

20 July 2020

Granules India

*Sturdy quarter, formulations to lead growth; retaining a Buy*Rating: **Buy**

Target Price: ₹330

Share Price: ₹264

Granules India' Q1 FY21 exceeded our expectations on all fronts and so far was one of its best quarters. Sales grew 24% y/y to ₹7.4bn driven by its formulations and PFI divisions. The former grew 35.2% to ₹3.9bn, the latter 42% to ₹1.4bn. API sales at ₹2.1bn came flat. Product rationalization and market-share gains in high-value products led to a 1,092bp surge in the gross margin (60%). The EBITDA margin though expanded 430bps to 25% due to product-recall costs (₹97m) and higher employee cost. PAT was up 32.6% to ₹1.1bn. We expect ~21%/~27% revenue/PAT CAGRs over FY20-23. We roll over valuations to FY23 and raise our target to ₹330 (earlier ₹312) while retaining our Buy call.

Launches to drive formulations growth. Sales of formulations grew 35.2% to ₹3.9bn (52% of sales) due to higher demand for existing products. In Q1 the company filed three ANDAs/dossiers in North America and Europe and received six approvals (including one tentative) from the US FDA. In FY21 it plans to launch seven products (two high-value) through GPI. We expect the formulations division to register a 25% CAGR over FY20-23.

EBITDA margin likely to expand 280bps in three years. The transformation from a pure API company to a front-end formulator has sweetened the company's operating profile. Besides product rationalization, benefits of backward integration and higher utilization of existing facilities are likely to boost margins. We expect the EBITDA margins to zoom to ~23% in FY23.

Outlook, Valuation. Strong demand for key products (Metformin, paracetamol, ibuprofen) due to Covid-19 has translated to a robust Q1 for Granules. Ahead, we expect launches in formulations and additional capacity in PFIs to be key growth drivers. At the CMP, the stock trades at 10x FY23e EPS of ₹27. **Risks:** ~9% of promoters' holdings have been pledged; increase in R&D spend; adverse currency movements.

Key data	GRAN IN / GRAN.NS
52-week high / low	₹274 / 84
Sensex / Nifty	37419 / 11022
3-m average volume	\$9.1m
Market cap	₹66bn / \$874.7m
Shares outstanding	247m

Shareholding pattern (%)	Jun '20	Mar '20	Dec '19
Promoters	42.1	42.9	42.9
- of which, Pledged	8.6	37.6	30.3
Free float	57.9	57.1	57.1
- Foreign institutions	23.0	21.7	17.7
- Domestic institutions	3.2	3.0	3.2
- Public	31.7	32.4	36.1

Estimates revision (%)	FY21e	FY22e
Revenue	(4.5)	(3.9)
EBITDA	0.0	2.5
EPS	4.8	7.3

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (₹ m)	22,792	25,986	32,444	39,159	46,556
Net profit (₹ m)	2,364	3,383	4,447	5,536	6,924
EPS (₹)	9.3	13.3	17.5	21.8	27.2
PE (x)	28.4	19.8	15.1	12.1	9.7
EV / EBITDA (x)	19.7	13.7	9.9	7.9	6.1
PBV (x)	4.4	3.6	3.0	2.5	2.0
RoE (%)	16.7	20.1	21.8	22.4	23.0
RoCE (%)	8.6	11.9	16.1	17.3	18.5
Dividend yield (%)	0.4	0.4	0.9	1.1	1.3
Net debt / equity (x)	0.6	0.3	0.2	0.1	-0.0

