

3 June 2020

## Granules India

*Short-lived brunt of export restriction dampens growth; retaining a Buy*

On the export restriction imposed on paracetamol by the government and on supply disruptions due to Covid-19, Granules India's Q4 FY20 topline slipped 2.2% y/y to ₹6bn. Its formulations division, however, grew 7.8% to ₹3.4bn, while PFI sales slid 18.5% to ₹781m and API sales 10.5% y/y to ₹1.8bn. Product launches from GPI and the higher contribution from formulations sales led to a 754bp y/y higher gross margin (53%). Adj. for the gains on divestment of a JV, an impairment charge and a deferred tax reversal, PAT was up 18.4% to ₹758m. We expect revenue/PAT CAGRs over FY20-22 of ~25%/~23%. We maintain our Buy recommendation and raise our target price to ₹227 (earlier ₹210).

**Resumption of exports of key products to revitalize growth.** Muted growth in Q4 FY20 stemmed from the government ban on export of all forms of paracetamol. With the ban no longer in place, we expect growth to pick up in Q1 FY21 as demand for paracetamol has risen amid the Covid-19 pandemic; we expect Granules to aptly capitalize on the opportunity. Management is upbeat about the near-term performance and expects to beat its previous guidance of 20% topline growth in FY21.

**Formulations sales continue to grow.** Q4 FY20 formulation sales grew 7.8% to ₹3.4bn (57% of sales). In FY20 it received approval for 12 ANDAs. It has a further 16 ANDAs (45 cumulative filings) pending approval with the US FDA.

**Outlook and Valuation.** Its dominance in key APIs (paracetamol, ibuprofen, metformin) would help Granules emerge a prime beneficiary as the Covid-19 outbreak has led to a surge in demand for such drugs. Granules is likely to retain strong traction for the next couple of years driven by formulations and the healthy contribution from new capacities. We expect ~25%/~23% revenue/PAT CAGRs over FY20-22. At the CMP, the stock trades at 9x FY22e EPS of ₹20. **Risks:** 38% of promoters' holdings have been pledged; Increase in R&D spend; adverse currency movements.

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (₹ m)	16,918	22,792	25,986	33,955	40,735
Net profit (₹ m)	1,326	2,364	3,383	4,241	5,157
EPS (₹)	5.2	9.3	13.3	16.7	20.3
PE (x)	19.8	19.5	13.6	10.9	8.9
EV / EBITDA (x)	12.5	14.2	9.7	7.0	5.7
PBV (x)	2.0	3.0	2.5	2.1	1.7
RoE (%)	12.0	16.7	20.1	20.9	21.2
RoCE (%)	7.1	8.6	11.9	15.4	16.3
Dividend yield (%)	0.9	0.6	0.6	1.2	1.5
Net debt / equity (x)	0.6	0.6	0.3	0.2	0.1

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: ₹227

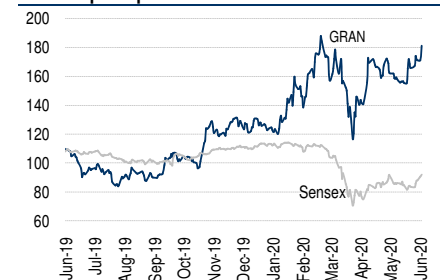
Share Price: ₹181

Key data	GRAN IN / GRAN.NS
52-week high / low	₹189 / 84
Sensex / Nifty	33826 / 9979
3-m average volume	\$5m
Market cap	₹46bn / \$611m
Shares outstanding	254m

Shareholding pattern (%)	Mar '20	Dec '19	Sep '19
Promoters	42.9	42.9	42.9
- of which, Pledged	37.6	30.3	37.0
Free float	57.1	57.1	57.1
- Foreign institutions	21.7	17.7	14.4
- Domestic institutions	3.0	3.2	3.3
- Public	32.4	36.1	39.4

