

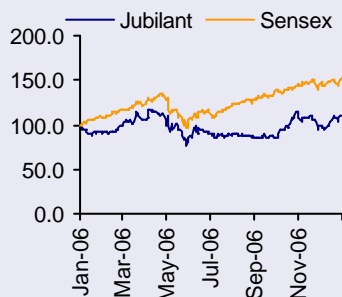
## Jubilant Organosys Ltd (Q3FY07)-Investment Update

<b>Recommendation</b>	<b>HOLD</b>
CMP	Rs259
Target Price	Rs275
Upside	6.2%
Market Cap	Rs46.89bn
Face Value	Re1
52W H/L	Rs261/180
BSE Code	530019
NSE Code	JUBILANT
Reuters Code	JUBO.BO
Bloomberg Code	VAM@IN

### Share holding pattern

Sep '06	(%)
Promoter	51.84
Inst. Investors	30.86
Public	9.9
Other Investors	7.4

### Share price chart



*Jubilant Organosys Limited's (Jubilant) Q3 FY07 sales increased by 11.2% to Rs4.69bn driven by continued growth momentum in Pharmaceuticals and Life Science division (PLSC) which comprises high growth segments like CRAMS, API's, drug discovery and formulations. Lower than expected sales were due to a 3.3% decline in the Industrial Products segment attributed to one time merchandise sales of alcohol in Q3 FY06. Normalized growth stands at 18.6% for the quarter. Operating profit margins expanded by 383bps to 19.1% on account of strong volume growth in PLSC, favorable raw material cost scenario and savings on S,G&A front. Robust margin expansion and contribution of other income has led to 74% bottom line growth to Rs637mn, translating into an annualized EPS of Rs14.1 on a fully diluted basis.*

*Jubilant is well placed to deliver revenue CAGR of 22.9% to Rs22.75bn over FY06-08. PLSC division estimated to account for 57% of sales in FY08 has all its growth drivers in place while the non pharma divisions will continue to generate cash flows for investment in PLSC. We estimate operating margins to expand by 520bps to 19.6% over the next two years driven by higher contribution from PLSC division and a favorable material cost scenario. Consequently earnings are likely to witness CAGR of 50% to Rs2.9bn over FY06-08. At Rs259, the stock is trading at 19.9x FY07E EPS of Rs13.0 and 16.2x FY08E EPS of Rs16 on a fully diluted basis. While the growth drivers are in place, we believe the market has factored in all the positives from the stock. Our target price of Rs275 at 17x FY08 earnings leaves an upside potential of 6.2% from current levels. We recommend a HOLD on the stock.*

*Jubilant has decided to venture into the healthcare space and has earmarked Rs800mn over a period of two years for this project. The management has indicated that they would be sharing further details about this venture over the next 2-3 months. We shall revisit our estimates post this announcement.*

### Financial highlights

Period to (Rs mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Net Sales	8,592	11,703	15,054	18,610	22,751
(%) growth	(11.3)	36.2	28.6	23.6	22.3
APAT	782	1,191	1,297	2,350	2,903
(%) growth	62.7	52.3	8.8	81.2	23.5
OPM (%)	18.1	17.7	14.4	18.0	19.6
ROCE (%)	18.7	19.2	11.1	11.7	14.0
ROAE (%)	21.9	16.7	9.7	12.6	12.5
Equity	117	130	142	181	181
Fully diluted EPS (Rs)	6.7	9.2	9.1	13.0	16.0
P/E(x)	38.9	28.2	28.4	19.9	16.2
EV/EBIDTA (x)	16.1	12.1	15.7	9.5	7.7

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**Growth momentum in PLSC sales continues**

PLSC sales which comprises of CRAMS, APIs, drug discovery services, formulations and food polymers continued its growth momentum recording 27.6% yoy increase in sales to Rs2.35bn. CRAMS which contributes around 60% to PLSC sales recorded a growth of 39% driven by higher volumes and better price realizations. The API business which accounts for 20% of PLSC sales saw a higher volume off take for some of its products. The management also highlighted that its Eli Lilly contract was progressing well in the drug discovery space, estimated to generate revenue of US\$5-7mn annually. PLSC division accounted for 50% of total sales as compared to 43.6% in Q3 FY06 and 45.4% in FY06.

