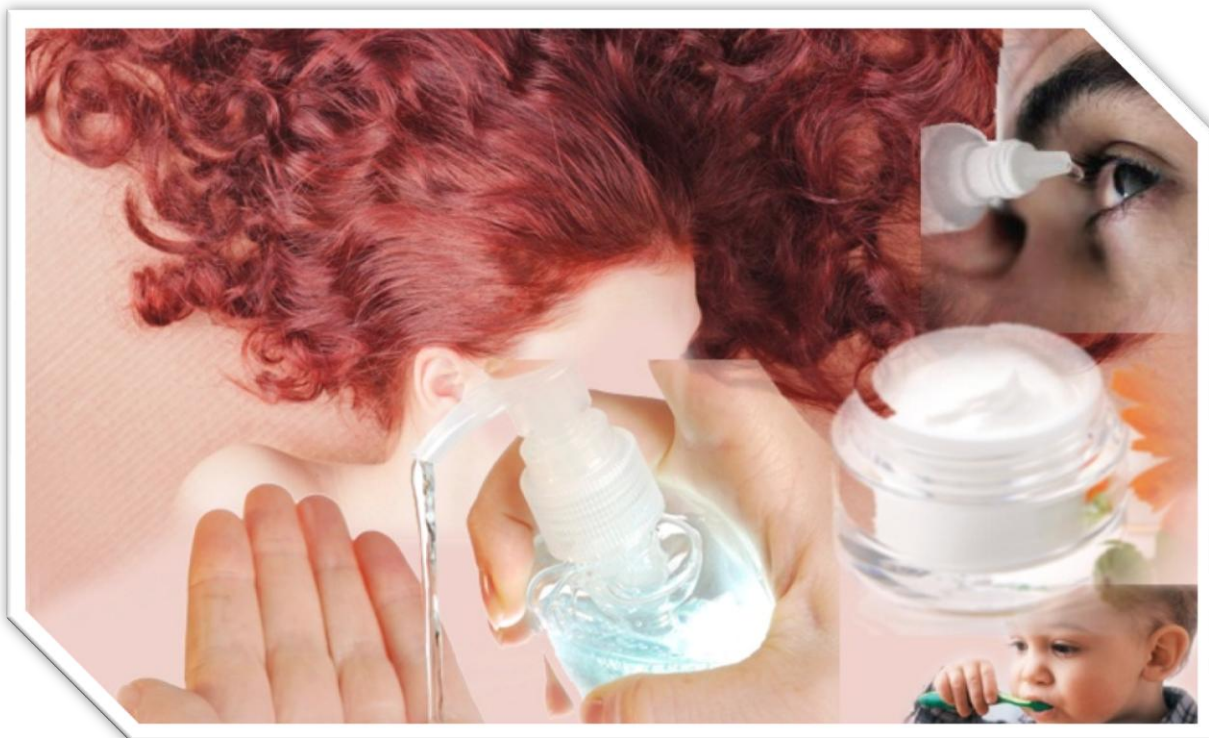


February 24, 2012

Vivimed Labs Limited



Initiating Coverage

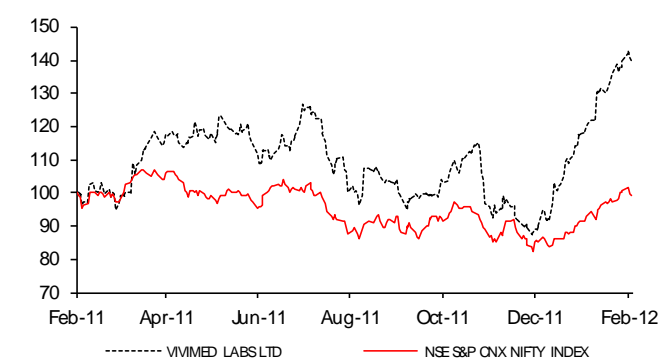
Vivimed Labs Ltd.

