

Biocon

Rs510
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs51bn; US\$1.1bn

Analyst : Nitin Agarwal, (91-22-6638 3395; nitinagarwal@sski.co.in)
Result : Q4FY07
Comment : Another strong quarter
Last report : 18 January 2007 (Price Rs410; Recommendation: Outperformer)

Key financials

Year to 31 March (Rs m)	Net Sales	% change	Net Profit	FDEPS	% change	PER (x)
FY05	7,138	32.0	1,988	19.9	43.3	25.6
FY06	7,885	10.5	1,740	17.4	-12.3	29.2
FY07E	9,860	25.0	2,025	20.3	16.2	25.1
FY08E	11,518	16.8	2,490	24.9	22.9	20.4
FY08E	13,840	20.2	3,197	32.0	28.4	15.9

Biocon's Q4'07 profits are ahead of expectations on back of stronger growth in biopharma and contract research business. A key positive is 30% yoy growth in Biopharma business. Biocon has maintained 30% EBITDA margins despite limited licensing income contribution which is indicative of core business health. Contract services business continues to be a key growth driver and the company is investing Rs2500m into the business over next 2 years. Biocon has managed to capture 21-22% market in US statins market which is very encouraging. Insulin is on track with steadily growing registrations across countries and the foray into Nephrology reinforces Biocon's gradual progression towards higher margin formulation business. Biocon's discovery and biosimilars programmes are progressing well and the company remains positive about the prospects for BIOMAB. On the flipside we are cautious on potential R&D cost escalations and the outlook of statins sales in US given the competitive intensity. We have been positive on Biocon's business model and the market has also begun to appreciate Biocon's growth story with the stock outperforming Sensex by about 30% over last 3 months. Maintain estimates and reiterate Outperformer with a price target of Rs. 560. Acceleration in licensing revenues growth will be upsides to our estimates.

RESULT HIGHLIGHTS

□ Q4'FY07 revenue growth of 30% yoy; Strong growth in biopharma

- Q4'FY07 revenues grew 30% on a yoy basis, 16% ahead of estimates. The key surprises have been the 30% growth in Biopharma business and 47% growth in licensing and contract research income.

	Q3FY06	Q4FY06	FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07
Biopharma	1,540	1,570	6,020	1,610	1,830	1,800	2,040
Enzymes	180	250	850	220	260	200	270
Contract Research and Licensing Income	270	320	1,010	290	420	470	450
Total Net Sales	1,990	2,140	7,880	2,120	2,510	2,450	2,780

- Biocon has indicated that it is supplying to 5 players and has captured ~22% marketshare in the Simva supplies to US and remains confident of maintaining and growing this marketshare over a period of time
- Currently, the Simva pricing in US is significantly better than in EU which is a positive. However given the escalated competition in formulations markets, we remain wary of the stability of these pricing levels.
- After a slow start, Biocon has also managed to capture close to 21% marketshare even in Pravastatin which is indicative of its strengths in the statins API space.
- In another positive development, Biocon's new fermentation facility has been inspected and approved by the USFDA. This has removed concerns related to Biocon's ability to meet the US statin demand requirements in FY08 and has eased capacity constraints.

