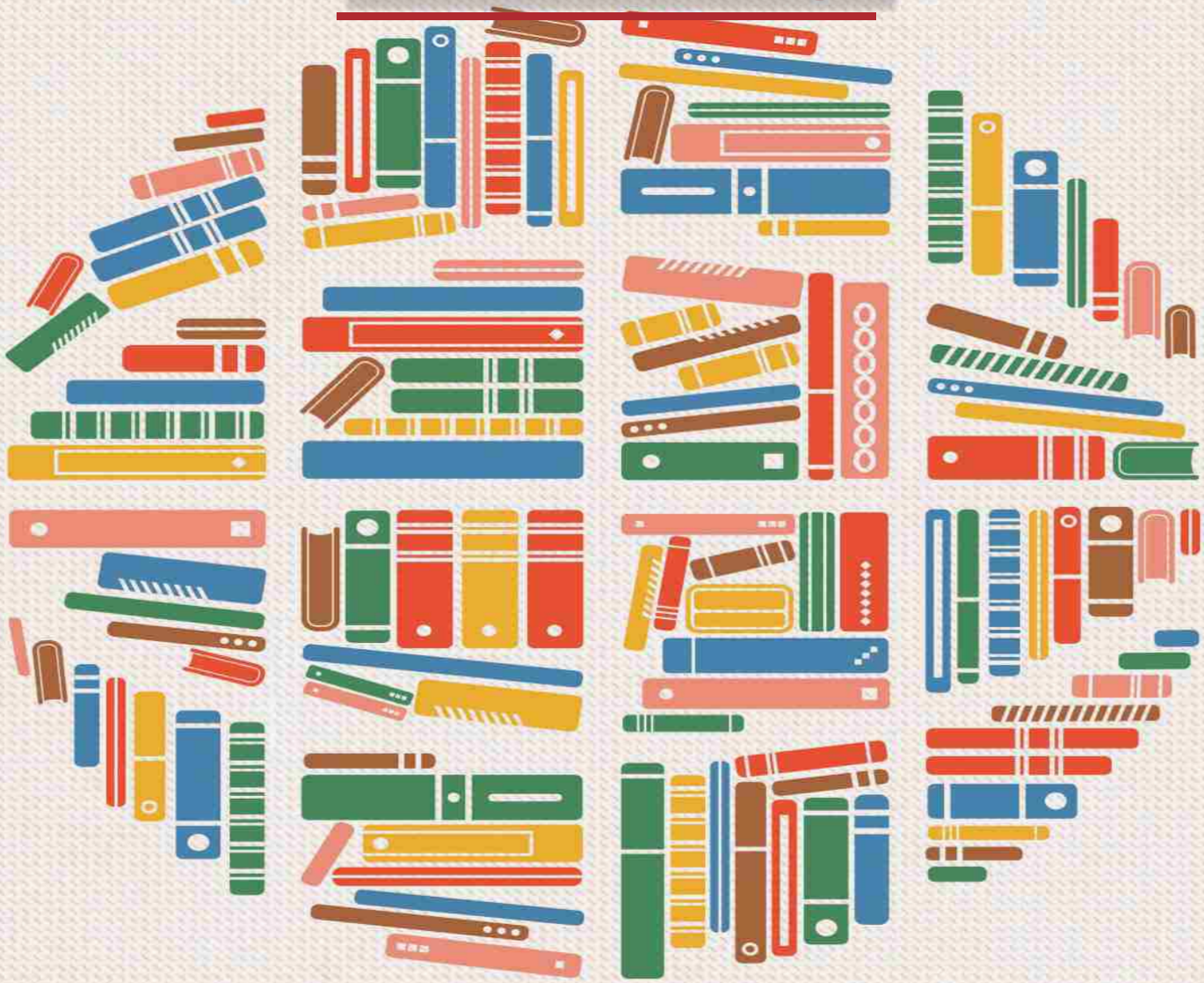
ICICI direct Research

September 15, 2020

Stock TALES



Stock Tales are concise, holistic stock reports across wider spectrum of sectors. Updates will not be periodical but based on significant events or change in price.

