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# Granules India

## Treading the right path

Initiating Coverage

July 9, 2014

**Rating**

Buy

| **CMP** | **Target Price** |
|---|---|
| Rs566 | Rs773 |

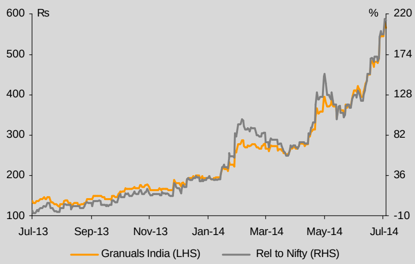
| | |
|---|---|
| EPS Chg FY15E/FY16E (%) | NA |
| Target Price change (%) | NA |
| Nifty | 7,623 |
| Sensex | 25,582 |

### Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---|---|---|---|---|
| Absolute | 38 | 111 | 185 | 336 |
| Rel. to Nifty | 37 | 85 | 131 | 229 |

Source: Bloomberg

### Relative price chart




Source: Bloomberg

### Stock Details

| | |
|---|---|
| Sector | Pharmaceuticals |
| Bloomberg | GRAN IB |
| Equity Capital (Rs mn) | 204 |
| Face Value(Rs) | 10 |
| No of shares o/s (mn) | 20 |
| 52 Week H/L | 614/ 120 |
| Market Cap (Rs bn/USD mn) | 12/ 192 |
| Daily Avg Volume (No of sh) | 398,341 |
| Daily Avg Turnover (US$mn) | 2.6 |

### Shareholding Pattern (%)

| | Jun'14 | Mar'14 | Jun'14 |
|---|---|---|---|
| Promoters | 48.9 | 48.9 | 48.9 |
| FII/NRI | 1.8 | 1.6 | 1.8 |
| Institutions | 0.2 | 0.1 | 0.2 |
| Private Corp | 5.6 | 3.1 | 5.6 |
| Public | 43.6 | 46.3 | 43.6 |

Source: Bloomberg

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- Granules offers three components of the pharma value-chain manufacturing APIs, PFIs and FDs and is seeing strong transformation to high profitable business mix
- Recent Auctus acquisition and Omnichem JV providing the much-needed product diversification and a fillip to create a high-end regulated markets exporter with stronger margins
- Improving return ratios, cashflows and profitability to re-rate stock valuations. The stock not pricing in improvement in business quality and growth
- Inexpensive and compelling valuations; the stock trades at PER of 8.8x FY16E. We initiate coverage with a Buy and a target price of Rs773 at 12x FY16E EPS of Rs64.4

### Upgrading business quality…

Till day, Granules India has been recognized the world over as a low-end paracetamol API player. But, in our view, the company has metamorphosed from merely being an API manufacturer into a high-end intermediates and formulations supplier. The company's key products include paracetamol, ibuprofen, and metformin. Its strong presence across the value-chain makes Granules a preferred integrated player for global customers. Recently, it has acquired Auctus Pharma, which has a USFDA-approved manufacturing facility and several products. This acquisition would help the company to diversify its product basket. Its recent entry into the CRAMS business through the Ajinomoto OmniChem JV bodes well for its long-term profitability, besides helping to upgrade the business quality a notch above peer pure play API manufacturers.

### …and moving onto the next orbit

We believe Auctus Pharma and Ajinomoto OmniChem, along with an improvement in the base business product mix, will help catapult Granules into better profitability and return metrics. We believe the contribution of the low-margin API business would come down from the current 32% to less than 25% over the next 2 years despite the Auctus acquisition. The business mix would change more towards PFIs and finished dosages (FD), besides sales increasing more towards regulated markets, implying better margins ahead. During FY14, Granules expanded its FD capacity from 6bn to 18bn tablets per annum, and PFI capacity from 9,840tpa to 14,400tpa at a total capital cost of Rs1.07bn. We are building in strong growth over FY14-16E for FD and PFI sales.

### Sharp improvement in return ratios to continue

ROEs have improved from 10% in FY11 to 24% in FY14, while ROCEs have improved from 12% to 19% during the same period. We believe the increased capacity utilization of the recently added capacity and improvement in EBITDA margins in the coming years would help improve ROEs and ROCEs to 27% and 26%, respectively, by FY16E.

### Valuations cheap; Initiate with a Buy at a target price of Rs773

We believe the current P/E of 8.8x FY16E EPS is unjustified, given the fact that the growth rate, going forward, would be very strong, which is supported by a healthy change in the business quality. We initiate coverage with a BUY and a TP of Rs773.

**Financial Snapshot (Consolidated)** **(Rsmn)**

| YE-Mar | Net Sales | EBITDA (Core) | EBITDA (%) | APAT | EPS (Rs) | EPS % chg | RoE (%) | P/E | EV/ EBITDA | P/BV |
|---|---|---|---|---|---|---|---|---|---|---|
| FY13A | 7,644 | 861 | 11.3 | 337 | 16.7 | 15.4 | 12.9 | 33.8 | 16.0 | 4.1 |
| FY14A | 10,959 | 1,584 | 14.5 | 753 | 37.4 | 123.9 | 23.9 | 15.1 | 9.6 | 3.2 |
| FY15E | 13,721 | 2,195 | 16.0 | 898 | 44.6 | 19.2 | 23.1 | 12.7 | 7.0 | 2.7 |
| FY16E | 17,006 | 2,843 | 16.7 | 1,296 | 64.4 | 44.4 | 27.0 | 8.8 | 5.3 | 2.1 |

# Investment Rationale

## Strong positioning as an API supplier

Granules has invariably enjoyed a stronghold in the API market for the drugs it supplies. The key APIs in the company's kitty, wherein it has a good market share, include paracetamol, guaifenesin, ibuprofen and metformin. We believe Granules' positioning in these products has been advantageous vis-à-vis competition, both in terms of quality and pricing.

Granules management indicates that the company only produces those products for which it feels it has a sustainable competitive advantage, whether it be a competitive cost position or the ability to offer multiple products across the value-chain, including APIs, PFIs and FDs to its customers.

