

3 November 2014

Granules India

*Strong performance, margin improvement to sustain; Buy*Rating: **Buy**

Target Price: ₹1,185

Share Price: ₹807

Key takeaways

Strong quarter. For 2QFY15, Granules India (Granules) reported revenue growth of 15.6% yoy, to ₹3.08bn, due to strong performance across product lines. EBITDA margin improved 445bps yoy, to 17%, on the back of increased capacity utilisation. Higher revenue and better EBITDA margin resulted in 46.1% yoy rise in adj. PAT, to ₹221m. Auctus' pharma division contributed revenues of ₹225m and EBITDA of (-₹34mn) during the quarter. However, management expects Auctus subsidiary to break even on EBITDA level on full year basis for FY15.

Growth across segments. Robust FD sales were driven by higher capacity and customer approvals. Finished dosages remained the largest contributor to revenue, at 50% utilisation. During the quarter, Granules commercialised the sale of Abacavir and expects to launch 4-5 APIs in H2FY15. Revenue growth in APIs is aided by de-bottlenecking of capacity. On standalone basis, FDs, APIs and PFIs contributed 40%, 32% and 28%, respectively.

Margin improvement to sustain. Granules reported strong EBITDA margin improvement to 17% for 2QFY15 and expects to maintain the same in FY15. We believe that turnaround of loss-making Auctus subsidiary and start of revenue from Omnicem JV would provide upside to margins from FY16.

Our take. We have a positive outlook on the stock, considering the robust revenues and improving margin. We believe the increasing emphasis on finished dosage would help maintain good growth momentum, going forward. Significant turnaround in business model towards a higher-value chain would improve profitability. The stock trades at attractive valuations of 16.2x FY15e and 12.6x FY16e earnings. We maintain Buy on the stock with target of ₹1,185, based on 14x FY17 earnings. **Risks.** Currency fluctuations and regulatory hurdles.

Key data	GRAN IN / GRAN.BO
52-week high / low	₹941 / ₹163
Sensex / Nifty	27031 / 8069
3-m average volume	US\$0.6m
Market cap	₹16bn / US\$260m
Shares outstanding	20.4m

Shareholding pattern (%)	Sep '14	Jun '14	Mar '14
Promoters	48.6	48.7	48.9
- of which, Pledged	15.2	15.2	24.7
Free Float	51.4	51.3	51.1
- Foreign Institutions	6.1	4.1	1.7
- Domestic Institutions	0.2	0.4	0.2
- Public	45.1	46.8	49.2

Financials (YE Mar)	FY16e	FY17e
Sales (₹m)	16,365	19,374
Net profit (₹m)	1,295	1,717
EPS (₹)	63.9	84.7
Growth (%)	27.9	32.6
PE (x)	12.6	9.5
PBV (x)	2.8	2.2
RoE (%)	24.8	25.5
RoCE (%)	15.7	18.0
Dividend yield (%)	0.7	0.9
Net gearing (%)	53.27	29.46

Source: Anand Rath Research

Quarterly results (YE Mar)	2QFY14	2QFY15	% yoy	H1FY14	H1FY15	% yoy
Sales (₹m)	2,660	3,076	15.6	4,943	6,186	25.1
EBITDA (₹m)	334	523	56.6	631	1,052	66.5
EBITDA margin (%)	12.6	17.0	445bps	12.8	17.0	422bps
Interest (₹m)	44	80	82.6	81	155	91.1
Depreciation (₹m)	62	131	112.5	118	247	109.1
Other income(₹m)	5	5	8.9	23	10	(59.1)
PBT (₹m)	234	318	36.0	456	659	44.6
Tax (₹m)	76	97	26.9	149	210	40.6
Tax rate (%)	35.3	30.5	-481bps	34.6	31.8	-279bps
PAT (₹m)	151	221	46.1	298	449	50.8

