Eris Lifesciences Limited

Strong fundamentals leading to growth rewards

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Issue Open: June 16, 2017
Issue Close: June 20, 2017

Eris Lifesciences is an Ahmedabad based pharma company. It manufactures and sells branded pharmaceutical products in the chronic and acute therapeutic areas and has 100% domestic focus. The company's 66% revenue contribution is from the chronic segment, while 34% is from the acute segment. It has a formulations facility located in Guwahati.

Focus on niche therapeutic segments: Since its inception, the company has been focusing on chronic and specialty acute therapeutic segments. This strategy has played well for the company, as it has gained market share in most of the therapeutic segments of its focus. This has also helped the company to become 32nd largest company by revenue in domestic pharma industry within a decade.

100% domestic branded generic player: The business of Eris is 100% domestic and the company has no intention to start exports. This, we believe is a differentiated strategy, as it insulates the company form the risk of foreign regulator as well as higher expenses in terms of R&D. This bodes well in the times of heightened regulatory issues in the sector.

Strong track record of growth and profitability: Eris has exhibited a growth CAGR of 16.5% in the top-line over the last five years. Company also has a good EBITDA margin profile, 37% in FY2017, much better than its Indian and MNC peers. Moreover, the margins have seen consistent expansion owing to which, its bottom-line CAGR works out to be 42.6% over the last five years (4.1x growth). Company has strong RoE and RoIC ratios as compared to peers, and we believe that with its specialty focus and marketing & selling capability, it will be able to maintain healthy financial profile going ahead.

Outlook and Valuation: On FY2017 EPS of ₹17.6, the issue is priced at P/E of 34.25x, which is at par with its MNC peers but higher than domestic peer, Alkem Labs. Considering that Eris' faster growth, superior returns, debt free status, and specialty play, we believe that this is a fair valuation. We believe that Eris is likely to continue growing faster than its competitors owing to its marketing capability, higher operating leverage and growing market share of its mother brands. While most pharma companies are currently facing issues on several fronts, this business model looks attractive with no USFDA concerns and pricing pressure. **Considering the company's superior growth, better margin profile and high return ratios, we rate this IPO as SUBSCRIBE.**

Key Financials

Y/E March (₹ cr)	FY14	FY15	FY16	FY17
Net Sales	**509**	**546**	**597**	**725**
% chg	*29.5*	*7.2*	*9.4*	*21.4*
Net Profit	**70**	**89**	**134**	**242**
% chg	*21.0*	*26.7*	*49.7*	*81.2*
OPM (%)	19.4	22.3	28.7	37.1
EPS (Rs)	**5.1**	**6.5**	**9.7**	**17.6**
P/E (x)	117.7	92.9	62.1	34.3
P/BV (x)	47.0	31.2	27.7	15.4
RoE (%)	39.9	33.6	44.6	44.8
RoCE (%)	49.2	38.7	46.4	44.2
EV/Sales (x)	16.1	14.9	13.6	11.1
EV/EBITDA (x)	83.0	66.9	47.3	29.9

Source: Company, Angel Research

Issue Details

Face Value: ₹1

Present Eq. Paid up Capital: ₹13.75cr

Offer for Sale: 2.89cr Shares

Fresh issue: Nil

Post Eq. Paid up Capital: ₹13.75cr

Issue size (amount): *₹1,732cr -**1,741 cr.

Price Band: ₹600-603

Lot Size: 24 shares and in multiple thereafter

Post-issue implied mkt. cap: *₹8,250cr - **₹8,591cr

Promoters holding Pre-Issue: 59.2%

Promoters holding Post-Issue: 55.93%

**Calculated on lower price band*
*** Calculated on upper price band*

Book Building

QIBs	75% of issue
Non-Institutional	15% of issue
Retail	10% of issue

Post Issue Shareholding Pattern

Promoters Group	55.9
DIIs/FIIs/Public & Others	44.1

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Company background

Eris Lifesciences is a Gujarat based Pharma Company. It was started in 2007 by Mr. Amit Bakshi and in the short period of ten years, it has become one of the fastest growing companies in the domestic pharma space. It has also ascended to the 32nd position in terms of market share during this short period. Company develops, manufactures and commercializes branded pharmaceutical products in select therapeutic areas within the chronic and acute categories, such as cardiovascular, anti-diabetics, vitamins, gastroenterology, and anti-infective. Its primary focus has been on developing products in the super specialties in the chronic and acute category, which are linked to lifestyle related disorders.

