

ACK Capital Management Pvt. Ltd.

INITIATING COVERAGE

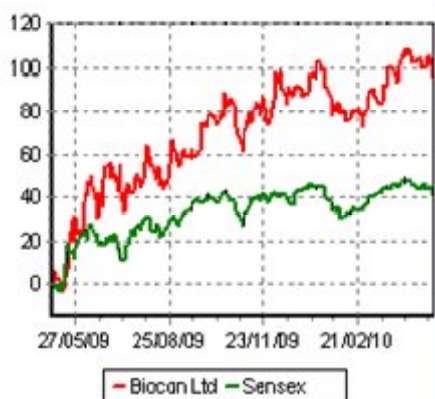
BUY (19% Upside)

| | |
|------------------|-----------------|
| CMP | 290 |
| Target | 344 |
| Sector | Pharmaceuticals |
| Market Cap (bn) | 57.86 |
| 52 WK High / Low | 311/140.5 |
| Face Value (Rs) | 5 |
| BSE Sensex | 17087.9 |
| Nifty | 5124.9 |

Shareholding Pattern (%)

| | |
|---------------------|----|
| Promoters | 61 |
| MF/Banks/Indian FIs | 12 |
| FII/ NRIs/ OCBs | 4 |
| Others | 23 |

Price Movement with Sensex



Investment rationale

IND Filing for Oral Insulin: Biocon has filed for an investigational new drug (IND) for IN-105 oral insulin with the US FDA in Dec'09. Insulin registration in US are in the advanced stages of the Phase-I clinical development. The phase-III development will also start soon. Insulin is likely to be one of the major growth drivers for the company as the world diabetes market is growing fast. In India, the product is undergoing phase III trial and expected to complete by June 2010. It is likely that in the next 3-4 quarters the data will be out on drug's performance in terms of a wider clinical trial. The expected launch date would be somewhere in 2011

Lead Player In STATINS: Biocon is the leading player in statins and exports over 80% of its production, commands over 20% global market share and derives over one third of its revenues from this business. Biocon caters to regulated markets like US and Europe and is one of the largest exporters of Lovastatin to the US. The global patents of Lovastatin, Simvastatin and Pravastatin have already expired and they have become generic. The patent for Atorvastatin is expiring in 2010 in UK and 2011 in Germany. It is likely to offer a huge opportunity due to its \$12bn market size

T1h in its phase II trial segment: Biocon's another research molecule T1h or Anti-CD6 monoclonal antibody is currently undergoing Phase II clinical trials in India. The results of this will be available in June'10. T1h is effective in the treatment of Psoriasis and Rheumatoid Arthritis (RA). It is likely to enter into Phase III clinical trials for rheumatoid arthritis (RA) by the end of CY10. The company has plans to out license this molecule to an MNC pharma or Biotech Company. We expect T1h to become a pioneer in these therapies, as there are few drugs in these therapeutic segments

Gain through joint ventures with foreign companies: The Company has entered into an agreement with US based biopharmaceutical company Amylin Pharmaceuticals to jointly develop, commercialize and manufacture a novel peptide for the treatment of diabetes. As mentioned earlier the company has brought out new medicines used in the treatment of diabetes, it shall stand to benefit immensely in the times to come. Biocon has also partnered with Mylan Labs for development and commercialization of complex biosimilars, including monoclonal antibodies, across the globe

Axicorp contribution gaining strength: Biocon acquired 78% stake in pharma Distribution Company Axicorp, Germany in Feb'08 for 30m euros. Axicorp is specialised in marketing and distribution of generic products in EU with a focus on Germany. It has posted a 93% YoY growth and although this is not strictly comparable to the previous year as the previous year factors in only three quarters of Axicorp revenue. On an adjusted basis, Axicorp has posted a strong 55% growth. This growth primarily came from more efficient sourcing of products for its business, a restructuring of its sales force and winning the AOK, BKK & DAK tenders for several generics



