



Powered by the Sharekhan 3R Research Philosophy

Pharmaceuticals

Sharekhan code: GRANULES

Company Update

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

Reco: Buy	↔
CMP: Rs. 331	
Price Target: Rs. 475	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

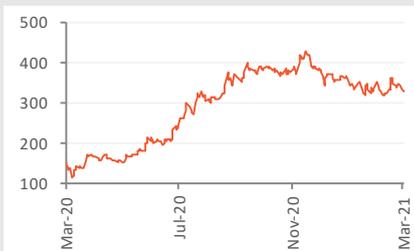
Company details

Market cap:	Rs. 8,203 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	-5.7	-12.9	-9.8	118.1
Relative to Sensex	-2.3	-20.8	-38.0	57.7

Sharekhan Research, Bloomberg

Summary

- We re-iterate our Buy recommendation on Granules India Limited (Granules) with an unchanged PT of Rs 475
- Granules' outlook is robust across segment with finished dosages (FD) segment is expected to be a key growth driver. The core molecules are also expected to sustain growth momentum backed by geographic expansion.
- Granules is in the midst of diversifying / shifting its supplier base to India to lower dependence on china. Also higher input costs (largely for paracetamol) could pressurise margins, though expected to be a transient issue for 1-2 quarter only
- Sturdy growth prospects, strong earnings visibility, healthy balance sheet & return ratios augur well.

Granules India Limited (Granules) is witnessing a robust outlook across segments and the finished dosages (FD) segment is expected to be a key growth driver. Granules is looking to increase contribution of the high-margin FD segment to 60% over the next the 2-3 years from 52% (FY2020) backed by a strong product pipeline and growth in existing business. The company is looking to add 23 new products across all dosage forms in FD segment over FY21-FY23. Also, it has relaunched Metformin in the US recently and has been able to quickly grab a 60% market share, which is a key positive. Further, traction in the core molecules is also expected to sustain backed by tapping new geographies. Moreover, demand for Ibuprofen has normalised post the decline in quarter ending December 2020. Strong overall demand would be supported by capacity expansion as Granules looks to commence new MUPS block and de-bottlenecking by Q3FY22, while the Genome Valley capacities could be ready by FY2024, which provides ample visibility on growth ahead. Further, to reduce dependence on China, Granules is in the midst of diversifying / shifting its supplier base to India. The exercise is expected to be completed by Q2FY22 and would shield the company from supply disruptions. Also, prices of key inputs for Paracetamol (~50% of sales) have almost doubled versus previous year and could exert pressure on the margins as the price hikes would be passed on to customers with a lag. However we see this as a transient issue over the next 1-2 quarters as with the completion of the supplier base diversification, margins are expected to normalise. Consequently, Granules sees its margins moving to 27% levels from 21.1% as of FY2020. Therefore, sales and PAT are expected to clock a 20% and 34% CAGR over FY2020-FY2023.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 475: Granules' FD segment is expected to be a key growth driver for the company with the growth being driven by strong new product pipeline. Further the recent launches / re-launches have also picked up with Granules regaining 60% market share in Metformin. Growth in the core five molecules is expected to be strong going ahead as the company taps new geographies. Further, to meet rising demand Granules is expanding capacities and strong demand supported by a capacity expansion plans provides ample growth visibility. Secondly, the cost of key inputs for Paracetamol have almost doubled since November 2020 and this could weigh on margins in the near term as the price increase would be passed on to customers with a lag. Further strategy to shift the supplier base to India from China could exert pressure on margins, but is expected to be a short lived issue and margins are likely to normalize Q2FY22 onwards. At CMP, the stock is trading at attractive P/E multiple of 13.2x/10.4x its FY22E/FY23E EPS. Sturdy growth prospects, strong earnings visibility, healthy balance sheet and return ratios augur well. Further, Granules' stock price has underperformed the benchmark Sensex and the BSE healthcare index by ~38% and 17% over the past six months respectively and the stock price has also corrected by almost 20% in past four months, thus providing a good opportunity for investors to get in the stock. We re-iterate a Buy 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) Steep increase in the input cost could have an adverse impact on profitability.

