

Jubilant Organosys

STOCK INFO.	BLOOMBERG
BSE SENSEX: 9,314	VAM IN
	REUTERS CODE
S&P CNX: 2,829	JUBO.BO

17 January 2006

Buy

Previous Recommendation: Buy

Rs1,140

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	28.4	03/05A	11,703	1,126	41.1	23.2	27.7	4.9	28.0	22.0	2.9	16.5
52-Week Range	1,205/741	03/06E	14,986	1,390	45.3	10.1	25.2	3.7	19.0	15.4	2.5	16.0
1,6,12 Rel. Perf. (%)	9/-7/-10	03/07E	19,414	2,218	72.0	59.0	15.8	3.0	23.0	18.4	1.9	10.6
M.Cap. (Rs b)	32.3											
M.Cap. (US\$ b)	0.7											

Jubilant's 3QFY06 performance was lower than our expectation, with a squeeze in EBITDA margins of 200bp. Results for the quarter are not fully comparable, as they include the impact of recently acquired Trinity Labs and Target Research.

- Net sales growth of 46.5% YoY to Rs 4.2b, driven by 68% growth in Pharma & Life Science business (P&LS) and 40% growth in Industrial Chemicals business.
- However, lower realizations in the API business, losses in PSI (Belgium), Chemsys and Clinsys, and higher staff costs led to a 200bp decline in EBITDA margins to 15.3%, resulting in lower profit growth at 36% to Rs366m. Staff costs include a one-time expenditure of Rs80m.
- We expect a gradual improvement in EBITDA margins and more than 100% increase in earnings over the next two years led by increased traction in CRAMS, commencement of supplies of Oxcarbazepine, and lower molasses prices.

We expect margins to stabilize and improve gradually over FY06, with the growing share of P&LS business and easing raw material prices. This along with healthy growth in revenues would lead to an impressive 38% CAGR in fully diluted earnings over FY05-08. The stock trades at 15.8x FY07E earnings. We maintain **Buy** with a price target of Rs1,230.

QUARTERLY PERFORMANCE										(Rs Million)	
Y/E MARCH	FY05				FY06				FY05	FY06E	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			
Net Sales	2,661	2,937	2,890	3,215	3,267	3,315	4,234	4,170	11,703	14,986	
YoY Change (%)	46.9	39.9	27.5	33.7	22.8	12.9	46.5	29.7	36.2	28.1	
Total Expenditure	2,085	2,350	2,390	2,802	2,873	2,878	3,588	3,283	9,627	12,622	
EBITDA	576	587	500	413	394	437	646	887	2,076	2,364	
Margins (%)	21.6	20.0	17.3	12.8	12.1	13.2	15.3	21.3	17.7	15.8	
Depreciation	94	97	96	94	111	118	129	130	381	488	
Interest	67	56	49	48	49	40	54	54	220	197	
Other Income	10	29	17	21	31	34	36	43	77	144	
PBT after EO Expense	425	463	372	381	265	313	499	746	1,641	1,823	
Tax	66	153	90	41	55	80	121	155	188	411	
Deferred Tax	77	0	4	0	0	0	0	0	243	0	
Rate (%)	33.6	33.0	25.3	10.8	20.8	25.6	24.2	20.8	26.3	22.5	
Minority Interest	13	-1	9	-3	-3	3	12	10	18	22	
Reported PAT	269	311	269	343	213	230	366	581	1,192	1,390	
Adjusted PAT	269	311	269	277	213	230	366	581	1,103	1,390	
YoY Change (%)	96.4	79.8	20.1	11.4	-20.8	-26.0	36.1	109.5	41.0	26.0	
Margins (%)	10.1	10.6	9.3	8.6	6.5	6.9	8.6	13.9	9.4	9.3	

E: MOST Estimates

Nimish Desai (Nimishdesai@MotilalOswal.com); Tel: +91 22 39825406/Jinesh K Gandhi (Jinesh@MotilalOswal.com); Tel +91 22 39825416

© Motilal Oswal Securities Ltd., 3 Floor, Hoechst House Nariman Point, Mumbai 400 021 Tel: +91 22 38925500 Fax: 2281 6161 www.MotilalOswal.com

Revenue growth driven by pharma and industrial chemicals business

Jubilant Organosys reported a 46.5% YoY growth in revenues (to Rs4.2b) for 3QFY06. Growth was largely driven by 68% growth (to Rs1.9b) in the pharma & life sciences (P&LS) business. Growth in P&LS business was largely driven by 58% YoY growth in CRAMS segment due to higher volume and better realizations as couple of pyridine facilities of its global competitor were shutdown. However, continued pricing pressure in API business restricted growth in API business to 25% led mainly by volume growth.

