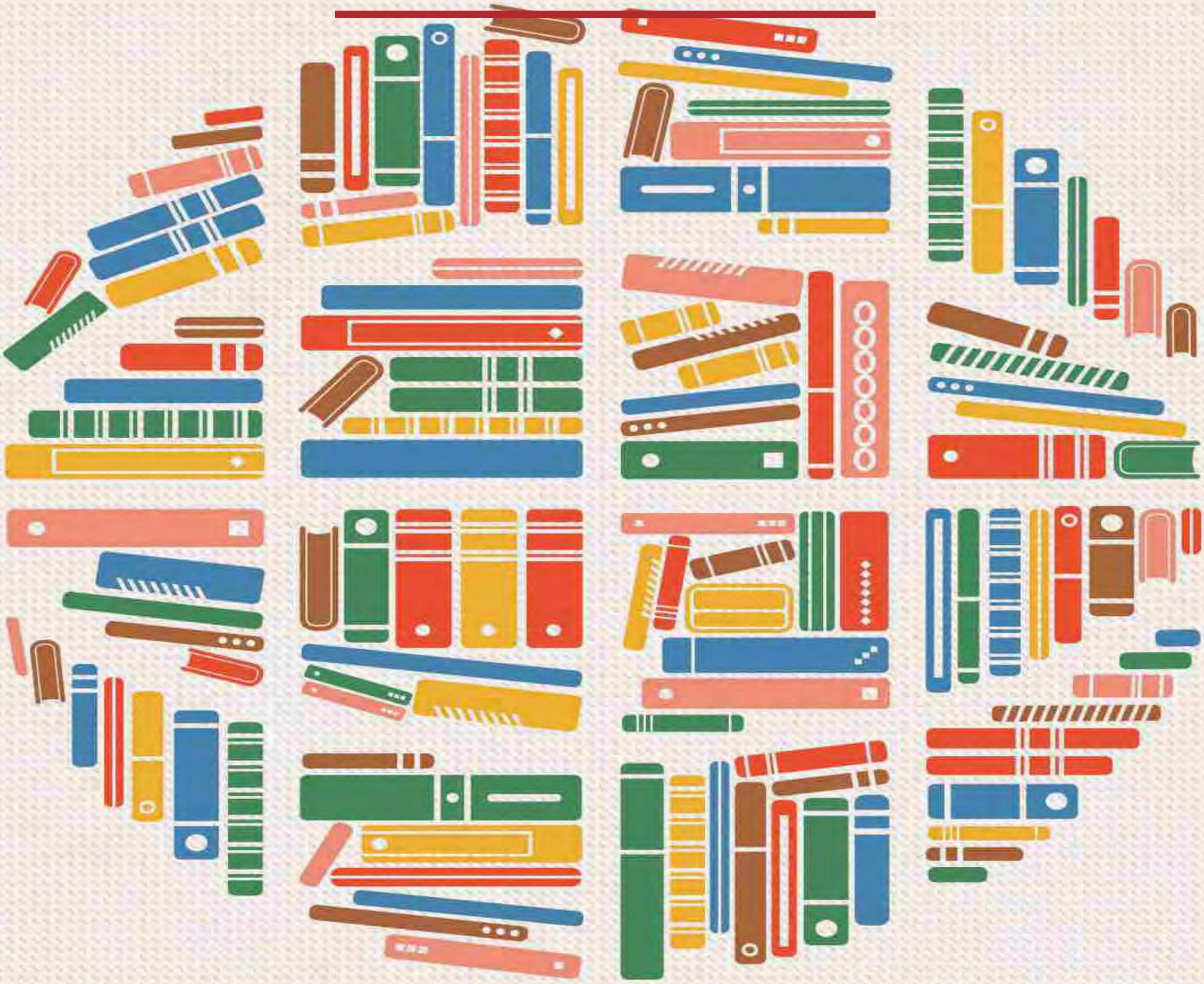
ICICI direct Research

April 23, 2020

Stock TALES



Stock Tales are concise, holistic stock reports across wider spectrum of sectors. Updates will not be periodical but based on significant events or change in price.

Caplin Point Laboratories (CAPPOI)

CMP: ₹ 345 | Target: ₹ 500 (45%) | Target Period: 12months | **BUY**

April 23, 2020

Thinking big after scripting unique success story…

Established in 1990 by first generation entrepreneur CC Paarthipan, Caplin Point (Caplin) is one of the fastest growing small cap Indian pharmaceutical companies. The growth story, so far, has been based on its unique business model with a strong, deeper presence in semi-regulated markets of Central America (CA) like Guatemala, El Salvador, Nicaragua, Ecuador and Honduras. It is also one of the leading formulation suppliers in these regions, with over 3100 product licenses globally. To further expand its wings, Caplin is now entering the larger markets of Latin America (LatAm). It has also forayed into the high risk-high value US injectable market with its own manufacturing facility. We are positive on the company mainly due to its unique business model, leadership position in its key geographies & leverage free balance sheet with strong free cash flows.

Robust growth in emerging markets likely to continue

Emerging markets (EM) account for 92% of revenues and consists of LatAm- 88% (both Central & South America) and Africa- 4%. Revenues grew at 25% CAGR over a decade mainly due to 1) early mover advantage in these untapped markets, 2) geographical expansion (starting with two countries to 10 at present) and 3) ability to address market gaps, especially in the generics space (via trading model) with a hold on end-to-end distribution channels. We expect growth momentum to persist mainly due to further expansion in the front end, increasing product basket, change in product mix and launching of own brands. Additionally, entry into South American countries is likely to propel growth. We expect EM revenues to grow at 21% CAGR in FY19-22E to ₹ 1089 crore.

Foray into high risk-high return US injectable market

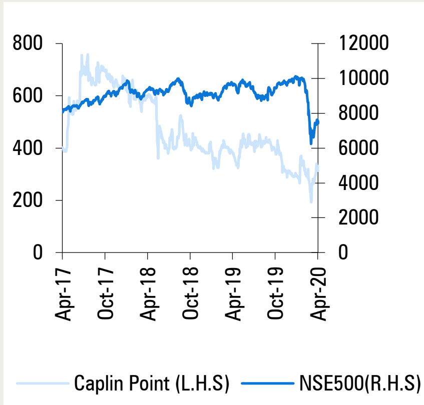
With a calculated approach to focus on injectables in the US, the company established an injectable plant in Tamil Nadu in 2014. Currently, the portfolio comprises 16 filed ANDAs, of which eight have already been approved. Currently, the company has ~35 products in the pipeline. In 9MFY20, revenue contribution from the US increased to 8% from just 2% in FY19. We expect US revenues to grow ~10 fold in FY19-22E to ~₹ 161 crore on the back of incremental product launches.

