



Biocon

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,858	BIOS IN
	REUTERS CODE
S&P CNX: 3,711	BION.BO

18 October 2006

Buy

Previous Recommendation: Buy

Rs382

Equity Shares (m)	100.0
52-Week Range	538/306
1,6,12 Rel. Perf. (%)	-6/-25/-81
M.Cap. (Rs b)	38.3
M.Cap. (US\$ b)	0.8

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	7,881	1,739	17.4	-12.0	22.0	4.3	19.6	19.9	4.9	16.8
03/07E	9,310	1,670	16.7	-4.0	22.9	3.8	16.4	17.7	4.1	15.3
03/08E	10,670	2,243	22.4	34.4	17.1	3.2	18.9	20.1	3.4	11.6

Biocon 2QFY07 results were above our estimates, led by higher statin sales in EU and incremental contribution from technology licensing income. Key highlights include:

- Net consolidated sales grew by 24% YoY to Rs2.5b (v/s estimate of Rs2.1b) while the PAT grew by 2% to Rs446m (v/s estimate of Rs340m). Sales growth was primarily driven by higher statin supplies to EU, increased contract research business and incremental contribution from licensing fees.
- However, EBITDA margins declined by 290bp to 26.5% led by weak statin prices YoY, higher investments in R&D and higher fixed expenses on new facilities. This coupled with higher depreciation (up by 54% YoY) translated in PBT decline of 11% YoY to Rs464m. However, lower tax provisioning (at 4.8% of PBT v/s 17.9% of PBT in 2QFY06) resulted in almost flat PAT to Rs446m.
- We have revised our earnings upwards by 8% for FY07E and 4% for FY08E to take into account the better than expected performance for 2QFY07 and incremental contribution from technology licensing fees.

While some of Biocon's initiatives look promising, as of now, the visibility of them is poor. This is particularly true in case of the biogeneric opportunity. Biocon is currently valued at 23x FY07E and 17x FY08E earnings. We believe that most of the negatives are already captured into the current valuations and that there is little downside to the stock from current levels. Maintain **Buy**.

CONSOLIDATED QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	1,740	2,006	1,993	2,143	2,120	2,490	2,295	2,405	7,881	9,310
YoY Change (%)	-0.1	7.8	12.1	22.8	21.9	24.2	15.2	12.2	10.6	18.1
Total Expenditure	1,235	1,416	1,404	1,538	1,577	1,831	1,690	1,737	5,593	6,835
EBITDA	505	589	589	605	544	659	605	668	2,288	2,476
Margins (%)	29.0	29.4	29.6	28.2	25.6	26.5	26.4	27.8	29.0	26.6
Depreciation	71.1	73.8	74.6	76.9	109.7	177.5	170.0	145.5	296.5	602.7
Interest	2.8	1.5	3.8	9.4	16.7	21.7	16.0	5.0	17.5	59.4
Other Income	17.8	11.3	18.1	4.3	13.6	3.6	17.0	32.5	51.4	66.7
PBT	449	525	529	523	431	464	436	550	2,026	1,880
Tax	66	94	94	51	42	22	57	105	306	226
Rate (%)	14.8	17.9	17.8	9.8	9.8	4.8	13.0	19.0	15.1	12.0
Minority Interest	-5	-4	-4	-7	-5	-5	-4	-1	-20	-15
PAT	387	435	439	478	394	446	383	446	1,740	1,670
YoY Change (%)	-20.3	-22.6	-12.8	12.9	1.8	2.4	-12.6	-6.7	-11.9	-4.0
Margins (%)	22.3	21.7	22.0	22.3	18.6	17.9	16.7	18.6	22.1	17.9

E: MOSt Estimates

1.4

Bio-Pharma and Contract research continues to drive top-line growth

Consolidated revenues grew 24% YoY in 2QFY07, driven by growth in Bio-Pharma and contract research business. Growth in bio-pharmaceutical sales was primarily driven by higher growth in statin supplies to the EU (from the recently commissioned facilities) and sales of insulin in unregulated markets. Although, statin prices in Europe have stabilized sequentially, however, on YoY basis statin prices were lower.

