Company Focus

7 March 2008 | 7 pages

Dishman Pharmaceuticals & Chemicals (DISH.BO)

Target price change ☑
Estimate change ☑

Buy: Robust Prospects

- **Maintain Buy; trim TP to Rs354** — We maintain Buy (1M) albeit with a lower target price of Rs354/share (vs. Rs372 earlier) as we cut estimates for FY08E-10E by 5-23% on the back of a worse than expected impact of a strong INR on Dishman's margins in 9MFY08. We continue to be positive on Dishman's business model notwithstanding the soft performance in 9MFY08.
- **Soft 9MFY08 performance** — was partly due to the strong INR leading to a worse than expected impact on margins & some postponement of sales in 3QFY08. Moreover, Dishman continues to invest to build businesses in Japan and Middle East markets – though both these remain in nascent stages. All the above factors contributed towards the soft 9MFY08 performance.
- **Pricing Power exists but comes with a lag** — Dishman had taken c5% price increase in 3Q for some of its key products in order to mitigate some of the losses due to the appreciating INR. We note that the price increases will come with a lag. However, this indicates that Dishman has pricing power with its customers and is resilient to currency pressures over the longer term.
- **Potential Catalysts** — 1) Increased supplies for Solvay. Dishman has put up a facility 3x its current size for Solvay. 2) A potential acquisition. 3) The commencement of the China facility for Quats. 4) Progress on the initiatives in Japan and Middle East.

Buy/Medium Risk	**1M**
Price (05 Mar 08)	Rs295.05
Target price	Rs354.00
from Rs372.00	
Expected share price return	20.0%
Expected dividend yield	0.6%
Expected total return	**20.6%**
Market Cap	Rs23,212M
	US$577M

Price Performance (RIC: DISH.BO, BB: DISH IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	522	6.46	57.2	45.7	10.8	31.3	0.2
2007A	928	11.47	77.7	25.7	6.8	36.8	0.3
2008E	903	11.16	-2.7	26.4	4.9	23.1	0.4
2009E	1,506	18.61	66.7	15.9	3.6	26.6	0.6
2010E	1,693	20.93	12.5	14.1	2.9	22.8	0.7

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	45.7	25.7	26.4	15.9	14.1
EV/EBITDA adjusted (x)	38.4	23.3	18.8	12.6	10.3
P/BV (x)	10.8	6.8	4.9	3.6	2.9
Dividend yield (%)	0.2	0.3	0.4	0.6	0.7
Per Share Data (Rs)					
EPS adjusted	6.46	11.47	11.16	18.61	20.93
EPS reported	6.46	11.34	11.16	18.61	20.93
BVPS	27.30	43.42	60.56	82.37	100.85
DPS	0.70	1.00	1.17	1.86	2.09
Profit & Loss (RsM)					
Net sales	2,774	5,786	7,917	10,145	11,860
Operating expenses	-2,248	-4,896	-6,801	-8,333	-9,664
EBIT	**526**	**889**	**1,116**	**1,812**	**2,197**
Net interest expense	-102	-189	-293	-323	-250
Non-operating/exceptionals	135	260	143	153	181
Pre-tax profit	**559**	**960**	**966**	**1,642**	**2,127**
Tax	-31	-32	-58	-131	-425
Extraord./Min.Int./Pref.div.	-5	-11	-5	-5	-8
Reported net income	**522**	**917**	**903**	**1,506**	**1,693**
Adjusted earnings	522	928	903	1,506	1,693
Adjusted EBITDA	647	1,153	1,526	2,262	2,672
Growth Rates (%)					
Sales	48.8	108.5	36.8	28.1	16.9
EBIT adjusted	24.9	69.0	25.5	62.4	21.2
EBITDA adjusted	28.3	78.2	32.4	48.3	18.1
EPS adjusted	57.2	77.7	-2.7	66.7	12.5
Cash Flow (RsM)					
Operating cash flow	**166**	**461**	**115**	**836**	**2,713**
Depreciation/amortization	121	263	410	450	475
Net working capital	-456	-835	-1,572	-1,527	216
Investing cash flow	**-817**	**-4,176**	**-1,015**	**-695**	**-615**
Capital expenditure	-832	-1,010	-750	-400	-400
Acquisitions/disposals	0	-3,150	0	0	0
Financing cash flow	**1,923**	**2,752**	**1,104**	**-426**	**-2,248**
Borrowings	2,064	2,777	513	-921	-2,050
Dividends paid	-34	-55	-106	-176	-198
Change in cash	**1,272**	**-962**	**205**	**-285**	**-150**
Balance Sheet (RsM)					
Total assets	**5,944**	**11,594**	**14,196**	**15,866**	**15,997**
Cash & cash equivalent	1,352	355	560	275	124
Accounts receivable	863	1,252	1,979	2,536	2,965
Net fixed assets	2,124	6,030	6,370	6,320	6,245
Total liabilities	**4,070**	**8,425**	**9,528**	**9,192**	**7,821**
Accounts payable	473	656	1,188	1,522	1,779
Total Debt	3,255	5,609	6,123	5,202	3,152
Shareholders' funds	**1,874**	**3,169**	**4,668**	**6,673**	**8,177**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	23.3	19.9	19.3	22.3	22.5
ROE adjusted	31.3	36.8	23.1	26.6	22.8
ROIC adjusted	15.1	13.8	11.1	14.9	14.6
Net debt to equity	101.5	165.8	119.2	73.8	37.0
Total debt to capital	63.5	63.9	56.7	43.8	27.8

