Jubilant Organosys (JUBO.BO)

Buy: 1Q Miss Mainly On Timing Issues – Stay Positive

Equity ☑
Target price change ☑
Estimate change ☑

- **Stay Positive** — We see no major cause for concern despite 1Q missing estimates. Most issues that hurt numbers were timing-related (delay in offtake by clients, time lag in passing on higher input costs) and are set to normalize over the FY – we expect strong sequential growth from 2Q. Our earnings revision is marginal (down 5%/2% for FY11E/12E); we raise TP to Rs475 (roll over to Sept 11E).

- **1Q Miss** — While not as bad as headline numbers suggest, 1QFY11 results (sales and recurring PAT up 9% each) were still below expectations, especially for the PLSPS biz. PLSPS sales growth (+4%) was tepid and EBIDTA margins declined (down 533bps). The APP biz continued to do well (sales up 44%; EBIDTA margins up 986bps) on the back of a strong performance in agri products.

- **Issues Mainly Timing-Related** — While adverse currency played its part, the below par showing was mainly on account of timing issues on key businesses. Delayed offtake / orders by some customers (CMO, research services) and a time lag in passing on higher input costs were key reasons for lower revenues and the squeeze in profitability respectively. We see these normalizing over the full year.

- **Sequential Improvement Ahead** — We see steady QoQ improvement in profitability from 2Q, on the back of its strong order book (cUS$1bn) in CRAMS, price hikes to pass on higher input cost (to be effective from 2Q), fresh capacity in pyridines and niacinamide (4QFY11) and generic launch of sartans (4Q). We also expect some of the delayed CMO orders to be executed in 2H, leading to improved profitability. We have marginally reduced our earnings estimates for FY11/12 by 5%/2%.

- **Maintain Buy (1M)** — with a TP of Rs475/share, as we believe that growth will pick and drive re-rating from its current attractive valuations of 12xFY11E earnings. Strong pick up in growth from 2Q and demerger of its APP biz (likely before end of FY11) would be key catalysts for the stock.

Buy/Medium Risk	**1M**
Price (28 Jul 10)	Rs352.95
Target price	Rs475.00
from Rs465.00	
Expected share price return	34.6%
Expected dividend yield	0.6%
Expected total return	**35.1%**
Market Cap	Rs56,041M
	US$1,201M

Price Performance (RIC: JUBO.BO, BB: JOL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	2,965	16.33	82.8	21.6	4.1	27.5	0.4
2009A	2,241	13.11	-19.7	26.9	4.1	17.8	0.4
2010E	4,543	24.94	90.2	14.2	2.7	27.5	0.6
2011E	5,117	29.36	17.7	12.0	2.2	22.6	0.6
2012E	5,957	37.52	27.8	9.4	1.9	21.8	0.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	21.6	26.9	14.2	12.0	9.4
EV/EBITDA adjusted (x)	15.6	17.1	11.2	9.6	8.1
P/BV (x)	4.1	4.1	2.7	2.2	1.9
Dividend yield (%)	0.4	0.4	0.6	0.6	0.6
Per Share Data (Rs)					
EPS adjusted	16.33	13.11	24.94	29.36	37.52
EPS reported	22.06	16.57	23.14	29.36	37.52
BVPS	85.37	85.88	128.42	157.36	186.61
DPS	1.49	1.51	2.00	2.00	2.00
Profit & Loss (RsM)					
Net sales	24,889	35,423	37,987	43,042	49,933
Operating expenses	-21,421	-32,159	-31,173	-36,111	-41,628
EBIT	**3,468**	**3,264**	**6,814**	**6,931**	**8,304**
Net interest expense	-337	-1,070	-1,505	-1,026	-1,163
Non-operating/exceptionals	1,430	772	-130	121	130
Pre-tax profit	**4,561**	**2,966**	**5,179**	**6,026**	**7,271**
Tax	-573	-267	-959	-904	-1,309
Extraord./Min.Int./Pref.div.	16	133	-5	-5	-5
Reported net income	**4,005**	**2,832**	**4,215**	**5,117**	**5,957**
Adjusted earnings	2,965	2,241	4,543	5,117	5,957
Adjusted EBITDA	4,507	4,896	8,061	8,998	10,527
Growth Rates (%)					
Sales	37.5	42.3	7.2	13.3	16.0
EBIT adjusted	81.3	-5.9	108.8	1.7	19.8
EBITDA adjusted	77.7	8.6	64.6	11.6	17.0
EPS adjusted	82.8	-19.7	90.2	17.7	27.8
Cash Flow (RsM)					
Operating cash flow	**2,444**	**3,867**	**5,284**	**6,017**	**6,691**
Depreciation/amortization	1,039	1,632	1,247	2,067	2,223
Net working capital	-1,851	-556	-182	-1,353	-1,931
Investing cash flow	**-11,394**	**-20,307**	**-2,500**	**-4,000**	**-3,500**
Capital expenditure	-5,135	-6,678	-2,500	-4,000	-3,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**5,928**	**12,517**	**-6,389**	**-2,141**	**-3,065**
Borrowings	6,123	15,198	-9,896	-1,776	-2,700
Dividends paid	-209	-258	-365	-365	-365
Change in cash	**-3,021**	**-3,923**	**-3,605**	**-124**	**125**
Balance Sheet (RsM)					
Total assets	**41,825**	**64,867**	**63,255**	**67,163**	**71,709**
Cash & cash equivalent	5,238	3,817	211	88	213
Accounts receivable	4,258	5,044	5,252	5,954	6,911
Net fixed assets	23,971	42,481	43,734	45,667	46,944
Total liabilities	**29,066**	**51,875**	**42,537**	**41,846**	**41,742**
Accounts payable	3,718	7,365	7,352	8,335	9,399
Total Debt	21,085	38,781	28,886	27,266	25,514
Shareholders' funds	**12,759**	**12,992**	**20,717**	**25,318**	**29,967**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	18.1	13.8	21.2	20.9	21.1
ROE adjusted	27.5	17.8	27.5	22.6	21.8
ROIC adjusted	10.9	7.2	11.3	11.1	12.1
Net debt to equity	124.2	269.1	138.4	107.4	84.4
Total debt to capital	62.3	74.9	58.2	51.9	46.0

