VIVIMED LABS LIMITED

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Long-term Bank Facilities	92.60 (reduced from 109.07	CARE BBB- (Triple B Minus)	Revised from CARE A- and removed from Credit Watch
Short-term Bank Facilities	166	CARE A3 (A Three)	Revised from CARE A2+ and removed from Credit Watch
Total Facilities	**258.60**		

Rating Rationale

The revision in the ratings assigned to the bank facilities of Vivimed Labs Ltd is on account of new acquisitions leading to the tight liquidity position, subsequent deterioration of the capital structure with high repayment obligations in the medium term and decline in the profitability levels and margins in FY13 (refers to the period April 1 to March 31) and H1FY14. The ratings continue to derive strength from the experienced and qualified promoter and management team, track record of operations with a diversified portfolio of pharmaceutical products and speciality chemicals, favourable industry outlook and geographically well-diversified presence with reputed customer base. The ratings are, however, constrained by, exposure to foreign exchange fluctuation risk, continued high exposure in the form of corporate guarantees to subsidiary companies and competition from other Indian manufacturers as well as manufacturers in other countries. Ability of the company to improve its liquidity position, capital structure and profitability margins are the key rating sensitivities.

The above ratings were placed under 'credit watch'; in view of an agreement entered into by Vivimed Labs Limited (VLL) with Actavis Holding Asia BV to acquire Actavis Pharma Manufacturing Pvt Limited's solid oral dosage (SOD) facility in Alathur, Tamil Nadu on July 31, 2013. The facility is being acquired from its parent, Actavis Holding Asia BV, an affiliate of Actavis Inc, a leading global generic and specialty pharmaceutical company. The ratings have now been removed from 'credit watch' on conclusion of the transaction and assessment of the impact of the same on the credit quality of the company.

Background

Incorporated in 1988, Vivimed Labs Limited (VLL) is a listed company engaged in the business of manufacturing products (active ingredients, formulations, etc) for pharmaceutical, personal care and colour chemistry industry. VLL (Consolidated) has manufacturing facilities in India and overseas.

Credit Risk Assessment

New acquisitions resulting in a tight liquidity position

VLL recently acquired Actavis Pharma Manufacturing Pvt Ltd's solid oral dosage facility in Alathur, Tamil Nadu, India (Vivimed Alathur) for a consideration of Rs.122 crore which was funded by way of debt of Rs.45 crore and the balance Rs.77 crore through internal accruals. The facility is being acquired from its parent Actavis Holding Asia B.V. This acquisition is a part of the strategy to move up the healthcare value chain. This acquisition is expected to provide a finished dosage formulation manufacturing platform with a US FDA (US Food and Drug Administration) approved facility and immediate access to the regulated markets. Along with the facility, it has also acquired two commercially valuable and marketable ANDAs (Abbreviated New Drug Application) which would help the company to generate additional revenues. As a part of the transaction, it is also observed that Actavis and VLL are also entering into a contract manufacturing agreement for VLL manufacture a set of products for Actavis Group over a period of 15 months.

Furthermore, the company has also acquired Finoso Pharma Pvt Limited for Rs.15 crore in a debt free transaction by issuance of 142,857 shares at a price of Rs.350 per share and the balance Rs.10 crore in the form of cash/cash equivalents.

[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

These acquisitions have been mainly funded by way of internal accruals of the company which has resulted in stretched liquidity position for VLL. Furthermore, there is no credit facilities sanctioned to the Actavis unit acquired, and hence the dependence is on VLL's credit facilities till the time, separate limits are sanctioned.

Adverse capital structure with high repayment obligations over the medium term

The total debt of VLL as on March 31, 2013 was Rs.799 crore as against Rs.599 crore as on March 31, 2012. Increase in debt was mainly on account of increase in loans to fund capex/acquisitions and working capital borrowings to support the increasing scale of operations. The overall gearing (including acceptances) deteriorated from 1.62x as on March 31, 2012 to 1.92x as on March 31, 2013. Furthermore, during 10MFY14, the company has raised additional tem debt to the tune of Rs.145 crore mainly to fund acquisitions and meet working capital requirements.

In addition to this, the company's debt service indicators are expected to be stressed on account of expected high repayment obligations over the next 2-3 years. Also the working capital utilisation of VLL has been at 100% for the 12 months ended in October 2013.