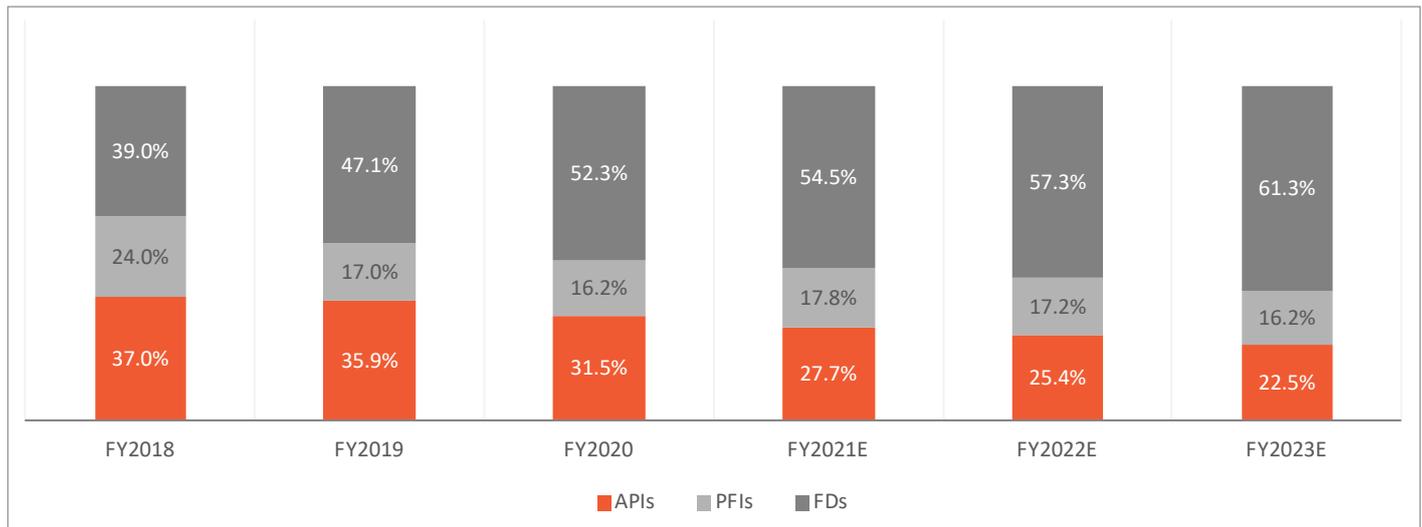
Valuations (Consolidated)

Particulars	Rs cr				
	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net Sales	2279.2	2598.6	3244.1	3821.0	4540.0
EBIDTA	384.0	547.3	850.0	983.9	1225.8
OPM (%)	16.8	21.1	26.2	25.7	27.0
Reported PAT	236.4	329.7	539.9	617.6	787.0
EPS (Rs)	9.6	13.3	21.8	25.0	31.8
PER (x)	34.6	24.8	15.1	13.2	10.4
EV/Ebidta (x)	23.2	16.1	9.7	8.1	6.3
P/BV (x)	5.3	4.4	3.5	2.9	2.4
ROCE (%)	11.6	15.8	23.7	23.8	26.9
RONW (%)	15.5	17.9	23.3	21.6	22.7

Source: Company; Sharekhan estimates

Growth in the base business, healthy new product pipeline to fuel FD sales; company to gain ~60% share in Metformin post US re-launch: For Granules, the finished dosages (FD) segment is one of the fastest-growing segments of the company over FY2016 to FY2020. 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 it to strengthen its presence in the key developed markets.

