

ALEXANDERS J CORP  
Form 10-Q  
November 12, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For quarterly period ended September 28, 2008

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

**Commission file number: 1-8766**

**J. ALEXANDER S CORPORATION**

*(Exact name of registrant as specified in its charter)*

**Tennessee**

*(State or other jurisdiction of  
incorporation or organization)*

**62-0854056**

*(I.R.S. Employer  
Identification No.)*

**3401 West End Avenue, Suite 260**

**P.O. Box 24300**

**Nashville, Tennessee**

*(Address of principal executive offices)*

**37202**

*(Zip Code)*

Registrant's telephone number, including area code: **(615)269-1900**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated  
filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting  
company)

Smaller reporting  
company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 11, 2008, 6,754,860 shares of the registrant's Common Stock, \$.05 par value, were outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****J. Alexander's Corporation and Subsidiaries****Condensed Consolidated Balance Sheets****(Unaudited in thousands, except share and per share amounts)**

	<b>September 28 2008</b>	December 30 2007
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 4,882	\$ 11,325
Accounts and notes receivable	3,820	3,365
Inventories	1,248	1,297
Deferred income taxes	1,047	1,047
Prepaid expenses and other current assets	1,456	1,596
<b>TOTAL CURRENT ASSETS</b>	<b>12,453</b>	18,630
<b>OTHER ASSETS</b>	<b>1,462</b>	1,341
<b>PROPERTY AND EQUIPMENT</b> , at cost, less allowances for depreciation and amortization of \$49,601 and \$45,698 at September 28, 2008, and December 30, 2007, respectively	<b>86,354</b>	78,551
<b>DEFERRED INCOME TAXES</b>	<b>5,583</b>	5,341
<b>DEFERRED CHARGES</b> , less amortization	<b>667</b>	716
	<b>\$ 106,519</b>	\$ 104,579

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	<b>September 28 2008</b>	December 30 2007
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 7,558	\$ 5,885
Accrued expenses and other current liabilities	5,194	5,123
Unearned revenue	1,324	2,255
Current portion of long-term debt and obligations under capital leases	901	955
<b>TOTAL CURRENT LIABILITIES</b>	<b>14,977</b>	14,218
<b>LONG-TERM DEBT AND OBLIGATIONS UNDER CAPITAL LEASES, net of portion classified as current</b>	<b>20,696</b>	21,349
<b>OTHER LONG-TERM LIABILITIES</b>	<b>7,037</b>	6,431
<b>STOCKHOLDERS EQUITY</b>		
Common Stock, par value \$.05 per share: Authorized 10,000,000 shares; issued and outstanding 6,686,559 and 6,655,625 shares at September 28, 2008, and December 30, 2007, respectively	334	333
Preferred Stock, no par value: Authorized 1,000,000 shares; none issued	36,187	35,764
Additional paid-in capital	27,288	26,484
Retained earnings		
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>63,809</b>	62,581
	<b>\$ 106,519</b>	\$ 104,579

See notes to condensed consolidated financial statements.

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**J. Alexander's Corporation and Subsidiaries**  
**Consolidated Statements of Operations**  
**(Unaudited in thousands, except per share amounts)**

	Quarter Ended		Nine Months Ended	
	Sept. 28 2008	Sept. 30 2007	Sept. 28 2008	Sept. 30 2007
Net sales	\$ 32,361	\$ 33,356	\$ 104,614	\$ 104,623
Costs and expenses:				
Cost of sales	10,695	10,945	33,546	33,938
Restaurant labor and related costs	11,469	11,068	34,421	33,430
Depreciation and amortization of restaurant property and equipment	1,492	1,304	4,382	3,881
Other operating expenses	7,426	6,736	22,105	20,571
Total restaurant operating expenses	31,082	30,053	94,454	91,820
General and administrative expenses	2,470	2,264	7,394	7,074
Pre-opening expense	872	537	1,205	593
Operating income (loss)	(2,063)	502	1,561	5,136
Other income (expense):				
Interest expense	(402)	(406)	(1,281)	(1,357)
Interest income	27	127	130	486
Other, net	17	17	51	55
Total other expense	(358)	(262)	(1,100)	(816)
Income (loss) before income taxes	(2,421)	240	461	4,320
Income tax benefit (provision)	426	150	343	(952)
Net income (loss)	\$ (1,995)	\$ 390	\$ 804	\$ 3,368
Basic earnings (loss) per share	\$ (.30)	\$ .06	\$ .12	\$ .51
Diluted earnings (loss) per share	\$ (.30)	\$ .06	\$ .12	\$ .48

See notes to condensed consolidated financial statements.

**Table of Contents****J. Alexander's Corporation and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(Unaudited in thousands)**

	Nine Months Ended	
	<b>Sept. 28 2008</b>	Sept. 30 2007
Cash flows from operating activities:		
Net income	<b>\$ 804</b>	\$ 3,368
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	<b>4,427</b>	3,939
Changes in working capital accounts	<b>(934)</b>	(1,985)
Other operating activities	<b>732</b>	786
Net cash provided by operating activities	<b>5,029</b>	6,108
Cash flows from investing activities:		
Purchase of property and equipment	<b>(9,667)</b>	(8,342)
Other investing activities	<b>(71)</b>	(46)
Net cash used in investing activities	<b>(9,738)</b>	(8,388)
Cash flows from financing activities:		
Payments on debt and obligations under capital leases	<b>(707)</b>	(659)
Decrease in bank overdraft	<b>(524)</b>	(1,113)
Payment of cash dividend	<b>(666)</b>	(657)
Exercise of stock options	<b>121</b>	379
Payment of required withholding taxes on behalf of an employee in connection with the net share settlement of an employee stock option exercised		(101)
Excess tax benefit related to share-based compensation	<b>42</b>	247
Net cash used in financing activities	<b>(1,734)</b>	(1,904)
Decrease in cash and cash equivalents	<b>(6,443)</b>	(4,184)
Cash and cash equivalents at beginning of period	<b>11,325</b>	14,688
Cash and cash equivalents at end of period	<b>\$ 4,882</b>	\$ 10,504
Supplemental disclosures of non-cash items:		
Property and equipment obligations accrued at beginning of period	<b>\$ 610</b>	\$ 123
Property and equipment obligations accrued at end of period	<b>\$ 3,281</b>	\$ 2,285
See notes to condensed consolidated financial statements.		





**Table of Contents****J. Alexander's Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Unaudited)****NOTE A BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and rules of the United States Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter and nine months ended September 28, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending December 28, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the J. Alexander's Corporation (the Company's) Annual Report on Form 10-K for the fiscal year ended December 30, 2007.

Net income and comprehensive income are the same for all periods presented.

**NOTE B EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Quarter Ended		Nine Months Ended	
	Sept. 28 2008	Sept. 30 2007	Sept. 28 2008	Sept. 30 2007
(In thousands, except per share amounts)				
<b>Numerator:</b>				
Net income (loss) (numerator for basic and diluted earnings per share)	\$ (1,995)	\$ 390	\$ 804	\$ 3,368
<b>Denominator:</b>				
Weighted average shares (denominator for basic earnings (loss) per share)	6,679	6,639	6,672	6,607
Effect of dilutive securities		380	195	369
Adjusted weighted average shares (denominator for diluted earnings (loss) per share)	6,679	7,019	6,867	6,976
Basic earnings (loss) per share	\$ (.30)	\$ .06	\$ .12	\$ .51
Diluted earnings (loss) per share	\$ (.30)	\$ .06	\$ .12	\$ .48

Due to the net loss incurred during the third quarter of 2008, all outstanding stock options were excluded from the computation of diluted loss per share for this period. The calculation of diluted earnings per share excludes stock options for the purchase of 305,000 shares of the Company's common stock for the quarter ended September 30, 2007, because the effect of their inclusion would be anti-dilutive. Anti-dilutive options to purchase 603,000 and 202,000 shares of common stock were excluded from the diluted earnings per share calculations for the nine months ended September 28, 2008 and September 30, 2007, respectively.

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**NOTE C INCOME TAXES**

The Company recorded an income tax benefit of \$343,000 for the first nine months of 2008. This benefit relates primarily to the effect of FICA tip tax credits earned by the Company which exceed the tax liability computed at statutory rates and is based on the actual effective tax rate for the year-to-date period. Management does not believe a reasonable estimate of the year-to-date tax provision can be made using the estimated annual effective tax rate because the Company's estimated pre-tax results for the year are expected to be close to break-even, and a relatively small change in the Company's estimated operating results for the year could result in a large change in the estimated annual effective tax rate. The tax benefit for the third quarter of 2008 represents the difference in the benefit for the first nine months of 2008 and the expense recorded for the first half of 2008.

The Company's income tax provision for the first nine months of 2007 was based on an estimated effective rate of 23.3% for the fiscal year and also included a favorable adjustment of \$55,000 which represents a discrete item recorded in connection with the finalization of tax matters upon filing of the Company's income tax return for 2006. This rate is lower than the statutory federal income tax rate of 34% due primarily to the effect of FICA tip tax credits, with the effect of those credits being partially offset by the effect of state income taxes. Because the estimated annual effective rate for 2007 was lower than the estimated rate applied to the first half of the year, an income tax benefit was recorded in the third quarter of 2007 to adjust the year-to-date amount. The income tax benefit for the third quarter of 2007 also includes a favorable adjustment of \$43,000 related to the discrete item noted above.

**NOTE D COMMITMENTS AND CONTINGENCIES**

As a result of the disposition of its Wendy's operations in 1996, the Company remains secondarily liable for certain real property leases with remaining terms of one to seven years. The total estimated amount of lease payments remaining on these 12 leases at September 28, 2008, was approximately \$2.0 million. Also, in connection with the sale of its Mrs. Winner's Chicken & Biscuit restaurant operations in 1989 and certain previous dispositions, the Company remains secondarily liable for certain real property leases with remaining terms of one to five years. The total estimated amount of lease payments remaining on these 19 leases at September 28, 2008, was approximately \$1.0 million. Additionally, in connection with the previous disposition of certain other Wendy's restaurant operations, primarily the southern California restaurants in 1982, the Company remains secondarily liable for real property leases with remaining terms of one to five years. The total estimated amount of lease payments remaining on these seven leases as of September 28, 2008, was approximately \$375,000.

The Company is from time to time subject to routine litigation incidental to its business. The Company believes that the results of such legal proceedings will not have a materially adverse effect on the Company's financial condition, operating results or liquidity.

**Table of Contents****NOTE E AMENDMENT TO LINE OF CREDIT AGREEMENT**

The Company maintains a secured bank line of credit agreement which provides up to \$10 million of credit availability for financing capital expenditures related to the development of new restaurants and for general operating purposes. The line of credit is secured by mortgages on the real estate of two of the Company's restaurant locations with an aggregate book value of \$7.2 million at September 28, 2008, and the Company has also agreed not to encumber, sell or transfer four other fee-owned properties. On October 31, 2008, the Company entered into an amendment to the credit agreement which changed the maximum adjusted debt to EBITDAR ratio (as defined in the amendment) from 3.5 to 1 to 4.5 to 1 through March 29, 2009, after which time the ratio reverts to 3.5 to 1 at the end of each quarter thereafter. Provisions of the loan agreement require that the Company maintain a fixed charge coverage ratio (also as defined in the amendment) of at least 1.5 to 1. The loan agreement also provides that defaults which permit acceleration of debt under other loan agreements constitute a default under the bank agreement and restricts the Company's ability to incur additional debt outside of the agreement. Any amounts outstanding under the line of credit, as amended, bear interest at the LIBOR rate as defined in the loan agreement plus a spread of 2.25% to 3.75%, depending on the Company's adjusted debt to EBITDAR ratio. The Company also pays a commitment fee of 0.25% to 0.75% per annum on the unused portion of the credit line, also depending on the Company's adjusted debt to EBITDAR ratio. The maturity date of this credit facility is July 1, 2009 unless it is converted to a term loan under the provisions of the agreement prior to May 1, 2009. The Company was in compliance with the covenants of its bank credit agreement, as amended, at September 28, 2008 and there were no borrowings outstanding under the agreement as of that date.

**NOTE F RECENT ACCOUNTING PRONOUNCEMENTS**

In 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 provides guidance for using fair value to measure assets and liabilities. The standard expands required disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years which began after November 15, 2007, except for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, which have been deferred for one year. Adoption of this Statement at the beginning of 2008 had no impact on the Company's Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ), which gives entities the option to measure eligible financial assets and financial liabilities at fair value on an instrument by instrument basis which are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This Statement is effective for fiscal years which began after November 15, 2007. Adoption of this Statement at the beginning of 2008 had no impact on the Company's Condensed Consolidated Financial Statements.

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In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS 161 ). SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities and is effective for fiscal years beginning after November 15, 2008, and the Company will adopt these provisions in the first quarter of 2009. The Company is currently evaluating the impact of adopting SFAS 161 on its 2009 Consolidated Financial Statements.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, Determination of the Useful Life of Intangible Assets ( FSP 142-3 ). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets and requires enhanced related disclosures. FSP 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008, and the Company will adopt these provisions in the first quarter of 2009. The Company is currently evaluating the impact of adopting FSP 142-3 on its 2009 Consolidated Financial Statements.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements of J. Alexander's Corporation (the Company) and related notes included elsewhere in this report and the Company's audited consolidated financial statements and the notes thereto for the year ended December 30, 2007, appearing in its Annual Report on Form 10-K for the year ended December 30, 2007.

**RESULTS OF OPERATIONS**

**Overview**

The Company operates upscale casual dining restaurants. At September 28, 2008, the Company operated 31 J. Alexander's restaurants in 12 states. The Company's net sales are derived primarily from the sale of food and alcoholic beverages in its restaurants.

The Company's strategy is for J. Alexander's restaurants to compete in the restaurant industry by providing guests with outstanding professional service, high-quality food, and an attractive environment with an upscale, high-energy ambiance. Quality is emphasized throughout J. Alexander's operations and substantially all menu items are prepared on the restaurant premises using fresh, high-quality ingredients. The Company's goal is for each J. Alexander's restaurant to be perceived by guests in its market as a market leader in each of the categories above. J. Alexander's restaurants offer a contemporary American menu designed to appeal to a wide range of consumer tastes. The Company believes, however, that its restaurants are most popular with more discriminating guests with higher discretionary incomes. J. Alexander's typically does not advertise in the media and relies on each restaurant to increase sales by building its reputation as an outstanding dining establishment. The Company has generally been successful in achieving sales increases in its restaurants over time using this strategy. Currently, however, the Company is experiencing decreases in same store sales as is further discussed under Net Sales, and these decreases are having a significant negative impact on the Company's profitability. Management believes it will be very difficult to increase, or even maintain, same store sales levels until consumers regain their confidence and consumer spending improves. The Company's newer restaurants are also experiencing difficulties in building sales in the current economic environment.

The restaurant industry is highly competitive and is often affected by changes in consumer tastes and discretionary spending patterns; changes in general economic conditions; public safety conditions or concerns; demographic trends; weather conditions; the cost of food products, labor and energy; and governmental regulations. Because of these factors, the Company's management believes it is of critical importance to the Company's success to effectively execute the Company's operating strategy and to constantly evolve and refine the critical conceptual elements of J. Alexander's restaurants in order to distinguish them from other casual dining competitors and maintain the Company's competitive position.

The restaurant industry is also characterized by high capital investment for new restaurants and relatively high fixed or semi-variable restaurant operating expenses. Because a significant portion of restaurant operating expenses are fixed or semi-variable in nature, changes in sales in existing restaurants are generally expected to significantly affect restaurant

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profitability because many restaurant costs and expenses are not expected to change at the same rate as sales. Management believes that excellence in restaurant operations, and particularly providing exceptional guest service, will help to maintain or increase net sales in the Company's restaurants over time and will support menu pricing levels which allow the Company to achieve reasonable operating margins while absorbing the higher costs of providing high-quality dining experiences and operating cost increases.

