Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Biocon Ltd

Acquisition to stress earnings in near term; long term levers stay intact

Pharmaceuticals	Sharekhan code: BIOCON

Reco/View: Buy	↔	CMP: **Rs. 349**	Price Target: **Rs. 420**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS	Positive	↔	Positive
RQ	Positive	↔	Positive
RV	Neutral	↔	Neutral

ESG Disclosure Score NEW

ESG RISK RATING 25.64

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

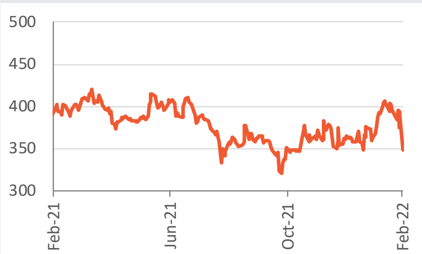
Company details

Market cap:	Rs. 41,895 cr
52-week high/low:	Rs. 424 / 315
NSE volume: (No of shares)	28 Lakh
BSE code:	532523
NSE code:	BIOCON
Free float: (No of shares)	47.2 Cr

Shareholding (%)

Promoters	60.6
FII	16.9
DII	7.4
Others	15.12

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.0	-3.8	0.6	-10.5
Relative to Sensex	-2.7	-2.6	0.1	-25.4

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Biocon with a revised PT of Rs 420. Despite near-term pressure, long-term levers are intact and possible listing of BBL is a key positive.
- Biocon Biologics has entered in to definitive agreement to acquire biosimilar assets of partner Viatris. The deal would yield synergies in the long term for Biocon Biologics, but it is likely to drive up debt, thus diluting earnings in FY23.
- The total consideration stands at $3.34 billion split into a cash consideration (of ~$2 billion), an issue of CCPS (compulsorily convertible preference shares) of $1 billion and a deferred payment of ~$335 million.
- Ability to fully realize revenues and profits of existing partnered assets, broad product portfolio, tapping new geographies for expansion would be key long term growth drivers for merged entity

Biocon's subsidiary, Biocon Biologics (BBL) has inked a deal to acquire its partner - Viatris' biosimilars portfolio, including existing partnered assets. While the deal would yield synergies in the form of own front end for BBL, a strong biosimilars portfolio and ability to fully realize revenues and profits of partnered assets, it also is likely to drive up debt, thus diluting earnings in FY23 and is likely to be earnings neutral for FY24. However, long-term synergies would play out well and support growth. Overall, the long-term outlook for biosimilars stays strong given greater acceptability in developed markets thus benefiting BBL.

Picking up Viatris' Biosimilar portfolio: BBL has entered into a definitive agreement with its partner Viatris to acquire the latter's biosimilar assets, including current partnered assets for a total consideration of $3.34 billion (~Rs 25,000 crore) split into a cash consideration (of ~$2 billion), an issue of CCPS (compulsorily convertible preference shares) of $1 billion and a deferred payment of ~$335 million. Post the acquisition, which is expected to be concluded in FY2023, BBL would be a leading and a vertically-integrated global biosimilars company.

BBL's near-term financials to be stressed: BBL expects Viatris's biosimilar business to report a revenue of $875 million in CY2022 and expects this to cross $1 billion mark by CY2023. These revenues reflect ~35-40% of revenues from partnered assets, which would be reduced as inter-segment post acquisition. OPM appears to be dilutive in the near term at least, while the steep rise in debt levels would add to the stress on earnings. Hence, the acquisition is likely to be earnings dilutive in the near term(FY23), while it is expected to be earnings neutral over FY24.

Long-term synergies: The deal is expected to yield long term synergies for BBL as post the acquisition, the new entity would be a leading vertically integrated biosimilar company globally. The deal offers BBL a presence in the front end, complementing current manufacturing and R&D capabilities, especially aimed at developed markets. Also, the ability to fully realise revenues and profits of existing partnered assets, broad product portfolio, tapping new geographies for expansion would be key points driving growth for merged entity. Subject to successful completion of due diligence, acquisition of bAflibercept can open up significant growth opportunities. .

