

INDUSTRY	PHARMA
CMP (as on 10 Nov 2017)	Rs 127
Target Price	Rs 170
Nifty	10,322
Sensex	33,315
KEY STOCK DATA	
Bloomberg	GRAN IN
No. of Shares (mn)	254
MCap (Rs bn) / (\$ mn)	32/493
6m avg traded value (Rs mn)	290
STOCK PERFORMANCE (%)	
52 Week high / low	Rs 157/98
	3M 6M 12M
Absolute (%)	18.3 (11.0) 11.5
Relative (%)	12.7 (21.1) (9.5)
SHAREHOLDING PATTERN (%)	
Promoters	48.2
FIs & Local MFs	1.6
FPIs	19.8
Public & Others	30.5
Source : BSE	

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## Ready to take off

Granules India (GRAN) reported another quarter of top-line growth (8% YoY), after a subdued FY17. Revenue was Rs 3.9bn, in-line with estimates. EBITDA was Rs 769mn (up ~4% YoY), implying a margin of 19.6%, ~190bps below estimates. An increase in employee costs (+8% QoQ) owing to hiring at the US subsidiary, led to the subdued margin performance. A higher tax rate and increasing finance costs (additional debt taken on during 2QFY18) led to PAT declining 1% YoY to Rs 403mn.

We believe that 2HFY18 will see the start of strong top-line growth for GRAN, on the back of expected ANDA approvals for the US market and core business capacity expansion kicking in. With the full impact of these factors likely to take some time to be visible, we expect FY19 to be a strong growth year. Overall, we expect ~17% revenue CAGR, ~21% EBITDA CAGR and ~24% PAT CAGR over FY17-20E. Maintain BUY with a revised TP of Rs 170 (16x Sep-19E EPS).

### Highlights of the quarter

- **Formulations:** The finished dosages segment grew ~23% YoY to Rs 1.6bn in 2QFY18. GRAN is on track to scale-up the US formulations segment starting 2HFY18,

### Financial Summary

(Rs mn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)	FY17	FY18E	FY19E	FY20E
Net Sales	3,926	3,584	9.5	3,787	3.7	14,106	16,108	19,749	22,369
EBIDTA	769	742	3.6	769	(0.0)	2,988	3,324	4,440	5,237
APAT	403	408	(1.2)	368	9.6	1,645	1,744	2,289	3,108
Diluted adj. EPS (Rs)	1.76	1.88	(6.6)	1.61	9.1	7.5	6.9	9.0	12.2
P/E (x)						16.8	18.4	14.0	10.3
RoE (%)						21.0	15.5	16.0	19.1

Source: Company, HDFC sec Inst Research # Consolidated

with 3 or 4 products expected to be launched over next 12 months. Two TAD dates in 4QFY18 have provided further visibility on this front. The first launch from its four-product basket tie-up with US pharma Windlas was on schedule, with gEffient (IMS MAT sales of ~US\$ 600mn) launched in Oct-17. GRAN is planning to file 20-22 ANDAs over the next two years, which would take its total ANDA filings to ~35 by FY19. We foresee ~24% rev. CAGR in the formulations business over FY17-20E.

- **Margins to scale up:** With the ramp-up in formulations, margins are likely to expand. The Omnicem JV ramp up would also reflect in net margin improvement from FY20E. However, increased R&D spending and fresh hiring at the US subsidiary prompts us to forecast only a ~200bps EBITDA margin expansion over FY17-20E.
- **Other takeaways:** (1) Growth in API and PFI segments was flat at -0.8% and -0.4% YoY respectively, (2) Among molecules, paracetamol/metformin/ibuprofen grew 11%/12%/16% YoY respectively.
- **Near-term outlook:** We expect 4QFY18 to be strong, considering the material ANDA launch in the US.

