Emkay
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JB Chemicals & Pharma

Turnaround of domestic business to fuel growth

Management meet

October 11, 2010

NOT RATED

Price	Target Price
Rs 108	**NR**
Sensex	**20,250**

Price Performance

(%)	1M	3M	6M	12M
Absolute	1	13	47	112
Rel. to Sensex	(7)	(2)	29	76

Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Reuters	JBCH.BO
Bloomberg	JBCP@IN
Equity Capital (Rs mn)	169
Face Value (Rs)	2
No of shares o/s (mn)	84
52 Week H/L (Rs)	119/45
Market Cap (Rs bn/USD mn)	9/204
Daily Avg Vol (No of shares)	429721
Daily Avg Turnover (US$ mn)	1.0

Shareholding Pattern (%)

	M'09	J'10	S'10
Promoters	55.5	55.6	55.6
FII/NRI	2.8	2.9	2.9
Institutions	3.0	3.0	2.9
Private Corp	5.0	3.7	3.8
Public	33.6	34.9	34.9

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- **Russia/CIS business to act as JBCPL's cash cow for funding its domestic expansion**
- **Higher thrust on the domestic business by way of increasing doctor coverage to contribute to top line as well as bottom line, going forward; Committed to grow domestic business by 3x in next 3-4 years**
- **Higher receivables in the Russia/CIS business not a concern as they are qualitatively sound**
- **22-25% earnings CAGR over FY10-12E; Ideal candidate for re-rating**

Key highlights of management meet

Russia/CIS – A 'Cash Cow' for its business expansion

Though Russia/CIS witnessed some pressure during FY10, it continues to remain one of the largest and most profitable markets for JBCPL (11% CAGR growth over FY06-10). While the Russian business grew in FY10, Ukraine and other countries witnessed de-growth because of inventory rationalization. However, going forward, company expects its business to do well because of new product launches and higher promotional expenditures in OTC segment. JBCPL is one among the three largest Indian players in Russia/CIS region and 90% of its revenues come from the OTC segment. Doktor Mom is the largest selling brand and contributes ~30% to the segmental revenues. Other top brands are Metrogyl ($10mn, Anti-diarrhea) and Rinza ($20mn, Cold and cough).

Despite high receivables cycle in CIS (180days) because of the nature of the market, company is very confident about the quality of its receivables as it supplies to the top 5-6 distributors of Russia. Historically also, the quality of receivables has been good, as is evident from the facts that bad debts or write-offs are very minimal.

Minimal bad debts write-off indicates higher receivables quality

(Rs mn)	FY06	FY07	FY08	FY09	FY10	Total
Debtors	2,530	3,130	3,220	3,030	3,450	15,360
Receivable days	198	218	209	165	176	967
Bad debts write-off	0	0	84.2	117.5	13.2	215
% write off to sales	0	0	1.5	1.8	0.2	0.7

We believe this region will continue to remain a 'Cash-Cow' for the company. With a total field force of over 320 MRs, the management has guided for 15-17% CAGR growth from this geography over FY10-12E, driven by new product launches, line extensions and geography expansions. The impact of reference price policy is also minimal for JBCPL as OTC contributes more than 90% of its revenues.

Focus on non-DPCO products and increase in field force to give a leg up to the domestic business in the coming years

During FY10, the company has reported 10% growth in domestic formulation business (CAGR growth of 9% over FY06-10). Approximately 80% of its domestic revenues come from top 5 brands such as Nicardia (CVS), Metrogyl (Anti-diarrhea), Rantac group (GI-Anti-infective) and Dicloran (Pain management).

Financials (Rs mn)

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY07	5,256	829	15.8	622	7.4	(16.5)	14.9	14.6	12.8	2.2
FY08	5,710	745	13.0	453	5.4	(27.1)	10.0	20.0	14.6	2.0
FY09	7,322	1,422	19.4	984	11.7	117.2	21.0	9.2	7.3	1.9
FY10	7,569	1,645	21.7	1,065	12.6	8.2	18.8	8.5	5.9	1.6

Source: Company, Emkay Research

The lower than industry growth in domestic formulation business is mainly attributed to couple of factors such as-

- Management focus was far more on CIS market as this market contributes significantly to the top line and bottom line of the company
- 50% of company's domestic revenue was from DPCO impacted products, which affected the domestic gross margins of the company.

