BUY
TP: Rs 700 | ▲ 30%

ERIS LIFESCIENCES | Pharmaceuticals | 14 December 2020

Chronic franchise, FCF growth underappreciated; initiate with BUY

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Eris Lifesciences' (ERIS) earnings are at inflection point and we expect a 16% EBITDA CAGR over FY21-FY24 (vs. 8%, FY18-FY21). Presence in fast-growing therapies, improving chronic share amid patent expiry upsides, and better field force output are key growth levers. Organic portfolio margins have risen sharply. ERIS could rerate closer to branded multiples over 12 months led by an undervalued chronic franchise (>75% of EBITDA) plus strong FCF (20% of MCap) and 1.5x ROIC expansion by FY24E. BUY, Mar'22 TP Rs 700 (20x EV/EBITDA).

Focus on fast-growing diabetes, cardiac, VMN segments; acute has bottomed out: ERIS is a pure India pharma market play, ranked among the top 5 by prescription share among diabetologists and cardiologists. Its top 15 brands formed 78% of FY20 sales with the top 3 together drawing >Rs 1bn. Strong product selection has enabled >75% of sales to come from growth markets. Emerging off-patent upsides in cardio-diabetes, Zomelis launch, prescription penetration in the cardiac & vitamin-mineral-nutrient (VMN) portfolios, and acute portfolio tailwinds are expected to drive a ~12% sales CAGR over FY21-FY24 (>15% in chronic).

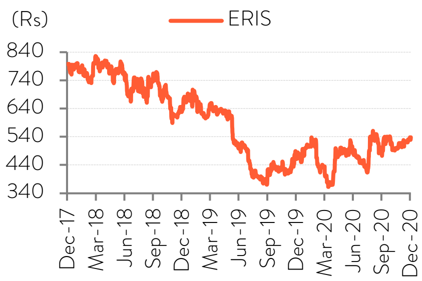
Skilled organic portfolio execution: Our evaluation of organic portfolio strength based on sales and profitability over two time periods suggests that while sales have grown 7-8%, ERIS has substantially scaled aggregate margins on older brands to 40% over FY17-FY20 (vs. 24% in FY14-FY16). M&A success has been decent.

Strong FCF, ROIC outlook merit rerating: We expect 16% EBITDA growth over FY21-FY24 (organic portfolio + Zomelis to contribute >85% of delta). Barring FY17-FY20, FCF conversion was strong at 65%. High FCF will help ERIS boost its India presence. After 50% downside vs. the healthcare index in the last 2Y, the stock could rerate led by an underappreciated chronic franchise and 1.5x ROIC expansion by FY24E. Better capital allocation presents added optionality.

Ticker/Price	ERIS IN/Rs 538
Market cap	US$ 990.7mn
Shares o/s	136mn
3M ADV	US$ 1.2mn
52wk high/low	Rs 595/Rs 321
Promoter/FPI/DII	54%/11%/11%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	9,822	10,741	11,903	13,349	14,987
EBITDA (Rs mn)	3,449	3,684	4,174	4,862	5,603
Adj. net profit (Rs mn)	2,908	2,965	3,346	4,013	4,721
Adj. EPS (Rs)	21.4	21.8	24.6	29.6	34.8
Adj. EPS growth (%)	(1.1)	2.0	12.9	19.9	17.6
Adj. ROAE (%)	31.1	26.5	25.7	25.5	24.8
Adj. P/E (x)	25.1	24.6	21.8	18.2	15.5
EV/EBITDA (x)	21.2	20.0	17.1	14.5	12.1

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.

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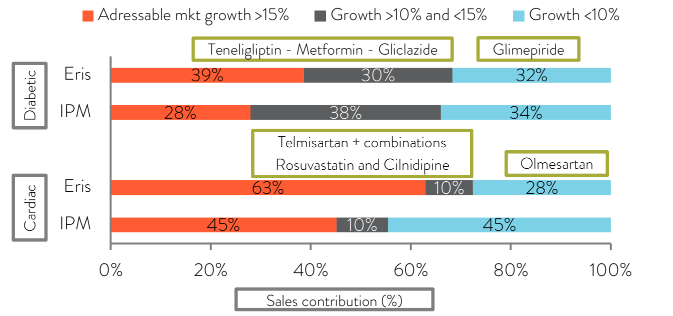
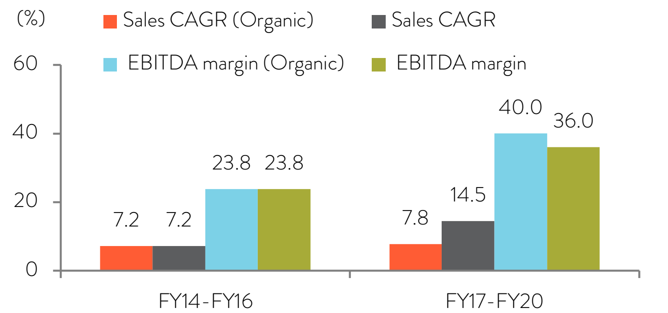
Focus charts

FIG 1 – ERIS PRESENT IN FAST-GROWING MOLECULES



Source: Company, BOBCAPS Research

FIG 2 – ROBUST EXECUTION IN ORGANIC PORTFOLIO



Source: Company, BOBCAPS Research

FIG 3 – KEY THERAPY MIX AND PRESCRIPTION RANKINGS

Key therapy	FY20 sales (%)	Growth FY18-FY20 (%) Covered market	Eris	Prescription ranking
Anti-diabetic	29.3	12.0	16.0	3
Cardiac	27.2	12.0	13.9	4
Neuro/ CNS	7.3	9.4	8.1	3
Vitamins / Minerals / Nutrients	18.7	9.0	9.1	8
Gastrointestinal	6.1	7.0	(1.1)	9

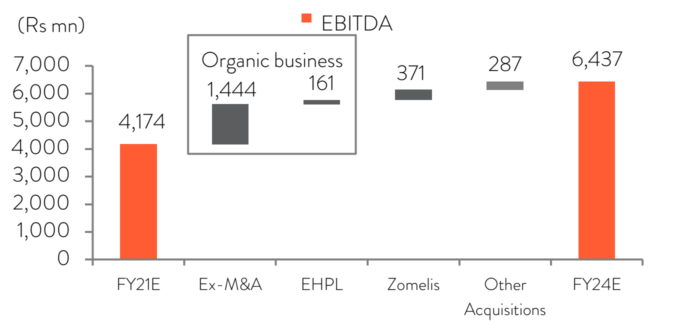
Source: Company, BOBCAPS Research

FIG 4 – DECENT SUCCESS WITH PAST M&A, REALISING 3-9X EV/EBITDA MULTIPLE ON AVERAGE

Acquisition	Year	EBITDA payback*	Headline EV/EBITDA multiple Y1 (x)	EV/EBITDA post synergy Y4 (x)
Aprica (earlier Amay)	FY17	~5 years	9.2x	2.7x
Kinedex	FY17	>10 years	26.5x	-
Strides CNS portfolio	FY18	< 8 years	17.7x	8.6x
Zomelis brand	FY20	~5 years	-	3.5x

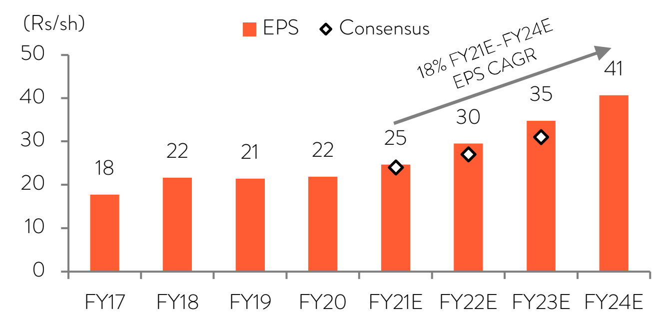
Source: Company, BOBCAPS Research | *5-8 years is a good benchmark

FIG 5 – ORGANIC+ZOMELIS TO DRIVE OVER 85% OF FY21E-FY24E EBITDA



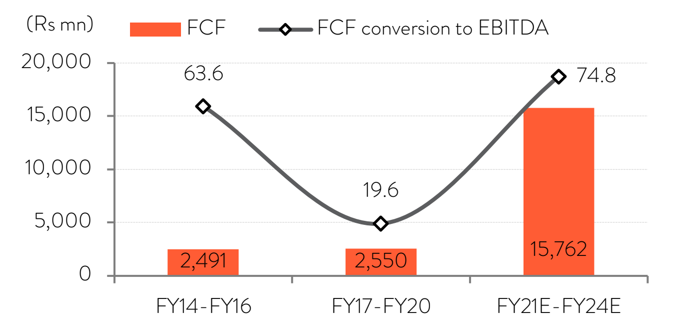
Source: Company, BOBCAPS Research

FIG 6 – EPS: 18% CAGR FOR FY21E-FY24E (VS. 4% FY18-FY21E), OUR FY22/FY23 EPS IS 10-12% AHEAD OF CONSENSUS EST.



