



**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. 12,168 cr
52-week high/low:	Rs. 507/287
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	20.2	8.1	36.7	83.8
Relative to Sensex	13.7	0.4	26.4	59.8

Sharekhan Research, Bloomberg

**Granules India Ltd**  
Value-added products to drive margins

<b>Pharmaceuticals</b>	<b>Sharekhan code: GRANULES</b>		
<b>Reco/View: Buy</b>	↔	<b>CMP: Rs. 502</b>	<b>Price Target: Rs. 600</b>
↑ Upgrade	↔ Maintain	↓ Downgrade	

**Summary**

- We reiterate a Buy on Granules as the company is focusing on value-added products to increase its EBITDA margins to 22% plus from 19% in FY24.
- Granules is diversifying from being an API company to a formulations company by raising its formulation contribution from 65% to 70% in the next two years.
- Granules has recently received approval for Ibuprofen and Metoprolol Succinate PR tablets to be launched in value-added products.
- The company expects a leadership position in key molecules like Metformin and Paracetamol by setting up backward integration plants of key KSM DCDA and PAP. At CMP, the stock trades 20x/16x its FY2025E/FY2026E earnings and due to the rise in margin towards 22%, we ascribe a PE of 19x on FY26E EPS to arrive at a price target of Rs.600 (earlier Rs 515).

Granules is focusing on value-added formulation products to mitigate price erosion pressures in North American. Granules' Europe market was affected by a decline in the prices of Paracetamol, while LATAM region sales were impacted due to destocking in FY24. Granules has set up a pilot project for DCDA (KSM for Metformin), under CZRO, which was commercialised in Q4FY24. Post successful commercialisation of the DCDA pilot plant; the company intends to set up a DCDA plant of ~10,000 tonnes over 4-5 years under CZRO. Granules also intends to set up backward integration for Paracetamol by installing a 30,000-tonnes capacity for PAP under CZRO over 4-5 years. These investments would require a capex of Rs. 2,000 crore over 4-5 years with an annual outflow of Rs 600 crore. In the near term, the company intends to increase formulation capacity from the current 24 billion tablets to 36 billion tablets over a period of 2-3 years. Granules' formulation segment is expected to grow at a CAGR of 21% to Rs 4,291 crore due to aggressive capex plan of expanding its capacity to 8.5 billion from the current 2.5 billion in its Genome Valley formulation facility and launch of new products in the value-added products. Thus, we maintain a Buy on the stock.

**Focus on value-added products to drive margins**

Granules' value-added formulations contributed 65% of sales in FY24 as compared to 50% in FY23. The surge is primarily on account of better product mix and stability in price erosion in the formulations segment. Granules product mix is shifting from legacy five products (Paracetamol, Metformin, Ibuprofen, Guaifenesin and Methocarbamol) to new products in the value-added segment. The contribution of legacy products has lowered from 84% in FY23 to 75% in FY24 and contribution of new products have increased from 16% in FY23 to 25% in FY24. An increase in value-added products to result in an increase in EBITDA Margin of 22% from an average of 18%. In-order to increase focus towards value-added products, Granules has entered large and complex molecules and increased its R&D pipeline for the formulation segment. Granules is making substantial investments in R&D, driven by its strategic intention to enter products with minimal competition, such as oncology treatments. Due to a focus on value-added products and increasing focus towards penetrating newer geographies, we expect the formulation division to grow by 21% CAGR from FY24E-26E.

**Launch of complex products in the regulated market to spur growth**

Granules continues to report healthy growth in the US led by volume growth in its core products. Granules has launched 35-36 ANDAs, particularly in the US, to date. This has resulted in revenue share gain from the US/European market from 57% in FY23 to 66% in FY24. Further, it plans to enhance its revenue share from the regulated market by filing complex products and increasing its focus on enzyme and fermentation technology. The management expects to launch a couple of complex products in complex therapy, like Oncology, in the regulated market, which would support overall growth for the company in 12-15 months. Hence, we expect sales to grow at 14% CAGR from FY24 to FY26E to Rs 5,843 crore.

