



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	■	↔	■

ESG Disclosure Score **NEW**

ESG RISK RATING
Updated Dec 01, 2022 **39.6**

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 8,153 cr
52-week high/low:	Rs. 381 / 227
NSE volume: (No of shares)	41.6 lakh
BSE code:	532482
NSE code:	GRANULES
Free float: (No of shares)	14.4 cr

Shareholding (%)

Promoters	42.0
FII	21.4
DII	4.2
Others	32.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.3	7.0	43.1	10.0
Relative to Sensex	3.8	6.7	29.4	5.4

Sharekhan Research, Bloomberg

Summary

- We upgrade our rating on Granules India to Buy from Hold and maintain the price target (PT) at Rs. 400 as we believe Granules India is well-poised to benefit from diversified supply of its Paracetamol API secured away from China in the recent quarters.
- The company management believes that paracetamol sales will continue at stable levels over short term as they have a set of marquee customers for the same in the US to whom it is trying to convert to formulations supplies from API as well. The company is gaining market share also from other suppliers for Paracetamol. Additionally, the company has launched Paracetamol in Europe in Q3FY23 and expects it to ramp up from Q4FY23E.
- The management believes that the China-led price rise in APIs should not affect it as it has diversified its supplies of PAP away from China by engaging with alternate set of sources over the last 2 quarters.
- The recent price changes taken up by NPPA in Paracetamol and Metformin in India should not cause concerns as it does not deal in these formulations in the Indian market. The company has announced setting up a green chemical plant soon, whose details are awaited.

Granules India's management believes that paracetamol sales will continue at a stable levels over short term as they have a set of marquee customers for the same in the US. In Q2FY23, the company witnessed strong revenue and earnings growth, beating our revenue and earnings estimates due to a strong show in API sales than we anticipated. This was largely driven by Paracetamol sales recovering back with improved availability of Key Starting Raw Material (KSMs) such as PAP. The company is gaining market share also from other suppliers for Paracetamol. In the wake of increased prices of APIs from China in the region of 15-25% due to increase in the COVID 19 cases there, Granules' management believes that it should not affect them severely as they have secured diversification away from Chinese supplies of PAP by engaging with alternate set of sources over the last 2 quarters and have an ability to pass on price rise to few customers for Paracetamol.

- APIs sales growth to stay stable in the short term:** API sales grew at a whopping 73.4% YoY to Rs. 3,303 million in Q2FY23. This was largely driven by paracetamol sales recovering back with improved availability of Key Starting Raw Materials (KSMs) such as PAP. The management believes that the paracetamol sales will continue at stable levels over the short term.
- Raw material concerns to be offset by alternative supplies and lower energy & freight costs:** The management believes that increase in API prices from China should not affect them severely as they have secured diversification away from Chinese supplies of PAP by engaging with alternate sources for the same over the last 2 quarters. We believe this coupled with its ability to pass on price increase to few customers will help the company to maintain its gross margins over short to medium term.
- Price changes announced by National Pharmaceutical Pricing Authority (NPPA) for Paracetamol and Metformin API a non-event:** The Recent price changes taken up by NPPA should not lead to any concerns for the company as it does not deal in Paracetamol or Metformin formulations in the Indian market.

Our Call

Valuation: Granules India is well poised to benefit from a diversified supply of its Paracetamol API in the recent quarters. The management believes that the China +1 strategy besides its ability to pass on price increases to few customers for paracetamol will help them to safeguard escalated price levels for its PAP API for Paracetamol from China over the medium term. We therefore maintain the CAGR earnings growth estimate at 25.9% over FY22-FY25E. The stock price has fallen by 12% since its Q2FY23 update. Hence, at CMP, the stock trades at a relatively attractive valuation of 11.7x/10.0x its FY2024E/FY2025E EPS. We continue to value the company's shares at 12.0x while applying it on FY25E EPS. As such, we maintain the PT at Rs. 400 and upgrade the rating to BUY from HOLD, as at the CMP, the stock indicates an upside potential of 22%.

Key Risks

Delay in product approvals or the negative outcome of facility inspections by the USFDA can affect future earnings prospects, and delay easing of input prices.

