

# Biocon

28 July 2017

Reuters: BION.BO; Bloomberg: BIOS IN

## Revenues Below Expectations

Biocon's revenues in 1QFY18 remained flattish at Rs9,337mn, posting sequential growth of 0.3% and YoY decline of 5%. They were below our/consensus estimates by 5%/6%, respectively. The revenue decline was on account of: sluggish API sales impacting the small molecule segment (down 8% QoQ), lower licencing income, channel destocking because of Goods and Services Tax or GST implementation in India, a weak US dollar impacting exports and continuous impact of Syngene performance after a fire incident there in December last year. Revival of growth in the near term hinges on successful approval and launch of biosimilars in emerging markets which, in our view, will be a gradual process and gain traction only in FY19. The contribution from developed markets for its biosimilar portfolio will be evident from FY20 onwards.

EBITDA stood at Rs1,921mn (and Rs2,461mn including other income), showing YoY decline of 27%. It was above our estimate by 2% and below consensus estimate by 8%. EBITDA margin stood at 21% (25% including other income). EBITDA was adversely impacted as costs relating to the Malaysian facility are now being charged to P&L account. During the quarter, an incremental cost of US\$12mn relating to the Malaysian facility was charged to P&L account. PAT declined 36%/51% on QoQ/YoY basis, respectively. It was 26%/25% below our/consensus estimate, respectively.

We have retained Sell rating on Biocon with a target price of Rs246 (revised from Rs739 earlier on account of the issue of bonus shares).

**Sell rating:** Our rating is based on the following:

### 1. Commercialisation hurdles

- Poor return on investment economics of its biosimilar portfolio as we believe the sales potential will not be commensurate with the investment in development of biosimilars.
- Barriers laid down by innovators in terms of improvement in offering over biosimilar options - combination and superior formulations.
- Lack of substitutability to limit adoption of biosimilars.
- Investment in marketing to limit the ability of biosimilar players to discount their copycat versions.

### 2. Regulatory risks: Our Sell rating is also because of regulatory risk in the form of:

- Approval delay- We are particularly concerned about significant delay in Biocon/Mylan's Pegfilgrastim approval in the US.

We are participating in AsiaMoney's Brokers Poll 2017. We would be pleased if you vote for us as the feedback helps us align our equity research offerings to meet your requirements. [Click Here](#)

## SELL

Sector: Pharmaceuticals

CMP: Rs391

Target Price: Rs246

Downside: 37%

**Vishal Manchanda**

Research Analyst

vishal.manchanda@nirmalbang.com

+91 9737437148

### Key Data

|                          |           |
|--------------------------|-----------|
| Current Shares O/S (mn)  | 600.0     |
| Mkt Cap (Rsbn/US\$bn)    | 234.5/3.7 |
| 52 Wk H / L (Rs)         | 439/256   |
| Daily Vol. (3M NSE Avg.) | 3,044,844 |

### Price Performance (%)

|             | 1 M  | 6 M  | 1 Yr |
|-------------|------|------|------|
| Biocon      | 19.2 | 15.0 | 42.2 |
| Nifty Index | 5.4  | 15.7 | 15.4 |