Company has a formulation facility located in Guwahati (Assam), which contributed 60% of FY2017 revenues (FY2016 - 51.56%). Its manufacturing partner Sozin Flora Pharma constituted 28.16% of its revenue in FY2016 and 18.67% in FY2017. The rest came from third party manufacturing.

Exhibit 1: Revenue mix based on manufacturing facilities

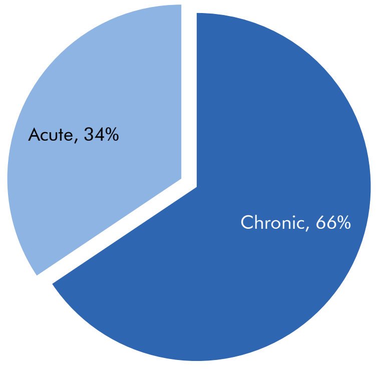
Manufacturer	FY16	FY17
Guwahati (Captive)	52%	59%
Sozin Flora Pharma (partner) – *until August 2016*	28%	19%
Third Party Manufacturers	20%	22%
Total	**100%**	**100%**

Source: Company, Angel Research

Eris is a 100% domestic branded generic player and has no intent to start exporting. Recently, in July 2016, company acquired Amay Pharma's trademarks of 40 brands in cardiovascular and anti-diabetics space for ₹32.9cr. Eris has also purchased 75.5% stake in a musculoskeletal disorder focused pharma company Kinedex for ₹77.2cr. Company has indicated that it will foray in neurological pain, dermatology and gynecology. Eris' top 10 brands have leading market share positions, while 10 mother brands represent 72.5% of its revenues. Company had total 1,501 medical representatives as of March 2017.

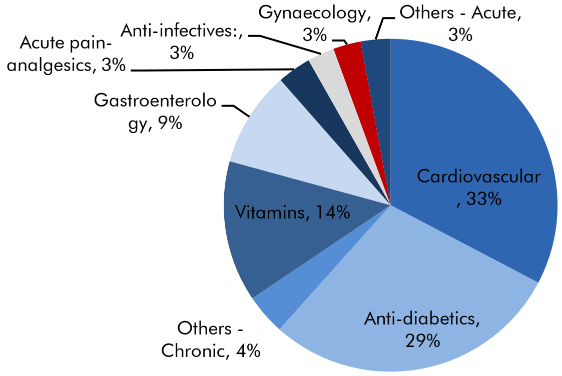
Botticelli, ChrysCapital's investment arm purchased 16.25% equity stake in the company for ₹87.27 per share (total ₹195cr), which is seeking exit from the company through this IPO.

Exhibit 2: Revenue mix (%)



Source: Company, Angel Research

Exhibit 3: Therapeutic segment mix (%)



Source: Company, Angel Research

Issue details

Through this IPO, existing shareholders i.e. ChrysCapital is selling its entire 16.25% shareholding from the company. Promoters are also selling some of their shares in this IPO. This is a 100% OFS issue and no fresh shares will be issued by the company.

Exhibit 4: Pre and Post-IPO shareholding of selling shareholders

Selling shareholders	Pre-issue shares held	Percentage of pre-issue capital	Post issue	Percentage of post- issue capital
Amit Indubhushan Bakshi	54,959,000	40.0%	54,271,500	39.5%
Himanshu Jayantbhai Shah	6,972,000	5.1%	6,284,500	4.6%
Inderjeet Singh Negi	6,971,000	5.1%	5,939,833	4.3%
Kaushal Kamlesh Shah	5,500,000	4.0%	4,468,833	3.3%
Mr. Rajendrakumar Rambhai Patel	6,971,000	5.1%	5,939,834	4.3%
Botticelli (ChrysCapital)	22,344,000	16.3%	Nil	Nil
Bhikhabhai Chimanlal Shah	12,429,000	9.0%	11,054,000	8.0%
Hetal Rasiklal Shah	5,500,000	4.0%	4,812,500	3.5%
Total	**121,646,000**	**88.5%**	**92,771,000**	**67.5%**

Source: Company, Angel Research

Objects of the offer

- Achieve the benefits of listing of the equity shares on the stock exchanges
- Sale of up to 28,875,000 Equity Shares by the Selling Shareholders

