Annual Report 2003

ElixSure™

TARO

Taro Pharmaceutical Industries Ltd.

FINANCIAL HIGHLIGHTS

Statement of Income Data

	Year ended December 31, In thousands of U.S. dollars, except per Ordinary Share data				
	2003	**2002**	**2001**	**2000**	**1999**
Net Sales	$ 315,458	$ 211,581	$ 149,230	$ 103,797	$ 83,785
Gross Profit	213,004	132,113	94,494	62,591	48,471
Operating Income	74,685	53,259	32,775	16,096	10,810
Income Before Taxes on Income and Minority Share in Profits of Subsidiaries	72,956	53,175	30,453	12,585	7,035
Net Income	61,155	44,555	25,994	10,027	5,539
Earnings per Ordinary Share: Basic:	$ 2.12	$ 1.55	$ 1.11	$ 0.47	$ 0.27
Diluted:	$ 2.06	$ 1.52	$ 0.99	$ 0.42	$ 0.25

Balance Sheet Data

	As of December 31, In thousands of U.S. dollars				
	2003	**2002**	**2001**	**2000**	**1999**
Working Capital	$ 279,955	$ 198,871	$ 196,711	$ 43,588	$ 25,964
Property, Plant and Equipment	182,306	93,358	54,024	41,827	34,624
Total Assets	616,523	379,845	307,762	120,446	90,957
Long-Term Debt	156,937	47,127	49,285	38,250	23,328
Shareholders' Equity	347,400	269,137	218,364	50,214	40,552

MISSION STATEMENT

Taro is a multinational, science-based pharmaceutical company dedicated to meeting the needs of its customers through the discovery, development, manufacturing and marketing of the highest quality healthcare products.

TO OUR SHAREHOLDERS

Barrie Levitt, M.D.
Chairman of the Board

Taro's financial performance in 2003 reflects continued growth in the Company's U.S. generic pharmaceuticals business and the early results of Taro's U.S. proprietary initiatives.

The Company's performance in recent years primarily reflects more than a decade of investment in research and development, as well as our strategic commitment to position Taro as an important provider of both generic and proprietary pharmaceutical products. During 2003, Taro maintained its commitment to research while initiating direct-to-physician and direct-to-consumer marketing of proprietary products in the United States. These long-term strategic initiatives included the establishment of the Taro Consumer Healthcare Products and TaroPharma divisions and the mid-year launch of the Company's innovative ElixSure® line of spill-resistant cough and cold medicines for children.

In addition to substantial and ongoing investments in research and marketing, Taro continued to make significant capital investments in 2003. These capital expenditures are designed to enable the Company to keep pace with anticipated demand for its products, enter new markets and broaden its product lines.

FINANCIAL PERFORMANCE

2003 was Taro's 20th consecutive year of record sales and sixth consecutive year of record net income.

Taro's net sales for the year ended December 31, 2003 increased 49% to $315.5 million, compared with net sales of $211.6 million in 2002. Gross profit in 2003 increased 61% to $213.0 million, or 68% of sales, compared with $132.1 million, or 62% of sales, in 2002. Selling, general and administrative expenses for the year increased as a percentage of sales to 31%, or $97.7 million, compared with 25%, or $52.5 million, in 2002.

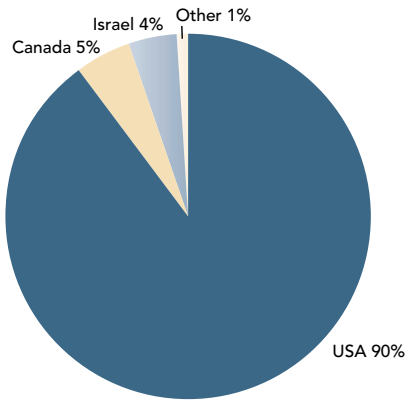
Operating income before R&D expenses in 2003 was $115.3 million, or 37% of sales, compared with $79.6 million, or 38% of sales, in 2002. R&D expenses were $40.6 million, or 13% of sales, compared with $26.4 million, or 12% of sales, in 2002. Operating income in 2003 was $74.7 million, or 24% of sales, compared with $53.3 million, or 25% of sales, in 2002.

Net income for 2003 increased 37% to $61.2 million, or $2.06 per diluted share, compared with net income of $44.6 million, or $1.52 per diluted share, in 2002.

EXPANDING U.S. SALES AND MARKETING

The U.S. market accounted for approximately 90% of Taro's sales in 2003. The Company's U.S. affiliate, Taro Pharmaceuticals U.S.A., Inc. ("Taro U.S.A."), comprises three divisions designed to optimize Taro's opportunities in generic and proprietary pharmaceutical markets.

Sales By Region



Taro Generics

In 2003, U.S. sales of generic pharmaceuticals continued to be the primary driver of Taro's growth. Through

innovative marketing to the pharmacy trade and dedication to customer service, the Taro Generics division of Taro U.S.A. performed well during the year. The Taro Generics sales team maintained the Company's prominence in generic topical prescription products while attaining growth in oral dose products. Taro increased its market share in existing products and introduced several new generic products during the year.

Taro Consumer Healthcare Products

In the U.S., Taro Consumer Healthcare Products ("Taro Consumer") was established to market proprietary over-the-counter ("OTC") products directly to consumers. In early 2003, Taro Consumer launched Kerasal® Ointment, a unique, exfoliating moisturizer for the feet. Kerasal® has become a leading product in the footcare category. Taro Consumer has also introduced a cream version of the product, Kerasal® AL™ Cream.

In mid-2003, Taro Consumer launched the ElixSure® line of children's medicines for fever, pain, cough and congestion. Based on Taro's patented NonSpil™ liquid drug delivery system, ElixSure® products pour like liquids but resist spilling.

The effective, good-tasting ElixSure® medicines are designed to provide relief of symptoms while affording parents increased accuracy and ease of dosing when giving liquid medicines to children. ElixSure® products enable parents to focus on comforting their children during illness, instead of struggling with them over taking their medicine. ElixSure® received the Good Housekeeping seal and was one of only seven products selected to receive the Good Housekeeping Institute's Good Buy Award for 2004.

In January 2004, Taro U.S.A. received approval from the U.S. Food and Drug Administration ("FDA") for its New Drug Application ("NDA") for Children's ElixSure® IB Ibuprofen Oral Suspension. Ibuprofen is a widely used fever reducer and pain reliever. In addition to its spill-resistant characteristics, ElixSure® IB is a unique suspension that does not require shaking before administration. This property reduces variability and potential errors in dosing.

Kerasal® and ElixSure® products are available in pharmacies, grocery chains and mass merchandisers across the U.S., and are being supported by print and television advertising. Physicians are receiving information about Kerasal® and ElixSure®, as well as samples of the products, from the professional medical representatives of the TaroPharma division. The total marketing costs associated with these OTC brands are many times higher than those normally incurred in Taro's U.S. generic drug business. Of course, the commercial success of the ElixSure® line will depend upon consumer acceptance of this new delivery system.

TaroPharma

In January 2003, Taro U.S.A. established its TaroPharma division to promote proprietary products directly to physicians. A skilled team of professional medical representatives has been assembled to familiarize doctors with TaroPharma's products.

TaroPharma representatives are visiting dermatologists and pediatricians to provide information about Taro's proprietary prescription products, including the Topicort® line of high-potency topical corticosteroid products, Ovide®, Taro's topical treatment for head lice, and U-cort™, a gentle topical corticosteroid cream suitable for pediatric use. In addition, TaroPharma representatives are distributing samples and clinical information to support Taro Consumer's OTC product launches.

In 2004, Taro will continue to make substantial investments in proprietary product initiatives and in research, which the Company believes are essential for long-term growth.

INTENSIFYING RESEARCH PROGRAMS

Taro's research has fueled the Company's growth for more than a decade. In total, Taro has invested more than $160 million in R&D since 1991. More than $100 million of this investment was made during 2000-2003.

Generic Research

On December 31, 2003, Taro had 35 Abbreviated New Drug Applications ("ANDAs") pending at the FDA.

In 2003, Taro U.S.A. received FDA approval of its ANDAs for ammonium lactate cream, 12% (bioequivalent to Bristol-Myers Squibb's Lac-Hydrin® cream); betamethasone dipropionate cream (augmented), 0.05% and betamethasone dipropionate gel (augmented), 0.05% (bioequivalent to Schering-Plough's Diprolene® products); etodolac extended-release tablets in 400, 500 and 600 mg strengths (bioequivalent to Wyeth's Lodine® XL tablets); and, fluorouracil topical solution in 2% and 5% strengths (bioequivalent to ICN Pharmaceuticals' Efudex® topical solutions).

Proprietary Research

Taro filed another NDA for a NonSpil™-related product soon after the NDA for ElixSure® IB was approved in January 2004. Taro believes that NonSpil™ has the potential to be a suitable vehicle for a broad range of prescription and OTC pharmaceutical products.

Clinical trials continue on T2000, the first compound in Taro's novel class of non-sedating barbiturates, which have potential applications in treating seizures, essential tremor and other disorders. Of course, there can be no assurance of regulatory approval or the successful commercialization of any proprietary pharmaceutical product for any indication.

Growing Infrastructure

The Company is expanding its infrastructure for developing new products, synthesizing active ingredients, and manufacturing and distributing finished pharmaceuticals in both new and existing markets.

Research Facilities

Taro's investments in generic and proprietary R&D programs have been accompanied by substantial capital investments in research facilities. In 2003, Taro expanded its research center in Toronto, Canada and established its first research laboratories in the U.S. Taro's new multipurpose pharmaceutical facility in Ireland, acquired during 2003, also includes the Company's first research operations in Europe.

Manufacturing and Distribution Capacity

Taro's multi-purpose pharmaceutical campus in Ireland is expected to serve as a manufacturing base for supplying the North American and European markets. Taro is currently renovating the manufacturing areas in preparation for plant qualifications and potential product certifications.

Extensive additions to Taro's original pharmaceutical campus in Israel continued in 2003. Construction has been completed on new chemical facilities for synthesizing active pharmaceutical ingredients and on a state-of-the-art pharmaceutical distribution center. Construction continues on a new pharmaceutical manufacturing plant for finished products.

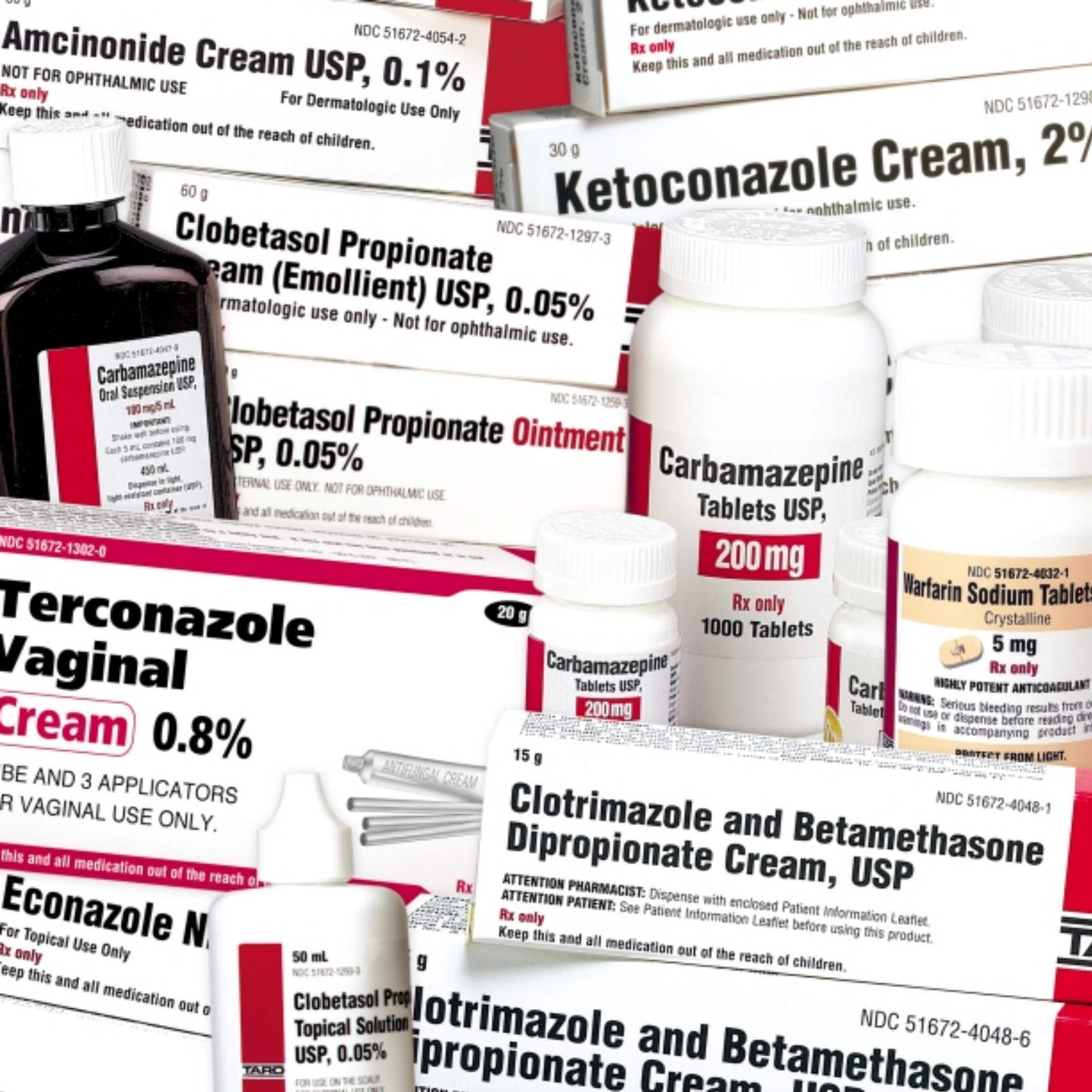
In Canada, Taro expanded its manufacturing and warehousing operations during 2003, including a new manufacturing facility for ElixSure®. In January 2004, Taro U.S.A. acquired a 315,000-square-foot distribution center in South Brunswick, New Jersey.

Taro's performance in recent years and plans for the future would not be possible without the wholehearted efforts of Taro's dedicated team of employees, now working in eight countries. This exceptional group of more than 1,500 professionals possesses the wide range of skills necessary for success in today's competitive pharmaceutical industry. Together, the people of Taro have written an impressive history since 1950. Yet, for all we have accomplished, we are confident that the Taro story has just begun.

Sincerely,

Barrie Levitt, M.D.
Chairman of the Board

May 2004

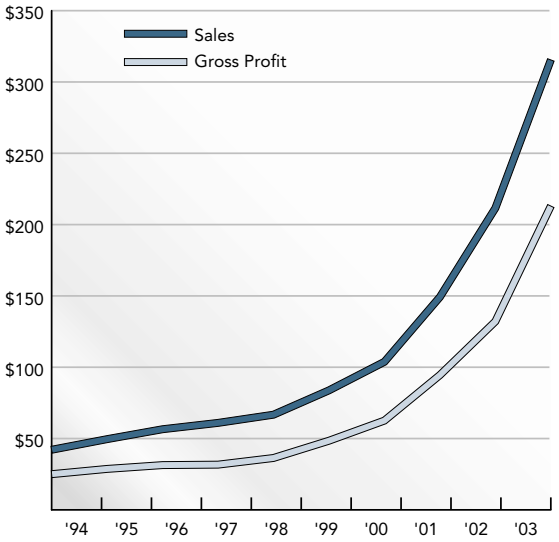

NDC 51672-4054-2
Amcinonide Cream USP, 0.1%
NOT FOR OPHTHALMIC USE
Rx only
For Dermatologic Use Only
Keep this and all medication out of the reach of children.
For dermatologic use only - Not for ophthalmic use.
Rx only
Keep this and all medication out of the reach of children.
NDC 51672-1298
30 g
Ketoconazole Cream, 2%
60 g
NDC 51672-1297-3
Clobetasol Propionate
eam (Emollient) USP, 0.05%
rmatologic use only - Not for ophthalmic use.
Carbamazepine
Oral Suspension USP,
100 mg/5 mL
450 mL
Rx only
lobetasol Propionate Ointment
SP, 0.05%
TERNAL USE ONLY. NOT FOR OPHTHALMIC USE
and all medication out of the reach of children.
NDC 51672-1302-0
Terconazole
Vaginal
Cream 0.8%
20 g
BE AND 3 APPLICATORS
R VAGINAL USE ONLY.
this and all medication out of the reach of
Econazole N
For Topical Use Only
Rx only
eep this and all medication out o
Carbamazepine
Tablets USP,
200 mg
Rx only
1000 Tablets
NDC 51672-4032-1
Warfarin Sodium Tablets
Crystalline
5 mg
Rx only
HIGHLY POTENT ANTICOAGULANT
PROTECT FROM LIGHT.
ANTIFUNGAL CREAM
15 g
NDC 51672-4048-1
Clotrimazole and Betamethasone
Dipropionate Cream, USP
ATTENTION PHARMACIST: Dispense with enclosed Patient Information Leaflet.
ATTENTION PATIENT: See Patient Information Leaflet before using this product.
Rx only
Keep this and all medication out of the reach of children.
50 mL
NDC 51672-1299-3
Clobetasol Prop
Topical Solution
USP, 0.05%
TARO
g
lotrimazole and Betamethasone
ipropionate Cream, USP
NDC 51672-4048-6

FINANCIAL PERFORMANCE

Taro's performance in 2003 demonstrates the strength of the Company's core generic pharmaceuticals business, augmented by new generic pharmaceutical products and initial sales of proprietary products in the U.S.

