Company Focus

31 January 2008 | 8 pages

Jubilant Organosys (JUBO.BO)

Buy: Strong Quarter; Story on Course

- **Strong quarter** — Jubilant's 3QFY08 results were in-line with expectations, with a robust trend in revenues as well as profitability. The high margin PLSPS business (especially CRAMS) was the key growth driver and now contributes c62% of revenues.

- **3Q highlights** — Sales growth of 37% yoy (19% organic) & 540 bps expansion in EBIDTA margins led to an 81% increase in recurring PAT. Reported PAT was buoyed by forex translation gains (Rs133m). CRAMS was the key growth driver, up 98% yoy (53% organic), while the legacy industrial & performance products business benefited from lower molasses prices (down 20% YoY).

- **Oxcarbazapine boosts API sales** — Jubilant's API sales got a boost for the second consecutive quarter from supply of oxcarbazapine during exclusivity period. We believe that Jubilant supplies the API to Glenmark (one of the exclusivity players). Moreover, it has tie-ups with 4 other ANDA filers and is likely to be a key player in this product, in our view

- **Conference call takeaways** — i) Research services business to gain traction in coming quarters; ii) Capacity expansion at Hollister-Stier to 120m vials/annum to come through in 1QFY09; iii) Total capex of Rs3bn in FY08 plus Rs2bn in subsidiaries including hospitals and SEZs; Capex of Rs2.5bn in FY09 with an additional Rs2bn capex in Hollister-Stier and research services business.

- **Maintain Buy (1L)** — as one of the superior Indian outsourcing picks given its integrated presence across the pharma & chemicals value chain.

Buy/Low Risk	1L
Price (31 Jan 08)	Rs321.30
Target price	Rs415.00
Expected share price return	29.2%
Expected dividend yield	0.6%
Expected total return	**29.8%**
Market Cap	Rs46,442M
	US$1,182M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,297	8.11	-12.1	39.6	5.6	19.6	0.4
2007A	2,280	12.56	54.7	25.6	5.1	26.4	0.4
2008E	3,154	17.37	38.3	18.5	3.9	30.2	0.5
2009E	4,014	22.11	27.3	14.5	3.0	29.2	0.6
2010E	4,902	27.00	22.1	11.9	2.3	27.4	0.6

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	39.6	25.6	18.5	14.5	11.9
EV/EBITDA adjusted (x)	24.0	17.3	13.3	10.9	9.1
P/BV (x)	5.6	5.1	3.9	3.0	2.3
Dividend yield (%)	0.4	0.4	0.5	0.6	0.6
Per Share Data (Rs)					
EPS adjusted	8.11	12.56	17.37	22.11	27.00
EPS reported	8.11	12.56	24.74	23.62	28.51
BVPS	57.74	62.75	82.75	108.39	140.21
DPS	1.25	1.25	1.70	2.00	2.00
Profit & Loss (RsM)					
Net sales	14,990	18,097	24,215	29,926	34,130
Operating expenses	-13,332	-15,526	-20,520	-25,174	-28,427
EBIT	**1,657**	**2,571**	**3,695**	**4,752**	**5,703**
Net interest expense	-173	-195	-446	-518	-526
Non-operating/exceptionals	197	576	1,868	690	767
Pre-tax profit	**1,681**	**2,953**	**5,117**	**4,924**	**5,944**
Tax	-392	-712	-605	-604	-737
Extraord./Min.Int./Pref.div.	8	39	-20	-30	-30
Reported net income	**1,297**	**2,280**	**4,492**	**4,289**	**5,177**
Adjusted earnings	1,297	2,280	3,154	4,014	4,902
Adjusted EBITDA	2,170	3,194	4,548	5,909	6,975
Growth Rates (%)					
Sales	28.1	20.7	33.8	23.6	14.0
EBIT adjusted	-2.2	55.2	43.7	28.6	20.0
EBITDA adjusted	4.6	47.2	42.4	29.9	18.0
EPS adjusted	-12.1	54.7	38.3	27.3	22.1
Cash Flow (RsM)					
Operating cash flow	**159**	**1,868**	**2,619**	**3,921**	**5,351**
Depreciation/amortization	513	623	853	1,156	1,271
Net working capital	-1,895	-886	-3,012	-1,740	-1,355
Investing cash flow	**-4,607**	**-3,675**	**-10,043**	**-3,000**	**-3,000**
Capital expenditure	-2,736	-3,674	-10,043	-3,000	-3,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**5,440**	**9,630**	**2,900**	**-328**	**-328**
Borrowings	4,542	9,831	3,179	0	0
Dividends paid	-189	-203	-279	-328	-328
Change in cash	**992**	**7,823**	**-4,524**	**593**	**2,023**
Balance Sheet (RsM)					
Total assets	**20,483**	**32,329**	**38,455**	**43,377**	**48,885**
Cash & cash equivalent	1,390	8,749	2,887	3,205	4,953
Accounts receivable	2,479	2,948	3,901	4,821	5,499
Net fixed assets	11,531	14,636	23,825	25,669	27,397
Total liabilities	**12,107**	**23,134**	**26,365**	**27,571**	**28,475**
Accounts payable	2,693	2,918	3,901	4,821	5,499
Total Debt	7,220	16,526	19,705	19,705	19,705
Shareholders' funds	**8,376**	**9,195**	**12,090**	**15,806**	**20,410**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.5	17.7	18.8	19.7	20.4
ROE adjusted	19.6	26.4	30.2	29.2	27.4
ROIC adjusted	9.6	10.0	11.8	12.4	13.5
Net debt to equity	69.6	84.6	139.1	104.4	72.3
Total debt to capital	46.3	64.3	62.0	55.5	49.1