Source: Bloomberg

| Y/E March (Rsmn)                      | 1QFY17       | 4QFY17       | 1QFY18       | YoY (%)          | QoQ (%)         |
|---------------------------------------|--------------|--------------|--------------|------------------|-----------------|
| <b>Net revenues</b>                   | <b>9,920</b> | <b>9,311</b> | <b>9,337</b> | <b>(5.9)</b>     | <b>0.3</b>      |
| Raw material costs                    | 4,380        | 3,484        | 4,099        | (6.4)            | 17.7            |
| % of revenues                         | 44.2         | 37.42        | 43.90        | (25 bps)         | 648 bps         |
| Staff costs                           | 1,642        | 1,939        | 1,931        | 17.6             | (0.4)           |
| % of revenues                         | 16.6         | 20.8         | 20.7         | 413 bps          | (14 bps)        |
| R&D                                   | 514.0        | 650          | 582          | 13.2             | (10.5)          |
| % of revenues                         | 5.2          | 7.0          | 6.2          | 105 bps          | (75bps)         |
| Other expenses                        | 753          | 1,363        | 804          | 6.8              | (41.0)          |
| % of revenues                         | 7.6          | 14.6         | 8.6          | 13.4             | (41.2)          |
| <b>EBITDA</b>                         | <b>2,631</b> | <b>1,875</b> | <b>1,921</b> | <b>(27.0)</b>    | <b>2.5</b>      |
| <b>EBITDA margin (%)</b>              | <b>26.5</b>  | <b>20.1</b>  | <b>20.6</b>  | <b>(595 bps)</b> | <b>44 bps</b>   |
| Other income                          | 409          | 432          | 540          | 32.0             | 25.0            |
| Interest costs                        | 57           | 50           | 161          | 182.5            | 222.0           |
| Depreciation                          | 661          | 725          | 988          | 49.5             | 36.3            |
| <b>PBT</b>                            | <b>2,322</b> | <b>1,532</b> | <b>1,312</b> | <b>(43.5)</b>    | <b>(14.4)</b>   |
| Tax                                   | 552          | 103          | 376          | (31.9)           | 265.0           |
| Tax rate (%)                          | 23.8         | 6.7          | 28.7         | 489 bps          | 2,194 bps       |
| Share of Profit and Minority interest | (104)        | (154)        | (123)        | 18.3             | (20.1)          |
| <b>Reported PAT</b>                   | <b>1,666</b> | <b>1,275</b> | <b>813</b>   | <b>(51.2)</b>    | <b>(36.2)</b>   |
| <b>PAT margin (%)</b>                 | <b>16.79</b> | <b>13.69</b> | <b>8.71</b>  | <b>(809bps)</b>  | <b>(499bps)</b> |

Source: Company, Nirmal Bang Institutional Equities Research

## Earnings conference-call highlights

- a) **Outlook:** Biocon remains cautious in FY18. The small molecule segment is expected to face its regular pricing challenge. Biologics segment can show growth, but will be dependent on tender outcome and regulatory approval in emerging markets. Syngene's research services are expected to be back on the high-teen growth trajectory. Branded formulations will also post growth as the GST impact is expected to taper off in the coming quarters.
- b) **R&D expenses:** During the quarter, R&D expenses stood at Rs0.96bn of which Rs0.38bn have been capitalised and Rs0.58bn adjusted in P&L account.
- c) **Malaysian insulin facility:** Biocon expects to make an annual charge worth US\$48mn in FY18. While the plant has been inspected by the European authority, the USFDA inspection is awaited.
- d) **Syngene's research business:** During the quarter, sustained impact of the fire in December last year was witnessed. However, this business is on the path of recovery. The agreement with Amgen has been modified with respect to scope and size. It will now involve increased headcount, doubling infrastructure allocation and increased R&D activity. Biocon has also signed an agreement with a Japanese pharmaceutical company for the commercial launch of a new chemical entity or NCE, of which it has been a part since the Proof of Concept stage.
- e) **Biologics business:** The guidance stands at US\$200mn which will mainly flow from approvals in various jurisdictions in emerging markets. Europe will also contribute to it in a small way by FY19.
- f) **Pegfilgrastim:** The TAD for this molecule is due in October this year. Biocon is not sure if an advisory committee will be constituted to decide whether to approve Biocon's biosimilar version of this molecule.
- g) **Insulin-Glargine:** Biocon has filed for the dossier in Europe in November 2016. Currently, it is in talks with the USFDA to enable filing for the same in the US. Filing will be through 505(B)(2) and not through the biosimilar pathway.
- h) **Copaxone filing:** Biocon will file a response to the Complete Response Letter (CRL) received from the USFDA by the end of FY18. The company is not factoring in revenues from this opportunity in FY18.

