

August 13, 2010

### BUY

Price	Target Price
<b>Rs 748</b>	<b>Rs 852</b>
<b>Sensex</b>	<b>18,074</b>

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	8	31	59
Rel. to Sensex	(3)	3	17	32

Source: Bloomberg

### Stock Details

Sector	Pharmaceuticals
Reuters	DIVI.BO
Bloomberg	DIVI@IN
Equity Capital (Rs mn)	130
Face Value (Rs)	2
No of shares o/s (mn)	65
52 Week H/L (Rs)	798/461
Market Cap (Rs bn /USD mn)	99/2,131
Daily Avg Vol (No of shares)	176613
Daily Avg Turnover (US\$ mn)	2.8

### Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	53.4	52.4	52.9
FII/NRI	17.4	16.5	17.4
Institutions	14.5	14.0	14.4
Private Corp	5.3	7.4	6.2
Public	9.3	9.8	9.1

Source: Capitaline

- Divi's Q1FY11 performance in-line with a) Revenue grew by 29% to Rs2.65bn; b) EBIDTA was up by 50% and c) APAT at Rs837mn, up by 44%
- Operating environment is improving and we expect strong growth from 2HFY11E onwards
- Carotenoids is a next growth driver for the company
- Maintain earning estimates and price target at Rs852

### Revenue at Rs2.65bn, up 29% YoY; expect traction to continue

Divi's Q1 revenue at Rs2.65bn (up 29% YoY) is in-line with our estimates. We believe this is on account of inventory re-stocking by some of the clients which also indicates that the operating environment across the globe is easing out and inventory rationalization may gradually phase out. Going forward, we expect strong traction in the CRAMS space on the back of a) increased outsourcing from global players post consolidation phase, b) restocking of the inventory as channel inventory has come down from the highs of 9-12 months to 3-4 months now and c) lower base effect. We believe that Carotenoids will be next growth driver for the company. Though the scale-up of Carotenoids took longer time than anticipated but now management is confident to attain higher revenue from this segment. Carotenoids segment did a revenue of Rs370mn (Rs170mn in Q4FY10) in FY10. We expect this business to record revenue of Rs750mn in FY11E. We are of the view that since depreciation and interest cost on account of Carotenoids plant is already in P&L account; incremental contribution of Carotenoids will boost the profitability of the company. We expect next two years to be strong for CRAMS companies and expect Divi's revenue to grow at a CAGR of 24% over FY10-12E.

### EBIDTA margin at 37.9% and APAT margin at 32% instills confidence

EBIDTA for the quarter was up by 50% YoY to Rs1bn (in-line). EBIDTA margin expansion of 547bps in Q1FY11 was on account of a) 356bps decline in raw material consumption due to favorable product mix (between CCS and generics) and b) 227bps decline in employee cost. We expect operating margins to go further as we see the improved traction going forward. Despite lower other income (down by 68% YoY), APAT was up 44% YoY on account of a) strong operating performance b) lower interest cost (down 34% YoY) and c) lower tax provisioning (8% vs.13.3% of Q1FY10). The EPS for the quarter is Rs6.3.

### Financials

YE-	Net	EBITDA		EPS	EPS	RoE	EV/			
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY09	11,852	4,861	41.0	4,166	31.4	19.9	39.6	24.5	20.0	8.0
FY10	9,501	4,137	43.5	3,403	25.6	(18.3)	24.7	30.0	47.8	13.4
FY11E	11,874	5,038	42.4	4,218	31.8	23.9	25.3	24.2	39.0	11.2
FY12E	14,585	6,253	42.9	5,306	40.0	25.8	26.5	19.2	31.2	9.3

Manoj Garg

manoj.garg@emkayglobal.com

+91 22 6612 1257

### Maintain earning estimates and Buy rating

Divi's Q1FY11 performance was in line with our expectations. Higher revenues and margins improvement signifies a healthy trend going ahead. Going forward, we believe that Carotenoids will be next growth driver for the company. Though the scale-up of Carotenoids took longer time than anticipated but now management is confident to attain higher revenue from this segment. Management expects this business to record revenue of Rs750mn in FY11E. Company is confident to maintain high operating margins on the back of yield improvement in raw materials and increased contribution of Carotenoids segment.

