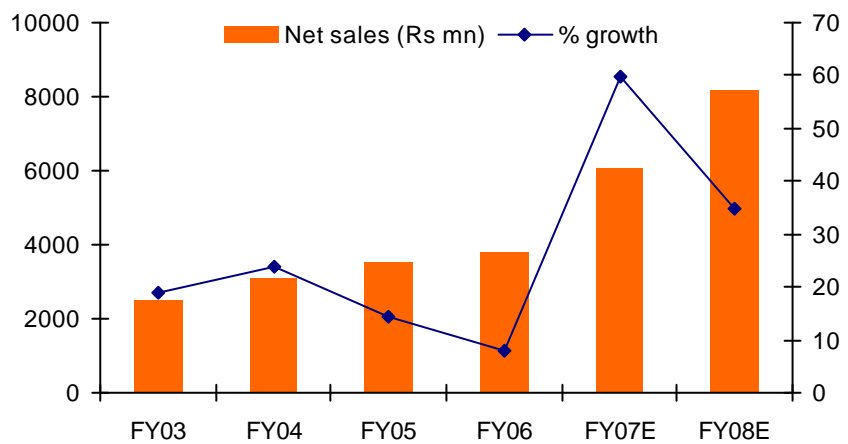
Period to	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Sales (Rs mn)	3,029	3,474	3,811	6,062	8,169
Growth (%)	22.9	14.7	9.7	59.1	34.8
APAT (Rs mn)	727	660	705	1,143	1,640
Growth (%)	32.4	(9.3)	6.9	62.1	43.5
OPM (%)	34.4	30.1	30.6	28.1	29.4
ROCE (%)	35.8	30.5	22.9	26.3	29.5
EPS (Rs)	56.8	51.5	55.1	89.2	128.1
PE (x)	55.0	60.6	56.7	35.0	24.4
EV/EBITDA (x)	34.2	33.4	32.5	22.3	16.0

**Sales driven by increased traction in CCS and volume growth in key generic products**

Sales increased by 38.5% to Rs1.5bn driven by increased traction in CCS business as well as volume growth in key generic products. CCS business grew over 100% and accounted for over 42% of the total sales as compared to 28% for FY06. Divi's key products like Diltiazem, Naproxen and Dextromethorphan witnessed strong volume growth. The management highlighted that it did not witness any pricing pressure for its key products. The company commands market leadership in these products and consequently has pricing power over these products.

Apart from sustainable volume driven growth, Divi's has a strong pipeline of difficult to manufacture products which are to be launched over 2007-09. The company would continue its run rate of filing 8-10 DMFs every year over the next two years. Divi's is set to launch its much awaited neutraceutical (carotenoids) formulations in April 2007, a market worth US\$1.1bn, growing at 5% annually dominated by DSM and BASF. We have assumed a 1% market share for Divi's by FY08, which translates into sales of US\$10mn. Increasing traction in CCS, volume growth in generic API and launch of carotenoids is likely to drive revenue CAGR of 46.7% to Rs8.2bn over FY06-08.

**Chart: Trend in sales over FY03-08E**



Source: Company/ India Infoline estimates

**Operating margin remained flat due to product mix in favor of generic API and ESOP expense charges**

Divi's operating margins remained flat at 28.4% for the quarter despite strong topline growth. Flat OPM yoy could be attributed to product mix in favor of generics (OPM at 20-22% as compared to 40% in CCS); overheads related to newly commissioned SEZ which is yet to realize its full potential as well as ESOP expenses worth Rs60mn charged to P&L. (FY07 Rs240mn). OPM is likely to remain at these levels for FY07.

### Lower tax outgo aids 74% PAT growth

Interest cost increased by 170% to Rs38mn on account of higher borrowings for working capital. Despite a flattish OPM, PAT recorded a handsome growth of 74% to Rs327mn mainly due to lower tax outgo for the quarter. The company had an effective tax rate of 7.3% for the quarter as compared to 33% in Q3 FY06 on account of tax breaks under IT depreciation. Tax benefits do not include the newly commissioned SEZ unit at Chippada as it will start operations in Q4 FY07. Annualized EPS for the quarter stood at Rs102 and for 9M FY07 stood at Rs95.

