Torrent Pharmaceuticals Limited

31st annual report 2003-04

Growth. Growth.

Bamboo is known for its phenomenal growth, that too in amazingly quick time.

We too believe in exponential growth. This year we are ready for the big leap, with focus on growth in all areas.

This includes R&D, Manufacturing, Marketing & Sales and International Operations.

Be prepared for the big leap.

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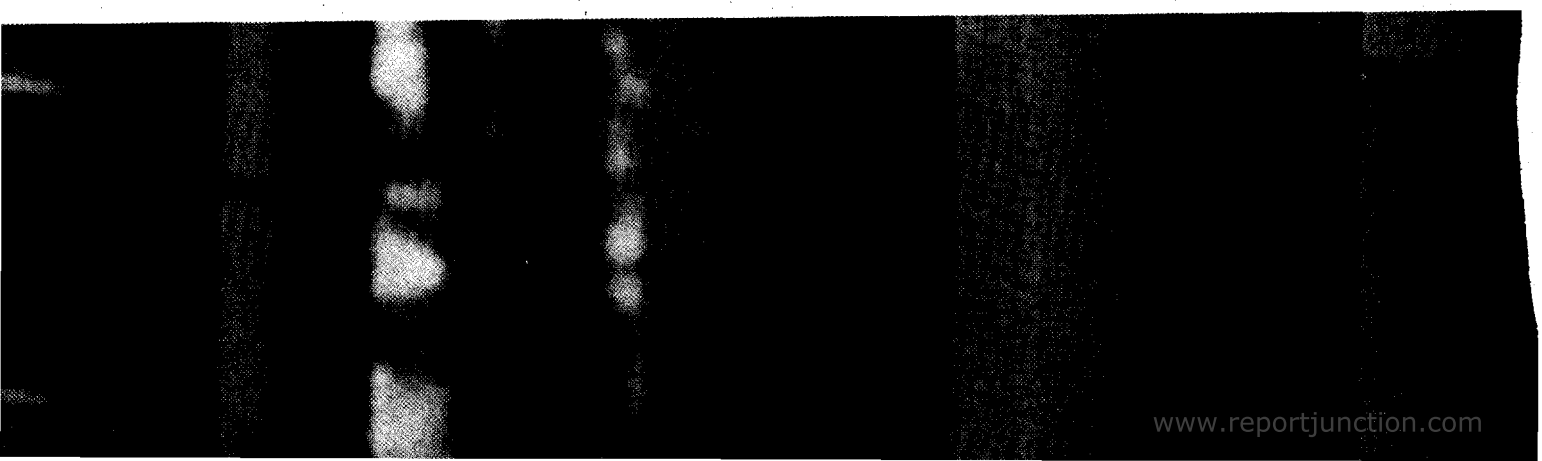


Corporate Information

Directors

Sudhir Mehta
Executive Chairman

Kiran Karnik

S. H. Bhojani

Dr. Prasanna Chandra

Mihir Thakore

Sanjay Lalbhai

Markand Bhatt

Dr. C. Dutt
Director (Research & Development)

Samir Mehta
Managing Director

Audit committee

Kiran Karnik
Chairman

S. H. Bhojani

Dr. Prasanna Chandra

Mihir Thakore

Securities Transfer & Investors' Grievance Committee

Markand Bhatt
Chairman

Samir Mehta

Dr. C. Dutt

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

Village Indrad, Taluka Kadi,
Dist. Mehsana
Telephone: 02764-233671
Fax: 02764-233676

Baddi Formulation Project Site

Village Bhud Makhnu Majra,
Tehsil Nalagarh,
District Solan (Himachal Pradesh)

