JUBILANT ORGANOSYS

May 04, 2009

Pharmaceuticals

JUBO.BO, Rs116	
Rating	BUY
Sector coverage view	Attractive
Target Price (Rs)	300
52W High -Low (Rs)	391 - 84
Market Cap (Rs bn)	20.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	36.4	44.0	52.0
Net Profit (Rs bn)	(1.0)	3.9	4.9
EPS (Rs)	(5.5)	21.7	27.6
EPS gth	*(124.7)*	*-*	*27.2*
P/E (x)	(20.8)	5.3	4.2
EV/EBITDA (x)	26.3	6.8	5.3
Div yield (%)	1.4	1.8	2.1

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
21.6	(2.3)	(28.7)	(69.2)

Shareholding, March 2009

	Pattern	% of Portfolio	Over/(under) weight
Promoters	50.4	-	-
FIIs	8.5	0.0	(0.0)
MFs	1.6	0.0	(0.0)
UTI	-	-	(0.1)
LIC	1.5	0.0	(0.0)

Jubilant Organosys : Operational performance beats KIE estimates, use lower PE multiples and cut price target

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- **4QFY09 revenues at Rs8.4 bn lower than KIE estimates, operating margins excluding forex better than our estimates**
- **FY2010-11E PAT reduced due to slower growth in industrials and proprietary intermediates segments due to lower crude prices**
- **Maintain BUY rating with SOTP-based target price at Rs250 (was Rs300)**

Jubilant revenues at Rs8.4 bn were 7% below KIE estimates. This was due to lower sales of (1) CMO operations at US$27 mn versus our estimate of US$34 mn (2) API revenues at US$9 mn versus our estimate of US$16 mn (3) Industrial performance business at Rs2.4 bn versus our estimate of Rs2.5 bn. EBITDA margins not excluding forex at 20% versus our estimate of 16% due to lower material costs at 48% versus our estimate of 52%. Company has suspended AS 11 as a result it has written back MTM losses on forex loans reported in first 3 quarters so the reported numbers are not comparable with our forecast below EBITDA line. Interest depreciation was broadly in line with our estimate. Company gives FY2010E guidance, sales growth of 15% and EBITDA margins of 27% in PLSPS segment and 11% in industrials segment. The company met its FY2009 sales growth guidance of 40% (reduced from earlier 50% due to weak industrial segment performance).The stock trades at 5X FY2010E and 4X FY2011E earnings. Maintain BUY rating with SOTP-based target price at Rs250

4QFY09 revenues, 7% below our estimate of Rs8.4 bn

This was due to lower (1) CMO sales at US$27 mn versus our estimate of US$34 mn. Draxis business was $10m, lower than our estimate of US$17 mn.

(2) API revenues at US$9 mn versus our estimate of US$16 mn. API revenues have been steadily declining to US$9 mn reported this quarter from US$18 mn in 2QFY09 However the number of products at ready to launch stage stand at 10 while 19 are under development providing clear visibility of revenues from this segment.

(3) Industrial performance business at Rs2.4 bn versus our estimate of Rs2.5 bn. Revenues from this segment have declined to Rs2.4 bn from Rs3.5 bn in 2QFY09 due to weak demand for products.

(4) However proprietary and excludingusive synthesis revenues were at US$53 mn versus our estimate of US$50 mn. The company has a healthy pipeline with 22 products in the development stage in the excludingusive synthesis business.

EBITDA margins not excluding forex at 20% versus our estimate of 16%. Margins adjusted for forex were at 20% versus our estimate of 16% due to lower materials cost at 48% versus our estimate of 52%. (1) Selling expenses at 10% and staff costs at 21% were in line with our estimate.

Industrial segment saw reported EBITDA margins declining to 4% this quarter from 6% last quarter. This was on account of input materials which were at a higher cost compared to current prices. The company expects high cost input inventory to be over by 1QFY10. Pharma and life science segment (PLSPS) which includes CRAMS reported EBITDA margin of 22% versus 26% last quarter.

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Company has suspended AS 11 as a result it has written back MTM losses reported in first 3 quarters so the reported numbers are not comparable with our forecast below EBITDA line. Interest at Rs388 mn versus our estimate of Rs350 mn and depreciation at Rs450 mn was in line with our estimate. Company reported exceptional item of loss of Rs370 mn due to (1) gain on buyback of FCCBs (2) MTM loss on forward covers and (3) sales of assets. We have revised FY2010E and FY2011E to be comparable to Jubilant's reported FY2009.

Company gives FY2010E guidance. Sales growth of 15% and EBITDA margins of 27% in PLSPS segment and 11% in industrials segment. The company met its FY2009 sales growth guidance of 40%(earlier 50%). Our model builds in 13% sales growth in FY2010E. Jubilant has forecast steady margin for FY2010E, however, we forecast lower forex related losses and hence build in margin expansion.

