Reliance Securities

Initiating Coverage

Vivimed Labs

April 2, 2012

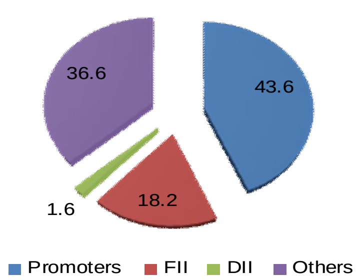
BUY

CMP*	Rs406
Target Price	Rs480
Stock Info	
Sector	Pharmaceuticals
Market Cap (Rs cr)	566
52 Week High/Low	435/212
Avg. Daily Volume (3m, '000)	50
Avg. Daily Value (3m, cr)	1.7
Dividend Yield (%)	0.4
Sensex	17,204
Nifty	5,296
BSE Code	532660
NSE Code	VIVIMEDLAB

Stock Performance

(%)	VIVIMED LAB	NIFTY
1-week	(2.1)	0.3
1-month	10.3	(1.7)
1-year	50.3	(8.5)

Shareholding Pattern (%)



Stock Price Chart

*Note: *CMP as on March 30, 2012*

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Acquisitions for a vivid future

- **Positioned to benefit from multiple growth drivers:** Vivimed's product portfolio for specialty chemicals and pharmaceuticals are broad based and spread across a range of B2B and B2C segments. On B2B, it benefits from supplying products in industrial care. On the B2C side, it is geared to a range of broad based demand drivers (rising personal care awareness, low penetration and competitive pricing of APIs). These are complimented by established client list, enhanced capacities and continued cost optimization, which is a key driver for expansion of product range and leveraging pricing power.
- **Uquifa acquisition to bolster growth:** Integration of Uquifa's operation will complement Vivimed's API business through backward integration. It will have automatic access to Uquifa's marquee client base and pipeline filings. We anticipate Uquifa to comprise 46% of the total sales in FY2013E and scale higher once manufacturing shifts to India.
- **Well funded for growth:** Vivimed has raised US$28mn through PE financing route to address its capex requirements for establishing a Greenfield project and also to facilitate its inorganic growth requirements. Besides, it has also raised US$7.5mn by way of FCCB from IFC and plans to raise US$12.5mn to set up SEZ in Andhra Pradesh.
- **Capacity expansion- apt for volume growth:** To augment its export driven growth, Vivimed is setting up a SEZ, to be completed in FY2014-15. Besides, it has also indulged in Brownfield expansion at existing facilities (expected by FY2013). Once upright and running, we expect Vivimed to generate FCF of Rs37cr by FY2014.
- **Transitioning into a niche player:** Our channel checks indicate that Vivimed is admired by dealers for the quality of its products and strong support. Relentless focus on building a consumer brand has set Vivimed apart from its peers. This has allowed Vivimed to extend its presence in more consumer centric segments. At present, it is addressing only 5-10% of the areas of growth, whereas the target is to address a bigger market over the next 5-10 years. The company plans to build upon the area of providing molecules as per client requirements. This opens up growth avenues and may pave way to a higher ROE model.

Outlook and Valuation

While, Vivimed's stock has appreciated by 42% over the past 2 months on the back of robust earnings visibility from both the business segments, we believe that there is further scope of re-rating once the actual earnings from Uquifa come in to play. Besides the B2B nature of business and a diverse product portfolio gives Vivimed an edge in bargaining power. The company is geared to enter the big league of companies through Uquifa acquisition by clocking a turnover of Rs1,100cr in FY2013E. Backed by expansion plans, new facilities and inorganic initiatives, we believe the company is rightly placed to show revenue CAGR of 62% and earnings CAGR of 50% over FY2011-13E. It is worthwhile to note that the growth in revenues is likely to be achieved without any significant decline in margins. No equity dilution in near future and strong growth visibility leads way to higher returns for shareholders. **Thus, we initiate coverage on the company with a Buy rating and a target price of Rs480.**

Risks to view

- High working capital cycle could impact future cash flows
- Early exit of the PE players, who own the ~20% stake in the company

Year End	Net Revenues		EBITDA		Net income (reported)		RoE	RoCE	EPS	Valuations (X)	
	(Rs cr)	% growth	(Rs cr)	% margin	(Rs cr)	% growth	%	%	(Rs)	P/E	EV/EBITDA
FY2010	343	24.4	63	18.4	31	60.2	21.4	15.4	31.1	13.0	9.1
FY2011	416	21.1	84	20.2	49	57.5	24.8	14.6	48.0	8.4	8.3
FY2012E	607	45.9	120	19.8	61	24.7	15.8	13.7	43.7	9.2	7.1
FY2013E	1,098	80.9	198	18.0	110	80.4	22.2	19.7	68.7	5.9	4.9

Vivimed operates across a range of B2B as well as B2C segments

Different segments are exposed to different market drivers

Investment Arguments

Specialty Chemicals: Positioned to benefit from multiple growth drivers

Vivimed's product portfolio of active ingredients for use within home and personal care products, and industrial care products like photo chromic dyes and imaging chemicals is broad based and spread across a range of B2B and B2C segments. On B2B, it benefits from supplying products in industrial segment. On the B2C side, it is geared to a range of broad based demand drivers (rising beauty and healthcare awareness, low penetration and competitive pricing). These are all complimented by established client list, enhanced capacities and continued cost optimization, which is a key driver for expansion of product range and leveraging pricing power. This will drive revenue CAGR of 17% over FY2011-13E (recorded CAGR of 34% over FY2007-11) for specialty chemicals.

Diverse product basket

Vivimed supplies essential ingredients to some of the world's most famous beauty brands. It is an approved supplier to global personal majors. On a volume basis, its presence in the product ranges 0.1% to 0.5%, like Triclosan, an active ingredient used in most toothpaste brands, however, it does not constitute more than 0.1% in the total toothpaste composition. Despite its small quantity, quality is of paramount importance in the personal care products, and hence, companies like Unilever, L'Oreal, etc trust qualified vendors for the same. Its B2B offerings are largely in the active ingredients segment for use within industrial care products like dyes, coatings, paints, etc. Its consumer related offerings are spread across hair, skin and oral care products like shampoos, beauty creams, toothpastes, etc. Across its various segments, Vivimed is geared towards growth drivers across industrial activity, enhanced capacity and consumer demand.

Exhibit 1: Vivimed's product usage in different business segments and key clientele

Segments	Usage / Applications	Key Products	Key Clients
Active Ingredients			
Hair Care	The company specializes in anti-dandruff agents, anti-fungal agents and hair loss actives, hair growth agents for use in shampoos, conditioners and styling products	Dantuff-Z, Vipirox, Vividine	Unilever, ITC, Dabur
Skin Care	It makes broad spectrum, water/oil soluble UV-A, UV-B filters and inhibitors for skin care formulations	Vintox, Vivinol	BASF, Sederma
Oral Care	Includes anti-bacterials for toothpastes/mouthwashes, neutraceuticals for dental enamel protection, antiseptic hand wipes, soaps, surgical scrubs for treating sore gums and ulcers	Viv-20, Vivcal-G	Unilever, P&G, Dabur, BDF
Industrial Care			
Anti-microbials and preservatives	Agents used in Handwash, soaps, shampoos, preservatives, cosmetics, paints, textiles, paper treatments, etc	Vivilide, Cosvat	Unilever, BASF, J&J
Photochromic Dyes	Used in photochromic lenses, plastic based toys, films, clothes, inks and coatings used in flexo printing, screen print for T-Shirt and nail varnish	Reversacol	Keystone, Corning, Mildex Optical
Imaging Chemicals	Used in X-rays, photography, graphic arts	Phenidone, Dimezone, Nitroindazole	Kodak, Fuji, LG

