



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✓	✗

+ Positive = Neutral - Negative

Reco/View

Reco: Buy	↔
CMP: Rs. 417	
Price Target: Rs. 495	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

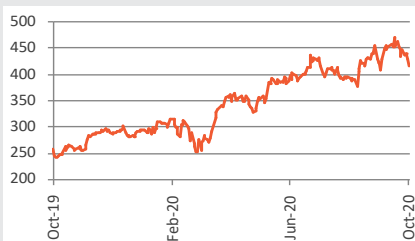
Company details

Market cap:	Rs. 50,064 cr
52-week high/low:	Rs. 478 / 236
NSE volume: (No of shares)	66.5 lakh
BSE code:	532523
NSE code:	BIOCON
Free float: (No of shares)	47.2 cr

Shareholding (%)

Promoters	60.7
FII	17.8
DII	6.3
Others	15.28

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.5	-3.0	20.0	61.5
Relative to Sensex	-9.5	-9.7	-7.7	57.3

Pharmaceuticals

Sharekhan code: BIOCON

Result Update

Summary

- Q2FY2021 was a soft quarter for Biocon. Revenues from operations grew by 11% y-o-y to Rs 1,745 crore. Adjusted PAT rose by 10.3% y-o-y to Rs. 173.8 crore.
- Improving traction in existing biosimilars, likely pick up in Semglee, geographical expansion are the key growth drivers for Biologics segment.
- Biocon has retained its guidance for \$1 billion in revenues from the biologics segment by FY2022. The generics business too is expected to grow at a healthy pace driven largely by formulations.
- Possible listing of Biocon Biologics provides value unlocking opportunity. We retain Buy recommendation on the stock with a revised PT of Rs. 495.

Q2FY2021 was a soft quarter for Biocon. Revenues from operations grew by 11% y-o-y to Rs 1,745 crore and were largely in line with estimates. Sales of generics grew by 8% y-o-y, while the Biologics segment growth moderated to 11.4% y-o-y. Logistics issues resulted in a moderate growth for the segment. Operating profits fell by 3.2% y-o-y to Rs. 390 crore. Operating margins contracted by 335 bps y-o-y to 22.4%, missing estimates. Higher R&D and staff costs impacted the margins. Adjusted PAT rose by 10.3% y-o-y to Rs. 173.8 crore, aided by a lower tax rate, though PAT missed estimates. Going ahead, Biocon expects the biologics segment to be a key growth driver. Operational hurdles (logistics issues) are likely to be resolved in the near term with operations expected to re-gain normalcy. Demand is expected to improve for existing biosimilars - Fulphila, Ogivri in the US as patient inflows are likely to improve. The same was adversely affected by the pandemic during the lockdown period. Further, recently launched biosimilars - Insulin Glargine (Semglee) too is expected to gain traction going ahead. In addition to this, expanding geographical reach would support topline growth. Generic segment is also well placed to capitalise on the opportunities in the formulations segment, while the APIs are likely to stage a steady growth. Biocon is looking to launch Remdesivir in the Indian markets for COVID-19 patients. It could also explore opportunities for the same, if any for the exports markets, though clarity on the same is yet to emerge. Consequently, Biocon's sales and earnings are expected to grow by a CAGR of 24.6% and 43.7% respectively over FY2020-FY2023.

Key positives

- Overall revenues grew in double digits.
- Launched Insulin Glargine (Semglee) in Spain (3rd largest market in EU5 value).
- Expanded geographically by setting up offices in Brazil, Malaysia, UAE & Saudi Arabia.

Key negatives

- Operating margins at 22.4% missed estimates led by higher R&D cost.

Our Call

Valuation: Retain Buy recommendation with a PT of Rs 495: Q2FY2021 was a soft quarter for Biocon. The biologics segment growth moderated for the quarter. Going ahead, the biologics segment offers substantial growth opportunities driven by new launches (such as Semglee), strong product pipeline and new initiatives (Insulia). Also expansion in to other geographies would support the growth. Biocon has retained its guidance for \$1 billion in revenues from the biologics segment by FY2022. The generics business too is expected to grow at a healthy pace. Based on Q2FY21 results, we have largely retained our FY2022 earnings estimates and have introduced FY2023 estimates. At the CMP, the stock is trading at P/E multiples of 32.1x / 24.8x its FY2022/FY2023 earnings, which is lower than the last 5 years' average PE multiple. Strong earnings visibility, healthy balance sheet position and lower debt-equity augur well for the company. Further, a possible listing of its wholly-owned subsidiary - Biocon Biologics Limited provides a significant value-unlocking opportunity and this bodes well for the company. We retain Buy recommendation on the stock with a revised PT of Rs. 495.

Key Risks

A delay in product approvals or the negative outcome of facility inspection by the USFDA can affect future earnings prospects.

