

Biocon

 Rs236
OUTPERFORMER
Event update: Signs joint development agreement with Amylin

Mkt Cap: Rs47.2bn; US\$973m

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Key financials

As on 31 March	FY08	FY09	FY10E	FY11E
Net sales (Rs m)	10,538	16,086	20,461	23,920
Adj. net profit (Rs m)	2,246	2,403	2,545	3,129
Shares in issue (m)	100	100	200	200
Adj. EPS (Rs)	11.2	12.0	12.7	15.6
% change	12.2	7.0	5.9	22.3
PE (x)	21.0	19.6	18.5	15.2
Price/ Book (x)	3.2	3.1	2.7	2.4
EV/ EBITDA (x)	16.7	15.7	12.9	10.8
RoE (%)	17.7	16.0	15.5	16.6
RoCE (%)	12.7	11.1	12.2	13.7

Biocon has signed a joint development and commercialization agreement with Amylin, a US-based biopharmaceutical company for the development of a novel peptide hybrid. As part of this deal while Amylin will provide the technology, Biocon will lead the development and manufacturing. After the biogenerics partnership with Mylan, this deal is yet another affirmation of Biocon's strong capabilities in the biotechnology arena, and diabetes in particular, as also its ability to partner with global players. Given the growing dominance of biotech drugs in the global pharma industry, this bodes well for Biocon. We believe that Biocon is a unique play on four big opportunities in the global pharma space – diabetes, biogenerics, CRAMS and NCE research – which can dramatically uplift Biocon's growth trajectory in the coming years, if executed well. With this view, Biocon is clearly one of the Indian pharma companies to watch out for on a medium term perspective. Despite recent outperformance, we remain positive on Biocon. Reiterate Outperformer with a price target of Rs250 (16x FY11E). Biocon may close fairly substantial outlicensing deals over the next 12-24 months as it seeks to outlicense Insulin, Glargine as well as other biogeneric products. This can provide significant upside to our estimates.

EVENT: BIOCON SIGNS DEVELOPMENT AND COMMERCIALIZATION AGREEMENT FOR DIABETES MOLECULE

□ The Amylin deal – reinforcing Biocon's strong Biotech credentials

Biocon and Amylin Pharmaceuticals have entered into an exclusive agreement to jointly develop, commercialize and manufacture a novel peptide therapeutic for diabetes treatment. Amylin and Biocon will jointly develop the therapeutic potential of the compound with shared development costs. As per the terms of the agreement, Amylin will provide expertise in peptide hormone development and metabolic diseases therapeutics while Biocon will leverage its expertise in recombinant microbial expression to manufacture the compound and also leverage its experience its pre-clinical and clinical development of diabetes products.

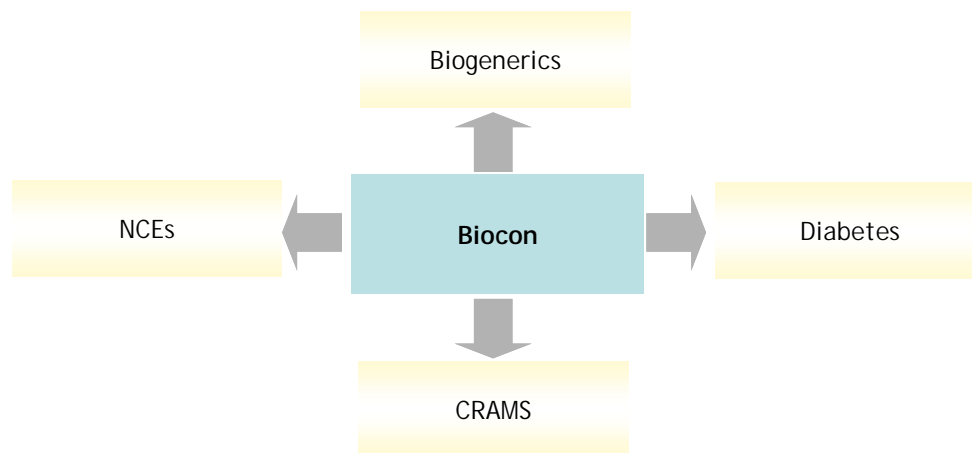
The research would focus on Amylin's "phybrid" technology. A phybrid is a peptide hybrid molecule that combines the pharmacological effects of two peptide hormones into a single molecular entity. Amylin is a US based biopharmaceutical company focused on development of new peptide hormone drug candidates for diabetes, obesity, and other metabolic diseases.