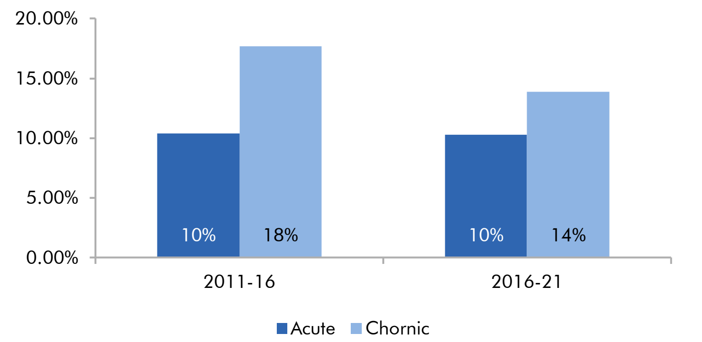
Investment Rationale

Chronic segment focus, a right strategy since inception: Since its incorporation, company has maintained its focus on bringing products primarily focused on therapeutic areas, which require the intervention of specialists and super specialists. This means focus on chronic segments like cardiology, diabetology, etc. The company is also focused on the acute therapeutic segments, which are linked to the lifestyle diseases such as, Gynecology, gastroenterology, etc. This has proved beneficial for the company, as it has differentiated itself by focusing on the segments in which it can use its sales and marketing expertise.

The strategy to focus on the chronic and lifestyle related acute therapies is a right strategy, as most pharma companies in Indian market are also focusing on the chronic segment. The Indian Pharma Market (IPM) is also witnessing this change. While acute is the largest segment in IPM, the growth of this segment has been slower (10.40%) than that of chronic segment (17.70%) from 2011 to 2016. Due to the faster growth, share of chronic therapies is going up in the IPM. It is believed that by 2021, chronic therapies will contribute 37% of IPM revenues v/s. 34% in 2016 and 27% in 2011.

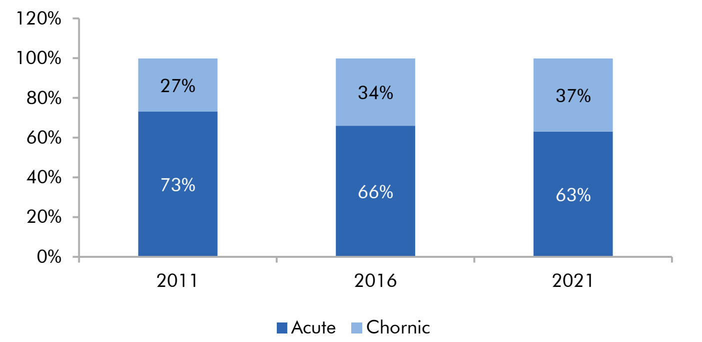
Chronic diseases like cancer, diabetes, cardiovascular, etc. are caused due to the change in the lifestyle and sometimes they are also not curable. These types of diseases also require prolonged medication. On the other hand, acute diseases are the ones where the market is competitive and they are mainly treated by general practitioners (GPs) and consulting physicians (CPs). Some indications from acute therapies are also moving to the OTC segment, where the already established brands have better chance to perform. The chronic therapies, however, are complex and need special attention by the specialists. This means that companies with strong relationship with doctors are better placed to benefit from pricing advantage and can fare better than others.

Exhibit 5: Chronic therapies to grow faster...



Source: Company, Angel Research

Exhibit 6: ...shifting IPM revenue mix

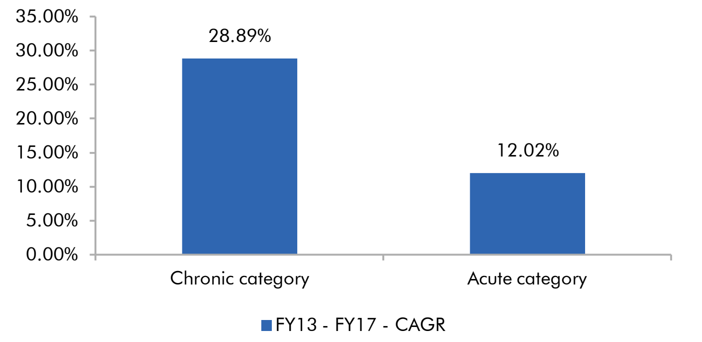


Source: Company, Angel Research

Strong track record of growth: Eris' portfolio is tilted more towards the chronic segment, which represents 66% of its sales. The revenue from the chronic segment has grown at a CAGR of 29% over FY2013-17. The acute segment revenue represents the rest 34% business mix and has grown at a CAGR of 12% during the same period. Due to the higher contribution from the high growth chronic segment, company has been able to outperform the IPM growth so far. Eris' top-line has grown at a CAGR of 21.7% over FY2013-17, giving a strong outperformance v/s. IPM growth of ~12% during this period.

