

Granules India

Refer to important disclosures at the end of this report

It only gets better!

CMP: Rs 264

as of (July 17, 2020)

TP: Rs 340 (▲)

12 months

Rating: BUY (■)

Upside: 28.8 %

We appreciate your support in the [Asiamoney Brokers Poll 2020](#)

- GRAN's Q1 print was solid, with revenue/EBITDA beating our estimates by 9%/18% – the best ever for the company. Gross margins rose 600bps qoq, helped by higher realizations, product rationalization and better mix.
- Current quarter GMs are largely sustainable, as per management, and should help drive a 30% increase in PAT in FY21. Over the last four quarters, GRAN's gross margins have improved by ~900bps and we factor in 600bps improvement in GMs yoy in FY21.
- Balance sheet improvement continued, with leverage further down (net debt/EBITDA at 0.8x vs. 1.2x in FY20), though FCF generation was relatively weak (Rs373mn) due to higher WC. In line with management guidance, promoter pledge fell to ~8% from ~37%.
- We raise FY21/22/23 EPS by 13%/8%/10%, factoring in higher margins. With strong operating performance and a leaner balance sheet, we expect GRAN to re-rate. We retain Buy with a revised TP of Rs340. GRAN remains our top small cap pick and OW in EAP.

Positive surprise: Q1 surprised positively with a 9%/18% beat in revenue/EBITDA, led by strong growth in the PFI (+42%yoy) and FD businesses (+35%yoy). The sharp improvement in GMs (+600bps qoq) was the key positive surprise and management guided to sustain it as the formulation business continues to gain. Over the last four quarters, GMs have improved by ~900bps, largely led by a ramp-up in the finished dosage business (up from 48% to 52.5% of sales). EBITDA of Rs1.8bn (vs. Rs1.6bn est.) includes a one-time Rs150mn hit due to metformin recall and Rs130mn Covid-19 related expenses (will partly continue). R&D spends were lower (Rs200mn vs. Rs1.5bn guidance in FY21), but should increase. Overall, GRAN expects to sustain margins at around 23% in FY21 (vs. 25% in Q1).

Leverage comes down, but FCF generation weak: Net debt/EBITDA is further down to 0.8x (vs. 1.2x in FY20), though FCF generation (at Rs373mn) was relatively weak due to higher working capital. With capacities running at 130-140% higher utilizations (vs. a year ago), GRAN is investing in a multi-purpose sustained release (SR) facility as well as into augmenting API/KSM capacities and increased its capex guidance to Rs3.5-4bn in FY21 (vs. Rs1.5bn earlier). This would be funded through internal accruals. After the buyback, the promoter pledge is down at 8% (vs. 37% earlier) and is guided to come down to zero by FY21 end.

Retain Buy: We Increase FY21/22/23 EPS by 13%/8%/10%, factoring in higher margins, and revise the TP to Rs340 (from Rs245), valuing the stock at 16xJun'22E EPS (vs. 13xMar'22E earlier). With strong operating performance (22% EPS CAGR over FY20-23) and a leaner balance sheet, we expect GRAN to re-rate. GRAN is an OW in EAP and our top small cap pick.

Please see our sector model portfolio (Emkay Alpha Portfolio): [Pharmaceuticals \(page 9\)](#)

Financial Snapshot (Consolidated)

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	22,792	25,986	30,144	34,666	39,866
EBITDA	3,840	5,254	7,235	8,424	9,807
EBITDA Margin (%)	16.8	20.2	24.0	24.3	24.6
APAT	2,364	3,133	4,201	5,023	5,950
EPS (Rs)	9.3	12.3	17.0	20.3	24.1
EPS (% chg)	78.0	32.5	37.9	19.6	18.5
ROE (%)	16.7	18.3	21.6	22.1	21.5
P/E (x)	28.4	21.4	15.5	13.0	11.0
EV/EBITDA (x)	19.3	13.7	9.8	8.2	6.7
P/BV (x)	4.4	3.7	3.2	2.6	2.2

Source: Company, Emkay Research



Change in Estimates

EPS Chg FY21E/FY22E (%)	13/8
Target Price change (%)	39
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates		
	FY21E	FY22E
Emkay	17.0	20.3
Consensus	15.0	18.5
Mean Consensus TP (12M)	Rs 231	

