



3R MATRIX

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

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✗	↔	✓
RQ	✗	↔	✓
RV	✗	↔	✗

Reco/View

Change

Reco: Buy	↔
CMP: Rs. 394	
Price Target: Rs. 470	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

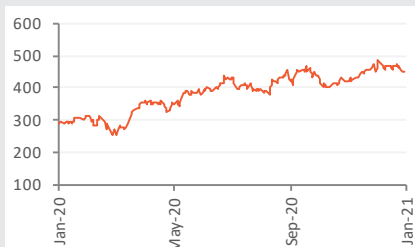
Company details

Market cap:	Rs. 47,256 cr
52-week high/low:	Rs. 488 / 236
NSE volume: (No of shares)	51.5 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	-14.7	-8.3	-8.6	34.5
Relative to Sensex	-21.0	-28.8	-37.7	15.6

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on Biocon Limited with a revised PT of Rs. 470.
- Q3FY2021 was a weak quarter as COVID-19 disruptions led to procurement and supply chain delays, and also affected Biocon's planned market expansion initiatives. Biocon sees this as a short-lived phenomenon and expects businesses to regain normalcy by FY2022.
- Biologics segment is expected to be a critical growth driver and the company is well placed to harness the growth opportunities.
- Better growth prospects, healthy balance sheet and lower debt-equity augur well for company. Possible listing of subsidiary – Biocon Biologics points towards significant value unlocking potential.

Q3FY2021 was a weak quarter for Biocon Limited (Biocon) with earnings missing ours as well as the street's estimates. COVID-19 related disruptions led to procurement and supply chain delays and also impacted the planned market expansion initiatives, stunting the quarter's performance. Revenues grew by 7.9% y-o-y, led by an 11% and 13% y-o-y growth, respectively in the biosimilars and the research services businesses, while the generic segment declined by 3% y-o-y. Operating margins contracted by 437 bps y-o-y to 21.5%, owing to higher R&D spends and staff costs. Lower EBITDA and higher depreciation expenses impacted the earnings and therefore PAT at Rs 169 crore, declined by 18% y-o-y. Near-term headwinds on account of the pandemic could continue to slow down growth as a delay in regulatory approvals, extension of tenders (especially in the emerging markets) and operational challenges would be a drag on the company's performance. However, Biocon sees this as a short-lived phenomenon and expects businesses to regain normalcy by FY2022. Going ahead, biologics segment would be a key growth driver backed by improving demand for existing biosimilars - Fulphila, Ogivri in the US and new launches. A pick-up in the recently launched biosimilar - Insulin Glargine (Semglee) is slower than anticipated, but with expected formularies process likely to be addressed by the next fiscal, provides growth visibility. Further, Biocon's efforts to expand geographical reach would support topline growth. The generic segment's performance is also expected to improve q-o-q as inventories normalise. This coupled with new launches would fuel the segment's growth. Biocon expects headwinds to abate by FY22 and sees business attaining normalcy. Consequently, sales and PAT are expected to grow by a 23.5% and 42% CAGR over FY2020-FY2023.

Key positives

- Biologics and Research services delivered double-digit revenue growth of 11% and 13%, respectively in challenging times.
- Insulin Aspart received approvals in Malaysia, Europe; Biocon launched in-house API based product Tacrolimus in US.

Key negatives

- Revenues from generics segment declined by 3% y-o-y due to inventory stocking and slower-than-expected regulatory approvals.
- Tender process especially in emerging markets has been delayed due to COVID-19 led disruptions.
- Operating margins shrunk by 437 bps y-o-y due to higher R&D cost & staff costs.
- Due to near-term headwinds, the sales target for Biosimilars of \$1bn by FY2022 could be stretched.

Our Call

Valuation: Retain Buy with a revised PT of Rs 470: Biocon is facing headwinds on account of COVID-19 which has affected operational, regulatory and commercial functions, leading to a delay in market expansion as well as in tenders in emerging markets. With COVID-19 vaccination drives commencing world over, Biocon expects the pandemic led impact to be short-lived and sees normalcy return by next fiscal. Steady market share in the biosimilars space in the US, tapping new markets such as Europe for existing biosimilars and gradual traction expected in existing biosimilars could fuel the growth of the biologics segment. With inventories normalising and new launches lined up, the generics segment is also set to stage a sequential pick up. Weak performance in Q3FY2021 is expected to slow down the topline and earnings growth in the near term and hence, we have reduced our estimates for FY2022/FY2023 by 10% and 8% respectively. At the CMP, the stock is trading at P/E multiples of 33.4x /24.3x its FY2022E/FY2023E earnings respectively. Better growth prospects, 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 a Buy on the stock with a revised PT of Rs. 470.

