

BUY

TP: Rs 890 | ▲ 28%

ERIS LIFESCIENCES

| Pharmaceuticals

| 29 January 2022

Cardio-metabolic segment headwinds hamper growth

- Industry-wide slowdown in cardiometabolic segment (59% revenue share for ERIS) affected Q3 growth
- Better product mix and operating leverage lifted EBITDA margin by 210bps YoY to 36.6%
- We cut FY23-FY24 EBITDA by 10-12%. On rolling valuations over to FY24, we have a new TP of Rs 890 (vs. Rs 975); retain BUY

Surajit Pal | Saad Shaikh
researchreport@bobcaps.in

Industry-wide slowdown in cardiometabolic segment: ERIS reported modest 7% YoY (-8% QoQ) growth in Q3FY22 revenue primarily due to a broad slowdown in the cardiometabolic segment (59% of revenue). Shift in preference for class of molecules by medical practitioners in the cardiometabolic market cause only 6% YoY (-7% QoQ) growth in the segment, albeit still ahead of the market. Management believes this slowdown is temporary and expects recovery in the next 2-3 quarters. Key drug Zomelis continues to perform better than expectations and is clocking a run-rate of Rs 70mn a month.

Robust therapy-wise performance: ERIS outperformed the IPM in all its top five key therapeutic areas: oral anti-diabetes (revenue up 18% YoY vs. 6% for the IPM), cardiology (17% vs. 9%), VMN (12% vs. 7%), CNS (17% vs. 8%) and women's health (13% vs. 8%).

Margin improves despite modest revenue growth: EBITDA margin expanded 210bps YoY to 36.6% on the back of improving MR productivity, a better product mix and operating leverage. Gross margin in 3Q for the quarter was largely stable at 81.5%.

India insulin foray in Q4 to compliment diabetes portfolio: ERIS plans to expand in the anti-diabetes segment by venturing into injectable insulin after an in-licensing agreement with MJ Pharma. It will initially launch human insulin and an insulin pen cartridge in the Indian market in Feb'22, followed by the long-acting Glargine in CY23, and then Aspart and insulin analogue.

Maintain BUY: We cut our revenue/EBITDA estimates for FY23 by 6%/12% and for FY24E by 7%/10% to build in cardiometabolic market headwinds. We also lower our target EV/EBITDA multiple to 19x (23x implied P/E) from 20x – a 15% discount to MNC pharma peers who trade at an average of 22.6x – and roll valuations forward to FY24. Retain BUY with a revised TP of Rs 890 (vs. Rs 975) as we continue to like ERIS for its focused presence in the chronic space and superior physician reach.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	ERIS IN/Rs 696
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%

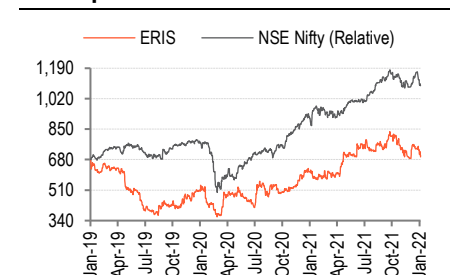
Source: NSE | Price as of 28 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	12,119	13,446	14,901
EBITDA (Rs mn)	4,306	5,020	5,436
Adj. net profit (Rs mn)	3,551	4,073	4,448
Adj. EPS (Rs)	26.2	30.0	32.8
Consensus EPS (Rs)	26.2	29.9	34.8
Adj. ROAE (%)	27.3	25.8	23.5
Adj. P/E (x)	26.6	23.2	21.3
EV/EBITDA (x)	21.6	18.6	17.0
Adj. EPS growth (%)	19.8	14.7	9.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net Sales	3,322	3,104	7.0	3,597	(7.6)	10,411	9,336	11.5
EBITDA	1,217	1,072	13.5	1,398	(12.9)	5,985	5,392	11.0
Depreciation	169	106		150	-	463	315	-
EBIT	1,048	966	8.5	1,249	(16.0)	5,522	5,076	8.8
Interest	10	4	-	11	-	29	13	-
Other Income	52	31	-	70	-	180	65	-
PBT	1,090	993	9.8	1,308	(16.7)	5,673	5,129	10.6
Less: Taxation	82	91	-	124	-	310	229	-
Less: Minority Interest			-		-			-
Recurring PAT	1,008	902	11.8	1,184	(14.9)	5,363	4,900	9.4
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,008	902	11.8	1,184	(14.9)	5,363	4,900	9.4
Key Ratios (%)								
Gross Margin	81.5	81.8	(32)	81.5	(4)	87.0	87.0	-
EBITDA Margin	36.6	34.5	210	38.9	(223)	57.5	57.8	-
Tax / PBT	7.5	9.2	-	9.5	-	5.5	4.5	-
NPM	30.3	29.0	-	32.9	-	51.5	52.5	-
EPS (Rs)	7.4	6.6	11.7	8.7	(14.9)	39.5	36.1	-

