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Independent Equity Research

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Important disclosure on the last page

Cupid Ltd

Cupid Ltd is a small but fast growing company in high-growth global prophylactics / contraceptive market. We believe its erratic performance is a thing of the past and the company has restructured itself well for a stable and growing performance. Rising comparative advantage of India over global competitors (China, Thailand, and Malaysia) is a tailwind for it.

Fair Value (1-year out) Rs.111 | **Current Price Rs.46** | **Potential 2.4x**

At current price, stock trades at 7.9x FY16E EPS and 5.2x FY17E EPS with expected earnings growth of ~48% in FY16-FY17. Our fair value of Rs.111 is 10.7x FY17E EPS. RoE is expected to expand from 22% in FY15E to 29% in FY17E. The company has zero net debt and will remain so.

Key Data

Market Cap	Rs.55cr US$9mn
Shares Outstanding	1.11cr
52 wk Hi-Lo	50 – 7
Avg Trading Vol	No. of shares
1 month	108,000
3 months	105,000
1 year	33,000
BSE Scrip Code	530843
BSE Group	B
Shareholding%	**30SEP14**
*Promoters	48.81
*South Korean collaborator	2.70
*Others	48.46
Valuation	**FY15E**
EV/ EBITDA	5.1x
Market Cap/Sales	1.4x
P/E	8.6x

Products

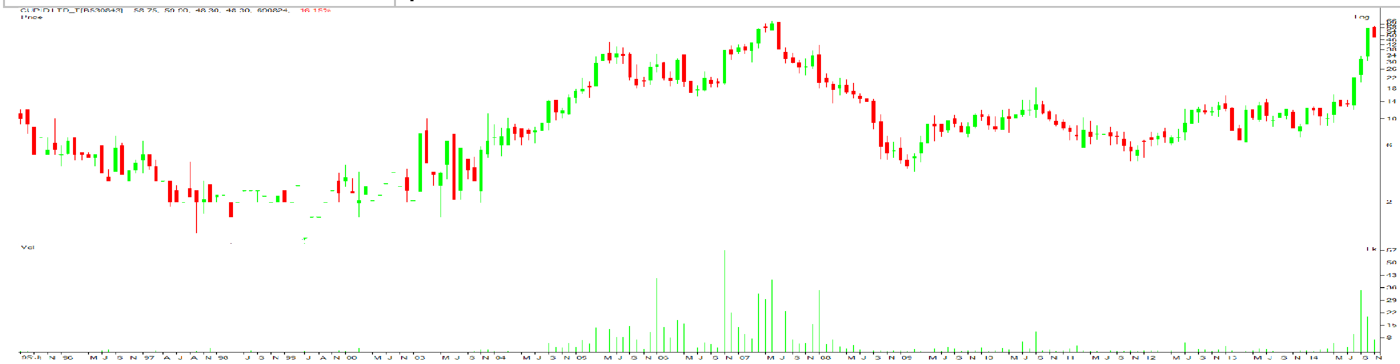
Prophylactics/contraceptives: Male & Female condoms.
-Exports 80%
-Contract manufacturing 15%
-Branded sales 5%

Key Investment Points

- China, Thailand, Malaysia and India are major condom manufacturers and exporters to the world. With labour costs rising sharply in Malaysia (contract labour cost up 80% in the last one year), Malaysia is being priced out, leaving China & Thailand as major competitors for India in global market. Chinese labour costs have also been rising at 18-20% for the last two years.
- Cupid Ltd, earlier dependent majorly on India's Ministry of Health (MoH) orders, has found a good foothold in Europe & Africa. With this we expect its erratic performance to give way to relatively stable and growing performance.
- It's currently operating at 37% capacity utilisation in male condom (MC) and 67% in female condom (FC). FC capacity doubled recently. No major capex required till it reaches 2.5x the current sales volume.
- High margin FC sales are rising rapidly leading to improved profits.
- Cupid recently signed a 10-year supply agreement with a US enterprise, which will distribute Cupid's brand Green Love in the US. This could be a game changer for Cupid. Cupid's plant is USFDA compliant.
- Cupid is among a handful of companies globally to make FC. Cupid is among the only two companies approved by WHO/UNFPA for worldwide bulk procurement of FC and only company so approved globally for both FC & MC.

