Wheeler Real Estate Investment Trust, Inc.
Form 10-K
March 10, 2016

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-35713

WHEELER REAL ESTATE INVESTMENT TRUST, INC.
(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	45-2681082 (I.R.S. Employer Identification No.)
2529 Virginia Beach Blvd., Suite 200 Virginia Beach. Virginia (Address of Principal Executive Offices)	23452 (Zip Code)

(757) 627-9088
(Registrant's Telephone Number, Including Area Code)
Securities registered pursuant to Section 12(b) of the Act:
Common stock, $0.01 par value (NASDAQ Capital Market)
Series B convertible preferred stock, no par value (NASDAQ Capital Market)
Warrants to acquire shares of common stock (NASDAQ Capital Market)
Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ
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 þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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.:

Large accelerated file	¨	þ	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). ¨
As of June 30, 2015 the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $108,315,321.
As of March 8, 2016, there were 66,259,673 shares of common stock, $0.01 par value per share, outstanding.

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FORWARD- LOOKING STATEMENTS

This Annual Report on Form 10-K ("Form 10-K") of Wheeler Real Estate Investment Trust, Inc. contains forward-looking statements, including discussion and analysis of our financial condition, anticipated capital expenditures required to complete projects, amounts of anticipated cash distributions to our shareholders in the future and other matters. These forward-looking statements are not historical facts but are the intent, belief or current expectations of our management based on its knowledge and understanding of our business and industry. Forward-looking statements are typically identified by the use of terms such as “may,” “will,” “should,” “potential,” “predicts,” “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” or the negative of such terms and variations of the words and similar expressions. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. You are cautioned to not place undue reliance on forward-looking statements, which reflect our management’s view only as of the date of this Form 10-K. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. Factors that could cause actual results to differ materially from any forward-looking statements made in this Form 10-K include:

- our business and investment strategy;
- our projected operating results;
- actions and initiatives of the U.S. government and changes to U.S. government policies and the execution and impact of these actions, initiatives and policies;
- the state of the U.S. economy generally and in specific geographic areas;
- economic trends and economic recoveries;
- our ability to obtain and maintain financing arrangements;
- financing and advance rates for our target assets;
- our expected leverage;
- availability of investment opportunities in real estate-related investments;
- changes in the values of our assets;
- our ability to make distributions to our stockholders in the future;
- our expected investments and investment decisions;
- changes in interest rates and the market value of our target assets;
- our ability to renew leases at amounts and terms comparable to existing lease arrangements;
- our ability to proceed with potential development opportunities for us and third-parties;
- effects of hedging instruments on our target assets;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters;
- our ability to maintain our qualification as a real estate investment trust (“REIT”);
- our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (the "Investment Company Act");
- availability of qualified personnel and management team;
- the ability of our operating partnership and each of our other partnerships and limited liability companies to be classified as partnerships or disregarded entities for federal income tax purposes;
- our ability to amend our charter to increase or decrease the aggregate number of authorized shares of stock, to authorize us to issue additional authorized but unissued shares of our preferred stock and to classify or reclassify unissued shares of our preferred stock;
- our understanding of our competition;
- market trends in our industry, interest rates, real estate values or the general economy;
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the imposition of federal taxes if we fail to qualify as a real estate investment trust (“REIT”) in any taxable year or forego an opportunity to ensure REIT status;

- uncertainties related to the national economy, the real estate industry in general and in our specific markets;
- legislative or regulatory changes, including changes to laws governing REITs;
- adverse economic or real estate developments in Virginia, Florida, Georgia, Alabama, South Carolina, North Carolina, Oklahoma, Kentucky, Tennessee, West Virginia and New Jersey;
- increases in interest rates and operating costs;
- inability to obtain necessary outside financing;
- litigation risks;
- lease-up risks;

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- inability to obtain new tenants upon the expiration of existing leases;
- inability to generate sufficient cash flows due to market conditions, competition, uninsured losses, changes in tax or other applicable laws; and
- the need to fund tenant improvements or other capital expenditures out of operating cash flow.

These forward-looking statements should be read in light of these factors.

Part I

Item 1. Business.

Overview

Wheeler Real Estate Investment Trust, Inc. is a fully-integrated, self-managed commercial real estate investment company focused on acquiring and managing income-producing retail properties with a primary focus on grocery-anchored centers. Our strategy is to opportunistically acquire and reinvigorate well-located, potentially dominant retail properties in secondary and tertiary markets that generate attractive risk-adjusted returns, with a particular emphasis on grocery-anchored retail centers. We target competitively protected properties in communities that have stable demographics and have historically exhibited favorable trends, such as strong population and income growth. We generally lease our properties to national and regional retailers that offer consumer goods and generate regular consumer traffic. We believe our tenants carry goods that are less impacted by fluctuations in the broader U.S. economy and consumers’ disposable income, generating more predictable property level cash flows.

As of December 31, 2015, we own a portfolio consisting of fifty-three properties, including thirty-nine retail shopping centers and three freestanding retail properties totaling 3,151,358 gross leasable square feet of which approximately 94% are leased (our "operating portfolio"), one office property and ten undeveloped land parcels totaling approximately 81 acres. We believe the current market environment creates a substantial number of favorable investment opportunities in our target markets with attractive yields on investment and significant upside potential in terms of income and gain.

We have 59 full-time and 2 part-time employees. Our management team has experience and capabilities across the real estate sector with experience in the aggregate and expertise particularly in the retail asset class, which we believe provides for flexibility in pursuing attractive acquisition, development and repositioning opportunities. Because varying market conditions create opportunities at different times across the retail property sector, we believe our expertise enables us to target relatively more attractive investment opportunities throughout economic cycles. In addition, our fully integrated platform with in-house development capabilities allows us to pursue development and redevelopment projects with multiple uses. We believe that our ability to pursue these types of opportunities differentiates us from many competitors in our markets.

Our executive officers and the members of the management team have extensive experience in all aspects of the commercial real estate industry, specifically in our target/existing markets. Jon S. Wheeler, our Chairman and Chief Executive Officer, has over thirty-four years of experience in the real estate sector with particular experience in strategic financial and market analyses and assessments of new or existing properties to maximize returns. Mr. Wheeler has overseen the acquisition of over seventy properties. Wilkes J. Graham became our Chief Financial Officer in January 2016. Prior to joining us, Wilkes spent 16 years in the real estate financial services industry. Since 2010 Mr. Graham worked with Compass Point Research & Trading, LLC (“Compass Point”), an independent, full-service investment firm focused exclusively on the financial services sector, where he served as Director of Research and as a Senior Sell-Side Equity Research Analyst. Steven M. Belote was our Chief Financial Officer from August 2011 until January 2016, and is now our Chief Operating Officer. Prior to joining us, Mr. Belote was the Chief

Financial Officer of Shore Bank for fifteen years. As Chief Financial Officer of Shore Bank, he played an integral role in their initial public offering. Prior to Shore Bank, Mr. Belote spent seven years in public accounting. David Kelly, our Senior Vice President and Director of Acquisitions, has over twenty-five years of experience in the real estate industry. Prior to joining us, he served for thirteen years as the Director of Real Estate for Supevalu, Inc., a Fortune 100 supermarket retailer. While at Supervalu, he focused on site selection and acquisitions from New England to the Carolinas, completing transactions totaling over $500 million. Jeff Parker is our Director of Leasing. Mr. Parker is responsible for leasing operations over our growing portfolio of commercial assets. Prior to joining us, Mr. Parker served as Real Estate Portfolio Manager for the Southeast and Mid-Atlantic regions of the United States for Dollar Tree Stores, Inc. While at Dollar Tree, Mr. Parker was responsible for a portfolio of over 1,100 stores and created many key relationships throughout the industry. Prior to Dollar Tree, Mr. Parker spent ten years handling the leasing and sale of commercial properties for CB Richard Ellis of Virginia, Inc.

Business Objectives and Investment Strategy

Our primary business objective is to provide attractive risk adjusted returns to our shareholders by increasing cash flows at our existing properties and acquiring additional properties with attractive yields below replacement cost. We intend to achieve this objective utilizing the following investment strategy:

- Focus on necessity-based retail. We intend to invest in retail properties that serve the essential day-to-day shopping needs of the surrounding communities. These necessity-based centers attract high levels of daily traffic resulting in cross-selling of goods and services from our tenants. The majority of our tenants provide non-cyclical consumer goods and services that are less impacted by fluctuations in the economy. According to the Food Marketing Institute, the average consumer in the US makes a trip to a grocery store 2.2 times per week. We believe targeting centers that provide essential goods and services such as groceries results in a stable, lower-risk portfolio of retail investment properties.

- Target secondary and tertiary markets with strong demographics and demand. We believe these markets have limited competition from institutional buyers and relatively low levels of new construction. In evaluating potential acquisitions, we focus on areas with strong demographics such as population density, population growth, tenant sales trends and growth in household income, and we seek to identify properties in locations where there is a need for necessity-based retail and limited new supply. We generally will seek to avoid markets where we believe potential yields have decreased as a result of acquisition activity from institutional buyers.

- Acquire properties that are the number one or number two centers in their respective markets. After we identify an attractive target market, we look to acquire the top center in that market. These centers will have anchor tenants with dominant market share, high sales per square feet, significant capital invested in their respective stores and limited proximity to competing centers.

- Increase operating income through leasing strategies and expense management. We employ intensive lease management strategies to optimize occupancy. Management has strong expertise in acquiring and managing under-performing properties and increasing operating income through more effective leasing strategies and expense management such as common area maintenance, or CAM reimbursement and experience utilizing exterior parking for build to suit outparcels or pad sales. Our leases generally require the tenant to reimburse us for a substantial portion of the expenses incurred in operating, maintaining, repairing, and managing the shopping center and the common areas, along with the associated insurance costs and real estate taxes. Operating expenses that qualify for CAM reimbursement include, but are not limited to, landscaping, parking field maintenance and repairs, building maintenance and repairs, utilities and their associated maintenance and repair within the shopping center. The amount that each tenant pays is determined on a pro-rata basis and our leases generally allow us to add an administrative fee of 15%. Some leases are structured such that there is a price per square foot cap on paying additional fees and charges. Additionally, in some cases the tenant is either fully or partially responsible for all maintenance of the property, thereby limiting our obligations towards maintaining the center and increasing our net income. We refer to this arrangement as a “triple net lease.”

- Selectively utilize our capital to improve retail properties. We intend to make capital investments where the return on such capital is accretive to our shareholders. We have significant expertise allocating capital to value-added improvements of retail properties to increase rents, extend long-term leases with anchor tenants and increasing occupancy. We will selectively allocate capital to revenue enhancing projects that we believe will improve the market position of a given property.

- Selectively utilize our development capabilities for third parties. We intend to invest capital in development and re-development opportunities where we believe the return on such capital is accretive to our shareholders. We believe our experience in development will benefit us by providing opportunities to either develop properties for us at higher cap rates that result in positive returns to our operations or to develop for third parties which will result in development fee income for us. While this objective is not always possible, we generally want a development project to be at least 50% pre-leased prior to commencement.

- Acquire properties that meet our strict underwriting guidelines and process. Initially, our underwriting process begins with a cursory review of the asset to determine if there is a fit with our acquisition criteria. The offering memorandum; seller's financials; lease abstracts (anchor and small shop); rent roll; delinquency reports; assumable debt, if any; tenant sales reports; and the general physical structure of the asset are reviewed. By analyzing the trade

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area we can determine trade area demographics, how the target asset sits within the trade area compared to its competition and how that trade area is currently being serviced by the existing retail base. Provided the cursory review of the target asset is satisfactory we begin the primary underwriting. The acquisition analyst develops an eleven year cash flow analysis using Argus software utilizing lease abstracts, rent roll, financials provided by seller, and historical data from our own portfolio. Lease administration reviews the third-party abstracts of all leases giving particular attention to use restrictions/conflicts, lease termination rights, relocation rights and accuracy against the provided rent roll. Tenant interviews are done with all key tenants per a multi-point checklist. The property is reviewed internally by leasing, asset management and property management departments. Third party reports are generated for environmental, zoning, appraisal and property condition assessment. Legal reviews newly produced survey and title binder. Discussions are held with the local municipality, particularly economic development, zoning and planning to determine potential competitive activity, changes in traffic patterns and possible real estate tax exposure. Lastly, an on-site review of the asset by representatives of the Investment Committee of the Board of Directors, Mr. Wheeler, and Mr. Kelly, our Senior Vice President of Acquisitions, is required before the due diligence portion of any contract closes. In all, a checklist of over 100 items is reviewed and signed off prior to moving into the closing phase of the contract.

Policies With Respect to Certain Activities

The following is a discussion of certain of our investment, financing and other policies. These policies have been determined by our board of directors and, in general, may be amended or revised from time to time by our board of directors without a vote of our stockholders.

Investment Policies

Investments in Real Estate or Interests in Real Estate

We will conduct all of our investment activities through our Operating Partnership, Wheeler REIT, L.P., and its subsidiaries. Our investment objectives are to maximize the cash flow of our properties, acquire properties with cash flow growth potential, provide monthly cash distributions and achieve long-term capital appreciation for our stockholders through increases in the value of our company. Consistent with our policy to acquire assets for both income and capital gain, our Operating Partnership intends to hold its properties for investment with a view to long-term appreciation, to engage in the business of acquiring, developing and owning its properties and to make occasional sales of the properties as are consistent with our investment objectives. We have not established a specific policy regarding the relative priority of these investment objectives.

We expect to pursue our investment objectives primarily through the ownership by our Operating Partnership of our portfolio of properties and other acquired properties and assets. We currently intend to invest primarily in retail properties. Future investment or development activities will not be limited to any geographic area, property type or to a specified percentage of our assets. While we may diversify in terms of property locations, size and market, we do not have any limit on the amount or percentage of our assets that may be invested in any one property or any one geographic area. We intend to engage in such future investment activities in a manner that is consistent with the maintenance of our status as a REIT for U.S. federal income tax purposes. In addition, we may purchase or lease income-producing properties for long-term investment, expand and improve the properties we presently own or other acquired properties, or sell such properties, in whole or in part, when circumstances warrant.

We may also participate with third parties in property ownership, through joint ventures or other types of co-ownership. We also may acquire real estate or interests in real estate in exchange for the issuance of common stock, units, preferred stock or options to purchase stock. These types of investments may permit us to own interests in larger assets without unduly restricting our diversification and, therefore, provide us with flexibility in structuring our portfolio. We will not, however, enter into a joint venture or other partnership arrangement to make an investment that would not otherwise meet our investment policies.

