

Cupid - My Analysis Aug 15, 2020

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1 BUSINESS ANALYSIS

1.1 About Cupid

Cupid Limited is a manufacturer of Male Condoms and Female Condoms (Cupid Angle), mostly for government or NGO sale in countries like Africa, Brazil, Venezuela and to a small extent, in India too. They also manufacture and market health and hygiene products like Lubricant Jelly, Hair Removal Cream, Sanity Wipes and Hand Sanitizer. It counts Africa as its top market and has a long-term agreement with the WHO/United Nations' Population Fund (UNFPA).

Cupid does not do B2C sales in India since market size is only Rs. 1500 Cr. And takes a lot of advertisements that eat into operating margins (almost 50% of profit is spent by the other companies).

Cupid was featured as the **Forbes Asia's Best Under a Billion** list this year -- is among a handful of global companies making female condoms.

It is the country's only female condom manufacturer and second in the world to have been pre-qualified by the WHO/UNFPA (United Nations Population Fund) for worldwide public distribution.

Female condoms, also known as femidoms.

Make In India will have positive effect on Cupid's Female condom since they are the only manufacturers.

1.2 Chairman's Letter

Let me highlight the reason for the tepid growth in revenue and decline in the margins and profitability. The revenue of the Company was impacted due to continuing slowdown in Female Condom orders from South Africa. Business development expenses and lower proportion of higher margin Female Condoms in the total revenue impacted the margins and profitability. However, we expect improvement in the top line and boom line in the coming fiscal year on the back of improved demand scenario.

We are pleased to announce the completion of capacity expansion from 400 to 560 million pieces of Male Condoms per year which would permit us to participate in large sized tenders from Brazil, South Africa, Zambia and India. Cupid shall continue to explore possibility of enhancing business prospects in South Africa and other Sub Saharan continents.

1.3 Management Discussions

The Female Condom segment is witnessing significant growth in various countries. For instance, according to National South African Female Condom Program, around 80% of female prefers Female Condom over other female contraceptives which is driving the sales of Female Condoms in the country. Rising awareness in schools, colleges, mass media campaigns, workshops, etc will have significant impact on the sales of Female Condoms in both developed and developing countries. Although Female Condoms have been introduced in many countries, their penetration remains low owing to lack of awareness, limited advertisement & promotion and due to financial and regulatory barriers. However, the potential market for Female Condoms is expanding in various regions, including North America, Russia, Eastern Europe, and in Sub Saharan African countries.

Reason for choosing condoms over other family planning methods includes the fear of side effects of other modern spacing methods.

Outlook: We are currently seeing robust demand for Male and Female Condoms from UNFPA, NGO as well as from tender businesses. In order to prepare the company to be ready for these opportunities, Cupid has decided to go for around 40% increase in production capacity ([Shows that the company is sure of both the demand and sales](#)). The Company has decided to market condoms in India through wholesalers in a cost-efficient manner. ([May see more sales next year](#)) “Cupid Angel” Trademark has been finally registered with the United States Patent and Trademark Office which would help us to promote and market our Cupid Female Condoms in USA. Some of the key initiatives planned for coming years are:

- Launch the newly developed products including different types of wipes, second generation Female Condoms and Vaginal Wash through online sales. ([New products if done properly can increase sales; else a RISK is that these could deplete Profits](#))
- Capitalizing on the digital marketing medium to sell Cupid’s products through already established ecommerce portals. ([May see more sales next year](#))
- Strengthen our distribution network and foray into newer geographies both for the institutional as well the retail business. ([Company is continually expanding successfully into different countries](#))

1.4 Key takeaways from Call transcripts

Growth in Africa?

We are in the process of discussing our technical and financial proposal with the Department of Treasury and Department of Health in South Africa and we hope to get some feedback by April 2020. And then, it will take about one year to get the equipment going there and start manufacturing and realizing the revenues.

How big is the U. S. market for us?

We really do not have an estimate for that. But based on the figures reported by our competitor Female Health Company, they are doing about \$20 million to \$25 million U. S. dollars. Of course, they have been well established there for many years. So, we have to start with may be \$2 million to \$5 million revenue in the first 12 months after we launch our product in 2021.

Why Debt Taken when we are cash rich?

Used it for WC since 31 Cr payment terms was for 90 days. Will clear it completely as soon as payment received.