Stock Details

Bloomberg Code	GRAN IN
Face Value (Rs)	1
Shares outstanding (mn)	254
52 Week H/L	268 / 84
M Cap (Rs bn/USD bn)	67 / 0.89
Daily Avg Volume (nos.)	30,84,689
Daily Avg Turnover (US\$ mn)	8.1

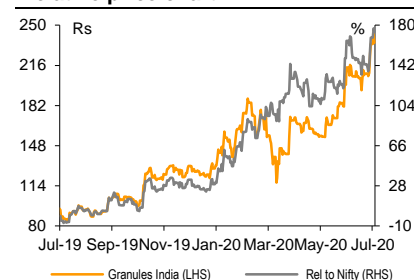
Shareholding Pattern Jun '20

Promoters	42.1%
FIIIs	23.0%
DIIIs	3.2%
Public and Others	31.7%

Price Performance

(%)	1M	3M	6M	12M
Absolute	23	59	86	179
Rel. to Nifty	11	35	111	199

Relative price chart



Source: Bloomberg

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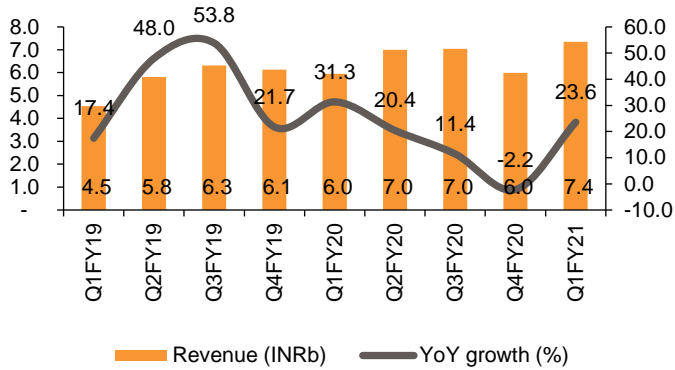
Praful Bohra

