

BUILDING BLOCKS OF GROWTH

ANNUAL REPORT 2006-07 DR. REDDY'S LABORATORIES LIMITED

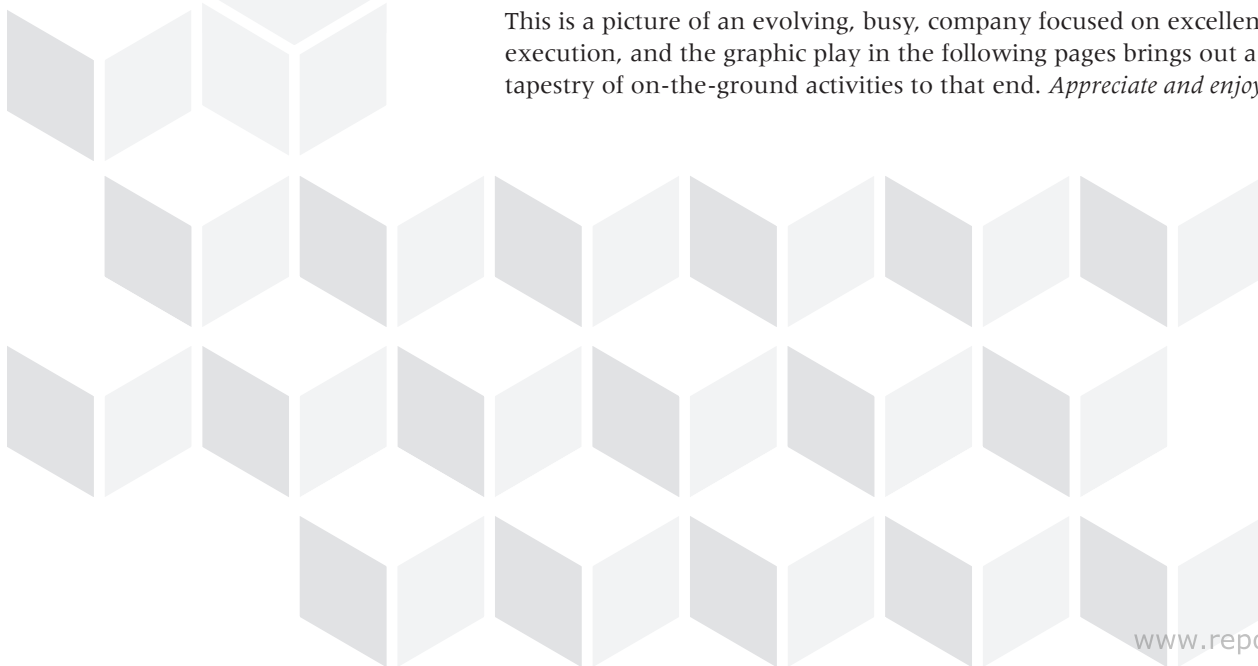


BUILDING BLOCKS OF GROWTH

We at Dr. Reddy's continually remember and reinforce the basics of executing effectively. As a fast growing, high quality and efficient manufacturer and marketer of global quality, accessible medicine, from actives to generics, we realize the importance of the correct building blocks, initiatives in quality, information handling, research and development.

The vibrant teamwork and ceaseless hard work needed to deliver these are best captured by a beehive, one of the most productive and effective social organizations in nature. This years graphic theme co-opts the honeycomb's hexagon, one of nature's most profound geometries, also shared by many organic chemicals, to illustrate a range of activities from chemistry, molecular development and the evolution of building blocks in third dimension.

This is a picture of an evolving, busy, company focused on excellence in execution, and the graphic play in the following pages brings out a rich tapestry of on-the-ground activities to that end. *Appreciate and enjoy.*



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This year has been a phenomenal year for your Company. Dr. Reddy's Laboratories succeeded in growing its consolidated US GAAP revenues more than two and a half times to Rs. 65,095 million and, in the process, crossed the historic U.S\$. 1.5 billion milestone.¹

Dear Shareholders



Today, Dr. Reddy's has become the largest and most profitable pharmaceuticals company in India. It is among the top 15 generics players in the world. And is well placed to grow towards becoming one of the top 10 global generics companies in the future.