1.5 Growth Drivers

1. **Large Population Growth:** The major demand for contraceptives arises from the rising population and the growing number of births every year.
2. Lifestyle changes and attitude of younger generation on Sex along with India having the largest young population, will mean a huge potential target segment that will drive Cupid's revenue/earnings.
3. Females moving away from oral contraceptives to condoms due to side effect has started. These are high margin business for Cupid
4. Company is continually expanding successfully into different countries
5. Company is increasing capacity by 40% that says it is sure of both demand and sales capabilities. Capacity expansion from 400 to 560 million pieces of Male Condoms per year which would help Cupid to participate in large sized tenders from Brazil, South Africa, Zambia and India
6. Large B2G sales to Government that is continually increasing with increase in population
7. Governments across the world are encouraging the use of Female Condoms over oral contraceptives.
8. Modern Indian culture is shifting towards the American way. It is being replaced by pseudo American lifestyle, where, contraceptive product fits evidently in the society. Here, Cupid plays a major role as it manufactures condoms for males and females.
9. The government in most of the developing countries are taking initiatives for creating awareness about contraceptives by conducting programs and collaborating with NGOs to have an effective spread of contraceptives in order to reduce poverty and illiteracy caused due to unplanned births. Governments are encouraging the use of female condoms by supplying them door to door and imparting knowledge to prevent the spread of STDs and restrict population growth. However, few rural areas, and cultural and religious opposition in certain emerging countries, such as China, India, Thailand, Vietnam, Malaysia, and Philippines, hinder the market growth.

The Global Female Condom Market is estimated to witness a CAGR of 15.55% during the forecast period 2017–2023.

1.6 Global B2G Condom Market Players

The Global B2G Condoms market contains 4 main players:

- Cupid Limited (<https://www.cupidlimited.com/>)
- Veru - FC2 (<https://fc2.us.com/>)
- HLL (<http://www.lifecarehll.com/>)

Out of these, Cupid and FC2 (A division of Veru, a pharmaceutical company in the United States) alone hold nearly 95% of the market between themselves with an almost equal share. HLL is a Government of India enterprises, but a very small player (In this market).

There also used to be a small Chinese player called PATH, but they lost their WHO pre-qualification in 2019 and no longer compete in this market.

Interestingly, FC2 is also the one of the major competitors in the U.S. Prescription market, which Cupid is trying to enter. So, a head-to-head with FC2 alone will be sufficient as far as Competitive Analysis is concerned.

1.7 Competition Analysis

We can hear it straight from the horse's mouth. Here are select quotes from Veru's last year's 10-K filing:

"Cupid received part of the last two South African tenders. Increasing competition in FC2's markets has, and will likely continue to, put pressure on pricing for FC2 and may also adversely affect sales of FC2."

"If other female condoms enter the U.S. market, we may face increased competition in the U.S., which may put downward pressure on pricing for FC2 and adversely affect sales of FC2 in the U.S."

"We have experienced increasing competition in the global public health sector, and competitors received part of the last three South African tenders and the latest Brazilian tender. Increasing competition in FC2's markets has put pressure on pricing for FC2 and adversely affected sales of FC2, and some customers, particularly in the global public health sector, may prioritize price over other features where FC2 may have an advantage."

"Over time, due to increased competition or other factors, we may experience price erosion in the U.S. market. Negative pressure on our price levels for U.S. sales may have a material adverse effect on our net revenues and gross margin in the U.S. market."

Cupid is a formidable competitor to FC2 (Veru) in words of Veru themselves.

1.8 Entry Barrier

In order for a company to get into the Female Condom manufacturing business, they need to do the following:

- An investment of Rs. 25-30 Crores for producing good quality Female Condoms.
- A gestation period of 5 years in which the design and quality of the Female Condoms will be tested by the World Health Organization (Meaning, there will be no Revenues for those 5 years, despite the Rs. 25-30 Crores of investment)
- A Pre-qualification issued by WHO after the 5-year gestation, which can be revoked at any time if they feel that the quality of the Female Condoms being produced are not up to the mark. The WHO has developed a set of medical eligibility criteria that is based on a collaborative review of all clinical, research, epidemiological, and modern contraceptive methods.

