

DIVI'S LABORATORIES LTD

Result Update: Q2 FY14

BUY

CMP	1139.25
Target Price	1253.00

DECEMBER 7th 2013

ISIN: INE361B01024

Index Details

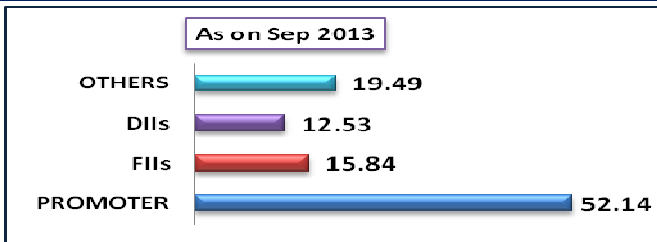
Stock Data

Sector	Pharmaceuticals
BSE Code	532488
Face Value	2.00
52wk. High / Low (Rs.)	1195.00/905.00
Volume (2wk. Avg.)	9292
Market Cap (Rs. in mn.)	151235.44

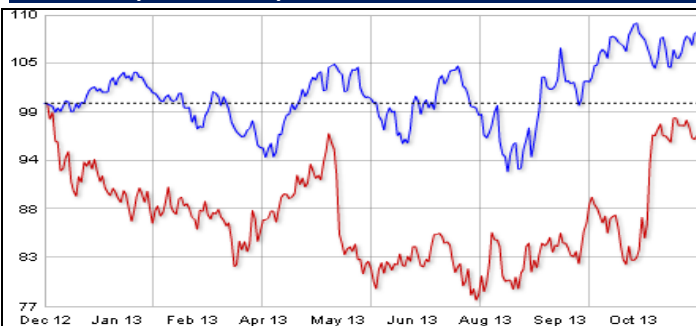
Annual Estimated Results (A*: Actual / E*: Estimated)

YEARS	FY13A	FY14E	FY15E
Net Sales	21288.90	23417.79	25291.21
EBITDA	8702.60	10500.53	11429.51
Net Profit	6114.20	7370.93	8041.57
EPS	46.06	55.52	60.58
P/E	24.74	20.52	18.81

Shareholding Pattern (%)



1 Year Comparative Graph



DIVIS LABORATORIES LTD

BSE SENSEX

SYNOPSIS

- Divis Laboratories Limited is engaged in manufacture of generic APIs, custom synthesis of active ingredients for innovator companies and other specialty chemicals like peptides and nutraceuticals.
- The company's net profit jumps to Rs. 2049.30 million against Rs. 1179.70 million in the corresponding quarter ending of previous year, an increase of 73.71%.
- Revenue for the quarter rose by 19.68% to Rs. 5669.50 million from Rs. 4737.40 million, when compared with the prior year period.
- EBITDA of Rs. 2852.60 million in the second quarter of FY 2014, compared to Rs. 1734.60 million in the comparable period in FY 2013, an increase of 64.45%.
- PBT at Rs. 2653.50 millions in Q2 FY14 compared to Rs. 1543.60 million in Q2 FY13, registered a growth of 70%.
- During the current half year, the Company has capitalized fixed assets aggregating to Rs. 1200.00 millions.
- Tax provision for the current quarter came to Rs.574.2 millions as against a tax provision of Rs.363.9 millions in Q2 FY13.
- Net Sales and PAT of the company are expected to grow at a CAGR of 11% and 14% over 2012 to 2015E respectively.

PEER GROUPS	CMP	MARKET CAP	EPS	P/E (X)	P/BV(X)	DIVIDEND
Company Name	(Rs.)	Rs. in mn.	(Rs.)	Ratio	Ratio	(%)
Divis Laboratories Ltd	1139.25	151235.44	46.06	24.74	5.92	750.00
Alembic Pharmaceuticals Ltd	205.65	38768.30	10.72	19.18	8.43	125.00
Dr Reddys Laboratories Ltd	2421.95	411973.10	91.89	26.36	5.29	300.00
Cipla Ltd	388.40	311854.70	18.15	21.40	3.52	100.00

Recommendation & Analysis - 'BUY'

Divi's Laboratories has earned a Profit after Tax (PAT) of Rs. 2049.30 millions on a total income of Rs. 5669.50 millions for the 2nd quarter of the year 2013-14 on a Standalone basis. PAT for the corresponding quarter of the last year was Rs. 1179.70 millions on a total income of Rs. 4737.40 millions. Tax provision for the current quarter came to Rs.574.2 millions as against a tax provision of Rs.363.9 millions for the corresponding quarter of last year. Forex gain for the current quarter amounted to Rs. 310 millions as against a loss of Rs. 210 millions during the corresponding quarter of the last year.