Changes in sales for existing restaurants are generally measured in the restaurant industry by computing the change in same store sales, which represents the change in sales for the same group of restaurants from the same period in the prior year. Same store sales changes can be the result of changes in guest counts, which the Company estimates based on a count of entrée items sold, and changes in the average check per guest. The average check per guest can be affected by menu price changes and the mix of menu items sold. Management regularly analyzes guest count, average check and product mix trends for each restaurant in order to improve menu pricing and product offering strategies. Management believes it is important to maintain or increase guest counts and average guest checks over time in order to improve the Company's profitability.

Other key indicators which can be used to evaluate and understand the Company's restaurant operations include cost of sales, restaurant labor and related costs and other operating expenses, with a focus on these expenses as a percentage of net sales. Since the Company uses primarily fresh ingredients for food preparation, the cost of food commodities can vary significantly from time to time due to a number of factors. The Company generally expects to increase menu prices in order to offset the increase in the cost of food products as well as increases which the Company experiences in labor and related costs and other operating expenses, but attempts to balance these increases with the goals of providing reasonable value to the Company's guests. Management believes that restaurant operating margin, which is net sales less total restaurant operating expenses expressed as a percentage of net sales, is an important indicator of the Company's success in managing its restaurant operations because it is affected by the level of sales achieved, menu pricing strategy, and the management and control of restaurant operating expenses in relation to net sales.

The number of restaurants opened or under development in a particular year can have a significant impact on the Company's operating results because pre-opening expense for new restaurants is significant and most new restaurants incur operating losses during their early months of operation.

Because large capital investments are required for J. Alexander's restaurants and because a significant portion of labor costs and other operating expenses are fixed or semi-variable in nature, management believes the sales required for a J. Alexander's restaurant to break even are relatively high compared to many other casual dining concepts and that it is necessary for the Company to achieve relatively high sales volumes in its restaurants in order to achieve desired financial returns. The Company's criteria for new restaurant development target locations with high population densities and high household incomes which management believes provide the best prospects for achieving attractive financial returns on the Company's investments in new restaurants. The Company opened one restaurant in the third quarter of 2008 and one restaurant at the beginning of the fourth quarter of 2008 and expects to open one additional restaurant in December of 2008.

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The following table sets forth, for the periods indicated, (i) the items in the Company's Condensed Consolidated Statements of Operations expressed as a percentage of net sales, and (ii) other selected operating data:

	Quarter Ended		Nine Months Ended	
	Sept. 28 2008	Sept. 30 2007	Sept. 28 2008	Sept. 30 2007
Net sales	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of sales	33.0	32.8	32.1	32.4
Restaurant labor and related costs	35.4	33.2	32.9	32.0
Depreciation and amortization of restaurant property and equipment	4.6	3.9	4.2	3.7
Other operating expenses	22.9	20.2	21.1	19.7
Total restaurant operating expenses	96.0	90.1	90.3	87.8
General and administrative expenses	7.6	6.8	7.1	6.8
Pre-opening expense	2.7	1.6	1.2	0.6
Operating income (loss)	(6.4)	1.5	1.5	4.9
Other income (expense):				
Interest expense	(1.2)	(1.2)	(1.2)	(1.3)
Interest income	0.1	0.4	0.1	0.5
Other, net	0.1	0.1		0.1
Total other expense	(1.1)	(0.8)	(1.1)	(0.8)
Income (loss) before income taxes	(7.5)	0.7	0.4	4.1
Income tax benefit (provision)	1.3	0.4	0.3	(0.9)
Net income (loss)	(6.2)%	1.2%	0.8%	3.2%

*Note: Certain percentage totals do not sum due to rounding.*

Restaurants open at end of period	31	28		
Average weekly sales per restaurant (1):				
All restaurants	\$81,600	\$91,500	\$89,100	\$95,700
Percent change	-10.8%		-6.9%	
Same store restaurants (2)	\$84,300	\$91,500	\$91,100	\$95,700
Percent change	-7.9%		-4.8%	

(1) The Company computes average weekly sales per restaurant by dividing total

restaurant sales for the period by the total number of days all restaurants were open for the period to obtain a daily sales average, with the daily sales average then multiplied by seven to arrive at weekly average sales per restaurant. Days on which restaurants are closed for business for any reason other than the scheduled closure of all J. Alexander's restaurants on Thanksgiving day and Christmas day are excluded from this calculation. Average weekly same store sales per restaurant are computed in the same manner as described above except that sales and sales days used in the calculation include only those for restaurants open for more than 18 months. Revenue associated with reductions in



liabilities for  
gift cards which  
are considered  
to be only  
remotely likely  
to be redeemed  
is not included  
in the  
calculation of  
average weekly  
sales per  
restaurant or  
average weekly  
same store sales  
per restaurant.

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- (2) Includes the 28 restaurants open for more than 18 months.

**Net Sales**

Net sales decreased by \$995,000, or 3.0%, and by \$9,000 in the third quarter and first nine months of 2008, respectively, compared to the same periods of 2007. These decreases were due to decreases in net sales in the same store restaurant base which more than offset net sales generated by two new restaurants opened in the fourth quarter of 2007 and one new restaurant opened in the third quarter of 2008.

The reported average weekly consolidated and same store sales per restaurant have been adjusted for the effect of 22 sales days and estimated net sales of approximately \$300,000 lost in the first nine months of 2008 due to a fire at the Company's Denver restaurant and severe winter weather conditions in the Ohio market. Also, the Company's fiscal calendar resulted in New Year's Eve, when the Company typically experiences much higher than normal net sales, being included as the first day of fiscal 2008, but not being included in the first nine months of 2007. Management estimates that average weekly same store sales excluding the first day of the first nine months of both fiscal 2008 and 2007 decreased by 5.1% compared to the 4.8% decrease for the full nine months.

Management estimates the average check per guest, including alcoholic beverage sales, increased by less than 1.0% in 2008, to approximately \$24.12 in the third quarter of 2008 and \$24.41 in the first nine months of 2008. Management believes these increases were due primarily to the effect of higher menu prices which it estimates averaged approximately 0.3% and 1.0% higher in the third quarter and first nine months of 2008, respectively, than in the corresponding periods of 2007. Menu price increase estimates reflect menu price changes, without regard to any change in product mix because of price increases, and may not reflect amounts effectively paid by the customer. Management estimates that weekly average guest counts decreased on a same store basis, as adjusted for sales days lost for the first nine months of 2008, by approximately 7.7% and 5.4% in the third quarter and first nine months of 2008, respectively, compared to the same periods of 2007.

The Company's same store sales have now decreased for four consecutive quarters. Management believes these decreases, as well as related guest count losses, are due to a significant slowdown in discretionary consumer spending due to the effects of rising inflation, the tightening of consumer credit and general concerns about lower home values, the financial markets and the U.S economy. The downturn in same store sales trends in recent months has affected virtually all of the Company's restaurants, with the restaurants in Ohio and Illinois having been affected somewhat more than those in most other markets.

**Restaurant Costs and Expenses**

Total restaurant operating expenses increased to 96.0% of net sales in the third quarter of 2008 from 90.1% in the third period of the previous year and to 90.3% of net sales in the first nine months of 2008 from 87.8% in the first nine months of 2007 due primarily to the adverse effects of lower same store sales and the effect of three new restaurants opened since the third quarter of 2007, with the effects of these factors being partially offset by lower cost of sales for the first nine months of 2008. Restaurant operating margins decreased to 4.0% in the third

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quarter of 2008 from 9.9% in the third quarter of 2007 and to 9.7% in the first nine months of 2008 compared to 12.2% in the same period of 2007.

Cost of sales, which includes the cost of food and beverages, increased by 0.2% as a percentage of net sales for the third quarter of 2008 and decreased by 0.3% as a percentage of net sales for the first nine months of 2008 compared to the same periods of 2007. During these periods, increases in input costs for a number of food products were largely offset by lower prices paid for beef which was purchased at weekly market prices beginning in March of 2008 rather than under a fixed price purchasing agreement as in 2007. The effect of lower prices paid for beef in 2008 reduced cost of sales by an estimated 1.0% of net sales in the third quarter of 2008 and 0.5% for the first nine months of 2008 compared to the same periods of 2007. In addition, cost of sales for the first nine months of 2008 included the settlement of a claim against a prospective vendor which decreased cost of sales for the period by 0.2%.

Beef purchases represent the largest component of the Company's cost of sales and comprise approximately 25% to 30% of this expense category. In recent years, the Company has entered into fixed price beef purchase agreements in an effort to minimize the impact of significant increases in the market price of beef. However, because of uncertainty in the beef market and the high prices at which beef has been quoted to the Company on a forward fixed price basis relative to current market prices, the Company has not entered into a fixed price beef purchase agreement to replace the agreement which expired in March of 2008, and has purchased beef based on weekly market prices since that time. Market prices for beef increased somewhat during the third quarter of 2008 compared to prices paid by the Company in the second quarter of 2008 and there can be no assurance prices will not increase further. Management will continue to monitor the beef market and if there are significant changes in market conditions or attractive opportunities to contract in the future, will consider entering into a fixed price purchasing agreement.

Management expects the Company to experience increases in many of the food commodities it purchases for the remainder of 2008 and throughout 2009. However, management is uncertain at this time to what extent it will raise menu prices in response to such increases because the Company is experiencing decreases in same store guest counts and continues to have concerns about reduced spending by consumers.

Restaurant labor and related costs increased to 35.4% of net sales in the third quarter of 2008 from 33.2% in the third quarter of 2007 and to 32.9% for the first nine months of 2008 from 32.0% for the first nine months of 2007. These increases were due primarily to the effects of lower same store sales and higher labor costs incurred in the three new restaurants opened since the third quarter of 2007, with the effects of these factors being partially offset by lower incentive compensation and other employee benefits expense.

The Company estimates that the impact of increases in minimum wage rates will be approximately \$150,000 in 2008 and \$300,000 in 2009. Most of these increases relate to increnbs; 221  
Effective portion of changes in fair value of cash flow hedges, net of tax expense of 6

1

Share based payment expense

64 64

Acquisition of non-controlling interests

Dividend paid (including corporate dividend tax)

Debenture Redemption Reserve

(211) 211

Profit/(loss) for the period

2,627 2,627

**Balance as of June 30, 2011****621 (5) 22,807 230 48,902**

**Convenience translation into U.S.\$**

**14 511 5 1,097**

**Balance as of April 1, 2010**

**692 (5) 18,035 42,915**

Issue of equity share on exercise of options

(165) 29

Net change in fair value of other investments, net of tax benefit of 1

2

Foreign currency translation differences, net of tax benefit of 76

237

Effective portion of changes in fair value of cash flow hedges, net of tax benefit of 194

(379)

Share based payment expense

66 66

Acquisition of non-controlling interests

Dividend paid (including corporate dividend tax)

Profit/(loss) for the period

2,096 2,096

**Balance as of June 30, 2010**

**593 (5) 20,131 44,966**

\* The number of equity shares held by a controlled trust as of April 1, 2010, June 30, 2010, April 1, 2011 and June 30, 2011 was 82,800.

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS**  
(in millions, except share and per share data)

<b>Particulars</b>	<b>For the three months ended June 30,</b>			
	<b>2011</b>	<b>2011</b>	<b>2010</b>	
	<i>Unaudited convenience translation into U.S.\$ (See Note 2.d)</i>			
<b>Cash flows from operating activities:</b>				
Profit/(loss) for the period	U.S.\$	59	2,627	2,096
Adjustments for:				
Income tax expense		3	120	357
Profit on sale of investments			(17)	(38)
Depreciation and amortization		28	1,233	976
Allowance for sales returns		7	292	272
Allowance for doubtful trade receivables			20	9
Inventory write-downs		7	305	241
(Profit)/loss on sale of property, plant and equipment and intangible assets, net			(23)	(1)
Share of profit of equity accounted investees, net of income tax			(4)	(5)
Unrealized exchange (gain)/loss, net		(17)	(766)	(90)
Interest (income)/expense, net		5	221	(9)
Share based payment expense		1	64	66
<i>Changes in operating assets and liabilities:</i>				
Trade receivables		31	1,397	(113)
Inventories		(36)	(1,605)	(1,497)
Other assets		25	1,123	(768)
Trade payables		(5)	(224)	(42)
Other liabilities and provisions		(30)	(1,317)	(57)
Income tax paid		(12)	(534)	(539)
<b>Net cash from operating activities</b>	<b>U.S.\$</b>	<b>65</b>	<b>2,912</b>	<b>858</b>
<b>Cash flows used in investing activities:</b>				
Expenditures on property, plant and equipment		(41)	(1,822)	(1,894)
Proceeds from sale of property, plant and equipment				23
Purchase of investments		(34)	(1,500)	(4,172)
Proceeds from sale of investments		33	1,463	5,462
Expenditures on intangible assets		(36)	(1,607)	(3)
Interest received			10	18
<b>Net cash used in investing activities</b>	<b>U.S.\$</b>	<b>(78)</b>	<b>(3,456)</b>	<b>(566)</b>
<b>Cash flows from/(used in) financing activities:</b>				
Interest paid		(3)	(130)	(69)
Proceeds from issuance of equity shares			3	29

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Proceeds/(repayment) of short term loans and borrowings, net		8	336	376
Repayment of long term loans and borrowings, net			(2)	(885)
Dividend paid (including corporate dividend tax)				
<b>Net cash from/(used in) financing activities</b>	<b>U.S.\$</b>	<b>5</b>	<b>207</b>	<b>(549)</b>
Net increase/(decrease) in cash and cash equivalents		(8)	(337)	(257)
Effect of exchange rate changes on cash and cash equivalents		3	145	48
Cash and cash equivalents at the beginning of the period		127	5,660	6,545
<b>Cash and cash equivalents at the end of the period</b>	<b>U.S.\$</b>	<b>123</b>	<b>5,468</b>	<b>6,336</b>

The accompanying notes form an integral part of these unaudited condensed consolidated interim financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**  
**(in millions, except share and per share data)**

**1. Reporting Entity**

Dr. Reddy s Laboratories Limited ( DRL or the parent company ), together with its subsidiaries (collectively, the Company ), is a leading India-based pharmaceutical company headquartered in Hyderabad, Andhra Pradesh, India. The Company s principal areas of operation are in pharmaceutical services and active ingredients, global generics, and proprietary products. The Company s principal research and development facilities are located in Andhra Pradesh, India and Cambridge, United Kingdom; its principal manufacturing facilities are located in Andhra Pradesh, India, Himachal Pradesh, India, Cuernavaca-Cuautla, Mexico, Mirfield, United Kingdom, Louisiana, United States and Tennessee, United States; and its principal marketing facilities are located in India, Russia, the United States, the United Kingdom and Germany. The Company s shares trade on the Bombay Stock Exchange and the National Stock Exchange in India and, since April 11, 2001, also on the New York Stock Exchange in the United States. As explained in Note 23 of these condensed consolidated interim financial statements, during the year ended March 31, 2011, the Company issued bonus debentures. These bonus debentures have been listed on the Bombay Stock Exchange and the National Stock Exchange in India since April 7, 2011.

**2. Basis of preparation of financial statements****a) Statement of compliance**

These unaudited condensed consolidated interim financial statements as at and for the three months ended June 30, 2011 have been prepared under the historical cost convention on the accrual basis, except for certain financial instruments which have been measured at fair values. These unaudited condensed consolidated interim financial statements are prepared in accordance with IAS 34, *Interim Financial Reporting* . They do not include all of the information required for full annual financial statements and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 20-F for the fiscal year ended March 31, 2011. These unaudited condensed consolidated interim financial statements were authorized for issuance by the Company s Board of Directors on August 31, 2011.