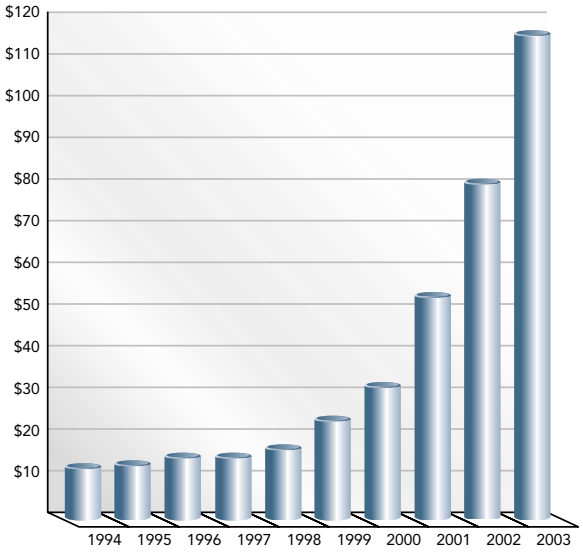
SALES AND GROSS PROFIT TREND

in millions



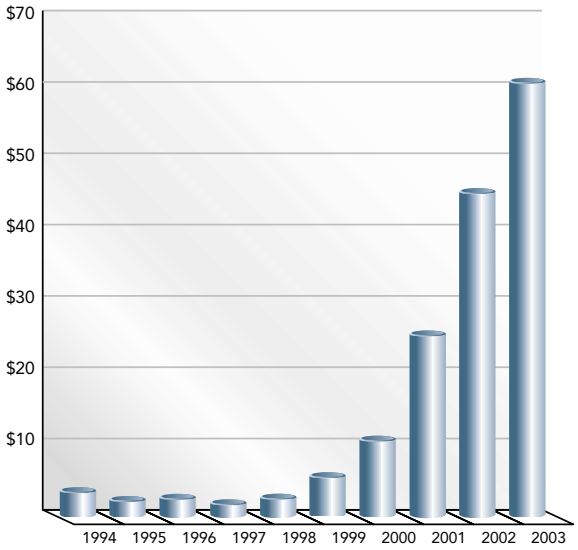
OPERATING INCOME BEFORE R&D

in millions



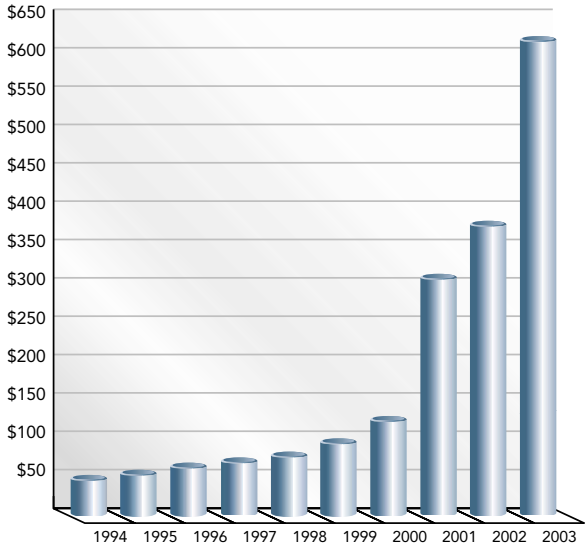
NET INCOME TREND

in millions



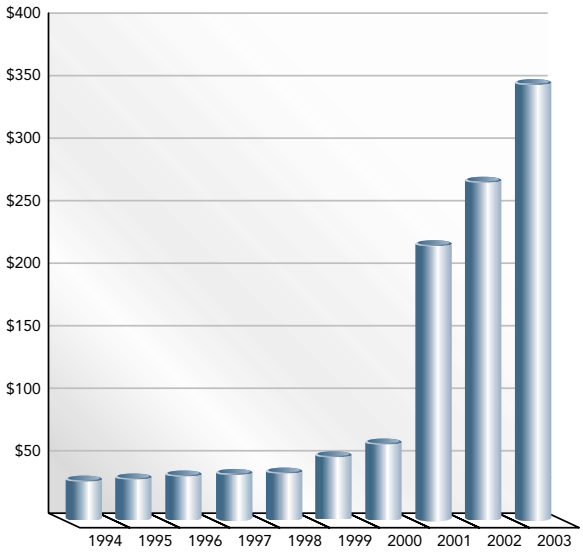
TOTAL ASSETS

in millions



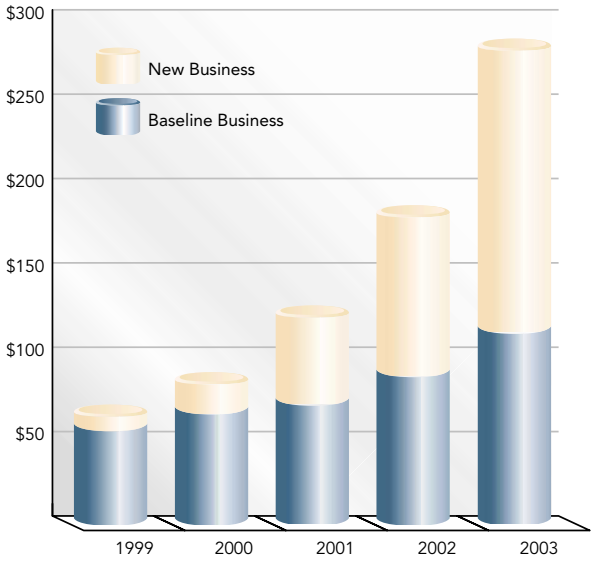
SHAREHOLDERS' EQUITY

in millions



SALES IN THE UNITED STATES

in millions



TARO GENERICS

Taro entered the U.S. market for generic pharmaceuticals in 1988. The Taro Generics division has been instrumental in supporting the Company's growth every year since then. In 2003, the Taro Generics team continued to grow the Company's core generic business and helped to launch strategic proprietary initiatives.

During 2003, Taro maintained a leadership position in the U.S. market for topical generic products used for dermatological conditions. Taro U.S.A. also has a growing portfolio of oral dose products (tablets, capsules and liquids) used primarily in cardiology and neurology. Several of Taro's generic products are marketed in forms suitable for children, such as chewable tablets and liquids.

Taro Generics has succeeded in building effective working relationships with the wholesalers, distributors and retailers in the U.S. pharmacy trade. Through these relationships, Taro Generics has also provided important support for the introduction and sale of the proprietary products of the Company's Taro Consumer and TaroPharma divisions.


Recommended
by Podiatrists
Kerasal®
water soluble ointment
• Clinically proven formula
Kerasal®
with salicylic acid

TARO CONSUMER HEALTHCARE PRODUCTS

Taro Consumer was established in 2002 to market proprietary OTC products directly to consumers. Taro Consumer's first initiatives are the launches of the Kerasal® and ElixSure® product lines in the U.S. Taro's management team brings extensive experience in branded pharmaceuticals to the Kerasal® and ElixSure® product initiatives.

KERASAL®

In 2003, Taro Consumer launched Kerasal® Ointment, a unique, exfoliating moisturizer for the feet. Kerasal® has achieved national distribution. The product is supported by television and print advertising, and in the year since its launch has become a leader in the footcare category. In early 2004, Taro Consumer introduced Kerasal® AL™ Daily Foot Cream, an elegant cream version of the product.

ELIXSURE®

ElixSure® can help parents comfort their children when they are sick, instead of struggling with them over taking liquid medicines.

During the second half of 2003, Taro launched its new line of spill-resistant ElixSure® products for children. The over-the-counter ElixSure® products are the first to utilize the patented NonSpil™ liquid drug delivery system developed by Taro researchers. ElixSure® products pour like liquids but resist spilling. The effective, good-tasting ElixSure® formulations are designed to provide relief of symptoms while affording parents increased accuracy and ease of dosing when they administer liquid medicines to children. ElixSure® Fever/Pain contains the active ingredient acetaminophen; ElixSure® Cough contains dextromethorphan HBr; and, ElixSure® Congestion contains pseudoephedrine HCl. ElixSure® products are available in pharmacies, grocery chains and mass merchandisers across the U.S.

In 2004, Taro Consumer has also introduced ElixSure® IB Ibuprofen Oral Suspension. In addition to its spill-resistant properties, ElixSure® IB is a unique suspension that does not require shaking before administration. The ElixSure® line now offers parents both ibuprofen and acetaminophen as active ingredients for treating fever and pain in children.

ElixSure® products are supported with significant national television and print advertising campaigns, as well as with direct-to-physician promotion by the professional medical representatives of the Company's

TaroPharma division. The total marketing investments in the ElixSure® and Kerasal® brands are many times higher than those normally incurred in Taro's U.S. generic drug business. While the Company believes these investments are sound, there can be no guarantee of the commercial success of these initiatives.

ElixSure® Recognition by Good Housekeeping

Shortly after their launch, the ElixSure® products received the Good Housekeeping Seal. In December 2003, the ElixSure® product line received a Good Housekeeping Institute "Good Buy Award" for 2004. Of the thousands of new products reviewed, ElixSure® was the only healthcare product, and one of only seven products in total, to receive the Good Buy Award for the year.

LIMITED WARRANTY TO CONSUMERS
Good Housekeeping
Promises
REPLACEMENT OR REFUND IF DEFECTIVE

From initial research to final manufacturing, ElixSure® products were developed in-house by Taro. This included installing and configuring the custom-designed manufacturing and packaging equipment for ElixSure® production in our Toronto facility.

TAROPHARMA

In January 2003, Taro U.S.A. established its TaroPharma division to promote proprietary products directly to physicians. TaroPharma has assembled a team of talented professional medical representatives who visit pediatricians and dermatologists across the country.

PROPRIETARY PRODUCT PLATFORM

TaroPharma is a platform for marketing acquired products as well as for launching products developed internally through Taro research. Current TaroPharma prescription products include Topicort® (desoximetasone) cream, ointment and gel, a line of topical corticosteroids used primarily for inflammatory skin diseases; Ovide® lotion (malathion), a prescription treatment for head lice; and, U-cort® cream, a unique formulation of hydrocortisone acetate in a urea base, which is suitable for pediatric use. These products are supported by providing samples and clinical data to dermatologists and pediatricians.

OTC SUPPORT

Physician recommendations are important for consumer acceptance of the ElixSure® and Kerasal® product lines. TaroPharma representatives are providing pediatricians and dermatologists with samples and professional information in support of these products.

RESEARCH

Taro's pharmaceutical research achievements are the result of coordinated efforts between R&D teams working in Israel, Canada and the U.S., who are now joined by scientists working in Taro's new R&D center in Ireland. Approximately one in five Taro employees, including more than 80 M.D.s and Ph.D.s, are involved in the Company's research efforts.

Taro's capital investment program has provided the Company's researchers with state-of-the-art facilities for developing topical and oral pharmaceuticals that respond to patient needs for both high quality generic products and innovative proprietary products. Since 2001, Taro's laboratories in Israel and Canada have been expanded significantly, and new research operations have been established in the U.S. and Ireland.

GENERIC RESEARCH

Taro filed 23 Abbreviated New Drug Applications ("ANDAs") during 2003. At year-end, the Company had 35 ANDAs, including tentative approvals for loratadine syrup and fluconazole tablets in four strengths, plus one New Drug Application ("NDA"), submitted to the U.S. FDA. According to industry sources, the ANDAs address markets with current annual U.S. sales in excess of one billion dollars.

PROPRIETARY RESEARCH

With the launch of the ElixSure® line in 2003, Taro introduced the first commercial products utilizing the patented NonSpil™ liquid drug delivery system developed by Taro researchers. In January 2004, Taro's NDA for ElixSure® IB Ibuprofen Oral Suspension was approved and an additional NDA for a NonSpil™-related product was submitted to the FDA. Taro intends to continue developing both prescription and over-the-counter products using the NonSpil™ vehicle.

T2000 is the first compound in Taro's novel class of non-sedating barbiturates, which have potential applications in treating seizures, essential tremor and other disorders. Taro continues to develop T2000 through Phase II trials. The results of an early Phase II trial suggested that T2000 was effective in reducing essential tremor, a common form of involuntary shaking not related to Parkinson's disease. Taro has filed a U.S. patent for this indication and intends to continue T2000 trials during 2004.

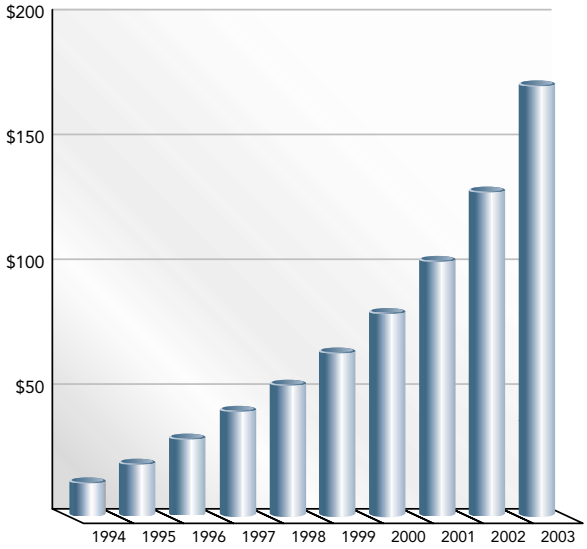
As with any novel drug, there can be no assurance of final approval or successful commercialization of NonSpil™ products, or of T2000 or any member of Taro's class of non-sedating barbiturates, for any indication.

CHEMICAL SYNTHESIS

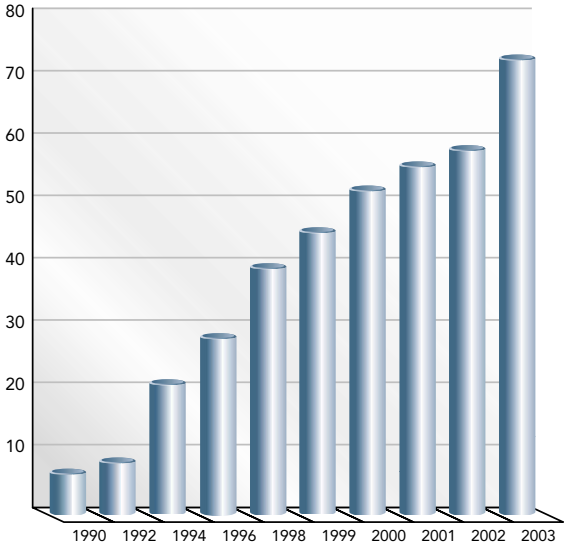
Taro submitted two Drug Master Files ("DMFs") to the FDA during 2003. At year-end, Taro had a total of 21 DMFs on file, enabling the Company to synthesize active pharmaceutical ingredients ("APIs") for many of its finished products. Internal API capability helps Taro control the quality, supply and cost of key raw materials.

CUMULATIVE R&D INVESTMENT

in millions



CUMULATIVE ANDA APPROVALS*



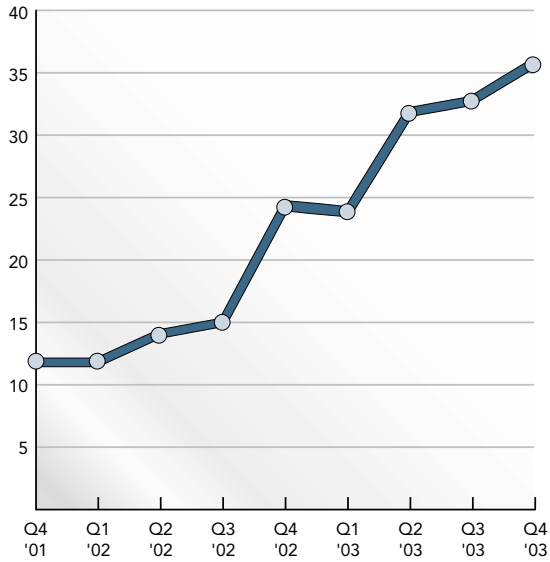
**Excludes acquired products.*

PRODUCT APPROVALS IN 2003-2004

Generic Name	Brand Name
Amcinonide ointment USP, 0.1%	Cyclocort®
Amiodarone hydrochloride tablets, 300 mg	N/A
Ammonium lactate cream, 12%	Lac-Hydrin®
Betamethasone dipropionate (augmented) cream, 0.05%	Diprolene®
Betamethasone dipropionate (augmented) gel, 0.05%	Diprolene®
Clindamycin phosphate topical solution, 1%[3]	Cleocin T®
Etodolac extended release tablets, 400, 500 and 600 mg	Lodine® XL
Fluconazole tablets, 50, 100, 150 and 200 mg[1]	Diflucan®
Fluorouracil topical solution, 2% and 5%	Efudex®
Hydrocortisone butyrate topical solution, 0.1%[3]	Locoid®
Ibuprofen oral suspension, 100 mg / 5 mL[2,3]	ElixSure® IB
Phenytoin oral suspension USP, 125 mg / 5 mL[3]	Dilantin-125®
Terconazole vaginal cream, 0.8%[3]	Terazol®

(1) Tentative approval (2) NDA approval (3) Approvals received through April 30, 2004

GROWTH IN U.S. FILINGS



Taro has grown its pipeline of FDA filings continuously during the past three years.

MANUFACTURING

Taro began manufacturing finished pharmaceutical products in Israel in 1950. In 1961, the Company constructed a plant for API synthesis at its campus in Israel. Since then, Taro has added manufacturing facilities in Canada (1984), the U.S. (2002) and Ireland (2003). Continuous facility improvements help Taro to manufacture high quality products, increase manufacturing efficiencies and control costs.

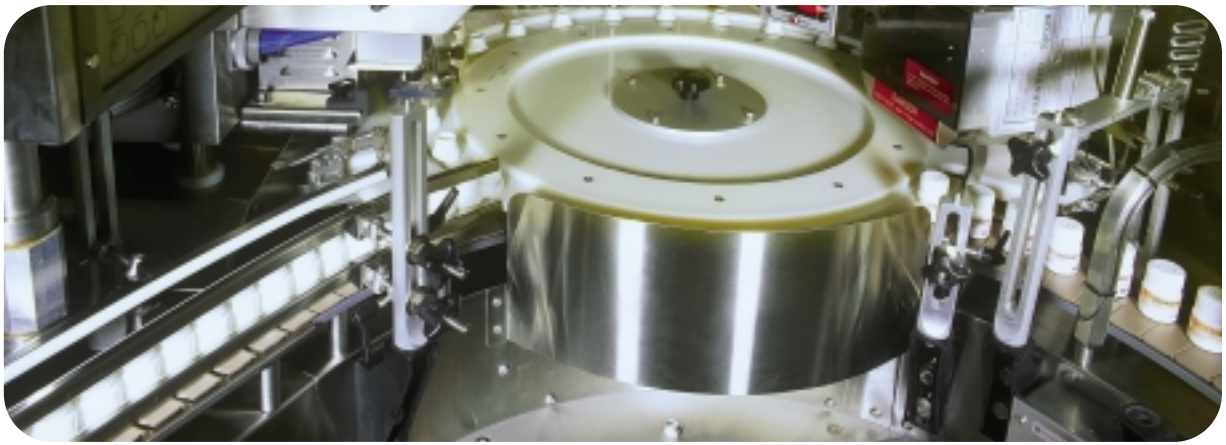
EXPANDING OPERATIONS

In recent years, Taro has expanded its manufacturing and distribution capacity to keep pace with rising demand for the Company's products and anticipated demand for products in development. During 2003, capital expenditures in property, plant and equipment were more than $90 million. Taro now has more than one million square feet of research, manufacturing and distribution space in its facilities worldwide.