Granules India (GRANUL)

ICICI direct Research

CMP: ₹ 371 | Target: ₹ 430 (16%) | Target Period: 12 months | BUY

September 15, 2020

Strong Integrated model to support volume play…

Incorporated in 1991 by first generation entrepreneur Krishna Prasad Chigurupati, Granules India (Granules) is a vertically integrated pharma player. Over the years, the company has been focusing on few basic but important global APIs like Paracetamol, Metformin, Ibuprofen, Guaifenesin, and Methocarbamol. With ~85% revenue contribution these products still remain the backbone of earnings with backward integration and economies of scale. Granules is now looking to rewrite its success story in other molecules with focus on formulations. We believe the company is well poised to extend its core strength by launching more complex/niche products besides volume based legacy products for future growth.

Formulation – Focus on fewer launches, higher market share

Granules' Formulation revenues grew 31% in FY16-20 to ₹ 1360 crore mainly due to timely launches and market share gains in both core and small but complex products like Methergine, along with extension of its core products launches in OTC segment. The company's vertically integrated business model, sustained market share in volume products and focus on select small but high value accretive launches where competition is less bodes well in the crowded generics market. Extending its core products via additional strength/different forms in the US and launching in other geographies is also likely to provide better operating leverage. We expect the company's formulation revenues to grow 21% in FY20-23E to ₹ 2411 crore.

API+PFI - Well poised to capture global opportunities besides complementing formulation foray

These segments grew just 7.7% in FY16-20E mainly due to captive consumption and capacity constraints. However, with new capacities getting commissioned (Vizag unit V) for multiple APIs and oncology blocks, we expect good traction in this space. The company is also working on backward integration for key APIs. Similarly, by already having critical mass globally in key APIs, we believe Granules could be one of the prime beneficiaries of 'China + one' substitute play. Overall, we expect 10.6% CAGR over FY20-23E owing to improved demand and capacity addition.

Valuation & Outlook

After achieving critical mass in commoditised but important products in the last few quarters, the company has been steadily expanding its reach into formulations with a vertically integrated model. This bodes well at a time when generic supply script globally is likely to be rewritten in the post-pandemic era that would be more conducive for vertically integrated players such as Granules. We like the company's clear vision to play on its strength of economies of scale and gradually expand into more complex products/forms to improve margins. Sustained margin expansion is likely to support FCF generation despite brownfield capex lined up till FY23E. We assign **BUY** rating to the stock with a target price of ₹ 430 (16x of FY23E EPS of ₹ 26.6).

GRANULES

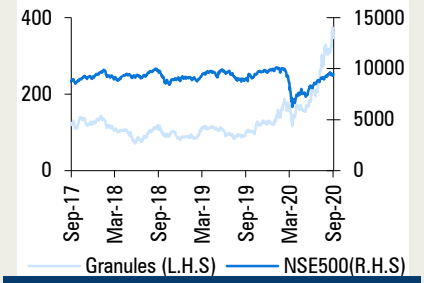
Particulars

Particular	Amount
Market Capitalisation	₹ 9191 crore
Debt (FY20)	₹ 892 crore
Cash (FY20)	₹ 284 crore
EV	₹ 9799 crore
52 week H/L	384/93
Equity capital	₹ 25.4 crore
Face value	₹ 1

Key Highlights

- Strong backward integration remains key strength for company in steep competitive generic market
- We like the company's clear vision to play on its strength of economies of scale, gradually expand to more complex products/forms to improve margins
- Assign BUY

Price movement



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Stock Tales

ICICI Securities – Retail Equity Research

Key Financial Summary

₹ Crore	FY20	FY21E	FY22E	FY23E	CAGR FY20-23(%)
Revenues	2598.6	3061.0	3532.4	4086.6	16.3
EBITDA	525.3	709.8	851.3	1021.6	24.8
EBITDA Margins (%)	20.2	23.2	24.1	25.0	
Net Profit	309.9	428.1	521.4	658.4	28.6
EPS (Adjusted)	12.4	17.3	21.1	26.6	
PE (x)	27.4	21.5	17.6	14.0	
EV to EBITDA (x)	18.7	13.8	11.3	9.0	
RoCE (%)	15.2	19.4	20.6	22.3	
RoE (%)	16.7	19.1	19.1	19.6	

