

BUY

TP: Rs 975 | ▲ 38%

ERIS LIFESCIENCES

Pharmaceuticals

06 December 2021

Foray into India's insulin market

- ERIS enters ten-year, 70:30 JV with MJ Biopharm for marketing rh-insulin, insulin analogues, GLP1 agonists and biosimilars
- India, currently the diabetes capital of the world, could see its diabetic population more than double in two decades
- We reiterate BUY on ERIS with TP unchanged at Rs 975 as our EBITDA estimates remain intact

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JV for insulin enhances diabetes portfolio: ERIS has announced a 70:30 joint venture with MJ Biopharm to complement its diabetes portfolio. The venture is for a ten-year period and includes the rollout of other complex products at a later stage. Deal highlights:

- ERIS is one of India's leading companies in the oral diabetes segment. The JV will extend its product offerings in insulin and GLP-1 agonists, besides leveraging its network reach among endocrinologists and diabetic patients.
- As per management, the Indian market for insulin and GLP-1 agonists is worth Rs 35bn-40bn and expected to double to Rs 80bn by CY26.
- ERIS will have rights to market and distribute human insulin (rh-insulin) for a period of ten years and similarly market future products of the JV, including insulin analogues (Lispro, Aspart and Glargine), one GLP-1 agonist (e.g. Liraglutide) and potentially other biopharmaceutical products.
- Management has guided for the launch of human insulin in Q4FY22 as part of ten products to be rolled out in FY22, alongside plans to increase manpower by 200 representatives over FY22-FY23.
- ERIS has also paid a one-time license fee of Rs 150mn to MJ Biopharm, apart from 30% share of the JV's net profit. As per the JV contract, MJ Biopharm is likely to keep certain manufacturing mark-up over the cost of production while ERIS will retain a part of marketing and distribution cost for the JV products.

Maintain BUY: We maintain FY22-FY24 earnings estimates as we await clarity on the timing of JV product launches and progress on prescription market share. Our TP thus remains at Rs 975, based on 20x Sep'23E EV/EBITDA – this implies 24x P/E, a steep 25% discount to MNC pharma peers who trade at an average of 32.5x. Retain BUY as we like ERIS for its focused presence in the chronic space and superior physician reach.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ERIS IN/Rs 705
Market cap	US\$ 1.3bn
Free float	27%
3M ADV	US\$ 1.0mn
52wk high/low	Rs 863/Rs 474
Promoter/FPI/DII	53%/13%/10%

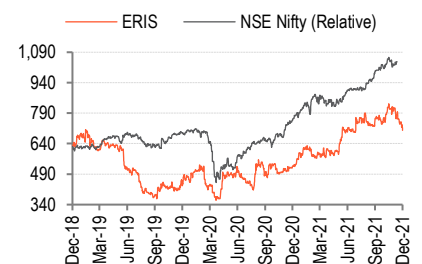
Source: NSE | Price as of 3 Dec 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	12,119	13,884	15,927
EBITDA (Rs mn)	4,306	5,113	6,161
Adj. net profit (Rs mn)	3,551	4,148	5,115
Adj. EPS (Rs)	26.2	30.6	37.7
Consensus EPS (Rs)	26.2	30.3	35.1
Adj. ROAE (%)	27.3	26.2	26.4
Adj. P/E (x)	27.0	23.1	18.7
EV/EBITDA (x)	21.9	18.5	15.2
Adj. EPS growth (%)	19.8	16.8	23.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Deal rationale

- India leads globally in the incidence of metabolic disorders, with its diabetic population expected to more than double in the next 20 years.
- Being an injectable, the adoption of insulin by India's diabetic population is merely at 30% among patients within the specialty/super-specialty doctor network and 2% among the general practitioner (GP) network. ERIS believes that frequent engagement with patients is one of the key requirements for gaining market penetration in the service-oriented insulin business.
- The MJ Biopharm JV will help ERIS expand the breadth and depth of its diabetes care portfolio and leverage the untapped opportunity in rh-insulin, insulin analogues and GLP-1 agonists.
- Given its own industry-leading sales in oral anti-diabetic products in India, including new therapy brands (Zomelis and Gluxit), ERIS expects to replicate this success with the new JV and insulin portfolio over FY22-FY24.

Our view

- While ERIS plans to launch its first JV product in Q4FY22, we expect the insulin analogues to be launched over the next 2-3 years given that a phase-3 clinical trial will have to be conducted for each of the products and ERIS will have to develop its team and network to support the new line of business.
- We expect slow, steady and minor additions to revenue in the near term. Operating profit is likely to flow through only 12-18 months after the launch of each product.
- Amid strong competition from leading MNC players (Abbott, Sanofi and Novo Nordisk), we expect ERIS to focus on new patients, besides pursuing existing insulin users. Given the low penetration in the GP market for endocrinology, we believe the company will initially target patients of GPs which will require a strategic pricing policy.

