

DISHMAN PHARMACEUTICALS & CHEM

INR 249

Carbogen-Amcis integration reaping benefits

BUY



Dishman Pharmaceuticals and Chemicals Limited's (Dishman's) Q3FY07 revenues were lower than our estimates; however, much higher EBITDA margins resulted in better than expected EBITDA. Higher depreciation costs (as the company commissioned its R&D facility) ensured that the net profit was in-line with our expectations. Sales increased by 180% Y-o-Y to INR 1,736 mn, and EBITDA and net income grew 168% and 26% respectively. This quarter bore the full impact of Carbogen and Amcis, Dishman's recent acquisitions.

This quarter saw revenues of ~INR 340 mn from Solvay's delayed contract, which were originally to be realised in Q2FY07. Increased revenues from CRAMS business from Solvay, together with Carbogen-Amcis' improved profitability led to an increase in EBITDA margins to 28.1% from 21% in Q2FY07.

A few of Amcis' clients have agreed, in principle, to transfer a portion of their manufacturing to Dishman with the former facing capacity constraints. We believe this is a big positive for the company, as these kinds of synergies will ensure better growth and profitability for Dishman. Overall, we believe the company will be able to deliver good growth, driven by CRAMS in India and synergies from Carbogen-Amcis.

We are reducing our estimates for FY07E, primarily based on (1) better than expected gross margins due to improved performance of CRAMS in India and better profitability of Carbogen-Amcis, (2) higher depreciation charges on account of higher capex, and (3) higher than expected tax rates. We have reduced FY07E EPS figure by 7%, while the FY08E figures remain the same.

Dishman's outlook remains positive based on the company's announcement of several new initiatives that are likely to translate into new sizeable contracts and synergies derived from Carbogen-Amcis. At CMP of INR 249, the stock trades at a P/E of 23.8x and 15.2x on FY07E and FY08E revised estimates. We retain our 'BUY' recommendation.

* **Core business: CRAMS growing as per expectations**

CRAMS segment contributed ~80% to Dishman's revenues in Q3FY07, showing a growth of more than 250%. The growth in CRAMS business from India (without Carbogen-Amcis) was ~40%. Marketable molecules showed an impressive growth rate of ~48%. In the CRAMS segment, contract research and contract manufacturing businesses contributed ~INR 500 mn and ~INR 910 mn, respectively, to the total revenues. In this quarter, the CRAMS revenues were up on account of revenues recorded from the Solvay contract, which were originally to be realised in Q2FY07. The management is confident of achieving INR 1,000 mn of sales from Solvay in FY07E and expects Q4FY07 to be much better than Q3FY07.

Financials

Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY07E	FY08E
Revenues (INR mn)	1,736	619	180.3	1,170	48.4	5,463	8,707
EBITDA (INR mn)	488	182	168.5	246	98.3	1,377	2,090
Net profit (INR mn)	244	194	25.8	168	45.6	848	1,327
EPS (INR)	3.0	2.8	6.7	2.1	45.6	10.5	16.4
PE (x)						23.8	15.2
EV/EBITDA (x)						17.1	11.8

January 29, 2007

Nimish Mehta

+91-22-2286 4295
nimish.mehta@edelcap.com

Amod Karanjikar

+91-22-2286 4429
amod,karanjikar@edelcap.comReuters : DISH.BO
Bloomberg : DISH IN

Market Data

52-week range (INR) : 273 / 132
Share in issue (mn) : 68.7
M cap (INR bn/USD mn) : 16.9 / 381.5
Avg. Daily Vol. BSE/NSE ('000) : 167.2

Share Holding Pattern (%)

Promoters : 71.2
MFs, Fls & Banks : 12.5
Fls : 11.0
Others : 5.4

Further, Dishman has declared receiving a contract from Nippon Kasei for a product, which is valued at ~USD 5.5 mn, spread over Q4FY07 and Q1FY08. Such new contracts are expected to drive the company's growth, going forward.

