

**BUY**

TP: Rs 955 | ▲ 15%

**ERIS LIFESCIENCES**

| Pharmaceuticals

| 07 August 2023

**In-line quarter; margins moving back on track**

- Q1 revenue/PAT in line but operating margin ahead of consensus at 36.4% (+395bps YoY)
- Margin improvement led by better mix, integration of acquired portfolios and softening input prices, FY24 EBITDA margin guided at 35%
- We raise FY24/FY25 EBITDA 5%/12% for a new TP of Rs 955 (vs. Rs 800), set at a higher FY25E EV/EBITDA of 16x; maintain BUY

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**Growth led by organic and inorganic portfolios:** ERIS posted in-line Q1FY24 revenue at Rs 4.7bn (+17% YoY) but a 4% beat over consensus EBITDA estimates to Rs 1.7bn (+31%). PAT, however, met forecasts at Rs 949mn (flat YoY). Core business posted low-single-digit growth (ahead of the market) and the company saw traction from the acquired portfolios of Oaknet, GNP and DRRD, as well as ERIS MJ. Growth came primarily from launches and price hikes. Emerging therapies contributed 26% in Q1FY24. Management expects ERIS MJ to clock revenue of Rs 500mn in FY24 (Rs 170mn in FY23). Field force productivity has risen 20% YoY to Rs 0.5mn per capita per month.

**FY24 EBITDA margin guided at 35%:** Given the improved traction in core operations, integration of acquired businesses and softening of raw material prices, ERIS reported a 455bps/395bps YoY improvement in Q1 gross/EBITDA margins (+125bps/+685bps QoQ). The acquisitions were margin dilutive in the year of purchase and are now showing visible improvement. Accordingly, management has put out gross/EBITDA margin guidance of 82%/35% for FY24.

**Interesting launch lineup:** ERIS has invested Rs 300mn on an active pipeline of 10 fixed dose combination products, 4 of which are in clinical trials and are to be launched in Q3-Q4FY24, with the remaining scheduled for FY25. Each of these products has the potential to generate Rs 80mn-100mn in the first 12-18 months of launch, per management. These products are in the diabetes, diabetes complications, cardiovascular and dermatology therapy areas.

**Maintain BUY; TP revised to Rs 955:** We remain positive on ERIS given sustained traction in Oaknet business and acquired portfolios. Post Q1, we raise our FY24/FY25 EBITDA estimates by 5%/12% and apply a higher target EV/EBITDA multiple of 16x (earlier 15x) to the stock – a 10% discount to the 5Y average – to reflect visible gross margin improvement towards the company's long-term average. Our TP stands revised to Rs 955 (earlier Rs 800). Further gross margin expansion should come from the shifting of outsourced manufacturing to the newly commissioned Gujarat facility. Maintain BUY.

**Key changes**

Target	Rating
▲	◀ ▶

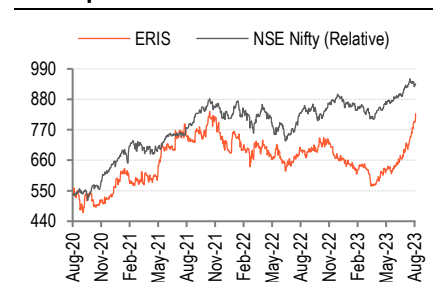
Ticker/Price	ERIS IN/Rs 828
Market cap	US\$ 1.4bn
Free float	29%
3M ADV	US\$ 1.7mn
52wk high/low	Rs 839/Rs 551
Promoter/FPI/DII	53%/14%/11%

Source: NSE | Price as of 7 Aug 2023

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	16,851	19,808	22,742
EBITDA (Rs mn)	5,367	6,836	8,636
Adj. net profit (Rs mn)	3,822	4,193	5,487
Adj. EPS (Rs)	28.1	30.9	40.4
Consensus EPS (Rs)	28.1	34.0	37.2
Adj. ROAE (%)	19.6	18.2	20.9
Adj. P/E (x)	29.4	26.8	20.5
EV/EBITDA (x)	20.8	17.0	13.7
Adj. EPS growth (%)	(5.9)	9.7	30.8