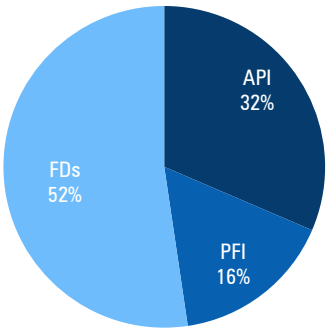
Source: ICICI Direct Research; Company

Company Background

Originating in 1984 and incorporated in 1991, Granules India Ltd (Granules) is a large-scale vertically integrated company manufacturing active pharmaceutical ingredient (API), pharmaceutical formulation intermediate (PFI) and finished dosage (Formulation). Over the years, it has created a strong presence in 'the first line of defence' products such as Paracetamol (pain), Ibuprofen (pain), Metformin (diabetic), Methocarbamol (muscle relaxant), and Guaifenesin (chest congestion control). Granules provides worldwide services to over 250 customers across 60+ countries. Exports comprise over 81% of total revenue. It has one of the largest PFI and single site formulation facilities in the world. It is also home to one of the world's largest Paracetamol API facilities.

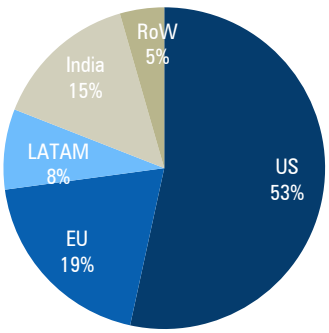
As of FY20, the company has filed 45 ANDAs, out of which 26 have been approved. Granules has also filed 20 US DMFs, 16 CEPs and seven EDMFs.

Segment Bifurcation



Source: ICICI Direct Research; Company

Geographical Bifurcation



Source: ICICI Direct Research; Company

Exhibit 1: Timeline of company events

Year	Details
1984	Granules formed as Triton Labs to produce Paracetamol API at Bonthapally
1987	Second Indian company to export pharmaceutical products to US
1990	Opened first PFI facility in Jeedimetla
1995	Listed on the Hyderabad Stock Exchange
2000	Triton Laborites private limited amalgamated with Granules India
2002	Listed on the BSE
2003	Opened a new large volume PFI facility in Gagillapur
2003	Setup a wholly owned subsidiary, Granules USA, for marketing in the US
2005	New Paracetamol plant was built in Bonthapally, Hyderabad
2006	Formed a joint venture (JV) with Hubei China for backward integration (Ibuprofen API)
2008	Entered into the Finished Dosage segment
2010	Received USFDA approval for its first ANDA
2011	JV with Ajinomoto OmniChem to venture into CRAMS business
2013	Established a 15,000 sq. foot R&D facility in Pragathi Nagar, Hyderabad
2014	Acquired Auctus Pharma to further strengthen the API portfolio
2015	Entered OTC business in the US through Granules Consumer Healthcare
2016	Acquisition of Formulation Facility GPI in Virginia
2017	QIP issue for ₹ 300 crore
2018	Commenced commercial operations of GPI
2019	Divested stake in Omnichem and Biocause JV to partner

Source: ICICI Direct Research, Company

The company has eight manufacturing facilities, seven plants are in India and one in the US. API facilities are located at Bonthapally, Jeedimetla and Vizag. The Bonthapally unit manufactures Paracetamol API. The Jeedimetla unit manufactures Metformin, Guaifenesin and Methocarbamol APIs. The Jeedimetla plant also has a PFI manufacturing facility. The Vizag unit manufactures API (oncology and non-oncology) and finished dosage in oncology therapeutics through acquisition of Auctus Pharmaceuticals. Granules has taken over a multi-product API manufacturing facility at Vizag and an intermediary manufacturing facility at Bonthapally. The Gagillapur unit manufactures PFIs and finished dosages.

Exhibit 2: Manufacturing facilities

Value chain	Location	Installed Capacity	Approvals	Inspection
API	Bonthapally	34,560 TPA	U.S. FDA, EDQM, WHO, COFEPRIS, INFARMED	Jul-19
	Jeedimetla	4,800 TPA	U.S. FDA, EDQM, COFEPRIS, WHO, CDCSO	Mar-18
	Vizag (Unit IV)	290 KL	U.S. FDA, KFDA, EU GMP, WHO GMP, EDQM	Dec-15
	Vizag (Unit V)		EU GMP	Apr-20
PFI	Gagillapur	23,200 TPA	US FDA, COFEPRIS, TGA, MCC, INFARMED	Feb-20
	Jeedimetla	1,440 TPA	WHO GMP, COFEPRIS, INFARMED	Mar-18
Formulations	Gagillapur	21.8 billion	US FDA, MCC, COFEPRIS, TGA, INFARMED	Feb-20
	Virginia, USA	1.5 billion	US FDA, DEA	Aug-19
API Intermediates	Bonthapally	61.5 KL		

