India I Equities

Pharmaceuticals

Initiating Coverage

13 April 2015

Vivimed Labs

Good times ahead, attractive valuations; initiating, with a Buy

Rating: **Buy**
Target Price: ₹600
Share Price: ₹366

We initiate coverage on Vivimed Labs with a Buy rating and a target price of ₹600. We expect strong growth in its pharmaceutical business—driven by US generics and branded formulations—and an improved balance sheet. The API segment is likely to report better profitability led by higher utilisation and an improved product mix. We estimate a 29% PAT CAGR over FY15-17. Successful monetisation of its land at the Vizag SEZ could offer further upside.

Ingredients in place to boost the pharmaceuticals business. Vivimed has built its pharma business chiefly through acquisitions. We expect the API segment to report a 9.5% CAGR in revenue over FY15-17, powered primarily by customised manufacturing operations (CMO) for innovators where capacity is available and orders are in place. The formulations segment is likely to report a 37% CAGR in revenue, fuelled by the start of US generics supplies (with five products in FY16), higher-than-industry growth in domestic branded formulations and a steady increase in contract formulations manufacturing for the domestic market, in our view.

Steady growth to continue in specialty chemicals. Vivimed has built a strong franchise in specialty chemicals across the personal-care, home-care and industrial segments. Its customers are large multinationals such as Unilever, P&G and L'Oreal. We expect revenue from specialty chemicals to report a 10% CAGR over FY15-17, driven by an increase in volumes.

Financials to improve. We expect Vivimed to register CAGRs of 15% in revenue and 29% in PAT over FY15-17. Strong profitability growth could lead to better RoE and RoCE from the current 12.4% and 8%, respectively, to 15.8% and 11.2% by FY17, in our view. Leverage could also decrease, with debt-equity falling to 0.8x by FY17, from 1.4x now.

Valuation. Our target price of ₹600 is based on 8x FY17e EPS. **Risks:** Delay in regulatory approvals and currency fluctuations.

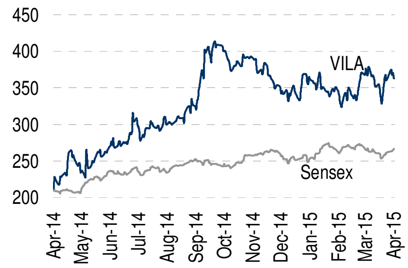
Key financials (YE Mar)	FY13	FY14	FY15e	FY16e	FY17e
Sales (₹ m)	11,088	13,508	13,926	16,172	18,420
Net profit (₹ m)	836	664	730	915	1,215
EPS (₹)	51.6	41.0	45.0	56.5	75.0
Growth (%)	32.4	-20.6	9.9	25.5	32.7
PE (x)	7.2	9.0	8.2	6.5	4.9
EV/EBITDA (x)	6.3	6.7	5.9	4.9	4.2
P/B (x)	1.3	1.2	1.0	0.8	0.7
RoE (%)	17.0	12.4	12.3	13.7	15.8
RoCE (%)	9.9	8.0	8.3	10.4	11.2
Dividend yield (%)	1.4	1.7	0.9	1.1	1.4
Net gearing (%)	109.1	132.7	116.5	100.7	84.2

Source: Company

Key data	VILA IN / VVMD.BO
52-week high/low	₹425/ ₹191
Sensex/Nifty	29044 / 8834
3-m average volume	US$0.52m
Market cap	₹5.9bn/ US$ 0.1bn
Shares outstanding	16.2m

Shareholding pattern (%)	Dec '14	Sep'14	Jun '14
Promoters	38.1	38.1	38.1
- of which, Pledged	25.2	19.2	17.0
Free Float	61.9	61.9	61.9
- Foreign Institutions	27.7	27.7	27.6
- Domestic Institutions	0.1	0.3	2.3
- Public	34.1	33.9	31.9

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Net revenues	11,088	13,508	13,926	16,172	18,420
Revenue growth (%)	66	22	3	16	14
- Oper. expenses	9,230	11,458	11,628	13,464	15,288
EBITDA	**1,858**	**2,051**	**2,298**	**2,709**	**3,131**
EBITDA margin (%)	16.8	15.2	16.5	16.8	17.0
- Interest expenses	409	603	771	771	771
- Depreciation	588	661	698	763	801
+ Other income	119	82	30	30	39
- Tax	143	205	129	289	384
Effective tax rate (%)	15	24	15	24	24
Reported PAT	836	664	730	915	1,215
+/- Extraordinary items	0	0	0	0	0
+/- Minority interest	0	0	0	0	0
Adjusted PAT	836	664	730	915	1,215
Adj. FDEPS (₹/sh)	51.6	41.0	45.0	56.5	75.0
Adj. FDEPS growth (%)	32.4	-20.6	9.9	25.5	32.7

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Share capital	800	802	802	802	802
Reserves & surplus	4,291	4,802	5,472	6,313	7,429
Net worth	5,091	5,604	6,274	7,115	8,230
Minority interest	0	0	0	0	0
Total debt	5,980	8,121	8,121	8,121	8,121
Def. tax liab. (net)	172	255	255	255	255
Capital employed	**11,244**	**13,979**	**14,649**	**15,490**	**16,606**
Net fixed assets	7,360	8,460	8,762	8,749	8,699
Investments	2	2	2	2	2
- of which, Liquid	0	0	0	0	0
Net working capital	3,642	5,171	5,366	6,039	6,924
Cash and bank balance	240	346	518	699	980
Capital deployed	**11,244**	**13,979**	**14,649**	**15,490**	**16,606**
Net debt	5741	7775	7603	7422	7141
WC days	139.6	151.8	163.9	151.7	150.0
Book value (₹/sh)	277.2	306.4	387.2	439.1	507.9

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
PAT	836	664	730	915	1,215
+Non-cash items	607	666	698	763	801
Cash profit	1,444	1,330	1,428	1,678	2,015
- Incr./(Decr.) in WC	(274)	1,528	196	673	886
Operating cash flow	1,718	(198)	1,232	1,006	1,130
-Capex	1,911	1,762	1,000	750	750
Free-cash-flow	(193)	(1,960)	232	256	380
-Dividend	75	57	59	74	99
+ Equity raised	0	0	0	0	0
+ Debt raised	538	2,140	0	0	0
-Investments	(5)	0	0	0	0
-Misc. items	399	18			
Net cash-flow	(124)	106	173	181	281
+Opening cash	363	240	346	518	699
Closing cash	240	346	518	699	980