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**

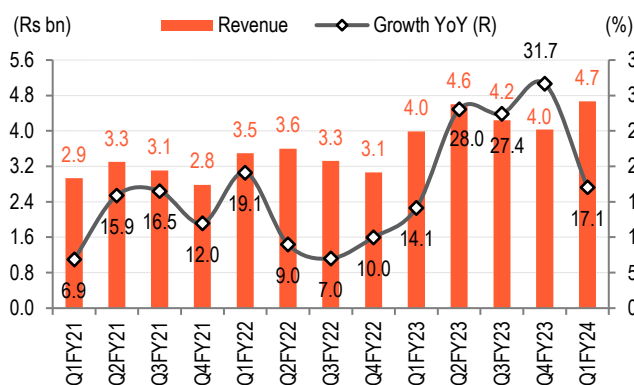
Source: NSE



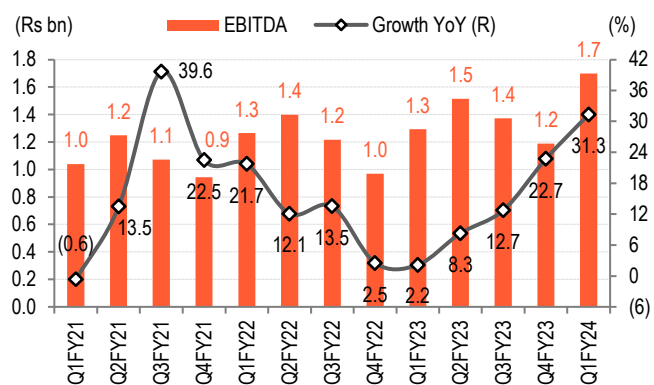
**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY23	FY22	YoY (%)
<b>Net Sales</b>	<b>4,666</b>	<b>3,986</b>	<b>17.1</b>	<b>4,028</b>	<b>15.8</b>	<b>16,852</b>	<b>13,470</b>	<b>25.1</b>
<b>EBITDA</b>	<b>1,697</b>	<b>1,293</b>	<b>31.3</b>	<b>1,189</b>	<b>42.8</b>	<b>5,368</b>	<b>4,850</b>	<b>10.7</b>
Depreciation	409	234	74	351	16	1,171	647	-
EBIT	1,289	1,058	21.8	838	53.8	4,197	4,203	(0.1)
Interest	174	72	140	89	96	262	41	-
Other Income	10	27	-	10	-	112	261	-
PBT	1,125	1,013	11.0	759	48.2	4,047	4,422	(8.5)
Less: Taxation	188	82	-	144	-	305	364	-
Minority Interest/Associate	(12)	(15)	-	(39)	-	(80)	(3)	-
Recurring PAT	949	946	0.2	654	45.0	3,822	4,061	(5.9)
Exceptional items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>949</b>	<b>946</b>	<b>0.2</b>	<b>654</b>	<b>45.0</b>	<b>3,822</b>	<b>4,061</b>	<b>(5.9)</b>
<b>Key Ratios (%)</b>								
			(bps)		(bps)			(bps)
Gross Margin	83.2	78.7	455	81.9	126	79.1	80.8	(172)
EBITDA Margin	36.4	32.4	395	29.5	686	31.9	36.0	(415)
Tax / PBT	16.7	8.1	-	19.0	-	7.5	8.2	-
NPM	20.3	23.7	-	16.2	-	22.7	30.1	-
EPS (Rs)	7.0	7.0	0.2	4.8	45.1	28.2	29.9	(5.9)

