



## 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 Updated Oct 08, 2022 **25.54**

## Medium Risk

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

Source: Morningstar

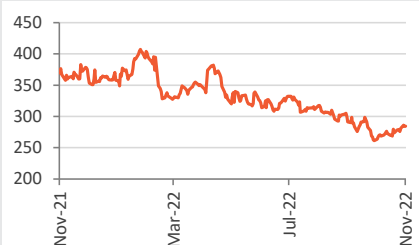
## Company details

Market cap:	Rs. 34,151 cr
52-week high/low:	Rs. 411 /258
NSE volume: (No of shares)	21.0 lakh
BSE code:	532523
NSE code:	BIOCON
Free float: (No of shares)	47.2 cr

## Shareholding (%)

Promoters	60.6
FII	16.7
DII	7.8
Others	14.94

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	7.9	-9.7	-15.8	-23.0
Relative to Sensex	1.8	-12.5	-30.1	-25.7

Sharekhan Research, Bloomberg

## Biocon Ltd

## Mixed performance

## Pharmaceuticals

## Sharekhan code: BIOCON

## Reco/View: Buy

CMP: Rs. 284

Price Target: Rs. 340



Upgrade



Maintain



Downgrade

## Summary

- Biocon registered mixed operating performance in Q2 with revenue growing in strong double digits, while higher cost pressures led to a decline in PAT.
- Revenue grew by 26% y-o-y to Rs. 2,319.7 crore, driven by strong 34% y-o-y growth in the biologics segment, 25.9% y-o-y growth in the research services segment, and 17.5% y-o-y growth in the generic segment. EBIDTA margin fell by 399 BPS to 20.3%; PAT was down by 10% y-o-y to Rs. 205.7 crore.
- Consolidation of Viatris and the strategic vaccines alliance with Serum Institute will add to growth of the Biosimilars business in H2FY2023. Margins might remain lower due to higher R&D cost.
- The stock is currently trading at 32.9/21.6x its FY2023/FY2024E earnings. We maintain our Buy rating on the stock with a revised PT of Rs. 340.

Biocon Limited (Biocon) reported mixed performance in Q2FY2023, with revenue growing in upwards of 20% on account of broad-based growth across key verticals, while higher cost pressures put pressure on EBIDTA margin and resulted in a decline in PAT during the quarter. Overall, revenue grew by 26% y-o-y to Rs. 2,319.7 crore, with 34% growth in biosimilars, 26% growth in research services, and 18% growth in generic business. The consolidation of Viatris' global biosimilars business and the strategic vaccines alliance with Serum Institute will add to growth of the Biosimilars business in H2FY2023. Enhanced capacities and new launches will drive growth for the API and generic formulations business, while continued business momentum should help Syngene achieve its guidance for the full year.

## Key positives

- Launched two important products, Sitagliptin and Vildagliptin in the EU, enabled by brownfield capacity expansions undertaken at our Bengaluru and Visakhapatnam facilities.
- The biologics segment's revenue grew by 34% y-o-y, driven by higher sales of its biosimilar insulin and antibodies in advanced and emerging markets.
- Syngene's revenue grew by 26% y-o-y to Rs. 610 crore
- Gross margin expanded by 180 BPS y-o-y due to a favourable mix.

## Key negatives

- Operating profit margin contracted by ~400 bps y-o-y due to a 200-bps y-o-y increase in R&D expenses and a 25-bps y-o-y increase in other expenses.

## Management Commentary

- The generic formulations business also secured several important approvals for vertically integrated products in the EU and rest of the world markets, providing further impetus to the geographical expansion in the quarters ahead. The company also received five product approvals across key markets.
- Viatri's-led advanced markets business reported strong y-o-y growth on account of improved performance by interchangeable bGlargine (Semglee), which witnessed an uptick of 14% in prescription share and 12% in overall prescription share. The company reported increased uptake of Fulphila in the U.S. with market share surpassing 10%, despite higher competition. Ogivri continues to be the leading bTrastuzumab brand in Canada and Australia with over 30% market share in both.
- Management sees FY2023 to be a year in which it expects to unlock the potential of several investments it has made. New launches planned or tapping new geographies with existing products and enhanced capacities leveraging partnerships would be the key growth drivers.

