Granules India Ltd: Q1FY18 Result Update

Strong quarter aided with improved product mix

CMP INR 121 **Target INR 228**

Rating: BUY **Upside: 88%**

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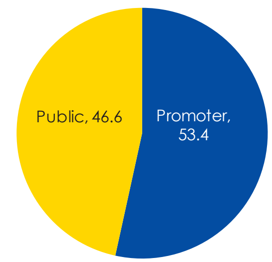
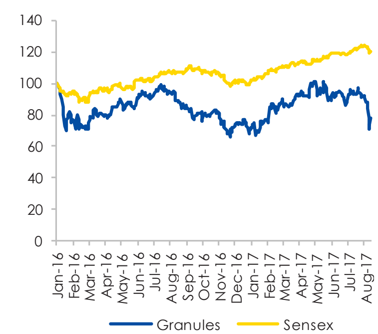
Bloomberg:	**GRAN:IN**
52-week range (INR):	157 / 92
Share in issue (cr):	27
M cap (INR cr):	2,657
Avg. Daily Vol. BSE/NSE :('000):	1746





Date: 16th August 2017

Granules India Limited (GIL) reported revenues of INR 386 cr, showing an annual growth of 10%. The strong uptick in numbers has been primarily on account of higher formulations (FD) sales (especially Ibuprofen) by the company. Geographically, regulated markets of North America and Europe continued to contribute nearly two-third to the overall topline with Europe growing at a stronger 21% y-o-y. Improving product mix due to higher formulations sales led to improvement in gross margins by 332 bps to 53%. The management continues to guide for higher FD sales while leveraging upon backward integration into APIs for margins improvement. In view of this strategy, the company is undergoing expansion in its key APIs which are expected to generate incremental inflows from H2FY18. Further, GIL continues to benefit from contract manufacturing and direct formulation sales in regulated markets through multiple joint-ventures (JV) and acquisitions. Although, profits from its Omni-chem JV has been muted this quarter, GIL is certain to compensate for it in the subsequent quarter leaving the annual targets unchanged. In a nutshell, we believe the management's clear vision of growth coupled with operational efficiency, supported by growing order inflows and strong brand reputation of the company, will contribute substantially to GIL's future growth strategy.

Augmented formulations sales to usher overall expansion

Formulation revenues have grown by 22% to contribute 39% to Q1FY18 revenues from 36% earlier. This is largely attributable to higher Ibuprofen sales which nearly doubled y-o-y to INR 73 cr in the current quarter. Going forward, we estimate similar increase in formulations sales and corresponding uptick in gross margins with major contribution from Ibuprofen and Metformin. With new expanded capacity in Metformin becoming operational from FY18, we estimate steep growth in its sales as well.

JVs business miss in Q1; to compensate in subsequent quarters

GIL gets profit share from two of its joint-ventures i.e. Biocause and Omni-chem. Revenues and profit share from Biocause JV has been higher than estimates due soaring Ibuprofen demand globally. The company received INR 5.5 cr from Biocause JV as against INR 3 cr y-o-y. However, from the Omni-chem JV of contract manufacturing, it incurred a loss share of INR (2.6) cr as dispatches scheduled for the quarter shifted to subsequent quarter resulting in postponement of revenue accounting. Resultantly, we estimate contributions from Omni-chem JV for the entire fiscal to remain in line with our estimates of INR 16 cr.

Valuation:

In our view, Granules India is at the cusp of a new growth story backed by the above stated factors. Ergo, we expect strong cash flows, improving margins and steady growth across its business segments. Our earnings estimates per share for FY18E and FY19E are INR 7.9 and INR 11.6 respectively. We value the company's base business at 17x FY19E earnings of INR 11.6/share, whilst the value from in-licensed opportunities and new filings at INR 30/share. We maintain our 'BUY' recommendation on the stock, with a target price of INR 228/share.