Amortisation related to unrealized losses Since Jubilant has suspended implementation of AS11 in the current year, it has carried Rs3,880 mn related to MTM losses on borrowings to the balance sheet. Of this Rs1,330 mn is added to capital assets and will be depreciated as per company policy. The remaining Rs2,550 mn will have to be written off before end of FY2011. Based on discussion with the management, we add amortization of Rs650 mn in FY2010E and Rs1900 mn in FY2011E.

KIE's FY2010E sales growth at 13% and EBITDA margin at 22%. We estimate sales growth of 13% in FY2010E led by

1. CMO business on the back increased capacity utilization of the enhanced capacity (48 mn to 120 mn vials per annum) while Draxis CMO revenues will grow due to the commencement of J&J contract in January 2009.
2. Revenue growth in drug discovery driven by recent contracts with Amgen and Eli Lilly. Company mentioned that it has not seen any slowdown in this segment as it caters to big pharma and has no exposure to small biotech companies.
3. However we estimate decline in FY2010E in the proprietary products & excludingusive synthesis in dollar sales. Industrial segment, which is largely Indian business will see conflicting trends with higher sales in feed and fertilizer segment and lower sales in acetyl products.

EBITDA margin expansion likely in FY2010E We forecast margin expansion driven by the (1) turnaround of the drug discovery business which is expected to turn positive at the EBITDA level by FY2010E (2) increasing contribution from high margin CMO segment led by capacity utilization of the enhanced capacities at Hollister and J&J contract of Draxis (3) generic sestamibi launch by Draxis in a three-player market. This approval was expected in 1Q2009 but US FDA has not yet approved it. Management expects the product to be in the market by 15th May 2009.

Plans for debt servicing and repayment For the past several months, stock market has been worrying about Jubilant's ability to repay its debt. Its gross debt increased from Rs2,1080 mn from FY2008 to Rs38,780 mn mainly due to acquisition of Draxis. In FY2009, Jubilant spent Rs5,440 mn on Capex and Rs1,0870 on acquisition.

It has a high gross debt:equity ratio of 3X at the end of FY2009. At net debt level, it falls to 2.6x. FY2010E, Jubilant has more cash equivalents on hand than the amount repayable.

Management has been focusing on generating cash from operations and brought down net current assets from Rs5,480 mn at March 2008 to Rs3,910 mn by March2009. Capex budget for FY2010E is reduced to Rs2,500 mn.

It is worth pointing out that repayment of foreign currency borrowings is spread over seven years while Rupee borrowing is spread over five years. FCCB is to be repaid in two installments. First is due in May2010 where US$50 mn is to be paid with premium of US$19 mn and the second is due in May 2011 where US$142 mn is due with premium of US$60 mn. These numbers could change if Jubilant is able to buy back more of its FCCB.

Maintain BUY rating with SOTP-based target price reduced to Rs250 (from Rs300) due to lower multiples. We continue to use SOTP method for valuation. We revise target price multiples used to value CRAMs segment of Jubilant's (see exhibit 5). It is now valued at 8X from 10X 12-months forward earnings. We think continuing large debt position of Jubilant will lead to continuing discount to index and industry peers. CRAMS segment is the most important segment from share value perspective. Industrial segment would account for about 6% of share price target.

Since the company has now suspended implementation of AS11, we have added amortization related to unrealized losses in estimates. We have also included in forecasts realized and unrealized losses on sales and working capital in FY2010-11E. However, for the purpose of valuation we excludingude unrealized losses and amortization.

We think there are a couple of catalysts for short term performance of the share price. Firstly, management expects to launch generic sestamibi in US by 15th May and could launch it in Europe in 2010. Secondly, Jubilant is about to close two more large R&D outsourcing deals like Lilly. While this is built into forecast of 15% sales in growth guidance for FY2010, we expect market to respond to the announcements.

Interim results- Jubilant, March fiscal year-ends (Rs mn)

