



3R MATRIX

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

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✓	↔	✓

Reco/View

Change

Reco: Buy	↔
CMP: Rs. 358	
Price Target: Rs. 475	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

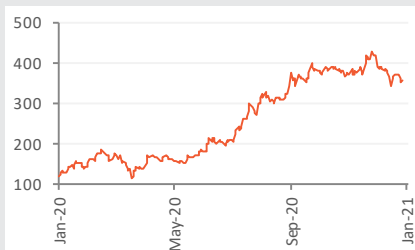
Company details

Market cap:	Rs. 8,858 cr
52-week high/low:	Rs. 438 / 115
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	-15.2	-6.4	71.2	196.8
Relative to Sensex	-22.1	-28.2	39.1	178.4

Sharekhan Research, Bloomberg

Pharmaceuticals

Sharekhan code: GRANULES

Company Update

Summary

- We maintain a Buy on Granules India Limited (Granules) with an unchanged PT of Rs 475.
- Granules is witnessing strong traction across segments, which is expected to sustain in the coming quarters as well.
- A favorable mix, operational efficiencies accruing would drive the margin expansion, which in turn would help company clock a 32% earnings CAGR over FY2020 to FY2023.
- Sturdy growth prospects, strong earnings visibility, healthy balance sheet and healthy return ratios augur well and could result in multiple re-rating.

Granules India Limited (Granules) is witnessing a robust growth outlook but in the near term, the company is confronting shortages of raw materials due to delayed shipments from China. Granules believes that this logistics issue is a temporary phenomenon, which is expected to normalise shortly. Due to this, the company has deferred its product launches to January-March 2021 quarter, which were planned for quarter ending December 2020. The financial performance of the company going ahead is unlikely to be impacted, though the performance for quarter ending December 2020 could moderate slightly. Hence, Granules has retained its earnings growth guidance of ~70% for FY2021 and 30% beyond FY2021. The finished dosage (FD) segment is expected to be a growth driver and Granules is looking to increase contribution of the high-margin FD segment to 60% over the next 2-3 years from 52% (FY2020). Moreover, the core five molecules, which include Paracetamol, Ibuprofen, Metformin, Guaifenesin and Methocarbamol, are slated to sustain their healthy growth momentum backed by tapping new geographies. Granules is amid a capacity expansion plan where in it is investing Rs. 400 crore, spread over the next two years, primarily towards de-bottlenecking and setting up a new Multi-Unit Pallet System (MUPS) block with a capacity of 2.5 - 5 billion FDs per annum, which will be operational by Q3FY22. Tapping new geographies, a strong product pipeline and benefits of incremental capacities would be key revenue growth drivers. A favorable revenue mix, operating efficiencies accruing 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% levels from 21.1% as of FY2020. Therefore, sales and PAT are expected to clock a 19% and 32% CAGR over FY2020-FY2023.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 475: Granules is witnessing strong traction across segments, which is expected to sustain going ahead as well. Granules is looking to expand its reach and tap new geographies for growth. Moreover, to meet demand, Granules is undertaking a capacity expansion plan, where in it is debottlenecking existing capacities and is also setting a new block at an existing facility. Further, a favourable mix, operational efficiencies accruing would drive the margin expansion, which in turn would result in a sturdy 32% earnings CAGR over FY2020 to FY2023. However, of late, Granules is facing logistics issues which has led to delayed shipments, causing raw material shortages. Granules believes that this is a short-lived phenomenon and business is expected to regain normalcy shortly. Therefore, company has retained its earnings growth guidance of ~70% for FY2021 and 30% beyond FY2021 and the above positives would enable the company to meet its stated earnings growth guidance. At CMP, the stock is trading at P/E multiple of 13.8x/11.7x its FY22/FY23E EPS. Sturdy growth prospects, strong earnings visibility, healthy balance sheet and healthy return ratios augur well and could result in multiple re-rating. Based on the above positives, we maintain our Buy recommendation on the stock with an unchanged PT of Rs. 475.

Key risk

- 1). A delay in product approvals or the negative outcome of a facility inspection by USFDA can affect future earnings prospects.
- 2) Delay in resolution of the logistics issues could have an adverse impact on profitability.