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1Q Miss Mainly on Timing Issues

We see no major cause for concern despite 1Q missing estimates. Most issues that hurt numbers were timing-related (delay in offtake by clients, time lag in passing on higher input costs) and are set to normalize over the full year – we expect strong sequential growth from 2Q. Our earnings revision is marginal (down 5%/2% for FY11E/12E) and we raise TP to Rs475 (roll over to Sept'11E).

Figure 1. Jubilant Organosys – Consolidated Income Statement (Rs m, %)

YE 31 Mar	1Q FY10	1Q FY11	*YoY ch (%)*	4Q FY10	*QoQ Ch (%)*
Net sales	8,960	9,820	*9.6*	9,903	*(0.8)*
Other Operating Income	50	36	*(27.8)*	40	*(10.3)*
Total Revenues	**9,010**	**9,856**	***9.4***	**9,943**	***(0.9)***
Material cost	4,139	4,741	*14.6*	4,457	*6.4*
% of sales	*45.9*	*48.1*	*217 bps*	*44.8*	*328 bps*
Mfr cost	614	727	*18.4*	784	*(7.3)*
% of sales	*6.8*	*7.4*	*56 bps*	*7.9*	*-51 bps*
Gross Profit	**4,257**	**4,388**	***3.1***	**4,703**	***7.2***
Gross margins (%)	*47.3*	*44.5*	*-273 bps*	*47.3*	*-277 bps*
Staff cost	1,832	1,856	*1.3*	1,848	*0.4*
% of sales	*20.4*	*18.9*	*-155 bps*	*18.7*	*24 bps*
SG & A expenses	771	925	*20.0*	625	*48.0*
% of sales	*8.6*	*9.4*	*82 bps*	*6.3*	*311 bps*
EBIDTA	**1,655**	**1,607**	***(2.9)***	**2,230**	***(27.9)***
EBIDTA Margins (%)	*18.5*	*16.4*	*-210 bps*	*22.5*	*-615 bps*
Interest	407	198	*(51.4)*	345	*(42.7)*
Depreciation	473	496	*4.7*	484	*2.5*
Other income	35	25	*(29.4)*	41	*(39.8)*
PBT	810	939	*16.0*	1,442	*(34.9)*
Tax - recurring	92	151	*63.5*	235	*(35.7)*
Effective tax rate (%)	*11.4*	*16.1*	*467 bps*	*16.3*	*-20 bps*
PAT	717	788	*9.8*	1,208	*(34.7)*
Minority Interest (MI)	(13)	(11)	*(17.1)*	(19)	*(42.2)*
Adjusted Net Income	**730**	**799**	***9.4***	**1,226**	***(34.9)***
Exceptional Items - net of tax	524	(166)	*n.a.*	146	*n.a.*
Reported Net Income	1,255	632	*(49.6)*	1,372	*(53.9)*

