MOTILAL OSWAL

3QFY11 Results Update

SECTOR: PHARMACEUTICALS

Dishman Pharma

BSE SENSEX	S&P CNX
17,729	5,310
Bloomberg	DISH IN
Equity Shares (m)	81.3
52-Week Range (Rs)	235/108
1,6,12 Rel. Perf. (%)	-9/-42/-53
M.Cap. (Rs b)	9.5
M.Cap. (US$ b)	0.2

Rs117 **Sell**

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/10A	9,154	1,157	14.2	-21.0	8.2	1.2	15.3	11.4	1.8	8.2
03/11E	8,804	607	7.5	-47.5	15.7	1.1	7.4	6.8	1.9	12.0
03/12E	9,841	368	4.5	-39.3	25.8	1.1	4.2	5.5	1.8	10.5
03/13E	11,669	720	8.9	95.6	13.2	1.0	7.8	7.7	1.5	8.2

- Dishman's 3QFY11 performance was significantly below our expectations. It reported a muted 4.3% YoY growth in revenue to Rs2.32b (v/s our estimate of Rs2.35b) while adjusted PAT declined 95% YoY to Rs17m (v/s our estimate of Rs209m), led by poor operational performance, and increase in depreciation and interest charges.
- CRAMS revenue declined 1.6% YoY to Rs1.58b (68% contribution to revenue) due to 16.1% YoY drop in the CRAMS revenue from India. MM business revenue reported 19.5% YoY growth to Rs736m, led by 29.9% YoY growth in Vitamin-D business.
- EBITDA declined 51% YoY to Rs253m while EBITDA margin contracted by 12.2 percentage points to 10.9% due to operating loss of Rs30.4m for CA. The local management of CA executed low-margin contracts to achieve topline target, resulting in poor profitability.
- Adjusted profit declined 94.6% YoY to Rs17m owing to poor operational performance, increase in depreciation charges due to ongoing capex, and higher interest cost on account of working capital borrowings.

Outlook and view: The macro environment for the CRAMS business remains favorable, given India's inherent cost advantage and chemistry skills. We believe that Dishman's India operations will benefit from increased outsourcing from India, given its strengthening MNC relations. However, the adverse business environment for CA and Euro depreciation will continue to impact earnings growth in FY11 and FY12. We expect revenue CAGR of 8.4%, EBITDA CAGR of 2.3% and earnings CAGR of -14.6% over FY10-13. The stock currently trades at 15.7x FY11E, 25.8x FY12E and 13.2x FY13E earnings. RoE will continue to be below 10% till new facilities and CRAMS contracts ramp up. We downgrade our rating from **Neutral** to **Sell**, with a revised target price of Rs89 (10x FY13E EPS).

QUARTERLY PERFORMANCE (CONSOLIDATED) (Rs Million)

Y/E MARCH	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	**2,277**	**2,174**	**2,223**	**2,479**	**2,019**	**2,128**	**2,318**	**2,339**	**9,154**	**8,804**
YoY Change (%)	*-3.5*	*-13.7*	*-21.2*	*-15.2*	*-11.3*	*-2.1*	*4.3*	*-5.6*	*-13.8*	*-3.8*
Total Expenditure	1,745	1,677	1,710	1,984	1,574	1,759	2,064	1,993	7,116	7,390
EBITDA	**532**	**498**	**513**	**495**	**445**	**369**	**253**	**346**	**2,038**	**1,414**
Margins (%)	*23.4*	*22.9*	*23.1*	*20.0*	*22.0*	*17.4*	*10.9*	*14.8*	*22.3*	*16.1*
Depreciation	145	174	141	135	161	168	171	172	594	672
Interest	104	99	85	100	82	95	133	147	388	458
Other Income	155	59	32	25	104	203	61	30	270	398
PBT after EO Income	**438**	**284**	**319**	**285**	**305**	**308**	**10**	**58**	**1,326**	**682**
Tax	9	25	30	-10	17	14	-7	51	54	75
Deferred Tax	37	14	-32	96	17	0	0	-17	115	0
Rate (%)	*10.5*	*14.0*	*-0.6*	*29.9*	*11.2*	*4.4*	*-68.1*	*59.6*	*12.8*	*11.0*
Prior Period Adjustment	1	5	-10	-12	-1	12	1	0	-17	0
Reported PAT	**391**	**240**	**331**	**212**	**272**	**283**	**17**	**23**	**1,174**	**607**
Adj PAT	**392**	**244**	**321**	**200**	**271**	**295**	**17**	**23**	**1,157**	**607**
YoY Change (%)	*41.5*	*725.7*	*-19.3*	*-73.7*	*-30.8*	*20.7*	*-94.6*	*-88.3*	*-21.0*	*-47.5*
Margins (%)	*17.2*	*11.2*	*14.4*	*8.0*	*13.4*	*13.9*	*0.8*	*1.0*	*12.6*	*6.9*