**Exhibit 1: Global market space for key products indicating strong presence for Granules**

| Market (tpa) | Demand | Supply | Supply Gap |
|---|---|---|---|
| **Regulated markets** | **46,500** | **44,200** | **2,300** |
| **ROW markets** | **53,500** | **97,000** | **-43,500** |
| **Paracetamol regulated Market suppliers (tpa)** | | | **Mkt. Share** |
| Mallinckrodt | | 25,000 | 56% |
| Granules | | 13,200 | 30% |
| Novocel | | 6,000 | 14% |
| **Ibuprofen suppliers (tpa)** | | | |
| Shasun | | 6,000 | 20% |
| IOL Chemicals | | 6,000 | 20% |
| Albemarle | | 5,200 | 17% |
| BASF | | 5,000 | 17% |
| Granules Biocause | | 4,800 | 16% |
| **Metformin suppliers (tpa)** | | | |
| Granules | | 1,800 | 5% |
| USV Ltd. | | 10,100 | 28% |
| Wanbury | | 9,000 | 25% |
| Harman | | 6,000 | 17% |
| **Methocarbamol suppliers (tpa)** | | | |
| Granules | | 200 | 20% |
| Synthochem | | 250 | 25% |
| **Guaifenesin Suppliers (TPA)** | | | |
| Granules | | 1,200 | 26% |
| Synthochem | | 800 | 17% |
| **Market Demand Growth (%)** | | | |
| Paracetamol | 2.7 | | |
| Ibuprofen | 4 | | |
| Metformin | 12 | | |

*Source: Company, Emkay Research*

Although one generally looks at API players as commodity, and investors fear if someone undercuts these players on price or if a new supplier comes in, existing players would lose their market share. The Granules management has indicated ways to overcome this challenge: it has inherently focused on customers that value quality and service more than pricing. The company is also able to charge a premium to such customers who appreciate the quality and service, thus implying that it hasn't got an entirely commoditized business.

Generally, Granules enters into 3-5 year contracts with major customers, including the ability to pass along certain raw materials costs. This makes the relationship more sustainable.

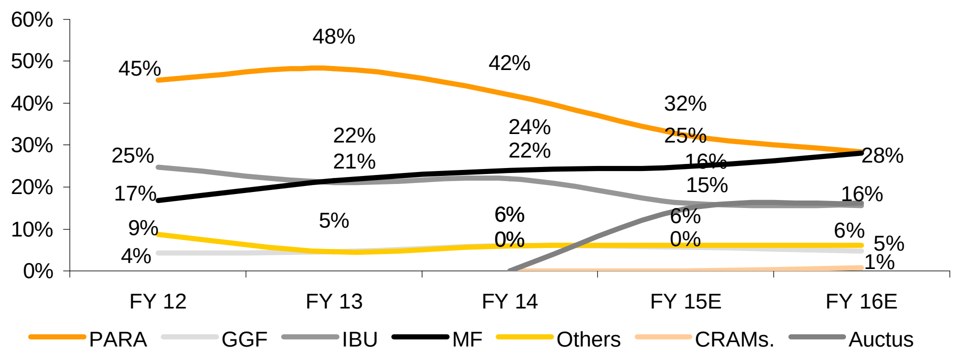
In addition, since most customers register their products in a couple of dozen markets, the switching cost is obviously high. Hence, even if someone offers a lower price, they are not inclined to change sources. Also, since Granules offers API/PFI/FD, customers enjoy flexibility. The company tends to begin with a single product and later offers more from its basket. The examples that have been cited by the company include a particular customer, with whom it forged a relationship by offering paracetamol API, but now it also sells paracetamol PFI. With another customer, Granules started with guaifenesin API, but it also supplies ibuprofen FD today. This value proposition demonstrates the fact that the company is not truly in the commodity part of the business. We believe this provides stability to Granules' profitability margins, besides helping to build stronger long-term relationships with customers.

The underlying philosophy is to consolidate the market share by targeting producers who have structural disadvantages that are not easy to overcome. Granules seeks to garner a significant market share, and if possible build a leadership position in such molecules, so that besides enjoying the economies of scale, coupled with process savings, it could create sustainable competitive advantage, though the market growth may prove to be slow. The company has built supply relationships with brand owners who are growing faster than the overall market. For example, according to company sources, GSK's paracetamol demand (sold under the brand-name, Panadol) is growing at 6-7% per annum, while the overall paracetamol market has clocked a mere 2% growth annually. Granules has garnered a healthy share of the incremental demand from GSK, and now intends to replicate this model with other key customers.

Another good example of the same is its recent contract with Reckitt Benckiser's Mucinex brand, which is incidentally the largest brand for guainfenesin.

Although the company's overall contribution of API is found to be declining, the same is being replaced by captive consumption for PFIs and FDs.

**Exhibit 2: Sales break-up indicates improving diversification**




*Source: Company, Emkay Research*

### PFIs and finished dose contribution to increase over the years

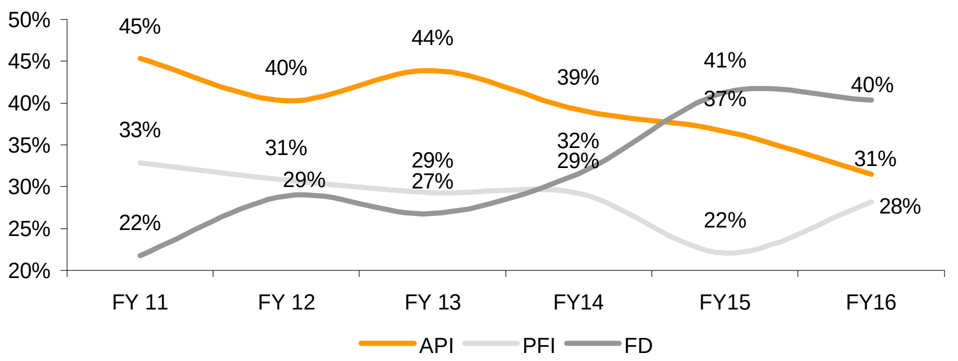
Realizing the need to move into higher value and higher profitability business segments, Granules, over the years, has deliberately stepped up its contribution of finished dose products to total sales. Also, PFI sales contributions have increased from 22% to around 29% in FY14.

Incidentally, Granules is among the very few Indian players to have scaled up pharmaceutical formulation intermediates (PFI) to a meaningful level.