For the half year ended 30th Sep, 2013, the Company earned a total income of Rs. 10841.00 millions as compared to an income of Rs. 9432.50 millions during the previous half year. PAT for the current half year came to Rs. 3796.40 millions as against Rs. 2853.50 millions for the previous half year. The Company has capitalized fixed assets aggregating to Rs. 1200.00 millions during the current half year. Over FY2012-15E, we expect the company to post a CAGR of 11% and 14% in its top-line and bottom-line respectively. **Hence, we recommend 'BUY' for 'Divi's Laboratories Ltd' with a target price of Rs. 1253.00 on the stock.**

QUARTERLY HIGHLIGHTS (STANDALONE)

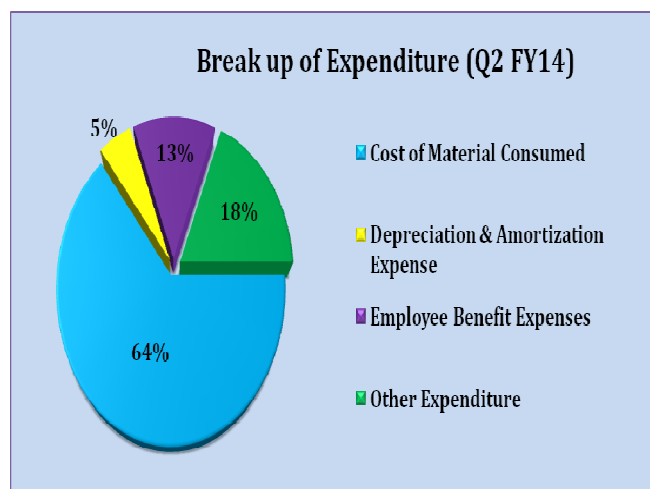
Results updates- Q2 FY14,

Months	Sep-13	Sep-12	% Change
Net Sales	5669.50	4737.40	19.68
PAT	2049.30	1179.70	73.71
EPS	15.44	8.89	73.71
EBITDA	2852.60	1734.60	64.45

The company's net profit jumps to Rs. 2049.30 million against Rs. 1179.70 million in the corresponding quarter ending of previous year, an increase of 73.71%. Revenue for the quarter rose by 19.68% to Rs. 5669.50 million from Rs. 4737.40 million, when compared with the prior year period. Reported earnings per share of the company stood at Rs. 15.44 a share during the quarter, registering 73.71% increases over previous year period. Profit before interest, depreciation and tax is Rs. 2852.60 millions as against Rs. 1734.60 millions in the corresponding period of the previous year.

Break up of Expenditure

Break up of Expenditure	Rs. Million	
	Q2 FY14	Q2 FY13
Consumption of Raw Materials	2814.90	2313.10
Depreciation	225.20	187.90
Employees Benefit Expenses	561.50	433.70
Other Expenditure	819.20	1038.50



COMPANY PROFILE

Divi's operates from its Headquarters and Registered Office at Hyderabad. The company has four multi-purpose manufacturing facilities with all support infrastructures like Utilities, environment management and safety systems.

Divi's is engaged in manufacture of generic APIs, custom synthesis of active ingredients for innovator companies and other specialty chemicals like peptides and nutraceuticals. The company constantly reviews its policies and procedures to adhere to conformity to the various regulatory approvals for its manufacturing facilities and its commitment to IPR.

Business Areas

The product portfolio of the company comprises of two broad segments:

- i) Generic APIs (active pharma ingredients) and Nutraceuticals and
- ii) Custom Synthesis of APIs, intermediates and specialty ingredients for innovator pharma giants.

