

21 January 2020

Granules India

Strong quarter, promoter's pledge to dip to 5%, post-buyback; Buy

Rating: **Buy**

Target Price: ₹181

Share Price: ₹140

Granules India's topline continues to be boosted by strong traction in formulations. Its Q3 FY20 sales grew 11% to ₹7bn. Formulations (FD) grew 23% to ₹4bn, PFI sales were up 8% to ₹1bn while APIs declined slightly (3%) to ₹2bn. The higher contribution from formulations and softening API prices helped to a record 23% EBITDA margin. Adjusted for an impairment charge of ₹320m on the Biocause JV, PAT shot up 44% to ₹871m. We expect revenue and PAT CAGRs over FY19-22 of respectively ~17% and ~25%. We maintain our Buy recommendation and raise our target to ₹181 (earlier ₹172).

Formulations continue to lead the growth wagon. In Q3 FY20 formulations sales grew 23% to ₹4bn (making up 54% of sales). Growth was largely driven by a rise in volumes of existing products and launches in the US. During Q3 the company filed two ANDAs and received approvals for three. It has another 19 ANDAs (39 cumulative) pending approval from the US FDA.

Proceeds from the sale of JVs to be distributed to shareholders. The stake sale of two China-based JVs (Omnichem, Biocause) is likely to help Granules generate ₹2bn cash (net of taxes). Further, the company announced a share buyback plan of nearly ₹2.5bn. Through a tender process, it is likely to purchase 1.3m shares at ₹200 each (43% more than the CMP). The promoter is planning to reduce its pledged shares to 5% of its stake by utilising the cash received upon tendering shares in the buyback.

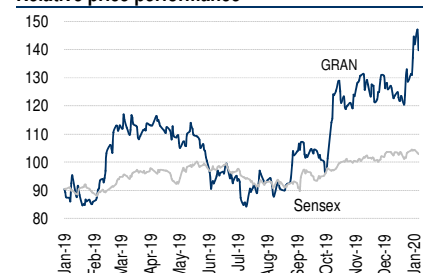
Outlook and Valuation. Granules continues to elevate corporate governance standards. The promoter is committed to fully revoking pledged shares by end-FY20, with debt-to-EBITDA at 1x. We expect it to maintain strong traction for the next couple of years, driven by formulations and huge contribution from the new capacities. We introduce FY22e, and expect revenue and PAT CAGRs over FY19-22 of respectively ~17% and ~25%. At the CMP, the stock trades at 8x FY22e EPS of ₹18. **Risks:** 30% of promoters' holdings have been pledged; increase in R&D spend; adverse currency movements.

Key data	GRAN IN / GRAN.NS
52-week high / low	₹153 / 84
Sensex / Nifty	41324 / 12170
3-m average volume	\$3.2m
Market cap	₹36bn / \$499.7m
Shares outstanding	254m

Shareholding pattern (%)	Dec '19	Sep '19	Jun '19
Promoters	42.9	42.9	42.9
- of which, Pledged	30.3	37.0	43.4
Free float	57.1	57.1	57.1
- Foreign institutions	17.7	14.4	13.9
- Domestic institutions	3.2	3.3	3.1
- Public	36.1	39.4	40.1

Estimates revision (%)	FY20e	FY21e
Revenue	0.8	0.8
EBITDA	2.5	1.0
EPS	4.9	4.1

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY18	FY19	FY20e	FY21e	FY22e
Sales (₹ m)	16,918	22,792	26,954	31,670	36,443
Net profit (₹ m)	1,326	2,364	3,316	3,786	4,598
EPS (₹)	5.2	9.3	13.0	14.9	18.1
PE (x)	19.8	15.0	10.7	9.4	7.7
EV / EBITDA (x)	12.5	11.4	7.9	6.5	5.3
PBV (x)	2.0	2.3	2.0	1.7	1.4
RoE (%)	12.0	16.7	19.9	19.3	19.8
RoCE (%)	7.1	8.6	12.6	14.1	15.3
Dividend yield (%)	0.9	0.7	1.1	1.4	1.7
Net debt / equity (x)	0.6	0.6	0.4	0.3	0.2

Source: Company, Anand Rathi Research

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Quick Glance – Consolidated Financials and Valuations

