

Biocon

Rs 469

Buy on declines

9th April 2007

SCRIP DETAILS

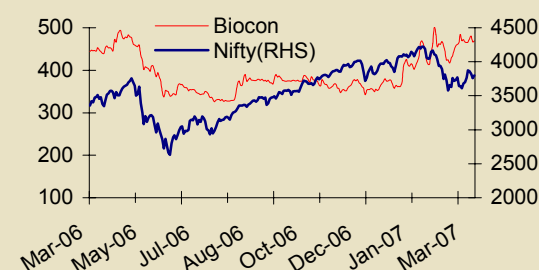
Market Cap (Rs crores)	4,690
P/E (x)-FY08(E)	19.0
Market Cap/Sales (x) FY08(E)	3.8
Market Cap/EBIDTA (x) FY08(E)	13.7
Dividend (Rs)/ Yield (%)	2.5/0.5
Equity Capital (Rs crores)	50.0
Face Value (Rs)	5.0
52 Week High/Low (Rs)	512/299.5

 Website: www.biocon.com

NSE Code	BIOCON
Sensex	12,856
Nifty	3,752.0

**SHARE HOLDING PATTERN
(As on 31 Dec 2006)**

Promoters	61.0
Mutual Funds/ Banks/ Fis	2.9
FII's	13.0
Public	21.3
Others	1.8

COMPARATIVE PRICE MOVEMENT


Biocon Limited is a fully integrated biotechnology enterprise focused on biopharmaceutical, custom research, clinical research and enzymes. Biocon is currently going through a transition phase- from a generic Company; it has set sights on becoming a discovery-led lifescience Company.

Multiple growth drivers: From being known as “Statin only” story for long, Biocon now has changed its strategy and currently has multiple growth drivers. The factors driving the growth for next few years would be statins for the US market, immunosuppressant, insulin for less regulated markets, contract research services and BIOMab. The sales from insulin and immunosuppressants would subsequently overtake statins sales.

Statin sale to the US market to pick up: Statins accounted for 58% of sales in FY06 and is the single largest product category in the Biocon portfolio. The statin sales were affected during FY06 due to significant pricing pressure in European markets. Sales were also affected due to delayed launch of Pravastatin and Simvastatin in the United States consequent to the grant of 6 months exclusivity to the generic players who were the first to file ANDAs. However, with the opening up of the US market, sales of Statin are likely to surge going forward.

Booming Contract Research business: This is one of the fastest growing segments with revenues growing at a CAGR of ~50% over FY01-FY06. It recorded revenues of Rs 100 crores in FY06 (Syngene contributed 90%); the management expects 30% growth for FY07. With slowdown in Satin business in FY06, the Contract Research Services business provided stability to the overall business. Operating margins for Syngene are very high (at 55% in FY06). Clinigene will break-even this year.

Insulin sales to take Biocon to a different orbit: Biocon presently has registration of the Insugen brand in 5 countries and expects to register Insugen in 25 countries by FY08 and in 75 countries in the next 4-5 years. The company is currently targeting 30-35 countries for the insulin crystals. It plans to ramp up insulin sales over a period of time. Biocon is attempting to build Insugen as a very big global brand. Non-invasive Insulins (Inhaled and oral) would emerge as potential growth drivers of the Insulin segment.

Monoclonal Antibodies (MABs) to be Rs 100 crores brand in next 4-5 years: Biocon has granted an exclusive license to Ferozsons Laboratories for marketing BIOMab-EGFR in Pakistan. Biocon believes that it along with Ferozsons will be able to create a very significant market for its antibody in the next 4 to 5 years. The monoclonals market is a rapidly expanding market. Currently the market in India is roughly about 75 to Rs 80 crores.

Valuation and Investment Argument: Biocon is currently undergoing a transition phase from a generic company to a discovery-led lifescience company. Insulin, immunosuppressant, BIOMab and contract research services would be the key growth drivers for the next few years. For FY07 and FY08, we expect net sales to rise by 24% and 26% to Rs 979 crores and Rs 1235 crores respectively and PAT to grow to Rs 193.2 crores and 247.8 crores during FY07 and FY08. At the current market price of Rs 469, the stock is available at PE of 24.3x its FY07 (E) EPS of Rs 19.3 and 19x its FY08 (E) EPS of Rs 24.8. One can BUY the stock on deep declines in the markets for a medium to long-term horizon with an investment perspective.

