

DR REDDYS LABORATORIES LTD

Form 20-F

October 02, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 20-F**

**o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
OR**

**þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the Fiscal Year Ended March 31, 2006  
OR**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
OR**

**o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
Date of event requiring this shell company report \_\_\_\_\_  
Commission File Number: 1-15182  
DR. REDDY S LABORATORIES LIMITED  
(Exact name of Registrant as specified in its charter)**

**Not Applicable**  
(Translation of Registrant's name  
into English)

**ANDHRA PRADESH, INDIA**  
(Jurisdiction of incorporation or  
organization)

**7-1-27, Ameerpet  
Hyderabad, Andhra Pradesh 500 016, India  
+91-40-23731946**

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

<b>Title of Each Class</b>	<b>Name of Each Exchange on which Registered</b>
<b>American depositary shares, each representing one equity share</b>	<b>New York Stock Exchange</b>

**Equity Shares\***

**New York Stock Exchange**

**\*Not for trading, but only in connection with the registration of American depositary shares, pursuant to the requirements of the Securities and Exchange Commission.**

Securities registered or to be registered pursuant to Section 12(g) of the Act. None.

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. None.

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

**76,694,570 Equity Shares**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☒ No ☐

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes ☐ No ☒

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Act of 1934. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ☐ Item 18 ☒

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Yes ☐ No ☒

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**Currency of Presentation and Certain Defined Terms**

In this annual report on Form 20-F, references to \$ or U.S.\$ or dollars or U.S. dollars are to the legal currency of the United States and references to Rs. or rupees or Indian rupees are to the legal currency of India. Our financial statements are presented in Indian rupees and translated into U.S. dollars and are prepared in accordance with United States Generally Accepted Accounting Principles ( U.S. GAAP ). References to Indian GAAP are to Indian Generally Accepted Accounting Principles. References to a particular fiscal year are to our fiscal year ended March 31 of such year. References to our ADSs are to our American Depositary Shares.

References to U.S. or United States are to the United States of America, its territories and its possessions. References to India are to the Republic of India. All references to we, us, our, DRL, Dr.Reddy s or the Company mean Dr. Reddy s Laboratories Limited and its subsidiaries. Dr. Reddy s is a registered trademark of Dr. Reddy s Laboratories Limited in India. Other trademarks or trade names used in this annual report on Form 20-F are trademarks registered in the name of Dr. Reddy s Laboratories Limited or are pending before the respective trademark registries.

Except as otherwise stated in this report, all translations from Indian rupees to U.S. dollars are based on the noon buying rate in the City of New York on March 31, 2006 for cable transfers in Indian rupees as certified for customs purposes by the Federal Reserve Bank of New York, which was Rs.44.48 per U.S.\$1.00. No representation is made that the Indian rupee amounts have been, could have been or could be converted into U.S. dollars at such a rate or any other rate. As of September 28, 2006, that rate was Rs.45.78 per U.S.\$1.00.

Any discrepancies in any table between totals and sums of the amounts listed are due to rounding.

Information contained in our website, [www.drreddys.com](http://www.drreddys.com), is not part of this Annual Report and no portion of such information is incorporated herein.

**Forward-looking and Cautionary Statement**

IN ADDITION TO HISTORICAL INFORMATION, THIS ANNUAL REPORT CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED (THE EXCHANGE ACT ). THE FORWARD-LOOKING STATEMENTS CONTAINED HEREIN ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE REFLECTED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN THE SECTIONS ENTITLED RISK FACTORS AND OPERATING AND FINANCIAL REVIEW AND PROSPECTS AND ELSEWHERE IN THIS REPORT. READERS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS, WHICH REFLECT MANAGEMENT S ANALYSIS ONLY AS OF THE DATE HEREOF. IN ADDITION, READERS SHOULD CAREFULLY REVIEW THE OTHER INFORMATION IN THIS ANNUAL REPORT AND IN OUR PERIODIC REPORTS AND OTHER DOCUMENTS FILED AND/OR FURNISHED WITH THE SECURITIES AND EXCHANGE COMMISSION ( SEC ) FROM TIME TO TIME.

**Table of Contents****PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****3.A. Selected financial data**

The selected consolidated financial data should be read in conjunction with the consolidated financial statements, the related notes and operating and financial review and prospects, which are included elsewhere in this annual report. The selected consolidated statements of income data for the five years ended March 31, 2006 and selected consolidated balance sheet data as of March 31, 2002, 2003, 2004, 2005 and 2006 which have been prepared and presented in accordance with U.S. GAAP and have been derived from our audited consolidated financial statements and related notes except for cash dividend per share. The selected consolidated financial data presented below for fiscal year 2006 reflects the acquisition of Industrias Quimicas Falcon de Mexico effective December 30, 2005 and beta Holding GmbH effective March 3, 2006 and therefore the results for fiscal year 2006 are not comparable to the results for prior fiscal years.

	Fiscal Year Ended March 31,					
	2002**	2003**	2004	2005	2006	
	(Rs. in millions, U.S.\$ in thousands, except share and per share data)					
						Convenience translation into U.S.\$ (unaudited)
Income Statement Data:						
Product sales	Rs.16,408.8	Rs.18,069.8	Rs.20,081.2	Rs.19,126.2	Rs.24,077.2	U.S.\$541,304
License fees	124.8			345.7	47.5	1,068
Services income	89.1	3.9	22.3	47.5	142.3	3,200
Total revenues	16,622.7	18,073.7	20,103.5	19,519.4	24,267.0	545,572
Cost of revenues	6,869.0	7,744.9	9,337.3	9,385.9	12,417.4	279,168
Gross profit	9,753.7	10,328.8	10,766.2	10,133.5	11,849.6	266,404
Operating expenses:						
Selling, general and administrative expenses	3,674.1	5,103.2	6,542.5	6,774.6	8,028.9	180,505
Research and development expenses, net	742.4	1,411.8	1,991.6	2,803.3	2,153.0	48,403
Amortization expenses	487.7	419.5	382.9	349.9	419.9	9,439
Foreign exchange (gain)/loss	(209.0)	70.1	(282.4)	488.8	126.3	2,840
Other operating (income) / expenses, net	27.1	0.2	83.2	6.0	(320.4)	(7,202)

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Total operating expenses	4,722.3	7,004.8	8,717.8	10,422.6	10,407.7	233,988
Operating income/(loss)	5,031.4	3,324.0	2,048.5	(289.1)	1,441.9	32,418
Equity in loss of affiliates	(130.5)	(92.1)	(44.4)	(58.1)	(88.2)	(1,984)
Other (expense) / income, net	181.6	576.8	535.9	454.2	533.6	11,997
Income before income taxes and minority interest	5,082.5	3,808.7	2,540.0	107.0	1,887.3	42,431
Income taxes (expense)/benefit	(153.8)	(398.1)	(69.2)	94.3	(258.3)	(5,809)
Minority interest	(14.9)	(6.7)	3.4	9.9	(0.1)	(2)
Net income	Rs.4,913.8	Rs.3,403.9	Rs.2,474.2	Rs.211.2	Rs.1,628.9	U.S.\$36,620
Earnings per equity share:						
Basic	Rs.64.63	Rs.44.49	Rs.32.34	Rs.2.76	Rs. 21.28	0.48
Diluted	Rs.64.53	Rs.44.49	Rs.32.32	Rs.2.76	Rs. 21.24	0.48
Weighted average number of equity shares used in computing earnings per equity share:*						
Basic***	76,027,565	76,515,948	76,513,764	76,518,949	76,546,658	76,546,658
Diluted***	76,149,568	76,515,948	76,549,598	76,559,801	76,701,923	76,701,923
Cash dividend per share (excluding dividend tax)	Rs.7.00	Rs.2.50	Rs.5.00	Rs.5.00	Rs.5.00	U.S.\$0.11

\* Each ADR represents one equity share.

\*\* Effective as of fiscal year 2003, we selected the retroactive modified method of adoption described in Statement of Financial Accounting Standards No. 148

*Accounting for  
Stock Based  
Compensation  
Transition and  
Disclosure.*

Accordingly,  
the operating  
results for the  
fiscal year  
ended  
March 31, 2002  
and 2003, which  
are the only  
prior periods  
impacted, have  
been modified  
in accordance  
with the  
retroactive  
modified  
method of  
adoption.



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The Company has reclassified certain expense/income for the fiscal years ended March 31, 2002, 2003, 2004 and 2005, between cost of revenues, operating expenses, revenues, other expense / income and other operating expense/income, to conform to the current year presentation. These reclassifications increased the previously reported gross profit of fiscal year 2002, 2003, 2004 and 2005 by Rs.Nil, Rs.106.6 million, Rs.31.1 million and Rs.47.4 million respectively and increased / (reduced) the previously reported operating income of fiscal years 2002, 2003 and 2004 by Rs.(27.1) million, Rs.106.4 million and Rs.(31.7) million respectively and reduced the operating loss for

the fiscal year 2005 by Rs.77.3 million. There is however no change in the previously reported net income for the fiscal years 2002, 2003, 2004 and 2005.

\*\*\* On August 30, 2006, we issued a stock dividend of one equity share for each equity share and ADR issued and outstanding as of August 29, 2006. The number of equity shares presented in the selected consolidated financial data do not reflect this stock dividend. Selected consolidated financial data on a unaudited pro forma basis, reflecting the impact of the stock dividend on the earning per share for the fiscal years ended March 31, 2002, 2003, 2004, 2005 and 2006 is as follows:

Fiscal Year Ended March 31,				
2002	2003	2004	2005	2006
(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
(Rs. in millions, U.S.\$ in thousands, except share and per share data)				

Convenience  
translation

Net income	Rs.4,913.8	Rs.3,403.9	Rs.2,474.2	Rs.211.2	Rs.1,628.9	into U.S.\$ U.S.\$36,620
Earnings per equity share:						
Basic	Rs.32.32	Rs.22.24	Rs.16.17	Rs.1.38	Rs. 10.64	0.24
Diluted	Rs.32.26	Rs.22.24	Rs.16.16	Rs.1.38	Rs. 10.62	0.24
Weighted average number of equity shares used in computing earnings per equity share:						
Basic	152,055,130	153,031,896	153,027,528	153,037,898	153,093,316	153,093,316
Diluted	152,299,136	153,031,896	153,099,196	153,119,602	153,403,846	153,403,846

**Fiscal Year Ended March 31,**  
**2002                      2003                      2004                      2005                      2006**  
**(Rs. in millions, U.S.\$ in thousands, except share and per share data)**

Convenience  
translation into  
U.S.\$(unaudited)

**Other Data:**

Net cash provided  
by / (used in):

Operating activities	Rs.4,652.8	Rs.4,366.7	Rs.3,999.2	Rs.2,291.6	Rs.1,643.1	U.S.\$36,941
Investing activities	(1,532.9)	(1,954.7)	(6,506.1)	632.9	(34,524.4)	(776,179)
Financing activities	1,421.8	(153)	(376.1)	1,931.3	27,210.9	611,757
Effect of exchange rate changes on cash	88.8	(95)	(14.2)	55.8	95.1	2,138
Expenditures on property, plant and equipment	(1,090.3)	(1,515.7)	(2,415.6)	(1,749.2)	(1,873.3)	(42,115)

**Balance Sheet****Data:**

Cash and cash equivalents	Rs.5,109.4	Rs.7,273.4	Rs.4,376.2	Rs.9,287.9	Rs.3,712.6	U.S.\$83,468
Working capital	9,518.6	2,023.5	11,103.3	10,770.9	1,345.1	30,242
Total assets	18,967.0	3,091.7	26,619.3	29,288.4	68,768.1	1,546,045
Total long-term debt, excluding current portion	47.0	40.91	31.0	25.1	20,937.1	470,709
Net assets	15,457.4	18,831.8	21,039.4	20,953.2	22,271.7	500,713
Total stockholders equity	15,457.4	18,831.8	21,039.4	20,953.2	22,271.7	500,713

**Exchange Rates**

The following table sets forth, for the fiscal years indicated, information concerning the number of Indian rupees for which one U.S. dollar could be exchanged based on the average of the noon buying rate in the City of New York on the last business day of each month during the period for cable transfers in Indian rupees as certified for customs

purposes by the Federal Reserve Bank of New York. The column titled **Average** in the table below is the average of the daily noon buying rate on the last business day of each month during the year.

**Fiscal Year Ended**

**March 31,**

**Period End**

**Average**

**High**

**Low**

2002	48.83	47.80	48.83	46.88
2003	47.53	48.43	49.07	47.53
2004	43.40	45.96	47.46	43.40
2005	43.62	44.86	46.45	43.27
2006	44.48	44.17	46.26	43.05

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The following table sets forth the high and low exchange rates for the previous six months and is based on the average of the noon buying rate in the City of New York on the last business day of each month during the period for cable transfers in Indian rupees as certified for customs purposes by the Federal Reserve Bank of New York:

<b>Month</b>	<b>High</b>	<b>Low</b>
March 2006	44.58	44.09
April 2006	44.39	45.09
May 2006	44.81	46.22
June 2006	46.25	45.50
July 2006	46.83	45.84
August 2006	46.61	46.32

On September 28, 2006, the noon buying rate in the city of New York was Rs.45.78 per U.S. dollar.

**3.B. Capitalization and indebtedness**

Not applicable.

**3.C. Reasons for the offer and use of proceeds**

Not applicable.

**3.D. Risk factors**

You should carefully consider all of the information set forth in this Form 20-F and the following risk factors that we face and that are faced by our industry. The risks below are not the only ones we face. Additional risks not currently known to us or that we presently deem immaterial may also affect our business operations. Our business, financial condition or results of operations could be materially or adversely affected by any of these risks. This Form 20-F also contains forward-looking statements that involve risks and uncertainties. Our results could materially differ from those anticipated in these forward-looking statements as a result of certain factors, including the risks we face as described below and elsewhere. See Forward-Looking Statements.

**RISKS RELATING TO OUR COMPANY AND OUR BUSINESS****Failure of our research and development efforts may restrict introduction of new products, which is critical to our business.**

Our future results of operations depend, to a significant degree, upon our ability to successfully commercialize additional products in our active pharmaceutical ingredients and intermediates, generics and formulations, critical care and biotechnology and drug discovery businesses, as well as our most recent business focus, specialty pharmaceuticals. We must develop, test and manufacture generic products as well as prove that our generic products are the bio-equivalent of their branded counterparts. All of our products must meet and continue to comply with regulatory and safety standards and receive regulatory approvals; we may be forced to withdraw a product from the market if health or safety concerns arise with respect to such product. The development and commercialization process, particularly with respect to innovative products, is both time consuming and costly and involves a high degree of business risk. Our products currently under development, if and when fully developed and tested, may not perform as we expect, necessary regulatory approvals may not be obtained in a timely manner, if at all, and we may not be able to successfully and profitably produce and market such products.

To develop our products pipeline, we commit substantial efforts, funds and other resources to research and development, both through our own dedicated resources and our collaborations with third parties. Our ongoing investments in new product launches and research and development for future products could result in higher costs without a proportionate increase in revenues. Our overall profitability depends on our ability to continue developing commercially successful products.

Our dependence on research and development makes it highly important that we recruit and retain high quality researchers and development specialists. Should we fail in our efforts, this could adversely affect our ability to continue developing commercially successful products and, thus, our overall profitability.

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### **If we cannot respond adequately to the increased competition we expect to face in the future, we will lose market share and our profits will go down.**

Our products face intense competition from products commercialized or under development by competitors in all our business segments based in India and overseas. Many of our competitors have greater financial resources and marketing capabilities than we do. Some of our competitors, especially multinational pharmaceutical companies, have greater experience than we do in clinical testing and human clinical trials of pharmaceutical products and in obtaining regulatory approvals. Our competitors may succeed in developing technologies and products that are more effective, more popular or cheaper than any we may develop or license. These developments could render our technologies and products obsolete or uncompetitive, which would harm our business and financial results. We believe some of our competitors have broader product ranges, stronger sales forces and better segment positioning than us, which enables them to compete effectively.

To the extent that we succeed in being the first to market a generic version of a significant product, and particularly if we obtain the 180-day period of market exclusivity provided under the Hatch-Waxman Act of 1984, as amended, our sales and profit can be substantially increased in the period following the introduction of such product and prior to a competitor's introduction of the equivalent product or the launch of an authorized generic. Selling prices of generic drugs typically decline, sometimes dramatically, as additional companies receive approvals for a given product and competition intensifies. Our ability to sustain our sales and profitability of any product over time is dependent on both the number of new competitors for such product and the timing of their approvals.

Our generics business is also facing increasing competition from brand-name manufacturers who do not face any significant regulatory approvals or barriers to entry into the generics market. These brand-name companies sell generic versions of their products to the market directly or by acquiring or forming strategic alliances with our competitor generic pharmaceutical companies or by granting them rights to sell authorized generics. Moreover, brand-name companies continually seek new ways to delay the introduction of generic products and decrease the impact of generic competition, such as filing new patents on drugs whose original patent protection is about to expire, developing patented controlled-release products, changing product claims and product labeling, or developing and marketing as over-the-counter products those branded products which are about to face generic competition.

### **If we cannot maintain our position in the Indian pharmaceutical industry in the future, we may not be able to attract co-development, outsourcing or licensing partners and may lose market share.**

In order to attract multinational corporations into co-development and licensing arrangements, it is necessary for us to maintain the position of a leading pharmaceutical company in India. Multinational corporations have been increasing their outsourcing of both active pharmaceutical ingredients and generic formulations to highly regarded companies that can produce high quality products at low cost that conform to standards set in developed markets. If we cannot maintain our current position in the market, we may not be able to attract outsourcing or licensing partners and may lose market share.

### **If we fail to comply fully with government regulations applicable to our research and development activities or regarding the manufacture of our products, it may delay or prevent us from developing or manufacturing our products.**

Our research and development activities are heavily regulated. If we fail to comply fully with applicable regulations, then there could be a delay in the submission or approval of potential new products for marketing approval. In addition, the submission of an application to a regulatory authority does not guarantee that a license to market the product will be granted. Each authority may impose its own requirements and/or delay or refuse to grant approval, even when a product has already been approved in another country. In the United States, as well as many of the international markets into which we sell our products, the approval process for a new product is complex, lengthy and expensive. The time taken to obtain approval varies by country but generally takes from six months to several years from the date of application. This registration process increases the cost to us of developing new products and increases the risk that we will not be able to successfully sell such new products.

Also, governmental authorities, including the U.S. Food and Drug Administration ( U.S. FDA ), heavily regulate the manufacture of our products. If we or our third party suppliers fail to comply fully with such regulations, then there could be a government-enforced shutdown of production facilities, which in turn could lead to product shortages. A

failure to comply fully with such regulations could also lead to a delay in the approval of new products.

**Reforms in the health care industry and the uncertainty associated with pharmaceutical pricing, reimbursement and related matters could adversely affect the marketing, pricing and demand for our products.**

Increasing expenditures for health care have been the subject of considerable public attention in almost every jurisdiction where we conduct business. Both private and governmental entities are seeking ways to reduce or contain health care costs. In many

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countries in which we currently operate, including India, pharmaceutical prices are subject to regulation. The existence of price controls can limit the revenues we earn from our products. In the United States, numerous proposals that would effect changes in the United States health care system have been introduced or proposed in Congress and in some state legislatures, including the enactment in December 2003 of expanded Medicare coverage for drugs, which became effective in January 2006. In Germany, the government has introduced several healthcare reforms in order to control healthcare spending and promote the prescribing of generic drugs. As a result, the prices of generic pharmaceutical products in Germany have declined and may further decline in the future. Similar developments may take place in our other key markets. We cannot predict the nature of the measures that may be adopted or their impact on the marketing, pricing and demand for our products.

In addition, governments throughout the world heavily regulate the marketing of our products. Most countries also place restrictions on the manner and scope of permissible marketing to physicians, pharmacies and other health care professionals. The effect of such regulations may be to limit the amount of revenue that we may be able to derive from a particular product. Moreover, if we fail to comply fully with such regulations, then civil or criminal actions could be brought against us.

**If a regulatory agency amends or withdraws existing approvals to market our products, this may cause our revenues to decline.**

Regulatory agencies may at any time reassess the safety and efficacy of our products based on new scientific knowledge or other factors. Such reassessments could result in the amendment or withdrawal of existing approvals to market our products, which in turn could result in a loss of revenue, and could serve as an inducement to bring lawsuits against us.

**If we are sued by consumers for defects in our products, it could harm our reputation and thus our profits.**

Our business inherently exposes us to potential product liability. From time to time, the pharmaceutical industry has experienced difficulty in obtaining desired amounts of product liability insurance coverage. Although we have obtained product liability coverage with respect to products that we manufacture, if any product liability claim sustained against us were to be not covered by insurance or were to exceed the policy limits, it could harm our business and financial condition. This risk is likely to increase as we develop our own new-patented products in addition to making generic versions of drugs that have been in the market for some time.

In addition, product liability coverage for pharmaceutical companies is becoming more expensive. As a result, we may not be able to obtain the type and amount of coverage we desire. Furthermore, the severity and timing of future claims are unpredictable. Our customers may also bring lawsuits against us for alleged product defects. The existence, or even threat of, a major product liability claim could also damage our reputation and affect consumers' views of our other products, thereby negatively affecting our business, financial condition and results of operations.

**If we are unable to patent new products and processes or to protect our intellectual property rights or proprietary information, or if we infringe on the patents of others, our business may be materially and adversely impacted.**

Our overall profitability depends, among other things, on our ability to continuously and timely introduce new generic as well as innovative products. Our success will depend, in part, on our ability in the future to obtain patents, protect trade secrets, intellectual property rights and other proprietary information and operate without infringing on the proprietary rights of others. Our competitors may have filed patent applications, or hold issued patents, relating to products or processes that compete with those we are developing, or their patents may impair our ability to successfully develop and commercialize new products.

Our success with our innovative products depends, in part, on our ability to protect our current and future innovative products and to defend our intellectual property rights. If we fail to adequately protect our intellectual property, competitors may manufacture and market products similar to ours. We have been issued patents covering our innovative products and processes and have filed, and expect to continue to file, patent applications seeking to protect our newly developed technologies and products in various countries, including the United States. Any existing or future patents issued to or licensed by us may not provide us with any competitive advantages for our products or may even be challenged, invalidated or circumvented by competitors. In addition, such patent rights may not prevent our competitors from developing, using or commercializing products that are similar or functionally equivalent to our



products.

We also rely on trade secrets, unpatented proprietary know-how and continuing technological innovation that we seek to protect, in part by confidentiality agreements with licensees, suppliers, employees and consultants. It is possible that these agreements will be breached and we will not have adequate remedies for any such breach. Disputes may arise concerning the ownership of intellectual property or the applicability of confidentiality agreements. Furthermore, our trade secrets and proprietary technology may otherwise become known or be independently developed by our competitors or we may not be able to maintain the confidentiality of information relating to such products.

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### **Changes in the regulatory environment may prevent us from utilizing the exclusivity periods that are important to the success of our generic products.**

The policy of the U.S. FDA regarding the award of 180 days of market exclusivity to generic manufacturers who challenge patents relating to specific products continues to be the subject of extensive litigation in the United States. During this 180-day market exclusivity period, nobody other than the generic manufacturer who won exclusivity relating to the specific product can market that product. The U.S. FDA's current interpretation of the Hatch-Waxman Act of 1984 is to award 180 days of exclusivity to the first generic manufacturer who files a Paragraph IV certification under the Hatch-Waxman Act challenging the patent of the branded product, regardless of whether that generic manufacturer was sued for patent infringement.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 amended the Hatch-Waxman Act and provides that the 180-day market exclusivity period is triggered by the commercial marketing of the product, as opposed to the old rule under which the exclusivity period was triggered by a final, non-appealable court decision. However, the Medicare Prescription Drug Act also contains forfeiture provisions, which, if met, will deprive the first Paragraph IV filer of exclusivity. As a result, under certain circumstances, we may not be able to exploit our 180-day exclusivity period since it may be forfeited prior to our being able to market the product.

In addition, legal and administrative disputes over triggering dates and shared exclusivities may also prevent us from fully utilizing the exclusivity periods.

### **If we are unable to defend ourselves in patent challenges, we could be subject to injunctions preventing us from selling our products, resulting in a decrease in revenues, or we could be subject to substantial liabilities that would lower our profits.**

There has been substantial patent related litigation in the pharmaceutical industry concerning the manufacture, use and sale of various products. In the normal course of business, we are regularly subject to lawsuits and the ultimate outcome of litigation could adversely affect our results of operations, financial condition and cash flow. Regardless of regulatory approval, lawsuits are periodically commenced against us with respect to alleged patent infringements by us, such suits often being triggered by our filing of an application for governmental approval, such as a new drug application. The expense of any such litigation and the resulting disruption to our business, whether or not we are successful, could harm our business. The uncertainties inherent in patent litigation make it difficult for us to predict the outcome of any such litigation.

If we are unsuccessful in defending ourselves against these suits, we could be subject to injunctions preventing us from selling our products, resulting in a decrease in revenues, or to damages, which may be substantial. An injunction or substantial damages resulting from these suits could adversely effect our consolidated financial position, results of operations or liquidity.

### **If we elect to sell a generic product prior to the final resolution of outstanding patent litigation, we could be subject to liabilities for damages.**

At times we seek approval to market generic products before the expiration of patents for those products, based upon our belief that such patents are invalid, unenforceable, or would not be infringed by our products. As a result, we are involved in patent litigations, the outcome of which could materially adversely affect our business. Based upon a complex analysis of a variety of legal and commercial factors, we may elect to market a generic product even though litigation is still pending. This could be before any court decision is rendered or while an appeal of a lower court decision is pending. To the extent we elect to proceed in this manner, if the final court decision is adverse to us, we could be required to cease the sale of the infringing products and face substantial liability for patent infringement. These damages may be significant as they may be measured by a royalty on our sales or by the profits lost by the patent owner and not by the profits we earned. Because of the discount pricing typically involved with generic pharmaceutical products, patented brand products generally realize a significantly higher profit margin than generic pharmaceutical products. In the case of a willful infringer, the definition of which is unclear, these damages may even be trebled. In April 2006, we launched, and continue to sell, generic versions of Allegra® (fexofenadine) despite the fact that litigation with the company that holds the patents for and sells this branded product is still pending. This is the only product that we have launched prior to the resolution of outstanding patent litigation.

**If we do not maintain and increase our arrangements for overseas distribution of our products, our revenues and net income could decrease.**

As of March 31, 2006, we market our products in 86 countries. Our products are marketed in most of these countries through our subsidiaries as well as joint ventures. Since we do not have the resources to market and distribute our products ourselves in all our export markets, we also market and distribute our products through third parties by way of marketing and agency arrangements. These arrangements may be terminated by either party providing the other with notice of termination or when the contract regarding the

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arrangement expires. We may not be able to successfully negotiate these third party arrangements or find suitable joint venture partners in the future. Any of these arrangements may not be available on commercially reasonable terms. Additionally, our marketing partners may make important marketing and other commercialization decisions with respect to products we develop without our input. As a result, many of the variables that may affect our revenues and net income are not exclusively within our control when we enter into arrangements like these.

### **If we fail to comply with environmental laws and regulations or face environmental litigation, our costs may increase or our revenues may decrease.**

We may incur substantial costs complying with requirements of environmental laws and regulations. In addition, we may discover currently unknown environmental problems or conditions. In all countries in which we have production facilities, we are subject to significant environmental laws and regulations which govern the discharge, emission, storage, handling and disposal of a variety of substances that may be used in or result from our operations. If any of our plants or the operations of such plants are shut down, we may continue to incur costs in complying with regulations, appealing any decision to close our facilities, maintaining production at our existing facilities and continuing to pay labor and other costs which may continue even if the facility is closed. As a result, our overall operating expenses may increase and our profits may decrease.

### **Our equity shares and our ADSs may be subject to market price volatility, and the market price of our equity shares and ADSs may decline disproportionately in response to adverse developments that are unrelated to our operating performance.**

Market prices for the securities of Indian pharmaceutical companies, including our own, have historically been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. Factors such as the following can have an adverse effect on the market price of our ADSs and equity shares:

general market conditions,

speculative trading in our shares and ADSs,

changes in the weight given to our shares in the Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE) indices, and

developments relating to our peer companies in the pharmaceutical industry.

### **If the world economy is affected due to terrorism, wars or epidemics, it may adversely affect our business and results of operations.**

Several areas of the world, including India, have experienced terrorist acts and retaliatory operations recently. For example, Mumbai was the target of serial railway bombings in July 2006. If the economy of our major markets is affected by such acts, our business and results of operations may be adversely affected as a consequence.

In recent years, Asia has experienced outbreaks of avian influenza and Severe Acute Respiratory Syndrome, or SARS. If the economy of our major markets is affected by such outbreaks or other epidemics, our business and results of operations may be adversely affected as a consequence.

### **If we have difficulty in identifying acquisition candidates or consummating acquisitions, our competitiveness and our growth prospects may be harmed.**

In order to enhance our business, we frequently seek to acquire or make strategic investments in complementary businesses or products, or to enter into strategic partnerships or alliances with third parties. It is possible that we may not identify suitable acquisition, strategic investment or strategic partnership candidates, or if we do identify suitable candidates, we may not complete those transactions on terms commercially acceptable to us or at all. We compete with others to acquire companies, and we believe that this competition has intensified and may result in decreased availability or increased prices for suitable acquisition candidates. Even after we identify acquisition candidates and/or announce that we plan to acquire a company, we may ultimately fail to consummate the acquisition. For example, we may be unable to obtain necessary acquisition financing on terms satisfactory to us or may be unable to obtain necessary regulatory approvals, including the approval of antitrust regulatory bodies. The inability to identify suitable

acquisition targets or investments or the inability to complete such transactions may affect our competitiveness and our growth prospects.

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**If we have difficulties in integration and employee retention for beta Holding GmbH or Industrias Quimicas Falcon de Mexico, SA de CV, our business may be harmed.**

In fiscal 2006, we expanded the scope of our generics and custom pharmaceutical services businesses through the acquisition of beta Holding GmbH in Germany and Industrias Quimicas Falcon de Mexico, SA de CV in Mexico, and we began our efforts to integrate them with our own operations. Should we ultimately fail to successfully integrate these companies with our existing operations, or should the achievement of a successful integration significantly divert management's attention away from the operation of our business, then our business, financial condition or results of operations could be materially adversely affected. In addition, beta Holding GmbH was a large acquisition relative to our size. As a consequence, the operating results of beta Holding GmbH could have a significant impact on our financial condition or results of operations.

**If we acquire other companies, our business may be harmed by difficulties in integration and employee retention, unidentified liabilities of the acquired companies, or obligations incurred in connection with acquisition financings.**

All acquisitions involve known and unknown risks that could adversely affect our future revenues and operating results. For example:

We may fail to successfully integrate our acquisitions in accordance with our business strategy.

Integration of acquisitions may divert management's attention away from our primary product offerings, resulting in the loss of key customers and/or personnel, and may expose us to unanticipated liabilities.

We may not be able to retain the skilled employees and experienced management that may be necessary to operate the businesses we acquire. If we cannot retain such personnel, we may not be able to locate or hire new skilled employees and experienced management to replace them.

We may purchase a company that has contingent liabilities that include, among others, known or unknown patent or product liability claims.

Our acquisition strategy may require us to obtain additional debt or equity financing, resulting in additional leverage, or increased debt obligations as compared to equity, and dilution of ownership.

We may purchase companies located in jurisdictions where we do not have operations and as a result we may not be able to anticipate local regulations and the impact such regulations have on our business.

In addition, if we make one or more significant acquisitions in which the consideration includes the equity shares or other securities, equity interests in us held by holders of the equity shares may be significantly diluted. If we make one or more significant acquisitions in which the consideration includes cash, we may be required to use a substantial portion of our available cash or incur a significant amount of debt or otherwise arrange additional funds to complete the acquisition, which may result in a dilution of earnings per equity share.

**Our principal shareholders control us and, if they take actions that are not in your best interests, the value of your investment in our ADSs may be harmed.**

Our full time directors together with members of their immediate families, in the aggregate, beneficially own 27.55% of our issued shares as at March 31, 2006. As a result, these people, acting in concert, are likely to have the ability to exercise significant control over most matters requiring approval by our shareholders, including the election and removal of directors and significant corporate transactions. This control by these directors and their family members could delay, defer or prevent a change in control of us, impede a merger, consolidation, takeover or other business combination involving us, or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us, even if that was in our best interest. As a result, the value of your ADSs may be adversely affected or you might be deprived of a potential opportunity to sell your ADSs at a premium.

**If we improperly handle any of the dangerous materials used in our business and accidents result, we could face significant liabilities that would lower our profits.**

We handle dangerous materials including explosive, toxic and combustible materials like sodium azide, acrolein and acetyl chloride. If improperly handled or subjected to the wrong conditions, these materials could hurt our employees and other persons, cause damage to our properties and harm the environment. This, in turn, could subject us to significant litigation, which could lower our profits in the event we were found liable.

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### **If there is delay and/or failure in supplies of materials, services and finished goods from third parties, it may adversely affect our business and results of operations.**

In some of our businesses, we rely on third parties for the timely supply of active pharmaceutical ingredients ( API ), specified raw materials, equipment, formulation or packaging services and maintenance services. For instance, we rely on third party manufacturers for our entire supply of finished dosages sold in Germany. Although we actively manage these third party relationships to ensure continuity of supplies and services on time and to our required specifications, some events beyond our control could result in the complete or partial failure of supplies and services or in supplies and services not being delivered on time. Any such failure could adversely affect our results of business and results of operations.

In the event that we experience a shortage in our supply of raw materials, we might be unable to fulfill all of the API needs of our generics and formulations segments, which could result in a loss of production capacity for these segments. In addition, this could result in a conflict between the API needs of our generics and formulations segments and the needs of customers of our active pharmaceutical ingredients and intermediates segment, some of whom are also our competitors in the formulations segment. In either case, we could potentially lose business from adversely affected customers and we could be subjected to lawsuits.

### **If as we expand into new international markets we fail to adequately understand and comply with the local laws and customs , these operations may incur losses or otherwise adversely affect our business and results of operations.**

Currently, we operate our business through subsidiaries and equity investees in other countries. In those countries where we have limited experience in operating subsidiaries, such as Germany and Mexico, and in reviewing equity investees we are subject to additional risks related to complying with a wide variety of national and local laws, including restrictions on the import and export of certain intermediates, drugs, technologies and multiple and possibly overlapping tax structures. In addition, we may face competition in other countries from companies that may have more experience with operations in such countries or with international operations generally. We may also face difficulties integrating new facilities in different countries into our existing operations, as well as integrating employees that we hire in different countries into our existing corporate culture. If we do not effectively manage our operations in these subsidiaries and review equity investees effectively, we may lose money in these countries and it may adversely affect our business and results of operations.

### **Fluctuations in exchange rates and interest rate movements may adversely affect our business and results of operations.**

Our principal subsidiaries are located in the United States, United Kingdom and Russia and each has significant local operations. A significant portion of our revenues are in other currencies, especially the U.S. dollar, Euro and Pound sterling, while a significant portion of our costs are in Indian rupees. As a result, if the value of the Indian rupee appreciates relative to these other currencies, our revenues may decrease.

We have entered into borrowing arrangements in connection with our acquisition of betapharm. In the future, we may enter into additional borrowing arrangements in connection with acquisitions or for general working capital purposes. In the event interest rates increase, our costs of borrowing will increase and our results of operations may be adversely affected.

### **Our success depends on our ability to retain and attract key qualified personnel and, if we are not able to retain them or recruit additional qualified personnel, we may be unable to successfully develop our business**

We are highly dependent on the principal members of our management and scientific staff, the loss of whose services might significantly delay or prevent the achievement of our business or scientific objectives. In India, it is not our practice to enter employment agreements with our executive officers and key employees that are as extensive as are generally used in the United States, and each of those executive officers and key employees may terminate their employment upon notice and without cause or good reason. Currently we are not aware that any executive officer or key employee is planning to leave or retire. Competition among pharmaceutical companies for qualified employees is intense, and the ability to retain and attract qualified individuals is critical to our success. There can be no assurance that we will be able to retain and attract such individuals currently or in the future on acceptable terms, or at all, and the failure to do so would have a material adverse effect on our business, financial condition and results of operations.



In addition, we do not maintain key person life insurance on any officer, employee or consultant.

**We operate in a highly competitive and rapidly consolidating industry.**

We operate in a highly competitive and rapidly consolidating industry. Our competitors, which include major multinational corporations, are consolidating, and the strength of the combined companies could affect our competitive position in all of our business areas. Furthermore, if one of our competitors or their customers acquire any of our customers or suppliers, we may lose business from the customer or lose a supplier of a critical raw material.

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**RISKS RELATING TO INVESTMENTS IN INDIAN COMPANIES**

We are an Indian company and a substantial part of our operations are conducted, and most of our assets are located, in India. In addition, approximately 34.09% of our total revenues for fiscal 2006 were derived from sales in India. As a result, the following additional risk factors apply.

**A slowdown in economic growth in India may adversely affect our business and results of operations.**

Our performance and the quality and growth of our business are necessarily dependent on the health of the overall Indian economy. The Indian economy has grown significantly over the past few years. Any future slowdown in the Indian economy could harm us, our customers and other contractual counterparties. In addition, the Indian economy is in a state of transition. The share of the services sector of the economy is rising while that of the industrial, manufacturing and agricultural sector is declining. It is difficult to gauge the impact of these fundamental economic changes on our business.

**A significant change in the Indian government or in its economic liberalization and deregulation policies may adversely affect the Indian economy, the health of which our business depends upon.**

The Indian government has traditionally exercised and continues to exercise a dominant influence over many aspects of the economy. The present government is a multi-party coalition and therefore there is no assurance that it will be able to generate sufficient cross-party support to implement economic policies or that the existing economic policies will continue. Any significant change in the government's economic policies could have a significant effect on private-sector entities, including us, and on market conditions and prices of Indian securities, including our shares and our ADSs. India's trade relationships with other countries can also influence Indian economic conditions, which in turn can affect our business.

**If communal disturbances or riots erupt in India, or if regional hostilities increase, this would adversely affect the Indian economy, which our business depends upon.**

India has experienced communal disturbances, terrorist attacks and riots during recent years. If such disturbances continue or are exacerbated, our operational, sales and marketing activities may be adversely affected. Additionally, India has from time to time experienced hostilities with neighboring countries. The hostilities have continued sporadically. The hostilities between India and Pakistan are particularly threatening, because both India and Pakistan are nuclear powers. Hostilities and tensions may occur in the future and on a wider scale. These hostilities and tensions could lead to political or economic instability in India and harm our business operations, our future financial performance and the price of our shares and our ADSs.

**If wage costs or inflation rise in India, it may adversely affect our competitive advantages over higher cost countries and our profits may decline.**

Wage costs in India have historically been significantly lower than wage costs in developed countries and have been one of our competitive strengths. However, wage increases in India may increase our costs, reduce our profit margins and adversely affect our business and results of operations.

In addition, although India's inflation levels were relatively moderate during fiscal 2006, its inflation levels have been much higher at times during the past decade. According to the monthly economic report for January 2006 released by the department of economic affairs, Ministry of Finance in India, the annual inflation rate in India, as measured by the benchmark wholesale price index (Base 1993-94=100), was 4.82% for the week ended August 5, 2006 as compared with 3.78% for the week ended August 5, 2005. The trend may continue and the rate of inflation may further rise. We may not be able to pass these costs on to our customers by increasing the price we charge for our products. If this occurs, our profits may decline.

**In the event that a natural disaster should occur in India, including drought, floods and earthquakes, it could adversely affect our production operations and cause our revenues to decline.**

Our main facilities are situated around Hyderabad, India. This region has experienced earthquakes, floods and droughts in the past and has experienced droughts in recent years. In the event of a drought so serious that the drinking water in the region is limited, the government could cut the supply of water to all industries, including our facilities. This would adversely affect our production operations and reduce our revenues. Even if we take precautions to provide back-up support in the event of such a natural disaster, the disaster may nonetheless affect our facilities, harming production and ultimately our business.



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**Indian law imposes certain restrictions that limit a holder's ability to transfer the equity shares obtained upon conversion of ADSs and repatriate the proceeds of such transfer, which may cause our ADSs to trade at a premium or discount to the market price of our equity shares.**

Under certain circumstances, the Reserve Bank of India must approve the sale of equity shares underlying ADSs by a non-resident of India to a resident of India. The Reserve Bank of India has given general permission to effect sales of existing shares or convertible debentures of an Indian company by a resident to a non-resident, subject to certain conditions, including the price at which the shares may be sold. Additionally, except under certain limited circumstances, if an investor seeks to convert the rupee proceeds from a sale of equity shares in India into foreign currency and then repatriate that foreign currency from India, he or she will have to obtain an additional approval from the Reserve Bank of India for each such transaction. Required approval from the Reserve Bank of India or any other government agency may not be obtained on terms favorable to a non-resident investor or at all.

**There are limits and conditions to the deposit of shares into the ADS facility.**

Indian legal restrictions may limit the supply of ADSs. The only way to add to the supply of ADSs will be through a primary issuance because the depositary will not be permitted to accept deposits of outstanding shares and issue ADSs representing those shares. However, an investor in ADSs who surrenders an ADS and withdraws shares will be permitted to redeposit those shares in the depositary facility in exchange for ADSs. In addition, an investor who has purchased shares in the Indian market will be able to deposit them in the ADS program, but only in a number that does not exceed the number of underlying shares that have been withdrawn from and not re-deposited into the depositary facility. Moreover, there are restrictions on foreign institutional ownership of shares as opposed to ADSs.

**There may be less company information available in Indian securities markets than securities markets in developed countries.**

There is a difference between the level of regulation and monitoring of the Indian securities markets over the activities of investors, brokers and other participants, as compared to the level of regulation and monitoring of markets in the United States and other developed economies. The Securities and Exchange Board of India is responsible for improving disclosure and other regulatory standards for the Indian securities markets. The Securities and Exchange Board of India has issued regulations and guidelines on disclosure requirements, insider trading and other matters. There may, however, be less publicly available information about Indian companies than is regularly made available by public companies in developed countries, which could affect the market for our equity shares.

**Indian stock exchange closures, broker defaults, settlement delays, and Indian government regulations on stock market operations could affect the market price and liquidity of our equity shares.**

The Indian securities markets are smaller than the securities markets in the United States and Europe and have experienced volatility from time to time. The regulation and monitoring of the Indian securities market and the activities of investors, brokers and other participants differ, in some cases significantly, from those in the United States and some European countries. Indian stock exchanges have at times experienced problems, including temporary exchange closures, broker defaults and settlement delays and if similar problems were to recur, they could affect the market price and liquidity of the securities of Indian companies, including our shares. Furthermore, any change in Indian government regulations of stock markets could affect the market price and liquidity of our shares.

**Financial instability in other countries, particularly emerging market countries in Asia, could affect our business and the price and liquidity of our shares and our ADSs.**

The Indian markets and the Indian economy are influenced by economic and market conditions in other countries, particularly emerging market countries in Asia. Although economic conditions are different in each country, investors reactions to developments in one country can have adverse effects on the securities of companies in other countries, including India. Any worldwide financial instability or any loss of investor confidence in the financial systems of Asian or other emerging markets could increase volatility in Indian financial markets or adversely affect the Indian economy in general. Either of these results could harm our business, our future financial performance and the price of our shares and ADSs.

**If you are not able to exercise preemptive rights available to other shareholders, your investment in our securities may be diluted.**

A company incorporated in India must offer its holders of shares preemptive rights to subscribe and pay for a proportionate number of shares to maintain their existing ownership percentages prior to the issuance of any shares, unless these rights have been waived by at least 75.0% of the company's shareholders present and voting at a shareholders' general meeting. U.S. investors in our

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ADSs may be unable to exercise preemptive rights for the shares underlying our ADSs unless a registration statement under the Securities Act of 1933 is effective with respect to the rights or an exemption from the registration requirements of the Securities Act is available. Our decision to file a registration statement will depend on the costs and potential liabilities associated with a registration statement as well as the perceived benefits of enabling U.S. investors in our ADSs to exercise their preemptive rights and any other factors we consider appropriate at the time. We might choose not to file a registration statement under these circumstances. If we issue any of these securities in the future, such securities may be issued to the depositary, which may sell them in the securities markets in India for the benefit of the investors in our ADSs. We cannot assure you as to the value, if any, the depositary would receive upon the sale of these securities. To the extent that you are unable to exercise preemptive rights, your proportional interests in us would be reduced.

### **If there is a change in tax regulations, it may increase our tax liabilities and thus adversely affect our financial results.**

Currently, we enjoy various tax benefits and exemptions under Indian tax laws. Any changes in these laws, or their application in matters such as tax exemption on exportation income and transfer pricing, may increase our tax liability and thus adversely affect our financial results.

### **Stringent labor laws may adversely affect our ability to have flexible human resource policies.**

Labor laws in India are more stringent than in other parts of the world. These laws may restrict our ability to have human resource policies that would allow us to react swiftly to the needs of our business.

### **If we experience labor union problems our production capacity and overall profitability could be negatively affected.**

Approximately 10% of our employees belong to a number of different labor unions. If we experience problems with our labor unions, our production capacity and overall profitability could be negatively affected.

## **ITEM 4. INFORMATION ON OUR COMPANY**

### ***4.A. History and development of our company***

Dr. Reddy's Laboratories Limited was incorporated in India under the Companies Act, 1956, by its promoter and our current Chairman, Dr. K. Anji Reddy as a Private Limited Company on February 24, 1984. We were converted to a Public Limited Company on December 6, 1985 and listed on the Indian Stock Exchanges in August 1986 and on the New York Stock Exchange on April 11, 2001. We are registered with the Registrar of Companies, Andhra Pradesh, Hyderabad, India as Company No. 4507 (Company Identification No. U85195AP1984PTC004507). Our registered office is situated at 7-1-27, Ameerpet, Hyderabad - 500 016, Andhra Pradesh, India and the telephone number of our registered office is +91-40-23731946. The name and address of our registered agent in the United States is Dr. Reddy's Laboratories, Inc., 200 Somerset Corporate Boulevard (Bldg II), Bridgewater, New Jersey 08807.

#### **Key business developments:**

In September 2005, we entered into a co-development and commercialization agreement with Denmark based Rheoscience A/S for the joint development and commercialization of balaglitazone (DRF 2593), a partial PPAR-gamma agonist, for the treatment of type 2 diabetes.

During September 2005, we also announced the formation of an integrated drug development company, Perlecan Pharma Private Limited, as a joint venture with Citigroup Venture Capital International Growth Partnership Mauritius Limited (Citigroup Venture) and ICICI Venture Funds Management Company (ICICI Venture). This arrangement was subject to certain closing conditions which were completed in March 2006. Citigroup Venture and ICICI Venture each committed to contribute U.S.\$22.5 million and the Company committed to contribute U.S.\$7.5 million to Perlecan Pharma.

In December 2005, we completed the sale of our formulations manufacturing facility located in Goa, India to Watson Pharmaceuticals Inc. for a total purchase price of U.S.\$16.5 million, of which U.S.\$14.9 million was received in December 2005 and the balance was received in June 2006.

During December 2005 we also acquired 100% of the share capital of Industrias Quimicas Falcon de Mexico (Falcon), a Roche group company, for a total purchase consideration of Rs.2,773.1 million (U.S.\$61 million). The operations of Falcon relate to the manufacture and sale of active pharmaceutical ingredients, intermediates and steroids primarily to innovator pharmaceutical companies. Its product portfolio is comprised of 18 products, including

mature active pharmaceutical ingredients (i.e, those which support off patent brands) and a range of intermediates and steroids. We acquired Falcon with an intent to add unique steroid

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manufacturing capabilities to our product portfolio and to enable us to offer a full range of services in our custom pharmaceutical services business to the innovator and emerging biotechnology companies.

In January 2006, we entered into an agreement with Merck & Co., Inc., allowing us to distribute and sell generic versions of finasteride and simvastatin (sold by Merck under the brand names Proscar® and Zocor®), upon the expiration of Merck's patents covering these products, provided that another company obtains 180-day exclusivity after the expiration of the patents for either product. Pursuant to this agreement, we launched sales of these products on June 19, 2006 and June 23, 2006 respectively.

In February 2006, we entered into an agreement with Argenta Discovery Limited for the joint development and commercialization of a novel approach to the treatment of Chronic Obstructive Pulmonary Disease.

In March 2006, we acquired 100% of beta Holding GmbH ( betapharm ) from 3i Group plc, a European private equity house. The purchase price for this transaction was 482.6 million in cash. The transaction was funded using a combination of our internal cash reserves and committed term loans. betapharm was founded in 1993 and, according to INSIGHT Health's National Pharmaceutical Information for Germany ( NPI-Gx ) reports, betapharm is the fourth-largest generics company (by sales) in Germany with a market share of approximately 3.5%. betapharm markets high-quality generic drugs with a focus on long-term therapy products with high prescription rates. betapharm's current portfolio is comprised of approximately 145 marketed products, and it has a strong track record of successful product launches. Located in Augsburg, Germany, betapharm currently employs approximately 370 people, including a sales force of approximately 250, with gross revenues of 164 million for the year ended November 30, 2005 (including value added taxes). The acquisition of betapharm provided us an entry into the second largest generics (branded) market in the world.

In April 2006, we launched, and continue to sell, generic versions of Allegra® despite the fact that litigation with Sanofi-Aventis, the holder of patents for this branded product, is still pending. This is the only product that we have launched prior to the resolution of outstanding patent litigation. In September 2002, we filed an ANDA for fexofenadine hydrochloride tablets 30 mg, 60 mg and 180 mg with a Paragraph IV certification on all orange book patents. We were granted summary judgment with respect to 3 patents. Five patents remain in the litigation, which is pending in the United States District Court for the District of New Jersey. Fexofenadine hydrochloride is the AB-rated generic equivalent of Sanofi-Aventis Allegra®.

During fiscal 2006, we filed 12 Abbreviated New Drug Applications ( ANDAs ), including 1 Paragraph IV. As of March 31, 2006, we had 50 ANDAs pending at the U.S. FDA. During fiscal 2006, we filed 17 Drug Master Files ( DMFs ) with the U.S. FDA. We also filed 508 dossiers in various international markets.

As of March 31, 2006, our capital work-in-progress was Rs.1,135.9 million, primarily in India. Our capital work-in-progress is financed entirely through internally generated funds. We are in the process of expanding our existing facilities in our generics, integrated product development organization, custom pharmaceutical services and biotechnology businesses.

During fiscal 2005 and fiscal 2006, no third party made any public takeover offers in respect of our shares and we did not make any public offers to take over any other company.

### **4.B. Business overview**

We are an emerging global pharmaceutical company with proven research capabilities. We produce active pharmaceutical ingredients and intermediates and finished dosage forms and biotechnology products and market them globally, with a focus on India, the United States, Europe and Russia. We are vertically integrated and use our active pharmaceutical ingredients and intermediates in our own finished dosage products. We conduct basic research in the areas of cancer, diabetes, cardiovascular disease, inflammation and bacterial infection.

Our total revenues for fiscal 2006 were Rs. 24,267.0 million (U.S.\$545.6 million). We derived 34.1% of these revenues from sales in India, 16.4% from the United States and Canada ( North America ), 14.7% from Russia and other countries of the former Soviet Union, 17.8% from Europe and 17.0% from other countries. Our net income for fiscal 2006 was Rs.1,628.9 million (U.S.\$36.6 million).

### **OUR STRATEGY**

Our vision is to build a discovery-led global pharmaceutical company, with a strong pipeline of generics as well as innovative products. Our strategy to achieve this vision is as follows:





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Our core businesses of active pharmaceutical ingredients and intermediates and formulations are well established with a track record of growth and profitability. We are focused on cost competitiveness and improving our position in existing markets and expanding into selected new markets in an effort to continue this growth and profitability.

In our global generics business, we are building a pipeline of products that will help us drive growth in the medium-term in the United States and Europe. We are focusing on key markets in Europe, including Germany, Spain, Italy, France and Poland in order to build a dominant presence in these markets.

We are also actively pursuing external business development opportunities to supplement our internal growth initiatives, including acquisitions and alliances.

We are also focused on positioning our custom pharmaceutical services business as partner of choice for the strategic outsourcing needs of innovator pharmaceutical companies.

In addition, we are focusing our investments on innovation led businesses, including drug discovery with a goal of building our drug discovery pipeline, and our most recent business focus, specialty pharmaceuticals, which is currently in the research and development phase. These businesses, while being investment intensive and having long lead times, have the potential to provide significant growth as well as sustained revenues and profitability for much longer periods due to patent protected franchises.

**OUR PRINCIPAL AREAS OF OPERATIONS**

The following table shows our revenues and percentage of total revenues of our formulations, active pharmaceutical ingredients and intermediates, generics, critical care and biotechnology and drug discovery segments for fiscal 2004, 2005 and 2006 respectively:

Segment	2004		Fiscal Year Ended March 31, 2005				2006	
			(Rs. in millions, U.S.\$ in thousands)					
Formulations	Rs. 7,507.5	37.3%	Rs. 7,822.9	40.1%	Rs. 9,925.9	40.9%	U.S.\$ 223,155.5	
Active pharmaceutical ingredients and intermediates	7,628.5	38.0	6,944.5	35.6	8,238.0	34.0	185,208.1	
Generics	4,337.5	21.6	3,577.4	18.3	4,055.8	16.7	91,181.7	
Critical care and biotechnology	411.0	2.0	527.1	2.7	691.1	2.8	15,536.7	
Drug discovery			288.4	1.5				
Custom pharmaceutical services	113.1	0.6	311.6	1.6	1,326.8	5.5	29,829.8	
Other	105.9	0.5	47.5	0.2	29.4	0.1	660.3	
Total revenues	Rs. 20,103.5	100.0%	Rs. 19,519.4	100.0%	Rs. 24,267.0	100.0%	U.S.\$ 545,572.1	

**Formulations Segment**

Formulations, also referred to as branded finished dosages, are finished pharmaceutical products ready for consumption by the patient. Branded means we package the formulations for sale under our brand name. We sell branded formulations in India, Russia and other emerging markets. Formulations accounted for 40.9% of our revenues in fiscal 2006.

Markets

We export our branded formulations to over 40 countries worldwide. Our major markets in this segment are India, Russia and other countries of the former Soviet Union, Central Eastern Europe, Southeast Asian countries and Latin America. We have also expanded our presence in emerging markets, such as Romania, Albania, South Africa, Peru and in the Middle East region. We have progressively increased the number of countries in which we market our formulations by registering our products in various markets around the world. During fiscal 2006, we filed 508 new product dossiers in various countries around the world. Our formulations portfolio includes brands covering several therapeutic segments.

The following table sets forth formulations revenues by geographic area for fiscal 2004, 2005 and 2006, respectively:

Country	2004		Fiscal Year Ended March 31, 2005		2006	
	Revenues (in millions)	% Total <sup>(1)</sup>	Revenues (in millions)	% Total <sup>(1)</sup>	Revenues (in millions)	% Total <sup>(1)</sup>
India	Rs. 4,729.3	63.0%	Rs. 4,360.2	55.7%	Rs. 5,525.70	55.7%
Russia	1,781.8	23.7	2,107.2	26.9	U.S.\$ 2,583.15	26.0
Ukraine	184.2	2.5	257.8	3.3	413.38	4.2
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Country	2004		Fiscal Year Ended March 31, 2005		2006	
	Revenues (in millions)	% Total <sup>(1)</sup>	Revenues (in millions)	% Total <sup>(1)</sup>	Revenues (in millions)	% Total <sup>(1)</sup>
Kazakhstan	154.5	2.1	183.7	2.3	239.40	5.4
Romania	82.0	1.1	102.6	1.3	192.27	4.3
Belarus	100.2	1.3	140.1	1.8	156.40	3.5
South Africa			52.1	0.7	142.00	3.2
Vietnam	56.7	0.8	73.5	0.9	94.95	2.1
Venezuela	70.4	0.9	96.0	1.2	55.63	1.3
Myanmar	47.6	0.6	68.1	0.9	81.42	1.8
Others	300.8	4.0	381.6	4.9	441.69	9.9
Total	Rs. 7,507.5	100.0%	Rs. 7,822.9	100.0%	Rs. 9,925.9	U.S.\$ 223.1

(1) Refers to our revenues from formulations sales in the applicable country expressed as a percentage of our total revenues from formulations sales throughout the world.

*India.* Our revenues from sales of formulations in India were 55.7% of our total formulations sales in fiscal 2006. In India, our formulations business focuses mainly on the therapeutic categories of cardiovascular, diabetes management, gastro-intestinal and pain management. As of March 31, 2006, we had a total of 119 brands. Our top ten brands together accounted for 51.4% of our formulations revenues in India in fiscal 2006. Our sales of formulations in India grew at 13.8% in fiscal 2006 as compared to the industry average growth of 15.4% according to Operations Research Group International Medical Statistics ( ORG IMS ), a market research firm, in its March Moving Annual Total report for the 12-month period ending March 2006. According to ORG IMS, as of March 2006, we had 39 brands that were ranked either first or second in terms of sales in India in their respective product categories. According to the Center for Marketing and Advertising Research Consultancy ( CMARC ) report for the period November 2005 to February 2006, which measures doctors' prescriptions, we were the sixth most prescribed company in India.

New product launches during fiscal 2006 accounted for 3.6% of our revenues from sales of formulations in India. Key product launches included Omez DSR, our brand of omeprazole, Domperidone SR, our brand of domperidone, and Razo D, our brand of rabeprazole.

