



Biocon

BSE SENSEX 19,008	S&P CNX 5,697	Rs367	Buy
Bloomberg Equity Shares (m)	BIOSIN 200.0		
52-Week Range	465/253		
1,6,12 Rel. Perf. (%)	-4/6/19		
M.Cap. (Rs b)	73.4		
M.Cap. (US\$ b)	1.6		

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BY	ROE	ROCE	EYI	EYI
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/10A	23,678	2,837	14.2	230.3	25.9	4.2	16.1	15.6	3.1	15.4
03/11E	27,686	3,469	17.3	22.3	21.4	3.7	17.1	17.5	2.7	12.6
03/12E	29,932	3,906	19.5	12.6	19.0	3.2	16.8	17.8	2.4	11.1
03/13E	33,446	4,330	21.6	10.8	17.1	2.8	16.3	17.5	2.1	9.7

Biocon's 3QFY11 performance was above our estimates. Key highlights:

- Revenues grew by 14.6%YoY to Rs7.28b (v/s estimate of Rs7.37b) while PAT grew by 24%YoY to Rs1b (v/s estimate of Rs908m).
- Topline growth was led by 22% YoY growth in Biopharma revenues to Rs3.5b on the back of higher supplies of Tacrolimus and Atorvastatin coupled with sustained traction in the domestic formulations business. Licensing income at Rs768m (up 3.4x YoY) also boosted topline growth.
- EBITDA grew 33%YoY to Rs1.68b (v/s estimate Rs1.49b) while EBITDA margins expanded by 300bpYoY to 23% primarily due to higher licensing income.
- PAT was above our estimates at Rs1b (v/s estimate Rs908m) mainly due to higher licensing income.

Key growth drivers for FY11/12 will be: (1) Traction in the company's Insulin initiative and Pfizer contract in emerging markets, (2) Ramp-up in contract research business, and (3) Incremental contribution from immuno-suppressants API supplies. We have cut our EPS estimates for FY12E by 5% to take into account the price decline for Axicorp products and the higher tax outgo in FY12 (20% effective tax rate vs 14.5% for FY11E). Option values for future include separate listing of Syngene and a potential out-licensing of the oral insulin NCE. We estimate EPS of Rs17.3 for FY11 (up 22.3%), Rs19.5 (up 12.6%) for FY12 and Rs21.6 for FY13 (up 10.8%) leading to 15% EPS CAGR for FY10-13. The stock is currently valued at 21.4x FY11E, 19x FY12E and 17.1x FY13E earnings. Adjusted for DCF value of Rs49/share for the Pfizer deal, the stock is valued at 18.6x FY11E, 16.5x FY12E and 15x FY13E EPS. Maintain **Buy** with target price of Rs440 (18x FY13E EPS + Rs49/sh DCF value of Pfizer deal).

CONSOLIDATED QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	4,959	5,800	6,351	6,568	6,623	6,788	7,281	6,994	23,678	27,686
YoY Change (%)	87.9	31.0	45.6	40.9	33.6	17.0	14.6	6.5	47.2	16.9
Total Expenditure	3,946	4,668	5,084	5,265	5,310	5,352	5,597	5,566	18,963	21,825
EBITDA	1,013	1,132	1,267	1,303	1,313	1,436	1,684	1,428	4,715	5,861
Margins (%)	20.4	19.5	19.9	19.8	19.8	21.2	23.1	20.4	19.9	21.2
Depreciation	324	351	360	366	375	390	406	450	1,401	1,621
Interest	56	52	27	34	70	65	66	77	169	278
Other Income	94	124	64	88	95	89	96	-14	370	266
PBT	727	853	944	991	963	1,070	1,309	887	3,515	4,228
Tax	142	94	107	144	164	156	292	1	487	613
Rate (%)	19.5	11.0	11.3	14.5	17.0	14.6	22.3	0.1	13.8	14.5
Minority Interest	14	17	24	41	31	22	10	10	96	73
PAT	571	742	813	806	767	892	1,007	876	2,932	3,542
YoY Change (%)	283.5	194.4	191.3	219.0	34.3	20.2	23.9	8.6	215.1	20.8
Margins (%)	11.5	12.8	12.8	12.3	11.6	13.1	13.8	12.5	12.4	12.8

E: MOSL Estimates

Revenue growth led by Biopharma revenues while licensing income boosts PAT

Topline growth was led by 22% YoY growth in Biopharma revenues to Rs3.5b on the back of higher supplies of Tacrolimus and Atorvastatin coupled with sustained traction in the domestic formulations business. Axicorp (Germany) reported 15.6% YoY de-growth in sales led by the 16% government mandated discounts for all companies operating in the non-tender market. This is part of the local government's efforts to bring down overall healthcare costs in Germany.

