



# Granules India

STOCK INFO.	BLOOMBERG
BSE Sensex:25,715	GRAN IN
S&P CNX:7,792	REUTERS CODE
	GRAN.BO

27 August 2015

Buy

Initiating Coverage

INR115

	(INR CRORES)		
Y/E MARCH	FY15	FY16E	FY17E`
Revenue	1293	1521	1764
EBITDA	209	252	312
EBITDA Margin	16.1%	16.6%	17.7%
NP (Adj.)	91	109	140
EPS (Adj.)	4.5	5.3	6.8
EPS Growth	21%	20%	28%
BV/share	21	28	36
ROE (%)	22	19	19
ROCE (%)	19	20	21
P/E (x)	25.8	21.5	16.8
P/BV (x)	5.3	4.0	3.1

## KEY FINANCIALS

Shares o/s (cr)	22.3
Market Cap. (Rs cr)	2497
Market Cap. (US\$ m)	403
Past 3 yrs Sales Growth (%)	26%
Past 3 yrs NP Growth (%)	45%

## STOCK DATA

52-W High/Low Range (INR)	134/72
Major Shareholders (as of June 2015)	
Promoter	48.5
Non Promoter Corp Holding	3.1
Public & Others	48.5
Average Daily Turnover(6 months)	
Volume	1993575
Value (Rs cr)	23.0
1/6/12 Month Rel. Performance (%)	3/42/52
1/6/12 Month Abs. Performance (%)	11/53/55

**Maximum Buy Price: INR125**

**We recommend a BUY on Granules with a target of INR 160 - valuing the company at 20x Sep 2017E EPS.**

**Metamorphosis into a formulations driven company:** Over the past seven years, Granules has ascended the pharma value chain by shifting away from APIs and PFIs towards formulations. The company started selling formulations in FY09 which today contributes 32% of revenues followed by 24% from PFIs and 44% from APIs. The EBITDA margins of the base business have correspondingly increased by 430bp over the last five years to 17.7% in FY15. We expect formulations to contribute 65% of revenues over the next five years and expect EBITDA margins to expand by 520bp to 23% by FY20E.

**Entry into high margin CRAMS business by forming a JV with Omnicem:** Granules has set up a JV (50:50) with Ajinomoto Omnicem, a CRAMS manufacturer with 40 years of experience. Omnicem makes patent-protected products (APIs) for reputed pharma companies globally. Going forward, as these products go off-patent, they will be shifted to the JV to consolidate market share. Omnicem customers will be able to retain certain market share by shifting to a low cost destination like India. Omnicem is operating its capacities at full in Belgium and there is no plan to setup additional capacity there since it is not cost effective. As a part of Omnicem's business continuity plan, it intends to grow via this JV in India owing to the cost effective manufacturing base. The JV will create opportunities for Granules to penetrate into more complex drugs which provide higher margins without making a significant outlay in R&D. The JV is currently awaiting USFDA approval which it expects to obtain by end of FY17E post which it would start mass scale production. Until that time, the JV will manufacture intermediates and supply it to Omnicem's Belgium plant where they will be converted into APIs. Management has indicated revenues of INR 550cr along with EBITDA margins of 20-25% by FY20E for this JV. We believe this JV will contribute significantly to earnings post FY17E.

**Valuations & View:** In the past decade the company's revenues and profits have grown at a CAGR of 23% & 33% while in the next three years (FY15-18E) we expect them to compound at 17% & 27% respectively. We expect the company's EBITDA margins to improve from 16.1% in FY15 to 19.0% by FY18E and keep improving from thereon due to a change in business mix. We recommend to BUY Granules for a price target of INR 160 based on 20x Sep 2017E EPS, a 10% discount to midcap pharmaceutical players (being a B2B player), offering an upside of 40% from current levels.

### Metamorphosis into a formulations driven company

* BASE BUSINESS SEGMENTS	INDICATIVE EBITDA MARGINS	REVENUE MIX		
		FY10	FY15	FY20E
API	10%	50%	44%	15%
PFI	17%	43%	24%	20%
Formulations	24%	7%	32%	65%
Base Business EBITDA		13.4%	17.7%	22.9%
Base Business ROCE		13%	26%	36%

\*Base Business: Consolidated less [Auctus & Omnicem JV]