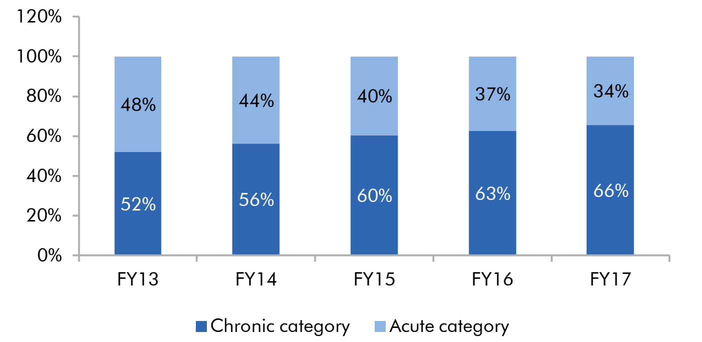
While the chronic play has benefitted the company, the promoter's experience in pharma marketing has also paid the company richly.

Exhibit 7: Eris' fastest growing segment - Chronic



Source: Company

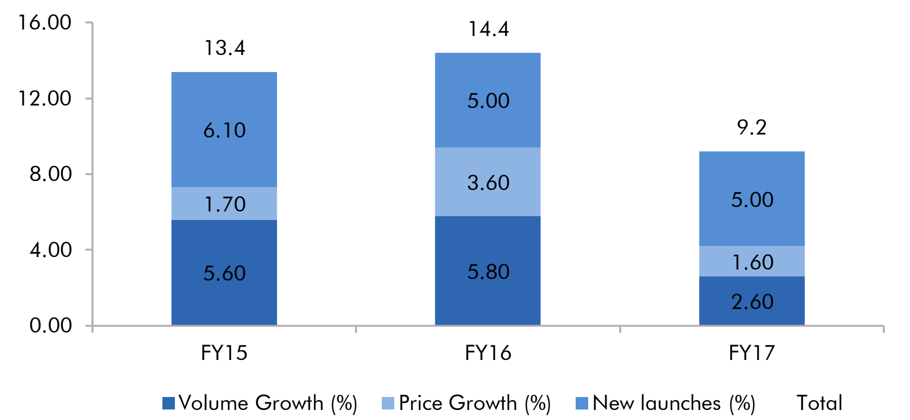
Exhibit 8: Rising contribution of Chronic in revenue mix



Source: Company

Foray in new chronic therapies to help gain further market share: As per IMS report, IPM largely remains volume growth market than price growth. In FY2015 and FY2016, domestic pharma market grew by 5.6% and 5.8% respectively, in volume terms, while in pricing terms it grew by 1.7% and 3.6% each. The new drug launches have also contributed meaningful 6.1% in FY2015 and 5% each in FY2016 and FY2017. We believe that the companies launching new drugs and keeping competitive prices will be successful in domestic pharma.

Exhibit 9: India Pharma Market (IPM) – Key growth drivers



Source: Company, Angel Research, data for FY17

Eris, while consolidating its presence in existing therapeutic areas, intends to focus on pursuing opportunities in other therapeutic areas such as, chronic neurological pain, dermatology and gynecology. These, we believe are significantly meaningful opportunities and if the company is able to replicate its success in existing therapies in these, it will be able to sustain the current growth rate trajectory, and while doing so, it would also gain market share and rise in the ranks in IPM at a faster pace.

Exhibit 10: Foray in the new therapies with meaningful market size

Segment	Market size (₹ cr.)	FY13-17 CAGR	Current revenue	Strategy
Neurology	6,884	12.20%	167.5	Focus on chronic neuropathic pain
Dermatology	7,993	18.20%	NA	New launches
Gynecology	5,571	9.90%	0	Focus on female infertility and endocrine disorders
Osteoarthritis and musculoskeletal	1,042	10.70%	0	leverage on Kinedex acquisition

Source: Company, Angel Research, data for FY17

Acquisitions in specialty therapeutic segments: Eris has also sought an inorganic growth route owing to the growth opportunities in the specialty therapies and its cash rich balance sheet.

