DR REDDYS LABORATORIES LTD
Form 6-K
September 26, 2005

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 6-K
REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13A-16 OR 15D-16
UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended June 30, 2005
Commission File Number 1-15182

DR. REDDY S LABORATORIES LIMITED
(Translation of registrant s name into English)
7-1-27, Ameerpet
Hyderabad, Andhra Pradesh 500 016, India
+91-40-23731946

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.
Form 20-F þ Form 40-F o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): __________

Note: Regulation S-T Rule 101(b)(1) only permits the submission in paper of a Form 6-K if submitted solely to provide an attached annual report to security holders.

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): __________

Note: Regulation S-T Rule 101(b)(7) only permits the submission in paper of a Form 6-K if submitted to furnish a report or other document that the registrant foreign private issuer must furnish and make public under the laws of the jurisdiction in which the registrant is incorporated, domiciled or legally organized (the registrant s home country), or under the rules of the home country exchange on which the registrant s securities are traded, as long as the report or other document is not a press release, is not required to be and has not been distributed to the registrant s security holders, and, if discussing a material event, has already been the subject of a Form 6-K submission or other Commission filing on EDGAR.

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No þ

If Yes is marked, indicate below the file number assigned to registrant in connection with Rule 12g3-2(b): 82-__________.

TABLE OF CONTENTS

Table of Contents

QUARTERLY REPORT
Quarter Ended June 30, 2005

Currency of Presentation and Certain Defined Terms

In this Quarterly Report, references to $ or dollars or U.S.$ 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 a particular fiscal year are to our fiscal year ended March 31 of such year. Reference to ADS are to our American Depository Shares, to the FASB means the Financial Accounting Standards Board, to SFAS means Statements of Financial Accounting Standards, to SAB means Staff Accounting Bulletin and to the EITF means the Emerging Issues Task Force.

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. Dr. Reddy s is a registered trademark of Dr. Reddy s Laboratories Limited in India. With respect to other trademarks or trade names used in this Quarterly Report, some are registered trademarks in our name and some 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 June 30, 2005 for cable transfers in Indian rupees as certified for customs purposes by the Federal Reserve Bank of New York, which was Rs.43.51 per U.S.$1.00. 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. 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, is not part of this quarterly report and no portion of such information is incorporated herein.

Forward-Looking and Cautionary Statement

IN ADDITION TO HISTORICAL INFORMATION, THIS QUARTERLY 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 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 SECTION ENTITLED OPERATING AND FINANCIAL REVIEW AND ELSEWHERE IN THIS REPORT. READERS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS, WHICH REFLECT OUR ANALYSIS ONLY AS OF THE DATE HEREOF. IN ADDITION, READERS SHOULD CAREFULLY REVIEW THE INFORMATION IN OUR PERIODIC REPORTS AND OTHER DOCUMENTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION (SEC) FROM TIME TO TIME.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data and where otherwise stated)

	As of March 31, 2005		As of June 30, 2005		2005 Convenience translation into U.S.$ Unaudited	
ASSETS						
Current assets:						
Cash and cash equivalents	Rs.	9,287,864	Rs.	10,363,949	U.S.$	238,197
Investment securities		310,887		160,691		3,693
Accounts receivable, net of allowances		3,587,289		3,932,885		90,390
Inventories		3,499,606		3,670,004		84,349
Deferred income taxes		236,931		225,776		5,189
Other current assets		1,430,256		1,686,398		38,759
Total current assets		18,352,833		20,039,703		460,577
Property, plant and equipment, net		7,058,308		7,027,790		161,521
Investment securities		995,431		1,015,501		23,339
Goodwill and intangible assets		2,588,381		2,575,010		59,182
Other assets		293,407		283,708		6,521
Total assets	Rs.	29,288,360	Rs.	30,941,712	U.S.$	711,140
LIABILITIES AND STOCKHOLDERS EQUITY						
Current liabilities:						
Borrowings from banks	Rs.	2,796,330	Rs.	3,917,866	U.S.$	90,045
Current portion of long-term debt		5,920		5,920		136
Trade accounts payable		1,415,648		1,838,497		42,255
Accrued expenses		2,375,087		2,468,301		56,730
Other current liabilities		988,937		547,706		12,588
Total current liabilities		7,581,922		8,778,290		201,753
Long-term debt, excluding current portion		25,145		23,665		544
Deferred income taxes		551,789		613,460		14,099
Other liabilities		176,345		190,524		4,379
Total liabilities	Rs.	8,335,201	Rs.	9,605,939	U.S.$	220,775
Stockholders equity:						
Equity shares at Rs.5 par value; 100,000,000 shares authorized; Issued and outstanding; 76,518,949	Rs.	382,595	Rs.	382,695	U.S.$	8,796

