

22 October 2020

Granules India

*Strong inclusive growth drives margins to peak; retaining a Buy*Rating: **Buy**

Target Price: Rs455

Share Price: Rs392

Driven by momentum in formulations and PFI, Granules had highest quarterly sales/margins/profit. Its Q2 FY21 sales grew 23% y/y to Rs8.6bn. Formulations grew 23% to Rs4.3bn, PFI sales were up 30% to Rs1.7bn and API sales grew 18% to Rs2.6bn. Product rationalisation and launches drove a 929bp surge in the gross margin (58%). Operating leverage and lower spending on R&D were prime drivers of the 935bp EBITDA-margin expansion to 30%. Adjusting for reversal of provisions and Covid-related costs, PAT grew 73% to Rs1.7bn. Formulation launches and a foray into newer regions are likely to drive revenue/PAT CAGRs of ~19%/~30% over FY20-23. We raise our target price to Rs455 (earlier Rs330) and maintain our Buy recommendation.

Formulations set to grow 24% over FY20-23. In Q2 FY21, Granules received four approvals from the US FDA and it had launched one product. Further, it has eight products pending approval from the US FDA and eleven being developed. In H2 FY21 it plans to launch two more and expects approval for its first MUPS product (a \$204m market).

Europe, LATAM are the catalyst for near-term growth. Management expects sales to Europe and LATAM over FY20-23 to expand 800bps and 400bps respectively to 28% and 12%. It plans to launch newer products and enter newer markets within these regions.

EBITDA margin to be ~26% by FY23. Higher pricing, launches and product rationalisation were primary drivers of the 935bp margin expansion to ~30% in Q2 FY20. Greater utilisation and a rise in formulations sales (59% of sales by FY23) are likely to be margin drivers; hence we factor in a slightly lower margin of ~26% by FY23.

Outlook, Valuation. Near-term growth is likely to be driven by the foray into MUPS products, entry into newer markets and capacity addition in PFIs. Beyond which, its US pipeline and oncology products would drive growth. At the CMP, stock trades at 13x FY23e EPS of Rs30. **Risks:** ~9% of promoters' holdings have been pledged; Increase in R&D spend; adverse currency movements.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs m)	22,792	25,986	32,054	37,896	43,966
Net profit (Rs m)	2,364	3,383	5,110	6,275	7,518
EPS (Rs)	9.3	13.3	20.6	25.3	30.4
PE (x)	42.1	29.4	19.0	15.5	12.9
EV / EBITDA (x)	27.5	19.4	12.5	10.0	8.1
PBV (x)	6.3	5.3	4.2	3.4	2.8
RoE (%)	16.7	20.1	24.7	24.5	23.8
RoCE (%)	8.6	11.9	18.5	19.6	19.9
Dividend yield (%)	0.3	0.3	0.7	0.8	1.0
Net debt / equity (x)	0.6	0.3	0.2	0.0	-0.1

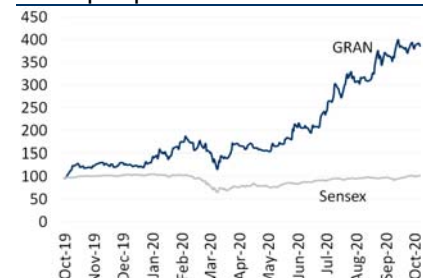
Source: Company, Anand Rathi Research

Key data	GRAN IN / GRAN.NS
52-week high / low	Rs407 / 103
Sensex / Nifty	40707 / 11938
3-m average volume	\$23.7m
Market cap	Rs96bn / \$1300.2m
Shares outstanding	248m

Shareholding pattern (%)	Sept'20	June'20	Mar'20
Promoters	42.0	42.1	42.9
- of which, Pledged	8.6	8.6	37.6
Free float	58.0	57.9	57.1
- Foreign institutions	26.3	23.0	21.7
- Domestic institutions	0.2	3.2	3.0
- Public	31.5	31.7	32.4

Estimates revision (%)	FY21e	FY22e
Revenue	(5.6)	(7.0)
EBITDA	12.1	13.8
EPS	20.5	21.7

