TARO PHARMACEUTICAL INDUSTRIES LTD
Form 6-K
March 31, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 OR 15d-16 UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the month of March, 2011

Commission File Number 000-22286

Taro Pharmaceutical Industries Ltd.

(Translation of registrant's name into English)

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

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.
Form 20-F x Form 40-F ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): _____

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): _____

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934. Yes ¨ No x

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-_____.

The Company is filing the attached audited consolidated financial statements for the year ended December 31, 2009.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, Item 308 of Regulation S-K requires a company's Annual Report to include management's annual report on internal control over financial reporting that contains, among other items, management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year, including a statement as to whether or not the company's internal control over financial reporting is effective. The Company is currently not providing the full disclosures required in an Annual Report on Form 20-F for the year ended December 31, 2009, however, the Company's management has performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2009. In connection with its assessment, management has determined that there were material weaknesses in the Company's internal control over financial reporting as of December 31, 2009 primarily related to (1) financial reporting and closing procedures, (2) certain revenue recognition procedures and (3) inventory valuation. Accordingly, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2009. The Company has instituted control procedures in order to remediate these material weaknesses and ensure that the consolidated financial statements are in conformity with United States generally accepted accounting principles.

SAFE HARBOR STATEMENT

Certain statements in this filing 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 and statements that refer or relate to events or circumstances the Company "estimates," "believes," or "expects" to happen or similar language, and statements with respect to the Company's financial performance, including its financial performance during the years discussed in this filing, availability of financial information, completion of the 2010 audit, and estimates of financial results and financial information for 2010. Although Taro Pharmaceutical Industries Ltd. believes the expectations reflected in such forward-looking statements to be based on reasonable assumptions, it can give no assurances that its expectations will be attained. Factors that could cause actual results to differ include the possible unavailability of financial information, completion of the aforesaid audit, actions of the Company's lenders and creditors, general domestic and international economic conditions, industry and market conditions, changes in the Company's financial position, litigation brought by any party in any court in Israel, the United States, or any country in which Taro operates, regulatory actions and legislative actions in the countries in which Taro operates, and other risks as detailed from time to time in the Company's SEC reports, including its Annual Reports on Form 20-F. 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.

SIGNATURES

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

Date: March 31, 2011

TARO PHARMACEUTICAL INDUSTRIES LTD.

By: /s/ James Kedrowski
Name: James Kedrowski
Title: Interim Chief Executive Officer

TARO PHARMACEUTICAL INDUSTRIES LTD.

TARO PHARMACEUTICAL INDUSTRIES LTD.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and 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, 2009 and 2008, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial position of the Company and its subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

Tel Aviv, Israel

March 30, 2011

/s/ Ziv Haft
Ziv Haft
Certified Public
Accountants (Isr)
BDO Member Firm

F-2

TARO PHARMACEUTICAL INDUSTRIES LTD.

CONSOLIDATED BALANCE SHEETS

U.S. dollars and shares in thousands

	December 31,	
	2009	2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$93,307	$68,828
Short-term bank deposits	20,974	10,000
Accounts receivable and other:		
Trade, net	61,643	62,098
Other receivables, prepaid expenses and other	45,603	19,605
Inventories	67,977	66,099
TOTAL CURRENT ASSETS	289,504	226,630
LONG-TERM RECEIVABLES AND OTHER ASSETS	31,549	27,856
PROPERTY, PLANT AND EQUIPMENT, NET	176,168	186,543
GOODWILL	7,265	7,217
INTANGIBLE ASSETS AND DEFERRED COSTS, NET	20,883	23,756
DEFERRED INCOME TAXES	50,520	1,096
TOTAL ASSETS	$575,889	$473,098

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

TARO PHARMACEUTICAL INDUSTRIES LTD.

CONSOLIDATED BALANCE SHEETS

U.S. dollars and shares in thousands

	December 31,	
	2009	2008
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank credit and short-term loans	$96,090	$100,116
Current maturities of long-term debt	29,277	29,888
Accounts payable:		
Trade payables	27,979	25,877
Other current liabilities	77,063	83,522
TOTAL CURRENT LIABILITIES	230,409	239,403
LONG-TERM LIABILITIES:		
Long-term debt, net of current maturities	38,380	58,019
Deferred income taxes	3,813	3,793
Other long-term liabilities	7,591	7,666
TOTAL LONG-TERM LIABILITIES	49,784	69,478
COMMITMENTS AND CONTINGENT LIABILITIES		
TOTAL LIABILITIES	280,193	308,881
SHAREHOLDERS' EQUITY:		
Taro shareholders' equity:		
Ordinary shares of NIS 0.0001 par value:		
Authorized at December 31, 2009 and 2008: 200,000,000 shares; Issued		
at December 31, 2009 and 2008: 39,509,257 and 39,460,509 shares, respectively.		
Outstanding at December 31, 2009 and 2008:		
39,249,082 and 39,200,082 shares, respectively	679	679
Founders' shares of NIS 0.00001 par value:		
Authorized, issued and outstanding at December 31, 2009 and 2008:		
2,600 shares	1	1
Additional paid-in capital	222,608	222,138
Accumulated other comprehensive income	21,980	7,722
Treasury stock: 260,175 shares at December 31, 2009 and 2008	(1,329)	(1,329)
Accumulated earnings (deficit)	49,029	(64,994)
Taro shareholders' equity	292,968	164,217
Non-controlling interest	2,728	-
TOTAL SHAREHOLDERS' EQUITY	295,696	164,217
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$575,889	$473,098

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

F-4

TARO PHARMACEUTICAL INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31,		
	2009	2008	2007
Sales, net	$357,643	$329,036	$319,554
Cost of sales	154,603	148,317	133,229
Impairment	171	27	170
Gross profit	202,869	180,692	186,155
Operating expenses:			
Research and development, net	34,243	35,044	29,817
Selling, marketing, general and administrative	102,202	99,025	97,274
Impairment	3,363	2,820	-
	139,808	136,889	127,091
Operating income	63,061	43,803	59,064
Financial expenses, net	16,527	795	22,816
Other gain, net	560	1,054	4,300
Income before income taxes	47,094	44,062	40,548
Tax (benefit) expense	(69,657)	13,541	6,212
Net income	116,751	30,521	34,336
Net income attributable to non-controlling interest	2,728	-	-
Net income attributable to Taro	$114,023	$30,521	$34,336
Basic net income per ordinary share attributable to Taro	$2.91	$0.78	$0.99
Diluted net income per ordinary share attributable to Taro	$2.81	$0.76	$0.98
Weighted-average number of ordinary shares used to compute basic income per share	39,232	39,200	34,725
Weighted-average number of ordinary shares used to compute diluted income per share	40,568	40,423	35,215

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

TARO PHARMACEUTICAL INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars and shares in thousands