praful.bohra@emkayglobal.com

+91 22 6612 1254

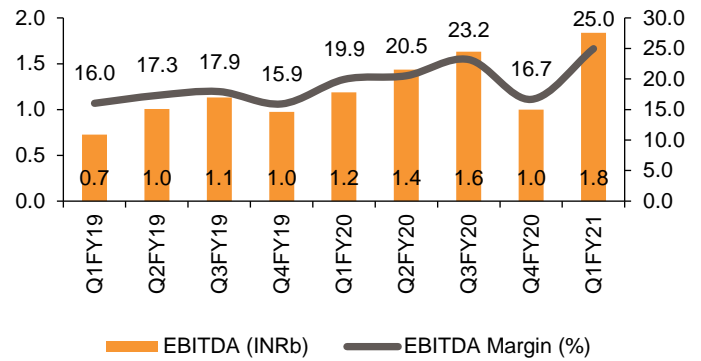
Story in Charts

Exhibit 1: Strong revenue growth due to market share gains



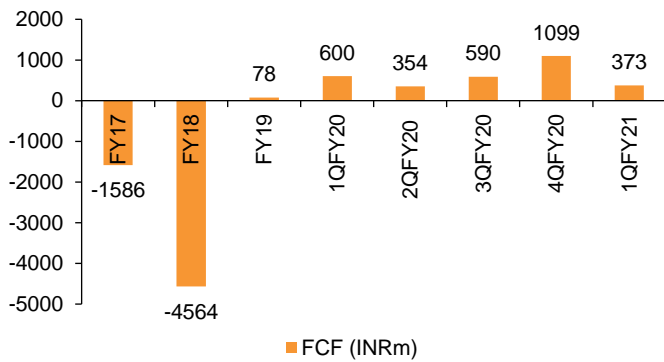
Source: Company

Exhibit 2: EBITDA margin at 25% beats estimates by 180bps



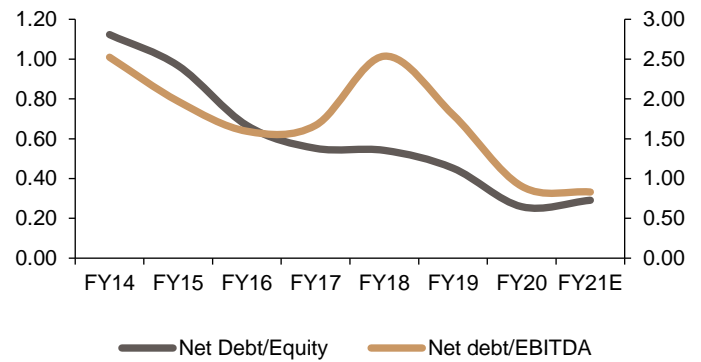
Source: Company

Exhibit 3: FCF down due to increase in inventory and receivables



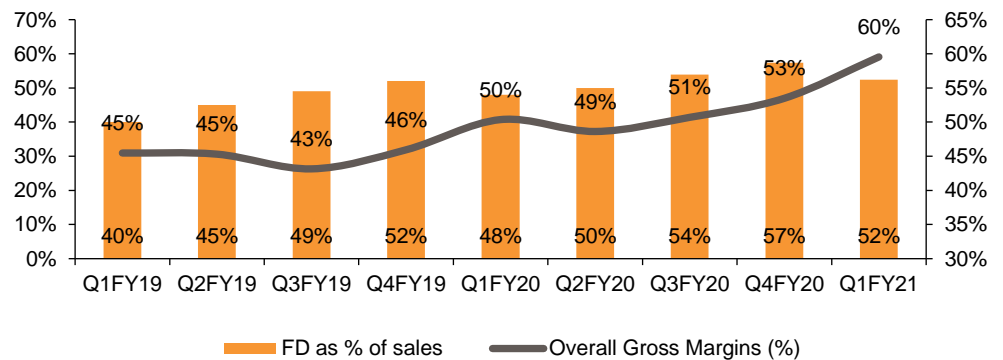
Source: Company

Exhibit 4: Net debt on a declining trend



Source: Company

Exhibit 5: Gross margins have improved with increased contribution from FD



Source: Company

Exhibit 6: Quarterly Snapshot

(Rs mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	YoY (%)	QoQ (%)
Revenue	5,953	6,995	7,040	5,999	7,356	23.6	22.6
Consumption of RM	2,955	3,594	3,470	2,790	2,976	0.7	6.6
as % of sales	49.6	51.4	49.3	46.5	40.5		
Employee costs	570	634	647	738	837	46.7	13.3
as % of sales	9.6	9.1	9.2	12.3	11.4		
Other expenditure	1,242	1,331	1,290	1,471	1,708	37.5	16.1
as % of sales	20.9	19.0	18.3	24.5	23.2		
EBITDA	1,186	1,436	1,632	999	1,836	54.8	83.7
Margins (%)	19.9	20.5	23.2	16.7	25.0		
Depreciation	287	303	390	390	341		
Other Income	19	87	35	225	56		
Interest	69	69	67	66	60		
PBT	850	1,151	1,210	769	1,492	75.6	94.0
Total Tax	272	193	249	444	377		
Tax rate (%)	32.0	16.8	20.6	57.7	25.3		
PAT before MI	578	958	961	326	1,115	92.9	242.3
Minority interest (MI)	-255	0	0	0	0		
Adj. PAT before extraordinary	833	958	897	445	1,115	33.8	150.3
Extraordinary expenses	-	-	320	-598			
Reported PAT	833	958	640	923	1,115	33.8	21
No. of shrs	254	254	254	254	247		
EPS	3.3	3.8	3.5	1.8	4.5		
Core EPS	3.3	3.8	3.5	1.8	4.5		
Margins (%)						bps	bps
Gross	50.4	48.6	50.7	53.5	59.5	918	606
EBIDTA	19.9	20.5	23.2	16.7	25.0	503	830
EBIT	15.4	17.4	18.1	13.9	21.1	567	717
PBT	14.3	16.5	17.2	12.8	20.3	601	746
Adj. PAT	14.0	13.7	12.7	7.4	15.2	116	773
Effective Tax rate	32.0	16.8	20.6	57.7	25.3	-669	-3,237