R & D Facility

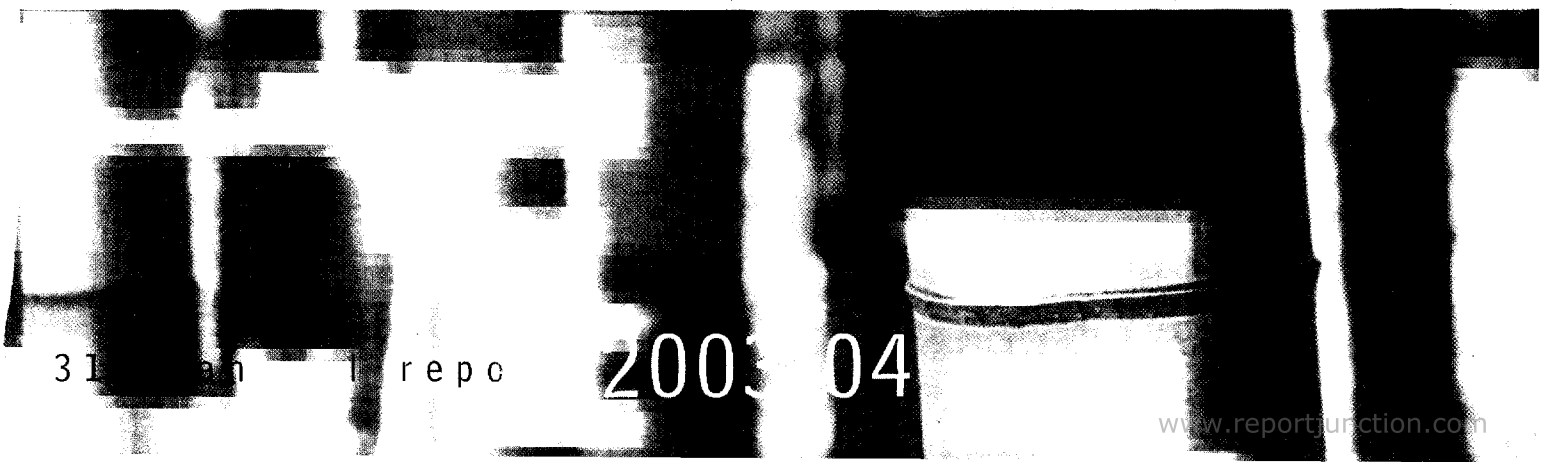
Torrent Research Centre,
Near Kanoria Hospital,
Village Bhat, District Gandhinagar,
Telephone: 079-23969100
Fax: 079-23969135

Website

www.torrentpharma.com

Registrars & Transfer Agents

MCS Limited,
101, Subh Shatdal Complex,
Opp. Bata Show Room,
Ashram Road,
Ahmedabad 380 009
Telephone: 079-26582878
Fax: 079-26584027



Directors' Report

To The Shareholders

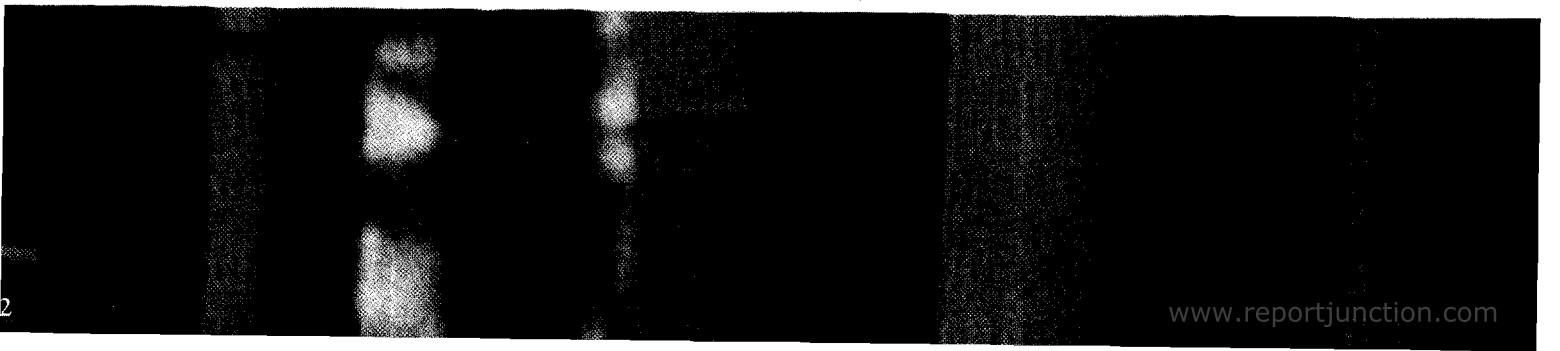
The Directors have the pleasure of presenting the Thirty First Annual Report of your Company for the Financial Year 2003-04.