Licensing income at Rs768m grew 3.4x YoY led by booking of licensing income from the recently signed deal with Pfizer. Biocon has also booked a one-time licensing income related to the capitalization of Rs350m Insulin clinical trial expenses. It has now booked these expenses in the P&L and has also booked the corresponding licensing income in revenues. While management has declined to give a break-up of the licensing income, we believe that licensing income attributable to Pfizer is likely to have been ~Rs530m (including the one-time licensing income) and that attributable to Mylan partnership at ~Rs230m.

Sales mix (Rs m)

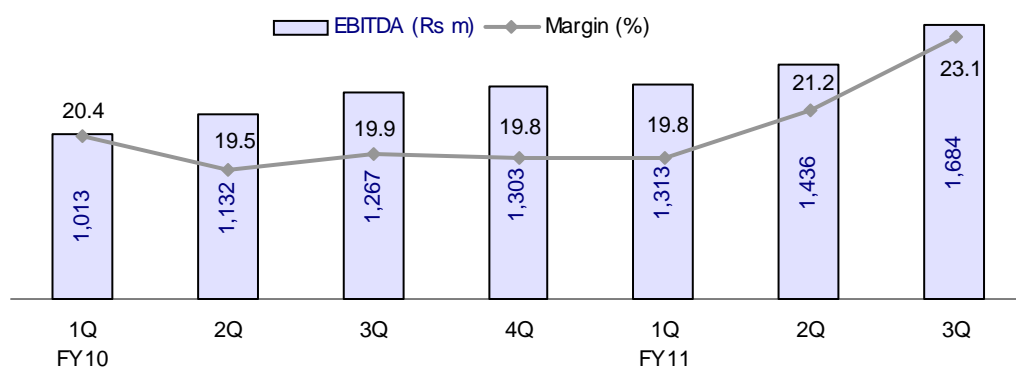
	3QFY11	3QFY10	% YoY	2QFY11	% QoQ
Bio-Pharma	3,541	2,895	22.3	3,138	12.8
% of sales	48.6	45.6		46.2	
Axicorp	2,184	2,587	-15.6	2,639	-17.3
% of sales	30.0	40.7		38.9	
Contract Research	788	694	13.5	780	1.0
% of sales	10.8	10.9		11.5	
Licensing Income	768	175	338.9	230	233.9
% of sales	10.5	2.8		3.4	
Total	7,281	6,351	14.6	6,788	7.3

Source: Company/MOSL

EBITDA at Rs1.68b was above estimates led partly by higher licensing income

EBITDA grew 33% YoY to Rs1.68b (vs estimate Rs1.49b) while EBITDA margins expanded by 300bpYoY to 23% primarily due to higher licensing income. While Biocon will be booking corresponding costs related to licensing income, we believe that the EBITDA Margins on such licensing income is likely to be higher than the company average EBITDA Margins.

EBITDA Margin Trend



Source: Company/MOSL

PAT grew 24%YoY led by higher licensing income

Biocon's 3QFY11 PAT grew by 24% to Rs1b and was higher than our estimates of Rs908m. The outperformance was primarily led by licensing income.

Pfizer deal - Offers good long-term value

Biocon recently entered into strategic agreement with Pfizer for global commercialization of Biocon's biosimilar versions of Insulin and Insulin analog products viz., Recombinant Human Insulin, Glargine, Aspart and Lispro.

As a part of the deal, Pfizer will make an upfront payment of US\$100m to Biocon with additional development and regulatory milestone payment of up to US\$150m spread over next few years. Biocon will also be eligible for additional US\$100m milestone payment (currently maintained in an escrow account by Pfizer) which will accrue in phases to Biocon depending on the progress on setting up the new US\$160m Insulin facility in Malaysia.

The money received by Biocon will be utilized for development and registration of these products in various markets and expansion of existing manufacturing facilities. Biocon will recognize this income in P&L account over the period of 4-5 years.

Further, Biocon will receive income linked to Pfizer's sales of these products across global markets. We note that under this agreement, Biocon will remain responsible for the clinical development, manufacture and supply of these biosimilar Insulin products, as well as for regulatory activities to secure approval for these products in various geographies.