	Taro Shareholders' Equity									
	Number of Shares	Share Capital	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Retained Earnings (Accumulated Deficit)	Total Taro Comprehensive Income (Loss)	Total Taro Shareholders' Equity	Non-controlling Interest	Total Shareholders' Equity
Balance at January 1, 2007	29,358	$680	$165,058	$14,106	$(1,388)	$(128,673)	$ -	$49,783	$-	$49,783
Release of treasury shares to employees under ESPP	1				27			27		27
Cumulative effect adjustment upon adoption of FIN 48						(1,178)		(1,178)		(1,178)
Exercise of options and issuance of shares of ESPP	49		183					183		183
Issuance of shares and warrants to Sun, net	6,788		39,189					39,189		39,189
Exercise of Sun warrants	3,000		17,100					17,100		17,100
Share-based compensation			284					284		284
Comprehensive income (loss), net of tax:										
Foreign currency translation adjustments				13,597			13,597	13,597		13,597
Unrealized gain from available for										

sale										
marketable securities				11			11	11		11
Reclassification of unrealized gains from marketable securties to earnings				(94)			(94)	(94)		(94)
Net income						34,336	34,336	34,336		34,336
Total comprehensive income:							$47,850		$-	
Balance at December 31, 2007	39,196	680	221,814	27,620	(1,361)	(95,515)		153,238		153,238
Exercise of options and issuance of shares of ESPP	4		2		32			34		34
Share-based compensation			322					322		322
Comprehensive income (loss), net of tax:										
Foreign currency translation adjustments				(19,898)			(19,898)	(19,898)		(19,898)
Net income						30,521	30,521	30,521		30,521
Total comprehensive income:							$10,623		$-	
Balance at December 31, 2008	39,200	680	222,138	7,722	(1,329)	(64,994)		164,217		164,217
Exercise of options and issuance of shares of ESPP	49		163					163		163
Share-based compensation			307					307		307
Comprehensive income (loss), net of tax:										
Foreign currency translation adjustments				14,258			14,258	14,258		14,258
Net income						114,023	114,023	114,023	2,728	116,751

Total comprehensive income:							$128,281	$2,728	
Balance at December 31, 2009	39,249	$680	$222,608	$21,980	$(1,329)	$49,029		$292,968	$295,696

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

TARO PHARMACEUTICAL INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2009	2008	2007
Cash flows from operating activities:			
Net income	$116,751	$30,521	$34,336
Adjustments required to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	18,445	21,187	22,614
Change in deferred charges and other assets	69	101	244
Impairment of long-lived assets	3,534	2,847	170
Share-based compensation expense	307	322	284
Accrued severance pay and other long-term liabilities, net	(539)	571	(1,492)
Loss (gain) on sale of long-lived assets	34	(56)	(3,727)
Realized gain on sale of marketable securities	-	-	(94)
Change in derivative instruments, net	(4,019)	13,066	(6,948)
Effect of exchange differences on inter-company balances	8,713	(13,328)	7,259
Increase in long-term debt due to currency fluctuations	2,401	3,736	7,714
Deferred income taxes, net	(78,191)	(115)	2,197
Decrease (increase) in trade receivables, net	1,081	6,606	(29,626)
Decrease in other receivables, prepaid expenses and other	3,229	1,187	730
(Increase) decrease in long-term receivables and other assets	(842)	(718)	2,125
Increase in income tax receivables	(1)	-	-
Decrease (increase) in inventories, net	762	(2,912)	(7,430)
Increase in trade payables	690	7,459	882
Decrease in other accounts payable and accrued expenses	(5,824)	(5,412)	(28,361)
(Decrease) increase in income tax payables	(2,681)	9,815	275
Net cash provided by operating activities	63,919	74,877	1,152

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

TARO PHARMACEUTICAL INDUSTRIES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2009	2008	2007
Cash flows from investing activities:			
Purchase of property, plant and equipment	(5,025)	(3,572)	(5,984)
Investment in other intangible assets	(120)	(594)	(229)
Investment in short-term bank deposits	(10,974)	(10,000)	-
Proceeds from (investment in) restricted bank deposits	1,000	(6,250)	-
Proceeds from long-term deposits and other assets	14	70	-
Proceeds from sale of marketable securities	-	-	125
Proceeds from sale of long-lived assets	1,655	65	10,151
Net cash (used in) provided by investing activities	(13,450)	(20,281)	4,063
Cash flows from financing activities:			
Proceeds from issuance of shares, net	163	34	56,499
Proceeds (repayments) of short-term bank debt, net	1,660	2,818	(6,388)
Repayment of long-term debt	(30,403)	(31,776)	(26,373)
Net cash (used in) provided by financing activities	(28,580)	(28,924)	23,738
Effect of exchange rate changes on cash and cash equivalents	2,590	(2,031)	94
Increase in cash and cash equivalents	24,479	23,641	29,047
Cash and cash equivalents at the beginning of the year	68,828	45,187	16,140
Cash and cash equivalents at the end of the year	$93,307	$68,828	$45,187
Supplemental disclosure of cash flow transactions:			
Cash paid during the year for:			
Interest	$8,256	$12,039	$14,793
Income taxes	$11,970	$3,197	$3,644
(a) Non-cash investing and financing transactions:			
Purchase of property, plant and equipment on credit	$755	$288	$317
Investment in intangible assets on credit	$-	$-	$14

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

NOTE 1: — GENERAL

a. Taro Pharmaceutical Industries Ltd. (the “Company” or “Taro”) is an Israeli corporation, which operates in Israel and elsewhere through its 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 quoted on the Pink Sheets Electronic Quotation Service (“Pink Sheets”) under the symbol TAROF. As used herein, the terms "we," "us," "our," “Taro” and the "Company" mean Taro Pharmaceutical Industries Ltd. and its subsidiaries, unless otherwise indicated.

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 U.S.A.”). Taro Research Institute Ltd. in Israel provides research and development services to the Group. Taro International Ltd. in Israel, Taro Pharmaceuticals Ireland Ltd. and Taro Pharmaceuticals Europe B.V. are engaged in the pharmaceutical activities of the Group outside North America.

The Group manufactures generic and proprietary drug products in facilities located in Israel and Canada, and manufactures bulk active pharmaceutical ingredients in its facilities located in Israel. The Group’s research facilities are located in Israel and Canada. 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 and Drug Administration (the “FDA”), the Canadian Health Products and Food Branch Inspectorate, and 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. In February 2009, our Canadian manufacturing facility received a warning letter from the FDA (the “Warning Letter”) expressing concern identified during a July 2008 inspection about certain quality control systems, including failure to complete investigations of quality issues in a timely manner. The Company responded to the Warning Letter on March 17, 2009, submitted and discussed a full compliance work plan with the FDA, provided periodic written updates to the FDA and is committed to working with the FDA to resolve all issues. The Company has corrected the specific observations cited during the July 2008 inspection and in the Warning Letter, and, to ensure its products meet all requirements, has improved its ability to adhere to current good manufacturing practices (“cGMPs”) by adding additional qualified personnel, engaging outside experts and adding new procedures to resolve any systemic issues and prevent recurrence. The observations cited in the Warning Letter do not relate to any of the Company's other

facilities. Until remedial action is complete and the FDA has confirmed compliance with cGMPs, new applications listing the Canadian facility as a manufacturing location of finished dosage forms may not be approved. However, one new product made at the Company's Canadian facility was approved by the FDA in May 2009 after the issuance of the Warning Letter. Other Federal agencies take the Warning Letter into account when considering the awards of contracts and in some cases may have the right to terminate any agreement they have with us or remove products from their pricing schedule as one agency has done. A formal cGMP re-inspection was conducted by the FDA in February 2011 to evaluate the effectiveness of corrective actions undertaken by Taro and the Company is awaiting final disposition. This has not had a material impact on the Company's financial condition.