Valuation & Outlook

After scripting a unique story by growing in uncharted territories, Caplin is looking at growth in known markets. These new markets of South America, US are a big opportunity but fraught with new challenges. That said, we continue to believe in Caplin's capability to replicate the success story in new markets. Secondly, despite likely dent in margins, return ratios due to investment phase in new markets, these prints continue to demonstrate earnings, balance sheet strength. We have a **BUY** rating on Caplin with a target price of ₹ 500 (12x of FY22E EPS of 41.7). We believe the company offers a compelling risk-reward scenario at current valuations. Similarly, the resilience shown by pharma stocks in the current Covid-19 related upheaval also offers an ideal platform for new idea generation like Caplin.

Particulars	
Particular	**Amount**
Market Capitalisation	₹2610 crore
Debt (FY19)	₹1 crore
Cash (FY19)	₹153 crore
EV	₹2457 crore
52 week H/L	467/176
Equity capital	₹15.1 crore
Face value	₹2

Price Performance



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Key Financial Summary (₹ crore)

₹Crore	FY19	FY20E	FY21E	FY22E	CAGR FY19-22E (%)
Revenues	648.7	851.9	1038.8	1281.0	25.5
EBITDA	231.3	262.8	301.1	380.4	18.0
EBITDA Margins (%)	35.7	30.8	29.0	29.7	
Net Profit	176.6	210.5	241.9	315.2	21.3
EPS (Adjusted)	23.3	27.8	32.0	41.7	
PE (x)	14.8	12.4	10.8	8.3	
RoCE (%)	34.6	27.2	26.3	27.5	
RoE (%)	27.9	22.4	20.9	21.9	

Source: ICICI Direct Research; Company

Company Background

Established in 1990 by first generation entrepreneur CC Paarthipan, the company as a matter of strategy focused on emerging markets of LatAm (Central and South America), Francophone and Southern Africa to cash in on the early mover advantage in the then untapped markets.

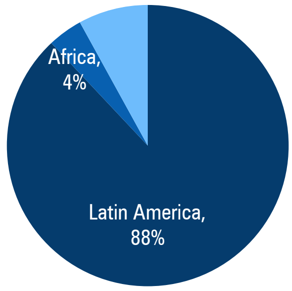
Over the years, the company has established a strong and deeper presence in semi-regulated markets of Central America (CA) such as Guatemala, El Salvador, Nicaragua, Ecuador and Honduras among others. It is also one of the leading formulation suppliers in these regions.

Another peculiarity is the focus on supply chain efficiencies by reducing intermediaries. For emerging market (mainly comprising CA countries), it procures finished goods from China and supplies them to these geographies by leveraging the trade agreements between China and some of these countries. Thus, besides in-house manufacturing (40%), it outsources~40% of its products directly from China [and from some Indian vendors (20%)]. To further expand the horizon, the company is now entering South American (Latin America or LatAm consists of Central American markets and South American markets) countries like Chile, Columbia, Brazil and Mexico. The company has also forayed into the US injectable market.

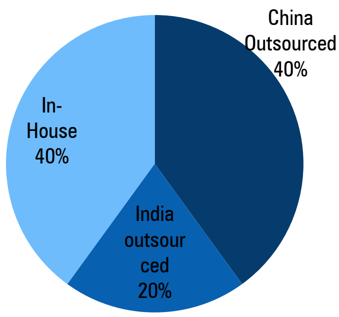
The company derives entire revenues through exports with 92% of revenues coming from Emerging Markets (Latam + Africa) where it has established an end-to-end business model through last mile logistical solutions for its exclusive distributors. The company employs 210+ scientists and has 3100+ internationally registered products.

Caplin has a total annual product capacity of 1000 million tablets, 400 million capsules, 65 million vials of liquid injections, 20 million liquid injection ampoules, 170 million soft gels, 30 million suppositories, 6 million bottles of liquids, 12 million pre-filled syringes and 12 million ophthalmic units.

Geographical Bifurcation

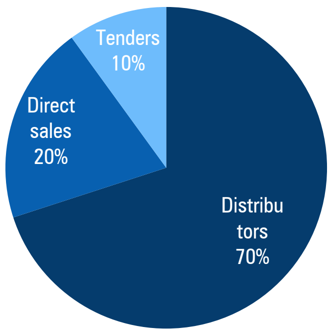


Manufacturing & Outsourcing



Source: ICICI Direct Research; Company

Revenues % by Channel



Source: ICICI Direct Research; Company

Exhibit 1: Company events timeline

Year	Details
1990	Incorporation of Caplin Point
1994	Initial public offering, proceeds used for Pondichery facility
2001	Enters Angola
2005	Partners with Chinese manufacturers for outsourcing
2006	Enters Carribean and South America
2014	Commissions CP4 injectable facility for US market
2016	Sets up Caplin Point Far East - Hong Kong, 100% subsidairy
2017	USFDA approval for liquid injectable facility
2017	Enters US market via launch of Ketorolac injection
2018	Facilitates China entry through JV with Hainan Jointown Pharma
2018	Starts CRO division (Amaris) for BA/BE studies
2019	Establishes Caplin Steriles for US/Europe
2019	Raises ₹218 crore from Fidelity US for sterile injectable business
Q4FY19	Transfers injectable plant & other assets to Caplin Steriles

Source: ICICI Direct Research, Company

The company launched its first product in the US market in FY18. The process for setting up a dedicated US focused injectable plant began in FY14. In the US, the company filed 16 ANDAs on its own and with partners till date with eight approvals from the USFDA (three for partners, five for own). Caplin is also working on a portfolio of 35 simple and complex injectable and ophthalmic products, to be filed over the next four years.

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The company has also set up Amaris Clinical, a Clinical Research division for BE/BA studies, which will be targeting the regulatory approvals for the US, China, Brazil, Chile and Colombia.