Source: Company, Anand Rath Research

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Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues	22,792	25,986	32,444	39,159	46,556
Growth (%)	34.7	14.0	24.8	20.7	18.9
Direct costs	12,556	12,809	16,125	19,305	22,813
SG&A	6,396	7,924	9,084	11,043	13,036
EBITDA	3,840	5,253	7,235	8,811	10,708
EBITDA margins (%)	16.8	20.2	22.3	22.5	23.0
- Depreciation	1,055	1,370	1,472	1,644	1,747
Other income	267	366	238	245	252
Interest expenses	285	270	226	223	221
PBT	2,768	4,256	5,775	7,189	8,992
Effective tax rate (%)	32.2	27.2	23.0	23.0	23.0
+ Associates / (Minorities)	487	255	-	-	-
Net income	2,364	3,354	4,447	5,536	6,924
Adjusted income	2,364	3,383	4,447	5,536	6,924
WANS	254	254	254	254	254
FDEPS (₹ / sh)	9.3	13.3	17.5	21.8	27.2
R&D (% of sales)	3.2	3.0	2.4	2.5	2.5

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	2,786	4,161	5,763	7,167	8,961
+ Non-cash items	1,055	1,370	1,472	1,644	1,747
Oper. prof. before WC	3,840	5,531	7,235	8,811	10,708
- Incr. / (decr.) in WC	377	944	2,136	2,234	2,706
Others incl. taxes	819	1,257	1,328	1,653	2,068
Operating cash-flow	2,644	3,330	3,770	4,923	5,934
- Capex (tang. + intang.)	2,544	1,949	2,500	2,000	1,500
Free cash-flow	99	1,381	1,270	2,923	4,434
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	306	254	576	717	897
+ Equity raised	0	-	-	-	-
+ Debt raised	-252	-1,398	-67	-100	-50
- Financial investments	539	-1,911	-	-	-
- Misc. (CFI + CFF)	(732)	(310)	(12)	(22)	(31)
Net cash-flow	-266	1,949	639	2,128	3,518

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (₹ m)

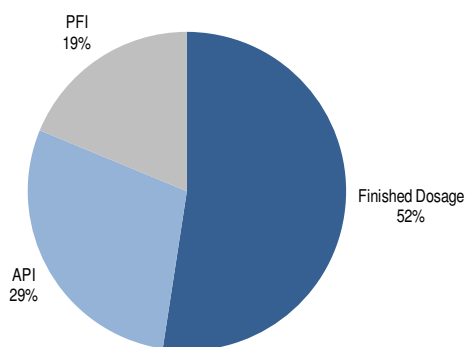
Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	254	254	254	254	254
Net worth	15,295	18,437	22,308	27,126	33,152
Debt	9,330	7,932	7,865	7,765	7,715
Minority interest	-	-	-	-	-
DTL / (Assets)	613	430	430	430	430
Capital employed	25,237	26,799	30,602	35,320	41,296
Net tangible assets	7,476	9,888	10,683	11,262	11,002
Net intangible assets	1,967	2,152	2,836	3,024	3,020
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	4,960	2,942	2,491	2,080	2,096
Investments (strategic)	2,104	193	193	193	193
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	12,389	14,948	16,628	19,620	23,462
Cash	890	2,839	3,478	5,606	9,124
Current liabilities	4,549	6,164	5,707	6,465	7,601
Working capital	7,841	8,784	10,921	13,155	15,861
Capital deployed	25,237	26,799	30,602	35,320	41,296
Contingent liabilities	33	-	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	28.4	19.8	15.1	12.1	9.7
EV / EBITDA (x)	19.7	13.7	9.9	7.9	6.1
EV / Sales (x)	3.3	2.8	2.2	1.8	1.4
P/B (x)	4.4	3.6	3.0	2.5	2.0
RoE (%)	16.7	20.1	21.8	22.4	23.0
RoCE (%) - after tax	8.6	11.9	16.1	17.3	18.5
ANDA filings	32.0	-	-	-	-
DPS (₹ / sh)	1.0	1.0	2.3	2.8	3.5
Dividend yield (%)	0.4	0.4	0.9	1.1	1.3
Dividend payout (%) - incl. DDT	13.0	7.6	13.0	13.0	13.0
Net debt / equity (x)	0.6	0.3	0.2	0.1	-0.0
Receivables (days)	108	103	95	95	97
Inventory (days)	62	62	54	54	55
Payables (days)	52	60	43	43	43
CFO : PAT %	111.8	98.4	84.8	88.9	85.7