Present Price	Rs.350
Target Price	Rs.685
Sector	Healthcare

Stock Details

BSE Code	532660
Bloomberg Code	VILA IN
Market Cap (Rs. cr)	487
Free Float (%)	56.4
52- wk HI/Lo (Rs)	361/213
Avg. Volume BSE (Monthly)	63328
Face Value (Rs)	10.0
Dividend (FY 11)	17%
Shares o/s (Cr)	1.4

Relative Performance	1Mth	6Mth	1Yr
Vivimed(%)	18.1	39.3	40.2
NIFTY(%)	8.4	10.5	0.6



Shareholding Pattern as of 31 Dec 2011

Promoters Holding	43.6%
Institutional (Incl. FII)	26.5%
Corporate Bodies	6.1%
Public & others	23.8%

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Snapshot

Set up as a formulations facility in 1985, Vivimed Labs has come a long way to evolve as a complete pharmaceutical and healthcare company. With the recent acquisition of Uquifa of Spain, the turnover of the company should almost treble to Rs.1,200 crore by FY13E (from Rs.416 crore in FY11) with equal contribution from pharmaceutical and specialty chemical segments.

Investment Rationale

- **Earnings poised to grow substantially:** The company's earnings are poised to grow substantially going forward on the back of a slew of organic as well as inorganic initiatives taken by the company over the past two years.
- **Equity dilution much lower compared to growth in earnings:** Net sales and earnings are set to jump multi-fold going forward. However, to achieve this growth, equity diluted is relatively much less, thereby leading to higher returns for shareholders.
- **Strong entry barriers in the business:** It is a difficult and time-consuming process to establish relationship with multi-national players to supply the products. It takes a time frame of at least around 3-4 years to build a relationship with a client. The top 10 customers of Vivimed include Unilever, P&G, L'Oreal, among others.
- **Business relatively immune to economic slowdown:** As the company caters to the personal care and pharmaceutical segments, product sales are relatively less impacted in the wake of the current slowdown.

Valuation & Recommendation

On the back of various organic as well inorganic initiatives, the company's turnover should almost treble to Rs.1,200 crore by the end of FY13. Net profit should be around Rs.109.6 crore, translating into an EPS of Rs.68.5. We value the company at 10x FY13 earnings considering the fact that the re-rating should happen on the back of higher contribution from the pharma segment, arriving at a target price of Rs.685 over the next 12 to 15 months, an upside potential of 95 per cent.

Particulars	Net Sales	Growth (%)	PAT	Growth (%)	EPS (Rs)	P/E (x)
FY'10	350.0	26.8	31.0	46.6	31.1	11.2
FY'11	416.9	21.1	48.9	22.1	44.4	7.9
FY'12E	625.2	50.2	60.2	53.2	48.2	7.3
FY'13E	1200.0	92.0	109.6	72.8	68.5	5.1

(Source: Company, Nirmal Bang Research)

INVESTMENT RATIONALE

Earnings poised to grow exponentially

Vivimed Labs (Vivimed) is expected to register a phenomenal improvement in its financial performance on the back of a slew of organic as well as inorganic initiatives taken by it over the past two years.

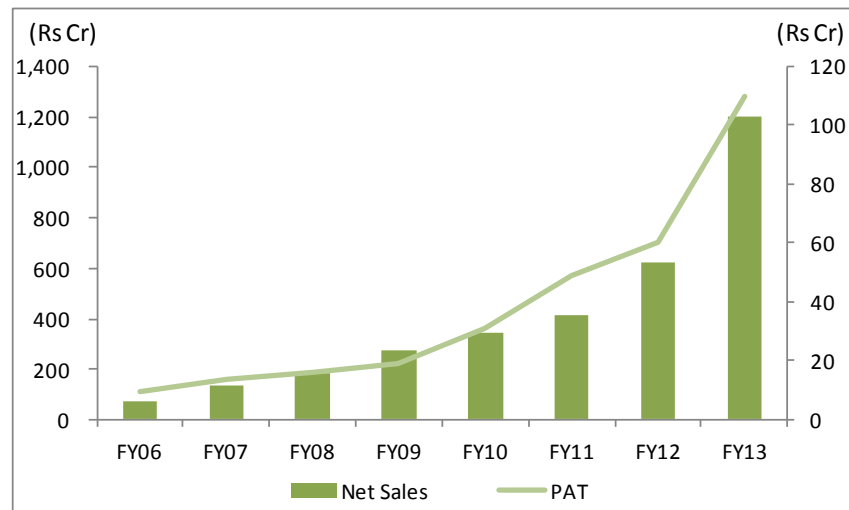
Vivimed is geared up to enter the ‘big league’ of companies by clocking a turnover of Rs.1,200 crore in FY13E. This is in line with the management’s vision in 2010 itself to breach a turnover target of Rs.900 crore when the turnover stood at just Rs.343 crore.