BIOCON

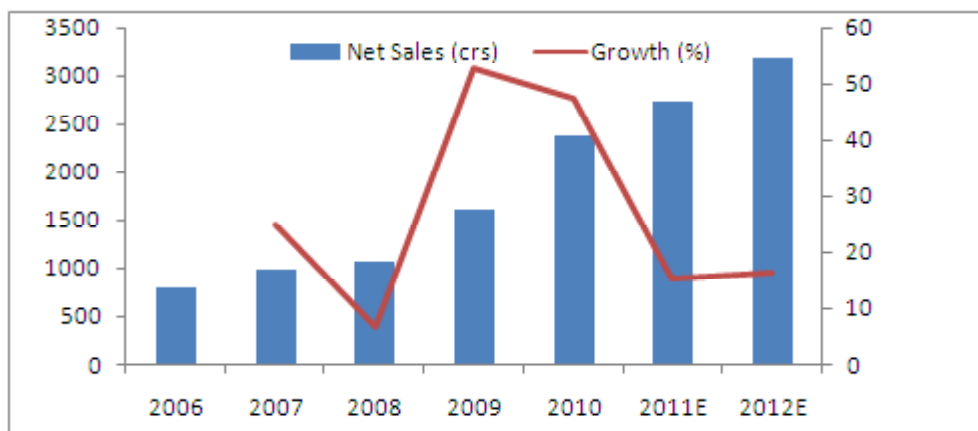
Valuations: The CMP discounts the FY11E EPS of Rs 18.2 by 15.9x and FY12E EPS of Rs 19.9 by 14.6 x. Going forward we expect the growth drivers for FY11 to be; company' insulin initiative and domestic formulation business, contribution from immuno- suppressants and potential listing of contract research business. We initiate the coverage with a BUY rating with a target of Rs.344, an upside of 19% over the next 12 months

Company Overview:

Biocon is an integrated Bangalore based largest biotechnology company with a presence in innovative biopharmaceutical solutions ranging from discovery (Syngene) to development (Clinigene) to commercialization. The company manufactures statins, anti-diabetics, immunosuppressants, neutraceuticals and other biopharma products. The company has the defining science, cost-effective drug development capabilities and significant manufacturing capacity. With successful initiatives in clinical development, bio – processing, and global marketing, Biocon delivers products and solutions to partners and customers in approximately 75 countries across the globe. The company's product offering includes the world's first recombinant human insulin Insugen. Biocon has adopted a partnership route with CIMAB, IATRICa, Abraxis, NeoPharma and Mylan. The company has also acquired a 70% stake in AxiCorp, Germany, for €30mn. It has an R&D pipeline of seven molecules, with lead molecules oral insulin (IN 105) and oncology (T1h) undergoing phase III & II clinical studies respectively

Strong Sales – Driven by Biopharmaceutical formulations and Research Business

Domestic branded formulations and contract research business are the major growth drivers. Biocon is likely to report 16% CAGR in net sales in the next two years on the back of strong growth in API business and contract research. Going ahead the growth is to be supported by newly acquired API facility at Hyderabad and expansion of monoclonal antibody facility at Biocon Biopharmaceuticals. The acquisition of API facility has helped the company to cut down the time required for setting up a green field facility for chemical synthesis. The facility would be operational from FY11 onwards



Source: Company, ACK Research

Biocon markets over 29 products in the domestic market. These are distributed across various therapeutic segments. The management expects the growth momentum to continue in FY11E. The company had launched insulin pens in the domestic market in 2HFY10 which had shown significant traction. In FY10 the major contribution from biopharmaceutical business was as follows,

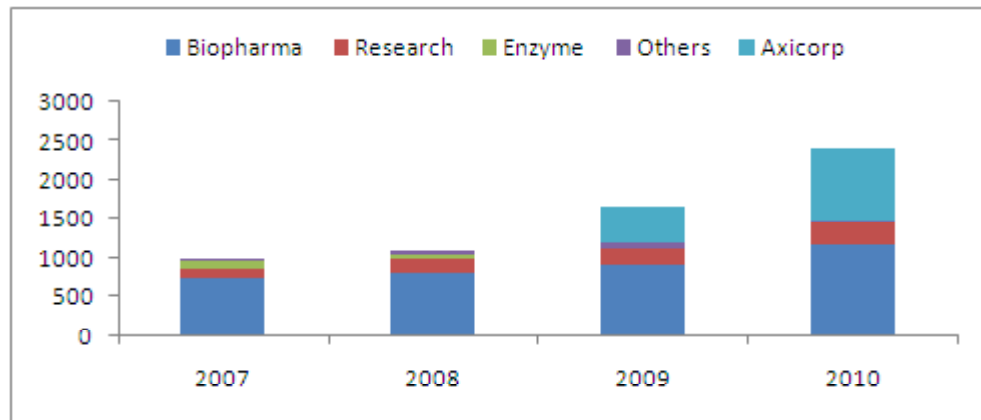
| Segments | Growth | Reason |
|------------------------------|------------|--|
| Insulins | 11% | Vials & Cartridge registrations in ~40 countries |
| Immuno. | 28% | Tacrolimus API supplies (batch quantities) to customers (awaiting ANDA approval) |
| Statins | 26% | Pick up in Atorvastatin and Rosuvastatin sales. |
| Domestic formulations | 36% | |
| Diabetology | 24% | Strong sales recorded in Insugen |
| Oncology | 59% | Key contributors Abraxane brand, BIOMAb EGFR |
| Cardiology | 26% | Healthy growth in key brands - Clotide and Myokinase |
| Nephrology | 57% | ERYPRO has recorded 50% growth (EPO segment growing at 16%) |