Revenue Mix improving



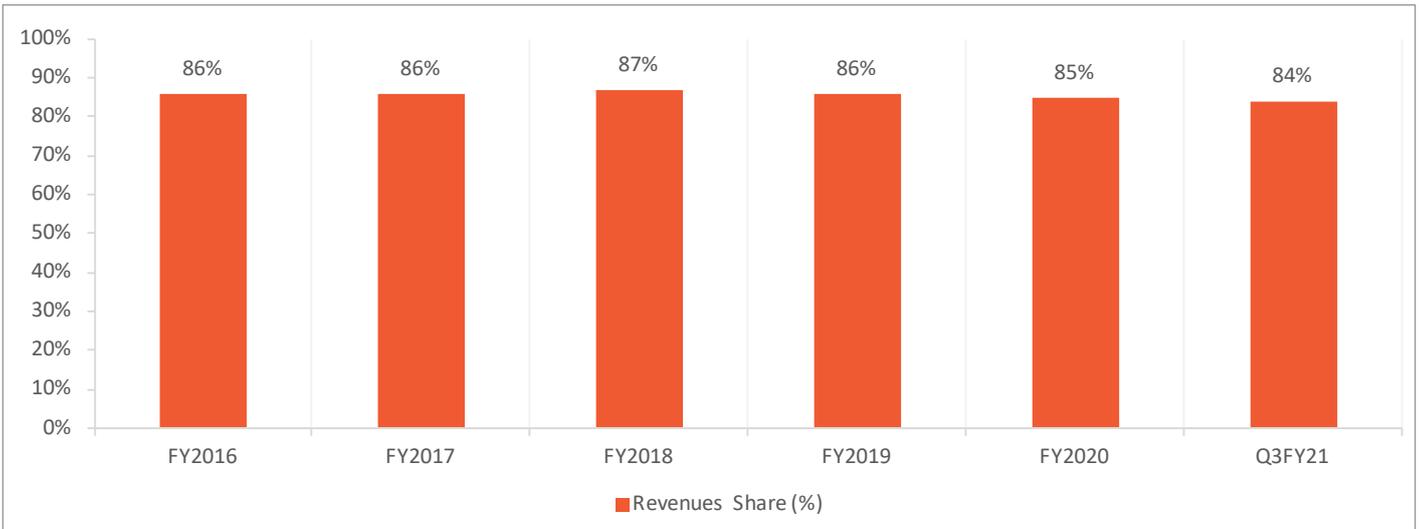
Source: Company; Sharekhan Research

The share of revenues from the lucrative FD segment has increased remarkably to 52% as of FY2020 and at 51% as of 9MFY2021, as compared to 32.5% as of FY2016. Going ahead, the contribution from the FD segment is expected to reach ~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. 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 has re-launched Metformin with strengths of 500 mg and 1000 mg in the US recently, which offers market potential of \$192 mn. Post re-launch, the company has gained ~60% market share in a short span, which points at a strong traction. In addition to this the company has also received USFDA approval for Potassium Chloride oral solution as well extended release capsules and collectively, both medicines offer a market potential of ~ \$115 million. As of quarter ending December 2020, Granules had a total of 35 approved ANDAs from the USFDA and of this company had plans to launch 9 products in FY2021. In Q3FY2021 Granules has launched 4 new products - Ramelteon, Dexmethylphenidate HCl ER and Potassium Chloride ER tablets and Guaifenesin ER tablets, which are also expected to pick up going ahead. In addition to the above the commissioning of Vizag unit-IV and unit-V offer backward integration benefits for the finished dosages and could aid the growth in the base business as well as also aid operational efficiencies. Therefore the above triggers would result in FD segment's topline is expected to stage a strong 27% CAGR over FY2020 to FY2023.

Commissioning of expanded capacities, geographic expansion to aid 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 also known as core molecules of the company and have been key growth drivers for the company. The share of revenues from core molecules has been in the range of around 85% over the period FY2016 to FY2020. A lion's share of revenues from the molecules also points towards the consistent market leadership enjoyed by the company.