Our Call

Valuation – Retain Buy with a revised PT of Rs 420: BBL's recent acquisition of Viatris' biosimilar assets offers significant long-term growth opportunities. However, a substantially higher debt to fund the acquisition and lower margins for the acquired portfolio could exert pressure on earnings leading to a likely earnings dilution in FY23 while FY24 is likely to be earnings neutral, though we have not factored in the financials of acquired business as it is yet to be disclosed. At CMP, the stock is trading at 47.1x/28.6x/20.6x its FY2022E/FY2023E/FY2024E EPS. Despite near-term pressure, long-term levers are intact and possible listing of BBL is a key positive. Hence, we retain a Buy on the stock with a revised PT of Rs. 420.

Key Risks

Delay in product approvals or the negative outcome of facility inspection by the USFDA and delay in responding to regulatory queries can affect earnings prospects.

Valuation (Consolidated) Rs cr

Particulars	FY2020	FY2021	FY2022E	FY2023E	FY2024E
Net sales	6300.5	7106.0	8024.7	10372.1	13185.4
Operating Profit	1603.1	1652.8	1899.6	2791.5	3697.9
OPM (%)	25.4%	23.3%	23.7%	26.9%	28.0%
Adj. PAT	709.6	573.1	889.1	1466.9	2035.9
EPS (Rs)	5.9	4.8	7.4	12.2	17.0
PER (x)	59.0	73.1	47.1	28.6	20.6
EV/Ebidta (x)	27.4	26.9	22.8	15.3	11.0
ROCE (%)	9.3	6.3	7.2	11.2	14.5
RONW (%)	10.6	7.5	10.5	14.9	17.2

Source: Company; Sharekhan estimates

Biocon Biologics acquires Viatris' biosimilar portfolio: Biocon, through its subsidiary, BBL has entered into a definitive agreement with its partner Viatris to acquire the latter's rights in the biosimilar assets. Post the acquisition, BBL will have a comprehensive portfolio comprising its current range of commercialised insulins, oncology and immunology biosimilars as well as several other biosimilar assets which currently under development. The total consideration for the acquisition stands at $3.335 billion (~Rs 25000 crore) split into a cash consideration (of ~$2 billion), an issue of CCPS (compulsorily convertible preference shares) of $1 billion and a deferred payment of ~$335 million. Adjusting for a $50 million payment from Viatris towards capex funding, the cash consideration stands at $1950 million. The balance consideration would in the form of CCPS would represent an equity stake of 12.9% in BBL. The consideration also has deferred payment of $335 million which includes $175 million towards an option to acquire bAfilibercept and $160 million would be deferred payment. The acquisition would position BBL as a global vertically-integrated leader in biosimilars.

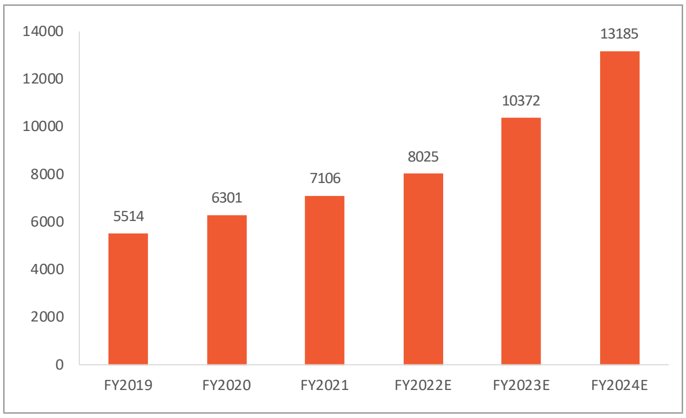
BBL's near-term financials to be stressed due to acquisition: Viatris' biosimilar business is expected to report a revenue of $875 million in CY2022 and the management expects this to cross the $1 billion mark by CY2023. However the revenues include around $400 million of inter-segment sales (which include revenues from the currently partnered assets), which would be reduced in consolidation post the acquisition is complete. The EBITDA for CY2022 is expected to be $200 million while BBL sees this improving to $250 million in CY2023. The overall consideration for the stake values the acquired business at 16.7x EV/EBITDA, which appears to be a steep premium (Viatris' EV/EBITDA - ~10x). In order to fund the acquisition, Biocon is expected to raise a debt of ~$1.2 billion, taking the total debt to $1.5 billion, which compares to ~$300 million now. Therefore a steep hike in the debt could exert pressure on earnings in the near term, while long-term synergies would benefit BBL and offset the high servicing cost. In addition, Viatris would be providing transition services to BBL for two years for a cost plus $44 million per annum payment, which would enable a smooth transition of acquired business.

