

BUY

TP: Rs 810 | ▲ 28%

ERIS LIFESCIENCES

Pharmaceuticals

18 January 2023

Oaknet continues to drive revenue growth

- Q3 consolidated revenue grew 27% YoY led by Oaknet, but standalone growth modest at 9%
- Announced the acquisition of Glenmark’s derma portfolio (Rs 850mn annual turnover) for Rs 3.4bn, to be funded by debt
- We cut FY23/FY24 EBITDA 8%/5% and revise our TP to Rs 810 (vs. Rs 970), based on 17x 1Y fwd EV/EBITDA vs. 19x earlier

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Oaknet aids strong print YoY; standalone growth in single digits: ERIS reported modest standalone Q3FY23 revenue growth of 9% YoY owing to the absence of one Covid-related product (Zac-D: ~Rs 300mn in Q3FY22) and of Zayo (~Rs 300mn) which is under a court injunction. On a consolidated basis, incremental revenue from Oaknet helped the company post strong YoY growth of 27%. Oaknet posted Q3 revenue of Rs 597mn (-12% QoQ), while the insulin business contributed Rs 62mn.

Guidance lowered; levers in place for margin improvement: Given the delays in launches/ramp-up of a few products and the impact of Zac-D product returns (~Rs 200mn in 9MFY23), management has lowered FY23 revenue and EBITDA growth guidance to 25-26% (vs. 30%) and 14-15% (vs. 16-17%) respectively. Owing to the addition of ~200 people to the field force and change in product/therapy mix, consolidated gross/EBITDA margins contracted YoY to 79%/32.4% (-250bps/-420bps), though gross margin improved QoQ by ~200bps.

On a standalone basis, gross margin improved 230bps QoQ to 82.5% while EBITDA margin contracted 160bps to 38.1%. We expect the full-year impact of new launches, increased contribution from acquired/JV brands and increasing productivity to aid margin improvement.

Acquisition to deepen dermatology presence: ERIS proposes to acquire Glenmark Pharma’s portfolio of nine dermatology brands for ~Rs 3.4bn at a valuation of 4x TTM sales. Acquired brands such as Onabet, Halovate and Sorvate are ranked #1 in their respective segments, while Demelan, Dositil and Aceret rank among the top-3. The acquired portfolio had an annual revenue base of ~Rs 850mn. The deal will be financed through borrowings at a cost of ~8%.

Maintain BUY: We lower our FY23/FY24 EBITDA estimates by 8%/5% considering the reduced guidance and margin pressures arising from a change in mix, employee addition and higher other costs. These headwinds also lead us to pare our target one-year forward EV/EBITDA multiple from 19x to 17x – a 10% discount to the 5Y average, yielding a revised TP of Rs 810 (from Rs 970 earlier). Maintain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	ERIS IN/Rs 633
Market cap	US\$ 1.1bn
Free float	27%
3M ADV	US\$ 0.4mn
52wk high/low	Rs 768/Rs 600
Promoter/FPI/DII	53%/13%/10%

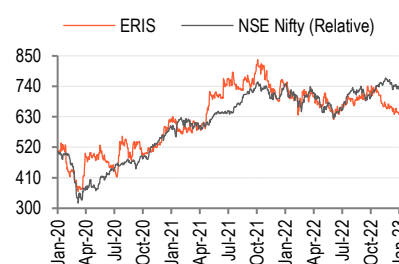
Source: NSE | Price as of 18 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	13,470	16,955	19,478
EBITDA (Rs mn)	4,849	5,518	6,622
Adj. net profit (Rs mn)	4,060	3,950	4,734
Adj. EPS (Rs)	29.9	29.1	34.9
Consensus EPS (Rs)	29.9	29.0	36.0
Adj. ROAE (%)	25.9	19.8	19.4
Adj. P/E (x)	21.2	21.7	18.1
EV/EBITDA (x)	17.5	15.4	13.3
Adj. EPS growth (%)	14.3	(2.7)	19.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net Sales	4,233	3,322	27.4	4,605	(8.1)	12,824	10,411	23.2
EBITDA	1,372	1,217	12.7	1,514	(9.4)	4,179	3,881	7.7
Depreciation	299	169	77	286	4	820	463	-
EBIT	1,073	1,048	2.3	1,228	(12.6)	3,359	3,417	(1.7)
Interest	30	10	188	71	(58)	173	29	-
Other Income	22	52	-	52	-	101	180	-
PBT	1,065	1,090	(2.2)	1,209	(11.9)	3,288	3,569	(7.9)
Less: Taxation	63	82	-	16	-	161	310	-
Minority Interest/Associate	(16)	0	-	(9)	-	(41)	0	-
Recurring PAT	1,019	1,008	1.1	1,203	(15.3)	3,168	3,258	(2.8)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,019	1,008	1.1	1,203	(15.3)	3,168	3,258	(2.8)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	79.0	81.5	(248)	77.0	198	78.2	81.1	(291)
EBITDA Margin	32.4	36.6	(423)	32.9	(47)	32.6	37.3	(469)
Tax / PBT	5.9	7.5	-	1.3	-	4.9	8.7	-
NPM	24.1	30.3	-	26.1	-	24.7	31.3	-
EPS (Rs)	7.5	7.4	1.0	8.8	(15.3)	23.3	24.0	-