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up (Q1 FY21)



Source: Company

Result highlights

Fig 7 – Quarterly financials (₹ m)

Quarterly results (YE Mar)	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	% Y/Y	% Q/Q
Sales	4,107	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	5,999	7,356	23.6	22.6
Gross profit (₹ m)	2,018	1,941	2,061	2,632	2,726	2,818	2,998	3,401	3,569	3,208	4,380	46.1	36.5
Gross margins (%)	49.1	38.5	45.5	45.3	43.2	45.9	50.4	48.6	50.7	53.5	59.5	918bps	606bps
EBITDA	740	436	726	1,005	1,133	976	1,186	1,436	1,631	999	1,836	54.8	83.7
EBITDA margins (%)	18.0	8.7	16.0	17.3	17.9	15.9	19.9	20.5	23.2	16.7	25.0	503bps	830bps
Finance expenses	82	62	65	76	75	68	69	69	67	66	59	(13.7)	(9.8)
Depreciation	196	204	245	265	270	274	287	303	390	390	341	18.9	(12.6)
Other income	9	97	147	42	59	19	19	87	35	225	56	203.6	(75.0)
PBT	471	267	563	706	847	652	849	1,151	889	1,367	1,492	75.7	9.2
Tax	169	95	191	234	265	202	272	193	249	444	377	38.8	(14.9)
Effective tax rate (%)	35.9	35.6	34.0	33.1	31.2	30.9	32.0	16.8	28.0	32.5	25.3	-671bps	-716bps
Adjusted PAT	350	204	518	603	603	640	832	958	692	758	1,115	33.9	47.0

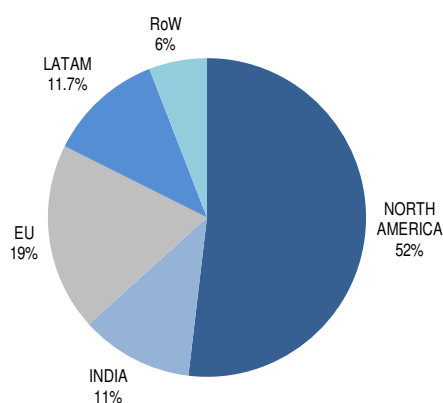
Source: Company, Anand Rathi Research

Fig 8 – Revenue break-up (₹ m)

Quarterly results (YE Mar)	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	% Y/Y	% Q/Q
API	1,479	2,015	1,813	2,265	2,148	1,985	2,129	2,169	2,091	1,777	2,121	(0.4)	19.4
% of sales	36.0	40.0	40.0	39.0	34.0	32.4	35.8	31.0	29.9	25.4	30.3		
PFI	986	1,209	906	929	1,074	958	971	1,329	1,155	781	1,379	42.0	76.6
% of sales	24.0	24.0	20.0	16.0	17.0	15.6	16.3	19.0	16.5	11.2	19.7		
Finished dosages	1,643	1,814	1,813	2,614	3,096	3,190	2,853	3,498	3,794	3,440	3,856	35.2	12.1
% of sales	40.0	36.0	40.0	45.0	49.0	52.0	47.9	50.0	54.2	49.2	55.1		
Total	4,107	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	5,998	7,356	23.6	22.6