Analyst: Nisha Khuman
Email: nishakhuman@way2wealth.com
Telephone: 022 - 40192900

Investment Positives

➤ Integrated Business Model



Biocon with its integrated business model has been able to establish a significant presence in the global biopharmaceutical market. From early stage drug discovery to clinical development and commercialisation, the company leverages its resources to provide an innovative range of products and services. This allows Biocon to offer high value solutions at any stage in the lifecycle of a drug - right from discovery to market.

Early Stage Drug Discovery

Syngene, a Biocon subsidiary offers outsourced, high value research and development - from target identification and validation to small molecule and library synthesis. Biocon provides pharmaceutical and biotechnology majors customised solutions in the areas of synthetic chemistry and molecular biology.

Clinical Development

Clinigene, another Biocon subsidiary, the company specialises in Phase I-IV clinical trials and studies, using well-characterized clinical databases in diabetes, oncology, lipidemia and cardiovascular diseases.

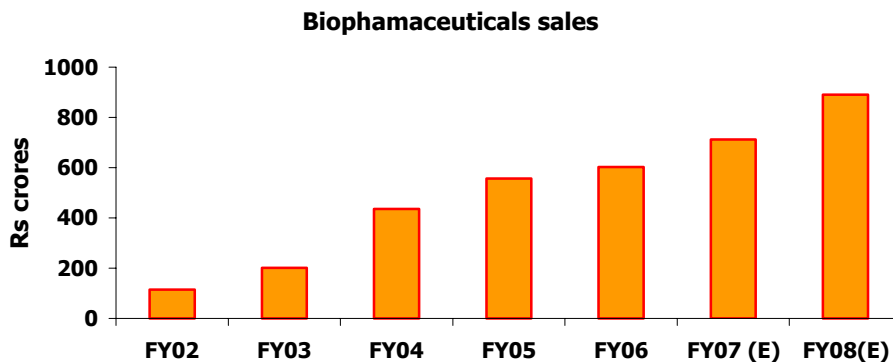
Commercialisation

Biocon has commercialised in excess of 25 enzymes over two decades. Biocon's biopharmaceutical foray began with statins and immunosuppressants. Their commercial success is evident in the rapid market share they have gained in the US and Europe. In fact, Biocon continues to be the only Indian company to have US FDA qualification for Lovastatin.

➤ Multiple growth drivers

Biocon, India's leading Biotechnology Company has over the past 28 years evolved from an enzyme manufacturing company to a fully integrated biopharmaceutical enterprise, focused on healthcare. From being a "Statins only" story, it now has multiple growth drivers. Statins for the US market, immunosuppressant, insulin for less regulated markets, contract research services and BIOMab would be the key growth drivers going forward. The sales from insulin and immunosuppressant would subsequently overtake statins sales in future.

○ **Bio-pharmaceuticals**



It involves manufacture and marketing of APIs that require fermentation and other skills. Having begun sales in FY98, the biopharmaceuticals business has since grown to constitute 76% of sales in FY06. It has been growing at a CAGR of 52% from FY01 to FY06. It comprises of the following segments:

(a) Statins

Statins are cholesterol-lowering agents used to treat and prevent coronary diseases and are amongst the largest selling drugs worldwide. Statins accounted for 58% of sales in FY06 and is the single largest product category. The Statin sales were affected during FY06 due to significant pricing pressure in European markets. Sales were also affected due to delayed launch of Pravastatin and Simvastatin in the United States consequent to the grant of 6 months exclusivity to the generic players who were the first to file ANDAs. However, with the opening up of the US market, sales of statin are likely to surge going forward.

Export of Statin to the US market has already begun in a small way; Biocon expects to steadily increase the volume sales of statin to US market. Biocon has a 20% market share for Simvastatin and 15-20% market share for Pravastatin in US. It is partnered with four customers in the US for Simvastatin and two more are in pipeline. Pravastatin has 3-4 customers. Since the launch of Simvastatin, sales of Pravastatin have declined. Biocon has closed its statins manufacturing deal for two (out of three) combination products with the innovator company.

(b) Immunosuppressant

Immunosuppressants prevent organ and tissue rejection in transplants and require high technology based manufacturing capabilities. Currently, Biocon produces Mycophenolate Mofetil (MMF), Sirolimus and Tacrolimus. MMF and Tacrolimus are sold largely in the domestic market and certain semi-regulated export markets. Biocon is positioning itself to enter new segments and address regulated exports markets aggressively in future. Biocon has filed a DMF for MMF and tacrolimus to address the US markets following patent expiry.