Source: Company, RSec Research

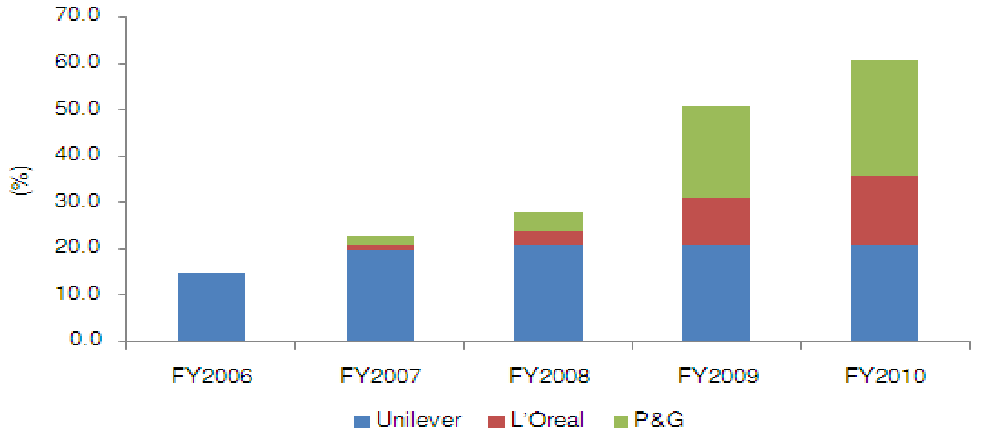
Vivimed boasts of top clientele and apex position in most existing markets, reaping the early mover advantage

Competition and scope for market share gain

Vivimed enjoys the early mover advantage as it has been a long time preferred supplier for global giants as well as domestic companies like L'Oreal, Unilever, P&G, Marico, etc for personal care products and faces limited competition in the market. Vivimed has achieved faster than industry growth on the back of its expertise in chemistry, scale up of client accounts and new product launches. While, the API market is relatively consolidated with the presence of number of large players, the markets that Vivimed operates in are relatively fragmented.

Despite having top clients and apex position in most of its existing markets, the company still has opportunities for market share expansion by taking share from the unorganized segment and expanding its client list. Besides, expansion in existing markets, Vivimed's foray into new product areas as well as broadening product portfolio in existing areas like anti-microbials, preservatives, grooming products should support faster than market growth rates over the medium term.

Exhibit 2: Top 3 clients comprise 20% of the total sales



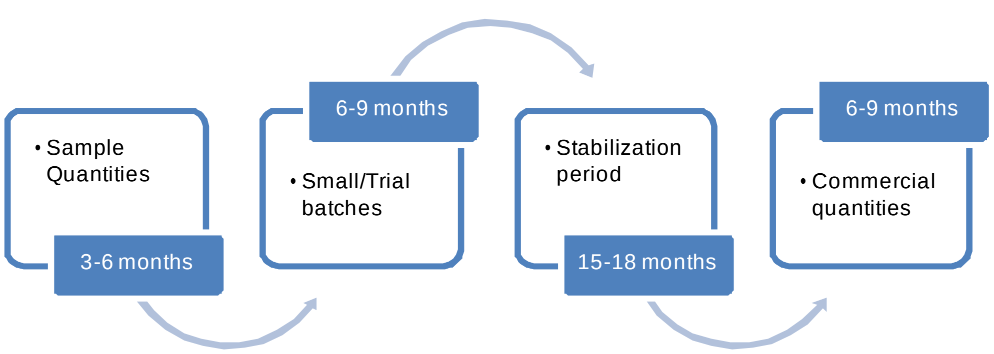
Source: Company, RSec Research

High entry barriers related to brand sensitivity makes Vivimed a scale player in the specialty chemicals division

High entry barriers

Vivimed operates in a niche specialty zone which makes it an arduous and time consuming process to become a preferred supplier to established players in the market. Further, factors such as brand sensitivity, technical qualification, pricing and timeliness act as entry barriers for the new suppliers and distinguish Vivimed as a scale player in the specialty chemicals division.

Exhibit 3: New product development process



Source: Company, RSec Research

Vivimed is a preferred choice for dealers as well as pharma companies for its product quality and technical expertise

Exhibit 4: New product approval timeline

Source: Company, RSec Research

Moving from 'API' player to a 'Specialty' brand

With specialty chemicals being a niche segment, Vivimed aims on becoming a preferred manufacturer, marketer and brand owner, building sustainable brand value through continuous cost optimization and leverage the advantage of low cost manufacturing in India. Our channel checks indicate that it is admired by dealers for the quality of its products, strong support and channel financing arrangements. Vivimed has boosted its brand visibility over the past few years through strong association with key clienteles like Pepsodent, L'Oreal, Unilever and P&G comprising over 20% of its total sales.

What has set Vivimed apart from its peers has been a relentless focus on building a consumer brand. This has allowed Vivimed to extend its presence into more consumer centric segments. At present, Vivimed is addressing only 5-10% of the areas of growth, whereas, the target is to address a bigger market over the next 5-10 years. The company plans to build upon the area of providing molecules as per the requirements of the clients. The acid test for this strategy will be its three pronged strategy:

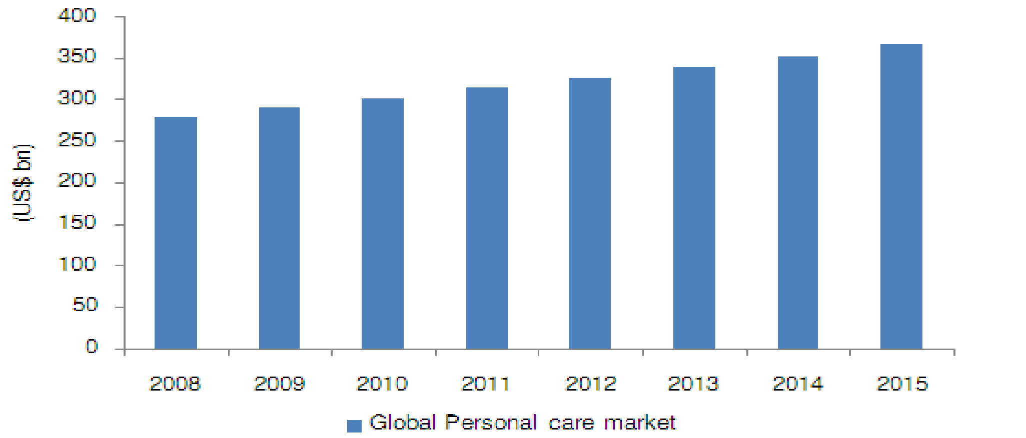
- **Market penetration:** Increased supplies for same product
- **Market development:** Increased supplies as a result of partnering in new locations
- **Product development:** Supplies for new products across the personal care spectrum

Rising beauty and healthcare awareness

The global market size for the personal care ingredient is ~US$10bn and forecasted to grow to ~US$15bn by 2015. The domestic market size is ~US$350mn and forecasted to grow to US$800mn by 2015.

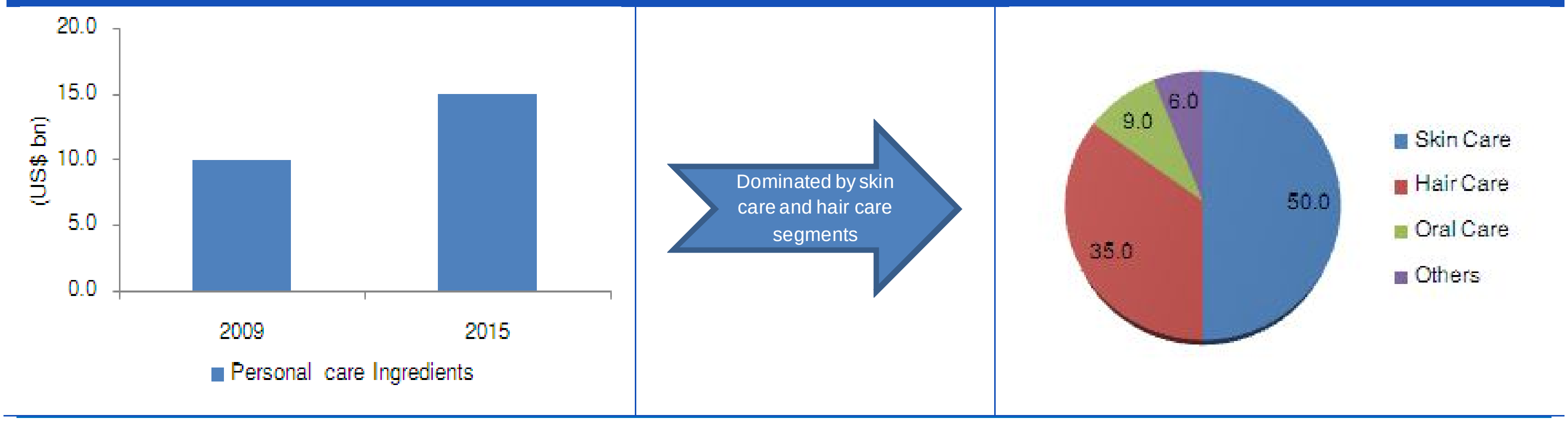
Indian consumer spending, particularly on discretionary products, has been growing in recent years. An increasing trend towards urbanization and increase in disposable incomes and introduction of new products by Corporates create a perfect push and pull effect for the domestic personal care market. Vivimed's product portfolio caters to more than 75% of the personal care ingredient market.