While the majority of the Company's products are either synthesized by the Company itself or are derived from multiple source materials, some raw materials and certain products are currently obtained from single domestic or foreign suppliers. The Company does not believe that any interruption of supply from a single supplier would have a material adverse effect on the Company's results of operations and financial position. To date, the Group has not experienced difficulties in obtaining raw materials.

b. On May 18, 2007, the Company, Alkaloida Chemical Company Exclusive Group Ltd. ("Alkaloida"), a subsidiary of Sun Pharmaceutical Industries Ltd. (together with its affiliates "Sun") (Reuters: SUN.BO, Bloomberg: SUNP IN, NSE: SUNPHARMA, BSE: 524715) and Aditya Acquisition Company Ltd. ("Aditya") entered into a merger agreement (the "Merger Agreement"). In addition, Taro entered into a Share Purchase Agreement with Alkaloida, pursuant to which Taro issued Alkaloida 6,787,500 ordinary shares at $6.00 per share, for a total of $40,725 (the "Share Purchase Agreement"). Under the terms of the Share Purchase Agreement, Sun also received a three-year warrant to purchase additional ordinary shares at $6.00 per share. On August 2, 2007, Sun exercised a portion of its warrant in favor of Alkaloida, as assignee, and purchased 3,000,000 additional shares at an exercise price of $6.00 per share, or $18,000. This additional investment, together with its original purchase of Taro's newly issued shares, brought Sun's investment in Taro to $58,725. Taro paid $2,436 in stock issuance costs and therefore retained $56,289 of the proceeds. The net proceeds were recorded within shareholders' equity on the consolidated balance sheet in accordance with FASB ASC Subtopic 815-40, "Derivatives and Hedging - Contracts in Entity's Own Equity" (formerly Emerging Issues Task Force ("EITF") Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"), as the Company did not meet the criteria of a derivative under FASB ASC Section 815-40-30, "Derivatives and Hedging - Contracts in Entity's Own Equity – Initial Measurement" (formerly EITF 00-19).

On May 28, 2008, the Company terminated the Merger Agreement. On the same day, the Company and its directors, other than the members of the Levitt and Moros families (the "Independent Directors"), brought a lawsuit against Sun and its affiliates in the Tel-Aviv District Court (the "District Court") seeking a declaratory judgment that, under the Israeli Companies Law, a "Special Tender Offer" was required. On June 25, 2008, Sun gave notice that it was exercising its option under the May 18, 2007 option agreement entered into by Sun, with Dr. Barrie Levitt, Dr. Daniel Moros, Ms. Tal Levitt, Dr. Jacob Levitt and Taro Development Corporation ("TDC") (the "Option Agreement"). Pursuant to the Option Agreement, Sun was granted the option to acquire certain ordinary shares owned by Dr. Barrie Levitt, Dr. Moros, Ms. Levitt, and TDC for $7.75 per share, as well as all of the founders' shares, which represented one third of the voting power of all of the Company's shares, for no consideration (the "Options"). A condition to the exercise of the Options required Sun to commence a tender offer to purchase any and all ordinary shares owned by all other shareholders for $7.75 per share. According to the terms of the Option Agreement, the transactions contemplated would be consummated contemporaneously with the expiration of the tender offer.

On June 30, 2008, Sun commenced a regular tender offer for any and all ordinary shares at a price of $7.75 per share (the "Sun Offer"). On August 26, 2008, the District Court ruled that Sun was not required to comply with the Special Tender Offer rules. On August 28, 2008, the Company and its Independent Directors filed an appeal to the Supreme Court of the State of Israel (the "Israeli Supreme Court") and requested a temporary injunction to prevent Sun from acquiring additional ordinary shares which would result in its voting power being more than 45% of the Company's voting power during the pendency of the appeal. On September 1, 2008, the Israeli Supreme Court granted the

temporary injunction.

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

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

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

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

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

In addition to the foregoing, the Company issued a letter dated September 20, 2010, to Sun and Alkaloida acknowledging the valid exercise by Alkaloida of a certain Warrant No. 2 issued August 1, 2007, for the purchase of 3,787,500 ordinary shares of Taro for an aggregate price of $22,725. With the exercise of Warrant No. 2 as well as the completion of the acquisition of the shares from the Levitt/Moros Shareholders and the acquisition of the shares from Templeton Asset Management Ltd. ("Templeton") on November 1, 2010, Sun increased its ownership of Taro's ordinary shares to 64.8% and, with Taro's founders' shares, its voting rights to 76.5%.

On January 18, 2011, Alkaloida acquired 712,500 ordinary shares of Taro pursuant to a certain Warrant No. 2 dated August 1, 2007 issued by the Company to Sun Pharma (the "Warrant"). Additionally, Alkaloida acquired 712,500 ordinary shares of the Company available pursuant to a certain Share Purchase Agreement dated May 18, 2007 between Alkaloida and the Company (the "SPA"). As a result of the exercise of the Warrant and the purchase of shares by Alkaloida pursuant to the SPA, the Company's issued and outstanding ordinary shares are 44,505,457 and Sun Pharma owns, or controls, 29,497,933, or 66.3%, of the Company's ordinary shares, and with the Company's founders' shares, 77.3% of the vote attributable to the share equity of the Company.

c. In July 2004, Taro U.S.A. entered into a license agreement with Medicis Pharmaceutical Corporation ("Medicis") for four product lines used in the treatment of skin disorders, including the Lustra® product line and two previously unmarketed products in the United States, Canada and Puerto Rico. The entire purchase price of $35,565 was treated as a product rights purchase and therefore, was recorded on the balance sheet under the line item "other intangible assets and deferred charges, net." The Company allocated $23,165 for the Lustra® product family. Lustra® and Lustra-AF® were marketed by Medicis for a number of years. One of the previously unmarketed products, from the Lustra® product family, was subsequently launched by Taro under the name Lustra-Ultra™. Taro allocated $12,400 for the second previously unmarketed product, which was subsequently launched by Taro under the name U-Kera™. During 2006, the Company recorded an impairment charge of $10,023, to write off the

remaining carrying value of the U-Kera™ intangible asset and recorded an impairment charge of $13,236 to reduce the carrying value of the Lustra® intangible asset to $6,298. These charges were the result of competitive market pressures and were recorded in cost of sales. The impairments were determined by conducting valuation studies and employing a discounted cash flow analysis. The remaining carrying value is being amortized to cost of sales over the weighted-average life of the product rights. See Note 2.k.

As part of the agreement, the Company received $20,000 from Medicis, which the Company estimated was its returns exposure for these products, and with which the Company established a reserve. This return reserve is presented together with the reserve for returns in current liabilities. The Company also agreed to accept expired returned goods in the future, even though the product returned may not have been sold by Taro. The reserve was established anticipating that customers will deduct, from their cash payments to the Company, the price that they originally paid to Medicis for the goods being returned. This reserve was utilized for the return exposure related to the acquired products.

d. In March 2005, the Company, through its subsidiaries, entered into multi-year agreements with Alterna-TCHP, LLC ("Alterna") to license the Company's over-the-counter ElixSure® and Kerasal® products in North America.