I am proud of what your Company has done over the year. Here are some financial facts based on unaudited consolidated US GAAP accounts for 2006–07.

- Your Company's consolidated revenues net of excise duties and sales returns grew by 168 per cent to Rs. 65,095 million, or U.S\$. 1.5 billion.
- Operating income increased almost eight-fold — from Rs. 1,442 million in 2005–06 to Rs. 11,224 million in 2006–07. This was despite charges that Dr. Reddy's took on account of amortization expenses of Rs. 1,571 million, and writing down of intangible assets to the tune of Rs. 1,770 million.

¹At an exchange rate of Rs. 43.10 = U.S\$. 1.

- Profit before tax and minority interests grew by more than 450 per cent to Rs. 10,500 million, or U.S.\$ 243.6 million.
- Profit after tax (net of minority interests) increased almost five-fold to Rs. 9,327 million, or U.S.\$ 216 million.
- Fully diluted earnings per share rose from Rs. 10.62 in 2005–06 to Rs. 58.56 in 2006–07.

These excellent financial results have been driven by three factors — one of which is quite apparent, while the other two have remained somewhat below the surface. Let me share these with you.

The first, and most widely reported, factor has been your Company's successful launches of Generic products in North America. In June 2006, Dr. Reddy's launched simvastatin and finasteride, the generic versions of Zocor® and Proscar® respectively, as authorized generic products of Merck. This authorized generic transaction was the first of its kind by an Indian company in the U.S.

Thereafter, in December 2006, your Company launched ondansetron in the U.S. — the generic version of Zofran® with 180-day exclusivity. By March 31, 2007, ondansetron alone generated Rs. 2,890 million in revenues; and our market share for this product was 62 per cent. In addition, we launched fexofenadine, the generic version of Allegra®, at risk, for which our market share at the end of the year was 11 per cent.

Thanks to these launches, your Company's revenues from its North American Generics business alone in 2006–07 was Rs. 23,617 million, or U.S.\$ 548 million.

Our successes in U.S. Generics during 2006–07 have been widely recognized by analysts and the financial press. What is perhaps less understood is the second factor: the impressive growth of your Company's basic businesses.

Take Active Pharmaceutical Ingredients (API) for instance. The API business grew by 44 per cent to Rs. 11,827 million, or U.S.\$ 274 million. Each of six API products sold over Rs. 500 million in

The first, and most widely reported, factor has been your Company's successful launches of generic products in North America. In June 2006, Dr. Reddy's launched simvastatin and finasteride, the generic versions of Zocor® and Proscar® respectively, as authorized generic products of Merck.

the year; three over Rs. 750 million; and one, sertraline, fetched revenue worth Rs. 2,461 million.

The Formulations business, another one of your Company's 'staples', grew by 24 per cent to Rs. 12,319 million, or U.S.\$ 286 million. Revenues in India increased by 16 per cent; and international sales grew by 34 per cent.

In addition, Custom Pharmaceuticals Services (CPS) earned revenues of Rs. 6,600 million, or a bit over U.S.\$ 153 million in 2006–07. To be sure, this has much to do with Dr. Reddy's Mexican acquisition of the previous year — whose revenues have grown by an impressive 67 per cent on an annualized basis. However, even if one were to exclude revenues from Mexico, sales from CPS grew by 134 per cent to Rs. 1,203 million.

The point I wish to make is that your Company's core business engines are firing on all cylinders. Even without its two international acquisitions, betapharm in Germany and Falcon in Mexico, its basic businesses have achieved excellent growth rates.

That is why I am particularly confident of your Company's future. I believe that API, Formulations and CPS will grow impressively in the years to come and thus achieve solid baseline results, over and above which will come the upside gains from new generics launches, specialty pharmaceuticals, biologics and drug discovery.