E: MOSL Estimates

Nimish Desai (NimishDesai@MotilalOswal.com); Tel: +91 22 3982 5406 / **Amit Shah** (Amit.Shah@MotilalOswal.com) + 91 22 3982 5423

Topline impacted by poor performance in CRAMS business

Dishman's 3QFY11 performance was significantly below our expectations. It reported a muted 4.3% YoY growth in revenue to Rs2.32b (v/s our estimate of Rs2.35b) while adjusted PAT declined 95% YoY to Rs17m (v/s our estimate of Rs209m), led by poor operational performance, and increase in depreciation and interest charges.

CRAMS revenue declined 1.6% YoY to Rs1.58b (68% contribution to revenue) due to 16.1% YoY drop in the CRAMS revenue from India. Carbogen AMCIS (CA) revenue grew 18.7% YoY to Rs795m on a low base (which was impacted by global credit crunch). MM business revenue reported 19.5% YoY growth to Rs736m, led by 29.9% YoY growth in Vitamin-D business. QUATs business grew just 10.3%YoY to Rs361m on a high base.

Sales mix (Rs m)

	3QFY11	3QFY10	% YoY	2QFY11	% QoQ
CRAMS	**1,582**	**1,607**	***-1.6***	**1,608**	***-1.6***
Dishman	787	938	*-16.1*	696	*13.1*
Carbogen AMCIS	795	670	*18.7*	912	*-12.9*
M M	**736**	**616**	***19.5***	***520***	***41.5***
Vitamin-D	375	289	*29.9*	247	*51.7*
QUATs	361	327	*10.3*	273	*32.3*
Total	**2,318**	**2,223**	***4.3***	**2,128**	***8.9***

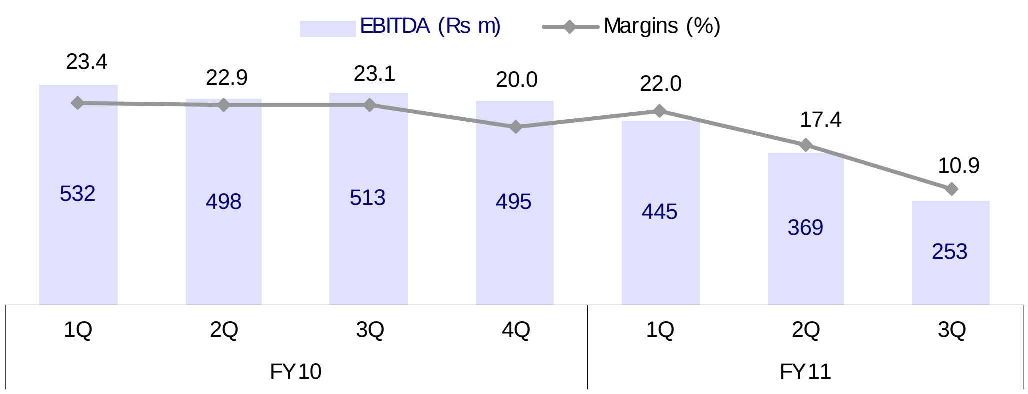
Source: Company/MOSL

EBITDA declines 51% YoY, significantly below our estimate

EBITDA declined 51% YoY to Rs253m while EBITDA margin contracted by 12.2 percentage points to 10.9% due to operating loss of Rs30.4m for CA. The local management of CA executed low-margin contracts to achieve topline target, resulting in poor profitability.