Relative price performance



Source: Bloomberg

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Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues	22,792	25,986	32,054	37,896	43,966
Growth (%)	34.7	14.0	23.4	18.2	16.0
Direct costs	12,556	12,809	14,008	16,939	19,653
SG&A	6,396	7,924	9,937	11,179	12,838
EBITDA	3,840	5,253	8,110	9,777	11,475
EBITDA margins (%)	16.8	20.2	25.3	25.8	26.1
- Depreciation	1,055	1,370	1,515	1,692	1,798
Other income	267	366	264	279	296
Interest expenses	285	270	223	215	208
PBT	2,768	4,256	6,636	8,150	9,764
Effective tax rate (%)	32.2	27.2	23.0	23.0	23.0
+ Associates / (Minorities)	487	255	-	-	-
Net income	2,364	3,354	5,110	6,275	7,518
Adjusted income	2,364	3,383	5,110	6,275	7,518
WANS	254	254	248	248	248
FDEPS (Rs / sh)	9.3	13.3	20.6	25.3	30.4
R&D (% of sales)	3.2	3.0	3.0	3.0	3.0

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	2,786	4,161	6,595	8,085	9,677
+ Non-cash items	1,055	1,370	1,515	1,692	1,798
Oper. prof. before WC	3,840	5,531	8,110	9,777	11,475
- Incr. / (decr.) in WC	377	944	2,482	1,936	2,311
Others incl. taxes	819	1,257	1,526	1,874	2,246
Operating cash-flow	2,644	3,330	4,102	5,967	6,919
- Capex (tang.+ Intang.)	2,544	1,949	2,500	2,000	1,500
Free cash-flow	99	1,381	1,602	3,967	5,419
Acquisitions					
- Div. (incl. buyback & taxes)	306	254	662	813	974
+ Equity raised	0	-	-7	-	-
+ Debt raised	-252	-1,398	-972	-250	-200
- Financial investments	539	-1,911	-	-	-
- Misc. (CFI + CFF)	(732)	(310)	(41)	(64)	(87)
Net cash-flow	-266	1,949	2	2,968	4,331

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rs m)

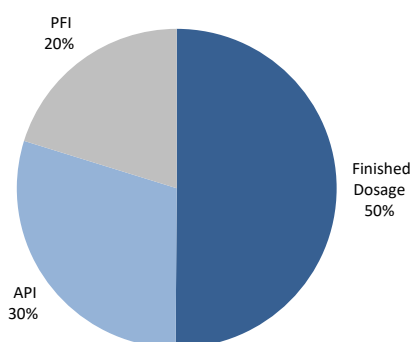
Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	254	254	248	248	248
Net worth	15,295	18,437	22,885	28,347	34,891
Debt	9,330	7,932	6,960	6,710	6,510
Minority interest					
DTL / (Assets)	613	430	430	430	430
Capital employed	25,237	26,799	30,275	35,486	41,830
Net tangible assets	7,476	9,888	11,041	11,603	11,320
Net intangible assets	1,967	2,152	2,436	2,591	2,560
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	16,468	19,103	22,315
Cash	890	2,839	2,848	5,817	10,148
Current liabilities	4,549	6,164	5,202	5,901	6,802
Working capital	7,841	8,784	11,266	13,202	15,512
Capital deployed	25,237	26,799	30,275	35,486	41,830
Contingent liabilities	33				

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	42.1	29.4	19.0	15.5	12.9
EV / EBITDA (x)	27.5	19.4	12.5	10.0	8.1
EV / Sales (x)	4.6	3.9	3.2	2.6	2.1
P/B (x)	6.3	5.3	4.2	3.4	2.8
RoE (%)	16.7	20.1	24.7	24.5	23.8
RoCE (%) - after tax	8.6	11.9	18.5	19.6	19.9
ANDA filings	32.0				
DPS (Rs / sh)	1.0	1.0	2.7	3.3	3.9
Dividend yield (%)	0.3	0.3	0.7	0.8	1.0
Dividend payout (%) - incl. DDT	13.0	7.6	13.0	13.0	13.0
Net debt / equity (x)	0.6	0.3	0.2	0.0	-0.1
Receivables (days)	108	103	95	95	97
Inventory (days)	62	62	54	54	55
Payables (days)	52	60	38	39	39
CFO : PAT %	111.8	98.4	80.3	95.1	92.0

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up (Q2 FY21)



Source: Company

Result highlights

Fig 7 – Quarterly financials (Rs m)