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

| (Rsmn)            | Actual | NBIE est. | Chg. (%) | Bloomberg cons. est. | Chg. (%) |
|-------------------|--------|-----------|----------|----------------------|----------|
| Sales             | 9,337  | 9,824     | (5.0)    | 9,919                | (5.9)    |
| EBITDA            | 1,921  | 1,889     | 1.7      | 2,098                | (8.4)    |
| EBITDA margin (%) | 21     | 19        | 135 bps  | 21                   | (58 bps) |
| Reported PAT      | 813    | 1,111     | (26.8)   | 1,084                | (25.0)   |

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Key financials

| Y/E March (Rsmn)  | FY15   | FY16   | FY17   | FY18E  | FY19E  |
|-------------------|--------|--------|--------|--------|--------|
| Net sales         | 30,486 | 33,810 | 39,216 | 45,909 | 52,278 |
| EBITDA            | 6,545  | 7,678  | 9,795  | 10,889 | 13,339 |
| Net profit        | 4,973  | 6,091  | 6,881  | 5,972  | 7,042  |
| Adjusted EPS (Rs) | 8      | 10     | 11     | 10     | 12     |
| EPS growth (%)    | 20.2   | 22.5   | 13.0   | (13.2) | 17.9   |
| EBITDA margin (%) | 21.5   | 22.7   | 25.0   | 23.7   | 25.5   |
| PER (x)           | 47.2   | 38.5   | 34.1   | 39.3   | 33.3   |
| P/BV (x)          | 7.2    | 5.8    | 4.8    | 4.4    | 4.0    |
| EV/EBITDA (x)     | 35.6   | 30.6   | 24.0   | 21.6   | 17.2   |
| RoCE (%)          | 11.8   | 8.8    | 11.3   | 9.6    | 11.1   |
| RoE (%)           | 15.2   | 15.1   | 14.2   | 11.2   | 12.1   |

Source: Company, Nirmal Bang Institutional Equities Research

## Financial statements

### Exhibit 3: Income statement

| Y/E March (Rsmn)         | FY15          | FY16          | FY17          | FY18E         | FY19E         |
|--------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Net sales</b>         | <b>30,486</b> | <b>33,810</b> | <b>39,216</b> | <b>45,909</b> | <b>52,278</b> |
| % growth                 | 7.1           | 10.9          | 16.0          | 17.1          | 13.9          |
| Raw material costs       | 12,561        | 13,240        | 14,771        | 18,175        | 20,255        |
| Staff costs              | 5,334         | 6,101         | 7,470         | 8,302         | 9,753         |
| R&D expenses             | 1,688         | 2,655         | 2,724         | -             | -             |
| Other expenses           | 4,358         | 4,136         | 4,456         | 8,544         | 8,931         |
| Total expenditure        | 23,941        | 26,132        | 29,421        | 35,020        | 38,939        |
| <b>EBITDA</b>            | <b>6,545</b>  | <b>7,678</b>  | <b>9,795</b>  | <b>10,889</b> | <b>13,339</b> |
| % growth                 | (0.1)         | 17.3          | 27.6          | 11.2          | 22.5          |
| <b>EBITDA margin (%)</b> | <b>21.5</b>   | <b>22.7</b>   | <b>25.0</b>   | <b>23.7</b>   | <b>25.5</b>   |
| Other income             | 943           | 792           | 1,571         | 2,200         | 2,100         |
| Interest                 | 89            | 293           | 260           | 360           | 380           |
| Gross profit             | 17,925        | 20,570        | 24,445        | 27,734        | 32,023        |
| % growth                 | 8.0           | 14.8          | 18.8          | 13.5          | 15.5          |
| Depreciation             | 2,210         | 2,487         | 2,772         | 4,015         | 4,806         |
| Profit before tax        | 5,930         | 7,513         | 8,497         | 7,714         | 9,092         |
| % growth                 | 13.9          | 26.7          | 13.1          | (9.2)         | 17.9          |
| Tax                      | 957           | 1,422         | 1,616         | 1,743         | 2,050         |
| Effective tax rate (%)   | 16.1          | 18.9          | 19.0          | 22.6          | 22.6          |
| <b>Net profit</b>        | <b>4,973</b>  | <b>6,091</b>  | <b>6,881</b>  | <b>5,972</b>  | <b>7,042</b>  |
| % growth                 | 20.2          | 22.5          | 13.0          | (13.2)        | 17.9          |
| <b>Adjusted EPS (Rs)</b> | <b>8</b>      | <b>10</b>     | <b>11</b>     | <b>10</b>     | <b>12</b>     |
| % growth                 | 20.2          | 22.5          | 13.0          | (13.2)        | 17.9          |

