

BIOCON

INR 540

*A hiccup due to no out licensing revenue***ACCUMULATE**

Biocon's Q3FY08 results were below our estimates with Y-o-Y sales, EBITDA, and adjusted net profit growth declining by 4%, 24%, and 5%, respectively.

The company recorded other income of INR 210 mn, which was significantly higher than expected and it helped boost profit for the quarter. If we adjust for this other income, the net profit will be ~INR 330 mn, which is significantly lower than our estimate. The EBITDA margin at 25% was also significantly lower than in the first two quarters. In the quarter, the company recorded extraordinary revenues of INR 3,300 mn from sale of the enzymes business and also took a write down of INR 220 mn on one of its IP projects. The post tax extraordinary income was ~ INR 2,390 mn.

Biocon has also announced that it will list its subsidiary Syngene separately on Indian exchanges before FY09 end. This could be an important step for the performance of the stock going forward.

With the disappointing numbers, we do not see any near term trigger for the stock. The listing of Syngene in FY09 will be an event to watch out for, but we believe at current prices the upsides due to this unlocking of value are already in the price. Biocon's R&D projects in various phases are progressing well and any new development on this front, which is uncertain, could give the stock some upsides going forward. With continuous pressure on biopharmaceuticals and services business margins (due to an appreciating rupee) we believe the stock will have limited upsides going forward. We have reduced our EPS estimates by ~2% for both FY08 and FY09. At CMP of INR 540, the stock is trading at 21x on our revised FY09E numbers. We maintain our 'ACCUMULATE' recommendation.

* Biopharmaceuticals: Subdued performance

The biopharmaceuticals revenues increased by 4% for the quarter which include licensing revenues of ~ INR 20 mn. We believe this subdued performance could have been driven by an appreciating rupee and much lower prices for its statins portfolio. Its insulin has now been registered in 15 countries and the company plans to have it registered in 40 countries by the end of this year. This could be a big opportunity in developed nations over the next two-three years. Its licensing revenues at INR 20 mn were significantly lower than the first half's licensing revenues of INR 320 mn. Because of this dip, margins for the quarter were at 25% compared to ~ 28% for the first half.

Financials

Year to March	Q3FY08	Q3FY07	% change	Q2FY08	% change	FY07	FY08E
Revenues (INR mn)	2,370	2,470	(4.0)	2,790	(15.1)	9,857	10,744
EBITDA (INR mn)	590	780	(24.4)	790	(25.3)	2,835	2,848
Net profit (INR mn)	2,910	540	438.9	500	482.0	1,941	5,578
EPS (INR)	5.2	5.4	(3.7)	5.0	4.0	19.4	18.4
P/E (x)						19.7	17.9
EV/EBITDA (x)						5.5	5.0

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Market Data

52-week range (INR) : 663 / 364
Share in issue (mn) : 100.0
M cap (INR bn/USD mn) : 54.1 / 1,375.9
Avg. Daily Vol. BSE/NSE ('000) : 412.3

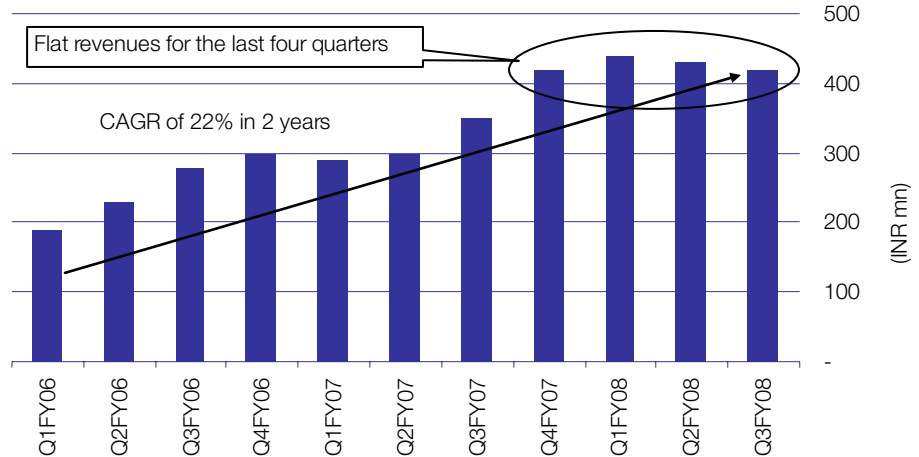
Share Holding Pattern (%)

Promoters : 60.9
MFs, FIs & Banks : 9.3
FIs : 7.3
Others : 22.5

*** Research services: Lowest growth in past few quarters**

Biocon’s research services registered revenues of INR 420 mn, which have more or less remained flat for the past four quarters, which is a cause of concern.

