



## 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

39.60

## High Risk

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

Source: Morningstar

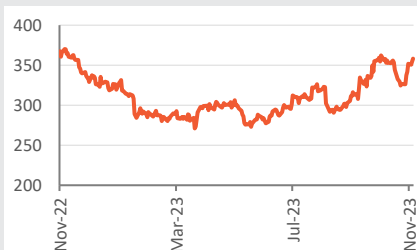
## Company details

Market cap:	Rs. 8,839 cr
52-week high/low:	Rs. 374 / 267
NSE volume: (No of shares)	45.6 lakh
BSE code:	532482
NSE code:	GRANULES
Free float: (No of shares)	14.4 cr

## Shareholding (%)

Promoters	42.0
FII	19.8
DII	6.9
Others	31.4

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	11.1	18.6	-3.1
Relative to Sensex	0.8	12.2	13.7	-9.6

Sharekhan Research, Bloomberg

# Granules India Ltd

## Strong sequential recovery

## Pharmaceuticals

Sharekhan code: GRANULES

Reco/View: Buy



CMP: Rs. 356

Price Target: Rs. 417



Upgrade



Maintain



Downgrade

## Summary

- For Q2FY2024, Granules reported revenue growth of ~3% y-o-y/+20% q-o-q to Rs. 1,189 crore driven by strong growth of 27% YoY in its formulations revenue (~62% of sales) and pick up in the North America region which grew by 11% YoY to Rs 799 crs.
- Some of the delayed launches of the approved products, both in the U.S. and other geographies, will be launched in this and the coming quarters and would contribute to higher revenue and profitability.
- The company plans to spend Rs. 2,000 crore over the next five years to build a green chemistry plant at Kakinada, AP, which will enable it to be carbon zero in API manufacturing. An ambitious capex plan should help it to become a fully integrated player, which can bring benefits of operating leverage over medium to long term.
- The stock currently trades at attractive valuations of ~14.7x/12.4x its FY2024E/25E earnings vs. its peers trading at ~21.0x/17.1x their FY24E/FY25E EPS estimates. We maintain Buy with a revised PT of Rs. 417.

For Q2FY2024, Granules India Limited (Granules) reported strong sequential sale growth in Q2FY2024, led by formulations growth of ~27% y-o-y, which offset the 9% decline in API sales and 38% y-o-y decline in pharmaceutical formulation intermediates (PFIs) sales. Revenue grew by ~16.1% y-o-y to Rs. 1,195.5 crore. EBITDA margin declined by 320 bps y-o-y to ~17.9% and net profit Margin (NPM) declined ~404 bps y-o-y to ~8.6% for Q2FY2023. An unfavorable product mix and price erosions in the regulated markets for finished dosages led to it posting slower growth at ~3% y-o-y in net income to Rs. 1,189 crore for Q2FY2024. Earnings for the quarter stood ~23% below the internal estimate. Slower growth can also be attributed to a massive rise in finance cost and depreciation cost.

## Key positives

- The FDF segment continued to post strong double-digit growth in Q2FY2024.
- Operating cash flows were healthy at Rs. 373 crore as of September 2023 versus Rs. 332.1 crore in FY2022. This was driven by improved EBITDA margins in FY2023 and the cash cycle.

## Key negatives

- Unfavourable products mix due to lower API sales.
- Slower growth in earnings in recent times due to higher finance, depreciation, and taxes.

## Management Commentary

- Price erosion was partially offset by significant volume growth in North America business.
- Europe sales declined due to increased price erosion.
- Volume decline continued in Latin America (y-o-y), primarily on account of inventory correction by customers in these regions coupled with demand challenges.
- A decline in the API segment on a YoY basis was primarily led by reduction in prices of key products, which were reduced in-line with the lower prices of key raw material (no impact on margins).
- Share of the PFI business reduced y-o-y, as more customers are converting into FD from PFI, coupled with correction in inventories in LATAM markets.
- FD volumes increased significantly in the U.S. across major products.
- The company received ANDA approval for Esomeprazole Magnesium Delayed-Release Capsules, Losartan and Hydrochlorothiazide Tablets and Acetaminophen and Ibuprofen Tablets, 250/125 mg.

