Contents

FOUNDER Late Mr. Ramanbhai B.Patel

BOARD OF DIRECTORS Pankaj R. Patel
Chairman & Managing Director

DIRECTORS Mukesh M. Patel
Pranlal Bhogilal
Sharvil P. Patel
H.K. Bilpodiwala
H. Dhanrajgir
A.S. Diwanji

C OMPANY SECRETARY Upen H. Shah

CHIEF ACCOUNTS OFFICER Jyotindra B. Gor

BANKERS Bank of Baroda
BNP Paribas
Corporation Bank
Citibank
ICICI Bank Limited
IDBI Bank
State Bank of India
State Bank of Saurashtra

AUDITORS R.R. Patel & Co.
Mukesh M. Shah & Co.
Chartered Accountants

REGISTERED AND CORPORATE OFFICE 'Zydus Tower', Satellite Cross Roads,
Ahmedabad - 380 015.
www.zyduscadila.com

REGISTRAR AND SHARE TRANSFER AGENTS M/S Pinnacle Shares Registry Pvt. Ltd.
Near Asoka Mills, Naroda Road,
Ahmedabad - 380 025.

WORKS

Formulation Units S.No. 417, 419 & 420, Village Moraiya,
Taluka Sanand, District Ahmedabad.

Kundaim Industrial Estate, Ponda,
Goa 403 401.

Village Saraj Mujra
P.O. - Baddi
Tehsil - Nalagarh
Dist. Solan (HP)

API Units GIDC Estate, Ankleshwar, Gujarat.
Patalganga, Dist. Raigad, Maharashtra - 410 220.
Dabhasa, Tal. Padra, Dist. Vadodara

Nutraceutical products Plot. No. 5504, GIDC Estate, Vatva, Ahmedabad.

Zydus Research Centre Zydus Research Centre
S.No. 396/403, Village Moraiya, Taluka Sanand,
District Ahmedabad.

Safe Harbour Statement

In this Annual Report we have disclosed forward-looking information (within the meaning of various laws) to enable investors to comprehend our prospects and take informed investment decisions. This report and other statements - written and oral - that we periodically make, contain forward-looking statements that set out anticipated results based on the Management's plans and assumptions. We have tried wherever possible to identify such statements by using words such as 'anticipate', 'estimate', 'expects', 'projects', 'intends', 'plans', 'believes' and words of similar substance in connection with any discussion of future performance.

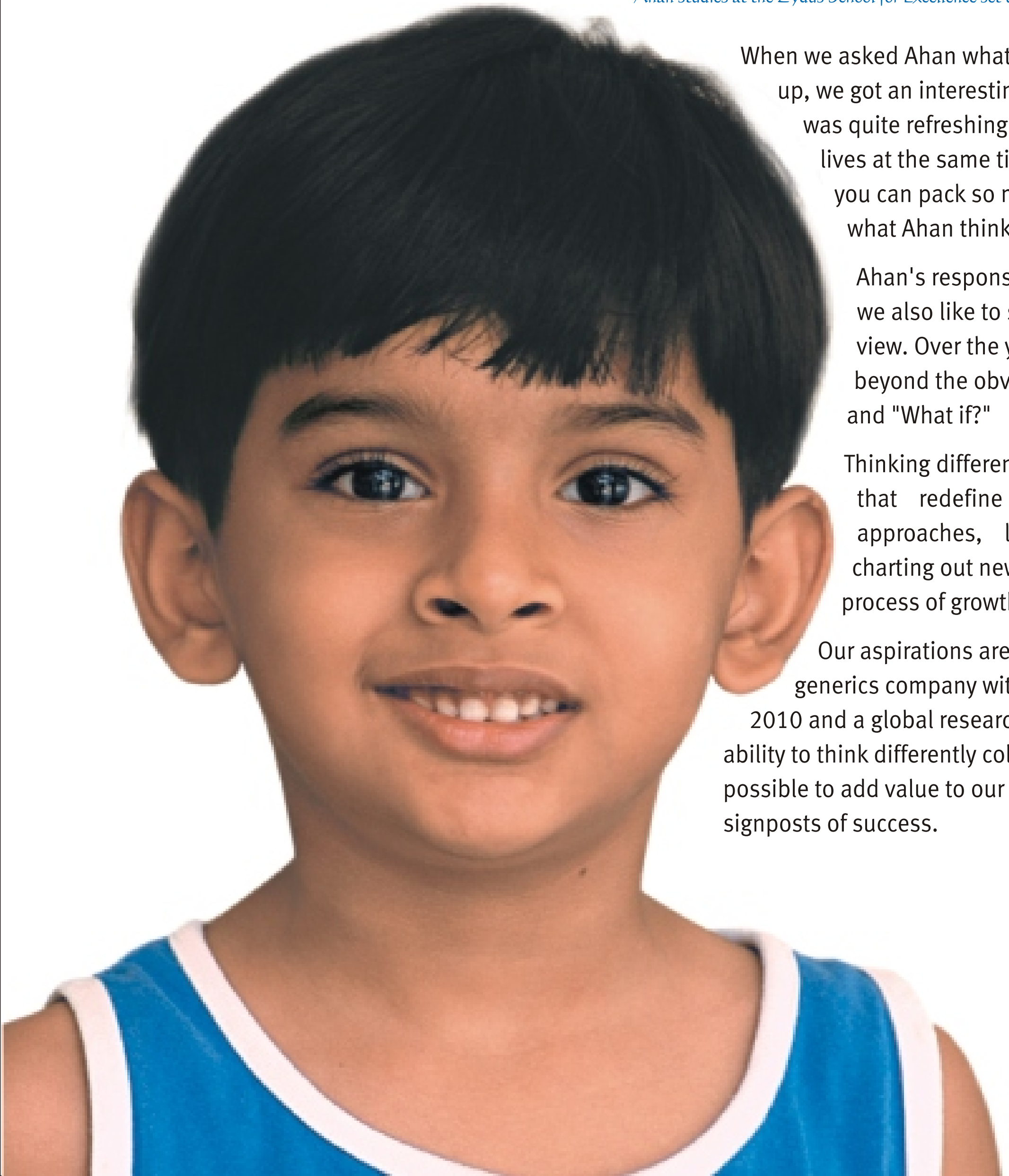
We cannot guarantee that these forward looking statements will be realised, although we believe we have been prudent in assumptions. The achievement of results is subject to risks, uncertainities and even inaccurate assumptions. Should known or unknown risks or uncertainties materialise or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Readers should bear this in mind.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

"When I grow up,
I want to be a pilot and fly like the birds,
A superman who is strong and can do anything,
A brave king who protects his people,
A leader like Gandhiji,
An artist, a dancer, a scientist and a singer...
I'll be anything I wish,
Because I'll be an actor,
A different person every day,
Do things in a different way."

~ Ahan Kayastha

7 years old and a budding theatre artiste,
Ahan studies at the Zydus School for Excellence set up by the Group.



When we asked Ahan what he wished to be when he grew up, we got an interesting response and a reasoning that was quite refreshing. How wonderful to lead many lives at the same time! And why lead one life, when you can pack so much more in a lifetime? That's what Ahan thinks. And that is thinking differently.

Ahan's response struck a chord with us because we also like to see the world from a different view. Over the years, we have been looking beyond the obvious, asking ourselves "Why not?" and "What if?"

Thinking differently for us is about creating ideas that redefine an outlook, trying out new approaches, looking at new strategies and charting out new paths. It's about making the process of growth an exciting one!

Our aspirations are to become a top ten global generics company with sales in excess of $1 bn by 2010 and a global research-driven company by 2020. Our ability to think differently colours these aspirations, making it possible to add value to our operations and set up new signposts of success.

Zydus
dedicated to life

Thinking Differently -
An Integrated Approach to Business

Research

- Continually investing in NME research, biologicals, formulation development, process research, NDDS, strategic technology
- Made headway through a focussed thrust. NME ZY H1 has reached Phase II clinical trials. Filed two INDs ZY H2 and ZY I1 consecutively within one year
- Promising NMEs under advanced pre-clinical testing

Development

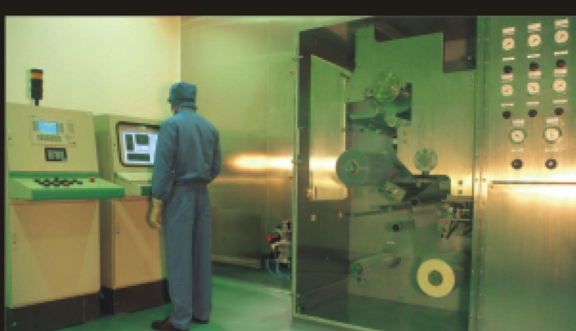
- Built robust regulatory pipeline. Filed total 36 ANDAs and 40 DMFs within three years
- Robust development engine to maximise value of research
- Capabilities for early stage, global clinical development

Manufacturing

- Globally compliant manufacturing infrastructure* to support product launch in markets like U.S., EU, Latin America and other emerging markets
- Expertise in manufacturing speciality chemicals, fine chemicals, advanced intermediates, high-end bulk actives and investigational bulk actives
- Unique capabilities to manufacture complex dosage forms such as transdermals, inhalers (MDI/DPI), suppositories, vaccines, injectables (sterile liquids and lyophilised) and oral dosage forms such as tablet, hard and soft gel capsules
- Leveraging these strengths to emerge as a strong player in CRAMS

Sales, Distribution & Marketing

- No. 1 player in CVS, GI and WHC segments in the Indian pharmaceutical industry
- Growing presence in U.S. and France. Maximising reach through unique distribution arrangements. Tie-ups with Mallinckrodt in U.S. and Evolupharm in France for greater access to customers by leveraging strengths of local partners
- Strengthening presence in emerging markets



- Maximising value through vertical integration of business
- Building strong platforms for win-win partnerships
- Continuously improving operating efficiencies resulting in competitive advantage
- Accelerating growth and generating quantum improvement in profitability which is sustainable

*Formulation plant at Moraiya approved by US FDA, MHRA (U.K.) - Solid Orals, AFSSAPS (France), MCC (South Africa), ANVISA (Brazil), PIC (Romania), BFAD (Philippines) etc. The group also has US FDA approved API plants at Ankleshwar and Dabhasa. The API plant at Ankleshwar is also approved by AFSSAPS (France).

Chairman's Message

Dear Shareholders,

The year 2005-06 has been a momentous one for the Company. Firstly, our efforts to establish business in the regulated markets and develop a strong base for our international business have now borne fruit. Secondly, we have leveraged our strengths as a vertically integrated company to open up new revenue streams through CRAMS. Thirdly, we have made brisk progress in our NME research programme, capping our sustained efforts over the last few years. Above all, we have once again demonstrated our ability to generate impressive results by growing revenues. On a consolidated basis, the gross sales reached Rs. 15,078 mn up by 18% y-y. The major growth driver was formulation exports, which grew by 114% over the preceding 12 months. Your Company is now better positioned to generate a stream of solid, strong and sustainable future revenues and profits. I'd like to share with you some of the key drivers of business performance which have helped us achieve these results.

When we did some crystal ball gazing and looked at how we are going to unleash value in the future, we identified four major drivers of growth. During the year, we made significant strides in each one of them.

Global Generics Business
An impressive year

The global generics business is one of the key drivers of growth and we have been focussing our energies over the past few years on creating a strong base in the U.S., Europe and Latin America. Our vision is to emerge as a top ten global generics company with sales in excess of $1 bn by 2010 and during the year we made a great start in this direction. We launched our operations in the U.S. during the year with just five products. I am happy to report that our U.S. operations turned profitable in the very first year. It's a differentiated strategy that we have adopted for this highly competitive market and it has reaped handsome dividends. Our focus has been on careful product selection, cost excellence through backward integration, a unique approach to distribution and an emphasis on customised solutions.

The two-pronged approach in distribution of products has helped us maximise our market coverage in the U.S. While we marketed products in alliance with Mallinckrodt, the seventh largest generics player in the U.S. under the joint label 'ZyPharma', we also extended our reach by servicing select customers directly under the label 'ZyGenerics'. We plan to launch another 10-12 products in 2006 and hope to triple the topline in U.S. operations.

In France, we decided to focus on the pure generics business to drive growth in the coming years. In line with this, we sold off the branded business of Zydus France SAS to Aerocid of France for 7mn Euros. The branded business, a non-core asset for your Company, comprised mature prescription and OTC products. We had acquired the branded business from Alpharma France for 3.7mn Euros. Another key initiative which is bound to have a significant impact on our generics business in France, is the distribution agreement with Evolupharm. With an additional reach through Evolupharm's network of 2250 pharmacies, I believe that we have greatly reinforced our marketing strengths in France. With 40 major drugs going off patent in France, we expect to grow at the rate of over 20% per annum in this key market.

2005-06 will also be remembered for the launch of operations in two more key markets - Brazil and South Africa. In Brazil, we have launched ten products through our subsidiary Zydus Healthcare Brasil Limitada. We have filed 23 pure and branded generics dossiers for this market so far. In South Africa, we have launched four products so far and plan to launch eight more in the coming year. Overall, it has been a great year for our International business with total consolidated exports registering a quantum jump of 30%, driven by growth of 114% in Formulation exports.

Domestic Operations
Anchoring growth

Our focus on the domestic market continues to be strong and our domestic formulations business grew by 15% during the year. I believe that the key to successful marketing and competing lies in differentiation and the concept of being unique or different is far more important today than it was ten years ago. One of the key aspects of our growth over the years has been our ability to stand apart in the marketplace. Our focus has not just been on being different from the rest, but on looking at possibilities which can help us deliver products, services and solutions better than anyone else. In this light, I'd like to share the developments on two initiatives undertaken during the year.

As part of Project Diamond, we restructured our domestic formulations business to ensure wider coverage, increase yield per person and improve efficiencies. On the other hand, Project Phoenix, a comprehensive programme, was launched to rejuvenate mature brands and strengthen pillar brands. The programme would also be looking at innovations in product positioning, packaging and promotion. Both these initiatives have helped us take stock of how we can continue to create a niche for ourselves in the domestic pharma business.

Global Contract Manufacturing
Opening up new revenue streams

The global pharmaceutical industry is witnessing a wave of change due to stricter regulatory norms and spiraling costs. Pharmaceutical companies are opting to outsource manufacturing requirements to improve efficiency and productivity. The opportunities for the in-sourcing partner lie in offering strategic value-added services. Indian companies with proven skills in process development, process optimisation and specialised technology are best placed to tap the opportunities emerging in this field.

By combining specialised skills, high quality products at low costs and adequate regulatory protection of intellectual property, India is poised to become a global manufacturing hub. It is estimated that approximately 30-50% cost-saving opportunity is possible in India. Your Company is well positioned to leverage its strengths as a vertically integrated manufacturer to make significant inroads in this sphere. Our Global Contract Manufacturing cell, set up to tap opportunities in this sphere has posted revenues of Rs. 92 mn during the year. We have signed 11 contracts with innovator and generic companies with a peak revenue potential of $23.6 mn. I am confident that with our customised approach and value-added services, we will be able to capitalise on this promising start.

Research and Development
Expanding our pipeline

During the fiscal 2005-06, we continued to make vital progress in our research programme. Of the four NMEs that we are working on, our first IND - ZY H1 has now reached the Phase II clinical trials. Additionally, we have filed two more INDs ZY I1 (NME for treating inflammatory disorders) and ZY H2 (NME for treating diabetes) during the year. This is indeed a remarkable achievement and reflects the high calibre of research professionals that your Company is fortunate to have. We now have a team of more than 500 professionals engaged in research and development, of which, 230 scientists alone are involved in the NME research programme at the Zydus Research Centre. We will continue to invest in research and strengthen our capabilities to develop newer drug-discovery targets. Our product pipeline is filled with new and exciting projects, which I believe will bring to fruition our goal of being a global research-driven pharma major by 2020.

Thinking Differently
To enhance value

The new world that is shaping up demands new solutions. It commands that we think out of the box. As the celebrated thinker Edward De Bono once said, "Breaking out of established patterns and look at things in a different way." The old economic order of protected markets and guaranteed margins no longer exists. And the new economic order is being created by companies that are constantly innovating their systems, processes, business solutions and approaches.

We have been looking at unleashing value by 'thinking differently' - in our approach to business, markets, customers and meeting the needs of all those with whom we do business. 'Working together on win-win partnerships' is one such example of our differentiated thinking and approach. Rather than focus on short-term gains, your Company believes in getting into partnership arrangements which create value in the long term. It is this philosophy that governs our Joint Ventures and Alliances with partners like Altana Pharma, Mayne Group of Australia, Bharat Serums and Vaccines, Mallinckrodt, Schering AG, Boehringer Ingelheim and Ambalal Sarabhai Enterprises, to name a few. We believe that these JVs combine the technological, manufacturing and marketing strengths of the respective partners in super-speciality areas to create value across the board.

We have also applied the process of 'thinking differently' to create a whole new way of working - which is faster, more efficient and certainly one that produces excellent results. Given that the regulated markets will play a crucial role in your Company's future growth, it was important that product development for the U.S. market be fast-tracked. With this in mind, in FY 2005-06, your Company formed a specialised Pharmaceutical Technology Centre (PTC) which grouped together six departments - Formulations Development, Analytical Development, Pharmacokinetics and Project Management, Regulatory Affairs, IPR and Packaging Development encapsulated within one cohesive team. This makes the team more fleet-footed, productive and better connected to achieve faster results. The process of 'thinking differently' is also reflected in the way we nurture leaders from within the organisation to come to the fore, lead transformation initiatives to cope with change and encourage fresh ideas in every aspect of our business. It's a culture that will continue to shape our future-focussed organisation.

Moving Ahead...
Continuing our distinctive approach

We will continue to:

- Leverage strengths of our vertically integrated business model
- Explore opportunities for inorganic growth and consolidate operations to meet our goal of becoming a top ten global generics company by 2010
- Optimise our processes and costs
- Build intellectual property and relentlessly focus on our NME programme
- Manage our alliances in such a manner that they continue to create value for both partners
- Retain our character as an innovative, fleet-footed and progressive global healthcare company
- Nurture growth and develop skills and competencies of our people
- Remain committed to building healthier communities globally

And as we go about the task of value creation, we are encouraged by your support. We believe that we are on the right track. We have the right strategy in place - a distinctive approach. We believe it is a strategy which will allow us to continue to deliver an outstandingly competitive performance. We are confident of the way ahead. We have the products, the people and the clarity of focus to maintain the momentum. And as we forge ahead, we remain committed to our goal of increasing shareholder value.