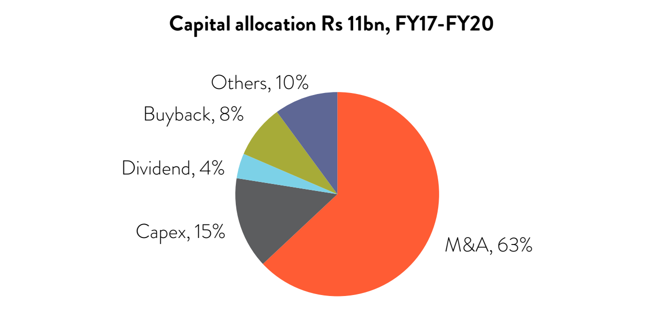
Source: Company, BOBCAPS Research

FIG 7 – FCF CONVERSION SET TO REBOUND; NEXT THREE-YEAR FCF PEGGED ~20% OF CURRENT MCAP



Source: Company, BOBCAPS Research

FIG 8 – CAPITAL ALLOCATION LIKELY TO BE MORE BALANCED BETWEEN M&A AND PAYOUTS THAN IN THE PAST



Source: Company, BOBCAPS Research

Investment summary

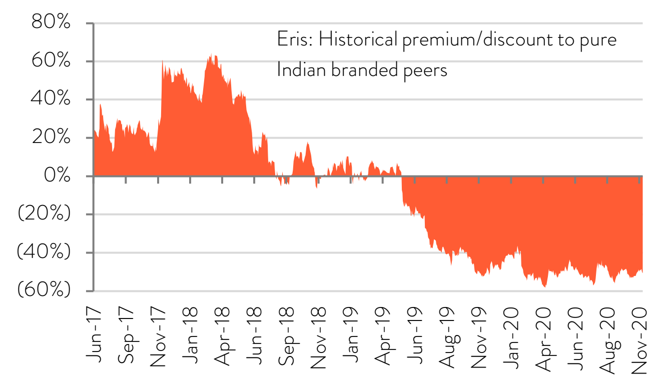
We initiate coverage on ERIS with a BUY rating and a Mar'22 target price of Rs 700, based on 20x FY23E EBITDA (implied P/E of 20x). Our target multiple is at a premium to frontline peers as well as the sector average of 12x FY23E EBITDA, but at a discount to the five-year average forward multiple of 24x for Indian generic pharma.

ERIS has significantly underperformed the BSE Healthcare index over the last six months, one year and two years by 28%, 28% and 50% respectively, due to concerns over a weak earnings profile. During the last 12 months, the company has taken corrective steps (rationalisation of tail brand portfolio in Kinedex/ Strides), adopted a new cluster-based approach (sharper focus on cardio-metabolic and VMN portfolios), and worked toward productivity enhancement to spur profitable growth. ERIS also owns a healthy chronic franchise with high prescription rankings in diabetes and cardiac therapy.

We expect rerating in Eris over the next 12 months led by (1) its under-appreciated chronic franchise (~75% of EBITDA), (2) expected earnings growth rebound to 18% CAGR over FY21-FY24, and (3) ROIC expansion to 54% by FY24 – better than our pharma coverage and higher than the average for MNCs ex-Abbott – with the optionality of better capital allocation.

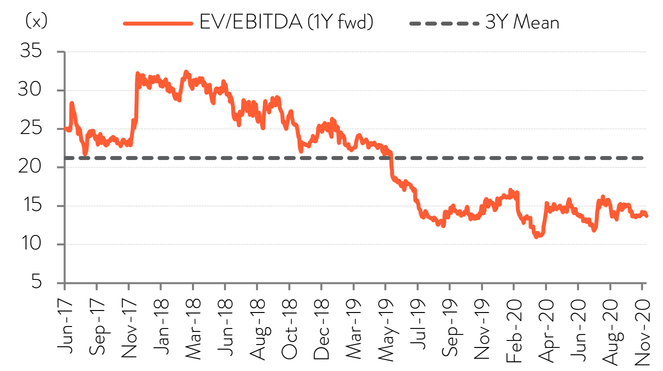
We have compared one-year forward EV/EBITDA multiples of pure play Indian generics such as ERIS against a basket of global generic companies that we cover. Indian generics have traded at a significant premium to global generics, in part due to their domestic business contribution as well as superior return generation profiles. ERIS is currently trading at compelling valuations of 18x P/E and 14x EV/EBITDA on FY22E, which is ~35% below the three-year mean and at ~45% discount to Indian branded generic players.

FIG 9 – ERIS EV/EBITDA – ~45% DISCOUNT TO INDIAN GENERIC VALUATION MULTIPLE



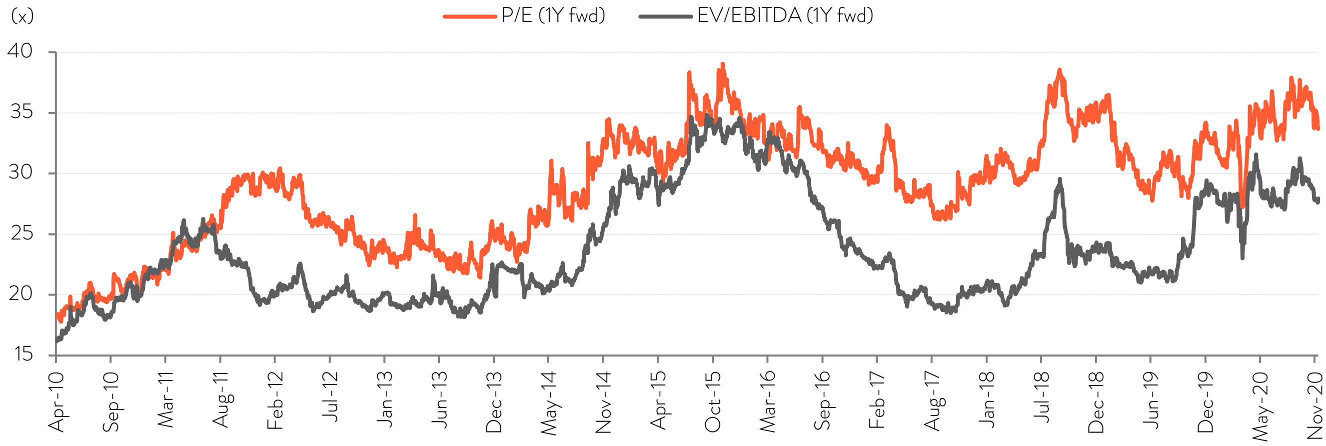
Source: Company, BOBCAPS Research

FIG 10 – ERIS'S EV/EBITDA 35% BELOW 3Y MEAN



Source: Company, BOBCAPS Research

FIG 11 – INDIAN GENERIC VALUATION MULTIPLE*



Source: BOBCAPS Research | *Average of Abbott India, Pfizer, Sanofi India, Glaxo Pharma

FIG 12 – VALUATION OF GENERIC COVERAGE UNIVERSE

Companies	Price (11-Dec-20)	Mcap (US$ mn)	Rating	EBITDA CAGR (%) (FY21E-FY23E)	P/E (x) FY22E	P/E (x) FY23E	EV/EBITDA (x) FY22E	EV/EBITDA (x) FY23E	ROE (%) FY21E	ROIC (%) FY21E
Coverage universe										
Aurobindo Pharma	895	7,121	BUY	4.3	15.5	14.4	9.4	8.9	16.2	21.1
Cipla	756	8,283	BUY	4.8	26.3	24.5	13.8	13.2	12.6	18.3
Dr Reddy's Labs	5,008	11,310	ADD	16.8	25.7	19.4	15.2	12.2	18.5	29.8
Lupin	939	5,784	ADD	20.0	33.5	27.2	14.0	11.9	6.6	12.0
Sun Pharma	568	18,514	ADD	10.1	22.2	19.1	13.6	11.9	12.5	18.2
Alkem Labs	2,896	4,699	BUY	9.2	20.8	18.0	15.5	13.6	27.4	36.4
Alembic Pharma	1,082	2,897	BUY	4.6	23.1	18.7	15.1	12.7	27.5	27.6
Ajanta Pharma	1,681	1,991	BUY	13.0	23.2	18.8	15.7	13.4	19.0	28.6
Aggregate					**23.2**	**19.5**	**14.1**	**12.2**	**18.4**	**24.1**
Indian MNCs*										
Sanofi	7,920	2,476	Not Rated	10.1	32.1	27.7	21.5	18.9	23.9	40.0
Glaxo Pharma	1,550	3,565	Not Rated	9.6	38.3	37.0	28.5	28.0	28.5	50.0
Abbott India	16,070	4,630	Not Rated	13.7	41.6	37.1	30.4	26.7	28.5	130.0
Pfizer	5,275	3,278	Not Rated	10.7	41.3	36.5	29.9	26.9	16.6	38.0
Aggregate					**38.3**	**34.6**	**27.6**	**25.1**	**24.4**	**64.5**
Eris Life	**538.0**	**933.8**	**BUY**	**15.9**	**18.2**	**15.5**	**14.5**	**12.1**	**25.7**	**35.8**

Source: BOBCAPS Research | *Bloomberg estimates

Investment thesis

Focus on fast-growing segments; acute sales have bottomed out

ERIS is a pure play on the Indian pharma market (IPM) with 4% share and FY20 sales of ~Rs 10bn (chronic mix 63%). In the last three years, sales clocked a brisk 13% CAGR including ~8% growth in the organic portfolio. ERIS is ranked 22nd in the IPM and has moved up 7 spots in the last three years. Its top 15 brands accounted for 78% of FY20 sales with three brands in >Rs 1bn sales range.

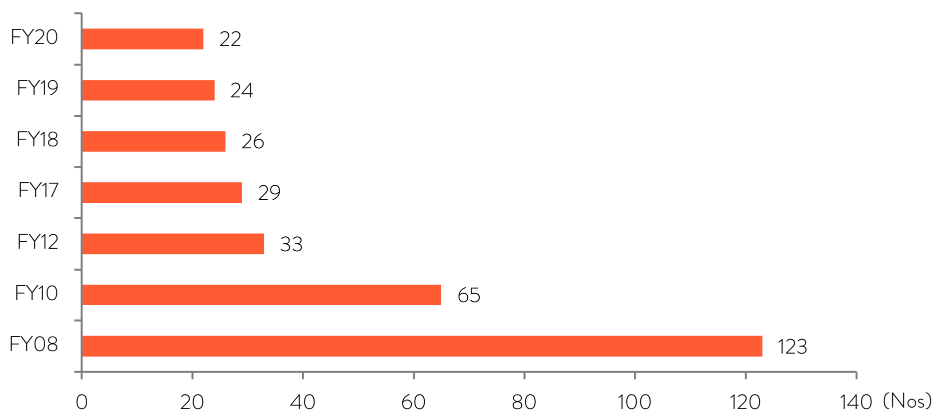
Product selection has remained strong with over 75% of sales coming from core markets such as diabetes, cardiac therapy and VMN (14% growth in these segments vs. 11% for IPM). ERIS ranks amongst the top 5 in prescription share from diabetologists (#3) and cardiologists (#4).

