Torrent Pharmaceuticals Limited

33rd annual report 2005-06

Contents

Milestones signify the path, the distance travelled & the miles to be covered while embarking on a journey. They help us to be on the right course and decide the acceleration levels which will take us to our desired destination.

For us, 2005-06 was significant in terms of crossing several milestones - acquisition of a business in Germany which can serve as a platform for forays into Europe, commissioning of a new manufacturing facility, field force expansion for optimizing product focus, striking a good balance between the Indian & International operations, research collaboration for drug development - all towards making Torrent one of the top pharma companies.

There are many more miles to be covered and many milestones will be crossed.

Corporate Information

Directors

Sudhir Mehta
Executive Chairman

Markand Bhatt

S. H. Bhojani

Dr. Prasanna Chandra

Kiran Karnik

Sanjay Lalbhai

Prof. S. Ramnarayan

Mihir Thakore

Dr. C. Dutt
Director (Research & Development)

Samir Mehta
Managing Director

Audit committee

Dr. Prasanna Chandra
Chairman

S. H. Bhojani

Kiran Karnik

Mihir Thakore

Samir Mehta

Securities Transfer & Investors' Grievance Committee

Markand Bhatt
Chairman

Dr. C. Dutt

Samir Mehta

GM (Legal) & Company Secretary

Mahesh Agrawal

Auditors

C. C. Chokshi & Co.
Chartered Accountants

Registered Office

Torrent House, Off Ashram Road,
Ahmedabad 380 009
Telephone: 079-26585090
Fax: 079-26582100

Manufacturing Facilities

1) Village Indrad, Taluka Kadi,
District Mehsana (Gujarat)
Telephone: 02764-233671
Fax: 02764-233676

2) Village Bhud & Makhnu Majra,
Baddi, Teh. Nalagarh,
District Solan
(Himachal Pradesh)
Telephone: 01795-246821
Fax: 01795-247159

R & D Facility

Torrent Research Centre,
Near Kanoria Hospital,
Village Bhat,
District Gandhinagar, (Gujarat)
Telephone: 079-23969100
Fax: 079-23969135

Website

www.torrentpharma.com

Registrars & Transfer Agents

MCS Limited,
101, Subh Shatdal Complex,
Opp. Bata Show Room,
Ashram Road,
Ahmedabad 380 009
Telephone: 079-30070671
Fax: 079-30070678

Directors' Report

To

The Shareholders

The Directors have the pleasure of presenting the Thirty Third Annual Report of your Company for the Financial Year 2005-06.

FINANCIAL RESULTS, DIVIDEND AND ACCOUNTS

The summary of operating results for the year and appropriation of divisible profits is given below:

		Rs. in crores
	2005-06	**2004-05**
Sales & Operating Income	*691.97*	*497.59*
Operating Profits (PBDIT)	120.10	81.79
Less Depreciation	23.66	18.18
Less Net Interest Expense	5.46	2.74
Profit Before Tax & Exceptional Items	90.98	60.87
Less Exceptional Items	8.06	—
Less Net Income Tax Expense	17.09	7.95
Net Profit for the Period	65.83	52.92
Balance brought forward from Last Year	38.67	39.05
Distributable Profits	104.50	91.97
Appropriated as under:		
Transfer to General Reserve	32.00	34.00
Proposed Equity Dividend	21.15	16.92
Tax on Distributed Profits	2.97	2.38
Balance Carried Forward	48.38	38.67

The Management Discussion and Analysis, giving a detailed analysis of performance for the year, has been included in the Annual Report.

During the year, equity shares of the Company of face value Rs.10 each were sub-divided into two new equity shares of Rs.5 each and bonus shares were issued on post-split basis in the ratio of one bonus share for every existing share held.

