AUROBINDO
PHARMA LTD.

Scaling up the organisation

Annual Report
2004 - 2005

CONTENTS

We are on the threshold of growth

The Aurobindo of today is **...**

... a multi-product company (65 APIs in the non-antibiotics and over 55 APIs in the antibiotics segment) with presence in diverse segments

... a multi-unit company with *all* units cGMP compliant

... built to excel with facilities to serve the premium markets

… from basic raw material to prescription drugs

... a research-led powerhouse with over 500 talented scientists

... a knowledge based company with Intellectual Property skills; holding patents and product/plant approvals

... targeting soon to be off-patent drugs for that *first-mover* advantage

... present in key segments like penicillins and has made significant footprints in the ARV, CNS and CVS segments

... strong in emerging markets and making forays into the Regulated Markets

... listed as one of Asia's 100 best growth companies by *Forbes* magazine (Nov 01, 2004)

Scaling up the organisation

Dear friends,

As Members are aware, Aurobindo Pharma has taken far reaching initiatives that have enhanced the fundamentals, scaled up the business model, improved the income earning abilities, added manufacturing and marketing strengths, ramped up the skill sets with some of the best professionals on board, and become a dynamic organisation. I am happy to report we have in the process, scaled up the organisation and now have the ability to face the future with confidence.

In 2004-05, continuing our efforts of the recent few years in our manufacturing operations, we have boosted our efficiencies, streamlined the cost structure and enhanced productivity.

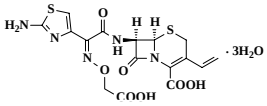
Today, Aurobindo Pharma is qualitatively different. A clutch of products and facilities have been approved by international regulatory authorities such as US FDA, World Health Organisation (WHO), MHRA (UK), EDQM, Health Canada, MCC(SA) etc.

Our marketing strategies have been tested out successfully in USA and Europe. The organisation has become very purposeful in its objective to become a significant player in the generics markets of the developed world. We are ensuring that our tomorrow is better.

Through the pages of this Annual Report, my colleagues and I will briefly describe the actions taken, the current situation and the emerging scenario. Members will notice that we had planned these changes, initiated actions in time, incurred extra-ordinary but necessary costs, received approvals from authorities, and are now busy translating the gains into the balance sheet.

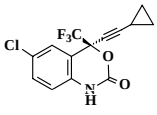
I must hasten to mention, your Company reported in 2004-05 lower revenues and net income. Our revenues were affected since we chose to get the manufacturing facilities ready for inspection by international authorities. Manufacturing was not at

What we make – one of the industry's best product portfolio

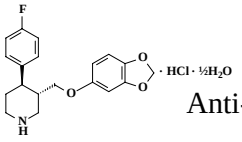


Cephalosporins

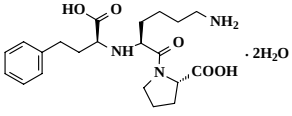
Anti-Retrovirals



Anti-Convulsants

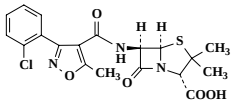


Anti-Depressants



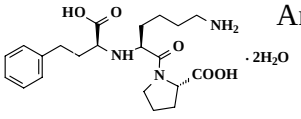
Anti-Fungals

Semi-synthetic Penicillins



Hypnotics & Anti-Psychotics

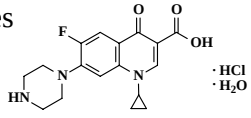
Beta Blockers



Anti-Hypertensives

Statins

Quinolones



…AND MUCH MORE

We are targeting the regulated markets ...huge potential for our products

US$ Billion

	Global	USA	EU	Others
Steriles				
Ceph	3.3	0.9	0.7	1.7
SSP	2.8	1.1	0.7	1.0
Sub-Total	**6.1**	**2.0**	**1.4**	**2.7**
Anti retrovirals	**6.6**	**3.9**	**1.4**	**1.3**
Oral betalactums				
Ceph	3.4	1.2	0.6	1.6
SSP	2.7	1.2	0.6	0.9
Sub-Total	**6.1**	**2.4**	**1.2**	**2.5**
CNS	**33.4**	**25.1**	**4.7**	**3.6**
CVS	**39.9**	**21.1**	**8.9**	**9.9**
Others	**36.7**	**22.9**	**6.1**	**7.7**
Total	**128.8**	**77.4**	**23.7**	**27.7**

full tilt. This was unavoidable. Capacities remained under utilised, at units earmarked for regulatory market sales. We were to some extent also affected by the competitive pressures of the market.

Some of our overseas operations, especially at China, were affected by low end-price for our products, as well as by rising manufacturing costs. We did take suitable action to become leaner, the favourable impact of which would be visible only in the current financial year.

