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EQUITY INVESTMENT POTENTIAL DETERMINANTATION- A COMPARATIVE STUDY BETWEEN GLENMARK AND NATCO PHARMACEUTICAL COMPANIES

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ABSTRACT

Every equity investor is advised to have enough information about the stock market before making any investment decisions. There are so many investment determinants which affect the investment in equity. This paper aims to study equity investment potential determinant of two pharmaceutical company for worth investments. In order to determine the equity investment potential of respective companies for the purpose of investment, we have selected five parameters such as Returns, Risk, Growth, Liquidity and Valuation respectively. For return performance we have chosen Gross profit margin, Operating profit margin relating to sales, Return on equity, Return on capital employed, Return on assets are selected to know the profitability of investments. For risk identification, we have used Volume of trade for market liquidity, current ratio for company liquidity, and Beta (β) for systematic risk and Debt equity ratio, Interest coverage ratio for financial risk. 3years sales growth, profit growth and sustainability of earnings growth are taken as proxy for growth potential assessment of companies. P/E ratio P/B ratio and EV/EBIT and price to sales along with margin of safety are used to know the valuation. Finally ranks are allotted respectively for all select variables to determine the worth of investment potential. In doing so, the least of total rank is taken as best, accordingly analysis was carried out and recommended for investment. The study Concludes that Glenmark Pharmaceutical company stands in merit. Hence, investment potential for more return on investment is high compared to NATCO Pharmaceutical company. Hence perspective investors can invest in Glenmark Pharmaceutical company if they invest in these two companies.

KEY WORDS: ***Return, Risk, Growth, Liquidity and Valuation.***

SECTION- I

INTRDUCTION

When an individual's current money income exceeds his current consumption desires, he saves the excess. Rather than keep these savings in his possession, the individual may consider worthwhile to forego immediate possession of the money for a larger future amount of consumption. This trade off of present consumption for a higher level of future consumption is the essence of investment. An investment is the current commitment of funds for a period of time in order to derive a future flow of funds that will compensate the investor for the time value of money, the expected rate of inflation over the life of the investment, and provide premium for the uncertainty associated with the future flow of funds.

Investing is a cognizant decision to set money aside for a long enough period in an avenue that is potential one. Investors from different social class or strata face a tough challenge in choosing where to invest? Reviewing the massive amount of data available on public companies is vital for assessing the quality of companies and determining whether they're suitable for their potential investment. So individual investors interested in buying equities are faced with much tougher task. There are so many variables which affect the potentiality for equity investment decisions Liquidity, Risk, Return, Growth and valuation. The investors preference of investment varies based on the expected return and perceived risk assumed on the investment, in this connection the purpose of investment will vary among investors based on the following reasons such as Income, Growth of money capital safety, tax minimisation. Marketability/Liquidity Multiplication of assets. Before buying a stock, it is important to study various investing strategies and choose the one which suit investing style. Below are three key types of strategies that are used by most successful investors:

1. **Value Investing:** Value investing is the type of investing in stocks that are undervalued compared to their peers in hopes of generating more profit. This is the strategy that is used by Warren Buffet to make huge profits.
2. **Growth Investing:** Growth investing is the type of investing in stocks that display market beating growth in terms of revenue and earnings. Growth investors believe that the upward trends in these stocks will continue and create an opportunity to generate profits.
3. **Income Investing:** Finally, investors should look for quality stocks that pay significant dividends. These dividends generate income that can be used or reinvested for increasing earnings potential. Thus, before buying a stock, one should consider various determinants which affects the investors decisions.

Against this background, this paper is organised in the following sections First section deals with introduction consisting of incisive investment objectives, Methodology coverage sources of information. Second section makes an attempt to provide brief profile of respective companies. Third section provides conceptual clarity as regards to variables selected. Fourth section brings comparative performance analysis to know the investment potential to earn in terms of return. The findings suggestions and conclusions are the subject matter of fifth and concluding sections.

OBEJECTIVES OF THE STUDY

The objectives are set for our study are as follows:

1. To know the Return, Risk, Growth, Liquidity and valuation of select company
2. To decide worth of investing and finally
3. To offer suggestions in the light of the findings.