The Board has recommended a dividend of Rs.2.50 per equity share on the expanded capital post issuance of bonus shares (50 % on fully paid up face value of Rs.5) (previous year Rs.8 per equity share, 80% on fully paid up face value of Rs.10), amounting to Rs.21.15 crores (previous year Rs. 16.92 crores). The tax on distributed profits payable on this dividend is Rs.2.97 crores (previous year Rs.2.38 crores) making the aggregate distribution Rs.24.12 crores (previous year Rs.19.30 crores). The distributed profits are 37% (previous year 36%) of the net profits for the year. The proposed dividend would be tax free in the hands of the shareholders.

DIRECTORS' RESPONSIBILITY STATEMENT

In terms of Section 217 (2AA) of the Companies Act, 1956, in relation to financial statements for the year 2005-06, the Board of Directors state that:

i the applicable accounting standards have been followed in preparation of the financial statements and there are no material departures from the said standards;

ii reasonable and prudent accounting policies have been used in preparation of the financial statements, that they have been consistently applied and that reasonable and prudent judgments and estimates have been made in respect of items not concluded by the year end, so as to give a true and fair view of the state of affairs of the Company as at 31-Mar-06 and of the profit for the year ended 31-Mar-06;

iii proper and sufficient care has been taken for maintenance of adequate accounting records in accordance with the provisions of the Companies Act, 1956, for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities;

iv the financial statements have been prepared on a going concern basis.

CAPITAL AND BORROWINGS

During the year, the Company split the face value of its equity shares from Rs. 10 to Rs. 5 and also issued bonus equity shares in the ratio of 1 bonus share for every share on a post-split basis by way of capitalization from Capital Redemption Reserve. The paid up share capital of the Company increased from Rs.21.15 crores to Rs. 42.31 crores as at 31-Mar-06 on account of the same. The Net worth stands at Rs. 382.52 crores as at 31-Mar-06 resulting in increase of Rs.41.71 crores on account of retained earnings. During the year, the Company increased contracted term loans (both in rupee and foreign currency) to Rs. 280.09 crores (previous year Rs. 193.75 crores) with banks / financial institution of which Rs. 244.08 crores (previous year Rs.181.25 crores) was drawn as on 31-Mar-06.

The capital expenditure programme of Company mainly comprising of formulation manufacturing facility at Baddi, API upgradation and expansion project at Indrad, (both completed during the year), expansion of research & development (under execution) and other maintenance capital expenditure were funded mainly from the term loans and internal accruals.

The Company had cash and bank balances and current investments aggregating Rs. 60.96 crores as on 31-Mar-06, representing term loans drawn pending utilization for capital expenditure and surplus internal accruals. The Company has sufficient financial flexibility, in terms of available liquid funds and committed facilities from banks / financial institution to finance the future growth plans and capitalize on emerging opportunities.

DOMESTIC BRANDED FORMULATIONS

The year 2005-06 saw the domestic pharmaceutical market growing at a healthy rate of 15.4%, shrugging off the low growth witnessed in the last three financial years. The year started on a positive note for our India business with the recovery of sales lost in February and March of 2005 on account of implementation of VAT from April 2005. The tone continued to be upbeat with sales growth recorded by your Company being higher than the market growth.

Turnover

The net turnover for the year was Rs. 392.10 crores, registering a growth of 35% over the previous year. This growth rate was largely due to buoyant performance of the Neurology, Psychiatry and Anti Infective portfolio, field force expansion and improved doctor coverage, recoupment of sales deferred from the previous year on account of VAT implementation and new introductions made during the year. Twenty Seven brands (as compared to Twenty in the previous year) of the Company enjoyed leadership positions in the respective molecule segments and top 10 brands contributed to 47% of the total domestic formulation sales as against 54% during previous year.

The year had its share of setbacks through the regulatory-led worldwide withdrawal of rofecoxib (impacting our brand Torrox during 04-05) followed by valdecoxib (impacting our brand Valz) announced in the current year. The Company has been successful to large extent to recoup the sales loss by replacing these brands with few brands newly launched during the year. Other adverse development impacting the sales was significant regulatory price cuts announced by

NPPA for few key brands of the Company. The impact due to these were blunted to large extent through volume increase in these brands.

