



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✗	✗

+ Positive = Neutral - Negative

Reco/View

Change

Reco: Buy	↔
CMP: Rs. 392	
Price Target: Rs. 475	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 9,699 cr
52-week high/low:	Rs. 407 / 103
NSE volume: (No of shares)	40 lakh
BSE code:	532482
NSE code:	GRANULES
Free float: (No of shares)	14.3 cr

Shareholding (%)

Promoters	42.0
FII	28.0
DII	0.2
Others	29.82

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.3	47.9	137.9	286.2
Relative to Sensex	2.9	39.5	109.8	283.0

Sharekhan Research, Bloomberg

Granules India Limited

Stellar quarter; Promising outlook

Pharmaceuticals

Sharekhan code: GRANULES

Result Update

Summary

- We retain a Buy rating on Granules with a revised PT of Rs 475.
- Q2FY2021 was yet another quarter of stellar performance with sales and PAT growing sturdily by 22.7% and 70.8% YoY respectively. Results were ahead of estimates.
- Tapping new geographies, strong product pipeline, growth in existing core molecules & capacity expansion to drive sales growth. Favorable mix, benefits of operating leverage accruing would lead to OPM expansion.
- Strong earnings visibility, a sturdy balance sheet and healthy return ratios augur well and could result in multiple re-rating for the stock.

Granules India Limited (Granules) continued its stellar performance in Q2FY2021 as well. The company reported a record performance for the quarter. Results are ahead of estimates. Revenues at Rs 858 cr grew 22.7% y-o-y backed by strong double digit growth across all the segments of API (Active Pharmaceutical ingredients), PFI (Pharmaceutical formulations intermediates) and FD's (Finished Dosages). The operating margin at 29.9% expanded 935 bps y-o-y on the back of 930 bps expansion in gross margin. Operating profits stood at Rs 256 cr, up 78.6% y-o-y for the quarter. The PAT for the quarter stood at Rs 163.6 crore, up by 70.8% y-o-y and was ahead of estimates. Granules sees strong demand traction across segments and expects the same to sustain going ahead as well. Tapping new geographies, a strong product pipeline and benefits of incremental capacities (including the MUPS block) would be key revenue drivers. Favorable mix, operating efficiencies generated due to benefits of operating leverage and higher margins from new product launches would result in OPM expansion. Consequently Granules sees its margin trajectory moving to 27% plus as compared to 21.1% as of FY2020. In the light of the above, Granules has revised its earnings growth guidance beyond FY2021 upwards to 30% as against earlier guidance of 25% earnings CAGR. Asturdy topline growth, expansion in operating margins leading to a strong earnings growth, healthy return ratios and a strong balance sheet position augur well and are the key positive for Granules.

Key positives

- Granules reported a record performance for Q2FY21 with highest ever quarterly revenues of Rs 858 cr. All segments clocked a sturdy double-digit growth.
- Gross margins expanded 930 bps y-o-y
- Operating margins expanded 935 bps y-o-y to 29.9%

Key negatives

- Tax rate for the quarter stood at 24.7% as compared to 16.8% Q2FY2021

Our Call

Valuation - Maintain Buy with a PT of Rs 475: Granules is witnessing strong demand tractions across segments, which is expected to sustain. Going ahead, growth for the company would be fuelled by new product launches, increasing geographical penetration, capacity expansion, commissioning of MUPS block by Q3FY22 and fortifying presence in the oncology space. Further, a favorable revenue mix, operational efficiencies would drive the margins. Witnessing a strong demand, Granules has revised its PAT growth guidance upwards to 30% for period beyond FY2021 as against earlier guidance of 25%. Based on the sturdy performance in Q2FY2021 and improved growth guidance, we have revised our earnings estimates upwards for FY2022/FY2023. At CMP, the stock is trading at P/E multiple of 15.1x/12.8x its FY22/FY23E EPS. Strong earnings visibility, a sturdy balance sheet and healthy return ratios augur well and could result in multiple re-rating. We maintain our Buy recommendation on the stock with a revised PT of Rs 475.

Key Risks

A delay in product approvals or the negative outcome of facility inspection by the USFDA can affect future earnings prospects.