Higher insulin sales is led by launches in emerging markets of Brazil, Chile in FY2010. Biocon has insulin registrations in 40 countries as of March 2010. Higher immunosuppressant sales is beneficial due to patent expiry of Mycophenolate Mofetil and Tacrolimus in regulated markets. The company started supplies of Mycophenolate Mofetil to US in 1QFY10. The generic market is estimated at US\$150 mn. Biocon has achieved 20-22% market share in this product in US and in the EU. Biocon has started tacrolimus API sales to partners awaiting ANDA approvals



BIOCON

Revenue Mix- FY10



Source: Company, ACK Research

Contract research revenues has grown 25% yoy in FY10 at Rs 281 cr. Syngene has grown revenues at 24% yoy in FY2010 and the management expects business to ramp up further with existing clients and new customers. Syngene is now operating at capacity utilization of 75-80% versus earlier utilization of 65%. We think the capacity utilization will increase further as BMS contract ramps up by end of FY2011E

Statins revenues grew 26% yoy despite pricing pressures due to enhanced capacity and higher productivity. The introduction of generic Lipitor in Spain led to revenue growth. Also Simvastatin remained the company' largest product by sale but Atorvastatin and Rosuvastatin are expected to add significantly in the coming fiscal

German subsidiary Axicorp revenues beat forecast at Rs2.5 bn versus Rs2.2 bn due to (1) ramp -in traditional business and (2) tender for Metformin. EBITDA margin has improved yoy in Axicorp to 6% of sales due to (1) cost cutting measures (2) sourcing material from India and (3) ramp-up in sales.

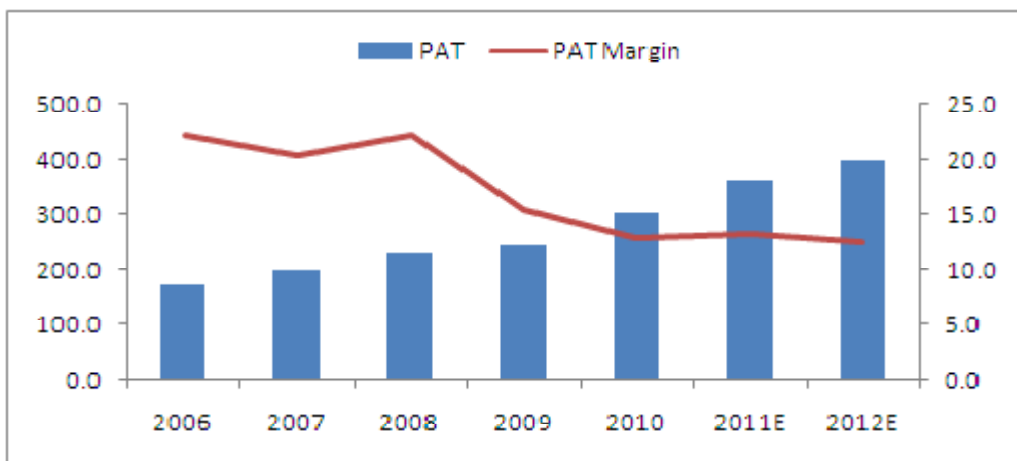
Biocon reported licensing income of US\$4 mn. Licensing income was largely on account of milestone-based income from Mylan towards product development. The management also expects similar milestone income on a quarterly basis for the next four quarters