New Products

New products have been a consistent growth driver of the market. The year witnessed introduction of a slew of new molecules and new combinations of existing products. The Company continued its prominent position in various segments by introducing new molecules and also line extensions of existing brands. During the year, 43 (as compared to 22 in the previous year) new products (including line extensions) were brought to the market.

The Company achieved significant market share in some of the products launched during the last two years and realized incremental sales from new products introduced during the year, contributing significantly to higher sales growth achieved during the year. The Company will continue its focus on strengthening existing therapies through new product introductions as also expand into new therapies.

Sales Operations

During the year, the Company in order to tap increasing business opportunities in CNS segment launched new divisions AXON and NEURON and expanded its field force. The Company also launched a new division 'PSYCAN AZUCA' in April-06 to exclusively cater to the needs of the significant and growing diabetes population in the country. With this the Company has put in place an extensive and effective marketing network comprising of 8 marketing divisions with expanded field force across the country enabling faster introduction of new products and improved market penetration.

Price Regulation

The price control regime continues to be governed by Drug Price Control Order, 1995. During the year, NPPA brought some of the products of Company under price control. On account of this, the proportion of sales under price control has increased from 11% in the last year to about 15% in the current year.

INTERNATIONAL OPERATIONS

International generic opportunity is the future growth engine. The opportunity in this market segment is expanding due to many blockbuster drugs going out of patent protection over next few years. An added factor is the mounting health care costs in developed markets, which is paving way for a more favourable regulatory regime for generics in such countries. Generics now get faster approvals and are actively encouraged by the governments. Over the last few years, the Company has developed a strategy and built infrastructure and capabilities focused on tapping this lucrative opportunity. The manufacturing facilities are upgraded to meet stringent quality assurance standards of the highly regulated developed countries; at the same time maintaining the competitive cost advantage. Torrent Research Center (TRC), the research & development facility, is upgraded to develop international generic versions of selected molecules in the required time frame and prepare the necessary regulatory dossiers for obtaining timely marketing approval in regulated markets. Going forward these processes will be further strengthened to sustain the growth.

Within the above-mentioned overall strategy, the current international operations are focused on five thrust areas: Brazil & Latin America, Russia & CIS countries, Europe, North America and Rest of the World comprising of less regulated countries of Africa and Asia.

In Latin America, the Company operates through its subsidiaries, Torrent do Brasil Ltda., Brasil (TDBL) and Laboratorios Torrent SA de CV, Mexico. TDBL has launched 20 products and has shown substantial growth in the sales during the year. Besides successfully launching its product basket in the North / North Eastern region, it has also doubled its Sales Force in the other regions so as to increase doctor coverage. Also refer to the section on "Torrent do Brasil Ltda" in this report.

Laboratorios Torrent SA de CV was incorporated in March-06 to enable the Company to seek registrations of its products in Mexico and subsequently launch a basket of products in the cardiovascular, central nervous system and oral anti-diabetes area. Activities for setting-up operations on the lines similar to that in Brazil commenced and the Company expects to commercialise 10-12 products by the middle of 2007. The Company hopes to benefit by leveraging product development costs incurred by replicating the existing product portfolio of Brazil market.

The performance in the Russia market (including the CIS countries) showed a quantum jump during the year. While past investments in sales promotion and establishment of effective marketing organization paid dividends in Russia, entry into other CIS countries like Ukraine and Kazakhstan also bolstered the sales. Further plans to sustain this growth for the current year from the existing basket of 15 products and 4 new product introductions planned during the year are already in effect. Also refer the section on "ZAO Torrent Pharma" in this report.

During the year, the Company acquired Heumann Pharma GmbH & Co Generica KG (Heumann) of Germany for a cash consideration of euro 3.31 million (Rs.17.20 crores). Heumann, is engaged in the business of marketing generic medicines in Germany under the brand name "Heumann", had last reported revenues of euro 50.07 million and is ranked 11th in the German generic market.