shares and 76,538,949 shares as of March 31, 2005 and June 30, 2005 respectively					
Additional paid-in capital		10,089,152	10,103,623		232,214
Equity-options outstanding		400,749	429,668		9,875
Retained earnings		10,009,305	10,356,622		238,029
Equity shares held by a controlled trust: 41,400 shares		(4,882)	(4,882)		(112)
Accumulated other comprehensive income		76,240	68,048		1,564
Total stockholders equity		20,953,159	21,335,774		490,365
Total liabilities and stockholders equity	Rs.	29,288,360	Rs. 30,941,712	U.S.$	711,140

See accompanying notes to the unaudited condensed consolidated financial statements.

3

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATION
(in thousands, except share data and where otherwise stated)

	Three months ended June 30, 2004		2005		2005 Convenience Translation into U.S.$ Unaudited	
Revenues:						
Sales, net of allowances for sales returns (includes excise duties of Rs.235,741, and Rs.300,124 for the three months ended June 30, 2004, and 2005 respectively)	Rs.	4,856,032	Rs.	5,573,819	U.S.$	128,104
License fees		251,860		13,383		308
		5,107,892		5,587,202		128,412
Cost of revenues		2,482,351		2,662,865		61,201
Gross profit		2,625,541		2,924,337		67,211
Operating expenses:						
Selling, general and administrative expenses		1,645,050		1,956,008		44,955
Research and development expenses		525,408		514,694		11,829
Amortization expenses		88,607		95,599		2,197
Foreign exchange (gain)/loss		322,657		65,756		1,511
Total operating expenses		2,581,722		2,632,057		60,493
Operating income		43,819		292,280		6,718
Equity in loss of affiliates		(11,389)		(14,504)		(333)
Other (expense)/income, net		111,698		142,156		3,267
Income before income taxes and minority interest		144,128		419,932		9,651
Income tax (expense)/benefit		24,630		(72,507)		(1,666)
Minority interest		4,664		(108)		(2)
Net income	Rs.	173,422	Rs.	347,317	U.S.$	7,982
Earnings per equity share						
Basic		2.27		4.54		0.10
Diluted		2.27		4.53		0.10
Weighted average number of equity shares used in computing earnings per equity share						
Basic		76,518,949		76,532,575		76,532,575
Diluted		76,518,949		76,662,175		76,662,175

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME
(in thousands, except share data and where otherwise stated)

Equity Shares		Additional		Equity Shares held by a Controlled Trust		Accumulated Other	Equity	
No. of shares	Amount	Paid In Capital	Comprehensive Income	No. of Shares	Amount	Comprehensive Income	options outstanding	Retained Earnings
6,518,949	Rs. 382,595	Rs. 10,089,152		41,400	Rs. (4,882)	Rs. 76,240	Rs. 400,749	Rs. 10,009,305
20,000	100	14,471					(14,471)	
			Rs. 347,317					347,317
			(19,550)			(19,550)		
			11,358			11,358		
			Rs. 339,125					
							43,390	
6,518,949	Rs. 382,695	Rs. 10,103,623		41,400	Rs. (4,882)	Rs. 68,048	Rs. 429,668	Rs. 10,356,622
	U.S.$ 8,796	U.S.$ 232,214			U.S.$ (112)	U.S.$ 1,564	U.S.$ 9,875	U.S.$ 238,029

