



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	■	↔	■

ESG Disclosure Score NEW

ESG RISK RATING **25.64**
Updated Jul 08, 2022

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 36,822 cr
52-week high/low:	Rs. 411 / 305
NSE volume: (No of shares)	28.0 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	-3.0	-18.5	-15.6	-19.6
Relative to Sensex	-9.9	-17.4	-15.0	-28.1

Sharekhan Research, Bloomberg

Biocon Ltd

High costs hit Q1; biologics a key growth driver

Pharmaceuticals	Sharekhan code: BIOCON		
Reco/View: Buy	↔	CMP: Rs. 307	Price Target: Rs. 362 ↓
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Biocon reported weak performance for Q1FY23 and results missed estimates; while double-digit topline growth supported performance, higher cost pressures dragged down OPM.
- Market share gains in Semglee, biosimilar launches in the US, EU and other emerging markets and growth in acquired biosimilars portfolio from partner would drive the Biologics sales higher, making it a key growth driver
- An expected pick-up in generics segment and healthy growth in research could add to overall momentum that is well supported by capex plans, providing ample growth visibility.
- The management expects to unlock the potential of several investments it has made, in FY23. We retain Buy on the stock with a revised PT of Rs 362.

Biocon Limited (Biocon) reported weak numbers for Q1FY23 that missed estimates. Performance was supported by a double-digit topline growth across segments, while higher cost pressures dragged down OPM. However, a low base of Q1FY22 drove up PAT. Market share gains in Semglee, biosimilar launches in the US, EU and other emerging markets and growth in acquired biosimilars portfolio from partner would drive the Biologics sales higher, making it a key growth driver. In addition, an expected pick-up in generics segment and healthy growth in research could add to overall momentum that is well supported by capex plans, providing ample growth visibility. The management expects to unlock the potential of several investments it has made, in FY23.

Key positives

- Biologics segment's revenues grew by 29% y-o-y on a strong rise in revenues from Semglee as well as foray into new markets with existing products
- Company launched bBevacizumab in Canada and received marketing authorisation for bAspart in UK
- Gross margins expanded by 180 bps y-o-y due to a favorable mix.

Key negatives

- The operating margins contracted by 343 bps y-o-y due to a 360 bps y-o-y increase in Other expenses / sales

Management Commentary

- The biologics segment is on a strong footing backed by strong growth and market share gains for Semglee in the US and plans to launch bBevacizumab, bAspart in the US, post likely plant inspection in August 2022. Strategic tie up for vaccines and acquisition of biosimilar portfolio from partner bodes well for the growth of biologic segment.
- Generic segment sales grew 19% y-o-y driven by new product launches across the geographies including US and EU. The management expects a strong prospect for generics.
- The management sees FY2023 to be year in which it expects to unlock potential of several investments it has made. New launches planned or tapping new geographies with existing products and enhanced capacities leveraging partnerships would be key growth drivers.

Revision in estimates – Q1FY23 was a weak quarter and results missed estimates. Though the revenues grew in double digits higher cost pressures dented OPM sharply and hence factoring in this, we have cut out estimates for FY23E/FY24E by 9% and 6% respectively.

Our Call

Valuation – Retain Buy with a revised PT of Rs 362: Biocon has laid a strong platform for growth of biosimilars in the insulin and oncology franchise across its key markets. Commercialization of new products / tapping new geographies with existing products could strengthen presence in insulins and the Oncology space. This coupled with efforts to increase penetration in existing markets and tap new areas of vaccines and recent acquisition of biosimilars portfolio from a partner company, could drive growth of Biosimilars over the long term. Though in the term cost pressures are expected to outweigh. At CMP, the stock is trading at P/E multiples of 20.9x/18.7x its FY2023E/FY2024E earnings. We retain Buy on the stock with a revised PT of Rs 362.