Equity investments in acquired properties may be subject to existing mortgage financing and other indebtedness or to new indebtedness which may be incurred in connection with acquiring or refinancing these properties. Debt service on such financing or indebtedness will have a priority over any dividends with respect to our common stock. Investments are also subject to our policy not to fall within the definition of an “investment company” under the Investment Company Act of 1940, as amended (the “1940 Act”).

Investments in Real Estate Mortgages

We do not intend presently or at any time in the future to invest in real estate mortgages.

Securities of or Interests in Persons Primarily Engaged in Real Estate Activities and Other Issuers

Although not presently contemplated, subject to the percentage of ownership limitations and the income and asset tests necessary for REIT qualification, we may in the future invest in securities of other REITs, other entities engaged in real estate activities or securities of other issuers where such investment would be consistent with our investment objectives. We may invest in the debt or equity securities of such entities, including for the purpose of exercising control over such entities. We have no current plans to invest in entities that are not engaged in real estate activities. While we may attempt to diversify our investments with respect to the retail properties owned by such entities, in terms of property locations, size and market, we do not have any limit on the amount or percentage of our assets that may be invested in any one entity, property or geographic area. Our investment objectives are to maximize cash flow of our investments, acquire investments with growth potential and provide cash distributions and long-term capital appreciation to our stockholders through increases in the value of our company. We have not established a specific policy regarding the relative priority of these investment objectives. We will not underwrite the securities of any other issuers and will limit our investment in such securities so that we will not fall within the definition of an “investment company” under the 1940 Act.

Investments in Other Securities

Other than as described above, we do not currently intend to invest in any additional securities such as bonds, preferred stocks or common stock, although we reserve the right to do so if our board of directors determines that such action would be in our best interests.

Dispositions

We disposed of the following free-standing properties in 2015: Harps, Jenks Reasor’s and Bixby Commons. Further, the following free-standing properties are currently listed for sale: Starbucks/Verizon and the Ruby Tuesday/Outback Steakhouse ground leases at Pierpont Centre. The sale and intended sale of these free-standing properties reflects the execution of our strategy of acquiring multi-tenant properties, monetizing core-assets and using proceeds to re-invest in our specialized markets. We may dispose of additional properties based upon management’s periodic review of our portfolio, and the determination by our board of directors that such activity would be in our best interest. The tax consequences to our directors and executive officers that hold common units resulting from a proposed disposition of a property may influence their decision as to the desirability of such proposed disposition.

Financings and Leverage Policy

In the future, we anticipate using a number of different sources to finance our acquisitions and operations, including cash flows from operations, asset sales, seller financing, issuance of debt securities, private financings (such as additional bank credit facilities, which may or may not be secured by our assets), property-level mortgage debt, common or preferred equity issuances or any combination of these sources, to the extent available to us, or other sources that may become available from time to time. Any debt that we incur may be recourse or non-recourse and may be secured or unsecured. We also may take advantage of joint venture or other partnering opportunities as such opportunities arise in order to acquire properties that would otherwise be unavailable to us. We may use the proceeds of our borrowings to acquire assets, to refinance existing debt or for general corporate purposes.

Although we are not required by our governing documents to maintain a ratio of debt to total market capitalization at any particular level, our Board of Directors will review our ratio of debt to total capital on a quarterly basis, with the goal of maintaining a reasonable rate consistent with our expected ratio of debt to total market capitalization going forward. Additionally, we intend, when appropriate, to employ prudent amounts of leverage and to use debt as a means of providing additional funds for the acquisition of assets, to refinance existing debt or for general corporate purposes. We expect to use leverage conservatively, assessing the appropriateness of new equity or debt capital based on market conditions, including prudent assumptions regarding future cash flow, the creditworthiness of tenants and future rental rates. Our charter and bylaws do not limit the amount of debt that we may incur. Our board of directors has not adopted a policy limiting the total amount of debt that we may incur.

Our board of directors will consider a number of factors in evaluating the amount of debt that we may incur. If we adopt a debt policy, our board of directors may from time to time modify such policy in light of then-current economic conditions, relative costs of debt and equity capital, market values of our properties, general conditions in the market for debt and equity securities, fluctuations in the market price of our common stock, growth and acquisition opportunities and other factors. Our decision to use leverage in the future to finance our assets will be at our discretion and will not be subject to the approval of our stockholders, and we are not restricted by our governing documents or otherwise in the amount of leverage that we may use.

Lending Policies

We have not made any loans to third parties, although we do not have a policy limiting our ability to make loans to other persons. We may consider offering purchase money financing in connection with the sale of properties where the provision of that financing will increase the value to be received by us for the property sold. We also may make loans to joint ventures in which we participate. However, we do not intend to engage in significant lending activities. Any loan we make will be consistent with maintaining our status as a REIT.

Equity Capital Policies

To the extent that our board of directors approve additional capital raises, we may issue debt or equity securities, including additional units or senior securities of our Operating Partnership, retain earnings (subject to provisions in the Code requiring distributions of income to maintain REIT qualification) or pursue a combination of these methods. As long as our Operating Partnership is in existence, we will generally contribute the proceeds of all equity capital raised by us to our Operating Partnership in exchange for additional interests in our Operating Partnership, which will dilute the ownership interests of the limited partners in our Operating Partnership.

Existing stockholders will have no preemptive rights to common or preferred stock or units issued in any securities 4,352,000 preferred shares in exchange for the transfer of eight products (of which 544,000 preferred shares were earned during 2003 for one product transfer) pursuant to our current products agreement.

Pursuant to various stock and option purchase agreements between Sun Pharma and three stockholders and their affiliates, Sun Pharma acquired in January and February, 2004, 3,452,291 shares of common stock and rights to acquire options for 1,679,066 shares of common stock. The shares were acquired for $9.00 per share and the rights to the options were acquired for $9.00 less the exercise price of each option.

During 2004, we issued 1,679,066 shares of common stock to Sun Pharma against exercise of stock options, which Sun Pharma had acquired from two former directors during the first quarter of 2004.

All shares of preferred stock and common stock specified above that were issued by the Company were issued pursuant to exemptions from registration under Section 4(2) of the Securities Act of 1933.

Dividend Policy

We never have declared or paid cash dividends on our common stock. We currently intend to retain all future earnings for the operation and expansion of our business. We do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future. Any payment of cash dividends on the common stock will be at the discretion of the Board of Directors and will depend upon our results of operations, earnings, capital requirements, and other factors deemed relevant by our Board of Directors.

Item 6. Selected Financial Data

The following selected financial data of the Company is qualified by reference to and should be read in conjunction with the financial statements and notes thereto and other financial information included elsewhere herein. The summary balance sheet data as of March 31, 2006 and 2005 and summary statements of operations data for the years ended December 31, 2003 and 2004, the three month period ended March 31, 2005 and the year ended March 31, 2006 are derived from and qualified by reference to the audited financial statements of the Company which are included elsewhere herein. The summary balance sheet data as of December 31, 2004, 2003 and 2002 and the summary of the statements of operations for the years ended December 31, 2004, 2003, 2002 and 2001 are derived from the audited financial statements of the Company which are not included herein and have been previously filed with the SEC.

In January 2005, the Company changed its fiscal year from December 31st to March 31st. The results from the twelve month period March 31, 2005 were derived from the Company s published quarterly results and are unaudited. Accordingly, this twelve month period is not disclosed in the accompanying financial statements. It is included in the selected financial data for comparative purposes only as defined below.

Financial Data

Statements of operations data	(In thousands, except per share data) Year ended March 31, 2006 (Audited)	2005 (Unaudited)
Net sales	$ 82,789	$ 64,116
Cost of goods sold	41,873	26,930
Gross profit	40,916	37,185
Selling, general and administrative expenses	8,183	5,874
Research and development costs affiliate non cash	35,055	26,769
Research and development costs other	8,437	6,640
Operating loss	(10,759)	(2,097)
Other income / (expenses)	336	(181)
Net Loss	(10,423)	(2,278)
Net Loss per share		
Basic	(0.39)	(0.09)
Diluted	(0.39)	(0.09)
Weighted Average Shares Outstanding:		
Basic	26,392	26,348
Diluted	26.392	26,348

Financial Data (continued)

(In thousands, except per share data)

Statements of operations data	Transition Period Ended March 31,	Year ended December 31,			
	2005	2004	2003	2002	2001
Net sales	$ 17,337	$ 60,340	$ 45,498	$ 22,381	$ 5,922
Cost of goods sold	7,879	24,441	19,507	12.047	4,186
Gross profit	9,457	35,899	25,991	10,334	1,736
Selling, general and administrative expenses	1,879	5,277	7,363	3,828	2,680
Research and development costs affiliate non cash	10,200	24,397	3,103	3,887	0
Research and development costs other	1,720	6,053	3,112	3,348	3,080
Operating (loss) / income	(4,342)	172	12,412	(730)	(4,024)
Other income / (expense)	21	(371)	(1,189)	(1,526)	(1,734)
Net (Loss) / Income	(4,322)	(199)	11,223	(2,256)	(5,757)
Net (Loss) / Income per share					

Basic	(0.16)	(0.01)	0.46	(0.10)	(0.29)
Diluted	(0.16)	(0.01)	0.44	(0.10)	(0.29)
Weighted Average Shares Outstanding:					
Basic	26,348	24,734	24,137	22,031	21,173
Diluted	26,348	24,734	25,482	22,031	21,173

Financial Data (continued)

(In thousands)

Balance Sheet Data	As at March 31, 2006	As at March 31, 2005	As at December 31, 2004	As at December 31, 2003	As at December 31, 2002
Current assets	$ 62,282	$ 32,938	$ 24,857	$ 18,918	$ 12,106
Property, plant and equipment, net	14,960	12,897	12,546	9,506	7,747
Total assets	77,242	45,835	37,403	28,424	19,853
Current liabilities	20,864	14,149	11,627	20,008	13,753
Long term debt				13,395	25,724
Total liabilities	20,864	14,149	11,627	33,404	39,476
Stockholders Equity (Deficit)	56,378	31,686	25,776	(4,980)	(19,623)
Working Capital (Deficiency)	41,418	18,789	13,230	(1,090)	(1,647)

Item 7. Management s Discussion and Analysis Of Financial Condition and Results of Operations.

The following discussion and analysis provides information that the management believes is relevant to an understanding of our results of operations and financial condition. The discussion should be read in conjunction with the financial statements and notes thereto.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. Certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations and require management s subjective judgments. As a result, these judgments are subject to an inherent degree of uncertainty. In applying these policies, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Our significant estimates include our provisions for price adjustments (primarily chargebacks), valuation allowances for deferred tax assets, and valuation of overhead components in inventory.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements. There have neither been material changes to our critical accounting policies for the periods presented nor any material quantitative revisions to our critical accounting estimates for the periods presented.

Revenue Recognition

Revenue from product sales, net of estimated provisions, is recognized when there is persuasive evidence that an arrangement exists, shipment of the goods has occurred, the selling price is fixed or determinable, and collectibility is reasonably probable. Our customers consist primarily of large pharmaceutical wholesalers who sell directly into the retail channel. Provisions for sales discounts, and estimates for chargebacks, rebates, and product returns are established as a reduction of product sales revenue at the time revenues are recognized, based on historical experience and current market trends adjusted to reflect known changes in the factors that impact these reserves. These revenue reductions are reflected as a direct reduction to accounts receivable through an allowance.

Chargebacks

Chargebacks represent our most significant provision against gross accounts receivable and related reduction to gross revenue. Chargebacks are credits given to our wholesale customers for the price difference on our product they sell (at a contractual price) to retail, chain stores, and managed care organizations at prices lower than we sell to our wholesale customer. We record an estimate at the end of the reporting period to the wholesaler of the amount to be charged back to us, over and above those already received by us. Such estimated amounts, in addition to certain other deductions, are deducted from our gross sales to determine our net revenues. We have recorded provisions for chargebacks based upon various factors, including current contract prices, historical trends, and our future expectations. The amount of actual chargebacks claimed could be either higher or lower than the amounts we accrued. Changes in our estimates, if any, would be recorded in the income statement in the period of the change. If we over or under estimate the amount that will ultimately be charged back to us by our wholesaler customers, there could be a material impact on our financial statements.

We consider the following factors in the determination of the estimates of chargebacks.

1. We consider the historical data of chargebacks as a percentage of sales, as well as the various chargeback reports that we receive from the customers.

2. Volume of product sold to wholesalers and the average chargeback rates, on a quarterly and annualized basis are applied to current period and annual product sales to make a realistic accrual.

3. The sales trends for future estimated prices, wholesale acquisition cost (WAC), the contract prices with the retailers, chain stores and managed care organizations (end-users). Our prices with the wholesalers and end users are contracted prices.

Shelf Stock Adjustments

Shelf stock adjustments are credits issued to our customers to reflect decreases in the selling prices of our product. These credits are customary in the industry and are intended to reduce the customers inventory cost to better reflect current market prices. The determination to grant a shelf stock adjustment to a customer following a price decrease is at our discretion.

Factors considered when recording a reserve for a shelf stock adjustments include estimated launch dates of competing products based on market intelligence, estimated decline in market price of our product based on historical experience and input from customers and levels of inventory held by customers at the date of the adjustments as provided by them.

Product returns and other allowances

In the pharmaceutical industry, customers are normally granted the right to return product for credit if the product has not been used prior to its expiration date. Our return policy typically allows product returns for products within a 12-month window from six months prior to the expiration date and up to six months after the expiration date. We estimate the level of sale, which will ultimately be returned pursuant to our return policy, and record a related reserve at the time of sale. These amounts are deducted from our gross sales to determine our net revenues. Our estimates take into consideration historical returns of our products and our future expectations. We periodically review the reserves established for returns and adjust them based on actual experience, if necessary. The primary factors we consider in estimating our potential product returns include shelf life of expiration date of each product and historical levels of expired product returns. In case we become aware of any returns due to product related issues, such information from the customers, is used to estimate an additional reserve. The amount of actual product return could be either higher or lower than the amounts we accrued. Changes in our estimates, if any, would be recorded in the income statement in the period of the change. If we over or under estimate the quantity of product which will ultimately be returned, there may be a material impact to our financial statements.

Discounts (trade and prompt payment discounts) are accrued at the end of every reporting period based on the gross sales made to the customers during the period and based on their terms of trade. We review the contracts between the customer and us as well as the historical data and percentages to estimate the discount accrual.