To put it simply, your Company's growing baseline revenues and profits will ensure a healthy increase in earnings per share and shareholder value. And by leveraging its strong generics, specialty, biologics and R&D pipeline, it will earn impressive upsides, whenever these products are launched.

It is every entrepreneur's dream to protect the baseline and reap the upsides. Your Company should do one better: grow the baseline and win the upsides.

The third factor in your Company's success is perhaps least understood by lay investors. It has

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Fully diluted earnings per share rose from Rs. 10.62 in 2005–06 to Rs. 58.56 in 2006–07.

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to do with the efforts that the management has been quietly making over the last few years to put in place the various building blocks for sustainable growth.

There are several such building blocks. We have taken a leaf from engineering and automobile industries to create a lean manufacturing organization across all our businesses. We are continuously strengthening our position in existing markets while developing several new geographies. We are building world class, globally compliant manufacturing capacities to achieve significantly greater production. We have created a faster, more focused and considerably more efficient product development process — which has dramatically increased our product filings, and reduced the time taken between concept and delivery. We are building wider technical capabilities and systematically leveraging our new acquisitions. And all of these initiatives are being optimized across the entire Company through a project called myDREEM — which uses a proactive and seamless information technology network to achieve execution excellence in everything that we do.

I am proud of your Company's record in filings. In 2006–07, Dr. Reddy's filed 33 Abbreviated New Drug Applications (ANDAs) in the U.S., including 7 Para IV filings. With these, your Company has joined the elite club of 100+ ANDA filers. No less significantly, the year also saw the highest number of approvals for our ANDA filings: 14 final approvals and 5 tentative approvals. This indicates that we not only file a great deal, but also do so in a smart way.

As far as APIs go, your Company filed 56 Drug Master Files (DMFs) globally in 2006–07. With these, we have cumulative filings of 227 DMFs, of which 104 are in the U.S. In Formulations, 479 dossiers have been filed for product registrations in various countries.

Regarding my favorite subject, Discovery Research, your Company had seven molecules

What is perhaps less understood is the second factor: the impressive growth of your Company's basic businesses — take Active Pharmaceutical Ingredients (API) for instance. The API business grew by 44 per cent to Rs.11,827 million, or U.S.\$ 274 million. Each of six API products sold over Rs. 500 million in the year; three over Rs. 750 million; and one, sertraline, fetched revenue worth Rs. 2,461 million.

or New Chemical Entities (NCEs) as on March 31, 2007, of which five are in clinical development and two at pre-clinical stages. We are continuing to advance these NCEs through a combination of in-house development, partnerships and co-development initiatives. You will recall that three key collaborative deals were finalized for discovery R&D in 2005–06 — with Perlecan, Rheosience and Argenta. This year, one more such deal was finalized: your Company entering into an agreement with ClinTec International for the joint development of Dr. Reddy's anti-cancer compound, DRF 1042.

Last year I wrote about the many challenges of growth. Let me recapitulate them.

I wrote of the challenge of successful integration of our two international acquisitions. This has been done. Mexico is already showing excellent results; and the real upside of betapharm will flow in as the products start being supplied from India — which will begin in 2007–08.

I wrote of the challenges of being a global company with over 2,000 international employees, and of creating global managerial talent pools. Your Company's significant human resource initiatives throughout the year has helped address these challenges. I am proud to inform you that Dr. Reddy's has won five major HR accolades in 2006–07; it has made a net addition of 1,500 employees — taking the strength to over 9,000 people representing more than 45 nationalities; and it has made several key overseas hires.

I wrote about the need to deal with increasing competitive pressures in the Generics and API businesses. Your Company's various efficiency initiatives that I touched upon earlier are now methodically dealing with these challenges.