Year to March	Q1FY18	Q1FY17	% Change	Q4FY17	% Change	FY17	FY18E	FY19E
Net Revenue (INR. Cr)	379	344	10.3	355	6.6	1,411	1,653	2,093
Growth (%)						3.9%	17.2%	26.6%
EBITDA (INR Cr)	77	68	12.8	77	(0.5)	297	383	527
Growth (%)						7.8%	29.1%	37.5%
Adj. Net Profit (INR Cr)	37	39	(4.9)	46	(19.4)	163	210	311
Growth (%)						33.2%	29.2%	48.0%
Adj. Diluted EPS (INR)	1	1		2		7	8	12
Diluted P/E (x)						17.2	15.5	10.5
EV/EBITDA (x)						11.2	9.7	6.9
RoE (%)						20.8	16.6	17.7

Q1FY18 Result Highlights

(INR Cr)	Q1FY18	Q1FY17	% Change	Q4FY17	%Change	FY17	FY18E	FY19E
Net Revenues	379	344	10.3	355	6.6	1,411	1,653	2,093
Raw Materials Cost	180	175	3.1	156	15.2	680	780	966
Gross Profit	199	169	17.7	199	(0.1)	731	873	1,126
Employee Expenses	39	34	15.2	36	7.8	140	164	187
Other Expenses	83	67	24.1	86	(3.2)	294	326	412
Operating Expenses	122	101	21.1	122	0.1	434	490	599
EBITDA	77	68	12.8	77	(0.5)	297	383	527
EBITDA margin	20.3%	19.9%		21.8%		21.0%	23.2%	25.2%
Depreciation	18	16	7.7	18	(2.2)	72	89	97
Other income	0	3	(87.8)	1	(68.6)	10	10	10
Exceptional Expenses	-	-				-	-	-
Net finance expense	8	8	3.3	8	7.0	32	36	37
Profit before tax	52	47	9.7	53	(2.5)	203	269	403
Provision for taxes	18	15	15.5	17	7.0	65	87	131
Reported net profit	34	32	6.9	36	(6.8)	138	181	272
Profit/Loss of Associate Company	3	7	(57.4)	9	(67.8)	25	29	39
Adj net profit (incl minority int.)	37	39	(4.9)	46	(19.4)	163	210	311
As % of net revenues	9.7%	11.3%		12.9%				
COGS	48	51		44		48	47	46
Employee cost	10	10		10		10	10	9
Other Expenses	22	19		24		21	20	20
Operating expenses	32	29		34		31	30	29
EBITDA	20	20		22		21	23	25
Reported net profit	9	9		10		10	11	13
Tax rate (% of PBT)	34	33		31		32	33	33

Key Takeaways from the Concall

- Increase in other expenses had significant share of higher lab consumables and freight charges, most of which is one-off
- Raw material prices, especially PAP, have increased in Q1FY18 with most of it getting passed on to consumers due to contracts
- The company expects to file 5-6 new ANDAs from its US unit and 5-6 from Hyderabad in the current fiscal
- GIL had very low impact of US pricing pressure with its price correction being lowest among peers due to pre-existing competitive pricing policy of the company
- PAT margins from Biocause JV have increased to 16% from 11% earlier; GIL reasoned it with high global demand outweighing capacities and expects the trend to continue
- The company incurred capex of nearly INR 150 cr in Q1FY18 in line with its annual capex estimate of ~INR 550 cr
- Incremental API capacity will become operational from H2FY18 with full utilization levels expected to be reached by FY21 across molecules
- Share of capex funding from debt, equity and internal accruals along with proposed QIP timeline has yet not been finalized
- GIL has appointed a new CFO, Mr. Ganesh, who comes with 30 years of experience in M&A, treasury and corporate with his last stint being with Dr. Reddy's Lab

Company Description

Established in 1984, Granules India Ltd (GIL) is a fully integrated pharmaceutical manufacturing company with presence across the entire value chain of API's, pharmaceutical formulation intermediates (PFI's) and finished dosage formulations (FDF). The company has largest PFI facility in the world along with one of the largest single-site FD facilities in the world. GIL caters to customers across 60 countries with exports contributing ~82% of the company's revenues.