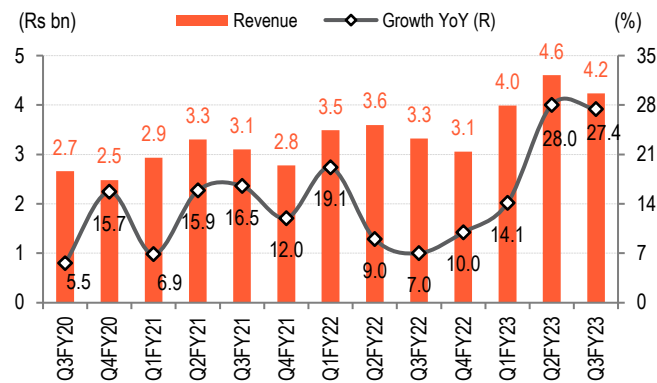
Source: Company, BOBCAPS Research

Fig 2 – Entity wise contribution

Eris Entities (Rs mn)	Q3FY23				9MFY23				EBITDA Margin (%)	
	Operating Revenue	YoY (%)	EBITDA	YoY (%)	Operating Revenue	YoY (%)	EBITDA	YoY (%)	9MFY23	9MFY22
Eris (Standalone)	3,320	9	1,264	3	10,161	9	3,936	3	38.7	41
Oaknet (BGx)	597	-	159	-	1,593	-	388	-	24.3	-
Aprica (BGx)	140	(5)	3	(90)	468	(4)	67	(30)	14.2	19.5
EHPL (TGx)	146	(29)	(7)	(89)	593	(31)	(30)	(15)	-	-
Eris M J (Insulin)	62	-	(40)	-	114	-	(146)	-	-	-
Eris Therapeutics	1	-	(7)	-	1	-	(15)	-	-	-
Eris Pharmaceuticals	-	-	(0)	-	-	-	0	-	-	-
Inter co adjustments	(34)	-	(0)	-	(107)	-	(21)	-	-	-
Consol. Op Revenue	4,232	27	1,372	13	12,824	23	4,179	8	32.6	37.3

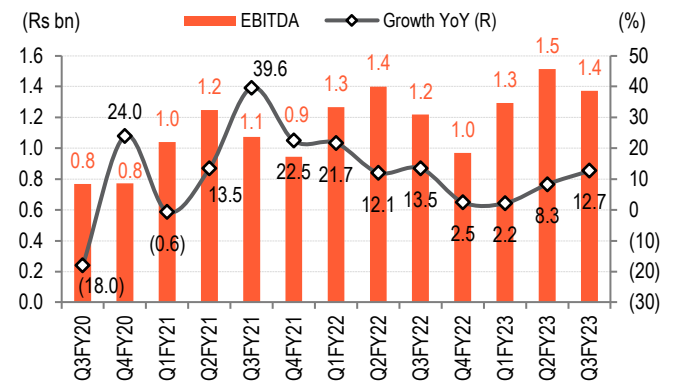
Source: Company

Fig 3 – Revenue



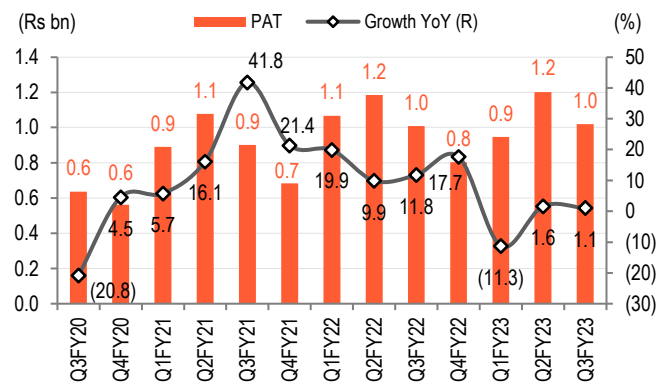
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