We expect 12% sales CAGR over FY21-FY24 (15% in chronic and 8% in acute therapies) backed by (1) emerging off-patent opportunities within cardio-diabetes (expiries worth Rs 30bn-35bn in next 3-5 years), (2) scale-up of the newly acquired Zomelis brand, (3) prescription penetration in cardiac care and VMN, (4) tailwinds in the sub-chronic/acute portfolios (pursuing high-growth opportunities in neurology, dermatology, women's health and osteoarthritis), and (5) foray into trade generic/OTC cocktails via subsidiary EHPL. Strategic acquisitions and in-licensing to enhance the product line are key elements of the company's growth strategy. These have been discussed in detail later in the report.

ERIS has been closely tracking peers such as Sun Pharma, Glenmark, Lupin and USV in terms of its addressable market size within the diabetes and cardiac segments, implying that growth upsides from market coverage expansion could be limited in the mid-term (Fig 18). However, this can potentially expand over three years following off-patent opportunities in the cardio-diabetic space. We estimate a healthy chronic segment (cardio, diabetes) sales CAGR of 15%.

ERIS has jumped 7 ranks in the last three years

FIG 13 – IPM RANK – ERIS CONTINUES TO MAKE STEADY GAINS



Source: Company, BOBCAPS Research

Core markets are diabetes, cardiac and VMN

ERIS grew 14% vs. covered market growth of 11%

FIG 14 – KEY THERAPIES: ACCOUNTED FOR 75% OF SALES

Therapy	FY20 Sales (%)	Growth FY18-FY20 (%)		Market share (%)		Covered market rank
		Covered market	ERIS	FY18	FY20	
Chronic						
Anti-diabetic	29.3	12.0	16.0	4.4	5.2	5
Cardiac	27.2	13.0	13.9	3.5	3.5	10
Neuro/CNS	7.3	9.4	8.1	3.1	2.9	10
Acute						
Vitamins / Minerals / Nutrients	18.7	9.0	9.1	4.9	5.1	3
Gastrointestinal	6.1	7.0	(1.1)	3.8	3.2	18

Source: Company, AIOCD, BOBCAPS Research

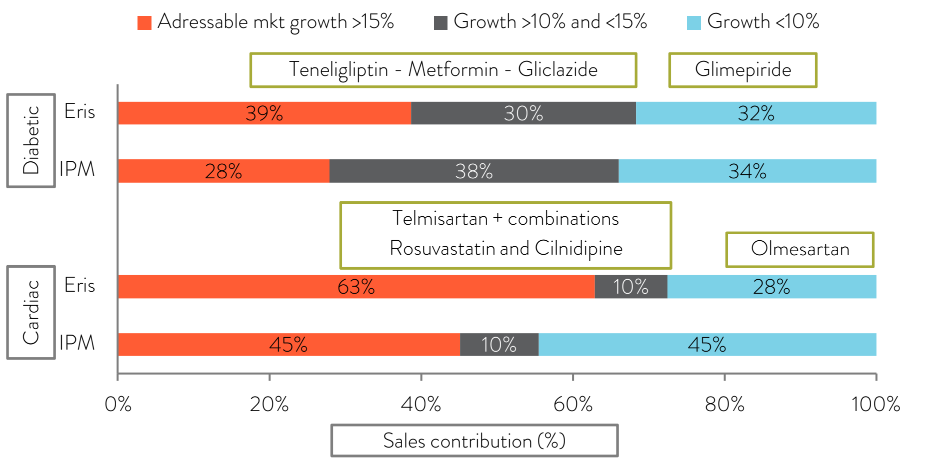
FIG 15 – EXPECT 12% REVENUE CAGR WITH PICKUP IN CHRONIC SHARE

(Rs bn)	FY18	FY19	FY20	FY21E	FY22E	FY23E	FY24E	CAGR (FY21E-FY24E)
Chronic	5.1	6.1	6.7	7.5	8.6	9.9	11.3	14.5
As % to sales	62.1	63.0	63.0	64.2	65.4	66.6	67.8	-
Acute	3.1	3.6	3.9	4.2	4.6	5.0	5.4	8.5
As % to sales	37.9	37.0	37.0	35.8	34.6	33.4	32.2	-
Total Sales	**8.3**	**9.7**	**10.6**	**11.7**	**13.2**	**14.8**	**16.7**	**12.4**
Growth (%)	13.3	16.9	9.4	11.0	12.3	12.4	12.5	-

Source: Company, BOBCAPS Research

Strong product positioning within addressable markets

FIG 16 – ERIS HAS A PRESENCE IN FAST-GROWING MOLECULES



Source: Company, BOBCAPS Research

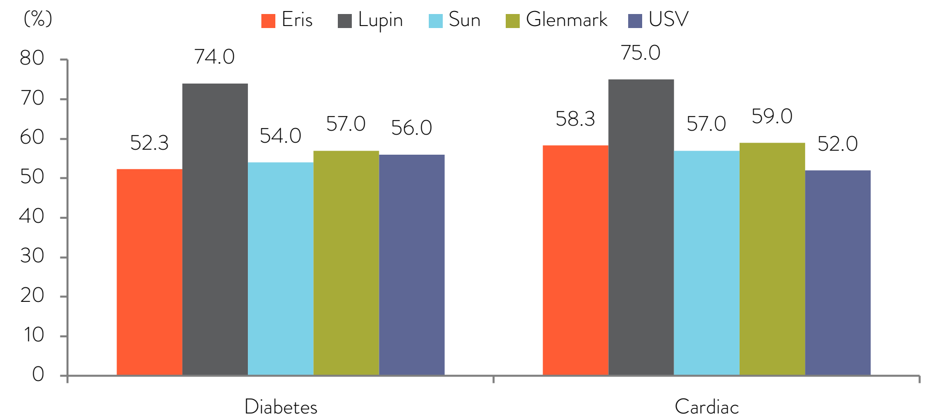
FIG 17 – ERIS RETAINED ITS PRESCRIPTION SHARE IN CORE THERAPIES

Specialist	Prescription ranking MAT Oct'20	Gain/(Loss) in last 12 months
Diabetologist	3	-
Cardiologist	4	-
Neurologist	3	+1
Gynaecologist	9	-
Physicians	7	+3

Source: Company, BOBCAPS Research

Market coverage expansion could be limited for now, but we see off-patent growth potential in three years

FIG 18 – ERIS'S ADDRESSABLE MARKET IS TRACKING CLOSE TO PEERS IN DIABETES AND CARDIOLOGY



Source: Company, BOBCAPS Research

Diabetes – future patent expiry to fuel growth; expect 15% sales CAGR

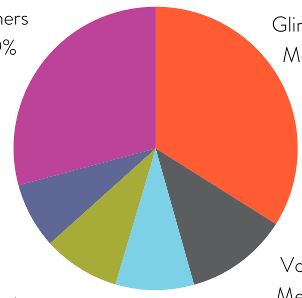
ERIS is a strong player in the diabetes market with an IPM rank of #6 by sales and #3 by prescriptions. The segment accounted for 29% of FY20 sales. Led by strong volumes, segment sales have grown 1.7x faster than the market, at a CAGR of 32% over FY11-FY20 (20% growth in FY20). The company commands 5.7% market share vs. 4% three years ago, mainly led by the Glimepiride combination which remains a flagship molecule. ERIS's strategic presence in key molecules along with traction in diabetes drug Zomelis and the upcoming patent cliff are key FY21-FY24 triggers; we expect a 15% sales CAGR in the diabetes portfolio.

- **Strong competitive positioning across key molecules:** Diabetes care is a highly concentrated segment with the top 5 combination molecules contributing 70% of the market (Fig 19). ERIS has a strategic presence across these combinations. The largest – Glimepiride + Metformin – alone accounts for 34% of the market. Despite the challenges of a bigger market size and concentration, ERIS has increased its market share by 80bps in the last three years to 5.2% (growing sales at 1.4x the market rate of 9.6%). As of Sep'20, ERIS has 5.7% share.

  Other combination molecules falling in the high-growth category are – (1) Voglibose + Metformin + Glimepiride: ERIS is growing 1.5x faster than the market rate of 20% and has increased market share by 150bps to 9.6% in FY20. (2) Teneligliptin + Metformin: Growth is in line with the market at ~40%. (3) Voglibose + Metformin + Gliclazide: ERIS is 1.7x of the market's 46% growth rate on a smaller base and has 62% share – in our view, this combination has high growth potential.

Highly concentrated market; top 5 combination molecules contribute 70% of market size

FIG 19 – REPRESENTED DIABETES MARKET (KEY MOLECULES) – SIZE SPLIT



Source: Company, BOBCAPS Research

Glimepiride + Metformin largest molecule; ERIS's market share up in last 3 years despite concentration hurdles

FIG 20 – ERIS'S POSITIONING IN KEY MOLECULES AND SHARE TREND

Key molecules	% of sales	FY20 mkt share (%)	Share chg over FY18 (ppt)	Covered mkt growth 3Y (%)	Eris growth 3Y (%)	Key brands
Glimepiride + Metformin	31.7	5.2	0.3	9.6	13.3	Glimisave M
Voglibose + Metformin + Glimepiride	20.2	9.6	1.5	19.5	29.7	Glimisave MV
Teneligliptin + Metformin	10.4	6.6	(0.3)	41.2	37.9	Tendia M
Glimepiride + Metformin + Gliclazide	8.1	61.7	19.3	45.6	75.7	Cyblex MV

Source: Company, BOBCAPS Research

ERIS expects >10% prescription share (vs. ~6%) & ~40% margins in 3-4 years

- **Vildagliptin to have accelerated payback; adding ~20% of FY21-FY24 EBITDA:** ERIS entered the Rs 10bn Vildagliptin market (DPP-4 inhibitor) with the launch of Zomelis in Dec'19 after the drug went off-patent. The company acquired the trademark from Novartis at an investment cost of Rs 930mn. Post patent expiry, Vildagliptin has become a crowded market with >50 generics but still remains an exciting opportunity, in our view.