Pankaj R. Patel

May 15, 2006

Highlights of 2005-06

Highlights of International Operations

- Entered the U.S. generics market with launch of five products. Revenues of Rs. 500 mn posted in seven months. Operations turned profitable in the first year of business
- Operations launched in Brazil and South Africa
- French operations grew by 78% y-y
- Branded business of Zydus France SAS comprising mature prescription and OTC brands sold to Aerocid of France for 7 mn Euros. These were acquired from Alpharma France for 3.7 mn Euros in 2003
- Agreement with Evolupharm, France, gives your Company access to 2250 more pharmacies across France
- Launched 76 generics presentations in France until March 2006 including three blockbuster brands - Simvastatin, Omeprazole and Sertraline
- Formulations manufacturing facility at Moraiya and API manufacturing facilities at Ankleshwar approved by AFSSAPS, the French regulatory agency. Commenced supply of products to France from India
- Formulations exports to emerging markets grew by 49% y-y
- 12 ANDAs and DMFs filed during the year, taking the cumulative filings to 36 ANDAs and 40 DMFs. So far your Company has received approval for 12 ANDAs

Highlights of Domestic Operations

- Restructured the domestic pharma business to optimise resources under Project Diamond
- Launched 34 new products including extensions (formulations) during the year
- Launched Project Phoenix - a comprehensive programme to rejuvenate mature brands, strengthen pillar brands and bring about innovations in the marketplace
- Maintained leadership positions in the CVS, Gastrointestinal and WHC segments
- Operations at Baddi formulation manufacturing facility streamlined and entire investment recovered within just one year

Pharmaceutical Technology Centre at Moraiya

Acquisitions and Joint Ventures

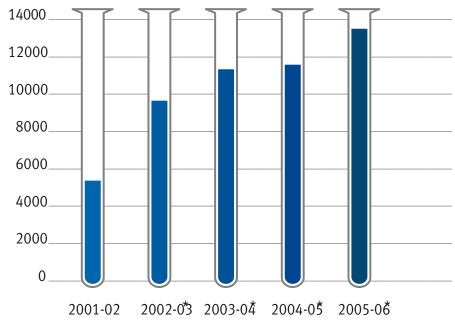
- Acquired 30.7% stake in Carnation Nutra-Analogue Foods Ltd., the manufacturers of Nutralite, which is India's largest selling margarine currently enjoying a market share close to 60%
- Capacity of Pantoprazole intermediate manufacturing facility of Zydus Altana Healthcare Pvt. Ltd. at Mumbai increased from 48 tons to 60 tons
- Signed a 50:50 JV with Bharat Serum and Vaccines Limited to develop, manufacture and market a non-infringing and proprietary Novel Drug Delivery System (NDDS) of an approved anti-cancer product for global markets
- Turned around the operations of joint venture Sarabhai Zydus Animal Health Ltd., from loss of Rs. 16 mn to profit of Rs. 66 mn due to all-round improvement in margins and reduction in expenses

Highlights of R&D and Contract Manufacturing

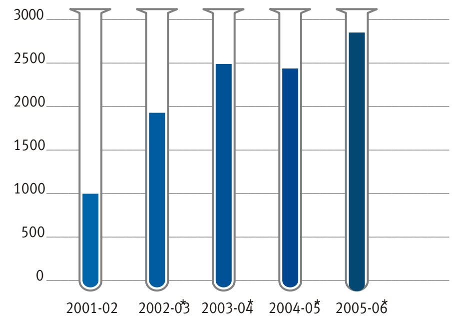
- ZY H1, the NME for metabolic disorders enters Phase II clinical trials
- Filed two additional INDs during the year - ZY I1 to treat inflammation and pain and ZY H2 for treating diabetes with Drug Controller General of India (DCGI)
- Two drug discovery collaborations are underway with Indian Institute of Chemical Technology (IICT), Hyderabad on drug discovery projects
- Established Clinical Research Department
- Signed 11 contract manufacturing deals with innovator and generic companies, having peak revenue potential of $23.6 mn

Financial Highlights

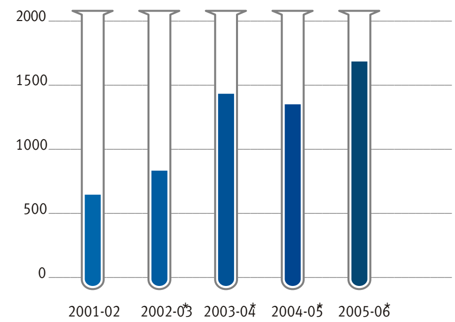
Gross Sales (Rs. in mn)



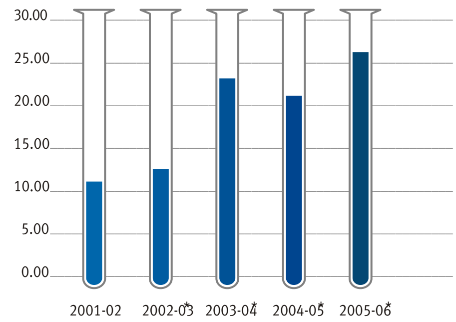
PBIDT (Rs. in mn)



Profit After Tax (Rs. in mn)

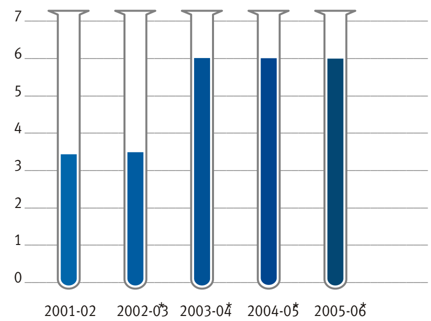


EPS (Rs.)

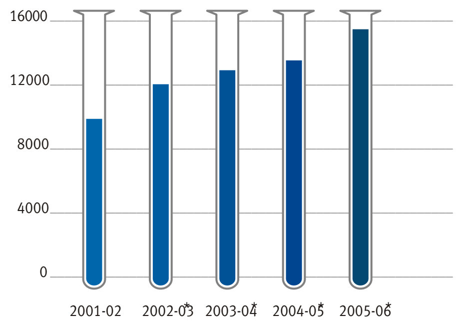


*Indicates post merger data

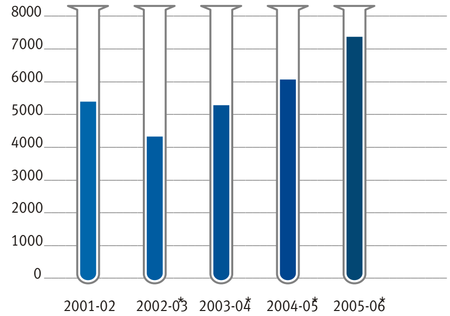
Dividend Per Share (Rs.)



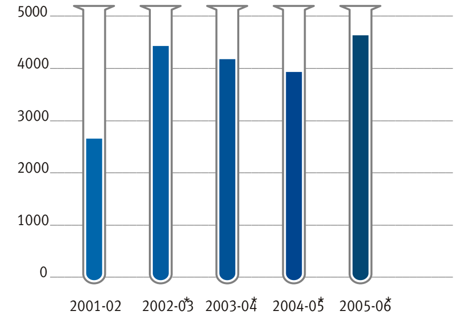
Total Assets (Rs. in mn)



Net Worth (Rs. in mn)

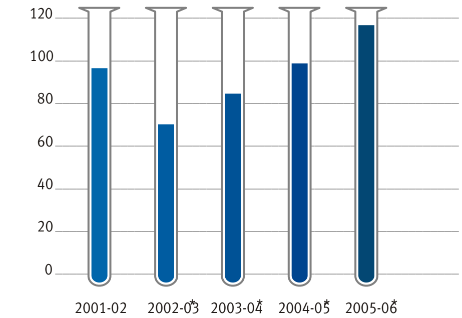


Total Debt (Rs. in mn)

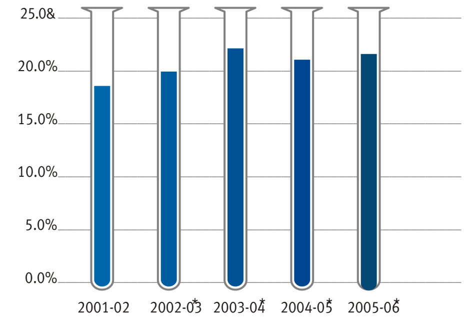


Note: Based on stand-alone results *Post-merger data - not strictly comparable with prior years. Regrouped figures taken wherever applicable.

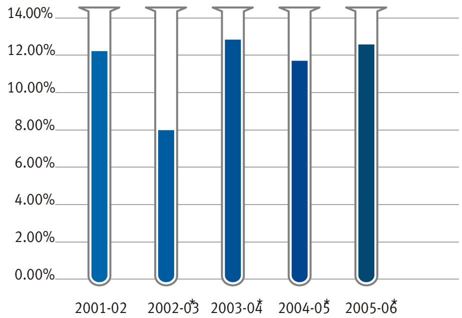
Book Value Per Share (Rs.)



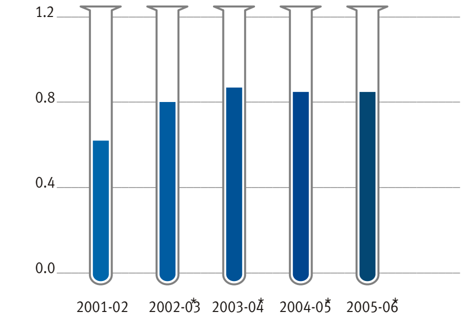
PBIDT% to Sales



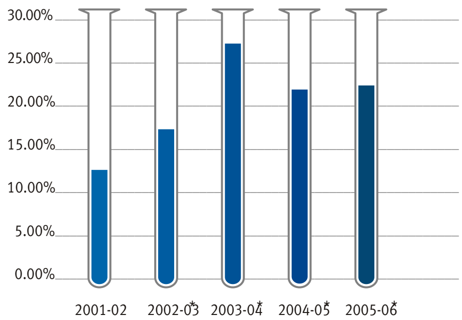
PAT% to Sales



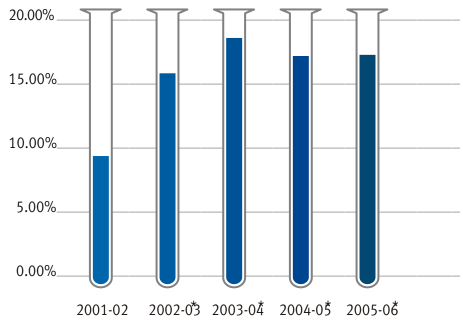
TA Turnover



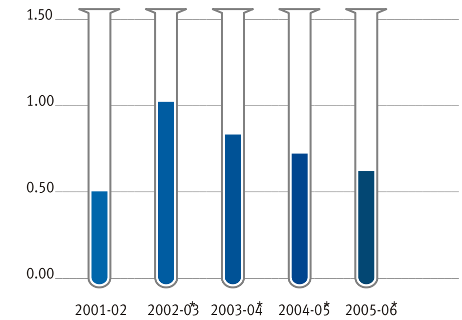
Return on Equity (%)



ROCE (%)



Debt/Equity Ratio



Economic Value Added®

A firm's management creates value when it makes decisions that generate benefits exceeding costs. Economic Value Added (EVA) is a measure of a firm's economic profit. It is the residual income after charging the Company for the cost of capital provided by lenders and shareholders.

It is calculated as the excess of economic profit over the cost of capital employed.

Rs. in Millions

	2004-05	2005-06
EBIT	1761	2165
Less : Adjusted Tax	94	149
NOPAT (Net Operating Profit Less Tax)	**1667**	**2016**
Adjusted Equity	6069	6979
Adjusted Debt	3946	3982
Total Adjusted Capital Employed	10015	10961
Average Adjusted Capital Employed	9659	10081
Post Tax Cost of Debt	5.20%	4.99%
Cost of Equity	11.80%	18.73%
WACC %	11.10%	13.74%
WACC	**1071**	**1385**
EVA® (NOPAT - WACC)	**596**	**631**

Notes:

- EVA® is a registered trademark of Stern, Stewart & Co.
- EBIT (Earnings before interest and taxes) include dividends from subsidiaries and JVs, being strategic investments
- Tax calculation excludes deferred tax and is adjusted for tax shield on interest, non operating incomes and expenses
- Cost of equity is based on the cost of risk free debt plus equity premium adjusted for firm's beta variant. The equity premium for the year 2005-06 is assumed at 16.5% while beta variant is taken at 0.68 (Source : Bloomberg)
- Cost of debt is based on 10 year Government of India bond
- WACC (Weighted average cost of capital) is based on book value based weights of debts and equity
- The above calculations are based on Indian GAAP for standalone accounts

Market Value Added

Market Value Added (MVA) is a measure of the value that the management has been able to add to the given resources. It is measured by calculating the difference between a firm's market value (equity and debt) and its capital as per book value.

Higher the MVA, the better. A high MVA indicates that the Company has been able to create substantial wealth for its shareholders. MVA is equivalent to the present value of all future expected EVAs.

Rs. in Millions

	2004-05	2005-06
Market value of equity (year end)	29180	42431
Market value of debt	3946	4522
Total market value of equity and debt	**33126**	**46953**
Less : Invested Capital		
Book value of equity	6069	7363
Book value of debt	3946	4522
Total book value of equity and debt	**10015**	**11885**
Market Value Added (MVA)	**23111**	**35068**

Notes:

- Market value of debt assumed to be same as book value in the absence of debt being listed / regularly quoted.

Management's Discussion & Analysis

The Executive Committee members of the Zydus Group are seen with the Chairman & Managing Director Mr. Pankaj R. Patel (5th from the left) at the 11th Annual Day celebrations of the group in January 2006.

Overview

The year 2005-06 has been a significant one for the company on many fronts. Your Company's concerted efforts to position itself as a global healthcare provider received a boost this year with the launch of operations in the focus markets of U.S.A., Brazil and South Africa. In France, a greater thrust on the pure generics business and strategic initiatives undertaken during the year are expected to have a positive impact on the business. On the home front, your Company's brands continued to perform well and register strong growth in the core segments. In all, it has been a favourable year for your Company as it looked at new initiatives for growth, made headway in its international business, continued to forge win-win partnerships, explored new opportunities and surged ahead with its promising research programme to unleash value for its shareholders.

Cautionary statement:

Shareholders and readers may be advised that some parts of this section contain data and information external to the Company and which are forward-looking. These are based on sources considered to be reliable, and on the best estimation available at that point of time. Further, the details and explanations given in the following paragraphs reflect the management's perception on material and relevant issues as on date, which are subject to change without notice due to change in government policies, competition and other risk factors. The company undertakes no obligation to publicly update or revise any of the opinions expressed hereinafter.

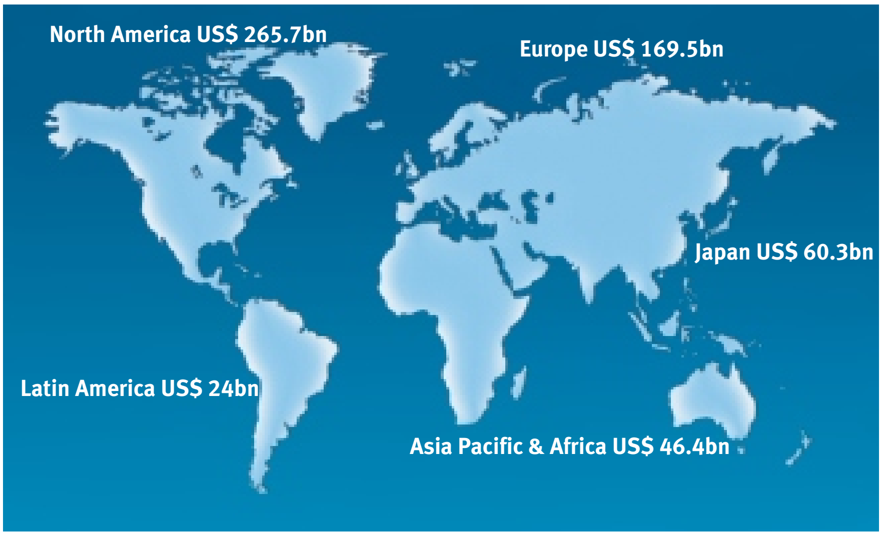
The Global Pharma Market

Global pharmaceutical sales

The global pharmaceutical market grew by 7% in 2005. North America, which accounts for 47% of global pharmaceutical sales, grew by 5.2% to $265.7 bn, while Europe experienced somewhat higher growth of 7.1% to $169.5 bn. Sales in Latin America grew at an exceptional 18.5% to $24 bn, while Asia Pacific (outside of Japan) and Africa grew by 11% to $46.4 bn. Japan, the world's second largest market, which has historically posted slower growth rates, performed strongly in 2005, growing by 6.8% to $60.3 bn.

Nearly 40% of total market growth was fuelled by the introduction of new products, including 30 new molecular entities launched in key markets. It also augurs well for the industry that more than 2,300 products were in clinical development, up 9% from 2004, and up 31% over the past three years (Source: IMS).

IMS forecasts that the total pharmaceutical market will expand at a compound annual growth rate of 5-8% over the next five years. North America and Europe are each projected to grow at a 5-8% pace; Asia Pacific/Africa, 9-12%; Latin America, 7-10%; and Japan, 3-6%.



Global Generics Market

In 2005, sales of generics in the top eight markets (U.S.A., Canada, France, Germany, Italy, Spain, U.K. and Japan) exceeded $55 bn, and are expected to experience double-digit growth over the next five years. Generics will assume a more central role as patients bear a greater percentage of their healthcare costs and payers seek to restrict the growth of healthcare expenditures. Price moderation for branded drugs is likely as a result (Source: IMS).

With an estimated $100 bn worth of branded pharmaceutical products to face patent expiry by 2010, generic growth opportunities for the future remain significant even after considering price erosion (Source: Datamonitor, Dec. 2005).

Indian Pharma Industry

FY 2005-06 was a watershed year, both for the Indian pharmaceutical industry as well as for your Company. As is well known, the long anticipated change in the country's patent regime took place on January 1, 2005. The amendment to the Patents Act of 1970 introduced was expected to usher in significant changes to the Indian pharma market. These were not long in coming.

The most important change was in the number of new products launched in the market. Over 7,200 brands were introduced in the last four years with over 2,700 new products launched in FY 2004-05 alone (Source: ORG Review) as Indian companies rushed to take advantage of the older patent law.