**Backward integration to maintain leadership position in core products**

Granules intends to backwards integrate its key products Metformin and Paracetamol by manufacturing its key raw materials like Para-amino Phenol (PAP) and Dicyandiamide (DCDA), which are key ingredients for making Paracetamol and Metformin, respectively. Granules is setting up a pilot project in DCDA which has been commercialised in Q4FY24. The successful commercialisation of the DCDA pilot plant, the company intends to set up a DCDA plant of ~10,000 tonnes over 4-5 years under CZRO. Granules also intends to set up backward integration for Paracetamol by installing a 30,000 tonnes capacity of PAP also under CZRO over 4-5 years. Granules is working across the value chain to improve sales prospects and maintain leadership position in Metformin and Paracetamol along with higher profitability in 3-5 years. Going forward, we expect the company's backward integration and better product mix to drive EBITDA margins to 22% in FY26E from 19% in FY24E.

**Our Call**

**View - Maintain Buy with increased PT of Rs. 600:** Granules reported all time high quarterly margins led by increased traction in value-added products. Going forward, contribution of the value-added segment will continue to remain higher driven by increased traction in North America followed by the European region in the long term. The management is confident of sustaining above 20% plus EBITDA Margin in the mid-long term driven by 1) Complex product launches, 2) increasing clinical trials in Phase 3 & 4 from earlier Phase 2 trials, 3) commercialisation 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 backward integration plants of key KSM DCDA and PAP hence we maintain BUY on the stock. At the CMP, the stock trades at ~20x/16x its FY2025E/FY2026E earnings of Rs 24.6 and 31.6 per share. Due to increase in margin trajectory from value added products, we ascribe a PE of 19x on FY26E EPS to arrive at a price target of Rs.600. (Earlier Rs 515).

**Key Risks**

- 1) Regulatory compliance risks, including delay in product approvals; 2) Currency risk; and 3) Delay in resolution of USFDA observations at the Halol plant.

**Valuation (Consolidated)**

Particulars	FY2022	FY2023	FY2024	FY2025E	FY2026E
Net Sales	3765	4512	4506	5074	5843
EBIDTA	722	914	856	1129	1338
EBITDA M (%)	19.2	20.3	19.0	22.3	22.9
Adjusted PAT	413	517	405	595	765
EPS (Rs)	16.2	21.3	16.7	24.6	31.6
PER (x)	31.1	23.7	30.2	20.5	16.0
EV/EBITDA (x)	18.7	14.3	15.3	8.4	6.6
P/BV (x)	5.0	4.3	3.8	3.3	2.9
ROCE (%)	15.7	18.7	14.3	18.2	20.2
RONW (%)	16.0	18.2	12.6	16.2	17.9