The alliance is targeting the US\$14b Insulin opportunity. By 2015, a number of insulin analogues are expected to lose patent thereby offering a large opportunity for biosimilar products. Post patent expiry, the market size is likely to reduce due to entry of generics.

Biocon expects revenues from emerging markets under this agreement to start in near future with Biocon having approval for Recombinant Human Insulin in 27 countries. However, the entry in Europe and US market is a few years away as the products will be launched post patent expiry in these markets. Both the companies expect an approval for Recombinant Human Insulin in Europe by 2013 followed by US approval in 2015-16. Approval for Recombinant Human Insulin will be followed by approval for Glargine, Lispro and Aspart.

We believe that the large upside for both companies will come from product launches in regulated markets which constitute ~80% of the overall market size. Given the branded nature of the biosimilars in regulated markets, Pfizer with its strong marketing prowess, will be able to leverage this opportunity better. We estimate DCF value of Rs49/sh from this deal for Biocon.

Oral Insulin NCE - Remains an option value

Biocon recently announced part of Phase-III clinical trial data for its oral Insulin NCE program indicating that the NCE did not meet the primary end-point (i.e. lowering HbA1c levels) due to high placebo effect but showed good results for the secondary end-point with good efficacy for lowering post prandial glucose levels.

While this raises some uncertainty, Biocon management has indicated that it is confident of developing this NCE and is planning to out-license it to a partner in the next 6 months.

We note that in the past many attempts by innovator companies to commercialize alternative insulin delivery methods have failed. So the risk to this project remains high in our opinion.

However, a successful out-licensing of this NCE has the potential to generate significant option value for Biocon as the oral delivery of Insulin will bring in significant convenience for diabetes patients over the current injectable form of delivery.

Contract Research (CR) - Changing focus may lead to temporary decline in profitability

Growth for Biocon's CR business has moderated for the past few quarters despite the ramp-up in the BMS contract. While the reasons for this are not clear, it may imply increased competitive pressures.

Biocon management has indicated that it is now attempting to change its CR focus to deliver value-added Integrated Drug Development services as compared to the existing FTE-based services.

While this is a long-term positive, we believe that in the short-term this may lead to a temporary decline in profitability of the CR business as the company will have to invest in resources/capabilities for the changed priorities of the business.

The BMS contract is also operating at ~70-80% of its full potential and hence we do not expect a major ramp-up in revenues from this contract. We expect Biocon's CR business to record 14% revenue CAGR for FY10-12. Management has reiterated its plans to unlock value through a separate listing of its CR subsidiary (expected over the next 18 months).

Biogenerics initiative - Has partnered entire product pipeline

Biocon has successfully partnered-out its entire biogeneric pipeline with the Pfizer tie-up for Insulins coupled with its previous tie-up with Mylan for other biogenerics.

These tie-ups ensure that the development and clinical trial costs get reimbursed/shared with the partner. The partners also contribute to the capex required for these opportunities. We view this as a long-term positive since it allows Biocon to participate in the biogeneric opportunity without significantly depressing its profitability (in turn Biocon will have to share part of the upsides with the partner).

R&D Expenses to increase significantly; Pfizer licensing income will help

We believe that Biocon's R&D expenses are likely to increase significantly on account of ramp-up in Biogenerics development and additional costs for conducting clinical trials for oral insulin NCE. These would be compensated by steady accrual of licensing income from Pfizer over the next 4-5 years while 4QFY11 will be last quarter of accrual of Mylan licensing income. R&D cost for FY10 grew 31% YoY to Rs784m and we expect it to increase by 60% to Rs1.25b in FY11E.

Valuation and view

Key growth drivers for FY11/12 will be: 1) Traction in the company's Insulin initiative and Pfizer contract in emerging markets, 2) Ramp-up in contract research business, and 3) Incremental contribution from immuno-suppressants API supplies.

We have cut our EPS estimates for FY12E by 5% to take into account the price decline for Axicorp products and the higher tax outgo in FY12 (20% effective tax rate vs 14.5% for FY11E). Option values for future include separate listing of Syngene and a potential out-licensing of the oral insulin NCE.

