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CMP Rs. 222

Dishman Pharma –2QFY07 Results Review

ACQUISITION GAINS

OUTPERFORMER

Dishman Pharmaceuticals & Chemicals (DPCL) has reported excellent results for 2QFY07. On a consolidated basis, net sales for the quarter grew by 71%, operating profit improved by 44% and net profit was up by 24%. The operating margin declined by 390 bps from 25.0% to 21.1% due to the lower margin of the acquired business of Carbogen Amcis. DPCL has received 'In-Principle' approval from Central Government for setting up a SEZ at Bavla to focus on pharma and engineering sectors. The company is likely to enter into JV with MNC pharma companies for manufacturing in the SEZ area. Two of the Carbogen Amcis customer's oncology molecules have cleared Phase III clinical trials and provide good opportunity for contract manufacturing.

Strong CRAMS sales

- For 2QFY07, on a consolidated basis, DPCL has reported 71% YoY growth in net sales from Rs. 684 million to Rs. 1170 million. Moreover, it has received Rs. 1 million from the share of income from the associate company.
- On a standalone basis, the CRAMS sales grew by 26% from Rs. 277 million to Rs. 350 million. The sales of Marketable Molecules (MM) grew marginally by 2% from Rs. 251 million to Rs. 256 million. The CRAMS business contributed about 58% whereas the MM contributed 42% to the standalone revenues during the quarter.
- **During the quarter, the contribution from Solvay was Rs. 220 million.** Other CRAMS contributed Rs.180 million and contract Research contributed Rs. 50 million. The MM contributed Rs. 280 million to the 2QFY07 revenues. **The recently acquired Carbogen Amcis contributed Rs. 520 million (for 40 days) during the quarter.**

Operating Margin Declined

- **On a consolidated basis, DPCL's operating profit for 2QFY07 was up by 44% from Rs. 171 million to Rs. 247 million. However, the operating margin declined by 390 bps from 25.0% to 21.1% mainly due to the increase in personnel cost.**

Valuations

PARTICULARS	FY05	FY06	FY07E	FY08E
EPS Rs.	4.7	7.4	10.3	16.4
P/E	47.2	30.0	21.6	13.5

- For 2QFY07, on consolidated basis, DPCL's material cost increased by 90 bps from 44.5% to 45.4% of net sales due to the change in product mix and delay in the dispatches of Solvay intermediates. DPCL's personnel cost went up by 410 bps from 10.9% to 15.0% of net sales due to additional salaries of high cost Carbogen Amcis employees. The company has also made leave accumulation provision for 6 months for its Indian employees during the quarter. Other expenses declined by 100 bps from 19.6% to 18.6% of net sales mainly due to the improvement in operational efficiency and strong sales growth.
- During the quarter, a fire broke off in the raw material warehouse at Bawla due to short circuit. The company has provided Rs. 33.0 million for the probable loss of raw materials, net of insurance claims for the quarter.

- The PBIT for CRAMS business declined by 520 bps from 33.4% to 28.2% mainly due to increase in personnel cost and other expenses. The PBIT for marketable molecules had a steep fall of 700 bps from 26.2% to 19.2% due to rise in prices of crude based chemicals. **As a result, the overall PBIT declined by 550 bps from 29.9% to 24.4%.**

Higher other income

- DPCL's other income grew by 48% from Rs. 28 million to Rs. 42 million mainly due to the exchange gain.

Quarterly Results-Consolidated

PARTICULARS	2Q07	2Q06	%	6-MONTHS ENDED		%	FY06
(in Rs. Million)	SEPT.06	SEPT.05	CHANGE	SEPT.06	SEPT.05	CHANGE	MAR.06
Net Sales	1170	684	71.0	1992	1294	53.9	2774
share of Income of associates	1	0	NA	1	0	NA	39
Total op. income	1170	684	71.1	1993	1294	54.0	2813
Total expenses	924	513	80.2	1544	1009	53.0	2129
as % of op. income	78.9%	75.0%		77.5%	77.9%		75.7%
Raw & Pkg Materials	1637	380	331.3	2071	679	204.8	1476
(Inc.)/Dec. in stock	-1107	-75	NA	-1187	-88	NA	-208
Personnel Expenses	175	74	135.1	274	159	72.5	343
Other expenses	218	134	62.7	386	259	49.0	517
Operating Profit	247	171.27	43.9	449	285	57.4	684
as % of op. income	21.1%	25.0%		22.5%	22.1%		24.3%
Other Income	42	28	48.2	76	56	35.2	40
EBIDTA	288	199	44.5	525	341	53.8	724
as % of op. income	24.6%	29.1%		26.3%	26.4%		25.7%
Interest	38	24	57.3	46	41	12.1	60
Depn. & amortisation	41	25	66.0	76	49	53.5	122
PBT	209	150	39.0	403	251	60.7	542
Prov. for Tax-current	39	12	216.7	46	19	147.2	32
Prov. for Tax-deferred	2	2	NA	2	1	NA	1
Prov. for FBT/prior period	0	0	NA	0	0	NA	2
Tax rate as % of PBT	19.5%	9.6%		12.2%	8.2%		6.3%
PAT	168	136	23.8	354	230	53.8	508
Equity Capital	138	137	0.7	138	137	0.7	137
EPS Rs.(Annualised) (Rs. 2/- pd.up)	9.8	7.9	22.9	10.3	6.7	52.7	7.4

Sharp rise in interest cost

- DPCL's interest cost went up by 57% from Rs. 24 million to Rs. 38 million due to the additional borrowing for Carbogen Amcis acquisition and increase in working capital. The company's depreciation increased by 66% from Rs. 25 million to Rs. 41 million due to the additional depreciation of Carbogen Amcis.

