

Biocon

24 October 2019

Reuters: BION.BO; Bloomberg: BIOS IN

Muted Performance - Eyes on Trastuzumab US launch and Fulphila® capacity expansion

Biocon's revenue in 2QFY20 stood at Rs15,730mn, which is 3.5%/1.0% above our/consensus estimates and up 19.1% YoY (up 7.3% QoQ). Net earnings at Rs2,170mn was 6.1% below our estimate. Net earnings came lower as high margin US biologics business contribution declined due to lower Fulphila® sales.

Trastuzumab launch in the US is the most imminent milestone for Biocon. The impact on earnings growth will be slow and gradual as market share shifts will take time. Initially only newly diagnosed patients may be considered for a biosimilar, while those which have already initiated on Herceptin® may not be switched. Other factors influencing Trastuzumab uptake would be:

- 1) Rate at which Kadcyra® cannibalizes Herceptin® in adjuvant setting in patients with residual disease post neoadjuvant treatment
- 2) Upcoming clinical data on Perjeta® + Kadcyra® combination in adjuvant setting
- 3) Launch timelines of fixed dose combination of Herceptin® + Perjeta® in SC format

We currently model US\$150mn in Trastuzumab sales in FY21.

Fulphila® sales growth has been hampered by capacity constraints, incremental capacity for which is likely to come up in 4QFY20. The impact of capacity expansion on market share will depend on competitive scenario (entry of Sandoz, Apotex). We currently model US\$150mn in peak sales for Fulphila®, which assumes a 20% share at 50% discount in the vial market.

Outlook and valuation: Biocon 2QFY20 net earnings were lower than our expectations as margins of biologic business slipped on account of lower share of high margin US business and also higher R&D expense during the quarter. R&D expense should remain elevated as the company would continue to spend on augmenting the biosimilar pipeline. Biocon has shared an aspirational target of reaching US\$1bn in biologic revenue by FY22, which implies more than trebling of existing revenue base. Our existing forecasts assume biologic revenue reaching US\$650mn by FY22. Assuming the target is met, this would imply a US\$350mn upside to our estimate and would potentially translate into an earnings upside of Rs5 per share to our FY22 EPS estimate of Rs12.3. We refrain from revising our estimates to guided targets as they remain contingent on timely / successful execution and potentially underestimates risks arising from any competitive response to Biocon launches and regulatory uncertainties (approval and manufacturing compliance related). Innovators would look to defend their market share aggressively, unlike in case of small molecules as capital costs are significant in case of biologics and facilities are not as fungible. We also do not model an upside from any biologic launch in China market, which potentially can happen only in FY23.

ACCUMULATE

Sector: Pharmaceuticals

CMP: Rs245

Target Price: Rs252

Upside: 2.7%

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Key Data

Current Shares O/S (mn)	1,200.0
Mkt. Cap (Rsbn/US\$bn)	294.7/4.2
52 Wk H / L (Rs)	341/211
Daily Vol. (3M NSE Avg.)	4,238,899

Price Performance (%)

