

Granules India

BUY

Strong quarter

We maintain **BUY** on Granules following yet another quarter of robust YoY growth driven by expanded capacities. EBITDA margin at 19.9% was 300bps above estimates, despite a 5% miss on revenue. Our TP is unchanged at Rs 170 (12x FY21E EPS).

HIGHLIGHTS OF THE QUARTER

- Revenue growth of 31% YoY was driven by new launches, market share gains, and utilization of expanded facilities in the formulations segment. The sequential dip of 3% was on account of lower API sales in India and ROW, intentionally subdued to protect profitability. The business mix improved with 72% of revenue coming from US & EU (v/s 61% YoY).
- Formulations revenue grew 58% YoY to Rs 2.86bn with expanded facilities and traction gained in high-volume products like Paracetamol and Metformin. Growth in API revenues was slower at 18% YoY to Rs 2.14bn owing to delayed approvals from expanded API capacities. PFI sales at Rs 952mn grew 5% YoY.
- Gross margin improved 490/450bps YoY/QoQ to 50.4% led by improved mix within formulations (higher no. of front-end products), and ramp up in US sales. GM is sustainable at current levels owing to stable raw material prices, better mix, higher US/EU contribution, and backward integration in place for most products. EBITDA margin at 19.9% was up 390/400bps YoY/QoQ.

Financial Summary (Consolidated)

(Rs mn)	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)	FY18	FY19	FY20E	FY21E
Net Sales	5,953	4,532	31.3	6,133	(2.9)	16,918	22,792	26,688	30,866
EBITDA	1,186	726	63.4	976	21.5	2,784	3,840	4,711	5,826
APAT	832	518	60.7	640	30.0	1,326	2,364	2,888	3,541
Diluted EPS (Rs)	3.3	2.0	60.7	2.5	30.0	5.2	9.3	11.4	13.9
P/E (x)						17.4	9.8	8.0	6.5
RoE (%)						12.0	16.7	17.5	18.5

Source: Company, HDFC sec Inst Research

- PAT stood at Rs 832mn, up 61/30% YoY/QoQ. Profits from JVs at Rs 255mn grew 74/34% YoY/QoQ and led to the beat of 23% to our estimates. Profits from JVs will be subdued over the remainder of FY20 due to: (1) Biocause plant shutdown, and (2) lower than anticipated offtake in Omnichem.
- Net debt reduced by Rs 450mn to Rs 8.63bn QoQ. FCF was at Rs 600mn for the quarter. **Promoter pledge (43% of holding) will reduce by 7-10% in a few days.**
- Near-term outlook:** Reduction in promoter pledge will drive re-rating, amidst strong operating performance.

STANCE

The mgmt is confident in achieving 20/25% revenue/PAT CAGR over the next few years driven by the ramp up in formulations and US sales by leveraging its expanded facilities. Increased efficiencies and oplev will enable EBITDA margin improvement (+200bps to 19% over FY19-21E). With limited capex requirements over the next few years, healthy FCF (Rs 1.5bn+ annually) will enable debt reduction (net debt at Rs 8.63bn now).

We model 16/23/22% revenue/EBITDA/PAT CAGR over FY19-21E. At 8.0/6.5x FY20/21E EPS, Granules is trading at a steep discount to peers. Improving fundamentals and promoter pledge release will drive re-rating.

INDUSTRY	PHARMA
CMP (as on 31 Jul 2019)	Rs 91
Target Price	Rs 170
Nifty	11,118
Sensex	37,481

KEY STOCK DATA

Bloomberg	GRAN IN
No. of Shares (mn)	254
MCap (Rs bn) / (\$ mn)	23/336
6m avg traded value (Rs mn)	106

STOCK PERFORMANCE (%)

52 Week high / low	Rs 123/79		
	3M	6M	12M
Absolute (%)	(18.9)	(0.5)	(11.6)
Relative (%)	(15.0)	(3.9)	(11.3)

SHAREHOLDING PATTERN (%)

	Mar-19	Jun-19
Promoters	42.90	42.90
FIs & Local MFs	3.01	3.11
FPIs	12.77	13.88
Public & Others	41.32	40.11
Pledged Shares*	18.62	18.62

Source : BSE; *% of total

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Revenue growth of 31% YoY was driven by expanded capacities for API and formulations