Decline in the profitability margins for FY13 despite growth in revenues

VLL's revenues witnessed an increase of 68% during FY13 vis-à-vis FY12. Increase in revenue was mainly attributable to successful operations of the acquired companies. The PBILDT margin of VLL declined by 203bps from 19.54 % in FY12 to 17.51% in FY13 mainly on account of one-off manufacturing costs related to Uquifa Spain, lower off-take of Octyl Methoxy Cinnamate (OMC) and also on account of product mix changes in the pharmaceutical segment.

Furthermore, the PAT margin also declined for FY13 vis-à-vis FY12 owing to high capital charge at the back of addition to debt and gross block and also on account of prior period expense of Rs.12.16 crore pertaining to Uquifa.

Decline in profits for H1FY14

Net sales for H1FY14 increased by 20% vis-à-vis H1FY13 to Rs.651.20 crore. Growth was driven by the continued ramp up of a key Contract Manufacturing Organisation (CMO) account in the API business and consolidation of Vivimed Alathur in the Contract Finished Dosage Formulation (FDF) segment. However, the PBILDT declined on account of prolonged wait for regulatory approvals in the contract FDF business and some product related issues in API business. PBILDT margins also declined to 15.54% for H1FY14 (Un-audited) vis-à-vis 21.05% for H1FY13. Furthermore, the increased capital charge during H1FY14 also impacted the PAT levels. PAT declined by 30% from Rs.52 crore in H1FY13 to Rs.36 crore to H1FY14.

Experienced promoters and management team

VLL has an experienced board of 10 directors, out of which four are independent. The promoters of VLL have over two decades of experience in the pharmaceutical and chemical business. Dr VManohar Rao (Chairman) (Mr Santosh's father and Mr Subash's elder brother), has over 30 years' experience in the manufacture, toxicology and control of bio-veterinary drugs. Mr Subash Varalwar (VC), is also a management graduate and chemical engineer, was with the Fertilizer Corporation of India for 15 years before promoting VLL. He is responsible for technology and new product development in the chemical segment. Mr Santosh Varalwar (CEO& MD), a management graduate, is mainly responsible for developing new markets for the company's products. Apart from marketing, he also looks after identifying and developing in-house innovations for niche molecules. Mr Sandeep Varalwar, (ED) has around two decades of experience in the manufacturing and marketing divisions in the pharma industry. VLL's board is supported by a team of professionals in the areas of finance, marketing, quality control, R&D, material and production.

Track record of operations with a well diversified portfolio of pharmaceutical products and speciality chemicals

VLL, established in 1988, is a global player engaged in the manufacturing of speciality chemicals and pharmaceutical products. The company has 12 manufacturing facilities and five R&D facilities spread across the world. Historically, Speciality Chemical segment was VLL's main revenue contributor. However, with new acquisitions, the company's pharmaceutical segment has become the major revenue contributor. For FY13, the pharmaceutical segment accounted for sales of Rs.738.4 crore (67% of gross sales of FY13), while specialty chemical segment contributed the balance 33%.

In the pharmaceutical product segment, VLL is into manufacturing and marketing of Active Pharmaceutical Ingredient (API) and Finished Dosage Formulations (FDF). VLL manufactures over 45 APIs covering various therapeutic segments at its three international US FDA facilities in Spain and Mexico. For FY13, API contributed about 75.50% as against 51.04% in FY12 of the pharmaceutical segment revenue while FDF contributed the balance which includes 3.90% of branded FDF. The company's main activities comprise contract manufacturing services for FDF apart from retail branded domestic sales, institutional sales and exports. CRAMS segment contributed about 20.60% of sales for FY13. VLL entered API space with acquisition of Uquifa in November 2011 and entered retail branded formulations with acquisition of Klar Sehen and Octtantis Nobel in the second quarter of 2011-12. Furthermore, in Q2FY14, the company has acquired another US FDA approved FDF plant with two ANDAs which are expected to further strengthen the value chain.

In the speciality chemical segment, the company is engaged in the manufacturing and marketing active ingredients used in Home & Personal Care (H&PC) and industrial products like photo chromic dyes and imaging chemicals (i.e. Colour Chemistry). Under the H&PC segment, VLL manufactures a wide range of products for hair care, skin care, oral care, anti-microbial, preservatives, thickeners, conditioners etc. Under Colour Chemistry, VLL manufactures a comprehensive range of dyes and derivatives. In FY08, VLL acquired a UK based company, James Robinson Ltd (JRL), which is a company with a more than 100 years old history in dyes and reportedly a market leader in the supply of hair dyes and intermediates. JRL is a supplier as well as development partner with the top global manufactures of hair dyes ie L'Oreal, P&G and Schwarzkopf. For FY13, hair care constituted around 50.2% of gross sales from the specialty chemical segment followed by skin care (47.1%), oral care (1.8%) and others (0.9%). Going forward, VLL proposes to become an integrated pharmaceutical player operating in the entire value chain.