Backed by expansion plans, new facilities and inorganic initiatives, we believe the company is rightly placed to show a CAGR of 70 per cent over FY11-13E. It is worthwhile to note that the growth in revenues is likely to be achieved without any significant decline in margins.

Going by the past track record of the company, net sales and earnings during FY’06-11 have witnessed CAGR of 40 per cent and 39 per cent, respectively. We expect net sales and net profit to grow 70 per cent and 50 per cent, respectively, over FY’11-13.

Geared up to enter the ‘big league’ of companies by clocking a turnover of Rs.1200 crore in FY’13E

Exhibit: Net Sales and Profit set to shoot



(Source: Company, Nirmal Bang Research)

A break-up of the capex plan of the company has been given below in tabular form:

(Rs. crore)

Facility	Land & Development	Facilities	Total investment outlay	Completion period
1. SEZ at Srikakulam district, Andhra Pradesh	45	75	120	March 2014
2. Formulation dosage facility, Choutuppal	2.5	37.5	40	June 2013
3. Expansion of existing manufacturing facilities at Bonthapally			10	June 2012
4. Expansion of existing manufacturing facilities at Bidar, Karnataka			10	June 2012
5. Expansion of pharma facility at Jeedimetla			10	Mar 2012

(Source: Company, Nirmal Bang Research)

The company is all geared up with inorganic initiatives as well. With already two acquisitions since 2008, Vivimed has closed three more acquisitions in the current financial year.

The pace of acquisitions has strengthened over the past few months and the recent big-ticket acquisition of Uquifa Limited augurs very well for the company going forward.

Vivimed has acquired 327 acres of land since FY09 at a total cost of Rs.40 crore for its SEZ facility. The current value of the same is much higher than the cost of acquisition. Considering the fact that 40 per cent of the project cost goes towards utilities and the balance 60 per cent towards productive assets, the asset utilisation ratio should improve going forward once these facilities commence operations.

Adequately funded to pursue its growth plan

Vivimed is adequately funded to pursue its organic as well as inorganic growth plans. The company has strengthened its resources through equity dilution as well as the debt mode, and is well-funded.

Vivimed has raised a sum of Rs.127 crore by roping in private equity players like Jacob Ballas and Kitara Capital. In addition, International Finance Corporation (Washington) has also invested in the company. It is to be noted that IFC conducted a due diligence for a period of nine months before investing in the company. Aided by internal accruals, the other sources of funding include debt from Exim Bank of India.

Three-pronged growth strategy

Vivimed has adopted a three-pronged growth strategy which has helped it to scale new heights. We expect the company to do significantly well going forward on the back of these levers:

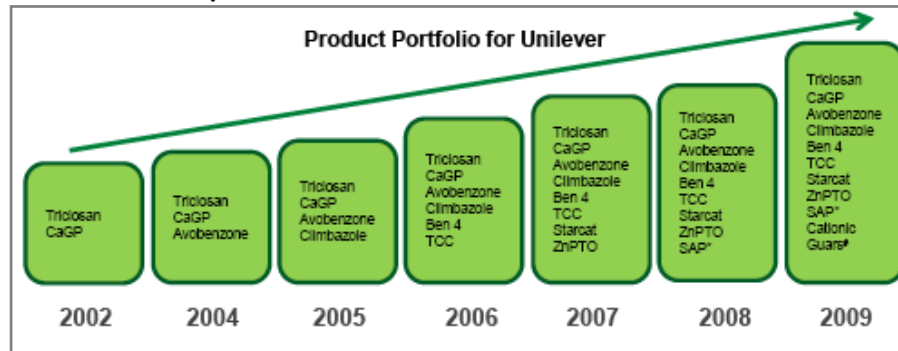
1. **Market Development** – Increased supply as a result of partnering in new locations
2. **Market Penetration** – Increased supply of the same product
3. **Product Development** – Supplying new products across the personal-care spectrum

Vivimed started supplying Triclosan to Unilever in 1998. The company was supplying two products in 2002, but the size of its product portfolio stood at more than 10 products by the end of 2009.