In 2003, Taro completed construction of a new chemical facility and a new pharmaceutical distribution center on the Company's campus in Israel. Construction of a new manufacturing site for finished pharmaceuticals is continuing. Since 2000, Taro Canada has increased its operating space significantly. In addition, in 2003, Taro Canada installed a complete manufacturing and packaging suite to accommodate ElixSure® and other products.

In 2002, Taro U.S.A. acquired a manufacturing facility in New York State. The New York operation has been integrated into Taro, providing the Company with its first manufacturing site in the U.S. In January 2004, Taro U.S.A. acquired a 315,000 square foot distribution center in South Brunswick, New Jersey.

In 2003, Taro acquired a multipurpose pharmaceutical research and manufacturing center in Ireland. This center consists of 124,000 square feet of manufacturing, laboratory, distribution and office space on a 14-acre campus. Taro is currently renovating the manufacturing areas in preparation for plant qualifications and potential product certifications.



TARO U.S.A. PRESCRIPTION PRODUCTS

Generic Name	Innovator Name*
Creams, Ointments, Gels and Solutions	
Amcinonide Cream and Ointment	Cyclocort®
Ammonium Lactate Cream and Lotion	Lac-Hydrin®
Betamethasone Dipropionate Cream	Diprosone®
Betamethasone Dipropionate (Augmented) Cream and Gel	Diprolene® AF, Diprolene®
Betamethasone Valerate Cream	Valisone®
Clindamycin Phosphate Topical Solution	Cleocin T®
Clioquinol/Hydrocortisone Cream	----------
Clobetasol Propionate Cream, Ointment, Gel and Topical Solution	Temovate®
Clobetasol Propionate Emollient Cream	Temovate E®
Clotrimazole and Betamethasone Dipropionate Cream	Lotrisone®
Clotrimazole Cream and Topical Solution	Lotrimin®
Desonide Cream and Ointment	Tridesilon® and DesOwen®
Desoximetasone Cream and Gel (0.05%)	Topicort®
Desoximetasone Cream and Ointment (0.25%)	Topicort®
Diflorasone Diacetate Cream and Ointment	Psorcon®
Econazole Nitrate Cream	Spectazole®
Fluocinonide Cream, Ointment, Gel and Topical Solution	Lidex®
Fluocinonide Emollient Cream	Lidex-E®
Fluorouracil Topical Solution (2% and 5%)	Efudex®
Gentamicin Sulfate Cream and Ointment	Garamycin®
Hydrocortisone Butyrate Solution	Locoid®
Hydrocortisone Cream and Lotion (2.5%)	Hytone®
Hydrocortisone Cream and Ointment (1%)	Hytone®, Cortril®
Hydrocortisone Valerate Cream and Ointment	Westcort®
Ketoconazole Cream	Nizoral®
Lidocaine Ointment	----------
Nystatin/Triamcinolone Acetonide Cream and Ointment	Mycolog® II
Nystatin Cream	Mycostatin®
Triamcinolone Acetonide Cream and Ointment	Kenalog®
Triamcinolone Acetonide Dental Paste	Kenalog® in Orabase
Otic Solutions	
Acetic Acid/Hydrocortisone Otic Solution	----------
Antipyrine Benzocaine Otic Solution	Auralgan®, Tympagesic®

*Brand names are the registered trademarks of the products' manufacturers.

TARO U.S.A. PRESCRIPTION PRODUCTS

Generic Name	Innovator Name*
Tablets, Capsules and Oral Suspensions	
Acetazolamide Tablets (125 mg and 250 mg)	Diamox®
Amiodarone Hydrochloride Tablets (100, 200, 300 and 400 mg)	Cordarone®, Pacerone®
Carbamazepine Oral Suspension	Tegretol®
Carbamazepine Tablets	Tegretol®
Carbamazepine Chewable Tablets	Tegretol®
Clomipramine Hydrochloride Capsules (25 mg, 50 mg, and 75 mg)	Anafranil®
Clorazepate Dipotassium Tablets (3.75 mg, 7.5 mg and 15 mg)	Tranxene®
Enalapril Maleate Tablets (2.5 mg, 5 mg, 10 mg and 20 mg)	Vasotec®
Enalapril Maleate/Hydrochlorothiazide Tablets (5/12.5 mg and 10/25 mg)	Vaseretic®
Etodolac Capsules (200 mg and 300 mg)	Lodine®
Etodolac Extended Release Tablets (400 mg, 500 mg and 600 mg)	Lodine®
Etodolac Tablets (400 mg and 500 mg)	Lodine® XL
Ketoconazole Tablets	Nizoral®
Nortriptyline Hydrochloride Capsules (10 mg (base), 25 mg (base) and 75 mg (base))	Pamelor®
Phenytoin Suspension	Dilantin-125®
Warfarin Sodium Tablets (1, 2, 2.5, 3, 4, 5, 6, 7.5, 10 mg)	Coumadin®

*Brand names are the registered trademarks of the products' manufacturers.

TAROPHARMA (U.S.A.)

Brand Name	Active Ingredient
Antibiotics	
Primsol® Oral Solution	Trimethoprim Hydrochloride
Pediculicides	
Ovide® Lotion	Malathion
Topical Antibiotics	
A/T/S® Gel and Solution	Erythromycin
Topical Corticosteroids	
Topicort® LP Cream, Ointment and Gel (0.05%)	Desoximetasone
Topicort® Cream and Ointment (0.25%)	Desoximetasone
U-cort™ Cream	Hydrocortisone with Urea

TARO CONSUMER HEALTHCARE PRODUCTS

Brand Name	Active Ingredient
Oral Preparations	
ElixSure® Fever/Pain	Acetaminophen
ElixSure® Cough	Dextromethorphan HBr
ElixSure® Congestion	Pseudoephedrine HCl
ElixSure® IB™ Fever/Pain	Ibuprofen

Brand Name	Contains
Footcare	
Kerasal®	Salicylic Acid, Urea
Kerasal® AL™	Ammonium Lactate

TARO U.S.A. OTC PRODUCTS

Generic Name	Innovator Name*
Antifungals	
Clotrimazole Cream	Lotrimin® AF
Clotrimazole Topical Solution	Lotrimin® AF
Miconazole Nitrate Cream	Micatin®
Tolnaftate Cream and Solution Spray	Tinactin®
Feminine Care	
Clotrimazole 2% 3 Day Vaginal Cream	Gyne-Lotrimin® 3
Clotrimazole 1% 7 Day Vaginal Cream	Gyne-Lotrimin® 7 and Mycelex®
Lubricating Jelly	K-Y® Jelly
Miconazole Nitrate 7 Day Vaginal Cream	Monistat-7®
First Aid	
Bacitracin Ointment	----------
Diphenhydramine Hydrochloride Cream (2%)	Benadryl®
Hydrocortisone Cream and Ointment (0.5%)	Cortaid® and Cortizone•5®
Hydrocortisone Cream and Ointment (1%)	Cortaid® Maximum Strength and Cortizone•10®
Hydrocortisone Cream with Aloe (0.5%)	Cortaid® Sensitive Skin & Cortizone•5®
Hydrocortisone Cream with Aloe (1%)	Cortaid® Maximum Strength and Cortizone•10®
Hydrocortisone Cream Plus 12 Moisturizers (1%)	Cortizone•10® Plus
Povidone Iodine Ointment and Solution	Betadine®
Triple Antibiotic Ointment	Neosporin®
Triple Antibiotic Ointment Plus Pramoxine	Neosporin® Plus
Nasal Sprays	
Oxymetazoline Hydrochloride Nasal Spray	Afrin®
Saline Nasal Spray	Ocean®
Skin Care	
Benzoyl Peroxide Gel and Lotion (5%)	----------
Benzoyl Peroxide Gel and Lotion (10%)	----------
Diaper Rash Ointment (Zinc Oxide 40%)	Desitin®
Hemorrhoid Treatments	
Hemorrhoidal Suppositories	Preparation H®

*Brand names are the registered trademarks of the products' manufacturers.

TARO CANADA PRESCRIPTION PRODUCTS

Taro Brand Name	Generic Name	Innovator Name•
Creams, Ointments, Gels and Lotions		
Betaderm® Cream and and Ointment (0.1% and 0.05%)	Betamethasone Valerate Cream and Ointment	Betnovate® and Celestoderm®-V and V/2
Hyderm® Cream	Hydrocortisone Acetate Cream	Cortocet®
Nyaderm® Vaginal Cream	Nystatin Vaginal Cream	Mycostatin®
Oracort® Dental Paste	Triamcinolone Acetonide Dental Paste	Kenalog® in Orabase
Taro-Amcinonide® Cream	Amcinonide Cream	Cyclocort®
Taro-Sone® Cream	Betamethasone Dipropionate Cream	Diprosone®
Triaderm® Cream (0.1% and 0.025%)	Triamcinolone Acetonide Cream	Kenalog®
Viaderm® K.C. Cream and Ointment	Nystatin, Neomycin Sulfate, Gramicidin and Triamcinolone Acetonide Cream and Ointment	Kenacomb®
Tablets and Capsules		
Taro-Carbamazepine® CR Tablets (200 mg and 400 mg)	Carbamazepine Controlled Release Tablets	Tegretol® CR
Taro-Carbamazepine® Chewable Tablets (100 mg and 200 mg)	Carbamazepine Chewable Tablets	Tegretol Chewable®
Taro-Warfarin Sodium® Tablets (1, 2, 2.5, 3, 4, 5, 6, 7.5, 10 mg)	Warfarin Sodium Tablets	Coumadin®

*Brand names are the registered trademarks of the products' manufacturers.

TAROPHARMA (CANADA)

Brand Name	Generic Name
Creams, Ointments, Gels and Lotions	
Dermalac® Cream & Lotion (12%)	Ammonium Lactate Cream & Lotion
Dermovate® Cream, Ointment, Scalp Application (0.05%)	Clobetasol Propionate Cream, Ointment, Topical Solution
Hydro Val™ Cream and Ointment	Hydrocortisone Valerate Cream and Ointment
Ketoderm®	Ketoconazole Cream
Lyderm® Cream, Ointment and Gel	Fluocinonide Cream, Ointment and Gel
Tiamol® Cream	Fluocinonide Emollient Cream

*Brand names are the registered trademarks of the products' manufacturers.

TARO CANADA OTC PRODUCTS

Taro Brand Name	Generic Name	Innovator Name•
Creams, Ointments, Gels and Lotions		
BP Gel	Benzoyl Peroxide Gel	----------
Clotrimaderm Cream	Clotrimazole Cream	Canesten®
Clotrimaderm Vaginal Cream (1% and 2%)	Clotrimazole Vaginal Cream	Canesten®
Hyderm Cream	Hydrocortisone Acetate Cream	Cortacet®
Kerasal® Ointment	Salicyclic Acid and Urea Ointment	----------
Micozole Vaginal Cream	Miconazole Nitrate Cream	Monistat®
Nyaderm Cream and Ointment	Nystatin Cream and Ointment	Mycostatin®
Polyderm Ointment	Bacitracin Zinc, Polymyxin B Sulfate Ointment	Polysporin®
Taro Base Cream	----------	Glaxal® Base
Taro Personal Gel Lubricant	Lubricating Jelly	K-Y® Jelly
Triple Antibiotic Ointment	Polymyxin B Sulfate, Bacitracin Zinc and Gramicidin Ointment	Polysporin®
Capsules		
Docusate Sodium Capsules	Docusate Sodium Sulfosuccinate Capsules	Colace®

*Brand names are the registered trademarks of the products' manufacturers.

TARO ISRAEL PRESCRIPTION PRODUCTS

Taro Brand Name	Active Ingredient
Analgesics	
Etopan® Capusles (200 mg and 300mg)	Etodolac
Etopan® Tablets	Etodolac
Etopan® XL Tablets	Etodolac
Morphex CR Tablets	Morphine Hydrochloride Controlled Release
Percocet®* Tablets	Oxycodone Hydrochloride, Acetaminophen
Percodan®* Tablets	Oxycodone Hydrochloride, Oxycodone, Terephthalate, Acetylsalicylic Acid
Tanyl Injection	Fentanyl (as citrate)
Anesthetics	
Curarine Injection	Turbocurarine Chloride
Diprofol 1% Injection (Ampoules and Vials)	Propofol
Diprofol 2% (Vials-Low Lipid Formula)	Propofol
Midazol Injection	Midazolam
Mycurium Injection (Ampoules and Vials)	Atracurium Besylate
Succinyl Forte Ampoules	Succinylcholine Chloride
Antiasthmatics	
Pulmotide Inhaler (50 mcg and 200 mcg)	Budesonide
Antibiotics	
Clavamox Tablets	Amoxicillin, Clavulanic Acid
Clavamox Powder for Suspension (125/31.25 mg and 250/62.5 mg)	Amoxicillin, Clavulanic Acid
Eryc** Enteric Coated Granules in Capsules	Erythromycin
Triax Powder for Injection, 1.0 g vials	Ceftriaxone Sodium
Antifungals	
Fluconazole Capsules (150 mg)	Fluconazole

*In Israel, Coumadin, Percodan and Percocet are registered trademarks of Taro Pharmaceuticals U.S.A., Inc. Elsewhere in the world, Coumadin is a trademark of the Bristol-Myers Squibb Company, and Percodan and Percocet are trademarks of Endo Pharmaceuticals, Inc.

**Eryc is a registered trademark of Faulding Pharmaceuticals Plc.

TARO ISRAEL PRESCRIPTION PRODUCTS

Taro Brand Name	Active Ingredient
Cardiovascular	
Butamine Injection	Dobutamine Hydrochloride
Coumadin®* Tablets (1, 2, 2.5, 3, 4, 5, 6, 7.5, and 10 mg)	Warfarin Sodium Clathrate
Napril Tablets (2.5, 5, 10 and 20 mg)	Enalapril Maleate
Naprizide Tablets (5/12.5 mg and 10/25 mg)	Enalapril Maleate/Hydrochlororthiazide
Nitroglycerin Alcohol Free Injection (Ampoules and Vials)	Nitroglycerin
Profex Tablets (150 mg and 300 mg)	Propafenone
Central Nervous System	
Diaz Tablets (2 mg, 5 mg and 10 mg)	Diazepam
Flexin Injection	Orphenadrine Citrate
Lozapine (25 mg and 100 mg)	Clozapine
Methozane Tablets (25 mg and 100 mg)	Levomepromazine (U.S. Name Methotrimeprazine)
Oprimol Tablets	Opipramol Hydrochloride
Partane Tablets (2 mg and 5 mg)	Trihexyphenidyl Hydrochloride
Perphenan Tablets (4 mg and 8 mg) and Injection (Ampoules)	Perphenazine
Ridazin Tablets (10 mg, 25 mg and 100 mg)	Thioridazine Hydrochloride
Taroctyl Tablets (25 mg and 100 mg) and Injection (Ampoules for I.V. and I.M. Use)	Chlorpromazine Hydrochloride
Teril® CR Tablets (200 mg and 400 mg)	Carbamazepine
Teril® Tablets	Carbamazepine
Uramox® Tablets	Acetazolamide
Dermatologicals	
Clotrizone Cream	Clotrimazole and Betamethasone Dipropionate
Curatane Capsules	Isotretinoin
Dermacombin Cream and Ointment	Nystatin, Neomycin Sulfate, Gramicidin, Triamcinolone Acetonide
Desicort Cream (0.05% and 0.25%)	Desoximetasone
Nystatin Ointment, Tablets and Vaginal Tablets	Nystatin
Zindaclin®*	Clindamycin Phosphate Zinc Complex

*Zindaclin is a registered trademark of Strakan Group Ltd.

TARO ISRAEL PRESCRIPTION PRODUCTS

Taro Brand Name	Active Ingredient
Endocrine	
Depolut Injection (250 mg and 500 mg Ampoules)	Hydroxyprogesterone Caproate
Mercaptizol Tablets	Methimazole
Sterocort Tablets	Triamcinolone
Expectorants/Antitussives	
Oxacatin Syrup	Oxomemazine, Potassium Guaiacolsulfonate, Sodium Benzoate
Gastrointestinal	
Meroken Powder	Polyethylene Glycol, Sodium Bicarbonate, Sodium Chloride, Potassium Chloride
Nutritional Supplements	
Avipur Tablets	Vitamin A (as palmitate)
Ophthalmic Preparations	
Glaucocarpine Eye Drops (1%, 2%, 3%, and 4%)	Pilocarpine Hydrochloride
Tarocidin Eye Drops	Chloramphenicol, Polymyxin B Sulfate
Tarocidin D Eye Drops	Chloramphenicol, Polymyxin B Sulfate, Dexamethasone Sodium Phosphate
Oral Preparations	
Nystatin Ready Mix (Oral Suspension)	Nystatin
Oracort Paste	Triamcinolone Acetonide
Oracort E Paste	Triamcinolone Acetonide, Lidocaine
Periostat®*	Doxycycline
Otic Preparations	
Otomycin Ear Drops	Neomycin Sulfate, Phenylephrine Hydrochloride, Sodium Propionate, Benzocaine

*Periostat is a registered trademark of CollaGenex International Ltd.