RESEARCH METHODOLOGY

Sources of Data The present study is based on the secondary data which are collected from various sources such as books, magazines, research articles, annual reports of the companies, websites www.moneycontrol.com, etc

Sample Design

The study consists of the comparative study of Mid Cap Active Pharmaceutica Ingredient Companies (API)

1. Glenmark Pharmaceutical company and
2. NATCO Pharmaceutical company

which have identical assists but not in value, operate in the same market segments belong to the same industry and they also face similar competitive and business conditions. Hence, we have the justifiable reason for the study

Tools used

In order to determine the equity investment potential of respective companies for the purpose of investment, we have selected five parameters such as Returns, Risk, Growth, Liquidity and Valuation respectively. For return performance we have chosen Gross profit margin, Operating profit margin relating to sales, Return on equity, Return on capital employed, Return on assets are selected to know the profitability of investments. For risk identification, we have used Volume of trade for market liquidity, current ratio for company liquidity, and Beta (β) for systematic risk and Debt equity ratio, Interest coverage ratio for financial risk. 3years sales growth, profit growth and sustainability of earnings growth are taken as proxy for growth potential assessment of companies. P/E ratio P/B ratio and EV/EBIT and price to sales along with margin of safety are used to know the valuation. Finally ranks are allotted respectively for all select variables to determine the worth of investment potential. In doing so, the least of total rank is taken as best, accordingly analysis was carried out and recommended for investment.

SECTION II

COMPANY PROFILE

NATCO PHARMACEUTICAL LIMITED

NATCO Pharmaceutical Limited was incorporated in Hyderabad in the year 1981 with an initial investment of INR 3.3million. it is an Indian-based company engaged in manufacturing active pharmaceutical ingredients and included in BSE 500. The company segments include bulk chemicals, finished dosage formulations, retail pharmacy and job work charges. The company products in the oncology segment include Desifer, Veenat, Bendit, Bortenat, lenalid and clokeran. The company product offerrings in the pharma segment include T-Score, PT-Max, Glatimer, Tarana and Tigi. The company operates in India, United States of America, Europe and rest of the world.

GLENMARK PHARMACEUTICALS LIMITED

Glenmark Pharmaceuticals Limited has a significant presence in the branded generic markets across emerging economies including India registered office is at Bombay and included in CNX Mid Cap-200. The company entered into dermatology market through the launch of its candid cream. Glenmark ground breaking drug discovery effort is primarily focussed in the areas of inflammation (Astma/CODD, rhematoid arthritis etc.) metabolic disorders (diabetes, obesity etc.) and pain (Neurophetic pain and inflammatory pain). The formulation business of the company focuses on therapeutic areas viz dermatology, anti-infective, respiratory, cardiac, diabetes, gynaecology, CNS and oncology. India is the largest market in terms of revenue for the organisation.

SECTION III

CONCEPTUAL FRAME WORK

3.1 RETURN

Gross Profit Margin

The gross profit margin ratio helps measure how much profit a company generates from its sales of goods and services after deducting direct costs or the cost of goods sold. Also, a higher Gross profit is a positive indication that the company can cover operating expenses, fixed costs, depreciation, etc., and generate net revenue for the company. In contrast, a low gross profit margin replicates poorly on the company, indicating high selling price, low sales, high costs, severe market competition etc.

FORMULA

Gross Profit Margin = Gross Profit/Net Sales

Operating Profit Margin

Operating profit margin helps measure the company's capacity to maintain operating expenses to generate profit before interest expense and tax deduction. In other words, the revenue that remains after costs is deducted from net sale. A higher ratio indicates that the company is well equipped to pay its fixed costs, interest obligations, handle economic slowdowns and also offer lower prices than its competitors at lower margins. Moreover, the company management most frequently uses this to improve profitability by managing its cost.