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Caplin currently has four subsidiaries: Caplin Steriles Ltd, Argus SaludPharma LLP, Caplin Point Far East Ltd – Hong Kong, Caplin Point Laboratories Colombia SAS Colombia. Also, Caplin has step down subsidiaries in El Salvador, Nicaragua and Honduras, which are held through its wholly owned subsidiary in Hong Kong.

It also started a JV with a large Chinese distribution firm, 'Hainan Jointown Pharmaceuticals' for entry into China for intermediates, API and formulations.

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In FY19, the company had raised ₹ 218 crore from Fidelity by issuing preferential shares for the injectable business earmarked for the US. The funds will be utilised for operational expenditure, R&D and potential future capex.

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Exhibit 2: Manufacturing and R&D facilities

Facility	Type	Location	Details
CP I	Mfg	Suthukeny, Pondicherry	Tablets, capsules, soft gels, suppositories, ointments & injections; approved by INVIMA & WHO-GMP
CP II	R&D	Gummidipoondi, Tamil Nadu	Development of safe and effective formulations for emerging markets. This facility is approved by DSIR
CP III	CRO	Chengalpattu, Tamil Nadu	Amaris Clinical CRO, bioequivalence studies for LATAM, US and China (that will cover BE/BA studies for own products, before scaling up as a commercial CRO)
CP IV*	Mfg/R&D	Gummidipoondi, Tamil Nadu	State-of-the art manufacturing facility, to focus on US and Europe; The facility is capable of handling liquid injectables in vials, ampoules, lyophilised vials and ophthalmic dosages; approved by USFDA, EU, INVIMA and WHO
CP V*	R&D	Perungudi, Tamil Nadu	Dedicated for development of complex injectables and opthalmics for regulated markets of US, EU and Brazil among others
CP VI	Mfg/R&D	Hyderabad	Focuses on API R&D in a Kilo lab setup

*Source: ICICI Direct Research, Company, * transferred to Caplin Steriles*

Market leader in Central American markets

Despite its small size, Caplin is a significant market player in its key markets –West Africa, Central America (Guatemala, El Salvador, Nicaragua, Dominical Republic, Ecuador and Honduras) due to early mover advantage, relentless pursuit to establish critical mass and efficient supply chain management. These relatively smaller and less important (in the global geo-political spectrum) markets were never extensively tracked by either Indian or any global larger generic players due to tiny market size. Sales from these geographies have grown at ~25% CAGR over the last five years.

Caplin is a significant market player in its key markets –West Africa, Central America (Guatemala, El Salvador, Nicaragua, Dominical Republic, Ecuador and Honduras). Sales from these geographies have grown at CAGR of ~25% over the last five years

The company had entered these markets in the late nineties when most of these markets were dominated by larger players selling expensive branded medicines. Due to skewed wealth distribution with a large pie of lower income group, affordability was the biggest issue in these countries. The smaller local players were unable to fill the gap with limited manufacturing capability. Expensive local manufacturing plants and imported raw materials could do little to reduce the cost of generic drugs.

Caplin identified these opportunities at a very early stage and efficiently capitalised on the same by leveraging on its experience in the generics space. The company identified China as the main destination for procurement of generic drugs to be despatched to these geographies in a finished dosage form. Over the years, the company has also developed a close relationship with local exclusive distributors for last mile reach to minimise channel inventory. Additionally, Caplin was able to maintain efficient working capital cycle in these geographies owing to advance payments from local distributers.

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The company outsources manufacturing of ~40% of its formulations to well integrated companies in China. The outsourced products include formulations like antibiotics, vitamins and others due to the cost benefit in production. Some of the companies with which Caplin works within China include - CPSC Pharma (mainly for cephalosporin), Northeast Pharma (for Vitamin C) among others.

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Currently, Caplin routes around 40% of its exports from China through its Hong Kong (HK) subsidiary, which translates to a custom duty benefit on account of the country's free trade agreement (FTA) with some of these countries. Going forward, in the next two years, the company plans to route majority of its exports from China through the HK subsidiary.

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Covid-19 situation in China has no major impact on operations, as its main suppliers in the city of Shijiazhuang (Hebei province) have continued production without stoppage. There may be some logistical issues though due to congestion at Chinese ports for ships disinfection process.

The Covid-19 situation in China has had no major impact on operations

Post establishment of its network in CA, the company is now looking to expand its front end presence for better supply management. In the process, it has started acquiring sole distributers with whom it has developed contacts over the years. Shift from distributer to front end model is likely to stretch the company's working capital cycle. However, in the long run, it is likely to provide better efficiency and command on the distribution channel.

Post establishment of its network in CA, the company is now looking to expand its front end presence for better supply management.

Uncharted territories but relatively safe countries

Though most of those countries are unknown (hence uncharted), the macro data as reflected by global agencies suggest that at the aggregate level most of them are stable (barring income inequality) (see exhibit 3). The GDP growth in these countries is stable and largely dependent on expatriate income (mainly from the US), agriculture and minerals. Currencies of these countries are also pegged with the US$.

Exhibit 3: Country wise economic data

Indicator/Country	Guatemala	Honduras	Nicaragua	El salvador	Brazil	Mexico	Chile	Colombia	Peru	India
S&P Credit rating (Industry)	BB-	BB-	B-	B-	BB-	BBB+	A+	BBB-	BBB+	BBB-
GDP (US$ bn, World Bank 2018)	78.5	23.8	13.1	26.1	1868.6	1223.8	298.2	331.0	222.2	2718.7
GDP GR (World bank, 2018)	3.15%	3.75%	-3.82%	2.54%	1.12%	2.14%	4.02%	2.57%	3.98%	6.81%
Population (mn)	17.2	9.6	6.5	6.4	209.5	126.2	18.7	49.6	32.0	1352.6
GNI PPP per capita (US$)	8310	4790	5400	7860	15850	19340	24190	14480	13710	7680
GDP per capita (US$)	4549.0	2482.7	2028.9	4058.3	8920.8	9698.1	15923.4	6667.8	6947.3	2010.0
Inflation (Industry)	3.80%	4.35%	4.98%	1.09%	3.67%	4.90%	2.32%	3.24%	1.30%	5.24%

Source: ICICI Direct Research, World Bank, Industry

Robust growth in key markets likely to continue

Revenues grew at 25% CAGR over a decade mainly due to 1) early mover advantage in these untapped markets, 2) geographical expansion (starting with two countries to 10 at present) and 3) ability to address market gaps, especially in the generics space (via trading model) with a hold on end-to-end distribution channels.