PFIs is a novel concept for large-volume blockbuster drug molecules within the pharmaceutical production, and offer significant savings for the dosage form manufacturers, besides presenting fewer handling issues, fewer regulatory hurdles and better overall efficiency. As an alternative to active pharmaceutical ingredients, the PFI concept is expected to transform the conventional pharmaceutical manufacturing model, since an increasing number of companies are switching over to compounding of PFIs.

Granules has a 6-ton batch-size technology, which provides advantage over peers, who generally have much a lower batch-size. Besides, the same is not easily replicable. The 6-ton batch-size helps Granules manufacture tablets more efficiently. Moreover, since PFI customers have to register their products in the market, it would be difficult to switch from a supplier to another. Thus, PFI offers a substantial advantage and provides Granules an edge over other API competitors.

**Exhibit 3: Segmental mix improving towards FDs**




*Source: Company, Emkay Research*

Granules has one of the largest single-site facilities for FDs. The company's sharp ramp-up in contribution to the total sales is indicative of customers' growing confidence in its long-term potential.

A higher contribution of late in value-chain products indicates not only improving business quality and profitability, but also growing confidence of customers in Granules' manufacturing abilities. We believe, going forward, the mix would further improve in favour of FDs and PFIs.

## Creating long-term value addition through JVs/acquisitions

In recent times, Granules has scaled up its top-line. It now intends to improve profitability through some of the JVs and acquisitions it has made. The company also seeks to mitigate concentration risks on select products. These initiatives are expected to help the company achieve its objectives.

## Granules Biocause (50-50 JV with Hubei Biocause)

### About Hubei Biocause

Hubei Biocause Pharmaceutical Co., Ltd. is based in Jingmen, Hubei, China. The company focuses on manufacturing chemicals and pharmaceuticals, including APIs and FDs. Biocause has 1,678 employees, with total assets of RMB2.10bn and annual revenue of RMB1bn. It is the largest producer of ibuprofen API and tablets in China. The company has a market capitalization of RMB3.61bn/USD579mn as on March 24, 2014. It is listed in the Shenzhen Stock Exchange.

### JV rationale

Biocause's primary facility is located in Jingmen, China, which is spread over 140 acres. On this site, the company had a 4,800tpa ibuprofen facility that was built in 1993. Granules used to buy ibuprofen API from Biocause, and for several years both companies had a healthy supplier-buyer relationship. When the Granules management decided to make ibuprofen a key product, it decided that it needed to be integrated. In 2006 Granules formed a joint venture with Biocause called Granules-Biocause. The JV was formed, because Granules required secure API supply in order to support PFI and FD growth. While there are other ibuprofen suppliers, none are able to fulfil Granules' requirements. The JV gives Granules access to high-quality material and is instrumental in Granules' FD focus on ibuprofen.

The JV's total sales are estimated at Rs985mn (granules' share) in FY14. It has grown at a CAGR of 25% over FY11-14. We expect the growth to be maintained at a CAGR of 3% over FY14-16E. Historically, the JV had an EBITDA margin in the vicinity of 8%. We are building in a similar margin going forward. The lower growth ahead is on account of increased captive usage of Ibuprofen and also because of already improved capacity utilization levels.

## Granules OmniChem (50-50 JV with Ajinomoto OmniChem)

### About Ajinomoto OmniChem

Ajinomoto OmniChem is a Belgian company that has a workforce of around 750 people on three of its facilities in the country, including Louvain-La-Neuve, Wetteren and Balen. The company specializes in contract manufacturing of intermediates and APIs for innovator companies. OmniChem focuses on manufacturing products for innovators from Phase-2 through commercialization, with an emphasis on Phase-3 and commercialization.

OmniChem was absorbed by a Japanese-based company, Ajinomoto, in 1989. But it continues to operate as an independent unit. The parent company has revenue of JPY1172bn (USD11.4bn) and a net income of JPY55bn (USD 535mn), with a market capitalization of JPY955bn (USD 9.28bn).

### JV rationale

OmniChem's customers ceded a large market share when their products went off-patent, as generics companies, primarily in India, introduced cheaper alternatives. Due to increasing margin pressures, OmniChem's customers no longer wished to concede a large market share, but wanted to retain the market share even when a product went off-patent. Due to the high operating costs in Belgium, OmniChem did not want to set up a new facility in the country. Since Granules had demonstrated low-cost/high-quality manufacturing capabilities, in 2011 Omnichem decided to partner with the company to set up a greenfield facility in Vizag SEZ. Initially, OmniChem will shift production of 6-7 products to the JV. The JV will also work on second-generation manufacturing processes in order to boost manufacturing efficiency. The JV will allow Granules to enter the CRAMS market without making a significant outlay in R&D. In addition, Granules will be working with an established CRAMS company, which has over 40 years of experience in the segment, with an established customer base.

We are building in a strong growth trajectory from Rs150mn sales in FY15E to Rs1,000mn in FY18E. We believe this business would be a healthy contributor for EBITDA margins, as the projects scale up over the years.

## Auctus Pharma (100% acquisition)

### Acquisition rationale

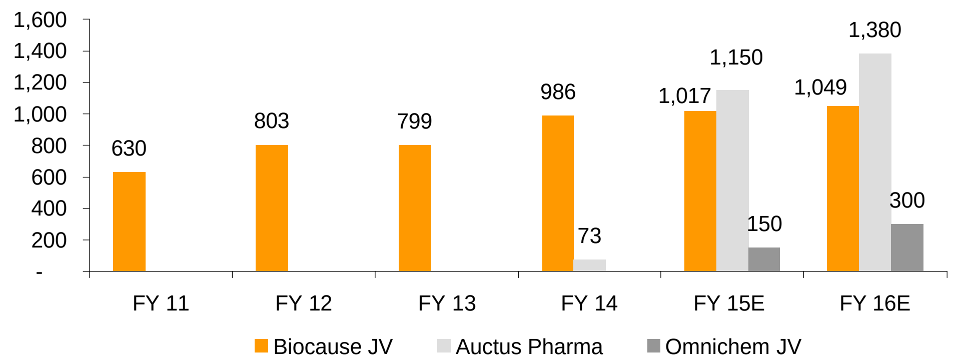
Granules was looking to expand its product portfolio and identified several molecules that it wanted to produce. While identifying manufacturing options, the company found an opportunity to acquire Auctus Pharma. Since Auctus already had an approved facility for regulated markets, this acquisition allowed Granules to reduce the time-to-market by around 4 years compared to a greenfield project. The acquisition gives the company access to the manufacturing know-how for 14 low-volume, high-value API across various therapeutic areas.

