

Sector: Pharmaceuticals

Result Update

	Change
View: Positive	↔
CMP: Rs. 264	
Upside potential: 18-20%	↑
↑ Upgrade ↔ No change ↓ Downgrade	

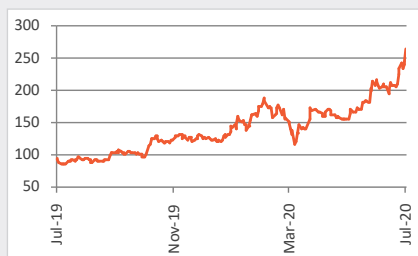
Company details

Market cap:	Rs. 6,713 cr
52-week high/low:	Rs. 268 / 84
NSE volume: (No of shares)	19.8 lakh
BSE code:	532482
NSE code:	GRANULES
Sharekhan code:	GRANULES
Free float: (No of shares)	14.5 cr

Shareholding (%)

Promoters	42.9
FII	19.7
DII	3.2
Others	34.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	23.1	58.4	85.9	179.0
Relative to Sensex	12.6	41.3	97.6	184.6

Sharekhan Research, Bloomberg

Granules India Limited (Granules) reported an impressive performance for the quarter. The company reported highest ever quarterly revenues of Rs 735.6 cr, up sharply by 23.6% y-o-y. The growth was driven by a sturdy double digit growth in the PFI and FD segments. Operating margins at 25% expanded 503 bps y-o-y on the back of 920 bps expansion in gross margin. Operating profits stood at Rs 183.6 cr, up 54.8% y-o-y for the quarter. The PAT for the quarter came in at Rs 111.4 cr as against Rs 83.2 cr reported in the corresponding quarter. Granules is witnessing strong demand traction across segments and expects the same to sustain going ahead as well. Tapping new geographies, strong product pipeline and benefits of incremental capacities are the key topline drivers. Given the strong demand traction, Granules has announced a capacity expansion plan with the new / expanded facilities likely to be ready by Q3FY2022. This provides visibility on the company's ability to cater to the incremental demand going ahead. A favorable mix, operating efficiencies accruing (backed by differentiated manufacturing process adopted by the company) and better margins from new product launches would result in OPM expansion. In the light of the above, Granules has revised its earnings growth guidance for FY2021 upwards to 30% and has retained a 25% growth guidance for FY2022. This compares with earlier guidance of 25% earnings CAGR for FY2020-FY2022. Expansion in operating margins leading to a strong earnings growth, healthy return ratios and a strong balance sheet position augur well and are the key positives for Granules.

Key positives

- Granules reported a record performance for Q1FY21 with highest ever quarterly revenues of Rs 735.6 cr. PFI and FD segment clocked a sturdy double digit growth
- Gross margins expanded 920 bps yoy
- Operating margins expanded 503 bps YoY to 25%
- Promoters pledge reduced by around 12.95% to 3.64%

Key negatives

- The API revenues were almost flat for the quarter with a decline of 0.4% yoy.
- Higher employee cost and other expenses partly offset the benefits of gross margin expansion

Our Call

Valuation - Maintain Positive view with upside potential of 18-20%: Granules is witnessing strong demand tractions across segments, which is expected to sustain going ahead as well. The lucrative high margin segments – PFI and FD are witnessing healthy growth. The company is also looking to expand its reach and tap new geographies for growth. With existing capacities expected to reach almost full utilization levels by end of FY2021, Granules has announced a capacity expansion plan, which would support the growth going ahead. Further, a favorable mix, operational efficiencies would drive the margins. Witnessing a strong demand, Granules has revised its PAT growth guidance upwards to 30% for FY2021. Basis the sturdy performance in Q1FY2021, we have revised our earnings estimates upwards by 9% / 6% for FY2021/FY2022. Strong earnings visibility, sturdy balance sheet and healthy return ratios augur well. At CMP, the stock is trading at 15.7x/12.6x its FY21/FY22E EPS. Basis the above positives coupled with modest multiple expansion, we maintain our Positive view and expect an upside of 18-20%.

