

March 30, 2011

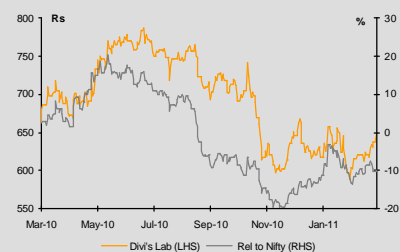
Reco	Previous Reco
Buy	Accumulate
CMP	Target Price
Rs650	Rs833
EPS change FY12E/13E (%)	-10 / NA
Target Price change (%)	+ 10
Nifty	5,736
Sensex	19,121

Price Performance

(%)	1M	3M	6M	12M
Absolute	9	1	(9)	(2)
Rel. to Nifty	1	6	(4)	(10)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Bloomberg	DIVI@IN
Equity Capital (Rs mn)	265
Face Value(Rs)	2
No of shares o/s (mn)	133
52 Week H/L	798/582
Market Cap (Rs bn/USD mn)	86/1,920
Daily Avg Volume (No of sh)	132831
Daily Avg Turnover (US\$m)	1.9

Shareholding Pattern (%)

	Dec'10	Sep'10	Jun'10
Promoters	52.2	52.2	52.4
FII/NRI	17.1	17.9	17.0
Institutions	12.7	12.4	13.4
Private Corp	8.9	8.2	8.1
Public	9.1	9.3	9.1

Source: Capitaline

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- **Getting ready for next leg of growth, scouting for acquisitions in the bio-similar space, accumulated Rs5bn cash for inorganic growth**
- **Growth momentum to accelerate led by 20% CAGR in CSS (Custom Synthesis) and Generics business over FY11-13E**
- **Nutraceuticals – confident of clocking over 100% sales CAGR over FY11-13E. Carotenoids* to be the next growth driver for the company**
- **With increased visibility on growth on back of increase in outsourcing from customers in US & Europe, commissioning of Vizag facility in Q1FY12, we upgrade the stock to Buy**

Key highlights of Management Meet

Organic and Inorganic growth drivers

Company is preparing itself for the next leg of growth. Company has accumulated Rs5bn in cash and investments and may also opt for debt in order to grow inorganically (Divi's has a low gearing on its book). The company is scouting for acquisition in the technology space outside India preferably in the bio-similar suite.

In existing businesses, Custom Synthesis and Generics business are set to grow at 20% CAGR over FY11-13E on the back of new capacity additions. Company has set up a new multipurpose facility at Vizag which will be commissioned in Q1FY12E. The investments in Nutraceuticals business will see 100% CAGR with Rs2.5bn revenues over FY11-13E. The Capex incurred on this facility is Rs2 billion with peak revenue potential of Rs3.5bn. Overall, management has clear visibility of Rs6bn of additional sales over the next 2 years.

Increased visibility on growth and sustained margins to drive earnings growth

Management has guided for sales CAGR of 20% and EBITDA margins at 40% levels over FY11-13E on back of good off-take from new products in the Generics segment and sustained momentum in the CSS business. Operating margins at 40% will be driven by a) improved product mix, b) higher contribution of high margin Carotenoids business, and c) normalization of demand from US and Europe. Moreover with capex investment stabilizing, benefits from operating leverage would come into play.

Strong business model, Attractive valuations – Upgrade to Buy

Divi's continues to maintain strong performance in the CRAMS space vis-à-vis its peers in terms of best-in-class operating metrics. We value the company at 20x FY13E earnings (in-line with its 3-year forward PE). Accordingly we upgrade the stock to Buy (earlier Accumulate) with a revised target price of Rs833 (Rs756 earlier). At CMP, the stock trades at 19x FY12E and 16x FY13E EPS.

