Vivimed Labs

February 21, 2013

BUY

CMP	Rs324
Target Price	Rs474

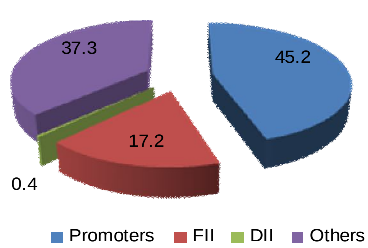
Stock Info

Sector	Pharmaceuticals
Market Cap (Rs cr)	400
52 Week High/Low	445/311
Avg. Daily Volume (3m, '000)	22
Avg. Daily Value (3m, cr)	0.7
Dividend Yield (%)	1.1
Sensex	19,374
Nifty	5,861
BSE Code	532660
NSE Code	VIVIMEDLAB

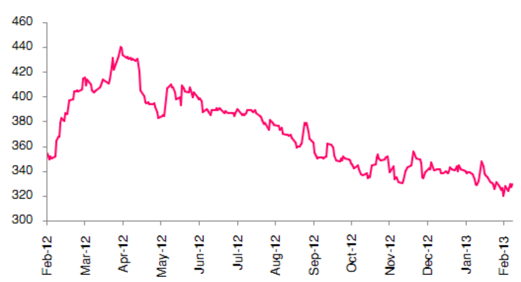
Stock Performance

(%)	VIVIMED	NIFTY
1-week	(0.3)	(0.6)
1-month	(4.2)	(3.6)
1-year	(8.7)	4.5

Shareholding Pattern (%)



Stock Price Chart



Analyst: Sapna Jhavar
sapna.jhavar@rcap.co.in

Sequentially weak quarter

Key highlights of the result

- **Poor operating performance:** For 3QFY2013, Vivimed reported a robust top-line growth of 62% yoy, which was above estimates largely attributed to consolidation of Uquifa. On a qoq basis, the top-line remained muted, as specialty chemicals (down 20% qoq) was impacted by continuous low off take of Triclosan (7% revenue impact), while Pharma division (up 0.5% qoq) suffered from planned holiday closure. The gross margins contracted 230bp both on qoq and yoy basis. This led the EBITDA margins to contract by 560bp yoy to 13.2% owing to weak specialty chemicals business. Aided by deferred tax, APAT came in at Rs17.9cr, up 11.7% yoy (against our estimate of Rs20.6cr).
- **Finoso acquisition:** The Company has proposed to acquire Finoso Pharma, a Hyderabad based company focused on formulations product development for Rs15cr. The payment would be made through cash, stock and deferred payment. The company plans to complete the acquisition by the end of FY2013 with deferred payments based on milestones achieved on dossier filings spread across 5 years. With a top-line of Rs5cr, Finoso's EBITDA margin was strong at 31% in FY2012. It currently has 31 dossier filings to its credit.
- **Concall takeaways:** (1) Vivimed has re-iterated its top-line growth guidance of Rs1,100cr, while the PAT is expected at Rs90-95cr in FY2013E, which looks realistic in our view. (2) It has chalked out detailed growth plan on the back of new order wins, product approvals and entry into new segments with partners in specialty chemicals. Besides, the pharma segment is also set to show significant progress with new client orders in CRAMS space. (3) Uquifa contributed Rs114cr in 3Q, margins declined due to internal shift in operations. Management remains confident of maintaining 13-14% of normalized margins going ahead. (3) Debt has increased in 9MFY2013 to Rs630cr due to various expansions and capacity build-up plans leaving cash balance of Rs13cr. (4) Tax rate for the year is guided at 10% for FY2013E.

Outlook and Valuation

For 3QFY2013 Vivimed's results have been disappointing on the operating front owing to lower contribution from high margin specialty chemicals division. With large orders in place, we expect a swift recovery from 4QFY2013E onwards from high margin specialty business. Further, continuous improvement in formulations (Pharma segment) will pave way for growth. Finoso is likely to fill the service gap in Vivimed's business on two major fronts: (a) formulation development, and (b) dossier filing and approvals. Besides, completion of facility expansion and ramp up in capacity utilization will be a structural growth driver for the company beyond FY2014E. Though we remain positive on the future business prospects, a soft 9MFY2013 performance has led to earnings cut of 18-20% each for FY2013E and 14E. **We also introduce our FY2015E numbers in this note and maintain our Buy rating on the stock with a revised Target Price of Rs474.**

Risks to the view

- High working capital cycle could impact future cash flows
- Delay in Uquifa integration could impact revenues