Geographically well diversified with reputed customer base

VLL has geographically diversified presence in Asia Pacific region (ASPAC), Africa/Middle East/Turkey (AMET), Latin America, North America, all European countries, Ukraine, Russia, Indonesia etc. On consolidated levels, Asia- Pacific region contributes around 54.3% of the specialty chemical sales for FY13 followed by Europe (21.8%), NAFTA (17.5%), Latin America (4.8%) and AMET (1.5%). For the pharmaceutical segment, ASPAC contributed around 29.6% of the sales for FY13 as against 42.63% in FY12, Europe contributed 41% in FY13 as against 30.95% in FY12, NAFTA contributed 14%, AMET (4.2%) and the balance from the rest of the world.

VLL continues to cater to reputed clientele across the globe. The company's clientele includes Unilever, L'oreal, International Specialty Chemicals (ISP), Proctor & Gamble, Novartis, Cipla, Merck, Lupin, Glenmark etc. During FY13, VLL entered the Partner to Win (PTW) list of Unilever.

VLL has a reputed client portfolio and presence across global markets, with the top 10 clients of the specialty chemical segment contributing around 37% of the segment revenue.

Foreign exchange fluctuation risk

Substantial portion of VLL's (standalone) sales revenue is the form of exports. Exports generally constitute around 40-50% of the company's sales. During FY13, VLL's exports were about 46% of the total sales as against 42% in FY12. VLL also has high exposure in foreign currency loans. Therefore, the company is subjected to the risk on account of foreign exchange fluctuations. VLL has natural hedge owing to raw material imports which account for about 32% of the total raw material consumption costs for FY13.

Continued high exposure in the form of corporate guarantees to subsidiary companies

VLL (standalone) has extended corporate guarantees to its Indian and Overseas subsidiaries for their debt. Exposure towards contingent liabilities in the form of corporate guarantees was high at Rs.176 crore as on March 31, 2013(49% of net-worth of VLL (Standalone)) Out of the above, around Rs.121.86 crore is towards corporate guarantee extended to Vivimed Labs Spain S.L. for Uquifa acquisition.

Prospects

VLL has been growing both organically and inorganically over the last 2-3 years while increasing its presence in the pharmaceutical space mainly through inorganic growth. The acquisitions in the past have harbored well for VLL with the infusion of private equity. However, the acquisition of Actavis has mainly been funded by way of internal accruals which has strained the company's liquidity position. VLL is also supporting the working capital requirements of the newly acquired unit which is further pressurizing its liquidity position and may lead to additional dependence on debt.

Going forward, the ability of the company to rationalize its capital structure and derive benefits from the newly acquired unit in a timely manner would be critical. Also any new capex/acquisition and their funding profile remains to be a key credit perspective.

Financial Performance (Consolidated)

(Rs.Cr)

For the period ended / as at March 31,	2011 (12m, A)	2012 (12m, A)	2013 (12m, A)
Working Results			
Net Sales	416.00	665.29	1108.68
Total Operating income	416.20	668.65	1125.00
PBILDT	88.18	130.63	197.00
Interest	22.10	28.37	50.44
Depreciation	10.20	26.79	58.81
PBT	55.26	77.82	85.72
PAT (after deferred tax)	48.83	63.14	71.42*
Reported PAT	48.83	63.14	83.58
Gross Cash Accruals	56.06	88.72	132.16
Financial Position			
Equity Capital	10.16	13.93	16.06
Networth	112.03	379.62	431.40
Total capital employed	517.34	1086.34	1324.75
Key Ratios			
Growth			
Growth in Total Operating income (%)	19.84	60.66	68.25
Growth in PAT (after D.Tax) (%)	57.00	29.31	13.12
Profitability			
PBILDT/Total Op. income (%)	21.19	19.54	17.51
PAT (after deferred tax)/ Total income (%)	11.73	9.44	6.35
ROCE (%)	16.95	13.24	12.30
Solvency			
Long-term Debt Equity ratio (times)	1.18	0.96	1.16
Overall gearing ratio(times) incl. acceptances	2.90	1.62	1.92
Interest coverage(times)	3.99	4.60	3.91
Term debt/Gross cash accruals(years)	2.35	4.13	3.77
Total debt/ Gross cash accruals (years)	5.80	6.92	6.26
Liquidity			
Current ratio(times)	1.30	1.36	1.26
Quick ratio(times)	0.95	0.83	0.73
Turnover			
Average collection period (days)	96	94	86
Average inventory (days)	93	116	119
Average creditor (days)	46	67	63
Operating cycle (days)	142	143	142