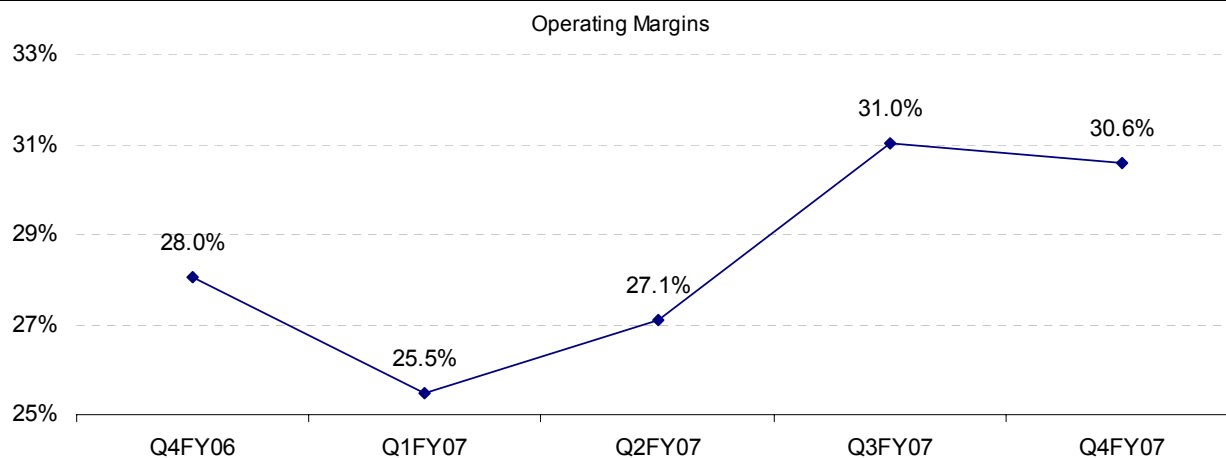
□ Contract Research – Growth unabated

- Contract Research services segment (including Syngene and Clinigene) has grown strongly at 47% yoy for the quarter and 37% yoy for the full year.
- The recent BMS deal for setting up a dedicated 400 seat facility further underlines Biocon's strong position in this segment and is indicative of the very positive outlook for the segment given that contract research is set to grow very strongly in countries like India.
- Biocon will be investing Rs2500m in contract research business over the next 2 years with Rs1000m investment in the BMS facility.
- Currently Syngene has 700 people on its rolls and plans to grow it by 35-40% in FY08.
- Clinigene business has also started to ramp up strongly and the management expects it to more than double in FY08 given the low base
- Overall we believe that this segment will grow at a CAGR of 40% over FY07-09
- Given that this segment has higher profitability, it will enhance the overall profitability for Biocon

□ Margin performance – Another positive

- Despite the limited contribution from licensing income, Biocon's operating profits at Rs855m are ahead of estimates of Rs744m which is very encouraging.
- Biocon has reported consolidated operating margins at 30.6% for the quarter and the management has expressed its confidence in its ability to maintain these margins going forward also

Operating Margin trends



- The core business margin growth has been helped by the operationalization of the new fermentation facility which has helped in the reduction of intermediates costs. Due to capacity constraints, Biocon was earlier

forced to purchase these intermediates from external sources which was depressing profitability. Management is confident of maintaining these margin levels going forward.

- One concern on the margin front is the steady escalation in R&D costs given the growth in Biocon's discovery programmes. Currently the R&D cost is around 4% of total sales and management has guided to it getting further escalated to 6-8% of sales if the discovery programmes proceeds as planned.

□ **Insulin – well on track**

We have been maintaining that Insulin will be the next big growth driver for Biocon and development in recent quarters vindicates our view. There are multiple positive development on Insulin front

- Biocon's generic Insulin strategy involves selling both Insulin crystals and formulations. While the insulin crystal sales have been picking up steadily, management is focusing on building the market for Biocon's Insulin formulation (Insugen) which will be a more profitable product.
- Currently, Biocon has registered Insugen in 6 countries and is targeting registrations in 25 countries by FY08 which will lead to a significant expansion in the Insugen franchise. Over the next few years, Biocon propose to register and sell Insugen in 75 markets globally. This could potentially make Insugen the biggest branded drug sold by an Indian company.
- Biocon has already tied up with Bayer for registration and supply for Insugen for China and the requisite registration process in underway.
- A key upside for Biocon in Insulin is the potential opportunity in the regulated market of US and EU. While the regulatory pathway in US is yet not defined, Biocon has already tied up with a large global player which ensures its early entry in US as and when the opportunity opens up
- Biocon has opted for interesting strategy for the EU market where it proposes to register Insugen on its own across different markets. If successful, this could lead to significant financial upsides. The key concern in this strategy is Biocon's ability to bear the expenses involved in clinical trails. Biocon management indicates that they are hopeful that given the extensive post market clinical studies that they already undertaken for Insugen, the regulatory requirement for clinical trial is likely to significantly muted. This will enable Biocon to conduct these trials on a relatively limited budget. However, we need to watch for the opinion of the EU regulators on this issue. All the same, Insulin supplies to EU remains an exciting opportunity for Biocon and the management is hopeful of entering the market post 18 months.
- While the management does not disclose productwise revenues, we estimate that Insulin is growing at a CAGR of 50% and is likely to be a Rs2000m product by FY09. Management expects Insulin to account for 15-25% of total portfolio by FY09.