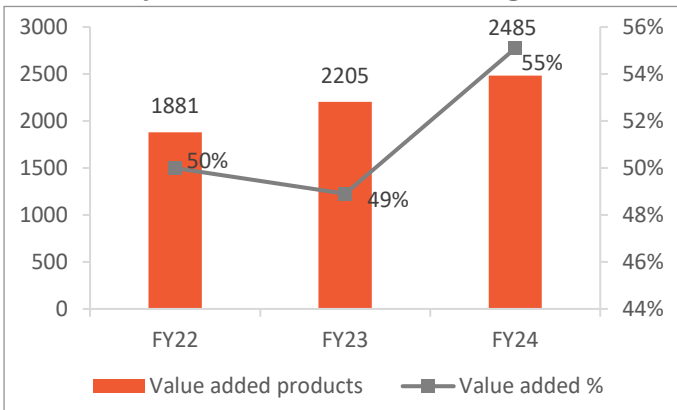
Source: Company; Sharekhan estimates

## Business highlights

### Focus on value-added products to increase margins

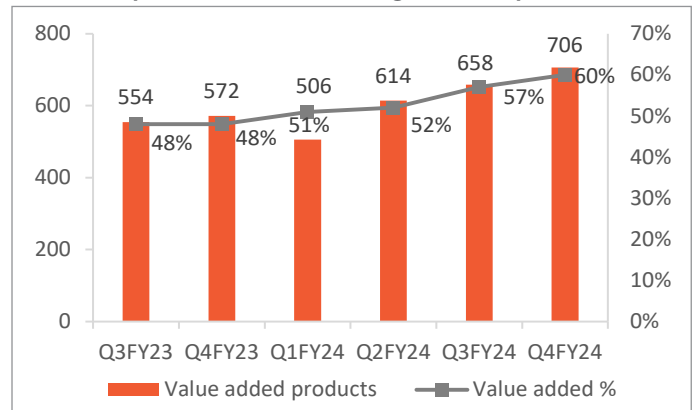
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#### Value added products recorded at an all time high



Source: Company, Sharekhan Research

#### Value added product contribution is rising due to new product launches

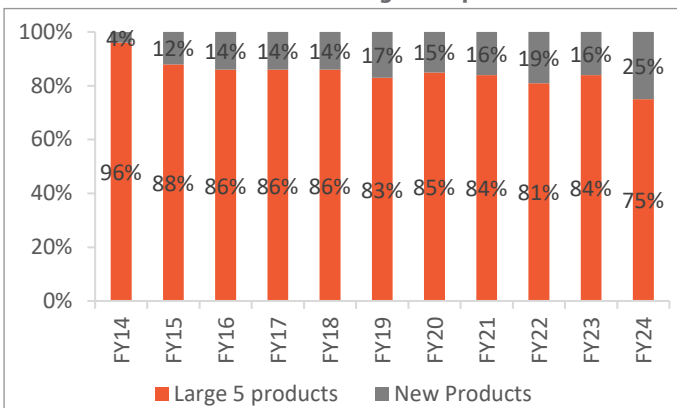


Source: Company, Sharekhan Research

### Launch of complex products in the regulated market to spur growth.

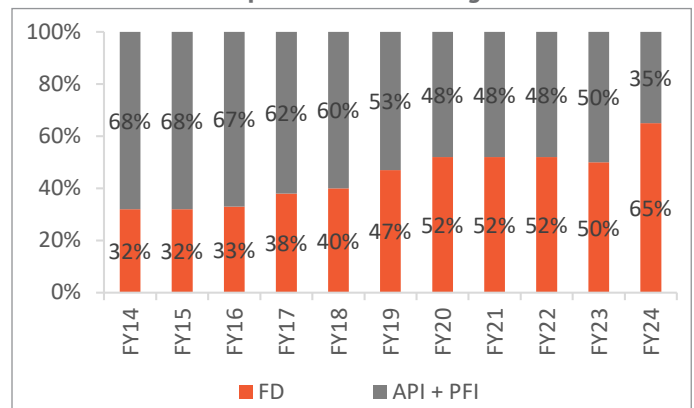
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#### Focus on R&D resulted in all time high new product launches



Source: Company, Sharekhan Research

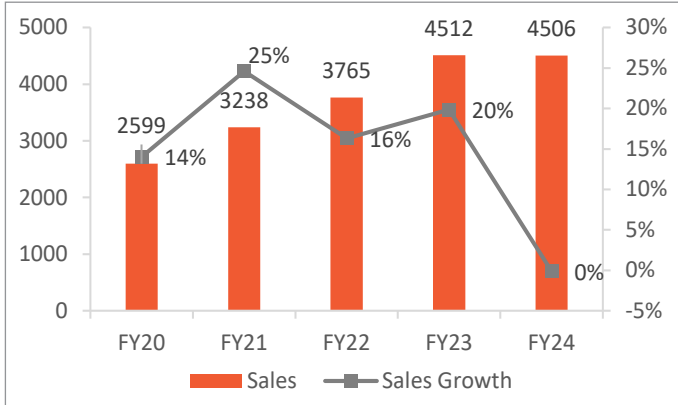
#### Focus on value added products is increasing formulation's share