In marked contrast, with the introduction of the product patent regime, FY 2005-06 saw a massive drop in the number of new products launched by Indian companies. Only 2080 new products were launched during the year.

What this also meant was that Indian pharma companies in the long term will have to deal with a completely new reality. Earlier, the launch of new products was one of the major growth drivers of any Indian company's marketing strategy. However, with this spigot turned off, the Indian pharma industry had to take a hard look at its existing brands and focus on rejuvenating some of the mature brands.

Your Company's management had foreseen most of these changes and has long been preparing for them. It has analysed the molecules which are out of purview of patent law and identified more than 150 molecules for launch in India. This will help your Company continue its new product launch programme as aggressively as before.

The year also saw several global pharma majors who had earlier exited the Indian market, returning with their latest product offerings, now protected by patents.

As discussed last year, your Company's response to the challenges in the Indian pharmaceutical market is multi-pronged. It involves:

- Increased R&D spend to create intellectual property
- De-risking the revenue stream by operating in the advanced markets of U.S. and Europe
- Leveraging the quality, size and low cost advantage of its manufacturing base to explore contract manufacturing opportunities and,
- Forging alliances and partnerships to in-license promising new products in the Indian market

All these initiatives have been highly successful and significant progress has been made on all fronts.

Apart from the changes induced by the new patent regime, several other changes are also taking place in the Indian pharma market. The most significant of them was the massive Rs. 12,500 crore hike in healthcare spending by the government, a significant increase of 22% (Source: Union Budget 2006-07).

The government also announced its decision to set up six more institutions on the lines of All India Institute of Medical Sciences (AIIMS) around the country besides allocating Rs. 100 crore each to 11 Central Government hospitals. It also gave special concessions to few anti-AIDS, anti-cancer and life-saving drugs. The cumulative impact of this increased focus on healthcare can only be positive for the Indian pharma industry.

Another significant change was the increased focus of government policies on rural areas. Its Rural Employment Guarantee Scheme is expected to kick-start growth and alleviate poverty in several rural areas. This, coupled with the Rs. 8,200 crore (Union Budget 2006-07) allocation to Rural Health Missions for improving healthcare at the district level and reducing regional imbalances in health infrastructure, is expected to have a significant impact on rural healthcare, besides opening up new markets for Indian pharma companies.

Other interesting trends that were discernible during the year were the emergence of corporate hospitals and health resorts as players of increasing importance in healthcare, as well as the growth in medical tourism that is expected to reach a figure of over $2 bn by 2012 (Source: A study by the Confederation of Indian Industry and international management consultancy McKinsey & Co., 2004).

With Schedule 'M' becoming compulsory, WHO GMP facilities are now a must. Even government hospitals have made it compulsory for purchase of goods. The medium to long-term impact of this in the market will see a consolidation of the industry with several smaller players being forced to exit. However, your Management believes that this process of consolidation itself offers a huge new opportunity which companies of its size and reach can exploit. This new development, alongwith the growing acceptance of medical insurance, is expected to boost market growth. Considering all these factors, the domestic market which is valued by ORG at Rs. 236 bn for FY 2005-06 will grow at higher rate in 2006-07.

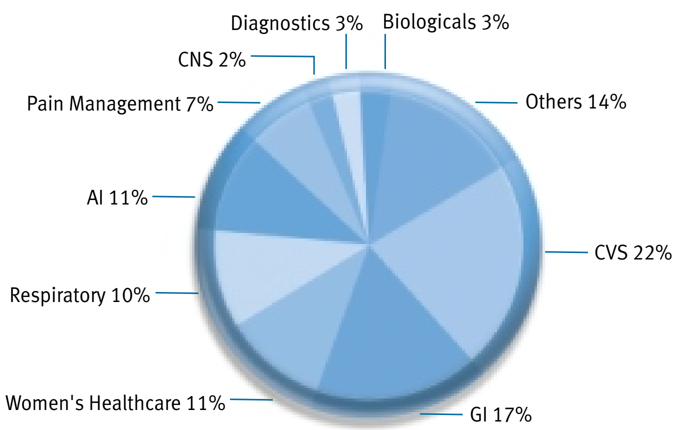
Management's Discussion & Analysis

Operating Highlights (Division-wise)

Domestic Formulations

In FY 2005-06, your Company grew its domestic formulations business by 15.5% to Rs. 9738 mn from Rs. 8431 mn in FY 2004-05.

Therapeutic area-wise break-up of domestic branded formulations sales



Among the therapeutic segments in the Indian pharma market, CVS recorded growth of 13.8%, while GIs and WHC segments grew at 13.3% and 10.1% respectively. Your Company continued to retain its No. 1 position in these segments (Source: ORG:Feb, MAT 2006 for the participated market).

During the year, your Company undertook the re-organisation of the marketing structure under Project Diamond. The objective was to optimise resources in line with industry standards and this was achieved by:

- Redefining the number of divisions required to manage the domestic portfolio
- Redefining objectives for each division with relation to therapy areas
- Reworking customer coverage and field strengths in individual divisions
- Standardising field norms across divisions and establishing review mechanisms

As a result of this exercise, the entire domestic pharma portfolio has been regrouped under three large multi-therapy divisions - Zydus Cadila, Zydus Alidac and German Remedies and the rest under seven speciality divisions, namely cardiovascular, respiratory disorders, women's healthcare, diagnostics, anti-cancer, neurosciences and biologicals.

While the three multi-therapy divisions are focussed on building mega brands in high growth markets, the seven speciality divisions are now marketing high-end products in niche therapies.

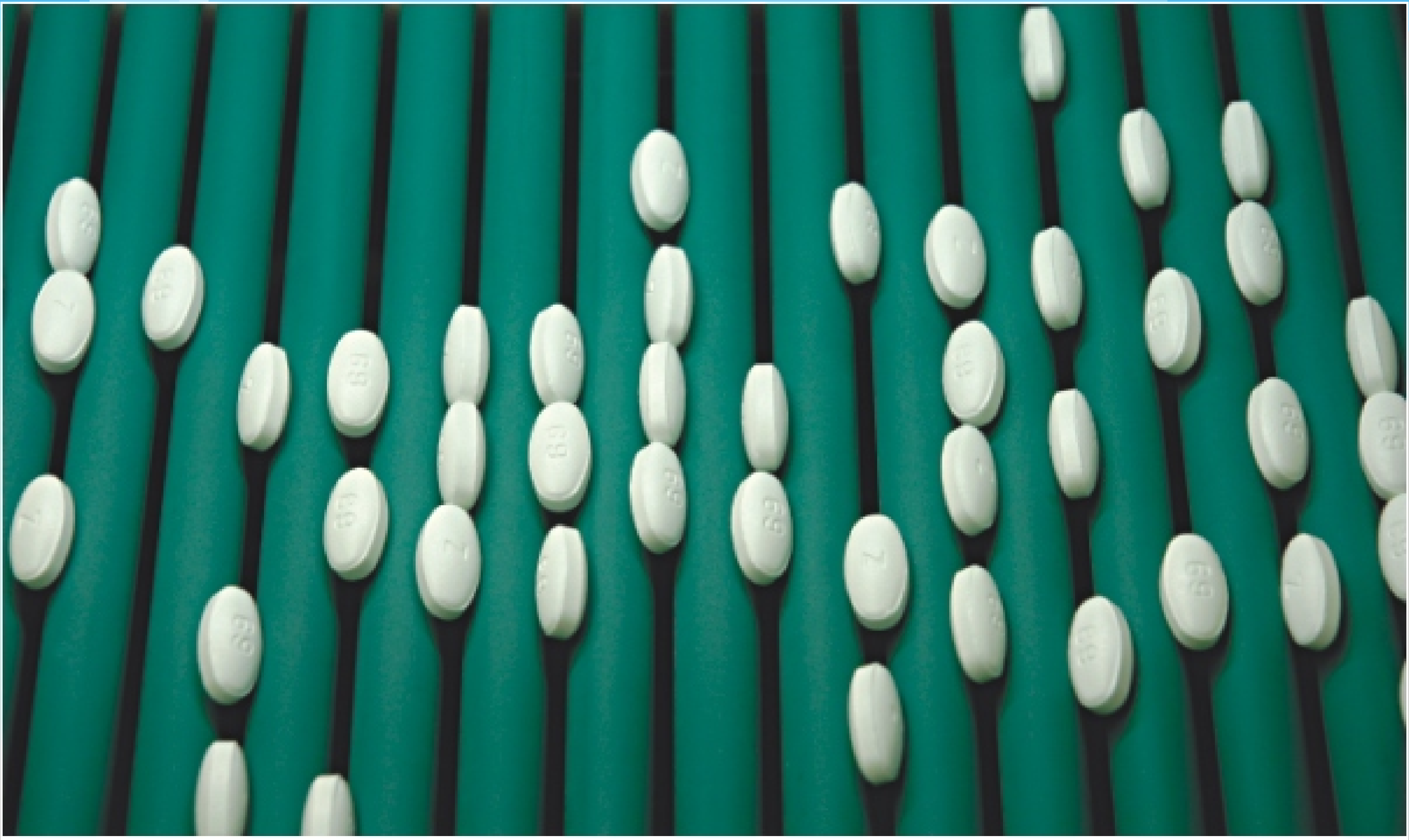
Another key initiative undertaken during the year was Project Phoenix to rejuvenate mature brands. The initiative is aimed at freezing a methodology to create excitement about mature brands as well as to strengthen pillar brands. It involves bringing in innovations in the product, positioning, packaging and promotion to introduce newness in the product to tap an unmet need and enhance interest in the brand.

The process involves understanding the doctors who prescribe the products, looking at how their preferences have changed and finding out how your Company can meet their needs. Different approaches of promoting the product are considered and out-of-the-box thinking is encouraged.

All marketing divisions of your Company have undertaken this initiative and it has shown encouraging results.

Highlights of 2005-06

- Restructured the domestic pharma business to optimise resources under Project Diamond
- Launched Project Phoenix - a comprehensive programme to rejuvenate mature brands and bring about innovations in the marketplace
- 34 new products including brand extensions were launched during the year
- Major brands Ocid, Amlodac and Ciprobid registered growth even as their respective segments were de-growing
- Smarti, launched in the anti-allergic segment in 2005-06, became the No.1 brand in the Rupatidine segment
- Maintained leadership positions in the CVS, Gastrointestinal and WHC segments

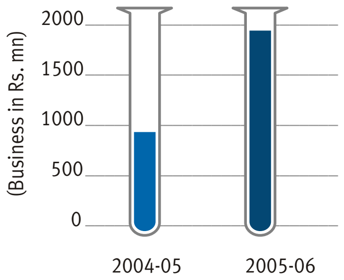


International Formulations

The international formulations business on a consolidated basis grew by 114% y-y to Rs. 1976 mn from Rs. 923 mn* in the previous year, with the launch of operations in key developed markets and a strong performance in the emerging markets.

The year 2005-06 marked the beginning of operations in U.S., Brazil and South Africa. With this, your Company is now present in major global generics markets and will be strengthening its operations to become one of the top global generics companies by 2010.

Growth of International Formulations



U.S. Market

The U.S. prescription drug sales grew 5.4% to $251.8 bn in 2005, compared with $238.9 bn in sales the previous year. Of this, the generics segment posted strong sales growth of 20.6% (Source: IMS Health, 2005). Even though the market has been under severe pricing pressure in recent years, it still presents a huge opportunity to companies which can target specific niches, manage their manufacturing costs well and have capabilities in backward integration.

* Preceding 12 months

Zydus Pharmaceuticals USA Inc., started operations in the U.S. with the launch of five products. The products launched were Atenolol, Metformin, Ribavarin capsules and tablets and Promethazine tablets. The performance of the products launched has been extremely encouraging. For FY 2005-06, sales in the U.S. generic market were to the tune of Rs. 500 mn.

According to your Company's motto of doing things differently, a two-pronged approach for marketing products in U.S. has been adopted. In alliance with Mallinckrodt, your Company markets products under a joint label 'ZyPharma'. Your Company has also retained the right to market generics directly, under the label 'ZyGenerics'. This differentiated approach has helped your Company gain greater access in the market and also build your Company's brand in the U.S. market, faster than others. Early indications are that this approach is paying off. In just seven months, your Company's U.S. operations have turned profitable.

Going forward, your Company is well positioned in the U.S. generics market though pricing pressures are expected to continue. This is because of your Company's strategic approach that rests on careful product selection, product differentiation and leveraging its strengths in backward integration.

Building a Sustainable Business in U.S.

Concept Product/ Identification

- Experienced sales and marketing team
- Consistent and reliable access to active ingredients and other inputs

Product Development Team in India

- Robust development programme focussed on multiple ANDA filings
- Filed additional 12 ANDAs and DMFs during the year taking the cumulative filings to 36 ANDAs and 40 DMFs
- Experienced product development team
- Formulation expertise and technology platform

IP and Legal expertise in India and U.S.

- In-house IP expertise to provide key inputs to product development efforts
- Evaluate IP estate of new products early in selection process

Regulatory expertise in India and U.S.

- Experienced regulatory team in U.S. with several man-years of liaisoning experience
- Quality of ANDAs and manufacturing facilities

API and FDF facility for commercial manufacturing

- API and finished dosage form manufacturing facilities approved by FDA

Sales marketing & distribution capabilities in U.S.

- U.S. operations underway with launch of five products, clocking sales of Rs. 500 mn in the first seven months
- Reach to customers, distributors through two-way distribution set-up
- Tie-up with Mallinckrodt for marketing products under a joint label 'ZyPharma'
- Offering customised solutions under own label 'ZyGenerics'

European Union

Generics Business in France

Your Company entered the French market in 2003 with the acqusition of Alpharma France with a focus on the generics market which is estimated at 1.5 bn Euros and growing at 24% per annum (IMS).

Your Company has been investing in developing the French market and the performance has been extremely encouraging. During the year under review, total sales in France were Rs. 623 mn, up 77.7% over preceding 12 months, which reflects your Company's improved performance in the French generics market.

Two strategic initiatives in this key market are expected to have a significant impact on the operations. Increasing the focus on generics opportunity, your Company decided to divest its branded business in France to Aerocid for 7 mn Euros. The branded business comprising OTC and mature brands was a non-core asset for your Company. Your Company paid 3.7 mn Euros for the branded business when it had acquired Alpharma France. This move will now enable your Company to totally focus on its pure generics business. Since the divestment happened after the close of FY 2005-06, the benefits will get reflected in the Profit & Loss Account next year.

Your Company's French subsidiary Zydus France SAS has also tied up with Evolupharm, the second largest "Groupment" (a buying group with a large network of pharmacies) in France, giving access to 2250 more pharmacists and supplementing its existing marketing force.

Highlights of 2005-06

- Launched 76 generic presentations until March 2006 including three blockbuster brands - Simvastatin, Omeprazole and Sertraline
- Branded business of Zydus France SAS - a non-core asset, comprising mature brands and OTC brands sold for an attractive price of 7 mn Euros
- Signed an agreement with Evolupharm for greater access to the market
- Formulations manufacturing facility at Moraiya and API manufacturing facilities at Ankleshwar approved by AFSSAPS, the French Regulatory Agency
- Filed two additional site transfers, taking the total to four site transfers. Received three approvals so far. Commenced supply of products from India for the French market, which will improve operating margins in France
- Submitted five additional dossiers, taking the total to six dossiers. Received approval for Sertraline, which was filed in 2004-05
- 28 site transfers and 30 new products are in the pipeline which will result in substantial revenue and cost-competitiveness of operations

Emerging Markets

Besides the developed markets of France and U.S., your Company is present in over 26 emerging markets. Of this, the generics formulation market for Brazil constitutes $6.3 bn, Russia $2.7 bn, South Africa $2.5 bn, Taiwan $2 bn and Ukraine $935 mn.

Sale of formulations to the emerging markets on a consolidated basis during FY 2005-06 were Rs. 853 mn, up from Rs. 572 mn, a rise of 49% y-y.

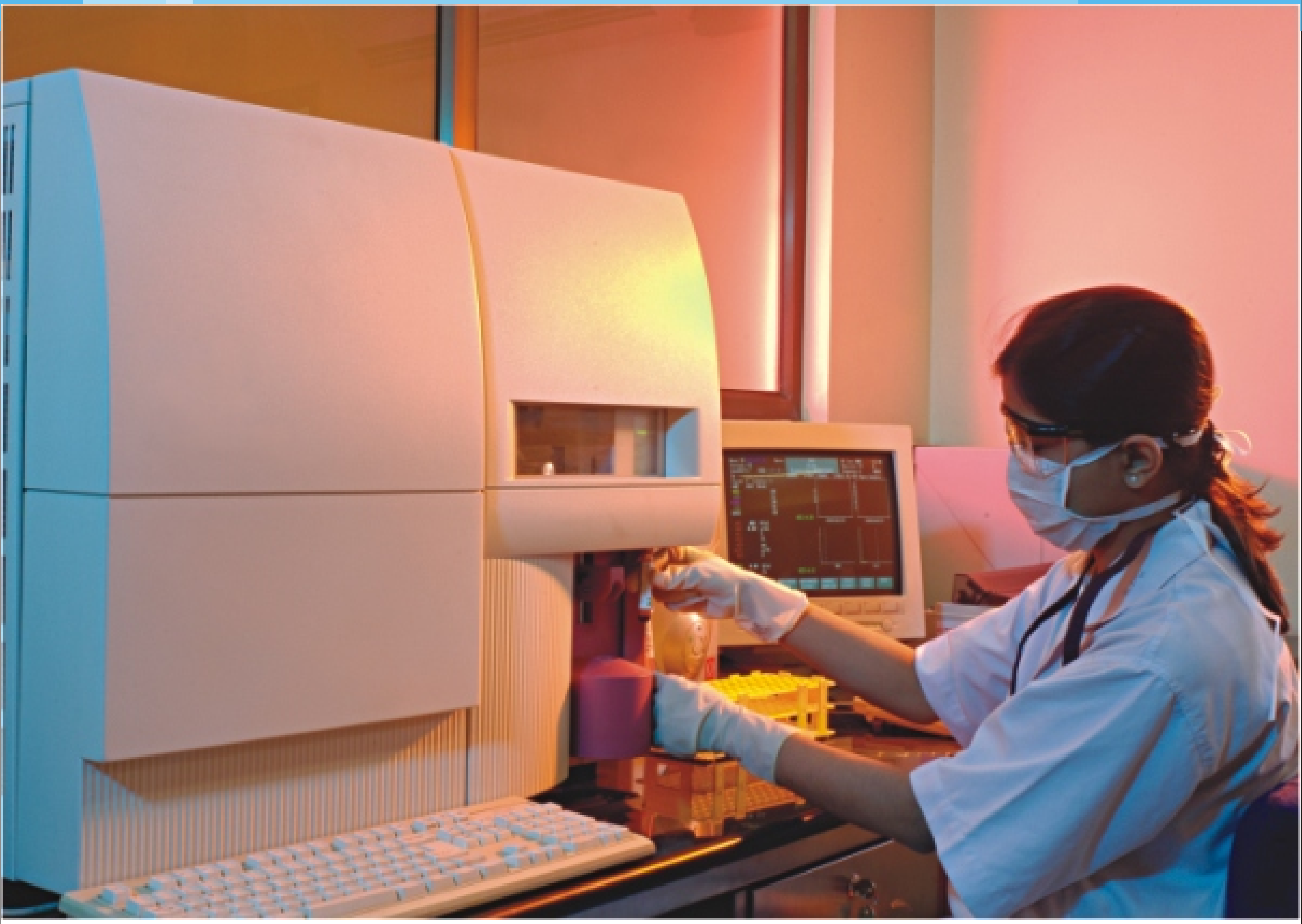
Your Company has been developing the Brazilian market for the last five years. It has got 13 approvals so far and has introduced ten products. Additionally, nine products were registered during the year. Your Company has a full-fledged set-up in Brazil, including ten managers and a fully owned quality control laboratory.

