Company Report
Industry: Pharma

Eris Lifesciences

Rising Star in Domestic Chronic Care

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Contents

Company Report
May 08, 2018

Eris Lifesciences

Rating	**Accumulate**
Price	Rs750
Target Price	Rs885
Implied Upside	18.0%
Sensex	35,208
Nifty	10,716

(Prices as on May 07, 2018)

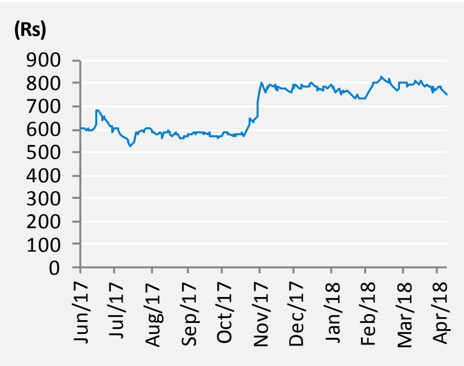
Trading data	
Market Cap. (Rs m)	103,125.0
Shares o/s (m)	137.5
3M Avg. Daily value (Rs m)	108.4

Major shareholders	
Promoters	55.93%
Foreign	8.59%
Domestic Inst.	10.82%
Public & Other	24.66%

Stock Performance			
(%)	**1M**	**6M**	**12M**
Absolute	(5.5)	31.2	0.0
Relative	(10.2)	25.7	0.0

How we differ from Consensus			
EPS (Rs)	**PL**	**Cons.**	***% Diff.***
2019	32.2	27.6	*16.7*
2020	38.3	34.0	*12.6*

Price Performance (RIC: ERIS.BO, BB: ERIS IN)



Source: Bloomberg

Eris Lifesciences (Eris), a pure play domestic pharmaceutical company, presents a strong growth opportunity, given its urban centric focus and a portfolio comprising high margin drugs that treat chronic lifestyle ailments prevalent in India's cities. Formed in 2007, Eris is not burdened with legacy products (unlike its peers), which maintains its healthy profitability.

Eris's focus on therapeutic areas, such as treating cardiovascular (CVS) and diabetes related diseases, allows for higher volume, better margin and strong growth across age groups in urban India, in our view. We also like Eris's strategy of targeting acute therapies where a major part of the growth accrues from the supplementary role to the treatment of chronic diseases.

With its formulation plant in Guwahati at 22% utilisation rate, Eris has begun tapping into operating leverage, which is likely to improve gross margin to 84-86%, while higher MR productivity is expected to expand EBITDA margin to 40% in FY20E. The company's revenues, EBITDA and PAT are expected to grow at 27%, 32% and 29% CAGR in FY17-20E, respectively. With superior return ratios (ROE of over 40% in FY18E-20E), we expect Eris to trade at a PER of 23.4x to arrive at a target price (TP) of Rs885. The stock trades at 25.9x and 21.8x PE of FY19E and FY20E. Strong cash flows and zero debt coupled with high capital return ratios will lead to high PERs for the company. We initiate coverage on Eris with an 'Accumulate'.

Key financials (Y/e March)	**2017**	**2018E**	**2019E**	**2020E**
Revenues (Rs m)	7,053	8,955	12,343	14,485
Growth (%)	*20.7*	*27.0*	*37.8*	*17.4*
EBITDA (Rs m)	2,482	3,338	4,824	5,750
PAT (Rs m)	2,410	3,084	4,432	5,262
EPS (Rs)	17.5	22.4	32.2	38.3
Growth (%)	*(98.3)*	*27.9*	*43.7*	*18.7*
Net DPS (Rs)	—	1.0	1.0	1.0

Profitability & Valuation	**2017**	**2018E**	**2019E**	**2020E**
EBITDA margin (%)	*35.2*	*37.3*	*39.1*	*39.7*
RoE (%)	*57.9*	*45.3*	*42.8*	*35.1*
RoCE (%)	*54.4*	*43.9*	*42.2*	*34.8*
EV / sales (x)	14.3	11.0	7.8	6.4
EV / EBITDA (x)	40.5	29.6	19.9	16.1
PE (x)	42.8	33.4	23.3	19.6
P / BV (x)	19.2	12.5	8.3	5.9
Net dividend yield (%)	—	*0.1*	*0.1*	*0.1*

Source: Company Data; PL Research

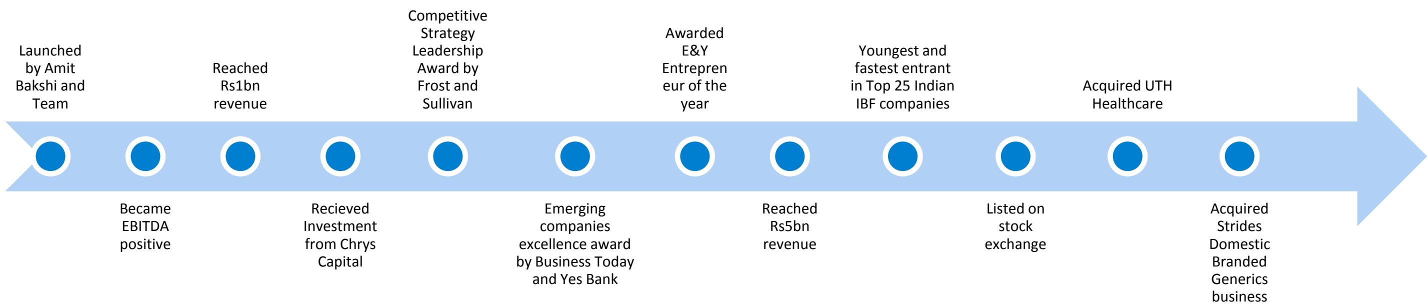
Company Background

Eris Lifesciences, founded by Amit Bakshi (along with four partners) in 2007, operates in the chronic and acute therapy categories, such as, cardiovascular, anti–diabetes, vitamins, gastroenterology, and gynaecology. The company targets chronic lifestyle related ailments treated by super specialist and specialist doctors.

Eris, with 2,645 employees across India as on March 31, 2017, focuses on the Indian branded formulations market, with the chronic segment accounting for 66% of its revenues. Eris's sales in the chronic therapy segment expanded at 34% CAGR, the fastest among the top-25 companies, while acute therapy products increased at 12% CAGR over FY13-17.

Eris adopts a two pronged growth strategy, driven by organic initiatives and acquisitions.

Exhibit 1: Genesis of Eris Lifesciences



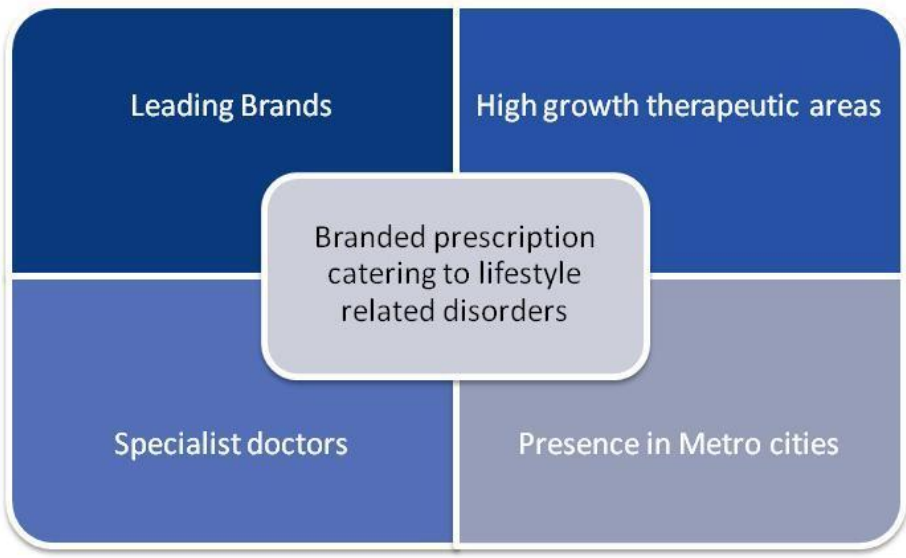
Source: Company Data, PL Research

Investment Thesis

Focus segments to remain key growth drivers

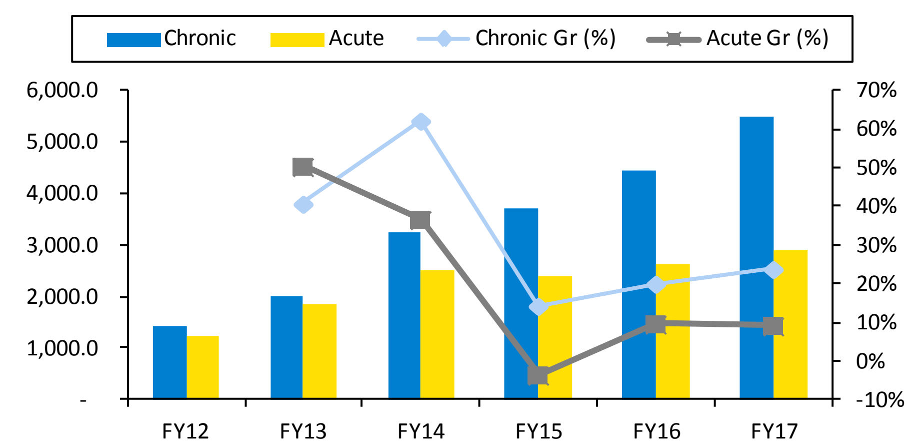
Eris will likely benefit from it urban centric strategy, given the rapidly increasing rate of lifestyle related diseases in these markets. We expect growth to be driven by drugs used to treat Cardiovascular (CVS) ailments and Diabetes, and complemented by the company's entry into other acute therapeutic areas, such as, Vitamins (Vit), Gastroenterology (GI), and Anti infective (AI). The chronic nature of these diseases and their rapid spread among the urban population, owing to a sedentary lifestyle, will likely translate into increased demand for Eris's products.

Exhibit 2: Eris' strategy



Source: Company Data, PL Research

Exhibit 3: Chronic and Acute therapy sales of Eris

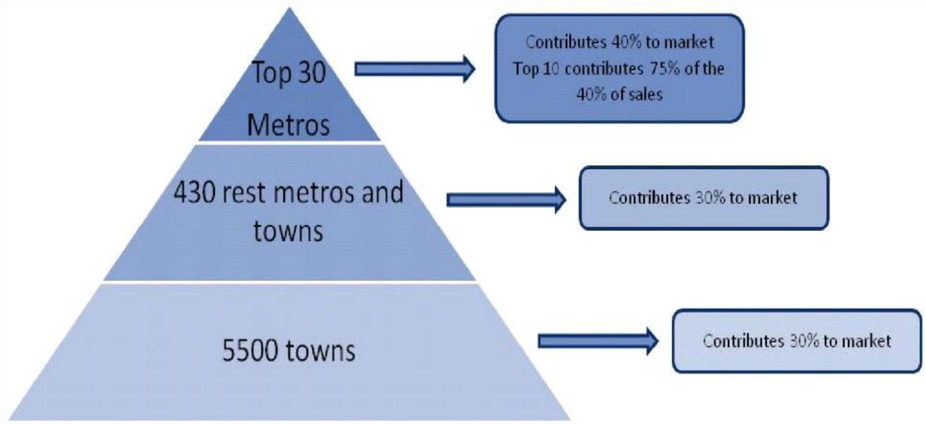


Source: Company Data, IPM, PL Research

Urban thrust to propel demand

Lifestyle diseases are more an urban phenomenon, dominated by metros and class-A towns, which Eris's products are targeted to treat. Sales in these areas totalled 77% of Eris's revenues in FY17. The company's coverage in metros and class-A towns increased to 15.7% (50,282) of doctors in FY17 v/s 13.8% (37,842) in FY13.