Gross margin expanded 490-440bps YoY/QoQ owing to improved product and geographic mix

R&D spend for the quarter was Rs 340mn; 6% of revenue. The budget for FY20E is ~Rs 1.50bn, 50-55% of which will be capitalized

Granules has recommended an interim dividend of Rs 0.25/sh

Net debt reduced by Rs 0.45bn QoQ to Rs 8.63bn. Mgmt expects a further ~Rs 1bn decrease over FY20E

Capex was Rs 0.54bn, estimate ~Rs 1.50bn for FY20E

Quarterly Financials Snapshot (Consolidated)

Particulars	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)
Net Sales	5,953	4,532	31.3	6,133	(2.9)
Material Expenses	2,954	2,471	19.5	3,316	(10.9)
Employee Expenses	570	503	13.5	513	11.1
Other Expenses	1,242	832	49.2	1,328	(6.5)
EBITDA	1,186	726	63.4	976	21.5
Depreciation	287	245		274	
EBIT	900	481	87.1	702	28.2
Other Income	19	147		19	
Interest Cost	69	65		68	
PBT	849	563	50.9	652	30.2
Tax	272	191		202	
Minority Interest	255	146	74.2	190	34.2
APAT	832	518	60.7	640	30.0

Source: Company, HDFC sec Inst Research

Margin Analysis

	1QFY20	1QFY19	YoY (bps)	4QFY19	QoQ (bps)
Material Expenses % Net Sales	49.6	54.5	(490)	54.1	(443)
Employee Expenses % Net Sales	9.6	11.1	(151)	8.4	121
Other Expenses % Net Sales	20.9	18.4	249	21.7	(79)
EBITDA Margin (%)	19.9	16.0	391	15.9	401
Tax Rate (%)	32.0	34.0	(195)	30.9	106
APAT Margin (%)	14.0	11.4	256	10.4	354

Source: Company, HDFC sec Inst Research

Granules continues to focus on regulated markets. US and EU accounted for 50/22% of total sales in 1QFY20

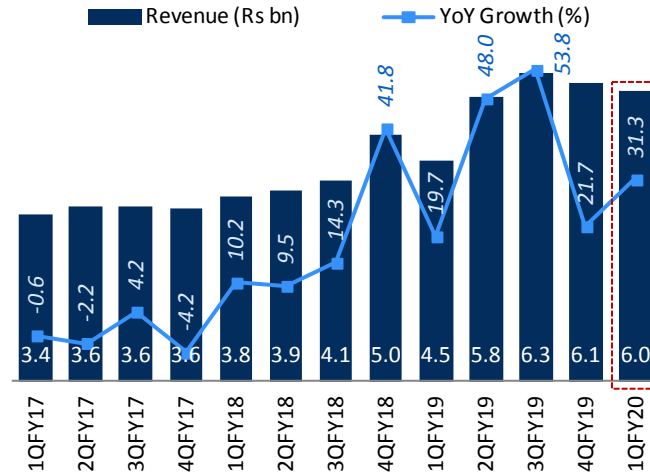
Formulations sales were driven by growth in US (+56% YoY)

The business mix continues to improve, with formulations contributing 48% of total sales in 1QFY20

EBITDA margin improved on the back of gross margin expansion. Mgmt believes it can improve beyond 20% over FY20E

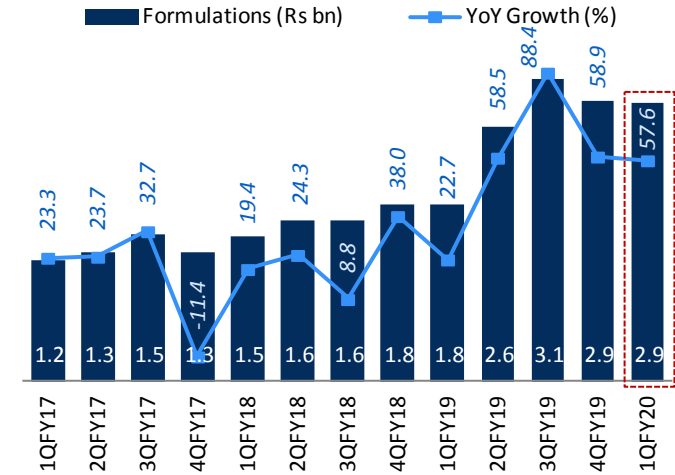
Price erosion in US is stable. Raw material prices have not seen a significant change QoQ

