Emkay
Research

24 December 2007

Dishman Pharma

Visit Note

A safe bet on CRAM

Not Rated

Price	Target Price
Rs320	N.A
Sensex	**19162**

Price Performance

(%)	1M	3M	6M	12M
Absolute	18	9	0	40
Rel. to Sensex	18	(4)	(32)	5

Source: Capitaline

Stock Details

Sector	Pharma
Reuters	DISH.BO
Bloomberg	DISH@IN
Equity Capital(Rs mn)	155
Face Value(Rs)	2
52 Week H/L	350/194
Market Cap(Rs bn)	25.5
Daily Avg Volume (No of shares)	94212
Daily Avg Turnover (US$mn)	0.7

Shareholding Pattern (%)

(30th Sep.'07)

Promoters	63.2
FII/NRI	10.8
Institutions	19.4
Private Corp.	3.1
Public	3.6

Source: Capitaline

Manoj Garg
manoj.garg@emkayshare.com
+91 22 6612 1257

Dishman is one of the fastest growing companies in Contract Research and Manufacturing Services (CRAMS) space. Company has grown at a CAGR of 51% over FY04-07 on the back of strong growth in CRAMS. To understand its future growth strategy, we have recently met with the management of the company. Dishman has a de-risked business model that provides the complete range of services in the CRAMS value chain with strict adherence to Intellectual Property Rights (IPR). Dishman has gradually moved up the value chain from being merely a chemicals supplier to a full service CRAMS player through organic and inorganic initiatives. We believe the acquisition of Carbogen-Amcis (CA) has enabled the company to offer the service across the CRAMS value chain and strengthen its position in high margin contract research space. Strong relationships with global pharmaceuticals companies coupled with access to new customers through the CA acquisition should augur well for the company's CRAMS business. Dishman is one of the few players in India which has adopted a collaborative approach with global MNCs and thus likely to benefit from the increased outsourcing opportunities. Company's focus on CRAMS (grew by 73%) has resulted in strong revenue growth in Q2FY08, which has grown by 60% to Rs1.86bn. Management expects revenues to grow at a CAGR of 30% p.a. for the next 2 years and EBIDTA margins to sustain at 21-22% level. At CMP of Rs. 320, stock is trading at 16.3x FY09E consensus EPS of Rs19.6. We do not have formal rating on the stock but believe that with robust industrial growth fundamental, strong earnings growth of 36% over FY07-10E and RoE of over 35%, Dishman is an excellent investment opportunity.

Key growth drivers are:

CRAMS: Continue to drive growth

CRAMS will continue to be the primary growth driver for the company on the back of a) Increased supplies to Solvay for Eposartan Mesylate (EM) API, b) Long term supplies agreement with other innovators companies and c) Increased tractions in contract research space, where company has built up significant capacity through organic (recently commissioned a new R&D centre) and inorganic (acquisition of CA and Syprotec) initiatives. We believe its dependency on Solvay (25% of CRAMS in FY07) to come down on the back of strong growth from the contracts of other innovators companies. We expect the contribution of CRAMS to increase from 72% in FY07 to 83% by FY10E (CAGR of 41% over FY07-10E).

Carbogen-Amcis acquisition to further strengthen its position in CRAMS

We believe CA acquisition is found to be a strategic fit and revenue accretive for Dishman. CA is a pharmaceutical service provider, offering a broad portfolio of drug development and commercialization services to large and mid-sized pharma companies. 7 of the top10 pharmaceutical majors are its customers and 75% of its revenues come from US. In CY05, CA has recorded the revenue of Rs3080mn and in CY06, it recorded revenue of Rs3633mn (against the projection of Rs3200mn). In Q2FY08, company has shifted 8 projects from CA to Dishman's India operations, resulted increased EBIDTA margins for CA to 23% from 20% in FY07. We believe, going forward, CA business will further strengthen its position in CRAMS, on the back of strong customer base. CA currently has three projects under Phase-III development, which are likely to get commercialize in next 1-2 years. We expect this business to grow at a CAGR of 16% over next 3 years.