Quarterly results (YE Mar)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	% Y/Y	% Q/Q
Sales	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	5,999	7,356	8,581	22.7	16.7
Gross profit	1,941	2,061	2,632	2,726	2,818	2,998	3,401	3,569	3,208	4,380	4,970	46.1	13.5
Gross margins (%)	38.5	45.5	45.3	43.2	45.9	50.4	48.6	50.7	53.5	59.5	57.9	929bps	-163bps
EBITDA	436	726	1,005	1,133	976	1,186	1,436	1,631	999	1,836	2,564	78.6	39.7
EBITDA margins (%)	8.7	16.0	17.3	17.9	15.9	19.9	20.5	23.2	16.7	25.0	29.9	935bps	492bps
Finance expenses	62	65	76	75	68	69	69	67	66	59	63	(8.5)	5.8
Depreciation	204	245	265	270	274	287	303	390	390	341	361	18.9	5.8
Other income	97	147	42	59	19	19	87	35	225	56	32	(62.8)	(42.8)
PBT	267	563	706	847	652	849	1,151	889	1,367	1,492	2,173	88.8	45.6
Tax	95	191	234	265	202	272	193	249	444	377	537	178.0	42.2
Effective tax rate (%)	35.6	34.0	33.1	31.2	30.9	32.0	16.8	28.0	32.5	25.3	24.7	792bps	-59bps
Adjusted PAT	204	518	603	603	640	832	958	692	758	1,115	1,654	72.7	48.4

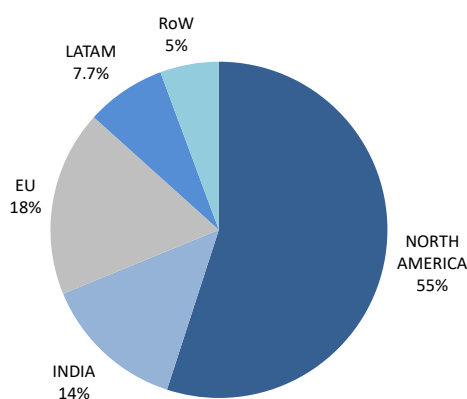
Source: Company, Anand Rathi Research

Fig 8 – Revenue break-up

Quarterly results (YE Mar)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	% Y/Y	% Q/Q
API	2,015	1,813	2,265	2,148	1,985	2,129	2,169	2,091	1,777	2,121	2,547	17.5	20.1
% of sales	40.0	40.0	39.0	34.0	32.4	35.8	31.0	29.7	29.6	28.8	29.7		
PFI	1,209	906	929	1,074	958	971	1,329	1,155	781	1,379	1,733	30.4	25.7
% of sales	24.0	20.0	16.0	17.0	15.6	16.3	19.0	16.4	13.0	18.7	20.2		
Finished dosages	1,814	1,813	2,614	3,096	3,190	2,853	3,498	3,794	3,440	3,856	4,301	23.0	11.5
% of sales	36.0	40.0	45.0	49.0	52.0	47.9	50.0	53.9	57.4	52.4	50.1		
Total	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	5,998	7,356	8,581	22.7	16.7

Source: Company, Anand Rathi Research

Fig 9 – Revenue break-up, area-wise (Q2 FY21)