In South Africa, your Company launched operations with four products and has a tie-up with VenturePharm for marketing its products. It has built up a strong pipeline and plans to introduce several more products during FY 2006-07.

Unlike other emerging markets, the Taiwanese market is far more controlled and not much price erosion is expected. Your Company has registered four products and expects revenues from this market to start by FY 2006-07.

Highlights of 2005-06

- Entered three new markets during the year - Brazil, South Africa and Algeria
- Amongst the top three Indian pharma companies in Sri Lanka, Myanmar, Philippines, Uganda and Sudan
- Set up our own laboratory at Sao Paulo in Brazil to expedite marketing of products and also to bring cost benefits
- Registered total of 104 products and launched 54 new products in various markets



Research & Development

As the world moves towards a uniform patent regime, one aspect that will have the biggest bearing on any pharma company's survival is its Intellectual Property (IP). As companies race to build greater IP, India again has inherent advantages in terms of costs, skill sets available and understanding of global IPR regimes.

Your Company has recognised this early and since the year 2000, has been investing nearly 6 to 8% of its turnover on research. A team of more than 500 professionals is spearheading your Company's research and development programme and over 230 scientists are engaged in NME research. The Zydus Research Centre also conducts research in biologics and NDDS.

NME Research

A strong discovery platform as well as a strong development engine to support early stage clinical development has been yielding remarkable results in the group's NME research programme. ZY H1, your Company's first NME, reached Phase II clinical trials within six years of initiating basic research. The aim is to target one IND filing every year and your Company made excellent progress with two successive IND filings in 2005-06.

Progress in NME research

Area of research	NME	Indication	Status
Metabolic disorders	ZY H1	Dyslipidemia	Phase II clinical trials
	ZY H2	Diabetes	IND filed
	ZY O1	Obesity	Advanced pre-clinical testing
Inflammatory diseases	ZY I1	Inflammation & Pain	Phase I clinical trials
		Arthritis	Active research
Cardiovascular diseases		Anti-thrombolytics	Active research
		Cardiovascular	Biological testing

Top Researchers on ZRC's Scientific Advisory Board

Dr. Richard DiMarchi- Ex-Sr. Vice President, Eli Lilly & Prof. at Indiana University, U.S.A.
Dr. Lee S. Simon, FDA Regulator & Prof. at Harvard University, U.S.A.
Dr. Robert R. Henry, Clinician on Diabetic Research, UC, San Diego, U.S.A.
Dr. Sunder Mudaliar, Associate Clinical Prof. of Medicine, Endocrinology division at the University of California, San Diego

Consultants

Dr. Walter Wahli, PPAR Research, Professor at Lausanne University, Switzerland
Dr. Ernest Brahn, Clinician on RA & OA Research, UC, Los Angeles, U.S.A.
Prof. Dr. Stefen Gay - Prof. & Clinical Research on RA, Zurich University, Switzerland
Dr. M. John Chapman, CETP Research, CV, Paris University, France

Highlights of the Division

- Promising leads in hand in anti-obesity, diabetes, anti-arthritic and cardiovascular projects
- ZY H1, the NME for metabolic disorders enters Phase II clinical trials
- Filed two additional INDs during the year - ZY I1 to treat inflammation and pain and ZY H2 for treating diabetes with Drug Controller General of India (DCGI)
- Two drug discovery collaborations ongoing with the Indian Institute of Chemical Technology (IICT), Hyderabad on drug discovery projects
- Established Clinical Research Department

Management's Discussion & Analysis

APIs

The Active Pharmaceutical Ingredient (API) business continued to remain under pricing pressure for most of the year. Towards the end of the year, however, there was a silver lining as investments made to reduce costs started paying off and the division was once again well placed to compete.

The total sales of the division (excluding captive sales) was Rs. 1542 mn, a drop of 11.6% y-y from Rs. 1745 mn in FY 2004-05. However towards the end of the financial year, the division has shown some recovery as it was able to clock up revenues of Rs. 401 mn in the last quarter, growth of 11.7% over the last quarter in the previous year. As an antidote to the pricing pressure in regulated markets like the U.S., your Company is looking at developing new markets such as Latin America, Asia and the Middle East. In a bid to maintain margins, it has also launched a range of new products in the CNS, anti-infective and anti-inflammatory segments in these markets.

Your Company has also relentlessly strived to cut costs to be competitive and profitable. Further, to de-risk revenues from pricing pressure, it is exploring global contract manufacturing opportunities in API and a small, yet significant target has been set for FY 2006-07. Going forward, your Company is looking at a combination of its intellectual property and technology to build exclusivity through complexity while keeping the costs competitive.

Highlights of the Division

- Ankleshwar and Dabhasa facilities approved by AFSSAPS, the French Regulatory Authorities
- Filed 12 DMFs, taking the cumulative filing to 40 DMFs at the end of the year
- Launched Pramipexole, Rupatadine, Clopidogrel Besylate, Topiramate during the year

Manufacturing

Your Company's state-of-the-art manufacturing facilities have always been the bedrock on which its success has been built. During the year under review, the manufacturing division continued its stellar performance, achieving many highlights. Some of these were:

- Commenced manufacturing of products for the regulated markets like U.S., France and Brazil at the Moraiya plant in 2005. Total of 670 mn pills exported to U.S. during the year (June 2005 - 31st March 2006).
- Streamlined operations at Baddi formulation manufacturing facility and recovered the entire investment in setting up the plant
- POBOS study initiated by European Pharmaceuticals Manufacturing Association for benchmarking of pharmaceutical companies worldwide show that Baddi and Moraiya units are highly competitive
- Continued to secure regulatory approvals from world's leading regulatory authorities. Received approval from the French health regulatory agency AFSSAPS
- Indigenously manufactured the transdermal product - Nupatch - Diclofenac 100 mg patch, which was launched for the first time in the Indian market

Management's Discussion & Analysis

Pharmaceutical Technology Centre

In a world of generics business, it is critical that a company fast tracks the process of filing ANDAs, DMFs, CTD/COS to create the pipeline of products for the regulated markets.

Traditionally, a molecule winds its way through various departments and divisions before reaching the final stage. But this process takes time and companies which are serious about exploiting the regulated market opportunity cannot afford this.

To ensure that the process does not lag behind market demands, your Company has set up a dedicated Pharmaceutical Technology Centre (PTC). It consists of twelve key role holders from six departments - Formulations Development, Analytical Development, Pharmacokinetics and Project Management, Regulatory Affairs, IPR and Packaging Develoment which have been encapsulated within just one cohesive team. This makes the team more fleet-footed, productive and better connected, to achieve faster results.

With its own dedicated infrastructure, the PTC has a mandate to accelerate the process of registrations or filings to generics market of U.S., Europe, Brazil and South Africa.

It has already performed creditably during FY 2005-06 and has been responsible for filing 12 ANDAs. In the years to come, the PTC is expected to play a key role in your Company's push in the regulated markets.

Contract Manufacturing

India has certain inherent advantages when it comes to CRAMS. These include low costs, availability of skilled technicians, strong IPR regime and the ability to meet compliance standards of various countries.

Within the Indian market space, given your Company's track record for IPR compliance, service, technical skills and manufacturing efficiencies, it has been a much sought after partner for CRAMS.

In a short while, CRAMS has emerged as a major strategic and de-risking thrust of your Company. It allows for steady, predictable revenues, which partly offset your Company's dependence on the domestic market. The Global Contract Manufacturing cell set up to spearhead operations in this sphere, posted revenues of Rs. 92 mn in 2005-06.

Meeting strategic developmental and manufacturing needs of global pharma companies

Development

- Feasibility studies for API/FDF
- Pre-formulation studies, prototype formulation development
- IPR clearances for API / FDF
- Analytical method validation
- Stability studies

Opportunity for customised product development of API / intermediates and FDF

Pilot

- c-GMP manufacturing
- Process development / improvement studies for intermediate / API / FDF
- Multiple production options for scale up
- Pilot / Pivotal batch

Opportunity for manufacturing intermediates / API / Finished Dosage Form for Clinical trial supplies

Commercial Manufacturing

- c-GMP manufacturing
- Proprietary technology in transdermal, pulmonary & APIs
- Investment in process equipments
- Broad range of approved production facilities
- Manufacturing of injectables, lyophiliser, anti-cancer, solid orals, soft gels and pulmonary dosage forms

Opportunity for Manufacturing intermediates / API & FDF

Environmental and Regulatory Issues

- Strong regulatory knowledge of U.S. / EU and other markets
- Post approval support for dossier compilation and submission.
- Excellent environmental and GMP compliance record

Proven regulatory and environment track record

Logistics

- Sufficient capacity for synthesis to assure future production

Reliable partner for global supplies

Highlights of Contract Manufacturing for 2005-06

- Your Company entered into 11 supply agreements with innovator and generics companies with peak revenues up to $23.6 mn
- The new facility to manufacture lyophilised vials in alliance with Zambon of Italy is nearing completion

Human Resources

Increasing globalisation of business, heightened competition, changes in the domestic market scenario and increasing focus on research, have all created a plethora of opportunities as well as challenges in the pharma industry.

In this scenario, it has become important for companies to create a culture that is unique, distinctive and one that inspires and motivates people to put in their best. This is reflected in your Company's innovative approach to HR, which seeks to create culture and values that are purely Zydan in spirit.

At the World HRD Congress held at Mumbai, the Team HR received an award for the 'Organisation with Innovative HR Practices'. Over 1,200 delegates comprising CEOs, HR professionals and consultants representing various countries in Asia, Middle East, Far East Europe and U.S. attended the Congress.

At the World HRD Congress, Mumbai, Zydus Cadila won an award for the 'Organisation with Innovative HR Practices'. Mr. S. Damodaran, Chairman, Securities and Exchange Board of India (SEBI) is seen presenting the award to Mr. P.R. Joshi, President - Group HR & Corporate Communications.

Here's a snapshot of how your Company has been able to make a difference:

- While expanding its business globally, your Company has retained the speed, agility and flexibility of a small enterprise. Faster, quicker responses to change and ability to adapt to a new world that is emerging, have made it possible for your Company to rapidly grow its business. This continues to shape your Company's successes as it races ahead into the future.

- Thinking local while going global has also been a differentiated approach of your Company. With subsidiaries in U.S., France, Brazil and South Africa and offices in several other countries, Zydus respects different work cultures. While retaining their distinctiveness, Zydans across the world have been able to harmonise and amalgamate those practices which help in bringing about a shared understanding of business.

- Your Company also enjoys one of the most harmonious records in industrial relations with no history of labour discord.

- Given the fact that the Indian pharma industry is prone to high attrition, your Company has an enviable track record in both attracting and retaining new talent. Here's how:

- In times of change, it is often the experience and expertise that steers one through. By valuing people, their contribution and nurturing their growth, your Company has been able to retain its people. The senior management team of your Company has spent an average 12 years with the Company.

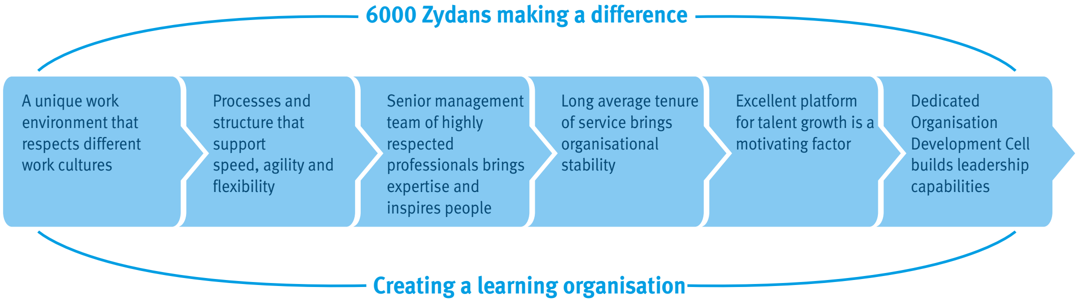
- With the Company evolving and expanding at an accelerated pace, there are ample opportunities for growth. By nurturing talent from within, expanding and enriching roles, helping people maximise their potential, providing new roles to perform and new responsibilities to grow into, your Company has built an excellent platform for talent growth.

- Zydus offers a wonderful opportunity to work with a team of highly respected professionals in the industry and having them as mentors. This, combined with a work environment that is professional, rewarding and supportive of individual aspirations, attracts new talent for your Company.

- Staying ahead of the change curve also needs leaders who can spearhead the Company's foray into new spheres of growth. To build leadership capabilities, a road map of interventions, developmental programmes, competency mapping tools to assess Zydus Leadership competencies and methodologies for executing the development plans has been put in practice. There are currently 92 leadership roles across the organisation, and Zydans in these roles are being nurtured and groomed for higher responsibility under this programme.

- As a learning organisation, HR initiatives in training and development have been ongoing. Training programmes are conducted in co-ordination with reputed institutes such as Indian Institute of Management, Ahmedabad and Indian School of Business, Hyderabad. The training calendar includes strategic leadership development programmes, executive and management development programmes, programmes on inter-functional linkages and other skill building and functional training programmes.

- Above all, it's a special bonding that knits the Zydan family together. It connects 6,000 Zydans who work together and face challenges together. It's a bonding that has evolved over time and now bridges different geographic locations.



Consumer Products Division

Your Company's Consumer Products Division markets products that promote a healthy lifestyle.

The division markets products under two major groups - the Sugar Free range and the EverYuth range. Sugar Free continues to dominate the low sugar artificial table sweetener market in the country and controls nearly 70% of the artificial table sweetener market. EverYuth range of skincare products also performed creditably. During the year under review, the EverYuth range grew by over 35%.

A significant development during the year was the acquisition of a 30.7% stake by your Company in Carnation Nutra-Analogue Foods Ltd., the manufacturers of Nutralite, India's largest selling margarine. Nutralite is a healthier substitute for butter as it is free from cholesterol and it enjoys a 60% market share. The acquisition strengthens the division's offerings to the health-conscious consumers.

Highlights of 2005-06

- Your Company's Consumer Products Division sustained its rapid growth, with combined revenue growing by 28% to Rs. 646 mn
- The Sugar Free group of products grew by over 25%, accounting for over 60% of the division's revenue
- The company launched Sugar Free Natura - a sucralose based sweetener
- It also expanded its EverYuth range with the launch of Dermacare

Operating highlights (Standalone)

Operating Incomes

Sales

The gross sales revenue increased by 16.3% to Rs. 13082 mn in 2005-06 from Rs. 11253 mn in 2004-05. The major drivers for growth have been domestic formulations and exports of formulations.

Rs. in Million

Break up of gross sales	2005-06	2004-05	% of Growth
Domestic formulations	9738	8431	15.5%
Exports - formulations	1157	572	102.3%
API - domestic	452	499	(9.5%)
API - exports	1090	1247	(12.6%)
Consumer and others	646	504	28.1%
Total	**13082**	**11253**	**16.3%**

The formulation exports grew handsomely by 102.3% y-y, on the back of start of business in U.S. and Brazilian markets, and healthy growth of 29% in sales to other emerging markets. However, APIs and intermediates business continued to face stiff competition and pressure on prices, resulting into de-growth in sales. Consumer business (Sugar Free and EverYuth range) also reported healthy 28.1% y-y growth.

Other Operating Incomes

The other operating incomes, which mainly comprise export incentives and contract manufacturing income, increased by 20.4% to Rs. 377 mn from Rs. 313 mn in 2004-05. Start of income from global contract manufacturing, which stood at Rs. 92 mn for 2005-06, and growth of 17% in other processing income y-y fuelled overall growth.

Exports incentives of 2004-05 were higher at Rs. 130 mn since it included one-time special incentive of Rs. 69 mn on account of Duty Free Credit Entitlement (DFCE) Scheme of the Government, which was allowed on growth in exports made in 2003-04 over exports of 2002-03. Against this higher base of 2004-05, exports incentives in 2005-06 were at Rs. 55 mn. as there was no such benefit of DFCE.

Operating Expenses

Material Cost

Consumption of materials and finished goods as % to sales increased marginally to 38.9% in 2005-06, compared to 38.3% in 2004-05. This is attributed to comparatively higher material costs for formulations sold to U.S. subsidiary, and write-off of certain obsolete and non-moving inventories.

Personnel Costs

Personnel cost (excluding R&D) increased by 7.4% y-y to Rs. 1357 mn. The total number of employees at the end of the year stands at 5700.

Research & Development Expenses

The research and development expenditure (incl. staff cost but excluding depreciation) increased by 15.1% y-y to Rs. 817 mn, compared to Rs. 710 mn in 2004-05. The company continued its conservative accounting policy of charging all revenue costs related to research and regulatory dossiers completely to revenue in the same year, irrespective of the potential future benefits. In terms of % to sales, the R&D expenses were 6.3% of sales, same as last year.

