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Initiating Coverage
March 16, 2011

Dishman Pharmaceuticals & Chemicals Ltd.

All negatives priced in; time to BUY

CMP	**: Rs.96**
Reco	**: BUY**
Target	**: Rs.144**

STOCK INFO	
BSE	532526
NSE	DISHMAN
Bloomberg	DISH IN
Reuters	DISH.BO
Sector	Pharmaceutical
Face Value (Rs)	2
Equity Capital (Rs mn)	161
Mkt Cap (Rs mn)	7,728
52w H/L (Rs)	235/87
Avg Daily Vol (BSE+NSE)	178,502

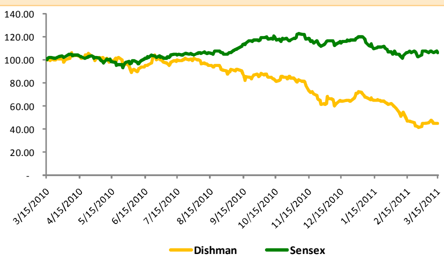
SHAREHOLDING PATTERN (as on 31st Dec. 2010)	%
Promoters	60.90
FIIs	8.64
DIIs	9.34
Public & Others	21.12

Source: BSE

STOCK PERFORMANCE (%)	1m	3m	12m
Dishman	-16	-31	-56
BSE SENSEX	2	-8	6

Source: IndiaNivesh Research

DISHMAN PHARMA v/s BSE SENSEX



Source: IndiaNivesh Research, Capitaline

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Investment Rationale

Revival in Global Economy: We believe that inventory de-stocking will get aligned with demand, after which innovators will start to outsource again.

Strong contracts pipeline would drive the growth: Dishman has many contracts in pipeline which are estimated to be worth Rs 7.5 billion. Currently it has won some contracts for phase III APIs & NCEs from Japanese MNCs which can be scaled up to Rs 2 billion.

Two HiPo facilities; additional boon: At full fledged operational stage HiPo facilities have the potential to contribute Rs 4 billion each. Additionally, the margins from HiPo facilities are expected to be 5% higher than normal.

CRAMS Business to move on slowly but steadily: From here onwards, slow but steady recovery is expected in CRAMS.

Disinfectant in pipeline & larger capacity will drive the growth of MM: we expect an incremental growth to come from its disinfectant unit, which is to commence from FY12 onwards. Hence this segment is expected to clock a revenue growth of 10% annually from FY12 to FY15

Vitamin D business is expected to remain on the track: In Q3 FY11, this unit reported a revenue growth of 29% y-o-y. Hence, we expect a conservative growth of 10% CAGR from FY12 to FY15 for Vitamin D business to be continued.

Technology would help to win the contracts: Dishman made an agreement with Codexis Inc for Enzymatic Biocatalyst Technology (Codexis Inc) in FY10: This technology reduces the cost of process by 50%. This would provide double benefit to the company: first, by winning more contracts on the benefit bases. Second, reduction in cost of material would lead to improvement in margins

Huge capex & availability of capacity: Availability of 60% capacity to provide services to its client, would provide good opportunity to win contracts in coming period.

Huge scope to improve the margins: We believe that going forward its Indian & Chinese HiPo facilities will assist the CA unit in Switzerland which provides a huge scope to improve margins.

Compelling valuations: Currently stock is trading in the lower band of PE 12.4x and 7.4x of FY12e and FY13e EPS estimate, which looks attractive compared to its historical five- year average forward PE of 15x.

Key Concern

Further delay in commencement of HiPo facilities *(poor execution)* is risk to our rating.

Leveraged balance sheet (D/E=1) may lead to liquidity crunch.

Valuation

The stock is trading at deep discount to its historical one year forward PE due to low confidence of the investor in stock linked with continuous muted performance on account of slowdown in CRAMS business. Commencement of new facilities and restructuring efforts in CA unit are expected to show the favorable results from first quarter of FY12 onwards. Increase in capacity utilization would improve the margin. Taking into account the weighted average of DCF value and 12x of FY13e earnings estimate, **we arrive at target price of Rs 144 and recommend BUY.**

Key Financials

	Sales (Rs mn)	EBITDA (Rs mn)	EBITDA %	PAT (Rs mn)	EPS (Rs.)	ROE %	P/E x	EV/EBITDA x	P/BV x
FY09	10,624	2,662	25.1	870	17.6	20.1	5.5	10.5	1.1
FY10	9,154	2,307	25.2	572	10.8	11.1	8.9	6.1	1.0
FY11e	9,012	1,911	21.2	966	2.8	2.7	33.8	7.0	0.9
FY12e	9,583	2,089	21.8	1,277	7.1	6.4	13.5	8.5	0.9
FY13e	10,507	2,574	24.5	1,722	12.0	9.9	8.0	7.8	0.8

Source: Company Filings; IndiaNivesh Research

Dishman operates its business under two business segments: contract research & contract manufacturing (CRAMS) and market molecule (MM). It's major revenue comes from CRAMS business (*contributed ~72% of net sales in FY10.)* while MM segment contributed ~28%. Under its MM segment company manufactures and sells specialty chemicals, intermediates and APIs, quatas, vitamins and chemicals, antiseptics and disinfectants.

Company has not performed since the time of global recession in 2008. In recent quarter, its margin shrunk to the bottom due to loss reported by Carbogen Amcis (CA) business linked with slowdown in CRAMS business and poor execution. The stock has corrected sharply *(more than 60%)* in last two years due to poor financials of Company, and currently it is trading at very cheap valuations. We believe that current market price does not truly reflect the intrinsic value of stock. On account of revival in CRAMS business and restructuring in its CA business, we expect a very conservative revenue growth in FY12 & FY13. However, we believe that restructuring efforts & commencement of HiPo facilities would bode well for its margins. *We are initiating coverage on the stock with strong BUY rating with a target price of Rs 144.*

Investment Rationale

Revival in global economy:

On account of recovery in the performance of pharma global, CRAMS business is expected to revive soon.

The global CRAMS business was estimated at $35- $40 billion at the end of FY10, out of which India accounted merely $1.2 billion. The global pharmaceutical companies spent ~18% of their sale on R&D, we believe that expiry of large number of drug patents *(almost $142 billion of drugs are likely to go off-patent globally in next five years)* would dry up the top-line of global pharma companies, which will lead to contraction in margin in coming periods. Hence to maintain their margin and profitability, these companies are more likely to outsource their R&D to the countries like India & China, which have low cost advantage & skilled labor.

The global leading pharmaceutical companies have shown revival in sale on the back of steady growth in demand of pharma products. Indian Pharma industry has clocked a healthy growth rate of 16%-17% in last 3-4 quarters and export of pharmaceutical drugs to USA, Europe, Russia, Latin America & other emerging countries has increased with a healthy rate of 18%-20% y-o-y. However, CRAMS industry is still waiting to show the signs of recovery. We believe that inventory de-stocking will get aligned with demand, after which innovators will start to outsource again.

Indian CRAMS industry has very bright future and is expected to clock 15-18% CAGR for next five years.

Strong contracts pipeline would drive the growth:

Dishman has a contracts pipeline of worth Rs 7.5 billion, which can be scaled up to Rs 16 billion.

Dishman has many contracts in pipeline which are estimated to be worth Rs 7.5 billion. Most of the projects are from US MNCs for the APIs & catalysts of minimum Rs 1 billion, which can be extended maximum up-to Rs3.9 billion. Contracts from Europe are of Rs 2.3 billion, which can be extended maximum up-to Rs 4.8 billion. Currently Dishman has won some contracts for phase III APIs & NCEs from Japanese MNCs which can be scaled up to Rs 2 billion.