Watch out for

- Sharp rise in INR appreciation not accompanied by similar appreciation in Baht and Yuan. Sharp rise in Indian labour cost not accompanied by similar rise in Thailand and china
- Latex consumption per piece of condom is rising due to product mix change and rising wastage & rejections.



Introduction

Cupid Ltd (formerly Cupid Condom Ltd), is a Rs.32crore Revenue company. It makes male and female condom at its plant at Nashik, Maharashtra, India.

Cupid was originally promoted by Amit & Shiv Agrawal. They are no longer with the company. Originally promoted as a 100% EOU, it was later converted into a domestic unit due to lack of export orders then. India's Ministry of Health (MoH) has been its biggest customer for many years. The company saw worst of times during 2008-2009. Mr Omprakash Garg, current CMD, then took charge and has been developing export market for the company.

Condoms cater to needs of Family planning and Birth control (contraceptive) and disease prevention (prophylactic). A condom is a barrier method commonly used during sexual intercourse that reduces the chances of pregnancy and the spread of STDs and AIDS. Condoms are also widely recommended in the prevention of STIs.

In Birth Control, condoms compete with contraceptive drugs and devices, which are temporary birth control methods and function majorly by altering the mechanism of ovulation and acting as physical barriers between the sperm and ovary.

Condoms are the only prevention products available against sexually transmitted infections (STIs: HIV/Aids). No near-term alternative prevention products on the horizon.

Cupid currently has four sales channels:

- Ministry of Health – Government of India (no orders in FY14 & FY15 so far but expected in Q4FY15)
- Exports to multiple clients (ground work for developing export market started in 2009-2010) – (80% of sales currently).
- Contract manufacturing [customers include Cipla, Chokhani Pharma, DKT (an international NGO working in India)] (~15% of sales currently)
- Own brands for Indian market (5% of sales currently)

Exports carry high margin, other channels at present have low margins. With DPCO's price cap on retailing of condoms in India, the margins have contracted. Mankind Pharma, the biggest branded player (Brand: Manforce) has shut down its plant.

Brazil is the largest buyer of condoms from India followed by United States and South Africa. Small quantity of condoms is imported into India from Malaysia, South Korea and Thailand.

Key Investment Point

Global condom market is growing at 8% annually

The global condom market has been growing at 8% annually driven by efforts of governments and NGOs globally to put across safety and birth control messages. Global market size at present is 17bn pieces and Indian market size is 2.4bn pieces. It's a huge and growing market and Cupid's current capacity is just 2.5% of the global market size. We expect Cupid's sales to grow at minimum 15% annually. Cupid is expecting large order inflows from Keyna, Uganda, Myanmar, South Africa, Brazil, and Indonesia. MoH orders may also come in towards the end of FY15.

One of the few companies in the world to have developed female condom (FC)

Cupid and Female Health Company (FHC)-Chicago (Plant: Malaysia) are the only companies in the world to have developed FC and gotten pre-qualification from WHO/UNFPA. Its uniquely designed FC have been approved by WHO/UNFPO for their worldwide bulk procurement programs. FC is an oligopolistic market with only a handful of players - Reckitt Benckiser, Origami Healthcare, Silk Parasol, Sanghai Dahua, HLL Lifecare Ltd and Tianjin Condom Bao.

Cupid has been spending and working on R&D in this field since 2008. It has an approved R&D Centre for this. It also developed a unique shaped specialty male condom (SMC-1) and has received worldwide patent on this.

FC has been in existence for many years but is likely reaching tipping point now with awareness creation by FHC. FC market has been growing exponentially lately. FHC (through its distributor Semina) last month won an order to supply 50mn FC to Brazil. This is the largest single order (previous Brazil order size: 20mn) for FC and indicates the high growth potential in FC. Cupid had also bid for this order through its distributor in Brazil and reportedly was L1 but yet the order went to FHC.

The worldwide need for FC far exceeds the current utilization of the product. HIV/AIDS continues to be the leading cause of death globally for women in the 15-44 year age group.

Western world condom manufacturing is being closed down

Condom manufacturing plants in the western world are being closed down due to high labour costs there. As a result, the opportunity for countries like China, India, Thailand and Malaysia has been growing.

India's rising competitive advantage due to rapidly rising labor costs in competing countries

Rapidly rising labour costs in Malaysia & china is making India more competitive in global markets. Malaysia has been almost priced out with 80% rise in casual labour cost in the last one year.