Customer rebates are estimated at every period end, based on direct or indirect purchases. If the purchases are direct, the rebates are recognized when products are purchased and a periodic credit is given. For indirect purchases, the rebates are recognized based on the terms with such customer. Medicaid Rebates are estimated based on the historical data we receive from the public sector benefit providers, which is based on the final dispensing of our product by a pharmacy to a benefit plan participant.

Doubtful Accounts

Doubtful accounts are estimated based on the data available from external sources, including information on financial condition of customers. Also, a regular review of past due receivables is done on a quarterly basis to identify and make provision for such receivables not expected to be recovered.

Our gross sales for Fiscal 2006 were $200.4 million, as compared to $141.9 million for Fiscal 2005. Chargebacks, returns, discounts and other customary customer deductions and other sales costs constituted approximately 59% for Fiscal 2006 compared to 54% for Fiscal 2005. Net sales for Fiscal 2006 were $82.8 million, as compared to $64.1 million for Fiscal 2005. The primary cause of increase in the sales diluters by almost 4% between the periods is the impact of price erosions for the products we sell and the corresponding impact of such price erosions on chargebacks

The following is a roll forward of the provisions for chargebacks, shelf stock adjustments, returns and allowances and estimated doubtful account allowances during Fiscal 2005 and Fiscal 2006.

($ in Millions)

		Allowances charged to Gross Sales			
	Balances at begining of period	**Current Period**	**Prior Period**	**Credits taken by customers**	**Balance at the end of period**
For Fiscal 2005					
Chargebacks & shelf stock adjustments	16,051	72,505	-0-	68,746	$ 19,810
Returns and other allowances	878	4,258	-0-	4,016	1,120
Doubtful Accounts	500	-0-	-0-	400	100
For Fiscal 2006					
Chargebacks & shelf stock adjustments	$ 19,810	$ 111,525	-0-	$ 119,868	$ 11,467
Returns and other allowances	1,120	7,471	-0-	7,091	1,500
Doubtful Accounts	100	-0-	-0-	-0-	100

Income Taxes

As part of the process of preparing our financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. We account for income taxes by the liability method. Under this method, deferred income taxes are recognized for tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end, based on enacted laws and statutory tax rates applicable for the differences that are expected to affect taxable income. Valuation allowances are provided if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. We have not recorded any federal tax provision or benefit for the Fiscal 2006, the Transition Period or for the years ended December 31, 2004 and 2003. We have provided a valuation allowance for the full amount of our net deferred tax assets since realization of any future benefit from deductible temporary differences and net operating loss carry forwards cannot be sufficiently assured at March 31, 2006, March 31, 2005, December 31, 2004 and 2003. At March 31, 2006, we had federal net operating loss carryforwards of approximately $58.8 million available to reduce future taxable income, which will expire between 2007 and 2017. Under the provisions of the Internal Revenue Code, certain substantial changes in our ownership may result in a limitation on the amount of net operating loss carry forwards which can be used in future years. We believe that ownership changes to date will not limit future utilization of net operating loss carryforwards.

Inventory

We value inventories at the lower of cost or market. We determine the cost of raw materials, work in process and finished goods using the specific identification cost method. We analyze our inventory levels quarterly and write down inventory that has become obsolete and inventory that has a cost basis in excess of its expected net realizable value. Expired inventory is disposed of and the related costs are written off. Materials acquired for R&D on products yet to be launched are written off in the year of acquisition. The determination of whether or not inventory costs will be realizable requires estimates by management. A critical estimate in this determination is the estimate of the future expected inventory requirements, whereby we compare our internal sales forecasts to inventory on hand. Actual results may differ from those estimates and inventory write-offs may be required. We must also make estimates about the amount of manufacturing overhead to allocate to our finished goods and work in process inventories. Although the manufacturing process is generally similar for our products, we must make judgments as to the portion of costs to allocate to purchased product, work in process and finished goods, and such allocations can vary based upon the composition of these components and the fact that each product produced does not necessarily require the same amount of time or effort for the same production step. Accordingly, the assumptions we make can impact the value of reported inventories and cost of sales.

FDA Compliance

The FDA commenced an inspection of the Company s facility on May 1, 2006. This is a routine inspection which will continue over the next few weeks. While there is no assurance that the FDA will not issue observations, we believe that we are cGMP compliant.

Overview of Fiscal 2006

We recorded net sales of $82.8 million during Fiscal 2006 compared to $64.1 million during Fiscal 2005. We have generated cash from operations of $8.9 million during Fiscal 2006 as compared to $20.6 million during Fiscal 2005. This cash was generated after funding our working capital requirements of $17.5 million and $4.9 million during the relevant periods. We incurred a net loss of $10.4 million during Fiscal 2006 compared to net loss of $2.3 million during Fiscal 2005. The higher loss was primarily due to higher non-cash research and development expense (R&D) of $35.1 million during Fiscal 2006 as compared to $26.8 million during Fiscal 2005. This non-cash R&D expense relates to nine products passing their bio-equivalency studies and related value of the preferred stock issued to Sun Global during Fiscal 2006 as compared to eight products during Fiscal 2005. At March 31, 2006, we had stockholders equity of $56.4 million as compared to stockholders equity of $31.7 million at March 31, 2005.

In January 2005, the Company changed its fiscal year end from December 31 to March 31. The following discussion of historical operating results compares Fiscal 2006 to Fiscal 2005. Results from Fiscal 2005 were derived from the Company s published quarterly results and are unaudited. Accordingly, this twelve month period is not disclosed in the accompanying financial statements. It is included in this discussion for comparative purposes only. For the previous calendar year ended December 31, 2004, the comparison is to the calendar year ended December 31, 2003. The discussion of historical operating results also includes and compares the three months ended March 31, 2006 to the Transition Period. Results from the three month period ended March 31, 2006 were derived from the Company s published quarterly results and are unaudited.

Fiscal 2006 Compared to Fiscal 2005

	Year ended March 31,	
	2006 (Audited)	2005 (Unaudited)
Statement of operations data	(in thousands, except per share data)	
	$	$
Net sales	82,789	64,116
Cost of goods sold	41,873	26,930
Gross profit	40,916	37,186
Selling, general and administrative expense	8,183	5,874
Research and development costs affiliate non cash	35,055	26,769
Research and development costs other	8,437	6,640
Operating loss	(10,759)	(2,097)
Other income (expense)	336	(181)
Net Loss	(10,423)	(2,278)
Net Loss per share		
Basic	(0.39)	(0.08)
Diluted	(0.39)	(0.08)
Weighted Average Shares Outstanding:		
Basic	26,392	26,348
Diluted	26.392	26,348

Net Sales. Net sales for the relevant periods of 2006 and 2005 were $82.8 and $64.1 million, reflecting an increase of over 29%. The increase is primarily due to the higher production, new product launches (primarily the sales of our generic equivalent of Ultracet® and increased marketing of our products to new and existing customers. Currently, we manufacture and market all except one of the approved products. Sales of three products accounted for approximately 70% and 77% of net sales for the relevant periods of 2006 and 2005, respectively. See Note 1 to Financial Statements Revenue Recognition for explanation of the determination of net sales.

Gross Profit. We earned a gross profit of $40.9 million as compared to a gross profit of $37.2 million during the relevant periods, reflecting an increase of 10%. The increase in gross profit for the relevant periods is primarily due to higher sales, new product launches, an improved balance in the mix of customers or the class of trade and product selection being sold partially offset by price erosion during the year.

The gross profit margin declined to 49% as compared to 58% during the relevant periods. The decrease was primarily the result of increased competition, both domestic and foreign, resulting in erosion of prices and profit margins.

Selling, General and Administrative Expense. Selling, general and administrative expense during the relevant periods were $8.2 million and $5.9 million, representing an increase of 39%. The selling, general and administrative expense have increased to 9.9% of net sales as compared to 9.2% of net sales during the relevant periods.

The increase in SG&A for Fiscal 2006 over Fiscal 2005 was due to an increase in regulatory costs for compliance with SEC regulations, including Sarbanes-Oxley requirements ($0.4 million), primarily additions to management and associated compensation ($0.7 million), higher taxes on property ($0.2 million) and higher SG&A expenses associated with higher sales volumes as well as a one time charge ($0.3 million) associated with our decision to forego an acquisition of real property in favor of alternate expansion opportunities.

Research and Development Expenses. Total R&D expenses for the relevant periods were $43.5 million for Fiscal 2006 and $33.4 million for Fiscal 2005. Cash research and development expenses were $8.4 million for Fiscal 2006 and $6.6 million during Fiscal 2005. We incurred non-cash research and development expenses (technology transfer cost) of $35.1 million for the 4,896,000 shares of preferred stock for nine product transfers as compared to $26.8 million for the 4,352,000 shares of preferred stock for eight product transfers. The substantially higher R&D expenses, both cash and non-cash, represent increased R&D activities.

Interest Expense. We incurred approximately four thousand dollars interest expense during Fiscal 2006 on a short term borrowing from JPMorgan Chase Bank See Note 2 to Financial Statements. Interest expense on loans from the EDC, ICICI Bank, the Bank of Nova Scotia and Citibank was $0.2 million during Fiscal 2005. The decrease in the amount of interest is primarily due to paying off the entire loans due to the EDC, ICICI Bank, the Bank of Nova Scotia and CitiBank during Fiscal 2005.

Results of Operations. We incurred a net loss of $10.4 million and $2.3 million during the relevant periods. The lower results of operation are primarily due to higher non-cash R&D expenses and higher Cash R&D expenses.

Three months ended March 31, 2006 compared with the Transition Period

Statement of operations data	2006 (Unaudited)	Transition Period (Audited)
	(in thousands, except per share data)	
Net sales	$ 24,701	$ 17,337
Cost of goods sold	12,011	7,879
Gross profit	12,690	9,457
Selling, general and administrative expenses	2,481	1,879
Research and development costs affiliate non cash	14,008	10,200
Research and development costs - other	2,925	1,720
Operating loss	(6,724)	(4,342)
Other income (expenses)	185	21
Net Loss	(6,539)	(4,322)
Net Loss per share		
Basic	(0.25)	(0.16)
Diluted	(0.25)	(0.16)
Weighted Average Shares Outstanding:		
Basic	26,392	26,348
Diluted	26,392	26,348

Net Sales. Net sales for the relevant periods of 2006 and 2005 were $24.7 million and $17.3 million, reflecting an increase of almost 43%. The increase is primarily due to the higher production, new product launches and increased marketing of our products to new and existing customers. Currently, we manufacture and market all except one of the approved products. See Part I, Item 1. Business Current Status above. Sales of four and three products accounted for approximately 76% and 77% of net sales for the relevant periods, respectively. See Note 1 to Financial Statements Revenue Recognition.

Gross Profit. We earned a gross profit of $12.7 million as compared to a gross profit of $9.5 million during the relevant periods, reflecting an increase of 34%. The improvement was primarily due to higher sales volumes during the three months ended March 31, 2006 compared to the Transition Period.

The gross profit margin declined to 51% as compared to 55% during the relevant periods. The decrease was primarily the result of increased competition, both domestic and foreign, resulting in erosion of prices and profit margins.

Selling, General and Administrative Expenses. Selling, general and administrative expenses during the relevant periods were $2.5 million and $1.9 million, representing an increase of 32%. The selling, general and administrative expenses have reduced to 9.4% of net sales compared to 10.8% of net sales during the relevant periods.

The increase in SG&A during the relevant periods has been due to an increase in regulatory costs for compliance with SEC regulations, including Sarbanes-Oxley requirements ($0.1 million), primarily additions to management and associated compensation ($0.2 million), and higher SG&A expenses associated with higher sales volumes.

Research and Development Expenses. Total R&D expenses for the relevant periods were $16.9 million and $11.9 million. Cash research and development expenses were $3.0 million and $1.7 million during the relevant periods. We incurred non-cash research and development expenses (technology transfer cost) of $14.0 million for the 1,632,000 shares of preferred stock for three product transfers as compared to $10.2 million for the 1,632,000 shares of preferred stock for three product transfers. The substantially higher R&D expenses, both cash and non-cash, represent increased R&D activities.

Interest Expense. Interest expense on loans from the JP Morgan Chase Bank was approximately four thousand dollars during the relevant period of 2006. There was no corresponding expense during the Transition Period.

Results of Operations. We incurred a net loss of $6.5 million and $4.3 million during the relevant periods. The lower results of operation are primarily due to higher non-cash R&D expenses.

Year Ended December 31, 2004 Compared with Year Ended December 31, 2003

Net Sales. Net sales for 2004 and 2003 were $60.3 million and $45.5 million, respectively, reflecting an increase of almost 33%. The increase is due to the higher production and marketing of our products to new and existing customers. Currently, we manufacture and market all except one of the approved products. See Part I, Item 1. Business Current Status above. Sales of two products accounted for approximately 74% and 87% of net sales in 2004 and 2003, respectively.

Gross Profit. We earned a gross profit of $35.9 million for 2004 as compared to a gross profit of $26.0 million for 2003, reflecting an increase of 38% over 2003. The improvement was primarily due to higher sales volumes with improved margins due to product mix in the current period as compared to the corresponding period of 2003 and ability to absorb operational overheads due to higher sales.

In addition to increased sales, the gross profit margin has marginally improved to 59% in 2004 as compared to 57% for 2003. The increase was primarily the result of:

- Change in the product mix of sales.
- Reduction in manufacturing costs due to increased batch sizes.
- Further improved efficiency in the overall manufacturing process associated with higher utilization of plant capacity.
- Utilization of newly installed larger and faster equipment to achieve economies of scale.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for 2004 and 2003 were $5.3 million and $7.4 million, respectively, representing a decrease of 28%. Selling, general and administrative expenses have decreased to 9% of net sales for 2004 as compared to 16% of net sales for 2003.

The decrease in SG&A of approximately $2.1 million in 2004 was primarily due to one time recording of variable compensation expense during 2003 on the extension of the term of two former directors stock options and severance compensation to a former CEO.

Research and Development Expenses. Total R&D expense for 2004 of $30.5 million was substantially higher as compared to $6.2 million during 2003. Cash research and development expenses of $6.1 million for 2004 were higher by 97% when compared with $3.1 million incurred for 2003. We incurred non-cash research and development expenses (technology transfer cost) of $24.4 million for the 3,808,000 shares of preferred stock for seven product transfers during 2004 as compared to $3.1 million for the 544,000 shares of preferred stock for one product transfer during 2003. The substantially higher R&D expenses, both cash and non-cash, represent increased R&D activities.