Exhibit 5: Global personal care market



Source: Company, RSec Research

Exhibit 6: PCI market



Source: Company, RSec Research

The 2 acquisitions in specialty chemicals will consolidate Vivimed's global presence and business integration

Historically more B2B focus

Going back about five years to FY2006-07 shows the picture of a company that was much more focused on its manufacturing capabilities and potential outsourcing driven opportunities. While the company still has a strong dealer network its focus was not entirely on building a consumer franchise. Hence, the rationale behind the acquisitions of James Robinson and Harmet International Ltd at the time was at least partly anchored in getting exposure to western end markets along with an established clientele whose acquisition takes ~3-5 years otherwise, thereby to consolidate its global presence and business integration. This demonstrates a change in the mindset that was still anchored to the manufacturing roots of the company.

Exhibit 7: Acquisitions in the Specialty Chemicals division

Acquisition	Cost	Products	Stake %	Rationale
James Robinson Ltd, UK-2008	US$21mn	Photochromic dyes and imaging chemicals	100	Global supplier of hair dye chemicals, photochromic dyes, imaging chemicals and intermediates to reputed clients like P&G, L'Oreal and Henkel
				Acquired in-order to increase its presence in the global specialty chemicals market
				Integration strategies involved process and technology transfer to Vivimed, enhanced product range to current customers and cost benefits of manufacturing JR products in India
				Post acquisition, achieved sales and profit growth in key business segments, increased customer penetration and achieved seamless integration of process and personnel
Harmet International, USA-2009	US$3mn	Sales and distribution firm	100	15 year old sales and distribution organization with established customer base
				Harmet provided a direct entry into a huge customer base in the developed market where typically the client acquisition is around 3-5 years

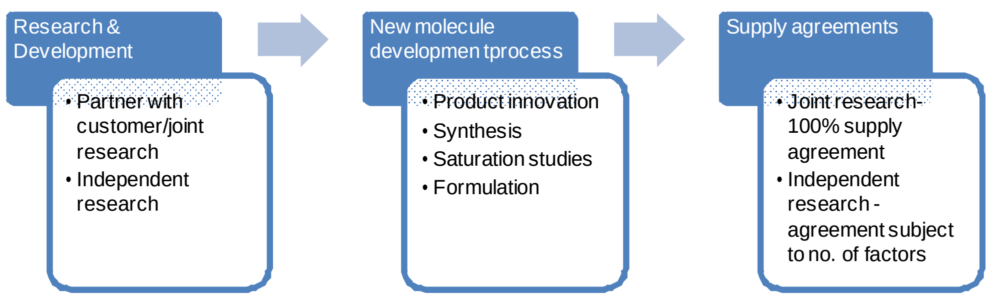
Source: Company, RSec Research

Increasing focus on R&D will enable Vivimed to cater to client's continuation need for innovation

Strong R&D focus

A key requisite to remain competitive in the field of specialty chemicals is to continuously come up with new products at regular intervals. Vivimed has 2 R&D facilities in Hyderabad and Huddersfield (UK), and also partners with its customers to continuously develop new ingredients. The R&D expenditure for Vivimed could be in the range of 1-2% of the sales, which puts it in a position to cater to the clients' continuous need for innovation.

Exhibit 8: R&D process



Source: Company, RSec Research

Uquifa acquisition to bolster growth in pharmaceutical division growth

Vivimed seems to be on the right growth track through series of inorganic initiatives. The recent acquisition of Uquifa (API and intermediate manufacturing company, Spain) and Klar Sehen and Nobel Occtantis (both in branded formulations) is expected to help register phenomenal improvement in Vivimed's financial performance.

The pharmaceuticals division focuses on APIs, contract manufacturing services and manufacturing and marketing of branded formulations. It constitutes 24% of the total sales in FY2011, which is expected to increase to 40% in FY2012E and ~60% in FY2013E largely due to integration of recently acquired Uquifa.

Uquifa Acquisition: Background and Rationale

Uquifa acquisition at US$55mn brings in strong franchise of anti-ulcerants, thereby filling the portfolio gap

Vivimed acquired Uquifa, a 75 year old API and intermediate manufacturing company, headquartered in Barcelona, Spain for a total consideration of US$55mn. The company has a strong franchise in anti-ulcer products (contributing 40% of the sales). Uquifa comes with 3 USFDA approved manufacturing sites – 2 in Spain and 1 in Mexico, and has a gamut of 47 Type II DMFs, more than 150 active DMFs and over 20 COS filed with the USFDA. The acquisition was funded through debt/equity ratio of 65:35 with equity infusion of US$20mn and debt financing of US$25mn. The balance of US$10mn would be deferred payment.

We estimate Uquifa to register US$25mn in FY2012E and US$108mn in FY2013E

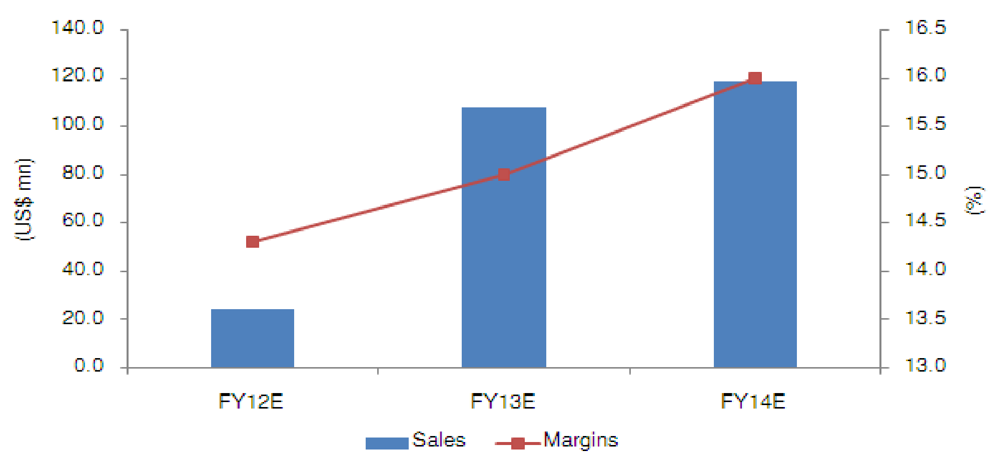
With products in over 15 therapeutic classes distributed across 70 countries and 100 customers, Uquifa plans to leverage its leading position in the API along with a robust pipeline of filings to accelerate growth across Europe and US in the next 5 years. We estimate Uquifa to register US$25mn sales in FY2012E (acquired in Dec 2011) and US$108mn for FY2013E. Coupled with backward integration initiatives, supply efficiencies and market-penetration strategy, Uquifa is likely to be a key growth driver for Vivimed.

Uquifa is a debt free company with assets over US$65mn

The acquisition apparently seems to be expensive, as the consideration paid is more than half of the present turnover of Vivimed. But Vivimed's equity infusion was only US$20mn and it borrowed US$25mn at a very cheap rate of 5%. By investing US$20mn, Vivimed got net assets of US$65mn. With a bottom line of around US$7mn, the payback period is also smaller, at less than three years. Moreover, Uquifa is a debt free company.

Uquifa has already given a boost to the revenues of Pharma division in 3QFY2012 (Uquifa's revenue of about one month was added to 3QFY2012 numbers). We expect Uquifa to report about Rs100cr additional turnover in 4QFY2012.