FINANCIAL RESULTS, DIVIDEND AND ACCOUNTS

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

Rs. in lacs

	2003-04	2002-03
Sales & Operating Income	46059	38055
Operating Profits (PBDIT)	10642	8658
Less Depreciation	1569	1495
Net Interest Income	24	153
Profit Before Tax & Exceptional Items	9097	7316
Less Exceptional items	160	—
Less Net income tax expense	2519	2139
Net Profit for the period	6417	5177
Balance brought forward from last year	6197	3447
Distributable profits	12614	8625
Appropriated as under:		
Transfer to General Reserve	6800	518
Proposed equity dividend	1692	1693
Tax on distributed profits	217	217
Balance carried forward	3905	6197



During the year 15% Secured Redeemable Non-convertible Debentures were fully redeemed as per the terms of the issue and Debenture Redemption Reserve of Rs. 400 lacs was transferred to General Reserve account, being no longer required due to the said redemption. The Managements' Discussion and Analysis, giving a detailed analysis of performance for the year, has been included in the Annual Report. The Board has recommended a dividend of Rs.8 per equity share (80% on fully paid up face value of Rs.10) (previous year Rs.8 per equity share, 80% on fully paid up face value of Rs.10), amounting to Rs.1692 lacs. The tax on distributed profits payable on this dividend is Rs.217 lacs making the aggregate distribution Rs.1909 lacs (previous year Rs.1910 lacs). The distributed profits are 30% (previous year 37%) 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 2003-04, 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 except for the changes in accounting policies mentioned in note no. 1(a), (b) & (c) of Schedule 22 "Notes Forming Part of the accounts" annexed to the financial statements for the year 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-2004 and of the profit for the year ended 31-Mar-2004;

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

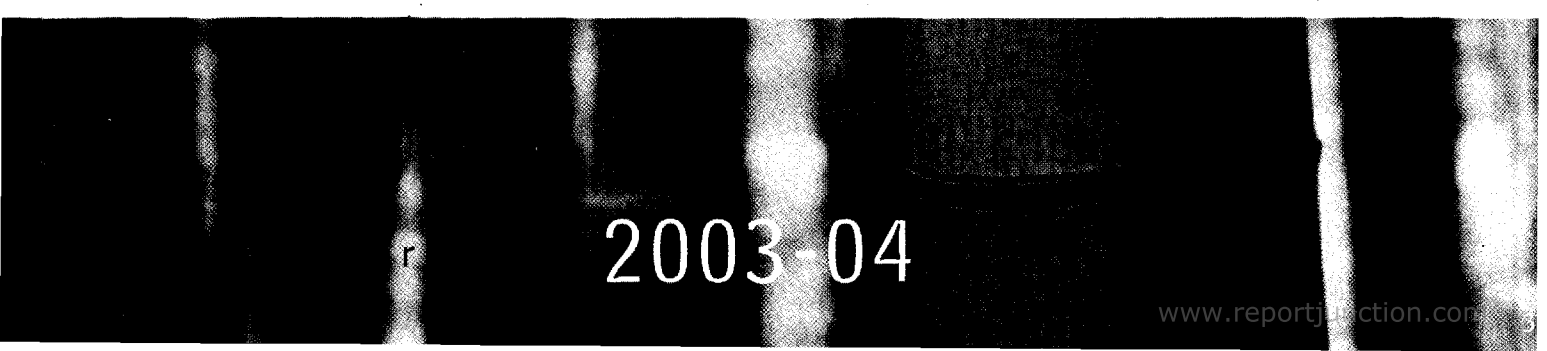
During the year the Company forfeited 7000 equity shares of Rs.10 each on which Rs.5 was paid up, after following the procedure laid down by the law. The forfeited shares were issued as part of the initial public offering made by the Company in 1994.