Interest Expense. Interest expense on loans from the EDC, Sun Pharma and its affiliates, ICICI Bank, the Bank of Nova Scotia and Citibank, was $0.4 million and $1.2 million for 2004 and 2003, respectively. The decrease in the amount of interest is primarily due to paying off the entire loans due to the EDC, ICICI Bank, the Bank of Nova Scotia and CitiBank during 2004 as well as Sun Pharma loans during 2003.

Results of Operations. We incurred a net loss of $0.2 million for 2004 as compared to earning a net income of $11.2 million for 2003. The significantly lower results of operation for 2004 as compared to 2003 are primarily due to higher non-cash R&D expenses.

Liquidity and Capital Resources

Fiscal 2006 and Fiscal 2005

We generated cash of $8.9 million from operations as compared to cash of $20.6 million during the relevant periods. The lower cash generation during Fiscal 2006 was primarily due to augmenting working capital. Cash generated from operations was used to finance our capital expenditures of $3.6 million. Cash from operations during Fiscal 2005 was used to

finance capital expenditure of $3.3 million.

At March 31, 2006, we had working capital of $41.4 million compared to a working capital of $18.8 million at March 31, 2005. The working capital was significantly higher due to higher receivables and inventories at the end of March 2006 compared to that at March 31, 2005, partially offset by higher current liabilities.

Three Months ended March 31, 2006 to the Transition Period

We generated cash of $4.3 million from operations as compared to cash of $4.8 million during the relevant periods. In addition to augmenting working capital, the cash generated from operations was used to finance our capital expenditures of $1.2 million and $0.7 million during the relevant periods.

At March 31, 2006, we had working capital of $41.4 million compared to a working capital of $18.8 million at March 31, 2005. The working capital was significantly higher due to higher receivables and inventories at the end of March 2006 compared to that at March 31, 2005, partially offset by higher current liabilities.

Years ended December 31, 2004 and 2003

During 2004, we generated cash of $22.0 million from operations as compared to cash of $15.5 million during 2003. The higher cash generation during 2004 has been primarily due to higher sales volumes, better-cost absorption, an improved product mix, obtaining more competitive prices for raw materials and better utilization of new equipment to improve production and productivity.

In addition to paying down debt, the cash generated from operations for both 2004 and 2003 was used to finance our capital expenditures of $4.0 million during 2004 and $2.4 million during 2003.

During 2004, we repaid the entire balance of $4.4 million due to ICICI Bank Limited and the $6.4 million mortgage loan due to the Economic Development Corporation of the City of Detroit (the EDC), and repaid $12.5 million due to the Bank of Nova Scotia. These payoffs were funded from internal cash flow and by utilizing a $10.0 million credit line arranged with Citibank, FSB. We have also repaid the entire borrowing of $10.0 million from Citibank during 2004. These repayments leave us debt-free (other than normal accounts payables and accruals) at December 31, 2004, and our entire property, plant, equipment and intellectual property free of any mortgages, liens or restrictions. In comparison, during 2003 we borrowed $1.6 million from the Bank of Nova Scotia and repaid the entire Sun Pharma loans of $9.7 million and the scheduled payments of $1.2 million to the EDC and $0.6 million to the ICICI Bank.

During 2004, we generated $3.5 million from the exercise of stock options by Sun Pharma, our employees and one officer and director. During 2003, we generated $0.9 million from the exercise of stock options by our employees and directors.

At December 31, 2004, we had working capital of $13.2 million compared to a negative working capital of $1.1 million at December 31, 2003. The negative working capital as on December 31, 2003 was primarily due to classification of loans as current of $8.8 million due to ICICI Bank and the Bank of Nova Scotia and $1.1 million due to the EDC.

The available increased cash flow during 2004 was partly utilized to increase inventories, up from $9.6 million in 2003 to $17.1 million. These increased inventories served us well to satisfy increased sales requirement from $45.5 million in 2003 to $60.3 million in 2004. To meet customer demands in timely manner, it is essential to keep sufficient inventories at all levels including Finished goods stock. Therefore, if necessary the trend of increasing inventories will continue in 2005 to support increased sales.

The following tables present a summary of each of the four quarters of Fiscal 2006. The unaudited interim financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of such information when read in conjunction with our audited financial statements and related notes. Our quarterly operating results have varied in the past, may continue to do so and are not necessarily indicative of results for any future period.

Fiscal 2006 April 1, 2005 to March 31, 2006 (unaudited)

(In thousands, except per share data)

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Net Sales	17,613	19,796	20,679	24,701
Net (Loss) Profit	1,616	(4,820)	(680)	(6,539)
Earnings Per Share				
Basic	0.06	(0.18)	(0.03)	(0.25)
Diluted	0.05	(0.18)	(0.03)	(0.25)

Contractual Obligations and Off Balance Sheet Transactions

Contractual Obligations

Contractual Obligations	1-3 years
Operating Leases	$ 0.5 million

There are no other contractual obligations requiring disclosure.

Off Balance Sheet Transactions

None

Future Outlook

Management is optimistic about our future outlook. We have been substantially compliant with cGMPs since 2001, and received approvals of 18 ANDAs and tentative approvals for 2 ANDAs. We expanded and upgraded our facilities and expanded our customer base during the last five years including Fiscal 2006. We have improved our market share on products that have been in our portfolio and we have gained the appropriate marketshare to date on new product launched in 2006. Our efforts in developing new products has increased and our momentum should permit us to grow at a reasonable level. We believe that we will continue to achieve 25% to 30% revenue growth during Fiscal 2007 over Fiscal 2006.

Pricing pressures, however, due to increased competition, have continued during 2004, the Transition Period and Fiscal 2006 and are expected to continue in Fiscal 2007, which may result in lower growth rates and gross margins. Management has and will continue to work diligently to counter the pricing pressures through increased sales volumes, better-cost absorption of operational overheads, and cost reductions where possible.

As disclosed, under the products agreement dated November 21, 2002 between Sun Global and the Company, Sun Global has agreed to transfer the technology for 25 products to the Company over a five year period in exchange for 544,000 preferred shares (which are convertible on a one-to-one basis into common shares) per product. Since the date of the products agreement, the Company has selected all 25 products for development and twenty of these products have passed their respective bio-equivalency studies (one in December 2003, seven in 2004, three during the Transition Period and nine during Fiscal 2006) and one since then. If some or all of the four remaining products pass their bio-equivalency studies in fiscal 2007, the fair value of the preferred shares earned by Sun Global in exchange for such products could cause our non-cash research and development expenses to increase to an amount which would significantly decrease profit or create a loss.

While the increased development of new products will increase both our cash and non-cash R&D expense and will impact EPS, we expect that cash will be available for among other things, to meet increased working capital requirements, fund potential Paragraph IV Certification litigation and finance further capital investments.

The Company will continue to aggressively move forward with the development of new products. We believe that receiving products from Sun provides us with a partner with a proven track record; one that already has provided us with quality products. Moreover, Sun Pharma s increased beneficial ownership in us to approximately 64%, should, we believe, provide it with the incentive to continue to help us succeed. Sun Pharma has previously provided us with capital, loans, guarantees of loans, personnel, raw materials and equipment, which have significantly helped us to date.

Management s plans for fiscal 2007 include:

Continued focus and improvement on FDA compliance.

Increased pace of research and development activities, with a view to maximize the number of ANDA filings.

Continue to invest in equipment and facilities to expand capacity to meet requirements of projected short term and long term growth.

Increased market share for certain existing products and recently introduced new products and enhanced customer reach and satisfaction.

Prompt introduction of new approved products to the market.

Achieving further operational efficiencies by attaining economies of scale and cost reduction per unit.

Increase the number of products, as well as anticipated volume increases for existing products, which, in turn, will improve manufacturing capacity utilization.

Consider alternative ways of increasing cash, such as marketing ANDAs owned by Sun Pharma,.

Expand our relationships with financial institutions to fortify our credit position and borrowings as necessary.

Research alternate product development sources and product licenses such as in licensing authorized generics from brand innovator companies and acquisitions of ANDAs from competitor manufacturers both domestically and abroad.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The Company has no debt or other market risk securities or transactions in foreign exchange.

Line of Credit

On November 17, 2005, the Company entered into a one-year, $10 million Credit Agreement with JP Morgan Chase Bank, N.A. Under the Credit Agreement, the lender may make loans and issue letters of credit to the Company for the Company s working capital needs and general corporate purposes. Letters of credit, if issued, expire one year from their date of issuance, but no later than November 17, 2007. As of March 31, 2006, we utilized $1.5 million of the available line and have repaid the same. Borrowings are secured by the Company s receivables, inventory and all proceeds therefrom. Borrowings may be prepaid at any time by the Company. Interest is payable based on LIBOR or an alternate base rate (determined by reference to the prime rate or the federal funds effective rate), as selected by the Company. The rate of interest is LIBOR plus 75 basis points or Prime rate minus 100 basis points. The Credit Agreement requires that certain financial covenants be met on a quarterly basis. The Company is in compliance with these financial convenants at March 31, 2006.

Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

3. Financial Statements:

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

a. The term disclosure controls and procedures is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act). These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report (the Evaluation Date), and have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in providing them with material information relating to the Company known to others within the Company which is required to be included in our periodic reports filed under the Exchange Act.

b. There has been no change in the Company s internal control over financial reporting that occurred during the Transition Period that materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance wit the policies or procedures may deteriorate.

Based on our evaluation, management concluded that our internal control over financial reporting was effective as of March 31, 2006. Our management s assessment of the effectiveness of our internal control over financing reporting as of March 31, 2006 has been audited by Rehmann Robson, an independent registered public accounting firm, as stated in its Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Report which appears on pages F-3 and F-4 below.

Item 9B. Other Information.

None.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The information with respect to directors and executive officers of the Corporation, the Corporation s Code of Ethics, and compliance with Section 16(a) of the Exchange Act included under the sections Nominees For Directors Terms Expiring in 2008, Incumbent Directors Terms Expiring in 2006, Incumbent Directors Terms Expiring in 2007, Committees and Meetings of Directors, Nomination of Directors, Execut Officers, Code of Business Conduct and Ethics, and Section 16(a) Beneficial Ownership Reporting Compliance in our 2005 Proxy Statement to be filed with the Securities and Exchange Commission on or before July 31, 2006, is incorporated herein by reference.

Item 11. Executive Compensation.

The information regarding executive compensation included under the section Compensation of Executive Officers and Compensation of Directors in our 2005 Proxy Statement to be filed with the Securities and Exchange Commission on or before July 31, 2006, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information with respect to the security ownership of certain beneficial owners and management and with respect to equity compensation plans included under the sections Security Ownership of Certain Beneficial Owners, Security Ownership of Management and Directors and Equity Compensation Plan Information in our 2005 Proxy Statement to be filed with the Securities and Exchange Commission on or before July 31, 2006, is incorporated herein by reference. In addition, the information contained under the Equity Compensation Plan Information subheading under Item 5 of this report is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions.

The information with respect to certain relationships and related transactions included under the section Transactions of Directors, Executive Officers and Certain Beneficial Owners of Caraco in our 2005 Proxy Statement to be filed with the Securities and Exchange Commission on or before July 31, 2006, is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

The information under the caption Relationship with Independent Auditors Audit and Non-Audit Fees in our 2005 Proxy Statement to be filed with the Securities and Exchange Commission on or before July 31, 2006, is incorporated herein by reference.

Part IV

Item 15. Exhibits Financial Statement Schedules.

(a) 1 Financial Statements

3. Financial Statements:

2 Financial Statement Schedules

None

3 Exhibits

The exhibits filed in response to Item 601 of Regulation S-K are listed in the Exhibit Index, which is incorporated herein by reference.

(b) Exhibits

The exhibits filed in response to Item 601 of Regulation S-K are listed in the Exhibit Index, which is incorporated herein by reference.

(c) Other Schedules

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on the 12th day of June, 2006.

CARACO PHARMACEUTICAL LABORATORIES, LTD.

/s/ Daniel H. Movens

Daniel H. Movens
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Daniel H. Movens and / or Jitendra N. Doshi, this 12th day of June, 2006, his true and lawful attorney(s)-in-fact and agent(s), with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any or all amendments to this report and to file the same, with all exhibits and schedules thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney(s)-in-fact and agent(s) full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney(s)-in-fact and agent(s), or their substitutes(s), may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the date indicated above.

/s/ Dilip S. Shanghvi Dilip S. Shanghvi	Chairman of the Board
/s/ Daniel H. Movens Daniel H. Movens	Director, Chief Executive Officer
/s/ Jitendra N. Doshi Jitendra N. Doshi	Director and CFO and COO (and Principal Accounting Officer)
John D. Crissman	Director
/s/ Sailesh T. Desai Sailesh T. Desai	Director
/s/ Timothy Manney Timothy Manney	Director
Madhava Reddy	Director
/s/ Georges Ugeux Georges Ugeux	Director
/s/ Sudhir V. Valia Sudhir V. Valia	Director

CARACO PHARMACEUTICAL LABORATORIES, LTD.

(a subsidiary of Sun Pharmaceutical Industries Limited)
FINANCIAL STATEMENTS

AND

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

FOR THE YEAR ENDED MARCH 31, 2006,
THE THREE MONTHS ENDED MARCH 31, 2005 AND
THE YEARS ENDED DECEMBER 31, 2004 AND 2003

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

INDEX TO FINANCIAL STATEMENTS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Stockholders and Board of Directors
Caraco Pharmaceutical Laboratories, Ltd.
Detroit, Michigan

We have audited management s assessment, included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting that **Caraco Pharmaceutical Laboratories, Ltd.** (a Michigan corporation) (a subsidiary of Sun Pharmaceutical Industries Limited) (the Corporation) maintained effective internal control over financial reporting as of March 31, 2006, based on criteria established in *Internal Control -Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Corporation s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the *Public Company Accounting Oversight Board (United States)*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A corporation s internal control over financial reporting is a process designed by, or under the supervision of, the corporation s principal executive and principal financial officers, or persons performing similar functions, and effected by the corporation s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A corporation s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Corporation maintained effective internal control over financial reporting as of March 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of March 31, 2006, based on the COSO criteria.

We have also audited, in accordance with the standards of the *Public Company Accounting Oversight Board (United States)*, the financial statements as of and for the year ended March 31, 2006 of the Corporation and our report dated May 7, 2006 expressed an unqualified opinion on those financial statements.