Q4 Result Highlights

| Particulars (Rs cr) | Q4FY10 | Q4FY09 | Y-o-Y (%) | FY10 | FY09 | Y-o-Y(%) |
|------------------------|--------|--------|-----------|------|------|----------|
| Income from Operations | 658 | 468 | 41 | 2375 | 1627 | 46 |
| Other Income | 7 | 18 | | 30 | 47 | |
| Total Income | 666 | 487 | 37 | 2405 | 1673 | 44 |
| Total Expenditure | 526 | 377 | 40 | 1896 | 1285 | 48 |
| PBIDT | 139 | 110 | 26 | 509 | 388 | 31 |
| PBIDT Margin (%) | 21 | 23 | | 21 | 23 | |
| Interest | 3 | 6 | -46 | 17 | 18 | -4 |
| Depreciation | 37 | 31 | 20 | 140 | 110 | 27 |
| PBT | 99 | 73 | 35 | 351 | 260 | 35 |
| Tax | 14 | -2 | | 49 | 12 | 311 |
| Reported PAT | 85 | 75 | 13 | 303 | 248 | 22 |
| EOI | 0 | 41 | | 0 | 147 | |
| RPAT(after EOI) | 85 | 33 | 154 | 303 | 101 | 200 |
| Minority Interest | -4 | -9 | | -10 | -8 | 22 |
| APAT | 81 | 66 | 22 | 293 | 240 | 22 |

PAT Margins to Remain Robust:

For Q4FY10, Biocon's consolidated net profit was at Rs 81 crore, up ~223% YoY on a lower base in Q4FY09 due to extraordinary expense of Rs 41 crore. In FY10, the net profit increased ~200% YoY to Rs 303 crore due to an extraordinary expense of Rs 141 crore on account of forex losses in FY09



Source: Company, ACK Research

Investment Thesis:

Strong Presence in Diabetes Segment:

The company markets the world's first recombinant human insulin under the brand name Insugen. Biocon has signed an agreement with Bristol Myers Squibb (BMS) to supply recombinant human insulin in bulk form for marketing in advanced countries. The company has applied for insulin registrations in US and Europe and plans to launch generic insulin in FY13 in Europe. Currently, Biocon markets its insulin in Asia, Middle East and Latin America. The company has focused its efforts to improve diabetes care in India through an awareness creation campaign and expects to introduce pen- based insulin in second half of 2010. The global market for insulin is likely to grow around 3% CAGR over next 6 years. As per ORG IMS data of November'09, the domestic insulin market of Rs3.76bn is dominated by Novo Nordisk, Eli Lilly and Sanofi Aventis with sales of Rs2.70bn, Rs0.56bn and Rs0.50bn respectively. The company' diabetology segment grew 24% YoY on the back of strong sales in brand Insugen. Biocon continues its Insulin filings in emerging markets. We expect few approvals to come through annually for the next two years thus boosting Insulin revenues. Currently the company has approvals for insulin in 30 countries and expects to receive approvals for another 50 countries over the next 2 years. As per ORG IMS estimates, the company' diabetology segment ranks 18th in the overall diabetic market.

Oral Insulin- BlockBuster:

Biocon is currently conducting Phase-III trials in India for IN-105 (its oral insulin candidate) and expects to release additional data on the trials by 2Q/3QFY11. Management has indicated its plan to evaluate out-licensing of this molecule to potential partner post the completion of these trials. If Biocon successfully out-licenses this NCE, it is likely to lead to a significant market cap re-rating. Oral Insulin, IN-105, could potentially grab a big chunk from injectables as the Indian insulin market (almost entirely injectables) is estimated at Rs 4.0bn and growing at 17% a year. Biocon is working further on this molecule so that it will eventually replace injectable insulin in future. Oral insulin, IN-105 is a global blockbuster market opportunity for Biocon. The company has plans to launch this product in India in 2011

Lead Player in Statins :

Biocon is the leading player in statins and exports over 80% of its production, commands over 20% global market share and derives over one third of its revenues from this business. Biocon caters to regulated markets like US and Europe. The global market size of statins is estimated at \$28.8bn (Rs1,325bn) in 2009 and growing at 6% per annum. The statin market is expected to decline from 2010 onwards due to the expiry of patent for Atorvastatin. Biocon has strong presence in US and European markets comprising 88% of the total statin market. As the company produces statins from the basic stage it derives cost advantages compared to its competitors. Simvastatin is seeing a stable market with volumes increasing and the US market share rising. Pravastatin is also stable. The company has also entered the European market with a partner before the patent expiry in Spain resulting in a huge upside in Atorvastatin. While all statins significantly reduce cholesterol, atorvastatin and simvastatin seem to reduce cholesterol levels to a greater extent than other "nonsuperstatins." Biocon is present with a different sort of Atorvastatin in Europe which is the only product available in the market. The company' statin segment grew 26% yoy despite pricing pressures owing to enhanced capacity enabled by improved productivity

