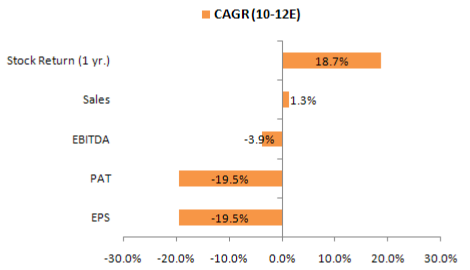
Visit Note

Industry	Pharmaceuticals

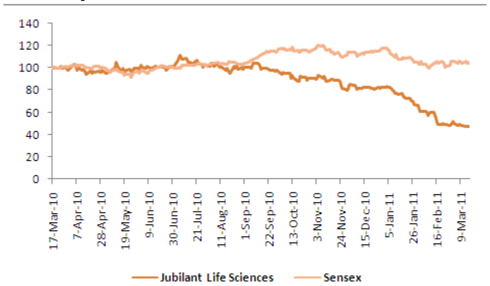


Price	160.0
Target Price	188
Last call	BUY (19-11-10 at ₹ 310)
Expected share price return	17.5%
Expected dividend yield	1.2%
Expected total return	18.7%

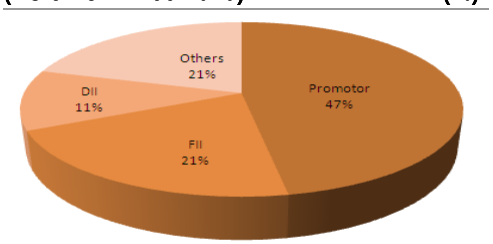
Market Data

Market Cap.	₹25.41bn/ US$ 564.6mn
Share Cap. (mn)	38743.2
52 Wk High/Low	395.45 /155.10
Avg. Vol. (Weekly)	279.6

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



Shareholding Pattern (As on 31st Dec 2010) (%)



Financials (₹ Mn)	FY10	FY11	FY12
Total Revenue	37812.7	34789.2	38801.6
Growth %	7.5	-8.0	11.5
EBITDA	8060.9	5948.9	7449.9
EBITDA margin %	21.2	17.1	19.2
Reported PAT	4214.6	2342.2	2728.5
Reported EPS (₹)	26.5	14.7	17.1
CEPS (₹)	31.0	24.6	29.1
EV/EBITDA	6.5	8.9	6.8
EV/Sales	1.4	1.5	1.3
ROE %	21.3	9.8	10.4
ROCE %	13.0	6.3	8.9
P/E (x)	6.1	11.0	9.4
P/CEPS (x)	5.2	6.6	5.5

Jubilant Life Sciences Ltd. (JOL IN)

March 18, 2011

Downgrade from Buy to "HOLD"

HOLD (CMP: ₹160)

Market Cap ₹99bn; USD: 2.15bn

We recently met the management of Jubilant Life Sciences Ltd. to get an update on its business segments, overall CRAMS industry and other developments. The management foresees a gradual recovery in the Pharma outsourcing here onwards, as the innovators are almost done with their stock rationalisation drive and the order flow (on both the manufacturing as well as research front) has been improved. Specific to Jubilant, the company (which struggled to revive its CRAMS operation in recent quarters) would continue to see the impact of high base of Q4FY10 (boosted by one-off H1N1 supply worth $22mn) on its CMO business in Q4FY11. The drug discovery services business (down by 20% in 9mFY11) is expected to recover gradually and the life science product segment (accounting for over 60% of total sales) is likely to deliver muted growth. The margins to remain under pressure in near future due to the weaker revenue and lower asset utilisation in the CRAMS operation. Moreover, Jubilant has raised fresh funds worth ₹7bn and has tied up for another ₹3bn at a cost of 10.75% for refinancing its FCCBs worth $202mn (including redemption premium due in May 2011). This refinancing would affect the overall profitability of the company (that has already reported 31% decline in PAT adjusted for demerger in 9mFY11) in the near future. Considering the scenario, we downgrade our rating from Buy to "HOLD" with a target price of ₹188/share.