We estimate EPS of Rs17.3 for FY11 (up 22.3%), Rs19.5 (up 12.6%) for FY12 and Rs21.6 for FY13 (up 10.8%) leading to 15% EPS CAGR for FY10-13. The stock is currently valued at 21.4x FY11E, 19x FY12E and 17.1x FY13E earnings. Adjusted for DCF value of Rs49/share for the Pfizer deal, the stock is valued at 18.6x FY11E, 16.5x FY12E and 15x FY13E EPS. Maintain **Buy** with target price of Rs440 (18x FY13E EPS + Rs49/sh DCF value of Pfizer deal).

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. 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

- Biocon is well placed to take advantage of emerging opportunities in the Biopharmaceutical space backed by established capabilities along the drug value chain.
- Biogenerics in emerging markets followed by regulated markets and contract research will be a key growth driver for the company in the short-to-medium term
- Biogenerics supplies to regulated markets through partners will be the key long-term growth driver
- Potential out-licensing of oral insulin NCE and listing of Syngene offers option value

Key investment risks

- Significant capex, investments to fund future initiatives and higher R&D costs may temper down earnings growth in the short-term.

Recent developments

- Biocon has entered into strategic agreement with Pfizer for global commercialization of Biocon's biosimilar versions of insulin and insulin analogues.

Valuation and view

- Traction in the company's Insulin initiative and domestic formulation business coupled with incremental contribution from immuno-suppressants and ramp-up in contract research business would be key growth drivers for FY11E.
- Biocon is valued at 21.4x FY11E, 19x FY12E and 17.1x FY13E earnings. Adjusted for DCF value of Rs49/share for the Pfizer deal, the stock is valued at 18.6x FY11E, 16.5x FY12E and 15x FY13E EPS. Maintain **Buy** with target price of Rs440 (18x FY13E EPS + Rs49/sh DCF value of Pfizer deal).

Sector view

- USA and emerging markets to remain the key sales and profit drivers in the medium term. Japan 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.

Comparative valuations

		Biocon	Cipla	DRL
P/E(x)	FY11E	21.4	27.4	24.6
	FY12E	19.0	21.8	21.9
P/BV(x)	FY11E	3.7	4.2	24.3
	FY12E	3.2	3.7	21.6
EV/Sales(x)	FY11E	2.7	4.5	16.5
	FY12E	2.4	3.9	19.4
EV/EBITDA(x)	FY11E	12.6	19.6	3.9
	FY12E	11.1	16.4	3.5

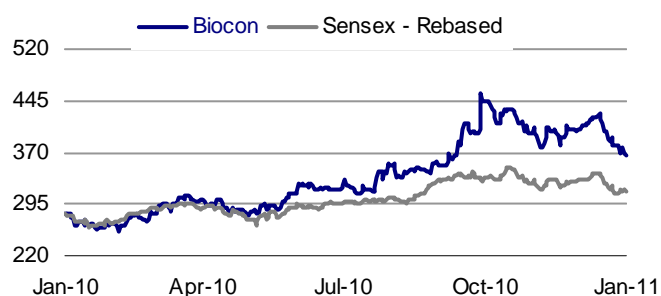
EPS: MOSL forecast v/s Consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	17.3	18.6	-6.8
FY12	19.5	22.0	-11.3

Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
367	440	19.9	Buy

Stock performance (1 year)



Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	60.9	60.9	60.9
Domestic Inst	11.5	12.0	12.0
Foreign	8.0	6.0	5.2
Others	19.6	21.1	22.0

Financials and Valuation

CONSOLIDATED INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Net Sales	13,841	20,364	24,654	26,294	29,081
Contract Research	2,246	2,807	3,032	3,638	4,365
Net Income	16,087	23,678	27,686	29,932	33,446
<i>Change (%)</i>	52.6	47.2	16.9	8.1	11.7
Total Expenditure	12,853	18,963	21,825	23,367	26,130
EBITDA	3,234	4,715	5,861	6,565	7,316
<i>Change (%)</i>	8.1	45.8	24.3	12.0	11.4
<i>Margin (%)</i>	20.1	19.9	21.2	21.9	21.9
Depreciation	1,103	1,401	1,621	1,710	2,005
Int. and Finance Charges	177	169	278	266	266
Other Income - Rec.	-827	370	266	294	368
PBT	1,127	3,515	4,228	4,883	5,412
Tax	118	487	613	977	1,082
<i>Tax Rate (%)</i>	10.5	13.8	14.5	20.0	20.0
Minority Interest	71.3	95.6	73.0	0.0	0.0
PAT	937	2,932	3,542	3,906	4,330
<i>Change (%)</i>	-58.3	212.8	20.8	10.3	10.8
<i>Margin (%)</i>	5.8	12.4	12.8	13.1	12.9