Dishman management indicated that it has taken corrective steps by changing the top management and targeting profitability improvement rather than topline growth. For the quarter, Dishman has reported the lowest ever quarterly EBITDA margin in the last four years.

EBITDA and Margin Trend



Source: Company

Adjusted profit declined 94.6% YoY to Rs17m owing to poor operational performance, increase in depreciation charges due to ongoing capex, and higher interest cost on account of working capital borrowings.

Management downgrades guidance for FY11

Management has downgraded FY11 revenue growth guidance from growth of 10% earlier to flat due to disappointing performance by CA, decline in CRAMS business from India and subdued performance of MM business. The company has guided for year-on-year decline in PAT as well. We are projecting revenue decline of 3.8% in FY11 considering the lower demand in QUATs business and contract research segment, impact of Euro depreciation and poor operational performance in 9MFY11 (revenue decline of 3.1%). Also, we estimate CA revenue at CHF75m v/s management guidance of ~CHF80m. We estimate overall consolidated PAT at Rs607m for FY11. Management has guided for 15% topline growth in non-CA business for FY12.

FY11 guidance

Parameter	Old Guidance	New Guidance	Remarks
Overall Sales Growth (%)	10	Flat	We forecast revenue decline of 3.8%YoY for FY11 due to muted performance in QUATs segment, slowdown at Carbogen AMCIS, lower contract research income and impact of Euro depreciation versus INR
Carbogen AMCIS Revenue (CHF m)	90	80	We estimate 8.5% decline in revenues as performance of contract research business at Carbogen remains subdued. Company recorded revenues of CHF82m for FY10
PAT Growth (%)	10	Decline	We estimate 47.5% decline in PAT due to depreciation of Euro, pressure on CA's profitability, increase in interest cost and 39%YoY decline in 9MFY11 PAT.
Capex (Rs b)	1.25-1.5	1.5	2 new API units are coming up at Bavla.

Source: Company/MOSL

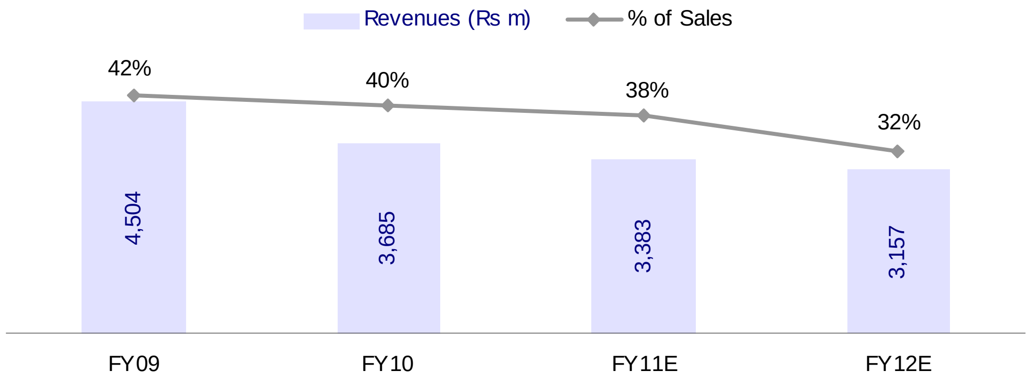
Euro depreciation to have negative impact on FY11 performance

Dishman derives ~50% of its revenue in Euro terms. In the last year, Euro has depreciated by 12% vis-à-vis the Rupee. The average Rupee/Euro rate stood at Rs60.9/Euro for 3QFY11 v/s Rs69.2/Euro for 3QFY10. If the situation worsens, it will have a negative impact on Dishman's performance. Our current estimates are based on Rs57/Euro.