We believe that along with the partnering deal with Mylan for MABs, this deal with Amylin clearly reinforces Biocon's strong credentials in the biotech manufacturing as well diabetes space. Given that most of the future growth in global pharma market will be driven by biotechnology drugs, Biocon's capabilities in the biotech arena is very positive and bodes well for its medium term growth outlook. Along with DRL, Biocon is clearly the leader in the biotech space in India. We do not expect any significant financial impact of this agreement in the near term.

□ **Biocon - Unique medium term play on four big opportunities in the global pharma space**

While the market has been concerned about the weakness in global statins market and Biocon's strong exposure to the same, Biocon has been working on creating new engines for growth. Along with an entry into the domestic formulations market, Biocon has created four highly scalable growth engines with immense potential. While these engines are at different stages of growth currently, they can create immense value for the firm, if executed well.

Biocon's growth engines for the future



□ **Diabetes**

- Diabetes is amongst the fastest growing disease segments in the world especially in Asia and other emerging markets. Sanofi estimates the Asian diabetes market to grow ~3x to 8bn Euro over next 5-6 years.
- Biocon is amongst the very few generic players in the world with a comprehensive anti-diabetes product portfolio including generic Human Insulin and generic Glargine (Insulin analogue). We expect Biocon to work on developing other Insulin analogues in due course of time. This will make it one of the few companies globally with such a strong insulin portfolio
- Given the recent MNC strategy to dive deep into emerging markets, we expect very strong MNC interest in sourcing Biocon's diabetes, especially Insulin portfolio. We would not be surprised if Biocon announces deals for generic Insulin and Glargine in due course

Expect generic Human Insulin launch in EU by 2011 and US a couple of years down the line

- Biocon has initiated trials for launching its generic Insulin in EU and is very hopeful of launching the product by 2011. Biocon will be launching the product on its own in EU through its newly acquired business Axicorp. Given that EU is a pen based insulin delivery market, Biocon is also working on developing its pen delivery device. Biocon's ability to develop this device will be critical to penetrate the market

- Biocon has already tied up with a partner in US and will be launching the product depending on the timing of clarity of the regulatory pathway in US
- Given that the Insulin market in EU and US are worth \$500-\$1bn each, Biocon's entry in any / both of these markets will entirely change its earnings trajectory

Recent Bayer-Bioton deals reflects the value of Insulin franchise even in non-regulated markets

- Bayer recently signed a deal with Bioton, Polish company, for exclusive rights for marketing and distributing Human Insulin only for the Chinese market. Towards this, Bayer paid ~US\$43mn upfront licensing fee to Bioton and would source Insulin from Bioton for the next 15 years. Bioton's estimates sales of ~US\$1.5-2bn over this period. This deal clearly indicates the value creating potential of Insulin if a company has obtained the requisite regulatory approvals in key markets.
- Biocon has been working on obtaining regulatory approvals across various key markets across the globe. While approvals have been slow given regulatory issues around biotech products, we believe approvals should start to fructify going forward.

□ Biogenerics

- It is estimated that \$25bn worth of biotech drugs are likely to use patent protection by 2016 and the generic competition will likely be much lesser as compared to typical small molecules given the technical complexities as well as high entry barriers due to high development costs as well as likely need for marketing front ends.
- Biocon has one of the most focused biogenerics programmes in the Indian industry and its capabilities are well proven in its ability to successfully develop and launch multiple biogeneric drugs like insulin, Glargine, GCSF, Streptokinase etc.
- Biocon's recent strategic alliance with Mylan for developing biogenerics and MABs, in particular, is a clear vindication of Biocon's capabilities in this segment. As per this alliance, Biocon and Mylan will jointly develop and commercialize Monoclonal Antibodies for various markets across world
- Given the regulatory hurdles in US, and even in EU to an extent, Biocon expects to start launching these products in the Indian and other RoW markets over the next 2-3 years
- Additionally, Biocon also has the capability to offer contract manufacturing for biologics in its MAB facility which can lead to significant upsides. Given its track record of IP compliance as well partnership with MNCs, we expect Biocon to be the partner of choice for MNCs seeking to get a low cost source for manufacture of their biotech drugs close to patent expiry.