Contract Research services (including Syngene & Clinigene) have recorded about 73% growth in 2QFY07 led mainly by the ramp-up in Syngene's performance. Commissioning of new facilities and addition of new clients has resulted in a significant growth in Syngene's operations. This ramp-up is also vindicated by the fact that the company added about 100 new employees to for its contract research business in 2QFY07.

TREND IN PRODUCT MIX (RS M)

	2QFY07	2QFY06	GR(YOY)	1QFY07	GR(QOQ)
Bio-Pharmaceuticals	1,830	1,558	17.4	1,610	14.0
% of sales	73.5	76.8		75.9	
Enzymes	260	240	8.5	220	18.0
% of sales	10.4	11.8		10.4	
Contract Research Fees	400	230	73.6	290	38.0
% of sales	16.1	11.4		13.7	
Total	2,490	2,028	24.2	1,740	17.0

Source: Company/Motilal Oswal Securities Ltd

Enzymes grew by 8.5% YoY, after subdued performance in FY06 as the company was able to free up extra capacity for enzymes due to the commissioning of new Statins facility. We believe that the enzymes business should revert back to normal growth phase. We expect enzymes business to grow at 26% YoY in FY07E, on low base of FY06.

Lower statin prices and higher R&D restricts margin expansion

Continued pricing pressure in European statins market, higher investments in R&D, higher fixed expenses on new facilities, setting of oncology division (to market BIOMAb) has impacted EBITDA margins. This coupled with higher

depreciation (up by 140% YoY) translated in PBT decline of 11% YoY to Rs464m. However, lower tax provisioning (at 4.8% of PBT v/s 17.9% of PBT in 2QFY06) resulted in almost flat PAT to Rs446m.

Europe statin prices stabilizing, but US supplies delayed

The statins business in Europe witnessed stable prices (on sequential comparison) after many quarters of severe competitive pressures, which was the main reason for the company's poor performance in the past. In fact, the company witnessed almost 40% volume growth in its supplies to the EU as it utilized its newly commissioned facilities to manufacture statins for the EU market.

Biocon has witnessed 20% growth in its Statins business for 1H (it mainly caters to the EU market) and expects supplies to the US to commence from 3QFY07. Its customers are yet to start sourcing commercial supplies of Pravastatin despite the expiry of Teva's 180-day exclusivity in Oct-06 implying that Teva might have pumped in significant inventories with the distributors. Simvastatin supplies, which are expected to begin in 3Q with the expiry of 180-day exclusivity in Dec-06, may also suffer the same fate. We believe that the Statins upside has been significantly diluted for Biocon due to the grant of the 180-day exclusivities for Simvastatin and Pravastatin. We do not expect Biocon's partners to garner significant market share as even after the expiry of the 180-day exclusivity, the incumbent generic players will continue to command a reasonable market share. This is likely to increase the pay-back period for Biocon as far as its investments in the Statins space (about Rs4.5b) is concerned.

For the US market, Biocon expects to garner around 40% of market share in Pravastatin and Simvastatin as there would be limited competition in API supplies (expects 3 more players post expiry of the 180-day exclusivity). We believe that competition is likely to be severe for both these products and hence have forecasted lower market share for Biocon (Simvastatin 25% and Pravastatin 15%).

Will supply statins to innovators also

Biocon, through its alliance partners, has tied up with some of the innovator companies for supply of statins for the latter's combination products. Supplies may begin in CY07 subject to a favourable approval from the regulatory authorities for the innovator's products. This is likely to bring in incremental benefits for Biocon from FY08 onwards.