CA reeling under pressure; management undertakes significant restructuring

CA has been reeling under pressure for the last two years due to global credit crunch. The company has lost some contract research business due to unavailability of funding for its customers to carry out research. In 3QFY11, CA reported operating loss due to adverse product mix. The local management at CA executed low margin contracts to boost revenue. Dishman's management has now commenced implementation of business restructuring to turn around the company. The existing CEO of CA has been fired and the management of Dishman has taken over CA's day-to-day working. It hopes to turn around the company in the next one year through cost restructuring (mainly manpower reduction) by targeting savings of CHF8m-9m. The management expects CA's topline to remain flat in FY11.

Carbogen AMCIS revenue hit in FY10 and FY11, likely to decline further in FY12



Source: Company/MOSL

Cutting earnings estimates by 37-64%

Based on poor 3QFY11 performance, we are cutting our revenue and PAT estimates to take into account subdued guidance for FY11, slow recovery in Carbogen AMCIS and flat revenue guidance for MM business. Accordingly, we are cutting FY11, FY12 and FY13 revenue estimates by 4.6%, 7.1% and 4.6%, and EPS estimates by 37.2%, 63.5% and 45.3%, respectively. We estimate FY11 EPS at Rs7.5 (down 47.5% YoY), FY12 EPS at Rs4.5 (de-growth of 39.3%) and FY13 EPS at Rs8.9 (up 95.6% on a very low base).

Outlook and view

The macro environment for the CRAMS business remains favorable, given India's inherent cost advantage and chemistry skills. We believe that Dishman's India operations will benefit from increased outsourcing from India, given its strengthening MNC relations. However, the adverse business environment for CA and Euro depreciation will continue to impact earnings growth in FY11 and FY12. We expect revenue CAGR of 8.4%, EBITDA CAGR of 2.3% and earnings CAGR of -14.6% over FY10-13. The stock currently trades at 15.7x FY11E, 25.8x FY12E and 13.2x FY13E earnings. RoE will continue to be below 10% till new facilities and CRAMS contracts ramp up. We downgrade our rating from Neutral to **Sell**, with a revised target price of Rs89 (10x FY13E EPS).

Dishman Pharma: an investment profile

Company description

Dishman Pharma is one of the leading players in the CRAMS segment and has developed strong relationships with innovator companies. It has established presence across the CRAMS value chain and is also one of the largest manufacturers of QUATs globally.

Key investment arguments

- We expect Dishman to benefit from the expected increase in pharmaceutical outsourcing from India over the next few years.
- Dishman's focus on establishing relationships with new customers and reducing its dependence on Solvay has begun bearing fruits. It has signed supply contracts with AstraZeneca and is in advanced discussions with large companies like GSK, Novartis, and J&J for outsourcing deals.

Key investment risks

- Since Dishman derives ~50% of its revenue in Euro, the recent depreciation in Euro is likely to have negative impact on the performance of the company.
- Dishman has been suffering from de-stocking of inventory carried out by its large customers and declining demand from Carbogen AMCIS customers due to unavailability of funding. This situation may continue in the near future, thereby impacting Dishman's performance.

Recent developments

- Has raised Rs750m through the issue of non-convertible debentures.

Valuation and view

- We expect Dishman to be a key beneficiary of the increased pharmaceutical outsourcing from India given its strong relationships with global innovator pharmaceutical companies.
- Valuations at 15.7x FY11E, 25.8xFY12E and 13.2x FY13E earnings.
- We downgrade our recommendation to **Sell**.