Manufacturing, Selling, Distribution and General Expenses

Manufacturing, selling, distribution and other general expenses increased by 14.3% y-y to Rs. 3132 mn from Rs. 2738 mn in the previous year. The selling and distribution costs increased by 19.4% to Rs. 1553 mn from Rs. 1301 mn in 2004-05, mainly due to incresase in distribution costs on sales to US, Brazil and other emerging markets. Other operating expenses grew by 9.8%, with increases in manufacturing expenses mainly because of production for U.S. markets.

Depreciation and Amortisation

Depreciation and amortisation expenses was up 8.8% y-y to Rs. 616 mn, versus Rs. 566 mn in 2004-05. This includes amortisation of Rs. 244 mn on intangible assets.

Interest and Financial Charges

Total interest and other financial charges increased marginally by 1.5%, from Rs. 202 mn to Rs. 205 mn, including the impact of exchange rate fluctuations on the debt portfolio. However, gross interest paid reduced from Rs. 186 mn to Rs. 175 mn due to switching over to lower cost loans as well as resorting to FC loans.

Profits and Margins

The PBITDA (Profit before interest, tax, depreciation and amortisation) increased by 17.7% to Rs. 2820 mn in 2005-06, from Rs. 2395 mn a year ago. The PBITDA margin (% to sales) was marginally higher at 21.6% in 2005-06, compared to 21.3% last year, inspite of expense growth y-y, lower dividend income and lower margins from sales to U.S. subsidiary.

Reconciliation of PBIDT margin	% to sales
PBIDT margin for 2004-05	21.3%
Lower material cost & excise	0.2%
Lower personnel cost	0.8%
Lower mfg., selling, distribution & other expenses	0.5%
Higher other operating income	0.1%
Lower other non-operating income	(1.3%)
PBIDT margin for 2005-06	**21.6%**

The PBT increased by 25.6% y-y to Rs. 1888 mn and the PAT (Profit after Tax) was up 25.5% y-y to Rs. 1649 mn, from Rs. 1314 mn in 2004-05. The net margin was higher at 12.6% from 11.7% in 2004-05.

Reconciliation of net margin	% to sales
PAT margin for 2004-05	11.7%
Higher PBIDT margin as above	0.2%
Lower depreciation and amortisation	0.3%
Effect of interest & ERF	0.2%
Effect of exceptional items (VRS compensation)	0.3%
Tax provision	(0.1%)
PAT margin for 2005-06	**12.6%**

Shareholder's Funds

The total shareholder's funds increased to Rs. 7363 mn at the end of March 31, 2006, from Rs. 6144 mn at the end of March 31, 2005. While the share capital remained at Rs. 314 mn, the free reserves increased to Rs. 7049 mn, from Rs. 5830 mn at the end of 2005-06 mainly on account of retained earnings.

The net worth (after deducting miscellaneous expenditure to the extent not written-off) increased to Rs. 7363 mn as on March 31, 2006 from Rs. 6069 mn at the end of March 31, 2005. The book value per share increased to Rs. 117.2 at the end of March 2006 from Rs. 96.6 a year ago. The return on equity (ROE) was 22.4-% in 2005-6 compared to 21.7% last year.

Debt

The total debt of the Company (including buyers credit) went up from Rs. 3946 mn at the end of 2004-05 to Rs. 4522 mn at the end of 2005-06. Debt of Rs. 3067 mn is in foreign currency of which approximately 65% is hedged forward. The debt to equity ratio at the end of March 31, 2006 was 0.61:1, improved from 0.65:1 at the end of 2004-05.

Fixed Assets and Capital Expenditure

The total gross block at the end of 2005-06 is Rs. 10151 mn, up by 6.8% y-y. 25.8% of this is by way of intangible assets such as trade marks, patents, technical know how and commercial rights. Net block stood at Rs. 6860 mn.

The total capital expenditure (including capital work in progress) during the year was about Rs. 900 mn. The majority of this was on plant and machinery and buildings.

Working Capital and Liquidity

The working capital (excl. Buyer's Credit) at the end of March 31, 2006 increased to Rs. 3682 mn, from Rs. 2475 mn at the end of March 31, 2005 and comprised current assets of Rs. 6088 mn net of current liabilities and provision of Rs. 2406 mn.

The receivables increased by Rs. 763 mn to Rs. 1851 mn at the end of 2005-06 and from 35 days (of turnover) in 2004-05 to 52 days in 2005-06. Last year, receivables were lower because of lower sales in the month of February and March because of destocking by trade. Inventory levels improved from 63 days last year to 59 days.

Loans and advances as on March 31, 2006 increased by Rs. 714 mn to Rs. 2086 mn, from Rs. 1372 mn as on March 31 2005 due to increase in loans given to subsidiaries.

Current liabilities of Rs. 2406 mn include sundry creditors of Rs. 1691 mn. The current ratio at the end of March 2006 was 2.53 (previous year 2.13).

Capital Employed and Operating Efficiency

The total Capital Employed (CE) at the end of the year was Rs. 12.8 bn, up from Rs. 10.8 bn at the end of the previous year. The Return On Capital Employed (ROCE = Profit Before Interest after Tax/CE) increased marginally from 17% in the previous year to 17.2%.

Performance on a Consolidated Basis

Note: The consolidated results of 2004-05 included a 15-month period ending on March 31, 2006 for the following subsidiaries and JV, to align their interim reporting periods, hitherto reported with a three-month lag, with that of the parent company.

- Zydus France SAS
- Zydus Healthcare (USA) LLC
- Zydus Pharmaceuticals (USA) Inc.
- Zydus Healthcare Brasil Ltda.
- Zydus International Pvt. Ltd.
- Zydus Altana Healthcare Pvt. Ltd.

Similarly, the consolidated results for the period ended March 2005 included a 13-month period ending on March 31, 2005 for Zydus Healthcare SA (Pty) Ltd. to align its interim reporting period with that of the parent company. Hence, consolidated results of 2005-06 are not strictly comparable with those of 2004-05.

On a consolidated basis, the sales revenue increased by 15.5% to Rs. 15.1 bn from Rs. 13.1 bn in 2004-05. Total income grew 16.2% to Rs. 14.9 bn from Rs. 12.8 bn in 2004-05. The operating expenses increased by 15.6% y-y, and the PBIDT increased by 18.6% to Rs. 2913 mn from Rs. 2457 mn in 2004-05. The net profit was higher by 27% to Rs. 1524 mn from Rs. 1199 mn in 2004-05.

Overall, although the profit contribution from the 50% owned Zydus Altana JV was lower (Rs. 460 mn for 12-month period ended March 31, 2006, compared to Rs. 754 mn for 15-month period ended March 31, 2005), the consolidated results of 2005-06 were higher due to:

- Standalone results getting positive impact of re-stocking due to VAT in the first quarter of the year, resulting into 25.5% higher net profit y-y.
- Lower losses of the French subsidiary - Rs. 238 mn for the 12-month period ended March 31, 2006, versus a loss of Rs. 307 mn for 15 month period ended March 31, 2005. The generics business of the subsidiary has gained momentum. With selling off of branded business and agreement with Evolupharm (the effect of which will be seen next year), the operations of the subsidiary are expected to improve further.
- Profits of Zydus Pharmaceuticals USA Inc. of Rs. 4 mn compared to loss of Rs. 95 mn for 15-month period ended March 31, 2005.
- Turnaround of business of Sarabhai Zydus Animal Health Ltd., which registered profits Rs. 66 mn versus loss of Rs. 16 mn in 2004-05 (50% of which is reported in consolidated results).

Losses by some subsidiaries, mainly Zydus France SAS and Dialforhealth India Ltd. resulted into consolidated net profit being lower than the parent company's stand alone net profit.

Threats, Risks and Risk Mitigation

Risk from R&D Spend proving to be infructuous

Globally, of every 10,000 compounds tried out, only one finally makes it to the market. This represents a substantial risk of the R&D spend not resulting in corresponding benefits.

Risk Mitigation

While there is no certainty of the benefit from the R&D spend, the Company is following a dual strategy to limit and mitigate this risk. It plans to take the development of NCEs up to a certain level and then seeks to license the molecule out to partners. Also as a matter of prudent accounting policy, the Company expenses the entire revenue spend (except capex) in the year of spend itself.

Risk from International Operations

As the Company steps up its international operations, and the contribution of exports to the total revenue grows larger, the ensuing risk from operating in foreign countries also grows higher. This includes, inter alia political risk, credit risk, litigation risk and currency risk.

Risk Mitigation

The Company's operations are spread over wide geographies from America to Europe to CIS to Far East to Southern Africa and this spread acts as a mitigating factor. Additionally, the Company principally operates in markets where the Rule of Law prevails and systemic redressal mechanisms exist.

Forex Risk

The company's exports are principally denominated in US Dollars. Similarly its imports and debts are partially denominated in Euro. Any Rupee appreciation versus the US Dollar or its depreciation versus the Euro may impact the company adversely.

Risk Mitigation

The Company has an institutionalised Forex Risk Management Policy in place, which seeks to protect the Company from adverse impact of exchange rate movements. As a matter of policy, the company hedges a portion of its export receivables in US Dollars and a portion of its payables in Euro. Also, a portion of company's debt is denominated in US Dollars, which partially creates a natural hedge against forex risks on future exports.

Litigation Risk

As the Company enters the generics markets in advanced countries, it faces the risk of entering into litigation with product originator or patent holder and the ensuing costs.

Risk Mitigation

While Litigation Risk can never really be completely ruled out, the Company has obtained expert legal advice and believes that at the present stage of the growth of the company, such a risk is minimal.

Price Controls

The Indian pharma industry is subject to the Drug Price Control Order (DPCO) 1995 enforceable by the National Pharmaceutical Pricing Authority (NPPA). While the new Drug Price Control Order has not yet taken final shape, it may have adverse effect on the prices of products marketed by the Company.

Risk Mitigation

While the DPCO does limit what a pharmaceutical company can do for certain classes of products, the Company is mitigating this risk, launching newer classes of products which are not covered by the DPCO as well as improving the operating efficiencies of its production processes to reduce costs.

JV Risk

The Company has several joint ventures with varied partners contributing substantially to its revenues. Any adverse developments in these JVs would impact the Company.

Risk Mitigation

While risks from adverse market developments and other external factors remain, it has to be noted that the Company has a lot of experience in managing the JVs in a manner that is profitable to both the partners. Additionally, most JV operations are covered by long-term agreements with the partners.

Joint Ventures

The Company has adopted a unique approach to create value for its stakeholders as well as its partners. This is to enter into win-win relationships, which are mutually beneficial to both your company, as well as its partners. As of date the Company has the following JVs:

Zydus Altana Healthcare Pvt. Ltd.
During FY 2005-06, the manufacturing capacity for the JV was expanded from 48 tonnes to 60 tonnes.

For the year ended March 31, 2006, the sales revenues were Rs. 1306 mn compared to Rs. 1296 mn in the immediately preceding corresponding 12 months.

Profit after tax for the year ended March 31, 2006 was Rs. 920 mn compared to Rs. 1142 mn in the immediately preceding corresponding 12 months.

The JV paid a total of Rs. 375 mn as dividend compared to Rs. 450 mn in the immediately preceeding corresponding 12 months. With the completion of expansion of the facility, the operations of the JV are expected to be back on track.

Sarabhai Zydus Animal Health Ltd.
This 50:50 JV with Ambalal Sarabhai Enterprises has a strong presence in the animal health market with a special focus in large animals, poultry and pet care segments.

The Company improved its performance significantly in FY 2005-06. Net sales grew from Rs. 709 mn in FY 2004-05 to Rs. 834 mn in FY 2005-06. As a result, from a net loss of Rs. 16 mn in FY 2004-05 the Company was able to report a PAT of Rs. 66 mn.

JV with Mayne Pharma
During the year, the Company signed up a 50:50 JV with Mayne Pharma of Australia to manufacture generic injectable, cytotoxic (anti-cancer) medicines as well as active pharmaceutical ingredients (API) for global markets.

Mayne Pharma (Mayne) focuses on the development, manufacture, sale and distribution of medicines used by oncologists. The Company markets its products in more than 50 countries around the world.

Your Company and Mayne will equally share the investment in construction and validation costs of the new facility and will share in the profits of the joint venture. Both companies will also have equal representation on the JV's Board of Directors. The plant will manufacture both solution and freeze-dried products and have a maximum capacity of approximately 10-12 mn vials per annum. Construction of the facility has already begun and following regulatory approval, the first set of products is expected to be launched around the middle of 2007. The products will be marketed globally by both companies in different territories.

JV with Bharat Serums and Vaccines Limited

During FY 2005-06, the Company also signed a 50:50 JV with one of India's top biotech companies - Bharat Serums and Vaccines Limited (BSV) to develop, manufacture and market a non-infringing and proprietary Novel Drug Delivery System (NDDS) of an approved anti-cancer product for global markets.

BSV is amongst the top 10 biotech companies in India. The Company has significant Research and Development activities with a focus on Biopharmaceuticals, Novel Drug Delivery Systems and Equine products.

The NDDS product being developed by the JVC, has shown evidence of promising safety and anti-tumour activity in variety of cancer models in animals, thereby giving it a competitive advantage that differentiates it from the currently available dosage form. The product has been approved by the Drug Controller General of India (DCGI) for commercialisation in India.

As per the agreement, both companies will undertake a core development programme and are initiating clinical trials for product registration in leading pharmaceutical markets for potential treatment of multiple types of cancer. The Company and BSV have also developed a global development programme to maximise the commercial potential of the product.

Internal Control Systems and their Adequacy

The Company has established procedures for purchase of raw materials and stores, manufacture of finished goods as well as for its sale. Proper procedures exist for receipt/transfer of raw materials, stores and finished products as well as for their proper accounting, including periodical physical verification thereof. Apart from these internal control procedures, a well defined and established system of internal audit is in place to independently review and strengthen these control measures, resulting in considerable cost savings. The Audit Committee of the Board reviews the report of the internal auditor and action as recommended by the Audit Committee is initiated to remedy any weakness in the system.

Financial Section, 2005-06

Directors' Report

Your Directors take pleasure in presenting the 11th Annual Report on the business and operations of the Company together with the Audited Accounts for the year ended 31st March 2006.

Financial Results

(Rs. in Millions)

For the year ended	31 arch 2006	31 arch 2005	Growth (%)
Sales and Other Income	13216	11419	15.74
Profit before Interest, Depreciation, Extraordinary items and Tax (PBIDT)	2820	2396	17.70
Less : Depreciation	616	566	8.83
Profit Before Interest and Tax and Extra Ordinary Items (PBIT)	2204	1830	20.44
Less : Interest	205	202	1.48
Less : Extraordinary items	111	124	(10.48)
Profit Before Tax	1888	1504	25.53
Less : Provision for tax	239	190	25.79
Profit After Tax	1649	1314	25.49
Add : Profit brought forward from the previous year	1490	1064	40.04
Profit available for appropriation	3139	2378	32.00
Earnings per share (EPS of FV Rs. 5/-) in Rs.			
- Before Extraordinary items	28.02	22.90	22.36
- After Extraordinary items	26.26	20.93	25.46

Operations and Business Performance

During the year under review, the Company achieved sales of Rs. 13082 mn, showing a growth of 16.25% compared to the previous year. The PBIDT increased by 17.70% to Rs. 2820 mn. The Profit Before Tax was higher 25.53 % to Rs. 1888 mn. The Profit After Tax increased to Rs. 1649 mn up 25.49% compared to Rs. 1314 mn in 2004-05. The Company achieved EPS (After Extraordinary items) of Rs. 26.26 compared to Rs. 20.93 in 2004-05.

Dividend

Your Directors are pleased to recommend a dividend of Rs. 6/- per equity share on 62,806,854 equity shares of Rs. 5/- each for the financial year ended 31st March 2006. The dividend, if approved, will be paid to the eligible shareholders within the period stipulated by the Companies Act, 1956. The Dividend Payout ratio for the current year (inclusive of corporate tax on dividend distribution) will be 26.08%.

Issue of Bonus Shares

Your Directors recommended an issue of bonus shares in the ratio of one equity share for every one existing equity share of the Company held by the members on a date to be fixed by the Board, by capitalising a part of the Share Premium Account to the extent of Rs. 314,034,270/-. The proposed issue of bonus shares is subject to the consent of the shareholders at the forthcoming Annual General Meeting. The bonus shares shall rank pari passu in all respects with the existing fully paid up equity shares of the Company, including any dividend declared for the financial year in which the bonus shares are allotted.

Acquisition

Your Company has acquired 14.96% stake in Carnation Nutra Analogue Foods Limited (Carnation), a listed public limited Company through open market. The Company has also made voluntary open offer to acquire 20% stake in Carnation in accordance with the SEBI Regulations. As on 31st March, 2006, your Company holds 30.69% stake in Carnation. Pursuant to the acquisition, your Company will have a leading additional brand "Nutralite" in the basket of their Consumer Health Products Division. At present, consumer division of the Company is marketing India's leading table-top Sweetener "Sugar Free". Acquisition of "Nutralite" brand will bring in synergy.

Performance of Subsidiary Companies

The performance of subsidiaries and joint ventures as per the audited accounts of the respective subsidiary / joint venture companies are summarised hereunder. The audited accounts for the foreign subsidiaries are as on December 2005 / February 2006. The January / February to March 2006 accounts are subjected to limited review.

Performance of subsidiary Companies during 2005-06

Sr. No.	Name of Subsidiary	% holding	Main business	Year ended on	Revenues 2005-06 (Rs mn)	Profit after tax 2005-06 (Rs mn)
1	Zydus Pharmaceuticals Limited	100%	Distribution of pharma goods	31st March	177	(2)
2.	German Remedies Limited	100%	Marketing of services	31st March	0	0.9
3.	Dialforhealth India Ltd.	100%	Operates a chain of retail pharmacies	31st March	68	(6)
4.	Dialforhealth Unity Limited	55%	Operates a chain of retail pharmacies on Franchisee basis	31st March	0.3	(0.5)
5.	Zydus International Pvt. Ltd.	100%	Based in Ireland to hold Company's Global Investments	31st Dec.	3	2
6.	Zydus Healthcare SA (Pty) Ltd.	100%	Operates formulation business of the Company in South Africa	28th Feb	0	(0.2)
7.	Zydus Healthcare (USA) LLC	100%	Operates API business in USA	31st Dec.	20	1
8.	Zydus Pharmaceuticals USA Inc.	70%	Marketing of generic formulations in USA	31st Dec.	247	(84)
9.	Zydus Healthcare Brasil LTDA.	100 %	Operates formulation business of the Company in Brazil	31st Dec.	28	(23)
10.	Zydus France SAS	100%	Marketing of generic Pharmaceuticals in France	31st Dec	564	(270)
11.	SCI Immopharm	100%	Purchase, Sale & Lease of properties	31st Dec	5	5

Directors' Report

As required under the provisions of Section 212 of the Companies Act, 1956, a statement of the holding Company's interest in the subsidiary companies is attached to this report.