While industrial chemical business grew by 40% YoY (to Rs1.9b), driven primarily by 18% volume growth in acetyl on account of de-bottlenecking, performance chemical business recorded 12% YoY growth due to improved performance by key growth units such as Industrial adhesives, V P Latex, Woodworking solutions and specialty gases.

Although some part of the growth was driven by consolidation of recently acquired Trinity Labs and Target Research, contributions from these entities are very marginal with 3QFY06 revenues of Rs100m and Rs200m respectively. The organic growth rate for the overall business was around 36%.

TREND IN PRODUCT MIX (RS M)

	3Q FY06	3Q FY05	YOY GR. (%)	2Q FY06	OOQ GR. (%)
Pharma & Life Sciences	1,854	1,102	68.2	1,344	37.9
% of Sales	43.8	38.1		40.5	
Performance Chemicals	485	433	12.0	531	-8.7
% of Sales	11.5	15.0		16.0	
Industrial Chemicals	1,895	1,355	39.9	1,440	31.6
% of Sales	44.8	46.9		43.4	
Total Revenues	4,234	2,890	46.5	3,315	27.7

Source: Company/Motilal Oswal Securities

Regulated market drives revenue growth

In terms of market mix, domestic operations grew by 41.4% YoY to Rs2.5b, whereas International operations grew at 54.6% YoY. Growth in international operations was driven by a 63.6% YoY growth in regulated markets due to

consolidation of recent acquisitions (Trigen and Target Research).

TREND IN MARKET MIX (RS M)

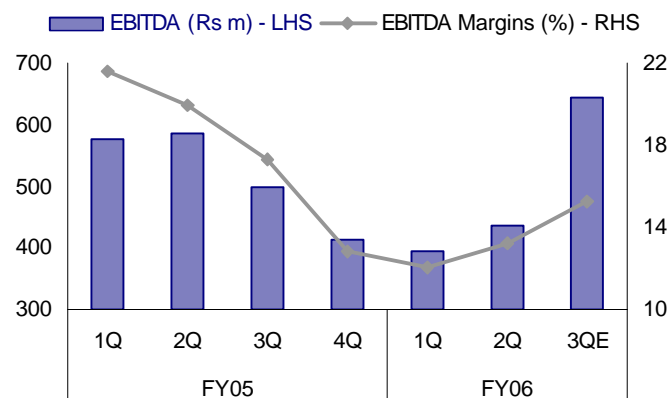
	3Q FY06	3Q FY05	YOY GR. (%)	2Q FY06	OOQ GR. (%)
Market Mix					
Domestic	2,502	1,770	41.4	2,269	10.3
% of Sales	59.1	61.2		68.4	
International Operations					
Regulated Markets	1,070	654	63.6	537	99.3
% of Sales	25.3	22.6		16.2	
Other Markets	662	466	42.1	509	30.1
% of Sales	15.6	16.1		15.4	
Total Inter. Operations	1,732	1,120	54.6	1,046	65.6
% of Sales	40.9	38.8		31.6	
Total Revenues	4,234	2,890	46.5	3,315	27.7

Source: Company/Motilal Oswal Securities

EBITDA margins – hit by lower API realizations and higher staff cost

Lower API realizations and higher staff cost (up by 130% YoY due to higher recruitment and consolidation of acquired companies), coupled with continued firmness in prices of key raw materials for most of 3QFY06 impacted EBITDA margins during the quarter. Also, higher investment in new areas like custom and clinical research (through Jubilant Biosys, Chemsys and Clinsys), along with consolidation of recent acquisitions (which have lower margins) also contributed to the margin decline. This resulted in 200bp YoY decline in EBITDA margins to 15.3%, translating into 36.1% net profit growth to Rs 366m.