Biogenerics can be big opportunity but lacks visibility as of now

Biocon expects to launch its first biogeneric (Insulin) in EU by Dec-08 or in early 2009. It is currently proceeding as per the EMEA guidelines for getting its generic version registered with the latter. We believe that, although biogenerics can be a significant opportunity, the time-line of the launch remains uncertain. Biocon has recently launched BioMab (mon-clonal anti-body) for treating head & neck cancer in the domestic market and is planning to launch EPO, GCSF and Streptokinase over the next 6-8 months in the domestic market. It should be noted that Biocon did not have any presence in the domestic formulations market (till the recent launch of its Insulin) and hence it may not be easy for the company to garner significant market share in the initial years.

Biocon has filed for registering its Insulin formulation in 34 non-regulated markets and has launched it in two countries. It expects to receive another 6-8 approvals by Mar-07. The company expects the Insulin business to become larger than its Statins business in the long-term. It has entered into a licensing arrangement for Insulin with a US-based company which is likely to generate licensing income for Biocon (details not disclosed). Its oral Insulin NCE is currently undergoing Phase-I clinical trials in India and the company expects to file an IND for this molecule in Europe in 4QFY07.

Building future growth engines - But visibility still poor

Biocon is in the process of building future growth engines to reduce its dependence on Statins. Biocon is building strengths in other biopharmaceutical products (immuno-

suppressants and anti-diabetes) as well as its own drug discovery and contract research efforts. The company's efforts to launch human insulin in India and in unregulated markets as well as a supply tie up with Bristol Myers Squibb (for the latter's NDDS version) are also likely to scale up over the next couple of years.

The company gradually progressing on the research front, with the knowledge gained through its custom and clinical research activities coming in handy in its own efforts to develop non-infringing processes. Biocon also has its own R&D program focusing on improving efficiencies and developing new biological entities (NBEs). However, although progress on any of these fronts could lead to higher growth and a re-rating, the visibility on these is still poor.

Long-term generic pipeline is exciting

The company is building its pipeline of immunosuppressants and has filed DMFs for Mycophenolate Mofetil and Tacrolimus. We believe that immunosuppressant's will be one of the key growth drivers for the company in the long-term (beyond FY08). We believe that this segment is likely to witness relatively less competition due to the technological entry barriers. Launch of bio-generics could be another exciting opportunity in the long-term, although, currently the visibility on this opportunity is poor.

Specialty pipeline is also being strengthened

Biocon expects to enter the specialty segment of the pharmaceutical market by developing proprietary products based on its developmental efforts with Monoclonal Antibodies (Mab). Its JV with a Cuban organization focuses on developing products using Mab. It is currently working on developing Mab for the immunosuppressant, arthritis and cancer segments. The JV has a pipeline of three Mab and three anti-cancer vaccines.

Insulin can be a very big long-term opportunity

Biocon is targeting launch of generic insulin in regulated markets in the long-term. It has already filed a DMF for insulin with the US FDA and expects to introduce the

product in the US market through the 505(b)(2) route. The company will have to conduct limited clinical trials for this product. We believe that the regulatory environment for biotech products (like insulin) is gradually becoming favourable for generic companies. Regulators in both, Europe and USA, have indicated their willingness to frame detailed guidelines for approving generic biotech products. In fact, the European authorities (EMEA) have already issued broad guidelines to be followed for approval of bio-generics.

Agreement with Bayer for Insulin in China

Biocon has signed agreement with Bayer to market Insugen (Biocon's human insulin) in China. Bayer would have exclusive marketing rights of Insugen for Chinese market. Biocon expects Insugen's launch in China in CY08. Bayer also has option to expand the marketing rights to other countries in Asia Pacific. Biocon has received some upfront (bonus) payment, which it would be accounting on pro-rata basis over the 10 year period (life of the contract). The Chinese insulin market is around US\$100m, dominated by Novo Nordisk (~65% MS) and Eli Lilly (~35% MS). As per the agreement, all the registration process/cost would be incurred by Bayer.

Biocon has already filed its Insulin application in 34 non-regulated markets and expects approvals to come through gradually in FY07E. It has recently commenced supplies to two of these markets.

