

Equities

13 November 2011 | 9 pages

Dishman Pharmaceuticals & Chemicals (DISH.BO)

Mixed Bag

- Mixed Bag** — Rising input costs & inferior product mix offset benefits of a pickup in revenues & recurring PAT missed our estimate by c9%. While growth trends are encouraging, profitability is yet to improve to the same extent. At 5xFY13E, valuations are attractive - if the company is able to sustain growth & improve profitability, there would be good scope for a re-rating.
- Growth Encouraging** — Revenues at Rs2.7bn were higher than expected (Rs2.5bn). Growth (+27% YoY) was driven by the Marketable Molecules (MM) biz (+93% YoY - Benzethonium supplies led) & Carbogen Amcis (CA) (+12%YoY, +42%QoQ). Overall, the CRAMS biz registered single digit growth (+5% YoY, +6% QoQ), with the India based biz staying muted.
- EBITDA margin improves but less than expected** — Sharp increase in input costs (RM/sales: +1,063 bps YoY, +563 QoQ) & an inferior product mix (high growth in MM) were offset by lower staff cost (-3% QoQ, CA restructuring benefit) & other expenses (excl forex) – leading to higher EBITDA margin (17.6%, +152 bps YoY). This was however lower than our expectation of 20%. Recurring net income (+26% YoY) was c9% lower than expected.
- New Contracts/Initiatives Update** —) The China facility (HiPo) has been put on the block now – delay in getting GMP certification for a foreign player like DISH could hurt viability of the plant. DISH expects to garner cUS\$25m+ & repay debt (Net D/E ~1.0); 2) Abbott contract value: US\$135m over CY12-CY14 – now sole supplier of Eprosartan; 3) CA restructuring benefits accruing now - Oct month sales & EBITDA: c8m CHF & c1m CHF resp vs. monthly run rate of c5m CHF & 0.2m CHF in 1HFY12.
- Earnings Call Takeaways** — 1) Onco facility in India has started supplying gemcitabine & 2 more products; 2) Inventory: Rs2.9bn, Receivables: Rs1.6bn; 3) Gross debt: Rs9.7bn – c70% forex debt; 4) Most subs have seen higher profitability.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	1,467	18.14	20.8	2.5	0.5	23.0	2.6
2010A	1,176	14.54	-19.9	3.2	0.5	15.8	2.6
2011E	814	10.06	-30.8	4.6	0.4	9.8	2.2
2012E	593	7.33	-27.1	6.2	0.4	6.7	1.6
2013E	827	10.22	39.3	4.5	0.4	8.8	2.2

Source: Powered by dataCentral

Company Update

Buy	1
Price (11 Nov 11)	Rs45.80
Target price	Rs115.00
Expected share price return	151.1%
Expected dividend yield	2.2%
Expected total return	153.3%
Market Cap	Rs3,696M US\$74M

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



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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	2.5	3.2	4.6	6.2	4.5
EV/EBITDA adjusted (x)	4.1	5.5	7.2	6.2	5.2
P/BV (x)	0.5	0.5	0.4	0.4	0.4
Dividend yield (%)	2.6	2.6	2.2	1.6	2.2
Per Share Data (Rs)					
EPS adjusted	18.14	14.54	10.06	7.33	10.22
EPS reported	18.07	14.51	9.89	7.33	10.22
BVPS	87.29	97.19	108.95	111.67	120.72
DPS	1.20	1.20	1.01	0.74	1.02
Profit & Loss (RsM)					
Net sales	10,624	9,154	9,909	11,272	12,659
Operating expenses	-8,638	-7,710	-8,974	-10,059	-11,131
EBIT	1,985	1,444	935	1,213	1,528
Net interest expense	-494	-480	-416	-502	-526
Non-operating/exceptionals	83	362	402	32	32
Pre-tax profit	1,575	1,325	922	743	1,035
Tax	-107	-150	-108	-149	-207
Extraord./Min.Int./Pref.div.	-5	-2	-14	-1	-1
Reported net income	1,462	1,174	800	593	827
Adjusted earnings	1,467	1,176	814	593	827
Adjusted EBITDA	2,615	2,038	1,623	2,011	2,413
Growth Rates (%)					
Sales	32.3	-13.8	8.3	13.8	12.3
EBIT adjusted	87.9	-27.3	-35.2	29.6	26.0
EBITDA adjusted	71.0	-22.1	-20.4	23.9	20.0
EPS adjusted	20.8	-19.9	-30.8	-27.1	39.3
Cash Flow (RsM)					
Operating cash flow	1,414	3,044	2,433	1,233	1,952
Depreciation/amortization	629	594	688	798	885
Net working capital	-106	466	425	-723	-361
Investing cash flow	-1,737	-2,950	-3,336	-1,490	-1,513
Capital expenditure	-1,744	-3,042	-2,920	-1,000	-1,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	500	-70	907	800	-96
Borrowings	577	503	1,062	870	0
Dividends paid	-94	-113	-95	-69	-96
Change in cash	177	24	3	544	342
Balance Sheet (RsM)					
Total assets	16,872	17,898	21,057	22,119	23,409
Cash & cash equivalent	452	455	664	904	1,246
Accounts receivable	1,494	1,131	1,737	1,513	1,699
Net fixed assets	9,925	11,927	14,160	14,362	14,477
Total liabilities	9,828	10,055	12,265	13,106	13,664
Accounts payable	495	796	950	679	763
Total Debt	7,237	7,739	8,801	9,671	9,671
Shareholders' funds	7,044	7,843	8,792	9,013	9,744
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.6	22.3	16.4	17.8	19.1
ROE adjusted	23.0	15.8	9.8	6.7	8.8
ROIC adjusted	13.8	8.5	4.9	5.9	7.0
Net debt to equity	96.3	92.9	92.5	97.3	86.5
Total debt to capital	50.7	49.7	50.0	51.8	49.8

