

BUY

TP: Rs 800 | ▲ 27%

ERIS LIFESCIENCES

Pharmaceuticals

18 May 2023

Integration costs weigh on quarter

- Consolidated Q4 revenue/EBITDA growth of 32%/23% YoY missed consensus by 3%/10%
- Higher tax and integration costs for acquired businesses resulted in 19% YoY PAT decline
- We cut FY24/FY25 EPS 11%/3% and roll to a revised TP of Rs 800 (vs. Rs 810) based on 15x FY25E EV/EBITDA (vs. 17x)

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Q4 a miss: ERIS' Q4FY23 revenue/EBITDA grew 32%/23% YoY (-5%/-13% QoQ) to Rs 4bn/Rs 1bn but were 3%/10% short of consensus estimates. While integration-led costs led to the miss on EBITDA, PAT at Rs 654mn (-19% YoY, -36% QoQ) was 17% below consensus due to higher depreciation & amortisation costs on acquired businesses, deferred tax reversal and interest on debt taken to fund the acquisitions. Standalone Q4 revenue growth was muted at 11% YoY to Rs 3bn with a weaker EBITDA margin of 35.4% (-60bps YoY/-260bps QoQ) due to a high base as well as write-offs during the year.

Margins guided to improve: Gross margin expanded 215bps YoY to 81.9% (+290bps QoQ), but EBITDA margin contracted 215bps due to higher other operating expenses on account of the ongoing integration of the three acquired businesses. ERIS expects EBITDA margin to improve led by scale-up of the new businesses, reducing losses from insulin and revival in base business growth.

Continued traction in Oaknet: During FY23, ERIS achieved organic growth of 22% in Oaknet base business which had three flat years before acquisition from FY20-FY22. Full year equivalent revenue for the year was at Rs 2.5bn (+28% YoY) with EBITDA of Rs 610mn (margin 24.4%).

Maintain positive stance....: We remain positive on ERIS given sustained traction in Oaknet business together with scope for margin improvement, therapy diversification from the acquired portfolios of Glenmark Pharma and Dr Reddy's, and anticipated revival in base business. Gross margin expansion should come from the shifting of outsourced manufacturing to the newly commissioned Gujarat facility. Moreover, though the tax benefit from the Guwahati facility will end by FY24, the new plant would be under a lower 15% tax rate.

...reiterate BUY: We cut our FY24/FY25 EPS estimates by 11%/3% and apply a lower target EV/EBITDA multiple of 15x to the stock from 17x – a 20% discount to the 5Y average – to reflect higher costs arising from integration and debt. On rollover to FY25E valuations, our TP stands revised to Rs 800 (from Rs 810). **BUY.**

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	ERIS IN/Rs 629
Market cap	US\$ 1.0bn
Free float	29%
3M ADV	US\$ 0.8mn
52wk high/low	Rs 750/Rs 551
Promoter/FPI/DII	53%/15%/10%

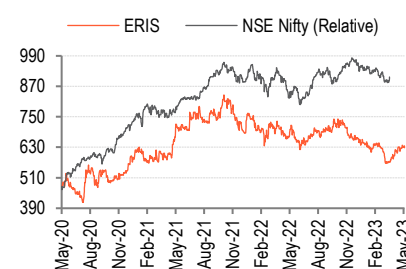
Source: NSE | Price as of 18 May 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	16,851	19,808	22,742
EBITDA (Rs mn)	5,367	6,542	7,734
Adj. net profit (Rs mn)	3,822	4,221	4,748
Adj. EPS (Rs)	28.1	31.1	35.0
Consensus EPS (Rs)	28.1	34.0	37.2
Adj. ROAE (%)	19.6	18.3	18.4
Adj. P/E (x)	22.4	20.2	18.0
EV/EBITDA (x)	15.8	13.6	11.8
Adj. EPS growth (%)	(5.9)	10.5	12.5