We assume that the company will have introductory pricing discounts and will focus on gaining minimum critical volumes in the near term to justify its foray into the new line of business. The company will also continue to leverage its synergy among specialty and super-specialty networks.

- With its focus on gaining a greater foothold in the insulin market, we anticipate a disproportionate increase in employee costs, SGA and promotion costs in comparison to sales initially. Besides, with ERIS sharing 30% of the JV's profit, profitability for the JV as well as for the company will reduce. This coupled with lower sales of JV products and higher overheads would limit profitability in FY23 and FY24, in our view. Management expects high return ratios (ROIC, ROE, ROCE) once ERIS gains sizeable prescription share among GPs and specialists.
- Overall, we expect a minimal earnings impact in FY22. For FY23, increased sales of JV products and higher overheads would reduce the EBITDA margin, though this won't be meaningful.

Valuation methodology

We maintain our FY22-FY24 earnings estimates as we await further clarity on the timing of JV product launches and progress on prescription market share. Our TP thus remains unchanged at Rs 975, based on 20x SEP'23E EV/EBITDA – this implies a 24x P/E multiple, which is a steep 25% discount to MNC pharma peers who trade at an average of 32.5x.

ERIS has taken corrective steps to catalyse sales (rationalisation of tail brand portfolio), adopted a new cluster-based approach (sharper focus on cardio-metabolic and VMN portfolios), and worked toward productivity enhancement to spur profitable growth. These initiatives have started to reflect in earnings and margins. The company also owns a decent chronic franchise with stronger prescription rankings than peers in diabetes and cardiac therapy. Moreover, its proposed new greenfield expansion, D&A policy change and reduction in useful life of brands will help alleviate investor concerns. Retain BUY.

Key risks

- **Regulatory action and slowdown in India formulation business:** Roughly 8% of ERIS's product portfolio is price-controlled vs. 17% for the IPM. The company's pricing for non-controlled drugs is around the industry average, with the exception of its Tenueligiptin, Gliclazide and Rosuvastatin molecules (together 15% of FY20 sales), where it is 10-15% higher than the average price for all players. This apart, any slowdown in IPM growth and delay in new launches can hurt earnings.
- **Risk of trade margin capping for generics business:** ERIS has recently forayed into trade generics (we expect this business to contribute ~8% of FY23E sales). The business operates in a dynamic regulatory environment marred by uncertainty over proposed changes related to trade margins.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.5	2,117	2,800	BUY
Alembic Pharma	ALPM IN	2.1	808	980	BUY
Alkem Labs	ALKEM IN	5.5	3,439	4,250	HOLD
Aurobindo Pharma	ARBP IN	5.3	674	886	BUY
Cipla	CIPLA IN	9.8	912	1,160	BUY
Divi's Labs	DIVI IN	16.8	4,757	5,540	HOLD
Dr Reddy's Labs	DRRD IN	10.2	4,597	5,500	BUY
Eris Lifesciences	ERIS IN	1.3	705	975	BUY
Laurus Labs	LAURUS IN	3.7	511	715	BUY
Lupin	LPC IN	5.3	873	1,045	HOLD
Sun Pharma	SUNP IN	24.0	752	955	BUY

Source: BOBCAPS Research, NSE | Price as of 3 Dec 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	10,741	12,119	13,884	15,927	17,897
EBITDA	3,684	4,306	5,113	6,161	7,047
Depreciation	503	430	621	698	755
EBIT	3,181	3,876	4,492	5,462	6,292
Net interest inc./(exp.)	(22)	(18)	(2)	0	0
Other inc./(exp.)	154	87	69	159	279
Exceptional items	0	0	0	0	0
EBT	3,313	3,945	4,559	5,621	6,570
Income taxes	349	394	410	506	657
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	2,965	3,551	4,148	5,115	5,913
Adjustments	0	0	0	0	0
Adjusted net profit	2,965	3,551	4,148	5,115	5,913

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	1,000	1,026	1,125	1,293	1,455
Other current liabilities	490	406	547	629	708
Provisions	562	588	675	776	873
Debt funds	0	68	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	136	136	136	136	136
Reserves & surplus	11,626	14,117	17,316	21,165	25,495
Shareholders' fund	11,761	14,253	17,452	21,300	25,630
Total liab. and equities	13,813	16,341	19,799	23,998	28,666
Cash and cash eq.	673	383	3,188	6,412	11,149
Accounts receivables	1,569	1,405	1,500	1,939	1,697
Inventories	695	945	1,125	1,508	1,552
Other current assets	1,305	2,114	1,793	2,060	2,318
Investments	780	2,940	2,940	2,940	2,940
Net fixed assets	873	779	1,819	2,045	2,258
CWIP	44	16	16	16	16
Intangible assets	7,876	7,760	7,419	7,077	6,736
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	13,814	16,341	19,799	23,998	28,666