The following table provides a summary of our sales in India in our therapeutic categories for fiscal 2004, 2005 and 2006 respectively:

Therapeutic Category <sup>(1)</sup>	Fiscal Year Ended March 31,											
	2004			2005			2006					
	Number of our Products	Revenues	% <sup>(2)</sup>	Number of our Products	Revenues	% <sup>(2)</sup>	Number of our Products <sup>(3)</sup>	Revenues	% <sup>(2)</sup>			
	(in millions)			(in millions)			(in millions)					
Cardiovascular	35	Rs. 928.3	19.6	35	Rs. 937.6	21.5	32	Rs. 1,094.1	U.S.\$ 24.6	19.8		
Gastro-intestinal	36	1,015.0	21.5	38	902.0	20.7	33	1,037.5	23.3	18.8		
Pain management	36	783.6	16.6	19	713.7	16.4	19	781.6	17.6	14.1		
Diabetes management	23	301.1	6.4	21	297.9	6.8	24	458.5	10.3	8.3		
Neutraceuticals	20	301.3	6.4	16	243.9	5.6	14	313.8	7.1	5.7		
Anti-infectives	30	439.1	9.3	19	324.1	7.4	16	295.9	6.7	5.4		
Dermatology	19	206.1	4.4	16	206.5	4.7	18	253.5	5.7	4.6		
Dental	23	173.2	3.7	22	177.3	4.1	21	220.4	5.0	4.0		
Urology	10	96.6	2.0	17	131.5	3.0	14	148.7	3.3	2.7		
Respiratory	19	206.6	4.4	14	177.5	4.1	11	140.2	3.2	2.5		
Gynecology	10	116.0	2.5	7	110.9	2.5	8	124.1	2.8	2.2		
Others	14	162.4	3.4	10	137.3	3.1	25	657.4	14.8	11.9		
Total	275	Rs. 4,729.3	100%	234	Rs. 4,360.2	100%	235	Rs. 5,525.7	U.S.\$ 124.4	100%		

(1) The categorization into therapeutic segments is based on current marketing practice and focuses on therapies.

(2) Refers to the therapeutic category's revenues from sales in India expressed as a percentage of our total revenues from sales in all of our therapeutic categories in India.

(3)

Products of the same strength sold in different packs have been re-grouped as one product in fiscal 2006.

The following tables summarize the position of our top 10 brands in the Indian market for fiscal 2004, 2005 and 2006 respectively:

<b>Brand</b>	<b>Therapeutic Category</b>	<b>Therapeutic Sub-Category<sup>(1)</sup></b>	<b>Rank of our Brand Within Product Category<sup>(1)</sup></b>	<b>Market Share of Our Brand Within Product Category <sup>(2)</sup></b>	<b>Brand Growth<sup>(3)</sup></b>
Nise	Pain management	Non-steroidal anti-inflammatory	1	23.9%	6.98%
Omez	Gastro-intestinal	Anti-ulcerant	1	45.2	12.6
Stamlo	Cardiovascular	Anti-hypertensive	1	24.2	4.1
Stamlo beta	Cardiovascular	Anti-hypertensive	2	14.0	12.4
Enam	Cardiovascular	Anti-hypertensive	2	26.0	(3.6)
Atocor	Cardiovascular	Lipid lowering agent	3	8.8	26.8

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<b>Brand</b>	<b>Therapeutic Category</b>	<b>Therapeutic Sub-Category<sup>(1)</sup></b>	<b>Rank of our Brand Within Product Category<sup>(1)</sup></b>	<b>Market Share of Our Brand Within Product Category <sup>(2)</sup></b>	<b>Brand Growth<sup>(3)</sup></b>
Razo	Gastro-intestinal	Anti-ulcerant	3	9.5	42.6
	Diabetes	Sulphonylurea	4	7.9	12.3
Reclimet	management	anti-diabetic			
Clamp	Anti-infectives	Anti-infectives	4	12.8	0.4
Mintop	Dermatology	Alopecia	1	73.9	1.2

(1) Therapeutic sub-categories are the specific groups within each therapeutic category and product categories are the compound groups within each therapeutic sub-category.

Source:

Operations

Research Group

March 2006.

(2) Refers to the brand's revenues from sales in India expressed as a percentage of our total revenues from sales in all of our therapeutic categories in India.

(3) Revenue growth determined based on retail sales over the corresponding 12-month period for the previous year. Source: Operations Research Group

March 2006.

Brand	Fiscal Year Ended March 31,					% Total <sup>(1)</sup>
	2004	2005	(in millions)	2006	(in millions)	
Nise	Rs. 655.6	Rs. 537.9	Rs. 736.0	U.S.\$16.5		13.3%
Omez	622.6	528.1	690.8	15.5		12.5
Stamlo	293.2	298.2	339.7	7.6		6.1
Stamlo Beta	187.7	186.7	262.8	5.9		4.8
Enam	163.9	162.1	172.7	3.9		3.1
Atocor	100.6	115.8	167.2	3.8		3.0
Razo	49.7	65.2	127.3	2.9		2.3
Reclimet	73.3	79.1	123.7	2.8		2.2
Clamp	106.5	100.6	118.3	2.7		2.1
Mintop	99.1	98.4	109.1	2.5		2.0
Total	Rs. 2,352.2	Rs. 2,172.1	Rs. 2,847.6	U.S.\$64.1		51.4

(1) Refers to the brand's revenues from sales in India expressed as a percentage of our total revenues from sales in all of our therapeutic categories in India.

*Russia.* Russia is our largest international market in our formulations business and our sales of formulations in this market accounted for 26.0% of our revenues in the formulations segment in fiscal 2006. Pharmexpert, a market research firm, ranked us number 18 in sales in Russia with a market share of 1.21% as of March 2006 in its moving annual total report for first quarter 2006 (the MAT Q1 2006 Report). Pharmexpert also reported that the market growth during fiscal 2006 was 20.13%. All of the companies ranked ahead of us by Pharmexpert were either multinational corporations or of European origin. Accordingly, we were the top ranked Indian pharmaceutical company in Russia.

The following table provides a summary of our revenues in Russia by therapeutic category for fiscal 2004, 2005 and 2006 respectively:

Therapeutic Category	Fiscal Year Ended March 31,												% Total <sup>(1)</sup>
	2004				2005				2006				
	Number of Products		% Total <sup>(1)</sup>	Number of Products		% Total <sup>(1)</sup>	Number of Products		% Total <sup>(1)</sup>				
	Revenues (in millions)	Revenues (in millions)		Revenues (in millions)	Revenues (in millions)								
Pain management	9	Rs.	477.4	26.8%	9	Rs.	660.3	31.3%	9	Rs.	929.6	U.S.\$21.3	36.0%
Anti-infectives	7		435.4	24.4	7		505.1	24.0	6		546.5	12.5	21.2



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Gastro-intestinal	2	400.2	22.5	2	493.0	23.4	3	608.6	14.0	23.6
Cardiovascular	4	338.2	19.0	4	306.2	14.5	4	288.9	6.6	11.2
Dermatology	4	92.7	5.2	4	96.4	4.6	4	142.4	3.3	5.5
Others	6	37.9	2.1	7	46.2	2.2	6	67.1	0.4	2.6
Total	32	Rs. 1,781.8	100.0%	33	Rs. 2,107.2	100.0%	32	Rs. 2,583.1	U.S.\$58.1	100.0%

(1) Refers to the therapeutic category's revenues from sales in Russia expressed as a percentage of our total revenues from sales in all of our therapeutic categories in Russia.

The following table provides a summary of our principal products in the Russian market for fiscal 2004, 2005 and 2006 respectively:

		Fiscal Year Ended March 31,							
		2004		2005		2006			
Brand	Therapeutic Category	Revenues (in millions)	% Total <sup>(1)</sup>	Revenues (in millions)	% Total <sup>(1)</sup>	Revenues (in millions)			% Total <sup>(1)</sup>
Omez	Gastro-intestinal	Rs. 394.6	22.1%	Rs. 488.7	23.2%	Rs. 603.5	U.S.\$13.6		23.4%
Ciprolet	Anti-infectives	385.0	21.6%	450.2	21.4%	484.7	10.9		18.8%
Ketorol	Pain management	263.1	14.8%	339.3	16.1%	511.9	11.5		19.8%
Nise	Pain management	185.6	10.4%	296.8	14.1%	379.2	8.5		14.7%
Total		1,228.3	68.9%	1,575.0	74.7%	1,979.3	44.5		76.6%

(1) Refers to the brand's revenues from sales in Russia expressed as a percentage of our total revenues from all formulation sales in Russia.

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Our top four brands, Omez, Ciprolet, Ketorol and Nise, accounted for 76.6% of our formulation revenues in Russia in fiscal 2006. Omez, our anti-ulcerant product and Ciprolet, our product in the anti-infective segment, are ranked as the 34th and 69th best selling formulation brands, respectively, in the Russian market as of March 2006 by Pharmexpert in its MAT Q1 2006 Report. Nise has also entered Pharmexpert's top 100 rankings ranked at number 95 and has become the top selling non-steroidal anti-inflammatory drug on the Russian pharmaceutical market for the year ended December 2005, according to the Pharmexpert MAT Q1 2006 Report.

Our strategy in Russia is to focus on the therapeutic areas of gastro-intestinal, pain management, anti-infectives and cardiovascular. Our focus is on building brand leaders in these therapeutic segments. Omez, Ciprolet, Enam and Nise continued to be brand leaders in their respective categories, as reported by the Pharmexpert MAT Q1 2006 Report.

Growth during the year was driven by marketing initiatives such as targeting the hospital segment, greater penetration in the key cities of Moscow and St. Petersburg, marketing campaigns for key products and an over the counter ( OTC ) initiative for a couple of brands.

Our growth was also due to the Russian government's implementation in January 2005 of the Dopolnitelnoye Lekarstvennoye Obespechenoye ( DLO ) program, pursuant to which the Russian government purchases drugs for free distribution to low income individuals. Our products Ciprolet 500 mg, Enam 2.5 mg, Enam 5 mg, Ketorol Tab, Ketorol Inj, Nise 500 mg, Cetrine and Finast are listed in the directory of drugs eligible for purchase under the DLO program. Our revenues from sales to the Russian government under the DLO program for fiscal 2006 were Rs.174.4 million.

During fiscal 2006, we reorganized our Russian sales force into a hospital division and an OTC division. The hospital division has six hospital specialists and nine key account managers focused on expanding our present network of relationships with hospitals and institutes. The OTC division has 13 medical representatives whose focus is to establish a network of relationships with OTC distributors in preparation for future OTC product launches.

*Other Markets.* We have operations in former Soviet Union countries other than Russia, including Ukraine, Kazakhstan, Belarus and Uzbekistan. We also have operations in other emerging markets, such as Venezuela, Vietnam, South Africa, Romania and Myanmar. Our export of formulations to these countries accounted for 13.9% of the revenues in our formulations segment in fiscal 2006.

In South Africa, we market through our consolidated subsidiary, Dr. Reddy's Laboratories (Proprietary) Limited ( DRLPL ). As of March 31, 2006, we held a 60% equity interest in DRLPL. We currently market three products through DRLPL in South Africa and have 17 products pending registration. During fiscal 2006, we launched lamotrigine tablets in South Africa through an in-licensing arrangement.

In China, we market through our equity investee, Kunshan Rotam Reddy Pharmaceuticals Co. Limited ( KRRP or Reddy Kunshan ). As of March 31, 2006, we held a 51.2% equity interest in KRRP. We currently market eight products through KRRP in China and have five products pending registration. During fiscal 2006, KRRP sold one product license and also obtained approval for one new product license, which was not yet commercialized as of March 31, 2006. Also, we opened a representative office in China during fiscal 2006 to expand our presence there.

### **Sales, marketing and distribution network**

*India.* We generate demand for our products by promoting them to doctors who prescribe them, and meeting with pharmacists to ensure that the pharmacists stock our brands. Our focus on brand building is thus primarily driven through efforts to build relationships with the medical community. While we do not sell directly to doctors or pharmacists, our approximately 1,589 field personnel frequently visit doctors and pharmacists throughout the country to promote our products. In addition, we sponsor medical conferences in different parts of the country and conduct seminars for doctors. During fiscal 2006, we increased our sales personnel in India by 229.

We sell our formulations primarily through clearing and forwarding agents to approximately 2,000 stockists who decide which brands to buy based on demand. The stockists pay for our products pursuant to an agreed credit period and in turn sell these products to retailers. Our clearing and forwarding agents are responsible for transporting our products to the stockists and ensuring that the stockists maintain adequate supplies of our products. We pay our clearing and forwarding agents on a commission basis. We have insurance policies that cover our products during shipment and storage at clearing and forwarding locations.

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*Russia.* In Russia, we sell our formulations to some of the principal national distributors directly as well as through our wholly-owned subsidiary located in Russia, OOO Dr. Reddy's Laboratories Limited, Russia. Our sales and marketing efforts are driven by a team of 117 marketing representatives, 11 regional managers, 4 zone managers and 9 key account managers to promote our products to doctors in 48 cities in Russia. During fiscal 2006, we have increased our sales personnel in Russia by 17.

In the Russian market, credit is generally extended only to customers after they have established a satisfactory history of payment with us. The credit ratings of these customers are based on turnover, payment record and the number of the customers' branches or pharmacies and are reviewed on a periodic basis. There were no material changes in the credit terms which we extended to our major customers during fiscal 2006.

*Other Markets.* In other markets, our key focus markets are South Africa, China, Kazakhstan, Uzbekistan, Ukraine, Belarus, Vietnam, Romania, Venezuela and Sri Lanka where we have our own sales personnel to promote our products. In South Africa, we sell our products to wholesale distributors, dispensing doctors and retail pharmacies. In China, where we market through KRRP, we have 85 (as of March 31, 2006) marketing representatives covering hospitals. In several of these markets, we market and distribute through local agents. We also have representative offices in several of these countries.

### **Manufacturing and Raw Materials**

We have three facilities for the manufacture of formulation products, all of which are situated in India, as of March 31, 2006. We manufacture most of our finished products at these facilities and also use third-party manufacturing facilities as we determine necessary. For each of our products, we endeavour to identify alternate suppliers of our products and the processes applicable to our products. The main difference between active pharmaceutical ingredients as compared to formulations and generics is the form in which they are produced and the way they are packaged. Active pharmaceutical ingredients are manufactured and distributed in bulk. In formulations and generics, these bulk ingredients are converted into finished dosages by adding other ingredients, called excipients, and packaged into individual doses that are ready for consumption by the patient. In fiscal 2006, our active pharmaceutical ingredients and intermediates business provided 34.2% of the active pharmaceutical ingredients and intermediates requirements of our formulations business, with the balance coming from various other suppliers.

We are also in the process of establishing a facility to manufacture oral solid and injectable forms of cyto-toxic and hormonal formulations at a Special Economic Zone located in Visakhapatnam, India. Upon completion of the facility, and commercialization of those products, the facility will cater to the requirements of our key markets for those products.

Our manufacture of formulations is subject to strict quality and contamination controls throughout the manufacturing process. Each production line consists of a series of rooms through which the product passes at different stages of its conversion to a finished dosage. In our facilities, we manufacture formulations in various dosage forms including tablets, capsules, injections and liquids. These dosage forms are then packaged and quarantined to be tested for quality and contamination. The Ministries of Health of Sudan, Brazil, Latvia and Romania have inspected some of our manufacturing plants. One of our facilities also has the approval of the U.K. Medicines and Health Care Products Regulatory Agency (MHRA). In April 2006, we completed the construction of a new facility at Baddi in the state of Himachal Pradesh, India. We will be manufacturing our key brands at this facility in Baddi to take advantage of certain financial benefits, which include exemption from income tax and excise duty for a specified period, offered by the government of India to encourage industrial growth in the state of Himachal Pradesh.

### **Competition**

We compete with different companies in different countries, depending upon therapeutic and product categories, and within each category upon dosage strengths and drug delivery. On the basis of sales, we are the seventh largest pharmaceutical seller in India, with a market share of 2.4% according to the ORG IMS March Moving Annual Total report for the 12-month period ending March 2006. Of the top ten participants in the Indian formulations market, three are multinational corporations and the rest are Indian corporations.

The business opportunities in India are on the rise and the Indian pharmaceutical business environment underwent considerable changes in fiscal 2006. Some of the most significant changes in the industry are as follows:

Introduction of the product patent regime, effective as of January 1, 2005;

Implementation of the Value Added Tax ( VAT ) system, effective as of April 1, 2005;

Introduction of the Maximum Retail Price ( MRP )-based excise duty structure for the pharmaceutical industry;

Higher investments by Indian companies in research and development, as well as an increase in the number of new product launches by Indian companies; and

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Improvement in sales of multinational corporations and increasing interest of global multinationals in India.

Our formulation segment's principal competitors in the Indian market are Cipla Limited, Glaxo SmithKline Pharmaceuticals Limited, Ranbaxy Laboratories Limited, Nicholas Piramal India Limited, Sun Pharmaceuticals Industries Limited and Zydus-Cadila.

Our formulation segment's principal competitors in the Russian market include Berlin Chemi AG, Gedeon Richter Ltd., Krka, dd, Novo mesto, Pliva dd, Nycomed A/S and Egis Pharmaceuticals Ltd.

In our export markets, we compete with local companies, multinational corporations and companies from other emerging markets. In Russia and in most of our export markets, we believe our products occupy a niche position between the less expensive local products and the more expensive products of the multinational corporations.

### **Government regulations**

All pharmaceutical companies that manufacture and market products in India are subject to various national and state laws and regulations, which principally include the Drugs and Cosmetics Act, 1940, the Drugs (Prices Control) Order, 1995 (DPCO), various environmental laws, labor laws and other government statutes and regulations. These regulations govern the testing, manufacturing, packaging, labeling, storing, record-keeping, safety, approval, advertising, promotion, sale and distribution of pharmaceutical products.

In India, manufacturing licenses for drugs and pharmaceuticals are generally issued by state drug authorities. Under the Drugs and Cosmetics Act, 1940, the state drug administrations are empowered to issue manufacturing licenses for drugs if they are approved for marketing in India by the Drug Controller General of India (DCGI). Prior to granting licenses for any new drugs or combinations of new drugs, DCGI clearance has to be obtained in accordance with the Drugs and Cosmetics Act, 1940.

Pursuant to the amendments in May 2005 to the Schedule Y of the Drugs and Cosmetics Act, 1940, manufacturers of finished dosages are required to submit additional technical data to the DCGI in order to obtain a no-objection certificate for conducting clinical trials as well as to manufacture new drugs for marketing.

All pharmaceutical manufacturers that sell products in any country are subject to regulations issued by the ministry of health (MoH) of the respective country. These regulations govern or influence the testing, manufacturing, packaging, labeling, storing, record-keeping, safety, approval, advertising, promotion, sale and distribution of products.

Our facilities and products are periodically inspected by various regulatory authorities such as the U.K. MHRA, the South African Medicines Control Council, the Brazilian National Agency of Sanitary Surveillance (also known as ANVISA), the Romanian National Medicines Agency, and the World Health Organization, all of which have extensive enforcement powers over the activities of pharmaceutical manufacturers operating within their jurisdiction.

MoH approval of an application is required before a generic equivalent of an existing or referenced brand drug can be marketed. When processing a generics application, the MoH waives the requirement of conducting complete clinical studies, although it normally requires bioavailability and/or bioequivalence studies. Bioavailability indicates the rate and extent of absorption and levels of concentration of a drug product in the blood stream needed to produce a therapeutic effect. Bioequivalence compares the bioavailability of one drug product with another, and when established, indicates that the rate of absorption and levels of concentration of the active drug substance in the body are the equivalent for the generic drug and the previously approved drug. A generic application may be submitted for a drug on the basis that it is the equivalent of a previously approved drug. Before approving a generic product, the MoH also requires that our procedures and operations conform to Current Good Manufacturing Practice (cGMP) regulations, relating to good manufacturing practices as defined by various countries. We must follow the cGMP regulations at all times during the manufacture of our products. We continue to spend significant time, money and effort in the areas of production and quality testing to help ensure full compliance with cGMP regulations.

The timing of final MoH approval of a generic application depends on various factors, including patent expiration dates, sufficiency of data and regulatory approvals.

Under the present drug policy of the government of India, certain drugs have been specified under the DPCO as subject to price control. The government of India established the National Pharmaceutical Pricing Authority (NPPA) to control pharmaceutical prices. Under the DPCO, the NPPA has the authority to fix the maximum selling price for specified products. At present, 74 drugs and



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their formulations are categorized as specified products under the DPCO. A limited number of our formulation products fall in this category. Adverse changes in the DPCO list or in the span of price control can affect pricing, and hence, our Indian revenues.

On March 22, 2005, the government of India passed the Patents (Amendment) Bill 2005 (the Amendment), introducing a product patent regime for food, chemicals and pharmaceuticals in India. The Amendment specifically provides that new medicines (patentability of which is not specifically excluded) for which a patent has been applied for in India on or after January 1, 1995 and for which a patent is granted cannot be manufactured or sold in India by other than the patent holder and its assignees and licensees. This will result in a reduction of the new product introductions in India, as well as other countries where similar legislation has been introduced, for all Indian pharmaceutical companies engaged in the development and marketing of generic finished dosages and APIs. Processes for the manufacture of APIs and formulations were patentable in India even prior to the Amendment, so no additional impact is anticipated from patenting of such processes.

**Active Pharmaceutical Ingredients and Intermediates Segment**

Our active pharmaceutical ingredients and intermediates business contributed 34.0% of our total revenues for fiscal 2006. Active pharmaceutical ingredients are the principal ingredients for finished dosages and are also known as bulk actives or bulk drugs. Active pharmaceutical ingredients become formulations when the dosage is prepared for human consumption in the form of a tablet, capsule or liquid using additional inactive ingredients. Intermediates are the compounds from which active pharmaceutical ingredients are prepared. We produce and market more than 100 different active pharmaceutical ingredients and intermediates in several markets. We export active pharmaceutical ingredients to emerging as well as developed markets covering over 80 countries. Our principal markets in this business segment include North America and Europe, which together contributed 37.4% of this segment's revenues. Our active pharmaceutical ingredients and intermediates business is operated independently from our formulations and generics businesses and, in addition to supplying API to our formulations and generics businesses, we sell APIs to third parties for use in creating generic products, subject to any patent rights of other third parties. Our active pharmaceutical ingredients business also manufactures and supplies all of the API required in our custom pharmaceutical services business. The research and development group within the active pharmaceutical ingredients and intermediates segment contributes to our business by creating intellectual property (principally with respect to novel and non-infringing manufacturing processes and intermediates), providing research intended to reduce the cost of production of our products and developing approximately 15-20 new products every year.

The following table sets forth active pharmaceutical ingredients and intermediates revenues by geographic area for fiscal 2004, 2005 and 2006 respectively:

	Fiscal Year Ended March 31,						
	2004		2005		2006		Total <sup>(1)</sup>
	Revenues (in millions) Rs.	% Total <sup>(1)</sup>	Revenues (in millions) Rs.	% Total <sup>(1)</sup>	Revenues (in millions) Rs.	U.S.\$	
<b>Emerging markets</b>							
India	2,115.1	27.7%	1,972.1	28.4%	2,296.4	51.6	27.8%
Bangladesh	94.1	1.2%	127.4	1.8%	265.7	6.0	3.2%
Other countries	1,847.5	24.2%	1,841.8	26.5%	2,558.9	57.5	31.1%
Total emerging markets	4,056.7	53.2%	3,941.3	56.8%	5,121.0	115.1	62.1%
<b>Developed markets</b>							
North America	1,902.9	24.9%	1,849.0	26.6%	1,655.0	37.2	20.1%

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Europe	1,626.9	21.3%	1,091.1	15.7%	1,420.9	31.9	17.3%
Japan	42.0	0.6%	63.1	0.9%	41.1	0.9	0.5%
Total developed markets	3,571.8	46.8%	3,003.2	43.2%	3,117.0	70.1	37.9%
Total	7,628.5	100.0%	6,944.5	100.0%	8,238.0	185.2	100.0%

(1) Refers to our revenues from API sales in the applicable country expressed as a percentage of our total revenues from API sales throughout the world.

The following table sets forth the sales of our key active pharmaceutical ingredients and intermediates for fiscal 2004, 2005 and 2006 respectively:



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Product	Category	Sub-Category	Fiscal Year Ended March 31,							
			2004		2005		2006		U.S.\$	% Total <sup>(1)</sup>
			Revenues	% Total	Revenues	% Total	Revenues			
			(in millions)		(in millions)		(in millions)			
Ciprofloxacin HCL	Anti-infective	Anti-bacterial	Rs. 959.8	12.6	Rs. 619.1	8.9	Rs. 778.5	U.S.\$17.4	9.5	
Ramipril	Cardiovascular	Anti-hypertensive	1314.2	17.2	783.4	11.3	642.5	14.4	7.8	
Ranitidine HCL	Gastro-intestinal	Anti-ulcerant	711.4	9.3	734.3	10.6	552.8	12.4	6.7	
Terbinafine HCL	Anti-infective	Anti-fungal	124.9	1.6	194.5	2.8	537.2	12.0	6.5	
Ibuprofen	Pain management	Analgesic	394.6	5.2	460.5	6.6	502.3	11.3	6.1	
Sertraline HCL	Cardiovascular	Anti-hypertensive	178.4	2.3	138.2	2.0	494.1	11.1	6.0	
Naproxen sodium	Pain management	Anti-inflammatory	437.3	5.7	470.0	6.8	380.4	8.5	4.6	
Naproxen	Pain management	Anti-inflammatory	233.8	3.1	229.6	3.3	375.0	8.4	4.6	
Atorvastatin	Cardiovascular	Lipid-lowering agent	211.2	2.8	252.5	3.6	321.1	7.2	3.9	
Montelukast	Respiratory	Anti-allergic		0.0	52.6	0.8	241.1	5.4	2.9	
Losartan potassium	Cardiovascular	Anti-hypertensive	214.2	2.8	180.5	2.6	172.7	3.9	2.1	
Sparfloxacin	Anti-infective	Anti-bacterial	197.1	2.6	117.5	1.7	168.2	3.8	2.0	
Nizatidine	Gastro-intestinal	Anti-ulcerant	159.6	2.1	216.8	3.1	160.9	3.6	2.0	
Clopidogrel	Cardiovascular	Anti-platelet agent		0.0	79.6	1.1	139.9	3.1	1.7	
Dextromethorphan	Respiratory	Anti-allergic	182.8	2.4	165.8	2.4	134.9	3.0	1.6	

(1) Refers to our revenues from key API sales expressed as a percentage of our total API revenues.

**Sales, Marketing and Distribution**

*Emerging Markets.* India is the single largest market in this region, contributing 27.8% to the segment's revenues in fiscal 2006. In India, we market our active pharmaceutical ingredients to Indian and multinational companies who are also our competitors in our formulations segment.

In India, our top six products are ciprofloxacin, ranitidine, sparfloxacin, losartan potassium, atorvastatin and ibuprofen. The market in India is highly competitive with severe pricing pressure and competition from cheaper Chinese imports in several products.

In India, our sales team works closely with our sales agents to market our products. We market our products through these sales agents, commonly referred to as indenting agents, with a focus on regional sales and marketing. The sales are made directly from the factory and to a limited extent through clearing and forwarding agents. Distribution through clearing and forwarding agents is done to give better service to the customer.

Our sales to other emerging markets were Rs.2,824.6 million for fiscal 2006. Our key emerging markets include Bangladesh, South Korea, China, Taiwan, Argentina, Brazil, Mexico, Turkey, Egypt, Saudi Arabia, South Africa and Kenya. While we work through our agents in these markets, our zonal marketing managers also interact directly with our key customers in order to service their requirements. Our strategy is to build relationships with top customers in

each of these markets and partner with them in product launches by providing timely technical and analytical support.

*Developed Markets.* Our principal markets are North America and Europe. In the United States and Europe, over the next five years, a large number of products are expected to lose patent protection, providing growth opportunities for our active pharmaceutical ingredients and intermediates business. We have been marketing APIs in the United States for over a decade. We market through our subsidiaries in the United States and Europe. These subsidiaries are engaged in all aspects of marketing activity and support our customers' pursuit of regulatory approval for their products focusing on building long-term relationships with the customers.

As of March 31, 2006, we had 81 DMFs on file in the United States. As of March 31, 2006, we had filed 41 DMFs in Europe and had 18 certificates of suitability granted by European authorities. For most of these, we are either already supplying commercial quantities or development quantities of API to various generic formulators.

#### Manufacturing and Raw Materials

We have seven facilities for the manufacture of our APIs. Six of these facilities have been inspected by the U.S. FDA and follow cGMP. All of these facilities are situated in the state of Andhra Pradesh, India. Six of these facilities have ISO 9001 certification, which is valid until December 5, 2006, at which time we will be reinspected. With over 500 reactors of different sizes offering 1.8 million litres of reaction volume annually, we have the flexibility to produce quantities that range from a few kilograms to several metric tons. The manufacturing process consumes a wide variety of raw materials that we obtain from sources that comply with the requirements of regulatory authorities in the markets to which we supply our products. We procure raw materials on the basis of our requirement planning cycles. We utilize a broad base of suppliers in order to minimize risk arising from dependence on a single supplier. Where possible, we have also entered into annual quantity and price contracts to reduce possible supply risks and minimize costs. Our formulations and generics businesses source approximately 34.2% and 72.7% respectively, of their API purchases from our active pharmaceutical ingredients and intermediates segment. We also outsource the manufacturing of some of our APIs to third-party manufacturers. The active pharmaceutical ingredients and intermediates segment also sources several APIs from third party suppliers for the emerging markets to optimally utilize the in-house manufacturing capacities for the developed markets, which are more profitable relative to the emerging markets. During fiscal 2006, 8.5% of our total revenues resulted from sale of APIs procured from third-party suppliers. We maintain stringent quality controls when procuring materials from third-party suppliers.

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### **Competition**

The global API market can broadly be divided into regulated and less regulated markets. The less regulated markets offer low entry barriers in terms of regulatory requirements with respect to the qualification process and intellectual property rights. The regulated markets, like the United States and Europe, have high regulatory entry barriers in terms of cGMP and approved facilities. As a result, there is a premium for quality and regulatory compliance along with relatively greater stability for both volumes and prices.

During fiscal 2006, the competitive environment for the API industry underwent significant changes. These changes included increased competition from companies based in India and China and increasing trends of consolidation in the global generics industry, with some of the key generics companies beginning to strengthen their in-house API development capabilities.

We compete with a number of manufacturers within and outside India, which vary in size. Our main competitors in this segment are Hetero Drugs Limited, Divi's Laboratories Limited, Shasun Chemicals and Drugs Limited, Aurobindo Pharma Limited, Ranbaxy Laboratories Limited, Cipla Limited, Matrix Laboratories Limited and Biocon India Limited, all based in India. In addition, we experience competition from European and Chinese manufacturers, as well as from Teva Pharmaceuticals Industries Limited, based in Israel.

### **Government regulations**

All pharmaceutical companies that manufacture and market products in India are subject to various national and state laws and regulations, which principally include the Drugs and Cosmetics Act, 1940, the Drugs (Prices Control) Order, 1995, various environmental laws, labor laws and other government statutes and regulations. These regulations govern the testing, manufacturing, packaging, labeling, storing, record-keeping, safety, approval, advertising, promotion, sale and distribution of pharmaceutical products.

In India, manufacturing licenses for drugs and pharmaceuticals are generally issued by state drug authorities. Under the Drugs and Cosmetics Act, 1940, the state drug administrations are empowered to issue manufacturing licenses for drugs if they are approved for marketing in India by the DCGI. Prior to granting licenses for any new drugs or combinations of new drugs, the DCGI clearance has to be obtained in accordance with the Drugs and Cosmetics Act, 1940.

Our active pharmaceutical ingredients and intermediates segment is subject to a number of government regulations with respect to pricing and patents as discussed above under our formulations segment.

We submit a DMF for active pharmaceutical ingredients to be commercialized in the United States. Any drug product for which an Abbreviated New Drug Application (ANDA) is being filed must have a DMF in place with respect to a particular supplier supplying the underlying active pharmaceutical ingredient. The manufacturing facilities are inspected by the U.S. FDA to assess cGMP compliance. The manufacturing facilities and production procedures utilized at the manufacturing facilities must meet U.S. FDA standards before products may be exported to the United States. Six of our manufacturing facilities have been inspected by the U.S. FDA and found Acceptable. For European markets, we submit a European DMF and, where applicable, obtain a certificate of suitability from the European Directorate for the Quality of Medicines.

### **Generics Segment**

Generic drugs are the chemical and therapeutic equivalents of reference brand drugs, typically sold under their generic chemical names at prices below those of their brand drug equivalents. Generic drugs are finished pharmaceutical products ready for consumption by the patient. Our generic products are marketed principally in North America and Europe. These drugs are required to meet governmental standards that are similar to those applicable to their brand-name equivalents and must receive regulatory approval prior to their sale in any given country.

Our generics operations started in the second half of fiscal 2001. This segment accounted for 16.7% of our total revenues for fiscal 2006, contributing Rs.4,055.8 million. Revenues from sales of omeprazole capsules in the United Kingdom accounted for 23.5% of our total revenues in this segment in fiscal 2006. Significant product launches in fiscal 2006 included glimpiride tablets and zonisamide tablets in the United States and terbinafine tablets in the United Kingdom.

In fiscal 2006, revenues in this segment were Rs.2,421.5 million from sales in Europe, Rs.1,630.6 million from sales in North America and Rs.3.7 million from sales in the rest of the world. Revenue from Europe includes

Rs.704.9 million of revenue from betapharm in Germany (starting March 3, 2006).

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The following table sets forth the sales of our principal generics finished dosages for fiscal 2004, 2005 and 2006 respectively:

			Fiscal Year Ended March 31,							
			2004	2005		2006				
Therapeutic			Revenues		Revenues		Revenues	Revenues		
			(in	%	(in	%	(in	(in	%	
Region / Product	Therapeutic Category	Sub-Category	millions)	Total <sup>(1)</sup>	millions)	Total <sup>(1)</sup>	millions)	million)	Total <sup>(1)</sup>	
North America										
Fluoxetine capsules	Central nervous system	Anti-psychotic	Rs. 1,898.4	43.8	Rs. 928.5	26.0	Rs. 373.8	U.S.\$8.4	9.2	
Ibuprofen tablets	Pain management	Analgesic	184	4.2	198.7	5.6	235.1	5.3	5.8	
Ranitidine tablets	Gastro-intestinal	Anti-ulcerant	205.8	4.7	194.0	5.4	225.9	5.1	5.6	
Famotidine tablets	Gastro-intestinal	Anti-ulcerant	143.4	3.3	141.1	3.9	156.1	3.5	3.9	
Citalopram tablets	Central nervous system	Anti-psychotic		0.0	201.6	5.6	143.4	3.2	3.5	
Ciproflaxacin tablets	Anti-infective	Anti-bacterial	1.6	0.0	166.1	4.6	135.3	3.0	3.3	
Tizanidine tablets	Spasticity	Muscle relaxant	591.1	13.6	206.2	5.8	62.8	1.4	1.6	
Ranitidine capsules	Gastro-intestinal	Anti-ulcerant	167.3	3.9	84.9	2.4	27.9	0.6	0.7	
Total			3,191.6	73.5	2,121.1	59.3	1,360.3	30.5	33.6	
Europe										
Omeprazole capsules	Gastro-intestinal	Anti-ulcerant	325.3	7.5	434.1	12.1	786.3	17.7	19.4	
Amlodipine maleate tablets	Cardiovascular	Anti-hypertensive	17.7	0.4	219.9	6.1	371.5	8.4	9.2	
Total			343.0	7.9	654.0	18.2	1,157.8	26.1	28.6	

(1) Refers to our revenues from generics sales in the applicable region expressed as a percentage of our total revenues from generics sales throughout the world.

Generic drugs may be manufactured and marketed only if relevant patents on their brand name equivalents and any additional government-mandated market exclusivity periods have expired, been challenged and invalidated, or otherwise validly circumvented.

Generic pharmaceutical sales have increased significantly in recent years, due in part to an increased awareness and acceptance among consumers, physicians and pharmacists that generic drugs are the equivalent of brand-name drugs. Among the factors contributing to this increased awareness are the passage of legislation permitting or encouraging substitution and the publication by regulatory authorities of lists of equivalent drugs, which provide physicians and pharmacists with generic drug alternatives. In addition, various government agencies and many private managed care or insurance programs encourage the substitution of generic drugs for brand-name pharmaceuticals as a cost-savings measure in the purchase of, or reimbursement for, prescription drugs. We believe that these factors, together with the large volume of branded products losing patent protection over the coming years, should lead to continued expansion of the generic pharmaceuticals market as a whole. We intend to capitalize on the opportunities resulting from this expansion of the market by leveraging our product development capabilities, manufacturing capacities inspected by various international regulatory agencies and access to our own APIs, which offer significant supply chain efficiencies.

Through the coordinated efforts of our teams in the United States, Europe and India, we constantly seek to expand our pipeline of generic products. As of March 31, 2006, our U.S. generics pipeline included 50 ANDA applications pending approval at the U.S. FDA. As of March 31, 2006, we had received 13 product approvals from the U.S. FDA and 10 tentative product approvals (tentative approvals do not allow us to market the generic product and are not converted to final approvals until all patent or exclusivity issues for the reference listed drug product have been resolved). As of March 31, 2006, we had received six product approvals in Europe (products approvals have been filed in one or more of the United Kingdom, Germany or France, and once approval in one of these countries is obtained, we have the ability to obtain approvals in other countries of the European Union as applicable patents expire in those countries), four product approvals in South Africa, two product approvals in Canada and one product approval in each of Australia and New Zealand. During fiscal 2005, we entered into an agreement with I-VEN Pharma Capital Limited ( I-VEN ) for the joint development and commercialization of generic drug products for the U.S. markets. The agreement gives I-VEN the right to fund up to fifty percent of the project costs (development, registration and legal costs) related to these products and the related U.S. Abbreviated New Drug Applications ( ANDA ) filed or to be filed in 2004-05 and 2005-06, subject to a maximum funding right of U.S.\$56.0 million.

#### Sales, Marketing and Distribution Network

*North America.* Dr. Reddy's Laboratories, Inc., our wholly-owned subsidiary in the United States, is engaged in the marketing of our generic products in North America. In early 2003, we commenced sales of generic products under our own label. We have our own sales and marketing team to market these generic products. During fiscal 2006, we launched glimepiride tablets, zonisamide capsules, fluoxetine capsules, ranitidine capsules, enalapril/hydrochlorothiazide tablets, famotidine tablets and tizanidine tablets. Key account representatives for generic products call on purchasing agents for chain drug stores, drug wholesalers, health maintenance organizations and pharmacy buying groups. They also contact retail pharmacy chains and support the retailer's selling efforts with exhibits at key medical and pharmaceutical conventions.

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In January 2006, we entered into an agreement with Merck & Co., Inc. allowing us to distribute and sell generic versions of finasteride and simvastatin (sold by Merck under the brand names Proscar® and Zocor®), upon the expiration of Merck's patents covered by these products, provided that some other company obtains 180-day exclusivity after the expiration of the patents for either product. Subsequently, the patents for both of these products expired and other companies obtained 180-day exclusivity. Accordingly, we launched sales of these products on June 19, 2006 and June 23, 2006 respectively.

On March 13, 2006, we acquired trademarks rights to three off-patent products, along with all the physical inventories of the products, from PDL Biopharma, Inc ( PDL ) for a total consideration of Rs.122.7 million. PDL is a company focused in the development and commercialization of novel therapies for treatment of inflammation and autoimmune diseases, acute cardiac conditions and cancer. As a result of the acquisition, we acquired an opportunity to sell these products using their existing brand names through our generics sales and marketing network.

In 2001, we entered into a profit sharing marketing alliance with Par Pharmaceuticals, Inc. to market certain prescription generic formulations, none of which are over-the-counter products. We currently market six generic products through Par Pharmaceuticals, Inc.

We market famotidine 10 mg tablets and ranitidine 75 mg tablets through Leiner Health Products, LLC ( Leiner ). In 2002, we entered into a 15-year exclusive agreement with Leiner to market additional over-the-counter products in the United States. We have not launched any product under this agreement.

In Canada, in fiscal 2002, we entered into a profit sharing arrangement with Cobalt Pharmaceuticals Inc. and Pharmascience Inc. to market certain of our generic products.

*United Kingdom.* Dr. Reddy's Laboratories (U.K.) Limited, which we acquired in fiscal 2003, is engaged in the marketing of our generic products in the United Kingdom and other European Union countries. We currently market approximately 36 generic products representing over 105 dosage strengths. New product launches in fiscal 2006 included the generic versions of glimepiride, lansoprazole, lisinopril, sertraline and terbinafine. We also seek to expand our presence to the other European countries either directly or through strategic alliances. Consistent with this strategy, during fiscal 2006 we commenced sales of generic terbinafine in certain European markets through an out-licensing arrangement.

*Germany.* In March 2006, we acquired 100% of beta Holding GmbH ( betapharm ) from 3i Group plc, a European private equity house. This acquisition allowed us to enter the German market. The German market has significant barriers to entry that largely emanate from the fact that generics in Germany are prescribed by brand rather than by active ingredient. The German generics market has certain distinct characteristics, as compared with other major markets including the United States, Japan and the United Kingdom. These include the method of promoting generics, the reimbursement and insurance system and the structure of the retail channel. As a result, physicians are the primary determinant of which drug and what brand is dispensed. In addition, pharmacists also have an important influence, as they have the ability to substitute brands. More recently, the Statutory Health Insurance (or SHI) funds, which in aggregate cover approximately 90% of the population in Germany, have been exerting their influence to contract directly with generics manufacturers, an option made possible under recent legislative reforms. Going forward, we expect that each of these customer groups will play an important role in the ultimate determination of which brand gets dispensed.

Through our national German sales force, we sell a broad and diversified range of generic pharmaceutical products, primarily solid dose, under the beta brand. The sales force targets primary care physicians and pharmacists and key account management targets SHI funds. These efforts are supported by a direct marketing team and an active public relations program. Value-added services provided by the beta Institute for Sociomedical Research, a non-profit organization engaged in research and development in order to seek means of improving the healthcare process in ways which promote the psychological welfare of patients, are fully integrated into the sales and marketing effort and provide a unique differentiation point for the sales calls of both physician and pharmacy representatives.

Our sales force promotes products to physicians and pharmacies by emphasizing product-specific factors, promoting our reputation and other promotional and customer relationship activities.

betapharm's key account management function focuses on SHI funds, which are attempting to increase their influence in the generics market. We are one of the few generics companies to have concluded agreements with SHI

funds.

Manufacturing and Raw Materials

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As with formulations, generics are packaged in individual doses for consumption by the patient. In fiscal 2006, our generics segment procured 72.7% of its API requirements from our active pharmaceutical ingredients and intermediates segment

For a majority of the products we sell in the United States and the United Kingdom (to the extent not manufactured in the United Kingdom), we manufacture our finished products at our plant in Bachupally, Andhra Pradesh, India. The facility in Andhra Pradesh, India is designed for the manufacture of tablets, hard gelatin capsules. We added large batch size tableting and pellets capabilities in this facility during fiscal 2003. We are dependent on third parties for the supply of the inactive pharmaceutical ingredients used in our products. In Germany, we outsource the manufacture of all of our products to third parties.

For our manufacturing operations in India, we source most of the raw material requirements with respect to the active pharmaceutical ingredients internally from our active pharmaceutical ingredients and intermediates segment. We are required to identify the suppliers of all the raw materials for our products in the drug applications that we file with the U.S. FDA. If raw materials for a particular product become unavailable from an approved supplier specified in a drug application, we would be required to qualify a substitute supplier with the U.S. FDA, which would likely interrupt manufacturing of the affected product. To the extent practicable, we attempt to identify more than one supplier in each drug application. However, some raw materials are available only from a single source and, in some of our drug applications, only one supplier of raw materials has been identified, even in instances where multiple sources exist. In addition, we obtain a significant portion of our inactive pharmaceutical ingredients from foreign suppliers. Arrangements with international raw material suppliers are subject to, among other things, U.S. FDA regulations, various import duties and other government clearances.

Our facilities in the United Kingdom are located at Battersea and Beverley. These facilities currently serve the requirements of the U.K. market. These facilities are designed for the manufacture and packaging of pharmaceutical products in a variety of dosage forms, including tablets, capsules, liquids and creams. All of our U.K. manufacturing operations are subject to stringent regulatory controls with both facilities subject to regular inspections from the U.K. regulatory bodies. The facilities hold all relevant licenses and authorizations required to conduct all necessary activities, including the supply of materials for use in clinical studies. In addition, the quality systems for ensuring product quality planning and control are ISO 9000 accredited. We are in the process of transferring the manufacturing of products from the Battersea facility to our facilities in India and we intend to close the Battersea facility in fiscal 2007.

For our manufacturing operations in the United Kingdom, we are dependent on third parties for the supply of all pharmaceutical ingredients and packaging materials used in manufactured products. Supply agreements are in place with all of our suppliers. We are required to identify the suppliers of key raw materials, including all active materials used in our products, within our applications to market products within the United Kingdom and Europe. If we wish to change to an alternative supplier, then we are required to substantiate the suitability of the alternative raw materials and seek prior approval from the health authority in each market where our products using the alternative raw materials are marketed.

We are in the process of expanding our facility at Bachupally, Andhra Pradesh to manufacture tablets and capsules. We are also in the process of establishing a facility at a Special Economic Zone located in Visakhapatnam, India to manufacture tablets and capsules. Upon completion of the facility, and commercialization of such products, the facility will cater to the requirements of North American and European customers for those products.

In Germany, manufacturing of betapharm's products and the logistics function have been outsourced to third party providers under supply and service agreements. These agreements provide the security of long-term supply on commercially attractive terms while also providing flexibility in the future.

## **Competition**

Revenues and gross profit derived from the sales of generic pharmaceutical products are affected by certain regulatory and competitive factors. As patents and regulatory exclusivity for brand name products expire, the first off-patent manufacturer to receive regulatory approval for generic equivalents of such products is generally able to achieve significant market penetration. As competing off-patent manufacturers receive regulatory approvals on similar products, market share, revenues and gross profit typically decline, in some cases significantly. Accordingly, the level

of market share, revenues and gross profit attributable to a particular generic product is normally related to the number of competitors in that product's market and the timing of that product's regulatory approval and launch, in relation to competing approvals and launches. Consequently, we must continue to develop and introduce new products in a timely and cost-effective manner to maintain our revenues and gross margins. In addition, the other competitive factors critical to this business include price, product quality, prompt delivery, customer service and reputation. Many of our competitors seek to participate in sales of generic products by, among other things, collaborating with other generic pharmaceutical companies or by marketing their own generic equivalent to their branded products. Our major competitors for the U.S. market include Ranbaxy Laboratories Limited,

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Teva Pharmaceutical Industries Limited, Barr Laboratories Inc., Mylan Laboratories Inc., Andrx Corporation, Watson Laboratories Inc., and Sandoz, a division of Novartis Pharma A.G.

Brand-name manufacturers have devised numerous strategies to delay competition from lower cost generic versions of their products. One of these strategies is to change the dosage form or dosing regimen of the brand product prior to generic introduction, which may reduce the demand for the original dosage form as sought by a generic ANDA dossier applicant or create regulatory delays, sometimes significant, while the generic applicant, to the extent possible, amends its ANDA dossier to match the changes in the brand product. In many of these instances, the changes to the brand product may be protected by patent or data exclusivities, further delaying generic introduction. Another strategy is the launch by the innovator or its licensee of an authorized generic during the 180-day generic exclusivity period, resulting in two generic products competing for the market rather than just the product that obtained the generic exclusivity. This may result in reduced revenues for the generic company, which has been awarded the generic exclusivity period. In January 2006, we entered into an agreement with Merck & Co., Inc., allowing us to distribute and sell generic versions of finasteride and simvastatin (sold by Merck under the brand names Proscar® and Zocor®), upon the expiration of Merck's patents covered by these products, provided that some other company obtains 180-day exclusivity after the expiration of the patents for either product. Subsequently, the patents for both of these products expired and other companies obtained 180-day exclusivity. Accordingly, we launched sales of these products on June 19, 2006 and June 23, 2006 respectively.

In Germany, the companies with the largest generics market shares are continuing to increase their generics market shares. The top five generics companies in Germany hold an aggregate market share of approximately 56.3% as per INSIGHT HEALTH NPI-Gx (September 2005). Our key competitors within the German generics market include Sandoz, a division of Novartis Pharma A.G., Ratiopharm GmbH, Stada Arzneimittel AG and Winthrop Pharmaceuticals.

## **Government regulations**

### ***U.S. Regulatory Environment***

All pharmaceutical manufacturers that sell products in the United States are subject to extensive regulation by the U.S. federal government, principally pursuant to the Federal Food, Drug and Cosmetic Act, the Hatch-Waxman Act, the Generic Drug Enforcement Act and other federal government statutes and regulations. These regulations govern or influence the testing, manufacturing, packaging, labeling, storing, record-keeping, safety, approval, advertising, promotion, sale and distribution of products.

Our facilities and products are periodically inspected by the U.S. FDA, which has extensive enforcement powers over the activities of pharmaceutical manufacturers. Non-compliance with applicable requirements can result in fines, criminal penalties, civil injunction against shipment of products, recall and seizure of products, total or partial suspension of production, sale or import of products, refusal of the U.S. government to enter into supply contracts or to approve new drug applications and criminal prosecution. The U.S. FDA also has the authority to deny or revoke approvals of drug active ingredients and dosage forms and the power to halt the operations of non-complying manufacturers. Any failure by us to comply with applicable U.S. FDA policies and regulations could have a material adverse effect on the operations in our generics business.

U.S. FDA approval of an ANDA is required before a generic equivalent of an existing or referenced brand drug can be marketed. The ANDA process is abbreviated because when processing an ANDA, the U.S. FDA waives the requirement of conducting complete clinical studies, although it normally requires bio-availability and/or bio-equivalence studies. An ANDA may be submitted for a drug on the basis that it is the equivalent of a previously approved drug or, in the case of a new dosage form, is suitable for use for the indications specified.

An ANDA applicant in the United States is required to review the patents of the innovator listed in the U.S. F.D.A. publication entitled *Approved Drug Products with Therapeutic Equivalence Evaluations*, popularly known as the

Orange Book, and make an appropriate certification. There are several different types of certifications that can be made. A Paragraph IV filing is made when the ANDA applicant believes its product or the use of its product does not infringe on the innovator's patents listed in the Orange Book or where the applicant believes that such patents are not valid or enforceable. The first generic company to file a Paragraph IV filing may be eligible to receive a six-month marketing exclusivity period from the date a court rules the patent is invalid or not infringed. A Paragraph III filing is

made when the ANDA applicant does not intend to market its generic product until the patent expiration. A Paragraph II filing is made where the patent has already expired. A Paragraph I filing is made when the innovator has not submitted the required patent information for listing in the Orange Book. Another type of certification is made where a patent claims a method of use, and the ANDA applicant's proposed label does not claim that method of use. When an innovator has listed more than one patent in the Orange Book, the ANDA applicant must file separate certifications as to each patent. Generally, Paragraph IV and Paragraph III filings are made before the product goes off patent, and Paragraph II and Paragraph I filings are made after the patent has expired.

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Before approving a product, the FDA also requires that our procedures and operations conform to Current Good Manufacturing Practice ( cGMP ) regulations, relating to good manufacturing practices as defined in the U.S. Code of Federal Regulations. We must follow cGMP regulations at all times during the manufacture of our products. We continue to spend significant time, money and effort in the areas of production and quality testing to help ensure full compliance with cGMP regulations.

The timing of final U.S. FDA approval of an ANDA depends on a variety of factors, including whether the applicant challenges any listed patents for the drug and whether the brand-name manufacturer is entitled to one or more statutory exclusivity periods, during which the U.S. FDA may be prohibited from accepting applications for, or approving, generic products. In certain circumstances, a regulatory exclusivity period can extend beyond the life of a patent, and thus block ANDAs from being approved on the patent expiration date. For example, in certain circumstances the U.S. FDA may now extend the exclusivity of a product by six months past the date of patent expiration if the manufacturer undertakes studies on the effect of their product in children, a so-called pediatric extension.

In June 2003, the U.S. FDA announced reforms in its generic drug review program with the goal of providing patients with greater and more predictable access to effective, low cost generic alternatives to brand name drugs.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Medicare Act of 2003 ) has modified certain provisions of the Hatch-Waxman Act. In particular, significant changes have been made to provisions governing 180-day exclusivity and forfeiture thereof. The new statutory provisions governing 180-day exclusivity may or may not apply to an ANDA, depending on whether the first Paragraph IV certification submitted by any applicant for the drug was submitted prior to the enactment of the Medicare Amendments on December 8, 2003.

Where the first Paragraph IV certification was submitted on or after December 8, 2003, the new statutory provisions apply. Under these provisions, 180-day exclusivity is awarded to each ANDA applicant submitting a Paragraph IV certification for the same drug with regard to any patent on the first day that any ANDA applicant submits a Paragraph IV certification for the same drug. The 180-day exclusivity period begins on the date of first commercial marketing of the drug by any of the first applicants. However, a first applicant may forfeit its exclusivity in a variety of ways, including, but not limited to (a) failure to obtain tentative approval within 30 months after the application is filed or (b) failure to market its drug by the later of two dates calculated as follows: (x) 75 days after approval or 30 months after submission of the ANDA, whichever comes first, or (y) 75 days after each patent for which the first applicant is qualified for 180-day exclusivity is either (1) the subject of a final court decision holding that the patent is invalid, not infringed, or unenforceable or (2) withdrawn from listing with the U.S. FDA (court decisions qualify if either the first applicant or any applicant with a tentative approval is a party; a final court decision is a decision by a court of appeals or a decision by a district court that is not appealed). The foregoing is an abbreviated summary of certain provisions of the Medicare Act, and accordingly it should be consulted for a complete understanding of both the provisions described above and other important provisions related to 180-day exclusivity and forfeiture thereof.

Where the first Paragraph IV certification was submitted prior to enactment of the Medicare Act, the statutory provisions governing 180-day exclusivity prior to the Medicare Act still apply. The U.S. FDA interprets these statutory provisions to award 180-day exclusivity to each ANDA applicant submitting a Paragraph IV certification for the same drug on the same day with regard to the same patent on the first day that any ANDA applicant submits a Paragraph IV certification for the same drug with regard to the same patent. The 180-day exclusivity period begins on the date of first commercial marketing of the drug by any of the first applicants or on the date of a final court decision holding that the patent is invalid, not infringed, or unenforceable, whichever comes first. A final court decision is a decision by a court of appeals or a decision by a district court that is not appealed.

### *European Union Regulatory Environment*

The activities of pharmaceutical companies within the European Union are governed by Directive 2001/83EC as amended. This Directive outlines the legislative framework, including the legal basis of approval, specific licensing procedures, and quality standards including manufacture, patient information and pharmacovigilance activities.

Our U.K. facilities are licensed and periodically inspected by the U.K. MHRA Inspectorate, which has extensive enforcement powers over the activities of pharmaceutical manufacturers. Non-compliance can result in product recall and closure. In addition, the U.K. MHRA Inspectorate has approved and periodically inspected our manufacturing facility based in Andhra Pradesh, India for the manufacture of generic tablets and capsules for supply to Europe.

All pharmaceutical companies that manufacture and market products in Germany are subject to the rules and regulations defined by the German drug regulator, the Bundesinstituts für Arzneimittel und Medizinprodukte ( BfArM ) and the Federal Drug Authorities. Our facilities in Germany are licensed and periodically inspected by the Federal Drug Authorities, which has extensive enforcement powers over the activities of pharmaceutical companies. Non-compliance can result in closure of the facility.

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Prior approval of a Marketing Authorization is required to supply products within the European Union. Such Marketing Authorizations may be restricted to one member state then recognized in other member states or can cover the whole of the European Union, depending upon the form of registration elected. In Germany, Marketing Authorizations have to be submitted for approval to the BfArM.

Generic or abridged applications omit full non-clinical and clinical data but may contain limited non-clinical and clinical data, depending upon the legal basis of the application or to address a specific issue. The majority of our generic applications are made on the basis of essential similarity although other criteria may be applied. In the case of an essentially similar application, the applicant is required to demonstrate that its generic product contains the same active pharmaceutical ingredients in the same dosage form for the same indication as the innovator product. Specific data is included in the application to demonstrate that the proposed generic product is essentially similar to the innovator product with respect to quality, safe usage and continued efficacy. The applicant is also required to demonstrate bioequivalence with the referenced product. Once all these criteria are met then a Marketing Authorization may be considered for grant.

Unlike in the United States, there is no regulatory mechanism within the European Union to challenge any patent protection. Nor is any period of market exclusivity conferred upon the first generic approval. In situations where the period of exclusivity given to the branded product expires before their patent expires, the launch of our product would then be delayed until patent expiration.

In Germany, the government has introduced several healthcare reforms in order to control healthcare spending and promote the prescribing of generic drugs. In late 2003, the German government passed the healthcare reform act ( GKV-Modernisierungs-Gesetz ) which became effective January 1, 2004. As the reform aimed to reduce overall healthcare costs, the majority of changes were related to reimbursement. Subsequently, the German government passed the Economic Optimization of the Pharmaceutical Care Act ( Arzneimittelsversorgungs-Wirtschaftlichkeitsgesetz or AVWG ) which became effective May 1, 2006 which also is designed to contain increased pharmaceutical costs. The AVWG s provisions include, among other things: prohibitions on the provision of free goods to pharmacists; limitations on the payment of rebates to wholesalers and pharmacists; prohibitions on price increases for generics prior to March 31, 2008; implementation of additional mandatory rebates of 10% if pharmaceutical prices are not 30% below the reference prices as published by the German government; reduction of fixed prices as of July 1, 2006; and empowering the SHI organizations to waive copayments by patients.

*Canada and South Africa Regulatory Environment*

In Canada and South Africa, we are required to file product dossiers with the particular country s regulatory authority for permission to market the generic formulation. The regulatory authorities may inspect our manufacturing facility before approval of the dossier.

