TARO PHARMACEUTICAL INDUSTRIES LTD
Form 20-F
September 22, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___to ___

OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report _____

Commission file number 0-22286

TARO PHARMACEUTICAL INDUSTRIES LTD.
(Exact name of Registrant as specified in its charter)

N/A
(Translation of Registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

14 Hakitor Street, Haifa Bay 26110, Israel
(Address of principal executive offices)

Michael Kalb
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(Name, telephone, email and/or facsimile number and address of Company contact person)

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

None
(Title of Class)

Securities registered or to be registered pursuant to Section 12(g) of the Act:

Ordinary Shares, NIS 0.0001 nominal (par) value per share
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report:

39,195,869 Ordinary Shares, NIS 0.0001 nominal (par) value per share, and 2,600 Founders' Shares NIS 0.00001 nominal (par) value per share were outstanding as of December 31, 2007

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
o Yes þ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
o Yes þ No

Note - checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those sections.

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.
o 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
o Yes o No

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

o Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP þ	International Financial Reporting Standards as issued by the International Accounting Standards Board o	Other ¨

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If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

o Item 17 o Item 18

If this is an anual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes þ No

INTRODUCTION

We, among other things, develop, manufacture and market prescription and over-the-counter ("OTC") pharmaceutical products, primarily in the United States, Canada and Israel. We also develop and manufacture active pharmaceutical ingredients ("APIs"), primarily for use in our finished dosage form products. We were incorporated in 1959 under the laws of the State of Israel. In 1961, we completed the initial public offering of our ordinary shares in the United States. Our ordinary shares are quoted on the Pink Sheets Electronic Quotation Service (the "Pink Sheets"), under the symbol "TAROF."

As used in this Annual Report on Form 20-F for the year ended December 31, 2007 (the "2007 Annual Report"), the terms "we," "us," "our," "Taro" and the "Company" mean Taro Pharmaceutical Industries Ltd. and its affiliates and subsidiari unless otherwise indicated.

This 2007 Annual Report is being filed in respect of the year ended December 31, 2007, and contains the audited consolidated financial statements for the year then ended. To disclose information of the latest practicable date and to provide material information to shareholders, this 2007 Annual Report discloses events and other information occurring after the fiscal year ended December 31, 2007.

FORWARD-LOOKING STATEMENTS

Except for the historical information contained in this 2007 Annual Report, the statements contained herein are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934 in particular with respect to our business, financial condition and results of operations. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in "Item 3D – Key Information: Risk Factors" and elsewhere in this Annual Report. We urge you to consider that statements which use the terms "believe," "expect," "plan," "intend," "estimate," "anticipate," "should," "will," "may," "hope" and similar expressions are intended to identify forward-loo statements. These statements reflect our views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PRESENTATION OF FINANCIAL INFORMATION

Our consolidated financial statements appearing in this 2007 Annual Report are reported in United States dollars in thousands, unless otherwise indicated, and are prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). Totals presented in this 2007 Annual Report may not total correctly due to rounding of numbers. References to a particular fiscal year are to the period ended December 31 of such year.

With respect to selected financial data included in Item 3 of this Annual Report and other information covering the five most recent financial years, we were not able to provide the financial data for the earliest year of the five year period (2003) without unreasonable effort and expense due to various factors including difficulty in obtaining computerized data and other information necessary to restate such period. Therefore, we were not able to include the selected financial data for the 2003 year.

All references in this 2007 Annual Report to "dollars," or "$," are to United States dollars and all references in this Annual Report to "NIS" are to New Israeli Shekels. The published (1) representative exchange rate between the NIS and the dollar for March 31, 2011, was NIS 3.48 per $1.00. The published (2) representative exchange rate between the Canadian dollar and the dollar for March 31, 2011, was $0.97 Canadian dollar per $1.00. No representation is made

that the NIS amounts or Canadian dollar amounts could have been, or could be, converted into dollars at rates specified herein or any other rate.

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(1) As published by The Bank of Israel.
(2) As published by The Bank of Canada.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

We have derived the following selected consolidated financial data as of December 31, 2007 and 2006, and for each of the years ended December 31, 2007, 2006 and 2005, from our audited consolidated financial statements set forth elsewhere in this 2007 Annual Report that have been prepared in accordance with U.S. GAAP. We have derived the consolidated selected financial data as of December 31, 2005 and 2004 and for each of the years ended December 31, 2005 and 2004 from our audited consolidated financial statements not included in this annual report. During 2010, we decided to sell our Irish facility. As we did not meet disclosure requirements under FASB ASC 205, "Presentation of Financial Statements – Discontinued Operations" until fiscal year 2010, there is no disclosure or comparative adjustments to prior years in the financial statements until the 2010 Annual Report. You should read the selected consolidated financial data together with "Item 5 - Operating and Financial Review and Prospects" and our consolidated financial statements, related notes and other financial information included elsewhere in this 2007 Annual Report.

As described in this 2007 Annual Report under the heading, "Presentation of Financial Information," we were not able to provide the financial data for the earliest year of the five year period (2003) without unreasonable effort and expense due to various factors including difficulty in obtaining computerized data and other information necessary to restate such period.

	Year Ended December 31,			
	2007	2006	2005	2004
	(In thousands of U.S. dollars except per ordinary share data)			
Consolidated Statements of Operations Data:				
Sales, net	$ 319,554	$ 252,269	$ 288,623	$ 270,988
Cost of sales	133,229	123,516	122,615	127,539
Impairment	170	25,862	-	-
Gross profit	186,155	102,891	166,008	143,449
Operating expenses:				
Research and development, net	29,817	36,273	45,714	41,956
Selling, marketing, general and administrative	97,274	109,048	110,748	130,392
Impairment	-	27,923	-	-
Total operating expenses	127,091	173,244	156,462	172,348
Operating income (loss)	59,064	(70,353)	9,546	(28,899)
Financial expenses, net	22,816	11,454	7,985	4,812
Other gain, net	4,300	-	-	-
Income (loss) before income taxes	40,548	(81,807)	1,561	(33,711)
Tax expense	6,212	872	1,477	3,776
Net income (loss)	$ 34,336	$ (82,679)	$ 84	$ (37,487)
Net income (loss) per ordinary share:				
Basic	$ 0.99	$ (2.82)	$ - (*)	$ (1.29)
Diluted	$ 0.98	$ (2.82)	$ - (*)	$ (1.29)
Weighted-average number of ordinary shares used to compute net income (loss) per share:				
Basic	34,725	29,347	29,250	29,058
Diluted	35,215	29,347	29,590	29,058

(*) Amount is less than $0.01

	As of December 31,			
	2007	2006	2005	2004
	(In thousands of U.S. dollars)			
Consolidated Balance Sheets Data:				
Working capital (deficiency)	$ (24,448)	$ (130,182)	$ (52,874)	$ (5,821)
Property, plant and equipment, net	211,929	219,753	246,251	220,204
Total assets	483,353	424,690	548,217	570,265
Short-term debt, including current maturities of long-term debt	140,340	147,754	109,077	76,454
Long-term debt	76,361	90,377	152,849	177,119
Shareholders' equity	153,238	49,783	128,069	127,485

Dividend Policy

We have never paid cash dividends and we do not anticipate paying any cash dividends in the foreseeable future. We intend to retain our earnings to finance the development of our business, but such policy may change depending upon, among other things, our earnings, financial condition and capital requirements.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Our business, operating results and financial condition may be seriously harmed due to any of the following risks, among others. If we do not successfully address the risks to which we are subject, we may experience a material adverse effect on our business, results of operations and financial condition and our share price may decline. We cannot assure you that we will successfully address any of these risks.

Material weaknesses in our disclosure controls and procedures could negatively affect shareholder and customer confidence towards our financial reporting and other aspects of our business.

The existence of a material weakness in our disclosure and control procedures could negatively affect shareholder and customer confidence towards our financial reporting and other aspects of our business. We have initiated and are undertaking remedial steps to address material weaknesses in our internal control over financial reporting. (See risk factor immediately below.) We may not be able to remediate the material weaknesses in a timely manner which could negatively affect shareholder and customer confidence, financial reporting and other aspects of our business.

We may fail to maintain effective internal controls in accordance with Section 404 of Sarbanes-Oxley.

Sarbanes-Oxley imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Sarbanes-Oxley, and in particular with Section 404 thereof, have resulted in diversion of the Company's management ("Management") time and attention, and we expect these efforts to require the continued commitment of resources.

We may fail to maintain effective internal controls in accordance with Section 404 of Sarbanes-Oxley. If we fail to maintain adequate internal controls, we may not be able to ensure that we can conclude that we have effective internal controls over financial reporting. Our Management believes that our disclosure controls and procedures were not effective at a reasonable level of assurance as of December 31, 2007, as a result of the material weaknesses in our internal control over financial reporting that existed as of year-end 2007. While we have undertaken remedial steps, we may identify additional material weaknesses or significant deficiencies in our future internal controls over financial reporting. See Item 15 – "Controls and Procedures" below.

Our ordinary shares do not trade on a stock exchange which may result in a reduction in liquidity and trading volume of our ordinary shares.

Our ordinary shares do not trade on a stock exchange. Our ordinary shares are quoted on the Pink Sheets under the symbol TAROF. Information regarding the Pink Sheets is available at www.pinksheets.com. Trading on the Pink Sheets may result in a reduction in liquidity and trading volume of our ordinary shares.

We are not in compliance with certain covenants contained in some of our loan agreements and two creditors have the right to elect to accelerate their indebtedness.

Although we are current with respect to our payment obligations under our various loan agreements, we are not in compliance with certain covenants and other provisions contained in certain loan agreements. As a result of the foregoing, two creditors have the right to accelerate our indebtedness and could elect to proceed against the collateral granted to them to secure such indebtedness. In the event such indebtedness is accelerated, Management believes we have sufficient capacity to satisfy such obligations.

Risks Relating to Our Industry

The pharmaceutical industry in which we operate is intensely competitive. We are particularly subject to the risks of competition. For example, the competition we encounter may have a negative impact upon the prices we may charge for our products, the market share of our products and our revenue and profitability.

The pharmaceutical industry in which we operate is intensely competitive. The competition which we encounter has an effect on our product prices, market share, revenue and profitability. Depending upon how we respond to this competition, its effect may be materially adverse to us. We compete with:

- generic manufacturers of our brand-name drugs;
- the original manufacturers of the brand-name equivalents of our generic products;
- other drug manufacturers (including brand-name companies that also manufacture generic drugs);
- other generic drug manufacturers; and
- manufacturers of new drugs that may compete with our generic drugs and proprietary products.

Most of the products that we sell are either generic drugs or drugs whose patents have expired. Most of these products do not benefit from patent protection and are therefore more subject to the risk of competition than patented products. In addition, because many of our competitors have substantially greater financial, production and research and development resources, substantially larger sales and marketing organizations, and substantially greater name recognition than we have, we are particularly subject to the risks inherent in competing with them. For example, many of our competitors may be able to develop products and processes competitive with, or superior to, our own. Furthermore, we may not be able to differentiate our products from those of our competitors, successfully develop or introduce new products that are less costly or offer better performance than those of our competitors or offer purchasers of our products payment and other commercial terms as favorable as those offered by our competitors.

Other pharmaceutical companies frequently take actions to prevent or discourage the use of generic drug products such as ours.

Other pharmaceutical companies have increasingly taken actions, including the use of state and federal legislative and regulatory mechanisms, to prevent, delay or discourage the use of generic equivalents to their products, including generic products that we manufacture or market. If these efforts to delay or prevent generic competition are successful, our ability to sell our generic versions of products may be limited or prevented. This could have a material adverse effect on our future results of operations. These efforts have included, among others:

- filing new patents or extensions of existing patents on products whose original patent protection is about to expire, which could extend patent protection for the product and delay launch of generic equivalents;
- developing patented controlled-release products or other product improvements;
- developing and marketing branded products as OTC products;
- pursuing pediatric exclusivity for brand-name products;

- submitting citizen petitions to request that the Commissioner of the U.S. Food and Drug Administration ("FDA") take administrative action with respect to an abbreviated new drug application ("ANDA") approval;

- attaching special patent extension amendments to unrelated federal legislation;

- engaging in state-by-state initiatives to enact legislation that restricts the substitution of some brand-name drugs with generic drugs;

- making arrangements with managed care companies and insurers to reduce the economic incentives to purchase generic pharmaceuticals;

- introducing authorized generics or their own generic equivalents to the marketplace; and
- setting the price of brand-name drugs at or below the price of generic equivalents.

Generally, no additional regulatory approvals are required for brand-name manufacturers to sell directly or through a third party to the generic market. Brand-name products that are licensed to third parties and are marketed under their generic names at discounted prices are known as authorized generics. Such licensing facilitates the sale of generic equivalents of their own brand-name products. Because many brand-name companies are substantially larger than we are and have substantially greater resources than we have, we are particularly subject to the risks of their undertaking to prevent or discourage the use of our products that compete with theirs. Moreover, the introduction of authorized generics may make competition in the generic market more intense. It may also reduce the likelihood that a generic company that obtains the first ANDA approval for a particular product will be the first to market and/or the only generic alternative offered to the market and thus may diminish the economic benefit associated with this position.

We may experience declines in the sales volume and prices of our products as the result of the continuing trend of consolidation of certain customer groups, such as the wholesale drug distribution and retail pharmacy industries, as well as the emergence of large buying groups. The result of such developments could have a material adverse effect on our business, financial position and results of operations, and could cause the market value of our ordinary shares to decline.

We make a significant portion of our sales to a relatively small number of wholesalers, retail drug chains, food chains and mass merchandisers. If demand decreases significantly, we could experience a negative impact on our profitability. Also, these customers constitute an essential part of the distribution chain for generic pharmaceutical products and continue to undergo significant consolidation. This consolidation may result in these groups gaining additional purchasing leverage and consequently increasing product pricing pressures facing us. In addition, the emergence of large buying groups representing independent retail pharmacies and the prevalence and influence of managed care organizations and similar institutions, potentially enables those groups to attempt to extract price discounts on our products. The result of these developments may have a material adverse impact on our business, financial position and results of operations, and could cause the market value of our ordinary shares to decline.

New developments by others could make our products or technologies non-competitive or obsolete.

The markets in which we compete and intend to compete are undergoing, and are expected to continue to undergo, rapid and significant technological change. We expect competition to intensify as technological advances are made. Our competitors may succeed in developing products and technologies that are more effective or less costly than any that we are developing, or that would render our products obsolete and noncompetitive.

We anticipate that we will face increased competition in the future as new companies enter the market and novel or advanced technologies emerge. Smaller or early-stage companies may also prove to be significant competitors, particularly through collaborative arrangements with large and established companies. Many of our competitors have significantly greater research and development, financial, sales and marketing, manufacturing and other resources than we have. As a result, they may be able to devote greater resources to the development, manufacture, marketing or sale of their products, initiate or withstand substantial price competition, or more readily take advantage of acquisitions or other opportunities.

Our ability to market products successfully depends, in part, upon the acceptance of the products not only by consumers, but also by independent third parties.

Our ability to market generic or proprietary pharmaceutical products successfully depends, in part, on the acceptance of the products by independent third parties (including physicians, pharmacies, government formularies, managed care providers, insurance companies and retailers), as well as patients. In addition, unanticipated side effects or unfavorable publicity concerning any of our products, or any brand-name product of which our generic product is the equivalent, could have an adverse effect on our ability to achieve acceptance by prescribing physicians, managed care providers, pharmacies and other retailers, customers and patients.

Our future profitability depends upon our ability to continue monitoring our inventory levels in the distribution channel.

Our future profitability depends upon our ability to continue monitoring our inventory levels in the distribution channel. As of the spring of 2006, after negotiating with our three largest wholesaler customers for a number of years, we have been able to obtain official reports of the amount of our products held in inventory by such wholesaler customers. We use these reports as part of our process for monitoring inventory levels in our distribution channel and our exposure to product returns. If we lose access to these reports, we may not be able to adequately monitor our inventory levels in the distribution channel. As a result of losing our visibility into the distribution channel, inventory levels could build, exceeding market demand and resulting in our incurring significant and unanticipated expenditures to reimburse these wholesaler customers for product returns, which could materially impact our profitability and cash flows.

Our future profitability depends upon our ability to introduce new generic or innovative products on a timely basis.

Our future profitability depends, to a significant extent, upon our ability to introduce, on a timely basis, new generic or innovative products for which we either are the first to market (or among the first to market) or can otherwise gain significant market share. Our ability to achieve any of these objectives is dependent upon, among other things, the timing of regulatory approval of these products and the number and timing of regulatory approvals of competing products. Inasmuch as this timing is not within our control, we may not be able to develop and introduce new generic and innovative products on a timely basis, if at all.

To the extent that we succeed in being the first to market a generic version of a significant product, and particularly if we obtain the 180-day period of market exclusivity for the U.S. market provided under the Drug Price Competition and Patent Term Restoration Act of 1984 (the "Hatch-Waxman Act"), our sales, profits and profitability can be substantially increased in the period following the introduction of such product and prior to a competitor's introduction of the equivalent product. However, at the end of the 180-day exclusivity period, these sales may diminish precipitously as may the profits therefrom.

Our revenue and profits from individual generic pharmaceutical products are likely to decline as our competitors introduce their own generic equivalents.

Revenue and gross profit derived from generic pharmaceutical products tend to follow a pattern based on regulatory and competitive factors unique to the generic pharmaceutical industry. As the patents for a brand-name product and the related exclusivity periods expire, the first generic manufacturer to receive regulatory approval for a generic equivalent of the product is often able to capture a substantial share of the market. However, as other generic manufacturers receive regulatory approvals for competing products, or brand-name manufacturers introduce authorized generics, that market share and the price of that product will decline. Our overall profitability depends on, among other things, our ability to continuously, and on a timely basis, introduce new products.

We are subject to extensive government regulation that increases our costs and could prevent us from marketing or selling our products.