The management has taken couple of initiatives to participate in the growing domestic consumption story. Few of them are

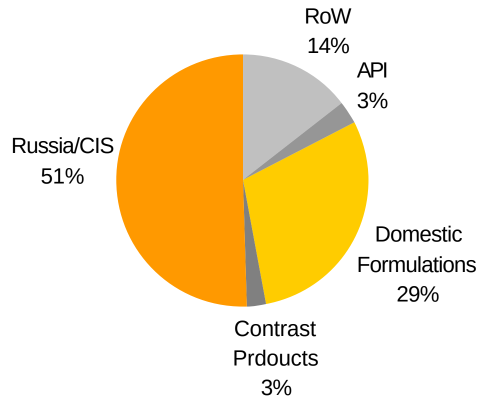
- Company has identified 14 non-DPCO products (contributes 35-40% of domestic market) and has put them on active promotion in-order to reduce the dependency on DPCO products. The initial result of this strategy is already visible as this restructured portfolio grew by 18% in FY10 and overall domestic formulations grew by 10% in FY10. In the first six months of FY11, this focused portfolio grew by 28%, resulting in JBCPL's domestic growth further improving to 15-16% in 1HFY11.
- JBCPL is trying to make-up for its past inertia of not capitalizing on its strong brands in tier-II and tier-IV cities. Currently, JBCPL is not only expanding its reach by strengthening its sales force in the domestic market from the current level of 600 (200 people have increased in last 6 months) to 2000 by FY12E but is also looking to enter into newer therapeutic areas to expand its product portfolio.
- Mr. Pranav Modi (Promoter's family) himself has taken over the charge of domestic market in order to enthuse more focus on this part of the business.

Going forward, management is confident of multiplying its domestic business by 2-3x in next 3-4 years.

Focus on South African JV and contract manufacturing of Lozenges will drive growth in ROW markets

JBCL is also building its ROW franchises (c US$21mn) with major focus on South Africa, Algeria, Uganda, Brazil, Venezuela, Romania, Australia and other SE Asian counties. Company expects this business to grow faster than the overall growth of the company because of low base. Company has almost doubled its South African revenue in the last one year and even its JV with Biotek has also become profitable in FY10. Company expects this business to grow from US$3mn in FY10 to US$8mn in FY12E. Moreover, contract manufacturing of Lozenges is also going to drive significant revenue growth, going forward as company has tied up with two large MNCs for the same. The revenue of this segment is likely to grow from US$1.5mn in FY10 to US$8mn in next 2-3 years. Today, JBPCL boasts of one of the most advanced Lozenges facilities in Asia. Company has also launched 4 products in the US and expects to launch one more in the next 1 month. It is also building its ANDA pipeline for future growth in the US market.

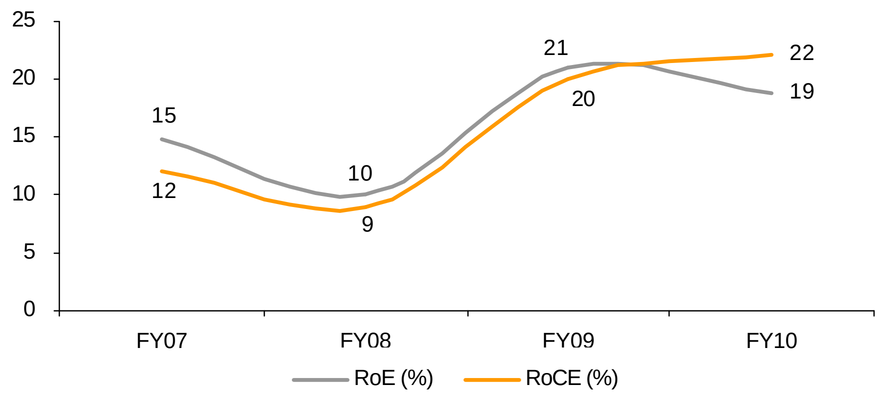
Revenue break-up (FY10)



