

HOLD

TP: Rs 850 | ▲ 10%

ERIS LIFESCIENCES

| Pharmaceuticals

| 30 July 2021

Strong quarter; cut to HOLD post recent rally

- Q1 EBITDA/PAT growth strong at 22%/20% YoY to Rs 1.3bn/Rs 1.1bn, meeting street estimates
- New greenfield facility announced for sterile injectables and oral liquids, with phase-I outlay of Rs 1.2bn-1.3bn
- TP revised to Rs 850 (vs. Rs 730); downgrade from BUY to HOLD post 30% rally in the last three months

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Sustained traction in core therapies: ERIS's Q1FY22 consolidated revenue grew 19% YoY to Rs 3.5bn on the back of (1) strong 11.6% growth in the cardio-metabolic segment (58% of sales) (2) 52.5% growth in the vitamins and minerals portfolio (VMN, 23% of sales). The company's top 3 therapies accounted for 88% of the Q1 topline. Chronic (63%) and sub-chronic (29%) therapies together formed 92% share.

Margin expands despite normalisation of A&P expense: Owing to higher in-house manufacturing (81% in Q1 vs. 60% in Q4FY21), EBITDA margin expanded 76bps YoY and 225bps QoQ to 36.2% in Q1. Management has maintained EBITDA margin guidance in the range of 38-40%.

Change in D&A policy: ERIS has reassessed its depreciation & amortisation policy and will be depreciating all assets on SLM basis vs. written down value method earlier, in line with industry practices. The company also revised the useful life of brands to 20 years from 50 years. Consequent to this, D&A expense increased by Rs 18mn in Q1.

New greenfield facility in Gujarat: Management announced a new greenfield facility to be commissioned by end-FY22. Phase-I outlay will total Rs 1.2bn-1.3bn (75% to be deployed in FY22) to be funded through internal accruals. This investment would help ERIS to increase in-house manufacturing, have better control over quality and cost, provide supply security and mitigate risk associated with single-location operations. The facility will be 10-12x larger than the Guwahati plant, house an R&D unit and manufacture dosage forms such as sterile injectables and oral liquids. It will attract a tax rate of 15%.

Cut to HOLD post stock rally: We marginally raise expected FY23 EPS and roll to a Jun'22 TP of Rs 850 (vs. Rs 730), based on a higher one-year forward EV/EBITDA multiple of 21.5x (vs. 20x). This implies a P/E of 26x vs. 24x for branded peers. The stock has run up ~30% in the last three months and is trading at 19x EV/EBITDA and 24x PE on Jun'22E valuations. Upsides look capped, driving our rating downgrade from BUY to HOLD.

Key changes

Target	Rating
▲	▼

Ticker/Price	ERIS IN/Rs 771
Market cap	US\$ 1.4bn
Free float	25%
3M ADV	US\$ 2.4mn
52wk high/low	Rs 793/Rs 441
Promoter/FPI/DII	53%/13%/10%

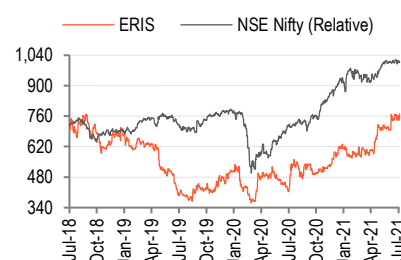
Source: NSE | Price as of 29 Jul 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	12,119	13,884	15,927
EBITDA (Rs mn)	4,306	5,113	6,161
Adj. net profit (Rs mn)	3,551	4,130	5,095
Adj. EPS (Rs)	26.2	30.4	37.5
Consensus EPS (Rs)	26.2	29.7	33.6
Adj. ROAE (%)	27.3	26.1	26.3
Adj. P/E (x)	29.5	25.4	20.6
EV/EBITDA (x)	24.0	20.3	16.6
Adj. EPS growth (%)	19.8	16.3	23.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- ERIS launched three products in Q1 and expects to introduce seven more in FY22.
- The sales run-rate for Gluxit/Zomelis stood at Rs 27mn/Rs 48mn in Jun'21
- MR strength totals 2,000 and ERIS could add one division (100 MRs) in FY22. Sales productivity increased to Rs 0.5mn in Q1 from Rs 0.42mn at FY21-end.
- Guwahati plant tax exemption is available until the end of FY24.