					% change		
	4QFY09	4QFY09E	4QFY08	3QFY09	4QFY09E	4QFY08	3QFY09
Net sales	**8,412**	**9,079**	**6,890**	**9,096**	**(7)**	**22**	**(8)**
Change in stock	(187)	-	(98)	(45)	NM	NM	NM
Cost of trading goods sold	242	-	156	274	NM	55	(12)
RM consumed	2,914	3,586	2,650	3,433	(19)	10	(15)
Stores, spares	501	499	454	484	0	10	4
Mfg exp	608	681	678	674	(11)	(10)	(10)
Staff cost	1,778	1,916	1,083	1,825	(7)	64	(3)
Selling exp	877	908	749	747	(3)	17	17
Exchange loss/(gain)	749	-	(23)	294	NM	NM	155
Total Expenditure	**7,483**	**7,591**	**5,648**	**7,686**	**(1)**	**32**	**(3)**
EBITDA	**929**	**1,489**	**1,242**	**1,411**	**(38)**	**(25)**	**(34)**
Other income	127	(475)	80	(1271)	(127)	60	NM
Interest	388	350	21	324	11	1749	20
Depreciation	451	450	361	434	0	25	4
PBT	**217**	**214**	939	(618)	**2**	**(77)**	**NM**
Tax	346	17	(22)	283	1925	NM	23
PAT	**(129)**	**197**	**961**	**(901)**	**NM**	**NM**	**NM**
Minority interest	(33)	(25)	27	(25)	NM	NM	NM
Exceptional item	220	0	(95)	0	NM	NM	NM
PAT	**124**	**222**	**840**	**(876)**	**(44)**	**(85)**	**NM**
Pharmaceutical and life science	6,000	6,559	4,609	6,122	(9)	30	(2)
CRAMS	5,010	5,555	4,005	5,130	(10)	25	(2)
Proprietary intermediates	2,416	2,259	2,317	2,205	7	4	10
Custom synthesis	254	251	257	245	1	(1)	4
API	460	803	480	700	(43)	(4)	(34)
Hollister/Draxis	1,350	1,707	950	1,460	(21)	42	(8)
Specialty chemicals	530	535	0	520	(1)	NM	2
Drugs discovery & development	660	703	400	690	(6)	65	(4)
Dosage forms	330	301	204	302	10	62	9
Industrial and performance polymers	2,402	2,500	2,281	2,954	(4)	5	(19)
Hospitals	10	20	0	20	(50)	NM	(50)
Total	**8,412**	**9,079**	**6,890**	**9,096**	**(7)**	**22**	**(8)**

Source: Company data, Kotak Institutional Equities.

Forecasts and valuation, March fiscal year-ends, 2007-2011E

	Net Revenue		EBITDA		Net Profit		EPS	ROCE	ROE	P/E
	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs mn)	Growth (%)	(Rs)	(%)	(%)	(X)
2007	18,097	20.7	2,567	18.3	2,280	75.8	13.0	9.5	26.3	8.8
2008	24,889	37.5	4,507	75.6	4,005	75.7	22.4	11.7	37.0	5.1
2009E	35,180	41.3	4,710	4.5	2,832	(29.3)	16.5	7.2	18.6	6.9
2010E	39,919	13.5	7,913	68.0	3,188	12.6	18.6	10.9	22.6	6.1
2011E	46,496	16.5	10,337	30.6	3,729	17.0	21.8	13.2	21.7	5.3

Source: Company data, Kotak Institutional Equities.

SOTP based price target, FY2010-FY2011E

	PAT (Rs mn)		P/E	Valuation (Rs mn)	
	2010E	2011E	(X)	2010E	2011E
Pharmaceutical and life science (PSLPS)					
CRAMS	3,742	4,747	8.0	29,936	37,975
Drugs discovery & development	(4)	78	10.0	(37)	783
Dosage forms	53	94	8.0	428	749
Industrial and performance polymers	111	426	6.0	664	2,557
Total	**3,902**	**5,345**		**30,991**	**42,064**
Share price target					**246**

Source: Company data, Kotak Institutional Equities.

Debt and interest cost details (Rs mn)

	FY2008	FY2009	FY2010E	FY2011E
FCCB	10,480	9,750	9,984	7,029
Others	10,600	29,030	22,759	23,678
Gross debt	21,080	38,780	32,743	30,707
Cash	5,694	6,200	1,656	1,656
Net debt	15,386	32,580	31,086	29,050
Fx debt US$ mn				
Jubilant	112	122		
Jubilant FCCB	261	192	192	142
Subsidiaries	105	255		
Exchange rate $/Rs	40.12	50.72	52.00	49.50
Rupee Debt	1,920	9,930		
Average interest rate %				
Fx debt ex FCCB	4.9	3.0		
Rupee Debt	10.0	11.0		
Total ex FCCB	5.6	5.5		
Amount repayable			3,370	3,485
Cash from operations		4,036	4,853	5,649
investment in working capital		1,532	(600)	(855)
Capex for the year		(2,483)	(2,500)	(2,500)
Interest cost in P&L	337	1,070	1,600	1,550
Interest bearing debt	10,600	29,030	22,759	23,678
% interest cost	3.2%	3.7%	7.0%	6.5%

Source: Company data, Kotak Institutional Equities.

