

# ANALYSING THE STOCK MOVEMENT OF Dr. REDDY'S LABORATORIES LIMITED USING CANSLIM APPROACH

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## ABSTRACT

The COVID19 pandemic has paved way for the downfall of the global economy. The Indian economy too faced an unstoppable downfall during this pandemic period. In fact, The Indian Stock Market crashed on a couple of occasions as well. The Pharmaceutical sector is one of the very few sectors that outperformed the bearish market. India is the largest provider of generic drugs. Hence pharmaceutical sector is one of the few sectors that helped the Indian market to sustain itself in this span. In this paper, we will be analyzing the stock movement of Dr. Reddy's Laboratories Ltd during this period with an impressive approach named CANSLIM proposed by William O'Neil, a famous writer, and stockbroker.

**KEYWORDS:** CANSLIM approach, COVID19, pharmaceutical sector, Dr. Reddy's Laboratories Ltd, EPS, ROE, RSI.

## 1. INTRODUCTION

A Stock market is a place where the shares are traded by the buyers and the sellers over a large scale. There are two kinds of markets namely primary and secondary markets which are overseen by **The Securities and Exchange Board of India (SEBI)**. Most of the trading in the Indian stock market takes place in one of the two stock exchanges: The National Stock Exchange (NSE) and The Bombay Stock Exchange (BSE). An investor or a trader must examine the profile and history of the company before buying the shares of the particular company. Besides that, one should also be aware of the recent price movements, support, and resistance levels, etc. Thus the analysis part plays a major role in the stock market. The best way to gain profit in the share market is to analyze the shares before buying. There are many tools out there in analyzing a company's share. Fundamental Analysis (FA) and Technical Analysis (TA) are the two major analyses of the stock market. Fundamental analysis involves the detailed study of the company's profile, balance sheet, profit & loss statement, cash flow, and other financial statements of the company whereas technical analysis involves the study and analysis of the pattern and trend of the share in the market during a specific period. Besides these two analyses, we are keen in focusing on an impressive approach named CANSLIM which was presented by WILLIAM O'NEIL, in his book titled "How to make money in stocks: A winning system in good times or bad". It is a process used to identify stocks that are poised to grow faster than average.

Each letter in the acronym represents a key factor that remains a strong indicator by predicting the movement of the stock. It is a strategy that can be used for the fast-moving markets.

## 2. PRELIMINARIES

In this section, we will be listing down some of the common terminologies in the stock market that are used in our study.

### 2.1. Earnings Per Share (EPS)

The growth of the company can be determined by its EPS. It is a ratio of the company's net profit after tax to the total number of outstanding shares in it.

$$\text{EPS} = \frac{\text{net profit after tax}}{\text{no of outstanding shares}}$$

**2.2. Volume:** Volume refers to the number of shares traded over a particular period. It indicates the market strength. It is directly proportional to market growth.

### 2.3. Relative Strength Index (RSI)

It is used to measure the speed and change of the price moments.

$$\text{RSI} = 100 - \frac{100}{1 + \text{RS}}, \quad \text{where } \text{RS} = \frac{\text{average gain}}{\text{average loss}}$$

### 2.4. Return on Equity (ROE)

Return on Equity is a measure of financial performance calculated by dividing the net profit by shareholder's equity.

$$\text{ROE} = \frac{\text{net profit}}{\text{shareholders equity}} * 100$$

## 3. CANSLIM – An Overview

CANSLIM approach is a stock-screening technique that was developed by William O'Neil in the year 1950. This strategy is one of the most studied investment strategy in the entire stock market world. It is an effective tool since it is a combination of both fundamental and technical analysis. CANSLIM is an acronym that is named after the following 7 characteristics that are vital in analyzing a stock:

**C:** Current earnings growth

**A:** Annual earnings growth

**N:** New product

**S:** Supply and demand

**L:** Leader

**I:** Institutional investment

**M:** Market direction

### **3.1. Current Earnings growth**

The first indicator is determining the company's current EPS. Compare the current quarterly earnings per share with that of the prior year's same quarter. If there is a major percentage increase in the current quarterly EPS then that is a good sign. EPS of the company is calculated by dividing the total profit after tax by the number of outstanding stocks. The greater the percentage of increase, the better the profit increase. If the current quarterly earnings per share turn out to be very poor then that remains as a negative indicator. Even if the present quarter's earnings are up 5% to 10%, that is simply not enough of an improvement to fuel any significant upward price movement in a stock. If the percentage increase is more than 20% then it shall be considered as a positive indicator.