Exhibit 4: Eris focus on metros: Key markets for cardio-metabolic diseases

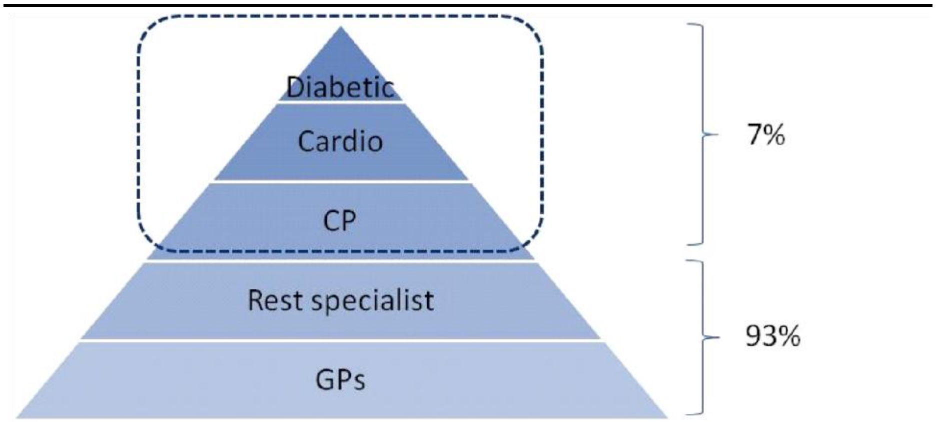


Source: Company Data, PL Research

Portfolio crafted to provide long-term care

The 80 Mother Brand groups in Eris portfolio focus largely on therapeutic areas, treated by specialists and super specialists that include cardiologists, diabetologists, endocrinologists, and gastroenterologists. With such lifestyle diseases needing long-term treatment, geographical focus has been a key growth driver for Eris since inception. As of September 2016, 87% of diabetologists / endocrinologists, 89% of cardiologists, and 90% of gastroenterologists were located in metros and class-A towns (among the top 780 cities and towns in India).

Exhibit 5: 7% of doctors drive 70% Rx in cardio-metabolic market



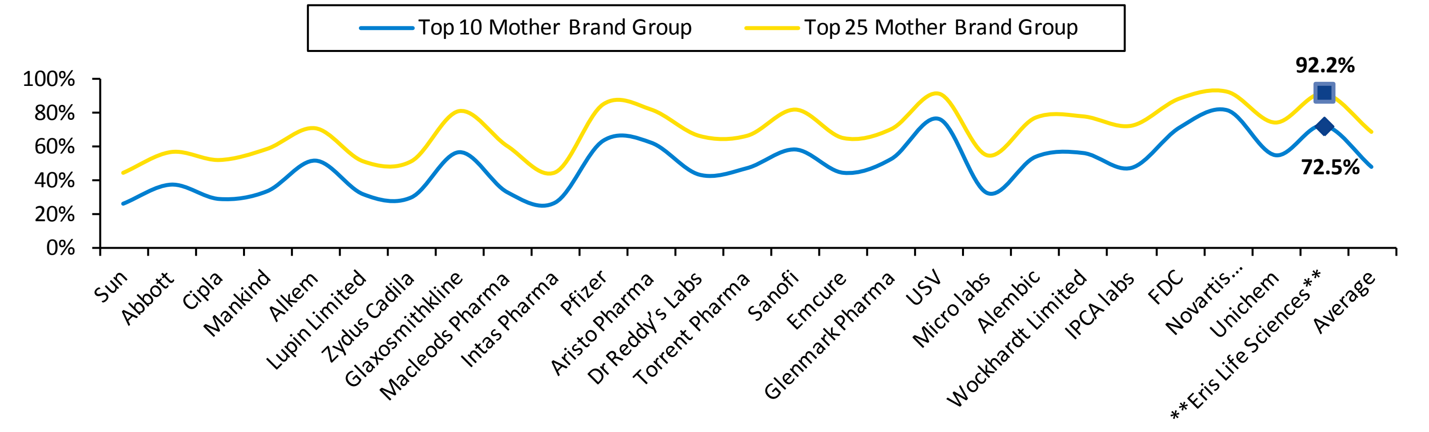
Source: Company Data, PL Research

Super specialists, specialists, and general physicians account for 53.5%, 42.6%, and 3.9% of average prescriptions (Rx) in Eris's mother brands, as compared to 23%, 38% and 38% of the total Rx for the overall Indian Pharmaceutical Market (IPM). Cardiologists, diabetologists/endocrinologists and consulting physicians comprised only 11.4% of all doctors in India (as of March 2017), but, contributed more than 52% of the prescriptions (Rx) for the diabetology and CVS segments.

Interdependency enhances cross-linking opportunity

To supplement robust growth in the CVS segment, Eris introduced chlortalidone (a diuretic drug) in combination with contemporary ARBs (angiotensin receptor blocker), and hypertension/high blood pressure drugs telmisartan and olmesartan, in CY12. In the diabetology segment, Eris ranked 10th on revenues in IPM in FY17 and third on revenue growth in FY13-17 among the top 25 companies. Eris also acquired trademarks of 40 brands from *Amay Pharma* in July FY17 in order to boost growth in the CVS and diabetology therapeutic areas. In the CVS therapeutic area of IPM, Eris ranked 18th on revenues in FY17, and third on revenue growth among the top 25 companies in FY13-17.

Exhibit 6: Top 10 and Top 25 brands contribution of Eris



Source: Company Data, PL Research

Vit and GI products, with a significant presence in the acute therapy portfolio, accounted for 23% of revenues in FY17. Eris has been sensitive to its dominant presence in the chronic diseases portfolio while selecting key products in acute segments (Vit and GI) that can treat lifestyle-related disorders. Other factors that determined the selection of products and therapeutic areas in acute categories are **a)** under-penetration; and **b)** potential to drive cross-linkages with existing portfolio and coverage at the doctor level.

Exhibit 7: Key Mother Brand groups of Eris in acute therapeutic areas

Brand groups	Molecules	Indications	Year of launch	Market share FY17 (%)	Rev FY17 (Rs m)	CAGR FY13-17 (%)	Rx Ranking
Rabonik	Rabeprazole	Gastroenterology	CY08	4.4	542	9.2	10
Remylin	Mecobalamin+Colecalciferol	Vitamins	CY07	6.3	530	10.2	8
Tayo	Vitamin D	Vitamins	CY11	4.9	527	7.7	5
Marzon	Ampicillin+Sulbactum	Anti-Infectives	CY11	57.0	188	7.6	1
Velgut	Probiotics	Gastroenterology	CY09	3.3	117	(0.8)	6
Metital	Inositol	Gynaecology	CY14	19.7	119	NA	1

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

Exhibit 8: Growth in key therapeutic areas (Eris v/s IPM)

Therapeutic	Eris		IPM	
	FY17 Revenue	CAGR FY13-17	MAT FY17	CAGR FY13-17
Chronic	5,491	28.9%	391,719	14.3%
Cardiovascular	2,738	25.8%	134,032	11.6%
Anti-diabetics	2,423	34.5%	100,586	19.1%
Others	330	20.5%	157,102	14.1%
Acute	2,885	12.0%	751,539	10.6%
Vitamins	1,147	7.4%	89,340	12.5%
Gastroenterology	777	8.2%	122,262	12.3%
Pain-Analgesics	275	64.6%	74,920	10.5%
Anti-infectives	220	5.7%	148,238	5.7%
Gynaecology	225	36.8%	55,708	9.9%
Others	242	17.5%	261,072	12.7%
Total	8,376	21.7%	1,143,258	11.8%

Source: Company Data, PL Research

Proactive product selection, engagement model to bridge gaps

Eris leveraged the strong marketing background of key management personnel to conduct detailed groundwork for devising its product selection and engagement model before marketing its products. The model comprises identifying and addressing diagnostic, therapeutic and patient compliance gaps.

Diagnostics gap: Eris combines diagnostics with commercialization and marketing to enhance the quality of diagnosis and prognosis. Initiatives to support doctors have helped the company to increase prescription rates of products. For example:

- ***Hypertension*****:** ABPM (ambulatory blood pressure monitoring) is a key tool in diagnosing and monitoring hypertension that records the overall profile of a patient's blood pressure over the course of a day. Eris launched an "ABPM on call" initiative that offers doctors and patients better insights and accessibility of the tool. Through "ABPM on call", the company has supported 16,300 patients and 2,800 doctors, as of March 31, 2017.

- ***Diabetes***: CGM (continuous glucose monitoring) is important for making choices related to the treatment for diabetes. Eris launched 'Tendia CGM On Call', which includes engaging with doctors who need CGM to treat patients. Eris executives attach CGM devices on patients that monitor glucose levels for 3-6 days, post which, the company collects the data for the relevant doctor.

Exhibit 9: Key Mother brands in CVS segment

Brand groups	Molecules	Indications	Year of launch	Market share FY17 (%)	Rev FY17 (Rs m)	CAGR FY13-17 (%)	Rx Ranking
Eritel	Telmisartan	Hypertension	CY08	5.3	1,022	28.5	4
Olmin	Olmesartan	Hypertension	CY10	6.8	487	36.1	3
Atorsave	Atorvastatin	Lipid Lowering	CY07	3.5	377	7.2	6
LN Bloc	Cilnidipine	Hypertension	CY12	10.8	360	168.4	2
Crevast	Rosuvastatin	Lipid Lowering	CY10	2.5	230	20.4	6

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus **Major flagship mother brand groups are Eritel, Olmin, LN Bloc*

Exhibit 10: Key Mother brands in Anti-Diabetic segment

Brand groups	Molecules	Indications	Year of launch	Market share FY17 (%)	Rev FY17 (Rs m)	CAGR FY13-17 (%)	Rx Ranking
Glimisave	Glimepiride	Anti-diabetics	CY07	5.5	1,709	29.0	3
Tendia	Teneligliptin	Anti-diabetics	CY15	7.2	288	NA	3
Cybex	Gliclazide	Anti-diabetics	CY14	4.2	220	NA	6
Advog	Voglibose	Anti-diabetics	CY09	2.5	109	11.7	14

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

Therapeutic gap: Eris identifies and addresses key therapeutic gaps in the IPM, where the clinical benefits of certain products and therapies are underutilised. For example:

- ***Vitamin D***: Tapping the therapeutic relevance of cholecalciferol (Vitamin D) in lipid metabolism, diabetes and hypertension, Eris launched its Vitamin D brand, *Tayo 60K*, in chewable form in CY11.