Chart 1: Research services revenues—Flat for past four quarters



Source: Company

In addition, Syngene’s profitability is significantly dependent on the USD/INR rate and with USD expected to depreciate further the profitability of Syngene might be under pressure going forward. As per our analysis, Syngene will contribute ~ 36% to the company’s net profit and have EPS of INR 9.4 for FY09E.

The following table details the sensitivity of Syngene’s and Biocon’s profits to currency movements.

Table 1: Sensitivity of Syngene’s FY09E EPS to USD/INR movement

USD/INR movement	Sensitivity of Syngene’s FY09E EPS to USD/INR
45.0	11.5
43.0	10.8
41.0	10.1
40.0	9.7
39.0	9.4
38.0	9.0

Source: Edelweiss research

Table 2: Sensitivity of Biocon’s FY09E EPS to USD/INR movement

USD/INR movement	Sensitivity of Biocon’s FY09E EPS to USD/INR
41.0	27.6
40.0	26.7
39.0	25.8
38.0	24.9
37.0	24.0
36.0	23.1

Source: Edelweiss research

We have assumed ~30% growth in revenues for the next couple of years and believe Syngene is likely to record PAT of ~ 935 mn for FY09E.

The company has announced that it is planning to list its subsidiary Syngene separately on Indian stock exchanges before FY09 end. This could be an important development for the stock. But we believe the upsides from this unlocking of value are already in the price.

* **Outlook and valuations: Wait and watch; maintain ACCUMULATE**

With the disappointing numbers, we do not see any near term trigger for the stock. The listing of Syngene in FY09 will be an event to watch out for, but we believe at current prices the upsides due to this unlocking of value are already in the price. Its R&D projects in various phases are progressing well and any new development on this front, which is uncertain, could give the stock some upsides going forward. With continuous pressure on biopharmaceuticals and services business margins (due to an appreciating rupee) we believe the stock will have limited upsides going forward. We have reduced our EPS estimates by ~2% for both FY08E and FY09E. At CMP of INR 540, the stock is trading at 21x on our revised FY09E numbers. We maintain our '**ACCUMULATE**' recommendation.

Financial snapshot								(INR mn)
Year to March	Q3FY08	Q3FY07	Growth (%)	Q2FY08	Growth (%)	FY07	FY08E	FY09E
Total operating income	2,370	2,470	(4.0)	2,790	(15.1)	9,857	10,744	13,512
Gross sales	2,370	2,470	(4.0)	2,790	(15.1)			
<i>Net sales</i>	2,370	2,470	(4.0)	2,790	(15.1)	9,857	10,744	13,512
Total expenses	1,780	1,690	5.3	2,000	(11.0)	7,022	7,896	9,715
Cost of goods sold	1,390	1,210	14.9	1,350	3.0	4,508	4,870	5,965
adj. to stock)	1,390	1,210	14.9	1,350	3.0	4,508	4,870	5,965
Gross profit	980	1,260	(22.2)	1,440	(31.9)	5,350	5,874	7,547
Other expenses	390	480	(18.8)	650	(40.0)	2,515	3,026	3,751
payments	280	250	12.0	300	(6.7)	910	1,010	1,244
Other expenses	110	230	(52.2)	350	(68.6)	1,605	2,016	2,506
EBITDA	590	780	(24.4)	790	(25.3)	2,835	2,848	3,797
Other income	210	-		20	950.0	38	275	227
PBDIT	800	780	2.6	810	(1.2)	2,873	3,123	4,024
Depreciation	230	180	27.8	250	(8.0)	667	905	1,063
Interest	30	20	50.0	20	50.0	96	168	168
PBT	540	580	(6.9)	540	-	2,110	2,050	2,793
Extra ordinary items	(2,390)	-		-		-	(3,736)	-
Tax (including deferred tax)	20	40	(50.0)	40		169	207	282
PAT	2,910	540	438.9	500	482.0	1,941	5,578	2,511
Minority interest	(10)	(20)	(50.0)	(20)	(50.0)	(62)	(62)	(62)
Net profit	2,920	560	421.4	520	461.5	2,003	5,640	2,573
Net profit for eq	2,910	540	438.9	500	482.0	1,941	5,578	2,511
Equity capital	500	500	500	500		500	500	500
Number of shares	100	100	100	100		100	100	100
EPS	29.1	5.4	438.9	5.0	482.0	20.0	56.4	25.7
EPS (w/o extraordinary items)	5.20	5.40	(3.7)	5.00	4.0	19.41	18.42	25.11
Annualised PE (x)						27.0	9.6	21.0
Annualised EV/EBITDA (x)						19.7	17.9	14.0
Annualised M.Cap / Revenues						5.5	5.0	4.0
EV						56,166	56,157	56,157
Market capital						54,000	54,000	54,000
as % of net revenues								
COGS	58.6	49.0		48.4		45.7	45.3	44.1
Other expenses	16.5	19.4		23.3		25.5	28.2	27.8
Total expenses	75.1	68.4		71.7		71.2	73.5	71.9
Depreciation	9.7	7.3		9.0		6.8	8.4	7.9
Gross profit	41.4	51.0		51.6		54.3	54.7	55.9
EBITDA	24.9	31.6		28.3		28.8	26.5	28.1
Net profit	122.8	21.9		17.9		19.7	51.9	18.6
Tax rate	3.7	6.9		7.4		8.0	10.1	10.1