Key Risks

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

Valuation (Consolidated)

Particulars	Rs cr				
	FY2020	FY2021	FY2022	FY2023E	FY2024E
Net sales	6300.5	7143.7	8184.0	10610.4	13455.3
Operating Profit	1603.1	1679.5	1919.0	2550.7	3522.4
OPM (%)	25.4%	23.5%	23.4%	24.0%	26.2%
Adj. PAT	709.6	610.8	758.0	1271.5	1973.3
EPS (Rs)	5.9	5.1	6.3	10.6	16.4
PER (x)	51.9	60.3	48.6	29.0	18.7
EV/Ebitda (x)	24.2	23.4	21.1	15.2	10.2
P/BV (x)	5.5	4.8	4.4	3.8	3.2
ROCE (%)	9.3	6.5	7.9	10.5	14.4
RONW (%)	10.6	8.0	9.0	13.2	17.1

Source: Company; Sharekhan estimates

High costs pressures impact OPM; Results miss estimates: Biocon reported weak numbers for Q1FY23 and numbers missed estimates. Performance was supported by a double-digit topline growth across segments, while higher cost pressures are apparent, which impacted the operating margins. A low base of Q1FY22 drove up PAT growth. Revenues at Rs 2140 crore, grew by 21.6% y-o-y and missed estimates. Revenue growth was driven by a strong 29% growth in biologics segment revenues, as the company tapped new markets for existing products, while the generic segment sales and research services sales grew by 19.3% and 8.3% y-o-y respectively. The operating margins at 18.7% (as against estimated 25.2%) contracted by 343 bps y-o-y. Whole gross margins expanded by 180 bps y-o-y, the other expenses / sales inched up by 360 bps y-o-y. The R&D expenses too were up 240 bps y-o-y. Consequently the operating profit at Rs 399 cr was up by a mere 2.7% y-o-y and missed estimates. The depreciation charge was up 12% y-o-y due to new assets capitalised, while share of JV loss stood at Rs 43 crore as compared to Rs. 56 crore in Q1FY22. Tax rate fell to 15% as compared to 34.5% in Q1FY22. Consequently, PAT stood at Rs 144 cr up by 72% largely due to a low adjusted PAT base in Q1FY22.

Q1FY2023 Conference Call Highlights

- ♦ **Biologics segment sales grow impressively; outlook stays strong:** Revenues from the biosimilar segment have staged a strong 29% y-o-y growth to Rs 977 crore. The segment's strong performance in Q1 could be attributable to the strong growth in the insulin glargine in the US, and in the Europe bPegfilgrastim and bTrastuzumab drove the performance. In the Emerging markets the company launched bTrastuzumab and rh-Insulin in additional markets and also made Regulatory submissions for key biosimilars in over 20 emerging markets. The growth prospects for the biosimilars segment are bright and would make the segment a key growth driver for Biocon. Based on the strong demand traction the management expects further market share gains likely by Semglee in the US. In addition to this, the recent acquisition of a biosimilar portfolio of its partner is expected to yield synergies over the long term as the acquisition makes Biocon a largest, integrated and cost effective biosimilar players globally. This along with the planned new Biosimilar launches in the US – Aspart, Adalimumab and Bevacizumab would also add up to growth prospects of the biologics segment's revenues (Biocon expects its facilities to be inspected in the current quarter (Q2FY23) and is expecting approvals for these biosimilars by end of the year). In addition to this, the multiple drivers exist for Biologics segments which include – strategic tie up for vaccines, and acquisition of a partner company's biologics business. These drivers are expected to yield benefits in the medium term and a meaningful contribution could be expected in FY24. Basis the above growth drivers, the biosimilar revenues are expected to gain traction going ahead and could be a key growth driver for the company.
- ♦ **Generics:** Revenues from generics / small molecules staged a strong show growing by 19% y-o-y. The strong growth can be attributable to new product launches across the geographies. In the US, the company introduced Mycophenolic Acid (MPA) Delayed-Release Tablets for the prophylaxis of kidney transplant patients. In addition to this, the company has also received approval / launched its oncology product – Lenalidomide in the EU, Fingolimod capsules in the UAE and Rosuvastatin tablets in Singapore. Going ahead, prospects for the generics division are bright driven by expansion or addition of peptides and hi potent oncology APIs. Also, the company has received an GMP approval from the MHRA UK for its oral solid dosage facility at Bengaluru and greenfield immunosuppressant API facility in Visakhapatnam remains on track, with qualification and validation activities likely in FY23. Further the new launches are also expected to offset the effect of the price pressures to a certain extent and this bodes well for generics division growth. Overall, based on above triggers, the generic segment sales are expected to grow in double digits for FY23 as compared slightly decline reported in FY22.
- ♦ **Vaccines arrangement:** Biocon Biologics entered in to an arrangement with the Serum Institute of India for distribution of Vaccines across areas. The arrangement is progressing as scheduled and the deal could be concluded in 2HCY22. The Competition Commission of India has approved the merger of Covishield Technologies of India, a wholly-owned subsidiary of Serum Institute Life Sciences, with Biocon Biologics.

