



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	✓	↔	✓

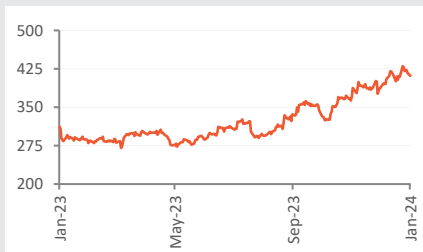
Company details

Market cap:	Rs. 10,230 cr
52-week high/low:	Rs. 435 / 267
NSE volume: (No of shares)	34.19 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	3.7	24.8	33.1	31.7
Relative to Sensex	5.1	14.9	27.0	16.2

Sharekhan Research, Bloomberg

Granules India Ltd

Strong sequential recovery

Pharmaceuticals

Sharekhan code: GRANULES

Reco/View: Buy



Upgrade



Maintain

CMP: Rs. 412

Price Target: Rs. 500



Downgrade

Summary

- Granules reported mixed set of earnings where revenue reported flat on yearly basis to Rs 1,155 crs (1% below our estimates), EBITDA grew by 8% YoY to Rs 2505 Crs (5% above our estimates) and PAT grew by 1% YoY to Rs 125 crs (1% below our estimate).
- Healthy traction in value added product in the US region in the Formulation's segment followed by RM cost rationalization led to an increase in EBITDA margin towards all time high levels of 21.7%.
- Capex guidance lowered from Rs 700 Crs to Rs 600 Crs in FY25E due to delay in the execution of Kakinada plant. As on 9MFY24, the company spent Rs 83 crs Capex and intends to spend Rs 500 crs by FY24E.
- The company expects leadership in key molecules like Metformin and Paracetamol by setting up backward integration through KSM plants of DCDA and PAP, hence we have increased our FY25 and FY26 earnings estimates. We have increased our FY25 EPS by 7% to Rs 31.8 per share and FY26E EPS by 18% to Rs 40.5 per share. At the CMP, the stock is trading at attractive levels of ~13x/10.2x its FY2025E/FY2065E earnings, thus we maintain Buy with increased price target (PT) of Rs.500

Granules India Limited (Granules) reported mixed set of numbers in Q3FY2024 where sales were flat on YoY basis due to lower realization in key molecules like Paracetamol across geographies. Segment-wise sales growth was driven by 46% YoY in its formulations segment (~66% of sales) which was offset by 46% YoY growth in the API segment (19% of sales) and 21% YoY growth in the FPI segment (15% of sales). The management is undergoing a paradigm shift of increasing its focus from Phase 2 to Phase 3 & 4 of clinical trials. During the quarter, Value added contribution increase from 48% in 3QFY23 to 57% in 3QFY24 led by better product mix driven by new product launches in the formulations segment and easing of Raw Material cost. During the quarter contribution from top 5 molecules have lowered from 85% to 72%, paving way for new product launches (4-5 products launched in the US market during the quarter). Rise in value added products in the FDF segment in the US region resulted in 860 bps YoY increase in Gross Margins at 57%. Despite higher R&D cost of Rs 47crs during the quarter, EBITDA margin increased by 150 bps YoY to 21.7%. Healthy operations led to 1% YoY growth in PAT to Rs 126 crs. Going forward, the management expects the trend of higher contribution from the FDF segment to continue driven by new product launches (4-5 launches expected in US region in FY25) followed by easing of RM cost, thereby sustaining above 20% EBITDA Margins.

Key positives

- FDF segment contribution increased to 66% in 3QFY24 from 62% contribution in 2QFY24 and 46% contribution in 3QFY23.
- Valued added product contribution increased from 48% in 3QFY23 to 57% in 3QFY24.
- Margins reported towards all time high of 57% Gross Margin and 21.7% EBITDA Margin.
- The North America region grew by 21% YoY to Rs 760 crs.

Key negatives

- API and PFI segment continues to decline by 46% YoY and 21% YoY respectively due to lower prices of Paracetamol
- LATM business declined by 39% YoY to Rs 58 crs due to inventory correction by customers in the region.
- Europe declined by 16% YoY to Rs 227 crs due to Paracetamol price erosion in the European region.

Management Commentary

- Formulation segment to drive the volume growth in the short to near terms, primarily in North America and Europe.
- DCDA plant at Vizag with a capacity of 108 tons per annum is expected to start by Q4 FY '24
- PAP plant at Vizag with 10,000 ton capacity which is expected to be completed by FY25E.
- Capex spent of 9MFY24 is Rs 283crs and expect to spend Rs 500 crs by FY24E and intend to spend Rs 600 crs in FY26E.

Revision in estimates – Due to subdued 1QFY24, 9m EPS growth is lower by 8% YoY. Hence we have lowered our FY24E EPS marginally by 1% to Rs 24.7. The management is confident of new product launches increasing the contribution in the value products, followed by commercialization of pilot projects of DCDA and PAP to bring leadership in Metformin and Paracetamol, thereby sustaining above 20% EBITDA Margins, Hence we have increased our FY25 EPS by 7% to Rs 31.8 per share and FY26E EPS by 18% to Rs 40.5 per share.

Our Call

View – Maintain Buy with a revised PT of Rs. 500: Granules reported healthy margins which were near to its all time highs led by increased traction in the value added products. The management believes the contribution of FDF segment to continue to remain higher and North America region to drive growth in the near term followed by European region in mid – long term. The management is confident of sustaining above 20% EBITDA Margin in the mid-long term driven by 1) new product launches, 2) increasing clinical trials in Phase 3 & 4 from earlier phase 2 trials, 3) commercialization of pilot projects of DCDA and PAP and 4) easing of input cost. The company expects leadership in key molecules like Metformin and Paracetamol by setting up KSM plants of DCDA and PAP, hence we have increased our FY25 and FY26 earnings estimates. We have increased our FY25 EPS by 7% to Rs 31.8 per share and FY26E EPS by 18% to Rs 40.5 per share. At the CMP, the stock is trading at attractive levels of ~13x/10.2x its FY2025E/FY2065E earnings, thus we maintain Buy with increased price target (PT) of Rs.500 (ascribing a PE of 12x).