Source: Company

Exhibit 7: Actual vs Estimates

Figures in Rs mn	Actual	Estimates		% Variation		Comments
		Emkay	Bloomberg	Emkay	Bloomberg	
Revenue	7,356	6,727	6,143	9%	20%	Strong beat due to increased FD and PFI sales
EBITDA	1,836	1,559	1,421	18%	29%	
EBITDA margin (%)	25.0%	23.2%	23.1%	179	183	Better Gross Margins led to 180bps beat
APAT	1,115	912	687	22%	62%	

Source: Company

Exhibit 8: Segmental Breakdown

Revenue Rs mn	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	YoY	QoQ
North America	2,614	3,285	3,290	2,976	3,710	3,726	3,450	3,814	28%	11%
Europe	1,162	821	1,187	1,310	1,400	1,491	864	1,405	7%	63%
Latin America	465	632	501	476	560	509	505	862	81%	71%
RoW	290	253	264	417	345	1,034	175	433	4%	147%
India	1,278	1,327	891	774	980	279	1,004	842	9%	-16%
Total	5,809	6,318	6,133	5,953	6,995	7,039	5,998	7,356	24%	23%

Product wise	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	YoY	QoQ
API	2,265	2,148	1,985	2,143	2,169	2,091	1,777	2,121	-1%	19%
PFI	929	1,074	958	952	1,329	1,155	781	1,379	45%	77%
FD	2,614	3,096	3,190	2,857	3,498	3,794	3,440	3,856	35%	12%

Source: Company

Exhibit 9: Change in earnings

Change in earnings estimates	FY21			FY22			FY23		
	Old	New	Chng (%)	Old	New	Chng (%)	Old	New	Chng (%)
Revenue	30,144	30,144	0.0%	34,666	34,666	0.0%	39,866	39,866	0.0%
EBITDA	6,627	7,235	9.2%	7,691	8,424	9.5%	8,964	9,807	9.4%
Margin (%)	22.0	24.0		22.2	24.3		22.5	24.6	
PAT	3,654	4,201	15.0%	4,554	5,023	10.3%	5,286	5,950	12.6%
EPS*	15.1	17.0	12.5%	18.8	20.3	7.9%	21.9	24.1	10.1%

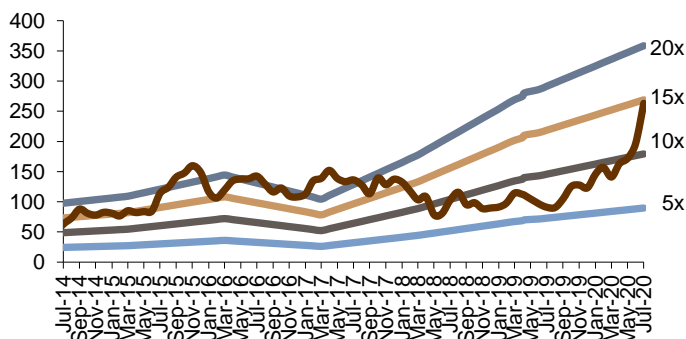
Source: Emkay Research

*Post completion of buyback, we have readjusted equity to account for lesser tendering