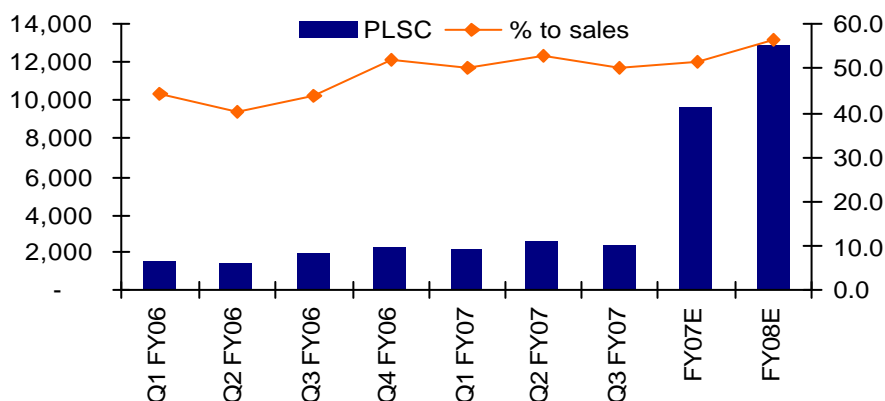
We believe this momentum will continue driven by growth in all four divisions. CRAMS is likely to grow over 25% annually on account of increasing volumes. Jubilant ranked second in pyridine and its derivative market, controls 21% of the world market, the largest producer being Reilly. Syngenta, its biggest customer accounts for around 20% of total pyridine sales. Demand from Syngenta is likely to increase due to cost competitiveness of Jubilant. Jubilant’s capacity is estimated to expand to 32,000 tons in FY08 as compared to 21,000 currently.

With US\$45bn worth of drugs going off patent over the next three years, API business is likely to witness increasing volumes. For one of its key products Oxcarbazepine, Jubilant has started supplies to 5 customers who are likely to commercialize their product over the next two months. For the quarter, Jubilant recorded marginal sales from this product.

With infrastructure and resources in place, drug discovery and development services which comprises of Biosys, Chemsys, Clinsys and Target Research is likely to attain higher traction over the next few years. Jubilant is believed to be close to signing another drug discovery contract with a global pharma company.

Formulations comprising of PSI and Trinity are estimated to contribute 9.6% to the total sales in FY08. Jubilant over the years through organic and inorganic means has transformed itself into a completely integrated player with presence across the entire pharma value chain, which will be a big advantage when the space becomes competitive.

**Sales breakup of PLSC division (Rs mn) and contribution to total sales**



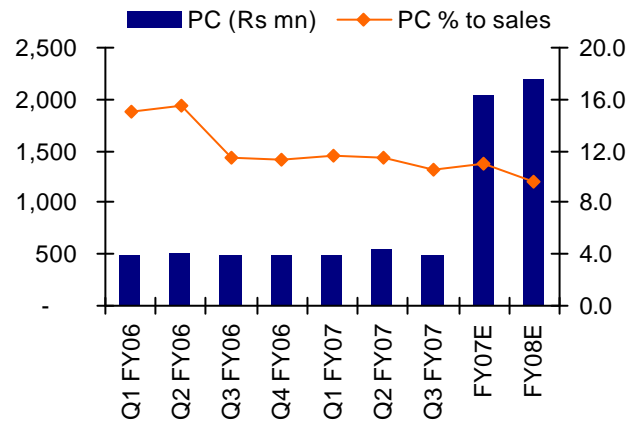
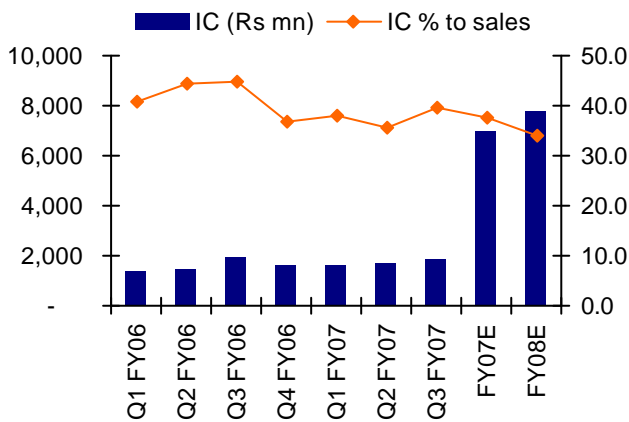
Source: Company/ India Infoline estimates