One-off gain from H1N1 order from GSK boosted H2FY10 earnings but no repeat orders thereupon

The CMO operations of the company (contributing about 14% of total sales), were boosted in H2FY10 by the one-off supply order of H1N1 vaccine worth $33mn from GlaxoSmithKline. However, there were no repeat orders (despite earlier indications), which has affected the recent revenue performance of the CMO business. Regarding the said order, $11mn was executed in Q3FY10 and $22mn in Q4FY11. Considering this supply opportunity, the company had expanded CMO capacity from 120mn Vials to 180mn, but owing to no repeat orders, the asset utilization remains just about 50-55%.

Refinancing of FCCBs to hit FY12 earnings

Jubilant has an outstanding FCCB worth $142.1mn, which is due for conversion (at a price of ₹379 v/s CMP of ₹161) on or before 10th May 2011. The redemption amount would be US$ 202mn (i.e. at a premium of 42.2%). The entire FCCB will be refinanced by fresh debt. The company has already raised debt worth ₹7bn at a cost of 10.75% and is about to raise ₹3bn shortly. This would act against the earlier thought process of financial deleveraging of the company. Thus, the incremental financial cost would surge substantially from the estimated ₹1.03bn to ₹1.7bn in FY12. Such a development would keep the company's FY12E D/E >1.1x (v/s our earlier estimate of 0.9x).

Cut FY11-FY12 earnings estimates by 43-51%

Given the facts, we estimate Jubilant to report weaker earnings performance in Q4 with a PAT (after adjusting for the demerger) of ₹699mn, 40% down on Y-o-Y basis. Considering the below expected performance in 9mFY11, weak core operating in the near future and higher finance cost (led by FCCB refinancing), we downgrade our FY11 and FY12 EPS estimates by 43% and 51% to ₹14.7/share and ₹17.1/share, respectively.

Downgrade Rating from Buy to "HOLD"

In line with the negative earnings surprises in recent quarters, the stock has faced the due consequences, by correcting ~ 50% to CMP of ₹160. At the CMP the stock discounts our revised FY12 EPS and EBITDA by 9.4x (v/s its historical range of 8-12) and 6.8x (v/s its historical range of 8-12), respectively. With no major earning triggers in the offing we believe the stock is fairly valued and accordingly downgrade our rating from Buy to "HOLD" with the revised 12-month target price of ₹188 (11x FY12E EPS).

We recently met the management of Jubilant Life Sciences Ltd. in order to get an update on the overall CRAMS industry and the company specific developments. The highlights of the meeting are as follows: -

One-off gain from H1N1 order from GSK boosted H2FY10 earnings but no repeat orders thereupon

The CMO operations of the company (contributing about 14% of total sales), were boosted in H2FY10 by the one-off supply order of H1N1 vaccine worth $33mn from GlaxoSmithKline. However, there were no repeat orders (despite earlier indications), which has affected the recent revenue performance of the CMO business. Regarding the said order, $11mn was executed in Q3FY10 and $22mn in Q4FY11. Considering this supply opportunity, the company had expanded CMO capacity from 120mn Vials to 180mn, but owing to no repeat orders, the asset utilization remains just about 50-55%.

Refinancing of FCCBs to hit FY12 earnings

JOL has an outstanding FCCB worth $142.1mn, which is due for conversion (at a price of ₹ 379 v/s CMP of ₹ 161) on or before 10th May 2011. The redemption amount would be US$ 202mn (i.e. at a premium of 42.2%). The entire FCCB will be refinanced by fresh debt. The company has already raised debt worth ₹ 7bn at a cost of 10.75% and is about to raise ₹ 3bn shortly. This would act against the earlier thought process of financial deleveraging of the company. Thus, the incremental financial cost would surge substantially from the estimated ₹ 1.03bn to ₹ 1.7bn in FY12. Such a development would keep the company's FY12E D/E >1.1x (v/s our earlier estimate of 0.9x).