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2QFY12 Financial Snapshot

Figure 1. Dishman – 2QFY12 Consolidated P&L (Rs m, %)

	2QFY11	2QFY12	YoY ch (%)	1QFY12	QoQ Ch (%)
Sales	2,129	2,692	26.5	2,372	13.5
Other Operating Income	203	4	(97.8)	57	(92.2)
Net revenues	2,331	2,697	15.7	2,429	11.0
RM Costs	597	977	63.7	735	32.9
as a % of Revenues	25.6	36.2	1,063 bps	30.3	596 bps
Staff Cost	693	697	0.5	720	(3.3)
as a % of Revenues	29.7	25.8	-390 bps	29.7	-383 bps
Other Expenses	469	736	57.0	480	53.4
as a % of Revenues	20.1	27.3	718 bps	19.8	753 bps
EBITDA	573	288	(49.8)	494	(41.8)
EBITDA Margins (%)	24.6	10.7	-1,391 bps	20.3	-966 bps
EBITDA (excl forex)	375	475	26.6	447	6.2
EBITDA Margins (%) (excl forex)	16.1	17.6	152 bps	18.4	-80 bps
Interest	95	150	57.5	137	9.4
Depreciation	168	207	23.2	187	11.0
PBT	309	(70)	(122.6)	170	(141.2)
Tax	14	(7)	(150.7)	17	(139.3)
PAT	296	(63)	(121.3)	152	(141.4)
Minority Interest	-	0	nm	1	nm
Reported Net Income	296	(63)	(121.4)	152	(141.8)
MTM gains (losses)	198	(188)	nm	46	nm
Recurring Net Income	98	124	26.5	105	18.0

Source: Citi Investment Research and Analysis, Company

Figure 2. Carbogen and Dishman Netherlands Profitability (Rs m, %)

	2QFY11	2QFY12	YoY ch (%)	1QFY12	QoQ Ch (%)
Carbogen Amcis					
Sales	952.0	1,062.1	11.6	748.0	42.0
EBITDA	90.0	98.0	8.9	(28.2)	(447.5)
EBITDA Margin	9.5	9.2	-23 bps	(3.8)	1,300 bps
Dishman Netherlands					
Sales	247.2	336.2	36.0	457.8	(26.6)
EBITDA	69.3	64.0	(7.6)	111.2	(42.4)
EBITDA Margin	28.0	19.0	-900 bps	24.3	-525 bps

Source: Citi Investment Research and Analysis, Company

Figure 3. Dishman – 2QFY12 Revenue Break up & Profitability (Rs m, %)

	2QFY11	2QFY12	YoY ch (%)	1QFY12	QoQ Ch (%)
CRAMS*					
Sales	1,608.1	1,688.3	5.0	1,587.5	6.4
EBIT	356.0	24.9	(93.0)	91.3	(72.7)
EBIT Margin	22.1	1.5	-2,066 bps	5.7	-427 bps
Marketable Molecules*					
Sales	519.9	1,003.8	93.1	784.6	27.9
EBIT	47.9	55.4	15.7	214.8	(74.2)
EBIT Margin	9.2	5.5	-369 bps	27.4	-2,186 bps

Source: Company, Citi Investment Research and Analysis, * Includes Forex

Dishman Pharmaceuticals & Chemicals

Company description

Dishman is a prominent contract research and manufacturing player offering its services globally. It has successfully transformed itself from an API/intermediate manufacturer into a company offering a complete CRAMS basket post the acquisition of the research services company called Carbogen Amcis. It has become a reliable partner for global players over the last few years and has tied up with global majors like GSK, Astra Zeneca, Abbott, etc.