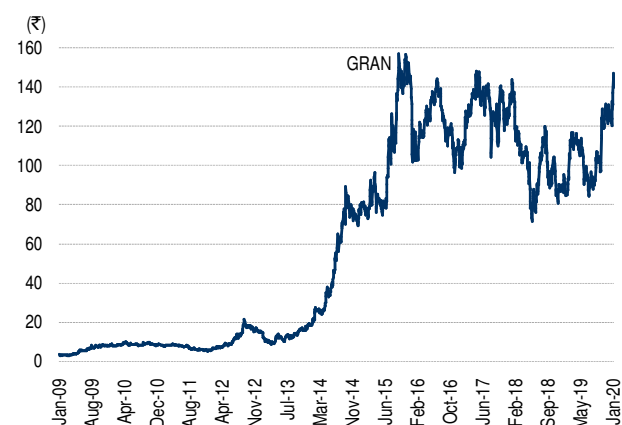
Fig 1 – Income statement (₹m)

Year-end: Mar	FY18	FY19	FY20e	FY21e	FY22e
Net revenues	16,918	22,792	26,954	31,670	36,443
Growth (%)	17.9	34.7	18.3	17.5	15.1
Direct costs	8,963	12,556	13,881	16,215	18,476
SG&A	5,171	6,396	7,655	8,994	10,350
EBITDA	2,784	3,840	5,418	6,461	7,617
EBITDA margins (%)	16.5	16.8	20.1	20.4	20.9
- Depreciation	762	1,055	1,383	1,578	1,734
Other income	108	267	216	259	311
Interest expenses	331	285	255	226	223
PBT	1,800	2,768	3,676	4,917	5,971
Effective tax rate (%)	35.2	32.2	23.0	23.0	23.0
+ Associates / (Minorities)	160	487	255	-	-
Net income	1,326	2,364	3,085	3,786	4,598
Adjusted income	1,326	2,364	3,316	3,786	4,598
WANS	254	254	254	254	254
FDEPS (₹ / sh)	5.2	9.3	13.0	14.9	18.1
R&D (% of sales)	3.1	3.2	2.7	2.5	2.6

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY18	FY19	FY20e	FY21e	FY22e
PBT	2,022	2,786	3,715	4,883	5,883
+ Non-cash items	762	1,055	1,383	1,578	1,734
Oper. prof. before WC	2,784	3,840	5,098	6,461	7,617
- Incr. / (decr.) in WC	2,579	377	1,065	1,705	1,782
Others incl. taxes	659	819	845	1,131	1,373
Operating cash-flow	-454	2,644	3,188	3,624	4,461
- Capex (tang.+ intang.)	4,557	2,544	1,286	1,891	1,895
Free cash-flow	-5,011	99	1,901	1,734	2,566
Acquisitions					
- Div. (incl. buyback & taxes)	290	306	400	491	596
+ Equity raised	2,575	0	-	-	-
+ Debt raised	3,602	-252	-1,100	-950	-100
- Financial investments	483	539	421	505	606
- Misc. (CFI + CFF)	(266)	(732)	(216)	(34)	(89)
Net cash-flow	659	-266	197	-178	1,353