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

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Net Sales	4,028	3,059	31.7	4,233	(4.8)	16,852	13,470	25.1
EBITDA	1,189	969	22.7	1,372	(13.3)	5,368	4,850	10.7
Depreciation	351	184	91	299	18	1,171	647	-
EBIT	838	785	6.7	1,073	(21.9)	4,197	4,203	(0.1)
Interest	89	13	604	30	195	262	41	-
Other Income	10	81	-	22	-	112	261	-
PBT	759	853	(11.1)	1,065	(28.8)	4,047	4,422	(8.5)
Less: Taxation	144	54	-	63	-	305	364	-
Minority Interest/Associate	(39)	(3)	-	(16)	-	(80)	(3)	-
Recurring PAT	654	803	(18.5)	1,019	(35.8)	3,822	4,061	(5.9)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	654	803	(18.5)	1,019	(35.8)	3,822	4,061	(5.9)
Key Ratios (%)			(bps)			(bps)		
Gross Margin	81.9	79.8	214	79.0	291	79.1	80.8	(172)
EBITDA Margin	29.5	31.7	(215)	32.4	(290)	31.9	36.0	(415)
Tax / PBT	19.0	6.3	-	5.9	-	7.5	8.2	-
Net Profit Margin	16.2	26.2	-	24.1	-	22.7	30.1	-
EPS (Rs)	4.8	5.9	-	7.5	-	28.2	29.9	-

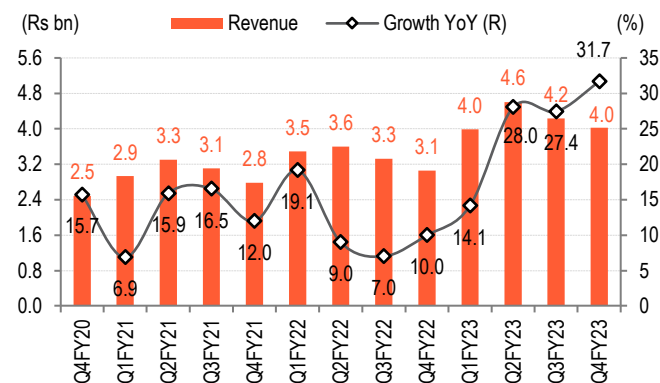
Source: Company, BOBCAPS Research

Fig 2 – Entity-wise contribution

Eris Entities	Q4FY23 (Rs mn)				FY23 (Rs mn)				EBITDA Margin (%)	
	Operating Revenue	YoY (%)	EBITDA	YoY (%)	Operating Revenue	YoY (%)	EBITDA	YoY (%)	FY23	FY22
Eris (Standalone)	3,146	11	1,115	10	13,307	9	5,051	4	38	40
Oaknet (BGx)	675	-	182	-	2,268	-	570	-	25	10*
Aprica (BGx)	74	(24)	(20)	-	542	(7)	46	(52)	9	16
EHPL (TGx)	104	(35)	(13)	(58)	696	(31)	(43)	(35)	-	-
Eris M J (Insulin)	58	-	(55)	-	172	-	(201)	-	-	-
Eris Therapeutics	5	-	(21)	-	6	-	(36)	-	-	-
Eris Pharmaceuticals	0	-	0	-	0	-	0	-	-	-
Inter co adjustments	(34)	-	0	-	(140)	-	(20)	-	-	-
Consol. Op Revenue	4,028	31.7	1,189	22.7	16,851	23	5,367	-	32	36

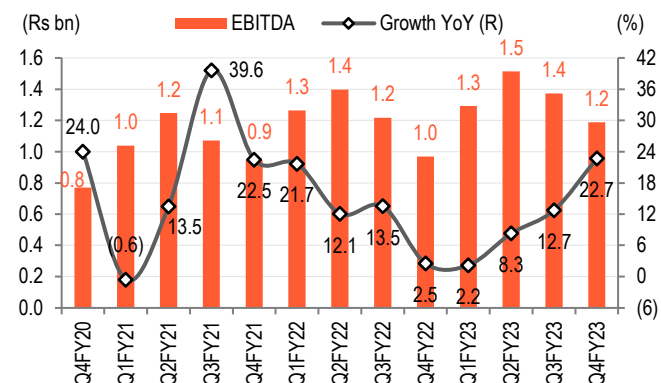
Source: Company | *Oaknet EBITDA margin pre-acquisition