**GRAN once again exhibited revenue momentum, growing 8%/4% YoY/QoQ**

**Employee expenses were higher, on account of hiring at the US subsidiary**

**Interest cost affected PAT growth, which was higher on account of an increase in debt from Mar-17 levels**

**EBITDA margin came in ~190bps lower-than-expected, largely owing to higher employee expenses**

### Quarterly Financials Snapshot (Consolidated)

Particulars	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
<b>Net Sales</b>	<b>3,926</b>	<b>3,638</b>	<b>7.9</b>	<b>3,787</b>	<b>3.7</b>
Material Expenses	1,977	1,874	5.5	1,800	9.8
Employee Expenses	423	340	24.4	390	8.2
Other Expenses	757	682	11.0	828	(8.5)
<b>EBITDA</b>	<b>769</b>	<b>742</b>	<b>3.7</b>	<b>769</b>	<b>(0.0)</b>
Depreciation	104	185		176	
<b>EBIT</b>	<b>665</b>	<b>557</b>	<b>19.4</b>	<b>593</b>	<b>12.1</b>
Other Income	68	38.8		4	
Interest Cost	186	83		82	
<b>PBT</b>	<b>547</b>	<b>513</b>	<b>6.7</b>	<b>515</b>	<b>6.3</b>
Tax	193	156		177	
Minority Interest	(49)	(51)		(30)	
<b>RPAT</b>	<b>403</b>	<b>408</b>	<b>(1.1)</b>	<b>368</b>	<b>9.6</b>
EO Items (Adj For Tax)	-	-		-	
<b>APAT</b>	<b>403</b>	<b>408</b>	<b>(1.1)</b>	<b>368</b>	<b>9.6</b>

Source: Company, HDFC sec Inst Research

### Margin Analysis

	2QFY18	2QFY17	YoY (bps)	1QFY18	QoQ (bps)
Material Expenses % Net Sales	50.4	51.5	(116)	47.5	284
Employee Expenses % Net Sales	10.8	9.3	142	10.3	45
Other Expenses % Net Sales	19.3	18.7	53	21.9	(257)
EBITDA Margin (%)	19.6	20.4	(80)	20.3	(72)
Tax Rate (%)	35.2	30.4	476	34.4	76
APAT Margin (%)	10.3	11.2	(94)	9.7	56

Source: Company, HDFC sec Inst Research

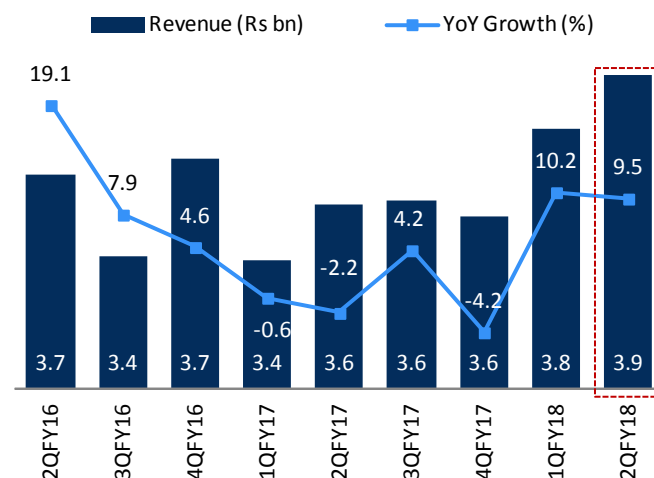
**Another quarter of top-line growth in 2QFY18 was encouraging, after stagnant revenue growth in FY17**

**Formulations continued to expand, growing 22.5% YoY**

**Contribution from formulations is rising, and was at 42% vs 37% YoY**

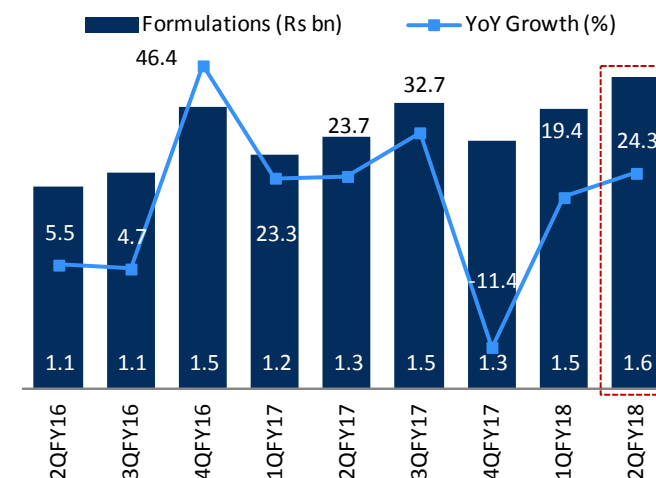
**EBITDA margin will be boosted by operating leverage from 2HFY18**

