

Healthcare
Biotechnology
Equity – India

Underweight

Target price (INR)	424.00
Share price (INR)	428.70
Potential total return (%)	-1.1

Performance	1M	3M	12M
Absolute (%)	-7.1	-8.2	17.7
Relative ^A (%)	0.4	-7.2	-4.4

Index^A BOMBAY SE IDX

RIC BION.BO
Bloomberg BIOS IN

Market cap (USDm) 1,038
Market cap (INRm) 42,870

Enterprise value (INRm) 43443
Free float (%) 34.7

Biocon Ltd

No visible catalysts – retain Underweight rating

- ▶ **News flow over partnering with Abraxis for launching Bio-generics in US markets only a long term positive**
- ▶ **Absence of credible legislation in the US to accelerate approval timelines for bio generics a key structural negative**
- ▶ **Retain earning estimates and Underweight rating, but raise target price from INR 342 to INR424 per share on rollover of valuation year to FY09 and change in valuation methodology**

One small step for entering the US biogenerics market

Biocon had announced a tie-up with Abraxis for launching G-CSF in developed markets, namely the US and Europe. The key highlights of the agreement are:

- ▶ Biocon has outlicensed G-CSF to Abraxis for the North American and European markets whereby Abraxis will be responsible for marketing the products in these markets.
- ▶ Abraxis will also be responsible for procuring regulatory approvals for the product from the authorities in both geographic regions. Biocon will be responsible for providing the data dossiers to be submitted for regulatory approval.
- ▶ Abraxis will bear all expenses for securing regulatory approval and Biocon in turn will get sales royalties once the product is commercialised.

However, regulatory uncertainties still abound

- ▶ Unlike chemical molecules, biological drugs require protein characterisation and hence innovator companies have raised questions about whether chemical characterisation of the active substance is sufficient to establish the similarity of a generic product.
- ▶ Current pieces of the legislation being piloted in the US are not clear whether:
 - a) clinical trials will be required for the biogeneric to be approved. Detailed clinical studies would be expensive and time consuming;
 - b) whether post marketing studies would also be required; these are usually expensive
- ▶ Even Europe, which had a head start in framing pathways for biogenerics, now seems to have taken a more cautious approach for such products.

20 August 2007

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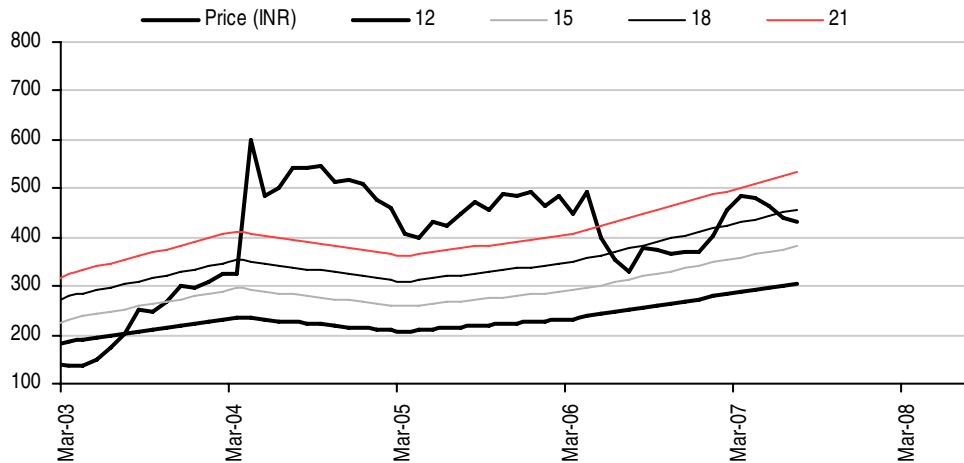
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Figure 1: Biocon – 12-month forward rolling PE band (x)