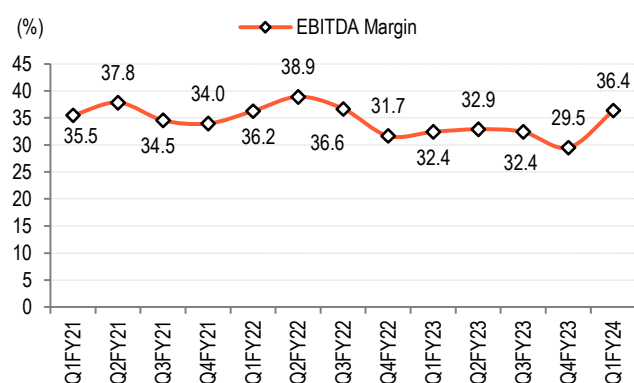
Source: Company, BOBCAPS Research

**Fig 2 – Revenue**

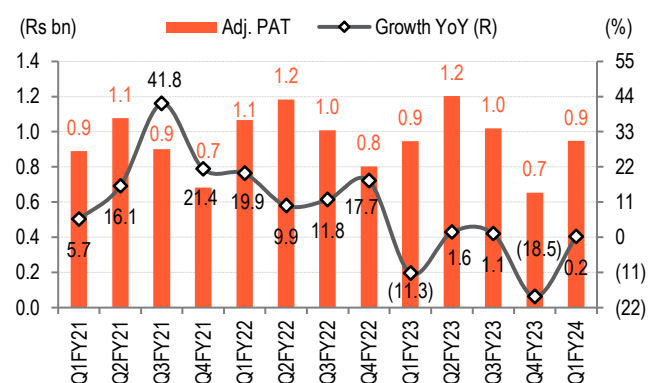
Source: Company, BOBCAPS Research

**Fig 3 – EBITDA**

Source: Company, BOBCAPS Research

**Fig 4 – EBITDA margin**

Source: Company, BOBCAPS Research

**Fig 5 – Adj. PAT**

Source: Company, BOBCAPS Research

## Earnings call highlights

- **Branded formulations:** Branded formulations (ERIS standalone + Oaknet + ERIS MJ) which form 97% of revenue grew 21% YoY to Rs 4.6bn in Q1FY24, accompanied by 30% EBITDA growth to Rs 1.7bn, translating into an EBITDA margin of 37%.
- **Organic portfolio:** ERIS's organic portfolio reported low-double-digit growth, which was ~200bps above market growth for the quarter.
- **Acquired portfolios:** The company has completed the integration of Oaknet. It also retained 75% of sales from the acquired GNP and DRRD's portfolios using its own sales team and expects to reach 100% soon.
- **ERIS MJ:** The joint venture kickstarted the injectable anti-diabetes business with a dedicated field-force of 140 representatives. Management expects ERIS MJ to clock revenue of Rs 500mn in FY24 vs. Rs 170mn in FY23 and to breakeven by Q4FY24. Phase-III clinical trials for Glargine and Liraglutide are complete, with commercial launch expected by Q4FY24.
- **Insulin:** ERIS's insulin sales run-rate increased to Rs 90mn in Q1 and its EBITDA burn reduced to Rs 25mn.
- **Product update:** (1) Sacubitril + Valsartan (Zayo): The combination was relaunched in Jan'23 and have seen revenue ramp up to ~Rs 20mn per month as of June. (2) FCM injection: This anti-anaemia medication is open for re-commercialisation through a non-infringing route, as per the latest court verdict. (3) Linagliptin: The drug loses exclusivity in Aug'23 and commercial relaunch is scheduled thereafter.
- **Guwahati facility:** Total investment made on the Guwahati facility is Rs 2.3bn.
- **Depreciation:** Depreciation and amortization surged YoY on account of acquisitions and, to a lesser extent, commissioning of the new Guwahati facility. ERIS expects a quarterly depreciation run-rate of Rs 410mn, translating to ~Rs 1.6bn for the entire year.
- **Debt:** Net debt reduced from Rs 7.7bn at FY23-end to Rs 6.7bn in Q1FY24. Management aims to bring debt below Rs 4bn by the end of FY24.
- **Capex:** ERIS indicated that it has no capex requirement in FY24, except for maintenance capex which would be 2-3% of gross block.
- **Tax rate:** The effective Q1 tax rate stood at 17% and that for FY24 is guided at 14-16%.
- **M&A:** No acquisitions are on the cards for the next couple of years, barring exceptional cases.