This acquisition has given access to the 90-year-old "Heumann" brand name, over 300 marketing authorizations and 30 product registration applications, together giving the Company a strong presence in Germany. Heumann's product portfolio provides good strategic fit and strong market position to Company with cardiovascular, gastro-intestinal and anti infective therapies constituting around 75% of the portfolio. Post-acquisition integration efforts revolve around improving the sales productivity, shifting the production to low cost facilities in India and linking the product pipeline for regulated markets with Heumann. The Company hopes to achieve break even in Heumann operations in the year 2007-08. Also refer to the section on "Heumann Pharma GmbH & Co Generica KG" (Heumann), in this report.

Torrent Pharma GmbH (TPG), Germany, is engaged primarily in business development and sales of product dossiers in Europe, followed by product supplies by Company directly to customers. The total revenue for product supplies touched Rs. 47.58 crores during the year. This was primarily achieved by enabling customers to launch 2 products on day 1 of patent expiry in major markets of Western Europe. TPG has executed 21 additional product dossier licensing agreements during the year. TPG added 10 new customers during the year thus increasing its penetration in European market, laying strong platform for future growth.

The Company has developed 3 new products during the year, one of them a unique off-patent product with no generic competition in West Europe. Additionally 18 new products are under various stages of development. Also refer to the section on "Torrent Pharma GmbH" in this report.

Torrent Pharma Inc. (TPI), the subsidiary in USA, is engaged in business development activities for North America, the world's largest market for generic pharmaceuticals. During the year, the Company has filed with US FDA 4 abbreviated new drug applications (ANDAs) and 3 drug master files (DMFs). Company proposes to submit 8 ANDAs and 3 DMFs in coming year. Company continues to commit significant resources to carry out product development work to build strong product basket for the US market. Also refer to the section on "Torrent Pharma Inc." in this report.

Sales and operating revenues at consolidated level in Rest of World (ROW) territory, comprising of Asian & African countries increased by 28%, from Rs. 40.50 crores to Rs. 51.67 crores during the year. The strategy of shifting from distributor driven to marketing based business model in select countries with focus on niche therapeutic areas has led to significant growth in the business of the existing major markets like Sri Lanka, Vietnam, Myanmar, Yemen and Zimbabwe. Efforts have been initiated to enter the more stringent markets like Australia, South Africa, Indonesia, UAE, Singapore & Malaysia, by utilizing the product portfolio of the Europe & US and thereby leverage the product development costs. The Company has utilized customized business models to cater to each of these strategic markets specifically like setting up of subsidiary Torrent Australasia Pty Ltd (TAPL) in Australia. TAPL was incorporated in December 2005 as a wholly owned subsidiary in Australia, with the objective of business development in the growing generics market of Australia. There were no operations in the subsidiary for the year.

Torrent Pharma Philippines Inc. (TPPI), the subsidiary of TPL in Philippines became operational with product portfolio, field staff and requisite activities in line to gear up sales. Also, refer to the section "Torrent Pharma Philippines Inc." in this report.

Torrent Pharma Japan Co. Ltd., was incorporated in April 2006 as a wholly owned subsidiary in Japan, to cover the generic market in the country effectively for future business prospects.

The progress done by Company in various markets such as Brazil, Russia, Europe and ROW provides a strong basis to make substantial investments to penetrate pan European markets and commence operations in USA. The Company is well poised to leverage its technical capabilities, strong manufacturing and R&D infrastructure, geographical reach to further improve its position in terms of exports in the coming years. The consolidated net sales of international operations increased from Rs. 130.14 crores to Rs. 418.96 crores, registering a strong growth of 222%. The international marketing initiatives including acquisition of Heumann, well complemented by the R&D and manufacturing capabilities, are expected to further propel the Company towards recognition as an important player in global generics business.