We expect EBIDTA and PAT to grow at FY10-12E CAGR of 23% and 25% respectively. Earnings are expected to grow at 24% and 26% clocking EPS of Rs32 & Rs40 for FY11E/FY12E respectively. We maintain our Buy rating on the stock on account of gradual recovery in the CRAMS business, 26% earning CAGR over FY10-12E and best in class margins and return profile (RoIC in excess of 31%) coupled with strong balance sheet. At CMP of Rs748, Divi's is trading at 18.6x FY12E EPS. We continue to remain positive on the stock with a target price to Rs852.

### Quarterly financials

Rs mn	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
<b>Revenue</b>	<b>2,058</b>	<b>2,275</b>	<b>1,963</b>	<b>3,141</b>	<b>2,648</b>	<b>28.6</b>	<b>(15.7)</b>
<b>Expenditure</b>	<b>1,392</b>	<b>1,200</b>	<b>1,144</b>	<b>1,628</b>	<b>1,645</b>	<b>18.2</b>	<b>1.1</b>
<i>as % of sales</i>	<i>67.6</i>	<i>52.8</i>	<i>58.3</i>	<i>51.8</i>	<i>62.1</i>	<i>(5.47)</i>	<i>10.31</i>
Consumption of RM	851	644	546	992	1,000	17.6	0.8
<i>as % of sales</i>	<i>41.3</i>	<i>28.3</i>	<i>27.8</i>	<i>31.6</i>	<i>37.8</i>	<i>(3.56)</i>	<i>6.20</i>
Employee Cost	192	177	176	189	187	(2.7)	(1.4)
<i>as % of sales</i>	<i>9.3</i>	<i>7.8</i>	<i>9.0</i>	<i>6.0</i>	<i>7.1</i>	<i>(2.27)</i>	<i>1.02</i>
Other expenditure	349	380	422	447	459	31.4	2.6
<i>as % of sales</i>	<i>17.0</i>	<i>16.7</i>	<i>21.5</i>	<i>14.2</i>	<i>17.3</i>	<i>0.36</i>	<i>3.09</i>
<b>EBITDA</b>	<b>667</b>	<b>1,074</b>	<b>819</b>	<b>1,513</b>	<b>1,003</b>	<b>50.3</b>	<b>(33.7)</b>
Depreciation	129	131	133	123	131	1.9	6.8
<b>EBIT</b>	<b>538</b>	<b>944</b>	<b>687</b>	<b>1,390</b>	<b>871</b>	<b>61.9</b>	<b>(37.3)</b>
Other Income	143	34	102	43	46	(67.9)	5.8
Interest	8	30	18	-28	6	(33.7)	(119.4)
<b>PBT</b>	<b>673</b>	<b>947</b>	<b>771</b>	<b>1,462</b>	<b>912</b>	<b>35.5</b>	<b>(37.6)</b>
Total Tax	89	100	93	168	74	(16.8)	(55.8)
<b>Adjusted PAT</b>	<b>583</b>	<b>848</b>	<b>678</b>	<b>1,294</b>	<b>837</b>	<b>43.5</b>	<b>(35.3)</b>
(Profit)/loss from JV's/Ass/MI							
<b>APAT after MI</b>	<b>498</b>	<b>848</b>	<b>678</b>	<b>1,294</b>	<b>837</b>	<b>68.0</b>	<b>(35.3)</b>
<b>Extra ordinary items</b>	<b>-455</b>	<b>8</b>		<b>540</b>			
<b>Reported PAT</b>	<b>43</b>	<b>856</b>	<b>678</b>	<b>1,834</b>	<b>837</b>	<b>1,833.7</b>	<b>(54.4)</b>
<b>AEPS</b>	<b>3.8</b>	<b>6.4</b>	<b>5.1</b>	<b>9.7</b>	<b>6.3</b>	<b>68.0</b>	<b>(35.3)</b>

Margins (%)						(bps)	(bps)
EBIDTA	32.4	47.2	41.7	48.2	37.9	547	-1031
EBIT	26.1	41.5	35.0	44.3	32.9	676	-1135
EBT	32.7	41.7	39.3	46.5	34.4	175	-1211
PAT	24.2	37.3	34.6	41.2	31.6	741	-956
Effective Tax rate	13.3	10.5	12.0	11.5	8.2	(513)	-335