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

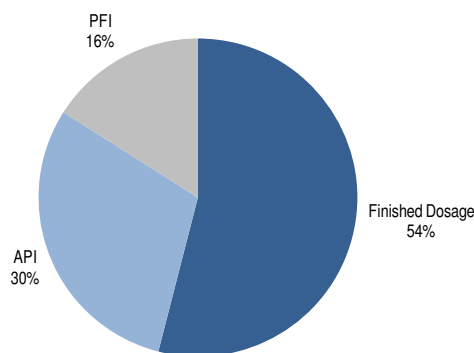
Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20e	FY21e	FY22e
Share capital	254	254	254	254	254
Net worth	13,042	15,295	17,980	21,275	25,277
Debt	9,582	9,330	8,230	7,280	7,180
Minority interest					
DTL / (Assets)	474	613	613	613	613
Capital employed	23,098	25,237	26,823	29,168	33,070
Net tangible assets	7,008	7,476	9,093	10,015	10,282
Net intangible assets	759	1,967	1,967	1,967	1,967
Goodwill					
CWIP (tang. & intang.)	5,145	4,960	3,246	2,636	2,531
Investments (strategic)	1,566	2,104	2,525	3,030	3,636
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	11,068	12,389	13,528	15,789	18,110
Cash	1,156	890	1,087	909	2,262
Current liabilities	3,605	4,549	4,622	5,179	5,718
Working capital	7,463	7,841	8,905	10,611	12,393
Capital deployed	23,098	25,237	26,823	29,168	33,070
Contingent liabilities	44	33	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20e	FY21e	FY22e
P/E (x)	19.8	15.0	10.7	9.4	7.7
EV / EBITDA (x)	12.5	11.4	7.9	6.5	5.3
EV / Sales (x)	2.1	1.9	1.6	1.3	1.1
P/B (x)	2.0	2.3	2.0	1.7	1.4
RoE (%)	12.0	16.7	19.9	19.3	19.8
RoCE (%) - after tax	7.1	8.6	12.6	14.1	15.3
ANDA filings	20.0	32.0			
DPS (₹ / sh)	1.0	1.0	1.6	1.9	2.3
Dividend yield (%)	0.9	0.7	1.1	1.4	1.7
Dividend payout (%) - incl. DDT	21.9	13.0	13.0	13.0	13.0
Net debt / equity (x)	0.6	0.6	0.4	0.3	0.2
Receivables (days)	136	108	102	102	102
Inventory (days)	60	62	54	54	54
Payables (days)	59	52	45	45	44
CFO : PAT %	-34.3	111.8	96.1	95.7	97.0

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up (Q3 FY20)


Source: Company

Result Highlights

Fig 7 – Quarterly financials (₹ m)

Quarterly results (YE Mar)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	% Y/Y	% Q/Q
Sales	3,847	3,926	4,107	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	11.4	0.6
Gross profit (₹m)	2,048	1,949	2,018	1,941	2,061	2,632	2,726	2,818	2,998	3,401	3,569	30.9	4.9
Gross margins (%)	53.2	49.6	49.1	38.5	45.5	45.3	43.2	45.9	50.4	48.6	50.7	755bps	208bps
EBITDA	760	769	740	436	726	1,005	1,133	976	1,186	1,436	1,631	44.0	13.6
EBITDA margins (%)	19.8	19.6	18.0	8.7	16.0	17.3	17.9	15.9	19.9	20.5	23.2	524bps	265bps
Finance expenses	82	104	82	62	65	76	75	68	69	69	67	(10.0)	(1.8)
Depreciation	176	186	196	204	245	265	270	274	287	303	390	44.4	28.6
Other income	13	68	9	97	147	42	59	19	19	87	35	(40.3)	(59.5)
PBT	515	547	471	267	563	706	847	652	849	1,151	889	5.0	(22.7)
Tax	177	193	169	95	191	234	265	202	272	193	249	(6.0)	28.8
Effective tax rate (%)	34.4	35.2	35.9	35.6	34.0	33.1	31.2	30.9	32.0	16.8	28.0	-328bps	1120bps
Adjusted PAT	368	403	350	204	518	603	603	640	832	958	871	44.4	(9.1)

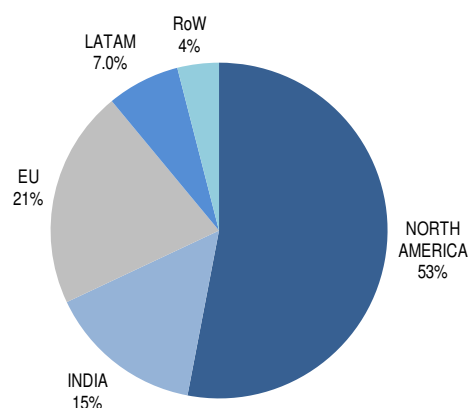
Source: Company, Anand Rathi Research

Fig 8 – Revenue break-up

Quarterly results (YE Mar)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	% Y/Y	% Q/Q
API	1,424	1,335	1,479	2,015	1,813	2,265	2,148	2,208	2,143	2,169	2,091	(2.7)	(3.6)
% of sales	37.0	34.0	36.0	40.0	40.0	39.0	34.0	36.0	36.0	31.0	29.9		
PFI	923	942	986	1,209	906	929	1,074	1,043	952	1,329	1,155	7.5	(13.1)
% of sales	24.0	24.0	24.0	24.0	20.0	16.0	17.0	17.0	16.0	19.0	16.5		
Finished dosages	1,500	1,649	1,643	1,814	1,813	2,614	3,096	2,883	2,857	3,498	3,794	22.6	8.5
% of sales	39.0	42.0	40.0	36.0	40.0	45.0	49.0	47.0	48.0	50.0	54.2		
Total	3,847	3,926	4,107	5,038	4,532	5,809	6,318	6,133	5,953	6,995	7,040	11.4	0.6