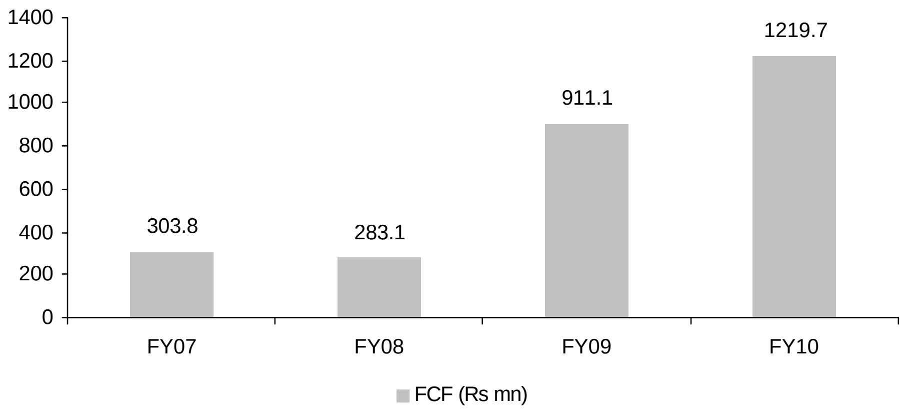
Strong balance sheet, stable returns ratios

JBCPL has a net debt of Rs380mn (Net D/E of less than 0.1) and gross Block of Rs3.86bn. The capex guided for FY11E is Rs400mn (funded through internal accruals). The net working capital is 170 days (receivables are 167days). Going forward, we expect the company to generate significant positive cash flows adjusting to capex, dividend, interest and tax liabilities. The RoCE and RoE of the company is 22% and 19% for FY10. The book value of the company is Rs67.4 for FY10. With net debt to equity of the company at 0.1x, we believe the company can comfortably go for increased leverage to fund its growth plans.

Return ratios at healthy levels



Increasing cash from operations has strengthened balance sheet



22-25% earnings CAGR over FY10-12E; Trading at 39% discount to comparable peers

JBCPL expects its operating margins to sustain at current level in FY11E because of field force expansion. However, margins are likely to improve by 200-300bps to 24% over next 2-3 years on the back of improved contribution from high margin domestic formulation business and profitable contribution from international subsidiaries. We expect revenue CAGR of 15% over FY10-12E driven by a) 15% CAGR in CIS countries, b) 20% CAGR in domestic market and 22% CAGR in ROW. Strong revenue growth coupled with 200-300bps improvement in operating margins will lead to over 22-25% earnings CAGR over FY10-12E. Company has reported recurring EPS of Rs12.6 (adjusting to forex gain) in FY10.

At CMP of Rs108, the stock is trading at 8.5x FY10E AEPS, 1.3x EV/Sales; 5.9x EV/EBIDTA and 1.6x P/BV (despite 19% RoE). The stock is trading at a significant discount to comparable peers on valuation parameters. JBPCL is trading at a discount to comparable peers on account of (a) subdued domestic growth, (b) over dependence on CIS markets and (c) higher receivable days. With 1) domestic business on recovery mode, 2) ROW business becoming meaningful, 3) high quality of receivables in CIS markets, coupled with 4) strong balance sheet and healthy return ratios, JBPCL seems to be an ideal candidate for re-rating. We do not have formal rating on the stock. However, we are positively biased on the company.

Peer Comparison

	Sales (Rs mn)	Gr. %	EBITDA (Rs mn)	Gr. %	EPS (Rs)	Gr. %	P/E (x)	P/BV (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
Indoco Remedies	4021.5	13.3	581.3	15.9	33.1	34.0	13.2	1.6	8.9	14.3	13.0
Elder Pharma	7216.0	16.3	1322.3	23.0	25.7	-19.1	15.3	1.4	9.3	10.7	11.2
FDC	6614.6	12.2	1955.9	64.3	7.7	76.6	13.5	2.9	7.6	31.5	38.0
Average							**14.0**	**2.0**	**8.6**	**18.8**	**20.7**
JB Chemicals	**7409.7**	**3.3**	**1644.9**	**15.6**	**12.6**	**8.2**	**8.5**	**1.6**	**5.9**	**18.8**	**22.0**

Source: Capitaline

Key Risks

- High receivable days in CIS region
- High dependency on Russia
- Top 5 brands contribute around 80% of the domestic revenue
- Subdued performance in the domestic market