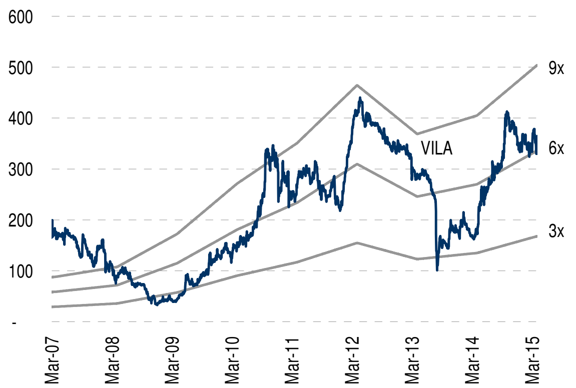
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹366

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
P/E (x)	7.2	9.0	8.2	6.5	4.9
P/B (x)	1.3	1.2	1.0	0.8	0.7
EV/EBITDA (x)	6.3	6.7	5.9	4.9	4.2
RoE (%)	17.0	12.4	12.3	13.7	15.8
RoCE (%)	9.9	8.0	8.3	10.4	11.2
Dividend yield (%)	1.4	1.7	0.9	1.1	1.4
Dividend payout (%)	7.8	7.3	7.0	7.0	7.0
Asset turnover (x)	0.8	0.8	0.7	0.8	0.9
Net Debt/Equity (x)	1.1	1.3	1.2	1.0	0.8
Net debt/EBITDA (x)	3.1	3.8	3.3	2.7	2.3
Net debt/Op. CF (x)	3.3	-39.2	6.2	7.4	6.3
Interest coverage (x)	3.1	2.3	2.1	2.5	3.0
P/CEPS (x)	4.2	4.5	4.2	3.6	3.0
EV/ sales (x)	1.1	1.0	1.0	0.8	0.7
M-cap/sales (x)	0.5	0.4	0.4	0.4	0.3

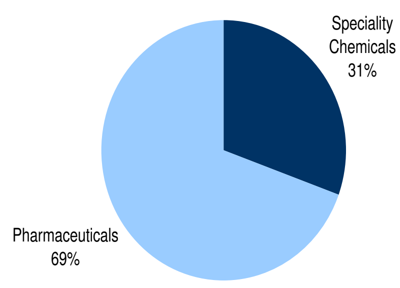
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Segment-wise revenue break-up (FY14)



Source: Company

Pharmaceuticals ready to take off

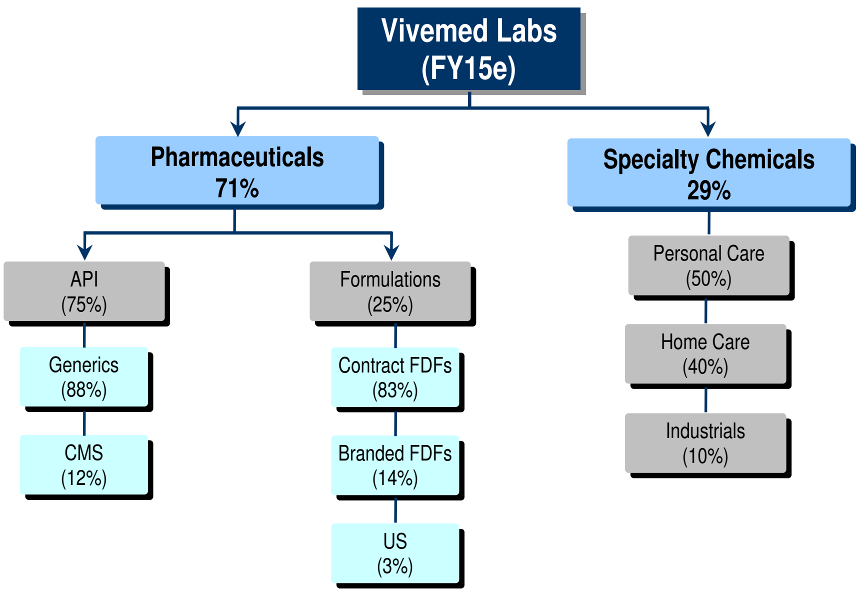
- Vivimed's pharmaceutical division comprises contract manufacturing, APIs, branded formulations and US generic formulations.

The pharmaceuticals segment to be the key growth driver, with a 17% revenue CAGR over FY15-17, driven by US generics and branded formulations

- We believe that formulations would be its key growth driver, propelled by the start of supplies of US generics with five products in FY16 ($22m in FY17), higher-than-industry growth in domestic branded formulations (a 25% CAGR over FY15-17) and a steady increase in contract manufacturing for formulations for the domestic market as well as emerging markets (a 15% CAGR).

- We expect the API business to register a 10% CAGR over FY15-17 driven by a 20% CAGR in customised manufacturing operations (CMO) for innovators, where capacity is available and orders are in place.

Fig 7 – Business model



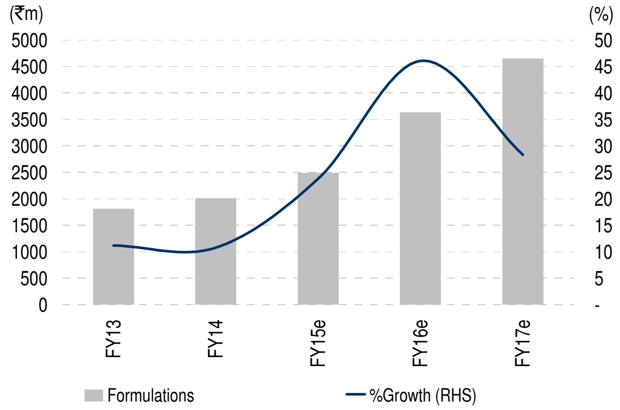
Source: Company

Formulations – Key growth driver

Formulations to grow faster, at a 37% revenue CAGR, driven by US generics and branded formulations

Vivimed practices a multi-pronged formulations strategy: manufacturing products across various delivery platforms for global pharmaceutical majors, manufacturing and marketing branded formulations in India and contract manufacturing of branded formulations for domestic players. It has eight manufacturing plants for formulations, including one US FDA-approved. We expect the formulations business to register a 37% revenue CAGR over FY15-17 to ₹4.6bn (25% of total revenue in FY17) stirred by the commencement of US generic supplies and strong growth in domestic branded formulations.

