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DEMOCRATIZING WEALTH CREATION

Vriddhi Growth

January 2019

Caplin Point Laboratories

CMP : ₹**413.50** | Target price: ₹**645** | HP* : **Upto 3 years**

The Vriddhi Pick for the month of January 2019 is Caplin Point Laboratories. A company which has embarked on the journey to provide medicines (creams, ointments, oleums, etc) in non-regulated and low-regulated markets of Latin America and Africa. The company's strength lies in its on the ground understanding of the business by its promoter C. C. Paarthipan and vision to explore new opportunities with equal passion and dedication to be an innovator. The company has evolved its business model to establish it presence in APIs, formulations and retail (only in South America).

All investments to fuel growth have been through internal accruals and sheer belief that risk pays. It is a company which has now matured, but it is still youthful and ready to embark on to the next stage of growth, which is going to kick in due to higher use of technology, focus on the China market and new subsidiaries.

The company has grown its profit at a CAGR of 59.3% over the last five years and has grown its ROE by 49.5%. The company, which was leapfrogging with 60-70% growth, witnessed slower growth in FY18 due to higher investments and longer time to get approvals on certain drugs leading to strain on receivables and extended cycles. We see that most of the investments the company has done over the last two years are going to bear fruits in the coming 2-3 years. The company has made some vital strides to qualify as a Vriddhi stock.

Investment Rationale -

China's entry can benefit formulations business : The company has set up a subsidiary in Sep 2018 with 33% equity holding with China's Jointown Pharmaceuticals Group (a US$11 billion publicly-traded distribution company in China). This is expected to benefit Caplin to enter highly regulated markets of China in terms of understanding the gaps and will help Jointown to market products in South America through Caplin. It also provides Caplin the opportunity to market its formulations to China whose forte is APIs. The changes in regulations in China are encouraging manufacturers of value-added formulations, driven by high process compliances. Caplin aims to target growing opportunities in cancer, stroke and diabetes segments, which are growing faster than the rest of the market.

The inane genes of both the companies are similar as Jointown was started by a village doctor who also addressed the bottom of the pyramid, with medicines supplied to far-flung mountainous villages on horseback. Jointown is today the fourth largest pharmaceutical distribution company in China catering to over 90% of the hospitals and drug stores through strategic partnerships with over 2,000 local pharmaceutical companies.

It is expected the growth in the sector will be driven by market expansion in emerging countries and ageing populations in the developed countries.

US injectables business to see green shoots by FY20 : The pharma market for chronic diseases is eventually moving to injectables from oral dosages. The company has invested in CP4 units for manufacture of injectables.

*HP : Holding Period

Company Details	
Industry	Pharmaceuticals & Drugs
Chairman	C C Paarthipan
Managing Director	Sridhar Ganesan
Company Secretary	Vinod Kumar
ISIN	INE475E01026
Bloomberg Code	CLPL IN
BSE Code	524742
Key Market Indicators (Consolidated)	
Latest Date	14-Jan-2019
Latest Price (Rs)	404.50
Previous Close (Rs)	414.25
1 Day Price Var%	-2.35
1 Year Price Var%	-39.03
52 Week High (Rs)	675.00
52 Week Low (Rs)	336.40
Beta	0.84
Face Value (Rs)	2.00
Industry PE	23.39
TTM Period	201809
TTM EPS(Rs)	20.35
TTM CEPS(Rs)	23.20
Price/TTM CEPS(x)	17.44
TTM PE (x)	19.88
Price/BV(x)	7.03
EV/TTM EBIDTA(x)	13.41
EV/TTM Sales(x)	5.07
Dividend Yield%	0.49
MCap/TTM Sales(x)	5.21
Latest Book Value (Rs)	57.56
Market Cap (Rs. In Crores)	3058.16
EV (Rs. In Crores)	2979.42
Latest no. of shares (In Crores)	7.56
Promoter No of shares (In Crores)	5.22
Promoter %	69.05
FII No of Shares (In Crores)	0.54
FII %	7.08
Total No of Shares (In Crores)	7.56
Free Float %	30.95