The Company redeemed long-term debt of Rs.400 lacs which became liable for redemption during the year under reference. There is no outstanding working capital borrowing and short-term debt as on 31-Mar-2004. With this the Company is debt free and as at the end of the year had surplus funds of about Rs.31 crores. The Company has sufficient financial flexibility to raise new debt to finance the future growth plans and capitalize on emerging opportunities.

DOMESTIC BRANDED FORMULATIONS

Domestic branded formulations are the key revenue generator for the Company. During the year the Company consolidated its strong position in the Cardiovascular, Central Nervous System, Gastro-intestinal, Oral Anti-diabetic and Pain Management segments. The annual growth of 19% was driven by growth in established brands, ramping sales of products launched in last two years and new introductions during the year for future growth.

The Company implemented a field force expansion towards the end of the year, which saw the strength of field force increasing to 1700 from 1142 last year. This was accompanied by further divisionalisation of marketing and sales activities by creation of a fifth division from earlier four divisions. These initiatives are expected to accelerate future growth through increase in doctors coverage, improved brand focus and increased capacity to introduce new products.



Improving the quality of sales operations was another thrust area for the year. Substantial improvements were achieved in areas of attrition and vacancy management, defined work norms, monitoring and control. There was increased emphasis on a comprehensive training cycle for the field force.

New Products

New products are a key to the growth strategy of pharma industry as a whole. With new therapies replacing existing ones, there is a need for the Company to keep pace with new product introductions. The year witnessed intense price competition in this segment and witnessed a slew of new combination products. The Company has well-established capabilities in early product development and continued its prominent position in the segment by introducing new molecules and also line extensions (combination products) of existing brands. During the year 25 new products (including line extensions) were brought to the market including Ecogat (Gatifloxacin), Modlip (Atorvastatin), Valz BCD (Valdecoxib), Nebicard (Nebivolol), Valzaar (Valsartan), Rozucor (Rosuvastatin), Arip (Aripiprazole) and Rivadem (Rivastigimine). Of the products launched during the last two years, Nexpro, Valz BCD, Veloz and Deplatt A performed very well during the last financial year and achieved significant market share gains. As in the past, new products will continue to be an important driver of the topline growth in the near term, although the competition will further intensify.

Turnover

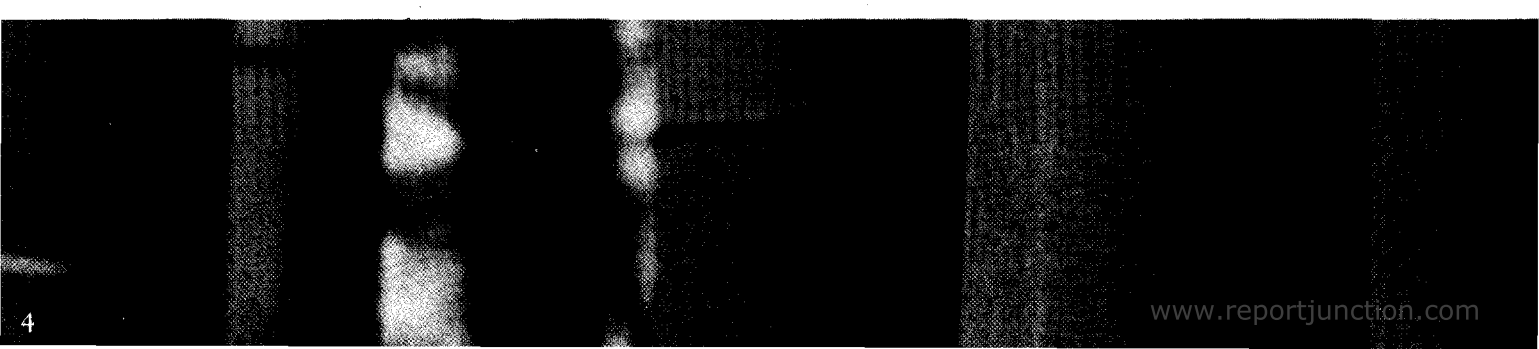
The turnover for the year was Rs.285 crores, registering a strong growth of 19% over the previous year. The strong sales performance during the year was contributed by structured brand promotions, pro-active pricing strategy and improved field force activity management. Spill over of sales from last financial year due to uncertainties relating to VAT also had a favourable impact on growth number. The growth of the Company as per ORG MARG industry data for March 2004 MAT was 10.1% compared with industry growth of 7.3%. The Company improved its turnover rank from 16th in previous year to 14th in the current year. Fifteen brands of the Company enjoyed leadership positions in the respective molecule segments and top 10 brands contributed to 55% of the total domestic formulation sales as against 56% during previous year.