Given Granules' operations and marketing strengths, the company hopes to turn around Auctus' operations by addressing manufacturing efficiencies in the next fiscal year. In addition, Granules will work on changing the revenue mix by focusing on regulated markets. In addition, the company will also file ANDAs for various products from the Auctus portfolio and launch new formulations in the future.

Auctus has not been very well managed so far, and going by the Granules management's ability to scale up good market shares in its products, clubbed with a strong customer base, we believe this could turn out to be a very strong and profitable acquisition by the company 2 years down the line.

We are building in a CAGR 20% on this business over the next few years. But, we believe, the improvement in margins and the scale-up in Granules' customer base will bring in healthy benefits in the long run.

**Exhibit 4: Sales from JVs and acquisitions increasing going ahead (Rs mn)**




*Source: Company, Emkay Research*

## Risks and Concerns

### Regulatory risk

Granules supplies to export markets, and hence being a pharma player it is mandatory that it secures approvals from several regulatory bodies across the globe. Granules has approved facilities from several regulatory bodies across the globe like USFDA, UK-MHRA, EDQM, KFDA, WHO GMP, Health Canada, TGA etc. The recent increase in scrutiny and adverse outcome for several players in the industry continues to be the biggest risk in the pharma sector and implies to Granules too.

### Foreign exchange risk

Most of Granules' revenue accrues from exports (roughly 87% FY14), but at the same time a large component (around 60%) of its raw material requirements is imported. Hence, it enjoys a natural hedge. The company also has most of its debt in foreign currency. Granules also has clauses in most of its contracts, wherein it adjusts the selling price based on the Forex rate.

The company does not have a hedging policy in accordance with the natural hedges and cost transfer clauses in the contracts. We see a limited impact of foreign currency fluctuations on the company's reported numbers.

### Limited disclosure risk

Agreements between Granules and its partners/customers are confidential in nature. We have limited visibility on the product-level/client-level information. Our assumptions are based on our analysis of publicly available information and a few citations by the Granules management (highlighted above). We however, continue to believe that limited disclosure in Contract Manufacturing business is a part and parcel of the business model and indicates healthy client confidentiality maintenance.

### Concentration risk

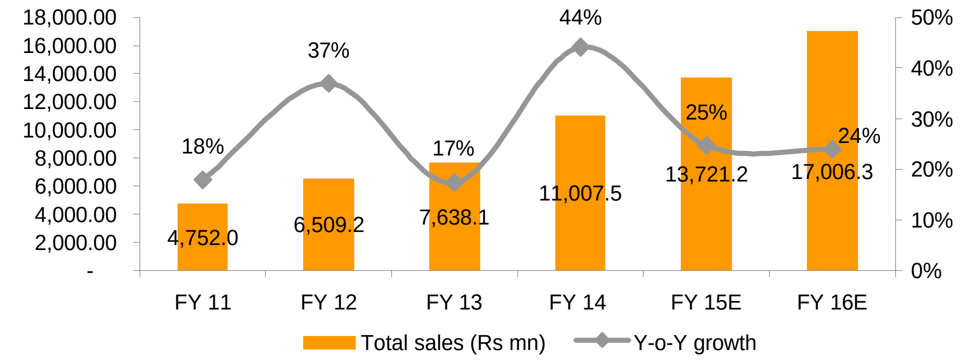
In the generics and API business, the companies have high dependency on select products. Hence, they face the risk of low diversity in products. Incidentally, Granules derives around 90% of its revenue from top-4 products.

## Financials

### Healthy past sales growth and solid future growth prospects

Granules has delivered a healthy CAGR of 32% over FY11-14. Based on our assumptions, we believe, the growth going forward would remain strong at a CAGR of 25% over FY14-16E. The business, being contractual in nature, calls for a ramp-up in capacity over time. We are building in Rs1,900mn for the same over the next 2 years.

**Exhibit 5: Net sales to grow at a CAGR of 25% (FY14-16E)**

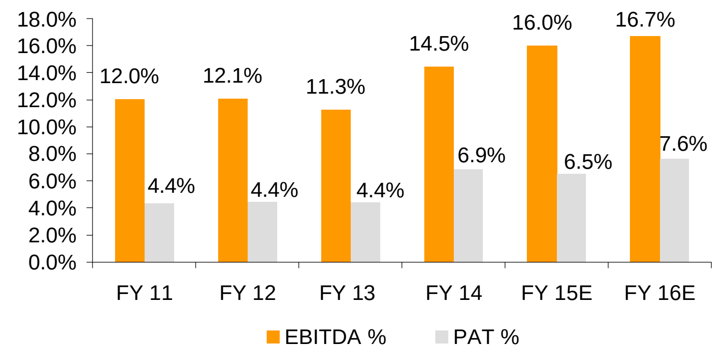



*Source: Company, Emkay Research*

### EBITDA CAGR of 34% on improving product mix

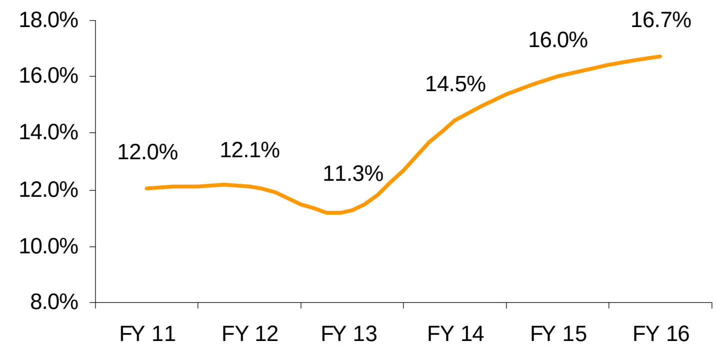
With the product mix improving towards higher profitable PFIs and FDs, we expect EBITDA margins for the company to see an improvement over the previous years. Also, we believe, the recently concluded acquisition of Auctus would break even in FY15E and generate incremental profits in FY16E. The OmniChem CRAMs business will see higher EBITDA over the next 3 years, with EBITDA margins at around 25% by FY18. Our EBITDA margins for FY15E are expanding by 150bps over FY14. We expect Granules to clock an EBITDA growth of 34% (CAGR) over FY14-16E, with EBITDA of Rs2.84bn in FY16E.

