



**Text of the speech delivered by Mr Dilip Shanghvi, Chairman and Managing Director of the Company, at the 14<sup>th</sup> Annual general meeting of the company held on Sept 20, 2006 in Vadodara**

Ladies and Gentlemen:

Welcome.

On behalf of the Board of Directors I take pleasure in welcoming you to the 14<sup>th</sup> AGM of your company.

**R&D Demerger**

This year, after your approval was received in June 2006, we took the first steps to demerge our innovative R&D business, comprising new molecule (or NCE) and new drug delivery system (or NDDS) research programs. As you know, this new company will be listed on the stock exchange on completion of regulatory formalities within the next few months. Innovation and process are different kinds of work and have different timeframes, outcomes and resource requirements. With this demerger we will allow the two companies to work in different businesses, so that the right focus and priority can be given to innovative projects that have the potential to earn revenues across international markets. This kind of demerger is a first for the Indian pharma sector.

Earlier in the year, we also began the process of integration of the manufacturing assets we had acquired with the controlled substance site in New Jersey, US and expect to begin the process of filing. At Karkhadi, near Baroda, we have now completed upgradation and created a totally new, international class facility for sterile and non-sterile cephalosporin dosage forms and active manufacturing site.

**I'd like to share select highlights of 2005-06 for the consolidated entity:**

- Revenues up 47%
- Net profit is up 45% to Rs. 5733 million.
- International operations accounted for 40% of revenues
- Formulations were 84% of revenues, which is in line with our objective of remaining a formulations driven company
- Net margins at 32%, continued to be amongst the highest in the sector

**Environment and challenges**

While those of us in the Indian pharma sector have always prided ourselves on strong chemistry and formulation skills, I believe the past year aligned the Indian pharma sector even more with international developments.

**India**

The Rs.28000 crore market in India continues to be quite competitive, with 16%+ growth rate that places it amongst the fastest growing markets in the world, with multiple challenges. As we



move into the second year of a newly implemented patent system, we have yet to see any major impact in the Indian market. While the Indian market continued to grow, the government is still formulating its revised drug policy. On a positive note, the strong competition in the Indian market has prepared companies to compete in intensely competitive markets, such as the US generic market.

### **International**

In line with a trend that has been evident for quite some time now, across the world, international markets are moving towards tighter regulatory norms and a close watch on costs in order to keep healthcare spending under check. In most markets this watch on costs is balanced with government moves to promote the growth of indigenous industry with preferential purchase. Such a move would favor high quality speciality products that offer the same quality as the innovator brands, but at a sensible price.

The USD 28 billion US generic market, where over 55% of the prescriptions are served by generics, continues to witness severe price erosion. However, recent changes in the manner in which universal healthcare is offered to all citizens in the US, Medicare, as well as a spate of patent expiries for large products is likely to drive opportunities for growth. After going off patent, some large brands have seen generic entry at 97% discount to the existing price. Several US generic companies have merged to optimize strengths. Several companies have set up R&D operations or bought manufacturing bases in India, leveling the playing field in an attempt to reduce their costs. Para 4 challenges continued to be extremely demanding, with higher courts at times overturning the verdicts of lower courts, making predictions extremely difficult. Branded companies continued to bring authorized generics to market, settle with generic companies to retain market share or even cut prices to generic levels, atypical moves impossible to guess even a year ago. On its part, government authorities such as the FTC continued to watch settlement moves by branded companies to keep generics away from the market.

### **Performance**

At Sun, we continue to work to create an international pharma company with world-class speciality brands. Our insistence on delivering quality and offering a range of products in a therapy area including complex products is a template that we apply in several international markets. We've consciously worked to remain a formulations company with the advantages of backward integration into API. International markets now account for 40% of our revenues, up from 25% in 2000. The US market moved from 2% of revenues in 2000 to 21%, with increasing margins in a market with cutthroat competition. This year's international revenues include sales from Caraco, Hungary and Bryan. International business is expected to reach 50% of revenues in the next 3 years.

### **India formulations**

The domestic formulation business with steady growth centered on speciality prescriptions continues to be bedrock for the rest of the business. We continue to be enthusiastic about increasing revenues at higher than industry growth. We posted sales of Rs 9596 mill, up 41% from the previous year. Market share as per IMS ORG is at 3.26% for July 2006.



Speciality customers continue to be central to our business. With key customers we continued to gain prescription share and rank. I am happy to share with you that we added Orthopedicians to the list of specialists with whom we are ranked 1<sup>st</sup>. We are now ranked 1<sup>st</sup> with 6 classes of doctors - Psychiatrists, Neurologists, Cardiologists, Ophthalmologists, Diabetologists and Orthopedicians. For over 50% of the brands that we market, we are among the top 3. Technically complex dosages form an important part of our product basket. A significant proportion of the products we market have a delivery system advantage, and this is a strength that we will eventually take to international markets.