DSIJ Pvt. Ltd. : C - 305, Trade Center, North Main Road, Near Axis Bank, Opp. Lane no. 6, Koregaon Park, Pune - 411001 I **For Customer Service : 020-49072626 OR service@dsij.in**

Registered Office Address: 419-A, 4th Floor, Arun Chambers, Tardeo, Next to AC Market, Mumbai - 400034

CIN No. : CIN-U22120MH2003PTC139276 SEBI Registration No: INA000001142

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Also, the price erosion is least in this segment. The company is seeing slight stabilisation in prices of oral solid dosages. Due to structural changes of consolidation in the geography, the company is directly dealing with the US distribution companies of GPOs, which is positive. It estimates 10-12 ANDAs in FY19-20 comprising a mix of simple and complex injectables and ophthalmics and correspondingly expanding the capacity to 48 million vials and 12 million ophthalmic units (Phase 1) by June 2019 from the FY18 capacity of 18 million vials and 9 million ophthalmic units.

The company is committed to build around the US injectables business and recognised the opportunity in the segment in the nascent stage. Though the market environment deteriorated with pricing pressure and higher costs of ANDA filings, the company continued with long term vision. We see the company to reap benefits of these investments by FY20 as having approvals in the US will qualify the company to market its drug in China. The company invested Rs.350 crore in opex and capex through accruals to enter the US market. It has an attractive pipeline of proprietary ANDAs with seven expected to be filed in FY18-19.

The company is also increasing its injectables capacity four-fold to 48 million vials. It intends to commission the work on Phase 2, involving significantly higher lyophilization capacity and differentiated fills comprising premix bags and pre-filled syringes by 2020-21. The company has also ramped up its count of R&D engineers' to 180 to target the US and China markets.

> ***Caplin has set up a subsidiary in Sep 2018 with 33% equity holding with China's Jointown Pharmaceuticals Group (a US$11 billion publicly-traded distribution company in China)***

Pharma-emerging companies to fuel future growth : The global pharmaceuticals market could reach US$1.12 trillion in 2022 growing at CAGR of 6.3% till 2022. Prescription sales excluding generics will reach US$1.006 trillion by 2022. This growth will come mainly from market expansion in pharma-emerging countries and ageing populations in developed countries. The global brand spending is forecast to increase to ~US$832 billion by 2021, while the global generic spending is expected to increase to ~US$ 505 billion by 2021. All drug makers need to cope with tightening cost controls over drug price-fixing as it is the only way to keep new medicines affordable for patients.

In terms of market share, generic drugs in Latin America have grown from 65% to 80% in volumes and 45% to 65% in value between 2006 and 2016. Mexico is one of the leading generic drug markets in Latin America (growing at a rate of 11% per annum over the past five years) while Brazil commands the largest share of 35.1%. The company has increased its registrations over the last decade from 100 to 400 in these geographies.

> ***It enjoys good market share in export of formulations and one of the top figuring companies from India in export to Guatemala (63.3% of Indian exports), El Salvador (77.25%) and Indian share of exports range 36-19% in markets of Nicaragua, Honduras, Dominican Republic and Ecuador***

Latin America continues to provide backing to aggressive growth plans of company : Latin America is the bastion of the company, being the main market fuelling growth in the early life of the company. It made commercial entries into Chile, Paraguay, Panama and Costa Rica in FY18. It has adopted well to the security threats, unregulated markets and established its retail chain with much ground work. The company enjoys good market share in export of formulations and it is one of the top companies from India in terms of exports to Guatemala (63.3% of Indian exports), El Salvador (77.25%) and the Indian share of exports range from 36-19% in markets of Nicaragua, Honduras, Dominican Republic and Ecuador. The company earlier used to sell generics and is moving to branded generics in these markets, which is expected to augment its market share.

Also, the company is moving towards digitisation and data analytics to manage the retail chains and be able to understand the off-take of the drugs to further build on the same. This is also expected to help in better

retail change management of credit and inventory.

Successful USFDA inspection located at Gummudipoondi : In Sep 2018, the company had a successful inspection of its facility at Gummudipoondi in Tamil Nadu, which implies that the company's plans to target US through this facility will be on track. This CP-IV facility in Gummidipoondi specialises in the manufacture of pharmaceutical formulations in injectable dosages and ophthalmic drops.

