TEVA PHARMACEUTICAL INDUSTRIES LTD
Form 20-F
March 20, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005

Or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File number: 0-16174

TEVA PHARMACEUTICAL INDUSTRIES LIMITED

(Exact name of Registrant as specified in its charter)

N/A	**ISRAEL**
(Translation of Registrant s name into English)	**(Jurisdiction of incorporation or organization)**

5 Basel Street

P.O. Box 3190

Petach Tikva 49131, Israel

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
None	None

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

American Depositary Shares (as evidenced by American Depositary Receipts),

each representing one Ordinary Share

(Title of Class)

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

0.25% Convertible Senior Debentures Due 2026

1.75% Convertible Senior Debentures Due 2026

5.55% Senior Notes due 2016

6.15% Senior Notes due 2036

and related Guarantees

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

646,660,148 Ordinary Shares 484,026,847 American Depositary Shares

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

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

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 ¨ Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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INTRODUCTION AND USE OF CERTAIN TERMS

Unless otherwise indicated, all references to the Company, we, our and Teva refer to Teva Pharmaceutical Industries Limited and its subsidiaries. References to U.S. dollars, U.S.$ and $ are to the lawful currency of the United States of America, and references to NIS are to New Israeli Shekels. Furthermore, unless otherwise specified, all information, data and figures provided in this annual report relate solely to Teva s financial results and business and do not include Ivax Corporation, which we acquired in January 2006.

FORWARD-LOOKING STATEMENTS

Our disclosure and analysis in this annual report contain some forward-looking statements. Forward-looking statements describe our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Such statements may include words such as anticipate, estimate, expect, project, intend, plan, believe and other words and terms meaning in connection with any discussion of future operating or financial performance. In particular, these statements include, among other things, statements relating to:

- our business strategy;
- the development of our products;
- our projected capital expenditures;
- our liquidity; and
- the results of our acquisition of Ivax.

This report contains forward-looking statements which express the beliefs and expectations of management. Such statements are based on management s current beliefs and expectations and involve a number of known and unknown risks and uncertainties that could cause our future results, performance or achievements to differ significantly from the results, performance or achievements expressed or implied by such forward-looking statements. Important factors that could cause or contribute to such differences include our ability to successfully develop and commercialize additional pharmaceutical products, the introduction of competing generic products, the impact of competition from brand-name companies that sell or license their own brand products under generic trade dress and at generic prices (so-called authorized generics) or seek to delay the introduction of generic products, the impact of consolidation of our distributors and customers, regulatory changes that may prevent us from exploiting exclusivity periods, potential liability for sales of generic products prior to a final resolution of outstanding litigation, including that relating to the generic versions of Allegra®, Neurontin®, Oxycontin® and Zithromax®, the effects of competition on Copaxone® sales, including as a result of the expected reintroduction of Tysabri® into the market, the impact of pharmaceutical industry regulation and pending legislation that could affect the pharmaceutical industry, the difficulty of predicting U.S. Food and Drug Administration (FDA), European Medicines Agency (EMEA) and other regulatory authority approvals, the regulatory environment and changes in the health policies and structures of various countries, our ability to successfully identify, consummate and integrate acquisitions, including risks related to our acquisition of Ivax, our potential exposure to product liability claims, our dependence on patent and other protections for innovative products, the fact that we have significant operations worldwide that may be adversely affected by terrorism or major hostilities, environmental risks, fluctuations in currency, exchange and interest rates, operating results and other factors that are discussed in this report and in our other filings made with the U.S. Securities and Exchange Commission (SEC).

Forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to publicly update any forward-looking statements or other information contained in this report, whether as a result of new information, future events or otherwise. You are advised, however, to consult any additional disclosures we make in our reports on Form 6-K to the SEC. Please also see the cautionary discussion of risks and uncertainties under Risk Factors starting on page 6 of this report. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed here could also adversely affect us. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

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PART I

ITEM 3: KEY INFORMATION

SELECTED FINANCIAL DATA

The Israeli Securities Law allows Israeli companies, such as Teva, whose securities are listed both on the Tel Aviv Stock Exchange and on certain stock exchanges in the United States (including NASDAQ), to report exclusively under SEC rules and generally accepted accounting principles in the United States (U.S. GAAP). All financial statements included in this annual report and all financial information released in Israel are presented solely under U.S. GAAP.

The following selected financial data for each of the years in the three-year period ended December 31, 2005 and at December 31, 2005 and 2004 are derived from Teva s audited consolidated financial statements set forth elsewhere in this report, which have been prepared in accordance with U.S. GAAP. The selected financial data for each of the years in the two-year period ended December 31, 2002 and at December 31, 2003, 2002 and 2001 are derived from audited financial statements not appearing in this report, which have also been prepared in accordance with U.S. GAAP.

The selected financial data should be read in conjunction with the financial statements, related notes and other financial information included in this report.

The currency of the primary economic environment in which the operations of Teva and its subsidiaries in Israel and in the United States are conducted is the U.S. dollar. The functional currency of Teva s other subsidiaries (principally operating in Europe and Canada) is their respective local currency.

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Operating Data

	For the year ended December 31				
	2005	2004	2003	2002	2001
	U.S. dollars in millions (except per ADR amounts)				
Net sales	5,250.4	4,798.9	3,276.4	2,518.6	2,077.4
Cost of sales	2,769.8	2,559.6	1,757.5	1,423.2	1,230.1
Gross profit	2,480.6	2,239.3	1,518.9	1,095.4	847.3
Research and development expenses:					
Total expenses	383.1	356.1	243.4	192.6	168.6
Less participations and grants	14.2	17.7	29.9	27.6	61.4
Research and development net	368.9	338.4	213.5	165.0	107.2
Selling, general and administrative expenses	798.8	696.5	520.6	406.4	358.1
Acquisition of in-process research and development		596.6			
Income from GSK litigation settlement			100.0		
Impairment of product rights		30.0			
Restructuring expenses			7.4		15.7
Operating income	1,312.9	577.8	877.4	524.0	366.3
Financial income (expenses) net	(4.3)	25.9	(5.0)	(24.6)	(26.0)
Income before income taxes	1,308.6	603.7	872.4	499.4	340.3
Income taxes	236.2	267.2	181.5	84.8	63.6
	1,072.4	336.5	690.9	414.6	276.7
Share in profits (losses) of associated companies net	1.7	(1.2)	1.5	(2.7)	0.8
Minority interests in losses (profits) of subsidiaries net	(1.8)	(3.5)	(1.4)	(1.6)	0.7
Net income	1,072.3	331.8	691.0	410.3	278.2
Earnings per ADR(1) Basic ($)	1.73	0.54	1.29	0.78	0.53
Diluted ($)	1.59	0.50	1.16	0.74	0.51
Weighted average number of ADRs (in millions) Basic	618.4	612.7	536.8	529.0	528.9
Diluted	680.8	688.0	608.8	580.9	567.8
Before one-time items(2)					
Operating income	1,312.9	1,218.3	784.8	524.0	382.0
Net income	1,072.3	964.6	617.8	410.3	287.9
Earnings per ADR(1) Basic ($)	1.73	1.57	1.15	0.78	0.55
Earnings per ADR(1) Diluted ($)	1.59	1.42	1.04	0.74	0.53

(1) Historical figures have been adjusted to reflect the two-for-one stock splits effected in June 2004 and December 2002. Each ADR represents one ordinary share.

(2) See the below reconciliation.

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Teva believes that excluding from its results of operations the following one-time items, which primarily relate to purchase accounting adjustments in connection with the Sicor acquisition (mainly in-process R&D) and to certain product rights acquired as part of a litigation settlement, represents a better indicator of the underlying trends in its business. The results, after these exclusions and inclusions, are the primary results used by management and Teva s board of directors to evaluate the operational performance of the Company, to compare against the Company s annual work plans and budgets, and ultimately to evaluate the performance of management.

	For the year ended December 31				
	2005	2004	2003	2002	2001
	U.S. dollars in millions				
Total income before taxes as reported*	1,308.6	599.0	872.5	495.1	341.8
Deduct:					
Income from GSK litigation settlement			100.0		
Add back charges:					
Sicor purchase accounting adjustments:					
In-process R&D		583.6			
Acquired inventory step-up		13.9			
Acquisition of in-process R&D		13.0			
Impairment of product rights		30.0			
Restructuring expenses			7.4		15.7
Total normalized income before taxes	1,308.6	1,239.5	779.9	495.1	357.5
Taxes on normalized income	236.2	274.9	162.1	84.8	69.6
Net normalized income	1,072.3	964.6	617.8	410.3	287.9
Net income as reported	1,072.3	331.8	691.0	410.3	278.2

* Includes share of profits (losses) of associated companies-net and minority interest in losses (profits) of subsidiaries-net.

Balance Sheet Data

	As at December 31				
	2005	2004	2003	2002	2001
	U.S. dollars in millions				
Working capital	3,245.2	1,997.6	2,021.5	1,377.2	1,439.8
Total assets	10,387.4	9,632.0	5,915.9	4,626.8	3,460.2
Short-term credit, including current maturities:					
Convertible senior debentures			352.5	562.4	
Other	375.5	560.4	291.7	176.1	206.5
Total short-term debt	375.5	560.4	644.2	738.5	206.5
Long-term debt, net of current maturities:					
Convertible senior debentures	1,313.9	1,513.4	449.9	810.0	912.0
Other	459.4	215.0	365.5	351.4	334.9
Total long-term debt	1,773.3	1,728.4	815.4	1,161.4	1,246.9
Minority interests	8.0	10.9	6.7	4.9	2.2
Shareholders equity	6,042.3	5,388.9	3,289.4	1,829.4	1,380.7

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Dividends

Teva has paid dividends on a regular quarterly basis since 1987. Future dividend policy will be reviewed by the board of directors based upon conditions then existing, including Teva s earnings, financial condition, capital requirements and other factors. Teva s ability to pay cash dividends may be restricted by instruments governing its debt obligations. Dividends are declared and paid in New Israeli Shekels. Dividends are converted into U.S. dollars and paid by the depositary of the ADRs for the benefit of owners of ADRs.

Dividends paid by an Israeli company to shareholders residing outside Israel are generally subject to withholding of Israeli income tax at a rate of up to 20%. Such tax rates apply unless a lower rate is provided in a treaty between Israel and the shareholder s country of residence. In Teva s case, the applicable withholding tax rate will depend on the particular Israeli production facilities that have generated the earnings that are the source of the dividend and, accordingly, the applicable rate may change from time to time. The rate of tax withheld on the dividend declared for the fourth quarter of 2005 was 16%.

The following table sets forth the amounts of the dividends paid in respect of each period indicated prior to deductions for applicable Israeli withholding taxes (in cents per ADR). All figures have been adjusted to reflect the 2-for-1 stock splits effected in June 2004 and December 2002. Actual dividends paid in U.S. dollars are subject to some deviation reflecting exchange rate fluctuations between the NIS (the currency in which dividends are declared) and the U.S. dollar between the declaration date and the date of actual payment.

	2005	2004	2003	2002	2001
			In cents per ADR		
1st interim	7.0	5.0	3.7	2.2	1.7
2nd interim	7.0	5.0	3.7	2.3	1.6
3rd interim	6.4	5.0	3.7	2.3	1.6
4th interim	7.2	6.9	5.0	3.5	2.4

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RISK FACTORS

Our business faces significant risks. You should carefully consider all of the information set forth in this annual report and in our other filings with the SEC, including the following risk factors which we face and which are faced by our industry. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. This report also contains forward-looking statements that involve risks and uncertainties. Our results could materially differ from those anticipated in these forward-looking statements, as a result of certain factors including due to the risks described below and elsewhere in this report. See Forward-Looking Statements on page 1.

Our success depends on our ability to successfully develop and commercialize additional pharmaceutical products.

Our future results of operations depend, to a significant degree, upon our ability to successfully commercialize additional generic and innovative branded pharmaceutical products as well as active pharmaceutical ingredients. We must develop, test and manufacture generic products as well as prove that our generic products are the bio-equivalent of their branded counterparts. All of our products must meet and continue to comply with regulatory and safety standards and receive regulatory approvals; we may be forced to withdraw a product from the market if health or safety concerns arise with respect to such product. The development and commercialization process, particularly with respect to innovative products, is both time-consuming and costly and involves a high degree of business risk. Our products currently under development, if and when fully developed and tested, may not perform as we expect, necessary regulatory approvals may not be obtained in a timely manner, if at all, and we may not be able to successfully and profitably produce and market such products. Delays in any part of the process or our inability to obtain regulatory approval of our products could adversely affect our operating results by restricting or delaying our introduction of new products. Our ability to introduce and benefit from new products may depend upon our ability to successfully challenge patent rights held by branded companies. The continuous introduction of new generic products and active pharmaceutical ingredients is critical to our business.

Our revenues and profits from any particular generic pharmaceutical product decline as our competitors (including brand name companies) introduce their own generic equivalents.

Selling prices of generic drugs typically decline, sometimes dramatically, as additional companies receive approvals for a given product and competition intensifies. To the extent that we succeed in being the first to market a generic version of a significant product, and particularly if we obtain the 180-day period of market exclusivity for the U.S. market provided under the Hatch-Waxman Act, our sales, profit and profitability can be substantially increased in the period following the introduction of such product and prior to a competitor s introduction of the equivalent product or the launch of an authorized generic. Our ability to sustain our sales and profitability on any product over time is dependent on both the number of new competitors for such product and the timing of their approvals. Our overall profitability depends, among other things, on our ability to continuously and timely introduce new products.

Our generic pharmaceutical products face intense competition from brand-name companies that have taken aggressive steps to thwart competition from generic companies. In particular, brand-name companies continue to sell or license their products directly or through licensing arrangements or strategic alliances with generic pharmaceutical companies (so-called authorized generics). No significant regulatory approvals are required for a brand-name company to sell directly or through a third party to the generic market. Brand-name companies do not face any other significant barriers to entry into such market. In addition, such companies continually seek new ways to delay generic introduction and decrease the impact of generic competition, such as:

- filing new patent applications on drugs whose original patent protection is about to expire;
- filing an increasing number of patent applications that are more complex and costly to challenge;

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filing suits for patent infringement that automatically delay FDA approval;

filing citizens petitions with the FDA contesting approval of the generic versions of products due to alleged health and safety issues;

developing controlled-release or other next-generation products, which often reduce demand for the generic version of the existing product for which we are seeking approval;

changing product claims and product labeling; or

developing and marketing as over-the-counter products those branded products which are about to face generic competition.

These strategies may increase the costs and risks associated with our efforts to introduce generic products and may delay or prevent such introduction altogether.

Sales of our products may be adversely affected by the continuing consolidation of our U.S. distribution network and the concentration of our customer base.

A significant amount of our sales are made to a relatively few U.S. drug wholesalers, retail drug chains, managed care purchasing organizations, mail order distributors and hospitals. These customers represent an essential part of the distribution chain of pharmaceutical products. These customers have undergone, and are continuing to undergo, significant consolidation. This consolidation may result in these groups gaining additional purchasing leverage and consequently increasing the product pricing pressures facing our business. Additionally, the emergence of large buying groups representing independent retail pharmacies and the prevalence and influence of managed care organizations and similar institutions potentially enable those groups to attempt to extract price discounts on our products. Our net sales and quarterly growth comparisons may be affected by fluctuations in the buying patterns of major distributors, retail chains and other trade buyers. These fluctuations may result from seasonality, pricing, wholesaler buying decisions or other factors. In addition, many of the major pharmaceutical distributors have experienced downturns and financial constraints which could impact both our sales and the collectibility of our receivables and cause greater consolidation among our customers. The result of these developments may have a material adverse effect on our business, financial condition and results of operations.

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

The FDA s interpretation of legislation regarding the award of 180-day market exclusivity periods to generic manufacturers who challenge patents relating to specific products continues to be the subject of extensive litigation in the United States. Although the FDA s interpretation of legislation may benefit some of the products in our pipeline, it may adversely affect others.

The Medicare Prescription Drug Act provides that the 180-day market exclusivity period provided under the Hatch-Waxman Act is only triggered by the commercial marketing of the product. However, the Medicare Act also contains forfeiture provisions which, if met, will deprive the first Paragraph IV filer of exclusivity. As a result, under certain circumstances, we may not be able to exploit our 180-day exclusivity period since it may be forfeited prior to our being able to market the product.

In addition, legal and administrative battles over triggering dates and shared exclusivities may also prevent us from fully utilizing the exclusivity periods.

If we elect to sell a generic product prior to the final resolution of outstanding patent litigation, we could be subject to liabilities for damages.

At times we or our partners seek approval to market generic products before the expiration of patents for those products, based upon our belief that such patents are invalid, unenforceable, or would not be infringed by

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our products. As a result, we are involved in patent litigations, the outcome of which could materially adversely affect our business. Based upon a complex analysis of a variety of legal and commercial factors, we may elect to market a generic product even though litigation is still pending. This could be before any court decision is rendered or while an appeal of a lower court decision is pending. To the extent we elect to proceed in this manner, if the final court decision is adverse to us, we could be required to cease the sale of the infringing products and face substantial liability for patent infringement. These damages may be significant as they may be measured by a royalty on our sales or by the profits lost by the patent owner and not by the profits we earned. Because of the discount pricing typically involved with generic pharmaceutical products, patented brand products generally realize a significantly higher profit margin than generic pharmaceutical products. In the case of a willful infringer, the definition of which is unclear, these damages may even be trebled. For example, we launched, and continue to sell, generic versions of Allegra®, Neurontin®, Oxycontin® and Zithromax® despite the fact that litigation with the companies that sell these branded products is still pending.

Our sales of Copaxone® could be adversely affected by competition.

Copaxone® is our leading innovative product, from which we derive substantial revenues and profits. To date, we and our marketing partners have been successful in our efforts to establish Copaxone® as the leading therapy for multiple sclerosis and have increased our global market share among the currently available major therapies for multiple sclerosis. However, Copaxone® faces intense competition from existing products, such as Avonex®, Betaseron® and Rebif®. We may also face competition from additional products in development and the expected reintroduction of Tysabri® into the market. In addition, the exclusivity protections afforded us in the United States through orphan drug status for Copaxone® expired on December 20, 2003. If our patents on Copaxone® are successfully challenged, we may also face generic competition for this product.

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

We are subject to extensive pharmaceutical industry regulations in the United States, Canada, the European Union and its member states including England, Hungary, The Netherlands, France and Italy, in Israel and in other jurisdictions. We cannot predict the extent to which we may be affected by legislative and other regulatory developments concerning our products.

We are dependent on obtaining timely approvals before marketing most of our products. In the United States, any manufacturer failing to comply with FDA or other applicable regulatory agency requirements may be unable to obtain approvals for the introduction of new products and, even after approval, initial product shipments may be delayed. The FDA also has the authority to revoke drug approvals previously granted and remove from the market previously approved drug products containing ingredients no longer approved by the FDA. Our major facilities, both in the United States and outside the United States, and our products are periodically inspected by the FDA, which has extensive enforcement powers over the activities of pharmaceutical manufacturers, including the power to seize, force to recall and prohibit the sale or import of non-complying products, and halt operations of and criminally prosecute non-complying manufacturers.

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

Data exclusivity provisions exist in many countries worldwide, including in the European Union and Israel, although their application is not uniform. Similar provisions may be adopted by additional countries or otherwise

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strengthened. In general, these exclusivity provisions prevent the approval and/or submission of generic drug applications to the health authorities for a fixed period of time following the first approval of a novel brand-name product in that country. As these exclusivity provisions operate independently of patent exclusivity, they may prevent the approval and/or submission of generic drug applications for some products even after the patent protection has expired.

We may not be able to successfully identify, consummate and integrate future acquisitions, including our recent acquisition of Ivax.

In the past, we have grown, in part, through a number of significant acquisitions, including our acquisition of Ivax in January 2006 and our acquisition of Sicor Inc. in January 2004. We continue to be engaged in various stages of evaluating or pursuing potential acquisitions and may in the future acquire other pharmaceutical and active pharmaceutical ingredients businesses and seek to integrate them into our own operations. For a more detailed discussion regarding our acquisition of Ivax, read carefully the section below entitled Risks Associated with Our Acquisition of Ivax.

Future acquisitions involve known and unknown risks that could adversely affect our future revenues and operating results. For example:

- We may fail to successfully integrate our acquisitions in accordance with our business strategy.
- We compete with others to acquire companies. We believe that this competition has intensified and may result in decreased availability or increased prices for suitable acquisition candidates.
- We may not be able to obtain the necessary regulatory approvals, including the approval of anti-competition regulatory bodies, in any countries in which we may seek to consummate potential acquisitions.
- We may ultimately fail to consummate an acquisition even if we announce that we plan to acquire a company.
- Potential acquisitions may divert management s attention away from our primary product offerings, resulting in the loss of key customers and/or personnel and expose us to unanticipated liabilities.
- We may not be able to retain the skilled employees and experienced management that may be necessary to operate the businesses we may acquire and, if we cannot retain such personnel, we may not be able to locate or hire new skilled employees and experienced management to replace them.
- We may purchase a company that has contingent liabilities that include, among others, known or unknown patent or product liability claims.

As a pharmaceutical company, we are susceptible to product liability claims that may not be covered by insurance, including potential claims relating to products that we previously sold or currently sell and that are not covered by insurance.

Our business inherently exposes us to claims relating to the use of our products. We sell, and will continue to sell, pharmaceutical products for which product liability insurance coverage is not available, and, accordingly, we may be subject to claims that are not covered by insurance as well as claims that exceed our policy limits. Additional products for which we currently have coverage may be excluded in the future. In addition, product liability coverage for pharmaceutical companies is becoming more expensive and increasingly difficult to obtain. As a result, we may not be able to obtain the type and amount of coverage we desire. Because of the nature of these claims, we are generally not permitted under U.S. GAAP to establish reserves in our accounts for such contingencies.

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Reforms in the health care industry and the uncertainty associated with pharmaceutical pricing, reimbursement and related matters could adversely affect the marketing, pricing and demand for our products.