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Equity Share Capital	1,000	1,000	1,000	1,000	1,000
Revaluation Reserves	9	9	9	9	9
Other Reserves	14,098	16,569	19,282	22,275	25,591
Net Worth	15,107	17,579	20,292	23,284	26,601
Loans	5,239	5,136	4,440	4,440	4,440
Minority Interest	248	338	411	411	411
Deferred liabilities	466	508	572	816	1086
Capital Employed	21,061	23,561	25,715	28,951	32,538
Gross Block	14,098	16,515	19,515	23,240	26,890
Less: Accum. Deprn.	3,613	4,862	6,483	8,193	10,198
Net Fixed Assets	10,485	11,653	13,032	15,047	16,691
Capital WIP	1,720	755	755	755	755
Investments	3,676	4,306	4,191	5,041	6,331
Intangibles	1,631	1,726	2,530	2,530	2,530
Curr. Assets	7,924	10,921	11,833	12,793	14,295
Inventory	3,192	3,716	4,172	4,510	5,040
Account Receivables	3,667	4,461	4,703	5,084	5,681
Cash and Bank Balance	118	1,399	834	902	1,008
Loans & Advances	947	1,344	2,124	2,296	2,566
Curr. Liability & Prov.	4,375	5,800	6,626	7,215	8,065
Account Payables	3,570	4,909	5,613	6,068	6,781
Provisions	806	891	1,013	1,146	1,284
Net Current Assets	3,548	5,121	5,207	5,578	6,230
Appl. of Funds	21,061	23,561	25,715	28,951	32,538

E: MGS Estimates

RATIOS					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Basic (Rs)					
EPS	4.3	14.2	17.3	19.5	21.6
Cash EPS	9.8	21.2	25.5	28.1	31.7
BV/Share	75.5	87.8	101.4	116.4	133.0
DPS	3.0	3.5	3.5	3.9	4.3
Payout (%)	81.7	27.3	23.9	23.4	23.4
Valuation (x)					
P/E	85.5	25.9	21.4	19.0	17.1
Cash P/E	37.4	17.3	14.6	13.2	11.7
P/BV	4.9	4.2	3.7	3.2	2.8
EV/Sales	4.7	3.1	2.7	2.4	2.1
EV/EBITDA	23.1	15.4	12.6	11.1	9.7
Dividend Yield (%)	0.8	1.0	1.0	1.1	1.2
Return Ratios (%)					
RoE	5.7	16.1	17.1	16.8	16.3
RoCE	6.2	15.6	17.5	17.8	17.5
Working Capital Ratios					
Fixed Asset Turnover (x)	1.6	2.1	2.2	2.1	2.1
Debtor (Days)	83	69	62	62	62
Inventory (Days)	72	57	55	55	55
Working Capital (Days)	78	57	58	57	57
Leverage Ratio (x)					
Current ratio	1.8	1.9	1.8	1.8	1.8
Debt/Equity	0.3	0.3	0.2	0.2	0.2

CONSOLIDATED CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Oper. Profit/(Loss) before T	3,234	4,715	5,861	6,565	7,316
Interest/Dividends Recd.	-827	370	266	294	368
Direct Taxes Paid	-117	-445	-550	-732	-812
(Inc)/Dec in WC	-1,185	-291	-651	-303	-546
CF from Operations	1,104	4,349	4,927	5,824	6,326
(Inc)/Dec in FA	-2,889	-1,604	-3,000	-3,725	-3,650
(Pur)/Sale of Investments	-283	-725	-689	-850	-1,290
CF from investments	-3,172	-2,330	-3,689	-4,575	-4,940
Issue of Shares	31	313	0	0	0
(Inc)/Dec in Debt	2,938	-108	-696	0	0
Interest Paid	-177	-169	-278	-266	-266
Dividend Paid	-702	-774	-829	-914	-1,013
CF from Fin. Activity	2,090	-739	-1,803	-1,180	-1,280
Incl/Dec of Cash	22	1,281	-565	68	106
Add: Beginning Balance	96	118	1,399	834	902
Closing Balance	118	1,399	834	902	1,008

E: MGS Estimates



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Biocon

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|---|----|
| 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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