- ***Hypertension***: Focusing on the concept of managing hypertension aimed at preventing vital organ damage, along with lowering elevated blood pressure levels, Eris introduced *Cilnidipine*, an anti-hypertensive molecule that reduces the adverse effects on the kidneys in CY12.

Exhibit 11: IPM-Revenues in some subgroups of Vit, CVS grown 3x-18x over 10 years

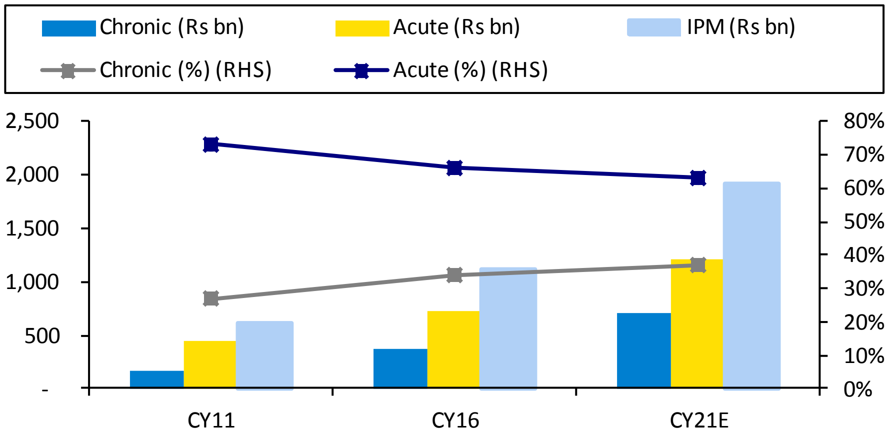
Year		Vitamins (Rs m)	Cardiovasculars (Rs m)
	Plain Vit-D	Clinidipine, combinations	Chlorthalidone, combinations
CY07	107.1	-	230.7
CY08	116.0	2.2	231.8
CY09	123.2	9.0	233.2
CY10	167.4	25.0	245.0
CY11	256.8	67.5	224.2
CY12	751.8	164.8	280.7
CY13	1,815.1	328.6	480.1
CY14	2,764.0	928.5	1,237.4
CY15	3,679.0	1,856.6	2,406.0
CY16	4,714.8	2,921.5	3,324.1
CY17	5,123.9	3,938.6	4,122.3

Source: Company Data, PL Research

Patient compliance gap: Patient compliance is a key part of Eris's marketing initiatives, which include technology-driven delivery systems, such as:

- ***Metformin***: It is a smaller version of the company's Glimisave M brand tablets.
- ***Rabeprazole***: Eris launched 'MacRabonik' in 2014, that enable the delayed dual release of rabeprazole that helps address compliance gaps arising from dual dosage requirements of proton pump inhibitors.

Exhibit 12: Market share progression of Chronic therapy in IPM remains steady



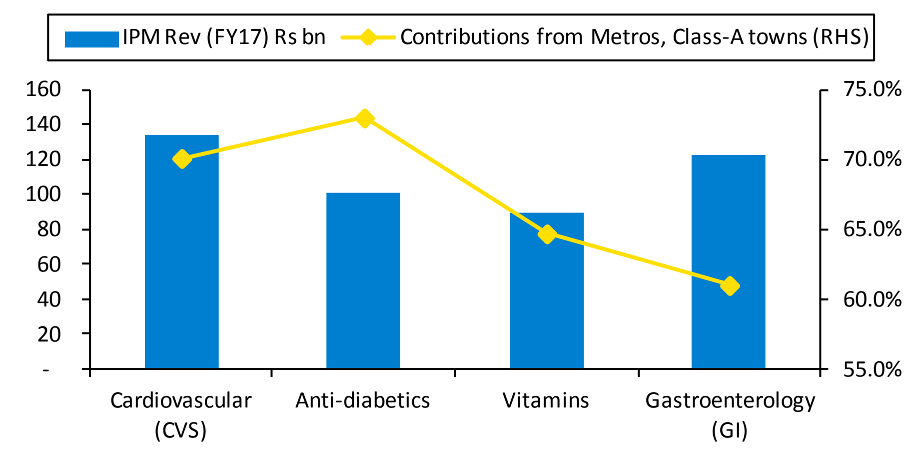
Source: IPM 2017, Company IPO prospectus

Widening portfolio depth by adding new generation molecules

Along with acquisitions, Eris plans to expand its existing portfolio by introducing new generation molecules. The company's initiatives include:

- Targeting new categories within the existing therapeutic areas, for example, launching new products in the insulin and 'glucagon-like peptide 1'(GLP1) categories to increase depth of its offerings in the diabetology segment
- Continuing to expand the network of KOLs (Key opinion leaders) in existing therapeutic areas and increase the coverage of specialists to drive growth in prescriptions
- Continuing to implement the doctor-patient engagement model by leveraging diagnostics and technology
- Enhancing product lifecycle management by identifying clinical benefits and commercializing new extensions or combinations, and
- Enhancing productivity and efficiency of sales personnel through training, technology, and exploiting synergies between divisions

Exhibit 13: Contribution of target therapies in target market of Eris in IPM



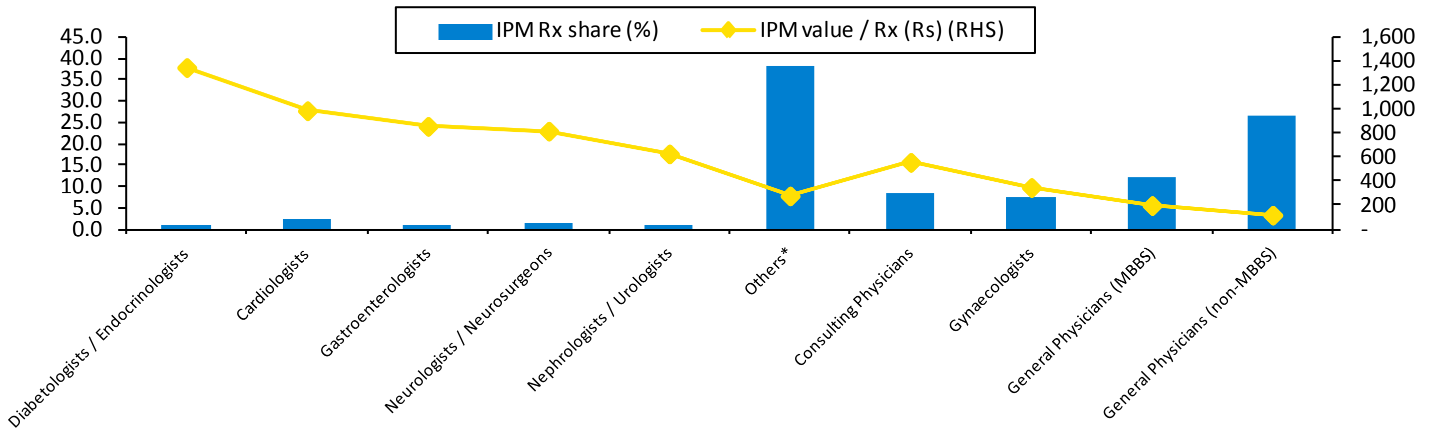
Source: IMS, IMS TSA, Medical audit MAT 2017

Targeting specialists to help bump up sales

Eris, with seven sales and marketing divisions since inception in CY07, has believed in strong sales, marketing and distribution capabilities being key growth factors. The company added two more divisions, Neuro Psychiatry and Nutrition, with its foray in the CNS segment, especially post the acquisition of Strides's domestic branded business. The marketing divisions are aligned with their key therapeutic areas and have focused on developing and growing their engagement with specialists and super specialists. These divisions are the key to Eris developing brand specific marketing strategies and engaging with doctors. The sales force covers doctors across India, with primary focus in metro cities and class-A towns.

The use of a sales force management system, which captures data at the headquarters and employee levels, will help transform its sales staff into a better informed and more productive force.

Exhibit 14: Eris strategy follows growing stimuluses of specialists in IPM



Source: IMS, IMS TSA, Medical audit MAT 2016
**Others include Dentists, Paediatricians, general surgeons, chest specialists, ENT specialists, ophthalmologists, oncologists, psychiatrists, orthopaedics, dermatologists*

CNS division, new distributors to boost growth

The acquisition of Strides's domestic branded portfolio has helped Eris to ramp up products and headcount of MRs in the Neuro-psychiatry division; the company added 250-300 reps in FY18. Eris also started a new division for nutrition products with the smaller brands acquired from Strides and UTH Healthcare. Eris added 500 new distributors (comprising many category-A distributors) in the new and existing regions post the Strides buy. We expect these developments to offer new growth opportunities FY19E onwards, led by **a)** own sales force with new distributors; and **b)** new divisions with new sales force. Eris guided that integration process and training of new sales force will be completed by Q4FY18E and gradually add to productivity from Q1FY19E. We expect revenues of Rs1.8bn from the Strides portfolio to grow at 15% in FY19E and 18% in FY20E.

Exhibit 15: CNS to be next driver in chronic segment other than CVS, anti-diabetic

Therapeutic areas	Revenues FY17 (Rs m)	Total Rev, contrib. (%)	CAGR FY13-17 (%)
Neurology (CNS)	168	2.4	11.5
Chronic Pain (Analgesics)	101	1.4	64.0
Chronic Respiratory	60	0.8	15.1
Urology	2	0.0	NA
Total	**330**	**4.7**	**20.5**

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

Entry into new therapeutic areas to tap unmet need

Eris plans to focus on pursuing opportunities in the therapeutic areas of chronic neurological pain, dermatology and gynaecology. The recent foray in the CNS segment was a case in point, as it complements its network in chronic therapy segments as well as leverages the large pool of products from the acquired business of Strides in India.

The strategy for expansion in existing and new therapeutic areas includes **a)** expanding focus to target lifestyle disorders and the chronic category (to benefit from Rx of same drugs over a longer period); **b)** identifying gaps in existing interventions; **c)** analyzing patient compliance and; **d)** working with KOLs, doctors and patients through active engagement. These initiatives will help develop, manufacture and market new indications, which will fulfil an unmet need or are clinically differentiated.