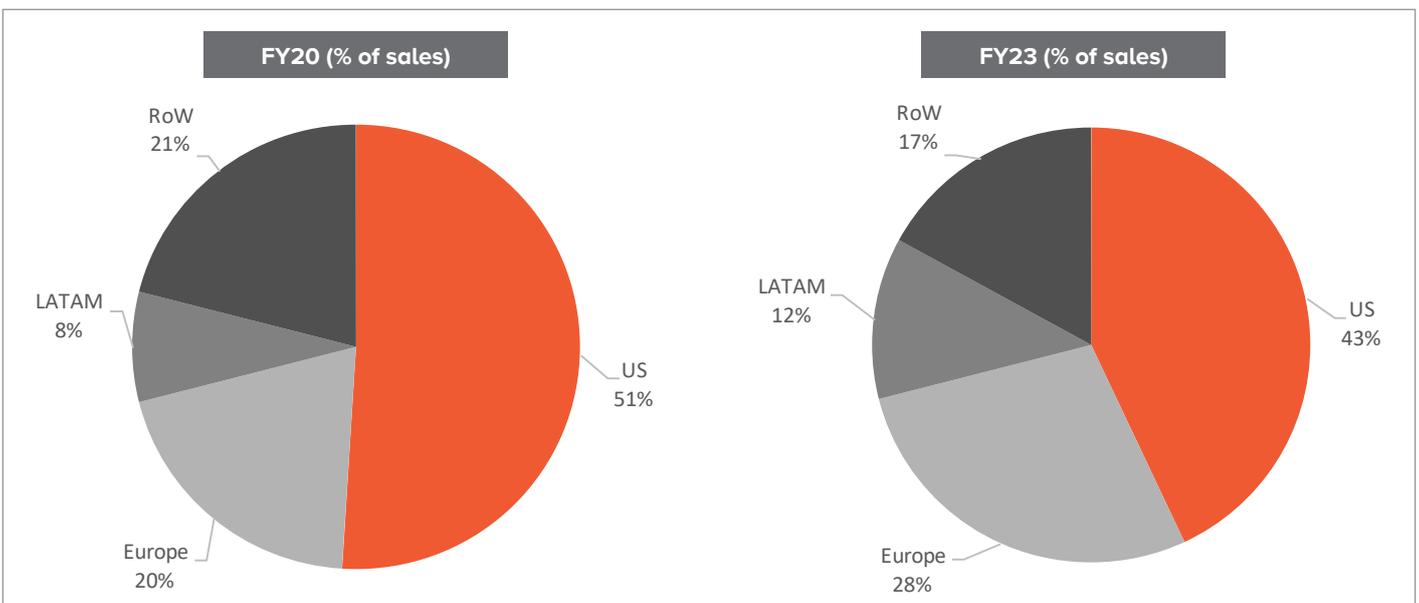
Revenue share of core molecules



Source: Company; Sharekhan Research

A strong growth in 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 OPMs 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 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. Further, the company has recently commissioned its multi API facility at Vizag (unit IV and V) which would enhance the manufacturing capabilities of the APIs. Large-scale manufacturing with sustained competitive advantages augurs well for Granules as it not only enables to sustain competitive advantage but also build operational efficiencies. Collectively, a sustained strong demand traction across the core molecules, expansion of filling footprint to new geographies and incremental capacities coming on stream point at sustained growth trajectory for the core molecules.

Revenue share of core molecules



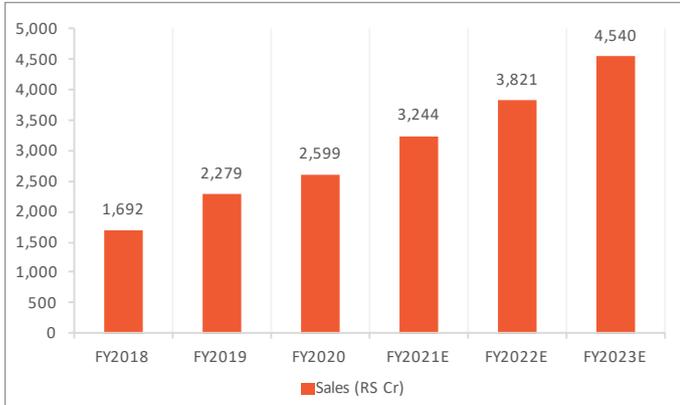
Source: Company, Sharekhan Research

Relocation / diversification of supplier base to reduce dependence on Chinese imports; steep rise in input prices could exert pressure on margins, albeit in the near term only: Granules imports a chunk of its raw materials / inputs for its key APIs from China, which constitute more than half of the raw material basket, pointing towards a higher dependence on China. Therefore, during the pandemic led lockdown the company confronted certain supply disruption and so avoid such a situation going ahead, Granules is in the process of diversifying / shifting its supplier base to India. The whole process is expected to be completed over the next 2-3 quarters and could be a positive development for the company in terms of assured supply of raw materials. However, during the transient times, the company could confront higher raw material prices, which could pressurize gross margins. Secondly, Paracetamol (one of the core molecules and constituting around 50% of sales) prices have increased steeply over the past 6 months due to a steep increase in the input prices. The cost of Para Amino Phenol (key input for Paracetamol) have shot up to \$7.5 per Kg as compared to \$ 3.5 per Kg (in the previous year), has led to the rise in the paracetamol prices. Consequently, the paracetamol API prices have almost doubled to levels of ~ Rs. 650 per kg as compared to Rs 320 per Kg as of November 2020. We believe the spike in the input prices could exert pressure on gross margins in the near term as the price (realisations) increase by the company could be with a lag. Hence the operating margins for granules could be under pressure for the current as well as the next quarter. However with the supplier base diversification likely to complete by Q2FY22, the margins could normalise back to earlier levels.