Other Highlights

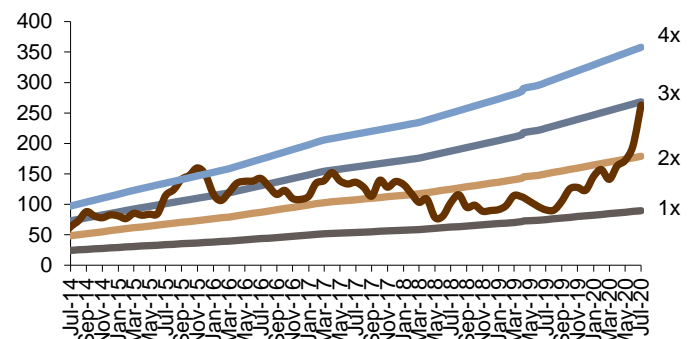
- Q1 sales did not see any positive impact of deferred sales from Q4.
- It expects approval of 4-5 high value and volume ANDAs in the next two year. Thus, additional capex of Rs2.5bn has been initiated to meet new demand. This facility will be ready by Q3FY22 and will provide additional PFI & compression capacity. It expects payback in 24-36 months. This project will be funded through internal accruals only.
- The company has guided for 30% PAT growth for FY21 and 25% for FY22.
- Metformin recall has affected only formulation sales of Metformin ER 750mg (0.3% of FY20 sales). The rest of the Metformin business continues its normal course. Of the total recall cost of Rs150mn, around Rs53mn is in material costs and the rest is accounted in other expenses.
- Backward integrating into Metformin has aided GM expansion.
- GPI sales were lower than anticipated as the quarter did not see the full effect of two launches. GRAN is targeting to launch seven new products from GPI this year in addition to two OTC products.
- Cash conversion cycle has decreased from 109 days in FY20 to 103 days in this quarter.
- FCF generation was at Rs373mn and witnessed a drop due to an increase in receivables and inventory.
- Capex guidance for FY21 stands at Rs3.5bn-Rs4bn for FY21. R&D guidance at Rs1.5bn.
- GRAN is pursuing only select ANDA filings. The target is to file only medium-large size, high-value, high-volume products.
- It plans to file for 7-9 products each year of which at least five will be for the US market.
- Currently, revenues from GPI stand at 11% of total sales. The company expects this business to grow at least four fold from here in the next 3-4 years. Overall, the US will be contributing 68%-70% of total sales in the next 3-4 years (currently: ~52%). With the increase in FD sales, EBITDA could increase 1% every year going ahead.
- It has three products, which come from China, of which GRAN has tied up with alternate sources for two products and is working to backward integrate the third product. There were some API price increases in this quarter, but largely passed on.
- Top five molecules contribute around 85% of revenues. These may come down to 70-75% over the next 3-4 years.
- Onco block will largely be focused on CDMO and CMO projects (GRAN won't have a front end for this business). GRAN has developed some APIs and is currently in talks to supply these with customers. It will take at least two quarters to ramp up.

Exhibit 10: P/E chart



Source: Bloomberg

Exhibit 11: P/B chart



Source: Bloomberg

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	22,792	25,986	30,144	34,666	39,866
Expenditure	18,952	20,733	22,910	26,242	30,059
EBITDA	3,840	5,254	7,235	8,424	9,807
Depreciation	1,055	1,369	1,598	1,838	2,078
EBIT	2,786	3,884	5,636	6,586	7,729
Other Income	267	365	269	302	332
Interest expenses	285	270	228	190	128
PBT	2,768	3,980	5,677	6,697	7,933
Tax	891	1,157	1,476	1,674	1,983
Extraordinary Items	0	277	0	0	0
Minority Int./Income from Assoc.	487	255	0	0	0
Reported Net Income	2,364	3,355	4,201	5,023	5,950
Adjusted PAT	2,364	3,133	4,201	5,023	5,950

Balance Sheet

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Equity share capital	254	254	247	247	247
Reserves & surplus	15,041	18,090	20,295	24,725	30,082
Net worth	15,295	18,344	20,543	24,972	30,329
Minority Interest	0	0	0	0	0
Loan Funds	9,912	9,912	9,112	7,612	5,112
Net deferred tax liability	613	613	613	613	613
Total Liabilities	25,945	28,995	30,393	33,322	36,179
Net block	9,442	9,573	11,725	12,886	13,808
Investment	2,561	2,561	2,561	2,561	2,561
Current Assets	12,822	16,202	16,049	18,469	21,154
Cash & bank balance	890	3,063	1,480	1,918	2,324
Other Current Assets	0	0	0	0	0
Current liabilities & Provision	3,841	4,302	4,902	5,554	6,304
Net current assets	8,982	11,901	11,147	12,915	14,850
Misc. exp	0	0	0	0	0
Total Assets	25,945	28,995	30,393	33,322	36,179

Cash Flow

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PBT (Ex-Other income) (NI+Dep)	2,501	3,869	5,409	6,395	7,601
Other Non-Cash items	0	0	0	0	0
Chg in working cap	(569)	(747)	(829)	(1,330)	(1,529)
Operating Cashflow	2,622	3,882	4,929	5,420	6,295
Capital expenditure	(2,544)	(1,500)	(3,750)	(3,000)	(3,000)
Free Cash Flow	78	2,382	1,179	2,420	3,295
Investments	(637)	0	0	0	0
Other Investing Cash Flow	216	0	0	0	0
Investing Cashflow	(2,698)	(1,135)	(3,481)	(2,698)	(2,668)
Equity Capital Raised	10	0	(7)	0	0
Loans Taken / (Repaid)	127	0	(800)	(1,500)	(2,500)
Dividend paid (incl tax)	(443)	(305)	(593)	(593)	(593)
Other Financing Cash Flow	312	0	0	0	0
Financing Cashflow	(278)	(575)	(1,628)	(2,283)	(3,221)
Net chg in cash	(353)	2,172	(180)	438	406
Opening cash position	1,244	890	3,063	1,480	1,918
Closing cash position	890	3,063	1,480	1,918	2,324