**Critical Care and Biotechnology Segment**

The critical care and biotechnology businesses were started in 1998 to focus on and create a strong technology base in these areas. While this area of our business generates low sales volume, the products are generally high value. Our critical care products are formulations used in hospitals to treat cancer and for supportive care. Our biotechnology products cover recombinant protein therapeutics development. The trading operations of our diagnostics division were discontinued in fiscal 2004.

The following table provides revenues for this segment for fiscal 2004, 2005 and 2006 respectively:

Division	Fiscal Year ended March 31,						
	2004		2005		2006		
	Revenues (in millions)	% Total	Revenues (in millions)	% Total	Revenues (in millions)		% Total
Critical Care	Rs. 325.2	79.1	Rs. 407.9	77.4	Rs. 517.5	U.S.\$11.6	74.9
Diagnostics	9.1	2.2					
Biotechnology	76.7	18.7	119.2	22.6	173.6	3.9	25.1

Total	Rs. 411.0	100.0	Rs. 527.1	100.0	Rs. 691.1	U.S.\$15.5	100.00
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The following table sets forth revenues of our critical care and biotechnology segment by geographic area for fiscal 2004, 2005 and 2006 respectively:

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Division	Fiscal Year ended March 31,						
	2004		2005		2006		
	Revenues (in millions) Rs.	% Total <sup>(1)</sup>	Revenues (in millions) Rs.	% Total <sup>(1)</sup>	Revenues (in millions) Rs. U.S.\$		% Total <sup>(1)</sup>
India	259.5	63.1	360.7	68.4	450.4	10.1	65.2
Russia	39.5	9.6	62.3	11.8	93.0	2.1	13.4
Other countries of the former Soviet Union	12.2	3.0	19.4	3.7	56.5	1.3	8.2
Other	99.8	24.3	84.7	16.1	91.2	2.0	13.2
Total	Rs. 411.0	100.0	Rs. 527.1	100.0	Rs. 691.1	U.S.\$ 15.5	100.0

(1) Refers to our revenues from market sales in the applicable country expressed as a percentage of our total revenues throughout the world.

*Critical care.* This business accounted for 74.9% of the segment's revenues in fiscal 2006, contributing Rs.517.5 million. We focus on high margin, low volume products for niche markets in India in the area of critical care. Our main products are Mitotax (paclitaxel), Cytogem (gemcitabine), Docetere (docetaxel) and Irinocam (irinotecan). We also market Dacotin (oxaliplatin), which is licensed and imported from Debiopharm S.A. of Switzerland.

*Biotechnology.* This business accounted for 25.1% of the segment's revenues in fiscal 2006, contributing Rs.173.6 million. Grafeel is the only biotechnology product we sold in fiscal 2006 and sell currently.

The following table sets forth the sales of our key products in fiscal 2004, 2005 and 2006:

Product	Therapeutic Category	Fiscal Year ended March 31,					
		2004		2005		2006	
		Revenues (in millions) Rs	% Total <sup>(1)</sup>	Revenues (in millions) Rs	% Total <sup>(1)</sup>	Revenues (in millions) Rs U.S.\$	% Total <sup>(1)</sup>
Mitotax	Ovarian/breast/lung cancer	123.8	30.1	178.8	33.9	231.8	33.5
Docetere	Breast/lung cancer	77.0	18.7	73.2	13.9	81.6	11.8
Cytogem		63.3	15.4	59.1	11.2	55.7	8.1

	Lung/pancreatic cancer							
Dacotin	Colorectal cancer	16.4	4.0	25.9	4.9	43.8	1.0	6.3
Grafeel	Supportive therapeutic	71.8	17.5	119.2	22.6	173.6	3.9	25.1
Total		352.3	85.7	456.2	86.5	586.5	13.2	84.9

(1) Refers to our revenues from sales of the applicable product expressed as a percentage of the total revenues of our critical care and biotechnology segment.

Our biotechnology portfolio is currently comprised of Grafeel, the bio-generic version of Filgrastim. Filgrastim is a recombinant protein used in chemotherapy-induced neutropenia and in bone marrow transplantation. Grafeel has been launched in India, Brazil and certain other countries.

We are also developing oncology generics focused on U.S. and European markets. We have entered into a revenue sharing agreement with Pliva d.d., an Eastern European generics company, for the development and marketing of a group of oncology products for the European markets.

We view biotechnology as a business with significant potential. Our commitment to the business is reflected in our investments in building the research and development infrastructure, including laboratories and scientific teams.

#### Sales, Marketing and Distribution Network.

The marketing of our critical care and biotechnology products is handled by a dedicated sales and marketing team. We sell our products through clearing and forwarding agents in India. In India, the marketing team promotes our products to medical specialists and focuses on sales to hospitals, government agencies and non-government institutional organizations.

We also have a partnership agreement with Pliva d.d., an Eastern European generics company, for the development by us and marketing by Pliva d.d. of a group of oncology products for the European markets.

#### Manufacturing and Raw Materials

For our critical care products, we manufacture all of the active pharmaceutical ingredients. The manufacturing of the formulation is undertaken at our formulations facility. We source some of the products from third party suppliers. We have completed construction

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of a completely contained API facility for the manufacture of cytotoxic products. Construction of another API facility for anti-hormonal products for cancer therapy was completed in August 2005. We are also in the process of establishing a fully contained facility (i.e., an isolated environment where the workers are not exposed to the materials or machinery) in Visakhapatnam, India for the manufacture of oral solid dosage form and injectable forms of cytotoxic as well as hormonal products catering primarily to the U.S. and European markets. We anticipate completion of the facility by December, 2006. As part of our plan to increase our range of cancer therapy products, we also plan to introduce certain other cancer therapy products in the Indian market.

We have a facility at Bachupally, Andhra Pradesh, India for the manufacture of our biotechnology products. The manufacture of our biotechnology products involves cloning proteins and then extracting the proteins by fermentation and purification.

### **Competition**

For our critical care products, our main competitors in the oncology market in India are Dabur Pharma Limited, Cipla Limited, Eli Lilly & Co. and Aventis India Limited. For our oncology products currently under development, our main competitors include generics companies in India, Europe and the United States with a focus on development of oncology products, including Mayne Group Limited (Australia), Zydus Cadila Group (India) and Pliva d.d. (Croatia).

In our biotechnology business, our marketed product faces competition primarily from the innovator company. Given the significant potential of the biogenerics market, several companies are focused on the development of biogenerics, including Pliva d.d., Biopartners, Sandoz, a division of Novartis Pharma A.G., and Barr Labs.

### **Government Regulations**

For critical care products, the regulations are similar to those as discussed in the formulations, API and generics segments.

The biotechnology sector in India is governed by the guidelines/rules formulated by the Department of Biotechnology ( DBT ), under the Indian government's Ministry of Science & Technology. The guidelines cover the entire requirements of various other related ministries/statutory departments of the government of India.

A business which intends to manufacture and market biotechnology products is required to form an Institutional Bio Safety Committee ( IBSC ) consisting of internal experts on related fields as well as a nominee of the DBT and Central Pollution Control Board ( CPCB ). The IBSC reviews, verifies and approves the product application before submitting it to the Review Committee of Genetic Manipulation ( RCGM ) under the Indian government's Ministry of Science & Technology. The RCGM verifies and approves all the data included in the application including the protocol and final reports on animal toxicity and human clinical trials.

Once clearance is obtained from the RCGM, the business is required to obtain clearance from the Genetic Engineering Approval Committee ( GEAC ) under the Ministry of Environment and Forest, government of India. The GEAC forwards its recommendation to the DBT and DCGI. Upon receipt of a No Objection Certificate from the DCGI, the business is required to obtain a manufacturing license from the State Drugs Authority and thereafter can commence commercial marketing.

### **Drug Discovery Segment**

Drug discovery is a key segment of our business. In this segment, we are actively pursuing discovery and development of new molecules, sometimes referred to as New Chemical Entities or NCEs. Our research programs focus on the following therapeutic areas:

Metabolic disorders

Cardiovascular disorders

Bacterial infections

Inflammation

Cancer

Our research laboratories are based in Hyderabad, India and Atlanta, Georgia, U.S. As of March 31, 2006, we employed a total of 254 scientists, including approximately 55 scientists who held Ph.D. degrees. We pursue an integrated research strategy with our laboratories in the United States focusing on discovery of new molecular targets and designing of screening assays to screen for promising lead molecules followed by selection and optimization of lead molecules and further clinical development of those optimized leads at our laboratories in India. By establishing a research facility in the United States, we have better access to research scientists in the United States, enhancing our screening abilities for new molecular targets and access to high technology platforms.

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While we continue to seek licensing and development arrangements with third parties to further develop our pipeline products, we also conduct clinical development of some of the candidate drugs ourselves where it is economically and technically feasible. Our long-term strategy for drug discovery is to increasingly undertake clinical testing ourselves, as we believe that this will enable us to derive higher value for our compounds. Our goal is to balance internal development of our own product candidates with in-licensing of promising compounds that complement our strengths. We also pursue licensing and joint development of some of our lead compounds with companies looking to implement their own product portfolio.

In September 2005, we entered into a co-development and commercialization agreement with Denmark based Rheoscience A/S for the joint development and commercialization of balaglitazone (DRF 2593), a partial PPAR-gamma agonist, for the treatment of type 2 diabetes. Under the terms of the agreement, Rheoscience will fund all the costs associated with the Phase III clinical trials of DRF 2593 and we will pay Rheoscience a pre-determined amount towards its share of the development costs. Rheoscience has exclusive marketing rights in the European Union and China, and we have exclusive marketing rights in the rest of the world. Rheoscience is obligated to obtain all necessary regulatory approvals on our behalf in the United States. Upon receiving final approval from the U.S. FDA, we are obligated to make a pre-determined milestone payment to Rheoscience. The agreement is valid for a period of ten years from the date of commercialization. Under the terms of the agreement, if either party chooses to commercialize the product without the other, then the other party will be entitled to a milestone-based royalty on sales. However, if the parties choose to commercialize the product through a third party, then each of the parties is entitled to share a pre-determined percentage of the net proceeds of commercialization received. We also retain the right to supply clinical development and commercial quantities of the requisite active pharmaceutical ingredients on arms-length basis to the party that commercializes DRF 2593.

In September 2005, we announced the formation of an integrated drug development company, Perlecan Pharma Private Limited ( Perlecan Pharma ), as a joint venture with Citigroup Venture Capital International Growth Partnership Mauritius Limited ( Citigroup Venture ) and ICICI Venture Funds Management Company ( ICICI Venture ). The terms of the joint venture were amended in March 2006. Perlecan Pharma is engaged in the clinical development and out-licensing of NCE assets. Citigroup Venture and ICICI Venture each committed to contribute Rs.1,020 million to Perlecan Pharma's initial capital and we committed to contribute Rs.340.0 million. As of June 30, 2006, Citigroup Venture contributed Rs.504.9 million, ICICI Venture contributed Rs.510.0 million and we contributed Rs.170.0 million to Perlecan Pharma. Perlecan Pharma has certain development rights with respect to additional NCE assets that we discover and we have certain commercialization rights with respect to products that Perlecan Pharma develops. In addition, as part of this arrangement, we transferred all rights and title, including the development and commercialization rights, of four NCE assets to Perlecan Pharma. As a result, we own approximately 14.28% of the equity of Perlecan Pharma and we have the right to designate three out of seven directors on the board of Perlecan Pharma. In addition, Perlecan Pharma has issued to us warrants to purchase 45,000,000 equity shares of Perlecan Pharma, the exercise of which will be contingent upon the success of certain research and development milestones. If the warrants are fully exercised, then we will own approximately 62.5% of the equity shares of Perlecan Pharma.

As part of our research program, we pursue collaborations with leading institutions and laboratories all over the world. We enter into these collaborations to utilize the expertise and facilities these institutions and laboratories provide. We have collaborated with the National Cancer Institute in Maryland, which is a part of the United States National Institutes of Health. In February 2006, we entered into an agreement with Argenta Discovery Limited ( Argenta ) for the joint development and commercialization of a novel approach to the treatment of Chronic Obstructive Pulmonary Disease ( COPD ). Under the terms of the agreement, the parties agreed to collaborate to identify clinical candidates from a certain class of our compounds for use as potential treatments for COPD. Both parties agreed to jointly develop the selected candidates from the pre-clinical stage up to Phase IIa (proof-of-concept). Upon successful completion of a Phase IIa trial, the parties may either license-out the candidate for further development and commercialization to a larger pharmaceutical company or continue the further co-development and commercialization themselves. We and Argenta have agreed to fund the joint collaboration up to proof-of-concept and share the development expenses equally and profits at a predetermined ratio. Currently, both the parties are in the process of identifying clinical candidates as mentioned above.

Our investments into research and development of NCEs have been consistently focused towards developing promising therapeutics. In fiscal 2004, 2005 and 2006, we spent Rs.729.4 million, Rs.868.9 million and Rs.814.5 million respectively, towards drug discovery activities. In fiscal 2004, 2005 and 2006, we received Rs.0, Rs.288.4 million and Rs.0 in revenues respectively, from drug discovery activities.

The compounds currently under development in our pipeline include:

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<b>Compound</b>	<b>Therapeutic Area</b>	<b>Status</b>	<b>Development partner</b>	<b>Remarks</b>
DRF 2593	Metabolic disorders	Phase II completed	Rheoscience	Long-term carcinogenicity studies completed. Results expected by end of calendar year.
DRF 10945	Metabolic disorders	Phase II in progress	Assigned to Perlecan	Non-fibrate predominantly PPAR alpha agonist for the treatment of dyslipidemia. Phase II safety and efficacy studies in patients commercially in Canada.
RUS 3108	Cardiovascular	Phase I in progress	Assigned to Perlecan	Perlecan inducer for the treatment of atherosclerosis. Phase I studies (U.K.) have shown good tolerability and safety profile for the drug.
DRL 11605	Metabolic disorders	Phase I initiated	Assigned to Perlecan	Pan PPAR (α,δ,γ) agonist for the treatment of obesity. Initiated Phase I in Canada.
DRL 16536	Metabolic disorders	Pre-clinical	Assigned to Perlecan	AMPK modulator for the treatment of diabetes. Regulatory toxicity studies initiated.
DRF 1042	Oncology	Phase I	Developed in-house	Single isomer in Phase I trials in India.
DRL 12424	Cardiovascular	Pre-clinical	Developed in-house	Pre-clinical development.
DRL 16805	Atherosclerosis	Pre-clinical	Developed in-house	Orally active agent being developed for treatment of atherosclerosis by reverse cholesterol transport and HDL elevation. Animal testing of molecule safety is in process.
DRL 15725	Rheumatoid Arthritis	Pre-clinical	Developed in-house	Noval orally active cytokine modulator for disease modification in rheumatoid arthritis and osteoarthritis. Animal testing of molecule safety is in process.

*Patents.* The status of patents filed and issued as of March 31, 2006 is summarized below:

<b>Category</b>	<b>USPTO<sup>(1)</sup> (Filed)</b>	<b>USPTO<sup>(1)</sup> (Granted)</b>	<b>PCT<sup>(2)</sup> (Filed)</b>	<b>India (Filed)</b>	<b>India (Granted)</b>
Anti-diabetic	62	35	58	99	24
Anti-cancer	12	7	12	42	12
Anti-bacterial	8	1	7	21	1
Anti-inflammation	1	1	2	11	1
Anti-ulcerant	1	1			

Cardiovascular			1		
Miscellaneous			3	22	5
TOTAL	84	45	83	195	43

(1) The United States Patent and Trademark Office.

(2) The Patent Cooperation Treaty, an international treaty that facilitates foreign patent filings for residents of member countries when obtaining patents in other member countries.

*Stages of Testing / Development.* The stages of testing required before a pharmaceutical product can be marketed in the United States are generally as follows:

Stage of Development	Description
Preclinical	Animal studies and laboratory tests to evaluate safety and efficacy, demonstrate activity of a product candidate and identify its chemical and physical properties.
Phase I	Clinical studies to test safety and pharmacokinetic profile of a drug in humans.
Phase II	Clinical studies conducted with groups of patients to determine preliminary efficacy, dosage and expanded evidence of safety.
Phase III	Larger scale clinical studies conducted in patients to provide sufficient data for statistical proof of efficacy and safety.

For ethical, scientific and legal reasons, animal studies are required in the discovery and safety evaluation of new medicines. Preclinical tests assess the potential safety and efficacy of a product candidate in animal models. The results of these studies must be submitted to the U.S. FDA as part of an Investigational New Drug ( IND ) application before human testing may proceed.

U.S. law further requires that studies conducted to support approval for product marketing be adequate and well controlled. In general, this means that either a placebo or a product already approved for the treatment of the disease or condition under study must be used as a reference control. Studies must also be conducted in compliance with good clinical practice requirements, and adverse event and other reporting requirements must be followed.



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The clinical trial process can take five to ten years or more to complete, and there can be no assurance that the data collected will be in compliance with good clinical practice regulations, will demonstrate that the product is safe or effective, or, in the case of a biologic product, pure and potent, or will provide sufficient data to support U.S. FDA approval of the product. The U.S. FDA may place clinical trials on hold at any point in this process if, among other reasons, it concludes that clinical subjects are being exposed to an unacceptable health risk. Trials may also be terminated by institutional review boards, who must review and approve all research involving human subjects. Side effects or adverse events that are reported during clinical trials can delay, impede, or prevent marketing authorization.

*Scientific Advisory Board.* Our Scientific Advisory Board is composed of seven leading professionals in the field of healthcare and chemical sciences. These professionals contribute to the strategic definition and implementation of pre-clinical development plans for our products. Members of the advisory committee meet individually and as a group with our management on an annual basis.

Dr. K. Anji Reddy	Chairman, Dr. Reddy's Laboratories Limited
Dr. R. Rajagopalan	President, Discovery Research, Dr. Reddy's Laboratories Limited
Dr. V. Mohan	Managing Director, M.V. Diabetes Specialties Center (P) Limited, Madras
Dr. K. Janardhan Reddy	Professor and Chairman, Department of Pathology, Northwestern University Medical School, Chicago, Illinois, U.S.A.
Dr. Sampath Parthasarthy	Director, Division of Research, Emory University School of Medicine, Atlanta, Georgia, U.S.A.
Dr. Henry Ginsberg	Herbert Irving Professor of Medicine, Division of Preventive Medicine, Presbyterian Hospital, New York, U.S.A.
Dr. Ira J. Goldberg	Professor of Medicine, Division of Preventive Medicine and Nutrition Columbia University College of Physicians and Surgeons, New York, U.S.A.
Dr. Uday Saxena	Chief Scientific Officer, Dr. Reddy's Laboratories Limited
Dr. Daniel Rader	Faculty in the Department of Medicine and the Director of Cardiovascular Metabolism unit at the Institute for Diabetes, Obesity and Metabolism, University of Pennsylvania

## **Competition**

The pharmaceutical and biotechnology industries are highly competitive. We face intense competition from organizations such as large pharmaceutical companies, biotechnology companies and academic and research organizations. The major pharmaceutical organizations competing with us have greater capital resources, larger overall research and development staff and facilities and considerably more experience in drug development. Biotechnology companies competing with us may have these advantages as well. In addition to competition for collaborators and investors, these companies and institutions also compete with us in recruiting and retaining highly qualified scientific and management personnel.

## **Government regulations**

Virtually all pharmaceutical and biotechnology products that we or our collaborative partners develop will require regulatory approval by governmental agencies prior to commercialization. The nature and extent to which these regulations apply varies depending on the nature of the products and also vary from country to country. In particular, human pharmaceutical products are subject to rigorous pre-clinical and clinical testing and other approval procedures by the relevant regulatory agency. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary widely from country to country.

In India, under the Drugs and Cosmetics Act, 1940, the regulation of the manufacture, sale and distribution of drugs is primarily the concern of the state authorities while the Central Drug Control Administration is responsible for approval of new drugs, clinical trials in the country, laying down the standards for drugs, control over the quality of imported drugs, coordination of the activities of state drug control organizations and providing expert advice with a view of bringing about the uniformity in the enforcement of the Drugs and Cosmetics Act, 1940.

For marketing a drug in the United States, we or our partners will be subject to regulatory requirements governing human clinical trials, marketing approval and post-marketing activities for pharmaceutical products and biologics.

Various federal and, in some cases, state statutes and regulations also govern or influence the manufacturing, safety, labeling, storage, record-keeping and marketing of these products. The process of obtaining these approvals and the subsequent compliance with applicable statutes and regulations is time consuming and requires substantial resources, and the approval outcome is uncertain.

Generally, in order to gain U.S. FDA approval, a company first must conduct pre-clinical studies in the laboratory and in animal models to gain preliminary information on a compound's activity and to identify any safety problems. Pre-clinical studies must be conducted in accordance with U.S. FDA regulations. The results of these studies are submitted as part of an IND application that the U.S. FDA must review before human clinical trials of an investigational drug can start. If the U.S. FDA does not respond with any questions, a drug developer can commence clinical trials thirty days after the submission of an IND.

In order to eventually commercialize any products, we or our collaborator first will be required to sponsor and file an IND and will be responsible for initiating and overseeing the clinical studies to demonstrate the safety and efficacy that are necessary to obtain

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U.S. FDA marketing approval. Clinical trials are normally done in three phases and generally take several years, but may take longer to complete. The clinical trials have to be designed taking into account the applicable U.S. FDA guidelines. Furthermore, the U.S. FDA may suspend clinical trials at any time if the U.S. FDA believes that the subjects participating in trials are being exposed to unacceptable risks or if the U.S. FDA finds deficiencies in the conduct of the trials or other problems with our product under development.

After completion of clinical trials of a new product, U.S. FDA marketing approval must be obtained. If the product is classified as a new pharmaceutical, we or our collaborator will be required to file a New Drug Application ( NDA ), and receive approval before commercial marketing of the drug. The testing and approval processes require substantial time and effort. NDAs submitted to the U.S. FDA can take several years to obtain approval and the U.S. FDA is not obligated to grant approval at all.

Even if U.S. FDA regulatory clearances are obtained, a marketed product is subject to continual review. If and when the U.S. FDA approves any of our or our collaborators products under development, the manufacture and marketing of these products will be subject to continuing regulation, including compliance with cGMP, adverse event reporting requirements and prohibitions on promoting a product for unapproved uses. Later discovery of previously unknown problems or failure to comply with the applicable regulatory requirements may result in restrictions on the marketing of a product or withdrawal of the product from the market as well as possible civil or criminal sanctions. Various federal and, in some cases, state statutes and regulations also govern or influence the manufacturing, safety, labeling, storage, record keeping and marketing of pharmaceutical products.

Our research and development processes involve the controlled use of hazardous materials and controlled substances. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of these materials and waste products.

**Custom Pharmaceutical Services**

Our Custom Pharmaceutical Services ( CPS ) business unit markets process development and manufacturing services to customers primarily consisting of innovator pharmaceutical and biotechnology companies. This segment accounted for 5.5% of our total revenues for fiscal 2006, contributing Rs.1,326.8 million.

The CPS business unit was established in 2001 to leverage our strength in process chemistry to serve the niche segment of the specialty chemical industry. Over the years, our CPS business strategy has evolved to focus on the marketing of process development and manufacturing services. The objective of our CPS segment is to be the preferred partner for innovator pharmaceutical companies, providing a complete range of services that are necessary to take their innovations to the market speedily and more efficiently. The focus is to leverage our skills in process development, analytical development, formulation development and cGMP manufacture to serve various needs of innovator pharmaceutical companies.

With the acquisition of the Falcon plant in Mexico, we are positioning our CPS segment to be the partner of choice for large and emerging innovator companies across the globe, with service offerings spanning the entire value chain of pharmaceutical services.

**Sales, Marketing and Distribution Network.**

We have focused business development teams dedicated to our key geographies of North America, the European Union and India targeting large and emerging innovator companies to build long-term business relationships focused on catering to their outsourcing needs.

**Manufacturing and Materials**

Our CPS segment has well-resourced synthetic organic chemistry laboratories, analytical laboratories, kilo laboratories and pilot plants at our technology development center at Miyapur, Hyderabad. Our trained chemists and engineers understand cGMP manufacturing and regulatory requirements for synthesis, manufacture and formulation of an NCE from pre-clinical stage to commercialization. Larger quantities of APIs and intermediates are sourced internally from our API segment. The expansion of research and development laboratories to cater to the CPS segment s future business requirements has already commenced in Hyderabad. We are also in the process of establishing a facility to manufacture oral and injectible cytotoxic finished dosages at a special economic zone in Visakhapatnam, India.

We acquired the Falcon plant, which was Roche's API manufacturing facility at Cuernavaca, Mexico, during fiscal 2006. This facility is U.S. FDA inspected and consists of seven manufacturing bays. The facility is well maintained with good systems and processes which were developed by Roche over the last decade. In addition to manufacturing the active pharmaceutical ingredients naproxen and naproxen sodium and a range of intermediates for Roche products, this facility synthesizes steroids for use in pharmaceutical and veterinary products.

**Table of Contents****Competition**

Globally, the pharmaceutical manufacturing services industry is estimated to generate sales of U.S.\$25-30 billion and is set to grow to sales of U.S.\$45 billion by 2010, according to Express Pharma, an Indian pharmaceutical publication, in its June 1-15, 2006 edition. Contract manufacturing is still a nascent industry in India with sales in excess of U.S.\$300 million concluded to date, according to said Express Pharma report. Contract manufacturing is a significant opportunity for Indian pharmaceutical companies based on their low-cost manufacturing infrastructure. Key competitors in India include Torrent Pharmaceuticals Ltd., Shasun Chemicals & Drugs Ltd., Divi's Laboratories Ltd., Matrix Laboratories Ltd., Dishman Pharmaceuticals & Chemicals Ltd., Syngene Ltd. and Nicholas Piramal India Ltd. Key competitors from outside India include Lonza Group Ltd., Koninklijke DSM N.V., Albany Molecular Research, Inc., Patheon, Inc. and Cardinal Health, Inc. Our CPS segment distinguishes itself from its key competitors by offering a wider range of services spanning the entire pharmaceutical value chain.

Growth in contract manufacturing is likely to be driven by increasing outsourcing of late-stage and off-patent molecules by large pharmaceutical companies to compete with generics. India is emerging as an alliance and outsourcing destination of choice for global pharmaceutical companies. Companies such as Roche, Bayer, Aventis and Chiron are all executing plans to make India the regional hub for API and supply of bulk drugs.

**Government Regulations**

For Custom Pharmaceutical Services, the regulations are similar to those as discussed in the formulations, API and generics segments.

**4.C. Organizational structure**

Dr. Reddy's Laboratories Limited is the parent company in our group. We had the following subsidiary companies where our direct and indirect ownership was more than 50% as of March 31, 2006:

<b>Name of Subsidiary</b>	<b>Country of Incorporation</b>	<b>Percentage of Direct/ Indirect Ownership Interest</b>
DRL Investments Limited	India	100%
Reddy Pharmaceuticals Hong Kong Limited	Hong Kong	100%
OOO JV Reddy Biomed Limited	Russia	100%
Reddy Antilles N.V.	Netherlands	100%
Reddy Netherlands B.V.	Netherlands	100% <sup>(1)</sup>
Reddy US Therapeutics, Inc.	U.S.A.	100% <sup>(1)</sup>
Dr. Reddy's Laboratories, Inc.	U.S.A.	100%
Dr. Reddy's Farmaceutica do Brasil Ltda	Brazil	100%
Cheminor Investments Limited	India	100%
Aurigene Discovery Technologies Limited	India	100%
Aurigene Discovery Technologies, Inc.	U.S.A.	100% <sup>(3)</sup>
Kunshan Rotam Reddy Pharmaceutical Co. Limited	China	51.2% <sup>(4)</sup>
Dr. Reddy's Laboratories (EU) Limited	United Kingdom	100%
Dr. Reddy's Laboratories (U.K.) Limited	United Kingdom	100% <sup>(5)</sup>
Dr. Reddy's Laboratories (Proprietary) Limited	South Africa	60%
Reddy Cheminor S.A. <sup>(2)</sup>	France	100% <sup>(2)</sup>
OOO Dr. Reddy's Laboratories Limited	Russia	100%
Dr. Reddy's Bio-sciences Limited	India	100%
Reddy Pharmaceuticals, Inc.	U.S.A.	100% <sup>(6)</sup>
Trigenesis Therapeutics, Inc.	U.S.A.	100%
Industrias Quimicas Falcon de Mexico, SA de CV	Mexico	100%
Reddy Holding GmbH	Germany	100% <sup>(7)</sup>

Lacock Holdings Limited	Cyprus	100%
beta Holding GmbH	Germany	100% <sup>(8)</sup>
beta Healthcare GmbH & Co. KG	Germany	100% <sup>(9)</sup>
beta Healthcare Verwaltungs GmbH	Germany	100% <sup>(9)</sup>
betapharm Arzneimittel GmbH	Germany	100% <sup>(9)</sup>
beta Healthcare Solutions GmbH	Germany	100% <sup>(9)</sup>
beta institut fur sozialmedizinische Forschung und Entwicklung GmbH	Germany	100% <sup>(9)</sup>

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- (1) Indirectly owned through Reddy Antilles N.V.
- (2) Subsidiary under liquidation.
- (3) Indirectly owned through Aurigene Discovery Technologies Limited.
- (4) Kunshan Rotam Reddy is a subsidiary as we hold a 51.2 % stake in it; however, we account for this investment by the equity method and do not consolidate it in our financial statements.
- (5) Indirectly owned through Dr. Reddy's Laboratories (EU) Limited.
- (6) Indirectly owned through Dr. Reddy's Laboratories Inc.
- (7) Indirectly owned through Lacock Holdings Limited.

- (8) Indirectly  
owned through  
Reddy Holding  
GmbH.
- (9) Indirectly  
owned through  
beta Holding  
GmbH.



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The following table sets forth current information relating to our principal facilities:

<b>Location</b>	<b>Approximate Area (Square feet)</b>	<b>Built up Area (Square feet)</b>	<b>Certification</b>	<b>Installed Capacity</b>	<b>Actual Production</b>
<b>Formulations</b>				1,907 <sup>(6)(7)</sup>	2,816 <sup>(6)(8)</sup>
Bollaram, Andhra Pradesh, India	217,729	207,959	(1)		
Bachupally, Andhra Pradesh, India	1,306,372	175,388	(2)		
Yanam, Pondicherry, India	457,000	26,226	None		
<b>Active Pharmaceutical Ingredients and Intermediates</b>				3,833 <sup>(9)</sup>	3,101 <sup>(9)</sup>
Bollaram, Andhra Pradesh, India	734,013	172,879	U.S. FDA		
Bollaram, Andhra Pradesh, India	648,173	282,220	U.S. FDA		
Bollaram, Andhra Pradesh, India	285,235	210,630	U.S. FDA		
Jeedimetla, Andhra Pradesh, India	228,033	74,270	U.S. FDA		
Miryalguda, Andhra Pradesh, India	2,787,840	261,734	U.S. FDA		
Pydibheemavaram, Andhra Pradesh, India	8,523,466	905,612	U.S. FDA		
Pydibheemavaram, Andhra Pradesh, India <sup>(4)</sup>	737,134	53,854			
<b>Generics</b>				5,500 <sup>(6)</sup>	1,939 <sup>(6)</sup>
Bachupally, Andhra Pradesh, India <sup>(4)</sup>	783,823	200,134	(3)		
Battersea, London, United Kingdom <sup>(5)</sup>	17,000	10,000	U.K. Medicine Control Agency		
Beverley, East Yorkshire, United Kingdom	64,904	15,179	U.K. Medicine Control Agency, ISO 9001: 2000		
<b>Critical Care and Biotechnology</b>					
Bachupally, Andhra Pradesh, India	174,183	114,588	(1)	370 <sup>(10)</sup>	73 <sup>(10)</sup>
Bollaram, Andhra Pradesh, India	20,089	20,089	U.S. FDA		
Pydibheemavaram, Andhra Pradesh, India	15,494	15,494	U.S. FDA		
<b>Drug Discovery<sup>(11)</sup></b>					
Miyapur, Andhra Pradesh, India	576,941	234,591	None		
Georgia, United States <sup>(5)</sup>	24,733	24,733	None		

**Custom Pharmaceutical Services**3,428<sup>(10) (12)</sup>1,832<sup>(10) (12)</sup>

Miyapur, Andhra Pradesh, India	113,211	73,587	None
Cuernavaca, Mexico	2,793,665	1,345,488	None

(1) Ministry of Health, Sudan; Ministry of Health, Uganda; ANVISA, Brazil; National Medicines Agency, Romania.

(2) Medicine Control Council, Republic of South Africa; The State Company for Marketing Drugs and Medical Appliances, Ministry of Health, Iraq; Sultanate of Oman, Ministry of Health, Muscat; Ministry of Health, Sudan; Ministry of Health, State of Bahrain; State Pharmaceutical Inspection, Republic of Latvia; Pharmaceutical and Herbal Medicines, Registration and Control Administrations, Ministry of Health, Kuwait; National Medicines Agency, Romania; ANVISA, Brazil;

Medicines and  
Health Care  
Products  
Regulatory  
Agencies  
(MHRA), U.K.

(3) U.S. FDA;  
Medicines and  
Healthcare  
Products  
Regulatory  
Agency, U.K.;  
Ministry of  
Health, UAE;  
Medicines  
Control Council,  
South Africa;  
ANVISA, Brazil  
; Environmental  
Management  
System ISO  
14001;  
Occupational  
Health and  
Safety  
Management  
System OHSAS  
18001; Quality  
Management  
System-ISO  
9001:2000.

(4) 100% Export  
Oriented Unit.

(5) Leased facilities.

(6) Million units.

(7) On a single shift  
basis.

(8) During the year  
ended March 31,  
2006, we sold  
one of our  
formulations  
manufacturing  
plants in Goa,  
India.

(9) Tonnes.

(10) Grams.

(11) Laboratories  
only.

(12) Mexico only.

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Except as indicated in the notes above, we own all of our facilities. All properties mentioned above, including leased properties, are either used for manufacturing and packaging of pharmaceutical products or for research and development activities. In addition, we have sales, marketing and administrative offices, which are leased properties. We believe that our facilities are optimally utilized.

The new facility for the manufacture of formulations at Baddi, Himachal Pradesh, India was completed in April 2006. This project was initiated to take advantage of certain financial benefits, which include exemption from income tax and excise duty for a specified period, offered by the government of India to encourage industrial growth in the state of Himachal Pradesh.

An expansion project has been commenced at our generics plant at Bachupally, Hyderabad, Andhra Pradesh, India, to increase the production capacity to manage high demand periods. The plant is intended to be a 100% export oriented unit under Indian law, meaning that it will export its total production to customers abroad and, as a result, will qualify for certain tax exemptions and other benefits under Indian law. We are also in the process of establishing a facility at a Special Economic Zone located in Visakhapatnam, India to manufacture tablets and capsules for our generics business. We are also in the process of establishing a facility to manufacture oral and injectible cytotoxic finished dosages at a special economic zone in Visakhapatnam, India. These facilities are expected to be operational by January 2007.

We have working capital facilities with banks and, in order to secure those facilities, we have created encumbrance charges on certain of our immovable and movable properties.

We are subject to significant national and state environmental laws and regulations which govern the discharge, emission, storage, handling and disposal of a variety of substances that may be used in or result from our operations at the above facilities. Non-compliance with the applicable laws and regulations may subject us to penalties and may also result in the closure of our facilities.

### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not applicable.

### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

#### **Overview**

We are an emerging global pharmaceutical company with proven research capabilities. We derive our revenues from the sale of finished dosage forms, active pharmaceutical ingredients and intermediates and biotechnology products, with a focus on India, the United States, Europe and Russia; from development and manufacturing services provided to innovator pharmaceutical and biotechnology companies; and from license fees from our drug discovery operations.

As of March 31, 2006, we had the following business segments:

**Formulations.** In this segment we derive revenues from the sale of finished dosage forms, primarily in India and other emerging markets. Key drivers of profitability in this segment are the volume and price of products sold, which in turn are dependent upon the popularity of our branded products in the relevant markets. Increases in this segment in recent periods have tended to flow from increased marketing efforts and expansion of our markets, as opposed to price increases.

**Active pharmaceutical ingredients and intermediates.** In this segment we derive revenues from our sales to third parties of the principal ingredients for finished dosages. Our principal markets are Europe, the United States and India. Revenues in this segment are dependent upon the number of products that lose patent protection in any given period, and the price of those products, which tends to decline over time. These being commoditized products, our ability to set prices is limited, while the cost of revenues generally remains stable. Thus, in any given period, different products will contribute varying amounts to our revenues and our gross profits. Recent increases in revenues from this segment have generally been due to increased sales volumes.

**Generics.** In this segment we derive revenues from the sale of therapeutic equivalents of branded drugs, primarily in Europe and the United States. Revenues from beta Holding GmbH ( betapharm ), our recently acquired subsidiary in Germany, are included in this segment from March 3, 2006 and thus will tend to increase revenues from this segment in future periods. Revenues from our sale of generics are highly cyclical. In the event that we obtain 180-day exclusivity for a particular product, we generally experience significantly increased revenues for this period,

particularly at the beginning of the period, with sales prices decreasing toward the end of the 180 days as other manufacturers enter the market. Cost of sales remains generally constant, however, and thus products coming off patent contribute significantly to gross margins for a limited period, tending to increase volatility in this segment. Subsequent to March 31, 2006, we launched two products pursuant to an agreement for authorized generics, pursuant to which the innovator company licensed us to distribute generic versions of their branded product and sell it in competition with the companies that have

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180-day exclusivity. In these cases, while sales volumes increase significantly (again, more significantly in the early part of the 180-day period), profit-sharing agreements with the innovator company mean that gross margins are much lower than would be the case if we were distributing the product under 180-day exclusivity. Additionally, the existence of authorized generic arrangements (a relatively new development) by innovator companies with other manufacturers in cases where we have obtained 180-day exclusivity could adversely affect overall sales revenues during the 180-day period.

**Critical care and biotechnology.** In this segment we derive revenues from the sale of our critical care and biotechnology products, primarily to hospitals in India. Revenues are driven by the volume of products sold, and the price of those products. These are generally low-volume, higher gross margin products, although pricing pressure in key products has recently reduced gross margins.

**Drug discovery.** Revenues in this segment are derived from licensing fees for new molecules that we discover. Thus, revenues are dependent upon the success of our research activities, and may vary significantly from period to period depending upon whether specified milestones in licensing agreements are reached. In September, 2005, we formed Perlecan Pharma Private Limited as a joint venture with Citigroup Venture Capital International Growth Partnership Mauritius Limited and ICICI Venture Funds Management Company and contributed capital and four NCE assets to Perlecan. Perlecan has continued development of these NCE assets.

**Custom pharmaceutical services.** In this segment we derive revenues from service fees for process development and manufacturing services provided to innovator pharmaceutical and biotechnology companies. Revenue from our newly acquired subsidiary Falcon are included in this segment from December 30, 2005 and thus would tend to increase revenues from this segment in future periods. The key driver of revenue in this segment is likely to be the increasing outsourcing of late-stage and off-patent molecules by large pharmaceutical companies to compete with generics.

In addition, we are currently in the research and development phase of a specialty pharmaceuticals business, which may become a separate segment at some point in the future.

Our revenues for fiscal 2006 were Rs.24,267 million (U.S.\$545.6 million). We derived 34.1% of these revenues from sales in India, 16.4% from North America, 14.7% from Russia and other countries of the former Soviet Union, 17.8% from Europe and 17.0% from other countries. Our net income for fiscal 2006 was Rs.1,628.9 million (U.S.\$36.62 million).

### **Acquisition of betapharm Group**

During fiscal 2006, we acquired beta Holding GmbH ( betapharm ) which, according to INSIGHT Health's NPI-Gx reports, is Germany's fourth largest generic pharmaceuticals company. The aggregate purchase price was 482.6 million (Rs.26,063.3 million) in cash. betapharm has a portfolio of 145 products and, according to INSIGHT Health's NPI-Gx reports, has been the fastest growing among the 10 largest generics companies in Germany. As a result of this acquisition, the financials of betapharm have been consolidated with our generics segment effective as of March 3, 2006. Revenues from betapharm were Rs.704.9 million in fiscal 2006 (starting March 3, 2006).

In accordance with U.S. GAAP, based on our estimate of fair values we have carried out a preliminary allocation of the total purchase price of the acquisition of betapharm to net tangible assets, amortizable intangible assets and intangible assets with indefinite lives, based on their fair values as of the date of completion of the acquisition. We have recorded the excess of the purchase price over those fair values as goodwill. The Company is in the process of obtaining third-party valuations of certain intangible assets and, accordingly, the allocation of the purchase price is preliminary and may be prospectively revised when additional information is obtained based on such third party valuations. The final purchase price allocation is expected to be completed by December 31, 2006. As a result of the betapharm acquisition, we will also incur additional depreciation and amortization expense over the useful lives of certain of the net tangible and intangible assets acquired in connection with the acquisition. In addition, to the extent the value of goodwill or intangible assets becomes impaired in the future, we may be required to incur material charges relating to the impairment of those assets.

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### **Acquisition of Industrias Quimicas Falcon de Mexico**

During fiscal 2006, we acquired Industrias Quimicas Falcon de Mexico ( Falcon ), one of Roche's manufacturing subsidiaries with facilities located at Cuernavaca, Mexico for a total purchase consideration of U.S.\$61.2 million (Rs.2,773.1 million). Falcon was acquired with an intent to add steroid manufacturing capabilities and permit us to offer a full range of services in our custom pharmaceutical services business. Falcon is engaged in the manufacture and sale of APIs, intermediates and steroids and has a portfolio of 18 products. As a result of this acquisition, the financials of Falcon have been consolidated with our custom pharmaceuticals services segment effective as of December 30, 2005. Revenues from Falcon were Rs.804 million in fiscal 2006 (starting December 30, 2005).

In accordance with U.S. GAAP, we allocated the total purchase price of the acquisition of Falcon to net tangible assets, customer contracts and non-competition agreement. As a result of the Falcon acquisition, we will also incur additional depreciation and amortization expense over the useful lives of certain of the net tangible and intangible assets acquired in connection with the acquisition.

### **Critical Accounting Policies**

Critical accounting policies are those most important to the portrayal of our financial condition and results and that require the most exercise of our judgment. We consider the policies discussed under the following paragraphs to be critical for an understanding of our financial statements. Our significant accounting policies and application of these are discussed in detail in Note 2 to the Consolidated Financial Statements.

#### **Accounting estimates**

While preparing financial statements we make estimates and assumptions that affect the reported amount of assets, liabilities, disclosure of contingent liabilities at the balance sheet date and the reported amount of revenues and expenses for the reporting period. Financial reporting results rely on our estimate of the effect of certain matters that are inherently uncertain. Future events rarely develop exactly as forecast and the best estimates require adjustments, as actual results may differ from these estimates under different assumptions or conditions. We continually evaluate these estimates and assumptions based on the most recently available information. Specifically, we make estimates of:

the useful life of property, plant and equipment and intangible assets;

impairment of long-lived assets, including identifiable intangibles and goodwill;

our future obligations under employee retirement and benefit plans;

allowances for doubtful accounts receivable;

inventory write-downs;

allowances for sales returns; and

valuation allowance against deferred tax assets.

We depreciate property, plant and equipment over their useful lives using the straight-line method. Estimates of useful life are subject to changes in economic environment and different assumptions. Assets under capital leases are amortized over their estimated useful life or lease term as appropriate. We review long-lived assets, including identifiable intangibles and goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by comparing the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Considerable management judgment is necessary to estimate discounted future cash flows. Accordingly, actual outcomes could vary significantly from such estimates. Factors such as changes in the planned use of buildings, machinery or equipment or lower than anticipated sales for products with capitalized rights could result in shortened useful lives or impairment.



In accordance with applicable Indian laws, we provide a defined benefit retirement plan ( Gratuity Plan ) covering certain categories of employees. The Gratuity Plan provides a lump sum payment to vested employees at retirement or termination of employment, in an amount based on the respective employee's last drawn salary and the years of employment with us. Liabilities with regard to the Gratuity Plan are determined by an actuarial valuation, based upon which we make contributions to the Gratuity Fund. In calculating the expense and liability related to the plans, assumptions are made about the discount rate, expected rate of return on plan assets, withdrawal and mortality rates and rate of future compensation increases as determined by us, within certain guidelines. The assumptions used may differ materially from actual results, resulting in a probable significant impact to the amount of expense recorded by us.

We make allowance for doubtful accounts receivable, including receivables sold with recourse, based on the present and prospective financial condition of the customer and ageing of the accounts receivable after considering historical experience and the

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current economic environment. Actual losses due to doubtful accounts may differ from the allowances made. However, we believe that such losses will not materially affect our consolidated results of operations.

We provide for inventory obsolescence, expired inventory and inventories with carrying values in excess of realizable values based on our assessment of future demands, market conditions and our specific inventory management initiatives. If the market conditions and actual demands are less favorable than our estimates, additional inventory write-downs may be required. In all cases, inventory is carried at the lower of historical costs or realizable value.

### **Revenue recognition**

#### ***Product sales***

Revenue is recognized when significant risks and rewards in respect of ownership of products are transferred to the customer, generally stockists or formulations manufacturers, and when the following criteria are met:

Persuasive evidence of an arrangement exists;

The price to the buyer is fixed and determinable; and

Collectibility of the sales price is reasonably assured.

Revenue from domestic sales of formulation products is recognized on dispatch of the product to the stockist by our consignment and clearing and forwarding agent. Revenue from domestic sales of active pharmaceutical ingredients and intermediates is recognized on dispatch of products to customers from our factories. Revenue from export sales is recognized when significant risks and rewards are transferred to the customer, generally upon shipment of products.

Revenue from product sales includes excise duties and is shown net of sales tax and applicable discounts and allowances.

Sales of formulations in India are made through clearing and forwarding agents to stockists. Significant risks and rewards in respect of ownership of formulation products is transferred by us when the goods are shipped to stockists from clearing and forwarding agents. Clearing and forwarding agents are generally compensated on a commission basis as a percentage of sales made by them.

Sales of active pharmaceutical ingredients and intermediates in India are made directly to the end customers, generally formulation manufacturers, from the factories. Sales of formulations and active pharmaceutical ingredients and intermediates outside India are made directly to the end customers, generally stockists or formulations manufacturers, from us or our consolidated subsidiaries.

We have entered into marketing arrangements with certain marketing partners for the sale of goods. Under such arrangements, we sell generic products to our marketing partners at a price agreed in the arrangement. Revenue is recognized on these transactions upon delivery of products to our marketing partners as all the conditions under Staff Accounting Bulletin No.104 ( SAB 104 ) are then met. Subsequently, the marketing partners remit an additional amount upon further sales made by them to the end customer. Such amount is determined as per the terms of the arrangement and is recognized by us when the realization is certain under the guidance given in SAB 104.

We have entered into certain dossier sales, licensing and supply arrangements that include certain performance obligations. Based on an evaluation of whether or not these obligations are inconsequential or perfunctory, we defer the upfront payments received towards these arrangements. Such deferred amounts are recognized in the income statement in the period in which we complete our remaining performance obligations.

Sales of generic products are recognized as revenue when the products are shipped and title and risk of loss passes on to the customers. Provisions for chargeback, rebates and medicaid payments are estimated and provided for in the year of sales. Such provisions are estimated based on average chargeback rates actually claimed over a period of time and average inventory holding by the wholesaler. A chargeback claim is a claim made by the wholesaler for the difference between the price at which the product is sold to customers and the price at which it is procured from us.

We account for sales returns in accordance with SFAS 48 by establishing an accrual in an amount equal to our estimate of sales recorded for which the related products are expected to be returned.

We deal in various products and operate in various markets and our estimate is determined primarily by our experience in these markets for the products. For returns of established products, we determine an estimate of the sales returns accrual primarily based on our historical experience regarding sales returns. Additionally other factors that we consider in our estimate of sales returns include levels of inventory in the distribution channel, estimated shelf life, product discontinuances, price changes of competitive products, introductions of generic products and introductions of competitive new products to the extent each of them has an impact on our business and markets. We consider all of these factors and adjust the accrual to reflect actual experience.

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In respect of certain markets, we consider the level of inventory in the distribution channel and determine whether an adjustment to our sales return accrual is appropriate. For example, if the level of inventory in the distribution channel increases, we analyze the reasons for the increase and if the reasons indicate that sales returns will be larger than expected, we adjust the sales returns accrual. Further, the products and markets in which we operate have a rapid distribution cycle and therefore products are sold to the ultimate customer within a very short period of time. As a result, the impact of changes in levels of inventory in the distribution channel historically has not caused any material changes in our return estimates. Further, we have not had any significant product recalls / discontinuances within our product portfolio, which could potentially require us to make material changes to our estimates.

With respect to new products that we introduce, they are either extensions of an existing line of products or in a general therapeutic category where we have historical experience. Our new product launches have historically been in therapeutic categories where established products exist and are sold either by us or our competitors. We have not yet introduced products in any new therapeutic category where the acceptance of such products is not known. The amount of sales returns for our newly launched products are not significantly different from current products marketed by us, nor are they significantly different from the sales returns of our competitors as we understand them to be based on industry publications and discussions with our customers. Accordingly, we do not expect sales returns for new products to be significantly different than expected sales returns of current products. We evaluate the sales returns of all of the products at the end of each reporting period and necessary adjustments, if any, are made. However, to date, no significant revision has been determined to be necessary.

*License fees*

Non-refundable milestone payments are recognized in the statement of income when earned, in accordance with the terms prescribed in the license agreement, and where we have no future obligations or continuing involvement pursuant to such milestone payment. Non-refundable up-front license fees are deferred and recognized when the milestones are earned, in proportion that the amount of each milestone earned bears to the total milestone amounts agreed in the license agreement. As the upfront license fees are a composite amount and cannot be attributed to a specific molecule, they are amortized over the development period. The milestone payments during the development period increase as the risk involved decreases. The agreed milestone payments reflect the progress of the development of the molecule and may not be spread evenly over the development period. Further, the milestone payments are a fair representation of the extent of progress made in the development of these molecules. Hence, the upfront license fees are amortized over the development period in proportion to the milestone payments received. In the event, the development is discontinued, the corresponding amount of deferred revenue is recognized in the income statement in the period in which the project is effectively terminated.

*Service income*

Income from services is recognized based on the services provided by the Company in accordance with the terms of the contract, as all the conditions under SAB 104 are met.

**Stock Based Compensation**

We use the Black-Scholes option pricing model to determine the fair value of each option grant. The Black-Scholes model includes assumptions regarding dividend yields, expected volatility, expected lives and risk free interest rates. These assumptions reflect our best estimates, but these assumptions involve inherent market uncertainties based on market conditions generally outside of our control. As a result, if other assumptions had been used in the current period, stock-based compensation expense could have been materially impacted. Furthermore, if we use different assumptions in future periods, stock based compensation expense could be materially impacted in future years.

The fair value of each option is estimated on the date of grant using the Black-Scholes model with the following assumptions:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Dividend yield	0.5%	0.5%	0.5%
Expected life	42-78 months	12-78 months	12-78 months
Risk free interest rates	5.2 - 6.8%	4.5-6.7%	5.7-7.5%

Volatility	45.7-50.7%	39.4-44.6%	23.4-36.9%
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At March 31, 2006, we had three stock-based employee compensation plans. Prior to April 1, 2003, we accounted for our plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost was reflected in previously reported results, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. During the first quarter of fiscal 2004, we adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for stock-based employee compensation. We have selected the retroactive method of adoption described in SFAS No. 148 Accounting for Stock Based Compensation Transition and Disclosure for all options granted after January 1, 1995. Consequently, for the years ended March 31, 2004, 2005 and 2006, an amount of Rs.122,177,000, Rs.144,001,000 and Rs.162,249,000 respectively, has been recorded as total employee stock based compensation expense.

During fiscal 2004, Aurigene Discovery Technologies Limited adopted two stock based employee compensation plans. We have accounted for these plans under SFAS 123, using the Black Scholes option pricing model to determine the fair value of each option grant.

### **Deferred Taxes**

Deferred taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits the future realization of which is uncertain.

### **Functional Currency**

Our foreign subsidiaries have different functional currencies, determined based on the currency of the primary economic environment in which they operate. For subsidiaries that operate in a highly inflationary economy, the functional currency is determined as the Indian rupee. Due to various subsidiaries operating in different geographic locations, a significant level of judgment is involved in evaluating the functional currency for each subsidiary.

In respect of our foreign subsidiaries which market our products in their respective countries/regions, the functional currency has been determined as the Indian rupee, based on an individual and collective evaluation of the various economic factors listed below.

The operations of these foreign subsidiaries are largely restricted to importing finished goods from us in India, sale of these products in the foreign country and remitting the sale proceeds to us. The cash flows realized from sale of goods are readily available for remittance to us and cash is remitted to us on a regular basis. The costs incurred by these subsidiaries are primarily the cost of goods imported from us. The financing of these subsidiaries is done directly or indirectly by us.

In respect of other subsidiaries, the functional currency is determined as the local currency, being the currency of the primary economic environment in which the subsidiary operates.

### **Income Taxes**

As part of the process of preparing our financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. We are subject to tax assessments in each of these jurisdictions. A tax assessment can involve complex issues, which can only be resolved over extended time periods. Additionally, the provision for income tax is calculated based on our assumptions as to our entitlement to various benefits under the applicable tax laws in the jurisdictions in which we operate. The entitlement to such benefits depends upon our compliance with the terms and conditions set out in these laws. Although we have considered all these issues in estimating our income taxes, there could be an unfavorable resolution of such issues that may affect our results of operations.

We also assess the temporary differences resulting from differential treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recognized in our consolidated financial statements. We also assess our deferred tax assets on an ongoing basis by assessing our

valuation allowance we consider the future taxable

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incomes and the feasibility of tax planning initiatives. If we estimate that the deferred tax assets cannot be realized at the recorded value, a valuation allowance is created with a charge to the statement of income in the period in which such assessment is made.

**Litigation**

We are involved in various patent challenges, product liability, commercial litigation and claims, investigations and other legal proceedings that arise from time to time in the ordinary course of our business. We assess in consultation with our counsel, the need to accrue a liability for such contingencies and record a reserve when we determine that a loss related to a matter is both probable and reasonably estimable. Because litigation and other contingencies are inherently unpredictable, our assessment can involve judgments about future events.

**5.A. Operating results****Financial Data**

The selected consolidated financial data presented below for fiscal year 2006 reflects the acquisition of Falcon and betapharm and therefore the results for fiscal year 2006 are not comparable to the results for prior fiscal years.

The following table sets forth, for the periods indicated, our consolidated net operating revenues by segment:

Segment	2004	Fiscal Year Ended March 31,		
		2005	2006	2006
		(Rs. in millions, U.S.\$ in thousands)		
Formulations	Rs. 7,507.5	Rs. 7,822.9	Rs. 9,925.9	U.S.\$ 223,155.5
Active pharmaceutical ingredients and intermediates	7,628.5	6,944.5	8,238.0	185,208.1
Generics	4,337.5	3,577.4	4,055.8	91,181.7
Diagnostics, critical care and biotechnology	411.0	527.1	691.1	15,536.7
Drug discovery		288.4		
Custom pharmaceuticals services	113.1	311.6	1,326.8	29,829.8
Others	105.9	47.5	29.4	660.3
Total revenues	20,103.5	19,519.4	24,267.0	545,572.1

The following table sets forth, for the periods indicated, our cost of revenues by segment:

Segment	2004	Fiscal Year Ended March 31,		
		2005	2006	2006
		(Rs. in millions, U.S.\$ in thousands)		
Formulations	Rs. 2,577.7	Rs. 2,492.8	Rs. 3,084.1	U.S.\$ 69,337.6
Active pharmaceutical ingredients and intermediates	5,102.4	5,013.6	5,916.6	133,107.1
Generics	1,324.5	1,620.4	2,168.8	48,759.0
Diagnostics, critical care and biotechnology	207.0	176.5	235.9	5,302.8
Drug discovery	0	0	0	0.0
Custom pharmaceuticals services	57.6	82.6	999.4	22,469.3
Others	68.3	0	12.6	282.6
Total revenues	9,337.3	9,385.9	12,417.4	279,168

The following table sets forth, for the periods indicated, our gross profit by segment:

Segment	2004	Fiscal Year Ended March 31,		
		2005	2006	2006



**(Rs. in millions, U.S.\$ in thousands)**

	Rs. 4,929.8	Rs. 5,330.1	Rs. 6,841.8	U.S.\$ 153,817.8
Formulations				
Active pharmaceutical ingredients and intermediates	2,526.1	1,931.0	2,321.5	52,191.0
Generics	3,013.1	1,957.1	1,887.0	42,422.8
Diagnostics, critical care and biotechnology	204.1	350.6	455.2	10,233.9
Drug discovery	0	288.4	0	
Custom pharmaceuticals services	55.5	229.0	327.4	7,360.5
Others	37.7	47.4	16.8	377.6
Total revenues	10,766.2	10,133.6	11,849.7	266,403.6

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The following table sets forth, for the periods indicated, financial data as percentages of total revenues and the increase (or decrease) by item as a percentage of the amount over the previous year. Cost of revenues and gross profit by segment are shown as a percentage of that segment's revenues.