TREND IN EBITDA



Source: Company/Motilal Oswal Securities

However, we are not overtly concerned by the situation on the margins front, as going forward, we expect EBITDA margins to stabilize and increase gradually over next couple of years. The full impact of lower molasses prices and increases in prices of industrial chemicals taken by the company would begin to take effect from 4QFY06, while the commencement of Oxcarbazepine supplies (to USA) would lead to significant improvement. Overall, we expect EBITDA margins to stabilize in the 15-16% range in FY06, with rapid topline growth expected to drive growth in bottomline.

CRAMS business: to be key growth driver

Good progress in CRAMS drove the higher growth in P&LS division during the quarter. While, the removal of capacity constraints and higher price realizations led to a healthy 58% growth in CRAMS turnover in 3QFY06, securing of Eli Lilly contract would augur well for future growth. Jubilant Biosys, the informatics services business, and Jubilant Chemsys, the chemistry services business, recorded a good growth during the year. Jubilant Clinsys, CRO has commenced operations by undertaking a few bio equivalence studies.

CRAMS division is expected to do well with increase in volumes of CRAMS I (fine chemicals) due to expanded capacity and robust business environment for CRAMS II (advance intermediates) on account of higher volumes due to addition of new products (around 3-4 every quarter), higher price realizations and softer raw material prices. Also, integration of Jubilant Clinsys with Target Research Associates, the CRO acquired in USA will strengthen Jubilant's presence in clinical research business as it would be able to offer full service clinical operations along with data management services. We expect Jubilant's CRAMS business (including contract research) to record almost 50% CAGR for FY05-08.

Oxcarbazepine: next big opportunity

Oxcarbazepine (*Trileptal*) is expected to be a major growth driver for Jubilant over the next couple of years. Trileptal is Novartis' US\$700m anti-epilepsy product, going off patent in July 2005 (including pediatric exclusivity). Although there are 10 DMFs filed for this product, Jubilant has already tied up with around 6-8 generic companies, including most major players, for API supply – of these, 3 have already filed their ANDAs. ANDA filings in Oxcarbazepine was delayed due to late expiry of data exclusivity – as such, entry of generics in this product is expected only by late 4QFY06 or early 1QFY07. Commercial supplies from Jubilant are thus expected to commence in 4QFY06. Jubilant also plans to target patent holder Novartis as a potential customer for this product – the company has an existing relationship with Novartis AG (for supply of Carbamazepine) and in fact is already supplying Oxcarbazepine to Novartis India. The company is setting up dedicated API facility to cater to the Oxcarbazepine opportunity.

We have factored in sales of only 20 tonnes (Rs272m) in FY06 taking into account any potential delay in entry of generics. This however is expected to grow to 58 tonnes (sales of Rs741m) in FY07E, as many of the company's partners launch their products and the full benefits of augmented capacity comes through.

Revising estimates

We are revising our earnings estimates for FY06 and FY07 to factor in:

- Higher than estimated staff cost
- Drug discovery contract from Eli Lilly spread over the next five years

REVISED FORECAST (RS M)

	FY06E			FY07E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	14,986	14,833	1.0	19,414	18,964	2.4
Net Profit	1,390	1,406	-1.1	2,218	2,249	-1.3
EPS (Rs)	45.3	45.8	-1.1	72.0	73.0	-1.3

Source: Company/Motilal Oswal Securities

Well placed to tap emerging opportunities

Jubilant has achieved global scale and presence without putting undue strain on its balance sheet or profitability and return ratios. Over the last three years (FY02-05), Jubilant has expanded its revenues and gross block at a CAGR of 25% and 19% respectively, while net profit has grown at 68% CAGR. Moreover, the company has been able to achieve this while maintaining healthy return ratios in excess

of 20% over this period. With revenues of Rs11.7b and cash flow from operations of around Rs1.4b in FY05, Jubilant is well placed to capitalize on the emerging opportunities for Indian Pharma companies. We expect the company to report a 38% CAGR in earnings (fully diluted) over FY05-08E. At 15.8x FY07E earnings, we maintain our **Buy** recommendation with price target of Rs1,230.

Jubilant Organosys: an investment profile

Company description

Jubilant Organosys is the largest specialty chemicals company in India with global scale and reach in almost all its key products. Its business model spans pharmaceuticals & life sciences, industrial chemicals and performance chemicals. It has forayed into API business (by acquiring Max India's API operations) and into formulations and regulatory services (by acquiring PSI n.v and PSI supply).

