

Dishman Pharma & Chemicals Ltd.

DOLAT CAPITAL

CMP: Rs 225

Target Price: Rs 240

Pharmaceuticals / Reduce

Dishman has registered 20% degrowth in revenues despite resuming normally in Eprosartan (EM) supplies to Solvay. This was primarily due to slowdown in Carbogen's contract research business and lower QUAT sales. The company has undertaken restructuring initiatives at Carbogen and anticipates deceleration in contract research revenues til Q2FY11E with US based mid size pharma companies going slow on early stage projects. The management has lowered FY10E PAT guidance to Rs.1.25-1.3bn (earlier 1.4bn) while it has retained 20% revenue growth for FY11E. Ramp up in supplies to Solvay, alongwith increased contribution from Non-Solvay contracts (Nippon, Novartis etc.) will be the key growth drivers for FY11E.

The current macro environment has proved challenging for CRAMS players. We anticipate Dishman to regain its growth momentum with the base business gaining scalability and higher operating efficiencies at Carbogen Amcis. Possibility of signing additional CRAMS contracts remains a latent trigger. We maintain our 'Reduce' rating on the stock with a revised price target of Rs.240 (12x FY11E FDEPS).

Q3FY10 Result (Consolidated)

| Particulars (Rs.mn) | Q3FY10 | Q3FY09 | YoY % | 9MFY10 | 9MFY09 | YoY % |
|---------------------------------|---------------|---------------|--------------|---------------|---------------|--------------|
| Net Sales | 2223.0 | 2819.6 | -21.2 | 6674.4 | 7698.5 | -13.3 |
| Other Operating Income | 31.8 | 1.9 | | 245.5 | 41.3 | |
| Income from Operations | 2254.8 | 2821.5 | -20.1 | 6919.9 | 7739.8 | -10.6 |
| Other Income | 0.0 | 0.0 | | 0.0 | 59.2 | |
| Total Income | 2254.8 | 2821.5 | -20.1 | 6919.9 | 7799.0 | -11.3 |
| Total Expenditure | 1729.7 | 2102.3 | -17.7 | 5356.9 | 5819.8 | -8.0 |
| PBIDT | 525.1 | 719.3 | -27.0 | 1563.1 | 1979.1 | -21.0 |
| PBIDTM-% | 23.3% | 25.5% | | 22.6% | 24.8% | |
| Interest | 85.3 | 100.9 | -15.5 | 287.6 | 280.7 | 2.5 |
| Depreciation | 140.7 | 170.0 | -17.2 | 459.5 | 453.7 | 1.3 |
| PBT | 299.1 | 448.4 | -33.3 | 816.0 | 1244.8 | -34.4 |
| Tax | -6.3 | 99.8 | -106.4 | 75.5 | 114.8 | -34.2 |
| Profit After Tax | 305.5 | 348.5 | -12.4 | 740.5 | 1130.0 | -34.5 |
| Prior Period Items & Provisions | -5.5 | 1.8 | | 3.7 | 4.4 | |
| Adj. Profit After Tax | 311.0 | 346.8 | -10.3 | 736.9 | 1125.6 | -34.5 |
| Forex (gain)/loss | -19.8 | -48.9 | | -225.3 | 425.5 | |
| Profit After Tax | 330.8 | 395.7 | -16.4 | 962.2 | 700.1 | 37.4 |

| Segment Breakup:- (Rs.mn) | Q3FY10 | Q3FY09 | YoY | 9MFY10 | 9MFY09 | YoY |
|-----------------------------|---------------|---------------|--------------|---------------|---------------|--------------|
| Revenues:- | 2223.0 | 2819.6 | -21.2 | 6674.4 | 7698.5 | -13.3 |
| CRAMS | 1607.2 | 1903.6 | -15.6 | 4907.4 | 5661.3 | -13.3 |
| Marketable Molecules | 615.8 | 916.1 | -32.8 | 1767.0 | 2037.3 | -13.3 |

Financial Highlights

- Carbogen Amcis (CA) revenues during Q3FY10 degrew by 41% YoY to Rs.669.5mn. This was due to slowdown in Carbogen's contract research revenues with its US clients (~50% of revenues) postponing drug discovery programmes. EBITDA margins have declined to ~10% and it anticipates an operating loss of CHF2m in Q4FY11E on the back of inventory valuation and ongoing restructuring initiatives.
- It's Vitamin business contributed Rs.288.7mn to the topline during the quarter (Rs.284.2mn in Q3FY09) with operating margins of ~20%. The Quats business registered a degrowth of 48% YoY at Rs.327mn due to closure of Naroda facility (till Feb'10) in order to prepare for FDA inspection.
- Operating margins declined by 220bps YoY at 23.3% led by higher employee costs (+520bps YoY) while raw material costs declined by 690bps YoY at 26.2% of sales.
- The company reported tax write back of Rs.6.3mn during the quarter. Adj.PAT excluding forex gain of Rs.19.8mn (gain of Rs.48.9mn - Q3FY09) degrew by 10.3% to Rs.311mn.