Valuations (Consolidated)

Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net Sales	2279.2	2598.6	3244.1	3803.3	4339.2
EBIDTA	384.0	547.3	859.7	1017.4	1171.6
OPM (%)	16.8	21.1	26.5	26.7	27.0
Reported PAT	236.4	329.7	553.2	641.1	754.5
EPS (Rs)	9.6	13.3	22.4	25.9	30.5
PER (x)	41.0	29.4	17.5	15.1	12.8
EV/Ebitda (x)	27.1	18.8	11.3	9.2	7.7
P/BV (x)	6.3	5.3	4.2	3.3	2.8
ROCE (%)	11.6	15.8	24.4	25.0	26.0
RONW (%)	15.5	17.9	23.7	22.1	21.7

Source: Company; Sharekhan estimates

Note: We now convert Granules into a Stock update; it was earlier a 'Viewpoint' under our coverage.

Stellar performance for Q2FY21: Granules reported an impressive performance for Q2FY2021 with earnings ahead of estimates. Sales for the quarter grew sturdily by 22.7% y-o-y to Rs 858 crore lead by a strong double digit growth across all segment – FD segment sales grew 22.9% y-o-y, PFI segment up 30.2% y-o-y and the API segment sales up 17.6%. Operating profit reported a sturdy growth of 78% y-o-y to Rs 256 crore. The OPM expanded sharply by 935 BPS to 29.9% during the quarter and are ahead of the estimates. The improvement in the operating margins is on account of marked 930 bps improvements in the gross margins and savings in cost on account of favorable mix and benefits of operating leverage. During the quarter, the company has reversed a provision made in the previous quarter, included in other expenses amounting to Rs 7.53 crores. Adjusting for this, the OPM stands at 30.8%. The tax rate for the quarter stood at 24.7% as compared to 16.8% in corresponding quarter previous year. Consequently, the PAT stood at Rs 163.6 cr as against Rs 95.8 cr in Q2FY20 and was ahead of estimates.

Healthy growth in core molecules; strong new product pipeline to fuel growth; Management revises PAT growth guidance upwards to 30% beyond FY2021: Granules reported an impressive performance for Q2FY21 with record all- round performance. A strong demand environment for its drugs, especially in the PFI and FD space has led to the outperformance. Granules expects the sturdy performance to sustain going ahead as well. The core molecules (revenue contribution dropped to 70% from 80-85% as of FY2020) would continue to sustain the robust growth trajectory as Granules looks to launch these products in new geographies of Europe, Canada and South Africa and Australia. Company's Vizag unit 5 has cleared the EU inspection, thus providing comfort on the company's ability to cater to increased demand. Further Granules has a strong pipeline of products. It has a total of 32 approved ANDA's and of this 6 are expected to be launched in FY2021. Granules is looking to launch a total of 9 products in remainder of FY2021. This points at a strong product pipeline. Consequently, given the sturdy demand, strong product pipeline and new capacities being set up, the revenues and PAT are expected to grow impressively over the next two years. Granules has revised its PAT growth guidance upwards to 30% beyond FY2021 (earlier it had a guidance of 25% beyond FY2021) While for FY2021 it expects to grow the bottom line by 70-80% given the low base in FY2020. This is commendable, especially amidst challenging times.

Q2FY2021 Concall highlights:

- ♦ **Core business:** Granules core molecules accounted for 70% of total revenues as compared to 80-85% as of FY2020. The decline in the share is attributable to the strong growth in new product launches. Granules looks to grow the core business by expanding geographic penetration and tapping countries like Europe, South Africa, Canada etc. The share of Europe in total sales stands at 23% which is expected to reach 28% by FY2023. While the share of revenues from the US is expected to decline to 43% by FY2023 from 50% currently.
- ♦ **Segmental revenue mix:** As of Q2FY2021, the API segment recorded a growth of 17.6% y-o-y to Rs 255 crore on the back of a strong growth in the US geography. PFI segment revenues continued its strong growth of 30% y-o-y to Rs 173 cr backed by a strong demand from the Europe region. The FD segment revenues at Rs 430 cr were up 23% y-o-y.
- ♦ **Product Pipeline:** Granules has a strong product pipeline which would fuel the growth in the times to come. The company looks to add a total of 23 new products in between FY2021 to FY2023 across all dosage forms in FD's. Granules aims to file 7-8 new ANDA's and 2-4 dossiers every year. Further, the management has specified that it had delayed a few launches so as to ensure un-interrupted supply of existing products. Granules is also looking to relaunch Metformin 750 mg in the US markets over the next 1-3 quarters. It had recalled the drug from the US markets a couple of quarters back.
- ♦ **Capex:** Granules is in the midst of a massive expansion plan to support the growth going ahead. Granules has announced a Rs 400 cr capacity expansion plan spread over the next two years. This includes de bottlenecking the existing plants and putting up a new block at an existing facility. The de bottlenecking exercises are likely to go on stream in FY2021, thus adding to the top line growth. Secondly, Granules is also putting up a Multi Unit Pallet System (MUPS) at its plant. The MUPS is an advanced technology which can also boost operating efficiencies. The MUPS block will have a capacity to manufacture 2.5 – 5 Bn Finished Dosages per annum and will be operational by Q3FY22. The said block would be set up at an already approved facility and hence can commence commercial production immediately once it is ready

- ♦ **Demand Outlook:** Granules has seen a robust demand outlook across geographies for all its segments. Q2FY2021 witnessed a surge in demand which the management believes to sustain going ahead as well. Volumes are expected to grow backed by improving market share, increasing penetration and growth from new launches. Further a negligible share of demand had the impact of COVID-19. The FD / formulations segment growth would be driven by tapping new geographies – LATAM, Australia and South Africa, while the growth in the PFI segment would be driven by launches in LATAM and RoW markets.
- ♦ **Operating margin expansion driven by new launches, operating leverage; favourable mix:** The operating margins for Q2FY21 surged by 935 BPS backed by a 930 BPS y-o-y expansion in gross margins. A favourable product mix (resulting from higher sales contribution of PFI and FD segment) and benefits of operating leverage resulted in margin expansion. This coupled with healthy share of revenues from the new launches would be the key driver for OPM's. Granules expects its margins trajectory to improve and sees OPM's in excess of 27% mark. This compares with a 21.1% as of FY2020.
- ♦ **Management has revised upwards its growth guidance upwards:** For 1HFY2021, Granules has reported a stellar performance with the topline and PAT clocking a strong growth of 23% and 79% y-o-y. The management expects the growth momentum to sustain going ahead and expects PAT for FY2021 to grow by around 70-80%. Granules has revised its PAT growth guidance upwards to 30% for the period beyond FY2021, from the earlier guidance of 25% levels. Further, the management expects to sustain operating margins more than 27%, whilst eyeing a 30% level.
- ♦ **Net Debt:** Granules had managed to reduce its net debt position by 25.8% y-o-y as of Q2FY2021. The net debt stood at Rs 613.3 cr as compared to Rs 826.5 cr as of corresponding quarter of the previous year.

Results

Particulars	Rs cr				
	Q2FY2021	Q2FY2020	YoY %	Q1FY2021	QoQ %
Total Income	858.1	699.5	22.7	735.6	16.7
Expenditure	601.7	555.9	8.2	552.0	9.0
Operating profit	256.4	143.6	78.6	183.6	39.7
Other income	3.2	8.7	-62.8	5.6	-42.8
EBIDTA	259.6	152.3	70.5	189.2	37.2
Interest	6.3	6.9	-8.5	6.0	5.3
Depreciation	36.1	30.3	18.9	34.1	5.8
PBT	217.3	115.1	88.8	149.2	45.7
Reported PAT	163.6	95.8	70.8	111.4	46.8
BPS			BPS		BPS
OPM (%)	29.9	20.5	935.2	25.0	492.3

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View: Growth momentum to improve:

Indian pharmaceutical companies are better placed to harness opportunities and clock healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in US generics market), rise in product approvals and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be the key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

■ Company Outlook - Strong growth prospects:

Granules is a fully integrated pharmaceutical company with presence across the API-PFI-FD value chain. The company is witnessing improved demand environment across its products. The core 5 molecules are likely to sustain the strong growth trajectory, as the company plans to tap new geographies of Europe, Canada and South Africa for growth. A strong product pipeline would add to the revenue growth. Granules has announced a capex wherein it plans to increase its capacities to cater to the increased demand. The new facility would be ready by Q3FY2022 and operations are expected to commence thereafter. We believe that new product launches in the US and augmented capacities will support the base business as well as emerging business. A changing mix (increasing share of high margin PFI and FD Segment) and efficient manufacturing process coupled with better utilization of plants will aid profitability growth.

■ Valuation - Maintain Buy with a PT of Rs 475:

Granules is witnessing strong demand tractions across segments, which is expected to sustain. Going ahead, growth for the company would be fuelled by new product launches, increasing geographical penetration, capacity expansion, commissioning of MUPS block by Q3FY22 and fortifying presence in the oncology space. Further, a favorable revenue mix, operational efficiencies would drive the margins. Witnessing a strong demand, Granules has revised its PAT growth guidance upwards to 30% for period beyond FY2021 as against earlier guidance of 25%. Based on the sturdy performance in Q2FY2021 and improved growth guidance, we have revised our earnings estimates upwards for FY2022/FY2023. At CMP, the stock is trading at P/E multiple of 15.1x/12.8x its FY22/FY23E EPS. Strong earnings visibility, a sturdy balance sheet and healthy return ratios augur well and could result in multiple re-rating. We maintain our Buy recommendation on the stock with a revised PT of Rs 475.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Granules India	392.0	24.7	9,699.0	29.4	17.5	15.1	18.8	11.3	9.2	17.9	23.7	22.1
Laurus Labs	337.0	53.2	18,055.0	70.2	35.4	28.4	33.5	20.1	16.5	14.4	22.3	21.7

Source: Company, Sharekhan estimates

About company

Granules is a vertically integrated pharmaceutical company, headquartered in Hyderabad, India. The company manufactures Active Pharmaceutical Ingredients (APIs) – 29.7% of sales, Pharmaceutical Formulation Intermediates (PFIs) – 20.2% of sales and Finished Dosages (FDs) – 50.1% of sales and supplies them to both regulated and semi-regulated markets. The regulated markets constitute around 73% of revenues, while LATAM accounts for 11% of revenues and RoW markets constitute around 16% of revenues.

Investment theme

Granules is one of the few Pharmaceutical companies with a vertical integration (from API to FD's). The company's focus on core business coupled with strong demand in APIs augur well for it. The company is expected to report strong performance from FY2020 onwards, as its core business is expected to grow sturdily backed by commissioning of capacities in the recent past, increasing ANDA approvals and launches for U.S. markets. Moreover, since the majority of capex is now behind, it intends to reduce debt over the next couple of years. Operational efficiencies coupled with economies of scale will help improve operating performance as well as profitability. Management has also assured that it will be gradually reducing the proportion of pledge which is a potential trigger for multiple re-rating.

Key Risks

- ♦ Delay in product approvals or negative outcome of facility inspection by the USFDA can affect future earnings prospects.
- ♦ Delay in product launches in the U.S.
- ♦ Adverse outcome of USFDA inspection at manufacturing facility also poses risk.

Additional Data

Key management personnel

Mr. Krishna Prasad Chigurupati	Chairman and Managing Director
Mrs. Uma Chigurupati	Executive Director
Ms. Priyanka Chigurupati	Executive Director of Granules Pharmaceuticals Inc
Mr. Karuppannan Ganesh	CFO
Mr. Stefan Lohle	Chief Marketing Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.07
2	Norges Bank	3.04
3	GOVERNMENT PENSION FUND - GLOBAL	2.76
4	Dimensional Fund Advisors LP	1.85
5	Mahima Stocks Pvt Ltd	1.79
6	TYCHE INVESTMENTS PVT LTD	1.47
7	BlackRock Inc	0.97
8	HBC Holdings PLC	0.79
9	DNB Asia	0.58
10	State Street Corp	0.58

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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