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Relative Valuation on Pharmaceutical Sector Stocks

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Abstract
This study explores the relative valuation of pharmaceutical stocks by analysing the financial performance of Sun Pharma, Cipla, Divis Laboratories, Torrent Pharmaceuticals and Dr. Reddy's Laboratories for the financial year 2020-2024. The study uses ratio analysis to assess profitability (EBITDA margin, net profit margin), liquidity (current ratio, quick ratio), leverage (debt/equity, interest coverage ratio) and efficiency (asset turnover, inventory turnover). Additionally, relative valuation measures such as price-to-earnings (P/E) ratio, price-to-book (P/B) ratio and enterprise value-to-sales (EV/Sales) ratio help determine whether the stocks are undervalued or overvalued compared to the industry benchmark. The results show that Sun Pharma, Cipla and Dr. Reddy's Laboratories are undervalued or overvalued compared to the industry benchmark. Reddy's Laboratories is showing strong financial performance and remains undervalued, making it an attractive investment option. Divis Laboratories, despite its high valuation ratio, is showing declining earnings, suggesting a possible overvaluation. Torrent Pharmaceuticals is facing liquidity and debt issues, which pose financial risks. This study highlights the importance of relative valuation in stock valuation, providing insights for investors to identify undervalued opportunities in the pharmaceutical sector.

Introduction

The pharmaceutical sector plays a crucial role in global health and economic stability. It is characterized by intensive research and development, high regulatory scrutiny, and significant contributions to healthcare innovation. The industry's financial performance is critical, not only for its stakeholders but also for sustaining its role in addressing global health challenges. This study focuses on analysing the financial performance of five leading pharmaceutical companies: Sun Pharma, Cipla, Divis Laboratories, Torrent Pharmaceuticals, and Dr. Reddy's Laboratories. These companies are among the most prominent players in the Indian pharmaceutical sector, with a significant global presence. Their contributions range from generic drug manufacturing and active pharmaceutical ingredients (APIs) to advanced biologics and innovative therapeutics. By leveraging key financial ratios and relative valuation metrics, the research aims to provide an in-depth understanding of their profitability, liquidity, leverage, efficiency, and valuation over a five-year period (FY 2020 to FY 2024).

Financial analysis, especially ratio analysis, serves as a vital tool for understanding a company's operational and strategic efficiency. It helps stakeholders make informed decisions by identifying trends, strengths, and areas of improvement. In the pharmaceutical industry, financial health often reflects a company's ability to sustain research and development efforts, penetrate markets, and maintain regulatory compliance.

Ratio analysis is central to evaluating the performance of these companies. Key ratios, such as EBITDA margin, Net Profit Margin (NPM), and Return on Equity (ROE), shed light on profitability and shareholder returns. Liquidity ratios, including the current and quick ratios, help assess short-term financial health, while leverage ratios such as Debt-to-Equity (D/E) indicate the companies' financial risk. Efficiency ratios, such as asset turnover and inventory turnover, provide insights into operational performance.

Relative valuation metrics, such as Price-to-Earnings (P/E) and Price-to-Book (P/B) ratios, play an equally important role. They allow investors to compare the valuation of a company against its peers within the same industry or sector. By analysing these metrics, stakeholders can determine if a company's stock is overvalued or undervalued, helping them make strategic investment decisions. High P/E ratios, for instance, may indicate growth potential, while low P/B ratios could suggest undervaluation or poor market sentiment. This makes relative valuation essential for identifying investment opportunities and benchmarking performance.

Research Methodology

Objectives of the Study

1. To evaluate the profitability of selected pharmaceutical companies using key parameters such as EBITDA margin and net profit margin (NPM).
2. Evaluate the liquidity position of the company using the current ratio and quick ratio.
3. Perform relative valuation of the companies using the price-to-earnings (P/E), price-to-book (P/B) and market value-to-sales ratios.
4. Find the intrinsic value of the selected sample to determine whether it is undervalued or overvalued.
5. Identify potential investment avenues with strong support from relative valuation and ratio analysis at selected pharmaceutical companies.

Scope of the Study

The study focuses on five major pharmaceutical companies: Sun Pharma, Cipla, Divis Laboratories, Torrent Pharmaceuticals and Dr. Reddy's Laboratories. This report analyses financial data from FY2020 to FY2024, focusing on ratio analysis to gain meaningful insights into the financial performance and market position of the company. The study considers both intrinsic and relative valuation approaches to provide an overview of the industry.

Data Sources

This study is based on secondary data collected from the following sources:

1. Annual reports and financial statements of the selected companies.
2. Financial databases such as Moneycontrol and Yahoo Finance.

Selection of Companies:

Five major pharmaceutical companies were selected based on their market capitalization, revenue and importance in the industry.

Data collection

Financial data is collected for the period from FY 2020 to FY 2024. Ratios such as profitability, liquidity, leverage, efficiency and recovery measures are calculated from the collected data.

Data Analysis

1. Profitability is analysed using EBITDA margin and NPM to determine operating efficiency and cost control.
2. Liquidity is assessed using the current ratio and quick ratio to assess short-term financial health.
3. Return to shareholders is assessed using ROE and ROCE to assess capital efficiency.
4. Relative valuation measures (P/E and P/B ratios) are used to compare market valuations.

Results and analysis

Profitability ratios:

Profitability ratios compare a company's ability to generate profits from its sales, operations, or other assets on its balance sheet or cash flow. shareholders. They show how effectively a company mobilizes its resources and creates value for its shareholders.

1) EBITDA margin
2) Net profit margin (NPM) or profit margin after tax (PAT margin)
3) Gross profit margin
4) Operating profit margin

EBITDA margin:

This ratio is useful for determining the profitability of a company without considering peripheral profits.

EBITDA margin = (EBITDA/Net sales)

EBITDA Margin (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	14.74	18.67	20.85	20.47	20.99
Cipla	11.62	16.39	15.88	16.59	19.75
Divis Laboratories	29.29	37.03	39.34	24.95	22.32
Torrent Pharmaceuticals	18.8	22.6	20.32	22.09	23.72
Dr Reddy's Laboratories	7.2	13.65	11.81	19.82	22.35
Average	16.33	21.668	21.64	20.784	21.826

Table – 1 EBITDA Margin (%)

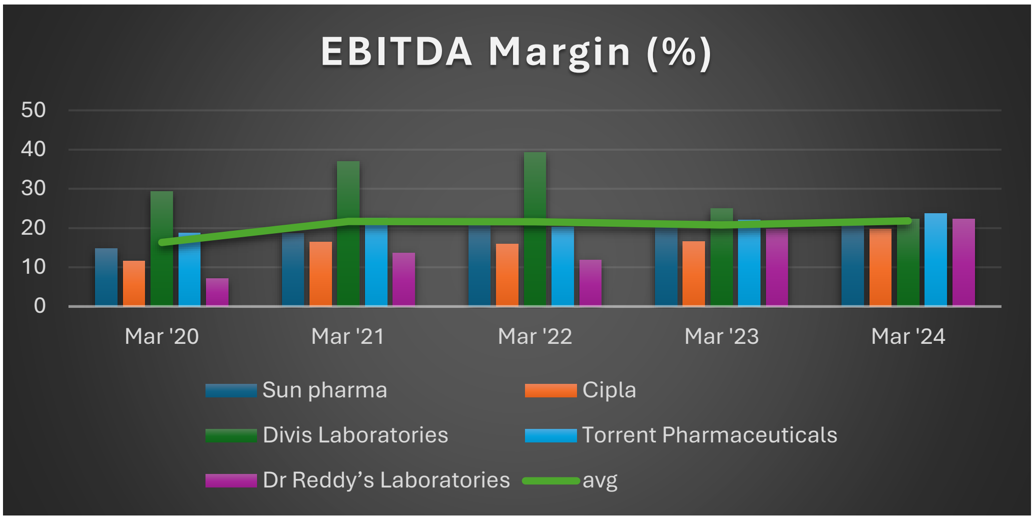

Fig – 1 EBITDA Margin (%)

Interpretation:

This table presents the earnings before interest and tax (EBIT) margins of five major pharmaceutical companies from 2020 to 2024. EBIT margin measures the profitability of a company's core operations before considering interest and tax expenses. The average EBIT margin increased significantly from 2020 to 2021, remained relatively stable in 2022, and then declined slightly in 2023, before increasing slightly in 2024. Companies such as Sun Pharma, Cipla, and Dr. Reddy's Laboratories showed an overall improvement in their businesses. EBIT margin, indicating improved operating efficiency and cost control. On the other hand, Divis Laboratories has seen a decline in its PBIT margin, which could indicate difficulties in managing operating costs or maintaining pricing power. Torrent Pharmaceuticals has a relatively stable profit margin

Net Profit Margin (NPM) or Profit After Tax Margin (PAT Margin):

Business owners receive dividends last, after all other stakeholders here, especially the government, have been paid. Therefore, it is important for them to know how much business the company is actually bringing them. This is found by applying the PAT margin calculation.