**Exhibit 6: EBITDA to grow around 34% CAGR during FY14-16E**




*Source: Company, Emkay Research*

**Exhibit 7: EBITDA margins to expand**

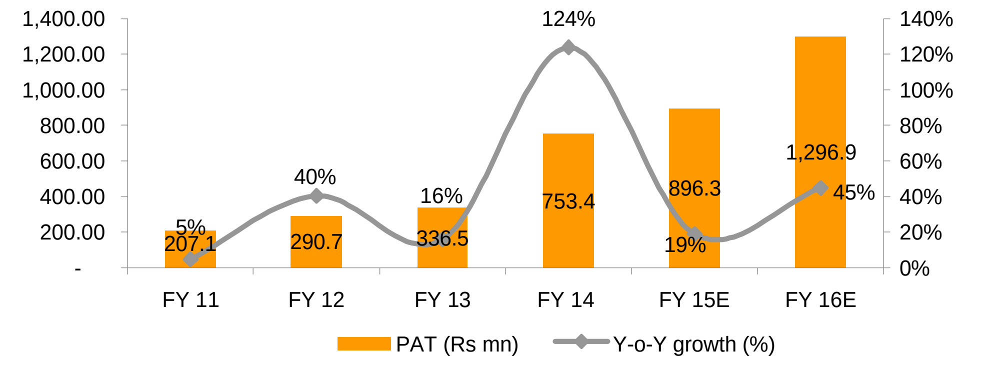



*Source: Company, Emkay Research*

### EPS to grow at a CAGR of 31%

As mentioned earlier, improved business mix, higher contribution and turn around in JVs and improved capacity utilization will lead to overall profitability improvement for the company. This, coupled with a CAGR of 31% in operating profit, is expected to further boost the earnings growth trajectory for the company, with its EPS expected to grow by around 31% (CAGR) over FY14-16E and EPS of Rs64.4 in FY16E.

**Exhibit 8: PAT to grow ~31% CAGR during FY14-16E**

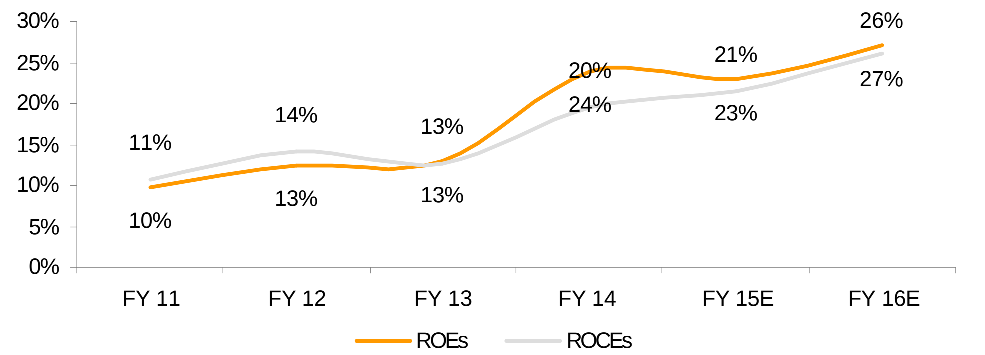



*Source: Company, Emkay Research*

### Return ratios to improve substantially; RoCEs to reach 27%

With improving capacity utilization and a margin rebound, we expect Granules to witness a sharp improvement in return ratios, with RoE expected to improve by 1403bps to 27.0% in FY16E from 13.0% in FY13, while ROCE is likely to move upwards by around 1400bps to about 27% in FY16E from around 13.0% in FY13.

**Exhibit 9: RoCE to improve to 27% by FY16E; RoE expected at 27%**




*Source: Company, Emkay Research*

## Valuations

### Valuations attractive vis-à-vis strong growth forecast and improving ROEs

Currently, Granules trades at 8.8x FY16E, which, we believe, is attractive in the light of the strong EPS growth that we are forecasting. Over FY14-16E, we believe, PAT would grow at a CAGR of 32%, and over FY16E-18E, the company would grow its PAT by another 25%. Along with the strong bottom-line, Granules would also see a healthy return ratios improvement as highlighted earlier.

At the CMP of Rs565, Granules is trading at PER of 8.8x its FY16E EPS, which, we believe, is at a significant discount to its fundamental value, considering the growth capabilities and quality of business improvement. As highlighted below, we believe, Granules has the best return ratios and growth potential compared to peers like Shasun Pharma and Dishman. We believe the strong earnings trajectory, improving return ratios, and improving FCF will drive the re-rating for the Granules stock.

At 12x FY16E P/E the PEG ratio for the stock comes to 0.48x (FY16-18E EPS growth of 25%.) Hence, we believe, there is still further scope for re-rating, provided the company delivers on our estimated numbers and sees the kind of return ratios improvement we have projected. We firmly believe that there is very limited downside risk to the stock at the present levels (assuming no adverse regulatory action on the company).

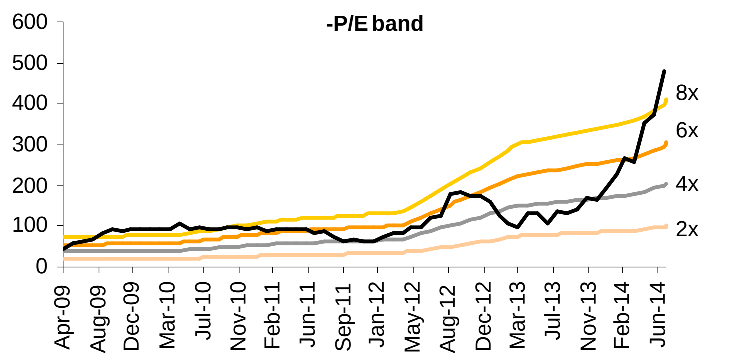
We initiate coverage on the stock with a BUY rating and a target price of Rs773, valuing the stock at 12x FY16E EPS of Rs64.4.