We expect the momentum to continue in CA and other EMs on the back of–

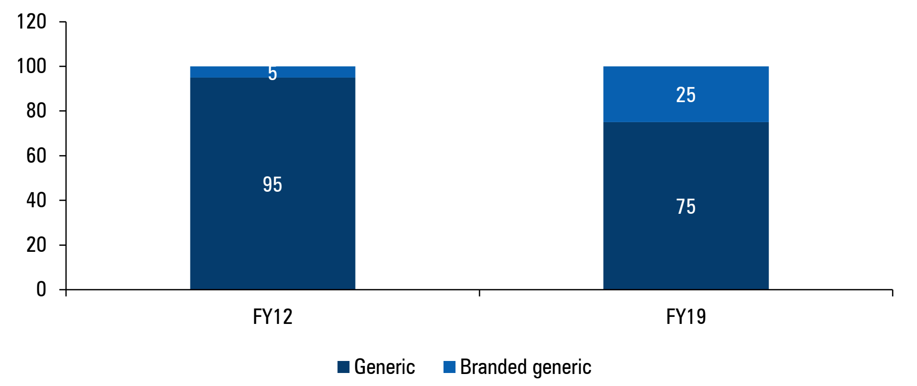
1) **Changing product mix** – After achieving critical mass in plain vanilla delivery products such as oral solids, capsules, powders, etc. the company is planning to scale up the product value chain and enhance focus on complex and differentiated products (soft gels, injectables and ophthalmics, suppositories, etc). These products are characterised by relatively low competition and low price erosion, resulting in attractive margins and better growth.

After achieving critical mass in plain vanilla delivery products such as oral solids, capsules, powders, etc. the company is planning to scale up the product value chain and enhance focus on complex and differentiated products

2) **Expansion of branded generic portfolio**– Branded generics contribution increased from 5% in FY12 to 25% in FY19. The company is slowly converting some of their best-selling plain generics into branded generics for longevity of the product and increased margins.

Branded generics contribution increased from 5% in FY12 to 25% in FY19

Exhibit 4: Branded generic increases to 25% in FY19 from 5% in FY12



Source: ICICI Direct Research, Company

3) **Front end presence**– Caplin operates through multiple sole distributers in all key markets. The company is currently acquiring most of the sole distributers for better efficiency and control on supply chain. It may also leverage this distributers' network to sell products manufactured by other players in future.

Apart from this, continuous increase in product registrations and pharmacy automation via installation of a retail interface (through healthcare portal) helps the company to develop direct channelling with the pharmacies.

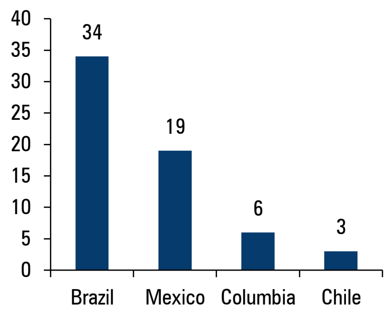
Caplin operates through multiple sole distributers in all key markets. The company is currently acquiring most of the sole distributers for better efficiency and control on supply chain.

The company is now planning to leverage its experience to expand in core LatAm markets like Brazil, Mexico, Colombia and Chile mainly through local distributers and tender businesses

4) **Foray into larger core LatAm (South American) markets** – After digging deep in the smaller CA markets, the company is now planning to leverage its experience to expand in core LatAm markets like Brazil, Mexico, Colombia and Chile mainly through local distributers and tender businesses. These are much larger markets but with more or less identical demographics composition. Although dominated by large generics players and innovators, even a smaller pie in these markets could provide significant revenue traction for Caplin.

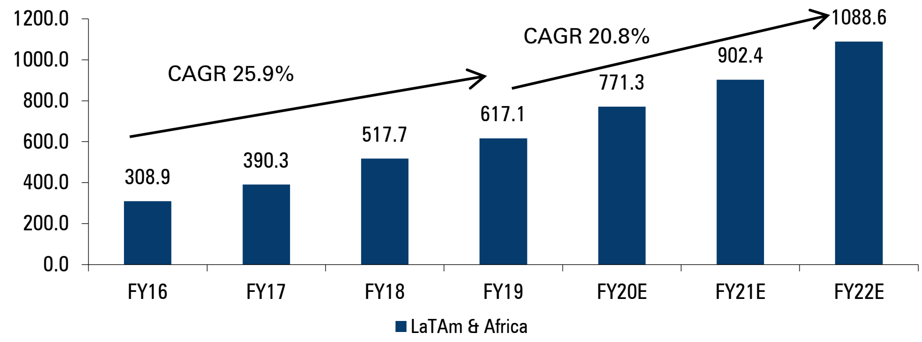
We expect EM revenues to grow at 21% CAGR over FY19-22E to ₹ 1089 crore

Pharma markets size of Core LatAm (US$ bn)



Source: Industry; based on 2019 forecasts

Exhibit 5: LatAm, Africa revenues expected to grow at 21% CAGR in FY19-22E



Source: ICICI Direct Research, Company

Foray into high risk-high gain US injectable market

Caplin is one of the few smaller Indian pharma companies that forayed directly in the US injectable segment. Caplin operates an injectable business via its subsidiary Caplin Steriles Ltd with a manufacturing facility at Gummidipoondi in Tamil Nadu. The process to set up a dedicated US focused injectable plant begun in FY14. In 2017, the company received the first establishment inspection report (EIR) from the USFDA. It launched first product in 2018, an anti-inflammatory drug Ketorolac Tromethamine, for which the approval was obtained by US based Cycle Pharmaceuticals Ltd (now Baxter) in 2017. This was the first instance for Caplin where its capabilities got validation from the USFDA as well as a US based customer.

Caplin operates an injectable business via its subsidiary Caplin Steriles with a manufacturing facility at Gummidipoondi in Tamil Nadu

It launched first product in 2018, an anti-inflammatory drug Ketorolac Tromethamine

A deal with US based Baxter in 2019 for a license and supply agreement with US based Baxter Healthcare Corporation for the commercialisation of five generic injectable ANDAs further vindicated Caplin's injectable capability. The company has also launched another two products through US based Fresenius Kabi.