Exhibit 16: Eris draws major revenues from growth-oriented portfolio of products

Rank by Rx	Company	Rx Contrib from Growth molecules (%)	Rx Contrib from Mature molecules (%)	Rx Contrib from Decline molecules (%)
1	Mankind	41.7	38.5	19.6
2	Sun	47.4	26.1	26.4
3	Abbott	25.8	49.1	25.1
4	Cipla	29.8	30.3	39.7
5	Alkem Labs	61.2	24.3	14.5
6	Glaxosmithkline	21.8	44.2	34.0
7	Zydus Cadila	22.5	50.6	26.9
8	Macleods	53.3	34.8	11.9
9	Aristo	50.3	28.8	20.9
10	Dr Reddy's Labs	24.4	32.9	42.8
11	Lupin	49.0	24.5	26.4
12	IPCA Labs	48.7	30.5	20.4
13	Micro Labs	50.7	28.6	20.4
14	Torrent	31.0	26.6	42.4
15	Pfizer Wyeth India	5.0	64.5	30.5
43	**Eris Life**	**73.0**	**25.1**	**1.6**
	IPM	30.7	39.4	28.7

Source: SMSRC; Eris IPO prospectus

Eris's initiatives to enter and expand into a few new sectors were in line with its short-to-medium term goals in the IPM:

Neurology: This is the ninth largest therapeutic area in the IPM, with revenues of Rs68.8bn in FY17, representing a 12% CAGR in FY13-17. Eris's revenues from the Neurology therapeutic area stood at Rs167.5m in FY17, an 11.5% CAGR in FY13-17. The company expects Strides's CNS drugs to be revenue accretive in FY19E-20E.

Dermatology: This is the 8th largest therapeutic area in the IPM, with revenues of Rs79.9bn in FY17, an 18% CAGR in FY13-17. Eris plans to launch products focused on the cosmeceuticals subgroup within the dermatology therapeutic area. The company expects high margin core cosmeceuticals products in derma to expand revenues. Eris will likely grow its derma products/portfolios inorganically going forward.

Gynaecology: This therapeutic area contributed Rs55.8bn to the IPM in FY17, a 10% CAGR in FY13-17. Eris has identified female infertility and endocrine disorders as opportunities for expansion within the gynaecology therapeutic area and complementary to its sales in women healthcare segments.

Osteoarthritis and musculoskeletal: These two therapeutic areas collectively contributed revenues of Rs.10.5bn to the IPM in FY17, a CAGR of 11% in FY13-17. Eris, in CY16, acquired Kinedex, a maker of drugs that treat mobility-related disorders in the two therapeutic areas. The company also plans to expand its portfolio to include controlled release, modified release, and injectable products.

Well positioned to forge in-licensing, co-development tie-ups

Eris, with its focus on therapeutics, alignment of divisions, and well-informed sales teams, is likely to emerge as a partner of choice for multinational pharmaceutical companies that would be keen to utilise its distribution channel for their marketing products in India. Post the WTO-patent regime, since CY05, Eris's management has been alive to the difficulty of finding new molecules (among non-biologics) without engaging in complex litigation. Hence, Eris plans to leverage its existing infrastructure of sales, marketing and distribution networks to forge partnerships for quality IP assets. While Eris initiated small partnership deals for local companies focused on niche products, its medium-term objective is to secure partnerships with medium-to-large companies for products that will increase the depth of its portfolio. For instance, Eris entered into a distribution agreement with India Medtronic for the distribution, marketing and promotion of the 'i-Port Advance' injection port in December FY17. The partnership product uses lesser frequency of injections than standard insulin delivery methods.

Seeking large molecules going off patent by FY24E

Eris aims to launch branded generics of large molecules (with wider acceptance and better technology) post expiry of relevant patent(s) in India. The company explores alternative drugs/molecules with equal efficiency or similar class until the key drugs in target molecule goes off patent. The launch of *Tenaligliptin* molecule by Eris in GLP-1 class is a case in point as the major drug in this class, *Sitagliptin* is likely to remain under patent until FY24E. Eris targets molecules, which fall within the therapeutic areas, where it has meaningful presence. With 62% revenues from the CVS and diabetology segments, Eris naturally targets six products (sitagliptin, vildagliptin, linagliptin, insulin, ticagrelor and liraglutide recombinant) in the two therapeutic areas, the patents of which are set to expire by FY24E. These six molecules had a combined market size of Rs22.6bn in FY17.

Acquisitions to increase for portfolio depth, utilisation

Eris guided that acquisitions of assets, brands and joint ventures will remain the cornerstone of its strategic expansion plan in India. To that end, Eris acquired the trademarks of 40 brands from *Amay Pharma* in the CVS and anti-diabetics therapeutic areas. Eris also acquired 75.48% of the outstanding equity shares of *Kinedex*, a company focusing on products catering to mobility-related disorders in the musculoskeletal therapeutic area, through two transactions in November and December FY17. Separately, Eris acquired *UTH Healthcare* and the India portfolio (branded) of *Strides* in October and November FY18 to boost its presence in the multi-vitamin segment and to enter the CNS segment.

Management outlined a few parameters for acquisitions in its India formulation business. They include:

- Consolidating market position and enhancing financial strength
- Developing operating leverage for key therapeutic areas by unlocking potential efficiency and synergy benefits
- Expanding product portfolio within existing therapeutic areas, especially in the CVS and diabetology segments
- Enhancing depth of experience, knowledge-base and know-how of sales force
- Growing the sales, marketing and distribution network, customer base, and geographical reach

Exhibit 17: Market share by revenues in Chronic therapy in IPM

Rank by Chronic mkt share (FY17)	Company	Market share FY17 (%)	CAGR FY13-17 (%)
1	Sun	12.0	14.8
2	Abbott	7.9	10.8
3	Cipla	7.4	14.9
4	Intas	5.2	15.4
5	Lupin	5.1	19.1
6	USV	4.9	16.1
7	Torrent	3.9	10.2
8	Sanofi	3.5	9.0
9	Zydus Cadila	3.2	7.7
10	Mankind	3.0	19.9
11	Dr Reddy's Labs	2.5	11.9
12	Macleods	2.4	20.4
13	Glenmark	2.1	20.3
14	Emcure	2.0	11.1
15	Micro Labs	2.0	7.7
16	Unichem	1.8	7.7
17	Novartis International	1.6	14.5
18	Alkem	1.5	24.5
19	IPCA Labs	1.4	14.5
20	**Eris Life**	**1.4**	**28.9**

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

Strides portfolio acquisition to expand reach in CNS/neurology

Purpose of acquisition: Eris acquired the domestic portfolio of Strides, comprising mainly neurology drugs (CNS), in Q2FY18. The portfolio had sales of Rs1.81bn and was EBITDA neutral, though, gross margins of those brands were 69-70% of sales in FY17. With synergies of portfolio, in-house production and normalization of expiry products (free medicine), Eris is confident of its core portfolio delivering a gross margin of 80-85% in two to four quarters post integration, including the shifting of manufacturing operations to its own plant. Management expects a large part of the portfolio to fit into Eris's CNS division, with the potential to generate significant EBITDA in the near term. The company expects to break even in the first month post integration.

Integration with Eris portfolio: The acquired portfolio of Strides, especially CNS products, contributed 10 days of consolidated sales of Eris in Q3FY18, while adding full quarter sales in Q4FY18E. The integration will also add 250-300 MRs.

Value, funding of the acquisition: Eris paid Rs5bn for the acquisition of the brands on a slump sale basis, which includes value of IP, brands, distribution agreement and human resources. Eris follows a policy of amortising costs of advertisement over 50 years and it will follow a similar strategy to amortise the value of intangibles from the Strides acquisition (as per IND-AS). Eris paid Rs4bn in cash for acquiring Strides, with the rest being paid by new loan.

Synergies: The big lever of the deal is 52% of the sales of the acquired brands are from Tamil Nadu. Adding sales of two more Southern states, this region contributes 70% of the acquired sales of the Strides portfolio. The estimated addition of one-quarter sales of the portfolio is 18-20% of projected sales of Eris in FY18E. The synergy of the acquisition will provide Eris's core portfolio immediate access to the South Indian markets and offer opportunities to expand Strides's portfolios in other parts of the country.

Operating leverage from underpenetrated sales force (MR) of Strides: There were 1400-1600 MRs in the sales and marketing division of Strides. Eris, however, cherry-picked only 250-300 MRs from the pool of experienced field force and added them to its neuropsychiatry (CNS) and women healthcare divisions. The existing CNS division of Eris has 65 MRs and there will be an addition of 35-50 MRs from Strides. The company also added a new division in the CNS therapeutics area, which contributes another 130 MRs. Eris found one value-added brand, *Raricap*, in Strides portfolio with a potential of good synergy with its existing Gynaecology/Women Health division. This has resulted in the addition of 40 MRs from Strides to the Gynaecology division of Eris.

Exhibit 18: Detail of seven marketing divisions of Eris (before additions of two new CNS div.)

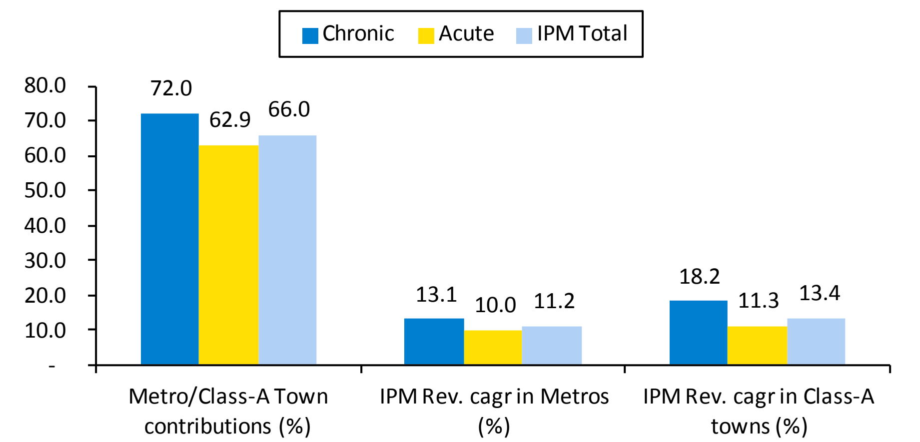
Name of Division	Launch year of the div.	Therapeutic areas covered	Doctors specialty covered	Key Mother Brands/ Groups
Eris	FY08	CVS, Anti-diabetics	Consulting physicians, Cardiologists, Endocrinologists, Diabetologists, Neurologists, Nephrologists	Glimisave, Eritel, Remylin D
Nikkos	FY09	GI, Acute and Chronic Respiratory	Gastroenterologists, ENTs, Consulting physicians, Cardiologists, Endocrinologists, Diabetologists	Rabonik, Alerfix, Marzon
Adura	FY10	CVS, Anti-diabetics	Consulting physicians, Cardiologists, Endocrinologists, Diabetologists, Neurologists, Nephrologists	Olmin, Crevast, Tayo 60
Montana	FY12	Gynaecology and Pediatrics	Gynaecologists, Paediatricians, Endocrinologists	Metital, Calshine P
Inspira	FY13	CVS, Anti-diabetics	Consulting physicians, Cardiologists, Endocrinologists, Diabetologists, Nephrologists	LN Bloc
Victus	FY14	Anti-diabetics	Consulting physicians, Endocrinologists, Diabetologists	Tendia, Cyblex
Eris 2	FY15	Acute and Chronic pain	Orthopeditricians	Mienta, Orthosenz, Reposit

Source: Company Data, PL Research

Rationalisation of Strides products: The Strides portfolio provides many top brands in psychiatry, including *Serlift* and *Levroxa,* with annual sales of Rs20-30m each. Out of Rs1.8bn sales of Strides products, the top-9-12 products contribute 74-80% of the portfolio. Eris plans to rationalize the tail end of the portfolio, as those do not fit in its strategic plan. There are, however, minimal overlaps between Strides and Eris's portfolios. All the CNS drugs in the Strides portfolio are primary therapy in CNS segment and at good stage of the product-life-cycle. Those drugs were growing at a slow speed when those were in the Ranbaxy portfolio. The largest brand of the acquired portfolio contributes 40% of sales.