FORMULA

Operating Profit Margin Ratio=Operating Profit/Net sales

Return on Equity

Return on equity measures how well a company can use its shareholder's money to generate profits. Also, it indicates the returns on the sum of money the investors have invested in the company. Furthermore, ROE is usually watch by investors and analysts. Moreover, a higher ROE ratio can be one of the reasons to buy a company's stock. Companies with a high return on equity can generate cash internally, and thus they will be less dependent on debt financing.

FORMULA

Return on Equity=

Net Profit after Taxes/Shareholder's Equity×100

Return on Capital Employed

Return on capital employed measures the company's overall return against the overall investment of both shareholders and debt holder. This ratio is very similar to ROE, but it is more comprehensive as it includes the return generated from the debt capital investments.

FORMULA

Return on Capital Employed (ROCE)=

EBIT/Capital employed

Return On Asset

Return on Assets (ROA) measure how well a company uses its assets to generate profits. In other words, it focuses on how much profit it generates on every rupee invested. Also, it measures the asset intensity of the company. Thus, a lower ROA indicates a more asset intensive company. On the contrary, a higher ROA indicates more profitability against company's number of assets to operate. Moreover, companies with higher asset intensity must invest a significant amount in machinery and equipment to generate income. For example, telecommunication, car manufactures, rail-roads etc.

FORMULA

Return on Assets=Net Profit after Taxes/Total Assets×100

3.2 GROWTH

Sustainable Growth

The sustainable growth rate is an indicator of what stage a company is in, during its life cycle. Understanding where a company is in its life cycle is important. The position often determines corporate finance objectives, such as which sources of financing to use, dividend pay-out policies and overall competitive strategy. The sustainable growth rate is calculated by multiplying the company's earnings retention rate by its return on equity. The formula to calculate sustainable growth rate is:

Sustainable Growth Rate = Retention rate × Return on equity

Retention Rate =

[(Net Income – Dividends) / Net Income)]

Return on Equity =

(Net Income/Total Shareholder's Equity)

3.3 LIQUIDITY

Trade Volume

Trade volume is an indicator of a stock's liquidity, market liquidity is important for a number of reasons, A high trade volume is generally an indication of a high liquidity level for a particular security or stock in the market. In complete opposition to the aforementioned fact are securities with a lower trade volume. A lower trade volume indicates a low overall market interest in that particular security or stock. Hence, such securities are being traded less frequently in turn results less liquidity.

Current Ratio

The current ratio is the simplest and least strict. It measures current assets (those that can reasonably be converted to cash in one year) against current liabilities.

Its formula would be:

Current Ratio = Current Assets / Current Liabilities

3.4 RISK

Before considering investment in any financial instrument, investor must know how much risk one is ready to take. Investing in the financial market carries some inherent risk which can be classified under systematic and unsystematic risk.

Systematic Risk

Systematic risk come from the influence of external factors on an organisation – those which are not under the control of the organisation. It includes risks such as interest risk, foreign exchange risk that are at a macro level which the organisation has no hold on. Beta which measures systematic risk with regards to investment influence more to the investor.

Beta

The higher the risk, the higher the returns. This is a common adage attached to the stock market. Every investor who enters the stock market hopes to earn the highest amount of profits with the invested amount. However, stock that offer high potential profits come with a high risk of losing capital or depreciating value. In such cases, investors are left with no choice but to analyse their risk appetite and invest in stocks that limit risk exposure. However, for investors to choose stocks that match their risk appetite is tricky. For example, a high-risk investor who has diversified within asset classes may want to invest in high-risk stocks as they can offer higher return. On the other hand, an investor who is just starting the market may want to invest in less risky stocks even though they may offer lower profits. Beta is to be calculated by using the following equation

Beta (β) = Co-variance of a specific stock with a benchmark index of the share market/The variance of the respective security over a specific period.