### **3.2. Annual Earnings growth**

The annual growth rate is a variation in the growth rate often used to assess an investment or company's performance. By Comparing the EPS growth either for 3 years or 5 years, the annual earnings growth of the company is calculated. For the past five years, for each year the respective annual earnings per share should show some significant raise over the prior year's earnings. The Annual Compound Growth Rate (ACGR) of earnings of stock that we have considered to buy should be from 25% to 50% or even 100% or more, per year over the last 3 or 5 years.

In addition, Return on Equity (ROE) should also be calculated, and if it is more than 17% then that too indicates the positive sign towards the growth of the company.

### **3.3. New product**

N indicates something new, that could be a new product, service etc., that is capable of accelerating the sales and bring in revenue rapidly compared to the previous year. It could also be new top management or any new important decision taken in the company during the last couple of years. This would sustain as a positive impact in the market and which in turn would increase the share value of the company.

### **3.4. Supply and demand**

The fluctuation in the market price is due to the increase and decrease of the demand and supply time to time. When the buyers are ready to buy a stock irrespective of the price and knowing it if the sellers are not keen in selling, then the demand of the stock increases in the market. Whereas if the seller wants to sell a stock and if the buyers are not interested, then automatically the price of the stock will drip down to balance the supply and demand ratio. Volume remains as an indicator to understand the supply and demand ratio in a better way.

### **3.5. Leader**

As the name sounds, whichever is capable of leading will be referred as a leader. In the stock market terminology, a stock is mentioned as a leader only if possesses the following characteristics.

#### **3.5.1. Industrial leader**

If the Market price of the company is strictly increasing in the particular industry, then the company is considered as a leader of the industry. If a particular stock outperforms all of its peers and tops the

movement in its sector, then it is referred as the leader of the sector. At times these sectorial leaders are capable of outperform the overall sectorial nifty as well. Then that would be clear positive indicator for such stocks.

### **3.5.2. Trending sector**

There are 11 major sectors in the Indian stock market. This Sector is classified by Global Industry Classification Standard (GICS). Using sector analysis we can compare the movement of the sector along side the movement of index to figure out the trending sector.

### **3.5.3. RSI**

If the Relative Strength Index (RSI) of the company is more than 80% or if the RSI of the company is better than its peers, then the company is considered as a leader.

### **3.6. Institutional investment**

If the company possess few of the bigshots who are interested in the functioning of the company and readily invest, then that offers a good feel not only to the management of the company but for the shareholders as well. These investors who make a big deal are classified into Foreign Institutional Investors (FIIs) and Domestic Institutional Investors (DIIs). Especially, Foreign Institutional Investors never invest in any company without any knowledge about the company. If there are more Institutional investors (FIIs and DIIs investors) in the company then it makes a big impact on the stock price. The key thing to notice is the number of institutional investors who has been recently stepped in during the recent quarter. The increase in the percentage of institutional investors in the recent quarterly period indicates a positive sign.

### **3.7. Market direction**

Market direction is the critical indicator when compared to other characteristics. Investors should always trade with the trend as 3 out of 4 shares usually follows the market trend. The direction of the particular stock mostly depends upon the direction of the market. If the market directions show a good sign, then it's advisable to purchase the shares of the particular stock which meet out the above said parameters.