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Cardio Metabolic + VMN	2,592	2,379	8.9	2,791	(7.1)	8,167	7,285	12.1
Cardio Metabolic Segment (diabetes and cardiac)	1,936	1,830	5.8	2,085	(7.1)	6,014	5,567	8.0
VMN	656	549	19.5	707	(7.1)	2,153	1,718	25.3
Others	689	671	2.7	742	(7.1)	2,084	1,897	9.8
Other Op. Revenue	41	54	(24.1)	63	(35.5)	160	153	-
Revenues	3,322	3,104	7.0	3,597	(7.6)	10,411	9,336	11.5

Source: Company, BOBCAPS Research

Earnings call highlights

- Within ERIS's cardiometabolic portfolio (59% revenue share), it is the DPP-4 and SGLT-2 molecules that are the main growth drivers. Excluding these two molecules, cardiometabolic revenue grew only 2-3% YoY in Q3FY22 due to a secular downtrend in the Telmisartan and Glimepiride molecules.
- Management indicated that its market intelligence suggests the following reasons for the systemic downtrend in Telmisartan:
 - Heavy stocking of acute therapy drugs (especially during the third Covid-19 wave), which caused lower offtake of chronic drugs
 - Lower patient demand in the market
 - Low new patient initiation as footfalls at dispensaries/hospitals are yet to normalise
- ERIS guided that DPP-4 and SGLT-4 are new growth drivers in the metabolic disorder segment as older generation drugs are being phased out. Dapagliflozin is now the second line of treatment in diabetes while Metformin remains the gold standard. Metformin and Glimepiride are more active in combination drugs with the new generation therapy while single use of Glimepiride is on the wane.
- ERIS maintains its preferred prescription ranking among specialists and super-specialists: #3 among diabetologists and neurologists, #4 among cardiologists and gastroenterologists, and #5 among consulting physicians.

Valuation methodology

ERIS has taken corrective steps to catalyse sales (rationalisation of the tail brand portfolio), adopted a new cluster-based approach (sharper focus on cardiometabolic 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 and foray into human insulin and insulin analogues provides earnings visibility.

In light of the unprecedented headwinds in the cardiometabolic market during Q2 and Q3FY22, we cut our revenue/EBITDA estimates for FY23E by 6%/12% and for FY24E by 7%/10%. We also lower our target EV/EBITDA multiple to 19x (23x implied P/E) from 20x – a 15% discount to MNC pharma peers who trade at an average of 22.6x – and roll valuations forward to FY24E. Retain BUY with a revised TP of Rs 890 (vs. Rs 975) as we continue to like ERIS for its focused presence in the chronic space and superior physician reach.

Fig 3 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Sales	13.4	14.9	16.7	13.9	15.9	17.9	(3.2)	(6.4)	(6.6)
EBITDA	5.0	5.4	6.3	5.1	6.2	7.0	(1.8)	(11.8)	(10.0)
EBITDA margin (%)	37.3	36.5	37.9	36.8	38.7	39.4	51bps	(220bps)	(146bps)
EPS (Rs)	30.0	32.8	38.7	30.5	37.7	43.5	(1.8)	(13.0)	(11.2)

Source: BOBCAPS Research

Fig 4 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
Eris Life	ERIS IN	BUY	890	5.3	17.00	14.1	23.5	23.5	19
Abbot India*	BOOT IN	NR	NA	15.0	26.34	22.78	31.3	32.0	-
Glaxo India*	GLXO IN	NR	NA	12.5	30.36	26.07	38.9	31.2	-
Pfizer India*	PFIZ IN	NR	NA	12.2	20.96	18.88	22.4	21.3	-
Aggregate	-	-	-	-	25.9	22.6	30.8	28.2	-

Source: BOBCAPS Research, Bloomberg | * Bloomberg consensus estimates; NR – Not Rated

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 Teneeligliptin, 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 FY23 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	2,178	2,800	BUY
Alembic Pharma	ALPM IN	2.0	746	980	BUY
Alkem Labs	ALKEM IN	5.4	3,417	4,250	HOLD
Aurobindo Pharma	ARBP IN	4.9	624	886	BUY
Cipla	CIPLA IN	10.0	932	1,160	BUY
Divi's Labs	DIVI IN	13.9	3,941	5,540	HOLD
Dr Reddy's Labs	DRRD IN	9.3	4,219	5,500	BUY
Eris Lifesciences	ERIS IN	1.3	696	890	BUY
Laurus Labs	LAURUS IN	3.6	500	570	HOLD
Lupin	LPC IN	5.4	900	1,045	HOLD
Sun Pharma	SUNP IN	26.4	827	955	BUY

Source: BOBCAPS Research, NSE | Price as of 28 Jan 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	10,741	12,119	13,446	14,901	16,720
EBITDA	3,684	4,306	5,020	5,436	6,340
Depreciation	503	430	621	698	755
EBIT	3,181	3,876	4,399	4,737	5,585
Net interest inc./(exp.)	(22)	(18)	(2)	0	0
Other inc./(exp.)	154	87	69	151	252
Exceptional items	0	0	0	0	0
EBT	3,313	3,945	4,466	4,888	5,836
Income taxes	349	394	393	440	584
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	2,965	3,551	4,073	4,448	5,253
Adjustments	0	0	0	0	0
Adjusted net profit	2,965	3,551	4,073	4,448	5,253