  Zomelis is among the top 3 preferred brands in the segment by diabetologists (besides Novartis and USV) with 6% prescription share. To ensure focused efforts to grow Zomelis, ERIS has launched a new division 'Aspire' with a field force of 186 marketing reps (MR). The brand is currently tracking yields per month (YPM) of Rs 160k and should reach breakeven levels of ~Rs 200k by FY21 (Rs 450mn sales). Management expects YPM of Rs 500k-600k in the next 3-4 years, implying over Rs 1.2bn in brand sales. We estimate that payback on the initial Zomelis investment could be five years or less (vs. the 5-8-year average).

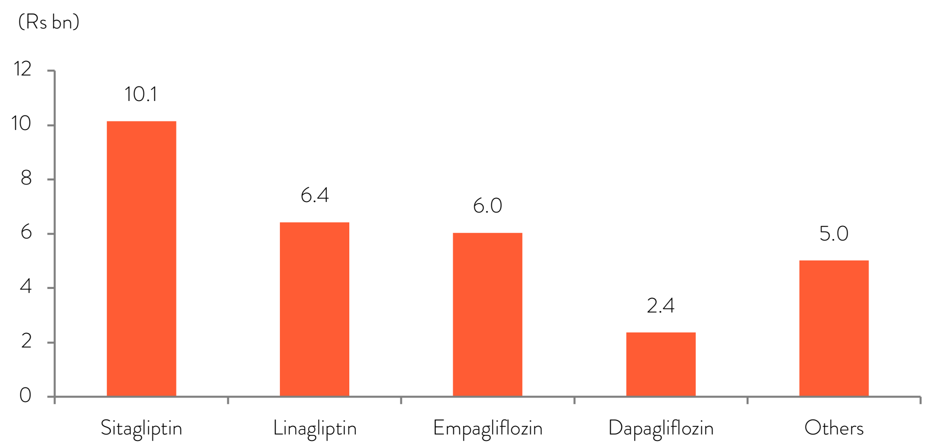
ERIS expects to capture >10% prescription share and ~40% margins, backed by an established and growing prescriber base, moderating competitive intensity (weaker players typically exit after 1.5-2 years, thus leaving 10-15 stronger players in the market), and sharper productivity gains from a dedicated field force. We believe Zomelis can emerge as a major contributor (17% to incremental EBITDA in next three years) outside the company's organic portfolio.

- **Upcoming patent expiry to spur new launches:** Roughly Rs 30bn worth of patented drugs will turn generic in the next 3-5 years. Key molecules include Sitagplitin (Rs 10bn), Linagliptin (Rs 6bn) and Empagliflozin (Rs 6bn). The earliest patent expiry is for Sitagliptin (in Jul'22) followed by Linagliptin (in FY23). These molecules are growing in high double digit vs. diabetes care market growth of 12%.

  ERIS has been working to tap most of these opportunities as and when they go off-patent, with a strong focus on prudent capital allocation. We believe an established presence with specialists and super-specialists would enable the company to gain significant leverage from these expirations.

Key molecules growing in high double digit vs. 12% diabetes care market growth

FIG 21 – KEY MOLECULES GOING OFF-PATENT IN NEXT 3-5 YEARS (RS 30BN)



Source: Company, BOBCAPS Research

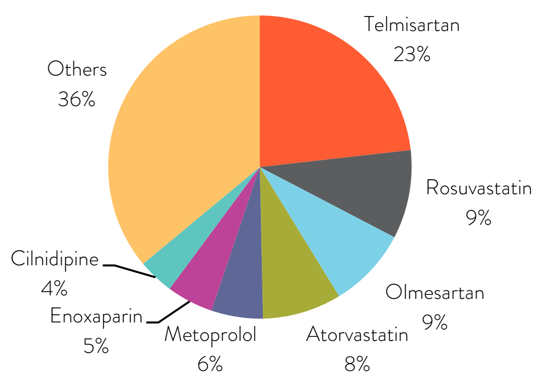
Cardiology – Deeper penetration will be key to growth

Unlike diabetes where the company is tapping off-patent opportunities for growth, we believe cardiovascular (CVS) segment growth will be led by a deeper market reach and increasing prescription share. This is because cardiac care is more fragmented (top 5 molecules account for 55% of the market) and hence gaining share will be key.

ERIS is ranked #9 by sales and #4 by prescriptions in cardiac care (gained one rank in the last three years). The segment accounted for 27% of FY20 sales, growing at 12.4% against market growth of 11.8%. Over FY11-FY20, segment sales have grown 1.7x faster than the market, at a CAGR of 34%. ERIS has a strong presence in sartans (54% of cardiac sales vs. 32% for the representative market) and statins (21% of sales vs. 18% for industry). Key flagship molecules include Telmisartan, Cilnidipine and Rosuvastatin.

Fragmented market – top 5 molecules account for 55%, so market share gains will be key

FIG 22 – REPRESENTED CARDIAC MARKET (KEY MOLECULES) – SIZE SPLIT



Source: Company, BOBCAPS Research

Execution in high-growth markets mixed. Key flagship molecules: Rosuvastatin, Telmisartan, Cilnidipine

FIG 23 – ERIS'S POSITIONING IN KEY MOLECULES AND SHARE TREND

Key molecules	% of sales	FY20 mkt share (%)	Share chg over FY18 (ppt)	Covered mkt growth 3Y (%)	Eris growth 3Y (%)	Key brands
Telmisartan +	36	4.3	(0.8)	17.0	12.0	Eritel
Olmesartan +	18	7.4	0.3	8.0	11.5	Olmin
Rosuvastatin	11	2.3	0.7	16.8	38.7	Crevast
Atorvastatin	10	2.3	(0.3)	10.0	5.5	Atorsave
Cilnidipine	15	8.5	(0.4)	20.9	17.8	LNBlock

Source: Company, BOBCAPS Research

- **Cardiac portfolio sales set to log 15% CAGR over FY21-FY24:** The company's cardiac sales have been slightly better than covered market growth of ~12% in the last three years but its performance in key molecules has been mixed. (Fig 23). Telmisartan is the largest molecule for ERIS by sales (~35% of cardiac sales), followed by Olmesartan (18%) and Cilnidipine (15%). In terms of covered market growth, Telmisartan, Rosuvastatin and Cilnidipine lead the pack (17-20% growth), as these are gaining market share from Olmesartan, Losartan, Atorvastatin and Amlodipine (8-10% growth).

Growth turning around in larger brands

- **Weakness in large brands abating:** Growth in Telmisartan has been behind the industry due to high market share, but this trend has corrected as per Oct/Nov'20 AIOCD data when sales grew 17% YoY, in line with the market. ERIS has gained market share in Olmesartan and Rosuvastatin and is taking necessary steps to turn growth around in Cilnidipine and Atorvastatin.
- **Off-patent opportunities:** Besides the organic portfolio, there could be new launches from off-patent opportunities over the next 2-3 years. These include the Sacubitril/Valsartan combination (expiring in 2023) and anticoagulant product Apixaban (2022). Together, the market size for both drugs is ~Rs 4bn and these molecules are growing in high double digits.
- **Reach expansion:** We see an opportunity for ERIS to expand sales in the coming years alongside deeper penetration and product launches in tier-2 and 3 cities for older molecules. The company is targeting significant reach with consulting physicians and top-level GPs which should be visible in the next 3-4 quarters. This can be managed by the existing field force, per management.

VMN – specialty focus; Gastro and CNS facing challenges

- **Vitamins-minerals-nutrients has several strong brands while Gastro lags market:** Over 70% of ERIS's VMN brands are in the high-growth portfolio, performing ahead of the market. Renerve, Tayo and Ginkocer are gaining share. Most of these brands were acquired from Strides Pharma. The company expects VMN to emerge in a big way in coming years as a complementary segment to chronic ailments. Gastro has been growing behind the industry due to a reduced focus given the Rabeprazole market is highly fragmented.
- **CNS – near-term challenges:** ERIS is a relatively new player in the CNS market with a portfolio acquired from Strides in FY18. The segment accounted for 7% of FY20 sales and has been growing at ~8%, behind market growth of 9.4% for the last two years. Key brands such as Serlift and Desval ER have been weak whereas Sonaxa and Levroxa have done well. The company currently has 4% share in the addressable CNS market given that this is a highly pro-incumbent space with the top 3 players (Sun Pharma, Torrent, Intas) holding 50-60% share.

  Over the last 12 months, ERIS has adopted a go-to-market strategy to scale up the business, using scientific engagement with doctors to drive better growth visibility. To this end, it is working with a group of 400+ neurologists and 300+ psychiatrists to help create a database for early detection of mild cognitive impairment in the Indian population. The company has also doubled its MR strength to 200 in FY20 which should start contributing now. Nevertheless, we have a conservative sales growth estimate of 8% over the next three years.