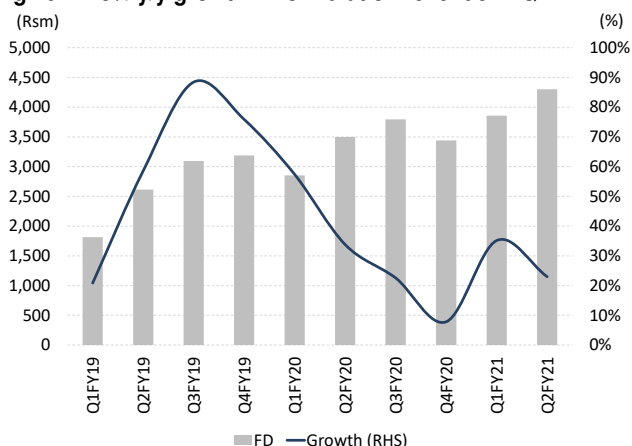


Source: Company

Highlights, by segment

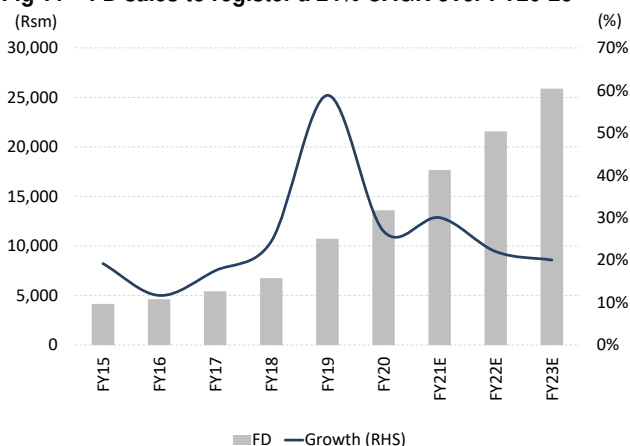
Formulation sales will continue to grow modestly. Over the years, the contribution from finished dosages forms has increased from 29% in FY12 to 52% in FY20. Granules' formulation revenues registered a 31% CAGR over FY16-20 to Rs13.6bn, mainly through launches. Ahead, we expect growth in this segment to be driven by the company's foray into high volume MUPS-based product manufacturing and its entry into new regions. We expect formulations revenue to register a 24% CAGR over FY20-23.

Fig 10 – 23% y/y growth in formulation revenue in Q2 FY21



Source: Company, Anand Rathi Research

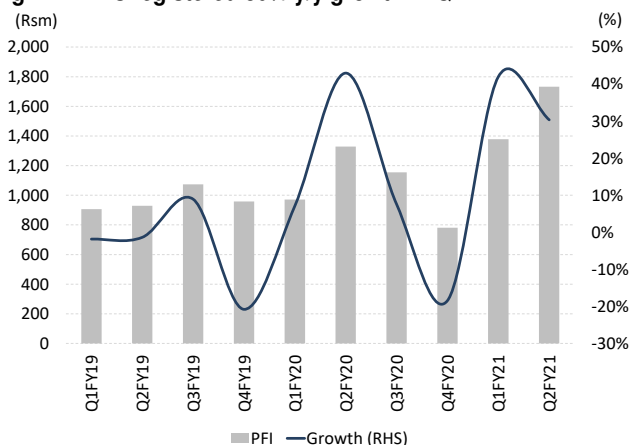
Fig 11 – FD sales to register a 24% CAGR over FY20-23



Source: Company, Anand Rathi Research

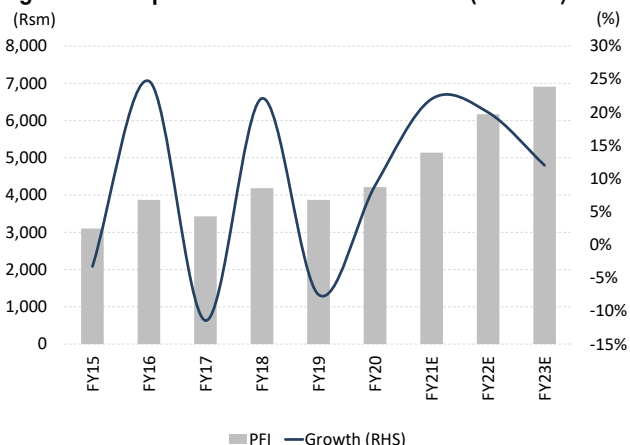
Deeper penetration of PFIs led to significant growth in Q2 FY21. PFI grew a significant 30% to Rs1.7bn in Q2 FY21 on account of deeper penetration. Ahead, we expect PFI sales to register an 18% CAGR over FY20-23.

Fig 12 – PFIs registered 30% y/y growth in Q2 FY21



Source: Company, Anand Rathi Research

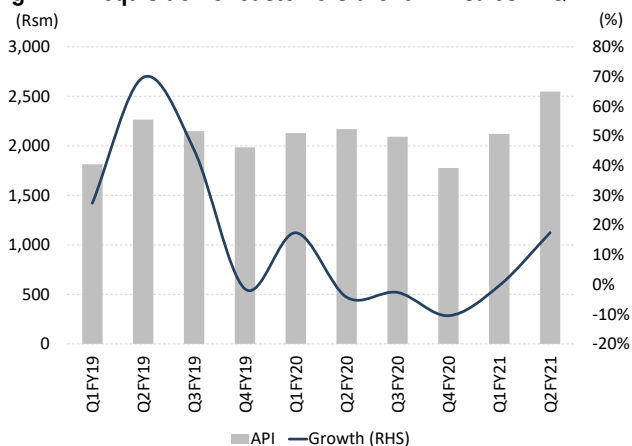
Fig 13 – PFI expected to clock an 18% CAGR (FY20-23)



