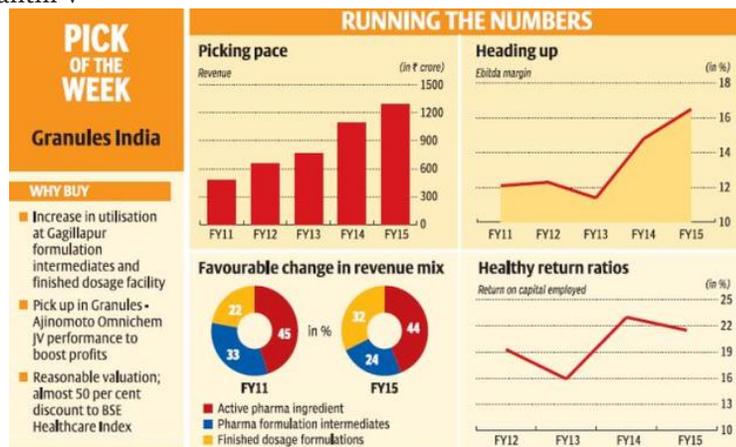


BusinessLine

Granules India: Healthy product mix

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Despite modest revenue growth, the company's profitability has improved

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Stocks of the so-called defensive pharma companies have taken a beating in the ongoing market weakness. The stock of active ingredient and drug formulations maker Granules India has lost about 30 per cent over the last two months.

Despite recording a modest revenue growth during the last two quarters, the company's profitability has improved significantly. A better product mix helped Granules India achieve this.

Increase in utilisation levels at its pharma formulation intermediates (PFI) and finished dosage formulations (FDF) facility at Gagillapur (Telangana), along with scale-up in the joint venture with the Belgian chemicals major Ajinomoto Omnicem to supply high-value active pharma ingredients, should provide a leg up to Granules India's revenue and profit over the next two to three years.

Further, the observations made by the US drug regulator during the inspection of Granules' Jeedimetla (Telangana) plant relate to procedural aspects. Hence, the risk of this progressing into a warning letter remains low.

At the current price, the stock trades at about 14 times its estimated 2016-17 earnings, implying a nearly 50 per cent discount to the BSE Healthcare Index. Given the good growth prospects over the medium term, investors with a three-year horizon can use the recent correction to buy the stock.

Slow revenue growth

Granules India reported docile revenue growth over the last quarters on two counts. One, realisation for paracetamol has been lower due to a sharp slide in crude price, given that its key raw material is a derivative of crude. Second, temporary halt in production by one of its clients in the US also played a part. This is expected to be resolved over the next few months.

The company is in the process of revamping the portfolio of Auctus Pharma, which it acquired in 2013. As part of this, the company plans to move out of low-margin products and focus only on those that are profitable. This led to a reduction in Granules India's overall revenue.

Despite slow revenue growth, Granules has improved its profitability over the last few quarters. Lower raw material spend due to fall in crude prices and fixed margin contracts entered into by the company aided margin improvement.

Also, the portfolio rebalancing at Auctus Pharma led to an improvement in the operating profit margin. The improved product mix should continue to benefit Granules' margin.

In 2013, the company undertook capacity expansion initiatives. The utilisation levels at the PFI and finished dosage formulations (FDF) facility at Gagillapur (Telangana) are currently at about 30 per cent and 50 per cent, respectively.

This leaves Granules with significant headroom for growth over the next two to three years.

Also, revenues from Granules' joint venture with Ajinomoto Omnicem have started flowing in the current year. The management expects the JV's revenues to grow at a healthy pace over the next two to three years. This should not only aid revenue growth but also profitability, given the healthy operating profit margin for these products.

Expansion initiatives

Two of the company's facilities located at Visakhapatnam (Andhra Pradesh) and Jeedimetla (Telangana) were inspected by the US drug regulator, Food and Drug Administration (FDA), in December 2015. While the Visakhapatnam plant completed the inspection without any observations, the FDA made three observations at the Jeedimetla plant.

According to the management sources, the observations are more procedural in nature. Also, the company has already responded to the FDA on the corrective actions and the same is expected to be resolved soon. This is unlikely to have an impact on Granules' business though the risk cannot be fully ruled out.

The company has firmed up its capital expenditure plan of ₹450 crore to be completed over the next two to three years. This includes a greenfield API plant at Visakhapatnam entailing a spend of ₹150 crore, ₹80 crore for expansion of its metformin and guaifenesin capacity and ₹70 crore for expanding capacity at its US-based controlled substances facility.

These initiatives should hold Granules in good stead over the next three to five years.

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