Exhibit 11: Recent acquisitions

Company	Description
Kinedex	75.48% stake acquired in 2016 for ₹77.2cr Rosiflex is the largest brand with ₹39.6cr sales in FY2017 Major focus on mobility related disorders like musculoskeletal therapies, acquisition likely to help company in gaining market share in this specialty segment
Aprica Pharma	Acquired 40 brands from Aprica Pharma (erstwhile Amay) in 2016 for ₹37.9cr. Total revenue ₹19.3cr in FY2017 Major focus on cardiovascular and anti-diabetics, acquisition is likely to consolidate its current position in the CV and anti-diabetic segments

Source: Company, Angel Research

Most brands of Eris are gaining market share: Eris, since launching its products, has seen strong growth traction in its mother brands. The DRHP speaks of 15 such mother brand groups, which represent 85% of its total business. In their respective categories, these mother brands have seen growth traction. Mother brands representing ~55% of its business have exhibited a strong growth rate, outperforming the segment growth. While old brands feature in the top 5 in their respective categories, recently launched brands like Metital (Gynac) and Cyblex and Tendia (anti-diabetic) have also quickly gained market share.

Exhibit 12:

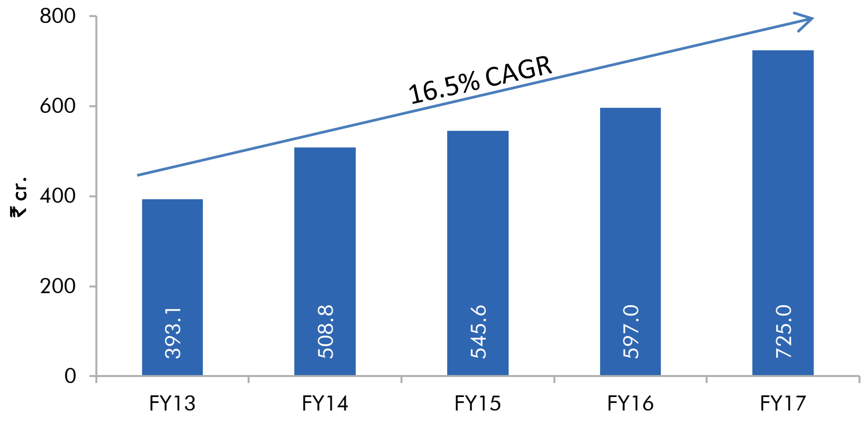
Mother brand	Launch year	Market Share	Revenue (₹ cr.)	CAGR FY13-17	Prescription rank	% of revenue
Glimisave	2007	5.50%	171	29.00%	3	20%
Eritel	2008	5.30%	102	28.50%	4	12%
Olmin	2010	6.80%	49	36.10%	3	6%
LN Bloc	2012	10.80%	36	168.4	2	4%
Tendia	2015	7.20%	29	NA	3	3%
Crevast	2010	2.50%	23	20.40%	6	3%
Cyblex	2014	4.20%	22	NA	6	3%
Marzon	2011	57.00%	19	7.60%	1	2%
Metital	2014	19.70%	12	NA	1	1%

Source: Company, Angel Research, data for FY17

Two of its brands, Glimisave (Anti-diabetics) and Eritel (Hypertension), which represent 31% of FY2017 sales, have seen a growth CAGR of ~29%. This we believe is an indication that these brands can further go on gaining market share. Also, going by the track record, there is also a probability that more brands will gain further market share in future implying that Eris' branded generics business has strong potential.

Eris is one of the fastest growing pharma companies in IPM: With its strong marketing and sales capabilities and strategy to focus on only specialty segments, company has been able to grow faster than its competitors. With 16.5% CAGR over FY2013-17, Eris has gained 0.7% market share and it is now ranked as 32nd company in IPM. During this period, top 35 companies in IPM grew by 12.1%. In the chronic category, Eris is ranked at 20th position with 1.4% market share and it is the fastest growing company in the top 25 companies in this category.

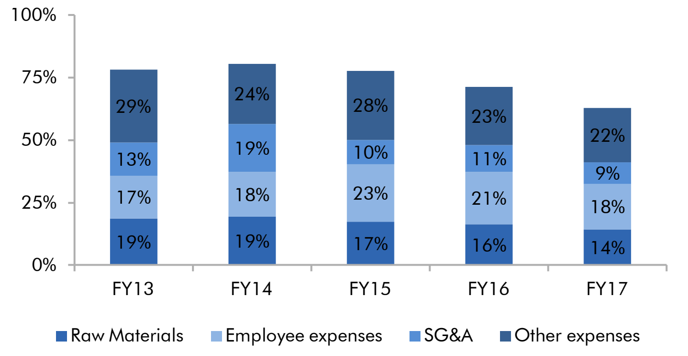
Exhibit 13: Net sales CAGR of 16.5% in the last 5 years