Source: Company, Anand Rathi Research

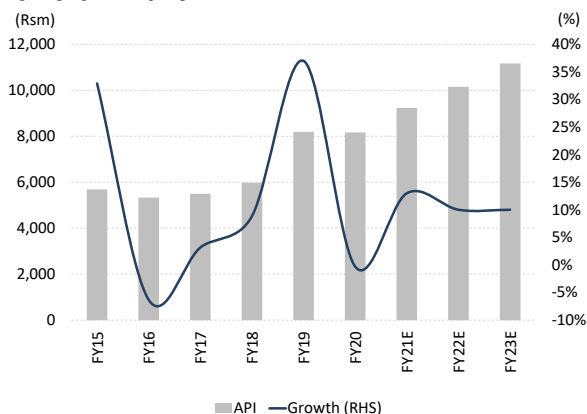
Ahead, capacity addition would drive API growth. Granules is in the process of commercialising its multi-API plant in Vishakhapatnam, which would help drive growth in APIs. Therefore, we expect an 11% CAGR over FY20-23 on the back of the capacity addition.

Fig 14 – Acquisition of customers drove API sales in Q2 FY21



Source: Company, Anand Rath Research

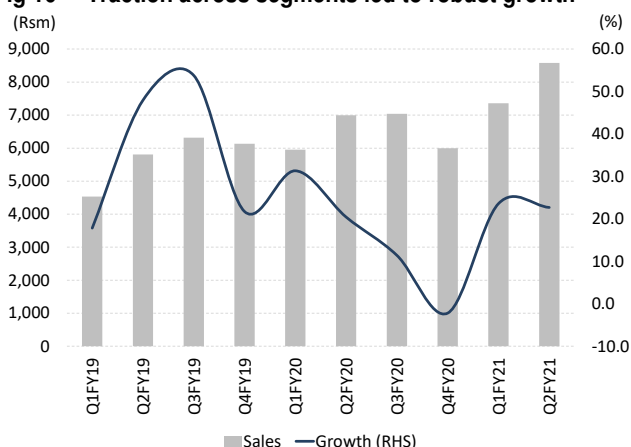
Fig 15 – Capacity addition to drive API sales at an 11% CAGR over FY20-23