Key risk

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

Valuation

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net sales	5514.4	6367.2	8033.9	9787.3	12003.9
Operating Profit	1393.7	1603.1	1966.6	2609.1	3366.9
OPM (%)	25.3%	25.2%	24.5%	26.7%	28.0%
Adj. PAT	729.1	680.7	1028.9	1413.8	1944.8
EPS (Rs)	6.1	5.7	8.6	11.8	16.2
PER (x)	64.8	69.5	46.0	33.4	24.3
EV/Ebitda (x)	34.5	30.7	24.6	18.4	14.0
P/BV (x)	7.8	7.1	6.4	5.4	4.5
Mcap/sales	8.6	7.4	5.9	4.8	3.9
ROCE (%)	9.9	9.3	10.7	14.0	16.6
RONW (%)	11.4	10.2	13.4	15.7	17.8

Source: Company; Sharekhan estimates

Weak quarter: Biocon reported weak numbers for Q3FY21 with PAT missing ours as well as street estimates. Operations were impacted on account of COVID-19 related disruptions, which led to procurement and supply chain delays, besides affecting the company's planned market expansion initiatives. Revenues grew by 7.9% y-o-y, led by an 11% and 13% y-o-y growth, respectively in the biosimilars and the research services businesses. The generics segment's revenues fell by 3% y-o-y attributable to advance purchases by customers in H1FY21. Moreover, delayed regulatory approvals for certain products that required inspection of facilities further weakened performance. Operating margins stood at 21.5%, contracting by 437 bps y-o-y and were below the estimate of 25.3%. Lower operating margins can be attributable to higher R&D spends which stood at Rs 171 crore (9.2% of Q3FY21 sales as compared to 7.6% in Q3FY2020). High staff cost and other expenses also impacted the operating margins. The operating profits for the quarter declined 10% y-o-y to Rs. 399 crore. Depreciation rose by 29% y-o-y to Rs. 186 crore. Lower EBITDA and higher depreciation expenses impacted the earnings and the PAT at Rs. 169 crore declined by 18% y-o-y and missed estimates.

COVID-19 related hindrances to decelerate near-term growth momentum: Biocon is confronting headwinds on account of the pandemic which has had an impact on the company's operational, regulatory and commercial functions. Consequently, overall performance for Q3FY21 has been impacted. Pandemic has slowed down the acceleration and the company continues to witness low patient footfalls. Moreover, tenders in few regions have been delayed. This coupled with the logistics challenges such as delay in the procurement of raw materials and other supply chain hindrances slowed down company's growth in the quarter. Management however sees this as a short-lived phenomenon and expects the growth to revive with apparent sequential improvement. The commencement of vaccination drive across geographies augur well as they would enable to combat the pandemic and also would aid re-booting of economies. Therefore, Biocon expects the normalcy across markets by FY2022.

Headwinds to slow growth momentum for biosimilars in near term; Long term outlook stays strong: Biosimilar sales stood at Rs. 769 crore, up by 11% y-o-y and grew 14% q-o-q. Growth could be attributable to maintenance of steady market share for biosimilar – Trastuzumab and Pegfilgrastim in the US markets despite of a challenging business environment. Also geographic expansion of recombinant human insulin (rHI) and insulin Glargine in markets such as Mexico, Malaysia and Algeria has contributed to the growth of the segment. However the biosimilars business is confronting headwinds due to Covid which has resulted in delays in the award of tenders, higher entry barriers preventing opening of new markets and low patient footfalls which have resulted in lower product offtake in critical care segments such as oncology. The company is working around to address these challenges and is confident of gaining normalcy by the next fiscal (FY2022). Also slower than expected ramp up of the insulin Glargine (Semglee) due to a slower progress on the formularies front is likely to slow down the expected ramp up and could result in delay, though Biocon expects the formularies issues to be resolved by the next fiscal. Overall the US and Europe would be the key growth drivers for biosimilars, while the emerging markets are witnessing an underperformance largely due to delayed tenders leading to extension of contracts. Therefore the management expects a postponement of revenue guidance of \$1bn by FY2022 for the biosimilars. Cumulatively, a comprehensive product portfolio in the biosimilars segment, a healthy new product pipeline and geographic expansion would be the key growth drivers, albeit in the long term.