Source: Company, Anand Rathi Research

Fig 9 – Revenue break-up, area-wise (Q3 FY20)



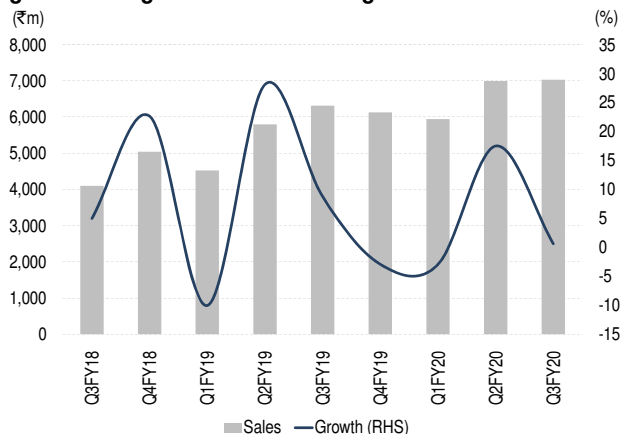
Source: Company

Concall highlights; Key takeaways

- Q3 FY20 revenue break-up:
 - Verticals-wise: FD--54%, API--30%, PFI--16%.
 - Geographically: North America--53%, Europe--21%, India--15%, LATAM--7%, RoW--4%.
- Growth in FD sales was attributed to an increase in the market shares of core molecules and GPI molecules as well as launches. Most of the launches are doing well and one product has captured a 60% market share.
- Five core API molecules contribute 85% to sales.
- Production details for the quarter: API—7,133 tonnes, PFI—3,806 tonnes, FD--3,291 tonnes.
- Increase in sales from GPI (Granules Pharmaceuticals, Inc.) and benefits of backward integration resulted in a higher gross margin for the quarter.
- The company has revised its accounting norms for R&D and going ahead is likely to expense majority portion of the R&D expenditure through P&L. For the previously capitalized amount, in Q3 it fully amortized development cost of around \$1.2m for one product (Oxycodone).
- During the quarter, Granules filed 2 ANDAs and received 3 approvals.
- It has 19 ANDAs pending with the US FDA and expects to receive 1-2 approvals in Q4 FY20.
- It proposes to buy back 12.5m equity shares (maximum) at ₹200 each, 4.92% of the paid-up equity capital through a tender offer.
- Management said that the buyback is being done to reward shareholders as well as to reduce the promoter’s pledge. After the buyback, the promoter’s pledge would come down to 5%.
- GPI’s operating performance: Sales – ₹887m, EBITDA – ₹193.8m and PAT – ₹34.5M
- Gross debt on 31st Dec’19 was ₹9bn; net debt, ₹7.89bn (₹9.41bn a year ago), with debt-EBITDA at 1.4x. The RoCE came at 22.67%. Interest on debt was 1.5%.
- Ahead, better free cashflow and RoCE would be management’s focus.
- The company, entered into an agreement to divest its stake in Granules-Biocrine Pharmaceuticals, with a carrying value of ₹1.4bn, for an agreed ₹1.1bn. For this, there was a one-time impairment charge of ₹320m.
- Also, it entered into an agreement to divest its stake in the Omnicem JV for ₹1.1bn. Management expects both transactions to be completed by Q4 FY20.
- It expects the working-capital cycle to lengthen as its US subsidiary GPI plans to stock additional inventory to avoid supply failures, which could result in penalties.
- R&D for the quarter was ₹323m (3.24% of sales).