	1 M	6 M	1 Yr
Biocon	9.4	(19.9)	(23.9)
Nifty Index	0.1	(1.1)	13.4

Source: Bloomberg

Y/E March (Rsmn)	2QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)	1HFY19	1HFY20	YoY (%)
Net revenue	13,210	14,660	15,730	19.1	7.3	24,450	30,390	24
Material & Power Costs	5,060	4,910	5,490	8.5	11.8	9,970	10,400	4
% of revenue	38.3	33.5	34.9	(340) bps	141 bps	40.8	34.2	(656) bps
Staff costs	2,630	3,090	3,220	22.4	4.2	5,000	6,310	26
% of revenue	19.9	21.1	20.5	56 bps	(61) bps	20.4	20.8	31 bps
R&D	770	790	1,040	35.1	31.6	1,210	1,830	51
% of revenue	5.8	5.4	6.6	78 bps	122 bps	4.9	6.0	107 bps
Other expenses	1,350	1,490	1,940	43.7	30.2	2,490	3,430	38
% of revenue	10.2	10.2	12.3	20.7	21.3	10.2	11.3	110 bps
EBITDA	3,400	4,380	4,040	18.8	(7.8)	5,780	8,420	46
EBITDA margin (%)	25.7	29.9	25.7	(5) bps	(419) bps	23.6	27.7	407 bps
Other income	540	240	380	(29.6)	58.3	1,230	620	(50)
Interest costs	190	170	140	(26.3)	(17.6)	370	310	(16)
Depreciation	1,120	1,240	1,320	17.9	6.5	2,110	2,560	21
Share of profit in JV	10	80	90	800.0	12.5	0	170	-
PBT before exceptional items	2,620	3,130	2,870	9.5	(8.3)	4,530	6,000	32
Exceptional Items	1,890	0	680	-	-	1,890	680	-
Tax	730	860	1,000	37.0	16.3	1,250	1,860	49
Tax rate (%)	27.9	27.5	34.8	698 bps	737 bps	27.6	31.0	341 bps
PAT before MI	3,780	2,270	2,550	(32.5)	12.3	5,170	4,820	(7)
MI	230	210	380	65.2	81.0	420	590	40
PAT after MI	3,550	2,060	2,170	(38.9)	5.3	4,750	4,230	(11)
PAT Margin (%)	26.9	14.1	13.8	(1308) bps	(26) bps	19.4	13.9	(551) bps

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Earnings conference-call highlights

Filings and approvals in the US

- **Avastin®** – Filing is on track for 2HFY20
- **Insulin Lispro®** – Initiated Phase 3 trials. Filing in EMA in 2HFY20 and US submission in mid-CY20.
- **Insulin Glargine (Semglee®)** – The Company remains confident of getting an approval before the pathway change takes place on 22 March, 2020. Management is confident of launching before the end of March.

Biosimilar Nuelasta® – Management has guided for additional capacity for the product to happen in November FY20.

Ogivri® – Management is looking forward to launch but hasn't given any formal timeline and has also iterated that this is a good 3-4 years opportunity.

Malaysian insulin facility – The company received GMP certification which means the company will launch Insulin Glargine in the EU.

In-Licensing – The company has in-licensed an early stage, pre-clinical bio-similar asset from Just-Evotec Biologics. The company will develop and commercialize the biosimilar under Biocon Biologics. The company paid an undisclosed fee to the counter party and it will also pay milestone payments in the future.

Biologic business – EBIT margin was 25% for 2QFY20 and 31% in H1FY20. Biocon biologic has 28 products under development.

Small molecule business – Growth led by generic formulation portfolio (statin portfolio) in the US. PBIT margin stood at 22% as against 20% last year.

Branded formulations business in India and the UAE - In India, the Market Access and immunotherapy divisions reported a double digit growth but it was offset by muted performance in other segments. In the UAE, the business continued to decline after the price revision. However, the biosimilars Trastuzumab and Insuline Glargine continue to show growth and market share gains.

Acquisition of R&D facility – The company has acquired the R&D facility from Pfizer Healthcare. The company will turn it around and will employ close to 250 scientists from the facility.

R&D expenses – Management has guided for 13-15% as R&D expenses. It has also guided for higher expenses to meet its aspirational target of US\$1bn revenue from Biologics.

Licensing deal with CMS – Three US approved generics have been out-licensed to China Medical System, which will be responsible for registration and commercialization. Biocon will be responsible for manufacturing and supply of products. The three generic products have a market size of US\$800mn.

EBITDA – EBITDA margin declined 200bps on account of higher profit share expense, higher R&D expense and the new organizational structure that gives autonomy to each business and is positioned as an independent entity.

Exhibit 1: Actual performance versus our estimates, Bloomberg consensus estimates