MANUFACTURING

During the financial year 2005-06, the Company has successfully completed capacity expansion and consolidation of bulk drug plant at manufacturing unit in Indrad.

Upon commencement of commercial production at new manufacturing unit at Baddi, Himachal Pradesh, production of over 90% domestic products has been successfully transferred to the new unit. Indrad manufacturing unit would now cater primarily to export markets. Company has commenced the process of transferring manufacturing of products of Heumann, its newly acquired wholly owned subsidiary in Germany, to its manufacturing unit at Indrad.

Your Company has entered into an agreement with Novo Nordisk India Pvt Ltd (a wholly owned subsidiary of Novo Nordisk A/S, Denmark) to extend existing contract manufacturing arrangement for manufacture of Human Insulin formulations.

RESEARCH AND DEVELOPMENT

The research collaboration agreement with AstraZeneca signed in February 2005 aimed at discovering a novel drug candidate for the treatment of hypertension has been progressing well and meeting its deliverables on time.

In July 2004, your Company had entered into licensing agreement with Novartis for its AGE-Breaker Compound (AGE Program). However during the year, Torrent and Novartis agreed to terminate the agreement. Torrent believes that its AGE Program has attractive development potential in CHF and certain long-term complications arising out of AGE formation. Accordingly Torrent intends to pursue the clinical development of the AGE Program in near future.

Your Company has been adopting and updating new and latest technologies for research processes. This has enabled the Company to create a discovery pipeline based on multiple biological targets and also work on collaborative research projects with multinational Pharmaceutical companies. Currently, the Company is working on 6 in-house NCE projects –within the areas of Diabetes and its related complications, obesity and cardiovascular disorders. The Company has cumulatively filed 219 patents for NCEs from these and earlier projects in all major markets. The patent offices of USA, Japan, Europe, Czech Republic, Australia, Brazil, Mexico, Argentina, China, Hong Kong, Russia and India have granted/accepted 123 patents so far. The Company intends to pursue suitable partnership opportunities with international drug companies at an appropriate stage to share the risks and resources required to take New Chemical Entities to the commercial stage.

New product development capabilities for international generic markets mainly for Europe and USA continued at much accelerated pace. Significant investments are being made to expand existing R&D infrastructure and strength of scientific staff has been increased to 538. Thus, your Company is gearing up very rapidly for developing and getting marketing approvals for large number of products in these developed markets. The R&D activities are expected to provide the necessary impetus to the Company's plans for introduction of many new products in the domestic market as well, in the year 2006-07 and thereafter.

During the year, the total revenue expenditure on R&D was 8.15% (previous year 10.20%) of sales and operating income.

INFORMATION TECHNOLOGY (IT)

FY 2005-06 was the year of IT collaboration, consolidation and extension to bring the higher value for our business. Field Force Management System was integrated with existing ERP System. ERP system was also extended to operation of new plant at Baddi, H.P., and Heumann, newly acquired subsidiary at Germany. The year ahead, concentration would be on more robust IT security, Disaster Recovery plan and service oriented architecture.

SUBSIDIARIES

ZAO Torrent Pharma (ZAO TP), Russia

ZAO Torrent Pharma, the wholly owned subsidiary of the Company in Russia, is essentially an importing and distributing company, sourcing its entire requirement from the Company. For the year 2005-06, ZAO TP achieved revenue of RRU 182.64 million (Rs. 28.49 crores), an increase of 245 % from RRU 52.51million (Rs.8.27 crores) for the previous year.