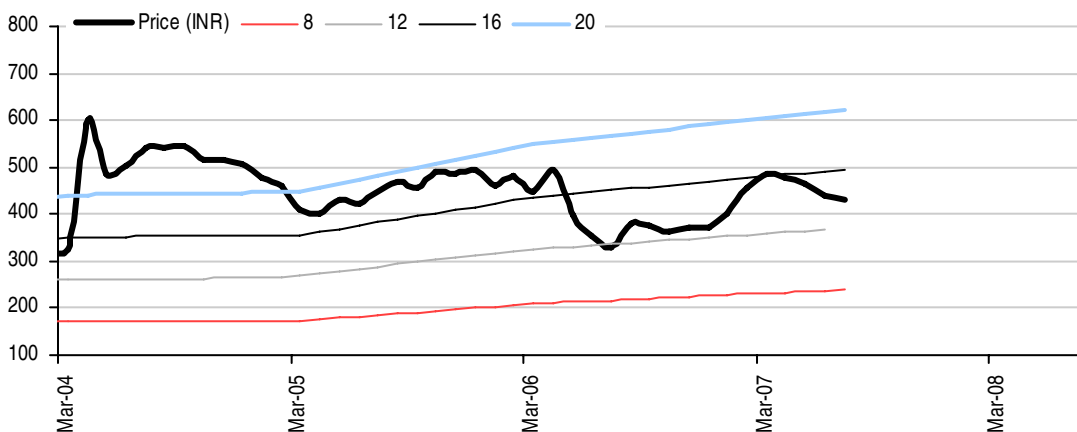


Source: HSBC

Estimates and valuations

We retain our EPS forecast of INR23.9 for FY08 and INR27.7 for FY09. In addition we now introduce our FY10 estimates where we project EPS of INR29.1. Our earlier valuations for Biocon were derived from DCF based valuations where we assumed cost of equity of 13.5%, explicit forecast period of 3 years, semi-explicit period of 10 years and fade period of 25 years. Based on these assumptions we derived a target price INR342 for Biocon. We now change our valuation methodology to a one year forward EV/EBITDA as we believe that in the absence of any significant medium term drivers the stock is likely to trade in a narrow band. Biocon has traded in a 12-20x one year forward EV/EBITDA band in the last two and a half years and the trading band has further narrowed to 12-16x in the last 18 months.

Figure 2: Biocon – 12-month forward rolling EV/EBITDA band (x)



Source: HSBC

Given the absence of any significant earning triggers, at least in the medium term, we use the lower end of the trading band i.e. 12x and apply it to our FY09e EBITDA to derive a target price of INR424 per share. Our new target price of INR 424 implies a target PE of 15.2x FY09e EPS (14.3x on FY08 e EPS earlier).

Under our research model, for stocks without a volatility indicator, the Neutral band is five percentage points above and below the hurdle rate for Indian stocks of 11.3%. This translates into a Neutral band of 6.3% to 16.3% around the current share price. Our new 12-month target price of INR424 for Biocon shares suggests a potential total return of -1.1%, which is below the Neutral band. Thus, we retain our Underweight stock rating.

Key risks

- ▶ Longer-term drivers are Biocon's fast developing biogeneric capabilities. The key risk to our estimates and rating is some dramatic regulatory changes in the US which would facilitate faster entry of Biogenerics.
- ▶ Outlicensing of any molecules under development could also provide earnings and stock price upsides from our current estimates.

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	9,857	10,048	13,184	15,799
EBITDA	2,835	3,108	3,619	3,773
Depreciation & amortisation	-665	-572	-602	-602
Operating profit/EBIT	2,169	2,536	3,018	3,172
Net interest	-59	66	86	86
PBT	2,110	2,602	3,104	3,258
HSBC PBT	0	0	0	0
Taxation	-169	-208	-325	-341
Net profit	1,941	2,394	2,778	2,916
HSBC net profit	1,941	2,394	2,778	2,916

Cash flow summary (INRm)

Cash flow from operations	1,568	1,761	2,511	3,046
Capex	-2,053	-1,664	-1,102	-602
Cash flow from investment	-1,841	-2,002	-1,044	-603
Dividends	-441	-662	-882	-309
Change in net debt	962	-417	-659	-1,593
FCF equity	-481	220	1,409	2,444