Source: Company, Angel research

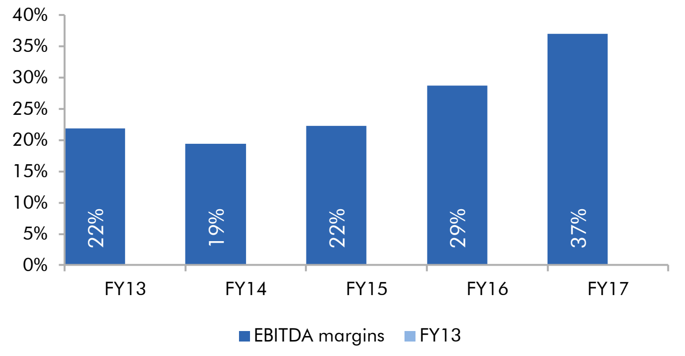
Superior financials vis-à-vis peers: Owing to its superior growth, low cost strategies and focus on niche therapeutic segments, Eris has exhibited strong record in profitability and returns. Between FY2014-17, company has consistently seen improvement in its margins and returns. The EBITDA margins increased from 19.4% in FY2014 to 37.1% in FY2017. This margin profile is far superior to its peers, who have highest domestic exposure like Alkem labs or MNC pharma companies.

Exhibit 14: Consistent decline in operating costs...



Source: Company, Angel Research

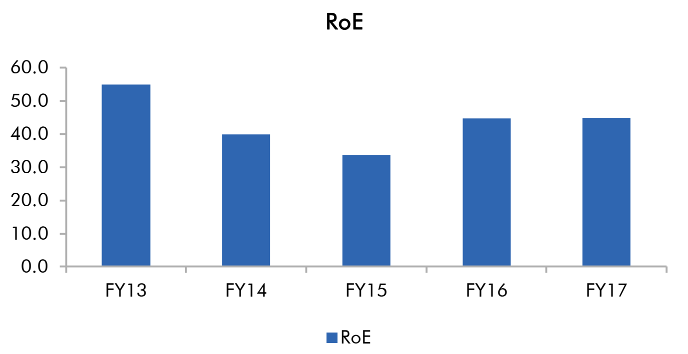
Exhibit 15: ...helping to improve EBITDA margins



Source: Company, Angel Research

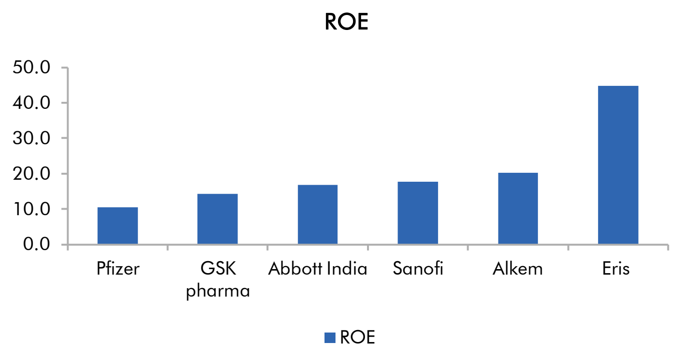
Healthy return ratios: Owing to the superior margin profile, company has consistently seen return on equity greater than 30% in the last five years. In the last two years, RoE has been healthy at 44% v/s. its MNC peers having RoE of 10%-18%.

Exhibit 16: More than 30% ROE for last five years...



Source: Company, Angel Research

Exhibit 17: ...and superior than its peers

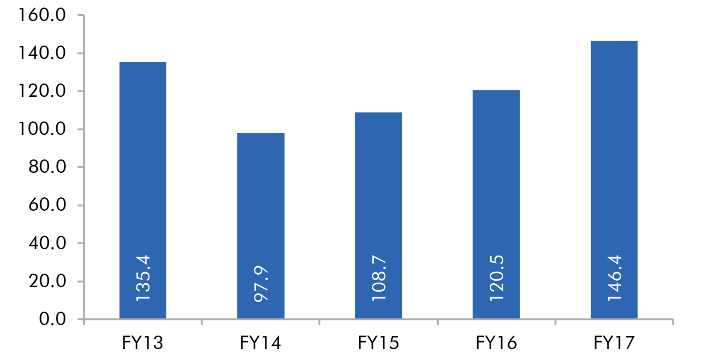


Source: Company, Angel Research

Eris is a debt free company and has been investing its cash flows in the liquid investments. So far, management has refrained from fund raising, expect the one that was raised from ChrysCapital. We believe that the strong cash flows so far have been the prime reason that the management has taken a conservative approach. Lately, with two acquisitions, we see some change in the approach and we see this as a positive change. Moreover, the company has also paid dividends in the last two years, and if this goes on, ratios are likely to improve further.