Price Regulation

The Government's Pharmaceutical Policy 2002, inter alia, to replace the Drug Policy 1984, is still enmeshed in litigation. The price control regime continues to be governed by Drug Price Control Order, 1995. During the year, NPPA announced price reductions affecting 7 products of the Company, the impact of which on profit for the year was not significant. Over the years, due to introduction of products mainly in non-controlled segments, your Company has continuously seen the proportion of sales under price control falling down to current level of 13%. In view of the litigation over Pharmaceutical Policy 2002, the pricing regulatory environment for the industry, however, remains uncertain.

INTERNATIONAL OPERATIONS

International generic opportunity is the future growth engine. 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 introduced the 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 arm, 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. 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: Russia & CIS countries, Brazil & Latin America, Europe, North America and Rest of the World comprising of less regulated countries of Africa and Asia.

In Russia & CIS, the Company's Russian growth plans suffered a setback, consequent to a restructuring of the oganisational set-up, temporary disruption in sales due to streamlining of marketing policies and the products portfolio and delay in launch of key products. Nonetheless, the growth initiative in Russia was augmented by increasing the sales force, new product launches and promotional spend. Currently, the sales in Russia are through the Company's subsidiary ZAO Torrent Pharma and direct sales to distributors. Also refer the section on "ZAO Torrent Pharma" in this report.

In Brazil & Latin America, the Company operates through its subsidiary "Torrent do Brasil Ltda.", which commenced sales in 2002-03 with the current year being the first full year of operations. The Company has currently 14 products in the market and has been able to achieve significant ramp up in sales during the completed financial year. The subsidiary has plans to augment its business by expanding its field force, doctor coverage, territorial coverage and distribution coverage. This is fully supported by a robust pipe line of new products. Also refer to the section on "Torrent do Brasil Ltda." in this report.

On the European generics front, the Company's subsidiary, Torrent Pharma GmbH, set up in 2002-03, has further consolidated its operational set-up and business during the year. The subsidiary was successful in entering into nine dossier licensing agreements during the year. The Company has six supply tie-up agreements for its products and expects revenue streams from generics business in the regulated markets of Europe from 2005-06 onwards on expiry of key patents.. Also refer to the section on "Torrent Pharma GmbH" in this report. The Company is also simultaneously exploring avenues for entry into the branded generics segment either by establishing its own marketing set-up or through the acquisition route.

In the lesser regulated markets, the Company continued its strategy of deeper penetration into select markets by augmenting its product basket and sales force. The year gone-by witnessed further in-roads into a number of Asian countries, including Philippines, Myanmar and Vietnam. To secure a longer term and more qualitative growth, the teams focusing on Africa and Asia are also targeting entry into the neighbouring regulated markets such as South Africa and Saudi Arabia.