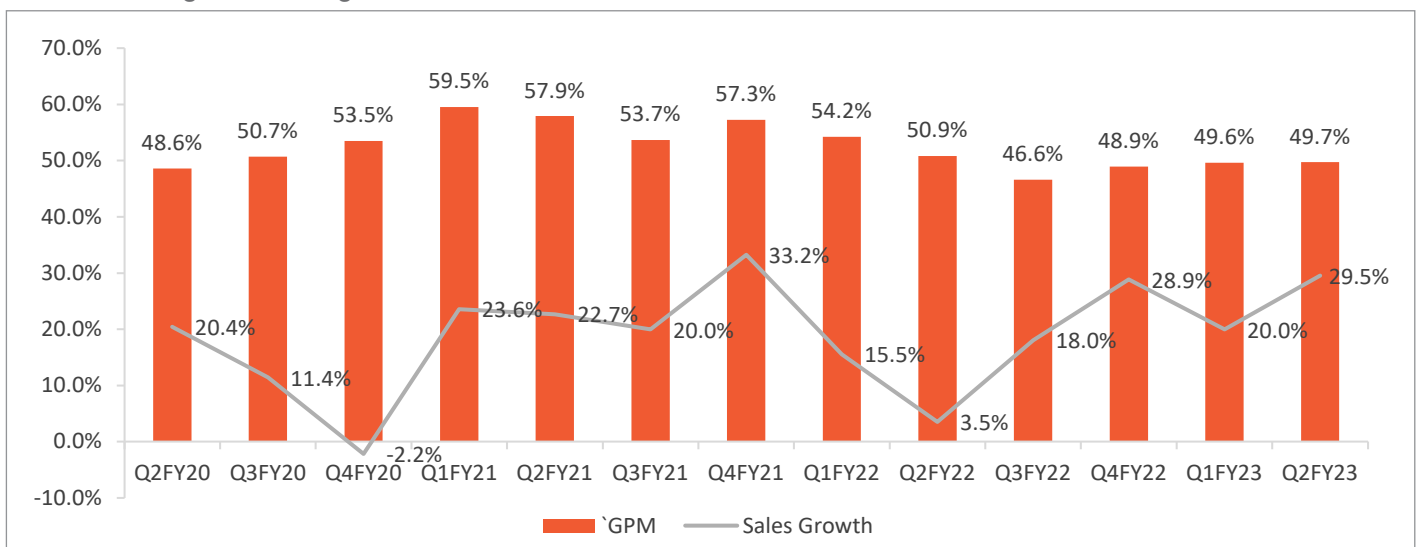
Valuation (Consolidated)

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	3237.5	3764.9	4431	5177.1	6023
EBIDTA	855.2	722.2	917.2	1128.6	1313
OPM (%)	26.4	19.2	20.7	21.8	21.8
Reported PAT	549.5	412.8	542.1	695.4	823.6
EPS (Rs)	22.2	16.7	21.9	28.1	33.3
PER (x)	14.8	19.7	15.0	11.7	9.9
EV/EBITDA (x)	9.72	11.88	8.97	7.39	6.18
ROCE (%)	25.0	15.7	18.7	21.2	22.3
RONW (%)	25.3	16.0	18.1	19.7	19.8

Source: Company; Sharekhan estimates

- ◆ **APIs sales growth to continue to be stable over short term:** The management believes that the paracetamol sales will continue at stable levels in the short term as it has a marquee set of customers for the same in the US to whom it is trying to convert to formulations supplies from API as well. The company is gaining market share also from other suppliers for paracetamol. Additionally, the company has launched paracetamol in Europe in Q3FY23 and expects it to ramp up from Q4FY23E. In Q2FY23, the company witnessed strong revenue and earnings growth, beating our revenue and earnings estimates due to strong show in API sales than we anticipated. API sales grew at a whopping 73.4% y-o-y to Rs. 3,303 million in Q2FY23. This was largely driven by Paracetamol’s sales recovering back with improved availability of Key Starting Raw Material (KSMs) such as PAP. We believe the prevalence of flu season in the US and Europe may continue to drive demand for Paracetamol and thereby drive Paracetamol’s sales for Granules India over short to medium term.
- ◆ **Raw material concerns to be offset by alternative supply secured and lower energy and freight costs:** In the wake of a 15-25% rise in API prices from China due to an increase in the COVID-19 cases there, the company management believes that it should not affect them severely as they have diversified supplies for PAP from an alternate set of sources for the same over the last 2 quarters. We believe this coupled with sequential fall in reefer container freight rates over the last three months and the company’s ability to pass on any increase in raw materials costs from a few customers, will help the company to maintain its gross margins over short to medium term.
- ◆ **Price changes announced by National Pharmaceutical Pricing Authority (NPPA) for Paracetamol and Metformin API is a non-event:** The recent price changes taken up by NPPA should not lead to any concerns for the company as it does not deal in Paracetamol or Metformin formulations in India market.