VMN – several high growth brands

ERIS is using a go-to-market strategy to scale up in CNS

FIG 24 – ERIS HAS HIGH GROWTH BRANDS IN VMN VS. GASTRO AND CNS

Therapy	% of FY20 Sales	Eris CAGR (FY18-FY20)	Represented market CAGR (FY18-FY20)	Market share FY20	Share chg over FY18 (ppt)
VMN	**18.7**	**9.1**	**9.0**	**5.1**	**0.2**
Renerve	7.8	14.3	6.8	7.1	2.9
Remylin	4.0	7.2	12.7	5.1	(0.6)
Tayo	4.0	12.2	7.6	4.6	0.2
Ginkocer	1.7	19.0	12.0	29.2	7.1
CNS	**7.3**	**8.1**	**9.4**	**2.9**	**(0.2)**
Serlift	1.0	11.4	15.8	16.0	0.0
Desval	1.0	6.0	8.8	8.0	0.0
Levroxa	0.7	15.0	17.0	1.0	0.0
Gastro	**6.1**	**(1.1)**	**7.0**	**3.2**	**(0.6)**
Rabonik	3.9	2.9	6.0	3.8	3.8

Source: Company, BOBCAPS Research

Trade generic and OTC cocktail forays picking up momentum

ERIS entered the trade generics business via its 100% subsidiary EHPL during Q4FY20, with a focus on driving synergies and leveraging its existing acute presence (37% of sales). The trade generics business in India has been growing at a healthy double-digit ~13% CAGR over the last five years and most peers have demonstrated good scalability both in sales and EBITDA (including Alkem Labs which has 25% share from trade generics, Cipla ~20% and Lupin ~5%).

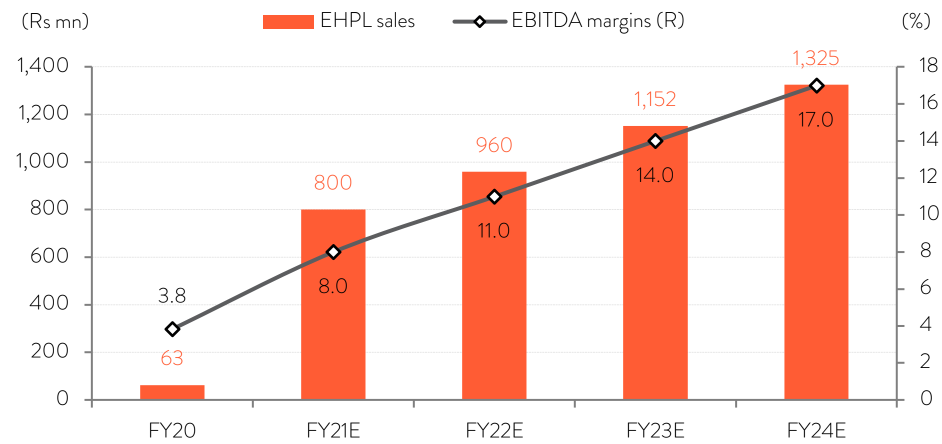
With a sharper focus on the OTC side for disease prevention, ERIS has seen some early traction in this segment, clocking sales of Rs 443mn in H1FY21 (~7% revenue share on an annualised basis) and margins of 5%. The company is continuing to build channel partnerships in tier-1/2 towns (now at 30% of targeted distribution reach), gradually expanding product offerings and developing a consumer connect with key brands. It is likely to use all channels possible for promotions while ensuring minimal cash burn. Management's goal is to create a large OTC portfolio over the mid-to-long-term.

Led by strong sales traction, we expect +15% EBITDA margins in this segment from FY23 (vs. ~5% now) on a conservative basis. Achievable margins in the trade generics business can reach ~20%, per the company.

No cash burn approach. Continues to build up channel partnerships in tier-1/2 towns

We expect +15% EBITDA margins from FY23 (vs. 5% now); achievable margins can be ~20%, per company

FIG 25 – EHPL SALES AND EBITDA MARGINS



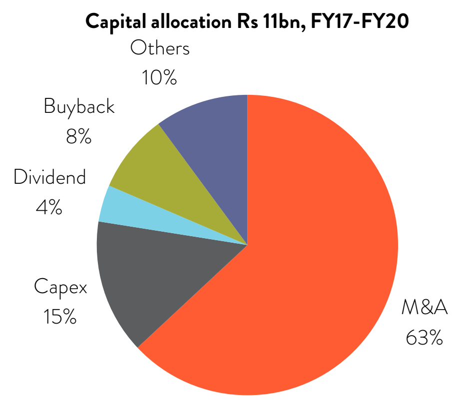
Source: Company, BOBCAPS Research

More balanced capital allocation ahead

ERIS has invested heavily in M&A over the last three years, achieving reasonable success in driving synergies over time. Going ahead, we expect more balanced capital allocation between M&A and payouts, in view of weak Dividend payout history, earning growth recovery and improving return on invested capital

We expect future capital allocation to be more balanced between M&A and payouts

FIG 26 – ERIS HAS INVESTED HEAVILY IN M&A OVER THE LAST 3 YEARS



Source: Company, BOBCAPS Research

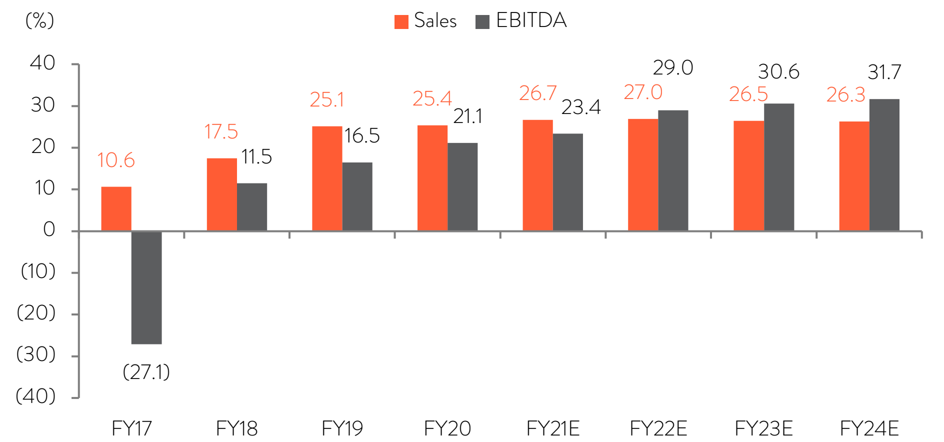
Ex-Kinedex, ERIS has had decent success based on payback period & EV/EBITDA

FIG 27 – ERIS HAVE BEEN SUCCESSFUL IN DRIVING SYNERGIES OVER TIME, REALISING 3-9X EV/EBITDA MULTIPLE ON AVERAGE

Acquisition	Year	Acquisition price (Rs mn)	EBITDA payback*	Headline EV/EBITDA multiple Y1 (x)	EV/EBITDA post synergy Y4 (x)	Therapy focus
Aprica (earlier Amay)	FY17	330	~5 years	9.2x	2.7x	Cardio, Diabetic
Kinedex	FY17	1,060	>10 years	26.5x	-	Muscoskeletal
Strides CNS portfolio	FY18	5,000	< 8 years	17.7x	8.6x	CNS and Neutraceuticals
Zomelis brand	FY20	930	~5 years	-	3.5x	Anti-Diabetic

Source: Company, BOBCAPS Research | *5-8 years is a good benchmark

FIG 28 – M&A CONTRIBUTION TO SALES AND EBITDA



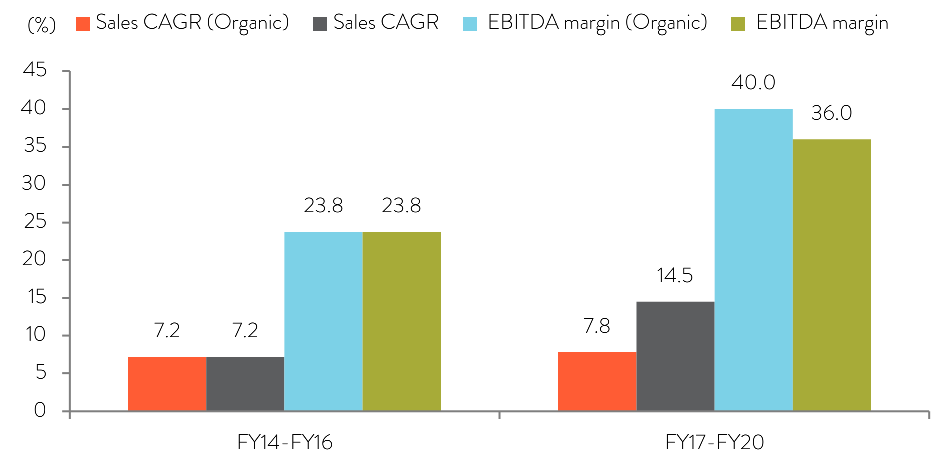
Source: Company, BOBCAPS Research

Robust organic portfolio execution

We evaluated ERIS's organic portfolio strength on sales and profitability (ex-M&A) over two time periods. The data suggests that while organic sales growth has been slower than peers (7-8%), ERIS has substantially scaled up its aggregate EBITDA margin profile to a 40% average over FY17-FY20 (vs. 24% over FY14-FY16), primarily backed by better profitability in mature diabetes and cardiac care brands as well as optimised SGA spends.

ERIS has substantially scaled up aggregate margins to 40% over FY17-FY20 (vs. 24% in FY14-16)...