□ **Launch of nephrology formulations division – Progression to a formulations company**

- As part of its medium term growth strategy, Biocon is attempting to make a progression to a formulations company. In line with this move, Biocon has launched its nephrology division for selling products like Immunosuppressants and EPO. This is the third such branded formulation team launched by Biocon after oncology and diabetes
- Given that Biocon is vertically integrated in most of these formulations, it significantly enhances its competitiveness

□ **Discovery programmes on track – Key to future upsides**

Biocon's discovery programmes are on track and remain an exciting prospect for future growth

- BIOMAb – Anti-Cancer Monoclonal Antibody – The management has indicated that BIOMAb has been received well by the oncologists in Indian market. The product was launched in September and 50% of all the oncologists in India have tried this product on their patients and have expressed satisfaction on the efficacy of the product.
- Biocon is working on conducting trials to cover more indications. It has also entered into tie-up with the leading oncology company for the drug in Pakistan as well as another company in the Middle East. The

company remains confident of BIOMAb generating Rs1000m sales over the next 3-4 years with the expanded indications and new geographies. Additionally, BIOMAb is already undergoing clinical trials in Europe and is expected to start trials in US soon. Commercial launch in any of these markets could provide contract manufacturing opportunities for Biocon going forward.

- Oral Insulin – Phase I trials are over and the Phase II trials are expected to start in 2HCY07
- Biocon is also working on another Monoclonal Antibody meant for Arthritis which is undergoing Phase I clinical trials currently.
- Biosimilars – Biocon's EPO has already been launched in the market while Streptokinase and GCSF are awaiting regulatory approval in the Indian market which is expected over the next 2 quarters. This will pave the way for launching in these products in other non-regulated markets globally.

□ Net profit up 22% on a yoy basis despite doubling of depreciation charges

- Q4FY07 Net profit at Rs. 600m is ahead of expectations. This growth has been achieved despite the sharp increase in depreciation for the current quarter (Rs. 200m in Q4FY07 as compared to Rs. 110m in Q3FY06). With incremental revenue and profit growth coming from Biocon's new SEZ facility, Biocon's effective tax rates have come down to 8% of PBT and we expect them to stabilize at current levels.

□ Valuations and view

Biocon has had yet another strong quarter which vindicates our positive view on Biocon's business model. We have been maintaining that Biocon will enter a higher growth trajectory from Q3FY07 onwards and the H2FY07 performance reinforces our confidence. There are multiple positives in form of significantly improved margins in the core business, very strong growth outlook for the contract research services business and management's ability to generate a sustainable licenses revenue stream by monetizing its IP. We remain excited about the potential for Biocon's insulin business and its discovery pipeline including the Monoclonal Antibody franchise. We have been positive on Biocon's business model and the market has also begun to appreciate Biocon's growth story with the stock outperforming Sensex by about 30% over last 3 months. Maintain estimates and reiterate Outperformer with a price target of Rs. 560. Acceleration in licensing revenues growth will be upsides to our estimates.

Quarterly results

(Rs m)	Q4FY06	FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY07E	FY08E	FY09E
Net Sales	2,140	7,880	2,120	2,510	2,450	2,780	9,860	11,518	13,840
Biopharma	1,570	6,020	1610	1830	1800	2040	7,280	8,243	9,636
Enzymes	250	850	220	260	200	270	950	1,093	1,224
Contract Research	320	1,010	290	420	450	470	1,380	1,883	2,681
Operating Expenses	1,540	5,590	1580	1830	1690	1930	7,005	8,090	9,572
Cost of Sales	1,220	4,340	1190	1330	1210	1400	5,253	6,081	7,184
Other Expenses	320	1,250	390	500	480	530	1,752	2,008	2,388
EBITDA	600	2,290	540	680	760	850	2,855	3,429	4,269
EBITDA	28.0	29.1	25.5	27.1	31.0	30.6	29.0	29.8	30.8%
Other Income	10	50	10	10		20	40	30	30
Depreciation	70	290	110	180	180	200	670	700	780
Interest	10	20	20	20	20	30	90	90	90
PBT	530	2,030	420	490	560	640	2,135	2,669	3,429
Extraordinary									
Provision for Taxation	50	310	40	20	40	70	170	239	302
Minority		(20)	(10)		(20)	(30)	(60)	(60)	-70
PAT	480	1740	390	470	540	600	2,025	2,490	3197
yoy growth (%)									
Net Sales						29.9	25.1	16.8	20.2
EBITDA						41.7	24.7	20.1	24.5
Net Profit						25.0	16.4	22.9	28.4

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2. Neutral: Within 0-10% to Index
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