I also wrote of the need to systematically make successful launches across the entire produce space, as well as to further develop the Company's NCE pipeline. We are increasingly doing so in Generics, API, Formulations, CPS and biologics;



The third factor in your Company's success is perhaps least understood by lay investors. It has to do with the efforts that the management has been quietly making over the last few years to put in place the various building blocks for sustainable growth.

and are pursuing collaborative strategies to accelerate the development of our discovery molecules.

2006–07, therefore, has demonstrated your Company's ability to create and sustain the momentum of rapid transformation to become a globally respected international pharmaceutical player. With an ADR issue of Rs. 10,013 million in 2006–07, and a comfortable debt-equity ratio of 0.59 on March 31, 2007, Dr. Reddy's is also financially well positioned to pursue attractive opportunities of even more profitable growth.

None of this would have occurred without the dedication and effort of your Company's employees. They have performed magnificently on all fronts, and deserve all the thanks. As do you, for the faith that you have reposed in this forever

young, forever seeking, forever learning therapeutic solutions venture called Dr. Reddy's Laboratories.

Thank you
Yours sincerely

Dr. K. Anji Reddy

DR. K. ANJI REDDY
Chairman



/ key highlights

BASED ON UNAUDITED U.S. GAAP FINANCIALS

FINANCIAL HIGHLIGHTS

CONSOLIDATED REVENUES

Consolidated revenues grew by 168 per cent, from Rs. 24,267 million in 2005–06 to Rs. 65,095 million, or U.S.\$ 1.51 billion.

OPERATING INCOME

Increased almost eight-fold from Rs. 1,442 million in 2005–06 to Rs. 11,224 million in 2006–07.

PROFIT BEFORE TAX AND MINORITY INTERESTS

Grew by more than 450 per cent from Rs. 1,888 million in 2005–06 to Rs. 10,500 million, or U.S.\$ 243.6 million.

PROFIT AFTER TAX

Profit after tax increased almost five-fold from Rs. 1,629 million in 2005–06 to Rs. 9,327 million, or U.S.\$ 216 million.

FULLY DILUTED EARNINGS PER SHARE

Rose from Rs. 10.62 in 2005–06 to Rs. 58.56 in 2006–07.

REVENUES FROM DIFFERENT BUSINESSES

REVENUE FROM API

Increased by 44 per cent from Rs. 8,238 million in 2005–06 to Rs. 11,827 million in 2006–07. International revenues accounted for 82 per cent of API revenues.

FORMULATIONS REVENUES

Increased by 24 per cent from Rs. 9,926 million in 2005–06 to Rs. 12,319 million in 2006–07.

- Revenues in India grew by 16 per cent to Rs. 6,415 million in 2006–07.
- Revenue from international markets increased by 34 per cent from Rs. 4,400 million in 2005–06 to Rs. 5,904 million in 2006–07.

REVENUES FROM GENERICS

Increased from Rs. 4,056 million in 2005–06 to Rs. 33,224 million in 2006–07.

- North American Generics revenue increased from Rs. 1,631 million in 2005–06 to Rs. 23,617 million in 2006–07, due to authorized generics and new product launches.
- Simvastatin and finasteride, launched as authorized generic versions of Zocor® and Proscar® respectively (under agreement with Merck), contributed Rs. 15,813 million.
- New products, other than authorized generics, launched during the year contributed Rs. 5,657 million to revenue. The most

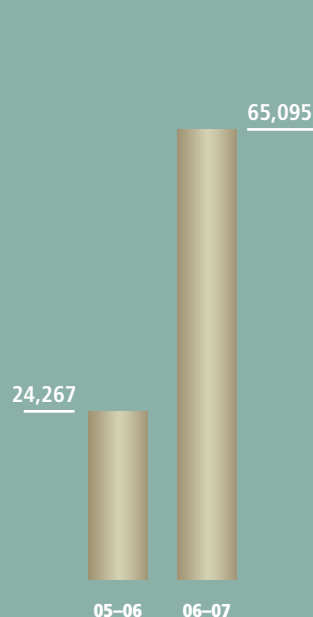
prominent launches were ondansetron and fexofenadine. Ondansetron, the generic version of Zofran®, was launched in the last week of December 2006 with 180-day marketing exclusivity, and contributed Rs. 2,890 million. Dr. Reddy's has already acquired 62 per cent market share. Fexofenadine, the generic version of Allegra®, contributed Rs. 2,429 million.