The terms of the agreements include, among other things, the license of rights to distribute ElixSure® and Kerasal® products and an option to acquire the ownership rights for additional consideration, multi-year manufacturing and supply arrangements and the sale of ElixSure® inventory on-hand at the outset of the arrangement. At the time of signing the agreements, the Company received $10,000 and there were to be additional payments due over the term of the agreements. In addition, the Company receives payments from Alterna for ongoing manufacturing and supply of the products during the agreement term.

The Company accounted for this transaction in accordance with FASB Subtopic ASC 605-25, "Revenue Recognition – Multiple-Element Arrangements" (formerly EITF Issue No. 00-21, "Revenue Arrangement with Multiple Deliverable"). The Company has concluded that the entire arrangement should be considered as one unit of accounting mainly because the Company could not establish fair value for all undelivered elements in the transaction. Accordingly, the total up-front consideration is being recognized as revenue over the three-year term of the arrangement. Revenue recognition is limited to cash received. In addition, the Company recorded deferred inventory cost in the amount of $2,037 related to the costs of ElixSure® products that were sold to Alterna at the outset of the agreement. The cost is amortized over the three-year term of the manufacturing and supply services under the agreements.

The Company determined that Alterna is a Variable Interest Entity ("VIE") in accordance with FASB ASC Subtopic 810-20, "Consolidation – Control of partnerships and similar entities" (formerly Financial Accounting Standards Board ("FASB") Interpretation No. 46 (Revised December 2003), "Consolidation of Variable Interest Entities"). However, the Company has concluded that it is not the primary beneficiary of the VIE, therefore Alterna has not been consolidated into the Company's results of operations. The Company concluded that the amendment to the agreements in June 2006 should not change this conclusion, primarily since the Company does not have exposure to losses from its involvement with Alterna.

e. The Company, through its Irish subsidiary, owns a pharmaceutical manufacturing and research facility in Ireland, designed primarily for the manufacture of sterile products. As a result of the delay in receiving regulatory approval for the manufacture of new products, the inability to pursue the launch of certain approved products, and further financial constraints during 2006 which significantly reduced the level of additional investment in the Irish facility, the Company recorded an impairment charge related to its Irish facility during 2006.

The Company used the market approach in determining the fair value of the group of assets. During 2009 and 2008, the Company recorded further impairment charges on land, building and machinery of $3,363 and $2,820, respectively. In November 2009, the Company's Irish subsidiary sold certain equipment, net of transaction costs, for $1,485.

During 2010, the Company announced the closure of the manufacturing facility in Ireland and is exploring its options related to the facility. The Company is currently analyzing the impact of that event on subsequent years' financial statements and any possible additional impairment that may be required in future years.

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

NOTE 2: — SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company's most critical estimates are used in its determination of its sales incentives reserves (see Note 4 for details), inventory reserves, income taxes, fixed assets, intangible assets, derivative instruments and contingencies.

b. Financial statements in U.S. dollars:

A majority of the revenue of the Company and certain of its subsidiaries (exclusive of its Canadian, Irish, and U.K. subsidiaries – see below) is generated in U.S. dollars ("dollars"). In addition, a substantial portion of the costs of the Company and these 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 these subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar, requiring re-measurement from the local currency into the dollar for each of these entities. All exchange gains and losses resulting from the re-measurement are reflected in the statement of operations as financial income or expenses, as appropriate.

The functional currency of the Company's Canadian, Irish, and U.K. subsidiaries are the Canadian Dollar, the Euro, and the British Pound, respectively.

Accordingly, 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 operations have been translated using the average exchange rate prevailing during the year. The resulting translation adjustments are reported as a component of shareholders' equity under accumulated other comprehensive income.

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 and non-controlling interest is included in equity.

A private corporation, TDC, owns 3.125% of the shares that have economic rights and has 50% of the voting rights in Taro U.S.A.; with the Company owning the remaining shares and voting rights. In 1993, TDC signed an agreement with the Company to assign its voting rights in Taro U.S.A. in all elections of directors of Taro U.S.A. as the Company may designate. TDC may terminate the agreement upon one year written notice. As of December 31, 2009, no such notice of termination has been provided. TDC is a minority shareholder in the Company by way of its ownership of Taro U.S.A. shares that have economic rights. Since losses applicable to TDC exceeded its interest in Taro U.S.A. equity, such excess and any further losses applicable to TDC were charged against the Company as TDC has no obligation to fund such losses. Effective January 1, 2009, the Company adopted FASB ASC Section 810-10-65,

"Consolidation – Overall – Transition and Open Effective Date Information – Transition Related to FASB Statements No. 160, Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51, and No. 164, Not-for-Profit Entities: Mergers and Acquisitions" (formerly SFAS No. 160). This standard requires that the Company allocate income or loss attributable to the non-controlling interest based on the respective ownership percentages. This aspect of the standard was adopted on a prospective basis. Had the Company continued to follow the accounting standards effective in 2008, the income attributed to Taro would have been higher by $2,728 or $0.07 per share.

d. Cash and cash equivalents:

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

e. Marketable securities:

Marketable securities are comprised primarily of shares of stock in other publicly-traded companies. These marketable securities covered by FASB ASC Section 320-10-25, "Investments: Debt and Equity Securities – Overall – Recognition" (formerly Statement of Financial Accounting Standard ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities"), were designated as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income, a separate component of shareholders' equity.

f. Allowance for doubtful accounts:

The allowance for doubtful accounts is calculated primarily with respect to specific balances, which, in the opinion of the Company's management, are doubtful of collection. The allowance, in the opinion of the Company's management, is sufficient to cover probable uncollectible balances. See Note 3.

g. Inventories:

Inventories are stated at the lower of cost or net realizable value. Inventory reserves are provided to cover risks arising from slow-moving items, short-dated inventory, excess inventory or obsolescence. Changes in these provisions are charged to cost of sales. 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 – average cost basis.

The amounts of inventory reserves recorded as cost of sales were $6,762, $5,704, and $2,403, for the years ended December 31, 2009, 2008, and 2007, respectively.

h. Property, plant and equipment:

1. Property, plant and equipment are stated at cost, net of accumulated depreciation. Payroll and other costs that are direct incremental costs necessary to bring an asset to the condition of its intended use incurred during the construction and validation period of property, plant and equipment are capitalized to the cost of such assets.

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

2. Interest costs are capitalized in accordance with FASB ASC Subtopic 835-20,"Interest – Capitalization of Interest" (formerly SFAS No. 34, "Capitalization of Interest Cost").

3. Depreciation is calculated utilizing the straight-line method over the estimated useful lives of the assets, from the date the assets are ready for their intended use, at the following annual rates:

	%
Buildings	2.5 - 10
Machinery and equipment	5 - 20 (mainly 10)
Motor vehicles	15 - 20
Furniture, fixtures, office equipment and computer equipment	6 - 33 (mainly 20)

Leasehold improvements are depreciated using the straight-line method over the shorter of their useful lives or the terms of the leases (generally 5-10 years).