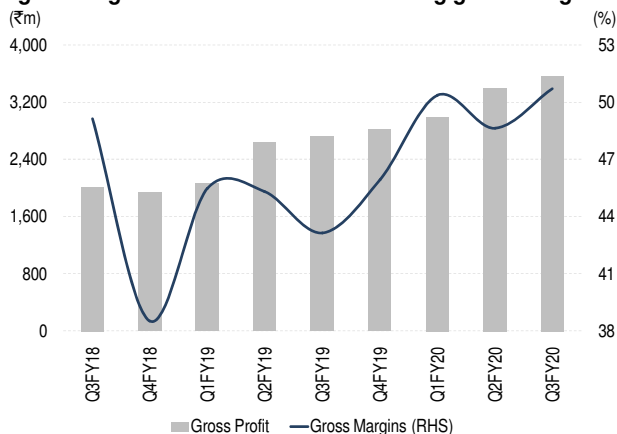
- Capex during 9M FY20 was ₹1.29bn and the company guided to FY20 capex of ₹1.5bn. The next round of huge capacity addition would be after 3-4 years and the company aims to maintain a debt-EBITDA ratio of 1x.
- FCF for 9M FY20 was ₹1.5bn.
- For the next three years, the company expects a 25% PAT CAGR.

Fig 10 – Strong traction in revenue growth to continue



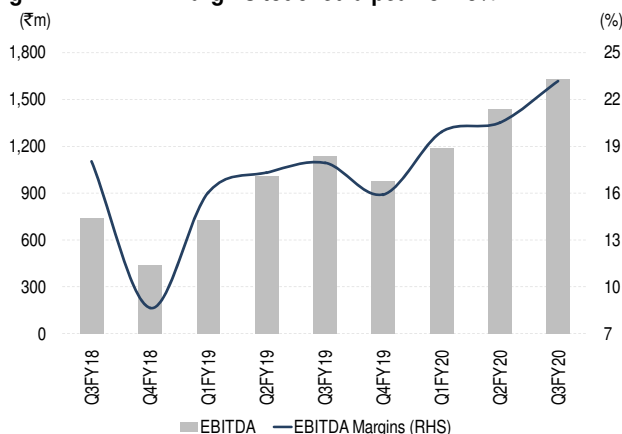
Source: Bloomberg, Anand Rathi Research

Fig 11 – Higher sales of formulations lifting gross margins



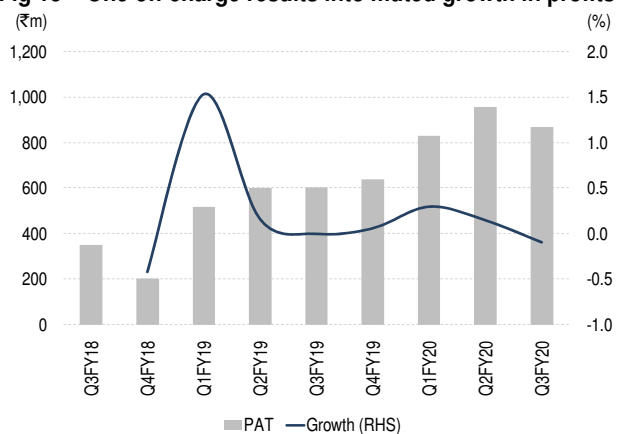
Source: Bloomberg, Anand Rathi Research

Fig 12 – EBITDA margins touched a peak of 23%



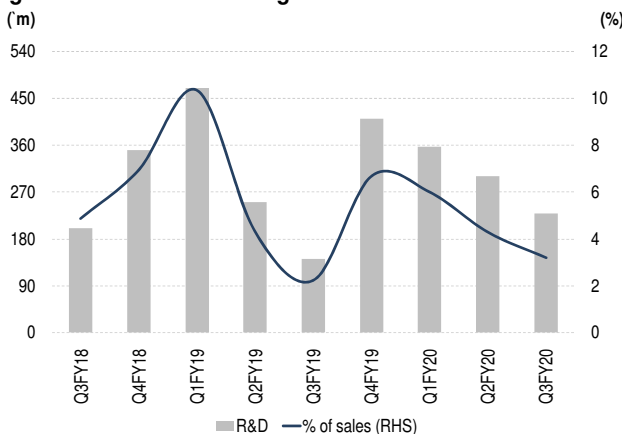
Source: Bloomberg, Anand Rathi Research

Fig 13 – One off charge results into muted growth in profits



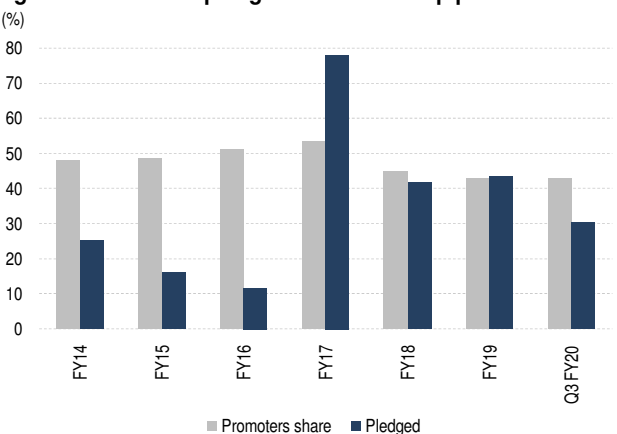
Source: Bloomberg, Anand Rathi Research

Fig 14 – R&D cost is inching lower to ~3% of sales



Source: Bloomberg, Anand Rathi Research

Fig 15 – Promoter’s pledge continues to dip post FY17



Source: Bloomberg, Anand Rathi Research

Valuation

Granules delivered a robust set of figures, backed by strong traction in formulations. It is also in the process of commercialising an API plant at Vishakapatnam, which would help drive growth in its API division. It maintains its leading position in certain APIs such as ibuprofen, paracetamol, metformin, etc., and is now trying to build dominance in formulations (a 60% market share in a single product).

