

BUY

TP: Rs 970 | ▲ 46%

ERIS LIFESCIENCES

Pharmaceuticals

04 May 2022

Launch investments cramp margins; forays into derma

- Q4 sales/EBITDA contracted 8%/20% QoQ (up 10%/3% YoY) due to structural decline in the cardiometabolic segment
- Growth nevertheless outperformed IPM across segments, except VMN which had a high base
- We raise FY23/FY24 EBITDA by 10% each incorporating the Oaknet (derma) acquisition; our TP rises to Rs 970 (vs. Rs 890) – maintain BUY

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Structural slowdown in core cardiometabolic segment induces QoQ decline:

ERIS reported 10% YoY sales growth in Q4FY22. With secondary sales up 9.2% YoY, the company outperformed India pharma market (IPM) growth of 3.9% across its segments of cardiometabolic, CNS and women's health. Only VMN underperformed due to a high base. Sequentially, however, a structural slowdown in the cardiometabolic segment caused the company to report a decline of 8%/20% in sales/EBITDA for the quarter.

Insulin division launched: ERIS launched its human insulin product in Feb'22 with a dedicated division (140-strong field force) as part of its expansion in the core oral antidiabetic market. It plans to launch insulin Glargine in 2023. Other pipeline products under this division include Aspart, Lispro and Liraglutide.

Oaknet acquired for Rs 6.5bn; guided to add Rs 500mn in EBITDA by FY24:

ERIS has acquired Oaknet Healthcare at 3.3x sales and 32.4x EBITDA (FY22) to expand its reach and portfolio in dermatology. Management plans to improve operational efficiencies and increase productivity, with guidance of Rs 2.5bn in sales and a 20% EBITDA margin (from 10% in FY22) from Oaknet in FY24. The all-cash acquisition at Rs 6.5bn will be funded via a mix of internal accruals (Rs 3bn) and external debt from Bajaj Finance (Rs 3.5bn at 6.7% interest, fixed for the first year).

Heavy investment on new products/division impacts margins: ERIS reported 150bps YoY gross margin expansion (-170bps QoQ), but heavy investment toward new product launches (Drolute, Xsulin, Linares) and the addition of field force for the insulin segment depleted the EBITDA margin by 230bps YoY and 500bps QoQ.

Maintain BUY; TP raised to Rs 970: We raise our revenue/EBITDA estimates for FY23 by 18%/10% and FY24 by 21%/10% after incorporating Oaknet into our numbers. Accordingly, our TP rises to Rs 970 (vs. Rs 890), based on an unchanged FY24E EV/EBITDA multiple of 19x – a 10% discount to branded players such as BOOT, GLXO and PFIZ (all Not Rated).

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	ERIS IN/Rs 663
Market cap	US\$ 1.2bn
Free float	27%
3M ADV	US\$ 0.6mn
52wk high/low	Rs 863/Rs 586
Promoter/FPI/DII	53%/13%/10%

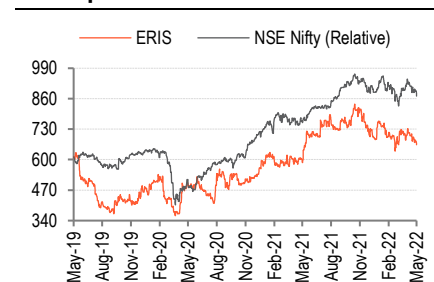
Source: NSE | Price as of 4 May 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	13,470	17,590	20,155
EBITDA (Rs mn)	4,849	5,973	6,956
Adj. net profit (Rs mn)	4,060	4,859	5,730
Adj. EPS (Rs)	29.9	35.8	42.2
Consensus EPS (Rs)	29.9	34.8	40.2
Adj. ROAE (%)	25.9	25.7	25.2
Adj. P/E (x)	22.2	18.5	15.7
EV/EBITDA (x)	18.3	15.0	12.6
Adj. EPS growth (%)	14.3	19.7	17.9