Source: Company, Anand Rathi Research

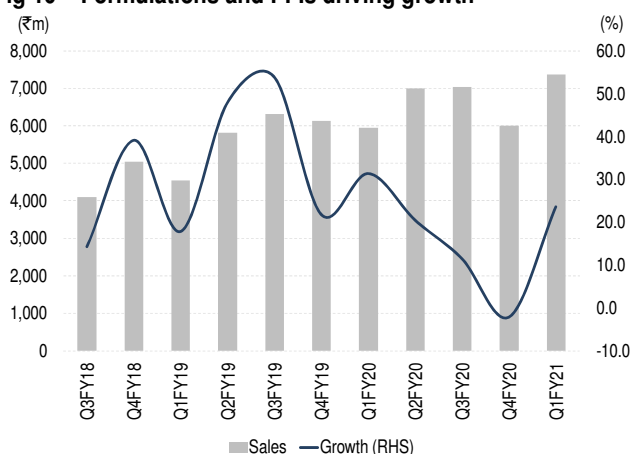
Fig 9 – Revenue break-up, area-wise (Q1 FY21)



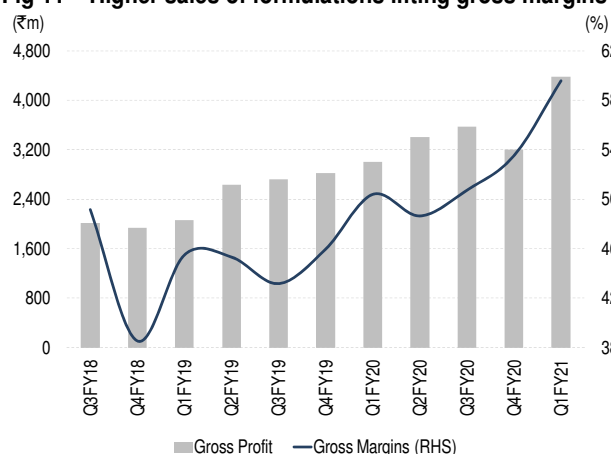
Source: Company

Concall highlights; Key takeaways

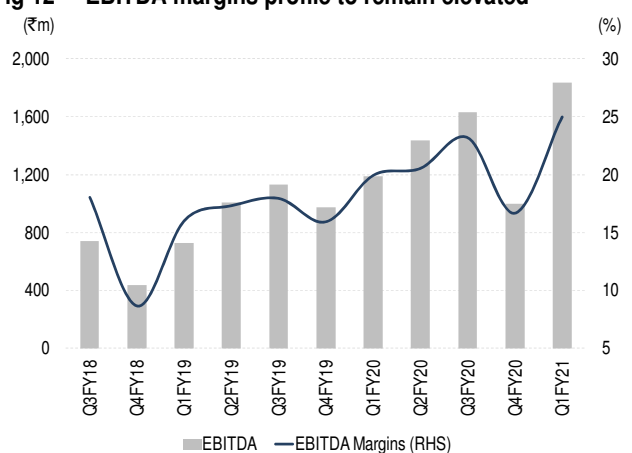
- During the quarter the company spent ₹130m toward the safety of employees.
- Stronger demand growth led to a robust Q1 FY21.
- Currently, production is 130-140% of the year-ago level.
- Four or five approvals expected in the next one or two years.
- Core molecule contribution in Q1 FY21 was ~85%.
- The company recalled 12 batches of Metformin ER 750mg due to the detection of N-Nitrosodimethylamine (NDMA), an impurity, out of an abundance of caution. A provision of ₹150m this quarter has been made for this. The drug contributed 0.3% to FY20 revenue. The impact was ~\$2m. ₹96.8m is included in other expenses.
- The company is expecting ₹2.5bn capex on the Gagillapur plant in the next 15-18 months, which will be ready by Q3 FY22 and have additional PFI capacity. Management said payback for this is expected 24-26 months from the commissioning of the plant.
- Management said net debt would be the same as in FY20.
- It stated that the focus is on profitability and 30% y/y growth.
- During the quarter the gross margin improved, led by 1) high realisations from the launches, 2) increased market share in existing products and 3) product rationalisation in PFI and FDs. Management said that the gross margin would be in a similar range.
- The EBITDA margin during the quarter improved as higher capacity led to greater operating efficiency.
- Management said GPI revenues were lower than expected; the full impact of the two launched tablets (Colchicine and Butalbital APAP caffeine) was not seen in the quarter.
- Management said GPI revenue would be fourfold in the next 3-4 years.
- 68-70% contribution is expected from the US business.
- Management expects seven (two high-value) launches from GPI in FY21.
- Capex guidance: FY21 ₹3.5bn-4bn; FY22 ₹3bn.
- Revenue carried forward from Q4 FY20 - ₹350m.
- Finished goods inventory at end-Q4 FY20 was ₹2bn and at end-Q1 FY21, ₹2.6bn. Higher inventory was due to transport issues.
- The company filed three ANDAs/dossiers in North America and Europe and received six ANDA approvals (including one tentative) from the US FDA during the quarter. Management said it will focus on a limited number of ANDAs and talked of 7-9 ANDAs and dossiers yearly.
- R&D guidance: ₹1.5bn.
- Long-term debt is ₹5.2bn and management said it would shrink to ₹4.3bn by end-FY21.