Net Profit Margin (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	11.46	8.66	8.46	19.3	19.74
Cipla	9.02	12.55	11.56	12.31	15.99
Divis Laboratories	25.51	28.47	33.04	23.47	20.39
Torrent Pharmaceuticals	12.9	15.63	9.13	12.94	15.44
Dr Reddy's Laboratories	11.56	10.24	10.12	18.27	19.91
Average	14.09	15.11	14.462	17.258	18.294

Table - 2 Net Profit Margin (%)

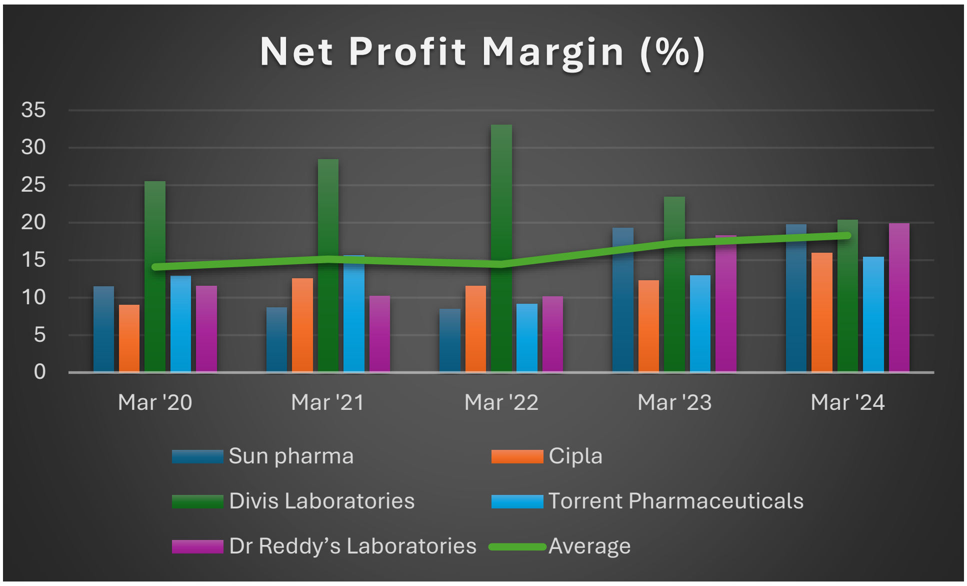

Fig – 2 Net Profit Margin (%)

Interpretation: The table shows the net profit margins of five major pharmaceutical companies from 2020 to 2024. Net profit margin measures a company's overall profitability by calculating the percentage of net income (profit) over sales revenue. total business. The average net profit margin has shown a mixed trend, initially increasing slightly, then decreasing, and finally increasing significantly in recent years. Companies such as Sun Pharma, Cipla, and Dr. Reddy's Laboratories have shown an overall improvement in net profit margins, indicating better profitability and cost management. On the other hand, Divis Laboratories sees a decline in net profit margin in 2023, although there is a slight recovery in 2024. Torrent Pharmaceuticals shows a mixed trend with a decline followed by an improvement.

Gross profit margin:

Gross profit margin measures the percentage of revenue that exceeds cost of goods sold, indicating the company's control over manufacturing costs. It focuses solely on the relationship between sales and cost of goods sold, providing information about the effectiveness of its pricing strategy. Margin = (Net Sales / Gross Profit) × 100

Gross Profit Margin (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	19.41	25.25	25.56	25.29	25.47
Cipla	11.85	16.62	16.08	16.94	20.33
Divis Laboratories	30.32	37.36	39.84	26.06	23.28
Torrent Pharmaceuticals	19.09	22.76	20.79	22.19	23.85
Dr Reddy's Laboratories	7.46	16.19	14.87	22.23	24.33
Average	17.626	23.636	23.428	22.542	23.452

Table – 3 Gross Profit Margin (%)

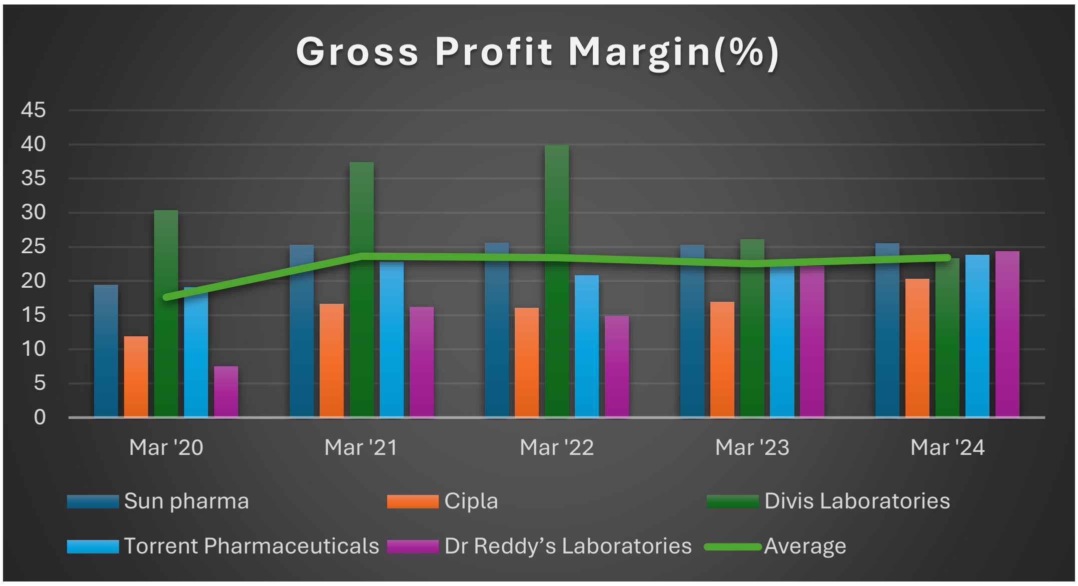

Fig – 3 Gross Profit Margin (%)

Interpretation:

The table shows the gross profit margins of five major pharmaceutical companies from 2020 to 2024. This metric measures the profitability of a company's core businesses. The average gross profit margin tends to be mixed, initially increasing and then fluctuating. Companies like Sun Pharma, Cipla and Dr. Reddy's Laboratories have shown overall improvement in gross profit margins, indicating better cost control or stronger pricing power. In contrast, Divis Laboratories saw its gross profit margin decline, likely indicating difficulty in maintaining price competitiveness or pricing power. Torrent Pharmaceuticals posted relatively stable earnings.

Operating profit Margin:

Operating profit margin measures the percentage of revenue remaining after covering all operating expenses, including cost of goods sold (COGS) and operating expenses such as selling, general, and administrative (SG&A) expenses.