Q4FY11 will remain depressed

While no major growth is anticipated in its Life Sciene Product segment (contributing over 70% of total revenue and reported growth of just 8% in 9mFY11), the CRAMS operations would see the impact of high base of Q4FY10, hence we believe that Jubilant would deliver weak revenue performance in Q4FY11. Due to the lower asset utilisation of the CRAMS operation, the margins will remain under pressure at 17%. Subsequently, the higher finance costs because of the refinancing of FCCB would drag the profitability of Q4FY11. We estimate Q4FY11 PAT at ₹ 699mn, which would be 40% down on Y-o-Y basis.

Q3FY11 as well as 9mFY11 results were disappointing

JOL reported 10% y-o-y decline in revenues to ₹8.69bn. While the CRAMS business saw the impact of destocking of products (specifically the H1N1 vaccine) coupled with delay in milestone receipts, the life science products division faced pricing pressure (by 2%), which resulted in 860bps fall in OPM to 15.2% (v/s est. 18.2%). Hence, both operating profit as well as the net profit reported 43% & 59% fall to ₹ 1.32bn and ₹ 441mn respectively in Q3FY11.

During 9mFY11, the revenues were down by 9% to ₹ 25.5bn, the OPM contracted by 420bps to 16.6% (led by under utilization in CRAMS operation and pricing pressures in the life science products segment), resulting in 41% fall in the net profit to ₹ 2.84bn. The decline in PAT was partly justified by the demerger (which happened in Q3FY11) of its Agro & Performance Polymer business (which contributed 15% & 14% to the combined revenues and profits respectively in H1FY11). Adjusting the impact of demerger, the PAT for 9mFY11 was down by 31%, mainly due to lower revenue and margin pressures.

Revise down FY11-FY12 earnings estimates by 43-51%; Downgrade to "HOLD"

JOL has already delivered a disappointing performance in 9mFY11 and demerged its APP business to a separate company (Jubilant Industries Ltd.) during the quarter (which contributed 15% & 14% to the combined revenues and profits respectively in H1FY11). Hence, in order to factor the below expected core operating performance, higher finance cost (led by FCCB refinancing) and demerger of APP operation, we downgrade our FY11 and FY12 EPS estimates by 43% and 51% to ₹14.7/share and ₹17.1/share, respectively.

Surya Narayan Patra
suryapatra@systematixshares.com
(+91 22 3029 8186)

Other Highlights

- After the demerger of the Agro & Performance Polymer business, Proprietary Product & Exclusive Synthesis becomes the largest revenue segment of the company and it is a commoditized segment. The growth of this space is subject to price performance of the Pyridine products, which is very volatile. Hence, we expect the said segment to deliver moderate growth of 6-7% in FY12.
- In order to counter the delay in research projects caused by FDA issues (i.e delay in approval) and to cater to their urgent need for building a pipeline of innovative products (to save their sales due to patent expiries worth >$90bn over next 5 year), leading innovators have shifted their focus from clinical to pre-clinical R&D. We believe either the outsourcing of such pre-clincal projects or collaborative research arrangments would revive the growth momentum for CRAMS players in the near term.

  We expect Jubilant (with larger capability on pre-clinicals compared to other Indian CRAMS players),would be the largest beneficiary of this wave of pre-clinicals research outsourcing. However, this is a long gestation operation and is a marginal (i.e.5%) revenue contributor implying no major growth in the near term.
- Company has setup an API Facility to tap the upcoming generic supply opportunity of “Sartans”. But the patent of these Sartan’s would expire by September 2012 onwards. Thus, we expect the supply of the Sartans would be materialised only in the fag end of FY12.