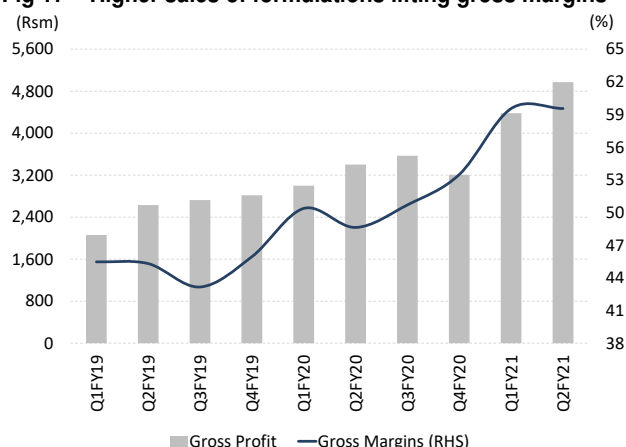
Source: Company, Anand Rath Research

Concall highlights; Key takeaways

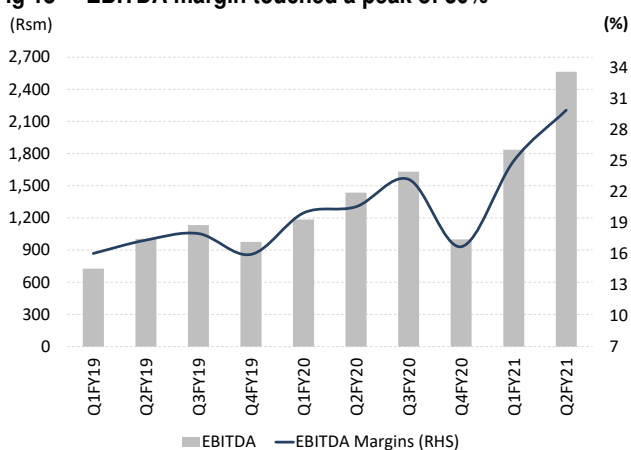
- Granules India's Q2 FY21 revenue grew 22.7% y/y on account of launches in FD, deeper penetration of PFIs and acquisition of customers in API.
- Q2 FY21 revenue break-up:
By vertical: FD 50%, API 30%, PFI 20%.
Geographically: North America 55%, Europe 18%, India 14%, LATAM 8%, RoW 6%.
- Five core molecules bring 70% to sales.
- The gross margin grew 929bps y/y to 57.9% on more FD sales, product rationalisation in the PFI and FD segments and greater capacity utilisation in the metformin API at the Bonthapally plant.
- The EBITDA margin grew 935bps y/y to 29.9% on account of the higher gross margin and greater operational efficiencies arising from the higher capacity utilisation.
- A reversal of a previous provision (failure to supply metformin due to the NDMA issue) of Rs75m has been recorded in other expenses in Q2 FY21. Adjusting for this, the EBITDA margin would have been 29%.
- Granules has 32 approved ANDAs (of which six products have yet to be launched) and 13 pending approval. It received four ANDA approvals and launched one product through GPI during the quarter.
- In H2 FY21, it expects to receive approvals for two acquired products; these will be mid- to high-volume products and will be launched by GIL and GPI. 3-5 product launches are expected in H2 FY21.
- The company talked of 7-8 ANDA filings and 2-4 dossier filings each year.
- The new plant at Vishakhapatnam is expected to be operational next year. The construction of the new MUPS block is on track and is expected to be commercialised by Q3 FY22.
- The company expects one MUPS-technology-based ANDA to be approved in Q3 or early Q4 FY21 (to be launched from its Gagillapur plant).
- Of the planned capex of Rs4bn in FY21 and FY22- Rs0.8bn is for API; the rest will be incurred on the new MUPS block and increasing capacity for FDs.
- R&D expense declined 26% to Rs222m.
- According to the management, the foray into high-volume MUPS-based product manufacturing supported by in-house API would be the major growth driver ahead.
- FY21 PAT growth is expected to be similar to that of FY20. The company said PAT would clock a 30% CAGR in coming years, with FY21 as the baseline.
- The EBITDA margin is expected to be ~27-30%.