/s/ Rehmann Robson

Troy, Michigan
May 7, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors
Caraco Pharmaceutical Laboratories, Ltd.
Detroit, Michigan

We have audited the accompanying balance sheets of ***Caraco Pharmaceutical Laboratories, Ltd.*** (a Michigan corporation) (a subsidiary of Sun Pharmaceutical Industries Limited) (the Corporation) as of March 31, 2006 and 2005 and the related statements of operations, stockholders equity (deficit) and cash flows for the year ended March 31, 2006, the three months ended March 31, 2005 and for each of the two years in the period ended December 31, 2004. These financial statements are the responsibility of the Corporation s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the *Public Company Accounting Oversight Board (United States)*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Caraco Pharmaceutical Laboratories, Ltd. as of March 31, 2006 and 2005, and the results of its operations and its cash flows for the year ended March 31, 2006, the three months ended March 31, 2005, and for each of the two years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the *Public Company Accounting Oversight Board (United States)*, the effectiveness of the Corporation s internal control over financial reporting as of March 31, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 7, 2006 expressed an unqualified opinion on management s assessment of the effectiveness of the Corporation s internal control over financial reporting and an unqualified opinion on the effectiveness of the Corporation s internal control over financial reporting.

/s/ Rehmann Robson

Troy, Michigan
May 7, 2006

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

BALANCE SHEETS

ASSETS

	March 31	
	2006	2005
Current assets		
Cash and cash equivalents	$ 11,924,245	$ 6,627,425
Accounts receivable, net	20,859,099	6,736,778
Inventories	26,965,690	18,467,693
Prepaid expenses and deposits	2,532,561	1,105,618
Total current assets	**62,281,595**	**32,937,514**
Property, plant and equipment		
Land	197,305	197,305
Buildings and improvements	10,790,703	9,605,888
Equipment	12,040,688	9,701,979
Furniture and fixtures	681,705	589,329
Total	23,710,401	20,094,501
Less accumulated depreciation	8,749,997	7,197,422
Net property, plant and equipment	**14,960,404**	**12,897,079**
Total assets	**$ 77,241,999**	**$ 45,834,593**

The accompanying notes are an integral part of these financial statements.

LIABILITIES AND STOCKHOLDERS EQUITY

	March 31	
	2006	**2005**
Current liabilities		
Accounts payable, trade	$ 3,696,265	$ 2,577,668
Accounts payable, Sun Pharma	14,678,085	9,639,890
Accrued expenses	2,489,398	1,931,442
Total liabilities (all current)	**20,863,748**	**14,149,000**
Commitments and contingencies (Notes 9, 11 and 12)		
Stockholders equity (Note 7)		
Series B convertible preferred stock, no par value; issued and outstanding 10,880,000 shares (March 31, 2006) 5,984,000 shares (March 31, 2005)	72,755,770	37,700,410
Common stock, no par value; authorized 30,000,000 shares, issued and outstanding 26,421,994 shares (March 31, 2006) 26,360,294 shares (March 31, 2005)	44,988,597	44,927,987
Additional paid-in capital	2,718,735	2,718,735
Accumulated deficit	(64,084,851)	(53,661,539)
Total stockholders equity	**56,378,251**	**31,685,593**
Total liabilities and stockholders equity	**$ 77,241,999**	**$ 45,834,593**

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

STATEMENTS OF OPERATIONS

	Year Ended March 31, 2006	Three Months Ended March 31, 2005	Year Ended December 31 2004	Year Ended December 31 2003
Net sales	$ 82,788,918	$ 17,336,500	$ 60,340,309	$ 45,498,400
Cost of goods sold (Notes 1 and 4)	41,872,834	7,879,425	24,441,569	19,507,406
Gross profit	**40,916,084**	**9,457,075**	**35,898,740**	**25,990,994**
Selling, general and administrative expenses	8,182,718	1,879,480	5,276,755	7,363,341
Research and development costs - affiliate (Note 7)	35,055,360	10,200,000	24,397,040	3,103,370
Research and development costs - other	8,437,338	1,719,865	6,053,334	3,112,294
Operating (loss) income	**(10,759,332)**	**(4,342,270)**	**171,611**	**12,411,989**
Other income (expense)				
Interest income	233,385	16,385	40,316	9,102
Interest expense	(3,740)		(407,330)	(1,233,531)
(Loss) gain on sale of equipment			(10,636)	25,531
Other income	106,375	4,172	6,671	9,627
Other income (expense) - net	**336,020**	**20,557**	**(370,979)**	**(1,189,271)**
Net (loss) income	**$ (10,423,312)**	**$ (4,321,713)**	**$ (199,368)**	**$ 11,222,718**
Net (loss) income per share				
Basic	$ (0.39)	$ (0.16)	$ (0.01)	$ 0.46
Diluted	$ (0.39)	$ (0.16)	$ (0.01)	$ 0.44

The accompanying notes are an integral part of these financial statements.

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

	Preferred Stock		Common Stock					
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Preferred Stock Dividends	Accumulated Deficit	Total
Balances at January 1, 2003		$	23,762,532	$ 40,457,028	$ 282,858	$ (350,380)	$ (60,012,796)	$ (19,623,290)
Payment of preferred stock dividends						350,380	(350,380)	
Issuance of common stock to directors in lieu of cash compensation			31,000	112,310				112,310
Common stock options exercised			784,296	872,973	2,435,877			3,308,850
Net income							11,222,718	11,222,718
Balances at December 31, 2003			24,577,828	41,442,311	2,718,735		(49,140,458)	(4,979,412)
Issuance of preferred stock to affiliate in exchange for product technology transfers	4,352,000	27,500,410						27,500,410
Common stock options exercised			1,756,866	3,453,946				3,453,946
Net loss							(199,368)	(199,368)
Balances at December 31, 2004	4,352,000	27,500,410	26,334,694	44,896,257	2,718,735		(49,339,826)	25,775,576
Issuance of preferred stock to affiliate in exchange for product technology transfers	1,632,000	10,200,000						10,200,000
Common stock options exercised			25,600	31,730				31,730
Net loss							(4,321,713)	(4,321,713)
Balances at March 31, 2005	**5,984,000**	**37,700,410**	**26,360,294**	**44,927,987**	**2,718,735**		**(53,661,539)**	**31,685,593**
Issuance of preferred stock to affiliate in exchange for product technology transfers	4,896,000	35,055,360						35,055,360
Common stock options exercised			61,700	60,610				60,610
Net loss							(10,423,312)	(10,423,312)

Balances at March 31, 2006	**10,880,000**	**$ 72,755,770**	**26,421,994**	**$ 44,988,597**	**$ 2,718,735**		**$ (64,084,851)**	**$ 56,378,251**

The accompanying notes are an integral part of these financial statements.

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

STATEMENTS OF CASH FLOWS

	Year Ended March 31, 2006	Three Months Ended March 31, 2005	Year Ended December 31 2004	Year Ended December 31 2003
Cash flows from operating activities				
Net (loss) income	$ (10,423,312)	$ (4,321,713)	$ (199,368)	$ 11,222,718
Adjustments to reconcile net (loss) income to net cash provided by operating activities				
Depreciation	1,552,578	306,626	932,419	683,339
Capital stock issued or to be issued to affiliate in exchange for product formula	35,055,360	10,200,000	24,397,040	3,103,370
Common shares issued in lieu of compensation				112,310
Loss (gain) on sale of property, plant and equipment			10,636	(25,531)
Variable compensation expense for stock options extended to director and officer				2,435,877
Changes in operating assets and liabilities which provided (used) cash				
Accounts receivable	(14,122,321)	(2,133,911)	(64,393)	945,662
Inventories	(8,497,997)	(1,333,882)	(7,523,001)	(3,994,848)
Prepaid expenses and deposits	(1,426,943)	(441,807)	(140,430)	(90,716)
Accounts payable	6,156,792	2,300,793	4,690,789	1,243,139
Accrued expenses	557,954	220,793	(64,548)	(126,829)
Net cash provided by operating activities	**8,852,111**	**4,796,899**	**22,039,144**	**15,508,491**
Cash flows from investing activities				
Purchases of property, plant and equipment	(3,615,901)	(657,673)	(3,982,413)	(2,493,173)
Proceeds from sale of property, plant and equipment				76,200
Net cash used in investing activities	**(3,615,901)**	**(657,673)**	**(3,982,413)**	**(2,416,973)**
Cash flows from financing activities				
Proceeds from loans payable to financial institutions	1,500,000		10,000,000	1,600,000
Repayments of loans payable to financial institutions	(1,500,000)		(26,875,000)	(625,000)
Payment of preferred stock dividends				(350,380)
Net repayments of subordinated stockholder notes				(9,700,000)
Repayments of EDC loan			(6,385,490)	(1,217,057)
Proceeds from issuance of common stock	60,610	31,730	3,453,946	872,973
Net cash provided by (used in) financing activities	**60,610**	**31,730**	**(19,806,544)**	**(9,419,464)**
Net increase (decrease) in cash and cash equivalents	**5,296,820**	**4,170,956**	**(1,749,813)**	**3,672,054**
Cash and cash equivalents, beginning of year	6,627,425	2,456,469	4,206,282	534,228

Cash and cash equivalents, end of year	**$ 11,924,245**	**$ 6,627,425**	**$ 2,456,469**	**$ 4,206,282**

The accompanying notes are an integral part of these financial statements.

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

NOTES TO FINANCIAL STATEMENTS

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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Business

Caraco Pharmaceutical Laboratories, Ltd. (Caraco or the Corporation), based in Detroit, Michigan, develops, manufactures and markets generic, prescription and over-the-counter pharmaceuticals in the United States. The process of developing a line of proprietary drugs requires approvals by the Food and Drug Administration (FDA) of Abbreviated New Drug Applications (ANDA). The Corporation s present product portfolio consists of a number of products in various strengths and package sizes. The Corporation s drugs relate to a variety of therapeutic segments including the central nervous system, cardiology, pain management and diabetes.

The Corporation s manufacturing facility and executive offices were constructed in 1991, pursuant to a $9.1 million loan from the Economic Development Corporation of the City of Detroit (the EDC). Since August 1997, capital infusions and loans have primarily come from Sun Pharmaceutical Industries Limited, a specialty pharmaceutical corporation organized under the laws of India (Sun Pharma). Among other things, Sun Pharma has acted as a guarantor on loans to Caraco, has supplied the Corporation with raw materials for certain products, assisted in obtaining machinery and equipment to enhance production capacities at competitive prices, and has transferred certain generic products. As of June 3, 2006, Sun Pharma beneficially owns approximately 64% (75% including its convertible Series B Preferred stock) of the outstanding common shares of Caraco.

Sun Pharmaceutical Industries Limited

Pursuant to a stock purchase agreement, a Mumbai, India based specialty pharmaceutical manufacturing company, Sun Pharmaceutical Industries Limited (Sun Pharma) made an initial investment of $7.5 million for the purchase of 5.3 million common shares of Caraco in 1997.

Sun Pharma and its affiliates have loaned the Corporation approximately $10 million since August 1997. As of December 31, 2003, all such loans had been repaid. Sun Pharma has also assisted the Corporation, by acting as guarantor, in a obtaining line of credit loans from ICICI Bank Limited, The Bank of Nova Scotia and Citibank FSB in the amounts of $5.0 million, $12.5 million and $10.0 million, respectively, all of which have been repaid and terminated as of December 31, 2004.

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

NOTES TO FINANCIAL STATEMENTS

In August 1997, Caraco entered into an agreement, whereby Sun Pharma was required to transfer the technology formula for 25 generic pharmaceutical products over a five-year period through August 2003 in exchange for 544,000 shares of Caraco common stock for each technology transfer of an ANDA product (when bio-equivalency studies were successfully completed) and 181,333 shares for each technology transfer of a DESI (Drug Efficacy Study Implementation) product. The products provided to the Corporation from Sun Pharma were selected by mutual agreement. Under such agreement, Caraco conducted, at its own expense, all tests including bio-equivalency studies. Pursuant to such agreement through 2002, Sun Pharma delivered the technology formula for 13 products. This agreement expired on November 21, 2002, and the Corporation entered into a new technology transfer agreement with Sun Global, Inc. (Sun Global), an affiliate of Sun Pharma.

Under the agreement, which was approved by the Corporation s independent directors, Sun Global agreed to provide the formulations for 25 new generic drugs over a five-year period. Caraco s rights to the products are limited to the United States and its territories or possessions, including Puerto Rico. Sun Global retains rights to the products in all other territories. The products are selected by mutual agreement. Under this agreement, Caraco conducts at its own expense all tests, including bio-equivalency studies. The Corporation also markets the products consistent with its customary practices and provides marketing personnel. In return for the technology transfer, Sun Global receives 544,000 shares of Series B Preferred Stock for each generic drug transferred when such drug has passed its bio-equivalency studies.

The products agreement was amended by the Independent Committee, comprised of the three independent directors, in the first quarter of 2004 to eliminate the provision requiring that the Independent Committee concur in the selection of each product, and provides instead that each product satisfy certain objective criteria developed by management and approved by the Independent Committee. Pursuant to such objective criteria, all 25 of the products under this agreement have been selected, 20 of which passed bio-equivalency studies through March 31, 2006.

Sun Pharma has established Research and Development Centers in Mumbai and Vadodara in India, where the development work for products is performed.

Sun Pharma and its subsidiaries supply the Corporation with certain raw materials (Note 4) and formulations, assist in acquiring machinery and equipment to enhance production capacities, and provide qualified technical professionals who work as Caraco employees.

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

NOTES TO FINANCIAL STATEMENTS

Also, four of the nine directors of Caraco are, or were, affiliated with Sun Pharma. Further, Sun Pharma and its affiliates may use Caraco as a contract manufacturer and/or distributor of their products. In December 2004, Caraco entered into an agreement for two such products.

During the three month period ended March 31, 2005 SPARC Bioresearch Private Limited (SPARC), an affiliate of Sun Pharma, performed certain analytical studies required as part of the bio-equivalency process for two products. The Corporation incurred approximately $172,000 of costs during this period for the studies performed by SPARC. No similar studies were performed by SPARC during the years ended March 31, 2006, December 31, 2004 or 2003.

While management has a basis to reasonably believe that Sun Pharma s substantial investment in Caraco provides Sun Pharma with sufficient economic incentive to continue to assist Caraco in developing its business, and Sun Pharma has expressed its intent to continue to support Caraco s operations in the near term, as it has done in the past, there can be no assurance that such support will, in fact, continue.

During the first quarter of 2004, Sun Pharma acquired 3,452,291 additional shares of common stock and 1,679,066 stock options from two former directors and a significant shareholder. Sun Pharma exercised these stock options during the fourth quarter of 2004, thereby increasing its beneficial ownership to 64%.