	Percentage of Sales Fiscal Year Ended March 31,			Percentage Increase (Decrease)	
	2004	2005	2006	2004 to 2005	2005 to 2006
<b>Income Statement Data:</b>					
Revenues by segment:					
Formulations	37.3	40.1	40.9	4.2	26.9
Active pharmaceutical ingredients and intermediates	37.9	35.6	33.9	(9.0)	18.6
Generics	21.6	18.3	16.7	(17.5)	13.4
Diagnostics, critical care and biotechnology	2.0	2.7	2.8	28.2	31.1
Drug discovery		1.5			(100.0)
Custom pharmaceutical services	0.6	1.6	5.5	175.5	325.8
Other	0.6	0.2	0.2	(55.2)	(38.1)
Total revenues	100.0	100.0	100.0	(2.9)	24.3
Cost of revenues by segment:					
Formulations	34.3	31.9	31.1	(3.3)	23.7
Active pharmaceutical ingredients and intermediates	66.9	72.2	71.8	(1.7)	18.0
Generics	30.5	45.3	53.5	22.3	33.8
Diagnostics, critical care and biotechnology	50.4	33.5	34.1	(14.7)	33.6
Drug discovery					
Custom pharmaceutical services	50.9	26.5	75.3	43.4	1110.6
Other	64.4		42.8	(100.0)	
Total cost of revenues	46.4	48.1	51.2	0.5	32.3
Gross profit by segment:					
Formulations	65.7	68.1	68.9	8.1	28.4
Active pharmaceutical ingredients and intermediates	33.1	27.8	28.2	(23.6)	20.2
Generics	69.5	54.7	46.5	(35.0)	- 3.6
Diagnostics, critical care and biotechnology	49.6	66.5	65.9	71.8	29.8
Drug discovery		100.0			(100.0)
Custom pharmaceutical services	49.1	73.5	24.7	312.3	43.0
Other	35.6	100.0	57.2	26.0	(64.6)
Total gross profit	53.5	51.8	48.8	(5.9)	16.9
Operating expenses:					
Selling, general and administrative expenses	32.5	34.7	33.1	3.5	18.5
Research and development expenses	9.9	14.4	8.9	40.8	(23.2)
Amortization expenses	1.9	1.8	1.7	(8.6)	20.0
Foreign exchange (gain)/loss	(1.4)	2.5	0.5		(74.2)
Other operating expense/(income)	0.4	0.0	(1.3)	(92.8)	
Total operating expenses	43.4	53.4	42.9	19.6	(0.1)
Operating income/(loss)	10.2	(1.5)	5.9		
Equity in loss of affiliates	(0.2)	(0.3)	(0.4)	31.0	51.9
Other (expense) / income, net	2.7	2.3	2.2	(15.2)	17.5
Income before income taxes and minority interest	12.6	0.5	7.8	(95.8)	1663.4
Income tax benefit / (expenses)	(0.3)	0.5	(1.1)		

Minority interest		0.1		195.5	(100.8)
Net income	12.3	1.1	6.7	(91.5)	671.1

**Fiscal Year Ended March 31, 2006 Compared to Fiscal Year Ended March 31, 2005****Revenues**

Total revenues increased by 24.3% to Rs.24,267.0 million in fiscal 2006, as compared to Rs.19,591.4 million in fiscal 2005, primarily due to an increase in revenues in our formulations segment and our active pharmaceutical ingredients and intermediates segment, as well as new revenues contributed by our recently acquired subsidiaries, Falcon in Mexico (starting December 30, 2005) and betapharm in Germany (starting March 3, 2006). Excluding revenues from Falcon and betapharm, revenues increased by 16.6% to Rs.22,758.2 million. betapharm contributed Rs.704.9 million and Falcon contributed Rs.804.0 million to our revenues for fiscal 2006. In fiscal 2006, we received 16.4% of our revenues from North America (United States and Canada), 34.1% of our revenues

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from India, 14.7% of our revenues from Russia and other countries of the former Soviet Union, 17.8% of our revenues from Europe and 17.0% of our revenues from other countries.

Revenues from sales to Russia and other former Soviet Union countries increased by 27.9% to Rs.3,559.5 million in fiscal 2006, as compared to Rs.2,782.2 million in fiscal 2005. The increase was primarily due to an increase in sales of our major brands such as Nise, our brand of nimesulide, Keterol, our brand of ketorolac tromethamine, Ciprolet, our brand of ciprofloxacin, and Omez, our brand of omeprazole. Revenues from sales in India increased by 23.6% to Rs.8,272.5 million in fiscal 2006, as compared to Rs.6,693.0 million in fiscal 2005, primarily due to an increase in revenues in our formulations and active pharmaceutical ingredients and intermediates segments. Revenues from sales to Europe increased by 50.8% to Rs.4,326.3 million in fiscal 2006, as compared to Rs.2,868.2 million in fiscal 2005, primarily as a result of an increase in revenues from sales in our generics segment and active pharmaceutical ingredients and intermediates segment, as well as new revenues contributed from betapharm. Excluding betapharm revenues, revenues from sales to Europe increased by 26.3% to Rs.3,621.4 million in fiscal 2006. Revenues from sales to North America decreased by 8.4% to Rs.3,983.9 million in fiscal 2006, as compared to Rs.4,349.2 million in fiscal 2005, primarily due to a decrease in sales in our generics segment and active pharmaceutical ingredients and intermediates segment.

*Formulations.* In fiscal 2006, we received 40.9% of our total revenues from the formulations segment, as compared to 40.1% in fiscal 2005. Revenues in this segment increased by 26.9% to Rs.9,926.0 million in fiscal 2006, as compared to Rs.7,822.9 million in fiscal 2005.

Revenues in India constituted 55.7% of our total formulations revenues in fiscal 2006, which is the same percentage it constituted in fiscal 2005. Revenues from sales of formulations in India increased by 26.7% to Rs.5,525.7 million in fiscal 2006, as compared to Rs.4,360.2 million in fiscal 2005. This was driven by an increase in revenues from increased sales volumes of our key brands such as Omez, our brand of omeprazole, Nise, our brand of nimesulide, Stamlo our brand of amlodipine, and Recliment, our brand of gliclazide and metformin. The increase was also attributable to our focused marketing strategy, in which we reorganized our Indian sales force by therapeutic categories, as well as the positive impact of inventory restocking by stockists and retailers after implementation of India's Value Added Tax system in April 2005.

Revenues from sales of formulations outside India increased by 27.1% to Rs.4,400.3 million in fiscal 2006, as compared to Rs.3,462.7 million in fiscal 2005. Revenues from sales of formulations in Russia accounted for 58.7% of our formulation revenues outside India in fiscal 2006, as compared to 60.9% in fiscal 2005. Revenues from sales of formulations in Russia increased by 22.6% to Rs.2,583.1 million in fiscal 2006, as compared to Rs.2,107.2 million in fiscal 2005. The increase was primarily due to an increase in sales volumes as a result of marketing activities as well as introduction of the DLO program pursuant to which the Russian government purchases drugs for free distribution to low income individuals. Revenues from sales to other countries of the former Soviet Union increased by 39.4% to Rs.826.8 million for fiscal 2006 as compared to Rs.593.3 million for fiscal 2005, primarily driven by an increase in revenues in the Ukraine and Kazakhstan. Revenues from sales to the rest of the world increased by 19.2% to Rs.731.1 million in fiscal 2006, as compared to Rs.613.1 million in fiscal 2005. This increase was primarily due to higher revenues from sales to South Africa, Myanmar, Vietnam and Jamaica and was offset by a decrease in revenues from sales to Venezuela and Sri Lanka.

*Active Pharmaceutical Ingredients and Intermediates.* In fiscal 2006, we received 33.9% of our total revenues from this segment as compared to 35.6% in fiscal 2005. Revenues in this segment increased by 18.6% to Rs.8,238.1 million in fiscal 2006, as compared to Rs.6,944.5 million in fiscal 2005.

During fiscal 2006, revenues from sales in India accounted for 27.8% of our revenues from this segment, as compared to 28.4% in fiscal 2005. Revenues from sales in India increased by 16.1% to Rs.2,289.6 million in fiscal 2006, as compared to Rs.1,972.1 million in fiscal 2005. This increase was primarily due to an increase in sales volumes of ciprofloxacin, sparfloxacin and ranitidine as well as an increase in the sales price of ciprofloxacin.

Revenues from sales outside India increased by 19.5% to Rs.5,941.7 million in fiscal 2006, as compared to Rs.4,972.5 million in fiscal 2005. Revenues from sales in Europe increased by 30.2% to Rs.1,420.9 million in fiscal 2006, as compared to Rs.1,091.2 million in fiscal 2006, primarily due to an increase in revenues from new product launches. Revenues from sales in North America (United States and Canada) decreased by 10.5% to

Rs.1,655.0 million in fiscal 2006, as compared to Rs.1,849.0 million in fiscal 2005, primarily due to a decrease in sales of ranitidine Hcl Form 1. Revenues from sales in the rest of the world increased from Rs.2,032.3 million in fiscal 2005 to Rs.2,865.7 in fiscal 2006, driven primarily by the growth of sales in Israel, Turkey, Mexico and Brazil.

*Generics.* In fiscal 2006, we received 16.7% of our total revenues from this segment, as compared to 18.3% in fiscal 2005. This segment's revenues, including revenues contributed by betapharm (starting March 3, 2006), increased by 13.4% to Rs.4,055.8 million

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in fiscal 2006, as compared to Rs.3,577.4 million in fiscal 2005. Excluding revenues contributed by betapharm, this segment's revenues declined by 6.3% to Rs.3,350.8 million. Revenues from sales in North America (United States and Canada) decreased by 26.9% to Rs.1,630.6 million in fiscal 2006, as compared to Rs.2,230.1 million in fiscal 2005. This was primarily on account of a decrease in prices of tizanidine and fluoxetine due to increased competition. Together, these products contributed Rs.437.8 million in revenue in fiscal 2006, as compared to Rs.1,134.7 million in fiscal 2005. This decline was partially offset by the revenues from new product launches of glimpiride and zonisamide as well as an increase in sales of ibuprofen and naproxen. The benefit of high pricing in omeprazole and amlodipine was more than offset by a decline in revenues from sales of key products in North America. Revenues from sales in Europe increased by 80.8% to Rs.2,421.5 million in fiscal 2006, as compared to Rs.1,339.6 million in fiscal 2005. Revenues contributed by betapharm (starting March 3, 2006) of Rs.704.9 million have been included in this segment's fiscal 2006 revenues. Excluding revenues contributed by betapharm, revenues from sales in Europe increased by 28.1% to Rs.1,716.6 million in fiscal 2006 primarily due to growth of sales volume and higher pricing of omeprazole and amlodipine maleate in the U.K. market.

*Critical Care and Biotechnology.* We received 2.8% of our total revenues from this segment in fiscal 2006, as compared to 2.7% in fiscal 2005. Revenues in this segment increased to Rs.691.1 million in fiscal 2006, as compared to Rs.527.1 million in fiscal 2005.

Revenues from our critical care division increased by Rs.109.6 million in fiscal 2006, primarily on account of an increase in revenues from sales in India of key products such as Dacotin, our brand of oxaliplatin, Docetere, our brand of docetaxel, and Mitotax, our brand of paclitaxel. Revenues from our biotechnology division increased by Rs.54.4 million in fiscal 2006, primarily due to growth in sales volumes of Grastim, our brand of filgrastim.

*Discovery Research.* There were no revenues from discovery research in fiscal 2006, as compared to Rs.288.4 million in fiscal 2005 (which was attributable to the recognition of Rs.235.6 million from Novartis Pharma A.G. and Rs.52.8 million from Novo Nordisk as the result of termination of license agreements with both of these companies)

*Custom Pharmaceutical Services.* Revenues from custom pharmaceutical services, including revenues from our recently acquired subsidiary Falcon, grew to Rs.1,326.8 million in fiscal 2006 as compared to Rs.311.6 million in fiscal 2005. Excluding revenues from Falcon, revenues grew by 67.8% to Rs.522.8 million driven by growth in our customer base and product portfolio.

*Others.* Revenues from our other businesses (consisting of service income in Aurigene Discovery Technologies Limited) were Rs.29.4 million in fiscal 2006 as compared to Rs.47.4 million in fiscal 2005.

**Cost of revenues**

Cost of revenues increased by Rs.3,031.6 million to Rs.12,417.4 million for fiscal 2006, as compared to Rs.9,385.8 million for fiscal 2005. As a percentage of total revenues, cost of revenues was 51.2% for fiscal 2006, as compared to 48.1% for fiscal 2005. Excluding revenues and cost of revenues from betapharm and Falcon, cost of revenues increased by Rs.1,987.9 million to Rs.11,373.8 million, which was 50% of total revenues for fiscal 2006, as compared to 48.1% for fiscal 2005.

*Formulations.* Cost of revenues in this segment was 31.1% of revenues for fiscal 2006, as compared to 31.9% of revenues for fiscal 2005. Cost of revenues increased by 23.7% to Rs.3,084.1 million in fiscal 2006, as compared to Rs.2,492.8 million in fiscal 2005 which is roughly in line with our overall increase in revenues.

*Active Pharmaceutical Ingredients and Intermediates.* Cost of revenues in this segment decreased to 71.8% of this segment's revenues in fiscal 2006, as compared to 72.2% of the segment's revenues in fiscal 2005. Cost of revenues increased by 18.0% to Rs.5,916.6 million in fiscal 2006, as compared to Rs.5,013.6 million in fiscal 2005. The decrease in cost of revenues as a percentage of revenues was primarily due to an overall increase in sales.

*Generics.* Cost of revenues, including revenues from betapharm, was 53.5% of this segment's revenues in fiscal 2006, as compared to 45.3% in fiscal 2005. Cost of revenues increased by 33.8% to Rs.2,168.8 million in fiscal 2006, as compared to Rs.1,620.4 million in fiscal 2005. The increase in cost of revenues as a percentage of sales in this segment was primarily as a result of a decline in average price realization in our US generics businesses due to continued pricing pressure.

*Critical Care and Biotechnology.* Cost of revenues in this segment increased to 34.1% of this segment's revenues in fiscal 2006, as compared to 33.5% in fiscal 2005. Cost of revenues increased by 33.6% to Rs.235.9 million in fiscal 2006, as compared to Rs.176.5 million in fiscal 2005. The increase was due to a decrease in prices of key products as well as an increase in production overhead costs.

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*Custom Pharmaceutical Services.* Cost of revenues in this segment increased from Rs.82.6 million to Rs.999.4 million primarily as a result of the acquisition of Falcon, which is included within this segment. The cost of revenue as a percentage of revenue was at 75.3% as compared to 26.5% in the previous year. This increase was primarily a result of increased sales of API products having lower margins.

**Gross profit**

As a result of the trends described in Revenues and Cost of revenues above, our gross profit, including profit from betapharm and Falcon, increased by 16.9% to Rs.11,849.7 million for fiscal 2006 from Rs.10,133.5 million during fiscal 2005. Excluding profit from betapharm and Falcon, gross profit increased by 12.3% to Rs.11,384.4 million for fiscal 2006. Gross margin percentage was 48.8% in fiscal 2006, as compared to 51.9% in fiscal 2005.

Gross margin of the formulations segment increased to 68.9% in fiscal 2006, as compared to 68.1% in fiscal 2005. The gross margin for our active pharmaceutical ingredients segment increased to 28.2% in fiscal 2006, as compared to 27.8% in fiscal 2005. The gross margin for our generics segment decreased to 46.5% in fiscal 2006, as compared to 54.7% in fiscal 2005. The gross margin for our critical care and biotechnology segment was 65.9% in fiscal 2006, as compared to 66.5% in fiscal 2005. The gross margin for our custom pharmaceutical services segment was 24.7% in fiscal 2006, as compared to 73.5% in fiscal 2005.

**Selling, general and administrative expenses**

Selling, general and administrative expenses, including expenses of betapharm and Falcon, increased by 18.5% to Rs.8,028.9 million in fiscal 2006, as compared to Rs.6,774.6 million in fiscal 2005. Excluding expenses of betapharm and Falcon, selling, general and administrative expenses increased 13.4% to Rs.7,687.4 million for fiscal 2006. Selling, general and administrative expenses, including expenses of betapharm and Falcon, as a percentage of revenues were 33.1% for fiscal 2006 as compared to 34.7% for fiscal 2005.

The increase in selling, general and administrative expenses as a whole was largely due to an increase in employee costs as well as marketing costs, largely offset by a decrease in legal and professional expenses. Employee costs increased by 18.0% primarily due to annual compensation increases and market corrections as well as an increase in the number of employees. Marketing expenses increased by 36.0% primarily on account of higher selling expenses and higher shipping costs. Legal and professional expenses decreased by 10.6% primarily due to lower legal and consultancy activity in fiscal 2006.

**Research and development expenses**

Research and development costs decreased by 23.2% to Rs.2,153.0 million for fiscal 2006, as compared to Rs.2,803.3 million for fiscal 2005. The acquisitions of betapharm and Falcon did not have any significant impact on research and development expenditure. As a percentage of revenue, research and development expenses were 8.9% of our total revenue in fiscal 2006 as compared to 14.4% in fiscal 2005. The decrease was primarily on account of lower research and development costs in our drug discovery segment and lower research and development costs in our generics segment, which includes costs for research and development related to our specialty pharmaceuticals business, offset by an increase in expenses in our formulations, biotechnology and CPS segments. Under the terms of the research and development partnership agreement with I-VEN Pharma Capital Limited, we received Rs.985.4 million (U.S.\$22.5 million) in March 2005 to be applied to research and development costs in our generics segment, of which Rs.384.5 million (U.S.\$8.6 million) was recorded as a reduction in the research and development expense line item in fiscal 2006 as compared to Rs.96.2 million (U.S.\$2.2 million) recognized in fiscal 2005.

**Amortization expenses**

Amortization expenses, including expenses of betapharm and Falcon, increased by 20.0% to Rs.419.9 million from Rs.350.0 million. The increase was primarily on account of amortization of intangibles acquired in the acquisition of betapharm and Falcon amounting to Rs.87.2 million and Rs.6.8 million respectively.

**Foreign exchange gain/loss**

Foreign exchange loss was Rs.126.3 million for fiscal 2006 as compared to a loss of Rs.488.8 million for fiscal 2005. In fiscal 2006, the rupee depreciated by 1.95%, resulting in a gain on translation and realization of foreign currency receivables and a loss on translation of foreign currency loans. This also caused a loss on forward foreign exchange contracts entered into to hedge receivables.





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### **Other operating expense/(income), net**

Other operating income net amounted to Rs.320.4 million in fiscal 2006, as compared to Rs.6.0 million in fiscal 2005. This includes profit of Rs.387.3 million in fiscal 2006 on sale of our finished dosages manufacturing facility located in Goa, India.

### **Operating income**

As a result of the foregoing, our operating income was Rs.1,441.9 million in fiscal 2006, as compared to an operating loss of Rs.289.2 million in fiscal 2005. Operating gain as a percentage of total revenues was 5.9% in fiscal 2006, as compared to (1.5%) in fiscal 2005.

### **Other income, net**

For fiscal 2006 our other income was Rs.533.6 million, as compared to Rs.454.2 million for fiscal 2005. This includes net interest income of Rs.418.8 million in fiscal 2006 as compared to Rs.271.9 million in fiscal 2005. The increase in other income was primarily a result of an increase in interest income earned on investment of surplus funds.

### **Equity in loss of affiliates**

Equity in loss of affiliates increased by Rs.30.1 million to Rs.88.2 million for fiscal 2006 from Rs.58.1 million for fiscal 2005, primarily due to loss pick up in Perlecan Pharma Pvt Ltd of Rs.40 million for fiscal 2006. However, the increase was offset by a decrease in loss pick up in Kunshan Rotam Reddy Pharmaceuticals by Rs.9.9 million on account of a reduction in losses.

### **Income before income taxes and minority interest**

As a result of the foregoing, income before income taxes and minority interest increased to Rs.1,887.3 million in fiscal 2006, as compared to Rs.107 million in fiscal 2005. As a percentage of revenues, income before income taxes and minority interest was 7.8% of revenues in fiscal 2006, as compared to 0.5% of revenues in fiscal 2005.

### **Income tax expense**

Income tax expense for fiscal 2006 was Rs.258.4 million as compared to an income tax net benefit of Rs.94.3 million for fiscal 2005. The income tax expense increase in fiscal 2006 was primarily a result of significantly higher income from operations in fiscal 2006 as compared to fiscal 2005, in which year we recorded a tax loss. Further, we had a higher weighted average deduction in fiscal 2005 as a result of research and development expenses principally related to increased research and development spending and lower credits arising from the I-VEN transaction.

### **Minority interest**

Minority interest for fiscal 2006 was an expense of Rs.0.1 million representing our minority share in the profits of Dr. Reddy's Laboratories (Proprietary) Limited, our subsidiary in South Africa. During fiscal 2005, we realized a gain of Rs.9.9 million on account of allocation of our minority share in the losses of this subsidiary.

### **Net income**

As a result of the above, our net income increased to Rs.1,628.9 million in fiscal 2006, as compared to Rs.211.1 million in fiscal 2005. Net income as a percentage of total revenues increased to 6.7% in fiscal 2006 from 1.1% in fiscal 2005.

### **Fiscal Year Ended March 31, 2005 Compared to Fiscal Year Ended March 31, 2004**

Pursuant to comments from the SEC staff, we have reclassified certain amounts for the fiscal year ended March 31, 2005 and this year on year discussion reflects those reclassified amounts.

### **Revenues**

Total revenues decreased by 2.9% to Rs.19,519.4 million in fiscal 2005, as compared to Rs.20,103.5 million in fiscal 2004, primarily due to a decrease in revenues in our generics and active pharmaceutical ingredients and intermediates segments. In fiscal

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2005, we received 22.3% of our revenues from the United States and Canada, 34.3% from India, 14.2% from Russia and other former Soviet Union countries, 14.7% from Europe and 14.5% from other countries.

Revenues from sales in Russia and other former Soviet Union countries increased by 21.7% to Rs.2,782.2 million in fiscal 2005, as compared to Rs.2,285.8 million in fiscal 2004. The increase was primarily due to an increase in sales of our major brands of formulations such as Nise, our brand of nimesulide, Keterol, our brand of ketorolac tromethamine, and Omez, our brand of omeprazole. Revenues from sales in Europe increased by 2.9% to Rs.2,868.2 million in fiscal 2005, as compared to Rs.2,788.6 million in fiscal 2004, primarily as a result of an increase in revenues from our generics segment largely offset by a decrease in revenues from our active pharmaceutical ingredients and intermediates segment. Revenues from sales in North America decreased by 18.2% to Rs.4,349.2 million in fiscal 2005, as compared to Rs.5,319.2 million in fiscal 2004, primarily due to a decrease in revenues in our generics segment. Revenues from sales in India decreased by 6.3% to Rs.6,693.0 million in fiscal 2005, as compared to Rs.7,143.8 million in fiscal 2004, primarily due to a decrease in revenues in our formulations and active pharmaceutical ingredients and intermediates segments. We made allowances for sales returns of Rs.105.2 million and Rs.169.5 million in fiscal 2005 and fiscal 2004, respectively.

*Formulations.* In fiscal 2005, we received 40.1% of our total revenues from the formulations segment, as compared to 37.4% in fiscal 2004. Revenues in this segment increased by 4.2% to Rs.7,822.9 million in fiscal 2005, as compared to Rs.7,507.5 million in fiscal 2004.

Revenues from sales in India constituted 55.7% of our total formulations revenues in fiscal 2005, as compared to 63.0% in fiscal 2004. Revenues from sales of formulations in India decreased by 7.8% to Rs.4,360.2 million in fiscal 2005, as compared to Rs.4,729.4 million in fiscal 2004. New products launched in India in fiscal 2005 accounted for 6% of the total revenues. These additional revenues were more than offset by a decrease in revenues from sales of our key brands (such as Omez, our brand of omeprazole, and Nise, our brand of nimesulide), as well as inventory reduction by stockists, retailers and other trade channels in March 2005 due to uncertainty relating to the implementation of the Value Added Tax ( VAT ) system in India.

Revenues from sales of formulations outside India increased by 24.6% to Rs.3,462.7 million in fiscal 2005, as compared to Rs.2,778.2 million in fiscal 2004. Revenues from sales of formulations in Russia accounted for 60.9% of our formulation revenues outside India in fiscal 2005, as compared to 64.1% in fiscal 2004. Revenues from sales of formulations in Russia increased by 18.3% to Rs.2,107.2 million in fiscal 2005, as compared to Rs.1,781.8 million in fiscal 2004. The increase was driven by increased revenues from sales of our key brands such as Nise, our brand of nimesulide, Keterol, our brand of ketorolac tromethamine, Omez, our brand of omeprazole, and Ciprolet, our brand of ciprofloxacin. Revenues from other former Soviet Union countries increased by 31.2% to Rs.593.3 million for fiscal 2005, as compared to Rs.452.3 million for fiscal 2004, primarily driven by an increase in revenues in Ukraine, Kazakhstan and Belarus. Revenues from the rest of the world increased by 40.4% to Rs.613.1 million in fiscal 2005, as compared to Rs.436.6 million in fiscal 2004. This increase was primarily due to higher revenues from sales in South Africa, Venezuela and new markets such as United Arab Emirates.

*Active Pharmaceutical Ingredients and Intermediates.* In fiscal 2005, we received 35.6% of our total revenues from this segment, as compared to 38.0% in fiscal 2004. Revenues in this segment decreased by 9.0% to Rs.6,944.5 million in fiscal 2005, as compared to Rs.7,628.5 million in fiscal 2004.

During fiscal 2005, revenues from sales in India accounted for 28.4% of our revenues from this segment, as compared to 27.7% in fiscal 2004. Revenues from sales in India decreased by 6.8% to Rs.1,972.1 million in fiscal 2005, as compared to Rs.2,115.1 million in fiscal 2004. This decrease was primarily due to a decrease in sales volumes of ciprofloxacin, sparfloxacin and gatifloxacin.

Revenues from sales outside India decreased by 9.8% to Rs.4,972.4 million in fiscal 2005, as compared to Rs.5,513.4 million in fiscal 2004. Revenues from sales in Europe decreased by 32.9% to Rs.1,091.1 million in fiscal 2005, as compared to Rs.1,626.9 million in fiscal 2004 primarily due to a decrease in revenues from ramipril. Ramipril, launched in Europe in fiscal 2004, accounted for Rs.753.3 million in revenue in fiscal 2005 compared to Rs.1,237.5 million in fiscal 2004. This decline was primarily due to a reduction in price due to additional competition. Revenues from sales in the United States and Canada decreased by 2.8% to Rs.1,849.0 million in fiscal 2005, as compared to Rs.1,902.9 million in fiscal 2004, primarily due to additional competition for our existing products.

*Generics.* In fiscal 2005, we received 18.3% of our total revenues from this segment, as compared to 21.6% in fiscal 2004. Revenues decreased by 17.5% to Rs.3,577.4 million in fiscal 2005, as compared to Rs.4,337.5 million in fiscal 2004. Revenues from sales in the United States and Canada decreased by 34.4% to Rs.2,230.1 million in fiscal 2005, as compared to Rs.3,398.6 million in fiscal 2004. This was primarily on account of increased competition with respect to sales of tizanidine and fluoxetine. Together these two products accounted for Rs.1,134.7 million in revenue in fiscal 2005 as compared to Rs.2,402.8 million in fiscal 2004. This decline

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was partially offset by revenues from new product launches of ciprofloxacin (launched in June 2004) and citalopram (launched in October 2004). Revenues in Europe increased by 44.1% to Rs.1,339.6 million in fiscal 2005, as compared to Rs.929.9 million in fiscal 2004, primarily due to growth in sales volumes of omeprazole and amlodipine maleate (launched in March 2004).

*Critical Care and Biotechnology.* We received 2.7% of our total revenues from this segment in fiscal 2005, as compared to 2.0% in fiscal 2004. Revenues in this segment increased to Rs.527.1 million in fiscal 2005, as compared to Rs.411.0 million in fiscal 2004.

Revenues from our critical care division increased by Rs.82.7 million, primarily due to an increase in domestic revenues from sales of key products of Dacotin, our brand of oxaliplatin, Docetere, our brand of docetaxel, and Mitotax, our brand of paclitaxel. Revenues from our biotechnology division increased by Rs.42.6 million, primarily due to sales volume growth of Grastim, our brand of filgrastim.

*Drug Discovery.* Revenues from our drug discovery segment were at Rs.288.4 million for fiscal 2005, as compared to no revenue for fiscal 2004. In September 2001, we received Rs.235.6 million as an upfront license fee from Novartis Pharma A.G. in connection with our out-licensing of DRF 4158 to Novartis. During fiscal 2005, on expiration of the terms of the agreement with Novartis, we accounted for the upfront license fee as income, which was deferred in the fiscal year ended March 31, 2002 as the up-front license fee did not represent the culmination of a separate earning process, the up-front license fee had been deferred to be recognized in accordance with our accounting policy proportionately upon the receipt of stated milestones. During fiscal 2005, we recognized an amount of Rs.52.8 million towards DRF 2593 pursuant to the discontinuation of our agreement with Novo Nordisk.

*Others.* Revenues from our custom pharmaceutical services segment were Rs.311.6 million in fiscal 2005, as compared to Rs.113.1 million in fiscal 2004. The increase is primarily on account of increases in both our customer base and our product portfolio.

**Cost of revenues**

Total cost of revenues increased by Rs.48.5 million to Rs.9,385.8 million for fiscal 2005, as compared to Rs.9,337.3 million for fiscal 2004. Cost of revenues as a percentage of total revenues was 48.1% for fiscal 2005, as compared to 46.5% for fiscal 2004.

*Formulations.* Cost of revenues in this segment decreased by 3.3% to Rs.2,492.8 million in fiscal 2005, as compared to Rs.2,577.7 million in fiscal 2004. Cost of revenues in this segment was 31.9% of formulations revenues for fiscal 2005, as compared to 34.3% of formulations revenues for fiscal 2004. The decrease in cost of revenues as a percentage of revenues was primarily due to a higher proportion of revenues from outside India, which generate relatively higher gross margins.

*Active Pharmaceutical Ingredients and Intermediates.* Cost of revenues in this segment decreased by 1.7% to Rs.5,013.6 million in fiscal 2005, as compared to Rs.5,102.4 million in fiscal 2004. Cost of revenues in this segment has increased to 72.2% of this segment's revenues in fiscal 2005, as compared to 66.9% of the segment's revenues in fiscal 2004. The increase in cost of revenues as a percentage of sales was primarily due to a decrease in revenues from sales of ramipril in Europe, which generates a higher gross margin compared to the segment's average gross margin, as well as a higher proportion of revenues from India, which generate lower gross margins, all as compared to fiscal 2004.

*Generics.* Cost of revenues in this segment increased by 22.3% to Rs.1,620.4 million in fiscal 2005, as compared to Rs.1,324.5 million in fiscal 2004. Cost of revenues was 45.3% of this segment's revenues in fiscal 2005, as compared to 30.5% in fiscal 2004. The cost of revenues as a percentage of revenues increased primarily due to a decline in revenues from sales of our key products fluoxetine and tizanidine, which generate a higher gross margin compared to segment's average gross margins.

*Critical Care and Biotechnology.* Cost of revenues in this segment decreased by 14.7% to Rs.176.5 million in fiscal 2005, as compared to Rs.207.0 million in fiscal 2004. Cost of revenues in this segment decreased to 33.5% of this segment's revenues in fiscal 2005, as compared to 50.4% in fiscal 2004. The decrease in cost of revenues is primarily due to a decrease in input costs of certain existing products.

**Gross profit and gross margin**

As a result of the trends described in Revenues and Cost of revenues above, our gross profit decreased by 5.9% to Rs.10,133.5 million for fiscal 2005 from Rs.10,766.3 million during fiscal 2004. Gross margin was 51.9% in fiscal 2005, as compared to 53.5% in fiscal 2004.

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The gross margin for our formulations segment increased to 68.1% in fiscal 2005, as compared to 65.7% in fiscal 2004. The gross margin for our active pharmaceutical ingredients segment decreased to 27.8% in fiscal 2005, as compared to 33.1% in fiscal 2004. The gross margin for our generics segment decreased to 54.7% in fiscal 2005, as compared to 69.5% in fiscal 2004. The gross margin for our critical care and biotechnology segment was 66.5% in fiscal 2005, as compared to 49.7% in fiscal 2004.

**Selling, general and administrative expenses**

Selling, general and administrative expenses increased by 3.5% to Rs.6,774.6 million in fiscal 2005, as compared to Rs.6,542.5 million in fiscal 2004. Selling, general and administrative expenditures as a percentage of total revenues were 34.7% for fiscal 2005 as compared to 32.7% for fiscal 2004. This increase is largely due to an increase in employee costs, which was largely offset by a decrease in legal and professional expenses. Employee costs increased by 21.7% to Rs.2,062.5 million in fiscal 2005, as compared to Rs.1,697.0 million in fiscal 2004, primarily due to annual salary increases and market corrections as well as an increase in the number of employees in our international offices. Legal and professional expenses decreased by 24.1% to Rs.995.0 million in fiscal 2005, as compared to Rs.1,311.0 million in fiscal 2004, primarily due to lower legal and consultancy activity during fiscal 2005.

**Research and development expenses**

Research and development costs increased by 40.8% to Rs.2,803.3 million for fiscal 2005, as compared to Rs.1,991.6 million for fiscal 2004. As a percentage of revenue, research and development expenditure accounted for 14.4% of total revenue in fiscal 2005, as compared to 9.9% in fiscal 2004. The increase was primarily on account of a charge of Rs.277.0 million recorded against research and development in-process associated with our acquisition of Trigenesis Therapeutics, Inc., international clinical trials in our drug discovery segment and an increase in research and development activity in our active pharmaceutical ingredients and intermediates, formulations, generics and biotechnology businesses. During the year, we entered into a research and development partnership agreement with I-VEN Pharma Capital Limited ( I-VEN ) for the development and commercialization of ANDA s to be filed in the U.S. in 2004-05 and 2005-06. Under the terms of the agreement, we received U.S.\$22.5 million in March 2005 of which U.S.\$2.2 million was recorded as a reduction in research and development expense in fiscal 2005.

**Amortization expenses**

Amortization expenses decreased by 8.6% to Rs.350.0 million in fiscal 2005, as compared to Rs.382.9 million in fiscal 2004. The decrease was primarily on account of higher amortization of our acquired brands and other intangibles in fiscal 2004.

**Foreign exchange gain/loss**

Foreign exchange loss was Rs.488.8 million for fiscal 2005 as compared to a gain of Rs.282.4 million for fiscal 2004. The loss was mainly on account of losses resulting from marking to market of our forward derivative contracts partially offset by gains realized on maturity of these forward derivative contracts.

**Other operating expense/(income)**

Other operating expense amounted to Rs. 6.0 million in fiscal 2005 as compared to Rs. 83.2 million in fiscal 2004. loss in previous year was primarily on account of sale of fixed assets in Pondicherry, India in our formulations business and certain other assets.

**Operating income**

As a result of the foregoing, our operating loss was at Rs.289.1 million in fiscal 2005, as compared to an operating gain of Rs.2,048.5 million in fiscal 2004. Operating loss as a percentage of total revenues was 1.5% in fiscal 2005, as compared to 10.1% in fiscal 2004.

**Other (expense)/income, net**

For fiscal 2005 our other income was Rs.454.2 million, as compared to Rs.535.9 million for fiscal 2004. This includes net interest income of Rs.272 million in fiscal 2005 as compared to Rs.406.8 million in fiscal 2004. This decrease in net interest income was partially offset by an increase in income from sale of investments by Rs.90.4 million.

**Table of Contents****Equity in loss of affiliates**

Equity in loss of affiliates increased by Rs.13.7 million to Rs.58.1 million for fiscal 2005 from Rs.44.4 million for fiscal 2004, primarily due to an increase in loss pick up in Kunshan Rotam Reddy Pharmaceuticals, which is accounted under the equity investee method.

**Income before income taxes and minority interest**

As a result of the foregoing, income before income taxes and minority interest decreased by 95.8% to Rs.107.0 million in fiscal 2005, as compared to Rs.2,540.3 million in fiscal 2004. As a percentage of revenues, income before income taxes and minority interest was 0.5% of revenues in fiscal 2005, as compared to 12.6% of revenues in fiscal 2004.

**Income tax expense**

We recorded a net income tax credit of Rs.94.3 million for fiscal 2005, as compared to an expense of Rs.69.2 million for fiscal 2004. The decrease was primarily on account of a decline in overall profits; higher research and development expenditures, which are eligible for weighted tax deductions partially offset by an increase in the enacted tax rate in India from 35.875% to 36.5925%.

**Minority interest**

Loss attributable to minority interest for fiscal 2005 was Rs.9.9 million, as compared to Rs.3.4 million for fiscal 2004. This represents the minority interest in the losses of Dr. Reddy's Laboratories (Proprietary) Limited, our 60% subsidiary in South Africa.

**Net income**

As a result of the above, our net income decreased by 91.5% to Rs.211.2 million in fiscal 2005, as compared to Rs.2,474.4 million in fiscal 2004. Net income as a percentage of total revenues decreased to 1.1% in fiscal 2005 from 12.3% in fiscal 2004.

**Recent Accounting Pronouncements**

In June 2006, the FASB issued FASB Interpretation Number ( FIN ) 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). FIN 48 establishes a recognition threshold and measurement for income tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 also prescribes a two-step evaluation process for tax positions. The first step is recognition and the second is measurement. For recognition, an enterprise judgmentally determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold it is measured and recognized in the financial statements as the largest amount of tax benefit that is greater than 50% likely of being realized. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements.

Tax positions that meet the more-likely-than-not recognition threshold at the effective date of FIN 48 may be recognized or, continue to be recognized, upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. FIN 48 will apply to fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company is currently evaluating the impact FIN 48 will have on its consolidated financial statements when it becomes effective for the Company in fiscal 2008 and is unable, at this time, to quantify the impact, if any, to retained earnings at the time of adoption.

**5.B. Liquidity and capital resources****Liquidity**

We have primarily financed our operations through cash flows generated from operations and through short-term borrowings for working capital. Our principal liquidity and capital needs are for making investments, the purchase of property, plant and equipment, regular business operations and drug discovery.

Our principal sources of short-term liquidity are internally generated funds and short-term borrowings, which we believe are sufficient to meet our working capital requirements and currently anticipated capital expenditures over the near term. As part of our growth strategy, we continue to review opportunities to acquire companies, complementary technologies or product rights. To fund the





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acquisition of betapharm in Germany, we borrowed 400 million under a bank loan facility with a maturity period of five years. If our future acquisitions involve significant cash payments, rather than the issuance of shares, we may need to further borrow from banks or raise additional funds from the debt or equity markets.

As of March 31, 2006 we anticipate expenditures of approximately U.S.\$ 120 million over the next two fiscal years in connection with the addition of manufacturing capacity in and expansion of infrastructure requirements for our business.

The following table summarizes our statements of cash flows for the periods presented:

	2004	Fiscal Year Ended March 31, 2005 2006 2006 (Rs. in million, U.S.\$ in thousands)		
Net cash provided by /(used in):				
Operating activities	Rs.3,992.2	Rs.2,291.6	Rs.1,643.1	U.S.\$36,941
Investing activities	(6,506.1)	632.9	(34,524.4)	(776,179)
Financing activities	(376.1)	1,931.3	27,210.9	611,757
Effect of exchange rate changes on cash	(14.2)	55.8	95.1	2,138
Net increase / (decrease) in cash and cash Equivalents	Rs.(2,897.2)	Rs.4,911.6	Rs.(5,575.2)	U.S.\$(125,342)

**Cash Flow From Operating Activities**

Net cash provided by operating activities decreased from Rs.2,291.6 million in fiscal 2005 to Rs.1,643.1 million in fiscal 2006. Net cash provided by operating activities consisted primarily of net income including adjustments for non-cash items and changes in working capital.

As net income increased from Rs.211 million in fiscal 2005 to Rs.1,629 million in fiscal 2006, there was also an increase in operating assets and liabilities of Rs.1,873.3 million in fiscal 2006 as compared to a decrease in operating assets and liabilities of Rs.113 million in fiscal 2005. The increase in operating assets and liabilities in fiscal 2006 was primarily due to an increase in accounts receivable by Rs.781 million due to increased sales, an increase in inventories by Rs.1,851 million, in line with our increased sales and anticipated product launches, and the effect of an increase in operating assets and liabilities subsequent to the acquisition of Falcon and betapharm.

**Cash Flow From Investing Activities**

Cash outflow from investing activities was Rs.34,524.4 million for the fiscal year ended March 31, 2006, primarily due to cash paid for the acquisition of betapharm and Falcon, which was approximately Rs.27,269 million, and restricted cash of Rs.6,017 million in connection with borrowing in relation to the betapharm acquisition and increased capital expenditures of Rs.1,873 million.

**Cash Flows From Financing Activities**

Net cash provided by financing activities for fiscal 2006 was Rs.27,210.95 million primarily due to short-term borrowings from banks of Rs.6,322.0 million and long term borrowings from banks incurred in connection with the acquisition of betapharm of Rs.21,598.30 million.

**Principal obligations**

The following table summarizes our principal debt obligations outstanding as of March 31, 2006:

		Payments due by period (Rs. in millions)				
Financial Contractual		Less than			After 5 years	Annual Interest Rate
Obligations	Total	1 year	1-3 years	3-5 years		
Short-term borrowings from banks	9,132.5	9,132.5				LIBOR + 50 to 65bps for foreign currency

					denominated loans and 10.25% to 10.5% for rupee demoninated loans
Long term debt From Indian Renewable Energy Development Agency For betapharm acquisition	21,627.1 25.1 21,602.0	906.0 5.9 900.1	7,212.4 11.8 7,200.6	13,508.7 7.4 13,501.3	2%*  EURIBOR + 150 bps
Total Obligations	30,759.6	10,038.5	7,212.4	13,508.7	

\* Loan received at a subsidized rate of interest from Indian Renewable Energy Development Agency Limited promoting use of alternative sources of energy.

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Subject to obtaining certain regulatory approvals, there are no legal or economic restrictions on the transfer of funds between us and our subsidiaries or for the transfer of funds in the form of cash dividends, loans or advances.

The maturities of our short-term borrowings from banks vary from one month to approximately six months. Our objective in determining the borrowing maturity is to ensure a balance between flexibility, cost and the continuing availability of funds. All of our debts except for short-term working capital loans from banks are at fixed rates of interest.

Cash and cash equivalents are held in Indian rupees, U.S. dollars, U.K. pounds sterling, Singapore dollars, Brazilian real, Euros, Russian roubles, Chinese yuan, South African rand and Hong Kong dollars.

As of March 31, 2005 and 2006, we had committed to spend approximately Rs.192.2 million and Rs.744.0 million, respectively, under agreements to purchase property and equipment and other capital commitments. These amounts are net of capital advances paid in respect of such purchases and we anticipate funding them from internally generated funds.

### ***5.C. Research and development, patents and licenses, etc.***

#### **Research and Development**

Our research and development activities can be classified into several categories, which run parallel to the activities in our principal areas of operations:

Formulations, where our research and development activities are directed at the development of product formulations, process validation, bioequivalency testing and other data needed to prepare a growing list of drugs that are equivalent to numerous brand name products for sale in the emerging markets.

Active pharmaceutical ingredients and intermediates, where our research and development activities concentrate on development of chemical processes for the synthesis of active pharmaceutical ingredients for use in our generics and formulations segments and for sales in the emerging and developed markets to third parties.

Generics, where our research and development activities are directed at the development of product formulations, process validation, bioequivalency testing and other data needed to prepare a growing list of drugs that are equivalent to numerous brand name products whose patents and regulatory exclusivity periods have expired or are nearing expiration in the regulated markets of the United States and Europe.

Critical care and biotechnology, where research and development activities are directed at the development of oncology and biotechnology products for the emerging as well as regulated markets. Our new biotechnology research and development facility caters to the highest development standards, including cGMP, Good Laboratory Practices and bio-safety level IIA. We are in the process of building our bio-generics pipeline. During fiscal 2005, we entered into an agreement with a U.S. based biotechnology company for the development of a bio-generics portfolio.

Drug discovery, where we are actively pursuing discovery and development of NCEs. Our research programs focus on the following therapeutic areas:

§ Metabolic disorders

§ Cardiovascular disorders

§ Bacterial infections

§ Inflammation

§ Cancer

Custom pharmaceutical services, where we intend to leverage the strength of our process chemistry and finished dosage development expertise to target innovator as well as emerging pharmaceutical companies. The research and development is directed toward providing services to support the entire pharmaceutical value chain from discovery all the way to the market.

In fiscal 2004, 2005 and 2006, we expended Rs.1,991.6 million, Rs.2,803.3 million and Rs.2,153.0 million, respectively, on research and development activities.



**Table of Contents****Patents, Trademarks and Licenses**

We have filed and been issued numerous patents in our principal areas of operations: drug discovery, active pharmaceutical ingredients and intermediates and generics. We expect to continue to file patent applications seeking to protect our innovations and novel processes in several countries, including the United States. Any existing or future patents issued to or licensed by us may not provide us with any competitive advantages for our products or may even be challenged, invalidated or circumvented by our competitors. In addition, such patent rights may not prevent our competitors from developing, using or commercializing products that are similar or functionally equivalent to our products. We have filed over 650 trademarks with the Registrar of Trademarks in India. We also have made application for registration for non-U.S. trademarks in other countries in which we do business. We market several products under licenses in several countries where we operate.

**5.D. Trend information**

*Formulations.* According to the Operations Research Group International Medical Statistics ( ORG IMS ) Annual Report 2004, the Indian retail pharmaceutical market, valued at Rs.230 billion for the twelve-month period ending December 31, 2005, grew by 9%. New product introductions, as well as increases in the prices but not sales volumes of the older products, had a positive contribution to our growth in 2005. Much of this growth was driven by the contribution from new products launched in the 24 month period ending on December 31, 2005. Year 2005 also marked the beginning of a new era with the introduction of the product patent regime. This motivated multinational corporations to bring in their research molecules and Indian companies to focus on developing brands and exploring in-licensing & marketing alliances. In fiscal 2006, new product introductions accounted for 2.0% of revenues in India. In fiscal 2006, the growth of our revenues in India was above industry average. We expect to continue the momentum in growth during fiscal 2007, driven by a combination of key brand performance and new product introductions during fiscal 2004, 2005 and 2006.

We expect that the Indian Ministry of Chemicals and Fertilisers, in order to control the prices of drugs in India, will implement a ceiling on sales margins for drugs not previously subject to price control. Under the proposal:

for drugs sold under generic names for more than Rs.3 per tablet, the wholesalers' margin cannot exceed 35% of the manufacturers' selling price and the retailers' margin cannot exceed 15% of the manufacturers' selling price;

for drugs sold under brand names more than Rs.3 per tablet, the wholesalers' margin cannot exceed 10% of the manufacturers' selling price and the retailers' margin cannot exceed 20% of the manufacturers' selling price; and

drugs priced at Rs.3 per tablet or less would be exempt from price controls.

A committee consisting of industry and Ministry representatives has been formed to consider the implementation of these sales margin controls as well as other cost containment proposals, including public-private partnership to help families living below poverty line and concessional pricing for government procurement. The committee is also ascertaining whether the pharmaceutical industry is prepared to implement voluntary price cuts. The committee is expected to examine whether the existing cost-based price control with respect to 74 bulk drugs and formulations containing them can be extended to other medicines in the National List of Essential Medicines or if any alternative scheme such as a ceiling price based on existing prices can be implemented. The committee's report is expected to be issued on September 30, 2006.

The competitive environment in the emerging markets outside India is changing with most countries moving towards recognizing product patents. This has the effect of reducing the window of opportunity for new product launches. In order to compete effectively in such a challenging environment, we are focusing on both our key therapeutic categories on a global basis and niche therapeutic segments. As part of our global business development program, we will continue to explore in-licensing and other opportunities to strengthen our product pipeline. Among our international markets, Russia is our single largest market. In fiscal 2006, the Russian pharmaceutical market grew by 30% driven by a strong economy and introduction of the DLO ( Dopolnitelnoye lekarstvennoye obespechenoye ) program, pursuant to which the Russian government purchases drugs for free distribution to low income individuals. Our total revenue growth rate in fiscal 2006 was approximately 26%, as compared to a growth rate of 30% for the pharmaceutical industry as a whole as reported by Pharmexpert, December 2005). We intend to promote growth in

fiscal 2007 through a combination of sales and marketing initiatives targeted towards physicians, hospital segments and pharmacies. We are also focusing on driving growth in other countries in the former Soviet Union, South Africa and China.

*Active Pharmaceutical Ingredients and Intermediates.* In this segment, we are focused on increasing our level of customer engagement in key markets globally to market additional products from our product portfolio to key customers. We are also focused on identifying unique product opportunities in key markets and protecting them through patenting strategies. As of March 31, 2006, we had a pipeline of over 81 drug master filings ( DMFs ) in the United States and 25 DMFs in Europe. With patent expiries in

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several markets in the next few years, we intend to promote growth in fiscal 2007 and beyond by leveraging our portfolio of markets and products. The success of our existing API products in our key markets is contingent upon the extent of competition in the generics market, and we anticipate that such competition will continue to be significant.

*Generics.* In this segment, we are focused on the regulated markets of North America and Europe. In the United States, our key product launches anticipated for fiscal 2007 include fexofenadine, the generic version of Allegra® (launched in April 2006), simvastatin, the generic version of Zocor®, finasteride 5 mg, the generic version of Proscar®, and ondansetron, the generic version of Zofran®.

In January 2006, we entered into an agreement with Merck & Co. allowing us to distribute and sell the authorized generic versions of two of their products, finasteride and simvastatin (sold by Merck under the brand names Zocor® and Proscar®), provided that some other company obtains 180-day exclusivity after the expiration of the patents for either product. Subsequently, the patents for both of these products expired and other companies obtained 180-day exclusivity. Accordingly, we launched sales of these products on June 19, 2006 and June 23, 2006, respectively. For the quarter ended June 30, 2006, the combined revenues from these two products were U.S.\$93 million. We intend to expand our opportunity with respect to finasteride and simvastatin over the next few years by adding solid dosage forms as well as alternate dosage forms of each product through alliances to complement our internal product development effort.

We also intend to expand our commercial portfolio through unique acquisition opportunities. For instance, in March 2006, we acquired for a total consideration of Rs.122.7 million trademarks rights to three off-patent products with annual sales of U.S.\$5 million, along with all the physical inventories of the products, from PDL Biopharma, Inc. ( PDL ). As a result of the acquisition, we acquired an opportunity to sell these products using their existing brand names through our generic sales and marketing network.

We are also expanding our presence in Canada by leveraging the infrastructure and assets that we have established for the U.S. market. The success of our existing products is contingent upon the extent of competition in the generics market, which we anticipate will continue to be significant. As of March 31, 2006, we had 49 ANDAs pending approval with the U.S. FDA. This includes 29 patent challenges. The launch of these products is contingent upon the successful outcome of litigation related to such products.

In the United Kingdom, we do not anticipate any significant product launches in fiscal 2007.

In Germany, the revenues and net income of betapharm, which we acquired in March 2006, will be reflected in our fiscal 2007 results. The German government passed the Economic Optimization of the Pharmaceutical Care Act which became effective May 1, 2006. As a response to this legislation, some of the leading pharmaceutical companies in Germany announced aggressive price cuts and we responded with an average price cut of about 24% on those of our products subject to the new regulations. Our performance in Germany in the first quarter ended June 30, 2006 was negatively impacted as a result of these changes.

*Critical Care and Biotechnology.* We expect that we will continue to market our existing products and develop additional products. The success of our existing products is contingent upon the extent of competition in this segment. In fiscal 2007, we expect to continue with our investments in building the infrastructure and capabilities for the development and launch of biogenerics in the less regulated markets in the next few years. Longer-term, we intend to target launches in the regulated markets as and when the regulatory pathway becomes clear in these markets.

*Custom Pharmaceutical Services.* In fiscal 2007, we expect to benefit from the full year impact of the acquisition of Falcon. Excluding the impact of the Falcon acquisition, we expect the base business to grow further as we continue to expand the portfolio of relationships and projects with large pharmaceutical companies and emerging pharmaceutical and biotechnology companies.

*Drug Discovery.* Currently, we have a pipeline of 9 NCEs of which 5 are in clinical development and 4 are in pre-clinical development. Four of the NCEs have been assigned to Perlecan Pharma and one NCE is under a co-development arrangement with Rheoscience A/S. As we make progress in advancing our pipeline through various stages of clinical development, we are building capabilities in drug development. We believe this will help to enhance the value of our NCE assets. We expect to further complement our internal research and development efforts by pursuing strategic partnerships and alliances in our key focus areas.



*Specialty.* We are currently in the research and development phase of our specialty pharmaceuticals business, which may become a separate segment at some point in the future. Following the acquisition of Trigenesis Therapeutics Inc. in May 2004, we commenced the pursuit of the development of dermatology products targeted towards specialty prescription dermatology segment, which products will have patent protected franchises.

***5.E. Off-Balance Sheet Arrangements***

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*Guarantees.* We adopted the provisions of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. The Interpretation requires that we recognize the fair value of guarantee and indemnification arrangements issued or modified by us after December 31, 2002, if these arrangements are within the scope of that Interpretation. In addition, under previously existing generally accepted accounting principles, we continue to monitor the conditions that are subject to the guarantees and indemnifications to identify whether it is probable that a loss has occurred, and would recognize any such losses under the guarantees and indemnifications when those losses can be estimated.

On December 14, 2001, in order to enable our affiliate Pathnet India Private Limited ( Pathnet ) to secure a credit facility of Rs.250 million from ICICI Bank Ltd. ( ICICI Bank ), we issued a corporate guarantee amounting to Rs.122.5 million in favor of ICICI Bank. Pathnet was an equity investee accounted for by the equity method. During the fiscal year ended March 31, 2006, we sold our stake in Pathnet and settled the guarantee by paying ICICI Bank Rs.21.0 million, a portion of the loan amount then outstanding. Our payment was determined based on our share of the outstanding guarantees of Pathnet's credit facility.

Kunshan Rotam Reddy Pharmaceutical Co. Limited ( KRRP ) secured a credit facility of Rs.32 million from Citibank, N.A. ( Citibank ). To enhance the credit standing of KRRP, we issued during fiscal 2006 a corporate guarantee amounting to Rs.45.0 million in favor of Citibank. The guarantee is required to be renewed every year and our liability may arise in case of non-payment or non-performance of other obligations of KRRP under its credit facility agreement with Citibank. As of March 31, 2006, it is not probable that we will be required to make payments under the guarantee. Accordingly, no liability has been accrued for a loss related to our obligation under this guarantee arrangement.

**5.F. Tabular Disclosure of Contractual Obligations**

The following summarizes our contractual obligations as of March 31, 2006 and the effect such obligations are expected to have on our liquidity and cash flows in future periods.

	Total	Payments Due by Period (Rs. in millions)			
		Less than 1 year	1-3 years	3-5 years	After 5 years
<i>Financial contractual obligations</i>					
Operating lease obligations	Rs.677.3	150.1	229.5	143.7	154.0
<i>Capital lease obligations</i>	235.7	19.8	39.5	39.5	136.9
<i>Current portion</i>	19.8	19.8			
<i>Non-current portion</i>	215.9		39.5	39.5	136.9
<i>Purchase obligations</i>					
Agreements to purchase property and equipment and other capital commitments <sup>(1)</sup>	744.0	744.0			
<i>Borrowings from banks</i>	9,132.5	9,132.5			
<i>Long term debt</i>	21,627.1	906.0	7,212.4	13,508.7	

Current portion	906.0	906.0			
Non-current portion	20,721.1		7,212.4	13,508.7	
<i>Total contractual obligations</i>	32,416.6	10,952.4	7,481.4	13,691.9	290.9

(1) These amounts are net of capital advances paid in respect of such purchases and are expected to be funded from internally generated funds.

**5.G. Safe harbor**

See page 2.

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**

**6.A. Directors and senior management**

The list of our directors and executive officers, their respective age and position as of March 31, 2006 are as follows:

**Directors**

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<b>Name<sup>(1)</sup></b>	<b>Age (in yrs)</b>	<b>Position</b>
Dr. K. Anji Reddy <sup>(2)</sup>	66	Chairman
Mr. G.V. Prasad <sup>(2),(3)</sup>	45	Chief Executive Officer and Executive Vice Chairman
Mr. Satish Reddy <sup>(2),(4)</sup>	38	Chief Operating Officer and Managing Director
Mr. Anupam Puri	60	Director
Prof. Krishna G. Palepu	53	Director
Dr. Omkar Goswami	49	Director
Mr. P.N. Devarajan	70	Director
Mr. Ravi Bhoothalingam	59	Director
Dr. V. Mohan <sup>(5)</sup>	51	Director

(1) Except for Dr. K. Anji Reddy, Mr. G.V. Prasad and Mr. Satish Reddy, all of the directors are independent directors under the corporate governance rules of the New York Stock Exchange.

(2) Full-time director.

(3) Son-in-law of Dr. K Anji Reddy.

(4) Son of Dr. K Anji Reddy.

(5) Retired on July 28, 2006.

**Executive Officers**

Our policy is to classify our officers as executive officers if they have membership on our Management Council. Our Management Council consists of various business and functional heads and is our senior management organization. As of March 31, 2006, the Management Council consisted of:

<b>Name</b>	<b>Age (in yrs)</b>	<b>Position</b>
Mr. G.V. Prasad <sup>(1)</sup>	45	Chief Executive Officer and Executive Vice Chairman
Mr. Satish Reddy <sup>(2)</sup>	38	Chief Operating Officer and Managing Director

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Mr. V.S. Vasudevan	54	President and Chief Financial Officer <sup>(3)</sup>
Mr. Abhijit Mukherjee	47	President Developing Businesses
Mr. Alan Shepard	58	Executive Vice President Europe
Mr. Andrew Miller	50	Executive Vice President and General Counsel <sup>(4)</sup>
Mr. Arun Sawhney	51	President API
Mr. Ashwani Kumar Malhotra	50	Senior Vice President Formulations Manufacturing
Mr. Jaspal Singh Bajwa	53	President Branded Formulations (Rest of the World) <sup>(5)</sup>
Mr. Jeffrey Wasserstein	47	Executive Vice President North America Specialty
Mr. K.B. Sankara Rao	52	Executive Vice President Integrated Product Development
Mr. Mark Hartman	47	Executive Vice President North America Generics
Dr. R. Rajagopalan	55	President Discovery Research
Mr. Raghu Cidambi	55	Advisor and Head Corporate Intellectual Property Management and Strategic Planning
Mr. Saumen Chakraborty	44	Executive Vice President and Global Chief of Human Resources, IT and Business Process Excellence <sup>(6)</sup>
Dr. Uday Saxena	48	Chief Scientific Officer

- (1) Son-in-law of Dr. K Anji Reddy.
- (2) Son of Dr. K Anji Reddy.
- (3) Has stepped down as Chief Financial Officer and assumed the responsibility of Head of Europe Generics effective July 28, 2006.
- (4) Term of employment expired on July 31, 2006.
- (5) Does not include North America and Europe.
- (6) Has stepped down as Global Chief of Human

Resources and  
assumed the  
responsibility of  
Chief Financial  
Officer effective  
July 28, 2006.  
He will  
continue to be  
responsible for  
IT and Business  
Process  
Excellence.