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

		Dishman	Divis
P/E (x)	FY11E	15.7	23.4
	FY12E	25.8	19.3
P/BV (x)	FY11E	1.1	4.7
	FY12E	1.1	4.0
EV/Sales (x)	FY11E	1.9	7.3
	FY12E	1.8	6.1
EV/EBITDA (x)	FY11E	12.0	19.4
	FY12E	10.5	15.4

EPS: MOSL forecast v/s consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	7.5	13.4	-44.2
FY12	4.5	16.8	-73.2

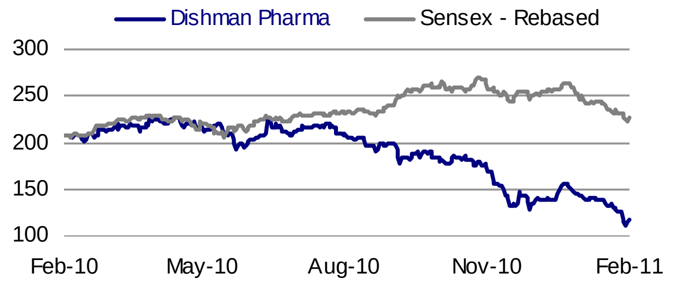
Target Price and Recommendation

Current Price (Rs)	Target * Price (Rs)	Upside (%)	Reco.
117	89	-23.9	Sell

Shareholding pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	60.9	60.9	60.8
Domestic Inst	9.3	11.1	12.5
Foreign	9.2	9.7	11.3
Others	20.5	18.4	15.4

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT					(Rs Million)
Y/E MARCH	2009	2010	2011E	2012E	2013E
Net Sales	**10,624**	**9,154**	**8,804**	**9,841**	**11,669**
Change (%)	*32.3*	*-13.8*	*-3.8*	*11.8*	*18.6*
Total Expenditure	8,009	7,116	7,390	8,142	9,486
% of Sales	*75.4*	*77.7*	*83.9*	*82.7*	*81.3*
EBITDA	**2,615**	**2,038**	**1,414**	**1,699**	**2,183**
Margin (%)	*24.6*	*22.3*	*16.1*	*17.3*	*18.7*
Depreciation	629	594	672	770	830
EBIT	**1,985**	**1,444**	**742**	**929**	**1,353**
Int. and Finance Charges	459	388	458	546	555
Other Income - Rec.	48	270	398	50	60
PBT before EO Expense	1,575	1,326	682	433	857
Extra Ordinary Expense/(Incom	0	0	0	0	0
PBT after EO Expense	1,575	1,326	682	433	857
Current Tax	45	54	75	65	137
Deferred Tax	66	115	0	0	0
Tax Rate (%)	*7.1*	*12.8*	*11.0*	*15.0*	*16.0*
Reported PAT	**1,463**	**1,157**	**607**	**368**	**720**
PAT Adj for EO Items	**1,463**	**1,157**	**607**	**368**	**720**
Change (%)	*20.4*	*-21.0*	*-47.5*	*-39.3*	*95.6*
Margin (%)	*13.77*	*12.64*	*6.89*	*3.74*	*6.17*

RATIOS					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Basic (Rs)					
EPS (fully diluted)	**18.0**	**14.2**	**7.5**	**4.5**	**8.9**
Cash EPS (fully diluted)	25.7	21.5	15.7	14.0	19.1
BV/Share	88.5	98.8	105.7	109.9	117.9
DPS	1.2	1.2	0.5	0.3	0.8
Payout (%)	7.7	9.8	8.0	8.0	10.0
Valuation (x)					
P/E (fully diluted)	6.5	8.2	15.7	25.8	13.2
Cash P/E (fully diluted)	4.5	5.4	7.4	8.4	6.1
P/BV	1.3	1.2	1.1	1.1	1.0
EV/Sales	1.5	1.8	1.9	1.8	1.5
EV/EBITDA	6.2	8.2	12.0	10.5	8.2
Dividend Yield (%)	1.0	1.0	0.4	0.3	0.7
Return Ratios (%)					
RoE	22.7	15.3	7.4	4.2	7.8
RoCE	15.2	11.4	6.8	5.5	7.7
Working Capital Ratios					
Fixed Asset Turnover (x)	1.9	1.4	1.2	1.2	1.3
Debtor (Days)	51	45	51	49	47
Inventory (Days)	104	97	102	100	99
Working Capital Turnover (Day:	141	142	143	138	128
Leverage Ratio (x)					
Current Ratio	3.0	3.1	3.3	2.9	2.7
Debt/Equity	1.0	1.0	1.1	1.0	1.0