Deals in pipeline:

Client	Projects	Minimum of Rs million
Europe	Mainly for API	1,584
Europe	Peptide intermediates	787
Japan	Intermediates & API	2,148
US MNCs	CRAMS	1,106
Other		1,875
Total		**7,500**

Source: Company Filings; IndiaNivesh Research

Two new customers from US *(pharma majors)* have selected Dishman as their preferred supplier. Company has total contracts of approximately Rs 7.5 billion in hand, which can be scaled up to Rs 16 billion.

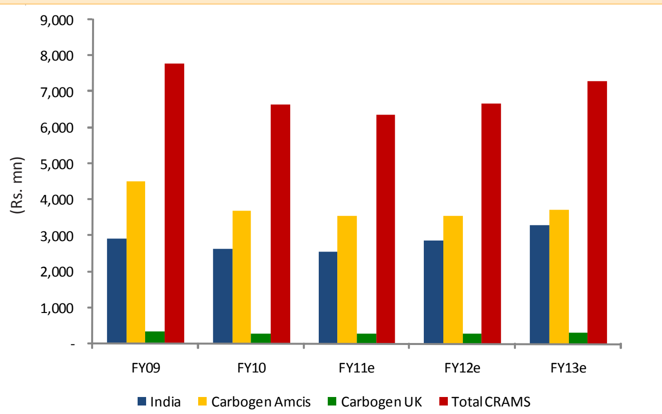
HIPO Facilities; additional boon:

At full fledged operational stage HiPo facilities have the potential to contribute Rs 4 billion each.

The world-wide market for high potency drugs alone is expected to reach $80 billion in FY12e. The commencement of company's HIPO (High Potency Unit) facility in India & China in second half of FY12 is expected to contribute ~Rs 200 million each to total revenue in FY12. These units are expected to contribute ~ Rs 400 million each in FY13e. At current stage HiPo facilities have phase I facilities but at very low infusion of capex to these units can be upgraded to phase II & Phase III. At full fledged operational stage these facilities have the potential to contribute Rs 4 billion each. Additionally, the margins from HiPo facilities are expected to be 5% higher than normal 25%.

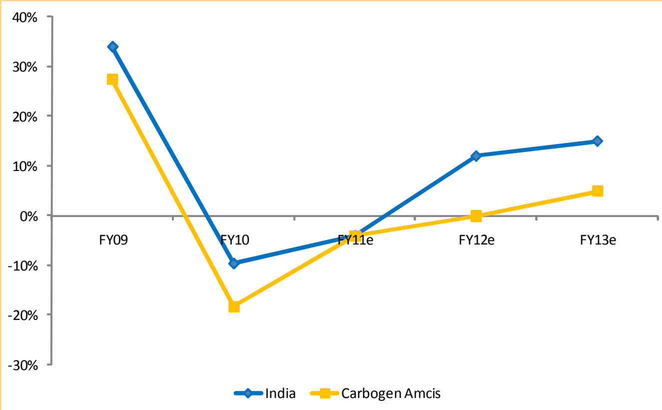
We believe that company has made a strategic move by establishing HiPo facility in China. This would provide services to its European clients and it would ease the working of Carbogen Amcis and help improving margins. Further we believe that establishing a facility in China will reduce the geographic risk for Dishman.

Segment wise Revenue Mix of CRAMS business:



Source: Company Filings; IndiaNivesh Research

CRAMS business growth (y-o-y):



Source: Company Filings; IndiaNivesh Research

CRAMS Business to move on; slowly but steadily

From here onwards, slow but steadily recovery is expected in CRAMS.

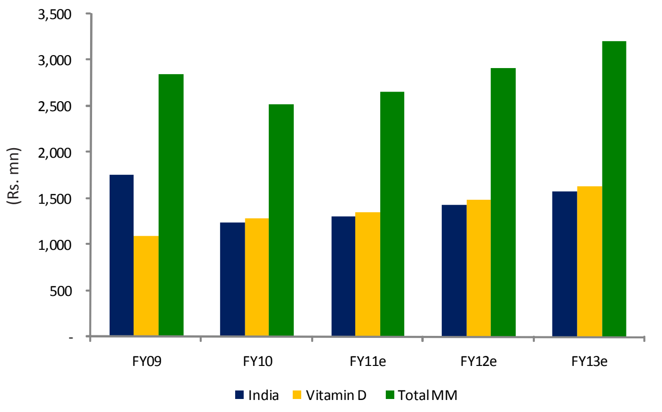
Despite there being revival in demand of pharma products in global market we expect a slow recovery in the CRAMS business. Company's Carbogen Amcis (CA) *(Switzerland)* business has not performed since the last two years due to slowdown in global recovery. In the recent quarter, CA reported net operating loss due to poor operating leverage linked with increase in fixed cost & lower realization in revenue. Dishman has taken requisite decision to restructure its business & reduce the headcounts from CA units. We believe that FY12 & FY13 would be the year of stabilization of its CA business and management is expected to focus more on its margins rather than revenue. In line with the same thought process, we expect almost flat revenue from CA business & 12% y-o-y growth from India CRAMS, in FY12. Considering the uncertainties in CRAMS in near term, we expect a conservative CAGR of 8.6% in total CRAMS business of Dishman from FY11 to FY15.

Disinfectant in pipeline & larger capacity will drive the growth of MM:

Incremental growth is expected to come from Disinfectant business.

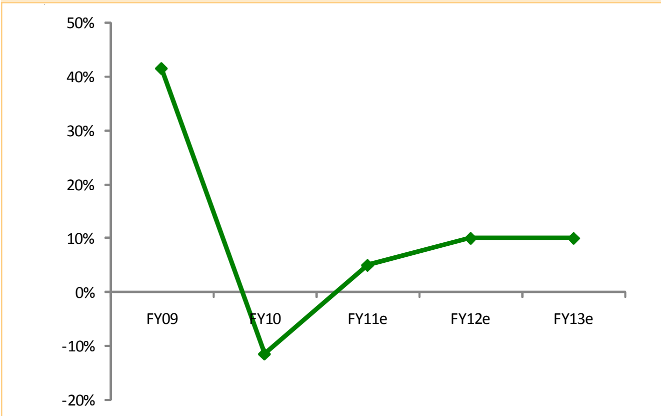
Dishman's MM business comprises of its legacy business Quant *(ammonium, phosphoranes & witting reagents)* in India, 25 APIs and 20 intermediates. We expect its base business in India to clock a growth of 4-5% annually. However at same time we expect an incremental growth to come from its disinfectant unit, which is to commence from FY12 onwards. This segment is expected to clock a revenue growth of 10% annually from FY12 to FY15.

Segment wise Revenue Mix of MM business:



Source: Company Filings; IndiaNivesh Research

MM business Growth



Source: Company Filings; IndiaNivesh Research

Vitamin D business is expected to grow with a conservative CAGR of 10% from FY12 to FY15.

Vitamin D business is expected to remain on the track:

Vitamin D business is likely to continued to clock a CAGR of 10% on the back of expansion of its operational unit in FY10. Despite there being a global slowdown, Vitamin D business has reported a growth of 17% y-o-y in FY10. In Q3 FY11, this has reported a revenue growth of 29% y-o-y. Hence, taking into account the expansion of its operational unit in FY10, a conservative growth of 10% CAGR from FY12 to FY15.

Dishman's agreement with Codexis Inc for Enzymatic Biocatalyst Technology would help to improve the margins.