In terms of the approval granted by the Central Government under Section 212 (8) of the Companies Act, 1956, copy of Balance Sheet, Profit and Loss Account, Report of the Board of Directors and the Report of the Auditors of the subsidiary companies have not been attached with the Balance Sheet of the Company. The Company will make these documents/details available upon request by any investor of the Company.

The annual accounts of the subsidiaries are also available for inspection by the investors at the Registered Office of the Company and also at the respective offices of its subsidiaries. However, pursuant to Accounting Standard AS - 21, issued by the Institute of Chartered Accountants of India, Consolidated Financial Statements presented by the Company includes the financial information of its subsidiaries. The following information for each subsidiary is also being disclosed in a separate annexure with consolidated balance sheet : (a) Capital (b) Reserves (c) Total assets (d) Total liabilities (e) Details of investment (except in case of investment in subsidiaries) (f) Turnover (g) Profit Before Taxation (h) Provision for Taxation (i) Profit after Taxation and (j) Proposed dividend.

Performance of Major Joint Venture Companies

Detailed discussion of performance of joint ventures is covered in Management Discussion and Analysis Report.

1. **Zydus Altana Healthcare Private Limited (ZAHL)**

   This 50:50 joint venture company between the Company and Altana Pharma AG, is a 100% EOU situated at Navi Mumbai. The company achieved turn over of Rs. 1280 mn for the year ended on 31st December, 2005 as against Rs.1367 mn in the previous year. The net profit of the Company was Rs. 935 mn as against Rs. 1121 mn in the previous year. ZAHL paid out four interim dividends of Rs. 750 mn in addition to a final dividend of Rs.5 mn during the year making total of Rs. 755 mn.

2. **Sarabhai Zydus Animal Health Ltd. (SZAHL)**

   SZAHL is a 50:50 joint venture formed between the Company and Ambalal Sarabhai Enterprises Limited to market animal healthcare products. The company recorded sales of Rs. 835 mn showing growth of 17.7%. The company improved its all round performance in the current year and earned a net profit of Rs. 66 mn. The spread of bird flu in India and other countries is likely to adversely affect its poultry business in the current year.

3. **Zydus Pharmaceuticals USA Inc.**

   The aforesaid Company though subsidiary of the Company is a Joint Venture between 100% subsidiary Zydus International Private Limited, Mr. Joseph Renner and Dr. Mahendra Patel. During the year, the Company has started marketing of generic products in the U.S. market and has achieved turnover of Rs. 247 mn in the very first year of its operations. The strategy for USA for dual marketing of products and by the Company's own staff and by Mallinckrodt Inc., is working well.

   The manufacturing facilities of the other Joint Venture Companies namely Zydus Mayne Oncology Private Limited and BSV Pharma Private Limited are under construction.

International market initiatives

Your Directors are pleased to inform you that the Company has started commercial activities in the regulated developed markets like U.S.; France and Brazil. The initial response in both U.S. and Brazil is encouraging. The French subsidiary Zydus France SAS has reorganised its product portfolio and its non-core OTC product portfolio has been disposed off. Zydus France has also entered into an agreement with one of the largest buying groups for marketing its generics in France. A detailed discussion on these initiatives are covered in Management Discussion and Analysis.

Fixed deposits

The Company does not accept any fresh deposits from the public. As on 31st March 2006, the Company had unclaimed fixed deposits of Rs.0.05 mn. All deposits that matured during 2005-06 were paid off.

Credit rating

During the year under review, CRISIL reviewed the credit rating and upgraded it to AA+ from AA, signifying the Company's strong position to repay its debts on time.

Disclosure

As required under Section 217(1)(e) of the Companies Act, 1956 read with the Companies (Disclosure of Particulars in the Report of Directors) Rules, 1988, the relevant information and data with respect to the conservation of energy, technology absorption and foreign exchange earnings/outgo have been provided in **Annexure-A**, attached to this report, and forms a part of this report.

There have been no material changes and commitments, which may affect the financial position of the Company between the end of the financial year and the date of the report.

As required under Section 217(2) of the Companies Act, 1956, the Board of Directors inform the members that during the financial year there has been:

* No change in the nature of the Company's business,
* No change in the Company's subsidiaries, except those specifically stated in this report or in the nature of the business carried out by them,
* No change in the classes of business in which the company has an interest.

Management's Discussion and Analysis (MDA)

MDA covering details of operations, international markets, research and development, opportunities and threats, etc. for the year under review is given as a separate statement, which forms a part of this Annual Report.

Directors

Mr. H.K. Bilpodiwala and Mr. H. Dhanrajgir, Directors of the Company retire by rotation at the ensuing Annual General Meeting and are eligible for re-appointment. The Board recommends the re-appointment of Mr. H. K. Bilpodiwala and Mr. H. Dhanrajgir who have offered themselves for re-appointment. In accordance with stipulation under Clause 49 of the Listing Agreement, brief resume of Mr. H. K. Bilpodiwala and Mr. H. Dhanrajgir together with nature of their expertise in specific functional areas and names of the companies in which they hold office of a Director and/or the Chairman/Membership of Committees of the Board, is given in the Notice of the Annual General Meeting.

Directors' Report

Auditors

The Audit Committee of the Board of Directors of the Company has recommended the re-appointment of M/s. R. R. Patel & Company and M/s. Mukesh M. Shah & Company, both Chartered Accountants, as joint auditors of the Company, who retire at the conclusion of the ensuing Annual General Meeting and, being eligible, offer themselves for re-appointment as statutory auditors.

Personnel

The statement of particulars of employees, providing information as per section 217(2A) of the Companies Act, 1956 read with Companies (particulars of Employees) Rules, 1975, form a part of this report. However, as per the provisions of Section 219(1)(b)(iv) of the Companies Act, 1956, the Annual Report excluding this statement is being sent to all the members. Any member interested in obtaining a copy of this statement may write to the Company Secretary at its registered office.

Directors' Responsibility Statement

Pursuant to the requirements under Section 217 (2AA) of the Companies Act, 1956 and to the best of their knowledge and belief, and according to the information and explanations provided to them, your Directors hereby state that:

(a)The Annual Accounts for the year ended 31st March 2006 are prepared on going concern basis.

(b)In preparation of the Annual Accounts, all the applicable accounting standards have been followed. Necessary explanations are given for material departures, if any;

(c) Sound accounting policies have been selected and applied consistently and judgements and estimates made that are reasonable and prudent so as to give true and fair view of the state of affairs of the Company as on 31st March, 2006 and of the profit of the Company for the year ended on that date;

(d)Proper and sufficient care has been taken for maintenance of adequate accounting records in accordance with the provisions of the Companies Act, 1956 for safeguarding the assets of the company and for prevention and detection of fraud and other irregularities;

Corporate Governance

The Company complies with the mandatory provisions of Corporate Governance as prescribed in Clause 49 of the Listing Agreement. The Board of Directors of the Company had evolved and adopted a Code of Conduct which is available on the website of the Company www.zyduscadila.com.

Acknowledgement

Your Directors place on record their deep sense of appreciation of the contribution made by the employees at all levels, including that of subsidiaries and joint ventures for their dedicated service, enabling the Company to achieve good performance during the year under review.

Your Directors also take this opportunity to place on record the valuable co-operation and continued support extended by the financial institutions, Company's bankers, medical professionals, foreign collaborators, business associates and investors.

By Order of the Board of Directors

Place : Ahmedabad
Date : 28th April 2006

Pankaj R. Patel
Chairman

Annexure to the Directors' Report

ANNEXURE - A

Information required under SectionK217(1)(e) of the Companies Act, 1956.

Disclosures

1. Conservation of Energy: M

a. The Company has taken the following measures for Conservation of Energy.

General measures :

- Regular preventive maintenance of Pumps & Air Compressors, Steam traps, Joints, Steam leakages to reduce transmission loss and to get maximum output.
- eeping lights and Air Conditioning systems off during non-working hours.
- aintenance of power factor at 99.8%.

Specific measures taken:

At Formulation units :-

- Use of Bagasse Briquette in place of furnace oil.
- Installation of HFO DG set to run on Furnace Oil to reduce power generation cost.
- Replacement of metal halide tube fitting with reflector type tube light fitting in all the warehouses.
- Installation of waste heat recovery system on exhaust of HFO DG Set to produce the steam.
- Installation of highly efficient centrifugal chiller in the HVAC System.
- VFDs provided in AHUs.

At API Plants

- Installation of Waste Heat recovery System for CPP Plant.
- Usage of Bagasse briquette in place of furnace oil.
- Installation of economiser to recover waste heat of boiler.
- Saving due to installation of automatic blow down and monitoring of steam traps.
- Introduction of VFD monitoring for cooling tower.
- Change to FRP fan for Cooling Tower.
- Installation of digital power factor controller.

b. Proposals for additional investments : -

Formulation Unit at Moraiya (Gujarat)

- Installation of neutral compensator to reduce neutral current to decrease maintenance on single phase electrical distribution.
- Installation of water Re-circulation System on water ring vacuum pump to reduce the wastage of water.
- New AHU to connect with BMS system to save energy.
- Condensate recovery in new areas.

API Unit-1 at Ankleshwar (Gujarat)

- Installation of heat recovery system for boiler fluegas to preheat boiler feed water.

c. Impact of measure (a) and (b) :

i) Reduction in Power Consumption

ii) Reduction in Steam Consumption and thereby reduction in Fuel Consumption.

iii) Reduction in diesel and oil consumption by utilising waste heat recovery system.

Form - A

(A) Power and fuel consumption

	Current Year Total Consolidation	Previous Year Total Consolidation
1. Electricity :-		
(a) Purchased		
Units	29945263	28165909
Total Amount (Rs. in mn)	139.63	131.70
Rate/Unit (Rs.)	4.66	4.68
(b) Own Generation :		
i) Through Diesel Generator		
Units	1677885	4042333
Units per lt. of Diesel oil	2.59	3.41
Cost/Unit (Rs.)	9.67	7.21
ii) Through LDO Generator		
Units	2130065	3133991
Units per lt. of Fuel Oil	3.5	3.90
Cost /Unit (Rs.)	7.45	5.60
iii) Through HFO DG Set		
Unit	1380800	Nil
Unit per lit. of Fuel	4.2	
Cost / Unit	4.01	
iv) Through CPP (Natural Gas)		
Unit	5167464	4173296
Unit per lit. of Gas (M3)	3.13	3.10
Cost / Unit	3.24	3.00
2. Coal (Specify quality and where used)	Nil	Nil
3. Furnace Oil / LDO		
Furnace OIL		
Quantity (K. Lt.)	2663.96	2930.48
Total Amount (Rs. in mn)	45.98	37.75
Average Rate per Lt.	17.27	12.88
Light Diesel Oil		
Quantity (K .Lt.)	27.4	118.65
Total Amount (Rs. in mn)	0.49	1.79
Average Rate per Lt.	18.1	15.08
HSD		
Quantity (K .Lt.)	48.774	1.3
Total Amount (Rs. in mn)	1.37	0.04
Average Rate per Lt.	28.09	27.30
4. Others / Internal Generation		
Natural Gas		
Quantity m^3	3654937	3192618
Total Cost (Rs. in mn)	32.55	28.51
Rate/Unit (Rs.)	8.90	8.93
Bagasse		
Quantity MT	1177.565	Nil
Total Amount (Rs. in mn)	0.41	
Rate / Unit MT	345	

(B) Consumption per unit of production

The Company manufactures a wide range of bulk drugs, a large number of formulations and other products. In view of this, it is impractical to apportion the utilities unit wise.

Form - B

Research and Development

1. Specific areas of Research & Development

Following Research & Development activities are carried out :

Sr. No.	Location	A. Main area of Focus	B. Benefits derived as a result of Research and Development Activities
1	Basic Research at Zydus Research Centre, Moraiya,Gujarat.	1. **NME Research:** The focus in this department is to develop new Molecular Entities based on specific targets. The research areas are: **a. Metabolic Disorders** Diabetes Obesity Dyslipidemia Cardiovascular risk **b. Inflammation and Pain** Rheumatoid arthritis Pain 2. **Biotechnology Research :** Research is being directed towards: a. Development of new Biological entities b. Development of screening assays. 3. **Novel Drug Delivery Research:** a. Development of Novel platform technology for slow/extended release of drug b. Development of Novel formulation.	**1. NME research :** a. Successfully completed Phase-I clinical trials for lead compound **ZYH1** for treating dyslipidemia and related disorders. Received permission for conducting Phase-II clinical trials. b. Filed IND application for conducting Phase-I clinical trial for our lead compound **ZYI1** for the treatment of Inflammatory disorders & pain to DCGI. c. Filed IND application for lead compound for treating diabetes **ZYH2** with DCGI. d. Identified lead compounds for treatment of obesity & related diseases and the compound is presently undergoing extensive pre-clinical testing. e. Several other compounds have reached different stages in drug discovery research and patents have been filed in USA, India and other countries.
2.	Research and Development in Formulations at Pharmaceutical Technology Centres (PTC) at Ahmedabad, Thana and at other Formulation Units.	Specific area of Research at "Pharmaceutical Technology Centre (PTC)" is formulation development for regulated markets like U.S., Europe, Brazil, S. Africa and emerging markets like Ukraine, Russia, Taiwan.	Commercial production for markets like U.S., Europe, Brazil has started. During the year 2005-06, 49 dossiers have been filed in the regulated markets and 385 dossiers have been filed in the emerging markets.
3.	Research and Development in Active Pharmaceutical Ingredients (APIs) at Ankleshwar, Dabhasa.Patalganga and Zyfine,	1. Cost Reduction and process improvements of Etoricoxib, Venlafaxien Hydrochloride, Atorvastatin, Parosetine, etc. 2. Developing commercially viable non-infringing processes for regulated markets. 3. Developing commercially viable processes for semi-regulated markets 4. Filing patents 5. Contract research 6. Custom/contract manufacturing	1. Cost of several APIs reduced. Improved sales and gross contribution. 2. Support to captive requirements for domestic & export markets by producing APIs. 3. Twelve DMFs have been filed during the year. 4. Eleven process patents have been filed during the year. 5. Research Collaboration with multinationals for their NCE / Pipeline molecules. 6. Several new products developed and successfully commercialised for semi regulated markets.

2. Future plan of action

A. Basic Research at Zydus Research Centre

NME Research:

I) To work on several new emerging targets in:

i. Metabolic disorders

ii. Inflammatory disorders

iii.Cardiovascular risk

II) Optimise existing leads molecules for IND application

III) Carry on further clinical trials on compounds in different phases

B. Research in Formulations at Pharmaceutical Technology Centres and other Formulation Units :

I) New Drug Delivery systems like Transdermal patches, Aerosol and other platform based oral dosage forms shall be the focus for the future.

II) To develop various products for domestic and international regulated & non-regulated markets

C. Research in Active Pharmaceutical Ingredients (APIs)

I) Further improvement in Technology planned for several APIs.

II) Develop more APIs for regulated and semi-regulated generic markets of U.S. and France.

3. Expenditure on R & D

	(Rs. in mn)
(i) Capital	370
(ii) Recurring	817
(iii)Total	1395
(iv)Total R&D expenditure as a percentage of turnover	10.66%

4. Technology absorption, adaptation and innovation:

During the year under report, the Company has not imported any technology.

I) Efforts in brief, made towards technology absorption, adaptation and innovation:

The Company has successfully introduced the technology developed by in-house research and introduced several new formulations. It has also implemented several new processes for API's, both in domestics and international market.

II) Benefits derived as a result of the above efforts:

- Innovative products for introduction of new Formulations / API's.
- Cost reduction in API to compete in the market.
- Manufactured new APIs for captive consumption and exports.
- Filed 11 ANDAs and 12 DMFs for developed market and filed several dossiers for developing and semi-regulated markets.

5. **Details of imported technology during the last five years :**

The Company has imported technology from Schering AG, Germany for the manufacture of certain pharmaceutical products in the year 2003-2004 and it has been fully absorbed and the products manufactured by the Company were also introduced in the market.

a. If not fully absorbed, areas where this has not taken place, reasons there of and future plans of actions:

There is no pending absorption so this is not applicable.

6. **Foreign exchange earnings and outgo:**

(Rs. in mn)

	2005-06	2004-05
Earnings :		
1. F.O.B. Value of exports	2073	1380
2. Others	117	8
Outgo :		
1. CIF value of imports	1315	1285
2. Expenditure in foreign currency	723	658

By order of the Board of Directors

Place : Ahmedabad
Date : 28th April, 2006.

Pankaj R. Patel
Chairman

Company's Philosophy on Corporate Governance Code

Cadila Healthcare Limited believes in continuous good corporate governance and always strives to achieve performance at all levels by adhering to good corporate governance practices, such as managing its affairs with diligence, transparency, responsibility and accountability. We have therefore designed our systems and action plans to enhance performance and stakeholder value in the long run. To create a culture of good governance, your Company has adopted practices which comprise performance accountability, effective management control, constitution of Board Committees as a part of the internal control system, fair representation of professionally qualified, non-executive and independent Directors on the Board, adequate and timely disclosure of information and the timely discharge of statutory duties. We take pleasure in reporting that your Company has complied in all respects with the features of corporate governance specified in Clause 49 of the Listing Agreement.

I. Board of Directors

The Executive Committee which comprises the Managing Director, Executive Director, the Chief Financial Officer and various business and service heads, manages the day-to-day business affairs of the Company. The Board of Directors monitors the overall business operations based on updates of the Company's performance provided by the Managing Director on a regular basis.

(A)Composition of the Board :

The Composition of the Board of Directors, with reference to the number of Executive and Non-Executive Directors, meets the requirement of the Code of Corporate Governance. The Board is headed by the Executive Chairman, Mr. Pankaj R. Patel, who is also the promoter Director. As on 31st March 2006, your Company's Board comprises seven Directors; which includes one Executive Director and six Non-Executive Directors who have considerable experience in their respective fields. Except Mr. Pankaj R. Patel and Mr. Sharvil P. Patel, all other Directors are independent Directors in terms of Clause-I (A) (iii) of Clause 49 of the listing agreement. Board represents a balance mix of professionalism, knowledge and expertise.