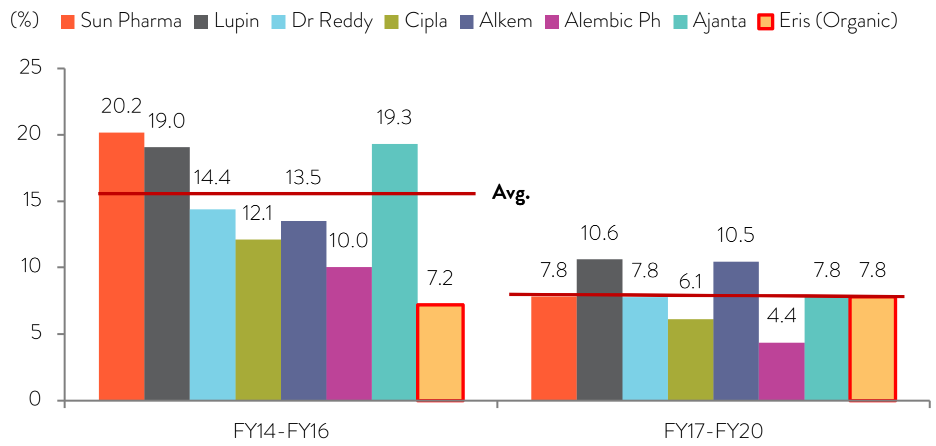
FIG 29 – ORGANIC PORTFOLIO SALES AND MARGINS



Source: Company, BOBCAPS Research

...despite slower organic sales growth than peers

FIG 30 – ERIS'S ORGANIC SALES CAGR VS. PEERS



Source: Company, BOBCAPS Research

Multiple levers to drive >300bps margin gains through FY24

ERIS's profitability was suppressed during the last three years over FY18-FY20, marked by EBITDA margin contraction of ~330bps to 34.3% due to integration-led challenges in multitherapy acquisitions, the FDC hit for Triglimisave, upfront cost on new divisions and absence of new launches. We expect over 300bps margin expansion over the next three years to 38%, with >85% of the delta being led by the organic portfolio and Zomelis.

Key margin drivers

- ERIS has augmented its field force from a headcount of 1,500 in FY17 to ~2,460 in FY20. The chronic business accounted for ~65% of the additions, which led to a decline in overall MR productivity from Rs 400k YPM to Rs 360k over FY17-FY20 (as chronic yield declined from Rs 580k to Rs 430k vs. Rs 700k for peers). Normalising for the exceptional increase in field force, we believe productivity from older MRs in the cardio-metabolic segment was healthy at Rs 600k-700k YPM.

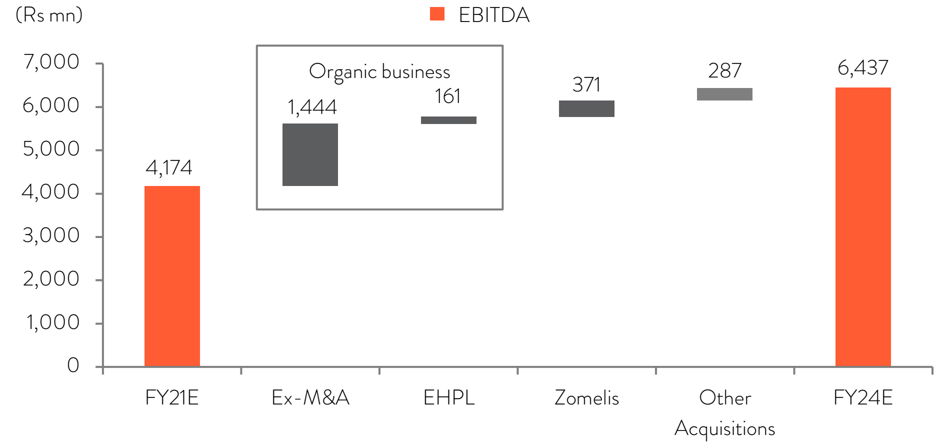
  ERIS has added two new divisions in H2FY20 and recruited new MRs (~20% of FY20 MR strength) to handle Zomelis and the pain management portfolio. This is a drag on overall YPM at present. Led by operating leverage from the existing field force and factoring in a gradual increase in new MR headcount by 150-200 p.a., we see YPM reaching Rs 430k-470k by FY23/FY24 (Rs 540k-590k for Chronic).

- We expect EHPL (trade generics/OTC business) margins to expand from 5% at present to >15% by FY24. The expected increase in chronic sales from 63% to ~66% would be a further margin lever.

Overall, we expect a 16% EBITDA CAGR over FY21-FY24 vs. 8% growth in the previous three years. The organic portfolio is projected to add ~70% of EBITDA, followed by Zomelis at ~20% and other acquisitions at ~10%.

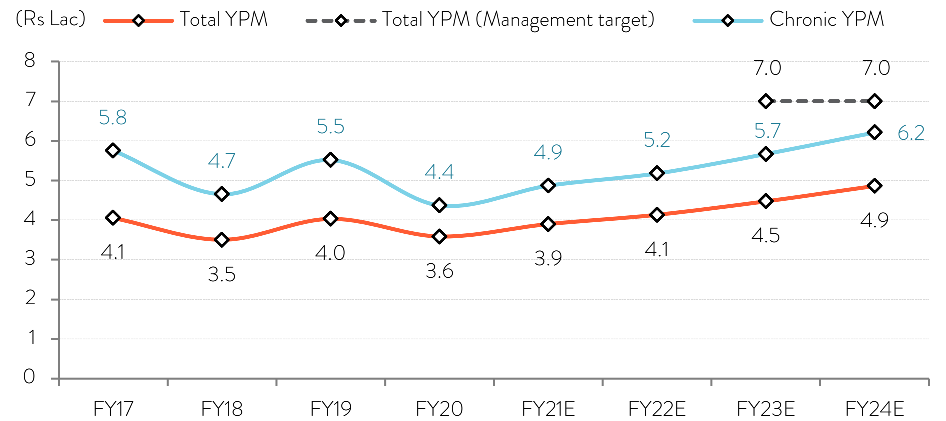
We expect 16% EBITDA growth in FY21-FY24 (vs. 8% growth in last three years)

FIG 31 – ORGANIC PORTFOLIO AND ZOMELIS TO DRIVE OVER 85% OF FY21E-FY24E EBITDA



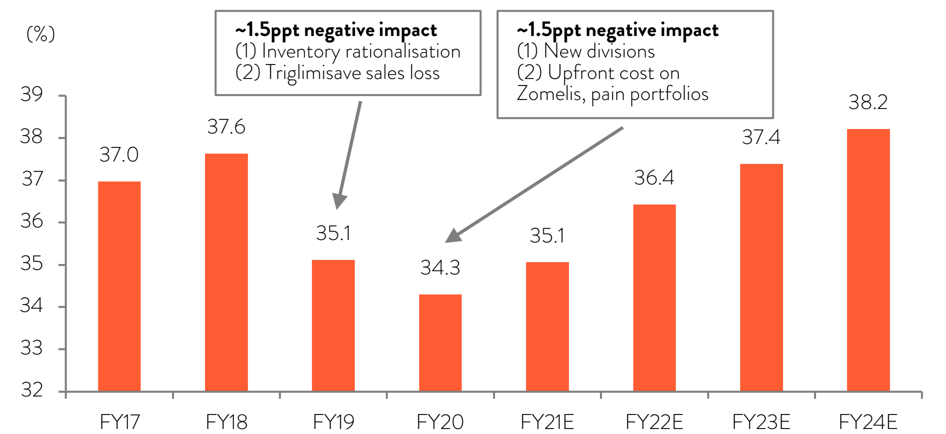
Source: Company, BOBCAPS Research

FIG 32 – FIELD FORCE PRODUCTIVITY TREND



Source: Company, BOBCAPS Research

FIG 33 – EBITDA MARGINS RECOVERY; EXPECT +300BPS OVER FY21E-FY24E



Source: Company, BOBCAPS Research

FCF conversion to rebound to +70%, ROIC by 1.5x in three years

We expect operating margin expansion to fuel an FY21-FY24 EPS CAGR of 18% for ERIS (vs. 4% over FY18-FY21E). This along with optimal capex levels should bolster cumulative free cash flow generation to >Rs 15bn or 20% of market cap through to FY24.

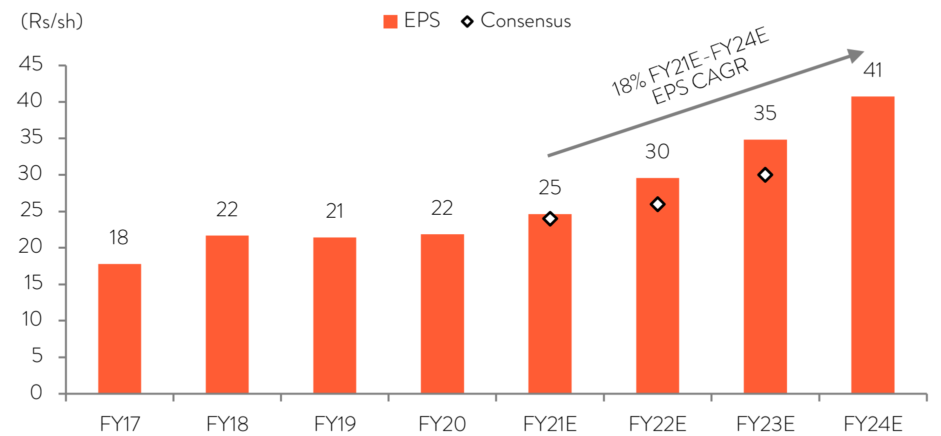
The FCF conversion rate from EBITDA has remained strong at 65% in the past (FY14-FY16), but was depressed at 20% during FY17-FY20 due to significantly higher M&A capex and integration-related challenges. We expect more balanced capital allocation between M&A and payouts, and hence model for over 70% FCF conversion during FY21-FY24.

The strong cash flow should bring flexibility to strengthen the India business. Higher earnings growth would also support better dividends and further enhance balance sheet strength. ROIC is thus estimated to expand to 54% by FY24 (vs. 36% in FY21).