Investment Theme

Granules India Limited (GIL) is one of the largest manufacturers of Paracetamol, Metformin, Ibuprofen and Guaifenesin globally with presence across the value chain in each of these. While the company supplies APIs and PFIs to global clients on contracts, its FD sales comprise of both direct market sale and contract manufacturing. High quality standards and cost advantage has aided GIL in retaining global clientele and generic-generic presence in FDs has insulated it from increasing price competition in regulated markets. GIL plans to enter the next phase of growth through higher FD sales while leveraging upon backward integration into APIs for margins improvement. In view of this strategy, the company is undergoing expansion in its key APIs which are currently fully utilized. Further, GIL is venturing into contract manufacturing and direct formulation sales in regulated markets through multiple joint-ventures and acquisitions. We believe the management's clear vision of growth coupled with operational efficiency, supported by growing order inflows and strong brand reputation of the company, will contribute substantially to GIL's growth going forward.

Key Risks

Regulatory Risk: The recent detailed scrutiny and the resultant adverse outcome for several players in the industry continues to be the biggest risk in the pharma sector; this implies to Granules too. However, annual audits of its facilities by global pharmaceutical companies with which GIL has contracts, ensures high facility standards at all times and reduces the risk of deviation from global regulatory standards.

Foreign exchange Risk: Much of GIL's revenue accrues from exports (82% in FY17), but at the same time around 40% of its raw material requirements is imported. Hence, the company enjoys a natural hedge. Also, much of GIL's debt is in foreign currency. Additionally, GIL has clauses in most of its contracts, wherein it adjusts the selling price based on the forex rate.

Limited disclosure Risk: Agreements between Granules and its partners/customers are confidential allowing limited visibility on the product or client level information. However, considering that limited disclosure in the contract manufacturing business is a feature of the business model, it indicates the maintenance of healthy client confidentiality.

Concentration Risk: In the generics and API businesses, the companies have high dependency on select products. Incidentally, Granules derives around 85% of revenue from its five key molecules. However, the growth plan of the company involves diversification across product classes and gaining a higher share from multiple products in US generic formulations.

Financials

Income statement (Standalone) (INR Cr)

Year to March	FY15	FY16R	FY17R	FY18E	FY19E
Income from operations	1,294	1,357	1,411	1,653	2,093
Direct costs	793	725	680	780	966
Employee costs	107	118	140	164	187
Other expenses	185	239	294	326	412
Total operating expenses	1,084	1,082	1,114	1,270	1,566
EBITDA	209	275	297	383	527
Depreciation and amortisation	53	58	72	89	97
EBIT	157	217	225	294	430
Interest expenses	32	37	32	36	37
Other income	4	5	10	10	10
Profit before tax	128	185	203	269	403
Provision for tax	37	61	65	87	131
Core profit	91	124	138	181	272
Profit after tax	91	126	136	181	272
Share from associates	0	-2	25	29	39
Adjusted net profit	91	125	161	210	311
Equity shares outstanding (mn)	20	22	23	27	27
EPS (INR) basic	4.4	5.6	7.1	7.9	11.6
Diluted shares (Cr)	20.4	21.7	22.9	26.7	26.7
EPS (INR) fully diluted	4.4	5.6	7.1	7.9	11.6
Dividend per share	0.5	0.6	0.9	1.2	1.8
Dividend payout (%)	11.2	11.2	12.7	15.2	15.2

Common size metrics- as % of net revenues

Year to March	FY15	FY16R	FY17R	FY18E	FY19E
Operating expenses	83.8	79.7	79.0	76.8	74.8
Depreciation	4.1	4.3	5.1	5.4	4.6
Interest expenditure	2.5	2.7	2.3	2.2	1.8
EBITDA margins	16.2	20.3	21.0	23.2	25.2
Net profit margins	7.0	9.2	11.4	12.7	14.9