Similarly, the company has increased the number of products supplied to L’ Oreal and P&G.

At present, Vivimed is addressing only 5-10 per cent of the areas of growth; 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.

Exhibit: Product portfolio for Unilever



(Source: Company)

Growth Initiatives:

The company’s earnings are expected to register a strong growth going forward on the back of organic as well as inorganic initiatives. A brief description of the expansion plans has been given below in a tabular form:

Particulars	Description
Organic initiatives	
Bidar (Karnataka)	Acquired 7 acres of land from Omnitel Industries adjacent to the existing facility, which has readily available superstructures in place
Bonthapally (Andhra Pradesh)	Acquired an additional 6 acres of land from Gram Organic Pvt. Ltd., which is adjacent to the existing facilities
Inorganic initiatives	
Acquisition of Klar Sehen Pvt. Ltd., Kolkata	Has a strong presence in North-Eastern states, Bihar and Andhra Pradesh. The company operates in a niche ophthalmic segment and owns about 50 trademarks and well-known brands
Acquisition of Octtantis Nobel Labs Pvt. Ltd., Hyderabad	Distributing various formulations, with a presence in Andhra Pradesh and certain states in the eastern region.
Acquisition of Uquifa, Spain & Mexico	Uquifa is a 75 year-old pharma company having a strong position in the API market, one of the oldest and also one of the largest companies in Spain. It has units in Spain & Mexico, but the business is spread across North America, Europe and Rest of the World (ROW).

(Source: Company, Nirmal Bang Research)

Uquifa's acquisition should be a **'game changer'** for the company considering the fact that it plans to leverage facilities in India and add more products to Uquifa's portfolio.

Uquifa has products in over 15 therapeutic classes distributed across 70 countries and over 100 customers with anti-ulcer segment contributing 40 per cent to its total sales. The company is a supplier to top 10 generic pharmaceutical players in the world. Vivimed also has a strong relationship with leading innovator companies.

Vivimed has ambitious plans to leverage leadership position of Uquifa in APIs along with robust pipeline of filings to accelerate growth across Europe and the USA over the next five years. This, coupled with backward integration initiatives, supply efficiencies and market-penetration strategy should augur well for Vivimed, going forward.

Successfully integrated previous overseas acquisition

We are optimistic that Vivimed would be able to integrate the operations of Uquifa with itself considering its past experience in successful integrating an acquired entity, James Robinson (in 2008). Before the acquisition, James Robinson was a global supplier of hair-dye chemical intermediates to P&G, L'Oreal and Henkel. It was also a global supplier of photochromic dyes used for ophthalmic, brand protection, anti-counterfeit and security applications.

As a part of the acquisition, the process technology and know-how got absorbed by Vivimed and it initiated the exercise of reducing its manufacturing costs by shifting the products that were manufactured at James Robinson to India. The company also initiated further steps to absorb process technology and know-how.

Over a period of time, post-acquisition, sales and profit growth was achieved in key business segments. Key products were successfully transferred and scaled up on the back of effective integration exercise initiated by the company.

The company acquired Harmet International in 2009, a 15-year old Sales & Distribution organization with established customer base. Harmet provided a direct entry into a huge customer base in the developed market.

Marquee list of customers

Vivimed has been catering to prominent multi-national players in the pharmaceutical as well as FMCG space. The FMCG space includes names like Unilever, Procter & Gamble, Colgate, L'oreal and Marico, while the pharma space has names like Merck, Novartis, AstraZeneca, Teva, GSK, Abbott, Baxter and Pfizer among others. Vivimed has created a niche for itself, as the client business development cycle in this business is at least 3-4 years, which is the main entry barrier in the business.