**b) Significant accounting policies**

The accounting policies applied by the Company in these unaudited condensed consolidated interim financial statements are the same as those applied by the Company in its audited consolidated financial statements as at and for the year ended March 31, 2011 contained in the Company s Annual Report on Form 20-F except as set forth below. Effective as of April 1, 2011, the Company has changed its policy on valuation of inventory from the first-in first-out method to the weighted average method. Under the prior policy, the cost of all categories of inventories, except stores and spares, had been based on the first-in first-out method. Stores and spares consists of packing materials, engineering spares (such as machinery spare parts) and consumables (such as lubricants, cotton waste and oils), which are used in operating machines or consumed as indirect materials in the manufacturing process, had been under the prior policy valued at cost based on a weighted average method. Effective as of April 1, 2011, the cost of all categories of inventory is based on a weighted average cost method. Using the weighted average method will produce more accurate, reasonable and relevant information on the amounts of inventory reported in the statement of the financial position and, in turn, more accurate cost of revenue in the income statement. The effect of this change in the methodology of valuation of inventory is immaterial and, accordingly, no further disclosures have been made in these unaudited condensed consolidated interim financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**  
**(in millions, except share and per share data)**

**2. Basis of preparation of financial statements (continued)****c) Functional and presentation currency**

The unaudited condensed consolidated interim financial statements are presented in Indian rupees, which is the functional currency of the parent company. Functional currency of an entity is the currency of the primary economic environment in which the entity operates.

In respect of all non-Indian subsidiaries that operate as marketing arms of the parent company in their respective countries/regions, the functional currency has been determined to be the functional currency of the parent company (i.e., the Indian rupee). Accordingly, the operations of these entities are largely restricted to import of finished goods from the parent company in India, sale of these products in the foreign country and remittance of the sale proceeds to the parent company. The cash flows realized from sale of goods are readily available for remittance to the parent company and cash is remitted to the parent company on a regular basis. The costs incurred by these entities are primarily the cost of goods imported from the parent company. The financing of these subsidiaries is done directly or indirectly by the parent company.

In respect of subsidiaries and associates whose operations are self-contained and integrated within their respective countries/regions, the functional currency has been determined to be the local currency of those countries/regions. The assets and liabilities of such subsidiaries are translated into Indian rupees at the rate of exchange prevailing as at the reporting date. Revenues and expenses are translated into Indian rupees at average exchange rates prevailing during the period. Resulting translation adjustments are included in foreign currency translation reserve. All financial information presented in Indian rupees has been rounded to the nearest million.

**d) Convenience translation**

The accompanying unaudited condensed consolidated interim financial statements have been prepared in Indian rupees. Solely for the convenience of the reader, the unaudited condensed consolidated interim financial statements as of June 30, 2011 have been translated into United States dollars at the noon buying rate in New York City on June 30, 2011 for cable transfers in Indian rupees, as certified for customs purposes by the Federal Reserve Bank of New York of U.S.\$1.00 = 44.59. No representation is made that the Indian rupee amounts have been, could have been or could be converted into U.S. dollars at such a rate or any other rate. Such convenience translation is unaudited and not subject to our auditor's review procedures.

**e) Use of estimates and judgments**

The preparation of unaudited condensed consolidated interim financial statements in conformity with IAS 34 requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

In preparing these unaudited condensed consolidated interim financial statements the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the audited consolidated financial statements as at and for the year ended March 31, 2011.

**f) Recent accounting pronouncements*****Standards issued but not yet effective and not early adopted by the Company***

In November 2009, the IASB issued IFRS 9, *Financial instruments*, to introduce certain new requirements for classifying and measuring financial assets. IFRS 9 divides all financial assets that are currently in the scope of IAS 39 into two classifications – those measured at amortized cost and those measured at fair value. The standard, along with proposed expansion of IFRS 9 for classifying and measuring financial liabilities, de-recognition of financial instruments, impairment, and hedge accounting, will be applicable for annual periods beginning on or after January 1, 2015, although entities are permitted to adopt earlier. The Company is evaluating the impact which this new standard will have on the Company's unaudited condensed consolidated interim financial statements.





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**(in millions, except share and per share data)**

**2. Basis of preparation of financial statements (continued)**

**f) Recent accounting pronouncements (continued)**

In May 2011, the IASB issued new standards and amendments on consolidated financial statements and joint arrangements. The following are new standards and amendments:

IFRS 10, *Consolidated financial statements* .

IFRS 11, *Joint arrangements* .

IFRS 12, *Disclosure of interests in other entities* .

IAS 27 (Revised 2011), *Consolidated and separate financial statements* , which has been amended for the issuance of IFRS 10 but retains the current guidance on separate financial statements.

IAS 28 (Revised 2011), *Investments in associates* , which has been amended for conforming changes on the basis of the issuance of IFRS 10 and IFRS 11.

All the standards mentioned above are effective for annual periods beginning on or after January 1, 2013; earlier application is permitted as long as each of the other standards in this group is also early applied. The Company is in the process of determining the impact of these amendments on its unaudited condensed consolidated interim financial statements.

On June 16, 2011 the IASB issued an amendment to IAS-19 *Employee benefits* , which amended the standard as follows:

The amended standard requires recognition of changes in the net defined benefit liability/(asset), including immediate recognition of defined benefit cost, disaggregation of defined benefit cost into components, recognition of re-measurements in other comprehensive income, plan amendments, curtailments and settlements.

The amended standard introduced enhanced disclosures about defined benefit plans.

The amended standard modified accounting for termination benefits, including distinguishing benefits provided in exchange for services from benefits provided in exchange for the termination of employment, and it affected the recognition and measurement of termination benefits.

The amended standard provided clarification regarding various issues, including the classification of employee benefits, current estimates of mortality rates, tax and administration costs and risk-sharing and conditional indexation features.

The amended standard incorporated, without change, the IFRS Interpretations Committee's requirements set forth in IFRIC 14 *IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* .

These amendments are effective for annual periods beginning on or after January 1, 2013, although earlier application is permitted. The Company is in the process of determining the impact of these amendments on its unaudited condensed consolidated interim financial statements.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
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(in millions, except share and per share data)

**3. Segment reporting**

The Chief Operating Decision Maker ( CODM ) evaluates the Company s performance and allocates resources based on an analysis of various performance indicators by operating segments. The reportable operating segments reviewed by the CODM are as follows:

- Pharmaceutical Services and Active Ingredients ( PSAI );
- Global Generics; and
- Proprietary Products.

**Pharmaceutical Services and Active Ingredients.** This segment includes active pharmaceutical ingredients and intermediaries, also known as active pharmaceutical products or bulk drugs, which are the principal ingredients for finished pharmaceutical products. Active pharmaceutical ingredients and intermediaries become finished pharmaceutical products when the dosages are fixed in a form ready for human consumption such as a tablet, capsule or liquid using additional inactive ingredients. This segment also includes contract research services and the manufacture and sale of active pharmaceutical ingredients and steroids in accordance with the specific customer requirements.

**Global Generics.** This segment consists of finished pharmaceutical products ready for consumption by the patient, marketed under a brand name (branded formulations) or as generic finished dosages with therapeutic equivalence to branded formulations (generics).

**Proprietary Products.** This segment involves the discovery of new chemical entities for subsequent commercialization and out-licensing. It also involves the Company s specialty pharmaceuticals business which engages in sales and marketing operations for in-licensed and co-developed dermatology products.

The CODM reviews revenue and gross profit as the performance indicator for all of the above reportable segments. The CODM does not review the total assets and liabilities for each reportable segment.

**Information about segments:**

Segments	For the three months ended June 30,									
	PSAI		Global Generics		Proprietary Products		Others		Total	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
<b>Segment revenues (Note 1)</b>	<b>4,831</b>	<b>4,499</b>	<b>14,424</b>	<b>11,917</b>	<b>197</b>	<b>122</b>	<b>331</b>	<b>293</b>	<b>19,783</b>	<b>16,831</b>
<b>Gross profit</b>	<b>1,044</b>	<b>1,002</b>	<b>9,264</b>	<b>7,735</b>	<b>161</b>	<b>80</b>	<b>86</b>	<b>97</b>	<b>10,555</b>	<b>8,914</b>
Selling, general and administrative expenses									6,755	5,481
Research and development expenses									1,197	993
Other (income)/expense, net									(186)	(185)
<b>Results from operating activities</b>									<b>2,789</b>	<b>2,625</b>
Finance (expense)/income, net									(46)	(177)
Share of profit/(loss) of equity accounted investees, net of income tax									4	5

<b>Profit/(loss) before income tax</b>	<b>2,747</b>	<b>2,453</b>
Income tax (expense)/benefit	(120)	(357)
<b>Profit/(loss) for the period</b>	<b>2,627</b>	<b>2,096</b>

Note 1: Segment revenue for the three months ended June 30, 2011 does not include inter-segment revenues from PSAI to Global Generics which is accounted for at cost of 929 (as compared to 777 for the three months ended June 30, 2010).

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**3. Segment reporting (continued)***Analysis of revenue by geography within Global Generics segment:*

The CODM reviews the geographical composition of revenues within the Company's Global Generics segment. Accordingly, the geographical revenue information within the Company's Global Generics segment has been provided for the three months ended June 30, 2011 and 2010.

The following table shows the distribution of the Company's revenues by geography within the Company's Global Generics segment, based on the location of the customer:

	<b>For the three months ended June</b>	
	<b>30,</b>	
	<b>2011</b>	<b>2010</b>
India	2,936	2,778
North America (the United States and Canada)	5,756	3,898
Russia and other countries of the former Soviet Union	3,018	2,552
Europe	1,802	1,836
Others	912	853
	<b>14,424</b>	<b>11,917</b>

*Analysis of revenue by key products within PSAI segment:*

An analysis of revenues by key products in the Company's PSAI segment is given below:

	<b>For the three months ended June</b>	
	<b>30,</b>	
	<b>2011</b>	<b>2010</b>
Escitalopram	269	42
Naproxen	264	157
Atorvastatin	254	67
Clopidogrel	239	225
Gemcitabine	230	359
Ciprofloxacin	224	292
Ramipril	197	151
Rabeprazole	180	137
Finasteride	156	193
Ranitidine	131	121
Others	2,687	2,755
<b>Total</b>	<b>4,831</b>	<b>4,499</b>

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**3. Segment reporting (continued)**

An analysis of revenues by key products in the Company's Global Generics segment is given below:

	<b>For the three months ended June</b>	
	<b>2011</b>	<b>2010</b>
	<b>30,</b>	
Omeprazole	2,609	1,658
Nimesulide	944	900
Tacrolimus	648	237
Ketorol	524	461
Lansoprazole	522	
Ciprofloxacin	522	561
Ceterizine	372	314
Ibuprofen	364	260
Ranitidine	328	283
Fexofenadine (hcl and pseudoephedrine)	314	192
Others	7,277	7,051
<b>Total</b>	<b>14,424</b>	<b>11,917</b>

**4. Business combination and other acquisitions****Acquisition of GSK's manufacturing facility in Bristol, Tennessee, U.S.A. and product rights**

On November 23, 2010, the Company through its wholly-owned subsidiary, Dr. Reddy's Laboratories Tennessee LLC, entered into an asset purchase agreement with Glaxosmithkline LLC and Glaxo Group Limited (collectively, "GSK") for the acquisition of GSK's penicillin-based antibiotics manufacturing facility in Bristol, Tennessee, U.S.A., the U.S. FDA approved product related rights over GSK's Augmentin® (branded and generic) and Amoxil® (brand) brands of oral penicillin-based antibiotics in the United States (GSK retained the existing rights for these brands outside the United States), certain raw materials and finished goods inventory associated with Augmentin®, and rights to receive certain transitional services from GSK. The transaction was subsequently consummated on March 29, 2011. The total cash consideration for the transaction amounted to 1,169 (U.S. \$26). Through this acquisition, the Company entered the U.S penicillin-containing antibacterial market segment, thereby broadening its portfolio in North America. The Company has accounted for this transaction as an acquisition of business in accordance with IFRS No. 3, Business Combinations (Revised), as the integrated set of assets acquired constitutes a business as defined in the standard. Accordingly, the financial results of this acquired business for the period from March 29, 2011 to March 31, 2011 have been included in the consolidated financial statements of the Company. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

<b>Particulars</b>	<b>Recognized values on acquisition</b>
Property, plant and equipment	688
Intangible assets	321
Inventories	146
Other assets	132
Deferred tax liability	(45)

Net identifiable assets and liabilities	<b>1,242</b>
Negative goodwill recognized in other expense/(income), net <sup>(1)</sup>	(73)
Consideration paid in cash	<b>1,169</b>

(1) The negative goodwill on acquisition is attributable mainly to lower amounts paid towards intangible and other assets.

No pro-forma information was disclosed in the consolidated financial statements for the year ended March 31, 2011 as the acquisition is immaterial.

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**5. Financial instruments**

*Hedging of fluctuations in foreign currency*

The Company is exposed to exchange rate risk which arises from its foreign exchange revenues, primarily in U.S. Dollars, British Pounds, Russian roubles and Euros, and foreign currency debt in U.S. Dollars, Russian roubles and Euros.

The Company uses forward exchange contracts and option contracts (derivatives) to mitigate its risk of changes in foreign currency exchange rates. Where necessary, the forward exchange contracts are rolled over at maturity. Further, the Company uses non-derivative financial instruments as part of its foreign currency exposure risk mitigation strategy.

*Forecasted transactions*

Derivatives:

The Company classifies its option and forward contract hedging forecasted transactions as cash flow hedges and measures them at fair value. The fair value of option and forward contracts used as hedges of forecasted transactions at June 30, 2011 was an asset of 571 (as compared to an asset of 516 at March 31, 2011). This amount was recognized as derivatives measured at fair value.

Non-derivatives:

The Company designates as hedging instruments certain non-derivative financial liabilities for hedging of foreign currency risk associated with forecasted transactions and, accordingly, applies cash flow hedge accounting for such relationships. The fair value of such non-derivative liabilities was 7,676 as at June 30, 2011 as compared to 8,398 as at March 31, 2011 which has been disclosed as a part of Short term borrowings in the statements of financial position. Re-measurement of these non-derivative financial liabilities, from their initial recognized value to the value in rupee terms as at the reporting date, resulted in a foreign exchange difference of 16 as at June 30, 2011, as compared to 37 as at March 31, 2011. Such foreign exchange difference has been disclosed as part of the hedging reserve.

*Recognized assets and liabilities*

Changes in the fair value of forward exchange contracts and option contracts that economically hedge monetary assets and liabilities in foreign currencies and for which no hedge accounting is applied are recognized in the income statements. Both the changes in fair value of the forward contracts and the foreign exchange gains and losses relating to the monetary items are recognized as part of net finance costs. The fair value of forward exchange contracts and option contracts used as economic hedges of monetary assets and liabilities in foreign currencies are recognized in fair value derivatives was an asset of 247 at June 30, 2011 (as compared to an asset of 268 at March 31, 2011).

*Fair values*

The net carrying amount and fair value of all financial instruments, except derivative financial instruments, as at June 30, 2011 was a net liability of 18,507 (as compared to a net liability of 19,171 at March 31, 2011).

Recognition:

In respect of foreign currency derivative financial instruments, the Company recognized a net gain of 156 and 12 for the three months ended June 30, 2011 and 2010, respectively. These amounts are included in finance (expense)/income.

In respect of foreign currency derivative contracts designated as cash flow hedges, the Company has recorded, as a component of equity, a net gain of 60, and a net loss of 573 for the three months ended June 30, 2011 and 2010, respectively. The Company also recorded, as part of revenue, a net gain of 158 and 126 during the three months ended June 30, 2011 and 2010, respectively.

In respect of non-derivative financial liabilities, the Company has recorded, as a component of equity, a net loss of 53 for the three months ended June 30, 2011 and 0 for the three months ended June 30, 2010.





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**6. Cash and cash equivalents**

Cash and cash equivalents consist of:

	<b>June 30,</b>	<b>As of</b>
	<b>2011</b>	<b>March 31, 2011</b>
Cash balances	9	10
Balances with banks	5,191	5,247
Time deposit balances with banks	268	472
<b>Cash and cash equivalents on the statements of financial position</b>	<b>5,468</b>	<b>5,729</b>
Bank overdrafts used for cash management purposes		(69)
<b>Cash and cash equivalents in the cash flow statement</b>	<b>5,468</b>	<b>5,660</b>

Balances with banks included restricted cash of 253 for the three months ended June 30, 2011 and the year ended March 31, 2011, which consisted of:

20 as of June 30, 2011 and March 31, 2011, representing amounts in the Company's unclaimed dividend account, which are therefore restricted;

150 as of June 30, 2011 and March 31, 2011, representing amounts in an escrow account for settlement of the payment due in respect of the Company's exercise of the portfolio termination value option under its research and development agreement with I-VEN Pharma Capital Limited; and

83 as of June 30, 2011 and March 31, 2011, representing amounts deposited as security for a bond executed for an environmental liability relating to the Company's site in Mirfield, United Kingdom.