Granules to invest Rs. 400 crore towards a new PFI-FD facility in Genome Valley; plant to be operational in early FY2024: Granules has announced setting up of a new plant for PFI – FD at Genome Valley Hyderabad with an outlay of Rs. 400 crore. The company has acquired the land for the said plant and the construction work is about to commence. The new facility would house a capacity of 10 billion units of oral solid dosages (OSD) and other dosage forms as well as also increase the capacity for PFI's. The new plant announcement comes on the back of an expected tractions in business across the PFI and FD segments. The existing capacities would support the demand over the next two years, post which, Granules expects the contribution from the new facility to support the growth. In addition to this, Granules is progressing as per schedule with the ongoing capacity expansion plan of Rs 400 crore, encompassing the setting up of a MUPS unit and capacity expansion plans. Announcement of the new capex plan points towards a strong growth visibility going ahead.

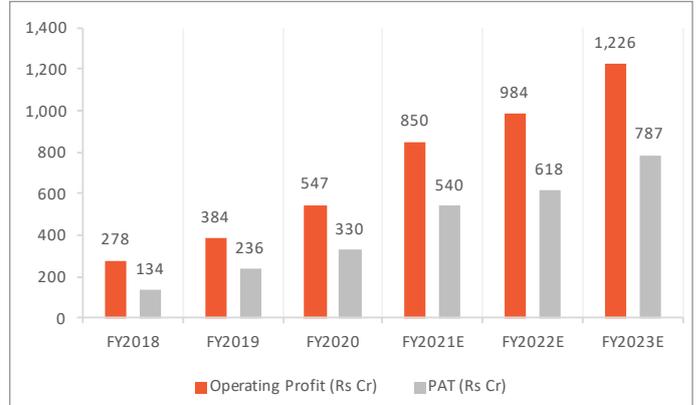
Financials in charts

Sales Trends



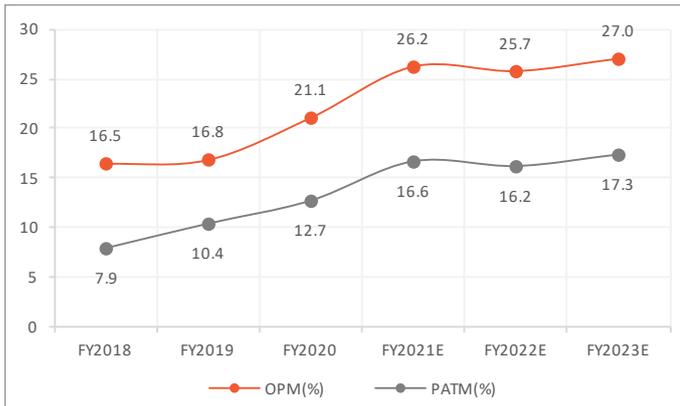
Source: Company, Sharekhan Research

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

RoE (%) Trends



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Growth momentum to improve

Indian pharmaceutical companies are well-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 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.