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Net Sales	3,059	2,782	10.0	3,322	(7.9)	13,470	12,118	11.2
EBITDA	969	945	2.5	1,217	(20.4)	4,850	4,305	12.7
Depreciation	184	115	-	169	-	647	430	-
EBIT	785	831	(5.4)	1,048	(25.1)	4,203	3,875	8.4
Interest	13	5	-	10	-	41	18	-
Other Income	81	22	-	52	-	261	87	-
PBT	853	847	0.7	1,090	(21.7)	4,422	3,944	12.1
Less: Taxation	54	165	-	82	-	364	393	-
Minority Interest/Associate	(3)	0	-	0	-	-	-	-
Recurring PAT	803	682	17.7	1,008	(20.3)	4,058	3,551	14.3
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	803	682	17.7	1,008	(20.3)	4,058	3,551	14.3
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	79.8	78.3	152	81.5	(171)	80.8	80.3	47
EBITDA Margin	31.7	34.0	(230)	36.6	(498)	36.0	35.5	48
Tax / PBT	6.3	19.5	-	7.5	-	8.2	10.0	-
NPM	26.2	24.5	-	30.3	-	30.1	29.3	-
EPS (Rs)	5.9	5.0	17.6	7.4	(20.3)	29.9	26.2	14.3

Source: Company, BOBCAPS Research

Fig 2 – Segmental mix

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Cardio Metabolic + VMN	2,379	2,167	9.8	2,592	(8.2)	10,545	9,452	11.6
Cardio Metabolic Segment (diabetes and cardiac)	1,807	1,646	9.8	1,936	(6.7)	7,820	7,213	8.4
VMN	572	521	9.8	656	(12.8)	2,725	2,239	21.7
Others	632	576	9.81	689	(8.2)	2,716	2,473	9.8
Other Op. Revenue	48	40	22.6	41	18.7	209	192	8.6
Revenues	3,059	2,782	10.0	3,322	(7.9)	13,470	12,118	11.2

Source: Company, BOBCAPS Research

Earnings call highlights

- **Reasons for lower sales and impact:** ERIS's consolidated revenue declined 8% QoQ in Q4FY22 due to a structural slowdown in the cardiometabolic segment. Nevertheless, the company managed to outperform IPM growth in each of its segments, except VMN which had a higher base during the pandemic. The fall in sales marked the only difference in sequential financial performance as the company had strong control over key cost items.
- **Guidance for FY23:** Management has guided for ex-Oaknet growth of 15% each in sales and EBITDA and 11-12% in PAT, with EBITDA margin to be maintained at ~36%. Including Oaknet, ERIS expects sales growth of 30% in FY23. Per management, the launch of the insulin franchise, acquired sales of Oaknet, field-force expansion in the cardiometabolic portfolio and key product launches (including in-license products) should drive growth and enable the company to maintain headline margins in FY23.
- **Tax rate guidance:** The tax rate for FY23 is guided to be similar to that in FY22, i.e. 27-29% of PBT, with levels of 28-29% in FY25 and a reduction to 18-19% by FY30, though the effective tax rate should remain below 27-29% till FY29 due to the availability of MAT credit. ERIS assumes that commissioning of the new plant in Gujarat will contribute more in sales while that from the Guwahati plant will taper down. This will allow for a favourable tax regime of 15% vs. the normalised tax rate at the Guwahati plant post FY24.
- **Acquisition of derma player Oaknet:** Oaknet's women's healthcare division is currently underperforming due to lower productivity. ERIS plans to shift the portfolio and MRs to its own women's healthcare division (along with the cross-selling opportunity). Management is also planning a price rise and enhanced productivity, which is behind its guidance of Rs 2.5bn in sales and a 20% EBITDA margin (vs. a 10% margin in FY22) in FY24. The all-cash acquisition at Rs 6.5bn will be funded via a mix of internal accruals (Rs 3bn) and external debt from Bajaj Finance (Rs 3.5bn at 6.7% interest, fixed for the first year).
- **Cash position:** Cash in hand stood at Rs 5bn at the end of Q4, of which Rs 3.5bn will be spent on the Oaknet transaction. The company received on an average cash of Rs 350mn per month. Management remains keen to undertake more acquisitions if they are a strategic fit.
- **New product launches and addition of new division:** ERIS launched Drolute, Xsulin and Linares during the quarter. It also introduced a dedicated insulin division with a field force of 140 personnel.

Valuation methodology

After venturing into human insulin and insulin analogues, ERIS has now announced the acquisition of Oaknet Healthcare which will give the company a footing in the dermatological segment. Moreover, its proposed greenfield expansion in Gujarat is underway, this gives earnings visibility for future.

We raise our revenue/EBITDA estimates for FY23 by 18%/10% and FY24 by 21%/10% to incorporate Oaknet into our numbers. Accordingly, our TP rises to Rs 970 (vs. Rs 890), based on an unchanged FY24E EV/EBITDA multiple of 19x – a 10% discount to branded players such as BOOT, GLXO and PFIZ (all Not Rated).