2 FINANCIAL ANALYSIS

2.1 Key Numbers

The key numbers for Cupid as of March 2019 wrt 5 years are as below:

- Sales: Growing at 15% to 30% at 85 Cr.
- OPM%: ~ 30% plus
- NPM%: ~ 20% plus
- Tax%: ~ 30% (Govt has reduced tax; will have upward impact on NPM%)
- Dividend Pay-out Ratio: ~ 30%
- Shareholders' Equity: ~ Rs. 76 Cr and growing at ~ 30%
- Total Debt: ~ 2.29 Rs. Cr (was zero; debt taken for WC; will become zero)
- Reserves: ~ Rs. 63 Cr; increasing at ~30%
- cCFO/cPAT: 73% due to Long payment term of 1 contract
- FCF: ~ Rs. 6.5 Cr (March '9; March 20 awaited) growing at ~ 20%
- Cash in Bank & Investments: Rs. 31 Cr. Growing at ~ 50%
- SSGR: 63%; very sufficient compared to Sales growth rate of 15%-30%
- Value created for MCAP with Retained earnings: Rs. 1.90
- Value created for EPS with Retained earnings: 9.02%
- Earnings Yield: 8% (Because of low PE of 8)
- Book Value: Rs. 57 growing at ~ 20%
- ROE DuPont: Increase because of increase in Profit margins
- DE ratio: 0.03
- Quick ratio: 2.4
- Current ratio: 2.64
- Interest Coverage: 99
- Inventory Turnover: 15 to 20 (Superbly High)
- Inventory days: ~ 30 to 45 Days
- Receivable Days: ~ 90 days
- NFA Turnover (Sales/NFA): 4.6 (Very Good and increasing as required)
- ROA: 25%
- ROIC: 21%
- Material cost as % of Sales: ~ 19%

3 MANAGEMENT ANALYSIS

The Board of Directors of Cupid Limited consist of 4 key people:

1. Mr. Omprakash Garg (Chairman and Managing Director)
2. Mr. J. L. Sharma (Independent Director)
3. Mrs. Veena Garg (Non-Executive Director), wife of Mr. Garg
4. Mr. Pradeep Kumar Jain (Independent Director)

Positives:

Mr. Omprakash Garg has catapulted Cupid from being a small, 1-2 Crore Revenue, mostly loss-making company into one with a nearly 200 Crores of Revenue with excellent Operating Margins, Returns and Shareholder Value Creation all over the course of a two decades. The numbers speak for themselves, especially the transition over the last half a decade.

Negatives

They did some real estate transactions a couple of years ago that was written off.

They issued warrants to promoters once.

4 VALUATION ANALYSIS

Since FCF has started, we will wait for another few years to use DCF valuation method.

We will Use the EPS and Dividend method that gives the intrinsic value as Rs. 257 assuming no growth in PE for 5 years in calculations. The current market price is Rs. 238. This is at a discount of 8%. Right time to buy.

Institutional Promoters are less than 1%. If they start to come in, the PE will at least double.

The price at end of 5 years is expected to be Rs. 500 to Rs. 600 by March 2026.

5 RISK ANALYSIS

1. The B2G growth depends on the amount of funding available with Governments and NGOs. This may be cyclic
2. Mr. Garg is quite old and the company couldn't find CEO even with 2-3 years of search. The new CEO may not be as good as Mr. Garg
3. This company is prime for take over by existing competition or by other large condom players who want to enter into the lucrative world of B2G business. This may result in de-listing or returns clubbed with parent company.

6 SUMMARY OF COMPANY ANALYSIS

6.1 Summary of Business Analysis

The Company is one of the 3 large Global players in the B2G space within an ever expanding market.

The company's product design and production process has given it unique advantage of large OPM% that other global players cannot get and cannot easily replicate. Hence their margins will be well protected for at least 7 to 10 years.

The barriers to entry are formidable and will be a huge deterrent for other players.

The company is regularly expanding into new countries with successful sales. Once they break into a new country, the orders will increase exponentially. This will result in even more cash!

The expansion requires considerably less capital that is a huge plus.

Their high margin (50%) product of Female condoms has currently a low uptake with huge potential. Female condoms are preferred over oral contraceptives and this is expected to take off in next 3-7 years. When this happens, it will generate substantially more cash! Thus making it a company with huge cash flows.

The institutional investors are less than 1%. Once this company catches the eye of Institutional investors, the PE will more than double making it the Multi-bagger.

6.2 Summary of Financial Analysis

This is company that is nicely increasing its sales with excellent Operational margin. The operating margin clearly indicates a strong moat. This company does not require large capital to grow which is a great plus. The best part is that this company is generating huge cash year on year.

6.3 Summary of Valuation Analysis

It is available at a discount of 8% and seems to be a good buy. Institutional investors will surely come in in the next 3 to 7 years that will exponentially pull up the PE.

6.4 Summary of Risks Analysis

Some small risks exist. The biggest risk are (a) The remaining alive of the old Mr. Garg before succession. If he dies before a market accepted CEO is appointed, the share price will tank. (b) A major player acquiring Cupid and delisting us.

Risk to Reward seems good. High Rewards with Medium Risk.