□ CRAMS

- Biocon is one of the leading and earliest contract research players in the country through Syngene and Clinigene.
- It has strong relationships with a host of MNCs including BMS, Novartis, Du pont, etc. Now Biocon is looking at increasing the scope of its activities by getting to small volume contract manufacturing also
- While there is a bit of softness in this segment in the near term due to global economic turmoil and restructuring at Big Pharma, eventually global pharma companies will outsource aggressively to countries like India
- Biocon is seeking to revisit its plans for listing these entities over the next year or so leading to value unlocking in the same.

□ NCEs

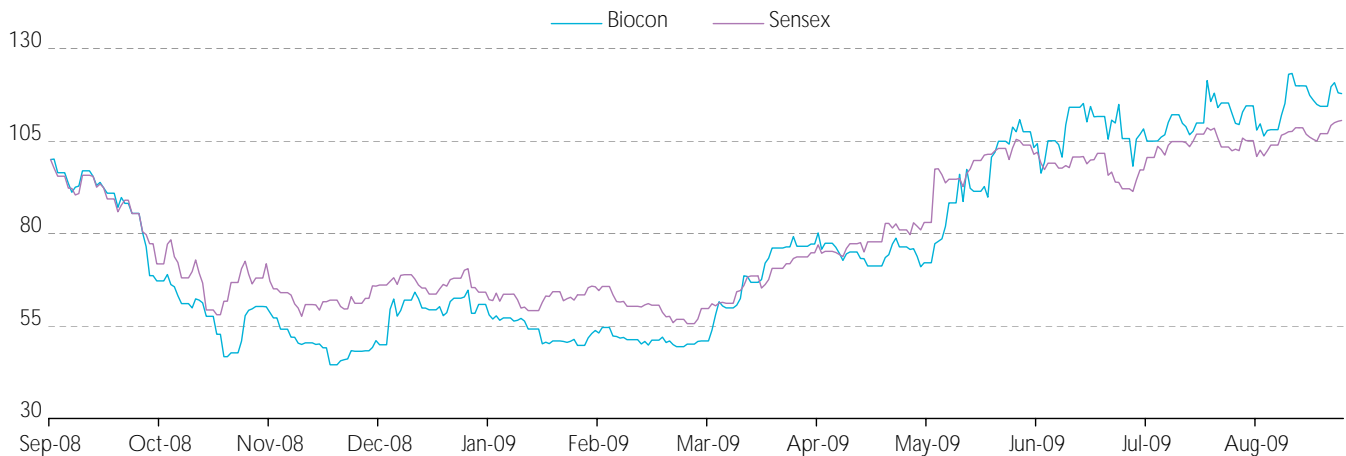
- Biocon has been very optimistic on two of its lead NCE programmes – Oral Insulin and T1-H MAB.
- Phase IIB data is expected on both these molecules over the next few quarters and positive data may provide interesting outlicensing opportunities. Additionally, Biocon is working on multiple early phase biotechnology drugs in collaboration with niche biotech companies.

While most of these opportunities will likely have limited financial impact in the near term earnings, we remain positive on the value creating potential of Biocon's differentiated and high quality product portfolio and Intellectual Property.

VALUATIONS AND VIEW

Biocon has been one of the biggest outperformers amongst Indian pharmaceutical companies over the last few quarters. We have been consistently positive on the company despite the operational challenges over the last few years. We have maintained that while there are limited near term triggers, there are some very exciting possibilities which will unlock over a period of time. While it is difficult to ascertain the timing of the value unlocking process (though it seems to be partially underway), Biocon is one of the Indian pharma companies to watch out for on a medium term perspective. While most of these opportunities will likely have limited financial impact in the near term earnings, we remain positive on the value creating potential of Biocon's differentiated and high quality product portfolio and Intellectual Property. Maintain Outperformer.