**7. Inventories**

Inventories consist of the following:

	<b>June 30,</b>	<b>As of</b>
	<b>2011</b>	<b>March 31, 2011</b>
Raw materials	5,517	4,777
Packing material, stores and spares	1,196	1,115
Work-in-process	4,618	4,220
Finished goods	6,070	5,947
	<b>17,401</b>	<b>16,059</b>

During the three months ended June 30, 2011, the Company recorded inventory write-downs of 305 (as compared to 241 for the three months ended June 30, 2010). These adjustments were included in cost of revenues. Cost of revenues for the three months ended June 30, 2011 include raw materials, consumables and changes in finished goods and work in progress recognized in the income statements of 5,830 (as compared to 5,041 for the three months ended June 30, 2010). The above table includes inventories of 972 and 860 which are carried at fair value less cost to sell as at June 30, 2011 and March 31, 2011, respectively.



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**8. Property, plant and equipment***Acquisitions and disposals*

During the three months ended June 30, 2011, the Company acquired assets at an aggregate cost of 1,692 (as compared to a cost of 2,164 and 10,146 for the three months ended June 30, 2010 and the year ended March 31, 2011, respectively). Assets with a net book value of 8 were disposed of during the three months ended June 30, 2011 (as compared to 22 and 450 for the three months ended June 30, 2010 and the year ended March 31, 2011, respectively), resulting in a net loss on disposal of 8 (as compared to net gain of 1 and 272 for the three months ended June 30, 2010 and the year ended March 31, 2011, respectively). Depreciation expense for the three months ended June 30, 2011 was 828 (as compared to 688 for the three months ended June 30, 2010).

*Government grants*

During the three months ended June 30, 2011, the Company obtained the approval for its application for certain grants associated with construction of a manufacturing facility in the United States from the State of Louisiana amounting to 30 (U.S.\$0.7). As per the terms of the grant, the State of Louisiana has placed certain ongoing conditions on the Company, requiring a minimum cost to be incurred and also requiring employment of a minimum number of people. In proportion to the actual cost incurred, the Company has accrued the proportionate share of the grant as a reduction from the carrying value of property, plant and equipment.

*Capital commitments*

As of June 30, 2011 and March 31, 2011, the Company was committed to spend approximately 3,292 and 3,459, respectively, under agreements to purchase property, plant and equipment. This amount is net of capital advances paid in respect of such purchases.

**9. Goodwill**

Goodwill arising upon business acquisitions is not amortized but tested for impairment at least annually or more frequently if there is any indication that the cash generating unit to which goodwill is allocated is impaired.

The following table presents the changes in goodwill during the three months ended June 30, 2011 and 2010 and the year ended March 31, 2011:

	<b>Three months ended June 30, 2011</b>	<b>Three months ended June 30, 2010</b>	<b>Year ended March 31, 2011</b>
Opening balance <sup>(1)</sup>	18,273	18,267	18,267
Goodwill arising on business combinations			
Effect of translation adjustments	4	(6)	6
Closing balance <sup>(1)</sup>	<b>18,277</b>	<b>18,261</b>	<b>18,273</b>
Less: Impairment loss <sup>(2)</sup>	(16,093)	(16,093)	(16,093)
	<b>2,184</b>	<b>2,168</b>	<b>2,180</b>

(1) This does not include goodwill arising upon investment in associates of 181, which is included in the carrying value of the investment in the equity accounted investees.

(2) The impairment loss of 16,093 includes 16,003 pertaining to the Company's German subsidiary, betapharm Arzneimittel GmbH, which is part of the Company's Global Generics segment.



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**10. Other intangible assets***Acquisitions of intangibles*

During the three months ended June 30, 2011, the Company acquired other intangible assets at an aggregate cost of 12 (as compared to a cost of 3 for the three months ended June 30, 2010 and 2,125 for the year ended March 31, 2011). Amortization expenses for the three months ended June 30, 2011 were 405 (as compared to amortization expenses of 288 for the three months ended June 30, 2010).

In November 2007, the Company entered into a Distribution and Supply Agreement with Ceragenix Pharmaceuticals, Inc. and Ceragenix Corporation (collectively, Ceragenix). Under this agreement, the Company made up-front and milestone payments of U.S.\$5 and commenced distribution of the dermatological product EpiCeram®, a skin barrier emulsion device, in the United States and its territories. In June 2010, Ceragenix (both entities) filed voluntary petitions under Chapter 11 of the U.S. Bankruptcy Code. On June 24, 2011 the United States Bankruptcy Court for the District of Colorado permitted Ceragenix to sell the patent rights, certain business assets and intellectual property relating to EpiCeram® to PuraCap Pharmaceutical LLC and to terminate the Company's rights under its Distribution and Supply Agreement with Ceragenix. However, the court ordered Ceragenix to pay U.S.\$2.75 to the Company out of the sales proceeds of the above mentioned assets and intellectual property, as compensation for the termination of the Distribution and Supply Agreement. Upon termination of the Distribution and Supply Agreement, the Company de-recognized the asset and recorded a gain of 27 (excess of amount received over the carrying value of the asset as at June 24, 2011) as part of other (income)/loss in these unaudited condensed consolidated interim financial statements during the three months ended June 30, 2011.

On March 31, 2011, the Company, through its wholly owned subsidiary Promius Pharma LLC, entered into an agreement with Coria Laboratories Limited (a subsidiary of Valeant Pharmaceuticals International, Inc.) (Coria) for the right to manufacture, distribute and market its Cloderm® (clocortolone pivalate 0.1%) product in the United States. Cloderm® is a cream used for treating dermatological inflammation, and is an existing U.S. FDA approved product. In addition to acquiring all relevant U.S. FDA product regulatory approvals and intellectual property rights (other than trademarks) associated with the Cloderm® product, the Company also acquired an underlying raw material supply contract and an exclusive license to use the trademark Cloderm® for a period of 8 years. The rights and ownership of this trademark would get transferred from Coria to the Company at the end of the 8th year, subject to payment of all royalties under the contract by the Company. Considerations for these transactions includes an upfront payment of 1,605 (U.S. \$36) in cash and contingent consideration in the form of a royalty equal to 4% of the Company's net sales of Cloderm® in the United States during the 8 year trademark license period.

Since the integrated set of assets acquired as part of these transactions does not meet the definition of a business, the acquisition has been recorded as a purchase of an integrated set of complementary intangible assets with similar economic useful lives. Furthermore, contingent payments associated with future sales have also been considered as an element of cost, as they are directly associated with the acquisition of absolute control over the product related intangibles and do not relate to any substantive future activities either by the Company or Coria. Accordingly an amount of 171 (U.S. \$4) has been measured as management's best estimate of the present value for the royalty payments over the 8 year trademark license period.

Product related intangibles acquired during the year ended March 31, 2010 included an amount of 2,680 (U.S. \$57), representing the value of re-acquired rights on the product portfolio that arose upon the exercise by I-VEN Pharma Capital Limited (I-VEN) of the portfolio termination value option under its research and development agreement with the Company entered into during the year ended March 31, 2005, as amended.

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**11. Loans and borrowings***Short term loans and borrowings*

The Company had undrawn lines of credit of 13,960 and 13,090 as of June 30, 2011 and March 31, 2011, respectively, from its banks for working capital requirements. These lines of credit are renewable annually. The Company has the right to draw upon these lines of credit based on its requirements.

An interest rate profile of short term borrowings from banks is given below:

	<b>June 30, 2011</b>	<b>As at March 31, 2011</b>
Rupee borrowings	9.75%	8.75%
Borrowings on receivables transfer arrangement	LIBOR+75-90 bps LIBOR+ 55-95 bps 5% to 20%	LIBOR+75-100 bps  LIBOR+ 50 -175 bps 5% to 8%
Other foreign currency borrowings		

*Transfer of financial asset*

During the year ended March 31, 2011, the Company entered into a receivables transfer arrangement with Citibank, India, in which the Company transferred 2,215 (U.S.\$49) of short term trade receivables in return for obtaining short term funds. As part of the transaction, the Company provided Citibank with credit indemnities over the expected losses of those receivables. Since the Company has retained substantially all of the risks and rewards of ownership of the trade receivables including the contractual rights to the associated cash flows, the Company continues to recognize the full carrying amount of the receivables and has recognized the cash received in respect of the transaction as short term borrowings. As of June 30, 2011, the carrying amount of the transferred short-term receivables which were subject to this arrangement was 767 (U.S \$17.16) and the carrying amount of the associated liability was 754 (U.S \$16.9). As of March 31, 2011, the carrying amount of the transferred short-term receivables which were subject to this arrangement was 838 (U.S \$18.78) and the carrying amount of the associated liability was 825 (U.S \$18.50).

*Short-term borrowings- hedging instruments*

During the year ended March 31, 2011, the Company borrowed foreign currency denominated short term loans amounting to 8,398. In connection with such borrowings, the Company documented an effective cash flow hedge relationship for the foreign currency exposure associated with such foreign currency borrowings and for the probable anticipated foreign currency sales transactions of approximately 7,676 (U.S.\$150 and EUR 15). Accordingly, the foreign exchange differences arising from re-measurement of these foreign currency monetary items before translation into the reporting currency of the Company has been recognized as a component of equity within the hedging reserve. The Company has recorded a loss of 53 towards foreign exchange differences arising from re-measurement of these foreign currency borrowings for the three months ended June 30, 2011 (as compared to 0 for the three months ended June 30, 2010).

*Long term loans and borrowings*

Long term loans and borrowings consist of the following:

	<b>June 30, 2011</b>	<b>As of March 31, 2011</b>
Obligations under finance leases	283	256

Bonus debentures	5,031	5,027
	<b>5,314</b>	<b>5,283</b>
Less: Current portion		
Obligations under finance leases	28	12
	<b>28</b>	<b>12</b>
Non-current portion		
Obligations under finance leases	255	244
Bonus debentures	5,031	5,027
	<b>5,286</b>	<b>5,271</b>



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**11. Loans and borrowings (continued)***Issuance of bonus debentures*

As explained in Note 23 of these condensed consolidated interim financial statements, during the year ended March 31, 2011, the Company issued unsecured redeemable bonus debentures amounting to 5,078. In relation to the issuance, the Company has incurred directly attributable transaction cost of 51. The bonus debentures do not carry the right to vote or the right to participate in any of the distributable profits or residual assets of the Company, except that the holders of the bonus debentures participate only to the extent of the face value of the instrument plus accrued and unpaid interest thereon. These bonus debentures are mandatorily redeemable at the face value on March 23, 2014 and the Company is obligated to pay the holders of its bonus debentures an annual interest payment equal to 9.25% of the face value thereof on March 24 of each year until (and including upon) maturity. These bonus debentures are measured at amortized cost using the effective interest rate method. The carrying value of these bonus debentures as at June 30, 2011 was 5,031.

Interest rate profile of long-term loans and borrowings

An interest rate profile of long-term loans and borrowings is given below:

	June 30, 2011	As of March 31, 2011
Bonus debentures	9.25%	9.25%

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

Other (income)/expense, net consists of the following:

	Three months ended	
	June 30, 2011	June 30, 2010
(Profit)/loss on sale of property, plant and equipment and intangible assets, net	(23)	(1)
Sale of spent chemical	(79)	(57)
Miscellaneous income	(92)	(127)
Provision for expected claim from innovator	8	
	<b>(186)</b>	<b>(185)</b>

**13. Finance (expense)/income, net**

Finance (expense)/income, net consists of the following:

	Three months ended	
	June 30, 2011	June 30, 2010
Interest income	12	60
Foreign exchange (loss)/gain	158	(224)
Profit on sale of investments	17	38
Interest expense	(233)	(51)
	<b>(46)</b>	<b>(177)</b>



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**14. Share capital and share premium**

During the three months ended June 30, 2011 and 2010, a total of 223,100 and 298,878 equity shares, respectively, were issued as a result of the exercise of vested options granted to employees pursuant to the Dr. Reddy s Employees Stock Option Plan 2002 and Dr. Reddy s Employees Stock Option Plan 2007. During the three months ended June 30, 2011, an aggregate of 5,000 options having an exercise price based upon the fair market value of the underlying shares (or Category A options) were exercised, with each having an exercise price of 448, and 218,100 options having an exercise price based upon par value of the underlying shares (or Category B options) were exercised, with each having an exercise price of 5. The amount of grant date fair value previously recognized for these options has been transferred from share based payment reserve to share premium in the unaudited condensed consolidated interim statement of changes in equity for the period ended June 30, 2011.

**15. Earnings per share***Basic earnings per share*

The calculation of basic earnings per share for the three months ended June 30, 2011 was based on the profit attributable to equity shareholders of 2,627 (as compared to a profit of 2,096 for the three months ended June 30, 2010) and a weighted average number of equity shares outstanding during the three months ended June 30, 2011 and 2010, calculated as follows:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Issued equity shares as on April 1	169,252,732	168,845,385
Effect of shares issued upon exercise of stock options	52,633	47,953
Weighted average number of equity shares at June 30	169,305,365	168,893,338

*Diluted earnings per share*

The calculation of diluted earnings per share for the three months ended June 30, 2011 was based on the profit attributable to equity shareholders of 2,627 (as compared to a profit of 2,096 for the three months ended June 30, 2010) and the weighted average number of equity shares outstanding during the three months ended June 30, 2011 and 2010, calculated as follows:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Weighted average number of ordinary shares at June 30 (Basic)	169,305,365	168,893,338
Effect of stock options outstanding	720,758	925,421
Weighted average number of equity shares at June 30 (Diluted)	170,026,123	169,818,759

The change in accounting policy had an immaterial impact on the basic and diluted earnings per share for each of the periods reported.

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**16. Employee stock incentive plans**

*Dr. Reddy s Employees Stock Option Plan-2002 (the DRL 2002 Plan ):*

The Company instituted the DRL 2002 Plan for all eligible employees pursuant to the special resolution approved by the shareholders in the Annual General Meeting held on September 24, 2001. The DRL 2002 Plan covers all employees of DRL and its subsidiaries and directors (excluding promoter directors) of DRL and its subsidiaries (collectively, eligible employees ). The compensation committee of the Board of DRL (the Compensation Committee ) administers the DRL 2002 Plan and grants stock options to eligible employees. The Compensation Committee determines which eligible employees will receive options, the number of options to be granted, the exercise price, the vesting period and the exercise period. The vesting period is determined for all options issued on the date of grant. The options issued under the DRL 2002 Plan vest in periods ranging between one and four years and generally have a maximum contractual term of five years.

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

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

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

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

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

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

Under the DRL 2002 Plan, the exercise price of the fair market value options granted under Category A above is determined based on the average closing price for 30 days prior to the grant in the stock exchange where there is highest trading volume during that period. Notwithstanding the foregoing, the Compensation Committee may, after obtaining the approval of the shareholders in the annual general meeting, grant options with a per share exercise price other than fair market value and par value of the equity shares.

After the stock split effected in the form of stock dividend issued by the Company in August 2006, the DRL 2002 Plan provides for stock options granted in the above two categories as follows:

<b>Particulars</b>	<b>Number of Options granted under Category A</b>	<b>Number of Options granted under Category B</b>	<b>Total</b>
Options reserved under original Plan	300,000	1,995,478	2,295,478
Options exercised prior to stock dividend date (A)	94,061	147,793	241,854
Balance of shares that can be allotted on exercise of options (B)	205,939	1,847,685	2,053,624
Options arising from stock dividend (C)	205,939	1,847,685	2,053,624
Options reserved after stock dividend (A+B+C)	505,939	3,843,163	4,349,102

In April 2007, certain employees surrendered their par value options under category B of the DRL 2002 Plan in exchange for par value options under category B of the DRL 2007 Plan (discussed below). The incremental cost due to such modifications was insignificant.