CPS REVENUE

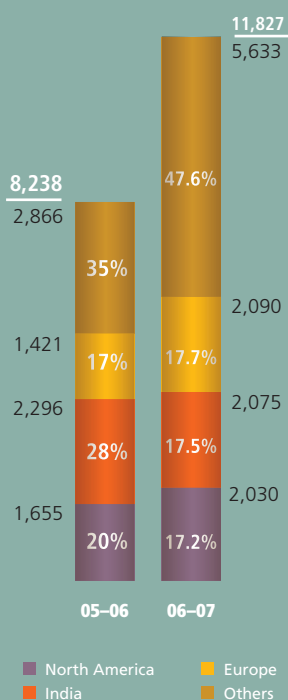
Increased from Rs. 1,327 million in 2005–06 to Rs. 6,600 million in 2006–07.

CONSOLIDATED REVENUES

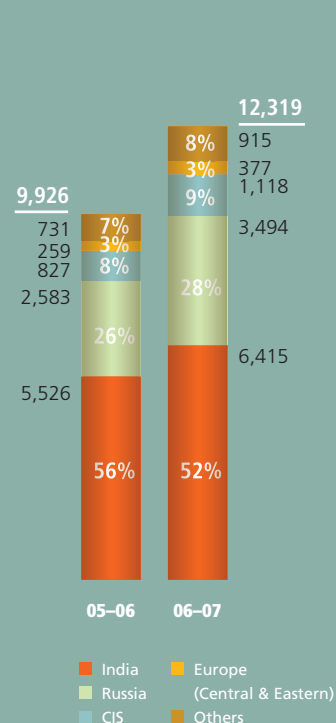
IN RS MILLION



GEOGRAPHIC MIX OF APIS



OF FORMULATIONS



ANDAs, DMFs, PRODUCT REGISTRATION AND NCEs

ANDAs IN U.S.

In 2006–07, the Company filed 33 ANDAs in the U.S., including 7 Para IV filings. With the current year filings, Dr. Reddy's has joined the elite club of 100+ ANDA filers.

HIGHEST NUMBER OF APPROVALS FOR ANDA FILINGS

2006–07 also saw the highest number of approvals for the Company's ANDA filings: 14 final approvals and 5 tentative approvals. As of March 31, 2007, the Company's U.S. Generic pipeline comprises 69 ANDAs pending with the U.S. FDA, including 12 tentative approvals and 29 Para IVs.

DMFs

Regarding APIs, the Company filed 56 DMFs globally in 2006–07. Of these, 23 were filed in U.S., 11 in Canada, 9 in Europe and 13 in other countries. With these filings, Dr. Reddy's has a total 104 U.S. DMFs up to date. As on March 31, 2007, the Company has made cumulative filings of 227 DMFs.

FORMULATIONS

In Formulations, a total of 479 dossiers have been filed for product registrations in various countries.

NEW CHEMICAL ENTITIES (NCEs)

As on March 31, 2007, Dr. Reddy's had seven molecules or New Chemical Entities (NCEs), of which five are in clinical development and two are in the pre-clinical stages.

DEVELOPMENT OF ANTI-CANCER COMPOUND

In 2006–07, Dr. Reddy entered into an agreement with ClinTec International for the joint development of its anti-cancer compound, DRF 1042.