Improvement in Net Profit

- For 2QFY07, on consolidated basis, DPCL's net profit grew by 24% from Rs. 136 million to Rs. 168 million due to the improvement in operating profit and higher other income.

SEZ

- Dishman Infrastructure, a company promoted by DPCL has received 'In Principle' approval from Central Government for setting up one Pharma & Fine Chemicals' SEZ and an other engineering SEZ at Bawla near Ahmedabad, spread over 200 acres of area. The pharma units will focus on the manufacture of Intermediates, API and CRAMS. **The total investment for both SEZs is around Rs. 6.5 billion spread over next 3-5 years.**
- **The SEZ funding will be mainly through debt/equity and self- financing model** i.e. through advances received from JV and franchisees. DPCL is likely to invest 5-10% in the equity capital.
- The Government has cleared only one engineering SEZ of DPCL in Gujarat till date. Currently, there is a good demand for engineering SEZ in Gujarat due to good export demand of brass fittings, pumps for the construction industry.
- The company's Bavla unit is a 100% EOU. The benefits of Sect 10B will be available up to 31.3.09 and hence in order to have tax advantage after FY09, DPCL has planned its own SEZ. DPCL will be utilizing about 50-60% of pharma SEEZ facility for captive use. **The SEZ benefits will be available up to 2019.**
- DPCL will share the cost of the common utilities like captive power, water, steam, compressed air, nitrogen, effluent treatment etc. with other SEZs.
- **Many MNC pharma companies from US and Europe have shown interest to establish their manufacturing units in a low cost and tax friendly base like pharma SEZ in India.** DPCL is likely to enter into JV with MNC pharma companies for the operation and management of manufacturing activities in India.
- **DPCL will involve other real estate developers/real estate funds to provide equity support.**

Carbogen Amcis-recent developments

- Carbogen Amcis's (CA) customer's two oncology molecules have cleared Phase III clinical trials and the customers are likely to file for market authorization over the next one year. There is a possibility of contract manufacturing on long- term basis. CA is likely to undertake a capex of $ 8 million (Rs. 360 million).
- **CA has reported revenues of Rs. 520 million and net profit of Rs. 60 million during the quarter. It is likely to grow at 25-30% in the current year.**
- CA is currently involved in the development of 6 molecules, which are undergoing Phase III clinical trials. At least 2-3 of these molecules are likely to clear Phase III clinical trials. The commercialization of any of these molecules will result in substantial revenue growth for CA.
- The operating margin of CA is likely to improve due to the sourcing of its raw materials and intermediate requirements from India or China and integration of its operations. The integration of CA with DPCL is completed. The CA order book is full till 2006.
- DPCL has raised $ 60 million (Rs.2.75 billion) loan from ICICI and Rabo Bank for CA acquisition. This loan is without any pre-payment penalty charges. The company has converted part of the loan in CA books as follows: $ 40 million in CHF currency at fixed interest rate of 4.3% and $ 12.5 million in Euro at fixed interest rate of 5.6%. Since a major portion of this loan will be in CHF, the company will be insulated from the currency fluctuations.

Other Developments

- DPCL is expanding its intermediate and API facilities at Bawla. The company is setting up one intermediate and 3 additional API facilities. The company has recently signed a contract with Ferro Corporation of US for the supply of electronic Quats. DPCL has also developed disinfectant Quats for Ecolabs of US. Both these are likely to result in long-term supply arrangements.
- DPCL has a strong order book of $ 4 million (Rs. 180 million) from Astra Zeneca, GSK, Merck, Nippon Gosai and Johnson & Johnson.
- Solvay has indicated 50% increase in off take of Eprosartan Mesylate for FY07. DPCL expects Solvay business to exceed by Rs. 1.0 billion in FY07.

Financials

- On a consolidated basis, we expect DPCL to report sales growth of 140% for FY07 (due to acquisition of CA) and 34% for FY08.
- We expect CA to contribute sales of CHF 82 million (Rs. 3.1 billion) in FY07 and CHF 120 million (Rs. 4.5 billion) in FY08. CA has carry forward loss of CHF 40 million (Rs.1.50 billion). This has to be set off against the future profits up to 2008.
- We expect operating margin to drop from 24.4% in FY06 to 23.0% in FY07 as CA has lower margins than DPCL. We expect the operating margin to improve to 24.3% in FY08 due to the benefits of synergy from CA and integration of businesses.
- We expect net profit to improve from Rs. 508 million in FY06 to Rs. 832 million in FY07 and further improve to Rs. 1330 in FY08.
- The management has given a guidance of minimum 30% top line growth for next 3 years. This does not include acquisitions.
- The CMP of Rs. 222 discounts the FY07E EPS of Rs. 10.3 by 21.6x and FY08E EPS of Rs. 16.4 by 13.5x. We expect the scrip to be **Market Outperformer**.

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