Technology would help to win the contracts:

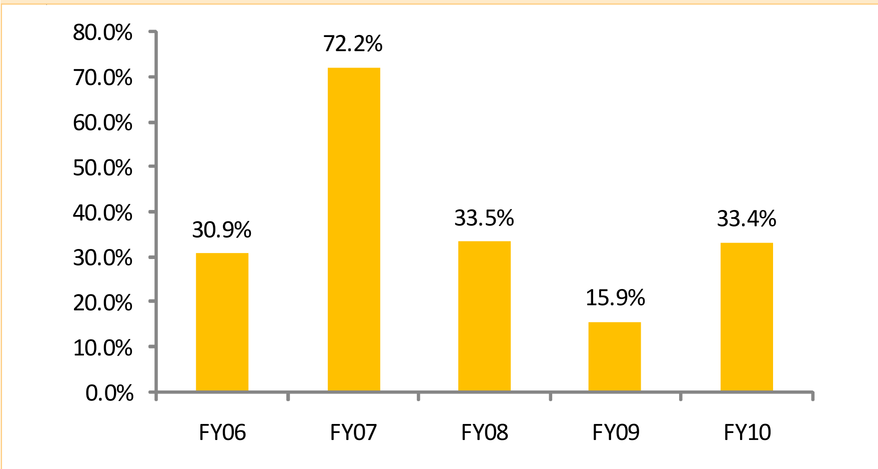
The CRAMS business is mainly driven by innovative technologies. Dishman made an agreement with Codexis Inc for Enzymatic Biocatalyst Technology in FY10: The technology reduces the cost of process by 50%. This would provide double benefit to the company: first, by winning more contracts on the benefit bases. As a result, already the company is working on two projects with its clients. Second, reduction in cost of material would lead to improvement in margins

60% availability of capacity would provide opportunities to win contracts.

Huge capex & availability of capacity:

Despite there being global slowdown in FY10, company had made a capex of ~Rs 3 billion to expand its capacity in India and China. In last five years it has made total capex of Rs 12.5 billion. This reflects company's confidence in its business and a long term revenue visibility. Company is currently working only at 40% capacity utilization and it has 60% capacity available to provide services to its client. Availability of large capacity will provide good opportunity to win contracts in coming period.

Capex % of Sale

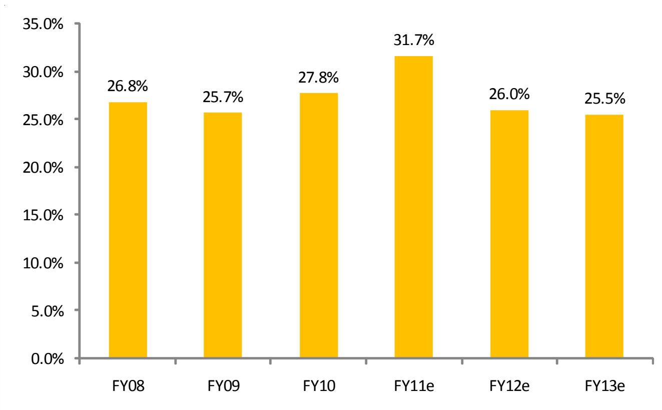


Source: Company Filings; IndiaNivesh Research

Huge scope to improve margins:

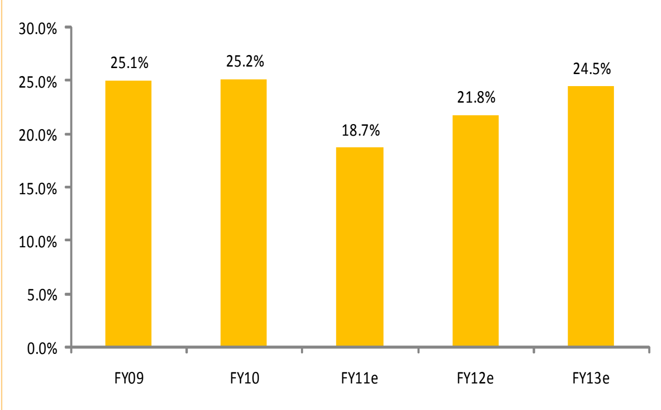
Company's employee cost is on the higher side than its peers. At present its employee cost constitutes ~30% to net sales compared to peers range from 7-9%. The higher employee cost is linked to its higher employee wages of Carbogen Amcis (Switzerland) unit. Dishman has ~1850 total employees, out of which ~80% employee are in India which accounts for 20% of total employee wages and remaining 20% employee *(outside of India)* accounts 80% of total employee wages. Currently, under its restructuring efforts, Dishman has plan to reduce its workforce by 60 employee in Switzerland CA unit, which would save ~CHF 8 million *(Rs 370 million)*.

Employee Expenses as% of Net Sales



Source: Company Filings; IndiaNivesh Research

EBITDA Margin



Source: Company Filings; IndiaNivesh Research

Higher capacity utilization and increasing contribution from India to assist its CA business; bode well on its margin.

Going forward, HiPo facility in China & India would provide the assistance to its CA operations. Which we believe would help the company in bringing down its employee expenses. However, we are not expecting any abrupt change in employee cost unless its HiPo facility starts contributing significantly to its top-line. Although, from next year onwards same positive impact could start occurring which in turn would lead to improvement in margins.

Additionally, we believe that company has significant presence in the European region as well as it has made a huge capex in India & China. In the coming period its strategy to win the contracts from Europe & than outsource it to India will bode well on its margins.

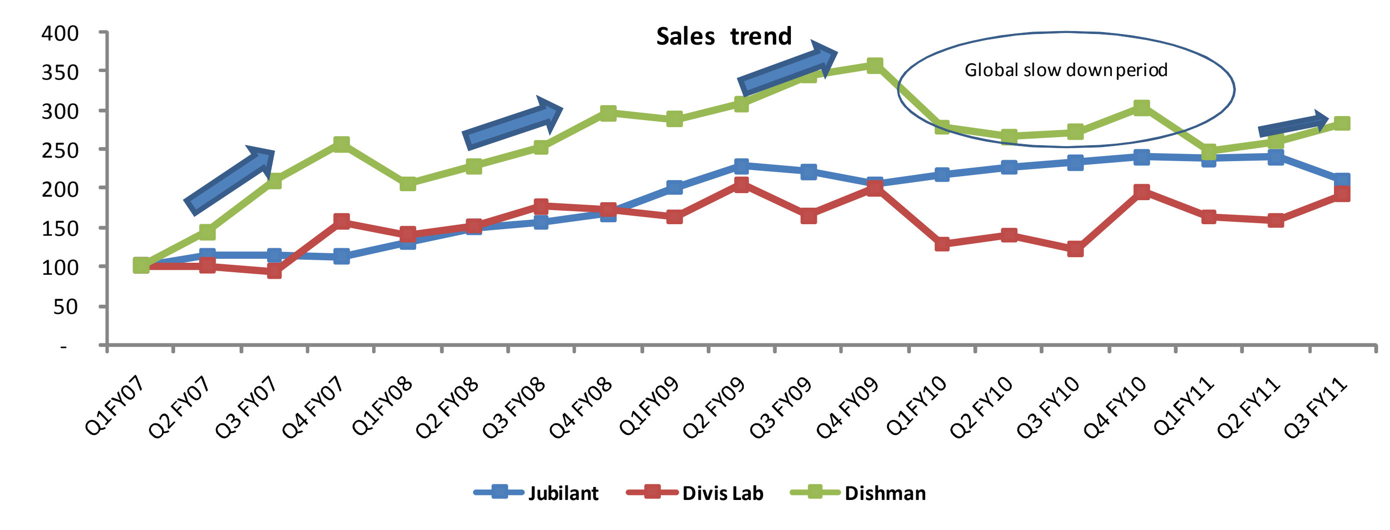
Compelling valuations:

All negatives are priced in...