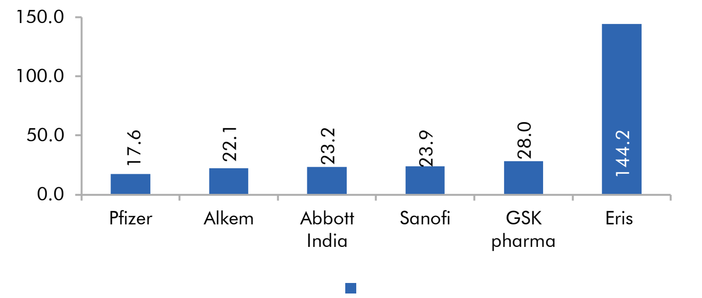
The company has a liquid balance sheet, in FY2017, 42% of its total assets were held in liquid instruments (cash and investments) v/s. 50% in FY2016. Due to this, we believe that RoIC is a good measure of calculating shareholders returns. Eris' average RoIC works out to be more than 100% over FY2013-17 v/s. peers RoIC of <30%. On the return ratios, Eris shows a far superior performance than its peers, which we like.

Exhibit 18: Average ~100% ROIC in last five years...



Source: Company, Angel Research

Exhibit 19: ...and leader amongst its peers



Source: Company, Angel Research

Overall we believe that this is a high RoE business and with its major thrust to third party manufacturing, and consolidating its position in the existing therapeutic segments, we expect Eris to maintain the same in the near future.

Outlook and Valuation:

On FY2017 EPS of ₹17.6, the issue is priced at P/E of 34.25x, which is at par with its MNC peers but higher than domestic peer, Alkem Labs. Considering that Eris' faster growth, superior returns, debt free status, and specialty play, we believe that this is a fair valuation. We believe that Eris is likely to continue growing faster than its competitors owing to its marketing capability, higher operating leverage and growing market share of its mother brands. While most pharma companies are currently facing issues on several fronts, this business model looks attractive with no USFDA concerns and pricing pressure. **Considering the company's superior growth, better margin profile and high return ratios, we rate this IPO as SUBSCRIBE.**

Downside risks

- High dependence on few suppliers and single manufacturing facility in Assam
- Change in domestic regulations adverse to the branded generic companies
- Increased competition in the chronic segments

Income Statement

Y/E March (Rs cr)	FY13	FY14	FY15	FY16	FY17
Total operating income	**393**	**509**	**546**	**597**	**725**
% chg		*29.5*	*7.2*	*9.4*	*21.4*
Total Expenditure	**307**	**410**	**424**	**425**	**456**
Cost of Materials	74	99	94	98	104
Personnel	67	91	126	125	132
Others Expenses	166	221	204	203	220
EBITDA	**86**	**99**	**121**	**172**	**269**
% chg		*15.2*	*22.8*	*41.2*	*56.6*
(% of Net Sales)	*21.9*	*19.4*	*22.3*	*28.7*	*37.1*
Depreciation& Amortisation	3	5	16	20	24
EBIT	**82**	**94**	**106**	**151**	**245**
% chg		*14.3*	*12.5*	*42.7*	*62.0*
(% of Net Sales)	*21.0*	*18.5*	*19.4*	*25.3*	*33.8*
Interest & other Charges	1	0	0	0	0
Other Income	1	4	3	3	19
(% of PBT)	*1.7*	*4.5*	*3.2*	*2.2*	*7.2*
Share in profit of Associates	-	-	-	-	-
Recurring PBT	**83**	**98**	**109**	**154**	**264**
% chg		*18.3*	*11.3*	*41.2*	*70.8*
Prior Period & Extraordinary Expense/(Inc.)	-	-	-	-	-
PBT (reported)	**83**	**98**	**109**	**154**	**264**
Tax	25	28	20	20	22
(% of PBT)	*29.7*	*28.3*	*18.4*	*12.7*	*8.3*
PAT (reported)	**58.4**	**70.5**	**89.3**	**134.9**	**241.9**
Add: Share of earnings of associate	-	-	-	-	-
Less: Minority interest (MI)	0	0	0	1	(0)
PAT after MI (reported)	**58**	**70**	**89**	**134**	**242**
ADJ. PAT	**58.2**	**70.4**	**89.2**	**133.6**	**242.1**
% chg		*21.0*	*26.7*	*49.7*	*81.2*
(% of Net Sales)	*14.8*	*13.8*	*16.4*	*22.4*	*33.4*
Basic EPS (Rs)	**4.2**	**5.1**	**6.5**	**9.7**	**17.6**
Fully Diluted EPS (Rs)	**4.2**	**5.1**	**6.5**	**9.7**	**17.6**
% chg		*21.0*	*26.7*	*49.7*	*81.2*