TARO ISRAEL OTC PRODUCTS

Taro Brand Name	Active Ingredient
Analgesics	
Rokacet Plus Caplets	Acetaminophen, Codeine, Caffeine
Rokacet Caplets	Acetaminophen, Codeine, Caffeine
Rokal Plus Caplets	Acetylsalicylic Acid, Codeine, Caffeine
Rokal Caplets	Acetylsalicylic Acid, Codeine, Caffeine
Rokamol Adult and Pediatric Syrup	Acetaminophen
Rokamol Gelcaps	Acetaminophen
Rokamol Plus Codeine Tablets	Acetaminophen, Codeine
Antidiarrheals	
Kapectin Forte Suspenison	Kaolin, Pectin
Antifungals	
Clotrimaderm Cream	Clotrimazole
Cough/Cold	
Tarodex Adult and Pediatric Syrup	Dextromethorphan Hydrobromide
Tarophed Syrup	Pseudoephedrine Hydrochloride
Laxatives	
Jungborn Granules	Senna Extract
Jungborn Tea	Folia Sennae, Herbal Ingredients
Medicated Shampoo	
Nikita	Plant Extracts (lice treatment)
Sebosel Suspension	Selenium Sulfide

TARO ISRAEL OTC PRODUCTS

Taro Brand Name	Active Ingredient
Nasal Preparations	
Alnase Nasal Drops, Spray and Metered Dose	Naphazoline Hydrochloride, Phenylephrine Hydrochloride, Mepyramine Maleate
Sinaf Nasal Drops, Spray and Metered Dose	Oxymetazoline Hydrochloride, Phenylephrine Hydrochloride
Nutritional Supplements	
Calcimore Tablets	Calcium Carbonate
Ce De Calcium Tablets (Veterinary)	Ascorbic Acid, Vitamin D, Calcium Phosphate
Polyvit 30 Plus Capsules	Multivitamin and Minerals
Polyvit Drops	Multivitamin and Minerals
Oral Preparations	
Anadent Gel	Benzocaine
Tarodent Mouthwash	Chlorohexidine Gluconate

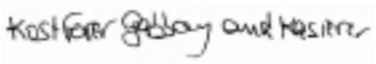
REPORT OF INDEPENDENT AUDITORS

To the Shareholders of Taro Pharmaceutical Industries Ltd.

We have audited the accompanying consolidated balance sheets of Taro Pharmaceutical Industries Ltd. ("the Company") and its subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2003 and 2002, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.



Tel-Aviv, Israel
February 16, 2004

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2003	2002
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 159,121	$ 130,717
Restricted short-term bank deposits	2,518	2,468
Accounts receivable:		
Trade (Note 3a)	120,522	69,038
Other receivables and prepaid expenses (Note 3b)	17,046	12,453
Inventories (Note 4)	84,486	42,439
TOTAL CURRENT ASSETS	383,693	257,115
LONG-TERM INVESTMENTS (Note 7)	2,888	1,348
PROPERTY, PLANT AND EQUIPMENT, NET (Note 5)	182,306	93,358
OTHER INTANGIBLE ASSETS AND DEFERRED CHARGES, NET (Note 6)	30,187	7,676
GOODWILL	7,199	7,150
DEFERRED INCOME TAXES (Note 14)	10,250	13,198
TOTAL ASSETS	**$ 616,523**	**$ 379,845**

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2003	2002
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit and short-term loans (Note 8)	$ 19,124	$ 2,310
Current maturities of long-term debt (Note 10)	24,420	7,962
Accounts payable:		
Trade	26,148	25,216
Other and accrued expenses (Note 9)	31,083	20,199
Income taxes payable	2,963	2,557
TOTAL CURRENT LIABILITIES	103,738	58,244
LONG-TERM LIABILITIES:		
Long-term debt, net of current maturities (Note 10)	156,937	47,127
Deferred income taxes (Note 14)	4,880	2,780
Accrued severance pay	1,857	1,398
TOTAL LONG-TERM LIABILITIES	163,674	51,305
COMMITMENTS AND CONTINGENCIES (Note 12)		
MINORITY INTEREST	1,711	1,159
SHAREHOLDERS' EQUITY (Note 13):		
Share capital:		
Ordinary Shares of NIS 0.0001 par value: Authorized at December 31, 2003 and 2002: 200,000,000 shares; Issued at December 31, 2003 and 2002: 29,234,618 and 29,008,589 shares, respectively; Outstanding at December 31, 2003 and 2002: 28,969,218 and 28,744,289, respectively	679	679
Founders' shares of NIS 0.00001 par value:		
Authorized, issued and outstanding at December 31, 2003 and 2002: 2,600 shares	1	1
Additional paid-in capital	182,699	173,584
Accumulated other comprehensive income (loss)	5,695	(2,358)
Treasury stock	(1,348)	(1,288)
Retained earnings	159,674	98,519
TOTAL SHAREHOLDERS' EQUITY	**347,400**	**269,137**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 616,523**	**$ 379,845**

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2003	2002	2001
Sales (Notes 15a and 16)	$ 315,458	$ 211,581	$ 149,230
Cost of sales	102,454	79,468	54,736
Gross profit	213,004	132,113	94,494
Operating expenses:			
Research and development, net (Note 15b)	40,601	26,373	19,633
Selling, marketing, general and administrative (Note 15c)	97,718	52,481	42,086
	138,319	78,854	61,719
Operating income	74,685	53,259	32,775
Financial expenses, net (Note 15d)	(1,722)	(162)	(2,594)
	72,963	53,097	30,181
Other income (loss), net	(7)	78	272
Income before income taxes	72,956	53,175	30,453
Income taxes (Note 14)	11,475	8,406	4,378
	61,481	44,769	26,075
Minority interest in earnings of a subsidiary	(326)	(214)	(81)
Net income	**$ 61,155**	**$ 44,555**	**$ 25,994**
Basic earnings per Ordinary Share (Note 13f)	$ 2.12	$ 1.55	$ 1.11
Diluted earnings per Ordinary Share (Note 13f)	$ 2.06	$ 1.52	$ 0.99

The accompanying notes are an integral part of the consolidated financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Treasury stock	Retained earnings	Total shareholders' equity
Balance at January 1, 2001	$ 680	$ 23,961	$ (1,381)	$ (1,016)	$ 27,970	$ 50,214
Net income	-	-	-	-	25,994	25,994
Other comprehensive (loss):						
Foreign currency translation adjustments	-	-	(1,204)	-	-	(1,204)
Unrealized loss on available-for-sale marketable securities	-	-	(6)	-	-	(6)
Total comprehensive income						24,784
Tax benefit related to exercise of stock options	-	16,045	-		-	16,045
Exercise of options	*)	989	-	-	-	989
Stock split effected as a stock dividend (100%)	*)	*)	-		-	-
Issuance of shares, net	*)	126,574	-		-	126,574
Amortization of compensation in respect of options granted to non-employees	-	30	-	-	-	30
Purchase of treasury stock	*)	-	-	(272)	-	(272)
Balance at December 31, 2001	680	167,599	(2,591)	(1,288)	53,964	218,364
Net income	-	-	-	-	44,555	44,555
Other comprehensive income (loss):						
Foreign currency translation adjustments	-	-	236	-	-	236
Unrealized loss on available-for-sale marketable securities	-	-	(3)	-	-	(3)
Total comprehensive income						44,788
Tax benefit related to exercise of stock options	-	5,195	-	-	-	5,195
Exercise of options and issuance of shares of ESPP	*)	651	-	-	-	651
Amortization of compensation in respect of options granted to non-employees	-	139	-	-	-	139
Balance at December 31, 2002	680	173,584	(2,358)	(1,288)	98,519	269,137
Net income	-	-	-	-	61,155	61,155
Other comprehensive income (loss):						
Foreign currency translation adjustments	-	-	9,501	-	-	9,501
Unrealized loss from hedging derivatives	-	-	(1,448)	-	-	(1,448)
Total comprehensive income						69,208
Tax benefit related to exercise of stock options	-	6,995	-	-	-	6,995
Exercise of options and issuance of shares of ESPP	*)	2,110	-	-	-	2,110
Amortization of compensation in respect of options granted to non-employees	-	10	-	-	-	10
Treasury stock purchase				(60)		(60)
Balance at December 31, 2003	**$ 680**	**$ 182,699**	**$ 5,695**	**$ (1,348)**	**$ 159,674**	**$ 347,400**

Accumulated unrealized gains on available-for-sale marketable securities	$ 46
Accumulated foreign currency translation adjustments	7,097
Accumulated unrealized loss from hedging derivatives	(1,448)
	$ 5,695

*) *Represents an amount lower than $1.*

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 61,155	$ 44,555	$ 25,994
Adjustments required to reconcile net income to net cash provided by operating activities:			
Minority interest in earnings of a subsidiary	326	214	81
Depreciation and amortization	14,405	8,263	6,728
Amortization of compensation in respect of options granted to non-employees	10	139	30
Accrued severance pay, net	27	55	35
Capital loss (gain) on sale of property, plant and equipment	9	-	(19)
Currency fluctuation of long-term debt	212	(327)	(622)
Deferred income taxes, net	9,223	4,254	2,117
Increase in trade receivables	(50,992)	(26,853)	(2,560)
Increase in other accounts receivable and prepaid expenses	(1,209)	(4,250)	(1,410)
Increase in inventories	(37,638)	(11,717)	(10,454)
Increase (decrease) in trade payables	(340)	11,090	4,125
Increase in other accounts payable and accrued expenses	10,132	3,142	2,662
Increase (decrease) in income taxes payable	(63)	1,077	687
NET CASH PROVIDED BY OPERATING ACTIVITIES	**5,257**	**29,642**	**27,394**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment	(94,421)	(43,246)	(19,258)
Acquisition of Thames Pharmacal Company, Inc. (a)	-	(6,436)	-
Investments in other intangible assets	(10,375)	(377)	(1,391)
Long-term and other deposits	(64)	(130)	10
Investment in restricted short-term bank deposits	(50)	(52)	(185)
Proceeds from sale of property, plant and equipment	24	371	26
NET CASH USED IN INVESTING ACTIVITIES	**(104,886)**	**(49,870)**	**(20,798)**

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2003	2002	2001
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from exercise of options and issuance of shares of ESPP	2,110	651	989
Proceeds from issuance of shares, net	-	-	126,574
Proceeds from long-term debt	116,346	7,183	15,750
Purchase of treasury stock	(60)	-	(272)
Repayment of long-term debt	(8,616)	(6,006)	(6,102)
Short-term bank credit and short-term loans, net	17,873	(1,636)	51
NET CASH PROVIDED BY FINANCING ACTIVITIES	**127,653**	**192**	**136,990**
Effect of exchange rate changes on cash and cash equivalents	380	21	(99)
Increase (decrease) in cash and cash equivalents	28,404	(20,015)	143,487
Cash and cash equivalents at the beginning of the year	130,717	150,732	7,245
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	**$ 159,121**	**$ 130,717**	**$ 150,732**
SUPPLEMENTAL DISCLOSURE OF CASH FLOW TRANSACTIONS:			
Cash paid during the year for:			
Interest	$ 3,102	$ 2,696	$ 3,557
Income taxes	$ 5,593	$ 3,270	$ 1,568
(a) Acquisition of Thames Pharmacal Company, Inc.:			
Estimated fair value of assets acquired and liabilities assumed at the date of acquisition:			
Working capital deficiency, net (excluding cash)		$ (1,788)	
Property, plant and equipment		220	
Intangible assets		4,697	
Goodwill		3,307	
		$ 6,436	
(b) Non-cash investing and financing transactions:			
Purchase of property, plant and equipment	$ 5,415	$ 5,870	$ 1,867
Investment in other intangible assets	$ 14,100	$ -	$ -
Tax benefit related to exercise of stock options	$ 6,995	$ 5,195	$ 16,045

The accompanying notes are an integral part of the consolidated financial statements.

U.S. dollars in thousands (except share data)

NOTE 1: GENERAL

a. Taro Pharmaceutical Industries Ltd. ("the Company") is an Israeli corporation, which operates in Israel and through Israeli, North American, and European subsidiaries ("the Group"). The principal business activities of the Group are the production, research, development and marketing of pharmaceutical products. The Company's Ordinary Shares are listed for trade on the NASDAQ National Market in the United States.

All of the industrial pharmaceutical activities of the Group in Israel are performed by the Company. The activities of the Group in North America are performed by Taro Pharmaceuticals Inc., Taro Pharmaceuticals North America, Inc. and Taro Pharmaceuticals U.S.A., Inc. Taro Research Institute Ltd. provides research and development services to the Group. Taro International Ltd., Taro Pharmaceuticals Ireland Ltd. and Taro Pharmaceuticals (U.K.) Ltd. are engaged in the pharmaceutical activities of the Group outside North America.

The Group manufactures generic and proprietary drug products in its facilities located in Israel, Canada and the U.S.A., and manufactures bulk active pharmaceutical ingredients in its facilities located in Israel. The majority of the Group's sales are in North America.

In North America, the Company sells and distributes its products principally to drug industry wholesalers, drug store chains and mass merchandisers. In Israel, the Group sells and distributes its products principally to healthcare institutions and private pharmacies.

In the generic pharmaceutical industry, selling prices and related profit margins tend to decrease as products mature due to increased competition from other generic pharmaceutical manufacturers as they gain approval from the U.S. Food & Drug Administration, the Canadian Therapeutic Products Directorate, the Israeli and other Ministries of Health ("Government Agencies") to manufacture equivalent products. The Group's future operating results are dependent on, among other things, its ability to introduce new products and maintain its approvals to market existing drugs.

While non-compliance with Government Agencies' regulations can result in refusal to allow entry, seizure, fines or injunctive actions to prevent the sale of products, no such actions against the Group or its products have ever occurred. The Group believes that it is in material compliance with all Government Agencies' regulations.

One customer accounted for 20%, 22% and 15% of the Group's revenues for the years ended December 31, 2003, 2002 and 2001, respectively (see also Note 15a).

Some raw materials and certain products are currently obtained from single domestic or foreign suppliers. Although the Group has not experienced material difficulties to date, future supply interruptions could require additional regulatory approvals and may result in the Group's inability to market affected products pending approvals. Any significant and prolonged interruption of supply could have a material adverse effect on the Group's results of operations and financial position.

b. On May 7, 2002, the Company through its subsidiaries purchased substantially all of the assets and assumed all liabilities of Thames Pharmacal, Inc. ("Thames"). Thames was a privately-held New York manufacturer of prescription and over-the-counter pharmaceutical products. The acquisition was made in order to broaden the Company's portfolio of products. The aggregate purchase price of $6,436 was paid in cash. The Company accounted for this acquisition by the purchase method. The results of Thames operations have been included in the consolidated financial statements since the acquisition date.

The following table summarizes the estimated fair value of assets acquired and liabilities assumed at the acquisition date:

Current assets	$ 3,024
Current liabilities	(4,812)
Property, plant and equipment	220
Intangible assets	4,697
Goodwill	3,307
	$ 6,436

The intangible assets acquired include product rights with a weighted average useful life of 11 years. No in-process research and development was identified.

Pro forma information in accordance with Statement of Financial Accounting Standard No. 141, "Business Combinations," has not been provided since the sales and net income for 2002 and 2001 were not material in relation to total consolidated sales and net income.

c. On January 14, 2003, Taro Pharmaceuticals North America, Inc. ("TNA") entered into a license and option agreement with Medicis Pharmaceutical Corporation ("Medicis"). According to the agreement, TNA purchased from Medicis four branded prescription product lines for sale in the United States and Puerto Rico for an aggregate purchase price of $23,800. The product lines are used primarily in dermatology and pediatrics. The purchase price was allocated to the product lines. Such product lines have a weighted average useful life of 15 years.

d. On March 21, 2003, the Company's Irish subsidiary, Taro Pharmaceuticals Ireland Ltd., acquired, for an amount equal to $5,900, a multi-purpose pharmaceutical manufacturing and research facility in Ireland. The facility was purchased in connection with liquidation proceedings from the Official Liquidator appointed by the High Court of Ireland. Based on a valuation analysis, $2,350 was allocated to land, $1,950 was allocated to buildings with an average useful life of 30 years and $1,600 was allocated to infrastructure, machinery and equipment with an average useful life of eight years.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared according to accounting principles generally accepted in the United States ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A majority of the revenues of the Company and certain of its subsidiaries is generated in U.S. dollars ("dollars"). In addition, a substantial portion of the costs of the Company and certain of its subsidiaries is incurred in dollars. The Company's management

believes that the dollar is the primary currency of the economic environment in which the Company and certain of its subsidiaries operate. Thus, the functional and reporting currency of the Company and certain of its subsidiaries is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with Statement of Financial Accounting Standard No. 52, "Foreign Currency Translation." All transaction gains and losses resulting from remeasurement of monetary balance sheet items are reflected in the statement of income as financial income or expenses, as appropriate.

The dollar has been determined to be the functional currency for the Company and all subsidiaries except the Canadian, Irish and the U.K. subsidiaries, for which their respective local currencies are their functional currencies. The financial statements of the Canadian, Irish and the U.K. subsidiaries have been translated into dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Amounts recorded in the statements of income have been translated using the average exchange rate for the year. The resulting translation adjustments are reported as a component of shareholders' equity, under "Accumulated other comprehensive income (loss)."

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Inter-company transactions and balances have been eliminated in consolidation. Profits from inter-company sales not yet realized outside the Group have been eliminated in consolidation. The Company holds 50% of the shares conferring voting rights and 96.9% of the shares conferring rights to profits of Taro Pharmaceuticals U.S.A., Inc. ("the U.S. subsidiary"); the remaining shares conferring 50% of the voting rights and 3.1% of the rights to profits are held by Taro Development Corporation (a shareholder of the Company). According to an agreement between the shareholder and the Company, the shareholder will appoint directors in the U.S. subsidiary as instructed by the Company.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less at the date acquired.

e. Restricted short-term bank deposits:

Restricted cash is primarily invested in certificates of deposit, which mature within one year and which are used as collateral for the Company's short-term bank loans. Such restricted short-term bank deposits are recorded at cost, including accrued interest.

f. Allowance for doubtful accounts:

The allowance for doubtful accounts is calculated primarily with respect to specific debts which, in the opinion of the Company's management, are doubtful of collection, and with respect to a fixed general allowance which, in the opinion of the Company's management, is sufficient to cover anticipated uncollectible balances.

g. Inventories:

Inventories are stated at the lower of cost or market value. Inventory reserves are provided to cover risks arising from slow-moving items or obsolescence. Cost is determined as follows:

Raw and packaging materials - average cost basis.