US FDA facility approval triggered EM supply to US market

Dishman's 100% EOU unit approval by US FDA has triggered EM supply for Solvay's US requirement. Currently Solvay sources 50% of its EM requirements from Dishman. Company (Dishman) has expanded its capacity of EM from 60 mt to 200 mt in order to meet the increased off take from Solvay. We expect Dishman's Solvay business to grow at a CAGR of 31% over next 3 years. Solvay's SLV-306 (Daglutril) is progressing well in Phase-lll for which Dishman has a custom synthesis contract, which could be potential trigger for the company. Management has also indicated that in H2FY08, company will announce one more supply agreement with Solvay, thus further strengthened its relationship with Solvay.

From single client to multiple clients- Looking beyond Solvay

To reduce its dependence on a single customer, Dishman entered into a long term association with some global pharma majors like GSK, AstraZeneca, Pfizer, Novartis, Merck, J&J,etc., for both on-patent as well as off-patent supplies of APIs and intermediates. We believe this initiative will help the company to reduce its dependency on Solvay and expect this segment to grow at a faster pace albeit on a low base (37% CAGR over next 3 years).

Other developments

- Dishman has also acquired Solvay's Vitamin business, which has revenue of Euro15mn in CY2006. Dishman has paid Euro12mn with Euro 7.2mn, as working capital. Company believes that this acquisition will further strengthen its relation with Solvay. Management also feels that since there are only 2 - 3 manufacturers in the world for Vitamin-D analogue and because of there expertise to develop low cost manufacturing process, this acquisition will be a strategic fit for the company. We believe this business to contribute Rs1593mn in FY10E.
- Dishman is setting up a manufacturing unit in China to produce low end Quats (used as catalyst) to leverage on low cost operations and to manufacture high ended Quats in India. Chinese facility will start production by June08E onwards. Company has also taken significant price revision in Quats supplies, to offset the impact of currency appreciation. We expect these initiatives will enable its Marketable Molecule segment (consist of Quats and specialty chemicals) ~ contributed 28% of revenues in FY07, to grow at a CAGR of 15% over next 3 years.
- Dishman has plans for significant capex (Rs1.5bn) to augment existing capacities and for investment in various initiatives like Saudi Arabia, China).
- Dishman is also looking for an acquisition in CRO space in Europe and US region in the range of $10 – 25 mn.
- Of its $50mn FCCB issued, $35mn already converted @ conversion price of Rs.172 per share. Post conversion fully diluted equity would be 81.33mn (FV Rs2).

Financials

Dishman has posted robust growth in revenues and earnings in FY07. Consolidated revenues grew by 108% to Rs5783mn driven by 181% growth in CRAMS and 26% growth in Marketable Molecule (MM). Though organically Dishman's CRAMS business grew by 29%, but acquisition of Carbogen-Amcis (Rs2248 contribution in FY07) resulted the CRAMS contribution in total revenues to 72% for Dishman. EBIDTA margins for the year was down by 340 bps due to one time write offs and significant increase in employee cost (up by 365%). PAT for the year was up by 79% to Rs918mn. Impact of lower tax rate (3.3% in FY07 v/s 5.7% in FY06) and higher other income was negated by118% increase in depreciation cost and 86% increase in interest cost.

Robust Q2FY08 Result

For Q2FY08, company has reported a topline of Rs1.8bn, up by 60%, driven by 72.5% growth in CRAMS and 28.7% growth in MM. Although y-o-y figures are not comparable given that Carbogen-Amcis was present only for one month in Q2FY07. Ebidta margin for the quarter was down by 60 bps y-o-y and 540 bps up on q-o-q basis to 21.7%. PAT of Rs281mn (Forex gain Rs.67mn), up by 67.7% over corresponding period. Impact of higher other income (Forex gain of Rs.67mn) was negated by higher depreciation cost (Rs111mn in Q2FY08 v/s Rs41mn in Q2FY07 and higher interest cost (Rs72mn v/s Rs38mn).