**Revision in estimates** – We estimate a ~17% CAGR in sales and a ~21.1% CAGR in net profit over FY2023-FY2025E.

## Our Call

**View – Maintain Buy with a revised PT of Rs. 417:** The company has been witnessing strong growth for its FDF sales, especially for Paracetamol Finished Dosages (FDs) which are growing strongly in regulated markets like North America and U.K. We believe the worst is over for Granules and H2 is expected to witness signs of recovery, led by new product launches and volume growth driving strong sales growth coupled with productivity measures will lead to decent earnings growth for the company in the short to medium term. At the CMP, the stock is trading at attractive levels of ~14.7x/12.4x its FY2024E/FY2025E earnings vs. its peers trading at ~21.0x/17.1x their FY2024E/FY2025E EPS estimates. We maintain Buy with increased price target (PT) of Rs. 417.

## Key Risks

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

## Valuation (Consolidated)

Rs cr

Particulars	FY2021	FY2022	FY2023	FY2024E	FY2025E
Net Sales	3237.5	3764.9	4511.9	5367.9	6173.1
EBIDTA	855.2	722.2	913.8	1127.3	1296.4
OPM (%)	26.4	19.2	20.3	21.0	21.0
Adjusted PAT	549.5	412.8	516.6	639.9	758.2
EPS (Rs)	21.6	16.2	20.3	25.2	29.8
PER (x)	17.1	22.8	18.2	14.7	12.4
EV/EBITDA (x)	11.5	14.0	11.2	7.4	5.9
P/BV (x)	4.3	3.6	3.3	2.8	2.4
ROCE (%)	25.0	15.7	18.7	21.6	22.8
RONW (%)	25.3	16.0	18.2	19.2	19.4

Source: Company; Sharekhan estimates

## Key conference call highlights

### Guidance

- ◆ Capex guidance of Rs. 7bn for FY2024 remains intact. The company has already spent Rs. 1.8bn in H1FY23 and expects to invest Rs. 4.0bn in H2FY2024.
- ◆ The company plans to file double-digit ANDA filing in FY2024.

### CZRO (Greenko) update

- ◆ Third-Party Technical Feasibility Report received is under the final review; discussion with AM Green (Greenko) is in progress.
- ◆ Management has identified and finalized two plants: One at Vizag (12 acres) and another at Kakinada (100 acres).
- ◆ Phase 1 update at Vizag –
- ◆ DCDA pilot plant – Will be completed by February 2024 and the final plant will be completed in FY2025.
- ◆ PAP plant – Projection is expected to be completed by the end of FY2025.
- ◆ Project work of phase 2 at Kakinada is expected to start in FY2025.
- ◆ Ongoing collaboration with multiple partners on technological know-how for molecules envisaged under CZRO for Kakinada.
- ◆ Aiming to get a leadership position in Paracetamol and Metformin.

### Business highlights

- ◆ Price erosion was partially offset by significant volume growth in North America business.
- ◆ Europe sales declined due to increased price erosion.
- ◆ Volume decline continued in Latin America (y-o-y), primarily on account of inventory correction by customers in these regions coupled with demand challenges.
- ◆ Decline in the API segment on a y-o-y basis was led primarily by reduction in the prices of the key products, which were reduced in line with the decline in key raw-material prices (no impact on margins).
- ◆ Share of the PFI business has reduced y-o-y, as more customers are converting into FD from PFI, coupled with correction in inventories in LATAM markets.
- ◆ FD volumes increased significantly in the U.S. across major products.
- ◆ The company has received ANDA approval for Esomeprazole Magnesium Delayed-Release Capsules, Losartan and Hydrochlorothiazide Tablets and Acetaminophen and Ibuprofen Tablets, 250/125 mg (OTC).
- ◆ The company currently has 33 US DMFs, 24 CEPs, five EDMF, eight KDMF, four Canadian DMFs, four China DMFs, two Japanese DMFs, and 50 filed across several regions.
- ◆ The company launched four products in the U.S. and one product in the U.K. in H1FY2024 and expects to launch about seven products in the U.S., two products in South Africa, two products in the U.K. and two products in Europe in H2FY2024.
- ◆ Granules expects to file new dosage forms in 41 products under various stages of development – expected to file in FY2024 and FY2025.
- ◆ Formulation sales were the major contributors for growth in the U.S. market. Most of the growth was from existing formulation products and the rest from new launches. Formulation sales increased mainly due to shift of most of the PFI customers towards FD.
- ◆ Going forward, management believes FD will grow and PFI and API growth will be subdued.
- ◆ ROCE as of September 2023 stood at 12.8%.
- ◆ Net debt during the quarter stood at Rs. 9.9bn. Debt is in foreign currency, Rs. 1.50bn is long-term debt, and the rest is short-term working capital debt.

