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PROFESSOR KAUSHIK ROY

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DR. REDDY'S ACQUISITION OF UCB BRANDS

"You would demand this kind of valuation when you're buying the leader in the industry. And I'm not sure if Dr Reddy's has got leading brands from UCB"¹

BACKGROUND

By the end of Quarter 1, 2019-20, Dr. Reddy's Laboratories (DRL) was one of the India's leading pharmaceutical company. A review of the company's annual report for the financial year 2018-19 also seemed impressive. The company had closed the year with consolidated revenues of INR 15,385 crores, a significant increase over the previous year, with a similar increase in earnings before interest, taxes, depreciation, and amortization (EBITDA) and profits (see **Exhibit 1** for the consolidated and standalone financial position of the company). The US market, which accounted for 42% of all sales, was seeing a consolidation of sales channels in generics among the large US buyers. Notwithstanding this, the pressure on prices as a result of this consolidation was aggravated by intense competition among generics suppliers in the US.

Competition from other generics suppliers had also made it difficult for DRL to overcome the decline in prices through an increase in volume. DRL's revenue from the US were down 6%. This was a concern, since generics was still DRL's largest business segment, accounting for

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80% of revenue, while the US market accounted for 52% of revenue.

To tackle the price erosion in the US generics market, DRL was focusing on a strong pipeline of complex formulations. The objective was to launch value-added products each year to offset the revenue loss from pure generics. However, DRL also needed to look beyond the US market to increase revenue. With the emerging markets presenting significant opportunities, Prasad knew these geographies could well be a perfect foil for the pressures in US generics.

There were challenges in the Indian market, too. India's transition to Goods and Services Tax (GST), replacing indirect taxes, such as value-added tax and excise duty, had impacted earningsⁱⁱ. **Exhibit 2** illustrates the business- and region-wise revenue contribution of DRL across a ten-year span.

Over the years, the company had made several acquisitions to consolidate its presence in both the global and Indian markets across segments and expand its footprint. One such high ticket-size acquisition of a select brand portfolio from Belgian drug-maker UCB was expected to give DRL a significant share of the domestic dermatology, respiratory, and paediatrics segments. As Prasad reflected on the extant performance, he wondered if the INR 800-crore UCB brand acquisition had indeed paid off! The company's goal was to create value by accessing innovation. In the UCB brands, this potential was visible. Had DRL been able to achieve this objective?

ⁱ Commented by Mr. Nimish Mehta of Equirus Securities and excerpted from <https://www.reuters.com/article/us-ucb-sa-dr-reddys-deals/indias-dr-reddys-to-buy-some-ucb-brands-for-128-million-idUSKBN0MS3HI20150401> in March 2020

ⁱⁱ Excerpted from <http://ficci.in/spdocument/22944/india-pharma-2018-ficci.pdf> in September 2019