Valuation

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	5514.4	6367.2	8165.5	10163.5	12316.7
Operating Profit	1393.7	1603.1	2177.8	2888.1	3621.4
OPM (%)	25.3%	25.2%	26.7%	28.4%	29.4%
Adj. PAT	729.1	680.7	1161.7	1560.8	2021.2
EPS (Rs)	6.1	5.7	9.7	13.0	16.8
PER (x)	68.6	73.5	43.1	32.1	24.8
EV/Ebitda (x)	36.5	32.4	23.4	17.5	13.7
P/BV (x)	8.2	7.5	6.7	5.6	4.6
ROCE (%)	9.9	9.3	12.3	15.8	17.9
RONW (%)	11.4	10.2	14.9	16.8	17.9

Source: Company; Sharekhan estimates

Note: We now convert Biocon into a Stock update; it was earlier a 'Viewpoint' under our coverage.

Q2FY21, a soft quarter: Biocon reported a soft performance for Q2FY2021 as the biologics segment faced operating challenges. Revenues from operations grew by 11% y-o-y, to Rs. 1,745 crore, largely matching estimates. The generics segment, which comprises API and formulations businesses, grew by a modest 8% y-o-y. The Biologics segment's growth, however, moderated to 11.4% y-o-y, while it declined by 2.3% q-o-q. Operating challenges leading to logistics issues primarily impacted the segment's performance. Operating profits declined by 3.2% y-o-y to Rs. 390 crore. Operating margins contracted by 335 bps y-o-y to 22.4% and missed our estimates. Higher R&D cost due to a focus on building the biosimilars pipeline coupled with a high staff cost and forex loss (as compared to a forex gain in corresponding quarter of the previous year) impacted margins. Depreciation for the quarter was up 35% y-o-y to Rs 178 crore, while the tax rate for the quarter stood at 10%, as against 33.8% in Q2FY2020. Consequently the PAT at Rs 173.8cr was up 10.3% y-o-y and missed our estimates of Rs. 211 crore.

Operational glitches impact the biologics growth in Q2FY21; Sturdy revival in sight: The biologics segment's revenues stood at Rs 676 crore in Q2FY21. Revenue growth moderated to 11% y-o-y while sequentially it declined 2%. Biocon confronted logistics challenges towards shipment of goods, which impacted performance. The management expects resolution of issues in the near term and sees re-gaining normalcy in operations. Going ahead, the biologics segment has a robust outlook. The existing products – Ogivri and Fulphila have just managed to hold grounds amid the pandemic. Gradually, with patient inflows improving with doctors commencing OPD check-ups, demand for both the biosimilars is expected to gather pace. This, along with a pick-up in the recently launched Semglee (Insulin Glargine) would be the key growth drivers for the Biosimilars segment. Biocon's efforts to expand the geographical presence with the existing biosimilars would also complement revenue growth of the segment. Management has retained its guidance of a \$1 billion in revenues from the Biologics segment by FY2022.

Formulations to fuel the generic segment growth: The generic segment which comprises the small molecules (API and formulations) has clocked 8% y-o-y revenue growth for the quarter. A chunk of the growth was fuelled by the formulations segment. Going ahead, the generic formulations business is expected to drive growth of the generics segment, backed by new launches in the US markets. In the API segment, immunosuppressants are witnessing a healthy demand and are expected to sustain the traction. Biocon has submitted DMF's (Drug Master Files) for 3 API's with USFDA and 7 APIs in other markets, which would contribute to the growth of the segment going ahead. Further Biocon is putting up a greenfield facility at Vizag for immunosuppressant APIs. Construction work for the plant has been delayed due to COVID-related issues at the Vendors end. The facility is expected to be ready by CY2022, however the benefits from the same would be accrued over the long term.

Q2FY2021 Conference Call Highlights

Biologics business: Post the resolution of logistics issues in the near term, management expects segment sales to stage a strong revival. Ogivri (biosimilars of Trastuzumab) co-developed by Mylan, has achieved a 6% market share in the overall Trastuzumab market in the US, while Biosimilar Fulphila, which was also co developed by partner Mylan also holds 15% of the prefilled syringe market in US as of Q2FY21. The developed markets constitute around 50% of the revenues of biologics segment, while the balance is from EM (emerging markets). Going ahead with more number of launches planned, Biocon sees the share of revenues from the developed markets rising.

Biosimilars demand scenario: With the launch of insulin Glargine (Semglee) in the US markets, Biocon now has three biosimilars in the US markets. Existing products - Trastuzumab and Pegfilgrastim are expected to witness improved traction in the US markets as patient inflows are expected to improve. The recently launched – Semglee is also expected to gain traction, though gradually. Therefore, Biocon sees the revenues from the segment to pick up meaningfully over the next 1-3 quarters.