During the year, the Company set up a wholly owned subsidiary Torrent Pharma Inc. in USA. This subsidiary is engaged in business development activities for North America, the world's largest and most profitable market for generic pharmaceuticals. During the year the Company started the process of building its product pipeline by commencing product development work on 9 products. The Company expects to submit its first abbreviated new drug application (ANDA) with US FDA during 2004-05. Also refer to the section on "Torrent Pharma Inc." in this report.

With the above new forays, the Company has now entered into an exciting growth phase. The Company is well set to leverage its technical capabilities, cost advantages and geographical reach to provide a quantum jump to exports in the coming years. The consolidated sales of international operations increased from Rs.4483 lacs to Rs.6683 lacs, registering a strong growth of 49%. The Company has made impressive advances on its international growth initiatives and has sustained the momentum. The progress includes regulatory approval of the Formulation and Bulk Drug manufacturing facilities for Europe and significant investments in Research and Development further elaborated hereafter. The international marketing initiatives, well complemented by the R&D and manufacturing capabilities, are expected to

propel the Company towards recognition as an important player in global generics business.

MANUFACTURING

The highlight of the manufacturing operations was the successful approval of Indrad plant by German regulatory authorities. This will help the Company's foray into the large and growing European generics market. Regulatory authorities from Columbia and South Africa also inspected the Indrad plant during year and granted approval for their respective markets.

To support the entry into highly regulated markets of Europe and North America, the Company has embarked upon further expansion of the bulk drug plant capacity. In addition, a process development laboratory will also be constructed to undertake continuous process improvements and cost management – a sine qua non to compete in international market place. This capacity enhancement and consolidation is scheduled to be completed in 2004-05 at an estimated cost of Rs.24 crores.

The Company has ambitious plans to enter the vast and profitable US generics market and to that intent Indrad formulation and bulk drug plants were prepared for approval by the US FDA. The Company expects to obtain the crucial approval during 2004-05.

To meet increased demand for its products arising from international expansion and domestic growth, the Company plans to build a new formulations manufacturing facility at Baddi, Himachal Pradesh, about 45 km from Chandigarh. The proposed facility will have capability to manufacture tablets, capsules and oral liquids. It will also have segregated manufacturing facilities for betalactam products. The new plant will increase the formulations manufacturing capacity by nearly 30 crore tablets per month, in addition to capacities for other products such as capsules and oral liquids. The Company will enjoy significant fiscal benefits in form of exemption from excise duty and income-tax for production out of this facility. The Company has acquired the required land for the facility and construction work will begin in early 2004-05. The formulations plant is expected to commence commercial operations in the second quarter of 2005-06, and is expected to cost Rs.129 crores.

For the fourth consecutive year, the Indrad plant received Quality Excellence Gold Award for formulations section and for the first time Gold Award for bulk drug section from Indian Drug Manufacturers' Association. The Indrad plant received a four star safety award from British Safety Council, UK, in addition to the ISO 14001:1996, and the OHSAS 18001:1999 safety compliances reported last year.

RESEARCH AND DEVELOPMENT

In the previous year's Directors' Report we had mentioned that the Company reached an agreement with Novartis Pharma AG, Switzerland ("Novartis") granting an option for global rights to its early stage Advanced Glycosylation End products ("AGE") Breaker compounds. During the year, the Company completed the research activities for one of the indications and presented the results to Novartis. Your Company and Novartis are currently reviewing the data with a view to take it forward.

Over the years, your Company has developed considerable capabilities in conceiving, running and managing discovery research projects. There have been continuous efforts to improve productivity of research processes by bringing in newer technologies and skill sets. During the year, several new technologies for increasing the throughput of the discovery research processes were adopted: use of Automated Liquid Handling System for increasing screening throughput; use of Microwave Synthesizer, Flash Purification System and Redley's 12-Pot Reaction System for improving synthesis throughput and quality. During the year, the efforts were also focused on consolidating the discovery portfolio keeping in line the Company's strategy to remain focused in thrust therapeutic areas that have good commercial potential, require common