Fig 10 – Formulations and PFIs driving growth

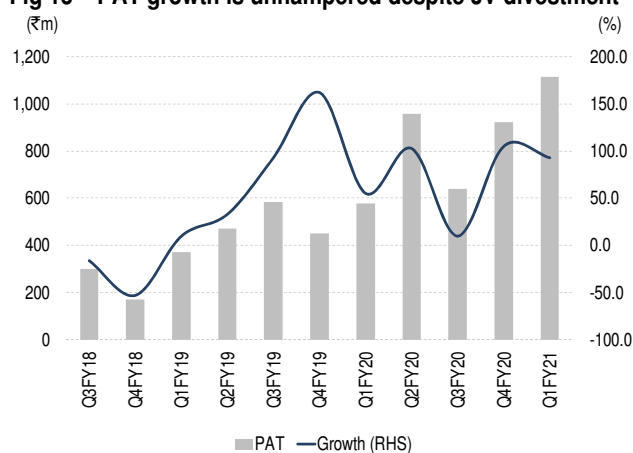
Source: Company, Anand Rath Research

Fig 11 – Higher sales of formulations lifting gross margins

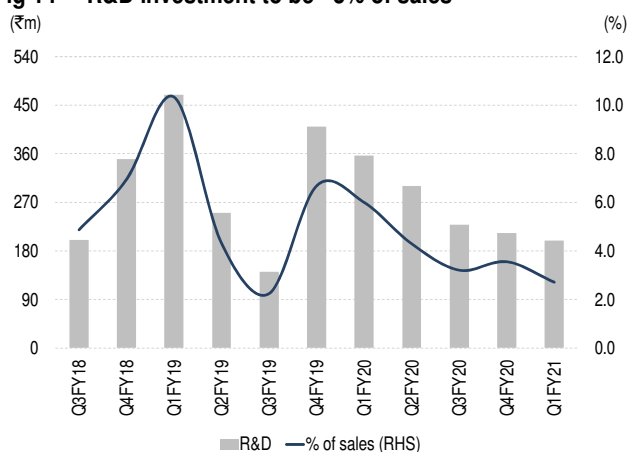
Source: Company, Anand Rath Research

Fig 12 – EBITDA margins profile to remain elevated

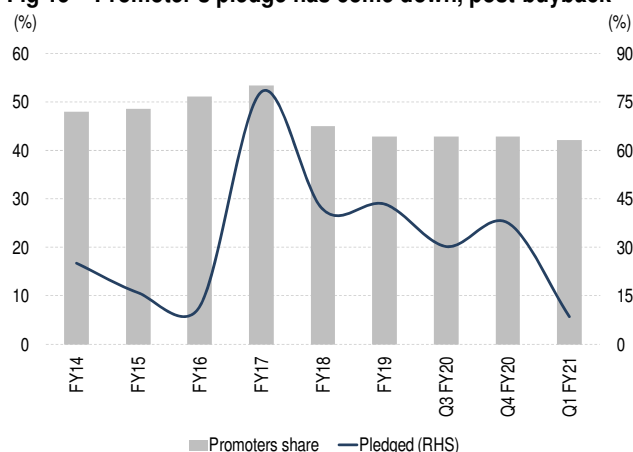
Source: Company, Anand Rath Research

Fig 13 – PAT growth is unhampered despite JV divestment

Source: Company, Anand Rath Research

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

Source: Company, Anand Rath Research

Fig 15 – Promoter's pledge has come down, post-buyback

Source: Company, Anand Rath Research

Valuation

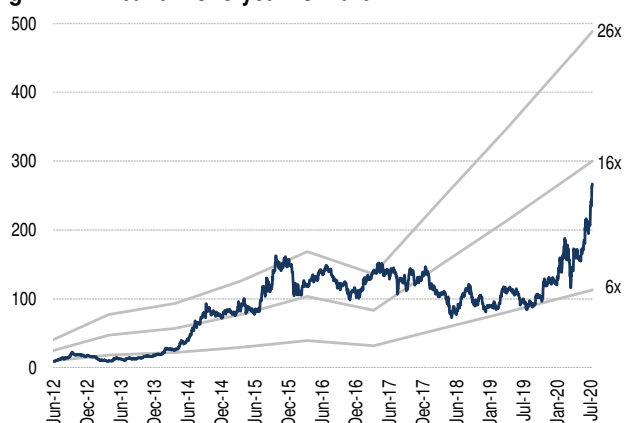
Strong demand for key products like metformin, paracetamol, and ibuprofen due to Covid-19 has translated into a robust Q1 for Granules. Ahead, we expect launches in formulations and additional capacity in PFIs to be key growth drivers. We introduce FY23e and expect ~21%/~27% revenue/PAT CAGRs over FY20-23. At the CMP, the stock trades at 10x FY23e EPS of ₹27. We roll over our valuation to FY23 and raise our target price to ₹330 (earlier ₹312) while maintaining our Buy recommendation.

Fig 16 – Change in estimates

₹ m	Old estimates		New estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	33,955	40,735	32,444	39,159	(4.5)	(3.9)
EBITDA	7,232	8,595	7,235	8,811	0.0	2.5
PAT	4,241	5,157	4,447	5,536	4.8	7.3

Source: Anand Rath Research

Fig 17 – PE band – one-year-forward



Source: Bloomberg, Anand Rath Research

Fig 18 – Standard deviation – one-year-forward



Source: Bloomberg, Anand Rath Research

Risks

- ~9% of the promoters' holdings have been pledged.
- Increase in absolute spending on R&D.
- Adverse currency fluctuations and regulatory hurdles.