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, except share data and where otherwise stated)

	Three months ended June 30, 2004	Three months ended June 30, 2005	2005 Convenience translation into U.S.$ (unaudited)
Cash flows from operating activities:			
Net income	Rs. 173,422	Rs. 347,317	U.S.$ 7,982
Adjustments to reconcile net income to net cash from operating activities:			
Deferred tax expense / (benefit)	(26,720)	72,507	1,666
Gain on sale of available for sale securities, net	(31,407)	(13,164)	(303)
Depreciation and amortization	295,778	369,692	8,497
Deferred revenue	(235,550)	15,923	366
Loss/(profit) on sale of property, plant and equipment	(25)	36,913	848
Equity in loss of affiliates.	11,389	14,504	333
Unrealized exchange (gain)/loss on remeasurement	237,530	51,018	1,173
Interest receivable on investment	(16,145)	(4,937)	(113)
Employees stock based compensation	23,796	43,390	997
Minority interest	(4,664)	108	2
Changes in operating assets and liabilities:			
Accounts receivable	(196,719)	(421,178)	(9,680)
Inventories	(253,173)	(192,687)	(4,429)
Other assets	(101,462)	(327,635)	(7,530)
Trade accounts payable	(116,830)	492,604	11,322
Accrued expenses	125,542	95,279	2,190
Other liabilities	304,189	(377,485)	(8,676)
Net cash provided by operating activities	188,951	202,169	4,647
Cash flows from investing activities:			
Expenditure on property, plant and equipment, net of proceeds from sale	(465,007)	(294,766)	(6,775)
Purchase of investment securities, net of proceeds from sale	(1,350,030)	161,320	3,708
Expenditure on intangible assets	(504,893)	(90,814)	(2,087)
Net cash used in investing activities	(2,319,930)	(224,260)	(5,154)
Cash flows from financing activities:			
Proceeds from / (repayment of) borrowing from banks, net	1,926,108	1,135,649	26,101
Repayment of long-term debt	(153,036)	(1,480)	(34)
Net cash provided by/(used in) financing activities	1,773,072	1,134,169	26,067

Effect of exchange rate changes on cash		116,184		(35,993)		(827)
Net increase / (decrease) in cash and cash equivalents during the period		(241,723)		1,076,085		24,732
Cash and cash equivalents at the beginning of the period		4,376,235		9,287,864		213,465
Cash and cash equivalents at the end of the period	Rs.	4,134,512	Rs.	10,363,949	U.S.$	238,197
Supplemental disclosures:						
Cash paid for:						
Interest (net of interest capitalized)	Rs.	46,903	Rs.	98,337	U.S.$	2,254
Income taxes		8,296				
Supplemental schedule of non-cash investing activities:						
Property, plant and equipment purchased on credit during the year		63,734		8,012		184

See accompanying notes to the unaudited condensed consolidated financial statements.

6

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share data and where otherwise stated)

1. Basis of preparation of financial statements

The accompanying unaudited interim condensed consolidated balance sheets as of June 30, 2005, and consolidated statements of income and statements of cash flows for the three months ended June 30, 2004 and 2005, have been prepared on substantially the same basis as the audited financial statements for the year ended March 31, 2005, and include all adjustments consisting only of normal recurring adjustments necessary for a fair presentation of the financial information set forth herein. The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States 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.

2. Interim information

These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Annual Report on Form 20-F for the year ended March 31, 2005. The results of the interim periods are not necessarily indicative of results to be expected for the full fiscal year.

3. Convenience translation

The accompanying unaudited interim consolidated financial statements have been prepared in Indian rupees. Solely for the convenience of the reader, the financial statements as of June 30, 2005 have been translated into United States dollars at the noon buying rate in New York City on June 30, 2005 for cable transfers in Indian rupees, as certified for customs purposes by the Federal Reserve Bank of New York of U.S.$1 = Rs.43.51 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.

