

## Jubilant Organosys

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,007	JOL IN
	REUTERS CODE
S&P CNX: 2,933	JUBO.BO

19 July 2006

**Buy**
*Previous Recommendation: Buy*
**Rs207**

Equity Shares (m)	142.4
52-Week Range	290/180
1,6,12 Rel. Perf. (%)	1/-14/-26
M.Cap. (Rs b)	29.5
M.Cap. (US\$ b)	0.6

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
03/06A	15,054	1,297	8.4	-3.5	24.7	3.1	17.0	14.3	2.3	16.1
03/07E	19,124	2,142	12.1	44.8	17.0	2.6	20.8	13.8	1.8	9.9
03/08E	21,783	2,898	16.4	35.2	12.6	2.1	23.2	14.1	1.4	7.1

Jubilant Organosys 1QFY07 results were in-line with expectations, with lower molasses prices and higher contribution from Pharma business being the key profit drivers. Key Highlights:

- Net sales grew by 26% to Rs4.12b based on 42% YoY growth in Pharma & Life Science (PLSC) business and 18% YoY growth in the industrial chemicals business. The results are not strictly comparable on YoY basis due to consolidation of its recent acquisition.
- EBITDA margins expanded by 490bp to 16.9% led mainly by lower input cost (mainly Molasses) and increased contribution from PLSC business (at 50% of sales v/s 44% in 1QFY06).
- We believe that the ANDA approvals for Jubilant's customers in the US for Oxcarbazepine have been delayed as Novartis (the innovator) has filed a new patent expiring in February 2018. Generic companies have challenged this patent, ruling for which is expected by 2QFY07. We expect the company to record sales of US\$16.5m from this product in FY07E. Our estimates factor-in the potential delay in approvals for Jubilant's partners.
- Jubilant is likely to benefit from the increased pharmaceutical/intermediates outsourcing from India due to its existing relationships with global pharmaceutical and agrochemical players. With expected PAT CAGR of 40% for FY06-08, valuations at 17x FY07E and 12.6x FY08E consolidated fully diluted earnings appears reasonable. Maintain **Buy**.

QUARTERLY PERFORMANCE										(Rs Million)
Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
<b>Net Sales</b>	<b>3,267</b>	<b>3,315</b>	<b>4,234</b>	<b>4,238</b>	<b>4,124</b>	<b>4,449</b>	<b>5,243</b>	<b>5,307</b>	<b>15,054</b>	<b>19,124</b>
YoY Change (%)	22.8	12.9	46.5	31.8	26.2	34.2	23.8	25.2	28.6	27.0
Total Expenditure	2,873	2,878	3,588	3,545	3,425	3,713	4,221	4,071	12,884	15,725
<b>EBITDA</b>	<b>394</b>	<b>437</b>	<b>646</b>	<b>693</b>	<b>699</b>	<b>736</b>	<b>1,022</b>	<b>1,237</b>	<b>2,170</b>	<b>3,398</b>
Margins (%)	12.1	13.2	15.3	16.4	16.9	16.5	19.5	23.3	14.4	17.8
Depreciation	111	118	129	155	146	162	168	172	513	648
Interest	49	40	54	30	55	85	90	111	173	341
Other Income	31	34	36	96	90	115	113	146	197	464
<b>PBT after EO Expense</b>	<b>265</b>	<b>313</b>	<b>499</b>	<b>604</b>	<b>588</b>	<b>604</b>	<b>877</b>	<b>1,099</b>	<b>1,681</b>	<b>2,873</b>
Tax	55	80	121	136	139	54	79	-14	392	259
Deferred Tax	0	0	0	0	0	97	141	223	0	462
Rate (%)	20.8	25.6	24.2	22.5	23.6	25.1	25.1	19.1	23.3	25.1
<b>PAT</b>	<b>210</b>	<b>233</b>	<b>378</b>	<b>468</b>	<b>449</b>	<b>453</b>	<b>657</b>	<b>889</b>	<b>1,289</b>	<b>2,153</b>
Minority Interest	-3	3	12	-14	-12	3	3	17	-8	11
<b>Reported PAT</b>	<b>213</b>	<b>230</b>	<b>366</b>	<b>482</b>	<b>461</b>	<b>450</b>	<b>654</b>	<b>873</b>	<b>1,297</b>	<b>2,142</b>
<b>Adjusted PAT</b>	<b>213</b>	<b>230</b>	<b>366</b>	<b>482</b>	<b>461</b>	<b>450</b>	<b>654</b>	<b>873</b>	<b>1,297</b>	<b>2,142</b>
YoY Change (%)	-20.8	-26.0	36.1	73.8	116.4	95.6	78.8	81.0	17.6	65.1
Margins (%)	6.5	6.9	8.6	11.4	11.2	10.1	12.5	16.4	8.6	11.2