Valuations (Consolidated)

Rs cr

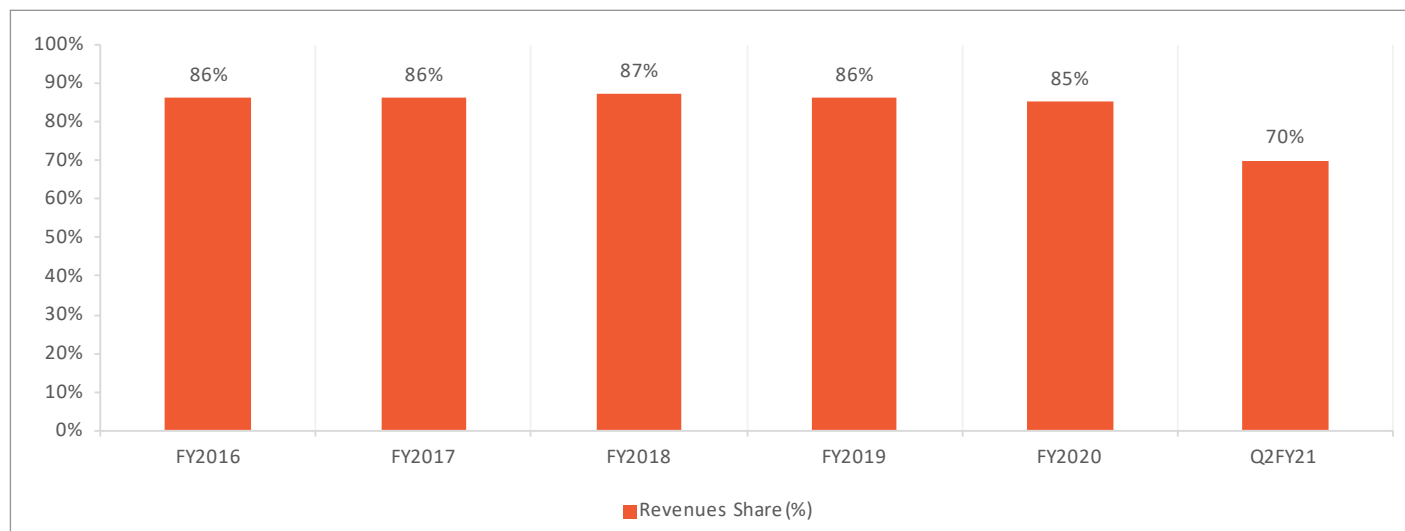
Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net Sales	2279.2	2598.6	3244.1	3803.3	4339.2
EBIDTA	384.0	547.3	859.7	1017.4	1171.6
OPM (%)	16.8	21.1	26.5	26.7	27.0
Reported PAT	236.4	329.7	553.2	641.1	754.5
EPS (Rs)	9.6	13.3	22.4	25.9	30.5
PER (x)	37.4	26.8	16.0	13.8	11.7
EV/Ebitda (x)	24.9	17.3	10.3	8.4	7.0
P/BV (x)	5.8	4.8	3.8	3.1	2.5
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

Geographic expansion to drive the growth in the core molecules

Granules has established its presence strongly over the years in the five products - Paracetamol, Ibuprofen, Metformin, Guaifenesin and Methocarbamol, which are core molecules for the company and have been key growth drivers for the company. The share of revenues from core molecules has been in the range of 85% to 87% over the period FY2016 to FY2020. A lion's share of revenues from the molecules also points towards the market leadership enjoyed by the company.

