

**BUY**

TP: Rs 730 | ▲ 17%

**ERIS LIFESCIENCES**

Pharmaceuticals

28 January 2021

## Healthy Q3; chronic franchise and FCF growth to unlock value

Eris Lifesciences (ERIS) reported a healthy Q3 with a 3% revenue beat led by superior execution on the core cardio-metabolic and VMN portfolios (~78% of sales). Growth rebound in the acute portfolio (15% YoY vs. -1% for the covered market), upcoming high-value launches in Q4 and reduction in debtors were highlights. EBITDA margin stood at 34.5% (+572bps YoY on low base). ERIS expects 15% topline growth and margin expansion in FY22. We retain BUY and raise Mar'22 TP to Rs 730 (vs. Rs 700) as we tweak EPS estimates.

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**Strong FY22 sales guidance backed by organic portfolio:** Q3 revenue growth of 16.5% YoY came on the back of a 14%/37% rise in the cardio-metabolic and VMN segments. ZAC D (launched in Q2) led to stellar growth in VMN. ERIS is guiding for 15% sales growth in FY22 steered by the organic portfolio (new launches, doctor reach expansion, higher MR productivity). It has launched three brands in Q3 (incl. Dapagliflozin in the SGLT 2 segment, Rivaroxaban) and expects Rs 1bn in sales each over five years. We continue to believe strong product selection, emerging off-patent upsides in cardio-diabetes, Zomelis scale-up and Rx penetration in the cardiac and VMN segments would support ~13% sales CAGR over FY21-FY24 (>16% in chronic).

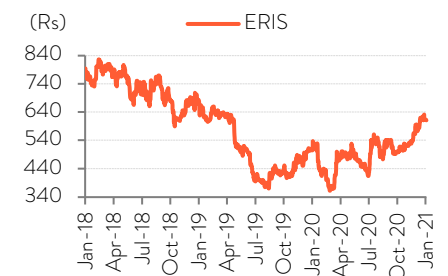
**Q3 margins set to expand; OCF conversion stays strong:** Gross margins expanded 120bps QoQ to 82% and EBITDA margins were at 34.5% (-330bps QoQ) on higher SGA spends. Management expects to retain margins in Q4 but to see operating leverage from launches in FY22. The Guwahati plant is utilised ~40% on a 3-shift basis. OCF/EBITDA conversion was at 93%.

**Earnings call takeaways:** (1) Expect three launches in Q4 (incl. Dapagliflozin + Metformin combo). (2) Debtors at 43 days in Q3; target of 30 days by FY22. (3) Zomelis tracking at Rs 400mn annually. (4) Limited M&A bandwidth.

Ticker/Price	ERIS IN/Rs 623
Market cap	US\$ 1.2bn
Shares o/s	136mn
3M ADV	US\$ 1.4mn
52wk high/low	Rs 643/Rs 321
Promoter/FPI/DII	54%/11%/11%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	9,822	10,741	11,903	13,566	15,355
EBITDA (Rs mn)	3,449	3,684	4,174	4,971	5,806
Adj. net profit (Rs mn)	2,908	2,965	3,346	4,113	4,910
Adj. EPS (Rs)	21.4	21.8	24.6	30.3	36.2
Adj. EPS growth (%)	(1.1)	2.0	12.9	22.9	19.4
Adj. ROAE (%)	31.1	26.5	25.7	26.0	25.5
Adj. P/E (x)	29.1	28.5	25.3	20.6	17.2
EV/EBITDA (x)	24.5	23.1	19.9	16.5	13.6