Profit and loss statement,March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007	2008	2009E	2010E	2011E
Gross operating revenues	**16,179**	**19,434**	**26,287**	**36,803**	**41,801**	**48,679**
Excise duty	(1,189)	(1,337)	(1,399)	(1,623)	(1,882)	(2,184)
Net sales	**14,990**	**18,097**	**24,889**	**35,180**	**39,919**	**46,496**
Operating expenses						
Materials	(9,776)	(11,274)	(13,834)	(18,461)	(19,555)	(22,228)
Selling and administration	(856)	(1,191)	(1,458)	(3,379)	(3,994)	(4,882)
Employee cost	(1,359)	(2,149)	(3,670)	(6,575)	(7,589)	(9,299)
R&D	(102)	(131)	(228)	0	0	0
Others	(828)	(916)	(1,420)	(2,056)	(868)	250
Total expenditure	**(12,819)**	**(15,530)**	**(20,382)**	**(30,470)**	**(32,005)**	**(36,159)**
EBITDA	**2,170**	**2,567**	**4,507**	**4,710**	**7,913**	**10,337**
Depreciation and amortisation	(513)	(623)	(1,039)	(1,632)	(2,475)	(3,900)
EBIT	**1,657**	**1,944**	**3,468**	**3,078**	**5,438**	**6,437**
Net finance cost	(173)	(195)	(337)	(1,070)	(1,600)	(1,550)
Other income	197	1,203	1,430	425	100	200
Pretax profits before extra-ordinaries	**1,681**	**2,953**	**4,561**	**2,432**	**3,938**	**5,087**
Current tax	(231)	(370)	(557)	(219)	(830)	(1,397)
Deferred tax	(139)	(319)	12	0	0	0
Fringe benefit tax	(22)	(24)	(28)	0	0	0
Reported net profit	**1,289**	**2,240**	**3,988**	**2,213**	**3,108**	**3,689**
Minority interests	8	39	16	133	80	40
Reported net profit after minority interests	**1,297**	**2,280**	**4,005**	**2,346**	**3,188**	**3,729**
Exceptional items				486		
PAT after minority interests and excep. Items	**1,297**	**2,280**	**4,005**	**2,832**	**3,188**	**3,729**

Source: Company data, Kotak Institutional Equities.

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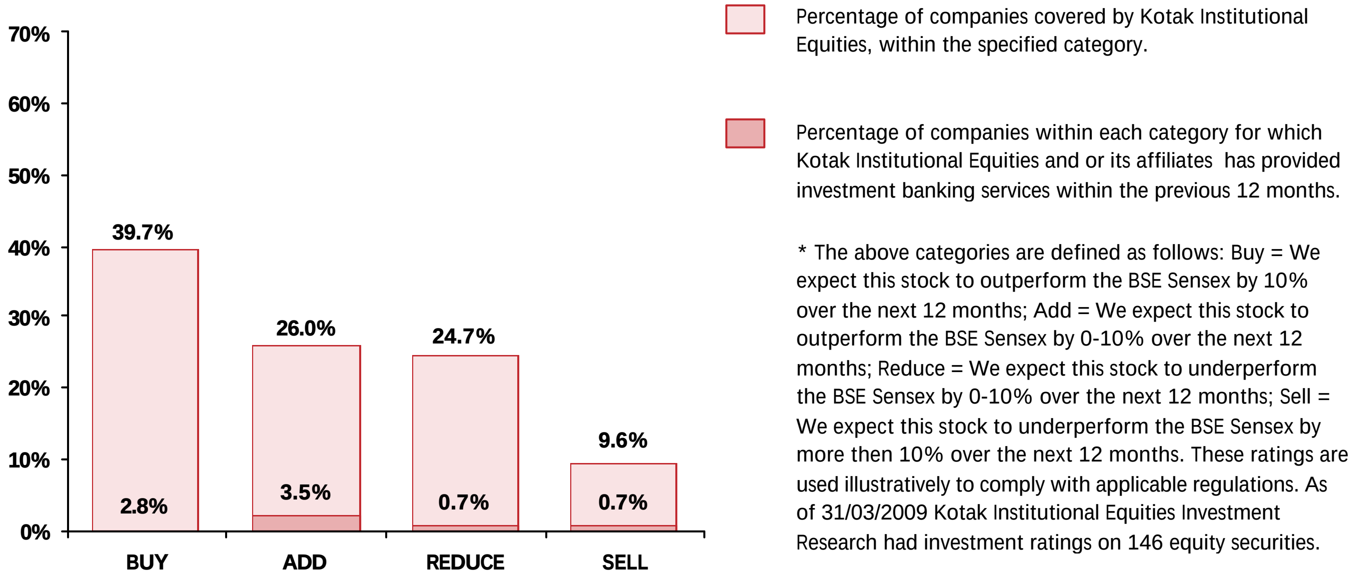

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Source: Kotak Institutional Equities

As of March 31, 2009

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

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