Operating profit margin = (EBIT operating profit/Net sales) ×100

Operating Profit Margin (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	21.28	25.34	26.89	26.53	26.85
Cipla	18.71	22.19	20.91	22.09	24.4
Divis Laboratories	33.77	41.03	43.32	30.48	28.1
Torrent Pharmaceuticals	27.33	30.98	28.57	29.54	31.39
Dr Reddy's Laboratories	14.1	20.31	17.48	25.73	28.32
Average	23.038	27.97	27.434	26.874	27.812

Table – 4 Operating Profit Margin (%)

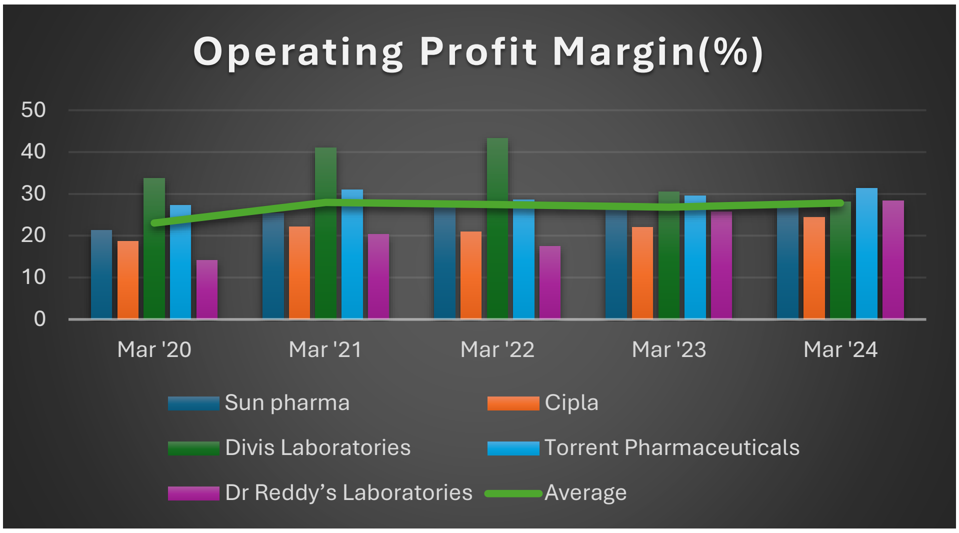

Fig – 4 Operating Profit Margin (%)

Interpretation:

The table shows the operating profit margin of five major pharmaceutical companies from 2020 to 2024. This metric measures the profitability of a company's core businesses after subtracting operating expenses from gross profit. Average operating profit margins tend to be mixed, initially increasing and then fluctuating. Companies such as Sun Pharma, Cipla, and Dr. Reddy's Laboratories have shown a general improvement in operating profit margins, indicating better operational efficiency and cost control. In contrast, Divis Laboratories has seen a decline, likely indicating difficulty in managing operating costs while maintaining pricing power. Torrent Pharmaceuticals has posted relatively stable earnings.

LIQUIDITY RATIO:

It is very important to note that a company's ability to meet its obligations depends on time and circumstances. Two simple steps to do this are

1) Current Ratio
2) Quick Ratio

Current Ratio:

This is a measure used in finance to determine an organization's liquidity position based on the relationship between the company's current assets and current liabilities.

Current ratio = current assets/current liabilities

Current Ratio (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	1.99	2.02	1.79	1.7	2.28
Cipla	2.06	2.1	2.36	2.48	2.68
Divis Laboratories	3.07	4.3	5.17	5.64	5.2
Torrent Pharmaceuticals	0.82	0.83	0.84	0.65	0.72
Dr Reddy's Laboratories	1.33	1.34	1.38	1.69	1.92
Average	1.854	2.118	2.308	2.432	2.56

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Table – 5 Current Ratio (%)

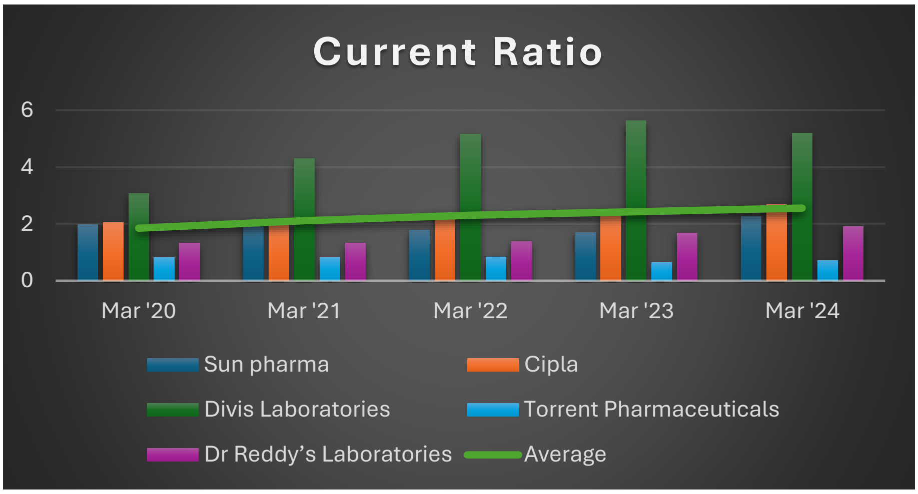

Fig – 5 Current Ratio (%)

Interpretation:

Analysis of the current ratios of five major pharmaceutical companies shows a positive trend from 2020 to 2024, indicating an improvement in overall liquidity in the industry. Companies such as Divis Laboratories and Cipla have demonstrated strong liquidity throughout the period with consistently high current ratios, indicating a strong ability to meet short-term financial obligations. In contrast, Torrent Pharmaceuticals has a weaker liquidity profile with a ratio consistently below 1, potentially indicating difficulty in meeting short-term debt obligations.

Quick ratio:

It represents a tighter version of the liquidity ratio as it excludes some assets that are considered short-term but cannot be easily liquidated with cash. Inventory is a typical example of these current assets.

Quick ratio = (prepaid expenses - inventory) / current liabilities.

Quick Ratio (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	1.99	1.51	1.2	1.5	1.8
Cipla	1.48	1.39	1.61	1.9	1.88
Divis Laboratories	1.67	2.85	3.44	3.84	3.52
Torrent Pharmaceuticals	0.66	0.83	0.92	0.9	0.83
Dr Reddy's Laboratories	1.27	1.44	1.52	1.46	1.64
Average	1.414	1.604	1.738	1.92	1.934

Table – 6 Quick Ratio (%)

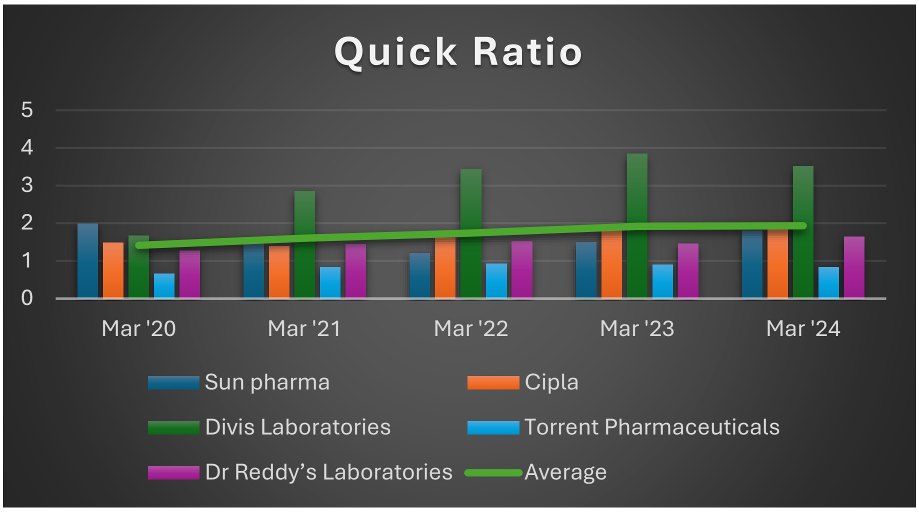

Fig – 6 Quick Ratio (%)

Interpretation:

This table shows the quick ratios of five major pharmaceutical companies from 2020 to 2024. The quick ratio, a strict measure of liquidity, assesses a company's ability to meet its short-term obligations using its most liquid assets. The average liquidity ratio of these companies shows a positive trend, increasing from 1.41 in 2020 to 1.93 in 2024, indicating an improvement in liquidity. While companies like Divis Laboratories have consistently shown strong liquidity with consistently high liquidity ratios, Torrent Pharmaceuticals paints a less favourable picture, with the ratio consistently below 1, indicating potential short-term liquidity issues.