Board Meetings / Director's Particulars:

Your Company's Board met eight times during the year under review on 29th April 2005, 26th July 2005, 27th August 2005, 22nd October 2005, 15th December 2005, 28th January 2006 and 17th March 2006 (Two meetings). The Company held one Board meeting in each quarter and the gap between any two Board meetings was not more than four months as prescribed under the Company Law and the listing agreement. Details of the Directors, their positions, attendance record at Board and last AGM, other Directorships (excluding private limited, foreign companies and alternate directorships) and the membership of Board Committees other than your Company as on 31st March, 2006 are as follows :-

Name of Directors	Position	Board Meetings held during the year	No. of Board meetings attended	Whether attended last AGM	Member (Chairman)*** of other Board Committees @	Number of other Directorships held
Mr. Pankaj R. Patel *	Chairman and Managing Director	8	8	Yes	3 (2)	7
Mr. Mukesh M Patel	Non-executive and independent	8	8	Yes	3 (3)	5
Mr. Pranlal Bhogilal	Non-executive and independent	8	7	Yes	0	2
Mr. H. K Bilpodiwala	Non-executive and independent	8	7	Yes	2 (1)	5
Mr. H. Dhanrajgir	Non-executive and independent	8	7	Yes	6 (3)	6
Mr. A S Diwanji	Non-executive and independent	8	6	No	0	0
Mr. Sharvil P Patel**	Non-executive	8	8	Yes	1	4

* Promoter Director

** Son of Mr. Pankaj R. Patel

*** Figures in ( ) indicates the number of Board Committees of which Chairman

@ For the purpose other committee means Audit Committee and Shareholders' Grievance Committee

(B) Non-Executive Directors' Compensation and Disclosures

Non executive directors, including independent directors are paid sitting fees and commission as recommended by the Board of Directors and approved by the Members at the Annual General Meeting held on 26th July 2005 and 30th September 2003 respectively, which is within the limits approved by the members at the General Meeting and are in accordance with the applicable laws.

Information available to the members of the Board :

The Board of your Company is presented with all information as specified in Clause 49 of the listing agreement whenever applicable and materially significant. Such information is submitted well in advance with the agenda papers and in very exceptional and urgent cases only some issues are tabled during the course of the Board meetings.

Role of Independent Directors:

The Independent Directors play an important role in the deliberations in Board Meetings and bring with them rich expertise in the field of pharmaceutical industry, accountancy, finance, taxation and law.

(C) Related Party transactions :

There are no materially significant related party transactions, pecuniary transaction or relationship between the Company and its Directors except those disclosed in the financial statements for the year ended 31st March 2006.

(D) Code of Conduct

Company's Board has laid down a code of conduct for all Board members and senior management of the Company. The Code of Conduct is available on the website of the Company www.zyduscadila.com. All Board members and senior management personnel have affirmed compliance with the Code of Conduct. A declaration signed by the Chairman and Managing Director to this effect is enclosed at the end of this report.

II.Committees of the Board

The Company has three Board-level Committees, namely;

a) Audit Committee;
b) Share Transfer Committee;
c) Shareholders' / Investors' Grievance Committee

a)Audit Committee:

As on 31st March 2006, the Audit Committee comprise of four Independent Directors. Name of the members and the Chairman of the Committee as on 31st March 2006 together with their attendance are given in the following table.

Name of the Member	No. of Meetings	Meetings Attended
Mr. Mukesh M. Patel, Chairman	4	4
Mr. Pranlal Bhogilal	4	4
Mr. H. K. Bilpodiwala	4	4
Mr. H. Dhanrajgir	4	4

All members of the committee have accounting and financial management expertise. The Audit Committee held four meetings during 2005-06 on 29th April 2005, 26th July 2005, 22nd October 2005 and 28th January 2006. The time gap between any two meetings was less than four months.

The Chairman of the Audit Committee attended the Annual General Meeting of the Company held on 26th July 2005 to answer shareholder queries.

The Managing Director, Chief Financial Officer, Chief Accounts Officer, Statutory Auditors, management Auditors and the Cost Auditors are invited to the meetings of the Audit Committee. The Company Secretary acts as Secretary to the Committee.

The Terms of Reference of the Audit Committee cover the matters specified for Audit Committees under Clause 49 of the Listing Agreement and Section 292A of the Companies Act, 1956.

The management of the Company is responsible for the Company's internal controls and the financial reporting process while the statutory auditors are responsible for performing independent audit of the Company's financial statements in accordance with the generally accepted auditing practices and for issuing reports based on such audits. The Audit Committee supervise these process and thus ensure proper and timely disclosures to maintain the transparency, integrity and quality of financial control and reporting.

The role of the Audit Committee, among others, include the following:

- Supervision of the Company's financial reporting process.
- Reviewing with management, the financial results before placing them to the Board with a special emphasis on accounting policies and practices, internal controls, compliance with the accounting standards and other legal requirements concerning financial statements.
- Reviewing the adequacy of the audit and compliance function, including their policies, procedures, techniques and other regulatory requirements with the statutory auditors.

- Recommending the appointment and removal of external auditors and their fees.
- Reviewing the observations of internal and statutory auditors about the findings during the audit of the Company.
- Reviewing the financial and risk management policies.
- Keeping watch on timely payment to depositors, debentureholders, shareholders and creditors.
- Reviewing the performance of statutory and internal auditors.
- Reviewing management discussion and analysis of financial condition and result of operations.
- Reviewing of significant related party transactions, if any.
- Reviewing of appointment, removal and terms of remuneration of Chief Internal Auditor.

The Company continued to derive benefit from the deliberations in the Audit committee meetings since members are experienced in the areas of finance, accounts, taxation, company law and the industry. It ensures accurate and timely disclosures that maintain the transparency, integrity and quality of financial control and reporting.

b) Share Transfer Committee:

1) **Terms of reference:**

The Committee is empowered to perform all the functions of the Board in relation to approve and monitor transfers, transmission, dematerialisation, rematerialisation, and issue of duplicate shares, splitting and consolidation of shares issued by the Company.

2) **Composition:**

The Share Transfer Committee comprises the following members:

Mr. Pankaj R. Patel - Chairman
Mr. Mukesh M. Patel; and
Mr. Pranlal Bhogilal (w.e.f. 29th April, 2005)

3) **Meetings and attendance during the year:**

The Committee meets on a need basis at least twice a month to ensure the regular process of transfers/transmissions of shares and issuance of duplicate Share Certificates to ensure timely transfers of shares.

c)Shareholders'/Investors' Grievance Committee:

1) **Terms of reference:**

The Shareholders'/Investors' Grievance Committee is empowered to perform all functions of the Board in relation to handling of Shareholders' Grievances. The prime Committee primarily focuses on review of investors complaints and their redressal and the queries received from the shareholders with respect to transfer of shares, non-receipt of shares, non- receipt of declared dividends, etc.

2) **Composition:**

The Committee met four times during the year. The Constitution and details of attendance of the Committee is given as below :

Name of the Members	No. of Meetings	Meetings Attended
Mr. Mukesh M. Patel, Chairman	4	4
Mr. Pankaj R. Patel	4	4
Mr. Pranlal Bhogilal*	4	4

* Appointed as a member of the Committee w.e.f 29th April, 2005.

The Company Secretary is the Secretary of the Committee who is designated as Compliance Officer of the Company.

Neither any complaint remained unresolved nor any request for transfer of shares is pending as on 31st March, 2006.

As on 31st March 2006, 37,443 equity shares remained in the in-transit account with National Securities Depository Limited and Central Depository Services Limited.

III Subsidiary Companies

None of the subsidiaries of the Company come under the purview of the material non- listed subsidiary. However, the particulars the significant transactions and arrangements entered into by the unlisted subsidiary Company are placed at the Board Meeting of the Company.

IV Disclosures

(A) **Related Party Transactions**

The Company has not entered into transaction of material nature with related parties i.e. Directors or Management, their subsidiaries or relatives conflicting with the Company's interest at large. The Register of Contracts containing transactions in which Directors are interested is placed before the Board regularly for its approval. The details of related party transactions are disclosed in financial section of this Annual Report.

(B) **Remuneration of Directors**

Mr. Pankaj R, Patel is the only Executive Director. The Board of Directors decides remuneration of the Executive Director within the ceiling fixed by the shareholders as per the resolution passed at the Annual General Meeting held on 16th July 2001. The remuneration paid to Mr. Pankaj R. Patel for the year ended on 31st March 2006 was as follows:

Rs. in Mn

Salary & Allowance	Commission	Perquisites	Retiral Benefits	Service Tenure	Notice Period
99	0	0	0.3	5 yrs. from 01.09.2001	3 months

Independent Directors are paid sitting fees of Rs. 5,500/- per Board and Audit Committee meeting as remuneration and commission which shall not exceed one per cent per annum of net profits of the Company, subject to maximum of Rs.50,00,000/- in aggregate to the Directors of the Company or some or any of them other than the Managing Director. Directors are also reimbursed the travelling and out-of-pocket expenses for attending such meetings. The details of the commission / sitting fees paid to the Non-Executive Directors during the year 2005-06 are given in the following table:

(Amount in Rs.)

Name of the Non-Executive Directors	Commission	Sitting fees		Total	No. of shares held in the Company
		Board Meetings	Audit Committee Meetings		
Mr. Mukesh M. Patel *	3,50,000/-	44,000/-	22,000/-	4,16,000/-	400
Mr. Pranlal Bhogilal	3,50,000/-	38,500/-	22,000/-	4,10,500/-	NIL
Mr. H. K. Bilpodiwala *	3,50,000/-	38,500/-	22,000/-	4,10,500/-	NIL
Mr. H. Dhanrajgir	3,50,000/-	38,500/-	22,000/-	4,10,500/-	NIL
Mr. Apurva Diwanji *	3,50,000/-	33,000/-	N.A.	3,83,000/-	NIL
Mr. Sharvil P. Patel	NIL	44,000/-	N. A.	44,000/-	1000

* Also paid professional fees for rendering professional services to the Company in their professional capacity or through the firms with which they are associated.

- Payment of Commission to the independent directors has been decided by the Board of Directors based on the performance of the Company.

The Directors' Remuneration Policy of your Company conforms to the provisions under the Companies Act, 1956. The Board determines the remuneration of the Non-Executive Directors within the limits approved by the shareholders.

Mr. Pankaj R. Patel was appointed as Managing Director of the Company for a period of five years from 1st September 2001, on a remuneration permissible under Section 198 and 309, read with Schedule - XIII of the Companies Act, 1956. As per the terms of agreement, Managing Director can resign from his office by giving three calendar months notice in writing to the Company and the Board may appoint any other person (s) to be Managing Director(s) at any time. The office of the Managing Director if determined before the expiry of his term of office, Company will pay compensation for loss of office in accordance with the provisions of Section 318 of the Companies Act, 1956.

The Company does not have any stock option scheme. Moreover, there is no separate provision for payment of severance fees to the Directors.

Remuneration paid/payable to the Managing Director towards salary and contribution to the provident fund and other funds amount to Rs. 99 mn for the year 2005-06. Computation of the remuneration of the Managing Director is given in Note 12 of Notes on Accounts, under Schedule 21 of the accounts.

(C) **Management**

(i) **Management Discussion and Analysis Report:**

Management Discussion and Analysis Report is set out in a separate section included in this Annual Report and forms a part of this Report.

(ii) **Disclosure of material financial and commercial transactions:**

As per the disclosure received from the senior management, no material, financial and commercial transactions that may have a potential conflict with the interest of the Company at large were reported to the Company during the year under report.

(D) **Shareholders**

(i) Disclosure regarding appointment or re-appointment of Directors

Mr. H. K. Bilpodiwala and Mr. H. Dhanrajgir will retire at the ensuing Annual General Meeting by rotation and they have offered themselves for re-appointment. The Board has recommended the re-appointment of the retiring Directors.

The information about the brief resume and other information required to be disclosed under this section are provided in the notice of the Annual General Meeting.

(ii) Quarterly results and presentation made by the Company to analyst are forwarded to the stock exchanges where the equity shares of the Company are listed and the same are posted on Company's Website.

(E) **Compliance by the Company**

The Company has complied with all the mandatory requirements of the Listing Agreements with Stock Exchanges as well as regulations and guidelines of SEBI. Further, during the last three years, no penalties or strictures are imposed on the Company by the Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets.

V CEO/CFO Certification

The Managing Director and the Chief Financial Officer of the Company has certified to the Board as required.

VI Means of Communication

(1)The quarterly and half yearly results are published in widely circulating national and local dailies such as "The Hindu Business Line" and "Jansatta", in English and Gujarati. These are not sent individually to the shareholders.

(2)As per requirements of Clause 51 of the Listing Agreement, all the data related to quarterly financial results, shareholding pattern, etc. are provided through the special website www.sebiedifar.nic.in within the timeframe prescribed in this regard.

(3)The Company's results and official news releases are displayed on the Company's website address - www.zyduscadila.com. The Company holds meetings and make presentations to the institutional investors and analysts. The copy of such presentation and the transcript of the phone calls are also made available on the Company's website.

VII General Body Meetings

The particulars of the last three Annual General Meetings of the Company are given hereunder.

Year	Date and Time	Venue
2002-2003	8th AGM on 30th September, 2003 at 10.00 a.m.	Town Hall, Ellisbridge Ahmedabad - 380 006
2003-2004	9th AGM on 20th July 2004 at 10.00 a.m.	Bhaikaka Bhavan Law College Road, Ahmedabad - 380 006
2004-2005	10th AGM on 26th July, 2005 at 10.00 a.m.	Bhaikaka Bhavan Law College Road, Ahmedabad - 380 006

All the resolutions, including the special resolutions set out in the respective notices were passed by the shareholders with the requisite majority. For the year ended 31st March 2006, there are no ordinary or special resolutions passed by the Company's shareholders that require a postal ballot.

VIII General shareholder information

Date and Time of 11th AGM	28th July 2006 at 10.00 a.m.
Venue of 11th AGM	Bhaikaka Bhavan, Near Law Garden, Ellisbridge, Ahmedabad - 380 006.
Financial Year	31st March 2006
Book Closure Date	15th July 2006 to 25th July 2006 (Both days inclusive)
Registered Office Address	"Zydus Tower", Satellite Cross Roads, Sarkhej Gandhinagar Highway, Ahmedabad -380 015.
Dividend Payment Date	On or after 2nd August, 2006
Compliance Officer	Mr. Upen Shah, Company Secretary is the Compliance Officer of the Company
Website Address	www.zyduscadila.com

Financial Calendar (subject to change) for the financial year 2006-07

First Quarter Results	Before 31st July 2006
Half Yearly ResultsBefore	Before 31st October 2006
Third Quarter Results	Before 31st January 2007
Audited Results for the year 2006-07	Before 30th June 2007

Listing of shares

The equity shares of the Company are listed on the following Stock Exchanges:

Name and Address of the Stock Exchange
Ahmedabad Stock Exchange Limited Kamdhenu Complex, Opp. Sahjanand College, Panjara Pole, Ahmedabad - 380 015.
Bombay Stock Exchange Limited 1st Floor, New Trading Ring, Rotunda Bldg, P. J. Towers, Dalal Street, Fort, Mumbai - 400 001.
The National Stock Exchange of India Limited Exchange Plaza, Bandra-Kurla Complex, Bandra (E), Mumbai - 400 051.

Stock Code

Ahmedabad Stock Exchange Limited	10927
Bombay Stock Exchange Limited	CDIHI 532321
The National Stock Exchange of India Limited, Mumbai	CADILAHC
Reuters	CADI-BO
Bloomberg	CDH IN

Listing fees

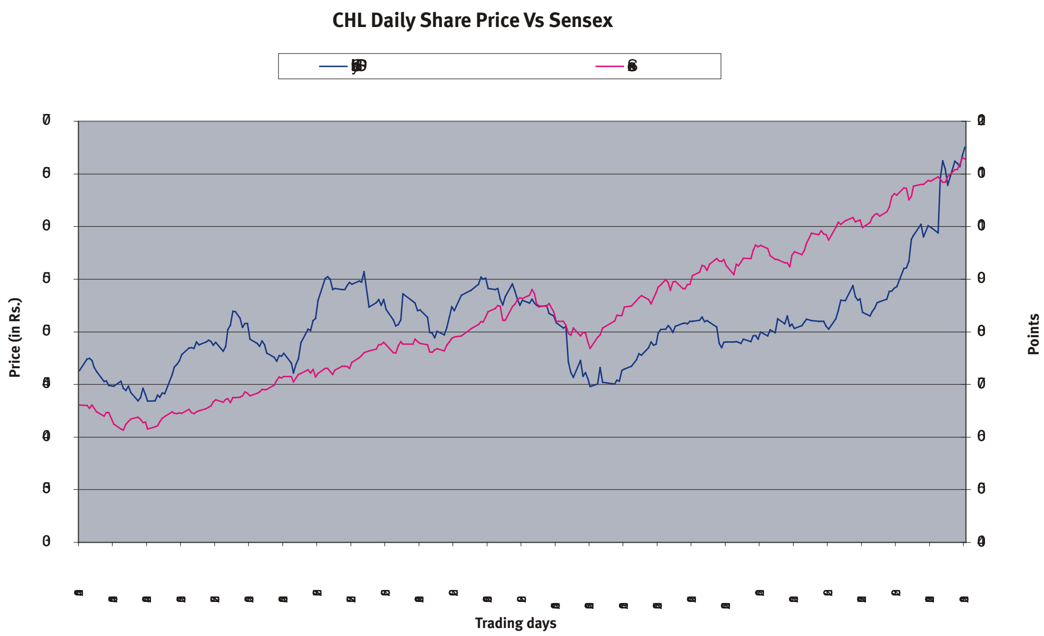
The Company has paid the annual listing fees for the financial year 2006-07 to all the Stock Exchanges where its securities are listed.