We are subject to extensive regulation by the United States, Canada, Israel and other jurisdictions. These jurisdictions regulate the approval, testing, manufacture, labeling, marketing and sale of pharmaceutical products. For example, approval by the FDA is generally required before any new drug or the generic equivalent to any previously approved drug may be marketed in the United States. In order to receive approval from the FDA for each new drug product we wish to market, we must demonstrate, through rigorous clinical trials, that the new drug product is safe and effective for its intended use and that our manufacturing process for that product candidate complies with current Good Manufacturing Practices ("cGMP"). We cannot provide an assurance that the FDA will, in a timely manner, or ever, approve our applications for new drug products. The FDA may require substantial additional clinical testing or find that our drug product does not satisfy the standards for approval. In addition, in order to obtain approval for our product candidates that are generic versions of brand-name drugs, we must demonstrate to the FDA that each generic product candidate is bioequivalent to a drug previously approved by the FDA through the new drug approval process, known as an innovator, or brand-name reference drug. Bioequivalency may be demonstrated by comparing the generic product to the innovator drug product in dosage form, strength, route of administration, quality, performance characteristics and intended use. If the FDA determines that an ANDA for a generic drug product is not adequate to support approval, it could deny our application or request additional information, including clinical trials, which could delay approval of the product and impair our ability to compete with other versions of the generic drug product.

If our product candidates receive FDA approval, the labeling claims and marketing statements that we can make for our new and generic products are limited by statutes and regulations and, with respect to our generic drugs, by the

labeling claims made in the brand-name product's packaging. In addition, if the FDA and/or a foreign regulatory authority approves any of our products, the labeling, packaging, adverse event reporting, storage, advertising and promotion for the product will be subject to extensive and ongoing regulatory requirements. As a manufacturer of pharmaceutical products distributed in the United States, we must also comply with cGMPs, which include requirements related to production processes, quality control and assurance and recordkeeping. Products that we manufacture and distribute in foreign jurisdictions may be regulated under comparable laws and regulations in those jurisdictions. The facilities of Taro Pharmaceuticals U.S.A., Inc. ("Taro U.S.A."), our U.S. subsidiary, our manufacturing facilities and procedures and those of our suppliers are subject to periodic inspection by the FDA and foreign regulatory agencies. Any material deviations from cGMPs or other applicable standards identified during such inspections may result in enforcement actions, including delaying or preventing new product approvals, a delay or suspension in manufacturing operations, consent decrees or civil or criminal penalties. Further, discovery of previously unknown problems with a product or manufacturer may result in restrictions or sanctions with respect to the product, including withdrawal of the product from the market.

In addition, because we market a controlled substance in the United States and other controlled substances in Israel, we must meet the requirements of the United States Controlled Substances Act and its equivalent in Israel, as well as the regulations promulgated thereunder in each country. These regulations include stringent requirements for manufacturing controls, importation, receipt and handling procedures and security to prevent diversion of, or unauthorized access to, the controlled substances in each stage of the production and distribution process. The United States Drug Enforcement Administration ("DEA") and comparable regulatory authorities in Israel and Canada may periodically inspect our facilities for compliance with the United States Controlled Substances Act and its equivalents in Israel and Canada. Any failure to comply with these laws and regulations could lead to a variety of sanctions, including the revocation, or a denial of renewal, of our DEA registration (or Israeli or Canadian equivalent), injunctions, or civil or criminal penalties.

Furthermore, most of the products that we manufacture and distribute are manufactured outside the United States and must be shipped into the United States. The FDA and the DEA, in conjunction with the United States Customs Service, can exercise greater legal authority over goods that we seek to import into the United States than they can over products that are manufactured in the United States.

Although we devote significant time, effort and expense to addressing the extensive government regulations applicable to our business and obtaining regulatory approvals, we remain subject to the risk of being unable to obtain necessary approvals on a timely basis, if at all. Delays in receiving regulatory approvals could adversely affect our ability to market our products.

Product approvals by the FDA and by comparable foreign regulatory authorities may be withdrawn if compliance with regulatory standards is not maintained or if problems relating to the products are experienced after initial approval. In addition, if we fail to comply with governmental regulations we may be subject to fines, unanticipated compliance expenditures, interruptions of our production and/or sales, prohibition of importation, seizures and recalls of our products, criminal prosecution and debarment of us and our employees from the generic drug approval process.

In February 2009, our Canadian manufacturing facility received a Warning Letter from the FDA (the "Warning Letter") expressing concern identified during a July 2008 inspection about certain quality control systems, including failure to complete investigations of quality issues in a timely manner. The Company has corrected the specific observations cited during the July 2008 inspection and in the Warning Letter, and, to ensure its products meet all requirements, has improved its ability to adhere to cGMPs by adding additional qualified personnel, engaging outside experts and adding new procedures to resolve any systemic issues and prevent recurrence. The observations cited in the Warning Letter did not relate to any of the Company's other facilities. A formal cGMP re-inspection was conducted by the FDA in February 2011 to evaluate the effectiveness of corrective actions undertaken by Taro and the FDA announced in April 2011 that the site has an acceptable regulatory status and issues were considered resolved. Additionally, Health Canada inspected the facility in early 2011 and rated it as compliant.

Regulatory Authorities may require New Drug Applications for products marketed under the Drug Efficacy Study Implementation Review and Compliance Policy.

Certain drug products were considered safe by the FDA as part of the Drug Efficacy Study Implementation ("DESI") Review and Compliance Policy Guide Chapter 4, Subchapter 440 of 1968. These products have been marketed for many years and, while considered to be safe for their indicated use, lack data supporting effectiveness. Therefore, the FDA may at any time, or from time to time, review a product on the DESI list to determine if the product requires the submission of a New Drug Application ("NDA"), for the continued marketing of the product in the United States. The Company, like many pharmaceutical companies, markets certain drug products under the DESI/Compliance Policy. As such, we may be required to cease marketing or file NDAs for such products. The filing of an NDA may be expensive, time consuming and require more resources than those available to the Company to support the research

for an application, thus requiring us to withdraw such products from the market or to cease marketing them.

Changes in regulatory environment may prevent us from utilizing the exclusivity periods that are important to the success of some of our generic products.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Medicare Act") provides that the 180-day market exclusivity period provided under the Hatch-Waxman Act is only triggered by commercial marketing of the product. However, the Medicare Act also contains forfeiture provisions which would deprive the first "Paragraph IV" filer (as defined below) of exclusivity if certain conditions are met. Accordingly, we may face the risk of forfeiture and therefore may not be able to exploit a given exclusivity period for specific products.

Under the terms of the Hatch-Waxman Act, a generic applicant must make certain certifications with respect to the patent status of the drug for which it is seeking approval. In the event that such applicant plans to challenge the validity or enforceability of an existing listed patent or asserts that the proposed product does not infringe an existing listed patent, it files a so-called "Paragraph IV" certification. The Hatch-Waxman Act provides for a potential 180-day period of generic exclusivity for the first company to submit an ANDA with a Paragraph IV certification. The Medicare Act modified certain provisions of the Hatch-Waxman Act. Under the Medicare Act, final ANDA approval for a product subject to Paragraph IV patent litigation may be obtained upon the earlier of a favorable district court decision or 30 months from notification to the patent holder of the Paragraph IV filing. Exclusivity rights may be forfeited pursuant to the Medicare Act if the product is not marketed within 75 days of the final court decision and under other specified circumstances. However, some of these changes apply to ANDAs where the first Paragraph IV certification was filed after the enactment of the Medicare Act; previously filed ANDAs generally continue to be governed by the previous law.

Health care reform

On March 23, 2010, the U.S. government enacted the Patient Protection and Affordable Care Act ("PPACA"). A companion bill, the Health Care Education Affordability Reconciliation Act of 2010, which was enacted by the U.S. government on March 30, 2010, contains amendments to the PPACA that reconcile the Senate and House versions of the legislation. Together, these bills (the "Acts") represent the most comprehensive overhaul ever enacted of both the public and private health care systems in the U.S.A.

It is expected that this legislation will have an impact on all segments of the health care industry. Pharmaceutical and medical device manufacturers will most likely see an increase in revenues by virtue of an additional 30 million Americans who will have access to health insurance; however, the legislation imposes on manufacturers a variety of additional rebates, discounts, fees, taxes and reporting and regulatory requirements. In December 2010, the FASB issued ASU No. 2010-27, "Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers (a consensus of the FASB Emerging Issues Task Force)." This standard addresses how fees mandated by the Acts should be recognized and classified in the income statements of pharmaceutical manufacturers. Under the proposal, the annual fee would be recognized as a liability for the total amount and a corresponding deferred cost over the calendar year. This is a liability and presented as an operating expense. This ASU is effective for calendar years beginning after December 31, 2010. Since the fees are anticipated to be less than 0.2% of net sales, the Company does not expect the provisions of ASU 2010-27 to have a material effect on its financial statements.

Pharmaceutical companies are required by international law to comply with adverse event reporting requirements.

Our failure to meet these reporting requirements in any jurisdiction could result in actions by regulatory authorities in that and/or other jurisdictions, including any of the following: warning letters, public announcements, restriction or suspension of marketing authorizations, revocation of marketing authorizations, fines or a combination of any of these actions.

Reimbursement policies of third-parties, cost containment measures and healthcare reform could adversely affect the demand for our products and limit our ability to sell our products.

Our ability to market our products depends, in part, on reimbursement levels for them and related treatment established by healthcare providers (including government authorities), private health insurers and other organizations, including health maintenance organizations and managed care organizations. Reimbursement may not be available for some of our products and, even if granted, may not be maintained. Limits placed on reimbursement could make it more difficult for people to buy our products and reduce, or possibly eliminate, the demand for our products. In the event that governmental authorities enact additional legislation or adopt regulations which affect third-party coverage and reimbursement, demand for our products may be reduced with a consequent adverse effect, which may be material, on our sales and profitability. In addition, the purchase of our products could be significantly influenced by the following factors, among others:

- trends in managed healthcare in the United States;
- developments in health maintenance organizations, managed care organizations and similar enterprises;
- legislative proposals to reform healthcare and government insurance programs; and
- price controls and reimbursement policies.

These factors could result in lower prices and/or a reduced demand for our products.

The Acts are a sweeping measure intended to expand healthcare coverage within the U.S., primarily through the imposition of health insurance mandates on employers and individuals and expansion of the Medicaid program. Among other things, the Acts contain provisions that will change payment levels for pharmaceuticals under Medicaid and increase pharmaceutical rebates under the Medicaid Drug Rebate Program. Effective October 1, 2010, the law changed the formula for calculating federal upper limits, which are a type of cap on the amount a state Medicaid program can reimburse pharmacies for multiple source drugs (drugs for which there are at least three equivalent versions on the market). When these provisions are implemented, the federal upper limit ("FUL") will be calculated based on the weighted-average of the average manufacturer prices (AMPs) of the equivalent drugs on the market. In addition, the law changed the preexisting definition of AMP so that it is based only on direct sales to retail community pharmacies and sales to wholesalers who sell to retail community pharmacies. The Centers for Medicare & Medicaid Services ("CMS") has not yet begun to implement the new FUL provisions and has not issued regulations to implement the new statutory definition of AMP. We do not know how the new methodology for calculating federal upper limits will affect our pharmacy customers.

In addition, the Acts require CMS to publish and provide states with the weighted-average monthly AMPs for multiple source drugs. CMS has encouraged state Medicaid programs to utilize these AMPs as a benchmark for prescription drug reimbursement in place of the widely used benchmark of average wholesale price. CMS has not yet begun to make weighted average AMPs available to the states or the public. When implemented, the disclosure may have the effect of reducing Medicaid reimbursement rates. Moreover, we cannot predict how the public disclosure of this information may affect competition in the market place.

Effective January 1, 2010, the Acts also increased the minimum Medicaid rebate rate from 15.1% to 23.1% of AMP for drugs approved under a new drug application, and increased the Medicaid rebate from 11% to 13% of AMP for drugs approved under an abbreviated new drug application. Also, the volume of rebated drugs has been expanded to include beneficiaries in Medicaid managed care organizations. These measures have increased our cost of selling to the Medicaid market.

The full effects of the Acts on Medicaid payment and on our Medicaid rebates cannot be known until all of these provisions are implemented and the CMS issues applicable regulations or guidance.

We are susceptible to product liability claims that may not be covered by insurance and could require us to pay substantial sums.

We face the risk of loss resulting from, and adverse publicity associated with, product liability lawsuits, whether or not such claims are valid. We may not be able to avoid such claims. In addition, our product liability insurance may not be adequate to cover such claims and we may not be able to obtain adequate insurance coverage in the future at acceptable costs. A successful product liability claim that exceeds our policy limits could require us to pay substantial sums. In addition, product liability coverage for pharmaceutical companies is becoming more expensive and, as a result, we may not be able to obtain the type and amount of coverage we desire or to maintain our existing coverage.

Product recalls could harm our business.

Product recalls or product field alerts may be issued at our discretion or at the discretion of the FDA, other governmental agencies or other companies having regulatory authority for pharmaceutical product sales. From time to time, we may recall products for various reasons, including failure of our products to maintain their stability through their expiration dates. Any recall or product field alert has the potential of damaging the reputation of the product or our reputation. Any significant recalls could materially affect our sales. In these cases, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Our reputation among consumers and our customers in the pharmacy trade may be negatively impacted by incidents of counterfeiting of our products.

The counterfeiting of pharmaceutical products is a widely reported problem for pharmaceutical manufacturers, distributors, retailers and consumers in the United States, which is our largest market. Such counterfeiting may take the form of illicit producers manufacturing cheaper and less effective counterfeit versions of our products, or producing imitation products containing no active ingredients, and then packaging such counterfeit products in a manner which makes them look like genuine products of the Company. If incidents occurred in which such products prove to be ineffective, or even harmful, to the individuals who used them, consumers and our customers might not buy our products out of fear that they might be ineffective or dangerous counterfeits. In addition, sales of counterfeit products could reduce sales of legitimate products of the Company. Such counterfeit products could have a material negative impact on our sales and net income.

The manufacture and storage of pharmaceutical products are subject to inherent risk.

Because chemical ingredients are used in the manufacture of pharmaceutical products and due to the nature of the manufacturing process itself, there is a risk of incurring liability for damages caused by or during the storage or manufacture of both the chemical ingredients and the finished pharmaceutical products. Although we have never incurred any material liability for damages of that nature, we may be subject to liability in the future. In addition, while we believe our insurance coverage is adequate, it is possible that a successful claim would exceed our coverage, requiring us to pay a substantial sum.

The manufacture and storage of pharmaceutical and chemical products are subject to environmental regulation and risk.

The pharmaceutical industry is subject to extensive environmental regulation and the risk of incurring liability for damages or the costs of remedying environmental problems because of the chemical ingredients contained in pharmaceutical products and the nature of their manufacturing process. Although we have never incurred any such liability in any material amount, we may be subject to liability in the future. We may also be required to increase expenditures to remedy environmental problems and comply with applicable regulations. If we fail to comply with environmental regulations to use, discharge or dispose of hazardous materials appropriately or otherwise to comply with the conditions attached to our operating licenses, the licenses could be revoked and we could be subject to criminal sanctions and substantial liability. We could also be required to suspend or modify our manufacturing operations.

Testing required for the regulatory approval of our products is sometimes conducted by independent third-parties. Any failure by any of these third-parties to perform this testing properly may have an adverse effect upon our ability to obtain regulatory approvals.

Our applications for the regulatory approval of our products incorporate the results of testing and other information that are sometimes provided by independent third-parties (including, for example, manufacturers of raw materials, testing laboratories, contract research organizations or independent research facilities). The likelihood that the products being tested will receive regulatory approval is, to some extent, dependent upon the quality of the work performed by these third-parties, the quality of the third-parties' facilities and the accuracy of the information provided by these third-parties. We have little or no control over any of these factors.

Some of our products are manufactured by independent third-parties. Any failure by any of these third-parties to perform this manufacturing properly or follow cGMPs, may have an adverse effect upon our ability to maintain regulatory approvals or continue marketing our products.

Certain products are manufactured by independent third-parties. Their compliance with cGMPs and other regulatory requirements is essential to our obtaining and maintaining regulatory approvals and marketing authorization for these products in the countries in which they are sold. Any failure by any of these third-parties to perform this manufacturing properly or follow cGMPs, may have an adverse effect upon our ability to maintain regulatory approvals or continue marketing our products.

Risks Relating to Our Company

Wholesaler customers account for a substantial portion of our consolidated sales.

We have no long-term agreements with the wholesalers that require them to purchase our products and they may therefore reduce or cease their purchases from us at any time. Any cessation or significant reduction of their purchases from us would likely have a material adverse effect on the results of our operations and our financial condition. Furthermore, changes in their buying patterns or in their policies and practices in relation to their working capital and inventory management may result in a reduction of, or a change in the timing of, their purchases of our products. While we receive periodic inventory reports from the wholesalers, we have no ability to obtain advance knowledge of such changes. We base our manufacturing schedules, inventories and internal sales projections principally on historical data. To the extent that actual orders from these wholesalers differ substantially from our internal projections, we may either find ourselves with excess inventory or in an out-of-stock position. Hence, factors beyond our control relative to these customers have in the recent past, and may have from time to time in the future, a material adverse effect upon our operating results, which has, in the recent past, resulted, and may from time to time in the future result, in substantial volatility of the market prices of our ordinary shares.

The nature of our business requires us to estimate future charges against wholesaler accounts receivable. If these estimates are not accurate, the results of our operations and financial condition could be adversely affected.

Sales to third-parties, including government institutions, hospitals, hospital buying groups, pharmacy buying groups, pharmacy chains and others generally are made through wholesalers. We sell our goods to wholesalers, and the wholesalers subsequently resell the goods to third-parties at times and in quantities ordered by the third-parties. Typically, we have a contract price with a third-party to which a wholesaler resells our goods that may be equal to or less than the price at which we sold the goods to the wholesaler. In such a case, following the purchase of the product by a third-party purchaser from the wholesaler, the wholesaler charges us back for any shortfall. At the time of any individual sale by us to a wholesaler, we do not know under which contracts the wholesaler will resell goods to third-parties. Therefore, we estimate the amount of chargebacks and other credits that may be associated with these sales and we reduce our revenue accordingly. One factor in calculating these estimates is information on customer inventory levels provided to us by our customers. As of the spring of 2006, after negotiating with our key wholesaler customers for a number of years, we have been able to obtain official reports of the amount of our products held in inventory by such wholesalers. If this information is inaccurate or not forthcoming, this may result in erroneously estimated reserves for chargebacks, returns or other deductions. In addition, from time to time, the amount of such chargebacks and other credits reported by a wholesaler may be different from our estimates. Discrepancies of this nature may result in a reduction in the value of our accounts receivable and a related charge to net income. The reconciliation of our accounts with wholesalers may, from time to time, delay, or otherwise impact, the collection of our accounts receivable or result in a decrease in their value and in a related charge to our net income. See Item 5 – "Operating and Financial Review and Prospects – Recent Developments."