CIRA Comments

Conclusion: 1Q not as bad as headline nos. look but still below expectations; Only minor change to full-year estimates as most issues are timing-related

Revenue growth below expectations on lower PLSPS sales – delay in orders from innovators & adverse currency hit key businesses

EBIDTA margins hit by currency, lower scale & delay in passing on higher input costs to customers – expected to scale up over the full year (mainly in 2H)

Interest cost declines on repayment of debt using internal cash flows and equity issue proceeds

Exceptional items relate largely to MTM gains / losses on foreign currency debt and hedging contracts (all non cash). 1QFY10 also included additional benefit of Rs165m by way of lower deprecation on change of policy.

Source: Company Reports and CIRA Estimates

Figure 2. Jubilant Organosys – Consolidated Revenue Breakdown (Rs m, %)

YE 31 Mar	1Q FY10	1Q FY11	*YoY ch (%)*	4Q FY10	*QoQ Ch (%)*
Proprietary Products (LSP)	2,390	2,250	*(5.9)*	2,160	*4.2*
API (LSP)	570	700	*22.8*	790	*(11.4)*
CMO (LSS)	1,310	1,400	*6.9*	2,210	*(36.7)*
Drug Discovery & Dvpt (LSS)	610	540	*(11.5)*	560	*(3.6)*
CRAMS	**4,880**	**4,890**	***0.2***	**5,720**	***(14.5)***
% of sales	*54.5*	*49.8*		*57.8*	
Specialty Pharma (LSP)	600	590	*(1.7)*	570	*3.5*
Dosage Form (LSP)	330	390	*18.2*	440	*(11.4)*
Life science Chemicals (LSP)	1,460	1,760	*20.5*	1,726	
Nutritionals (LSP)	500	470	*(6.0)*	500	
Healthcare Business (LSS)	20	30	*50.0*	20	*50.0*
PLSPS	**7,790**	**8,130**	***4.4***	**8,976**	***(9.4)***
% of sales	*86.9*	*82.8*		*90.6*	
APP	**1,170**	**1,690**	***44.4***	**927**	***82.3***
% of sales	*13.1*	*17.2*		*9.4*	
Total Revenues	**8,960**	**9,820**	***9.6***	**9,903**	***(0.8)***

CIRA Comments

Sales below expectations due to lower growth in the PLSPS segment – hit by postponement in offtake by some innovator customers & adverse currency

Life science Products grows 5% YoY but volume growth at c16% - currency also hits growth

Life science Services growth of 1% hit by postponement of orders by innovator customers & slow CRO biz in the US – to ramp up in 2H

Steady growth in APIs & Dosage forms to continue; Radiopharma sales growth to pick up in 2H

APP sales growth driven primarily by Agri products (SSP; up 85% YoY) on price stabilization & shift to nutrient based subsidy scheme

Source: Company Reports and CIRA Estimates

*LSP – Life Science Products; LSS – Life Science Services

Figure 3. Jubilant Organosys – Broad Segmental Break Up of Revenues & Margins (Rs m, %)

YE 31 Mar	1QFY10	1QFY11	YoY ch (%)	4QFY10	QoQ Ch (%)	CIRA Comments
Pharma & Life Sc Products & Services (PLSPS)	**7,790**	**8,130**	***4.4***	**8,976**	***(9.4)***	PLSPS margins are lower on account of delay in passing on higher input costs and adverse currency impact
% of sales	*86.9*	*82.8*		*90.6*		
EBIDTA Margins	*24.4*	*19.1*	*-533 bps*	*26.2*	*-712 bps*	
Agri Products & Performance Polymers (APP)	**1,170**	**1,690**	***44.4***	**927**	***82.3***	APP margins are back to their normalized range – continuing the trend witnessed towards the end of FY10
% of sales	*13.1*	*17.2*		*9.4*		
EBIDTA Margins	*2.6*	*12.4*	*986 bps*	*10.8*	*164 bps*	
Total Revenues	**8,960**	**9,820**	***9.6***	**9,903**	***(0.8)***	
EBIDTA Margins	*21.5*	*17.9*	*-362 bps*	*24.7*	*1,792 bps*	

Source: Company Reports and CIRA Estimates

Earnings Revision

Figure 4. Jubilant Organosys – Earnings Revision

	FY11E	FY11E
Revenues		
New	43,042	49,933
Old	43,034	49,967
Change (%)	*0%*	*0%*
EBITDA		
New	8,998	10,527
Old	9,190	10,675
Change (%)	*-2%*	*-1%*
EPS		
New	29.4	37.5
Old	30.8	38.3
Change (%)	*-5%*	*-2%*