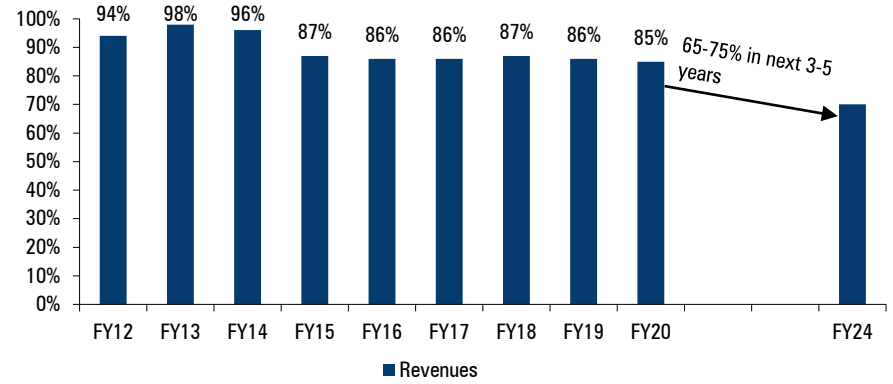
Source: ICICI Direct Research, Company

Core molecules remain key driver for company

Granules is one of the largest global manufacturers of five 'first line of defence' products, including Paracetamol, Metformin, Ibuprofen, Guaifenesin and Methocarbamol. Across the value chain, these core five products contribute 85% of revenues. Due to an integrated business model, economies of scale and gradually moving up in the value chain, the company is able to generate healthy growth along with improvement in margins despite catering to predominantly commoditised products. In the US, the company is exploring different strength/form for core molecules and further expanding core products into other geographies to gain economies of scale. It is also looking for end-to-end integration of these products to improve margins and stability. The management expects core molecules to contribute 65-75% over the next three to five years.

Core molecules expected to contribute 65-75% over the next three to five years. Geographical expansion and launches of different strength and forms in the US continue to drive these products

Exhibit 3: Core molecules contribution



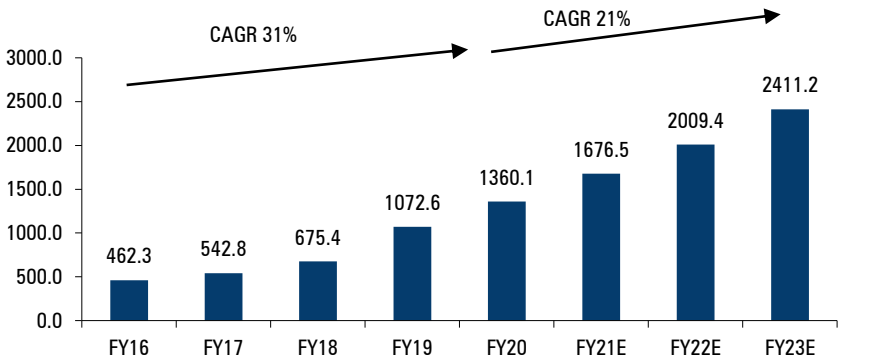
Source: Company, ICICI Direct Research

Formulation –Focus on fewer launches, higher market share

Granules' Formulation revenues grew 31% over FY16-20 to ₹ 1360 crore mainly due to timely launches and market share gains in both core and small but complex products like Methergine, along with extension of its core products launches in the OTC segment. The company's vertically integrated business model, sustained market share in volume products and focus on select small but high value accretive launches, where competition is less, bode well in the crowded generics market. Extending its core products via additional strength/different forms in the US and launching in other geographies is also likely to provide better operating leverage. We expect formulation revenues to grow 21% in FY20-23E to ₹ 2411 crore.