Strong entry barriers in the business

Supply of ingredients, especially while catering to multi-national clients, involves adhering to stringent quality and product safety norms which are customer-specific.

As the products in the specialty chemicals segment find their application in branded products of the FMCG segment, mainly MNC players, it is actually a lengthy process to enter this segment and create a favourable impression on FMCG majors. It is a time-consuming process with the duration ranging at least around 30-42 months. The same has been given below in a tabular form:

Activity	Duration
Sample quantities	3-6 months
Small/trial batches	6-9 months
Stabilization period	15-18 months
Commercial quantities	6-9 months
Total	30-42 months

(Source: Company, Nirmal Bang Research)

After five years of concerted efforts, Vivimed got a breakthrough with Unilever in 1998. The company started with the supply of a single product from one location and now supplies several key ingredients to Unilever's global brands from multiple locations.

Apart from the business entry, continuous efforts are also required on the pricing mechanism front. As FMCG players themselves operate in a competitive environment across the globe, providing the ingredients (that find application in the final product) at prices without any significant increase in the cost of the final product is a challenge. Considering this condition, it is a problem for suppliers of the ingredients to maintain consistency in their margins. Vivimed has been consistently maintaining its operating profit margin at around 18-20 per cent. We expect this trend in respect of consistency in margins to continue going forward.

Strong focus on Research & Development

Vivimed has a strong focus on the Research & Development aspect through the facilities located at Mallapur (Hyderabad, India), Nacharam (Hyderabad, India), Huddersfield(UK) and Sant Celoni(Barcelona, Spain) with the acquisition of Uquifa.

These facilities are aided by a strong team of 75 dedicated scientists and engineers. The laboratories are GLP-compliant and recognized by Council for Scientific Industrial Research having focused and idea-generating right from creation of a molecule (Molecular Research) to partnering with a manufacturer(Collaborative Manufacturing).

Relatively immune to general economic slowdown

As Vivimed caters mainly to the FMCG and pharmaceutical segments, the demand for the company's product range is relatively stable and immune to the general economic slowdown. Vivimed offers a comprehensive and diversified product portfolio for the personal care industry. The company is a global supplier of active ingredients for oral care, skin care, sun protection, hair care, preservatives and anti-microbials.

The company has a strong relationship with global FMCG players like Unilever, P&G and L'Oreal, among others.

Exhibit: Range of products

Beauty Care	Oral Care Sun Care Skin Care Hair Care & Hair Dyes Preservatives
Industrial Care	Photo Chromic Photographic Biocides
Health Care	Osteoarthritis Oncology Tuberculosis Hygiene

(Source: Company)

Well-diversified in terms of geography and client base

The company is geographically well-diversified considering the fact that it derives more than 50 per cent of its revenue from exports to over 50 countries across the globe.

Its manufacturing activity is not restricted to a single state, but has presence at Bidar in Karnataka, Kashipur and Haridwar in Uttaranchal, and Srikakulam and Hyderabad in Andhra Pradesh along with a presence in various countries.

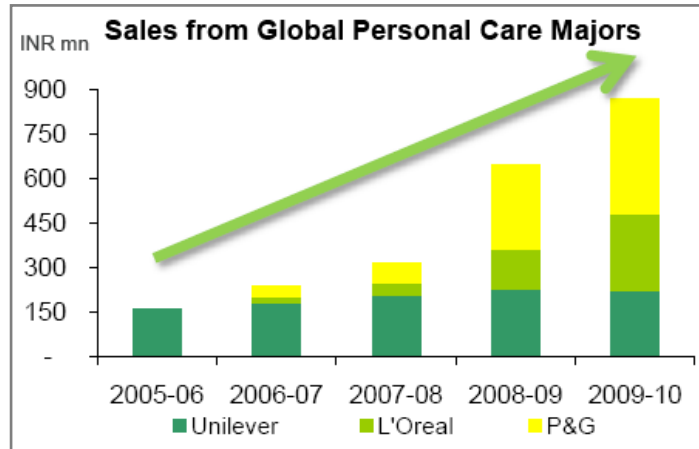
A brief description of the company's manufacturing units in India has been given below in a tabular form:

Particulars	Description
Andhra Pradesh & Karnataka	
Bonthapally (Hyderabad)	Equipped with 78 reactors with over 350kl capacity
Bidar (Karnataka)	Currently equipped with 60 reactors with over 300kl capacity
Jeedimetla(Hyderabad)	Equipped to manufacture dosage forms such as liquid orals, tablets, capsules and ointments in various therapeutic categories
Uttarakhand	
Kashipur	Located in an area having various tax concessions
Haridwar	Manufactures a wide range of sterile products and low-volume parenterals

(Source: Company, Nirmal Bang Research)

The top 10 clients of Vivimed contributed around 40 per cent to its sales in FY'11. These include names like L'Oreal (Rs.30 crore), P&G (Rs.25.45 crore) and Unilever (Rs.23.1 crore) among others.

Exhibit: Sales from global majors



(Source: Company)

Various initiatives taken by the company point towards improved corporate governance

At the board meeting to consider Q2FY12 results, the company initiated the following steps which should further improve corporate governance:

- Considered proposals from internationally acclaimed audit firms such as KPMG, Deloitte, Grand & Thornton and one of them is likely to be appointed as statutory auditor of the company
- The board shall appoint either Ernst & Young or Price Water house Coopers(PWC) as internal auditors in Q4FY'12

Steps to improve working capital cycle

The company's working capital cycle is pretty long with a duration of close to seven months. The same has been quite lengthy in the past too, barring FY10. The company's board has taken initiatives in this direction and is contemplating serious steps to reduce the duration. The target is to reduce the working capital cycle to four months over the next three quarters by adopting the following measures:

- Improved logistics and distribution structure will enable the company to reduce the transit time in effecting deliveries to customers and advance the invoicing time
- Increasing interaction and coordination with top and key customers to align the production schedules with their planned intake and reduce the need for higher

inventory retention levels. The company now has dedicated key account managers for each of its top-rung customers, and the objective in creating this structure is essentially for bringing in efficiency in the planning of supply and demand schedules

- Enhance the customer base to Tier II and Tier III levels that permeate second-rung customers as well as the locations and negotiate softer credit terms to improve on the receivable days

The improvement on the working capital front has to be monitored closely to analyse the impact on interest costs as well as valuation fronts.

Vivimed has a proven track record of achieving its guidance. Going by this record, we expect the company to be able to reduce its working capital cycle as per the given guidance.

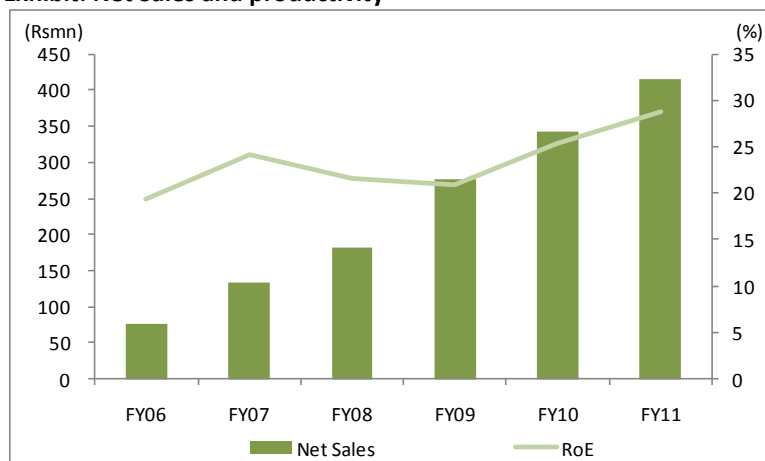
Consistent track record in the past

Vivimed has been maintaining a consistent financial track record over the past several years. Net sales and PAT of the company have registered a CAGR of 40 per cent and 39 per cent, respectively, over FY06-11. During 9MFY'12, the company derived 61 per cent of its revenue and 62 per cent of EBIT from the specialty chemicals segment.

With the acquisition of Uquifa, the break-up should tilt more in favour of the pharmaceutical segment. This is in line with the management's strategy to have equal contribution to the topline from the specialty chemicals and pharmaceutical segments.