Currently stock is trading in the lower band of PE 12.4x and 7.4x of FY12e and FY13e EPS estimate, which looks attractive compared to its historical five- year average forward PE of 15x. Additionally, considering the poor performance of company in last two years, we have forecasted the revenue growth very conservatively. Any positive news & scale up in revenue/margin could become a trigger for the stock. We believe all the negatives are factored in the current stock price.

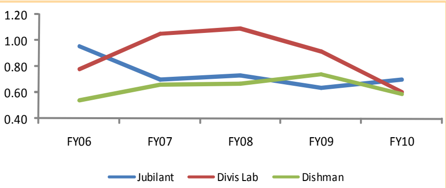
Financial Performance

Revenue Trend & Track; Dishman v/s Peers



Source: Company Filings; IndiaNivesh Research

Asset Turnover: (x)

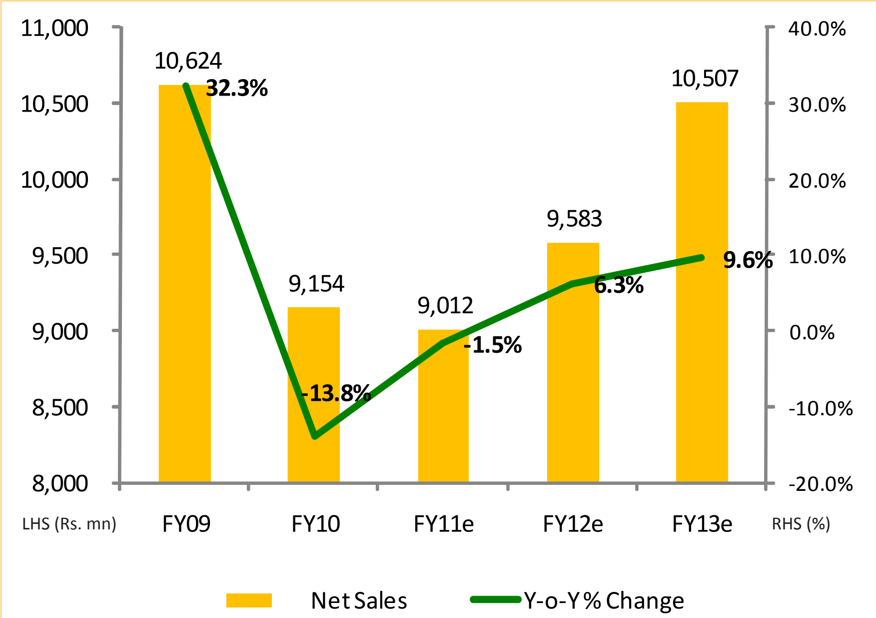


Source: Company Filings; IndiaNivesh Research

Dishman; Revenue trend & track:

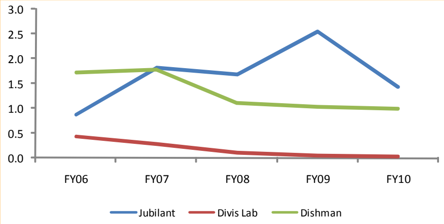
Dishman acquired Switzerland based Carbogen Amcis (CA) in August 2006 at $75 million. (*CA contributed 34% to total revenue in Q3FY11)*. After that its revenue growth in FY08 & FY09 was 57% y-o-y & 27% y-o-y respectively, and company as a whole reported revenue growth of 39% & 32% respectively. However, in FY10, CA's revenue declined by 18% y-o-y and company reported 14% y-o-y decline in revenue due to global slowdown & de-stocking of inventory by pharma majors which resulted in slowdown in CRAMs business in India. Consistent slowdown in CRAMS business, in last seven quarters, have taken back Dishman's topline in FY11 back to where it was in FY08. We expect a slow recovery in CRAMS business from FY12e onwards thereby leading to marginal revenue growth for Dishman.

Net Sales Growth



Source: Company Filings; IndiaNivesh Research

Debt to Equity: (x)



Source: Company Filings; IndiaNivesh Research

Over leveraged balance sheet:

The company had high debt to equity (1.73x in FY06 to 1x in FY10) ratio compared to peers. It had Rs 8.84 billion of debt on its balance sheet at the end of Dec 2010. Most of the debt (~80%) is in the form of ECB and effective interest rate is ~6.5%. Company has repayment obligations to the tune of approximately Rs 1billion annually. We believe that in short term, company may be in tight position to repay its debt from its internal accruals. But in the long term it has enough capabilities to generate the free cash flow to repay its debt.

	FY09	FY10	FY11e	FY12e	FY13e
Debt to Equity (x)	1.03	0.99	1.03	1.07	0.97
Net Debt to Capital (x)	0.51	0.50	0.51	0.52	0.49
Interest Coverage Ratio (x)	4.4	4.4	1.6	2.1	2.9

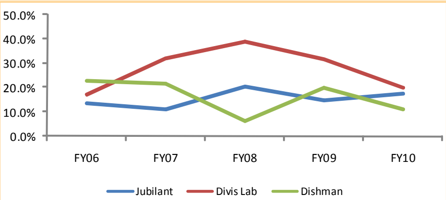
Source: Company Filings; IndiaNivesh Research

Revenue mix by operating segments:

Revenue (In Rs Million)		FY09	FY10	FY11e	FY12e	FY13e
Segment	**CRAMS**					
	India	2,935	2,654	2,548	2,854	3,282
	Carbogen Amcis	4,504	3,685	3,537	3,537	3,714
	Carbogen UK	334	290	276	276	303
	Total CRAMS	**7,774**	**6,629**	**6,361**	**6,667**	**7,300**
	MM					
	India	1,753	1,241	1,303	1,433	1,576
	Vitamin D	1,097	1,284	1,348	1,483	1,631
	Total MM	**2,850**	**2,524**	**2,650**	**2,915**	**3,207**
	TOTAL SALE	**10,624**	**9,154**	**9,012**	**9,583**	**10,507**
Y-o-Y	**Growth**					
	CRAMS					
	India	34%	-10%	-4.0%	12.0%	15.0%
	Carbogen Amcis	27%	-18%	-4.0%	0.0%	5.0%
	Carbogen UK	16%	-13%	-5.0%	0.0%	10.0%
	Total CRAMS	29%	-15%	-4.0%	4.8%	9.5%
	MM					
	India	3%	-29%	5.0%	10.0%	10.0%
	Vitamin D	251%	17%	5.0%	10.0%	10.0%
	Total MM	**41%**	**-11%**	**5.0%**	**10.0%**	**10.0%**
	TOTAL SALE	**32%**	**-14%**	**-1.5%**	**6.3%**	**9.6%**
Contribution						
	CRAMS					
	India	28%	29%	28%	30%	31%
	Carbogen Amcis	42%	40%	39%	37%	35%
	Carbogen UK	3%	3%	3%	3%	3%
	Total CRAMS	**73%**	**72%**	**70.6%**	**69.6%**	**69.5%**
	MM					
	India	16%	14%	14%	15%	15%
	Vitamin D	10%	14%	15%	15%	16%
	Total MM	**27%**	**28%**	**29%**	**30%**	**31%**
	TOTAL SALE	**100%**	**100%**	**100%**	**100%**	**100%**

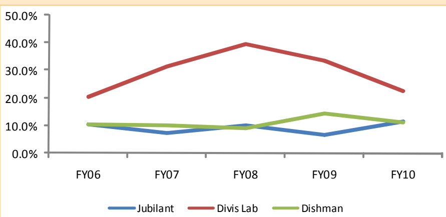
Source: Company Filings; IndiaNivesh Research