E: M0St Estimates

### Pharma & Life Science (PLSC) business drives revenue growth

Jubilant Organosys reported a 26% YoY growth in revenues (to Rs4.1b) for 1QFY07. Growth was largely driven by 43% YoY growth (to Rs2.1b) in the PLSC business. The industrial chemical business grew by 18% YoY (to Rs1.6b), driven primarily by volume growth as prices remained stable. The performance chemical business, however, de-grew by 2% YoY due to restructuring of product portfolio in favor of more profitable products. 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. The organic growth rate for the overall business was around 17%.

#### TREND IN PRODUCT MIX (RS M)

	1QFY07	1QFY06	YOY GR. (%)	4QFY06	QOQ GR. (%)
Pharma & LifeScie.	2,072	1,447	43.2	2,192	-5.5
% of sales	50.2	44.3		51.7	
Performance Chem.	478	489	-2.2	480	-0.4
% of sales	11.6	15.0		11.3	
Industrial Chemicals	1,574	1,331	18.3	1,566	0.5
% of sales	38.2	40.7		37.0	
<b>Total Revenues</b>	<b>4,124</b>	<b>3,267</b>	<b>26.2</b>	<b>4,238</b>	<b>-2.7</b>

Source: Company/Motilal Oswal Securities

### International operations drive revenue growth

In terms of market mix, domestic operations grew by 12% YoY to Rs2.3b, whereas International operations grew at 53% YoY. Growth in international operations was driven by an 82% YoY growth in regulated markets due to consolidation of recent acquisitions (Trigen and Target) as well as higher growth in the CRAMS business.

#### TREND IN MARKET MIX (RS M)

	1QFY07	1QFY06	YOY GR. (%)	4QFY06	QOQ GR. (%)
Domestic	2,346	2,103	11.6	2,229	5.2
% of Sales	56.9	64.4		52.6	
<b>Internat. Oper.</b>					
Regulated markets	1,227	675	81.8	1,303	-5.8
% of Sales	29.7	20.7		30.7	
Other markets	552	489	12.9	706	-21.8
% of Sales	13.4	15.0		16.7	
<b>Total Internat. Oper.</b>	<b>1,779</b>	<b>1,164</b>	<b>52.8</b>	<b>2,009</b>	<b>-11.4</b>
% of Sales	43.1	35.6		47.4	
<b>Total Revenues</b>	<b>4,125</b>	<b>3,267</b>	<b>26.3</b>	<b>4,238</b>	<b>-2.7</b>

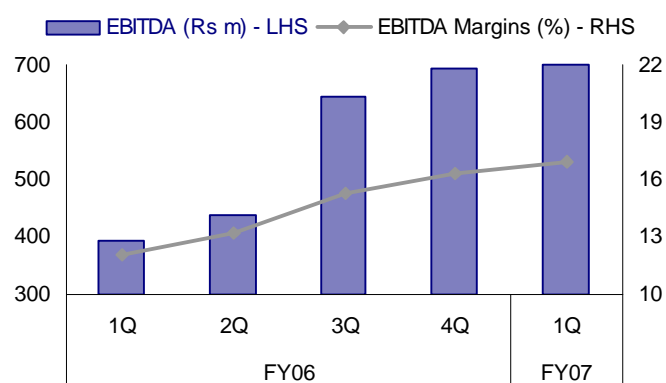
Source: Company/ Motilal Oswal Securities

### Lower molasses prices aids margin expansion

Reduction in input costs (mainly Molasses) helped the company to improve EBITDA margins by 490bp to 16.4% for the quarter. Molasses prices have declined by about 20% due to the good sugarcane crop in the current sugar season. This is reflected in lower RM cost (at 51% of sales v/s 60% in 1QFY06). However, EBITDA margin expansion could have been higher but for 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). Impact of higher depreciation (up by 31% YoY) was negated by higher other income on idle FCCB proceeds (at Rs90m v/s Rs30m in 1QFY06). This translated into 116% YoY growth in PAT to Rs461m.