Management is addressing concerns about the promoter’s pledges and higher debt (net debt now ₹8bn). It is fully committed to redeeming the pledge in FY20 and expects to generate healthy cash-flows, which would bring debt to similar levels of reported EBITDA. Besides, it expects current capacity to deliver over 20% growth in the next 3-4 years, and does not anticipate any major capex in the near term.

We roll over our estimates to FY22 and expect 17% and 25% CAGRs over FY19-22 in respectively revenue and earnings. We expect more than a 400bp expansion in the EBITDA margin to 20.9% in FY22, bolstered by operational efficiencies and higher revenue from its formulations division (a high-margin business). It is expected to be on track to generate over the next few years healthy cash flows, which it is likely to utilise to reduce leverage and supplement long-term growth.

At the CMP of ₹139, the stock quotes at 9x and 8x respective FY21e and FY22e. We maintain our Buy rating, with a revised target of ₹181 (earlier ₹172), based on 10x FY22e EPS.

Fig 16 – Change in estimates

Rs mn	Old estimates		New estimates		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	26,740	31,432	26,954	31,670	0.8	0.8
EBITDA	5,287	6,398	5,418	6,461	2.5	1.0
PAT	3,162	3,635	3,316	3,786	4.9	4.1

Source: Anand Rathi Research

Fig 17 – PE band – one-year-forward



Source: Bloomberg, Anand Rathi Research

Fig 18 – Standard deviation – one-year-forward



Source: Bloomberg, Anand Rathi Research

Risks

- 30% of the promoters’ holdings have been pledged.
- Increase in absolute spending on R&D.

- Higher raw-material prices.
- Adverse currency movements and regulatory hurdles.