Earning CAGR of 36% estimated over FY07-10E

Our quick estimates suggest that the Dishman is likely to achieve a CAGR of 35% in topline to Rs14246mn by FY10E. PAT should increase at a CAGR of 36% to Rs2040mn over FY07-10E. The management has given the guidance of 30% CAGR in revenues over FY07-09E, but given the robust industry growth outlook and Dishman's strong relation with global innovator companies coupled with presence across the CRAMS value chain, we believe company will surpass its revenue guidelines. Management is confident to maintain the EBIDTA margins at 21-22%, but in our projection, we have consider the EBIDTA margins to be at 20-21% level to offset the risk of currency appreciation impact (Though management has said that any fluctuation in currency is a pass-on expense).

We believe Dishman will report an EPS of Rs14.5 for FY08E, Rs20.3 for FY09E and Rs25.2 for FY10E on fully diluted equity of 81mn (a CAGR of 36% over FY07-10E).

Quick Estimates

Rs. mn	2007	2008	2009	2010	CAGR
Sales	5786	8905	11699	14246	35.0%
Growth	109.2%	53.9%	31.4%	21.8%	
Other inc.	120	141	166	180	14.5%
Ebidta	1149	1825	2422	2992	37.6%
Ebidta %	19.9%	20.5%	20.70%	21.00%	
Depreciation	263.0	458	500	530	26.3%
Interest	162	246	325	350	29.3%
PBT	844.0	1262.4	1762.7	2291.7	39.5%
Tax	39	84	114.6	252	86.3%
Tax %	4.6%	6.7%	6.5%	11.00%	11.0%
PAT	805	1178	1648	2040	36.3%
PAT%	13.9%	13.2%	14.1%	14.3%	
FD Equity	81	81	81	81	
DEPS	9.9	14.5	20.3	25.2	36.3%

Source : Emkay Research

Valuations and outlook

At CMP of Rs. 320, stock is trading at 16.3x FY09E consensus EPS of Rs19.6. We do not have formal rating on the stock but believe that with robust industrial growth fundamental, strong earnings growth of 36% over FY07-10E and RoE of over 35%, Dishman is an excellent investment opportunity.

QUARTERLY -CONSOLIDATED RESULTS

Income Statement Rs mn

	Q2FY08	Q2FY07	YoY %	Q1FY08	QoQ %	FY07	FY06	%YoY
Net Sales	1866	1173	59.1%	1680	11.1%	5783	2774	108.5%
Raw Material Consumed	664	520	27.5%	710	-6.5%	2024	1292	56.6%
% of Sales	35.6	44.4		42.3		35.0	46.6	
Employee Expenses	462	175	164.1%	496	-6.8%	1356	291	365.4%
% of Sales	24.8	14.9		29.5		23.4	10.5	
Other Expenses	335	216	55.4%	199	68.4%	1252	544	130.1%
% of Sales	18.0	18.4		11.9		21.7	19.6	
TOTAL EXPENDITURE	1461	911	60.3%	1406	3.9%	4632	2128	117.7%
EBIDTA	405	262	54.6%	274	47.9%	1151	646	78.2%
EBIDTA%	21.7	22.3	(60) bps	16.3	540 bps	19.9	23.3	(340) bps
Interest	72	50	43.4%	61	17.3%	189	102	85.7%
Depreciation	111	41	171.4%	89	24.3%	263	121	118.3%
Other Income	91.3	38	140.9%	108	-15.1%	261	122	114.7%
PBT	313.7	209.1	50.0%	231	35.7%	960	545	76.0%
Tax	32.2	40.7	-20.9%	16.1	100.0%	32	31	2.2%
Tax Rate (%)	10.3	19.5	-20.9%	7.0	100.0%	3.3	5.7	-41.9%
RPAT	282	168	67.2%	215	30.9%	928	514	80.5%
APAT	282	168	67.2%	215	30.9%	918	514	78.6%
Net Margin (%)	15.1	14.4	70 bps	12.8	230 bps	15	18	(300) bps
Equity (fully diluted)	81	81		81		81	81	
DEPS	3.5	2.1	67.2%	2.7	30.9%	11.3	6.3	78.6%