There was no arrangement or understanding with major shareholders, customers, suppliers or others pursuant to which any director or executive officer referred to above was selected as a director or member of senior management.

## **Biographies**

### **Directors**

*Dr. K. Anji Reddy* is our Founder and Chairman of our Board of Directors. He is also the Founder of Dr. Reddy's Research Foundation and Dr. Reddy's Foundation. He has an undergraduate degree in Technology of Pharmaceuticals and Fine Chemicals from the University of Bombay and a Ph.D. in Chemical Engineering from National Chemical Laboratories, Pune. He has six years experience with Indian Drugs and Pharmaceuticals Limited in the manufacture and implementation of new technologies in bulk drugs. He is a member of the Board of Trade as well as the Prime Minister's Task force on pharmaceuticals and knowledge-based industries. The government of India bestowed the Padmashri Award upon him for his distinguished service in the field of trade and commerce. In addition to positions held in our subsidiaries and joint ventures, he is a Director in Diana Hotels Limited, OOO JV Reddy Biomed Limited, and Pathenco APS.

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*Mr. G.V. Prasad* is a member of our Board of Directors and serves as our Vice-Chairman and Chief Executive Officer. He was the Managing Director of Cheminor Drugs Limited, a Dr. Reddy's Group Company, prior to its merger with us. He has a Bachelor of Science degree in Chemical Engineering from Illinois Institute of Technology, Chicago, U.S.A. and an M.S. in Industrial Administration from Purdue University, U.S.A. He is also an active member of several associations including the National Committee on Drugs & Pharmaceuticals. In addition to positions held in our subsidiaries and joint ventures, he is a Director of Diana Hotels Limited, Nipuna Services Limited and Ocimum Bio Solutions Limited.

*Mr. Satish Reddy* is a member of our Board of Directors and serves as our Managing Director and Chief Operating Officer. He has a Master of Science degree in Medicinal Chemistry from Purdue University, U.S.A. and a Bachelor of Technology degree in Chemical Engineering from Osmania University, Hyderabad. He is the member of the Confederation of Indian Industries for Andhra Pradesh. In addition to positions held in our subsidiaries and joint ventures, he is also a Director of Diana Hotels Limited and OOO JV Reddy Biomed Limited.

*Mr. Anupam Puri* has been a member of our Board of Directors since 2002. He retired from McKinsey & Company in late 2000. He was a Director and played a variety of other leadership roles during his 30-year career there. Before joining McKinsey & Company, he was Advisor for Industrial Development to the President of Algeria, and consultant to General Electric's Center for Advanced Studies. He holds a Bachelor of Arts degree in Economics from St. Stephen's College, Delhi University, and Master of Arts and M. Phil. degrees from Oxford University. He is also on the Boards of ICICI Bank Limited, Mahindra and Mahindra Limited and Mahindra British Telecom Limited.

*Professor Krishna G. Palepu* has been a member of our Board of Directors since 2002. He is the Ross Graham Walker Professor of Business Administration at the Harvard Business School. He holds the title of Senior Associate Dean, Director of Research. Professor Palepu has a Masters degree in physics from Andhra University, an M.B.A. from the Indian Institute of Management and a Ph.D. from the Massachusetts Institute of Technology. He is also a recipient of an honorary M.A. from Harvard, and an honorary Doctorate from the Helsinki School of Economics. He teaches finance, control and strategy in Harvard's M.B.A. and Executive programs. He has published numerous research papers and is also the co-author of the book titled Business Analysis & Valuation: Text and Cases. He serves as a consultant to a wide variety of businesses and is on the boards of Satyam Computer Services Limited, Exetor Group, Enamics Limited and Harvard Business School Publishing Company.

*Dr. Omkar Goswami* has been a member of our Board of Directors since 2000. He is a founder and Chairman of CERG Advisory Private Limited, a corporate advisory and economic research and consulting company. He was a senior consultant and chief economist at the Confederation of Indian Industry for six years. He has also served as editor of Business India, associate professor at the Indian Statistical Institute, Delhi, and as an honorary advisor to the Ministry of Finance. He holds a Bachelor of Economics degree from St. Xavier's College, Calcutta University, a Master of Economics degree from the Delhi School of Economics, Delhi University and a Ph.D. degree from Oxford University. He is also a Director of Infosys Technologies Limited, DSP-Merrill-lynch Investment Managers Limited, Crompton Greaves Limited, Infrastructure Development Finance Company Limited, SRF Limited, Sona Koyo Steering Systems Limited and Cairn India Limited.

*Mr. P.N. Devarajan* has been a member of our Board of Directors since 2000. He has previously served as a Director of Cheminor Drugs Limited. He was a member of the Planning Board of Madhya Pradesh, Chairman of Research at the Council of National Environment Engineering Research Institute, member of the Assessment Committee of the Council of Scientific and Industrial Research and a member of the Research Council of National Chemical Laboratory. He has previously served as a Director of the Bank of Baroda, a member of the Central Board of Directors of the Reserve Bank of India and Group President and consultant of Reliance Industries Limited. Currently, he is also a Director on the Board of Kothari Sugars and Chemicals Limited, Shriram EPC Ltd. and Tropical Technologies Pvt Ltd. Mr. Devarajan was reappointed to the Board at the Annual General Meeting of the Shareholders held on July 28, 2006.

*Mr. Ravi Bhoothalingam* has been a member of our Board of Directors since 2000. He has served as the President of The Oberoi Group and was responsible for its worldwide operations. He has also served as the Head of Personnel at BAT Plc, Managing Director of VST Industries Limited, and as a Director of ITC Limited. He holds a Bachelor of Science degree in physics from St. Stephens College, Delhi and a Master of experimental psychology degree from

Gonville and Caius College, Cambridge University. He is also a Director of Nicco Internet Ventures Limited and Sona Koyo Steering Systems Limited.

*Dr. V. Mohan* has been a member of our Board of Directors since 1996. He is also a visiting professor of Diabetology at Sri Ramachandra Medical College and a professor of International Health at the University of Minnesota, U.S.A. He holds a Bachelor of Medicine degree, Doctor of Medicine degree, Ph.D. and a Doctor of Science degree from Madras University. He was awarded the prestigious Dr. B.C. Roy National Award by the Medical Council of India in 2005. He is also the Chairman and Managing Director of



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Dr. Mohan's Diabetes Specialties Centre Private Limited and Dr. Mohan's Diabetes Specialties Centre (Hyderabad) Private Limited and he is also the President of the Madras Diabetes Research Foundation. He retired from the Board on July 28, 2006.

### ***Executive Officers***

*Mr. V.S. Vasudevan* was our Chief Financial Officer and is currently head of our European Generics business. In the position of Chief Financial Officer, he was responsible for managing our finance organization. He also was the head of the Secretarial, Legal, Compliance, Investor Relations and Internal Audit functions. He played an important role in establishment of our corporate governance framework. Under his leadership, we received external recognition for our corporate governance and financial reporting practices from the Institute of Company Secretaries of India and the Institute of Chartered Accountants of India. He played a key role in the integration of Cheminor Drugs Limited with us, the acquisition of betapharm in Germany and in our growth through various other corporate initiatives, including acquisition of other companies in India and overseas and acquisition of brands in India. He is a Chartered Accountant by qualification, and a member of the Peer Review Board of the Institute of Chartered Accountants of India.

*Mr. Abhijit Mukherjee* is our President of Developing Business. Before joining us, he worked with Atul Limited for 10 years, where he held numerous positions of increasing responsibility. In his last assignment there he was President, Bulk Chemicals and Intermediates Business, and Managing Director, Amal Products Limited. He started his career as a management trainee in Hindustan Lever Limited (HLL) and put in 13 years in that company including 3 years in a Unilever company. He was primarily involved in the technical assignments in Aroma chemicals business in HLL and Unilever and also in detergents and sulphonation plants of HLL. He is a graduate in Chemical Engineering from the Indian Institute of Technology, Kharagpur.

*Mr. Alan Shepard* is our Executive Vice President Europe Business. He joined us from Pliva, where he was Vice President for Global Corporate Strategy. He has a unique combination of experience in areas of commercial, general management, research and development, manufacturing and strategic planning across a variety of product lines, including generics, ethical branded, over the counter and vaccines. He has been associated with several pharmaceutical companies and held several management positions such as General Manager of Rhone Poulenc Rorer (now Aventis), European Marketing Director for Medeva and held various positions with Institute Merieux, Smith Kline and Upjohn. He has a Bachelors of Technology (Honors) degree from Bradford University and is an honorary lecturer for the University of Wales Medical faculty. He has served on several U.K. government committees and been a long-standing member of the Association of British Pharmaceutical Industry's code of practice committee.

*Mr. Andrew Miller* was Executive Vice President Legal and Intellectual Property Management. He is also a principal at Budd Lerner, P.C., our legal counsel in the United States. He has represented us since the formation of our first U.S. entity in 1992. He is a graduate of the University of Michigan Law School where he was an Editor of the University of Michigan's Journal of Law Reform. He holds a B.A. degree from the State University of New York at Buffalo, where he graduated summa cum laude in 1977 and was elected a member of Phi Beta Kappa. Mr. Miller's term of employment ended on July 31, 2006.

*Mr. Arun Sawhney* is President of our Europe and Global API businesses. He joined us in 2001 as President of our API business from Max-GB Limited, where he was Chief Executive. Prior to that he headed the Global Business Development function at Ranbaxy Laboratories Limited. He has also had successful stints as Manager Exports with Hindustan Ciba Geigy and as Regional Sales Manager with Bayer India, earlier in his career. He is a silver medalist, holds an MBA from the International Management Institute, New Delhi, and a Bachelor's degree in Commerce from Sydenham College of Commerce and Economics, Mumbai.

*Mr. Ashwani Kumar Malhotra* is Senior Vice President of our Formulations Technical Operations and from March 2004 is responsible for formulation manufacturing operations, supply chain management and projects. He joined us as Vice President in February 2001, and was responsible for the India operations supporting our generics and specialty businesses with new product development filings and manufacturing and supply of products to regulated markets such as the United States, Canada, Europe, the United Kingdom, South Africa, Australia and New Zealand. Prior to joining us, he worked with Cipla Limited for 13 years in various capacities and with Warner Hindustan, a division of Parke Davis in formulations development and manufacturing for 7 years. He holds a postgraduate degree

in Pharmacy from the Institute of Technology, Banaras Hindu University. He also holds a Diploma in Industrial Engineering & Management and a Postgraduate Diploma in Computer Systems from the Institute of Public Enterprises, government of India.

*Mr. Jaspal Singh Bajwa* is President of our Branded Formulations (Rest of the World) business. He joined us from Marico Industries, where he was Executive Director and Chief Operating Officer. He has 27 years of diverse experience in the consumer and healthcare products industries, having worked with Nestlé, S.A. and Bausch and Lomb, Inc. He started his career with Nestlé, S.A. After 15 years with Nestlé, S.A. in Sales and Marketing, his last position was Chief of Marketing in India. Subsequently, he spent over 10 years with Bausch and Lomb, Inc., where he held several senior management positions including those of Managing Director for India/ SAARC, and Head of their Canadian Subsidiary. He has a Bachelor's degree in Food Technology and an MBA from the Indian Institute of Management, Ahmedabad.

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*Mr. Jeffrey Wasserstein* is Executive Vice President of our North America Specialty business and head of our North America business. He joined us in January 2005. He focuses on building our specialty business in North America and in addition works with the North American Management Team on selected opportunities for adding value to our other businesses in North America. He is also head of our New Jersey office where he leads our North America Operations function. Immediately prior to joining us he was EVP and Chief Business Officer of Avigenics, Inc., a biotechnology company engaged in the development of therapeutic proteins. He had a long career with Schering Plough Corporation where he was Senior Vice President of Corporate Consent Decree Integration. Prior to this role, he was the President of Schering Canada. He also held several positions of increasing responsibility at the Vice President level over Corporate Business Development, Strategic Planning and Internal Consulting and as Associate General Counsel-Commercial. Prior to joining Schering Plough Corporation, he was an Associate Attorney with Wachtell, Lipton, Rosen & Katz. He holds a Bachelor of Arts degree from Franklin & Marshall College and a J.D. degree from New York University School of Law.

*Mr. K.B. Sankara Rao* is Executive Vice President responsible for Integrated Product Development for our Branded Formulations, Generics, API and speciality businesses and for formulation development of NCEs. He has been with us since 1986 in various capacities, establishing the manufacturing facilities, quality assurance systems, formulation research and development and managing supply chain for our formulations business. He also upgraded manufacturing facilities to the present day business needs, which resulted in the attainment of various statutory approvals, including U.K. MHRA approval. He is also responsible for the design and implementation of the Self Managed Team concept in two of our formulations manufacturing units. He holds a Masters degree in Pharmacy from Andhra University. He is a life member of the Indian Pharmaceutical Association, Indian pharmacy graduates association amongst his other affiliations. He has also been a member of CII-Southern Regional Quality & Productivity Sub-committee.

*Mr. Mark Hartman* is Executive Vice President of our North America Generics business. He has 21 years of experience in the pharmaceutical industry. Before joining us, Mark spent five years at Watson Laboratories. His last three positions at Watson were Director of Marketing for Trade and Managed Care, Executive Director, Sales and Marketing Watson Generics, and Vice President, Sales and Marketing, Watson Generics. He was involved in multiple product and company acquisitions during his tenure with Watson. Before Watson, he was Director of Marketing for Alpharma USPD, Marketing Manager at Geneva Pharmaceuticals, and held various brand and generic sales and marketing positions during his 10 years at Lederle Laboratories. He holds a bachelors degree in Dairy Science from Virginia Tech, Virginia.

*Dr. R. Rajagopalan* is the President of our Discovery Research division. A distinguished postgraduate student from the University of Madras, Rajagopalan obtained his doctoral degree from the University of Bombay. He began his career about three decades ago in Hoechst India Ltd. and made impressive contributions in cardiovascular and general pharmacology research. He joined Dr. Reddy's Discovery Research in 1994, and was instrumental in building discovery biology capabilities in Hyderabad. He has headed the Discovery Research Program as President since 2001, and under his management, our company has created a leadership position in the areas of metabolic disorders and cardiovascular research. He has several research publications and patents to his credit, and is associated with several academic and professional organisations. He has also been the recipient of a number of prestigious awards, including the R. N. Chopra Oration Award as an accomplished Discovery Research Pharmacologist in 2005.

*Mr. Raghu Cidambi* is Advisor and Head of Corporate Intellectual Property Management and Strategic Planning. Prior to joining us, he served with the Eenadu Group, a large south India-based media conglomerate, where he was responsible for its legal affairs. He has graduated from the Indian Institute of Management, Calcutta and thereafter obtained a Bachelor's Degree in Law from the Osmania University in Hyderabad.

*Mr. Saumen Chakraborty* was Executive Vice-President and Global Chief of Human Resources, Information Technology and Business Process Excellence, and is currently our Chief Financial Officer. He has 22 years of experience in strategic and operational aspects of management. Prior to joining us, he held various positions including line manager and a human resources facilitator, with diverse portfolios such as Senior Manager (Finance and Accounts) in Eicher, and Vice President (Operations) in Tecumseh. A member of various industry fora including the CII and the National HRD Network, he graduated with honors as the valedictorian of his class from Visva-Bharati

University in Physics, and went on to pursue management from the Indian Institute of Management, Ahmedabad. He continues to be responsible for Information Technology and Business Process Excellence.

*Dr. Uday Saxena* is our Chief Scientific Officer. Since 2000, he has also been the President and CEO of Reddy US Therapeutics, Inc., our subsidiary located in Atlanta, Georgia. Reddy US Therapeutics, Inc. is engaged in drug discovery in the areas of diabetes, inflammation and cardiovascular disease. He has been in the pharmaceutical/biotech industry for over a decade. From 1997 to early 2000, he was Vice President of Research and a member of the executive committee at AtheroGenics, Inc, a publicly traded biopharmaceutical company located in Alpharetta, Georgia. While at AtheroGenics, he directed several drug discoveries and early development programs that lead to identification of novel compounds currently in late phase clinical trails for restenosis,

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atherosclerosis and chronic inflammation. Prior to that he was at Parke-Davis Research Division, Ann Arbor, Michigan, where he was responsible for establishing a discovery program in inflammation and atherosclerosis.

**6.B. Compensation of directors and executive officers****Directors' compensation**

*Full-Time Directors.* The compensation of our Chairman, Chief Executive Officer and Chief Operating Officer (who we refer to as our full-time directors) is divided into salary, commission and benefits. They are not eligible to participate in the stock option plan. The compensation committee of the Board of Directors initially recommends the compensation for full-time directors. If the Board of Directors (the Board) approves the recommendation, it is then submitted to the shareholders for approval at the general shareholders meeting.

On January 24, 2006, our Board recommended re-appointment of Dr. K Anji Reddy as Chairman with effect from July 13, 2006 and re-appointment of Mr. G. V. Prasad as Vice Chairman and CEO with effect from January 30, 2006. The compensation of Dr. K. Anji Reddy and Mr. G. V. Prasad are proposed to be revised. The Board also recommended revision in the compensation of Mr. Satish Reddy, Managing Director and COO. The re-appointment and revision in the compensation was approved by the shareholders at our annual general meeting held on July 28, 2006. Our Managing Director and COO and Vice Chairman and CEO are each entitled to receive a maximum commission of up to 0.75% of our net profit (as defined under the Indian Companies Act, 1956) for the fiscal year. Our Chairman is entitled to receive a maximum commission of up to 1.0% of our net profit (as defined under the Indian Companies Act, 1956) for the fiscal year. The compensation committee, which is composed of independent directors, recommends the commission for our Chairman, Vice Chairman and CEO and Managing Director and COO within the limits of 1%, 0.75% and 0.75% respectively of the net profits (as defined under the Indian Companies Act, 1956) for each fiscal year.

*Non-Full Time Directors.* Each of our non-full time directors receives an attendance fee of Rs.5,000 (U.S.\$112.4) for every Board meeting and Board committee meeting they attend. In fiscal 2006, we paid an aggregate of Rs.360,000 (U.S.\$8,093.5) to our non-full time directors as attendance fees. Non-full time directors are also eligible to receive a commission on our net profit (as defined under the Indian Companies Act, 1956) for the fiscal year. Our shareholders have approved a maximum commission up to 0.5% of the net profits (as defined under the Indian Companies Act, 1956) for the fiscal year for all non-full time directors in a year. The Board determines the entitlement of each of the non-full time directors to commission within the overall limit. The non-full time directors were granted stock options under the Dr. Reddy's Employee Stock Option Scheme, 2002 in fiscal 2006 as mentioned in the table below.

For fiscal 2006, the directors were entitled to the following amounts as compensation:

Name of Directors	Attendance fees	Amount Rs. (in thousands)			Total	Stock Options
		Commission	Salary	Perquisites		
Dr. K. Anji Reddy		23,051	1,800	144	24,995	
Mr. G.V. Prasad		12,488	1,514	195	14,197	
Mr. Satish Reddy		12,457	1,500	195	14,152	
Mr. Anupam Puri	75	1,785			1,860	3,000
Prof. Krishna G. Palepu	50	1,785			1,835	3,000
Dr. Omkar Goswami	80	1,785			1,865	3,000
Mr. P.N. Devarajan	60	1,785			1,845	3,000
Mr. Ravi Bhoothalingam	75	1,785			1,860	3,000
Dr. V. Mohan	20	892			912	2,000

The options granted to directors have an exercise price of Rs.5 per option. These options vest in annual increments over a period of four years, and expire five years from the date of vesting.

**Executive officers compensation**

The initial compensation to all our executive officers is determined through appointment letters issued at the time of employment. The appointment letter provides the initial amount of salary and benefits the executive officer will receive as well as a confidentiality provision and a non-compete provision applicable during the course of the executive officer's employment with us. We provide salary, certain perquisites, retirement benefits, stock options and variable pay to our executive officers. The compensation committee of the

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Board reviews the compensation of executive officers on a periodic basis.

All our employees in the managerial and staff levels are eligible to participate in a variable pay program, which consists of performance bonuses based on the performance of their function or business unit, and a profit sharing plan through which part of our profits can be shared with our employees. Our variable pay program is aimed at rewarding performances of the individual, business unit/function and the organization with significantly higher rewards for superior performances.

We also have an employee stock option scheme, the Dr. Reddy's Employee Stock Option Scheme, 2002. The scheme is applicable to all of our employees and directors and employees and directors of our subsidiaries. The scheme is not applicable to promoter directors, promoter employees and persons holding 2% or more of our outstanding share capital. The compensation committee of the Board of Directors awards options pursuant to the scheme based on the employee's performance appraisal. Some employees have also been granted options upon joining us.

Compensation for executive officers who are full time directors is summarized in the table under Directors compensation, above. The following table presents the annual compensation paid for services rendered to us for fiscal 2006 and stock options held by all of our other executive officers as of March 31, 2006:

Name	Compensation Rs.	Fiscal Year of Grant	Stock Options		
			No. of options	Exercise price	Expiration Date
Mr. V.S. Vasudevan	7,844,918	2003	5,740	Rs.1,063.02	(1)
		2004	10,000	883.00	(1)
		2005	10,000	885.00	(1)
		2006	25,000	725.00	(1)
Mr. Abhijit Mukherjee	6,358,655	2005	2,400	5.00	(1)
		2006	5,000	5.00	(1)
Mr. Alan Sheppard	8,853,803				
Mr. Andrew Miller	21,359,871	2005	6,800	5.00	(1)
		2006	2,400	5.00	(1)
Mr. Arun Sawhney	9,053,022	2005	6,855	5.00	(1)
		2006	4,000	5.00	(1)
Mr. Ashwani Kumar Malhotra	5,645,643	2005	4,503	5.00	(1)
		2006	3,500	5.00	(1)
Mr. Jaspal Singh Bajwa	8,763,583	2005	8,000	5.00	(1)
		2006	5,000	5.00	(1)
Mr. Jeffrey Wasserstein	20,359,739	2005	10,000	5.00	(1)
Mr. K.B. Sankara Rao	5,527,308	2005	4,620	5.00	(1)
		2006	4,000	5.00	(1)
Mr. Mark Hartman	32,044,189	2004	10,000	883.00	(1)
		2005	6,000	885.00	(1)
		2006	6,000	5.00	(1)
Dr. R. Rajagopalan	5,627,265	2005	5,430	5.00	(1)
		2006	3,000	5.00	(1)
Mr. Raghu Cidambi	8,200,000	2005	5,250	5.00	(1)
		2006	5,000	5.00	(1)
Mr. Saumen Chakraborty	7,435,692	2004	5,000	883.00	(1)
		2005	3,825	5.00	(1)
		2006	5,000	5.00	(1)

Dr. Uday Saxena	12,209,541	2005	5,250	5.00	(1)
		2006	4,000	5.00	(1)

- (1) The expiration date is five years from the date of vesting. The options vest in annual increments over a period of four years.

Retirement benefits.

We provide the following benefit plans to our employees:

*Gratuity benefits:* In accordance with applicable Indian laws, we provide a defined benefit retirement plan (the Gratuity Plan ) covering all of our permanent employees. The Gratuity Plan provides a lump sum payment to vested employees at retirement or termination of employment in an amount based on the respective employee's last drawn salary and the years of employment with us. Effective September 1, 1999, we established Dr. Reddy's Laboratories Gratuity Fund (the Gratuity Fund ). Liabilities with regard to the Gratuity Plan are determined by an actuarial valuation, based upon which we make contributions to the Gratuity Fund. Trustees administer the contributions made to the Gratuity Fund. The amounts contributed to the Gratuity Fund are invested in specific



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securities as mandated by law and generally consist of federal and state government bonds and the debt instruments of government-owned corporations.

In respect of certain of our other employees, the gratuity benefit is provided through annual contribution to a fund managed by the Life Insurance Corporation of India ( LIC ) and ICICI Prudential Life Insurance Company Limited ( ICICI Pru ). Under this scheme, the settlement obligation remains with us, although the LIC and ICICI Pru administers the fund and determines the contribution premium required to be paid by us. The net contribution amounts recognized by us were Rs.18.0 million, Rs.31.2 million and Rs.80.8 million during the years ended March 31, 2004, 2005 and 2006, respectively.

*Superannuation benefits.* Apart from being covered under the Gratuity Plan described above, our senior officers also participate in superannuation, a defined contribution plan administered by the LIC. We make annual contributions based on a specified percentage of each covered employee's salary. We have no further obligations under the plan beyond our annual contributions. We contributed Rs.24.2 million, Rs.27.0 million and Rs.24.8 million to the superannuation plan during the years ended March 31, 2004, 2005 and 2006, respectively.

*Provident fund benefits.* In addition to the above benefits, all employees receive benefits from a provident fund, a defined contribution plan. Both the employee and employer each make monthly contributions to the plan each equal to 12% of the covered employee's basic salary. We have no further obligations under the plan beyond our monthly contributions. We contributed Rs.58.7 million, Rs.64.2 million and Rs.64.4 million to the provident fund plan during the years ended March 31, 2004, 2005 and 2006, respectively.

**6.C. Board practices**

Our Articles of Association require us to have a minimum of three and a maximum of 20 directors. As of March 31, 2006, we have nine directors on our Board, of which six are non-full time independent directors.

The Companies Act, 1956 and our Articles of Association require that at least two-thirds of our directors be subject to re-election by our shareholders in rotation. At every annual general meeting, one-third of the directors who are subject to re-election must retire and, if eligible for re-election, may be reappointed at the annual general meeting. Our full time directors are not subject to re-election.

The terms of each of our directors and their expiration dates are provided in the table below.

Name	Expiration of Current		Period of Service
	Term of Office	Term of Office	
Dr. K. Anji Reddy <sup>(1)</sup>	July 13, 2006	5 years	22 years
Mr. Satish Reddy <sup>(1)</sup>	September 30, 2007	5 years	13 years
Mr. G.V. Prasad <sup>(1)</sup>	January 30, 2011	5 years	20 years
Mr. Anupam Puri <sup>(2)</sup>	Retirement by rotation	Due for retirement by rotation in 2007	4 years
Dr. Krishna G. Palepu <sup>(2)</sup>	Retirement by rotation	Due for retirement by rotation in 2008	4 years
Mr. P.N. Devarajan <sup>(2)</sup>	Retirement by rotation	Due for retirement by rotation in 2006	5.5 years
Dr. Omkar Goswami <sup>(2)</sup>	Retirement by rotation	Due for retirement by rotation in 2007	5.5 years
Mr. Ravi Bhoothalingam <sup>(2)</sup>	Retirement by rotation	Due for retirement by rotation in 2008	5.5 years
Dr. V. Mohan <sup>(2)(4)</sup>	Retirement by rotation	Due for retirement by rotation in 2006	10 years

(1) Full time director.

(2) Non-full time independent director.

(3) Reappointed at the 22<sup>nd</sup> Annual

General  
Meeting of  
Shareholders  
held on July 28,  
2006.

- (4) Retired at the  
22<sup>nd</sup> Annual  
General  
Meeting of  
Shareholders  
held on July 28,  
2006.

The terms of the contracts with our full-time directors are also disclosed to all the shareholders in the notice of the general meeting. The directors are not eligible for any termination benefit on the termination of their tenure with us.

**Committees of the Board**

Committees appointed by the Board focus on specific areas and take decisions within the authority delegated to them. The Committees also make specific recommendations to the Board on various matters from time-to-time. All decisions and recommendations of the Committees are placed before the Board for information or approval. We have seven Board-level Committees:

Audit Committee.

Compensation Committee.

Nomination Committee.

Shareholders Grievance Committee.

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Management Committee.

Investment Committee.

Strategy Committee.

The details of the Audit Committee, Compensation Committee and Nomination Committee are discussed hereunder.

**Audit Committee.** Our management is primarily responsible for our internal controls and financial reporting process. Our statutory auditors are responsible for performing independent audits of our financial statements in accordance with generally accepted auditing standards and for issuing reports based on such audits. The Board of Directors has entrusted the Audit Committee to supervise these processes and thus ensure accurate and timely disclosures that maintain the transparency, integrity and quality of financial controls and reporting.

The Audit Committee consists of the following five non-full time independent directors:

Dr. Omkar Goswami (Chairman)

Mr. Anupam Puri

Prof. Krishna G. Palepu

Mr. P. N. Devarajan

Mr. Ravi Bhoothalingam

Our Company Secretary is the Secretary of the Audit Committee. This Committee met on five occasions during fiscal 2006. Our statutory auditors were present at all Audit Committee meetings during the year.

The primary responsibilities of the Audit Committee are to:

Supervise the financial reporting process;

Review the financial results, along with the related public filings, before recommending them to the Board;

Review the adequacy of our internal controls, including the plan, scope and performance of our internal audit function;

Discuss with management our major policies with respect to risk assessment and risk management;

Hold discussions with statutory auditors on the nature and scope of audits, and any views that they have about the financial control and reporting processes;

Ensure compliance with accounting standards, and with listing requirements with respect to the financial statements;

Recommend the appointment and removal of external auditors and their fees;

Review the independence of our auditors;

Ensure that adequate safeguards have been taken for legal compliance both for us and for our Indian and foreign subsidiaries;

Review related party transactions; and

Review the functioning of our whistle blower policies and procedures.

**Compensation Committee.** The Compensation Committee considers and recommends to the Board the compensation of the full time directors and executives above Vice-President level, and also reviews the remuneration package that we offer to different grades/levels of our employees. The Compensation Committee also administers our Employee Stock Option Scheme.

The Compensation Committee consists of the following five non-full time, independent directors:

Mr. Ravi Bhoothalingam (Chairman)

Mr. Anupam Puri

Prof. Krishna G. Palepu

Dr. Omkar Goswami

Mr. P. N. Devarajan

The Chief of Human Resources is the Secretary of the Committee. The Compensation Committee met three times during fiscal 2006.

**Nomination Committee.** The primary function of the Nomination Committee is to assist the Board of Directors in fulfilling its responsibilities by reviewing and making recommendations to the Board regarding the Board's composition and structure, establishing criteria for Board membership and evaluating corporate policies relating to the recruitment of Board members and

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establishing, implementing and monitoring policies and processes regarding principles of corporate governance in order to ensure the Board's compliance with its fiduciary duties.

The Nomination Committee consists of the following five non-full time, independent directors:

Mr. Anupam Puri (Chairman)

Prof. Krishna G. Palepu

Dr. Omkar Goswami

Mr. P. N. Devarajan

Mr. Ravi Bhoothalingam

Our Company Secretary is the Secretary of the Committee. The Nomination Committee met once during fiscal 2006.

## **Corporate Governance**

Companies listed on the New York Stock Exchange ( NYSE ) must comply with certain standards regarding corporate governance as codified in Section 303A of the NYSE's Listed Company Manual. Listed companies that are foreign private issuers (as such term is defined in Rule 3b-4 under the Securities Exchange Act of 1934, as amended (the Exchange Act )) are permitted to follow home country practice in lieu of the provisions of this Section 303A, except that such companies are required to comply with the requirements of Sections 303A.06, 303A.11 and 303A.12(b) and (c), which are as follows:

- (i) establish an independent audit committee that has specified responsibilities;
- (ii) provide prompt certification by its chief executive officer of any material non-compliance with any corporate governance rules;
- (iii) provide periodic written affirmations to the NYSE with respect to its corporate governance practices; and
- (iv) provide a brief description of significant differences between its corporate governance practices and those followed by U.S. companies.

The following table compares our principal corporate governance practices to those required of U.S. NYSE listed companies.

### **Standard for U.S. NYSE Listed Companies**

Listed companies must have a majority of independent directors, as defined by the NYSE.

The non-management directors of each listed company must meet at regularly scheduled executive sessions without management.

Listed companies must have a nominating/corporate governance committee composed entirely of independent directors. The nominating/corporate governance committee must have a written charter that addresses the committee's purpose and responsibilities, subject to the minimum purpose and responsibilities established by the NYSE, and an annual evaluation of the committee.

### **Our practice**

We comply with this standard. Six of our nine directors are independent directors, as defined by the NYSE.

We comply with this standard. Our non-management directors meet periodically without management directors in scheduled executive sessions.

We have a Nomination Committee composed entirely of independent directors which meets these requirements. The committee has a written charter that meets these requirements. We do not have a practice of evaluating the performance of the Nomination Committee.

Listed companies must have a compensation committee composed entirely of independent directors. The compensation committee must have a written charter that addresses the committee's purpose and responsibilities, subject to the minimum purpose and responsibilities established by the NYSE, and an annual evaluation of the committee.

We have a Compensation Committee composed entirely of independent directors which meets these requirements. The committee has a written charter that meets these requirements. We do not have a practice of evaluating the performance of Compensation Committee

Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Exchange Act.

Our Audit Committee satisfies the requirements of Rule 10A-3 under the Exchange Act.

The audit committee must have a minimum of three members all being independent directors.

We have an Audit Committee composed of five members, all being independent directors. The committee has a written charter that meets these

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### **Standard for U.S. NYSE Listed Companies**

The audit committee must have a written charter that addresses the committee's purpose and responsibilities, subject to the minimum purpose and responsibilities established by the NYSE, and an annual evaluation of the committee.

Each listed company must have an internal audit function.

Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions.

Listed companies must adopt and disclose corporate governance guidelines.

All listed companies, U.S. and foreign, must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

Listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards.

Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards, qualifying the certification to the extent necessary.

Each listed company CEO must promptly notify the NYSE in writing after any executive officer of the listed company becomes aware of any material non-compliance with any applicable provisions of this Section 303A.

Each listed company must submit an executed Written Affirmation annually to the NYSE. In addition, each listed company must submit an interim Written Affirmation each time a change occurs to the board or any of the committees subject to Section 303A. The annual and interim Written Affirmations must be in the form specified by the NYSE.

### **Our practice**

requirements. We also have an internal audit function. We do not have a practice of evaluating the performance of our Audit Committee

We comply with this standard. Our Employee Stock Option Plan was approved by our shareholders.

We have not adopted corporate governance guidelines.

We comply with this standard. More details on our Code of Business Conduct and Ethics are given under Item 16.B.

This requirement is being addressed by way of this table.

We filed our most recent written certification on August 30, 2005.

There are no such instances.

We filed our most recent written affirmation on August 30, 2005.





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The following table sets forth the number of our employees during fiscal 2004, 2005 and 2006.

**For the Fiscal Year Ended March 31, 2006**

	North America	Europe	Rest of the World	Total
Manufacturing <sup>(1)</sup>		56	2,841	2,897
Sales and Marketing <sup>(2)</sup>	27	291	2,268	2,586
Research and Development	19		1,167	1,186
Others <sup>(3)</sup>	32	129	695	856
Total	78	476	6,971	7,525

**For the Fiscal Year Ended March 31, 2005**

	North America	Europe	Rest of the World	Total
Manufacturing <sup>(1)</sup>		45	2,517	2,562
Sales and Marketing <sup>(2)</sup>	21	4	1,833	1,858
Research and Development	15	2	1,106	1,123
Others <sup>(3)</sup>	45	13	534	592
Total	81	64	5,990	6,135

**For the Fiscal Year Ended March 31, 2004**

	North America	Europe	Rest of the World	Total
Manufacturing <sup>(1)</sup>		52	2,270	2,322
Sales and Marketing <sup>(2)</sup>	25	4	2,193	2,222
Research and Development	17		876	893
Others <sup>(3)</sup>	33	3	682	718
Total	75	59	6,021	6,155

(1) Includes quality, technical services and warehouse.

(2) Includes business development.

(3) Includes shared services, corporate business

development  
and the  
intellectual  
property  
management  
team.

We have not experienced any material work stoppages in the last three fiscal years and we consider our relationship with our employees and labor unions to be good. Approximately 10% of our employees belong to labor unions. We did not experience any strikes at our manufacturing facilities in fiscal 2006.

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The following table sets forth, as of March 31, 2006 for each of our directors and executive officers, the total number of our equity shares and options owned by them:

Name	No. of shares held <sup>(1),(3)</sup>	% of outstanding capital	No. of options held	Fiscal Year of the Grant	Exercise price	Expiration date
Dr. K. Anji Reddy <sup>(2),(4)</sup>	400,478	0.52%				
Mr. G.V. Prasad <sup>(4)</sup>	675,720	0.88%				
Mr. Satish Reddy <sup>(4)</sup>	597,916	0.78%				
Mr. Anupam Puri	2,000		3,000	2006	Rs. 5.00	(5)
Prof. Krishna G Palepu	1,000		3,000	2006	5.00	(5)
Dr. Omkar Goswami			3,000	2006	5.00	(5)
Mr. P.N. Devarajan			3,000	2006	5.00	(5)
Mr. Ravi Bhoothalingam			3,000	2006	5.00	(5)
Dr. V. Mohan			2,000	2006	5.00	(5)
Mr. V.S. Vasudevan			5,740	2003	1,063.02	(5)
			10,000	2004	883.00	(5)
			10,000	2005	885.00	(5)
			25,000	2006	725.00	(5)
Mr. Abhijit Mukherjee	800		2,400	2005	5.00	(5)
			5,000	2006	5.00	(5)
Mr. Alan Shephard						
Mr. Andrew Miller			6,800	2005	5.00	(5)
			2,400	2006	5.00	(5)
Mr. Arun Sawhney	5,025	0.01%	6,855	2005	5.00	(5)
			4,000	2006	5.00	(5)
Mr. Ashwani Kumar Malhotra	2,905		4,503	2005	5.00	(5)
			3,500	2006	5.00	(5)
Mr. Jaspal Singh Bajwa			8,000	2005	5.00	(5)
			5,000	2006	5.00	(5)
Mr. Jeffrey Wasserstein			10,000	2005	5.00	(5)
Mr. K.B. Sankara Rao	18,622	0.02%	4,620	2005	5.00	(5)
			4,000	2006	5.00	(5)
Mr. Mark Hartman			10,000	2004	883.00	(5)
			6,000	2005	885.00	(5)
			6,000	2006	5.00	(5)
Dr. R. Rajagopalan	4,250	0.01%	5,430	2005	5.00	(5)
			3,000	2006	5.00	(5)
Mr. Raghu Cidambi	2,750		5,250	2005	5.00	(5)
			5,000	2006	5.00	(5)
	5,875	0.01%	5,000	2004	883.00	(5)

Mr. Saumen  
Chakraborty

3,825 2005 5.00 (5)

5,000 2006 5.00 (5)

Dr. Uday Saxena

5,250 2005 5.00 (5)

4,000 2006 5.00 (5)

(1) Shares held in  
their individual  
name only.

(2) Does not  
include shares  
held  
beneficially. See  
Item 7.A. for  
beneficial  
ownership of  
shares by this  
individual.

(3) All shares have  
voting rights.

(4) Not eligible for  
grant of Stock  
Options.

(5) The expiration  
date is five  
years from the  
date of vesting.  
The options vest  
in annual  
increments over  
a period of four  
years.

### Employee Stock Incentive Plans

*Dr. Reddy's Employees Stock Option Plan-2002 (the DRL 2002 Plan)*. We instituted the DRL 2002 Plan, our employee stock option scheme, in fiscal 2002 for all eligible employees. The shareholders approved the reservation of 2,295,478 equity shares (being 3% of the outstanding equity shares on that day) for the purposes of making grants of options under the DRL 2002 Plan. The DRL 2002 Plan is applicable to our employees and directors and to employees and directors of our subsidiaries. The DRL 2002 Plan is not applicable to promoter directors, promoter employees and the persons holding 2% or more of our outstanding share capital.

The Compensation Committee administers the DRL 2002 Plan and determines the employees and directors eligible for receiving the options, the number of options to be granted, the exercise price, the vesting period and the exercise period. The vesting period is determined for all options issued on the date of the grant, with a minimum vesting period of 12 months.

The DRL 2002 Plan was amended on July 28, 2004 at the annual general meeting of shareholders to provide for stock option grants in two categories:



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**Category A:** 1,721,700 stock options out of the total of 2,295,478 were reserved for grant of options having an exercise price equal to the fair market value of the underlying equity shares on the date of grant; and

**Category B:** 573,778 stock options out of the total of 2,295,478 were reserved for grant of options having an exercise price equal to the par value of the underlying equity shares (i.e., Rs.5 per option).

The DRL 2002 Plan was further amended on July 27, 2005 at the annual general meeting of shareholders to provide for stock option grants in two categories:

**Category A:** 300,000 stock options out of the total of 2,295,478 were reserved for grant of options having an exercise price equal to the fair market value of the underlying equity shares on the date of grant; and

**Category B:** 1,995,478 stock options out of the total of 2,295,478 were reserved for grant of options having an exercise price equal to the par value of the underlying equity shares (i.e., Rs.5 per option).

The fair market value of a share on each grant date falling under Category A above is defined as a price which is not less than the weighted average closing price for 30 days prior to the grant in the stock exchange where there is highest trading volume during that period, as may be decided by the Compensation Committee. Notwithstanding the foregoing, the Compensation Committee may, after getting the approval of the shareholders in the annual general meeting, grant options with a per share exercise price other than fair market value and par value of the equity shares.

Stock option activity under the DRL 2002 Plan in two categories of options (i.e. fair market value and par value options) is as follows:

Fiscal Year ended March 31, 2005				
	Shares arising out of options	Range of exercise prices	Weighted- average exercise price	Weighted- average remaining contractual life (months)
<b>Category A Fair Market Value Options</b>				
Outstanding at the beginning of the period	911,038	Rs. 883-1,396	Rs. 968.95	66
Granted during the period	466,500	747-885	872.82	82
Expired / forfeited during the period	(352,657)	765-1,063.02	918.84	
Surrendered by employees during the period in exchange for Category B options	(725,931)	747-1,396	928.07	
Exercised during the period				
Outstanding at the end of the period	298,950	747-1149	977.31	50
Exercisable at the end of the period	188,538	Rs. 883-1,149	Rs. 996.54	35

Fiscal Year ended March 31, 2005				
	Shares arising out of options	Range of exercise prices	Weighted- average exercise price	Weighted- average remaining contractual life (months)
<b>Category B Par Value Options</b>				
Outstanding at the beginning of the period				
Granted during the period				
In exchange for Category A surrendered options	280,873	Rs. 5	Rs. 5	84

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New options	102,650		5		5	84
Forfeited during the period	(3,974)		5		5	
Exercised during the period						

Outstanding at the end of the period	379,549	Rs.	5	Rs.	5	84
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Exercisable at the end of the period

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	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
<b>Category A Fair Market Value Options</b>				
Outstanding at the beginning of the period	298,950	Rs. 747-1,149	Rs. 977.31	50
Granted during the period	32,500	725	725	81
Expired / forfeited during the period	(46,700)	725-1,149	994.35	
Surrendered by employees during the period	(90,000)	977.30-1,063.02	1,034.45	
Exercised during the period	(77,500)	883-977.30	943.84	
Outstanding at the end of the period	117,250	725-1,063.02	878.85	64
Exercisable at the end of the period	37,882	Rs. 725-1,063.02	Rs. 943.85	45

**Fiscal Year ended March 31, 2006**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
<b>Category B Par Value Options</b>				
Outstanding at the beginning of the period	379,549	Rs. 5	Rs. 5	84
Granted during the period	216,860	5	5	81
Forfeited during the period	(133,304)	5	5	
Exercised during the period	(98,121)	5	5	
Outstanding at the end of the period	364,984	5	5	81
Exercisable at the end of the period	18,136	Rs. 5	Rs. 5	59

The weighted average grant date fair value of options granted under the DRL 2002 Plan at fair market value during the years ended March 31, 2005 and March 31, 2006 was Rs.377.60 and Rs.293.42 respectively. The weighted average grant date fair value for options granted under the DRL 2002 Plan at par value during the years ended March 31, 2005 and March 31, 2006 was Rs.707.40 and Rs.705.88 respectively.

*Aurigene Discovery Technologies Limited ESOP Plan 2003.* Aurigene Discovery Technologies Limited ( Aurigene ), a consolidated subsidiary, adopted the Aurigene Discovery Technologies Limited Employee Stock Option Plan (the Aurigene Employee Plan ) to provide for issuance of stock options to employees of Aurigene and its subsidiary, Aurigene Discovery Technologies Inc., who have completed one full year of service with Aurigene and its subsidiary. Aurigene has reserved 4,550,000 of its ordinary shares for issuance under this plan. Under the Aurigene Employee Plan, stock options may be granted at an exercise price as may be determined by Aurigene's compensation committee. As of March 31, 2006, there were 528,907 stock options outstanding.



*Aurigene Discovery Technologies Limited, Management Group Stock Grant Plan.* In fiscal 2004, Aurigene adopted the Aurigene Discovery Technologies Limited Management Group Stock Grant Plan (the Aurigene Management Plan ) to provide for issuance of stock options to management employees of Aurigene and its subsidiary Aurigene Discovery Technologies Inc. Aurigene has reserved 2,950,000 of its ordinary shares for issuance under this plan. Under the Aurigene Management Plan, stock options may be granted at an exercise price as may be determined by Aurigene's compensation committee. As of March 31, 2006, there were no stock options outstanding under the Aurigene Management Plan.

## **ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

### **7.A. Major shareholders**

All of our equity shares have the same voting rights. A total of 27.55% of our equity shares is held by the following parties:

Dr. K. Anji Reddy (Chairman),

Mr. G .V. Prasad (Executive Vice Chairman and CEO),

Mr. Satish Reddy (Managing Director and COO),

Mrs. K. Samrajyam, wife of Dr. K. Anji Reddy, and Mrs. G. Anuradha, wife of Mr. G.V. Prasad (hereafter collectively referred as the Family Members ), and

Dr. Reddy's Holdings Private Limited (a company in which Dr. K. Anji Reddy owns 40% of the equity and remainder is owned by Mr. G V Prasad, Mr. Satish Reddy and the Family Members)

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The following table sets forth information regarding the beneficial ownership of our shares by the foregoing persons as of March 31, 2006:

<b>Name</b>	<b>Equity Shares Beneficially Owned</b>	
	<b>(1)</b>	
	<b>Number of Shares</b>	<b>Percentage of Shares</b>
Dr. K. Anji Reddy <sup>(2)</sup>	19,293,723	25.16%
Mr. G.V. Prasad	675,720	0.88%
Mr. Satish Reddy	597,916	0.78%
Family Members	558,428	0.73%
Subtotal	21,125,787	27.55%
Others/public float	55,568,783	72.45%
Total number of shares outstanding	76,694,570	100.00%

(1) Beneficial ownership is determined in accordance with rules of the U.S. Securities and Exchange Commission, which provide that shares are beneficially owned by any person who has or shares voting or investment power with respect to the shares. All information with respect to the beneficial ownership of any principal shareholder has been furnished by that shareholder and, unless otherwise indicated below, we believe that persons named

in the table have sole voting and sole investment power with respect to all shares shown as beneficially owned, subject to community property laws where applicable.

- (2) Dr. Reddy s Holdings Private Limited owns 18,893,245 shares of Dr. Reddy s Laboratories Limited. Dr. K. Anji Reddy owns 40% of Dr. Reddy s Holdings Private Limited. The remainder is owned by Mr. G.V. Prasad, Mr. Satish Reddy and the Family Members. The entire amount beneficially owned by Dr. Reddy s Holdings Private Limited is included in the amount shown as beneficially owned by Dr. K. Anji Reddy.

As otherwise stated above and to the best of our knowledge, we are not owned or controlled directly or indirectly by any government or by any other corporation or by any other natural or legal persons. We are not aware of any arrangement, the consummation of which may at a subsequent date result in a change in our control.

The following shareholders held more than 5% of our equity shares as of March 31, 2006:

Name	March 31, 2006		March 31, 2005		March 31, 2004	
	No. of equity shares held*	% of equity shares held	No. of equity shares held*	% of equity shares held	No. of equity shares held*	% of equity shares held
Dr. Reddy's Holdings Pvt. Limited	18,893,245	24.64	17,877,730	23.36	17,461,730	22.82
Life Insurance Corporation of India	5,156,011	6.72	7,355,048	9.61	5,295,128	6.92

As of March 31, 2006, we had 76,694,570 issued and outstanding equity shares. As of March 31, 2006, there were 50,877 record holders of our equity shares listed and traded on the Indian stock exchanges. Our American Depositary Shares (ADSs) are listed on the New York Stock Exchange. One ADS represents one equity share of Rs.5 par value per share. As of March 31, 2006, 20.03% of our issued and outstanding equity shares were held by ADS holders. On March 31, 2006 we had approximately 12,550 ADS holders on record in the United States.

Our Board of Directors, at its meeting held on May 31, 2006, recommended the issuance of a stock dividend in the ratio of 1:1, which was approved by the shareholders in the Annual General Meeting held on July 28, 2006. The Board paid the above stock dividend on August 30, 2006 to all of our shareholders of record on August 29, 2006.

#### **7.B. Related party transactions**

We have entered into transactions with the following related parties:

Diana Hotels Limited for hotel services;

AR Chlorides for processing services of raw materials and intermediates;

Dr. Reddy's Holdings Private Limited for purchase and sale of active pharmaceutical ingredients and intermediates;

Madras Diabetes Research Foundation for undertaking research on our behalf;

Dr. Reddy's Heritage Foundation for purchase of services;

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SR Enterprises for transportation services; and

Manava Seva Dharma Samvardhani Trust for social contribution to which we have made contributions. Our directors have either a significant ownership interest, controlling interest or exercise significant influence over these entities ( significant interest entities ).

We have also carried out transactions with our two affiliates, Perlecan Pharma Private Limited and Kunshan Rotam Reddy Pharmaceuticals Co. Limited . These transactions are in the nature of reimbursement of research and development expenses by Perlecan Pharma Private Limited and purchase of active pharmaceutical ingredients by us from Kunshan Rotam Reddy Pharmaceuticals Co. Limited. We have also entered into transactions with our employees and directors and their relatives.

One of our former executives and U.S. general counsel, hired on July 15, 2002, is a shareholder of a law firm that we engage for provision of legal services. Legal fees paid by us to the law firm were Rs.423,137,000, Rs.468,758,000 and Rs.466,567,000 during the years ended March 31, 2004, 2005 and 2006 respectively.

The following is a summary of significant related party transactions:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
	(thousands)		
Purchases from:			
Significant interest entities	Rs. 59,889	Rs. 45,239	Rs. 182,870
Affiliates	107,801	39,278	5,410
Sales to:			
Significant interest entities	1,185	1,055	32,255
Lease rental paid under cancelable operating leases to:			
Directors and their relatives	16,891	17,144	18,927
Administrative expenses paid to:			
Significant interest entities	4,793	4,649	7,401

We had the following amounts due from related parties:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
	(thousands)	
Significant interest entities		Rs. 6,084
Directors and their relatives	Rs. 3,680	4,380
Employee loans (interest free)	18,199	7,537
Affiliates		234,541
	Rs. 21,879	Rs. 252,542

We had the following amounts due to related parties:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
	(thousands)	
Significant interest entities	Rs. 16,397	Rs. 18,958
Payable towards legal fees	123,106	131,392
Directors and their relatives		1,328

Rs. 139,503      Rs. 151,678

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As of March 31, 2006, the required repayments of employee loans are given below:

Repayable in the year ending March 31:

	(thousands)
2007	Rs. 5,735
2008	1,448
2009	296
2010	58
2011	
Thereafter	
	Rs. 7,537

***7.C. Interests of experts and counsel***

Not applicable.

**ITEM 8. FINANCIAL INFORMATION*****8.A. Consolidated statements and other financial information***

The following financial statements and auditors report for fiscal 2006 are incorporated herein by reference and are included in Item 18 of this report on Form 20-F:

Report of Independent Registered Public Accounting Firm.

Consolidated Balance Sheets as of March 31, 2005 and 2006.

Consolidated Statements of Operations for the years ended March 31, 2004, 2005 and 2006.

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended March 31, 2004, 2005 and 2006.

Consolidated Statements of Cash Flow for the years ended March 31, 2004, 2005 and 2006.

Notes to the Consolidated Financial Statements.

**Amount of Export Sales**

For the fiscal year ended March 31, 2006, our export revenues were Rs.15,994.6 million, contributing 65.9% to our total revenues.

**Legal Proceedings*****Patent Challenges***

At times, following our determination that an innovator's patent is invalid or not infringed by our products, we seek to develop generic products for sale prior to patent expiration in various countries. In the United States, to obtain generic approval for a product prior to the expiration of the innovator's patent, we challenge the innovator's patent. As a result of invoking such patent challenge procedures, in the ordinary course of business we often become a party to, and expect to continue to be involved in, patent litigation regarding the validity or infringement of innovator patents. In addition, in the ordinary course of business we are, and expect to continue to be, a party to patent litigation involving the extent to which manufacturing process techniques may infringe on innovator or third party process patents.

***Environmental Litigation***

The Indian Council for Enviro Legal Action (the Council) filed a writ petition in 1989 under Article 32 of the Indian Constitution against the Union Government and others in the Supreme Court of India. Two hundred twenty five industries in and around Hyderabad, India, including four API manufacturing units belonging to us, are respondents. The Council is seeking relief in the nature of an order directing the Union and the State Government to

avert pollution and compensate those affected by such pollution. The Supreme Court of India issued certain directions and sent the writ to the Andhra Pradesh High Court (the High Court ). Presently the writ is pending before the High Court.

We believe it will be some time before there is a resolution of this environmental litigation as a large number of industries are respondents. We believe that we have been maintaining our effluent treatment plants as per the prescribed norms and the effluents are



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within the limits prescribed by the environmental authorities. We will continue to upgrade our effluent treatment plants and also comply with any additional directives that may be issued from time to time by the Pollution Control Board and/or by the High Court.

The total compensation that we have paid to date at the direction of the High Court is Rs.2,013,000. Such payments were made during fiscal years 1993, 1994, 1996, 1997, 2001 and 2004 and have been charged to our income statement in the year of payment. Such payments were made in full to the extent demanded from us by the High Court. Although the matter is still pending before the courts, in consultation with our external legal counsel in India, we consider the possibility of additional liability to be remote. We cannot estimate our loss or liability in the event that we are unsuccessful in this litigation. Even if we are discharged from this litigation, the amount already paid to the High Court will not be returned to us.

### ***Norfloxacin litigation***

We manufacture and distribute norfloxacin, a formulations product. Under the Drugs (Prices Control) Order, 1995 ( DPCO ), the government of India has the authority to designate a pharmaceutical product as a specified product and to fix the maximum selling price for such product. In 1995, the government of India issued a notification and designated norfloxacin as a specified product and fixed the maximum selling price.

In 1995, the government of India designated Norfloxacin as a specified product and fixed the maximum selling price. In 1996, we filed a statutory Form III before the government of India for the upward revision of the maximum selling price and a legal suit in the High Court challenging the validity of the designation on the grounds that the applicable rules of the DPCO were not complied with while fixing the maximum selling price. The High Court had earlier granted an interim order in our favor, however it subsequently dismissed the case in April 2004. We filed a review petition in the High Court in April 2004 which was also dismissed by the High Court in October 2004. Subsequently, we appealed to the Supreme Court of India, New Delhi (the Supreme Court ) by filing a Special Leave Petition. The appeal is currently pending with the Supreme Court.

During fiscal 2006, we received a notice from the government of India demanding the recovery of the price we charged for norfloxacin in excess of the maximum selling price fixed by the government of India, amounting to Rs.284.98 million including interest thereon. We filed a writ petition in the High Court challenging the government of India's demand order. The High Court has admitted the writ petition and granted an interim order, however it ordered us to deposit 50% of the principal amount claimed by the government of India, which amounts to Rs.77.1 million. We deposited this amount with the government of India on November 14, 2005 while we await the outcome of our appeal with the Supreme Court. The next hearing date for both appeals is November 21, 2006. The Company has provided fully against the potential liability in respect of the principal amount demanded and believes that the possibility of any liability that may arise on account of interest and penalties is remote.

In the event that we are unsuccessful in the litigation in the Supreme Court, we will be required to remit the sale proceeds in excess of the maximum selling price to the Indian government and penalties or interest, if any, the amounts of which are not readily ascertainable.

### ***Excise litigation***

During fiscal 2003, 2005 and 2006, the Indian Central Excise authorities (the Authorities ) issued a total of three demand notices on one of our vendors with regard to the assessable value of the products it supplied to us, and imposed a total of approximately Rs. 435.26 million in claims and penalties against such vendor. We were named as a co-defendant in the notices given during fiscal 2003 and 2005 and, as a result, the Authorities assessed claims and penalties against us in an aggregate amount of Rs.76.50 million. We have filed appeals against these notices.

### ***Others***

Additionally, the Company is involved in other lawsuits, claims, investigations and proceedings, including patent and commercial matters, which arise in the ordinary course of business. However, there are no such matters pending that the Company expects to be material in relation to its business.

### ***Dividend Policy***

In the fiscal years ended March 31, 2004, 2005 and 2006, our shareholders declared cash dividends of Rs.5, Rs.5 and Rs.5, respectively, per equity share. Every year our Board of Directors recommends the amount of dividends to be paid to shareholders, if any, based upon conditions then existing, including our earnings, financial condition, capital

requirements and other factors.