Our inventories of finished goods have expiration dates after which they cannot be sold.

Industry standards require that pharmaceutical products be made available to customers from existing stock levels rather than on a made-to-order basis. Therefore, in order to accommodate market demand adequately, we strive to maintain sufficiently high levels of inventories. However, inventories prepared for sales that are not realized as or when anticipated may approach their expiration dates and may have to be written off. These write-offs, if any, could have an adverse effect on the results of our operations and financial condition.

Our future success depends on our ability to develop, manufacture and sell new products.

Our future success is largely dependent upon our ability to develop, manufacture and market new commercially viable pharmaceutical products and generic equivalents of proprietary pharmaceutical products whose patents and other exclusivity periods have expired. Delays in the development, manufacture and marketing of new products will negatively impact the results of our operations. Each of the steps in the development, manufacture and marketing of our products involves significant time and expense. We are, therefore, subject to the risks, among others, that:

- any products under development, if and when fully developed and tested, will not perform in accordance with our expectations;
- any generic product under development will, when tested, not be bioequivalent to its brand-name counterpart;
- necessary regulatory approvals will not be obtained in a timely manner, if at all;
- any new product cannot be successfully and profitably produced and marketed;
- other companies may launch their version of generic products, either prior to or following the launch of our newly approved generic version of the same product;

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- brand-name companies may launch their products, either themselves or through third-parties, in the form of authorized generic products which can reduce sales, prices and profitability of our newly approved generic products; or

- generic companies may launch generic versions of our brand-name drugs.

If we are unable to obtain raw materials, our operations could be seriously impaired.

While the majority of the Company's products are either synthesized by the Company itself or are derived from multiple source materials, some raw materials and certain products are obtained from single domestic or foreign suppliers. Although we have not experienced significant difficulty in obtaining raw materials to date, material supply interruptions may occur in the future and we may have to obtain substitute raw materials or products. For most raw materials we do not have any long-term supply agreements and therefore we are subject to the risk that our suppliers of raw materials may not continue to supply us with raw materials on satisfactory terms or at all.

Furthermore, obtaining the regulatory approvals required for adding alternative suppliers of raw materials for finished products we manufacture may be a lengthy process. We strive to maintain adequate inventories of single source raw materials in order to ensure that any delays in receiving regulatory approvals will not have a material adverse effect upon our business. However, we may not be successful in doing so and, consequently, we may be unable to sell some products pending approval of one or more alternate sources of raw materials. Any significant interruption in our supply stream could have a material adverse effect on our operations.

Research and development efforts invested in our innovative pipeline may not achieve expected results.

We invest increasingly greater resources to develop our innovative pipeline, both through our own efforts and through collaborations with third-parties, which results in higher risks.

The time from discovery to a possible commercial launch of an innovative product is substantial and involves multiple stages during which the product may be abandoned as a result of such factors as serious developmental problems, the inability to achieve our clinical goals, the inability to obtain necessary regulatory approvals in a timely manner, if at all, and the inability to produce and market such innovative products successfully and profitably. In addition, we face the risk that some of the third-parties we collaborate with may fail to perform their obligations. Accordingly, our investment in research and development of innovative products can involve significant costs with no assurances of future revenues or profit.

We are continuing our efforts to develop new proprietary pharmaceutical products, but these efforts may not be successful.

Our principal business has traditionally been the development, manufacture and marketing of generic equivalents of pharmaceutical products first introduced by other companies. However, we have increased our efforts to develop new proprietary products.

Expanding our focus beyond generic products and broadening our product pipeline to include new proprietary products may require additional internal expertise or external collaboration in areas in which we do not have substantial resources and personnel. Also, we may not have sufficient financial resources to complete certain clinical studies, and thus be unable to receive regulatory approval or commercialize these products. We may have to enter into collaborative arrangements with others that may require us to relinquish rights to some of our technologies or products that we would otherwise pursue independently. We may not be able to acquire the necessary expertise or enter into collaborative agreements on acceptable terms, if at all, to develop and market new proprietary products.

In addition, although a newly developed product may be successfully manufactured in a laboratory setting, difficulties may be encountered in scaling up for manufacture in commercially-sized batches. For this reason and others, only a small minority of all new proprietary research and development programs ultimately result in commercially successful drugs. A program (including any program of ours) cannot be deemed successful until it actually produces a drug that is commercially marketed for a significant period of time.

In order to obtain regulatory approvals for the commercial sale of our new proprietary products, we are required to complete extensive clinical trials in humans to demonstrate the safety and efficacy of the products to the satisfaction of FDA and regulatory authorities abroad. Conducting clinical trials is a lengthy, time-consuming and expensive process, and the results of such trials are inherently uncertain. We have limited experience in conducting clinical trials in these new product areas.

A clinical trial may fail for a number of reasons, including:

- failure to enroll a sufficient number of patients meeting eligibility criteria;
- failure of the new product to demonstrate safety and/or efficacy;
- the development of serious (including life threatening) adverse events (including, for example, side effects caused by or connected with exposure to the new product); or
- the failure of clinical investigators, trial monitors and other consultants or trial subjects to comply with the trial plan or protocol.

The results from early clinical trials may not be predictive of results obtained in later clinical trials. Clinical trials may not demonstrate the safety and efficacy of a product sufficient to obtain the necessary regulatory approvals, or to support a commercially viable product. Any failure of a clinical trial for a product in which we have invested significant time or other resources could have a material adverse effect on our results of operations and financial condition.

Even if launched commercially, our proprietary products may face competition from existing or new products of other companies. These other companies may have greater resources, market access, and consumer recognition than we have. Thus, there can be no assurance that our proprietary products will be successful or profitable. In addition, advertising and marketing expenses associated with the launch of a proprietary product which, if not successful, may adversely affect the results of our operations and our financial condition.

We may not be able to successfully identify, consummate and integrate future acquisitions.

We have in the past, and may in the future, pursue acquisitions of product lines and/or companies and seek to integrate them into our operations. Acquisitions of additional product lines and companies involve risks that could adversely affect our future revenue and results of operations. Any one or more of the following examples may apply:

- we may not be able to identify suitable acquisition targets or acquire companies on favorable terms;
- we compete with other companies that may have stronger financial positions to acquire product lines and companies. We believe that this competition will increase and may result in decreased availability or increased prices for suitable acquisition targets;
- we may not be able to obtain the necessary financing, on favorable terms or at all, to finance any of our potential acquisitions;
- we may not be able to obtain the necessary regulatory approvals, including the approval of antitrust regulatory bodies, in any of the countries in which we may seek to consummate potential acquisitions;
- we may ultimately fail to complete an acquisition after we announce that we plan to acquire a product line or a company;
- we may fail to integrate our acquisitions successfully in accordance with our business strategy;
- we may choose to acquire a business that is not profitable, either at the time of acquisition or thereafter;

- acquisitions may require significant management resources and divert attention away from our daily operations, result in the loss of key customers and personnel, and expose us to unanticipated liabilities;

- we may not be able to retain the skilled employees and experienced management that may be necessary to operate businesses we acquire, and if we cannot retain such personnel, we may not be able to locate and hire new skilled employees and experienced management to replace them; and

- we may purchase a company that has contingent liabilities that include, among others, known or unknown intellectual property or product liability claims.

We depend on our ability to protect our intellectual property and proprietary rights, but we may not be able to maintain the confidentiality, or assure the protection, of these assets.

Our success depends, in large part, on our ability to protect our existing and future technologies and products and to defend our intellectual property rights. If we fail to protect our intellectual property adequately, competitors may manufacture and market products similar to ours. Numerous patents covering our technologies have been issued to us, and we have filed, and expect to continue to file, patent applications seeking to protect newly developed technologies and products in various countries, including the United States. Some patent applications in the United States are maintained in secrecy until the patent is issued. Because the publication of discoveries tends to follow their actual discovery by many months, we may not be the first to invent, or file patent applications on any of our discoveries. Patents may not be issued with respect to any of our patent applications and existing or future patents issued to or licensed by us may not provide competitive advantages for our products. Patents that are issued may be challenged, invalidated or circumvented by our competitors. Furthermore, our patent rights may not prevent our competitors from developing, using or commercializing products that are similar or functionally equivalent to our products. Where trade secrets are our sole protection, we may not be able to prevent third-parties from marketing generic equivalents to our products, reducing prices in the marketplace and reducing our profitability.

We also rely on trade secrets, non-patented proprietary expertise and continuing technological innovation that we seek to protect, in part, by entering into confidentiality agreements with licensees, suppliers, employees, consultants and others. These agreements may be breached and there may not be adequate remedies in the event of a breach. Disputes may arise concerning the ownership of intellectual property or the applicability of confidentiality agreements. Moreover, our trade secrets and proprietary technology may otherwise become known or be independently developed by our competitors. If patents are not issued with respect to products arising from research, we may not be able to maintain the confidentiality of information relating to these products.

Third-parties may claim that we infringe on their proprietary rights and may prevent us from manufacturing and selling certain products.

There has been substantial litigation in the pharmaceutical industry with respect to the manufacture, use and sale of new products. These lawsuits relate to the validity and infringement of patents or proprietary rights of third-parties. We may be required to commence or defend against charges relating to the infringement of patent or proprietary rights. Any such litigation could:

- require us to incur substantial expenses, even if we are insured or successful in the litigation;
- require us to divert significant time and effort of our technical and management personnel;
- result in the loss of our rights to develop or make certain products;
- require us to pay substantial monetary damages or royalties in order to license proprietary rights from third-parties; and
- prevent us from launching a developed, tested and approved product.

Although patent and intellectual property disputes within the pharmaceutical industry have often been settled through licensing or similar arrangements, costs associated with these arrangements may be substantial and could include the long-term payment of royalties. These arrangements may be investigated by United States regulatory agencies and, if improper, may be invalidated. Furthermore, the required licenses may not be made available to us on acceptable terms. Accordingly, an adverse determination in a judicial or administrative proceeding or a failure to obtain

necessary licenses could prevent us from manufacturing and selling some of our products or increase our costs to market these products.

From time to time, we seek to market products before the patents for them expire. In order to do so in the United States, we must challenge the patent under the procedures set forth in the Hatch-Waxman Act. In the United States, in order to obtain a final approval for a generic product prior to expiration of certain of the innovator's patents, we must, under the terms of the Hatch-Waxman Act, as amended by the Medicare Act, notify the patent holder as well as the owner of an NDA, that we believe that the patents listed in the Approved Drug Products with Therapeutic Equivalence Evaluations contained on the FDA website (the "Orange Book") for the new drug are either invalid or not infringed by our product. To the extent that we engage in patent challenge procedures, we are involved and expect to be involved in patent litigation regarding the validity or infringement of the originator's patent. Patent challenges are complex, costly and can take a significant amount of time to complete.

In addition, when seeking regulatory approval for some of our products, we are required to certify to the FDA and its equivalents in foreign countries, that such products do not infringe upon third-party patent rights. Filing a certification against a patent gives the patent holder the right to bring a patent infringement lawsuit against us. Any lawsuit would delay regulatory approval by the FDA until the earlier of the resolution of such claim or 30 months from the patent holder's receipt of notice of certification. A claim of infringement and the resulting delay could result in substantial expenses and even prevent us from manufacturing and selling certain products.

In addition, it is not required that pharmaceutical patents be listed with the FDA or other regulatory authorities. For example, patents relating to antibiotics might not be listed in the Orange Book. Any launch of a pharmaceutical product by us that may infringe a patent, whether listed or not, may involve us in litigation; in certain circumstances, such litigation may result in significant damages which could have a material adverse effect on the results of our operations and financial condition.

Our launch of a product prior to a final court decision or the expiration of a patent held by a third-party may result in substantial damages to us. Depending upon the circumstances, a court may award the patent holder damages equal to three times the patent holder's loss of income. If we are found to infringe a patent held by a third-party and become subject to significant damages, these damages could have a material adverse effect on the results of our operations and financial condition.

Volatility of the market price of our ordinary shares could adversely affect us and our shareholders.

The market price of our ordinary shares may be volatile, and may, in the future, be subject to wide fluctuations, for the following reasons, among others:

- actual or anticipated variations in our quarterly operating results or those of our competitors;
- announcements by us or our competitors of new and enhanced products;
- market conditions or trends in the pharmaceutical industry;
- developments or disputes concerning proprietary rights;
- introduction of technologies or product enhancements by others that reduce the need for our products;
- general economic and political conditions;
- departures of key personnel;
- changes in the market valuations of our competitors;
- regulatory considerations; and
- the other risk factors listed in this section.

One of our directors, and members of his immediate family control approximately 77.5% of the voting power in our Company.

Dilip Shanghvi and members of his immediate family control, through their beneficial ownership of approximately 66.3% of outstanding ordinary shares and 100% of founders' shares through Sun Pharmaceutical Industries Ltd.

(Reuters: SUN.BO, Bloomberg: SUNP IN, NSE: SUNPHARMA, BSE: 524715) ("Sun Pharma") and its affiliates (together with its affiliates, "Sun"), approximately 77.5% of the voting power in our Company.

50% of the voting power in our subsidiary Taro U.S.A. is held by a corporation which is controlled by Sun.

The share capital of Taro U.S.A. is divided into two classes. The Company owns 96.9% of the shares that have economic rights and 50% of the shares that have voting rights in Taro U.S.A. Taro Development Corporation ("TDC") owns 3.1% of the shares that have economic rights and 50% of the shares that have voting rights in Taro U.S.A. Sun owns all of the outstanding voting shares of TDC and thereby controls TDC. Although TDC has agreed to vote all of its shares in Taro U.S.A. for the election to its board of directors of such persons as the Company may designate, TDC may terminate the agreement upon one year written notice. In the event that TDC were to cease voting its shares in Taro U.S.A. for our designees or otherwise in accordance with the Company's preference, TDC could prevent the Company from electing a majority of the board of directors of Taro U.S.A., effectively block actions that require approval of a majority of the voting power in Taro U.S.A. and potentially preclude the Company from consolidating Taro U.S.A. into the Company's financial statements. Taro U.S.A. accounted for approximately 81% of the Company's consolidated revenue during 2007, approximately 76% during 2006 and approximately 84% during 2005.

No citizen or resident of the United States who acquired or acquires any of our ordinary shares at any time after October 21, 1999, is permitted to exercise more than 9.9% of the voting power in our Company, with respect to such ordinary shares, regardless of how many shares the shareholder owns.

In order to reduce our risk of being classified as a Controlled Foreign Corporation ("Controlled Foreign Corporation") under the United States Internal Revenue Code of 1986, as amended (the "Code"), we amended our Articles of Association in 1999 to provide that no owner of any of our ordinary shares is entitled to any voting right of any nature whatsoever with respect to such ordinary shares if (a) the ownership or voting power of such ordinary shares was acquired, either directly or indirectly, by the owner after October 21, 1999 and (b) the ownership would result in our being classified as a Controlled Foreign Corporation. This provision has the practical effect of prohibiting each citizen or resident of the United States who acquired or acquires our ordinary shares after October 21, 1999 from exercising more than 9.9% of the voting power in our Company, with respect to such ordinary shares, regardless of how many shares the shareholder owns. The provision may therefore discourage United States persons from seeking to acquire, or from accumulating, 15% or more of our ordinary shares (which, due to the voting power of the founders' shares, would represent 10% or more of the voting power of our Company).

We face risks related to foreign currency exchange rates.

Because some of our revenue, operating expenses, assets and liabilities are denominated in foreign currencies, we are subject to foreign exchange risks that could adversely affect our operations and reported results. To the extent that we incur expenses in one currency but earn revenue in another, any change in the values of those foreign currencies relative to the United States dollar could cause our profits to decrease or our products to be less competitive against those of our competitors. To the extent that our foreign currency holdings and other assets denominated in a foreign currency are greater or less than our liabilities denominated in a foreign currency, we have foreign exchange exposure.

The recent financial crisis and uncertainty in global economic conditions could negatively affect the Company's operating results.

The financial crisis and uncertainty in global economic conditions have resulted in substantial volatility in the credit markets and a low level of liquidity in many financial markets. These conditions may result in a further slowdown to the global economy that could affect the Company's business by reducing the prices that drug wholesalers and retailers, hospitals, government agencies and managed healthcare providers may be able or willing to pay for the Company's products or by reducing the demand for the Company's products, which could in turn negatively impact the Company's sales and revenue generation and result in a material adverse effect on the Company's business, cash flow, results of operations, financial position and prospects.

Our business requires us to move goods across international borders. Any events that interfere with, or increase the costs of, the transfer of goods across international borders could have a material adverse effect on our business.

We transport most of our goods across international borders, primarily those of the United States, Canada and Israel. Since September 11, 2001, there has been more intense scrutiny of goods that are transported across international borders. As a result, we may face delays, and increases in costs due to such delays, in delivering goods to our customers. Any events that interfere with, or increase the costs of the transfer of goods across international borders could have a material adverse effect on our business.

Risks Relating to Key Employees

Our future success is highly dependent on our continued ability to attract and retain key personnel. Any failure to do so could have a material adverse effect on our business, financial position and results of operations and could cause

the market value of our ordinary shares to decline.

The pharmaceutical industry, and our company in particular, is science based. It is therefore imperative that we attract and retain qualified personnel in order to develop new products and compete effectively. If we fail to attract and retain key scientific, technical or management personnel, our business could be affected adversely. If we are unsuccessful in retaining or replacing key employees, it could have a material adverse effect on our business, financial position and results of operations and could cause the market value of our ordinary shares to decline.