Key investment arguments

- ✍ A composite and integrated player with offerings across the pharma and specialty chemicals value chain
- ✍ Continuous forward integration, with global scale capacities in key products and widespread global presence puts Jubilant on the high growth path
- ✍ Growing share of the profitable Pharma business, driven by APIs (Lamotrigine & Oxcarbazepine) & CRAMS business, to ensure higher profitability

Key investment risks

- ✍ Rising molasses prices and inability to pass it on would erode profitability of Industrial Chemicals
- ✍ Ability to maintain its strong relationships with global clients and build on them is critical for continued success
- ✍ Severe pricing pressure in regulated markets could impact the company's future revenues and profitability

COMPARATIVE VALUATIONS

		JUBILANT	BIOCON	NPIL
P/E (x)	FY06E	25.1	27.6	40.5
	FY07E	15.8	20.4	21.4
P/BV (x)	FY06E	3.7	5.5	6.5
	FY07E	3.0	4.6	5.4
EV/Sales (x)	FY06E	2.5	6.1	4.0
	FY07E	1.9	4.7	3.4
EV/EBITDA (x)	FY06E	16.0	20.3	24.0
	FY07E	10.5	15.3	14.9

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	52.9	53.2	57.3
Domestic Institutions	2.1	2.3	4.0
FII's/FDIs	29.6	29.5	16.5
Others	15.4	15.0	22.2

Recent developments

- ✍ Entered into a 5 year agreement with Eli Lilly, US for providing a range of collaborative drug discovery services

Valuation and view

- ✍ Growing share of P&LS business to boost profitability and improve quality of earnings
- ✍ With global scale and reach in place, it is well placed to capitalize on the emerging opportunities for Indian pharma companies
- ✍ Valuations at 15.8x FY07E EPS do not fully reflect strong earnings growth and healthy return ratios, leaving significant room for re-rating; **Buy** with a target price of Rs1,230

Sector view

- ✍ Regulated markets would remain the key sales and profit drivers in the medium term
- ✍ FY05 and FY06 to be years of consolidation in terms of profitability
- ✍ We are overweight on companies that are towards the end of the investment phase

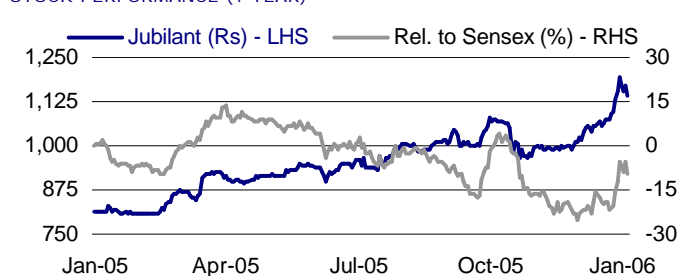
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	49.0	48.3	1.4
FY07	78.2	79.6	-1.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,140	1,230	7.9	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Net Sales	8,592	11,703	14,986	19,414	22,164	
Change (%)	20.9	36.2	28.1	29.5	14.2	
EBITDA	1,551	2,076	2,364	3,479	4,457	
Margin (%)	18.1	17.7	15.8	17.9	20.1	
Depreciation	326	381	488	497	527	
EBIT	1,225	1,695	1,876	2,982	3,930	
Int. and Finance Charges	358	220	197	107	56	
Other Income - Rec.	99	77	144	100	105	
PBT before EO Expense	966	1,552	1,823	2,975	3,979	
Extra Ordinary Expense/(Income)	0	-89	0	0	0	
PBT	966	1,641	1,823	2,975	3,979	
Current Tax	64	188	167	282	381	
Deferred Tax	115	243	244	464	618	
Tax Rate (%)	18.5	26.3	22.5	25.1	25.1	
PAT	787	1,210	1,412	2,229	2,981	
Less: Minority Interest	5	18	22	11	17	
Adj Net Profit	782	1,126	1,390	2,218	2,963	
Change (%)	133.6	44.0	23.4	59.6	33.6	
Margin (%)	9.1	9.6	9.3	11.4	13.4	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Equity Share Capital	117	130	142	142	142	
Fully Diluted Share Capital	117	139	155	155	155	
Total Reserves	1,981	5,860	8,551	10,485	13,097	
Net Worth	2,098	5,989	8,693	10,627	13,239	
Minority Interest	39	178	204	229	269	
Deferred liabilities	742	984	1,229	1,693	2,310	
Total Loans	4,210	3,833	7,695	6,495	5,995	
Capital Employed	7,089	10,985	17,820	19,044	21,813	
Gross Block	7,344	8,943	13,483	13,983	14,460	
Less: Accum. Deprn.	2,840	3,251	3,739	4,235	4,729	
Net Fixed Assets	4,504	5,693	9,745	9,748	9,731	
Capital WIP	446	446	446	446	446	
Goodwill	0	0	1,988	2,344	2,344	
Curr. Assets	3,731	7,007	8,416	10,158	13,517	
Inventory	1,314	1,931	2,349	3,049	3,509	
Account Receivables	1,421	2,148	2,592	3,363	3,866	
Cash and Bank Balance	227	1,876	2,136	2,067	4,235	
Loans & Advances	769	1,053	1,338	1,679	1,907	
Curr. Liability & Prov.	1,614	2,182	2,795	3,674	4,247	
Account Payables	1,386	1,796	2,352	3,043	3,456	
Provisions	229	387	444	631	791	
Net Current Assets	2,117	4,825	5,620	6,484	9,270	
Misc Expenditure	22	22	22	22	22	
Appl. of Funds	7,089	10,986	17,821	19,044	21,812	

