**Management Q&A – Caplin Point Labs Limited**

Management – Vivek Partheeban, COO
Analysts – Nine Rivers Capital, Akshay Saxena

The session started with Mr. Vivek giving us a brief on the company’s history and business which was pretty similar to that said in the Q3, FY19 earnings call followed by the Q&A session. Some key takeaways are as follows -

**Latin America (85% of present operations):**

What worked in the past and how?

* Caplin entered the countries of Guatemala, Honduras, El Salvador etc where regulations and penetration was very low in early 2000s and targeted bottom of the pyramid consumers
* Most competition came from local players in the target market and not the Indian/Chinese manufacturers which gave Caplin the cost advantage at the risk of entering into a physically hostile market
* Caplin sold un-branded generics into these markets by outsourcing ~40% of formulations manufacturing to China and running quality checks at company premises to get the additional cost advantage
* The company focused on forward integration and wanted to own the distribution network in these target markets in order to avoid favoritism by middle men while taking a hit on margins. Accordingly, the company has setup subsidiaries in the local markets to distribute the product at the last mile level
* Over 7-8 years, a strong company-as-a-brand presence developed among pharmacies in the unbranded generics market. This helped CPL to run with a negative working capital cycle between 2012-2016
* The currency risk is limited to USD as it is widely accepted in these countries and prices are pegged to it. The manufacturing in China is also imported in USD terms

What is changing and how does Caplin plan to deal with it?

* Early 2010s saw a shift in the income levels of the bottom of the pyramid and CPL saw an opportunity to sell branded generics instead of un-branded generics which would yield higher margins and stronger consumer loyalty
* The price of branded generics is almost 3x the cost of generics
* Gencloben, an anti-fungal cream in the region is an example of CPL’s branded product and is worth more than a million dollars alone
* However, not only would this attract a marketing cost but also an increase in the receivables cycle as establishing market presence of essentially a new product takes time. This is what increased the receivable days and caused a 40% drop in share price within a week in 2017
* Marketing of branded generics is done through doctors and pharmacies both while that of unbranded generics mainly focused on pharmacies and very little with doctors
* These countries, like in India, allow pharmacist to replace prescription drugs with a different drug using the same API but available at a different price by a different company

I personally don’t think that the increasing in working capital is a negative sign and the drop in the share price is completely unjustified especially when the company is rapidly expanding in every direction while maintaining receivables within or below industry standards

**Latin America – new ventures:**

* CPL is now focusing on expanding into larger economies like Columbia, Brazil, Peru, Argentina etc through a segment-by-segment approach. It has received product approvals in some places
* Again, it plans to establish subsidiaries for the distribution network and gain on margins
* The currency, however, is going to be a concern in these markets as the local currency forms majority of the sales and they are highly volatile w.r.t USD as well as INR
* Sales to Peru will occur through Caplin’s HongKong subsidiary in order to exploit the free trade agreement between the two countries
* Entering into new markets is again attracting a working capital investment

**US Sales:**

* The company is having a laser sharp focus on entering the injectable market because of high-criticality and low cost-pressure
* Some amount of R&D made CPL realize that it is better off selling its own product rather than doing CRAMS with other players for their product
* There are currently 4 registered ANDAs, 10 filed and 10 products in pipeline
* US sales will be a major part of CPL revenues going forward
* Eight roads, Fidelity and CPL are invested in Caplin Steriles which focusses on R&D and CRO of the injectable business and forms a major part of CPL’s R&D expense

**China ventures:**

* The JV with Jointown a USD 13bn worth Chinese pharma distributor will be making CPL’s dream of entering the largest untapped market in the world
* CPL will be positioning itself as a cost leader with most Manufacturing and Distribution happening through Jointown’s network while the technical and marketing expertise will be provided by Caplin’s competent management

In conclusion, the management is highly professional, transparent and ambitious everything a value-investor looks for while searching for a long-term opportunity.