Source : Emkay Research

Income Statement

Y/E,Mar (Rs. mn)	FY04	FY05	FY06	FY07
Net Sales	1676	1864	2774	5783
Growth (%)		*11*	*49*	*108*
Expenses	1260	1361	2128	4632
Growth (%)		*8*	*56*	*118*
Raw Materials	763	746	1292	2024
% of sales	*46*	*40*	*47*	*35*
Employee cost	145	175	291	1356
% of sales	*9*	*9*	*11*	*23*
Manufacturing exps	126	160	231	528
% of sales	*8*	*9*	*8*	*9*
R&D	0	0	0	0
% of sales	*0*	*0*	*0*	*0*
Selling & Dist exps	226	281	313	724
% of sales	*13*	*15*	*11*	*13*
EBIDTA	416	504	646	1151
Growth (%)		*21*	*28*	*78*
EBIDTA %	*25*	*27.0*	*23*	*19.9*
Other income	22	33	122	261
Interest	128	114	102	189
Depreciation	76	83	121	263
Misc. Exp. W/O		0		
PBT	235	340	545	960
Total Tax	18	8	31	32
Effective tax rate (%)	9	2	6	3
PAT (Before E/O items)	208	332	514	928
Growth (%)		*60*	*55*	*81*
Profit from Ass.	*0*	*0*	*6*	*0*
Net Margin (%)	*12*	*18*	*18*	*15*
E/O items	*0*	*-2*	*0*	*10*
RPAT	208	332	520	928
Adjuted PAT (Cons, Before E/O items)	208	334	520	918
Growth (%)		*61*	*56*	*77*

Source : Emkay Research

Balance Sheet

Y/E, Mar (Rs. mn)	FY04	FY05	FY06	FY07
Equity share capital	103	137	137	144
Share Application Money	0	0	0	0
Share Premim	0	504	394	933
Other Reserves	561	829	1354	2076
Networth	663.7	1470.7	1885.2	3153.3
Deferred tax liability	28	1	(1)	109
Secured Loans	651	679	550	3316
Unsecured Loans	456	504	472	728
FCCB	0	0	2232	1566
Loan Funds	1107	1183	3255	5610
Total Liabilities	1800	2655	5140	8872
Gross Block	1295	1550	2190	6079
Less: Depreciation	242	321	440	699
Net block	1053	1229	1750	5380
Capital work in progress	61	129	373	650
Investment	4	4	75	140
Current Assets	1140	1853	3746	5424
Inventories	584	814	1082	2978
Sundry debtors	307	668	863	1252
Cash & bank balance	70	92	1352	356
Loans & advances	179	280	449	839
Other assets	0	0	0	0
Current liabilities	489	567	816	2737
Current liabilities	392	446	657	2526
Provisions	97	121	159	211
Net current assets	651	1286	2930	2687
Misc. expenditure	30	7	11	15
Total Assets	1800	2655	5140	8872

Key Ratios

Mar end	FY04	FY05	FY06	FY07
Profitability (%)				
EBIDTA margin	24.8	27.0	23.3	19.9
PAT margin	12.4	17.9	18.3	15.9
ROCE	19.8	19.4	13.7	12.9
ROE	33.8	32.2	32.1	37.8
Per share data (Rs.)				
EPS (Consolidated)	**2.6**	**4.1**	**6.3**	**11.3**
CEPS	5.5	6.0	9.3	16.4
BVPS	11.9	21.0	26.2	42.4
DPS (Rs)	0.4	0.5	0.7	1.0
Valuations				
P/E	209.0	129.9	85.4	47.3
Cash PE	97.4	88.8	57.5	32.8
P/BV	44.9	25.5	20.5	12.6
EV / Net Sales	17.1	20.4	14.4	7.7
EV / EBITDA	69.1	75.4	62.0	38.5
Dividend Yield (%)	0.1	0.1	0.1	0.2
Turnover (x) Days				
Debtors T/O	67.0	130.7	113.6	77.9
Inventory T/O	159.6	206.0	175.7	219.0
Gearing Ratio				
Net debt/ Equity (x)	1.7	0.8	1.1	1.7
Total Debt/Equity (x)	1.8	0.8	1.8	1.8

Emkay Share and Stock Brokers Ltd.,
Paragon Center, Ground Floor, C-6
Pandurang Budhkar Marg, Worli, Mumbai – 400 013. , Tel no. 66121212. Fax: 66121299