Improving operating margins expected to drive FY21-FY24 EPS CAGR of 18%

Our FY22/FY23 EPS is 10%/12% ahead of consensus

FIG 34 – EXPECT EPS CAGR OF 18% FOR FY21E-FY24E (VS. 4% IN FY18-FY21E), OUR FY22/FY23 EPS IS 10-12% AHEAD OF CONSENSUS ESTIMATES

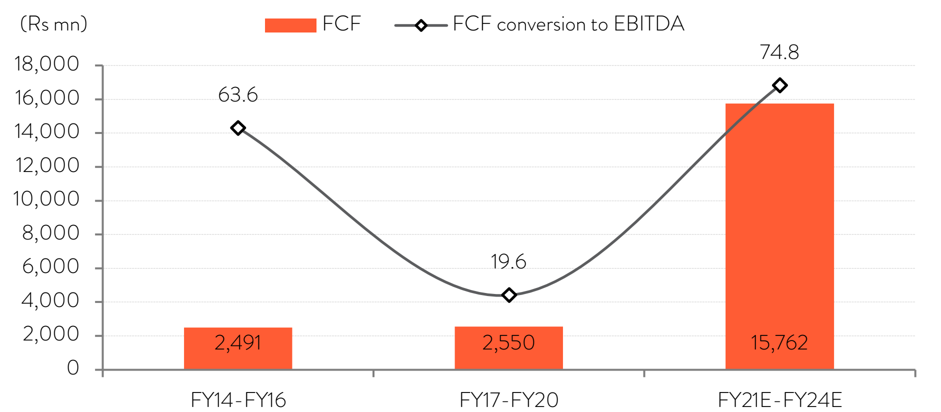


Source: Company, BOBCAPS Research

Strong FCF should bring flexibility to strengthen India business

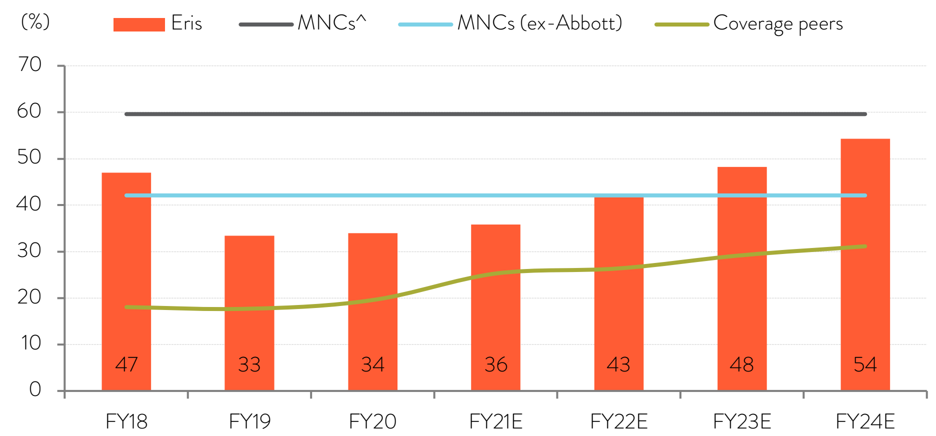
Next three year FCF implies ~20% of current MCap

FIG 35 – FCF CONVERSION SET TO REBOUND



Source: Company, BOBCAPS Research

FIG 36 – ROIC TO EXPAND 1.5X BY FY24E, NARROWING DISCOUNT TO MNCs



Source: Company, BOBCAPS Research | ^Abbott, Pfizer, Glaxo Pharma and Sanofi

Valuation methodology

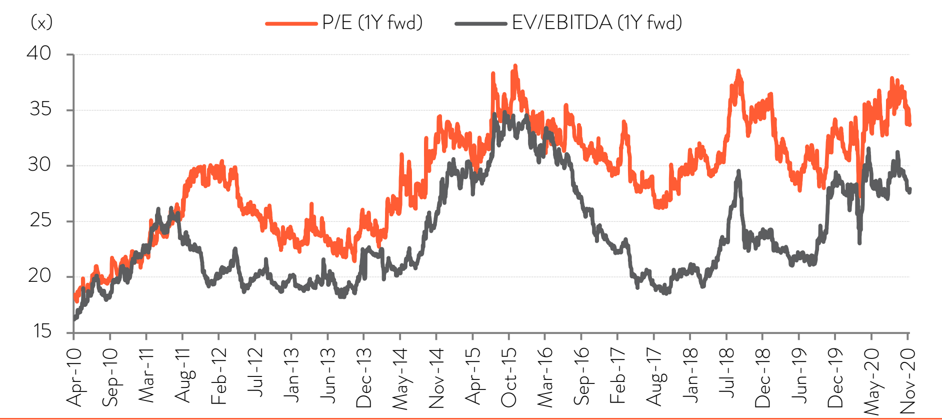
We initiate coverage on ERIS with a BUY rating and a Mar'22 target price of Rs 700, based on 20x FY23E EBITDA (implied P/E of 20x). Our target multiple is at a premium to frontline peers as well as the sector average of 12x FY23E EBITDA, but at a discount to the five-year average forward multiple of 24x for Indian generic pharma (ERIS is a pure domestic play).

ERIS has significantly underperformed the BSE Healthcare index over the last six months, one year and two years by 28%, 28% and 50% respectively, due to concerns over a weak earnings profile and delayed turnaround from acquisitions. During the last 12 months, the company has taken corrective steps (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 the 9MFY21 margin recovery besides the fact that Eris owns a decent chronic franchise with stronger prescription ranking in Diabetes and Cardiac therapy

We expect ERIS to witness a rerating over the next 12 months led by (1) its under-appreciated chronic franchise (~75% of EBITDA), (2) expected earnings growth rebound to 18% CAGR over FY21-FY24, and (3) accompanying ROIC expansion to 54% by FY24 – better than our pharma coverage and higher than the average for MNCs ex-Abbott – with the optionality of better capital allocation between M&A and Payouts than in the past.

The stock is currently trading at compelling valuations of 18x P/E and 14x EV/EBITDA on FY22E, which is ~35% below the three-year mean and at ~45% discount to Indian branded generic players. We present a comparison of one-year forward EV/EBITDA multiples of pure play Indian generics (Fig 37) versus a basket of global generic companies that we cover (Fig 38). Our analysis shows that Indian generics have traded at a significant premium to global generics, in part due to domestic contribution besides a superior return generation profile.

FIG 37 – INDIAN GENERICS VALUATION MULTIPLE^



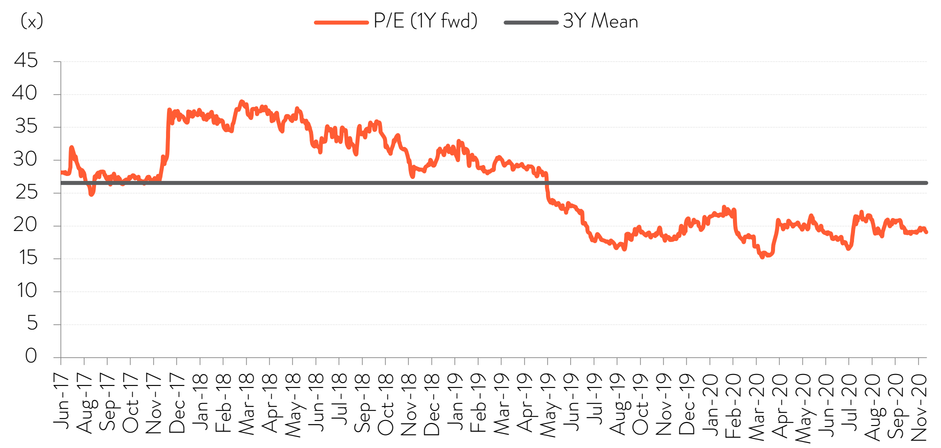
Source: Company, BOBCAPS Research | ^Average of Abbott India, Pfizer, Sanofi India, Glaxo Pharma

FIG 38 – VALUATION OF GENERIC COVERAGE UNIVERSE

Companies	Price (11-Dec-20)	Mcap (US$ mn)	P/E (x)		EV/EBITDA (x)		ROE (%)	ROIC (%)
			FY22E	FY23E	FY22E	FY23E	FY21E	FY21E
Coverage universe								
Aurobindo Pharma	895	7,121	15.5	14.4	9.4	8.9	16.2	21.1
Cipla	756	8,283	26.3	24.5	13.8	13.2	12.6	18.3
Dr Reddy's	5,008	11,310	25.7	19.4	15.2	12.2	18.5	29.8
Lupin	939	5,784	33.5	27.2	14.0	11.9	6.6	12.0
Sun Pharma	568	18,514	22.2	19.1	13.6	11.9	12.5	18.2
Alkem Labs	2,896	4,699	20.8	18.0	15.5	13.6	27.4	36.4
Alembic Pharma	1,082	2,897	23.1	18.7	15.1	12.7	27.5	27.6
Ajanta Pharma	1,681	1,991	23.2	18.8	15.7	13.4	19.0	28.6
Aggregate			**23.2**	**19.5**	**14.1**	**12.2**	**18.4**	**24.1**
Indian MNCs*								
Sanofi	7,920	2,476	32.1	27.7	21.5	18.9	23.9	40.0
Glaxo Pharma	1,550	3,565	38.3	37.0	28.5	28.0	28.5	50.0
Abbott India	16,070	4,630	41.6	37.1	30.4	26.7	28.5	130.0
Pfizer	5,275	3,278	41.3	36.5	29.9	26.9	16.6	38.0
Aggregate			**38.3**	**34.6**	**27.6**	**25.1**	**24.4**	**64.5**
Eris Life	**538.0**	**933.8**	**18.2**	**15.5**	**14.5**	**12.1**	**25.7**	**35.8**