Growth metrics (%)

Year to March	FY15	FY16R	FY17R	FY18E	FY19E
Revenues	18.1	4.9	3.9	17.2	26.6
EBITDA	32.3	31.5	7.8	29.1	37.5
PBT	13.9	44.6	9.7	32.3	50.0
Net profit	20.6	36.8	29.3	30.4	48.0
EPS	18.4	26.5	26.2	10.6	48.0

Balance sheet (Standalone) (INR Cr)

As on 31st March	FY15	FY16R	FY17R	FY18E	FY19E
Equity share capital	20	22	22.87	27	27
Reserves & surplus	411	640	881	1,596	1,860
Shareholders funds	431	662	904	1,623	1,886
Borrowings	482	577	598	698	648
Sources of funds	**913**	**1,239**	**1,502**	**2,321**	**2,534**
Gross block	844	747	897	1,147	1,357
Depreciation	227	181	253	342	439
Net block	617	566	644	805	919
Capital work in progress	62	77	261	611	500
Total fixed assets	679	642	905	1,416	1,419
Investments	0	70	116	116	116
Inventories	225	254	276	317	401
Sundry debtors	137	375	418	543	688
Cash and equivalents	65	130	50	241	290
Loans and advances	74	59	91	107	136
Total current assets	500	818	835	1,208	1,515
Sundry creditors and others	223	260	309	362	459
Total CL & provisions	236	260	309	362	459
Net current assets	264	558	526	846	1,057
Net Deferred tax	-49	-57	-57	-57	-57
Uses of funds	**913**	**1,239**	**1,502**	**2,321**	**2,534**
Book value per share (INR)	21	31	40	61	71

Cash flow statement (INR Cr)

Year to March	FY15	FY16R	FY17R	FY18E	FY19E
Net profit	91	120	164	210	311
Add: Depreciation	53	58	72	89	97
Add: Misc expenses written off	-16	-14	13	12	0
Gross cash flow	147	163	248	311	408
Less: Changes in W. C.	24	127	48	130	161
Operating cash flow	123	35	200	181	247
Less: Capex	124	-44	334	600	100
Free cash flow	**-1**	**79**	**-134**	**-419**	**147**

Ratios

Year to March	FY15	FY16R	FY17R	FY18E	FY19E
ROAE (%)	23.1	18.8	20.8	16.6	17.7
ROACE (%)	17.5	17.4	15.8	15.0	17.3
Debtors (days)	39	101	108	120	120
Current ratio	2.1	3.1	2.7	3.3	3.3
Debt/Equity	1.1	0.9	0.7	0.4	0.3
Inventory (days)	63	68	71	70	70
Payable (days)	63	70	80	80	80
Cash conversion cycle (days)	39	99	99	110	110
Debt/EBITDA	2.3	2.1	2.0	1.8	1.2
Adjusted debt/Equity	1.0	0.7	0.6	0.3	0.2

Valuation parameters

Year to March	FY15	FY16R	FY17R	FY18E	FY19E
Diluted EPS (INR)	4.4	5.6	7.1	7.9	11.6
Y-o-Y growth (%)	*18.4*	*26.5*	*26.2*	*10.6*	*48.0*
CEPS (INR)	7.0	8.3	10.2	11.2	15.3
Diluted P/E (x)	27.4	21.7	17.2	15.5	10.5
Price/BV(x)	5.8	4.0	3.1	2.0	1.7
EV/Sales (x)	2.2	2.3	2.4	2.2	1.7
EV/EBITDA (x)	13.9	11.2	11.2	9.7	6.9
Diluted shares O/S	20.4	21.7	22.9	26.7	26.7
Basic EPS	4.4	5.6	7.1	7.9	11.6
Basic PE (x)	27.4	21.7	17.2	15.5	10.5
Dividend yield (%)	0.4	0.5	0.7	1.0	1.4

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Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period

Granules 5 years price chart

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