Revenue: Growth Driven By Expanded Capacities



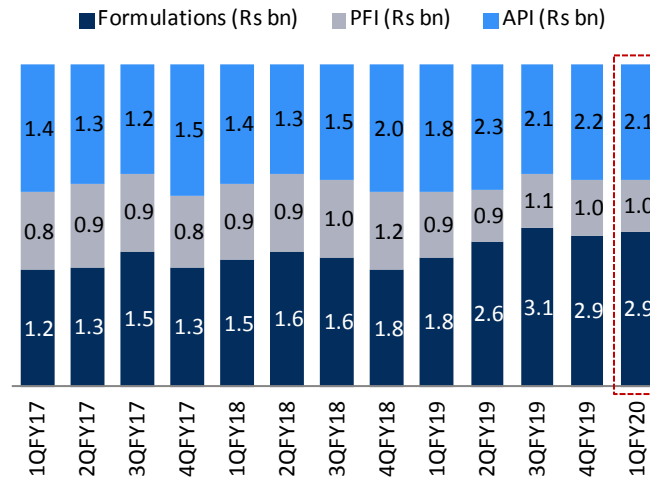
Source: Company, HDFC sec Inst Research

Formulations: Ramp Up In US Continues



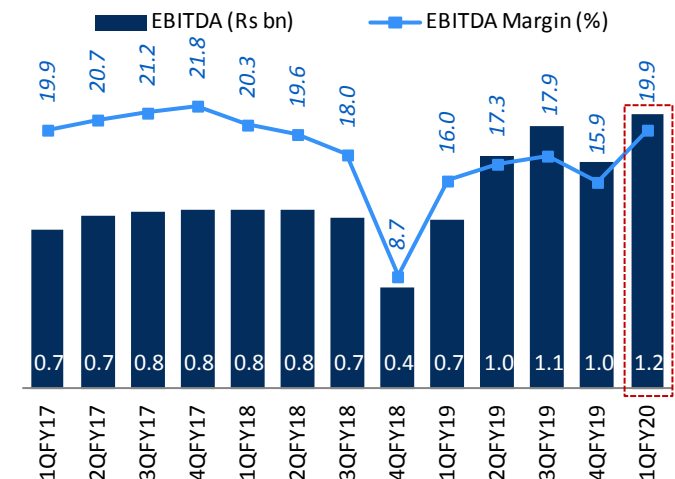
Source: Company, HDFC sec Inst Research

Mix: Formulations Is Now 48% Of Revenue



Source: Company, HDFC sec Inst Research

EBITDA Margin: Expansion Led By Better Mix



Source: Company, HDFC sec Inst Research

Revenue growth was aided by high-volume molecules including Paracetamol, Metformin, Ibuprofen, Guaifenesin, Naproxen, Methocarbamol, Cetirizine, and Fexofenadine. 1QFY20 also saw an uptick in gMethergine sales

Granules filed 3 ANDAs, and received 2 approvals during the quarter. Expect more 12/8/6 US filings/ approvals/ launches over FY20E

API sales are expected to ramp up in FY20E with expanded facilities

PFI can achieve stable growth owing to ramp up in high-volume products

The Biocause/Omnichem JVs contributed Rs 300/-45mn to PAT in 1QFY20. However, they will remain subdued over the rest of FY20E

Segmental Quarterly Performance

(Rs mn)	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)
Finished Dosages	2,857	1,813	57.6	2,883	(0.9)
PFI	952	906	5.1	1,043	(8.7)
APIs	2,143	1,813	18.2	2,208	(2.9)
Total	5,953	4,532	31.3	6,133	(2.9)

Source: HDFC sec Inst Research

Assumptions

Key Segments (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Finished Dosages	5,388	6,582	10,760	12,912	15,236
Growth (%)	22.0	22.2	63.5	20.0	18.0
PFI	3,401	4,046	3,870	4,257	4,683
Growth (%)	(11.5)	19.0	(4.4)	10.0	10.0
APIs	5,380	6,230	8,200	9,519	10,947
Growth (%)	18.6	15.8	31.6	16.1	15.0
Total	14,169	16,858	22,830	26,688	30,866
Growth (%)	1.2	19.0	35.4	16.9	15.7