Although, there was hardly any contribution to EBITDA from Jubilant's subsidiaries in 1QFY07, the management has indicated that most of them would start contributing positively from FY07 onwards.

#### TREND IN EBITDA



Source: Company/Motilal Oswal Securities

Molasses prices have declined by about 20% due to the good sugarcane crop in the current sugar season. Molasses prices are likely to remain soft for the next few quarters, as the company already has contracts running till 3QFY07. At the beginning of the new crushing season, the company would have to re-negotiate the contracts, which might be at higher prices. However, the commencement of Oxcarbazepine sales to US would result in an expansion of 340bp in Jubilant's EBITDA margins for FY07E, resulting in growth of 45% in fully diluted EPS.

### **CRAMS business: to be key growth driver**

The 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 36% CAGR for FY06-08.

### **Oxcarbazepine: New patent by Novartis could delay the 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, which went 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 of the major players, for API supply – of these, 5 have already filed their ANDAs. We believe that the ANDA approvals for Jubilant's customers in the US for Oxcarbazepine have been delayed as Novartis (the innovator) has filed a new patent expiring in Feb'2018. The generic companies have challenged this patent, ruling for which is expected by 2QFY07. We expect the company to record sales of \$16.5m from this product in FY07E. Our estimates factor-in the potential delay in approvals for Jubilant's partners. However, adverse court ruling for Jubilant's partners is the key risk.

### **Raised US\$200m through FCCB**

The company recently concluded its US\$200m FCCB issue priced at Rs413.45/share, with zero coupon and YTM of 7.2% maturing in 5 years. This issue was part of US\$325m in-principle approval which the company sought for growth initiatives through acquisitions and capex.

### **Targeting an acquisition of a company with US\$500m revenues**

Jubilant is evaluating an acquisition of a pharmaceutical company having revenues and market cap of US\$500m. Jubilant indicated that it is one of several bidders in the competitive bidding process and this process is currently at a very early stage. Although, the company didn't divulge any further details, we believe that the target company would be in CRAMS segment giving Jubilant access to its client base, critical technologies and backward integration synergies with Jubilant. The outcome of this bid is expected in the next 2-3 months.

### **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 (FY03-06), Jubilant has expanded its revenues and gross block at a CAGR of 28% and 27% respectively, while net profit has grown at 57% CAGR. Moreover, the company has been able to achieve this while maintaining healthy return ratios in excess of 20% over this period. Also, the potential acquisition which the company is targeting could catapult Jubilant into different league. With expected EPS CAGR of 40% for FY06-08, valuations at 17x FY07E and 12.6x FY08E consolidated fully diluted earnings appears reasonable. We have lowered are target price to Rs260 (~16x FY08E EPS), in line with our downgrade of earnings estimates with our 1QFY07 preview. Maintain **Buy**.

## Jubilant Organosys: an investment profile

### Company description

Jubilant Organosys Limited is the largest specialty chemicals company in India with high degree of vertical integration along with global scale and reach in almost all its key products. Its business model thus spans pharma & life sciences, industrial chemicals and performance chemicals. It has forayed into API business.

### 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 improved profitability, return ratios and earnings visibility

### Key investment risks

- ☞ Volatility in Molasses prices may impact the profitability of Industrial Chemicals division.
- ☞ 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	DIVIS	NPIL
P/E (x)	FY07E	17.0	21.0	21.8
	FY08E	12.6	15.9	17.0
P/BV (x)	FY07E	2.6	4.1	4.0
	FY08E	2.1	3.4	3.7
EV/Sales (x)	FY07E	1.8	4.2	2.2
	FY08E	1.4	3.6	2.0
EV/EBITDA (x)	FY07E	9.9	13.7	14.0
	FY08E	7.1	11.2	11.7

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	51.9	52.9	57.2
Domestic Institutions	1.9	2.1	3.8
FII's/FDIs	30.6	29.6	19.5
Others	15.5	15.5	19.6

### Recent developments

- ☞ Has raised \$200m at Rs413.45/share for funding capex and potential acquisitions.