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 5: Balance sheet

| Y/E March (Rsmn)                     | FY15          | FY16          | FY17          | FY18E         | FY19E         |
|--------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Equity                               | 1,000         | 1,000         | 1,000         | 1,000         | 1,000         |
| Reserves                             | 31,622        | 39,338        | 47,377        | 52,149        | 57,390        |
| Net worth                            | 32,622        | 40,338        | 48,377        | 53,149        | 58,390        |
| Minority Interest                    | 1,121         | 2,658         | 3,761         | 4,760         | 5,920         |
| Total debt                           | 10,281        | 24,673        | 22,054        | 23,412        | 23,019        |
| Deferred tax liabilities             | -             | -             | -             | 346           | 346           |
| Other non-current liabilities        | 5,931         | 4,204         | 3,939         | 3,802         | 3,802         |
| <b>Liabilities</b>                   | <b>49,955</b> | <b>71,873</b> | <b>78,131</b> | <b>85,468</b> | <b>91,478</b> |
| Net block                            | 15,982        | 16,811        | 35,529        | 40,054        | 40,135        |
| Capital work-in-progress             | 15,582        | 20,597        | 5,327         | 9,885         | 9,803         |
| Non-current Investments              | 395           | 268           | 1,888         | -             | -             |
| Other non-current assets             | 6,610         | 7,196         | 10,721        | 5,783         | 5,783         |
| Current investments                  | 2,478         | 8,747         | 10,650        | 4,285         | 4,285         |
| Inventories                          | 4,756         | 5,424         | 6,353         | 6,504         | 7,177         |
| Debtors                              | 6,833         | 7,145         | 8,832         | 11,242        | 12,404        |
| Cash                                 | 9,204         | 15,386        | 10,443        | 18,439        | 23,333        |
| Other current assets                 | 1,479         | 3,007         | 4,199         | 3,091         | 3,091         |
| Total current assets                 | 24,750        | 39,709        | 40,477        | 43,561        | 50,290        |
| Trade payables                       | 4,126         | 6,098         | 7,397         | 6,958         | 7,678         |
| Other current liabilities/provisions | 9,238         | 6,610         | 8,414         | 6,856         | 6,856         |
| Total current liabilities            | 13,364        | 12,708        | 15,811        | 13,814        | 14,534        |
| Net current assets                   | 11,386        | 27,001        | 24,666        | 29,746        | 35,756        |
| <b>Total assets</b>                  | <b>49,955</b> | <b>71,873</b> | <b>78,131</b> | <b>85,468</b> | <b>91,478</b> |

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 4: Cash flow

| Y/E March (Rsmn)               | FY15     | FY16    | FY17    | FY18E    | FY19E   |
|--------------------------------|----------|---------|---------|----------|---------|
| PAT                            | 4,973    | 6,091   | 6,881   | 5,972    | 7,042   |
| Depreciation                   | 2,210    | 2,487   | 2,772   | 4,015    | 4,806   |
| Other income                   | (943)    | (792)   | (1,571) | (2,200)  | (2,100) |
| (Inc.)/dec. in working capital | 275      | (3,164) | (705)   | (3,450)  | (1,116) |
| Cash flow from operations      | 6,515    | 4,622   | 7,377   | 4,337    | 8,632   |
| Capital expenditure            | (33,774) | (8,331) | (6,220) | (13,098) | (4,806) |
| Net cash after capex           | (27,259) | (3,709) | 1,157   | (8,761)  | 3,826   |
| Other investment activities    | 29,582   | (5,936) | (5,477) | 15,391   | 2,100   |
| Cash from financing activities | (1,163)  | 15,827  | (623)   | 1,366    | (1,032) |
| Opening cash balance           | 8,044    | 9,204   | 15,386  | 10,443   | 18,439  |
| Closing cash balance           | 9,204    | 15,386  | 10,443  | 18,439   | 23,333  |
| Change in cash balance         | 1,160    | 6,182   | (4,943) | 7,996    | 4,894   |