During the year, there were large amounts incurred on accelerated regulatory and R&D programmes. In the process, we got a head start and made the production facilities ready for regulatory inspection.

Members will appreciate these are expenses in the nature of investment. They are incurred to create internationally benchmarked assets that add value to your Company in the long-term, and will in all likelihood generate revenues and profits from the regulated markets. These have been debited to operating profits earned from the domestic and emerging markets.

Costs are being charged to present earnings, while the assets are being created to earn future revenues. With the transformation that we are effecting in our market mix, we hope to make a dramatic change in the quality of future revenues.

I must reiterate, we will continue to pursue regulatory approval of products and facilities. We have a large basket of products, and we wish to submit all our main revenue earners to international authorities. We will work towards first mover advantage.

We surely are looking at the emerging opportunities in the generics market in the future. Aurobindo would like to position itself better, and derive value for its products, and ultimately for its stakeholders.

These efforts will necessitate incurring significant costs. In the near term, we expect the bottomline to be subdued. Lower bottomline is a price we pay today, so that our tomorrows are better. We see all these as essential costs.

Indeed, seen in the right perspective, these are investments made to improve your Company's business model. In the process, we are ensuring long-term sustainability, growth and profit. Our singular focus is to enable Aurobindo to take its rightful place in its chosen segments, in the premium markets of US and Europe.

We had in recent times focused on building infrastructure and delivery capabilities. We will now be making greater impact on positioning of our products, be it with hospitals, chain stores or through other intermediaries.

Now that we hold regulatory approvals, we are investing on the marketing of Aurobindo, and its products. We have added relevance and value. We have earned credentials. We are better positioned to market our products. Today, we have presence in Europe, US and Latin American countries and have started export to some of these markets.

Our improved business model and revenue stream have been put into action. Initial orders and consignments are eliciting encouraging signs. Wherever we have approvals, we have commenced marketing, and we hope to convert all certification and approvals into invoicing.

The financial results for FY06 will show much greater momentum and the impact of the initiatives made. While we would continue to serve the domestic and global markets, both in the API and formulations segments, we hope to make meaningful impact in the regulated markets. Numbers will naturally follow.

We believe we would be able to translate our strong initiatives into better top and bottom line, before the end of FY06. The improved income streams would help the Company take the future costs of filing new dossiers and ANDAs in its stride. Increasing revenues from regulatory markets will make the difference.

Our global footprints

Subsidiaries
Branch Offices
Joint Ventures

Manufacturing facilities in India...
- Hyderabad (10 plants)
- Cuddalore
- Vizag
- Bhiwadi, Rajasthan

Apart from multiple locations in India, Aurobindo has manufacturing facilities in the USA, Brazil and China

As Members are aware, we have always kept the needs of our customers and markets in forefront, and thereby created value for all stakeholders. Probably, our best efforts did not get the visibility it deserved, due primarily to the fact that costs were absorbed and charged off while the assets had not turned income earning.

At Aurobindo, long term stability and sustainability is as important as growth and profits. We carefully plan our strategies, initiate actions that will add value, gain ground and consolidate before we accelerate.

While what we had set out a couple of years ago may have cost the company time and resources, it has actually made Aurobindo a wealth creator. We have today the opportunity and strength to make a healthy impact in the regulated markets.

We have done all the hard work. We have taken care of the hardware and the software. We are now executing the strategies. The results should be visible in a few months. We believe we have mapped out what needs done, and today have the strength and the excitement to ensure that we go on to deliver results.

My colleagues on the Board and I are certain, our dedicated team of professionals would make every effort to carve a significant market share for our products. Together, we shall create a new level of success.

Our efforts will be to reciprocate the trust and support of all our stakeholders. We are confident that we shall be more effective in creating wealth, and justifiably we can look forward to the future with optimism.

Warm regards,

P. V. Ramaprasad Reddy
Chairman

Leveraging the present for the future

Fortunes of pharma industry were under pressure throughout FY05. The pressures in the global markets were influenced by the new patent regulations, consolidation in the industry worldwide and the compulsions of various governments to lower their health cover costs.

Domestic markets experienced the impact. Newer variables further affected the market adversely. Competitive pressures influenced prices, while volume sales were under pressure when the traders protested the imposition of VAT. Implementation of MRP based excise regime had an effect on some of our customers, and volatility in forex market hurt realisation from exports. Strengthening of the rupee against the dollar was another factor.

While Aurobindo sold more volume in 2004-05 than ever before, the revenue per unit dropped. Capacity utilisation was high at the facilities earmarked for emerging and domestic markets, while production units reserved for manufacturing for the regulated markets were under utilised. Inspections by regulators and time lag between product approvals and shipments to customers meant under recovery of overheads.