**Exhibit 10:** ***Peer comparison table***

| | | | M Cap | Price | EPS | | | P/E | | | BPS | P/B | RoE | | | Div Yield | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Company** | **Reco.** | **CMP** | **Rs. Mn.** | **Target** | **FY14A** | **FY15E** | **FY16E** | **FY14A** | **FY15E** | **FY16E** | **FY14A** | **FY15E** | **FY14A** | **FY15E** | **FY16E** | **FY14A** | **FY15E** |
| Granules | Buy | 565 | 11,382 | 773 | 37.4 | 44.5 | 64.4 | 15.1 | 12.7 | 8.8 | 177 | 2.7 | 24% | 23% | 27% | 1% | 1% |
| Shasun | NR | 173 | 9,683 | NA | 5.3 | 12.6 | 15.3 | 32.0 | 13.6 | 12.6 | 53 | 2.8 | 11% | 22% | 20% | 1% | 1% |
| Dishman | NR | 133 | 1,098 | NA | 13.5 | 17.3 | 21.3 | 10.0 | 7.9 | 6.4 | 146 | 0.9 | 9% | 10% | 10% | 1% | 2% |

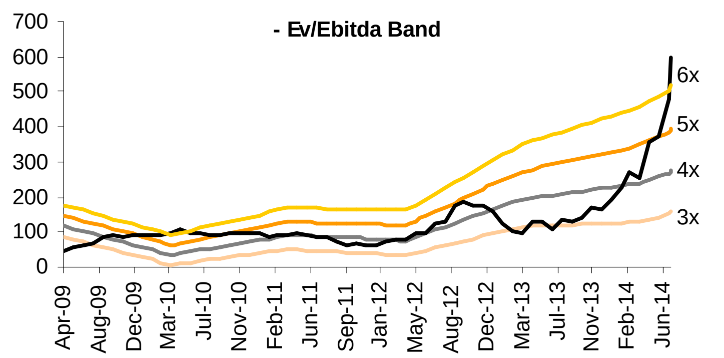
*Source: Emkay Research, Industry*

**Exhibit 11: One-year forward P/E band**




*Source: Company, Emkay Research*

**Exhibit 12: One-year forward EV/EBITDA band**



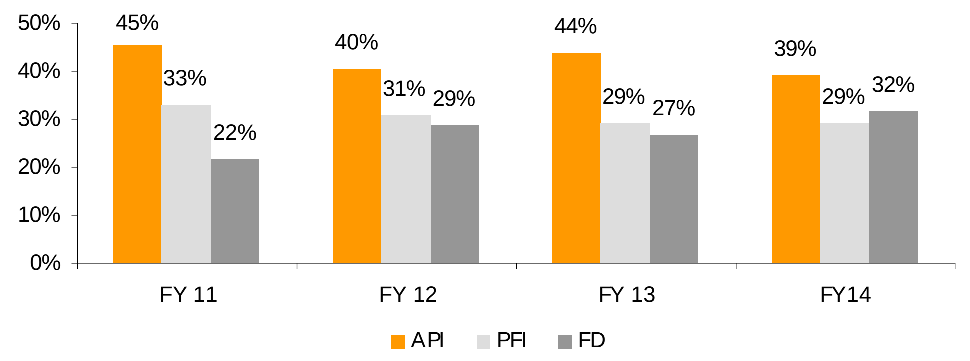

*Source: Company, Emkay Research*

## Company Background

Granules is an integrated pharmaceutical manufacturing company that offers all the three components of the value-chain: APIs, PFIs and FDs. The company boasts of being fully integrated for all products.

Granules' segment-wise sales have increased over the years from high-value FDs and PFIs, and reduced from low-value APIs

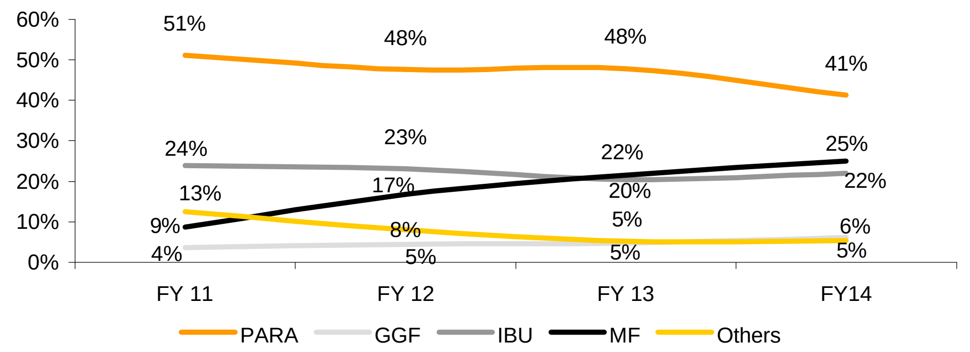
**Exhibit 13: Segment-wise sales**




*Source: Company, Emkay Research*

With five core products, Granules is among the top suppliers of these products globally. The company has a strong presence in the analgesics space. It is among the largest manufacturer of paracetamol and ibuprofen. In addition, it competes in the diabetic business through metformin, which is the first-line of defense product for type-2 diabetes. Granules is also a market leader in guaifenesin and methocarbamol, which are used for mucus thinning, nasal decongestion and muscle relaxation, respectively.

**Exhibit 14: Molecule-wise percentage contribution**




*Source: Company, Emkay Research*

Granules has seven manufacturing facilities, six are located in Andhra Pradesh, including one that is under construction through its CRAMS JV. Besides, it has another facility in China, which is an ibuprofen API JV.