Strong growth in formulation mainly owing to 1) growth in core molecules, 2) adding more volume based products and 3) launches of small but high value low competition products

Exhibit 4: Formulation expected to grow 21% over FY20-23E (₹ crore)



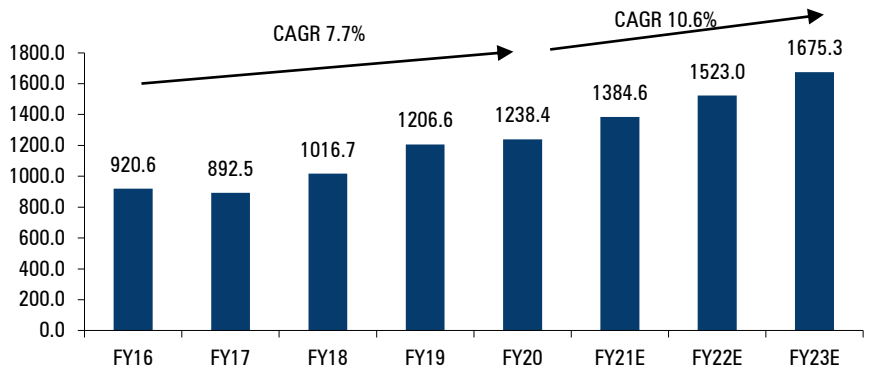
Source: Company, ICICI Direct Research

API+PFI- Well poised to capture global opportunities besides complementing formulation foray

API+PFI expected to witness 10.6% CAGR over FY20-23E owing to improved demand and capacity addition

These segments grew just 7.7% in FY16-20E mainly due to captive consumption and capacity constraints. However, with new capacities getting commissioned (Vizag unit V) for multiple APIs and oncology blocks, we expect good traction in this space. The company is also working on backward integration for key API. Similarly, by already having critical mass globally in key APIs, we believe Granules could be one of the prime beneficiaries of 'China + one' substitute play. Overall, we expect 10.6% CAGR in FY20-23E owing to improved demand and capacity addition.

Exhibit 5: API+PFI expected to grow 11% in FY20-23E (₹ crore)



Source: Company, ICICI Direct Research

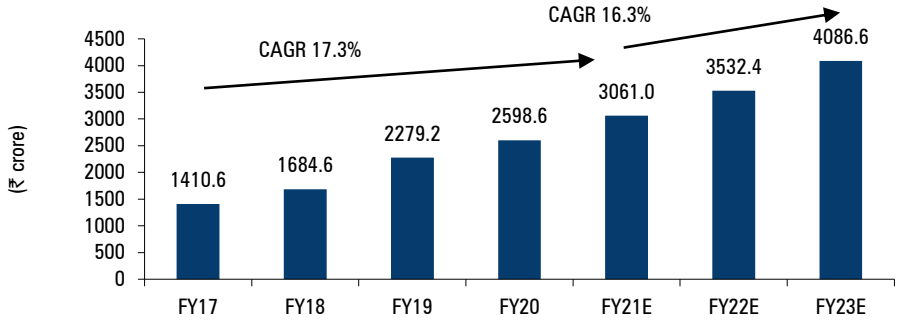
Financials

Revenues expected to grow at 16% CAGR over FY20-23E

Granules' revenues grew 17.3% over FY16-20 to ₹ 2599 crore mainly due to 31% growth in formulation amid new launches and market share gained in core molecules in the US. Although formulations remain a key driver for the company, we expect API+PFI segment to do reasonably well as well on the back of China driven opportunities and new capacities for other APIs going on stream. We expect revenues to grow 16.3% in FY20-23E.

Revenues expected to grow 16.3% over FY20-23E mainly due to strong growth in formulations segment and increased demand and capacity addition in API