Return on Equity (ROE):



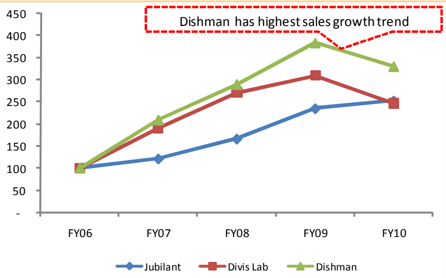
Source: Company Filings; IndiaNivesh Research

Return on Capital Employed (ROCE):



Source: Company Filings; IndiaNivesh Research

Sales Trend; Dishman v/s Peers



Source: Company Filings; IndiaNivesh Research

Recent Performance:

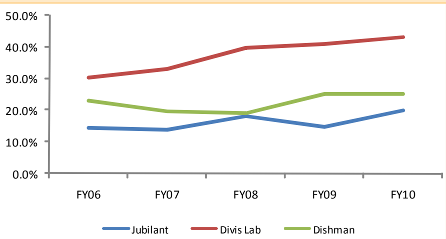
In 9 M FY11, company's net sale declined 3% y-o-y to Rs 6.46 billion due to 6% decline in revenue from CRAMS business on account of a setbacks in its CA business and a delay in CRAMS projects partially offset by 4.5% revenue growth in MM business. EBITDA declined 19.6% y-o-y to Rs1.44 billion and Operating margin was down by 540 bps y-o-y to 14.5% due to increase in material cost, employee cost & other expenditure linked with poor execution and low margin contracts in CA business.

In Q3 FY11, Dishman reported net sale of Rs 2.32 billion, up 4.3% y-o-y. Lower growth in revenue was due to muted performance in CRAMS business linked with poor execution. Its EBITDA margin declined 1093 bps y-o-y to 13.6% due increase in material cost, employee cost & other expenditure linked with muted performance of Carbogen Amcis unit.

Savings of Rs 370 million annually by reducing employment cost and at the same time assistance from China & Indian facilities will bring back CA business to its previous levels.

Carbogen Amics unit *(Contributes ~ 50% to total CRAMS business)* has reported almost flat revenue in Q3 FY11, although at EBITDA level, it reported net loss of Rs 30.4 million due to poor execution & low margin contracts. Since the past two years CA has been under pressure since the global recession due to a credit crunch with customer, as a result company lost few contracts as well. However, recently company has made changes in top management of Carbogen Amcis. Also, it is in process to restructure its employee base, which would save ~ Rs 370 million annually. Further we believe that employer friendly law in Switzerland will ease the restructuring process.

EBITDA Margin:



Source: Company Filings; IndiaNivesh Research

Q3 FY11 Cons

Particulars (Rs Mn except EPS)	Q3 FY11	Q3 FY10	Y-o-Y	Q2 FY11	Q-o-Q	FY 10
Net Sales	2,318	2,223	*4.3%*	2,128	*8.9%*	9,154
Other Operating Income	61	32		203		269
Total Income	**2,379**	**2,255**	*5.5%*	**2,330**	*2.1%*	**9,423**
Total Expenditure	**2,064**	**1,710**	***20.7%***	1,759	***17.4%***	**7,115**
EBITDA	**315**	**545**	*-42.2%*	**572**	*-45.0%*	**2,308**
Depreciation & Ammortization	171	141	*121.5%*	168	*19.6%*	594
EBIT	**144**	**404**	*-64.4%*	**404**	*180.8%*	**1,714**
Interest Expenses/ (income)	133	85	*56.4%*	95	*39.7%*	388
Pre-tax Profit	**10**	**319**	*-96.8%*	**308**	*-96.6%*	**1,326**
Tax	(7)	(6)	*11.1%*	14	*-152.1%*	150
Net Profit (Recurring)	**17**	**325**	*-94.7%*	**295**	*-94.1%*	**1,176**
Provision for Income Tax	1	4	*NM*	-	*NM*	20
Extraordinary Items			*NM*	12	*NM*	(17)
Net Profit (Reported)	**18**	**330**	*-95%*	**307**	*-94.1%*	**1,179**
Adj EPS	0.2	4.1	*-95%*	3.8	*-94.1%*	14.6
Adj O/ Share (In Million)	81	81	*0%*	81	*0.0%*	81

Ratios	Q3FY11	Q3FY10	Bps	Q2FY11	Bps	FY10
EBITDA margin	13.6%	24.5%	*(1,093)*	26.9%	*(1,330)*	25.2%
Net Margin	0.8%	14.6%	*(1,388)*	13.8%	*(1,310)*	12.9%
Material cost/Net Sales	36.0%	18.8%	*1,724*	27.5%	*849*	25.3%
Purchage of finished goods/ Net sales	5.2%	7.6%	*(245)*	2.6%	*256*	4.1%
Employee Cost/ Net Sales	31.4%	30.4%	*100*	32.6%	*(115)*	27.8%
Other Expenditure/ Net Slaes	21.5%	19.9%	*155*	22.0%	*(54)*	19.7%
Tax Rate	-68.2%	-2.0%	*(6,624)*	4.4%	*(7,263)*	11.3%

Source: Company Filings; IndiaNivesh Research

Industry Analysis

CRAMS

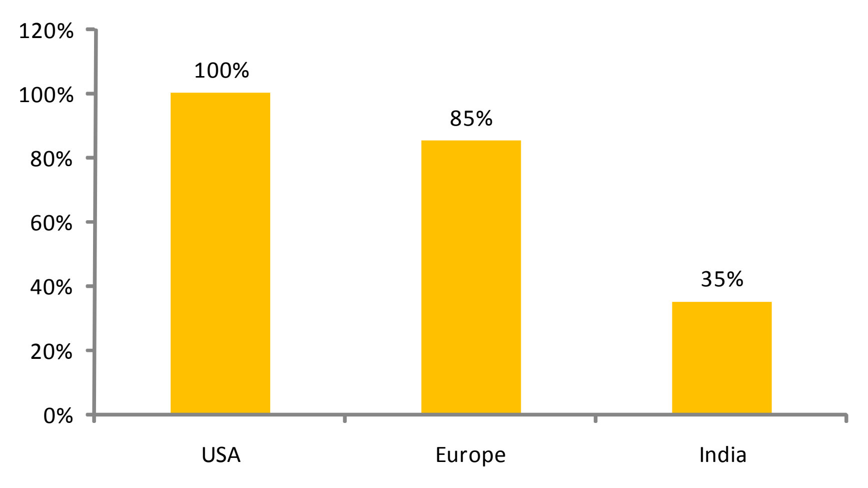
The contract research and contract manufacture (CRAMs) services are organization that provides research and support to the pharmaceuticals industry in the form of outsourced pharmaceutical research services. These organizations offer their clients the experience of moving a new drug from its conception to USFDA or other regulatory approvals to market.

Opportunities in CRAMS in India:

The opportunity for CRAMS in India is very large. The US companies spent ~18% of their sale *($55 billion)* into R&D in 2008. These companies are outsourcing their R&D mainly to reduce their operating cost. As a result, the developing countries like India and China are good destination for outsourcing. In the year 2010, world market for CRAMS was approximately $35-$40 billion, while India contributed merely ~ $1.2 billion. Lower employee wages, skilled labor and well equipped facilities are advantage that will help India to grab the opportunity in the global market.