The company operates predominantly in export markets and has a broad product portfolio under generics and custom synthesis. Business has been growing decently across both these segments & is broadly equal distributed.

R&D Centers

The company has 4 Research Centers with the well defined functional focus on custom synthesis, contract research for MNC companies as also future generics involving processes like route design, route selection, establishing gram scale process and structural confirmation, process optimization, impurity profile, pilot studies,

prevalidation batches, validation of process and transfer of technology to Plant, review efficiency of processes and ongoing process.

Regulatory Filings/Approvals

Divi has triple Certifications ISO-9001 (Quality Systems), ISO-14001 (Environment Management Systems) and OHSAS-18001 (Occupational Health and Safety systems) for its manufacturing facilities and adheres to cGMP and standard operating practices in its manufacturing/operating activities and these certifications are renewed from time to time. All the manufacturing sites have been inspected by US-FDA, barring the recently implemented DSN SEZ Unit which expects an inspection next year.

Divi has a total of 37 drug master files (DMFs) with US-FDA and 204 EDMFs and 16 CoS (Certificates of Suitability) with various European Union authorities. Divi has filed a total number of 8 patents for generic products.

Subsidiaries:

The company has two wholly owned subsidiaries for marketing its nutraceutical products and greater reach to customers within this region.

- Divis Laboratories (USA) Inc. New Jersey, USA.
- Divis Laboratories Europe AG Basel, Switzerland.

FINANCIAL HIGHLIGHT (STANDALONE)

Balance sheet as at March31, 2012 to 2015E

(A*- Actual, E* -Estimations & Rs. In Millions)

DIVI'S LABORATORIES LTD.	FY12A	FY13A	FY14E	FY15E
SOURCES OF FUNDS	(Rs.in.mn)			
Shareholder's Funds				
Share Capital	265.50	265.50	265.50	265.50
Reserves and Surplus	21482.48	25267.30	32638.23	39165.88
1. Sub Total - Net worth	21747.98	25532.80	32903.73	39431.38
Non Current Liabilities				
Long Term Borrowings	25.56	21.00	21.63	19.90
Deferred Tax Liabilities	672.87	865.52	1021.31	1143.87
Other Long term Liabilities	62.55	0.00	0.00	0.00
Long Term Provisions	16.46	23.91	28.21	31.60
2. Sub Total - Non Current Liabilities	777.44	910.43	1071.16	1195.37
Current Liabilities				
Short Term Borrowings	502.03	305.14	335.65	352.44
Trade Payables	1573.11	1583.07	2137.14	2265.37
Other Current Liabilities	1346.95	1293.53	1202.98	1094.71
Short Term Provisions	2082.14	2334.16	116.71	128.38
3. Sub Total - Current Liabilities	5504.23	5515.90	3792.49	3840.90
Total Liabilities (1+2+3)	28029.65	31959.13	37767.38	44467.65
APPLICATION OF FUNDS				
Non-Current Assets				
Fixed Assets				
Tangible assets	7381.95	9084.99	10926.59	12674.84
Capital Work in Progress	1815.78	3034.14	3398.24	3873.99
Expenditure during construction period pending Capitalization	4.11	0.00	0.00	0.00
a) Sub Total - Fixed Assets	9201.84	12119.13	14324.83	16548.83
b) Non-current investments	28.16	28.16	30.98	32.83
c) Long Term Loans and Advances	1246.91	1072.70	1158.52	1274.37
e) Other Non-current Assets	39.27	0.00	0.00	0.00
1. Sub Total – Non Current Assets	10516.18	13219.99	15514.32	17856.04
Current Assets				
Current Investment	4770.39	4078.14	3466.42	3882.39
Inventories	6509.69	8059.48	11560.50	14913.12
Trade receivables	5339.67	5589.01	6092.02	6579.38
Cash and Bank Balances	218.22	346.83	357.23	375.10
Short-terms loans & advances	640.30	598.91	688.75	757.62
Other current assets	35.20	66.77	88.14	104.00
2. Sub Total - Current Assets	17513.47	18739.14	22253.06	26611.61
Total Assets (1+2)	28029.65	31959.13	37767.38	44467.65

