

		Rs657	Buy							
BSE SENSEX	S&P CNX									
18,008	5,396									
Bloomberg	DIVI IN									
Equity Shares (m)	132.1									
52-Week Range (Rs)	798/558									
1,6,12 Rel. Perf. (%)	10/-12/0									
M.Cap. (Rs b)	86.8									
M.Cap. (US\$ b)	1.9									
YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BY	ROE	ROCE	EY/	EY/
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/10A	9,416	3,403	25.8	-19.9	25.5	5.7	24.7	27.3	9.2	21.5
03/11E	11,437	3,593	27.2	5.6	24.2	4.9	21.8	24.4	7.6	20.1
03/12E	13,639	4,343	32.9	20.9	20.0	4.1	22.4	26.7	6.4	15.9
03/13E	16,467	5,600	42.4	28.9	15.5	3.5	24.3	28.7	5.3	12.6

Divi's Lab 3QFY11 performance was above estimates. Key highlights:

- Net sales increased by 57.8%YoY to Rs3.1b (v/s our estimate of Rs2.76b), EBITDA grew by 77%YoY to Rs1.17b (v/s our estimate of Rs1b) and adjusted PAT increased by 45.1%YoY to Rs984m (v/s our estimate of Rs854m). Topline growth was higher due to lower base (impacted by inventory de-stocking at customer's end) and a recovery in the CCS business which reported growth of 50.3% while generic API business grew by 62.9%.
- EBITDA grew by robust 77%YoY to Rs1.17b (vs estimate of Rs1.03b) on a low base of 4QFY10 which was impacted due to inventory destocking. EBITDA margins improved by 420bp to 37.8%. Adj PAT grew by 45%YoY to Rs984m (vs estimate of 37.8%) reflecting the strong operational performance and low base effect.
- Guidance** - Management has upgraded its FY11E guidance marginally to Rs11.5b and has maintained FY12E revenue growth guidance at 20%.

We continue to be positive on prospects of pharmaceutical outsourcing from India, given the unique combination of low costs and chemistry skills which India offers. 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. We estimate 20% revenue CAGR for FY10-13 led mainly by recovery in CRAMS business and 18% EPS CAGR excluding any significant upsides from the new Rs2b SEZ. We note that the company is likely to show a YoY decline in 4QFY11 performance due to the significantly high base of 4QFY10 which was boosted due to a one-time supply of some highly profitable products. Divi's stock currently trades at 24.2x FY11E, 20x FY12E and 15.5x FY13E consolidated earnings. Maintain **Buy** with a target price of Rs790 (24x FY12E EPS).

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Op Revenue	2,058	2,253	1,963	3,141	2,635	2,553	3,097	3,152	9,416	11,437
<i>YoY Change (%)</i>	<i>-22.6</i>	<i>-31.8</i>	<i>-25.9</i>	<i>-1.5</i>	<i>28.0</i>	<i>13.3</i>	<i>57.8</i>	<i>0.3</i>	<i>-20.2</i>	<i>21.5</i>
Total Expenditure	1,392	1,200	1,304	1,628	1,645	1,711	1,927	1,853	5,364	7,133
EBITDA	667	1,053	659	1,513	990	842	1,170	1,298	4,052	4,304
<i>Margins (%)</i>	<i>32.4</i>	<i>46.7</i>	<i>33.6</i>	<i>48.2</i>	<i>37.6</i>	<i>33.0</i>	<i>37.8</i>	<i>41.2</i>	<i>43.0</i>	<i>37.6</i>
Depreciation	129	131	133	123	131	133	135	159	515	558
Interest	8	30	18	7	6	5	6	5	28	22
Other Income	143	55	262	43	59	92	102	106	343	359
PBT before EO Income	673	947	771	1,427	912	797	1,131	1,240	3,853	4,083
EO Income	-540	0	0	540	0	0	0	0	0	0
PBT after EO Income	132	947	771	1,967	912	797	1,131	1,240	3,853	4,083
Tax	87	83	104	135	71	77	130	212	408	490
Deferred Tax	2	17	-11	34	3	0	17	-20	42	0
<i>Rate (%)</i>	<i>67.5</i>	<i>10.5</i>	<i>12.0</i>	<i>8.5</i>	<i>8.2</i>	<i>9.7</i>	<i>13.0</i>	<i>15.4</i>	<i>11.7</i>	<i>12.0</i>
Reported PAT	43	848	678	1,799	837	719	984	1,048	3,403	3,593
Adj PAT	594	848	678	1,305	837	719	984	1,048	3,403	3,593
<i>YoY Change (%)</i>	<i>-38.4</i>	<i>-37.8</i>	<i>-14.7</i>	<i>25.2</i>	<i>40.9</i>	<i>-15.2</i>	<i>45.1</i>	<i>-19.7</i>	<i>-18.3</i>	<i>5.6</i>
<i>Margins (%)</i>	<i>28.9</i>	<i>37.6</i>	<i>34.6</i>	<i>41.5</i>	<i>31.8</i>	<i>28.2</i>	<i>31.8</i>	<i>33.3</i>	<i>36.1</i>	<i>31.4</i>