Finished goods and work in progress - average production costs including materials, labor and direct and indirect manufacturing expenses.

Purchased products for commercial purposes - at cost.

h. Property, plant and equipment:

1. Property, plant and equipment are stated at cost net of accumulated depreciation.

2. Interest and payroll expenses incurred during the construction period of property, plant and equipment are capitalized to the cost of such assets.

3. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	%
Buildings	2.5 - 4
Installations, machinery and equipment	5 - 10 (mainly 10)
Motor vehicles	15 - 20
Furniture, fixtures, office equipment and EDP equipment	6 - 33 (mainly 20)

Leasehold improvements are depreciated by the straight-line method over the term of the leases (5-10 years).

4. The Group accounts for costs of computer software developed or obtained for internal use in accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP No. 98-1"). SOP No. 98-1 requires the capitalization of certain costs incurred in connection with developing or obtaining internal use software. During the years 2003 and 2002, the Group capitalized $958 and $777 of software costs, respectively. Capitalized software costs are amortized by the straight-line method over their estimated useful life of three years.

i. Goodwill:

Goodwill represents the excess of the costs over the fair value of net assets of businesses acquired. Goodwill that arose from acquisitions prior to July 1, 2001, was amortized until December 31, 2001, on a straight-line basis over 40 years. Under Statement of Financial Accounting Standard No.142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") goodwill acquired in a business combination on or after July 1, 2001 and all goodwill after December 31, 2001, is not amortized.

SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair values of the reporting units were determined using expected future discounted cash flows. The Company performed the impairment tests during the fourth fiscal quarter. According to those tests, no impairment exists as of December 31, 2003.

Pro-forma information in accordance with SFAS No. 142 has not been provided, since the goodwill amortization expenses for 2001 were not material.

Changes in goodwill during the year resulting from translation adjustment related to goodwill recorded in the Canadian subsidiary.

j. Other intangible assets and deferred charges:

Product rights subject to amortization arising from acquisitions prior to July 1, 2001 continue to be amortized on a straight-line basis over their useful life. Such product rights are amortized over eight and 20 years.

Intangible assets acquired in a business combination on or after July 1, 2001, should be amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. Related product rights are amortized over a weighted average life of 15 years.

Debt issuance costs in respect of long-term bonds are deferred and amortized under the effective interest method over the term of the bonds.

k. Impairment of long-lived assets:

The Group's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2003, no impairment losses have been identified.

l. Revenue recognition:

Revenues from product sales are recognized when delivery has occurred, persuasive evidence of an agreement exists, the vendor's fee is fixed or determinable and collection is probable. The Group maintains a provision for product returns, in accordance with Statement of Financial Accounting Standard No. 48, "Revenue Recognition When Right of Return Exists." Provision for returns and other sale allowances are determined on the basis of past experience and are deducted from revenues.

m. Sales incentives and trade promotional allowances:

The Company has adopted Emerging Issues Task Force ("EITF") No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer or Reseller of the Vendor's Products," effective December 31, 2001. All sales incentives and trade promotional allowances generated during prior periods, including selling, marketing, general and administrative expenses, were reclassified as a reduction from sales and accordingly, sales were reduced by $904 in 2001.

n. Research and development:

Research and development expenses, net of related grants received, are charged to expenses as incurred.

o. Royalty-bearing grants:

Royalty-bearing grants from the Government of Israel through the Office of the Chief Scientist for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred and included as a deduction from research and development costs.

p. Advertising expenses:

The Group expenses advertising costs as incurred. Advertising expenses were approximately $22,309, $4,075 and $4,038 for the years ended December 31, 2003, 2002 and 2001, respectively.

q. Income taxes:

The Group accounts for income taxes in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). SFAS No. 109 prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

r. Basic and diluted net earnings per share:

Basic earnings per share are calculated based on the weighted average number of Ordinary Shares outstanding during each year. Diluted net earnings per share are calculated based on the weighted average number of Ordinary Shares outstanding during each year, plus dilutive potential Ordinary Shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, "Earnings per Share." Options that have an anti-dilutive effect are immaterial.

The total weighted average number of shares related to the outstanding options excluded from the calculations of diluted net earnings per share, as a result of anti-diluted effect, was 49,000, 164,050 and 11,725 for the years ended December 31, 2003, 2002 and 2001, respectively.

s. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Statement No. 25, "Accounting for Stock Options Issued to Employees" ("APB No. 25") and FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock options plans. Under APB No. 25, when the exercise price of an employee stock option is equivalent to or above the market price of the underlying stock on the date of grant, no compensation expense is recognized.

The Company adopted the disclosure provisions of Financial Accounting Standards Board Statement No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which amended certain provisions of Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25 in accounting for stock-based compensation.

Pro-forma information regarding the Company's net income and net earnings per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

The fair value for options granted in 2003, 2002 and 2001 is amortized over their vesting period and estimated at the date of grant using the Black-Scholes Options Pricing Model with the following weighted average assumptions:

	2003	2002	2001
Dividend yield	0%	0%	0%
Expected volatility	52%	52.3%	54.6%
Risk-free interest	3.00%	3.50%	2.75%
Expected life of up to	5 years	5 years	7 years

Pro forma information under SFAS No. 123 is as follows:

	Year ended December 31,		
	2003	2002	2001
Net income - as reported	$ 61,155	$ 44,555	$ 25,994
Less - total stock-based compensation expenses determined under fair value method for all awards, net of related tax effect	1,752	1,250	947
Net income - pro-forma	**$ 59,403**	**$ 43,305**	**$ 25,047**
Earnings per share:			
Basic - as reported	$ 2.12	$ 1.55	$ 1.11
Basic - pro-forma	$ 2.06	$ 1.47	$ 1.05
Diluted - as reported	$ 2.06	$ 1.52	$ 0.99
Diluted - pro-forma	$ 2.00	$ 1.47	$ 0.95

The Company applies SFAS No. 123 and EITF No. 96-18 "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services" with respect to options issued to non-employees. SFAS No. 123 requires the use of option valuation models to measure the fair value of the options when performance is completed.

t. Concentrations of credit risk:

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, restricted short-term bank deposits, marketable securities and trade receivables. Cash and cash equivalents and restricted short-term bank deposits are invested in major banks in Israel, the United States, Canada and the Cayman Islands. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Group's cash and cash equivalent and restricted short-term bank deposits are financially sound, and accordingly, minimal credit risk exists with respect to these financial instruments.

The Group's trade receivables are mainly derived from sales to customers in the United States, Canada, Europe and Israel. The Group has adopted credit policies and standards intended to accommodate industry growth and inherent risk. Management believes that credit risks are moderated by obtaining credit insurance, and by the diversity of the Group's customer base and geographic sales areas. The Group performs ongoing credit evaluations of its customers' financial condition and requires collateral when deemed necessary.

u. Fair value of financial instruments:

The following methods and assumptions were used by the Group in estimating their fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, restricted short-term bank deposits, trade receivables and trade payables approximate their fair value due to the short-term maturities of these instruments.

The carrying and fair values for marketable securities are based on quoted market prices. The carrying amounts of the Group's borrowing arrangements under its short-term and long-term debt agreements approximate their fair value based on the Group's incremental borrowing rates for similar types of borrowing arrangements.

v. Accounting for derivatives:

Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the same line item associated with the hedged item in current earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

For derivative instruments not designated as hedging instruments, the gain or loss is recognized in financial income/expense in current earnings during the period of change.

The cumulative effect of the adoption of SFAS No. 133 was a decrease in income before taxes of $194 for the year ended December 31, 2001. This amount is included in financial expenses, net, and not as an accumulated effect of an accounting change, due to immateriality. The adoption did not have a material effect on other comprehensive income.

w. Impact of recently issued accounting standards:

In May 2003, the EITF reached a consensus on Issue 00-21, addressing how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (1) the delivered item has value to the customer on a standalone basis; (2) there is objective and reliable evidence of the fair value of undelivered items; and (3) delivery of any undelivered item is probable. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values, with the amount allocated to the delivered item being limited to the amount that is not contingent on the delivery of additional items or on compliance with other specified performance conditions. The final consensus will be applicable to agreements entered into in fiscal periods beginning after June 15, 2003 with early adoption permitted. The provisions of this consensus are not expected to have a significant effect on the Company's financial position or operating results.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, "Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"). SFAS No. 149 amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under

SFAS No. 133. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company does not expect the adoption of SFAS No. 149 to have a material impact on its results of operations or financial position.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104, "Revenue Recognition," ("SAB No. 104") which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's consolidated results of operations, consolidated financial position or consolidated cash flows.

NOTE 3: ACCOUNTS RECEIVABLE

a. Trade:

	December 31,	
	2003	**2002**
Open accounts	$ 119,716	$ 67,753
Notes and checks receivable	1,116	1,311
	120,832	69,064
Less - allowance for doubtful accounts	310	26
	$ 120,522	**$ 69,038**

As for pledges, see Note 11.

b. Other and prepaid expenses:

	December 31,	
	2003	**2002**
Employees	$ 262	$ 175
Office of the Chief Scientist	670	345
Government authorities	4,344	5,233
Derivative instruments (Note 18)	1,313	653
Deferred income taxes (Note 14)	5,487	2,707
Prepaid expenses	3,917	2,025
Other	1,053	1,315
	$ 17,046	**$ 12,453**

NOTE 4: INVENTORIES

	December 31, 2003	December 31, 2002
Raw and packaging materials	$ 32,665	$ 17,240
Finished goods	42,650	19,865
Work in progress	7,587	3,810
Purchased products for commercial activities	1,584	1,524
	$ 84,486	**$ 42,439**

As for pledges, see Note 11.

NOTE 5: PROPERTY, PLANT AND EQUIPMENT

a. Composition of assets grouped by major classifications are as follows:

	December 31, 2003	December 31, 2002
Cost:		
Land	$ 12,491	$ 3,028
Leasehold land (1)	12,539	9,217
Buildings (1)	73,712	36,457
Leasehold improvements	3,401	2,657
Installation, machinery and equipment	100,948	56,465
EDP equipment	23,248	15,490
Motor vehicles	342	290
Furniture, fixtures and office equipment	6,212	3,965
Advance for property and equipment	2,023	4,693
	234,916	132,262
Accumulated depreciation:		
Buildings (1)	5,375	3,652
Leasehold improvements	1,566	1,151
Installation, machinery and equipment	29,663	22,013
EDP equipment	13,392	9,816
Motor vehicles	163	164
Furniture, fixtures and office equipment	2,451	2,108
	52,610	38,904
Depreciated cost	**$ 182,306**	**$ 93,358**

Depreciation expenses were $12,181, $7,875 and $6,402, for the years ended December 31, 2003, 2002 and 2001, respectively.

(1) Certain buildings (the depreciated balance of which as of December 31, 2003 was $35,877) were constructed on land leased from the Israel Land Administration pursuant to four leases. These leases expire between 2009 and 2049. The Company has the option to renew each lease for an additional term of 49 years.

b. Cost of property, plant and equipment includes capitalized interest expenses, payroll and related expenses and other expenses incurred until the assets are ready for their intended use in the amount of $8,211 and $3,222 as of December 31, 2003 and 2002, respectively.

c. Cost of EDP equipment includes costs of computer software developed for internal use in the amount of $2,460 and $1,502 as of December 31, 2003 and 2002, respectively.

d. As of December 31, 2003, the Company has outstanding contractual commitments to expand its buildings and to purchase equipment in the amount of $17,153.

NOTE 6: OTHER INTANGIBLE ASSETS AND DEFERRED CHARGES

a. Composition:

	December 31,	
	2003	2002
Original amount:		
Product rights	$ 32,049	$ 7,872
Deferred charges in respect of bonds	1,327	794
	33,376	8,666
Accumulated amortization:		
Product rights	2,667	616
Deferred charges in respect of bonds	522	374
	3,189	990
Amortized cost	**$ 30,187**	**$ 7,676**

b. Amortization expenses were $2,199, $388 and $326, for the years ended December 31, 2003, 2002 and 2001, respectively.

c. As of December 31, 2003, the estimated amortization expenses of intangible assets for 2004 to 2008 is as follows: 2004 - $2,512; 2005 - $2,461; 2006 - $2,446; 2007 - $2,432 and 2008 - $2,725.

NOTE 7: LONG-TERM INVESTMENTS

	December 31,	
	2003	2002
Severance pay fund (1)	$ 1,489	$ 1,057
Derivative instrument (2)	1,044	-
Long-term deposit	355	291
	$ 2,888	**$ 1,348**

(1) Under Israeli law, the Company and its Israeli subsidiaries are required to make severance or pension payments to dismissed employees and to employees terminating employment under certain other circumstances. Deposits are made with a pension fund to secure pension and severance rights for the majority of the employees in Israel who have joined the pension fund. The deposits, together with a one-time payment made to that fund, relieve the Company and its Israeli subsidiaries of their severance pay liability to those employees whose employment started after June 1, 1979. As of December 31, 2003, the Company has no related severance pay liability for such employees. The severance pay liability for several senior employees is covered by insurance policies.

The severance pay liability for the period through May 31, 1979 is covered by the balance sheet accrual. The balance sheet accrual also covers the severance pay liability to employees of the Company who have not joined the pension fund. The Company has made deposits with recognized severance pay funds with respect to this accrual.

The Company may only withdraw the amounts funded for the purpose of disbursement of severance pay.

The Company's non-Israeli subsidiaries maintain a retirement savings plan covering substantially all of their employees. The subsidiaries' matching contribution to the plan was approximately $882, $477 and $378 for the years 2003, 2002 and 2001, respectively.

	Year ended December 31,		
	2003	2002	2001
Pension, retirement savings and severance expenses	$ 3,060	$ 2,138	$ 1,930

(2) As for derivative instruments, see Note 18.

NOTE 8: SHORT-TERM BANK CREDIT AND SHORT-TERM LOANS

Classified by currency, linkage terms and interest rates, the credit and loans are as follows:

	Interest Rate December 31,		Amount December 31,	
	2003	2002	2003	2002
	%			
Short-term bank credits and loans:				
In, or linked to, U.S. dollars	2.94	2.72	$ 14,605	$ 2,310
In other currency	5.15	-	4,519	-
			$ 19,124	**$ 2,310**
Total authorized credit lines (approximate)			$ 28,500	$ 28,500
Unutilized credit lines (approximate)			$ 9,006	$ 26,190
Weighted average interest rates at the end of the year	3.45	2.72		

NOTE 9: ACCOUNTS PAYABLE - OTHER AND ACCRUED EXPENSES

	December 31,	
	2003	2002
Employees and payroll accruals (including accrual for vacation pay)	$ 14,599	$ 11,876
Interest payable	1,117	494
Suppliers of property, plant and equipment	4,683	5,130
Accrued expenses and other	10,684	2,699
	$ 31,083	**$ 20,199**

NOTE 10: LONG-TERM DEBT

a. Composed as follows:

	December 31,	
	2003	2002
Bonds	$ 130,432	$ 20,724
Banks	29,672	29,620
Other	21,253	4,745
	181,357	55,089
Less – current maturities	24,420	7,962
	$ 156,937	**$ 47,127**

The Company has undertaken to maintain certain financial ratios in respect of its long-term debt. As of December 31, 2003, the Company was in compliance with these ratios. Under certain restrictive debt covenants, any dividend distribution requires the prior approval of certain banks.

b. Classified by currency, linkage terms and interest rates, the total amount of the liabilities (before deduction of current maturities) is as follows:

	Interest Rate December 31,		Amount December 31,	
	2003	2002	2003	2002
	%			
In, or linked to, U.S. dollars	4.58	3.08	$ 107,604	$ 31,882
In Canadian dollars	5.29	5.41	9,891	4,905
In Israeli currency - linked to CPI	6.41	8.25	63,862	18,302
			$ 181,357	**$ 55,089**

As for hedging foreign currency and interest rate risk of the portion linked to the Israeli CPI, see Note 18.

c. The liabilities mature as follows:

	December 31, 2003
2004 (current maturity)	$ 24,420
2005	10,478
2006	21,778
2007	20,291
2008	25,950
Thereafter	78,440
	$ 181,357

NOTE 11: LIABILITIES COLLATERALIZED BY PLEDGES

a. Balance of liabilities collateralized by pledges is as follows:

	December 31, 2003
Short-term bank credit and short-term loans*)	$ 19,124
Long-term debt (including current maturities)	$ 164,091

*) Including a short-term loan of $2,300 received by the U.S. subsidiary, collateralized by a short-term bank deposit of the North American subsidiary in an equal amount.

b. The above mentioned liabilities are collateralized by:

1. A mortgage which includes a first priority charge on all property, plant and equipment of the Canadian subsidiary, specifically including land, buildings, production machinery, furniture and fixtures, and a floating charge covering all assets of the Canadian subsidiary.
2. Pledges on assets of the Company and its Israeli subsidiaries, including a first priority mortgage on Company's rights to land and buildings and a first priority floating charge on all property, plant and equipment.

NOTE 12: COMMITMENTS AND CONTINGENCIES

a. Companies of the Group have leased offices, warehouse space, production facilities and equipment under operating leases for periods through 2010. The minimum annual rental payments, under non-cancelable lease agreements, are as follows:

	December 31, 2003
2004	$ 4,696
2005	4,066
2006	3,579
2007	1,874
Thereafter	2,295
	$ 16,510

Total rent expenses were $3,366, $1,967 and $1,985 for the years ended December 31, 2003, 2002 and 2001, respectively.

b. Royalty commitments:

One of the subsidiaries is committed to pay royalties at the rate of 3%-5% to the Government of Israel through the Office of the Chief Scientist ("OCS") on proceeds from sales of products in which the Government participates in the research and development by way of grants. The obligation to pay these royalties is contingent on actual sales of the products and, in the absence of such sales, no payment is required. The commitment is on a product by product basis, is in an amount not exceeding the total of the grants received by the subsidiary and is linked to the dollar. Commencing 1999, grants are subject to interest at a rate of dollar LIBOR. As of December 31, 2003, the aggregate contingent liability to the OCS amounted to $8,243.

c. A claim in a prior year for compensation in the amount of approximately $550 was filed by a customer against the Company. Based on a legal opinion and insurance coverage, management believes that the final outcome of the lawsuit will not have a material adverse effect on the accompanying financial statements and, accordingly, no provision was made for this claim.