Exhibit 6: Revenues expected to grow at 16.3% CAGR over FY20-23E



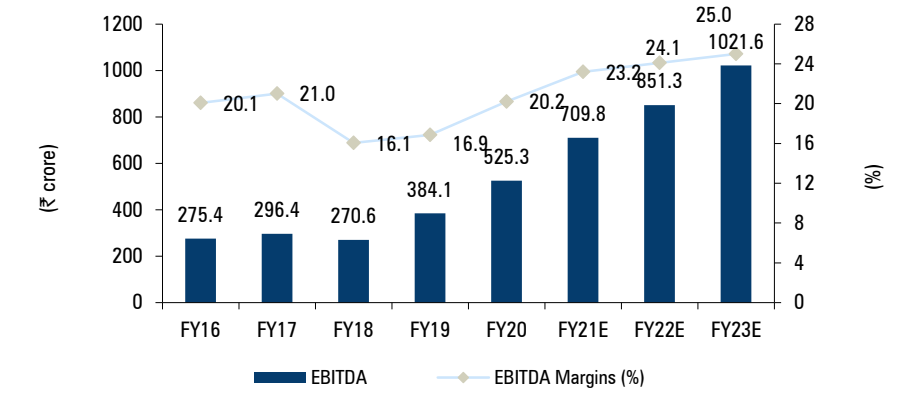
Source: ICICI Direct Research, Company

Change in product mix likely to drive margins

EBITDA margins are expected to improve 479 bps to 25% in FY20-23E, mainly due to a change in product mix and better operating leverage based on plant utilisation and geographical diversification. High margin formulation contribution is expected to increase from 52% in FY20 to 59% in FY23E. Among Formulation, margins are expected to improve due to 1) shifting from partnership model to own launches, 2) incremental contribution from margin accretive differentiated form of core molecules along with launch of small but niche products through Granules Pharmaceuticals Inc. (GPI).

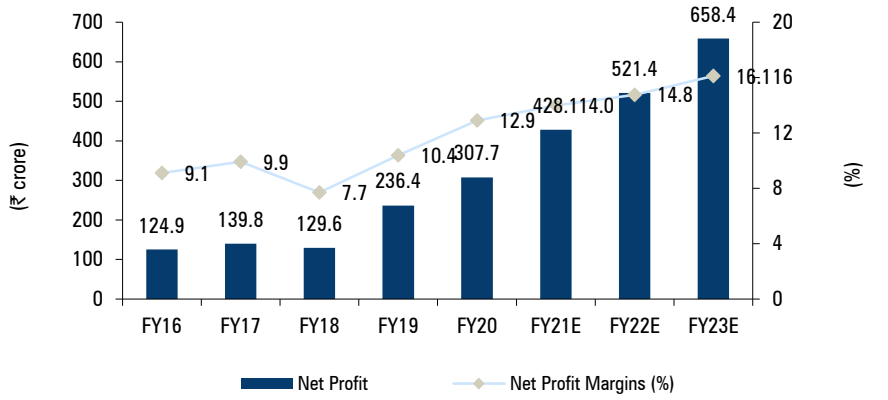
EBITDA margins expected to improve 479 bps to 25% over FY20-23E mainly due to change in product mix and economies of scale

Exhibit 7: EBITDA margins likely to improve 479 bps over FY20-23E



Source: ICICI Direct Research, Company

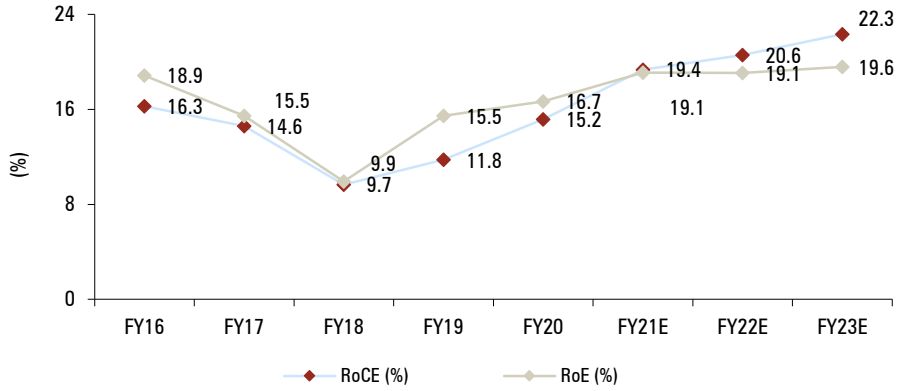
Exhibit 8: Net profit expected to grow along with operational performance



Source: ICICI Direct Research, Company

PAT expected to grow at 28.9% CAGR over FY20-23E mainly due to strong operational leverage and reduction in financial cost amid repayment of debt

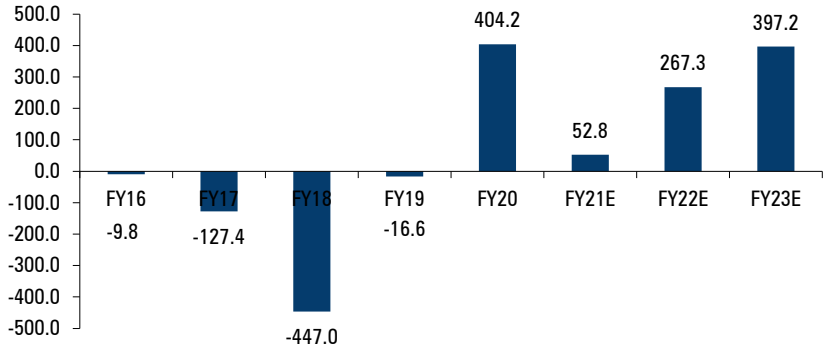
Exhibit 9: Improved margins, turnover drive return ratios