Financials

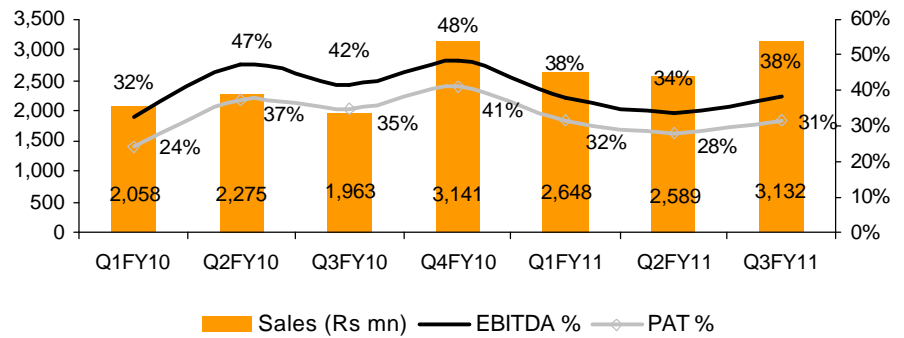
	Rs mn									
YE-	Net	EBITDA		EPS	EPS	RoE	EV/			
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY10	9,501	4,137	43.5	3,403	25.8	(60.0)	24.7	25.2	20.8	5.7
FY11E	11,247	4,283	38.1	3,474	26.3	2.1	21.3	24.7	20.1	4.9
FY12E	13,712	5,443	39.7	4,422	33.5	27.3	23.1	19.4	15.8	4.1
FY13E	16,201	6,605	40.8	5,504	41.6	24.4	23.8	15.6	13.0	3.4

* Refer Annexure for Carotenoids

Divi's Financial Performance

Post two quarters of lower revenues due to inventory de-stocking by MNC customers, Divi's revenues returned to normalcy in Q3FY11 quarter. Although the recovery will be gradual going ahead, the coming quarters are likely to report strong numbers on account of low base YoY.

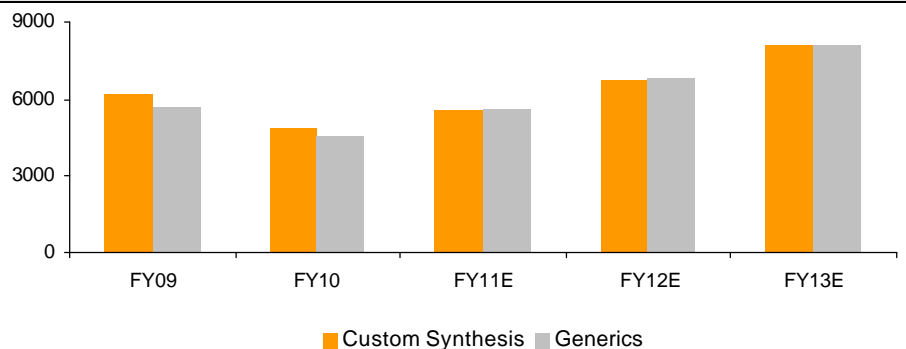
Quarterly trend



During FY10-13E, we expect the company to report 20% CAGR in top line. The key revenue drivers going ahead will be the commissioning of Vizag SEZ facility in Q1FY12 and increased traction in the Carotenoids segment.

Business-wise revenues

(Rs mn)



Strong business model, Attractive valuations – Upgrade to Buy

Divi's continues to maintain strong performance in the CRAMS space vis-à-vis its peers. With its strong business model and operating leverage, the company is likely to be one of the key beneficiaries of an improved global outsourcing environment. Best in class margins and return profile (RoIC in excess of 31%), strong balance sheet (near zero debt), India centric assets coupled with positive cash flow provides incremental comforts to the investors.

The company expects its Vizag plant to get commissioned in Q1FY12. Management has guided for 50% capacity utilization from this plant in its first year of operation. Moreover, increased traction in the Carotenoids space will provide further momentum.

We value the company in-line with its 3-year forward multiple of 20x to arrive at a target price of Rs833 (earlier Rs756). Accordingly we upgrade the stock to Buy (earlier Accumulate). At CMP, the stock trades at 19xFY12E and 16xFY13E EPS.