Source: Citi Investment Research and Analysis

Jubilant Organosys

Company description

Jubilant Organosys is the largest specialty chemicals company in India, with a high degree of vertical integration, and global scale and reach in almost all its key products. The company has established itself as a serious player from fine chemicals to advanced intermediates and APIs. More recently, it has forayed into formulations and regulatory services through acquisitions in Belgium (PSI n.v. and PSI supply) and the US (Trigyn Laboratories). It has set up wholly owned subsidiaries to tap into the high-potential areas of bioinformatics, medicinal chemistry services and clinical services.

Investment strategy

We rate Jubilant Buy/Medium Risk (1M) with a target price of Rs475. Jubilant is among the top Indian pharma outsourcing plays under our coverage. It is a story of continuous forward integration with a business model that spans pharma & life sciences (P&LS), industrial chemicals and performance chemicals. Jubilant's strong presence in acetyls and pyridines builds a high degree of integration into its business and allows it to offer services across the value chain. Besides a natural cost advantage, this allows the company to leverage its customer relationships in strong areas to scale up new businesses, thus providing an edge in an increasingly competitive industry. Jubilant's P&LS business is in the midst of a high growth phase not only raising profitability levels but also improving earnings quality by reducing Jubilant's exposure to the more volatile non-P&LS businesses.

Valuation

We use sum-of-the-parts to value Jubilant in view of the diversified nature of its business and earnings streams. We value both its businesses using P/E, but different target multiples are applied given the differences in growth profiles and operating parameters. We arrive at a one-year target price of Rs475 based on the following factors: We ascribe a value of Rs462/share to Jubilant's Pharma & Life Sciences (PLSPS) business at 15x Sept 11E EPS. Our target multiple is at a 5-10% discount to the target multiple used for Piramal Healthcare, given Jubilant's higher leverage and lower return ratios and liquidity. We value Jubilant's Agri & Performance Polymers (APP) business at Rs13/share based on 6x Sept 11E EPS. We believe the lower multiple is justified given that this is a commodity business with lower operating margins (c10 -14%) and growth rates vis-à-vis Jubilant's pharma business.

Risks

Our risk rating for Jubilant is Medium as against our quants-based High Risk rating. We believe that the lower rating is warranted given the strong growth in the pharma business, recovery in the APP business and greater financial discipline (reducing debt and lower capex). The main downside risks to our target price and estimates include: (1) Any delay in filing / launch or a litigation loss would affect the timing and quantum of revenues and profits; (2) Inability to integrate and exploit the synergies with its acquired subsidiaries could hurt profitability; and (3) Increases in molasses and / or other input prices.

Appendix A-1

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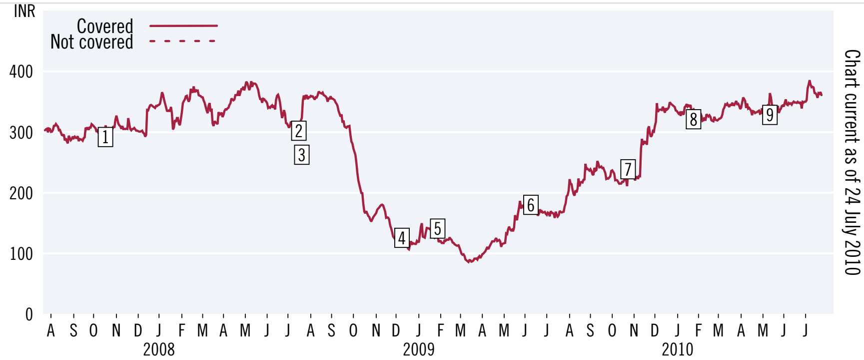
Jubilant Organosys (JUBO.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	17-Oct-07	1L	*415.00	310.95
2	16-Jul-08	1L	*473.00	311.35
3	21-Jul-08	*1M	473.00	323.40
4	9-Dec-08	*1H	*211.00	119.60
5	28-Jan-09	1H	*184.00	128.15
6	9-Jun-09	1H	*245.00	171.00
7	23-Oct-09	1H	*350.00	237.30
8	24-Jan-10	1H	*440.00	336.40
9	12-May-10	*1M	*465.00	364.30

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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% of companies in each rating category that are investment banking clients	47%	45%	40%

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