Immunosuppressants have been a key contributor to the overall sales growth of 8% in bio-pharmaceuticals in FY06. This segment will offer significant growth opportunities during 2008 to 2010 consequent to product patent expiry of MMF and Tacrolimus in the US market. This is likely to increase sales of immunosuppressants from FY09 onwards.

(c) Insulin

Biocon markets recombinant human insulin in India under its own brand name 'Insugen' and is also registering Insulin in several semi-regulated export markets to address a significant export opportunity. In addition, Biocon has a supply arrangement with two pharmaceutical companies to supply recombinant human insulin for use in their novel formulation, which is presently undergoing clinical trials. Biocon has adopted a multi-pronged strategy for growth in the insulin business. It would be exporting insulin to regulated markets, unregulated & semi-regulated market entry and in-house development of oral insulin. Biocon wants to play a significant role in the insulin market that is currently valued at Rs 300 crores in India.

Biocon expects to launch its insulin formulation in the EU in the next 18 months. The company expects its large-scale Phase IV Insugen studies done in India to facilitate filing in the EU. Biocon presently has registration of the Insugen brand in 5 countries and expects to register the brand in 25 countries by FY08 and in 75 countries in the next 4-5 years. The company is currently targeting 30-35 countries for the insulin crystals. It plans to ramp up insulin sales over a period of time. The company has also tied up with a partner for developing/registering/marketing the product in the US. Biocon is attempting to build Insugen as a very big global brand.

Oral Insulin

Non-invasive insulins (inhaled & oral) would emerge as potential growth drivers of the insulin segment. Oral insulin is reckoned to be the most acceptable of all insulin delivery routes both in terms of patient convenience as well as therapeutic benefit. Oral Insulin has an estimated market potential of \$ 1-3 billion. Biocon believes that non-injectable insulin will be driving the future of diabetes therapy throughout the world.

Biocon’s licensing partner, Bentley Pharmaceuticals has received approval from the drug controller general of India (DCGI) to proceed with a phase II clinical trials of Nasulin in type II diabetic patients. As per the licensing agreement, the company will develop and market Nasulin in India and select territories. Biocon’s subsidiary, Clinigene International will conduct and complete clinical trials by the end of the year. Nasulin is the second non-injectable insulin that Biocon is working on, besides tablet-form insulin IN 105 which has now progressed to Phase II of clinical trials.

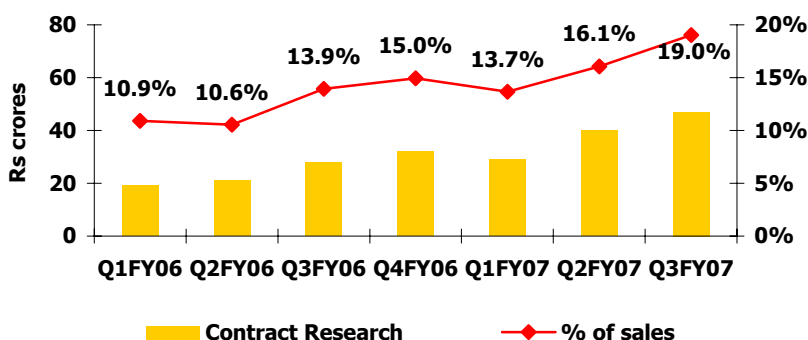
(d) Monoclonal Antibodies (MABs)

BIOMAb-EGFR is indicated for head and neck cancer and is being studied in global clinical trials for colorectal, lung cancer, glioma and pancreatic cancers. Biocon has granted an exclusive license to Ferozsons Laboratories for marketing BIOMAb-EGFR in Pakistan. Ferozsons Laboratories is ranked as No.1 National Oncology Company. The Pakistan oncology market is valued at approximately USD 70 million. Monoclonal Antibodies represent the fastest growing category of therapeutics with a CAGR of 30%. Biocon believes that it along with Ferozsons will be able to create a very significant market for its antibody in the next 4 to 5 years. The monoclonals market is a rapidly expanding market. Currently the market in India is roughly about 75 to Rs 80 crore. Its monoclonal antibody is the most affordable monoclonal antibody today in the Indian subcontinent. Biocon expects BioMab EGFR to become a Rs 100 crore brand in next 4-5 years.