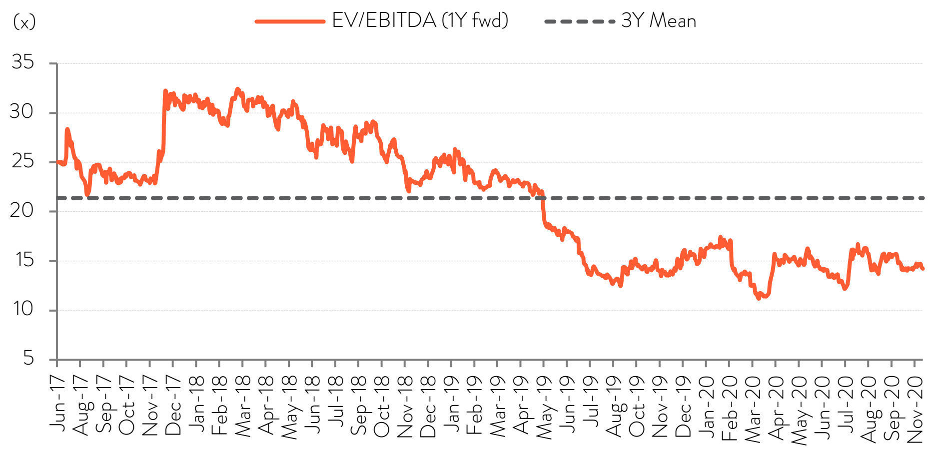
Source: Company, BOBCAPS Research | *Bloomberg estimates

FIG 39 – ERIS: P/E MULTIPLE (ONE-YEAR FORWARD)



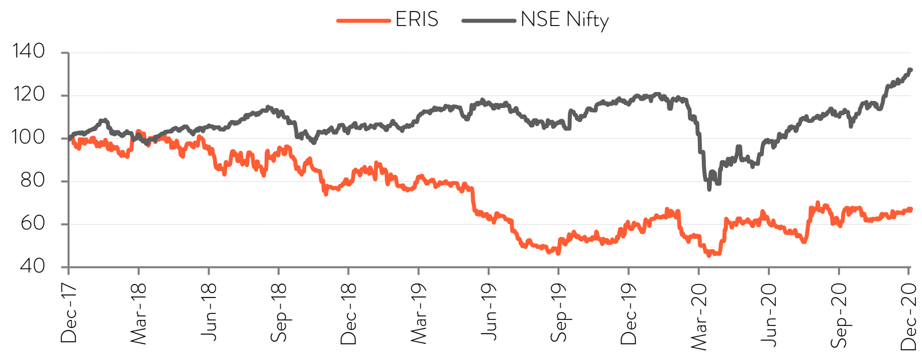
Source: Company, BOBCAPS Research

FIG 40 – ERIS: EV/EBITDA MULTIPLE (ONE-YEAR FORWARD)



Source: Company, BOBCAPS Research

FIG 41 – RELATIVE STOCK PERFORMANCE



Source: NSE

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 exceptions of molecules like Teneligliptin, Gliclazide, Rosuvastatin where its price is 10-15% higher than drug average price for all the players (these accounted for 15% of FY20 sales). Any slowdown in IPM growth and delay in new launches can hurt earnings.
- **Risk of trade margin capping for generics business:** ERIS has forayed into trade generics recently (to contribute ~8% of FY23E sales). This business operates in a dynamic regulatory environment marred by uncertainty over proposed changes related to trade margins.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	**9,822**	**10,741**	**11,903**	**13,349**	**14,987**
EBITDA	3,449	3,684	4,174	4,862	5,603
Depreciation	364	503	579	614	663
EBIT	3,085	3,181	3,595	4,248	4,940
Net interest income/(expenses)	(229)	(22)	0	0	0
Other income/(expenses)	317	154	82	162	248
Exceptional items	0	0	0	0	0
EBT	3,174	3,313	3,677	4,410	5,188
Income taxes	262	349	331	397	467
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	4	0	0	0	0
Reported net profit	**2,908**	**2,965**	**3,346**	**4,013**	**4,721**
Adjustments	0	0	0	0	0
Adjusted net profit	**2,908**	**2,965**	**3,346**	**4,013**	**4,721**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	841	1,000	965	1,084	1,219
Other current liabilities	322	490	470	528	593
Provisions	404	562	624	701	788
Debt funds	1,764	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	138	136	136	136	136
Reserves & surplus	10,620	11,626	14,101	17,164	20,618
Shareholders' fund	10,758	11,761	14,236	17,299	20,754
Total liabilities and equities	**14,088**	**13,813**	**16,295**	**19,612**	**23,354**
Cash and cash eq.	75	673	3,294	5,990	9,039
Accounts receivables	840	1,569	1,126	1,265	1,422
Inventories	827	695	965	1,084	1,219
Other current assets	1,156	1,305	1,539	1,728	1,943
Investments	3,559	780	780	780	780
Net fixed assets	553	873	672	845	1,032
CWIP	27	44	44	44	44
Intangible assets	7,052	7,876	7,876	7,876	7,876
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**14,088**	**13,814**	**16,295**	**19,612**	**23,354**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	3,271	3,468	3,925	4,627	5,384
Interest expenses	229	22	0	0	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(604)	(261)	(55)	(193)	(219)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	**2,896**	**3,228**	**3,870**	**4,434**	**5,165**
Capital expenditures	(50)	(1,309)	(378)	(787)	(850)
Change in investments	95	2,779	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	**45**	**1,470**	**(378)**	**(787)**	**(850)**
Equities issued/Others	0	(2)	0	0	0
Debt raised/repaid	(2,004)	(1,764)	0	0	0
Interest expenses	(229)	(22)	0	0	0
Dividends paid	0	(467)	(871)	(950)	(1,267)
Other financing cash flows	(740)	(1,846)	0	0	0
Cash flow from financing	**(2,973)**	**(4,100)**	**(871)**	**(950)**	**(1,267)**
Changes in cash and cash eq.	**(31)**	**598**	**2,621**	**2,697**	**3,049**
Closing cash and cash eq.	**75**	**673**	**3,294**	**5,990**	**9,039**

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	21.4	21.8	24.6	29.6	34.8
Adjusted EPS	21.4	21.8	24.6	29.6	34.8
Dividend per share	0.0	2.9	5.5	6.0	8.0
Book value per share	77.9	86.6	104.8	127.4	152.9

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	7.4	6.9	6.0	5.3	4.5
EV/EBITDA	21.2	20.0	17.1	14.5	12.1
Adjusted P/E	25.1	24.6	21.8	18.2	15.5
P/BV	6.9	6.2	5.1	4.2	3.5

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	91.6	89.5	91.0	91.0	91.0
Interest burden (PBT/EBIT)	102.9	104.2	102.3	103.8	105.0
EBIT margin (EBIT/Revenue)	31.4	29.6	30.2	31.8	33.0
Asset turnover (Revenue/Avg TA)	19.9	22.1	22.9	21.2	19.7
Leverage (Avg TA/Avg Equity)	1.3	1.1	1.0	1.0	1.0
Adjusted ROAE	31.1	26.5	25.7	25.5	24.8

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	14.8	9.4	10.8	12.1	12.3
EBITDA	7.1	6.8	13.3	16.5	15.2
Adjusted EPS	(1.1)	2.0	12.9	19.9	17.6
Profitability & Return ratios (%)					
EBITDA margin	35.1	34.3	35.1	36.4	37.4
EBIT margin	31.4	29.6	30.2	31.8	33.0
Adjusted profit margin	29.6	27.6	28.1	30.1	31.5
Adjusted ROAE	31.1	26.5	25.7	25.5	24.8
ROCE	27.6	27.5	28.3	28.0	27.3
Working capital days (days)					
Receivables	32	54	35	35	35
Inventory	31	24	30	30	30
Payables	32	34	30	30	30
Ratios (x)					
Gross asset turnover	1.2	1.1	1.2	1.3	1.3
Current ratio	1.8	2.1	3.4	4.4	5.2
Net interest coverage ratio	13.5	147.3			
Adjusted debt/equity	(0.1)	(0.1)	(0.3)	(0.4)	(0.5)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

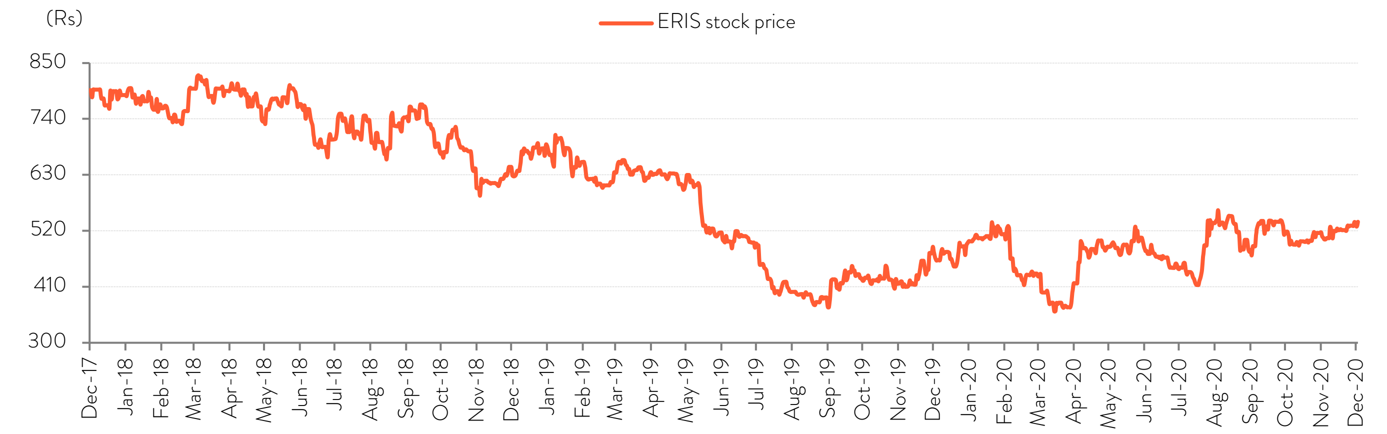
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): ERIS LIFESCIENCES (ERIS IN)



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

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