NOTE 13: SHAREHOLDERS' EQUITY

a. Pertinent rights and privileges of Ordinary Shares:

1. 100% of the rights to profits are allocated to the Ordinary Shares.
2. Two-thirds of the voting power of the Company's shares are allocated to the Ordinary Shares.
3. 100% of the dissolution rights are allocated to the Ordinary shares.

b. Founders' shares:

One-third of the voting power of all of the Company's shares is allocated to the Founders' shares.

c. Public offering:

On October 5, 2001, the Company completed a public offering of 3,950,000 Ordinary shares, at $34.30 per share. The public offering included an additional 1,800,000 Ordinary Shares sold by certain shareholders of the Company.

d. Stock option plans:

1. The Company's 1991 Stock Incentive Plan ("1991 plan") and 1999 Stock Incentive Plan ("1999 plan") provide for the issuance of incentive stock options, non-qualified stock options and stock appreciation rights to key employees and associates of the Group. The options are granted for at least 100% of the fair market value on the date of grant. As of December 31, 2003, none of the options granted include stock appreciation rights. The options are granted to employees and associates, have a four-year to five-year vesting term and generally expire 10 years after the date of the grant. Each option entitles its holder the right to purchase one Ordinary share of NIS 0.0001 par value (subject to adjustments). As of December 31, 2003, an aggregate of 983,100 options in respect of the 1999 plan are still available for future grants. Any options that are canceled or forfeited before expiration become available for future grants.

2. A summary of the Company's stock option activity (except options to associates) and related information for the three years ended December 31, 2003 is as follows:

	Number of options	Exercise price $	Weighted average exercise price $
Outstanding at January 1, 2001	**4,265,698**		**3.40**
Exercised	(3,427,851)	1.44 - 8.97	3.39
Canceled and forfeited	(44,150)	2.38 - 22.61	2.82
Granted	282,900	12.91 - 42.46	21.32
Outstanding at December 31, 2001	**1,076,597**		**9.67**
Exercised	(91,834)	2.17 - 11.91	3.77
Canceled and forfeited	(21,674)	2.44 - 38.58	19.87
Granted	266,500	24.10 - 38.98	32.02
Outstanding at December 31, 2002	**1,229,589**		**14.72**
Exercised	(192,167)	2.38- 39.03	7.28
Canceled and forfeited	(46,300)	2.49 - 46.28	22.29
Granted	295,750	30.30 - 71.15	45.59
Outstanding at December 31, 2003	**1,286,872**		**23.10**

The number of options exercisable in 2003, 2002 and 2001 are 466,561, 436,160 and 392,099, respectively. The weighted average exercise price for the options exercisable in 2003, 2002 and 2001 are $7.94, $4.82, and $4.41, respectively.

The stock options outstanding and exercisable as of December 31, 2003 have been classified into ranges of exercise prices as follows:

Options outstanding				Options exercisable	
Range of exercise price $	Outstanding as of December 31, 2003	Weighted average remaining contractual life years	Weighted average exercise price $	Exercisable as of December 31, 2003	Weighted average exercise price $
2.08 - 6.82	346,322	5.08	3.51	318,990	3.40
6.83 - 13.18	282,750	6.95	12.31	96,198	12.14
13.19 - 20.75	41,000	7.04	15.15	13,950	15.28
20.76 - 33.98	306,700	8.30	31.55	15,528	27.70
33.99 - 42.46	146,600	8.31	37.05	21,895	37.02
42.47 - 71.20	163,500	9.65	56.90	-	-
	1,286,872	**7.27**	**23.10**	**466,561**	**7.94**

3. The weighted average fair values for options granted were:

	Year ended December 31,		
	2003	2002	2001
Weighted average fair value on the date of grant	$ 22.33	$ 14.85	$ 11.21

Options to employees were issued at fair market value. No compensation expenses were recognized in 2003, 2002 or 2001.

4. **a)** A summary of the Company's stock option activity in respect of associates and related information for the three years ended December 31, 2003 is as follows:

	Number of options	Exercise price $	Weighted average exercise price $
Outstanding at January 1, 2001	**42,500**		**4.17**
Exercised	(16,500)	1.88 - 6.19	3.62
Granted	6,500	12.91 - 36.38	24.58
Outstanding at December 31, 2001	**32,500**		**9.58**
Exercised	(12,500)	2.63 - 6.19	3.82
Outstanding at December 31, 2002	**20,000**	2.75 - 36.38	**10.82**
Exercised	(4,500)	2.63 - 6.19	5.16
Canceled	(2,000)	32.61 - 32.61	32.61
Outstanding at December 31, 2003	**13,500**	**2.75 - 6.19**	**4.62**

The number of options exercisable in 2003, 2002 and 2001 were 11,375, 14,750 and 21,025, respectively.

The stock options outstanding and exercisable as of December 31, 2003 have been classified into ranges of exercise prices as follows:

Options outstanding				Options exercisable	
Range of exercise price $	Outstanding as of December 31, 2003	Weighted average remaining contractual life years	Weighted average exercise price $	Exercisable as of December 31, 2003	Weighted average exercise price $
2.08 - 6.19	13,500	5.85	4.62	11,375	4.42

b) The Company accounts for its options granted to associates under the fair value method as prescribed in SFAS No. 123 and EITF 96-18. These options vest primarily over 4-5 years.

The fair value of these options was estimated using the Black-Scholes Option Pricing Model with the following weighted-average assumptions for 2003, 2002 and 2001: risk-free interest rates of 3.00%, 3.50% and 2.75%, respectively; dividend yield of 0% for each year; expected volatility of 52.0%, 52.3% and 58.7%, respectively; and contractual life of five years for options granted in 2003 and 2002, and seven years for options granted in 2001.

Compensation expenses of approximately $10, $139 and $30 amortized over the vesting period were recognized in the years ended December 31, 2003, 2002 and 2001, respectively.

5. In 2003, 2002 and 2001, 196,667, 104,334 and 3,444,351 options were exercised to purchase 196,667, 104,334 and 3,444,351 Ordinary Shares, respectively. The amount of consideration received therefrom in 2003, 2002 and 2001 was $1,422, $651 and $989, respectively.

e. Dividends:

The Company may declare and pay dividends in dollars out of its retained earnings (as for restrictions on dividend distribution see Notes 10 and 14c).

f. Earnings per share:

	Year ended December 31, 2003			Year ended December 31, 2002			Year ended December 31, 2001		
	Net income (numerator)	Shares (denominator)	Per Share Amount	Net income (numerator)	Shares (denominator)	Per Share Amount	Net income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS:									
Net income available to holders of Ordinary Shares	$ 61,155	28,872,839	$ 2.12	$ 44,555	28,664,887	$ 1.55	$ 25,994	23,370,224	$ 1.11
Effect of dilutive securities:									
Stock options	-	801,309	(0.06)	-	743,307	(0.03)	-	2,931,705	(0.12)
Diluted EPS:									
Income available to holders of Ordinary Shares plus assumed exercises	**$ 61,155**	**29,674,148**	**$ 2.06**	**$ 44,555**	**29,408,194**	**$ 1.52**	**$ 25,994**	**26,301,929**	**$ 0.99**

g. Stock repurchase:

The Group acquired Ordinary Shares of the Company in the amount of $60 and $272 in 2003 and 2001, respectively, which in the aggregate represent less than 2% of the total outstanding Ordinary Shares.

h. 2000 Employee Stock Purchase Plan:

In May 2000, the Company's Board of Directors approved and implemented the 2000 Employee Stock Purchase Plan ("the Plan"). The Plan was approved at an Extraordinary General Meeting of Shareholders held on May 2, 2001. The purpose of the

Plan is to provide employees of the Company and those of its subsidiaries designated by the Board with an opportunity to purchase Ordinary Shares. The maximum number of shares issuable under the Plan is 500,000 Ordinary Shares, subject to adjustment.

Under the terms of the Plan, participating employees accrue funds in an account through payroll deductions during six-month offering periods. The funds in this account are applied at the end of such offering periods to purchase Ordinary Shares at a 15% discount from the closing price of the Ordinary Shares on (i) the first business day of the offering period or (ii) the last business day of the offering period, whichever closing price is lower. As of December 31, 2003, participating employees purchased an aggregate of 87,682 Ordinary Shares at a weighted average exercise price of $29.70.

The amount of consideration received therefrom in 2003 was $688.

NOTE 14: INCOME TAXES

a. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes were measured in terms of earnings in new Israeli shekels ("NIS") after certain adjustments for increases in Israel's CPI. As explained in Note 2b, the financial statements are measured in dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities. The Company and its Israeli subsidiaries are taxed under this law.

As of January 1, 2003, for tax purposes, the Company's earnings are measured in terms of dollars.

b. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969:

The Company is an "industrial company" as defined by this law and, as such, is entitled to certain income tax benefits, mainly accelerated depreciation in respect of machinery and equipment (as prescribed by regulations published under the Inflationary Adjustments Law) and the right to claim public issuance expenses, amortization of patents and other intangible property rights as deductions for tax purposes.

c. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

The Company's production facilities in Israel have been granted "Approved Enterprise" status under the Law. The main benefits arising from such status are tax exempt income for a period of 2-4 years and reduction in tax rates on income derived from Approved Enterprises. The Company is also a "foreign investment company," as defined by the Law and, as such, is entitled to a 10 or 15 year period of benefits, based on the level of investment, and to a reduction in tax rates to 10% - 25% (based on the percentage of foreign ownership in each tax year) and to accelerated depreciation of machinery and equipment.

The period of tax benefits, described above, is the earlier of 12 years from commencement of production or 14 years from the date receiving the Approved Enterprise status.

The Company has three "Approved Enterprise" plans. Under the first approval, the undistributed income derived from one Approved Enterprise will be exempt from corporate tax for a period of four years from 2001, and it will be eligible for a reduced tax rate of between 10% to 25% (based on the percentage of foreign ownership in each tax year) for an additional two years.

Under the second approval, the undistributed income derived from another Approved Enterprise will be exempt from corporate tax for a period of four years from 2001, and it will be eligible for a reduced tax rate of between 10% to 25% (based on the percentage of foreign ownership in each tax year) for an additional eight years. Under the third approval (benefit period starting 2003), the undistributed income will be exempt from corporate tax for a period of two years following implementation of the plan and it will be eligible for a reduced tax rate of between 10% to 25% (based on the percentage of foreign ownership in each tax year) for an additional 13 years thereafter.

The entitlement to these benefits is conditional upon the Company fulfilling the requirements of the Law, regulations published thereunder and the letters of approval for the specific investments in Approved Enterprises. In the event of failure to comply with these requirements, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2003, management believes that the Company is meeting all of the aforementioned requirements.

The tax-exempt income attributable to the Approved Enterprises can be distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of the Company. As of December 31, 2003, retained earnings included approximately $86,216 of tax-exempt profits earned by the Company's Approved Enterprises. The Company has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved Enterprises.

If the retained tax-exempt income is distributed in a manner other than in the complete liquidation of the Company, it will be taxed at the corporate tax rate applicable to such profits as if the Company had not chosen the alternative tax benefits (currently 10%), and an income tax liability would be incurred of approximately $8,622 as of December 31, 2003.

Income not eligible for Approved Enterprise benefits mentioned above is taxed at the regular rate of 36%.

d. On July 24, 2002, Amendment 132 to the Israeli Income Tax Ordinance ("the Amendment") was approved by the Israeli Parliament and came into effect on January 1, 2003. The principal objectives of the Amendment were to broaden the categories of taxable income and to reduce the tax rates imposed on employees' income.

The material consequences of the Amendment applicable to the Company include, among other things, imposing a tax on all income of Israeli residents, individuals and corporations, regardless of the territorial source of income, certain modifications in the qualified taxation tracks of employee stock options and the introduction of the "controlled foreign corporation" concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary, if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid by the subsidiary in its country of residence.

e. Income before income taxes comprises the following:

	Year ended December 31,		
	2003	**2002**	**2001**
Domestic (Israel)	$ 40,666	$ 28,095	$ 16,491
Foreign (North America, the Cayman Islands and the U.K.)	32,290	25,080	13,962
	$ 72,956	**$ 53,175**	**$ 30,453**

f. The provision for income taxes comprises the following:

	Year ended December 31,		
	2003	2002	2001
Current taxes	$ 2,206	$ 4,148	$ 2,261
Deferred income taxes	9,269	4,258	2,117
	$ 11,475	**$ 8,406**	**$ 4,378**
Domestic	$ 2,556	$ 373	$ (91)
Foreign	8,919	8,033	4,469
	$ 11,475	**$ 8,406**	**$ 4,378**

g. A reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to income of the Group and the actual tax expense, is as follows:

	Year ended December 31,		
	2003	2002	2001
Income before income taxes	**$ 72,956**	**$ 53,175**	**$ 30,453**
Statutory tax rate	**36%**	**36%**	**36%**
Theoretical tax expenses	$ 26,264	$ 19,143	$ 10,963
Deferred tax on losses for which valuation allowance was provided	465	193	405
"Approved Enterprise" benefit (1)	(11,704)	(8,864)	(5,590)
Effect of different tax rates in other countries	(1,024)	(993)	(561)
Non-deductible expenses	150	150	53
Canadian tax benefits in respect of research and development expenses	(2,556)	(1,078)	(815)
Other	(120)	(145)	(77)
Income taxes in the statements of income	**$ 11,475**	**$ 8,406**	**$ 4,378**
(1) Earnings per share amounts of the tax benefit resulting from the income exemption:			
Basic	**$ 0.41**	**$ 0.31**	**$ 0.24**
Diluted	**$ 0.39**	**$ 0.30**	**$ 0.21**

h. Current taxes are calculated at the following rates:

	2003	2002	2001
On Israeli operations (not including "Approved Enterprise")	36%	36%	36%
On U.S. operations *)	40.6%	40.6%	40.6%
On Canadian operations *)	33.8%	33.8%	33.8%
On U.K. operations *)	35%	35%	35%

*) The U.S., U.K. and Canadian subsidiaries are taxed on the basis of the tax laws prevailing in their countries of residence. The Canadian subsidiary qualifies for research and development tax credits, thereby reducing its effective tax rate.

i. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

	December 31,	
	2003	2002
Deferred tax assets:		
Net operating losses carryforward	$ 14,714	$ 25,656
Other, net	6,147	2,173
Total deferred tax assets	20,861	27,829
Valuation allowance for deferred tax assets *)	(5,124)	(11,924)
Net deferred tax assets	15,737	15,905
Deferred tax liabilities:		
Tax over book depreciation	(3,196)	(1,539)
Other, net	(1,684)	(1,241)
Total deferred tax liabilities	(4,880)	(2,780)
Net deferred tax assets	**$ 10,857**	**$ 13,125**
Domestic	$ 1,794	$ 396
Foreign	9,063	12,729
	$ 10,857	**$ 13,125**

*) This allowance consists of (i) $3,651 related to the carryforward tax losses of the U.S. subsidiary, (ii) $1,385 to the U.K., and (iii) $87 to the Hungarian subsidiary's operations.

The deferred income taxes are presented in the balance sheet as follows:

	December 31,	
	2003	2002
Among current assets ("other accounts receivable and prepaid expenses")	$ 5,487	$ 2,707
Long-term deferred income taxes	10,250	13,198
Among long-term liabilities	(4,880)	(2,780)
	$ 10,857	**$ 13,125**

j. Carryforward tax losses:

1. The Company:

As of December 31, 2003, the Company had no carryforward tax losses.

2. Israeli subsidiaries:

As of December 31, 2003, the Israeli subsidiaries have carryforward tax losses in the amount of $1,329, linked to Israel's CPI, which may be carried forward and offset against taxable income for an indefinite period in the future.

3. Canadian subsidiary:

As of December 31, 2003, this subsidiary has no carryforward tax losses.

4. U.K. subsidiary:

As of December 31, 2003, this subsidiary has carryforward tax losses in the amount of $3,893, which may be carried forward and offset against taxable income for an indefinite period in the future.

5. U.S. subsidiary:

As of December 31, 2003, this subsidiary has carryforward tax losses in the amount of $37,478 from the options exercised by certain shareholders which can be carried forward and offset against taxable income for 20 years, expiring in 2021.

k. During 2002, 84.4% of the shares conferring rights to profits of the U.S. subsidiary were transferred, in the form of a dividend, to the Company from Taro Pharmaceuticals North America, Inc. pursuant to section 104 (c) of the Israeli Income Tax Ordinance. According to a tax ruling received from the Israeli Income Tax Commission, in the event that the U.S. subsidiary pays a dividend to its shareholders, a portion of $5,200 of total retained earnings, at the distribution date, will not be entitled to tax benefits under the tax treaty between Israel and the United States.

The Company's Board of Directors has determined that its U.S. subsidiary will not pay any dividend as long as such payment will result in any tax expenses for the Company.