T1h in its phase II trial segment:

Biocon's another research molecule T1h or Anti-CD6 monoclonal antibody is currently undergoing Phase II clinical trials in India. The results of this will be available in June'10. T1h is effective in the treatment of Psoriasis and Rheumatoid Arthritis (RA). It is likely to enter into Phase III clinical trials for rheumatoid arthritis (RA) by the end of CY10. The company has plans to out license this molecule to an MNC pharma or Biotech Company. We expect T1h to become a pioneer in these therapies, as there are few drugs in these therapeutic segments

Immunosuppressants- Potential Growth Driver:

Higher immunosuppressant sales is beneficial due to patent expiry of Mycophenolate Mofetil and Tacrolimus in regulated markets. The company started supplies of Mycophenolate Mofetil to US in 1QFY10. The generic market is estimated at US\$150 mn. Biocon has achieved 20-22% market share in this product in US and in the EU. Biocon has started Tacrolimus API sales to partners awaiting ANDA approvals.

Tacrolimus is the patented product of Astellas-Japan and is currently marketed under the brand name Prograf in 0.5,1 and 5mg strengths. Prograf had sales of \$2.24bn and growth rate of -1% in 2008. Sandoz and Mylan have already launched generic Tacrolimus in the US market. Besides Biocon, Dr. Reddy's Labs, Concord Biotech, Antibiotic SPA, Zhejiang Hisun Pharma are likely to market generic Tacrolimus. Biocon is likely to benefit from the supply of Tacrolimus API to generic manufactures, as it is cost competitive.

Mycophenolic Acid is the patented product of Novartis-Switzerland and is currently marketed under the brand name Myfortic. The patent for the same is expiring in April'17. Myfortic had sales of \$353m and growth rate of 22% in 2008. Besides Biocon, Antibiotic SPA, Zhejiang Hisun Pharma, API Corporation and Sandoz are likely to market generic Mycophenolic Acid. For Biocon, the sales for generic Mycophenolic Acid from regulated market would accrue from FY18 onwards. The company is likely to benefit due to its low cost manufacturing base.

Gain through joint ventures with foreign companies:

Collaboration with Mylan, US:

Biocon's collaboration with Mylan is a long-term positive for Biocon as it gets a partner to share the development costs of biogenerics (which can be higher than a normal generic due to requirement of limited clinical trials) and, at the same time, it can leverage Mylan's distribution strengths in the US and Europe. We do not expect any major upsides from this tie-up in the near term as the launch of Biocon's biogenerics in regulated markets of the US and Europe is at least two years

away. In the interim, Biocon will be entitled to milestone payments from Mylan thus boosting the licensing income over FY10-11. For FY10, Biocon has recorded Rs507m of licensing income. This is likely to sustain in FY11E as well having a favourable impact on EBITDA Margins. Biocon has indicated that the JV continues to make good progress and products are expected to enter clinical trials in FY11. The full benefit from the deal will come after FY14(\$25bn opportunity by 2016), when the full benefits of biosimilars are likely to accrue.



Exclusive agreement with Amylin Pharma:

Biocon has entered into exclusive agreement with Amylin Pharma in Sept'09. The company will use Amylin's 'Phybrid' technology to develop therapeutic potential antidiabetic drug candidates. We expect a good potential upside from this deal in future.

Co-development with IATRI Ca, US:

Biocon has entered a co-development agreement with IATRI Ca in 2008 for the co-development of anti-cancer molecules based on technology licensed from Johns Hopkins University, US. The first molecule will be conjugated Trastuzumab for the treatment of breast cancer. The company has plans to file its IND by Q2FY11.

Axicorp contribution gaining strength:

Biocon acquired 78% stake in pharma Distribution Company Axicorp, Germany in Feb'08 for 30m euros. Axicorp is specialised in marketing and distribution of generic products in EU with a focus on Germany. It has posted a 93% YoY growth and although this is not strictly comparable to the previous year as the previous year factors in only three quarters of Axicorp revenue. On an adjusted basis, Axicorp has posted a strong 55% growth. Axicorp works on price differentials between various EU countries. The performance of Axicorp has improved due to the receipt of AOK tender for Metformin for five German territories over the next two years