CRAMS…Huge opportunities to capture……Indian companies are building their capacities to win

Cost advantage to India compared to western countries :



Source: www.ibef.com

Despite there being huge opportunities, the CRAMS business is still not up-to the mark in India. There are mainly two reasons for this:

First, global leaders need considerable capacity at a single unit to outsource formulations. For example, if a company out sources ten formulations to ten plants in India, all ten will require inspections by several country regulatory agencies and it is considerably expensive and risky. As global leaders' requirements are huge, outsourcing capacity available for such companies is inadequate at a single point. This is the reason that the Industry has been investing heavily on capital expenditure in the last few years in augmenting their capacities.

Second, India has earned an uncanny reputation of being "master in copy cat version of drugs." Hence, India's ability to challenge the patents in USFDA is threat to some global companies. For example, any company which is outsourcing its molecule research to India and if that molecule get patent by USFDA for marketing, than the Indian outsourced company has all the information which is required to develop copy cat version of original molecule. Hence, researcher company can come up easily with the generic version of original molecule. Although, the Indian patent protection amendment act 2005 has provide a great relief to MNCs and huge opportunity to Indian research companies.

Despite there being slowdown, some of Indian companies, engaged in CRAMS business, like Jubilant, Divis Lab and Dishman Pharma had invested ~ Rs 40 billion together, in last five years to expend their capacity. *(See table & graph below)*

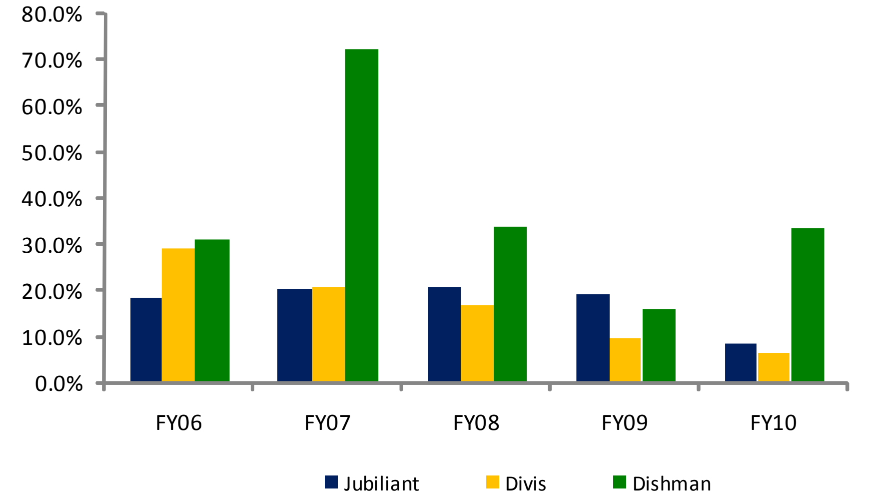
Capex by CRAMs companies:

Capex (Rs Mn)	FY 06	FY07	FY08	FY09	FY10	Total
Jubilant	2,736	3,674	5,135	6,678	3,075	21,297
Divis Lab	1,108	1,503	1,711	1,104	602	6,028
Dishman	858	4,178	2,692	1,685	3,058	12,471
Total	**4,703**	**9,355**	**9,537**	**9,467**	**6,735**	39,796

Source: Capital line; IndiaNivesh Research

Among these, Jubilant is on the top with total capex of Rs 21.3 billion from FY06 to FY10. But Dishman has higher capex as % of its sales:

Capex as % of Sales



Source: Company Filings; IndiaNivesh Research

Outlook

On the back of favorable & positive outlook of CRAMS in India, Dishman is expected to clock CAGR 9% from FY11 to FY15.

The CRAMS business is all set to revive after a forgettable year, on the back of destocking in inventories by global pharma, rationalizing in R&D pipeline and M&A. The global CRAMS business is expected to grow with 4-5% CAGR for next five years. In the global market, major pharma players have high competition in price, hence to protect their margins these companies would continue to outsource their research and manufacturing of APIs. India being efficient on cost front is a good destination to attract the major contracts for at least next five years. In FY12, company is expected to invest Rs 500 million to manufacture a new facility in India, while another Rs 500 million will be maintenance capex. The company's management is expecting a almost flat revenue in FY11 and a growth of 15% y-o-y in FY12. While conservatively, we expect that company's revenue to be Rs 9.01billion and Rs 9.58 billion with de-growth of 1.5% y-o-y in FY11 & growth of 6.3% in FY12. Further, we assume a growth of 9.6% in FY13.

Improvement in adj. EBITDA margin by 470 bps & 270 bps y-o-y to reach at 21.8% & 24.5% level in FY12 and FY13 respectively.

Due to lower capacity utilization, poor execution & loss from CA business, its adj EBITDA margin is expected to shrink to 17.1% in FY11. However, on back of restructuring in CA business, in FY12 & FY13, we expect improvement in adj. EBITDA margin by 470 bps & 270 bps y-o-y to reach at 21.8% & 24.5% level respectively. We expect, company to report adj EPS of Rs 7.1 and Rs 12 in FY12 and FY13 respectively.

Valuation

DCF valuation methodology to value Dishman

We have followed the two phases DCF model. In first phase from FY11e to FY15e we have considered the stabilization period of business and taken revenue CAGR of merely 9%. EBITDA is expected to stabilize at 25.5% in FY15 and average EBITDA to be at 22.5%. In Second Phase, from FY16e to FY20e, we have normalized the revenue growth to 13% in FY16e to 11% in FY20e. Considering the growth in revenue & operating leverage we have estimated EBITDA margin at 26%. We assumed long term growth of 4% *(calculated on the bases of internal growth of company, assuming 70% payout ratio),* WACC 10.3% and five year average beta 0.6883 and arrived at intrinsic value of Rs 144 at the end of FY12.

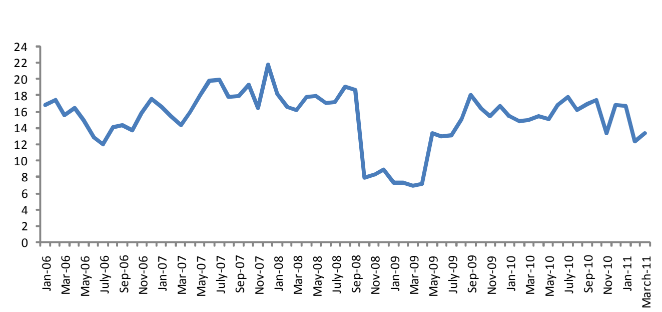
Sum of PV	7,305
Terminal value	11,623
Total Value	18,928
Total Debt	8,739
Intrinsic value	10,189
No of Share	81
Value per share (At the end of FY11)	*126*
Value per share (At the end of FY12)	***144***

Source: Company Filings; IndiaNivesh Research

Assumption:	
Rm	17.0%
Rf	8.0%
Risk Premium	9.0%
Beta	0.69
Tax Rate	16.0%
Interest Rate	7.5%
WACC	10.3%
Long Term Growth	4.0%

Source: Company Filings; IndiaNivesh Research

Forward P/E



Source: Company Filings; IndiaNivesh Research

Forward EV/EBITDA

Source: Company Filings; IndiaNivesh Research

	5-Years		2- Years	
	PE(x)	**EV/EBITDA(x)**	**PE(x)**	**EV/EBITDA(x)**
Max	21.7	18.1	18.0	12.4
Min	6.9	6.5	6.9	6.5
Average	15.2	12.4	14.2	10.0

Source: Company Filings; IndiaNivesh Research

Average PE methodology to value Dishman

The stock has been trading at average forward PER of 15x & average forward EV/ EBITDA 12.4x in the last five years with max 21.7x & 18.1x and lowest 6.9x & 6.5x respectively. At current market price Rs 96,the stock is trading at PER 12x & 7.2x of FY12 & FY13 EPS estimates respectively, which looks attractive. We are valuing the stock at Rs 144 (12x of FY13 EPS estimates). We believe that at the end of FY12, valuations of stock will factor in the earnings estimate of FY13, which is likely to trade at higher price.