## Valuation methodology

We remain positive on ERIS given sustained traction in Oaknet business and the acquired portfolios of DRRD and GNP. Post Q1, we raise our FY24/FY25 EBITDA estimates by 5%/12% and apply a higher target EV/EBITDA multiple of 16x (earlier 15x) to the stock – a 10% discount to the five-year average – to reflect visible gross margin improvement towards the company's long-term average. Our TP stands revised to Rs 955 (earlier Rs 800). Further gross margin expansion should come from the shifting of outsourced manufacturing to the newly commissioned Gujarat facility. Maintain BUY

**Fig 6 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	19.8	22.7	19.8	22.7	0.0	0.0
EBITDA	6.8	8.6	6.5	7.7	4.5	11.7
EBITDA margin (%)	34.5	38.0	33.0	34.0	148	396
EPS (Rs)	30.8	40.3	31.0	34.9	(0.7)	15.6

Source: BOBCAPS Research

**Fig 7 – Key assumptions**

(Rs bn)	FY23A	FY24E	FY25E
Sales	16.9	19.8	22.7
EBITDA	5.4	6.8	8.6
EBITDA margin (%)	31.9	34.5	38.0
EPS (Rs)	28.1	30.8	40.3

Source: Company, BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- delays in launch/ramp-up of new products,
- weaker supply security of products not manufactured in-house,
- adverse policy decision on fixed dose combination drugs, and
- inclusion of the company's products into the National List of Essential Medicines (NLEM) that carry a price cap.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.7	1,746	1,860	BUY
Alembic Pharma	ALPM IN	1.9	793	615	HOLD
Alkem Labs	ALKEM IN	6.0	4,132	3,000	SELL
Cipla	CIPLA IN	12.0	1,224	1,250	BUY
Divi's Labs	DIVI IN	12.6	3,911	3,200	HOLD
Dr Reddy's Labs	DRRD IN	11.4	5,631	4,900	HOLD
Eris Lifesciences	ERIS IN	1.4	828	955	BUY
Glenmark Life Sciences	GLS IN	1.0	648	620	HOLD
Laurus Labs	LAURUS IN	2.6	400	340	HOLD
Lupin	LPC IN	6.0	1,081	800	SELL
Sun Pharma	SUNP IN	33.9	1,161	1,160	HOLD

Source: BOBCAPS Research, NSE | Price as of 7 Aug 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Total revenue</b>	<b>12,119</b>	<b>13,470</b>	<b>16,851</b>	<b>19,808</b>	<b>22,742</b>
EBITDA	4,306	4,849	5,367	6,836	8,636
Depreciation	430	647	1,171	1,567	1,693
EBIT	3,876	4,202	4,197	5,268	6,943
Net interest inc./(exp.)	(18)	(41)	(262)	(406)	(286)
Other inc./(exp.)	87	261	112	71	34
Exceptional items	0	0	0	0	0
EBT	3,945	4,421	4,046	4,933	6,691
Income taxes	394	364	305	740	1,204
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	(3)	(80)	0	0
<b>Reported net profit</b>	<b>3,551</b>	<b>4,060</b>	<b>3,822</b>	<b>4,193</b>	<b>5,487</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>3,551</b>	<b>4,060</b>	<b>3,822</b>	<b>4,193</b>	<b>5,487</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	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	24,268	27,852
Shareholders' fund	14,253	17,112	22,044	24,404	27,988
<b>Total liab. and equities</b>	<b>16,341</b>	<b>20,256</b>	<b>34,160</b>	<b>32,907</b>	<b>37,048</b>
Cash and cash eq.	383	523	585	836	5,246
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
<b>Total assets</b>	<b>16,341</b>	<b>20,256</b>	<b>34,160</b>	<b>32,907</b>	<b>37,048</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Cash flow from operations</b>	<b>3,072</b>	<b>4,384</b>	<b>4,102</b>	<b>6,889</b>	<b>7,106</b>
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
<b>Cash flow from investing</b>	<b>(2,218)</b>	<b>(2,152)</b>	<b>(4,886)</b>	<b>(1,340)</b>	<b>(1,447)</b>
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
<b>Cash flow from financing</b>	<b>(1,144)</b>	<b>(2,091)</b>	<b>846</b>	<b>(5,298)</b>	<b>(1,249)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(290)</b>	<b>141</b>	<b>62</b>	<b>251</b>	<b>4,410</b>
<b>Closing cash &amp; cash eq.</b>	<b>383</b>	<b>523</b>	<b>585</b>	<b>836</b>	<b>5,246</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	26.2	29.9	28.1	30.9	40.4
Adjusted EPS	26.2	29.9	28.1	30.9	40.4
Dividend per share	5.5	6.0	8.0	10.0	12.0
Book value per share	105.0	126.0	160.5	179.7	206.1