Fig 1 – Quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Net Sales	3,493	2,932	19.1	2,782	25.5
EBITDA	1,265	1,040	21.7	945	33.9
Depreciation	145	104	-	115	-
EBIT	1,120	936	19.7	831	34.9
Interest	8	4	-	5	-
Other Income	59	13	-	22	-
PBT	1,171	945	23.9	847	38.2
Less: Taxation	104	56	-	165	-
Less: Minority Interest	-	-	-	-	-
Recurring PAT	1,067	889	19.9	682	56.3
Exceptional items	0	0	-	0	-
Reported PAT	1,067	889	19.9	682	56.3
Key Ratios (%)			(bps)		(bps)
Gross Margin	80.3	80.4	(7)	78.3	200
EBITDA Margin	36.2	35.5	76	34.0	225
Tax / PBT	8.9	5.9	-	19.5	-
NPM	30.5	30.3	-	24.5	-
EPS (Rs)	7.9	6.6	-	5.0	-

Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Cardio Metabolic + VMN	2,784	2,304	20.8	2,167	28.5
Cardio Metabolic (diabetes & cardiac)	1,993	1,786	11.6	1,646	21.1
VMN	790	518	52.5	521	51.7
Others	653	576	13.4	576	13.4
Other Op. Revenue	56	52	8.8	40	42.0
Revenues	3,493	2,932	19.1	2,782	25.5

Source: Company, BOBCAPS Research

Valuation methodology

ERIS has taken corrective steps to catalyse sales (rationalisation of tail brand portfolio), adopted a new cluster-based approach (sharper focus on cardio-metabolic 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, D&A policy change and reduction in useful life of brands will help alleviate investor concerns.

We marginally increase our FY23 EPS estimate by 4% and raise our one-year forward EV/EBITDA multiple to 21.5x (from 20x) to factor in the improved sales growth outlook. Our multiple implies a P/E of 26x vs. 24x for branded peers. On rollover, we have a revised Jun'22 TP of Rs 850 (vs. Rs 730). The stock has run up ~30% in the last three months and is currently trading at 24x P/E and 19x EV/EBITDA on Jun'22E valuations. Upsides look capped at these levels, driving our rating downgrade from BUY to HOLD.

Fig 3 – Revised estimates

(Rs mn)	New			Old		Change (%)	
	FY22E	FY23E	FY24E	FY22E	FY23E	FY22E	FY23E
Sales	13.9	15.9	17.9	13.6	15.4	2.3	3.7
EBITDA	5.1	6.2	7.0	5.0	5.8	2.9	6.1
EBITDA Margin (%)	36.8	38.7	39.4	36.6	37.8	18	87
EPS (Rs)	30.4	37.5	43.4	30.3	36.2	0.4	3.6

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Cardio-Metabolic	6,815	8,013	9,427	10,841
VMN	2,312	2,659	3,058	3,364
Others	2,799	3,012	3,243	3,492
Operating Revenue	11,926	13,684	15,727	17,697

Source: Company, BOBCAPS Research

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 Teneeligiptin, 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 FY23E sales). The business operates in a dynamic regulatory environment marred by uncertainty over proposed changes related to trade margins.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	10,741	12,119	13,884	15,927	17,897
EBITDA	3,684	4,306	5,113	6,161	7,047
Depreciation	503	430	641	720	779
EBIT	3,181	3,876	4,472	5,440	6,268
Net interest inc./(exp.)	(22)	(18)	(2)	0	0
Other inc./(exp.)	154	87	68	158	277
Exceptional items	0	0	0	0	0
EBT	3,313	3,945	4,538	5,598	6,545
Income taxes	349	394	408	504	654
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	2,965	3,551	4,130	5,095	5,890
Adjustments	0	0	0	0	0
Adjusted net profit	2,965	3,551	4,130	5,095	5,890

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	1,000	1,026	1,125	1,293	1,455
Other current liabilities	490	406	547	629	708
Provisions	562	588	675	776	873
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	17,297	21,125	25,433
Shareholders' fund	11,761	14,253	17,433	21,261	25,568
Total liab. and equities	13,813	16,341	19,780	23,959	28,604
Cash and cash eq.	673	383	3,164	6,361	11,068
Accounts receivables	1,569	1,405	1,500	1,939	1,697
Inventories	695	945	1,125	1,508	1,552
Other current assets	1,305	2,114	1,793	2,060	2,318
Investments	780	2,940	2,940	2,940	2,940
Net fixed assets	873	779	1,825	2,057	2,276
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	19,780	23,959	28,604