4. Stock based compensation

Dr. Reddy s Laboratories Limited (the Company or DRL) 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. As a result, if other assumptions had been used in the current period, stock-based compensation expense could have been materially impacted. Furthermore, if management uses 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:

	Three months ended June 30,	
	2004	2005
Dividend yield	0.5%	0.5%
Expected life	42-78 months	12-78 months
Risk free interest rates	4.5 - 6.8%	4.5 - 7.1%
Volatility	44.5 - 50.7%	26.4 - 50.7%

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

4. Stock based compensation (continued)

Dividend yield assumption has not been considered for determining the fair value in respect of options given by the subsidiaries, as these companies are not listed and have not declared dividends.

At June 30, 2005, the Company had three stock-based employee compensation plans, which are described more fully in Note 10, including two stock based employee compensation plans in Aurigene Discovery Technologies Ltd. The Company has accounted for these plans under SFAS 123, using the Black-Scholes option pricing model to determine the fair value of each option grant.

5. Acquisition of 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 the 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, and accordingly the transaction did not meet the definition of a business combination.

The total purchase consideration has 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	Rs. 86,619
In-Process technology	Rs. 277,343

The Company has expensed the amount allocated towards in-process technology, being research and development projects having no future alternate uses as research and development expenses. The Core-technology rights and licenses and marketing rights have been capitalized as intangible assets to be amortized over the period over which the intangible assets are expected to contribute directly or indirectly to the future cash flows.

Table of Contents

**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(CONTINUED)
(in thousands, except share data and where otherwise stated)**

6. Deferred revenue

The Company had, pursuant to an agreement entered into with Novartis Pharma AG (Novartis), 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 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. The agreement with Novartis for the further development of the compound expired on May 30, 2004 and Novartis has decided 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 three months ended June 30, 2004.

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 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 obligations for some of the contracts, the Company recognized income of Rs.13,383 in the income statement during the quarter ended June 30, 2005. The balance, aggregating to Rs.73,466, represents the deferred revenue relating to these arrangements.

7. Goodwill and intangible assets

On April 1, 2002, the Company adopted SFAS No. 142, Goodwill and Other Intangible Assets. Adoption of SFAS No. 142 did not result in reclassification of existing goodwill and intangible assets.

As required by SFAS No. 142, the Company identified its reporting units and assigned assets and liabilities, including goodwill to the reporting units on the date of adoption. Subsequently, the Company compared the fair value of the reporting unit to its carrying value including goodwill, to determine whether goodwill is impaired at the date of adoption. This transitional impairment evaluation did not indicate an impairment loss.

Subsequent to the adoption of SFAS No. 142, the Company does not amortize goodwill but tests goodwill for impairment at least annually. The carrying value of the goodwill (including the goodwill arising on investment in affiliate of Rs.181,943) and net other intangible assets on the date of adoption was Rs.1,473,605 and Rs.1,276,397 respectively.

Trademarks, marketing know-how, customer related intangibles and non-compete arrangements are amortized over the expected benefit period or the legal life, whichever is lower.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

7. Goodwill and intangible assets (continued)

The following table presents the changes in goodwill during the year ended March 31, 2005 and three months ended June 30, 2005:

	Year ended March 31, 2005	Three months ended June 30, 2005
Balance at the beginning of the period	Rs. 1,704,492	Rs. 1,743,442
Acquired during the period	38,950	90,823
Balance at the end of the period	Rs. 1,743,442	Rs. 1,834,265

During the quarter ended June 30, 2005, the Company released the balance of the escrow amount relating to the contingent consideration payable for its acquisition of Dr. Reddy s Laboratories (EU) Limited (formerly BMS Laboratories Limited) and its consolidated subsidiary, Dr. Reddy s Laboratories (U.K.) Limited (formerly Meridian Healthcare Limited), amounting to Rs.81,133, as the contingency related to certain legal and tax matters was resolved.