Source: Company

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Net revenues	7,644	10,959	13,883	16,365	19,374
Revenue growth (%)	16.9	43.4	26.7	17.9	18.4
- Oper. expenses	6,794	9,376	11,662	13,665	16,032
EBIDTA	850	1,583	2,221	2,700	3,342
EBITDA margin (%)	11.1	14.4	16.0	16.5	17.3
- Interest expenses	177	204	328	328	288
- Depreciation	231	298	425	482	534
+ Other income	21	43	43	43	43
- Tax	138	371	499	638	846
Effective tax rate (%)	29.7	33.0	33.0	33.0	33.0
Reported PAT	326	752	1,013	1,295	1,717
+/- Extraordinary items	0	0	0	0	0
+/- Minority interest	0	0	0	0	0
Adjusted PAT	326	752	1,013	1,295	1,717
Adj. FDEPS (₹/sh)	16.2	37.1	49.9	63.9	84.7
Adj. FDEPS growth (%)	8.7	131.0	34.6	27.9	32.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Share capital	201	203	203	203	203
Reserves & surplus	2,547	3,357	4,370	5,665	7,382
Net worth	2,749	3,560	4,572	5,868	7,585
Minority interest	0	0	0	0	0
Total debt	2,610	4,102	4,102	4,102	3,102
Def. tax liab. (net)	245	303	303	303	303
Capital employed	5,603	7,964	8,977	10,272	10,990
Net fixed assets	3,723	6,070	6,646	7,163	7,629
Investments	97	2	2	2	2
- of which, Liquid	95	0	0	0	0
Net working capital	1,367	1,474	1,818	2,131	2,491
Cash and bank bal.	417	417	511	976	867
Capital deployed	5,603	7,964	8,977	10,272	10,990
Net debt	2,098	3,684	3,591	3,126	2,235
WC days	60.9	46.5	46.3	47.6	47.4
Book value (₹/sh)	136.6	175.5	225.5	289.3	374.0

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
PAT	326	752	1,013	1,295	1,717
+Non-cash items	245	298	425	482	534
Cash profit	570	1,050	1,437	1,777	2,251
- Incr./(Decr.) in WC	(97)	108	237	176	180
Operating cash-flow	667	943	1,201	1,602	2,072
-Capex	1,156	2,646	1,000	1,000	1,000
Free cash-flow	(489)	(1,703)	201	602	1,072
-Dividend	47	83	107	136	181
+ Equity raised	3	11	-	-	-
+ Debt raised	709	1,492	0	0	(1,000)
-Investments	95	(95)	0	0	0
-Misc. items	(17)	(189)			
Net cash-flow	97	0	94	465	(109)
+Op. cash & bank bal.	320	417	417	511	976
Cl. cash & bank bal.	417	417	511	976	867

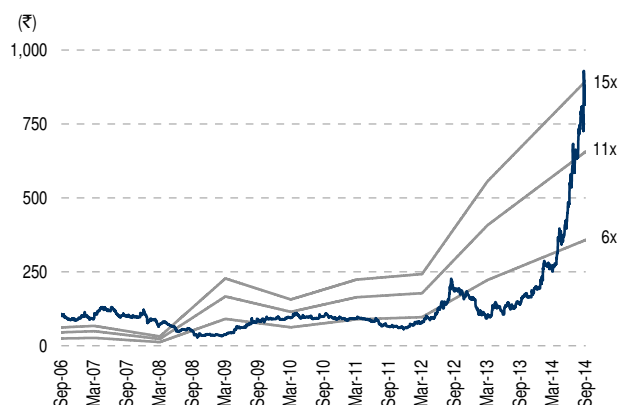
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @₹807

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
P/E (x)	49.9	21.8	16.2	12.6	9.5
P/B (x)	5.9	4.6	3.6	2.8	2.2
EV/EBITDA (x)	21.7	12.7	9.0	7.2	5.6
RoE (%)	12.5	23.9	24.9	24.8	25.5
RoCE (%)	8.8	13.1	14.6	15.7	18.0
Dividend yield (%)	2.1	1.4	0.6	0.7	0.9
Dividend payout (%)	0.2	0.3	0.4	0.6	0.8
Asset turnover (x)	3.0	2.9	2.7	2.9	3.1
Net Debt/Equity (x)	0.8	1.0	0.8	0.5	0.3
Net debt/EBITDA (x)	2.5	2.3	1.6	1.2	0.7
Net debt/Op. CF (x)	3.1	3.7	3.0	2.0	1.1
Interest coverage (x)	3.5	6.3	5.5	6.8	9.7
P/CEPS (x)	29.2	15.6	11.4	9.2	7.3
EV/ sales (x)	2.6	1.8	1.4	1.1	0.0
M-cap/sales (x)	2.1	1.5	1.2	1.0	0.8

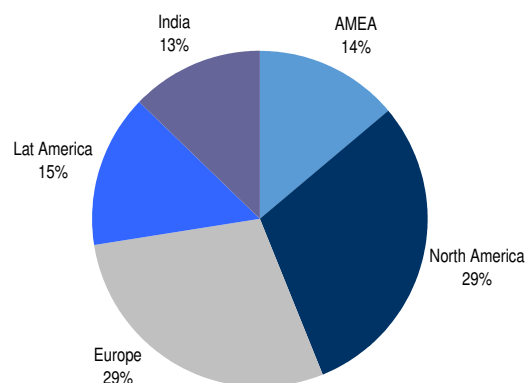
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up (FY14)