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	3,228	3,072	5,146	5,075	6,947
Capital expenditures	(1,309)	(378)	(1,687)	(952)	(998)
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	(2,539)	(1,687)	(952)	(998)
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)	(2)	341	341	341
Cash flow from financing	(4,100)	(823)	(678)	(925)	(1,242)
Chg in cash & cash eq.	598	(290)	2,781	3,197	4,707
Closing cash & cash eq.	673	383	3,164	6,361	11,068

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	21.8	26.2	30.4	37.5	43.4
Adjusted EPS	21.8	26.2	30.4	37.5	43.4
Dividend per share	2.9	5.5	6.0	8.0	10.0
Book value per share	86.6	105.0	128.4	156.6	188.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	9.8	8.5	7.5	6.4	5.6
EV/EBITDA	28.6	24.0	20.3	16.6	14.1
Adjusted P/E	35.3	29.5	25.4	20.6	17.8
P/BV	8.9	7.3	6.0	4.9	4.1

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	89.5	90.0	91.0	91.0	90.0
Interest burden (PBT/EBIT)	104.2	101.8	101.5	102.9	104.4
EBIT margin (EBIT/Revenue)	29.6	32.0	32.2	34.2	35.0
Asset turnover (Rev./Avg TA)	22.1	23.2	21.9	20.6	19.1
Leverage (Avg TA/Avg Equity)	1.1	1.0	1.0	1.0	1.0
Adjusted ROAE	26.5	27.3	26.1	26.3	25.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	9.4	12.8	14.6	14.7	12.4
EBITDA	6.8	16.9	18.7	20.5	14.4
Adjusted EPS	2.0	19.8	16.3	23.4	15.6
Profitability & Return ratios (%)					
EBITDA margin	34.3	35.5	36.8	38.7	39.4
EBIT margin	29.6	32.0	32.2	34.2	35.0
Adjusted profit margin	27.6	29.3	29.7	32.0	32.9
Adjusted ROAE	26.5	27.3	26.1	26.3	25.2
ROCE	27.5	30.4	28.6	28.9	28.0
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	1.2	1.2	1.3	1.3
Current ratio	2.1	2.4	3.2	4.4	5.5
Net interest coverage ratio	147.3	215.1	2,199.6		
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.3)	(0.5)

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

Disclaimer

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

BUY – Expected return >+15%

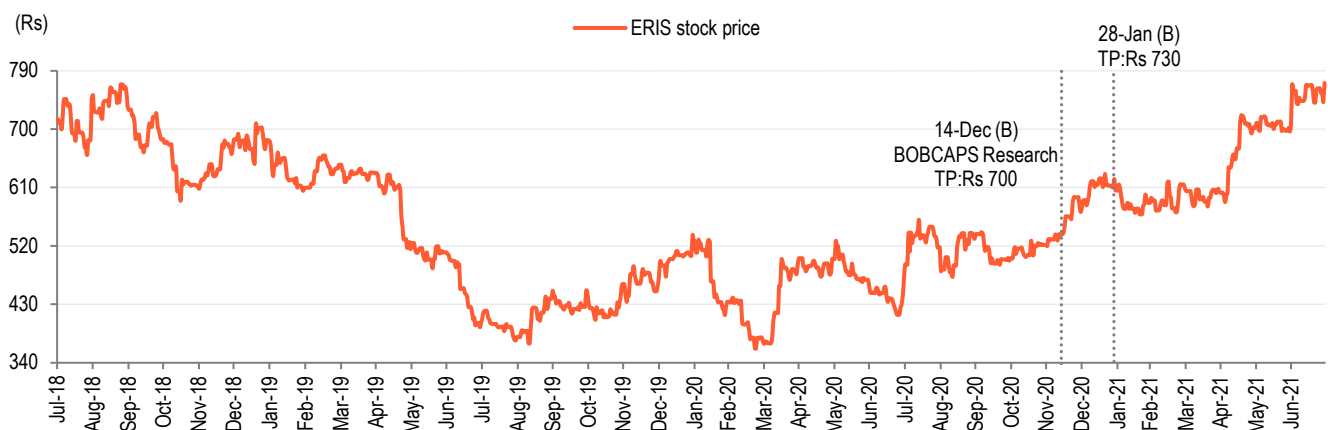
HOLD – Expected return from -6% to +15%

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

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