Exhibit 9: Uquifa – Operational forecasts



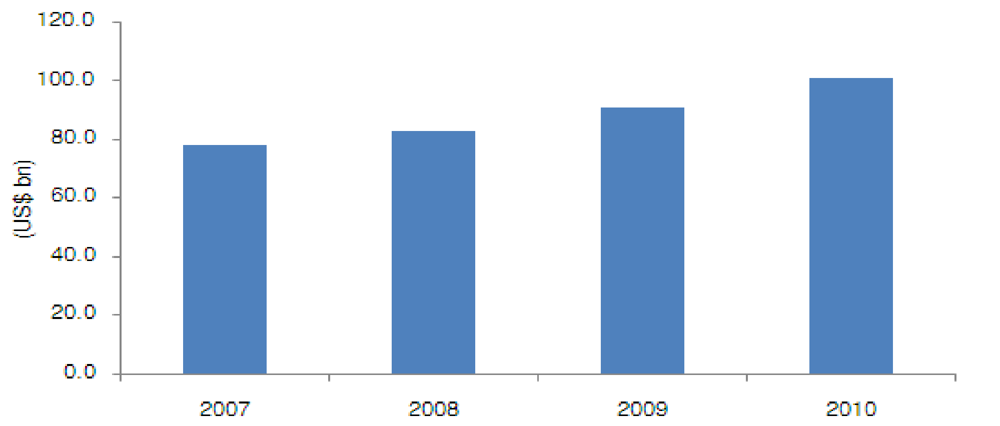
Source: Company, RSec Research

Indian advantage plays for Pharmaceuticals

Key Industry growth drivers:

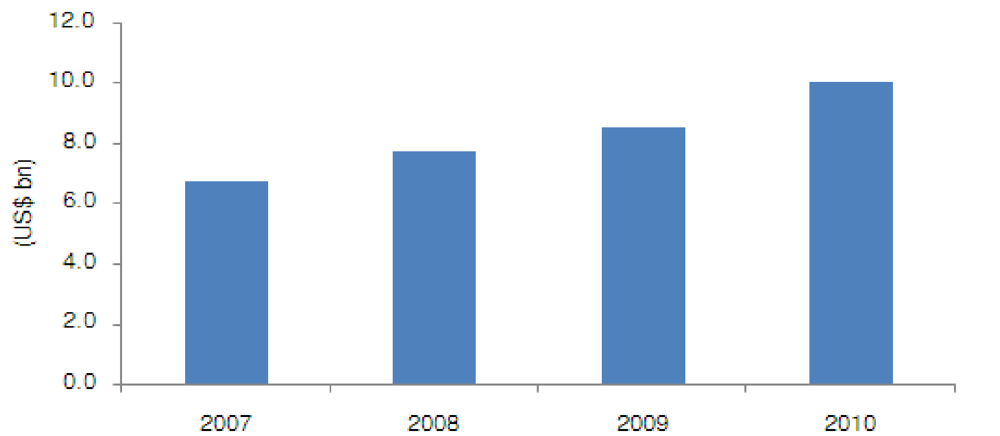
- Increasing cost cutting initiatives by the global pharmaceutical majors
- Drugs with market size of US$224bn to go off-patent by 2015, leading to surge in generic sales
- Rising disposable incomes and improvement in income demographics
- Better medical infrastructure

Exhibit 10: Global API market Size



Source: Company, RSec Research

Exhibit 11: Domestic formulations market size



Source: Company, RSec Research

Increasing focus on branded formulations

The 2 acquisitions in branded formulations to help transition from API to formulations and new drug delivery systems

Vivimed has seen a steady growth in pharma segment and has strengthened its position amongst marquee MNCs like Novartis, Merck, Astra Zeneca, etc. as a preferred player in collaborative research and supply chain partner in drug discovery/delivery in various segments like oncology, tuberculosis and anti-ulcerants. It also offers customized cost effective molecules in anti-malarials, pain management, etc.

Realizing the potential of formulations, Vivimed is in a transitional phase from APIs to formulations and new drug delivery systems. Further, the company intends to create a marketing and distribution network for introducing new formulations. It has also raised funds from IFC in form of debt and equity and is setting up a new manufacturing facility of formulations at Chouttupal, Hyderabad.

New product introductions in sub-continents and capacity expansions to boost growth in the pharma division

Branded formulations just got better with inorganic initiatives

The branded formulation forms a small part of the overall business forming 3% of the total sales. Vivimed has been actively registering more products for future exports. It exports in Russia/CIS, and has appointed a fully fledged sales team for the African continent. With current expansion of capacity and 2 new acquisitions, the company seems to be on the right track to exploit this segment in regulated markets like US and Europe.

Exhibit 12: Acquisition in branded formulations segment

Acquisition	Cost	Products	Stake (%)	Rationale
Klar Sehen Pvt Ltd, Kolkata-Oct 2011	Rs24cr	50 trademarks in Opthalmic segment	100	Strong marketing presence in North East, Bihar and AP
Octtantis Nobel Labs Pvt Ltd, Hyderabad-Sep 2011	Rs5cr	Pharmaceutical and Nutraceutical segment	60	Product marketing company engaged in promotion of finished dosage forms with a strong marketing field force

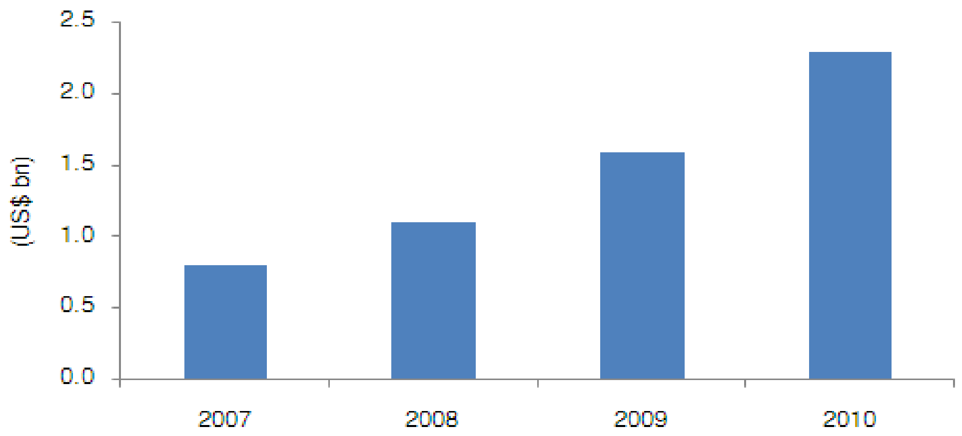
Source: Company, Industry, RSec Research

CRAMS making its presence felt

Vivimed enjoys a reputed clientele like Merck, Novartis, etc. for its steady CRAMS business segment

Vivimed has reputed clients like Merck, Novartis, Cipla, Glenmark, Lupin, Ranbaxy amongst others to whom it supplies products on a contractual basis. It manufactures capsules, tablets, syrups, liquids, and parenterals. CRAMS contribute ~20% of the total sales and with steady state of the business we expect it to post 16% CAGR growth over FY2011-14E.

Exhibit 13: Domestic CRAMS market size



Source: Company, RSec Research

Exhibit 14: CRAMS key product list

Product types	End products
Capsules/Tablets	Flexasur, Spasmosip plus, codarin, brozaproxivon, valenzia tablets, arachitol tablet, C Pink tablet
Syrups n Liquids	Codarex, Inalgel, Viscodyne, Brozedex, Celadrin, MITS Codeine Linctus, Candid Lotion, Candid mouth paint
Small Volume Parenterals	Otrivin, Nasivion Moist, Navision, Candbiotic ear drop, otrivin nasal spray, tobrop

Source: Company, Industry, RSec Research

Vivimed has adopted PE financing route and raised US$28mn, FCCB of US$7.5mn, and proposed term finance of US$12.5mn for capex and inorganic ventures

Well funded for growth

Vivimed used a PE financing route to fund its expansion plan. It is backed by reputed financial institutions like NYLIM Jacob Ballas, Kitaara Capital, IFC and DSP Blackrock. Jacob Ballas and Kitaara Capital together bought in US$28mn in September 2011, to address its capex requirements in relation to establishing a green field project and also to facilitate its inorganic growth requirements.

Besides, Vivimed has also raised US$7.5mn by way of FCCB from IFC. It will also lend another US$12.5mn as term finance to facilitate the setting up of infrastructure and manufacturing facilities at its proposed SEZ in Srikakulam district of Andhra Pradesh. We note that PE players own the ~20% + stake in the company.

Exhibit 15: Top Shareholders' holding amongst P/E players

	(%)
Kitaara Piin	14.7
Emerging India Focus Fund	2.9
William Harvey	2.2
DSP Blackrock	2
Total	**21.8**

Source: Company, RSec Research

Capacity expansion –apt for volume growth

The pharma division is expected to post a 95% CAGR revenue growth during FY2011-14E once the capacity expansions are in place.

