

Granules India

Another deal to 'Jump-Start' generic pipeline

- Granules acquired a 12.5% stake in USPharma, a privately held US generic company. The investment gives Granules access to USPharma's future R&D pipeline with a first right of refusal and also potentially raise its stake further in future
- Granules had earlier in-licensed 4 ANDA's awaiting approval in the US, from USPharma in June 2016. Granules expects to be a co-FTF for 3 products, though eventually we expect intense generic competition once other Para IV's launch, post exclusivity period
- In our view, recent in-licensing deals (gZegerid-OTC agreement with Par, gGilenya, gEffient, gMultaq and gLatuda) will help strengthen Granules' launch pipeline in the US and its eventual transition into a more 'pure-play' formulations player
- Granules also setting stage to move to next level of growth with ongoing investments in developing a generic ANDA pipeline. We maintain our ACCUMULATE rating with target price of Rs 162/share, valuing Granules at 15x FY18E EPS of Rs10.8/share

- Emkay View:** Granules deal to take a 12.5% stake in USPharma marks a stronger commitment to building a US pipeline following the earlier deal to in-license 4 products awaiting FDA approval. This deal jump starts Granules efforts' to build a US generics pipeline. The company is expected to take board seat on USPharma and have a first right of refusal for pipeline under development. Moreover Granules would also be able to channel future product development efforts at the US Company and raise its stake in future. We don't expect the current deal to add to Granules overall debt levels.
- In-licensing opportunity:** In June 2016, Granules had In-licensed 2 CVS drugs (gMultaq, gEffient) and 2 CNS drugs (gGilenya and gLatuda) from USPharma. We expect the first ANDA (gLatuda) to be commercialized in the US by July 2018 (FY2019). In-licensed innovator products have combined annual US revenues of ~USD4.4bn as per IMS.
- Competitive Intensity:** We expect Granules to be present on first day launch for 3 of the 4 in-licensed products with competitive intensity to vary. However post exclusivity expect intense generic competition. Prasugrel (gEffient) has seen 17 P-IV's being filed, while Dronedarone (gMultaq) has been confronted with 10 P-IV's. Competition is expected to be moderate in gGilenya and gLatuda (6 P-IV's each). A detailed assessment of the litigation landscape and competitive landscape for the 4 drugs is highlighted in **Exhibit 1**.
- Valuation and Risk:** Maintain ACCUMULATE rating valuing the company 15x FY18E EPS of Rs 10.8/share which gives our target price of Rs 162/share. Expect next phase of growth to kick start in 2HFY17 driven by commissioning of capacity expansions in key APIs/PFIs. Omnicem JV to also provide the additional earning trigger over FY17E-18E. Scaling up ongoing expansions remains the biggest near term risk.

Financial Snapshot (Consolidated)

(Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	10,959	12,929	14,295	17,048	23,924
EBITDA	1,584	2,116	2,767	3,410	5,024
EBITDA Margin (%)	14.5	16.4	19.4	20.0	21.0
APAT	753	939	1,185	1,573	2,468
EPS (Rs)	3.7	4.6	5.5	6.9	10.8
EPS (% chg)	122.2	23.8	18.9	26.1	56.9
ROE (%)	23.9	23.9	21.6	19.9	24.1
P/E (x)	38.3	30.9	26.0	20.6	13.1
EV/EBITDA (x)	20.7	15.7	12.3	10.6	7.0
P/BV (x)	8.1	6.7	4.6	3.6	2.8

Source: Company, Emkay Research

CMP Rs146	Target Price Rs162 (=)
Rating ACCUMULATE (=)	Upside 11.3 %

Change in Estimates

EPS Chg FY17E/FY18E (%)	NA
Target Price change (%)	NA
Previous Reco	ACCUMULATE

Emkay vs Consensus

EPS Estimates		
	FY17E	FY18E
Emkay	6.9	10.8
Consensus	7.5	9.8
Mean Consensus TP		Rs 164

Stock Details

Bloomberg Code	GRAN IN
Face Value (Rs)	1
Shares outstanding (mn)	217
52 Week H/L	164 / 84
M Cap (Rs bn/USD bn)	32 / 0.47
Daily Avg Volume (nos.)	1,120,940
Daily Avg Turnover (US\$ mn)	2.4

Shareholding Pattern Jun '16

Promoters	51.1%
FII's	7.2%
DII's	0.9%
Public and Others	40.9%

Price Performance

(%)	1M	3M	6M	12M
Absolute	5	14	16	71
Rel. to Nifty (2)	5	4	72	

Relative price chart



Source: Bloomberg

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Exhibit 1: Deep-dive into the in-licensed products