Fig 3 – Revenue



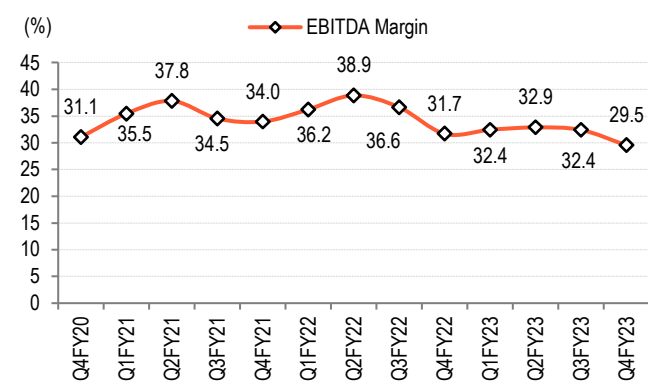
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



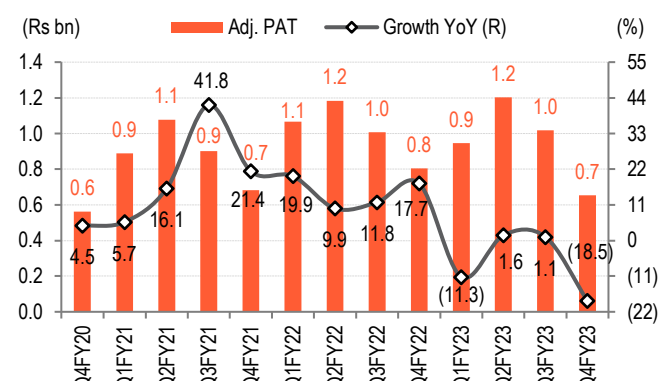
Source: Company, BOBCAPS Research

Fig 5 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 6 – Adj. PAT



Source: Company, BOBCAPS Research

Earnings call takeaways

- **ERIS MJ:** Though supply-related issues hit insulin sales for the quarter, ERIS MJ (insulin business) clocked Rs 170mn in organic revenue during FY23 – its first year of commercial operations. ERIS expects to scale up the insulin business over the near term and remains confident of breakeven in FY24.
- **Therapy & product concentration:** Revenue concentration of the top-3 therapies reduced from 80% to 66% in FY23 (after 15% growth for the year). Emerging therapies (dermatology, CNS, Women's healthcare) now account for 26% of revenue and grew 17% in FY23. ERIS's top-20 mother brands accounting for 70% of revenue grew organically by 17%.
- **Field force:** ERIS may add one more division comprising ~100 market representatives (MR) in dermatology in FY24. Total MR strength stands at 2,900.
- **Guwahati & Gujarat sites:** The Guwahati site in Assam accounted for ~70% of standalone revenue in FY23 (vs. ~80% in FY22). The Gujarat site commenced operations in Mar'23, augmenting capability in oral solids, oral liquids, sterile injectables and creams/ointments (in process). The unit will deliver in-sourcing and fiscal benefits from FY24.
- **Depreciation & Amortisation:** D&A expenses were higher in Q4FY23 as ERIS charged six months of amortisation expenses (per statutory requirements) while booking only Rs 120mn in revenues from the acquired Glenmark Pharma and Dr Reddy's businesses. Financial upside from the deals has been minimal during FY23 as these were consummated only in Q4FY23.
- **Effective tax rate:** ETR was higher at 19% in Q4 due to reversal in deferred tax assets.
- **Debt:** Management is targeting debt repayment of Rs 4bn-5bn in FY24. Consolidated net debt was at Rs 7.7bn as on 31 Mar 2023 with net debt/EBITDA at 1.45x.
- **Business restructuring:** Effective 1 April 2024, ERIS proposes to demerge Oaknet's domestic formulations business and amalgamate it with itself.

Valuation methodology

We increase our FY24/FY25 revenue estimates for ERIS by 2%/4% but lower EBITDA by 1%/2% and earnings by 11%/3% as we cut operating margin assumptions considering pressures arising from a change in mix, employee addition and integration costs for acquired entities. In addition, we apply a lower target EV/EBITDA multiple of 15x to the stock from 17x – a 20% discount to the five-year average – to reflect higher costs arising from acquisitions and debt. On rollover to FY25E valuations, our TP stands revised to Rs 800 (from Rs 810).

We remain positive on ERIS given sustained traction in Oaknet business together with scope for margin improvement, therapy diversification from the acquired portfolios of Glenmark Pharma and Dr Reddy's, and anticipated revival in base business. Gross margin expansion should come from the shifting of outsourced manufacturing to the newly commissioned Gujarat facility. Moreover, though the tax benefit from the Guwahati facility will end by FY24, the new plant would be under a lower 15% tax rate. Maintain BUY.