Exhibit 16: Capacity Expansion-Pharma Division

Facility	Place	Land & Development (Rs cr)	Facilities (Rs cr)	Total Investment Outlay (Rs cr)	Completion period	Products	Rationale
Formulation dosage Facility	Choutuppal, AP	2.5	37.5	40	Jun-13	Tablets and capsules	Plants to be utilized for manufacturing tablets and capsules in complaint with USFDA and cGMP standards
Expansion of Pharma facility	Jeedimatla			5	Mar-12	Liquidorals, tablets, capsules & ointments	De-bottlenecking of existing facility by upgradation to cGMP standards

Source: Company, Industry, RSec Research

Capacity expansion is expected to come on stream during FY2013-15E. This accompanied by an increasingly diverse product portfolio to boost future

Vivimed is setting up a SEZ in AP, which is expected to be completed by FY2015 and a pharmaceutical formulation plant in AP, to be completed in FY2014. The Company has also indulged into Brownfield expansion by capacity addition at existing specialty chemicals facilities of Bidar and Bonthapally expected to come on stream in FY2013.

Exhibit 17: Capex plan for Specialty Chemicals division

Facility	Place	Land & Development (Rs cr)	Facilities (Rs cr)	Total Investment Outlay (Rs cr)	Completion period	Products	Rationale
SEZ at Srikullam District	Andhara Pradesh	45	75	120	Mar-14	Synthetic organic chemicals (cosmetics, dye intermediates, bulk drugs and commercial R&D)	To support growing demand of exports, recd in-principle approval from the authorities and has acquired 327 acres of land
Expansion of existing mfg facilities	Bonthapally			10	Jun-12	API for home and personal care, anti-microbials and preservatives	To cater to increasing global demand for specialty chemicals acquired lands at both Bonthapally and Bidar
Expansion of existing mfg facilities	Bidar, Karnataka			15	Jun-12		

Source: Company, RSec Research

FY2013 to be a year of consolidation for Vivimed, while we built in steady growth base from FY2014E onwards

Transitioning into a niche player: *post integration picture and prospects*

Following the acquisitions and fund raising events, Vivimed now is set for consolidation where it plans to integrate the acquired entities and has no major equity dilution in place. Looking ahead, the company's focus varies across geographies. The company targets a steady growth base from FY2014E onwards as FY2013E will be a year of consolidation. This implies modest margin expansion in the Uquifa business. We build in moderate earnings growth for FY2013E and FY2014E due to consolidation but keep our expectations modest beyond that. We expect operating margins to improve once the manufacturing base for Uquifa is shifted to India.

Our channel checks indicate that Vivimed is admired by dealers for the quality of its products and strong support. Relentless focus on building a consumer brand has set Vivimed apart from its peers. This has allowed Vivimed to extend its presence in more consumer centric segments. At present, it is addressing only 5-10% of the areas of growth, whereas the target is to address a bigger market over the next 5-10 years. The company plans to build upon the area of providing molecules as per client requirements. This opens up growth avenues and may pave way to a higher ROE model

Competitive advantages in pricing

It enjoys the benefits of early mover advantage as it has been in this line of business since a long time and it is already an approved supplier for global giants as well as domestic companies like Unilever, P&G etc for certain personal care ingredients and therefore it faces limited competition. Vivimed's growth and healthy return ratios have underpinned a clutch of competitive advantages centered on branding and distribution.

Large clientele/ distribution network

With over 1,500 professionals under the roof, Vivimed has built holistic relationships with global and domestic clients with its products being sold in more than 50 countries. This network along-with the ready base of clients and sales force through acquisitions gives it a strong reach in the regulated and semi-regulated markets.

Key Clientele

Specialty Chemicals: Unilever, P&G, L'Oreal, J&J, ISP, Buntech, Microban, etc

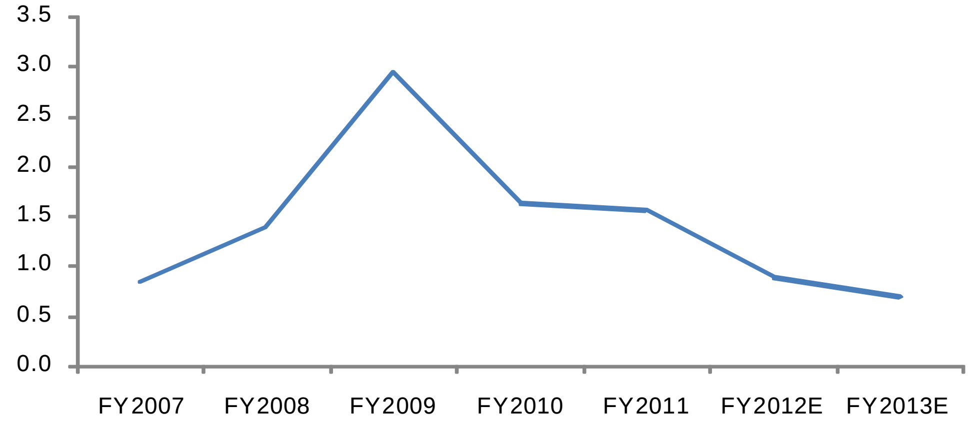
Pharmaceuticals: Novartis, Merck, Cipla, Lupin, Wockhardt, Glenmark, Astra Zeneca, etc

Initiatives for cost efficiency to de-leverage balance sheet

Post inorganic run up in the past 3 years, the company intends to focus on integration and financial scaling over the next 2-3 years. The management is fairly confident of driving the revenue and profitability through integration of acquisitions, capacity expansion and enhanced product range across both business segments. High capex and acquisitions have put pressure on its balance sheet. The D/E ratio has remained higher than 1.5x over the past 4 years.

Management has outlaid a strategy to de-leverage the balance sheet through a series of growth drivers

Exhibit 18: D/E ratio: To lower down due to equity dilution in FY2013E



Source: Company, RSec Research

However, the management outlays a cost efficient plan to de-leverage its balance sheet:

- Integration of Uquifa's operation will complement Vivimed's formulation business through backward integration
- With the acquisition of Klar Sehen and Octtantis Nobel, the focus of the division will shift from contract manufacturing to branded formulations, which will improve margins
- Specialty chemical, which is a low volume and high margin business, is witnessing strong demand growth of around 20-25% p.a. Strong entry barrier with high growth ensures revenue visibility
- Vivimed is trying hard to manage its working capital cycle efficiently by reducing the high debtor's days of around 110 in FY2011. We believe, with the strengthening footprint in the new markets and stronger relationships with the clients, Vivimed will be able to reduce it
- No equity dilution further despite capex, will scale up operations from FY2014E onwards

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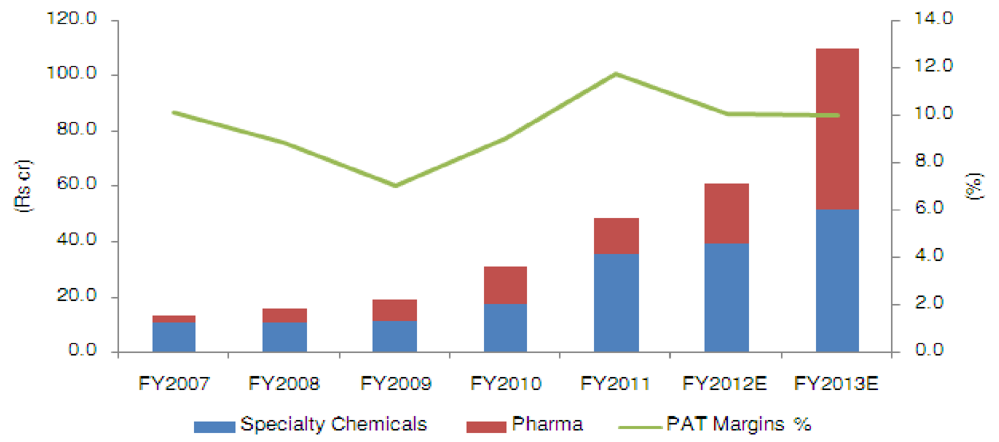
We build in significantly higher growth rates for FY2013E as all the 3 acquisitions would consolidate

Financial Analysis

Quality at a modest price

While Vivimed's stock has appreciated by 42% over the past 2 months on the back of robust earnings visibility from both the business segments, we believe that there is further scope of re-rating once the actual earnings from Uquifa comes into play. Besides, the B2B nature of business and a diverse product portfolio gives Vivimed an edge in bargaining power. Vivimed is geared up to enter the big league of companies through Uquifa acquisition by clocking a turnover of Rs1,100cr in FY2013E. Backed by expansion plans, new facilities and inorganic initiatives, we believe the company is rightly placed to show revenue CAGR of 62% and earnings CAGR of 50% over FY2011-13E. It is worthwhile to note that the growth in revenues is likely to be achieved without any significant decline in margins.