Key Risks

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

Valuation (Consolidated)

Particulars	FY2018	FY2019	FY2020	FY2021E	FY2022E
Net Sales	1691.8	2279.2	2598.6	3213.3	3866.9
EBIDTA	278.4	384.0	547.3	726.6	890.4
OPM (%)	16.5	16.8	21.1	22.6	23.0
Reported PAT	133.6	236.4	329.7	415.9	518.3
EPS (Rs)	5.4	9.6	13.3	16.8	21.0
PER (x)	48.8	27.6	19.8	15.7	12.6
EV/Ebidta (x)	26.1	18.9	13.1	9.2	7.3
P/BV (x)	5.0	4.3	3.5	3.0	2.4
ROCE (%)	9.0	11.6	15.8	19.6	20.8
RONW (%)	10.2	15.5	17.9	18.8	19.4

Source: Company; Sharekhan estimates

Strong performance for Q1FY21: Granules reported strong performance for Q1FY2021. Results were ahead of estimates. The revenues at Rs 735.6 cr were up 23.6% y-o-y. The revenue growth is attributable to the strong growth in the PFI and FD segment sales, which grew 42% and 35% y-o-y respectively. The operating profits for the quarter stood at Rs 183.6 cr, up 54.8% y-o-y. The operating profit margins at 25% were ahead of estimates and expanded sharply by 503 bps y-o-y. OPM expansion is on the back of 920 bps expansion in gross margins. Favorable mix (high share of FD and PFI sales) and higher API prices resulted in the gross margins expansion. During the quarter, Granules reported one time provision of Rs 15 cr towards voluntary recall of metformin. This is included in the other expenses and adjusting for this operating margins stand at 27%. Tax rate for the quarter stood at 25% as compared to 32% in the corresponding quarter of the previous year. Consequently, the reported PAT stood at Rs 111.4 cr as compared to Rs 83.2 cr in Q1FY20 and was ahead of estimates.

Healthy growth in core molecules; strong new product pipeline to fuel growth; Management revises PAT growth guidance upwards for FY21: Granules reported an impressive performance for Q1FY21 with record all-round performance. A strong demand environment for its drugs, especially in the PFI and FD space has led to the outperformance. Granules expects the sturdy performance to sustain going ahead as well. The core molecules (~85% of the sales) would continue to sustain the robust growth trajectory as Granules looks to launch these products in new geographies of Europe, Canada and South Africa. Company's Vizag unit 5 has cleared the EU inspection, thus providing comfort on the company's ability to cater to increased demand. Further Granules had filed for 3 ANDA's during the quarter and has received approval for 6. Going ahead, the company plans to file 7-9 ANDA's / Dossiers every year, across geographies. This points at a strong product pipeline. Further, considering the robust demand, the management expects the facilities to achieve almost full capacity utilization levels by the end of FY2021. In order to sustain the growth trajectory, Granules would be investing around Rs 350-400 cr in FY2021 towards expanding capacities. For FY2022, the company has guided for a capex of Rs 300 cr largely towards putting up new capacities/ brownfield expansions. Consequently, given the sturdy demand, strong product pipeline and new capacities being set up, the revenues and PAT are expected to grow impressively over the next two years. Granules has revised its PAT growth guidance upwards to 30% for FY2021. This is commendable, especially amidst challenging times.

OPM's to expand backed by favorable product mix, operating efficiencies: The operating margins have surged by 503 bps y-o-y for the quarter to a record 25% levels. The expansion can be attributable to the rise in gross margins and favorable product mix. The share of PFI's and FD segment in the total sales surged 2.7% and 4.4% y-o-y to 18.7% and 52.4% respectively. As these segments fetch better margins as compared to the API segment, a higher revenue contribution augurs well. The gross margins for the quarter stood at 59.5% and expanded 920 bps y-o-y. This was partly aided by increase in the API prices as well, which were passed on to the end users. Going ahead, the management expects the margin expansion to continue and had guided for sustainable levels of around 23%. In addition to the favorable product mix, operating efficiencies (due to a differentiated production methods being adopted) and increasing the number of new launches (which would yield better margins compared to the existing products) that could be a key driver for margin expansion.

Q1FY2021 Conference Call Highlights:

Geography Mix: The revenues across geographies reported a strong double digit growth for the quarter. The North America sales were up 26.8% y-o-y for the quarter, followed by Europe and Latin America which clocked a growth of 9% and 70.7% y-o-y respectively. India sales were up 10.5% while RoW sales grew 11.6% y-o-y for the quarter

Management has revised upwards its growth guidance: In view of the increasing demand and tapping new geographies for growth, Granules India has revised its earnings growth guidance upwards. For FY2021, the company expects the earnings to grow by 30% (as against earlier guidance of 25% CAGR for next two years).

New products / approvals: Launched Colchicine tablets and Butalbital APAP caffeine tablets through subsidiary company in the US markets. Granules has filed for 3 ANDA's / Dossiers in the North America and the Europe markets during the quarter and had received approval for 6 ANDA's (including one tentative approval) from the USFDA. Granules sees the share of revenues from the lucrative US markets increasing to around 68-70% levels from around 53.4% as of FY2020.

Product recalls: Granules did a voluntary nationwide Class 2 recall of Metformin Hydrochloride Extended-Release Tablets USP - 750 mg due to the detection of NNitrosodimethylamine (NDMA) Impurity out of abundance of caution. The company has provided for Rs 15 cr during the quarter towards the recall.