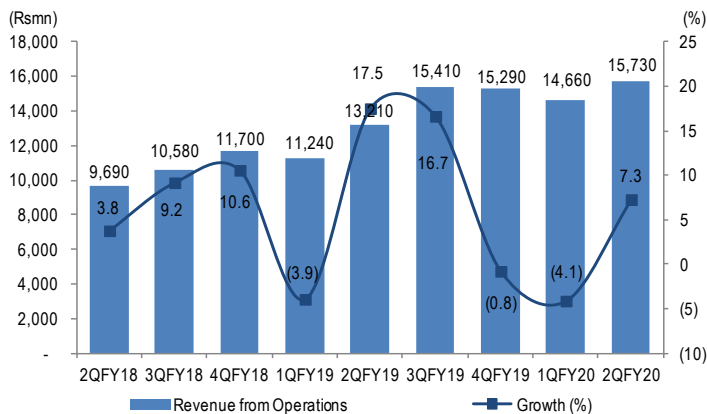
(Rsmn)	Actual	NBIE estimate	Var.(%)	Consensus estimate	Var.(%)
Revenues	15,730	15,192	3.5	15,572	1.0
EBITDA	4,040	4,610	(12.4)	4,383	(7.8)
EBITDA margin (%)	25.7	30.3	(466) bps	28.1	(247) bps
PAT	2,170	2,310	(6.1)	2,207	(1.7)

Source: Company, Nirmal Bang Institutional Equities Research

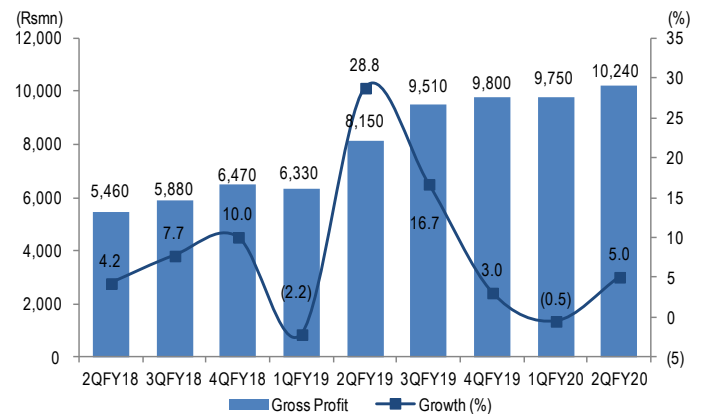
Exhibit 2: Key financials

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	41,300	55,140	69,035	77,244	86,792
EBITDA	8,290	13,930	21,095	23,543	26,688
Net profit	3,720	9,060	11,474	12,662	14,805
Adjusted EPS (Rs)	3.1	7.6	9.6	10.6	12.3
EPS growth (%)	(39.2)	143.5	26.6	10.4	16.9
EBITDA margin (%)	20.1	25.3	30.6	30.5	30.7
P/E (x)	77.4	32.5	25.6	23.2	19.9
P/BV (x)	5.6	4.8	4.3	3.8	3.4
EV/EBITDA (x)	34.7	21.1	13.9	12.3	10.6
RoCE (%)	7.4	14.2	20.9	21.4	22.1
RoE (%)	7.2	14.9	16.7	16.5	17.1

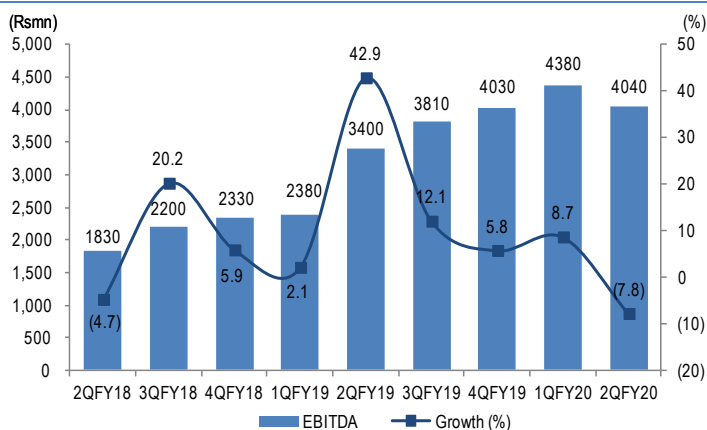
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Revenue and growth trend


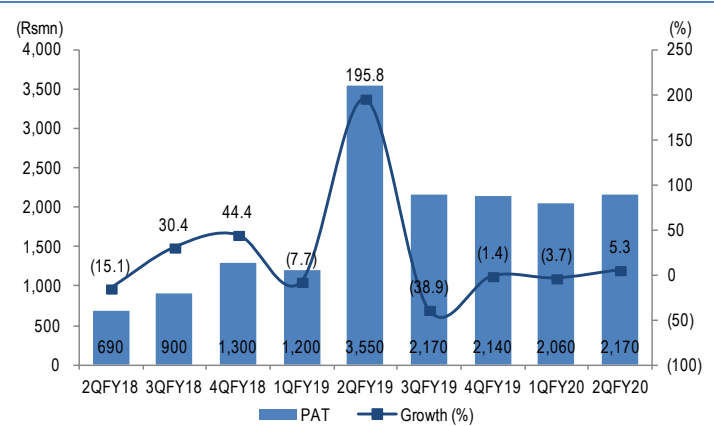
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Gross profit and growth trend