Fig 8 – Formulations revenue trend



Source: Company

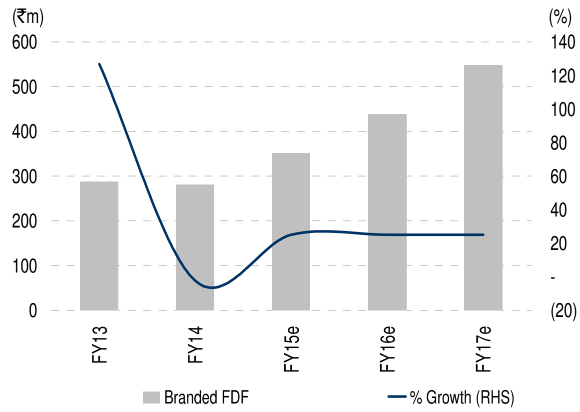
Branded formulations to register strong growth

Vivimed's branded formulations business consists of products in key therapeutic areas: ophthalmology, nutraceuticals and dermatology. The ophthalmic sub-segment comprises 50+ trademarked products including brands such as Renicol, Lysicon-V, Care Tears and Dexacort. The nutraceuticals sub-segment targets women and children, largely for enzymatic preparations, betalactams, antioxidants and multi-vitamins. India is the key market for branded formulations and the emerging markets are largely Russia and the CIS.

Low base and improvement in field-force productivity would help branded formulations in registering a strong 25% revenue CAGR

Branded formulations constitute a small part of the overall business, accounting for only 3% of Vivimed's pharmaceuticals business. We expect branded formulations to register a 25% revenue CAGR over FY15-17 on a low base, driven by product launches and improved field-force productivity.

Fig 9 – Revenue growth in branded formulations



Source: Company, Anand Rathi Research

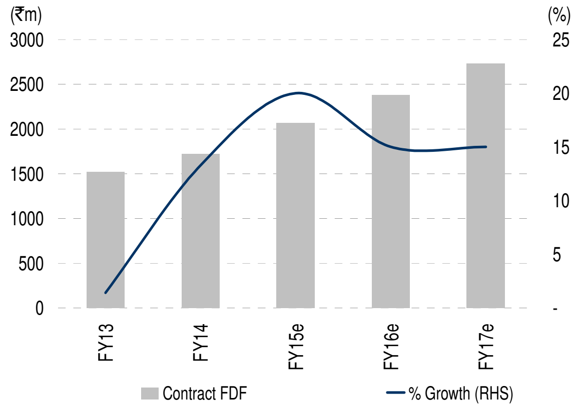
Steady growth in contract formulations

Vivimed has seen steady growth in its contract FDF (finished dosage formulations) business division and has strengthened its position by holding on to its customers – MNCs such as Novartis, Merck and Astra Zeneca and domestic companies such as Cipla, Wockhardt and Lupin. We believe that this augurs well for it as this business has certain entry barriers—stringent quality and product controls. These Vivimed has successfully established. It also offers customized cost-effective molecules in anti-malarials, pain management, etc. Realising the potential in formulations, Vivimed is now establishing its presence in formulations and new drug delivery systems after developing a strong base in its API business.

We expect a steady 15% revenue CAGR in contract formulations for domestic players, largely in line with industry growth

We expect the contract FDF business to register a 15% revenue CAGR over FY15-17 and to account for ~20% of its pharmaceuticals business. Growth would be driven by an increase in orders from customers driven by more products and greater quantities.

Fig 10 – Revenue growth in contract FDF



Source: Company, Anand Rathi Research

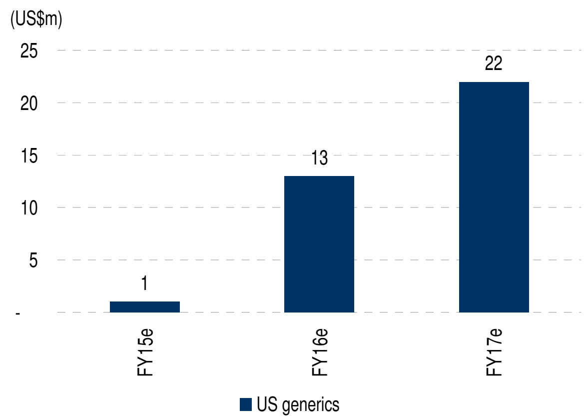
US generics to accelerate growth

Vivimed acquired one US FDA-approved formulations manufacturing plant in Alathur, Chennai, from Actavis for ₹1.2bn. This gave it entry into the most lucrative US market for formulations with two product approvals already in place for losartan and donepezil. Furthermore, the company has acquired three ANDAs for which site transfer is already in place. This would enable it to actively market five products in the US from Q2 FY16 in addition to contract manufacturing for large generics manufacturers, for which also site transfers are taking place. In addition, the company expects to file 4-5 ANDAs every year on its own in order to widen its product range. The plant has recently been re-inspected by the US FDA without any major observations, offering strong assurance of revenue ramp-up in the near term.

US generics to become the major focus area with more product launches, and revenue to touch to $22m by FY17

We expect the US generic formulations business to generate revenue of $1m, $13m and $22m in FY15, FY16 and FY17, respectively, with further potential over the years.

Fig 11 – Revenue from US generics



Source: Company, Anand Rathi Research

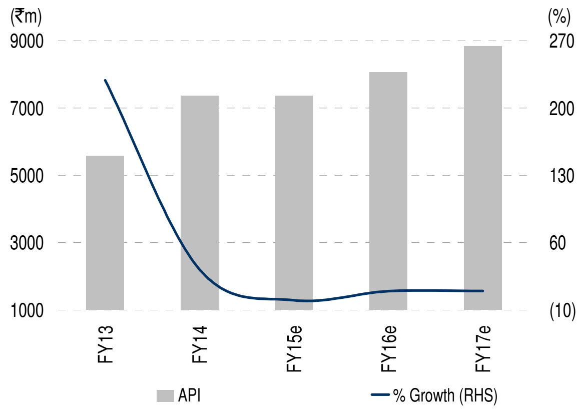
APIs to register steady growth

Vivimed's API business comprises generic products and customised manufacturing services (CMS) for global pharmaceutical majors. The API business brought ~69% to revenue in FY14 and is expected to record a steady 10% CAGR over FY15-17. The company has filed more than 150 DMFs, of which 50 are active. About 40% of its portfolio comprises anti-ulcer medication; the rest in various segments such as oncology, HIV, general therapeutics and quaternary APIs. Generic APIs bring in 88% of API revenue, 12% arising from customised manufacturing for innovators.