Gross Profit Margin and Sales growth



Source: Company and Sharekhan Research

Outlook and Valuation

■ Sector view - Multiple growth engines ahead

The Indian Pharma market (IPM) is growing with increased consumer spend and awareness. Additionally, Indian pharmaceutical players with large market share in IPM and a strong pipeline of speciality products will help them gain market share in the US and thereby partially offset any effect of competitive pricing pressures in the US. Moreover, other factors such as faster product approvals and resolutions by the USFDA regards to plant observations and strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars and injectables) and commissioning of expanded capacities by select players in the medium term. Collectively, this indicates a strong growth potential going ahead for Indian pharma companies

■ Company outlook - Cost pressures to abate

Granules is a fully integrated pharmaceutical company with a presence across the API-PFI-FD value chain. Over a long-term period, the company's growth levers are intact. While FY23 could stage an improvement, regaining normalcy i.e., previous period margins and growth, apparently is likely only over medium – long term. Nevertheless, the raw material and freight costs are easing up sequentially and that coupled with the price increase should support margins. Measures taken to reduce dependence on China and initiating a price hike across a few customers will help it offset any concerns around China led API price increases. Commissioning of the MUPS block and a strong product pipeline across regions would support growth. We believe that new product launches in the US, tapping new geographies, and augmented capacities will support the base business as well as an emerging business.

■ Valuation - Upgrade to Buy; maintain PT at Rs. 400

Granules India is well poised to benefit from a diversified supply of its Paracetamol API in the recent quarters. The management believes that the China +1 strategy besides its ability to pass on price increases to few customers for paracetamol will help them to safeguard escalated price levels for its PAP API for Paracetamol from China over the medium term. We therefore maintain the CAGR earnings growth estimate at 25.9% over FY22-FY25E. The stock price has fallen by 12% since its Q2FY23 update. Hence, at CMP, the stock trades at a relatively attractive valuation of 11.7x/10.0x its FY2024E/FY2025E EPS. We continue to value the company's shares at 12.0x while applying it on FY25E EPS. As such, we maintain the PT at Rs. 400 and upgrade the rating to BUY from HOLD, as at the CMP, the stock indicates an upside potential of 22%.

Peer Comparison

Companies	CMP (Rs/ Share)	O/S Shares (Cr)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Granules India	328.0	24.8	8,144.0	19.7	15.0	11.7	11.9	9.0	7.4	16.0	18.1	19.7
Laurus Labs	385.0	53.7	20,688.3	24.6	19.7	17.1	18.2	13.8	11.8	24.8	23.7	21.4

Source: Company; Sharekhan Research

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 a fully integrated pharmaceutical company with a presence across the API-PFI-FD value chain. Over a long-term period, the company's growth levers are intact. As FY23 could stage an improvement, regaining normalcy i.e., previous period margins and growth, apparently is likely over medium term. Nevertheless, the raw material and freight costs are easing up QoQ, that coupled with the price increase should support margins. Measures taken to reduce dependence on China and initiating a price hike across customers will help it offset any concerns around China led API price increases. Positives continue to be commissioning of the MUPS block, strong product pipeline across regions to support growth. We believe that new product launches in the US, tapping new geographies, and augmented capacities will support the base business as well as an emerging business.

Key Risks

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

Additional Data

Key management personnel

Krishna Prasad Chigurupati	Chairman and Managing Director
Kandiraju Venkata Sitaramrao	Chief Executive Officer and Managing Director
Sandip Neogi	Chief Financial Officer
Chaitanya Tummala	Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FIL Ltd	6.37
2	Norges Bank	3.91
3	FMR LLC	3.08
4	BNP Paribas SA	2.48
5	Dimensional Fund Advisors LP	1.83
6	Vanguard Group Inc.	1.82
7	TYCHE Investments Pvt Ltd.	1.50
8	Aditya Birla Sun Life AMC	1.42
9	Mahima Stocks Pvt Ltd	1.39
10	Aditya Birla Sun Life AMC	1.39

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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