Fig 16 – Traction across segments led to robust growth

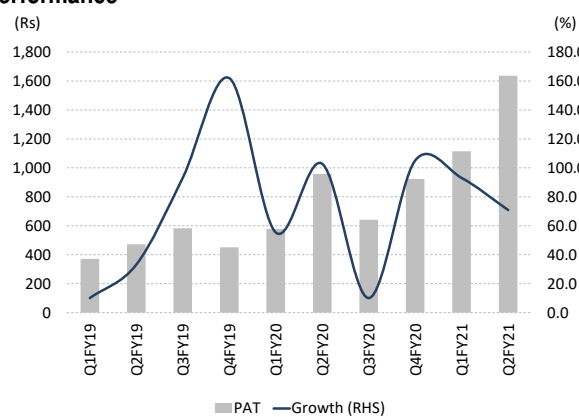
Source: Company, Anand Rathi Research

Fig 17 – Higher sales of formulations lifting gross margins

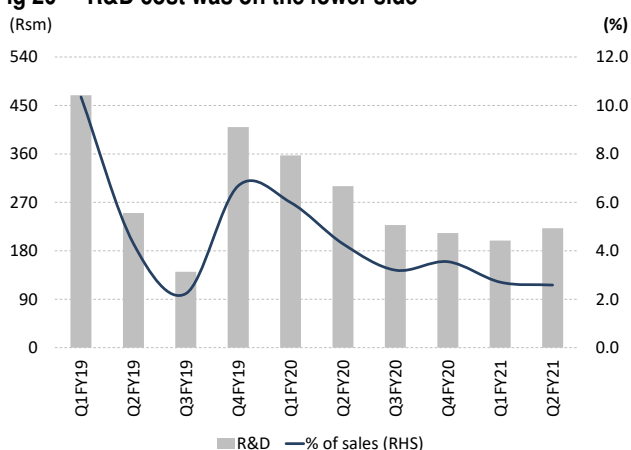
Source: Company, Anand Rathi Research

Fig 18 – EBITDA margin touched a peak of 30%

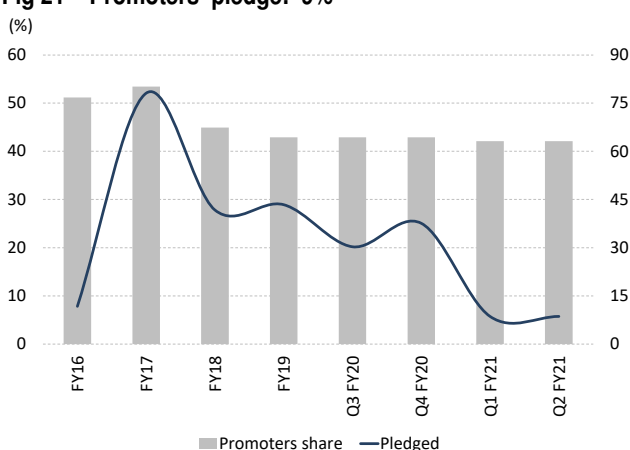
Source: Company, Anand Rathi Research

Fig 19 – PAT grew 73% y/y on account of better operating performance

Source: Company, Anand Rathi Research

Fig 20 – R&D cost was on the lower side

Source: Company, Anand Rathi Research

Fig 21 – Promoters' pledge: 9%

Source: Company, Anand Rathi Research

Valuation

Near-term growth is likely to be driven by the foray into MUPS products, entry into newer markets and capacity addition in PFIs. Beyond which, its US pipeline and oncology products would drive growth. We expect revenue/PAT CAGRs of respectively ~19%/~30% over FY20-23.

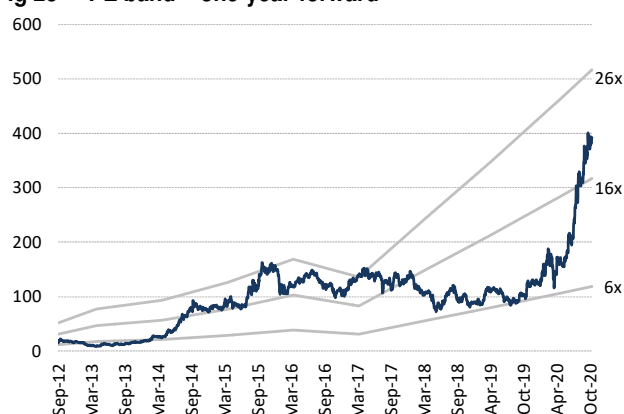
At the CMP, the stock trades at 13x FY23e EPS of Rs30. We raise our target price to Rs455 (earlier Rs330) based on 15x FY23e earnings, and maintain our Buy recommendation.

Fig 22 – Change in estimates

Rs m	Old estimates		New estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	33,955	40,735	32,054	37,896	(5.6)	(7.0)
EBITDA	7,232	8,595	8,110	9,777	12.1	13.8
PAT	4,241	5,157	5,110	6,275	20.5	21.7

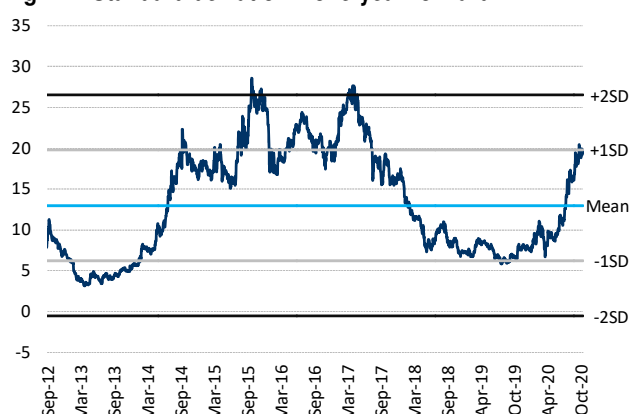
Source: Anand Rath Research

Fig 23 – PE band – one-year-forward



Source: Bloomberg, Anand Rath Research

Fig 24 – 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 25 – Valuation Summary