Company Description

Biocon started as a company supplying industrial enzymes to several industries using fermentation technology. In the past four-five years the company has begun using these fermentation facilities for supplying APIs of biotech products like statins to pharmaceutical industries. The company is now supplying these products in regulated markets. It has now entered the formulations market by introducing insulin and monoclonal anti bodies like Insugen and Biomabs. It has entered the contract research space via Syngene and Clinigene. It is also aggressively investing in its own R&D to develop products like oral insulin.

Investment Theme

We believe Biocon is not likely to see any significant upsides going forward because: (1) pricing pressure in the biopharma segment, which forms about 73% of revenues; (2) increased investment required in the company's formulations entry of insulin and Biomab (higher S,G&A costs); (3) increased expenses committed in future for R&D (6-8% of revenues); and (4) though licensing income could help improve margins, recurrence and scalability of this income is still not clear.

Key Risks

If the licensing income keeps on increasing on Q-o-Q basis, it will drive margins up significantly, which will help much faster growth of the company.

If pricing in the biopharma segment remains stable, growth could be much higher than expected.

If some of the R&D initiatives are monetized, the stock could see a significant run-up.

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Income from operations	7,881	9,857	10,744	13,512	15,913
Total operating expenses	5,593	7,022	7,896	9,715	11,555
Materials cost	5,593	7,022	7,896	9,715	11,555
EBITDA	2,288	2,835	2,848	3,797	4,358
Other income	51	38	275	227	276
Depreciation and amortisation	298	667	905	1063	1138
Interest	16	96	168	168	168
Extraordinary items [expenses/(gain)]	-	-	(3,736)	-	-
Profit before tax	2,025	2,110	5,786	2,793	3,328
Provision for tax	306	169	205	279	333
PAT(inc. excep. & pre minority interests)	1,720	1,941	5,581	2,514	2,995
Minority interest & others	19.7	61.8	61.8	61.8	61.8
PAT (inc. excep.) for equity shareholders	1,740	2,003	5,642	2,576	3,057
PAT excluding exceptional items	1,740	2,003	1,906	2,576	3,057
Prior period items					
PAT (inc. excep.) for equity shareholders	1,740	2,003	5,642	2,576	3,057
Shares outstanding (mn)	100.0	100.0	100.0	100.0	100.0
Dividend per share (INR)	2.5	3.0	3.5	3.5	3.5

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Material cost	71.0	71.2	73.5	71.9	72.6
Depreciation	3.8	6.8	8.4	7.9	7.1
Interest expenditure	0.2	1.0	1.6	1.2	1.1
EBITDA margins	29.0	28.8	26.5	28.1	27.4
Net profit margins	22.1	20.3	52.5	19.1	19.2

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	10.6	25.1	9.0	25.8	17.8
EBITDA	2.2	23.9	0.5	33.3	14.8
Net profit	(11.9)	15.1	181.8	(54.4)	18.7
EPS	(11.9)	15.1	181.8	(54.4)	18.7

Cash flow statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Cash flow from operations	2,025	2,110	6,547	3,638	4,195
Cash for working capital	(989)	(459)	1,682	(2,624)	1,923
Net operating cash flow	1,037	1,651	8,230	1,014	6,118
Net purchase of fixed assets	(2,284)	(1,883)	(2,742)	(2,875)	(1,825)
Net purchase of investments	1,396	(109)	-	-	-
Net cash flow from investing	(888)	(1,991)	(2,742)	(2,875)	(1,825)
Proceeds from LTB/STB	47	511	(662)	(401)	(401)
Net cash flow from financing	47	511	(662)	(401)	(401)
Free cash flow	149	(340)	5,488	(1,861)	4,293