HR AWARDS



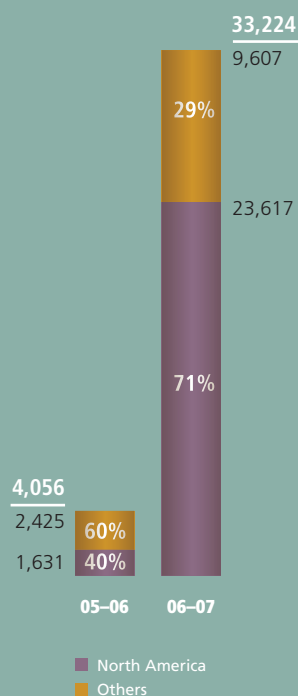
WON 5 AWARDS AND ACCOLADES FOR ITS HR INITIATIVES

- Ranked 4th in 'The Best Companies to Work for in India' survey conducted by Business Today, Mercer Human Resource Consulting and TNS India.
- Featured among the Best Employers in India 2007 — a study done by Hewitt Associates, in association with The Economic Times.
- Received awards in three categories — Innovation in Recruitment, Talent Management and Innovation in Career Development — in the first ever 'Employer Branding Awards' given

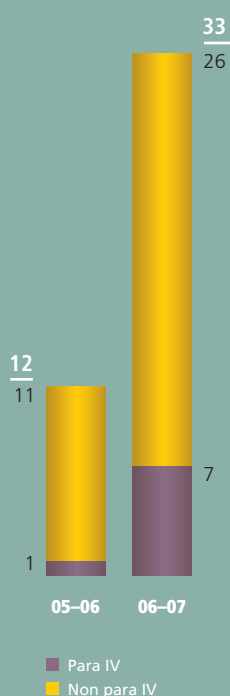
in India by the U.S.-based Star of the Industry Awards Foundation.

- Received the Recruitment and Staffing Best in Class (RASBIC) award for the second time in a row in the Asia-Pacific HRM Congress.
- Received the Global HR Excellence Award for Innovative HR Practices in the Manufacturing Sector.

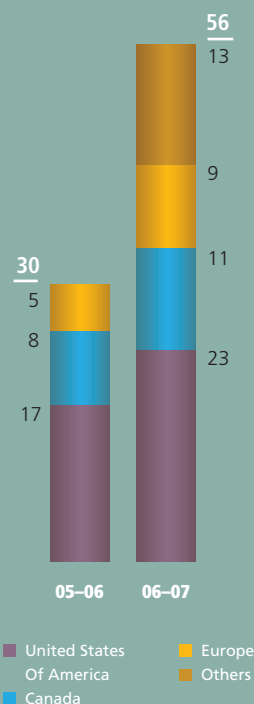
OF GENERICS



ANDAs IN U.S.



DMFs



/ building blocks
of growth

INTEGRATED PRODUCT DEVELOPMENT ORGANIZATION



significant reduction in the time taken between concept and delivery

The Integrated Product Development Organization (IPDO) at Dr. Reddy's is all about better identifying new products, and significantly reducing the time taken between concept and delivery of the product in the market place.

At the beginning of 2006-07, the IPDO was restructured in terms of three overlapping sets of team: Product Delivery Teams (PDTs), Centers of Excellence (COEs) and Common Resources (CRs).

PDTs are designed to take end-to-end ownership of new product development. COEs are designed to build technical capabilities in the organization by taking up projects of high

complexities. CRs are the functions to support PDTs and COEs.

In a year, the IPDO has already helped create value creation through IP and proactive patenting; by early development work on certain promising molecules; breakthrough product delivery; by delivering cost leadership in API.

The number of products under development within the IPDO has significantly increased. In Generics, there are currently 120 projects, including 37 new ones; in API, there are 40 projects, of which 25 are new; in Formulations, there are 48 projects; and in CPS, 7 projects.

LEAN MANUFACTURING



improvement in overall

Over the last few years, the Company has been engaged in several initiatives to improve the overall manufacturing efficiencies — including reduction in wastage and operational cost. All these have now been put under one banner, whose core objective is to 'Simplify'.

The Company started with a pilot project with the help of a Japanese consultant to: **(i) reduce change-over time, and (ii) improve productivity in selected areas.** The pilot was implemented by a single team, and achieved impressive results. The success has led to the Company spread the processes and learning across all Formulation plants, with 20