We may be unable to retain and attract key personnel.

We are dependent upon the leadership and expertise of certain key employees. The loss of the services of key employees and the inability to recruit and retain additional, qualified personnel could have a material adverse effect on our business. There can be no assurance that we will be successful in retaining and attracting skilled and experienced technical and management personnel. If we are unable to do so, this may materially affect our future financial performance and results of operations.

Risks Relating to Our Location in Israel

Conditions in Israel affect our operations and may limit our ability to produce and sell our products.

We are incorporated under Israeli law and our principal offices and a significant component of our manufacturing and research and development facilities are located in Israel. Political, economic and military conditions in Israel may directly affect our operations, and we could be adversely affected by hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners or a significant downturn in the economic or financial condition of Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, Israel frequently has been subject to civil unrest and terrorist activity, with varying levels of severity. The impact of the recent civil disturbances in various countries in the Middle East may also adversely affect our operations. Furthermore, certain parties with whom we do business periodically have declined to travel to Israel, forcing us to make alternative arrangements where necessary, and the United States Department of State has issued an advisory regarding travel to Israel. As a result, the FDA has at various times curtailed or prohibited its inspectors from traveling to Israel to inspect the facilities of Israeli companies, which, should it occur with respect to our Company, could result in the FDA withholding approval for new products we intend to produce at those facilities.

If terrorist acts were to result in substantial damage to our facilities, our business activities would be disrupted since, with respect to some of our products, we would need to obtain prior FDA approval for a change in manufacturing site. Our business interruption insurance may not adequately compensate us for losses that may occur and any losses or damages sustained by us could have a material adverse effect on our business.

Many male Israeli citizens, including our employees, are subject to compulsory annual reserve military service through middle age. Additionally, these employees are subject to being called to active duty at any time under emergency circumstances. Ongoing and revived hostilities with the Palestinians or Arab countries might require more widespread military reserve service by some of our employees. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of our other employees due to obligatory military service requirement. Any disruption in our operations would harm our business.

We may be affected by fluctuations in Isareli currency exchange rates.

A substantial portion of our expenses, primarily labor and occupancy expenses in Israel, is incurred in NIS. As a result, the cost of our operations in Israel, as measured in United States dollars, is subject to the risk of exchange rate fluctuations among the U.S. dollar and the NIS. During the year-ended December 31, 2007, the value of the NIS increased 9.0% with respect to the United States dollar. This increase did not have a material impact on the United States dollar-measured results of operations; however a material exchange rate fluctuation could adversely affect our United States dollar-measured results of operations. We have experienced material impacts on our United States dollar-measured results of operations in previous years as a result of exchange rate fluctuations.

Our operations may be affected by negative economic conditions in Israel.

In the past, Israel has experienced periods of recession in economic activity, resulting in low growth rates and growing unemployment. Our operations could be adversely affected if the economic conditions in Israel were to deteriorate again. In addition, strikes and work-stoppages occur in Israel on occasion. If Israeli trade unions threaten additional strikes or work-stoppages and such strikes or work-stoppages occur, those may, if prolonged, have a material adverse effect on the Israeli economy and on our business, including our ability to deliver products to our customers and to receive raw materials from our suppliers in a timely manner.

Government price control policies can materially impede our ability to set prices for our products.

All pharmaceutical products sold in Israel are subject to price controls. Permitted price increases and decreases are enacted by the Israeli government as part of a formal review process. The inability to control the prices of our products may adversely affect our operations.

We may benefit from government programs and tax benefits, both or either of which may be discontinued or reduced.

We have, in the past, received grants and substantial tax benefits under government of Israel programs, including the Approved Enterprise program and programs of the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor of the State of Israel. In order to be eligible for these programs and benefits, we must meet specified conditions including making specified investments in fixed assets from our equity and paying royalties with respect to grants received. In addition, some of these programs could restrict our ability to manufacture particular products and transfer particular technology outside of Israel. If we fail to comply with these conditions in the future, the benefits received could be canceled and we could be required to refund payments previously received under these programs or pay increased payments and/or taxes. In the future, the government of Israel may discontinue or curtail these and the tax benefits available under these programs. If the government of Israel ends these programs and tax benefits while we are recipients, our business, financial condition and results of operations could be materially adversely affected.

Provisions of Israeli law may delay, prevent or make more difficult a merger or acquisition. This could prevent a change of control and depress the market price of our ordinary shares.

Provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult a merger or acquisition. The Israeli Companies Law, and the regulations promulgated thereunder, generally requires that a merger be approved by a company's board of directors and by a shareholder vote at a shareholders' meeting that has been called on at least 35 days' advance notice by each of the merger parties. Under our Articles of Association, the required shareholder vote is a supermajority of at least 75% of the shares voting in person or by proxy on the matter. Any creditor of a merger party may seek a court order blocking a merger if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of any party to the merger. Moreover, a merger may not be completed until at least 50 days have passed from the time that a merger proposal has been delivered to the Israeli Registrar of Companies and at least 30 days have passed from the time each merging company received shareholder approval.

Other potential means of acquiring a public Israeli company such as ours might involve additional obstacles. In addition, a body of case law has not yet developed with respect to the Israeli Companies Law. Until this happens, uncertainties will exist regarding its interpretation.

Finally, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than do United States tax laws. The provisions of Israeli corporate and tax law and the uncertainties surrounding such laws may have the effect of delaying, preventing or making more difficult a merger or acquisition. This could prevent a change of control of the Company and depress the market price of our ordinary shares which otherwise might rise as a result of such a change of control.

It may be difficult to effect service of process and enforce judgments against our directors and officers.

We are incorporated in Israel. A majority of our executive officers and directors are non-residents of the United States and a substantial portion of our assets and the assets of such persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any of those persons or to effect service of process upon those persons. It may also be difficult to enforce civil liabilities under United States federal securities laws in original actions instituted in Israel.

We are subject to government regulation that increases our costs and could prevent us from marketing or selling our products.

We are subject to extensive pharmaceutical industry regulations in countries where we operate. We cannot predict the extent to which we may be affected by legislative and other regulatory developments concerning our products.

In Israel, the manufacture and sale of pharmaceutical products is regulated in a manner substantially similar to that in the United States. Legal requirements generally prohibit the handling, manufacture, marketing and importation of any pharmaceutical product unless it is properly registered in accordance with applicable law. The registration file relating to any particular product must contain medical data related to product efficacy and safety, including results of clinical testing and references to medical publications, as well as detailed information regarding production methods and quality control. Health ministries are authorized to cancel the registration of a product if it is found to be harmful or ineffective or manufactured and marketed other than in accordance with registration conditions.

We are subject to legislation in Israel, primarily relating to patents and data exclusivity provisions. Modifications of this legislation or court decision regarding this legislation may adversely affect us and may prevent us from exporting Israeli-manufactured products in a timely fashion. Additionally, the existence of third-party patents in Israel, with the attendant risk of litigation, may cause us to move production outside of Israel or otherwise adversely affect our ability to export certain products from Israel.

Risks Relating to Our Location in Canada

Government price control policies can materially impede our ability to set prices for our products.

The Canadian Government Patented Medicine Prices Review Board ("PMPRB") monitors and controls prices of patented drug products marketed in Canada by persons holding, or licensed under, one or more patents. The PMPRB will approve an introductory price (based on a comparative analysis) and will require that the price not be increased each year thereafter by more than the annual increase of the Canadian Consumer Price Index. Consequently, the existence of one or more patents relating to a drug product, while providing some level of proprietary protection for the product, also triggers a governmental price control regime that significantly affects the Canadian pharmaceutical industry's ability to set pricing. The inability to control the prices of our products may adversely affect our operations.

Sales of our products in Canada depend, in part, upon their being eligible for reimbursement from drug benefit formularies.

In each province of Canada there is a drug benefit formulary. A formulary lists the drugs for which a provincial government will reimburse qualifying persons and the prices at which the government will reimburse such persons. There is not complete uniformity among provinces. However, provincial governments generally will reimburse the lowest available price of the generic equivalents of any drug listed on the formulary list of the province. The formularies can also provide for drug substitution, even for patients who do not qualify for government reimbursement. The effect of these provincial formulary regimes is to encourage the sale of lower-priced versions of pharmaceutical products. The potential lack of reimbursement represents a significant threat to our business. Additionally, the substitution effect may adversely affect our ability to profitably market our products.

We may be adversely affected if the rate of inflation in Canada exceeds the rate of devaluation of the Canadian dollar against the United States dollar.

A substantial portion of our expenses, primarily labor and occupancy expenses in Canada, is incurred in Canadian dollars. As a result, the cost of our operations in Canada, as measured in United States dollars, is subject to the risk that the rate of inflation in Canada will exceed the rate of devaluation of the Canadian dollar in relation to the United States dollar or that the timing of any devaluation will lag behind inflation in Canada. During the year-ended December 31, 2007, the value of the Canadian dollar increased 15.2% with respect to the United States dollar. This increase in the value of the Canadian dollar has had the effect of increasing the United States dollar cost of our goods manufactured in Canada. If the United States dollar cost of our operations in Canada continues to increase, our United States dollar-measured results of operations will continue to be adversely affected.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

The legal and commercial name of our company is Taro Pharmaceutical Industries Ltd. We were incorporated under the laws of the State of Israel in 1959 under the name Taro-Vit Chemical Industries Ltd. In 1984, we changed our name to Taro Vit Industries Ltd. and in 1994 we changed our name to Taro Pharmaceutical Industries Ltd., which was

the name of a subsidiary of Taro Vit Industries Ltd. incorporated under the laws of the State of Israel in 1950.

In 1961, we completed the initial public offering of our ordinary shares, which are quoted on the Pink Sheets under the symbol "TAROF." In that year, we also acquired 97% of the outstanding stock of an Israeli corporation, then known as Taro Pharmaceutical Industries Ltd. ("TPIL"). In 1981, we sold 37% of our interest in TPIL. In 1993, after acquiring all of the outstanding shares of TPIL, we merged TPIL into our company. In July 2001, we completed a split of our ordinary shares by distributing one ordinary share for each ordinary share then outstanding and one ordinary share for every ten founders' shares then outstanding. In October 2001, we sold 3,950,000 of our ordinary shares, and shareholders sold 1,800,000 of our ordinary shares, in a public offering.

On January 14, 2003, Taro Pharmaceuticals North America, Inc., our wholly-owned Cayman Island subsidiary ("TNA"), entered into a license and option agreement with Medicis Pharmaceutical Corporation ("Medicis"). According to the agreement, on June 1, 2004, TNA exercised its option and purchased from Medicis certain branded prescription product lines for sale in the United States and Puerto Rico. Two of these products, Topicort® and Ovide®, are used in dermatology and pediatrics.

On March 21, 2003, our Irish subsidiary, Taro Pharmaceuticals Ireland Limited, acquired, for 5.55 million euros, a multi-purpose pharmaceutical manufacturing and research facility in Ireland. The facility was purchased out of liquidation proceedings under the Official Liquidator appointed by the High Court of Ireland. The facility consists of 124,000 square feet of manufacturing, laboratory, office and warehouse space located on a 13.2-acre campus in central Ireland. On February 18, 2010, we announced our intention to discontinue manufacturing at our Irish facility because it is no longer in the best interests of the Company or its shareholders to continue to incur losses at the facility or make the significant capital investments that would be required to achieve the level of operating efficiency found at Taro's other manufacturing facilities. The discontinuance of operations, following both cash and non-cash one-time expenses associated with the decision, is expected to improve the Company's earnings and cash flow.

In December 2003, our indirectly wholly-owned Canadian subsidiary, Taro Pharmaceuticals Inc. ("Taro Canada") expanded its distribution capacity with the purchase of a 108,797 square foot distribution facility located on 6.7 acres in Brampton, Ontario in close proximity to our existing facilities (the "Brampton Distribution Facility").

In January 2004, Taro U.S.A. expanded its distribution capacity with the purchase of a 315,000 square foot distribution center on 25 acres of land in South Brunswick, New Jersey (the "NJ Distribution Center"). Taro U.S.A. acquired the facility for $18.0 million.

In July 2004, Taro U.S.A. entered into a license and option agreement with Medicis for four products, including the Lustra® product line, for sale in the United States, Puerto Rico and Canada. These products are used for the treatment of dyschromia (discoloration of the skin) and other dermatologic conditions.

In March 2005, the Company entered into multi-year agreements to divest the ElixSure® and Kerasal® brands in North America. In June 2006, the Company completed its divestiture of these products to Alterna-TCHP, LLC ("Alterna") in North America. As part of the final divestiture agreement, the Company received an additional cash payment, including payment for services and products.

The Company has not made any material acquisitions or divestitures of products since the completion of its divestiture of ElixSure® and Kerasal® to Alterna in June 2006. On February 27, 2007 and March 29, 2007, the Company sold a parking lot in Ireland and its Brampton Distribution Facility, respectively, both of which Management believes were not material divestitures.

See Item 5 – "Operating and Financial Review and Prospects – Recent Developments – Investment by Sun" for a summary of public takeover offers by third parties in respect of the Company's shares.

Our principal executive offices are located at Italy House, Euro Park, Yakum 60972, Israel. Our telephone number at that address is +972-9-971-1800. Our registered office is located at 14 Hakitor Street, Haifa Bay 26110, Israel. Our telephone number at that address is +972-4-847-5700. Our agent for service of process in the United States is Taro Pharmaceuticals U.S.A., Inc., 3 Skyline Drive, Hawthorne, NY 10532.

Capital Expenditures

During 2007, 2006 and 2005, our capital expenditures were $6.0 million, $21.9 million and $47.3 million respectively. The focus of our capital expenditure program has been the expansion and upgrade of our manufacturing facilities and information technology systems in order to enable us to increase operational efficiencies, remain in compliance with cGMP, accommodate anticipated increased demand for our products, and maintain a competitive position in the marketplace.

The major projects undertaken during these three years, as part of our capital expenditure program, include:

- the continuing construction of the manufacturing facility in Israel during 2005 of which portions remained unfinished during 2006. Part of buildings and certain equipment were utilized for commercial production beginning in the first quarter of 2006;

- the acquisition of additional production and packaging equipment; and

- the upgrade of our information technology systems.

For a detailed presentation of our property, plant and equipment, see Note 6 to our consolidated financial statements included elsewhere in this 2007 Annual Report. Also see Item 4.D – "Property, Plant and Equipment."

B. BUSINESS OVERVIEW

We are a multinational, science-based pharmaceutical company. We develop, manufacture and market prescription and OTC pharmaceutical products primarily in the United States, Canada and Israel. Our primary areas of focus include pediatric creams and ointments, liquids, capsules and tablets, mainly in the dermatological and topical, cardiovascular, neuropsychiatric and anti-inflammatory therapeutic categories. We operate principally through three entities: Taro Pharmaceutical Industries Ltd. ("Taro Israel"), and two of its subsidiaries (including indirect), Taro Canada and Taro U.S.A. The principal activities and primary product lines of these subsidiaries may be summarized as follows:

Entity	Principal Activities	Primary Product Lines
Taro Israel	Manufactures more than 190 finished dosage form pharmaceutical products for sale in Israel and for export	Dermatology: Prescription and OTC semi-solid products (creams, ointments and gels) and liquids
	Produces APIs used in the manufacture of finished dosage form pharmaceutical products	Cardiology and Neurology: Prescription oral dosage products
	Markets and distributes both proprietary and generic products in the local Israeli market	Oral analgesics, both prescription and OTC
	Performs research and development independently and through Taro Research Institute Ltd., a wholly-owned subsidiary	OTC oral and nasal sprays and ophthalmic products
Taro Canada	Manufactures more than 90 finished dosage form pharmaceutical products for sale in Canada and for export	Dermatology: Prescription and OTC semi-solid products (creams, ointments and gels) and liquids
	Markets and distributes both proprietary and generic products in the local Canadian market	Cardiology and Neurology: Prescription oral dosage products
	Performs research and development	
Taro U.S.A.	Markets and distributes both proprietary and generic products in the U.S. market	Dermatology: Prescription and OTC semi-solid products (creams, ointments and gels) and liquids
		Cardiology and Neurology: Prescription oral dosage products
		Other prescription and OTC products

Warfarin sodium tablets are sold under the Coumadin® brand-name by us in Israel, and as generic warfarin sodium tablets in the United States, Canada, the United Kingdom and elsewhere. This product group accounted for approximately 11.6% of our sales in 2007.

As of March 31, 2011, 24 of our ANDAs were being reviewed by the FDA. In addition, there are several products for which either development or internal regulatory work is in process. The applications pending before the FDA are at various stages in the review process, and there can be no assurance that we will be able to successfully complete any remaining testing or that, upon completion of such testing, approvals for any of the applications under review at the FDA will be granted. In addition, there can be no assurance that the FDA will not grant approvals for competing products submitted by our competitors, prior to, simultaneous with or after the granting of approval to us.

The Generic Pharmaceutical Industry

Generic pharmaceuticals are the chemical and therapeutic equivalents of brand-name drugs and are typically marketed after the patents for brand-name drugs have expired. Generic pharmaceuticals generally must undergo clinical testing that demonstrates that they are bioequivalent to their branded equivalents and are manufactured to the same standards. Proving bioequivalence generally requires data demonstrating that the generic formulation results in a product whose rate and extent of absorption are within an acceptable range of the results achieved by the brand-name reference drug. In some instances, bioequivalence can be established by demonstrating that the therapeutic effect of the generic formula falls within an acceptable range of the therapeutic effects achieved by the brand-name reference drug.

Generic pharmaceutical products must meet the same quality standards as branded pharmaceutical products although they are generally sold at prices that are substantially lower than those of their branded counterparts. As a result, generic pharmaceuticals represent a much larger percentage of total drug prescriptions dispensed than their corresponding percentage of total sales. This discount tends to increase (and margins tend to decrease) as the number of generic competitors increases for a given product. Because of this pricing dynamic, companies that are among the first to develop and market a generic pharmaceutical tend to earn higher profits than companies that subsequently enter the market for that product. Furthermore, products that are difficult to develop or are intended for niche markets generally attract fewer generic competitors and therefore may offer higher profit margins than those products that attract a larger number of competitors. However, profit is influenced by many factors other than the number of competitors for a given drug or the size of the market. Depending on the actions of each of our competitors, price discounts can be just as significant for a specific product with only a few competitors or a small market, as for a product with many competitors or a large market.