Long term supply contracts

Cupid has long term supply contract from WHO/UNFPO. The current 3-year contract is valid till March-2016. Cupid is a pre-qualified supplier and expects regular renewal of contract.

It recently entered into a 10-year supply agreement with a newly formed enterprise in the US – Safeware & co. This company is promoted by three individuals; one of them has been in the business of pharmaceutical distribution in the US. It intends to distribute cupid's condoms under Cupid's Green Love brand in the US. If Safeware & co is able to establish the brand there, it would open up many opportunities to Cupid to leverage its brand.

Cupid's FC capacity recently doubled, FC has very high profit margin

Cupid's 12mn pieces FC capacity has been recently expanded to 25mn pieces in expectation of strong demand growth and large orders. In the half year ended Sep-2014, it made only 4mn FC (67% capacity utilisation). As FC production ramps up with inflow of orders, profit margins will significantly improve as FC carries significantly high margin than that in MC. FC realisation is 17-18x higher than that of Mc but FC cost is only 2-3x higher than that of MC. MC market is competitive and offers low margin. However, Cupid does not currently have FC orders beyond Dec14. High capacity utilisation may not happen soon.

Enough slack in the capacity to grow 2.5 fold

Cupid's current annual production capacity is 375mn pieces of MC and 25mn pieces of FC. In the 1st half of FY15, it doubled its sales and yet is operating at only 37% capacity utilisation in Mc and at 32% utilisation in FC on expanded capacity. It will not require any capex till its sales volume grows 2.5 fold. In any case, it's not a capital intensive business.

High margin South African tenders

South Africa is a large market and offers high margins. Cupid has been successful in bagging a lucrative tender from South African government. This order is currently being executed and is expected to be over by Dec-14. This order is the main reason for significantly improved performance of Cupid since QE Mar-14. It's now working on a large 3-year FC supply order from South Africa. If Cupid gets this order, it will be a significant win and supplies are likely to commence from April-15. If Cupid does not get any other FC order in the meanwhile, QE Mar-15 performance may show de-growth in profits.

Foray into new products

Cupid is contemplating foray into new but related products (e.g. Lubricants), which are already being demanded by its current customers. It has already got license for this from Maharashtra FDA.

Quality products – Cupid only company with WHO pre-qualification for both MC & FC

Cupid is one of the only two companies pre-qualified with WHO/UNFPA for FC and contract manufactures for Cipla and DKT. This indicates that Cupid's products are quality products. Even for MC, there are currently only 25 WHO/UNFPA pre-qualified plants belonging to 20 companies worldwide. Cupid is the only company worldwide to have pre-qualification from WHO to supply both MC and FC.

Risks/Concerns:

Forex and labor cost

As the key input is a global commodity and input price is largely a pass through for Cupid, its global competitiveness hinges on comparative exchange rate and labour costs vis-à-vis China and Thailand, the two main competing countries.

Top management continuity

Currently only one member from the promoter family (CMD Mr Omprakash Garg – OPG)) is part of the management. Other promoter family members are engaged in other businesses and professions. OPG is 71 and has partial visual impairment. However, the company has long serving employees (12 since 1998 and two since 2008).

Rising consumption of latex

Latex rubber is the main input to both MC and FC made by Cupid. FHC uses Nitrile polymer to make FC. Latex consumption per piece of MC and FC has risen by 20% in FY14. Part of this is due to change in production mix with higher proportion of longer & thicker pieces and part due to rising wastage and rejection during latex handling and production process.

Volatility in quarterly earnings

Bulk of Cupid's sales is dependent on tender wins and issue of purchase orders by UNFPA under long term supply contract. Timing and quantity of these are not fixed and therefore causes volatility in quarterly revenues. As FC has significantly high profits margins than that in MC, the product mix causes volatility in quarterly margins and profits. Based on current order book, QE Mar-15 profits are likely to de-grow, as currently there are no orders for FC for that quarter. MoH MC Order may come in that quarter but margins will be lower.

Significant quarter-to-quarter variations in the Company's results are likely due to the timing and shipment of large orders rather than from any fundamental changes in the business or the underlying demand for condoms.