Types of Betas in the stock market

There are four types of BETA values, allowing investors to understand the risk attached to the stocks. These are:

1. **β>1:** BETA value greater than one with a stock implies they are performing better than the overall market. These stocks are called high BETA stocks and can allow investors to earn substantial profits. However, such high BETA stocks accompany a high-risk factor with a possibility that the price can crash anytime to average with the present market.
2. **β<1:** BETA value lower than 1 with a stock implies they are performing lower or close to the overall market. These stocks are called low BETA stocks and can allow investors to earn lower but steady returns. Such stocks come with a low-risk factor and are considered stable against the volatility of the market.
3. **β=1:** BETA value equal to 1 signifies that the stock is ideally co-related to the stock market or the indices. These stocks are also considered stable and have a parallel effect on the share price and the returns with market fluctuations as the comparable indices. Generally, stocks of large-cap companies have a BETA value equal to 1 as these companies are the major part of such indices
4. **β<0:** Securities other than stocks have a BETA value of 0 when compared to stock market indices. For example, gold is a security that may have a BETA value of 0, signifying that its value may rise over time, irrespective of how the stock market indices are performing. Investors use these securities to hedge against a stock market crash.

Unsystematic Risk

Unsystematic risk refers to the internal risks that an organisation is exposed to which are usually within the control of the organisation. These include business risk such as management decisions, financial risk such as profits and losses and operational risk which pertains to the manpower that a company employs. While these are the overall risks that concern the financial markets, you must, at an individual level recognise yours before you start investing. For our study we considered financial risk are as follows:

Debt Equity Ratio

The debt equity ratio compares a company's total debt to its total equity to determine the riskiness of its financial structure. The ratio displays the proportion of debt and equity financing used by a company. Lenders and creditors keep a careful eye on it since it can signal when a company is so in debt that it can't satisfy its obligations. Whatever the cause for debt consumption, if business cash flows are insufficient to fulfils recurring debt payments, the result can be disastrous. When a company's debt to equity ratio is high, it has imposed a significant block of fixed costs in the form of interest expenditure, which raises the breakeven point. To break this cycle, the company needs to generate more revenue by selling more goods or services. The revenue and net income will be regular and predictable without a significant interest expense.

FORMULA
Debt to Equity Ratio=
Total Liabilities/Shareholder's Equity

Interest Coverage Ratio

Interest coverage ratio is an accounting ratio. It determines how many times the company can Pay off the accumulated interest before taxes and interest are deducted. The ratio is commonly referred to as times interest earned". it does not take into consideration the principal debt repayment. It is concerned with payment of accumulated interest only. The term "coverage" in the interest coverage ratio refers to the number of times usually quarters or financial years. It is the number of times the interest payments may be made with the company's existing earnings.

FORMULA
Interest Coverage Ratio =EBIT/Interest Expense

3.5 VALUATION

Price To Earnings Ratio (P/E)

Price to Earnings Ratio or P/E Ratio shows the relationship between a company's share price and Earnings per share (EPS). Simply put, it denotes what the market is willing to pay for a stock based on the company's share price and Earnings per share (EPS). Simply put it denotes what the market is ready to pay for a stock based on the company's past and future earnings. Also, this valuation ratio helps investors analyse whether the stock is undervalued or overvalued. Earnings are essential as it help is appraising a company. This shows the company's current profitability and also estimates how profitable the company will be in future. If the company's growth and earnings remain constant, you can interpret the P/E ratio as the number of years it takes for the company to pay back the price paid for each share. The P/E ratio is one the most popular metrics that analysts and investors use worldwide. They consider earnings from different periods for calculation this ratio. Therefore, the other names for the P/E are "earning multiplier" or "price multiplier."

FORMULA
Price Earnings Ratio=
Market price per share/Earnings per share.

Price To Book Ratio (P/B)

The Price to Book ratio or P/B ratio is a financial ratio that helps to compare the company's current value to its book value. The company's current market value is the stock price of all outstanding shares. The book value is the amount that remains after discharging all the assets and repaying all the company's liabilities. Hence, a company's book value is available from the balance sheet. This valuation ratio shows the company's equity pricing in accordance with the market. Simply put, this ratio shows the market's perception of stock's value. Value investors commonly use this ratio and other metrics to determine whether the company's stock is understated or overstated. This valuation ratio doesn't work well for companies with asset-light such as the technology sector.

FORMULA
P/B/ ratio = Market Capitalisation/Net Book Value
Or
P/B ratio=Market price per share/Book Value per share.