Recommendation:

As we mentioned earlier that our valuation is based on a very conservative method. Company is more likely to perform as per our estimates in FY12, However, positive surprises may be recorded on revenue front as well as on margin fronts, which will provide further space to rerate the stock. **We recommend BUY with target price of Rs 144 by valuing the stock on the weighted average methods of DCF valuation and average PE trend.** ***(given in table).***

	Price	Weightage	Value
DCF method	144	50%	72
Average PE	144	50%	72
Target Price			**144**

Source: Company Filings; IndiaNivesh Research

Key Concerns

Poor execution can further erode the shareholder value:

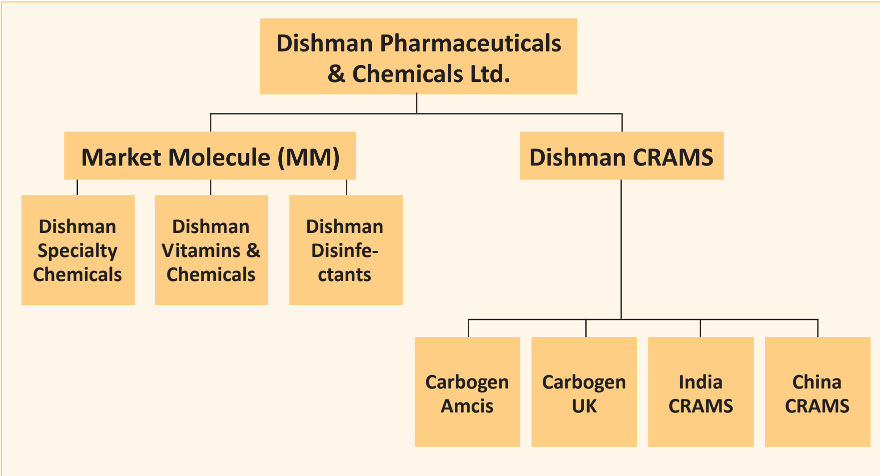
Company has performed poorly on execution part in the last two years. Management has not met their guidelines. Further, restructuring process in its CA unit may lower down confidence of remaining employee which may lead to lower revenue realization and hit the margins negatively. Additionally, company was expected to commence HiPo facility *(already delay by 2 quarters)* in second half of FY11 which now is expected to commence in second half of FY12. Further delay in the process can downgrade our rating.

Leveraged balance sheet may lead to liquidity crunch:

At the end of Dec-2010, the Company had net debt of Rs 8.84 billion on its balance sheet & Rs 540 million of cash. (D/E= 1.02) Company is expected to make a capex of Rs 1 billion in FY12. As in last recent quarter its CA business reported adj net operating loss of Rs 30 million. Hence, poor performance may lead to poor cash generation which may lead to liquidity crunch. Already it has high debt to equity ratio as compared to its peers.

Business Description

Dishman Pharmaceuticals & Chemicals Ltd (DPCL) is an Ahmedabad (India) based company involved in the CRAMS business (Contract Research & Manufacturing Services) and manufacturing of active pharmaceuticals ingredients (API). The company was established in 1983 and listed to BSE and NSE in 2004. Currently, company has its manufacturing sites globally, like Europe (4) India (2) China, Saudi Arabia etc. The company operates its business under two business segments: contract research & contract manufacturing (CRAMS) and market molecule (MM). It's major revenue comes from CRAMS business (*contributed ~72% of net sales in FY10.)* while MM segment contributed ~ 28%. Under its MM segment company manufactures and sales specialty chemicals, intermediates and APIs, quatas, vitamins and chemicals, antiseptics and disinfectants.



Source: Company Filings; IndiaNivesh Research

(1) Market Molecules:

(A) Dishman Specialty Chemicals (DSC):

The company's DSC business unit manufactures and supply quaternary compounds (Quats) like: ammonium and phosphorus Quats, phosphoranes and witting reagents. These products are used as phase transfer catalysts, personal care ingredients, fine chemicals, pharma intermediates and disinfectants. DSC business unit also manufactures and sells APIs and intermediates. Currently, DSC offers approximately 25 APIs for generic & ethical pharma products, while it's another 11 APIs are in development stage. Further, DSC unit is in development stage to DMFs (Drug Master Files), for advanced intermediates and final APIs. The facility for unit is located in Naroda, India, which got US-FDA approval in 2010.This unit contributed 14% to total revenue in FY10.

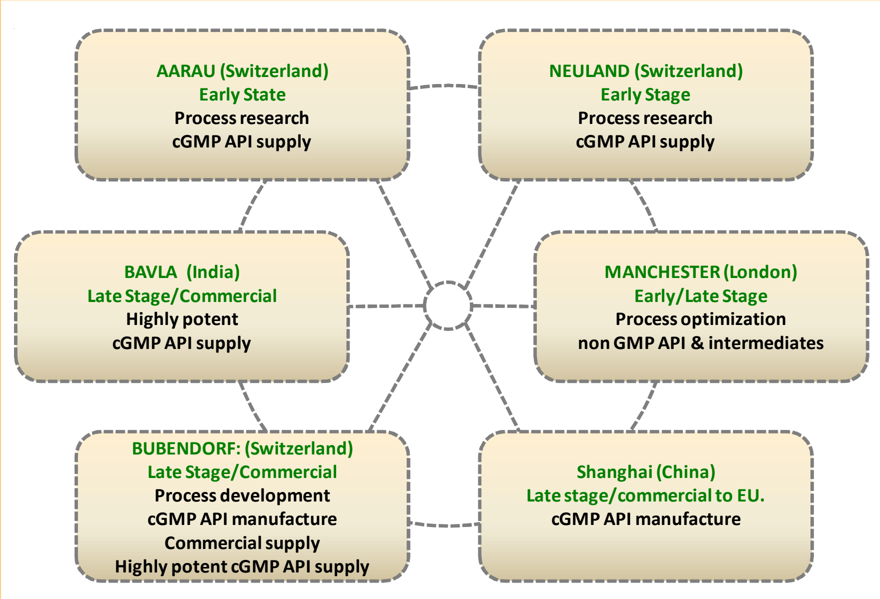
(B) Dishman Vitamins & Chemicals (DVC):

Dishman Pharma acquired its DVC unit in the year 2007, in Neatherland. This unit manufactures and sells cholesterol & Vitamin D products. The unit is involved in making intermediates for cosmetics *(Cholesterol NF & HP, Dusoran MD, Dusogel*) & technical uses *(Lanolin alcohol etc*). The unit had reported revenue increment from Euro 15 million in 2007 to Euro19 million (~Rs 1.28 billion) and contributed 15% to total revenue in 2010.

(C) Dishman Disinfectants:

In the process of expansion of its business, company has established a new wholly owned subsidiary Dishman Care Limited, which would offer a range of antiseptics and disinfectants. It would be commercialized in FY12. The unit would cater its products to hospitals, hotels and other communities through tender process or it may supply its products through agents. We have not added any significant revenue from this business in our model in the coming period.

(2) CRAMS:



Source: Company Filings; IndiaNivesh Research

(A) Carbogen Amcis(CA)(Switzerlands):

The company acquired CA business in the year 2006. The key business segment CA, provides drug development and commercialization services to various other pharmaceutical & bio-pharmaceutical companies. The segment is also involved in providing contract chemical process research and supply of active pharmaceutical ingredients (APIs) for preclinical studies, clinical trials and commercial use. It also develops and sells highly potent APIs. It contributed 40% to total revenue in FY10.