On the acquisition of the Spain-based Uquifa in FY12 for $56m, Vivimed entered the API business. Uquifa has three US FDA-approved API manufacturing plants, two in Spain, one in Mexico. The rationale behind this acquisition was to enter regulated markets such as the US and the EU and to have in-house API manufacturing plants. Uquifa supplies generic APIs to generics companies and has contracts in place with innovators to supply intermediates as well as APIs for patented products.

Given its strong product range with over 150 DMFs, ready capacity and contracts in place, we expect customised manufacturing for innovators to be a key growth driver – of a 20% revenue CAGR over FY15-17 to ₹1.3bn. We expect generic APIs to report an 8% CAGR over FY15-17. Overall, the API business could register a 10% CAGR over FY15-17 to ₹8.8bn, in our view. Yet, we expect its percentage in the overall pharmaceuticals business to decline given the company's greater focus on the high-margin formulations business.

Fig 12 – Revenue growth momentum in API



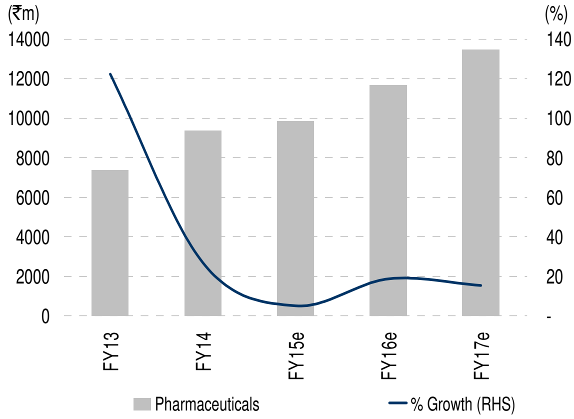
Source: Company, Anand Rathi Research

Pharma business to report 17% revenue CAGR

Vivimed's pharmaceutical business accounts for ~70% of its revenue (regulated markets - 85%; semi-regulated markets - 15%); over FY10-FY14 the business has registered an 84% revenue CAGR. Ahead, we expect a 17% revenue CAGR over FY15-17, driven by commencement of US generic supplies, more-than-industry growth in domestic branded formulations growth in its API division (chiefly CMO) and steady growth in contract manufacturing for formulations.

A 17% revenue CAGR in the pharmaceuticals segment would be driven by the formulations segment

Fig 13 – Revenue growth momentum in pharmaceuticals



Source: Company, Anand Rathi Research

Sustainable revenue from specialty chemicals

- Vivimed has built a strong franchise in specialty chemicals across the personal-care, home-care and industrial segments. It provides different ingredients for various sub-segments such as oral-care, sun-care, skin-care, hair dyes, thickeners and conditioners, naturals, reversacol photo-chromic dyes, anti-microbials and preservatives and imaging chemicals.

Vivimed has established strong operations in specialty chemicals by becoming the preferred supplier for large MNCs, and the launch of products

- It is an approved supplier of specialty chemicals to some of the large global MNCs: L'Oreal, Johnson & Johnson, Unilever, P&G and Colgate, among others.

- We expect revenue from specialty chemicals to come at a steady 10% CAGR over FY15-17, fuelled by greater volumes, new products and diversification into new categories.

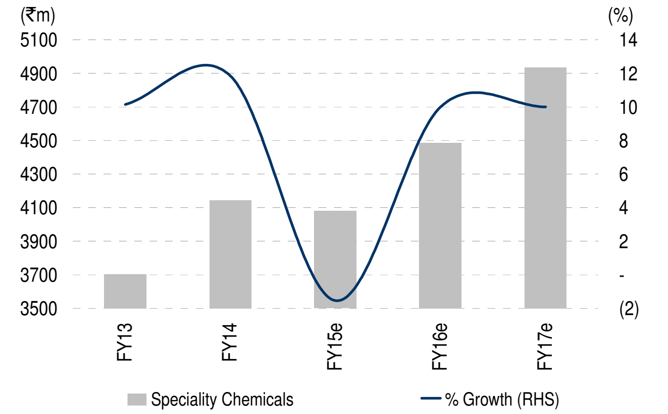
Niche product portfolio to drive growth

Vivimed is an approved supplier of specialty chemicals, which are used in oral care, skin care, hair dyes, anti-ageing elements, etc, to global personal care companies. Quality is of paramount importance in personal-care products. The company has, over the years, passed some of the most stringent quality norms and product requirements to become the preferred supplier for MNCs such as Unilever, P&G, L'Oreal and Colgate, among others. These can be considered as entry barriers in themselves, ensuring sustainable revenue.

We expect the specialty chemicals division to continue its steady growth momentum across the personal-care, home-care and industrial segments and to register a 10% revenue CAGR over FY15-17, driven by volume growth and product launches.

The specialty chemicals business would register a steady 10% revenue CAGR over FY15-17, in line with the past growth momentum

Fig 14 – Revenue growth momentum in specialty chemicals



Source: Company, Anand Rathi Research

Personal care: This segment constitutes the largest portion of specialty chemicals revenue (~50%). The segment comprises sun care, skin care, hair dyes, oral care, etc. Revenue from this segment has recorded a 12% CAGR over FY10-14.