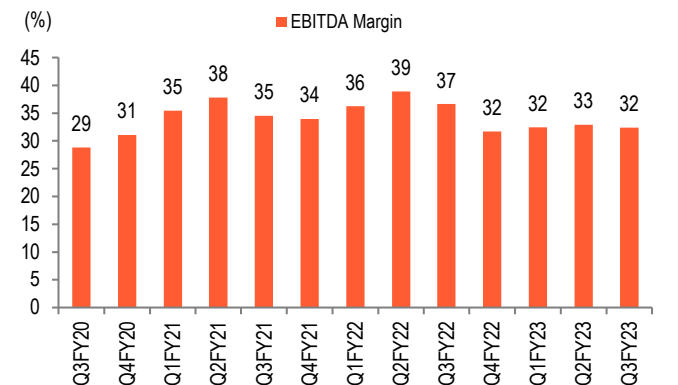
Source: Company, BOBCAPS Research

Fig 5 – PAT



Source: Company, BOBCAPS Research

Fig 6 – EBITDA Margin



Source: Company, BOBCAPS Research

Earnings call highlights

- **Acquisition to deepen dermatology presence:** ERIS proposes to acquire Glenmark Pharma’s portfolio of nine dermatology brands for ~Rs 3.4bn at a valuation of 4x TTM sales. Acquired brands such as Onabet, Halovate and Sorvate are ranked #1 in their respective segments, while Demelan, Dosestil and Aceret rank among the top-3. The other three brands are Luligee, Revize and Powercort. This acquisition will deepen the company’s presence in the medical dermatology (anti-fungal and anti-psoriasis) segment.
 - **Derma contribution guided to rise to 12.7%:** As per management, the deal will raise ERIS’s share in its covered dermatology market from 2.8% to 4.6% and improve its rank from #12 to #6. Derma therapy contribution to revenue is guided to rise from 7.6% to 12.7% with this acquisition.
 - **Deal to be funded by borrowings:** The acquired portfolio had an annual revenue base of ~Rs 850mn. ERIS’s purchase consideration of ~Rs 3.4bn is at a valuation of 4x TTM sales. The deal will be financed through borrowings at a cost of ~8%.

- **FY23 guidance lowered:** Management has guided for FY23 revenue growth of 25-26% and EBITDA growth of 14-15%, down from its earlier guidance of 30% and 16-17% respectively.
- **Margins to improve in FY24:** EBITDA margin is guided to be flattish in the range of 32-33% for FY23, with improvement from FY24 factoring in newly launched brands, improvement in Oaknet's full-year margins to Q3 levels (~27%), a shift of outsourced manufacturing in-house with the new Gujarat facility scheduled to come online in FY24, and improvement in productivity of the newly added field force.
- **One-offs:** ERIS saw a negative revenue impact of Rs 180mn-200mn from stock returns in 9MFY23.
- **Gujarat facility:** The Gujarat plant is running trial batches and expected to come online in FY24.
- **Field force:** A total of ~200 people were added to the field force in Q3, taking the tally to 2,200 standalone and 3,000 on a consolidated basis.
- **Tax rate:** The effective tax rate is guided at 9-10% for FY23.

Valuation methodology

We believe ERIS's long-term growth levers remain intact with expansion of dermatology offerings through acquisitions (Oaknet and Glenmark Pharma portfolio), broadening of its antidiabetic offering via insulin/analogues, new product launches and an increasing field force. Though the company's current margins are lower than historical levels, we expect margin improvement from FY24 onwards as the new Gujarat facility brings more manufacturing in-house and acquired business/brands are fully integrated.

We lower our FY23/FY24 EBITDA estimates by 8%/5% considering the reduced guidance and margin pressures arising from a change in mix, employee addition and higher other costs. These headwinds also prompt us to pare our target one-year forward EV/EBITDA multiple from 19x to 17x – a 10% discount to the five-year average, yielding a revised TP of Rs 810 (from Rs 970 earlier). Maintain BUY.