* **Carbogen-Amcis: Dishman gaining access to wider customer base**

Dishman said some of Amcis' clients have agreed, in principle, to transfer a portion of their manufacturing from the Amcis facility to Dishman, as the former faces capacity constraint. We consider this development as a major positive for the company as it signals (1) higher growth, (2) better profitability, as Dishman can use its low cost base to manufacture high value products, and (3) significant growth upon the successful execution of these contracts, as the clients may extend similar contracts to the company for other products as well.

In Q3FY07, Carbogen-Amcis recorded revenues of ~INR 820 mn, delivering better than expected results. Amcis has two USFDA approved plants, one for ophthalmology and other products, and another for high potency oncology products. Amcis' oncology facility is facing capacity constraints, as a result of which, its clients are considering to shift manufacturing of three products to Dishman. However, Dishman intends to undertake capex of ~USD 8 mn in the Amcis facility, which may get the company new contracts going forward.

Carbogen is working on six molecules in Phase III and nine molecules in Phase II. With improved capacity utilisations in Carbogen-Amcis, we believe the high fixed overheads will be distributed on a wider sales base, resulting in better profitability going forward.

Further, Dishman's joint venture (JV) in Saudi Arabia is progressing well and is likely to commence operations in FY09. The company's Chinese project has also commenced and is expected to be commissioned by FY09.

* **Change in estimates: driven by high capex and more than expected tax rates**

Dishman is expanding capacities at its Bavla facility for intermediates and doubling its *eprosartan* capacities; these expansion plans are likely to cost Dishman INR 400 mn. Post capacity expansion, Solvay may increase its offtake of *eprosartan* from Dishman, instead of sourcing the molecule from other supplier.

Further, Dishman is planning a capex of ~INR 360 mn for its high potency facility, which could be deferred and conducted when the SEZ construction starts in 2007. Due to some capacity constraints at Amcis, the company is likely to undertake capex of about INR 360 mn. We had earlier not factored in these capex programmes in our estimates. The company is also providing a higher tax rate of ~14%. Higher depreciation costs (due to higher capex) and increased tax provisioning, are however, offset by better than expected margins from higher growth in CRAMS and better profitability in Carbogen-Amcis. As a result, we are decreasing our FY07E EPS figure by 7%, while FY008E figures remain same as earlier.

* **Valuations**

Dishman's outlook remains positive with new contracts in the pipeline and strong growth signals from Carbogen-Amcis. We believe its strong order flow will ensure a growth of ~30% in the next two years. At CMP of INR 249, the stock trades at a P/E of 23.8x and 15.2x on FY07E and FY08E earnings. With robust growth and good earnings visibility, we believe the stock is attractively valued. We retain our 'BUY' recommendation.

Financial snapshot

INR mn	Q3FY07	Q3FY06	Growth (%)	Q2FY07	Growth (%)	FY06	FY07E	FY08E
Total operating income	1,736	619	180.3	1,170	48.4	2,774	5,463	8,707
Total expenses	1,248	438	185.2	924	35.1	2,128	4,087	6,617
Cost of goods sold	696	233	199.1	531	31.1	1,268	2,349	3,787
Gross profit	1,040	387	169.0	639	62.8	1,506	3,114	4,919
Other expenses	552	205	169.4	393	40.5	860	1,737	2,830
Salaries, wages, other payments	185	79	133.3	175	5.9	343	645	1,088
Other expenses	367	126	192.2	218	68.3	517	1,093	1,741
EBITDA	488	182	168.5	246	98.3	646	1,377	2,090
Other income	34	44	(21.4)	41.5	(17.2)	79	164	218
PBDIT	522	225	131.7	287	81.7	725	1,541	2,307
Depreciation	156	27	471.2	41	276.9	120	388	597
Interest	72	1	9,932.4	38	91.2	59	189	202
PBT	294	197	49.1	209	41.2	545	964	1,508
Tax (including deferred tax)	50	3	1,394.3	41	23.2	31	116	181
Net profit for eq	244	194	25.8	168	45.6	514	848	1,327
Equity capital (FV INR 2)	162	137		162		162	162	162
Dividend per share (INR)	-	-		-		0.6	0.7	0.7
Number of shares (mn)	81	69		81		81	81	81
EPS (INR)	3.0	2.8	6.7	2.1	45.6	6.3	10.5	16.4
PE (x)						39.2	23.8	15.2
EV/EBITDA (x)						34.2	17.1	11.8
M. Cap/Revenues (x)						7.3	3.7	2.3
as % of net revenues								
Gross profit	59.9	62.4		54.6		54.3	57.0	56.5
EBITDA	28.1	29.3		21.0		23.3	25.2	24.0
Net profit	14.1	31.3		14.3		18.5	15.5	15.2
Dividend payout	-	-		-		9.4	6.7	4.3
Tax rate	17.1	1.7		19.6		5.7	12.0	12.0