Source: Company

Concall Highlights

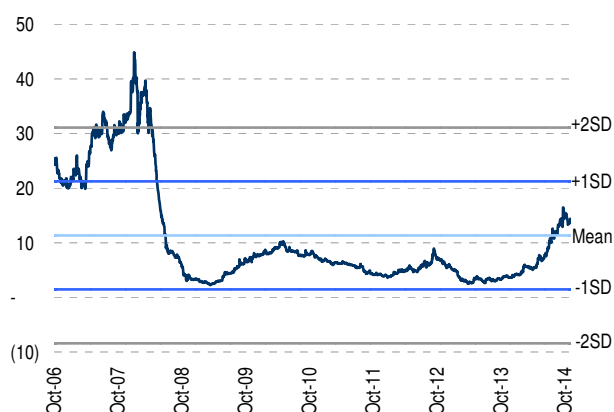
- Granules' Omnicem JV's commercial sale would commence in a meaningful way from FY17.
- Biocause JV reported sales of ₹550m for H1FY15.
- Pharmaceutical formulation intermediates (PFI) reported flat growth, as most of the production went for finished dosage (FD) i.e. more captive consumption.
- Current Utilisation level- PFI 70% and FD-50%.
- Focused primarily on API capacity for the Auctus unit by expanding clean room facilities, which will be available by the end of 3QFY15; sale will come from 4QFY15 (max shutdown of two weeks expected due to Vizag cyclone).
- Capex guidance for FY15 ₹750m-₹1,000m and FY16 ~₹750m.
- Margins would be maintained at 17%.
- Management expects revenue from Auctus for FY15 ~₹1.3-1.4bn.

Valuation

We have a positive outlook on the stock, considering the robust revenue growth and improving margin. We believe, ahead, the increasing emphasis on finished dosage would help to maintain good growth momentum. Significant turnaround in the business model towards a higher-value chain would improve profitability. Granules has commercialised sale of Abacavir and intends to commercialise an additional 4-5 APIs during H2FY15

The stock trades at attractive valuations of 16.2x FY15e and 12.6x FY16e earnings. We maintain Buy on the stock with target of ₹1,185 based on 14x FY17 earnings.

Fig 7 – Mean PE and standard deviation



Source: Bloomberg, Anand Rath Research

Risks

- Currency fluctuations and regulatory hurdles.
- Pricing pressure in generic products in regulated markets.

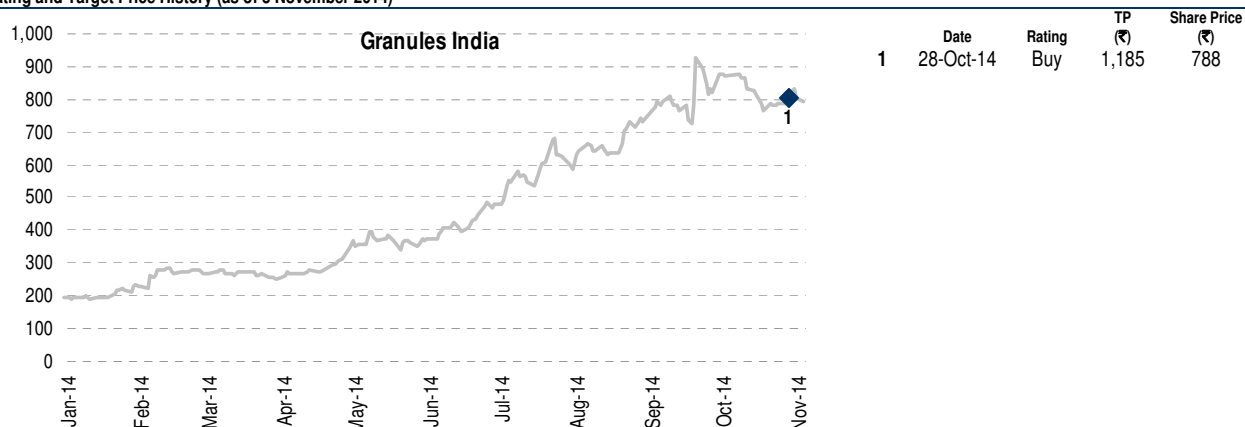
Appendix

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