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Every week ICICIdirect research team will select a stock based on fundamental and/or technical parameter, which is likely to return 20% over a 3-6 month perspective.

Biocon Ltd.(BIOCON)

Current Price: 512.50

Target Price: 615.00

Potential upside: 20%

Time Frame: 3-6 mths

Company Background

Biocon is a research-driven, global healthcare company with a strong matrix of capabilities along the gene-to-patient continuum. It manufactures and markets biotech-based pharmaceutical products. Its subsidiaries, Syngene and Clinigene, provide contract research and clinical research services to global pharma majors. The company's bio-pharmaceutical products comprise anti-diabetic agents, anti-hypertensive agents, anti-inflammatory agents, anti-oxidants, cardiovascular agents, digestive aid enzymes, haemostatic agents, hepatoprotective agents, immunosuppressants and nutraceuticals.

The company recently divested its enzymes business to Novozymes A/S for US\$115 million. This will enable Biocon to focus on its core bio-pharmaceuticals business. Its subsidiary Syngene provides custom research services in the areas of synthetic chemistry and molecular biology. In Sept 2006, Biocon launched BIOMAB EGFR, a monoclonal antibody for head and neck cancer. In addition, the company offers renal therapy products to treat kidney disorders. Its innovative R&D has few products in pipeline in various phases of clinical trials.

Changing product mix to boost core business

We believe Biocon's exposure to the vagaries of statin business is declining with its changing product mix and rapid growth in the newly added products such as insulin. Moreover, with launch of BIOMAB and INSUGEN, we believe that the company is gradually moving up in the value chain by shifting its focus towards formulations. It already has a formidable presence in Indian biosimilar space and the niche therapeutic segments of nephrology and oncology. We see good future prospects in its discovery focused R&D, where it has two monoclonal antibodies related to oncology and rheumatoid arthritis along with the oral insulin. We believe revenue from the biosimilars and formulations would grow at a CAGR of around 20% over FY07-09E.

Customs & clinical research to add more value

We believe Biocon's custom research outsourcing would grow at a CAGR of over 40% during FY07-09E. As per Frost and Sullivan estimates, Asian contract research outsourcing (CRO) market will grow at a CAGR of over 13.50% to \$2 billion in 2010 from \$1.2 billion in 2006 indicating a strong growth momentum. Biocon's presence in CRO business is through two companies - Syngene and Clinigene. Syngene provides contract research while Clinigene focuses on Clinical research.

Syngene: Syngene is a leading global custom research service provider and is providing services to external customers from few years. It has over 50 clients, including 6 of the top 10 global pharma companies as its customers. It contributes almost 90% of Biocon's CRO businesses. Syngene provides a broad range of services, which enables it to participate in drug development process from discovery to supply of development compounds. Recently, Bristol-Myers Squibb entered into a long-term contract with it to set up a new research facility to house more than 400 scientists. This will further improve its capabilities in medicinal chemistry, biology, drug metabolism and pharmaceutical development. Syngene has a strong knowledge base with over 700 scientists.

Clinigene: Clinigene started operations for external customers only couple of years back. It provides clinical research services. With demand for outsourced research expected to grow exponentially, the company has expanded its operations into a new 60,000 sq ft facility. This facility will house a new unit for conduct of BE/BA and Phase I studies and coordinate Phase II to Phase IV Clinical Trials for a large number of global pharma and biotech companies.

Sales proceed from enzymes business boosts cash position

With a view to become a more focused player in the biotech pharma space, the company sold its enzymes business to Novozymes A/S for US\$115 million. The company plans to utilize the cash generated from the sale of the business for inorganic growth opportunity.

Leg-up from regulatory environment

The Biologics Price Competition and Innovation Act aims to create a pathway for the approval of follow-on biologics. The bill proposes a 12-year data exclusivity period for innovators and a one-year exclusivity for biosimilars if a limited clinical trials has been done on the biosimilars. As the exclusivity period will be effective only after the clinical trials, the cost incurred on conducting trials can be a negative. Also, the 12-year period for data exclusivity may be a negative. But if the company gets a one-year exclusivity for the biosimilar, it is a positive for companies producing biosimilars.

Risk & Concerns

Biocon generates over 55% of its revenue from the export markets. The appreciating rupee may impact negatively top and bottom line. The generics industry is subject to patent litigations and regulatory issues. Such challenges or delay in receipt of regulatory approvals could delay its product launch in key markets. Further, increased competition for various companies for the same product may increase pricing pressure resulting in pressure on margins and profits.

Financials

We estimate its consolidated top line to grow at a CAGR of 16% over FY07-09E to Rs 1,324.12 crore on the back of a 40% CAGR in custom research outsourcing business. With a stable outlook on the pricing front in the statin business, the company's move up the value chain to formulations in less competitive and niche therapeutic segments, and increasing revenue contribution of custom research business, we believe its operating margins would improve to over 31% in FY09E from the current 29%. Rising margins at operating level and improving revenue contribution from the CRO business are likely to result in consolidated bottom line growing at a CAGR of 22% over FY07-09E to Rs 298 crore in FY09E.

Key Financial Ratios

	2007/03	2006/03	2005/03	2004/03	2003/03
EPS	15.84	13.35	17.44	12.47	195.21
CEPS	21.6	15.63	19.25	13.85	260.61
Book Value	94.05	80.18	69.45	54	679.11
Dividend/Share	3	2.5	2	1	0
OPM	22.72	26.03	29.18	30.74	24.65
RONW	15.82	16.66	24.46	22.47	28.27
Debt/Equity	0.11	0.13	0.1	0.11	0.54
Ratio	1.87	1.34	1.13	3.71	1.71
Interest Cover	27.85	75.08	76.24	50.83	12.69

Valuations

The stock is currently trading at 17x FY09E EPS of 29.78. With all the businesses in full throttle, changing revenue mix and improving revenue contribution from the custom research outsourcing business, we expect the margins to improve. The maturing BIOMAB is likely to start fetching improved revenue. We rate the stock an OUTPERFORMER with price target of Rs 615, 20.65x FY09 EPS.



Technicals

The stock has been trading above the 200-day simple moving average (SMA), which is at Rs 453. It has shown a head & shoulder pattern on the weekly charts and strongly bounced back from Rs 455 levels to Rs 505 levels, touching a high of Rs 525 on good volumes. Once it closes above the Rs 532 levels with good volumes, we could see it move further up to the Rs 570-620 levels. On the downside, the stock has formed a strong base at around Rs 422. The RSI momentum has begun to show strength, which is another positive sign. Technically the stock is looking for a breakout after almost one-and-a-half years.

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