

Creating a Global Enterprise

ANNUAL REPORT 2005-06 DR. REDDY'S LABORATORIES LIMITED





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CREATING A GLOBAL ENTERPRISE

In the world of matter, a drop of liquid diffuses slowly in another and forms a pattern that it is distinctive, reflective of its nature.

Through more than a decade of steady effort and guided by an unswerving original vision, Dr. Reddy's Laboratories has been growing into a business that has earned the right to be called global. When a business evolves, rather than changes suddenly, its growth is likely to endure.

This year's cover images, as a whole, tell the story of this transformation. The front shows how an enterprise, like a drop of reagent, can take a global shape in its own distinctive way, guided by its inherent nature. The back cover reflects our focus on three continental geographies and in the inside covers are images of diffusion, reflective of our creative energy.

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chairman's letter

Dear Shareholders

2005-06 has been a momentous transformational year in the history of your Company. The transformation is not just of the company coming out of its financial and operation trough of 2004-05. It is about thinking out of the box, aggressively growing its businesses, making landmark deals and completing two significant global acquisitions.

2005-06 has proved to me that your Company has it in its DNA to quickly

what has happened in 2005-06 — and has occurred across various businesses of your Company.

Let me share with you some of the major developments of the year.

On a consolidated basis and as per U.S.GAAP, your Company's revenues have grown by almost 24 per cent to Rs.24.3 billion in 2005-06. Thus, for the first time in its history, it has comfortably crossed the U.S.\$500 million mark. Net profits have increased from a mere Rs.211 million in 2004-05 to



DR. K ANJI REDDY
CHAIRMAN

In my last year's letter to you, I had written, "There is nothing like a year of adversity to strengthen, re-focus and re-channel entrepreneurial drives." That is exactly what has happened in 2005-06 — and has occurred across various businesses of your Company.

overcome adversity and get back on to the path of rapid and broad-based growth to realise its vision of becoming a discovery-led global pharmaceutical company.

If you will recollect, 2004-05 was a difficult and challenging year. Consolidated revenues had declined; and profits had fallen precipitously. In my last year's letter to you, I had written, "There is nothing like a year of adversity to strengthen, re-focus and re-channel entrepreneurial drives." That is exactly

Rs.1.6 billion in 2005-06. And earning per share has increased from Rs.2.76 to Rs.21.24.

These numbers reflect fundamental changes in your Company's ways of doing business. I would like to touch upon a few of these.

To begin with, we have become more aggressive in growing our businesses. The Branded Formulations team has succeeded in increasing its revenues by 27 per cent to Rs.9.9 billion — and has done so in international markets as well as in India. Revenue from Active Pharmaceutical Ingredients (API) has grown by 19 per cent to Rs.8.2 billion.



In March 2006, we completed the acquisition of the betapharm Group, Germany's fourth largest Generics pharmaceutical company for an all cash deal of €483 million — which, I am told is largest international acquisition made by an Indian company up to date. It has a portfolio of 145 marketed products and several more in the pipeline.

Sustained efforts of the Generics business in Europe have helped overcome difficult market conditions in the U.S.; and revenues have grown by 13 per cent to Rs.4.1 billion. Customs Pharmaceutical Services (CPS) has grown its stand-alone business by 68 per cent to Rs.523 million; with its Mexican acquisition — which I will share with you shortly — revenues have grown to Rs.1.3 billion. These are examples of the re-discovered energy of your Company's employees.

But there is more. Instead of purely focusing on organic growth and cost cutting, your Company's senior management decided that it was time to leverage the cash in its balance sheet to actively scout for international acquisitions.

In November 2005, your Company purchased Roche's API business, its order books and its state of the art manufacturing plant at Cuernavaca in Mexico for U.S.\$61 million. This acquisition alone increased Dr. Reddy's fourth quarter revenue by Rs.804 million and will help the Company's CPS business to grow from around U.S.\$12 million to U.S.\$100 million in the next 15 months.

In March 2006, your Company completed the acquisition of the betapharm Group, Germany's fourth largest Generics pharmaceutical