Exhibit 19 : Bottom-line sees a spike

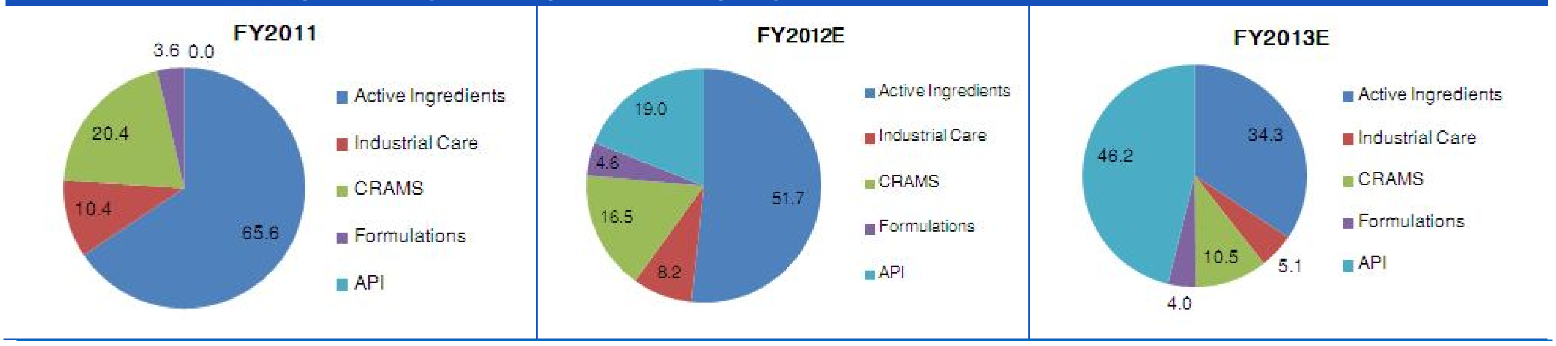


Source: Company, RSec Research

Key assumptions and forecast

In the consolidated business, we build in 95% CAGR growth for the pharma division (largely aided by Uquifa (API), Branded formulations (Klar Sehen and Occtantis Nobel)) and 16% CAGR for the specialty chemicals division on the back of new product launches over FY2011-14E. This drives the overall revenue growth of 44% CAGR where FY2013E revenue is likely to spike up by 81%.

Exhibit 20: Business segments: Uquifa changes the earnings equilibrium

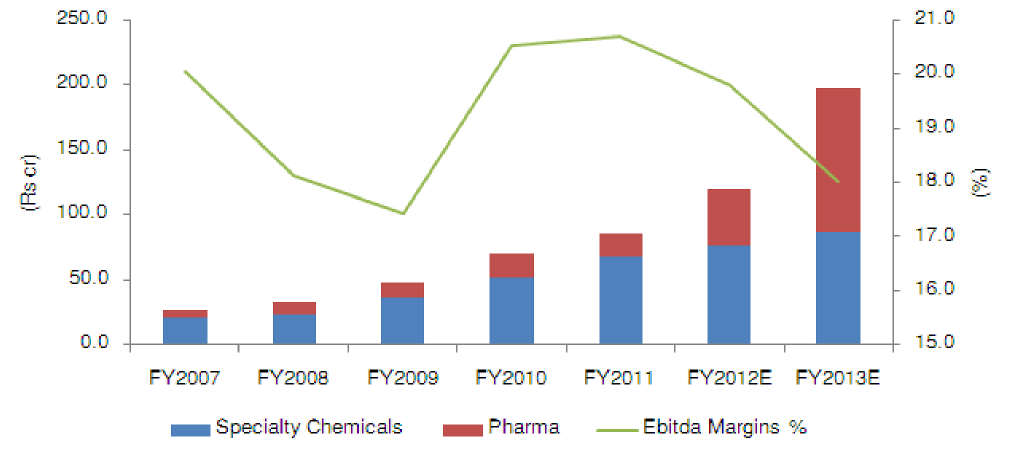


Source: Company, RSec Research

Product mix shift and margin improvements in individual businesses to drive operating margins from FY2014E onward, while, FY2013E will witness a margin contraction due to the acquisitions

We build in margin contraction of 180bp in FY2013E at 18% as the acquired companies will consolidate with marginal contribution to the bottom-line and high capex restricting the margins. However, with manufacturing being shifted to India and completion of capex for capacity enhancement, we forecast margin expansion of 80bp from the operating leverage benefits around administration and selling costs in FY2014E.

Exhibit 21 : Operating margins: Contraction only temporary in FY2013E

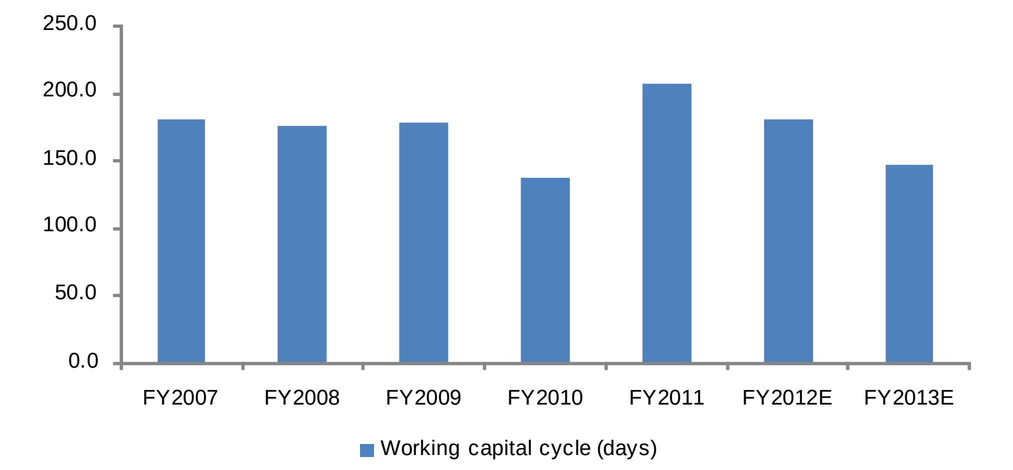


Source: Company, RSec Research

Vivimed's net working capital (ex cash) stood at 25% of the sales in FY2011 with sudden rise in the debtors' days. However, with major capex complete, we model the working capital to lower at 10-12% of sales and remain steady over the next couple of years.

With major capex on the verge of completion, working capital cycle to improve over the next couple of years

Exhibit 22 : High working capital days mending their ways

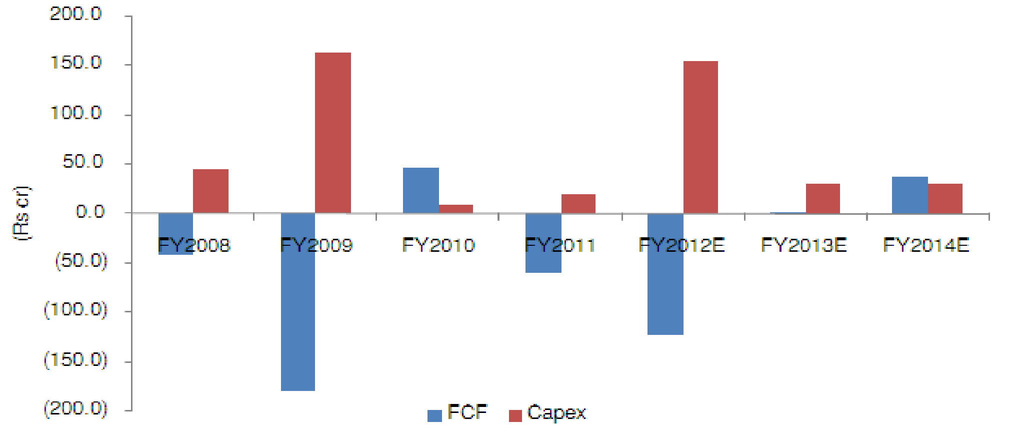


Source: Company, RSec Research

Steady operating performance likely to deliver a FCF of Rs37cr in FY2014E

We model in slight addition in gross debt in FY2013E, while, net debt will drop faster. We also build in steady working capital ratios despite the shift towards more working capital efficient business. We model in Rs30cr of capex per annum going forward. Steady operating performance and capex should help Vivimed deliver over Rs37cr as free cash flow (FCF) in FY2014E.