In recent years, the market for generic pharmaceuticals has grown. We believe that this growth has been driven by the following factors, among others:

- efforts by governments, employers, third-party payers and consumers to control healthcare costs;
- increased acceptance of generic products by physicians, pharmacists and consumers; and
- the increasing number of pharmaceutical products whose patents have expired and are therefore subject to competition from, and substitution by, generic equivalents.

Products

As of March 31, 2011, we market more than 180 pharmaceutical products in over 20 countries. The following table represents some of our key product groups and the major markets in which they are sold:

Generic Name	Dosage Form	Brand Name(1)	Therapeutic Category	Major Markets	Rx/OTC
Acetazolamide	tablets	Diamox®	Neuropsychiatric	U.S., Israel	Rx
Acetaminophen, Codeine and Caffeine	tablets, gelcaps	Rokacet®(2)	Neuropsychiatric & Analgesic	Israel	OTC
Adapalene	gel	Differin®	Dermatologics and topicals	U.S., Israel	Rx
Amiodarone Hydrochloride	tablets	Cordarone®	Cardiovascular	U.S.	Rx
Ammonium Lactate	cream, lotion	Lac-Hydrin®	Dermatologics and topicals	U.S., Canada	Rx
Aspirin, Codeine and Caffeine	tablets	Rokal®(2)	Neuropsychiatric & Analgesic	Israel	OTC
Augmented Betamethasone Dipropionate	lotion	Diprolene AF®	Dermatologics and topicals	U.S.	Rx
Calcipotriene	ointment	Dovonex®	Dermatologics and topicals	U.S.	Rx
Carbamazepine	tablets, controlled release tablets, chewable tablets, oral suspension	Tegretol®	Neuropsychiatric	U.S., Israel, Canada	Rx
Cetirizine Hydrochloride	solution	Zyrtec®	Allergy	U.S.	OTC
Clobetasol Propionate	cream, ointment, gel, topical solution	Temovate®	Dermatologics and topicals	U.S.	Rx
Clomipramine Hydrochloride	capsule	Anafranil®	Neuropsychiatric	U.S.	Rx
Clorazepate Dipotassium	tablets	Tranxene®	Neuropsychiatric	U.S.	Rx
Clotrimazole	cream, topical solution, vaginal cream	Lotrimin® Gyne-Lotrimin®	Dermatologics and topicals	U.S., Canada	Rx/OTC
Clotrimazole and Betamethasone Dipropionate	cream, lotion	Lotrisone®	Dermatologics and topicals	U.S., Israel	Rx
Desonide	cream, ointment	Tridesilon®	Dermatologics and topicals	U.S.	Rx
Desoximetasone	cream, ointment, gel	Topicort®(2)	Dermatologics and topicals	U.S.	Rx
Diflorasone Diacetate	cream, ointment	Psorcon®	Dermatologics and topicals	U.S.	Rx
Econazole Nitrate	cream	Spectazole®	Dermatologics and topicals	U.S.	Rx
Enalapril Maleate	tablets	Vasotec®	Cardiovascular	U.S.	Rx
Enalapril Maleate and Hydrochlorothiazide	tablets	Vaseretic®	Cardiovascular	U.S.	Rx
Etodolac	tablets, capsules, extended release tablets	Etopan®(2) Lodine®	Anti-Inflamatory & Analgesic	U.S., Israel	Rx
Fluconazole	tablets	Diflucan®	Dermatologics and topicals	U.S.	Rx
Fluocinonide	cream, ointment, gel, topical solution	Lidex®	Dermatologics and topicals	U.S., Canada	Rx
Fluorouracil	topical solution, cream	Efudex®	Topical Anti-neoplastic	U.S.	Rx
Halobetasol Propionate	cream, ointment	Ultravate®	Dermatologics and topicals	U.S.	Rx

Hydrocortisone Valerate	cream, ointment	Westcort®	Dermatologics and topicals	U.S.	Rx
Hydrocortisone	cream, ointment	Cortizone 10®	Dermatologics and topicals	U.S., Israel, Canada	Rx/OTC
Hydroquinone	cream	Lustra®(2)	Dermatologics and topicals	U.S., Canada	Rx
Ketoconazole	tablets, cream	Nizoral®	Dermatologics and topicals / Antifungal	U.S., Canada	Rx
Lamotrigine	tablets	Lamictal®	Neuropsychiatric	U.S.	Rx
Loratadine	solution	Claritin®	Allergy	U.S.	OTC
Malathion	lotion	Ovide®(2)	Dermatologics and topicals	U.S.	Rx
Metronidazole	gel	MetroGel®	Dermatologics and topicals	U.S.	Rx
Miconazole Nitrate	vaginal cream, cream	Monistat® 3 Monistat® 7 Micatin®	Dermatologics and topicals	U.S., Canada	OTC
Mometasone Furoate	cream, ointment, lotion	Elocon®	Dermatologics and topicals	U.S., Canada	Rx
Nystatin	oral suspension, vaginal cream	Mycostatin®	Dermatologics and topicals	U.S., Israel, Canada	Rx
Nystatin/Triamcinolone	cream, ointment	Mycogen II®, Mycolog II®, Myconel®	Dermatologics and topicals	U.S.	Rx
Ondansetron Hydrochloride	solution	Zofran®	Antinauseant	U.S.	Rx
Oxcarbazepine	tablets	Trileptal®	Anticonvulsant	U.S.	Rx
Phenytoin Sodium	extended release capsules, suspension	Dilantin®	Neuropsychiatric	U.S.	Rx
Terconazole	vaginal cream	Terazol®	Dermatologics and topicals	U.S., Canada	Rx
Terbinafine Hydrochloride	cream	Lamisil®	Dermatologics and topicals	U.S.	OTC
Triamcinolone Acetonide	cream, ointment, dental paste	Kenalog®	Dermatologics and topicals	U.S., Canada, Israel	Rx
Warfarin Sodium	tablets	Coumadin®	Cardiovascular	U.S., Israel, Canada	Rx

(1) Presented in this column are the brand-names under which the products are most commonly prescribed in the United States. Except as noted below, we do not own any of the specific names. In some cases, we manufacture and sell the generic equivalent of the product sold by the third-party owner of such name. For example, we sell our product Warfarin Sodium Tablets under that name in the United States. Warfarin Sodium is the generic equivalent of Coumadin, a product sold under that name in the United States by the third-party owner of the United States rights to that name and by us in Israel, where we own the right to use that name.

(2) Company brands.

Topical corticosteroids are used in the treatment of some dermatologic conditions (including psoriasis, eczema and various types of skin rashes). Topical antineoplastics are used in the treatment of cancer (including skin cancer). Antifungals are used in the treatment of some infections (including athlete's foot, ringworm and vaginal yeast infections). Anticonvulsants are used in the treatment of various seizure disorders (including epilepsy). Cardiovascular products are used in the treatment of heart disease. There are several categories of cardiovascular drugs, including anticoagulants, antihypertensive and antiarrhythmics. Anticoagulants, commonly known as blood thinners, are used in the treatment of heart disease and stroke associated with heart disease.

Some of our products are dependent on seasonality, such as allergy drugs, however, in the aggregate our products are not materially dependent on seasonality.

Sales and Marketing

In the United States, Israel and Canada, our sales are primarily generated by our own dedicated sales force. In other countries, we sell through agents and other distributors. Our sales force is supported by our medical representatives, customer service and marketing employees.

The following is a breakdown of our sales by geographic region, including the percentage of our total consolidated net sales for each period:

	2007		2006		2005	
	Sales in thousands	% of total sales	Sales in thousands	% of total sales	Sales in thousands	% of total sales
U.S.A.	$258,519	81 %	$192,785	76 %	$243,416	84 %
Canada	34,913	11 %	37,266	15 %	26,420	9 %
Israel	17,362	5 %	14,942	6 %	15,243	5 %
Other	8,760	3 %	7,276	3 %	3,544	2 %
Total	$319,554	100 %	$252,269	100 %	$288,623	100 %

In 2007, revenue in the United States accounted for 81% of total consolidated net sales. In addition to marketing prescription drugs, Taro U.S.A. markets its generic OTC products primarily as store brands under its customers' labels to wholesalers, drug chains, food chains and mass merchandisers. During 2007, we sold to approximately 142 customers in the United States. The following table represents sales to our two largest customers as a percent of consolidated sales during the last three years:

Customer	2007	2006	2005
Customer A	15.8 %	*	23.0 %
Customer B	10.1 %	12.0 %	*

* Less than 10%

The following table sets forth the percentage of consolidated net sales by each type of customer of Taro U.S.A. in 2007:

Customer Type	Percentage of Consolidated Sales
Drug wholesalers and store chains	35%
Generic drug distributors	23%
Mass merchandisers food and retail chains	13%
Managed care organizations	6%
Other	4%

In 2007, sales in Israel accounted for 5% of our total consolidated net sales. The marketing, sale and distribution of prescription pharmaceuticals and OTC products in Israel is closely monitored by the Israeli government. The market for these products is dominated by institutions that are similar to health maintenance organizations in the United States, as well as private pharmacies. Most of our marketing efforts in Israel focus on selling directly to these groups.

All pharmaceutical products sold in Israel are subject to price controls. Permitted price increases and decreases are enacted by the Israeli government as part of a formal review process. There are no restrictions on the import of pharmaceuticals, provided that they comply with registration requirements of the Israeli Ministry of Health.

In Israel, the pharmaceutical market generally is divided into two market segments: (i) the private market, which includes drug store chains, private pharmacies and wholesalers; and (ii) the institutional market, which includes Kupat Holim Clalit ("Kupat Holim") (the largest health maintenance organization in Israel), other health maintenance organizations, the Israel Ministry of Health and the Armed Forces.

In 2007, sales to other international markets accounted for approximately 3% of consolidated net sales.

The following table sets forth the percentage of consolidated net sales by each type of customer of Taro Israel and other international markets in 2007:

Customer Type	Percentage of Consolidated Sales
Institutional	3%
Private	1%
Other international	4%

In 2007, sales in Canada accounted for 11% of our total consolidated net sales. During 2007, Taro Canada had approximately 172 customers.

The following table sets forth the percentage of consolidated net sales by each type of customer of Taro Canada in 2007:

Customer Type	Percentage of Consolidated Sales

Drug wholesalers	10%
Drug chains, independent pharmacies and others	1%

We have expanded the production capacity of our Israeli and Canadian operations to meet anticipated greater demand for our products in future years. As discussed below under "Industry Practice Relating to Working Capital Items," future demand for our products may not increase at a rate we previously anticipated. In addition, we utilize contract manufacturing for certain products to satisfy customer demand in a timely manner. As a result, in each of 2005, 2006 and 2007, backorders generally represented less than 5% of our consolidated sales.

Competition and Pricing

The pharmaceutical industry is intensely competitive. We compete with the original manufacturers of the brand-name equivalents of our generic products, other generic drug manufacturers (including brand-name companies that also manufacture generic drugs or license their products to other generic drug manufacturers) and manufacturers of new drugs that may compete with our generic drugs. Many of our competitors have greater financial, production and research and development resources, substantially larger sales and marketing organizations, and substantially greater name recognition than we have.

Historically, brand-name drug companies have attempted to prevent generic drug manufacturers from producing certain products and to prevent competing generic drug products from being accepted as equivalent to their brand-name products. We expect such efforts to continue in the future. Also, some brand-name competitors, in an attempt to participate in the generic drug sales of their branded products, have introduced generic equivalents of their own branded products, both prior and subsequent to the expiration of their patents or FDA exclusivity periods for such drugs. These competitors have also introduced authorized generics or generic equivalents of brand-name drug products.

In the United States, we compete with branded pharmaceutical manufacturers such as Bristol-Myers Squibb, GlaxoSmithKline, Medicis Pharmaceutical, Novartis, Pfizer/Wyeth and Merck/Schering-Plough, as well as with generic companies such as Altana (now Nycomed), Teva Pharmaceuticals U.S.A. (now including Barr Laboratories) ("Teva"), Mylan Laboratories, Perrigo Company, Ranbaxy Pharmaceuticals Inc. and Sandoz Pharmaceuticals. Many of these companies have more resources, market and name recognition and better access to customers than we have. Therefore, there can be no assurance of the success of any of our products.

We compete in the Canadian market with Hoffmann-La Roche, Schering-Plough Canada, Novartis Pharmaceuticals Canada Inc., GlaxoSmithKline Inc., Bayer Inc. and Bristol-Myers Squibb Canada, as well as with other manufacturers of generic products, such as Apotex Inc., Novopharm (part of Teva), Ratiopharm, Genpharm Inc. and Pharmascience Inc.

Depending on the product, pricing in Canada is established by competitive factors or by Canadian formulary price lists published by the Canadian provinces.

In Israel, we compete with Teva Pharmaceutical Industries Ltd., Perrigo Israel Pharmaceuticals Ltd., Dexxon Ltd., and Rafa Laboratories Ltd., among others. In addition, many leading multinational companies, including Bayer AG, Eli Lilly and Company, Merck & Co., Inc. and Pfizer Inc., market their products in Israel.

In Israel, the government establishes the prices for pharmaceutical products as part of a formal review process. There are no restrictions on the import of pharmaceuticals provided that they comply with registration requirements of the Israeli Ministry of Health.

Manufacturing and Raw Materials

We manufacture finished pharmaceutical products at our government approved facilities in Canada and Israel and APIs at our facilities in Israel. We have expanded our research and development and warehousing facilities in Israel. An auxiliary warehouse in Canada that was used primarily for warehousing of finished goods pharmaceutical products for the U.S. market was sold for $5.2 million on March 29, 2007, as Taro U.S.A. acquired a warehouse in Cranbury, New Jersey.

For the manufacture of our finished dosage form pharmaceutical products, we use pharmaceutical chemicals that we either produce ourselves or purchase from chemical manufacturers in the open market globally. Substantially all of such chemicals are obtainable from a number of sources, subject to regulatory approval. However, we purchase certain raw materials from single source suppliers. The decision to purchase APIs is a function of our sales forecast and prevailing prices in the market. When appropriate purchasing opportunities arise, the Company may acquire certain APIs in excess of its ordinary requirements or rate of growth. Obtaining the regulatory approvals required to add alternative suppliers of such raw materials for products sold in the United States or Canada may be a lengthy process. We strive to maintain adequate inventories of single source raw materials in order to ensure that any delays in receiving such regulatory approvals will not have a material adverse effect on our business. However, we may become unable to sell certain products in the United States or Canada pending approval of one or more alternate sources of raw materials.

We synthesize the APIs used in some of our key products, including our warfarin sodium tablets, carbamazepine products, etodolac tablets, oxcarbazepine tablets and clorazepate dipotassium tablets. We also synthesize the API for our Ovide® lotion. We plan to continue the strategic selection of APIs for synthesis in order to maximize the advantages from this scientific and manufacturing capability.

Although, prices of principal raw materials have been relatively stable, the Company has instituted programs to keep the cost of APIs consistent or to improve upon them; for example, by the qualification of alternate suppliers.

Industry Practices Relating to Working Capital Items

Certain customary industry selling practices affect our supply of working capital, including, but not limited to, providing favorable payment terms to customers and discounting selling prices through the issuance of free products as well as other incentives within a specified time frame if a customer purchases more than a specified threshold of a product. These incentives are provided principally with the intention of maintaining or expanding our distribution to the detriment of competing products.

Industry practice requires that pharmaceutical products be made available to customers from existing stock rather than on a made-to-order basis. Therefore, in order to accommodate market demand adequately, we strive to maintain a sufficient level of inventory.

Government Regulation

We are subject to extensive pharmaceutical industry regulations in the United States, Canada, Israel and other jurisdictions, and may be subject to future legislative and other regulatory developments concerning our products and the healthcare field generally. Any failure by us to comply with applicable policies and regulations of any of the numerous authorities that regulate our industry could have a material adverse effect on our results of operations.

In the United States, Canada, Israel and other jurisdictions, the manufacture and sale of pharmaceutical products are regulated in a similar manner. Legal requirements generally prohibit the handling, manufacture, marketing and importation of any pharmaceutical product unless it is properly registered in accordance with applicable law. In addition, approval is required before any new drug or a generic equivalent to a previously approved drug can be marketed. Furthermore, each country requires approval of manufacturing facilities, including adherence to cGMPs during the production and storage of pharmaceutical components, including, but not limited to, raw materials and finished products. As a result, we have had periodic inspections of our facilities and records. For example, Taro Canada was inspected by the FDA in 1995, 1996, 1998, 2001, 2005, 2008 and 2011. Our facilities in Haifa Bay, Israel were inspected by the FDA in 1996, 1997, 1999, 2002, 2006, 2009 and 2010 by the United Kingdom Medicines Control Agency in 1997 and 1998, and by the Irish Medicines Board in 2005.

As described in the Risk Factors, our Canadian manufacturing facility received a Warning Letter from the FDA in February 2009 expressing concerns identified during a July 2008 inspection about certain quality control systems, including failure to complete investigations of quality issues in a timely manner. A formal cGMP re-inspection was conducted by the FDA in February 2011 to evaluate the effectiveness of corrective actions undertaken by Taro and the FDA announced in April 2011 that the site has an acceptable regulatory status and issues were considered resolved.

Regulatory authorities in each country also have extensive enforcement powers over the activities of pharmaceutical manufacturers, including the power to seize, force the recall of and prohibit the sale or import of non-complying products and to halt the operations of and criminally prosecute and fine non-complying manufacturers. These regulatory authorities also have the power to revoke approvals previously granted and remove from the market previously approved drug products.

In the United States, Canada, Israel and other jurisdictions, we, as well as other manufacturers of drugs, are dependent on obtaining timely approvals for products. The approval process in each country has become more rigorous and costly in recent years. There can be no assurance that approvals will be granted in a timely manner or at all. In the United States, Canada, Israel and other jurisdictions, the procedure for drug product approvals, if such approval is ultimately granted, generally takes longer than one year. Inability or delay in obtaining approvals for our products could adversely affect our product introduction plans and our results of operations.