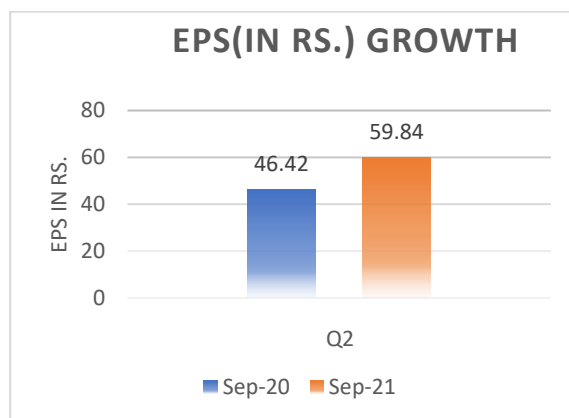
## **4. COMPANY PROFILE**

Dr. Reddy's Laboratories Ltd is the leading pharmaceutical company founded by Kallam Anli Reddy in 1984. Erez Israeli is the current CEO of the company (2021). Its headquarters is located in Hyderabad, Telangana, India. Dr. Reddy manufactures and markets have a wide range in India and overseas. The company has over 190 medications and 60 Active Pharmaceutical Ingredients (APIs) all over the world. They began as a supplier to Indian drug manufacturers. Their Net income was 1,950 crores INR during the year 2020. The company has been maintaining a healthy dividend of 19.62%. In April 2001, they began trading on the New York Stock Exchange (NYSE).

## **5. CANSLIM approach for Dr. Reddy's Laboratories Ltd**

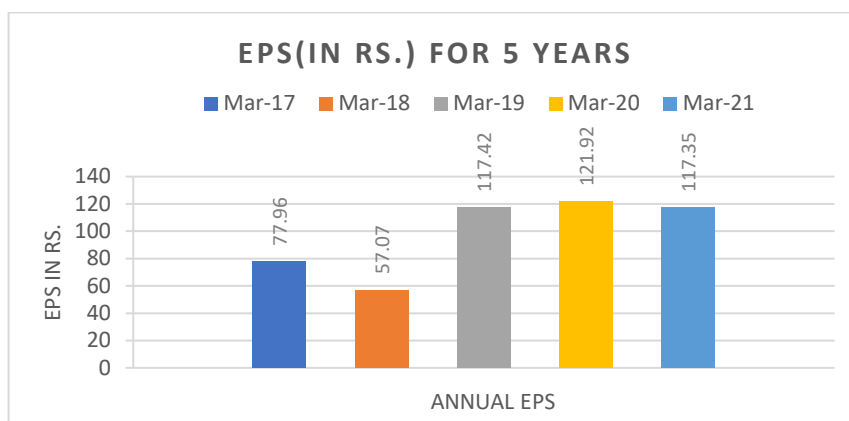
### **5.1. Current Earnings growth**

The EPS rate has been consistently increasing. Particularly during Q2 of FY 2020, the EPS rate was Rs.46.42 whereas during Q2 of FY 2021 it has rapidly increased to Rs.59.84. The increase of 12.62% in EPS rate is reasonably good.



## 5.2. Annual Earnings growth

The Annual CAGR of EPS has been increased by 57.43% over the past 5 years. Return on Equity (ROE) for the last 3 years is 13.7%.