Margin of Safety

The Margin of Safety represents the downside risk protection afforded to an investor when the security is purchased significantly below its intrinsic value.

Margin of safety =Current Market Price - Intrinsic Value (Industry P/E×EPS)

The margin of safety (MOS) is one of the important principles in value investing, where securities are purchased only if their share price is currently trading below their approximated intrinsic value. By only investing if there is a sufficient margin of safety, an investor's downside is more protected. Therefore, the margin of safety is a "cushion" allowing for some degree of losses to be incurred without suffering any major implication on returns. In other words, buying assets at discount decreases the negative effects of any declines in value (and reduces the chance of overpaying)

SECTION IV

RESULTS & ANALYSIS

4.1 TABLE SHOWING RETURN RISK GROWTH LIQUIDITY AND VALUATION RATIO

PARAMETERS	NATCO PHARMACEUTICAL	GLENMARK PAHARMACEUTICAL
RETURNS	**(In %)**	**(In %)**
Operating profit margin (In %)	13.54	**18.85**
Gross Profit Margin (In %)	6.21	**14.90**
Return on equity (In %)	3.99	**10.36**
Return on capital employed (In %)	4.71	**15.67**
Return on assets (In %)	233.41	**334.49**
RISK	**NATCO PHARMACEUTICAL**	**GLENMARK PAHARMACEUTICAL**
Beta **	0.54	**0.93**
Debt equity ratio	3.62	**0.40**
Interest Coverage ratio	**12.42**	6.71
GROWTH	**NATCO PHARMACEUTICAL**	**GLENMARK PAHARMACEUTICAL**
3 years sales growth	**-4%**	9%
3 years profit growth	**-46%**	7%
Sustainable earning growth	**2%**	**9.5**
LIQUIDITY	**NATCO PHARMACEUTICAL**	**GLENMARK PAHARMACEUTICAL**
Volume of Trade**	467,560	**1,362,832**
Current Ratio	1.89	**1.77**
VALUATION	**NATCO PHARMACEUTICAL**	**GLENMARK PAHARMACEUTICAL**
P/E**	**26.95**	12.42
P/B **	**2.73**	1.11
EV/EBIT	7.21	1.23
Margin of Safety	-55	-1672

www.money control.com (**as on 16.09.2022)

Above table reveals parameters used for the determination investment potential in terms of Return, Risk, Growth, Liquidity and Valuation ratio of Natco Pharmaceutical company and Glenmark Pharmaceutical company that as regards to Return Glenmark pharmaceutical company performance is better than the Natco pharmaceutical company that is operating profit margin, Gross Profit Margin, Return on equity, Return on capital employed and Return on asset of Glenmark pharmaceutical is more than the Natco Pharmaceutical company. Next, we compare the Risk of both the companies. Beta value of Natco Pharmaceutical is $\beta <1$. That is 0.54. These stocks are called low Beta stocks and can allow investors to earn lower but steady returns. Such stocks come with a low-risk factor and are considered stable against the volatility of the market at the same time Beta value of Glenmark Pharmaceutical company is $\beta =1$. Beta value equal to 1 signifies that the stock is ideally co-related to the stock market or the indices. These stocks are also considered stable and have a parallel effect on the share price and the returns with market fluctuations as the comparable indices. Debt equity ratio of Glenmark Pharmaceutical company is less i.e 0.4 as against the debt equity ratio of Natco Pharmaceutical company is 3.62 but interest coverage ratio of Natco is 12.42 times as against Glenmark Pharmaceutical company is 6.71 times. When we observe the 3years sales growth and 3years profit growth of Natco Pharmaceutical company is negative i.e -4% and -46% respectively but Glenmark Pharmaceutical company 3years sales growth and 3years profit growth are positive value so in terms of growth Glenmark Pharmaceutical Company is far better than the Natco Pharmaceutical company. As regards to liquidity position of both the company market liquidity of Glenmark Pharmaceutical is more with trade volume of Rs. 1,362,832 crores as compared to Natco Pharmaceutical company is Rs. 467,560 crores but the company liquidity of Natco Pharmaceutical is more than the Glenmark Pharmaceutical company. Lastly, we look at the valuation ratio in terms of P/E, P/B, and EV/EBIT Glenmark Pharmaceutical is more as compared to Natco Pharmaceutical company. Margin of safety of both the companies are showing negative margin of safety is more in case of Natco Pharmaceutical Company as compared to that of Glenmark Pharmaceutical company.

