

Profitability and Leverage Analysis: A Study on Lupin Pharmaceuticals Ltd.

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ABSTRACT

This study analyzes the operating leverage, financial leverage and combined leverage for Lupin, the Leading multinational pharmaceutical company. For the purpose of analysis, the researchers have collected the data from the moneycontrol.com. This study covers the period from 1st April 2013 to 31st March 2018 which consists of a five year period. The empirical findings of the study expose that, the company has very high operating risk (1.21 times) during the year 2016-2017 and has least operating risk (1.08 times) during the year 2014-2015. The EBIT of the company was maximum (4208.48) during the period of 2015-2016 and it was minimum (1827.17) in the period 2016-2017. Moreover, Lupin Pharmaceuticals has stagnant financial risk during the study period.

1. Introduction

It is often profitable to increase the proportion of debt in the firm's capital structure, because borrowed funds may earn more than their interest cost. This is known as "leverage" or "trading on the equity." The use of financial leverage involves a compromise between liquidity and earning power. Cash flows must be arranged to meet fixed payments on debt; the more sales and profits fluctuate, the more difficult is the task of the financial manager in meeting the cash outflow for interest and debt repayments. Companies with stable sales and profits are therefore more likely to use higher degrees of leverage, resulting in capital structures with 50 to 70 per cent senior capital (bonds and preferred stock). On the other hand, manufacturing and retailing companies have volatile earnings and sales and, when possible, use a much lower degree of financial leverage (www.britannica.com). Hence, the study concerned with the analysis of profitability and leverage position of the company.

2. Review of literature

Mukesh C Ajmera (2012), the study showed that there is a significant relationship between DFL and EPS, DCL and EPS, and DOL and EPS. The earning capacity of the firm is significantly influenced by the fixed operating expenses and the financing mix decisions of the firm. And he also found out that the leverage effect is positive when the earnings of the firm are higher than the fixed financial charges.

Asha Rani *et al.*, (2016), the study observed that, profitability, size, growth opportunities and uniqueness, to an extent, are important determinants of capital structure for the firms. Solvency and liquidity are, however, not found to be affecting leverage decisions. Surprisingly, collateral capacity, observed by the tangibility of assets, and corporate taxation was also not found to be significantly affecting the capital structure decisions.

Mohan Kumar *et al.*, (2016), the study has concluded that there is a positive correlation between DOL, DCL & EPS and negative correlation between DFL, DER & EPS among the

majority of the companies selected for the study during the study period.

AyanChakraborty (2017), the study indicates that that degree of operating leverage is a statistically significant positive correlation with the EPS. The financial performance of ITC is satisfactory. The analysis has shown that ITC has financed its activities mainly from its Reserve & Surplus and the amount of Debt has fallen over the years. It is suggested that ITC must increase its Debt funding to take advantage of Tax Shield. Moreover, the Cost of Debt is cheaper than the Cost of Equity

KennNdubuisiet *al.*, (2018), examined the effects of financial leverage on the profit growth in Nigeria using the total debt to capital ratio, debt to equity ratio, cost of debt, debt to asset ratio and long term debt to capital ratios as proxies for financial leverage for a sample of 80 non-financial firms quoted on the Nigerian Stock Exchange over the period of 2000 to 2015. The findings of the study exposed that financial leverage has a significant effect on the profit growth of firms in Nigeria and also there exists a significant relationship between the inflation rate and profit growth but the relationship with the interest and exchange rates on financial leverage of quoted companies in Nigeria.

3. Objectives of the study

The overall objective of the study is to analyze and understand the impact of leverage on the profitability of the Lupin Pharmaceuticals Ltd. The following are more specific objectives. They are

1. to know the overall operating efficiency and performance of the Lupin Pharmaceuticals Ltd. through financial analysis; and
2. to find out the leverages namely: a) operating leverage b) financial leverage c) composite or combined leverage.