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Buy: Strong Quarter; Story on course

We maintain our Buy/Low Risk (1L) rating on Jubilant Organosys as we continue to rate the company as one of the superior Indian outsourcing picks with an integrated presence across the pharma and chemicals value chain. 3QFY08 results were strong as expected, with a robust trend in revenues as well as profitability. The high margin PLSPS business (especially CRAMS) was the key growth driver and now contributes c62% of revenues. The CRAMS revenues grew by 98% yoy overall and 53% yoy excluding Hollister-Stier sales. EBITDA margins increased 540bps yoy driven by shift in product mix toward higher margin CRAMS and favorable input prices in the legacy industrial and performance products business.

Strong 3Q – CRAMS, the key driver

Figure 1. 3QFY08 Consolidated Earnings Summary (Rupees in Million. Percent)

Year ended 31 Mar	3Q FY07	3Q FY08	*YoY Ch (%)*	2Q FY08	*QoQ Ch (%)*	CIR Comments
Net sales	**4,693**	**6,416**	***36.7***	**6,183**	***3.8***	**Sales growth driven by 98% increase in CRAMS revenues; not comparable yoy due to inclusion of Rs811m revenues from Hollister-Stier in 3QFY08 – organic growth of 19% YoY**
Material cost	2,485	2,858	*15.0*	2,772	*3.1*	YoY decline (as % of sales) due to lower raw material requirement at Hollister Stier and higher margins in oxcarbazepine sales to Glenmark during exclusivity period
% of sales	*53.0*	*44.5*	*-841 bps*	*44.8*	*-29 bps*	
Manufacturing cost	463	614	*32.6*	543	*13.1*	
% of sales	*9.9*	*9.6*	*-30 bps*	*8.8*	*79 bps*	
Gross Profit	1,745	2,944	*68.7*	2,868	*64.4*	Margin expansion driven by lower material consumption in CRAMS business of Hollister-Stier and lower molasses prices
Gross margins	*37.2*	*45.9*	*870 bps*	*46.4*	*920 bps*	
Staff cost	581	1,033	*77.8*	1,029	*0.4*	Not comparable yoy due to inclusion of Hollister-Stier
% of sales	*12.4*	*16.1*	*372 bps*	*16.6*	*-54 bps*	
SG & A expenses	470	616	*31.1*	706	*(12.7)*	
% of sales	*10.0*	*9.6*	*-41 bps*	*11.4*	*-182 bps*	
EBIDTA	**694**	**1,295**	***86.6***	**1,133**	***14.3***	**Margin expansion due to change in product mix; driven by higher margin CRAMS business**
EBIDTA Margins (%)	***14.8***	***20.2***	***540 bps***	***18.3***	***186 bps***	
Interest	49	123	*151.0*	109	*12.8*	
Depreciation	158	247	*56.3*	237	*4.2*	
Other income	168	98	*(41.7)*	96	*2.1*	
PBT	655	1,023	*56.2*	883	*15.9*	
Tax	236	244	*3.4*	76	*221.1*	
Effective tax rate (%)	*36.0*	*23.9*	*-1,218 bps*	*8.6*	*1,524 bps*	
PAT	419	779	*85.9*	807	*(3.5)*	
Minority Interest (MI)	-14	-7	*(50.0)*	-4	*75.0*	
Adjusted Net Income	**433**	**786**	***81.5***	**811**	***(3.1)***	
Exceptional Items	220	108	*(50.9)*	289	*(62.6)*	Includes forex gains of Rs133m and a one-time write-off of fixed assets worth Rs25m in 3QFY08
Reported Net Income	**653**	**894**	***36.9***	**1,100**	***(18.7)***	