Increasing expenditures for health care have been the subject of considerable public attention in almost every jurisdiction where we conduct business. Both private and governmental entities are seeking ways to reduce or contain health care costs. In many countries in which we currently operate, including Israel, pharmaceutical prices are subject to regulation. In the United States, numerous proposals that would effect changes in the United States health care system have been introduced or proposed in Congress and in some state legislatures, including the enactment in December 2003 of expanded Medicare coverage for drugs, which became effective in January 2006. Similar activities are taking place throughout Europe and Israel. We cannot predict the nature of the measures that may be adopted or their impact on the marketing, pricing and demand for our products.

The success of our innovative products depends on the effectiveness of our patents, confidentiality agreements and other measures to protect our intellectual property rights.

Our success with our innovative products may depend, in part, on our ability to protect our current and future innovative products and to defend our intellectual property rights. If we fail to adequately protect our intellectual property, competitors may manufacture and market products identical or similar to ours. We have been issued numerous patents covering our innovative products, and have filed, and expect to continue to file, patent applications seeking to protect newly developed technologies and products in various countries, including the United States. Any existing or future patents issued to or licensed by us may not provide us with any competitive advantages for our products or may be challenged, invalidated or circumvented by competitors. In addition, such patent rights may not prevent our competitors from developing, using or commercializing products that are similar or functionally equivalent to our products.

We also rely on trade secrets, unpatented proprietary know-how, trademarks, data exclusivity and continuing technological innovation that we seek to protect, in part by confidentiality agreements with licensees, suppliers, employees and consultants. It is possible that these agreements will be breached and we will not have adequate remedies for any such breach. Disputes may arise concerning the ownership of intellectual property or the applicability of confidentiality agreements. Furthermore, our trade secrets and proprietary technology may otherwise become known or be independently developed by our competitors or, if patents are not issued with respect to products arising from research, we may not be able to maintain the confidentiality of information relating to such products.

We have significant international operations, including in Israel, which may be adversely affected by acts of terrorism, major hostilities or adverse legislation or litigation.

Significant portions of our operations are conducted outside of the United States, and we import a substantial number of products into the United States. We may, therefore, be directly affected and denied access to our customers by a closure of the borders of the United States for any reason or as a result of other economic, political and military conditions in the countries in which our businesses are located. We may also be affected by currency exchange rate fluctuations and the exchange control regulations of such countries or other political crises or disturbances, which impede access to our suppliers.

Our executive offices and a substantial number of our manufacturing facilities are located in Israel. Our Israeli operations are dependent upon materials imported from outside of Israel. We also export significant amounts of products from Israel. Accordingly, our operations could be materially and adversely affected by acts of terrorism or if major hostilities should occur in the Middle East or trade between Israel and its present trading partners should be curtailed, including as a result of acts of terrorism in the United States or elsewhere. Any such effects may not be covered by insurance.

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

Our failure to comply with applicable environmental laws and regulations worldwide could adversely impact our business and results of operations.

We are subject to laws and regulations concerning the environment, safety matters, regulation of chemicals and product safety in the countries where we manufacture and sell our products or otherwise operate our business. These requirements include regulation of the handling, manufacture, transportation, use and disposal of materials, including the discharge of pollutants into the environment. In the normal course of our business, we are exposed to risks relating to possible releases of hazardous substances into the environment which could cause environmental or property damage or personal injuries, and which could require remediation of contaminated soil and groundwater. Under certain laws, we may be required to remediate contamination at certain of our properties regardless of whether the contamination was caused by us, or by previous occupants of the property.

In recent years, the operations of all companies have become subject to increasingly stringent legislation and regulation related to occupational safety and health, product registration and environmental protection. Such legislation and regulations are complex and constantly changing, and we cannot assure you that future changes in laws or regulations would not require us to install additional controls for certain of our emission sources, to undertake changes in our manufacturing processes or to remediate soil or groundwater contamination at facilities where such clean-up is not currently required.

Risks Associated with Our Acquisition of Ivax

We may experience difficulties in integrating Ivax s business with our existing businesses.

The acquisition involves the integration of two companies that have previously operated independently. The difficulties of combining the companies operations include:

the necessity of coordinating and consolidating geographically separated organizations, systems and facilities; and

the integration of our management and personnel with that of Ivax, while maintaining employee morale and retaining key employees. In addition, as a result of the Ivax acquisition, we will be assuming its contingent liabilities.

The process of integrating operations could cause an interruption of, or loss of momentum in, the activities of one or more of the combined company s businesses, the loss of key personnel and issues relating to our internal control over financial reporting. The diversion of management s attention and any delays or difficulties encountered in connection with the acquisition and the integration of Ivax s operations could have an adverse effect on our business, results of operations, financial condition or prospects.

Achieving the anticipated benefits of the acquisition will depend in part upon whether we can integrate Ivax s businesses in an efficient and effective manner. We may not accomplish this integration process smoothly or successfully. If management is unable to successfully integrate the operations, the anticipated benefits of the acquisition may not be realized.

We may not achieve the revenue and cost synergies we have anticipated for the combined company.

Our rationale for the Ivax acquisition is, in part, predicated on the projected ability of the combined company to realize certain revenue and cost synergies. Achieving these synergies is dependent upon a number of factors, some of which are beyond our control. These synergies may not be realized in the amount or time frame that we currently anticipate.

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Charges to earnings resulting from the Ivax acquisition could have a material adverse impact on our results of operations.

In accordance with U.S. GAAP, we will allocate the total purchase price of the acquisition to Ivax s net tangible assets, amortizable intangible assets, intangible assets with indefinite lives and in-process research and development, based on their fair values as of the date of completion of the acquisition. We will record the excess of the purchase price over those fair values as goodwill. We will expense a portion of the purchase price allocated to in-process research and development in the first quarter of 2006. The preliminary estimate of the amount to be expensed related to in-process research and development is $1,300 million. We will also be required to step-up the value of Ivax s inventory on the date of our acquisition of Ivax. As a result of the Ivax acquisition, we will also incur additional depreciation and amortization expense over the useful lives of certain of the net tangible and intangible assets acquired in connection with the acquisition. Annual amortization of intangible assets of Ivax, currently estimated at $28.4 million for 2006, will result in an estimated increase in amortization expense of $71.6 million on an annual basis. In addition, to the extent the value of goodwill or intangible assets becomes impaired in the future, we may be required to incur material charges relating to the impairment of those assets. These amortization and in-process research and development and potential impairment charges could have a material impact on our results of operations.

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ITEM 4: INFORMATION ON THE COMPANY

Teva Pharmaceutical Industries Limited is a global pharmaceutical company producing drugs in all major treatment categories. It is the world s leading generic drug company and has the leading position in the U.S. generic market. Teva has successfully utilized its production and research capabilities to establish a global pharmaceutical operation focused on supplying the growing demand for generic drugs and on opportunities for proprietary branded products for specific niche categories, with its leading branded drug being Copaxone® for multiple sclerosis. Teva s active pharmaceutical ingredients (API) business provides both significant revenues and profits from sales to third-party manufacturers and strategic benefits to Teva s own pharmaceutical production through its timely delivery of significant raw materials.

Teva s operations are conducted directly and through subsidiaries in Israel, Europe, North America and several other jurisdictions. During 2005, Teva generated approximately 60% of its sales in North America, 29% in Europe and 11% in the rest of the world, predominantly in Israel. For a breakdown of Teva s sales by business segment and by geographic market for the past three years, see Item 5: Operating and Financial Review and Prospects Results of Operations Sales General.

Teva was incorporated in Israel on February 13, 1944 and is the successor to a number of Israeli corporations, the oldest of which was established in 1901. Its executive offices are located at 5 Basel Street, P.O. Box 3190, Petach Tikva 49131 Israel, telephone number 972-3-926-7267.

Ivax Acquisition. On January 26, 2006, Teva completed its acquisition of Ivax Corporation, a multinational generic pharmaceutical company with headquarters in Miami, Florida and with operations mainly in the United States, Europe and Latin America, for approximately $3.8 billion in cash and 123 million ADRs. For accounting purposes, the transaction was valued at $7.9 billion, based on the value of the ADRs during the five trading day period commencing two trading days before the date of the merger agreement with Ivax.

This acquisition, Teva s largest to date, enhances Teva s leadership position in the United States, expands its strong presence in Western Europe and significantly boosts Teva s reach in Latin America, Russia and other Central and Eastern European countries. The acquisition further provides Teva with an opportunity to expand the vertical integration between Teva s API business and Ivax s finished dose manufacturing operations in both existing and new regions. Ivax brings Teva new capabilities in the respiratory business, including proprietary technologies. In addition, it provides Teva with an enhanced innovative pipeline focused on the central nervous system and cancer, with products in various stages of clinical development. Ivax also adds to Teva s existing veterinary business through the Ivax animal health business. The acquisition strengthens Teva s ability to respond, on a global scale, to a wider range of requirements of patients, customers and healthcare providers, both therapeutically and economically. As a result of the acquisition, Teva now has direct operations in more than 50 markets, as well as 44 pharmaceutical manufacturing sites, 15 generic R&D centers operating mostly within those sites and 18 API sites around the world.

Pharmaceutical Products

Generic Products

Teva is the world s leading generic drug company. Generic drugs are the chemical and therapeutic equivalents of brand-name drugs, typically sold under their generic chemical names at prices below those of their brand-name equivalents. These drugs are required to meet similar governmental regulations as their brand-name equivalents and must receive regulatory approval prior to their sale in any given country. Generic drugs may be manufactured and marketed only if relevant patents on their brand-name equivalents (and any additional government-mandated market exclusivity periods) have expired, been challenged and invalidated, or otherwise legally circumvented.

Global generic pharmaceutical consumption has been positively impacted in recent years by the increased awareness and acceptance among consumers, physicians and pharmacists that generic drugs are the equivalents

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of brand-name drugs. Among the factors contributing to this increased awareness are the passage of legislation permitting or encouraging substitution and the publication by regulatory authorities of lists of equivalent drugs, which provide physicians and pharmacists with generic drug alternatives. In addition, various government agencies and many private managed care or insurance programs encourage the substitution of generic drugs for brand-name pharmaceuticals as a cost-savings measure in the purchase of, or reimbursement for, prescription drugs. Teva believes that these factors, together with demographic trends, including an aging population and a corresponding increase in health care costs, as well as the large volume of branded products losing patent protection over the coming years, should lead to continued expansion of the generic pharmaceuticals market.

Through the coordinated efforts of research and development staff in Israel, Europe, North America and India, and through alliances with other companies, Teva seeks to constantly expand its range of generic products. Teva s product development strategy emphasizes not only introducing its generic products upon the patent expiration date of the equivalent brand-name pharmaceutical, but also the goal of market introduction at the earliest possible date, which may involve attempting to invalidate or otherwise validly circumvent such patents.

Teva is able to differentiate itself from its competitors in its major markets by offering a range of capabilities that it believes ultimately adds value for its customers and enhances Teva s business:

- global research and development facilities that have provided Teva with both the broadest product line and the most extensive generic pipeline in the U.S. and a leading generic pipeline globally;
- manufacturing facilities inspected by the FDA and other regulatory authorities and located in a variety of countries around the world, which provide Teva with a broad array of production technologies and with the ability to concentrate production to achieve economies of scale; and
- its own active pharmaceutical ingredient business that offers stability of high-quality supply as well as vertical integration efficiencies.

North America

Teva Pharmaceuticals USA Inc. (Teva USA), Teva s principal subsidiary, is the leading generic drug company in the United States. Teva USA markets approximately 250 generic products representing approximately 680 dosage strengths and packaging sizes, which are distributed and sold in the United States. In addition, Teva USA has the capability to formulate, fill, label and package finished dosage forms of injectable pharmaceutical products, which are principally sold in the United States. Teva believes that a broad line of products has been and will continue to be of strategic significance as the generics industry continues to grow and as it experiences the effects of consolidation among purchasers, including large drugstore chains, wholesaling organizations, buying groups and managed care providers.

Through Novopharm Limited, Teva manufactures and markets generic prescription drugs in Canada. Novopharm is the second largest generic drug company in Canada with a product portfolio covering approximately 80% of the Canadian generic market sales requirements. Novopharm s portfolio includes 170 generic products representing over 700 dosage forms and packaging sizes.

Ivax Acquisition: In addition to the above products marketed by Teva USA, in the United States Ivax manufactures and markets approximately 76 generic drugs in capsule or tablet forms in an aggregate of approximately 181 dosage strengths. Ivax also distributes in the United States approximately 158 additional generic prescription and over-the-counter drugs and vitamin supplements, in various dosage forms, dosage strengths and package sizes. Ivax s domestic generic drug distribution network encompasses most trade classes of the pharmaceutical market, including wholesalers, retail drug chains, retail pharmacies, mail order companies, managed care organizations, hospital groups, nursing home providers and government agencies.

Products. Teva USA manufactures and sells all types of generic pharmaceutical products in a variety of dosage forms, including tablets, capsules, ointments, creams, liquids, injectables and, through its recent

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acquisition of Ivax, inhalers. During 2005, Teva sold the generic versions of the following branded products in the United States that were not sold during 2004 (listed in the order of their launch during the year): Augmentin® (chewable tablets and suspension), Glucovance®, Calcijex®, Depo-Medrol®, Diflucan®, Clozaril®, Lamictal®, Biaxin®, Cleocin®, Remeron®, Allegra®, Arava®, Depo-Provera®, Retrovir®, Paxil®, Amaryl®, Vasotec®, Prostigmin®, Metaglip®, Aredia®, Sandostatin®, Sandostatin LAR®, Zithromax®, Copegus® and Cefzil® (tablets and suspension).

The FDA requires companies to submit abbreviated new drug applications (ANDAs) for approval to manufacture and market generic forms of brand-name drugs. During 2005, Teva received in the United States 27 final generic drug approvals and 16 tentative approvals. The 16 tentative approvals received were for generic equivalents of the following products: Levaquin® (injectables three dosage forms), Topamax® (capsules), Zyprexa®, Norvasc®, Ambien®, Ultracet®, Actonel®, Kytril® (multidose and single dose), Cipro®, Tequin®, Sonata®, Provigil® and Zocor®. A tentative approval letter indicates that the FDA has substantially completed its review of an application and final approval is expected once the relevant patent expires, a court decision is reached or the 30 month stay elapses.

Teva s potential for revenue growth of generic products in the United States is closely related to its pipeline of pending ANDAs with the FDA, as well as tentative approvals already granted. As of February 28, 2006, Teva (including products acquired through the Ivax acquisition) had 160 product registrations awaiting FDA approval (including some from strategic partnerships), including 38 tentative approvals. Collectively, the brand-name versions of these products had corresponding U.S. 2005 sales exceeding $94 billion. Of these applications, 88 were Paragraph IV applications, i.e., applications that challenge patents of branded products. Teva believes it is the first to file on 49 of these applications, the branded products for which have aggregate annual U.S. sales of more than $37 billion in 2005. Branded product market size is a commonly used measurement of the relative significance of a potential generic product. Generic equivalents of any given product are typically sold at prices below the branded price, and in those instances where there are multiple generic producers of the same product, substantially below the branded price.

In most instances, FDA approval is granted on the expiration of the underlying patents. However, companies are rewarded with a period of marketing exclusivities, as provided by law, for successfully challenging or circumventing these patents. As part of its strategy, Teva actively reviews pharmaceutical patents and seeks opportunities to challenge those patents where it believes that such patents are either invalid or are not infringed by the generic version. Aside from the financial benefits of marketing exclusivities, Teva believes that these activities improve health care by allowing consumers quicker access to more affordable, high quality medications.

In Canada, the Therapeutic Products Directorate of Health Canada requires companies to make an Abbreviated New Drug Submission (ANDS) in order to receive approval to manufacture and market generic pharmaceuticals. During 2005, Novopharm launched 13 generic equivalents of the following brand products: Arava®, Wellbutrin®, Inhibace®, Fosamax Once Weekly®, Monopril®, Monocor®, Coumadin®, Imitrex®, Topamax®, Tenormin®, Zithromax®, Propofol Injectable® and Carboplatin Injectable®.

In 2005, Novopharm submitted applications for 34 products to the Therapeutic Products Directorate of Health that are still awaiting approval. Collectively, the brand name versions of the products subject to pending applications by Novopharm (including those submitted in 2005) had annual Canadian sales in 2005 of approximately U.S. $4.1 billion.

Collaborations. As part of its strategy to reach the market with generic versions as early as possible, Teva seeks to enter into alliances with partners to acquire rights to products it does not have and/or to otherwise share development costs or litigation risks or resolve patent barriers to entry. Teva s most significant arrangements are described below in chronological order:

In 1997, Teva and Biovail Corporation International entered, through subsidiaries, into a ten-year marketing and product development agreement that provided Teva with exclusive U.S. marketing rights for certain of

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Biovail s pipeline of controlled-release generic versions of successful brands. Biovail was responsible for the regulatory filing and approval process as well as for manufacturing the products. The products currently marketed by Teva USA under this arrangement are generic versions of Trental®, Cardizem®CD, Adalat®CC, Procardia XL® and Voltaren®XR.

This 1997 agreement with Biovail was extended in 2004 by an additional four-year period and also granted Teva an option to market an additional generic product currently under development by Biovail. Furthermore, under the 2004 amendment, Biovail transferred all development and intellectual property rights for two additional extended-release generic products, which Teva will have the right to independently develop and ultimately manufacture. In consideration for these agreements, Teva made up-front payments and has committed to certain milestone payments. As part of the 2004 amendment, the gross margin percentage shared with Biovail was modestly increased for the remaining extended term. Teva and Biovail have also entered into a long-term API supply agreement under which Biovail will increase its purchases of raw material from Teva.

In June 2001, Teva entered into a strategic alliance agreement for twelve controlled-release generic pharmaceutical products with Impax Laboratories, Inc. The agreement grants Teva exclusive U.S. marketing rights and an option to acquire exclusive marketing rights in the rest of North America, Latin America, the European Union and Israel. Teva subsequently exercised its option with respect to the marketing rights of certain products in Canada. The products subject to the agreement include the following products as to which Impax had pending ANDAs at the FDA and has now received final or tentative approval: generic versions of Claritin® D12, Claritin® D24, Claritin® Reditabs, Wellbutrin® SR tablets, Zyban® tablets, Prilosec® capsules, Ditropan® XL and Allegra® D12H. During 2004, generic versions of Wellbutrin® SR tablets, Zyban® tablets and Prilosec® capsules were launched.

In December 2003, Teva entered into a strategic alliance agreement with Andrx Pharmaceuticals, Inc. to develop and market generic oral contraceptive pharmaceutical products. The agreement grants Teva exclusive marketing rights in the U.S. and Canada to Andrx s line of generic oral contraceptive products currently pending regulatory approval. Andrx is responsible for all formulations, U.S. regulatory submissions and the manufacturing of products covered under the agreement. The agreement also provides Teva with an option to acquire from Andrx similar marketing rights in the U.S. and Canada to additional oral contraceptive products that are currently in development but have not yet been submitted for regulatory approval as well as other future oral contraceptive products that the parties agree upon.

Teva participates in an exclusive U.S. distribution arrangement with Baxter Healthcare Corporation for the generic version of Propofol®. Under the agreement, Teva produces the product and sells it to Baxter, which then performs all marketing and distribution functions related to the product. The contract pays Teva a manufacturing fee and an additional profit split based on gross margin.

In April 2004, Teva entered into an exclusivity sharing agreement with Alpharma Inc. pertaining to the distribution of gabapentin, the generic version of Neurontin®, tablets and capsules. Alpharma held statutory exclusivity for these generic products. Under the terms of the agreement, Alpharma permitted Teva to launch its generic version of Neurontin® in the U.S. within Alpharma s exclusivity period in exchange for royalties on sales. In addition, the parties agreed to certain risk-sharing arrangements relating to patent litigation risks regarding the products. Teva s capsules and tablets were launched in October and December 2004, respectively. This product is the subject of patent litigation more fully described under Contingent Liabilities included in Note 8 to Teva s consolidated financial statements included in this report.

In June 2005, Teva entered into a strategic alliance arrangement with Barr Pharmaceuticals, Inc. for the marketing rights in the U.S. for the generic version of Allegra® (fexofenadine) tablets. Under the agreement, Barr enabled Teva to launch its own product, with the parties sharing profits. The percentage of profit share to Barr is dependent on multiple factors including the number of competitors and resolution of related patent litigation with Sanofi-Aventis. The parties have agreed to share the patent litigation risks on a proportionate basis to that of the

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profit split arrangement. The generic version of Allegra® was launched in September 2005. This product is the subject of a patent litigation more fully described under Contingent Liabilities included in Note 8 to Teva s consolidated financial statements included in this report.

Recent Litigation Settlements. During 2005, Teva entered into a number of agreements settling patent litigation between it and branded companies, where it found it advantageous to enter into agreements to accelerate the entry of its products to the market. Teva believes that these agreements benefit all relevant parties. While generic companies and U.S. consumers benefit from an increased likelihood of bringing generic products to the market at an earlier date, branded companies benefit from increased predictability. Teva will continue to judge any potential future settlements on a case-by-case basis. Below are examples of settlements Teva reached during 2005:

In February 2005, as settlement of a patent dispute with GlaxoSmithKline (GSK) over the generic version of Lamictal®, GSK granted Teva an exclusive royalty-bearing license to distribute generic lamotrigine chewable tablets (5 mg and 25 mg) in the United States no later than June 2005. GSK also granted Teva the exclusive right to manufacture and sell its own generic version of lamotrigine tablets (25 mg, 100 mg, 150 mg and 200 mg) in the U.S., with an expected launch in 2008 prior to patent expiry in July 2008 (plus six months of expected pediatric exclusivity).

In October 2005, as settlement of a patent dispute with Wyeth over the generic version of Effexor XR®, Wyeth granted Teva a royalty-bearing license to manufacture and sell generic Effexor XR® in the United States no later than July 2010. The license is exclusive for the first six months after launch by Teva.

In December 2005, as settlement of a patent dispute with Cephalon Inc. over the generic version of Provigil®, Cephalon granted Teva a non-exclusive royalty-bearing license to manufacture and distribute a generic form of the product. Concurrently, Teva granted Cephalon a non-exclusive royalty-bearing license to certain rights concerning the manufacture of generic drugs. In addition, Teva agreed to supply Cephalon with modafinil, the active ingredient in Provigil®.