In addition to its substantial relationship with and dependence on Sun Pharma as described above, the Corporation is subject to certain risks associated with companies in the generic pharmaceutical industry. Profitable operations are dependent on the Corporation s ability to market its products at reasonable profit margins. In addition to maintaining profitable operations, the ongoing success of the Corporation will depend, in part, on its continuing ability to attract and retain key employees, obtain timely approvals of its ANDAs, and develop new products (see Operations , below).

Operations

The Corporation recorded net sales of $82.8 million during for the year ended March 31, 2006 (Fiscal 2006) and generated cash from operations of $8.9 million during Fiscal 2006. This cash was generated after funding working capital requirements of $17.5 million. The Corporation incurred a net loss of $10.4 million during Fiscal 2006. The loss was primarily due to non-cash research and development expense (R&D) of $35.1 million recorded during Fiscal 2006. This non-cash R&D expense relates to nine

CARACO PHARMACEUTICAL LABORATORIES, LTD.
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NOTES TO FINANCIAL STATEMENTS

products passing their bio-equivalency studies and the related value of the preferred stock issued to Sun Global during this period. At March 31, 2006, the Corporation had stockholders equity of $56.4 million.

Management s plans for fiscal 2007 include:

Continued focus on FDA compliance.

Increased pace of research and development activities, with a view to maximize ANDA filings.

Continuing to invest in equipment and facilities to expand capacity to meet requirements of projected growth in the near term.

Increased market share for certain existing products and recently introduced new products and enhanced customer reach and satisfaction.

Prompt introduction of newly approved products to the market.

Achieving further operational efficiencies by attaining economies of scale and cost reduction per unit.

Increase the number of products, as well as anticipated volume increases for existing products that, in turn, will improve manufacturing capacity utilization.

Expanding relationships with financial institutions to fortify the Corporation s credit position and borrowings as necessary.

Considering alternative ways of increasing cash, such as through marketing ANDAs owned by Sun Pharma

Research alternative product development sources and product licenses such as in licensing authorized generics from brand innovator companies and acquisitions of ANDAs from competitor manufacturers both domestic and abroad.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates include, but are not limited to, provisions for estimated

CARACO PHARMACEUTICAL LABORATORIES, LTD.
(a subsidiary of Sun Pharmaceutical Industries Limited)

NOTES TO FINANCIAL STATEMENTS

customer returns, discounts, rebates and other price adjustments, including customer chargebacks (see Revenue Recognition , below), valuation allowances for deferred tax assets, and valuation of overhead components in inventory.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits in banks, cash on hand and all highly liquid investments purchased with an original maturity of three months or less. The Corporation invests its excess cash primarily in deposits with major banks and in other high quality short-term liquid money market investments. During the normal course of business, the Corporation may maintain cash on deposit in excess of federally insured limits with financial institutions. The Corporation maintains a policy of making investments only with institutions with at least an investment grade credit rating.

Revenue Recognition

Revenue from product sales, net of estimated provisions, is recognized when there is persuasive evidence that an arrangement exists, shipment of the goods has occurred, the selling price is fixed or determinable, and collectibility is reasonably probable. The Corporation s customers consist primarily of large pharmaceutical wholesalers who sell directly into the retail channel. Provisions for sales discounts, and estimates for chargebacks, rebates, and product returns are established as a reduction of product sales revenue at the time revenues are recognized, based on historical experience and current market trends adjusted to reflect known changes in the factors that impact these reserves. These revenue reductions are reflected as a direct reduction to accounts receivable through an allowance.

Allowances for Sales Adjustments

Chargebacks

Chargebacks represent the Corporation s most significant provision against gross accounts receivable and related reduction to gross revenue. Chargebacks are credits given to wholesale customers for the price difference on the products they sell (at a contractual price) to retail, chain stores, and managed care organizations at prices lower than the Corporation sells to the wholesale customer. The Corporation records an estimate at the end of the reporting period to the wholesaler of the amount to be charged back to them, over and above those already received by the Corporation. Such estimated amounts, in addition to certain other deductions, are deducted from the Corporation s gross sales to

CARACO PHARMACEUTICAL LABORATORIES, LTD.
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NOTES TO FINANCIAL STATEMENTS

determine their net revenues. The Corporation records provisions for chargebacks based upon various factors, including current contract prices, historical trends, and their future expectations. The amount of actual chargebacks claimed could be either higher or lower than the amounts accrued. Changes in these estimates, if any, are recorded in the income statement in the period of the change. If the Corporation has over or under estimated the amount that will ultimately be charged back to them by their wholesale customers, there could be a material impact on the Corporation s financial statements.

The Corporation considers the following factors in the determination of the estimates of chargebacks:

1. Historical data of chargebacks as a percentage of sales, as well as the various chargeback reports that are received from the wholesale customers.

2. Volume of product sold to wholesalers and the average chargeback rates, on a quarterly and annualized basis are applied to current period and annual product sales.

3. The sales trends for future estimated prices, wholesale acquisition cost (WAC), the contract prices with the retailers, chain stores and managed care organizations (end-users). The Corporation s prices with the wholesalers and end users are contracted prices.

Approximately 88% and 94% of the total allowance for trade receivables at March 31, 2006 and 2005, respectively has been established to provide for estimated chargebacks (see Note 3).

Shelf Stock Adjustments

Shelf stock adjustments are credits issued to customers to reflect decreases in the selling prices of products. These credits are customary in the industry and are intended to reduce the customers inventory cost to better reflect current market prices. The determination to grant a shelf stock adjustment to a customer following a price decrease is at the Corporation s discretion.

Factors considered when recording a reserve for shelf stock adjustments include estimated launch dates of competing products based on market intelligence, estimated decline in market price of products based on historical experience and input from customers, and levels of inventory held by customers at the date of the pricing adjustments.

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Product Returns and Other Allowances

In the pharmaceutical industry, customers are normally granted the right to return product for credit if the product has not been used prior to its expiration date. The Corporation s return policy typically allows product returns for products within a 12-month window from six months prior to the expiration date and up to six months after the expiration date. The Corporation estimates the level of sales, which will ultimately be returned pursuant to its return policy, and records a related reserve at the time of sale. These amounts are deducted from its gross sales to determine net revenues. These estimates take into consideration historical returns of our products and the Corporation s future expectations. The Corporation periodically reviews the reserves established for returns and adjusts them based on actual experience, as necessary. The primary factors considered in estimating its potential product returns include shelf life of expiration date of each product and historical levels of expired product returns. If the Corporation becomes aware of any returns due to product related issues, this information is used to estimate an additional reserve. The amount of actual product return could be either higher or lower than the amounts reserved. Changes in these estimates, if any, would be recorded in the income statement in the period of the change. If the Corporation over or under estimates the quantity of product that will ultimately be returned, there may be a material impact to its financial statements.

Discounts (trade and prompt payment discounts) are reserved for at the end of every reporting period based on the gross sales made to the customers during the period and based on their terms of trade. The Corporation reviews its contracts with its customers in addition to historical data and percentages to estimate the reserve for estimated discounts.

Customer rebates are estimated at the end of every reporting period, based on direct or indirect purchases. If the purchases are direct, the rebates are recognized when products are purchased and a periodic credit is given. For indirect purchases, the rebates are recognized based on the terms with such customer. Medicaid Rebates are estimated based on the historical data the Corporation receives from the public sector benefit providers, which is based on the final dispensing of our products by a pharmacy to a benefit plan participant.

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Doubtful Accounts

Doubtful accounts are estimated based on the data available from external sources, including information obtained related to the financial condition of customers. Delinquent accounts are reviewed by management on a quarterly basis, to identify and record allowances, as considered necessary, for accounts receivable not expected to be recoverable.

Accounts Receivable

The Corporation sells its products using customary trade terms; the resulting accounts receivable are unsecured. Accounts receivable are stated at the amount management expects to collect from outstanding balances. The Corporation provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on management s assessment of the current status of individual accounts. Balances that are still outstanding after the Corporation has attempted reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable.

Inventories

Inventories, which consist principally of raw materials, goods in transit and finished goods, as well as work-in-process, are stated at the lower of cost, determined using the specific identification method, or market. The Corporation analyzes its inventory levels quarterly and writes down any inventory that has become obsolete and inventory that has a cost basis in excess of its expected net realizable value. Expired inventory is disposed of and the related costs are written off. Materials acquired for research and development on products yet to be launched are written off in the year of acquisition. The determination of whether or not inventory costs will be realizable requires estimates by management. A critical estimate in this determination is the estimate of the future expected inventory requirements, whereby the Corporation compares its internal sales forecasts to inventory on hand. Actual results may differ from those estimates and inventory write-offs may be required. The Corporation must also make estimates about the amount of manufacturing overhead to allocate to its finished goods and work in process inventories. Although the manufacturing process is generally similar for its products, the Corporation must make judgments as to the portion of costs to allocate to purchased product, work in process and finished goods, and such allocations can vary based upon the composition of these components and the fact that each product produced does not necessarily require the same amount of time or effort for the same production

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step. Accordingly, the assumptions made can impact the value of reported inventories and cost of sales.

Net (Loss) Income Per Share

Net (loss) income per share is computed using the weighted average number of common shares outstanding during each period and considers a dual presentation and reconciliation of basic and diluted per share amounts. Diluted reflects the potential dilution of all common stock equivalents.

At March 31, 2006 and 2005 and at December 31, 2004 options to purchase 341,400, 357,000 and 381,600 shares respectively, 10,880,000, 5,984,000 and 4,352,000 shares of convertible preferred stock, respectively and 45,000 shares of common stock granted to the Corporation s Chief Executive Officer during 2006 (Note 7) were excluded from the computation of earnings per share because they would have an antidilutive effect on net loss per share.

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

	Year Ended March 31	Three Months Ended March 31	Year Ended December 31	
	2006	2005	2004	2003
Numerator:				
Net (loss) income available for common stockholders	$ (10,423,312)	$ (4,321,713)	$ (199,368)	$ 11,222,718
Denominator:				
Weighted average shares outstanding, basic	26,392,054	26,348,347	24,734,282	24,137,108
Incremental shares from assumed conversion of common stock options				1,344,851
Weighted average shares outstanding, diluted	26,392,054	26,348,347	24,734,282	25,481,959
Net (loss) income per common share				
Basic	$ (0.39)	$ (0.16)	$ (0.01)	$ .46
Diluted	$ (0.39)	$ (0.16)	$ (0.01)	$ .44

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Property, Plant and Equipment and Depreciation

Property, plant and equipment is carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements and renewals are capitalized while ordinary maintenance and repairs are expensed. Management annually reviews these assets for impairment and reasonably believes the carrying value of these assets will be recovered through cash flows from operations.

Federal Income Taxes

Deferred income tax assets and liabilities are determined based on the difference between the financial statement and federal income tax basis of assets and liabilities as measured by the estimated tax rates that will be in effect when these differences reverse. The principal difference between assets and liabilities for financial statement and federal income tax return purposes is attributable to accounts receivable allowances and the anticipated utilization of tax net operating losses.

Research and Development Costs

Series B convertible preferred stock (Note 7) is issued on an ongoing basis to Sun Pharma and its affiliates under the Products Agreement between the Corporation and Sun Global in exchange for the formulations of technology products delivered by Sun Global to the Corporation. The resulting amount of research and development expense is charged to operations and is determined based on the fair value of the preferred shares on the date the respective product formula passes its bio-equivalency studies. The fair value of such shares is based upon an independent valuation.

Research and development costs settled in cash are charged to expense as incurred.

Common Stock Issued to Directors

Common stock was issued from time to time in lieu of cash for directors fees, and was recorded as compensation expense at the fair values of such shares on the dates they were earned. Subsequent to December 31, 2003, directors fees are paid in cash. Also, since December 31, 2003, independent directors are granted stock options upon completion of their anniversary of serving on the board of directors.

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Fair Values of Financial Instruments

The carrying values of cash equivalents, accounts receivable, and accounts payable approximate their fair values due to the short-term maturities of these financial instruments.

Recent Accounting Pronouncements

In July 2005, the *Financial Accounting Standards Board* (FASB) published an Exposure Draft of a proposed Interpretation, Accounting for Uncertain Tax Positions. The Exposure Draft seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. It would apply to all tax positions accounted for in accordance with *Statement of Financial Accounting Standards* (SFAS) 109, Accounting for Income Taxes. The Exposure Draft requires that a tax position meet a probable recognition threshold for the benefit of the uncertain tax position to be recognized in the financial statements. This threshold is to be met assuming that the tax authorities will examine the uncertain tax position. The Exposure Draft contains guidance with respect to the measurement of the benefit that is recognized for an uncertain tax position, when that benefit should be derecognized, and other matters. This proposed Interpretation would clarify the accounting for uncertain tax positions in accordance with SFAS 109. This Interpretation, once approved, is expected to be effective as of the end of the fiscal year ending after December 15, 2005. The Corporation does not expect that the exposure draft will have a significant impact on its operating results.

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections, which replaces APB Opinion No. 20, Accounting Changes, and supersedes FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements an amendment of APB Opinion No. 28. SFAS 154 requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, SFAS 154 requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, SFAS 154 requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. SFAS 154 shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Corporation does not expect that the provisions of the SFAS 154 will have a significant impact on its operating results.

The FASB has proposed amending SFAS 128, Earnings per Share, to make it consistent with International Accounting Standard 33, Earnings per Share , and make earning per share, or EPS, computations comparable on a global basis. Under the proposed amendment, the year-to-date EPS computation would be performed independently from the quarterly computations. Additionally, for all contracts that may be settled in either cash or shares of stock, companies must assume that settlement will occur by the issuance of shares for purposes of computing diluted EPS, even if they intend to settle by paying cash or have a history of cash-only settlements, regardless of who controls the means of settlement. Lastly, under the proposed amendment, shares that will be issued upon conversion of a mandatory convertible security must be included in the weighted-average number of shares outstanding used in computing basic EPS from the date that conversion becomes mandatory, using the if-converted method, regardless of whether the result is anti-dilutive. The proposed amended standard was expected to be issued during the first quarter of 2005. However, the FASB has not yet finalized the revised effective date of the proposed amendment or its transition provisions. Retrospective application in all periods presented would be required and could require the restatement of previously reported EPS. The Corporation does not expect that the provisions of the amended SFAS 128 will have a significant impact on its operating results.