Estimates revision (%)	FY21e	FY22e
Revenue	0.4	6.7
EBITDA	0.4	7.7
EPS	(2.7)	5.7

### Relative price performance



Source: Bloomberg

**Abdulkader Puranwala**  
Research Analyst

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Research Analyst

## Quick Glance – Consolidated Financials and Valuations

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Net revenues	16,918	22,792	25,986	33,955	40,735
Growth (%)	17.9	34.7	14.0	30.7	20.0
Direct costs	8,963	12,556	12,809	17,215	20,653
SG&A	5,171	6,396	7,924	9,507	11,487
<b>EBITDA</b>	<b>2,784</b>	<b>3,840</b>	<b>5,253</b>	<b>7,232</b>	<b>8,595</b>
EBITDA margins (%)	16.5	16.8	20.2	21.3	21.1
- Depreciation	762	1,055	1,370	1,515	1,692
Other income	108	267	366	17	17
Interest expenses	331	285	270	226	223
PBT	1,800	2,768	4,256	5,508	6,697
Effective tax rate (%)	35.2	32.2	27.2	23.0	23.0
+ Associates / (Minorities)	160	487	255	-	-
Net income	1,326	2,364	3,354	4,241	5,157
Adjusted income	1,326	2,364	3,383	4,241	5,157
WANS	254	254	254	254	254
FDEPS (₹ / sh)	5.2	9.3	13.3	16.7	20.3
R&D (% of sales)	3.1	3.2	3.0	3.0	3.0

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT	2,022	2,786	4,161	5,717	6,903
+ Non-cash items	762	1,055	1,370	1,515	1,692
Oper. prof. before WC	2,784	3,840	5,531	7,232	8,595
- Incr. / (decr.) in WC	2,579	377	944	2,495	2,199
Others incl. taxes	659	819	1,257	1,267	1,540
Operating cash-flow	-454	2,644	3,330	3,470	4,855
- Capex (tang.+ Intang.)	4,557	2,544	1,949	2,500	2,000
Free cash-flow	-5,011	99	1,381	970	2,855
Acquisitions					
- Div. (incl. buyback & taxes)	290	306	254	550	668
+ Equity raised	2,575	0	-	-	-
+ Debt raised	3,602	-252	-1,398	-67	-100
- Financial investments	483	539	-1,911	-	-
- Misc. (CFI + CFF)	(266)	(732)	(310)	209	206
Net cash-flow	659	-266	1,949	144	1,881

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

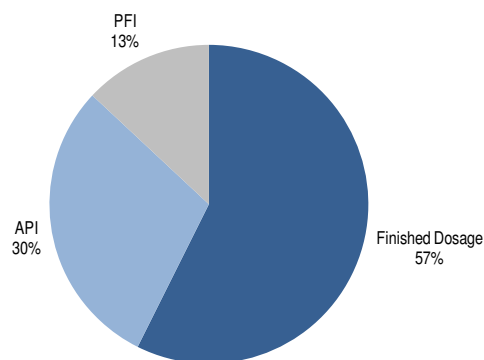
**Fig 2 – Balance sheet (₹ m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	254	254	254	254	254
Net worth	13,042	15,295	18,437	22,129	26,618
Debt	9,582	9,330	7,932	7,865	7,765
Minority interest	-	-	-	-	-
DTL / (Assets)	474	613	430	430	430
<b>Capital employed</b>	<b>23,098</b>	<b>25,237</b>	<b>26,799</b>	<b>30,423</b>	<b>34,812</b>
Net tangible assets	7,008	7,476	9,888	10,641	11,171
Net intangible assets	759	1,967	2,152	2,836	3,024
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	5,145	4,960	2,942	2,491	2,080
Investments (strategic)	1,566	2,104	193	193	193
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	11,068	12,389	14,948	17,246	20,265
Cash	1,156	890	2,839	2,984	4,865
Current liabilities	3,605	4,549	6,164	5,967	6,786
Working capital	7,463	7,841	8,784	11,279	13,479
<b>Capital deployed</b>	<b>23,098</b>	<b>25,237</b>	<b>26,799</b>	<b>30,423</b>	<b>34,812</b>
Contingent liabilities	44	33	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	19.8	19.5	13.6	10.9	8.9
EV / EBITDA (x)	12.5	14.2	9.7	7.0	5.7
EV / Sales (x)	2.1	2.4	2.0	1.5	1.2
P/B (x)	2.0	3.0	2.5	2.1	1.7
RoE (%)	12.0	16.7	20.1	20.9	21.2
RoCE (%) - after tax	7.1	8.6	11.9	15.4	16.3
ANDA filings	20.0	32.0	45.0		
DPS (₹ / sh)	1.0	1.0	1.0	2.2	2.6
Dividend yield (%)	0.9	0.6	0.6	1.2	1.5
Dividend payout (%) - incl. DDT	21.9	13.0	7.6	13.0	13.0
Net debt / equity (x)	0.6	0.6	0.3	0.2	0.1
Receivables (days)	136	108	103	95	95
Inventory (days)	60	62	62	54	54
Payables (days)	59	52	60	44	44
CFO : PAT %	-34.3	111.8	98.4	81.8	94.1