Annual Profit & Loss Statement for the period of 2012to 2015E

Value(Rs.in.mn)	FY12A	FY13A	FY14E	FY15E
Description	12m	12m	12m	12m
Net Sales	18449.30	21288.90	23417.79	25291.21
Other Income	657.60	485.10	1250.50	1313.03
Total Income	19106.90	21774.00	24668.29	26604.24
Expenditure	-11500.60	-13071.40	-14167.76	-15174.73
Operating Profit	7606.30	8702.60	10500.53	11429.51
Interest	-37.40	-17.80	-20.47	-23.13
Gross profit	7568.90	8684.80	10480.06	11406.38
Depreciation	-620.30	-769.00	-907.42	-1043.53
Profit Before Tax	6948.60	7915.80	9572.64	10362.85
Tax	-1488.90	-1801.60	-2201.71	-2321.28
Net Profit	5459.70	6114.20	7370.93	8041.57
Equity capital	265.50	265.50	265.50	265.50
Reserves	21482.50	25267.30	32638.23	39165.88
Face value	2.00	2.00	2.00	2.00
EPS	41.13	46.06	55.52	60.58

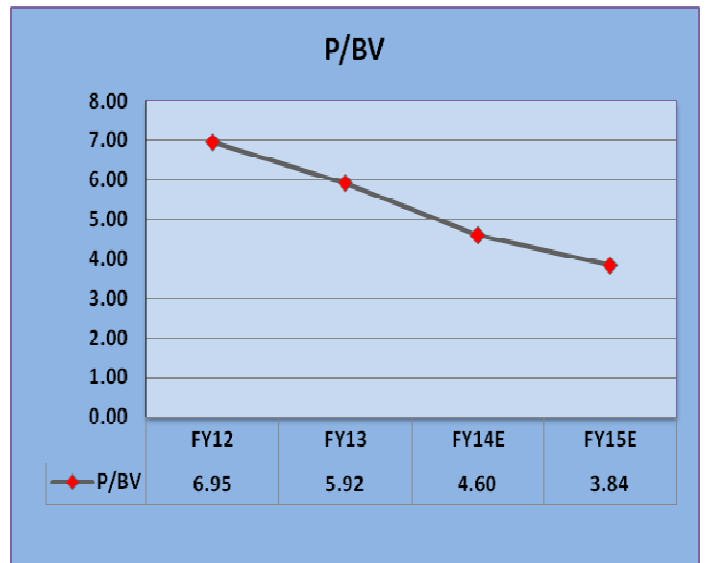
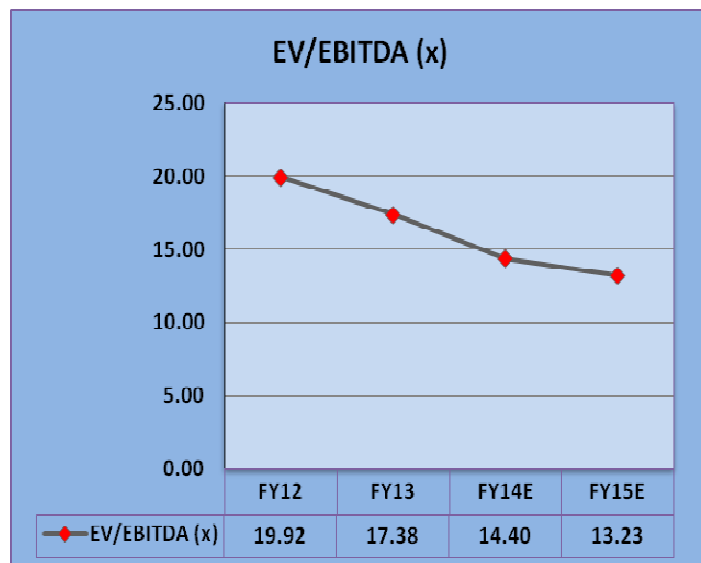
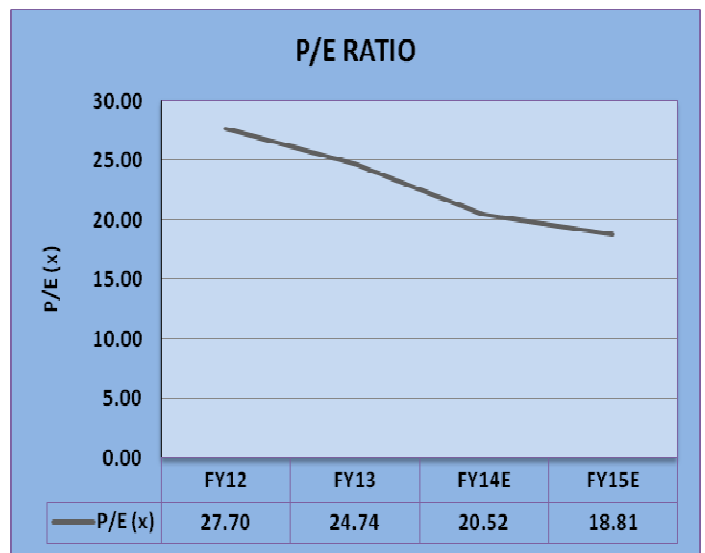
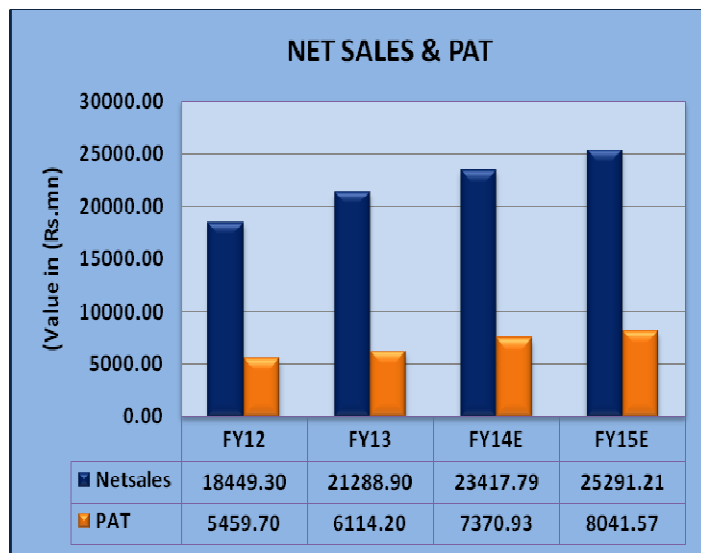
Quarterly Profit & Loss Statement for the period of 31st Mar, 2013 to 31st Dec, 2013E