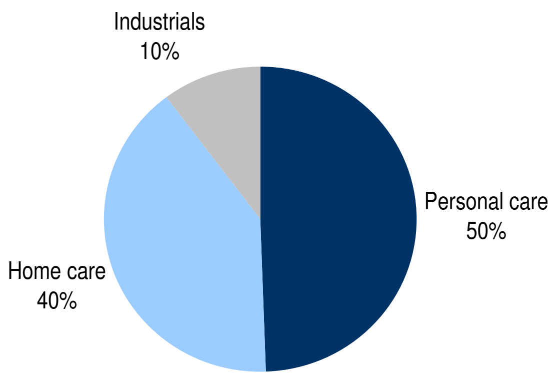
Home care: This segment comprises anti-microbials, specialty intermediates and preservatives. It contributes ~40% to specialty chemicals revenue and has seen a 30% revenue CAGR over FY10-14.

Industrial: This segment comprises photo-chromic dyes and imaging chemicals and brings ~10% to specialty chemicals revenue. Revenue from this segment has been declining over the years due to lack of a strong product range and a shrinking focus (very small business). However, the company has developed a range of products which would revive the growth momentum and this is visible from the 22% yoy increase in revenue in 9M FY15.

We expect revenue from specialty chemicals to register a steady 10% CAGR over FY15-17, driven equally by all the three segments.

Personal care and home care are the key segments in specialty chemicals and contribute 90% of specialty chemicals revenue

Fig 15 – Segment-wise revenue break-up of specialty chemicals (FY15e)



Source: Company, Anand Rathi Research

Fig 16 – Product range

Personal Care

Category	No. of products	End Uses	Revenue share in FY14 (%)
Sun care	7	Sunscreen lotions, lipstick	36.6
Skin care	6	Anti-wrinkle and skin-whitening creams, moisturisers	5.9
Hair care	4	Shampoos, conditioners, scalp treatment and hair dyes	31
Oral care	2	Toothpastes and mouth-washes	1
Naturals	5	Soaps and shampoos	0.9

Key clients: L'Oreal, Johnson & Johnson, Unilever, ITC, Dabur, Beiserdorf

Home and Industrial Care

Home and Industrial Care

Category	No of products	End Uses	Revenue share in FY14 (%)
Anti-microbials and Preservatives	6	Soaps, hand-washes, textiles, paints, hand-gels and cosmetics	20.1
Photo-chromic dyes	18	Lenses, toys, films, clothes and cosmetics like nail varnishes	3.5
Imaging chemicals	4	X-rays and photography	1

Key clients: BASF India, Johnson & Johnson, Unilever, Corning, Keystone, Mildex Optical, Kodak and LG

Source: Companies

The wide product range across the personal-care and home-care segments would help in maintaining a steady growth momentum

Marquee clientele – The competitive edge

Vivimed caters to prominent multi-nationals in FMCG, including Unilever, Procter & Gamble, Dabur, L'Oreal, and ITC. In the industrial segment it has clients such as Fujifilm, Kodak, Corning, LG, etc. It has created a niche for itself, as the client business-development cycle in this business is at least 3-4 years. This is the chief entry barrier and would ensure a sustainable revenue stream.

Financials

- We expect Vivimed's revenue to register a 15% CAGR over FY15-17, fuelled by a strong 17% CAGR in its pharmaceuticals division and steady, 10%, growth in its specialty-chemicals division.
- We estimate adjusted PAT to record a strong, 29%, CAGR over FY15-17, driven by strong revenue growth, steady margins and no increase in interest cost.
- We expect that, with higher PAT growth, its balance sheet would improve, which could result in lower leverage and better RoE and RoCE.

The growth momentum would increase at a 15% revenue CAGR over FY15-17, powered by strong growth in the pharmaceuticals business

15% revenue CAGR over FY15-17e

Over FY15-17, we expect Vivimed to register a 15% revenue CAGR, likely to be driven largely by its pharmaceutical business. We expect the pharmaceutical business to register a 17% revenue CAGR over FY15-17, fuelled by CAGRs of 10% in revenue in the API segment, 15% in contract FDFs, 25% in brand-named FDFs, and higher revenue from commercial supplies for US generics, of $22m by FY17 with further potential. The specialty chemicals businesses are expected to hold steady, at a 10% revenue CAGR over FY15-17.

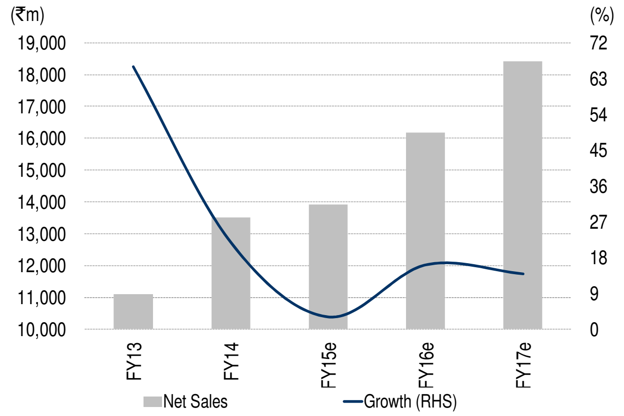
The share of the pharmaceuticals business would rise to 73.2% of revenue in FY17, from 69.3% now, driven by strong growth

Fig 17 – Revenue break-up

(₹ m)	FY 13	FY14	FY15e	FY16e	FY17e
Pharmaceuticals	**7,384**	**9,365**	**9,842**	**11,681**	**13,479**
% of sales	66.6	69.3	70.7	72.2	73.2
API	5,575	7,361	7,361	8,058	8,832
yoy %	228.9	32.0	0.0	9.5	9.6
% of pharmaceuticals	75.5	78.6	74.8	69.0	65.5
Contract FDFs	1,521	1,723	2,068	2,378	2,735
yoy %	1.4	13.3	20.0	15.0	15.0
% of pharmaceuticals	20.6	18.4	21.0	20.4	20.3
Brand-named FDFs	288	281	351	439	549
yoy %	126.8	(2.4)	25.0	25.0	25.0
% of pharmaceuticals	3.9	3.0	3.6	3.8	4.1
US Formulations	-	-	62	806	1,364
yoy %	0.0	0.0	0.0	1200.0	69.2
% of pharmaceuticals	-	-	0.6	6.9	10.1
Specialty Chemicals	**3,704**	**4,143**	**4,079**	**4,487**	**4,935**
% of sales	33.4	30.7	29.3	27.8	26.8
Personal care	2,233	2,335	2,054	2,260	2,486
yoy %	20.0	4.6	(12.0)	10.0	10.0
% of specialty chemicals	60.3	56.4	50.4	50.4	50.4
Home care	1,042	1,456	1,602	1,762	1,938
yoy %	(9.7)	39.8	10.0	10.0	10.0
% of specialty chemicals	28.1	35.2	39.3	39.3	39.3
Industrial	429	352	423	465	511
yoy %	23.4	(18.0)	20.0	10.0	10.0
% of specialty chemicals	11.6	8.5	10.4	10.4	10.4
Total Revenue	**11,088**	**13,508**	**13,921**	**16,168**	**18,415**