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Holders of ADSs will be entitled to receive dividends payable on equity shares represented by such ADSs. Cash dividends on equity shares represented by ADSs are paid to the Depositary in Indian rupees and are converted by the Depositary into U.S. Dollars and distributed, net of depositary fees, taxes, if any, and expenses, to the holders of such ADSs.

**8.B. Significant changes**

In April 2006, we launched, and continue to sell, generic versions of Allegra® despite the fact that litigation with Sanofi-Aventis, the holders of the patents for this branded product, is still pending. This is the only product that we have launched prior to the resolution of outstanding patent litigation. In September 2002, we filed an ANDA for fexofenadine hydrochloride tablets 30 mg, 60 mg and 180 mg with a Paragraph IV certification on all orange book patents applicable to such products. We were granted summary judgment with respect to 3 patents. Five patents remain in the litigation. in the United States District Court for the District of New Jersey. Fexofenadine hydrochloride is the AB-rated generic equivalent of Sanofi-Aventis Allegra®. Allegra® is indicated for the relief of symptoms associated with seasonal allergic rhinitis and for the treatment of uncomplicated skin manifestations of chronic idiopathic urticaria in adults and children 6 years of age and older.

We launched sales of Proscar® and Zocor® as authorized generics on June 19, 2006 and June 23, 2006, respectively, pursuant to an agreement we entered into with Merck & Co., Inc. in January 2006 allowing us to distribute and sell generic versions of finasteride and simvastatin (sold by Merck under the brand names Proscar® and Zocor®), upon the expiration of Merck's patents covered by these products, provided that some other company obtains 180-day exclusivity after the expiration of the patents for either product. Subsequent to our entering into this agreement, the patents for both of these products expired and other companies obtained 180-day exclusivity, allowing us to launch the authorized generics products.

The German government passed the Economic Optimization of the Pharmaceutical Care Act ( Arzneimittelversorgungs-Wirtschaftlichkeitsgesetz or AVWG ), which became effective May 1, 2006, and which is designed to contain increased pharmaceutical costs. The AVWG's provisions include, among other things, prohibitions on the provision of free goods to pharmacists, limitations on the payment of rebates to wholesalers and pharmacists, prohibitions on price increases for generics prior to March 31, 2008, implementation of additional mandatory rebates of 10% if pharmaceutical prices are not 30% below the reference prices as published by the German government, reduction of fixed prices as of July 1, 2006, and empowering Statutory Health Insurance organizations to waive copayments by patients.

**ITEM 9. THE OFFER AND LISTING****9.A. Offer and listing details***Information Regarding Price History*

The following tables set forth the price history for our shares on the Bombay Stock Exchange Limited, ( BSE ) and for our ADSs on the New York Stock Exchange ( NYSE ).

Fiscal Year	BSE Price Per Equity Share		NYSE Price Per ADS(1)	
	High (Rs.)	Low (Rs.)	High (\$)	Low (\$)
Ended March 31,				
2006	1,513.00	613.00	33.34	14.91
2005	1,002.90	652.50	24.80	15.05
2004	1,470.00	808.00	33.05	17.58
2003	1,149.90	675.00	24.00	13.30
2002	1,120.00	432.00 <sup>(1)</sup>	25.64	10.04

  

Quarter Ended	BSE Price Per Equity Share		NYSE Price Per ADS	
	High (Rs.)	Low (Rs.)	Low (\$)	

			<b>High (\$)</b>	
June 30, 2004	1,002.90	692.00	24.80	16.73
September 30, 2004	795.00	652.50	17.74	15.05
December 31, 2004	879.00	703.00	19.90	16.18
March 31, 2005	890.00	690.00	19.89	16.56
June 30, 2005	762.00	613.00	17.59	14.91
September 30, 2005	865.00	725.00	19.69	17.00

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Quarter Ended	BSE Price Per Equity Share		NYSE Price Per ADS	
	High (Rs.)	Low (Rs.)	High (\$)	Low (\$)
December 31, 2005	990.00	781.50	22.20	17.61
March 31, 2006	1,513.00	950.00	33.34	21.79
June 30, 2006	1,754.00	1,158.00	38.12	24.61

  

Month Ended	BSE Price Per Equity Share		NYSE Price Per ADS	
	High (Rs.)	Low (Rs.)	High (\$)	Low (\$)
March 31, 2006	1,513.00	1,290.00	33.34	28.27
April 30, 2006	1,539.50	1,314.00	33.30	30.73
May 31, 2006	1,754.00	1,282.10	38.12	27.89
June 30, 2006	1,451.50	1,158.00	29.21	24.61
July 31, 2006	1,454.80	1,195.00	31.40	26.31
August 30, 2006 <sup>(1)</sup>	751.50 <sup>(2)</sup>	711.70 <sup>(2)</sup>	32.11 <sup>(3)</sup>	29.76 <sup>(3)</sup>

Source:

www.bseindia.com  
and www.adr.com,  
respectively.

- (1) Stock prices per share reflect a stock dividend, effective on August 30, 2006, of one equity share for each equity share held by our shareholders as of August 29, 2006.
- (2) Adjusted for stock dividend for comparison purpose.
- (3) Stock dividend and subsequent price adjustment was effective on NYSE on September 7, 2006, hence there is no adjustment effected in the ADS

price at NYSE for August 2006. The prices at BSE and NYSE are not comparable as of August 30, 2006.

**9.B. Plan of distribution**

Not applicable.

**9.C. Markets**

*Markets on Which Our Shares Trade*

Our equity shares are traded on the Bombay Stock Exchange Limited ( BSE ) and National Stock Exchange of India Limited ( NSE ), or collectively, the Indian Stock Exchanges. Our American Depositary Shares (or ADSs ), as evidenced by American Depositary Receipts (or ADRs ), are traded in the United States on the New York Stock Exchange ( NYSE ), under the ticker symbol RDY. Each ADS represents one equity share. Our ADSs began trading on the NYSE on April 11, 2001. Our shareholders approved the delisting of our shares from the Hyderabad Stock Exchange Limited, The Stock Exchange, Ahmedabad, The Madras Stock Exchange Limited, and The Calcutta Stock Exchange Association Limited at the general body meeting held on August 25, 2003.

**9.D. Selling shareholders**

Not applicable.

**9.E. Dilution**

Not applicable.

**9.F. Expenses of the issue**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**10.A. Share capital**

Not applicable.

**10.B. Memorandum and articles of association**

Dr. Reddy s Laboratories Limited was incorporated under the Indian Companies Act, 1956. We are registered with the Registrar of Companies, Andhra Pradesh, and Hyderabad, India as Company No. 4507 (Company Identification No. U85195AP1984PTC0004507). Our registered office is located at 7-1-27, Ameerpet, Hyderabad 500 016, India and the telephone number of our registered office is +91-40-23731946. The summary of our Articles of Association and Memorandum of Association that is included in our registration statement on Form F-1 filed with the U.S. Securities and Exchange Commission s (the SEC ) on

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April 11, 2001, together with copies of the Articles of Association and Memorandum of Association that are included in our registration statement on Form F-1, are incorporated herein by reference.

The Memorandum and Articles of Association were amended at the 17<sup>th</sup> Annual General Meeting held on September 24, 2001, 18<sup>th</sup> Annual General Meeting held on August 26, 2002 and 20<sup>th</sup> Annual General Meeting held on July 28, 2004. A full description of these amendments was given in the Form 20-F filed with the SEC on September 30, 2003 and September 30, 2004, which description is incorporated herein by reference. The Memorandum and Articles of Association were further amended at the 22<sup>nd</sup> Annual General Meeting held on July 28, 2006 to increase the authorized share capital in connection with the stock dividend that occurred on August 30, 2006.

### **10.C. *Material contracts***

In March 2006, we entered into an agreement by which we acquired betapharm in Germany. This acquisition was completed in March 2006. The share purchase agreement is filed as Exhibit 4.3 to this Annual Report on Form 20-F.

Other than the contracts mentioned above and other contracts entered into in the ordinary course of business, there are no material contracts to which we or any of our direct and indirect subsidiaries is a party for the two years immediately preceding the date of this Form 20-F.

### **10.D. *Exchange controls***

Foreign investment in Indian securities, whether in the form of foreign direct investment or in the form of portfolio investment, is governed by the Foreign Exchange Management Act, 1999, as amended ( FEMA ), and the rules, regulations and notifications issued thereunder. Set forth below is a summary of the restrictions on transfers applicable to both foreign direct investments and portfolio investments, including the requirements under Indian law applicable to the issuance and transfer of ADSs.

#### **Foreign Direct Investment**

The Foreign Direct Investment Policy under the Reserve Bank of India s ( RBI ) Automatic Route enables Indian companies (other than those specifically excluded in the scheme) to issue shares to persons who reside outside of India without prior permission from the RBI, except in cases where there are ceilings of investments in certain industry sectors and subject to certain conditions.

The Department of Industrial Policy and Promotion, a part of the Ministry of Commerce and Industry, issued detailed guidelines in January 1997 for consideration of foreign direct investment proposals by the Foreign Investment Promotion Board (the Guidelines ). The basic objective of the Guidelines is to improve the transparency and objectivity of the Foreign Investment Promotion Board s consideration of proposals. However, since these are administrative guidelines and have not been codified as either law or regulations, they are not legally binding with respect to any recommendation made by the Foreign Investment Promotion Board or with respect to any decision taken by the government of India in cases involving foreign direct investment.

Under the Guidelines, sector specific guidelines for foreign direct investment and the levels of permitted equity participation have been established. In February 2000, the Department of Industrial Policy and Promotion issued a notification that foreign ownership of up to 50%, 51%, 74% or 100%, depending on the category of industry, would be allowed without prior permission of the Foreign Investment Promotion Board and, in certain cases, without prior permission of the RBI. Over a period of time, the government of India has relaxed the restrictions on foreign investment, including the revision of the investment cap to 26% in the insurance sector and 74% subject to RBI guidelines for setting up branches / subsidiaries of foreign banks in the private banking sector.

In May 1994, the government of India announced that purchases by foreign investors of ADSs, as evidenced by ADRs, and foreign currency convertible bonds of Indian companies would be treated as foreign direct investment in the equity issued by Indian companies for such offerings. Therefore, offerings that involve the issuance of equity that results in Foreign Direct Investors holding more than the stipulated percentage of direct foreign investments (which depends on the category of industry) would require approval from the Foreign Investment Promotion Board.

In addition, offerings by Indian companies of any such securities to foreign investors require Foreign Investment Promotion Board approval, whether or not the stipulated percentage limit would be reached if the proceeds will be used for investment in specified industries.

For investments in the pharmaceutical sector, the Foreign Direct Investment limit is 100%. Thus, foreign ownership of up to 100% of our equity shares would be allowed without prior permission of the Foreign Investment

Promotion Board and, in certain cases, without prior permission of the RBI.



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### **Portfolio Investment Scheme**

Investments by persons of Indian nationality or origin residing outside of India (also known as non-resident Indians or NRIs) or registered Foreign Institutional Investors (FIIs) made through a stock exchange are known as portfolio investments (Portfolio Investments).

#### *Portfolio Investments by NRIs*

A variety of methods for investing in shares of Indian companies are available to NRIs. These methods allow non-resident Indians to make portfolio investments in existing shares and other securities of Indian companies on a basis not generally available to other foreign investors.

The RBI no longer recognizes overseas corporate bodies (OCBs) as an eligible class of investment vehicle under various circumstances under the RBI's foreign exchange regulations.

#### *Portfolio Investments by FIIs*

In September 1992, the government of India issued guidelines that enable FIIs, including institutions such as pension funds, investment trusts, asset management companies, nominee companies and incorporated/institutional portfolio managers, to invest in all of the securities traded on the primary and secondary markets in India. Under the guidelines, FIIs are required to obtain an initial registration from the Securities and Exchange Board of India (SEBI), and a general permission from the RBI to engage in transactions regulated under the Foreign Exchange Management Act. FIIs must also comply with the provisions of the SEBI Foreign Institutional Investors Regulations, 1995. When it receives the initial registration, the FII also obtains general permission from the RBI to engage in transactions regulated under the Foreign Exchange Management Act. Together, the initial registration and the RBI's general permission enable the registered FII to: (i) buy (subject to the ownership restrictions discussed below) and sell unrestricted securities issued by Indian companies; (ii) realize capital gains on investments made through the initial amount invested in India; (iii) participate in rights offerings for shares; (iv) appoint a domestic custodian for custody of investments held; and (v) repatriate the capital, capital gains, dividends, interest income and any other compensation received pursuant to rights offerings of shares. The current policy with respect to purchase or sale of securities of an Indian company by an FII is in Schedule 2 and Regulation 5(2) of the Foreign Exchange Management (Transfer or Issue of Securities by a Person Resident Outside India) Regulations, 2000.

#### **Ownership restrictions**

The SEBI and the RBI regulations restrict portfolio investments in Indian companies by foreign institutional investors, non-resident Indians and overseas corporate bodies, all of which we refer to as foreign portfolio investors. Under current Indian law, foreign institutional investors in the aggregate may hold not more than 24.0% of the equity shares of an Indian company, and non-resident Indians in the aggregate may hold not more than 10.0% of the shares of an Indian company through portfolio investments. The 24.0% limit referred to above can be increased to sectoral cap/statutory limits as applicable if a resolution is passed by the board of directors of the company followed by a special resolution passed by the shareholders of the company to that effect. The 10.0% limit referred to above may be increased to 24.0% if the shareholders of the company pass a special resolution to that effect. No single foreign institutional investor may hold more than 10.0% of the shares of an Indian company and no single non-resident Indian may hold more than 5.0% of the shares of an Indian company.

In our case, our shareholders have passed a resolution enhancing the limits of portfolio investment by foreign institutional investors in the aggregate to 49%. Non-resident Indians in the aggregate may hold not more than 10.0% of our equity shares through portfolio investments. Holders of ADSs are not subject to the rules governing FIIs unless they convert their ADSs to equity shares. As of March 31, 2006, FIIs held 28.46% of our equity shares.

Under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the Takeover Code), upon the acquisition of more than 5%, 10%, 14%, 54% or 74% of the outstanding shares or voting rights of a publicly-listed Indian company, the acquirer is required to disclose the aggregate of his shareholding or voting rights in that target company to such company. The target company and the acquirer are required to notify all of the stock exchanges on which the shares of such company are listed. For these purposes, an acquirer means any person or entity who, directly or indirectly, either alone or acting in concert with any other person or entity, acquires or agrees to acquire shares or voting rights in, or control over, a target company.

A person or entity who holds more than 15% of the shares or voting rights in any company is required to make an annual disclosure of his, her or its holdings to that company, which in turn is required to disclose the same to each of the stock exchanges on which the company's shares are listed. A holder of our ADSs would be subject to these notification requirements.

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Upon the acquisition of 15% or more of such shares or voting rights, or upon acquiring control of the company, the acquirer is required to make a public announcement offering to purchase from the other shareholders at least a further 20% of all the outstanding shares of the company at a minimum offer price determined pursuant to the Takeover Code. If an acquirer holding more than 15% but less than 55% of shares acquires 5% or more shares during a fiscal year, the acquirer is required to make a public announcement offering to purchase from the other shareholders at least 20% of all the outstanding shares of the company at a minimum offer price determined pursuant to the Takeover Code. Any further acquisition of outstanding shares or voting rights of a publicly listed company by an acquirer who holds more than 55% but less than 75% of shares or voting rights (or where the company concerned has obtained the initial listing of shares by making an offer of at least 10% of the issue size to the public pursuant to Rule 19(2)(b) of the Securities Contracts (Regulations) Rules 1957, less than 90% of the shares or voting right of the company) also requires the making of an open offer to acquire such number of shares as would not result in the public shareholding being reduced to below the minimum specified in the listing agreement. Where the public shareholding in the target company may be reduced to a level below the limit specified in the listing agreement the acquirer may acquire such shares or voting rights only in accordance with guidelines or regulations regarding delisting of securities specified by SEBI.

Since we are a listed company in India, the provisions of the Takeover Code will apply to us and to any person acquiring our equity shares or voting rights in our company. However, the Takeover Code provides for a specific exemption to holders of ADSs from the requirements of making a public announcement for a tender offer. This exemption will apply to a holder of ADSs so long as he or she does not convert the ADSs into the underlying equity shares.

We have entered into listing agreements with each of the Indian stock exchanges on which our equity shares are listed. Each of the listing agreements provides that if a person or entity acquires or agrees to acquire 5% or more of the voting rights of our equity shares, the purchaser shall report its holding to us and we must, in accordance with the provisions of the Takeover Code, report its holding to the relevant stock exchanges.

Although the provisions of the listing agreements entered into between us and the Indian stock exchanges on which our equity shares are listed will not apply to equity shares represented by ADSs, holders of ADSs may be required to comply with such notification and disclosure obligations pursuant to the provisions of the Deposit Agreement to be entered into by such holders, our company and a depository.

### **Subsequent transfer of shares**

A person resident outside India holding the shares or debentures of an Indian company may transfer the shares or debentures so held by him, in compliance with the conditions specified in the relevant Schedule of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 as follows:

(i) A person resident outside India, not being a non-resident Indian ( NRI ) or an overseas corporate body ( OCB ), may transfer by way of sale or gift the shares or convertible debentures held by him or it to any person resident outside India;

(ii) A non-resident Indian may transfer by way of sale or gift, the shares or convertible debentures held by him or it to another non-resident Indian only;

provided that the person to whom the shares are being transferred pursuant to clauses (i) or (ii) has obtained prior permission of the government of India to acquire the shares if he has a previous venture or tie up in India through an investment in shares or debentures or a technical collaboration or a trade mark agreement or investment by whatever name called in the same field or allied field in which the Indian company whose shares are being transferred is engaged.

Provided further that the restriction in clauses (i) and (ii) shall not apply to the transfer of shares to international financial institutions such as Asian Development Bank ( ADB ), International Finance Corporation ( IFC ), Commonwealth Development Corporation ( CDC ), Deutsche Entwicklungs Gessellschaft ( DEG ) and transfer of shares of an Indian company engaged in the Information Technology sector.

(iii)

A person resident outside India holding the shares or convertible debentures of an Indian company in accordance with the said Regulations, (a) may transfer the same to a person resident in India by way of gift; or (b) may sell the same on a recognized Stock Exchange in India through a registered broker.

Restrictions for subsequent transfers of shares of Indian companies between residents and non-residents (other than OCBs) were relaxed significantly as of October 2004. As a result, for a transfer between a resident and a non-resident of securities of an Indian company, no prior approval of either the RBI or the government of India is required, as long as certain conditions are met.

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### **ADS guidelines**

Shares of Indian companies represented by ADSs may be approved for issuance to foreign investors by the government of India under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 (the 1993 Scheme), as modified from time to time, promulgated by the government of India. The 1993 Scheme is in addition but without prejudice to the other policies or facilities, as described below, relating to investments in Indian companies by foreign investors. The issuance of ADSs pursuant to the 1993 Scheme also affords to holders of the ADSs the benefits of Section 115AC of the Income Tax Act, 1961 for purpose of the application of Indian tax laws. In March 2001, the RBI issued a notification permitting, subject to certain conditions, two-way fungibility of ADSs. This notification provides that ADSs converted into Indian shares can be converted back into ADSs, subject to compliance with certain requirements and the limits of sectoral caps.

### **Fungibility of ADSs**

A registered broker in India can purchase shares of an Indian company that has issued ADSs, on behalf of a person resident outside India, for the purposes of converting the shares into ADSs. However, such conversion of equity shares into ADSs is possible only if the following conditions are satisfied:

- (i) the shares are purchased on a recognized stock exchange;
- (ii) the shares are purchased with the permission of the Custodian to the ADS offering of the Indian company and are deposited with the Custodian;
- (iii) The custodian has been authorized to accept shares from non-resident investors for reissuance of ADSs;
- (iv) the shares purchased for conversion into ADSs do not exceed the number of shares that were released by the Custodian pursuant to conversions of ADSs into equity shares under the Depositary Agreement; and
- (v) a non-resident investor, broker, the Custodian and the Depository comply with the provisions of the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 and the related guidelines issued by the Central Government from time to time.

### **Transfer of ADSs**

A person resident outside India may transfer ADSs held in Indian companies to another person resident outside India without any permission. A person resident in India is not permitted to hold ADSs of an Indian company, except in connection with the exercise of stock options.

Shareholders resident outside India who intend to sell or otherwise transfer equity shares within India should seek the advice of Indian counsel to understand the requirements applicable at that time.

The RBI placed various restrictions on the ability of OCBs to make investments in Indian companies in AP (DIR) Series Circular No. 14 dated September 16, 2003. For further information on these restrictions, the circular is available on [www.rbi.org.in](http://www.rbi.org.in) for review.

## **10.E. Taxation**

### **Indian Taxation**

*General.* The following summary is based on the law and practice of the Income-tax Act, 1961 (the Income-tax Act), including the special tax regime contained in Sections 115AC and 115ACA of the Income-tax Act read with the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depositary Receipt Mechanism) Scheme, 1993 (the Scheme), as amended on January 19, 2000. The Income-tax Act is amended every year by the Finance Act of the relevant year. Some or all of the tax consequences of Sections 115AC and 115ACA may be amended or changed by future amendments to the Income-tax Act.

We believe this information is materially complete as of the date hereof. However, this summary is not intended to constitute an authoritative analysis of the individual tax consequences to non-resident holders or employees under Indian law for the acquisition, ownership and sale of ADSs and equity shares. *Each prospective investor should consult tax advisors with respect to taxation in India or their respective locations on acquisition, ownership or disposing of equity shares or ADSs.*

*Residence.* For purposes of the Income-tax Act, an individual is considered to be a resident of India during any fiscal year if he or she is in India in that year for:  
a period or periods of at least 182 days; or

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at least 60 days and, within the four preceding fiscal years has been in India for a period or periods amounting to at least 365 days.

The period of 60 days referred to above shall be read as 182 days in case of a citizen of India or a Person of Indian Origin living outside India who is visiting India.

A company is a resident of India under the Income-tax Act if it is formed or registered in India or the control and the management of its affairs is situated wholly in India. Individuals and companies that are not residents of India would be treated as non-residents for purposes of the Income-tax Act.

### *Taxation of Distributions.*

a) As per Section 10(34) of the Income-tax Act, dividends paid by Indian Companies on or after April 1, 2003 to their shareholders (whether resident in India or not) are not subject to tax in the hands of the shareholders. However, the Indian company paying the dividend is subject to a dividend distribution tax at the rate of 14.02%, including applicable surcharges and the special levy called the education cess, on the total amount it distributes, declares or pays as a dividend.

b) Any distributions of additional ADSs or equity shares by way of bonus shares (i.e., stock dividends) to resident or non-resident holders will not be subject to Indian tax.

*Taxation of Capital Gains.* The following is a brief summary of capital gains taxation of non-resident holders and resident employees relating to the sale of ADSs and equity shares received upon redemption of ADSs. The relevant provisions are contained mainly in sections 10(36), 10(38), 45, 47(via), 111A, 115AC and 115ACA, of the Income-tax Act, in conjunction with the Scheme. *You should consult your own tax advisor concerning the tax consequences of your particular situation.*

A non-resident investor transferring our ADS or equity shares, whether transferred in India or outside India to a non-resident investor, will not be liable for income taxes arising from capital gains on such ADS or equity shares under the provisions of the Income-tax Act in certain circumstances. Equity shares (including equity shares issuable on the conversion of the ADSs) held by the non-resident investor for a period of more than 12 months are treated as long-term capital assets. If the equity shares are held for a period of less than 12 months from the date of conversion of the ADSs, the capital gains arising on the sale thereof is to be treated as short-term capital gains.

Capital gains are taxed as follows:

gains from a sale of ADSs outside India by a non-resident to another non-resident are not taxable in India;

long-term capital gains realized by a resident from the transfer of the ADSs will be subject to tax at the rate of 10%, plus the applicable surcharge and education cess; short-term capital gains on such a transfer will be taxed at graduated rates with a maximum of 30%, plus the applicable surcharge and education cess.

long-term capital gains realized by a non-resident upon the sale of equity shares obtained from the conversion of ADSs are subject to tax at a rate of 10%, plus the applicable surcharge and education cess; and short-term capital gains on such transfer will be taxed at the maximum marginal rate of tax applicable to the seller, plus the applicable surcharge and education cess, if the sale of such equity shares is settled outside of a recognized stock exchange in India;

long-term capital gain realized by a non-resident upon the sale of equity shares obtained from the conversion of ADSs is exempt from tax and any short term capital gain is taxed at 10%, plus the applicable surcharge and education cess, if the sale of such equity shares is settled on a recognized stock exchange and securities transaction tax ( STT ) is paid on such sale. The rate of surcharge in the case of individuals whose taxable income is greater than Rs.1,000,000 is 10%; and

short-term capital gains realized upon the sale of equity shares obtained from the redemption of ADSs will be taxed at variable rates with a maximum of (i) 41.82%, including the prevailing surcharge and education cess, in case of foreign companies and (ii) 10%, in the case of resident employees or non-resident individuals. An additional surcharge of 10% will be charged if the aggregate taxable income of an individual exceeds

Rs.1,000,000 during the relevant fiscal year. An education cess of 2% will be charged on tax and surcharge.

As per Section 10(38) of the Income-tax Act, long term capital gains arising from the transfer of equity shares on or after October 1, 2004 in a company completed through a recognized stock exchange in India and on which sale the STT has been paid are exempt from Indian tax.



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As per Section 111A of the Income-tax Act, short term capital gains arising from the transfer of equity shares on or after October 1, 2004 in a company completed through a recognized stock exchange in India are subject to tax at a rate of 10.2% including education cess but excluding the applicable surcharge

Purchase or sale of equity shares of a company listed on a recognized stock exchange in India is subject to a security transaction tax of 0.1% (0.125% from June 1, 2006) of the transaction value for any delivery based transaction and 0.02% (0.025% from June 1, 2006) for any non-delivery based transaction.

The applicable provisions of the Income Tax Act, 1961 in the case of non-residents, may offset the above taxes, except the STT. The capital gains tax is computed by applying the appropriate tax rates to the difference between the sale price and the purchase price of the equity shares or ADSs. Under the Scheme, the purchase price of equity shares in an Indian listed company received in exchange for ADSs will be the market price of the underlying shares on the date that the Depository gives notice to the custodian of the delivery of the equity shares in exchange for the corresponding ADSs, or the stepped up basis purchase price. The market price will be the price of the equity shares prevailing on the Stock Exchange, Mumbai or the National Stock Exchange. There is no corresponding provision under the Income-tax Act in relation to the stepped up basis for the purchase price of equity shares. However, the tax department in India has not denied this benefit. In the event that the tax department denies this benefit, the original purchase price of ADSs would be considered the purchase price for computing the capital gains tax.

According to the Scheme, a non-resident holder's holding period for the purposes of determining the applicable Indian capital gains tax rate relating to equity shares received in exchange for ADSs commences on the date of the notice of the redemption by the Depository to the custodian. However, the Scheme does not address this issue in the case of resident employees, and it is therefore unclear as to when the holding period for the purposes of determining capital gains tax commences for such a resident employee.

The Scheme provides that if the equity shares are sold on a recognized stock exchange in India against payment in Indian rupees, they will no longer be eligible for the preferential tax treatment.

It is unclear as to whether section 115AC and the Scheme are applicable to a non-resident who acquires equity shares outside India from a non-resident holder of equity shares after receipt of the equity shares upon redemption of the ADSs.

It is unclear as to whether capital gains derived from the sale of subscription rights or other rights by a non-resident holder not entitled to an exemption under a tax treaty will be subject to Indian capital gains tax. If such subscription rights or other rights are deemed by the Indian tax authorities to be situated within India, the gains realized on the sale of such subscription rights or other rights will be subject to Indian taxation. The capital gains realized on the sale of such subscription rights or other rights, which will generally be in the nature of short-term capital gains, will be subject to tax

(i) at variable rates with a maximum rate of 41.82%, including the prevailing surcharge and education cess, in the case of a foreign company and (ii) in the range of 30.6% to 33.66%, including the applicable surcharge, in the case of resident employees and of non-resident individuals with taxable income over Rs.250,000.

*Withholding Tax on Capital Gains.* Any gain realized by a non-resident or resident employee on the sale of equity shares is subject to Indian capital gains tax, which, in the case of a non-resident is to be withheld at the source by the buyer. However, as per the provisions of Section 196D(2) of the Income-tax Act, no withholding tax is required to be deducted from any income by way of capital gains arising to FIIs (as defined in Section 115AD of the Act) on the transfer of securities (as defined in Section 115AD of the Act).

*Buy-back of Securities.* Indian companies are not subject to any tax on the buy-back of their shares. However, the shareholders are taxed on any resulting gains. We are required to deduct tax at source according to the capital gains tax liability of a non-resident shareholder.

*Stamp Duty and Transfer Tax.* Upon issuance of the equity shares underlying our ADSs, we are required to pay a stamp duty of 0.1% per share of the issue price of the underlying equity shares. A transfer of ADSs is not subject to Indian stamp duty. A sale of equity shares in physical form by a non-resident holder is also subject to Indian stamp duty at the rate of 0.25% of the market value of the equity shares on the trade date, although customarily such tax is borne by the transferee. Shares must be traded in dematerialized form. The transfer of shares in dematerialized form is currently not subject to stamp duty.

*Wealth Tax.* The holding of the ADSs and the holding of underlying equity shares by resident and non-resident holders will be exempt from Indian wealth tax. Non-resident holders are advised to consult their own tax advisors regarding the taxation of ADS in their country of residence.

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*Gift Tax and Estate Duty.* Currently, there are no gift taxes or estate duties. These taxes and duties could be restored in future. Non-resident holders are advised to consult their own tax advisors regarding this issue.

*Service Tax.* Brokerage or commission paid to stockbrokers in connection with the sale or purchase of shares is subject to a service tax of 12.24%. The stockbroker is responsible for collecting the service tax from the shareholder and paying it to the relevant authority.

### **United States Federal Taxation**

The following is a summary of the material U.S. federal income and estate tax consequences that may be relevant with respect to the acquisition, ownership and disposition of equity shares or ADSs and is for general information only. This summary addresses the U.S. federal income and estate tax considerations of holders that are U.S. holders.

U.S. holders are beneficial holders of equity shares or ADSs who are (i) citizens or residents of the United States, (ii) corporations (or other entities treated as corporations for U.S. federal tax purposes) created in or under the laws of the United States or any state thereof or the District of Columbia, (iii) estates, the income of which is subject to U.S. federal income taxation regardless of its source, and (iv) trusts for which a U.S. court exercises primary supervision and a U.S. person has the authority to control all substantial decisions. This summary is limited to U.S. holders who will hold equity shares or ADSs as capital assets. In addition, this summary is limited to U.S. holders who are not resident in India for purposes of the Convention Between the Government of the United States of America and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income. If a partnership holds the equity shares or ADSs, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. A partner in a partnership holding equity shares or ADSs should consult his own tax advisor.

This summary does not address tax considerations applicable to holders that may be subject to special tax rules, such as banks, insurance companies, financial institutions, dealers in securities or currencies, tax-exempt entities, persons that will hold equity shares or ADSs as a position in a straddle or as part of a hedging or conversion transaction for tax purposes, persons that have a functional currency other than the U.S. dollar or holders of 10% or more, by voting power or value, of the shares of our company. This summary is based on the tax laws of the United States as in effect on the date of this Annual Report and on United States Treasury Regulations in effect or, in some cases, proposed, as of the date of this Annual Report, as well as judicial and administrative interpretations thereof available on or before such date, and is based in part on the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms. All of the foregoing are subject to change, which change could apply retroactively and could affect the tax consequences described below.

*Each prospective investor should consult his, her or its own tax advisor with respect to the U.S. Federal, state, local and non-U.S. tax consequences of acquiring, owning or disposing of equity shares or ADSs.*

*Ownership of ADSs.* For U.S. federal income tax purposes, holders of ADSs will be treated as the holders of equity shares represented by such ADSs.

*Dividends.* Except for ADSs or equity shares, if any, distributed pro rata to all shareholders of our company, including holders of ADSs, the gross amount of any distributions of cash or property with respect to ADSs or equity shares (before reduction for any Indian withholding taxes) will generally be included in income by a U.S. holder as foreign source dividend income at the time of receipt, which in the case of a U.S. holder of ADSs generally should be the date of receipt by the Depositary, to the extent such distributions are made from our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Such dividends will not be eligible for the dividends received deduction generally allowed to corporate U.S. holders. To the extent, if any, that the amount of any distribution by us exceeds our current and accumulated earnings and profits (as determined under U.S. federal income tax principles) such excess will be treated first as a tax-free return of the U.S. holder's tax basis in the equity shares or ADSs and thereafter as capital gain.

Subject to certain limitations, dividends paid to non-corporate U.S. holders, including individuals, may be eligible for a reduced rate of taxation if we are deemed to be a qualified foreign corporation for United States federal income tax purposes and certain holding period requirements are met. A qualified foreign corporation includes a foreign corporation if (1) its shares (or, according to legislative history, its ADSs) are readily tradable on an established securities market in the United States or (2) it is eligible for the benefits under a comprehensive income tax treaty with

the United States. In addition, a corporation is not a qualified foreign corporation if it is a passive foreign investment company (as discussed below) for either its taxable year in which the dividend is paid or the preceding taxable year. The ADSs are traded on the New York Stock Exchange. Due to the absence of specific statutory provisions addressing ADSs, however, there can be no assurance that we are a qualified foreign corporation solely as a result of our listing on the New York Stock Exchange. Nonetheless, we may be eligible for benefits under the comprehensive income tax treaty between India and the United States. Absent congressional action to extend these rules, the reduced rate of taxation will not apply to

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dividends received in taxable years beginning after December 31, 2010. Each U.S. holder should consult its own tax advisor regarding the treatment of dividends and such holder's eligibility for a reduced rate of taxation.

Subject to certain conditions and limitations, any Indian withholding tax imposed upon to a U.S. holder with respect to distributions on ADSs or equity shares should be eligible for credit against the U.S. holder's federal income tax liability. Alternatively, a U.S. holder may claim a deduction for such amount, but only for a year in which a U.S. holder does not claim a credit with respect to any foreign income taxes. The overall limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, distributions on ADSs or equity shares will be income from sources outside the United States, and, for tax years beginning before January 1, 2007, will generally be passive income or financial services income, and for tax years beginning after December 31, 2006, will generally be passive category income or general category income for purposes of computing the United States foreign tax credit allowable to a U.S. holder.

If dividends are paid in Indian rupees, the amount of the dividend distribution included in the income of a U.S. holder will be in the U.S. dollar value of the payments made in Indian rupees, determined at a spot exchange rate between Indian rupees and U.S. dollars applicable to the date such dividend is included in the income of the U.S. holder, regardless of whether the payment is in fact converted into U.S. dollars. Generally, gain or loss, if any, resulting from currency exchange fluctuations during the period from the date the dividend is paid to the date such payment is converted into U.S. dollars will be treated as U.S. source ordinary income or loss.

*Sale or exchange of equity shares or ADSs.* A U.S. holder generally will recognize gain or loss on the sale or exchange of equity shares or ADSs equal to the difference between the amount realized on such sale or exchange and the U.S. holder's tax basis in the equity shares or ADSs, as the case may be. Such gain or loss will be capital gain or loss, and will be long-term capital gain or loss if the equity shares or ADSs, as the case may be, were held for more than one year. Gain or loss, if any, recognized by a U.S. holder generally will be treated as U.S. source passive category income or loss for U.S. foreign tax credit purposes. Capital gains realized by a U.S. holder upon the sale of equity shares (but not ADSs) may be subject to certain tax in India. See *Taxation Indian Taxation Taxation of Capital Gains*. Due to limitations on foreign tax credits, however, a U.S. holder may not be able to utilize any such taxes as a credit against the U.S. holder's federal income tax liability.

*Estate taxes.* An individual shareholder who is a citizen or resident of the United States for U.S. federal estate tax purposes will have the value of the equity shares or ADSs held by such holder included in his or her gross estate for U.S. federal estate tax purposes. An individual holder who actually pays Indian estate tax with respect to the equity shares will, however, be entitled to credit the amount of such tax against his or her U.S. federal estate tax liability, subject to a number of conditions and limitations.

*Backup withholding tax and information reporting requirements.* Any dividends paid, or proceeds on a sale of, equity shares or ADSs to or by a U.S. holder may be subject to U.S. information reporting, and a backup withholding tax (currently at a rate of 28%) may apply unless the holder establishes that he, she or it is an exempt recipient or provides a U.S. taxpayer identification number, certifies that such holder is not subject to backup withholding and otherwise complies with any applicable backup withholding requirements. Any amount withheld under the backup withholding rules will be allowed as a refund or credit against the holder's U.S. federal income tax, provided that the required information is furnished to the Internal Revenue Service.

*Passive foreign investment company.* A non-U.S. corporation will be classified as a passive foreign investment company for U.S. Federal income tax purposes if either:

75% or more of its gross income for the taxable year is passive income; or

on average for the taxable year by value, or, if it is not a publicly traded corporation and so elects, by adjusted basis, if 50% or more of its assets produce or are held for the production of passive income.

We do not believe that we will be treated as a passive foreign investment company for the current taxable year. Since this determination is made on an annual basis, however, no assurance can be given that we will not be considered a passive foreign investment company in future taxable years. If we were to be a passive foreign investment company for any taxable year, U.S. holders would be required to either:

pay an interest charge together with tax calculated at ordinary income rates (which may be higher than the ordinary income rates that otherwise apply to U.S. holders) on excess distributions, as the term is defined in relevant provisions of the U.S. tax laws, and on any gain on a sale or other disposition of ADSs or equity shares;

if a qualified electing fund election (as the term is defined in relevant provisions of the U.S. tax laws) is made, include in their taxable income their pro rata share of undistributed amounts of our income; or

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if the equity shares are marketable stock and a mark-to-market election is made, mark-to-market the equity shares each taxable year and recognize ordinary gain and, to the extent of prior ordinary gain, ordinary loss for the increase or decrease in market value for such taxable year.

If we are treated as a passive foreign investment company, we do not plan to provide information necessary for the qualified electing fund election.

*The above summary is not intended to constitute a complete analysis of all tax consequences relating to the ownership of equity shares or ADSs. You should consult your own tax advisor concerning the tax consequences to you based on your particular situation.*

**10.F. Dividends**

Not applicable.

**10.G. Statements by experts**

Not applicable.

**10.H. Documents on display**

This report and other information filed or to be filed by us can be inspected and copied at the public reference facilities maintained by the SEC at Room 1200, 450 Fifth Street, Washington, DC, U.S.A. These reports and other information may also be accessed via the SEC's website at [www.sec.gov](http://www.sec.gov).

Additionally, documents referred to in this Form 20-F may be inspected at our corporate office, which is located at 7-1-27, Ameerpet, Hyderabad, 500016, India.

**10.I. Subsidiary information**

Not applicable.

**Table of Contents****ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Market Risk**

Market risk is the risk of loss of future earnings or to fair values or to future cash flows that may result from a change in the price of a financial instrument. The value of a financial instrument may change as a result of changes in the interest rates, foreign currency exchange rates and other market changes that affect market risk sensitive instruments. Market risk is attributable to all market risk sensitive financial instruments including foreign currency receivables and payables.

Our exposure to market risk is a function of our investment and borrowing activities and our revenue generating and operating activities in foreign currency. The objective of market risk management is to avoid excessive exposure in our foreign currency revenues and costs.

We are exposed to market risk primarily related to foreign exchange rate risk, interest rate risk and the market value of our investments. We actively monitor these exposures. To manage the volatility relating to these exposures, we enter into a variety of derivative financial instruments to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in interest rates and foreign currency rates and to enhance the yield on the investment. We only sell existing assets in transactions and future transactions (in the case of anticipatory hedges), which we reasonably expect we will have in the future based on past experience. Our portfolio is only for hedging purpose.

**Foreign Exchange Rate Risk**

We use the Indian rupee as our reporting currency and we are therefore exposed to foreign exchange movements, primarily in U.S. dollars, Euros, Pounds sterling, Russian rubles, Brazilian real and Asian currencies. Consequently, we enter into various contracts, which change in value as foreign exchange rates change, to preserve the value of assets, commitments, liabilities and anticipated transactions. We use forward contracts and foreign currency option contracts to hedge firm and anticipated net revenues in foreign currencies.

A significant portion of our revenues are in U.S. dollars while a significant portion of our costs are in Indian rupees. The exchange rate between Indian rupees and U.S. dollars has fluctuated significantly in recent years and may continue to fluctuate in the future. Appreciation of Indian rupees against U.S. dollars can adversely affect our results of operations.

We purchase forward foreign exchange contracts and options to mitigate the risk of changes in foreign exchange rates on accounts receivable and deposits. The forward contracts typically mature between one and six months. The Indian market for U.S. dollar forward contract is well traded up to 12 months. The counter parties for our exchange contracts are banks and counter party risk is minimal. Although we believe that these contracts are effective as hedges from an economic perspective, they do not qualify for hedge accounting under SFAS No. 133, as amended. Any derivative that is either not designated as a hedge, or is so designated but is ineffective pursuant to SFAS No. 133, is marked to market with resultant differences being recognized in the consolidated income statement.

The following table sets forth sell U.S. dollars/Indian rupees foreign currency forward contracts held by us as of March 31, 2006 by maturity month of the contracts:

<b>Description</b>	<b>Apr-06</b>	<b>May-06</b>	<b>June-06</b>	<b>July-06</b>	<b>Aug-06</b>	<b>Total</b>
Contracts outstanding (U.S.\$ million)	40	30	20	5	10	105
Average contractual exchange rate (U.S.\$/Rs.)	44.4569	44.192	44.9405	44.5775	44.9713	

The following table sets forth buy U.S. dollars/Indian rupees foreign currency forward contracts held by us as of March 31, 2006 by maturity month of the contracts:

<b>Description</b>	<b>Apr-06</b>	<b>May-06</b>	<b>June-06</b>	<b>Total</b>
Contracts Outstanding (U.S.\$ million)	49.5	25	5	79.5



Average Contractual Exchange Rate (U.S.\$/Rs.)	44.8722	46.5119	46.45
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The following table sets forth sell Euro/U.S. dollars foreign currency forward contracts held by us as of March 31, 2006 by maturity month of the contracts:

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<b>Description</b>	<b>June-06</b>
Contracts Outstanding (   million)	36
Average Contractual Exchange Rate (   /U.S.\$)	1.22134

As of March 31, 2006, the spot exchange rate was Rs.44.615 per U.S. dollar. For each of the U.S. dollars/Indian rupees and Euro/ U.S. dollars options, the strike price depends on the spot exchange rate on the date of expiration of the option.

Increase/(decrease) in fair value of forward contracts and options has been recorded in the consolidated income statement in the foreign exchange (gain)/loss line item.

**Sensitivity analysis of exchange rate risk**

A Rs.1 decrease/increase in the spot rate for exchange of Indian rupees with U.S. dollars would result in approximately Rs.25.5 million decrease/increase in the fair value of our short U.S. dollars/Indian rupees currency forward contracts outstanding as of March 31, 2006.

A U.S.\$0.01 decrease/increase in the spot rate for exchange of U.S. dollars with Euro would result in approximately Rs.16.2 million decrease/increase in the fair value of our short Euro/U.S.\$ currency forward contracts outstanding as of March 31, 2006.

**Commodity Rate Risk**

Our exposure to market risk with respect to commodity prices primarily arises from the fact that we are a purchaser and seller of active pharmaceutical ingredients and the components for such active pharmaceutical ingredients. These are commodity products whose prices can fluctuate sharply over short periods of time. The prices of our raw materials generally fluctuate in line with commodity cycles, though the prices of raw materials used in our active pharmaceutical ingredients business are generally more volatile. Raw material expense forms the largest portion of our operating expenses. We evaluate and manage our commodity price risk exposure through our operating procedures and sourcing policies.

We do not use any derivative financial instruments or futures contracts to hedge our exposure to fluctuations in commodity prices.

**Interest Rate Risk**

As of March 31, 2006 we had a loan of 400 million at an interest rate of 1-month Euribor plus 150 basis points. This exposes us to risk of changes in interest rates, particularly Euribor. Our investments in bank fixed deposits and short-term liquid mutual funds do not expose us to significant interest rate risk.

**Amount of Long Term Loans as at March 31,**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Rupee Term Loans*	Rs. 25.1million	Rs. 31.1million	Rs. 183.7million
Foreign Currency Loans	400million		

\* Loan received at a subsidized rate of interest from Indian Renewable Energy Development Agency Limited promoting use of alternative sources of energy.

*Interest Rate Profile.* An interest rate profile of long-term debt is given below:

	<b>For the Fiscal Year Ended March 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Foreign Currency Loans	1-month		
Rupee Term Loans*	Euribor		
	+ 150		
	bps		
	2%	2%	2%

\* Loan received at a subsidized rate of interest from Indian Renewable Energy Development Agency Limited promoting use of alternative sources of energy.

As of March 31, 2006, we have not entered into any derivative financial instruments to hedge our interest rate risk.

*Maturity Profile.*

A maturity profile of rupee term loans outstanding is as follows:

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	Rupee Term Loans (Rs.in Thousands)	Foreign Currency Loans (Euro in Thousands)
Maturing in Year ending March 31,		
2007	5,920	16,667
2008	5,920	66,667
2009	5,920	66,666
2010	5,920	116,667
Thereafter	1,465	133,333
	25,145	400,000

Our major market risks of foreign exchange, interest rate and counter party risk are managed centrally by our Group Treasury department, which evaluates and exercises independent control over the entire process of market risk management. The activities of this department include management of cash resources, implementing hedging strategies for foreign currency exposures, and borrowing strategies.

We have a written treasury policy, and we do regular reconciliations of our positions with our counter-parties. In addition, audits of the treasury function are performed at regular intervals.

**Counter-Party Risk**

Counter-party risk encompasses settlement risk on derivative and money market contracts and credit risk on cash and time deposits. Exposure to these risks is closely monitored and kept within predetermined parameters. Our group treasury department does not expect any losses from non-performance by these counter-parties and does not have any significant grouping of exposures to financial sector or country risk.

**Derivative financial instruments**

The contract or underlying principal amount of derivative financial instruments (in millions) at March 31, 2005 and 2006 are set forth by currency in the table below:

	For the Fiscal Year Ended March 31,					
	U.S. \$ million	2006 EURO million	Rs. million	U.S. \$ million	2005 GBP million	Rs. million
<b>Currency related instruments</b>						
Forward foreign exchange rate contracts (sell)	105	36		30	2	
Forward foreign exchange rate contracts (buy)	79.5			40		
Over the counter currency options						
<b>Currency related derivatives</b>	184.5	36		70	2	
<b>Interest rate related instruments</b>						
Interest rate swaps						
Forward rate agreements						

Interest rate options

**Interest rate related  
derivatives**

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

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**Table of Contents****PART II****ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS****Modification in the rights of security holders**

None.

**Use of Proceeds**

On April 11, 2001, we completed our initial U.S. public offering ( U.S. IPO ), of 13,225,000 American Depositary Shares (or ADSs ), as evidenced by American Depositary Receipts (or ADRs ), representing 6,612,500 equity shares of par value Rs.10 per share (including the exercise of the underwriters over allotment option consisting of 1,725,000 ADSs representing 862,500 equity shares) at a public offering price of U.S.\$10.04 per ADS pursuant to a registration statement filed on Form F-1 (File No. 333-13310) with the SEC.

All of the shares registered were sold before termination of the offering date. The lead underwriter was Merrill Lynch & Co. and the co-lead underwriters were ABN AMRO Rothschild LLC & Credit Lyonnais Securities (USA) Inc.

The proceeds of the offering (prior to the underwriting discount and commissions and expenses of the offering) were U.S.\$132.7 million. We paid underwriting discounts and commission of approximately U.S.\$7.3 million. A significant portion of other expenses incurred in connection with our U.S. IPO was reimbursed by the Depositary. Accordingly, the net proceeds from the offering after underwriting discounts and commissions was approximately U.S.\$125.4 million. None of the net proceeds from the initial public offering were paid, directly or indirectly, to any of our directors, officers or general partners or any of their associates, or to any persons owing ten percent or more of any class of our equity securities, or any affiliates.

In fiscal 2002, we retired U.S.\$74.1 million of our liabilities, thereby reducing our interest outflows substantially. In April 2002, we also invested a sum of U.S.\$9.0 million for the acquisition of U.K. based BMS Laboratories Limited (now Dr. Reddy's Laboratories (EU) Limited) along with its wholly-owned subsidiary Meridian Healthcare Limited (now Dr. Reddy's Laboratories (U.K.) Limited).

The proceeds of the offering were utilized during fiscal 2004 as follows:

	<b>Amount in U.S.\$ million</b>
<b>Particulars</b>	
Loan to wholly owned subsidiary and a step down subsidiary	5.0
Payment of contingent consideration in relation to acquisition of BMS Laboratories Limited	0.2
<b>Total utilization during the year</b>	<b>5.2</b>

The proceeds of the offering were utilized during fiscal 2005 as follows:

	<b>Amount in U.S.\$ million</b>
<b>Particulars</b>	
Expenses	0.7
Loan to an affiliate	0.9
<b>Total utilization during the year</b>	<b>1.6</b>

The proceeds of the offering were utilized during fiscal 2006 as follows:

	<b>Amount in</b>
<b>Particulars</b>	

	U.S.\$ million
Acquisition of Falcon from Roche in Mexico	35.5
<b>Total utilization during the year</b>	<b>35.5</b>

As a result, the balance of the funds raised through the ADSs were fully utilized during fiscal 2006.

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**ITEM 15. CONTROLS AND PROCEDURES**

**(a) *Disclosure Controls And Procedures***

As of the end of the period covered by this Annual Report on Form 20-F, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act).

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective, as of March 31, 2006, to provide reasonable assurance that the information required to be disclosed in filings and submissions under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified by the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions about required disclosure.

**(b) *Management's Annual Report on Internal Control Over Financial Reporting***

Our executive management is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting as such term is defined in Rule 13a-15(f) of the Exchange Act. As defined by the SEC, internal control over financial reporting is a process designed under the supervision of company's principal executive and principal financial officers, and effected by company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the United States.

Our internal control over financial reporting is supported by written policies and procedures, that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management conducted an assessment of the effectiveness of our internal control over financial reporting as of March 31, 2006 based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Our management's assessment of the effectiveness of our internal control over financial reporting excludes the evaluation of the internal controls over financial reporting of Falcon, which was acquired on December 30, 2005, and over financial reporting of betapharm which was acquired on March 3, 2006 associated with total assets of Rs.38,999 million and total revenue of Rs.998 million included in our consolidated financial statements as of and for the year ended March 31, 2006.

Based on this assessment, our management has concluded that our internal control over financial reporting was effective as of March 31, 2006.

KPMG India, independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report on Form 20-F and, as part of their audit, has issued their report, included herein, on (1) our management's assessment of the effectiveness of our internal control over financial reporting and (2) the effectiveness of our internal control over financial reporting as of March 31, 2006.

**(c) *Attestation Report of the Registered Public Accounting Firm.***

The following is the attestation report we received from KPMG on management's assessment of our internal control over financial reporting.

The Board of Directors and Stockholders

Dr. Reddy's Laboratories Limited



We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Dr. Reddy's Laboratories Limited and subsidiaries (the Company) maintained effective internal control over financial reporting as of March 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of March 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Dr. Reddy's Laboratories Limited acquired Industrias Quimicas Falcon De Mexico S.A.de.C.V. (Falcon) and beta Holdings GmbH (betapharm) during the year ended March 31, 2006, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of March 31, 2006, Falcon's and betapharm's internal control over financial reporting associated with total assets of Rs.38,999 million and total revenues of Rs.998 million included in the consolidated financial statements of the Company as of and for the year ended March 31, 2006. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of Falcon and betapharm.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of March 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended March 31, 2006, and our report dated May 31, 2006, expressed an unqualified opinion on those consolidated financial statements.

KPMG

Hyderabad, India

May 31, 2006

(d) *Changes in Internal Control over Financial Reporting*

During the period covered by this Annual Report, there were no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**ITEM 16. [RESERVED]**

**ITEM 16.A. AUDIT COMMITTEE FINANCIAL EXPERT**

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Our Audit Committee is composed of independent directors and brings in expertise in the fields of finance, economics, human resource development, strategy and management. Please see Item 6. Directors, Senior Management and Employees for the experience and qualifications of the members of the Audit Committee. As of March 31, 2006, no member of our audit committee met the requirements to be an audit committee financial expert under the SEC definition. We believe that the combined knowledge, skills and experience of the Board of Directors and their authority to engage outside experts as they deem appropriate to provide them with advice on the matters related to their responsibilities, enable them, as a group, to act effectively in the fulfillment of their tasks and responsibilities required under the Sarbanes-Oxley Act of 2002.

**ITEM 16.B. CODE OF ETHICS**

We have adopted a code of business ethics applicable to our executive officers, directors and all other employees, including a separate code of ethics applicable to our senior financial officers. A copy of the code is available, without charge, to all of our employees upon request to our human resources department, to investors by contacting our investor relations department and to others if a written request is made to our Company Secretary at our corporate office situated at 7-1-27, Ameerpet, Hyderabad 500 016, Andhra Pradesh, India. The code is also available on our corporate website, [www.drreddys.com](http://www.drreddys.com). Any waivers of this code for executive officers or directors will be disclosed through filing of a Form 6-K. In addition, the audit committee of the Board of Directors has approved a whistleblower policy, which functions in coordination with our code of business ethics and provides an anonymous means for employees and others to communication with various internal organizations, including the audit committee of the Board of Directors.

**ITEM 16.C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The following table sets forth for the fiscal years ended March 31, 2005 and March 31, 2006, the fees paid to our principal accountant and its associated entities for various services they provided us in these periods.

Type of Service	Fiscal Year Ended		Description of Services
	March 31, 2005	March 31, 2006	
	(Rs. in millions)		
Audit Fees	Rs. 8.58	Rs. 30.71	Audit of the financial statements and review of statutory filings
	7.05		Services rendered in connection with the review of Sarbanes-Oxley documentation related to certification
Audit-Related Fees			
Tax Fees	0.22	0.60	
	0.17	0.05	Statutory certifications, other certifications and advisory services
All Other Fees			
Total	Rs. 16.02	Rs. 31.36	

Our audit committee charter requires us to take the prior approval of our audit committee on every occasion we engage our principal accountants or their associated entities to provide us any non-audit services. We disclose to our audit committee the nature of services that are provided and the fees to be paid for the services. The fees listed in the above table as Tax Fees and All Other Fees were approved by our audit committee.

**ITEM 16.D. EXEMPTION FROM THE LISTING STANDARDS FOR AUDIT COMMITTEE**

We have not sought any exemption from the listing standards for audit committees applicable to us as foreign private issuer.

**ITEM 16.E. PURCHASE OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

During fiscal 2006, there was no purchase made by or on behalf of us or any affiliated purchaser of shares of any class of our securities that are registered by us pursuant to Section 12 of the Exchange Act.

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**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

The following financial statement and auditors report for fiscal 2006 are incorporated herein by reference and are included in this Item 18 of this report on Form 20-F:

Report of Independent Registered Public Accounting Firm.

Consolidated Balance Sheets as of March 31, 2005 and 2006.

Consolidated Statements of Operations for the years ended March 31, 2004, 2005 and 2006.

Consolidated Statements of Stockholders Equity and Comprehensive Income for the years ended March 31, 2004, 2005 and 2006.

Consolidated Statements of Cash flows for the years ended March 31, 2004, 2005 and 2006.

Notes to the Consolidated Financial Statements.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Dr. Reddy's Laboratories Limited

We have audited the accompanying consolidated balance sheets of Dr. Reddy's Laboratories Limited and subsidiaries (the Company) as of March 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended March 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of March 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of March 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated May 31, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

This report includes an explanatory paragraph stating that management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of March 31, 2006, Industrias Quimicas Falcon De Mexico S.A.de.C.V. and beta Holdings GmbH's internal control over financial reporting associated with total assets of Rs.38,999 million as of March 31, 2006 and total revenue of Rs.998 million for the year ended March 31, 2006.