Regulatory Aspects: During the quarter, Granules successfully cleared the EU inspection at Vizag unit 5. The regulatory clearance of this unit provides ample visibility on the company's ability to cater to the demand from European region.

Pledge Shares: During the quarter, the promoters pledge was released to the tune of ~12.95%. Post this, the proportion of pledged shares has reduced to 3.64%.

Buyback updates: Granules has successfully completed the buyback of around 1.25 cr equity shares, with a total spends of Rs 142 cr (excluding taxes). The taxes amounting to Rs 32.9 cr would be paid in Q2FY21.

Capex Plans: Granules has announced a capacity expansion program, wherein the company shall be investing Rs 350-400 cr in FY2021 and around Rs 300 cr in FY2022. The capex would be towards setting up new facilities / expanding existing facilities, to support growth going ahead. The management has mentioned that these capex would be funded internally completely.

Results					Rs cr	
Particulars	Q1FY21	Q1FY20	YoY %	Q4FY20	QoQ %	
Total Income	735.6	595.3	23.6	599.9	22.6	
Expenditure	552.0	476.7	15.8	497.8	10.9	
Operating profit	183.6	118.6	54.8	102.1	79.8	
Other income	5.6	1.9	203.6	22.5	-75.0	
EBIDTA	189.2	120.5	57.1	124.6	51.8	
Interest	6.0	6.9	-13.4	6.6	-9.4	
Depreciation	34.1	28.7	18.9	39.0	-12.6	
PBT	149.2	84.9	75.6	79.1	88.6	
Tax	37.7	27.2	38.8	44.4	-14.9	
Adjusted PAT	111.4	64.0	74.1	34.7	220.9	
Reported PAT	111.4	83.2	33.9	92.3	20.7	
BPS						
OPM (%)	25.0	19.9	503.1	17.0	793.5	