*Dr. Reddy s Employees ADR Stock Option Plan-2007 (the DRL 2007 Plan ):*

The Company instituted the DRL 2007 Plan for all eligible employees in pursuance of the special resolution approved by the shareholders in the Annual General Meeting held on July 27, 2005. The DRL 2007 Plan became effective upon its approval by the Board of Directors on January 22, 2007. The DRL 2007 Plan covers all employees of DRL and its subsidiaries and directors (excluding promoter directors) of DRL and its subsidiaries (collectively, eligible employees ). The Compensation Committee administers the DRL 2007 Plan and grants stock options to eligible employees. The Compensation Committee determines which eligible employees will receive options, the number of options to be granted, the exercise price, the vesting period and the exercise period. The vesting period is determined for all options issued on the date of grant. The options issued under DRL 2007 Plan vest in periods ranging between one and four years and generally have a maximum contractual term of five years.

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**16. Employee stock incentive plans (continued)**

The DRL 2007 Plan provides for option grants in two categories:

**Category A:** 382,695 stock options out of the total of 1,530,779 stock options reserved for grant having an exercise price equal to the fair market value of the underlying equity shares on the date of grant; and

**Category B:** 1,148,084 stock options out of the total of 1,530,779 stock options reserved for grant having an exercise price equal to the par value of the underlying equity shares (i.e., 5 per option).

*Aurigene Discovery Technologies Ltd. Employee Stock Option Plan 2003 (the Aurigene ESOP Plan ):*

Aurigene Discovery Technologies Limited ( Aurigene ), a consolidated subsidiary, adopted the Aurigene ESOP Plan to provide for issuance of stock options to employees of Aurigene and its subsidiary, Aurigene Discovery Technologies Inc., who have completed one full year of service with Aurigene or its subsidiary. Aurigene has reserved 4,550,000 of its ordinary shares for issuance under this plan. Under the Aurigene ESOP Plan, stock options may be granted at an exercise price as determined by Aurigene s compensation committee. The options issued under the Aurigene ESOP Plan vest in periods ranging from one to three years, including certain options which vest immediately on grant, and generally have a maximum contractual term of three years.

During the year ended March 31, 2008, the Aurigene ESOP Plan was amended to increase the total number of options reserved for issuance to 7,500,000.

*Aurigene Discovery Technologies Ltd. Management Group Stock Grant Plan (the Aurigene Management Plan ):*

In the year ended March 31, 2004, Aurigene adopted the Aurigene Management Plan to provide for issuance of stock options to management employees of Aurigene and its subsidiary Aurigene Discovery Technologies Inc. Aurigene has reserved 2,950,000 of its ordinary shares for issuance under this plan. Under the Aurigene Management Plan, stock options may be granted at an exercise price as determined by Aurigene s compensation committee. As of March 31, 2008, there were no stock options outstanding under the Aurigene Management Plan. The plan was closed by a resolution of the shareholders in January 2008.

Stock option activity during the period:

The terms and conditions of the grants made during the three months ended June 30, 2011 under the above plans were as follows:

	<b>Number of instruments</b>	<b>Exercise price</b>	<b>Vesting period</b>	<b>Contractual life</b>
<b><i>DRL 2002 Plan:</i></b>				
- Category A				
- Category B	262,520	5.00	1 to 4 years	5 years
<b><i>DRL 2007 Plan:</i></b>				
- Category A				
- Category B	56,060	5.00	1 to 4 years	5 years
<b><i>Aurigene ESOP Plan:</i></b>				

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**16. Employee stock incentive plan (continued)**

The terms and conditions of the grants made during the three months ended June 30, 2010 under the above plans are as follows:

	Number of instruments	Exercise price	Vesting period	Contractual life
<b><i>DRL 2002 Plan:</i></b>				
- Category A				
- Category B	284,070	5.00	1 to 4 years	5 years
<b><i>DRL 2007 Plan:</i></b>				
- Category A				
- Category B	58,660	5.00	1 to 4 years	5 years

***Aurigene ESOP Plan:***

The weighted average inputs used in computing the fair value of such grants were as follows:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Expected volatility	28.92%	34.34%
Exercise price	5.00	5.00
Option life	2.42 Years	2.43 Years
Risk-free interest rate	8.34%	6.04%
Expected dividends	0.70%	0.40%
Grant date share price	1598.57	1242.55

The fair values of services received in return for share options granted to employees are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model.

For the three months ended June 30, 2011 and 2010 amounts of 64 and 66, respectively, have been recorded as total employee share based expense under all employee stock incentive plans. As of June 30, 2011, there was approximately 528 of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of 3.41 years.

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**17. Employee benefit plans***Gratuity benefits*

In accordance with applicable Indian laws, the Company provides for gratuity, a defined benefit retirement plan (the Gratuity Plan ) covering certain categories of employees. The Gratuity Plan provides a lump sum payment to vested employees at retirement or termination of employment. The amount of payment is based on the respective employee's last drawn salary and the years of employment with the Company. Effective September 1, 1999, the Company established the Dr. Reddy's Laboratories Gratuity Fund (the Gratuity Fund ). Liabilities in respect of the Gratuity Plan are determined by an actuarial valuation, based upon which the Company makes contributions to the Gratuity Fund. Trustees administer the contributions made to the Gratuity Fund. Amounts contributed to the Gratuity Fund are invested in specific securities as mandated by law and generally consist of federal and state government bonds and debt instruments of government-owned corporations.

The components of net periodic benefit cost for the three months ended June 30, 2011 and 2010 are as follows:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Service cost	21	16
Interest cost	13	9
Expected return on plan assets	(9)	(8)
Recognized net actuarial (gain)/loss	3	1
Net amount recognized	<b>28</b>	<b>18</b>

*Pension plan*

All employees of Industrias Quimicas Falcon de Mexico S.A. de C.V. ( Falcon ) are entitled to a pension plan in the form of a defined benefit plan. The pension plan provides a payment to vested employees at retirement or termination of employment. This payment is based on the employee's integrated salary and is paid in the form of a monthly pension over a period of 20 years computed based on a predefined formula. Liabilities in respect of the pension plan are determined by an actuarial valuation, based upon which the Company makes contributions to the pension plan fund. This fund is administered by a third party who is provided guidance by a technical committee formed by senior employees of Falcon.

The components of net periodic benefit cost for the three months ended June 30, 2011 and 2010 are as follows:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Service cost	5	4
Interest cost	7	6
Expected return on plan assets	(7)	(7)
Recognized net actuarial (gain)/loss	2	2
Net amount recognized	<b>7</b>	<b>5</b>

*Long service benefit recognitions*

During the year ended March 31, 2010, the Company introduced a new post-employment defined benefit scheme under which all eligible employees of the parent company who have completed the specified service tenure with the Company would be eligible for a Long Service Cash Award at the time of their employment separation. The amount of such cash payment would be based on the respective employee's last drawn salary and the specified number of years



of employment with the Company. Accordingly the Company has valued the liability through an independent actuary.

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**17. Employee benefit plans (continued)**

The components of net periodic benefit cost for the three months ended June 30, 2011 and 2010 are as follows:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Service cost	2	2
Interest cost	1	1
Expected return on plan assets		
Recognized net actuarial (gain)/loss		
 Net amount recognized	 <b>3</b>	 <b>3</b>

*Severance payments of German subsidiaries*

In Germany, many statutory health insurance funds ( SHI funds ) and other health insurance providers have been announcing new competitive bidding tenders which continue to cause pressure on the Company s existing level of revenues due to a steep decrease in product prices. The Company believes that this is leading to a business model of high volumes and low margins in the German generic pharmaceutical market.

On account of these developments and other significant adverse events in the German generic pharmaceutical market, during the year ended March 31, 2010 the Company implemented workforce reductions and restructuring of the Company s German subsidiaries, betapharm Arzneimittel GmbH ( betapharm ) and Reddy Holding GmbH, to achieve a more sustainable workforce structure in light of the current situation within the German generic pharmaceuticals industry. Accordingly, during the year ended March 31, 2010, the management and the works councils (i.e., organizations representing workers) of betapharm and Reddy Holding GmbH entered into reconciliation of interest agreements that set out the overall termination benefits payable to identified employees. Accordingly, an amount of 885 (Euro 13.2) was recorded as termination benefits included as part of selling, general and administrative expenses in the consolidated income statement for the year ended March 31, 2010. A total of 435 (Euro 6.6) of such severance payments were recorded during the three months ended June 30, 2010. There were no restructuring activities during the three months ended June 30, 2011.

*Termination benefits in India*

On June 20, 2011, the Company announced a voluntary retirement scheme (i.e., a termination benefit) applicable to certain eligible employees of Dr. Reddy s Laboratories Limited. As per the scheme, employees whose voluntary retirement is accepted by the Company will be paid an amount computed based on the methodology described in the scheme, with the maximum amount restricted to 0.8 per employee. An amount of 136 has been recognized as a termination benefit in the unaudited condensed consolidated interim financial statements for the three months ended June 30, 2011.

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**18. Income taxes**

Income tax expense is recognized based on the Company's best estimate of the average annual income tax rate expected for the fiscal year applied to the pre-tax income of the interim period. The average annual income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pre-tax income of each jurisdiction. The difference between the estimated average annual income tax rate and the enacted tax rates is accounted for by a number of factors, including the effect of differences between Indian and foreign tax rates, expenses that are not deductible for tax purposes, income exempted from income taxes, effects of changes in tax laws and rates.

The Company's consolidated weighted average tax rate for the three months ended June 30, 2011 and 2010 was 4.35% and 14.55%, respectively. Income tax expense was 120 for the three months ended June 30, 2011, as compared to income tax expense of 357 for the three months ended June 30, 2010. The decrease in the consolidated weighted average tax rate during the three months ended June 30, 2011 is primarily due to deductible temporary differences arising from unrealized inter-company profits on inventory held by the Company at the end of reporting period in higher tax jurisdictions. As per the requirements of IFRS, the Company is required to create a deferred tax asset in respect of unrealized inter-company profit arising on inventory held by the Company at the end of reporting period by applying the tax rate of the jurisdiction in which the inventory is held.

Total tax benefit recognized directly in the equity amounting to 42 for the three months ended June 30, 2011 (as compared to a tax benefit amounting to 271 for the three months ended June 30, 2010).

There are certain income-tax related legal proceedings that are pending against the Company that have arisen in the ordinary course of business. Potential liabilities, if any, have been adequately provided for, and the Company does not currently estimate any material incremental tax liability in respect of these matters.

During the year ended March 31, 2010, the German tax authorities concluded their preliminary tax audits for betapharm, covering the fiscal years 2001 to 2004, and had objected to certain tax positions taken in those years income tax returns filed by betapharm. Management's best estimate of the additional tax liability that could arise on conclusion of the tax audits was 302 (EUR 5). Accordingly, the Company had recorded that amount as additional current tax expense in the income statement for the year ended March 31, 2010. Included as part of the Company's acquisition of betapharm during the year ended March 31, 2006 were certain pre-existing income tax liabilities pertaining to betapharm for the fiscal periods prior to the date of the closing of the acquisition (in March 2006). Accordingly, the terms of the Sale and Purchase Agreement provided that a certain portion of the purchase consideration amounting to 324 (EUR 6) would be set aside in an escrow account, to be set off against certain indemnity claims by the Company in respect of legal and tax matters that may arise covering such pre-acquisition periods (the indemnity right). The right to make tax related indemnity claims would lapse and be time barred at the end of the seven year anniversary of the closing of the acquisition (in March 2013). Upon receipt of such preliminary tax demands, the Company initiated the process of exercising such indemnity rights against the sellers of betapharm and had concluded that, as of March 31, 2010, the Company's recovery of the full tax amounts demanded by the German tax authorities was virtually certain. Accordingly, a separate asset amounting to 302 (EUR 5) representing such indemnity right against the sellers was recorded as part of other assets in the statement of financial position, with a corresponding credit to the current tax expense for the year ended March 31, 2010.

During the three months ended June 30, 2011, the aforesaid tax audits were completed and the Company is awaiting the final tax demand notice. The Company does not expect the amount of tax demand to be materially different from that recognized in the statement of financial position (i.e., 302 (EUR 5)).

**19. Acquisition of Non-controlling Interests***Dr. Reddy's Laboratories (Proprietary) Limited*

During the three months ended June 30, 2010, the Company acquired the non-controlling interest of 40% in Dr. Reddy's Laboratories (Proprietary) Limited from Calshelf Investments 214 (Proprietary) Limited, as a result of which it became the Company wholly-owned subsidiary. The total purchase consideration was 525 (or, in South

African Rand, ZAR 81).

Acquisition of the non-controlling interest was recorded as a treasury transaction as part of the unaudited condensed consolidated interim statement of changes in equity, as it represented changes in ownership interest without the loss of control by the Company. The difference between the carrying value of such non-controlling interest and the consideration paid by the Company was recognized as a reduction from retained earnings and attributed to the shareholders of the Company.

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**20. Related parties**

The Company has entered into transactions with the following related parties:

Green Park Hotel and Resorts Limited (formerly known as Diana Hotels Limited) for hotel services;  
A.R. Life Sciences Private Limited for availing processing services of raw materials and intermediates;  
Dr. Reddy s Holdings Limited;  
Dr. Reddy s Foundation for Human and Social Development towards contributions for social development;  
Institute of Life Science towards contributions for social development;  
K.K. Enterprises for availing packaging services for formulation products;  
SR Enterprises for transportation services; and  
Dr. Reddy s Laboratories Gratuity Fund.

These are enterprises over which key management personnel have control or significant influence ( significant interest entities ). Key management personnel consists of the Company s Directors and Management council members. Additionally, the Company has also provided or taken loans and advances from significant interest entities.

The Company has also entered into transactions with its joint venture Kunshan Rotam Reddy Pharmaceuticals Co. Limited ( Reddy Kunshan ). These transactions are in the nature of purchase of active pharmaceutical ingredients by the Company from Reddy Kunshan.

The Company has also entered into cancellable operating lease transactions with key management personnel and their relatives.

The Company contributes to the Dr. Reddy s Laboratories Gratuity Fund (the Gratuity Fund ), which maintains the plan assets of the Company s Gratuity Plan for the benefit of its employees. See Note 17 for further information on transactions between the Company and the Gratuity Fund.

The following is a summary of significant related party transactions:

	<b>Three months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Purchases from significant interest entities*	212	60
Sales to significant interest entities*	139	27
Contribution to a significant interest entity towards social development	34	26
Lease rental paid under cancellable operating leases to key management personnel and their relatives	8	7
Hotel expenses paid	5	7

\* Purchases and sales are to A.R. Life Sciences Private Limited for processing services of raw materials and intermediates.

The above table does not include the following transactions between key management personnel and the Company:

During the three months ended June 30, 2010, the Company exchanged a parcel of land owned by it for another parcel of land of equivalent size that adjoins its research facility, owned by the key management personnel. The Company concluded that this exchange transaction lacks commercial substance and has accordingly recorded the land acquired at the carrying amount of the land transferred, with no profit or loss being recorded for the same.

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**20. Related parties (continued)**

The following table describes the components of compensation paid to key management personnel:

<b>Particulars</b>	<b>Three months ended</b>	
	<b>2011</b>	<b>June 30, 2010</b>
Salaries	74	64
Commission*	76	86
Other perquisites		1
Contributions to defined contribution plans	3	2
Share-based payments	13	13
<b>Total</b>	<b>166</b>	<b>166</b>

\* Accrued based on profit as of the applicable date in accordance with the terms of employment.

Some of the key management personnel of the Company are also covered under the Company's Gratuity Plan along with the other employees of the Company. Proportionate amounts of gratuity accrued under the Company's Gratuity Plan have not been separately computed or included in the above disclosure.

