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DOWNSIDE RISKS include exit of US partner from oral insulin project, capex on biosimilars and impact of demonetisation

Biocon has Little Room to Slip Up After Strong 2016

ET ANALYSIS

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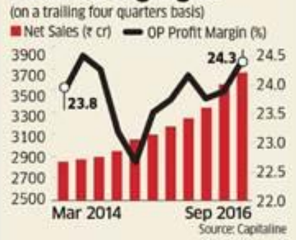
ET Intelligence Group: The past year was special for Biocon even as it was a difficult one for most Indian pharmaceutical companies. With a gain of 82%, it was the best-performing stock in the ET Pharma Index — the index itself lost more than 12% in 2016. A host of reasons, such as the progress made by its biosimilar pipeline, gains from listing of its subsidiary Syngene and the fact that not many companies were doing well, helped Biocon to outperform.

The question now is what lies ahead in 2017?

Biocon has been the classic case of the Street discounting future returns, leaving little room for negative surprises. The progress of the regulatory filing of its biosimilars in the regulated markets of Japan and the European Union, launch of biosimilars in emerging markets and building of a product pipeline have proved to be the positive triggers last year. Valuations of Syngene International doubled since listing in August 2015. The TINA (there is no alternative) factor also worked in its favour. Little wonder, the institutional holding in Biocon has steadily risen to 21% over the past several quarters.

Biocon Consolidated Financial Highlights

(on a trailing four quarters basis)



Source: Capitaline

CAUTIOUS OPTIMISM

Only 38% of analysts tracking Biocon have a buy on it, shows Bloomberg data

However, there are certain caveats to the estimated growth. Biocon's oral insulin project suffered a setback after the exit of its US partner, BMS. Opportunities of monetising biosimilars in the EU and the US are likely to take 18-24 months to materialise. The entire exercise of development and commercialisation of the biosimilars pipeline involves capital expenditure and is fraught with uncertainty.

The current stock valuation hardly gives any room to account for a delay or uncertain outcomes. Biocon is trading at 33 times FY17 estimated earnings, higher than that of Sun Pharma, Lupin, Dr Reddy's and Glenmark Pharmaceuticals.

At the end of 2015, 70% of analysts tracking the Biocon stock had a buy recommendation on it. Data from Bloomberg show that this number has almost halved to 38% now.

Analysts are cautiously optimistic in the near term and expect the company's performance over the next few quarters to be lacklustre — impacted by headwinds in its branded formulations segment, high R&D cost (of 12% of its biopharma revenue), accounting of revenue expenditure related to the Malaysian facility, adverse impact of price control and demonetisation on domestic sales. The management's commentary after third-quarter results should provide further clarity to investors.