○ **Contract Research Services**

Biocon’s two subsidiaries, Syngene and Clinigene are among the leading providers of contract research services in India. The Contract Research business is one of the fastest growing segments with revenues growing at a CAGR of ~50% over FY01-FY06. The business recorded of Rs 100 crores during FY06, out of which 90% came from Syngene. With slowdown in satin business in FY06, the contract research services business provided stability to the overall business. Operating margins for Syngene are very high (at 55% in FY06). Clinigene will break-even this year. Syngene is in the process of expanding its employee base. From its present employee strength of 600, around 300 employees will be added over the next 1-year. Clinigene has close to 100 employees.

Increasing contribution of Contract Research Services to total revenues

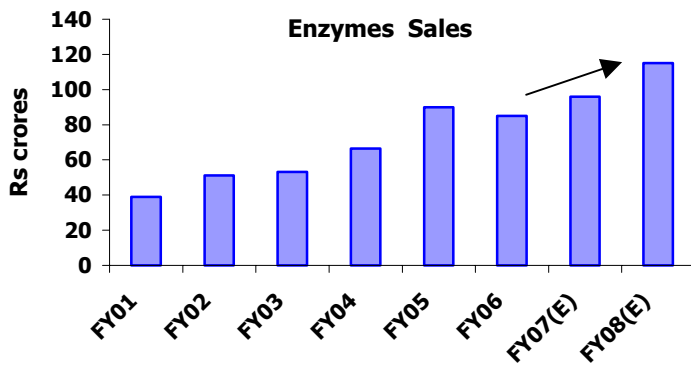


Recently, Syngene entered into a research partnership with Bristol-Myers Squibb, where Syngene will provide R&D services for discovery and early drug development. Under the terms of the agreement, Syngene will partner Bristol-Myers Squibb through a dedicated research facility at Biocon Park, Bangalore. This deal will significantly ramp-up Syngene’s manpower base and lead to accelerated growth in business over the next few years. With the business segment gaining momentum, revenues are expected to grow at a CAGR of 30% over the next two years.

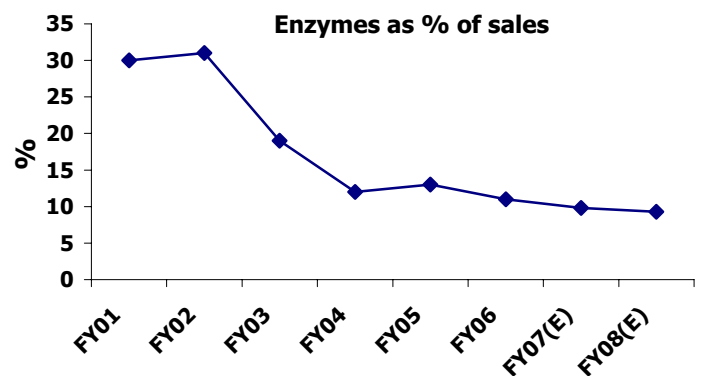
○ **Enzymes**

Biocon develops and markets a mix of specialty and industrial enzymes for a broad range of industries including food and beverages, brewing and distilling, textiles and paper. After growing steadily at a CAGR of 21% over FY02-FY05, the sale of Enzymes declined by 5.5% during FY06 due to capacity constraints. From contributing 30% to sales in FY01, it contributed 11% to sales in FY06. This is further expected to come down due to pick up in biopharmaceuticals and contract research business. The increased capacity consequent to the setting up of the new facility at Biocon Park is expected to contribute to the sales growth of enzymes in the coming years. We expect enzymes to grow by ~16% on FY07 and FY08. Biocon has thus successfully transformed itself from being primarily manufacturer and exporter of industrial enzymes company to a lifescience company.

Pick-up in Enzyme sales in FY07 and FY08



... but contribution to total sales has come down



Key Risks

- Increased competition in the insulin space - Insulin major Novo Nordisk is pursuing its inhaled version of insulin, *Aerx*, which is expected to be out in two years. Pfizer has already released its inhaled version of insulin named *Exubera* in the US. Biocon may face intense competition from well-established players in this space as non-injectable form of insulin gain acceptance.