Revenue Share of Core Molecules



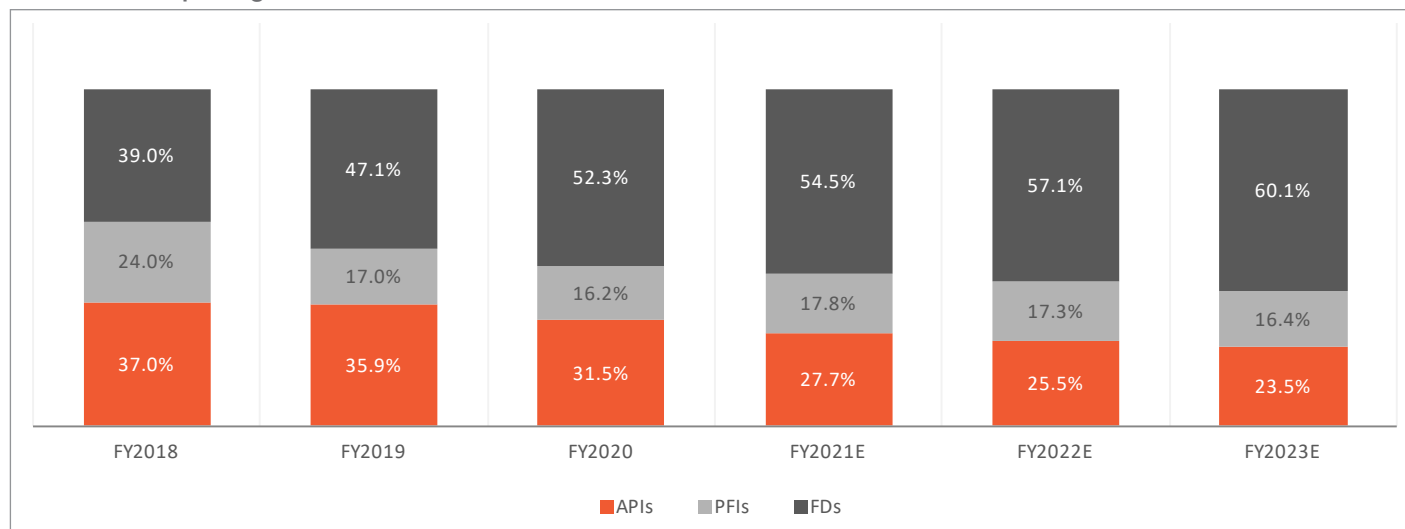
Source: Company; Sharekhan Research

A strong growth in the core molecules over the past can be attributable to the benefits of backward integration, economies of scale and efforts to move up the value chain. This has also yielded better margins for the company, which is reflected in the OPM's rising from 16.5% in FY2018 to 21.1% in FY2020. Regulated markets constitute more than 65-70% of total revenues and Granules has been working around with introducing different strengths of the existing molecules in these markets. Granules is also expanding geographical reach for core molecules and looks to launch these products in Europe, Canada and South Africa and Australia. During Q2FY2021, it has launched one of the products in Spain and has commenced supplies for the same during Q3FY21, which is expected to ramp up. Further, Company's Vizag unit-5 has cleared the EU inspection, thus providing comfort on the company's ability to cater to increased demand. Though the share of revenues from core molecules have dropped to 70% as of Q2FY2021 (due to faster revenue growth recorded by other segments), the management is confident of sustaining the strong growth momentum backed by introduction of new products and improving the geographical reach and penetration.

Strong new product pipeline; expected traction in the existing drugs to drive the FD segment sales

The company's finished dosage (FD) segment is one of the fastest-growing segments of the company over FY2016 to FY2020. The revenues from the segment have recorded a 32.4% CAGR over FY2016-FY2020. The strong growth performance can be attributable to the new product launches / line extensions and benefits of backward integration accruing, which helped fortify the presence in the key developed markets. The share of revenues from the lucrative FD segment has increased remarkably and stood at 52% as of FY2020 as compared to 32.5% as of FY2016. Going ahead, the contribution from the FD segment is expected to reach around 60% over the next 2-3 years. Granules aims to achieve this through a mix of geographic expansion as well as a strong new product pipeline.

Revenue Mix improving



Source: Company; Sharekhan Research

Granules has a strong product pipeline, which would fuel 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 FDs. Granules aims to file 7-8 new ANDAs and 2-4 dossiers every year. Moreover, Granules is also looking to relaunch Metformin 750 mg in the US (it had recalled the drug from the US markets a couple of quarters back) over the next 1-3 quarters. As of quarter ending September, Granules had a total of 32 approved ANDAs and of this company had plans to launch 6-9 products in FY2021. However, given the raw material shortage, the company has postponed its product launches to Q4FY2021 as against the earlier plans to launch in Q3FY2021. Recently the company has received approval for its ANDA - for Penicillamine Capsules USP, 250 mg, which has a market size of around \$67 million for the recent 12 months to October 2020. Therefore, in addition to the sturdy new product pipeline, the company is also looking to tap new markets / geographies for growth. Overall, the FD segment's topline is expected to stage a strong 24% CAGR over FY2020 to FY2023.