Marketing and Sales. The marketing of generic pharmaceutical products in the United States is conducted through Teva USA. During 2005, 54% of Teva USA s sales were made to drug store chains, 30% to drug wholesalers, 7% to generic distributors, hospitals and affiliated organizations, 7% to managed care institutions and 2% to others, including mail order distributors, governmental institutions and managed care institutions.

Teva USA has a sales force that actively markets Teva USA s products. Key account representatives for generic products call on purchasing agents for chain drug stores, drug wholesalers, health maintenance organizations, pharmacy buying groups and nursing homes. Teva USA also contacts its retail customers and supports its wholesale selling effort with telemarketing as well as professional journal advertising and exhibitions at key medical and pharmaceutical conventions. From time to time, Teva USA bids for government-tendered contracts.

Finished-dosage injectable pharmaceutical products are primarily used in hospitals and clinics for critical care, anesthesiology and cancer, and are marketed through a dedicated sales force and its marketing partners, as well as through relationships with hospital group purchasing organizations, managed care groups and other large health care purchasing organizations.

In Canada, Novopharm has a sales force which markets its products to approximately 7,500 pharmacies. Novopharm also has a hospital sales division, which covers approximately 900 hospitals throughout Canada. The business is conducted primarily through multi-year contracts with major group purchasing organizations, or buying groups to which many hospitals belong. Novopharm is the generic market leader within this segment, and offers over 50 generic injectable dosage forms.

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Europe

The European market as a whole is Teva s second largest generic market, following the United States. The European generics market varies considerably from country to country: in certain European countries, there is a market for both branded generic products and drugs sold under their generic chemical names; in other European countries, there is a market for branded generics only. In any event, in the newly expanded European Union (EU), the generic pharmaceutical industry is becoming an increasingly important supplier of pharmaceuticals. While some European generic markets, such as the United Kingdom, The Netherlands, Germany and Denmark, reach a 40% to 55% share of total pharmaceutical sales, when measured by unit volumes, other European countries, such as France, Italy and Portugal, still have a relatively small generic market with penetration of less than 15%.

In 2005, among the significant products sold by Teva in Europe were the generic versions of Lipitor®, Zithromax®, Lamictal®, Zoton®, Seroxat/Deroxat®, Staril/Fosinopril® and Fosamax Once Weekly® that were launched in 2004 and 2005. In 2005, Teva received 357 generic approvals, corresponding to 22 new compounds in 56 formulations. In addition, in Europe, as of February 28, 2006, excluding products acquired through the Ivax acquisition, Teva had 125 compounds representing 260 formulations and 810 marketing authorization applications pending approval, with over 280 additional compounds approved for development. Teva believes that this pipeline of approvals and applications will generate significant growth in the next several years and includes important products, some of which Teva expects to launch in 2006 in various EU countries.

Teva has experienced rapid growth in the fragmented European market over the last few years. This growth has been generated by a combination of development, registration, launch of new generic products and marketing activities, as well as acquisitions (the latest being Dorom S.r.l in Italy at the end of 2004 and Medika AG in Switzerland in July 2005), and, to a lesser extent, the establishment of new operations in the Slovak Republic, Spain, Sweden and Portugal. Teva is now the leading generic pharmaceutical company in the U.K., The Netherlands and Italy.

Ivax Acquisition: The acquisition of Ivax provides Teva with new and significant opportunities in Europe. Teva is expected to benefit from Ivax s substantial presence in the U.K., France, the Czech Republic and Poland. This acquisition will also allow Teva to enter into the asthma/chronic obstructive pulmonary disease and the immunosuppressant segments, which are both important markets in Europe.

In Europe, Ivax operates a group of companies that manufactures and markets a significant portfolio of generic prescription products within the European Economic Area (EEA) and in Eastern European territories outside of the EEA. Ivax also distributes throughout Europe generic prescription and over-the-counter drugs and vitamin supplements, in various dosage forms, dosage strengths and package sizes. Ivax s European generic drug distribution network encompasses most trade classes of the pharmaceutical market, including wholesalers, retail drugstore chains, retail pharmacies, mail order companies, managed care organizations, hospital groups, nursing home providers and government agencies.

Operations in Selected European Countries

United Kingdom. In 2005, Teva consolidated its position as leader of the U.K. generics market driven by product launches as well as increased sales and marketing activities. Teva launched generic versions of Fosamax Once Weekly®, Staril®, Lamictal®, Lustral® and Zoton®. Teva benefited from its generic sales force, the largest in the U.K., which led to a significant increase in its market share, with particular growth in the independent community pharmacy sector.

The Netherlands. The Dutch market continues to be characterized by increasing price erosion as pressure from the government and buyers negatively impacts margins. Through Pharmachemie B.V., its Dutch subsidiary, Teva maintained its leading position in the generic market in 2005, as well as its market share. Teva launched during 2005, among others, generic versions of Fosamax Once Weekly®, Lamictal® and Newace®, which represented key new product opportunities. The reimbursement prices for multi-source products were reduced

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substantially after negotiations among the government, the insurers, the generic manufacturers and the pharmacists association. The result was that discounts were exchanged for reduced list prices for generic products. A further result of the negotiations was that a number of generic products that were also available as over-the-counter products in the Dutch market were removed from the reimbursement list, which had a negative effect on their sales.

Hungary. Teva operates in Hungary through its subsidiaries: Teva Pharmaceutical Works Private Limited Company (Teva Pharmaceutical Works), Teva Hungary Pharmaceutical Marketing Company Limited by Shares and Humantrade Pharmaceutical Wholesale Company Limited by Shares. Teva Pharmaceutical Works, one of the largest pharmaceutical manufacturers in Hungary, develops and produces both finished dosage pharmaceutical products and API. Teva Pharmaceutical Works products include pharmaceuticals in all major treatment categories, and its production capabilities include solid forms, tablets, coated pellets, soft and hard gelatin capsules, liquid and other semi-solid forms, as well as sterile products and blood fractionation products. In 2005, the company substantially strengthened its position as a result of increased sales of the generic version of Tritace® and launched new products such as the generic version of Norvasc®. The sale of finished dosage pharmaceutical products in Hungary and to other Teva subsidiaries outside Hungary represented approximately 60% of Teva Pharmaceutical Works sales, with the balance coming from sales of APIs. Humantrade Co. Ltd. is the marketing company of Teva in Hungary, a wholesale company that distributes both Teva products and products of other manufacturers to pharmacies and hospitals in Hungary and is one of the leading companies in the market.

France. While market conditions in France remained challenging in 2005, Teva Classics S.A., Teva s French subsidiary, launched a number of significant products, including the generic equivalent of Neurontin® and Zocor®. At the end of 2005, the French government introduced new measures to determine prices of generic and innovative products, which are intended to increase generic substitution.

Italy. Teva Pharma Italia S.r.l. was established and commenced operations in the mid-1990 s. Since the end of 2004, following its launch of the generic version of Neurontin®, as well as the acquisition of Dorom S.r.l., the company achieved a leading position in the retail generic market in addition to its well-established position in hospital anticancer generics. Dorom s leading products are the generic versions of Tiklid®, Aulin® and Tavor®. Market conditions in Italy are marked by the Italian government s efforts to reduce the prices of pharmaceutical products by fixing the prices of newly launched generic products and promoting reference prices.

Other European Highlights. Teva continues to register products in most European countries and is actively exploring the expansion of its sales and marketing organization to markets where it currently does not have a presence. Teva has several small operations in Germany, Belgium and the Czech Republic and continues to look for ways to expand them. In 2004, Teva established subsidiaries in Spain, Sweden, Portugal and the Slovak Republic, which started their commercial activities in 2005. The purchase of Medika AG in July 2005 also created the opportunity for Teva to establish its presence in Switzerland.

Israel and Other Countries

Teva s pharmaceutical sales outside of North America and Europe reached $488 million in 2005. The Israeli market represented approximately 58% of these sales, with the balance sold through Teva s International Products Division.

Israel. Teva is the largest non-governmental supplier of health care products and services in Israel. In the domestic market, Teva is involved in the marketing, promotion, selling and distribution of a wide range of health care products. These include innovative pharmaceutical products, generics, over-the-counter and consumer health care products, hospital supplies, dialysis equipment and disposables, diagnostics and home care services. In recent years, Teva has increased its distribution and wholesaling activities in Israel.

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In Israel, Teva has aligned all of its products and services with the needs of its main customers, namely health funds, hospitals, private pharmacies and pharmacy chains. It has built its Israeli product portfolio through licensing arrangements, as well as through its own product development. Teva intends to introduce new products into the Israeli market and maintains ongoing contact with other pharmaceutical, biotechnology, hospital supply and health care companies around the world.

Teva estimates that in 2005 the Israeli market for pharmaceuticals was approximately $720 million based on manufacturers selling prices, comprised of three market categories: health care plans, private pharmacies/chains and governmental hospitals. Teva is a significant medical supplier to each of these market categories. Substantially all of Teva s pharmaceutical and hospital supplies sales in Israel are made through its distribution company, Salomon, Levin and Elstein Ltd., Israel s largest drug wholesaler, which sells directly to institutional customers, as well as to the private pharmacies and chains. New regulations which became effective in May 2005 enable sales of some over-the-counter products for the first time in many retail locations in addition to pharmacies (such products sold outside of pharmacies are referred to as general sales list). However, major retail stores have not yet started selling general sales list products.

Several issues affected Teva s product pricing in Israel in 2005. While the national health budget was increased during 2005, government-sponsored health funds continue to conduct cost-saving measures restricting expenditures for pharmaceutical products. Furthermore, Teva s prices were affected by pricing regulations that mandate that the retail prices of pharmaceuticals in Israel may not exceed the average of prices in four European markets (the U.K., Germany, France and Belgium) (the so-called Dutch Model). Lastly, and to a lesser degree, the Israeli health care funds utilized parallel importing, primarily to pressure the prices of Israeli producers.

Other countries. Teva s International Products Division oversees Teva s various activities in the rest of the world. Its focus is on pharmaceuticals, mainly Copaxone®, Alpha D3® (Teva s bone metabolism product) and a line of cancer products. Sales include direct exports from Israel and sales from Teva s other manufacturing sites. Sales are made through affiliated companies, local representatives and distributors in the different markets.

In 2005, Teva completed the integration of Sicor s operations in Mexico and leveraged its marketing platforms and increased product breadth in its international markets. These Mexican operations serve both government and private sectors with a wide variety of injectable oncolytic agents, biopharmaceutical and critical care products. During 2005, Teva commenced registration activities of generic products in Japan and enhanced its registration activities in Turkey and Russia.

Ivax Acquisition: As a result of its acquisition of Ivax, Teva now owns Ivax s subsidiaries in Argentina, Chile, Mexico, Peru, Uruguay and Venezuela that market and sell mostly branded non-proprietary pharmaceutical products in their respective countries. The pharmaceutical products are marketed in these countries by over a thousand sales representatives.

Biopharmaceutical Operations

Teva s biopharmaceutical operations provide a platform for developing, manufacturing and marketing biopharmaceutical products. Teva s Lithuanian subsidiary develops and manufactures generic recombinant protein bulk substances that are and are expected to be registered and marketed in various countries worldwide. Teva s finished dosage biopharmaceutical manufacturing facility in Toluca, Mexico became operational in 2002. Teva s biopharmaceutical operations also include a 45% ownership interest in Tianjin Hualida Biotechnology Company Ltd., a biopharmaceutical development and manufacturing company located in China and capable of producing bulk recombinant proteins and finished products. Teva has recently entered into an agreement to increase its interest in Hualida to 60%.

During 2005, Teva s biopharmaceutical marketed product portfolio included interferon alpha 2b, granulocyte colony-stimulating factor (GCSF) and human growth hormone (hGH). Teva s sales of hGH in

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the U.S. market began in 2005 pursuant to an agreement originally entered into with Savient Pharmaceuticals Inc. In 2005, Teva also established a dedicated R&D group based in Israel and specializing in the development of mammalian cell culture products.

At present, the EMEA is expected to finalize guidelines on biosimilar products within the first half of 2006. Once these guidelines are released, Teva will be able to determine its plans for the development and sale of biosimilar products in Europe. See Regulation Europe below.

Proprietary Products

Teva s strategy with regard to its proprietary products is to leverage its access to Israeli-based academic research and start-up companies in order to develop innovative compounds for use in selected therapeutic markets. Teva s proprietary research and development pipeline is currently focused mainly in three specialty areas: neurological disorders, autoimmune diseases and cancer.

In conducting its research and development, Teva seeks to manage its resources conservatively and to limit its risk exposure. At the drug discovery phase, Teva leverages its relationship with the Israeli academic community and start-up companies to gain early access to potential projects. Once these projects progress into the more costly clinical study phase, Teva s strategy is to explore corporate partnering options through which it can share financial as well as other risks associated with each project.

Ivax Acquisition: Ivax markets in various countries a number of proprietary and brand name products treating a variety of conditions. These products are marketed by Ivax s direct sales forces to physicians, pharmacies, hospitals, managed health care organizations and government agencies. Ivax has substantial expertise in the development, manufacture and marketing of respiratory drugs, primarily for bronchial asthma, delivered by metered-dose and dry powder inhalers. At the core of Ivax s respiratory business franchise is an advanced delivery system, a breath-activated inhaler called Breathmatic® in the United States and Easi-Breathe® in other countries, and a patented dry powder inhaler, as well as conventional metered-dose inhalers.

Multiple Sclerosis

Copaxone®

Copaxone®, Teva s leading product and its first major innovative drug, is now the leading multiple sclerosis (MS) therapy in the United States in terms of total prescriptions as well as new prescriptions. Copaxone®, which is indicated for the reduction of relapse rate in patients with relapsing-remitting MS, is a new class of modifying therapy with a dual mode of action that offers MS patients a different treatment concept.

Multiple sclerosis is a chronic disease of the central nervous system characterized by both inflammation and neurodegeneration, which are interrelated but are also independent of each other. Copaxone® effectively addresses both MS pathologies via its unique dual mode of action.

Copaxone® regulates inflammation as shown by the significant reduction of relapses in the short term and the reduction in disease activity, as monitored by magnetic resonance imaging (MRI).

Copaxone® also controls neurodegeneration, as demonstrated by: (1) reduction of 50% in the evolution of new lesions into permanent black holes (permanent MS lesions in the brain), which represent areas where the most severe and irreversible brain tissue damage has occurred (*Neurology* 2001); (2) significant reduction in the rate of brain atrophy (*Neurology* 2004); (3) significant reduction of axonal damage, as demonstrated by magnetic resonance spectroscopy, a technique which looks at the integrity of neuron function (*Multiple Sclerosis* 2005); and (4) significant secretion of a brain-derived neurotrophic factor, BDNF, which helps to protect the brain from axonal loss (*Brain* 2002, *J Neurological Sciences* 2003).

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Furthermore, Copaxone® has demonstrated sustained efficacy over 10 years, the longest term of any of the current MS therapies. MS patients followed up since the beginning of the U.S. Phase III pivotal study, taking Copaxone® for over 10 years, experienced on the average a relapse rate of approximately one every five years, while physical function was maintained in the majority of patients. An additional study which followed a group of patients using Copaxone® since it was approved in the U.S. for compassionate use in 1978 has shown that of the 18 patients still injecting Copaxone® daily (now for an average of 17 years), only 26.7% progressed to EDSS of 6 or more (requiring aid to walk) (Miller et. al. *ECTRIMS* 2005).

To date, Copaxone® has been approved for marketing in 44 countries worldwide, including the United States, Mexico, Israel, Canada, 22 European Union countries, Switzerland, Australia, Russia, Brazil and Argentina. Copaxone® was first launched in Israel in December 1996, followed by the launch in the United States in March 1997, and European approval in 2001 through the European mutual recognition procedures.

In 2005, in-market global sales of Copaxone® reached a new record of $1,176 million, of which $782 million were in the United States, where Copaxone® continued to strengthen its position as the market leader, according to current IMS data, reaching highs of 34.3% in terms of total prescriptions and 35.2% in terms of new prescriptions in December 2005. Global in-market sales of Copaxone® in 2005 grew by 26% over those of 2004, a rate of growth that almost double the growth of the global market of MS products.

Outside the United States, Copaxone® in-market sales reached $394 million in 2005, an increase of 27%, driven by significant sales increases in Germany, the largest MS market in Europe, as well as in France, Spain and the U.K.

In North America, Copaxone® is marketed through Teva Neuroscience and is distributed by Sanofi-Aventis. Teva manufactures the product and supplies it to Sanofi-Aventis. Teva Neuroscience Inc. and Teva Neuroscience G.P.-S.E.N.C, wholly owned subsidiaries of Teva, actively market and promote the product in the United States and Canada, respectively, through a wide range of activities, including doctor detailing, educational seminars, websites and patient support programs, such as Shared Solutions and MS Watch. The agreement with Sanofi-Aventis terminates in March 2008, at which point Teva expects to take over U.S. distribution responsibilities for Copaxone® in exchange for payment by Teva of previously agreed-upon consideration to Sanofi-Aventis.

Teva and Sanofi-Aventis have an additional collaborative arrangement for the marketing of Copaxone® in Europe and other markets. Under the terms of this arrangement, following approval in these markets, Copaxone® is either co-promoted with Teva or is marketed solely by Sanofi-Aventis. The product is manufactured by Teva, and Sanofi-Aventis purchases it from Teva and sells and distributes it in Europe. Teva expects to take over European distribution responsibilities for Copaxone® when the agreement with Sanofi-Aventis terminates in February 2012, at which time Sanofi-Aventis will be entitled to pre-agreed residual payments.

Teva is seeking to develop effective and more convenient therapies for MS. An oral formulation of Copaxone® was tested in a large clinical trial, CORAL, conducted from 2000 to 2002; however, the results of the trial were not statistically significant. In late 2004, Teva and H. Lundbeck A/S, a Denmark-based, publicly traded pharmaceutical company and Teva s strategic partner in the development of oral Copaxone®, initiated two pilot Phase II clinical studies with two doses of an enteric coated formulation of Copaxone®. Based on the results, received in March 2006, Teva and Lundbeck will not continue the development of this formulation. Nevertheless, Teva is considering future development of Copaxone® in various non-parenteral formulations and will make its decision in the context of its entire MS portfolio.

Laquinimod

In June 2004, Teva signed an agreement with Active Biotech, a Sweden-based, publicly traded biotechnology company, to develop and commercialize laquinimod, a novel immunomodulatory compound. A

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Phase II study performed by Active Biotech showed that oral laquinimod in a dosage of 0.3 mg daily is well tolerated and effective in suppressing development of active MRI lesions in patients with relapsing MS. Treatment over six months with 0.3 mg of laquinimod daily resulted in a 44% decrease in MRI disease activity. Patients with disease activity at the start of the study showed a decrease of more than 50%. The study also confirmed laquinimod s advantageous safety profile.

During 2005, Teva started a double-blind, placebo-controlled multicenter Phase II clinical study in several European countries, in which the effects of laquinimod administered orally, once daily at doses of 0.3 and 0.6 mg/day, are compared to those of placebo over nine months of treatment. Results are expected during 2006.

Teva submitted an investigational new drug application (an IND) in 2005 to the FDA to initiate a clinical trial in the U.S. with laquinimod to assess drug-drug interaction. Teva is currently working with the FDA to resolve various issues raised in connection with this IND.

Under the terms of the agreement, Teva acquired the exclusive rights to develop, register, manufacture and commercialize laquinimod worldwide, with the exception of the Nordic and Baltic countries, where Active Biotech will retain all commercial rights. Teva has made an upfront payment to Active Biotech and has agreed to conduct and fund the further clinical development of laquinimod. The agreement between the two companies also calls for Teva to make payments to Active Biotech upon the achievement of various sales targets and other milestones, with maximum payments of $92 million. Active Biotech will also receive tiered double-digit royalties on sales of the product.

MS remains an important focus of Teva s development efforts, and it continues to investigate potential improvement of Copaxone® and explore other molecules as future therapies for MS.

Ivax Acquisition: Ivax and Serono are parties to an agreement for the development of a proprietary oral formulation of cladribine (Mylinax®) as a treatment of multiple sclerosis. Previous clinical trials had demonstrated the positive effect of injectable cladribine in patients with multiple sclerosis as well as a dramatic reduction in new lesion development in the brain as seen on magnetic resonance imaging scans. In 2005, Serono initiated a 1,200 patient two-year double-blind placebo-controlled study in patients with relapsing forms of multiple sclerosis. Ivax has a passive financial interest in such agreement, but does not have any active involvement in the development of this product.

Parkinson s Disease

Azilect® (rasagiline mesylate)

Azilect®, Teva s second innovative drug, was launched in its first market, Israel, in March 2005. Teva launched Azilect® for the treatment of Parkinson s disease both as initial monotherapy in early Parkinson s disease and as an adjunct to levodopa in moderate to advanced stages of the disease.

The development of Azilect® is part of a long-term strategic alliance with Lundbeck which includes the global co-development and marketing of Azilect®, mainly in Europe for the treatment of Parkinson s disease. Under this agreement, Lundbeck and Teva jointly market the product in certain key European countries. Lundbeck will exclusively market Azilect® in the remaining European countries and certain other overseas markets.

In February 2005, Azilect® was granted marketing authorization by the EMEA, with a broad indication as in Israel, and was launched jointly by Teva and Lundbeck in the U.K. in June 2005 and in Germany in July 2005. This was followed in 2005 by additional launches in Ireland, Austria, Denmark, Finland, Poland, Iceland and Norway, with additional countries expected in 2006.

In the U.S, in May 2005, Teva received a notification from the FDA that a technical error had occurred in the earlier submission of the file of Azilect®. Shortly thereafter, Teva submitted data to clarify this technical error. Subsequently, in August 2005, Teva received a follow-up approvable letter from the FDA regarding its NDA for Azilect®. However, the FDA has continued to have issues regarding the NDA. Teva has had a number of follow-up meetings with the FDA to discuss issues raised by them, and Teva has made additional submissions of information to the FDA. Teva intends to continue to work closely with the agency to resolve the open issues. In Canada, Azilect® is still under review by regulatory authorities.