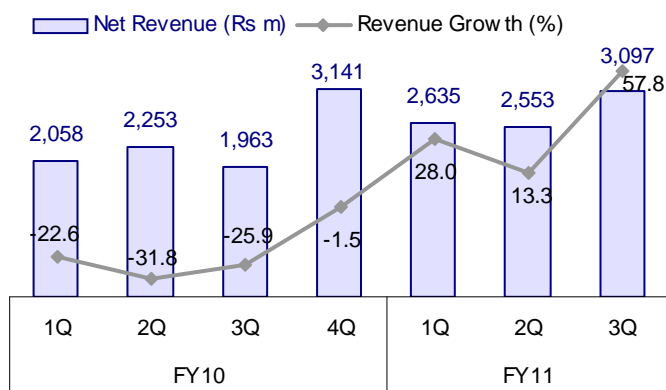
E: MOSL Estimates

Revenues boosted by low base and recovery in CCS business

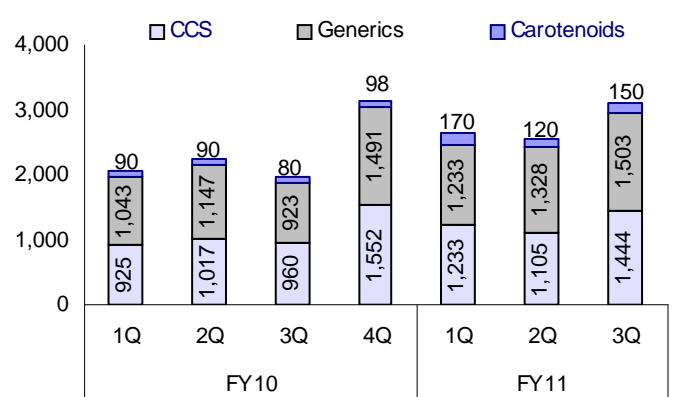
Divi's net sales increased by 57.8% YoY to Rs3.1b (v/s our estimate of Rs2.76b), EBITDA grew by 77% YoY to Rs1.17b (v/s our estimate of Rs1b) and adjusted PAT increased by 45.1% YoY to Rs984m (v/s our estimate of Rs854m).

Topline growth was higher due to lower base (impacted by inventory de-stocking at customer's end). CCS business reported growth of 50.3% to Rs1.44b while generic API business grew by 62.9% YoY to Rs1.5b. Carotenoids contributed Rs150m to revenues.

Revenue trend (Rs m)



Revenue mix (Rs m)