4.2 TABLE SHOWING RESPECTIVE RANKS FOR VARIABLES FOR TWO COMPANIES

S.No.	Parameters	Ratios used	NATCO PHARMA RANK	GLENMARK PHARMA RANK
1	Return	1. Gross profit margin	2	1
		2. Operating profit margin (related to sales)	2	1
		3. Return on equity	2	1
		4. Return on capital employed	2	1
		5. Return on asset (in relation to profitability)	2	1
2	Risk	1. Beta (for systematic Risk)	2	1
		2. Debt equity ratio (unsystematic risk)	2	1
		3. Interest coverage ratio for (unsystematic risk)	1	2
3	Growth	1. 3years sales growth	2	1
		2. 3 years Profit growth	2	2
		3. Earning sustainability growth	2	1
4	Liquidity	1. Volume of Trade (Market liquidity)	2	1
		2. Current ratio (for company liquidity)	1	2
5	Valuation	1. P/E ratio	2	1
		2. P/B ratio	2	1
		3. EV/EBIT ratio	2	1
		4. Margin of safety	1	2
		TOTAL	31	21

(Compiled and computed by the author)

By looking at the above table 4.2 it is clear that rank score of Glenmark Pharmaceutical is 21points and that of Natco Pharmaceutical company rank score is 31points. Least of total rank is taken as the best for potential investment. Hence, Glenmark Pharmaceutical Company performance is best for potential investment as compared to Natco Pharmaceutical company.

SECTIONS V

FINDING OF THE STUDY

1. From our study it is found that as regards to the return ratios Glenmark Pharmaceutical company gross profit margin, operating profit margin and return on equity, return on capital employed and return on asset is good as compared to NATCO Pharmaceutical company.
2. It is found from our study with regards to risk, more risk is found in NATCO Pharmaceutical company as compared to Glenmark as beta value of NATCOis 0.54 as against beta value 0.93 in case of Glenmark Pharmaceutical company
3. The interest coverage ratio in NATCO is more i.e 12.42 times as against 6.71 times in case of Glenmark pharmaceutical company.
4. Debt equity ratio of Glenmark pharmaceutical company is less as compared to NATCO Pharmaceutical company.
5. 3years sales growth and profit growth of NATCO Pharmaceutical company shows negative values.
6. Market liquidity in terms of Volume of trade is more in Glenmark Pharmaceutical company as compared to NATCO pharmaceutical company.
7. Both the companies have maintained company liquidity.
8. All valuation ratio of NATCO Pharmaceutical company is less than the Glenmark pharmaceutical company.
9. Margin of safety in both companies are showing negative values

SUGGESTIONS

1. Natco Pharmaceutical company try to bring positive growth in sales and profit.
2. Glenmark Pharmaceutical Company has to improve interest coverage ratio.
3. Natco Pharma has to try to minimise the debt equity ratio.

CONCLUSION

By looking at the table Glenmark Pharmaceutical company stands in merit. Hence, we conclude that investment potential for more return on investment is high compared to NATCO Pharmaceutical company. Hence prospective investors can invest in Glenmark Pharmaceutical company if they invest in these two companies.

LIMITATIONS OF THE STUDY

1. This study is based on the data collected from secondary sources only.
2. The study is limited to pharmaceutical industry and considered only two companies for our study which of course, is a comparative study in nature.
3. Risk cannot be measured accurately because the market condition is fluctuating and uncertain.
4. Margin of safety can be calculated by various methods but we calculated margin of safety based on earnings.
5. There are so many risks are associated with the business but we covered beta for systematic risk and debt equity ratio and interest coverage ratio for financial risk only
6. The accuracy of the study is based on the accuracy of the data in the website of stock market.

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