Acquisition to yield long-term synergies: The deal offers BBL a presence in the front end, which would complement the current manufacturing and R&D arrangement for Viatris in the developed markets. Front-end operations largely comprise supply chain, regulatory and commercialization aspects, which would be in house for BBL after the deal, thus offering possible cost synergies. On the existing partnered assets, BBL would be in a position to fully realise the revenues and profits from these, which is one of the key growth drivers for the new entity. BBL and viatris have arrangement in the areas of diabetelogy, oncology and immunology and post the deal, BBL would be offering these products in newer markets thus expanding the geographic reach. In the near future BBL looks to launch bBevacizumab, bAspart, bAdalimumab in the US markets. In addition to these, bAfilibercept is a product, which currently is not a part of the deal, but BBL has the option of buying that out, subject completion of due diligence process. bAflibercept has a substantial addressable market size and the acquisition can open up significant growth opportunities.

Extensive portfolio of biosimilars: BBL currently has a portfolio of seven biosimilars, which are already commercialized in various markets globally. With its own front end, the company looks to expand the geographic reach for the products by entering new markets. Also, it has a strong pipeline of 20 biosimilars products and the acquisition of biosimilars assets of Viatris significantly strengthens BBL's position in the areas of diabetes, oncology, immunology and other non-communicable diseases. After integration of Viatris' portfolio, BBL will have one of the broadest and deepest commercialised biosimilar portfolio among peers and this could be the key growth driver in the near term.

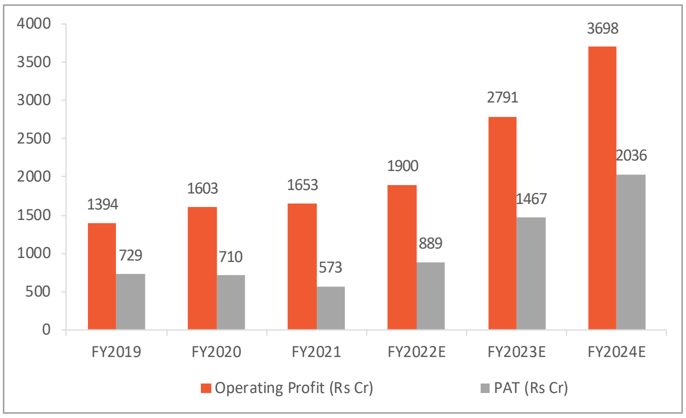
Financials in charts

Sales Trends (RS Cr)



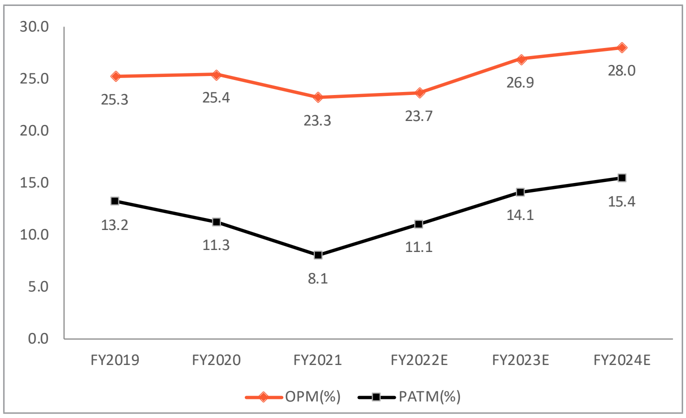
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