Brand	Generic	Patents	Dosage Form	Innovator	US Brand Sales (USD mn)	Generic Competitors	Para IV Filing	Anticipated Availability	Comments
Multaq	Dronedarone Hcl	Compound Patent: July 2016, Other Patents: Jun 2018, Apr 2029, Jun 2031	Tablet; Oral	Sanofi	\$327 mn	No	10 (First Time US generics (Granules partner), Alkem, Glenmark, Alembic, Sun Pharma, Unimark remedies, Lupin, Allergan, Amneal and Sandoz)	2018-19	<ul style="list-style-type: none"> Allergan (Watson), Alkem labs and Glenmark have received tentative approval in Dec 2015. Only Alkem labs tentative approval letter available, which states that litigation against Alkem was dismissed (probably confidential settlement). Regulatory exclusivity expired. Compound patent expiring in Jul 2016. Other patents: 2 patents expiring in Jun 2018, 2 in Apr 2029 and 1 in Jun 2031. None of the ANDA filers have challenged the compound patent. For all para IV filers, litigation ongoing against patents expiring Jun 2018 and Apr 2029. Patents expiring 2031, probably not challenged by the innovator.
Gilenya	Fingolimod Hcl	PTE: Feb 2019, Patent on formulation: Mar 2026, Patent on dose: Jun 2027. Other Sep 2017	Capsule; Oral	Novartis	\$1.5 bn	No	6 (Torrent Pharma, Allergan (Actavis), EZRA ventures, HEC pharma, Mylan, Apotex)	2018-19	<ul style="list-style-type: none"> No Tentative approvals currently Compound patent has already expired in 2014. All para IV filers, litigation ongoing against patent expiring Feb 2019. Torrent Pharma's IPR had invalidated patent '283 (Exp Mar 2026) in Sep 2015. However the innovator was allowed to appeal the board decision. Apotex and Mylan had joined the case on Torrent's side, through a separate petition seeking review The earliest automatic 30-month stays preventing FDA approval will expire in March 2018.
Effient	Prasugrel HCL	Compound Patent: Oct 2017, Other Patents: Jul 2023	Tablet; Oral	Eli Lilly and Co	\$418 mn	No	17 (First time US generics (Granules partner), Aurobindo, Lupin, Dr Reddy, Sun Pharma, Zydus Cadila, Mylan, Par, Accord, Apotex, Panacea, HEC pharma, Amneal, Glenmark, Hetero, Teva, Allergan)	2018-19	<ul style="list-style-type: none"> Aurobindo (Jan 04, 2016) and Mylan (Jan 08, 2016) have received tentative approval. No tentative approval letter available Compound patent expiring in Oct 2017. Other patents : 2 patents expiring in Jul 2023 Only Mylan has challenged the compound patent. All other para IV filers, litigation ongoing against the two patents expiring Jul 2023 (covering methods of using Effient with aspirin).
Latuda	Lurasidone HCL	Jul 2018, June 2025, May 2026, June 2026, May 2031	Tablet; Oral	Sunovion Pharms (Sumitomo Dainippon Pharma)	\$1 bn	No	6 (Lupin, Sun Pharma, Invagen (Cipla), Emcure, MSN Labs, Teva)	2018-19	<ul style="list-style-type: none"> Lupin, MSN, Sun Pharma (Jan 25, 2016) and Emcure (Feb 23, 2016) have received tentative approval. No tentative approval letter available. Regulatory exclusivity expired. Other patents: expiring in Jul 2018, Jun 2025, 2 patents expiring in May 2026, Jun 2026 and May 2031. All para IV filers, litigation ongoing against patent expiring Jul 2018 Other patents, probably not challenged by the innovator.