PROFIT AND LOSS STATEMENT

BALANCE SHEET

| P&L Statement (Rs cr) | 2009 | 2010 | 2011E | 2012E |
|-----------------------|-------|-------|-------|-------|
| Total Sales | 1609 | 2368 | 2734 | 3185 |
| Bio Pharmaceuticals | 1384 | 2087 | 2433 | 2835 |
| Enzymes | - | 0 | 0 | 0 |
| Research | 225 | 281 | 301 | 350 |
| Expenditure | 1285 | 1896 | 2160 | 2516 |
| Other Income | 64 | 37 | 38 | 36 |
| EBITDA | 388 | 509 | 612 | 705 |
| Depreciation | 110 | 140 | 172 | 215 |
| EBIT | 278 | 369 | 440 | 489 |
| Interest | 18 | 16.9 | 20.8 | 21.5 |
| PBT | 260 | 352 | 419 | 468 |
| Tax | 12 | 48.7 | 56 | 69 |
| PAT | 248 | 303 | 363 | 399 |
| Adj Profit | 93.0 | 293.8 | 363.1 | 398.9 |
| Equity Capital | 100.0 | 100.0 | 100.0 | 100.0 |
| FV | 5.0 | 5.0 | 5.0 | 5.0 |
| No of shares | 20 | 20 | 20 | 20 |
| Basic EPS (Rs) | 5.5 | 14.7 | 18.2 | 19.9 |
| DPS(Rs) | 3 | 3.5 | 4 | 4.5 |
| Payout Ratio(%) | 24 | 22 | 22 | 23 |
| Equity Dividend Paid | 60 | 70 | 80 | 90 |
| Dividend Tax | 10.2 | 12.3 | 14 | 15.8 |
| Total | 70.2 | 82.3 | 94 | 105.8 |

| Balance Sheet (Rs Cr) | 2009 | 2010 | 2011E | 2012E |
|---------------------------------|--------|--------|--------|--------|
| Share Capital | 100 | 100 | 100 | 100 |
| Reserves & Surplus | 1411 | 1657 | 1902 | 2170 |
| Networth | 1511 | 1757 | 2002 | 2270 |
| Minority Interest | 25 | 34 | 40 | 47 |
| Deferred Tax Liability | 47 | 51 | 54 | 57 |
| Secured Loans | 396 | 331 | 267 | 200 |
| Unsecured Loans | 128 | 182 | 144 | 108 |
| Total Debt | 524 | 513 | 410 | 308 |
| Total Capital Employed | 2107 | 2355 | 2506 | 2682 |
| Fixed Assets | | | | |
| Gross Block | 1409 | 1578 | 1767 | 1980 |
| Avg Gross Block | 1281.5 | 1494 | 1673 | 1873 |
| Acc Dep | 361 | 509 | 681 | 897 |
| Net Block | 1048 | 1069.1 | 1086.2 | 1082.8 |
| Capital W IP | 172 | 191 | 210 | 231 |
| Net Fixed Assets | 1220 | 1244 | 1296 | 1314 |
| Intangible Assets | 163 | 170 | 154 | 123.7 |
| Investments | 368 | 430 | 427 | 470 |
| Current Assets, L&A | | | | |
| Inventories | 319 | 372 | 451 | 526 |
| Receivables | 367 | 446 | 515 | 621 |
| Cash & Bank balances | 12 | 140 | 193 | 255 |
| Loans & Advances | 94 | 134 | 154 | 180 |
| CA | 792 | 1092 | 1159 | 1402 |
| Current Liabilities | 437 | 580 | 684 | 807 |
| Net Current Assets | 355 | 512 | 475 | 594 |
| Capital Deployed | 2106 | 2356 | 2506 | 2682 |

Key Ratios

| Key Ratios | 2009 | 2010 | 2011E | 2012E |
|-------------------|------|-------|-------|-------|
| EBITDA Margin (%) | 24 | 21 | 22.4 | 22.1 |
| EBIT Margin (%) | 22 | 19 | 20 | 19 |
| PAT Margin (%) | 16.2 | 14.9 | 15.3 | 15 |
| ROE | 16 | 17 | 18 | 18.5 |
| ROCE | 12 | 13 | 14 | 15 |
| EPS (Rs) | 5.1 | 14.7 | 18.2 | 19.9 |
| DPS (Rs) | 3 | 3.5 | 4 | 4.5 |
| Payout Ratio(%) | 24 | 22 | 22 | 23 |
| P/E(x) | 28 | 19.35 | 15.9 | 14.6 |
| Dividend/Yield | 2.1 | 1.2 | 1.4 | 1.6 |

Source: Company, ACK Research



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BIOCON



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