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Azilect® is a potent, second-generation, irreversible monoamine oxidase type B (MAO-B) inhibitor with neuroprotective activities demonstrated in various in vitro and in vivo studies. Its beneficial clinical effect, seen in the entire spectrum of the disease, combined with its once-daily dosing, lack of need for titration and high tolerability, allows Azilect® to address significant unmet needs in the treatment of Parkinson s disease. Although many therapies are available, there is still a high level of dissatisfaction with many of these treatments, both in terms of their efficacy and tolerability. An estimated four million patients are affected by this chronic disease worldwide, which typically occurs at a late age, affecting approximately 1% of the population over the age of 65.

Azilect® has demonstrated efficacy and safety in three pivotal studies which included over 1,500 patients with Parkinson s disease at different stages of the disease. In two Phase III studies with Azilect® as adjunctive therapy to levodopa in more advanced patients the LARGO study conducted in Europe, Israel and Argentina and the PRESTO study in North America Azilect® demonstrated beneficial effects in the two categories defined as the goals for adjunctive therapy in Parkinson s disease: symptomatic control of Parkinsonian symptoms and treatment of levodopa-induced motor complications. In these advanced patients as well, Azilect® was found to be well-tolerated.

In the TEMPO Phase III study, conducted in North America in early stage patients, Azilect® demonstrated efficacy and safety as monotherapy treatment. This clinical trial, which used an innovative delayed-start design, showed a highly statistically significant effect on the primary endpoint progression of Parkinsonian symptoms. Azilect® was well-tolerated in this patient population. Moreover, the one year results of this study, which were published in the April 2004 issue of *Archives of Neurology*, suggest a possible effect on disease progression. In an open extension of the TEMPO trial, approximately half of the patients who were still in the study after two years (121 out of 266) were adequately maintained on monotherapy with Azilect® (without additional dopaminergic treatment). In this same open extension, results of six and a half years follow up-of patients treated with Azilect® show that the benefit of early treatment is maintained over time.

In November 2005, Teva initiated a large clinical study to determine whether treatment with once-daily Azilect® can modify the progression of Parkinson s disease. The ADAGIO study (Attenuation of Disease progression with Azilect® Once-daily) will enroll approximately 1,100 patients, recently diagnosed with Parkinson s disease, in North America, Europe and additional countries, including Israel and Argentina. This study, which has a similar delayed-start design as the previously published TEMPO 12 months trial, is aimed at reproducing and confirming the earlier findings of the TEMPO study.

In May 2003, Teva entered into a strategic alliance with Eisai Co. Ltd. and Eisai Inc., a U.S. leader in the field of Alzheimer s disease, for the global co-development of rasagiline for several additional indications and its co-promotion of Azilect® in the U.S. market. The parties agreed to initially develop rasagiline for the treatment of Alzheimer s disease, and, assuming its approval by the FDA, the parties will also co-promote the product in the U.S. for the treatment of Parkinson s disease. In 2004, a phase II clinical study of potential uses of rasagiline in the treatment of Alzheimer s disease was initiated.

Other Projects

Teva has innovative research projects in early clinical stages, in the areas of Alzheimer s disease, cancer and systemic lupus erythematosus, as well as several projects in the pre-clinical stage. Teva has also made equity investments and entered into participation arrangements with various other start-up and early-stage ventures primarily with the goal of leveraging Israeli expertise and scientific initiatives.

Intellectual Property and Other Protections

Teva relies on a combination of intellectual property protections and exclusivity periods provided under applicable regulations to protect its innovative products. Teva seeks to obtain, where possible, product, process and use patents on its innovative products. Teva also relies on trade secrets, unpatented proprietary know-how

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and confidentiality agreements, as well as FDA exclusivities, trademark and copyright protection, for its innovative products. Similar laws and regulations in Europe provide for six to ten years of data exclusivity. Newer EU legislation provides for a uniform period of European data exclusivity for newly registered products for a period of ten years which, under certain circumstances, can be extended to 11 years.

The market exclusivity protections afforded Copaxone® in the United States due to its status as an orphan drug expired on December 20, 2003. Teva also has patents relating to Copaxone® with terms expiring in 2014 in the U.S. and in 2015 in most of the rest of the world. In Europe, Copaxone® is also protected by data exclusivity protections in most European countries, which remain in effect for a period of ten years from the 2001 market authorization date.

Teva also relies on patent protection and trade secret protection to protect generic processes, products and formulations for its API and final dosage forms.

Active Pharmaceutical Ingredients

In addition to its production and sale of pharmaceutical products, Teva manufactures and sells active pharmaceutical ingredients. With a leading global market share in the production of many major chemicals for generic pharmaceuticals, Teva s API division facilitates Teva s entry into new drug markets and offers a high quality and cost-effective source of API. Teva s API division provides Teva with the benefits of vertical integration while pursuing its strategy of continuing to grow its significant third party business.

Teva s acquisition of Sicor complemented Teva s existing API capabilities with a broad portfolio of APIs for respiratory, dermatological hormones, anti-inflammatories, oncolytics, immunosuppressants, muscle relaxants and custom-manufactured APIs for a variety of proprietary drug manufacturers. The consolidation with Teva opened traditional Teva markets to Sicor s API products and also gave Teva access to new customers, mainly in the inhalation, injectibles and dermatology fields.

The API business sells products to Teva s finished pharmaceutical product businesses and to third parties in a competitive market for APIs mainly intended for generic products. Sales to Teva s finished pharmaceutical product businesses are on an arm s-length basis, fulfilling Teva s generic and proprietary manufacturing needs. Teva s API sales are affected by pharmaceutical trends and are directly related to the ability of its API customers, both Teva itself and third-party customers, to launch new products and maintain market share.

Teva offers over 220 different API, using synthetic, semi-synthetic, fermentation and high-potent technologies (compounds that have a therapeutic effect at very low dosages, typically at microgram levels), for use in pharmaceuticals. Teva believes it is among the world s principal suppliers of many of these chemicals. The products are sold, subject to the patent position, to formulators of pharmaceutical products mainly in the United States and Europe, the Far East and Latin America. The API division s portfolio of products is a combination of high volume products as well as low volume, high value products.

The production of APIs requires a high level of technical and regulatory skills. In order for chemicals to be approved for use as API sold in the United States, the facilities and production procedures utilized at such facilities must meet FDA standards. Teva s API plants (other than India) meet such standards and are regularly inspected by the FDA. Many of the products are produced in dedicated computer-controlled automated facilities, facilitating optimization of the production processes and high quality.

Teva s API division has developed an expertise in specialized technologies, such as fermentation processes and the production of peptide API. Teva has established a leading position in the sale of fermentation products such as lovastatin, simvastatin, pravastatin and tobramycin. In addition, through the establishment of joint ventures, Teva has taken steps towards supplying various peptides such as desmopressin, calcitonin, octreotide and others to its customers. With the acquisition of Sicor, Teva s API division gained Sicor s API expertise in the chemistry of steroids and high-potentcy production, which supplemented its existing capabilities. This expertise gives Teva s API business access to new therapeutic and formulation segments.

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During 2005, API sales to Teva s various pharmaceutical units were approximately 51% of the division s total sales as compared with 47% during 2004. Teva believes that its ability to produce these APIs is a strategic advantage for its production of finished pharmaceuticals.

Ivax Acquisition: The acquisition of Ivax is expected to provide Teva s API division with an additional 30 APIs and access to new technologies, mainly plant extraction technology. The acquisition is also expected to open new markets for Teva such as Central and Eastern Europe and Latin America. In addition, the acquisition is expected to enhance and strengthen back integration activities with Teva s pharmaceutical units. As a result of the Ivax acquisition, Teva s existing API sales to Ivax will shift from third-party sales to intercompany sales, while Ivax s own third-party API sales will be included in Teva s third-party API sales.

Marketing and Sales

In North America, the API division has marketed its products for over 20 years through its U.S. subsidiary Plantex USA. Most of Plantex USA s customers are generic dosage form manufacturers located in the United States and Canada. Additionally, Plantex USA has been able to make significant inroads into the emerging drug delivery segments and is venturing into selected custom synthesis projects for new drug applications. The direct contact with the customers enables the API division to establish long-term relationships.

In Europe, a Teva European subsidiary, Plantex Chemicals BV, is responsible for marketing to western European customers. In the Far East, Latin America, Australia and New Zealand, Teva sells APIs through either local subsidiaries or local distributors.

Production

Teva produces APIs worldwide through 16 production sites located in the United States, Israel, Hungary, Italy, Switzerland, India and Mexico. The plants manufacture APIs through synthetic and fermentation processes, process control, a variety of milling equipment and Teva s expertise in the field of physical properties, enabling tailoring of the products physical characteristics for the customer s needs. Ivax adds two additional API manufacturing sites to Teva s existing plants: one in Puerto Rico and the other in the Czech Republic.

Animal Health

IVX Animal Health markets veterinary pharmaceutical products mainly under private labels and other identities. These include virtually every major animal health distributor network, both prescription and over-the-counter, in the United States. This provides nationwide access to every segment of the animal health market. It also provides an existing and an extensive base of marketing, sales and technical support for the products manufactured. Its areas of focus include antimicrobials, antiparasitics, antipruritics and antiseborrheics, grooming aids, nutraceuticals and otics.

Research and Development

Teva s research and development efforts are involved in all of its major business activities. Teva s research and development expenses were as follows:

	U.S. dollars in millions		
	2005	**2004**	**2003**
Gross R&D expenses	383	356	243
Participations and grants	14	18	30
Net R&D expenses	369	338	213

The Global Generic R&D Division is in charge of product formulation, bioequivalence testing registration and approval of a growing list of generic drugs for all of the markets where Teva operates. It also focuses on the

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development of complex drug delivery systems and a growing variety of dosages for generic drugs. The division operates from eight development centers located in the United States, Canada, Israel, Hungary, Mexico and The Netherlands, enabling optimization of both human resources and the prevailing patent law situation.

The Global Innovative R&D Division employs researchers in Israel, the United States, Canada, Hungary, India and several Western European countries. The division conducts all activities required for the identification of lead compounds as well as all pre-clinical development, clinical testing and regulatory submissions for Teva s growing pipeline of proprietary products. The division is deeply involved in supporting Teva s effort to achieve and maintain a leading position in the treatment of multiple sclerosis and to establish a franchise in Parkinson s disease. Teva collaborates intensively with Israel s major universities, medical institutions and research institutes in order to leverage the extensive, first-class research activities conducted in Israel and to source projects, specifically in the areas of neurodegeneration/neuroprotection, autoimmunity and cancer.

In addition to the funding received through collaborations with third parties such as Lundbeck, Sanofi-Aventis and Eisai, Teva avails itself of government funding for research conducted in Israel. The Israeli government offers grants, which are repayable as royalties from the sale of products resulting from funded research, with the aggregate amount of such royalties limited to the amount of the original grant (in respect of grants since 1999, with the addition of LIBOR interest). The royalties are at rates between 2% and 3.5% (depending on the number of years elapsed since the commencement of the royalty payments) of sales relating to a product or a development resulting from the funded research. The maximum amount of the contingent liability in respect of royalties to the Israeli government at December 31, 2005 amounted to $39.5 million. In recent years, however, Israeli government grants have played a reduced role and became insignificant in the overall funding of Teva s innovative R&D efforts.

The Global API R&D Division Researchers from the API division focus on the development of chemical and biological (fermentation) processes and on the production of active ingredients of interest to the generic drug industry, as well as for Teva s proprietary drugs. This group s facilities include a large center in Israel (chemical processes and peptides), a large center in Hungary (fermentation and downstream processing), a facility in India and additional sites in Italy, Mexico and the United States. The process research groups seek ways to continuously improve processes to reduce API production costs, enabling Teva to remain a supplier of key API products in an environment of falling prices after other competitors cease to be able to produce these products economically.

Biopharmaceutical R&D Teva has R&D operations specifically dedicated to the development of biopharmaceutical products located in Lithuania, China (through its holding in Hualida), Mexico and Israel. These groups expertise covers aspects related to recombinant protein expression and production, including genetic engineering, recombinant bacterial fermentation, mammalian tissue culture, protein purification and the development of analytical methods and formulation.

Competition

In the ***United States***, Teva is subject to intense competition in the generic drug market from other generic drug manufacturers, brand-name pharmaceutical companies through authorized generics, manufacturers of branded drug products that continue to produce those products after patent expirations and manufacturers of therapeutically similar drugs. Teva believes that the primary competitive factors are its ability to continually introduce new generic equivalents for brand-name drug products on a timely basis, its emphasis on regulatory compliance and high volume cost effective production, its customer service and the breadth of its product line.

Price competition from additional generic versions of the same product may result in significant reductions in sales and margins over time. To compete on the basis of price and remain profitable, a generic drug manufacturer must manufacture its products in a cost efficient manner. In addition, Teva s competitors may also develop their products more rapidly or complete the regulatory approval process sooner, and therefore market their products earlier. New drugs and future developments in improved and/or advanced drug delivery technologies or other therapeutic techniques may provide therapeutic or cost advantages to competing products.

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Many brand-name competitors try to prevent, discourage or delay the use of generic equivalents through several tactics, including legislative initiatives (e.g., pediatric exclusivity), changing dosage form or dosing regimen just prior to the expiration of an original patent, regulatory processes, filing new patents, patent extensions, litigation, including citizens petitions, and negative public relations campaigns. In addition, the brand-name companies sometimes launch, either through an affiliate or through licensing arrangements with another company, an authorized generic concurrent with the first generic launch, so that the patent challenger no longer has the exclusivity granted by the Hatch-Waxman Act.

A significant amount of our United States generic sales are made to a relatively small number of drug wholesalers and retail drug chains. Teva s customers (wholesalers and retail drug chains) have undergone and continue to undergo significant consolidation resulting in customers gaining more purchasing leverage. As a result of these developments, there is heightened competition among generic drug producers for the business in this smaller and more selective customer base.

In ***Western Europe***, the various Teva companies compete with other generic companies (several major multinational generic drug companies and various local generic drug companies) and branded drug companies that continue to sell or license branded pharmaceutical products after patent expirations. As in the United States, the generic market in Western Europe is very competitive, with the main competitive factors being prices, time to market, reputation, customer service and breadth of product line.

In ***Hungary***, the Teva companies compete with local Hungarian manufacturers but also face increasing competition from multinational pharmaceutical companies. Teva s Hungarian subsidiaries continue to strengthen Teva s position and presence in Hungary, while creating a more diversified product and service portfolio, including wholesaling services.

In ***Canada***, the competitive landscape continues to intensify with the increasing presence of foreign competitors. Five major generic drug manufacturers, three of which, including Novopharm, are subsidiaries or divisions of global manufacturers, and the remaining two privately owned companies, satisfy a substantial amount of the Canadian demand for generic pharmaceuticals.

The customer base for Novopharm continues to change as the number of independent community pharmacies shrinks at the expense of chain drug and banner-aligned store groups, which work closely with selected suppliers for specific products. This trend is expected to continue, resulting in increased competition for generic drug manufacturers at the chain and banner buying offices. These larger customers look to generic suppliers to timely launch cost-effective generic products, maintain high levels of product availability and provide increased levels of overall customer value and service.

In ***Israel***, Teva, with a market share (including distribution, on behalf of third parties) of approximately one-quarter of the total pharmaceutical market, is the largest supplier of health care products. Teva s success is based primarily on its ability to market products within the medical community, combined with its ability to provide clients with a broad line of products at competitive prices and prompt service. Teva s products compete with those of other local manufacturers as well as with imported products. Generic competition has increased in recent years in Israel, and this trend is expected to continue, with additional price pressure coming from the health care funds and other institutional purchasers. Teva has the broadest line of products in the Israeli pharmaceutical market including generic, over-the-counter and branded drugs. New regulations, which became effective in May 2005, enable the sale of general sales list products in many retail locations in addition to the pharmacies; however, major retail stores have not yet started selling general sales list products. Furthermore, Israeli governmental price controls concerning products included in the general sales list have been removed and have been replaced recently by a notification requirement.

Copaxone® is the only non-interferon therapy available for the treatment of relapsing remitting multiple sclerosis. Its primary competition is with three other therapies for the treatment of this form of multiple sclerosis, Avonex®, Betaseron® and Rebif®, all of which are forms of beta-interferon.

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On March 8, 2006, an FDA advisory panel recommended that the FDA should allow back onto the U.S. market Tysabri®, an MS therapy which was originally launched in the United States in December 2004 and shortly thereafter was voluntarily withdrawn from the market after two patients developed a rare brain disorder, known as progressive multifocal leukoencephalopathy, or PML, resulting in the death of one of the patients. A third patient was later discovered to have PML and also died. According to press reports, the FDA is currently evaluating various elements of a risk-management plan proposed by the makers of Tysabri®. As reported, the manufacturers of Tysabri® proposed that the drug carry a strict black box warning that highlights the risk of PML and states that Tysabri® should be given alone rather than in combination with other drugs. The FDA is expected to make a final decision with regard to Tysabri® s expected reentry into the U.S. market and any related restrictions by the end of March 2006. Teva continues to believe that Copaxone® is a superior product and that it, alone among all of the existing MS therapies, is the only product for which efficacy has been shown to be sustained for over 10 years.

In 2003, Schering AG initiated a trial which compares the efficacy of the current dose Betaseron® with a higher dose Betaseron® and the current dose of Copaxone®. Serono has also announced the initiation of a head-to-head comparison between Rebif® and Copaxone®. Both studies are ongoing. In 2004, Teva initiated a comparative trial in which patients who are on a high dose of interferon who experienced at least one relapse in the year prior to study entry are randomly switched to Copaxone® or remain on the high dose interferon for the duration of the trial. The trial is being conducted in North America, with results expected in 2009.

In the sale of ***active pharmaceutical ingredients***, Teva competes in all of its markets with specialty chemical producers, mainly located in Europe, particularly in Italy and Spain, in India and in the Far East. Teva competes based on price, quality, timely delivery and its ability to meet the stringent FDA requirements for approved suppliers of API. Many of its competitors are smaller than Teva, in terms of sales and breadth of offerings of API. Teva believes that its extensive portfolio (one of the broadest available in the industry), combined with the creation of intellectual property rights and its financial resources, make its API division a leader in the industry.

Regulation

United States. All pharmaceutical manufacturers selling products in the United States are subject to extensive regulation by the U.S. federal government, principally by the FDA and the Drug Enforcement Administration, and, to a lesser extent, by state and local governments. The Federal Food, Drug, and Cosmetic Act, the Controlled Substances Act and other federal statutes and regulations govern or influence the development, manufacture, testing, safety, efficacy, labeling, approval, storage, distribution, recordkeeping, advertising, promotion and sale of Teva s products. Teva s major facilities and products are periodically inspected by the FDA, which has extensive enforcement powers over the activities of pharmaceutical manufacturers. Non-compliance with applicable requirements may result in fines; criminal penalties; civil injunction against shipment of products; recall and seizure of products; total or partial suspension of production, sale or import of products; refusal of the government to enter into supply contracts or to approve new drug applications and criminal prosecution. The FDA also has the authority to deny or revoke approvals of drug active ingredients and dosage forms and the power to halt the operations of non-complying manufacturers. Any failure by Teva to comply with applicable FDA policies and regulations could have a material adverse effect on the operations of Teva.

FDA approval is required before any new drug (including generic versions of previously approved drugs) may be marketed, including new strengths, dosage forms and formulations of previously approved drugs. Applications for FDA approval must contain information relating to bioequivalence (for generics), safety, toxicity and efficacy (for new drugs), product formulation, raw material suppliers, stability, manufacturing processes, packaging, labeling and quality control. FDA procedures require that commercial manufacturing equipment be used to produce test batches for FDA approval. The FDA also requires validation of manufacturing processes before a company may market new products. The FDA conducts pre-approval and post-approval reviews and plant inspections to implement these requirements. Generally the generic drug development and the ANDA review processes can take two to five years.

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The Hatch-Waxman Act of 1984 established the procedures for obtaining FDA approval for generic forms of brand-name drugs. This Act also provides market exclusivity provisions that can delay the submission and/or the approval of ANDAs. One such provision allows a five-year market exclusivity period for new drug applications (NDAs) involving new chemical entities and a three-year market exclusivity period for NDAs (including different dosage forms) containing new clinical trial data essential to the approval of the application. The Orphan Drug Act of 1983 grants seven years of exclusive marketing rights to a specific drug for a specific orphan indication. The term orphan drug refers to a product that treats a rare disease affecting fewer than 200,000 Americans. Market exclusivity provisions are distinct from patent protections and apply equally to patented and non-patented drug products. Another provision of the Hatch-Waxman Act extends certain patents for up to five years as compensation for the reduction of effective life of the patent which resulted from time spent in clinical trials and time spent by the FDA reviewing a drug application. Patent term extension and non-patent market exclusivity may delay the submission and approval of generic drug applications.

Under the terms of the Hatch-Waxman Act, a generic applicant must make certain certifications with respect to the patent status of the drug for which it is seeking approval. In the event that such applicant plans to challenge the validity or enforceability of an existing listed patent or asserts that the proposed product does not infringe an existing listed patent, it files a so-called Paragraph IV certification. As originally legislated, the Hatch-Waxman Act provides for a potential 180-day period of generic exclusivity for the first company to submit an ANDA with a Paragraph IV certification. This filing triggers a regulatory process in which the FDA is required to delay the final approval of subsequently filed ANDAs for 180 days after the earlier of the first commercial marketing of the drug by the first applicant or a final court decision in the generics company s favor regarding the patent that was the subject of the Paragraph IV certification. Submission of an ANDA with a Paragraph IV certification can result in protracted and expensive patent litigation. When this occurs, the FDA generally may not approve the ANDA until the earlier of thirty months or a relevant court decision finding the patent invalid, not infringed or unenforceable.

The Medicare Prescription Drug, Improvement and Modernization Act (the Medicare Act) of 2003 modified certain provisions of the Hatch-Waxman Act. Under the Medicare Act, final ANDA approval may be obtained upon the earlier of a favorable district court decision or 30 months from notification to the patent holder of the Paragraph IV filing. Exclusivity rights may be forfeited pursuant to the Medicare Act if the product is not marketed within 75 days of the final court decision and under other specified circumstances. However, some of these changes apply only to ANDAs containing such Paragraph IV certification that were filed after enactment of the Medicare Act; previously filed ANDAs generally continue to be governed by the previous law.