Source: Company, Sharekhan Research

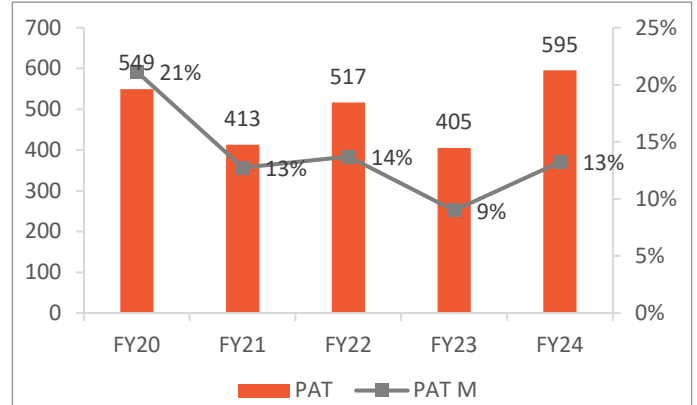
Financials in charts

Sales growth flat due to pricing Ibutrofen pricing pressure



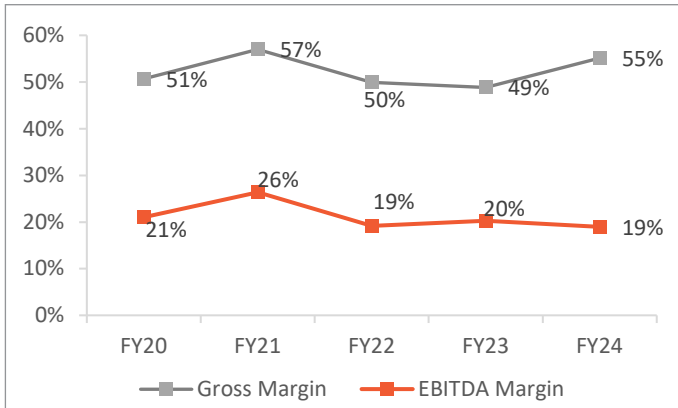
Source: Company, Sharekhan Research

Healthy operations resulted in higher profitability



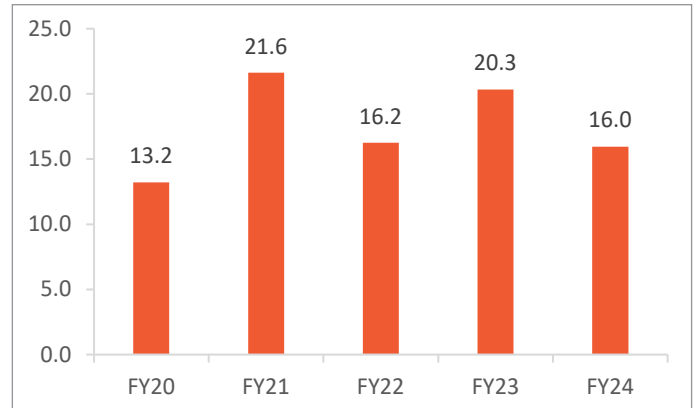
Source: Company, Sharekhan Research

Increase focus in Value added products resulted in higher margins



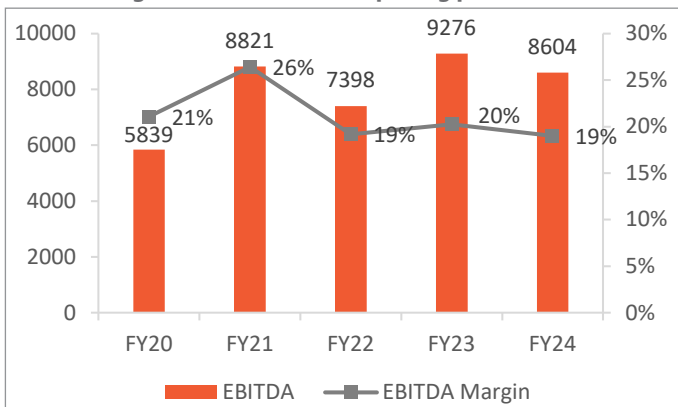
Source: Company, Sharekhan Research

EPS Trend



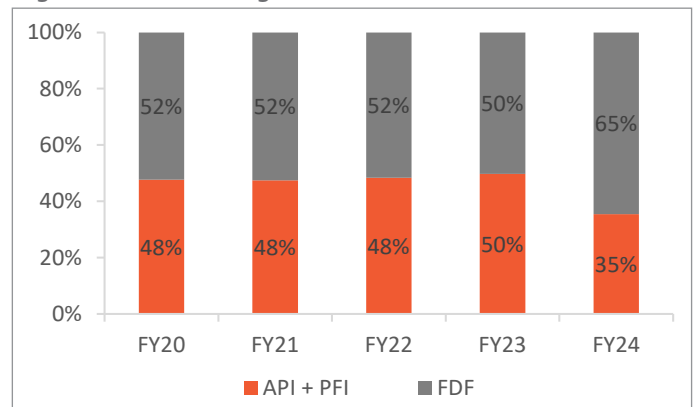
Source: Company, Sharekhan Research

EBITDA Margins contracted due to pricing pressure



Source: Company, Sharekhan Research

Higher R&D resulted higher contribution of FDF



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 speciality/complex products and emerging opportunities in the API space, would be key growth drivers over the long term. The sector is witnessing an easing of input costs – raw material, freight and power - expected to aid the sector in expanding margins. The sector is also witnessing an easing of price erosion followed by increasing contributions 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 the operational profit of the companies. The sector is mainly a low-debt sector with rising operational profit followed by experiencing advantages of a low tax rate due to its operations in the SEZ sector; hence, overall, we stay positive on the sector.

### ■ Company outlook - Cost pressures continue to be partially offset by strong sales growth and productivity measures

Granules is a fully integrated pharmaceutical company that is present across the API-PFI-FD value chain. Over the long term, growth levers are intact. As FY2023 could stage an improvement, regaining normalcy i.e., previous period margins and growth, apparently are likely over the medium term. Nevertheless, raw material and freight costs are easing q-o-q. Measures taken to reduce dependence on China and initiate a price hike across customers will help offset any concerns around China, leading to API price increases. Positives continue to be the 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 the short to medium term.