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Q3FY21E	Var (%)	9MFY21	9MFY20	YoY (%)
<b>Net Sales</b>	<b>3,104</b>	<b>2,664</b>	<b>16.5</b>	<b>3,300</b>	<b>(5.9)</b>	<b>3,004</b>	<b>3.3</b>	<b>9,336</b>	<b>8,255</b>	<b>13.1</b>
<b>EBITDA</b>	<b>1,072</b>	<b>768</b>	<b>39.6</b>	<b>1,248</b>	<b>(14.1)</b>	<b>1,088</b>	<b>(1.4)</b>	<b>3,360</b>	<b>2,914</b>	<b>15.3</b>
Depreciation	106	127	-	106		120	-	315	359	-
<b>EBIT</b>	<b>966</b>	<b>641</b>	<b>50.7</b>	<b>1,142</b>	<b>(15.4)</b>	<b>968</b>	<b>-</b>	<b>3,045</b>	<b>2,555</b>	<b>19.2</b>
Interest	4	4	-	5	-	4	-	13	18	-
Other Income	31	85	-	21	-	40	-	65	165	-
<b>PBT</b>	<b>993</b>	<b>722</b>	<b>37.6</b>	<b>1,159</b>	<b>(14.3)</b>	<b>1,004</b>	<b>(1.1)</b>	<b>3,097</b>	<b>2,701</b>	<b>14.6</b>
Less: Taxation	91	86	-	81	-	80	-	229	296	-
Less: Minority Interest	-	-	-	-	-	0	-	-	-	-
<b>Recurring PAT</b>	<b>902</b>	<b>636</b>	<b>41.8</b>	<b>1,077</b>	<b>(16.3)</b>	<b>924</b>	<b>(2.4)</b>	<b>2,868</b>	<b>2,406</b>	<b>19.2</b>
Exceptional items	0	0		0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>902</b>	<b>636</b>	<b>41.8</b>	<b>1,077</b>	<b>(16.3)</b>	<b>924</b>	<b>(2.4)</b>	<b>2,868</b>	<b>2,406</b>	<b>19.2</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>					
Gross Margin	81.8	83.9	(211)	80.7	116	81.3	-	81.0	83.7	-
EBITDA Margin	34.5	28.8	572	37.8	(327)	36.2	-	36.0	35.3	-
Tax / PBT	9.2	11.9	-	7.0		8.0	-	7.4	10.9	-
NPM	29.0	23.9	517	32.7	(361)	30.8	-	30.7	29.1	-
<b>EPS (Rs)</b>	<b>6.6</b>	<b>4.7</b>	<b>-</b>	<b>7.9</b>	<b>-</b>	<b>6.8</b>	<b>-</b>	<b>21.1</b>	<b>17.5</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Cardio Metabolic + VMN	2,379	2,010	18.4	2,602	(8.6)	7,285	6,557	11.1
Cardio Metabolic (diabetes & cardiac)	1,830	1,610	13.7	1,952	(6.2)	5,567	4,953	12.4
VMN	549	400	37.1	651	(15.6)	1,718	1,603	7.1
Others	671	607	10.5	651	3.1	1,897	1,584	19.8
<b>Revenues</b>	<b>3,050</b>	<b>2,618</b>	<b>16.5</b>	<b>3,253</b>	<b>(6.2)</b>	<b>9,183</b>	<b>8,141</b>	<b>12.8</b>

Source: Company, BOBCAPS Research

## Valuation methodology

We retain our BUY rating and raise our Mar'22 price target to Rs 730 (from Rs 700), based on an unchanged 20x FY23E EBITDA (implied P/E of 20x). We marginally increase FY22/FY23 EPS estimates by 3-4% to factor in an improved sales growth outlook. The stock is currently trading at compelling valuations of 17x P/E and 14x EV/EBITDA on FY23E, which is ~30% below the three-year mean and at ~40% discount to Indian branded generic players.