Rationalisation of distribution network: Post the screening of Strides's distribution network, Eris added only 500 distributors to its existing network. This increased the number of active distributors to 1,500-1,600 from 1,000-1,100 before acquisition. There are also 100-150 non-active distributors in the Eris network. Qualitatively, the addition of new distributors increased category-A stockists (mainly in South India), which will significantly improve the coverage and open up many channels in major cities and associated towns.

Exhibit 19: Metro/Class-A town vs. others in IPM in Chronic, Acute therapies of IPM



Source: IPM 2017, Company IPO prospectus

Financials

Eris develops, manufactures and commercializes prescription based branded pharma products in select chronic and acute therapeutic areas, such as, CVS, Diabetology, Vit, GI, AI and Gynaecology. The chronic segment contributed to 66% of Eris revenues, while the acute segment contributed 34% in FY17, compared to 31% in FY13. We expect contribution of revenues from chronic products to increase to 72% in FY19E, post addition of revenues from the Strides portfolio.

Exhibit 20: xxx

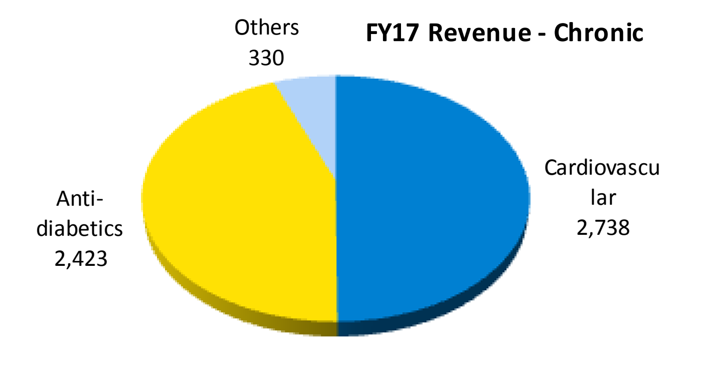


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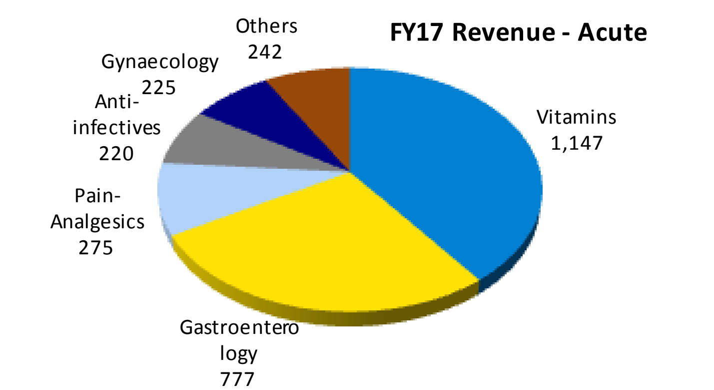
Exhibit 21: xxx



Source: xxx

Fastest growing company in target market

Eris's revenues increased at 22% CAGR and outperformed overall IPM growth of 12% CAGR in FY13-17. In the IPM chronic category, Eris emerged as the fastest growing company among the top 25, with 29% revenue CAGR in FY13-17. Eris also ranked 20th on revenues, of the 377 domestic and multinational companies in the chronic category of the IPM in FY17 v/s 26th rank in FY13. The company's market share (by revenue) in the chronic category increased from 0.9% in FY13 to 1.4% in FY17.

Acquisitions, expansions to help maintain revenue momentum

With multiple acquisitions in its focus therapeutic areas and expansion into new ones, we expect Eris to maintain its growth momentum, lower sales due to the implementation of GST in FY18E notwithstanding. The company expects its core portfolio to grow 9.5% YoY, and Amay and Kinedex Pharma to grow at 5% in FY18E, citing the ongoing integration process. Eris expects revenues from UTH Healthcare and Strides to account for 6.2% of consolidated revenues in FY18E.

Exhibit 22: Acquisition track record in recent past

Acquired company	Acquisition Timeline	Acquisition Value (Rs m)	Major presence in	Sales during acquisition (Rs m)
Amay Pharma (40 brands) (Aprica)	Acquired in FY17-Jul 2016	378.7	CVS, Diab	243
Kinedex Pharma (75.48% stake)	Acquired in FY17-Nov & Dec 2016	771.8	Ortho	830
UTH Healthcare	Acquired in FY18-Oct 2017 (brands in Obesity+Diabetes+Gestational diabetes mellitus+maternal nutrition+CVS)	128.5	Multi-Vit	256
Strides (Branded gen, 130+ brands)	Acquired in FY18-Nov 2017 (brands in Neurology+Psychiatry+Nutraceuticals+Women health)	5,000.0	CNS	1,810

Source: Company Data, PL Research

Management guided for gradual improvement in inventory pick up, reaching the pre-GST level in FY18E. The company expects increase in inventory days to reach its previous normalised average of 40 days in H1FY19E. While Eris's inventory days are higher than industry average, its current inventory days of 30-32 days compare better with the industry level of 28-30 days.

Eris's revenues will likely grow at 27% CAGR, backed by 14% and 15% CAGR in top-10 and top-25 product categories in FY17-20E. The company's foray into new therapeutic areas and its broader portfolio in focus therapeutic areas, Eris has lowered the concentration risk of revenues; the contributions of top-10 and top-25 products decreased to 62% and 68% of revenues in FY20E, from 86% and 92% of revenues in FY17, respectively. Acquisitions and launch of products in new therapeutics will expand the scope of Eris's core portfolio in FY18E-20E, in our view.

Exhibit 23: The growth of Top-10 mother brands from Eris in IPM in FY13-17

Mother Brand Group	Therapeutic Area	Revenue (Rs m)			Market Share	
		FY13	FY17	CAGR	FY13	FY17
Glimisave	Anti-diabetics	616	1,709	29%	3.9%	5.5%
Eritel	Cardiovascular	374	1,022	29%	4.2%	5.3%
Rabonik	Gastroenterology	381	542	9%	5.3%	4.4%
Remylin	Vitamins	359	530	10%	7.1%	6.3%
Tayo	Vitamins	391	527	8%	8.4%	4.9%
Olmin	Cardiovascular	142	487	36%	4.0%	6.8%
Atorsave	Cardiovascular	286	377	7%	3.0%	3.6%
LN Bloc	Cardiovascular	7	360	168%	2.0%	10.8%
Tendia	Anti-diabetics	0	288	NA	NA	7.2%
Crevast	Cardiovascular	109	230	20%	2.8%	2.5%
Total		**2,666**	**6,071**	**23%**		

Source: Company Data, PL Research

Exhibit 24: Revenue break up (Mother brand basis)

Top Brands	FY16	FY17	FY18E	FY19E	FY20E
Glimisave (Diab)	1,423	1,709	1,965	2,358	2,759
Eritel (CVS)	915	1,022	1,084	1,235	1,383
Rabonik (GI)	591	542	569	626	682
Remylin (Multi-Vit)	494	530	551	606	667
Tayo (Multi-Vit)	554	527	553	603	675
Olmin (CVS)	406	487	536	643	759
Atorsave (CVS)	352	377	389	427	462
LN Bloc (CVS)	270	360	425	552	690
Tendia (Diab)	-	288	325	384	461
Crevast (CVS)	192	230	257	314	376
Top-10 brands	**5,371**	**6,071**	**6,653**	**7,748**	**8,914**
YoY growth		*13%*	*10%*	*16%*	*15%*
Next 15 brands	145	432	281	393	539
Top-25 brands	**5,515**	**6,503**	**6,934**	**8,141**	**9,452**
YoY growth		*18%*	*7%*	*17%*	*16%*
Post Top-25 brands	**327**	**550**	**1,805**	**3,899**	**4,618**
Total Sales	**5,843**	**7,053**	**8,739**	**12,040**	**14,071**
YoY growth		*21%*	*24%*	*38%*	*17%*

Source: Company Data, PL Research

Exhibit 25: Revenue break up (Core, acquired assets)

Acquired company	FY17	FY18E	FY19E	FY20E
Amay Pharma (40 brands, Aprica)	243	255	280	314
Kinedex Pharma (75.48% stake)	173	872	976	1,103
UTH Healthcare	-	107	281	318
Strides (Branded gen, 130+ brands)	-	453	2,082	2,456
Total (M&A, Subs)	**415**	**1,685**	**3,619**	**4,191**
YoY growth		*306%*	*115%*	*16%*
Core/ Own sales	6,638	7,054	8,421	9,880
YoY growth		*6%*	*19%*	*17%*
Total Sales	**7,053**	**8,739**	**12,040**	**14,071**
YoY growth		*24%*	*38%*	*17%*

Source: Company Data, PL Research

Judicious mix of strategy, execution to maintain better margin profile

The greater focus on chronic therapies helps build a business with higher operating margin, but, three key factors help the company maintain a better margin profile vis-à-vis its peers, even those with a chronic-heavy portfolio:

- *Judicious selection of portfolio*—Management's selection of products in its focussed portfolio has helped keep the prime portfolio's contribution high, while that of the tail-portfolio (or 2nd / 3rd portfolio) remains small. The Top-10 and Top-25 products contribute 75% and 95% of revenues, while the specialty and super-specialty segments contribute 97% of prescriptions (Rx). In a like-to-like comparison with peers (of chronic-heavy portfolio), Eris has a similar margin profile in the prime portfolio, while the tail portfolio remains a drag. With the smaller contribution of tail-portfolio, Eris has higher blended margin v/s peers.