The following table presents acquired and amortized intangible assets as at March 31, 2005 and June 30, 2005:

	As of March 31, 2005		As of June 30, 2005	
	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Trademarks	Rs. 2,570,242	Rs. 1,833,303	Rs. 2,559,144	Rs. 1,909,907
Core-technology rights	132,753		132,753	
Non-compete arrangements	111,289	98,602	109,653	99,108
Marketing know-how	80,000	80,000	80,000	80,000
Marketing rights	94,852	3,659	94,421	7,803
Customer related intangibles	125,156	73,908	118,612	76,557
Others	8,027	5,965	7,607	6,128
	Rs. 3,122,319	Rs. 2,095,437	Rs. 3,102,190	Rs. 2,179,503

The aggregate amortization expense for the three months ended June 30, 2004 and 2005 was Rs.88,607 and Rs.95,599 respectively.

Estimated amortization expense for the next five years with respect to such assets is as follows:

For the year ended March 31,	
2006	Rs. 213,544
2007	271,446
2008	196,928
2009	69,430
2010	18,907
Thereafter	152,432

Total	Rs. 922,687

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

7. Goodwill and intangible assets (continued)

The intangible assets (net of amortization) as of June 30, 2005 have been allocated to the following segments:

	Formulations	Active Pharmaceutical Ingredients and Intermediates	Generics	Drug Discovery	Total
Goodwill	Rs. 349,774	Rs. 997,025	Rs. 397,029	Rs. 90,437	Rs. 1,834,265
Trademarks	574,748		74,489		649,237
Core-technology rights			132,753		132,753
Non-compete arrangements			10,545		10,545
Customer related intangibles			42,055		42,055
Marketing rights			86,618		86,618
Others			1,479		1,479
	Rs. 924,522	Rs. 997,025	Rs. 744,968	Rs. 90,437	Rs. 2,756,952

The intangible assets (net of amortization) as of March 31, 2005 have been allocated to the following segments:

	Formulations	Active Pharmaceutical Ingredients and Intermediates	Generics	Drug Discovery	Total
Goodwill	Rs. 349,774	Rs. 997,025	Rs. 306,206	Rs. 90,437	Rs. 1,743,442
Trademarks	647,369		89,570		736,939
Core-technology rights			132,753		132,753
Non-compete arrangements			12,687		12,687
Customer related intangibles			51,248		51,248
Marketing rights			91,193		91,193
Others			2,062		2,062
	Rs. 997,143	Rs. 997,025	Rs. 685,719	Rs. 90,437	Rs. 2,770,324

8. Property, plant and equipment, net

Property, plant and equipment consist of the following:

	As of March 31, 2005	As of June 30, 2005
Land	Rs. 519,902	Rs. 527,642
Buildings	2,064,956	2,145,350
Plant and machinery	6,947,490	6,884,918
Furniture, fixtures and equipment	734,721	730,416
Vehicles	238,556	241,734

Computer equipment	429,266	433,375
Capital work-in-progress	567,974	460,080
	11,502,865	11,423,515
Accumulated depreciation	(4,444,557)	(4,395,725)
	Rs. 7,058,308	Rs. 7,027,790

Depreciation expense for the three months ended June 30, 2004 and 2005 was Rs.207,171 and Rs.274,093 respectively.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

9. Inventories

Inventories consist of the following:

	As of March 31, 2005	As of June 30, 2005
Raw materials	Rs. 1,008,729	Rs. 1,088,281
Stores and spares	316,915	318,601
Work-in-process	1,068,115	1,070,906
Finished goods	1,105,847	1,192,216
	Rs. 3,499,606	Rs. 3,670,004

During the three months ended June 30, 2004 and 2005, the Company recorded an inventory write-down of Rs.35,939 and Rs.57,312 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 cost of goods sold.