The Company had the following amounts due from related parties:

	<b>June 30, 2011</b>	<b>As at March 31, 2011</b>
Significant interest entities	104	114
Key management personnel	5	5

As at March 31, 2010, the Company had advanced 1,447 for the purchase of land from a significant interest entity, which was disclosed as part of capital work-in-progress and included in the property, plant and equipment in the Company's audited Consolidated Financial Statements for the year ended March 31, 2010. The acquisition of such land was expected to be consummated through the acquisition of shares of a special purpose entity that was formed through a court approved scheme of arrangement during the year ended March 31, 2010.

During the three months ended June 30, 2010, the Company completed the acquisition of this special purpose entity and has therefore obtained control over the land. Consequently, an amount of 1,447 has been classified out of capital work-in-progress and included as cost of land acquired as at June 30, 2010.

The Company had the following amounts due to related parties:

	<b>June 30, 2011</b>	<b>As at March 31, 2011</b>
Significant interest entities	63	81
Key management personnel	2	1

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**21. Disclosure of Expense by Nature**

The below tables disclose the details of certain expenses incurred by their nature for the three months ended June 30, 2011 and 2010, respectively.

<b>Particulars</b>	<b>Cost of revenues</b>	<b>Three months ended June 30, 2011</b>		<b>Total</b>
		<b>Selling, general and administrative expenses</b>	<b>Research and development expenses</b>	
Employee benefits*	1,502	2,267	307	4,076
Depreciation and amortization	615	526	92	1,233

<b>Particulars</b>	<b>Cost of revenues</b>	<b>Three months ended June 30, 2010</b>		<b>Total</b>
		<b>Selling, general and administrative expenses</b>	<b>Research and development expenses</b>	
Employee benefits*	1,174	1,782	257	3,213
Depreciation and amortization	505	393	78	976

\* Employee benefits include all forms of consideration given by an entity in exchange for services rendered by employees.

**22. Change in currency translation rate in Venezuela**

The Company's Venezuela operations are primarily restricted to the import by Dr. Reddy's Venezuela, C.A. of pharmaceutical products from the parent company or other subsidiaries of the Company for the purpose of supply in the local market, Venezuela. The operations are conducted as an extension of the parent company and accordingly, the functional currency of that operation has been determined as the Indian rupee since its formation. In the recent past, the inflationary trends in Venezuela have been volatile. On January 8, 2010, the Venezuelan government announced the devaluation of the Bolivar Fuerte ( VEF ), the currency of Venezuela. The official exchange rate of 2.15 VEF per U.S. dollar, in effect since 2005, was replaced effective January 11, 2010, with a dual-rate regime. The two-tiered official exchange rates were (1) the essentials rate at VEF 2.60 per U.S. dollar for items designated by the Venezuelan government as essential items (such as food, medicine, and heavy machinery; remittances to relatives settled abroad; and public sector imports, including school supplies, science, and technology needs) and (2) the non-essentials rate at VEF 4.30 per U.S. dollar applied to other items in the economy. Therefore, effective January 1, 2010, the country was hyperinflationary (a label generally considered to apply if the cumulative three-year inflation exceeds 100%). The Company's products were exchanged at the essentials rate and, accordingly, the Company used VEF 2.60 per U.S. dollar in recording its VEF denominated transactions for the applicable periods, and the resulting exchange gains/losses were recorded through profit or loss.

On December 30, 2010, the Foreign Exchange Administration Commission of Venezuela (commonly referred to as the CADIVI) enacted a decree (exchange agreement No. 14) to further devalue the exchange rate from 2.60 VEF per U.S. dollar to 4.30 VEF per U.S. dollar effective January 1, 2011, thereby repealing the essential rate. Furthermore, on January 13, 2011, the CADIVI issued another decree to interpret the transitional requirements for the use of the new official exchange rate and stated that if the following conditions were satisfied, the use of the pre-devaluation rate of 2.60 VEF per U.S. dollar would be permissible:

For fund repatriation to the extent the CADIVI has issued approvals in the form of approvals of Autorización de Liquidación de Divisas ( ALD ) and which have been sent to and received by the Banco Central de Venezuela by December 31, 2010; and

For foreign currency acquisition to the extent the CADIVI had issued an Authorization of Foreign Currency Acquisition ( AAD ) by December 31, 2010 and the approval relates to imports for the health and food sectors or certain other specified purposes.

The Company has not applied the requirements of IAS 29, *Financial reporting in hyperinflationary economies*, as the functional currency of the Venezuelan operation is the Indian Rupee. As at June 30, 2011 the Company has repatriated all monetary items for which it obtained the approval to use the essentials rate in its Venezuelan operations except for approximately U.S.\$2. The Company secured sufficient approvals for the use of the essentials rate for U.S.\$2 of VEF denominated monetary items and, accordingly, the Company's remaining monetary items of approximately U.S.\$2 has been translated into the functional currency at the preferential rate of 2.60 VEF per U.S. dollar.



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**23. Bonus Debentures**

On March 31, 2010, the Company's Board of Directors approved a scheme for the issuance of bonus debentures (in-kind, i.e., for no cash consideration) to its shareholders to be effected by way of capitalization of its retained earnings. The scheme was subject to the successful receipt of necessary approvals of the Company's shareholders, the High Court of Andhra Pradesh, India and other identified regulatory authorities as mentioned in the scheme. All necessary approvals to effectuate the scheme, including that of the High Court, were received during the year ended March 31, 2011. Accordingly, on March 24, 2011, the Company issued these debentures to the shareholders of the Company.

The following is a summary of the key terms of the issuance:

Particulars	No. of instruments issued	Face value	Currency	Interest Rate	Maturity	Aggregate Face Amount	Redemption price
Unsecured, non-convertible, redeemable debentures	1,015,516,392	5 each	(Indian Rupee)	9.25% per annum	36 months	5,078	5 each (plus interest)

The following is a summary of certain additional terms of the issuance:

Fully paid up bonus debentures carrying a face value of 5 each were issued to the Company's shareholders in the ratio of 6 bonus debentures for each equity share held by such shareholders on March 18, 2011.

The bonus debentures are unsecured and are not convertible into equity shares of the Company.

The Company delivered cash in the aggregate value of the bonus debentures into an escrow account of a merchant banker in India appointed by the Company's Board of Directors. The merchant banker received such amount for and on behalf of and in trust for the shareholders who are entitled to receive bonus debentures. Upon receipt of such amount, the merchant banker paid the amount to the Company, for and on behalf of the shareholders as consideration for the allotment of debentures to them.

These bonus debentures have a maturity of 36 months, at which time the Company must redeem them for cash in an amount equal to the face value of 5 each, plus any unpaid interest, if any.

These bonus debentures carry an interest rate of 9.25% per annum. The interest on the debentures shall be paid at the end of 12, 24 and 36 months from the date of issuance.

These bonus debentures are listed on stock exchanges in India so as to provide liquidity for the holders.

Issuance of these bonus debentures will be treated as a deemed dividend under section 2 (22) (b) of the Indian Income Tax Act, 1961 and accordingly, the Company will be required to pay a dividend distribution tax.

Under Indian Corporate Law and as per the terms of the approved bonus debenture scheme, the Company has created a statutory reserve (the Debenture Redemption Reserve) in which it is required to deposit a portion of its profits made during each year prior to the maturity date of the bonus debentures until the aggregate amount retained in such reserve equals 50% of the face value of the debentures then issued and outstanding. The funds in the Debenture Redemption Reserve shall be used only to redeem the debentures for so long as they are issued and outstanding.

The Company has accounted for the issuance of such debentures as a pro-rata distribution to the owners acting in the capacity as owners on a collective basis. Accordingly, the Company has measured the value of such financial instrument at fair value on the date of issuance which corresponds to the value of the bonus debentures issued on March 24, 2011. The Company has disclosed the issuances as a reduction from retained earnings in the consolidated statement of changes in equity with a corresponding credit to loans and borrowings for the value of the financial liability recognized. Furthermore, in relation to the above mentioned scheme, the Company incurred costs of 51 in directly attributable transaction costs payable to financial advisors. This amount has been accounted for as a reduction

from debenture liability on the date of issuance of the bonus debentures and is being amortized over a period of three years using the effective interest rate method. The associated cash flows for the delivery of cash to the merchant banker and the subsequent receipt of the same for and on behalf of the shareholders upon issuance of the bonus debentures has been disclosed separately in the consolidated statement of cash flows as part of financing activities.

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**23. Bonus Debentures (continued)**

Further, the dividend distribution tax paid by the Company on behalf of the owners in the amount of 843 has been recorded as part of a reduction from retained earnings in the consolidated statement of changes in equity for the year ended March 31, 2011. The Company transferred 211 and 19 from the profits earned during the three months ended June 30, 2011 and the year ended March 31, 2011, respectively, into the Debenture Redemption Reserve and recorded the transfer through the statement of comprehensive income and statement of changes in equity.

The regulatory framework in India governing issuance of ADRs by an Indian company does not permit the issuance of ADRs with any debt instrument (including non-convertible rupee denominated debentures) as the underlying security. Therefore, the depository of the Company's ADRs (the Depository) cannot issue depository receipts (such as ADRs) with respect to the bonus debentures issued under the Company's bonus debenture scheme. Therefore, in accordance with the deposit agreement between the Company and the Depository (the Deposit Agreement), the bonus debentures issuable in respect of the shares underlying the Company's ADRs were distributed to the Depository, who sold such bonus debentures on April 8, 2011. The Depository converted the net proceeds from such sale into U.S. dollars and, on June 23, 2011, distributed such U.S. dollars, less any applicable taxes, fees and expenses incurred and/or provided for under the Deposit Agreement, to the registered holders of ADRs entitled thereto in the same manner as it would ordinarily distribute cash dividends under the Deposit Agreement.

**24. Contingencies*****Litigations, etc.***

The Company is involved in disputes, lawsuits, claims, governmental and/or regulatory inspections, inquiries, investigations and proceedings, including patent and commercial matters that arise from time to time in the ordinary course of business. The more significant matters are discussed below. Most of the claims involve complex issues. Often, these issues are subject to uncertainties and therefore the probability of a loss (if any) being sustained, and an estimate of the amount of any loss, is difficult to ascertain. Consequently, for a majority of these claims, it is not possible to make a reasonable estimate of the expected financial effect, if any, that will result from ultimate resolution of the proceedings. This is due to a number of factors, including: the stage of the proceedings (in many cases trial dates have not been set) and the overall length and extent of pre-trial discovery; the entitlement of the parties to an action to appeal a decision; clarity as to theories of liability; damages and governing law; uncertainties in timing of litigation; and the possible need for further legal proceedings to establish the appropriate amount of damages, if any. In these cases, the Company discloses information with respect to the nature and facts of the case. The Company also believes that disclosure of the amount sought by plaintiffs, if that is known, would not be meaningful with respect to those legal proceedings.

Although there can be no assurance regarding the outcome of any of the legal proceedings or investigations referred to in this Note 24 to the unaudited condensed consolidated financial statements, the Company does not expect them to have a materially adverse effect on its financial position. However, if one or more of such proceedings were to result in judgments against the Company, such judgments could be material to its results of operations in a given period.

***Product and patent related matters******Norfloxacin litigation***

The Company manufactures and distributes Norfloxacin, a formulations product. Under the Drugs Prices Control Order (the DPCO), the Government of India has the authority to designate a pharmaceutical product as a specified product and fix the maximum selling price for such product. In 1995, the Government of India issued a notification and designated Norfloxacin as a specified product and fixed the maximum selling price. In 1996, the Company filed a statutory Form III before the Government of India for the upward revision of the maximum selling price and a legal suit in the Andhra Pradesh High Court (the High Court) challenging the validity of the designation on the grounds that the applicable rules of the DPCO were not complied with while fixing the maximum selling price. The High Court had previously granted an interim order in favor of the Company; however it subsequently dismissed the case in April 2004. The Company filed a review petition in the High Court in April 2004 which was also dismissed by the

High Court in October 2004. Subsequently, the Company appealed to the Supreme Court of India, New Delhi (the Supreme Court ) by filing a Special Leave Petition, which is currently pending.

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**24. Contingencies (continued)*****Product and patent related matters (continued)***

During the year ended March 31, 2006, the Company received a notice from the Government of India demanding the recovery of the price charged by the Company for sales of Norfloxacin in excess of the maximum selling price fixed by the Government of India, of 285 including interest thereon. The Company filed a writ petition in the High Court challenging this demand order. The High Court admitted the writ petition and granted an interim order, directing the Company to deposit 50% of the principal amount claimed by the Government of India, which amounted to 77. The Company deposited this amount with the Government of India in November 2005 and is awaiting the outcome of its appeal with the Supreme Court. In February 2008, the High Court directed the Company to deposit an additional amount of 30, which was deposited by the Company in March 2008. Additionally in November 2010, the High Court allowed the Company's application to include additional legal grounds that the Company believes will strengthen its defense against the demand. The Company has fully provided for the potential liability related to the principal amount demanded by the Government of India. In the event the Company is unsuccessful in its litigation in the Supreme Court, it will be required to remit the sale proceeds in excess of the maximum selling price to the Government of India including penalties or interest, if any, which amounts are not readily ascertainable.

***Fexofenadine United States litigation***

In April 2006, the Company launched its fexofenadine hydrochloride 30 mg, 60 mg and 180 mg tablet products, which are generic versions of Sanofi-Aventis (Aventis) Allegra<sup>®</sup> tablets. The Company is presently defending patent infringement actions brought by Aventis and Albany Molecular Research (AMR) in the United States District Court for the District of New Jersey. There are three formulation patents, three methods of use patents, and three synthetic process patents which are at issue in the litigation. The Company has obtained summary judgment with respect to two of the formulation patents. Teva Pharmaceuticals Industries Limited (Teva) and Barr Pharmaceuticals, Inc. (Barr) were defending a similar action in the same court. In September 2005, pursuant to an agreement with Barr, Teva launched its fexofenadine hydrochloride 30 mg, 60 mg and 180 mg tablet products, which are AB-rated (bioequivalent) to Aventis Allegra<sup>®</sup> tablets. Aventis brought patent infringement actions against Teva and its active pharmaceutical ingredients (API) supplier in the United States District Court for the District of New Jersey. There were three formulation patents, three use patents, and two API patents at issue in the litigation. Teva obtained summary judgment in respect of each of the formulation patents. On January 27, 2006, the District Court denied Aventis' motion for a preliminary injunction against Teva and its API supplier on the three use patents, finding those patents likely to be invalid, and one of the API patents, finding that patent likely to be not infringed. The issues presented during Teva's hearing are likely to be substantially similar to those which will be presented with respect to the Company's fexofenadine hydrochloride tablet products. Subsequent to the preliminary injunction hearing, Aventis sued Teva and Barr for infringement of a new patent claiming polymorphic forms of fexofenadine.

The Company utilizes an internally developed polymorph and has not been sued for infringement of the new patent. On November 18, 2008, Teva and Barr announced settlement of their litigation with Aventis. On September 9, 2009, AMR added a new process patent to the litigation. This new process patent is related to the manufacturing of the active ingredient contained in the group of tablets being sold under the Allegra<sup>®</sup> franchise (which include Allegra<sup>®</sup>, Allegra-D 12<sup>®</sup> and Allegra-D 24<sup>®</sup>). Subsequent to the receipt of the U.S. FDA approval in March 2010 for the Company's ANDA relating to fexofenadine-pseudoephedrine higher strength (the generic version of Allegra-D 24<sup>®</sup>), AMR and Aventis sought a preliminary injunction against the Company in the District Court of New Jersey to withhold the launch of the Company's product.

Subsequent to the receipt of the U.S. FDA approval in March 2010 for the Company's ANDA relating to fexofenadine-pseudoephedrine higher strength (the generic version of Allegra-D 24<sup>®</sup>), AMR and Aventis sought a preliminary injunction against the Company in the District Court of New Jersey to withhold the launch of the Company's generic version of Allegra D24<sup>®</sup> product in the U.S. market, arguing that they were likely to prevail on their claim that the Company infringed AMR's U.S. Patent No. 7,390,906. In June 2010, the District Court of New

Jersey issued the requested preliminary injunction against the Company. Sanofi-Aventis and

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**24. Contingencies (continued)**

***Product and patent related matters (continued)***

AMR posted security of U.S \$40 with the District Court of New Jersey towards the possibility that the injunction had been wrongfully granted. The security posted shall remain in place until further order of the Court. Pending the final outcome of the case, the Company has not recorded any asset in the consolidated financial statements in connection with this product in the United States.