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Robust Prospects

We maintain Buy (1M) albeit with a lower target price of Rs354/share (vs. Rs372 earlier) as we cut estimates for FY08E-10E by 5-23% on the back of a worse than expected impact of a strong INR on Dishman's margins in 9MFY08. We continue to be positive on Dishman's business model notwithstanding the soft performance in 9MFY08 and believe that Dishman is most leveraged to the innovator CRAMS opportunity.

Trimming estimates on soft 9MFY08

Dishman reported a soft 9MFY08 performance partly due to the strong INR (worst than expected impact on margins) and some postponement of sales in 3QFY08. Moreover, Dishman continues to invest to build businesses in Japan and Middle East markets – though both these remain in nascent stages. All the above factors contributed towards the soft performance in 9MFY08. Consequently we cut our FY08-FY10 estimates by 5-23% and our target price to Rs354/share (Rs372 earlier). We maintain our Buy rating on the stock as we believe Dishman will be a key player in the attractive innovator CRAMS opportunity.

Figure 1. 9M FY08 Performance(Rs m,)

	9M FY07	9M FY08	Ch YoY
Sales	3,727	5,612	51%
EBITDA	945	1,078	14%
EBITDA Margin	25.3%	19.2%	-614 bps
Recurring Net Income	598	615.6	3%
Reported net Income (including MTM gains on forex loans)	598	814.6	36%

Source: Citi Investment Research

Figure 2. Earnings Revision (Rs m)

	FY08E	FY09E	FY10E
Revenue			
Old	8,473	10,509	12,575
New	7,917	10,145	11,860
Variation	-7%	-3%	-6%
Reported Net Income			
Old	1,168	1,585	1,815
New	903	1,506	1,693
Variation	-22.7%	-5%	-6.7%

Source: CIR estimates

Maintain Buy, Medium Risk

We continue to be positive on Dishman's prospects in the innovator CRAMS.

Pricing Power exists but comes with a lag

Dishman had taken c5% price increase in 3Q for some of its key products in order to mitigate some of the losses due to the appreciating INR. We note that the price increases will come with a lag. However, this indicates that Dishman has pricing power with its customers and is resilient to currency pressures over the longer term. Most of Dishman's engagements with customers are long term in nature (more than 3 years) and as such customers are also interested in Dishman's financial well being over the longer term to sustain its supplies.

Potential Catalysts

- **Increased supplies for Solvay** – We note Dishman has put up a facility 3x its current size for Solvay. We believe this could be for increased supplies for Eprosartan Maleate and also for another phase III molecule (SLV 306, Daglutril) from Solvay's pipeline.
- **A potential acquisition** – Dishman has been open to acquisitions and may be looking at various companies. We are positive on reasonably priced acquisitions that add new customer relationships or technological capabilities in line with the earlier acquisitions like Carbogen Amcis and the Vitamins Business of Solvay.