Source: Company Reports and Citi Investment Research

Figure 2. 3QFY08 Consolidated Sales Summary (Rupees in Million. Percent)

Year ended 31 Mar	3Q FY07	3Q FY08	*YoY ch (%)*	2Q FY08	*QoQ Ch (%)*	CIR Comments
Pharma & Life Sciences (PLS)	2,348	3,978	*69.4*	3,682	*8.0*	Not comparable yoy due to inclusion of Hollister-Stier in 3QFY08; Margin expansion due to higher margin CRAMS business of Hollister-Stier; Organic growth of 53% yoy in CRAMS
% of sales	*50.0*	*62.0*		*59.6*		
EBIT Margins	*16.1*	*22.1*	*605 bps*	*20.9*	*121 bps*	
Performance & Industrial products	2,345	2,438	*4.0*	2,501	*(2.5)*	Margin expansion due to favourable input pricing environment and improved productivity
% of sales	*50.0*	*38.0*		*40.4*		
EBIT Margins	*12.2*	*14.9*	*269 bps*	*18.9*	*-398 bps*	
Total Revenues	**4,693**	**6,416**	***36.7***	**6,183**	***3.8***	**Margin expansion due to shift in product mix toward the higher margin CRAMS business**
PBIT Margins	***14.1***	***19.4***	***524 bps***	***20.1***	***-71 bps***	

Source: Company Reports and Citi Investment Research

Figure 3. 3QFY08 Consolidated Revenue Mix (Rupees in Million. Percent)

Year ended 31 Mar	3Q FY07	3Q FY08	*YoY ch (%)*	2Q FY08	*QoQ Ch (%)*	CIR Comments
Domestic	2579	2954	*14.5*	2923	*1.1*	Robust growth driven by better productivity
% of sales	*55.0*	*46.0*		*47.3*		
International Operations	2114	3462	*63.8*	3260	*6.2*	
% of sales	*45.0*	*54.0*		*52.7*		
Regulated markets	1396	2416	*73.1*	2117	*14.1*	Not comparable yoy due to inclusion of Hollister-Stier
% of sales	*29.7*	*37.7*		*34.2*		
Other Markets	718	1046	*45.7*	1143	*(8.5)*	Driven by growth in Chinese operations (21% of exports for 9mFY08 growth of 94% yoy for 9mFY08
% of sales	*15.3*	*16.3*		*18.5*		
Total Revenues	**4693**	**6416**	***36.7***	**6183**	***3.8***	

Source: Company Reports and Citi Investment Research

Jubilant Organosys

Company description

Jubilant Organosys is the largest specialty chemicals company in India, with a high degree of vertical integration, and global scale and reach in almost all its key products. The company has established itself as a serious player right from fine chemicals to advanced intermediates and APIs. More recently, it has forayed into formulations and regulatory services through acquisitions in Belgium (PSI n.v. and PSI supply) and the US (Trigyn Laboratories). It has set up wholly owned subsidiaries to tap into the high-potential areas of bioinformatics, medicinal chemistry services and clinical services.