## 2<sup>nd</sup> Consecutive Quarter Of Top-line Growth



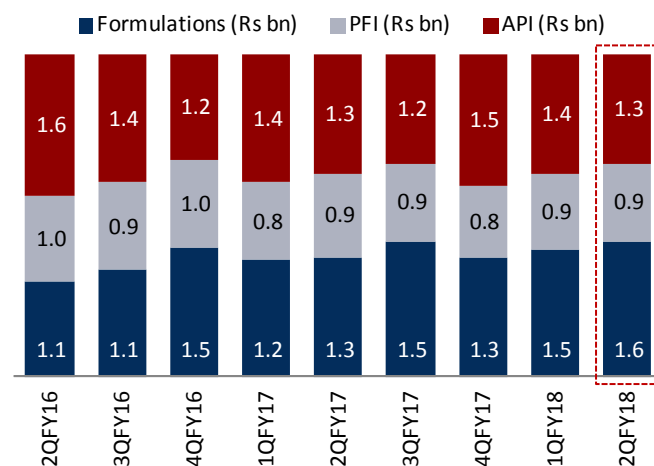
Source: Company, HDFC sec Inst Research

## Formulations Continue To Scale Up



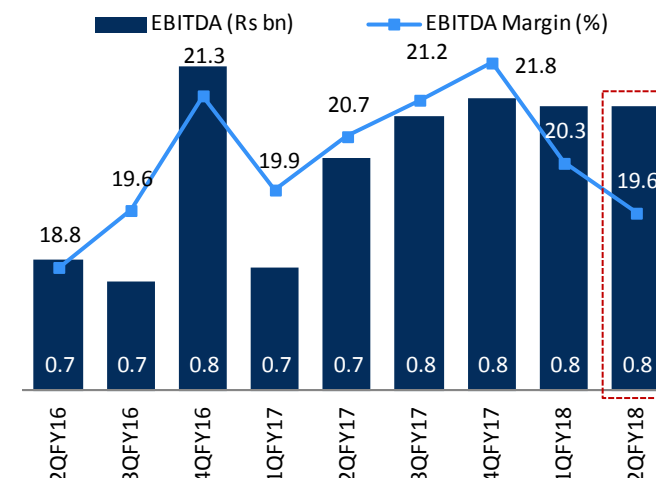
Source: Company, HDFC sec Inst Research

## Contribution From Formulations Visibly Rising



Source: Company, HDFC sec Inst Research

## Higher Employee Costs Lead To Margin Miss



Source: Company, HDFC sec Inst Research

*API growth will be constrained by high requirements captive consumption going forward, however core capacities coming on stream will provide a boost*

### Segmental Quarterly Performance

(Rs mn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
Finished Dosages	1,649	1,346	22.5	1,477	11.6
PFIIs	942	946	(0.4)	909	3.7
APIs	1,335	1,346	(0.8)	1,401	(4.8)
<b>Total</b>	<b>3,926</b>	<b>3,638</b>	<b>7.9</b>	<b>3,787</b>	<b>3.7</b>

Source: HDFC sec Inst Research

### Assumptions

	FY16	FY17	FY18E	FY19E	FY20E
Finished Dosages	4,417	5,388	6,358	9,028	10,653
<i>Growth (%)</i>	<i>7.0</i>	<i>22.0</i>	<i>18.0</i>	<i>42.0</i>	<i>18.0</i>
PFIIs	3,843	3,401	3,809	4,266	4,693
<i>Growth (%)</i>	<i>24.0</i>	<i>-11.5</i>	<i>12.0</i>	<i>12.0</i>	<i>10.0</i>
APIs	5,737	5,380	5,941	6,455	7,023
<i>Growth (%)</i>	<i>0.6</i>	<i>18.6</i>	<i>10.4</i>	<i>8.7</i>	<i>8.8</i>
<b>Total</b>	<b>14,248</b>	<b>16,369</b>	<b>18,332</b>	<b>21,997</b>	<b>25,892</b>
<i>Growth (%)</i>	<i>10.2</i>	<i>14.9</i>	<i>12.0</i>	<i>20.0</i>	<i>17.7</i>