Product portfolio /new launches: Biocon is focusing on expanding product portfolio in biosimilars in the US as well as in the other Most of the World (MoW) markets. Biocon has launched insulin Glargine (Semglee) in the US markets at a 65% discount to the innovator prices and is targeting a double digit market share for the product in the US markets. Semglee is one of the lowest priced and long acting insulin Glargine in the US markets. Biocon has also expanded Semglee to the other European markets – Spain which is the third-largest market in the EU5 by value.

During Q2FY2021 Biocon had five product launches and three new market entries wherein the company launched its biosimilars - Trastuzumab, rh- Insulin and Insulin Glargine. Also the company has set up commercial offices in other countries -Brazil, Malaysia, UAE and Saudi Arabia, which would enable it to foray in the Most of the World markets, thus providing a new growth avenue.

Generics: Revenues of this segment grew by 8% y-o-y to Rs. 599 crore driven by a strong performance in the US generic formulations business. Biocon has a mid-to-high teens market share in the segments in the US market. API business growth was driven by immunosuppressants and specialty APIs. Going ahead, the company expects the generic formulations to drive the growth in the US markets backed by new product launches. It is also looking to commercialize Remdesivir in the Indian markets for treatment of COVID-19.

Regulatory updates: Biocon has submitted its Biologics License Application (BLA) to the USFDA under the 351 K pathway and the same is under review. Also, the company has submitted BLA for insulin Glargine for interchangeability status and is currently under review. The outcome of the interchangeability status for insulin Glargine is critical as if the BLA is approved, it could open up a huge growth opportunity for Biocon Biologics.

Novel Biologics (Itolizumab): Itolizumab, is the company's first-in-class anti-CD6 monoclonal antibody, to treat Covid-19, globally. Biocon's US partner has also hinted a positive responses from a pre-IND (Investigational New Drug) meeting with USFDA and is progressing ahead on the regulatory pathway, initiating a global Phase III, randomised, double-blind, placebo-controlled clinical trial in Q4CY20.

Results

Particulars	Q2FY2021	Q2FY2020	Y-o-Y %	Q1FY2021	Q-o-Q %
Total Income	1744.8	1567.6	11.3	1672.0	4.4
Operating profit	390.8	403.6	-3.2	413.0	-5.4
Other income	16.0	38.0	-57.9	18.0	-11.1
EBIDTA	406.8	441.6	-7.9	431.0	-5.6
Interest	7.0	14.0	-50.0	13.0	-46.2
Depreciation	178.0	132.0	34.8	167.0	6.6
PBT	221.8	295.6	-25.0	251.0	-11.6
Adj. PAT after MI	173.8	157.6	10.3	152.0	14.3
Margins			BPS		BPS
OPM (%)	22.4	25.7	-335	24.7	-230

Source: Company, Sharekhan Research

Outlook and Valuation

Sector view

Indian pharmaceutical companies are better placed to harness opportunities and clock healthy growth going ahead. Indian companies are among the most competitive globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in US generics market), rise in product approvals and plant resolutions by the USFDA and strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for Indian pharmaceutical companies

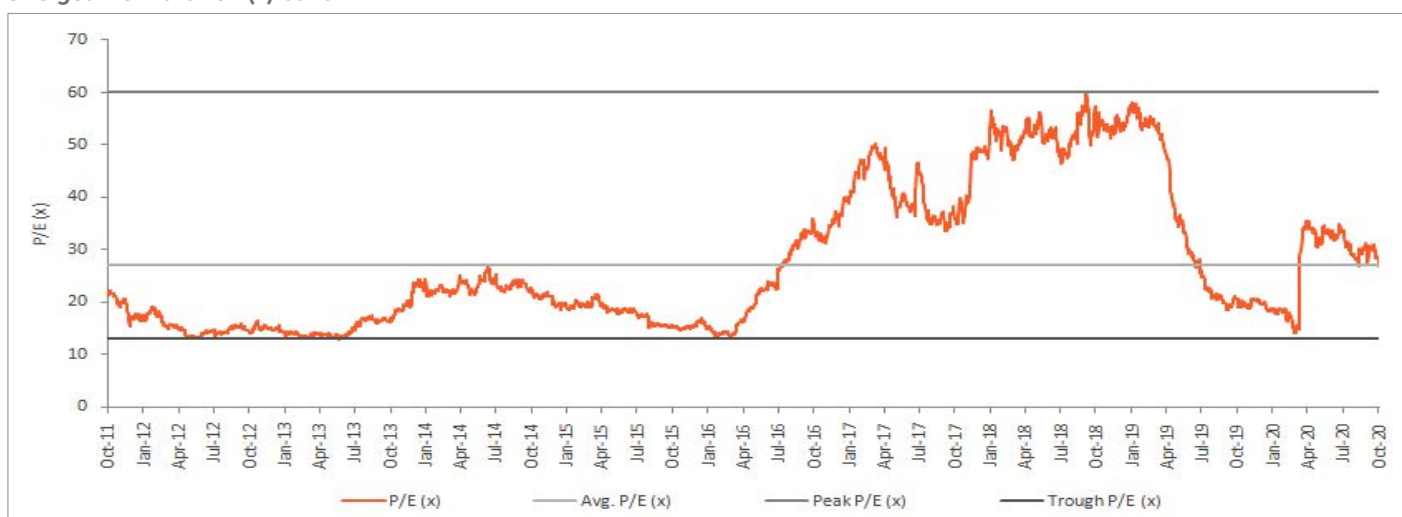
Company outlook - Biologics continues to be a key growth driver