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 6: Key ratios

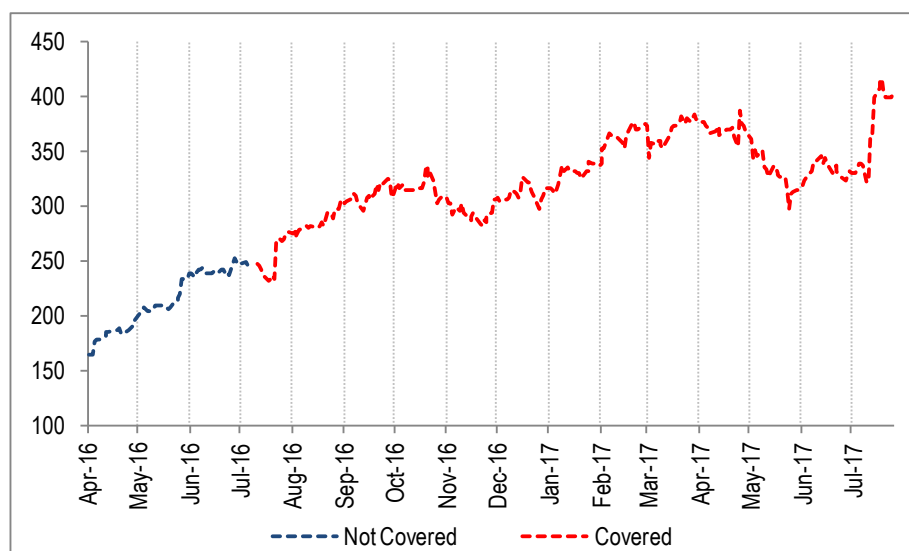
| Y/E March                                     | FY15  | FY16  | FY17  | FY18E | FY19E |
|-----------------------------------------------|-------|-------|-------|-------|-------|
| <b>Profitability &amp; return ratios</b>      |       |       |       |       |       |
| EBITDA margin (%)                             | 21.5  | 22.7  | 25.0  | 23.7  | 25.5  |
| EBIT margin (%)                               | 14.2  | 15.4  | 17.9  | 15.0  | 16.3  |
| Net profit margin (%)                         | 16.3  | 18.0  | 17.5  | 13.0  | 13.5  |
| RoE (%)                                       | 15.2  | 15.1  | 14.2  | 11.2  | 12.1  |
| RoCE (%)                                      | 11.8  | 8.8   | 11.3  | 9.6   | 11.1  |
| <b>Working capital &amp; Liquidity ratios</b> |       |       |       |       |       |
| Receivables (days)                            | 75.8  | 74.4  | 73.3  | 78.7  | 81.4  |
| Inventory (days)                              | 122.1 | 138.4 | 143.5 | 127.3 | 121.6 |
| Payables (days)                               | 108.9 | 139.0 | 164.5 | 142.2 | 130.1 |
| Working capital days                          | 89.0  | 73.8  | 52.4  | 63.9  | 72.9  |
| Current ratio (x)                             | 1.9   | 3.1   | 2.6   | 3.2   | 3.5   |
| Quick ratio (x)                               | 1.5   | 2.7   | 2.2   | 2.7   | 3.0   |
| <b>Valuation ratios</b>                       |       |       |       |       |       |
| EV/Sales (x)                                  | 7.6   | 7.0   | 6.0   | 5.1   | 4.4   |
| EV/EBITDA (x)                                 | 35.6  | 30.6  | 24.0  | 21.6  | 17.2  |
| P/E (x)                                       | 47.2  | 38.5  | 34.1  | 39.3  | 33.3  |
| P/BV (x)                                      | 7.2   | 5.8   | 4.8   | 4.4   | 4.0   |