NOTE 15: SELECTED STATEMENTS OF INCOME DATA

		Year ended December 31,		
		2003	2002	2001
a.	**Sales by destination (1) (2) (3):**			
	Israel	$ 13,468	$ 11,809	$ 13,690
	Canada	15,603	12,819	8,968
	U.S.A.	283,197	183,857	123,762
	U.K.	1,878	1,449	870
	Other	1,312	1,647	1,940
		$ 315,458	**$ 211,581**	**$ 149,230**
(1)	Including commercial activities	$ 3,983	$ 1,529	$ 1,353
(2)	Including sales to customer A	$ 62,693	$ 46,548	$ 22,351
	Including sales to customer B	$ 52,997	$ 25,389	$ 22,382
(3)	Sales to customer A as a percentage of total sales	20%	22%	15%
	Sales to customer B as a percentage of total sales	17%	12%	15%
b.	**Research and development expenses, net:**			
	Total expenses	$ 42,479	$ 27,500	$ 20,740
	Less - grants and participations	1,878	1,127	1,107
		$ 40,601	**$ 26,373**	**$ 19,633**
c.	**Selling, marketing, general and administrative expenses:**			
	Selling and marketing	$ 30,149	$ 15,947	$ 15,249
	Advertising	22,309	4,075	4,038
	General and administrative *)	45,260	32,459	22,799
		$ 97,718	**$ 52,481**	**$ 42,086**
	*) Including allowance for doubtful accounts	$ 284	$ -	$ 101
d.	**Financial expenses, net *):**			
	Interest and linkage differences on long-term liabilities	$ 2,720	$ 2,944	$ 2,078
	Income in respect of deposits	(1,469)	(2,351)	(794)
	Expenses in respect of short-term credit	1,245	506	1,070
	Foreign currency translation losses (gains)	(774)	(937)	240
		$ 1,722	**$ 162**	**$ 2,594**
	*) Net of interest capitalized in cost of property, plant and equipment	$ 1,180	$ 479	$ -

NOTE 16: SEGMENT INFORMATION

The Group operates in one industry segment. The Company has three main reportable geographic areas. The data is presented in accordance with Statement of Financial Accounting Standard No. 131, "Disclosure About Segments of an Enterprise and Related Information." Information by geographic area is as follows:

Year ended December 31, 2003:	Israel *)	Canada **)	U.S.A.	Elimination	Consolidated
Sales to unaffiliated customers	$ 16,658	$ 15,603	$ 283,197	$ -	$ 315,458
Inter-area sales to affiliates	109,838	79,262	-	(189,100)	-
Total sales	$ 126,496	$ 94,865	$ 283,197	$ (189,100)	$ 315,458
Operating income	$ 51,053	$ 13,843	$ 18,390	$ (8,601)	$ 74,685
Financial income (expenses), net	$ (1,594)	$ 1,234	$ (1,362)	$ -	(1,722)
Other loss, net					(7)
Income before income taxes					72,956
Income taxes	$ 3,948	$ 1,565	$ 7,291	$ (1,329)	11,475
Minority interest in earnings of a subsidiary					326
Net income					$ 61,155
Depreciation and amortization	$ 6,832	$ 4,555	$ 3,018	$ -	$ 14,405
Long-lived assets	$ 124,627	$ 73,699	$ 20,561	$ -	$ 218,887
Capital expenditures	$ 61,119	$ 20,391	$ 12,911	$ -	$ 94,421

Year ended December 31, 2002:	Israel *)	Canada **)	U.S.A.	Elimination	Consolidated
Sales to unaffiliated customers	$ 14,905	$ 12,819	$ 183,857	$ -	$ 211,581
Inter-area sales to affiliates	74,044	56,148	-	(130,192)	-
Total sales	$ 88,949	$ 68,967	$ 183,857	$ (130,192)	$ 211,581
Operating income	$ 35,099	$ 13,908	$ 12,742	$ (8,490)	$ 53,259
Financial income (expenses), net	$ 870	$ 31	$ (1,063)	$ -	(162)
Other income, net					78
Income before income taxes					53,175
Income taxes	$ 595	$ 3,245	$ 4,788	$ (222)	8,406
Minority interest in earnings of a subsidiary					214
Net income					$ 44,555
Depreciation and amortization	$ 4,647	$ 1,493	$ 2,123	$ -	$ 8,263
Long-lived assets	$ 68,327	$ 29,397	$ 10,040	$ -	$ 107,764
Capital expenditures	$ 25,061	$ 10,859	$ 7,326	$ -	$ 43,246

*) Includes operations in Europe and other markets. **) Includes operations in both Canada and Cayman Islands.

Year ended December 31, 2001:	Israel *)	Canada **)	U.S.A.	Elimination	Consolidated
Sales to unaffiliated customers	$ 16,500	$ 8,968	$ 123,762	$ -	$ 149,230
Inter-area sales to affiliates	45,730	42,082	-	(87,812)	-
Total sales	$ 62,230	$ 51,050	$ 123,762	$ (87,812)	$ 149,230
Operating income	$ 21,361	$ 10,938	$ 4,254	$ (3,778)	$ 32,775
Financial income (expenses), net	$ (2,304)	$ 51	$ (341)	$ -	(2,594)
Other income, net					272
Income before income taxes					30,453
Income taxes	$ 94	$ 2,792	$ 1,777	$ (285)	4,378
Minority interest in earnings of a subsidiary					81
Net income					$ 25,994
Depreciation and amortization	$ 4,048	$ 1,200	$ 1,480	$ -	$ 6,728
Long-lived assets	$ 44,610	$ 11,789	$ 3,877	$ -	$ 60,276
Capital expenditures	$ 15,043	$ 2,457	$ 1,758	$ -	$ 19,258

*) Includes operations in Europe and other markets. **) Includes operations in both Canada and Cayman Islands.

The Group's primary product lines in Israel are prescription and over-the-counter pharmaceutical products in multiple strengths, including capsules, creams and ointments, liquids, sterile products and tablets. Its primary product lines in Canada and the United States are prescription dermatological cream, ointment, lotion and gel products; oral dosage form prescription products; and over-the-counter products.

NOTE 17: TRANSACTIONS WITH RELATED PARTIES

Transactions with related parties:

	Year ended December 31,		
	2003	2002	2001
Compensation to related parties *):			
Wages and salaries	$ 2,131	$ 1,669	$ 1,184
Management fees	1,382	1,060	808
Directors' fees	103	74	88
	$ 3,616	**$ 2,803**	**$ 2,080**
*) Compensation was paid to related parties, as follows:			
Related parties employed by the Group	$ 2,150	$ 1,689	$ 1,201
Related parties not employed as above - directors (including companies held by these directors)	$ 1,466	$ 1,114	$ 879
Number of individuals to whom the compensation relates (includes all directors)	11	11	10

NOTE 18: DERIVATIVE FINANCIAL INSTRUMENTS

The Company's primary objective for holding derivative financial instruments is to manage foreign currency and interest rate risks. The Company's derivative instruments are recorded at fair value and are included in assets and liabilities as of December 31, 2003 as follows:

	As recorded	Fair value
Other accounts receivable and prepaid expenses	$ 1,313	$ 1,313
Long-term investment	$ 1,044	$ 1,044
Other accounts payable and accrued liabilities	$ 63	$ 63
Long-term debt	$ 2,060	$ 2,060

Foreign currency and interest rate risk:

The Company transacts business in various foreign currencies, primarily NIS. In 2000, the Company entered into a cross currency swap to hedge the NIS denominated fixed rate bonds. This swap has been designed as a fair value hedge of the changes in fair value of the bonds, due to both interest rate risk and foreign exchange risk. In 2003, the Company entered into an additional cross currency swap to hedge the NIS denominated fixed rate bonds. This swap has been designed as a cash flow hedge of a fixed rate due to the foreign exchange risk.

There is no material ineffectiveness related to these hedges. Management believes that the financial institution associated with the aforementioned investments is financially sound and, accordingly, minimal credit risk exists with respect to these derivative instruments.

As of December 31, 2003, the notional amount of the swap is $62,700.

NOTE 19: SUBSEQUENT EVENTS (UNAUDITED)

On January 8, 2004, the Company's U.S. subsidiary 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 subsidiary acquired the facility for approximately $18,000. In conjunction with the purchase, the subsidiary expects to receive certain financial incentives from the New Jersey Economic Development Authority.

END OF CONSOLIDATED FINANCIAL STATEMENTS

Quarterly Profit and Loss Information (Unaudited)

	Quarter Ended 2003			
	In thousands of U.S. dollars, except per Ordinary Share data			
	Dec 31	Sep 30	June 30	Mar 31
Net Sales	$ 88,621	$ 83,115	$ 74,753	$ 68,969
Gross Profit	62,060	56,556	50,007	44,381
Operating Income	18,901	19,658	18,010	18,116
Income Before Taxes on Income	18,340	19,073	17,689	17,854
Net Income	16,613	15,736	14,818	13,988
Net Income Per Diluted Ordinary Share	$ 0.56	$ 0.53	$ 0.50	$ 0.47

Price Range of Ordinary Shares
The Company's Ordinary Shares are traded in the National Market System of the over-the-counter market (NASDAQ symbol: TARO).

As of March 31, 2004:
Number of record holders: 363
Number of outstanding Ordinary Shares: 29,010,977
Dividends: The Company has never paid cash dividends on its Ordinary Shares.

The following table sets forth, for the periods indicated, the high and low, split adjusted, sale price, as reported by the National Quotation Bureau, Incorporated.

	2003		2002		2001		2000		1999	
	$		$		$		$		$	
	High	Low	High	Low	High	Low	High	Low	High	Low
Fourth Quarter	72.11	57.34	39.26	32.13	47.54	34.30	17.47	8.30	9.50	5.25
Third Quarter	58.71	48.85	34.90	22.56	48.50	30.20	9.82	5.82	8.50	4.69
Second Quarter	57.77	39.43	30.46	21.60	44.00	23.00	6.32	3.66	5.41	2.88
First Quarter	38.92	30.14	38.34	28.35	22.69	13.44	8.44	4.71	3.25	2.44

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and related notes for the three years ended December 31, 2003, which are included elsewhere in this annual report.

OVERVIEW

We are a multinational, science-based pharmaceutical company. We develop, manufacture and market prescription and OTC pharmaceutical products, as well as active pharmaceutical ingredients, primarily in Israel, Canada and the United States. 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.

We generate most of our revenues from the sales 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 past three years, three major drug wholesalers in the United States accounted for the following proportion of our total consolidated sales in millions.

	2003		2002		2001	
Customer	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
AmerisourceBergen Corporation	$62.7	20%	$46.5	22%	$19.4	13%
McKesson Corporation	$53.0	17%	$25.4	12%	$22.3	15%
Cardinal Health, Inc.	$28.4	9%	$19.0	9%	$13.4	9%

We also sell active pharmaceutical ingredients to unaffiliated customers around the world. Sales of active pharmaceutical ingredients to third parties have historically represented less than 1% of consolidated revenues. Our primary reason for manufacturing active pharmaceutical ingredients is to support our pharmaceutical manufacturing operations.

Due to increased competition from other generic pharmaceutical manufacturers as they gain regulatory approvals to manufacture 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, the operating results are dependent on the impact of pricing pressures on existing products. These pricing pressures are inherent in the generic pharmaceutical industry.

In 2003 and 2002, sales of seven product lines contributed approximately 54% and 53% of our consolidated sales, respectively. These seven product lines include four topical product families and three oral product families. Clotrimazole and betamethasone dipropionate cream, our generic equivalent of Lotrisone® cream, which we introduced into the market in May 2001, contributed approximately 10% and 16% to our consolidated sales during 2003 and 2002, respectively.

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 seven 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. Since the

allocation of various elements of overhead to individual products or product lines is to some extent arbitrary, it is not practical to determine the specific amount or percentage of our profits that may be attributed to any individual product or product line, including our generic equivalent of Lotrisone® cream.

Certain customary industry selling practices affect our supply of working capital, including, but not limited to providing favorable payment terms to customers and discounting of 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. Such incentives are provided primarily with the intention of maintaining and expanding our distribution at the expense of competing products.

For example, the payment terms that we typically provide to our U.S. customers vary from 30 to more than 90 days, with the longer terms typically allowed to customers purchasing higher volumes of a product. Similarly, the cash discounts that we offer may range from two to more than ten percent, with the higher discounts offered in connection with larger sales.

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, has 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.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 2 to our Consolidated Financial Statements, which we have prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses. We evaluate, on an ongoing basis, our estimates, including those related to bad debts, income taxes and contingencies. We base our estimates on currently 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:

Revenue Recognition. Revenue is recognized when delivery to our customers has occurred. When we recognize and record revenue from the sale of our pharmaceutical products, we simultaneously record an estimate of various future costs related to the sale. This has the effect of reducing the amount of reported product sales. These costs include our estimates of product returns, rebates, chargebacks and other sales allowances. In addition, we may record allowances for shelf-stock adjustments when appropriate. We base our estimates for these sales allowances on a variety of factors, including actual return experience of products returned, rebate agreements for each product and estimated sales by our wholesale customers to other third parties who have contracts with us. Actual experience associated with any of these items may differ materially from our estimates. We conduct a review of the factors that influence our estimates periodically. When we find that actual product returns, credits and other allowances differ from our established reserves we make the necessary adjustments. In addition, it is customary in the generic industry to grant customers shelf-stock adjustments based on customers' existing levels of inventory and the decrease in market price of the related product. When market prices for our product decline, we may elect to provide shelf-stock adjustments and thereby allow customers with existing inventories to compete at the lower product price. These shelf-stock adjustments are intended to support our market position and to promote customers' loyalty.

Functional and Reporting Currency. A majority of our revenues is generated, and a substantial portion of our expenses are incurred, in U.S. dollars. Hence, the U.S. dollar is our functional and reporting currency. Monetary accounts that are maintained in other currencies are re-measured into dollars in accordance with Statement No. 52 of the Financial Accounting Standards Board.

Product Rights. Our rights in licensed or acquired products are stated at cost, less accumulated amortization. Product rights are amortized using the straight-line method over their estimated useful lives ranging from five to twenty years. We determine amortization periods for product rights based on our assessment of various factors impacting estimated useful lives and cash flows of the acquired products. These factors include a product's position in its life cycle, the existence of like products in the marketplace, various other competitive and regulatory issues, and contractual terms. Significant changes to any of these factors may result in a reduction in a product right's useful life and an acceleration of related amortization expense, which could cause our operating income, net income and earnings per share to decline.

Deferred Taxes. In 2001, we conducted a public offering of our ordinary shares. In connection with the offering, we recorded, as of December 31, 2003, approximately $9.5 million of deferred tax assets due to the exercise of stock options by the selling shareholders. In the event that it appears that the amount of these deferred tax assets is, at any time, greater than the amount that we will more likely than not realize, we will reduce the amount at which we carry the deferred tax assets accordingly. Any such reduction would result in a charge to income, in the amount of the reduction, for the period in which the reduction was made. For additional analysis of tax issues, please refer to Note 14 of our consolidated financial statements included elsewhere in this annual report.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, selected items from our consolidated statement of income as a percentage of total sales:

	Year ended December 31,		
	2003	**2002**	**2001**
Statement of Income Data:			
Sales	100%	100%	100%
Cost of sales	32	38	37
Gross profit	68	62	63
Operating expenses:			
Research and development, net	13	12	13
Selling, marketing, general and administrative	31	25	28
Total operating expenses	44	37	41
Operating income	24	25	22
Financial expenses, net	1	-	2
Other income, net	-	-	-
Income before taxes on income	23	25	20
Taxes on income	4	4	3
Minority interest in earnings of a subsidiary	-	-	-
Net income	**19%**	**21%**	**17%**

YEAR ENDED DECEMBER 31, 2003 COMPARED WITH YEAR ENDED DECEMBER 31, 2002

Sales. During 2003, our sales increased $103.9 million, or 49%, from the amount of sales we reported in 2002. Of this increase, $27.7 million, or 27%, was attributable to the sale of products that we introduced in 2003. The balance of this increase was

attributable to increased sales of products which were sold in both 2002 and 2003, including clotrimazole and betamethasone dipropionate cream, our generic version of Lotrisone®, which we began to sell in May 2001. Sales in the United States during 2003 increased $99.3 million, or 54%, from the amount we reported in 2002. Sales in Canada increased by $2.8 million, or 22%, and sales in Israel and other international markets increased $1.8 million, or 12%, from 2002. The products introduced during the year in the United States included bethametasone dipropionate (augmented) cream, ammonium lactate cream and etodolac XR tablets in three strengths, 400, 500 and 600 mg. In the United States, we also introduced our ElixSure® line of products and the four branded products we acquired earlier in the year from Medicis Pharmaceutical Corporation.

Cost of Sales. Cost of sales increased by 29% in 2003, as a result of the 49% increase in sales described above.

Gross Profit. Gross profit margin increased from 62% in 2002 to 68% in 2003. The increase reflects a higher level of branded product sales and a favorable competitive environment for the generic products.

Research and Development. Net R&D expenses increased $14.2 million, or 54%, in 2003. R&D expenses equaled 13% and 12% of sales in 2003 and 2002, respectively. The increase in R&D expenses during 2003 was the result of expanding our research facilities, recruiting additional scientists and pursuing more projects.

Selling, General and Administrative. In 2003, SG&A increased $45.2 million, or 86%, from the amount we recorded in 2002. Our SG&A expenses as a percentage of sales increased from 25% in 2002 to 31% in 2003. Selling and marketing expenses increased $32.4 million, or 162%, primarily due to the recruitment of medical representatives and promotional campaigns, including media advertising, aimed at supporting our branded initiatives in the United States. General and administrative expenses increased $12.8 million, or 39%, primarily due to investments in personnel, facilities and infrastructure necessary to accommodate continued growth and expansion in the United States and other markets.

Operating Income. Operating income increased $21.4 million, or 40%, in 2003. The increase was primarily the result of increased sales and improved gross profit margins.

Financial Expenses. Financial expenses consist of interest expense and income, and impact of currency fluctuations. Net financial expenses increased $1.5 million, or 962%, in 2003. The increase is primarily the result of a higher level of interest expenses as we increased our level of borrowing during the second half of 2003. The increase in interest expenses was partially offset by interest income that we earned on our cash balances and from hedges against currency fluctuations.

Taxes on Income. Due to a higher level of pre-tax income, our tax expense increased $3.1 million, or 36%, in 2003. Our effective tax rate was 16% in both 2002 and 2003.

Net Income. Our net income increased $16.6 million from $44.6 million in 2002 to $61.2 million in 2003, an increase of 37%, based on the factors cited above.