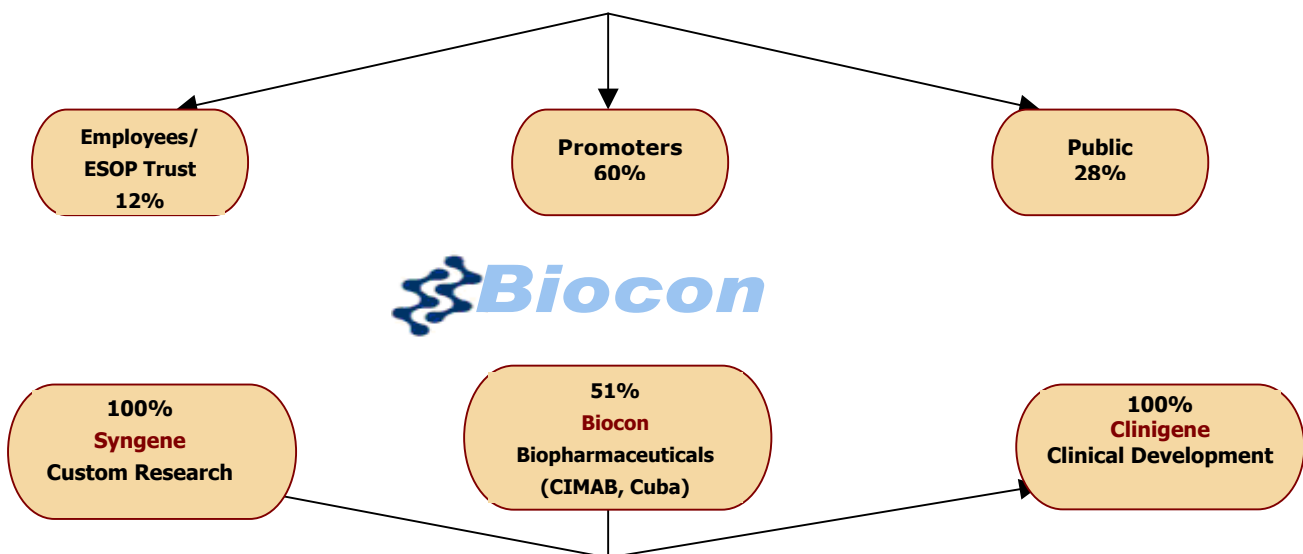
Company Background

Biocon Limited, promoted by Ms. Kiran Mazumdar Shaw, was incorporated at Bangalore in 1978 for manufacture of biotechnology products. It is one of India's premier biotechnology companies with a presence in biopharmaceuticals, enzymes, customs research and clinical research. The company was promoted as a joint venture with Ireland-based MNC Biocon Biochemicals. Later, Unilever Plc acquired Biocon Biochemical's stake in February 1995, but sold it to the current promoters in June 1999. The Company has its facilities at Hebbagodi and Bommasandra, Bangalore district, Karnataka and is engaged in manufacturing biotechnological products in the pharmaceutical and enzyme sectors through fermentation based technology.

Biocon and its two subsidiary companies, Syngene International Pvt Ltd and Clinigene International Pvt Ltd form a fully integrated biotechnology enterprise, specializing in biopharmaceuticals, custom research, clinical research and enzymes. With successful initiatives in clinical development, bioprocessing and global marketing, Biocon delivers products and solutions to partners and customers across the globe. Many of these products have USFDA and EMEA acceptance. Biocon launched the world's first recombinant human insulin, Insugen in November 2004 using Pichia expression and India's first indigenously produced monoclonal antibody BIOMAb-EGFR.

Biocon Group - Corporate Structure

The Biocon Group's corporate structure comprises of Biocon (the holding company), its two subsidiaries, Syngene & Clinigene and its joint venture company Biocon Biopharmaceuticals.



Subsidiaries and Joint Ventures:

Syngene

Syngene is 99.99% owned subsidiary of Biocon. It was incorporated on November 18, 1993 and is involved in two main research areas- synthetic chemistry and molecular biology. Syngene is also involved in custom chemical synthesis. It is today one of India's leading custom research service providers. Its state-of-the-art infrastructure and a broad set of service offerings, enable it to participate in the drug development process, from discovery to supply of development compounds. Syngene has a strong knowledge base, where out of the total strength of about 600 employees. It plans to add another 300 plus over the next 1-year.

Syngene grew at a CAGR of 40% over the last five years, which reflects its increased acceptance as a 'research hub' for the biggest names in the pharma industry. Having firmly established its reputation amongst leading European and American pharma companies, Syngene plans to aggressively target newer markets like Japan and a large number of small biotech and specialty pharma companies from around the world. To facilitate these opportunities for growth, it is investing in additional laboratories located at Biocon Park.