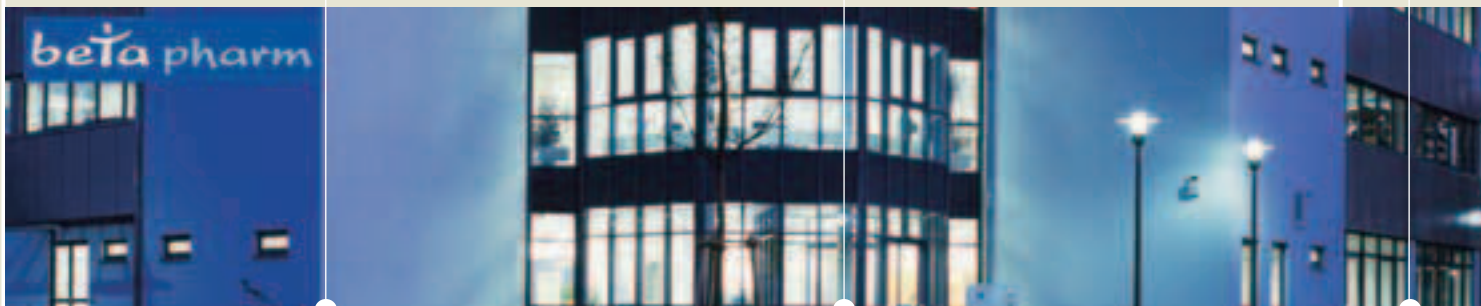
company for an all cash deal of €483 million — which, I am told is largest international acquisition made by an Indian company up to date. With a portfolio of 145 marketed products and several more in the pipeline, betapharm had a turnover of €164 million in 2005. This is expected to increase in the future. More significantly it gives your Company a strong foothold in the large German Generics market.

Given the way in which your Company's management is charged up and its successes in integrating these international entities, something tells me that you may well be seeing more global acquisitions in the coming years.

The scientist in me is delighted in the way your Company has re-engineered its R&D and has built an even stronger pipeline for the future. Last year, I wrote about the need for 'smart R&D'. We are seeing that happen at Dr. Reddy's on several fronts.

In March 2006, your Company concluded a landmark deal in discovery research where Dr. Reddy's, Citigroup Venture and ICICI Venture joined hands to form an integrated drug development company called Perlecan Pharma Private Limited with an equity capital commitment of U.S.\$52.5 million. In this deal, Dr. Reddy's has transferred to Perlecan all rights and titles of four discovery molecules in the area of cardiovascular and metabolic disorders. Perlecan's priority is to accelerate the development of these molecules and thereafter seek out-licensing, co-development or joint commercialisation opportunities.

Also in the year, Dr. Reddy's and Rheoscience A/S have agreed to co-partner the development of balaglitazone (DRF 2593) a partial PPAR-gamma agonist for the treatment of Type 2 diabetes, which is expected to move to Phase III clinical trials. The



arrangement allows Dr. Reddy's to keep its full rights for North America, Japan and the rest of the world, except Europe (excluding Russia and CIS) and China.

Today, five of the Company's seven key NCEs have advanced to clinical development. And there are a few in pre-clinical that are showing considerable promise.

In addition, we have significantly strengthened our Generics and API pipelines. In 2005-06, your Company filed 12 Abbreviated New Drug Applications (ANDAs), taking the total number of ANDA filings to 70. As of

R&D and product pipeline. Something else has also occurred which I need to share with you.

As you know, we are a company that is also listed on the New York Stock Exchange and thus, subject to the laws and regulations of the U.S. Securities and Exchanges Commission (SEC). In 2002 the U.S. passed the Sarbanes-Oxley Act (SOX), which imposed stringent corporate governance conditions and internal control over financial reporting on all companies registered with the SEC. As a foreign registrant, your Company had to comply with



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March 31, 2006, our U.S. Generics pipeline comprised 49 ANDAs pending with the U.S. Food and Drugs Administration, including 29 Para IVs. As far as APIs are concerned, the Company increased the number of products in its Drug Master File (DMF) by 30 during 2005-06, of which 17 were U.S. DMFs, 8 Canadian and 5 European. The total number of DMFs now stand at 151 — 81 filed in the U.S., 28 in Canada and 42 in Europe.

Thus, 2005-06 has seen growth in revenues, increase in profitability, two significant global acquisitions and a fundamental re-engineering of its

Section 404 of SOX by March 31, 2007.

Instead of waiting for the deadline, we took the view that this is a worthy exercise which needed to be fast-forwarded. Therefore, 18 months ago, we began an all-out effort to comply with the provisions of SOX-404 of the Sarbanes Oxley Act, 2002.

I am delighted to inform you that your Company has become SOX-404 compliant 10 months before the mandated deadline. That makes us one of the earliest Asian companies to be SOX compliant — and demonstrates our commitment to having global



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Adversity brings with it optimism. Successful growth ought to be accompanied with a few words of warning. We have done well. However, there are many challenges ahead. There is a challenge of successful integration; of being a global company with over 2,000 employees at international locations; of creating global managerial talent pools; of dealing with increasing competitive pressures in the Generics and API businesses; of systematically making successful launches across the entire produce space; of further developing the Company's NCE pipeline; and of maintaining the momentum of rapid transformation to become a globally recognised, discovery-led international pharmaceutical player.

These are the challenges of growth. I am confident that your Company's employees — both within and outside India — will surmount each of them. And, with your support, deliver even better therapeutic solutions while generating superior shareholder value.