Source: Company, Emkay Research

Exhibit 2: Financial Assumptions Snapshot

Earnings Calculation	FY15	FY16	YoY		YoY		YoY		Comments
			Growth	FY17E	Growth	FY18E	Growth		
Revenues									
Molecule Segmentation									
Paracetamol	5,301	5,289	0%	5,460	3%	5,678	4%	Growth in line with industry demand growth of 4%	
Ibuprofen	2,069	2,430	17%	2,869	18%	3,069	7%	Growth to be driven by Ibuprofen Rx sales	
Metformin	2,974	3,574	20%	4,096	15%	8,577	109%	3,500 TPA expansion to be completed by 2HFY17, validation of batches to commence from Q3FY17	
Guaifenesin	646	715	11%	929	30%	2,168	133%	2,000 TPA expansion to be completed by 2HFY17	
Others	1,939	2,287	18%	3,695	62%	4,432	20%	Sales from Omnicem CRAMS JV, Abacavir, Auctus, gZegerid OTC to drive growth	
Total Revenues	12,929	14,295	11%	17,048	19%	23,924	40%	Revenues to exhibit a CAGR of c29% over FY16-18E	
EBITDA	2,116	2,767		3,410		5,024		EBITDA to exhibit a CAGR of c34% over FY16-18E	
EBITDA margins	16%	19%		20%		21%		Margins to improve with increasing utilization and move up the value chain	
Depreciation and amortization	527	643		737		1,034			
Interest Expenses	323	399		440		440		Rs 500 mn capex shortfall to be funded through debt and rest through equity warrants	
Non-operating Income	43	77		80		80			
PBT	1,310	1,801		2,312		3,629			
Tax Expenses	371	617		740		1,161			
Tax Rate	28%	34%		32%		32%			
PAT before extra ordinaries	939	1,185		1,572		2,468			
PAT Margin	7%	8%		9%		10%			
No of Shares	204	217		228		228		Warrants Issued to promoter/promoter group to primarily fund capex	
EPS	4.6	5.5		6.9		10.8		EPS to exhibit a CAGR of c40% over FY16-18E	

Source: Company, Emkay Research

Exhibit 3: Forward integration to FD's to increase revenue and profitability

Business Segment	EBITDA Margins (%)	Revenue Mix						
		FY11	FY12	FY13	FY14	FY15	FY16	FY20E
API	~10%	45%	40%	44%	39%	44%	15%	15%
PFI	15%-20%	33%	31%	29%	29%	24%	20%	20%
Formulation	>20%	22%	29%	27%	32%	32%	65%	65%

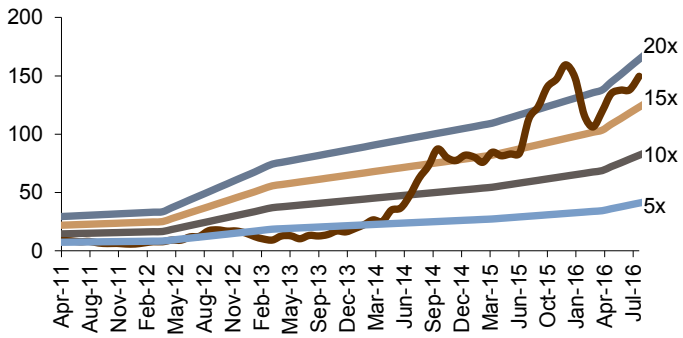
Source: Company, Emkay Research

Exhibit 4: Manufacturing Capacities

Molecule wise	Current Capacities	Comments
Paracetamol	18,000 TPA	Debottlenecking API capacity in Paracetamol will release capacity by about 5,000 TPA
Ibuprofen	4,800 TPA	No planned capex addition
Metformin	2,000 TPA	Capex to increase capacities by 7000 TPA to 9000 TPA by Nov 2017
Methocarbamol	360 TPA	No planned capex addition
Guaifenesin	1,200 TPA	To increase capacities by 2000 TPA. Construction expected to be completed by 2HFY17

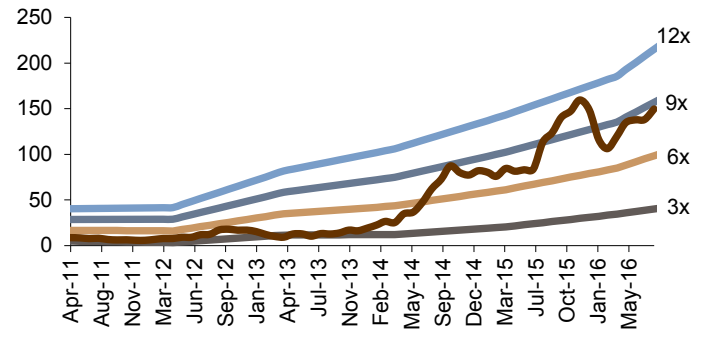
Source: Company, Emkay Research

Exhibit 5: Forward P/E band – Significant re-rating



Source: Company, Emkay Research

Exhibit 6: Forward EV/EBITDA trajectory over the past 5 years



Source: Company, Emkay Research

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	10,959	12,929	14,295	17,048	23,924
Expenditure	9,374	10,813	11,528	13,638	18,900
EBITDA	1,584	2,116	2,767	3,410	5,024
Depreciation	298	527	643	737	1,034
EBIT	1,286	1,590	2,124	2,673	3,990
Other Income	43	43	77	80	80
Interest expenses	204	323	399	440	440
PBT	1,124	1,310	1,801	2,313	3,629
Tax	371	371	617	740	1,161
Extraordinary Items	0	(30)	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	753	909	1,185	1,573	2,468
Adjusted PAT	753	939	1,185	1,573	2,468