Investment strategy

We rate Dishman Pharma Buy (1), with a TP of Rs115. Dishman is the most leveraged, among Indian companies, to the innovator CRAMS opportunity. After a torrid phase (FY09-11), on the back of a challenging macro environment for outsourcing, we believe things are turning around, though the pace of recovery is uncertain. With new capacities coming online, better visibility on new contracts & benefits from Carbogen Amcis (CA) restructuring, we forecast revenue and recurring PAT CAGRs (FY11-14E) of 13% and 32% respectively. We thus see limited downside though any material re-rating is likely only after visible signs of recovery over a few quarters.

Valuation

Given that pharma is a growth sector, we use P/E as our primary method to value the base business of every company. For Dishman, we use a target P/E multiple of 13x, which is at a 15% discount to our target multiple for Jubilant Lifesciences, which is a leading player in the CRAMS segment. We believe that a discount is justified, given Dishman's relatively smaller size and pipeline, inferior return ratios & lower market cap/liquidity. Over the last 5 years, Dishman has traded in a band of 6-26x 1-year forward earnings. Our target P/E of 13x is towards the lower end of this band. At 13x Sep 12E EPS we value Dishman at Rs115.

Risks

The key risks to our target price include: (1) slower than expected recovery in the CRAMS space; (2) Regulatory risk - delayed execution of contracts due to delays in regulatory approvals or any adverse outcome at the customer end could impact Dishman's revenues & profitability. (3) Delay in restructuring at Carbogen could limit expected upside in margins; (4) Lumpy business - CRAMS revenues tend to be lumpy across quarters and the quarterly performance of the company might be volatile.

Appendix A-1

Analyst Certification

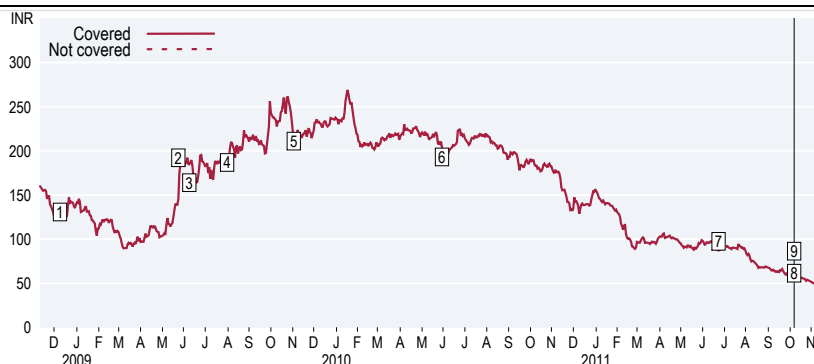
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Dishman Pharmaceuticals & Chemicals (DISH.BO)

Ratings and Target Price History Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	9-Dec-08	1H	*189.00	122.90
2	25-May-09	1H	*204.00	145.35
3	9-Jun-09	1H	*275.00	184.70

* Indicates change

	Date	Rating	Target Price	Closing Price
4	31-Jul-09	1H	*250.00	186.85
5	3-Nov-09	*1M	250.00	211.00
6	30-May-10	1M	*265.00	210.50

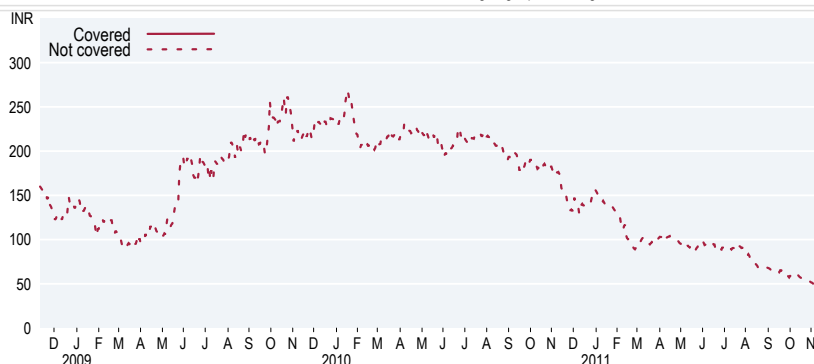
	Date	Rating	Target Price	Closing Price
7	23-Jun-11	1M	*115.00	87.40
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*1	115.00	58.95

Rating/target price changes above reflect Eastern Standard Time

Dishman Pharmaceuticals & Chemicals (DISH.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Prashant Nair, CFA



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Rating/target price changes above reflect Eastern Standard Time

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