**Industrial Products records a decline in sales, Performance Polymers records stable growth**

Industrial Products (IP) recorded a decline of 3.3% to Rs1.85bn which impacted overall sales. In Q3 FY06, Jubilant reported merchandise sales of alcohol worth Rs312mn which did not result in this quarter. If we normalize the sales, IP division has grown by 13%. The company has undergone selective long term contracts with large users which protects it from adverse price fluctuations. Jubilant is increasing its export contribution to South East Asia, Middle East and Europe where margins are comparatively better than the domestic market. The growth in this segment is likely to stabilize over the next quarter. IC is estimated to record revenue CAGR of 10.5% to Rs7.7bn over FY06-08.

Performance Polymers (PP) which finds application in construction, textile and tyre industry recorded revenue growth of 6.1% to Rs493mn. This segment has witnessed stable performance over the past two quarters after rationalization of product mix which has provided differentiation to customers. We estimate this division to record revenue CAGR of 7.6% to Rs2.18bn over FY06-08 driven by better product mix and venture into international markets.

**Sales breakup of PLSC division and contribution to total sales**



Source: Company/ India Infoline estimates

**Margins up by 383bps to 19.1% driven by volume led growth and favorable input pricing scenario**

Operating profit margin expanded by 383bps to 19.1% driven by volume led growth and a favorable input pricing scenario. The management expects pricing of molasses as well as alcohol to remain stable over the year. Jubilant produces acetaldehyde using the molasses route as compared to its competitors who use the petroleum route, which enables it to save approximately 10% on costs. Staff cost as a percentage of sales increased to 12.4% from 10.5% in Q3FY06 mainly due to increased head count in the drug discovery division. S,G& A expenses declined by 40% in absolute terms. We estimate operating margins to expand by 520bps to 19.6% over the next two years driven by higher contribution from PLSC division and a favorable material cost scenario.

### Margin expansion and other income leads to a 74% increase in profitability

Margin expansion of 383bps as well as three times increase in other income to Rs168mn from unutilized FCCB proceeds has led to a 74% increase in profitability to Rs637mn, translating into an annualized EPS of Rs14.1 on a fully diluted basis.

### Venture into healthcare space

The management of Jubilant Organosys has decided to venture into the healthcare space with an initial investment of Rs800mn (max commitment over a period of 2 years) in the equity of a company managed by a team of successful professional doctors in West Bengal to acquire up to 96% stake. This Company plans to set up tertiary care super specialty hospital near Kolkata and secondary hospitals in the state of West Bengal. The management has indicated that they would provide further details about this venture over the next 2-3 months. We shall revisit our estimates post this announcement.

### Quarterly Financials

Period to (Rs mn)	12/06 (3)	12/05 (3)	% growth	12/06 (9)	12/05 (9)	% growth
Net Sales	4,693	4,220	11.2	13,464	10,764	25.1
Expenditure	(3,795)	(3,574)	6.2	(11,066)	(9,287)	19.2
Operating profit	898	646	39.0	2,398	1,477	62.4
Other income	168	36	366.7	403	101	299.0
Interest	(49)	(54)	(9.3)	(141)	(143)	(1.4)
Depreciation	(158)	(129)	22.5	(457)	(358)	27.7
PBT	859	499	72.1	2,203	1,077	104.5
Tax	(236)	(121)	95.0	(590)	(256)	130.5
PAT	623	378	64.8	1,613	821	96.5
Minority Interest	(14)	12		(29)	6	(583.3)
APAT	637	366	74.0	1,642	815	101.5
OPM (%)	19.1	15.3	3.83	17.8	13.7	4.09
Equity	143.4	140.3		143.4	140.3	
EPS (Rs) Annualized	17.8	10.4		15.3	7.7	
EPS(Rs) Annualized fully diluted	14.1	8.1		12.1	6.0	
PE(x) Rs259	14.6			17.0		