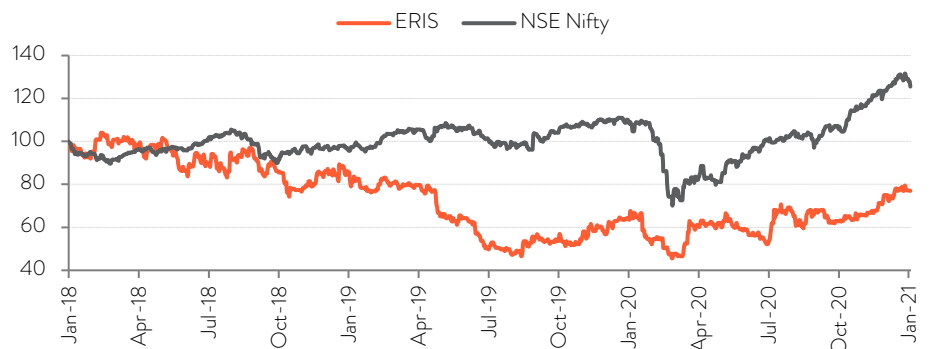
ERIS has significantly underperformed the BSE Healthcare index over the last six months, one year and two years by 20%, 20% and 40% respectively, due to concerns over a weak earnings profile and delayed turnaround from acquisitions. During the last 12 months, the company has taken corrective steps (rationalisation 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 9MFY21 sales growth and margins. ERIS also owns a decent chronic franchise with stronger prescription rankings than peers in diabetes and cardiac therapy.

We expect the stock to witness a rerating over the next 12 months led by (1) its underappreciated chronic franchise (~75% of EBITDA), (2) expected earnings growth rebound to 18% CAGR over FY21-FY24, and (3) accompanying ROIC expansion to +55% by FY24E – better than our pharma coverage and higher than the average for MNCs ex-Abbott – with the optionality of better capital allocation between M&A and payouts than in the past.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	11.9	13.6	15.4	11.9	13.3	15.0	0.0	1.6	2.5
EBITDA	4.2	5.0	5.8	4.2	4.9	5.6	0.0	2.2	3.6
EBITDA margin (%)	35.1	36.6	37.8	35.1	36.4	37.4	0bps	22bps	43bps
EPS (Rs)	25	30	36	25	30	35	0.0	2.5	4.0