Source: Company, Nirmal Bang Institutional Equities Research

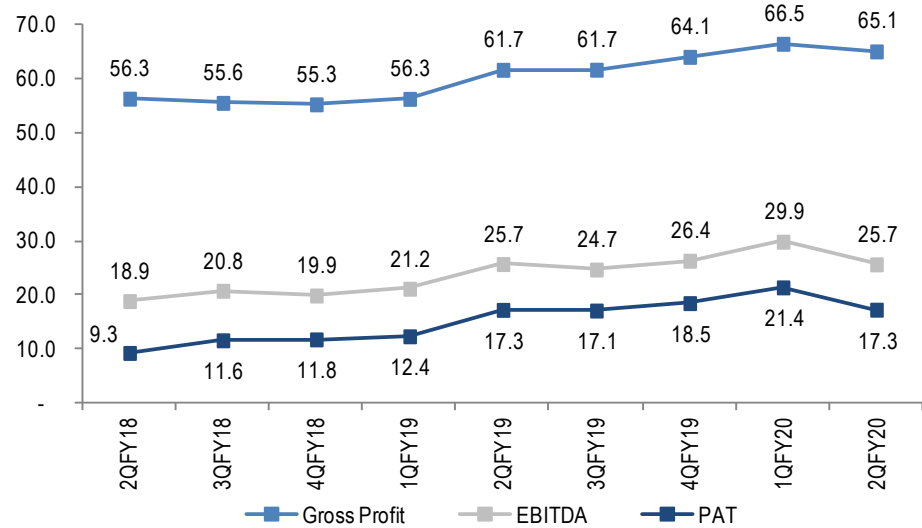
Exhibit 5: EBITDA


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: PAT


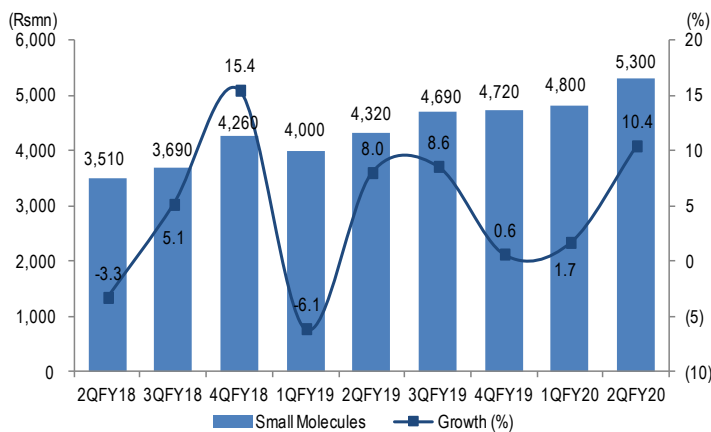
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Margin trend (%)



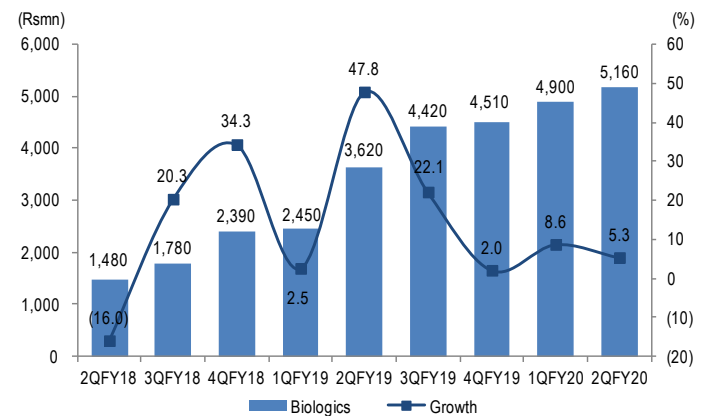
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Small molecules revenue and growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Biologics business revenue and growth trend