Balance Sheet

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
SOURCES OF FUNDS					
Equity Share Capital	0.1	0.1	0.1	0.1	13.8
Reserves& Surplus	106	176	266	299	526
Shareholder's Funds	**106**	**177**	**266**	**299**	**540**
Minority Interest	5	4	4	3	-
Total Loans	10	15	8	27	14
Deferred Tax Liability	-	-	-	-	-
Other long-term liabilities	2	1	1	2	4
Total Liabilities	**122**	**197**	**279**	**332**	**558**
APPLICATION OF FUNDS					
Net Block	**24**	**71**	**67**	**71**	**55**
Capital Work-in-Progress	-	-	-	-	0
Intangibles	3	4	4	1	116
Investments	47	84	167	190	269
Other long-term assets	18	23	21	35	66
Current Assets	80	89	94	95	126
Inventories	43	45	58	48	56
Sundry Debtors	17	22	24	25	49
Cash	5	7	6	10	2
Loans & Advances	15	14	7	12	11
Other Assets	-	-	0	0	8
Current liabilities	50	74	78	66	83
Net Current Assets	**30**	**15**	**16**	**29**	**43**
Deferred Tax Asset	**0**	**0**	**3**	**6**	**10**
Mis. Exp. not written off					
Total Assets	**122**	**197**	**279**	**332**	**558**

Cash Flow Statement

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
Profit before tax	83	98	109	154	264
Depreciation	3	5	16	20	24
Change in Working Capital	(16)	21	(8)	(8)	(16)
Interest / Dividend (Net)	0	0	0	-	-
Direct taxes paid	(36)	(30)	(23)	(35)	(53)
Others	3	(4)	(3)	(0)	(18)
Cash Flow from Operations	**38**	**90**	**90**	**131**	**200**
(Inc.)/ Dec. in Fixed Assets	(8)	(52)	(13)	(24)	(50)
(Inc.)/ Dec. in Investments	(28)	(31)	(79)	(20)	(134)
Cash Flow from Investing	**(36)**	**(83)**	**(92)**	**(44)**	**(184)**
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	(2)	(2)	0	(1)	(7)
Finance costs	(1)	(0)	(0)	(0)	(0)
Others	-	-	-	(83)	(17)
Cash Flow from Financing	**(3)**	**(2)**	**0**	**(84)**	**(24)**
Inc./(Dec.) in Cash	(1)	5	(2)	4	(8)
Opening Cash balances	**3**	**2**	**7**	**5**	**9**
Closing Cash balances	**2**	**7**	**5**	**9**	**2**

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17
Valuation Ratio (x)					
P/E (on FDEPS)	142.5	117.7	92.9	62.1	34.3
P/CEPS	133.9	110.1	79.1	53.4	31.2
P/BV	78.2	47.0	31.2	27.7	15.4
Dividend yield (%)	0.0	0.0	0.0	1.0	0.2
EV/Sales	21.0	16.1	14.9	13.6	11.1
EV/EBITDA	96.0	83.0	66.9	47.3	29.9
EV / Total Assets	48.02	30.36	22.75	20.43	12.53
Per Share Data (Rs)					
EPS (Basic)	4.2	5.1	6.5	9.7	17.6
EPS (fully diluted)	4.2	5.1	6.5	9.7	17.6
Cash EPS	4.5	5.5	7.6	11.3	19.3
DPS	0.0	0.0	0.0	6.0	1.2
Book Value	7.7	12.8	19.3	21.8	39.3
Returns (%)					
ROCE	71.3	49.2	38.7	46.4	44.2
Angel ROIC (Pre-tax)	135.4	97.9	108.7	120.5	146.4
ROE	54.9	39.9	33.6	44.6	44.8
Turnover ratios (x)					
Asset Turnover (Net Block)	16.7	7.2	8.1	8.4	13.1
Inventory / Sales (days)	40	32	39	29	28
Receivables (days)	15	16	16	16	25
Payables (days)	20	27	25	15	19
Working capital cycle (ex-cash) (days)	35	21	30	30	33

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