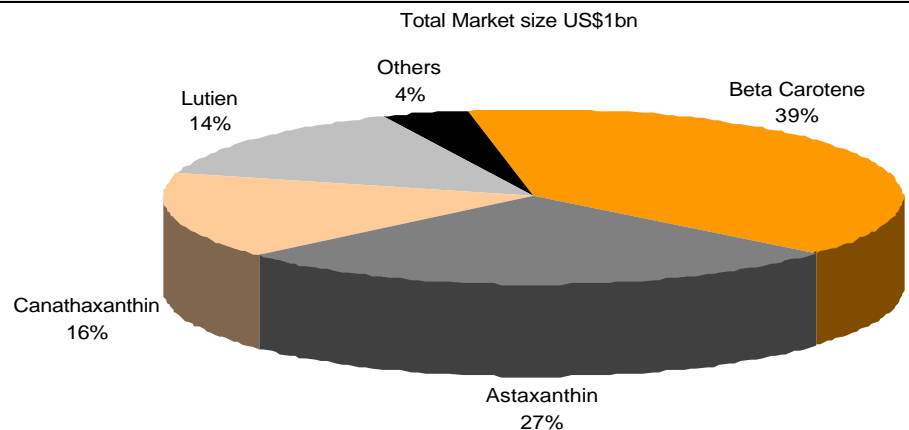
Annexure

Carotenoids

Although there are hundreds of known carotenoids, substances most well-known for being rich in vitamin A and for making certain fruits and vegetables red, orange or yellow—only a handful contributes for most of the current global sales of US\$1.07bn, projected to be US\$1.2bn by 2015E growing at ~ 3% p.a. Rising consumer awareness about the health benefits offered by various carotenoids amidst the ongoing trend favoring healthy and natural food products have benefited the carotenoids industry.

Beta-carotene represented the largest product segment with 2010 sales estimated at \$390 million. The fastest growing carotenoid globally was Canathaxanthin—the preferred coloring agent for imparting red coloration to egg yolks, as well as for providing red background color in shrimp and fish. Astaxanthin, a carotenoid used for coloring shrimp and fish, is predominantly chemically synthesized, though astaxanthin products derived from algae are rapidly penetrating the market as antioxidant enriched supplements, due to associated health benefits Luten's connection to eye health was expected to benefit from an increased need for eye health supplements among the elderly.

Carotenoids – segment break up



Market Breakdown

In terms of markets, the U.S. and Europe collectively account for a major share of sales in the global carotenoids market with developing countries expected to have stronger growth rates.

Leading players

DSM and BASF collectively accounted for about 55% share of the market, while DSM reigned as the world's largest producer of synthetic carotenoids, followed by BASF. For Divi's the ramp-up in this segment is panning out gradually. Management has guided for revenues of Rs1.25bn and Rs2.5bn in FY12E/ 13E respectively.

Applications

The largest end-use market for carotenoids is animal feed and human food. Human food segment is expected to witness robust growth, driven largely by the use of carotenoids as antioxidants. Astaxanthin, lutein and canthaxanthin are expected to garner popularity due to their growing utilization in animal feed and food industries. Over-the-counter (OTC) health supplements are also posting considerable growth for carotenoids due to their antioxidative properties. Another area, which is generating huge interest, is the cosmeceutical market and it continues to emerge as one of the major growth drivers for the nutraceuticals market. Consumers continue to look to nutraceuticals as an alternative to cosmetic surgery. Boosting this trend was the increased numbers of cosmeceutical ingredients offered by distributors in the food and pharmaceutical industries that promoted the effectiveness of cosmeceuticals by scientific approach.

Financials

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
Net Sales	9,501	11,247	13,712	16,201
<i>Growth (%)</i>	-19.8	18.4	21.9	18.2
Expenditure	5,364	6,964	8,269	9,596
Raw Materials	3,032	4,122	4,888	5,621
SGA	1,304	1,538	1,969	2,313
Employee Cost	733	936	964	1,124
Other Exp	294	368	448	538
EBITDA	4,137	4,283	5,443	6,605
<i>Growth (%)</i>	-14.9	3.5	27.1	21.3
EBITDA margin (%)	43.5	38.1	39.7	40.8
Depreciation	515	547	662	691
EBIT	3,622	3,736	4,781	5,914
EBIT margin (%)	38.1	33.2	34.9	36.5
Other Income	259	233	639	826
Interest expenses	28	21	28	29
PBT	3,853	3,948	5,393	6,712
Tax	450	474	971	1,208
<i>Effective tax rate (%)</i>	11.7	12.0	18.0	18.0
Adjusted PAT	3,403	3,474	4,422	5,504
(Profit)/loss from JV's/Ass/MI	0	0	0	0
Adjusted PAT after MI	3,403	3,474	4,422	5,504
<i>Growth (%)</i>	-18.3	2.1	27.3	24.4
Net Margin (%)	35.8	30.9	32.3	34.0
E/O items	0	0	0	0
Reported PAT	3,403	3,474	4,422	5,504
<i>Growth (%)</i>	-18.3	2.1	27.3	24.4