Source: HDFC sec Inst Research

Peer Set Comparison

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E
Sun Pharma	1,024	427	BUY	540	12.7	14.9	18.0	24.6	33.6	28.7	23.7	17.4	8.2	9.0	10.0	12.4
Divi's Labs	434	1,634	SELL	1,445	32.4	48.8	56.7	65.6	50.5	33.5	28.8	24.9	15.2	20.1	20.4	20.8
Dr Reddy's Labs	428	2,575	BUY	3,360	59.2	104.9	128.4	148.8	43.5	24.6	20.0	17.3	7.8	13.1	14.3	14.5
Cipla	420	521	BUY	625	18.5	19.0	20.7	28.4	28.1	27.4	25.1	18.4	11.2	10.5	10.6	12.9
Lupin	346	765	BUY	910	38.1	16.4	41.2	41.3	20.1	46.6	18.6	18.5	12.8	5.4	12.8	11.7
Aurobindo Pharma	335	571	BUY	790	41.7	42.9	48.8	52.8	13.7	13.3	11.7	10.8	23.2	19.7	18.8	17.1
Torrent Pharma	283	1,671	NEU	1,615	37.0	40.1	52.5	67.3	45.2	41.7	31.8	24.8	14.0	14.5	17.6	19.5
Cadila Healthcare	233	228	BUY	280	12.7	11.1	12.0	15.7	18.0	20.5	19.0	14.5	16.5	11.9	11.2	13.2
Alkem Laboratories	208	1,742	BUY	2,225	57.6	64.7	78.7	101.0	30.3	26.9	22.1	17.2	14.8	15.0	16.3	18.4
Abbott India	178	8,364	NR	8,990	188.8	211.9	248.6	299.6	44.3	39.5	33.6	27.9	26.1	24.3	24.1	24.5
Glenmark	120	426	BUY	565	17.5	27.4	29.6	35.4	24.4	15.6	14.4	12.0	9.4	13.3	13.1	13.9
Alembic Pharma	99	524	NEU	570	21.9	25.8	25.1	31.6	23.9	20.3	20.8	16.6	20.0	19.7	16.4	18.1
Jubilant Life Sciences	70	439	BUY	845	45.5	53.8	54.1	67.2	9.6	8.2	8.1	6.5	19.3	19.3	16.6	17.7
Laurus Labs	36	336	BUY	515	15.8	10.7	16.0	28.6	21.2	31.4	21.0	11.8	11.9	6.2	10.2	16.4
Strides Pharma	35	385	BUY	650	13.2	6.9	30.4	41.5	29.3	56.1	12.7	9.3	2.9	2.3	9.9	12.3
Dishman Carbogen Amcis	34	208	BUY	375	13.2	16.7	19.6	24.9	15.7	12.4	10.6	8.4	14.6	15.4	15.1	16.4
J B Chemicals & Pharmaceuticals	30	371	NR	485	16.6	24.1	28.8	34.6	22.4	15.4	12.9	10.7	9.9	13.3	14.7	15.6
Suven Life Sciences	29	228	NR	455	9.7	6.8	9.1	10.7	23.4	33.3	25.1	21.2	17.2	10.9	13.2	13.9
Granules India	23	91	BUY	170	5.2	9.3	11.4	13.9	17.4	9.8	8.0	6.5	12.0	16.7	17.5	18.5
Solara Active Pharma Science	9	333	NR	650	2.4	26.0	26.9	43.1	137.4	12.8	12.4	7.7	2.9	13.4	10.9	12.6
Neuland Labs	6	496	BUY	920	10.8	12.8	32.1	65.8	45.9	38.7	15.5	7.5	2.2	2.6	5.7	10.9

Source: HDFC sec Inst Research

Change In Estimates (Consolidated)

Rs mn	Previous			New			Change (%)		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Revenue	22,792	26,688	30,866	22,792	26,688	30,866	0.0	0.0	0.0
EBITDA	3,840	4,711	5,826	3,840	4,711	5,826	0.0	0.0	0.0
APAT	2,364	2,888	3,541	2,364	2,888	3,541	0.0	0.0	0.0