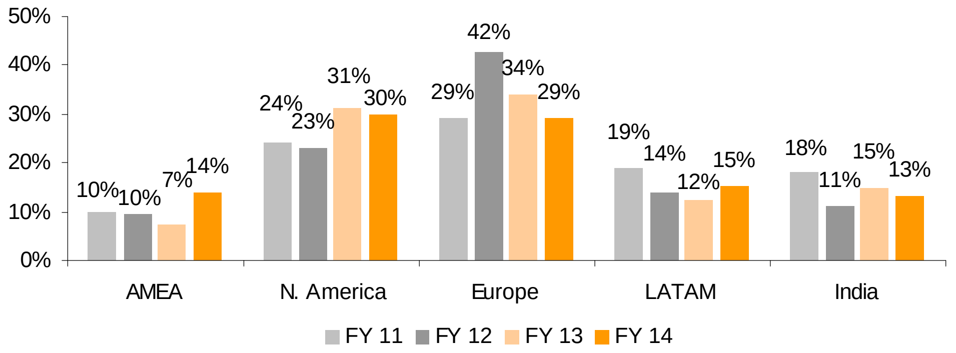
**Exhibit 15: Plant locations and capacities**

| Product Category | Facility Location | Approvals |
|---|---|---|
| API | Bonthapally | USFDA, EDQM, WHO GMP |
| | Jeedimetla | USFDA, KFDA, TGA, EDQM |
| | Jingmen, China | USFDA, MHRA, EDQM, TGA, KFDA, Health Canada |
| PFI | Gagillapur | USFDA, EDQM, TGA, GHCA |
| | Jeedimetla | HHA (Germany) |
| FD | Gagillapur | USFDA, EDQM, TGA, GHCA |
| API (CRAMs) | Vizag | Construction is in progress (US FDA Compliant) |
| API (Auctus) | Vizag & Hyderabad | USFDA, EDQM, KFDA, WHO GMP, Health Canada |

*Source: Company, Emkay Research*

Granules' major source of income over the years has been trending more from regulated and semi-regulated markets. Contributions from India sales have fallen 18% in FY11 to around 13% in FY14.

**Exhibit 16: Geographical spread of revenue**




*Source: Company, Emkay Research*

**Exhibit 17: Corporate structure**

**Group Structure and Manufacturing Capabilities**

| | |
|---|---|
| **Granules India** | Incorporated in 1984, this is the only listed entity in the group, with 3 plants located in Hyderabad (Jeedimetla, Bonthapally and Gagillapur) |
| **Auctus Pharma (100% subsidiary)** | Granules recently acquired a 100% stake in this company from its erstwhile promoters. It has an API plant located in Vizag Pharma City and an intermediate factory in Hyderabad. A merger proposal is in place with the parent company. |
| **Granules Biocause** | An equal joint venture with China-based Hubei Biocause. The JV has been operational since 2006, and manufactures ibuprofen API at a plant located in central China. |
| **Granules Omnichem** | An equal joint venture with Ajinomoto OmniChem, to focus on high-value, low-volume APIs and intermediates for the latter's existing customers, with a manufacturing facility at the Vizag SEZ expected to commence operations by June 2014. |

*Source: Company, Emkay Research*

## Management Team

### Mr. C. Krishna Prasad – Managing Director

Mr. C. Krishna Prasad, the founder of Granules, has three decades of experience in the pharmaceutical industry. In 1984, he set up a paracetamol manufacturing facility, which has since become one of the world's reputed manufacturers of paracetamol in regulated markets. Mr. Prasad pioneered and popularized the concept of pharmaceutical formulations intermediates (PFI) as a cost-efficient product for global formulations manufacturers.

### Mr. Harsha Chigurupati – Executive Director

Mr. Harsha Chigurupati has been with Granules since 2005, and served as CMO from 2006-10. As CMO, Mr. Chigurupati was instrumental in commercializing the company's Finished Dosage Division, and also changed the company's focus to marquee customers in regulated markets. As Executive Director, Mr. Chigurupati is responsible for the standalone operations of Granules India, including the P&L.

### Mr. Madhusudan Rao – Chief Operating Officer

Mr Madhusudan has over two decades of experience with global pharmaceutical companies. He previously served as COO of Global Generics at Orchid Pharmaceuticals, where he was responsible for entire operations of Global generics and CRAMS businesses. Prior to it, Mr. Rao worked at Dr. Reddy's, where he held various positions in Global Generics Portfolio Management, Global Regulatory Affairs and Compliance, API - New Product Development and Corporate Quality Assurance.

### Mr. V.V.S. Murthy – Chief Financial Officer

Mr. V.V.S. Murthy has three decades of finance experience across various industries, including nearly two decades in pharmaceuticals. Mr. Murthy previously was Group Chief Financial Officer at Dishman Pharmaceuticals which encompassed Indian operations and nine international operations. Prior to it, Mr. Murthy was VP – Finance at Dr. Reddy's, where he had extensive roles, including several international M&A transactions.

### Mr. Stefan Lohle – Chief Marketing Officer

Mr. Stefan Lohle has over two decades of experience in the pharmaceutical industry. Mr. Lohle has been associated with Granules since 2001, and previously was Head of Latin American Operations, where he primarily focused on the PFI Business. Mr. Lohle previously served at Kimberly Clark Corporation for New Project Development.

## Key Financials (Consolidated)

### Income Statement

| Y/E Mar (Rsmn) | FY13A | FY14A | FY15E | FY16E |
|---|---|---|---|---|
| **Net Sales** | **7,644** | **10,959** | **13,721** | **17,006** |
| *Growth (%)* | *16.9* | *43.4* | *25.2* | *23.9* |
| **Expenditure** | **6,783** | **9,374** | **11,526** | **14,163** |
| Raw Materials | 4,669 | 6,453 | 7,958 | 9,864 |
| Employee Cost | 639 | 879 | 1,098 | 1,361 |
| Other Exp | 1,475 | 2,043 | 2,470 | 2,939 |
| **EBITDA** | **861** | **1,584** | **2,195** | **2,843** |
| *Growth (%)* | *8.8* | *84.0* | *38.6* | *29.5* |
| ***EBITDA margin (%)*** | ***11.3*** | ***14.5*** | ***16.0*** | ***16.7*** |
| Depreciation | 231 | 298 | 472 | 531 |
| **EBIT** | **630** | **1,286** | **1,723** | **2,313** |
| ***EBIT margin (%)*** | ***8.2*** | ***11.7*** | ***12.6*** | ***13.6*** |
| Other Income | 21 | 43 | 38 | 43 |
| Interest expenses | 177 | 204 | 420 | 420 |
| **PBT** | **474** | **1,124** | **1,340** | **1,935** |
| **Tax** | **138** | **371** | **442** | **639** |
| *Effective tax rate (%)* | *29.0* | *33.0* | *33.0* | *33.0* |
| **Adjusted PAT** | **337** | **753** | **898** | **1,296** |
| *Growth (%)* | *15.8* | *123.9* | *19.2* | *44.4* |
| ***Net Margin (%)*** | ***4.4*** | ***6.9*** | ***6.5*** | ***7.6*** |
| (Profit)/loss from JVs/Ass/MI | 0 | 0 | 0 | 0 |
| **Adj. PAT After JVs/Ass/MI** | **337** | **753** | **898** | **1,296** |
| E/O items | -11 | 0 | 0 | 0 |
| **Reported PAT** | **326** | **753** | **898** | **1,296** |
| **PAT after MI** | **337** | **753** | **898** | **1,296** |
| *Growth (%)* | 15.8 | 123.9 | 19.2 | 44.4 |