Exhibit 23 : To generate positive FCF from FY2013E



Source: Company, RSec Research

Exhibit 24: Peer comparison

Peer comparison	CMP	Mkt Cap (Rs cr)	EPS (Rs)			P/E (x)			EV/EBITDA (x)			RoE (%)		
			FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E
Omkar Specialty Chemicals*	61	119	5.2	8.6	12.1	11.7	7.1	5.0	5.6	4.0	3.2	11.0	16.0	19.1
Ajanta Pharma*	476	559	40.0	56.0	63.7	11.9	8.5	7.5	4.6	6.4	5.5	22.0	25.0	23.0
Vivimed Labs	406	579	48.0	43.7	68.7	8.5	9.3	5.9	8.3	7.1	4.9	24.8	15.8	22.2

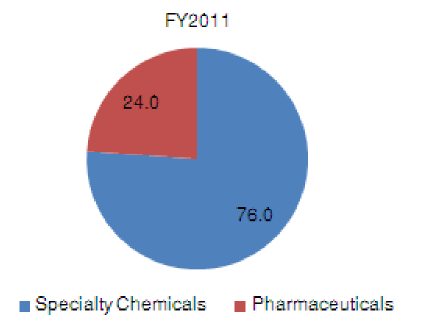
*Source: Company, RSec Research; * Consensus estimate*

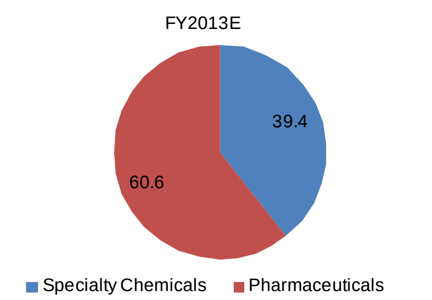
Company Background

Founded in 1989, Vivimed has a presence in 2 distinct industry segments: Specialty chemicals and Pharmaceuticals. Headquartered in Hyderabad (India), it has 9 manufacturing facilities (6 in India and 3 overseas) and 2 R&D facilities at Hyderabad and Huddersfield (UK). It expanded into APIs, mainly Ibuprofen, Chlorzoxazone, at Bidar facility in Karnataka, where it took over a sick unit. It got a major breakthrough from Unilever for anti-bacterial Viv-20 (Triclosan) and subsequently, the client list included Novartis, Merck, Cipla and Glenmark amongst others. Vivimed was a pure API player till 1995. It became public in 2005 and the proceeds of the same were used to fund the expansion of its Triclosan capacity (one of its best selling products ever).

Vivimed is the global supplier of APIs for a diverse range of beauty care products (hair, skin and oral care) as well as industrial products such as preservatives, antimicrobials, photochromic dyes etc. It supplies products in all major markets including US and Europe and has strong clientele, namely, L'Oreal, P&G, Unilever amongst others. In pharma segment, it is a partner of choice for large global players and has formed partnership agreements in drug discovery/ delivery in segments like oncology, tuberculosis and anti-ulcerants. The company offers branded formulations and contract manufacturing of formulations & APIs to a strong clientele comprising pharmaceutical majors like Novartis and Merck among others. 50% of company's revenues come from exports. ~20% of the shareholding is owned by the PE players as the company has raised funds for capital expenditure. The promoter holding currently is 43.6%.

Exhibit 25: Revenue segment – Changing Equilibrium





Source: Company, RSec Research

Exhibit 26: List of Manufacturing and R&D facilities

Place	Usage	Regulatory approval
Vishakhapatnam	Greenfield project for chemical sector	
Choutuppal, Hyderabad	Greenfield project for finished dosages in export market	USFDA compliant
Jeedimetla, Hyderabad	Equipped to manufacture dosage forms such as liquid orals, tablets, capsules and ointments in various therapeutic categories	WHO cGMP compliant
Haridwar and Kashipur (Uttranchal)	Kashipur is Located in an area having various tax concessions while Haridwar Manufactures a wide range of sterile products and low volume parenterals	WHO cGMP compliant
Hyderabad	R&D	
Huddersfield, UK	Kilo Lab and Mktg dept	
Bidar, Karnataka	Specialty chemical Unit I equipped with 60 reactors with over 300Kl capacity	
Bonthapally, AP	Specialty chemical Unit II Equipped with 78 reactors with over 350kl capacity	

Source: Company, RSec Research

Backed by marquee clients and adequate funding for capacity addition, Vivimed is attempting to create a 'pull' demand from a 'push' strategy for its products

Business Model: Transitioning into a niche player

Vivimed commenced business with manufacturing of bulk drugs and thereafter it gradually moved into manufacturing specialty chemicals. It has a well established franchise in the domestic pharma market, backed by marquee clients and distributors. While the company has traditionally levered its manufacturing base, it has increasingly focused on building the Vivimed brand and is now attempting transition to create a 'pull' demand from a 'push' strategy. This opens up growth avenues and may pave the way to a higher ROE model.

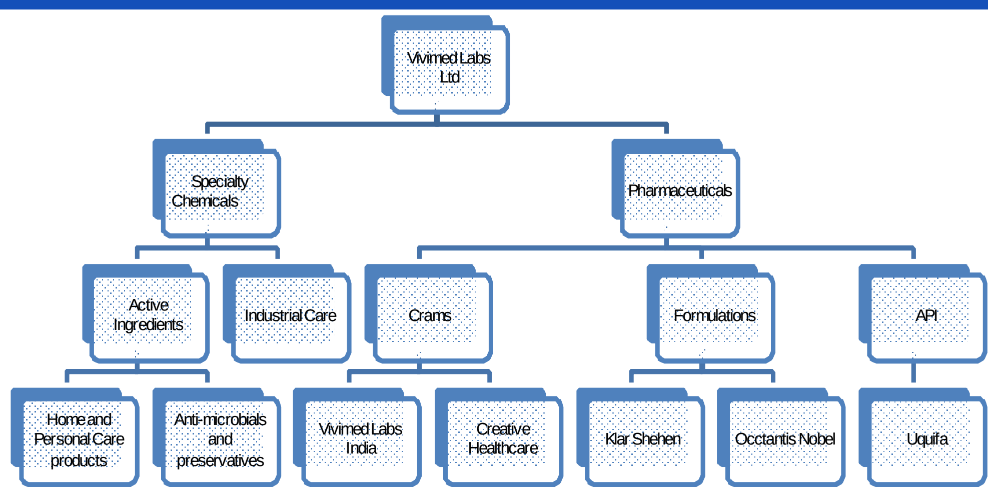
The company's business model now focuses on Specialty segments (personal and beauty care and industrial usage) and Pharmaceuticals (API, branded formulations and CRAMS) with specialty comprising 76% of the total sales in FY2011.

Adopting the inorganic route, the company started a spree of acquisitions every year post 2007. Vivimed acquired James Robinson in UK and Harmet International in US in 2008 and 2009 respectively in its specialty division. It recently made strategic acquisitions in its pharmaceuticals division, across API's (Uquifa) and branded formulations (Klar-Sehen & Octtantis Nobel). These have enabled it to increase its presence across the pharmaceutical value chain, and are aimed at securing longer term growth for the division.

Vivimed is backed by reputed financial institutions like NYLIM Jacob Ballas, Kitaara Capital, IFC (International Finance Corporation) and DSP Blackrock. It has raised ~US$28mn from the PE players to further facilitate its inorganic growth requirements. Besides, it has also raised US$7.5mn by way of FCCB from IFC. IFC has agreed to lend Vivimed another US$12.5mn as term finance to facilitate the setting up of infrastructure and manufacturing facilities at its proposed SEZ in Srikakulam district of Andhra Pradesh.

The company is geographically well-diversified considering the fact that it derives more than 50% of its revenue from exports to over 50 countries across the globe. However, we note that PE players own the ~20% + stake in the company.