4. The Group accounts for costs of computer software developed or obtained for internal use in accordance with FASB ASC Subtopic 350-40, "Intangibles: Goodwill and Other – Internal-Use Software" (formerly Statement of Position ("SOP") No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use"). FASB ASC Subtopic 350-40 requires the capitalization of certain costs incurred in connection with developing or obtaining internal use software during the application development stage. During the years 2009 and 2008, the Group capitalized $71 and $76 of software costs, respectively. Software costs are amortized using the straight-line method over their estimated useful life of three years.

5. On February 7, 2007, the Company, in an effort to improve liquidity, sold a car park adjacent to its Irish facility, net of transaction costs, for $4,050, and recorded a pre-tax gain on this transaction of $3,721.

i. Lease of land from Israel Land Administration:

The Company leases land from the Israel Land Administration ("ILA"), which is accounted for pursuant to FASB ASC Subtopic 840-20, "Leases – Operating Leases" (formerly SFAS 13, "Accounting for Leases", as amended by SFAS 98). Taro leases several parcels from the ILA. The lease period of the industrial parcel ends between 2018 and 2058. The Company has the right to extend each of the lease agreements for an additional period of 49 years. The ILA lease agreements are standard agreements covering substantial portions of the land of Israel. The standard agreements call for a Lease Period of 49 years, with an option for one additional Lease Period (i.e., total of 98 years). The ownership of the land is not transferred at the end of the lease period and there is no option to buy the land at the end of such period. The expectation, based on practice and accumulated experience is that the renewal price would be substantially below fair market value. Since such leases do not qualify as a capital lease, they are being accounted for as operating

leases. The prepaid lease amount is included in long-term receivables and other assets and amortized over the term of the lease.

j. Goodwill:

The Company follows the provisions of FASB ASC Subtopic 350-20, “Intangibles: Goodwill and Other – Goodwill” (formerly SFAS No. 142, “Goodwill and Other Intangible Assets”). Goodwill is not amortized, but rather is subject to an annual impairment test (or more frequently if impairment indicators arise).

FASB ASC Subtopic 350-20 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment; while the second phase (if necessary) measures impairment.

In the first phase of impairment testing, goodwill attributable to one reporting unit is tested for impairment by comparing the fair value of the reporting unit with the carrying value of the reporting unit. When the carrying value exceeds the fair value, the second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

The Company operates in one operating segment, comprising its only reporting unit. Fair value of the reporting unit is determined using market capitalization. The Company performs its annual impairment test during the fourth fiscal quarter of each year. As of December 31, 2009 and 2008, no impairment loss had been identified.

k. Intangible assets and deferred charges and long-lived assets:

Intangible assets and deferred charges:

Acquired intangible assets and product rights to be held and used are not considered to have an indefinite useful life and are amortized over their useful life of a weighted-average amortization period of 14 years using a straight-line 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 142.

Debt issuance costs in respect to long-term loans from institutional investors and bondholders are deferred and amortized under the effective interest method over the term of the loans from institutional investors and bondholders.

Long-lived assets:

The Group's long-lived assets, excluding goodwill, are reviewed for impairment in accordance with FASB ASC Topic 360, "Property, Plant and Equipment" (formerly SFAS 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. Impairment exists when the carrying amount of the asset exceeds the aggregate future undiscounted cash flows expected to be generated by the asset. The impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the asset. In the years ended December 31, 2009 and 2008, the Company recorded $3,363 and $2,820 impairment loss, respectively, in operating expenses, primarily related to the fixed assets of its Irish facility. No impairment loss was recorded on these assets in the year ended December 31, 2007. See Notes 1.c, 1.d and 1.e.

l. Treasury shares:

The Company repurchases its ordinary shares from time to time on the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity.

From time to time the Company reissues treasury shares under the stock purchase plan, upon exercise of options and upon vesting of restricted stock units. When treasury stock is reissued, the Company accounts for the re-issuance in

accordance with FASB ASC Subtopic 505-30, “Equity – Treasury Stock” (formerly Accounting Principles Board Opinion (“APB”) No. 6, “Status of Accounting Research Bulletins”) and charges the excess of the purchase cost, including related stock-based compensation expenses, over the re-issuance price (loss) to retained earnings. The purchase cost is calculated based on the specific identification method.

In cases where the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

m. Revenue recognition:

The Company recognizes revenue from product sales when title and risk of loss have transferred to its customers and when the criteria in FASB ASC Subtopic 605-15, "Revenue Recognition – Products" (formerly the Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" ("SAB 104"), codified as SAB Topic 13, "Revenue Recognition" and SFAS No. 48, "Revenue Recognition When Right of Return Exists"), have been satisfied. Those criteria generally require that (i) persuasive evidence of an arrangement exists; (ii) product delivery has occurred; (iii) the price to customers is fixed or determinable; (iv) collectability is reasonably assured, and (v) the amount of product returns, chargebacks, rebates and other sales deductions can be reasonably estimated. The Company ships products to its customers only in response to, and to the extent of, the orders that customers submit to the Company. Depending on the terms of our customer arrangements, revenue is recognized when the product is received by the customer ("FOB Destination Point") or at the time of shipment ("FOB Shipping Point").

When the Company recognizes and records revenue from the sale of its pharmaceutical products, the Company, in the same financial reporting period, records an estimate of various future deductions related to the sale. This has the effect of reducing the amount of reported product sales. These deductions include the Company's estimates, which may require significant judgment of chargebacks, product returns, rebates, cash discounts and other sales deductions.

Chargebacks result from pricing arrangements the Company has with end-user customers establishing contract prices which are lower than the wholesalers' acquisition costs or invoice prices. When these customers buy the Company's products from their wholesaler of choice, the wholesaler issues a credit memo (chargeback) to the Company for the difference between the invoice price and the end-user contract price. Chargeback reserves are estimated using current wholesaler inventory data beyond the Company's control, and historical data. Due to the passage of time from the balance sheet date to the issuance of these financial statements, the Company has considered actual wholesaler returns in estimating its chargeback reserve.

Product returns result from agreements allowing the Company's customers to return unsold inventory that is expired or close to expiration. Product return reserves are calculated using the average lag period between sales and product expiry, historical product returns experience, and specific return exposures to estimate the potential obligation for returns of inventory in the distribution channel.

Rebates result from contractual agreements with the Company's customers and are earned based on the Company's direct sales to customers or the Company's customers' sales to third parties. Rebate reserves from the Company's direct sales to customers and the Company's customers' sales to third parties are estimated using historical and contractual data.

The Company generally offers discounts to its customers for payments within a certain period of time. Cash discount reserves are calculated by multiplying the specified discount percentage by the outstanding receivable at the end of each period.

Reserves for returns, Medicaid and indirect rebates are included in current liabilities. All other sales deductions allowances are recorded as accounts receivable reserves. The reserve for returns is included in current liabilities as

substantially all of these returns will not be realized until after the year-end accounts receivable balances are settled. Medicaid and indirect rebates are included in current liabilities because the Company does not have direct customer relationships with any of the payees. See Notes 4 and 12.