Balance Sheet

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Equity share capital	203	204	217	228	228
Reserves & surplus	3,357	4,107	6,444	8,899	11,161
Net worth	3,560	4,312	6,660	9,127	11,389
Minority Interest	0	0	0	0	0
Loan Funds	4,404	4,824	4,674	5,158	5,158
Net deferred tax liability	0	0	0	0	0
Total Liabilities	7,964	9,136	11,335	14,286	16,548
Net block	4,730	6,166	6,681	7,944	8,909
Investment	132	30	16	16	16
Current Assets	3,812	5,155	7,066	9,361	12,157
Cash & bank balance	418	653	1,419	1,581	2,356
Other Current Assets	382	676	103	1,168	522
Current liabilities & Provision	1,956	2,836	3,194	3,801	5,300
Net current assets	1,856	2,320	3,872	5,560	6,857
Misc. exp	0	0	0	0	0
Total Assets	7,964	9,136	11,335	14,286	16,548

Cash Flow

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
PBT (Ex-Other income) (NI+Dep)	1,082	1,266	1,725	2,233	3,549
Other Non-Cash items	0	0	0	0	0
Chg in working cap	(34)	(228)	(786)	(1,526)	(522)
Operating Cashflow	1,309	1,437	1,652	1,144	3,341
Capital expenditure	(2,551)	(1,337)	(1,304)	(2,000)	(2,000)
Free Cash Flow	(1,242)	100	347	(856)	1,341
Investments	15	102	14	0	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(2,494)	(1,192)	(1,214)	(1,920)	(1,920)
Equity Capital Raised	11	14	1,037	1,087	0
Loans Taken / (Repaid)	1,550	420	(150)	484	0
Dividend paid (incl tax)	(83)	(119)	(160)	(192)	(206)
Other Financing Cash Flow	0	0	0	0	0
Financing Cashflow	1,274	(10)	328	938	(646)
Net chg in cash	89	236	766	162	775
Opening cash position	328	418	653	1,419	1,581
Closing cash position	417	653	1,419	1,581	2,356

Key Ratios

Profitability (%)	FY14	FY15	FY16E	FY17E	FY18E
EBITDA Margin	14.5	16.4	19.4	20.0	21.0
EBIT Margin	11.7	12.3	14.9	15.7	16.7
Effective Tax Rate	33.0	28.3	34.2	32.0	32.0
Net Margin	6.9	7.3	8.3	9.2	10.3
ROCE	19.6	19.1	21.5	21.5	26.4
ROE	23.9	23.9	21.6	19.9	24.1
RoIC	25.2	22.7	25.0	25.4	31.5

Per Share Data (Rs)	FY14	FY15	FY16E	FY17E	FY18E
EPS	3.7	4.6	5.5	6.9	10.8
CEPS	5.2	7.2	8.4	10.1	15.4
BVPS	17.6	21.1	30.7	40.0	49.9
DPS	0.4	0.6	0.7	0.8	0.9

Valuations (x)	FY14	FY15	FY16E	FY17E	FY18E
PER	38.3	30.9	26.0	20.6	13.1
P/CEPS	27.4	19.8	16.9	14.0	9.3
P/BV	8.1	6.7	4.6	3.6	2.8
EV / Sales	3.0	2.6	2.4	2.1	1.5
EV / EBITDA	20.7	15.7	12.3	10.6	7.0
Dividend Yield (%)	0.3	0.4	0.5	0.6	0.6

Gearing Ratio (x)	FY14	FY15	FY16E	FY17E	FY18E
Net Debt/ Equity	1.1	1.0	0.5	0.4	0.2
Net Debt/EBIDTA	2.5	2.0	1.2	1.0	0.6
Working Cap Cycle (days)	47.9	47.1	62.6	85.2	68.7

Growth (%)	FY14	FY15	FY16E	FY17E	FY18E
Revenue	43.4	18.0	10.6	19.3	40.3
EBITDA	84.0	33.6	30.8	23.2	47.3
EBIT	104.1	23.6	33.6	25.8	49.3
PAT	131.3	20.7	30.3	32.7	56.9

Quarterly (Rs mn)	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Revenue	3,546	3,459	3,664	3,449	3,723
EBITDA	520	618	689	677	783
EBITDA Margin (%)	14.7	17.9	18.8	19.6	21.0
PAT	254	271	310	272	332
EPS (Rs)	1.2	1.3	1.5	1.3	1.6

Shareholding Pattern (%)	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
Promoters	48.5	48.4	49.5	51.2	51.1
FIIIs	2.9	7.3	5.8	6.4	7.2
DIIIs	0.2	1.0	1.1	1.2	0.9
Public and Others	48.5	43.3	43.6	41.3	40.9

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

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