Balance sheet summary (INRm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	9,657	10,750	11,250	11,250
Current assets	6,086	6,687	7,716	10,210
Cash & others	878	1,312	1,566	3,160
Total assets	15,744	17,437	18,966	21,461
Operating liabilities	2,324	2,368	2,050	2,477
Gross debt	1,867	1,885	1,480	1,481
Net debt	990	573	-86	-1,679
Shareholders funds	10,692	12,424	14,320	16,354
Invested capital	12,542	13,757	15,350	15,823

Ratio, growth and per share analysis

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	25.1	1.9	31.2	19.8
EBITDA	23.9	9.6	16.4	4.3
Operating profit	8.9	16.9	19.0	5.1
PBT	4.2	23.3	19.3	5.0
HSBC EPS	12.8	23.3	16.1	5.0

Ratios (%)

Revenue/IC (x)	0.9	0.8	0.9	1.0
ROIC	18.0	17.7	18.6	18.2
ROE	19.8	20.7	20.8	19.0
ROA	14.2	15.0	15.6	14.8
EBITDA margin	28.8	30.9	27.5	23.9
Operating profit margin	22.0	25.2	22.9	20.1
EBITDA/net interest (x)	47.7			
Net debt/equity	9.3	4.6	-0.6	-10.3
Net debt/EBITDA (x)	0.3	0.2	0.0	-0.4
CF from operations/net debt	158.4	307.2		

Per share data (INR)

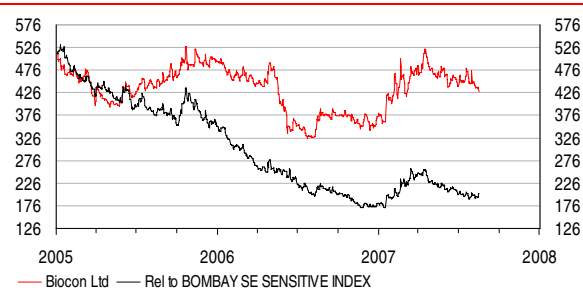
EPS reported (fully diluted)	19.41	23.94	27.78	29.16
HSBC EPS (fully diluted)	19.41	23.94	27.78	29.16
DPS	4.00	6.00	8.00	3.09
NAV	106.92	124.24	143.20	163.54

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	4.4	4.3	3.2	2.6
EV/EBITDA	15.5	14.0	11.8	10.9
EV/IC	3.5	3.2	2.8	2.6
PE*	22.1	17.9	15.4	14.7
P/NAV	4.0	3.5	3.0	2.6
FCF yield (%)	-1.1	0.5	3.3	5.7
Dividend yield (%)	0.9	1.4	1.9	0.7

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 17 Aug 2007

Disclosure appendix

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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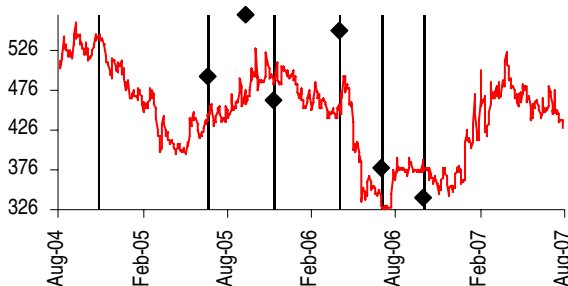
Rating distribution for long-term investment opportunities

As of 20 August 2007, the distribution of all ratings published is as follows:

Overweight (Buy)	46%	(24% of these provided with Investment Banking Services)
Neutral (Hold)	35%	(24% of these provided with Investment Banking Services)
Underweight (Sell)	19%	(18% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Biocon Ltd Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Add	N/R	15 November 2004
N/R	Overweight	08 July 2005
Overweight	Neutral	29 November 2005
Neutral	Overweight	21 April 2006
Overweight	Neutral	20 July 2006
Neutral	Underweight	18 October 2006
Target Price	Value	Date
Price 1	N/R	15 November 2004
Price 2	492.00	08 July 2005
Price 3	570.00	29 September 2005
Price 4	462.00	29 November 2005
Price 5	550.00	21 April 2006
Price 6	378.00	20 July 2006
Price 7	342.00	18 October 2006

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BIOCON LIMITED	BION.NS	428.70	17-Aug-2007	6

Source: HSBC

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
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