Net loss after tax for the year was lower at RRU 5.83 million (Rs. 1.06 crores) as against a net loss after tax of RRU 8.63 million (Rs.1.41 crores) for the previous year. The reduction in loss reflects improved productivity of marketing spend on the back of higher sales growth achieved during the year. At consolidated level, for the year 2005-06, the Russia & CIS operations of the Company registered sales of Rs. 37.66 crores (previous year Rs.13.04 crores) and loss before tax of Rs. 3.27 crores (previous year Loss before tax of Rs. 11.21 crores)

Torrent Pharma GmbH (TPG), Germany

During the year, TPG earned revenues of Euro 1.01 million (Rs. 5.45 crores) as compared to Euro 1.09 million (Rs.6.22 crores) for the previous year. Net loss for the year was at EURO 0.77 million (Rs. 3.70 crores) as against a net profit of EURO 0.05 million (Rs.0.35 crores) for the previous year. The loss was primarily on account of increase in product registration expenses incurred in Germany. At a consolidated level, for the year 2005-06, the European operations (other than Heumann) earned a revenue of Rs. 55.78 crores as against revenue in the previous year of Rs. 27.67 crores. Net Profit before Tax for the year was Rs. 12.75 crores (previous year profit before tax was Rs.2.34 crores).

Heumann Pharma GmbH & Co Generica KG (Heumann), Germany

Heumann posted revenues of 33.42 million Euros (Rs 178.96 crores) for the nine months ended 31-Mar-06, post acquisition. During the year Heumann focused on revenue growth by day one product launches, sharper doctor / pharmacy focus and product rationalisation. Shifting of manufacturing to its low cost manufacturing facilities in India is under way and benefits are expected in the coming year. At a consolidated level, for the year 2005-06, Heumann earned a revenue of Rs. 168.64 crores and posted loss before tax of Rs. 4.59 crores.

Torrent Do Brasil Ltda. (TDBL), Brazil

TDBL achieved revenue of R$ 60.16 million (Rs.116.12 crores), as compared to R$ 37.72 million (Rs.59.62 crores) in the previous year. The drivers of sales growth include expansion of geographical reach as also increasing its sales force in the existing geographical areas to improve doctor coverage on the back of robust product pipeline.

TDBL earned a net profit after tax of R$ 1.54 million (Rs. 5.23 crores), as compared to a net loss after tax of R$ 2.14 million (Rs.2.29 crores) in the previous year. At a consolidated level, for the year 2005-06, TDBL earned a revenue of Rs. 117.72 crores (previous year Rs. 60.48 crores) and made a net loss before tax of Rs. 1.38 crores (previous year loss before tax of Rs. 4.50 crores).

Torrent Pharma Inc. (TPI), USA

TPI was incorporated in FY 2003-04 as a wholly owned subsidiary in the US, with the objective of business development in the large, growing North American generic market. As on 31-Mar-06, the Company has invested USD 100,000 as capital in the subsidiary. On a consolidated basis, the US operations made a net loss before tax of Rs. 18.22 crores (previous year loss before tax of Rs.14.16 crores). This is mainly on account of product development expenses incurred during the year for launching products in US market.

Torrent Pharma Philippines Inc. (TPPI), Philippines

TPPI has achieved a revenue of peso 27.68 million (Rs. 2.27 crores) in first full year of operation. The year witnessed building up a strong corporate image backed by a good product pipeline and promotional set up in the country. At a consolidated level, for the year 2005-06, TPPI earned revenue of Rs. 2.75 crores as against revenue in the previous year of Rs. 1.16 crores. Net Profit before Tax for the year was Rs. 0.78 crores (previous year loss before tax of Rs. 0.10 crores). As on 31-Mar-06, the Company has invested peso 11.17 million (Rs. 92 lacs) as capital in the subsidiary and given a loan of peso 10.35 million (Rs.89.22 Lacs).

Consolidated Numbers

The consolidated sales of the Company and its subsidiaries were Rs. 936.74 crores for 2005-06 (previous year Rs. 516.33 crores). The share of sales outside India has gone up to 45 % for the year which was 25% in the previous year. The consolidated net profit was Rs. 50.86 crores (previous year Rs. 48.76 crores). The consolidated profit was less than the stand-alone profit of the Company mainly due to unrealised profits in inventories supplied to subsidiaries and losses in subsidiaries.