**Revision in estimates** – Though revenue grew in double digits, higher cost pressures dented OPM, which sharply declined on a y-o-y basis. Further, the company indicated of R&D expenses remaining higher at 12-15% in the coming years. Hence, we have toned down our earnings estimates for FY2023 and FY2024 to factor in lower-than-earlier-expected EBIDTA margins. We have introduced FY2025E earnings through this note.

## Our Call

**Valuation: Retain Buy with a revised PT of Rs 340:** Biocon has laid a strong platform for growth of biosimilars in the insulin and oncology franchise across its key markets. Commercialisation of new products/tapping new geographies with existing products could strengthen its presence in the insulin and oncology space. This coupled with the efforts to increase penetration in existing markets and tap new areas of vaccines and the recent acquisition of biosimilars portfolio from a partner company could drive growth of biosimilars over the long term. Though in the near term, cost pressures are expected to overweigh. At the CMP, the stock is trading at P/E multiples of 32.9x/21.6x its FY2023E/FY2024E earnings. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 340.

## 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	FY21	FY22	FY23E	FY24E	FY25E
Net sales	7143.7	8184.0	10610.4	13137.2	16054.8
OPM (%)	23.5%	23.4%	21.2%	22.9%	21.4%
Adj. PAT	610.8	758.0	1036.8	1577.2	1869.0
EPS (Rs)	5.1	6.3	8.6	13.1	15.6
PER (x)	55.9	45.0	32.9	21.6	18.3
EV/Ebidta (x)	21.8	19.7	16.1	11.2	9.4
ROCE (%)	6.5	7.9	8.7	11.9	12.7
RONW (%)	8.0	9.0	11.0	14.5	14.7

Source: Company; Sharekhan estimates

## Mixed Q2 – Revenue growth at 26% y-o-y; EBITDA margin declined by 399 bps y-o-y

Biocon's revenue at Rs. 2,319.7 crore grew by 26% y-o-y and were ahead of our as well as average street estimates of Rs. 2,206 crore-2,278 crore. Revenue growth was driven by strong 34% y-o-y growth in the biologics segment, 25.9% y-o-y growth in research services and 17.5% y-o-y growth in the generic segment. EBITDA margin at 20.3% declined by 399 bps y-o-y, which can be largely attributed to higher staff costs, other expenses, and R&D expenses. EBITDA margin came in line with our estimate of 20.3%, but it was lower than average street estimate of 21.2%. Consequently, operating profit grew by just 5.3% to Rs. 470.7 crore. Lower other income, higher interest, and depreciation led to a 10.2% y-o-y decline in adjusted profit to Rs. 205.7 crore, largely in line with our as well as street expectation of Rs. 209 crore-212 crore. Exceptional item includes tax expense on adoption of a new tax regime to the extent of Rs. 107 crore. Reported PAT stood at Rs. 46.7 crore, registering a decline of 66.2% y-o-y.

### Segment-wise update

#### Biosimilars: Biocon Biologics Limited (BBL)

Revenue from the biosimilar segment has staged strong 34% y-o-y growth to Rs. 997 crore. The segment's strong performance in Q2 can be attributed to strong performance of its biosimilars portfolio in advanced and emerging markets. BBL continued to progress on two of BBL's own research assets, bDenosumab and bUstekinumab, which are undergoing global clinical trials, as well as other pipeline molecules. The company has raised its R&D investments this quarter by 142% y-o-y to Rs. 184 crore, representing 18% of BBL's revenue. Core EBITDA (excluding R&D, forex, licensing income, and mark-to-market loss on investments) stood at Rs. 449 crore, reflecting growth of 48% y-o-y. Core EBITDA margin was at 46% in Q2FY2023 versus 42% in Q2FY2022 benefitted from rupee depreciation and accrual of performance-linked incentives (PLI) benefits. EBITDA for the quarter at Rs. 214 crore was impacted by higher R&D investments and non-cash foreign currency translational loss of Rs. 35 crore. Profit before tax and exceptional items stood at Rs. 78 crore. Fulphila's US market shares surpassed 10% and Ogivri has started recovering, following a temporary dip in Q1FY2023. In Glargine, the company's market share has increased to 16% (from 10%). Trastuzumab market share decreased to 8% (from 10%) due to the loss of one major client, while the increase in the competition in Pegfilgrastim led to a stable market share (9%). The company has launched two new products – Bevacizumab in Canada and bAspart in the UK.