Leverage Ratios:

Debt ratios help examine how much debt a company is using and whether it can repay its debts. The two key metrics are the Debt-to-Equity Ratio and Interest Coverage Ratio

1) Debt/Equity (D/E)
2) Interest Coverage Ratio

Debt/Equity (D/E):

As we have seen before, too much debt in a company can be detrimental. If a company cannot pay its creditors, it can go bankrupt. When companies rapidly increase assets with borrowed funds, it is risky if those assets do not generate the expected cash and profits. The company still has to pay its debts. Investors should be careful to stay away from companies that are carrying high debt levels.

D/E ratio = Long-term debt / Net worth

Debt Equity Ratio (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	0.17	0.07	0.02	0.11	0.04
Cipla	0.18	0.08	0.04	0.02	0.01
Divis Laboratories	--	--	--	--	--
Torrent Pharmaceuticals	0.91	0.83	0.67	0.85	0.57
Dr Reddy's Laboratories	0.11	0.15	0.16	0.05	0.06
Average	0.3425	0.2825	0.2225	0.2575	0.17

Table – 7 Debt Equity Ratio (%)

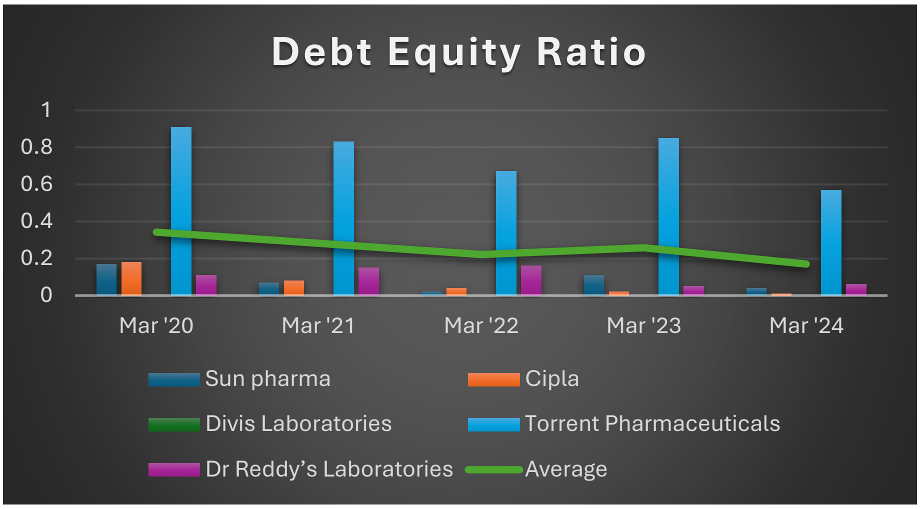

Fig – 7 Debt Equity Ratio (%)

Interpretation:

The table shows the debt ratio of five major pharmaceutical companies from 2020 to 2024. This ratio represents the proportion of the company's assets financed by debt compared to equity. The average debt-to-equity ratio of these companies decreased significantly from 0.34 in 2020 to 0.17 in 2024, indicating an overall improvement in the financial health of these companies as they rely less on debt financing. Sun Pharma, Cipla and Dr. Reddy's Laboratories have seen a significant reduction in their debt-to-equity ratios, indicating a significant improvement in their capital structures. However, Torrent Pharmaceuticals still maintains a relatively high debt-to-equity ratio, indicating a higher level of financial risk than its peers**.**

Interest Coverage Ratio:

Companies with significant debt often face high interest payments. A straightforward way to assess if a company is in trouble is to compare its earnings to its interest expenses (not considering principal repayment at this stage). This comparison is captured by the Interest Coverage Ratio, which indicates how many times a company's earnings can cover its interest obligations.

Interest Coverage Ratio = EBIT/ Interest Expense

Interest Coverage (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	18.41	51.24	72.05	56.7	49.57
Cipla	12.04	21.47	35.56	39.53	66.61
Divis Laboratories	299.27	3065.41	4605.38	3536.27	722
Torrent Pharmaceuticals	3.63	5.32	7.71	6.54	7.4
Dr Reddy's Laboratories	19.61	30.23	32.22	43.1	43
Average	70.592	634.734	950.584	736.428	177.716

Table – 8 Interest Coverage (%)

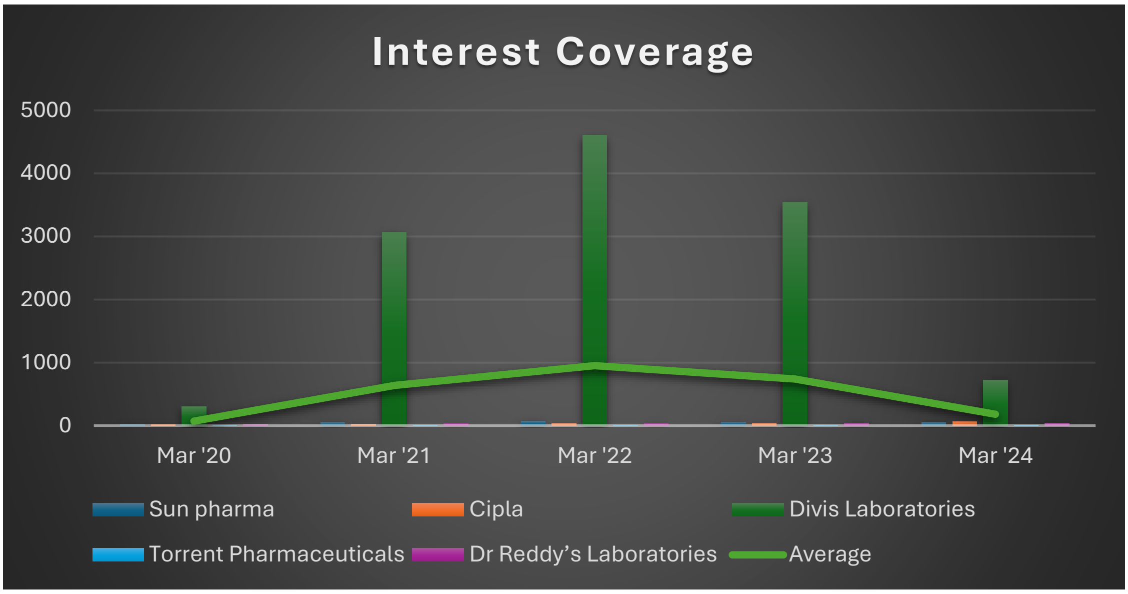

Fig – 8 Interest Coverage (%)

Interpretation:

The table presents the Interest Coverage Ratio for five major pharmaceutical companies from 2020 to 2024. This ratio evaluates how effectively a company can manage its interest expenses on debt. The average Interest Coverage Ratio shows a mixed trend, with a significant increase in 2022, followed by a decline in 2023 and a rebound in 2024, generally indicating a positive outlook. Divis Laboratories stands out with an exceptionally high Interest Coverage Ratio, demonstrating a strong ability to handle interest expenses. Cipla and Dr. Reddy's Laboratories exhibit steady improvement in their ratios, reflecting a better capacity to meet interest payments. Conversely, Torrent Pharmaceuticals has a relatively lower Interest Coverage Ratio, indicating a weaker ability to cover its interest obligations compared to its competitors.

Efficiency Ratios:

Efficiency ratios are financial metrics that assess how effectively a company utilizes its assets and liabilities in its operations to generate sales and maximize profits. These ratios offer insights into a company's operational efficiency, showing how effectively it utilizes its resources to generate revenue.

1) Asset Turnover Ratio
2) Inventory Turnover Ratio.