The Medicare Act further expanded the scope of Medicare coverage for participants by creating what is known as the Medicare Part D prescription drug benefit. The Part D prescription drug benefit became available to Medicare beneficiaries on January 1, 2006. Medicare prescription drug coverage under Part D is insurance that covers the Medicare beneficiary s cost (subject to certain statutory purchasing thresholds, co-payments, insurance premiums, and deductibles) of prescription drugs at participating pharmacies. Medicare prescription drug coverage under the Part D benefit is available to all Medicare beneficiaries regardless of income and resources or health status. As a result, Teva s products are, as of January 1, 2006, available for government-subsidized purchase by a larger market of Americans participating in government-sponsored third party payor insurance programs.

The Best Pharmaceuticals for Children Act, signed into law in 2002, continues the so-called pediatric exclusivity program begun in the FDA Modernization Act of 1997. This pediatric exclusivity program provides a six-month extension both to certain listed patents and to regulatory exclusivities for all formulations of an active ingredient, if the sponsor performs and submits adequate pediatric studies on any one single dosage form. The effect of this program has been a delay in the launch of numerous generic products by an additional six months.

The Generic Drug Enforcement Act of 1992 established penalties for wrongdoing in connection with the development or submission of an ANDA by authorizing the FDA to permanently or temporarily debar such

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companies or individuals from submitting or assisting in the submission of an ANDA, and to temporarily deny approval and suspend applications to market generic drugs. The FDA may suspend the distribution of all drugs approved or developed in connection with wrongful conduct and also has authority to withdraw approval of an ANDA under certain circumstances. The FDA may also significantly delay the approval of a pending NDA or ANDA under its Fraud, Untrue Statements of Material Facts, Bribery, and Illegal Gratuities Policy. Manufacturers of generic drugs must also comply with the FDA s current Good Manufacturing Practices (cGMP) standards or risk sanctions such as the suspension of manufacturing or the seizure of drug products and the FDA s refusal to approve additional ANDAs.

Products manufactured outside the United States and marketed in the United States are subject to all of the above regulations, as well as to FDA and U.S. customs regulations at the port of entry. Products marketed outside the United States that are manufactured in the United States are additionally subject to various export statutes and regulations, as well as regulation by the country in which the products are to be sold.

The Center for Medicare & Medicaid Services is responsible for enforcing legal requirements governing rebate agreements between the federal government and pharmaceutical manufacturers. Drug manufacturers agreements with the Center provide that the drug manufacturer will remit to each state Medicaid agency, on a quarterly basis, the following rebates: for generic drugs marketed under ANDAs covered by a state Medicaid program, manufacturers are required to rebate 11% of the average manufacturer price (net of cash discounts and certain other reductions); for products marketed under NDAs, manufacturers are required to rebate the greater of 15.1% of the average manufacturer price (net of cash discounts and certain other reductions) or the difference between such average manufacturer price and the best price during a specified period. An additional rebate for products marketed under NDAs is payable if the average manufacturer price increases at a rate higher than inflation. Teva USA has such a rebate agreement in effect with the federal government. Federal and/or state governments have and are expected to continue to enact measures aimed at reducing the cost of drugs to the public, including the enactment, in December 2003, of Medicare legislation that expands the scope of Medicare coverage for drugs in 2006 and beyond. Teva cannot predict the nature of such measures or their impact on its profitability.

Various state Medicaid programs have in recent years adopted supplemental drug rebate programs that are intended to provide the individual states with additional manufacturer rebates that cover patient populations that are not otherwise included in the traditional Medicaid drug benefit coverage. These supplemental rebate programs are generally designed to mimic the federal drug rebate program in terms of how the manufacturer rebates are calculated, e.g., as a percentage of average manufacturer price. While some of these supplemental rebate programs are significant in size, they are dwarfed, even in the aggregate, by comparison to Teva USA s quarterly Medicaid drug rebate obligations.

Teva s products also include biotechnology-derived products that are comparable to brand-name drugs. Teva currently distributes these products outside of the U.S. and plans to introduce these products into the U.S. marketplace, but currently a definitive regulatory pathway, such as the Hatch-Waxman Act, does not exist for these products. In 2005, Teva worked closely with the FDA and other organizations in taking steps to define the requirements for demonstration of safety and efficacy through abbreviated preclinical and clinical studies. Teva plans to continue these efforts to make affordable biotechnology-derived products that are comparable to brand-name drugs available to patients.

Canada. The Canadian federal government, under the Food and Drugs Act and the Controlled Drug and Substances Act, regulates the therapeutic products that may be sold in Canada and the applicable level of control. The Therapeutic Products Directorate is the national authority that evaluates and monitors the safety, effectiveness and quality of drugs, medical devices and other therapeutic products.

Issuance of a Notice of Compliance for generic drug products is also subject to the Patented Medicines (Notice of Compliance) Regulations under the Patent Act. The Therapeutic Products Directorate will not issue a

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Notice of Compliance if there are any patents registered with the Health Canada Patent Registrar for the relevant drug product. Generic pharmaceutical manufacturers can either wait for the patents to expire or file a patent allegation. Filing a patent allegation often results in patent litigation with the brand company, in which case a Notice of Compliance will not be issued until the earlier of the expiration of a 24-month stay or resolution of the litigation in the generic company s favor.

Provincial governments control expenditures on therapeutic products by establishing interchangeability formularies and benefit lists and only reimbursing products that are listed in the formulary and benefits lists. Provincial Ministries of Health, through their own review processes, determine the eligibility of the products for interchangeability by evaluating the drug quality, bioequivalence data, drug therapeutics, drug utilization and pharmacoeconomic issues.

Health Canada and Industry Canada have recently proposed amendments that, among other things, provide a market exclusivity period of eight and a half years for new pharmaceutical products. This may delay introduction of generic products. Other features of the amendments are designed to prevent multiple 24-month stays.

The Canadian federal government and several provincial governments are studying possible improvements of their publicly funded Medicare system. Many of these governments acknowledge the need to limit brand patent extensions and speed the approval process for generic drugs. Branded pharmaceutical companies continue to lobby against expedited approvals of generic drugs, which would enhance generic drug sales at the expense of branded products. The Quebec government has passed legislation that could introduce further regulations applicable to all generics sold in the province and is in the process of developing regulations aimed at reducing prices paid by the government for generic drugs.

Israel. Israel, like other countries with advanced pharmaceutical industries, requires pharmaceutical companies to conform to international developments and standards. To this end and in order to meet the three basic criteria for drug registration (quality, safety and efficacy), regulatory requirements are constantly changing in accordance with scientific advances as well as social and ethical values. Legal requirements prohibit the manufacture, importation and marketing of any medicinal product, unless it is duly approved in accordance with these requirements.

As a result of the 1998 amendments to the patent law, the term of certain pharmaceutical patents may be extended under certain conditions for up to five years. The Israeli Knesset (Parliament) recently enacted new legislation, which ensures that the patent term extension in Israel will terminate upon the earliest date of the parallel patent term extension in the U.S., Europe and several other countries. In 2005, the Knesset ratified legislation which provides for data exclusivity provisions, which may prevent the marketing of a generic product for a period of time after the initial registration of the innovator product. The maximum term of data exclusivity is five and a half years measured from the first registration of the drug product in one of a number of Western countries.

Europe. A directive of the European Union requires that medicinal products shall have a marketing authorization before they are placed on the market in the European Union. Authorizations are granted after the assessment of quality, safety and efficacy. In order to control expenditures on pharmaceuticals, most member states of the European Union regulate the pricing of such products and in some cases limit the range of different forms of a drug available for prescription by national health services. These controls can result in considerable price differences among member states.

The duration of certain pharmaceutical patents may be extended in Europe by up to five years in order to extend effective patent life to fifteen years. Some older French and Italian patents were extended up to eight and eighteen years, respectively. Additionally, data exclusivity provisions in Europe may prevent launch of a generic product by six or ten years from the date of the first market authorization in the European Union. New legislation, effective as of November 21, 2005, lengthens the exclusivity period for new products to 10 years for

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all members of the EU, with a possibility of extending the period to 11 years under certain circumstances. This legislation will begin to have an effect on the European market only after the current periods have expired. This legislation also enables the submission of a generic dossier to the health authorities eight years after the first market authorization, and allows for research and development work during the patent term for the purpose of submitting registration dossiers (comparable to the so-called Bolar Amendment in the United States).

During the course of 2005, Teva continued to register its products in Europe. As part of the mutual recognition procedure established by the European Union, an attempt was made to simplify registration, although centralized registration for generic products is, as yet, only possible in a few cases in Europe. Due to recent court interpretations of essential similarity, it has become possible to register generic drugs containing different salts of the active ingredient. Teva has significantly increased its registration efforts in a number of European countries: Hungary, the United Kingdom, France, Germany, The Netherlands and Poland.

In 2005, a legal pathway was established to allow approval of Similar Biological Medicinal Products (Biosimilars) using abbreviated marketing applications. Appropriate tests for demonstration of safety and efficacy include preclinical or clinical testing or both. The reference product for this testing is the brand-name drug and the scientific principles of comparability are followed. Draft guidelines were also issued providing further interpretation of these requirements, including product-specific guidelines for a biosimilar recombinant insulin, human growth hormone, erythropoetin and granulocyte-colony stimulating factor. Teva anticipates that this legal pathway and abbreviated application requirements will enable distribution in the European Union of affordable biotechnology-derived products with demonstrated safety and efficacy comparable to the brand-name product.

At present, the EMEA is expected to finalize guidelines on biosimilar products within the first half of 2006. Once these guidelines are released, Teva will be able to determine its plans for the development and sale of biosimilar products in Europe.

Hungary. Only registered drugs may be marketed in Hungary. OGYI (the National Pharmaceutical Institute), an agency of the Ministry of Health, examines and approves the documents filed for health registration. Standards of approval correspond substantially to European Union standards. On granting marketing authorization, the price and amount of the National Health Authority subsidy are published in the official Health Gazette of the Ministry of Health. A pharmaceutical product may only be placed on the Hungarian market after such price and subsidy amounts have been published.

On January 1, 2003, Hungary joined the European Patent Convention and simultaneously amended its own patent act to conform to this convention. On the whole, the new patent act retained most provisions of the previous act, including the permission to perform research and development work and to submit dossiers during the patent term. This act, however, considers stockpiling of such generics prior to the expiration of the patent to be infringement of the patents.

In May 2004, Hungary joined the EU. As a result: (1) supplementary protection certificates became available in Hungary for products having marketing authorizations dated not earlier than January 1, 2000, which may extend the patent protection period for up to five years; (2) Hungary was able to participate in the EU s mutual recognition procedure; and (3) for products which receive their marketing authorization through the centralized EU procedure, the data exclusivity protection period was extended to 10 years.

Miscellaneous Regulatory Matters

National, regional and local laws of general applicability, such as laws regulating working conditions, also govern Teva. In addition, Teva is subject, as are manufacturers generally, to various national, regional and local environmental protection laws and regulations, including those governing the discharge of material into the environment. Compliance with such environmental provisions is not expected to have a material effect on the operations of Teva in the foreseeable future.

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As discussed above, data exclusivity provisions exist in many countries worldwide and may be introduced by additional countries in the future, although their application is not uniform. In general, these exclusivity provisions prevent the approval and/or submission of generic drug applications to the health authorities for a fixed period of time following the first approval of the brand name product in that country. As these exclusivity provisions operate independently of patent exclusivity, they may prevent the submission of generic drug applications for some products even after the patent protection has expired.

Pharmaceutical Production

Teva operates 20 finished dosage pharmaceutical plants in North America, Europe and Israel. The plants manufacture solid dosage forms, injectables, liquids and semi-solids. During 2005, Teva s plants produced approximately 22 billion tablets and capsules and over 200 million injectable units. In September 2005, Teva completed the construction of a new state-of-the-art facility in Jerusalem for solid dosage forms. With the Ivax acquisition, Teva now has 44 pharmaceutical manufacturing sites.

Teva s two main manufacturing technologies (solid dosage forms and injectables) are available in each of the three above-mentioned geographical areas. Teva USA derives a majority of its sales from products manufactured outside of the United States mainly by other Teva subsidiaries.

Teva s plants in the United States and Canada, Kfar Sava, and a cephalosporin site in Jerusalem, Israel and the Haarlem plant in The Netherlands are FDA-inspected or approved. Achieving and maintaining quality standards in compliance with the current Good Manufacturing Practice (cGMP) regulations, as established by the FDA and other regulatory agencies worldwide, require sustained efforts and expenditures. Teva has spent, and will continue to spend, significant funds and dedicate substantial resources for this purpose.

Raw Materials for Pharmaceutical Production

Teva has taken a global approach to manage the commercial relations with its main suppliers. Strategic decisions are made on a global basis, while day-to-day operations are run locally. Most packaging materials are purchased locally.

Teva s API division is by far the major raw materials supplier for Teva s pharmaceutical businesses. The remaining raw materials are purchased from suppliers located mainly in Europe, the Far East and the United States. Most of the purchases from the U.S.-based suppliers are controlled substances. Teva has implemented a supplier audit program to ensure that its suppliers meet its standards.

In the United States, Teva USA utilizes controlled substances in certain of its products and therefore must meet the requirements of the Controlled Substances Act and the related regulations administered by the Drug Enforcement Administration. These regulations include quotas on procurement of controlled substances and stringent requirements for manufacturing controls and security to prevent pilferage of or unauthorized access to the drugs in each stage of the production and distribution process. Quotas for controlled substances may from time to time limit the ability of Teva USA to meet demand for these products in the short run.

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Organizational Structure

The following table sets forth, by geographic area (alphabetically), as of December 31, 2005, the name and jurisdiction of Teva s principal operating subsidiaries. Except as otherwise indicated, Teva directly or indirectly wholly owns the listed subsidiaries.

North America:	
Canada:	Novopharm Limited
Mexico:	Lemery S.A. de C.V.
	Sicor de Mexico S.A. de C.V.
	Sicor Latinoamerica S.A. de C.V.
United States:	Plantex U.S.A., Inc.
	Sicor Inc.
	Sicor Pharmaceuticals, Inc.
	Sicor Pharmaceuticals Sales, Inc.
	Teva Neuroscience, Inc.
	Teva Pharmaceuticals USA, Inc.
Europe:	
France:	Teva Classics S.A.
	Teva Santé SAS
Germany:	Teva Pharmaceuticals Germany GmbH
Hungary:	Humantrade Kft (97.36%)
	Humantrade Pharmaceutical Wholesale Company Limited by Shares (99.9%)
	Teva Hungary Pharmaceutical Marketing Company Limited by Shares (formerly known as Biogal Teva Pharma Rt)
	Teva Pharmaceutical Works Private Limited Company (formerly known as Biogal Pharmaceutical Works Ltd.) (99.4%)
Italy:	Dorom S.r.l.
	Prosintex Industrie Chimiche Italiane S.r.l.
	Sicor Societa Italiana Conticosteroidi S.r.l.
	Teva Pharmaceutical Fine Chemicals S.r.l.
	Teva Pharma Italia S.r.l.
Lithuania:	Sicor Biotech UAB
Switzerland:	Medica A.G.
The Netherlands:	Pharmachemie Group
	Teva Pharmaceuticals Europe B.V.
United Kingdom:	Teva U.K. Limited (formerly known as Approved Prescription Services Limited)
Israel:	Abic Biological Laboratories Teva Ltd.
	Abic Ltd.
	Assia Chemical Industries Ltd.
	Plantex Ltd.
	Salomon, Levin and Elstein Ltd.
	Teva Medical Ltd.
China:	Tianjin Hualida Biotechnology Company Ltd. 45%

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In addition, through its acquisition of Ivax, Teva acquired Ivax s principal operating subsidiaries listed below. Except as otherwise indicated, Teva directly or indirectly wholly owns the listed subsidiaries:

United States:	Goldline Laboratories, Inc.
	Ivax Laboratories, Inc.
	Ivax Pharmaceuticals, Inc.
	Ivax Research, Inc.
	IVX Animal Health, Inc.
Latin America:	
Chile:	Laboratorio Chile S.A.
Argentina:	Ivax Argentina S.A.
Venezuela:	Laboratorios Elmor, S.A.
Mexico:	Ivax Pharmaceuticals Mexico, S.A. de C.V.
Europe:	
France:	Ivax Pharmaceuticals SAS
Switzerland:	Ivax International GmbH
Czech Republic:	Ivax Pharmaceuticals Sro
Poland:	Kutnowskie Zaklady Farmaceutyczne Polfa SA
Ireland:	Norton (Waterford) Limited
United Kingdom:	Norton Healthcare Limited

Properties and Facilities

Listed below are Teva s principal facilities by square feet as of December 31, 2005:

Plant Location	Square Feet (in thousands)	Main Function
Israel		
Kfar Sava	352	Pharmaceutical manufacturing, research laboratories
Jerusalem	130	Pharmaceutical manufacturing, research laboratories, offices (two adjacent sites)
Jerusalem	293	Pharmaceutical plant
Netanya (2 sites)	390	API (chemical) manufacturing, pharmaceutical warehouses and distribution center
Petach Tikva	125	Corporate headquarters
Ramat Hovav (Teva Tech)	527	API (chemical) manufacturing and R&D
United States		
North Wales, PA	335	U.S. headquarters, warehousing and distribution center
Sellersville, PA	213	Pharmaceutical manufacturing, R&D laboratories
Irvine, CA	307	Pharmaceutical manufacturing, R&D laboratories
Canada		
Scarbourough, Ontario (4 adjacent sites)	363	Canadian headquarters, pharmaceutical packaging, warehousing, distribution center and laboratories
Europe		
Debrecen, Hungary	1,280	Pharmaceutical manufacturing, API (chemical) manufacturing, R&D laboratories, warehousing
Gödöllõ, Hungary	442	Pharmaceutical manufacturing, hospital supplies manufacturing, R&D laboratories, distribution center (three adjacent sites)
Haarlem, The Netherlands	232	Pharmaceutical manufacturing, warehousing, offices

Rest of the World		
Gajraula (U.P.), India	247	API (chemical) manufacturing

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Teva leases certain of its facilities. The Kfar Sava plant, the Jerusalem pharmaceutical plant, the Netanya chemical plant and the Ramat Hovav plant are operated out of buildings owned by Teva on land leased from the Israel Lands Administration. The leases with respect to the Kfar Sava plant extend until 2032 and 2034, with an option to renew until 2081 and 2083, respectively. The leases with respect to the Netanya plant extend until 2018 and 2022, with an option to renew until 2067 and 2071, respectively. The lease with respect to the Ramat Hovav plant extends until 2043, with an option to renew until 2092. The lease with respect to the Jerusalem pharmaceutical plant extends until 2021, with an option to renew until 2070. Most of the above payments due under these leases (other than the options) have been prepaid. The corporate headquarters in Petach Tikva is leased until December 2006, with an option to renew annually until December 2012.

In North America, Teva leases its facility located in North Wales, Pennsylvania, the initial term of which expires in 2011, with a five-year extension option. The leases on the two buildings in which Sicor conducts its manufacturing operations in Irvine, California expire in 2007 and 2008, respectively. Leases on the other Irvine buildings, which are used for warehouse, packaging, research and office purposes, expire at various times from September 2006 through 2010; all but one of those leases (used for office purposes) contain options to renew for various periods. Part of Novopharm s headquarters in Toronto, Ontario is leased through 2010, with an option to renew for one additional five-year period, while the other part currently is in month-to-month status. Novopharm also leases a manufacturing site on a month-to-month basis and a warehouse in Toronto under a lease that expires next year and which Novopharm may or may not renew.

Teva owns or leases various other facilities worldwide.

In addition through its acquisition of Ivax in January 2006, Teva acquired pharmaceutical manufacturing facilities in Buenos Aires, Argentina; Munro, Argentina; Santiago, Chile; Opava, Czech Republic; Preston Brook, England; Runcorn, England; Miami, Florida; Falkenhagen, Germany; Waterford, Ireland; Mexico City, Mexico; Ramos Arizpe, Mexico; Northvale, New Jersey; Congers, New York; Lima, Peru; Kutno, Poland; Cidra, Puerto Rico; Guayama, Puerto Rico; St. Croix, the U.S. Virgin Islands; and Guacara, Venezuela. Ivax owns the manufacturing facilities in Argentina, Chile, the Czech Republic, England (Preston Brook), Florida, Germany, Mexico, New York, Poland, Puerto Rico and Venezuela and leases its remaining manufacturing facilities. Ivax also owns or leases various other facilities worldwide.

ITEM 4A: UNRESOLVED STAFF COMMENTS

None.

ITEM 5: OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Introduction

Teva is a global pharmaceutical company producing drugs in all major treatment categories. It is the world s leading generic drug company and has the leading position in the U.S. generic market. Teva has successfully utilized its production and research capabilities to establish a global pharmaceutical operation focused on supplying the growing demand for generic drugs and on opportunities for proprietary branded products for specific niche categories, with its leading branded drug being Copaxone® for multiple sclerosis. Teva s active pharmaceutical ingredients (API) business provides both significant revenues and profits from sales to third-party manufacturers and strategic benefits to Teva s own pharmaceutical production through its timely delivery of significant raw materials.

The generic drug industry as a whole, and therefore Teva s own operations, are affected by demographic trends and budgetary constraints of governments and health care organizations. In each of the markets in which Teva operates, governments as well as private employers are working to control growing health care costs, and there is a steadily growing recognition of the importance of generics in providing access to affordable pharmaceuticals. The generic industry is significantly affected by trends of consolidation among managed care

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providers, large pharmacy chains, wholesaling organizations and other buyer groups. Teva, as an industry leader and a consolidator, differentiates itself by balancing its portfolio with generic and innovative activities, by its geographic breadth, by the strategic depth of its vertical integration, by combining local customer responsiveness with a global edge and by successfully managing increasing growth and complexity.

Highlights

In 2005, Teva net sales grew to $5.3 billion, an increase of 9% over 2004 net sales. In contrast with previous years, almost all of this sales growth was organic growth within Teva s existing operations, with currencies having only a negligible positive impact on sales.