The company has also started CP V at Perungudi, Tamil Nadu, as an additional R&D facility dedicated to the development of injectables and opthalmics for fully regulated markets of the US and EU, among others.

Strong financial growth

In FY18, the company had shown a revenue growth of 34% and PAT growth of 51% YoY. It expects to have net profit of ~Rs.230 cr by FY21-22 from the current FY18 net profit of Rs.145 cr.

The company is cash-rich and has been meeting all the expansion plans and capex through internal accruals. In fact, it extended higher credit to customers to enter new markets and establish its position. The capex for FY18-19 was Rs.52 cr and cash/cash equivalents were Rs.125 cr.

Caplin's revenue in Q2FY19 grew by 18.7% YoY to Rs 155.9 cr from Rs. 131.31 cr. EBITDA grew by 13% YoY to Rs. 55.8 cr as against Rs. 49.4 cr in Q2FY18. EBITDA margin for the quarter stood at 35.8% in Q2FY19, which was at 37.6% in Q2FY18. PAT grew by 22.4% YoY to Rs. 43.5 cr in Q2FY19 from Rs. 35.5 cr in Q2FY18. PAT margin grew from 27.06% to 27.91% during the quarter.

Inc/Exp Statement(Consolidated) (Rs in Crore)

Description	201803	201703	201603	201506	201406
Net Sales	539.84	401.65	238.72	251.77	173.09
Total Income	552.51	411.60	242.38	254.80	176.81
Total Expenditure	344.52	276.84	174.51	192.06	136.90
PBIDT	207.98	134.76	67.87	62.74	39.91
PAT	144.64	95.50	45.77	41.13	25.93
Dividend %	100.00	75.00	60.00	50.00	40.00
Adj. EPS(Rs)	19.15	12.65	6.06	5.43	3.42

Quarter On Quarter (Consolidated) (Rs in Crore)

Particulars	201809	201806	Q on Q Var%	201709	Y on Y Var%
Net Sales	155.86	146.46	6.42	131.31	18.70
Total Expenditure	100.08	93.43	7.12	81.95	22.12
PBIDT (Excl OI)	55.79	53.03	5.20	49.36	13.01
PAT	43.50	37.39	16.32	35.54	22.40
PBIDTM% (Excl OI)	35.79	36.21	-1.16	37.59	-4.79
PBIDTM%	40.29	37.31	7.99	40.32	-0.07
PATM%	27.91	25.53	9.32	27.06	3.14
Adj. EPS(Rs)	5.75	4.95	16.16	4.71	22.08

> ***Estimates 10-12 ANDAs in FY19-20 comprising a mix of simple and complex injectables and ophthalmics and correspondingly expanding capacity to capacity to 48 million vials and 12 million ophthalmic units (Phase 1) by June 2019 from FY18 capacity of 18 million vials and 9 million ophthalmic units***

> ***Latin America is the bastion of the company with being the main market fuelling growth in the early life of the company***

> ***It has invested in CP4 units for manufacture of injectables and also the price erosion is least in this segment***

Valuation

The company is currently trading at TTM P/E of 19.8x with TTM EPS of Rs 20.35. Its 5-year median P/E has been around 32.3x. In FY18, it delivered strong ROE and ROCE of 49.4% and 64.08% respectively. We urge investors to invest in tranches to average the entry price considering the market volatility. We see a potential upside of 56% with target price of Rs.645 over a period of three years.

About the company

Caplin Point Laboratories is a mid-cap pharmaceutical company in India. It holds over 2,000 product licences across the globe, with a dominant position in Latin America. The company is entering in the regulated markets of the US, EU, Brazil, Mexico, Australia, with state-of-the-art manufacturing facility for Injectables already approved by EU-GMP, ANVISA and the US FDA.

The company has been investing in a healthcare portal to automate and create an end-to-end connectivity to the distributors and pharmacists in Latin America. This has helped the company to position branded generics in the market and also further understand whether or not the products supplied on credit to the distributors/chemists were sold on time to the ultimate customers. This, in turn, enables the company to monitor credit terms.