Fig 19 – Valuation Summary

	RATING	CMP (₹)	TP (₹)	M Cap (₹ bn)	EPS (₹)			PE (x)		EV / EBITDA		RoE (%)		RoCE (%)	
					FY20	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Aarti	Buy	1530	1028	35.6	59.2	71.0	86.8	21.5	17.6	11.5	9.6	22.7	22.4	16.2	17.5
Ajanta	Hold	1445	1442	126.1	53.6	58.1	73.7	24.9	19.6	14.4	12.3	18.8	19.1	18.7	19.0
Alembic	Hold	1025	780	193.3	45.8	43.1	43.3	23.8	23.6	15.6	14.7	23.0	19.8	15.3	13.9
Alkem	Hold	2502	2526	299.2	94.3	97.1	115.1	25.8	21.7	18.6	15.6	17.7	18.5	17.5	19.3
Cadila	Hold	375	383	384.0	13.9	15.1	17.5	24.9	21.5	14.5	12.7	14.3	15.3	9.5	10.6
Eris	Hold	437	549	60.2	21.8	24.7	25.0	17.7	17.4	14.6	13.4	22.9	18.9	25.1	20.3
Granules India	Buy	235	330	59.8	13.3	17.5	21.8	13.5	10.8	9.9	7.9	21.8	22.4	16.1	17.3
Indoco Remedies	Sell	200	170	18.4	2.6	6.8	10.0	29.3	20.1	11.5	9.0	8.9	11.7	8.8	11.1
Ipca Labs.	Buy	1788	1900	225.8	50.8	68.1	80.5	26.3	22.2	16.8	14.0	21.5	21.0	18.9	19.2
JB Chemicals	Sell	714	720	57.2	36.2	37.5	43.7	19.0	16.3	12.4	10.3	18.9	19.2	18.1	18.5
Natco Pharma	Hold	675	733	122.8	25.3	27.3	29.3	24.7	23.0	18.8	16.8	12.5	12.1	11.8	11.5
Neuland	Hold	681	488	8.8	30.7	31.3	39.0	21.8	17.5	7.6	6.0	4.1	6.1	4.7	6.1
Pfizer	Hold	4154	4417	190.0	105.8	110.3	122.9	37.7	33.8	27.1	24.1	14.1	14.1	14.3	14.3
Suven Pharma	Buy	610	522	77.6	24.9	28.9	34.9	21.1	17.5	15.9	12.8	37.3	34.3	28.6	28.9
Torrent Pharma	Hold	2369	2648	401.0	57.4	62.4	80.2	38.0	29.5	19.7	16.4	20.2	23.4	13.9	17.2
HCG	Hold	127	90	11.3	-9.6	-6.6	0.1	NM	NM	6.3	4.6	NM	NM	5.6	11.2

Source: Company, Anand Rathi Research

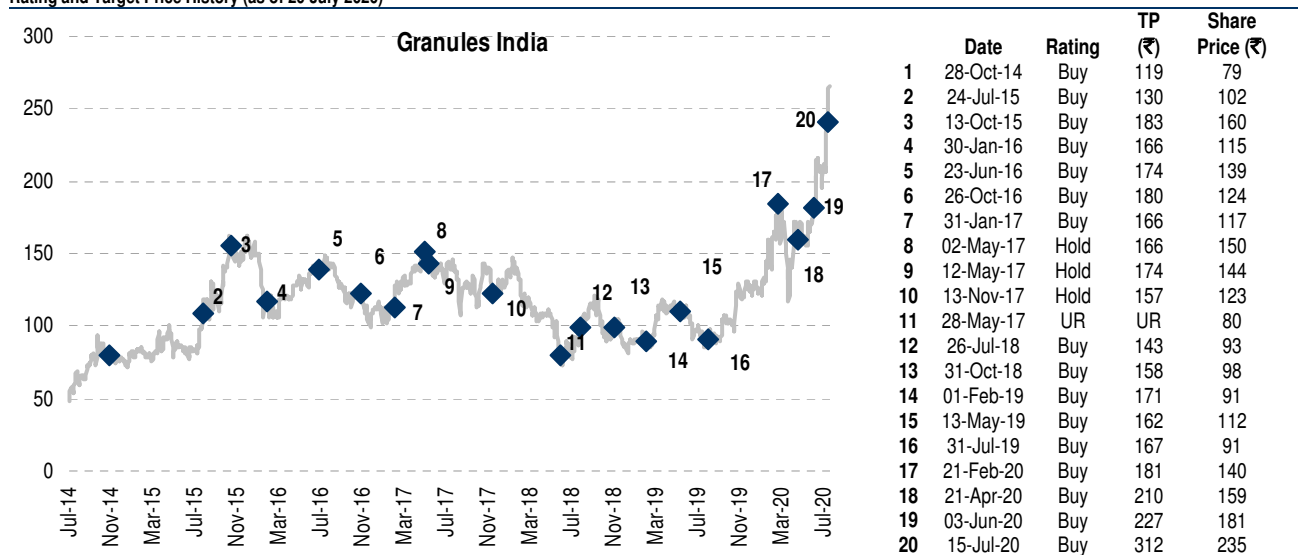
Appendix

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Rating and Target Price History (as of 20 July 2020)



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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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