* PAT is lower than reported PAT by Rs. 12.16 Cr of prior period item which has been adjusted directly to the reserves

Analyst Contact

Name: Vidhyasagar. L
Tel: 040-40102030
Mobile : 8801880184
Email: vidhya.sagar@careratings.com

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CARE is headquartered in Mumbai, with Offices all over India. The office addresses and contact numbers are given below:

HEAD OFFICE: MUMBAI

Mr. D.R. Dogra
Managing Director
Mobile : +91-98204 16002
E-mail : dr.dogra@careratings.com

Mr. Rajesh Mokashi
Dy. Managing Director
Mobile +91-98204 16001
E-mail: rajesh.mokashi@careratings.com

Ms. Meenal Sikchi
Vice President –Bank Loan & Instrument Rating
Mobile: +91-9819009839
mail: meenal.sikchi@careratings.com

Mr.Ankur Sachdeva
Vice President – Banking & Financial Services
Mobile: +91-9819698985
E-mail: ankur.sachdeva@careratings.com

CREDIT ANALYSIS & RESEARCH LTD.

HEAD OFFICE | 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022 |Tel: +91-022- 6754 3456 | E-mail: care@careratings.com | Fax: +91-022- 6754 3457.

KOLKATA | **Ms. Priti Agarwal** | Cell: +91-98319 67110 | Tel: +91-33- 4018 1600/ 1602 | E- mail: priti.agarwal@careratings.com | 3rd Flr., Prasad Chambers (Shagun Mall Bldg), 10A, Shakespeare Sarani, Kolkata -700 071

CHENNAI | **Mr. V Pradeep Kumar** | Cell: +91 9840754521 | Tel: +91-44-2849 7812/2849 0811 | Fax: +91-44-2849 0876 | Email: pradeep.kumar@careratings.com | Unit No. O-509/C, Spencer Plaza, 5th Floor, No. 769, Anna Salai, Chennai - 600 002

AHMEDABAD | **Mr. Mehul Pandya** | Cell: +91-98242 56265 | Tel: +91-79-40265656 | Fax: +91-79-40265657 | E-mail:mehul.pandya@careratings.com | 32, Titanium, Prahaladnagar Corporate Road, Satellite, Ahmedabad - 380 015.

NEW DELHI | **Ms. Swati Agrawal** | Cell: +91-98117 45677 | Tel: +91-11-2331 8701/ 2371 6199 | E-mail: swati.agrawal@careratings.com | 3rd Floor, B -47, Inner Circle, Near Plaza Cinema, Connaught Place, New Delhi - 110 001.

BENGALURU | **Mr. Dinesh Sharma** | Cell: +91 9900041975 | Tel: +080-4115 0445/ 4165 4529| Tele fax: 080-41514599 | E-mail: dinesh.sharma@careratings.com | Unit No.1101-1102, 11th Floor, Prestige Meridian II No-30, M .G. Road, Bengaluru -560001.

HYDERABAD | **Mr. Saikat Roy** |Tel: +91-40-40102030 |E-mail: saikat. roy@careratings.com | 401, Ashoka Scintilla | 3-6-520, Himayat Nagar | Hyderabad - 500 029.

PUNE | **Mr. Rahul Patni** | Cell: +91-78754 33355 | Tel: +91-20- 4000 9000 |E-mail: rahul.patni@careratings.com | 9th Floor, Pride Kumar Senate, Plot No. 970, Bhamburda, Senapati Bapat Road, Shivaji Nagar, Pune - 411 015.

JAIPUR| **Mr. Rahul Jain** | Cell: +91-9314921496 | Tel: +91-0141-4020213/14 |E-mail: rahul.jain@careratings.com | 304, Pashupati Akshat Heights, Plot No. D-91, Madho Singh Road, Near Collectorate Circle, Bani Park , Jaipur – 302016.