4. Methodology of the study

In order to analyse the profitability and leverage analysis in Pharma Company, the researchers have chosen Lupin pharmaceuticals Ltd., which is among the top five pharmaceutical companies in India. For the purpose of analysis, the data has been collected from annual reports of the selected company and from moneycontrol.com. The sample included from 2013-14 to 2017-2018 which consists of a five year period.

5. Tools used for the study

1. Operating Leverage

Operating leverage reflects the change in operating profits of the firm due to a unit change in the level of sales. It is a measure of the magnification effect of fixed costs on operating profits or EBIT.

$$OL = \frac{\text{Contribution}}{\text{EBIT}}$$

2. Financial Leverage

Financial leverage measures the effect of the change in EBIT on the EPS of the company. Alternatively, it is a ratio between proportionate changes in EPS and proportionate change in EBIT. It is a tool with which a financial manager can maximize the returns to the equity shareholders.

$$FL = \frac{\text{EBIT}}{\text{EBT}}$$

3. Combined Leverage

Combined leverage is the combination of operating and financial leverages. Symbolically % change in the sales volume of the firm leads to a certain % change in the EPS.

$$CL = OL * FL$$

6. Data Analysis and Interpretation

Table 1.1 INCOME STATEMENT OF LUPIN PHARMACEUTICALS LTD
(` in Crores)

Particulars	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Sales	10103.90	11579.41	12899.93	10127.03	11454.91
(-) Variable cost	6550.02	7405.56	8325.34	7910.05	8650.77
Contribution	3553.88	4173.85	4574.59	2216.98	2804.14
(-) Fixed cost	336.79	305.61	366.11	389.81	426.30
EBIT	3217.09	3868.24	4208.48	1827.17	2377.84
(-) Interest	4.90	24.11	29.42	33.24	35.47
PBT	3212.19	3844.13	4179.06	1793.93	2342.37
(-) Tax	814.84	1013.26	1037.73	449.27	803.54
PAT	2397.35	2830.87	3141.33	1344.66	1538.83

Source: Compiled from moneycontrol.com

Table - 1.1, displays the income statement of Lupin Limited for the five year study period. In the three years i.e., 2013-2014 to 2015-2016 sales volume has steady growth. During 2016-2017 sales was quite unsatisfactory. Variable cost and fixed cost has increased during the study period. In the first three years i.e., 2013-2014, 2014-2015 and 2015-2016 profit was satisfactory. During the year 2016-2017 and 2017-2018 profit was quite unsatisfactory.

It has been found that, during the study period maximum of sales occurred during 2015-2016 (12899.93) and 2014-2015 (11579.41). Similarly, during the study period, the maximum of profit has occurred during 2015-2016 (3141.33) and 2014-2015 (2830.87). It's understood that the sales and profit of Lupin Pharmaceuticals slightly decreased during 2016-2017 and 2017-2018.

Table 1.2 OPERATING LEVERAGE OF LUPIN PHARMACEUTICALS LTD

S.NO	YEAR	CONTRIBUTION	EBIT	OPERATING LEVERAGE
1	2013-2014	3553.88	3217.09	1.10
2	2014-2015	4173.85	3868.24	1.08
3	2015-2016	4574.59	4208.48	1.09
4	2016-2017	2216.98	1827.17	1.21
5	2017-2018	2804.14	2377.84	1.18

Source: Compiled from Excel

Table 1.2 exposes the operating leverage of Lupin Limited for the five year study period. The contribution of the company fluctuated positively during the study period of 2013-2014 to 2015-2016 and it was decreased during the period of 2016-2017 and 2017-2018. Similarly, the EBIT of the company also increased till the year of 2015-2016 and in the year of 2016-

2017 and 2017-2018 it was decreased. The operating leverage of the company was highest (1.21 times) in the year 2016-2017 and it was lowest (1.08 times) in the year 2014-2015.

It is found out that, the contribution of the company was maximum (4574.59) during the period of 2015-2016 and it was

minimum (2216.98) in the period 2016-2017. Moreover, Lupin Pharmaceuticals has very high operating risk (1.21 times)

during the year 2016-2017 and has least operating risk (1.08 times) during the year 2014-2015.

