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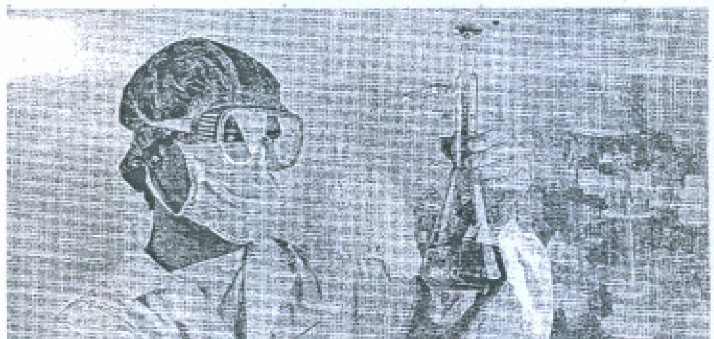
FERMENTING PROFITS

Key hurdles of high costs and regulatory uncertainty easing; major gains for drug firms in bio-pharma space expected post 2012



RAM PRASAD SAHU

Miscellaneous

Biocon's recent \$350-million deal with Pfizer has put the spotlight on the potential for revenue generation in the bio-pharma space. Regulatory issues in the EU and the US remain but given that by 2014 over half of the drugs by sales worldwide will be bio-pharma products (drugs manufactured using biological substances), Indian drug companies are investing in sprucing their biotech research and are acquiring companies in this space.

Over the last six months, while Cipla invested ₹300 crore to acquire two biotech firms; Piramal Healthcare has increased its stake in Canadian biotech firm BioSyntech. Earlier this year, Ranbaxy, which has a presence in this space through a majority stake in Zenotech, acquired Biovel, a Bangalore-based biotech company. Lupin, which is looking to launch its first bio-similar drug in the Indian market by mid-2011, expects to generate about 5-7 per cent of its revenues in the next five years from the biotech business.

The potential

Action on the bio-similar (copies of patented bio-pharma products) drug front is likely to intensify after 2012 when patents on bio-pharmaceuticals expire. A Nomura report estimates that the potential market for bio-similars will increase by \$10 billion every year from 2012, with the potential market size reaching about \$80 billion by 2020. So far, the high cost of manufacture and distribution and uncertainty due to the process of regulatory approval had been the key concerns of pharma companies. Analysts at Nomura say technological advances, which have led to a drop in manufacturing costs, and the need for developed countries to cut healthcare costs would mean that authorities are likely to approve inexpensive and effective bio-similars.

EYEING THE BIO-PHARMA MARKET

FY12E	Sales	Ebidta	PAT	P/E (x)
Biocon	3,090	635	430	20.0
Dr Reddy's	8,450	1,800	1,150	24.1
Cadila	5,300	1,166	835	17.9
Ranbaxy*	9,200	2,085	1,200	19.7
Lupin	6,690	1,310	1,098	23.2

Estimates in ₹crore; *CY 2011 Source: Analyst reports

The Indian market for bio-pharma drugs, believes Sanjay Singh, associate director, KPMG, is worth ₹8,800 crore (2009-10) with about 90 per cent being bio-similar drugs. While the bio-pharma segment has grown at 18 per cent and 13 per cent in 2008-09 and 2009-10, respectively, it is expected to grow 10-15 per cent annually.

Compared to small molecule drugs (which are based on chemical synthesis), the drop in prices and the number of players in bio-similars will be lower, helping companies earn better margins, believes Singh.

We look at the prospects of the major listed players in this segment.

Biocon

Biocon's scrip is up 21 per cent, over the last one month to near ₹432, on the back of its tie-up with Pfizer and good September results. The company will get \$200 million as upfront payment from Pfizer, which will enable the latter to market insulin bio-similars globally. The company would also get a further \$150 million as milestone payments as well as sales-linked income. Biocon's insulin product portfolio would constitute about 10-14 per cent of the 2009-10 sales of ₹2,400 crore, believes Kotak Securities. While analysts are bullish on the company's prospects, the recent spike in its share price already reflects the deal with Pfizer and Biocon's near-term growth prospects. Citi analysts advise **buying the stock at ₹400 levels.**

Dr Reddy's Laboratories

A key player in this space, the company is getting ready to launch its fourth bio-similar product in the country. It has a pipeline of eight generic bio-pharma drugs in various stages of development, with two in clinical development targeting oncology, auto-immune diseases and CNS. While the share of revenues from this segment is not much currently, once the company takes the launched products to emerging markets and starts to develop generic versions of patented drugs after 2012, bio-similars will form a sizeable chunk of its revenues, believe analysts. Given its pipeline of first-to-files and growth prospects for the core pharmaceuticals business, analysts have pegged the price target at ₹1,650. **Buy on dips.**

Zydus Cadila

The company manufactures and markets Erythropoetin, a drug that stimulates red blood cell production. While Zydus has indicated that it plans to enter the bio-similar market in a big way, Elara Securities believes there could be a possibility of an outlicensing deal with a global major for contract manufacturing of biotech/bio-similar products. The research firm believes that domestic formulations, US generics and consumer healthcare will trigger growth, with Ebitda margins jumping 300 basis points to 24 per cent by 2012-13 on the back of the chronic diseases portfolio. The stock is up about 13 per cent over the last month. At ₹714, it discounts all near-term upsides. **Buy on dips.**