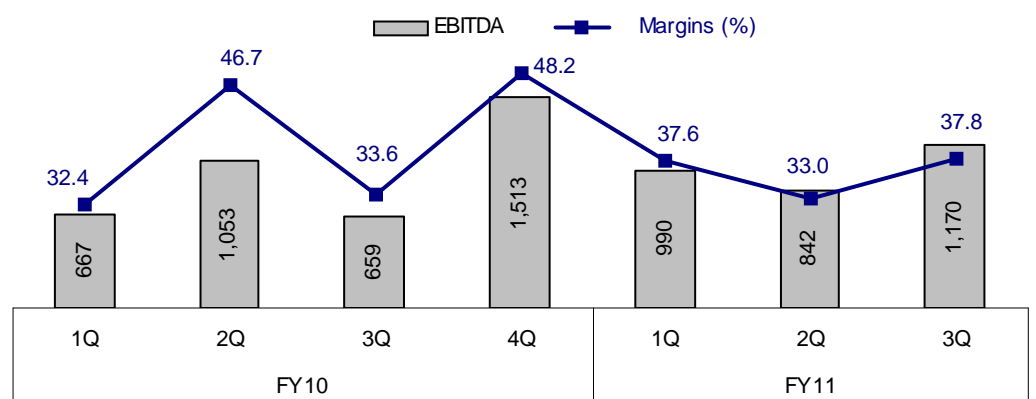


Source: Company

EBITDA and adjusted PAT were above estimates

EBITDA grew by robust 77% YoY to Rs1.17b (vs estimate of Rs1.03b) on a low base of 4QFY10 which was impacted due to inventory destocking. EBITDA margins improved by 420bp to 37.8%. Adj PAT grew by 45% YoY to Rs984m (vs estimate of 37.8%) reflecting the strong operational performance and low base effect.

EBITDA trend (Rs m)



Source: Company

Minor upgrade in FY11E guidance

In light of the good 3QFY11 performance, management has upgraded its revenue guidance for FY11E marginally. It has now guided for a topline of Rs11.5b for FY11E compared to the previous guidance of Rs11-11.5b. FY12E revenue growth guidance has been retained at 20%.

Revised Guidance - Post 3QFY11 results

	Old	Revised
FY11 Revenues (Rs b)	11-11.5	11.5
FY12 Revenues (Rs b)	13.2-13.8	13.8

Source: Company/MOSL

Global M&As may lead to rationalization of R&D pipelines

In the last 12 months, the global pharmaceutical industry has witnessed announcement of three large M&A deals, viz, the acquisition of Wyeth by Pfizer, Solvay's pharmaceutical business by Abbott, and Schering Plough by Merck. If this becomes a trend, it signals consolidation of customer base for CRAMS players like Divi's, who are strong in the Custom Chemical Synthesis (CCS) segment and could potentially reduce the number of R&D projects under development.

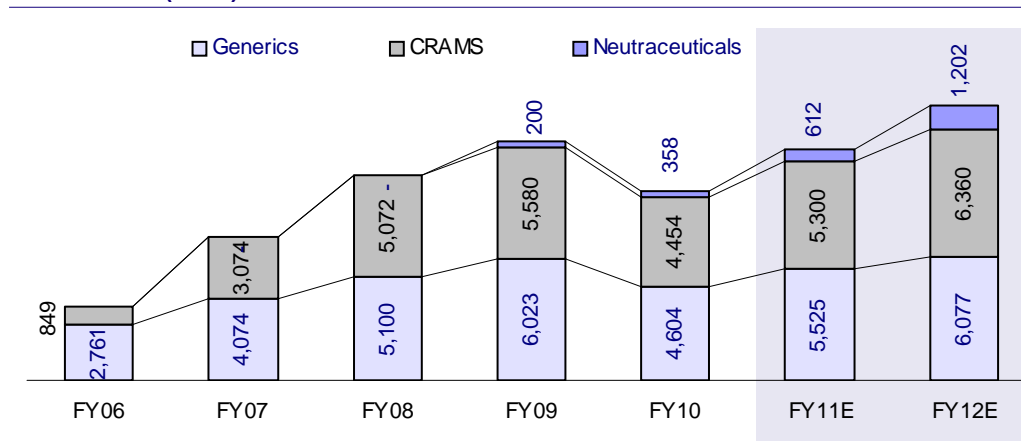
Slow ramp-up in Neutraceuticals business

Divi's has commercialized its neutraceuticals facility in FY09 to target the US\$1b 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 that the ramp-up in this business is very gradual with the company recording revenues of Rs200m from this opportunity in FY09 and Rs358m for FY10.

For 9MFY11, Carotenoids revenues were at Rs440m. We have reduced our revenue estimates to Rs612m for FY11 from this opportunity compared to our previous estimate of Rs680m.

Revenue mix (Rs m)



Source: Company/MOSL

Raising estimates

Given the better than expected 3QFY11 performance, we have upgraded our EPS estimates for FY11E by 4.4%, FY12E EPS by 1.6% and for FY13E by 5%.