Source: ICICI Direct Research, Company

Improvement in return ratios mainly on the back of better margins and assets turnover

Exhibit 10: Strong free cash flow expected



Source: ICICI Direct Research, Company

Strong operational performance and improvement in assets turnover likely to drive free cash flow

Valuation & Outlook

After achieving critical mass in commoditised but important products over the last few quarters, the company has been steadily expanding its reach into formulations with a vertically integrated model. This bodes well at a time when the generic supply script globally is likely to be re-written in the post-pandemic era that would be more conducive for vertically integrated players such as Granules. We like the company's clear vision to play on its strength of economies of scale and gradually expand into more complex products/forms to improve margins. Margins and return ratios are expected to improve on the back of a change in product mix. Sustained margin expansion is likely to support FCF generation despite brownfield capex lined up till FY23E. We assign a **BUY** rating to the stock.

Key Risk

Product concentration risk

Granules derives ~85% of revenues from five core molecules, Paracetamol, Metformin, Ibuprofen, Guaifenesin and Methocarbamol. The company expects core molecules contribution to remain at 65-75% over the next three to five years. Hence, any adverse impact on any of these products in the near term could impact future growth.

Regulatory issues

Indian pharmaceutical companies have received 19 warning letters, out of the 41 (46%) issued by the USFDA in 2019, the most in four years. Total 73% of Granules' revenues comes from developed markets. The company's future growth and margins improve largely depend on the performance of these geographies. Also, recently, a number of companies received warning letters mainly due to issues related to N-nitrosodimethylamine (NDMA) impurity above the acceptable intake limit. Granules already recalled a small batch of Metformin ER 750 from the US due to this issue. The company does not expect any material impact due to this product. However, any adverse outcome from the USFDA could impact Granules' US business prospects.

Financial Summary

Exhibit 11: Profit and loss statement ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Total Operating Income	2,598.6	3,061.0	3,532.4	4,086.6
Growth (%)	14.0	17.8	15.4	15.7
Raw Material Expenses	1,280.9	1,367.3	1,607.2	1,839.0
Gross Profit	1,317.7	1,693.7	1,925.2	2,247.6
Gross Profit Margins (%)	50.7	55.3	54.5	55.0
Employee Expenses	259.0	348.1	378.0	429.1
Other Expenditure	533.4	635.8	695.9	796.9
Total Operating Expenditure	2,073.3	2,351.2	2,681.1	3,064.9
EBITDA	**525.3**	**709.8**	**851.3**	**1,021.6**
Growth (%)	36.8	35.1	19.9	20.0
Interest	27.0	23.8	20.3	17.3
Depreciation	137.0	136.3	164.1	183.6
Other Income	36.6	23.4	28.3	57.2
PBT before Exceptional Item	**397.9**	**573.1**	**695.1**	**877.9**
Less: Exceptional Items	-27.7	0.0	0.0	0.0
PBT after Exceptional Items	425.6	573.1	695.1	877.9
Total Tax	115.7	145.0	173.8	219.5
PAT before MI	309.9	428.1	521.4	658.4
PAT	**309.9**	**428.1**	**521.4**	**658.4**
Growth (%)	65.2	38.1	21.8	26.3
EPS (Adjusted)	**12.4**	**17.3**	**21.1**	**26.6**