## Financial

## Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>Net Sales</b>	<b>11,852</b>	<b>9,501</b>	<b>11,874</b>	<b>14,585</b>
<i>Growth (%)</i>	14.1	-19.8	25.0	22.8
<b>Expenditure</b>	<b>6,992</b>	<b>5,364</b>	<b>6,837</b>	<b>8,332</b>
Raw Materials	4,253	3,032	3,994	4,872
SGA	1,766	1,304	1,609	1,960
Employee Cost	663	733	858	1,038
Other Exp	309	294	376	461
<b>EBITDA</b>	<b>4,861</b>	<b>4,137</b>	<b>5,038</b>	<b>6,253</b>
<i>Growth (%)</i>	17.0	-14.9	21.8	24.1
<b>EBITDA margin (%)</b>	<b>41.0</b>	<b>43.5</b>	<b>42.4</b>	<b>42.9</b>
Depreciation	479	515	593	679
<b>EBIT</b>	<b>4,382</b>	<b>3,622</b>	<b>4,445</b>	<b>5,574</b>
<b>EBIT margin (%)</b>	<b>37.0</b>	<b>38.1</b>	<b>37.4</b>	<b>38.2</b>
Other Income	172	259	370	462
Interest expenses	72	28	21	6
<b>PBT</b>	<b>4,482</b>	<b>3,853</b>	<b>4,794</b>	<b>6,030</b>
Tax	316	450	575	724
<i>Effective tax rate (%)</i>	7.0	11.7	12.0	12.0
<b>Adjusted PAT</b>	<b>4,166</b>	<b>3,403</b>	<b>4,218</b>	<b>5,306</b>
(Profit)/loss from JV's/Ass/MI	0	0	0	0
<b>Adjusted PAT after MI</b>	<b>4,166</b>	<b>3,403</b>	<b>4,218</b>	<b>5,306</b>
<i>Growth (%)</i>	19.9	-18.3	23.9	25.8
<b>Net Margin (%)</b>	<b>35.2</b>	<b>35.8</b>	<b>35.5</b>	<b>36.4</b>
E/O items	0	0	0	0
<b>Reported PAT</b>	<b>4,166</b>	<b>3,403</b>	<b>4,218</b>	<b>5,306</b>
<i>Growth (%)</i>	19.9	-18.3	23.9	25.8

## Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>PBT (Ex-Other income)</b>	4,310	3,595	4,423	5,568
Depreciation	479	515	593	679
Interest Provided	72	28	21	6
Other Non-Cash items	0	0	0	0
Chg in working cap	-1,856	147	459	-1,066
Tax paid	-316	-450	-575	-724
<b>Operating Cashflow</b>	<b>2,689</b>	<b>3,834</b>	<b>4,922</b>	<b>4,464</b>
Capital expenditure	-971	-557	-2,074	-1,378
<b>Free Cash Flow</b>	<b>1,718</b>	<b>3,277</b>	<b>2,848</b>	<b>3,086</b>
Other income	172	259	370	462
Investments	-1,162	-2,695	-506	-500
<b>Investing Cashflow</b>	<b>-1,961</b>	<b>-2,993</b>	<b>-2,209</b>	<b>-1,416</b>
Equity Capital Raised	68	297	0	0
Loans Taken / (Repaid)	-334	-197	-110	-100
Interest Paid	-72	-28	-21	-6
Dividend paid (incl tax)	-456	-925	-1,237	-1,546
Income from investments	0	0	0	0
Others	72	27	0	0
<b>Financing Cashflow</b>	<b>-722</b>	<b>-825</b>	<b>-1,369</b>	<b>-1,652</b>
<b>Net chg in cash</b>	<b>6</b>	<b>16</b>	<b>1,344</b>	<b>1,395</b>
Opening cash position	142	148	165	1,508
<b>Closing cash position</b>	<b>148</b>	<b>164</b>	<b>1,508</b>	<b>2,904</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	130	264	264	264
Reserves & surplus	12,284	14,914	17,896	21,656
<b>Net worth</b>	<b>12,414</b>	<b>15,178</b>	<b>18,160</b>	<b>21,920</b>
<b>Minority Interest</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Secured Loans	473	243	182	82
Unsecured Loans	53	87	37	37
<b>Loan Funds</b>	<b>526</b>	<b>330</b>	<b>219</b>	<b>119</b>
Net deferred tax liability	432	474	474	474
<b>Total Liabilities</b>	<b>13,373</b>	<b>15,982</b>	<b>18,816</b>	<b>22,476</b>
Gross Block	7,828	8,329	10,329	11,666
Less: Depreciation	1,929	2,431	3,022	3,700
<b>Net block</b>	<b>5,899</b>	<b>5,898</b>	<b>7,307</b>	<b>7,966</b>
Capital work in progress	195	238	310	350
<b>Investment</b>	<b>1,718</b>	<b>4,413</b>	<b>4,919</b>	<b>5,419</b>
<b>Current Assets</b>	<b>7,672</b>	<b>8,040</b>	<b>9,537</b>	<b>12,756</b>
Inventories	4,213	4,985	4,699	5,766
Sundry debtors	2,661	2,232	2,467	3,027
Cash & bank balance	148	165	1,508	2,904
Loans & advances	650	658	863	1,059
Other current assets	0	0	0	0
<b>Current lia &amp; Prov</b>	<b>2,164</b>	<b>2,695</b>	<b>3,258</b>	<b>4,016</b>
Current liabilities	1,674	1,731	1,915	2,338
Provisions	489	964	1,343	1,678
<b>Net current assets</b>	<b>5,509</b>	<b>5,345</b>	<b>6,279</b>	<b>8,740</b>
Misc. exp & Def. Assets	0	0	0	0
<b>Total Assets</b>	<b>13,373</b>	<b>15,982</b>	<b>18,815</b>	<b>22,475</b>

## Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
<b>Profitability (%)</b>				
EBITDA Margin	41.0	43.5	42.4	42.9
Net Margin	35.2	35.8	35.5	36.4
ROCE	39.1	25.5	26.2	27.6
ROE	39.6	24.7	25.3	26.5
RoIC	35.5	22.0	23.6	26.5
<b>Per Share Data (Rs)</b>				
EPS	31.4	25.6	31.8	40.0
CEPS	35.2	29.7	36.4	45.3
BVPS	93.5	114.4	136.8	165.2
DPS	6.0	6.0	8.0	10.0
<b>Valuations (x)</b>				
PER	24.5	30.0	24.2	19.2
P/CEPS	22.0	26.1	21.2	17.1
P/BV	8.0	13.4	11.2	9.3
EV / Sales	8.2	20.8	16.5	13.4
EV / EBITDA	20.0	47.8	39.0	31.2
Dividend Yield (%)	0.7	0.8	0.8	1.0
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	0.0	0.0	-0.1	-0.1
Net Debt/EBITDA	0.1	0.0	-0.3	-0.4
Working Cap Cycle (days)	180	236	188	188

**Recommendation History: Divi's Laboratories Ltd – DIVI IN**

Date	Reports	Reco	CMP	Target
01.07.2010	<a href="#">Divi's Laboratories Management Meet Update</a>	Buy	779	852
24.05.2010	<a href="#">Divi's Laboratories Q4FY10 Result Update</a>	Buy	690	731
01.02.2010	<a href="#">Divi's Laboratories Q3FY10 Result Update</a>	Hold	610	566
03.11.2009	<a href="#">Divi's Laboratories Q2FY10 Result Update</a>	Hold	532	480

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
13.08.2010	<a href="#">Disman Pharma Q1FY11 Result Update</a>	Hold	208	224
13.08.2010	<a href="#">Ranbaxy Q2CY10 Result Update</a>	Reduce	445	395
11.08.2010	<a href="#">Piramal Healthcare Q1FY11 Result Update</a>	Hold	482	531
02.08.2010	<a href="#">Torrent Pharma Q1FY11 Result Update</a>	Buy	565	650

**Emkay Global Financial Services Ltd.**

Paragon Center, H -13 -16, 1st Floor, Pandurang Budhkar Marg, Worli, Mumbai – 400 013. Tel No. 6612 1212. Fax: 6624 2410

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