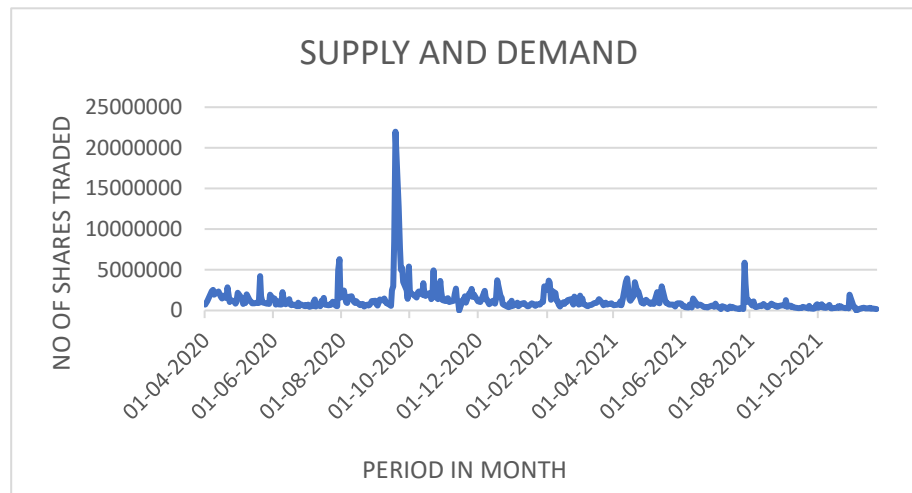
## 5.3. New product

Dr. Reddy is one of the companies in India which is leading in the pharmaceutical sector. It has healthy management. The company launches new products frequently. Even in this pandemic, to prevent the people from getting infected by COVID, the company has come out with Vaccines as well. Thus, it keeps the come busy, as they are receiving orders across the globe. The company aims to launch SPUTNIK V in Hyderabad, India on May 14. Thus, no wonder, its stock movement is typically good and in particular during June 2021, the stock price had reached its new high.

## 5.4. Supply and Demand

With the help of historical data, we observed that the volume movement remained almost similar most of the time. The same can be noticed from the following graph. Post lock down, there was a huge

demand for the stocks of pharmaceutical sector and hence the volume has massively gone up during October 2020. But in all other occasions, the demand and supply ratio looked stable.

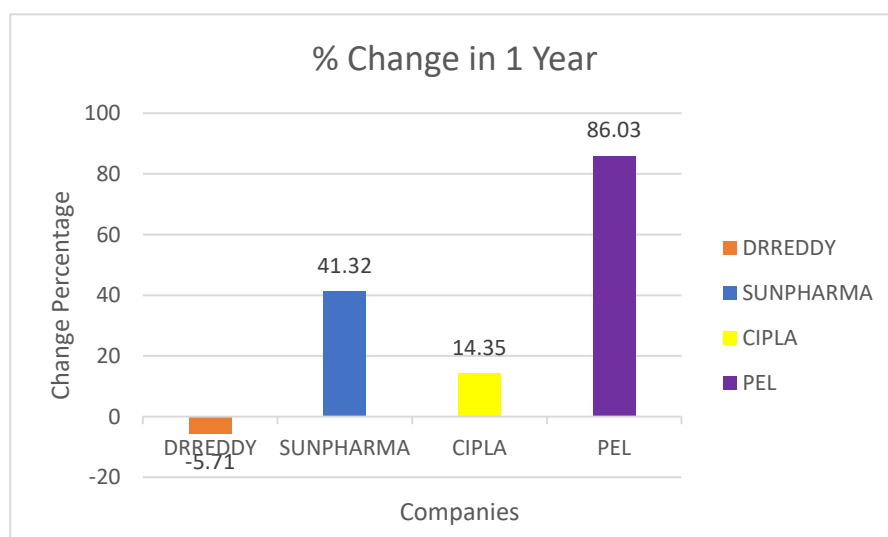


## 5.5. Leader

In this section we will be analyzing the leadership parameters of the stock market one by one.

### 5.5.1. Industrial leader

Dr. Reddy is one among the leading pharmaceutical companies in India. But as far as Industrial leader position is concerned, Piramal Enterprises Limited (PEL) holds it by a vast margin. In fact, it has outperformed not only the pharma sector but it has given more than three times return of the total index during the last one year. But Dr. Reddy's Laboratories Limited though had high demand at some point, still since the demand and supply ratio remain stable, it couldn't with stand with its peers which is a major drawback.