## Financials

### Income Statement

Period to (Rs in mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Net Sales	8,592	11,703	15,054	18,610	22,751
Operating expenses	(7,041)	(9,626)	(12,883)	(15,260)	(18,292)
Operating profit	1,551	2,077	2,170	3,350	4,459
Other income	99	166	197	558	341
PBIDTA	1,650	2,243	2,367	3,908	4,800
Interest	(358)	(220)	(173)	(185)	(282)
Depreciation	(326)	(381)	(513)	(694)	(772)
Profit before tax (PBT)	966	1,641	1,681	3,029	3,747
Tax	(179)	(432)	(392)	(727)	(899)
Profit after tax (PAT)	787	1,209	1,289	2,302	2,847
Extraordinary / prior period items	(5)	(18)	8	48	55
Adjusted profit after tax (APAT)	782	1,191	1,297	2,350	2,903

### Balance Sheet

Period to (Rs in mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
<b>Sources</b>					
Equity Share Capital	117	130	142	142	142
Reserves & Surplus	1,981	4,915	8,115	10,222	12,687
Net Worth	2,098	5,045	8,257	10,364	12,829
Loan Funds	4,210	3,719	7,220	15,851	14,630
Def Tax liability	742	858	1,042	1,115	1,205
Minority Interest	39	51	151	151	151
<b>Total</b>	<b>7,089</b>	<b>9,672</b>	<b>16,671</b>	<b>27,481</b>	<b>28,815</b>
<b>Uses</b>					
Gross Block	7,344	9,443	14,020	16,179	18,450
Accd Depreciation	(2,840)	(3,151)	(3,779)	(4,473)	(5,245)
Net Block	4,504	6,292	10,242	11,706	13,205
Capital WIP	446	977	1,290	1,346	1,394
Total Fixed Assets	4,950	7,269	11,531	13,052	14,599
Investments	-	2	2	2	2
Total Current Assets	3,732	5,298	8,949	19,525	20,046
Total Current Liabilities	(1,615)	(2,953)	(3,844)	(5,099)	(5,832)
Net Working Capital	2,117	2,346	5,105	14,426	14,214
Miscellaneous expenditure	22	56	32	0	0
<b>Total</b>	<b>7,089</b>	<b>9,672</b>	<b>16,670</b>	<b>27,481</b>	<b>28,815</b>

**Key Ratios**

Period to	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
<b>Per share ratios (Rs)</b>					
Consolidated EPS	6.7	9.2	9.1	16.5	20.4
Fully diluted EPS	6.7	9.2	9.1	13.0	16.0
Div per share	0.7	1.2	1.3	1.6	2.2
Book value per share	17.9	38.9	58.0	72.8	90.1
<b>Valuation ratios (x)</b>					
P/E	38.9	28.2	28.4	15.7	12.7
P/BV	14.5	6.7	4.5	3.6	2.9
M Cap/Sales	3.5	2.9	2.5	2.0	1.6
EV/EBIDTA	16.1	12.1	15.7	9.5	7.7
<b>Profitability ratios (%)</b>					
OPM	18.1	17.7	14.4	18.0	19.6
PAT	9.1	10.2	8.6	12.6	12.8
ROCE	18.7	19.2	11.1	11.7	14.0
ROAE	21.9	16.7	9.7	12.6	12.5
<b>Liquidity ratios</b>					
Current ratio	2.3	1.8	2.3	3.8	3.4
Debtors days	60.4	55.1	60.1	56.4	55.6
Inventory days	55.8	60.4	75.6	59.4	66.6
Creditors days	58.9	69.3	65.3	73.7	67.4
<b>Leverage ratios</b>					
Debt / Total equity	2.01	0.74	0.87	1.53	1.14
<b>Component ratios</b>					
Material Cost	42.7	45.4	46.2	44.1	43.1
Manufacturing Expenses	19.9	10.6	9.5	9.0	8.8
Employee Expenses	7.0	6.9	9.0	10.5	10.4
S&G Exps	2.8	3.3	3.1	2.9	2.8
Other expenses	9.5	16.1	17.8	15.5	15.3
<b>Payout ratios</b>					
Dividend payout	12.2	15.5	16.1	11.1	12.3
Tax payout	18.5	26.3	23.3	24.0	24.0



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