Value(Rs.in.mn)	31-Mar-13	30-Jun-13	30-Sep-13	31-Dec-13E
Description	3m	3m	3m	3m
Net sales	6512.80	5171.50	5669.50	6236.45
Other income	75.90	534.20	365.40	277.70
Total Income	6588.70	5705.70	6034.90	6514.15
Expenditure	-3989.00	-3199.70	-3182.30	-3741.87
Operating profit	2599.70	2506.00	2852.60	2772.28
Interest	-6.20	-4.10	-3.90	-4.41
Gross profit	2593.50	2501.90	2848.70	2767.88
Depreciation	-202.70	-208.80	-225.20	-236.46
Profit Before Tax	2390.80	2293.10	2623.50	2531.42
Tax	-572.50	-546.00	-574.20	-577.16
Net Profit	1818.30	1747.10	2049.30	1954.25
Equity capital	265.50	265.50	265.50	265.50
Face value	2.00	2.00	2.00	2.00
EPS	13.70	13.16	15.44	14.72

Ratio Analysis

Particulars	FY12A	FY13A	FY14E	FY15E
EPS (Rs.)	41.13	46.06	55.52	60.58
EBITDA Margin (%)	41.23	40.88	44.84	45.19
PBT Margin (%)	37.66	37.18	40.88	40.97
PAT Margin (%)	29.59	28.72	31.48	31.80
P/E Ratio (x)	27.70	24.74	20.52	18.81
ROE (%)	25.10	23.95	22.40	20.39
ROCE (%)	36.93	36.63	34.30	31.34
Debt Equity Ratio	0.02	0.01	0.01	0.01
EV/EBITDA (x)	19.92	17.38	14.40	13.23
Book Value (Rs.)	163.83	192.34	247.86	297.03
P/BV	6.95	5.92	4.60	3.84