Stock price and BSE Sensex data

Month	BSE Sensex	The Stock Exchange, Mumbai			National Stock Exchange of India Limited		
		High	Low	Av. Volume (In Nos.)	High	Low	Av. Volume (In Nos.)
April, 05	6154.44	484.95	408.50	10843.75	492.00	423.25	16256
May, 05	6715.11	501.00	429.00	5311.91	503.70	429.00	14567
June, 05	7193.85	524.00	455.00	29909.61	525.00	452.55	28640
July, 05	7635.42	641.00	471.60	27055.45	562.95	470.25	43627
Aug., 05	7805.43	553.90	491.05	13649.05	551.00	490.00	33659
Sept., 05	8634.48	555.00	500.00	18511.53	556.00	514.00	39003
Oct., 05	7892.32	549.95	428.00	15453.35	539.00	435.00	18864
Nov., 05	8788.81	510.00	448.00	10027.10	510.00	450.00	22396
Dec., 05	9397.93	517.00	470.05	18581.64	517.00	478.00	22013
Jan., 06	9919.89	530.00	482.00	18983.20	540.00	455.65	28221
Feb., 06	10370.24	565.00	492.00	38852.00	564.00	496.00	25337
March, 06	11279.96	685.00	531.40	55338.14	678.90	505.50	57176

No Trading Recorded on the Stock Exchange, Ahmedabad.

Chart 'A' Stock Performance



Share transfer agents:

For lodgment of transfer deeds and other documents or any grievances/complaints, investors may contact the Company's Registrar and Transfer Agent at the following address:

M/s. Pinnacle Shares Registry Pvt. Ltd.,
Near Ashoka Mills, Naroda Road,
Ahmedabad - 380 025.
Telephone: 079 - 22204226, 22200338, 22200582.
Fax number: 079 - 22202963.
Email: gautam.shah@psrpl.com

Share transfer system:

Shares sent for transfer in physical form are registered and returned by Registrar and Share Transfer Agents within 30 days from the date of receipt of documents, provided the documents are found in order. Shares under objection are returned within 21 days. The Share Transfer Committee meets generally twice in a month to approve share transfers/transmissions.

Distribution of shareholding:

The shareholding distribution of equity shares as on 31st March 2006 is given below.

No. of equity Shares	No. of Folios	% to total folios	No. of Shares	% share-holding
Less than 100	28618	79.64	1420058	2.26
101 to 500	6378	17.75	1518967	2.42
501 to 1000	548	1.52	404631	0.64
1001 to 5000	303	0.84	616040	0.98
5001 to 10000	37	0.10	287195	0.45
10001 and above	50	0.14	58559963	93.24
Grand Total	**35934**	**100.00**	**62806854**	**100.00**
Shareholders in Physical Mode	8409	23.40	861420	1.37
Shareholders in Electronic Mode	27525	76.40	61995434	98.63
	35934	**100.00**	**62806854**	**100.00**

Shareholding pattern as at 31st March, 2006:

Category	No. of Shares held		Total Shares	% of shareholding
	Physical	Electronic		
Promoter's holding	1200	45230425	45231625	72.02
Mutual Funds and UTI	1249	2455917	2457166	3.91
Banks, FIs and Insurance Companies	641	5232885	5233526	8.33
Foreign Institutional Investors	125	4979107	4979232	7.93
NRIs / OCBs	18703	106556	125259	0.20
Other Corporate Bodies	1487	501513	503000	0.80
Indian public	838015	3439031	4277046	6.81
Total	**861420**	**61945434**	**62806854**	**100.00**

Dematerialisation of shares and liquidity :

The Company's equity shares are traded compulsorily in dematerialised form with effect from 24th July, 2000. Approximately 98.63 % of the equity shares have been dematerialised. ISIN number for dematerialisation of the equity shares of the Company is INE010B1019.

Location of the company's manufacturing plants:

The details of the location of the plants of the Company are mentioned on the inside cover page of the annual report.

Address for correspondence:

Shareholders correspondence should be addressed to the Company's Registrar and Transfer Agent at the address mentioned above.

Shareholders may also contact Mr. Upen H. Shah, Company Secretary, at the Registered Office of the Company for any assistance.
Tele. Nos. 079 - 26868100 Extension - 326
e-mail id : upen.shah@zyduscadila.com

Shareholders holding shares in the electronic mode should address all their correspondence to their respective depository participants.

Outstanding GDRs/ADRs/Warrants, its conversion date and likely impact on equity :

The Company has not issued GDRs/ADRs/warrants or any convertible instruments.

Details of non-compliance

There was no non-compliance during the year and no penalties were imposed or strictures passed on the company by the Stock Exchanges, SEBI or any other statutory authority. The Company obtained a Certificate from the Statutory Auditors of the Company with respect to compliance with the conditions of Corporate Governance and annexed the certificate with the Directors' Report and sent the same to all the shareholders of the Company. The same certificate shall also be sent to all the concerned Stock Exchanges along with the annual reports filed by the Company.

IX Extent of compliance with the non-mandatory requirements:

1. **The Board:**

   The Chairman and Managing Director of the Company Mr. Pankaj R. Patel is entitled to maintain Chairman's office at the expense of the Company and is also reimbursed the expenses incurred by him in the course of performance of his duties.

2. **Remuneration Committee:**

   The Board has not formed a Remuneration Committee. The Board of Directors and shareholders approve the remuneration of Managing Director and also payment of commission to the Directors.

3. **Shareholders' Rights:**

   The quarterly / half-yearly results, after they are taken on record by the Board of Directors, are sent forthwith to the Stock Exchanges where the Company's shares are listed. The results in the prescribed proforma are published in leading Gujarati and English dailies. These results are also made available on Company's website www.zyduscadila.com .

4. **Postal ballot:**

   Provisions relating to postal ballots have been introduced by the Companies (Amendment) Act, 2000. However, the same were not utilised for any business of the Company. The same shall be complied with, as and when used.

Social Report

Community Development

Continuing with it's mission to create healthier communities globally, your Company is actively engaged in developing the community of which it forms a part. Through the Ramanbhai Foundation, it spearheads programmes in the field of education and healthcare.

Education

'The Zydus School for Excellence' - a centre for learning where young minds are free to grow in relationship to his or her potential, has been set up under the aegis of the Ramanbhai Foundation. The school, affiliated to the ICSE Board, is now into it's fifth academic year. Spread over 80,000 sq. ft., the school has classes from Kindergarten to class nine (scalable to class 12 with each passing year).

The Shri Ramanbhai B. Patel - AMA Centre for Excellence in Education, which was inaugurated by His Excellency, President of India Dr. APJ Abdul Kalam in May 2002 provides a platform for parents, teachers and students to highlight the critical educational issues of the day. The centre invites experts from various fields to deliver memorial lectures.

On 25th February 2006, Dr. C. Rangarajan, noted Economist and Chairman, Economic Advisory Council to the Prime Minister of India delivered the Shri. Ramanbhai Patel 4th Memorial Lecture. He spoke on the theme "Responding to Globalisation: India's Answer". The past memorial lectures were delivered by Dr. Abid Hussain, an eminent educationist, a leading statesman and former Indian Ambassador to the United States, Justice (Rtd.) P.N. Bhagwati, Former Chief Justice of India and Member United Nations Human Rights Committee and Chancellor, Hyderabad University and Dr. Karan Singh, a noted scholar. The centre conducts open house discussions, memorial lectures on excellence in education, progressive learning programmes for academicians and knowledge sharing forums, which study the successful learning models across the country.

The Centre also recognises and honours teachers who have contributed to the child's world of learning through the 'The Shreshtha Shikshak Award.' In 2005-06, Ms. Nutan Kasliwal, Project Coordinator for 'Prerna' an initiative of Calorx Foundation and Mr. Jasubhai Babubhai Kavi, the Principal of Secondary and Higher Secondary School for the Blind received the awards.

Ms. Nutan Kasliwal, was awarded for her contribution towards helping children with Dyslexia which causes learning disabilities in children making it difficult for them to read, write and spell. Mr. Jasubhai Babubhai Kavi, was presented the award for his efforts towards making learning fun for visually impaired children. Ms. Kasliwal and Mr. Jasubhai Kavi were awarded the Shreshtha Shikshak Award by Dr. Suresh Dalal, Former Vice Chancellor, M.S. University, Vadodara and a noted poet and Litterateur.

The seminars and programmes conducted for Teachers and Head of institutions by the centre include:

- School Safety (25 June 2005)
- Art of being an effective teacher (09 July 2005)
- Reaching out to students (06 August 2005)
- How okay are you? (03 September 2005)
- Innovative teaching: A way of making learning a wonderful experience (03 September 2005)
- Team work in school: A new concept for effective teaching (17 September 2005)
- Self assessment and personal growth for teachers (17 September 2005)

Healthcare Camps

As a part of it's outreach programmes, the group organises annual healthcare camps at Moraiya. Leading specialists from Ahmedabad, the group's medical advisors and the employees volunteer their services in organising these camps. So far, the group has organised general healthcare camps, diagnostic, dental-care, eye-care and paediatric camps. In January 2006, more than 1000 people attended the healthcare camp at Moraiya.

Besides this, the group organises a hypertension awareness drive called 'ATENsion Hypertension', which creates awareness on hypertension across the country, particularly in the far-flung remote districts. The programme co-ordinators visit various towns on a mobile van and conduct hypertension detection camps. The camps provide free blood pressure check-up and also counsel the people on the perils of hypertension, map the family history on hypertension for future record and emphasise on the need for regular, periodic check-ups with the local doctors. So far, 180 villages across Andhra Pradesh and Tamil Nadu have been covered. The programme plans to cover 360 villages in 2006-07.

Our group has been quick in extending a helping hand in times of natural calamities. When the floods that caused havoc in several parts of Gujarat in June 2005, our group supplied medicines free of cost to the flood-affected areas. The group had also instituted the Zydus Helpline as part of it's community outreach programme. In the past also, the group has reached out to those affected by the killer waves - Tsunami that struck the coast of Southern India in 2004, the earthquake that struck Gujarat in 2001, and the cyclone that created havoc in many parts of Gujarat in 1998.

Code of Conduct

All Board Members and senior management have affirmed compliance with the code of conduct adopted by the Board .

Pankaj R. Patel
Chairman and Managing Director

Auditors' Certificate on Corporate Governance

We have examined the compliance of the conditions of Corporate Governance by Cadila Healthcare Limited, for the year ended on 31st March, 2006 as stipulated in Clause 49 of the Listing Agreement of the said Company with the concerned Stock Exchanges in India.

The Compliance of the conditions of corporate governance is the responsibility of the management. Our examination was limited to the procedures and implementation thereof, adopted by the Company for ensuring the compliance of the conditions of corporate governance. It is neither an audit nor an expression of an opinion on the financial statements of the Company.

In our opinion and to the best of our information and explanations given to us, we certify that the company has complied with the conditions of corporate governance as stipulated in the above mentioned listing agreements.

We state that in respect of the investor grievances received during the year ended 31st March 2006, no such investor grievances remained unattended/pending for more than 30 days.

We further state that such compliance is neither an assurance as to the future viability of the Company nor the efficiency or effectiveness with which the management has conducted the affairs of the Company.

For **R. R. Patel & Co.**
Chartered Accountants

R. R. Patel
Proprietor

Place : Ahmedabad
Date : 28th April 2006

For **Mukesh M. Shah & Co.**
Chartered Accountants

Mukesh M. Shah
Partner

Place : Ahmedabad
Date : 28th April 2006

Auditors' Report to the Members of Cadila Healthcare Ltd.

We have audited the attached Balance Sheet of Cadila Healthcare Limited ('the company') as at 31st March, 2006, and also the Profit and Loss Account and the Cash Flow Statement for the year ended on that date annexed thereto. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. 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 applied and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As required by the Companies (Auditor's Report) Order, 2003 as amended by the Companies (Auditor's Report) (Amendment) Order, 2004 issued by the Central Government of India in terms of section 227(4A) of the Companies Act, 1956 we enclose in the annexure, a statement on the matters specified in paragraph 4 and 5 of the said Order.

Further to our comments in the Annexure referred to above, we report that:

(a) We have obtained all the information and explanations, which to the best of our knowledge and belief, were necessary for the purposes of our audit;

(b) In our opinion, proper books of account as required by law have been kept by the company, so far as it appears from our examination of the books;

(c)The Balance Sheet, Profit and Loss account and Cash Flow Statement dealt with by this report are in agreement with the books of account;

(d)In our opinion, the Balance Sheet, Profit and Loss account and Cash Flow Statement dealt with by this report comply with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

(e)On the basis of the written representations received from the directors of the company and taken on record by the Board of Directors, we report that no director is disqualified as on 31st March, 2006 from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Companies Act, 1956; and

(f)In our opinion, and to the best of our information and according to the explanations given to us, the said accounts subject to significant accounting policies and notes thereon give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India;

(i) In the case of the Balance Sheet, of the state of affairs of the Company as at 31st March, 2006;

(ii) In the case of the Profit and Loss account, of the profit for the year ended on that date; and

(iii)In the case of cash flow statement, of the cash flows for the year ended on that date.

For R.R. PATEL & CO.,
CHARTERED ACCOUNTANTS

(R. R. Patel)
PROPRIETOR
Membership No. 7871

For MUKESH M. SHAH & CO.,
CHARTERED ACCOUNTANTS

(Mukesh M. Shah)
PARTNER
Membership No.30190

Place : Ahmedabad
l 2006

Annexure to the Auditors' Report

With reference to the Annexure referred to in paragraph 3 of the report of the Auditors to the Members of Cadila Healthcare Ltd on the accounts for the year ended 31st March, 2006, we report that:

1. (a)The company has maintained proper records showing full particulars, including quantitative details and situation of fixed assets.

   (b) Some of the fixed assets were physically verified during the year by the management in accordance with programme of verification, which in our opinion provides for physical verification of all the fixed assets at reasonable intervals. According to the information and explanations given to us no material discrepancies were noticed on such verification.

   (c) Fixed assets disposed off during the year were not substantial and therefore do not affect the going concern assumption.

2. (a) The inventory has been physically verified by the management during the year. In our opinion, the frequency of such verification is reasonable.

   (b)In our opinion the procedures for the physical verification of inventory followed by management are reasonable and adequate in relation to the size of the company and the nature of its business.

   (c) The Company has maintained proper records of inventory. No material discrepancies were noticed on physical verification of inventory.

3. (a)The Company has not granted any loans, secured or unsecured, to companies, firms or other parties covered in the register maintained under Section 301 of the Companies Act,1956. Accordingly, clause (iii)(b) to (iii)(d) of paragraph 4 of the Order are not applicable to the company for the current year.

(b)The Company has not taken any loans, secured or unsecured, from companies, firms or other parties covered in the register maintained under Section 301 of the Act. Accordingly, clause (iii)(f) and (iii)(g) of paragraph 4 of the Order are not applicable to the company for the current year.

4. n our opinion and according to the information and explanations given to us, there is adequate internal control system commensurate with the size of the company and the nature of its business for the purchase of inventory and fixed assets and for the sale of goods and services. In our opinion and according to the information and explanations given to us, there is no continuing failure to correct major weaknesses in internal control system.

5. (a) In our opinion, and according to the information and explanations given to us, the particulars of Contracts or Arrangements referred to in Section 301 of the Companies Act, 1956, have been so entered in the register required to be maintained under that section.

(b)In our opinion and according to the information and explanations given to us the transactions made in pursuance of such Contracts or Arrangements have been made at prices, which are reasonable having regard to prevailing market prices at the relevant time.

6.In our opinion, and according to the information and explanations given to us, the company has complied with the directives issued by the Reserve Bank of India and provisions of sections 58A, 58AA or other relevant provisions of the Companies Act, 1956 and the rules framed there under with regard to deposits accepted from the public, which have matured and are remaining unclaimed as at 31st March 2006. We are informed that no order has been passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other Tribunal.

7.The C ompany has an internal audit system which, in our opinion is commensurate with size and the nature of its business.

8. We have broadly reviewed the books of accounts maintained by the Company pursuant to the Rules made by the Central Government for maintenance of cost records under section 209(1) (d) of the Companies Act, 1956, and are of the opinion that prima facie the prescribed accounts and records have been made and maintained. We have not, however, made a detailed examination of the records.

9.(a)According to the information and explanations given to us and on the basis of our examination of the books of account, the company has been generally regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth tax, Service tax, Custom duty, Excise duty, cess and any other dues during the year with the appropriate authorities. However, at 31st March 2006, there are no undisputed dues payable for a period of more than six months from the date they became payable.

(b)According to the information and explanations given to us, the particulars of dues of income tax, sales tax, excise duty and service tax as at 31st March, 2006 which have not been deposited on account of any dispute, are as follows :

Name of the Statute	Amounts involved (Rs. in Millions)	Forum where the dispute is pending
Income Tax Act, 1961	52	Appellate Tribunal
The Central Sales Tax and Local Sales Tax Acts	13	Commissioner of Sales Tax
	64	High Court
The Central Excise Act and the Service Tax Act	19	ACCE/DCCE/JCCE/Add Comm.
	169	Commissioner
	3	Commissioner (Appeals)
	70	CESTAT
	3	High Court

10. The company does not have any accumulated losses at the end of the financial year and has not incurred cash losses in the financial year and in the immediately preceding financial year.

11. The company has not defaulted in repayment of dues to a financial institution or bank or debenture holder.

12. The company has granted an advance to a joint venture company for honouring its obligations as a guarantor to a bank against the security of some of the assets of the said company & against pledge of shares of a party to joint venture. Adequate records are maintained for the same.

13. The company is not a chit fund/nidhi/mutual benefit fund/society.

14. According to the information and explanations given to us, the company is not dealing or trading in shares, securities, debentures and other investments.

15. In our opinion and according to the information and explanations given to us, the terms and conditions of guarantees given by the company for loans taken by a joint venture company and subsidiaries from banks and are not prima facie, prejudicial to the interest of the company.

16. Term loans obtained by the Company were applied for the purpose for which the loans were obtained.

17. According to the Cash-flow statement and other records examined by us and the information and explanation given to us, on an overall basis, funds raised on short term basis have not, prima facie, been used during the year for long term investment.

18. The company has not made any preferential allotment of shares to parties and companies covered in the register maintained under section 301 of the Companies Act, 1956.

19. The Securities/charges have been created in respect of debentures issued.

20. The company has not raised any money by public issues during the year.

21. To the best of our knowledge and belief, and according to the information and explanations given to us, no fraud on or by the company was noticed or reported during the year.

For R. R. PATEL & CO.,
CHARTERED ACCOUNTANTS

(R. R. Patel)
PROPRIETOR
Membership No. 7871

For MUKESH M. SHAH & CO.,
CHARTERED ACCOUNTANTS

(Mukesh M. Shah)
PARTNER
Membership No.30190

Place : Ahmedabad
Date : 28 l 2006

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