Asset Turnover Ratio:

This ratio indicates how many times a business's assets are utilized to generate revenue. If resources are left unused, it negatively impacts the business since capital is invested without generating income. Conversely, if assets are consistently utilized to create products and services, it can lead to increased revenue and profit.

Asset Turnover Ratio = Average Total Assets / Net Sales

Asset Turnover Ratio (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	0.59	0.61	0.74	0.75	0.72
Cipla	0.89	0.98	1.03	0.99	1.01
Divis Laboratories	0.75	0.84	0.85	0.63	0.6

Torrent Pharmaceuticals	0.85	0.81	0.82	0.9	0.96
Dr Reddy's Laboratories	1.01	1.01	1.01	1.06	1.03
Average	0.818	0.85	0.89	0.866	0.864

Table – 9 Asset Turnover Ratio (%)

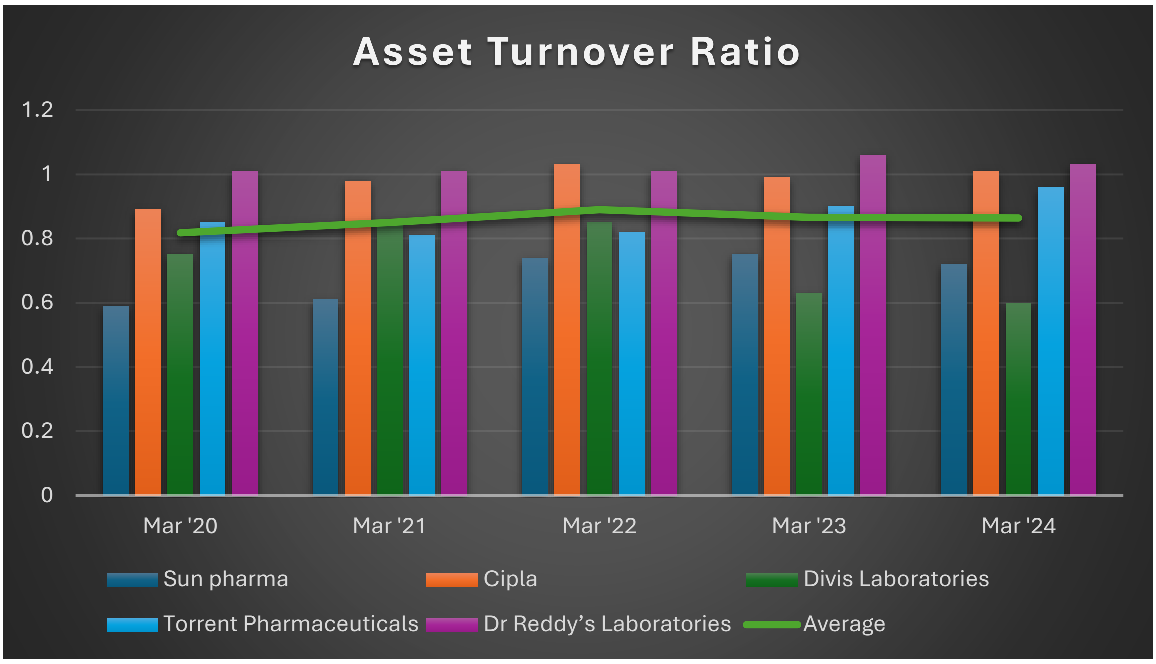

Fig- 9 Asset Turnover Ratio (%)

Interpretation:

The table shows the asset turnover ratios of five major pharmaceutical companies from 2020 to 2024. This ratio measures how efficiently a company uses its assets to generate sales. The average asset turnover ratio has been mixed, initially increasing and then decreasing slightly in recent years. Companies such as Cipla and Dr. Reddy's Laboratories have maintained relatively stable asset turnover ratios, indicating stable asset utilization. Sun Pharma has shown a significant improvement, indicating better asset utilization. On the other hand, Divis Laboratories saw a decline, indicating a potential decrease in asset utilization.

Inventory Turnover Ratio:

This ratio indicates the number of times a company replenishes its inventory. Obviously, a higher ratio means better performance. Inventory, if not converted into sales quickly, means money is tied up in the business. Additionally, these perishable products can start to spoil if the inventory is not converted into sales quickly enough.

Inventory Turnover = Sales/ Inventory

Inventory Turnover Ratio (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	4.17	3.72	4.3	4.17	4.91
Cipla	3.91	4.1	4.07	4.41	4.92
Divis Laboratories	2.89	3.25	3.17	2.59	2.46
Torrent Pharmaceuticals	3.7	2.99	3.46	4.31	4.71
Dr Reddy's Laboratories	5	4.19	4.23	5.07	4.41

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Average	3.934	3.65	3.846	4.11	4.282

Table – 10 Inventory Turnover Ratio (%)

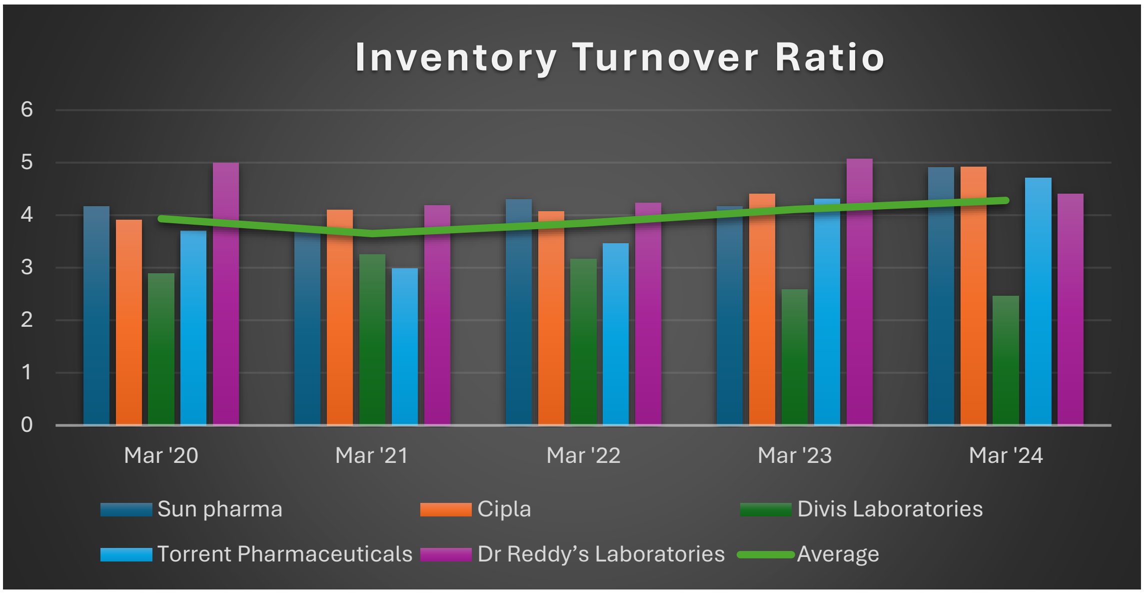

Fig- 10 Inventory Turnover Ratio (%)

Interpretation:

The table displays the Inventory Turnover Ratio for five leading pharmaceutical companies from 2020 to 2024. This ratio assesses how effectively a company handles its inventory by monitoring the speed at which it sells and restocks its products. The overall trend in the average Inventory Turnover Ratio reveals a slight initial decline, followed by an increase, and then a minor drop again in 2024. Companies such as Cipla and Dr. Reddy's Laboratories have maintained relatively stable Inventory Turnover Ratios, reflecting consistent inventory management practices. In contrast, Sun Pharma and Torrent Pharmaceuticals have shown improvements, indicating enhanced efficiency in managing their inventory. On the other hand, Divis Laboratories has seen a decline, which may point to a potential reduction in its inventory management efficiency.

Return Ratio:

Return ratios are crucial for assessing a company's ability to generate returns relative to the capital invested by shareholders and the total capital employed in the business.

1)Return on Net Worth (RoNW)

2)Return on Capital Employed (ROCE).