Biocon has also entered into a non-exclusive agreement with BMS for supply of r-Human Insulin for the latter's NDDS insulin. This is a 9-year deal with commercial supplies to BMS expected to commence after two years. Biocon has already supplied sample quantities of Insulin to BMS. It has also filed a DMF for Insulin with the US FDA.

The global insulin market is currently worth \$ 4-5bn and can be a very big opportunity for generic suppliers like Biocon as very few generic players are prepared for exploiting this opportunity (particularly in regulated markets).

Aggressive plans to invest in domestic formulations business - may impact margins

Biocon is planning to give significant thrust to its domestic formulations business which would be having two niche products in form of human insulin and BIOMAb. The company intends to double its field force from 135 MRs to 265 MRs, which would help to get into new territories. The company intends to double its current market share of 10% in human insulin in next two years. Although Biocon would be investing resources in domestic formulations form current year onwards, the pursuant benefits would be reflected in next 9-12 months, thereby impacting margins in FY07.

Commenced Phase-I trials on oral insulin

Also, Biocon has commenced Phase-I clinical trials for its oral insulin molecule IN105. Biocon had recently acquired this molecule from Nobex. The Phase-I studies are expected to be completed by 3QFY07 and would be used to support IND filings with international regulatory authorities.

Contract research operations are being ramped up

Syngene's operations are growing at a robust pace led by commissioning of new facilities and ramp-up of the customer base. New client additions as well as ramp-up from existing clients, is likely to result in an improved performance for Syngene in the coming years. Syngene has 6 of the top 10 global pharmaceutical companies as its clients. Syngene has scientist strength of more than 600 (100 added in 2QFY07) working on various MNC projects.

Biocon's CRO subsidiary, Clinigene is also expected to commence operations from a new 65,000 sq. ft. facility in FY07E and hence will witness a rapid growth in revenues, albeit on a lower base. Between Syngene and Clinigene, about 150 new employees were added in FY06 and a similar number will be further added in FY07E taking the overall strength to about 750.

Capex

Biocon has guided a consolidated capex of about Rs1.0b each for FY07E and FY08E. The company has already incurred a significant capex of about Rs6.0b in the last two years for setting up new Statins and biologics facility as well as capacity ramp-up for Syngene.

Revising estimates upwards

We have revised our earnings upwards by 8% for FY07E and 4% for FY08E to take into account the better than expected performance for 2QFY07 and incremental contribution from technology licensing fees.

REVISED FORECAST (RS M)

	FY07E			FY08E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	9,310	8,823	5.5	10,670	10,536	1.3
Net Profit	1,670	1,544	8.1	2,243	2,142	4.7
EPS (Rs)	16.7	15.4	8.4	22.4	21.4	4.8

Source: Motilal Oswal Securities

Valuation and view

We believe that the US Statins opportunity for Biocon has been diluted due to the grant of 180-day exclusivity to some of the generic companies, thus delaying the sourcing by Biocon's partners. We do not expect Biocon's partners to garner significant market share as even after the expiry of

the 180-day exclusivity, the incumbent generic player will continue to command a reasonable market share. This is likely to increase the pay-back period for Biocon as far as its investments in the Statins space is concerned.

Supply of Insulin to non-regulated markets will be a key growth driver in the short-to-medium term. Biocon is targeting 34 non-regulated markets for Insulin supplies and is likely to receive regulatory approval from some of these markets in FY07E.

Biocon's initiatives in the immunosuppressant's and biogenerics space as well as its NCE program (including oral Insulin and monoclonal anti-body) will be key determinants of long-term success.

Sales growth for FY07E will be led mainly by Statin supplies to the US (post the 180-day expiry), improvement in the Enzyme business and a ramp-up in operations at Syngene and Clinigene.