Relative price performance



Source: Bloomberg

Income statement

Year to Mar 31 (Rs m)	FY08	FY09	FY10E	FY11E
Net sales	10,538	16,086	20,461	23,920
% growth	6.9	52.6	27.2	16.9
Operating expenses	7,573	12,740	16,402	19,006
EBITDA	2,965	3,346	4,059	4,914
% change	8.1	12.8	21.3	21.1
Other income	387	646	400	450
Net interest	(102)	(177)	(250)	(300)
Depreciation	940	1,103	1,268	1,459
Pre-tax profit	2,310	2,600	2,941	3,606
Deferred tax	17	-	-	-
Current tax	112	118	346	426
Profit after tax	2,181	2,482	2,595	3,180
Minorities	65	(79)	(50)	(51)
Non-recurring items	2,394	(1,472)	-	-
Net profit after non-recurring items	4,640	931	2,545	3,129
% change	131.7	(79.9)	173.4	23.0

Balance sheet

As on Mar 31 (Rs m)	FY08	FY09	FY10E	FY11E
Paid-up capital	500	1,000	1,000	1,000
Preference share capital	-	-	-	-
Reserves & surplus	14,341	14,107	16,223	18,719
Total shareholders' equity	14,768	15,355	17,521	20,068
Total current liabilities	2,300	3,570	4,119	4,629
Total debt	2,551	5,239	5,239	5,239
Deferred tax liabilities	465	466	466	466
Other non-current liabilities	705	806	606	809
Total liabilities	6,020	10,081	10,430	11,143
Total equity & liabilities	20,789	25,436	27,950	31,211
Net fixed assets	10,419	12,205	12,937	13,479
Investments	4,748	3,675	3,675	3,675
Total current assets	5,346	7,925	9,708	12,426
Deferred tax assets	-	-	-	-
Other non-current assets	276	1,631	1,631	1,631
Working capital	3,046	4,355	5,589	7,797
Total assets	20,789	25,436	27,950	31,211

Cash flow statement

Year to Mar 31 (Rs m)	FY08	FY09	FY10E	FY11E
Pre-tax profit	2,310	2,600	2,941	3,606
Depreciation	940	1,103	1,268	1,459
Chg in working capital	214	(1,185)	(1,376)	(2,133)
Total tax paid	(112)	(118)	(346)	(426)
Ext ord. items	-	(1,472)	-	-
Operating cash inflow	3,351	928	2,487	2,506
Capital expenditure	(2,072)	(2,887)	(2,000)	(2,001)
Free cash flow (a+b)	1,280	(1,959)	487	505
Chg in investments	(3,957)	1,072	-	-
Debt raised/ (repaid)	684	2,689	-	-
Capital raised/ (repaid)	-	500	-	-
Dividend (incl. tax)	(328)	(628)	(429)	(633)
Misc	1,833	842	-	-
Net chg in cash	(489)	2,516	58	(128)

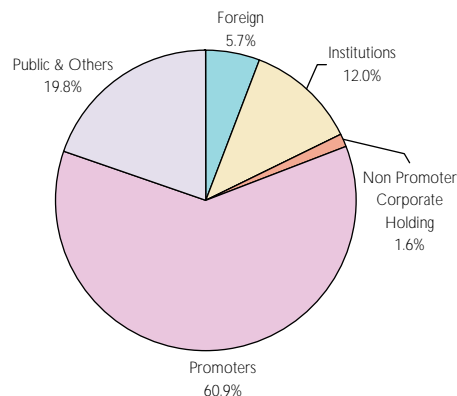
Key ratios

Year to Mar 31 (Rs m)	FY08	FY09	FY10E	FY11E
EBITDA margin (%)	28.1	20.8	19.8	20.5
EBIT margin (%)	19.2	13.9	13.6	14.4
PAT margin (%)	21.3	14.9	12.4	13.1
RoE (%)	17.7	16.0	15.5	16.6
RoCE (%)	12.7	11.1	12.2	13.7
Gearing (x)	0.2	0.3	0.3	0.3

Valuations

Year to Mar 31 (Rs m)	FY08	FY09	FY10E	FY11E
Reported EPS (Rs)	23.2	4.7	12.7	15.6
Adj. EPS (Rs)	11.2	12.0	12.7	15.6
PE (x)	21.0	19.6	18.5	15.2
Price/ Book (x)	3.2	3.1	2.7	2.4
EV/ Net sales (x)	4.7	3.3	2.6	2.2
EV/ EBITDA (x)	16.7	15.7	12.9	10.8
EV/ CE (x)	2.7	2.4	2.2	2.0

Shareholding pattern



As of June 2009

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1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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