KPMG

Hyderabad, India

May 31, 2006

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share data)

	2005	As of March 31, 2006	2006 Convenience translation into U.S.\$ (unaudited)
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and cash equivalents	Rs. 9,287,864	Rs. 3,712,637	U.S.\$ 83,468
Investment securities	310,887	14,703	331
Restricted cash	57,866	1,606,245	36,112
Accounts receivable, net of allowances	3,587,289	4,801,794	107,954
Inventories	3,499,606	6,894,712	155,007
Deferred income taxes and deferred charges	236,931	173,750	3,906
Due from related parties	10,812	246,360	5,539
Other current assets	1,361,578	2,639,818	59,348
Total current assets	18,352,833	20,090,019	451,664
Property, plant and equipment, net	7,058,308	9,086,331	204,279
Due from related parties	11,067	6,182	139
Investment securities	995,431	1,090,202	24,510
Investment in affiliates	180,894	132,659	2,982
Goodwill	1,561,499	16,634,509	373,977
Intangible assets, net	1,026,882	17,034,555	382,971
Restricted cash		4,468,840	100,469
Other assets	101,446	224,772	5,053
Total assets	Rs. 29,288,360	Rs. 68,768,069	U.S.\$ 1,546,045
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
<b>Current liabilities:</b>			
Borrowings from banks	2,796,330	9,132,462	205,316
Current portion of long-term debt	5,920	925,761	20,813
Trade accounts payable	1,415,648	3,639,217	81,817
Due to related parties	139,503	151,678	3,410
Accrued expenses	2,375,087	3,083,120	69,315
Other current liabilities	849,434	1,812,623	40,751
Total current liabilities	7,581,922	18,744,861	421,422
Long-term debt, excluding current portion	25,145	20,937,132	470,709
Deferred revenue	58,255	56,466	1,269

Deferred income taxes	551,789	6,346,174		142,675
Other liabilities	118,090	411,703		9,256
Total liabilities	Rs. 8,335,201	Rs. 46,496,336	U.S.\$	1,045,331

**Stockholders equity:**

Equity shares at Rs.5 par value; 100,000,000 shares authorized; Issued and outstanding; 76,518,949 shares and 76,694,570 shares as of March 31, 2005 and 2006 respectively

	382,595	383,473		8,621
Additional paid-in capital	10,089,152	10,261,783		230,706
Equity options outstanding	400,749	463,128		10,412
Retained earnings	10,009,305	11,201,794		251,839
Equity shares held by a controlled trust: 41,400 shares	(4,882)	(4,882)		(110)
Accumulated other comprehensive income	76,240	(33,563)		(755)

Total stockholders equity	20,953,159	22,271,733		500,713
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Total liabilities and stockholders equity	Rs. 29,288,360	Rs. 68,768,069	U.S.\$	1,546,045
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See accompanying notes to the consolidated financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except share data)

	<b>2004</b>	<b>For the Years ended March 31, 2005</b>	<b>2006</b>	<b>2006 Convenience translation into U.S.\$ (unaudited)</b>
<b>Revenues:</b>				
Product sales, net of allowances for sales returns (includes excise duties of Rs.870,079, Rs.815,007, and Rs.1,153,273 for the years ended March 31, 2004, 2005 and 2006 respectively)	Rs. 20,081,249	Rs. 19,126,188	Rs. 24,077,209	U.S.\$ 541,304
Service income	22,273	47,441	142,317	3,200
License fees		345,737	47,521	1,068
	20,103,522	19,519,366	24,267,047	545,572
Cost of revenues	9,337,255	9,385,820	12,417,413	279,168
Gross profit	10,766,267	10,133,546	11,849,634	266,404
Operating expenses:				
Selling, general and administrative expenses	6,542,501	6,774,563	8,028,884	180,505
Research and development expenses, net	1,991,629	2,803,311	2,152,950	48,403
Amortization expenses	382,857	349,991	419,867	9,439
Foreign exchange (gain)/loss	(282,419)	488,819	126,342	2,840
Other operating (income)/expenses, net	83,208	5,969	(320,361)	(7,202)
Total operating expenses:	8,717,776	10,422,653	10,407,682	233,988
Operating income/(loss)	2,048,491	(289,107)	1,441,952	32,418
Equity in loss of affiliates	(44,362)	(58,101)	(88,235)	(1,984)
Other income, net	535,909	454,237	533,606	11,997
Income before income taxes and minority interest	2,540,038	107,029	1,887,323	42,431
Income taxes (expense)/benefit	(69,249)	94,277	(258,390)	(5,809)
Minority interest	3,364	9,942	(76)	(2)
Net income	Rs. 2,474,153	Rs. 211,248	Rs. 1,628,857	U.S.\$ 36,620

Earnings per equity share				
Basic	32.34	2.76	21.28	0.48
Diluted	32.32	2.76	21.24	0.48
Weighted average number of equity shares used in computing earnings per equity share				
Basic	76,513,764	76,518,949	76,546,658	76,546,658
Diluted	76,549,598	76,559,801	76,701,923	76,701,923

See accompanying notes to the consolidated financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
**For the fiscal years ended March 31, 2004, 2005 and 2006**  
(in thousands, except share data)

	Equity Shares			Additional Paid In Capital	Comprehensive Income	Accumulated Other Comprehensive Income		Equity Shares held by a Controlled Trust	
	No. of shares	Amount						No. of shares	Amount
<b>Balance as of March 31, 2003</b>	76,515,948	Rs. 382,580	Rs.	10,085,004		Rs.	46,328	41,400	(4,882)
Issuance of equity shares on exercise of options	3,001	15		4,148					
Dividends									
Comprehensive income									
Net income					Rs. 2,474,153				
Translation adjustment					24,725		24,725		
Unrealized gain on investments, net of tax					15,020		15,020		
Comprehensive income					Rs. 2,513,898				
Stock based compensation									
<b>Balance as of March 31, 2004</b>	76,518,949	Rs. 382,595	Rs.	10,089,152		Rs.	86,073	41,400	Rs. (4,882)
Dividends									
Comprehensive income									
Net income					Rs. 211,248				
Translation adjustment					13,512		13,512		
Unrealized loss on investments,					(23,345)		(23,345)		

net of tax

Comprehensive  
income

Rs. 201,415

Stock based  
compensation**Balance as of  
March 31,  
2005**

76,518,949 Rs. 382,595 Rs. 10,089,152 Rs. 76,240 41,400 Rs. (4,882)

Issuance of  
equity shares  
on exercise of  
options

175,621

878

172,631

Dividend  
Comprehensive  
income

Net income

Rs. 1,628,857

Translation  
adjustment

11,041

11,041

Unrealized loss  
on  
investments,  
net of tax

(120,844)

(120,844)

Comprehensive  
income

Rs. 1,519,054

Stock based  
compensation**Balance as of  
March 31,  
2006**

76,694,570 Rs. 383,473 Rs. 10,261,783 Rs. (33,563) 41,400 Rs. (4,882)

Convenience  
translation into  
U.S.\$  
(unaudited)

U.S.\$ 8,621 U.S.\$ 230,706

U.S.\$ (755)

U.S.\$ (110)

See accompanying notes to the consolidated financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
**For the fiscal years ended March 31, 2004, 2005 and 2006**

(in thousands, except share data)

[Continued from above table, first column(s) repeated]

	<b>Equity Options Outstanding</b>	<b>Retained Earnings</b>	<b>Total Stockholders Equity</b>
<b>Balance as of March 31, 2003</b>	Rs. 135,694	Rs. 8,187,117	Rs. 18,831,841
Issuance of equity shares on exercise of options	(1,123)		3,040
Dividends		(431,598)	(431,598)
Comprehensive income			
Net income		2,474,153	2,474,153
Translation adjustment			24,725
Unrealized gain on investments, net of tax			15,020
Comprehensive income			
Stock based compensation	122,177		122,177
<b>Balance as of March 31, 2004</b>	Rs. 256,748	Rs. 10,229,672	Rs. 21,039,358
Dividends		(431,615)	(431,615)
Comprehensive income			
Net income		211,248	211,248
Translation adjustment			13,512
Unrealized loss on investments, net of tax			(23,345)
Comprehensive income			
Stock based compensation	144,001		144,001
<b>Balance as of March 31, 2005</b>	Rs. 400,749	Rs. 10,009,305	Rs. 20,953,159
Issuance of equity shares on exercise of options	(99,870)		73,639
Dividend paid		(436,368)	(436,368)
Comprehensive income			
Net income		1,628,857	1,628,857
Translation adjustment			11,041
Unrealized loss on investments, net of tax			(120,844)
Comprehensive income			
Stock based compensation	162,249		162,249
<b>Balance as of March 31, 2006</b>	Rs. 463,128	Rs. 11,201,794	Rs. 22,271,733
Convenience translation into U.S.\$ (unaudited)	U.S.\$ 10,412	U.S.\$ 251,839	U.S.\$ 500,713

See accompanying notes to the consolidated financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	<b>For the year ended March 31,</b>				
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2006</b>	
				Convenience translation into U.S.\$ (unaudited)	
Cash flows from operating activities:					
Net income	Rs. 2,474,153	Rs. 211,248	Rs. 1,628,857	U.S.\$	36,620
Adjustments to reconcile net income to net cash from operating activities:					
Deferred tax benefit	(134,867)	(95,580)	(55,157)		(1,240)
(Gain) / loss on sale of available for sale securities, net	(24,786)	(64,997)	3,924		88
Depreciation and amortization	1,128,453	1,309,290	1,567,090		35,231
In-process research and development expensed		277,343			
Loss/(gain) on sale of property, plant and equipment	29,319	(1,810)	(320,361)		(7,202)
Provision for doubtful accounts receivable	19,871	79,442	33,629		756
Allowance for sales returns	169,511	105,245	239,462		5,384
Inventory write-downs	31,898	52,692	100,783		2,266
Equity in loss of affiliates	44,362	58,101	88,235		1,984
Unrealized exchange (gain)/loss	(109,602)	105,227	67,650		1,521
Stock based compensation	122,177	144,001	162,249		3,648
Loss on sale of subsidiary interest	58,473	8,122			
Minority interest	(3,364)	(9,942)	76		2
Changes in operating assets and liabilities:					
Accounts receivable	(379,413)	77,368	(781,607)		(17,572)
Inventories	(335,092)	(514,187)	(1,851,724)		(41,630)
Other assets	(276,467)	142,486	(1,123,076)		(25,249)
Due to / from related parties, net	148,576	(40,249)	15,223		342
Trade accounts payable	690,182	(763,523)	1,511,074		33,972
Accrued expenses	510,768	1,094,768	243,625		5,477
Deferred revenue		(247,604)	(16,277)		(366)
Taxes payable	(115,375)	42,513	84,794		1,906
Other liabilities	(49,547)	321,657	44,684		1,005
Net cash provided by operating activities	3,999,230	2,291,611	1,643,153		36,941

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Cash flows from investing activities:

Restricted cash	(67,221)	49,304	(6,017,219)	(135,279)
Expenditure on property, plant and equipment	(2,415,638)	(1,749,172)	(1,873,268)	(42,115)
Proceeds from sale of property, plant and equipment	33,558	44,673	691,273	15,541
Investment in affiliate	(63,238)	(49,935)	(100,800)	(2,266)
Purchase of investment securities	(13,178,735)	(10,226,471)	(5,074,184)	(114,078)
Proceeds from sale of investment securities	9,167,150	13,079,463	5,274,899	118,590
Expenditure on intangible assets	(105)	(8,299)	(41,517)	(933)
Cash paid towards contingent consideration			(114,244)	(2,568)
Proceeds from sale of subsidiary	81,464	29,000		
Cash paid for acquisition, net of cash acquired	(63,290)	(535,665)	(27,269,382)	(613,071)
Net cash provided by / (used in) in investing activities	(6,506,055)	632,898	(34,524,442)	(776,179)

Cash flows from financing activities:

Proceeds from issuance of equity	3,040		73,639	1,656
Proceeds from issuance of equity, in subsidiary	2,435			
Purchase of treasury stock	(115,990)			
Proceeds from borrowing from banks, net	177,071	2,520,409	6,322,206	142,136
Proceeds from issuance from long-term debt			21,598,301	485,573
Repayment of long-term debt	(11,072)	(157,476)	(6,577)	(148)
Debt issuance costs			(340,243)	(7,649)
Dividends	(431,598)	(431,615)	(436,368)	(9,810)
Net cash provided by/(used in) financing activities	(376,114)	1,931,318	27,210,958	611,757

Effect of exchange rate changes on cash and cash equivalents

(14,224)	55,802	95,104	2,138
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Net increase / (decrease) in cash and cash equivalents during the year

(2,897,163)	4,911,629	(5,575,227)	(125,342)
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Cash and cash equivalents at the beginning of the year

7,273,398	4,376,235	9,287,864	208,810
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Rs.	4,376,235	Rs.	9,287,864	Rs.	3,712,637	U.S.\$83,468
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Cash and cash equivalents at the  
end of the year

See accompanying notes to the consolidated financial statements  
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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	2004	Year ended March 31, 2005	2006	2006 Convenience translation into U.S.\$ (unaudited)
Supplemental disclosures:				
Cash paid for:				
Interest	Rs. 11,234	Rs. 98,337	Rs. 225,284	U.S.\$ 5,065
Income taxes	425,144		223,000	5,013
Supplemental schedule of non-cash investing activities:				
Property, plant and equipment purchased on credit during the year	36,710	22,827	54,276	1,220
Property, plant and equipment purchased under capital lease			222,701	5,007
Treasury stock issued on acquisition of minority interest including compensation cost	115,990			
Promissory notes issued on acquisition			209,456	4,708
See accompanying notes to the consolidated financial statements				
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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except share data and where otherwise stated)**

**1. Overview**

Dr. Reddy s Laboratories Limited ( DRL ) together with its subsidiaries (collectively, the Company ) is a leading India-based pharmaceutical company headquartered in Hyderabad, India. The Company s principal areas of operation are formulations, active pharmaceutical ingredients and intermediates, generics, custom pharmaceutical services, critical care and biotechnology, and drug discovery. The Company s principal research and development and manufacturing facilities are located in Andhra Pradesh , India and Cuernavaca-Cuautla, Mexico with principal marketing facilities in India, Russia, the United States, the United Kingdom ,Brazil and Germany. The Company s shares trade on several stock exchanges in India and, since April 11, 2001, on the New York Stock Exchange in the United States. As of March 31, 2006, the list of subsidiaries is as follows:

- § DRL Investments Limited ( DRL Investments )
- § Reddy Pharmaceuticals Hong Kong Limited ( RPHL )
- § Reddy Antilles N.V. ( RANV )
- § Reddy US Therapeutics Inc. ( Reddy US )
- § Dr. Reddy s Laboratories Inc. ( DRLI )
- § Dr. Reddy s Farmaceutica Do Brazil Ltda. ( DRFBL )
- § Aurigene Discovery Technologies Limited ( ADTL )
- § Dr. Reddy s Laboratories (EU) Limited ( DRL EU )
- § Dr. Reddy s Laboratories (Proprietary) Limited ( DRSA )
- § Reddy Pharmaceuticals, Inc. USA ( RPI )
- § Reddy Holding GmbH ( RHG )
- § beta Healthcare GmbH & Co KG ( Beta KG )
- § beta Healthcare Solutions GmbH ( Beta HSG )
- § OOO Dr. Reddy s Laboratories Limited, Russia ( OOO DRL )
- § OOO JV Reddy Biomed Limited ( Reddy Biomed or RBL )
- § Reddy Netherlands B.V. ( RNBV )
- § Reddy Cheminor SA ( RCSA )
- § Aurigene Discovery Technologies Inc. ( ADTI )
- § Dr. Reddy s Laboratories (U.K.) Limited ( DRL U.K. )

- § Cheminor Investment Limited ( CIL )
- § Dr. Reddy s Bio-sciences Limited ( RBSL )
- § Trigenesis Therapeutics Inc. ( Trigenesis )
- § Industrias Quimicas Falcon De Mexico S.A.de.C.V. ( FALCON )
- § beta Healthcare Verwaltungs GmbH ( Beta HVG )
- § beta Holding GmbH ( Beta HG )
- § betapharm Arzneimittel GmbH ( Beta AG )
- § beta institut fur sozialmedizinische Forschung und Entwicklung GmbH ( Beta IG )
- § Lacock Holdings Limited ( LHL )

## **2. Significant accounting policies**

### *a) Basis of preparation*

The accompanying consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States (U.S. GAAP). The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share data and where otherwise stated)

**2. Significant accounting policies (continued)***b) Functional currency*

The functional currency of the Company is the Indian rupee, being the currency of the primary economic environment in which the Company operates. The functional currencies of the subsidiaries have been determined as follows based on an individual and collective evaluation of economic factors described in Statement of Financial Accounting Standards ( SFAS ) SFAS 52, Foreign currency translation :

<b>Name of the Subsidiary</b>	<b>Functional Currency</b>
DRL Investments, RPHL, RANV, DRLI, DRFBL, ADTL, DRSA, RPI, OOO DRL, RBL, RNBV, RCSA, CIL, RBSL, Trigenesis	Indian Rupee
Reddy US and ADTI	U.S. Dollar
DRL EU and DRL U.K.	Pound Sterling
FALCON	Mexican Peso
RHG, Beta KG, Beta HSG, Beta HG, Beta AG, Beta HVG, Beta IG and LHL	Euro

In respect of all non-Indian subsidiaries that operate as marketing arms of the parent company in their respective countries/regions (i.e., all those listed in the first row of the table above), the functional currency has been determined to be the functional currency of the parent company, i.e. the Indian rupee. Accordingly, the operations of these entities are largely restricted to import of finished goods from the parent company in India, sale of these products in the foreign country and remittance of the sale proceeds to the parent. The cash flows realized from sale of goods are readily available for remittance to the parent company and cash is remitted to the parent company on a regular basis. The costs incurred by these entities are primarily the cost of goods imported from the parent. The financing of these subsidiaries is done directly or indirectly by the parent company. In respect of the subsidiaries whose operations are self contained and integrated within their respective countries/regions (i.e., all those listed in the second through fifth rows of the table above), the functional currency has been determined to be the currency of those countries/regions. The assets and liabilities of such subsidiaries are translated into Indian rupees at the rate of exchange prevailing as at the balance sheet date. Revenues and expenses are translated into Indian rupees at average monthly exchange rates prevailing during the year. Resulting translation adjustments are included in accumulated other comprehensive income. For entities that operate in a highly inflationary economy, the functional currency is determined as the Indian rupee.

*c) Foreign currency transactions*

Foreign currency transactions are converted into Indian rupees at the rates of exchange prevailing on the date of the respective transactions. Assets and liabilities in foreign currency are converted into Indian rupees at the exchange rate prevailing on the balance sheet date. The resulting exchange gains/losses are included in the statement of income.

*d) Convenience translation*

The accompanying financial statements have been prepared in Indian rupees, the national currency of India. Solely for the convenience of the reader, the financial statements as of and for the fiscal year ended March 31, 2006 have been translated into United States dollars at the noon buying rate in New York City on March 31, 2006 for cable transfers in Indian rupees, as certified for customs purposes by the Federal Reserve Bank of New York of U.S.\$1 = Rs.44.48. No representation is made that the Indian rupee amounts have been, could have been or could be converted into United States dollars at such a rate or any other rate.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except share data and where otherwise stated)**

**2. Significant accounting policies (continued)**

*e) Principles of consolidation*

The consolidated financial statements include the financial statements of DRL, all of its subsidiaries which are more than 50% owned, controlled and entities where the Company has variable interest; Dr. Reddy s Research Foundation (the Research Foundation ), a special purpose entity that is funded by and carries out research activities on behalf of and for the benefit of the Company, and beta Institut for sociomedical research GmbH, a non-profit organization which is engaged in research and development to seek ways to improve the healthcare process in ways which promote the psychological welfare of patients, including development of patient pathways, case management, disease management and health systems management. The Company does not consolidate entities where the minority shareholders have certain significant participating rights which provide for effective involvement in significant decisions in the ordinary course of business. Such investments are accounted by the equity method of accounting. All inter-company balances and transactions are eliminated on consolidation.

The Company accounts for investments by the equity method of accounting where it is able to exercise significant influence over the operating and financing policies of the investee. The Company s equity in the income / loss of equity method affiliates, Reddy Kunshan, Pathnet India Private Limited ( Pathnet ) and Perlecan Pharma Private Limited is included in the statement of operations. Inter company profits and losses have been eliminated until realized by the investor or investee.

Newly acquired subsidiaries have been included in the consolidated financial statements from the dates of acquisition. Effective January 2004, the Company adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 46 (revised December 2003 FIN 46R ), Consolidation of Variable Interest Entities ( VIE ), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity.

For any VIEs that must be consolidated under FIN 46R that were created after January 1, 2004, the interpretation generally requires the primary beneficiary initially to measure the assets, liabilities and noncontrolling interests of the newly consolidated VIE at their fair values at the date the enterprise first becomes the primary beneficiary.

Based on the evaluation of FIN 46R, the Company has consolidated the financial statements of APR LLC, a VIE. See footnote 16 for additional information required by FIN 46R.

*f) Cash equivalents*

The Company considers all highly liquid investments with remaining maturities, at the date of purchase / investment, of three months or less to be cash equivalents.

*g) Revenue recognition*

**Product sales**

Revenue is recognized when significant risks and rewards in respect of ownership of products are transferred to customers, generally, the stockists or formulations manufacturers and when the following criteria are met:

Persuasive evidence of an arrangement exists;

The price to the buyer is fixed and determinable; and

Collectibility of the sales price is reasonably assured.

Revenue from domestic sales of formulation products is recognized on dispatch of the product to the stockist by the consignment and clearing and forwarding agent of the Company. Revenue from domestic sales of active pharmaceutical ingredients and intermediates is recognized on dispatch of products to customers, from the factories of the Company. Revenue from export sales is recognized when significant risks and rewards are transferred to customers, which is based on terms of contract.

Revenue from product sales includes excise duty and is shown net of sales tax and applicable discounts and allowances.

Sales of formulations in India are made through clearing and forwarding agents to stockists. Significant risks and rewards in respect of ownership of formulation products is transferred by the Company when the goods are shipped to stockists from clearing and forwarding agents. Clearing and forwarding agents are generally compensated on a commission basis as a percentage of sales made by them.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
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(in thousands, except share data and where otherwise stated)**

**2. Significant accounting policies (continued)**

Sales of active pharmaceutical ingredients and intermediates in India are made directly to the end customers generally, formulation manufacturers, from the factories. Sales of formulations and active pharmaceutical ingredients and intermediates outside India are made directly to the end customers, generally stockists or formulations manufacturers, from the Company or its consolidated subsidiaries.

The Company has entered into marketing arrangements with certain marketing partners for sale of goods. Under such arrangements, the Company sells generic products to the marketing partners at a price agreed in the arrangement. Revenue is recognized on these transactions upon delivery of products to the marketing partners as all the conditions under Staff Accounting Bulletin No.104 ( SAB 104 ) are met. Subsequently, the marketing partners remit an additional amount based on the ultimate sale proceeds upon further sales made by them to the end customer. Such amount is determined as per the terms of the arrangement and is recognized by the Company when the realization is certain under the guidance given in SAB 104.

The Company has entered into certain dossier sales, licensing and supply arrangements that include certain performance obligations. Based on an evaluation of whether or not these obligations are inconsequential or perfunctory, the Company defers the upfront payments received towards these arrangements. Such deferred amounts are recognized in the income statement in the period in which the Company completes its remaining performance obligations.

Sales of generic products are recognized as revenue when products are shipped and title and risk of loss passes on to the customer. Provisions for chargeback, rebates and medicaid payments are estimated and provided for in the year of sales. A chargeback claim is a claim made by the wholesaler for the difference between the price at which the product is sold to the customer and the price at which it is procured from the Company. Such provisions are estimated based on average chargeback rate actually claimed over a period of time and average inventory holding by the wholesaler.

The Company accounts for sales returns in accordance with SFAS 48, Revenue Recognition when Right to Return Exists by establishing an accrual in an amount equal to the Company's estimate of sales recorded for which the related products are expected to be returned.

The Company deals in various products and operates in various markets and the Company's estimate is determined primarily by its experience in these markets for the products. For returns of established products, the Company determines an estimate of the sales returns accrual primarily based on historical experience regarding sales returns. Additionally, other factors that the Company considers in its estimate of sales returns include levels of inventory in the distribution channel, estimated shelf life, product discontinuances, price changes of competitive products, introductions of generic products and introductions of competitive new products, to the extent each of them has an impact on the Company's business and its markets. The Company considers all of these factors and adjusts the accrual to reflect its actual experience.

With respect to new products that the Company introduces, they are either extensions of an existing line of products or in a general therapeutic category where the Company has historical experience. The Company's new product launches have historically been in therapeutic categories where established products exist and are sold either by the Company or its competitors. The Company has not yet introduced products in any new therapeutic category where the acceptance of such products is not known. The amount of sales returns for the Company's newly launched products are not significantly different from current products marketed by the Company, nor are they significantly different from the sales returns of the Company's competitors as the Company understands them to be based on industry publications and discussions with its customers. Accordingly, the Company does not expect sales returns for new products to be significantly different than expected sales returns of current products. The Company evaluates the sales returns of all of the products at the end of each reporting period and necessary adjustments, if any, are made. However, to date, no significant revision has been determined to be necessary.





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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
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(in thousands, except share data and where otherwise stated)**

**2. Significant accounting policies (continued)**

**Service income**

Income from service are recognised based on the services provided by the Company in accordance with the terms of the contract, as all the conditions under SAB 104 are met.

**License fees**

Non-refundable milestone payments are recognized in the statement of income when earned, in accordance with the terms prescribed in the license agreement, and where the Company has no future obligations or continuing involvement pursuant to such milestone payments. Non-refundable up-front license fees are deferred and recognized when the milestones are earned, in proportion that the amount of each milestone earned bears to the total milestone amounts agreed in the license agreement. As the upfront license fees are a composite amount and cannot be attributed to a specific molecule, they are amortized over the development period. The milestone payments during the development period increase as the risk involved decreases. The agreed milestone payments reflect the progress of the development of the molecule and may not be spread evenly over the development period. Further, the milestone payments are a fair representation of the extent of progress made in the development of these molecules. Hence, the upfront license fees are amortized over the development period in proportion to the milestone payments received. In the event, the development is discontinued, the corresponding amount of deferred revenue is recognized in the income statement in the period in which the project is effectively terminated.

***h) Shipping and handling costs***

Shipping and handling costs incurred to transport products to customers are included in selling, general and administrative expenses.

***i) Inventories***

Inventories are stated at the lower of cost or market value. Cost is determined using the first-in-first-out method for all categories of inventories except stores and spares, where cost is determined using the weighted average method. Stores and spares comprise engineering spares such as machinery spares and consumables such as lubricants, cotton waste and oils, which are used in operating machines or consumed as indirect materials in the manufacturing process. Cost in the case of raw materials and stores and spares comprises the purchase price and attributable direct costs, less trade discounts. Cost in the case of work-in-process and finished goods comprises direct labor, material costs and production overheads.

A write-down of inventory to the lower of cost or market value at the close of a fiscal period creates a new cost basis and is not marked up based on changes in underlying facts and circumstances.

Inventories are reviewed on a monthly basis for identification and write-off of slow-moving, obsolete and impaired inventory. Such write-downs, if any, are included in cost of goods sold.

***j) Investment securities***

Investment securities consist of available for sale debt and equity securities and non-marketable equity securities accounted for by the cost method.

Available for sale securities are carried at fair value based on quoted market prices. For debt securities where quoted market prices are not available, fair value is determined using pricing techniques such as discounted cash flow analysis or at the swap rates and forward rate agreements on the date of the valuation, obtained from market sources. Unrealized holding gains and losses, net of the related tax effect, on available for sale securities are excluded from earnings and are reported as a separate component of stockholders' equity until realized. Decline in the fair value of any available for sale security below cost that is determined to be other than temporary, results in reduction in the carrying amount to fair value. Such impairment is charged to the statement of operations. Realized gains and losses from the sale of available for sale securities are determined on a first-in-first-out method and are included in earnings.

Non-marketable equity securities accounted for by the cost method are stated at cost, less provision for any other than temporary decline in value.



**Table of Contents****DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(in thousands, except share data and where otherwise stated)****2. Significant accounting policies (continued)***k) Derivative financial instruments*

The Company enters into forward foreign exchange contracts and options where the counterparty is generally a bank. The Company purchases forward foreign exchange contracts and options to mitigate the risk of changes in foreign exchange rates on accounts receivable and foreign currency loans and deposits. Although these contracts are effective as hedges from an economic perspective, they do not qualify for hedge accounting under SFAS No. 133, ,

Accounting for Derivative Instruments and Hedging Activities as amended,. Any derivative that is either not designated as a hedge, or is so designated but is ineffective per SFAS No. 133, is marked to market and recognized in income immediately.

*l) Property, plant and equipment*

Property, plant and equipment including assets acquired under capital lease agreements are stated at cost less accumulated depreciation. The Company depreciates property, plant and equipment over the estimated useful life using the straight-line method. The estimated useful lives of assets are as follows:

## Buildings

-Factory and administrative buildings	25 to 40 years
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-Ancillary structures	3 to 15 years
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Plant and machinery	3 to 15 years
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Furniture, fixtures and office equipment	4 to 10 years
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Vehicles	4 to 5 years
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Computer equipment	3 to 5 years
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Advances paid towards the acquisition of property, plant and equipment outstanding at each balance sheet date and the cost of property, plant and equipment not put to use before such date are disclosed under capital work-in-progress. The interest cost incurred for funding an asset during its construction period is capitalized based on the actual investment in the asset and the average cost of funds. The capitalized interest is included in the cost of the relevant asset and is depreciated over the estimated useful life of the asset.

*m) Goodwill*

Goodwill represents the excess of purchase cost over the fair value of the net tangible and identified intangible assets of businesses acquired. Goodwill is not amortized but is tested for impairment at least annually.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
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(in thousands, except share data and where otherwise stated)

**2. Significant accounting policies (continued)***o) Intangible assets*

Intangible assets consist of goodwill and other acquired intangibles, which include core-technology rights, trademarks, customer related intangibles, marketing rights, marketing know-how, beneficial toll manufacturing contracts and non-compete arrangements. All intangible assets with definite life are amortized over the expected benefit period or the legal life, whichever is lower. Such periods are as follows:

## Trademarks

	Tested for impairment at least
-Trademarks with indefinite life	annually
-Trademarks with definite life	3 to 10 years
Core technology rights and licenses	10 to 15 years
Product related intangibles	12 to 14 years
Marketing rights	11 to 16 years
Non-competition arrangements	1.5 to 10 years
Marketing know-how	6 months
Customer-related intangibles including customer contracts	2 to 5 years
Beneficial toll manufacturing contract	58 months
Other intangibles	5 to 15 years

*p) Impairment of long-lived assets*

Long-lived assets and finite life intangibles are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying amount of assets may not be fully recoverable. Each impairment test is based on a comparison of the undiscounted cash flows expected to be generated from the use of the asset to its recorded value. If impairment is indicated, the asset is written down to its fair value. Long-lived assets to be disposed are reported at the lower of the carrying value or fair value, less cost to sell.

*q) Start-up costs*

Costs of start-up activities including organization costs are expensed as incurred.

*r) Research and development*

Research and development cost is expensed as incurred. In-process technologies used in research and development projects and having no alternate future uses are expensed upon purchase. Capital expenditure incurred on equipment and facilities acquired or constructed for research and development activities and having alternative future uses, is capitalized as property, plant and equipment when acquired or constructed.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share data and where otherwise stated)

**2. Significant accounting policies (continued)***s) Stock-based compensation*

At March 31, 2006, the Company had three stock-based employee compensation plans, which are described more fully in Note 23. During the first quarter of fiscal 2004, the Company adopted the fair value recognition provisions of SFAS No. 123, *Accounting for Stock- Based Compensation* , for stock-based employee compensation. The Company has selected the retroactive method of adoption described in SFAS No. 148 *Accounting for Stock Based Compensation Transition and Disclosure* for all options granted after January 1, 1995. Consequently, for the years ended March 31, 2004, 2005 and 2006, an amount of Rs.122,177, Rs.144,001 and Rs.162,249 respectively, has been recorded as total employee stock based compensation expense.

During fiscal 2004 , Aurigene Discovery Technologies Limited adopted two stock based employee compensation plans, which are described more fully in Note 23. The Company has accounted for these plans under SFAS 123 *Accounting for Stock- Based Compensation* .

The Company uses the Black-Scholes option pricing model to determine the fair value of each option grant. The Black-Scholes model includes assumptions regarding dividend yields, expected volatility, expected lives and risk free interest rates. These assumptions reflect management's best estimates, but these assumptions involve inherent market uncertainties based on market conditions generally outside of the control of the Company.

The fair value of each option is estimated on the date of grant using the Black-Scholes model with the following assumptions:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Dividend yield	0.5%	0.5%	0.5%
	42-78	12-78	12-78
Expected life	months	months	months
Risk free interest rates	5.2 - 6.8%	4.5-6.7%	5.7-7.5%
Volatility	45.7-50.7%	39.4-44.6%	23.4-36.9%

*t) Income taxes*

Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount considered more likely than not to be realized.

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**2. Significant accounting policies (continued)**

*u) Leases*

Leases of property, plant and equipment where the Company has substantially all of the risks and rewards of ownership are classified as capital leases. The amount recorded is the lesser of the present value of the rental and other lease payments during the lease term, excluding that portion of the payments representing executory costs paid to the lessor, or the asset's fair value. The rental obligations, net of interest charges, are reflected in long term debt.

Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and recorded as expenses as payments are made over the lease term.

*v) Earnings per share*

In accordance with SFAS No.128, Earnings per Share, basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period, using the treasury stock method for options, except where the results would be anti-dilutive.

*w) Reclassifications*

The Company has reclassified certain expenses/income for the years ended March 31, 2004 and 2005, between cost of revenues and operating expenses and product sales, other (expense) / income and other operating expense/(income) respectively, to conform to the current year's presentation. These reclassifications increased the previously reported gross profit by Rs.31,135 and Rs.47,441 respectively and reduced the previously reported operating income for the fiscal year ended March 31, 2004 by Rs.31,718 and reduced the the previously reported operating loss for the fiscal year ended March 31, 2005 by Rs.77,343, which is not material. The above reclassification had no impact on reported net income or stockholder's equity.

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**3. Business combinations**

All of the Company's acquisitions have been accounted for using the purchase method of accounting. Revenues and expenses of the acquired businesses have been included in the accompanying consolidated financial statements beginning on the respective dates of acquisition. Contingent consideration pursuant to earnout agreements is accrued as an additional cost of the transaction when payment thereof is deemed to be probable by the Company.

*Industrias Quimicas Falcon de Mexico, S.A. de C.V ( Falcon )*

On December 30, 2005 the Company acquired 100% of the share capital of Industrias Quimicas Falcon de Mexico, S.A.de C.V ( Falcon ), a Roche group company for a total purchase consideration of Rs.2,773,126 (U.S.\$61,233). Falcon was acquired with an intent to add steroid manufacturing capabilities and permit the Company to offer a full range of services in its custom pharmaceutical services business. The operations of Falcon relate to the manufacture and sale of active pharmaceutical ingredients and steroids in accordance with the customer's specifications.

The Company has accounted for the acquisition under the purchase method as defined in SFAS No. 141,

Business Combinations . Accordingly, the financial results for the period from December 30, 2005 through March 31, 2006 have been included in the consolidated financial statements of the Company. The purchase cost of Rs.2,773,126 has been allocated as follows:

- o Property, plant and equipment and intangible assets by third party valuer and
- o Others based on management's estimates.

Current assets	
Cash and cash equivalents	Rs. 217
Accounts receivable	39,736
Inventories	1,150,730
Other current assets	259,465
Property, plant and equipment	1,418,799
Intangible assets	
Customer contracts	51,493
Non-competition agreement	20,242
<b>Total assets</b>	<b>2,940,682</b>
Liabilities assumed	(40,613)
Deferred tax liability	(126,943)
 Purchase cost	 Rs. 2,773,126

The weighted average useful lives of intangibles acquired are as follows:-

Customer contracts	2.6 years
Non competition agreement	3 years

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**3. Business combinations (continued)***beta Holding GmbH*

On March 3, 2006, the Company, through its wholly owned subsidiary Lacock Holdings Limited, acquired 100% of the outstanding common shares of beta Holding GmbH. Accordingly, the financial results of beta Holding GmbH have been included in the consolidated financial statements since that date. beta Holding GmbH is a leading generics pharmaceuticals company in Germany. Under the beta brand, the Company markets a broad and diversified portfolio comprising formulations, primarily solid dose, focused on medical conditions requiring long-term therapy that are typically prescribed by primary care physicians.

The aggregate purchase price of Rs.26,063,321 (Euro 482,654) includes direct acquisition cost amounting to Rs.201,548 (Euro 3,732). The acquisition agreement included the payment of contingent consideration amounting up to Rs.518,400 (Euro 9,600), which was paid into an escrow account. This amount is subject to set-off for certain indemnity claims in respect of legal and tax matters that might arise, pertaining to the periods prior to the acquisition. The escrow will lapse and be time barred at the end of 2013. Since the maximum amounts pertaining to such claims are determinable at the date of acquisition, the same has been included as part of the purchase price.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The Company is in the process of obtaining third-party valuations of certain intangible assets and, accordingly, the allocation of the purchase price is preliminary and may be prospectively revised when additional information is obtained based on such third party valuations. The final purchase price allocation is expected to be completed by December 31, 2006. The purchase price of beta Holding GmbH has been allocated based on management's estimate of fair values as follows:

Current assets	
Cash and cash equivalent	Rs. 1,357,395
Inventories	538,860
Other current assets	552,938
Property, plant and equipment	372,382
Intangibles	
Trademarks	3,970,118
Product related intangibles	11,734,422
Beneficial toll manufacturing contract	621,058
Other assets	142,541
Goodwill	14,958,766
Total assets	34,248,480
Deferred tax liability, net	(5,825,388)
Liabilities assumed	(2,359,771)
Purchase cost	Rs. 26,063,321

Trademarks have an indefinite useful life and are therefore not subject to amortization but will be tested for impairment annually. The weighted average useful lives of other intangibles acquired are as follows:

Products related intangibles	11.6 years
Beneficial toll manufacturing contract	58 months



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**3. Business combinations (continued)**

All goodwill arising from the acquisition of beta Holding GmbH was assigned to the Company's Generics segment.

Proforma Information: The table below reflects unaudited pro forma consolidated results of operations as if both the Falcon and beta Holding GmbH acquisitions had been made at the beginning of the periods presented below:

	<b>Fiscal Year ended March 31,</b>	
	<b>2005</b>	<b>2006</b>
	(unaudited)	(unaudited)
Revenues	Rs. 28,658,645	Rs. 33,766,668
Net income	1,227,528	1,991,090
Earning per equity share		
Basic	16.04	26.01
Diluted	16.03	25.96
Weighted average number of equity shares used in computing earnings per share		
Basic	76,518,949	76,546,658
Diluted	76,559,801	76,701,923

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**4. Asset Purchase*****Trigenesis Therapeutics Inc.***

On April 27, 2004, the Company acquired the entire share capital of Trigenesis Therapeutics Inc. ( Trigenesis ) for a total consideration of Rs.496,715 (U.S.\$11,000).

Trigenesis is a U.S. based research company specializing in dermatology field. As a result of the acquisition, DRL has acquired certain technology platforms and marketing rights. The acquisition has been accounted for as a purchase of intangible assets as Trigenesis did not meet the definition of a business as described in EITF Issue No. 98-3 Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business and accordingly the transaction did not meet the definition of a business combination.

The total purchase consideration had been allocated to the acquired assets as of March 31, 2005 based on a valuation carried out by an independent valuer.

Core-technology rights and licenses	Rs. 132,753
Marketing rights	86,619
In-process technology	277,343
	Rs. 496,715

The Company expensed the amount allocated towards in-process technology being research and development projects having no future alternate uses as research and development expenses during the fiscal year ended March 31, 2005. The core-technology rights and licenses and marketing rights have been capitalized as intangible assets to be amortized over the period such assets are expected to contribute directly or indirectly to the future cash flows.

***PDL Biopharma, Inc***

On March 13, 2006, the Company acquired trademark rights to three off-patent products, along with all the physical inventories of the products, from PDL Biopharma, Inc ( PDL ) for a total consideration of Rs.122,691 (U.S.\$2,750). PDL is a U.S. based biopharmaceutical company focused in the development and commercialization of therapies for treatment of inflammation and autoimmune diseases, acute cardiac conditions and cancer. As a result of the acquisition, the Company acquired an opportunity to sell generic versions of these products using their existing brand names.

The acquisition has been accounted for as a purchase of intangible assets as PDL did not meet the definition of a business as described in EITF Issue No. 98-3, Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business .

The total purchase consideration has been allocated to the acquired assets as of March 31, 2006 based on a fair valuation carried out by the Company s management as follows:

Inventories	Rs. 115,845
Registered trademarks	6,846
	Rs. 122,691

The value attributable to the registered trademarks are amortized over the period over which the intangible assets are expected to contribute directly or indirectly to the future cash flows.

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**5. Goodwill**

In accordance with, SFAS No. 142, Goodwill and Other Intangible Assets the Company tests goodwill for impairment, at least annually.

The following table presents the changes in goodwill during the years ended March 31, 2005 and 2006:

	<b>Fiscal Year ended March 31,</b>	
	<b>2005</b>	<b>2006</b>
Balance at the beginning of the year <sup>(1)</sup>	Rs. 1,704,492	Rs. 1,743,442
Acquired during the year	38,950	15,073,010
Balance at the end of the year <sup>(1)</sup>	Rs. 1,743,442	Rs. 16,816,452

Goodwill acquired during the years ended March 31, 2005 and 2006 represents the following :

	<b>Fiscal Year ended March 31,</b>	
	<b>2005</b>	<b>2006</b>
Cash paid towards contingent consideration in purchase business combinations	Rs. 38,950	Rs. 114,244
Excess of fair value over carrying value of acquired net assets, in a purchase business combination (beta Holding GmbH)		14,958,766
	Rs. 38,950	Rs. 15,073,010

The following table presents the allocation of Goodwill to the following segments:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Formulations <sup>(1)</sup>	Rs. 349,774	Rs. 349,774
Active Pharmaceutical Ingredients and Intermediates	997,025	997,025
Generics	306,206	15,379,216
Drug Discovery	90,437	90,437
	Rs. 1,743,442	Rs. 16,816,452

<sup>(1)</sup> includes goodwill arising on investment in an affiliate amounting to Rs.181,943.

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**6. Intangible assets, net**

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, intangible assets are amortized over the expected benefit period or the legal life, whichever is lower.

The following table presents acquired and amortized intangible assets as of March 31, 2005 and 2006:

	<b>As of March 31, 2005</b>		<b>As of March 31, 2006</b>	
	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Trademarks	Rs.2,570,242	Rs.1,833,303	Rs. 2,575,224	Rs.2,113,374
Trademarks not subject to amortization			3,970,118	
Product related intangibles			11,759,317	77,326
Beneficial toll manufacturing contract			621,058	10,708
Core-technology rights and licenses	132,753		132,753	
Non-competition arrangements	111,289	98,602	128,883	105,019
Marketing know-how	80,000	80,000	80,000	80,000
Marketing rights	94,852	3,659	94,369	9,222
Customer related intangibles including customer contracts	125,156	73,908	167,233	98,799
Others	8,027	5,965	7,556	7,508
	Rs.3,122,319	Rs.2,095,437	Rs. 19,536,511	Rs.2,501,956

The aggregate amortization expense for the years ended March 31, 2004, 2005 and 2006 was Rs.382,857, Rs.349,991 and Rs.419,867 respectively.

Estimated amortization expense for the next five years and thereafter with respect to such assets is as follows:

For the fiscal year ended March 31,	
2007	Rs. 1,463,808
2008	1,358,792
2009	1,239,464
2010	1,175,376
2011	1,159,714
Thereafter	6,667,283
Total	Rs. 13,064,437

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**6. Intangible assets, net (continued)**

The intangible assets (net of amortization) as of March 31, 2006 have been allocated to the following segments:

	<b>Formulations</b>	<b>Generics</b>	<b>Custom Pharmaceutical Services</b>	<b>Total</b>
Trademarks	Rs. 412,346	Rs. 4,019,622		Rs. 4,431,968
Product related intangibles		11,681,991		11,681,991
Beneficial toll manufacturing contract		610,350		610,350
Core-technology rights and licenses		132,753		132,753
Non-competition arrangements		6,052	17,812	23,864
Customer related intangibles		24,082	44,352	68,434
Marketing rights		85,147		85,147
Others		48		48
	Rs. 412,346	Rs. 16,560,045	Rs. 62,164	Rs. 17,034,555

The intangible assets (net of amortization) as of March 31, 2005 have been allocated to the following segments:

	<b>Formulations</b>	<b>Generics</b>	<b>Total</b>
Trademarks	Rs. 647,369	Rs. 89,570	Rs. 736,939
Core-technology rights and licenses		132,753	132,753
Non-competition arrangements		12,687	12,687
Customer related intangibles		51,248	51,248
Marketing rights		91,193	91,193
Others		2,062	2,062
	Rs. 647,369	Rs. 379,513	Rs. 1,026,882

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**7. Formation of Perlecan Pharma Private Limited**

In September 2005, the Company announced the formation of an integrated drug development company, Perlecan Pharma Private Limited ( Perlecan Pharma ), as a joint venture with Citigroup Venture Capital International Growth Partnership Mauritius Limited ( Citigroup Venture ) and ICICI Venture Funds Management Company ( ICICI Venture ). Perlecan Pharma is engaged in the clinical development and out-licensing of New Chemical Entity ( NCE ) assets. Citigroup Venture and ICICI Venture each committed to contribute Rs.1,003,725 (U.S.\$22,500) and the Company committed to contribute Rs.340,000 (U.S.\$7,500) towards equity in Perlecan Pharma. The arrangement was subject to certain closing conditions which were completed on March 27, 2006 which resulted in the terms of the investment agreement being amended.

As a result, the Company owns approximately 14.28% of the equity of Perlecan Pharma as of March 31, 2006. In addition, Perlecan Pharma will issue to the Company warrants to purchase 45 million equity shares of Perlecan Pharma, at an exercise price of Re.1.00 per equity share, the exercise of which will be contingent upon the success of certain research and development milestones. If the warrants are fully exercised, then the Company will own approximately 62.5% of the equity shares of Perlecan Pharma.

As of March 31, 2006, the three investors have invested Rs.705,700 (U.S.\$15,818) in Perlecan Pharma. The Company s share of equity was Rs.100,800 (U.S.\$2,259) and the Company has also committed to invest an additional amount of Rs.239,200 (U.S.\$5,241) as its proportionate equity contribution in the future. As per the terms of the amended agreement, the Company is to be reimbursed by Perlecan Pharma for research and development costs of Rs.231,023 it incurred prior to closing. Further, three out of seven directors on the board of Perlecan Pharma will be designated by the Company. In addition as per the terms of the arrangement, the Company will have the first right to conduct product development and clinical trials on behalf of Perlecan Pharma on an arms length basis subject to the final decision by the board of directors of Perlecan Pharma. Considering these factors the Company has accounted for its investment in Perlecan Pharma in accordance with APB 18, The Equity Method of Accounting for Investments in Common Stock .

The Company s equity in the loss of Perlecan Pharma for the period ended March 28, 2006 to March 31, 2006 amounted to Rs.40,000. The reimbursement for the pre-closing research and development costs have been applied to reduce the carrying value of the equity investment in Perlecan Pharma as of March 31, 2006 to zero with the remaining balance of Rs.170,223 reflected as a deferred liability. The Company will continue to reflect its equity share of losses to the extent of its net investment and future funding commitments to Perlecan Pharma.

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**8. Cash, cash equivalents and restricted cash**

Cash and cash equivalents as of March 31, 2005 and 2006 amounted to Rs.9,287,864 and Rs.3,712,637 respectively. This excludes restricted cash included in current assets of Rs.57,866 and Rs.1,606,245 as of March 31, 2005 and 2006 respectively and restricted cash included in non-current assets of Rs.Nil and Rs.4,468,840 as on March 31, 2005 and 2006 respectively against the following obligations or commitments of the Company:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Restricted cash – current		
Against performance guarantees issued by the Company	Rs. 16,157	Rs. 1,394
Against short term loan from State Bank of India		1,584,600
Against unclaimed dividend	11,831	12,633
Against other obligations	29,878	7,618
	Rs. 57,866	Rs. 1,606,245
Restricted cash – non current		
Against long term loan from Citibank		4,468,840
Total restricted cash	Rs. 57,866	Rs. 6,075,085

The fair values of cash and cash equivalents approximate their carrying values.

**9. Accounts receivable**

Accounts receivable as of March 31, 2005 and 2006 are stated net of allowance for doubtful accounts. The Company maintains an allowance for doubtful accounts on all accounts receivable, including receivables sold with recourse, based on present and prospective financial condition of the customer and ageing of the accounts receivable after considering historical experience and the current economic environment. Accounts receivable are generally not collateralized.

The activity in the allowance for doubtful accounts receivable is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Balance at the beginning of the year	Rs. 141,949	Rs. 139,569	Rs. 171,154
Additional provision	19,871	79,442	33,629
Bad debts charged to provision	(22,251)	(47,857)	(16,782)
Balance at the end of the year	Rs. 139,569	Rs. 171,154	Rs. 188,001

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**10. Inventories**

Inventories consist of the following:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Raw materials	Rs. 1,008,729	Rs. 2,002,246
Stores and spares	316,915	450,658
Work-in-process	1,068,115	1,421,151
Finished goods	1,105,847	3,020,657
	Rs. 3,499,606	Rs. 6,894,712

During the years ended March 31, 2004, 2005 and 2006 the Company recorded an inventory write-down of Rs.31,898, Rs.52,692 and Rs.100,783 respectively, resulting from a decline in the market value of certain finished goods and write down of certain raw materials and these amounts are included in the cost of goods sold.

**11. Other assets**

Other assets consist of the following:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Prepaid expenses	Rs. 124,972	Rs. 432,680
Advances to suppliers	135,352	367,485
Balances with statutory authorities	193,806	928,423
Deposits	99,896	223,409
Export benefits receivable	215,750	291,210
Others	693,248	621,383
	1,463,024	2,864,591
Less: Current assets	1,361,578	2,639,818
	Rs. 101,446	Rs. 224,772

Balances with the statutory authorities represent amounts deposited with the excise authorities and the unutilized excise input credits on purchases. These are regularly utilized to offset the excise liability on the goods produced. Accordingly, these balances have been classified as current assets.

Deposits mainly comprise telephone, premises and other deposits. Others mainly represent receivables of duties and income tax deducted at source on interest received by the Company.

**12. Property, plant and equipment, net**

Property, plant and equipment consist of the following:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Land	Rs. 519,902	Rs. 861,951
Buildings	2,064,956	2,470,029
Plant and machinery	6,947,490	7,966,645
Furniture, fixtures and equipment	734,721	826,370



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Vehicles	238,556	288,162
Computer equipment	429,266	514,935
Capital work-in-progress	567,974	1,135,905
	11,502,865	14,063,997
Accumulated depreciation	(4,444,557)	(4,977,666)
	Rs. 7,058,308	Rs. 9,086,331

Depreciation expense for the years ended March 31, 2004, 2005 and 2006 was Rs.745,596, Rs.959,299 and Rs.1,147,223 respectively.

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**13. Investment securities**

Investment securities consist of the following:

	As of March 31, 2005				As of March 31, 2006			
	Carrying value	Gross unrealized holding gains	Gross unrealized holding losses	Fair value	Carrying value	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Equity securities	Rs. 3,096	Rs. 4,787		Rs. 7,883	Rs. 3,096	Rs. 8,520		Rs. 11,617
Debt securities	1,009,785		(24,965)	984,820	1,250,020		(174,163)	1,075,857
	1,012,881	4,787	(24,965)	992,703	1,253,116	8,520	(174,163)	1,087,474
Non-marketable equity securities	2,728			2,728	2,728			2,728
	Rs. 1,015,609	Rs. 4,787	Rs. (24,965)	Rs. 995,431	Rs. 1,255,844	Rs. 8,520	Rs. (174,163)	Rs. 1,090,202
Current Mutual fund units	300,000	10,887		310,887	14,703			14,703
	Rs. 300,000	Rs. 10,887		Rs. 310,887	Rs. 14,703			Rs. 14,703

**14. Leases***Capital leases*

Property, plant and equipment includes Rs.Nil and Rs.223,379 (accumulated depreciation of Rs.Nil and Rs.678) in respect of assets acquired under capital lease and other beneficial right of use, during the years ended March 31, 2005 and 2006.

The depreciation charge of Rs.Nil, Rs.Nil and Rs.678 during the years ended March 31, 2004, 2005 and 2006 respectively is included within depreciation. The financial obligations arising from these contractual arrangements are reflected in long-term debt.

*Operating leases*

The Company leases office and residential facilities under operating lease agreements that are renewable on a periodic basis at the option of both the lessor and the lessee. Rental expense under those leases was Rs.101,845, Rs.198,692 and Rs.229,956 for the years ended March 31, 2004, 2005 and 2006 respectively.

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**14. Leases (continued)**

The schedule of future minimum rentals payments in respect of non-cancellable operating leases is set out below:

Fiscal Year ended March 31,	
2007	Rs. 150,051
2008	133,844
2009	95,699
2010	78,482
2011	65,207
Thereafter	154,033
	Rs. 677,316

**15. Investment in affiliates**

*Reddy Kunshan:* Reddy Kunshan is engaged in manufacturing and marketing of active pharmaceutical ingredients and intermediates and formulations in China. During the fiscal year ended March 31, 2005, the Company further invested Rs.49,935 along with one of its other joint venture partners in Reddy Kunshan. Consequently, the Company's interest in Reddy Kunshan increased to 51.2%.

Three of the directors of the Company are on the board of directors of Reddy Kunshan, which comprises seven directors. Under the terms of the agreement, all decisions with respect to operating activities, significant financing and other activities are taken by the majority approval of at least five of the seven directors of the board. These significant decisions include amendments to the Articles, suspensions of the operations, alterations to the registered capital, etc. As the Company does not have control over the board and as the other partners have significant participating rights, acting on its own, the Company is not in a position to control or take any significant operating decisions of Reddy Kunshan and would require approval of other shareholders. Therefore, the Company has accounted for its interest in Reddy Kunshan under the equity method.

The Company's equity in the loss of Reddy Kunshan for the years ended March 31, 2004, 2005 and 2006 was Rs.44,362 Rs.58,101 and Rs.48,235 respectively. The carrying value of the investment in Reddy Kunshan as of March 31, 2005 and 2006 was Rs.180,894 and Rs.132,659 respectively.

*Pathnet:* Pathnet is engaged in the business of setting up medical pathology laboratories. The Company acquired a 49% interest in Pathnet on March 1, 2001 for a consideration of Rs.4,000. During the fiscal year ended March 31, 2002 the Company further invested Rs.60,310 and has accounted for its 49% interest in Pathnet under the equity method. The carrying value of the investment in Pathnet as of March 31, 2005 was Rs.Nil. During the fiscal year ended March 31, 2006, the Company sold its stake in Pathnet and was released from its guarantee issued to ICICI Bank when its share of the outstanding loan amount granted by ICICI to Pathnet, Rs.21,000 was repaid.

**16. Variable interest entities**

On January 30, 2004, the Company along with two individuals formed APR LLC, a Delaware limited liability company. APR LLC is a development stage enterprise, which is in the process of developing an active pharmaceutical ingredient ( API ). Equity capital of APR LLC consists of Class A equity interests, which are held by two individuals and Class B equity interests held by DRL. The initial contribution for the Class A interests was U.S.\$400 (Rs.17,487) in cash. Class A interests carry voting rights and participate in the profits and losses of APR LLC in the normal course of business. DRL contributed U.S.\$500 (Rs.21,859) in cash for Class B interests, which was used to acquire intellectual property rights. Class B interests carry certain protective rights only.

Further, DRL has entered into a development and supply agreement under which DRL and APR will collaborate in the development, marketing and sale of API and generic dosages. Under the terms of the agreement, DRL is committed to fund the entire research and development of API. This amount is repayable by APR LLC upon

successful commercialization of the product. Under this agreement, the Company has paid U.S.\$670 (Rs.29,291), U.S.\$900 (Rs.39,346) and U.S.\$Nil (Rs.Nil) during the years ended March 31, 2004, 2005 and 2006 respectively to fund ongoing research and development.

The Company has evaluated this transaction and believes that APR meets the criteria to be a variable interest entity and that the Company, being the primary beneficiary, is required to consolidate APR under the requirements of FIN 46R. Accordingly, on

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**16. Variable interest entities (continued)**

January 30, 2004, the Company recorded the net assets to the non-controlling interest at a fair value of U.S.\$900 (Rs.39,346). The creditors of APR LLC do not have any recourse to the general credit of the Company, the primary beneficiary. There are no consolidated assets that are collateral for APR LLC's obligations.

**17. Financial instruments and concentration of risk**

*Concentration of risk:* Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents, accounts receivable, investment securities and marketable securities. The Company's cash resources are invested with financial institutions with high investment grade credit ratings. Limits have been established by the Company as to the maximum amount of cash that may be invested with any such single entity. To reduce credit risk, the Company performs ongoing credit evaluations of customers.

Pursuant to the terms of an agreement with Par Pharmaceuticals Inc. ( PAR ), the Company supplies certain generic formulations to PAR for further sale to customers in the United States. Under this arrangement the Company sells its products to PAR at an agreed price. Subsequently, PAR remits additional amount based on the ultimate sale proceeds realized from further sales made by it to the end customers. As of March 31, 2005 and 2006, receivables from PAR under this arrangement aggregated Rs.210,463 and Rs.113,684 respectively representing 5.9% and 2.4% of the total receivables and revenues during the years ended March 31, 2004, 2005 and 2006 aggregated to respectively Rs.3,224,647, Rs.1,638,939 and Rs.529,252 respectively, representing 16.0%, 8.4% and 2.2% of the total revenues of the Company.

*Derivative financial instruments.* The Company enters into certain forward foreign exchange contracts and certain derivative arrangements where the counterparty is generally a bank. The Company does not consider the risk of non-performance by the counterparty to be significant.

The following table presents the aggregate contracted principal amounts of the Company's derivative financial instruments outstanding:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Forward exchange contracts (U.S.\$-Rs.) (sell)	U.S.\$ 30,000	U.S.\$ 105,000
Forward exchange contracts (U.S.\$-Rs.) (buy)	U.S.\$ 40,000	U.S.\$ 79,500
Forward exchange contracts (GBP/U.S.\$) (sell)	GBP 2,000	
Forwards exchange contracts (EUR / U.S.\$) (sell)		EUR 36,000
Interest rate swap		EUR 75,000

The foreign forward exchange contracts mature between one to six months.

**18. Research and development arrangement**

The Company undertakes a significant portion of the research and development activities relating to drug discovery through its research facilities located in the United States and India. The Company under an existing arrangement also undertakes research and development activities through the Research Foundation, a special purpose entity, organized as a Section 25 company under the Indian Companies Act, to avail certain tax benefits under the Indian Income Tax Rules. At present, the Research Foundation does not undertake research and development activity for any other entity. The operations of the Research Foundation are funded by the Company and as a result this entity has been consolidated in the financial statements. The Company has the first right to use the intellectual property rights relating to patents, copyrights, trademarks and know-how discovered or developed by the Research Foundation.