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Net Revenues	14,353	16,918	22,792	26,688	30,866
Growth (%)	5.8	17.9	34.7	17.1	15.7
Material Expenses	6,796	8,963	12,556	13,878	15,741
Employee Expenses	1,402	1,652	2,098	2,535	2,871
Other Expenses	3,166	3,519	4,298	5,564	6,428
EBITDA	2,988	2,784	3,840	4,711	5,826
EBITDA Margin (%)	20.8	16.5	16.8	17.7	18.9
EBITDA Growth (%)	8.2	(6.8)	37.9	22.7	23.7
Depreciation	715	762	1,055	1,236	1,461
EBIT	2,273	2,022	2,786	3,475	4,365
Other Income (Including EO Items)	99	108	267	133	154
Interest	323	331	285	269	246
PBT	2,050	1,800	2,768	3,340	4,273
Tax (Incl Deferred)	652	634	891	1,002	1,282
Minority Interest / Share of profit	247	160	487	550	550
APAT	1,645	1,326	2,364	2,888	3,541
APAT Growth (%)	29.8	(19.4)	78.3	22.2	22.6
Adjusted EPS (Rs)	7.5	5.2	9.3	11.4	13.9

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

As at March (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	229	254	254	254	254
Reserves	8,807	12,788	15,040	17,427	20,450
Total Shareholders Funds	9,036	13,042	15,295	17,681	20,705
Long Term Debt	1,242	4,331	3,780	3,080	2,465
Short Term Debt	4,738	5,251	5,550	5,500	5,365
Total Debt	5,981	9,582	9,330	8,580	7,830
Net Deferred Taxes	565	474	613	519	528
Other Non-current Liabilities & Provns	39	24	79	87	96
TOTAL SOURCES OF FUNDS	15,620	23,121	25,316	26,867	29,158
APPLICATION OF FUNDS					
Net Block	6,443	7,767	9,442	11,707	12,746
CWIP	2,674	5,145	4,960	3,000	2,000
Investments	1,082	1,566	2,104	2,104	2,104
Other Non-current Assets	306	359	457	503	553
Total Non-current Assets	10,506	14,837	16,963	17,314	17,404
Cash & Equivalents	498	1,156	890	1,114	1,984
Inventories	2,692	2,799	3,842	4,455	5,076
Debtors	4,177	6,171	6,735	8,043	9,302
Other Current Assets	915	1,406	1,354	1,586	1,834
Total Current Assets	7,784	10,376	11,932	14,084	16,213
Creditors	2,160	2,522	3,235	4,215	4,802
Other Current Liabilities & Provns	1,007	726	1,235	1,430	1,640
Total Current Liabilities	3,167	3,248	4,469	5,645	6,442
Net Current Assets	4,617	7,128	7,463	8,439	9,770
TOTAL APPLICATION OF FUNDS	15,620	23,121	25,316	26,867	29,158

Source: Company, HDFC sec Inst Research

Cash Flow (Consolidated)