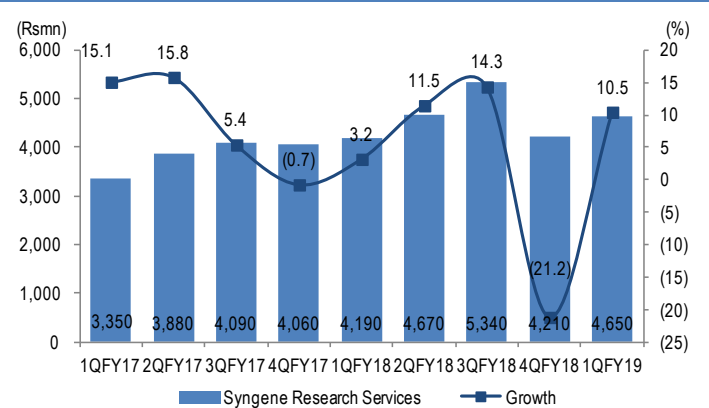
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Branded formulations revenue and growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Syngene revenue and growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements
Exhibit 12: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	41,300	55,140	69,035	77,244	86,792
% growth	5.3	33.5	25.2	11.9	12.4
Raw material costs	18,250	21,360	24,324	27,275	30,454
Staff costs	8,460	10,620	12,186	13,984	16,047
R&D expenditure	2,160	2,900	4,142	4,635	5,207
Other expenditure	4,140	6,330	7,287	7,807	8,396
Total expenditure	33,010	41,210	47,940	53,700	60,104
EBITDA	8,290	13,930	21,095	23,543	26,688
% growth	(15.4)	68.0	51.4	11.6	13.4
EBITDA margin (%)	20.1	25.3	30.6	30.5	30.7
Other income	2,060	1,440	1,509	1,417	1,741
Interest costs	610	710	534	698	688
Gross profit	23,050	33,780	44,711	49,969	56,338
% growth	(0.3)	46.6	32.4	11.8	12.7
Depreciation	3,850	4,480	5,104	5,469	5,793
Profit before tax	5,290	11,180	15,610	17,227	20,143
% growth	(31.7)	111.3	39.6	10.4	16.9
Tax	1,570	2,120	4,137	4,565	5,338
Effective tax rate (%)	29.7	19.0	26.5	26.5	26.5
Net profit	3,720	9,060	11,474	12,662	14,805
% growth	(39.2)	143.5	26.6	10.4	16.9
Adjusted EPS (Rs)	3.1	7.6	9.6	10.6	12.3
% growth	(39.2)	143.5	26.6	10.4	16.9

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity	3,000	3,000	3,000	3,000	3,000
Reserves	48,810	57,980	65,854	73,715	83,721
Net worth	51,810	60,980	68,854	76,715	86,721
Minority Interest	4,680	6,090	7,424	8,966	10,745
Total Debt	19,200	18,030	17,812	17,456	17,197
Other Non Current Liabilities	4,090	9,060	9,060	9,060	9,060
Liabilities	79,780	94,160	103,149	112,197	123,723
Net Block	36,300	42,530	45,574	48,276	50,860
Capital work-in-progress	7,790	12,870	12,222	12,255	12,567
Intangible Assets (IA)	690	2,180	2,180	2,180	2,180
IA under development	5,240	6,120	6,120	6,120	6,120
Other Non Current Assets	8,390	9,990	9,990	9,990	9,990
Current Investments	6,110	8,290	8,290	8,290	8,290
Inventories	7,230	10,320	12,426	13,904	15,622
Debtors	10,640	12,920	17,259	19,311	21,698
Cash	13,230	10,570	9,421	13,474	19,474
Other Current assets	4,280	6,140	6,140	6,140	6,141
Total Current assets	41,490	48,240	53,536	61,119	71,226
Trade payables	10,060	11,980	10,683	11,953	13,431
Other current liabilities/provisions	10,060	15,790	15,790	15,790	15,790
Total current liabilities	20,120	27,770	26,473	27,743	29,221
Net current assets	21,370	20,470	27,063	33,376	42,005
Total Assets	79,780	94,160	103,149	112,197	123,723