### 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 17x FY07E & 12.6x FY08E EPS do not fully reflect strong earnings growth and healthy return ratios, leaving significant room for re-rating; Maintain **Buy**.

### Sector view

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

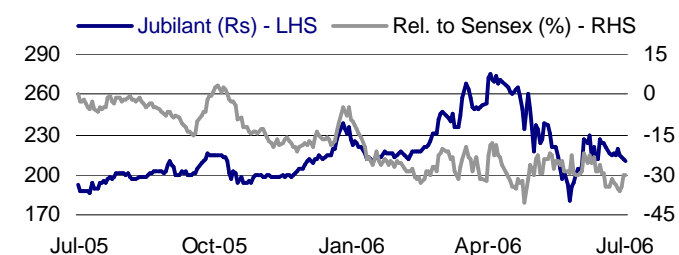
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	12.1	12.9	-6.1
FY08	16.4	17.5	-6.3

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
207	260	25.6	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Net Sales</b>	<b>8,592</b>	<b>11,703</b>	<b>15,054</b>	<b>19,124</b>	<b>21,783</b>	
Change (%)	20.9	36.2	28.6	27.0	13.9	
<b>EBITDA</b>	<b>1,551</b>	<b>2,076</b>	<b>2,170</b>	<b>3,398</b>	<b>4,343</b>	
Margin (%)	18.1	17.7	14.4	17.8	19.9	
Depreciation	326	381	513	648	653	
<b>EBIT</b>	<b>1,225</b>	<b>1,695</b>	<b>1,657</b>	<b>2,750</b>	<b>3,690</b>	
Int. and Finance Charges	358	220	173	341	359	
Other Income - Rec.	99	166	197	464	560	
<b>PBT</b>	<b>966</b>	<b>1,641</b>	<b>1,681</b>	<b>2,873</b>	<b>3,891</b>	
Current Tax	64	431	392	259	350	
Deferred Tax	115	0	0	462	625	
Tax Rate (%)	18.5	26.3	23.3	25.1	25.1	
<b>PAT</b>	<b>787</b>	<b>1,210</b>	<b>1,289</b>	<b>2,153</b>	<b>2,915</b>	
Less: Minority Interest	5	18	-8	11	17	
<b>Adj Net Profit</b>	<b>782</b>	<b>1,192</b>	<b>1,297</b>	<b>2,142</b>	<b>2,898</b>	
Change (%)	133.6	52.3	8.8	65.1	35.3	
Margin (%)	9.1	10.2	8.6	11.2	13.3	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Equity Share Capital	117	130	142	142	142	
Fully Diluted Share Capital	117	139	155	177	177	
Total Reserves	1,981	5,773	9,239	11,096	13,621	
<b>Net Worth</b>	<b>2,098</b>	<b>5,903</b>	<b>9,382</b>	<b>11,239</b>	<b>13,763</b>	
Minority Interest	39	51	43	53	70	
Deferred liabilities	742	742	742	1,203	1,829	
Total Loans	4,210	3,833	6,813	19,075	16,175	
<b>Capital Employed</b>	<b>7,089</b>	<b>10,528</b>	<b>16,979</b>	<b>31,570</b>	<b>31,837</b>	
Gross Block	7,344	8,943	13,483	13,983	14,460	
Less: Accum. Deprn.	2,840	3,251	3,764	4,417	5,042	
<b>Net Fixed Assets</b>	<b>4,504</b>	<b>5,693</b>	<b>9,720</b>	<b>9,567</b>	<b>9,419</b>	
Capital WIP	446	446	446	446	446	
Goodwill	0	0	1,988	2,344	2,344	
<b>Curr. Assets</b>	<b>3,731</b>	<b>6,943</b>	<b>7,898</b>	<b>22,938</b>	<b>23,990</b>	
Inventory	1,314	2,016	2,418	3,060	3,526	
Account Receivables	1,421	2,244	2,669	3,379	3,889	
Cash and Bank Balance	227	1,578	1,432	14,799	14,639	
Loans & Advances	769	1,105	1,380	1,700	1,936	
<b>Curr. Liability &amp; Prov.</b>	<b>1,614</b>	<b>2,576</b>	<b>3,095</b>	<b>3,746</b>	<b>4,384</b>	
Account Payables	1,386	1,885	2,425	3,081	3,510	
Provisions	229	690	669	665	874	
<b>Net Current Assets</b>	<b>2,117</b>	<b>4,367</b>	<b>4,804</b>	<b>19,191</b>	<b>19,606</b>	
Misc Expenditure	22	22	22	22	22	
<b>Appl. of Funds</b>	<b>7,089</b>	<b>10,528</b>	<b>16,979</b>	<b>31,570</b>	<b>31,837</b>	