While some of Biocon's initiatives look promising, as of now, the visibility of them is poor. Biocon is currently valued at 23x FY07E and 17x FY08E earnings. We believe that most of the negatives are already captured into the current valuations and that there is little downside to the stock from current levels. **Maintain Buy.**

Biocon: an investment profile

Company description

Biocon is an integrated biotechnology company encompassing all the three critical stages of drug development - drug discovery, development and manufacturing, and commercialization of biopharmaceuticals and enzymes. With over 25 years of expertise in fermentation technology, the company has built a strong presence in lucrative high-growth segments like statins, immuno-suppressants and anti-diabetes.

Key investment arguments

- Strong expertise in the complex fermentation process and decision to stay out of formulations in regulated markets make it the best positioned to capitalize on the lucrative statins opportunity.
- Biogenerics, immuno-suppressants and contract research to be the key long-term growth drivers.

Key investment risks

- Higher than estimated fall in prices of Simvastatin and Pravastatin post-generic launch would result in lower profitability for Biocon.
- Delay in capacity expansion or stabilizing production at the new plant would result in the loss of a big market opportunity.

COMPARATIVE VALUATIONS

		BIOCON	CIPLA	DRL
P/E(x)	FY07E	22.9	28.1	33.9
	FY08E	17.1	23.7	21.7
P/BV(x)	FY07E	3.8	6.1	4.5
	FY08E	3.2	5.1	3.9
EV/Sales(x)	FY07E	4.1	5.3	3.4
	FY08E	3.4	4.4	2.7
EV/EBITDA(x)	FY07E	15.3	21.3	21.7
	FY08E	11.6	17.4	16.7

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	52.0	52.0	53.2
Domestic Inst	2.2	1.8	2.3
Foreign	35.9	29.8	29.5
Others	9.9	16.4	15.0

Recent developments

- Acquired IP assets (incl. oral insulin and oral BNP program) of Nobex for US\$5m

Valuation and view

- We believe that most of the negatives are already captured into the current valuations and that there is little downside to the stock from current levels.
- The stock trades at 23x FY07E and 17x FY08 earnings, which now factor in a fair share of the negatives. Maintain **Buy** with target price of Rs430.

Sector view

- Regulated markets to remain the key sales and profit drivers in the medium term. Europe to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

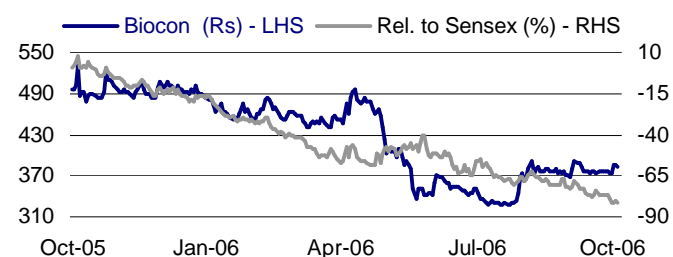
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	16.7	19.0	-11.9
FY08	22.4	23.8	-5.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
382	430	12.6	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATE INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Exports	3,753	3,584	4,095	4,696	4,843
Net Domestic Sales	2,711	3,291	3,543	3,954	4,805
Net Sales	6,464	6,875	7,638	8,650	9,648
Contract Research Fees	662	1,006	1,672	2,020	2,415
Net Income	7,126	7,881	9,310	10,670	12,063
Change (%)	318	10.6	18.1	14.6	13.1
Total Expenditure	4,887	5,593	6,835	7,520	8,507
EBITDA	2,239	2,288	2,476	3,151	3,556
Change (%)	25.6	2.2	8.2	27.3	12.9
Margin (%)	31.4	29.0	26.6	29.5	29.5
Depreciation	223	297	603	668	738
Int. and Finance Charges	20	18	59	37	29
Other Income - Rec.	156	51	67	81	82
PBT	2,151	2,025	1,880	2,526	2,871
Tax	186	306	226	303	345
Tax Rate (%)	8.6	15.1	12.0	12.0	12.0
Minority Interest	-10.4	-19.7	-15.0	-20.0	-25.0
Reported PAT	1,976	1,739	1,670	2,243	2,551
Change (%)	417	-2.5	-3.8	34.4	13.6
Margin (%)	27.6	21.8	17.8	20.8	20.9