### ■ Valuation - Maintain Buy with increased PT of Rs. 600

Granules reported all time high quarterly margins led by increased traction in value-added products. Going forward, contribution of the value-added segment will continue to remain higher driven by increased traction in North America followed by the European region in the long term. The management is confident of sustaining above 20% plus EBITDA Margin in the mid-long term driven by 1) Complex product launches, 2) increasing clinical trials in Phase 3 & 4 from earlier Phase 2 trials, 3) commercialisation 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 backward integration plants of key KSM DCDA and PAP hence we maintain BUY on the stock. At the CMP, the stock trades at ~20x/16x its FY2025E/ FY2065E earnings of Rs 24.6 and 31.6 per share. Due to increase in margin trajectory from value added products, we ascribe a PE of 19x on FY26E EPS to arrive at a price target of Rs.600. (Earlier Rs 515).

## 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. It supplies them to both regulated and semi-regulated markets. The regulated markets constitute around 73% of revenue, LATAM accounts for 11%, and RoW markets constitute around 16% of revenue.

## Investment theme

Granules is a fully integrated pharmaceutical company that is present across the API-PFI-FD value chain. Over a long-term period, the company's growth levers are intact, which bodes well. However, in the near term, that could substantially outweigh 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 rising 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 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 commissioning 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 help the base business as well as the emerging business.

## Key Risks

- ◆ Delays in product approvals or negative outcomes of facility inspections 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: BSE; 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	
<b>Positive</b>	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
<b>Neutral</b>	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
<b>Negative</b>	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	
<b>Positive</b>	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
<b>Neutral</b>	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
<b>Negative</b>	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	
<b>Positive</b>	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.
<b>Neutral</b>	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
<b>Negative</b>	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

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