The Company offers incentives to certain resellers and retailers through various marketing programs where the Company agrees to reimburse them for advertising costs incurred to include the Company's products. The Company accounts for these in accordance with FASB ASC Subtopic 605-50, "Revenue Recognition – Customer Payments and Incentives" (formerly EITF Issue No. 01-09 "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of Vendor's Product)"), as reductions of revenue unless the customer receives an identifiable benefit in exchange for the consideration that is sufficiently separable from the customer's purchase of the products and the fair value of the benefits can be reasonably estimated.

With respect to revenue recognition policies in the Alterna transaction, see Note 1.d.

n. Research and development:

Research and development expenses, net of grants received, are charged to expense 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. The Company did not earn any grants during the years ended December 31, 2009, 2008, and 2007.

p. Advertising expenses:

The Group expenses advertising costs as incurred. Product samples are recorded within prepaid expense on the consolidated balance sheet and recorded within advertising expenses when provided to potential customers. Advertising expenses were $5,505, $6,979 and $6,473 for the years ended December 31, 2009, 2008 and 2007, respectively.

q. Income taxes:

Income taxes are accounted for in accordance with FASB ASC Topic 740, “Income Taxes” (formerly SFAS No. 109, “Accounting for Income Taxes”). FASB ASC Topic 740 prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined for temporary differences between the financial reporting and tax basis of assets and liabilities, and for carryforward losses and credits. Deferred taxes are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. As of December 31, 2009, management determined that it was more likely than not that the Company will benefit from the deferred tax asset in the U.S., resulting in the reversal of $76,694 of the valuation allowance against these deferred tax assets. As of December 31, 2008, management determined that it was more likely than not that the Company will not benefit from the deferred tax asset in the U.S., resulting in a full valuation allowance against this deferred tax asset. As of December 31, 2009 and 2008, management determined that it was more likely than not that the Company will not benefit from the deferred tax assets in the Ireland and certain other subsidiaries. Therefore, for these locations a full valuation allowance was provided against the deferred tax assets. In future years, if it is more likely than not that the Company will be in a position to utilize its deferred tax asset, the valuation allowance for such assets may be modified.

Effective January 1, 2007, the Company adopted FASB ASC Topic 740, “Income Taxes” (formerly FASB Interpretation (“FIN”) No. 48, “Accounting for Uncertainty in Income Taxes – an Interpretation of FAS 109”), which was issued in June 2006. FASB ASC Topic 740 requires that the tax effect of a position be recorded only if it is more likely than not to be sustained based solely on the tax position’s technical merits at the reporting date. If a tax position is not considered more likely than not to be sustained based solely on its technical merits, no benefits of the tax position are recorded.

The Company’s accounting policy, pursuant to the adoption of ASC 740, is to classify interest and penalties recognized in the financial statements relating to uncertain tax positions as income tax expense. See Note 17. The following table presents the impact at January 1, 2007, on the consolidated balance sheet as a result of implementing ASC 740:

Increase to short-term accrued taxes	$	1,178
Decrease to valuation allowance	$	6,220
Decrease to deferred tax assets	$	6,220
Increase to accumulated deficit	$	1,178

r. Sales and other taxes collected and remitted to governmental authorities:

The Company collects various taxes from customers and remits them to governmental authorities. These taxes are recorded on a net basis and therefore do not impact the statement of operations.

s. Basic and diluted net income per share attributable to Taro:

Basic net income per share is calculated based on the weighted-average number of ordinary shares outstanding during each year. Diluted net income per share is calculated based on the weighted-average number of ordinary shares outstanding during each year, plus potential dilutive ordinary shares considered outstanding during the year (except where anti-dilutive), in accordance with FASB ASC Topic 260, "Earnings per Share" (formerly SFAS No. 128, "Earnings per Share").

The total weighted-average number of options excluded from the calculations of diluted net earnings per share, as a result of their anti-dilutive effect, was 956,849, 1,012,359 and 1,126,528 for the years ended December 31, 2009, 2008 and 2007, respectively.

t. Freight and distribution costs:

In accordance with FASB ASC Subtopic 605-45, "Revenue Recognition – Principal Agent Considerations" (formerly EITF 00-10, "Accounting for Shipping and Handling Fees and Costs"), the Company's accounting policy is to classify shipping and handling costs as a part of sales and marketing expense. Freight and distribution costs and distribution warehousing costs related to shipping and handling to customers, primarily through the use of common carriers or external distribution services amounted to $10,206, $9,420 and $9,436 for the years ended December 31, 2009, 2008 and 2007, respectively.

u. Accounting for stock-based compensation:

On January 1, 2006, the Company adopted FASB ASC Topic 718, "Compensation: Stock Compensation" (formerly SFAS No. 123 (revised 2004), "Share-Based Payment"), which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. In March 2005, the SEC issued SAB No. 107 ("SAB 107") codified as SAB Topic 14, "Share-Based Payment" relating to SFAS No. 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). SFAS No. 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated income statement.

The Company recognizes compensation expense for the value of its awards granted subsequent to January 1, 2006, based on the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures. For awards granted prior to January 1, 2006, the Company recognizes compensation expense based on the

straight line-method over the requisite service period of each of the awards. Forfeitures were previously accounted for as they occurred, but have been estimated with the adoption of SFAS No. 123(R) for those awards not yet vested. Upon the adoption of SFAS No. 123(R) the expected life of the option is estimated using the “simplified” method as provided in SAB 107. Under this method, the expected life equals the arithmetic average of the vesting term and the original contractual term of the option. On December 21, 2007, the SEC issued SAB No. 110 (“SAB 110”), which, effective January 1, 2008, amends and replaces SAB 107. The Company currently uses the simplified method as adequate historical experience is not available to provide a reasonable estimate. The Company adopted SAB 110 effective January 1, 2008 and will continue to apply the simplified method until sufficient historical experience is available to provide a reasonable estimate of the expected term for stock option grants.

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

Stock Options: The fair value of options granted under the Stock Incentive Plan in 2009, 2008 and 2007 is amortized over their vesting period on a straight-line basis and estimated at the date of grant using a Black-Scholes options pricing model with the following assumptions:

	2009		2008		2007	
Dividend yield	0	%	0	%	0	%
Expected volatility	44.5	%	48.4	%	53.1	%
Risk-free interest rate	1.7	%	3.1	%	4.7	%
Expected life of up to	6.9 years		6.9 years		6.9 years	

The risk-free interest rate is based upon the yields of U.S. Treasury Bills with maturity terms similar to those of the expected lives of the options at the time of grant. The expected volatility is based upon daily movements in the Company's stock price.

Employee Stock Purchase Plan: The fair value of the incentive rewards granted under the Company's 2000 Employee Stock Purchase Plan, in 2006, is amortized over their vesting period on a straight-line basis and estimated at the date of the grant using a Black-Scholes options pricing model with the following weighted assumptions: 0% dividend yield, 72.7% volatility, 3.7% risk free interest rate and expected life of six months.

Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company applies FASB ASC Subtopic 505-50, "Equity - Equity-Based Payments to Non-Employees" (formerly SFAS No. 123(R) 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. FASB ASC Subtopic 505-50 requires the use of option valuation models to measure the fair value of the options granted. Compensation expensed to non-employees was not material.

v. Concentrations of credit risk:

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, bank deposits and trade receivables. Cash and cash equivalents and 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 equivalents and bank deposits are financially sound and that low credit risk therefore exists with respect to these financial instruments. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk.

The Group's trade accounts receivables are mainly derived from sales to customers in the United States, Canada, Europe and Israel. At December 31, 2009, three different customers in the United States represented approximately 15.4%, 14.9% and 13.7% of the trade accounts receivable, net. The Group has adopted credit policies and standards intended to mitigate inherent risk while accommodating sales growth. The Group performs ongoing credit evaluations

of its customers' financial condition when deemed necessary, but does not generally require collateral for its customers' accounts receivable.

w. Fair value of financial instruments:

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

The carrying amount of long-term bank deposits approximates their fair value because such deposits bear market interest rates.

The carrying amounts of the Group's borrowing arrangements under its short-term and long-term debt agreements approximate their fair value since the loans bear interest at rates that approximate the Group's incremental borrowing rates for similar types of borrowing arrangements.

The fair value of currency and interest rate contracts is determined by discounting to the present all future cash flows of the currencies to be exchanged at interest rates prevailing in the market for the period the currency exchanges are due and expressing the results in U.S. dollars at the current spot foreign currency exchange rate.

x. Accounting for derivatives:

FASB ASC Topic 815, "Derivatives and Hedging" (formerly SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"), 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 (i.e., gains or losses) in the fair value of a derivative instrument depends on whether the instrument has been designated and qualifies as part of a hedging relationship and on the type of hedging relationship. For derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation. The designation is based upon the nature of the exposure being hedged. At December 31, 2009 and 2008, no derivative instruments were designated as hedging instruments.

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. See Note 9.

y. Fair value measurements:

Effective January 1, 2008, the Company adopted FASB ASC Topic 820, "Fair Value Measurements and Disclosures" (formerly SFAS No. 157, "Fair Value Measurements"). FASB ASC Topic 820 provides a fair value hierarchy that distinguishes between assumptions based on market data obtained from independent sources (observable inputs) and those based on an entity's own assumptions (unobservable inputs). FASB ASC Topic 820 also requires additional disclosure about fair value measurements. The adoption of FASB ASC Topic 820 did not impact the Company's consolidated balance sheet or consolidated statement of operations.

z. Impact of recently issued accounting standards:

In February 2007, the FASB issued FASB ASC Topic 825, "Financial Instruments" (formerly SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115"). FASB ASC Topic 825 permits companies to value many financial instruments and certain other items at fair value. The adoption of FASB ASC Topic 825 did not have a material impact on the consolidated financial statements.

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

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

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

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

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

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

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

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

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

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

In December 2010, the FASB issued ASU No. 2010-27, "Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers (a consensus of the FASB Emerging Issues Task Force)." This standard addresses how fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act should be recognized and classified in the income statements of pharmaceutical manufacturers. Under the proposal, the annual fee would be recognized as a liability for the total amount and a corresponding deferred cost over the calendar year. This is a liability and presented as an operating expense. This ASU is effective for calendar years beginning after December 31, 2010. Since the fees are anticipated to be less than 0.2% of net sales, the Company does not expect the provisions of ASU 2010-27 to have a material effect on its financial statements.

In December 2010, the FASB also issued ASU No. 2010-28, "Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a

consensus of the FASB Emerging Issues Task Force).” Under this standard, if the carrying amount of a reporting unit is zero or negative, an entity must assess whether it is more likely than not that goodwill impairment exists. To make that determination, an entity should consider whether there are adverse qualitative factors that could impact the amount of goodwill, including those listed in ASC 350-20-35-30. As a result of the new guidance, an entity can no longer assert that a reporting unit is not required to perform the second step of the goodwill impairment test because the carrying amount of the reporting unit is zero or negative, despite the existence of qualitative factors that indicate goodwill is more likely than not impaired. The equity or enterprise valuation premise can be used to determine the carrying amount of a reporting unit. ASU 2010-28 is effective for public entities for fiscal years, and for interim periods within those years, beginning after December 15, 2010, with early adoption prohibited. The Company’s goodwill test does not currently have a zero or negative carrying amount where this standard would apply.

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

In December 2010, the FASB also issued ASU No. 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations (a consensus of the FASB Emerging Issues Task Force)." This standard specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in this update also expand the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amended guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. ASU 2010-29 affects the disclosure of business combinations occurring on or after January 1, 2011. Currently, Taro is not involved in any business combinations which would require this disclosure.

NOTE 3: — ACCOUNTS RECEIVABLE AND OTHER

a. Trade, net:

The following tables summarize the impact of accounts receivable reserves and allowance for doubtful accounts on the gross trade accounts receivable balances at each balance sheet date:

	December 31,	
	2009	2008
Trade accounts receivable, gross	$117,122	$126,668
Reserves for sales deductions:		
Chargebacks	(19,360)	(23,904)
Customer rebates	(16,356)	(17,544)
Other sales deductions	(19,216)	(22,492)
Allowance for doubtful accounts	(547)	(630)
Trade accounts receivable, net	$61,643	$62,098

b. Other receivables, prepaid expenses and other:

	December 31,	
	2009	2008
Prepaid expenses	$7,736	$6,277
Deferred income taxes (1)	32,069	3,815
Government authorities	2,098	1,343
Advances to suppliers	2,189	473

Derivative instruments	917	299
Receivable related to class action lawsuit (2)	-	7,000
Other	594	398
	$45,603	$19,605

(1) See Note 2.q.

(2) See Note 15.c.4.iii.

NOTE 4: — SALES INCENTIVES

When the Company recognizes and records revenue from the sale of its pharmaceutical products, it records an estimate in the same financial reporting period for product returns, chargebacks, rebates and other sales deductions, which are reflected as reductions of the related gross revenue. Beginning in 2006, the Company regularly monitors customer inventory information at its three largest wholesale customers to assess whether any excess product inventory levels may exist. The Company reviews this information together with historical product and customer experience, third-party prescription data, industry and regulatory changes and other relevant information and revises its estimates as necessary.

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

The Company considers any information available subsequent to the balance sheet date, but before the issuance of the financial statements, that provides additional evidence with respect to conditions existing at the balance sheet date and adjusts the reserves accordingly.

Product returns:

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

The Company's product returns reserve at December 31, 2009 and 2008 and related statement of operations impact for the years then ended, considered actual product returns experienced subsequent to the balance sheet dates to validate

the product returns reserve estimate based on the methodology described above.

Beginning in 2006, the Company monitors the levels of inventory in its distribution channels to assess the adequacy of the product returns reserve and to identify potential excess inventory on hand that could have an impact on its revenue recognition. The Company does not ship products to its wholesalers when it appears they have an excess of inventory on hand, based on demand and other relevant factors, for that particular product. Additionally, as a general practice, the Company does not ship products that have less than 12 months until expiration (i.e., “short-dated sales”).