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
PBT (Ex-Other income)	3,595	3,715	4,754	5,885
Depreciation	515	547	662	691
Interest Provided	28	21	28	29
Other Non-Cash items	0	0	0	0
Chg in working cap	145	-1,073	-754	-1,298
Tax paid	-450	-474	-971	-1,208
Operating Cashflow	3,832	2,737	3,719	4,099
Capital expenditure	-557	-1,250	-2,062	-517
Free Cash Flow	3,275	1,487	1,657	3,582
Other income	259	233	639	826
Investments	-2,695	-200	-1,000	-2,000
Investing Cashflow	-2,993	-1,217	-2,423	-1,691
Equity Capital Raised	297	0	0	0
Loans Taken / (Repaid)	-198	-50	2	12
Interest Paid	-28	-21	-28	-29
Dividend paid (incl tax)	-925	-1,237	-928	-1,082
Income from investments	0	0	0	0
Others	31	0	0	0
Financing Cashflow	-822	-1,308	-953	-1,099
Net chg in cash	17	212	343	1,310
Opening cash position	148	165	376	719
Closing cash position	165	376	719	2,029

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
Equity share capital	264	264	264	264
Reserves & surplus	14,914	17,151	20,646	25,067
Net worth	15,178	17,415	20,910	25,331
Minority Interest	0	0	0	0
Secured Loans	298	182	182	182
Unsecured Loans	30	96	98	110
Loan Funds	328	278	280	292
Net deferred tax liability	474	474	474	474
Total Liabilities	15,981	18,168	21,664	26,098
Gross Block	8,329	9,529	11,529	12,029
Less: Depreciation	2,431	2,977	3,637	4,326
Net block	5,898	6,553	7,892	7,704
Capital work in progress	238	286	346	361
Investment	4,413	4,613	5,613	7,613
Current Assets	8,037	9,307	10,969	14,154
Inventories	4,985	5,495	6,324	7,480
Sundry debtors	2,232	2,656	2,976	3,520
Cash & bank balance	165	376	719	2,029
Loans & advances	655	780	950	1,124
Other current assets	0	0	0	0
Current liab & Prov	2,605	2,590	3,156	3,734
Current liabilities	1,643	1,587	1,934	2,288
Provisions	962	1,003	1,222	1,445
Net current assets	5,432	6,717	7,813	10,420
Misc. exp & Def. Assets	0	0	0	0
Total Assets	15,981	18,168	21,664	26,098

Key Ratios

Y/E, Mar	FY10	FY11E	FY12E	FY13E
Profitability (%)				
EBITDA Margin	43.5	38.1	39.7	40.8
Net Margin	35.8	30.9	32.3	34.0
ROCE	26.3	23.1	27.1	28.1
ROE	24.7	21.3	23.1	23.8
RoIC	32.0	30.9	34.1	37.9
Per Share Data (Rs)				
EPS	25.8	26.3	33.5	41.6
CEPS	29.6	30.4	38.5	46.9
BVPS	114.9	131.8	158.2	191.7
DPS	6.0	8.0	6.0	7.0
Valuations (x)				
PER	25.2	24.7	19.4	15.6
P/CEPS	21.9	21.4	16.9	13.9
P/BV	5.7	4.9	4.1	3.4
EV / Sales	9.1	7.7	6.3	5.3
EV / EBITDA	20.8	20.1	15.8	13.0
Dividend Yield (%)	0.9	1.2	0.9	1.1
Gearing Ratio (x)				
Net Debt/ Equity	0.0	0.0	0.0	-0.1
Net Debt/EBIDTA	0.0	0.0	-0.1	-0.2
Working Cap Cycle (days)	238	235	219	219

Recommendation History: Divi's Laboratories Ltd – DIVI IN

Date	Reports	Reco	CMP	Target
04/02/2011	Divis Lab Q3FY11 Result Update	Accumulate	633	756
10/11/2010	Divis Lab Q2FY11 Result Update	Accumulate	723	756
13/08/2010	Divi's Lab Q1FY11 Result Update	Buy	748	852
01/07/2010	Divi's Lab Management Meet Update	Buy	779	852

Recent Research Reports

Date	Reports	Reco	CMP	Target
24/02/2011	Ranbaxy Labs Q4CY10 Result Update	Hold	443	396
21/02/2011	GlaxoSmithKline Pharma Q4CY10 Result Update	Hold	2,229	2,161
18/02/2011	Panacea Biotec Q3FY11 Result Update	Accumulate	180	221
16/02/2011	Jubilant Life Sciences Q3FY11 Result Update	Accumulate	185	215

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