Based on our revised estimates, we expect EPS of Rs27.2 for FY11 (up 5.6% YoY), Rs32.9 for FY12E (up 21%) and Rs42.4 for FY13E (up 29%) leading to 18% EPS CAGR for FY10-13. Our EPS estimates are likely to see upgrades once the Rs2b SEZ is fully commissioned (expected in FY13) and more visibility on utilization of this large capex is available.

Valuation and view

Divi's performance has suffered in 1HFY11E due to customer de-stocking, which now seems to have corrected. We continue to be positive on prospects of pharmaceutical outsourcing from India, given the unique combination of low costs and chemistry skills which India offers.

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 of Rs2b for setting up a new SEZ, implying positive prospects for the outsourcing business (generally Divi's does not undertake capex without adequate revenue visibility from customers).

We estimate 20% revenue CAGR for FY10-13 led mainly by recovery in CRAMS business and 18% EPS CAGR excluding any significant upsides from the new Rs2b SEZ.

We note that the company is likely to show a YoY decline in 4QFY11 performance due to the significantly high base of 4QFY10 which was boosted due to a one-time supply of some highly profitable products.

Divi's stock currently trades at 24.2x FY11E, 20x FY12E and 15.5x FY13E consolidated earnings. Maintain **Buy** with a target price of Rs790 (24x FY12E 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 24.2x FY11E, 20x FY12E and 15.5x 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)	FY11E	24.2	10.4	10.1
	FY12E	20.0	10.0	9.0
P/BV(x)	FY11E	4.9	1.1	1.3
	FY12E	4.1	1.0	1.3
EV/Sales(x)	FY11E	7.6	1.9	1.4
	FY12E	6.4	1.7	1.4
EV/EBITDA(x)	FY11E	20.1	9.4	8.2
	FY12E	15.9	7.4	7.2

Shareholding pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	52.2	52.2	52.9
Domestic Inst	12.7	12.4	14.4
Foreign	17.1	17.9	17.4
Others	18.0	17.5	15.3

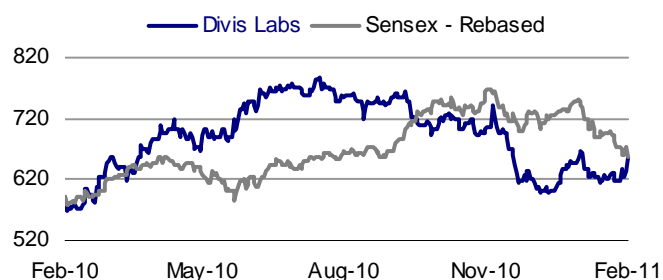
EPS: MOSL forecast v/s consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	27.2	28.0	-3.0
FY12	32.9	35.8	-8.2

Target price and recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
657	790	24.0	Buy

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2009	2010	2011E	2012E	2013E	Y/E MARCH	2009	2010	2011E	2012E	2013E
Net Sales	11,803	9,416	11,437	13,639	16,467	Basic (Rs)					
Change (%)	14.3	-20.2	21.5	19.3	20.7	EPS	32.2	25.8	27.2	32.9	42.4
Total Expenditure	6,625	5,364	7,133	8,182	9,585	Cash EPS	35.9	29.7	31.4	37.9	48.1
% of Sales	56.1	57.0	62.4	60.0	58.2	BV/Share	95.8	114.9	134.9	158.8	189.8
EBITDA	5,178	4,053	4,304	5,457	6,883	DPS	3.0	6.0	6.1	7.7	9.8
Margin (%)	43.9	43.0	37.6	40.0	41.8	Payout (%)	10.9	27.2	26.3	27.3	27.0
Depreciation	479	515	558	664	757	Valuation (x)					
EBIT	4,700	3,538	3,746	4,793	6,125	P/E	20.4	25.5	24.2	20.0	15.5
Int. and Finance Charges	72	28	22	26	28	Cash P/E	18.3	22.2	20.9	17.3	13.7
Other Income - Rec.	-145	343	359	465	569	P/BV	6.9	5.7	4.9	4.1	3.5
						EV/Sales	7.4	9.2	7.6	6.4	5.3
						EV/EBITDA	16.8	21.5	20.1	15.9	12.6
						Dividend Yield (%)	0.5	0.9	0.9	1.2	1.5
PBT before EO Expense	4,482	3,853	4,083	5,232	6,667	Return Ratios (%)					
Extra Ordinary Expense/(Inc)	0	0	0	0	0	RoE	39.6	24.7	21.8	22.4	24.3
PBT after EO Expense	4,482	3,853	4,083	5,232	6,667	RoCE	40.6	27.3	24.4	26.7	28.7
Current Tax	266	408	490	889	1,067	Working Capital Ratios					
Deferred Tax	50	42	0	0	0	Fixed Asset Turnover (x)	2.2	1.6	1.8	1.8	1.9
Tax Rate (%)	7.0	11.7	12.0	17.0	16.0	Debtor (Days)	82	88	86	86	86
Reported PAT	4,166	3,403	3,593	4,343	5,600	Inventory (Days)	130	193	183	164	164
PAT Adj for EO Items	4,166	3,403	3,593	4,343	5,600	Working Capital Turnover (I)	167	204	206	185	183
Change (%)	19.9	-18.3	5.6	20.9	28.9	Leverage Ratio (x)					
Margin (%)	35.3	36.1	31.4	31.8	34.0	Current Ratio	3.6	3.1	3.7	3.3	3.2
						Debt/Equity	0.0	0.0	0.0	0.0	0.0