Clinigene

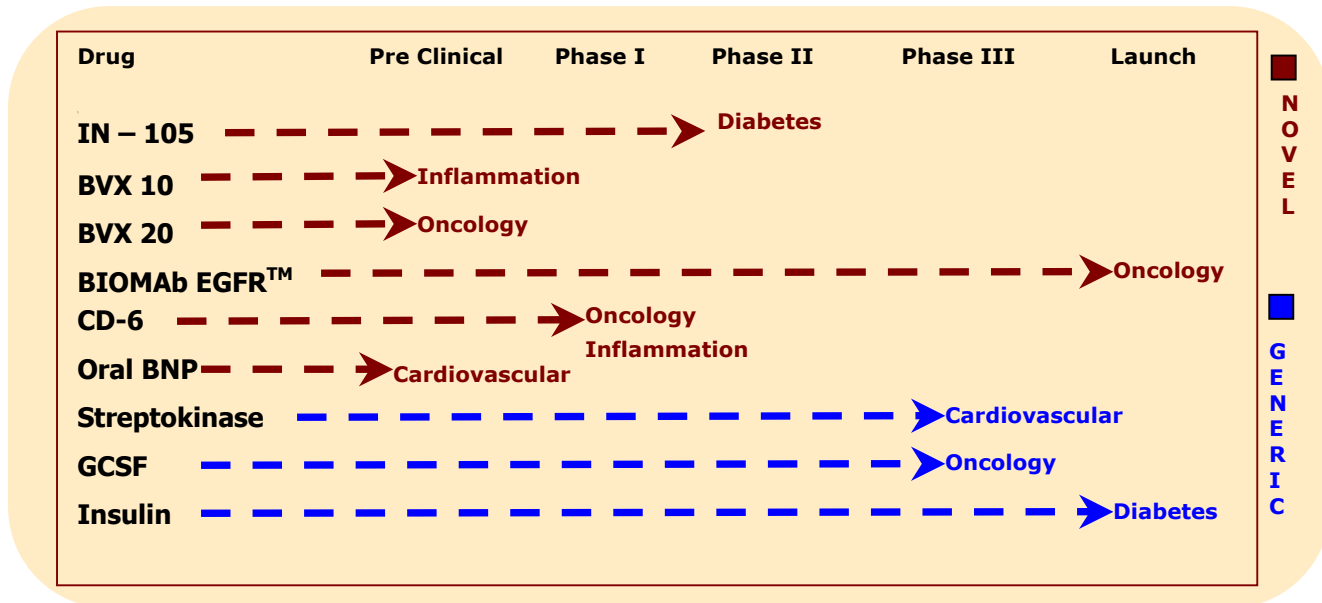
Clinigene is a 100% owned subsidiary of Biocon. Clinigene was established to undertake clinical trials and studies for validation of drugs and to conduct research in the area of medical sciences for development of new and improve upon existing medical diagnostic, surgical and therapeutic techniques.

Biocon Biopharmaceuticals

This is Biocon's 51:49 JV with a Cuban Company, to manufacture monoclonal antibodies and other Recombinant therapeutics. The most advanced therapy developed is a monoclonal antibody, BIOMAB EGFR for the treatment of head and neck cancers and represents a significant initiative in the Company's foray into original molecules.

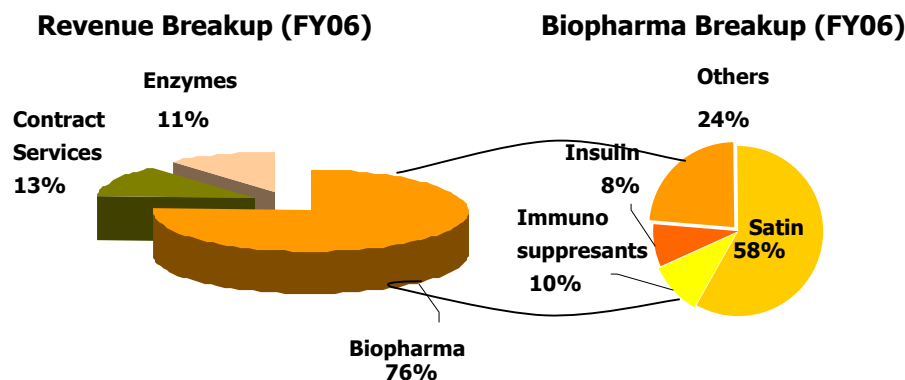
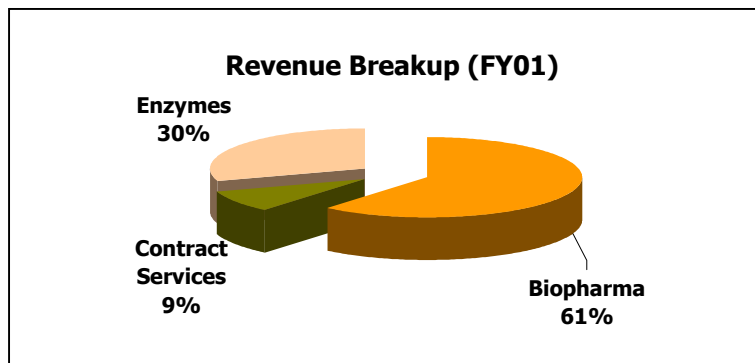
Research Pipeline