- ◆ Net debt to EBITDA for Q2FY2024 was at 1.41x.
- ◆ Working capital days in Q2FY2024 was 162 days.
- ◆ Operating cash flow as of September 2023 was Rs 329mn.
- ◆ Capex for Q2FY2024 was at Rs. 129mn
- ◆ R&D expense during the quarter was Rs. 496mn.
- ◆ Net zero emission is targeted by 2050.
- ◆ Staff expense increased due to manpower hired as MUPs blocks and packaging plant were fully operational, but there was some delay in launches. By the end of Q4FY2024, the plant is expected to generate revenue and cover the increase in manpower costs.
- ◆ The company has ramped up manpower by 50% vs. FY23 for both API and formulation put together.
- ◆ Launch of Metoprolol has been delayed. It is expected to be launched by the end of Q3FY2024 or early Q4FY2024, which will drive U.S. sales further.
- ◆ Raw-material cost benefit and cost improvement benefit were largely offset by product mix and price erosion.
- ◆ Inventory built-up was largely due to new launches and to serve U.S. region.
- ◆ No inventory write-off issues seen in H2FY2024.
- ◆ Product mix for 2 to 3 years down the line will be in the same range, formulation contribution will be beyond 60%.
- ◆ Management highlighted that legacy products will continue to grow, while new products will be more profitable but volumes may not be at the same level. However, it expects the legacy brand to contribute 65% to total sales.
- ◆ The company has already received PLI approval for 8000 TPA DCDA projects and management plans to get approval beyond 8000 TPA (Can be applied to receive approval for 30,000 TPA).

#### **IT incident update**

- ◆ Production and sales restored to normalcy.
- ◆ The company has enhanced its security environment.
- ◆ The company initiated continuous improvement process for systems and security are put in place.
- ◆ Launches in the U.S. and other geographies were delayed and are expected in Q3 and Q4 of FY2024, which will contribute to higher revenue and profitability.
- ◆ A part of sales lost in Q1FY2024 and Q2FY2024 is irrecoverable. Operations in October 2023 were normal and the company expects Q3 and Q4 of FY2024 to be normal quarters.

#### **Facility inspection update**

- ◆ ANVISA audit completed for Gagillapur formulations plant and Bonthapally API plant and cGMP approval received.
- ◆ PMDA, Japan certification received for Bonthapally and Jeedimetla API plants.
- ◆ Canada audit completed with zero observations for the Jeedimetla API plant.
- ◆ Management has signed an MOU with NIPER Mohali to establish a Centre of Excellence in Innovative and Sustainable Pharmaceutical Development.
- ◆ Construction at Genome Valley is progressing at a good pace. The company has completed its first phase in October 2023 and expects to complete its next phase by May 2024, with 2.5bn dosage p.a. capacity. All phases are expected to be completed by December 2024, whereby Genome Valley will add 8bn dosages p.a. capacity to the existing finished dosages capacity.
- ◆ Granules has recently launched a new greenfield packaging facility in Virginia, with which the company has enough capacity to cater to emerging new opportunities and demand in the near term.

### Results (Consolidated)

					Rs cr
Particulars	Q2FY24	Q2FY23	Y-o-Y %	Q1FY24	Q-o-Q %
Total Income	1189.5	1150.7	3.4	985.5	20.7
Expenditure	976.5	907.8	7.6	848.8	15.1
Operating profit	213.0	242.9	-12.3	136.8	55.7
Other income	1.5	4.8	-68.1	0.3	339.7
EBIDTA	214.5	247.7	-13.4	137.1	56.5
Interest	26.0	13.2	96.3	22.5	15.6
Depreciation	52.5	44.1	19.2	49.2	6.7
PBT	136.0	190.4	-28.6	65.4	108.0
Tax	33.9	45.3	-25.2	17.6	92.9
Adjusted PAT	102.1	145.1	-29.6	47.8	113.5
Rep. EPS (Rs.)	4.1	5.8	-29.6	1.9	113.5
<b>Margins</b>			<b>BPS</b>		<b>BPS</b>
GPM (%)	48.1	43.8	430	56.3	-816
OPM (%)	17.9	21.1	-320	13.9	403
Net profit margin (%)	8.6	12.6	-402	4.9	373
Tax rate (%)	24.9	23.8	113	26.9	-195