Management & Ownership

Promoters (Garg family) owned 48.8% in Cupid as on 30SEP14. 18.5% of the promoters' holding is pledged with ING Vysya Bank. While the loan, for which the pledge was made, has been repaid, the bank has retained the pledge for CC limits that the company has. There is negligible institutional holding. Mr Omprakash Garg (71) is chairman and managing director. An Engineer and a US Citizen, he has real estate business in the US. He has been spending two thirds of his time in India for last few years to bring the company back on track. He has been part of an organisation that provides inputs on process formulation for contraceptives for many years. The promoter family is also into jewellery business in India.

Valuation

At current price, Cupid trades at 7.6x and 5x FY16 and FY17 estimated earnings. Cupid's FY15E EV is 6.1x EBITDA. In 2010, Reckitt Benckiser acquired SSL International at 18x EBITDA. SSL had lower growth prospects and global market valuations were significantly lower than what they are today. At our fair value, Cupid's Enterprise Value works out to 12.3x FY15 EBITDA.

Financials

Income Statement

Rs. Cr.	FY14	FY15E	FY16E
Net Revenues	19.6	34.4	44.8
EBIT	0.61	7.5	10.3
PBT	0.11	6.9	10.1
PAT-Adj.	0.10	4.6	6.6
EPS Rupees	0.09	4.12	5.98

Ratios

%	FY14	FY15E	FY16E
Revenue Gr%	-31.3	75.6	30.3
EPS Growth %	-86.1	4639.6	44.9
RoE %	0.5	21.9	25.1
Net D/E x	0.17	0.17	-
Debtors Days	59	59	59
Creditors Days	81	55	55
Customer advance	8	9	9
RM Days	24	24	24
FG Days	76	60	45
WIP Days	3	2	2

Balance Sheets

Rs. Cr.	31Mar14	31Mar15	31Mar16
Assets			
Net Block	16.3	16.6	16.6
CWIP	0.3	-	-
Net Curr. Assets	6.3	11.5	14.0
Investments	0.1	-	-
Cash equivalent	0.3	0.4	0.5
Liabilities			
Equity Capital	11.1	11.1	11.1
Reserves	7.5	12.1	18.7
Debt	3.2	3.8	-

Interim Performance

Rs.Cr.	Dec13	Mar14	Jun14	Sep14
Months	**3**	**3**	**3**	**3**
Revenues	3.6	8.4	9.7	10.0
EBITDA	0.2	2.6	2.5	2.9
EBIT	-0.2	2.3	2.0	2.4
PBT	-0.3	2.1	1.9	2.4
PAT-Adjusted	-0.3	2.1	1.9	1.7
Eq Capital	11.1	11.1	11.1	11.1
EPS Rs.	-0.28	1.87	1.70	1.54
EBIDTA Margin %	5.5	31.5	25.9	28.4
Other income/PBT %	-3.2	-	-	3.3
Tax/PBT %	-	3.3	-	29.3
RM/Sales%	56	44	45	45

Multiple Valuation

	FY14	FY15E	FY16E
EV/EBITDA x	26.9	6.3	4.8
Mkt. Cap/Sales x	2.7	1.5	1.2
P/E x	540.0	11.4	7.9
Price/Book x	2.8	2.3	1.8

Free Cash Flow

Rs. Cr.	FY14	FY15E	FY16E
NOPLAT	0.3	5.0	6.8
Change in Net Working Capital	1.6	5.3	2.6
Operating Cash Flows	**-1.3**	**-0.3**	**4.2**
Net Capex & others	-0.7	-	-
Free Cash Flow	**-0.6**	**-0.3**	**4.2**
Non-opr. Cash flow	-0.1	-	-
Cash Flow to Investors	-0.6	-0.3	4.2

Financing Cash Flow

Rs. Cr.	FY14	FY15E	FY16E
Post-tax Interest	0.2	0.3	0.2
Repayment/ (issue) of Debt	-0.7	-0.6	3.8
Minority Interest	-	-	-
Pref Sh Redemption	-	-	-
Equity Share Dividend	-	-	-
Equity Buyback/(issue)	-	-	-
Inc / (Dec) in surplus cash/Investments	-0.1	-0.1	-
Financing Cash Flow	**-0.6**	**-0.3**	**4.2**

DCF Valuation

Key Assumptions	%
Terminal Growth Rate	3.0
WACC	14.9
Cost of Equity	15.1
Terminal ROIC	17.9
Outcome	
Fair Value Per Share (Rs.)	**96**
FV-1 year out (Rs./share)	**111**

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