Besides these partnership deals, the company has also launched two own registered products via Meitheal US.

High entry barriers due to demanding compliance requirements

Injectable products require specialised and sterile manufacturing facilities and techniques as well as high end machinery, which must meet the strict quality standards imposed by regulatory authorities. Complying with these stringent regulatory requirements, as well as capital intensive manufacturing processes demand significant real-time investment. Operational costs are high due to high level of maintenance and compliance requirements. Hence, it requires a higher degree of quality and care in manufacturing, packaging, storage, and distribution. At the same time, investment in training and development programmes is essential to ensure the highest levels of precision are implemented throughout the manufacturing process. These factors have created a market with high barriers to entry and, as a result, a limited number of competitors relative to other segments. Injectable plants require 1.3-1.5x capex vis-à-vis oral solid plants because of manufacturing complexities. Further, the cost related to compliance embargo is much higher due to longer resolution time and higher compliance costs. The frequency of inspections by the USFDA for injectables is also higher- once or twice in a year against once in one and half to two years for oral solids. Hence, chances of observations are higher in case of injectables. All these factors have created high entry barriers for new entrants.

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Caplin has a decent cGMP track record, with three USFDA audits till date with just two observations.

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Gradually increasing presence in US injectable space

Currently, the company's portfolio comprises 16 filed ANDAs, eight of which have been approved (three for partners, five for own). The company has ~35 injectable and ophthalmic products under pipeline, to be filed over the next four years. In 9MFY20, revenue contribution from the US increased to 8% from just 2% in FY19. We expect US contribution in total revenues to reach ~13% by FY22E, to be driven by new launches and market share gains in existing products.

The company has ~35 injectable and ophthalmic products under pipeline, to be filed over the next four years.

In 9MFY20 revenue contribution from the US increased to 8% from just 2% in FY19

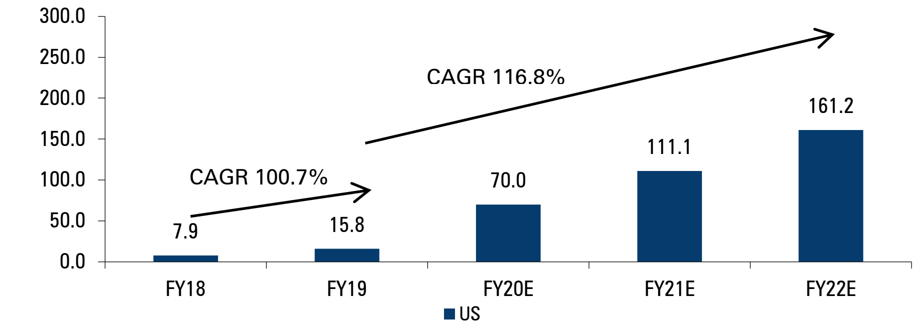
Exhibit 6: Key ANDA approvals

Company	Active Ingredient	Therapy/Usage	Dosage Form
Caplin Steriles	Ropivacaine Hydrochloride	Pain (anesthesia)	Solution, injection
Caplin Steriles	Verapamil Hydrochloride	Cardiac (calcium channel blocker)	Solution, injection
Caplin Steriles	Sodium Nitroprusside	Cardiac (reducing blood pressure)	Injectable
Caplin Steriles	Tranexamic Acid	Anti-inflammatory (procoagulant)	Injectable
Caplin Steriles	Glycopyrrolate	GI therapy (anticholinergic)	Injectable
Cycle Pharma*	Ketorolac Tromethamine	Pain (NSAID)	Injectable

*Source: ICICI Direct Research, Company, USFDA, *now Baxter*

We expect US revenues to grow ~10 fold in FY19-22E to ~₹ 161 crore on the back of incremental product launches.

Exhibit 7: US revenues expected to grow at 117% CAGR over FY19-22E



Source: ICICI Direct Research, Company

Investment cum strategic partnership to reduce risk

The company recently entered into a financial cum strategic collaboration with Eight Roads Ventures, the proprietary investment arm of Fidelity International Ltd and its US-based sister fund F-Prime Capital for the developed market Injectable and ophthalmology businesses. Fidelity has vast experience and sizable investments in the healthcare sector (over 50% of its worldwide private investments into healthcare). It invested ~₹ 218 crore as a partner through compulsorily convertible preference shares (CCPS) that are to be converted into equity shares of Caplin Steriles Ltd. This implies a ~₹ 870 crore valuation of Caplin Steriles Ltd. We believe this is the right strategy in order to mitigate risk and get advantage of Fidelity's expertise in the field of expansion and product launches across the US and Europe.

Fidelity recently invested ~₹ 218 crore in the injectable business earmarked for US through compulsorily convertible preference shares. This implies ~₹ 870 crore valuation of Caplin Steriles

Aggressive R&D spend to support US growth

The company has five dedicated R&D setups (three –DSIR approved and two under approval). The company has spent ~11% of its FY19 revenues on R&D, one of the highest spend for a company of this size. We believe aggressive R&D spending is likely to continue mainly to support the company's aggressive stance on US filings.

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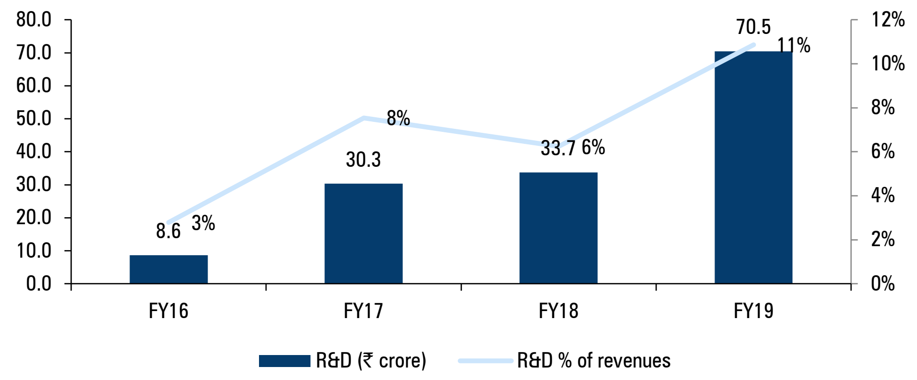
Exhibit 8: R&D spend



Source: ICICI Direct Research, Company

Valuation & Outlook

By thriving in lesser known CA markets and cracking the most difficult US generic pharma code of injectables, that too in different therapies, Caplin has created its own identity with long drawn plans.