In December 2004, the FASB issued SFAS 123R (revised 2004), Share-Based Payment, (SFAS 123R). SFAS 123R addresses the accounting for share-based payments to employees, including grants of employee stock options. Under the new standard, Caraco will no longer be able to account for share-based compensation transactions using the intrinsic method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees. Instead, Caraco will be required to account for such transactions using a fair-value method and recognize the expense in the statement of operations. On April 14, 2005, the Securities and Exchange Commission announced the adoption of a new rule that amends the compliance dates for SFAS 123 (R). The new rule allows companies to implement SFAS 123 (R) at the beginning of their next fiscal year, instead of their next reporting period beginning after June 15, 2005. The Corporation plans to adopt the new statement beginning in the first quarter of fiscal 2007. The Corporation expects that the adoption of SFAS 123R will not have a significant impact on its results of operations, nor does it expect that the adoption of SFAS 123R will impact its overall financial position.

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However, the calculation of compensation cost for share-based payment transactions after the effective date of SFAS 123R may be different from the calculation of compensation cost under SFAS 123, but such differences have not yet been quantified.

In December 2004, the FASB issued SFAS 153 Exchanges of Nonmonetary Assets, and Amendment of APB Opinion No. 29. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in APB Opinion No. 29, however, included certain exceptions to the principle. SFAS 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for nonmonetary asset exchanges in fiscal periods beginning after June 15, 2005. The Corporation does not believe that the adoption of SFAS 153 will have a material impact on its results of operations or financial position.

2. SUPPLEMENTAL CASH FLOWS INFORMATION

Non-Cash Financing Activities

As described in Notes 1 and 7, pursuant to the technology transfer agreement with an affiliate of the Corporation s parent, Caraco, on an ongoing basis, finances the acquisition of research and development costs in exchange for the issuance of preferred stock to its parent. Preferred stock earned or issued to affiliates had fair values of $35,055,360 for the year ended March 31, 2006, $10,200,000 for the three month period ended March 31, 2005, and $24,397,040 and $3,103,370 for the years ended December 31, 2004 and 2003, respectively.

Other Cash Flows Information

Cash paid for interest was approximately $4,000, $407,000 and $1,783,000 for the years ended March 31, 2006, December 31, 2004 and 2003, respectively. No cash was paid for interest for the three month period ended March 31, 2005.

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3. ACCOUNTS RECEIVABLE, NET OF ALLOWANCES FOR SALES ADJUSTMENTS AND DOUBTFUL ACCOUNTS (NOTE 1)

Accounts receivable and related allowances are summarized as follows:

	March 31	
	2006	2005
Accounts receivable - gross	$ 33,926,099	$ 27,766,778
Allowances:		
Chargebacks	11,467,000	19,810,000
Sales returns and allowances	1,500,000	1,120,000
Doubtful accounts	100,000	100,000
Total allowances	13,067,000	21,148,000
Accounts receivable, net of allowances	$ 20,859,099	$ 6,736,778

A summary of the activity in accounts receivable allowances is as follows:

	Total Allowances
Balance at December 31, 2002	**$ 9,305,000**
Additions charged to net sales	56,515,000
Deductions allowed to customers	(49,777,000)
Balance at December 31, 2003	**16,043,000**
Additions charged to net sales	67,670,000
Deductions allowed to customers	(65,578,000)
Balance at December 31, 2004	**18,135,000**
Additions charged to net sales	21,712,000
Deductions allowed to customers	(18,817,000)
Balance at March 31, 2005	**21,130,000**
Additions charged to net sales	118,996,000
Deductions allowed to customers	(126,959,000)

Balance at March 31, 2006	**$**	**13,067,000**

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4. INVENTORIES

Inventories consist of the following amounts:

	March 31	
	2006	2005
Raw materials	$ 9,735,502	$ 5,504,006
Goods in transit	5,974,600	3,700,651
Work in process	3,283,911	2,607,903
Finished goods	7,971,677	6,655,133
Total inventories	$ 26,965,690	$ 18,467,693

The principal components used in the Corporation s business are active and inactive pharmaceutical ingredients and certain packaging materials. Some of these components are purchased from single sources, however, the majority of the components have an alternate source of supply. Because the FDA approval process requires manufacturers to specify their proposed supplier of components in their applications, FDA approval of a new supplier would be required if components were no longer available from the specified suppliers.

During the year ended March 31, 2006, the three months ended March 31, 2005, and during the years ended December 31, 2004 and 2003, the Corporation purchased inventory components of approximately $28.1 million, $5.3 million, $16.7 million and $10.3 million, respectively, from Sun Pharma.

5. DEBT

EDC Loan

During 2004, the Corporation repaid the entire amount due to the EDC under the Development and Loan Agreement dated August 10, 1990.

Loans Payable to Financial Institutions

During 2004, the Corporation obtained a $10,000,000 line-of-credit with Citibank, N.A., that incurred interest at the London Interbank Offered Rate (LIBOR) plus 125 basis points. Borrowings on the line-of-credit were available to Caraco only when secured by an irrevocable standby letter-of-credit from Sun Pharma. Such a letter was provided by

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Sun Pharma during 2004. The letter had expired as of December 31, 2004, and was terminated on March 15, 2005.

On November 17, 2005, the Corporation entered into a one-year, $10 million Credit Agreement with JP Morgan Chase Bank, N.A. Under the Credit Agreement, the lender may make loans and issue letters of credit to the Corporation for the Corporation s working capital needs and general corporate purposes. Letters of credit, if issued, expire one year from their date of issuance, but no later than November 17, 2007. Borrowings are secured by the Corporation s receivables and inventory. Interest is payable based on a LIBOR Rate or an alternate base rate (determined by reference to the prime rate or the federal funds effective rate), as selected by the Corporation. The rate of interest is LIBOR plus 75 basis points or the bank s prime rate minus 100 basis points (effective rates of 6.0% and 6.75%, respectively at March 31, 2006.) The Credit Agreement requires that certain financial covenants be met on a quarterly basis. The Corporation is in compliance with these financial covenants at March 31, 2006. There are no borrowings under this Credit Agreement at March 31, 2006.

6. INCOME TAXES

The Corporation s deferred income taxes result principally from its net operating loss carryforwards. At March 31, 2006 a net deferred income tax asset of approximately $20.1 million (computed using a 34% tax rate) relating to these temporary differences exists. Based on the Corporation s prior operating results and operating characteristics, utilization of this deferred tax asset to offset future taxable income is not reasonably assured. Accordingly, Caraco has recorded a valuation allowance to fully offset the net deferred tax asset, resulting in no net deferred tax asset or liability in the accompanying balance sheets. The valuation allowance increased by approximately $3.7 million for the year ended March 31, 2006, $2.0 million for the three month period ended March 31, 2005, $0.4 million in 2004, and decreased by approximately $4.1 million in 2003.

At March 31, 2006, net operating loss carryforwards of approximately $58.8 million, which expire between 2007 and 2017, are available to offset future federal taxable income, if any. Sun Pharma has, over time, increased its ownership of the Corporation s capital stock. Under rules established by the Internal Revenue Code, this change in ownership may adversely affect how the Corporation is able to utilize these net operating loss carryforwards in future years.

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7. STOCKHOLDERS EQUITY (DEFICIT)

Common Stock

During 2003, the Corporation s shareholders approved the authorization of an additional 20,000,000 shares of common stock. The Corporation has not yet filed an amendment to its articles of incorporation to effect this change.

The Corporation granted 45,000 shares of common stock on May 2, 2005 to its Chief Executive Officer, which vest at a rate of 15,000 shares on each anniversary date until they are fully vested on May 2, 2008. The Corporation has recorded compensation expense of approximately $109,000 related to the portion of the stock grant that vested during fiscal 2006.

Preferred Stock

Accrued dividends of $0.4 million on Series A preferred shares were paid during 2003, and the holder, then a Corporation director, converted all Series A outstanding shares into an equivalent number of common shares. Accordingly, at March 31, 2006 and 2005, no Series A shares remain designated.

In November 2002, in connection with the new technology transfer agreement established with Sun Global (Note 1), the Corporation designated the Series B Convertible Preferred Stock. The Series B preferred shares are non-redeemable and have no par value. In addition, the Series B Convertible Preferred Stock has no voting or dividend rights or liquidation preference other than priority liquidation based on their values on the dates they were earned, and can be converted after three years from the issuance date (or immediately upon a change in control) into one share of common stock, subject to a conversion adjustment (Note 1). While such preferred shares are outstanding, Caraco cannot, without the consent of the holders of a majority of the outstanding shares of the preferred stock, amend or repeal its articles of incorporation or bylaws if such action would adversely affect the rights of the preferred stock. In addition, without such consent, capital stock having any preference or priority superior to the preferred stock may not be issued. As of March 31, 2006, the Corporation has issued 10,880,000 shares of the Series B Convertible Preferred stock to Sun Pharma in exchange for twenty product transfers. Such shares have been cumulatively valued at $72,755,770 million as of March 31, 2006.

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8. COMMON STOCK OPTIONS

Common Stock Option Plans

As of March 31, 2006, the Corporation maintains one stock option plan, the 1999 Equity Participation Plan (the 1999 Plan) (all options under the 1993 plan were exercised during 2003, under which the Corporation may grant options to employees and non-employee-directors for the purchase of up to 3,000,000 shares of common stock.) The exercise price of options granted may not be less than the fair value of the common stock on the date of grant. Options granted under this plan generally vest in annual installments, from the date of grant, over a five-year period, and expire within six years from the date of the grant. Activity with respect to these options is summarized as follows:

	Year Ended March 31,		Three Months Ended March 31		Year Ended December 31,			
	2006		2005		2004		2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	160,500	1.68	181,600	1.41	277,000	$ 1.00	687,138	$ 1.04
Granted	46,000	8.39	4,500	9.60	9,000	9.60		
Exercised	(61,700)	0.98	(25,600)	1.24	(80,400)	1.08	(410,138)	0.97
Terminated	(3,400)	9.30			(24,000)	0.80		
Outstanding, end of year	141,400	$ 3.93	160,500	$ 1.67	181,600	$ 1.41	277,000	$ 1.00
Options exercisable, end of year	71,720	$ 1.32	79,418	$ 1.50	49,800	$ 1.02	102,500	$ 1.07

Options at March 31, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares	Remaining Contractual Life *	Exercise Price *	Shares	Exercise Price *
$0.68 to $1.00	60,400	1.2	$ 0.78	48,320	$ 0.78
$1.01 to $2.00	25,000	1.7	1.25	20,000	1.25
$7.01 to $8.00	1,500	5.0	7.90	300	7.90
$8.01 to $9.00	47,500	5.2	8.41	300	8.76
$9.01 to $10.00	7,000	3.8	9.55	2,800	9.55

Total	141,400	2.8	$	3.93	71,720	$	1.32

*Weighted average

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Other Common Stock Option Agreements

The Corporation has issued other stock options outside of the 1999 Plan. These stock options have been issued with various vesting schedules and expire at various dates through October 2006. Activity with respect to these options is summarized as follows:

	Year Ended March 31		Three Months Ended March 31		Year Ended December 31			
	2006		2005		2004		2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	200,000	$ 3.50	200,000	$ 3.50	1,876,666	$ 2.01	2,250,824	$ 2.00
Exercised					(1,676,666)	2.01	(374,158)	1.16
Outstanding, end of period	200,000	$ 3.50	200,000	$ 3.50	200,000	$ 3.50	1,876,666	$ 2.01
Options exercisable, end of period	200,000	$ 3.50	200,000	$ 3.50	200,000	$ 3.50	1,876,666	$ 2.01

Options at March 31, 2006:

	Options Outstanding and Exercisable		
Range of Exercise Prices	Shares	Remaining Contractual Life	Exercise Price
$3.01 to $4.00	200,000		$ 3.50

The Corporation follows only the disclosure aspects of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation . Management believes that the fair value and pro-forma disclosures, required by SFAS No. 123, are not material to the financial statements. The Corporation continues to apply Accounting Principles Board (APB) Opinion No. 25 in accounting for its plan and, accordingly, no compensation cost has generally been recognized in the financial statements for its outstanding stock options. Options to purchase 46,000, 4,500 and 9,000 shares of common stock were granted for the year ended March 31, 2006, the three month period ended March 31, 2005 and the year ended December 31, 2004, respectively, to the independent directors of the Corporation. No options were granted during 2003.

In December 2001, the Board of Directors extended the exercise date to December 31, 2005 with respect to options for 224,158 shares of Caraco common stock previously granted to a then independent director. Variable compensation expense of $2.1 million and $0.3 million triggered by the extension was recorded during 2003 and 2002 in recognition of this modification.

On October 2, 2003, the Corporation entered into a severance agreement with its former Chief Executive Officer. The agreement allowed vesting of options for the purchase of 40,000 common shares held by the former officer to be accelerated. The modification resulted in the options being treated as variable rather than fixed in accordance with Financial Accounting Standards Board Interpretation 44 (FIN 44). As a result variable compensation expense of $0.3 million was charged to operations during 2003 for the difference between the fair value of the underlying common stock and the exercise price of the respective options.

The options modified for the independent director and for the former officer were exercised during 2003 resulting in an increase to additional paid in capital of $2.4 million during 2003.

The Corporation granted options to purchase 40,000 shares of common stock on May 2, 2005 to its Chief Executive Officer, which vest at a rate of 15,000 shares on each anniversary date until they are fully vested on May 2, 2008.

Strategic Alliance Stock Options Agreement

Pursuant to an agreement between the Corporation and an unaffiliated large generic pharmaceutical Corporation, dated October 1, 1993, the Corporation was to receive the formulations, technology, manufacturing processes and know-how, and other relevant information, and to pay for the bio-equivalency studies required for the preparation of ANDAs for two products. Pursuant to the agreement, the Corporation was required to pay (i) a Sign-Up Option to purchase 100,000 shares of Common Stock at $3.50 per share; and (ii) a Product Option to purchase shares to an exercise price of $3.50 per share. These options may be exercised and payment for shares may be made only out of royalties and any interest earned on the royalties while held by the Corporation. No options have yet been exercised (Note 12).

9. LEASES (INCLUDING RELATED PARTY)

The Corporation entered into two non-cancelable operating leases during 2000 with Sun Pharma to lease production machinery. The leases each required quarterly rental payments of $4,245 and expired during 2005.

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The Corporation entered into a non-cancelable operating lease with an unrelated party during 2002 to lease additional warehouse space. This lease was subsequently modified during 2003 in lieu of a new non-cancelable operating lease for additional space at this warehouse. The new lease requires monthly payments that increase from $15,458 to $16,892 over the term of the lease that expires in 2007 with an option to renew for an additional year.

Net rental expense on these operating leases was $224,569 for the year ended March 31, 2006, $64,896 for the three months ended March 31, 2005 and $181,129 and $176,065 for the years ended December 31, 2004 and 2003, respectively.