- ◆ **Novel Biologics:** Biocon's partner is on track to a Pivotal Study for use of Itolizumab in First-Line treatment of Acute Graft Versus Host Disease and the company has initiated a phase III Equator study of Itolizumab for the said patient group. Equillium has started patient dosing for the same. Also Bicara's lead molecule, BCA101, has demonstrated encouraging safety, pharmacokinetic, pharmacodynamic and efficacy profiles based on the findings from the dose escalation phase of the ongoing Phase 1/1b trial. Primary results for the dose expansion arm of this study are expected in H22022.
- ◆ **Capex and R&D:** Based on the strong demand for insulins globally and citing new growth opportunities and avenues, the company has already initiated investments for expansion of its facility. Biocon plans to invest \$300 million over three years (\$100 million per year). Further with the company's two biosimilars assets entering the clinical trials stage, R&D expenses (as a % of sales) are likely to inch up and the management has guided for 10-15% range for R&D going ahead.
- ◆ **Outlook for FY2023:** The management expects the FY2023 to be year in which it expects to unlock potential of several investments it has made. Also the new launches planned or tapping new geographies with existing products and enhanced capacities would be the key growth drivers for the API and generics business. The likely conclusion of the Viatrix and Serum Institute deal is also likely in H2FY23 and could add up to the growth. Strong traction in existing customer orders and extension of contracts would drive the Research services revenues upwards.

Results (Consolidated)

Particulars	Rs cr				
	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Total Income	2140.5	1761.0	21.6	2409.0	-11.1
Operating profit	399.5	389.0	2.7	591.0	-32.4
Other income	78.0	47.0	66.0	67.0	16.4
EBIDTA	477.5	436.0	9.5	658.0	-27.4
Interest	20.0	20.0	0.0	11.0	81.8
Depreciation	217.0	195.0	11.3	212.0	2.4
PBT	240.5	221.0	8.8	435.0	-44.7
Adj. PAT after MI	144.5	84.0	72.0	277.0	-47.8
Reported PAT	144.5	84.0	72.0	236.0	-38.8
Margins			BPS		BPS
OPM (%)	18.7	22.1	-343	24.5	-587
Adj.Net profit margin (%)	6.8	4.8	198	11.5	-475

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – 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 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. 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. 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 362:** Biocon has laid a strong platform for growth of biosimilars in the insulin and oncology franchise across its key markets. Commercialisation of interchangeable Insulin Glargine (Semglee) in US, planned launch of Insulin Aspart would strengthen the insulin franchise further while the launch of bBevacizumab in key markets of EU and US would fortify the presence in the Oncology space. This coupled with the efforts to increase penetration in existing markets and tap new markets and new areas of vaccines (through a strategic partnership) and recent acquisition of biosimilars portfolio from a partner company, could drive growth of Biosimilars. Backed by product launches in the US, uptick in the API business and normalization of supply challenges, are the key positives. Q1FY23 was a weak quarter and results missed estimates. Though the revenues grew in double digits, higher cost pressures dented the operating margins sharply and hence factoring in this we have cut out estimates for FY23E/FY24E by 9% and 6% respectively. At CMP, the stock is trading at P/E multiples of 20.9x/18.7x its FY2023E/FY2024E earnings. We retain Buy on the stock with a revised PT of Rs 362.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Sun Pharma	895.0	239.9	2,14,675.0	27.4	25.8	22.8	20.3	16.2	13.4	16.3	14.9	14.6
Biocon	307.0	120.0	36,822.0	48.6	29.0	18.7	21.1	15.2	10.2	9.0	13.2	17.1

Source: Company, Sharekhan estimates

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 Shreehas Tambe	Deputy CEO Biocon Biologics Limited

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	1.10
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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