Source: HDFC sec Inst Research

## Peer Valuations

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E
Sun Pharma	1,270	528	NEU	525	26.0	15.9	23.1	30.9	20.3	33.2	22.9	17.1	17.9	10.2	13.6	16.1
Cipla	489	609	NEU	630	12.5	21.2	27.6	35.2	48.7	28.7	22.1	17.3	8.4	12.8	14.7	16.3
Cadila Healthcare	475	464	BUY	570	14.5	14.4	19.1	26.5	31.9	32.3	24.2	17.5	23.5	19.0	20.8	23.6
Aurobindo Pharma	433	740	NEU	800	39.3	37.7	46.7	53.7	18.8	19.6	15.8	13.8	27.6	21.3	21.5	20.3
Dr Reddy's Labs	398	2,346	SELL	2,220	72.7	71.0	118.8	158.9	32.3	33.0	19.7	14.8	9.5	9.2	14.1	16.6
Lupin	375	833	BUY	1,125	56.9	36.7	46.6	66.0	14.6	22.7	17.9	12.6	20.9	11.8	13.6	17.0
Divi's Labs	270	1,016	NEU	1,100	39.9	35.9	46.5	53.1	25.4	28.3	21.9	19.1	22.0	16.8	19.4	19.8
Alkem Laboratories	233	1,945	BUY	2,100	74.6	63.6	85.5	104.8	26.1	30.6	22.7	18.6	21.9	16.0	18.8	19.8
Torrent Pharma	207	1,224	BUY	1,480	51.2	46.9	60.7	79.0	23.9	26.1	20.2	15.5	22.1	17.8	20.6	22.7
Glenmark	165	585	BUY	1,000	29.6	25.1	41.9	54.6	19.8	23.3	14.0	10.7	18.1	13.1	18.4	20.0
Jubilant Life Sciences	99	623	BUY	850	37.0	41.9	55.1	70.1	16.9	14.9	11.3	8.9	18.0	17.9	19.7	20.9
Alembic Pharma	97	514	NEU	555	21.4	21.1	24.7	31.1	24.0	24.3	20.8	16.5	23.0	19.5	19.6	21.0
Strides Shasun	71	799	BUY	1,200	34.0	34.9	51.5	67.6	23.5	22.9	15.5	11.8	13.1	11.6	16.0	18.3
Dishman Carbogen Amcis	49	306	BUY	410	9.0	11.8	16.7	22.9	33.9	25.9	18.3	13.4	3.0	4.2	5.5	6.9
<b>Granules India</b>	<b>32</b>	<b>127</b>	<b>BUY</b>	<b>170</b>	<b>7.5</b>	<b>6.9</b>	<b>9.0</b>	<b>12.2</b>	<b>16.8</b>	<b>18.4</b>	<b>14.0</b>	<b>10.3</b>	<b>21.0</b>	<b>15.5</b>	<b>16.0</b>	<b>19.1</b>

Source: HDFC sec Inst Research

*We have reduced our estimates for FY18/19E owing to a more conservative outlook for the Omnicem JV performance over the next two years*

## Change In Estimates (Consolidated)

Rs mn	Previous			New			% Chg		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Revenue	16,277	19,850	22,369	16,108	19,749	22,369	(1.0)	(0.5)	(0.0)
EBITDA	3,525	4,464	5,237	3,324	4,440	5,237	(5.7)	(0.5)	(0.0)
APAT	1,975	2,484	3,130	1,744	2,289	3,108	(11.7)	(7.9)	(0.7)

Source: HDFC sec Inst Research

### Income Statement (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
<b>Net Revenues</b>	<b>13,572</b>	<b>14,106</b>	<b>16,108</b>	<b>19,749</b>	<b>22,369</b>
<b>Growth (%)</b>	<b>5.0</b>	<b>3.9</b>	<b>14.2</b>	<b>22.6</b>	<b>13.3</b>
Material Expenses	7,250	6,796	7,893	9,618	10,782
Employee Expenses	1,176	1,402	1,675	1,837	2,125
Other Expenses	2,383	2,919	3,215	3,855	4,225
<b>EBITDA</b>	<b>2,763</b>	<b>2,988</b>	<b>3,324</b>	<b>4,440</b>	<b>5,237</b>
<b>EBITDA Margin (%)</b>	<b>20.4</b>	<b>21.2</b>	<b>20.6</b>	<b>22.5</b>	<b>23.4</b>
<b>EBITDA Growth (%)</b>	<b>32.4</b>	<b>8.2</b>	<b>11.2</b>	<b>33.6</b>	<b>18.0</b>
Depreciation	584	715	680	965	1,055
<b>EBIT</b>	<b>2,179</b>	<b>2,273</b>	<b>2,645</b>	<b>3,475</b>	<b>4,182</b>
Other Income (Incl EO Items)	52	99	129	158	179
Interest	371	323	618	730	749
<b>PBT</b>	<b>1,860</b>	<b>2,050</b>	<b>2,155</b>	<b>2,903</b>	<b>3,612</b>
Tax (Incl Deferred)	611	652	668	871	1,048
<b>RPAT</b>	<b>19</b>	<b>247</b>	<b>257</b>	<b>257</b>	<b>543</b>
Minority Interest	1,268	1,645	1,744	2,289	3,108
EO (Loss) / Profit (Net Of Tax)	-	-	-	-	-
<b>APAT</b>	<b>1,268</b>	<b>1,645</b>	<b>1,744</b>	<b>2,289</b>	<b>3,108</b>
<b>APAT Growth (%)</b>	<b>39.4</b>	<b>29.8</b>	<b>6.0</b>	<b>31.3</b>	<b>35.8</b>
<b>Adjusted EPS (Rs)</b>	<b>6.1</b>	<b>7.5</b>	<b>6.9</b>	<b>9.0</b>	<b>12.2</b>