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital	500	500	500	500	500
Revaluation Reserves	14	13	11	9	9
Other Reserves	6,891	8,368	9,657	11,389	13,359
Net Worth	7,405	8,881	10,168	11,898	13,868
Loans	763	1,050	435	435	400
Minority Interest	9	32	17	-3	-28
Deferred liabilities	234	297	344	406	477
Capital Employed	8,412	10,261	10,964	12,737	14,717
Gross Block	3,300	4,070	10,140	11,390	12,390
Less: Accum. Deprn.	763	1,061	1,663	2,331	3,069
Net Fixed Assets	2,537	3,010	8,477	9,059	9,321
Capital WIP	3,245	5,260	500	500	500
Investments	2,350	1,002	831	1,973	3,280
Curr. Assets	2,768	3,601	3,507	4,001	4,660
Inventory	738	1,105	1,225	1,394	1,586
Account Receivables	1,824	2,237	1,974	2,262	2,644
Cash and Bank Balance	34	20	110	126	165
Loans & Advances	171	239	199	219	264
Curr. Liability & Prov.	2,487	2,613	2,351	2,797	3,044
Account Payables	2,115	2,184	1,794	2,087	2,214
Provisions	373	429	558	709	830
Net Current Assets	280	989	1,156	1,205	1,616
Appl. of Funds	8,412	10,261	10,964	12,737	14,717

E: M OSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs) EPS	19.8	17.4	16.7	22.4	25.5
Cash EPS	22.0	20.4	22.7	29.1	32.9
BV/Share	73.9	88.7	101.6	118.9	138.6
DPS	2.0	2.5	3.3	4.5	5.1
Payout (%)	11.5	16.4	22.8	22.8	22.8
Valuation (x)					
P/E	19.4	22.0	22.9	17.1	15.0
Cash P/E	17.4	18.8	16.9	13.2	11.6
P/BV	5.2	4.3	3.8	3.2	2.8
EV/Sales	5.1	4.9	4.1	3.4	2.9
EV/EBITDA	16.4	16.8	15.3	11.6	9.9
Dividend Yield (%)	0.5	0.7	0.9	1.2	1.3
Return Ratios (%)					
RoE	26.7	19.6	16.4	18.9	18.4
RoCE	25.8	19.9	17.7	20.1	19.7
Working Capital Ratios					
Asset Turnover (x)	0.8	0.8	0.8	0.8	0.8
Debtor (Days)	93	104	77	77	80
Inventory (Days)	38	51	48	48	48
Working Capital (Days)	13	45	41	37	44
Leverage Ratio (x)					
Current ratio	1.1	1.4	1.5	1.4	1.5
Debt/Equity	0.1	0.1	0.0	0.0	0.0

CONSOLIDATED CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Oper. Profit/(Loss) before	2,239	2,288	2,476	3,151	3,556
Interest/Dividends Recd.	156	51	67	81	82
Direct Taxes Paid	-128	-243	-179	-241	-274
(Inc)/Dec in WC	623	-722	-78	-33	-371
CF from Operations	2,889	1,374	2,285	2,958	2,993
(Incr)/Dec in FA	-3,812	-2,785	-1,310	-1,250	-1,000
(Pur)/Sale of Investments	-2,128	1,347	171	-1,142	-1,307
CF from investments	-5,940	-1,437	-1,138	-2,392	-2,307
Issue of Shares	28	21	-2	-2	0
(Inc)/Dec in Debt	136	330	-615	0	-35
Interest Paid	-20	-18	-59	-37	-29
Dividend Paid	-228	-285	-381	-511	-582
CF from Fin. Activity	-84	49	-1,057	-550	-646
Inc/Dec of Cash	-3,135	-14	89	16	40
Add: Beginning Balance	3,169	34	20	110	126
Closing Balance	34	20	110	126	165

E: M OSt Estimates

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Disclosure of Interest Statement	Biocon
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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