Biocon is a leading company manufacturing biosimilars in India and one of the few global companies to receive approvals for its products across the regulated markets of - US, EU, Japan and other developed markets. The company is expected to benefit substantially from the opportunities in the lucrative biosimilars space. A robust opportunity lies ahead in the biosimilars segment for Biocon, as some key global brands would lose patent exclusivity in the medium to long term. Price erosion in biosimilars is much lesser than that in the other segments as of now and this works to the advantage of the company. Scientific expertise in developing and manufacturing complex biosimilars together with commercialization strength of partner companies would further strengthen Biocon's presence in globally in the biosimilars. Also, with the possible listing of Biocon Biologics, there exists a significant value un-locking opportunity going ahead.

Valuation - Retain Buy recommendation with a PT of Rs 495

Q2FY2021 was a soft quarter for Biocon. The biologics segment growth moderated for the quarter. Going ahead, the biologics segment offers substantial growth opportunities driven by new launches (such as Semglee), strong product pipeline and new initiatives (Insulia). Also expansion in to other geographies would support the growth. Biocon has retained its guidance for \$1 billion in revenues from the biologics segment by FY2022. The generics business too is expected to grow at a healthy pace. Based on Q2FY21 results, we have largely retained our FY2022 earnings estimates and have introduced FY2023 estimates. At the CMP, the stock is trading at P/E multiples of 32.1x /24.8x its FY2022/FY2023 earnings, which is lower than the last 5 years' average PE multiple. Strong earnings visibility, healthy balance sheet position and lower debt-equity augur well for the company. Further, a possible listing of its wholly-owned subsidiary - Biocon Biologics Limited provides a significant value-unlocking opportunity and this bodes well for the company. We retain Buy recommendation on the stock with a revised PT of Rs. 495.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Aurobindo Pharma	783.0	58.6	45,882.0	15.7	13.9	12.8	10.0	8.5	7.2	19.0	17.9	16.6
Sun Pharma	484.0	239.9	116,209.0	28.8	22.4	18.6	17.0	14.0	11.9	8.9	11.2	12.0
Biocon	417.0	120.0	50,064.0	73.5	43.1	32.1	32.4	23.4	17.5	10.2	14.9	16.8

Source: Company, Sharekhan Research

About company

Established in 1978, Bengaluru-based Biocon is India's premier biotechnology company. Biocon is now a fully-integrated biopharma player with API manufacturing facilities, strong capabilities in biologics, innovative drug development and a branded generics business in India. With over 25 years of expertise in fermentation technology, the company has built a strong presence in lucrative high-growth segments such as statins, immuno-suppressants and anti-diabetes drugs. Biocon is among the few companies globally to have received approvals for its biosimilars from developed countries such as the US, EU, Australia and Japan.

Investment theme

Biocon has one of the largest global biosimilars portfolios, spanning from recombinant human Insulin (rh-Insulin), insulin analogs, monoclonal antibodies and other biologics for diabetes, oncology and immunology. Thus, Biocon has the early-mover advantage as global markets have begun to accept biosimilars and the role they are expected to play in increasing access to high-quality and yet affordable drugs and improve quality of life for patients around the world.

Key Risks

Any delay in product approvals, change in regulatory landscape or negative outcome of the facility inspection by the USFDA can affect future earnings prospects.

Additional Data

Key management personnel

Ms. Kiran Mazumdar Shaw	Executive Chairperson Biocon Limited
Mr. Siddharth Mittal	CEO & Managing Director – Biocon Limited
Dr. Christiane Hamacher	CEO & Managing Director Biocon Biologics
Mr. Prasad BSV	Chief Operating Officer Generic & API
Mr. Anupam Jindal	Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Glentec International	19.77
2	Life Insurance Corp of India	1.67
3	ICICI Prudential Asset Management	1.43
4	Jupiter Investment Management Group	1.32
5	NATIONAL WESTMINSTER	1.1
6	Aditya Birla Sun Life Asset Management	1.07
7	Standard Life Aberdeen PLC	1.06
8	Mirae Asset Large Cap fund	1.02
9	Societe Generale SA	1.01
10	Norges Bank	0.86

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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