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
FY2012	665	59.9	127	19.1	63	29.3	13.3	10.0	39.5	7.1	7.5
FY2013E	1,114	67.5	194	17.4	91	43.8	16.2	12.8	56.8	5.7	5.3
FY2014E	1,259	13.0	220	17.5	107	17.9	16.2	13.5	66.9	4.8	4.5
FY2015E	1,446	14.9	255	17.6	126	18.1	16.2	14.2	79.0	4.1	3.8

**EPS is fully diluted*

Exhibit 1: Quarterly Performance (Consolidated)

(Rs cr)	3QFY13	3QFY12	% yoy	2QFY13	% qoq	9MFY13	9MFY12	% yoy
Net Sales	**272.1**	**168.0**	***62.0***	**266.1**	***2.3***	**810.7**	**417.3**	***94.3***
Material cost	139.5	82.4	*69.2*	130.2	*7.1*	379.6	220.1	*72.5*
% of net sales	*51.2*	*49.1*		*48.9*		*46.8*	*52.8*	
Staff costs	9.3	8.4	*11.6*	12.4	*(24.8)*	36.0	20.3	*76.8*
% of net sales	*3.4*	*5.0*		*4.7*		*4.4*	*4.9*	
Other expenses	87.5	45.6	*91.7*	75.1	*16.4*	249.8	92.8	*169.3*
% of net sales	*32.1*	*27.2*		*28.2*		*30.8*	*22.2*	
Total operating exp.	**236.2**	**136.4**	***73.2***	**217.7**	***8.5***	**665.4**	**333.2**	***99.7***
Operating profit	35.9	31.6	*13.4*	48.4	*(25.8)*	145.4	84.0	*73.0*
OPM (%)	*13.2*	*18.8*		*18.2*		*17.9*	*20.1*	
Interest	9.8	5.9	*68.0*	10.8	*(8.5)*	36.5	20.3	*79.9*
Depreciation	14.3	6.9	*107.2*	14.1	*1.6*	42.5	13.3	*218.7*
EBIT	**11.7**	**18.9**	***(37.7)***	**23.5**	***(50.1)***	**66.4**	**50.4**	***31.6***
Other Income	2.3	1.6	*43.2*	9.7	*(76.7)*	13.8	1.8	*675.2*
PBT	**14.0**	**20.5**	***(31.5)***	**33.3**	***(57.9)***	**80.2**	**52.2**	***53.6***
Total tax	(3.9)	4.4	*(188.9)*	3.5	*(210.8)*	5.4	11.4	*(52.4)*
Tax Rate (%)	*(27.9)*	*21.5*		*10.6*		*6.7*	*21.7*	
Minority Interest	0.0	0.0	-	0.0	-	0.0	0.0	-
Adjusted PAT	**17.9**	**16.1**	***11.7***	**29.7**	***(39.7)***	**74.8**	**40.9**	***83.0***
Net profit margin (%)	6.6	9.6		11.2		9.2	9.8	
Extra-ordi. Items	(1.0)	0.0	-	(4.2)	-	(6.2)	0.0	-
Forex (loss)/gain	(1.0)	0.0		(4.2)		(6.2)	0.0	
Others	0.0	0.0		0.0		0.0	0.0	
Reported Net profit	**16.9**	**16.1**	***5.4***	**25.5**	***(33.7)***	**68.6**	**40.9**	***67.9***
Reported EPS (Rs)	**12.1**	**12.9**		**18.3**		**49.2**	**29.3**	

Source: Company, RSec Research

Key Highlights

Strong order book in the sun care segment and Triclosan to boost growth in 4Q and FY2014E

Specialty Chemicals: The contribution of specialty chemicals declined sequentially to 35.1% from 44.9% of the total sales in 3QFY2013. The same has declined 20% qoq owing to lower off-take of Triclosan and OMC. Lower sales from Triclosan impacted the business by 7%. Further, one time severance cost in Europe due to shift in internal operations added to the dismal performance. However, the management seems confident of a pick-up in 4QFY2013E through healthy order book in the sun care segment (Rs10.8cr) and Triclosan order from Colgate (Rs5cr). Vivimed is foraying into newer avenues of fragrances and silicones in a partnership based model. With its relentless focus on the Indian market and partnerships based on innovation led R&D molecules (gross margins of 60-70%), we estimate 19% CAGR over FY2012-15E.