During the fiscal year ended March 31, 2005, the Company entered into an agreement with I-VEN Pharma Capital Limited ( I-VEN ) for the joint development and commercialization of generic drug products. As per the terms of the agreement, I-VEN will have the right to fund up to fifty percent of the project costs (development, registration and legal costs) related to these products and the related U.S. Abbreviated New Drug Applications ( ANDA ) filed or to be

filed in the fiscal years ended March 31, 2005 and March 31, 2006, subject to a maximum contribution of U.S.\$56,000. The terms of the arrangement do not require the Company to

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**18. Research and development arrangement (continued)**

repay the funds or purchase I-VEN's interest in the event that the Company is not able to develop or commercialize one or more of the products subject to this agreement. However, upon successful commercialization of these products, the Company will pay I-VEN a royalty on net sales at agreed rates for a period of 5 years from the date of commercialization of each product. The first tranche advanced by I-VEN of Rs.985,388 (U.S.\$22,500 ) was received on March 28, 2005.

The amount received from I-VEN has been treated as an advance and is being recognized in the income statement as a credit to research and development expenses upon completion of specific milestones as detailed in the agreement. A milestone (i.e. a product filing as per the terms of the agreement) will be completed once the appropriate ANDA has been submitted to the U.S. FDA. Achievement of a milestone entitles the Company to take a credit to the research and development expenses in a fixed amount equal to I-VEN's share of the research and development costs of the product, which share varies depending on whether the ANDA is a Paragraph III or Paragraph IV filing. Accordingly, Rs.96,239 and Rs.384,488 has been recognized as a reduction to research and development expenses during the years ended March 31, 2005 and 2006 respectively.

**19. Borrowings from banks**

The Company had a line of credit of Rs.5,319,000 and Rs.10,760,000 as of March 31, 2005 and 2006, respectively from its bankers for working capital requirements. The line of credit is renewable annually. The credit bears interest at the prime rate of the banks, which averaged 10.25% and 10.5% for rupee borrowings and LIBOR+65 basis points for foreign currency borrowing during the years ended March 31, 2005 and 2006 respectively. As of March 31, 2005 and 2006, the Company had partly drawn down upon such facilities, for packing credit loans, cash credit and as temporary overdraft facilities, all of which are repayable within one year from the balance sheet date. These borrowings, except for the foreign currency packing credit loan, are secured by inventories, accounts receivable and certain property. The Company has an option to draw down the balance of the line of credit based on its requirements.

**20. Long-term debt**

Long-term debt consists of the following:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Rupee term loan	Rs. 31,065	Rs. 25,145
Euro loan		21,602,000
Obligation under capital lease		235,748
	31,065	21,862,893
Less: Current portion		
- Rupee term loan	5,920	5,920
- Euro loan		900,083
- Obligation under capital lease		19,758
	5,920	925,761
Non Current Portion		
- Rupee term loan	25,145	19,225
- Euro Loan		20,701,917
- Obligation under capital lease transaction		215,990

Rs. 25,145      Rs. 20,937,132

Rupee term loan represents a loan from Indian Renewable Energy Development Agency Limited which is secured by way of hypothecation of specific movable assets pertaining to the Company's solar grid interactive power plant located in Bachupally, Hyderabad.

Euro loan represents a loan from Citibank, N.A., Hong Kong to fund the acquisition of beta Holding GmbH during the year, which is guaranteed by the Company and its wholly owned subsidiaries, OOO DRL, DRLI and DRL U.K. The agreement places limitations on the Company's ability to incur additional debt and incur capital expenditure.

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**20. Long-term debt (continued)**

Further, the Company is also subject to certain financial covenants which includes maintenance of financial ratios as defined in the Facility Agreement. Such financial ratio requirements include Consolidated Net Debt to Consolidated EBITDA of not more than 4 times, which will decrease to not more than 3 times by March 31, 2008. The Company is also required to maintain a Consolidated EBITDA to Consolidated Interest Expense of not less than 4 times and Consolidated Free Cash Flow to Consolidated Debt Service of not less than 2 times, which ratios will decrease to not less than 1.5 times after March 31, 2009.

As of March 31, 2006, the Company was in compliance with such financial covenants.

An interest rate profile of long-term debt is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Foreign currency loan notes	4%	4.8%	
Rupee term loan	2%	2.0%	2.0%
			EURIBOR + 150
Euro loan			bps

A maturity profile of the long-term debt outstanding as of March 31, 2006 is as follows:

Maturing in the year ending March 31,	Rupee loan	Euro loan	Capital lease	Total
2007	5,920	900,083	19,758	925,761
2008	5,920	3,600,333	19,761	3,626,014
2009	5,920	3,600,333	19,761	3,626,014
2010	5,920	6,300,583	19,761	6,326,264
2011	1,465	7,200,668	19,761	7,221,894
Thereafter			136,946	136,946
	25,145	21,602,000	235,748	21,862,893

The fair value of outstanding payments on the Rupee term loan were Rs.23,573 and Rs.19,953 as of March 31, 2005 and 2006. The fair value of outstanding payments on the Euro loans were Rs.21,602,000 as of March 31, 2006.

**21. Shareholders equity***Equity shares and dividend*

The Company presently has only one class of equity shares. For all matters submitted to vote in the shareholders meeting, every holder of equity shares, as reflected in the records of the Company on the date of the shareholders meeting shall have one vote in respect of each share held.

Indian statutes mandate that the dividends shall be declared out of the distributable profits only after the transfer of up to 10% of net income computed in accordance with current regulations to a general reserve. Should the Company declare and pay dividends, such dividends will be paid in Indian rupees to each holder of equity shares in proportion to the number of shares held by him to the total equity shares outstanding as on that date. Indian statutes on foreign exchange govern the remittance of dividend outside India.

In the event of liquidation of the affairs of the Company, all preferential amounts, if any, shall be discharged by the Company. The remaining assets of the Company, after such discharge, shall be distributed to the holders of equity shares in proportion to the number of shares held by them.



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**21. Shareholders equity (continued)**

Dividends on common stock are recorded as a liability at the point of their approval by the shareholders in the annual general meeting. The shareholders approved and the Company paid dividends (including dividend tax) of Rs.431,598, Rs.431,615 and Rs.436,368 during the years ended March 31, 2004, 2005 and 2006 respectively. The dividend per share was Rs.5.00, Rs.5.00 and Rs.5.00 during the years ended March 31, 2004, 2005 and 2006 respectively.

**22. Deferred revenue**

The Company had entered into an agreement with Novartis Pharma AG ( Novartis ), whereby it agreed to provide Novartis with an exclusive license to develop, promote, distribute, market and sell certain products to be further developed into drugs for the treatment of specified diseases. Pursuant to the terms of the agreement, during the fiscal year ended March 31, 2002, the Company received Rs.235,550 (U.S.\$5,000) as an up-front license fee. As the up-front license fee did not represent the culmination of a separate earning process, the up-front license fee had been deferred to be recognized in accordance with the Company s accounting policy proportionately upon the receipt of stated milestones payments. The agreement with Novartis for the further development of the compound expired on May 30, 2004 and Novartis has determined to discontinue further development and, accordingly, the Company recognized the entire amount of deferred revenue of Rs.235,550 (U.S.\$5,000) as license fees during the fiscal year ended March 31, 2005.

The Company had entered into a licensing arrangement with Novo Nordisk A/S in February 1997, whereby the Company had licensed two molecule compounds for further development and conducting clinical trials. Under the arrangement, the Company received a non-refundable upfront license fee upon signing of the agreement and was also entitled to receive certain additional non-refundable payments upon the achievement of certain defined milestones. As of March 31, 2004, the Company had unamortized non-refundable upfront license fees of Rs.52,832 (U.S.\$1,273) on account of the second molecule compound. On October 22, 2004, Novo Nordisk announced that it had suspended clinical trials on both compounds due to unsatisfactory results. Accordingly, the Company has recognized the entire amount of deferred revenue of Rs.52,832 (U.S.\$1,273) as license fees during the fiscal year ended March 31, 2005.

The Company has entered into certain dossier sales, licensing and supply arrangements in Europe and Japan. These arrangements include certain performance obligations and based on an evaluation that these obligations are not inconsequential or perfunctory, the Company has deferred the upfront payments of Rs.33,757 received towards these arrangements. These amounts will be recognized in the income statement in the period in which the Company completes all its performance obligations.

Upon completion of all its performance obligation for some of the contracts, the Company recognized an amount of Rs. Nil, Rs.7,355 and Rs.47,521 in the income statement during the years ended March 31, 2004, 2005 and 2006 respectively. The balance amounts aggregating Rs.58,255 and Rs.56,466 as of March 31, 2005 and 2006 respectively, represent the deferred revenue relating to these arrangements.

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**23. Employee stock incentive plans**

*Dr. Reddy s Employees Stock Option Plan-2002 (the DRL 2002 Plan ):*

The Company instituted the DRL 2002 Plan for all eligible employees in pursuance of the special resolution approved by the shareholders in the Annual General Meeting held on September 24, 2001. The DRL 2002 Plan covers all employees of DRL and all employees and directors of its subsidiaries. Under the DRL 2002 Plan, the Compensation Committee of the Board (the Compensation Committee ) shall administer the DRL 2002 Plan and grant stock options to eligible employees of the Company and its subsidiaries. The Compensation Committee shall determine the employees eligible for receiving the options, the number of options to be granted, the exercise price, the vesting period and the exercise period. The vesting period is determined for all options issued on the date of the grant.

The DRL 2002 Plan was amended on July 28, 2004 at the annual general meeting of shareholders to provide for stock option grants in two categories:

Category A: 1,721,700 stock options out of the total of 2,295,478 reserved for grant of options having an exercise price equal to the fair market value of the underlying equity shares on the date of grant; and

Category B: 573,778 stock options out of the total of 2,295,478 reserved for grant of options having an exercise price equal to the par value of the underlying equity shares (i.e., Rs.5 per option).

The DRL 2002 Plan was further amended on July 27, 2005 at the annual general meeting of shareholders to provide for stock option grants in two categories:

Category A: 300,000 stock options out of the total of 2,295,478 reserved for grant of options having an exercise price equal to the fair market value of the underlying equity shares on the date of grant; and

Category B: 1,995,478 stock options out of the total of 2,295,478 reserved for grant of options having an exercise price equal to the par value of the underlying equity shares (i.e., Rs.5 per option).

The fair market value of a share on each grant date falling under Category A above is defined as the average closing price for 30 days prior to the grant in the stock exchange where there is highest trading volume during that period. Notwithstanding the foregoing, the Compensation Committee may, after obtaining the approval of the shareholders in the annual general meeting, grant options with a per share exercise price other than fair market value and par value of the equity shares.

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**23. Employee stock incentive plans (continued)**

Stock option activity under the DRL 2002 Plan in the two categories of options (i.e. fair market value and par value options) was as follows:

<b>Category A Fair Market Value Options</b>		<b>Fiscal Year ended March 31, 2004</b>		
	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	543,871	Rs. 884-1,063.02	Rs. 995.42	56
Granted during the year	423,300	883-1,396	934.44	62
Expired / forfeited during the year	(53,132)	883-1,063.02	962.54	
Exercised during the year	(3,001)	911-1,063.02	1,013.12	
Outstanding at the end of the year	911,038	883-1,396	968.95	66
Exercisable at the end of the year	315,068	Rs. 884-1,063.02	Rs. 976.15	45

<b>Category A Fair Market Value Options</b>		<b>Fiscal Year ended March 31, 2005</b>		
	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	911,038	Rs. 883-1,396	Rs. 968.95	66
Granted during the year	466,500	747-885	872.82	82
Expired / forfeited during the year	(352,657)	765-1,063.02	918.84	
Surrendered by employees during the year in exchange of category B options	(725,931)	747-1,396	928.07	
Exercised during the year				
Outstanding at the end of the year	298,950	747-1149	977.31	50
Exercisable at the end of the year	188,538	Rs. 883-1,149	Rs. 996.54	35

<b>Category A Fair Market Value Options</b>		<b>Fiscal Year ended March 31, 2006</b>		
			<b>Weighted- average</b>	<b>Weighted- average remaining</b>

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>exercise price</b>	<b>contractual life (months)</b>
Outstanding at the beginning of the year	298,950	Rs. 747-1,149	Rs. 977.31	50
Granted during the year	32,500	725	725	81
Expired / forfeited during the year	(46,700)	725-1,149	994.35	
Surrendered by employees during the year	(90,000)	977.30-1,063.02	1,034.45	
Exercised during the year	(77,500)	883-977.30	943.84	
Outstanding at the end of the year	117,250	725-1,063.02	878.85	64
Exercisable at the end of the year	37,882	Rs. 725-1,063.02	Rs. 943.85	45

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<b>Category B Par Value Options</b>		<b>Fiscal Year ended March 31, 2005</b>		
	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year				
Granted during the year				
In exchange for category A surrendered options	280,873	Rs. 5	Rs. 5	84
New options	102,650	5	5	84
Forfeited during the year	(3,974)	5	5	
Exercised during the year				
Outstanding at the end of the year	379,549	Rs. 5	Rs. 5	84
Exercisable at the end of the year				

<b>Category B Par Value Options</b>		<b>Fiscal Year ended March 31, 2006</b>		
	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted- average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	379,549	Rs. 5	Rs. 5	84
Granted during the year	216,860	5	5	81
Forfeited during the year	(133,304)	5	5	
Exercised during the year	(98,121)	5	5	
Outstanding at the end of the year	364,984	5	5	81
Exercisable at the end of the year	18,136	Rs. 5	Rs. 5	59

The weighted average grant date fair value of options granted under the DRL 2002 Plan at fair market value during the years ended March 31, 2004, 2005 and March 31, 2006 was Rs. 410.50, Rs.377.60 and Rs.293.42 respectively. The weighted average grant date fair value for options granted under the DRL 2002 Plan at par value during the years ended March 31, 2005 and March 31, 2006 was Rs.707.40 and Rs.705.88 respectively.

*Aurigene Discovery Technologies Ltd. Employee Stock Option Plan* (the Aurigene ESOP Plan ):

In fiscal 2004, Aurigene Discovery Technologies Limited ( Aurigene ), a consolidated subsidiary, adopted the Aurigene ESOP Plan to provide for issuance of stock options to employees. Aurigene has reserved 4,550,000 of its

ordinary shares for issuance under this plan. Under the Aurigene ESOP Plan, stock options may be granted at a price per share as may be determined by the Compensation Committee. The options vest at the end of three years from the date of grant of option.

Stock option activity under the Aurigene ESOP Plan was as follows:

**Fiscal Year ended March 31, 2004**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted-average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year				
Granted during the year	200,000	Rs. 10	Rs. 10	65
Expired / forfeited during the year	(30,812)	10	10	
Outstanding at the end of the year	169,188	Rs. 10	Rs. 10	65
Exercisable at the end of the year				

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**23. Employee stock incentive plans (continued)****Fiscal Year ended March 31, 2005**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted-average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	169,188	Rs. 10	Rs. 10	65
Granted during the year	342,381	10	10	61
Expired / forfeited during the year	(314,391)	10	10	
Outstanding at the end of the year	197,178	Rs. 10	Rs. 10	59
Exercisable at the end of the year				

**Fiscal Year ended March 31, 2006**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted-average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	197,178	Rs. 10	Rs. 10	59
Granted during the year	500,000	10	10	70
Expired / forfeited during the year	(168,271)	10	10	
Outstanding at the end of the year	528,907	Rs. 10	Rs. 10	67
Exercisable at the end of the year				

The weighted average grant date fair value for options granted under the Aurigene ESOP Plan during the years ended March 31, 2004, 2005 and March 31, 2006 was Rs. 4.82, Rs.4.29 and Rs.4.01 respectively.

*Aurigene Discovery Technologies Ltd. Management Group Stock Grant Plan* (the Management Plan ):

In fiscal 2004, Aurigene adopted the Management Plan to provide for issuance of stock options to management employees of Aurigene and its subsidiary Aurigene Discovery Technologies Inc. Aurigene has reserved 2,950,000 ordinary shares for issuance under this plan. Under the Management Plan, stock options may be granted at a price per share as may be determined by Aurigene's compensation committee. The options vest on the date of grant of the options.

Stock option activity under the Management Plan was as follows:

**Fiscal Year ended March 31, 2004**

**Weighted-  
average**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted-average exercise price</b>	<b>remaining contractual life (months)</b>
Outstanding at the beginning of the year				
Granted during the year	783,333	Rs. 10	Rs. 10	77
Expired during the year	(166,667)	10	10	
Outstanding at the end of the year	616,666	Rs. 10	Rs. 10	77
Exercisable at the end of the year	616,666	Rs. 10	Rs. 10	77
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**23. Employee stock incentive plans (continued)****Fiscal Year ended March 31, 2005**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted-average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	616,666	Rs. 10	Rs. 10	77
Granted during the year	616,667	10	10	73
Expired during the year	(1,133,333)	10	10	
Outstanding at the end of the year	100,000	Rs. 10	Rs. 10	65
Exercisable at the end of the year	100,000	Rs. 10	Rs. 10	65

**Fiscal Year ended March 31, 2006**

	<b>Shares arising out of options</b>	<b>Range of exercise prices</b>	<b>Weighted-average exercise price</b>	<b>Weighted- average remaining contractual life (months)</b>
Outstanding at the beginning of the year	100,000	Rs. 10	Rs. 10	65
Granted during the year				
Expired during the year	(100,000)	10	10	

Outstanding at the end of the year

Exercisable at the end of the year

The weighted average grant date fair value for options granted under the Aurigene Management Plan during the fiscal year ended March 31, 2004 and 2005 was Rs. 4.25 and Rs.3.76 respectively.

**24. Allowances for sales returns**

Product sales are net of allowances for sales returns. The activity in the allowance for sales returns is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Balance at the beginning of the year	Rs. 89,026	Rs. 99,919	Rs. 95,123
Acquired during the year			51,251
Additional provision	169,511	105,245	239,462
Sales returns charged to the provision	(158,618)	(110,041)	(217,480)
Balance at the end of the year	Rs. 99,919	Rs. 95,123	Rs. 168,356

**25. Other (expense)/income, net**

Other (expense)/ income consists of the following:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Interest expense	Rs. (14,970)	Rs. (103,027)	Rs. (298,603)
Interest income	421,763	374,928	717,410
Gain / (loss) on sale of available for sale securities, net	24,786	64,997	(3,924)
Other	104,330	117,339	118,723
	Rs. 535,909	Rs. 454,237	Rs. 533,606

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**26. Shipping costs**

Selling, general and administrative expenses include shipping and handling costs of Rs.557,969, Rs.642,508 and Rs.823,883 for the years ended March 31, 2004, 2005 and 2006 respectively.

**27. Income taxes**

Income taxes consist of the following:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Pre-tax income			
Domestic	Rs. 3,021,098	Rs. 562,343	Rs. 2,144,176
Foreign	(481,060)	(455,314)	(256,853)
	Rs. 2,540,038	Rs. 107,029	Rs. 1,887,323
Income tax benefit / (expense) attributable to continuing operations:			
Current taxes:			
Domestic	Rs. (202,364)	Rs. (250)	Rs. (279,466)
Foreign	(1,752)	(1,053)	(34,081)
	(204,116)	(1,303)	(313,547)
Deferred taxes:			
Domestic	20,126	190,087	(48,503)
Foreign	114,741	(94,507)	103,660
	134,867	95,580	55,157
	Rs. (69,249)	Rs. 94,277	Rs. (258,390)
Deferred tax benefit / (expense) attributable to other comprehensive income	Rs. (3,873)	Rs. 5,206	Rs. 35,079

The reported income tax expense differed from amounts computed by applying the enacted tax rates to income / (loss) before income taxes as a result of the following:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Income before income taxes and minority interest	Rs. 2,540,038	Rs. 107,029	Rs. 1,887,323
Enacted tax rate in India	35.875%	36.5925%	33.66%
Computed expected tax benefit / (expense)	Rs. (911,239)	Rs. (39,164)	Rs. (635,272)

Effect of:			
Differences between Indian and foreign tax rates	(2,325)	13,362	(8,546)
Valuation allowance	(149,805)	(254,243)	(142,206)
In-process technology written-off		(110,771)	
Expenses not deductible for tax purposes	(39,149)	(36,552)	(67,403)
ESOP cost not deductible for tax purpose	(43,831)	(52,694)	(54,614)
Income exempt from income taxes	856,317	333,310	538,151
Foreign exchange (loss) / gain	64,008	(5,300)	8,335
Incremental deduction allowed for research and development expenses	172,259	254,245	166,308
Indexation of capital assets	907	8,275	1,413
Tax rate change	12,111	(9,466)	12,534
Minimum alternate tax	(639)	(3,910)	(3,019)
Resolution of prior period tax matters			(73,970)
Others	(27,863)	(2,815)	(101)
Income tax benefit / (expense)	Rs. (69,249)	Rs. 94,277	Rs. (258,390)

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**27. Income taxes (continued)**

The tax effects of significant temporary differences that resulted in deferred tax assets and liabilities and a description of the items that create these differences is given below:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Deferred tax assets:		
Inventory	Rs. 62,644	47,407
Deferred revenue	5,868	7,957
Minimum Alternate Tax		140,400
Accounts payable	46,300	47,655
Investments	93,762	169,737
Operating loss carry-forward	874,187	1,320,961
Capital loss carry forward	36,890	44,622
Expenses deferred for tax purposes		
Research and development expenses	52,026	47,787
Employee costs	62,009	34,062
Legal costs	66,647	33,269
Start-up costs	42,138	37,460
Others	31,824	15,464
Other current liabilities	96,265	179,178
	1,470,560	2,125,959
Less: Valuation allowance	(781,392)	(923,598)
Deferred tax assets	689,168	1,202,361
Deferred tax liabilities		
Property, plant and equipment	(876,483)	(824,174)
Intangible assets	(134,054)	(6,425,661)
Investment securities	(14,094)	(12,964)
Others	(45,518)	(162,691)
Deferred tax liabilities	(1,070,149)	(7,425,490)
Net deferred tax assets / (liabilities)	(380,981)	(6,223,129)
Deferred charges	66,123	50,705
	Rs. (314,858)	Rs. (6,172,424)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets and tax loss carry forwards is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. Management considers the scheduled reversal of the projected future taxable income and tax planning strategy in making this assessment. Based on the level of historical taxable income and projections for future taxable incomes over the periods in which the deferred tax assets are deductible,

management believes that it is more likely than not the Company will realize the benefits of those deductible differences and tax loss carry forwards, net of the existing valuation allowances. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

Operating loss carry forward comprises business losses and unabsorbed depreciation. The period for which such losses can be carried forward differs from five years to indefinite.

The Company has during the year, set up a full valuation allowance against the deferred tax asset on account of tax effect of operating and capital losses carry forward and other net deferred tax assets of AMPNH, RNBV, RPI, RANV, RPS, RBL, RCSA, DRSA, DRFBL, Reddy US and others amounting to Rs.108,850 as the management based on future profit projections believes that the likelihood of not realizing these deferred tax assets is more likely than not.

Valuation allowance has been created with regard to operating losses and other net deferred tax assets arising out of ADTL, ADLINC, RUSTI amounting to Rs.33,356 as these subsidiaries specializes in research activities and the Company believes that the likelihood of not realizing these deferred tax assets is more likely than not.

Income exempt from tax represents export earnings exempt for tax purposes and earnings derived from units set up in backward areas for which the Company is eligible for tax concessions under the local laws.

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**27. Income taxes (continued)**

Incremental deduction allowed for research and development expenses represents tax incentive provided by the government of India for carrying out such activities.

As of March 31, 2006 the Company had operating and capital loss carry-forward of Rs.3,558,808 that expires as follows:

	<b>Rs. 000</b>
<b>Expiring in the year ending March 31,</b>	
2007	21,931
2008	217,651
2009	14,576
2010	
2011	
Thereafter (2012 - 2024)	1,007,767
Thereafter (indefinite)	2,296,883
	<b>Rs. 3,558,808</b>

Operating loss carry forward includes unabsorbed depreciation of Rs.107,832, which can be carried forward indefinitely. Further, as of March 31, 2006 the Company had capital loss carry forward of Rs.176,422 that expires on March 31, 2013 and Rs.22,430 that expires on March 31, 2014 and the valuation allowance has been created for the same.

Undistributed earnings of the Company's foreign subsidiaries and unrecognized deferred tax liability on the same amounted to approximately Rs.245,906 Rs.273,274, Rs.307,012 and Rs.88,219, Rs.100,163, Rs.103,340 as of March 31, 2004, 2005 and 2006 respectively. Such earnings are considered to be indefinitely reinvested and, accordingly no provision for income taxes has been recorded on the undistributed earnings.

**28. Earnings per share**

A reconciliation of the equity shares used in the computation of basic and diluted earnings per equity share is set out below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Basic earnings per equity share - weighted average number of equity shares outstanding	76,513,764	76,518,949	76,546,658
Effect of dilutive equivalent shares-stock options outstanding	35,834	40,852	155,265
Diluted earnings per equity share - weighted average number of equity shares outstanding	76,549,598	76,559,801	76,701,923

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**29. Employee benefit plans**

*Gratuity benefits:* In accordance with applicable Indian laws, the Company provides for gratuity, a defined benefit retirement plan (the Gratuity Plan) covering certain categories of employees. The Gratuity Plan provides a lump sum payment to vested employees, at retirement or termination of employment, an amount based on the respective employee's last drawn salary and the years of employment with the Company. Effective September 1, 1999, the Company established Dr. Reddy's Laboratories Gratuity Fund (the Gratuity Fund). Liabilities with regard to the Gratuity Plan are determined by an actuarial valuation, based upon which the Company makes contributions to the Gratuity Fund. Trustees administer the contributions made to the Gratuity Fund. The amounts contributed to the Gratuity Fund are invested in specific securities as mandated by law and generally consist of federal and state government bonds and the debt instruments of government-owned corporations.

In respect of certain other employees of the Company, the gratuity benefit is provided through annual contribution to separate funds managed by the Life Insurance Corporation of India (LIC) and ICICI Prudential Life Insurance Company Limited (ICICI Pru). Under this scheme, the settlement obligation remains with the Company, although the LIC and ICICI Pru administer the funds and determine the contribution premium required to be paid by the Company.

The following table sets out the funded status of the Gratuity Plan and the amounts recognized in the Company's financial statements:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
<b>Change in the benefit obligations</b>		
Projected Benefit Obligations (PBO) at the beginning of the year	Rs. 147,309	Rs. 200,039
Service cost	20,379	26,926
Interest cost	10,217	15,255
Actuarial (gain)/ loss	34,362	(14,384)
Benefits paid	(12,228)	(19,800)
 PBO at the end of the year	 Rs. 200,039	 Rs. 208,036
<b>Change in plan assets</b>		
Fair value of plan assets at the beginning of the year	Rs. 130,939	Rs. 127,122
Actual return on plan assets	(26,003)	11,066
Employer contributions	34,414	101,882
Benefits paid	(12,228)	(19,800)
 Plan assets at the end of the year	 Rs. 127,122	 Rs. 220,270
<b>Funded status</b>	Rs. (72,917)	12,234
Unrecognized actuarial loss	92,014	68,560
Unrecognized transitional obligation	12,146	
 <b>Net amount recognized</b>	 Rs. 31,243	 Rs. 80,794

Amounts recognized in the statement of financial position consist of:

**Fiscal Year ended March 31,**  
**2005**                      **2006**

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Prepaid benefit cost	Rs. 35,231	Rs. 85,991
Accrued benefit liability	(3,988)	(5,197)
<b>Net amount recognized</b>	<b>Rs. 31,243</b>	<b>Rs. 80,794</b>

The accumulated benefit obligation for the Gratuity Plan was Rs.105,931 and Rs.112,873 as at March 31, 2005 and 2006 respectively.

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**29. Employee benefit plans (continued)***Components of net periodic benefit cost:*

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Service cost	Rs. 16,061	Rs. 20,379	Rs. 26,926
Interest cost	8,992	10,217	15,255
Expected return on plan assets	(8,831)	(10,468)	(9,211)
Amortization of transition obligation / (assets)	770	770	12,146
Recognized net actuarial (gain) / loss	881	288	7,215
Net amount recognized	Rs. 17,873	Rs. 21,186	Rs. 52,331

*Summary of the actuarial assumptions:* The actuarial assumptions used in accounting for the Gratuity Plan are:  
Weighted-average assumptions used to determine benefit obligations:

	<b>As at March 31,</b>	
	<b>2005</b>	<b>2006</b>
Discount rate	8.0%	8%
Rate of compensation increase	7.0%	8% per annum for first 5 years and 6% per annum thereafter.

Weighted-average assumptions used to determine net periodic benefit cost:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Discount rate	8.0%	8.0%	8.0%
Rate of compensation increase	12.0% for first year and 7.0% thereafter	7.0%	8.0% per annum for first 5 years and 6.0% per annum thereafter
Expected long-term return on plan assets	8.0%	7.5%	7.5%

The expected long-term return on plan assets is based on the expectation of the average long-term rate of return expected to prevail over the next 15 to 20 years on the types of investments prescribed as per the statutory pattern of investment.

*Plan assets:* The Company's gratuity plan weighted-average asset allocations at March 31, 2005 and 2006, by asset category are as follows:

	<b>Fiscal Year ended March 31,</b>	
	<b>2005</b>	<b>2006</b>
Debt	100%	63%
Funds managed by LIC		37%

*Contributions:* The Company expects to contribute Rs.10,098 to its gratuity plan during the year ending March 31, 2007

*Estimated future benefit payments:* The following benefit payments are expected to be paid:

Fiscal Year ended March 31,	
2007	Rs. 18,828
2008	20,166
2009	25,495
2010	23,692
2011	27,513
2012 to 2015	174,756

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**29. Employee benefit plans (continued)**

*Superannuation benefits:* Apart from being covered under the Gratuity Plan described above, the senior officers of the Company also participate in a superannuation, a defined contribution plan administered by the LIC. The Company makes annual contributions based on a specified percentage of each covered employee's salary. The Company has no further obligations under the plan beyond its annual contributions. The Company contributed Rs.24,192, Rs.26,994 and Rs.24,832 to the superannuation plan during the years ended March 31, 2004, 2005 and 2006 respectively.

*Provident fund benefits:* In addition to the above benefits, all employees receive benefits from a provident fund, a defined contribution plan. Both the employee and employer each make monthly contributions to the plan each equal to 12% of the covered employee's salary. The Company has no further obligations under the plan beyond its monthly contributions. The Company contributed Rs.58,685, Rs.64,223 and Rs.64,443 to the provident fund plan during the years ended March 31, 2004, 2005 and 2006 respectively.

*Pension plan:* All the employees of Falcon are governed by a Defined Benefit Plan in the form of pension plan. The pension plan provides a payment to vested employees at retirement or termination of their employment. This payment is based on the employee's integrated salary and is paid in the form of a monthly pension over a period of 20 years computed based on a predefined formula. Liabilities with regard to the pension plan are determined by an actuarial valuation, based upon which the Company makes contributions to the pension plan fund. This fund is administered by a third party who is provided guidance by a technical committee formed by senior employees of the Company.

The following table sets out the funded status of the Falcon pension plan and the amounts recognized in the Company's financial statements:

	<b>As of March 31, 2006</b>
<b>Change in the benefit obligations</b>	
Projected Benefit Obligations (PBO) as on January 1, 2006	Rs. 275,001
Service cost	4,173
Interest cost	3,490
Actuarial (gain)/ loss	892
Benefits paid	
Inflationary effect over initial balance	2,383
 PBO at the end of the year	 285,939
<b>Change in plan assets</b>	
Fair value of plan assets at the beginning of the year	246,173
Actual return on plan assets	2,947
Employer contributions	
Benefits paid	
Inflationary effect over initial balance	2,134
 Plan assets at the end of the year	 251,254
 <b>Funded status</b>	 (34,685)
Unrecognized actuarial gain	(711)

<b>Net amount recognized</b>	Rs.	(35,396)
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Amounts recognized in the statement of financial position consist of:

		<b>As of March 31,</b>
		<b>2006</b>
Accrued benefit liability	Rs.	(35,396)
<b>Net amount recognized</b>	Rs.	(35,396)

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**29. Employee benefit plans (continued)***Components of net periodic benefit cost:*

	<b>Fiscal Year ended March 31,</b>
	<b>2006</b>
Service cost	Rs. 4,137
Interest cost	3,460
Expected return on plan assets	(3,725)
Cost price inflation index adjustment over net periodic pension cost	43
Net periodic pension cost adjusted by cost price inflation index	Rs. 3,915

*Summary of the actuarial assumptions:* The actuarial assumptions used in accounting for the Falcon pension plan are:  
Weighted-average assumptions used to determine benefit obligations:

	<b>As at March 31,</b>
	<b>2006</b>
Discount rate	5.25%
Rate of compensation increase	0.75%
Weighted-average assumptions used to determine net periodic benefit cost:	

	<b>Fiscal Year ended March</b>
	<b>31, 2006</b>
Discount rate	5.25%
Rate of compensation increase	2.00%
Expected long-term return on plan assets	7.75%
Inflation rate of fiscal year	0.87%

*Plan assets:* The Company's pension plan weighted-average asset allocations, by asset category are as follows:

	<b>Fiscal Year ended March 31,</b>
	<b>2006</b>
Equity	27%
Debt	73%

*Estimated future benefit payments:* The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Fiscal Year ended March 31,	
2007	Rs. 23,473
2008	28,118
2009	28,490
2010	26,143
2011	28,391
2012 to 2017	150,502



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**30. Related party transactions**

The Company has entered into transactions with the following related parties:

Diana Hotels Limited for availing hotel services

AR Chlorides for availing processing services of raw materials and intermediates

Dr. Reddy s Holdings Private Limited for purchase and sale of active pharmaceutical ingredients and intermediates

Madras Diabetes Research Foundation for undertaking research on behalf of the Company

Dr. Reddy s Heritage Foundation for purchase of services

SR Enterprises for transportation services

Manava Seva Dharma Samvardhani Trust for social contribution to which the Company has made contribution.

The directors of the Company have either a significant ownership interest, controlling interest or exercise significant influence over these entities ( significant interest entities ).

The Company has carried out transactions with its two affiliates, Perlecan Pharma and Reddy Kunshan. These transactions are in the nature of reimbursement of research and development expenses by Perlecan Pharma and the purchase of active pharmaceutical ingredients by the Company from Reddy Kunshan. The Company has also entered into transactions with employees, directors of the Company and their relatives.

One of the Company s executives and U.S. general counsel, hired on July 15, 2002, is a partner of a law firm that the Company engages for provision of legal services. Legal fees paid by the Company to the concerned law firm were Rs.423,137, Rs.468,758 and Rs.466,567 during the years ended March 31, 2004, 2005 and 2006 respectively.

The following is a summary of significant related party transactions:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Purchases from:			
Significant interest entities	Rs. 59,889	Rs. 45,239	Rs. 182,870
Affiliates	107,801	39,278	5,410
Sales to:			
Significant interest entities	1,185	1,055	32,255
Lease rental paid under cancelable operating leases to:			
Directors and their relatives	16,891	17,144	18,927
Administrative expenses paid to:			
Significant interest entities	4,793	4,649	7,401

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**30. Related party transactions (continued)**

The Company has the following amounts due from related parties:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Significant interest entities		Rs. 6,084
Directors and their relatives	Rs. 3,680	4,380
Employee loans (interest free)	18,199	7,537
Affiliates		234,541
	Rs. 21,879	Rs. 252,542

The Company has the following amounts due to related parties:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
Significant interest entities	Rs. 16,397	Rs. 18,958
Payable towards legal fees	123,106	131,392
Directors and their relatives		1,328
	Rs. 139,503	Rs. 151,678

As of March 31, 2006, the required repayments of employee loans are given below:

Repayable in the year ending March 31:	
2007	Rs. 5,735
2008	1,448
2009	296
2010	58
2011	
Thereafter	
	Rs. 7,537

**31. Commitments and Contingencies**

*Capital Commitments:* As of March 31, 2005 and 2006, the Company had committed to spend approximately Rs.192,161 and Rs.744,006 respectively, under agreements to purchase property and equipment. The amount is net of capital advances paid in respect of such purchases.

*Guarantees:* In accordance with the provisions of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others, the Company recognizes the fair value of guarantee and indemnification arrangements issued or modified by the Company, if these arrangements are within the scope of that Interpretation. In addition, under previously existing generally accepted accounting principles, the Company continues to monitor the conditions that are subject to the guarantees and indemnifications to identify whether it is probable that a loss has occurred, and would recognize any such losses under the guarantees and indemnifications when those losses are estimable.



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**31. Commitments and Contingencies (continued)**

On December 14, 2001, in order to enable the Company's affiliate Pathnet India Private Limited ( Pathnet ) to secure a credit facility of Rs.250,000 from ICICI Bank Ltd. ( ICICI Bank ), the Company issued a corporate guarantee amounting to Rs.122,500 in favor of ICICI Bank. Pathnet was an equity investee accounted for by the equity method. During the fiscal year ended March 31, 2006, the Company sold its stake in Pathnet and settled the guarantee by paying ICICI Bank Rs.21,000, representing the Company's share of the loan amount then outstanding. The Company's payment was determined based on its share of the outstanding guarantees of Pathnet's credit facility.

KRRP secured a credit facility of Rs.32,000 from Citibank, N.A. ( Citibank ). To enhance the credit standing of KRRP the Company issued during the fiscal year ended March 31, 2006, a corporate guarantee amounting to Rs.45,000 in favor of Citibank. The guarantee is required to be renewed every year and the liability of the Company may arise in case of non-payment or non-performance of other obligations of KRRP under its credit facility agreement with Citibank. As of March 31, 2006, it is not probable that the Company will be required to make payments under the guarantee. Accordingly, no liability has been accrued for a loss related to the Company's obligation under this guarantee arrangement.

*Litigations / Contingencies:* The Company manufactures and distributes Norfloxacin, a formulations product. Under the Drugs Prices Control Order (the DPCO ), the government of India has the authority to designate a pharmaceutical product as a specified product and fix the maximum selling price for such product. In 1995, the government of India notified Norfloxacin as a specified product and fixed the maximum selling price. In 1996, the Company filed a statutory Form III before the government of India for the upward revision of the price and a legal suit in the Andhra Pradesh High Court (the High Court ) challenging the validity of the notification on the grounds that the applicable rules of the DPCO were not complied with while fixing the ceiling price. The High Court had earlier granted an interim order in favor of the Company, however it subsequently dismissed the case in April 2004. The Company filed a review petition in the High Court in April 2004 which was also dismissed by the High Court in October 2004. Subsequently the Company appealed to the Supreme court of India by filing a Special Leave Petition. The appeal is currently pending with the Supreme Court.

During the fiscal year ended March 31, 2006 the Company received a notice from the Government of India demanding the recovery of the price the Company charged for norfloxacin in excess of the maximum selling price fixed by the government of India, amounting to Rs.284,984 including interest thereon. The Company filed a writ petition in the High Court challenging the government of India's demand order. The High Court has admitted the writ petition and granted an interim order, however it ordered the Company to deposit 50% of the principal amount claimed by the Government of India, which amounts to Rs.77,149. The Company deposited this amount with the Government of India on November 14, 2005 while it awaits the outcome of its appeal with the Supreme Court. The Company has provided fully against the potential liability in respect of the principal amount demanded and believes that the possibility of any liability that may arise on account of interest and penalty is remote. In the event that the Company is unsuccessful in the litigation in the Supreme Court, it will be required to remit the sale proceeds in excess of the maximum selling price to the Government of India and penalties or interest if any, the amounts of which are not readily ascertainable.

During the fiscal year ended March 31, 2003, the Central Excise Authorities of India (the Authorities ) issued a demand notice on one of the Company's vendors with regard to the assessable value of its products supplied to the Company. The Company has been named as a co-defendant in the notice. The Authorities demanded payment of Rs.175,718 from the vendor including a penalty of Rs.90,359. The Authorities, through the same notice, issued a penalty claim of Rs.70,000 against the Company.

During the fiscal year ended March 31, 2005, the Authorities issued an additional notice on the vendor demanding Rs.225,999 from the vendor including a penalty of Rs.51,152. The Authorities, through the same notice, issued a penalty claim of Rs.6,500 against the Company. Further, during the fiscal year ended March 31, 2006, the Authorities issued an additional notice on the vendor demanding payment of Rs.33,549. The Company has filed

appeals against these notices.

The Indian Council for Environmental Legal Action filed a writ in 1989 under Article 32 of the Constitution of India against the Union of India and others in the Supreme Court of India for the safety of people living in the Patancheru and Bollaram areas of Medak district of Andhra Pradesh. The Company has been named in the list of polluting industries.

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**31. Commitments and Contingencies (continued)**

In 1996, the Andhra Pradesh District Judge proposed that the polluting industries compensate farmers in the Patancheru, Bollaram and Jeedimetla areas for discharging effluents which damaged the farmers' agricultural land. The compensation was fixed at Rs.1.3 per acre for dry land and Rs.1.7 per acre for wet land over the following three years. Accordingly, the Company has paid a total compensation of Rs.2,013. The matter is still pending in the courts and the possibility of additional liability is remote. The Company would not be able to recover the compensation paid, even if the decision of the court is in its favor.

Additionally, the Company is also involved in other lawsuits, claims, investigations and proceedings, including patent and commercial matters, which arise in the ordinary course of business. However, there are no such matters pending that the Company expects to be material in relation to its business.

**32. Segment reporting and related information**

*a) Segment information*

The Chief Operating Decision Maker ( CODM ) evaluates the Company's performance and allocates resources based on an analysis of various performance indicators by product segments. The product segments and the respective performance indicators reviewed by the CODM are as follows:

Formulations Revenues by therapeutic product category; Gross profit

Active pharmaceutical ingredients and intermediates Gross profit, revenues by geography and revenues by key products;

Generics Gross profit;

Critical care and biotechnology Gross profit;

Drug discovery Revenues and expenses.

Custom pharmaceutical services Gross profit; and

The CODM of the Company does not review the total assets for each reportable segment. The property and equipment used in the Company's business, depreciation and amortization expenses, are not fully identifiable with/ allocable to individual reportable segments, as certain assets are used interchangeably between segments. The other assets are not specifically allocable to the reportable segments. Consequently, management believes that it is not practicable to provide segment disclosures relating to total assets since allocation among the various reportable segments is not possible.

**Table of Contents****DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(in thousands, except share data and where otherwise stated)****32. Segment reporting and related information (continued)***Formulations*

Formulations, also referred to as finished dosages, consist of finished pharmaceutical products ready for consumption by the patient. An analysis of revenues by therapeutic category of the formulations segment is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Gastro-intestinal	Rs. 1,624,811	Rs. 1,740,087	Rs. 2,252,528
Pain control	1,386,362	1,540,665	1,873,921
Cardiovascular	1,444,055	1,494,701	1,707,223
Anti-infectives	1,013,595	1,001,797	1,118,631
Dermatology	313,076	338,016	427,165
Others	1,732,039	1,526,753	2,535,664
	Rs. 7,513,938	Rs. 7,642,019	Rs. 9,915,132
Intersegment revenues <sup>1</sup>	19,519	17,702	40,426
Adjustments <sup>2</sup>	(25,979)	163,192	(29,603)
Total revenues	Rs. 7,507,478	Rs. 7,822,913	Rs. 9,925,955
Cost of revenues	2,450,906	2,280,473	3,024,070
Intersegment cost of revenues <sup>3</sup>	211,182	259,727	242,080
Adjustments <sup>2</sup>	(84,424)	(47,397)	(182,012)
	Rs. 2,577,664	Rs. 2,492,803	Rs. 3,084,138
Gross profit	4,871,369	5,119,521	6,689,408
Adjustments <sup>2</sup>	58,445	210,589	152,409
	Rs. 4,929,814	Rs. 5,330,110	Rs. 6,841,817

- (1) Intersegment revenues comprises transfers to the active pharmaceutical ingredients and intermediates segment and is accounted for at cost to the

transferring  
segment.

- (2) The adjustments represent reconciling items to conform the segment information to U.S. GAAP. Such adjustments primarily relate to elimination of sales made to subsidiaries and other adjustments.
- (3) Intersegment cost of revenues is comprised of transfers from the active pharmaceutical ingredients and intermediates segment to formulations and is accounted for at cost to the transferring segment.

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**Table of Contents****DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(in thousands, except share data and where otherwise stated)****32. Segment reporting and related information (continued)***Active pharmaceutical ingredients and intermediates*

Active pharmaceutical ingredients and intermediates, also known as active pharmaceutical products or bulk drugs, are the principal ingredients for formulations. Active pharmaceutical ingredients and intermediates become formulations when the dosage is fixed in a form ready for human consumption such as a tablet, capsule or liquid using additional inactive ingredients.

An analysis of gross profit for the segment is given below.

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Revenues from external customers	Rs. 6,973,891	Rs. 5,946,765	Rs. 7,448,681
Intersegment revenues <sup>1</sup>	602,060	742,294	1,064,816
Adjustments <sup>2</sup>	52,552	255,469	(275,440)
 Total revenues	 Rs. 7,628,503	 Rs. 6,944,528	 Rs. 8,238,057
 Cost of revenues	 Rs. 4,666,757	 Rs. 4,499,140	 5,462,935
Intersegment cost of revenues <sup>3</sup>	19,519	17,702	40,426
Adjustments <sup>2</sup>	416,082	496,713	413,239
	Rs. 5,102,358	Rs. 5,013,555	Rs. 5,916,600
 Gross profit	 Rs. 2,889,675	 Rs. 2,172,217	 Rs. 3,010,135
Adjustments <sup>2</sup>	(363,530)	(241,244)	(688,679)
	Rs. 2,526,145	Rs. 1,930,973	Rs. 2,321,456

(1) Intersegment revenues comprises transfers to formulations, generics and custom pharmaceutical services and is accounted for at cost to the transferring segment.

(2) The adjustments represent

reconciling items to conform the segment information to U.S. GAAP. Such adjustments primarily relate to elimination of sales made to subsidiaries and other adjustments.

- (3) Intersegment cost of revenues is comprised of transfers from the formulations segment to active pharmaceutical ingredients and intermediates segment and is accounted for at cost to the transferring segment.

An analysis of revenue by geography is given below:

	Fiscal Year ended March 31,		
	2004	2005	2006
North America	Rs. 1,902,922	Rs. 1,848,963	Rs. 1,654,953
India	2,160,297	1,988,134	2,302,434
Europe	1,626,890	1,091,190	1,420,930
Others	1,983,551	2,032,258	2,865,743
	7,673,660	6,960,545	8,244,060
Adjustments <sup>1</sup>	(45,157)	(16,017)	(6,003)
	Rs. 7,628,503	Rs. 6,944,528	Rs. 8,238,057

<sup>(1)</sup> The adjustments represent reconciling items to conform the segment information to U.S. GAAP. Such adjustments primarily relate to elimination of sales made to subsidiaries and other adjustments.

**Table of Contents****DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(in thousands, except share data and where otherwise stated)****32. Segment reporting and related information (continued)**

An analysis of revenues by key products is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Ciprofloxacin hydrochloride	Rs. 959,773	Rs. 619,112	Rs. 778,458
Ramipril	1,314,164	783,362	642,538
Terbinafine HCl	124,923	194,482	537,155
Ibuprofen	394,634	460,490	502,263
Sertraline hydrochloride	178,537	138,158	494,101
Ranitidine HCl Form 1 & 2	711,445	734,265	552,845
Naproxen sodium	437,339	470,044	380,409
Naproxen	233,835	229,553	374,997
Atorvastatin	211,192	252,466	321,139
Montelukast	29,825	52,626	241,090
Losartan potassium	214,231	180,528	172,682
Sparfloxacin	197,055	117,520	168,200
Nizatidine	159,592	216,757	160,857
Clopidogrel	140,310	79,586	139,941
Dextromethorphan HBr	182,775	165,836	134,884
Others	2,138,873	2,249,743	2,636,498
Total	Rs. 7,628,503	Rs. 6,944,528	Rs. 8,238,057

*Generics*

Generics are generic finished dosages with therapeutic equivalence to branded formulations. The Company entered the global generics market during the fiscal year ended March 31, 2001 with the export of ranitidine 75mg and oxaprozin to the United States. The Company's acquisition of beta Holding during the year ended March 31, 2006 has been assigned to this segment.

An analysis of gross profit for the segment is given below.

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Revenues	Rs. 4,337,525	Rs. 3,577,421	Rs. 4,055,764
Less:			
Cost of revenues	989,125	1,222,401	1,464,479
Intersegment cost of revenues <sup>1</sup>	335,342	397,969	704,321
	1,324,467	1,620,370	2,168,800
Gross Profit	Rs. 3,013,058	Rs. 1,957,051	Rs. 1,886,964

<sup>(1)</sup> Intersegment cost of revenues comprises transfers from the active pharmaceutical ingredients and intermediates segment to the generics segment and is accounted for at cost to the transferring segment.



**Table of Contents****DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES  
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An analysis of revenues by key products for the fiscal years ended March 31, 2004, 2005, and 2006 is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Omeprazole	Rs. 325,304	Rs. 434,090	Rs. 786,341
Fluoxetine	1,825,546	857,927	381,265
Amlodipine	7,797	200,459	384,411
Ranitidine	205,799	194,003	235,621
Ibuprofen	183,973	198,666	251,430
Ciprofloxacin	28,057	196,010	158,158
Others	1,761,049	1,496,266	1,858,538
	Rs. 4,337,525	Rs. 3,577,421	Rs. 4,055,764

*Critical care and biotechnology*

Diagnostic pharmaceuticals and equipment and specialist products are produced and marketed by the Company primarily for anti-cancer and critical care. An analysis of gross profit for the diagnostics, critical care and biotechnology segment is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Revenues	Rs. 411,028	Rs. 527,108	Rs. 691,074
Cost of revenues <sup>1</sup>	206,974	176,534	235,869
Gross profit	Rs. 204,054	Rs. 350,574	Rs. 455,205

- (1) Intersegment cost of revenues comprises transfers from the active pharmaceutical ingredients and intermediates segment to the critical care and biotechnology segment and is accounted for at cost to the transferring segment.

*Drug discovery*

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The Company is involved in drug discovery through the research facilities located in the United States and India. The Company commercializes drugs discovered with other products and also licenses these discoveries to other companies. An analysis of the revenues and expenses of the drug discovery segment is given below:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Revenues	Rs.	Rs. 288,382	
		Rs. 288,382	
Research and development expenses	Rs. 729,434	Rs. 868,992	Rs. 814,485

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share data and where otherwise stated)

**32. Segment reporting and related information (continued)***Custom pharmaceutical services ( CPS )*

Custom pharmaceutical services operations relate to the manufacture and sale of active pharmaceutical ingredients and steroids in accordance with the customer's requirements. The Company's acquisition of Falcon, Roche's manufacturing facility in Mexico, during the year ended March 31, 2006 has been assigned to this segment.

An increase in the revenues of custom pharmaceutical services business coupled with the acquisition of Falcon has resulted in disclosure of CPS as a separate segment. Segment data for the previous periods has been reclassified on a comparable basis. In earlier periods the result of CPS business was grouped under Others in segment information.

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Revenues	Rs. 113,094	Rs. 311,574	Rs. 1,326,828
Less:			
Cost of revenues	2,213		829,302
Intersegment cost of revenues <sup>1</sup>	55,339	82,559	118,415
Adjustments			51,717
	57,552	82,559	999,434
Gross Profit	Rs. 55,542	Rs. 229,015	Rs. 327,394

- (1) Intersegment cost of revenues comprises transfers from the active pharmaceutical ingredients and intermediates segment to the custom pharmaceutical services and is accounted for at cost to the transferring segment.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
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**32. Segment reporting and related information (continued)**

(1) The adjustments represent reconciling items to conform the segment information with U.S. GAAP. Such adjustments primarily relate to deferral of up-front non-refundable license fees.

*a) Reconciliation of segment information to entity total*

	<b>Fiscal Year ended March 31, 2004</b>		<b>Fiscal Year ended March 31, 2005</b>		<b>Fiscal Year ended March 31, 2006</b>	
	<b>Revenues</b>	<b>Gross profit</b>	<b>Revenues</b>	<b>Gross profit</b>	<b>Revenues</b>	<b>Gross profit</b>
Formulations	Rs. 7,507,478	Rs. 4,929,814	Rs. 7,822,913	Rs. 5,330,110	Rs. 9,925,955	Rs. 6,841,817
Active pharmaceutical ingredients and intermediates	7,628,503	2,526,145	6,944,528	1,930,973	8,238,057	2,321,456
Generics	4,337,525	3,013,058	3,577,421	1,957,051	4,055,764	1,886,964
Critical care and biotechnology	411,028	204,054	527,108	350,574	691,074	455,205
Drug discovery			288,382	288,382		
Custom pharmaceutical services	113,094	55,542	311,573	229,015	1,326,828	327,394
Others	105,894	37,654	47,441	47,441	29,369	16,798
	Rs. 20,103,522	Rs. 10,766,267	Rs. 19,519,366	Rs. 10,133,546	Rs. 24,267,047	Rs. 11,849,634

*b) Analysis of revenue by geography*

The Company's business is organized into five key geographic segments. Revenues are attributable to individual geographic segments based on the location of the customer.

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
India	Rs. 7,143,798	Rs. 6,693,042	Rs. 8,272,468
North America	5,319,160	4,349,191	3,983,860
Russia and other countries of the former Soviet Union	2,285,838	2,782,171	3,559,477
Europe	2,788,648	2,868,233	4,326,366
Others	2,566,078	2,826,729	4,124,876
	Rs. 20,103,522	Rs. 19,519,366	Rs. 24,267,047

*c) Analysis of property, plant and equipment by geography*

Property, plant and equipment (net) attributed to individual geographic segments are given below:

	<b>As of March 31,</b>	
	<b>2005</b>	<b>2006</b>
India	Rs. 6,723,966	Rs. 7,063,595
North America	157,549	1,511,068



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Russia and other countries of the former Soviet Union	34,681	30,118
Europe	122,449	468,314
Others	19,663	13,236
	Rs. 7,058,308	Rs. 9,086,331

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share data and where otherwise stated)

**33. Other operating (income)/ expense, net**

Other operating (income)/ expense consists of the following:

	<b>Fiscal Year ended March 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
(Profit) / loss on sale of property, plant and equipment	Rs. 29,319	Rs. (1,810)	Rs. (320,361)
Loss on sale of subsidiary interest	58,473	8,122	
Other	(4,584)	343	
	Rs. 83,208	Rs. 5,969	Rs. (320,361)

The above profit on sale of property, plant and equipment for the fiscal 2006 includes an amount of Rs.387,337 on account of sale of one of the manufacturing facilities of the Company in Goa.

**34. Subsequent event (Unaudited)**

On July 28, 2006, the members of the Company approved a one-for-one stock dividend on the equity shares of the Company. Consequently the authorised capital of the Company was increased from Rs.500,000 as of March 31, 2006 to Rs.1,000,000 effective July 28, 2006. The stock dividend has the nature of a stock split with one additional share being issued for every share held. The additional share of common stock was distributed to shareholders of record on August 30, 2006.

Information pertaining to shares and earnings per share has not been restated in the consolidated financial statements and notes to the consolidated financial statements to reflect this change in capital structure. This information will be presented in the Company's September 30, 2006 interim condensed financial statements when this change in capital structure becomes effective. Information on a unaudited pro forma basis, reflecting the impact of the stock dividend on the earning per share for the fiscal years ended March 31, 2004, 2005 and 2006 is as follows:

	<b>Fiscal Year ended March 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2006</b>
				Convenience translation into U.S.\$
Net income	2,474,153	211,248	1,628,857	36,620
Earnings per equity share:				
Basic	16.17	1.38	10.64	0.24
Diluted	16.16	1.38	10.62	0.24
Weighted average number of equity shares used in computing earnings per equity share:				
Basic	153,027,528	153,037,898	153,093,316	153,093,316
Diluted	153,099,196	153,119,602	153,403,846	153,403,846
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**ITEM 19. EXHIBITS**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
1.1.*/**	Memorandum and Articles of Association of the Registrant dated February 4, 1984.
1.2.*/**	Certificate of Incorporation of the Registrant dated February 24, 1984.
1.3.*/**	Amended Certificate of Incorporation of the Registrant dated December 6, 1985.
2.1.*	Form of Deposit Agreement, including the form of American Depositary Receipt, among Registrant, Morgan Guaranty Trust Company as Depositary, and holders from time to time of American Depositary Receipts Issued there under, including the form of American Depositary.
4.1.*	Agreement by and between Dr. Reddy s Laboratories Limited and Dr. Reddy s Research Foundation regarding the undertaking of research dated February 27, 1997.
4.2.**	Dr. Reddy s Laboratories Limited Employee Stock Option Scheme, 2002.
4.3****	Sale and Purchase Agreement Regarding the Entire Share Capital of Beta Holding GmbH dated February 15 <sup>th</sup> /16 <sup>th</sup> 2006
8.	List of subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm
99.1	Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
99.2	Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
99.3	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.4	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*	Previously filed on March 26, 2001 with the SEC along with Form F-1
**	Previously filed on October 31, 2002 with the SEC along with Form S-8.

\*\*\* Previously filed  
with the  
Company's Form  
20-F for the  
fiscal year  
ended  
March 31, 2003.

\*\*\*\* Portions of  
exhibit have  
been omitted  
and filed  
separately with  
the SEC  
pursuant to a  
request for  
confidential  
treatment.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

For Dr. Reddy's Laboratories Limited,

By: /s/ G.V. Prasad

G.V. Prasad  
Executive Vice Chairman and CEO

For Dr. Reddy's Laboratories Limited,

By: /s/ Saumen Chakraborty

Saumen Chakraborty  
Chief Financial Officer

Hyderabad, India  
October 2, 2006