10. 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 and directors 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 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 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.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

10. Employee stock incentive plans (continued)

Stock option activity under the DRL 2002 Plan is as follows:

	Three months ended June 30, 2004					
	Shares arising out of options		Range of exercise prices		Weighted-average exercise price	Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	911,038	Rs.	883-1,396	Rs.	968.75	66
Granted during the period	411,600		885		885	72
Forfeited during the period	(17,030)		883-1063.02		918.49	
Exercised during the period						
Outstanding at the end of the period	1,305,608		883-1396		943.14	71
Exercisable at the end of the period	480,021	Rs.	883-1063.02	Rs.	964.13	48

Category A Fair Market Value Options	Three months ended June 30, 2005					
	Shares arising out of options		Range of exercise prices		Weighted-average exercise price	Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	298,950	Rs.	747-1149	Rs.	977.31	50
Granted during the period	32,500		725		725	90
Expired / forfeited during the period	(31,700)		747-1,147		1,053	
Surrendered by employees during the period	(90,000)		977.30-1,063.02		1,034	
Exercised during the period						
Outstanding at the end of the period	209,750		725-1,147		902.30	58
Exercisable at the end of the period	117,382	Rs.	883-1,149	Rs.	948.38	37

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

10. Employee stock incentive plans (continued)

Category B Par Value Options

	Three months ended June 30, 2005			
	Shares arising out of options	Range of exercise prices	Weighted-average exercise price	Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	379,549	Rs. 5	Rs. 5	84
Granted during the period	208,560	5	5	90
Forfeited during the period	(7,543)	5	5	
Exercised during the period	(20,000)	5	5	
Outstanding at the end of the period	560,566	Rs. 5	Rs. 5	85
Exercisable at the end of the period				

The weighted average grant date fair value for options granted under the DRL 2002 Plan at fair market value during the three months ended June 30, 2004 and 2005 was Rs.388.63 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 three months ended June 30, 2005 was Rs.703.07.

*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 Aurigene s 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:

	Three months ended June 30, 2004			
	Shares arising out of options	Range of exercise prices	Weighted-average exercise price	Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	169,188	Rs. 10	Rs. 10	65
Granted during the period	342,381	10	10	70
Forfeited during the period	(104,201)	10	10	

Outstanding at the end of the period	407,368	Rs.	10	Rs.	10	67
Exercisable at the end of the period						

	Three months ended June 30, 2005					
	Shares arising out of options	Range of exercise prices		Weighted-average exercise price		Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	197,178	Rs.	10	Rs.	10	59
Granted during the period						
Forfeited during the period	(46,979)		10		10	
Outstanding at the end of the period	150,199	Rs.	10	Rs.	10	56
Exercisable at the end of the period						

14

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

10. Employee stock incentive plans (continued)

*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:

	Three months ended June 30, 2004			
	Shares arising out of options	Range of exercise prices	Weighted-average exercise price	Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	616,666	Rs. 10	Rs. 10	77
Granted during the period	616,667	10	10	82
Forfeited during the period				
Outstanding at the end of the period	1,233,333	Rs. 10	Rs. 10	78
Exercisable at the end of the period	1,233,333	Rs. 10	Rs. 10	78

	Three months ended June 30, 2005			
	Shares arising out of options	Range of exercise prices	Weighted-average exercise price	Weighted-average remaining contractual life (months)
Outstanding at the beginning of the period	100,000	Rs. 10	Rs. 10	65
Granted during the period				
Forfeited during the period	(100,000)	Rs. 10	Rs. 10	
Outstanding at the end of the period				
Exercisable at the end of the period				

No options were granted during the three months ended June 30, 2005 under the Management Plan.

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

11. Employer 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 the 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.