Yours sincerely,

DR. K ANJI REDDY
CHAIRMAN

key highlights

BASED ON U.S. GAAP
FINANCIALS

ACQUISITIONS

ACQUISITION OF BETAPHARM, the fourth largest generics company in Germany, for €483 million (\$584 million) in cash. The combination of Dr. Reddy's and betapharm offers an excellent opportunity to build on the unique strengths of each company to emerge as a leading generics player in Europe.

ACQUISITION OF ROCHE'S API BUSINESS at the manufacturing site in Cuernavaca, Mexico including all employees and business supply contracts for U.S.\$61.5 million. This will help Dr. Reddy's to emerge as a leading player in Customs Pharmaceutical Services (CPS) segment and position itself as a partner of choice for strategic outsourcing needs of global innovator companies.

FINANCIALS HIGHLIGHTS

REVENUES CROSS the milestone of U.S.\$500 million driven by a well diversified business and market growth

TOTAL CONSOLIDATED revenues rises by 24.3 per cent — from Rs.19,519 million in 2004-05 to Rs.24,267 million in 2005-06.

REVENUES FROM Active Pharmaceutical Ingredients and Intermediates (**API**) grows by 19 per cent to Rs.8,238 million.

REVENUES FROM BRANDED FORMULATIONS increases by 27 per cent to

Rs.9,926 million.

REVENUES FROM GENERICS grows by 13 per cent to Rs.4,056 million, including 28 days revenue from betapharm — Dr. Reddy's German acquisition.

REVENUES FROM CUSTOMS PHARMACEUTICAL SERVICES rises from Rs.312 million to Rs.1,327 million, including fourth quarter revenue from Dr. Reddy's Mexican acquisition.

R&D SPEND net of income under the

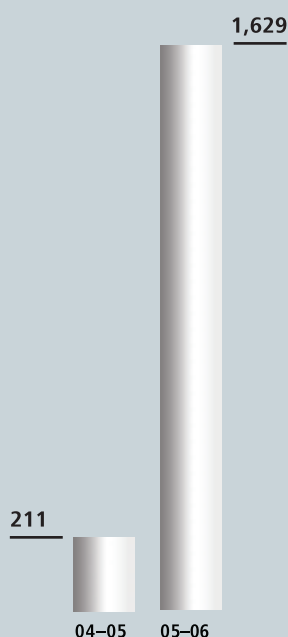
ICICI Venture Capital Funds Management Company – Generics deal at Rs.2,153 million, reflecting a decline of 23 per cent over 2004-05.

PROFIT AFTER TAX increases to Rs.1,629 million from Rs.211 million in 2004-05. This growth also includes the profit from the sale of formulations facility in Goa, India.

FULLY DILUTED EARNINGS PER SHARE (EPS) grows from Rs.2.76 in 2004-05 to Rs.21.24 in 2005-06.

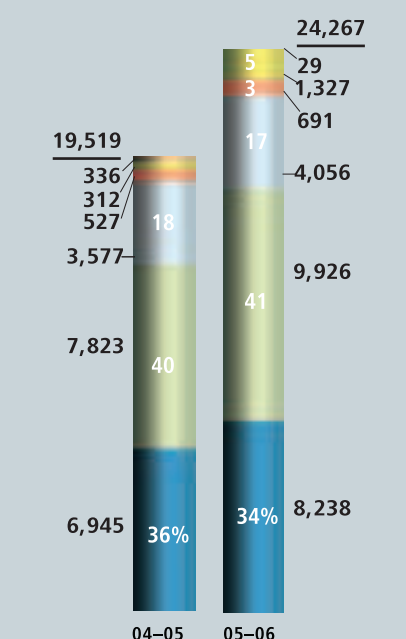
PROFIT AFTER TAX

IN RS MILLION



BUSINESS REVENUE MIX

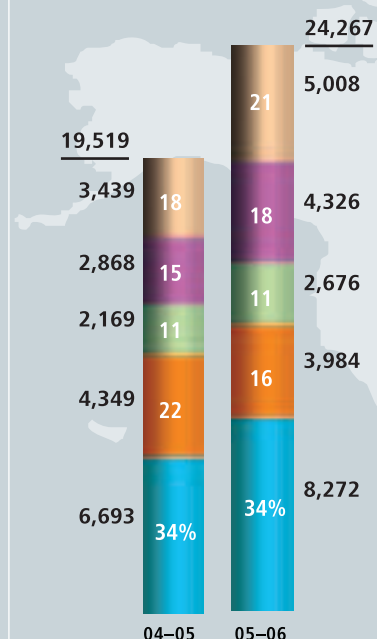
IN RS MILLION | 00%



■ APIs
■ Branded Formulations
■ Generics
■ Critical Care & Biotech
■ CPS
■ Others

GEOGRAPHIC REVENUE MIX

IN RS MILLION | 00%



■ India
■ North America
■ Europe
■ Russia & other countries of the former Soviet Union
■ Others