The CA Switzerland unit operates its operations under three manufacturing units namely

Aarau (Switzerland): This facility is primarily focused on early phase API supply, chromatography and product handling. It has ~100 employees.

Hunzenschwil (Neuland), (Switzerland): the increasing demand at its Aarau site, led to Neuland facility. Currently it has ~100 employees.

Bubendorf (Switzerland): The facility is mainly engaged in process optimization and synthesis of late phase and commercial API supplies. Currently, it has ~150 employees.

(B) Carbogen UK:

Manchester (England): This facility is engaged in research and custom synthesis for early phase APIs and intermediates. Currently, it has ~ 25 employees. This unit contributed 3% to total revenue in FY10.

(C) CRAMS India:

Bavla (India): This segment has contributed 29% to total revenue in FY10. CA had established its high potency unit (HIPO) in India in 2010 for late stage and high potent substances. (The facility caters to cytotoxic and non cytotoxic highly active substances). The commercialization of unit is expected to commence in second half of FY12.

(D) CRAMS China:

Shanghai (China): The company has established a new unit in Shanghai China in 2010. Its commercialization would begin second half of FY12. This facility is established for the synthesis of late phase and commercial supply of APIs. This unit will assist to CA business and contracts.

Cosolidated Financial Statements

Income statement

Y E March (Rs m)	FY09	FY10	FY11e	FY12e	FY13e
Net sales	10,624	9,154	9,012	9,583	10,507
Growth %	*32.3%*	*-13.8%*	*-1.5%*	*6.3%*	*9.6%*
Expenditure					
Raw Material	2,669	2,318	2,629	2,779	2,837
Finished goods	521	380	318	287	315
Employee cost	2,730	2,541	2,852	2,491	2,679
Other expenses	2,038	1,808	1,892	1,936	2,101
EBITDA	**2,662**	**2,307**	**1,911**	**2,089**	**2,574**
Growth %	*72.6%*	*-13.3%*	*-17.2%*	*9.3%*	*23.2%*
EBITDA Margin %	***24.6%***	***22.3%***	***17.1%***	***21.8%***	***24.5%***
Deprecaition	629	594	672	827	843
EBIT	2,033	1,713	1,239	1,262	1,731
EBIT Margin %	*14.8%*	*14.5%*	*7.4%*	*7.1%*	*10.9%*
Other Income	48	269	368	-	-
Interest	459	388	568	581	581
PBT	1,575	1,325	671	681	1,150
Tax	111	169	74	109	184
Effective tax rate %	7.0%	12.8%	11.0%	16.0%	16.0%
Extraordinary items	-1.2	17.2	0	0	0
Minority Interest					
Adjusted PAT	**1,417**	**870**	**229**	**572**	**966**
Growth%	*278.8%*	*-38.6%*	*-73.6%*	*149.7%*	*68.7%*
PAT margin %	***13.3%***	***9.5%***	***2.5%***	***6.0%***	***9.2%***
Reported PAT	1,464	1,156	597	572	966
Growth%	*22.2%*	*-21.0%*	*-48.4%*	*-4.1%*	*68.7%*

Source: Company; IndiaNivesh Research

Balance sheet

Y E March (Rs m)	FY09	FY10	FY11e	FY12e	FY13e
Share Capital	161	161	161	161	161
Reserves & Surplus	6,883	7,681	8,251	8,766	9,635
Net Worth	**7,044**	**7,843**	**8,412**	**8,927**	**9,797**
Secured Loans	6,643	7,169	8,169	8,369	8,369
Unsecured Loans	594	571	571	571	571
Total Debt	**7,237**	**7,739**	**8,739**	**8,939**	**8,939**
Net defered tax liability					
Total Liabilities	**14,281**	**15,582**	**17,151**	**17,867**	**18,736**
Gross Block	9,734	10,910	13,956	15,616	16,531
Less Depreciation	1,953	2,481	3,153	3,980	4,823
Net Block	**7,781**	**8,430**	**10,803**	**11,637**	**11,708**
Capital Work in Progress	2,227	3,574	1,430	536	357
Investments	14	14	14	14	14
Current Assets					
Inventories	3,040	2,424	3,457	3,807	4,174
Sundry Debtors	1,494	1,131	2,222	2,625	2,879
Cash & Bank Balance	452	455	280	298	619
Loans & advances	1,517	1,871	1,352	1,437	1,576
Current Liabilities & provisions					
Current Liabilities	1,687	1,744	1,729	1,788	1,854
Provisions	348	256	360	383	420
Net Current Assets	**4,467**	**3,880**	**5,221**	**5,996**	**6,973**
Total assets	**14,281**	**15,582**	**17,152**	**17,867**	**18,736**

Source: Company; IndiaNivesh Research

Cash flow

Y E March (Rs m)	FY09	FY10	FY11e	FY12e	FY13e
PBT	**1,575**	**1,325**	**671**	**681**	**1,150**
Depreciation	629	594	672	827	843
Interest	459	388	568	581	581
Other non cash charges					
Changes in working capital	(106)	466	(1,515)	(758)	(655)
Tax	(203)	(39)	(74)	(109)	(184)
Cash flow fromoperations	**1,318**	**3,022**	**396**	**1,331**	**1,919**
Capital expenditure	(1,685)	(3,058)	(901)	(767)	(735)
Free Cash Flow	**(368)**	**(36)**	**(505)**	**565**	**1,183**
Other income					
Investments	9				
Cash flow from investments	**(1,676)**	**(2,949)**	**(901)**	**(767)**	**(735)**
Equity capital raised	-	-	-	-	-
Loans availed or (repaid)	1,260	526	1,000	200	-
Interest paid	(555)	(518)	(568)	(581)	(581)
Dividend paid (incl tax)	(81)	(97)	(28)	(57)	(97)
Inc from other investments					
Cash flow from Financing	**439**	**(70)**	**331**	**(547)**	**(862)**
Net change in cash	**81**	**3**	**(175)**	**18**	**322**
Cash at the beginning of the yr.	371	452	455	280	298
Cash at the end of the year	**452**	**455**	**280**	**298**	**619**

Source: Company; IndiaNivesh Research

Key ratios

Y E March	FY09	FY10	FY11e	FY12e	FY13e
EPS (Rs)	17.6	10.8	2.8	7.1	12.0
Cash EPS (Rs)	18.1	37.4	4.9	16.5	23.8
DPS (Rs)	1.0	1.2	0.3	0.7	1.2
BVPS	87	97	104	111	121
ROCE	14.2%	11.0%	7.2%	7.1%	9.2%
ROE	20.1%	11.1%	2.7%	6.4%	9.9%
EBITDA Margin %	24.6%	22.3%	17.1%	21.8%	24.5%
Net Margin %	13.3%	9.5%	2.5%	6.0%	9.2%
PER (x)	5.5	8.9	33.8	13.5	8.0
P/BV (x)	1.1	1.0	0.9	0.9	0.8
P/CEPS (x)	5.9	2.6	19.6	5.8	4.0
EV/EBITDA (x)	10.5	6.09	7.02	8.48	7.76
Dividend Yield %	1.0%	1.2%	0.4%	0.7%	1.2%
m cap/sales (x)	0.7	0.8	0.9	0.8	0.7
net debt/equity (x)	1.0	1.0	1.0	1.0	0.9
net debt/ebitda (x)	2.7	3.4	4.6	4.3	3.5

Source: Company; IndiaNivesh Research

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Disclosure of Interest Statement		
1.	Analyst ownership of the stock	No
2.	Group/Directors ownership of the stock	Yes
3.	Broking relationship with company covered	No
4.	Investment Banking relationship with company covered	No

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