In the United States, any drug that is not generally recognized as safe and effective by qualified experts for its intended use is deemed to be a new drug which generally requires FDA approval. Approval is obtained, either by the submission of an ANDA or a NDA. If the new drug is a new dosage form, a strength not previously approved, a new indication or an indication for which the ANDA procedure is not available, an NDA is required.

We generally receive approval for generic products by submitting an ANDA to the FDA. When processing an ANDA, the FDA waives the requirement of conducting complete clinical studies, although it may require bioavailability and/or bioequivalence studies. Bioavailability is generally determined by the rate and extent of absorption and levels of concentration of a drug product in the blood stream needed to produce a therapeutic effect. Bioequivalence compares the bioavailability of one drug product with another and, when established, indicates that the rate of absorption and levels of concentration of a generic drug in the body or on the skin are substantially equivalent to the previously approved brand-name reference drug. An ANDA may be submitted for a drug on the basis that it is bioequivalent to a previously listed drug, contains the same active ingredient, has the same route of administration, dosage form, and strength as the listed drug, and otherwise complies with legal and regulatory requirements. There can be no assurance that approval for ANDAs can be obtained in a timely manner, or at all. ANDA approvals are granted after the review by the FDA of detailed information submitted as part of the ANDA regarding the pharmaceutical ingredients, drug production methods, quality control, labeling, and demonstration that the product is therapeutically equivalent or bioequivalent to the brand-name reference drug. Demonstrating bioequivalence generally requires data demonstrating that the generic formula results in a product whose rate and extent of absorption are within an acceptable range of the results achieved by the brand-name reference drug. In some instances, bioequivalence can be established by demonstrating that the therapeutic effect of the generic formula falls within an acceptable range of the therapeutic effects achieved by the brand-name reference drug. Approval of an ANDA, if granted, generally takes more than two years from the submission of the application.

Products resulting from our proprietary drug program may require us to submit an NDA to the FDA. When processing an NDA, the FDA generally requires, in addition to the ANDA requirements (except for bioequivalence), complete pharmacological and toxicological studies in animals and humans to establish the safety and efficacy of the drug. The clinical studies required prior to the NDA submission are both costly and time consuming, and often take five to seven years or longer, depending, among other factors, on the nature of the chemical ingredients involved and the indication for which the approval is sought. Approval of an NDA, if granted, generally takes at least one year from the submission of the application to the FDA.

Among the requirements for drug approval by the FDA is that manufacturing procedures and operations conform to cGMP. The cGMP regulations must be followed at all times during the manufacture of pharmaceutical products. In complying with the standards set forth in the cGMP regulations, a manufacturer must expend time, money and effort in the areas of production and quality control to ensure full compliance.

If the FDA believes a company is not in compliance with cGMP, certain sanctions may be imposed, including: (i) withholding new drug approvals as well as approvals for supplemental changes to existing applications; (ii) preventing the receipt of necessary licenses to export products; (iii) preventing the importation of certain products into the United States; (iv) classifying the company as an unacceptable supplier and thereby disqualifying the company from selling products to federal agencies; and (v) pursuing a consent decree or court action that limits company operations or imposes monetary fines.

In addition, because we market a controlled substance in the United States and other controlled substances in Israel, we must meet the requirements of the United States Controlled Substances Act and its equivalent in Israel, as well as the regulations promulgated thereunder in each country. These regulations include stringent requirements for manufacturing controls, receipt and handling procedures and security to prevent diversion of, or the unauthorized access to, the controlled substances in each stage of the production and distribution process.

In May 1992, the Generic Drug Enforcement Act of 1992 (the “Generic Act”) was enacted. The Generic Act, a result of legislative hearings and investigations into the generic drug approval process, allows the FDA to impose debarment and other penalties on individuals and companies that commit certain illegal acts relating to the generic drug approval process. In some situations, the Generic Act requires the FDA not to accept or review, for a period of time, ANDAs

from a company or an individual that has committed certain violations. It also provides for temporary denial of approval of applications during the investigation of certain violations that could lead to debarment and also, in more limited circumstances, provides for the suspension of the marketing of approved drugs by the affected company.

Lastly, the Generic Act allows for civil penalties and withdrawal of previously approved applications. To our knowledge, neither we nor any of our employees has ever been subject to debarment.

The review processes in Canada and Israel are substantively similar to the review process in the United States.

Environmental Compliance

We believe that we are in compliance with all applicable environmental laws and regulations in Canada and the United States. In Israel, we are in compliance with all applicable environmental laws and regulations subject to the following clarification: new regulations concerning air emissions were enacted in Israel during 2008. The Israel Ministry of Environmental Protection (the "MEP") conducted tests of air emissions at the Haifa Bay facility during May 2008 and provided the results of such testing to the Company in January 2009. The MEP concluded that the Company should reduce its levels of emissions. In response, the Company has taken steps to improve its emission output by implementing a Regenerative Thermal Oxidizer ("RTO") system to meet the EU TALUFT 2002 standards. Implementation is in its final stages. See Item 5 – "Operating and Financial Review and Prospects – Recent Developments" for an update.

C. ORGANIZATIONAL STRUCTURE

The legal and commercial name of our company is Taro Pharmaceutical Industries Ltd. We were incorporated under the laws of the State of Israel in 1959 under the name Taro-Vit Chemical Industries Ltd. In 1984, we changed our name to Taro Vit Industries Ltd., and in 1994, we changed our name to Taro Pharmaceutical Industries Ltd.

The following is a list of our significant subsidiaries and their countries of incorporation as of March 31, 2011:

Name of Subsidiary	Country of Incorporation
Taro Research Institute Ltd.	Israel
Taro Pharmaceuticals U.S.A., Inc.	United States
Taro Pharmaceuticals Inc.	Canada
Taro Pharmaceuticals North America, Inc.	Cayman Islands
Taro Pharmaceuticals Europe B.V.	Netherlands
Taro International Ltd.	Israel

The share capital of Taro U.S.A. is divided into two classes. The Company owns 96.9% of the shares that have economic rights and 50% of the shares that have voting rights in Taro U.S.A. TDC owns 3.1% of the shares that have economic rights and 50% of the shares that have voting rights in Taro U.S.A. TDC has agreed to vote all of its shares in Taro U.S.A. for such persons as we may designate for any election to its board of directors; however, TDC may terminate the agreement upon one year's written notice.

The Company owns 99.8% of the shares of Taro Research Institute Ltd. and Taro International Ltd. owns the remaining 0.2%. The Company owns 100% of Taro Pharmaceuticals North America, Inc., which owns 100% of Taro Pharmaceuticals Inc. The Company owns 99.75% of Taro Pharmaceuticals Europe B.V. and Taro Pharmaceuticals North America, Inc. owns the remaining 0.25%.

Sun beneficially owns 77.5% of the voting power of the Company.

D. PROPERTY, PLANT AND EQUIPMENT

The following is a list of our principal facilities as of December 31, 2007:

Location	Square Footage	Main Use	Own/Lease
Haifa Bay, Israel1	890,000		Long-term Lease

		Pharmaceutical manufacturing, production laboratories, offices, warehousing, chemical production (including tank farm and chemical finishing plant), and research	Own Lease Use permit
Yakum, Israel	15,000	Administrative offices	Lease
Brampton, Canada	142,000	Pharmaceutical manufacturing, production laboratories, laboratories, administration, distribution and warehousing	Own
Brampton, Canada	75,400	Administration and warehousing	Lease
Hawthorne, New York	124,000	Administrative offices	Own
South Brunswick, New Jersey	315,000	Distribution facility	Own
Roscrea, Ireland2	124,000	Pharmaceutical manufacturing, research laboratories and warehousing	Own

1. The majority of the land is held by the Company under a long-term lease from the Israeli Land Authority ("ILA"), which has not yet provided approval for the change of control of the Company.
2. The Irish facility has been discontinued and is held for sale.

From 2005 through 2007, we invested $75.2 million in property, plant and equipment ("PP&E") projects. Most of these projects have been completed and are subject to depreciation in accordance with our accounting policy of capitalizing costs that are direct and incremental to the activities required to bring the facilities to commercial production.

Our plant, research and office facilities in Haifa Bay, Israel, are located in a complex of buildings with an aggregate area of approximately 890,000 square feet. We lease much of the land underlying these facilities from the ILA pursuant to long-term ground leases that expire between 2018 and 2058. We have the option to renew each lease for an additional 49 years. We also lease approximately 10,000 square feet of adjacent space in Haifa Bay. The lease for this property commenced on September 30, 1994. For additional information, please refer to Note 2.i. to our consolidated financial statements included elsewhere in this 2007 Annual Report.

We lease approximately 15,000 square feet of space in a facility located in Yakum, Israel, which is used for administrative and marketing offices.

In February 2002, Taro Canada purchased 74,000 square feet of space that it had leased since March 1997, adjacent to the 68,000 square foot main manufacturing facility which it owns in Brampton, Canada. In September 2000, Taro Canada leased an additional 75,400 square feet of office and warehouse space, adjacent to the other two facilities, which lease term continues to 2015. In December 2003, Taro Canada purchased a 108,797 square foot building in close proximity to its existing facilities for $3.6 million. This building was used primarily for warehousing and was sold for net proceeds of $5.2 million on March 29, 2007.

In August 2002, Taro U.S.A. purchased a 32% interest in a 124,000 square foot building in Hawthorne, New York, in which it located its United States research operations, for $4.4 million. In February 2005, Taro U.S.A. exercised its option to purchase the remaining 68% interest in this building and, in May 2005, Taro U.S.A. consolidated its administrative offices and research laboratory to this location. In September 2006, such research laboratory operations were discontinued. As of December 31, 2007, a subsidiary of Taro U.S.A. had a mortgage on this property of $11.1 million.

In January 2004, Taro U.S.A. purchased a 315,000 square foot distribution facility in South Brunswick, New Jersey for $18.0 million. As of December 31, 2007, a subsidiary of Taro U.S.A. had a mortgage on this property of $10.5 million.

In the pharmaceutical industry, both manufacturing plants and equipment must be constructed and installed in accordance with regulations designed to meet stringent quality and sterility guidelines, among others. In order to meet these requirements, certain validation processes are required to be completed prior to commencing commercial production.

Design qualification ("DQ"), installation qualification ("IQ"), operational qualification ("OQ"), performance qualification ("PQ") and validation are the steps required by cGMPs to bring plants and/or equipment to the status of their intended use. In the performance of these activities, the Company uses both internal and external resources. The Company capitalizes external costs and those internal costs that are direct and incremental to the activities required to bring the facilities and activities to commercial production.

In the pharmaceutical industry, project life cycles (e.g., the construction of a new manufacturing facility) are typically longer than those in other industries. Such projects are technically complicated due to the highly regulated nature of the industry and the necessity of complying with specific detailed demands of regulatory authorities such as the FDA.

Certain internal resources utilized in bringing these facilities to the status required for their intended use are completely dedicated to these projects. The costs of personnel involved in such a process are capitalized only to the extent that they are directly dedicated to the completion of the facilities.

As fully described below, the nature of the activities performed by the employees whose salaries were capitalized include only the work and the direct costs associated with the factory acceptance test ("FAT"), the installation of equipment and the qualification and testing of the equipment prior to its commercial use.

The typical stages for defining the beginning and the completion of such construction projects include: planning and design of the facilities; construction; purchase, transportation and installation of equipment; equipment and facility validation (run in tests); and process and product validation.

All new equipment must undergo IQ, OQ and PQ in order to test and verify, according to written protocols, that all aspects of the equipment meet pre-determined specifications. IQ is defined as the documented evidence that the equipment has been installed according to the approved drawings and specifications. OQ is the documented evidence that all aspects of the equipment and the facility operate as intended within pre-determined ranges, according to the operational specifications. PQ is defined as the documented evidence that all aspects of the facility, utility or equipment that can affect product quality perform as intended in the pre-determined acceptance criteria.

Such qualification and validation activities are required for all equipment and systems that have an impact on or affect product quality and are required prior to commencing commercial production. At the time of installation and validation, all employees who will operate and maintain the equipment from the engineering, technology and maintenance departments are appropriately trained. At this stage in the installation and validation process, experts from the equipment manufacturer are on site, as part of the purchase contract, to provide training to Company employees in the operation and maintenance of the equipment.

This phase, which is necessary to bring the asset to the condition required for its intended use, is handled by a multi-functional team of engineers and technologists. The direct costs are the direct labor and the material consumed during this stage of installation and validation such as bottles, ampoules and raw materials. Incremental costs, which have arisen in direct response to the additional activity, include the expenses directly attributable to any employee's time fully dedicated to the project in question.

After the equipment has passed all IQ, OQ and PQ tests, it is then tested for its ability to actually manufacture the specific products that are intended to be produced on the equipment. Three consecutive successful validation batches must be produced. This process is performed jointly by the technology and the manufacturing departments. In addition, the cleaning of the equipment must be validated to assure that there is no carry-over residue to the next product to be manufactured using the equipment. Only after the validation batches that are manufactured using the new equipment pass quality control and quality assurance tests can they be released for sale, completing the validation process. No further costs are capitalized. This process is performed for all products.

This phase is handled by the technology department. On occasion, the engineering department is also involved. Direct costs for this stage would include all direct costs, such as payroll, attributable to the project. Incremental costs would include the expenses attributable to any management time fully dedicated to the project in question.

During the installation process, materials from inventory are consumed. For example, in order to qualify a tablet press machine or an ampoule filling machine, we use raw materials, including APIs and excipients, to run the qualification test. As part of this test, actual tablets are manufactured and costs are incurred. These tablets may neither be distributed nor sold. These qualification procedures are part of cGMPs mandated by the FDA and its international

counterparts. The amount of inventory capitalized as part of these projects is less than one percent of the total cost of the assets. We do not capitalize, as part of the asset cost, inventories that are routinely produced in commercial quantities on a repetitive basis.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RECENT DEVELOPMENTS

Investment by Sun

In early November 2006, because of decreasing liquidity, the Company retained The Blackstone Group ("Blackstone"), an investment banking firm, to assist it in exploring strategic alternatives, which included efforts to raise capital or find a suitable merger partner for Taro. Following an extensive process begun in 2006 and review of numerous proposals, on May 18, 2007 we entered into a merger agreement, among the Company, Alkaloida Chemical Company Exclusive Group Ltd. ("Alkaloida"), a subsidiary of Sun Pharma and Aditya Acquisition Company Ltd. ("Aditya"), a subsidiary of Alkaloida (the "Merger Agreement") to effect an investment and a merger with Alkaloida. On that same day, we entered into a share purchase agreement (the "Share Purchase Agreement") with Alkaloida, pursuant to which, in May 2007, Alkaloida invested $40.7 million in consideration for 6,787,500 of our ordinary shares at a price per share of $6.00, and Sun received a 3-year warrant to purchase an additional 6,787,500 of our ordinary shares with an exercise price per share of $6.00.

On May 28, 2008, the Company terminated the Merger Agreement. The proposed merger was subject to a number of terms and conditions, including the approval by our shareholders, certain Israeli governmental authorities and the U.S. Federal Trade Commission (the "FTC"). After it became clear that the merger may not be approved by the shareholders at the proposed price of $7.75 per share, Sun offered, in early 2008, to raise the merger price to $10.25, subject to certain conditions. The Company's board of directors (the "Board" or "Board of Directors") and its advisors evaluated Sun's offer and found that it was inadequate. On May 27, 2008, the Board determined that permitting the Merger Agreement to remain in force was no longer in the best interests of the Company's shareholders. On May 28, 2008, the Company announced it had terminated the Merger Agreement in accordance with its terms. That same day, Taro and its directors (other than the members of the Levitt and Moros families, who are comprised of Dr. Barrie Levitt, Ms. Tal Levitt and Dr. Daniel Moros), filed an originating motion against Sun Pharma, Alkaloida and Aditya with the Tel-Aviv District Court (the "District Court") seeking, among other things, a declaratory ruling and a permanent injunction prohibiting Sun Pharma, Alkaloida and Aditya from purchasing or offering to purchase additional ordinary shares that would result in an increase in Sun's voting power to more than 45% of the total voting power of the Company, other than by means of a special tender offer ("Special Tender Offer") in accordance with provision 328 of the Israeli Companies Law – 1999 (the "Israeli Companies Law"). The "special tender offer" rules under Israeli law provide certain protections for minority shareholders. An additional shareholder in the Company, Franklin Advisers, Inc. and Templeton Asset Management Ltd. (together "Templeton"), joined as an applicant to the proceeding, also arguing that a Special Tender Offer is required.

Sun thereafter claimed that the Company was not entitled to terminate the Merger Agreement and on June 25, 2008, Sun gave notice that it was exercising its option under the option agreement entered into by Sun on May 18, 2007, with Dr. Barrie Levitt, Dr. Daniel Moros, Ms. Tal Levitt, Dr. Jacob Levitt and TDC (the "Option Agreement"). Pursuant to the Option Agreement, Sun was granted the option to acquire certain ordinary shares owned by Dr. Barrie Levitt, Dr. Moros, Ms. Levitt, and TDC for $7.75 per share, as well as all of the founders' shares for no consideration (the "Options"). A condition to the exercise of the Options required Sun to commence a tender offer to purchase any and all ordinary shares owned by all other shareholders for $7.75 per share, while Sun is not permitted to consummate the transactions contemplated by the Options until such tender offer expires.

On June 30, 2008, Sun commenced a regular tender offer for any and all ordinary shares at a price of $7.75 per share (the "Sun Offer"). On August 26, 2008, the District Court ruled that Sun was not required to comply with the Special Tender Offer rules. On August 28, 2008, the Company and its Independent Directors filed an appeal to the Supreme Court of the State of Israel (the "Israeli Supreme Court") and requested a temporary injunction to prevent Sun from

acquiring additional ordinary shares which would result in its voting power being more than 45% of the Company's voting power during the pendency of the appeal. On September 1, 2008, the Israeli Supreme Court granted the temporary injunction.