Q3FY2021 Conference Call Highlights

- ♦ **Biocon Biologics' top management churn:** Dr. Christiane Hamacher has stepped down from the post of Managing Director of Biocon Biologics, effective January 20, 2021. The decision to step down was on account of professional differences with the Chairperson on strategic priorities and vision for the Company. Consequent to this, Dr Arun Chandavarkar, member of the board of Biocon Biologics Limited

would take over as the MD, for a period of up to two years starting with effect 21 January 2021. Ms Kiran Mazumdar Shaw will take up the position of Executive Chairperson of Biocon Biologics Limited effective from Jan 21, 2021 until March 31, 2022.

- ♦ **Regulatory Approvals for Biosimilars:** During the quarter biosimilar – Bevacizumab was approved by National Pharmaceutical Regulatory Agency (NPRA) – Malaysia, while the USFDA deferred action on the BLA (Biologics License Application) due to the inability to inspect the facility y due to COVID-19-related travel restrictions. Insulin Aspart too has received the approval from NPRA – Malaysia as well as from European Medical Agency – CHMP for the treatment of Type 1 & 2 diabetes. While BLA for insulin Aspart is under review by the USFDA. Also Biosimilars Trastuzumab and Glargine too have received approval from the two MoW (Most of the World) countries. Collectively, approvals point to a strong product pipeline which would support the growth of Biologics going ahead.
- ♦ **Biocon Biologics Fund Infusion:** During the quarter, Biocon Biologics received a fund infusion of Rs. 555 crore (\$75 million) for a 1.8% minority stake from Abu Dhabi-based ADQ, which values the Biocon Biologics at ~\$4.17 billion.
- ♦ **Generics – APIs and Formulations:** Revenues from this segment reported a decline of 3% y-o-y for Q3FY2021. The subdued performance can be attributable to weak demand due to advance buying by customers in H1FY2021. Also, the regulatory delays (due to inability to inspect the facilities on the back of COVID-led travel restrictions) also added to weak performance. During the quarter, the company launched Tacrolimus capsules (used in the treatment of organ transplant) in the US. On the API front, the company has expanded geographic reach and has also received approval for two DMF's (Drug Master Files) and has filed for 10 DMFs for APIs in the US, Europe and MoW (Most of World) markets.
- ♦ **Novel Biologics (Itolizumab):** Biocon's US based partner is conducting a clinical trial for Itolizumab and is making a steady progress in the Phase 1b clinical trials for Itolizumab in the first-line treatment of acute graft-versus-host disease. The topline data for phase 1b of the clinical trials is expected in H1CY2021.

Results

					Rs cr
Particulars	Q3FY2021	Q3FY2020	y-o-y %	Q2FY2021	q-o-q %
Total Income	1852.0	1717.0	7.9	1745.0	6.1
Operating profit	399.0	445.0	-10.3	391.0	2.0
Other income	28.0	36.0	-22.2	16.0	75.0
EBIDTA	427.0	481.0	-11.2	407.0	4.9
Interest	5.0	18.0	-72.2	7.0	-28.6
Depreciation	186.0	144.0	29.2	178.0	4.5
PBT	236.0	319.0	-26.0	222.0	6.3
Reported PAT	169.0	206.0	-18.0	174.0	-2.9
Margins			BPS		BPS
OPM (%)	21.5	25.9	-437	22.4	-86

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – improving growth prospects

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.