### **US generics**

The US continues to be the highest priority market for us, as we ramp up our presence with filings now made from 4 plants in place of filings just from Caraco, as previously.

Last year's acquisition of the Ohio site will equip us to file for interesting liquids, ointments and creams. As a first step, realigning of production and streamlining of production and quality processes, has already begun.

Our site in Halol is now approved for injectables and nasal sprays, one of the few sites in India with this USFDA approval for these kind of products. Injectables, especially in the anticancer, steroid and hormone areas, offer strong product opportunities.

Between Sun Pharma and Caraco we now have 50 ANDA awaiting approval. A sense of prudence underlies our filings. We file Para 3s as well as select Para 4's, we work on complex products with a technology advantage as well as competitive products where the margins may justify manufacturing in India. This philosophy brings flexibility so that we can capture the upside on uncertain projects such as patent challenges, while we build a basket with products that are certain. This helps us build stability for our generics business, which is otherwise inherently cyclical.

Caraco had revenues of \$83 mill for the year ending March 31, 2006, up 29% from last year. On this it had a cash profit of \$25mill. This performance was in a period where most of its competitors were posting quarter after quarter of falling profit. Caraco now markets 23 products and has another 15 filings pending approval with the USFDA. For 14 of its products it is among the top 3 by prescription share.

We are actively looking for opportunities to ramp up our US generic business as we seek to deploy the \$450 mill funds raised through an FCCB. As shareholders, you are aware of our strategy of creating value by identifying turnaround opportunities.

### **International formulations (non US)**

Our ex-US international business continues to show solid growth, with a CAGR of 43% over the last 2 years. These markets across SE Asia, China, CIS, some countries in Latin America such as Brazil and Mexico, have good potential for speciality brand offerings. Using regular customer visits and focused promotion for priority brands, we have been able to carve out a niche in these



markets. Complex products like Lupride Depot and Lipodox are now being sold in certain markets such as Ukraine, Sri Lanka. Such products will offer a fillip to our revenues in these markets going ahead.

### **Speciality API**

Our strengths with API manufacturing have enabled our entry into interesting dosage form markets and cost sensitive markets such as the US. We also sell API to some of the most quality conscious customers in the world, and this is a learning process that helps us upgrade our systems and processes. Three of our plants are now approved for the US and Europe. After the recent upgradation of our Karkhadi facility and new facility for cephalosporin dosage forms, we will be strongly positioned to compete in this space.

We have 72 filings received or awaiting approval for US/ Europe.

### **R&D**

Sun Pharma has over the years been recognized as one of the earliest and highest spenders in R&D in the Indian pharma space. So far, we have invested in excess of Rs. 700 crores on R&D, starting with 4% in 1994 and increasing to 12% of revenues now. At the moment, in our estimate 35-40% is being invested on innovative projects for new to the world technology and products.

This investment has equipped us to build a fairly good intellectual property library, with close to 60 patents received and another 300 pending approval. Our understanding of patents has begun to translate into business advantages. The approval last December of generic version of Ultracet with summary judgment in Caraco's favor, and the recent approval of Gabapentin is a validation of our IP strength.

At Sun Pharma we boast of a fairly strong productivity record. Every year we introduce something like 20 APIs, bring more than 30 formulations to the Indian market and make more than 20 US market filings. All of this is based on the projects developed in-house. In all, our scientist team numbers 500 and the lab area dedicated for research is about 300,000 sq ft across two research centers, in Baroda and in Mumbai.

So far, we have shared developments only for a few projects in our innovative pipeline.

We have one NCE program, which will go into phase 2 shortly in the US. We also have spoken from time to time about two NDDS projects that would enter phase 2 studies in the US. In addition, we have a follow-on pipeline of projects. Our intention is to share the details of some of these projects a short time before listing the R&D company to enable the market to value them appropriately.

### **Growth and Team Sun Pharma**

Sun Pharma enjoys reputation as a steady business with dependable revenue streams, yet with a knack for differentiation and innovation. We have shared 18-20% revenue growth numbers for this year. Caraco has shared 25% growth projections after factoring generic pricing pressure. This



year we intend to file 30 ANDAs across the two companies. We continue to actively look for opportunities to deploy the USD 450 million available with us.

Today we are a vastly more international company, with 6 plants outside of India and close to 20% of employees in international operations. As we scale up our business in international markets, we appreciate the focused effort that the team has put in. We will continue to build a work environment that is challenging and supportive. We will work to create an environment that recognizes individual contribution as well as team effort.

Thank you.