Financial Outlook remains weak

- Since, there are no major revenue triggers in the offing, we estimate Jubilant to deliver just 11% growth in FY12 to ₹ 38.8bn.
- With the improving CRAMS business scenario and likely improvement in asset utilisation, the margins would expand by 200bps to 19.2%, resulting in 25% growth in EBITDA in FY12.
- Due to a substantial jump in the finance cost on the back of FCCB refinancing, the net profit would see just 17% growth to ₹ 2.72bn in FY12. The revised EPS for FY11 and FY12 stands at ₹14.7/share (down by 43%) and ₹17.1/share (down by 51%), respectively.
- The company has been incurring Capex in the range of ₹2-4bn pa but the asset turnover has consistently been less than 1x and we expect it to remain at those levels in the near future. Hence, the estimated return ratios remain weak. The estimated ROCE & ROE for FY12 is 8.9% and 10.4%, respectively.
- At CMP of ₹ 161, the stock is trading 9.4x its FY12EPS and 6.8x its FY12 EV/EBITDA. We feel the stock is almost fully priced. Hence, in line with our cutting of estimates, we downgrade our rating from Buy to **“HOLD”** with the revised 12-month target price of ₹ 188 (11x FY12E EPS).

Table 1: Earning Estimates (₹ Mn.)

Revision in Earning Estimates:	Old Estimates		Revised Estimates		Revision (%)	
	FY11	FY12	FY11	FY12	FY11	FY12
Sales	41688.1	47277.3	34789.2	38801.6	-16.5	-17.9
EBITDA	8045.8	9880.9	5948.9	7449.9	-26.1	-24.6
EBITDA margin%	19.3	20.9	17.1	19.2		
PAT	4087.6	5548.4	**2342.2**	**2728.5**	-42.7	-50.8
EPS	25.7	34.8	14.7	17.1	-42.7	-50.8

Source: Company and Systematix Institutional Research

Table 2: Profit & Loss Statement (₹ Mn)

Y/E March	FY2008	FY2009	FY2010	FY2011	FY2012
Net Sales	24888.8	35179.8	37812.7	34789.2	38801.6
% Growth	37.5	41.3	8.0	-8.0	11.5
EBIDTA	4507.1	4652.9	8060.9	5948.9	7449.9
% Growth	77.7	3.2	73.2	-21.3	25.2
Other Income	390.3	425.0	198.6	104.4	116.4
Interest	336.7	1070.4	1505.2	1025.5	1703.7
Depreciation	1039.1	1632.4	1246.8	1986.7	2400.0
PBT	3521.6	2375.1	5507.5	3041.2	3462.6
% Growth	53.4	-32.6	131.9	-41.3	13.9
Tax	572.8	267.2	959.4	403.3	692.5
PAT	3988.5	2698.6	4219.5	2377.8	2770.1
% Growth	152.0	-32.3	56.4	-43.6	16.5
Minority Int. (MI)	16.5	133.2	4.9	35.7	41.6
Reported PAT	4004.9	2831.8	4214.6	2342.2	2728.5
% Growth	146.9	-29.3	48.8	-44.4	16.5
Reported EPS	25.1	17.8	26.5	14.7	17.1
Dividend (%)	126.0	127.0	128.0	129.0	130.0
BVPS (Rs)	71.3	87.6	124.9	136.2	149.4

Source: Company, Systematix research

Table 3: Balance sheet (₹ Mn)

Y/E March	FY2008	FY2009	FY2010	FY2011	FY2012
Eqty Cap	147.0	147.6	158.8	159.3	159.3
Reserves	12415.0	15278.9	21854.6	23842.6	26156.9
Networth	12561.9	15426.5	22013.4	24001.9	26316.2
Secured loans	10585.9	29663.0	21607.9	30838.3	27864.1
Unsecured loans	10498.7	9754.9	10119.4	7904.9	1510.4
Total loans	21084.5	39417.9	31727.3	38743.2	29374.6
Deffered Tax Liab	1302.3	1150.6	1924.2	1849.2	1849.2
Minority Int.	213.9	319.5	379.2	414.8	456.4
Total Liability	**35162.7**	**56314.6**	**56044.1**	**65009.2**	**57996.3**
Net Block	23971.1	42481.2	43245.2	44943.3	45685.7
Investments	456.4	2713.6	2564.1	1064.1	1064.1
Inventory	4349.7	5956.1	6909.5	7111.3	6871.6
Debtors	4257.8	5044.1	5186.1	5242.2	5315.3
Cash balance	5237.7	3816.6	5036.7	11666.8	4060.3
Other CA	3552.7	4854.9	5182.7	5566.3	4656.2
Current Liabilities	3717.8	6727.8	7535.3	6195.3	7654.0
Provisions	2961.3	4578.5	4665.9	4389.4	2002.8
NCA	10718.8	8365.5	10114.0	19001.8	11246.6
Misc Exp	16.5	3.3	0.0	0.0	0.0
Total Assets	**35162.7**	**56314.6**	**56044.0**	**65009.2**	**57996.3**