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

Chargebacks:

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

Rebates and other deductions:

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

The Company establishes reserves for rebates and these other various sales deductions based on contractual terms and customer purchasing activity, tracking and analysis of rebate programs, processing time lags, the level of inventory in the distribution channel and other relevant information. Based on the Company's historical experience, substantially all claims for rebates and other sales deductions are received within 24 months. At December 31, 2009 and 2008, and for

the years then ended, the Company considered subsequent actual claims submitted by its customers in determining the Company's reserves and related statements of operations impact for rebates and other sales deductions.

As discussed above, the Company believes it has the experience and information that it believes are necessary to reasonably estimate the amounts of reserves for its sales incentives programs. Several of the assumptions used by the Company for certain estimates are based on information received from third parties, such as wholesale customer inventory levels, market data, and other factors beyond the Company's control. The most critical estimates in determining these reserves, and the ones therefore that would have the largest impact if these estimates were not accurate, are related to contract sales volumes, average contract pricing, customer inventories and return volumes. The Company regularly reviews the information related to these estimates and adjusts its reserves accordingly, if and when actual experience differs from previous estimates.

Notes to consolidated financial statements

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

Use of estimates in reserves:

The Company believes that its reserves, allowances and accruals for items that are deducted from gross revenue are reasonable and appropriate based on current facts and circumstances. Changes in actual experience or changes in other qualitative factors could cause the Company's allowances and accruals to fluctuate, particularly with newly launched or acquired products. The Company regularly reviews the rates and amounts in its reserve estimates. If future estimated rates and amounts are significantly greater than those reflected in the Company's recorded reserves, the resulting adjustments to those reserves would decrease the Company's reported net revenue; conversely, if actual product returns, rebates and chargebacks are significantly less than those reflected in the Company's recorded reserves, the resulting adjustments to those reserves would increase the Company's reported net revenue. If the Company were to change its assumptions and estimates, its reserves would change, impacting the net revenue that the Company reports. The Company regularly reviews the information related to these estimates and adjusts its reserves accordingly, if and when actual experience differs from previous estimates.

The following tables summarize the activities for sales deductions and product returns for the years ended December 31, 2009 and 2008:

For the Year Ended December 31, 2009 (in thousands)

	Beginning balance	Provision recorded for current period sales	Credits processed/ Payments	Ending balance
Accounts Receivable Reserves				
Chargebacks	$ (23,904)	$ (208,482)	$ 213,026	$ (19,360)
Rebates and Other	(40,666)	(80,262)	84,809	(36,119)
Total	$ (64,570)	$ (288,744)	$ 297,835	$ (55,479)
Current Liabilities				
Returns	$ (22,279)	$ (11,327)	$ 11,092	$ (22,514)
Other (1)	(9,697)	(25,838)	20,271	(15,264)
Total	$ (31,976)	$ (37,165)	$ 31,363	$ (37,778)

For the Year Ended December 31, 2008 (in thousands)

	Beginning balance	Provision recorded for current period sales	Credits processed/ Payments	Ending balance
Accounts Receivable Reserves				

Chargebacks	$ (18,525)	$ (172,582)	$ 167,203	$ (23,904)
Rebates and Other	(29,015)	(65,572)	53,921	(40,666)
Total	$ (47,540)	$ (238,154)	$ 221,124	$ (64,570)
Current Liabilities				
Returns	$ (25,101)	$ (13,898)	$ 16,720	$ (22,279)
Other (1)	(10,556)	(13,509)	14,368	(9,697)
Total	$ (35,657)	$ (27,407)	$ 31,088	$ (31,976)

(1) Includes indirect rebates.

Notes to consolidated financial statements

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

NOTE 5: — INVENTORIES

	December 31,	
	2009	2008
Raw and packaging materials	$ 22,385	$ 19,768
Finished goods	26,457	23,927
Work in progress	14,872	17,842
Purchased products for commercial purposes and other	4,263	4,562
	$ 67,977	$ 66,099

As of December 31, 2009 and 2008, reserves recorded against inventories for slow-moving, short-dated, excess and obsolete inventory totaled $12,006 and $15,726, respectively.

As for pledges, see Note 14.

NOTE 6: — PROPERTY, PLANT AND EQUIPMENT

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

	December 31,	
	2009	2008
Cost:		
Land	$12,411	$12,090
Buildings	140,068	158,570
Leasehold improvements	3,186	3,010
Machinery and equipment	144,111	145,212
Computer equipment	31,610	30,339
Motor vehicles	303	304
Furniture, fixtures and office equipment	8,787	8,402
Advances for property and equipment	489	160
	340,965	358,087
Accumulated depreciation and impairment charges:		
Buildings	$33,771	$47,177
Leasehold improvements	3,021	2,709
Machinery and equipment	91,495	86,647
Computer equipment	29,611	28,645
Motor vehicles	288	284

Furniture, fixtures and office equipment	6,611	6,082
	164,797	171,544
Depreciated cost	$176,168	$186,543

Depreciation expenses were $15,530, $18,374, and $19,874 for the years ended December 31, 2009, 2008 and 2007, respectively. For related impairment charges, see Note 2.k.

b. Cost of property, plant and equipment includes capitalized interest expenses, capitalized direct incremental costs (such as payroll and related expenses) and other internal costs incurred in order to bring the assets to their intended use in the amount of $16,826 as of December 31, 2009 and 2008. Capitalized interest and other costs were $71, $76, and $56 for the years ended December 31, 2009, 2008 and 2007, respectively.

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

c. Cost of computer equipment includes capitalized development costs of computer software developed for internal use in the amount of $4,634 and $4,507 as of December 31, 2009 and 2008, respectively.

d. As for pledges – see Note 14.

NOTE 7: —INTANGIBLE ASSETS AND DEFERRED COSTS

a. Composition:

	December 31,	
	2009	2008
Cost:		
Product rights	$68,382	$67,958
Deferred charges in respect of loans and bonds from institutional investors	1,304	1,277
Other deferred costs	1,541	1,541
	71,227	70,776
Accumulated amortization and impairment charges:		
Product rights	47,593	44,338
Deferred charges in respect of loans and bonds from institutional investors	1,276	1,226
Other deferred costs	1,475	1,456
	50,344	47,020
Amortized cost	$20,883	$23,756

b. Amortization expenses related to product rights were $2,915, $2,813 and $2,740 for the years ended December 31, 2009, 2008 and 2007, respectively.

c. As of December 31, 2010, the estimated amortization expense of product rights for 2010 to 2014 is as follows: 2010 - $2,819; 2011 - $2,777; 2012 - $2,604; 2013 - $2,564; 2014 - $2,328.

d. The weighted-average amortization period for product rights is approximately 8 years.

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

NOTE 8: — LONG-TERM RECEIVABLES AND OTHER ASSETS

	December 31,	
	2009	2008
Prepayment of land leased from Israel Land Administration (1)	$14,774	$14,838
Restricted bank deposits (2)	5,250	6,250
Derivative instruments (3)	4,077	1,470
Severance pay fund (4)	5,480	4,221
Employee escrow (5)	1,947	967
Other	21	110
	$31,549	$27,856

(1) The land is leased for a period of 49 years and is subject to renewal. This amount was prepaid (see Note 2.i).

(2) Amount represents restricted bank deposits pursuant to an interest rate swap agreement associated with loan agreements in Israel (see Note 9).