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	17.6	20.2	14.9	16.7	18.0	20.5
EBITDA	6.0	7.0	5.4	6.3	9.9	9.7
EBITDA Margin (%)	34.0	34.5	36.5	37.9	(253)	(341)
EPS (Rs)	35.7	42.2	33.2	38.7	7.5	8.9

Source: BOBCAPS Research

Fig 4 – Key assumptions

(Rs bn)	FY22A	FY23E	FY24E
Revenue	13.5	17.6	20.2
EBITDA	4.8	6.0	7.0
EBITDA Margin (%)	36.0	34.0	34.5
EPS (Rs)	29.9	35.7	42.2

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Eris Lifesciences	ERIS IN	BUY	970	17.5	26.8	23.7	30.7	30.3	19.0
Abbot India*	BOOT IN	NR	NA	15.0	27.3	24.0	34.3	38.2	-
Glaxo India*	GLXO IN	NR	NA	13.9	20.8	18.8	20.3	19.6	-
Pfizer India*	PFIZ IN	NR	NA	11.4	16.6	15.2	33.1	35.5	-

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

Key risks

Key downside risks to our estimates are:

- 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 Teneligliptin, 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.
- **Integration hurdles:** Any hindrance to the Oaknet Healthcare acquisition could pose downside risks to our estimates.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.0	1,759	2,655	BUY
Alembic Pharma	ALPM IN	1.9	734	770	HOLD
Alkem Labs	ALKEM IN	5.0	3,191	4,000	BUY
Aurobindo Pharma	ARBP IN	4.8	625	850	BUY
Cipla	CIPLA IN	10.1	958	1,200	BUY
Divi's Labs	DIVI IN	15.1	4,344	5,250	BUY
Dr Reddy's Labs	DRRD IN	8.7	3,992	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	663	970	BUY
Laurus Labs	LAURUS IN	4.1	579	645	HOLD
Lupin	LPC IN	4.3	727	800	HOLD
Sun Pharma	SUNP IN	28.3	901	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 4 May 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	10,741	12,119	13,470	17,590	20,155
EBITDA	3,684	4,306	4,849	5,973	6,956
Depreciation	503	430	647	698	755
EBIT	3,181	3,876	4,202	5,274	6,201
Net interest inc./(exp.)	(22)	(18)	(41)	(25)	0
Other inc./(exp.)	154	87	261	91	166
Exceptional items	0	0	0	0	0
EBT	3,313	3,945	4,421	5,340	6,367
Income taxes	349	394	364	481	637
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	(3)	0	0
Reported net profit	2,965	3,551	4,060	4,859	5,730
Adjustments	0	0	0	0	0
Adjusted net profit	2,965	3,551	4,060	4,859	5,730

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	1,000	1,026	1,178	1,429	1,640
Other current liabilities	490	406	411	696	798
Provisions	562	588	712	933	1,071
Debt funds	0	68	844	0	0
Other liabilities	0	0	0	0	0
Equity capital	136	136	136	136	136
Reserves & surplus	11,626	14,118	16,976	20,568	24,714
Shareholders' fund	11,761	14,253	17,112	20,704	24,850
Total liab. and equities	13,813	16,341	20,256	23,762	28,359
Cash and cash eq.	673	383	523	3,165	7,702
Accounts receivables	1,569	1,405	1,610	2,144	1,913
Inventories	695	945	1,179	1,668	1,749
Other current assets	1,305	2,114	2,320	2,278	2,614
Investments	780	2,940	5,204	5,204	5,204
Net fixed assets	873	779	1,679	1,904	2,117
CWIP	44	16	240	240	240
Intangible assets	7,876	7,760	7,501	7,160	6,818
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	13,814	16,341	20,256	23,762	28,359

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	3,228	3,072	4,384	5,361	6,749
Capital expenditures	(1,309)	(57)	(1,661)	(924)	(968)
Change in investments	2,779	(2,161)	(2,263)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	1,470	(2,218)	(3,925)	(924)	(968)
Equities issued/Others	(2)	0	0	0	0
Debt raised/repaid	(1,764)	68	776	(844)	0
Interest expenses	(22)	(18)	(41)	(25)	0
Dividends paid	(467)	(871)	(951)	(1,268)	(1,585)
Other financing cash flows	(1,846)	(323)	(102)	342	341
Cash flow from financing	(4,100)	(1,144)	(318)	(1,795)	(1,244)
Chg in cash & cash eq.	598	(290)	141	2,641	4,537
Closing cash & cash eq.	673	383	523	3,165	7,702