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	9.2	8.3	6.6	5.9	5.2
EV/EBITDA	25.8	23.0	20.8	17.0	13.7
Adjusted P/E	31.7	27.7	29.4	26.8	20.5
P/BV	7.9	6.6	5.2	4.6	4.0

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	90.0	91.8	94.4	85.0	82.0
Interest burden (PBT/EBIT)	101.8	105.2	96.4	93.6	96.4
EBIT margin (EBIT/Revenue)	32.0	31.2	24.9	26.6	30.5
Asset turnover (Rev./Avg TA)	23.2	20.9	17.3	16.5	18.4
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.3	1.3	1.2
<b>Adjusted ROAE</b>	<b>27.3</b>	<b>25.9</b>	<b>19.6</b>	<b>18.2</b>	<b>20.9</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	12.8	11.1	25.1	17.5	14.8
EBITDA	16.9	12.6	10.7	27.4	26.3
Adjusted EPS	19.8	14.3	(5.9)	9.7	30.8
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	35.5	36.0	31.9	34.5	38.0
EBIT margin	32.0	31.2	24.9	26.6	30.5
Adjusted profit margin	29.3	30.1	22.7	21.2	24.1
Adjusted ROAE	27.3	25.9	19.6	18.2	20.9
ROCE	30.4	27.7	17.7	17.8	22.5
<b>Working capital days (days)</b>					
Receivables	43	44	64	50	50
Inventory	29	32	29	32	30
Payables	31	32	27	30	30
<b>Ratios (x)</b>					
Gross asset turnover	1.3	1.4	1.0	1.1	1.2
Current ratio	2.4	2.4	2.4	2.1	3.1
Net interest coverage ratio	215.1	101.3	16.0	13.0	24.3
<b>Adjusted debt/equity</b>	<b>(0.1)</b>	<b>0.0</b>	<b>0.4</b>	<b>0.1</b>	<b>0.0</b>

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

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**BUY** – Expected return >+15%

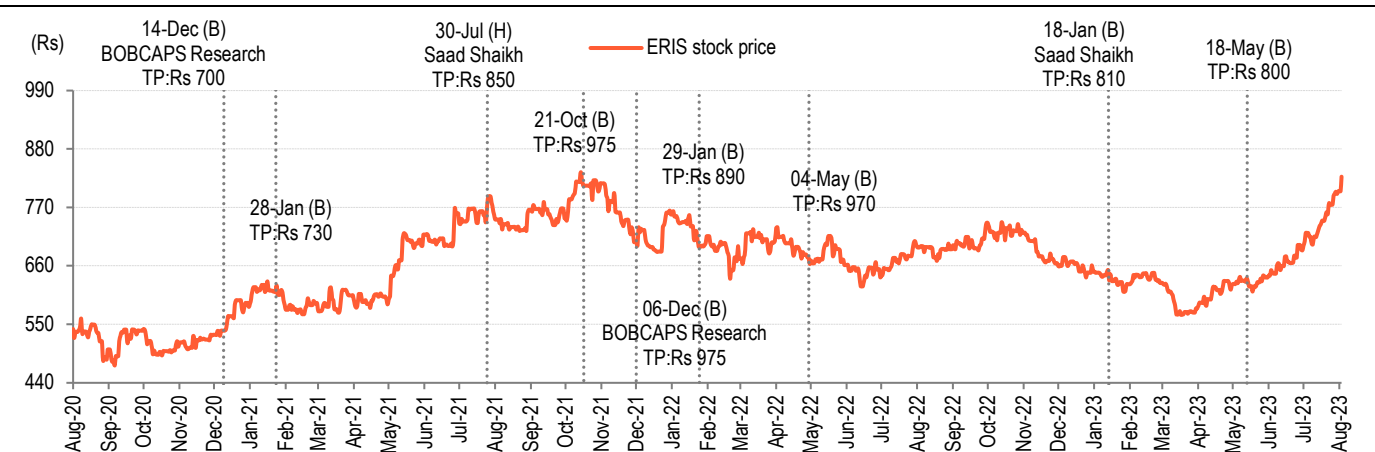
**HOLD** – Expected return from -6% to +15%

**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)



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

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