New order wins to act as growth drivers going ahead

Pharma: The revenues from pharma business also remained muted with 0.5% qoq growth at Rs176.6cr in 3QFY2013 based on lower contribution from Uquifa. EBITDA margins also declined to 10.4% yoy in 3QFY2013 vis-à-vis 12.2% in 2QFY2013 owing to lower margins at Uquifa. Uquifa contributed Rs114cr in 3QFY2013, in-line with company's internal target. The shift of manufacturing base of Uquifa to India has commenced in early 2013, which would further help boost the margin, in our view. Management expects margins to normalize at 13-14% levels going ahead.

The retail branded formulations contributed Rs6cr in 3Q and Rs22cr in 9M as it continued to expand its operations across India. The company continues to focus on therapeutic areas such as ophthalmic, gynecology for growth in branded formulations. New orders from Uquifa (US$20mn for an anti-HIV drug and US$2mn from Ranbaxy), new client addition in Ukraine and product approvals in Europe is likely to boost the top-line growth with 38% CAGR over FY2013-15E.

Exhibit 2: Segment wise sales performance

Particulars (Rs cr)	3QFY13	3QFY12	% yoy	2QFY13	% qoq	9MFY13	9MFY12	% yoy
Specialty Chem.	96	84	*13.7*	119	*(20.0)*	320	295	*8.4*
Pharma*	177	84	*110.1*	147	*20.3*	491	122	*301.7*
Total Sales	**272**	**168**	***62.0***	**266**	***2.3***	**811**	**417**	***94.3***

*Source: Company, RSec Research; * includes the adjusted inter-segment revenue*

Capacity expansion: To augment its export driven growth, Vivimed is setting up a SEZ in Andhra Pradesh (AP; expected to be completed by FY2015) and also a pharmaceutical formulation plant in AP (to be completed by June 2013). The USFDA approval for the intermediary plant is expected in March 2014. The company has also indulged into Brownfield expansion by capacity addition at existing specialty chemicals facilities of Bidar and Bonthapally and pharmaceutical plant at Jeedimetla.

Our Assumptions: Vivimed's 9MFY2013 performance has been weak owing to several one-off factors. It has also chalked out a detailed order book reflecting a promising growth in FY2014-15E. We are of the view that successful execution of these orders will drive the top-line, however margins are likely to remain muted at 17.5% due to large fixed overheads. Higher interest cost on the back of huge debt is also a worrisome factor. Although, the management has committed for organic growth in FY2014E, further equity dilution may impact growth. Post acquisitions, we expect the top-line to grow at CAGR of 30% over FY2012-15E, while the PAT is expected to grow at 26% CAGR with gradual improvement in operating performance.

Outlook and Valuation

For 3QFY2013 Vivimed's results have been disappointing on the operating front owing to lower contribution from high margin specialty chemicals division. With large orders in place, we expect a swift recovery from 4QFY2013E onwards from high margin specialty business. Further, continuous improvement in formulations (Pharma segment) will pave way for growth. Finoso is likely to fill the service gap in Vivimed's business on two major fronts: (a) formulation development and (b) dossier filing and approvals. Besides, completion of facility expansion and ramp up in capacity utilization will be a structural growth driver for the company beyond FY2014E. Though we remain positive on the future business prospects, a soft 9MFY2013 performance has led to earnings cut of 18-20% each for FY2013E and 14E. **We also introduce our FY2015E numbers in this note and maintain our Buy rating on the stock with a revised Target Price of Rs474.**

Profit & Loss Statement

Y/E March (Rs cr)	FY2012	FY2013E	FY2014E	FY2015E
Net Sales	**665**	**1,114**	**1,259**	**1,446**
Total Expenditure	**538**	**920**	**1,039**	**1,192**
Cost of Materials	337	529	603	688
R&D Expense	21	38	42	49
Personnel	34	48	55	62
Others	145	305	339	392
EBITDA	**127**	**194**	**220**	**255**
% chg	*47.0*	*52.3*	*13.6*	*15.5*
(% of Net Sales)	*19.1*	*17.4*	*17.5*	*17.6*
Depre. & Amortisation	27	57	64	72
EBIT	**100**	**137**	**156**	**182**
% chg	*31.6*	*36.5*	*13.9*	*16.8*
(% of Net Sales)	*15.1*	*12.3*	*12.4*	*12.6*
Interest & other Chg	28	47	50	54
Other Income	6	16	20	20
(% of PBT)	*7.3*	*15.1*	*15.9*	*13.4*
Recurring PBT	**78**	**106**	**126**	**149**
% chg	*40.8*	*36.5*	*18.5*	*18.1*
Tax	15	15	19	22
(% of PBT)	*18.9*	*14.5*	*15.0*	*15.0*
Reported PAT	**63**	**91**	**107**	**126**
% chg	*29.3*	*43.8*	*17.9*	*18.1*
(% of Net Sales)	*9.5*	*8.2*	*8.5*	*8.7*
Basic EPS (Rs)	**45.3**	**65.2**	**76.8**	**90.7**
Fully Diluted EPS (Rs)	**39.5**	**56.8**	**66.9**	**79.0**
% chg	*29.3*	*43.8*	*17.9*	*18.1*