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	21.8	26.2	29.9	35.8	42.2
Adjusted EPS	21.8	26.2	29.9	35.8	42.2
Dividend per share	2.9	5.5	6.0	8.0	10.0
Book value per share	86.6	105.0	126.0	152.5	183.0

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	8.4	7.3	6.6	5.1	4.3
EV/EBITDA	24.6	20.6	18.3	15.0	12.6
Adjusted P/E	30.4	25.4	22.2	18.5	15.7
P/BV	7.7	6.3	5.3	4.4	3.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	89.5	90.0	91.8	91.0	90.0
Interest burden (PBT/EBIT)	104.2	101.8	105.2	101.2	102.7
EBIT margin (EBIT/Revenue)	29.6	32.0	31.2	30.0	30.8
Asset turnover (Rev./Avg TA)	22.1	23.2	20.9	22.7	22.1
Leverage (Avg TA/Avg Equity)	1.1	1.0	1.0	1.0	1.0
Adjusted ROAE	26.5	27.3	25.9	25.7	25.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	9.4	12.8	11.1	30.6	14.6
EBITDA	6.8	16.9	12.6	23.2	16.5
Adjusted EPS	2.0	19.8	14.3	19.7	17.9
Profitability & Return ratios (%)					
EBITDA margin	34.3	35.5	36.0	34.0	34.5
EBIT margin	29.6	32.0	31.2	30.0	30.8
Adjusted profit margin	27.6	29.3	30.1	27.6	28.4
Adjusted ROAE	26.5	27.3	25.9	25.7	25.2
ROCE	27.5	30.4	27.7	27.8	28.0
Working capital days (days)					
Receivables	54	43	44	45	35
Inventory	24	29	32	35	32
Payables	34	31	32	30	30
Ratios (x)					
Gross asset turnover	1.1	1.3	1.2	1.5	1.5
Current ratio	2.1	2.4	2.4	3.0	4.0
Net interest coverage ratio	147.3	215.1	101.3	208.3	
Adjusted debt/equity	(0.1)	(0.1)	0.0	(0.2)	(0.4)

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

Disclaimer

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

BUY – Expected return >+15%

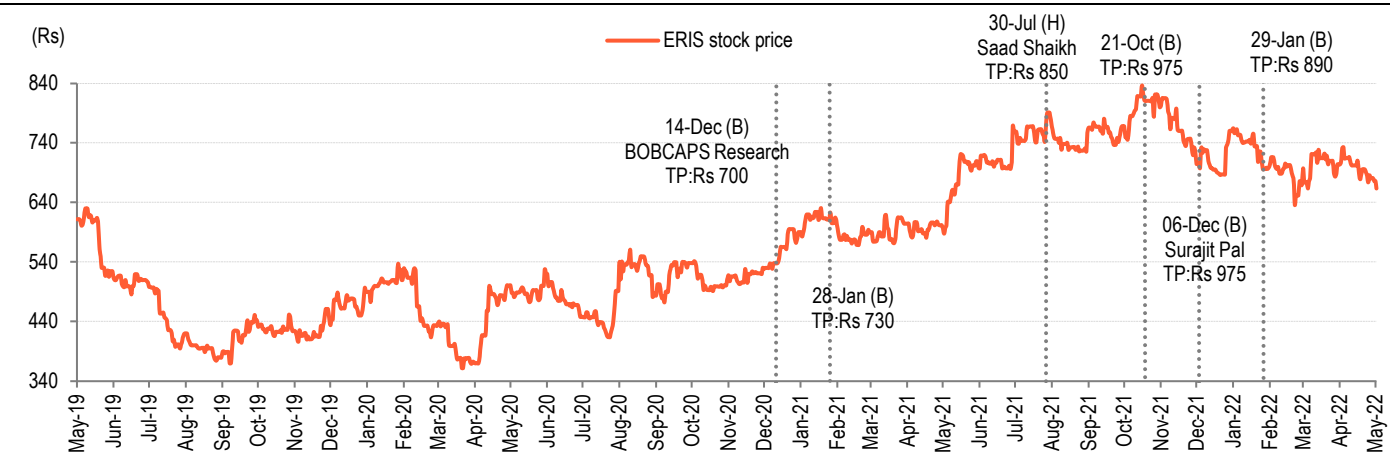
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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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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