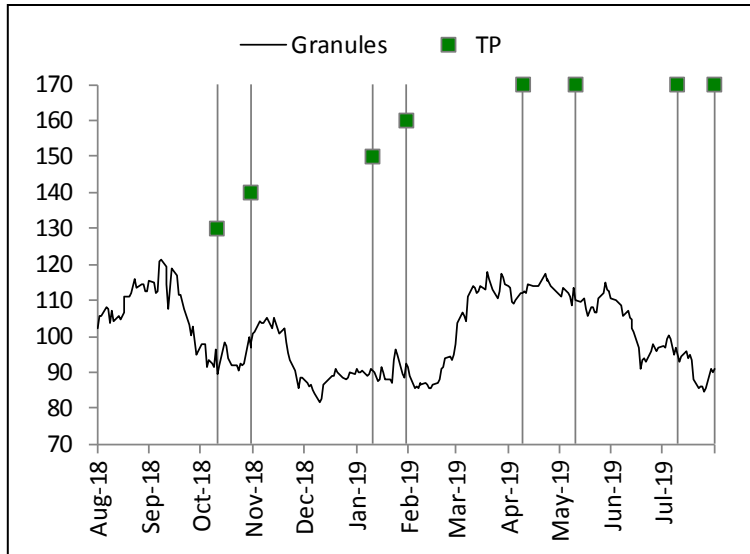
Year ending March (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Reported PBT	2,050	1,800	2,768	3,340	4,273
Non-operating & EO items	(42)	13	-	-	-
Interest expenses	278	300	18	135	92
Depreciation	715	762	1,055	1,236	1,461
Working Capital Change	(524)	(2,300)	(279)	(644)	(1,316)
Tax Paid	(595)	(581)	(891)	(1,002)	(1,282)
OPERATING CASH FLOW (a)	1,882	(7)	2,670	3,065	3,228
Capex	(3,157)	(4,463)	(2,544)	(1,540)	(1,500)
Free cash flow (FCF)	(1,274)	(4,469)	126	1,525	1,728
Non-operating Income	(104)	(160)	(272)	133	154
INVESTING CASH FLOW (b)	(3,261)	(4,623)	(2,816)	(1,407)	(1,346)
Debt Issuance/(Repaid)	272	2,960	(252)	(750)	(750)
Interest Expenses	(319)	(314)	(285)	(269)	(246)
FCFE	(1,321)	(1,823)	(411)	506	732
Share Capital Issuance	829	2,930	0	-	-
Dividend	(223)	(290)	(304)	(502)	(517)
Others	14	2	721	86	502
FINANCING CASH FLOW (c)	573	5,288	(120)	(1,435)	(1,011)
NET CASH FLOW (a+b+c)	(806)	659	(266)	224	871
Closing Cash & Equivalents	497	1,157	890	1,114	1,984

Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19	FY20E	FY21E
PROFITABILITY (%)					
GPM	52.6	47.0	44.9	48.0	49.0
EBITDA Margin	20.8	16.5	16.8	17.7	18.9
APAT Margin	11.5	7.8	10.4	10.8	11.5
RoE	21.0	12.0	16.7	17.5	18.5
RoIC (or Core RoCE)	12.7	7.8	9.0	10.8	12.8
RoCE	13.1	8.0	10.6	11.8	13.3
EFFICIENCY					
Tax Rate (%)	31.8	35.2	32.2	30.0	30.0
Fixed Asset Turnover (x)	1.5	1.4	1.5	1.5	1.5
Inventory (days)	68.5	60.4	61.5	60.9	60.0
Debtors (days)	106.2	133.1	107.9	110.0	110.0
Other Current Assets (days)	23.3	30.3	21.7	21.7	21.7
Payables (days)	54.9	54.4	51.8	57.6	56.8
Other Current Liab & Provns (days)	25.6	15.7	19.8	19.6	19.4
Cash Conversion Cycle (days)	117.4	153.8	119.5	115.4	115.5
Debt/EBITDA (x)	2.0	3.4	2.4	1.8	1.3
Net D/E (x)	0.6	0.6	0.6	0.4	0.3
Interest Coverage (x)	7.0	6.1	9.8	12.9	17.7
PER SHARE DATA (Rs)					
EPS	7.5	5.2	9.3	11.4	13.9
Dividend	0.8	1.1	1.0	1.7	1.7
Book Value	35.5	51.3	60.2	69.5	81.4
VALUATION					
P/E (x)	12.1	17.4	9.8	8.0	6.5
P/BV (x)	2.6	1.8	1.5	1.3	1.1
EV/EBITDA (x)	8.8	11.3	8.2	6.5	5.0
EV/Revenues (x)	1.8	1.9	1.4	1.1	0.9
OCF/EV (%)	7.2	(0.0)	8.5	10.0	11.1
FCF/EV (%)	(4.8)	(14.2)	0.4	5.0	6.0
FCFE/Mkt Cap (%)	(6.3)	(7.9)	(1.8)	2.2	3.2
Dividend Yield (%)	0.9	1.2	1.1	1.8	1.9

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY


Date	CMP	Reco	Target
10-Oct-18	93	BUY	130
31-Oct-18	97	BUY	140
10-Jan-19	90	BUY	150
31-Jan-19	92	BUY	160
9-Apr-19	112	BUY	170
13-May-19	110	BUY	170
9-Jul-19	97	BUY	170
1-Aug-19	91	BUY	170

Rating Definitions

- BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
Disclosure:

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