BALANCE SHEET						CASH FLOW STATEMENT					
(Rs Million)						(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E	Y/E MARCH	2009	2010	2011E	2012E	2013E
Equity Share Capital	259	264	264	264	264	Op.Profit/(Loss) bef. Tax	5,178	4,053	4,304	5,457	6,883
Total Reserves	12,155	14,914	17,562	20,721	24,812	Interest/Dividends Recd.	-145	343	359	465	569
Net Worth	12,414	15,178	17,826	20,986	25,076	Direct Taxes Paid	-266	-408	-490	-889	-1,067
Deferred liabilities	432	474	474	474	474	(Inc)/Dec in WC	-1,855	145	-1,172	-471	-1,353
Total Loans	526	328	290	290	290	CF from Operations	2,912	4,133	3,001	4,561	5,032
Capital Employed	13,372	15,981	18,590	21,750	25,841	EO Expense / (Income)	0	0	0	0	0
Gross Block	7,828	8,329	10,107	12,107	13,107	CF from Operations in	2,912	4,133	3,001	4,561	5,032
Less: Accum. Deprn.	1,929	2,431	3,084	3,748	4,505	(inc)/dec in FA	-971	-557	-1,640	-2,000	-1,000
Net Fixed Assets	5,899	5,898	7,023	8,359	8,602	(Pur)/Sale of Investments	-1,162	-2,695	0	-1,500	-2,500
Capital WIP	195	238	195	195	195	CF from Investments	-2,133	-3,252	-1,640	-3,500	-3,500
Investments	1,718	4,413	4,413	5,913	8,413	Change in networth	89	285	0	0	0
Curr. Assets	7,671	8,040	9,555	10,465	12,552	Inc/(Dec) in Debt	-334	-198	-38	0	0
Inventory	4,213	4,985	5,718	6,138	7,410	Interest Paid	-72	-28	-22	-26	-28
Account Receivables	2,660	2,232	2,630	3,137	3,787	Dividend Paid	-456	-925	-945	-1,183	-1,509
Cash and Bank Balance	148	165	520	372	366	Others	0	0	0	0	0
Loans & Advances	650	658	686	818	988	CF from Fin. Activity	-773	-865	-1,005	-1,210	-1,537
Curr. Liability & Prov.	2,110	2,608	2,595	3,182	3,921	Inc/Dec of Cash	6	17	356	-148	-5
Account Payables	1,621	1,643	1,601	1,909	2,305	Add: Beginning Balance	142	148	165	520	372
Provisions	489	964	994	1,272	1,616	Closing Balance	148	165	520	372	366
Net Current Assets	5,561	5,432	6,960	7,283	8,631						
Appl. of Funds	13,372	15,981	18,590	21,750	25,841						

E: MGS Estimates

N O T E S



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Disclosure of Interest Statement

Divi's Laboratories

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|---|----|
| 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 |

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