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	3,228	3,072	5,145	5,074	6,947
Capital expenditures	(1,309)	(57)	(1,661)	(924)	(968)
Change in investments	2,779	(2,161)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	1,470	(2,218)	(1,661)	(924)	(968)
Equities issued/Others	(2)	0	0	0	0
Debt raised/repaid	(1,764)	68	(68)	0	0
Interest expenses	(22)	(18)	(2)	0	0
Dividends paid	(467)	(871)	(950)	(1,267)	(1,583)
Other financing cash flows	(1,846)	(323)	341	341	341
Cash flow from financing	(4,100)	(1,144)	(678)	(925)	(1,242)
Chg in cash & cash eq.	598	(290)	2,805	3,224	4,737
Closing cash & cash eq.	673	383	3,188	6,412	11,149

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	21.8	26.2	30.6	37.7	43.5
Adjusted EPS	21.8	26.2	30.6	37.7	43.5
Dividend per share	2.9	5.5	6.0	8.0	10.0
Book value per share	86.6	105.0	128.5	156.9	188.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	9.0	7.8	6.8	5.9	5.1
EV/EBITDA	26.2	21.9	18.5	15.2	12.8
Adjusted P/E	32.3	27.0	23.1	18.7	16.2
P/BV	8.1	6.7	5.5	4.5	3.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	89.5	90.0	91.0	91.0	90.0
Interest burden (PBT/EBIT)	104.2	101.8	101.5	102.9	104.4
EBIT margin (EBIT/Revenue)	29.6	32.0	32.4	34.3	35.2
Asset turnover (Rev./Avg TA)	22.1	23.2	21.8	20.6	19.1
Leverage (Avg TA/Avg Equity)	1.1	1.0	1.0	1.0	1.0
Adjusted ROAE	26.5	27.3	26.2	26.4	25.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	9.4	12.8	14.6	14.7	12.4
EBITDA	6.8	16.9	18.7	20.5	14.4
Adjusted EPS	2.0	19.8	16.8	23.3	15.6
Profitability & Return ratios (%)					
EBITDA margin	34.3	35.5	36.8	38.7	39.4
EBIT margin	29.6	32.0	32.4	34.3	35.2
Adjusted profit margin	27.6	29.3	29.9	32.1	33.0
Adjusted ROAE	26.5	27.3	26.2	26.4	25.2
ROCE	27.5	30.4	28.7	29.0	28.0
Working capital days (days)					
Receivables	54	43	40	45	35
Inventory	24	29	30	35	32
Payables	34	31	30	30	30
Ratios (x)					
Gross asset turnover	1.1	1.3	1.2	1.3	1.4
Current ratio	2.1	2.4	3.2	4.4	5.5
Net interest coverage ratio	147.3	215.1	2,209.5		
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.3)	(0.5)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

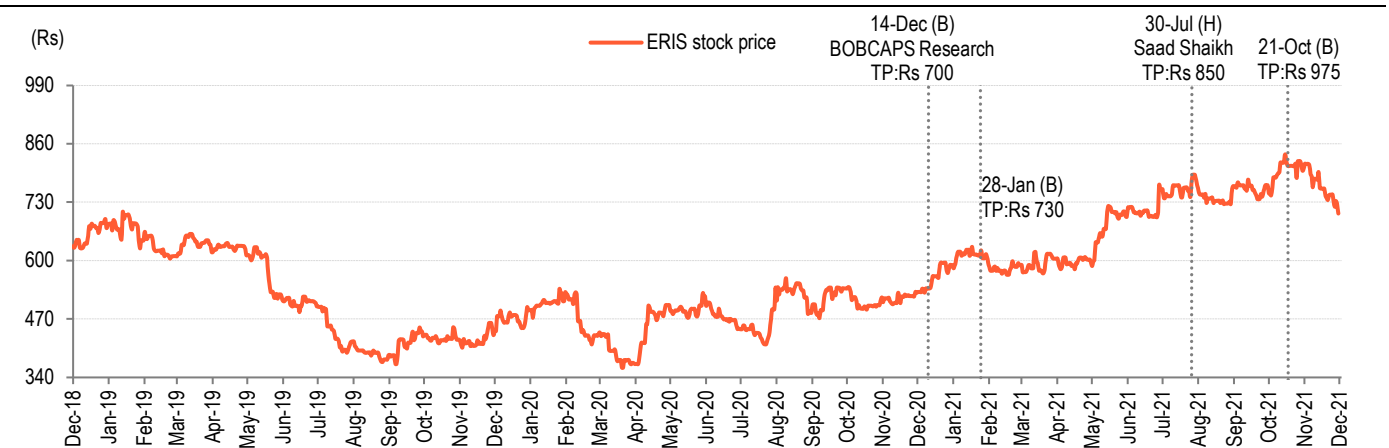
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): ERIS LIFESCIENCES (ERIS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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