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
PAT	3,720	9,060	11,474	12,662	14,805
Depreciation	3,850	4,480	5,104	5,469	5,793
Other income	(2,060)	(1,440)	(1,509)	(1,417)	(1,741)
(Inc./dec. in working capital	1,540	420	(7,742)	(2,259)	(2,629)
Cash flow from operations	7,050	12,520	7,326	14,454	16,228
Capital expenditure	(7,080)	(15,790)	(7,500)	(8,203)	(8,690)
Net cash after capex	(30)	(3,270)	(174)	6,251	7,539
Other investment activities	4,890	(4,710)	1,509	1,417	1,741
Cash from financing activities	(2,070)	5,320	(2,484)	(3,615)	(3,279)
Opening cash balance	10,440	13,230	10,570	9,421	13,474
Closing cash balance	13,230	10,570	9,421	13,474	19,474
Change in cash balance	2,790	(2,660)	(1,149)	4,053	6,000

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Key ratios

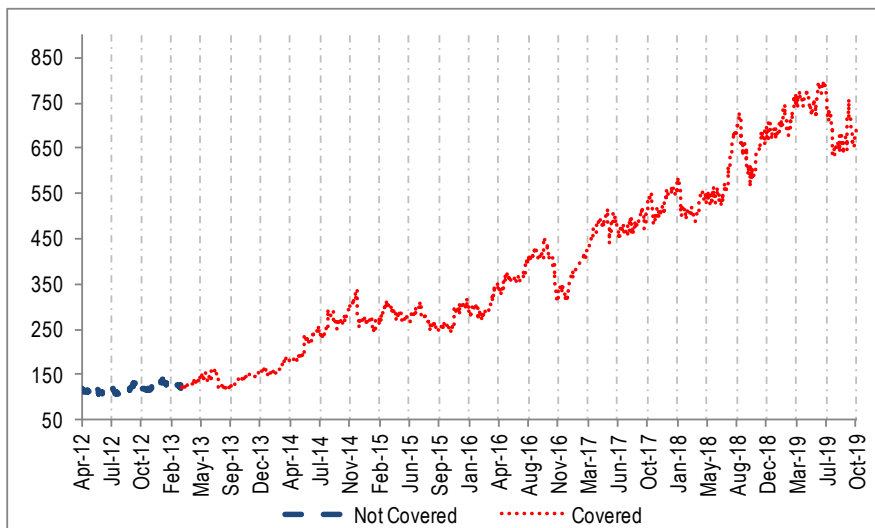
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Profitability & return ratios					
EBITDA margin (%)	20.1	25.3	30.6	30.5	30.7
EBIT margin (%)	10.8	17.1	23.2	23.4	24.1
Net profit margin (%)	9.0	16.4	16.6	16.4	17.1
RoE (%)	7.2	14.9	16.7	16.5	17.1
RoCE (%)	7.4	14.2	20.9	21.4	22.1
Working capital & Liquidity ratios					
Receivables (days)	85	77	79	85	85
Inventory (days)	134	148	168	174	175
Payables (days)	172	186	168	149	150
Working capital days	47	39	79	110	110
Current ratio (x)	2.1	1.7	2.0	2.2	2.4
Quick ratio (x)	1.7	1.4	1.6	1.7	1.9
Valuation ratios					
EV/Sales (x)	7.0	5.3	4.3	3.8	3.3
EV/EBITDA (x)	34.7	21.1	13.9	12.3	10.6
P/E (x)	77.4	32.5	25.6	23.2	19.9
P/BV (x)	5.6	4.8	4.3	3.8	3.4

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
10 June 2016	Sell	119	104
25 July 2016	Sell	135	105
11 August 2016	Sell	141	105
14 February 2017	Sell	179	122
2 May 2017	Sell	181	122
28 July 2017	Sell	195	124
27 October 2017	Sell	179	154
25 January 2018	Sell	304	167
27 April 2018	Sell	327	160
30 July 2018	Sell	291	160
29 October 2018	Sell	311	230
28 January 2019	Sell	325	230
26 April 2019	Sell	310	253
26 July 2019	Accumulate	239	257
24 October 2019	Accumulate	245	252

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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