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	1,000	1,026	1,087	1,208	1,358
Other current liabilities	490	406	529	588	661
Provisions	562	588	652	725	815
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	17,240	20,422	24,091
Shareholders' fund	11,761	14,253	17,376	20,558	24,227
Total liab. and equities	13,813	16,341	19,644	23,079	27,060
Cash and cash eq.	673	383	3,181	5,852	9,914
Accounts receivables	1,569	1,405	1,449	1,813	1,584
Inventories	695	945	1,087	1,410	1,448
Other current assets	1,305	2,114	1,733	1,926	2,164
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	19,644	23,079	27,060

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	3,228	3,072	5,138	4,521	6,271
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)	2,799	2,671	4,061
Closing cash & cash eq.	673	383	3,181	5,852	9,914

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	21.8	26.2	30.0	32.8	38.7
Adjusted EPS	21.8	26.2	30.0	32.8	38.7
Dividend per share	2.9	5.5	6.0	8.0	10.0
Book value per share	86.6	105.0	128.0	151.4	178.4

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	8.9	7.7	6.9	6.2	5.4
EV/EBITDA	25.8	21.6	18.6	17.0	14.1
Adjusted P/E	31.9	26.6	23.2	21.3	18.0
P/BV	8.0	6.6	5.4	4.6	3.9

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	89.5	90.0	91.2	91.0	90.0
Interest burden (PBT/EBIT)	104.2	101.8	101.5	103.2	104.5
EBIT margin (EBIT/Revenue)	29.6	32.0	32.7	31.8	33.4
Asset turnover (Rev./Avg TA)	22.1	23.2	21.2	19.6	18.7
Leverage (Avg TA/Avg Equity)	1.1	1.0	1.0	1.0	1.0
Adjusted ROAE	26.5	27.3	25.8	23.5	23.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	9.4	12.8	11.0	10.8	12.2
EBITDA	6.8	16.9	16.6	8.3	16.6
Adjusted EPS	2.0	19.8	14.7	9.2	18.1
Profitability & Return ratios (%)					
EBITDA margin	34.3	35.5	37.3	36.5	37.9
EBIT margin	29.6	32.0	32.7	31.8	33.4
Adjusted profit margin	27.6	29.3	30.3	29.8	31.4
Adjusted ROAE	26.5	27.3	25.8	23.5	23.5
ROCE	27.5	30.4	28.2	25.8	26.1
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	1.2	1.3
Current ratio	2.1	2.4	3.3	4.4	5.3
Net interest coverage ratio	147.3	215.1	2,163.7		
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.3)	(0.4)

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

Disclaimer

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

BUY – Expected return >+15%

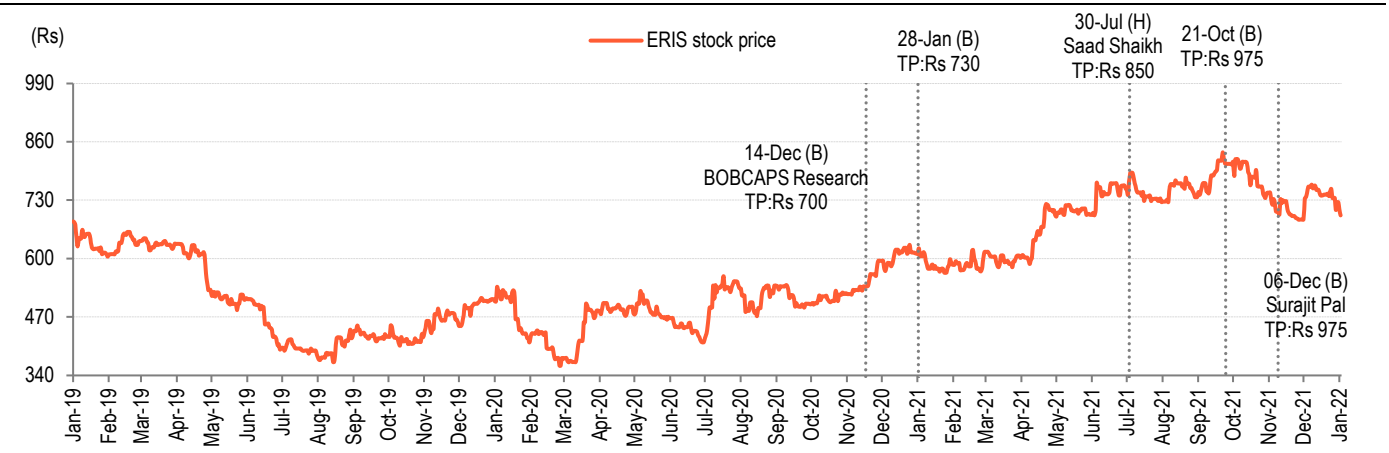
HOLD – Expected return from -6% to +15%

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

Rating distribution

As of 31 December 2021, out of 115 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 57 have BUY ratings, 31 have HOLD ratings, 5 are rated ADD*, 2 are rated REDUCE* and 20 are rated SELL. None of these companies have been investment banking clients in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.