Source: Company, Anand Rathi Research

Fig 18 – Revenue growth trend

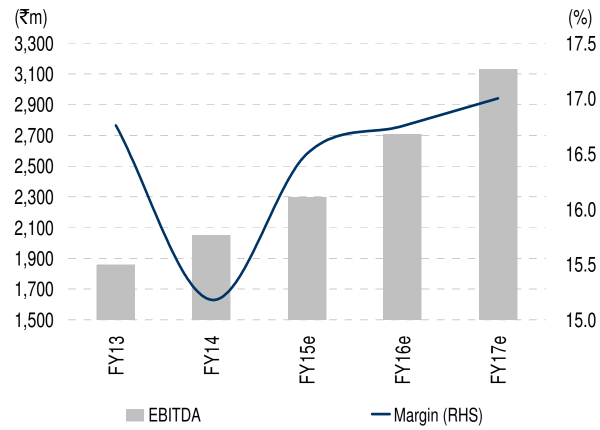


Source: Company, Anand Rathi Research

EBITDA margin to be stable

We expect the EBITDA margin to endure at a sustainable ~17%, with a slight, 50bp, improvement over FY15-17, from 16.5% to 17%. In absolute terms, we expect EBITDA to register a 16.7% CAGR over FY15-17, powered by the strong revenue growth. The margin could be better if the US generics business picks up quicker than expected, in our view.

Fig 19 – Improving EBIDTA margin



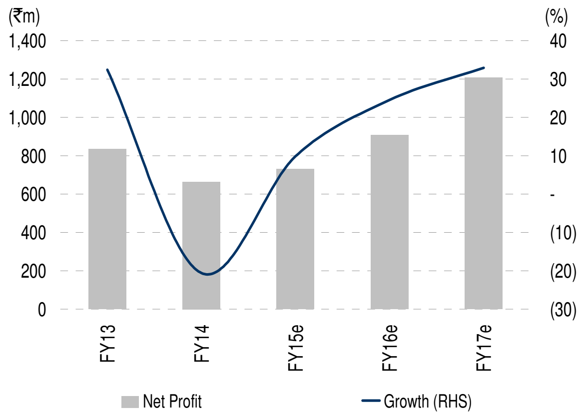
Source : Company, Anand Rathi Research

Strong, 29%, net profit CAGR

We expect the company to register a 29% adjusted-net-profit CAGR over FY15-17 to ₹1.21bn, boosted by strong revenue growth and sustainable EBITDA margins. Net profit growth, we estimate, would be higher than revenue growth, largely because there are no major increases in depreciation charges and interest costs as we do not expect any major capex in the next two years. The net-profit margin, too, could improve from the present 4.9% to 6.6% in FY17, driven by strong PAT growth, in our view.

We expect a strong, 29%, PAT CAGR led by better revenue growth and margins

Fig 20 – Net profit and growth



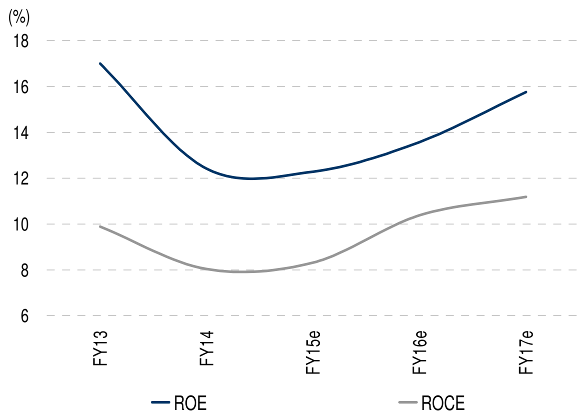
Source : Company, Anand Rathi Research

Return ratios to improve

Given the healthy net-profit growth expected in the next two years, we expect considerably better return ratios. We estimate RoE and RoCE to improve from 12.4% and 8% in FY15, respectively, to 15.8% and 11.2% in FY17.

The RoE and RoCE would improve on account of strong profit growth and no major capex expected over the next two years

Fig 21 – Expanded return ratios



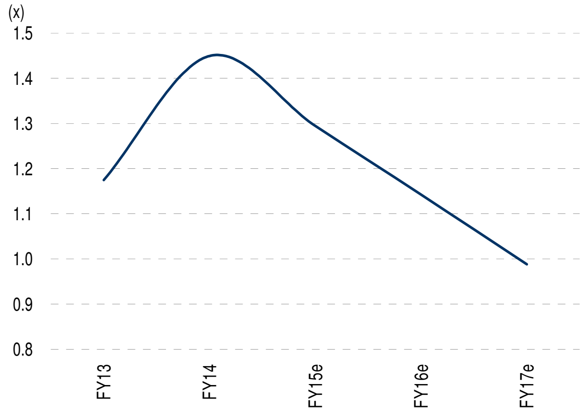
Source: Company, Anand Rathi Research

Strengthening balance sheet

Vivimed's net debt-to-equity ratio has fallen from 2.9x in FY09 to 1.4x in FY14, and is likely to further decline to 0.8x by FY17, in our view, given a 29% PAT CAGR over FY15-17 and generation of free cash-flows, thus strengthening the balance sheet. We expect the interest-coverage ratio to improve to 3x in FY17, from 2.3x now.