Capacity expansion offer growth visibility

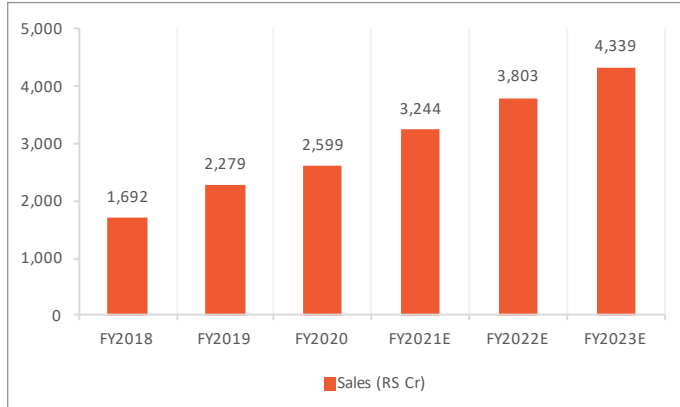
Granules is amid a capacity expansion plan, which in turn would support the growth going ahead. Granules has announced a Rs. 400 crore capacity expansion plan spread over the next two years. This includes de bottlenecking the existing plants (expected to be completed by end of FY2021) and putting up a new block at an existing facility. Granules is also putting up a Multi Unit Pallet System (MUPS) block 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 billion 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. Amid a likely strong topline growth, capacity expansion provides comfort on the company's ability to cater to the incremental demand.

Near-term headwinds could overweigh on the performance; long term drivers in tact

Granules is confronting raw material shortages on the back of delayed shipments from China. This could led to the postponement of sales, though in the near term only. Also, the planned new product launches have been pushed ahead by the company and now could be launched in the January-March 2021 quarter. Further, a shortage / delay of raw materials could drive up raw material costs, thus exerting pressure on margin performance in the near term. However, Granules sees this as a short-lived phenomenon with the business is expected to regain normalcy shortly. Hence this is unlikely to have any material impact on the financial performance of the company and so the company has retained its earnings growth guidance of ~70% for FY2021 and 30% beyond FY2021. Given the headwinds, Granules' topline is expected to decline 5% sequentially, whilst rising 15.7% on a y-o-y basis. Adjusted earnings are also expected to decline 16% sequentially whilst increasing by a sturdy ~44% y-o-y.

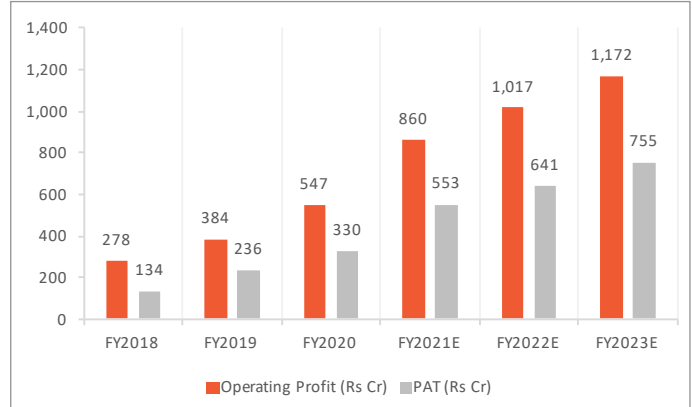
Financials in charts

Sales Trends



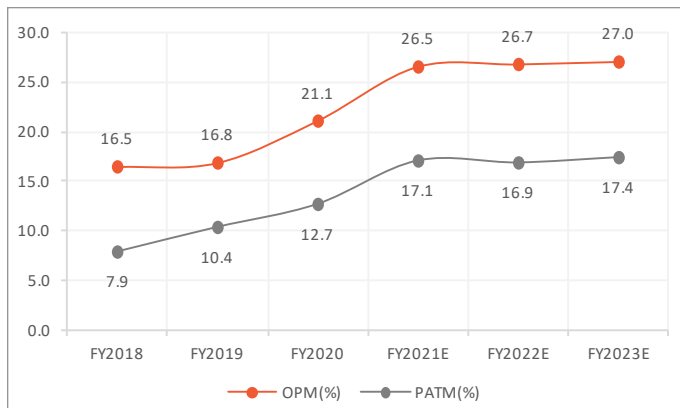
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