On September 7, 2010, the Supreme Court denied the Company's appeal and ordered the revocation of the temporary injunction which had prohibited the closing of the Sun Offer.

On the same day, Sun announced the decision of the Israeli Supreme Court and the expiration date of the Sun Offer (the "Announcement Date") as the fifth business day following the Announcement Date which was 12:00 midnight, New York City time, on Tuesday, September 14, 2010.

On September 21, 2010, the Company announced that the controlling shareholders of the Company, the Levitt and Moros families (together with their affiliated entities, the "Levitt/Moros Shareholders"), executed a letter agreement (the "Letter Agreement") on September 20, 2010 with Sun. Pursuant to the Letter Agreement, the Levitt/Moros Shareholders transferred certain beneficial interests in the Company to Sun in accordance with the Option Agreement. Among the interests transferred was beneficial ownership of the founders' shares of Taro, which represent one-third of the voting power of Taro's capital stock.

Concurrent with the execution of the Letter Agreement, Sun and the members of the Board, including the Levitt/Moros Shareholders, entered into a settlement agreement and release, pursuant to which Sun and the incumbent members of Taro's Board agreed, among other things, to release each other from, and covenanted not to sue based on, certain claims related generally to the acquisition of Taro by Sun and litigation arising therefrom.

Also, on September 20, 2010, Taro's Board passed a resolution appointing Dilip Shanghvi, Sudhir Valia, Aalok Shanghvi, Hasmukh Shah and Ilan Leviteh as members of the Board, and the incumbent members of Taro's Board submitted their resignations as directors and officers of the Company and its subsidiaries, as applicable. At a subsequent Board meeting, Mr. Dilip Shanghvi was elected Chairman of Taro's Board.

In addition to the foregoing, the Company issued a letter dated September 20, 2010, to Sun Pharma and Alkaloida acknowledging the valid exercise by Alkaloida of a certain Warrant No. 2 issued August 1, 2007, for the purchase of 3,787,500 Ordinary Shares of Taro for an aggregate price of $22,725,000. As of December 31, 2010, with the exercise of Warrant No. 2 as well as the completion of the acquisition of the shares from the Levitt/Moros Shareholders and the acquisition of the shares from Templeton on November 1, 2010, Sun owned, or controlled, 28,072,933, or 65.2%, of Taro's Ordinary Shares and, with Taro's Founders' Shares, 76.8% of the vote attributable to the share equity of the Company.

Subsequent to December 31, 2010, Alkaloida acquired 712,500 Ordinary Shares remaining under the Share Purchase Agreement and 712,500 Ordinary Shares pursuant to Warrant No. 2. The Ordinary Shares available pursuant to the Share Purchase Agreement and the Warrant had been reserved for purchase pending the outcome of a lawsuit initiated on May 10, 2007 in Israel against, among others, the Company and Sun by Templeton. Sun and Templeton subsequently entered into a settlement agreement, whereby the litigation ceased and Sun became eligible to purchase the reserved Ordinary Shares of the Company. As a result of the exercise of Warrant No. 2 and the purchase of shares by Alkaloida pursuant to the Share Purchase Agreement, Sun owns, or controls, 29,497,933, or 66.3%, of the Company's Ordinary Shares, and with the Company's Founders' Shares, 77.5% of the vote attributable to the share equity of the Company.

As a result of the changes described in the preceding paragraphs, the Company has a substantial relationship with Sun. Certain of Taro's Board members, including the Chairman, are also on Sun Pharma's Board of Directors. In addition, certain of Taro's officers and executives are also executives of Sun. Taro's Interim Chief Executive Officer, who is also a member of the Board of Directors of Taro, is an officer of an indirect subsidiary of Sun Pharma.

General Shareholders Meeting

The Company held its annual general shareholders meeting on December 30, 2010, in Yakum, Israel. The Company's shareholders voted to elect all of the directors who were recommended for election, including two statutory external directors. The Company's shareholders also approved the appointment of the Company's independent auditors. At an extraordinary general shareholders meeting held on May 12, 2011 in Yakum, Israel, the Company's shareholders approved indemnification of directors, elected James Kedrowski as an additional director to the Board and approved and ratified the remuneration of the directors who are not statutory external directors.

Late Filing of our Annual Reports on Form 20-F for Years-Ended 2005, 2006, 2007, 2008 and 2009

We did not timely file our Annual Report on Form 20-F for fiscal years ended 2005, 2006, 2007, 2008 and 2009. As a result, the Company experienced a number of significant negative consequences. See "NASDAQ Stock Market Delisting," and "Compliance with Covenants in Debt and Loan Agreements," in this "Recent Developments" section.

In addition, we are not able to access public capital markets due to our non-compliance with SEC reporting requirements.

The Company received a letter from the SEC in May 2009 noting that the Company is not in compliance with its SEC reporting requirements, and advising that, until the Company complies with such reporting requirements, an administrative proceeding could be brought to revoke the Company's registration under the Exchange Act and that the Company's stock also could be subject to a trading suspension by the SEC pursuant to the Exchange Act. The Company communicated with the SEC, explaining the reasons for the delay in filing its annual reports as well as its significant and continuing efforts to return to compliance with its financial reporting obligations as soon as possible. As of September 22, 2011, the Company has filed an Annual Report on Form 20-F for the fiscal years ended 2005, 2006, 2007, 2008, 2009 and 2010.

Appointment of New Interim Chief Financial Officer

On November 19, 2010, we announced that we had appointed Michael Kalb to the position of Interim Chief Financial Officer of the Company following the departure of the Company's former Chief Financial Officer. Mr. Kalb is also Group Vice President, Chief Accounting Officer of the Company and Chief Financial Officer of Taro U.S.A.

NASDAQ Stock Market Delisting

On July 21, 2006, we received a staff determination from the Listing Qualifications Department of The NASDAQ Stock Market stating that because NASDAQ had not received our 2005 Annual Report as required by NASDAQ Marketplace Rule 4320(e)(12), our ordinary shares were subject to delisting from The NASDAQ Global Select Market unless we requested a hearing. We requested a hearing before a NASDAQ Listing Qualifications Panel (the "Panel") to review the staff determination. Our ordinary shares remained listed pending the review. The Panel determined to continue the listing of our ordinary shares on The NASDAQ Global Select Market, subject to certain conditions, until November 17, 2006. Subsequently, the Panel granted a further extension of time to December 11, 2006. On December 12, 2006, we received a notification from the Listing Qualifications Department of NASDAQ that our ordinary shares would be delisted from The NASDAQ Global Select Market after the close of business on Wednesday, December 13, 2006, because we had failed to file our 2005 Annual Report by December 11, 2006.

Following delisting, our ordinary shares are now quoted on the Pink Sheets under the symbol TAROF. Information regarding the Pink Sheets is available at www.pinksheets.com. Investors should be aware that trading on the Pink Sheets may result in a reduction in liquidity and trading volume of our ordinary shares.

Compliance with Covenants in Debt and Loan Agreements

The delay in issuing the audited financial statements for the years ended December 31, 2005, 2006, 2007, 2008 and 2009 resulted in the Company not being in compliance with certain reporting obligations with respect to certain debt instruments, however, as all of our Form 20-Fs have been filed as of September 22, 2011, we are in compliance with all material reporting covenants under our debt instruments. For further information on our debt instruments, see Note 12 "Long-Term Debt" to the consolidated financial statements herein.

Although we are current with respect to our payment obligations under our various loan agreements, we are not in compliance with certain financial covenants and other provisions contained in certain loan agreements. As a result of the foregoing, various creditors have the right to accelerate their indebtedness and certain creditors may elect to proceed against the collateral granted to them to secure such indebtedness. In the event such indebtedness is accelerated, Management believes we have sufficient capacity to satisfy such obligations.

Recent Developments as of and since the Filing of the 2010 Annual Report

The Company filed its 2010 Annual Report on Form 20-F with the SEC on June 29, 2011.

As of June 29, 2011, the Company finalized its implementation of the RTO system to meet the EU TALUFT 2002 standards in Israel and is in compliance with applicable environmental laws and regulations in Israel.

The Company has been involved in an appeal challenging a tax assessment by the Israel Income Tax Authority ("ITA") on certain options granted in 1992 to certain officers of Taro U.S.A., as further described in Item 8A – "Legal Proceedings." As of June 29, 2011, the Company has entered into a settlement agreement with the ITA whereby the Company will pay the ITA NIS 7,500,000.

Effective August 22, 2011, Mr. Hasmukh Shah resigned from the Board due to personal reasons and the vacancy was filled by the appointment of Professor Dov Pekelman, who will serve until Taro's next Annual General Meeting of Shareholders. Professor Pekelman also agreed to serve on the Company's Audit Committee. Professor Pekelman is currently Chairman of Atera Networks Ltd. as well as Gilon Investments (TASE: GILN) and serves as a long standing Director of Makhteshim Agan Industries Ltd. (TASE: MAIN). He lectures at the Arison School of Business of the Interdisciplinary Center (IDC), Herzliya, Israel, serves on the Board of Directors of the IDC and is Chairman of the IDC Corporation, the center's economic arm. Professor Pekelman served as a senior consultant to Teva Pharmaceutical Industries Ltd. (NASDAQ: TEVA) from 1985 to 2008 and also founded and ran a leading, Israeli-based management-consulting firm, P.O.C. Ltd. Professor Pekelman served on the Board of Directors of several large industrial corporations, including Koor Industries Ltd. (TASE: KOR). Professor Pekelman was also a member of the advisory committee of the Bank of Israel. He holds a Ph.D. from the University of Chicago and a B.S. from the Technion, Israeli Institute of Technology. Professor Pekelman is a published author writing on various aspects of business operations.

As of September 22, 2011, the Company has filed all of its required Annual Reports on Form 20-F.

A. OPERATING RESULTS

The following discussion should be read in conjunction with our consolidated financial statements and related notes for the three years ended December 31, 2005, 2006 and 2007, which are included elsewhere in this 2007 Annual Report.

OVERVIEW

We are a multinational, science-based pharmaceutical company. We develop, manufacture and market prescription and OTC pharmaceutical products, primarily in the United States, Canada and Israel. We also develop and manufacture APIs primarily for use in our finished dosage form products. Our primary areas of focus include topical creams and ointments, liquids, capsules and tablets. We operate principally through three entities: Taro Israel and two of its subsidiaries, Taro Canada and Taro U.S.A.

The following is a breakdown of net sales by geographic region, including the percentage of our total consolidated sales for each period:

	2007		2006		2005	
	Sales in thousands	% of our total sales	Sales in thousands	% of our total sales	Sales in thousands	% of our total sales
U.S.A.	$258,519	81 %	$192,785	76 %	$243,416	84 %
Canada	34,913	11 %	37,266	15 %	26,420	9 %
Israel	17,362	5 %	14,942	6 %	15,243	5 %
Other	8,760	3 %	7,276	3 %	3,544	2 %
Total	$319,554	100 %	$252,269	100 %	$288,623	100 %

We generate most of our revenue from the sale of prescription and OTC pharmaceutical products. Portions of our OTC products are sold as private label products primarily to chain drug stores, food stores, drug wholesalers, drug distributors and mass merchandisers in the United States. During the years ended 2007, 2006 and 2005, two customers in the United States accounted for the following proportion of our total consolidated net sales:

Customer	2007	2006	2005
Customer A	15.8 %	*	23.0 %
Customer B	10.1 %	12.0 %	*

Due to increased competition from other generic pharmaceutical manufacturers as they gain regulatory approvals to market generic products, selling prices and related profit margins tend to decrease as products mature. Thus, our future operating results are dependent on, among other factors, our ability to introduce new products. In addition, our operating results are dependent on the impact of pricing pressures on existing products. These pricing pressures are inherent in the generic pharmaceutical industry.

Percentage of net sales of certain products on a consolidated basis:

Product	2007	2006	2005
Warfarin	12 %	14 %	14 %
Clomitrazole	*	*	10 %

* Less than 10%

Our sales of these and other product lines are subject to market conditions and other factors. We are therefore unable to predict the extent, if any, to which the relative contribution to our total revenues of these two product lines as well as other product lines may increase or decrease in the future.

Cost of goods sold consists of direct costs and allocated costs. Direct costs consist of raw materials, packaging materials and direct labor identified with a specific product. Allocated costs are costs not associated with a specific product.

Certain customary industry selling practices affect our level of working capital; for example, industry practice requires that pharmaceutical products be made available to customers on demand from existing stock levels rather than on a made-to-order basis. Therefore, in order to accommodate market demand, we try to maintain adequate levels of inventories. Increased demand for existing products and preparation for new product launches, the exact timing of which cannot be determined accurately, have generally resulted in higher levels of inventory. However, anticipated growth in sales of any individual product, or of all products, may not materialize. Consequently, inventories prepared for these sales may become obsolete and have to be written off.

Another industry practice causes us to provide our customers with limited rights to return products, receive rebates, assert chargebacks and take other deductions with respect to sales that we make to them. See Item 5.A – "Critical Accounting Policies – Allowance for Sales Deductions and Product Returns." The exercise of these rights by customers to whom we have granted them has an impact, which may be substantial, upon our working capital. Although we feel that such sales are collectible, payment may not be received in a timely manner.

We continuously monitor our aged receivables and our customers' creditworthiness. We also engage in active and intensive collection efforts as necessary.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 2 to our consolidated financial statements, which are prepared in conformity with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We evaluate our estimates on an ongoing basis. We base our estimates on available information, our historical experience and various other assumptions that we believe to be reasonable under the circumstances. The results of these assumptions are the basis for determining the carrying values of assets and liabilities that are not readily apparent from other sources. Since the factors underlying these assumptions are subject to change over time, the estimates on which they are based are subject to change accordingly.

The following is a summary of certain policies that have a critical impact upon our financial statements and, we believe, are most important to keep in mind in assessing our financial condition and operating results.

Use of Estimates. In preparing the consolidated financial statements, we use certain estimates and assumptions that affect reported amounts and disclosures. These estimates and underlying assumptions can impact all elements of our financial statements. Taro uses estimates when accounting for product returns and sales deductions from revenues, determining the valuation and recoverability of assets (e.g., accounts receivables, inventories, and intangible assets), and the reported amounts of accrued liabilities. We regularly evaluate our estimates and assumptions, using historical experience, third-party data, and market and external factors. Our estimates are often based on complex judgments, probabilities and assumptions that we believe to be reasonable but that are inherently uncertain and unpredictable. As future events and their effects cannot be determined with precision, our estimates and assumptions may prove to be incomplete or inaccurate, or unanticipated events and circumstances may occur that might cause us to change those estimates and assumptions. We adjust our estimates and assumptions when facts and circumstances indicate the need for change. It is possible that other professionals, applying reasonable judgment to the same facts and circumstances, could develop and support a range of alternative estimated amounts.

Revenue Recognition. We sell our products directly to wholesalers, retail drug store chains, mass merchandisers, grocery chains and other direct purchasers and customers that acquire our products indirectly through wholesalers.

We recognize revenue from product sales when title and risk of loss have transferred to our customers and when the criteria in FASB ASC Subtopic 605-15, "Revenue Recognition – Products" have been satisfied. Those criteria generally require that (i) persuasive evidence of an arrangement exists; (ii) product delivery has occurred; (iii) our price to our customers is fixed or determinable; (iv) collectibility is reasonably assured; and (v) the amount of product returns, chargebacks, rebates and other sales deductions can be reasonably estimated. We ship products to our customers only in response to, and to the extent of, the orders that customers submit to us. Depending on the terms of our customer arrangements, revenue is recognized when the product is received by the customer ("FOB Destination Point") or at the time of shipment ("FOB Shipping Point").

Allowance for Sales Deductions and Product Returns. When we recognize and record revenue from the sale of our pharmaceutical products, we record an estimate in the same financial reporting period for product returns, chargebacks, rebates and other sales deductions, which are reflected as reductions of the related gross revenue. Beginning in 2006, we regularly monitor customer inventory information at our three largest wholesale customers to assess whether any excess product inventory levels may exist. We review this information along with historical product and customer experience, third-party prescription data, industry and regulatory changes and other relevant information and revise our estimates as necessary.

Our estimates of inventory in the distribution channel are based on inventory information reported to us by our major wholesale customers, historical shipment and return information from our accounting records and third-party data on prescriptions filled. Our estimates are subject to inherent limitations pertaining to reliance on third-party information.

Product returns

Consistent with industry practice, we generally offer our customers the right to return inventory within three to six months prior to product expiration and up to 12 months thereafter (the "return period"). Product returns are identified by their manufacturing lot number. Because we manufacture in bulk, lot sizes are generally large and, therefore, shipments of a particular lot may occur over a one-to-three month period. As a result, although we cannot associate a product return with the actual shipment in which such lot was included, we can reasonably estimate the period (in months) over which the entire lot was shipped and sold. We use this information to estimate the average time period between lot shipment (and sale) and return for each product, which we refer to as the "return lag." The shelf life of most of our products ranges between 18-36 months. Because returns of expired products are heavily concentrated during the return period, and given our historical data, we are able to reasonably estimate return lags for each of our products. These return lags are periodically reviewed and updated, as necessary, to reflect our best knowledge of facts and circumstances. Using sales and return data (including return lags), we determine a rolling average monthly return rate to estimate our return reserves. We supplement this calculation with additional information including customer and product specific channel inventory levels, competitive developments, external market factors, our planned introductions of similar new products and other qualitative factors in evaluating the reasonableness of our return reserve. We continuously monitor factors that could affect our estimates and revise the reserves as necessary. Our estimates of expected future returns are subject to change based on unforeseen events and uncertainties.

Our product returns reserve at December 31, 2007 and 2006 and related statement of operations impact for the years then ended, considered actual product returns experienced subsequent to the balance sheet dates to validate the product returns reserve estimate based on the methodology described above. We monitor the levels of inventory in our distribution channels to assess the adequacy of our product returns reserve and to identify potential excess inventory on hand that could have an impact on our revenue recognition. We do not ship product to our wholesalers when it appears they have an excess of inventory on hand, based on demand and other relevant factors, for that particular product. Additionally, as a general practice, we do not ship products that have less than 12 months until expiration (i.e., "short dated sales").