Leverage would come down to 0.8x net-debt-to-equity, driven by strong profit growth and an improved balance sheet

Fig 22 – Leverage (net debt to equity)



Source: Company, Anand Rathi Research

Fig 23 – Income statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Revenues	**11,088**	**13,508**	**13,926**	**16,172**	**18,420**
Growth in revenues (%)	*65.9*	*21.8*	*3.1*	*16.1*	*13.9*
Raw materials	5,132	6,563	6,475	7,520	8,565
% of Sales	*46.3*	*48.6*	*46.5*	*46.5*	*46.5*
Personnel expenses	503	659	1,845	2,143	2,441
% of Sales	*4.5*	*4.9*	*13.3*	*13.3*	*13.3*
Selling and other expenses	3,594	4,236	3,307	3,801	4,283
% of Sales	*32.4*	*31.4*	*23.8*	*23.5*	*23.3*
EBITDA	**1,858**	**2,051**	**2,298**	**2,709**	**3,131**
EBITDA Margin (%)	*16.8*	*15.2*	*16.5*	*16.8*	*17.0*
Depreciation	588	661	698	763	801
PBIT	**1,270**	**1,389**	**1,600**	**1,946**	**2,331**
Interest expenses	409	603	771	771	771
PBIT from operations	**860**	**786**	**828**	**1,174**	**1,559**
Other non-operating income	119	82	30	30	39
PBT before extraordinary items	979	869	858	1,204	1,598
Extraordinary income/ (expenses)	-	-	-	-	-
PBT	979	869	858	1,204	1,598
Provision for tax	143	205	129	289	384
Effective tax rate	*14.6*	*23.6*	*15.0*	*24.0*	*24.0*
PAT	836	664	730	915	1,215
Minority Interest	-	-	-	-	-
PAT after minority interest	**836**	**664**	**730**	**915**	**1,215**
Adjusted PAT	**836**	**664**	**730**	**915**	**1,215**
Growth in PAT (%)	*32.4*	*(20.6)*	*9.9*	*25.5*	*32.7*
PAT margin (%)	*7.5*	*4.9*	*5.2*	*5.7*	*6.6*

Source: Company, Anand Rathi Research

Fig 24 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Equity Share Capital	800	802	802	802	802
Reserves	4,291	4,802	5,472	6,313	7,429
Shareholders' fund	5,091	5,604	6,274	7,115	8,230
Minority Interest	-	-	-	-	-
Debt	5,980	8,121	8,121	8,121	8,121
Deferred Tax Liability	172	255	255	255	255
Capital Employed	**11,244**	**13,979**	**14,649**	**15,490**	**16,606**
Gross Block	13,295	15,260	14,887	15,637	16,387
Accumulated Depreciation	6,205	7,181	6,506	7,269	8,070
Net Block	7,090	8,079	8,381	8,368	8,317
Capital WIP	269	381	381	381	381
Fixed Assets	7,360	8,460	8,762	8,749	8,699
Investments	2	2	2	2	2
Inventories	3,403	4,267	4,330	4,763	5,408
Debtors	3,082	3,478	3,586	4,164	4,743
Cash and Bank balances	240	346	518	699	980
Loans and Advances	1,198	1,530	1,578	1,832	2,087
Other Current / non-Current Assets	411	425	432	469	507
Current Assets	8,334	10,046	10,444	11,928	13,725
Current Liabilities and Provisions	4,452	4,530	4,559	5,190	5,820
Net Current Assets	3,882	5,516	5,884	6,738	7,904
Miscellaneous Expenditure	-	-	-	-	-
Total Assets	**11,244**	**13,979**	**14,649**	**15,490**	**16,606**

Source: Company, Anand Rathi research

Fig 25 – Cash flow statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Cash flow from operating activities					
Profit before tax	979	869	858	1204	1598
Depreciation	588	661	698	763	801
Interest expenses	409	603	771	771	771
Operating profit before working capital change	**1,977**	**2,133**	**2,328**	**2,739**	**3,170**
Working capital adjustment	(274)	1528	196	673	886
Gross cash generated from operations	**2,251**	**604**	**2,132**	**2,066**	**2,285**
Direct taxes paid	124	200	129	289	384
Cash generated from operations	**2,127**	**405**	**2,003**	**1,777**	**1,901**
Cash flow from investing activities					
Capex	(1,911)	(1,762)	(1,000)	(750)	(750)
Investment	5	0	0	0	0
Cash generated from investment activities	**(1,906)**	**(1,762)**	**(1,000)**	**(750)**	**(750)**
Cash flow from financing activities					
Proceeds from share capital and premium	30	31	0	0	0
Borrowings/ (Repayments)	538	2,140	0	0	0
Interest paid	(409)	(603)	(771)	(771)	(771)
Dividend paid	(75)	(57)	(59)	(74)	(99)
Cash generated from financing activities	**84**	**1,512**	**(831)**	**(846)**	**(870)**
Others	(429)	(49)			
Net cash increase/ (decrease)	**(124)**	**106**	**173**	**181**	**281**

Source: Company, Anand Rathi Research

Fig 26 – Ratios

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Margins (%)					
EBITDA margin	16.8	15.2	16.5	16.8	17.0
PBIT margin	11.5	10.3	11.5	12.0	12.7
PBT margin	8.8	6.4	6.2	7.4	8.7
PAT margin	7.5	4.9	5.2	5.7	6.6
Growth (%)					
Revenues	65.9	21.8	3.1	16.1	13.9
EBITDA	42.6	10.4	12.1	17.9	15.6
Net Profit	32.4	(20.6)	9.9	25.5	32.7
Returns (%)					
RoCE	9.9	8.0	8.3	10.4	11.2
RoIC	10.8	8.3	9.8	10.2	11.5
RoE	17.0	12.4	12.3	13.7	15.8
Turnover (x)					
Asset-turnover (x)	0.8	0.8	0.7	0.8	0.9
Working-capital cycle (days)	140	152	164	152	150
Average collection period (days)	87	89	93	87	88
Average payment period (days)	64	59	64	59	60
Inventory holding (days)	116	122	135	123	121
Per share (₹)					
EPS	51.6	41.0	45.0	56.5	75.0
CEPS	88.7	81.8	88.1	103.6	124.4
Book Value	277.2	306.4	387.2	439.1	507.9
Solvency (x)					
Net Debt/ Equity	1.1	1.4	1.2	1.0	0.9
Interest coverage	3.1	2.3	2.1	2.5	3.0
Net Debt/ EBITDA	3.1	3.8	3.3	2.7	2.3
Valuation parameters (x)					
P/E	7.2	9.0	8.2	6.5	4.9
P/BV	1.3	1.2	1.0	0.8	0.7
EV/ EBITDA	6.3	6.7	5.9	4.9	4.2
EV/ Sales	1.1	1.0	1.0	0.8	0.7
M-Cap/ Sales	0.5	0.4	0.4	0.4	0.3

Source: Company, Anand Rathi Research

Valuation

From a mid- to long-term perspective, we view the stock favourably, considering expectations of revenue-growth recovery from FY16 driven by strong traction in its pharmaceutical business, a sturdy, 29%, adjusted PAT CAGR over FY15-17, rationalisation of its balance sheet with no major capex planned for the next two years and an expanded RoE and RoCE in FY17 to, respectively, 15.8% and 11.2%.