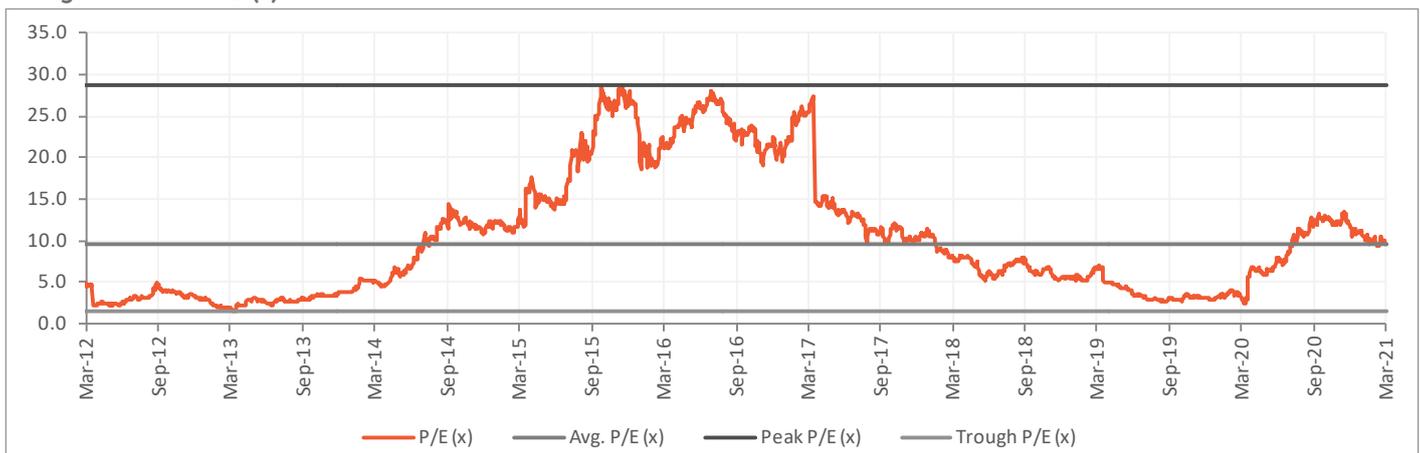
■ Company Outlook – Healthy prospects

Granules is a fully-integrated pharmaceutical company with presence across the API-PFI-FD value chain. The company is witnessing an improved growth across its products / segments. The core molecules, which constitutes ~85% of the overall sales, are likely to sustain the strong growth trajectory, as the company plans to tap new geographies of Europe, Canada, Australia and South Africa for growth. Also commissioning of Vizag unit IV and V offer benefits of backward integration and could aid higher volumes. A strong product pipeline could add to the revenue growth. Granules has announced a capex wherein it plans to increase its capacities to cater to the increased demand. A part of the capex plan encompassing de-bottlenecking and setting up of a MUPS block, which is expected to be ready by Q4FY2022 and operations are expected to commence thereafter. While the balance part of capex which includes setting up a new facility at Genome valley for PFI and FDs is likely to be ready in early FY2024. We believe that new product launches in the US, tapping new geographies and augmented capacities will support the base business as well as emerging business. A changing mix (increasing share of high-margin PFI and FD segments) and efficient manufacturing process coupled with better utilization of plants will aid profitability growth. Further, given the steep spike in the input prices of Paracetamol and the company efforts to diversify / shift its vendor base to India could exert pressure on the gross margins in transient times and margins are expected to normalise from Q2FY2022 onwards.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 475

Granules' FD segment is expected to be a key growth driver for the company with the growth being driven by a strong new product pipeline. Further the recent launches / re-launches have also picked up with Granules regaining 60% market share in Metformin. Growth in the core five molecules is expected to be strong going ahead as the company taps new geographies. Further, to meet rising demand Granules is expanding capacities and strong demand supported by a capacity expansion plans provides ample growth visibility. Secondly, the cost of key inputs for Paracetamol have almost doubled since November 2020 and this could weigh on margins in the near term as the price increase would be passed on to customers with a lag. Further strategy to shift the supplier base to India from China could exert pressure on margins, but is expected to be a transient issue and margins are likely to normalize Q2FY22 onwards. At CMP, the stock is trading at attractive P/E multiple of 13.2x/10.4x its FY22E/FY23E EPS. Study growth prospects, strong earnings visibility, healthy balance sheet and return ratios augur well. Further, Granules' stock price has underperformed the benchmark Sensex and the BSE healthcare index by ~38% and 17% over the past six months respectively and the stock price has corrected by almost 20% in past four months, thus providing a good opportunity for investors to get in the stock. We re-iterate a Buy 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	331.0	24.7	8,203.0	24.8	15.1	13.2	16.1	9.7	8.1	17.9	23.3	21.6
Laurus Labs	362.0	53.2	19,401.0	75.4	20.6	17.4	35.8	14.1	11.8	14.4	34.6	29.0
Strides Pharma Sciences	839.0	9.0	7,523.0	53.7	28.7	18.8	14.4	11.8	9.3	1.7	11.1	12.8

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. Further given the steep spike in the input prices of paracetamol and the company efforts to diversify / shift its vendor base to India could exert pressure on the gross margins in the transient times and the margins are expected to normalize from Q2Fy2022 onwards.

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
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	2.99
4	Vangaurd Group Inc	1.91
5	Mahima Stocks Pvt Ltd	1.66
6	TYCHE INVESTMENTS PVT LTD	1.47
7	Dimensional Fund Advisors LLP	1.41
8	BlackRock Inc	1.09
9	DNB Asia	0.37
10	Capital Securities Investment Trust Co	0.26

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.