Exhibit 27: Business Model

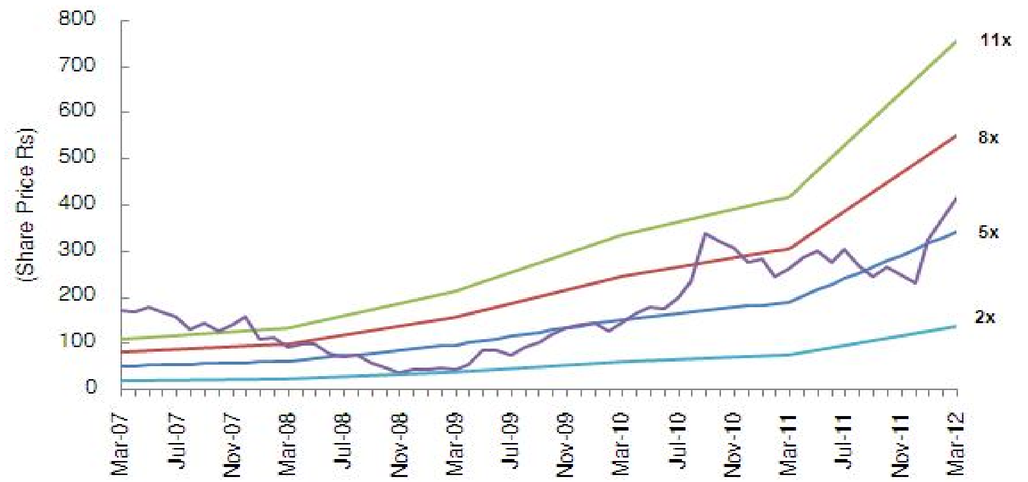


Source: Company, RSec Research

Outlook and Valuation

While, Vivimed's stock has appreciated by 42% over the past 2 months on the back of robust earnings visibility from both the business segments, we believe that there is further scope of re-rating once the actual earnings from Uquifa come in to play. Besides the B2B nature of business and a diverse product portfolio gives Vivimed an edge in bargaining power. The company is geared to enter the big league of companies through Uquifa acquisition by clocking a turnover of Rs1,100cr in FY2013E. Backed by expansion plans, new facilities and inorganic initiatives, we believe the company is rightly placed to show revenue CAGR of 62% and earnings CAGR of 50% over FY2011-13E. It is worthwhile to note that the growth in revenues is likely to be achieved without any significant decline in margins. No equity dilution in near future and strong growth visibility leads way to higher returns for shareholders. **Thus, we initiate coverage on the company with a Buy rating and a target price of Rs480.**

Exhibit 28: P/E band analysis



Source: Company, RSec Research

Vivimed has historically traded in the broad range of 2x-10x. The slowdown in the business due to building of capacities and no incremental growth had led it to trade at the lowest level of 2x its growth multiple. At our target price, Vivimed would trade at 7x its FY2013E earnings.

Risks and Concerns

- **High working capital cycle**

  Vivimed currently has high working capital cycle ranging as high as 7 months in FY2011. Although, the management has laid out a cost efficiency plan to bring down the working capital cycle, high receivables could impact future cash flows.

- **Early exit of the PE players**

  Although, the PE players (angel investors in this case) are long term investors, however, if they decide to exit early it could impact Vivimed's share price, who owns the ~20% + stake in the company.

- **Further Equity Dilution to hamper earnings growth**

  In order to keep debt levels under check, the company might think of diluting equity further to fund its future expansion plans. However, our estimates factor the conversion of preferential warrants.

- **Delay in Uquifa integration**

  The pharmaceutical divisions' future cash flows are heavily dependent on Uquifa's timely integration. Any delay or issues with the same would impact the synergies between the two companies and thereby impact our estimates.

Profit & Loss Statement

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Net Sales	**343**	**416**	**607**	**1,098**
Total Expenditure	**280**	**332**	**487**	**900**
Cost of Materials	203	237	316	571
R&D Expense	3	12	18	33
Personnel	22	20	30	60
Others	51	63	123	236
EBITDA	**63**	**84**	**120**	**198**
% chg	*40.2*	*33.3*	*42.9*	*64.5*
(% of Net Sales)	*18.4*	*20.2*	*19.8*	*18.0*
Depre. & Amortisation	9	9	21	33
EBIT	**54**	**75**	**99**	**165**
% chg	*43.6*	*37.9*	*31.9*	*66.8*
(% of Net Sales)	*15.8*	*18.0*	*16.3*	*15.0*
Interest & other Charges	21	21	26	31
Other Income	7	1	3	4
(% of PBT)	*16.5*	*1.7*	*3.9*	*2.6*
Recurring PBT	**40**	**55**	**76**	**137**
% chg	*71.5*	*39.4*	*37.8*	*80.4*
PBT	**40**	**55**	**76**	**137**
Tax	9	6	15	27
(% of PBT)	*21.8*	*11.6*	*20.0*	*20.0*
Adjusted PAT	**31**	**49**	**61**	**110**
PAT after MI (reported)	**31**	**49**	**61**	**110**
% chg	*60.2*	*57.5*	*24.7*	*80.4*
(% of Net Sales)	*9.0*	*11.7*	*10.0*	*10.0*
Reported EPS (Rs)	**22.3**	**35.0**	**43.7**	**78.9**
Fully Diluted EPS (Rs)	**19.4**	**30.5**	**38.1**	**68.7**
% chg	-	*57.5*	*24.7*	*80.4*

Cash Flow Statement

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Profit before tax	40	55	76	137
Depreciation	10	10	21	33
Change in Working Capital	6	(106)	(65)	(139)
Others	5	(3)	0	0
Cash Flow from Operations	**60**	**(44)**	**32**	**31**
(Inc.)/ Dec. in Fixed Assets	9	19	154	30
(Inc.)/ Dec. in Investments	(3)	1	(5)	0
Cash Flow from Investing	**(12)**	**(18)**	**(159)**	**(30)**
Issue of Equity	13	5	131	2
Inc./(Dec.) in loans	(65)	72	35	3
Dividend Paid (Incl. Tax)	2	2	2	2
Direct Taxes paid	5	8	15	27
Cash Flow from Financing	**(59)**	**67**	**148**	**(25)**
Inc./(Dec.) in Cash	(11)	5	22	(24)
Opening Cash balances	**17**	**6**	**11**	**33**
Closing Cash balances	**6**	**11**	**33**	**9**

Balance Sheet

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
SOURCES OF FUNDS				
Equity Share Capital	10	10	14	16
Warrant app. money	5	9	10	10
Reserves & Surplus	130	178	362	470
Shareholders' Funds	**145**	**197**	**386**	**496**
Minority Interest	0	0	0	0
Total Loans	235	308	343	346
Total Liabilities	**380**	**504**	**729**	**841**
APPLICATION OF FUNDS				
Gross Block	195	223	355	385
Less: Acc. Depreciation	34	44	65	98
Net Block	**161**	**180**	**290**	**287**
Capital W-I-P	95	86	109	109
Investments	**0**	**0**	**5**	**5**
Current Assets	194	315	429	612
Inventories	79	84	125	217
Sundry Debtors	94	128	175	277
Cash	6	11	33	9
Loans & Advances	15	92	97	110
Other	0	0	0	0
Current liabilities	59	68	96	163
Net Current Assets	**135**	**246**	**334**	**449**
Misc expenditure	6	7	7	7
Net Deferred Tax	(16)	(15)	(15)	(15)
Total Assets	**380**	**504**	**729**	**841**

Key Ratios

Y/E March	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)				
P/E (on FDEPS)	13.0	8.4	9.2	5.9
P/CEPS	10.1	7.1	6.9	4.5
P/BV	2.8	2.1	1.5	1.3
Dividend yield (%)	0.4	0.5	0.4	0.3
EV/Sales	4.1	3.7	3.2	2.8
EV/EBITDA	9.1	8.3	7.1	4.9
EV / Total Assets	1.6	1.4	1.2	1.1
Per Share Data (Rs)				
EPS (Basic)	31.1	48.0	43.7	68.7
EPS (fully diluted)	31.1	48.0	43.7	68.7
Cash EPS	39.9	57.0	59.0	89.1
DPS	1.5	2.0	1.5	1.3
Book Value	145.4	193.5	277.0	309.7
Returns (%)				
RoCE	15.4	14.6	13.7	19.7
RoIC	21.3	19.9	20.0	26.8
RoE	21.4	24.8	15.8	22.2
Turnover ratios (x)				
Asset Turnover (Gross Block)	1.8	1.9	1.7	2.9
Inventory / Sales (days)	84	74	75	72
Receivables (days)	100	112	105	92
Payables (days)	55	51	50	52
WCC (days)	137	206	181	146