On January 28, 2011, the District Court of New Jersey ruled that, based on Sanofi-Aventis and AMR's likely inability to prove infringement by the Company's products, the preliminary injunction issued in June 2010 should be dissolved. However, Aventis and AMR have the right to appeal this order in the Federal Circuit of the United States Court of Appeals. The Company subsequently launched sales of its generic version of Allegra-D 24®. Although the preliminary injunction has been removed, all such sales are at risk pending final resolution of the litigation. Additionally, on April 27, 2011 a trial was held regarding two of the listed formulation patents 6039974 and 5738872 (on Allegra-D and Allegra-D 12 products) that were asserted against the Company. The Company presented non-infringement and invalidity arguments for both. A decision on this trial is not expected until September 2011. If Aventis and AMR are ultimately successful in their allegation of patent infringement, the Company could be required to pay damages related to fexofenadine hydrochloride and fexofenadine-pseudoephedrine tablet sales made by the Company, and could also be prohibited from selling these products in the future.

***Oxycodon, Germany litigation***

Since 2007, the Company has sold Oxycodon beta (generic oxycontin) in Germany pursuant to a license from and supply arrangement with Acino Holding Ltd. (formerly Cimex) (Acino). Since April 2007, there had been ongoing patent litigation among Mundipharma International (Mundipharma), the innovator of generic oxycontin, and Acino and certain of its licensees of generic oxycontin. In January 2011, Mundipharma initiated a separate (secondary) legal action against the Company. The Company also signed a cost sharing agreement under which Acino agreed to share a portion of the losses resulting from any Mundipharma damage claim. In August 2011, Acino and Mundipharma entered into a settlement agreement for all patent litigation with respect to Acino's oxycodone product and Mundipharma's patents. As a result of this settlement agreement, all legal proceedings concerning Acino's oxycodone product in Europe have been discontinued by all parties involved, and the Company is allowed to continue selling the oxycodone product in Germany.

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**24. Contingencies (continued)*****Product and patent related matters (continued)******Olanzapine, Canada litigation***

The Company supplies certain generic products, including olanzapine tablets (the generic version of Eli Lilly's Zyprexa® tablets), to Pharmascience, Inc. for sale in Canada. Several generic pharmaceutical manufacturers have challenged the validity of the Zyprexa® patents in Canada. In June 2007, the Canadian Federal Court held that the invalidity allegation of one such challenger, Novopharm Ltd., was justified and denied Eli Lilly's request for an order prohibiting sale of the product. Eli Lilly responded by suing Novopharm for patent infringement. Eli Lilly also sued Pharmascience for patent infringement, but that litigation was dismissed after the parties agreed to be bound by the final outcome in the Novopharm case. As reflected in Eli Lilly's regulatory filings, the settlement allows Pharmascience to market olanzapine tablets subject to a contingent damages obligation should Eli Lilly be successful in its litigation against Novopharm. The Company's agreement with Pharmascience includes a provision under which the Company shares a portion of all cost and expense incurred as a result of settling lawsuits or paying damages that arise as a consequence of selling the products.

For the preceding reasons, the Company is exposed to potential damages in an amount that may equal the Company's profit share derived from sale of the product. During October 2009, the Canadian Federal Court decided, in the Novopharm case, that Eli Lilly's patent for Zyprexa is invalid. This decision was, however, reversed in part by the Federal Court of Appeal on July 21, 2010 and remanded for further consideration. Pending the final decision, the Company continues to sell the product to Pharmascience and remains exposed to potential damages in an amount that may equal the Company's profit share derived from sale of the product.

***Ceragenix Bankruptcy Litigation***

In November 2007, the Company entered into a Distribution and Supply Agreement with Ceragenix Pharmaceuticals, Inc. and Ceragenix Corporation (collectively, Ceragenix). Under this agreement, the Company made up-front and milestone payments of U.S.\$5 and commenced distribution of the dermatological product EpiCeram, a skin barrier emulsion device, in the United States and its territories. As of June 30, 2011, the Company carried a balance intangible value of U.S.\$2.1 relating to these payments.

In June 2010, Ceragenix (both entities) filed voluntary petitions under Chapter 11 of the U.S. Bankruptcy Code. On June 24, 2011, the United States Bankruptcy Court for the District of Colorado permitted Ceragenix to sell the patent rights, certain business assets and intellectual property relating to EpiCeram® to PuraCap Pharmaceutical LLC and to terminate the Company's rights under the Distribution and Supply Agreement. However, the court ordered Ceragenix to pay U.S.\$2.75 to the Company out of the sales proceeds of such assets and intellectual property, as compensation for the termination of the Distribution and Supply Agreement.

***Environmental matter***

The Indian Council for Environmental Legal Action filed a writ in 1989 under Article 32 of the Constitution of India against the Union of India and others in the Supreme Court of India for the safety of people living in the Patancheru and Bollaram areas of Medak district of Andhra Pradesh. The Company has been named in the list of polluting industries. In 1996, the Andhra Pradesh District Judge proposed that the polluting industries compensate farmers in the Patancheru, Bollaram and Jeedimetla areas for discharging effluents which damaged the farmers' agricultural land. The compensation was fixed at 1.30 per acre for dry land and 1.70 per acre for wet land. Accordingly, the Company has paid a total compensation of 3. The matter is pending in the courts and the possibility of additional liability is remote. The Company will not be able to recover the compensation paid, even if the decision of the court is in favor of the Company.

***Indirect taxes related matter***

During the year ended March 31, 2003, the Central Excise Authorities of India (the Authorities) issued a demand notice to a vendor of the Company regarding the assessable value of products supplied by this vendor to the Company. The Company has been named as a co-defendant in this demand notice. The Authorities demanded payment of 176



from the vendor, including penalties of 90. Through the same notice, the Authorities issued a penalty claim of 70 against the Company. During the year ended March 31, 2005, the Authorities issued an additional notice to this vendor demanding 226 from the vendor, including a penalty of 51. Through the same notice, the Authorities issued a penalty claim of 7 against the Company. Furthermore, during the year ended March 31, 2006, the Authorities issued an additional notice to this vendor demanding 34. The Company has filed appeals against these notices. In August and September 2006, the Company attended the hearings conducted by the Customs, Excise and Service Tax Appellate Tribunal (the CESTAT ) on this matter. In October 2006, the CESTAT passed an order in favor of the Company setting aside all of the above demand notices. In July 2007, the Authorities appealed against CESTAT 's order in the Supreme Court of India, New Delhi. The matter is pending in the Supreme Court of India, New Delhi.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**  
**(in millions, except share and per share data)**

**24. Contingencies (continued)***Regulatory matters*

In November 2007, the Attorneys General of the State of Florida and the Commonwealth of Virginia each issued subpoenas to the Company's U.S. subsidiary, Dr. Reddy's Laboratories, Inc. ( DRLI ). In March 2008, the Attorney General of the State of Michigan issued a Civil Investigative Demand ( CID ) to DRLI. These subpoenas and the CID generally required the production of documents and information relating to the development, sales and marketing of the products ranitidine, fluoxetine and buspirone, all of which were sold by Par Pharmaceuticals Inc. ( Par ) pursuant to an agreement between Par and DRLI. DRLI has responded to the initial requests. On July 8, 2011, the Company was notified that the Attorneys General intended to conclude their respective investigations of the Company, and that the Company would be voluntarily dismissed without prejudice from the legal action.

*Other*

Additionally, the Company and its affiliates are involved in other disputes, lawsuits, claims, governmental and/or regulatory inspections, inquiries, investigations and proceedings, including patent and commercial matters that arise from time to time in the ordinary course of business. The Company does not believe that there are any such pending matters that will have any material adverse effect on its financial position, results of operations or cash flows in any given accounting period.

**25. Letter from the U.S. Food and Drug Administration**

The Company's Mexico facility produces intermediates and active pharmaceutical ingredients ( API ) and steroids. During the month of November 2010, the U.S. FDA inspected the Company's Mexico facility and issued audit observations relating to process for manufacture of API and steroids, to which the Company responded by agreeing to implement certain corrective actions. Subsequently, on June 3, 2011, the Company received a warning letter from the U.S. FDA seeking further clarifications and corrective actions on some of the prior audit observations to which the Company had previously responded. Thereafter, on June 28, 2011, the U.S. FDA posted an import alert, or Detention without Physical Examination ( DWPE ), on its website for certain specified products manufactured at the Mexico facility. Further details of the warning letter and the DWPE alert are available on the U.S. FDA website.

As a consequence of the DWPE alert, the Company's Mexico facility is unable to export some API and steroids to U.S. customers until such time as the concerns raised by the U.S. FDA in their warning letter is addressed to their satisfaction and the DWPE alert is lifted. The Company is working collaboratively with the U.S. FDA to resolve the matters contained in the warning letter.

The impact to the Company's revenues for the year ending March 31, 2012 from API and steroid sales to U.S. customers affected by this DWPE, and to the Company's generic products which include API impacted by this DWPE, is not expected to be material to the Company's business as a whole even if the DWPE remained in effect throughout the year ending March 31, 2012. Further, the Company believes that the DWPE alert is of a temporary nature and that it is not expected to have a material long term effect on the Company's Mexico operations. Nonetheless, the Company cannot be assured that satisfying the U.S. FDA's concerns will not take longer than currently anticipated or that the U.S. FDA will not request additional corrective actions that would result in the DWPE remaining in effect longer than currently anticipated.

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**DR. REDDY S LABORATORIES LIMITED AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**  
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**26. Subsequent events**

*Approval for Fondaparinux Sodium Injection*

On July 11, 2011, the U.S. FDA approved the Company's abbreviated new drug application ( ANDA ) for fondaparinux sodium injection. The Company launched the product in the United States on July 22, 2011. Fondaparinux is a generic version of GlaxoSmithKline plc's Arixtra® injection.

*Joint Venture arrangement with Fuji Film Corporation*

On July 28, 2011 the Company signed a Memorandum of Understanding with FUJIFILM Corporation to enter into an exclusive partnership in the generic drugs business for the Japanese market and to establish a joint venture in Japan. A definitive agreement is expected to be signed during the year ending March 31, 2012.

*Acquisition of prescription business of JB Chemicals and Pharmaceuticals*

On July 22, 2011 the Company entered into an agreement with JB Chemicals and Pharmaceuticals Limited ( JB Chemicals ) to acquire the intellectual property rights (including trademarks, patents and know-how) to certain prescription portfolio brands in Russia and other countries of the former Soviet Union for a total consideration of U.S.\$34.85. This acquisition involves the acquisition of, among other things, approximately 20 brands in Russia. The Company and JB Chemicals also entered into a manufacturing and supply agreement pursuant to which JB Chemicals will manufacture and supply to the Company the products associated with the acquired brands.

*Acquisition of assets and intellectual property from APR LLC*

The Company holds class B shares in APR LLC, which is being consolidated by the Company under Standing Interpretations Committee Interpretation SIC-12: Special purpose entities . On July 8, 2011, the Company entered into an agreement with APR LLC to purchase certain of its assets, including a manufacturing facility in New York and certain intellectual property, for a total consideration of U.S.\$2.85. In addition, pursuant to this agreement the Company will relinquish its class B shares in APR LLC.

*Settlement of Oxycodon litigation*

In August 2011, Acino Holding Ltd. (formerly Cimex) ( Acino ) and Mundipharma International ( Mundipharma ) entered into a settlement agreement for all patent litigation with respect to Acino's oxycodone (generic oxycontin) product and Mundipharma's patents. As a result of this settlement agreement, all legal proceedings concerning Acino's oxycodone product in Europe have been discontinued by all parties involved, and the Company is allowed to continue selling the oxycodone product in Germany (for further details, please refer to Note 24 of these condensed consolidated financial statements).

**Table of Contents****ITEM 2. OPERATING AND FINANCIAL REVIEW, TREND INFORMATION**

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements, the related cash flow statements and notes, and the Operating and Financial Review and Prospects included in our Annual Report on Form 20-F for the fiscal year ended March 31, 2011, all of which is on file with the SEC (collectively, our Form 20-F ) and the unaudited condensed consolidated interim financial statements contained in this report on Form 6-K and the related statement of cash flow and notes (collectively, the Financial Statements ). This discussion contains forward-looking statements that involve risks and uncertainties. When used in this discussion, the words anticipate , believe , estimate , intend , will and expect and other similar expressions as to us or our business are intended to identify such forward-looking statements. We undertake no obligation to publicly update or revise the forward-looking statements, whether as a result of new information, future events, or otherwise. Actual results, performances or achievements could differ materially from those expressed or implied in such forward-looking statements. Factors that could cause or contribute to such differences include those described under the heading Risk Factors in our Form 20-F. Readers are cautioned not to place reliance on these forward-looking statements that speak only as of their dates.

**Three months ended June 30, 2011 compared to the three months ended June 30, 2010**

The following table sets forth, for the periods indicated, our consolidated revenues and gross profits by segment: (in millions)

	Three months ended June 30, 2011				Three months ended June 30, 2010			
	Revenues	Revenues % to total	Gross profit	Gross profit % to revenues	Revenues	Revenues % to total	Gross profit	Gross profit % to revenues
Global Generics Pharmaceutical Services and Active Ingredients Proprietary Products Others	14,424	73%	9,264	64%	11,917	71%	7,735	65%
	4,831	24%	1,044	22%	4,499	27%	1,002	22%
	197	1%	161	82%	122	1%	80	66%
	331	2%	86	26%	293	2%	97	33%
<b>Total</b>	<b>19,783</b>	<b>100%</b>	<b>10,555</b>	<b>53%</b>	<b>16,831</b>	<b>100%</b>	<b>8,914</b>	<b>53%</b>

The following table sets forth, for the periods indicated, financial data as percentages of total revenues and the increase (or decrease) by item as a percentage of the amount over the comparable period in the previous year.

	Percentage of Sales Three months ended June 30,		Percentage Increase/(Decrease)
	2011	2010	
Revenues	100%	100%	18%
<b>Gross profit</b>	<b>53%</b>	<b>53%</b>	<b>18%</b>
Selling, general and administrative expenses	34%	33%	23%
Research and development expenses	6%	6%	21%
Impairment loss on goodwill/other intangible assets			NC
Other (income)/expense, net	(1)%	(1)%	0%
<b>Results from operating activities</b>	<b>14%</b>	<b>15%</b>	<b>6%</b>
Finance (income)/expense, net	0%	1%	(74)%

<b>Profit before income taxes</b>	<b>14%</b>	<b>14%</b>	<b>12%</b>
Income tax (expense)/benefit, net	1%	2%	(67)%
<b>Profit for the period</b>	<b>13%</b>	<b>12%</b>	<b>25%</b>

NC = No change

**Table of Contents****Revenues**

Our overall consolidated revenues were 19,783 million for the three months ended June 30, 2011, an increase of 18% as compared to 16,831 million for the three months ended June 30, 2010.

The following table sets forth, for the periods indicated, our consolidated revenues by geography:

	2011		2010	
	Revenues	Revenues % to total	Revenues	Revenues % to total
North America (the United States and Canada)	6,991	35	5,024	30
Europe	3,744	19	3,617	22
Russia and other countries of the former Soviet Union	3,018	16	2,552	15
India	3,597	18	3,411	20
Others	2,433	12	2,227	13
<b>Total</b>	<b>19,783</b>	<b>100</b>	<b>16,831</b>	<b>100</b>

During the three months ended June 30, 2011, the average Indian rupee/U.S.\$ exchange rate appreciated by 2% and the average Indian rupee/Euro exchange rate depreciated by approximately 11%, compared to the average exchange rates in the three months ended June 30, 2010. This change in exchange rates resulted in higher reported revenue growth rates on account of higher rupee realization from sales in Euros, partially offset by a decrease in rupee realization from sales in U.S. dollars.