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	16.8	20.2	24.0	24.3	24.6
EBIT Margin	12.2	14.9	18.7	19.0	19.4
Effective Tax Rate	32.2	29.1	26.0	25.0	25.0
Net Margin	8.2	10.9	13.9	14.5	14.9
ROCE	12.4	15.5	20.0	21.7	23.3
ROE	16.7	18.3	21.6	22.1	21.5
RoIC	17.0	21.6	28.3	29.1	30.8

Per Share Data (Rs)	FY19	FY20	FY21E	FY22E	FY23E
EPS	9.3	12.3	17.0	20.3	24.1
CEPS	13.4	17.5	23.5	27.8	32.5
BVPS	60.2	72.2	83.1	101.0	122.7
DPS	1.2	1.2	2.4	2.4	2.4

Valuations (x)	FY19	FY20	FY21E	FY22E	FY23E
PER	28.4	21.4	15.5	13.0	11.0
P/CEPS	19.6	15.1	11.3	9.5	8.1
P/BV	4.4	3.7	3.2	2.6	2.2
EV / Sales	3.2	2.8	2.3	2.0	1.7
EV / EBITDA	19.3	13.7	9.8	8.2	6.7
Dividend Yield (%)	0.5	0.5	0.9	0.9	0.9

Gearing Ratio (x)	FY19	FY20	FY21E	FY22E	FY23E
Net Debt/ Equity	0.5	0.3	0.3	0.1	0.0
Net Debt/EBIDTA	1.8	0.9	0.8	0.4	0.1
Working Cap Cycle (days)	129.6	124.1	117.0	115.8	114.7

Growth (%)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	34.7	14.0	16.0	15.0	15.0
EBITDA	37.9	36.8	37.7	16.4	16.4
EBIT	37.7	39.4	45.1	16.8	17.4
PAT	78.3	41.9	25.2	19.6	18.5

Quarterly (Rs mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21
Revenue	5,953	6,995	7,040	5,999	7,356
EBITDA	1,186	1,436	1,632	999	1,836
EBITDA Margin (%)	19.9	20.5	23.2	16.7	25.0
PAT	833	958	640	923	1,115
EPS (Rs)	3.3	3.8	2.5	3.6	4.4

Source: Company, Emkay Research

Shareholding Pattern (%)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoters	42.9	42.9	42.9	42.9	42.1
FIIIs	13.9	14.4	17.7	21.7	23.0
DIIIs	3.1	3.3	3.2	3.0	3.2
Public and Others	40.1	39.4	36.1	32.4	31.7