Company	RATING	CMP (Rs)	TP (Rs)	M Cap (Rs bn)	EPS (Rs)			PE (x)			EV/EBITDA (x)			RoE (%)		
					FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
Aarti Drugs	Buy	769	540	79.3	25.5	28.1	36.0	30.2	27.4	21.4	20.8	18.9	15.0	31.5	27.4	28.0
Ajanta	Hold	1,604	1,614	140.4	57.8	73.2	87.8	27.8	21.9	18.3	17.3	14.0	11.5	18.1	19.8	20.4
Alembic	Hold	997	950	183.3	45.6	46.6	53.0	21.8	21.4	18.8	15.4	14.4	12.5	24.3	21.0	20.4
Alkem	Hold	2,652	3,145	329.4	106.0	123.9	136.8	25.0	21.4	19.4	19.6	16.5	14.6	19.2	19.6	18.9
Zydus Cadila	Hold	426	391	424.1	15.1	17.5	19.6	28.3	24.4	21.8	16.7	14.7	13.1	14.3	15.3	15.5
Eris	Hold	492	565	73.4	21.8	24.2	26.0	22.5	20.4	18.9	19.5	17.8	15.9	24.2	23.0	20.9
Granules India	Buy	392	455	97.0	20.6	25.3	30.4	19.0	15.5	12.9	12.5	10.0	8.1	24.7	24.5	23.8
Indoco Remedies	Sell	253	190	24.5	7.5	10.3	12.5	33.6	24.6	20.3	14.3	11.6	10.0	9.7	12.0	12.9
Ipca Labs.	Buy	2,075	2,300	271.4	87.6	90.8	103.5	23.7	22.8	20.1	17.5	16.4	14.0	26.9	22.4	21.0
JB Chemicals	Sell	1,022	760	75.5	43.4	45.9	50.7	23.5	22.2	20.2	15.1	13.8	12.1	21.6	19.8	19.1
Natco Pharma	Hold	929	851	172.9	28.1	31.0	75.5	33.1	30.0	12.3	26.8	23.3	9.5	12.8	12.7	26.3
Neuland	Hold	1,216	880	15.5	36.7	44.5	53.0	33.2	27.3	22.9	14.6	12.7	11.2	6.5	7.4	8.2
Pfizer	Hold	5,013	4,713	225.2	112.4	123.1	131.6	44.6	40.7	38.1	32.1	29.3	26.7	14.4	14.3	13.8
Suven Pharma	Buy	342	380	49.7	29.5	35.6	42.2	11.6	9.6	8.1	11.3	9.0	6.9	38.1	34.8	32.0
Torrent Pharma	Buy	2,703	2,995	478.2	66.0	82.0	100.6	41.0	33.0	26.9	21.8	18.9	16.3	21.7	23.7	25.2

Source: Company, Anand Rathi Research

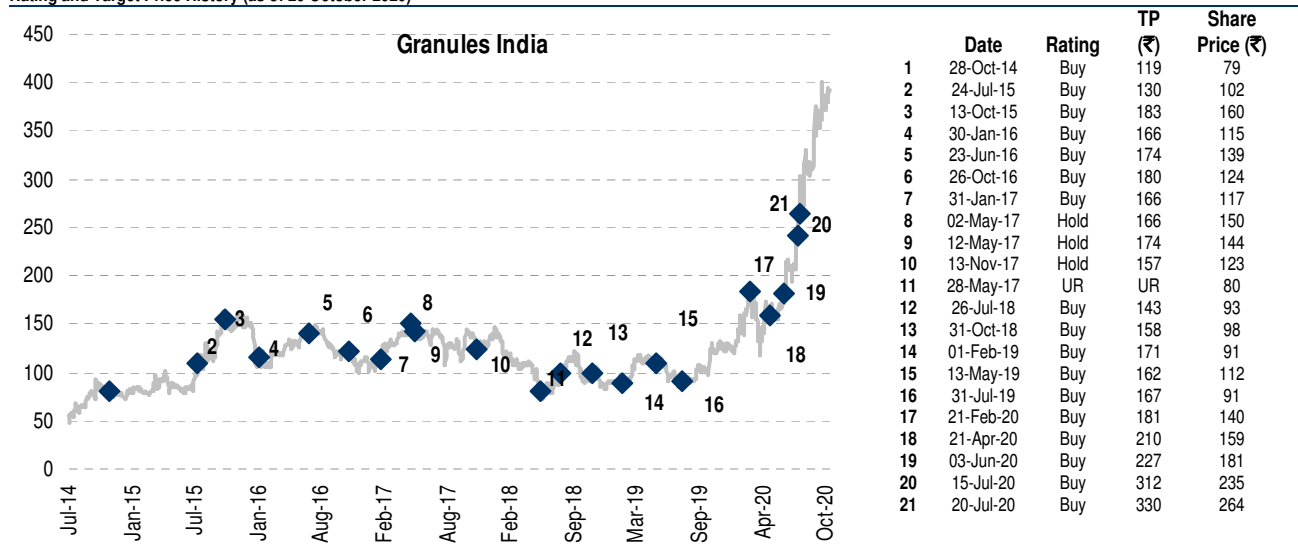
Appendix

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