Fig 19 – Key data

	RATING	CMP (₹)	TP (₹)	M Cap (₹ bn)	EPS			PE (x)		EV / EBITDA		RoE (%)		RoCE (%)	
					FY19	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Aarti	Buy	618	796	14.6	38.1	51.0	66.3	12.1	9.3	7.5	6.2	20.1	21.4	12.6	14.3
Ajanta	Hold	1,199	1,072	105.1	44.1	48.5	59.5	24.7	20.1	16.1	13.5	17.6	18.8	17.6	18.7
Alembic	Hold	599	624	112.9	31.0	37.4	34.6	16.0	17.3	11.2	11.3	23.6	18.6	17.9	14.9
Alkem	Buy	2360	2282	282.1	63.9	87.8	108.7	26.9	21.7	20.5	16.3	18.1	19.6	18.2	19.9
Cadila	Hold	267	257	273.4	17.5	13.3	15.1	20.1	17.7	12.9	11.5	12.7	13.5	8.5	9.0
Dishman	Buy	80	227	12.9	17.2	19.2	22.7	4.2	3.5	3.3	2.7	15.4	16.3	11.2	12.1
Eris	Buy	505	614	69.5	21.1	25.8	30.7	19.6	16.5	16.0	12.8	26.7	24.6	27.0	27.2
Granules India	Buy	140	181	35.5	9.3	13.0	14.9	10.7	9.4	7.9	6.5	19.9	19.3	12.6	14.1
Indoco Remedies	Buy	212	191	19.5	-0.3	3.3	10.6	64.0	20.0	17.8	10.3	4.5	13.5	5.0	11.6
Ipca Labs.	Hold	1,219	1,172	154.0	36.6	46.9	58.6	26.0	20.8	17.3	13.9	17.5	18.6	15.2	16.4
JB Chemicals	Buy	483	551	38.8	24.1	36.0	39.4	13.4	12.3	9.0	7.8	18.1	18.3	17.4	17.6
Natco Pharma	Buy	640	729	116.5	35.3	32.5	28.1	19.7	22.8	15.3	17.1	15.9	12.2	14.7	11.5
Neuland	Hold	487	644	6.3	12.7	31.1	42.9	15.7	11.3	8.5	6.6	5.6	7.3	5.6	6.9
Pfizer	Hold	4007	4265	183.3	89.5	100.5	116.6	39.9	34.4	25.2	21.7	14.5	15.2	14.5	15.2
Suven Life Sciences*	Buy	303	387	38.5	6.8	11.6	13.1	26.1	23.1	16.0	13.9	16.6	16.6	15.3	15.1
Torrent Pharma	Buy	2,028	2,265	343.2	42.2	55.7	72.9	36.4	27.8	17.3	14.8	18.9	22.0	13.2	17.0
HCG	Buy	114	211	10.0	-2.8	-12.6	1.5	NM	NM	10.1	8.2	NM	NM	2.3	18.2

Source: Company, Anand Rathi Research

Stock price as on 20/01/2020

* awaiting listing of Suven Pharma

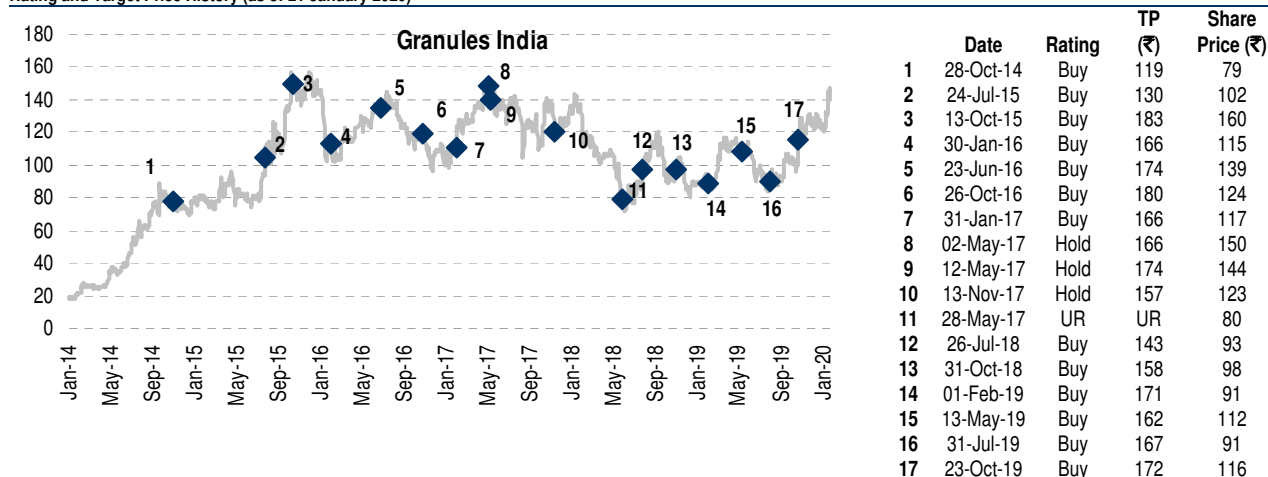
Appendix

Analyst Certification

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Important Disclosures on subject companies

Rating and Target Price History (as of 21 January 2020)



Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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