Dishman Pharmaceuticals & Chem INR 249

Carbogen-Amcis integration reaping benefits BUY

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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.

Reuters	:	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, FIs & Banks	:	12.5
FIIs	:	11.0
Others	:	5.4

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

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.

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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