Balance Sheet

Y/E March (Rs cr)	FY2012	FY2013E	FY2014E	FY2015E
SOURCES OF FUNDS				
Equity Share Capital	14	16	16	16
Preference Capital	131	62	62	62
Warrant application	2	2	2	2
Reserves& Surplus	328	481	582	702
Shareholders' Funds	**475**	**561**	**662**	**782**
Total Loans	577	626	628	631
Total Liabilities	**1,051**	**1,187**	**1,290**	**1,413**
APPLICATION OF FUNDS				
Gross Block	1,113	1,233	1,283	1,313
Less: Acc. Depreciation	572	629	693	765
Net Block	**541**	**604**	**590**	**548**
Capital Work-in-Progress	63	84	90	98
Investments	**1**	**1**	**1**	**1**
Current Assets	647	899	1,039	1,231
Inventories	248	351	386	436
Sundry Debtors	222	321	373	436
Cash	36	33	58	103
Loans & Advances	141	189	214	246
Other	0	6	8	10
Current liabilities	234	408	440	483
Net Current Assets	**413**	**492**	**598**	**748**
Misc. Expense	48	20	25	31
Net Deferred Tax	(13)	(13)	(13)	(13)
Total Assets	**1,051**	**1,187**	**1,290**	**1,413**

Cash Flow Statement

Y/E March (Rs cr)	FY2012	FY2013E	FY2014E	FY2015E
Profit before tax	78	106	126	149
Depreciation	27	57	64	72
Interest / Dividend (Net)	28	47	50	54
Change in Working Capital	(142)	(83)	(81)	(105)
Direct Taxes Paid	(15)	(15)	(19)	(22)
Others	630	0	0	0
Cash Flow from Operations	**607**	**112**	**141**	**148**
(Inc.)/ Dec. in Fixed Assets	(866)	(141)	(56)	(39)
(Inc.)/ Dec. in Investments	(40)	28	(5)	(6)
Cash Flow from Investing	**(907)**	**(113)**	**(61)**	**(45)**
Issue of Equity	90	2	0	0
Inc./(Dec.) in loans	270	49	2	3
Dividend Paid (Incl. Tax)	(6)	(6)	(6)	(6)
Interest / Dividend (Net)	(28)	(47)	(50)	(54)
Cash Flow from Financing	**325**	**(2)**	**(54)**	**(57)**
Inc./(Dec.) in Cash	25	(4)	26	45
Opening Cash balances	**11**	**36**	**33**	**58**
Closing Cash balances	**36**	**33**	**58**	**103**

Key Ratios

Y/E March	FY2012	FY2013E	FY2014E	FY2015E
Valuation Ratio (x)				
P/E (on FDEPS)	7.1	5.7	4.8	4.1
P/CEPS	5.0	3.5	3.0	2.6
P/BV	0.9	0.9	0.8	0.7
Dividend yield (%)	1.2	1.0	1.0	1.0
EV/Sales	1.5	1.0	0.9	0.7
EV/EBITDA	7.5	5.3	4.5	3.8
EV / Total Assets	0.9	0.9	0.8	0.7
Per Share Data (Rs)				
EPS (Basic)	45.3	65.2	76.8	90.7
EPS (fully diluted)	39.5	56.8	66.9	79.0
Cash EPS	64.5	92.2	107.0	124.2
DPS	3.9	3.4	3.4	3.4
Book Value	340.7	350.8	413.8	488.8
Returns (%)				
RoCE	10.0	12.8	13.5	14.2
RoIC	13.2	17.9	19.1	20.8
RoE	13.3	16.2	16.2	16.2
Turnover ratios (x)				
Asset Turnover (Gross Block)	0.6	0.9	1.0	1.1
Inventory / Sales (days)	136	115	112	110
Receivables (days)	122	105	108	110
Payables (days)	135	145	140	135
WCC (days)	206	150	157	163