Dishman Pharmaceuticals & Chemicals

Company description

Dishman commenced operations in 1989 as a Quats manufacturer and has since transformed itself to focus on intermediates/ API manufacturing – with a specific focus on innovator CRAMS. Dishman ventured into CRAMS with a contract to manufacture eprosartan mesylate for Solvay for the European market. Since then, Dishman has entered into contracts with various other pharma companies including GSK, AstraZeneca and Nippon Gosai. In 2006, Dishman acquired Carbogen Amcis from Solutia. With this, Dishman has the complete CRAMS basket for innovator pharma companies from building blocks to the commercialization stage.

Investment strategy

We have a Buy/Medium Risk (1M) rating on Dishman. We believe that Dishman is the Indian pharma company most leveraged to the innovator CRAMS opportunity – especially post the acquisition of Carbogen Amcis – with c78% of its revenues coming from this segment. Over the past two years, Dishman has grown in scale as well as diversified its customer and revenue bases. With synergies from the Carbogen Amcis acquisition expected to play out over the next 1-2 years and with rapid growth in its Indian business, we expect Dishman to report a 22% CAGR in earnings over FY07-10E.

Valuation

Given that Pharma is a growth sector, we use P/E as our primary method to value the base business of every company. At the same time, since many pharma companies have some unique opportunities that could play out, we ascribe a separate value for these. For Dishman, we use a target P/E multiple of 19x, which is at a 5% discount to our target multiple for Nicholas Piramal, which is the leader in the innovator CRAMS segment. We believe that a 5% discount is justified given Dishman's relatively smaller size as well as the smaller pipeline but higher exposure to CRAMS.

In its limited trading history of less than 4 years, Dishman has traded in a band of 13-26x 1-year forward earnings. Our target multiple of 19x is within this band and in line with the median/average multiple of 19x. Using a 19x multiple on FY09E FDEPS, we arrive at a target price of Rs354/share.

Risks

We rate Dishman shares Medium Risk, based on our quantitative risk-rating system, which tracks 260-day historical share price volatility.

Regulatory risks - Delays in the execution of various contracts due to delays in regulatory approvals or any adverse outcome at the customer end could impact Dishman's revenues and profitability, especially given that Dishman has to build the facilities upfront. Generally, the time lag between entering into a contract and commencement of revenues is around 2-3 years.

Lumpy business - CRAMS revenues tend to be lumpy across quarters and hence the quarterly performance of the company might be volatile.

These risks could impede the stock from achieving our price target.

Appendix A-1

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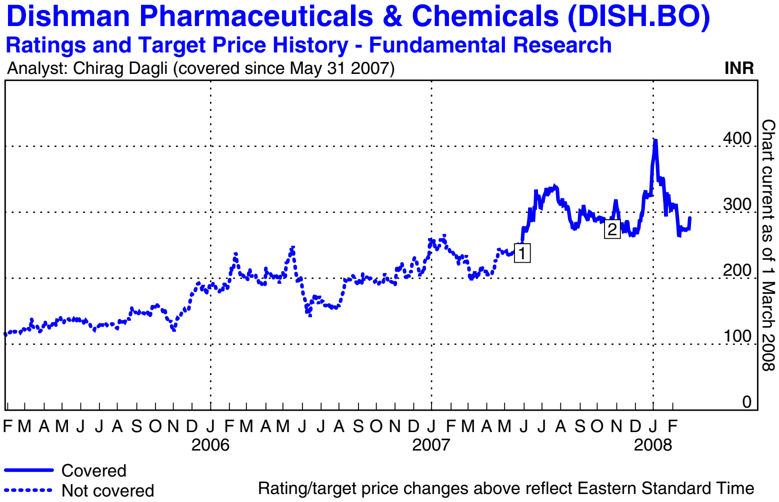

#	Date	Rating	Target Price	Closing Price
1:	30 May 07	1M	313.00	258.00
2:	25 Oct 07	1M	*372.00	287.00

*Indicates change.

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