BIOMAb EGFR has herald Biocon's foray into the oncology market to establish it as an innovator company. Other programs that are moving up the development path are oral insulin, oral BNP, BVX 10, BVX 20 and Anti-CD6 monoclonal antibodies. The oral insulin IN 105 has progressed into Phase II clinical trials.



Financials

Consolidated (Rs crores)	FY 04	FY 05	FY06	FY07(E)	FY08(E)
Net Sales	540.6	712.6	789.1	979.0	1235.0
<i>Growth (%)</i>		<i>31.8%</i>	<i>10.7%</i>	<i>24.1%</i>	<i>26.1%</i>
EBIDTA	178.3	223.9	229.9	275.7	343.2
<i>Growth (%)</i>		<i>25.6%</i>	<i>2.7%</i>	<i>19.9%</i>	<i>24.5%</i>
PBT	161.7	215.1	202.5	204.7	263.2
PAT	138.6	196.5	172.0	190.9	244.8
Minority Interest	0.0	-1.0	-2.0	-2.4	-3.0
Adjusted PAT	138.6	197.5	174.0	193.2	247.8
<i>Growth (%)</i>		<i>42.5%</i>	<i>-11.9%</i>	<i>11.0%</i>	<i>28.3%</i>
Equity Paid Up	50.0	50.0	50.0	50.0	50.0
Networth	563.1	740.5	888.1	1055.8	1278.1
Capital Employed	645.4	840.3	1022.9	1191.8	1414.1
EPS (Rs)	13.9	19.7	17.4	19.3	24.8
CEPS (Rs)	15.8	22.5	20.8	26.0	31.9
Dividend (%)	20.0	40.0	50.0	50.0	50.0
Payout (%)	7.2	10.2	14.5	13.1	10.2
Debt: Equity (times)	0.2	0.1	0.1	0.1	0.1
ROCE (%)	38.1	29.3	22.0	19.3	21.0
RONW (%)	39.7	30.3	21.3	19.9	21.1
EBIDTM (%)	33.0	31.4	29.1	28.2	27.8



Sales Break-up

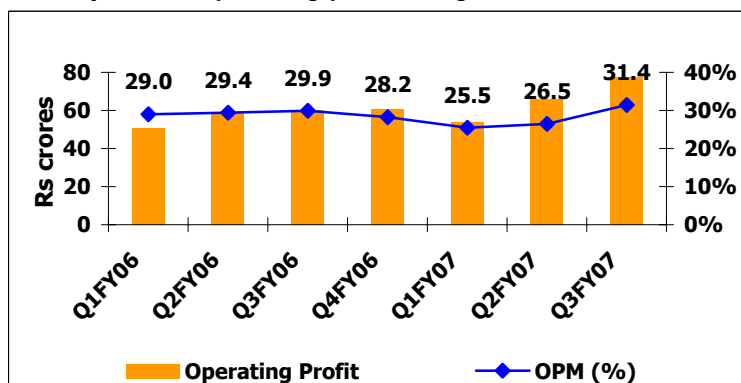
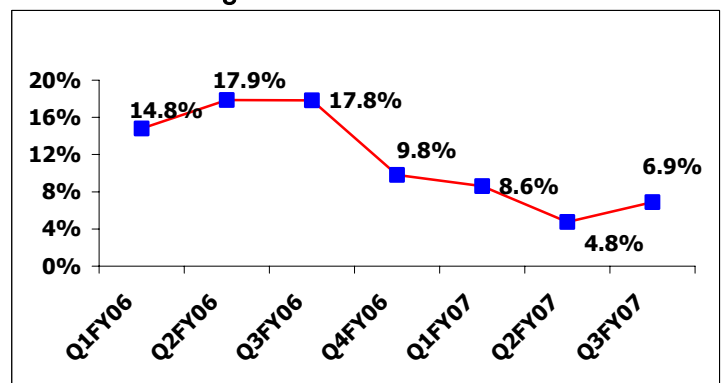
(Rs crores)	Q3FY07	Q2FY07	Q1FY07	Q4FY06	Q3FY06	Q2FY06	Q1FY06	Q4FY05
Biopharmaceuticals	180.0	183.0	161.0	157.0	155.0	156.0	135.0	132.0
% of total sales	72.9	73.5	75.9	73.4	77.1	78.4	77.6	75.4
YoY growth (%)		-1.6	13.7	2.5	1.3	-0.6	15.6	2.3
Enzymes	20.0	26.0	22.0	25.0	18.0	22.0	20.0	24.0
% of total sales	8.1	10.4	10.4	11.7	9.0	11.1	11.5	13.7
YoY growth (%)		-23.1	18.2	-12.0	38.9	-18.2	10.0	-16.7
Contract Research	47.0	40.0	29.0	32.0	28.0	21.0	19.0	19.0
% of total sales	19.0	16.1	13.7	15.0	13.9	10.6	10.9	10.9
YoY growth (%)		17.5	37.9	-9.4	14.3	33.3	10.5	0.0
Total	247.0	249.0	212.0	214.0	201.0	199.0	174.0	175.0