#### Generics: APIs and Generic Formulations

Revenue from generics/small molecules staged a strong show, growing by 17.5% y-o-y to Rs. 623 crore, aided by continued performance in API and recently launched generic formulations, coupled with a lower base in the last year. During the quarter, the company launched two important products – Sitagliptin and Vildagliptin – in the EU. The company has also received five product approvals across the markets. In the EU, it received three approvals for Posaconazole, Lenalidomide, an oncology product, and Everolimus, which are used in the treatment of certain types of cancers and tumours. Two more approvals such as Posaconazole and Mycophenolic have been granted in Q2FY2023. Commissioning and qualification of the immunosuppressants facility at Visakhapatnam and peptides facility at Bengaluru have been completed and process validation of batches will commence in Q3FY2023.

#### Novel Biologics

The company's US-based partner Equillum announced encouraging interim data from the EQUALISE study, evaluating Itolizumab in patients with Lupus Nephritis. The study continued to enroll patients with topline data expected in mid-2023. In India, DCGI approved Equillum's application for Phase 2 clinical trials with Itolizumab in Ulcerative Colitis in October. Biocon's Boston-based associate, Bicara Therapeutics' lead molecule BCA101, in combination with Pembrolizumab, was evaluated in front-line systemic patients with unresectable, recurrent, or metastatic head and neck squamous cell carcinoma with very encouraging response rates. In Q2FY2023, BCA101 as a monotherapy was evaluated in patients with advanced or incurable cutaneous squamous cell carcinoma who have received previous anti-PD-1 therapy.

#### Vaccines arrangement

Biocon Biologics entered into an arrangement with the Serum Institute of India for the distribution of vaccines across areas. The arrangement is progressing as scheduled and the deal could be concluded in Q3FY2023. 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.

Results (Consolidated)

					Rs cr
Particulars	Q2FY23	Q2FY22	YoY %	Q1FY23	QoQ %
Total Income	2319.7	1841.0	26.0	2139.5	8.4
Expenditure	1849.0	1394.0	32.6	1741.0	6.2
Operating profit	470.7	447.0	5.3	398.5	18.1
Other income	65.0	105.0	-38.1	78.0	-16.7
EBIDTA	535.7	552.0	-3.0	476.5	12.4
Interest	30.0	23.0	30.4	20.0	50.0
Depreciation	231.0	202.0	14.4	217.0	6.5
PBT	274.7	327.0	-16.0	239.5	14.7
Tax	41.0	47.0	-12.8	30.0	36.7
Share of JV + MI	63.0	80.0	-21.3	66.0	-4.5
Adj. Profit	205.7	229.0	-10.2	167.5	22.8
Adj. PAT after MI	170.7	200.0	-14.7	143.5	19.0
Exceptional Item (Net)	-124.0	-62.0	-	0.0	-
Reported PAT	46.7	138.0	-66.2	143.5	-67.5
<b>Adj. EPS (Rs.)</b>	<b>1.4</b>	<b>1.7</b>	<b>-14.7</b>	<b>1.2</b>	<b>19.0</b>
<b>Reported EPS (Rs.)</b>	<b>0.4</b>	<b>1.2</b>	<b>-66.2</b>	<b>1.2</b>	<b>-67.5</b>
			<b>BPS</b>		<b>BPS</b>
OPM (%)	20.3	24.3	-399	18.6	167
EBIDTA margin (%)	23.1	30.0	-689	22.3	82
Adj.Net profit margin (%)	7.4	10.9	-350	6.7	65

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.