### 5.5.2. Trending sector

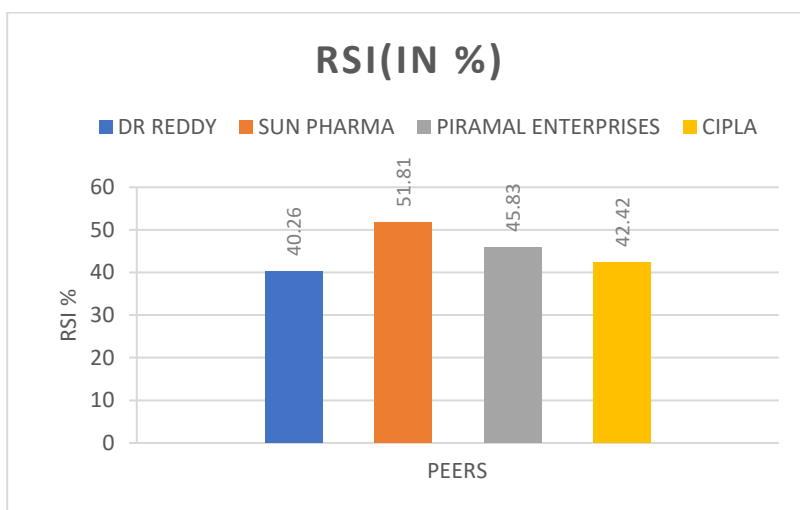
For the financial year 2020-2021 the top 5 trending sectors were

1. Banking sector
2. Infrastructure sector
3. Pharmaceutical sector
4. IT sector
5. Chemical sector

Thus, the sector we have considered is in positive direction on the whole.

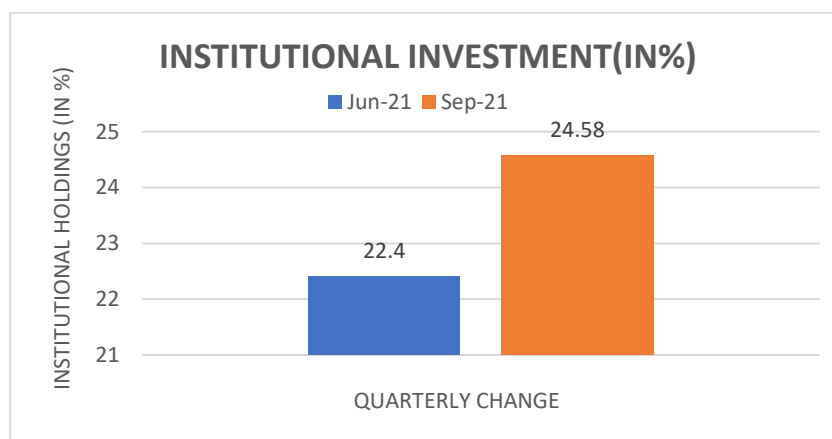
### 5.5.3. RSI of the company

Though the RSI of the company looks good, when compared with its peers, again it couldn't stand with them in this aspect as well.



### 5.6. Institutional investment

The institutional holding which was 22.40% in June 2021 has raised to a good number of 24.58% in September 2021.



## 5.7. Market direction

The Market direction of Dr. Reddy Laboratories Ltd can be observed from the following graph. We could witness that it has consistently taken sideways movement since April 2020. But still it is good as the market crashed couple of times during this period and still the stock of this company had managed to survive and maintained the sideways movement throughout.



## 6. INTERPRETATION

The current earnings growth of the company shows an increase of about 29% during the Q2 of FY 2021. Also, the annual earnings growth for the last five years shows an increase of about 57.43%. Because of the new launch of the Sputnik V vaccine in India during May, there is an increase in the company's stock value. But though the demand was observed high at some point, in all other cases the supply and demand ratio remained stable. Moreover, it stands last among its peers even when the sector is really performing well, which is not a good sign. There is an increase in institutional investors between Q1 and Q2 of FY 2021 which is a positive sign. Amidst the swinging index, Dr. Reddy's Laboratories Ltd stock has managed to maintain the sideways movement throughout.

## 7. CONCLUSION

After analyzing the stock movement of Dr. Reddy's Laboratories Ltd, we arrive at a conclusion that, investing in this stock is risk free as out of seven parameters, six are reasonably good but in terms of better returns, Piramal Enterprises and Sun Pharma stands out to be a better choice as on date. In short, the study can be represented in stock terminology as '**CANSLIM**'.

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