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After scripting a unique story by growing in an uncharted territory, the company is looking for growth in known markets. These new markets of LatAm and the US are big in opportunities but fraught with a new set of challenges. That said, we continue to believe in Caplin's capability to replicate the success story in the new markets. Secondly, despite likely dent on margins and return ratios due to investment phase in the new markets, these prints continue to demonstrate earnings and balance sheet strength. We have a BUY recommendation on Caplin with a target price of ₹ 500 (12x of FY22E EPS of 41.7). We believe the company offers a compelling risk-reward scenario at the current valuations. Similarly, the resilience shown by pharma stocks in the current Covid-19 related upheaval also offers an ideal platform for new idea generation like Caplin.

We have a BUY recommendation on Caplin with a target price of ₹ 500 (12x FY22E EPS of 41.7)

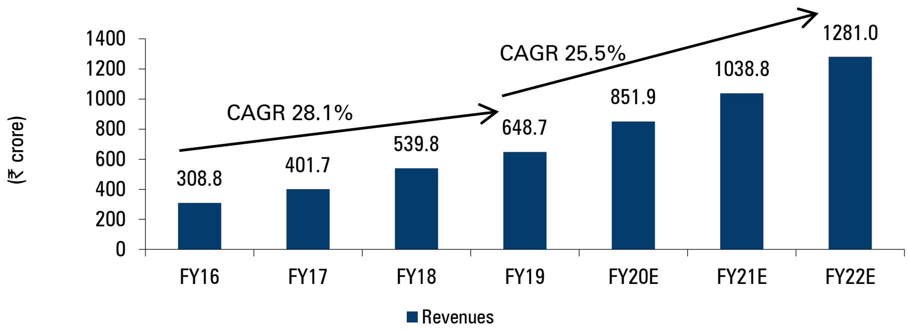
Financials

Revenues expected to grow at 26% CAGR over FY19-22E

In 9MFY20, revenues grew ~40% YoY to ₹ 632 crore mainly due to strong growth in the US. US contribution in overall revenues increased to 8% from 2.5% in FY19. The US growth is likely to be strong mainly due to lower base and aggressive filings. We believe US contribution in total revenues will increase to ~13% by FY22. Apart from US, we believe strong growth in CA and other EMs is likely to persist mainly due to geographical expansion (entry into South American LatAm markets), new product registration, change in product mix and lastly increased branded generic contribution. We expect revenues to grow 25.5% over FY19-22E to ₹ 1281 crore.

In 9MFY20, revenues grew ~40% YoY to ₹ 632 crore mainly due to strong growth in the US. US contribution in overall revenues increased to 8% from 2.5% in FY19

Exhibit 9: Revenues expected to grow at 26% CAGR over FY19-22E



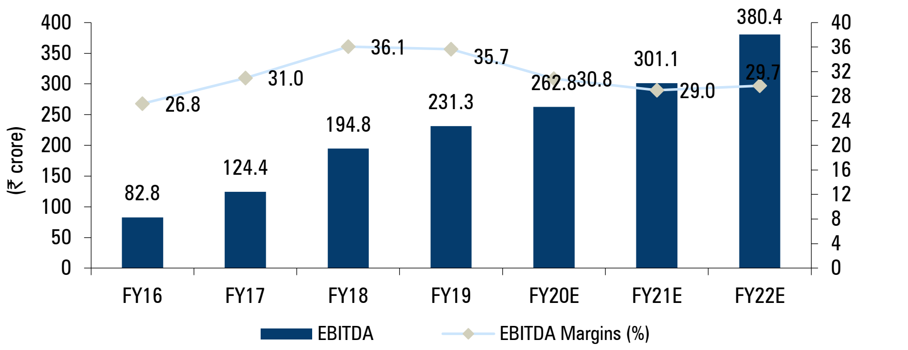
Source: ICICI Direct Research, Company

Higher R&D, foray into related businesses may pull down margin

EBITDA margins came down to 32% in 9MFY20 from 35.7% in FY19 mainly to due to higher level of R&D spend and also entry into API and CRO businesses. The trend is likely to continue also due to shaping up of US business, which is still in an investment phase. EBITDA margins are likely to come down further to 29.7% in FY22 on account of these reasons. Even then, they are likely to remain healthy on the back of a change in product mix in EMs and incremental US launches.

EBITDA margins came down to 32% in 9MFY20 from 35.7% in FY19 mainly to due to higher level of R&D spend and also entry into API and CRO businesses

Exhibit 10: EBITDA margins likely to decline 596 bps over FY19-22E

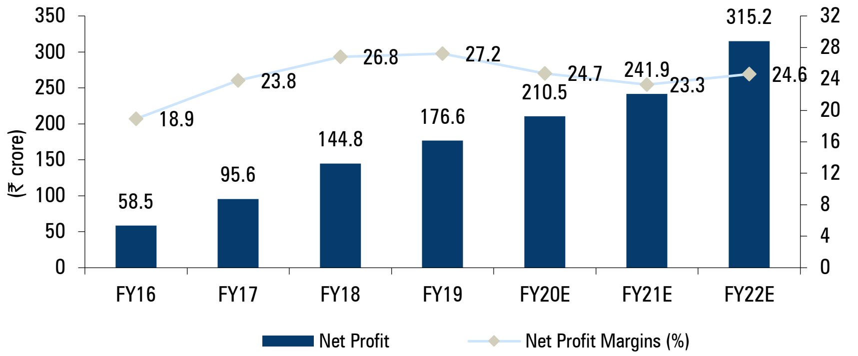


Source: ICICI Direct Research, Company

Net profit likely to grow ~21% over FY19-22E

EBITDA being pulled down is likely to slow down net profit growth as well. We expect net profit to grow 21.3% over FY19-22E mainly in sync with strong growth in revenues, which is likely to be partially offset by additional operational cost and R&D due to US ramp up.