Source: Company, Systematix research

Table 4: Ratio Analysis

Y/E March	FY2008	FY2009	FY2010	FY2011	FY2012
OPM %	18.1	13.2	21.2	17.1	19.2
NPM %	16.1	8.0	11.1	6.7	7.0
ROE %	31.9	18.4	19.1	9.8	10.4
ROCE %	11.0	6.1	11.9	6.3	8.9
Int. Cover (x)	14.5	4.7	5.3	5.9	4.4
D/E (x)	1.7	2.6	1.4	1.6	1.1
Asset Turnover (x)	0.8	0.7	0.7	0.6	0.6
Debtors Days	62.4	52.3	49.8	55.0	50.0
Inventory Days	77.9	71.2	84.3	90.0	80.0
Valuation ratios					
P/CF per share (x)	5.6	6.3	5.2	6.5	5.5
EV/Cash Profit (x)	7.8	13.3	9.5	12.1	9.9
EV/EBIDTA (x)	8.7	12.7	6.9	8.8	6.8
EV/Sales (x)	1.6	1.7	1.4	1.5	1.3
Mkt Cap/Sales(x)	0.9	0.7	0.7	0.7	0.7
CEPS (Rs)	28.6	25.3	31.0	24.6	29.1
P/ BV (x)	2.2	1.8	1.3	1.2	1.1

Source: Company, Systematix research

Table 5: Cash Flow Statement (₹ Mn)

Y/E March	FY2008	FY2009	FY2010	FY2011	FY2012
PAT	4004.9	2831.8	4214.6	2342.2	2728.5
Depreciation	1039.1	1632.4	1246.8	1986.7	2400.0
Change in WC	(1824.0)	932.2	(528.3)	(2257.8)	148.8
Operating CF	3220.1	5396.4	4933.1	2071.1	5277.3
Capex	(10777.7)	(21707.7)	(1995.2)	(3684.8)	(3142.3)
Misc Exp	(432.0)	(812.3)	2715.7	0.0	0.0
Investing CF	(11209.7)	(22520.1)	720.5	(3684.8)	(3142.3)
Equity	593.8	(112.3)	3477.9	100.7	0.0
Dividends	(256.6)	(261.3)	(370.3)	(372.8)	(372.8)
Debt	4558.4	18333.4	(7690.6)	7015.9	(9368.6)
Investments	(417.5)	(2257.2)	149.5	1500.0	0.0
Financing CF	4478.2	15702.7	(4433.5)	8243.8	(9741.4)
Net Change	(3511.4)	(1421.0)	1220.1	6630.1	(7606.5)
Opening Cash	8749.1	5237.7	3816.6	5036.7	11666.8
Closing Cash	5237.7	3816.6	5036.7	11666.8	4060.3