Financials

Income Statement

Y/E, Mar (Rs. mn)	FY07	FY08	FY09	FY10
Net Sales	**5255.7**	**5624**	**7170.9**	**7409.7**
Growth (%)	*12.8*	*7.0*	*27.5*	*3.3*
Other Operating Income	0	85.8	151	159.1
Total Income	**5255.7**	**5709.8**	**7321.9**	**7568.8**
Total Expenditure	**4427.1**	**4965.3**	**5899.5**	**5923.9**
Raw Material Consumed	1856	2046.2	2442.1	2355.7
Employee Expenses	773.2	934.7	979.6	1052.2
Other Expenses	1797.9	1984.4	2477.8	2516
EBITDA	**828.6**	**744.5**	**1422.4**	**1644.9**
EBITDA margin (%)	*15.8*	*13.0*	*19.4*	*21.7*
Interest	112.5	162	127.3	90.7
Other Income	108.9	23.4	7	20.1
PBDT	**825**	**605.9**	**1302.1**	**1574.3**
Depreciation	113.4	169	204.3	215.7
Forex loss/ (gain)	0	0	727.1	-122.1
PBT	**711.6**	**436.9**	**370.7**	**1480.7**
Tax	89.8	-16.3	113.5	293.2
Effective tax rate (%)	*12.6*	*-3.7*	*30.6*	*19.8*
Reported PAT	**621.8**	**453.2**	**257.2**	**1187.5**
APAT	**621.8**	**453.2**	**984.3**	**1065.4**
Adjusted Net margin (%)	*11.8*	*7.9*	*13.4*	*14.1*

Balance Sheet

Y/E, Mar (Rs. mn)	FY07	FY08	FY09	FY10
Share Capital	168.7	168.7	168.7	168.7
Reserves Total	4015.9	4361.6	4520.2	5512.5
Total Shareholders Funds	**4184.6**	**4530.3**	**4688.9**	**5681.2**
Secured Loans	842	1544.9	1343	984.9
Unsecured Loans	901.7	418.6	444.7	382.6
Total Debt	**1743.7**	**1963.5**	**1787.7**	**1367.5**
Net Deferred Tax liability	184.9	154.6	128.5	158.5
Total Liabilities	**6113.2**	**6648.4**	**6605.1**	**7207.2**
Gross Block	**3118.9**	**3599.2**	**3666.5**	**3866.7**
Less: Accumulated Depreciation	839.4	1006.3	1198.6	1398.9
Net Block	**2279.5**	**2592.9**	**2467.9**	**2467.8**
Capital Work in Progress	222.7	22.9	66.2	0.7
Investments	74.8	75.2	74.9	242.7
Inventories	835.7	746.9	807.7	834.7
Sundry Debtors	3133.1	3224.3	3028	3448.3
Cash and Bank	203.9	149.6	438.4	778.6
Loans and Advances	373.1	601.1	580	596.8
Total Current Assets	**4545.8**	**4721.9**	**4854.1**	**5658.4**
Current Liabilities	842.5	614	646.5	828.4
Provisions	167.2	150.5	211.5	334
Total Current Liabilities	**1009.7**	**764.5**	**858**	**1162.4**
Net Current Assets	**3536.1**	**3957.4**	**3996.1**	**4496**
Misc Exp not written off	0.1	0	0	0
Total Assets	**6113.2**	**6648.4**	**6605.1**	**7207.2**

Cash Flow

Y/E, Mar (Rs. mn)	FY07	FY08	FY09	FY10
Opening Cash	**116**	**203.9**	**149.6**	**438.5**
Operating Cash Flow	303.8	283.1	911.1	1219.7
Investing Cash Flow	-1166	-280.6	-143.1	-294.6
Financing Cash Flow	950	-56.8	-479.1	-585
Net Inc/(Dec) in Cash	**87.9**	**-54.3**	**288.9**	**340.1**
Closing Cash	**203.9**	**149.6**	**438.5**	**778.6**

Ratios

Y/E, Mar (Rs. mn)	FY07	FY08	FY09	FY10
Profitability (%)				
EBITDA Margin	15.8	13.0	19.4	21.7
Net Margin	11.8	7.9	13.4	14.1
ROCE	12.1	9.0	20.0	22.0
ROE	14.9	10.0	21.0	18.8
Per Share Data (Rs)				
EPS	7.4	5.4	11.7	12.6
CEPS	8.7	7.4	14.1	15.2
BVPS	49.6	53.7	55.6	67.4
DPS	2.6	0.5	1.0	2.0
Valuations (x)				
PER	14.6	20.0	9.2	8.5
P/CEPS	12.4	14.6	7.6	7.1
P/BV	2.2	2.0	1.9	1.6
EV / Sales	2.0	1.9	1.4	1.3
EV / EBITDA	12.8	14.6	7.3	5.9
Dividend Yield (%)	2.4	0.5	0.9	1.9
Gearing Ratio (x)				
Net Debt/ Equity	0.4	0.4	0.3	0.1
Net Debt/EBIDTA	1.9	2.4	0.9	0.4

Source: Capitaline

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