### Quarterly Financials

Period to (Rs mn)	12/06 (3)	12/05 (3)	% change	12/06 (9)	12/05 (9)	% change
Net sales	1,496	1,80	38.5	4,718	2,540	85.7
Expenditure	(1,071)	(770)	39.1	(3,397)	(1,761)	92.9
Operating Profit	425	310	37.1	1321	779	69.6
Other Income	25	22	13.6	102	80	27.5
PBDIT	450	332	35.5	1423	859	65.7
Interest	(38)	(14)	171.4	(65)	(34)	91.2
Depreciation	(59)	(37)	61.6	(143)	(110)	30.0
PBT	353	282	25.4	1215	715	69.9
Tax	(26)	(93)	(72.4)	(307)	(239)	28.5
PAT	327	189	73.6	908	476	90.8
OPM	28.4	28.7	-	28.0	30.7	-
Equity	128	128		128	128	
EPS	102.3	58.9		94.6	49.6	
P/E	30.6			33.0		

## Financials

### Projected Income Statement

Period to (Rs in mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Net Sales	3,029	3,474	3,811	6,062	8,169
Expenditure	(1,987)	(2,428)	(2,644)	(4,359)	(5,767)
Operating profit	1,042	1,046	1,167	1,703	2,402
Other income	145	171	106	152	204
PBIDT	1,187	1,217	1,273	1,855	2,606
Interest	(37)	(43)	(56)	(98)	(115)
Depreciation	(132)	(151)	(148)	(233)	(303)
Profit before tax (PBT)	1,018	1,023	1,069	1,524	2,187
Tax	(291)	(363)	(364)	(381)	(547)
Profit after tax (PAT)	727	660	705	1,143	1,640

### Projected Balance Sheet

Period to (Rs in mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
<b>Sources</b>					
Equity Share Capital	128	128	128	128	128
Reserves & Surplus	2,164	2,709	3,280	4,262	5,757
Net Worth	2,292	2,837	3,408	4,390	5,885
Loan Funds	659	661	1,502	1,771	1,921
Def Tax liability	223	250	283	320	374
<b>Total</b>	<b>3,174</b>	<b>3,748</b>	<b>5,192</b>	<b>6,481</b>	<b>8,180</b>
<b>Uses</b>					
Gross Block	2,236	2,538	3,018	3,999	5,174
Accumulated Depreciation	(573)	(723)	(871)	(1,104)	(1,407)
Net Block	1,663	1,815	2,148	2,896	3,767
Capital WIP	56	12	803	824	844
Total Fixed Assets	1,719	1,827	2,950	3,719	4,611
Investments	-	-	4	4	4
Total Current Assets	2,115	2,716	3,546	4,696	5,974
Total Current Liabilities	(660)	(795)	(1,309)	(1,938)	(2,409)
Net Working Capital	1,455	1,921	2,237	2,758	3,565
<b>Total</b>	<b>3,174</b>	<b>3,748</b>	<b>5,192</b>	<b>6,481</b>	<b>8,180</b>

**Key Ratios**

Period to	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
<b>Per share ratios</b>					
EPS (Rs)	56.8	51.5	55.1	89.2	128.1
Div per share	8.0	8.0	10.0	10.0	10.0
Book value per share	179.1	221.6	266.2	342.7	459.4
<b>Valuation ratios</b>					
P/E	55.0	60.6	56.7	35.0	24.4
P/BV	17.5	14.1	11.7	9.1	6.8
M Cap/Sales	13.2	11.5	10.5	6.6	4.9
EV/EBIDTA	34.2	33.4	32.5	22.3	16.0
<b>Profitability ratios (%)</b>					
OPM	34.4	30.1	30.6	28.1	29.4
PAT	24.0	19.0	18.5	18.9	20.1
ROCE	35.8	30.5	22.9	26.3	29.5
RONW	31.7	23.2	20.7	26.0	27.9
<b>Liquidity ratios</b>					
Current ratio	3.2	3.4	2.7	2.4	2.5
Debtors days	104.5	107.4	102.9	93.6	88.0
Inventory days	129.7	146.1	176.1	142.9	140.0
Creditors days	64.1	71.2	110.3	105.9	98.6
<b>Leverage ratios</b>					
Debt / Total equity	0.29	0.23	0.44	0.40	0.33
<b>Component ratios</b>					
Raw material	41.5	45.6	44.6	45.0	44.5
Manufacturing expenses	10.0	9.4	8.9	9.2	9.0
Staff expenses	4.1	4.3	4.8	6.0	5.7
Other expenses	10.0	10.5	11.1	11.7	11.4
<b>Payout ratios</b>					
Dividend payout	15.9	17.5	20.4	12.6	8.8
Tax payout	28.6	35.5	34.1	25.0	25.0



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