Source: Company, Systematix research

For any queries contact us at: Institutional Team

N. Subramaniam	Sr. VP & Head of Sales Trading	+91- 22-3029 8285	nsubramaniam@systematixshares.com
Equity Sales			
Mamta Singh	AVP– Sales	+91-22-3029 8092	mamtasingh@systematixshares.com
Ridhim Thapar	AVP– Sales	+91-22-3029 8265	ridhimt@systematixshares.com
Derivatives			
Raghvendra Kedia	VP – Sales (Derivatives)	+91- 22-3029 8091	rkedia@systematixshares.com
Abhishek Karande	Technical Analyst	+ 91-22-3029 8261	abhishekk@systematixshares.com
Barath Krishnan	Derivatives Strategist	+ 91-22-3029 8249	barathk@systematixshares.com
Sales Trading / Dealing			
Sachin Parekh	Sr. Manager	+ 91-22-3029 8291	sachinp@systematixshares.com
Jigar Kamdar	Sales Trader	+ 91-22-3029 8181	jigarkamdar@systematixshares.com
Vinod Bhuwad	Sales Trader	+ 91-22-3029 8267	vinodbhuwad@systematixshares.com
Vijayendra Devadiga	Trader	+ 91-22-3029 8268	vijayendrad@systematixshares.com
Nayan Narnoli	Derivatives Dealer	+ 91-22-3029 8180	nayan@systematixshares.com
Monish Lotia	Derivatives Dealer	+ 91-22-3029 8252	monishlotia@systematixshares.com
Equity Research			**Telephone: + 91-22- 3029 8000**
RESEARCH ANALYST	**SECTOR ALLOCATION**	**DIRECT Nos.**	**E-mail**
Sudarshan Narasimhan	Sr. VP & Head of Research –Oil & Gas, Petrochemicals	+ 91-22-3029 8293	sudarshan@systematixshares.com
Surya Narayan Patra	AVP - Pharma	+ 91-22-3029 8186	suryapatra@systematixshares.com
Vibhash Prakash Awasthi	AVP - Metals & Mining	+ 91-22-3029 8296	vawasthi@systematixshares.com
Madhu Babu	AVP - IT, Telecom	+ 91-22-3029 8258	madhu@systematixshares.com
Eric Martins	AVP – Metals & Mining, Pipes	+ 91-22-3029 8253	eric@systematixshares.com
Shreegopal Jaju	AVP – Capital Goods	+ 91-22-3029 8187	gopaljaju@systematixshares.com
Vishal Shah	AVP – Banking	+ 91-22-3029 8260	vishalshah@systematixshares.com
Binod Modi	Sr. Analyst – Cement & Construction	+ 91-22-3029 8264	binodmodi@systematixshares.com
Rohit Jain	Analyst - Real Estate	+ 91-22-3029 8269	rohitj@systematixshares.com
Reshma Bathija	Analyst – Oil & Gas, Petrochemicals	+ 91-22-3029 8294	reshmab@systematixshares.com
Abhishek Gaoshinde	Analyst - Automobile	+ 91-22-3029 8292	abhishekg@systematixshares.com
Samruddhi Trivedi	Associate	+ 91-22-3029 8263	samruddhit@systematixshares.com

Stock Ratings

BUY (B)	The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A)	The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H)	The stock's total return is expected to be within0-10% over the next 12 months.
SELL (S)	The stock's is expected to give negative returns over the next 12 months.
NOT RATED (NR)	The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT)	Fundamentals /Valuations of the sector is expected to be attractive over the next 12-18 months.
NEUTRAL (NL)	Fundamentals /Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS)	Fundamentals /Valuations of the sector is expected to deteriorate over the next 12-18 months.

Disclosure of Interest

1. The analysts who have prepared the report have in no way received or are expected to receive any compensation from the subject company.
2. The analysts do not hold any position in the subject company's stock, as on the date of release.
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SYSTEMATIX SHARES & STOCKS (I) LTD.

Head Office J. K. Somani Building, 2nd Floor, British Hotel Lane, Fort, Mumbai, Pin: 400001, Tel: +91 22 66198000, Fax: +91 22 66198029

Registered Office EGA Trade Center, 4th Floor, 809-, Poonamalle High Road, Kilpauk, Chennai, Pin: 600010Tel: +91 44 26612184/ 87/ 88Fax: +91 44 26612190