### Balance Sheet

| Y/E Mar (Rsmn) | FY13A | FY14A | FY15E | FY16E |
|---|---|---|---|---|
| Equity share capital | 201 | 201 | 201 | 201 |
| Reserves & surplus | 2,547 | 3,358 | 4,019 | 5,198 |
| **Net worth** | **2,748** | **3,559** | **4,220** | **5,399** |
| **Minority Interest** | **0** | **0** | **0** | **0** |
| Long Term Debt | 2,000 | 3,395 | 3,192 | 3,192 |
| Short Term Debt | 855 | 1,009 | 1,009 | 1,009 |
| **Loan Funds** | **2,854** | **4,404** | **4,201** | **4,201** |
| Other Liabilities | 0 | 0 | 0 | 0 |
| **Total Liabilities** | **5,603** | **7,964** | **8,422** | **9,600** |
| Gross Block | 3,874 | 6,268 | 7,268 | 8,168 |
| Less: Depreciation | 1,240 | 1,538 | 2,010 | 2,541 |
| **Net block** | **2,635** | **4,730** | **5,258** | **5,627** |
| Capital work in progress | 1,088 | 1,246 | 1,246 | 1,246 |
| **Other Assets** | **146** | **132** | **132** | **132** |
| **Current Assets** | **2,958** | **3,812** | **3,870** | **5,187** |
| Inventories | 1,365 | 1,742 | 1,963 | 2,476 |
| Sundry debtors | 710 | 1,109 | 1,266 | 1,598 |
| Cash & Cash Equivalents | 328 | 418 | 46 | 410 |
| Loans & advances | 203 | 162 | 174 | 220 |
| Other current assets | 352 | 382 | 420 | 483 |
| **Current liabilities** | **1,225** | **1,956** | **2,083** | **2,591** |
| Accounts Payable | 918 | 1,355 | 1,679 | 2,081 |
| Other Current Liabilities | 306 | 600 | 404 | 510 |
| **Net current assets** | **1,734** | **1,857** | **1,786** | **2,596** |
| Misc. exp | 0 | 0 | 0 | 0 |
| **Total Assets** | **5,603** | **7,964** | **8,422** | **9,600** |

### Cash Flow

| Y/E Mar (Rsmn) | FY13A | FY14A | FY15E | FY16E |
|---|---|---|---|---|
| **PBT (Ex-Other income)** | **454** | **1,082** | **1,303** | **1,892** |
| Depreciation | 231 | 298 | 472 | 531 |
| Interest Provided | 177 | 204 | 420 | 420 |
| Other Non-Cash items | 0 | 0 | 0 | 0 |
| Chg in working cap | 160 | -34 | -301 | -446 |
| Tax paid | -138 | -371 | -442 | -639 |
| **Operating Cashflow** | **844** | **1,237** | **1,391** | **1,759** |
| Capital expenditure | -1,156 | -2,551 | -1,000 | -900 |
| **Free Cash Flow** | **-312** | **-1,314** | **391** | **859** |
| Other income | 21 | 43 | 38 | 43 |
| Investments | -38 | 15 | 0 | 0 |
| **Investing Cashflow** | **-1,174** | **-2,494** | **-962** | **-857** |
| Equity Capital Raised | 1 | 0 | 0 | 0 |
| Loans Taken / (Repaid) | 608 | 1,550 | -203 | 0 |
| Interest Paid | -177 | -204 | -420 | -420 |
| Dividend paid (incl tax) | -47 | -82 | -94 | -118 |
| Income from investments | 0 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 |
| **Financing Cashflow** | **384** | **1,263** | **-717** | **-538** |
| **Net chg in cash** | **55** | **7** | **-289** | **364** |
| Opening cash position | 227 | 328 | 418 | 46 |
| **Closing cash position** | **281** | **335** | **129** | **410** |

### Key Ratios

| Y/E Mar | FY13A | FY14A | FY15E | FY16E |
|---|---|---|---|---|
| **Profitability (%)** | | | | |
| EBITDA Margin | 11.3 | 14.5 | 16.0 | 16.7 |
| Net Margin | 4.4 | 6.9 | 6.5 | 7.6 |
| ROCE | 12.6 | 19.6 | 21.5 | 26.1 |
| ROE | 12.9 | 23.9 | 23.1 | 27.0 |
| RoIC | 15.5 | 25.2 | 26.2 | 31.2 |
| **Per Share Data (Rs)** | | | | |
| EPS | 16.7 | 37.4 | 44.6 | 64.4 |
| CEPS | 28.2 | 52.2 | 68.1 | 90.8 |
| BVPS | 136.6 | 176.9 | 209.7 | 268.3 |
| DPS | 2.3 | 4.1 | 4.7 | 5.8 |
| **Valuations (x)** | | | | |
| PER | 33.8 | 15.1 | 12.7 | 8.8 |
| P/CEPS | 20.1 | 10.8 | 8.3 | 6.2 |
| P/BV | 4.1 | 3.2 | 2.7 | 2.1 |
| EV / Sales | 1.8 | 1.4 | 1.1 | 0.9 |
| EV / EBITDA | 16.0 | 9.6 | 7.0 | 5.3 |
| Dividend Yield (%) | 0.4 | 0.7 | 0.8 | 1.0 |
| **Gearing Ratio (x)** | | | | |
| Net Debt/ Equity | 0.9 | 1.1 | 1.0 | 0.7 |
| Net Debt/EBIDTA | 2.8 | 2.5 | 1.8 | 1.3 |
| Working Cap Cycle (days) | 67.1 | 47.9 | 46.3 | 46.9 |

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