Source: Company, HDFC sec Inst Research

### Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
<b>SOURCES OF FUNDS</b>					
Share Capital - Equity	217	229	254	254	254
Reserves	6,399	8,807	13,168	14,971	17,092
<b>Total Shareholders Funds</b>	<b>6,616</b>	<b>9,036</b>	<b>13,422</b>	<b>15,225</b>	<b>17,346</b>
Long Term Debt	1,842	1,242	4,356	4,431	7,581
Short Term Debt	3,929	4,738	5,125	5,550	2,400
<b>Total Debt</b>	<b>5,771</b>	<b>5,981</b>	<b>9,481</b>	<b>9,981</b>	<b>9,981</b>
Net Deferred Taxes	479	541	541	541	541
Other Non-current Liabilities & Provns	47	39	45	60	897
<b>TOTAL SOURCES OF FUNDS</b>	<b>12,912</b>	<b>15,596</b>	<b>23,489</b>	<b>25,807</b>	<b>28,765</b>
<b>APPLICATION OF FUNDS</b>					
Net Block	5,599	6,443	11,264	11,799	12,243
CWIP	766	2,605	2,500	2,500	2,500
Investments	701	1,082	1,200	1,250	1,250
Other Non-current Assets	295	259	250	320	320
<b>Total Non-current Assets</b>	<b>7,361</b>	<b>10,390</b>	<b>15,214</b>	<b>15,869</b>	<b>16,313</b>
<b>Cash &amp; Equivalents</b>	<b>1,303</b>	<b>498</b>	<b>3,090</b>	<b>3,808</b>	<b>6,131</b>
Inventories	2,537	2,760	3,174	3,801	4,254
Debtors	3,753	4,177	3,972	4,870	5,516
Other Current Assets	586	915	1,045	1,281	1,451
<b>Total Current Assets</b>	<b>6,877</b>	<b>7,852</b>	<b>8,190</b>	<b>9,952</b>	<b>11,220</b>
Creditors	1,811	2,160	2,483	2,974	3,328
Other Current Liabilities & Provns	817	984	522	848	1,572
<b>Total Current Liabilities</b>	<b>2,628</b>	<b>3,144</b>	<b>3,005</b>	<b>3,822</b>	<b>4,900</b>
<b>Net Current Assets</b>	<b>4,249</b>	<b>4,708</b>	<b>5,185</b>	<b>6,129</b>	<b>6,320</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>12,912</b>	<b>15,596</b>	<b>23,489</b>	<b>25,806</b>	<b>28,764</b>

Source: Company, HDFC sec Inst Research

## Cash Flow

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	1,860	2,050	2,155	2,903	3,612
Non-operating & EO items	716	-	-	-	-
Interest expenses	318	223	490	572	570
Depreciation	584	715	680	965	1,055
Working Capital Change	(735)	(467)	(471)	(929)	646
Tax Paid	(611)	(652)	(668)	(871)	(1,048)
<b>OPERATING CASH FLOW ( a )</b>	<b>2,132</b>	<b>1,869</b>	<b>2,186</b>	<b>2,640</b>	<b>4,836</b>
Capex	(1,509)	(3,658)	(5,395)	(1,500)	(1,500)
Free cash flow (FCF)	623	(1,789)	(3,209)	1,140	3,336
Non-operating Income	86	(250)	11	108	179
<b>INVESTING CASH FLOW ( b )</b>	<b>(1,423)</b>	<b>(3,908)</b>	<b>(5,384)</b>	<b>(1,392)</b>	<b>(1,397)</b>
Debt Issuance/(Repaid)	30	210	3,500	500	-
Interest Expenses	(371)	(323)	(618)	(730)	(749)
FCFE	368	(2,152)	(316)	1,018	2,691
Share Capital Issuance	805	1,345	2,977	-	-
Dividend	(169)	(246)	(334)	(486)	(987)
Others	(249)	247	266	187	543
<b>FINANCING CASH FLOW ( c )</b>	<b>47</b>	<b>1,234</b>	<b>5,790</b>	<b>(529)</b>	<b>(1,192)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>756</b>	<b>(806)</b>	<b>2,592</b>	<b>719</b>	<b>2,247</b>
<b>Closing Cash &amp; Equivalents</b>	<b>1,304</b>	<b>497</b>	<b>3,090</b>	<b>3,808</b>	<b>6,055</b>