Net income in 2005 amounted to $1,072 million. On a U.S. GAAP reported basis, after taking into account certain charges in 2004 relating principally to the acquisition of Sicor, 2005 net income increased 223% over 2004. Excluding such charges from 2004, 2005 net income increased 11% over the full year of 2004. Teva believes that excluding these one-time items from its results of operations represents a better indicator of the underlying trends in its business. The results, after these exclusions, are the primary results used by management and Teva s board of directors to evaluate the operational performance of the Company, to compare against the Company s annual work plans and budgets, and ultimately to evaluate the performance of management.

Among the more significant highlights of 2005 were:

- The introduction during 2005 in the United States of 27 new generic products, the most significant of which were fexofenidine and azithromycin, which were introduced in the second half of the year. However, U.S. generic sales did not match 2004 record levels because of a decreased number of significant generic product introduction opportunities in 2005 as well as price erosion on several significant products introduced in 2004 for which Teva had enjoyed generic market exclusivity.

- The continued success of Copaxone® in both the U.S., where Copaxone® for the first time became the leading MS drug both in terms of total and new prescriptions, and in Europe. Global in-market sales of Copaxone® in 2005 exceeded $1 billion for the first time, making Copaxone® Teva s first blockbuster drug.

- Significantly higher European sales of generic products, resulting from new product launches. Net sales increased in every European country in which Teva operates.

- Slightly higher gross profit margins of 47.2%, compared with 46.7% in 2004, with quarterly margins fluctuating within a range of 46.3% for the first quarter of 2005 and 48.3% for the fourth quarter of 2005.

- Operating profit margin of 25% and net income margin of 20.4% compared with 25.4% and 20.1%, respectively, for 2004 (after excluding the one-time items in 2004 described above).

- Financial expenses in 2005 of $4 million compared with financial income of $26 million in 2004, with quarter-to-quarter fluctuations mainly the result of hedging activities as well as currency movements.

- An effective tax rate of 18%, compared with a 22% effective rate in 2004, mainly reflecting the impact of changes in the geographic sources of income.

Ivax Acquisition

On January 26, 2006, Teva completed its acquisition of Ivax Corporation, a multinational generic pharmaceutical company with headquarters in Miami, Florida and with operations mainly in the United States, Europe and Latin America, for approximately $3.8 billion in cash and

123 million ADRs. For accounting purposes, the transaction was valued at $7.9 billion, based on the value of the ADRs during the five trading day period commencing two trading days before the date of the merger agreement with Ivax.

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This acquisition, Teva s largest to date, enhances Teva s leadership position in the United States, expands its strong presence in Western Europe and significantly boosts Teva s reach in Latin America, Russia and other Central and Eastern European countries. The acquisition further provides Teva with an opportunity to expand the vertical integration between Teva s API business and Ivax s finished dose manufacturing operations in both existing and new regions. Ivax brings Teva new capabilities in the respiratory business, including proprietary technologies. In addition, it provides Teva with an enhanced innovative pipeline focused on the central nervous system and oncology, with products in various stages of clinical development. Ivax also adds to Teva s existing veterinary business through the Ivax animal health business. The acquisition strengthens Teva s ability to respond, on a global scale, to a wider range of requirements of patients, customers and healthcare providers, both therapeutically and economically. As a result of the acquisition, Teva now has direct operations in more than 50 markets, as well as 44 pharmaceutical manufacturing sites, 15 generic R&D centers operating mostly within those sites and 18 API sites around the world.

Pursuant to a consent order entered into among Teva, Ivax and the U.S. Federal Trade Commission, Teva and Ivax divested certain formulations of eleven generic products with respect to which they had a product overlap, representing approximately $15 million in aggregate annual sales. In addition, prior to or in connection with Ivax s acquisition by Teva, various authorized generic distribution agreements to which Ivax was a party were terminated or assigned to third parties. These distribution agreements related to, among other products, oxycodone and amoxicillin clavunalate, and represented approximately $198 million in Ivax aggregate sales during 2005.

While the inclusion of Ivax sales will increase Teva s sales in all of Teva s main geographies, it is anticipated that the impact on the relative weight of the geographies will be minimal with some increased weight for Europe and Latin America, at the expense of North America. Regarding API sales, Teva s existing API sales to Ivax will shift from third-party sales to intercompany sales, while Ivax s own third-party API sales will be included in Teva s third-party API sales.

For the purpose of financing the cash portion of the acquisition, Teva used approximately $1.7 billion of its own cash together with short-term borrowings under bridge financing facilities. These bridge loans were then replaced within several days with the proceeds of publicly issued debt securities, comprised of a mixture of convertible senior debentures and long-term straight debt instruments, as follows:

$750 million of 1.75% convertible senior debentures due 2026;

$500 million of 0.25% convertible senior debentures due 2026;

$500 million of 5.55% senior notes due 2016; and

$1,000 million of 6.15% senior notes due 2036.

Teva sold an additional $67.5 million of its 1.75% convertible senior debentures due 2026 and $75 million of its 0.25% convertible senior debentures due 2026 on March 1, 2006 pursuant to the over-allotment options granted to the underwriters of such securities.

As the acquisition of Ivax took place on January 26, 2006, the results of operations of Ivax will be consolidated with those of Teva commencing on February 1, 2006 and are not reflected in the financial results covered by this annual report.

Sicor Acquisition

In addition to several recent but less significant regional acquisitions, in January 2004 Teva completed its acquisition of Sicor Inc., a generic pharmaceutical company based in California, for approximately $3.46 billion in cash and Teva shares. This acquisition combined Teva s oral dose generic drugs franchise with Sicor s generic injectables business, with Sicor s API business complementing Teva s global API offerings. The Sicor acquisition further provided Teva with new capabilities for the development and production of biological products. Integration of Sicor s business into Teva s operations was substantially completed during 2004.

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Results of Operations

The following table sets forth, for the periods indicated, certain financial data presented as percentages of net sales and the increase/decrease by item as a percentage of the amount for the previous year.

In the years ended December 31, 2004 and 2003, Teva recorded certain one-time items, the exclusion of which management believes presents a better indicator of the trends in its underlying operations. These items included:

- in 2004, a charge of $633 million for expenses primarily related to a write-off of in-process R&D in connection with the acquisition of Sicor; and
- in 2003, $73 million of net income primarily related to a litigation settlement with GSK which resulted in Teva s receipt of rights to Purinethol®.

A detailed reconciliation of our U.S. GAAP reported results and our results after the exclusion of such items, a non-GAAP financial measure, is presented under Item 3 above. Both the table of percentage changes which accompanies this analysis and the textual descriptions below analyze results before, as well as after, giving effect to such charges and benefits.

	Percentage of Net Sales Year Ended December 31			Percentage Change Comparison	
	2005	2004	2003	2005-2004	2004-2003
	%	%	%	%	%
Reported results					
Net sales	100.0	100.0	100.0	9.4	46.5
Gross profit	47.2	46.7	46.4	10.8	47.4
Research & development expenses	7.3	7.4	7.4	7.6	46.3
Less participations and grants	(0.3)	(0.4)	(0.9)	(19.8)	(40.8)
Research & development net	7.0	7.1	6.5	9.0	58.5
Selling, general and administrative expenses	15.2	14.5	15.9	14.7	33.8
Operating income	25.0	12.0	26.8	127.2	(34.1)
Financial income (expenses) net	(0.1)	0.5	(0.2)	N/A	N/A
Income before income taxes	24.9	12.6	26.6	116.8	(30.8)
Net income	20.4	6.9	21.1	223.2	(51.3)
Data before one-time items (non-GAAP financial measures)					
Operating income	25.0	25.4	24.0	7.8	55.2
Income before income taxes	24.9	25.7	23.8	5.6	58.9
Net income	20.4	20.1	18.9	11.2	56.1

Sales General

Consolidated sales by geographic areas and business segments were as follows:

Sales by Geographical Areas

				%	%	Percent Change	
Sales for the Period	**2005**	**2004**	**2003**	**of 2005**	**of 2004**	**2005 from 2004**	**2004 from 2003**
	U.S. dollars in millions						
North America	3,146	3,059	2,055	60%	64%	3%	49%
Europe	1,529	1,245	861	29%	26%	23%	45%

Israel and other countries	575	495	360	11%	10%	16%	37%
Total	5,250	4,799	3,276	100%	100%	9%	46%

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Sales by Business Segments

Sales for the Period	2005	2004	2003	% of 2005	% of 2004	Percent Change 2005 from 2004	Percent Change 2004 from 2003
	U.S. dollars in millions						
Pharmaceuticals	4,703	4,276	2,885	90%	89%	10%	48%
API*	524	501	371	10%	10%	5%	35%
Other	23	22	20		1%	5%	13%
Total	5,250	4,799	3,276	100%	100%	9%	46%

* Third-party sales only.

Teva s overall sales growth for 2005 was driven principally by organic growth of both the pharmaceutical and the API business segments, with almost no impact from currency fluctuations.

Pharmaceutical Sales

North America

In 2005, pharmaceutical sales in North America amounted to $2,837 million, representing an increase of 3% over 2004. The increase in sales was attributable to:

- two major new generic product launches in the U.S.: the generic version of Allegra®, which was launched in September 2005 in cooperation with Barr Pharmaceuticals, Inc., and the generic version of Zithromax®, which was launched in December 2005. Both of those products represent at risk launches given the pendency of ongoing patent litigation. While the following additional generic products were lauched in the U.S. during 2005 (listed in the order of their launch during the year), in general, 2005 was a year in which there were fewer opportunities for major new product launches, and these additional new generic products represented relatively minor opportunities for Teva: Augmentin® (chewable tablets and suspension), Glucovance®, Calcijex®, Depo-Medrol®, Diflucan®, Clozaril®, Lamictal®, Biaxin®, Cleocin®, Remeron®, Allegra®, Arava®, Depo-Provera®, Retrovir®, Paxil®, Amaryl®, Vasotec®, Prostigmin®, Metaglip®, Aredia®, Sandostatin®, Sandostatin LAR®, Zithromax®, Copegus® and Cefzil® (tablets and suspension);

- the continued growth in sales of Copaxone®, which reached a market-leading share of 34.3% of total U.S. MS prescriptions in December 2005; and

- the continued substantial growth in Canada due to 13 new product launches, as well as the revaluation of the Canadian dollar against the U.S. dollar.

On the other hand, price erosion of several major products that were introduced to the market during 2004, such as oxycodone 80mg, gabapentin and carboplatin, where Teva experienced limited competition in 2004, combined with a higher rate of erosion of the base business of generic products in 2005, more than offset the contribution of the new product sales in 2005.

In 2005, Teva dispensed 252 million generic prescriptions in the U.S., an increase of 32 million prescriptions as compared to 2004 and 40 million prescriptions ahead of Teva s nearest generic competitor.

While a major portion of 2005 product launches were derived from Teva s R&D pipeline, some of the key products that were launched in 2005 were derived either from existing or new collaboration agreements. Such agreements demonstrated Teva s commitment to bringing important new generic products to the U.S. market in the face of complex legal and regulatory barriers. These collaborations included a June 2005 strategic alliance arrangement with Barr for the marketing rights in the U.S. for the generic version of Allegra® (fexofenadine) tablets. Under the

agreement, Barr enabled Teva to launch its own product, with the parties sharing profits. The

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percentage of profit share to Barr is dependent on multiple factors including the number of competitors and resolution of related patent litigation with Sanofi-Aventis. The parties have agreed to share the patent litigation risks on a proportionate basis to that of the profit split arrangement. This product, which was launched at risk in September 2005, is the subject of a patent litigation more fully described under Contingent Liabilities included in Note 8 to Teva s consolidated financial statements included in this report.

In February 2005, Ivax announced that it had entered into a settlement of its litigation with the FDA and Alpharma Inc. regarding gabapentin, the generic equivalent of Neurontin®. Pursuant to the settlement, Alpharma waived its FDA-awarded 180-day marketing exclusivity in favor of Ivax, effective on March 23, 2005 for gabapentin capsules and April 29, 2005 for gabapentin tablets. As a result, Ivax was able to market generic gabapentin capsules and tablets prior to the expiration of Alpharma s 180-day marketing exclusivity periods. Under the terms of the exclusivity sharing agreement with Alpharma, Teva had already launched its generic gabapentin capsules and tablets in October and December 2004, respectively. Ivax s launch of its generic gabapentin capsules and tablets, as well as introductions of this product by other manufacturers, resulted in price erosion, which had an adverse impact on Teva s sales in 2005.

Teva expects that its growth in North America will continue to be fueled by its strong U.S. generic pipeline, which, as of February 28, 2006, including products acquired through the Ivax acquisition, included 160 ANDAs, including 38 tentative approvals and 122 pending ANDAs. Total annual branded sales of this pipeline exceed $94 billion. Of these applications, 88 were Paragraph IV applications i.e., applications that challenge patents of branded products. Teva believes it is the first to file on 49 of these applications, relating to branded products whose aggregate annual U.S. sales exceeded $37 billion in 2005.

While all of Teva s North American pharmaceutical sales growth during 2005 was driven by organic growth, the inclusion of Sicor sales contributed a major portion of the growth in sales from 2003 to 2004. In 2004, pharmaceutical sales in North America amounted to $2,758 million, representing an increase of 51% over 2003. In addition to the inclusion of Sicor sales, the increase in sales was also attributable to launches of some major new generic products in 2004, as well as the continued growth in sales of Copaxone®.

In Canada, during 2005, Teva continued to experience substantial growth. Pharmaceutical sales in the Canadian market increased approximately 22% from 2004 due to 13 new product launches as well as the revaluation of the Canadian dollar against the U.S. dollar. The new products launched by Novopharm, Teva s principal Canadian subsidiary, included the generic versions of (listed in the order of their launch during the year): Arava®, Wellbutrin®, Inhibace®, Fosamax Once Weekly®, Monopril®, Monocor®, Coumadin®, Imitrex®, Topamax®, Tenormin®, Zithromax®, Propofol Injectable® and Carboplatin Injectable®. A further 34 products have been submitted to the Canadian Therapeutic Products Directorate and are awaiting approval. Collectively, the brand name versions of the products subject to pending applications by Novopharm (including those submitted in 2005) had annual Canadian sales in 2005 of approximately U.S. $4.1 billion.

Europe

Pharmaceutical sales in Europe in 2005 amounted to $1,378 million, an increase of 25% compared to 2004, primarily due to 146 new launches of generic products, including many of the same key products in a variety of countries within Europe. Among the significant products sold by Teva in Europe during 2005 were the generic versions of Lipitor®, Zithromax®, Lamictal®, Zoton®, Seroxat/Deroxat®, Staril/Fosinopril® and Fosamax Once Weekly®, that were launched during 2004 and 2005. Other contributors to the year-over-year sales growth included: higher sales of third-party products in Hungary, the continued penetration of Copaxone® in Europe, sales from newly acquired companies including Dorom S.r.l. in Italy, which was acquired at the end of 2004, and Medika AG in Switzerland, which was acquired in July 2005 and, to a lesser extent, the establishment of new operations in the Slovak Republic, Spain, Sweden and Portugal.

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Most of the European currencies remained relatively constant as against the U.S. dollar in 2005 (on an annual average compared to annual average basis), although they experienced some quarter-to-quarter swings in 2005. Accordingly, currency fluctations relative to the U.S. dollar had practically no impact on European sales growth in 2005.

In 2005, Teva received 357 generic approvals, corresponding to 22 new compounds in 56 formulations. In addition, in Europe, as of February 28, 2006, excluding products acquired through the Ivax acquisition, 125 compounds representing 260 formulations and 810 marketing authorization applications were pending approval, with over 280 additional compounds approved for development. Teva believes that this pipeline of approvals and applications will generate significant growth in the next several years and includes important products, some of which Teva expects to launch in 2006 in various EU countries.

Over the course of 2005, Teva continued to register its products in Europe. As part of the mutual recognition procedure established by the European Union, an attempt was made to simplify the registration process, although centralized registration for generic products is, as yet, only possible in a few cases in Europe. Due to recent court interpretations of essential similarity, it has become possible to register generic drugs containing different salts of the active ingredient. Teva has significantly increased its registration efforts in a number of European countries: Hungary, the United Kingdom, France, Germany, The Netherlands and Poland.

A significant number of legislative changes in Europe aimed at reducing health care costs were introduced in Europe during 2005. Some of these changes, such as in The Netherlands, France and Italy, had the effect of reducing the prices of generic products, while others provided more favorable conditions for European generics. The impact of these price reductions is dependent upon the extent to which increased sales due to lower prices can offset the price reductions. It is anticipated that 2006 will continue to be a year of additional legislative changes in the European pharmaceutical industry.

Pharmaceutical sales in Europe in 2004 amounted to $1,099 million, an increase of 46% compared to 2003, primarily due to the sale of new generic products. In addition, higher sales of third-party products in Hungary, the continued penetration of Copaxone® in Europe and the 10% revaluation of the Euro against the U.S. dollar (when annual average compared to annual average) contributed to the sales increase.

In December 2004, Teva acquired Dorom S.r.l., one of the largest suppliers of generic pharmaceuticals to the Italian retail market, for approximately $85 million in cash. This acquisition had an insignificant impact on 2004 results, but further strengthened Teva s position in the Italian market for generic products.

Israel and Other Countries

***Israel*.** Pharmaceutical sales in Israel, which amounted to $282 million in 2005, increased by 7% compared to 2004. Since the rate of exchange of the NIS relative to the U.S. dollar remained at the same level during 2005 (when annual average compared to annual average), the sales increase represents currency-neutral growth. The increased NIS sales were achieved by new product launches as well as increased sales under existing and new distribution agreements, although at somewhat reduced margins.

Several issues affected Teva s product pricing in Israel in 2005. While the national health budget was increased during 2005, government-sponsored health funds continue to conduct cost-saving measures restricting expenditures for pharmaceutical products. Furthermore, Teva s prices were affected by pricing regulations that mandate that the retail prices of pharmaceuticals in Israel may not exceed the average of prices in four European markets (the U.K., Germany, France and Belgium) (the so-called Dutch Model). Lastly, and to a lesser degree, the Israeli health care funds utilized parallel importing, primarily to pressure the prices of Israeli producers.

Pharmaceutical sales in Israel, which amounted to $263 million in 2004, increased by 8% compared to 2003. However, net of the impact of the strengthening during the year of the NIS relative to the U.S. dollar, sales increased by 6%. The increased NIS sales were achieved by new product launches as well as new distribution agreements.

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Other Countries. Teva s pharmaceutical sales to markets outside of North America, Europe and Israel amounted to $206 million in 2005, an increase of 32% over 2004. This increase represents higher sales primarily in Russia and to a lesser extent in Latin America and Asia, including higher sales of Copaxone®. During 2005, Teva commenced registration activities of generic products in Japan and enhanced its registration activities in Turkey and Russia.

Teva s pharmaceutical sales to markets outside of North America, Europe and Israel amounted in 2004 to $156 million, an increase of 143%. This increase represents primarily the inclusion of Sicor s sales in these regions, largely in Mexico, where it maintains significant operations, as well as growth, including increased sales of Copaxone® in certain countries.

Innovative Products

In-market global sales of Copaxone® in 2005 reached a new record of $1,176 million, an increase of 26% over 2004. According to IMS, Copaxone® continued to strengthen its position as the market leader in the U.S. both in terms of new and total prescriptions, with market shares of 35.2% and 34.3%, respectively, in December 2005. U.S. Copaxone® sales represented 66% of total in-market global sales in 2005 and amounted to $782 million, an increase of 25% over 2004. In-market sales outside the United States, primarily in Europe, increased 27% to $394 million, driven by significant sales increases in Germany, the largest MS market in Europe, France, Spain and the U.K. Copaxone® s global sales growth rate was almost double the growth rate of the global market for MS products. The growth of in-market sales of Copaxone® in the United States also reflected the impact of two price increases of 9.4% each, announced in October 2004 and May 2005. Since the European currencies remained at the same level as against the U.S. dollar in 2005 (when annual average compared to annual average), sales growth of Copaxone® in Europe was not impacted by currency movements.

In 2004, in-market global sales of Copaxone® amounted to $936 million, an increase of 30% over the previous year. U.S. sales in 2004 accounted for 67% of global sales of Copaxone®. The growth of in-market sales of Copaxone® in the United States in 2004 also reflected the impact of price increases. Sales growth of Copaxone® in 2004 in Europe also reflected the positive impact of the strengthening of the European currencies against the U.S. dollar.

On March 8, 2006, an FDA advisory panel recommended that the FDA should allow back onto the U.S. market, Tysabri®, an MS therapy which was originally launched in the United States in December 2004 and shortly thereafter was voluntarily withdrawn from the market after two patients developed a rare brain disorder, known as progressive multifocal leukoencephalopathy, or PML, resulting in the death of one of the patients. A third patient was later discovered to have PML and also died. According to press reports, the FDA is currently evaluating various elements of a risk-management plan proposed by the makers of Tysabri®. As reported, the manufacturers of Tysabri® proposed that the drug carry a strict black box warning that highlights the risk of PML and states that Tysabri® should be given alone rather than in combination with other drugs. The FDA is expected to make a final decision with regard to Tysabri® s expected reentry into the U.S. market and any related restrictions by the end of March 2006. Teva continues to believe that Copaxone® is a superior product and that it, alone among all of the existing MS therapies, is the only product for which efficacy has been shown to be sustained for over 10 years.

Azilect®, Teva s second innovative drug, was launched in its first market, Israel, in March 2005. Teva launched Azilect® for the treatment of Parkinson s disease, both as initial monotherapy in early Parkinson s disease and as an adjunct to levodopa in moderate to advanced stages of the disease.

In February 2005, Azilect® was granted marketing authorization by the EMEA and was launched jointly by Teva and Lundbeck in the U.K. in June 2005 and in Germany in July 2005. This was followed in 2005 by additional launches in Ireland, Austria, Denmark, Finland, Poland and Norway, with additional countries expected in 2006.

In August 2005, Teva received a second approvable letter from the FDA regarding its NDA for Azilect®. However, the FDA has continued to have issues regarding the NDA. Teva has had a number of follow-up

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meetings with the FDA to discuss issues raised by them, and Teva has made additional submissions of information to the FDA. Teva intends to continue to work closely with the agency to resolve the open issues. In Canada, Azilect® is still under review by regulatory authorities.