Key Updates

- Eprosartan Mesylate (EM) supplies to Solvay have resumed normalcy in Sep'09 and despatches are expected to accelerate in the subsequent quarters. Revenue contribution from Solvay during the quarter stood at Rs.390mn. The management confirmed contracts for three new products (including Fenofibrate) which will generate incremental revenues beginning FY11E.
- Restructuring initiatives undertaken at Carbogen includes change in top management and layoff of 50ppl (workforce of ~380ppl). This will consequently result in cost savings of CHF8mn and improvement in margins during FY11E to ~16%. The company anticipates slowdown in Carbogens revenue to last till June'10. It has lowered its FY10E revenue guidance to CHF 80-85mn (earlier CHF110mn) and estimates ~CHF 90mn revenues during FY11E.
- Dishman has commissioned high potency Oncology API facility located at Bavla site. It has incurred capital investment of Rs.~\$20mn and is currently negotiating with Big Pharma companies for supply based contracts.
- Dishman has inaugurated its new Vitamin-D Analogue facility at Veenendaal (Netherlands) during Nov'09 with capital outlay of Rs.350mn. Consequently, it is now the only company globally having manufacturing capability for more than 7 Vitamin-D Analogues.
- The company plans to set up 4 new API plants entailing spend of Rs 1.25bn. The board has recently approved NCD issuance upto Rs.750mn. The new plants are expected to be fully operational by FY11E.
- The Chinese plant is built as per USFDA standards and is undergoing validation process. It is expected to start production by Q1FY11E.
- Guidance: Dishman has guided revenues of Rs.9.5bn - 10bn for FY10E and has lowered its PAT guidance to 1.25bn-1.3bn (earlier 1.4bn). The management however maintains 20% revenue growth for FY11E. Ramp up in supplies to Solvay, alongwith increased contribution from Non Solvay Contracts (Nippon, Novartis, Takeda etc.) will be the key growth drivers for FY11E.
- Dishman expects to incur Rs.1.25bn-1.5bn of capex during FY11E.

Revised Estimates

| Particulars (Rs.mn) | REVISED* | | EARLIER | | CHANGE % | |
|----------------------------------|----------|---------|---------|---------|----------|-------|
| | FY10E | FY11E | FY10E | FY11E | FY10E | FY11E |
| Net Sales/Income from Operations | 9721.7 | 11950.8 | 10719.5 | 13082.3 | -9.3% | -8.6% |
| EBITDA | 2342.9 | 2987.7 | 2631.6 | 3270.6 | -11.0% | -8.6% |
| Adj.Net Profit | 1221.5 | 1628.4 | 1315.2 | 1705.0 | -7.1% | -4.5% |

* Slowdown in Contract Research revenues at Carbogen, and lower interest costs.

Valuations

The current macro environment has proved challenging for CRAMS players. We anticipate Dishman to regain its growth momentum with the base business gaining scalability and higher operating efficiencies at Carbogen Amcis. Possibility of signing additional CRAMS contracts remains a latent trigger. At CMP of Rs.225, the stock trades at 15x FY10E and 11.2x FY11E earnings. **We maintain our 'Reduce' rating on the stock with a revised price target of Rs.240 (12x FY11E FDEPS).**

Financials

| Year | Net Sales | % growth | EBIDTA | OPM % | Adj.PAT* | % growth | FDEPS(Rs.) | % growth | PER (x) | ROANW% | ROACE% |
|-------|-----------|----------|--------|-------|----------|----------|------------|----------|---------|--------|--------|
| FY08 | 8,044 | 36.0 | 1,542 | 19.2 | 818 | 0.6 | 10.1 | 0.6 | 22.4 | 27.3 | 10.9 |
| FY09 | 10,671 | 32.7 | 2,662 | 24.9 | 1,462 | 78.6 | 18.0 | 78.6 | 12.5 | 23.1 | 15.2 |
| FY10E | 9,722 | -8.9 | 2,343 | 24.1 | 1,222 | -16.4 | 15.0 | -16.4 | 15.0 | 16.2 | 11.7 |
| FY11E | 11,951 | 22.9 | 2,988 | 25.0 | 1,628 | 33.3 | 20.0 | 33.3 | 11.2 | 18.5 | 13.9 |

Figure in Rs mn, * Excl. forex exceptional items



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The ratings are based on the absolute upside of our target price from the current price.

Upside

> 25 %
15% - 25%
0% - 15%
< 0 %

Ratings

Buy
Accumulate
Reduce
Sell

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