Balance sheet					(INR mn)
As on 31st March	FY06	FY07E	FY08E	FY09E	FY10E
Shareholders funds	8,881	10,686	15,667	17,842	20,498
Capital (incl. eq. and pref. capital)	500	500	500	500	500
Reserves & surplus	8,381	10,186	15,167	17,342	19,998
Borrowings	1,050	1,868	1,868	1,868	1,868
Secured loans	678	737	737	737	737
Unsecured loans	373	1,130	1,130	1,130	1,130
Deferred tax liability (net)	297	448	448	448	448
Minority interest	32	(8)	(8)	(8)	(8)
Sources of funds	10,261	12,994	17,975	20,150	22,806
Gross block	4,070	10,150	13,025	15,900	17,900
Depreciation	1,061	1,713	2,618	3,681	4,818
Net block	3,010	8,437	10,407	12,219	13,082
Capital work in progress	5,260	708	575	575	400
Investments	1,002	1,302	1,302	1,302	1,302
Inventories	1,105	1,613	1,285	2,321	1,912
Sundry debtors	2,237	3,065	2,523	4,430	3,734
Cash and bank balances	20	87	4,914	2,652	6,544
Loans and advances	239	530	298	733	477
Total current assets	3,601	5,296	9,019	10,136	12,667
Current liabilities	2,184	2,324	2,719	3,405	3,811
Provisions	429	425	610	678	834
Total current liabilities and provisions	2,613	2,749	3,328	4,083	4,645
Net current assets	989	2,547	5,691	6,053	8,022
Uses of funds	10,261	12,994	17,975	20,150	22,806
Book value per share (INR)	89	107	157	178	205

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROE (%)	21.4	20.5	17.3	15.4	15.9
ROCE (%)	21.3	18.6	12.5	14.3	15.0
Inventory days	43	50	49	49	49
Debtors days	94	98	95	94	94
Fixed assets T/o (x)	2.1	1.4	0.9	0.9	0.9
Debt/equity	0.1	0.2	0.1	0.1	0.1

Valuation parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS, inc. exceptionals (INR)	17.4	20.0	56.4	25.8	30.6
Y-o-Y growth (%)	(11.9)	15.1	181.8	(54.4)	18.7
CEPS (INR)	20.4	26.7	65.5	36.4	41.9
P/E (x)	31.0	27.0	9.6	21.0	17.7
Price/BV(x)	22.1	22.1	22.1	22.1	22.1
EV/Sales (x)	7.0	5.7	4.7	3.9	3.1
EV/EBITDA (x)	24.1	19.7	17.9	14.0	11.3

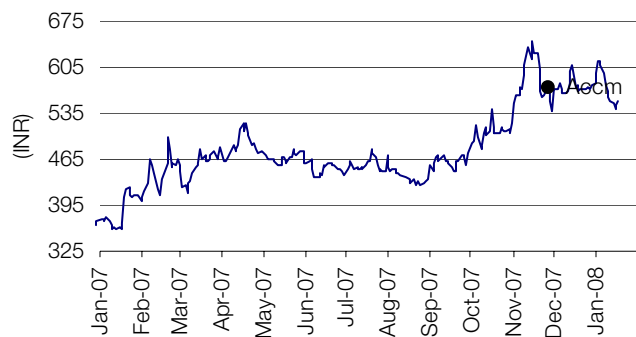
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Coverage group(s) of stocks by primary analyst(s): Pharmaceuticals:

Aurobindo Pharma, Cadila Healthcare, Cipla, Dishman Pharmaceuticals and Chemicals, Dr.Reddy's Laboratories, Glaxosmithkline Pharmaceuticals, Glenmark, Ipca Laboratories, Jubilant Organosys, Lupin, Nicholas Piramal India, Ranbaxy Laboratories, Sun Pharmaceuticals Industries, Torrent Pharmaceuticals and United Phosphorus.

Blocon



Recent Research

Date	Company	Title	Price (INR)	Recos
14-Jan-08	Pharma	Fact Sheet		
02-Jan-08	Sun Pharma	On an upswing, but Taro overhang Persists; Visit Note	1,199	Accum.
14-Dec-07	Pharma	Fact Sheet		
01-Nov-07	Jubilant Organosys	Value in store; Visit Note	306	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	108	44	16	3	188

* 12 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	66	19

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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