Charts



OUTLOOK AND CONCLUSION

- At the current market price of **Rs.1139.25**, the stock P/E ratio is at 20.52 x FY14E and 18.81 x FY15E respectively.
- Earning per share (EPS) of the company for the earnings for FY14E and FY15E is seen at Rs.55.52 and Rs.60.58 respectively.
- Net Sales and PAT of the company are expected to grow at a CAGR of 11% and 14% over 2012 to 2015E respectively.
- On the basis of EV/EBITDA, the stock trades at 14.40 x for FY14E and 13.23 x for FY15E.
- Price to Book Value of the stock is expected to be at 4.60 x and 3.84 x respectively for FY14E and FY15E.

The company operates predominantly in export market and has a broad product portfolio under generics and custom synthesis. Business has been growing decently across both these segments and Exports constituted 90% of Sales and about 77% to Advanced Markets in North America and Europe. The company continues to increase capacities created at its multi –purpose manufacturing facilities and also additional capacities aimed at the business opportunities in the field of Generic market. We recommend '**BUY**' in this particular scrip with a target price of **Rs.1253.00** for Medium to Long term investment.

INDUSTRY OVERVIEW

India is now among the top five pharmaceutical emerging markets globally and is a front runner in a wide range of specialties involving complex drugs' manufacture, development, and technology. The Indian pharmaceutical industry is a highly knowledge based industry which is growing steadily and plays a major role in the Indian economy. As a highly organised sector, the number of pharmaceutical companies is increasing their operations in India. The industry is expected to touch US\$ 35.9 billion by 2016.

The Department of Pharmaceuticals has prepared a 'Pharma Vision 2020' document for making India one of the leading destinations for end-to-end drug discovery and innovation. The department provides requisite support by way of world class infrastructure, internationally competitive scientific manpower for pharma research and development (R&D), venture fund for research in the public and private domain and such other measures.

Sector Structure/ Market Size

The domestic pharma market has reported total sales of Rs 6,370 crore (US\$ 1.03 billion) in the month of May 2013, registering a growth of 6.8 per cent, as per IMS Health. The major factors responsible are increasing sales of generic medicines, continued growth in chronic therapies and a greater penetration in rural markets.

The cumulative drugs and pharmaceuticals sector has attracted foreign direct investments (FDI) worth US\$ 11,304.91 million during April 2000 to April 2013, according to the Department of Industrial Policy and Promotion (DIPP).

Growth

The Indian pharmaceutical industry would continue to experience strong growth as structural growth drivers continue to remain impervious. The industry is expected to revert a growth of 10-12 percent in 2013-14, according to a study by ICRA. It is also expected that in-organic investments will gain momentum in the medium-term as companies plan to create stronger presence in emerging markets and build expertise in select therapy areas.

Among the top 10 companies, Cipla with total sales of Rs 302 crore (US\$ 49.13 million), Sun Rs 297 crore (US\$ 48.32 million), Alkem Rs 222 crore (US\$ 36.12 million) and Sanofi Rs 186 crore (US\$ 30.26 million) were the fastest growing corporations for the month of May 2013.

Exports

The Ministry of Commerce has targeted Indian pharma sector exports at US\$ 25 billion by 2016. The Government has also planned a 'Pharma India' brand promotion action plan spanning over a three-year period to give an impetus to generic exports.

In order to boost the export capability, Export-Import Bank of India (Exim Bank), has decided to expand the scope of its finance to pharmaceutical companies for extended repayment periods. Eligible export oriented companies can avail finance from Exim Bank for a maximum repayment period of 10 years with a moratorium of up to 36 months.

"Of the export markets, Indian pharma will focus on the US market which presents significant opportunities for the next two years for generics, due to patent cliffs and recent changes in healthcare policies".