Source: Company, Anand Rathi Research

**Fig 6 – Revenue break-up (Q4 FY20)**


Source: Company

## Result highlights

**Fig 7 – Quarterly financials (₹ m)**

Quarterly results (YE Mar)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	% Y/Y	% Q/Q
Sales	3,926	4,107	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	5,999	(2.2)	(14.8)
Gross profit (₹m)	1,949	2,018	1,941	2,061	2,632	2,726	2,818	2,998	3,401	3,569	3,208	13.9	(10.1)
Gross margins (%)	49.6	49.1	38.5	45.5	45.3	43.2	45.9	50.4	48.6	50.7	53.5	754bps	278bps
EBITDA	769	740	436	726	1,005	1,133	976	1,186	1,436	1,631	999	2.4	(38.7)
EBITDA margins (%)	19.6	18.0	8.7	16.0	17.3	17.9	15.9	19.9	20.5	23.2	16.7	75bps	-651bps
Finance expenses	104	82	62	65	76	75	68	69	69	67	66	(4.0)	(2.3)
Depreciation	186	196	204	245	265	270	274	287	303	390	390	42.1	(0.1)
Other income	68	9	97	147	42	59	19	19	87	35	225	1,096.6	541.6
PBT	547	471	267	563	706	847	652	849	1,151	889	1,367	109.6	53.7
Tax	193	169	95	191	234	265	202	272	193	249	444	119.8	78.3
Effective tax rate (%)	35.2	35.9	35.6	34.0	33.1	31.2	30.9	32.0	16.8	28.0	32.5	151bps	448bps
Adjusted PAT	403	350	204	518	603	603	640	832	958	692	758	18.4	9.6

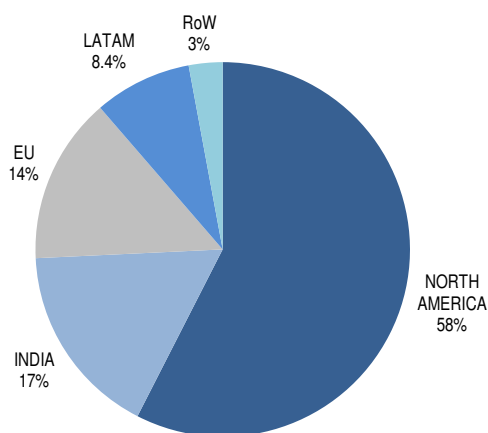
Source: Company, Anand Rathi Research

**Fig 8 – Revenue break-up**

Quarterly results (YE Mar)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	% Y/Y	% Q/Q
API	1,335	1,479	2,015	1,813	2,265	2,148	1,985	2,143	2,169	2,091	1,777	(10.5)	(15.0)
% of sales	34.0	36.0	40.0	40.0	39.0	34.0	32.4	36.0	31.0	29.9	25.4		
PFI	942	986	1,209	906	929	1,074	958	952	1,329	1,155	781	(18.5)	(32.4)
% of sales	24.0	24.0	24.0	20.0	16.0	17.0	15.6	16.0	19.0	16.5	11.2		
Finished dosages	1,649	1,643	1,814	1,813	2,614	3,096	3,190	2,857	3,498	3,794	3,440	7.8	(9.3)
% of sales	42.0	40.0	36.0	40.0	45.0	49.0	52.0	48.0	50.0	54.2	49.2		
<b>Total</b>	<b>3,926</b>	<b>4,107</b>	<b>5,038</b>	<b>4,532</b>	<b>5,809</b>	<b>6,318</b>	<b>6,133</b>	<b>5,953</b>	<b>6,995</b>	<b>7,040</b>	<b>5,998</b>	<b>(2.2)</b>	<b>(14.8)</b>