Exhibit 26: Cardiovascular (CVS) therapy: Top-15 in IPM vs Eris

Rank by CAGR	Company	CVS Rev FY17 (Rs m)	CVS Rev. CAGR FY13-17 (%)	CVS Rank by Rev FY17
1	Ajanta	2,624	36.4	20
2	Alembic	2,709	27.0	19
3	**Eris Life**	**2,738**	**25.8**	**18**
4	Unique Pharma	1,972	24.8	24
5	Mankind	4,007	21.2	14
6	Macleods	4,576	20.5	11
7	Aristo	2,235	18.6	22
8	Glenmark	5,230	17.7	7
9	Lupin	8,595	16.3	2
10	USV	7,247	15.4	4
11	Serdia	1,537	14.7	25
12	Sun	16,644	12.4	1
13	Astrazeneca	2,251	12.1	21
14	IPCA Labs	2,818	12.0	17
15	Cipla	6,623	11.6	5

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

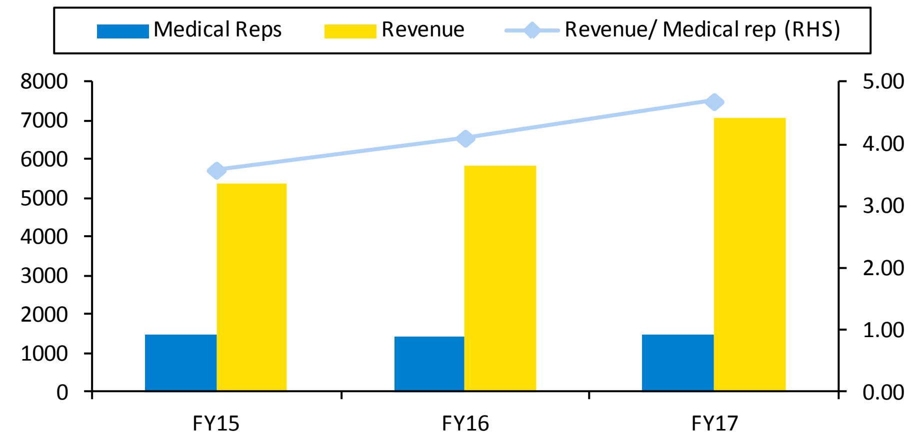
Exhibit 27: Anti-Diabetics (Anti-Diab) therapy: Top-15 in IPM vs Eris

Rank by CAGR	Company	Anti-Diab Rev FY17 (Rs m)	Anti-Diab Rev. CAGR FY13-17 (%)	Anti-Diab Rank by Rev FY17
1	Boehringer Ingelheim	2,233	76.9	13
2	Macleods	1,057	42.2	22
3	**Eris Life**	**2,423**	**34.5**	**10**
4	Mankind	2,744	34.4	9
5	Alembic	1,315	29.6	19
6	Glenmark	1,664	27.8	16
7	Lupin	4,722	27.1	6
8	MSD	5,106	24.4	5
9	Eli Lily	3,531	20.1	8
10	Intas	2,421	19.8	11
11	Torrent	1,818	19.8	15
12	Astrazeneca	1,282	18.9	20
13	USV	11,628	18.6	2
14	Dr. Reddy's Lab	1,903	17.9	14
15	Sun	8,047	17.2	3

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

- *Higher productivity of sales and marketing team*—Eris believes that adding people is not the only way to increase revenues. With sales force turnover of less than 10% annually, Eris has largely kept its core sales team intact for a longer period. It focuses on detailed background work before zooming in on products and arriving at the best geographic fit. This has resulted in a) structural boost for the medical reps team as a whole; b) lower dependency on key sales personnel and; c) higher productivity of medical reps, which is also comparatively higher than peers.

Exhibit 28: Productivity of sales representatives



Source: Company Data, PL Research

- *Superior process of sales and strategic management*—Eris's business model focusing largely on the super specialty segment contributes to its superior growth and margin profile v/s peers. Eris's non-linear growth in the super specialty segment more than compensates for its higher operating cost.

Exhibit 29: Prescription (Rx) share in IPM: Top-5 vs Eris

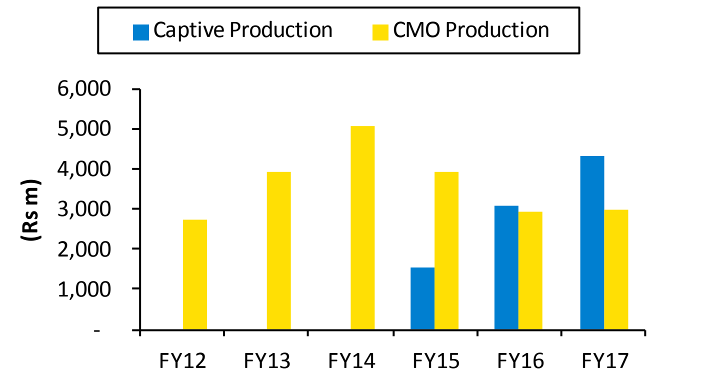
Rx Rank	Company	Rx Share (%)	Avg. Prescribers	Average Rx per Doctor per month
Cardiologists				
1	Sun	20.5	6,891	88
2	**Eris Life**	**10.9**	**4,710**	**65**
3	USV	10.0	5,172	57
4	Lupin	8.3	5,490	44
5	Glenmark	7.0	5,601	38
	Cardiologists	100.0	7,881	374
Diabetologists/ Endocrinologists				
1	Sun	22.4	3,854	84
2	USV	13.3	3,467	55
3	**Eris Life**	**11.6**	**3,051**	**55**
4	Lupin	8.4	3,014	40
5	Glenmark	7.5	3,141	35
	Diabetologists/ Endocrinologists	100.0	4,442	
Consulting Physicians				
1	Sun	11.7	17,683	51
2	USV	6.7	12,436	42
3	Alkem	6.5	13,923	36
4	Mankind	6.2	14,044	34
5	**Eris Life**	**5.8**	**8,922**	**50**
	Consulting Physicians	100.0	23,976	323

Source: IMS TSA MAT (Mar 2017); Eris IPO prospectus

Better utilisation of Guwahati plant to improve margin

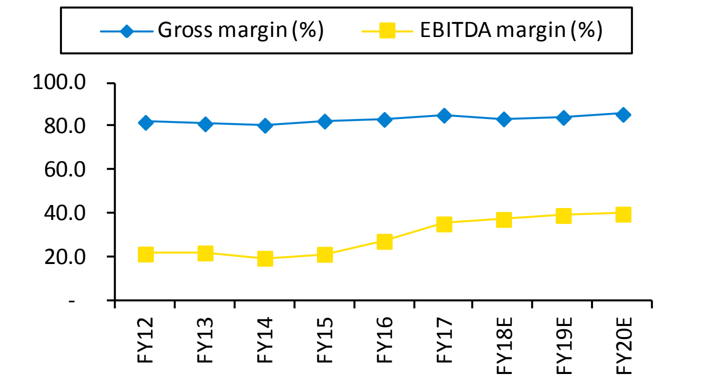
Increase in utilisation of and contribution from its own (Guwahati) plant places Eris in a better position to improve its gross and EBITDA margin. While outsourced manufacturing still contributes 40% of material costs, management guided for higher volume of captive production at Guwahati in H2FY19E, resulting in gross margin expansion. The outsourced production costs account for fixed cost and conversion costs in material costs, while captive production costs account for only cost of materials (8-10% of sales) in COGS. The conversion and fixed costs are accounted as overheads (other operating costs). Hence, greater contribution from the Guwahati plant will improve gross margin in foreseeable future, in our view. As a result, management guided 50% difference between its own cost of production and that of third-party suppliers.

Exhibit 30: Rising captive production over the years….



Source: Company Data, PL Research

Exhibit 31: ….Changes for better margin profile



Source: Company Data, PL Research

The increase in capacity utilisation at the Guwahati plant to 35% in H1FY18 from 18% in FY16 improved gross margin to 84.5% from 83.3% during the same period. Consequently, the Guwahati plant's contribution to standalone sales grew to 80-83% in H1FY18 from 52% in FY16. The increased production at the Guwahati plant also helps in reducing unit cost of materials from suppliers (due to larger order book) and other operating costs due to benefits from economies of scale. These have led to EBITDA margin improving to 39% in H1FY18 from 27% in FY16.

Exhibit 32: The utilisation track record at Guwahati plant over years

Product category	FY15		FY16		FY17	
	Output (Units m)	Utilisation (%)	Output (Units m)	Utilisation (%)	Output (Units m)	Utilisation (%)
Tablets	379.7	38.0	508.4	50.8	760.5	76.1
Capsules	55.5	66.9	41.4	49.9	47.8	57.6
Sachets	2.7	14.7	3.9	21.4	3.5	19.6

Source: Company Data, PL Research

Eris to maintain larger contribution from Guwahati plant

Eris guided to maintain 80-83% of contribution of Guwahati plant to standalone sales, gradually improving to 85-87% in FY18E-20E. This guidance implies at a gradual shift of the manufacturing base of Strides's products over FY18E-20E. While the plant has enough capacity to improve contribution to 93-95%, management plans to continue outsourcing manufacturing activities of Kinedex (except Rosiflex) and Amay Pharma. Those products belong to the tail portfolio, and hence, have lower sales and production and lack benefits of economies of scale. Also, around 5% of standalone sales (belonging to tail portfolio) are liquid products, while the Guwahati plant has installed capacity only in oral solid dosages (OSD). Hence, management continues to outsource the manufacturing of liquid products.

Exhibit 33: Tail-portfolio contribution remains lowest helps better margin profile

Therapeutic areas	Revenues FY17 (Rs m)	Total Rev, contrib. (%)	CAGR FY13-17 (%)
Acute Respiratory	162	2.3	29.4
Hepatoprotectives (Acute)	34	0.5	(3.7)
Hormones (Acute)	26	0.4	1.2
Dermatology (Acute)	11	0.2	NA
Hematology (Acute)	9	0.1	14.8
Chronic Pain (Analgesics)	101	1.4	64.0
Chronic Respiratory	60	0.8	15.1
Urology (Chronic)	2	0.0	NA
Total	**405**	**5.7**	

Source: Eris IPO prospectus

Improving financial health of acquired business

The two acquired companies (Kinedex and Amay), in the last 12 months, reported moderate sales growth and positive EBITDA, despite weak sales growth in the IPM in M9FY18. Currently, gross margins of Kinedex and Amay Pharma are at 78-79% and EBITDA margins at 9-11%, post the transfer of Kinedex‘s Rosiflex to the Guwahati plant. Management expects EBITDA margins of the acquired businesses (in the last 12 months) to continue to improve, but, stay below Eris’s average margin. Management also guided that third-party manufacturing operation of acquired business will continue, citing a shift to the Guwahati plant as uneconomical. Eris sees merit in shifting only large brands of acquired entities to its own plant, as they will help increase gross margin by helping negotiate better raw material prices.

Margin play: production rejig, lowering expiry products

Gross margin from the Strides portfolio of 68-70% of sales is largely due to the outsourcing of manufacturing to a third party. We believe the management’s plan to shift manufacturing operations to its Guwahati plant, once implemented, can boost gross margin from Strides products by 10-12% of sales. Besides, the portfolio reported 10% expiry (free medicines) products in FY17, which are accounted in COGS. Eris plans to bring expiry products down to industry standard of 2-3%, which will immediately boost gross margin, considered as low-lying booster for improving margin of the Strides portfolio. The shifting of production to Guwahati could happen over the next 2-4 quarters, while lower expiry can occur from the second quarter, post integration. Overall, gross margin could reach 85-86% over the next 2-4 quarters. Management, however, guided for minimum achievement of 75% gross margin as a maintainable margin in the initial quarters by H1FY19E. The addition of personnel from Strides and new recruits for the new and expanded divisions of Eris increased employee costs by 36% YoY in Q3FY18, or, by Rs50m QoQ.