Active Pharmaceutical Ingredients (API) Sales

Sales of active pharmaceutical ingredients to third parties in 2005 amounted to $524 million, an increase of 5% over 2004. At the same time, intercompany sales of active pharmaceutical ingredients during 2005 increased 24% and amounted to $543 million. The substantially higher increase in intercompany sales reflects a trend which commenced in 2004 and is expected to also continue during 2006, with the result that intercompany sales will reflect a higher portion of the total API sales. The high proportion of intercompany sales reflects the strategic importance of vertical integration and is one of the reasons for Teva s continued improvement in gross profitability. Teva s portfolio of API products is expected to increase from over 220 to approximately 250 as a result of the Ivax acquisition.

Sales of active pharmaceutical ingredients to third parties in 2004 amounted to $501 million, an increase of 35% over 2003. At the same time, intercompany sales of active pharmaceutical ingredients increased 55% and amounted to $439 million. The increase in both the sales to third parties and intercompany sales reflects primarily the inclusion of Sicor API sales, as well as significant sales of gabapentin and pravastatin API. Total sales of the API division in 2004, including intercompany sales, increased by 44% to $940 million.

As noted above, as a result of the Ivax acquisition, Teva s existing API sales to Ivax will shift from third-party sales to intercompany sales, while Ivax s own third-party API sales will be included in Teva s third-party API sales.

Other Income Statement Line Items

Gross Profit

Gross profit margins reached 47.2% in 2005 compared with 46.7% in 2004 and 46.4% in 2003, reflecting a change in the product mix in which higher sales of newly launched products and Copaxone®, as well as the increasing benefits of Teva s vertically integrated API division, more than offset lower margins on Teva s base business. Gross margins also improved in 2004 due to the inclusion of Sicor with its higher gross profit margins. In 2005, fexofenadine, which was launched with Barr, had a positive impact on gross margins, since the profit split with Barr was recorded under SG&A. Several of the products launched in 2004 also involved collaborations with partners but on a royalty basis, which impacts gross margins. Despite these royalties, gross margins increased in 2004. As required under U.S. GAAP, Sicor s acquired inventories were stepped up to their fair market value at the date of acquisition in 2004. As a result, the sales of these inventories negatively impacted Teva s gross profit margins during the first quarter of 2004.

In the fourth quarter of 2005, our gross margins reached 48.3%. However, we continue to believe that the gross margins of our operations excluding Ivax will fluctuate between 45% 48% due to shifts in our product mix and shifts in the geographic spread of our sales. Our gross margins in 2006 will reflect a blending of the gross margin rates of Teva and Ivax s historical operations, negatively impacted by the amortitization of the acquired Ivax product rights. In addition, gross margin will initially be negatively impacted by a step-up in Ivax acquired inventories. Gross margin will continue to have quarter-to-quarter fluctuations as a result of shifts in the product mix and geographic spread of the sales of the combined companies.

Research and Development (R&D) Expenses

Gross research and development expenses and net research and development expenses as a percentage of sales remained practically the same in 2005, relative to 2004.

Generic R&D expenses in 2005 accounted for 54% of Gross R&D expenses, an increase of approximately 4% compared to 2004, due to increased R&D activity for North America, including R&D efforts for the

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Canadian market, as well as generic R&D efforts for Europe. Innovative R&D expenses amounted to approximately 26% of Gross R&D expenses for 2005, an increase of 19% compared to 2004, mainly attributed to higher expenditures relating to MS and other pipeline projects. The balance was dedicated to the development of other products, principally new products for the API division.

In 2005, Teva submitted a total of 151 files worldwide, including 38 ANDAs to the FDA, 29 abbreviated new drug submissions in Canada and files for 30 new molecules in various European markets.

In November 2005, Teva initiated a large clinical study to determine whether treatment with once-daily Azilect® can modify the progression of Parkinson disease. The ADAGIO study (Attenuation of Disease progression with Azilect® Once-daily) will enroll approximately 1,100 patients recently diagnosed with Parkinson s disease in North America, Europe and additional countries, including Israel and Argentina. This study, which has a similar delayed-start design as the previously published TEMPO 12 months trial, is aimed at reproducing and confirming the earlier findings of the TEMPO study.

In 2004, Teva signed an agreement with Active Biotech, a Sweden-based, publicly traded biotechnology company, to develop and commercialize laquinimod as an oral treatment for multiple sclerosis. In 2005, pursuant to this agreement, Teva initiated a double-blind, placebo-controlled multicenter Phase II clinical study in several European countries, in which the effects of laquinimod are being tested. Results of this study are expected during 2006.

Teva submitted an investigational new drug application (an IND) to the FDA in 2005 to initiate a clinical trial in the U.S. with laquinimod to assess drug-drug interaction. Teva is currently working with the FDA to resolve various issues raised in connection with this IND.

Teva is seeking to develop effective and more convenient therapies for MS. An oral formulation of Copaxone® was tested in a large clinical trial, CORAL, conducted from 2000 to 2002; however, the results of the trial were not statistically significant. In late 2004, Teva and H. Lundbeck A/S, a Denmark-based, publicly traded pharmaceutical company and Teva s strategic partner in the development of oral Copaxone®, initiated two pilot Phase II clinical studies with two doses of an enteric coated formulation of Copaxone®. Based on the results, received in March 2006, Teva and Lundbeck will not continue the development of this formulation. Nevertheless, Teva is considering future development of Copaxone® in various non-parenteral formulations and will make its decision in the context of its entire MS portfolio.

While gross research and development expenses and net research and development expenses as a percentage of sales remained practically the same, they increased in 2004 in absolute terms by 46% and 59%, respectively, as a result of increased spending, mainly on generic R&D.

Generic R&D expenses in 2004 accounted for 55% of Gross R&D expenses, an increase of approximately 49% compared to 2003, due to increased R&D activity for North America, including R&D efforts for Novopharm, as well as generic R&D efforts for Europe. Generic R&D also increased due to the inclusion of Sicor s generic R&D activities. Innovative R&D expenses amounted to approximately 27% of Gross R&D expenses for 2004, an increase of 12% compared to 2003, mainly attributed to higher expenditures relating to MS and other pipeline projects. The balance was dedicated to the development of other products, principally new products for the API division.

In 2004, Teva substantially increased its research efforts to enhance the development of its generic pipeline. During the course of the year, Teva submitted an additional 53 ANDAs to the FDA and 31 abbreviated new drug submissions in Canada.

Selling, General and Administrative Expenses

SG&A expenses in 2005 amounted to $799 million, an increase of 15% over 2004, and as a percentage of sales, SG&A expenses increased from 14.5% for 2004 to 15.2% for 2005. These higher SG&A expenses are primarily the results of the profit-sharing agreement with Barr Pharmaceuticals related to the launch of fexofenadine described above. Teva believes that SG&A expenditures as a percentage of sales should generally decline as sales continue to increase, although the launch of Azilect®, additional profit-sharing agreements and increased support for Copaxone® could impact this trend going forward.

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As of the first quarter of 2006, Teva will, for the first time, expense employees stock options. We expect the annual pre-tax charge to amount to approximately $50 million, most of which will fall under the SG&A line item.

SG&A expenses in 2004 amounted to $697 million, an increase of 34% over 2003, but as a percentage of sales, SG&A expenses decreased to 14.5% for 2004 from 15.9% for 2003. These results reflect the combined impact of offsetting factors, including, on the one hand, increased expenses resulting from the consolidation of Sicor, offset, on the other hand, by higher sales volumes.

Operating Income

Operating income increased as a result of the combined impact of the factors described above.

Financial Income (Expenses)

In 2005, Teva recorded financial expense of $4 million, compared with financial income of $26 million during 2004. During 2005, higher yields on Teva s increased cash and investment balances were more than offset by the negative effect of currency erosions and hedging activities. In addition, Teva saved both interest and the amortization of issuance expenses associated with certain debentures that were converted during 2004 and 2005. In general, income or expense from hedging activities are partially offset in other line items which enjoy or suffer from the impact of currency movements on the base asset. The impact on the financial income/expense line item is however highlighted, as this line item is of relative small magnitude compared to sales, cost of goods and other income statement line items.

Financial expenses will increase substantially during 2006, as Teva s interest-bearing assets decreased and its borrowed amounts increased due to the acquisition of Ivax. The annual interest payments and amortization of issuance expenses on the $2.9 billion raised in connection with the acquisition will amount to approximately $120 million.

In 2004, Teva recorded financial income of $26 million, compared with an expense of $5 million during 2003. During 2004, financial income benefited from the strengthening of currencies against the U.S. dollar, mainly the Euro, as well as the Hungarian Forint and the Canadian dollar. In addition, Teva saved both interest and the amortization of issuance expenses associated with the debentures that were converted and started to benefit from the increasing interest rates through higher yields on a larger pool of investments, at the same time that most of its liabilities bore fixed interest rates. However, the 2004 financial income did not flow directly into net income, as it was partially offset by the negative impact that currency fluctuations had on various expense items.

Taxes

Provisions for taxes as a percentage of pre-tax income amounted to 18.0% in 2005, compared with 22.2% in 2004 and 20.8% in 2003. The rate of tax fluctuates with the source of taxable income. The statutory Israeli corporate tax rate was 34% in 2005 compared to 35% in 2004 and 36% in 2003. It is scheduled to further decrease to 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% from 2010 and onwards. However, historically, Teva s effective consolidated tax rates have been considerably lower, since a major portion of Teva s income in Israel is derived from approved enterprises (as more fully described in Item 10 Israeli Taxation below) and from operations outside of Israel, where Teva has enjoyed lower tax rates. The lower tax rate in 2005 represents the increased Copaxone® and API sales and profits, most of which derived from low tax sources, as well as some products introduced into the U.S. market that originated from an Israeli source. The increased tax rate in 2004 as compared to 2003 mainly represents the addition of Sicor with its generally higher tax rates. Nevertheless, this increase was partially offset by the commencement of the realization of new tax benefits on incremental Copaxone® sales as a result of building a second production facility for Copaxone® in the south of Israel in a tax-advantaged zone, as well as increased profits in low tax jurisdictions, primarily in Hungary.

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Most of Teva s projects in Israel were granted approved enterprise status, which confers certain tax benefits. These benefits include a tax exemption for undistributed income generated by such projects, and lower rates of tax on dividends distributed, the source of which is approved enterprise income, for the periods set forth in the law, as described in Item 10 Israeli Taxation.

The most recent example of such an approved enterprise is Teva s new state-of-the-art pharmaceutical production facility in Jerusalem that was inaugurated in September 2005 and which will benefit from a ten-year tax exemption for undistributed income generated at such facility. This new facility has the capacity, when fully operational, to produce up to eight billion tablets annually.

Going forward, the combined Teva and Ivax tax rate is expected initially to be the blended average of the current tax rate of both companies. This blended average is expected to decrease over time with the integration of Ivax.

Net Income and Earnings per ADR

Net income in 2005 amounted to $1,072 million. On a U.S. GAAP reported basis, after taking into account certain charges in 2004 relating principally to the acquisition of Sicor, 2005 net income increased 223% over 2004. Excluding such charges from 2004, 2005 net income increased 11% over the full year of 2004. Fully diluted earnings per ADR reached $1.59 in 2005, an increase of 218% over fully diluted earnings per ADR in 2004 on a U.S. GAAP reported basis and 12% excluding one-time charges recorded in 2004. After taking into account one-time items (net of tax), in 2004 and also excluding $73 million of net income from the 2003 results primarily related to the settlement with GSK which resulted in the receipt of Purinethol®, net income totaled $332 million in 2004, as compared with $691 million in 2003 and fully diluted earnings per ADR amounted to $0.50 and $1.16 in 2004 and 2003, respectively. Before taking into account these items, net income increased by 56% over 2003 to $965 million and fully diluted earnings per ADR amounted to $1.42 and $1.04 in 2004 and 2003, respectively, an increase of 37%. Teva believes that excluding these one-time items from its results of operations represents a better indicator of the underlying trends in its business. The results, after these exclusions, are the primary results used by management and Teva s board of directors to evaluate the operational performance of the Company, to compare against the Company s annual work plans and budgets, and ultimately to evaluate the performance of management. A detailed reconciliation of our U.S. GAAP reported results and our results after the exclusion of such items, a non-GAAP financial measure, is presented under Item 3 above.

The difference between the net income growth rate and the fully diluted earnings per ADR growth rate in 2004 over 2003, is attributable to the substantial increase in share count year over year, mainly resulting from the Sicor acquisition, both the shares actually issued to the previous owners of Sicor (approximately a 6% dilution) and those deemed outstanding for purposes of the calculation arising from the convertible debentures sold to finance a portion of that acquisition (approximately a 4% dilution).

During 2005, Teva spent $379 million to repurchase 12.7 million of its shares at an average price of $29.91 per share, pursuant to an authorization by its board of directors to repurchase Teva securities in an amount valued at up to $300 million of Teva s securities, which was increased to $600 million in December 2004, as well as pursuant to a previous $50 million repurchase authorization. During 2004, Teva spent $188 million to repurchase 6.9 million of its shares and $25 million of convertible debentures under this plan. This purchase of securities had the result of decreasing total outstanding shares on a fully diluted basis at December 31, 2005 by 10.4 million shares.

During 2005, and particularly in the fourth quarter, approximately $200 million of the $450 million of Convertible Senior Debentures due 2022 were converted by their holders as the stock price was significantly higher than their original conversion price. An additional $115.5 million of these debentures were converted subsequent to December 31, 2005.

In August 2004, as a result of a call for their redemption, $360 million of 0.75% Convertible Senior Debentures due 2021 were converted into approximately 17 million ADRs. These debentures had already become dilutive as of the third quarter of 2003 as a result of the contingent conversion feature having been triggered.

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In connection with the acquisition of Ivax, approximately 123 million additional Teva ADRs were issued in January 2006. In addition, Teva used $1.7 billion of its existing cash resources, together with a total of $2.8 billion in proceeds from bridging facilities, to pay the cash portion of the purchase price for the acquisition of Ivax. As part of the acquisition, substantially all of Ivax s employee stock options become fully vested in accordance with the terms of the applicable option plans and, in accordance with the merger agreement with Ivax, became exercisable for an aggregate of approximately 16 million Teva ADRs.

The bridge loans for the Ivax acquisition were promptly refinanced through public offerings of debt securities of two Teva finance subsidiaries, who issued an aggregate of $1 billion principal amount of 6.15% Senior Notes due 2036, $500 million principal amount of 5.55% Senior Notes due 2016, $817.5 million principal amount of 1.75% Convertible Senior Debentures due 2026 and $575 million principal amount of 0.25% Convertible Senior Debentures due 2026. Holders of the 0.25% Convertible Senior Debentures due 2026 have the right to cause Teva to repurchase their debentures for 100% of the principal amount, plus accrued interest, in cash on February 1, 2008; holders of the 1.75% Convertible Senior Debentures due 2026 have a similar repurchase right on February 1, 2011. The 0.25% Convertible Senior Debentures due 2026 include a net share settlement feature according to which principal will be paid in cash and, in the case of conversion, only the residual conversion value above the principal will be paid in Teva s shares. Therefore, these convertible debentures will become dilutive only if the stock price exceeds the conversion price of approximately $47.16. The $817.5 million of 1.75% Convertible Senior Debentures due 2026, are convertible into approximately 16 million Teva ADRs.

Going forward, the share count for the purpose of calculating earning per share will take into account the shares issued to Ivax shareholders and the dilutive effect of convertible debentures as well as employee stock options. As of February 28, 2006, this amounts to approximately 835 million shares. The actual number of shares for the EPS calculation will vary each quarter based on the share price during that quarter. For purposes of calculating the combined company market capitalization, the share count excluding the dilutive impact of options and convertible debentures was approximately 753 million shares as of February 28, 2006.

Certain One-Time (Charges)/Benefits

The table below details certain one-time charges or benefits, net of applicable taxes, for the periods indicated that have been eliminated or added to enhance the understanding of the business and their respective effect on earnings per ADR. Teva believes that excluding the following one-time items, which primarily relate to purchase accounting adjustments in connection with the Sicor acquisition (mainly in-process R&D) and to certain product rights acquired as part of a litigation settlement, from its results of operations represents a better indicator of the underlying trends in its business. The results, after these exclusions and inclusions, are the primary results used by management and Teva s board of directors to evaluate the operational performance of the Company, to compare against the Company s annual work plans and budgets, and ultimately to evaluate the performance of management.

Year	U.S. dollars in millions	U.S. dollars per ADR*	Details
2004	(633)	(0.92)	Sicor acquisition in-process R&D; in-process R&D relating to two collaboration agreements; step-up of Sicor inventory; partial impairment of Purinethol® product rights.
2003	73	0.12	Receipt of North American rights to Purinethol® from GSK net of restructuring expenses related to impairment of property, plant and equipment in connection with the shutdown of an API facility.

* After giving retroactive effect to the 2-for-1 stock split effected in June 2004.

The in-process R&D acquired as part of the Sicor acquisition related to 32 injectable products having a range of values of between $1 million and $68 million, with an average value of approximately $18.2 million per

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product, and includes two products each with a value marginally above 10% of the total value. Since the acquisition, six of these products have been launched, including medroxyprogesterone, the product with the highest value.

Impact of Currency Fluctuations and Inflation

Because Teva s results are reported in U.S. dollars, changes in the rate of exchange between the U.S. dollar and the local currencies in the markets in which Teva operates mainly the NIS, Euro, Canadian dollar, Pound Sterling and Hungarian Forint affect Teva s results. During 2005, the movements of the main European currencies relevant to Teva, relative to the U.S. dollar, have been less significant than in previous years. While in 2005 the European currencies continued to fluctuate in value relative to the dollar, the Euro essentially maintained a constant rate of exchange relative to the dollar, when annual average compared to annual average. The Hungarian Forint revalued against the dollar by 1%, the Canadian dollar revalued against the dollar by 7% and the Pound Sterling devalued against the dollar by 1%. The NIS remained at the same level relative to the U.S. dollar. The Euro s exchange rate relative to the U.S. dollar reached the level of US$1.24 per Euro as at December 31, 2005, representing a 13% year-end to year-end revaluation, but the average to average Euro to U.S. dollar exchange rate remained relatively steady.

In terms of the Israeli Consumer Price Index (CPI), 2005 was another year with low inflation rates, as the CPI increased by just 2.4%.

Historically, the NIS has been devalued in relation to the U.S. dollar and other major currencies principally to reflect the extent to which inflation in Israel exceeded average inflation rates in western economies. Such devaluations in any particular fiscal period were never completely synchronized with the rate of inflation in Israel and therefore may have lagged behind or exceeded the underlying inflation rate.

The table below sets forth the annual rate of inflation in Israel, the annual rate of devaluation of the NIS against the U.S. dollar and the gap between them.

	Year ended December 31,				
	2005	**2004**	**2003**	**2002**	**2001**
Inflation (CPI)	2.4%	1.2%	(1.9)%	6.5%	1.4%
Devaluation/(revaluation)	6.8%	(1.6)%	(7.6)%	7.3%	9.3%
Inflation/devaluation gap	(4.4)%	2.8%	5.5%	(0.8)%	(7.9)%

Critical Accounting Policies

The preparation of Teva s consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in certain circumstances that affect the amounts reported in the accompanying consolidated financial statements and related footnotes. Actual results may differ from these estimates. To facilitate the understanding of Teva s business activities, certain Teva accounting policies that are more important to the portrayal of its financial condition and results of operations and that require management s subjective judgments are described below. Teva bases its judgments on its experience and various assumptions that it believes to be reasonable under the circumstances. Please refer to Note 1 to Teva s consolidated financial statements included in this annual report for a summary of all of Teva s significant accounting policies.

Revenue Recognition and Sales Reserves and Allowances

Revenue is recognized generally when title and risk of loss for the products is transferred to the customer. Provisions for chargebacks, returns, customer volume rebates, Medicaid rebates, other promotional arrangements, prompt pay discounts and price protection payments are established concurrently with the recognition of revenue. Accordingly, and in compliance with EITF 01-9, reported net sales is presented net of

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those deductions. These provisions primarily relate to sales of pharmaceutical products in the North American marketplace, principally the United States. The following briefly describes the nature of each deduction and how provisions are estimated in Teva s financial statements.

Provisions for chargebacks, returns, rebates, other promotional items and price protection provisions are included in Accounts payable and accrued expenses under the heading of current liabilities in Teva s balance sheets included in the accompanying financial statements. Prompt pay discount provisions are netted against Accounts receivable, net. Teva adjusts these provisions in the event that it appears that the actual amounts may differ from the estimated provisions.

Chargebacks. Teva has arrangements with various third parties, such as managed care organizations and drug store chains, establishing prices for certain of its products. While these arrangements are made between Teva and these customers, the customers independently select a wholesaler from which they purchase the products. Alternatively, certain wholesalers may enter into agreements with the customers, with the concurrence of Teva, that establish the pricing for certain products which the wholesalers provide. Under either arrangement, Teva will issue a credit (referred to as a chargeback) to the wholesaler for the difference between the invoice price to the wholesaler and the customer s contract price.

Provisions for chargebacks are the most significant component of Teva s revenue recognition process, involving estimates of contract prices across in excess of 500 products and multiple contracts with multiple wholesalers. The provision for chargebacks varies in relation to changes in product mix, pricing and the level of inventory at the wholesalers and therefore will not necessarily fluctuate in proportion with an increase or decrease in sales.

Provisions for estimating chargebacks are calculated using historical chargeback experience, or expected chargeback levels and wholesaler sales information for new products. Chargeback provisions are compared to externally obtained distribution channel reports for reasonableness. Teva regularly monitors the provision for chargebacks and makes adjustments when it believes actual chargebacks may differ from estimated provisions. In addition, because Teva will often agree to modify contract pricing with changes in the marketplace, Teva considers current and expected price competition when evaluating the provision for chargebacks.