Key Risks

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

Valuation (Consolidated)

Particulars	FY2022	FY2023	FY2024E	FY2025E	FY2026E
Net Sales	3764.9	4511.9	5034.0	5836.0	6788.2
EBIDTA	722.2	913.8	1107.5	1356.9	1680.1
OPM (%)	19.2	20.3	22.0	23.3	24.8
Adjusted PAT	412.8	516.6	627.3	807.0	1029.9
EPS (Rs)	16.2	20.3	24.7	31.8	40.5
PER (x)	25.4	20.3	16.7	13.0	10.2
EV/EBITDA (x)	15.4	12.3	8.5	6.4	4.6
P/BV (x)	4.0	3.7	3.2	2.7	2.2
ROCE (%)	15.7	18.7	21.0	23.8	26.3
RONW (%)	16.0	18.2	18.9	20.5	21.8

Source: Company; Sharekhan estimates

Key Conference call takeaways

Guidance

- ♦ Capex guidance lowered from Rs 700 Crs to Rs 600 crs in FY25E. The company has already spent Rs. 283 crs in 9MFY24 and expects to invest Rs. 500 crs by FY24E.
- ♦ The company plans to file double-digit ANDA filing in FY2024.

CZRO (Greenko) update

- ♦ **Management has identified and finalised 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 Q4FY24 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 at 6-8% in the North America region for the base products.
- ♦ Europe sales declined due to paracetamol 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 like Paracetamol 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 Sildenafil PFOS, Pantoprazole DR capsules and Esomeprazole Magnesium Delayed-Release Capsules.
- ♦ The company currently has total 75 dossiers approved and 21 global dossiers to be approved. The company has total 36 US DMFs, 24 CEPs, 5 EDMF, 9 KDMF, 5 Canadian DMFs, 5 China DMFs, 2 Japanese DMFs, and 50 filed across several regions.
- ♦ Going forward, management believes FD will grow and PFI and API growth will be subdued.
- ♦ ROCE as of December quarter stood at 15.3% as against 12.8% in 2QFY24.
- ♦ Launch of Metoprolol has been delayed due to ship going around the cape. The product will be launched once the ship reaches which will drive U.S. sales further.

Results (Consolidated)

				Rs cr	
Particulars	Q3FY24	Q3FY23	y-o-y %	Q2FY24	q-o-q %
Sales	1155.6	1146.1	0.8	1189.5	-2.9
Gross profit	572.0	503.9	13.5	554.4	3.2
Expenditure	905.1	914.8	-1.1	976.5	-7.3
Operating profit	250.5	231.3	8.3	213.0	17.6
Other income	0.7	0.9	-31.1	1.5	-57.4
EBIDTA	251.1	232.2	8.1	214.5	17.1
Interest	28.6	17.0	68.8	26.0	10.3
Depreciation	52.4	48.4	8.3	52.5	-0.3
PBT	170.1	166.9	1.9	136.0	25.0
Tax	44.4	42.6	4.4	33.9	31.1
Adjusted PAT	125.7	124.3	1.1	102.1	23.0
Reported PAT	145.1	80.7	79.8	127.6	13.7
Rep EPS (Rs)	5.1	5.0	1.1	4.1	23.0
Margins			BPS		BPS
GPM (%)	49.5	44.0	553	46.6	289
OPM (%)	21.7	20.2	150	17.9	377
EBIDTA margin (%)	21.7	20.3	147	18.0	370
Net profit margin (%)	10.9	10.8	3	8.6	229
Tax rate (%)	26.1	25.5	62	24.9	120

Source: Company; Sharekhan Research

Segment-wise revenue break-up

				Rs cr	
Particulars	Q3FY24	Q3FY23	y-o-y %	Q2FY24	q-o-q %
API	221.2	411	-46.1	302	-26.8
FD	765.8	522	46.6	742	3.2
PFI	169	213	-20.8	146	15.7
Total	1,156	1146	0.8	1189.5	-2.8

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. 500

Granules reported healthy margins which were near to its all time highs led by increased traction in the value added products. The management believes the contribution of FDF segment to continue to remain higher and North America region to drive growth in the near term followed by European region in mid – long term. The management is confident of sustaining above 20% EBITDA Margin in the mid-long term driven by 1) new product launches, 2) increasing clinical trials in Phase 3 & 4 from earlier phase 2 trials, 3) commercialization of pilot projects of DCDA and PAP and 4) easing of input cost. The company expects leadership in key molecules like Metformin and Paracetamol by setting up KSM plants of DCDA and PAP, hence we have increased our FY25 and FY26 earnings estimates. we have increased our FY25 EPS by 7% to Rs 31.8 per share and FY26E EPS by 18% to Rs 40.5 per share. At the CMP, the stock is trading at attractive levels of ~13x/10.2x its FY2025E/FY2065E earnings , thus we maintain Buy with increased price target (PT) of Rs.500 (ascribing a PE of 12x).

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 Tummala	Company Secretary & Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FIL Ltd	7.35
2	LIC	2.58
3	Fidelity Funds SICAV	2.34
4	Vanguard Group Inc.	2.21
5	Quant Money managers	2.20
6	Dimensional Fund Advisors LP	1.78
7	TYCHE Investments Pvt Ltd.	1.47
8	Blackrock Inc	1.18
9	Aditya Birla Sun Life AMC	1.17
10	Norges Bank	1.15

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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