The components of net periodic benefit cost for the three months ended June 30, 2004 and 2005 is as follows:

	Three months ended June 30,	
	2004	**2005**
Service cost	Rs. 5,095	Rs. 6,731
Interest cost	2,554	3,814
Expected return on plan assets	(2,617)	(2,303)
Amortization of transition Obligation / (Assets).	193	156
Recognized net actuarial (Gain) / Loss	72	1,804
Net amount recognized	Rs. 5,297	Rs. 10,202

12. Commitments and Contingencies

Capital Commitments: As of March 31, 2005 and June 30, 2005, the Company had committed to spend approximately Rs.192,161 and Rs.271,969 respectively, under agreements to purchase property and equipment. The amount is net of capital advances paid in respect of such purchases.

Guarantees: The Company 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 the Company recognize the fair value of guarantee and indemnification arrangements issued or modified by the Company after December 31, 2002, 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.

The Company has entered into a guarantee arrangement, which arose in transactions related to enhancing the credit standing and borrowings of its affiliate, Pathnet India Private Limited (Pathnet).

Pathnet, an equity investee accounted for by the equity method, secured a credit facility of Rs.250 million from ICICI Bank Ltd. (ICICI Bank). To enhance the credit standing of Pathnet, on December 14, 2001 the Company issued a corporate guarantee amounting to Rs.122.5 million in favor of ICICI Bank. In July 2005, the Company released by ICICI Bank from this guarantee when its share of the outstanding loan amount, Rs.21.0 million, was repaid.

16

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

12. Commitments and Contingencies (continued)

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. The Company has appealed to the Supreme court of India by filing a Special Leave Petition. The appeal is currently pending with the Supreme Court. However, in March 2005, the Company received a notice from the Government of India demanding the recovery of the price charged in excess of the ceiling price fixed by the Government of India including interest thereon. The Company believes that as the validity of the price notification is under dispute and the litigation is pending before the Supreme Court, the notice is not a final demand. As of March 31, 2005, the Company has provided an amount of Rs 183,605 representing the excess of the selling price over the maximum selling price fixed by the Government of India on sales through that date. During the quarter ended June 30, 2005 the Company has further provided an amount of Rs 1,749 representing the excess of the selling price over the maximum selling price fixed by the Government of India. Based on a legal evaluation, the Company has stopped charging excess price over the maximum selling price fixed by the Government of India, effective June 2005.

In October 2004, the Company signed an agreement to sell its equity shares in Biomed, Russia to KT&T, a Russian Company, for a total consideration of U.S.$5 million. Under the terms of the agreement, the transfer of shares was to be completed by September 30, 2005. Although a Moscow court had subsequently issued an order of injunction halting the transfer of shares, on appeal this order of injunction was vacated by the Moscow court and the order is no longer in effect.

During the 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 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 quarter ended June 30, 2005, the Authorities issued an additional notice on the vendor demanding Rs.33,549. The Company has filed appeals against these notices. Pending resolution of these appeals the ultimate liability of the Company is not ascertainable

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

12. Commitments and Contingencies (continued)

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 Bollarum areas of Medak district of Andhra Pradesh. The Company also has been named in the list of polluting industries.

In 1996, the Andhra Pradesh District Judge proposed that the polluting industries compensate farmers in the Patancheru, Bollarum 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.

13. 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;

Active pharmaceutical ingredients and intermediates Gross profit, revenues by geography and revenues by key products;

Generics Gross profit, and revenues by key products;

Critical care and biotechnology Gross Profit; and

Drug discovery Revenues and expenses.

The CODM of the Company does not review the total assets for each reportable segment. The property, plant 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.

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:

Table of Contents

DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(in thousands, except share data and where otherwise stated)

13. Segment reporting and related information (continued)

	Three months ended June 30, 2004	Three months ended June 30, 2005
Gastrointestinal	Rs. 488,042	Rs. 586,927
Pain Control	407,136	509,529
Cardiovascular	409,640	488,239
Anti-infectives	211,745	299,510
Dermatology	85,531	124,212
Others	380,272	713,071
	1,982,366	2,721,488
Intersegment revenues[1]	4,664	9,213
Adjustments[2]	(4,663)	(152,273)
Total revenues	1,982,367	2,578,428