Costs were incurred in anticipation of future revenues, and prudential norms were followed in charging them off against current income. Since we believe in quality of earnings and sustainable profits in the future, the efforts and costs have to be leveraged today for visibly improved payback in the foreseeable future.

In the light of the above, it will be easier to appreciate the year's workings. Gross sales were lower 13.5% at Rs.11591 million and the profit after tax saw a 72.4% deceleration.

The numbers however, do not tell the full story. We sold more, used our capacities better and worked on the market pressures to improve on costs. Significant gain was in the ratio of raw material costs as a proportion to revenues. Raw material costs as a proportion of sales were lower, even as the selling prices fell.

More important, we at Aurobindo are upbeat by the fact that our proposals to international regulatory authorities for approvals are receiving encouraging response, and we are getting organised to make an impact in the premium markets of the world.

A few years ago, we had shifted our emphasis and invested in knowledge capital, and made the transition to a research led, chemistry company. We got vertically and horizontally integrated - from chemical and process research to regulatory product approvals and manufacturing excellence, from fermentation to formulation, and across all markets from domestic to the premium, regulated markets. We have created synergies that are improving the productivity of research.

Our manufacturing facilities compare well with the best in the industry; our processes and standard operating procedures are

Cost-revenue mismatch impacted short-term profitability

- Around Rs.4,950 million invested in India on plants (representing 54% of the balance sheet)
- These investments will yield revenue from the end of FY05
- Depreciation and other expenses being charged to P&L, not capitalized
- Incremental regulatory expenditure such as R & D expenses, bio-equivalence studies and maintenance of regulatory plants amounted to approx Rs.870 million more than FY04
- This reduced operating profit by around 7% of revenues as compared to 2004
- Impacted by timing differences between Long-term investments and short-term profitability.
- Regulatory approvals will be converted to revenues and cashflows from FY06 onwards
- In the future revenue from regulated markets will support further regulatory filing expenses

our pride; our products have demand pull; we are piloted by dedicated leadership ably supported by talented professionals; and, due to the approvals and recognitions on hand, we are able to create new marketing structures in the developed world. Our systems, structures and fundamentals have never been as strong as they are now.

The impact of the change is visible. We are able to create value for customers, and offer uniformly high quality, leading to better margin sales.

There has been another qualitative change in looking at business as a whole. Today, your Company is addressing the needs of the quality conscious markets. This has a rub-off effect on all the production units, and the quality systems have been further upgraded. The thinking in all the plants has become regulatory-centric. We believe we will be offering customers in the domestic and less regulated markets better than expected products and services. We expect long-term gains from these markets.

There is considerable satisfaction within the Aurobindo team, that the Company is making a paradigm shift from a domestic market player to a serious player in the generics markets. There is a momentum and sense of urgency in our efforts and we are determined to take our due market share. There is an inspired team that is taking the Company forward.

At Aurobindo, we see the quarterly results as a short-term score card. Actually, we work for the medium-to-longer term, map our goals, and work to create an architecture that enables us to contribute and play a role in advanced markets, have a larger customer base, and create a healthy organization.

As the year unfolds, our optimism will translate into meaningful growth, improved operating profit, wealth creation and shareholder value. We'll stay focused on these goals, and look forward to exceeding your expectations.

K. Nityananda Reddy
Managing Director

Ten tough questions

1

Why did the revenues and profits fall in FY05?

In terms of financials, the numbers were lower than expectations. Lower revenues and lower net profit meant lower earnings per share. In a bid to conserve resources, the dividend has been pruned to 10 per cent.

Competitive pressures kept the product prices lower. This was an industry phenomenon. But more important from Aurobindo's angle was, capacities earmarked for regulatory markets remained under utilised, awaiting product approvals. Incremental regulatory expenditure such as R&D expenses, bio-equivalence studies and maintenance of regulatory plants were approximately Rs.950 million more than that incurred in FY04.

Regulatory expenses were approximately 7% of revenues in FY04, while it was 14% of revenues in FY05. In keeping with prudential norms, profits of the year were debited while the revenue potential was increased for future years.

2

What were the gains of the year?

In real terms, FY05 was one of the most successful years. This was a year in which the Company filed a record number of Drug Master Files (DMFs), Abbreviated New Drug Applications (ANDAs), dossiers and process patents. For instance, the Company filed 64 DMFs (including 24 with US FDA and 11 in Europe) and 25 ANDAs (including 15 with US FDA and 4 in Europe). The Company started receiving approvals as well.

A significant feature of the year was successful inspection of facilities by the regulatory authorities such as the US FDA. Product and facilities approval are enabling the Company to manufacture products for the premium markets.