Fig 7 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	19.8	22.7	19.5	21.8	1.7	4.3
EBITDA	6.5	7.7	6.6	7.9	(1.2)	(2.4)
EBITDA margin (%)	33.0	34.0	34.0	36.3	(97bps)	(233bps)
EPS (Rs)	31.0	34.9	34.8	36.1	(10.8)	(3.2)

Source: BOBCAPS Research

Fig 8 – Key assumptions

Parameter (Rs bn)	FY23E	FY24E	FY25E
Sales	16.9	19.8	22.7
EBITDA	5.4	6.5	7.7
EBITDA margin (%)	31.9	33.0	34.0
EPS (Rs)	28.1	31.0	34.9

Source: Company, BOBCAPS Research

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	2.0	1,273	1,520	BUY
Alembic Pharma	ALPM IN	1.3	559	615	HOLD
Alkem Labs	ALKEM IN	4.8	3,326	3,000	SELL
Aurobindo Pharma	ARBP IN	4.3	600	635	BUY
Cipla	CIPLA IN	9.0	915	1,170	BUY
Divi's Labs	DIVI IN	10.2	3,154	3,200	HOLD
Dr Reddy's Labs	DRRD IN	9.0	4,423	4,900	HOLD
Eris Lifesciences	ERIS IN	1.0	629	800	BUY
Glenmark Life Sciences	GLS IN	0.8	525	600	BUY
Laurus Labs	LAURUS IN	2.0	310	340	HOLD
Lupin	LPC IN	4.3	779	700	HOLD
Sun Pharma	SUNP IN	27.1	930	1,100	HOLD

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Total revenue	12,119	13,470	16,851	19,808	22,742
EBITDA	4,306	4,849	5,367	6,542	7,734
Depreciation	430	647	1,171	1,567	1,693
EBIT	3,876	4,202	4,197	4,974	6,042
Net interest inc./(exp.)	(18)	(41)	(262)	(406)	(286)
Other inc./(exp.)	87	261	112	71	35
Exceptional items	0	0	0	0	0
EBT	3,945	4,421	4,046	4,639	5,790
Income taxes	394	364	305	418	1,042
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	(3)	(80)	0	0
Reported net profit	3,551	4,060	3,822	4,221	4,748
Adjustments	0	0	0	0	0
Adjusted net profit	3,551	4,060	3,822	4,221	4,748

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	1,026	1,178	1,248	1,612	1,852
Other current liabilities	406	411	966	784	901
Provisions	588	712	1,136	1,340	1,540
Debt funds	68	844	8,767	4,767	4,767
Other liabilities	0	0	0	0	0
Equity capital	136	136	136	136	136
Reserves & surplus	14,118	16,976	21,908	24,297	27,142
Shareholders' fund	14,253	17,112	22,044	24,433	27,278
Total liab. and equities	16,341	20,256	34,160	32,936	36,338
Cash and cash eq.	383	523	585	864	4,536
Accounts receivables	1,405	1,610	2,927	2,686	3,087
Inventories	945	1,179	1,314	1,719	1,852
Other current assets	2,114	2,320	3,068	2,569	2,952
Investments	2,940	5,204	367	367	367
Net fixed assets	779	1,679	3,560	3,332	3,086
CWIP	16	240	217	217	217
Intangible assets	7,760	7,501	22,121	21,181	20,241
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	16,341	20,256	34,160	32,936	36,338

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Cash flow from operations	3,072	4,384	4,102	6,918	6,368
Capital expenditures	(57)	111	(9,723)	(1,340)	(1,447)
Change in investments	(2,161)	(2,263)	4,837	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,218)	(2,152)	(4,886)	(1,340)	(1,447)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	68	776	7,923	(4,000)	0
Interest expenses	(18)	(41)	(262)	(406)	(286)
Dividends paid	(871)	(951)	(1,269)	(1,586)	(1,903)
Other financing cash flows	(323)	(1,875)	(5,547)	693	940
Cash flow from financing	(1,144)	(2,091)	846	(5,298)	(1,249)
Chg in cash & cash eq.	(290)	141	62	279	3,672
Closing cash & cash eq.	383	523	585	864	4,536