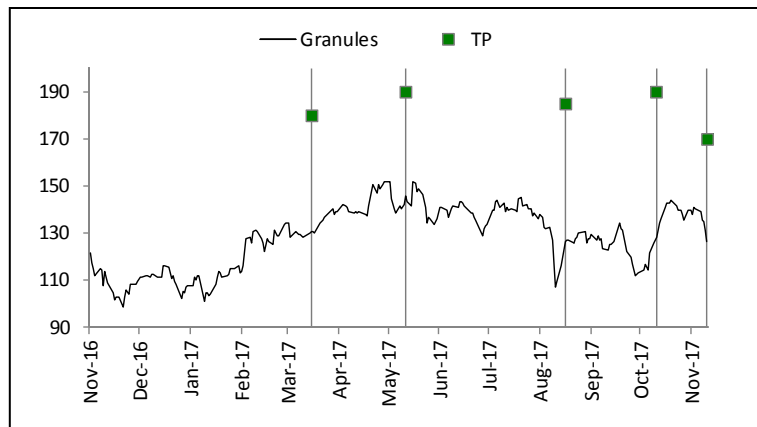
Source: Company, HDFC sec Inst Research

## Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
<b>PROFITABILITY (%)</b>					
GPM	46.6	51.8	51.0	51.3	51.8
EBITDA Margin	20.4	21.2	20.6	22.5	23.4
APAT Margin	9.3	11.7	10.8	11.6	13.9
RoE	23.2	21.0	15.5	16.0	19.1
RoIC (or Core RoCE)	14.8	12.7	11.2	12.4	14.3
RoCE	13.0	13.1	11.1	11.4	13.3
<b>EFFICIENCY</b>					
Tax Rate (%)	32.9	31.8	31.0	30.0	29.0
Fixed Asset Turnover (x)	1.6	1.4	1.1	1.2	1.2
Inventory (days)	68.2	71.4	71.9	70.3	69.4
Debtors (days)	100.9	108.1	90.0	90.0	90.0
Other Current Assets (days)	15.8	23.7	23.7	23.7	23.7
Payables (days)	48.7	55.9	56.3	55.0	54.3
Other Current Liab & Provns (days)	22.0	25.5	11.8	15.7	25.6
Cash Conversion Cycle (days)	114.3	121.8	117.5	113.3	103.1
Debt/EBITDA (x)	2.1	2.0	2.9	2.2	1.9
Net D/E (x)	0.7	0.6	0.5	0.4	0.2
Interest Coverage (x)	5.9	7.0	4.3	4.8	5.6
<b>PER SHARE DATA (Rs)</b>					
EPS	6.1	7.5	6.9	9.0	12.2
Dividend	0.6	0.8	1.1	1.6	3.3
Book Value	26.1	35.6	52.9	60.0	68.4
<b>VALUATION</b>					
P/E (x)	20.7	16.8	18.4	14.0	10.3
P/BV (x)	4.9	3.6	2.4	2.1	1.9
EV/EBITDA (x)	11.6	11.5	11.6	8.6	6.9
EV/Revenues (x)	2.4	2.4	2.4	1.9	1.6
OCF/EV (%)	6.7	5.4	5.7	6.9	13.4
FCF/EV (%)	2.0	(5.2)	(8.3)	3.0	9.3
FCFE/Mkt Cap (%)	1.3	(7.4)	(1.0)	3.2	8.4
Dividend Yield (%)	0.4	0.6	0.9	1.3	2.6

Source: Company, HDFC sec Inst Research

## RECOMMENDATION HISTORY



Date	CMP	Reco	Target
15-Mar-17	129	BUY	180
12-May-17	146	BUY	190
17-Aug-17	127	BUY	185
10-Oct-17	126	BUY	190
11-Nov-17	127	BUY	170

### Rating Definitions

**BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period  
**NEUTRAL** : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period  
**SELL** : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period



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