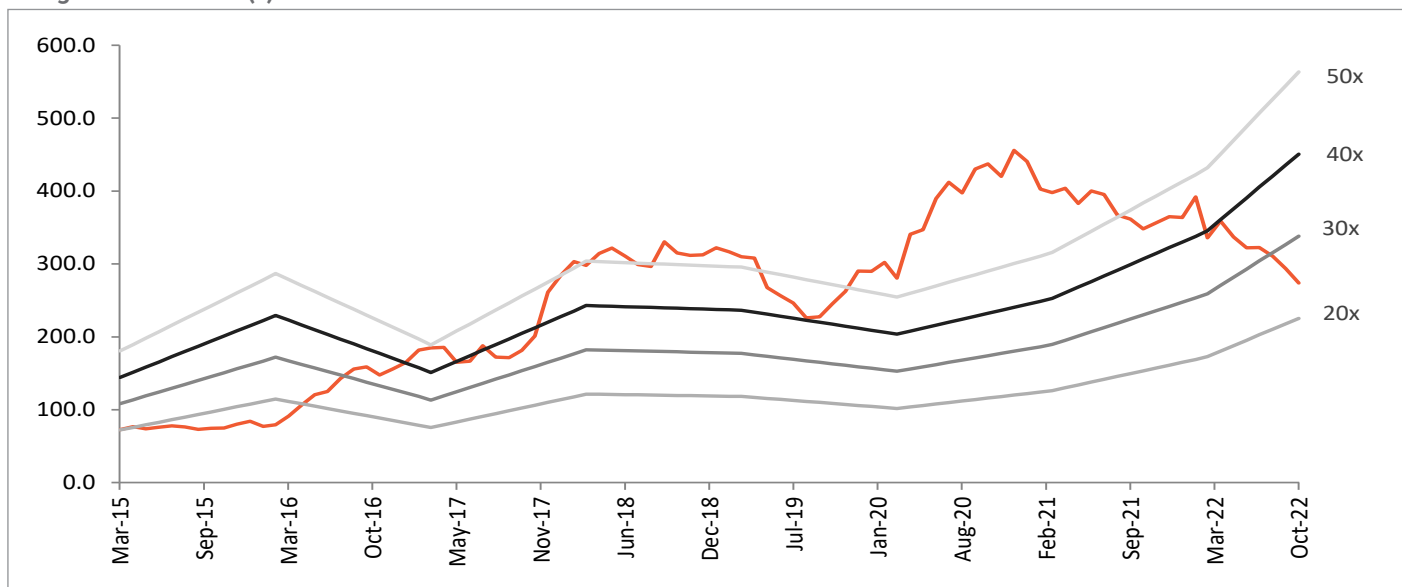
### ■ Company outlook - Biologics to be a key growth driver

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 commercialisation strength of partner companies would further strengthen Biocon's presence globally in 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 340

Biocon has laid a strong platform for growth of biosimilars in the insulin and oncology franchise across its key markets. Commercialisation of new products/tapping new geographies with existing products could strengthen its presence in the insulin and oncology space. This coupled with the efforts to increase penetration in existing markets and tap new areas of vaccines and the recent acquisition of biosimilars portfolio from a partner company could drive growth of biosimilars over the long term. Though in the near term, cost pressures are expected to outweigh. At the CMP, the stock is trading at P/E multiples of 32.9x/21.6x its FY2023E/FY2024E earnings. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 340.

#### One-year forward P/E (x) band



Source: Sharekhan Research

#### Peer Comparison

Companies	CMP (Rs/ Share)	CMP (Rs/ Share)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Sun Pharma	1,021	240	244,972	31.3	28.1	23.7	23.2	18.1	14.9	16.3	15.5	15.7
Biocon	284	120	34,097	45.0	32.9	21.6	19.7	16.1	11.2	9.0	11.0	14.5

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 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 globally in the biosimilars space. 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 and Managing Director
Mr. Indranil Sen	CFO
Mr. Mayank Verma	Company Secretary

Source: Company

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp India	4.25
2	Ahan I Ltd.	2.33
3	Vanguard Group Inc.	1.26
4	Chandavarkar Arun Suresh	1.1
5	BlackRock Inc.	1.01
6	ICICI Prudential AMC	0.98
7	Aditya Birla Sun Life AMC	0.65
8	Biocon India Ltd EMP TR	0.65
9	Beneficial HDGS Under MGT	0.46
10	Bank of Montreal	0.46

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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