Source: Company, Anand Rathi Research

**Fig 9 – Revenue break-up, area-wise (Q4 FY20)**



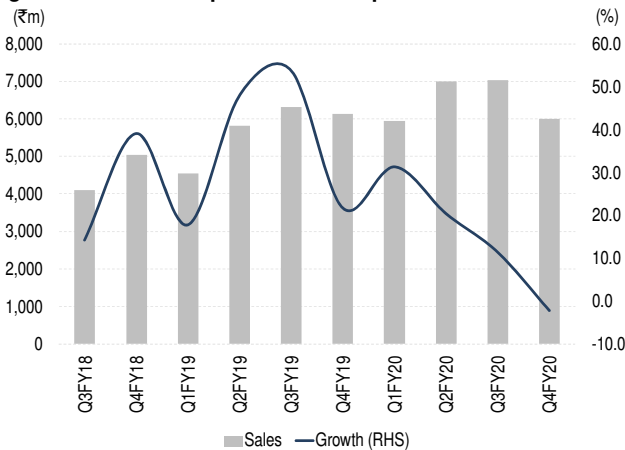
Source: Company

## Concall highlights; Key takeaways

- Granules India's Q4 FY20 revenue slipped 2.2% y/y to ₹6bn on the export restrictions imposed on paracetamol (API, PFI and FDs) in Mar'20 and supply disruption on account of the Covid-19 pandemic.
- The restriction imposed on PFI and FDs exports was lifted in April, that on API in May.
- Q4 FY20 revenue break-up:
  - Verticals-wise: FD – 57%, API – 30%, PFI – 13%.
  - Geographically: North America--58%, Europe--14%, India--17%, LATAM--8%, RoW--3%.
- Due to Covid-19, the company suffered a ₹600m-700m loss in sales and EBITDA margins on it could had been 30%.
- It spent ~₹170m-180m on employee safety measures concerning Covid-19. If the pandemic eases, management doesn't see any major impact on profitability.
- The gross margin during the quarter improved 754bps y/y assisted by product launches from GPI and the greater contribution from FD sales.
- The EBITDA was impacted by a one-time ₹217m impairment of investments in its US pharma business as a conservative measure due to delay in product launches and in approvals.
- Business operations in the last week of Mar'20 were at 25% utilisation; they returned to 85% in Apr'20 in strict compliance with safety and government guidelines.
- During Q4 FY20, the company received five US FDA approvals: Hydro/APAP Tab (3<sup>rd</sup> Jan), Valgan PFOS (31<sup>st</sup> Jan), Colchicine Tab (5<sup>th</sup> Feb), Colchicine Cap (10<sup>th</sup> Feb) and KCL ER Tab (4<sup>th</sup> Mar).
- The Gagillapur (Hyderabad) plant underwent a successful inspection by the US FDA in Feb'20.
- Also, the European inspection of Unit-5 at Vishakhapatnam has been successfully completed.
- The company has completed capitalisation of Unit-5 Vishakhapatnam and started from Q4 FY20 to depreciate the assets. Management said this unit would be the next growth engine for the company.
- The share buyback of ₹2.5bn (4.9% of paid-up capital) is expected to be completed by end-Jun'20.
- During FY20, the company completed the divestment of two JVs, Biocause and Omnicem and received ₹2.2bn, of which ₹1.1bn was realised in May'20, though recorded as divestment in FY20 books.
- Till date, Granules has filed 45 ANDAs, received approval for 29 products (12 in FY20) and launched five in the US.
- A more conservative approach in R&D has been adopted since Q3 FY20.
- It invested ₹400m as maintenance capex toward enhancing capacities at the Gagillapur plant. This will start yielding results from Apr'20.