Exhibit 11: Net profit expected to grow 21% over FY19-22E

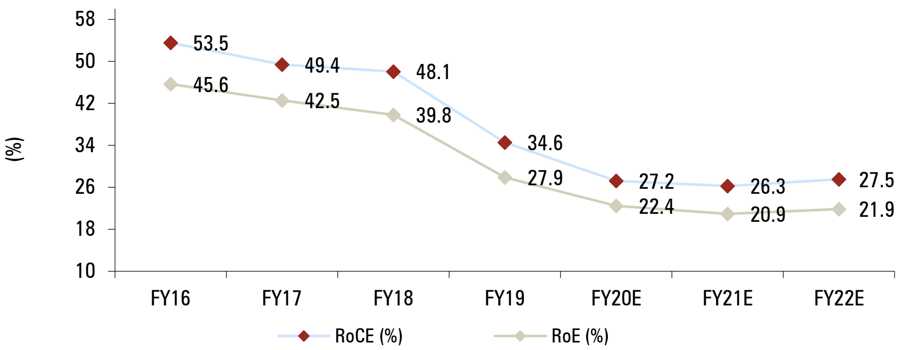


Source: ICICI Direct Research, Company

RoE likely to decline ~600 bps over FY19-22E

RoE is expected to decline 604 bps to 21.9% in FY22 mainly on infusion of Fidelity funds, which has increased the equity base coupled with a decline in EBITDA margins due to higher R&D spend and operational expenses.

Exhibit 12: RoCE & RoE trend



Source: ICICI Direct Research, Company

No capital dilution and no leverage

The key USP of the company is a free cash flow generating ability mainly due to strong operational profit (~40% in EM markets) and low working capital cycle. Hence, despite its smaller size and recent aggressive capex for the US, Caplin has never done any capital dilution in the past decade and remained a net debt free company during the same period. Cumulative outlay of more than ₹ 400 crore for US Injectable capex and opex was also managed through internal accruals before inducting a 'Capital plus' partner.

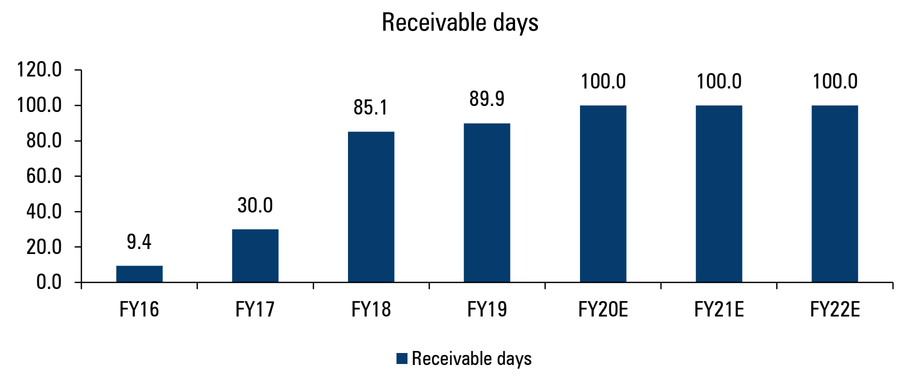
The key USP of the company is a free cash flow generating ability mainly due to strong operational profit (~40% in EM markets) and low working capital cycle.

Optical change in business model impacts receivable days

Receivable days have increased from ~9 days to 90 days mainly due to shift in business model from predominantly generics to a mix of generics and branded generics (75/25). Branded generics require longer credit lines to be extended till the brands get established in the markets. Secondly, moving into larger geographies of South America where business model is mostly tender-based besides requirement of credit to be offered also has an impact on the cycle

Receivable days have increased from ~9 days to 90 days mainly due to shift in business model from predominantly generics to a mix of generics and branded generics (75/25)

Exhibit 13: Change in business model impacts receivable days



Source: ICICI Direct Research, Company

Marked improvement expected in free cash flows

Free cash flows have declined in the recent past mainly due to investment in the US and restructuring in existing markets. However, the major capex is now through with near term capex mainly confined to maintenance purpose only. Going ahead, strong margins in the existing business, currency tailwinds and improvement in US margins are likely to provide significant boost to cash flows.

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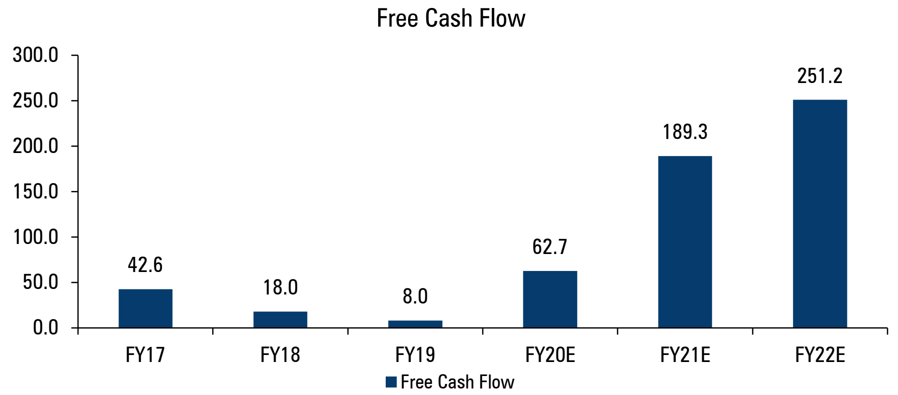
Exhibit 14: Free cash flow likely to improve



Source: ICICI Direct Research, Company

Key risk

Geographical risk

The company's operations are principally located in Central America mainly in Guatemala, El Salvador, Nicaragua, Ecuador and Honduras where it generated 76% of total revenue in 9MFY20. Despite being in decent shape geopolitically, these geographies are still elusive with almost non-existing third party check such as market research agency reports either for primary or secondary markets. Note that the population is heavily dependent on the US. Hence, any downturn in the US economy, especially in the current backdrop of Covid-19 pandemic, could have a material impact on the repatriation, purchasing power and overall financial health of distributors. Similarly, having no presence in the relatively safe Indian pharma market is also an issue.

Regulatory issues

Indian pharmaceutical companies have received 19 warning letters, out of the 41 (46%) issued by the USFDA in 2019, the most in four years. This means it will affect new drug applications that will delay new product launches. Also, injectable plants are fraught with maximum USFDA scrutiny with higher number of observations and warning letters vis-à-vis oral solids. Caplin has just a single USFDA approved formulation plant. Although the track record has been satisfactory till now, any adverse outcome from the USFDA could impact Caplin's US business prospects.