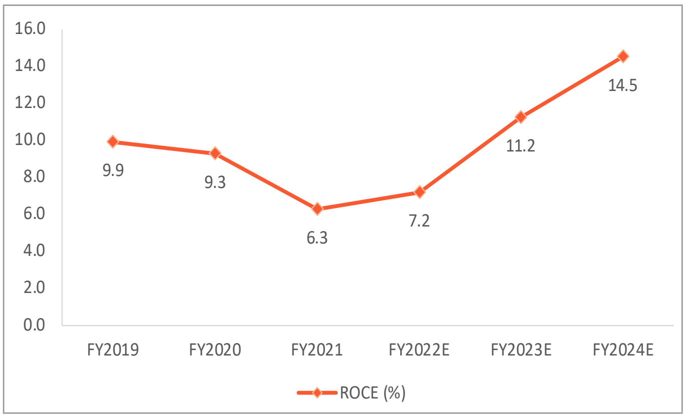
Source: Company, Sharekhan Research

OPM's - PAT Margin (%)



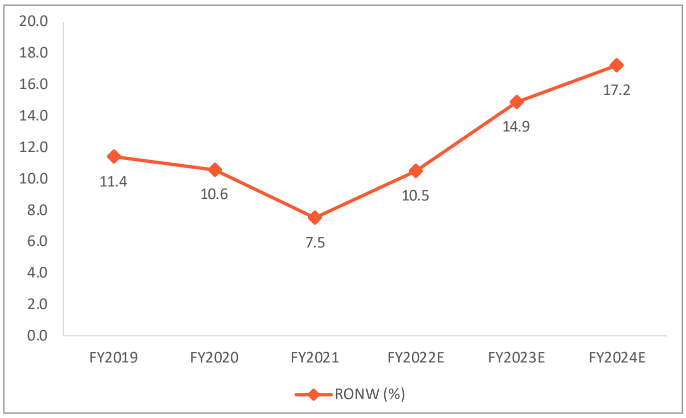
Source: Company, Sharekhan Research

ROCE Trends (%)



Source: Company, Sharekhan Research

RoE Trends (%)



Source: Company, Sharekhan Research

Debt : Equity (x)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – Improving growth prospects

Indian pharmaceutical companies are better-placed to harness opportunities and report healthy growth going ahead. They 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 the US generics market), rise in product approvals, plant resolutions by the USFDA, 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 and 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.

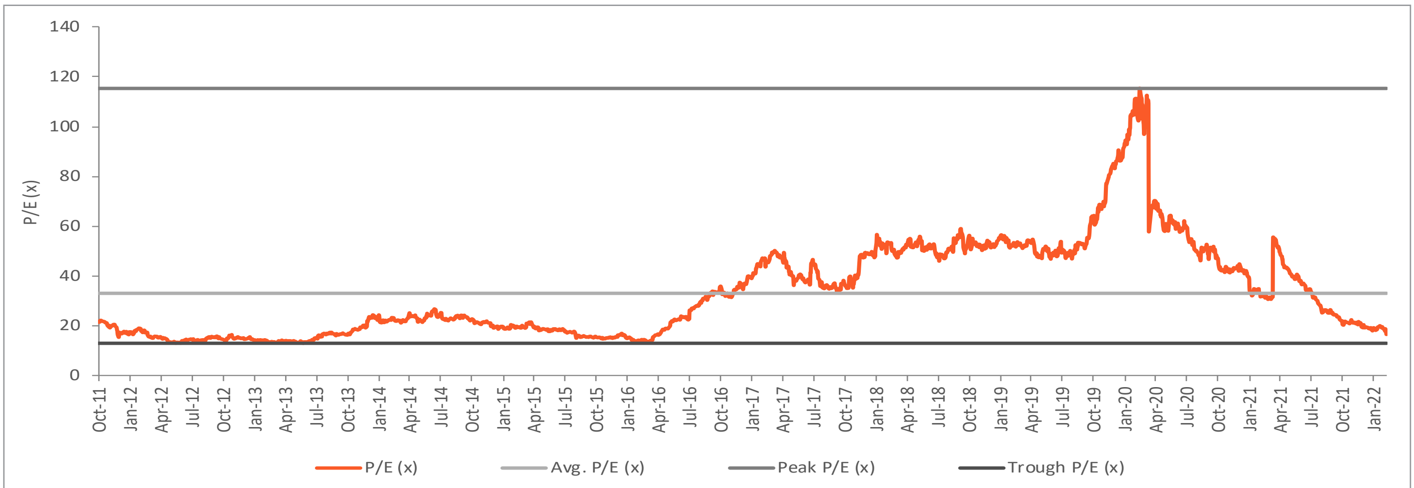
■ Company outlook – Biologics stays a key growth driver