Return on Net Worth / Equity:

Return on Net Worth / Equity measures a company's profitability by comparing its net income to shareholders' equity. This ratio reflects how effectively a company generates profit from the funds invested by its shareholders.

ROE= (Net Income/Shareholders Equity) ×100

Return on Net Worth / Equity (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	8.31	6.24	6.81	15.13	15.04
Cipla	9.81	13.15	10.16	10.27	15.43
Divis Laboratories	18.83	21.34	25.24	14.28	11.78

Torrent Pharmaceuticals	21.24	21.44	13.05	20.09	24.15
Dr Reddy's Laboratories	12.98	11.06	11.35	19.35	19.74
Average	14.234	14.646	13.322	15.824	17.228

Table- 11 Return on Net Worth / Equity (%)

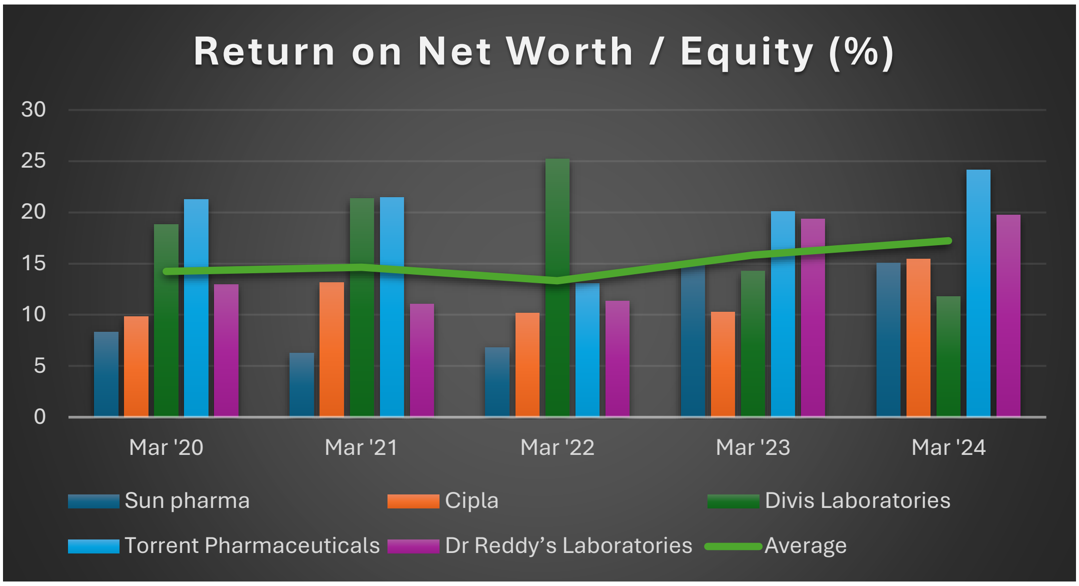

Fig-11 Return on Net Worth / Equity (%)

Interpretation:

The table displays the Return on Net Worth (ROE) for five leading pharmaceutical companies from 2020 to 2024. ROE assesses how effectively a company utilizes its shareholders' equity to produce profits. The average ROE reveals a varied trend, starting with a slight increase, followed by a decline, and culminating in a notable rise in the later years. Companies such as Sun Pharma, Cipla, and Dr. Reddy's Laboratories have demonstrated an overall enhancement in their ROE, indicating improved profitability and a more efficient use of shareholder capital. Conversely, Divis Laboratories saw a drop in its ROE in 2023, although it experienced a slight recovery in 2024. Torrent Pharmaceuticals exhibits a mixed trend, with a decline followed by some improvement.

Return on Capital Employed (ROCE):

Return on Capital Employed (ROCE) assesses a company's profitability in relation to the total capital utilized in the business, which includes both equity and debt. This ratio reflects how effectively a company is leveraging its capital to generate profits.

Return on Capital Employed ROCE = (Operating Profit/Total Capital Employed) × 100

Return On Capital Employed (%)					
Company Name	Mar '20	Mar '21	Mar '22	Mar '23	Mar '24
Sun pharma	10.54	14.55	18.74	15.67	17.77
Cipla	12.78	17.4	17.49	18.14	22.21
Divis Laboratories	24.85	28.69	31.41	18.55	15.96
Torrent Pharmaceuticals	17.76	17.62	19.71	18.96	24.24
Dr Reddy's Laboratories	11.09	14.42	13.84	25.21	24.6
Average	15.404	18.536	20.238	19.306	20.956

Table – 12 Return On Capital Employed (%)

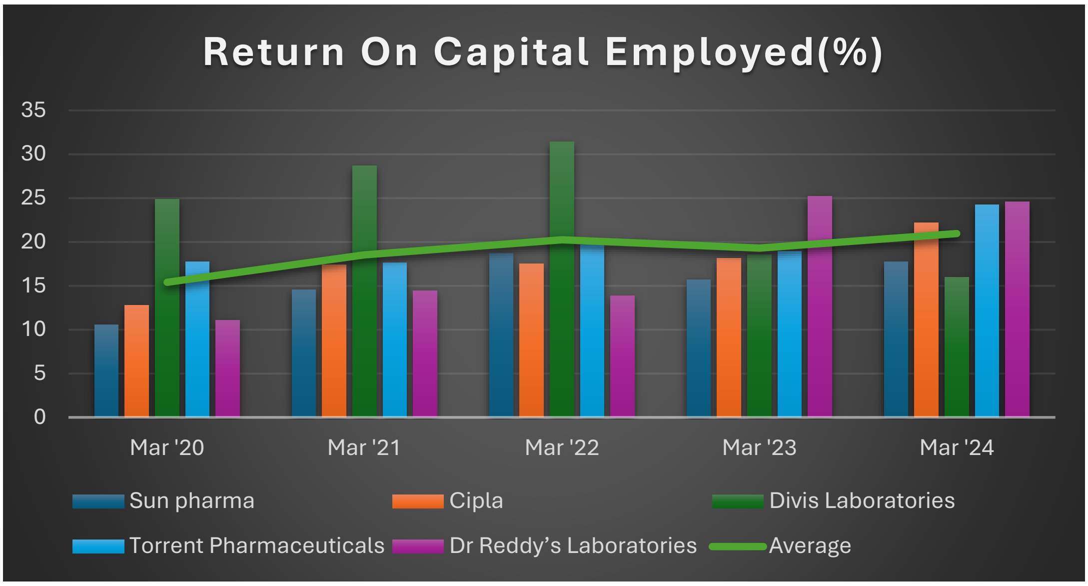

Fig- 12 Return On Capital Employed (%)

Interpretation:

The table outlines the Return on Capital Employed (ROCE) for five leading pharmaceutical companies from 2020 to 2024. ROCE indicates how profitable a company is in relation to the total capital invested. The average ROCE displays a varied trend, showing a significant increase from 2020 to 2022, followed by a drop in 2023, and then a rise again in 2024. Companies such as Sun Pharma, Cipla, and Dr. Reddy's Laboratories have demonstrated an overall enhancement in their ROCE, indicating improved capital efficiency and better returns on investment. On the other hand, Divis Laboratories, which initially reported strong ROCE, has seen a decline in recent years. Torrent Pharmaceuticals exhibits a mixed trend, with a slight initial decline followed by recovery.

RELATIVE VALUATION OF PHARMACEUTICAL COMPANIES

Relative valuation serves as an effective method for evaluating the stock prices of pharmaceutical companies by comparing essential financial metrics, including Price-to-Earnings (P/E), Price-to-Book (P/B), Earnings Per Share (EPS), and Enterprise Value-to-Revenue (EV/Revenue) ratios among industry competitors. These ratios assist investors in determining whether a stock is overvalued or undervalued, offering a clearer insight into its market potential. This approach is particularly significant in the Indian pharmaceutical sector, where firms like Sun Pharma and Cipla play a crucial role.