Generics

Generics will continue to dominate the market while patent-protected products are likely to constitute 10 per cent of the pie till 2015.

Global demand for generic drugs from Indian companies is booming as developed nations battle rising healthcare costs. As a result, generics companies are increasingly focusing on expanding presence in relatively under-penetrated markets (i.e. France, Spain & Italy), branded generic markets of East Europe and niche areas like complex generics, OTCs etc.

Diagnostics Outsourcing/ Clinical Trials

India is fast becoming the preferred destination for high-end pathology and diagnostic services. The highly fragmented diagnostics and pathology labs market in India is pegged at US\$ 3.4 billion, according to a report by PricewaterhouseCoopers.

An increasing number of hospitals from the UK, US, Middle East and neighbouring countries are tying up with Indian diagnostic centres to conduct laboratory tests. The Indian diagnostic services market is expected to grow at a compound annual growth rate (CAGR) of around 26 per cent during 2012-2015 on back of huge investments, fast expansion into tier II & III cities, and strong government support strengthening the healthcare infrastructure in the country.

Investments

Some of the investments in the sector are:

- Piramal's healthcare vertical plans to invest US\$ 2.5 million to upgrade their antibody drug conjugate (ADC) manufacturing suites. The upgrade will give Piramal two commercial grade ADC suites at the Grangemouth facility, while retaining clinical phase manufacturing capacity in other suites on-site
- Dr Reddy's Laboratories (DRL) has launched Donepezil Hydrochloride tablets in the US market following the approval by the United States Food and Drug Administration (USFDA)
- US-based drug maker MSD has tied up with Mumbai-based Lupin to market MSD's 23-valent Pneumococcal Polysaccharide Vaccine in India. Lupin would have a non-exclusive licence to market, promote and distribute the vaccine under a different brand name
- Aurobindo Pharma, Natco Pharma and Glenmark have received approvals from the US Food and Drug Administration (USFDA) to launch their migraine drugs in the US market
- Elder Pharmaceuticals has acquired UK-based Max Healthcare. The acquisition is through Elder's fully-owned UK subsidiary, NutraHealth, and will mark the re-entry of Elder Pharma into the over-the-counter (OTC) pharmaceutical category
- Zydus Group has launched Lipaglyn™ (Saroglitazar), a novel drug targeted for treating diabetic dyslipidemia or hypertriglyceridemia in Type II diabetes. The drug has been approved for launch in India by the Drug Controller General of India (DCGI)

Government Initiatives

The Foreign Investment Promotion Board (FIPB) has cleared seven FDI proposals for investment in the Indian pharmaceutical companies. Currently, 100 per cent FDI in pharma sector is permitted through automatic

approval route in the new projects but the foreign investment in the existing pharma companies requires FIPB approval.

In the Union Budget 2013-14, investment allowance of 15 per cent on new plant and machinery has been allowed. The allowance is expected to increase investments in new projects while simultaneously providing tax benefit to the industry.

In order to provide relief to the common man in the area of healthcare, a countrywide campaign in the name of 'Jan Aushadhi Campaign' has been initiated by the Department of Pharmaceuticals, Government of India, in collaboration with the State Governments, by way of opening up of Jan Aushadhi Generic Stores in the Government Hospitals by way of supply of generic medicines through Central Pharma Public Sector Undertakings, to make available quality generic medicines at affordable prices to all.

Road Ahead

In spite of some recent adverse developments, with the support of Pharmexcil and the Government in the form of Brand India Pharma project iPHEX, the sector would continue to grow and meet the healthcare requirements of the developing world.

The country will see the largest number of merger and acquisitions (M&A) in the pharmaceutical and healthcare sector, according to consulting firm Grant Thornton. A survey conducted across 100 companies has revealed that one-fourth of the respondents were optimistic about acquisitions in the pharmaceutical sector.

The pharma companies such as Cipla, Ranbaxy, Dr Reddy's Labs and Lupin might soon be part of the government's ambitious 'Jan Aushadhi' project. In an attempt to commercialise the project, the Government is likely to rope in the private sector to bulk-procure generic drugs from them.

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