E: M OSt Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>6.7</b>	<b>9.2</b>	<b>9.1</b>	<b>15.0</b>	<b>20.4</b>	
<b>Fully Diluted EPS</b>	<b>6.7</b>	<b>8.7</b>	<b>8.4</b>	<b>12.1</b>	<b>16.4</b>	
Cash EPS	9.4	11.3	11.7	15.8	20.1	
BV/Share	17.7	45.4	65.7	78.8	96.5	
DPS	1.0	1.3	1.3	2.0	2.8	
Payout (%)	12.2	15.5	15.6	15.5	15.5	
<b>Valuation (x)</b>						
P/E (on fully diluted EPS)		23.8	24.7	17.0	12.6	
Cash P/E		18.3	17.7	13.1	10.3	
P/BV		4.6	3.1	2.6	2.1	
EV/Sales		2.7	2.3	1.8	1.4	
EV/EBITDA		15.3	16.1	9.9	7.1	
Dividend Yield (%)		0.6	0.6	1.0	1.3	
<b>Return Ratios (%)</b>						
RoE	44.0	30.0	17.0	20.8	23.2	
RoCE	22.3	23.3	14.3	13.8	14.1	
<b>Working Capital Ratios</b>						
Asset Turnover (x)	12	1.1	0.9	0.6	0.7	
Debtor (Days)	60	70	65	64	65	
Inventory (Days)	56	63	59	58	59	
Working Capital Turnover (Days)	90	136	116	366	329	
<b>Leverage Ratio (x)</b>						
Current Ratio	2.3	2.7	2.6	6.1	5.5	
Debt/Equity	2.1	0.7	0.7	1.7	1.2	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Oper. Profit/(Loss) before Tax	1,500	2,254	2,189	3,468	4,453	
Interest/Dividends Recd.	16	166	197	464	560	
(Inc)/Dec in WC	-319	-468	-554	-981	-534	
<b>CF from Operating incl EO</b>	<b>1,133</b>	<b>1,460</b>	<b>1,437</b>	<b>2,674</b>	<b>4,099</b>	
(inc)/dec in FA	-801	-1,518	-6,529	-857	-478	
(Pur)/Sale of Investments	66	0	0	0	0	
<b>CF from investments</b>	<b>-736</b>	<b>-1,518</b>	<b>-6,529</b>	<b>-857</b>	<b>-478</b>	
Issue of Shares	0	2,248	2,373	0	0	
Inc/(Dec) in Debt	199	-377	2,948	12,223	-2,973	
Interest Paid	-396	-227	-173	-341	-359	
Dividend Paid	-136	-185	-203	-332	-449	
<b>CF from Fin. Activity</b>	<b>-333</b>	<b>1,459</b>	<b>4,946</b>	<b>11,549</b>	<b>-3,781</b>	
<b>Inc/Dec of Cash</b>	<b>64</b>	<b>1,401</b>	<b>-146</b>	<b>13,367</b>	<b>-160</b>	
Add: Beginning Balance*	106	334	1,578	1,432	14,799	
<b>Closing Balance</b>	<b>171</b>	<b>1,735</b>	<b>1,432</b>	<b>14,799</b>	<b>14,639</b>	

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



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@motiloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

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 |
| 4. Investment Banking relationship with company covered | No |

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.