**Segment Analysis****Global Generics**

Revenues from our Global Generics segment were 14,424 million for the three months ended June 30, 2011, an increase of 21% as compared to 11,917 million for the three months ended June 30, 2010. This growth was largely led by increases in sales volumes of existing products and launches of new products in our key markets of North America (the United States and Canada) and Russia.

North America (the United States and Canada), Germany, India and Russia were the four key markets of our Global Generics segment, generating approximately 86% of the revenues in this segment for the three months ended June 30, 2011.

*North America.* Our Global Generics segment's revenues in North America (the United States and Canada) were 5,756 million for the three months ended June 30, 2011, an increase of 48% over the three months ended June 30, 2010. In absolute currency terms (i.e., without taking into account the effect of currency exchange rates), such revenues grew by 51% in the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. This was the result of market share expansion in our key products such as tacrolimus, omeprazole Rx and omeprazole Mg OTC. According to IMS Health in its Moving Annual Total report for the 12 months ended March 31, 2011, 22 products in our prescription portfolio were ranked among the top 3 in their respective market shares.

New products launched in the twelve months ended June 30, 2011 accounted for 24% of our Global Generics segment's revenues in North America (the United States and Canada) in the three months ended June 30, 2011. We launched nine new products in North America (the United States and Canada) during the three months ended June 30, 2011, four of which were launched from our facility in Bristol, Tennessee, U.S.A. Other launches include donepezil, venlafaxine-extended release, letrozole, levofloxacin and topotecan injection. During the three months ended June 30, 2011, we also launched the over-the-counter ( OTC ) version of fexofenadine, a bioequivalent generic version of Allegra®.



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The following table sets forth, for the three months ended June 30, 2011, products launched in North America (the United States and Canada), other than those from our penicillin facility in Bristol, Tennessee, U.S.A.:

<b>Product</b>	<b>Brand</b>	<b>Innovator</b>	<b>Total annual market size*</b>
Donepezil	Aricept®	Eisai Pfizer	\$2.1 Billion
venlafaxine-XR	Effexor XR®	Pfizer	\$2.5 Billion
Letrozole	Femara®	Novartis	\$0.7 Billion
Levofloxacin	Levaquin®	Johnson & Johnson	\$1.7 Billion
topotecan injection	Hycamtin®	GlaxoSmithKline	\$0.1 Billion

\* Total annual market size in the United States at the time of our generic launch, as per IMS Health.

During the three months ended June 30, 2011, the U.S. FDA approved our ANDAs for fondaparinux sodium injection, a bioequivalent generic version of GlaxoSmithKline's product Arixtra®, and for fexofenadine-pseudoephedrine OTC, a generic version of Sanofi-Aventis' product Allegra D2®. We launched fondaparinux sodium injection on July 22, 2011. We expect that these limited competition products will be key drivers of growth in our North America (the United States and Canada) Generics business during the year ending March 31, 2012, as well as products launched from our facility in Bristol, Tennessee, U.S.A. in the second half of the year ending March 31, 2012. During the three months ended June 30, 2011, we made three new ANDA filings, bringing our cumulative ANDA filings to 180. We now have 76 ANDAs pending approval at the U.S. FDA, of which 36 are Paragraph IV filings and 11 have first to file status.

*Germany.* Our Global Generics segment's revenues in Germany were 1,207 million for the three months ended June 30, 2011, a decrease of 9% as compared to the three months ended June 30, 2010. In Euro currency terms (i.e., without taking into account the effect of currency exchange rates), such revenues declined by 17% in the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. The decline was largely due to the continuing pricing challenges resulting from the continuing shift of the German generic pharmaceutical market towards a tender (i.e., competitive bidding) based supply model.

In December 2010, the preliminary results of the competitive bidding sale (or tender) process from the Allgemeine Ortskrankenkassen (AOK), one of the largest SHI funds in Germany, were announced and our subsidiary betapharm was awarded three products from this tender. Due to litigation relating to most of the products in the tender, AOK conducted a subsequent rebidding process, in which our subsidiary betapharm was awarded the tenders for 12 products in 74 lots. During three months ended June 30, 2011 we commenced the supplies for this new AOK tender. The success rate for betapharm's bids for this tender increased as compared to prior years. While the prices are low for the products won by us in this tender, due to the competitive bidding, we believe that this tender will help us strengthen our market presence in Germany.

*India.* Our Global Generics segment's revenues in India for the three months ended June 30, 2011 were 2,936 million, an increase of 6% as compared to the three months ended June 30, 2010. This increase in the three months ended June 30, 2011 was primarily due to new products launched in India in the twelve months ended June 30, 2011. Our sales volume growth in India was impacted, and we experienced pricing pressures in a few of our top brands, due to intensive competitive activities. Revenues from our biosimilar portfolio in India for the three months ended June 30, 2011 recorded growth of 69% as compared to the three months ended June 30, 2010. During the three months ended June 30, 2011, we launched 12 new products in India.

*Russia.* Our Global Generics segment's revenues in Russia were 2,485 million for the three months ended June 30, 2011, an increase of 20% as compared to the three months ended June 30, 2010. This growth in the three months ended June 30, 2011 was led by volume growth in our key brands and new products launched in Russia in the twelve months ended June 30, 2011. We were ranked 13<sup>th</sup> in the Russian pharmaceutical market according to Pharmexpert, a



market research firm, in its May 2011 report. Our prescription secondary sales growth of 17% in value and 25% in volume terms for the three months ended June 30, 2011 exceeded the Russian pharmaceutical market's growth rates of 7% in value and 8% in volume terms during the same period. Our over-the-counter ( OTC ) portfolio represented 30% of our Global Generics segment's sales in Russia for the three months ended June 30, 2011, as compared to 25% of our Global Generics segment's sales in Russia for the three months ended June 30, 2010. In the Russian market, we intend to focus on increasing the over-the-counter and in-licensed products in our portfolio.

*Other countries of the former Soviet Union:* Revenues from other countries of the former Soviet Union were 533 million for the three months ended June 30, 2011, an increase of 15% as compared to the three months ended June 30, 2010. This increase was due to volume growth in our key brands in Kazakhstan and Belarus.

*Other Markets.* Our Global Generics segment's revenues from our Rest of the World markets (i.e., all markets other than North America, Germany, Russia and other countries of the former Soviet Union and India) were 1,507 million in the year ended June 30, 2011, representing a growth of 10% over the three months ended June 30, 2010. Our Rest of the World markets include markets such as Venezuela, South-Africa, Australia and New Zealand, as well as various other small markets.

**Table of Contents****Pharmaceutical Services and Active Ingredients ( PSAI )**

Our PSAI segment's revenues for the three months ended June 30, 2011 were 4,831 million, an increase of 7% as compared to the three months ended June 30, 2010. This was largely attributable to an increase in revenues due to new product launches in our active pharmaceutical ingredients business, offset by a decrease in revenues from our Custom Pharmaceutical Services business. During the three months ended June 30, 2011, our Custom Pharmaceutical Services facility in Mexico received a warning letter from the U.S. FDA and an import alert, or Detention without Physical Examination, was issued for certain specified products manufactured at the Mexico facility (for details, please see Note 25 of these unaudited condensed consolidated financial statements). In the three months ended June 30, 2011, we filed 9 Drug Master Files ( DMFs ) worldwide, including 1 DMFs in the United States. Cumulatively, our total worldwide DMFs as of June 30, 2011 were 495, including 174 DMFs in the United States.

**Voluntary Retirement Scheme**

On June 20, 2011, we announced a voluntary retirement scheme (i.e., a termination benefit) applicable to certain eligible employees of our parent company. As per the scheme, employees whose voluntary retirement is accepted by us will be paid an amount computed based on the methodology mentioned in the scheme, with the maximum amount restricted to 0.8 million per employee. An amount of 136 million has been recognized as a termination benefit in the unaudited consolidated financial statements for the three months ended June 30, 2011.

**Gross Margin**

Our total gross margin was 10,555 million for the three months ended June 30, 2011, representing 53% of revenues for that period, as compared to 8,914 million for the three months ended June 30, 2010, representing 53% of revenues for that period.

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

	June 30, 2011		June 30, 2010	
	Gross profit	%	Gross profit	%
	Gross profit	to revenues	Gross profit	to revenues
Global Generics	9,264	64%	7,735	65%
Pharmaceutical Services and Active Ingredients	1,044	22%	1,002	22%
Proprietary Products	161	82%	80	66%
Others	86	26%	97	33%
<b>Total</b>	<b>10,555</b>	<b>53%</b>	<b>8,914</b>	<b>53%</b>

The gross margin for our Global Generics segment was 64% for the three months ended June 30, 2011, as compared to 65% for the three months ended June 30, 2010. The marginal decrease in gross margin was on account of change in the products mix (i.e., a decrease in the proportion of sales of higher gross margin products and an increase in the proportion of sales of lower gross margin products) within our Global Generics segment.

The gross margin for our Pharmaceutical Services and Active Ingredients ( PSAI ) segment was 22% for the three months ended June 30, 2011, as compared to 22% for the three months ended June 30, 2010.

**Selling, general and administrative expenses**

Our selling, general and administrative expenses were 6,755 million for the three months ended June 30, 2011, an increase of 23% as compared to 5,481 million for the three months ended June 30, 2010. The increase was largely on account of the following:

increases in employee costs across our businesses, due to annual raises and also to field force expansion in India and Russia;



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increases in selling and marketing costs in connection with efforts to expand our over-the-counter business;  
and

general overhead costs of our recently acquired penicillin facility in Bristol, Tennessee, U.S.A.

**Research and development expenses**

Our research and development costs were 1,197 million for the three months ended June 30, 2011, an increase of 21% as compared to 993 million for the three months ended June 30, 2010. This increase was due to a significant scale-up in the research and development activities across all business segments.

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

Our net interest expense was 221 million for the three months ended June 30, 2011, as compared to net interest income of 9 million for the three months ended June 30, 2010. This change was largely due to an increase in the outstanding amount of our short term loans, interest on debentures of 117 million and lower interest income.

Our foreign exchange gain was 158 million for the three months ended June 30, 2011, as compared to a loss of 224 million for the three months ended June 30, 2010.

As a result of the above, our net finance expense was 46 million for the three months ended June 30, 2011, as compared to 177 million for the three months ended June 30, 2010.

**Profit before income taxes**

Profit before income taxes was 2,747 million for the three months ended June 30, 2011, as compared to 2,453 million for the three months ended June 30, 2010.

**Income tax expense**

Income tax expense was 120 million for the three months ended June 30, 2011, as compared to income tax expense of 357 million for the three months ended June 30, 2010.

Our consolidated effective tax rate was 4.35% for the three months ended June 30, 2011, as compared to 14.55% for the three months ended June 30, 2010. The reduction in our effective tax rate for the three months ended June 30, 2011 was primarily due to net income tax benefits on significant movement in inter-company inventory between different tax jurisdictions.

**Profit for the period**

As a result of the above, our net income was 2,627 million for the three months ended June 30, 2011, representing 13% of our total revenues for such period, as compared to 2,096 million for the three months ended June 30, 2010.

**Table of Contents****ITEM 3. LIQUIDITY AND CAPITAL RESOURCES**

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

As part of our growth strategy, we continue to review opportunities to acquire companies, complementary technologies or product rights. To the extent that any such acquisitions involve cash payments, rather than the issuance of shares, we may need to borrow from banks or raise additional funds from the debt or equity markets.

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

	<b>Three months ended June 30,</b>		
	<b>2011</b>	<b>2011</b>	<b>2010</b>
	(in millions, U.S.\$ in millions)		
	<i>Convenience translation into U.S.\$</i>		
Net cash from/(used in):			
Operating activities	2,912	U.S.\$	65
Investing activities	(3,456)		(78)
Financing activities	207		5
			(549)
Net increase/(decrease) in cash and cash equivalents	(337)	U.S.\$	(8)
			(257)

***Operating Activities***

The net result of operating activities was a cash inflow of 2,912 million for the three months ended June 30, 2011, as compared to a cash inflow of 858 million for the three months ended June 30, 2010. The net cash provided by operating activities increased during the current period primarily on account of the following:

Our business performance improved during the three months ended June 30, 2011, resulting in earnings before interest expense, tax expense, depreciation, impairment and amortization of 4,202 million, as compared to 3,420 million for the three months ended June 30, 2010.

During the three months ended June 30, 2011, our accounts receivables collections improved and we collected accounts receivable due from sales of fexofenadrine, which was outstanding as at March 31, 2011. As a result, our accounts receivable balance as at June 30, 2011 was 1,397 million less than the balance as at March 31, 2011. In contrast, our accounts receivable balance as at June 30, 2010 was 113 million higher than the balance as at March 31, 2010.

There was a smaller increase in our inventory during the three months ended June 30, 2011 as compared to three months ended June 30, 2010.

***Investing Activities***

Our investing activities resulted in a net cash outflow of 3,456 million for the three months ended June 30, 2011, as compared to a net cash outflow of 566 million for the three months ended June 30, 2010. This 2,890 million increase in cash outflow from investing activities was primarily due to the following:

Approximately 1,605 million of cash outflow during the three months ended June 30, 2011 for settlement of a liability created as at March 31, 2011 relating to the acquisition of the rights to manufacture, distribute and market the product Cloderm® (clocortolone pivalate 0.1%) in the United States.

Approximately 1,290 million in cash inflow upon liquidation of certain investments during the three months ended June 30, 2010. Such liquidation was effected to raise funds for the settlement of the I-VEN portfolio termination value option, and to meet our capital expenditure requirements.

**Table of Contents****Financing Activities**

Our financing activities resulted in a net cash inflow of 207 million for the three months ended June 30, 2011, as compared to a net cash outflow of 549 million for the three months ended June 30, 2010. The change to a net cash inflow from financing activities was primarily due to the repayment in full of long term debt of 885 million during the year ended March 31, 2011, which had been outstanding and had required debt service during the three months ended June 30, 2010.

The following table provides a list of our principal debts outstanding as of June 30, 2011:

Debt	Principal Amount (in millions, U.S./EURO in millions)		Interest Rate
Short-term borrowings from banks	17,872	U.S.\$401	Rupee borrowings 9.75% Foreign currency borrowings LIBOR+ 55 - 95 bps (5% to 20%)
Borrowings on receivable transfer arrangement	754	U.S.\$16.9	LIBOR+ 75-90 bps

**ITEM 4. RECENT DEVELOPMENTS***Approval for Fondaparinux Sodium Injection*

On July 11, 2011, the U.S. FDA approved our abbreviated new drug application ( ANDA ) for fondaparinux sodium injection. We launched the product in the United States on July 22, 2011. Fondaparinux is a generic version of GlaxoSmithKline plc's Arixtra<sup>®</sup> injection.

*Joint Venture arrangement with Fuji Film Corporation*

On July 28, 2011 we signed a Memorandum of Understanding with FUJIFILM Corporation to enter into an exclusive partnership in the generic drugs business for the Japanese market and to establish a joint venture in Japan. A definitive agreement is expected to be signed during the year ending March 31, 2012.

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*Acquisition of assets and intellectual property from APR LLC*

We hold class B shares in APR LLC, which is being consolidated by us under Standing Interpretations Committee Interpretation SIC-12: Special purpose entities. On July 8, 2011, we entered into an agreement with APR LLC to purchase certain of its assets, including a manufacturing facility in New York and certain intellectual property, for a total consideration of U.S.\$2.85. In addition, pursuant to this agreement we will relinquish our class B shares in APR LLC.

*Appointment of additional director*

The Board of Directors of our Company, at their meeting held on August 22, 2011, approved the appointment of Mr. Sridar Iyengar as an additional director on the Board.



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**ITEM 5. EXHIBITS**

Exhibit Number	Description of Exhibits
99.1	Independent Auditors Report on Review of Unaudited Condensed Consolidated Interim Financial Statements



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DR. REDDY S LABORATORIES LIMITED  
(Registrant)

Date: August 31, 2011

By: /s/ Sandeep Poddar  
Name: Sandeep Poddar  
Title: Company Secretary