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**

Source: NSE

### 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 exceptions of molecules like Tenzeligiptin, Gliclazide, Rosuvastatin where its price is 10-15% higher than drug average price for all the players (these accounted for 15% of FY20 sales). Any slowdown in IPM growth and delay in new launches can hurt earnings.
- Risk of trade margin capping for generics business:** ERIS has forayed into trade generics recently (to contribute ~8% of FY23E sales). This 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)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>9,822</b>	<b>10,741</b>	<b>11,903</b>	<b>13,566</b>	<b>15,355</b>
EBITDA	3,449	3,684	4,174	4,971	5,806
Depreciation	364	503	579	614	663
EBIT	3,085	3,181	3,595	4,357	5,143
Net interest income/(expenses)	(229)	(22)	0	0	0
Other income/(expenses)	317	154	82	163	253
Exceptional items	0	0	0	0	0
EBT	3,174	3,313	3,677	4,520	5,396
Income taxes	262	349	331	407	486
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	4	0	0	0	0
<b>Reported net profit</b>	<b>2,908</b>	<b>2,965</b>	<b>3,346</b>	<b>4,113</b>	<b>4,910</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,908</b>	<b>2,965</b>	<b>3,346</b>	<b>4,113</b>	<b>4,910</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	841	1,000	965	1,102	1,249
Other current liabilities	322	490	470	536	608
Provisions	404	562	624	712	807
Debt funds	1,764	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	138	136	136	136	136
Reserves & surplus	10,620	11,626	14,101	17,264	20,907
Shareholders' fund	10,758	11,761	14,236	17,399	21,043
<b>Total liabilities and equities</b>	<b>14,088</b>	<b>13,813</b>	<b>16,295</b>	<b>19,750</b>	<b>23,707</b>
Cash and cash eq.	75	673	3,294	6,061	9,278
Accounts receivables	840	1,569	1,126	1,286	1,457
Inventories	827	695	965	1,102	1,249
Other current assets	1,156	1,305	1,539	1,756	1,991
Investments	3,559	780	780	780	780
Net fixed assets	553	873	672	845	1,032
CWIP	27	44	44	44	44
Intangible assets	7,052	7,876	7,876	7,876	7,876
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>14,088</b>	<b>13,814</b>	<b>16,295</b>	<b>19,750</b>	<b>23,707</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	3,271	3,468	3,925	4,727	5,573
Interest expenses	229	22	0	0	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(604)	(261)	(55)	(222)	(239)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>2,896</b>	<b>3,228</b>	<b>3,870</b>	<b>4,504</b>	<b>5,334</b>
Capital expenditures	(50)	(1,309)	(378)	(787)	(850)
Change in investments	95	2,779	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>45</b>	<b>1,470</b>	<b>(378)</b>	<b>(787)</b>	<b>(850)</b>
Equities issued/Others	0	(2)	0	0	0
Debt raised/repaid	(2,004)	(1,764)	0	0	0
Interest expenses	(229)	(22)	0	0	0
Dividends paid	0	(467)	(871)	(950)	(1,267)
Other financing cash flows	(740)	(1,846)	0	0	0
<b>Cash flow from financing</b>	<b>(2,973)</b>	<b>(4,100)</b>	<b>(871)</b>	<b>(950)</b>	<b>(1,267)</b>
<b>Changes in cash and cash eq.</b>	<b>(31)</b>	<b>598</b>	<b>2,621</b>	<b>2,767</b>	<b>3,217</b>
<b>Closing cash and cash eq.</b>	<b>75</b>	<b>673</b>	<b>3,294</b>	<b>6,061</b>	<b>9,278</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	21.4	21.8	24.6	30.3	36.2
Adjusted EPS	21.4	21.8	24.6	30.3	36.2
Dividend per share	0.0	2.9	5.5	6.0	8.0
Book value per share	77.9	86.6	104.8	128.1	155.0

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	8.6	7.9	7.0	6.0	5.2
EV/EBITDA	24.5	23.1	19.9	16.5	13.6
Adjusted P/E	29.1	28.5	25.3	20.6	17.2
P/BV	8.0	7.2	5.9	4.9	4.0

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	91.6	89.5	91.0	91.0	91.0
Interest burden (PBT/EBIT)	102.9	104.2	102.3	103.7	104.9
EBIT margin (EBIT/Revenue)	31.4	29.6	30.2	32.1	33.5
Asset turnover (Revenue/Avg TA)	19.9	22.1	22.9	21.4	20.0
Leverage (Avg TA/Avg Equity)	1.3	1.1	1.0	1.0	1.0
Adjusted ROAE	31.1	26.5	25.7	26.0	25.5

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	14.8	9.4	10.8	14.0	13.2
EBITDA	7.1	6.8	13.3	19.1	16.8
Adjusted EPS	(1.1)	2.0	12.9	22.9	19.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	35.1	34.3	35.1	36.6	37.8
EBIT margin	31.4	29.6	30.2	32.1	33.5
Adjusted profit margin	29.6	27.6	28.1	30.3	32.0
Adjusted ROAE	31.1	26.5	25.7	26.0	25.5
ROCE	27.6	27.5	28.3	28.6	28.1
<b>Working capital days (days)</b>					
Receivables	32	54	35	35	35
Inventory	31	24	30	30	30
Payables	32	34	30	30	30
<b>Ratios (x)</b>					
Gross asset turnover	1.2	1.1	1.2	1.3	1.3
Current ratio	1.8	2.1	3.4	4.3	5.2
Net interest coverage ratio	13.5	147.3			
Adjusted debt/equity	(0.1)	(0.1)	(0.3)	(0.4)	(0.5)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): ERIS LIFESCIENCES (ERIS IN)



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

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