YEAR ENDED DECEMBER 31, 2002 COMPARED WITH YEAR ENDED DECEMBER 31, 2001

Sales. During 2002, sales increased $62.0 million, or 42%, from the amount we recorded in 2001. Of this increase, $7.6 million, or 4%, was attributable to the sale of products that we introduced in 2002. The balance of the increase was attributable to increased sales of products that were sold in both 2001 and 2002, including clotrimazole and betamethasone dipropionate cream, our generic version of Lotrisone®, which we began to sell in May 2001. Sales in the United States increased $60.1 million, or 49%, in 2002. Sales in Canada increased by $3.8 million, or 44%, in 2002. Sales in Israel and other international markets decreased $1.6 million, or 10%, in 2002. The products introduced during the year in the United States were amcinonide cream, ketoconazole cream and econazole nitrate cream.

Cost of Sales. Cost of sales increased $24.8 million, or 45%, in 2002, as a result of the 42% increase in sales described above.

Gross Profit. Gross profit increased $37.6 million, or 40%, in 2002 but gross profit margins declined from 63% in 2001 to 62% in 2002. The decrease reflects a higher level of OTC product sales and a competitive environment for some products, which was partially offset by increased volume for other products.

Research and Development. Net R&D expenses increased $6.8 million, or 35%, in 2002. R&D expenses equaled 12% and 13% of sales in 2002 and 2001, respectively. The increase in R&D expenses during 2002 was the result of expanding our research facilities, recruiting additional scientists and pursuing more projects.

Selling, General and Administrative. SG&A increased $10.4 million, or 25%, in 2002. Our SG&A expenses as a percentage of sales declined from 28% in 2001 to 25% in 2002. Selling and marketing expenses increased $0.8 million, or 4%, in 2002. General and administrative expenses increased $9.7 million, or 43%, in 2002, primarily due to investments in personnel, facilities and infrastructure necessary to accommodate continued growth and expansion in both the United States and international markets.

Operating Income. Operating income increased $20.5 million, or 62%, in 2002. The increase was primarily the result of increased sales and improved SG&A margin.

Financial Expenses. Net financial expenses decreased $2.4 million, or 92%, in 2002 primarily as a result of interest income realized from the high cash balance maintained during 2002. This income nearly offset most of the company's cost of borrowing.

Taxes on Income. Due to a higher level of pre-tax income, our tax expense increased $4.0 million, or 91%, in 2002, with our effective tax rate increasing from 14% in 2001 to 16% in 2002.

Net Income. Our net income increased $18.6 million from $26.0 million in 2001 to $44.6 million in 2002, an increase of 71%, based on the factors cited above.

IMPACT OF INFLATION, DEVALUATION, (APPRECIATION) AND EXCHANGE RATES ON RESULTS OF OPERATIONS, LIABILITIES AND ASSETS

We conduct manufacturing, marketing and research and development operations primarily in Israel, Canada and the United States. As a result, we are subject to risks associated with fluctuations in the rates of inflation and foreign exchange in each of these countries.

The following table sets forth the annual rate of inflation, the devaluation (appreciation) rate of the NIS and the Canadian dollar against the U.S. dollar and the exchange rates between the U.S. dollar and each of the NIS and the Canadian dollar at the end of the year indicated:

Year	Rate of Inflation		Rate of Devaluation (Appreciation) Against U.S. Dollar		Rate of Exchange of U.S. Dollar	
	Israel[1]	Canada[2]	Israel[1]	Canada[3]	Israel[1]	Canada[3]
1999	1.3%	2.6%	(0.2%)	(5.9%)	4.15	1.44
2000	0.0%	3.2%	(2.7%)	3.9%	4.04	1.50
2001	1.4%	0.7%	9.3%	6.2%	4.42	1.59
2002	6.5%	3.9%	7.2%	(1.2)%	4.74	1.58
2003	(1.9)%	2.0%	(7.6)%	(17.8)%	4.38	1.30

Sources: (1) Bank of Israel. (2) Statistics Canada. (3) Bank of Canada.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Cash and cash equivalents increased by $28.4 million to $159.1 million at December 31, 2003. During 2003, we completed two private placements of bonds to institutional investors in Israel in the aggregate amount of $110 million, primarily to fund our capital expansion programs. Our increase in sales caused trade accounts receivable to increase by 75%, to $120.5 million, at December 31, 2003. Inventory levels increased 99% from December 31, 2002 to December 31, 2003, primarily due to strategic API acquisitions and to support increased level of sales. Shareholders' equity increased from $269.1 million at December 31, 2002 to $347.4 million at December 31, 2003, principally due to net income contribution to retained earnings and tax benefits related to the exercise of stock options.

We generated cash from operations amounting to $5.2 million for the year ended December 31, 2003 as compared to $29.6 million in the prior year. The decrease in cash from operations is the result of increases in trade receivables and inventory, which were partially offset by higher amortization and depreciation, higher net income and other working capital items.

Our long-term debt outstanding as of December 31, 2003 was approximately $181.4 million, including current maturities of $24.4 million, and was comprised of the following:

- bonds payable of $130.4 million;
- obligations of $29.7 million under a bank credit agreement; and
- mortgage payable, capital leases and other obligations of $21.3 million.

Our bond obligations consist of the following, in millions:

Amount	Linkage	Rate	Maturity
$ 15.8	Israel CPI	8.25%	2004-2010
$ 48.0	Israel CPI	5.8%	2004-2014
$ 2.1	Dollar	Libor + 2-3%	2004-2010
$ 64.5	Dollar	6%	2004-2010

We have a contract to hedge our exposure to CPI fluctuations in Israel. Under the bond agreements, our debt to equity ratio may not be greater than 2:1 and our current ratio may not be lower than 1:1. In addition the bonds that we issued during the year require that we maintain an interest coverage ratio of 2:1. The interest coverage ratio is defined as earnings before interest, taxes. depreciation and amortization, or EBITDA, divided by net interest expenses plus the current principal repayment. We are currently in compliance with these covenants.

We anticipate that our operating cash flow, together with available borrowings under our credit facilities and cash balances, will be sufficient to meet all of our working capital, capital expenditure and interest requirements for both the short-term and the foreseeable future. As for commitments for future capital expenditures please see Note 5(d) to our consolidated financial statements included elsewhere in this annual report.

CAPITAL EXPENDITURES

We invested $94.4 million in capital equipment and facilities in the year ended December 31, 2003 and $43.2 million during the year ended December 31, 2002. These investments are principally related to expanding and upgrading our research and development laboratories and our pharmaceutical and chemical manufacturing facilities in Israel, Canada, Ireland and the United States and maintaining compliance with cGMPs, while increasing manufacturing capacity. In addition to facility-related

investments, we acquired certain manufacturing and packaging equipment to increase production capacity. We also continued to upgrade our information systems infrastructure, to enable more efficient production scheduling and enhanced inventory analysis. See Note 5 to our consolidated financial statements included elsewhere in this annual report for an analysis of property, plant and equipment activity in 2003.

TAX MATTERS

Tax Loss Carryforward and Effective Tax Rates

As of December 31, 2003, on an unconsolidated basis, we had an available tax loss carryforward of $1.3 million in Israel, $3.9 million in the United Kingdom and $37.5 million in the United States. The loss carryforward in the United States principally resulted from the exercise by employees of stock options during 2001. Our consolidated effective tax rates were 16%, 16% and 14% in 2003, 2002 and 2001, respectively.

Approved Enterprise Status in Israel

Israeli companies are generally subject to tax at the rate of 36% of taxable income. However, our facilities in Israel have received Approved Enterprise status from the Israel Investment Center, which entitles us to receive specified tax benefits. We have received three approvals granting us a package of benefits, subject to compliance with applicable requirements. Under the first approval, our undistributed income derived from one Approved Enterprise will be exempt from corporate tax for a period of four years from 2001, and we will be eligible for a reduced tax rate of between 10% to 25% for an additional two years. Under the second approval, our undistributed income derived from another Approved Enterprise was exempt from corporate tax for a period of two years from 2001, and we will be eligible for a reduced tax rate of 10% to 25% for an additional eight years. Under the third approval (benefit period starting 2003), our undistributed income will be exempt from corporate tax for a period of two years following implementation of the plan. We will be eligible for a reduced tax rate of between 10% to 25% for an additional thirteen years thereafter. All of these programs are subject to time limits imposed by the Law for Encouragement of Capital Investments, 1959 and are based upon the percentage of foreign ownership in each tax year. To maintain the most favorable rates, we must maintain a foreign shareholders' ownership level of at least 90%. Currently, we exceed this level. As a result of these programs, a substantial portion of the profits derived from products manufactured in Israel may benefit from a reduced Israeli tax rate. Additionally, in October 2003, we submitted an application for a fourth approval for capital investments that will be implemented by the end of 2005.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk for changes in interest rates and foreign currency rates relates mainly to our long-term debt obtained to purchase fixed assets. Our interest expenses are sensitive to the LIBOR and CPI, as most of our long-term debt bears a LIBOR or CPI-linked interest rate. As of December 31, 2003, $181.4 million of our outstanding debt bears an average interest rate of 5.3%. Consequently, each 0.25% increase in interest rates will reduce pretax income by approximately $0.5 million.

Our functional currency and that of our U.S. subsidiary is the U.S. dollar. The functional currency of our European and Canadian subsidiaries is the local currency in their respective countries.

In 2003, over 90% of our revenues were generated in U.S. dollars. However, the remainder of our sales were denominated in the local currencies of the countries in which they occurred. As such, our reported profits and cash flows are exposed to changing exchange rates. If the U.S. dollar weakens relative to the foreign currencies, the earnings generated in these foreign currencies will, in effect, increase when converted into U.S. dollars, and vice versa. Therefore, from time to time we attempt to manage exposures that arise in the normal course of business related to fluctuations in foreign currency

exchange rates by entering into offsetting positions through the use of foreign exchange forward contracts. Due to the relative low level of non-U.S. dollar revenues, the effects of currency fluctuation on consolidated net revenues and operating income were not significant.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any material off-balance sheet arrangements.

CONTRACTUAL OBLIGATIONS

As of December 31, 2003, we have contractual obligations in connection with the construction and installation of new pharmaceutical facilities in the amount of $17.2 million. In addition, we have contractual obligations under several operating leases in relation to facilities and equipment which we lease from third parties.

The following table describes the payment schedules of our contractual obligations, in millions:

	Payments due by period				
Contractual Obligation	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**Over 5 years**
Operating lease obligation	$16.5	$4.7	$7.6	$2.9	$1.3
Purchase obligations	$17.2	$17.2	-	-	-

RESEARCH AND DEVELOPMENT, PATENTS, TRADE MARKS AND LICENSES

Most of our sales are derived from products that are the result of our own research and development. We believe that our research and development activities have been a principal contributor to our achievements to date and that our future performance will depend, to a significant extent, upon the results of these activities.

In 1991, we formed the Taro Research Institute Ltd., or the Institute, for the purpose of consolidating our pharmaceutical and chemical research activities. The Institute coordinates all of our research and development activities on a global basis.

Recruiting talented scientists is essential to the success of our research and development programs. Approximately 20% of our employees work in our worldwide research and development programs. More than 80 of our scientists hold either M.D. or Ph.D. degrees.

We currently conduct research and development in three principal areas:

- generic pharmaceuticals, where our programs have resulted in our developing and introducing a wide range of pharmaceutical products (including tablets, capsules, injectables, suspensions, solutions, creams and ointments) that are equivalent to numerous brand-name products whose patents and FDA exclusivity periods have expired;
- proprietary pharmaceuticals and delivery systems, in which we are developing T-2000 and products utilizing the NonSpil™ delivery system; and
- organic and steroid chemistry, where our programs have enabled us to synthesize the active ingredients used in many of our products.

Generic Pharmaceuticals

In 2003, we received multiple product approvals in Canada, Israel and the United States. The following table sets forth the approvals in the United States by the FDA during 2003 and through April 30, 2004:

Generic Name	Brand Name
Amcinonide ointment USP, 0.1%	Cyclocort®
Amiodarone hydrochloride tablets, 300 mg	N/A
Ammonium lactate cream, 12%	Lac-Hydrin®
Betamethasone dipropionate (augmented) cream, 0.05%	Diprolene®
Betamethasone dipropionate (augmented) gel, 0.05%	Diprolene®
Clindamycin phosphate topical solution, 1%[3]	Cleocin T®
Etodolac extended release tablets, 400, 500 and 600 mg	Lodine® XL
Fluconazole tablets, 50, 100, 150 and 200 mg[1]	Diflucan®
Fluorouracil topical solution, 2% and 5%	Efudex®
Hydrocortisone butyrate topical solution, 0.1%[3]	Locoid®
Ibuprofen oral suspension, 100 mg / 5 mL[2,3]	ElixSure® IB
Phenytoin oral suspension USP, 125 mg / 5 mL[3]	Dilantin-125®
Terconazole vaginal cream, 0.8%[3]	Terazol®

(1) Tentative approval (2) NDA approval (3) Approvals received in 2004

As of April 29, 2004, 31 of our ANDAs and 1 NDA were being reviewed by the FDA. In addition, there are multiple products for which either developmental 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 currently 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.

PROPRIETARY TECHNOLOGIES

T-2000

We are currently conducting Phase II studies on T-2000, our non-sedating barbiturate compound. This product is currently intended for the treatment of epilepsy and essential tremor, but may have other indications. It is intended to be a long-acting, non-sedating barbiturate compound that permits increased patient compliance and reduced side effects.

T-2000 must complete Phase II testing, successfully undergo Phase III studies and obtain regulatory approval in order to reach the market. There can be no assurance of the successful completion of Phase II or Phase III testing, the approval by the FDA of the drug or the commercial success of the drug.

NonSpil™

We also continue to work on our NonSpil™ liquid drug delivery system, which allows liquid medications to pour, but not spill, thereby increasing the accuracy of dosage and ease of use.

NonSpil™ development activities include improving product formulations, refining taste and texture, "scaling up" from laboratory sized manufacturing to commercial sized manufacturing and preparing the marketing program for this new delivery system. While there can be no assurance of regulatory approvals or commercial success, we hope to introduce more NonSpil™ formulations in commercial markets where they can contribute to both pediatric and geriatric healthcare.

In 2003, we launched the ElixSure® line of children's medicines for fever/pain, cough and congestion. ElixSure® is the first line of products to use our NonSpil™ liquid drug delivery system. The commercial success of the ElixSure® line will depend upon consumer acceptance of this new delivery system. Furthermore, competition from other products for the same clinical indications may prevent successful commercialization of these products. Thus, there can be no assurance of the success of the ElixSure® product line.

PATENTS, TRADEMARKS AND LICENSES

We have filed and received patents in the United States in a variety of areas, including:

- a class of anticonvulsant, tranquilizer and muscle relaxant drugs;
- a class of antiarrhythmic drugs;
- novel oral delivery for pharmaceutical and related products; and
- the synthesis and formulation of some of our products.

We have registered trademarks in the United States and in Canada. Moreover, we have recently acquired the rights to use the A/T/S®, Kerasal®, Ovide®, Primsol® and Topicort® trademarks in the United States. Taro U.S.A. typically does not use trademarks in the sale and marketing of its generic products. We do not believe that any single patent or license is of material importance to us in relation to our current commercial activities.

From time to time, we seek to develop products for sale prior to patent expiration in various countries. 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 Drug Price Competition and Patent Term Restoration Act of 1984 ("Hatch-Waxman Act"), as amended by the Medicare Prescription Drug Improvement and Modernization Act of 2003, notify the patent holder as well as the owner of a New Drug Application that we believe that the patents listed in the Approved Drug Products with Therapeutic Equivalence Evaluations ("Orange Book") for the new drug are either invalid or not infringed by our product. To the extent that we seek to utilize this mechanism to obtain approval to sell products, we are involved and expect to be involved in patent litigation regarding the validity, enforceability or infringement of patent(s) listed in the Orange Book, as well as other patents, for a particular product for which we have sought approval. We may also be involved in patent litigation with third parties to the extent that claims are made that our finished product, an ingredient in our product, or our manufacturing process may infringe the innovator's or third party's process patents. We may also become involved in patent litigation in other jurisdictions where we conduct business, including Israel, Canada and Europe.

On November 14, 2003, Godecke Aktiengesellschaft, Pfizer and Warner-Lambert (collectively, "Warner Lambert"), responding to our filing of an ANDA requesting approval for gabapentin capsules prior to the expiration of certain listed patents, filed a complaint against us and our U.S. subsidiary, Taro Pharmaceuticals U.S.A., Inc. (collectively, "Taro") in the district court in New Jersey alleging that under the provisions of the Hatch-Waxman Act, Taro's ANDA infringed certain Warner-Lambert patents.

TARO CANADA 20TH ANNIVERSARY

2004 is the twentieth anniversary of the establishment of Taro Canada and the acquisition of Taro's first facility in North America, near Toronto. Taro Canada has evolved into a recognized center for developing and producing topical pharmaceutical products in North America. Taro Canada has grown from 32 employees in 1984 to more than 400 today and has become a significant Canadian exporter of topical pharmaceutical products.

Certain statements in this release are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, but are not limited to, statements that do not describe historical facts; events or circumstances the Company "anticipates," "expects," "plans," "intends," or "designs" to happen or exist; consumer, physician or marketplace acceptance of the Company's new or existing products; comments concerning marketing and consumer acceptance of proprietary products including ElixSure® and Kerasal® products; the potential benefits of ElixSure® products; initiatives undertaken by the Taro Consumer Healthcare Products and TaroPharma divisions; the Company's research and facilities expansion programs; Taro's filings with the FDA; and the Company's growth. Although Taro Pharmaceutical Industries Ltd. believes that the expectations reflected in such forward-looking statements are based on reasonable assumptions, it has no assurance that its expectations will be attained. Factors that could cause actual results to differ include general economic conditions, industry and market conditions, slower than anticipated penetration of new markets, changes in the Company's financial position, regulatory actions and legislative actions in the countries in which Taro operates, future demand and market size for products under development, marketplace acceptance of new or existing products, either generic or proprietary, and other risks detailed from time to time in the Company's SEC reports, including its 2003 Annual Report on Form 20-F where we explain that the preparation of the Company's financial statements requires us to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses. We evaluate, on an ongoing basis, our estimates, including those related to bad debts, income taxes and contingencies. We base our estimates on currently 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. Forward-looking statements speak only as of the date on which they are made. The Company undertakes no obligations to update, change or revise any forward-looking statement, whether as a result of new information, additional or subsequent developments or otherwise.

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