Net sales and the RoE of the company have been given below in the form of a graph.

Exhibit: Net Sales and productivity



(Source: Company, Nirmal Bang Research)

About the promoters

Mr. Santosh Varalwar and his father, Mr. V. Manohar Rao, started a pharmaceutical formulations facility in 1985 with a seed capital of Rs. One lakh and a Rs.2.5 lakh loan from Andhra Pradesh State Finance Corporation. The company managed to garner Rs.50 lakh in revenue in its first year of operations.

The company expanded into APIs, mainly Ibuprofen, at Bidar in Karnataka, where it took over a sick unit. It got a major breakthrough from Lupin for Ibuprofen and subsequently, the client list included Novartis, Merck, Cipla and Glenmark.

Vivimed was a pure API player till 1995. The company clocked a turnover of Rs.52 crore in 2005, the year in which it went public, offering shares at Rs.70 each. The proceeds of the same were used to fund the expansion of its Triclosan capacity. In April 2007, the company raised USD15 million through the FCCB route which were bought back by the company in Sep 2009.

Company Background

Set up in 1985, Vivimed Labs has a presence in specialty chemicals as well as pharmaceutical segments. It is a global supplier of active ingredients for oral care, skin care, sun protection, hair care, preservatives and microbials. The company offers a comprehensive and diversified product portfolio for the personal care industry. It has strong relationships with clients comprising global personal care majors such as Unilever, P&G and L'Oreal, to name a few. Vivimed has a large presence in both developed and emerging markets. The company also offers cost-effective molecules customised to customers' requirements.

In the pharmaceutical segment, the company is a global provider of formulations for key therapeutic areas like oncology, tuberculosis, anti-malarials, pain management and Ophthalmic products. The company offers branded formulations and offers contract manufacturing of formulations & APIs. Vivimed has a strong clientele comprising pharmaceutical majors like Novartis and Merck among others. The company is actively focused on product registrations across the globe and exports to Europe, Russia and CIS.

The company's products are sold in more than 50 countries, accounting for more than 50 per cent of its revenue.

Risks & Concerns

Issues in integration with Uquifa

Effective integration process in any acquisition is key for deriving complete synergies from the combined entity. The company's financial performance going forward depends significantly on the future prospects of Uquifa and how effectively the company is able to derive the benefits out of the same.

Delay/failure to improve working capital cycle

The company's working capital cycle has been pretty long. The valuation of the company in future would depend a lot on the fact as to how it is able to improve upon its working capital cycle.

Any government action/directive against any of the products of the company

As the company deals mainly in the healthcare segment, its products are exposed to stringent rules and regulations. Any adverse announcement by any authority impacting the sale of its products can not only impact the financial performance but also the reputation of the company.

VALUATION AND RECOMMENDATION

Vivimed posted net sales of Rs.416 crore during FY11, registering an increase of 21.1% y-o-y. PAT during that period stood at Rs.48.9 crore, an increase of 57.5% y-o-y, translating into an EPS of Rs.44.4.

During 9MFY12, the company registered net sales of Rs.417.2 crore (equal to FY'11 figure) compared to Rs.296.2 crore, an increase of 40.8% y-o-y. EBITDA for the 9MFY'12 stood at Rs.85.8 crore compared to Rs.63.3 crore, an increase of 35.5% y-o-y. On account of higher interest and depreciation charges, the net profit growth during this period was muted at 11.4% at Rs.40.8 crore. We expect the company to post net sales and net profit of Rs.625 crore and Rs.60.2 crore, respectively, for FY'12E. This translates into an EPS of Rs.48.2.

The complete integration of Uquifa with the parent company would be in FY13. On the domestic front, the company's expansion plans at Choutuppall and the SEZ should start contributing only from FY14 onwards.

Considering the robust fundamentals and improvement in earnings on the back of integration of acquired entities, we expect Vivimed to post net sales of Rs.1200 crore for FY13E and net profit of Rs.109.6 crore. On a fully diluted equity of Rs.17 crore, the EPS for FY13E should be Rs.68.5.