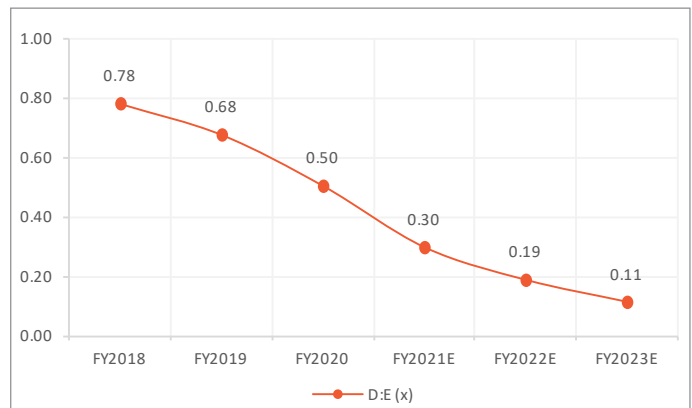
Source: Company, Sharekhan Research

Margin Trends



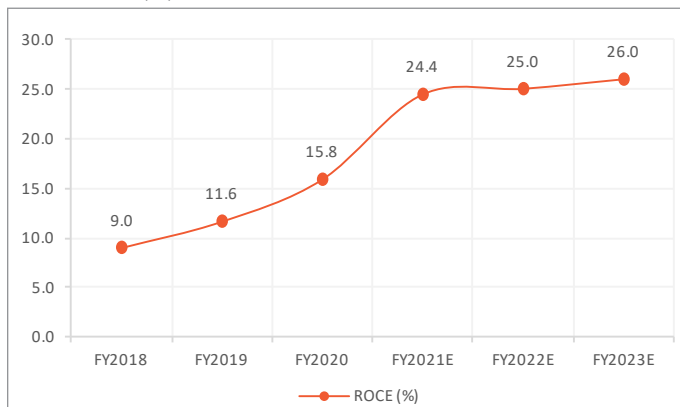
Source: Company, Sharekhan Research

Improving Leverage



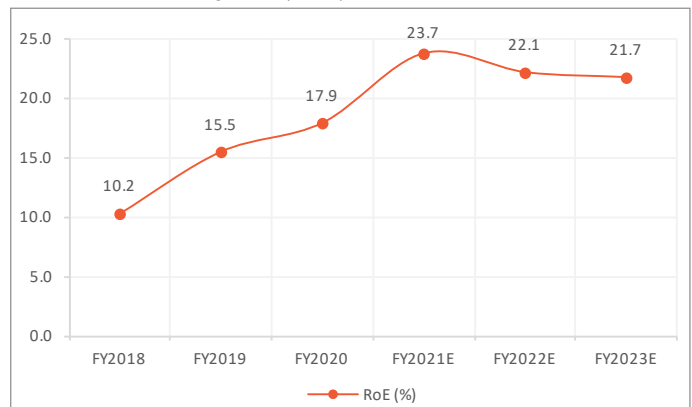
Source: Company, Sharekhan Research

RoCE Trend (%)



Source: Company, Sharekhan Research

Return ratios to improve (ROE)



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.