Financial Summary

Exhibit 15: Profit and loss statement				₹ crore
(Year-end March)	**FY19**	**FY20E**	**FY21E**	**FY22E**
Total Operating Income	648.7	851.9	1,038.8	1,281.0
Growth (%)	20.2	31.3	21.9	23.3
Raw Material Expenses	288.8	399.9	498.4	612.5
Gross Profit	359.9	451.9	540.5	668.5
Gross Profit Margins (%)	55.5	53.1	52.0	52.2
Employee Expenses	47.1	66.6	81.8	98.6
Other Expenditure	81.5	122.6	157.6	189.5
Total Operating Expenditure	417.4	589.1	737.7	900.5
EBITDA	**231.3**	**262.8**	**301.1**	**380.4**
Growth (%)	18.8	13.6	14.6	26.3
Interest	0.1	0.2	0.1	0.1
Depreciation	23.4	31.6	34.1	37.3
Other Income	19.0	30.9	43.6	61.5
PBT before Exceptional I	**226.9**	**261.9**	**310.6**	**404.6**
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	226.9	261.9	310.6	404.6
Total Tax	50.3	51.0	68.3	89.0
PAT before MI	176.6	210.9	242.3	315.6
Minority Interest	0.0	0.4	0.4	0.4
PAT	**176.6**	**210.5**	**241.9**	**315.2**
Growth (%)	22.1	19.2	14.9	30.3
EPS (Adjusted)	**23.3**	**27.8**	**32.0**	**41.7**

Source: ICICI Direct Research

Exhibit 16: Cash Flow Statement				₹ crore
(Year-end March)	**FY19**	**FY20E**	**FY21E**	**FY22E**
Profit/(Loss) after taxation	184.4	210.5	241.9	315.2
Add: Depreciation & Amort	23.4	31.6	34.1	37.3
Net Increase in Current Ass	-91.6	-109.8	-70.5	-90.3
Net Increase in Current Lia	-28.5	20.2	18.8	24.0
Others	-4.3	0.2	0.1	0.1
CF from Operating activi	**83.5**	**152.7**	**224.3**	**286.2**
Investments	-19.9	-200.0	-200.0	-200.0
(Purchase)/Sale of Fixed A	-75.5	-90.0	-35.0	-35.0
Others	-4.2	0.6	0.6	0.6
CF from Investing activiti	**-99.5**	**-289.4**	**-234.4**	**-234.4**
Proceeds from Preference	105.0	113.0	0.0	0.0
(inc)/Dec in Loan	0.0	0.0	0.0	0.0
Dividend & Dividend tax	-15.1	-18.5	-22.7	-30.3
Other	-0.1	-0.2	-0.1	-0.1
CF from Financing activi	**89.8**	**94.3**	**-22.7**	**-30.3**
Net Cash Flow	**73.7**	**-42.4**	**-32.8**	**21.5**
Cash and Cash Equivalent	79.3	153.0	110.6	77.7
Cash	**153.0**	**110.6**	**77.7**	**99.2**
Free Cash Flow	**8.0**	**62.7**	**189.3**	**251.2**

Source: ICICI Direct Research

Exhibit 17: Balance Sheet	₹ crore			
(Year-end March)	**FY19**	**FY20E**	**FY21E**	**FY22E**
Equity Capital	15.1	15.1	15.1	15.1
Reserve and Surplus	617.8	922.8	1,142.0	1,426.9
Total Shareholders funds	632.9	937.9	1,157.1	1,442.0
Total Debt	0.5	0.5	0.5	0.5
Deferred Tax Liability	17.6	18.5	19.4	20.4
Other Non Current Liabilitie	5.6	5.9	6.2	6.5
Source of Funds	**656.7**	**962.8**	**1,183.2**	**1,469.4**
Gross Block - Fixed Assets	271.5	361.5	396.5	431.5
Accumulated Depreciation	44.7	76.3	110.4	147.7
Net Block	226.8	285.2	286.1	283.8
Capital WIP	9.7	9.7	9.7	9.7
Fixed Assets	236.5	294.9	295.8	293.5
Investments	70.0	270.0	470.0	670.0
LT Loans and Advances	12.0	12.5	13.2	13.8
Inventory	37.5	70.0	85.4	105.3
Debtors	159.8	233.4	284.6	350.9
ST Loans and Advances	48.7	51.1	53.7	56.4
Other Current Assets	25.1	26.4	27.7	29.1
Cash	153.0	110.6	77.7	99.2
Total Current Assets	424.1	491.5	529.1	640.9
Creditors	60.5	79.4	96.8	119.4
Provisions	1.4	1.5	1.6	1.7
Other Current Liabilities	23.9	25.1	26.4	27.7
Total Current Liabilities	85.9	106.1	124.8	148.8
Net Current Assets	338.2	385.4	404.3	492.1
Application of Funds	**656.7**	**962.8**	**1,183.2**	**1,469.4**

Source: ICICI Direct Research

Exhibit 18: Ratio Analysis				₹ crore
(Year-end March)	**FY19**	**FY20E**	**FY21E**	**FY22E**
Per share data (₹)				
Reported EPS	23.3	27.8	32.0	41.7
Cash EPS	20.8	25.4	29.0	37.7
BV per share	83.7	124.0	153.0	190.6
Cash per Share	20.2	14.6	10.3	13.1
Dividend per share	2.6	2.4	3.0	4.0
Operating Ratios (%)				
Gross Profit Margins	55.5	53.1	52.0	52.2
EBITDA margins	35.7	30.8	29.0	29.7
PAT Margins	27.2	24.7	23.3	24.6
Cash Conversion Cycle	77.0	96.0	96.0	96.0
Asset Turnover	2.4	2.4	2.6	3.0
EBITDA conversion Rate	36.1	58.1	74.5	75.2
Return Ratios (%)				
RoE	27.9	22.4	20.9	21.9
RoCE	34.6	27.2	26.3	27.5
RoIC	49.0	40.3	42.6	49.7
Valuation Ratios (x)				
P/E	14.8	12.4	10.8	8.3
EV / EBITDA	10.3	8.5	6.9	4.8
EV / Net Sales	3.7	2.6	2.0	1.4
Market Cap / Sales	4.0	3.1	2.5	2.0
Price to Book Value	4.1	2.8	2.3	1.8
Solvency Ratios				
Debt / EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	3.2	3.6	3.6	3.6

Source: ICICI Direct Research

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