E: Most Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Basic (Rs)						
EPS	33.4	43.5	49.0	78.2	104.4	
Fully Diluted EPS	33.4	41.1	45.3	72.0	96.0	
Cash EPS	47.2	54.2	60.6	87.6	112.6	
BV/Share	88.5	230.2	305.6	373.8	465.8	
DPS	5.0	6.3	7.0	10.0	12.5	
Payout (%)	12.2	15.5	14.8	13.3	12.4	
Valuation (x)						
P/E (on fully diluted EPS)		27.7	25.2	15.8	11.9	
Cash P/E		21.0	18.8	13.0	10.1	
P/BV		4.9	3.7	3.0	2.4	
EV/Sales		2.9	2.5	1.9	1.5	
EV/EBITDA		16.5	16.0	10.6	7.6	
Dividend Yield (%)		0.5	0.6	0.9	1.1	
Return Ratios (%)						
RoE	44.0	28.0	19.0	23.0	24.9	
RoCE	22.3	22.0	15.4	18.4	22.2	
Working Capital Ratios						
Asset Turnover (x)	12	1.1	0.8	1.0	1.0	
Debtor (Days)	60	67	63	63	64	
Inventory (Days)	56	60	57	57	58	
Working Capital Turnover (Days)	90	150	137	122	153	
Leverage Ratio (x)						
Current Ratio	2.3	3.2	3.0	2.8	3.2	
Debt/Equity	2.1	0.7	0.9	0.6	0.5	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Oper. Profit/(Loss) before Tax	1,500	2,076	2,364	3,479	4,457	
Interest/Dividends Recd.	16	77	144	100	105	
(Inc)/Dec in WC	-319	-628	-506	-893	-577	
CF from Operating incl EO	1,133	1,426	1,835	2,404	3,604	
(inc)/dec in FA	-801	-1,518	-6,529	-857	-478	
(Pur)/Sale of Investments	66	0	0	0	0	
CF from investments	-736	-1,518	-6,529	-857	-478	
Issue of Shares	0	2,248	1,497	0	0	
Inc/(Dec) in Debt	199	-377	3,840	-1,214	-532	
Interest Paid	-396	-220	-197	-107	-56	
Dividend Paid	-136	-185	-206	-295	-369	
CF from Fin. Activity	-333	1,466	4,934	-1,616	-956	
Inc/Dec of Cash	64	1,374	240	-69	2,169	
Add: Beginning Balance*	106	334	1,876	2,136	2,067	
Closing Balance	171	1,708	2,116	2,067	4,237	

*Cl. & Opn. cash balances for FY03, FY04 and FY05 do not match due to acquisition

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

Jubilant Organosys

- | | |
|--|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

MOST is not engaged in providing investment-banking services.

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.