Company Description

Dishman started as an intermediate and specialty chemicals manufacturer, specialising in QUATS. Over the last five years, it has made significant progress in the pharmaceuticals space via CRAMS model by entering into contracts with Solvay for *eprosartan* and other intermediates. The company recently acquired Carbogen-Amcis in the UK and ventured into the contract research space by acquiring Synprotec. With these initiatives, Dishman expects to be one of the leading CRAMS players in India.

Investment Thesis

We believe Dishman will grow significantly going forward with: (1) its CRAMS business from India expected to deliver more than 30% growth with the existing order pipeline, (2) synergies obtained from Carbogen-Amcis, and (3) improved margins due to higher contribution from CRAMS and improving profitability of Carbogen-Amcis.

Key Risks

Any delay in obtaining regulatory approvals could hurt the Dishman's growth.

Revenues in the CRAMS business could be lumpy, resulting in fluctuations in numbers on Q-o-Q basis.

If integration process at Carbogen-Amcis does not go smoothly, Dishman's margins could be severely hit.

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



Naresh Kothari – 2286 4246

Head, Institutional Equities

Vikas Khemani – 2286 4206

Head, Institutional Equities

INDIA RESEARCH

SECTOR

INSTITUTIONAL SALES

Shriram Iyer - 2286 4256	Head – Research	Nischal Maheshwari - 2286 4205
Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Shabnam Kapur - 2286 4394
Vishal Goyal, CFA - 2286 4370	Banking & Finance	Amish Choksi - 2286 4201
Revathi Myneni - 2286 4413	Cement	Balakumar V - (044) 4263 8283
Sumeet Budhraj - 2286 4430	FMCG	Monil Bhala - 2286 4363
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Ashish Agrawal - 2286 4301
Priyanko Panja - 2286 4300	Infrastructure, Engineering, Telecom	Nikhil Garg - 2286 4282
Hitesh Zaveri - 2286 4424	Information Technology	Swati Khemani - 2286 4266
Parul Inamdar - 2286 4355	Information Technology	Neha Shahra - 2286 4276
Priyank Singhal - 2286 4302	Media, Retail	Priya Ramchandran - 2286 4389
Prakash Kapadia - 2286 4432	Mid Caps	Anubhav Kanodia - 2286 4361
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Tushar Mahajan - 2286 4439
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Harsh Biyani - 2286 4419
Manika Premsingh - 4019 4847	Economist	Nirmal Ajmera - 2286 4258
Sunil Jain - 2286 4308	Alternative & Quantitative	Ankit Doshi - 2286 4671
Yogesh Radke - 2286 4328	Alternative & Quantitative	Ravi Pilani - 4009 4533
		Dipesh Shah - 2286 4434

Email addresses: firstname.lastname@edelcap.com

e.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

This document has been prepared by Edelweiss Securities Private Limited (Edelweiss). Edelweiss and its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. Analyst holding in stock: no.