Latest Results

(Rs crores)	Q3FY07	Q3FY06	Chg (%)	9mFY07	9mFY06	Chg (%)
Net Sales	246.5	200.3	23.0%	707.5	574.8	23.1%
Total expenditure	169.0	140.4	20.4%	509.7	405.5	25.7%
Operating Profit	77.5	60.0	29.2%	197.8	169.4	16.8%
OPM (%)	31.4%	29.9%		28.0%	29.5%	
PBT	57.6	52.9	9.0%	147.1	150.2	-2.1%
Profit after Tax	55.3	43.9	26.1%	139.6	126.1	10.7%
Equity Share Capital	50.0	50.0	0.0%	50.0	50.0	0.0%
EPS (Rs)	5.5	4.4	26.1%	14.0	12.5	11.8%

Net sales for Q3FY07 grew by a healthy 23% to Rs 246.5 crores mainly due to exports of statin to the US market, and technology & licensing fees (Rs 12 crores in Q3FY07). The biopharmaceutical segment contributed 73% to the sales, followed by contract research and licensing 19%, and enzymes 8%. Operating profit grew by 29.2% to Rs 77.5 crores and margins expanded by 150 bps to 31.4%. PAT for the quarter grew by 26% to Rs 55.3 crores.

For the 9mFY07, net sales witnessed a 23% jump to Rs 707.5 crores. Licensing fees which was insignificant in the corresponding period last year grew to Rs 26 crores for 9mFY07. Doubling of power cost to Rs 47 crores, increase in other expenses by 50.7% to Rs 70.2 crores and increase in staff cost by 39.2% to Rs 66 crores exerted some pressure on the operating margins, which declined by 150 bps. Interest and depreciation cost went up significantly to Rs 6.3 crores and Rs 47 crores respectively. PBT as a result was flattish for the nine months period. Effective tax rates have come down from 17% in 9mFY06 to 7% in 9mFY07. PAT thus showed an increase of 10.7% to Rs 139.6 crores.

Steady rise in operating profit margins

Tax rates off highs. . .


Valuation and Conclusion

Biocon is currently undergoing a transition phase from a generic company to a discovery-led lifescience company. Insulin, immunosuppressant, BIOMab and contract research services would be the key growth drivers for the next few years. With the opening up of US market, statin sales are likely to improve in the coming years. Immunosuppressants offers significant growth opportunities during 2008 to 2010 consequent to product patent expiry of MMF and Tacrolimus in the US market. This is likely to increase sales of immunosuppressants from FY09 onwards. Sale from insulin would gain momentum as Biocon targets regulated and non-regulated market entry. The company is also aggressively venturing into non-injectable form of insulin, Nasulin and IN 105 has progressed into Phase II of clinical trials.

For FY07 and FY08, we expect net sales to rise by 24% and 26% to Rs 979 crores and Rs 1235 crores respectively and PAT to grow to Rs 193.2 crores and 247.8 crores during FY07 and FY08. At the current market price of Rs 469, the stock is available at PE of 24.3x its FY07 (E) EPS of Rs 19.3 and 19x its FY08 (E) EPS of Rs 24.8. One can BUY the stock on deep declines in the markets for a medium to long-term horizon with an investment perspective.

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