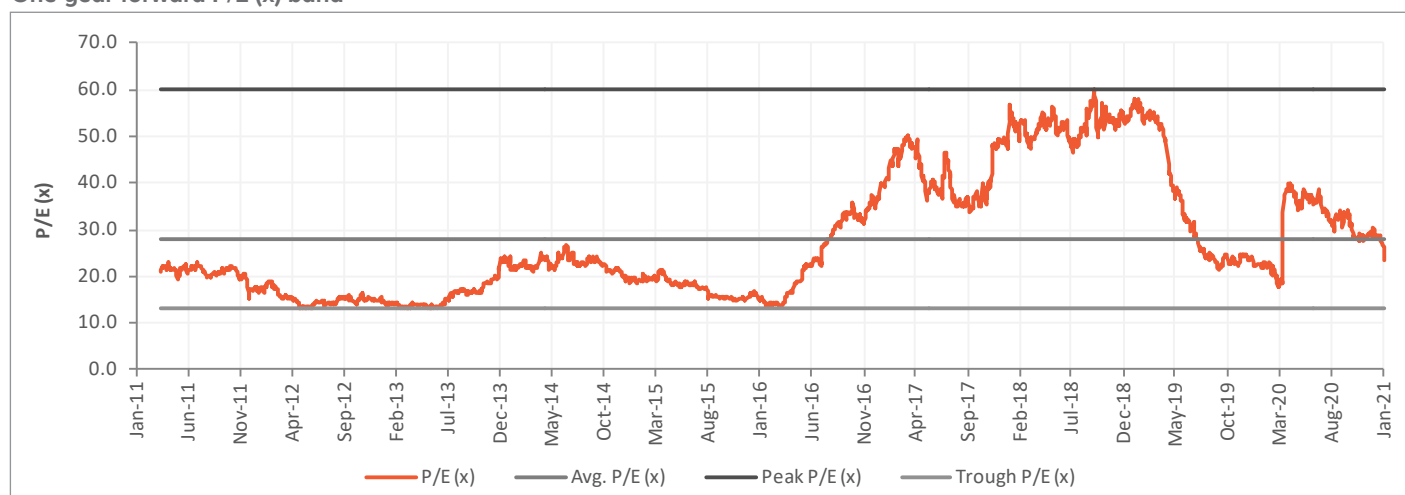
■ Company Outlook – Biologics continues to be a key growth driver

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 lower than that in the other segments as of now and this works to the company's advantage. Scientific expertise in developing and manufacturing complex biosimilars together with commercialisation strength of partner companies would further strengthen Biocon's presence in globally in the biosimilars. Moreover, with the possible listing of Biocon Biologics, there exists a significant value un-locking opportunity going ahead. Though given the headwinds, the growth momentum in the near term could slow down, but growth levers over the long term stay intact.

■ Valuation – Retain Buy with a revised PT of Rs 470

Biocon is facing headwinds on account of COVID-19 which has affected operational, regulatory and commercial functions, leading to a delay in market expansion as well as in tenders in emerging markets. With COVID-19 vaccination drives commencing world over, Biocon expects the pandemic led impact to be short-lived and sees normalcy return by next fiscal. Steady market share in the biosimilars space in the US, tapping new markets such as Europe for existing biosimilars and gradual traction expected in existing biosimilars could fuel the growth of the biologics segment. With inventories normalising and new launches lined up, the generics segment is also set to stage a sequential pick up. Weak performance in Q3FY2021 is expected to slow down the topline and earnings growth in the near term and hence, we have reduced our estimates for FY2022/FY2023 by 10% and 8% respectively. At the CMP, the stock is trading at P/E multiples of 33.4x /24.3x its FY2022E/FY2023E earnings respectively. Better growth prospects, 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 a Buy on the stock with a revised PT of Rs. 470.

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 (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
AurobindoPharma	924.0	58.6	54,120.0	18.6	17.2	15.0	11.7	10.4	8.5	19.0	17.2	16.8
Sun Pharma	575.0	239.9	1,37,970.0	34.3	25.3	21.3	20.1	15.8	13.7	8.9	11.7	12.4
Biocon	394.0	120.0	47,256.0	69.5	46.0	33.4	30.7	24.6	18.4	10.2	13.4	15.7

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. The company is expected to benefit substantially from the opportunities in the lucrative biosimilars space, as some key global brands would lose patent exclusivity in the medium to long term. Scientific expertise in developing and manufacturing complex biosimilars together with commercialisation strength of partner companies would further strengthen Biocon's presence in globally in the biosimilars. Moreover, with the possible listing of Biocon Biologics, there exists a significant value unlocking opportunity going ahead.

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
Mr. Prasad BSV	Chief Operating Officer Generic & API
Mr. Anupam Jindal	Chief Financial Officer

Source: Company Website

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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