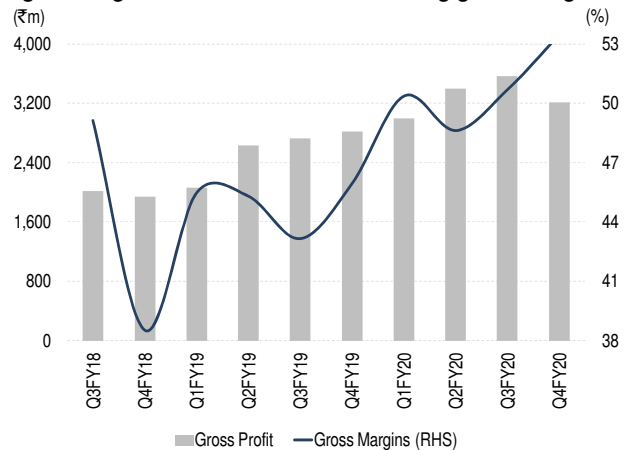
- FY20 PAT includes ₹277m as exceptional gains from sale of the Omnicem JV. The tax on long-term gains is ₹278.7m. The net impact is thus nil.
- The US pharma business: Impaired ₹220m of investment in FY20 besides a write-off of ₹112m against milestones paid to the US pharma business for a few products. Book value of the investment on 31<sup>st</sup> Mar: ₹413m; balance in the books: ₹190m.
- Five core API molecules bring 85% to sales; in absolute terms, revenue from these has slipped 5% y/y on account of the ban on paracetamol, the lockdown and the greater contribution from other molecules.
- Management said ~70% of R&D will be toward the core business; the rest toward the US generic business.
- R&D for the quarter was ₹213m (3.6% of sales).
- Management said that in Q1 FY21 the lifting of the restriction on paracetamol would boost revenues.
- Management reiterated its guidance of 20% topline growth and 25% profit growth with a fair chance of exceeding it.
- Also, it guided to a ~50%-and-better gross margin ahead.