BALANCE SHEET					(Rs Million)
Y/E MARCH	2009	2010	2011E	2012E	2013E
Equity Share Capital	161	161	161	161	161
Fully Diluted Equity Capital	*163*	*163*	*163*	*163*	*163*
Total Reserves	6,981	7,808	8,366	8,705	9,353
Net Worth	**7,143**	**7,969**	**8,528**	**8,866**	**9,514**
Deferred liabilities	208	316	316	316	431
Total Loans	7,237	7,739	9,153	9,098	9,256
Capital Employed	**14,588**	**16,025**	**17,997**	**18,280**	**19,202**
Gross Block	7,979	9,320	10,820	11,820	12,820
Less: Accum. Deprn.	1,953	2,481	3,153	3,153	3,747
Net Fixed Assets	**6,027**	**6,839**	**7,667**	**8,667**	**9,073**
Capital WIP	2,227	3,574	3,574	3,574	3,574
Investments	14	14	14	14	14
Goodwill	1,754	1,590	1,590	1,590	1,590
Curr. Assets	**6,850**	**5,880**	**7,429**	**6,826**	**7,858**
Inventory	3,040	2,423	2,465	2,706	3,151
Account Receivables	1,494	1,131	1,233	1,329	1,517
Cash and Bank Balance	452	455	1,706	724	857
Loans & Advances	1,865	1,871	2,025	2,067	2,334
Curr. Liability & Prov.	**2,284**	**1,873**	**2,278**	**2,392**	**2,908**
Account Payables	1,588	1,617	1,585	1,771	2,100
Provisions	696	256	693	621	808
Net Current Assets	**4,566**	**4,007**	**5,151**	**4,434**	**4,950**
Appl. of Funds	**14,588**	**16,025**	**17,997**	**18,280**	**19,202**

E: MOSL Estimates

CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	2009	2010	2011E	2012E	2013E
Oper. Profit/(Loss) before Tax	2,615	2,038	1,414	1,699	2,183
Interest/Dividends Recd.	48	270	398	50	60
Direct Taxes Paid	-45	-54	-75	-65	-137
(Inc)/Dec in WC	-371	562	107	-265	-383
CF from Operations	**2,246**	**2,816**	**1,844**	**1,419**	**1,722**
EO Expense / (Income)	0	0	0	0	0
CF from Operating incl E(	**2,246**	**2,816**	**1,844**	**1,419**	**1,722**
(inc)/dec in FA	-2,514	-2,524	-1,500	-1,000	-1,000
(Pur)/Sale of Investments	-1	0	0	0	0
CF from Investments	**-2,514**	**-2,524**	**-1,500**	**-1,000**	**-1,000**
Issue of shares	2	0	0	0	0
(Inc)/Dec in Debt	657	503	1,414	-56	159
Interest Paid	-459	-388	-458	-546	-555
Dividend Paid	-113	-113	-49	-29	-72
Others	261	-290	0	-770	-121
CF from Fin. Activity	**348**	**-288**	**908**	**-1,401**	**-590**
Inc/Dec of Cash	**81**	**3**	**1,252**	**-982**	**133**
Add: Beginning Balance	371	452	455	1,706	724
Closing Balance	**451**	**455**	**1,706**	**724**	**857**

NOTES

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

Disclosure of Interest Statement	Dishman Pharma
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