Source: Company; Sharekhan Research

### Segment-wise revenue break-up

					Rs cr
Particulars	Q2FY24	Q2FY23	Y-o-Y %	Q1FY24	Q-o-Q %
API	302.1	330	-8.5	300	0.7
FD	741.7	586	26.7	537	38.0
PFI	146	235	-38.0	148	-1.7
Total	1,190	1150.8	3.4	985.5	20.7

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector View – Input cost easing with companies focusing on complex product launches

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global peers. A confluence of other factors, including a focus on specialty/complex products in addition to emerging opportunities in the API space, would be key growth drivers over the long term. The sector is witnessing an easing of input costs – of raw material, freight and power, which are expected to aid the sector in expanding margins. The sector is also witnessing an easing of price erosion followed by increasing contribution from new product launches. We believe the sector is in a sweet spot, where it is experiencing a healthy product mix and cost rationalisation, which increases operational profit of the companies. The sector is mainly a low-debt sector and increasing operational profit followed by experiencing advantages of low tax rate due to its operations in the SEZ sector, hence overall, we stay positive on the sector.

### ■ Company Outlook – Cost pressures to continue partially offset by strong sales growth and productivity measures.

Granules is a fully integrated pharmaceutical company present across the API-PFI-FD value chain. Over the long term, the company's growth levers are intact. As FY2023 could stage an improvement, regaining normalcy i.e., previous period margins and growth, apparently is likely over the medium term. Nevertheless, raw-material and freight costs are easing q-o-q. 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 and a strong product pipeline across regions to support growth. We believe given the recent unfavourable change in the product mix and expected rise in R&D spending coupled with increased finance and depreciation costs, and continued price erosions seen in the formulations segment together with the increase in the share of regulated markets, the outlook on profitability weakens; nevertheless, strong sales growth coupled with productivity measures should help it offset its impact partially over short to medium term.

### ■ Valuation – Maintain Buy with a revised PT of Rs. 417

The company has been witnessing strong growth for its FDF sales, especially for Paracetamol Finished Dosages (FDs) which are growing strongly in regulated markets like North America and U.K. We believe the worst is over for Granules and H2 is expected to witness signs of recovery, led by new product launches and volume growth driving strong sales growth coupled with productivity measures will lead to decent earnings growth for the company in the short to medium term. At the CMP, the stock is trading at attractive levels of ~14.7x/12.4x its FY2024E/FY2025E earnings vs. its peers trading at ~21.0x/17.1x their FY2024E/FY2025E EPS estimates. We maintain Buy with increased PT of Rs. 417.

## 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 revenue, while LATAM accounts for 11% of revenue and RoW markets constitute around 16% of revenue.

## Investment theme

Granules is a fully integrated pharmaceutical company present across the API-PFI-FD value chain. Over a long-term period, the company's growth levers are intact, and this bodes well. However, in the near term, there have been severe headwinds that could substantially overweigh on the financial performance. Though FY2023 could stage an improvement, but regaining normalcy i.e. previous period margins and growth, apparently is a challenge. As raw material-prices are looking up coupled with higher and firm logistics costs, the price increase is inevitable, though channel de-stocking across the segments could act as a dampener. Therefore, as markets open and Covid cases ease out, the business would evolve towards to a new normal and this could moderate the growth prospects. Though Granules is taking measures to reduce dependence on China and initiating a price hike across customers, these could take a while to be reflected in the financials, clearly pointing at near-term challenges. We believe the revival remains a key monitorable. However, positives such as the commissioning of the MUPS block and product pipeline across regions could support growth. We believe new product launches in the U.S., tapping new geographies, and augmented capacities will support the base business as well as the 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 U.S.
- ♦ Adverse outcome of USFDA inspection at the 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 Tummla	Company Secretary & Compliance Officer

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FIL Ltd	6.38
2	Norges Bank	3.19
3	FMR LLC	3.08
4	BNP Paribas SA	2.48
5	Vanguard Group Inc.	2.14
6	Dimensional Fund Advisors LP	1.83
7	TYCHE Investments Pvt Ltd.	1.50
8	Mahima Stocks Pvt Ltd.	1.39
9	Aditya Birla Sun Life AMC	1.34
10	Alliance Bernstein LP	0.99

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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