Source: Company, Nirmal Bang Institutional Equities Research

## Rating track

| Date             | Rating | Market price | Target price (Rs) |
|------------------|--------|--------------|-------------------|
| 10 June 2016     | Sell   | 721          | 630               |
| 25 July 2016     | Sell   | 809          | 630               |
| 11 August 2016   | Sell   | 835          | 630               |
| 14 February 2017 | Sell   | 1,080        | 739               |
| 2 May 2017       | Sell   | 1,104        | 739               |
| 28 July 2017     | Sell   | 386          | 246               |

## Rating Track Graph



## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

This report is published by Nirmal Bang's Institutional Equities Research desk. Nirmal Bang group has other business units with independent research teams separated by Chinese walls, and therefore may, at times, have different or contrary views on stocks and markets. Reports based on technical and derivative analysis may not match with reports based on a company's fundamental analysis. This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information for the clients of Nirmal Bang Equities Pvt. Ltd., a division of Nirmal Bang, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

Nirmal Bang or any persons connected with it do not accept any liability arising from the use of this document or the information contained therein. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information. Nirmal Bang or any of its connected persons including its directors or subsidiaries or associates or employees or agents shall not be in any way responsible for any loss or damage that may arise to any person/s from any inadvertent error in the information contained, views and opinions expressed in this publication.

*Nirmal Bang Equities Private Limited (hereinafter referred to as "NBEPL") is a registered Member of National Stock Exchange of India Limited, Bombay Stock Exchange Limited. NBEPL has registered with SEBI as a Research Entity in terms of SEBI (Research Analyst) Regulations, 2014. (Registration No: INH000001436 - 19.08.2015 to 18.08.2020).*

*NBEPL or its associates including its relatives/analyst do not hold any financial interest/beneficial ownership of more than 1% in the company covered by Analyst.*

*NBEPL or its associates/analyst has not received any compensation from the company covered by Analyst during the past twelve months. NBEPL /analyst has not served as an officer, director or employee of company covered by Analyst and has not been engaged in market-making activity of the company covered by Analyst.*

*The views expressed are based solely on information available publicly and believed to be true. Investors are advised to independently evaluate the market conditions/risks involved before making any investment decision.*

**Access all our reports on Bloomberg, Thomson Reuters and Factset.**

| Team Details:  |                  |                               |                                         |
|----------------|------------------|-------------------------------|-----------------------------------------|
| Name           |                  | Email Id                      | Direct Line                             |
| Rahul Arora    | CEO              | rahul.arora@nirmalbang.com    | -                                       |
| Girish Pai     | Head of Research | girish.pai@nirmalbang.com     | +91 22 3926 8017 / 18                   |
| Dealing        |                  |                               |                                         |
| Ravi Jagtiani  | Dealing Desk     | ravi.jagtiani@nirmalbang.com  | +91 22 3926 8230, +91 22 6636 8833      |
| Pradeep Kasat  | Dealing Desk     | pradeep.kasat@nirmalbang.com  | +91 22 3926 8100/8101, +91 22 6636 8831 |
| Michael Pillai | Dealing Desk     | michael.pillai@nirmalbang.com | +91 22 3926 8102/8103, +91 22 6636 8830 |
| Atul Vitha     | Dealing Desk     | atul.vitha@nirmalbang.com     | 022-3926 8071 / 022 -3926 8226          |

## Nirmal Bang Equities Pvt. Ltd.

### Correspondence Address

B-2, 301/302, Marathon Innova,  
 Nr. Peninsula Corporate Park,  
 Lower Parel (W), Mumbai-400013.  
 Board No. : 91 22 3926 8000/1; Fax. : 022 3926 8010