Chargebacks

We have arrangements with certain customers that allow them to buy our products directly from our wholesalers at specific prices. Typically these price arrangements are lower than the wholesalers' acquisition costs or invoice prices. In exchange for servicing these third party contracts, our wholesalers can submit a "chargeback" claim to us for the difference between the price sold to the third-party and the price at which it purchased the product from us. We generally pay chargebacks on generic products, whereas branded products are typically not eligible for chargeback claims. We consider many factors in establishing our chargeback reserves including inventory information from our largest wholesale customers (beginning in 2006) and the completeness of their reports, estimates of Taro inventory held by smaller wholesalers and distributors, processing time lags, contract and non-contract sales trends, average historical contract pricing, actual price changes, actual chargeback claims received from the wholesalers, Taro sales to the wholesalers and other relevant factors. Our chargeback provision and related reserve varies with changes in product mix, changes in pricing, and changes in estimated wholesaler inventory. We review the methodology utilized in estimating the reserve for chargebacks in connection with analyzing our product return reserve each quarter and make revisions as considered necessary to reasonably estimate our potential future obligation.

Rebates and other deductions

We offer our customers various rebates and other deductions based primarily on their volume of purchases of our products. Chain wholesaler rebates are rebates that certain chain customers claim for the difference in price between what the chain customer paid a wholesaler for a product purchase and what the chain customer would have paid if such customer had purchased the same product directly from us. Cash discounts, which are offered to our customers, are generally 2% of the gross sales price, and provide our customers an incentive for paying within invoice terms (30 to 90 days). Medicaid rebates are earned by states based on the amount of our products dispensed under the Medicaid plan. Billbacks are special promotions or discounts provided over a specific time period to a defined customer base, and for a defined product group. Distribution allowances are a fixed percentage of gross purchases for inventory shipped to a national distribution facility that we pay to our top wholesalers on a monthly basis. Administration fees are paid to certain wholesalers, buying groups, and other customers for stocking our products and managing contracts and servicing other customers. Shelf stock adjustments, which are customary in the generic pharmaceutical industry, are based on customers' existing levels of inventory and the decrease in the market price of the related product. When market prices for our products decline, we may, depending on our contractual arrangements, elect to provide shelf-stock adjustments and thereby allow our customers with existing inventories to compete at the lower product price. We use these shelf-stock adjustments to support our market position and to promote customer loyalty.

The Company establishes reserves for rebates and these other various sales deductions based on contractual terms and customer purchasing activity, tracking and analysis of rebate programs, processing time lags, the level of inventory in the distribution channel and other relevant information. Based on our historical experience, substantially all claims for rebates and other sales deductions are received within 24 months. Therefore, for the years ended December 31, 2007 and 2006, we considered subsequent actual claims submitted by our customers in determining our reserves and related statements of operations impact for rebates and other sales deductions.

Three-year summary

The following table summarizes the activities for sales deductions and product returns for the three years ended December 31, 2007:

December 31, 2007 (in thousands)

	Beginning Balance	Provision recorded for current period sales	Credits processed	Ending balance
Accounts Receivable Reserves				
Chargebacks	$(40,211)	$(170,447)	$192,133	$(18,525)
Rebates and Other	(38,792)	(63,005)	72,782	(29,015)
Total	$(79,003)	$(233,452)	$264,915	$(47,540)
Current Liabilities				
Returns	$(34,144)	$(9,243)	$18,286	$(25,101)
Others (1)	(23,271)	(14,498)	27,213	(10,556)
Total	$(57,415)	$(23,741)	$45,499	$(35,657)

December 31, 2006 (in thousands)

	Beginning Balance	Provision recorded for current period sales	Credits processed	Ending balance
Accounts Receivable Reserves				
Chargebacks	$(87,281)	$(200,582)	$247,652	$(40,211)
Rebates and Other	(64,612)	(81,804)	107,624	(38,792)
Total	$(151,893)	$(282,386)	$355,276	$(79,003)
Current Liabilities				
Returns	$(63,535)	$(11,850)	$41,241	$(34,144)
Others (1)	(26,164)	(19,182)	22,075	(23,271)
Total	$(89,699)	$(31,032)	$63,316	$(57,415)

December 31, 2005 (in thousands)

	Beginning Balance	Provision recorded for current period sales	Credits processed	Ending balance
Accounts Receivable Reserves				
Chargebacks	$(106,205)	$(241,750)	$260,674	$(87,281)
Rebates and Other	(20,763)	(100,939)	57,090	(64,612)
Total	$(126,968)	$(342,689)	$317,764	$(151,893)
Current Liabilities				
Returns	$(73,042)	$(44,411)	$53,918	$(63,535)
Others (1)	(48,219)	(8,453)	30,508	(26,164)
Total	$(121,261)	$(52,864)	$84,426	$(89,699)

(1) Includes indirect rebates and others.

Inventory. Inventories are stated at the lower of cost or market. Cost is determined as follows: raw and packaging materials—mainly on an average cost basis; finished goods products and products still in process, mainly on an average production cost including direct and indirect, or overhead, manufacturing expenses. Our finished goods inventories generally have a limited shelf life and are subject to obsolescence as they approach their expiration dates. As a result, we record a reserve against our entire finished goods inventory with expiration dates of less than 12 months and use historical experience to estimate the reserve for products with expiration dates of more than 12 months from the balance sheet date. When available, we used actual data to validate our estimates. We regularly evaluate our policies and the carrying value of our inventories and establish a reserve against the carrying value of our inventories. The determination that a valuation reserve is required, as well as the appropriate level of such reserve, requires us to utilize significant judgment. Although we make every effort to ensure the accuracy and reasonableness of our forecasts of future demand for our products, any significant unanticipated decreases in demand, or unanticipated changes in our major customer inventory management policies, could have a material impact on the carrying value of our inventories and reported operating results.

Valuation of Long-Lived Assets and Goodwill. We evaluate our long-lived assets for impairment and perform annual impairment testing on December 31 for goodwill and other indefinite-lived intangible assets and other long-lived assets when impairment indicators exist. Impairments are recorded for the excess of a long-lived asset's carrying value over fair value. Some examples of impairment indicators are as follows:

Changes in legal or business climate that could affect an asset's value. For example, a failure to gain regulatory approval for a product or the extension of an existing patent that prevents our ability to produce a generic equivalent.

Changes in our ability to continue using an asset. For example, restrictions imposed by the FDA could reduce our production and sales volume.

Decreases in the pricing of our products. For example, consolidation among our wholesale and retail customers could place downward pressure on the prices of some of our products.

We estimate the fair value of our long-lived assets other than goodwill, such as product rights, using a discounted cash flow analysis or market approach where appropriate when required under applicable U.S. GAAP. Under the discounted cash flow method, we estimate cash flows based on our forecasts and discount these cash flows using the appropriate rate to determine the net present value of the asset. The net present value of our assets is affected by several estimates, such as:

The timing and amount of forecasted cash flows

Discount rates

Tax rates

Regulatory actions

Amount of competition

Manufacturing efficiencies

The number and size of our customers

For the year-ended December 31, 2007, we recorded $170,000 of impairment losses, primarily related to product rights. For the year ended December 31, 2006, we recorded $53.8 million of impairment losses, of which approximately $24.0 million was related to intangible assets including U-Kera and Lustra Product rights, and approximately $29.8 million was related to property, plant and equipment, the majority of which arose from the discontinuation of our manufacturing facility in Ireland. $25.9 million of these impairments, including all of the product rights were charged to cost of goods sold, and $27.9 million of these impairments, including the facility charges were charged to operating expenses in our consolidated Statements of Operations. We may have additional impairments related to our manufacturing facilities in future years.

We estimate the fair value of goodwill using a two step procedure. First, we compare the market value of our equity to the carrying value of our equity. If the carrying value exceeds the market value of our equity, we calculate the implied fair value of our goodwill by taking the excess of our market capitalization over the fair value of our assets other than goodwill and obligations. An impairment is recorded for the difference between the implied fair value and carrying value of goodwill. The implied fair value of goodwill and any potential impairment is sensitive to estimates of the fair value of other assets and liabilities. We have not recorded any impairments for goodwill for the years ended December 31, 2007, 2006 and 2005. For the year ended December 31, 2006, we determined that certain of our long-lived assets were impaired. Accordingly we reduced the value of our property, plant and equipment and intangible assets by $53.8 million. Approximately $24.0 million was related to intangible assets including U-Kera and Lustra product rights, and approximately $29.8 million was related to property, plant and equipment, the majority of which arose from the discontinuation of our manufacturing facility in Ireland.

Income Taxes. We determined deferred taxes by utilizing the asset and liability method based on the estimated future tax effects of differences between the financial accounting and tax basis of assets and liabilities under the applicable tax laws. Deferred taxes are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. As of December 31, 2007, Management determined that it was more likely than not that we will not benefit from the deferred tax asset in the U.S., Ireland and certain other subsidiaries resulting in a full valuation allowance against these deferred tax assets. In future years, if it is more likely than not that we will be in a position to utilize its deferred tax asset, the valuation allowance for such assets may be modified.

Stock Options. We account for stock-based compensation in accordance with the provisions of ASC Topic 718 "Compensation – Stock Compensation." Under the fair value recognition provisions of ASC 718, stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. We estimate the fair value of stock options granted using the Black-Scholes-Merton option-pricing model and valued restricted stock based on the market value of the underlying shares at the date of grant. We recognize compensation expense for the value of its awards granted subsequent to January 1, 2006, based on the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures.

The fair value of an award is affected by our stock price on the date of grant and other assumptions, including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options.

Recent Accounting Pronouncements that may have an impact on future consolidated financial statements.

In February 2007, the FASB issued FASB ASC Topic 825, "Financial Instruments" (formerly SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." FASB ASC Topic 825 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. FASB ASC Topic 825 is effective for us as of the beginning of the first fiscal year that begins after November 15, 2007. We believe that the adoption of FASB ASC Topic 825 will not have a material impact on our consolidated financial statements.

In June 2007, the FASB ratified FASB ASC Subtopic 730-20, "Research and Development – Research and Development Arrangements" (formerly EITF Issue 07-3, "Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development Activities." FASB ASC Subtopic 730-20 provides guidance on the capitalization of non-refundable advance payments for goods and services to be used in future research and development activities, until such goods have been delivered or the related services have been performed. This issue will be effective for us for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. We believe that the adoption of FASB ASC Subtopic 730-20 will not have a material impact on our consolidated financial statements.

In November 2007, the FASB issued FASB ASC Topic 808, "Collaborative Arrangements" (formerly EITF Issue No. 07-1, "Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property"). Companies may enter into arrangements with other companies to jointly develop, manufacture, distribute and market a product. The consensus requires collaborators in such an arrangement to present the result of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other GAAP, based on analogy to authoritative accounting literature or a reasonable, rational and consistently applied accounting policy election. FASB ASC Topic 808 is effective for collaborative arrangements in place at the beginning of the annual period beginning after December 15, 2008. We do not expect the adoption of ASC 808 to have a material impact on our consolidated financial statements.

In December 2007, the SEC issued Topic 14.D.2 (formerly SAB No. 110 ("SAB 110")), codified into FASB ASC Topic 718, "Compensation – Stock Compensation," relating to the use of a "simplified" method in developing an estimate of the expected term of "plain vanilla" share options. SAB 107 previously allowed the use of the simplified method until December 31, 2007. FASB ASC Topic 718 allows, under certain circumstances, the continuation of the use of the simplified method beyond December 31, 2007. Effective January 1, 2008, we believe that the adoption of FASB ASC Topic 718 will not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued FASB ASC Topic 805, "Business Combinations" (formerly SFAS No. 141 (revised 2007), "Business Combinations"). FASB ASC Topic 805 will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Key changes include: acquired in-process research and development will no longer be expensed on acquisition, but capitalized and amortized over its useful life; fair value will be based on market participant assumptions; acquisition costs will generally be expensed as incurred; and restructuring costs will generally be expensed in periods after the acquisition date. Early adoption is not permitted. We do not expect the adoption of this pronouncement to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued FASB ASC Section 810-10-65, "Consolidation – Overall – Transition and Open Effective Date Information – Transition Related to FASB Statements No. 160, Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51, and No. 164, Not-for-Profit Entities: Mergers and Acquisitions" (formerly SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51"). FASB ASC 810-10-65 establishes accounting and reporting standards for non-controlling interests in a subsidiary and deconsolidation of a subsidiary. Early adoption is not permitted. We expect the adoption of FASB ASC 810-10-65 to result in the presentation of non-controlling interest in the consolidated financial statements.

In February 2008, the FASB issued FASB ASC Topic 820, "Fair Value Measurements and Disclosures" (formerly FASB Staff Position ("FSP") No. FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" and FSP No. FAS 157-2, "Effective Date of FASB Statement No. 157"). Collectively, the Staff Positions defer the effective date of FASB ASC Topic 820 to fiscal years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of FASB ASC Topic 820. We do not expect the adoption of FASB ASC Topic 820 to have a material impact on our consolidated financial statements.

In March 2008, the FASB issued FASB ASC Section 815-10-50, "Derivatives and Hedging – Overall – Disclosure" (formerly SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB No. 133"). This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We do not expect the adoption of FASB ASC Section 815-10-50 to have a material impact on our financial position, results of operations or cash flows.

In June 2008, the FASB ratified the consensus reached on FASB ASC Subtopic 815-40, "Derivatives and Hedging – Contracts in Entity's Own Equity" (formerly EITF Issue No. 07-05, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"). FASB ASC 815-40-15 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is not permitted. We do not expect the adoption of this pronouncement to have a material impact on our consolidated financial statements.

In May 2009, the FASB issued FASB ASC Topic 855, "Subsequent Events" (formerly SFAS No. 165, "Subsequent Events"). FASB ASC Topic 855 establishes general standards of accounting for and disclosure of events that occur between the balance sheet date and the date financial statements are issued or are available to be issued. This statement is effective for interim or annual periods ending after June 15, 2009. We do not expect the adoption of FASB ASC Topic 855 will have a material effect on our consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued FASB ASC 105-10-65-1, "Generally Accepted Accounting Principles – Overall – Transition Related to FASB Statement No. 168, The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles" (formerly SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162"). With this statement, the FASB Accounting Standards Codification ("ASC") becomes the single source of GAAP recognized by FASB in the United States. The ASC is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of this standard will not affect our results of operations or our financial position. However, because the Codification replaces any existing GAAP standards, it will affect the way we reference US GAAP within our financial statements.

In June 2009, the FASB issued FASB ASC Paragraph 810-10-65-2, "Consolidation – Overall – Transition and Open Effective Date Information – Transition Related to FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R)," which amends existing accounting rules for consolidation of variable interest entities. Under ASC Paragraph 810-10-65-2, the primary beneficiary of a variable interest entity is determined by a qualitative rather than a quantitative test previously required under FIN 46-(R). In addition, ASC Paragraph 810-10-65-2 requires an ongoing assessment of whether an entity is a primary beneficiary of a variable interest entity, and additional disclosure. ASC Paragraph 810-10-65-2 is effective at the beginning of the first annual reporting period that begins after November 15, 2009. We do not expect the adoption of ASC Paragraph 810-10-65-2 to have a material impact on our consolidated financial position, results of operations or cash flows.

In October 2009, the FASB issued Accounting Standard Update ("ASU") No. 2009-13, "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13"). ASU 2009-13 revises the model for recording revenue from multiple element arrangements and expands disclosure requirements. This standard requires entities to allocate revenue in an arrangement at inception using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendments eliminate the residual method of revenue allocation and require revenue to be allocated using the relative selling price method. ASU 2009-13 will be effective for arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We do not have any multiple element arrangements. Accordingly, we do not expect adoption of ASU 2009-13 to have a material impact on the results of operations or financial condition.

In December 2010, the FASB issued ASU No. 2010-27, "Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers (a consensus of the FASB Emerging Issues Task Force)." This standard addresses how fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act should be recognized and classified in the income statements of pharmaceutical manufacturers. Under the proposal, the annual fee would be recognized as a liability for the total amount and a corresponding deferred cost over the calendar year. This is a liability and presented as an operating expense. This

ASU is effective for calendar years beginning after December 31, 2010. Since the fees are anticipated to be less than 0.2% of net sales, we do not expect the provisions of ASU 2010-27 to have a material effect on its financial statements.

In December 2010, the FASB also issued ASU No. 2010-28, "Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)." Under this standard, if the carrying amount of a reporting unit is zero or negative, an entity must assess whether it is more likely than not that goodwill impairment exists. To make that determination, an entity should consider whether there are adverse qualitative factors that could impact the amount of goodwill, including those listed in ASC 350-20-35-30. As a result of the new guidance, an entity can no longer assert that a reporting unit is not required to perform the second step of the goodwill impairment test because the carrying amount of the reporting unit is zero or negative, despite the existence of qualitative factors that indicate goodwill is more likely than not impaired. The equity or enterprise valuation premise can be used to determine the carrying amount of a reporting unit. ASU 2010-28 is effective for public entities for fiscal years, and for interim periods within those years, beginning after December 15, 2010, with early adoption prohibited. Our goodwill test does not have a zero or negative carrying amount where this standard would apply.

RESULTS OF OPERATIONS

The following table sets forth selected items from our consolidated statements of operations as a percentage of total sales:

	For the year ended December 31,					
	2007		2006		2005	
Consolidated Statements of Operations						
Sales, net	100.0	%	100.0	%	100.0	%
Cost of sales	41.6	%	49.0	%	42.5	%
Impairment	0.1	%	10.2	%	0.0	%
Gross profit	58.3	%	40.8	%	57.5	%
Operating expenses:						
Research and development, net	9.3	%	14.4	%	15.8	%
Selling, marketing, general and administrative	30.5	%	43.2	%	38.4	%
Impairment	0.0	%	11.1	%	0.0	%
Total operating expenses	39.8	%	68.7	%	54.2	%
Operating income (loss)	18.5	%	-27.9	%	3.3	%
Financial expenses, net	7.1	%	4.5	%	2.8	%
Other gain, net	1.3	%	0.0	%	0.0	%
Income (loss) before taxes	12.7	%	-32.4	%	0.5	%