Source: ICICI Direct Research

Exhibit 12: Cash Flow Statement ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit/(Loss) after taxation	306.6	428.1	521.4	658.4
Add: Depreciation & Amortiza	137.0	136.3	164.1	183.6
Net Increase in Current Asset	-88.9	-213.3	-217.8	-255.3
Net Increase in Current Liabili	101.6	77.8	79.3	93.1
Others	19.9	23.8	20.3	17.3
CF from Operating activities	**476.2**	**452.8**	**567.3**	**697.2**
Investments	0.0	0.0	0.0	-300.0
(Purchase)/Sale of Fixed Ass	-72.0	-400.0	-300.0	-300.0
Others	3.5	-0.2	-0.3	-0.3
CF from Investing activities	**-68.4**	**-400.2**	**-300.3**	**-600.3**
(inc)/Dec in Loan	-155.6	-115.7	-100.0	-100.0
Dividend & Dividend tax	-30.7	-29.7	-29.7	-29.7
Other	-26.6	-23.8	-20.3	-17.3
CF from Financing activities	-212.9	-169.2	-150.0	-147.0
Net Cash Flow	**194.9**	**-116.6**	**117.1**	**-50.1**
Cash and Cash Equivalent	89.0	283.9	167.3	284.4
Cash	**283.9**	**167.3**	**284.4**	**234.3**
Free Cash Flow	**404.2**	**52.8**	**267.3**	**397.2**

Source: ICICI Direct Research

Exhibit 13: Balance Sheet ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Equity Capital	25.4	25.4	25.4	25.4
Reserve and Surplus	1,818.3	2,216.7	2,708.4	3,337.1
Total Shareholders funds	1,843.7	2,242.2	2,733.8	3,362.6
Total Debt	892.1	776.4	676.4	576.4
Net Deferred Tax Liability	43.0	43.8	44.7	45.6
Long-Term Provisions	0.0	0.0	0.0	0.0
Other Non Current Liabilities	21.5	21.9	22.4	22.8
Source of Funds	**2,800.3**	**3,084.3**	**3,477.3**	**4,007.4**
Gross Block - Fixed Assets	1,875.2	2,075.2	2,525.2	2,825.2
Accumulated Depreciation	671.3	807.6	971.7	1,155.4
Net Block	1,204.0	1,267.7	1,553.5	1,669.9
Capital WIP	294.2	494.2	344.2	344.2
Fixed Assets	1,498.2	1,761.9	1,897.7	2,014.1
Investments	19.3	19.3	19.3	319.3
Other non-Current Assets	76.9	78.4	80.0	81.6
Inventory	438.4	516.0	595.5	688.9
Debtors	735.2	866.0	999.3	1,156.1
Other Current Assets	244.3	249.2	254.2	259.2
Cash	283.9	167.3	284.4	234.3
Total Current Assets	1,701.8	1,798.5	2,133.4	2,338.6
Creditors	430.0	506.5	584.5	676.2
Provisions	11.7	11.9	12.1	12.4
Other Current Liabilities	54.3	55.4	56.5	57.6
Total Current Liabilities	496.0	573.8	653.1	746.2
Net Current Assets	1,205.9	1,224.7	1,480.2	1,592.4
Application of Funds	**2,800.3**	**3,084.3**	**3,477.3**	**4,007.4**

Source: ICICI Direct Research

Exhibit 14: Ratio Analysis

(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
Reported EPS	13.6	17.3	21.1	26.6
Cash EPS	11.2	16.1	19.9	25.4
BV per share	74.5	90.6	110.5	135.9
Cash per Share	11.5	6.8	11.5	9.5
Dividend per share	1.2	1.2	1.2	1.2
Operating Ratios (%)				
Gross Profit Margins	50.7	55.3	54.5	55.0
EBITDA margins	20.2	23.2	24.1	25.0
PAT Margins	11.8	14.0	14.8	16.1
Cash Conversion Cycle	104.4	104.4	104.4	104.4
Asset Turnover	1.4	1.5	1.4	1.4
EBITDA conversion Rate	90.6	63.8	66.6	68.2
Return Ratios (%)				
RoE	16.7	19.1	19.1	19.6
RoCE	15.2	19.4	20.6	22.3
RoIC	17.5	23.7	24.1	26.8
Valuation Ratios (x)				
P/E	27.4	21.5	17.6	14.0
EV / EBITDA	18.7	13.8	11.3	9.0
EV / Net Sales	3.8	3.2	2.7	2.3
Market Cap / Sales	3.5	3.0	2.6	2.2
Price to Book Value	5.0	4.1	3.4	2.7
Solvency Ratios				
Debt / EBITDA	1.7	1.1	0.8	0.6
Debt / Equity	0.5	0.3	0.2	0.2
Current Ratio	2.9	2.8	2.8	2.8
Quick Ratio	**2.0**	**1.9**	**1.9**	**1.9**

Source: ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%

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ANALYST CERTIFICATION

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