Other key benefits, guidance

- **Plant Infrastructure**: Guwahati remains Eris's only manufacturing plant with 22% utilisation in FY17. With integration of the Strides portfolio and Kinedex's Rosiflex, we expect the utilisation rate to increase to 35% in FY18E and 45% in FY20E. This will improve contribution in consolidated revenues from the plant to 78% in M9FY18 from 55% in FY17. The higher utilisations also benefit Eris from higher operating leverage and resulted in gross and EBITDA margin expanding 120bps and 350bps in M9FY18. Management guided the contribution of Guwahati plant to be maintained at 80-83% of consolidated sales in FY19E.

- **Not to enter low margin segments**: The super-specialty CVS and diabetes therapeutic segments account for a substantial part of Eris's business, with Chlorthalidone and Vitamin D being success stories, to name a few. Eris has a 7-7.5% share of the hypertension market, while it ranks among the top-3 players in the Vit-D segment. The company claims to avoid launching any me-too products, and says has no plans to foray into any business where the margin profile is below the company's average gross/EBITDA margin.

- **Guidance for foray in new therapies, M&A focus**: Women healthcare and orthopaedics (bone health) are the two new super-specialty areas where Eris is aggressively planning to enter. We expect any acquisition going forward to be in these two areas. Eris guided its M&A focus only in specialty/super-specialty and highly attractive therapeutic areas. Eris targets a payback period of 5-10 years for acquisition of brands/company though it achieved outperformance through a shorter payback period, such as, two years in some of the acquired brands/products.

- **Acquisition of UTH Healthcare to open new division**: The acquisition will allow Eris to launch a new division in Q4FY18E for nutritional products with niche market placements. With experience of selling chronic-heavy products, management believes it has a field force with better understanding of nutrition markets/products and will be able to scale up, going forward. The new division is expected to have 35 MRs across India.

- **Coverage of CNS division before Strides**: Eris's CNS division (before the Strides acquisition) comprised 65 MRs for covering 2,500 neurologists across India. Post the integration of Strides's products and MRs, the coverage list of neurologists is expected to increase multi-fold. Management guided employee costs of Rs300-350m/quarter post integration of MRs from Strides, FY18E onwards.

- **Instant increase in productivity of Strides portfolio**: Eris plans to promote the acquired CNS drugs with 240 MRs (110 in existing div and 130 in the new neurology division) as against 1,200-1,300 MRs of Strides. This has resulted productivity improving to Rs7.5m/MR in Eris from Rs1.5m/MR in Strides.

- **Current field force**: Eris's headcount is 2,000 MRs (from 1,600 before the Strides acquisition), including addition of sales reps from Strides and recruitment of new reps for its new/divisions. Neurology division added 170 MRs (total 240 MRs) and Gynaecology divisions added 50 MRs (total 210 MRs) from Strides. A new nutrition division added 35 MRs, mainly for UTH Healthcare products. Eris also recruited 60 and 62 MRs in two of its nine divisions in M9FY18.

Exhibit 34: Department-wise employee count in Eris

Particulars (FY17)	Number of Employees (FY17)	% of Total Employees
Medical Representatives	1,501	56.8%
Field Managers	696	26.3%
Manufacturing Facility employees	198	7.5%
Corporate Office	250	9.5%
Sales and Marketing	60	2.3%
Intellectual Property and Research	32	1.2%
Distribution and IT	47	1.8%
Administration	32	1.2%
Finance, Accounting and Legal	33	1.3%
Human Resources	17	0.6%
Others	29	1.1%
Total Employees	**2,645**	**100%**

Source: Company Data, PL Research

- **New launches in FY18E**: Eris launched four drugs in M9FY18, three in Q2FY18 and one in Q3FY18, along with re-launching two-brands of UTH Healthcare. Eris launched two brands in its CNS division (before integration of Stride products) in Q2FY18. It also re-launched two chronic-therapy products (from UTH Healthcare) with own field force in Q2FY18. UTH is a nutrition company and its two products support the treatment of chronic lifestyle diseases. One was a meal replacement product (in diabetic div), while the other was launched in the Gynaecology division. Eris launched one respiratory drug (nasal corticosteroid—bio-adhesive drug) in India's Rs2.2bn nasal spray market. Post price restriction of Tayo, Eris launched a branch extension of Tayo along with another launch in the CVS segment in October CY17.

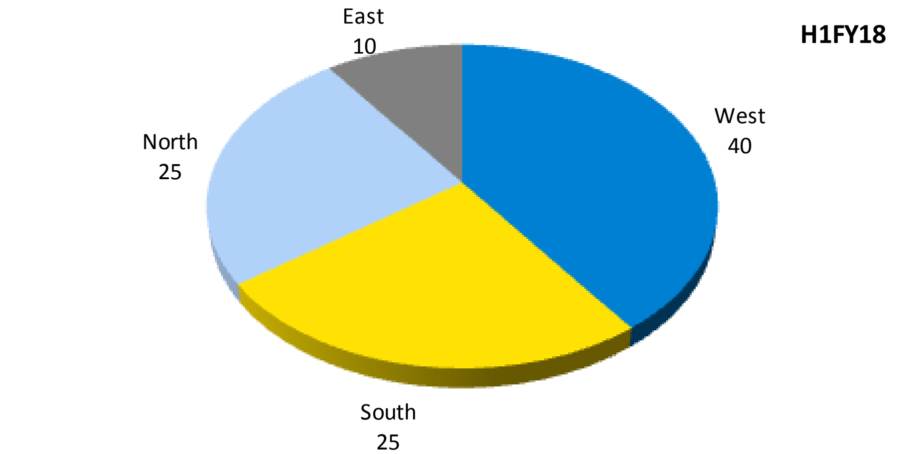
- **Maturity profile of own portfolio, in-license opportunity**: Eris being a new company (inception year CY07), its overall maturity profile of products is young as around 73% of portfolio is in growth stage, 25% in maturity stage, with the remaining 2-4% in declining stage. Management's strategy of building a business model for in-licensing opportunities is still in the planning stage. There is not much clarity from management on the timeline over its foray for licensing-in global molecules in India.

- **Competition, price control, NLEM in top-10 drugs**: Management believes that its top-10 drugs will continue to face competition, going forward, but that is unlikely to affect the growth prospects for the top-10 mother brands. Price control of its top-10 drugs remains unclear, given the lack of visibility from the regulator. Tayo, one of Eris's large brands, has received price restriction in H1FY18, which led to its price being cut by 30%, impacting revenues of the Vit-D portfolio. Overall, Eris had 13% revenue exposure to NLEM drugs before the Strides acquisition; The Strides portfolio's exposure to NLEM is 5%.

- **Sales growth guidance**: Management guided 15-20% YoY growth in consolidated revenues in FY19E and expects higher growth in tail-products in subsidiaries (than core products) due to a very low base

- **Geographic break of sales**: Eris's geographic break-down (across India) of revenues in H1FY18—West 40%, South 25% (ex-Strides), North 25%, East 10%.

Exhibit 35: Stride buy to up contribution from South India to 35% from 25%

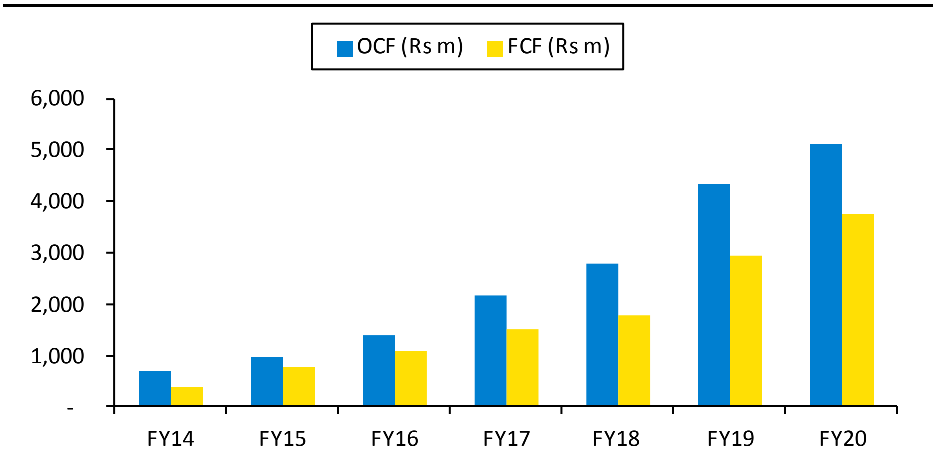


Source: Company Data, PL Research

- **Capex**: With current utilisation of 25-30% in the Guwahati plant, Eris will not require any major capex for investment in a new plant at least until FY20E.

- **Cash flows comfortable**: Cash flow of standalone financials was Rs550m in H1FY18. Cumulative cash flows were 3,000m in FY17 and Rs3,520m in H1FY18.

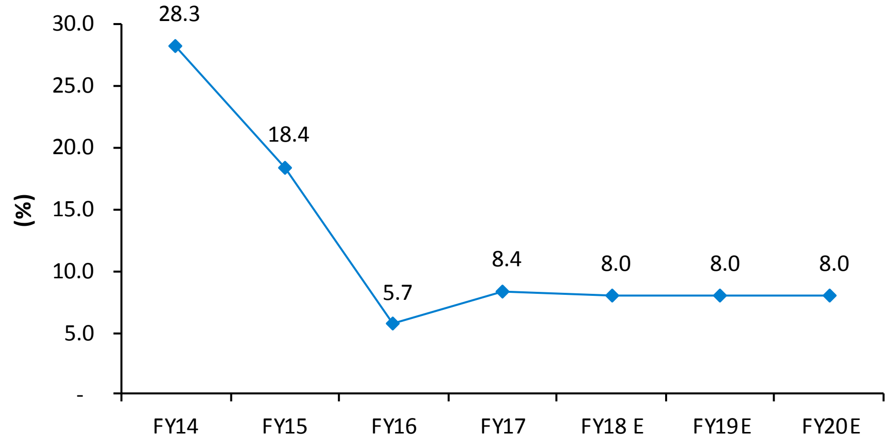
Exhibit 36: OCF and FCF mark steady rise



Source: Company Data, PL Research

- **Tax rate, benefit guidance**: Tax benefits of Guwahati plant to continue until FY24; tax rate of Eris to be in the single-digit. Management guided consolidated tax rate to be 8-9% in FY18E.

Exhibit 37: Growing utilisation of Guwahati plant significantly reduces effective tax rate



Source: Company Data, PL Research

Valuation

Eris being a relatively younger company with a shorter history is in the early stages of growth. In comparison to the older peers, Eris benefits from its selective entry in lifestyle drugs in the chronic therapeutic space. The choice of high growth therapeutic drugs with better profitability has helped the company to achieve the second fastest growth in the IPM. The marketing background of promoters led to Eris focusing on the high-growth, high-margin chronic segment with differentiated products. This has resulted in higher MR productivity and operating leverage. The contributions of chronic drugs increased to 78% in FY17 from 52% in FY13. With strong operating cash flow and miniscule capex requirement, the company's business continues to generate strong free-cash-flow (FCF) and bolsters its M&A ambitions in focused therapeutic areas. Eris being a pure domestic play in selected chronic therapies, we expect its growth to remain higher than the industry average.