We initiate coverage on the stock, with a Buy rating and a target price of ₹600, implying a 64% potential

In the recent past the stock has significantly undershot its peers due to restrained growth in FY15 and a stretched balance sheet. However, with the major focus on profitability, we expect the growth momentum to improve over FY15-17. Further, monetisation of its land at the Vizag SEZ in the near future may offer an additional upside to the valuations with improvement in the balance sheet.

At present, the stock trades at attractive valuations of 6.5x FY16e and 4.9x FY17e earnings. We believe that a slide from current valuations would be contained as growth momentum picks up. We initiate coverage on Vivimed Labs, with a price target of ₹600 based on 8x FY17e earnings. Our target PE multiple is at a discount to other mid-cap pharmaceuticals due to the company's low-margin business model, stretched balance sheet and lower return ratios.

Fig 27 – One-year-forward mean PE and Standard deviation

Source: Bloomberg, Anand Rathi research

Company Background & Management

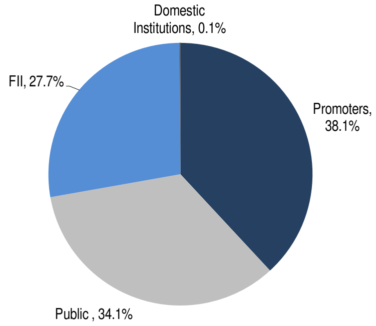
Overview

Established in 1989 and headquartered in Hyderabad, Vivimed Labs has come a long way, evolving into a complete pharmaceutical and healthcare entity. Its forte is pharmaceuticals (which bring ~70% to revenue) and specialty chemicals. Its product range covers more than 75% of the personal-care-ingredients market within specialty chemicals.

In specialty chemicals, the company manufactures active ingredients that are used in home- and personal-care segments such as hair, skin, oral-care and anti-microbial preservatives. It also operates in industrial-care sub-segments such as photo-chromic dyes and imaging chemicals. In the pharmaceutical segment it is engaged in the manufacture of active pharmaceutical ingredients (APIs) and finished dosage formulations (FDFs) with a global customer base including Pfizer, Novartis and GSK.

It has a global reach with 12 manufacturing units (four US FDA), five R&D centres, and a workforce of over 1,650. The company is an approved supplier to global personal-care brands and is following stringent product safety norms, which itself constitute a high entry barrier to competition. It counts some of the top pharmaceutical and personal-care companies among its clients such as Merck, Cipla, Novartis, AstraZeneca, Lupin, Wockhardt, Unilever, P&G, Johnson & Johnson, L'Oreal, and Microban.

Fig 28 – Shareholding pattern



Source: BSE

Fig 29 – Management and Board of Directors

Name	Position	Profile
Board of Directors		
Dr. V. Manohar Rao	Chairman	Retired as joint director of The Veterinary Biological and Research Institute and has over 40 years of industry experience. Responsible for developing sophisticated and well-equipped in-house quality control, and introduced various cost-control systems in the production process
Santosh Varalwar	MD and CEO	First-generation entrepreneur, Focus on key global client relationships. Previously associated with The Shipping Corporation of India
Subhash Varalwar	Vice-Chairman	Responsible for technology and product development in the API segment; was previously associated with The Fertilizer Corporation of India for 15 years.
Sandeep Varalwar	Executive Director	Has over 19 years of experience in manufacturing and marketing in the healthcare sector; has been associated with Vivimed since its incorporation and heads the Healthcare FDF division

Source: Company

Annexure – Balance sheet analysis

Inputs from the forensic team

Based on forensic analysis of the balance sheet, the following are our specific observations:

- We have identified instances where some adjustments have been made directly in the balance sheets in FY13 and FY12:

1. During FY13, preliminary expenses were ₹301m. Of this, ₹132m (related to acquisition costs) were adjusted from the securities-premium reserve, ₹163m were shifted to intangible assets and, after retaining ₹0.6m on the balance sheet, the balance was written off.

   According to the management, ₹163m was related to costs incurred for product R&D. It was shifted to intangible assets in FY13 as it had been mis-classified the previous year under preliminary expenses.

   Based on this analysis, had the items been routed directly from the income statement, the profit would have been 39% and 26% lower in FY12 and FY13, respectively. However, this would not impact our future estimates as we have not factored in any further write-offs

   Analytical view: The preliminary expenses of ₹163m pertaining to product R&D could have been expensed off from the Profit & Loss Account. This would have cut into profits by 13.5%.

2. During FY13, a prior-period adjustment of ₹122m had been deducted from reserves and surplus in the balance sheet.

   According to the management, the prior-period adjustment arose because of the consolidation of certain subsidiaries at the end of previous year.

   Analytical view: The prior-period items of ₹122m pertaining to subsidiaries could have been expensed off from the Profit & Loss Account. This would have led to a 12.5% impact on profits.

3. During FY12, intangible assets of ₹304m were adjusted from the securities-premium reserve.

   According to management, intangible assets were adjusted from reserves as they were related to acquisition costs previously recognized as intangible assets.

   Analytical view: The intangible assets of ₹304m pertaining to acquisition costs could have been written off from the Profit & Loss Account. This could have eaten into profits by 39%.

- Management has assumed a 2% increase in compensation levels while actuarially valuing liability on account of Gratuity and Leave Encashment. However, management says that annual increments to employees were in the range of 10% to 15%.

  According to management, the assumed increase turned out to be lower than the actual annual increments to employees, and the liability could be re-calculated taking the actual average increment into consideration.

  Analytical view: The re-statement of the growth-rate assumption more than the present 2% could result in a one-time impact on earnings.

Appendix

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