Price to Earnings (P/E) Ratio:

The Price to Earnings (P/E) Ratio expresses the relationship between a company's current share price and its earnings per share (EPS). This ratio indicates how much investors are willing to pay for each unit of earnings, providing insights into market expectations regarding a company's growth prospects. **Price to Earnings Ratio (P/E) = Market Price per Share/Earnings per Share EPS**

The Price to Book Value (P/BV) Ratio:

Ratio compares a company's market price per share to its book value per share. This ratio provides insights into how much investors are willing to pay for each unit of net assets owned by the company**. Price to Book Value Ratio (P/BV) = Market Price per Share/Book Value per Share**

The Enterprise Value-to-Revenue (EV/Revenue):
ratio is a key valuation metric that assesses a company's enterprise value (EV) in relation to its total revenue. This ratio helps investors understand how much they are willing to pay for every dollar of revenue the company generates, making it a valuable tool for comparing companies within the same industry. **EV/Revenue = Enterprise Value/Total Revenue**

Company Name	P/E Ratio	P/B Ratio	EV/Revenue
Sun pharma	38.36	16.41	8.75
Cipla	27.07	4.31	4.74
Divis Laboratories	83.09	6.75	19.12
Torrent Pharmaceuticals	58.32	12.89	10.13
Dr Reddy’s Laboratories	19.17	4.24	3.77
Average	45.20	8.92	9.30

Table – 13 valuation ratios

P/E Ratio (Price-to-Earnings Ratio):

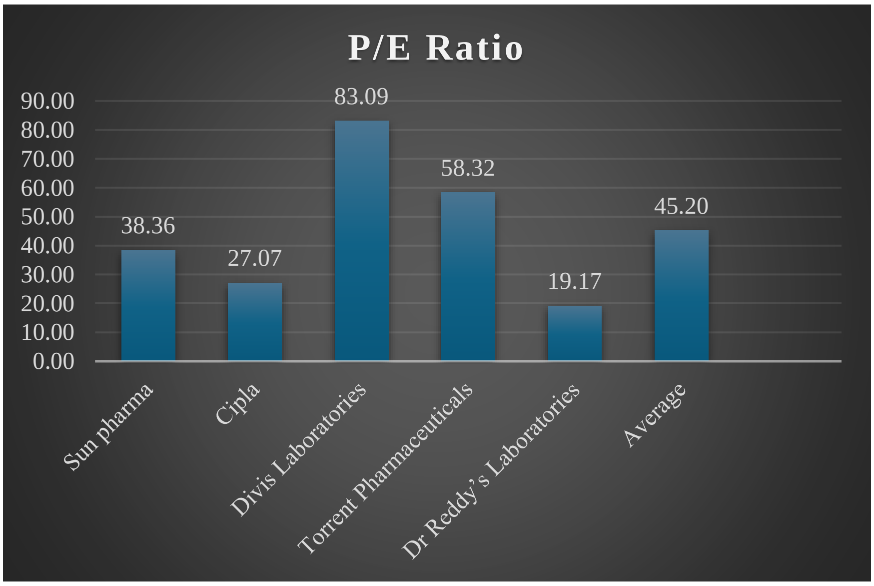

Figure -13 P/E Ratio (Price-to-Earnings Ratio)

The P/E Ratio is a key indicator of how the market perceives a company's value in relation to its earnings per share. A higher P/E Ratio often suggests that investors are expecting significant growth in future earnings. In this regard, Divis Laboratories stands out with the highest P/E Ratio of 83.09, reflecting strong investor confidence in its future performance. Following closely is Torrent Pharmaceuticals, which has a P/E Ratio of 58.32. Sun Pharma's P/E Ratio is 38.36, while Cipla's stands at 27.07. Dr. Reddy's Laboratories has the lowest P/E Ratio at 19.17, indicating that investors may have more conservative expectations for its future earnings growth compared to the other companies.

P/B Ratio (Price-to-Book Ratio):

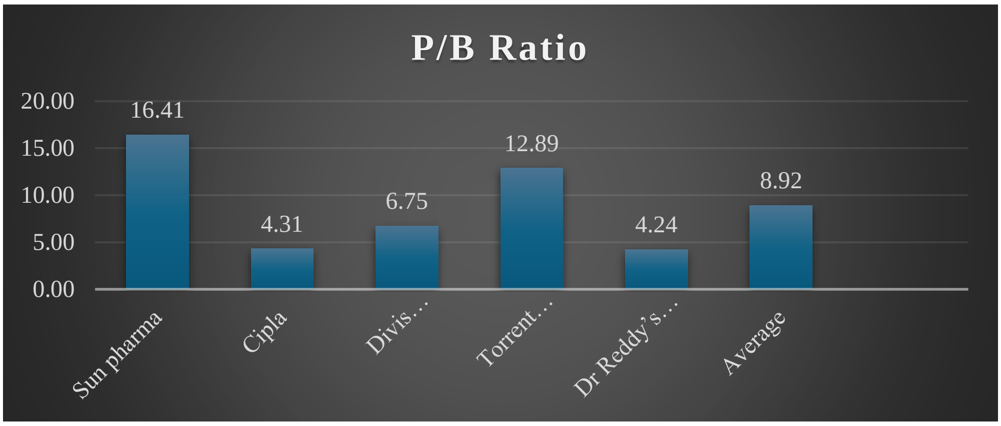

Figure – 14 P/B Ratio (Price-to-Book Ratio)

The P/B Ratio is a metric that compares a company's market value to its book value, which is determined by subtracting liabilities from assets. A higher P/B Ratio usually indicates that investors believe the company's assets are worth more than what is shown in its financial statements. For example, Divis Laboratories has a P/B Ratio of 6.75, suggesting that investors view its assets as significantly more valuable than the book value. Torrent Pharmaceuticals has a P/B Ratio of 12.89, while Sun Pharma's P/B Ratio is at 16.41. In contrast, Cipla has a P/B Ratio of 4.31, and Dr. Reddy's Laboratories has a P/B Ratio of 4.24.

EV/Revenue (Enterprise Value to Revenue Ratio):

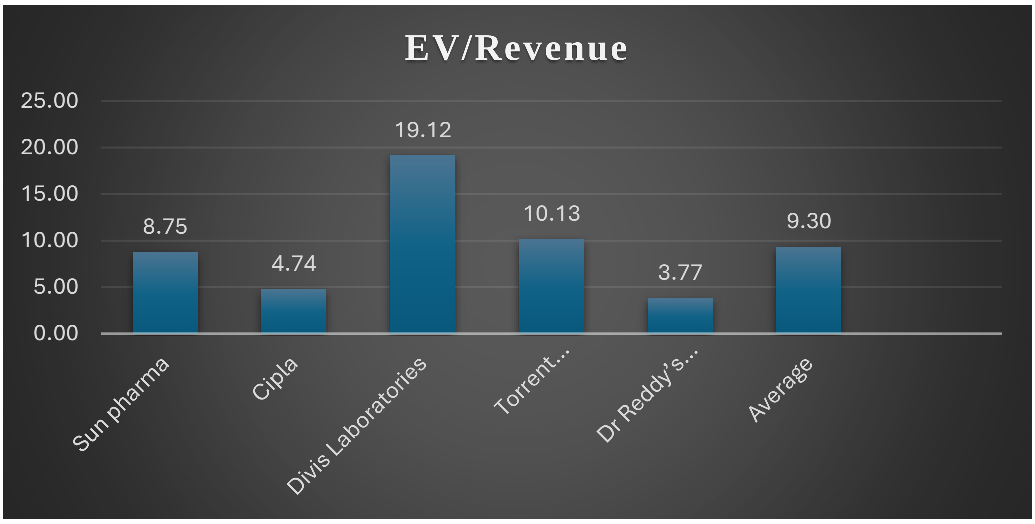

Figure – 15 EV/Revenue (Enterprise Value to Revenue Ratio)

The EV/Revenue Ratio measures a company's enterprise value (which includes market capitalization, debt, and cash) against its total revenue. A higher EV/Revenue Ratio typically suggests that investors are willing to pay more for each dollar of revenue produced. Divis Laboratories leads with the highest EV/Revenue Ratio at 19.12, indicating strong investor confidence in its revenue potential. Torrent Pharmaceuticals follows with an EV/Revenue Ratio of 10.13, while Sun Pharma has a ratio of 8.75. Cipla's EV/Revenue Ratio stands at 4.74, and Dr. Reddy's Laboratories has the lowest at 3.77.