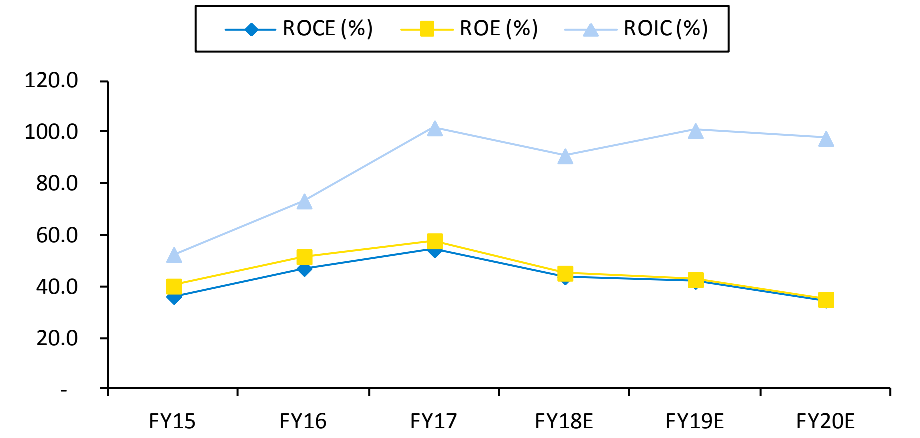
Exhibit 38: Key revenue drivers mostly better than industry benchmark (averages)

Therapeutic areas	Eris Life		IPM	
	Rev FY17 (Rs m)	Rev. Contrib from Metros/ Class-A towns (%)	Rev FY17 (Rs m)	Rev. Contrib from Metros/ Class-A towns (%)
CVS	2,738.3	74.8	134,031.7	70.1
Anti-Diabetic	2,422.5	75.0	100,586.2	73.1
Vitamins	1,146.9	81.7	89,339.7	64.7
Gastrointestinal	776.9	78.8	122,262.2	61.0

Source: Company Data, PL Research

With adequate headroom for operating leverage, Eris is likely to further improve its strong financials as its Revenues, EBITDA and PAT are also likely to grow at 27%, 32% and 29% CAGR in FY17-20E. Better utilisation of its own plant to maintain gross margin at 84-86% and higher MR productivity are expected to increase EBITDA margin to over 40% in FY20E from 35% in FY17.

Exhibit 39: High return ratios to maintain higher valuation multiple



Source: Company Data, PL Research

With superior return ratios (ROE of over 40% in FY18E-20E) and better margin than peers, we assign 23.4x PE, backed by 20% discount to earnings growth (29% CAGR) in FY17-20E. We derive TP of Rs885 on 23.4x PE of earnings of FY20E. The stock trades at 25.9x and 21.8x PE of FY19E and FY20E, which implies that a major part of potential earnings growth from the acquisition of Strides portfolio are discounted in the current valuation. With 7% upside to our TP Rs885, we initiate coverage on Eris with an '***Accumulate***' recommendation. Future acquisitions in the focused therapeutic areas are likely to trigger an earnings upgrade, while new price ceiling/government policy of generic prescription may act as downside risks to our earnings estimates.

Risk and concerns

High concentration of revenues among the leading brands

Eris derived 65% and 95% of its revenues from top-10 and top-26 products. While management believes lower contribution of tail-portfolio was one of the reasons for its efficient management of sales growth and operating margin, we believe the concentration carries high risk as any regulatory restriction (such as price restriction or ban) among the top brands may strongly impact growth and margin.

Exhibit 40: Eris have high concentration from Top-10, Top-25 brands

Rank by Rev (FY17) in IPM	Company	Rev. Contrib (FY17) of Top-10 Mother brands (%)	Rev. Contrib (FY17) of Top-25 Mother brands (%)
1	Sun	26.2	44.6
2	Abbott	37.5	57.1
3	Cipla	29.0	52.3
4	Mankind	33.6	59.0
5	Alkem	51.7	71.4
6	Lupin	31.8	51.5
7	Zydus Cadila	29.9	51.5
8	Glaxosmithkline	56.7	81.7
9	Macleods	33.0	60.7
10	Intas	26.9	44.9
11	Pfizer	63.5	85.8
12	Aristo	62.3	82.6
13	Dr Reddy's Labs	43.4	66.8
14	Torrent Pharma	47.3	66.9
15	Sanofi	58.3	82.6
16	Emcure	44.5	65.5
17	Glenmark	52.7	70.9
18	USV	76.3	92.1
19	Micro Labs	32.5	55.1
20	Alembic	53.9	77.7
32	**Eris Life**	**72.5**	**92.2**

Source: Company Data, PL Research

Concentration of few therapeutic areas

While the product portfolio is a combination of chronic-heavy drugs and a few acute therapy drugs, there is strong concentration in a few therapeutic areas. For example, CVS and diabetic drugs contribute 94% and 73% of revenues to the chronic segment and consolidated revenues, respectively. Vitamins and GI segment drugs contribute 66% and 27% of revenues to acute therapy and consolidated revenues. Any broad-based price restriction from the regulator in the four therapeutic areas or strong price competition from deep-pocket peers may cause serious disruption for Eris, given the lack of diversification in its focused portfolio.

High margin may fuel greater competition

The judicious mix of branded generics in a few therapeutic areas helped Eris derive 80-85% gross margin and 35-40% EBITDA margin in its standalone business. The high margin profile of its portfolio may trigger competition as peers could copy its portfolio with similar sounding brands and launch a price war. The new entrants may also target the same group of specialists and super specialists, who currently prescribe Eris's drugs.

Government may revisit mandatory prescription plan for generics

There exists the possibility of the Central government revisiting its plan to introduce a revised pharma policy for mandatory prescription of generics from doctors. Eris's revenues being driven by branded generics could face a serious threat to the new pharma policy as it recommends mandatory prescription of generics from doctors. Nevertheless, there is a less likely scenario of finalisation of new pharma policy in near to medium term.

Income Statement (Rs m)

Y/e March	2017	2018E	2019E	2020E
Net Revenue	**7,053**	**8,955**	**12,343**	**14,485**
Raw Material Expenses	1,043	1,477	1,951	2,084
Gross Profit	6,010	7,478	10,391	12,400
Employee Cost	1,320	1,701	2,222	2,638
Other Expenses	2,208	2,439	3,346	4,012
EBITDA	**2,482**	**3,338**	**4,824**	**5,750**
Depr. & Amortization	237	257	291	330
Net Interest	2	—	—	—
Other Income	388	271	285	299
Profit before Tax	**2,630**	**3,352**	**4,818**	**5,720**
Total Tax	220	268	385	458
Profit after Tax	**2,410**	**3,084**	**4,432**	**5,262**
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	**2,410**	**3,084**	**4,432**	**5,262**
Avg. Shares O/S (m)	**137.5**	**137.5**	**137.5**	**137.5**
EPS (Rs.)	**17.5**	**22.4**	**32.2**	**38.3**

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
Shareholder's Funds	5,361	8,245	12,463	17,502
Total Debt	6	—	—	—
Other Liabilities	152	55	(40)	(132)
Total Liabilities	**5,520**	**8,300**	**12,423**	**17,370**
Net Fixed Assets	917	1,010	1,069	1,089
Goodwill	793	951	1,141	1,370
Investments	101	101	101	101
Net Current Assets	3,088	5,358	8,887	13,068
Cash & Equivalents	*2,609*	*4,243*	*7,042*	*10,650*
Other Current Assets	*1,236*	*1,862*	*2,680*	*3,282*
Current Liabilities	*757*	*747*	*835*	*864*
Other Assets	621	690	769	860
Total Assets	**5,520**	**8,110**	**11,968**	**16,488**

Cash Flow Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
C/F from Operations	1,999	2,147	3,306	4,113
C/F from Investing	(1,841)	(988)	(1,149)	(1,350)
C/F from Financing	(223)	(170)	(165)	(165)
Inc. / Dec. in Cash	(65)	988	1,992	2,598
Opening Cash	89	23	1,012	3,003
Closing Cash	23	1,012	3,003	5,602
FCFF	1,995	2,355	3,643	4,669
FCFE	1,996	2,349	3,643	4,669

Quarterly Financials (Rs m)

Y/e March	Q1FY18	Q2FY18	Q3FY18
Net Revenue	**1,852**	**2,492**	**2,090**
EBITDA	**714**	**978**	**811**
% of revenue	*38.6*	*39.2*	*38.8*
Depr. & Amortization	46	53	67
Net Interest	—	—	28
Other Income	69	65	58
Profit before Tax	**737**	**989**	**774**
Total Tax	28	58	25
Profit after Tax	**708**	**929**	**746**
Adj. PAT	**708**	**929**	**746**

Key Financial Metrics

Y/e March	2017	2018E	2019E	2020E
Growth				
Revenue (%)	20.7	27.0	37.8	17.4
EBITDA (%)	56.3	34.5	44.5	19.2
PAT (%)	65.7	27.9	43.7	18.7
EPS (%)	(98.3)	27.9	43.7	18.7
Profitability				
EBITDA Margin (%)	35.2	37.3	39.1	39.7
PAT Margin (%)	34.2	34.4	35.9	36.3
RoCE (%)	54.4	43.9	42.2	34.8
RoE (%)	57.9	45.3	42.8	35.1
Balance Sheet				
Net Debt : Equity	(0.5)	(0.5)	(0.6)	(0.6)
Net Wrkng Cap. (days)	86	133	152	172
Valuation				
PER (x)	42.8	33.4	23.3	19.6
P / B (x)	19.2	12.5	8.3	5.9
EV / EBITDA (x)	40.5	29.6	19.9	16.1
EV / Sales (x)	14.3	11.0	7.8	6.4
Earnings Quality				
Eff. Tax Rate	8.4	8.0	8.0	8.0
Other Inc / PBT	14.7	8.1	5.9	5.2
Eff. Depr. Rate (%)	15.1	13.4	12.8	12.6
FCFE / PAT	82.8	76.2	82.2	88.7

Source: Company Data, PL Research.

Key Operating Metrics

Y/e March	2017	2018E	2019E	2020E
Top 25 Products	6,503	6,934	8,141	9,452
Top 10 Products	6,259	6,653	7,748	8,914
Next 15 Products	244	281	393	539
Ex-Top 25 products	550	1,805	3,899	4,618

Source: Company Data, PL Research.

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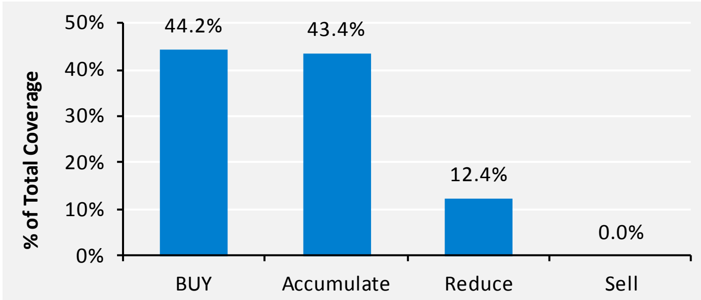

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BUY	:	Over 15% Outperformance to Sensex over 12-months
Accumulate	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months
Sell	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month
Trading Sell	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock
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