We value the company at 10x FY13 earnings considering the fact that the re-rating should happen on the back of higher contribution from the pharma segment, arriving at a target price of Rs.685 over the next 12 to 15 months. This provides an upside of 95% over the next 12 to 15 months.

Initiating Coverage
Vivimed Labs Ltd.

Profit & Loss Account	FY'10	FY'11	FY'12E	FY'13E	Balance Sheet (Rs. Cr.)	FY'10	FY'11	FY'12E	FY'13E
Net Sales	343.5	416.0	625.0	1200.0	Equity Capital	10.0	10.2	14.0	17.0
Other Operating income	6.5	0.9	0.2	0.0	Reserves & Surplus	135.0	177.7	336.9	478.5
Total Income	350.0	416.9	625.2	1200.0	Networth	145.0	187.8	350.9	495.5
Raw material	205.9	236.97	330.0	662.3	Secured loans	235.0	306.9	550.0	600.0
Employee Expenses	22.1	20.0	30.0	54.5	Unsecured loans	0.7	0.7	0.7	0.7
Other expenses	52.4	75.0	135.0	258.2	Total loan funds	235.7	307.6	550.7	600.7
Total Expenses	280.4	331.9	495.0	975.0	Total Liabilities	380.7	495.5	901.6	1096.2
PBIDT	69.6	85.0	130.2	225.0	Net Block	254.8	264.3	464.3	494.2
Depreciation	8.7	9.2	20.0	34.5	Inventories	79.4	84.5	123.3	160.0
Interest	21.2	20.6	33.0	50.0	Sundry Debtors	93.9	127.6	205.0	310.0
Profit before tax	39.7	55.3	77.2	140.5	Cash & Bank	5.6	11.1	10.0	48.2
Taxes	8.6	6.4	17.0	30.9	Loans & Advances	15.2	91.6	127.0	135
Extra-ordinary item	0.0	0.0	0.0	0.0	Current Assets	194.0	314.7	465.3	653.2
Net Profit	31.0	48.9	60.2	109.6	Less: Provisions & liabilities	68.1	83.5	28.0	51.4
						126.0	231.2	437.3	601.8
Quarterly	Mar. 11	Jun. 11	Sep. 11	Dec. 11	Total Assets	380.7	495.5	901.6	1096.0
Net Sales	119.8	120.5	128.7	168.0	Cash flow (Rs. Cr.)	FY'10	FY'11	FY'12E	FY'13E
Other Operating income	0.8	0.1	0.1	1.6	Cash at the beginning of the year	17.0	5.7	11.2	10.1
Total Income	120.6	120.6	128.8	169.6	Net cash from operating activities	55.2	10.4	-50.8	3.7
Total Expenses	98.9	95.9	100.9	136.4	PBT	39.7	55.3	77.2	140.5
PBIDT	21.7	24.7	27.9	33.2	Adjustments	8.7	10.2	20.0	34.5
Interest	7.0	6.5	7.9	5.9	Working capital changes	6.8	-55.1	-148.0	-171.3
Depreciation	3.6	2.7	3.8	6.9					
Taxes	-1.1	3.2	3.8	4.4	Cash from Investment activities	-7.1	-72.4	-255.0	-64.9
Net Profit	12.2	12.4	12.4	16.1					
Profitability Ratios	FY'10	FY'11	FY'12E	FY'13E	Cash used in financing activities	-59.4	67.5	304.7	99.3
EBITDA margin	20.3%	20.4%	20.8%	18.8%					
PAT margin	9.0%	11.7%	9.6%	9.1%	Change in cash	-11.3	5.5	-1.1	38.1
Growth Ratios	FY'10	FY'11	FY'12E	FY'13E	Cash at the end	5.7	11.2	10.1	48.2
Net Sales growth	26.8%	21.1%	50.2%	92.0%					
EBITDA growth	46.6%	22.1%	53.2%	72.8%	Valuation Ratios	FY'10	FY'11	FY'12E	FY'13E
PAT growth	60.8%	57.5%	23.2%	82.0%	Marketcap/Sales	0.8	1.2	0.9	0.5
					EPS	31.1	44.4	48.2	68.5
					P/E	11.2	7.9	7.3	5.1

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