Table 1.3 FINANCIAL LEVERAGE OF LUPIN PHARMACEUTICALS LTD

S.NO	YEAR	EBIT	EBT	FINANCIAL LEVERAGE
1	2013-2014	3217.09	3212.19	1.00
2	2014-2015	3868.24	3844.13	1.01
3	2015-2016	4208.48	4179.06	1.01
4	2016-2017	1827.17	1793.93	1.02
5	2017-2018	2377.84	2342.37	1.02

Source: Compiled from Excel

Table 1.3 exposes the financial leverage of Lupin Limited for the five year study period. The EBIT of the company was fluctuated positively during the study period of 2013-2014 to 2015-2016 and decreased from 2016 to 2017. The EBT of the company also increased till the year of 2015-2016 and in the year 2016-2017 and 2017-2018 it was decreased. The financial leverage of the company was stagnant over the study period.

It is found out that, the EBIT of the company was maximum (4208.48) during the period of 2015-2016 and it was minimum (1827.17) in the period 2016-2017. Lupin Pharmaceuticals has stagnant financial risk during the study period.

Table 1.4 COMBINED LEVERAGE OF LUPIN PHARMACEUTICALS LTD

S.NO	YEAR	OPERATING LEVERAGE	FINANCIAL LEVERAGE	COMBINED LEVERAGE
1	2013-2014	1.10	1.00	1.10
2	2014-2015	1.08	1.01	1.09
3	2015-2016	1.09	1.01	1.10
4	2016-2017	1.21	1.02	1.23
5	2017-2018	1.18	1.02	1.20

Source: Compiled from Excel

Table No.1.4 displays that combined leverage of Lupin Limited for the five year study period. It can be understood from the analysis the operating leverage inadequately fluctuated during the study period. However, the financial leverage of the company was stagnant over the study period. The composite / combined leverage of the company was highest (1.23 times) in the year 2016-2017 and it was lowest (1.09 times) in the year 2014-2015.

It is found out that, Lupin Pharmaceuticals has very high combined leverage ratio (1.23 times) was during the year 2016-2017 and has the lowest combined leverage ratio (1.09 times) during the year 2014-2015.

7. Major findings of the study

- It's found out that, during the study period maximum of sales occurred during 2015-2016 (12899.93) and 2014-2015 (11579.41). Similarly, during the study period, the maximum of profit has occurred during 2015-2016 (3141.33) and 2014-2015 (2830.87). It's understood that the sales and profit of Lupin Pharmaceuticals slightly decreased during 2016-2017 and 2017-2018.
- It is found out that, the contribution of the company was maximum (4574.59) during the period of 2015-2016 and it was minimum (2216.98) in the period 2016-2017. Moreover, Lupin Pharmaceuticals has very high operating risk (1.21 times) during the year

2016-2017 and has least operating risk (1.08 times) during the year 2014-2015.

- It is found out that, the EBIT of the company was maximum (4208.48) during the period of 2015-2016 and it was minimum (1827.17) in the period 2016-2017. Moreover, Lupin Pharmaceuticals has stagnant financial risk during the study period.
- It is found out that, Lupin Pharmaceuticals has very high combined leverage ratio (1.23 times) was during the year 2016-2017 and has the lowest combined leverage ratio (1.09 times) during the year 2014-2015.

8. Conclusion

The researchers have taken an attempt to study the profitability and leverage analysis namely operating leverage, financial leverage and combined leverage for Lupin pharmaceuticals. For the purpose of analysis, the data has been collected from annual reports of the selected company and from moneycontrol.com. The sample included from 2013-14 to 2017-2018 which consists of five year period. The empirical findings of the study expose that the contribution of the company was maximum (4574.59) during the period of 2015-2016 and it was minimum (2216.98) in the period 2016-2017. Moreover, Lupin Pharmaceuticals has very high operating risk (1.21 times) during the year 2016-2017 and has least operating risk (1.08 times) during the year 2014-2015. Moreover, Lupin Pharmaceuticals has undergone stagnant financial risk during the study period.

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