Fig 7 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	17.0	19.5	21.8	17.6	20.2	NA	(3.6)	(3.4)	NA
EBITDA	5.5	6.6	7.9	6.0	7.0	NA	(7.6)	(4.8)	NA
EBITDA margin (%)	32.5	34.0	36.3	34.0	34.5	NA	(141bps)	(52bps)	NA
EPS (Rs)	29.0	34.8	40.9	35.7	42.1	NA	(18.7)	(17.4)	NA

Source: BOBCAPS Research

Fig 8 – Key assumptions

Parameter	FY22	FY23E	FY24E	FY25E
Sales (Rs bn)	13.5	17.0	19.5	21.8
EBITDA (Rs bn)	4.8	5.5	6.6	7.9
EBITDA margin (%)	36.0	32.5	34.0	36.3
EPS (Rs)	29.9	29.0	34.8	40.9

Source: Company, BOBCAPS Research

Fig 9 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Eris Life	ERIS IN	BUY	810	14.5	14.4	12.1	19.8	19.4	17x
Abbot India	BOOT IN	NR	NA	14.6	36.0	31.3	30.4	30.2	NA
Glaxo India	GLXO IN	NR	NA	6.9	26.5	23.9	26.4	34.4	NA
Pfizer India	PFIZ IN	NR	NA	7.1	19.7	18.2	20.3	19.7	NA
Aggregate			-	-	27.4	24.5	-	-	-

Source: BOBCAPS Research | NR: Not Rated

Key risks

Key downside risks to our estimates are:

- delay in launch/ramp-up of new products,
- weaker supply security of products not manufactured in-house, and
- delays in commissioning the new facility at Gujarat.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	1.9	1,185	1,470	HOLD
Alembic Pharma	ALPM IN	1.3	553	615	HOLD
Alkem Labs	ALKEM IN	4.5	3,059	2,700	SELL
Aurobindo Pharma	ARBP IN	3.2	444	635	BUY
Cipla	CIPLA IN	10.5	1,063	1,320	BUY
Divi's Labs	DIVI IN	11.1	3,389	3,450	HOLD
Dr Reddy's Labs	DRRD IN	8.9	4,364	4,700	HOLD
Eris Lifesciences	ERIS IN	1.1	633	810	BUY
Glenmark Life Sciences	GLS IN	0.6	405	535	BUY
Laurus Labs	LAURUS IN	2.3	355	540	HOLD
Lupin	LPC IN	4.3	767	700	HOLD
Sun Pharma	SUNP IN	30.7	1,040	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 18 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	12,119	13,470	16,955	19,478	21,798
EBITDA	4,306	4,849	5,518	6,622	7,922
Depreciation	430	647	981	1,045	1,128
EBIT	3,876	4,202	4,537	5,577	6,793
Net interest inc./(exp.)	(18)	(41)	(373)	(397)	(397)
Other inc./(exp.)	87	261	122	80	147
Exceptional items	0	0	0	0	0
EBT	3,945	4,421	4,285	5,260	6,543
Income taxes	394	364	386	526	1,636
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	(3)	(50)	0	0
Reported net profit	3,551	4,060	3,950	4,734	4,907
Adjustments	0	0	0	0	0
Adjusted net profit	3,551	4,060	3,950	4,734	4,907

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	1,026	1,178	1,377	1,585	1,774
Other current liabilities	406	411	670	771	864
Provisions	588	712	899	1,035	1,159
Debt funds	68	844	6,619	6,619	6,619
Other liabilities	0	0	0	0	0
Equity capital	136	136	136	136	136
Reserves & surplus	14,118	16,976	23,041	25,886	28,891
Shareholders' fund	14,253	17,112	23,177	26,022	29,027
Total liab. and equities	16,341	20,256	32,742	36,032	39,442
Cash and cash eq.	383	523	999	4,899	8,027
Accounts receivables	1,405	1,610	2,754	1,849	2,070
Inventories	945	1,179	1,377	1,690	1,774
Other current assets	2,114	2,320	2,195	2,525	2,828
Investments	2,940	5,204	42	42	42
Net fixed assets	779	1,679	8,037	8,332	8,650
CWIP	16	240	1,087	1,087	1,087
Intangible assets	7,760	7,501	16,250	15,606	14,963
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	16,341	20,256	32,742	36,032	39,442