The Corporation entered into a non-cancelable operating lease with an unrelated party on March 13, 2006 to obtain additional space for its administrative staff. The lease commences in May 2006 and requires monthly payments that increase from $8,481 to $9,066 over the term of the lease that expires in 2009.

The following is a schedule of annual future minimum lease payments required under the operating leases with remaining non-cancelable lease terms in excess of one year as of March 31, 2006:

Year	Amount
2007	293,046
2008	104,992
2009	63,171

The Corporation also paid approximately $0.2 million for the year ended March 31, 2006, $0.1 million for the three month period ended March 31, 2005, respectively, and $0.6 million and $0.5 million to Sun Pharma during the years ended December 31, 2004 and 2003, respectively, for the purchase of various parts and machinery needed for operations.

10. RETIREMENT PLAN

The Corporation maintains a deferred compensation plan qualified under Section 401(k) of the Internal Revenue Code. Under this plan, eligible employees are permitted to contribute up to the maximum allowable amount determined by the Internal Revenue Code. The Corporation may make discretionary matching and profit sharing contributions under the provisions of the Plan. The Corporation made no discretionary contributions during the year ended March 31, 2006, the three months ended March 31, 2005, or for the years ended December 31, 2004 or 2003.

11. CONCENTRATIONS AND COMMITMENTS

Major Customers

Shipments to three wholesalers accounted for approximately 77% of gross revenue for the year ended March 31, 2006, 60% of gross revenue for the three months ended March 31, 2005 and 79% and 80% of gross revenue for the years ended December 31, 2004 and 2003, respectively. Balances due from these customers represented approximately 72% and 77% of gross accounts receivable at March 31, 2006 and 2005, respectively.

The loss of these customers could have a materially adverse effect on short-term operating results.

Major Products

Shipments of three products accounted for approximately 80% of gross revenue for the year ended March 31, 2006, 74% of gross revenue for the three months ended March 31, 2005 and 80% of gross revenue for the year ended December 31, 2004, respectively. Shipments of two products accounted from approximately 87% of gross revenue for the year ended December 31, 2003.

Approximately 84% of raw material purchases for the year ended March 31, 2006 and for the three months ended March 31, 2005 were made from Sun Pharma. Approximately 75% and 73% of Caraco s raw material purchases for the years ended December 31, 2004 and 2003, respectively, were made from Sun Pharma.

Product Sales Commitment

Certain of the Corporation s customers purchase its products through designated wholesalers, who act as an intermediary distribution channel for the Corporation s products. One such customer, the Veterans Administration, an agency of the United States Government, entered into a sales contract with the Corporation effective August 5, 2002 to purchase approximately $13,000,000 of product per year over a one year base contract period that ended June 30, 2003. The contract has four one-year option periods,

CARACO PHARMACEUTICAL LABORATORIES, LTD.
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NOTES TO FINANCIAL STATEMENTS

the first three of which were exercised. The agreement may be terminated by the purchaser without cause and in such case, Caraco would only be entitled to a percentage of the contract price, plus reasonable charges that have resulted from the termination. The agreement further provides for certain penalty provisions if the Corporation is unable to meet its sales commitment.

Labor Contract

The majority of the Corporation s hourly work force is covered by a collective bargaining agreement that expires in September 2008.

12. OTHER MATTERS

Employment Contracts

The Corporation has employment agreements with four of its executive officers that provide for fixed annual salaries and at least a six-month continuance including insurance benefits and immediate vesting of stock options upon termination without cause.

Litigation

As previously disclosed, on June 9, 2005, Novo Nordisk A/S and Novo Nordisk, Inc. (Novo Nordisk) filed a complaint in the United States District Court for the Eastern District of Michigan alleging that the Corporation s filling of an ANDA seeking approval to market its generic version of Novo Nordisk s Prandin® drug product infringed Novo Nordisk s patent, which expires June 12, 2018. Novo Nordisk seeks an order from the Court which, among other things, directs the FDA not to approve Caraco s ANDA any earlier than the claimed expiration date. The ANDA filed by Caraco contains a Paragraph IV certification challenging the Novo Nordisk patent. The corporation believes that the Novo Nordisk patent is invalid and/or will not be infringed by Caraco s manufacture, use or sale of the product, and the corporation intends to vigorously defend this action in order to capitalize on the potential 180 days of marketing exclusivity available for this product.

As previously disclosed, on September 22, 2004, Ortho-McNeil Pharmaceutical, Inc. (Ortho-McNeil) filed a complaint in the United States District Court for the Eastern District of Michigan alleging that the Corporation s filing of an ANDA seeking approval to market its generic version of Ortho-McNeil s Ultracet® drug product infringed Ortho-

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McNeil s patent, which expires on September 6, 2011. Ortho-McNeil seeks an order from the Court which, among other things, directs the FDA not to approve Caraco s ANDA any earlier than the claimed expiration date. The ANDA filed by Caraco contained a Paragraph IV Certification challenging the Ortho-McNeil patent. The corporation believes that the Ortho-McNeil patent is invalid and/or will not be infringed by Caraco s manufacture, use or sale of the product, and the corporation intends to vigorously defend this action. Since this action, Ortho-McNeil has entered into a license agreement with another manufacturer and has launched its product generically while another manufacturer has launched its approved generic at risk. On October 8, 2005, arguments were heard in the US District Court in the Eastern District of Michigan, on the Corporation s motion for summary judgment on the issue of non-infringement. On October 19, 2005 the motion for summary judgment was granted in the Corporation s favor. On December 19, 2005, the FDA approved the manufacture, use and sale of the product.Ortho-McNeil has filed an appeal of the finding of non-infringement by the Eastern District of Michigan. Additionally, the United States Patent and Trademark Office has allowed Ortho-McNeil s request for a reissue patent that, if issued, Ortho-McNeil could contend that is product will be infringed by Caraco s now-marketed product. The corporation believe that, like its original patent, Ortho-McNeil s reissue patent will be invalid and unenforceable.

As previously disclosed, on February 12, 2003, C. Arnold Curry filed a complaint in the Wayne County Circuit Court alleging breach of a written employment agreement. Dr. Curry sought 175,000 shares of the Corporation s common stock (35,000 shares for each of the first five ANDAs approved by the FDA). The corporation and the plaintiff each filed a motion for summary disposition. Both parties motions were denied, and the parties submitted the matter to binding arbitration. In connection with the submission to arbitration, the parties agreed that Mr. Curry would receive a minimum of 15,000 shares of common stock. On April 20, 2006, the arbitrator entered a determination of no cause of action against Mr. Curry and in favor of the Corporation, thus capping the Corporation s liability to Mr. Curry at 15,000 shares. The Corporation has recorded an expense of approximately $116,000 related to the 15,000 shares earned by Mr. Curry.

The Corporation is involved in certain legal proceedings from time to time incidental to normal business activities. While the outcome of any such proceedings cannot be accurately predicted, the Corporation does not believe the ultimate resolution of any existing matters would have a material adverse effect on its financial position or results of operations.

Product Liability and Insurance

The Corporation currently maintains general and product liability insurance, with coverage limits of $10 million per incident and in the aggregate. The Corporation also maintains special product liability insurance coverage for one of its products with coverage limits of $1 million per incident and in the aggregate. The Corporation s insurance policies provide coverage on a claim made basis and are subject to annual renewal. Such insurance may not be available in the future on acceptable terms or at all. There can be no assurance that the coverage limits of such policies will be adequate to cover the Corporation s liabilities, should they occur.

Royalty Accrual

Pursuant to the Strategic Alliance Stock Options Agreement (Note 8), Caraco received the formulation for one product, Metoprolol Tartrate, in March 1995. However, Caraco has determined that the formula provided to it with respect to Metoprolol Tartrate is different than the formula submitted in an ANDA to the FDA in 1995, approved by the FDA in 1996 and manufactured and introduced by Caraco since 1997. The Corporation has accrued royalties of approximately $1 million, which is included with accrued expenses in the accompanying balance sheets at March 31, 2006 and 2005, and since April 2003, has discontinued to accrue royalties related to this agreement.

Subsequent Transactions With and Relating to Sun Pharma

On June 1, 2006 Sun Global earned 544,000 shares of Series B preferred stock pursuant to the products transfer agreement for one product transfer (Note 1).

13. SEGMENT INFORMATION

The Corporation does not manufacture, produce or sell branded products or controlled-release products. The Corporation is primarily in the business of manufacturing, developing, selling and distributing various therapeutic classes of solid oral dosage of generic pharmaceuticals. There are no separate management teams or individuals assigned to a product or products or therapeutic classes of products, no separate allocation of funds or resources to distinct products or products or therapeutic classes or products, and the performance of any individual product or products or therapeutic classes of products is not separately assessed. The Corporation revenues are solely based on the receipt of customers orders.

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NOTES TO FINANCIAL STATEMENTS

SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information establishes standards for reporting of financial information about operating segments in annual financial statements. The Corporation considers its business to be a single segment entity, as its revenues are solely attributable to its generic drug product line.

For informational purposes, the Corporation s sales, grouped by therapeutic categories, for the years ended March 31, 2006 and December 31, 2004 and the three months ended March 31, 2005 are as follows:

Therapeutic Category	Year Ended March 31 2006	Three Months Ended March 31 2005	Year Ended December 31 2004
Antianxiety Drug	$ 2,890,213	$ 631,670	$ 2,119,276
Antibiotic	652,055	132,624	549,261
Anticonvulsant	232,669	45,578	204,003
Antidepressant	8,010,744	507,480	957,558
Antidiabetic	32,110,625	7,362,962	30,842,081
Antihypertensive Drug/Beta Blocker	16,788,820	4,178,650	14,257,386
Antipsychotic	2,167,911	484,780	1,293,620
Cardiac	1,239,431	514,139	1,344,603
Decongestants	116,257	316,524	358,059
Hormonal Replacement Therapy		295,172	
Nonsteroidal Antiinflammatory Agent	2,101,804	544,983	1,719,487
Opiate Agonist/Analgesic	14,082,000	1,887,640	5,121,809
Platelet Aggregation Inhibitor	147,856	24,571	80,730
Skeletal Muscle Relaxant	1,150,073	201,673	1,492,437
Vascular and Migraine Headache Suppressant	1,098,460	208,054	
Net Sales	**$ 82,788,918**	**$ 17,336,500**	**$ 60,340,309**

Similar data for the year ended December 31, 2003 has not been presented as it is considered by the Corporation to be impracticable to do so.

* * * * *

EXHIBIT INDEX

3.01	Registrant s Amended and Restated Articles of Incorporation, as amended. (1)
3.02	Certificate of Amendment to the Articles of Incorporation filed February 13, 1997. (2)
3.03	Certificate of Amendment to the Articles of Incorporation filed February 10, 2000. (3)
3.04	Certificate of Determination of Rights, Privileges and Preferences Series B Preferred Stock. (4)
3.05	Registrant s Amended and Restated Bylaws. (5)
10.01	Agreement, dated as of October 1, 1993, among Registrant and Non-Affiliate (6)
10.02	Employment Agreement, dated October 22, 1993, of Robert Kurkiewicz. (6)
10.03	Stock Purchase Agreement by and between Caraco Pharmaceutical Laboratories, Ltd. and Sun Pharmaceutical Industries, Ltd. dated as of April 23, 1997. (7)
10.04	Products Agreement by and between Caraco Pharmaceutical Laboratories, Ltd. and Sun Pharmaceutical Industries, Ltd. dated as of April 23, 1997. (7)
10.05	Registration Rights Agreement dated as April 1997. (7)
10.06	Amendment to Employment Agreement of Robert Kurkiewicz dated as of April 1, 1997. (8)
10.07	1999 Equity Participation Plan. (9)
10.08	Renewal to Employment Agreement of Robert Kurkiewicz dated as of January 1, 1999. (3)
10.09	Third Amendment to Employment Agreement of Robert Kurkiewicz dated August 30, 2002. (3)
10.10	Employment Agreement of Jitendra N. Doshi. (3)
10.11	Agreement between Caraco and Sun Pharma Global, Inc. dated November 21, 2002. (4)
10.12	Sales contract with government vendor. (4)
10.13	Employment Agreement of Mr. Singh (5)
10.14	Employment Agreement of Mr. Movens (10)
10.15	Confidentiality and Non-Competition Agreement of Dan Movens (10)
10.16	Summary of Fiscal 2006 Executive Officer Salaries (11)
10.17	Credit Agreement with JPMorgan Chase Bank, N.A. (12)
10.18	Security Agreement with JPMorgan Chase Bank, N.A. (12)
10.19	Form of Grant of Employee Stock Option (+)
21	Subsidiaries of the Registrant (+)
23.01	Consent of Registered Independent Public Accountants (+)

24.1	Power of Attorney (included on signature page) (+)
31.1	Certificate of Chief Executive Officer (+)
31.2	Certificate of Chief Financial Officer(+)
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (+)

+ Filed herewith

(1) Incorporated by reference from Exhibits to Registrant s Form 10-KSB filed on or about March 30, 1995 as Commission File no. 0-24676.

(2) Incorporated by reference from Exhibits to Registrant s Form 10-KSB filed on or about March 31, 1997, as Commission File No. 0-24676.

(3) Incorporated by reference from Exhibits to Pre-Effective Amendment No. 1 to Form SB-2 filed on September 4, 2002 as Commission File No. 333-91968.

(4) Incorporated by reference from Exhibits to Registrant s Form 10-KSB filed on or about March 31, 2003, Commission File No. 0-24676.

(5) Incorporated by reference from Exhibit to Registrant s Form 10-K filed on or about March 15, 2005, Commission File No. 0-24676.

(6) Incorporated by reference from Exhibits to Registrant s Registration Statement on Form SB-2, as amended, filed on November 5, 1993 as Commission File No. 33-71398C.

(7) Incorporated by reference from Exhibits to Registrant s Form 10-QSB filed on November 14, 1997 as Commission File No. 0-24676.

(8) Incorporated by reference from Exhibits to Registrant s Form 10-KSB filed on or about March 31, 1998, as Commission File No. 0-24676.

(9) Incorporated by reference from Appendix A to Registrant s Proxy Statement dated April 28, 1999 as Commission File No. 0-24676.

(10) Incorporated by reference from Exhibits to Registrant s Form 10-K/A filed on or about May 2, 2005, Commission File No. 0-24676.

(11) Incorporated by reference from Exhibits to Registrant s Form 8-K filed on or about August 25, 2005. Commission File No. 0-24676

(12) Incorporated by reference from Exhibits to Registrant s Form 10-Q filed on or about January 26, 2006. Commission File No. 0-24676