**Fig 10 – Growth hampered due to export restrictions**



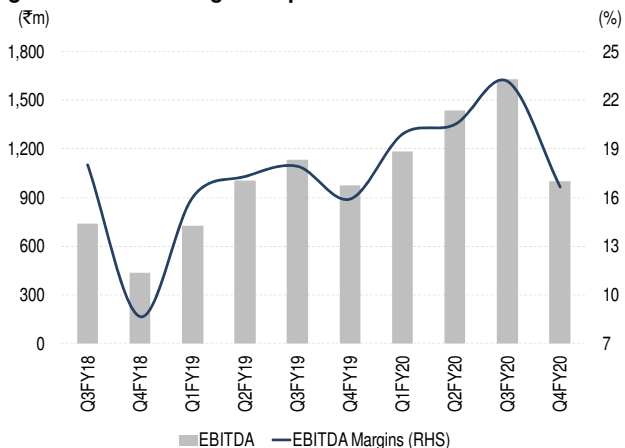
Source: Company, Anand Rathi Research

**Fig 11 – Higher sales of formulations lifting gross margins**



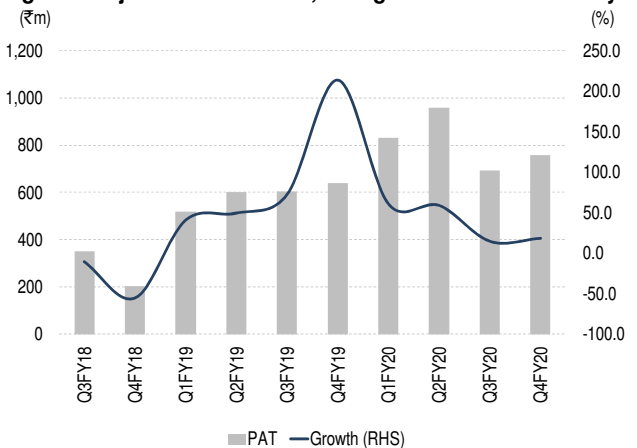
Source: Company, Anand Rathi Research

**Fig 12 – EBITDA margins to pull back from current levels**



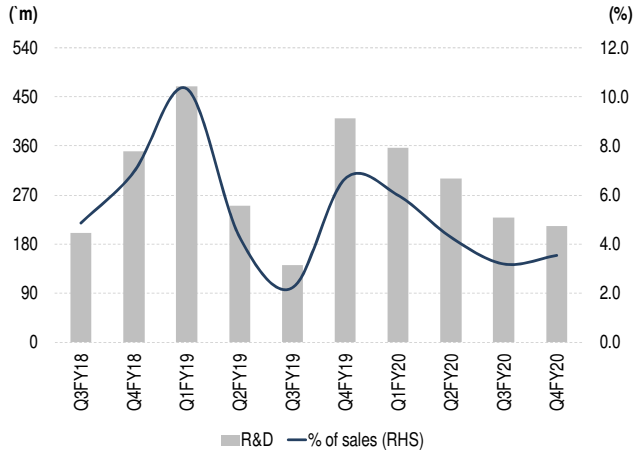
Source: Bloomberg, Anand Rathi Research

**Fig 13 – Adjusted for one-offs, PAT growth remains healthy**



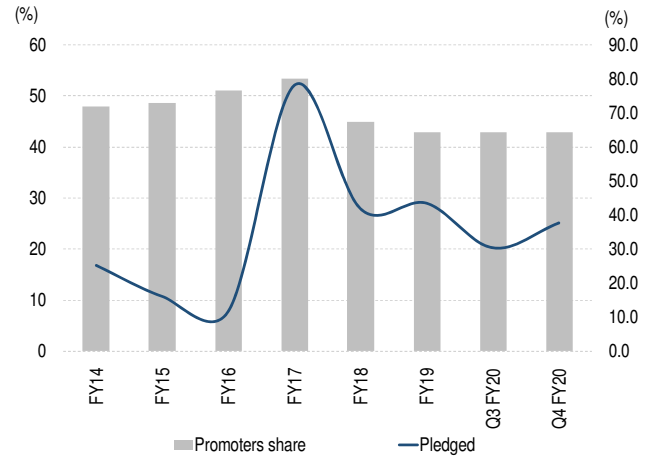
Source: Bloomberg, Anand Rathi Research

**Fig 14 – R&D investment to be ~3% of sales**



Source: Bloomberg, Anand Rathi Research

**Fig 15 – Promoter’s pledge to come down, post-buyback**



Source: Bloomberg, Anand Rathi Research

## Valuation

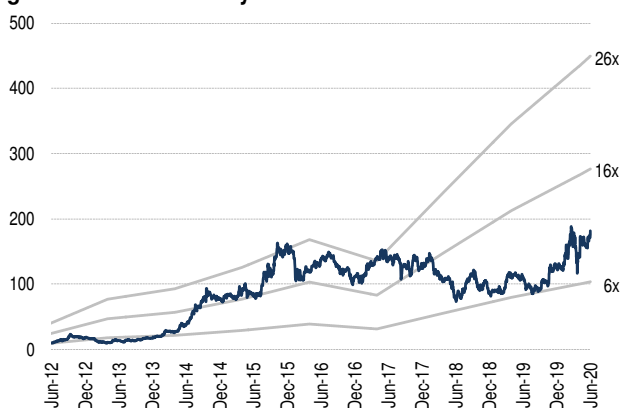
Its dominance in key APIs such as paracetamol, ibuprofen and metformin is likely to help Granules emerge as a prime beneficiary since the Covid-19 outbreak has led to a surge in demand for such drugs. Granules is likely to maintain strong traction for the next couple of years, driven by formulations and the healthy contribution from the new capacities. We expect revenue and PAT CAGRs over FY20-22 of ~25% and ~23% respectively. At the CMP of ₹181, the stock quotes at 9x FY22e EPS of ₹20.

**Fig 16 – Change in estimates**

₹ m	Old estimates		New estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	33,814	38,187	33,955	40,735	0.4	6.7
EBITDA	7,202	7,981	7,232	8,595	0.4	7.7
PAT	4,357	4,879	4,241	5,157	(2.7)	5.7

Source: Anand Rathi Research

**Fig 17 – PE band – one-year-forward**



Source: Bloomberg, Anand Rathi Research

**Fig 18 – Standard deviation – one-year-forward**



Source: Bloomberg, Anand Rathi Research

### Risks

- 38% of the promoters' holdings have been pledged.
- Increase in absolute spending on R&D.
- Higher raw-material prices.
- Adverse currency fluctuations and regulatory hurdles.