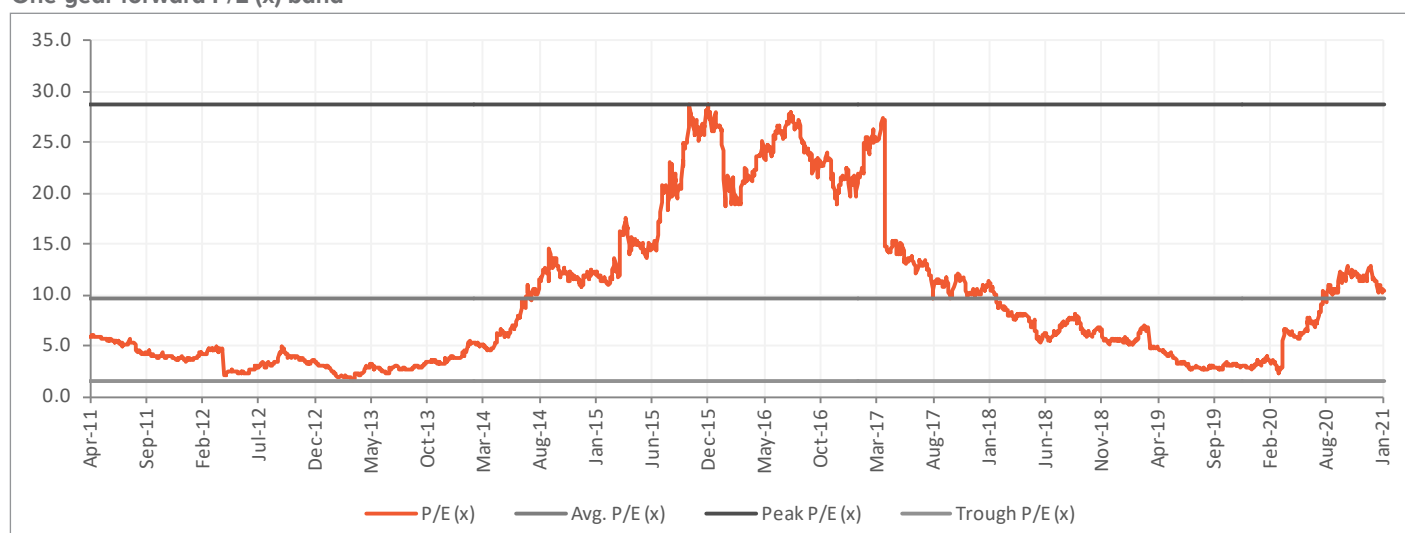
■ Company Outlook – Strong growth prospects

Granules is a fully integrated pharmaceutical company with presence across the API-PFI-FD value chain. The company is witnessing better traction across its segments. 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 is in the midst of a capacity expansion plan wherein it is increasing 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 recent 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 an unchanged PT of Rs. 475

Granules is witnessing strong traction across segments, which is expected to sustain going ahead as well. Granules is looking to expand its reach and tap new geographies for growth. Moreover, to meet demand, Granules is undertaking a capacity expansion plan, where in it is debottlenecking existing capacities and is also setting a new block at an existing facility. Further, a favourable mix, operational efficiencies accruing would drive the margin expansion, which in turn would result in a sturdy 32% earnings CAGR over FY2020 to FY2023. However, of late, Granules is facing logistics issues which have led to delayed shipments, causing raw material shortages. Granules believes that this is a short-lived phenomenon and business is expected to regain normalcy shortly. Therefore, company has retained its earnings growth guidance of ~70% for FY2021 and 30% beyond FY2021 and the above positives would enable the company to meet its stated growth guidance. At CMP, the stock is trading at P/E multiple of 13.8x/11.7x its FY22/FY23E EPS. Sturdy growth prospects, strong earnings visibility, healthy balance sheet and healthy return ratios augur well and could result in multiple re-rating. Based on the above positives, we maintain our Buy recommendation on the stock with an unchanged PT of Rs. 475.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Granules India	358.0	24.7	8,858.0	26.8	16.0	13.8	17.3	10.3	8.4	17.9	23.7	22.1
Laurus Labs	356.0	53.2	19,071.0	74.2	29.0	23.0	35.3	17.7	14.3	14.4	27.0	25.4

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. The company is witnessing increased traction across its segments and in order to support the growth, the company is investing Rs 400 crores spread over the next two years wherein it is increasing its capacities. The expanded capacities would be ready by Q3FY2022 and operations are expected to commence thereafter. We believe that recent 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.

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 Sandip Neogi	Chief Financial 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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