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	26.2	29.9	28.1	31.1	35.0
Adjusted EPS	26.2	29.9	28.1	31.1	35.0
Dividend per share	5.5	6.0	8.0	10.0	12.0
Book value per share	105.0	126.0	160.5	179.9	200.9

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	6.9	6.3	5.0	4.5	4.0
EV/EBITDA	19.5	17.4	15.8	13.6	11.8
Adjusted P/E	24.1	21.0	22.4	20.2	18.0
P/BV	6.0	5.0	3.9	3.5	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	90.0	91.8	94.4	91.0	82.0
Interest burden (PBT/EBIT)	101.8	105.2	96.4	93.3	95.8
EBIT margin (EBIT/Revenue)	32.0	31.2	24.9	25.1	26.6
Asset turnover (Rev./Avg TA)	23.2	20.9	17.3	16.5	18.6
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.3	1.3	1.2
Adjusted ROAE	27.3	25.9	19.6	18.3	18.4

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
YoY growth (%)					
Revenue	12.8	11.1	25.1	17.5	14.8
EBITDA	16.9	12.6	10.7	21.9	18.2
Adjusted EPS	19.8	14.3	(5.9)	10.5	12.5

Profitability & Return ratios (%)

EBITDA margin	35.5	36.0	31.9	33.0	34.0
EBIT margin	32.0	31.2	24.9	25.1	26.6
Adjusted profit margin	29.3	30.1	22.7	21.3	20.9
Adjusted ROAE	27.3	25.9	19.6	18.3	18.4
ROCE	30.4	27.7	17.7	16.8	19.8

Working capital days (days)

Receivables	43	44	64	50	50
Inventory	29	32	29	32	30
Payables	31	32	27	30	30

Ratios (x)

Gross asset turnover	1.3	1.4	1.0	1.1	1.2
Current ratio	2.4	2.4	2.4	2.1	2.9
Net interest coverage ratio	215.1	101.3	16.0	12.3	21.1
Adjusted debt/equity	(0.1)	0.0	0.4	0.1	0.0

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

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BUY – Expected return >+15%

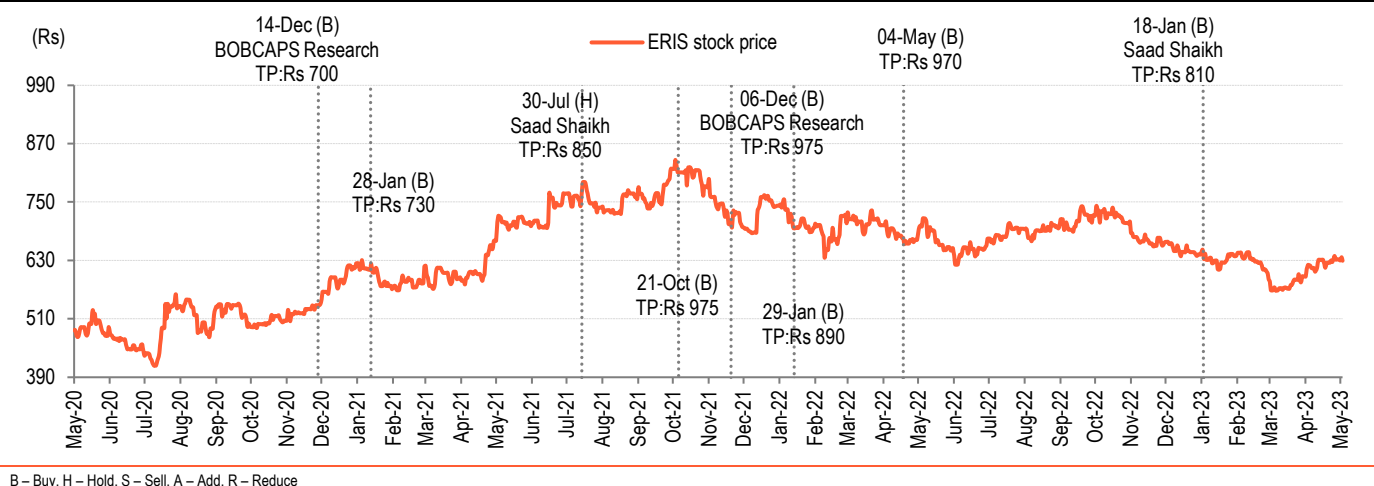
HOLD – Expected return from -6% to +15%

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)



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