Fig 19 – Valuation Summary

	RATING	CMP (₹)	TP (₹)	M Cap (₹ bn)	EPS (₹)			PE (x)		EV / EBITDA		RoE (%)		RoCE (%)	
					FY20e	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Aarti	Buy	947	1028	22.1	59.2	71.3	85.7	13.3	11.1	7.1	5.8	22.7	22.1	16.3	17.3
Ajanta	Hold	1442	1442	125.9	53.6	60.0	72.4	24.0	19.9	14.4	12.3	18.8	19.1	18.7	19.0
Alembic	Buy	851	780	160.4	45.8	43.1	43.3	19.8	19.6	12.7	11.9	23.0	19.8	15.3	13.9
Alkem	Hold	2401	2897	287.1	95.3	105.1	133.2	22.8	18.0	18.8	14.7	18.7	20.5	19.5	21.5
Cadila	Hold	353	328	361.4	13.0	15.9	18.2	22.2	19.4	13.2	11.6	14.6	15.3	9.9	10.8
Dishman	Buy	67	227	10.5	18.5	21.1	23.2	3.2	2.9	3.3	3.0	15.3	15.1	11.7	11.9
Eris	Hold	520	500	71.5	21.2	25.0	25.2	20.8	20.6	15.1	14.1	22.5	18.5	23.9	19.5
Granules India	Buy	181	227	46.1	13.3	16.7	20.3	10.9	8.9	7.0	5.7	20.9	21.2	15.4	16.3
Indoco Remedies	Sell	206	170	19.0	2.9	6.9	9.7	30.0	21.2	14.1	11.4	9.0	11.8	8.2	10.3
Ipca Labs.	Buy	1555	1900	196.5	50.8	74.0	79.2	21.0	19.6	14.9	13.6	22.8	20.1	19.8	18.2
JB Chemicals	Buy	701	633	56.2	36.1	37.6	45.2	18.7	15.5	9.6	7.6	17.2	18.1	16.6	17.5
Natco Pharma	Hold	594	649	108.2	25.6	23.8	25.3	25.0	23.5	19.0	17.3	10.8	10.5	10.2	10.0
Neuland	Hold	390	488	5.0	30.7	31.3	37.5	12.5	10.4	7.6	6.0	4.1	6.1	4.7	6.1
Pfizer	Hold	4023	4665	184.0	106.0	116.6	129.2	34.5	31.1	26.3	23.3	15.0	14.8	15.2	15.0
Suven Pharma	Buy	321	403	40.8	23.9	27.2	35.4	11.8	9.1	6.8	4.9	29.0	30.1	26.4	27.6
Torrent Pharma	Hold	2370	2648	401.1	57.4	61.3	80.2	39.2	30.0	19.7	16.4	20.2	23.4	13.9	17.2
HCG	Buy	115	90	10.2	-9.6	-6.6	0.1	NM	NM	6.3	4.6	NM	NM	5.6	11.2

Source: Company, Anand Rathi Research



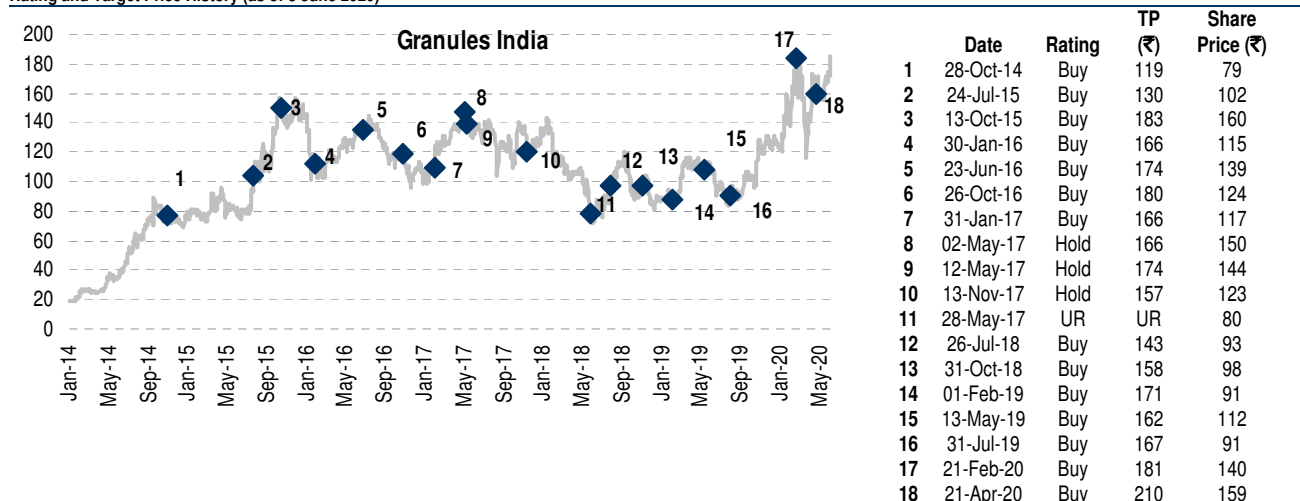
## Appendix

### Analyst Certification

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