Investment strategy

We maintain our Buy/Low Risk (1L) rating on Jubilant, with a revised target price of Rs.415 (from Rs386 earlier). Jubilant is among the top Indian pharma outsourcing plays under our coverage. It is a story of continuous forward integration with a business model that spans pharma & life sciences (P&LS), industrial chemicals and performance chemicals. Jubilant's strong presence in acetyls and pyridines builds a high degree of integration into its business and allows it to offer services across the value chain. Besides a natural cost advantage, this allows the company to leverage its customer relationships in strong areas to scale up new businesses, thus providing an edge in an increasingly competitive industry. Jubilant's P&LS business is in the midst of a high growth phase. We expect the share of this business to increase from 51% in FY07 to 68% in FY10E. This would not only raise profitability levels but also improve earnings quality by reducing Jubilant's exposure to the more volatile non-P&LS businesses. Overall, we expect 25% and 30% CAGRs in revenues and fully diluted earnings, respectively, for FY07-10E

Valuation

We use sum-of-the-parts to value Jubilant in view of the diversified nature of its business and earnings streams. We value both businesses using the

EV/EBIDTA methodology but apply different target multiples to each business given the difference in their growth and operating parameters. We arrive at a one-year target price of Rs415 (from Rs386 earlier).

We value Jubilant's P&LS business at 15x March 2009E EV/EBIDTA and the non-P&LS business at 7x March 2009E EV/EBIDTA – rolled forward from June'08E earlier. Our target valuation for the P&LS business is benchmarked to the upper end of Jubilant's past four-year EV/EBIDTA range. We are comfortable using a higher multiple vis-à-vis some of its mid-sized Pharma peers due to strong growth rates and the upside potential when idle FCCB proceeds are deployed in the core business. Industrial chemicals and performance chemicals are mature businesses in which Jubilant has indicated that it does not intend to make any significant incremental investment. However, the company's competitive edge in these areas would ensure that it is able to generate steady profits from these businesses. We therefore value these businesses at 7x March 2009E EBIDTA, which is in-line with the multiple that Jubilant used to trade at around four years ago when these businesses contributed almost entirely to the company's revenues and profits.

Risks

We rate Jubilant Low Risk based on our quantitative risk-rating system. The main downside risks to our target price and estimates include: (1) The generics business has become very competitive; (2) Any delay in filing / launch or a litigation loss would affect the timing and quantum of revenues and profits; (3) Inability to integrate and exploit the synergies with its acquired subsidiaries could hurt profitability; and (4) Increases in molasses prices. The main upside risks to our target price include: (1) A significant value accretive acquisition could lead to upside to our estimates; and (2) Pyridine prices could firm up in the medium term.

Appendix A-1

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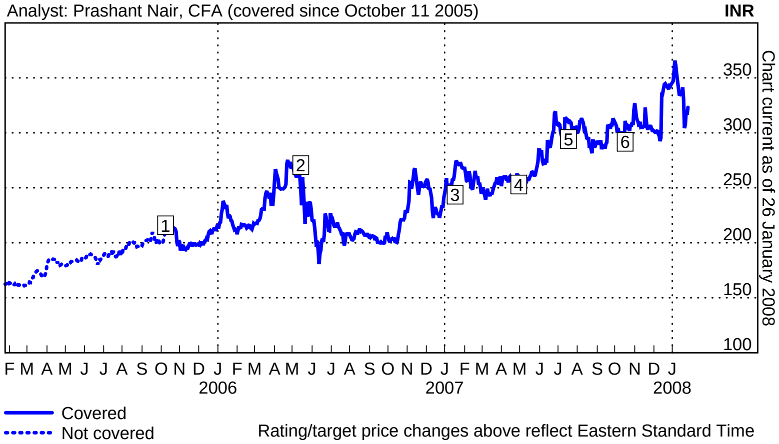
Jubilant Organosys (JUBO.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Prashant Nair, CFA (covered since October 11 2005)



#	Date	Rating	Target Price	Closing Price
1:	10 Oct 05	1L	249.80	209.47
2:	15 May 06	1L	*299.00	248.30
3:	17 Jan 07	1L	*368.00	267.95
4:	30 Apr 07	1L	*340.00	260.75
5:	18 Jul 07	1L	*386.00	310.20
6:	17 Oct 07	1L	*415.00	310.95

*Indicates change.

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