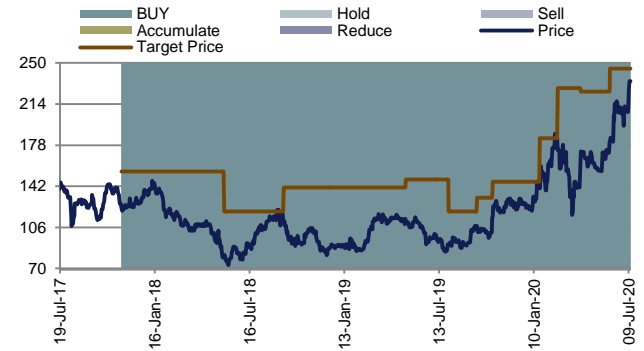
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
03-Jun-20	181	245	12m	Buy	Praful Bohra
08-Apr-20	173	225	12m	Buy	Praful Bohra
27-Mar-20	146	228	12m	Buy	Praful Bohra
24-Feb-20	174	228	12m	Buy	Praful Bohra
21-Jan-20	140	184	12m	Buy	Praful Bohra
16-Dec-19	131	146	12m	Buy	Praful Bohra
14-Nov-19	124	146	12m	Buy	Praful Bohra
23-Oct-19	116	146	12m	Buy	Praful Bohra
23-Sep-19	107	132	12m	Buy	Praful Bohra
17-Sep-19	104	120	12m	Buy	Praful Bohra
19-Aug-19	95	120	12m	Buy	Praful Bohra
31-Jul-19	91	120	12m	Buy	Praful Bohra
10-May-19	110	148	12m	Buy	Praful Bohra
31-Oct-18	99	141	12m	Buy	Jatin Kotian
19-Sep-18	112	141	12m	Buy	Jatin Kotian
25-Jul-18	94	120	12m	Buy	Jatin Kotian
11-Jul-18	91	120	12m	Buy	Jatin Kotian
10-Jul-18	92	120	12m	Buy	Jatin Kotian
29-Jun-18	81	120	12m	Buy	Jatin Kotian
28-May-18	80	120	12m	Buy	Jatin Kotian
26-Apr-18	108	155	12m	Buy	Jatin Kotian
13-Nov-17	123	155	12m	Buy	Jatin Kotian

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – Pharmaceuticals

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Pharmaceuticals	4.35	4.35	0%	0	100.00
Aurobindo Pharma	0.41	0.57	40%	16	13.12
Cadila Healthcare	0.16	0.16	-3%	-1	3.56
Cipla	0.59	0.61	3%	2	14.09
Divi's Lab	0.49	0.37	-24%	-12	8.53
Dr. Reddy's Lab	0.87	0.84	-4%	-4	19.20
Glenmark Pharma	0.11	0.11	-4%	0	2.42
Granules India	0.00	0.40	NA	40	9.15
Ipca Lab	0.21	0.28	32%	7	6.39
Lupin	0.37	0.48	31%	11	11.00
Sun Pharma	0.94	0.55	-42%	-39	12.54
Suven Life Sciences*	0.00	0.00	NA	0	0.00
Torrent Pharma	0.20	0.00	-100%	-20	0.00
Cash	0.00	0.00	NA	0	0.0

Source: Emkay Research

* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

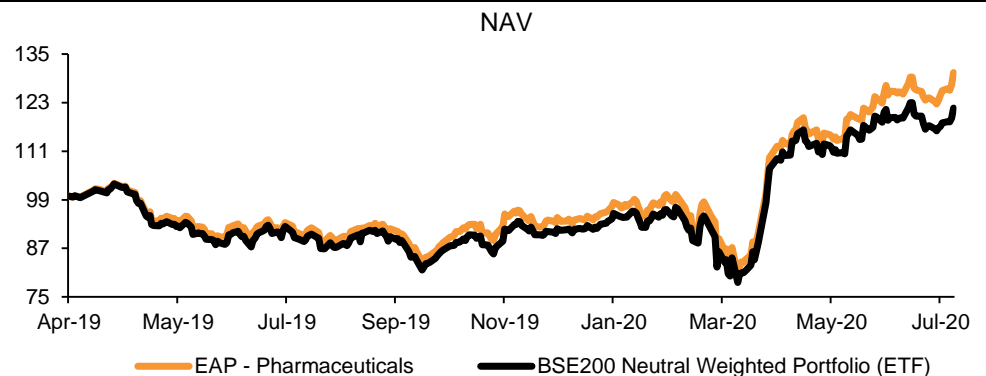
Sector portfolio NAV

	Base					Latest
	1-Apr-19	15-Oct-19	16-Jan-20	16-Apr-20	16-Jun-20	16-Jul-20
EAP - Pharmaceuticals	100.0	86.6	97.4	113.6	125.4	130.4
BSE200 Neutral Weighted Portfolio (ETF)	100.0	85.1	94.3	110.9	118.7	121.7

*Performance measurement base date 1st April 2019

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”



Analyst: Praful Bohra

Contact Details

praful.bohra@emkayglobal.com
+91 22 6612 1254

Sector

Pharmaceuticals

Analyst bio

Praful Bohra holds an MBA in Finance and has more than 11 years of experience in equity research. His team currently covers 12 stocks in the Pharmaceuticals space.

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 18 Jul 2020 03:34:15 (SGT)

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7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India

Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com