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	3,072	4,384	4,733	6,882	6,231
Capital expenditures	(57)	111	(9,784)	(1,340)	(1,447)
Change in investments	(2,161)	(2,263)	5,162	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,218)	(2,152)	(4,622)	(1,340)	(1,447)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	68	776	5,775	0	0
Interest expenses	(18)	(41)	(373)	(397)	(397)
Dividends paid	(871)	(951)	(1,269)	(1,586)	(1,903)
Other financing cash flows	(323)	(1,875)	(3,768)	341	644
Cash flow from financing	(1,144)	(2,091)	365	(1,642)	(1,656)
Chg in cash & cash eq.	(290)	141	476	3,900	3,128
Closing cash & cash eq.	383	523	999	4,899	8,027

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	26.2	29.9	29.1	34.9	36.1
Adjusted EPS	26.2	29.9	29.1	34.9	36.1
Dividend per share	5.5	6.0	8.0	10.0	12.0
Book value per share	105.0	126.0	168.5	191.6	213.8

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	7.0	6.3	5.0	4.5	4.1
EV/EBITDA	19.6	17.5	15.4	13.3	11.3
Adjusted P/E	24.2	21.2	21.7	18.1	17.5
P/BV	6.0	5.0	3.8	3.3	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	90.0	91.8	92.2	90.0	75.0
Interest burden (PBT/EBIT)	101.8	105.2	94.5	94.3	96.3
EBIT margin (EBIT/Revenue)	32.0	31.2	26.8	28.6	31.2
Asset turnover (Rev./Avg TA)	23.2	20.9	17.8	15.6	16.0
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.2	1.3	1.2
Adjusted ROAE	27.3	25.9	19.8	19.4	17.8

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	12.8	11.1	25.9	14.9	11.9
EBITDA	16.9	12.6	13.8	20.0	19.6
Adjusted EPS	19.8	14.3	(2.7)	19.8	3.7
Profitability & Return ratios (%)					
EBITDA margin	35.5	36.0	32.5	34.0	36.3
EBIT margin	32.0	31.2	26.8	28.6	31.2
Adjusted profit margin	29.3	30.1	23.3	24.3	22.5
Adjusted ROAE	27.3	25.9	19.8	19.4	17.8
ROCE	30.4	27.7	19.5	18.1	20.3
Working capital days (days)					
Receivables	43	44	60	35	35
Inventory	29	32	30	32	30
Payables	31	32	30	30	30
Ratios (x)					
Gross asset turnover	1.3	1.4	1.0	1.1	1.1
Current ratio	2.4	2.4	2.5	3.2	3.9
Net interest coverage ratio	215.1	101.3	12.2	14.0	17.1
Adjusted debt/equity	(0.1)	0.0	0.2	0.1	0.0

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

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

BUY – Expected return >+15%

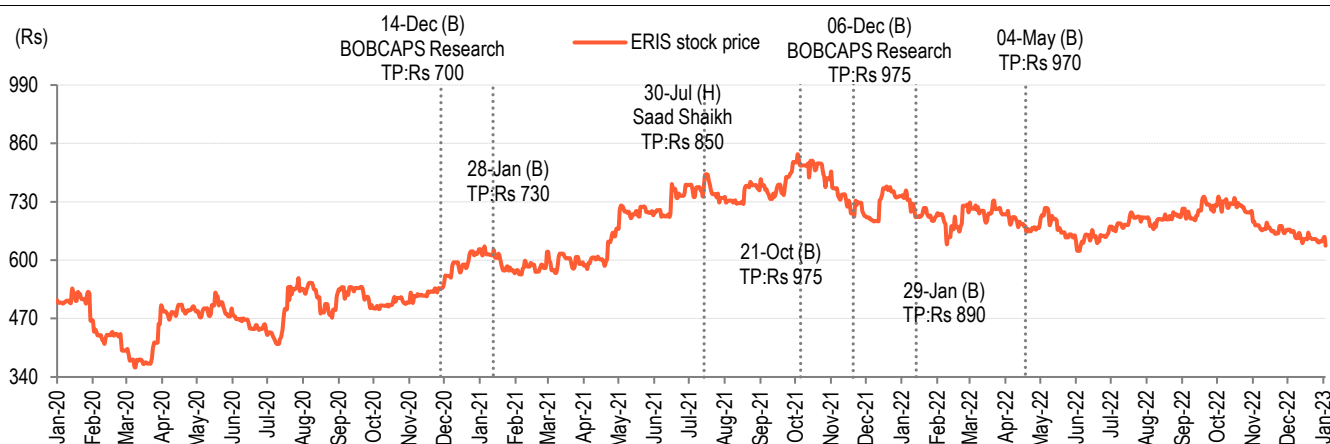
HOLD – Expected return from -6% to +15%

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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