Source: Company; Sharekhan Research

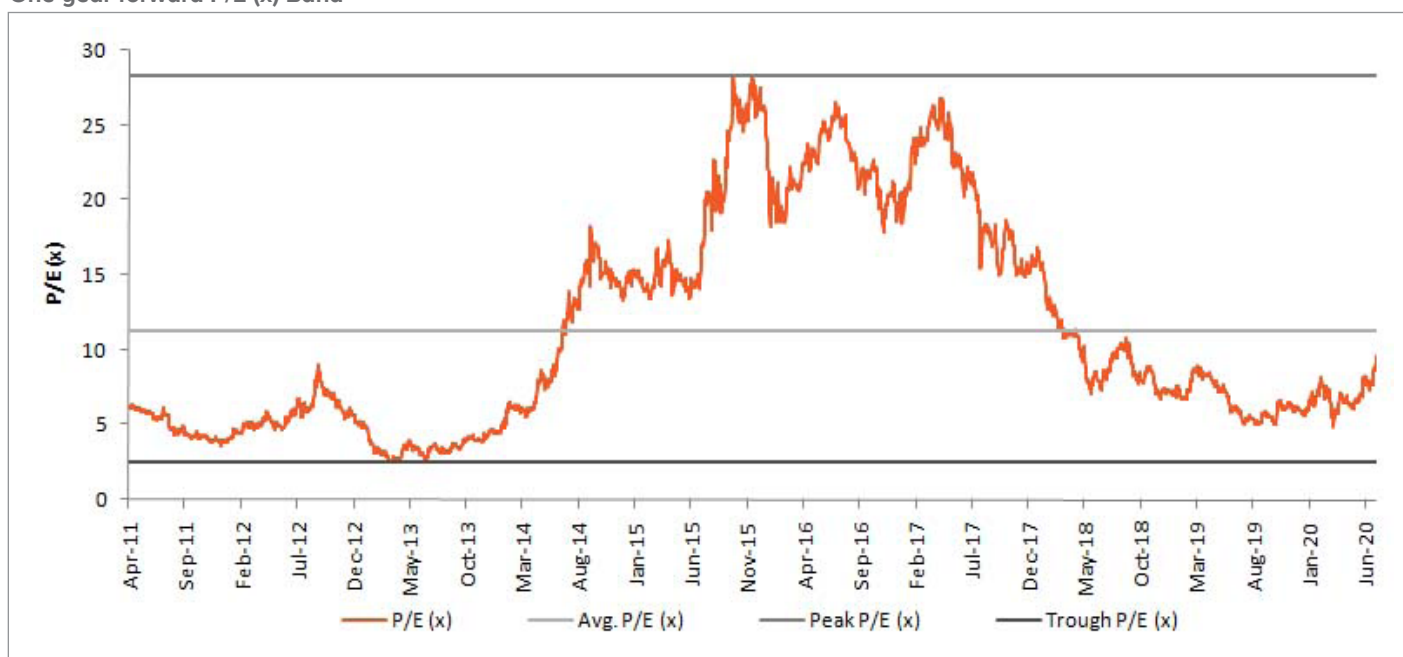
Outlook

Strong growth prospects: Granules is a fully integrated pharmaceutical company with presence across the API-PFI-FD value chain. The company is witnessing improved demand environment across its products. The core 5 molecules, which account for 85% of the sales are likely to sustain the strong growth trajectory, as the company plans to tap new geographies of Europe, Canada and South Africa for growth. A strong product pipeline would add to the revenue growth. Granules has announced a capex wherein it plans to increase its capacities to cater to the increased demand. The new facility would be ready by Q3FY2022 and operations are expected to commence thereafter. We believe new product launches in the US and augmented capacities will support the base business as well as emerging business. A changing mix (increasing share of high margin PFI and FD Segment) and efficient manufacturing process coupled with better utilization of plants will aid profitability growth.

Valuation

Maintain Positive view with upside potential of 18-20%: Granules is witnessing strong demand tractions across segments, which is expected to sustain going ahead as well. The lucrative high margin segments – PFI and FD are witnessing healthy growth. The company is also looking to expand its reach and tap new geographies for growth. With existing capacities expected to reach almost full utilization levels by end of FY2021, Granules has announced a capacity expansion plan, which would support the growth going ahead. Further, a favorable mix, operational efficiencies would drive the margins. Witnessing a strong demand, Granules has revised its PAT growth guidance upwards to 30% for FY2021. Basis the sturdy performance in Q1FY2021, we have revised our earnings estimates upwards by 9% / 6% for FY2021/FY2022. Strong earnings visibility, sturdy balance sheet and healthy return ratios augur well. At CMP, the stock is trading at 15.7x/12.6x its FY21/FY22E EPS. Basis the above positives coupled with multiple expansion, we maintain our Positive view and expect an upside of 18-20%.

One-year forward P/E (x) Band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Granules India	264.0	24.7	6,713.0	19.8	15.7	12.6	13.1	9.2	7.3	17.9	18.8	19.4
Laurus Labs	640.0	10.6	6,848.0	26.7	22.3	17.5	13.8	11.6	9.6	14.4	14.7	15.8

Source: Company, Sharekhan estimates

About company

Granules is a vertically integrated pharmaceutical company, headquartered in Hyderabad, India. The company manufactures Active Pharmaceutical Ingredients (APIs), Pharmaceutical Formulation Intermediates (PFIs) and Finished Dosages (FDs) and supplies them to both regulated and semi-regulated markets. Exports constitutes around 80% of revenues. The regulated markets constitute around 66% of revenues, while LATAM accounts for 10% of revenues. Granules' business is bucketed into three areas: 1) Core business comprising our core molecules- Paracetamol, Ibuprofen, Metformin, Guaifenesin and Methocarbamol; 2) Emerging business that focuses on manufacturing APIs with a focus on vertical integration; and 3) CRAMS segment focusing on contract research and manufacturing.

Investment theme

Granules is one of the few Pharmaceutical companies with a vertical integration (from API to FD's). The company's focus on core business coupled with strong demand in APIs augur well in upcoming years. The company is expected to report strong performance from FY2020 onwards, as its core business is expected to grow sturdily backed by commissioning of capacities in the recent past, increasing ANDA approvals and launches for U.S. markets. Moreover, since the majority of capex is now behind, it intends to reduce debt over the next couple of years. Operational efficiencies coupled with economies of scale will help improve operating performance as well as profitability. Management has also assured that it will be gradually reducing the proportion of pledge which is a potential trigger for multiple re-rating.

Key Risks

- ◆ Delay in product approvals or negative outcome 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 manufacturing facility also poses risk.

Additional Data

Key management personnel

Mr. Krishna Prasad Chigurupati	Chairman and Managing Director
Mrs. Uma Chigurupati	Executive Director
Ms. Priyanka Chigurupati	Executive Director of Granules Pharmaceuticals Inc
Mr. Karuppannan Ganesh	CFO
Mr. Stefan Lohle	Chief Marketing Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	2.99
2	Norges Bank	2.96
3	GOVERNMENT PENSION FUND - GLOBAL	2.96
4	TRITON SECURITIES PVT LTD	2.69
5	Mahima Stocks Pvt Ltd	2.15
6	Dimensional Fund Advisors LP	1.77
7	HSBC Holdings PLC	1.53
8	TYCHE INVESTMENTS PVT LTD	1.5
9	FIL Ltd	0.97
10	BlackRock Inc	0.71

Source: Bloomberg

As on - 02 June, 2020

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