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 – the US, EU, Japan and other developed markets. 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 commercialization strength of partner companies would further strengthen Biocon's presence in globally in the biosimilars. With the recent acquisition of the Viatris' biosimilar assets, has offered BBL its own front-end presence, which bodes well. Moreover, with the possible listing of Biocon Biologics, there exists a significant value unlocking opportunity going ahead.

■ Valuation – Retain Buy with a revised PT of Rs 420

The Viatris acquisition bodes well and offers significant growth opportunities over the long term. Access to own front-end, especially across the developed markets, an extensive portfolio of biosimilars and full realization of revenues and profits of the partnered assets would be key positive triggers. However, given the expensive valuations rendered for the acquisition, the debt are likely to inch up significantly, and exert pressure on earnings in near to medium term. While the expected synergies and benefits from the deal could play out over the long term and help tide over the high servicing cost. Therefore, the acquisition is expected to be earnings dilutive for FY23 while it is expected to be earnings neutral for FY24E onwards, though we have not factored in the financials of Viatris' biosimilars business as it is yet to be disclosed. Overall, Biocon has laid a strong platform for growth of biosimilars across therapies and is likely to gain further traction backed by new launches and expanding geographic reach. This coupled with new areas of vaccines (through a strategic partnership) would also add to the growth of the biosimilars business. At CMP, the stock is trading at P/E multiples of 47.1x/28.6x/20.6x its FY2022E/FY2023E/FY2024E earnings. While the earnings are likely to be stressed in near term, long-term levers are intact and this coupled with possible listing of the biologics segment are the key positives. We retain Buy on the stock with revised PT of Rs. 420.

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 (%)		
				FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
AurobindoPharma	625.0	58.6	36,647.0	14.8	12.4	10.0	6.6	6.5	4.7	12.8	12.6	13.9
Sun Pharma	843.0	239.9	2,02,343.0	29.7	27.1	23.8	23.6	18.4	15.6	14.6	14.0	13.9
Biocon	349.0	120.0	41,895.0	73.1	47.1	28.6	26.9	22.8	15.3	7.5	10.5	14.9

Source: Company, Sharekhan estimates

About the 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 un-locking 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 Shreehas Tambe	Deputy CEO Biocon Biologics Limited

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Glentec International	19.8
2	Life Insurance Corp of India	1.7
3	ICICI Prudential Asset Management	1.4
4	Jupiter Investment Management Group	1.3
5	NATIONAL WESTMINSTER	1.1
6	Aditya Birla Sun Life Asset Management	1.1
7	Standard Life Aberdeen PLC	1.1
8	Mirae Asset Large Cap fund	1.0
9	Societe Generale SA	1.0
10	Norges Bank	0.9

Source: Bloomberg

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 detoriating 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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