#### Auctus acquisition provides strong synergy; to replicate Granules' business strategy & move up the value chain:

Granules acquired Auctus in Feb'14 for INR 102cr as Auctus provides strong synergy. (i) Auctus has a USFDA approved API facility which reduces the time to market by four years compared to a green field project. (ii) Granules offers five APIs to its customers: paracetamol, metformin, ibuprofen, guaifenesin and methocarbamol. With the acquisition of the API business of Auctus, it has added 12 APIs to its product basket, which offer higher margins than Granules' existing APIs. (iii) Auctus predominantly supplied intermediates (80%) with APIs forming the balance (20%). Granules is changing Auctus' product profile entirely towards APIs and in the long run shall forward integrate towards formulations which would improve margins significantly. Granules shall also file 10 ANDA applications over the next couple of years, the benefits of which would be visible after two-three years. (iv) Granules will look at predominantly focusing on high margin regulated market exports, thereby boosting both topline and bottom-line in comparison to Auctus' hitherto largely domestic customer base (75% of sales). To this effect, Granules will leverage its direct access to over 300 customers in 60 countries. (v) Operating efficiencies to be improved by capacity de-bottlenecking and direct procurement from end suppliers as opposed to traders which would lower costs. We expect Auctus to clock low double digit EBITDA margin in the next 3-4 years from an EBITDA loss in FY15. The margins could witness a further uptick post approval of ANDAs in the long run.

**Low regulatory risks:** While most big pharma companies have struggled against USFDA inspections, Granules has never had any observations or issues on this front. This is owing to the nature of Granules' business, as being a B to B company the customers of Granules conduct 4-5 audits each month (which are more stringent than USFDA) unlike the B to C companies which are more relaxed in handling and managing processes.

#### Company Background

Granules is a Hyderabad based company established in 1984 by Mr. C. Krishna Prasad having four USFDA approved facilities in and around Hyderabad and one in China. Largely an export-oriented company (84% of revenues), Granules exports to more than 300 customers in 60 countries. The company derives 63% of its revenues from regulated markets of North America (32%) and EU (31%) and balance from LATAM (11%), ROW (10%) and India (16%). Until 2008, Granules focused on building a large scale in select APIs/PFIs like Paracetamol, Ibuprofen, Metformin and Guaifenesin wherein it is amongst the largest producers globally. Post 2008, the company forward integrated into manufacturing formulations which has resulted in the company moving higher up the value chain. Going forward, the company shall continue to witness margin expansion on the back of (i) continued increase in share of formulations in the base business, (ii) turnaround of and filing of ANDAs in the newly acquired company Auctus and (iii) commencement of high margin business in the CRAMS JV with Omnicem from FY18 onwards.

**Base Business (Consolidated less Auctus less Omnichem JV)**

	FY14	FY15	FY16E	FY17E	FY18E	FY19E	FY20E
Revenues	1096	1178	1321	1519	1747	2008	2309
Growth	47%	7%	12%	15%	15%	15%	15%
Revenue Mix	100%	91%	87%	86%	85%	84%	83%
EBITDA	158	209	256	304	365	440	529
EBITDA Margin	14.4%	17.7%	19.4%	20.0%	20.9%	21.9%	22.9%
PAT	75	104	123	142	175	219	273
ROCE	23%	26%	29%	26%	29%	32%	36%

AUCTUS	FY14	FY15	FY16E	FY17E	FY18E	FY19E	FY20E
Revenues	-	115	160	200	230	264	304
Growth	-	-	39%	25%	15%	15%	15%
Revenue Mix	-	9%	11%	11%	11%	11%	11%
EBITDA	-	-0.4	0	10	18	26	33
EBITDA Margin	-	-0.3%	0.0%	5.0%	8.0%	10.0%	11.0%
PAT	-	-13	-4	5	13	21	27
ROCE	-	-3%	-3%	3%	7%	11%	15%

OMNICHEM JV -50% SHARE	FY14	FY15	FY16E	FY17E	FY18E	FY19E	FY20E
Revenues	-	-	40	45	75	125	175
Growth	-	-	-	13%	67%	67%	40%
Revenue Mix	-	-	3%	3%	4%	5%	6%
EBITDA	-	-	-4	-2	5	16	32
EBITDA Margin	-	-	-10.0%	-5.0%	7.0%	13.0%	18.0%
PAT	-	-	-9	-8	-1	10	24
ROCE	-	-	-8%	-6%	-1%	7%	17%

CONSOLIDATED	FY14	FY15	FY16E	FY17E	FY18E	FY19E	FY20E
Revenues	1096	1293	1521	1764	2051	2397	2787
Growth	-	18%	18%	16%	16%	17%	16%
EBITDA	158	209	252	312	389	482	594
EBITDA Margin	14.4%	16.1%	16.6%	17.7%	19.0%	20.1%	21.3%
PAT	75	91	109	140	188	249	325
ROCE	20%	19%	20%	21%	24%	28%	33%



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