Overall Observations:

Divis Laboratories is notable for its high P/E, P/B, and EV/Revenue ratios, reflecting strong investor expectations for future growth and a premium valuation. Torrent Pharmaceuticals also shows relatively high valuations across these metrics. In contrast, Dr. Reddy's Laboratories exhibits lower valuations compared to its peers in all three ratios.

Company Name	Market Price	EPS
Sun pharma	₹ 1,768.60	46.1
Cipla	₹ 1,499.75	55.4
Divis Laboratories	₹ 5,750.10	69.2
Torrent Pharmaceuticals	₹ 3,102.40	53.2
Dr Reddy’s Laboratories	₹ 1,226.70	64
Average	₹ 2,669.51	57.58

Table – 14 current market price and EPS

Market Price and Earnings Per Share (EPS) of Pharmaceutical Companies:
The table presents the Market Price and Earnings Per Share (EPS) for five leading pharmaceutical companies: Sun Pharma, Cipla, Divis Laboratories, Torrent Pharmaceuticals, and Dr. Reddy's Laboratories.

Interpretation:

Market Valuation: The Market Price indicates how the market views a company's worth. A higher Market Price typically suggests that investors are optimistic about the company's future. In this instance, Divis Laboratories has the highest Market Price, implying that investors anticipate significant growth ahead.

Profitability: EPS measures a company's profitability on a per-share basis. A higher EPS usually signifies better financial health and greater earnings potential. Dr. Reddy's Laboratories boasts the highest EPS, indicating robust profitability.

Key Observations: Market Price Variation: There is a notable difference in the Market Prices of these companies. Divis Laboratories leads with a Market Price of ₹5,750.10, while Dr. Reddy's Laboratories has the lowest at ₹1,226.70. EPS Range: The EPS figures also differ among the companies. Dr. Reddy's Laboratories has the highest EPS at 64, whereas Sun Pharma records the lowest at 46.1.

To determine the valuation range (intrinsic value) of these companies and assess whether they are undervalued or overvalued, we can multiply each company's Earnings Per Share (EPS) by the average industry Price to Earnings (P/E) ratio. This result can then be compared to the respective market price of the stock to identify if the stock is undervalued or overvalued.

Valuation range/(Intrinsic value):

Company Name	EPS	Average industry P/E	Valuation range (Intrinsic value)
Sun pharma	46.1	41.78	₹ 1926.21
Cipla	55.4	41.78	₹ 2314.80
Divis Laboratories	69.2	41.78	₹ 2891.41
Torrent Pharmaceuticals	53.2	41.78	₹ 2222.88

Dr Reddy's Laboratories	64	41.78	₹ 2674.14

Table – 15 Valuation range

Company Name	Market Price	Valuation range (Intrinsic value)	Valuation status
Sun pharma	₹ 1,768.60	₹ 1,926.22	**Undervalued**
Cipla	₹ 1,499.75	₹ 2,314.80	**Undervalued**
Divis Laboratories	₹ 5,750.10	₹ 2,891.42	**Overvalued**
Torrent Pharmaceuticals	₹ 3,102.40	₹ 2,222.88	**Undervalued**
Dr Reddy's Laboratories	₹ 1,226.70	₹ 2,674.14	**Undervalued**

Table – 16 valuation status

Interpretation:

Divis Laboratories appears to be significantly overvalued, with its Market Price at ₹5,750.10, which is much higher than the estimated Intrinsic Value of ₹2,891.42. This indicates that the market might be overrating the company's actual value. In contrast, Sun Pharma, Cipla, Torrent Pharmaceuticals, and Dr. Reddy's Laboratories are considered undervalued, as their Market Prices fall below their estimated Intrinsic Values. This suggests that these companies could be trading at a discount compared to their true worth based on the valuation estimates provided.

Findings and Conclusions:

Findings were drawn from the analysis carried across various financial parameters and key metrics:

Profitability Ratios:

The EBITDA margin exhibits a positive trend in the case of most companies in the pharmaceutical industry for a projected FY 2020-2024. This indicates enhanced operational efficiency. Sun Pharma and Cipla improved their profitability every year with better focus on cost management and a few core business operations strategies. Divis Laboratories revealed fall in EBITDA margin post-2022 due to the potential challenges in the cost structure and industrial dynamics. A synchronized positive trend has been recorded in Net Profit Margins (NPM), as most firms have recorded more profitability with Sun Pharma and Dr. Reddy's Laboratories surprisingly increasing in growth while there was thorny cost control mechanisms and market expansion strategies in their financial year 2023-24.

Liquidity Ratios:

At the point of analysis, Cipla and Divis Laboratories illustrated a strong current ratio with suitable current assets-outstanding short-term liabilities. However, Torrent Pharmaceuticals remains weak with the current ratio implying its weak abilities in current handling.

Being most helpful for Divis Laboratories, the quick ratio revealed good quick assets to meet current liabilities, whereas Torrent Pharmaceuticals needs improvement.

Leveraged Ratios:

After completing the analysis for the period under discussion, it has been noticed that nearly all companies show a very fine debt to equity profile average for the firms ever since the very beginning. Companies like Cipla and Sun Pharma have been good at concerning the operational leverage and degree of capital structure strength. However, apparently, Torrent Pharmaceuticals had a high variation, which could indicate that it held significant financial risks.

Interest Coverage Ratios for companies such as Divis Laboratories were notably high, demonstrating a strong capacity to meet interest obligations, whereas Torrent Pharmaceuticals fell short, indicating weaker coverage.

Efficiency Ratios:

The asset turnover ratio, which assesses how well a company uses its assets to generate revenue, showed consistent improvements for Cipla and Dr. Reddy’s Laboratories, suggesting enhanced resource utilization. Inventory turnover ratios for Sun Pharma and Torrent Pharmaceuticals have seen improvements over the years, reflecting effective inventory management strategies.

Return Ratios:

Return on Net Worth/Equity (ROE) and Return on Capital Employed (ROCE) exhibited positive trends for Sun Pharma and Cipla, indicating better use of shareholder and employed capital. In contrast, Divis Laboratories experienced a slight decline in recent years, hinting at operational inefficiencies.

Relative Valuation Metrics:

Firms like Sun Pharma and Cipla seem to be undervalued, as evidenced by their lower P/E and P/B ratios compared to competitors. Divis Laboratories appears to be potentially overvalued due to its elevated P/E and EV/Revenue ratios. The valuation ranges derived from the average ratios imply that Sun Pharma might have potential for price growth if it aligns more closely with peer valuations.

Conclusion

Even without looking at the training data, this can already be deduced from the data analysis and financial interpretation: most pharmaceutical companies are positioned for success. An analysis of several indicators shows that most pharmaceutical companies are shifting towards sound profitability, full cash flow, and the most efficient asset management approaches. For instance, Sun Pharma, Cipla, and Dr. Reddy's Laboratories have demonstrated the potential to adapt to shifts within the market, implement cost control strategies, and leverage enhancing shareholder value. So, these are the possible avenues for investment as well.

On the other hand, the financial performance of companies like Torrent Pharmaceuticals does not leave these any options, lags behind in many key indicators raising questions about the sustainability of the company and its operations. Just looking at Divis Laboratories' margins and returns eroding, this already suggests that the recognition of excessive costs for operational efficiencies is imperative to be maintained competitively.

Exciting growth prospects are still, however, underpinned by the pharmaceutical sector, thanks to innovation and tremendously growing market demands and robust financial management implemented by several industry leaders. Investors should consider investing in firms showing continuous profits growth, improving liquidity, as well as operational efficiency, whereas selecting their stocks carefully when buying shares in companies faced with persistent challenges.

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