Returns. Under certain conditions, the customer is able to return its purchases to Teva. Teva records a reserve for estimated sales returns in accordance with the provision of FAS 48, Revenue Recognition When Right of Return Exists. The returns provision is estimated by applying a historical return rate to the amounts of revenue estimated to be subject to returns. Revenue subject to returns is estimated based on the lag time from time of sale to date of return. The estimated lag time is developed by analyzing historical experience. Lag times during 2005 were generally between 22-27 months from the date of sale. Additionally, Teva considers factors such as levels of inventory in the distribution channel, product dating and expiration, size and maturity of launch, entrance of new competitors and changes in formularies or packaging for determining the overall expected levels of returns.

Customer Volume Rebates. Rebates are primarily related to volume incentives and are offered to key customers to promote loyalty. These rebate programs provide that, upon the attainment of pre-established volumes or the attainment of revenue milestones for a specified period, the customer receives a rebate. Since rebates are contractually agreed upon, rebates are estimated based on the specific terms in each agreement. Externally obtained inventory levels are evaluated in relation to estimates made for rebates payable to indirect customers.

Medicaid Rebates. Pharmaceutical manufacturers whose products are covered by the Medicaid program are required to rebate to each state a percentage of their average manufacturer s price for the products dispensed. Many states have also implemented supplemental rebate programs that obligate manufacturers to pay rebates in excess of those required under federal law. Teva estimates these rebates based on historical trends of rebates paid as well as changes in wholesaler inventory levels and increases or decreases in sales.

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Other Promotional Arrangements. Other promotional or incentive arrangements are periodically offered to customers specifically related to the launch of product or other targeted promotions. Provisions are made or expenses recorded in the period for which the customer earns the incentive in accordance with the contractual terms.

Prompt Pay Discounts. Prompt pay discounts are offered to most customers to encourage timely payment. Discounts are estimated at the time of invoice based on historical discounts in relation to sales. Prompt pay discounts are almost always utilized by customers. As a result, the actual discounts do not vary significantly from the estimated amount.

Price Protection Payments. The custom in the pharmaceutical industry is generally to grant customers price protection based on the customers existing inventory contemporaneously with decreases in the market price of the related product. Provisions for price reductions depend on future events, including price competition, new competitive launches and the level of customer inventories at the time of the price decline. Teva regularly monitors the factors that influence the pricing of its products and customer inventory levels and adjusts these estimates where appropriate.

Sales reserves and allowances for third-party sales of pharmaceutical products to U.S. customers at December 31, 2005 and 2004 were as set forth in the below table. Such sales reserves and allowances to U.S. customers comprised approximately 90% of Teva s total sales reserves and allowances as of December 31, 2005, with the balance primarily in Canada and the U.K.

	Reserves included in Accounts Receivable, net	Accounts Payable and Accrued Expenses Chargebacks	Returns	Other Sales Reserves and Allowances	Total
		(U.S. dollars in thousands)			
Balance at December 31, 2003	$ 19,607	$ 110,329	$ 65,011	$ 74,753	$ 269,700
Acquisition of Sicor	2,821	31,391	9,214	11,402	54,828
Provisions related to sales made in current period	74,890	945,498	81,964	449,635	1,551,987
Provisions related to sales made in prior periods			19,394	782	20,176
Credits and payments	(70,077)	(781,159)	(54,936)	(431,102)	(1,337,274)
	$ 27,241	$ 306,059	$ 120,647	$ 105,470	$ 559,417
Balance at December 31, 2004	$ 27,241	$ 306,059	$ 120,647	$ 105,470	$ 559,417
Provisions related to sales made in current year period	83,768	1,250,416	87,629	547,120	1,968,934
Provisions related to sales made in prior periods		6,387		2,091	8,478
Credits and payments	(78,192)	(1,242,454)	(72,818)	(455,782)	(1,849,246)
Balance at December 31, 2005	$ 32,817	$ 320,409	$ 135,458	$ 198,900	$ 687,584

Since chargeback reserves are calculated on a product and customer basis, changes may not appear to be directly reflective of the overall change in net sales due to a change in any one variable. The chargeback reserve for the year ended December 31, 2005 increased by approximately $14 million over the December 31, 2004 reserve. Reserves for returns are estimated by analyzing past returns rates, taking into consideration current product sales levels and customer mix. Returns reserves as of December 31, 2005 increased by approximately $15 million over the reserve as of December 31, 2004 primarily due to an increase in the estimated lag period between period of sale and actual return. The primary contributor to the increased Other Sales Reserves and Allowances was rebate reserves. The payment terms associated with rebate agreements can vary between

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monthly and annual, and at times payment is dependent on obtaining certain information from customers or outside sources, such as market share data. The increase in rebate reserves from December 31, 2004 to December 31, 2005 of approximately $93 million is primarily due to a change in timing of certain of the incentive payments, resulting in a higher outstanding payable due. Rebates as a percentage of gross sales did not vary significantly for the years ended December 31, 2004 or 2005.

Actual inventory on hand with our customers may be higher or lower due to differences between actual and projected demand. Teva monitors inventory levels to minimize risk of excess quantities. As is customary in the industry, Teva may provide additional incentives to wholesalers for the purchase of certain inventory items or in relation to wholesale trade shows. Revenue is recognized for sales associated with the incentives and launches, in accordance with the criteria in Staff Accounting Bulletin (SAB) 104: primarily whether the product ownership was transferred to the customer and whether provisions for sales deductions, such as chargebacks, returns, rebates, promotional and other incentives and price adjustments, can be reasonably estimated.

Income Taxes

The provision for income tax is calculated based on Teva s assumptions as to its entitlement to various benefits under the applicable tax laws in the jurisdictions in which it operates. The entitlement to such benefits depends upon Teva s compliance with the terms and conditions set out in these laws.

Deferred taxes are determined utilizing the asset and liability method based on the estimated future tax effects of differences between the financial accounting and tax bases of assets and liabilities under the applicable tax laws. Valuation allowances are provided if, based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Taxes, which would apply in the event of disposal of investments in subsidiaries, have not been taken into account in computing deferred taxes, as it is Teva s intention to hold these investments, rather than realize them.

Teva intends to permanently reinvest the amounts of tax exempt income in Israel and does not intend to declare dividend distributions from such income. Therefore, no deferred taxes have been provided in respect of such tax exempt income. As a result of the recent amendment to the Israeli Investment Encouragement Law, Teva will be required under U.S. GAAP to record a provision for deferred taxes in respect of tax-exempt income from approved enterprises (other than strategic enterprises) with respect to which the recent amendment applies (as described in Item 10 Israeli Taxation below). Through December 31, 2005, Teva did not generate any such tax exempt income that would have required it to provide for deferred taxes under U.S. GAAP.

Since Teva does not expect non-Israeli subsidiaries to distribute dividends in the foreseeable future, it does not provide for related taxes.

Contingencies

Teva is from time to time subject to claims arising in the ordinary course of its business, including patent, product liability and other litigation. In determining whether liabilities should be recorded for pending litigation claims, Teva assesses the allegations made and the likelihood that it will successfully defend itself. When Teva believes that it is probable that it will not prevail in a particular matter, it then estimates the amount of the liability based in part on advice of legal counsel.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined as follows: raw and packaging materials and purchased products mainly on a moving average basis; finished products and products in process; raw material and packaging component mainly on a moving average basis; labor and overhead on an average basis over the production period.

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Teva s inventories generally have a limited shelf life and are subject to impairment as they approach their expiration dates. Teva regularly evaluates the carrying value of its inventories and when, in its opinion, factors indicate that impairment has occurred, it establishes a reserve against the inventories carrying value. Teva s determination that a valuation reserve might be required, in addition to the quantification of such reserve, requires it to utilize significant judgment. Although Teva makes every effort to ensure the accuracy of forecasts of future product demand, any significant unanticipated decreases in demand could have a material impact on the carrying value of its inventories and reported operating results. To date, inventory adjustments have not been material.

Valuation of Intangible Assets, Marketable Securities and Long-Lived Assets

Intangible assets:

Goodwill reflects the excess of the purchase price of subsidiaries acquired over the fair value of net assets acquired. As from January 1, 2002, pursuant to FAS 142, Goodwill and Other Intangible Assets, goodwill is no longer amortized but rather is tested annually for impairment.

Intangible assets consist mainly of marketing and other rights relating to products in respect of which an approval for marketing was provided by the FDA or an equivalent agency. Intangible assets are amortized mainly using the straight-line method over their estimated period of useful life. In conjunction with acquisitions of businesses or product rights, Teva allocates the purchase price based upon the relative fair values of the assets acquired and liabilities assumed. In certain circumstances, fair value may be assigned to purchased in-process technology and expensed immediately.

Teva regularly assesses whether indefinite life intangibles and goodwill have been impaired and will adjust the carrying values of these assets whenever events or changes in circumstances indicate that some or all of the carrying value of the assets may not be recoverable. Its judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operating performances of its businesses and products. Future events could cause Teva to conclude that impairment indicators exist and that the carrying values of its intangible assets or goodwill are impaired. Any resulting impairment loss could have a material adverse impact on its financial position and results of operations. No impairment losses relating to goodwill and indefinite life intangible assets have been recorded to date.

Teva evaluates the recoverability and measures the possible impairment of its goodwill under FAS 142. The impairment test is a two-step process that begins with the estimation of the fair value of the reporting unit. The first step screens for potential impairment, and the second step measures the amount of the impairment, if any. Teva s estimate of fair value considers publicly available information regarding the market capitalization of the company, as well as (1) publicly available information regarding comparable publicly traded companies in the pharmaceutical industry, (2) the financial projections and future prospects of its business, including its growth opportunities and likely operational improvements, and (3) comparable sales prices, if available. As part of the first step to assess potential impairment, Teva compares, on a reporting unit level, its estimate of fair value for such reporting unit to the book value of the reporting unit. If the book value of any of the reporting units is greater than the estimate of its fair value, Teva would then proceed to the second step to measure the impairment, if any. The second step measures the amount of impairment by comparing the implied fair value of goodwill with its carrying value. The implied fair value is determined by allocating the fair value of the reporting unit to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. If the carrying amount of the reporting unit s goodwill is greater than its implied fair value, an impairment loss will be recognized in the amount of the excess.

Teva has selected December 31 as the date on which it performs its annual impairment test for goodwill and other indefinite life intangible assets.

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Marketable securities:

Marketable securities primarily consist of equity investments and debt securities classified as available-for-sale securities which are carried at market value, with unrealized gains and losses, net of taxes, reported as a separate component of accumulated other comprehensive income (loss). If it is determined, based on valuations, that a decline in the fair value of any of the investments is other than temporary, an impairment loss is recorded and included in the consolidated statements of income as financial expenses.

Long-lived assets:

Teva tests long-lived assets, including definite life intangible assets, for impairment in the event an indication of impairment exists. If the sum of expected future cash flows (undiscounted and without interest charges) of the long-lived assets is less than the carrying amount of such assets, an impairment would be recognized and the assets would be written down to their estimated fair values, based on expected future discounted cash flows.

Allowance for doubtful accounts

Teva performs ongoing credit evaluations of its customers for the purpose of determining the appropriate allowance for doubtful accounts and generally does not require collateral. Allowance is made for specific debts doubtful of collection.

Recent Accounting Pronouncements

In December 2004, the FASB issued FAS 123R, Share-Based Payment, which addresses the accounting for share-based payment transactions in which Teva obtains employee services in exchange for (a) equity instruments of Teva or (b) liabilities that are based on the fair value of Teva s equity instruments or that may be settled by the issuance of such equity instruments. This statement requires that employee equity awards be accounted for using the grant-date fair value based method. This statement applies to all awards granted or modified after the statement s effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the statement s effective date will be recognized on or after the effective date, as the related services are rendered, based on the awards grant-date fair value as previously calculated for the pro forma disclosure under FAS 123.

Teva expects that, upon the adoption of FAS 123R, it will apply the modified prospective application transition method, as permitted by the statement. Under such transition method, upon the adoption of FAS 123R, the new standard will be implemented as from the first quarter of 2006, with no restatement of prior periods. Taking into account the transition method adopted by Teva, Teva expects that the effect of applying this statement on its results of operations in 2006 as it relates to existing option plans would not be materially different from the FAS 123 pro forma effect previously reported.

In November 2004, the FASB issued FAS 151, Inventory Costs an amendment of ARB 43, Chapter 4. This statement amends current guidance to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This statement requires that those items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. As applicable to Teva, this statement will be effective for inventory costs incurred after January 1, 2006 and the provisions of this statement will be applied prospectively. Teva does not expect this statement to have a material effect on its financial statements or its results of operations.

In May 2005, the FASB issued FAS 154, Accounting Changes and Error Corrections, a replacement of APB No. 20, Accounting Changes and FAS No. 3, Reporting Changes in Interim Financial Statements. This statement provides guidance on the accounting and reporting of accounting changes and error corrections, and

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guidance in the determination of retrospective application of changes in accounting principles. As applicable to Teva, the provisions of FAS 154 are effective for accounting changes and correction or errors made in fiscal years beginning after December 15, 2005.

In November 2005, the FASB issued FSB FAS 115 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments (FSP 115-1), which provides guidance on determining when investments in certain debt and equity securities are considered to be impaired, whether that impairment is other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary. FSP 115-1 is required to be applied to reporting periods beginning after December 15, 2005. Teva intends to adopt FSP 115-1 in the second quarter of 2006. Teva does not expect these FSB statements to have a material effect on its financial statements or its results from operations.

Liquidity and Capital Resources

On December 31, 2005, Teva s working capital was $3.2 billion, compared to $2.0 billion at December 31, 2004. Cash, cash equivalents and short-term investments increased by $1.2 billion reflecting the cash generated during the year, as well as liquidation of certain long-term investments in anticipation of the acquisition of Ivax. Accounts receivables increased by $0.3 billion, representing the expansion of Teva s business. Inventories decreased by $0.2 billion. Total current liabilities increased by $56 million, reflecting a decrease in short-term credit of $185 million and an increase in accounts payable of $241 million.

During 2005, days sales in inventory, which began the year at approximately 167 days, decreased to 142 days at the end of 2005. The days sales outstanding (DSO) remained at the same level (62 days in December 2005 compared with 61 days as of December 31, 2004). The DSO calculation is made on a net basis after netting out provisions for sales reserves and allowances, presented in Teva s consolidated balance sheet in Accounts payable and accruals, from accounts receivables in the amount of $733 million for December 2005 and $591 million for December 2004. A net DSO calculation is presented in order to facilitate a more meaningful understanding of Teva s business. The accounts payables days decreased from 44 days to 41 days.

Cash generated by operations for 2005 amounted to $1,370 million, as compared with $1,246 million in 2004. Investment in fixed assets in 2005 amounted to $310 million, similar to the $311 million in the previous year. Depreciation in 2005 and 2004 represented 51% and 45% of the total investment in fixed assets respectively.

Among the more significant capital expenditures during 2005 were further investments in Teva s new state-of-the-art pharmaceutical facility in Jerusalem, Teva s expansion of its state-of-the-art API facility in southern Israel and its API plant in Hungary and the deployment of modernized information systems, including Teva North America s new enterprise resource planning system.

During 2005, Teva paid $162 million in dividends on its shares, compared to $121 million in 2004.

Free cash flow (cash flow from operations net of capital investment and dividends paid) amounted to $901 million in 2005, compared to $818 million in 2004. Net of share repurchases, 2005 free cash flow amounted to $521 million, compared to $629 million in 2004.

During 2005, the Company spent $379 million to repurchase 12.7 million of Teva s shares pursuant to an authorization by Teva s board of directors to repurchase Teva securities in an amount valued at up to $300 million of Teva s securities, which was increased to $600 million in December 2004, as well as pursuant to a previous $50 million repurchase authorization. This purchase of securities was in addition to $188 million spent to repurchase 6.9 million of Teva s shares and $25 million of convertible debentures in 2004.

In addition to Teva s financing obligations as reflected by short-term debt and long-term loans, its major contractual obligations and commercial commitments include leases, royalty payments and participation in joint ventures associated with research and development activities.

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Teva is committed to pay royalties to owners of know-how and to parties that financed research and development, at rates ranging mainly from 0.5% to 10% of sales of certain products, as defined in the agreements. In some cases, the royalty period is not defined; in other cases, the royalties will be paid over various periods, not exceeding 20 years, commencing on the date of the first royalty payment. Teva has undertaken to pay royalties to the Government of Israel, at the rates of 2.0% 3.5% of sales relating to a product or a development resulting from the research funded by the Office of the Chief Scientist. The royalties due to the Government should not exceed the amount of participation, in U.S. dollar terms (in respect of research grants commencing 1999 with the addition of U.S. dollar LIBOR interest). The maximum amount of the contingent liability in respect of royalties to the Government at December 31, 2005 and 2004 was $39.5 million and $36 million, respectively. The Company is also committed to pay royalties to partners in alliances and other arrangements.

Teva has agreed to invest in certain venture capital funds in Israel and to participate in the funding of research and development conducted by other companies. As of December 31, 2005, Teva s remaining commitment is $23.4 million.

In connection with certain development, supply and marketing, and research and collaboration or services agreements, Teva is required to indemnify, in unspecified amounts, the parties to such agreements against third-party claims relating to (1) infringement or violation of intellectual property or other rights of such third party; or (2) damages to users of the related products. As of December 31, 2005, Teva is not aware of any material pending infringement action that may result in the counterparties to these agreements claiming such indemnification.

Certain of Teva s loan agreements and debentures contain restrictive covenants, mainly the requirement to maintain certain financial ratios. Teva currently meets all applicable financial ratios.

Teva s principal sources of short-term liquidity are its existing cash and investments in liquid securities, as well as internally generated funds, which Teva believes are sufficient to meet its operating needs and anticipated capital expenditures over the near term. Teva s existing cash is generally invested in liquid securities that bear fixed and floating interest rates.

Teva continues to review additional opportunities to acquire companies in the generic and API industries and to acquire complementary technologies or product rights. To the extent that any such acquisitions involve cash payments, rather than the issuance of shares, they may require Teva to draw upon credit lines available to Teva from Israeli and other banks, or may involve raising additional funds from debt or equity markets.

In November 2005, Teva fully drew down its $350 million multicurrency term loan facility, which was established in September 2005 with a syndicate of banks. This loan, which bears a floating interest rate, is divided into a 3-year tranche and a 5-year tranche of $175 million each. The syndicate participants comprise 21 banks based in Israel, Europe, the United States and China, each of which committed to lending between $10 million and $25 million. The funds were used to finance working capital needs of several European subsidiaries of Teva.

In connection with the acquisition of Ivax, approximately 123 million additional Teva ADRs were issued in January 2006. In addition, Teva used $1.7 billion of its existing cash resources, together with a total of $2.8 billion in proceeds from bridging facilities, to pay the cash portion of the purchase price for the acquisition of Ivax. These bridge loans were promptly refinanced through public offerings of debt securities of two Teva finance subsidiaries, who issued an aggregate of $1 billion principal amount of 6.15% Senior Notes due 2036, $500 million principal amount of 5.55% Senior Notes due 2016, $817.5 million principal amount of 1.75% Convertible Senior Debentures due 2026 and $575 million principal amount of 0.25% Convertible Senior Debentures due 2026. Holders of the 0.25% Convertible Senior Debentures due 2026 have the right to cause Teva to repurchase their debentures for 100% of the principal amount, plus accrued interest, in cash on February 1, 2008; holders of the 1.75% Convertible Senior Debentures due 2026 have a similar repurchase right on February 1, 2011. The 0.25% Convertible Senior Debentures due 2026 include a net share settlement feature according to which principal will be paid in cash and, in the case of conversion, only the residual conversion value above the principal will be paid in Teva s shares.

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Therefore, these convertible debentures will become dilutive only if the stock price exceeds the conversion price of approximately $47.16. The $817.5 million of 1.75% Convertible Senior Debentures due 2026 are convertible into approximately 16 million Teva ADRs. In addition, in connection with the Ivax acquisition, Teva guaranteed the $231.1 million principal amount outstanding of Ivax s 4.5% Convertible Senior Subordinated Notes due 2008, which, as a result of the acquisition, are now convertible into an aggregate of approximately $93.8 million in cash and 3.1 million Teva ADRs.

As of February 28, 2006, Teva s cash and other liquid assets (including Ivax) amounted to approximately $1 billion.

Research and Development, Patents and Licenses

Teva s gross research and development spending totaled $383 million, $356 million and $243 million for the years 2005, 2004 and 2003, respectively. Its research and development teams are categorized by the three main R&D groups generic, innovative and API. See Item 4. Information on the Company Research and Development.

Trend Information

Please see Item 5. Operating and Financial Review and Prospects and Item 4. Information on the Company for trend information.

Off-Balance Sheet Arrangements

Teva does not have any material off-balance sheet arrangements, as defined in Item 5.E of the instructions to Form 20-F.

Aggregate Contractual Obligations

The following table summarizes Teva s contractual obligations and commitments as of December 31, 2005:

		Payment due by period*			
	Total	Less than 1 year*	1-3 years	3-5 years	More than 5 years
			(U.S. $ in million)		
Long-term debt obligations	1,883.7	110.4	955.9**	798.6***	18.8
Operating lease obligations	93.7	22.3	31.3	23.5	16.6
Purchase obligations (including purchase orders)	468.2	420.7	47.5		
	2,445.6	553.4	1,034.7	822.1	35.4

* Table does not include amounts payable pursuant to the merger agreement with Ivax.

** Includes $244.5 million of 0.375% Convertible Senior Debentures due 2022 with a first redemption date of November 18, 2007 and $450.0 million of 0.50% Convertible Senior Debentures due 2024 with a first redemption date of August 1, 2008.

*** Includes $619.5 million of 0.25% Convertible Senior Debentures due 2024 with a first redemption date of February 1, 2010.

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ITEM 6: DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following table sets forth information as to the executive officers and directors of Teva as of February 15, 2006:

Executive Officers

Name	Age	Officer Since	Position
Israel Makov	66	1995	President and Chief Executive Officer
George S. Barrett	50	1999	Group Vice President North America and President and CEO Teva North America
Amir Elstein	50	2005	Group Vice President Specialties Product Management
Chaim Hurvitz (1)	45	1995	Group Vice President International
Dr. Itzhak Krinsky	53	2005	Corporate Vice President Business Development
Moshe Manor	50	1995	Group Vice President Global Innovative Resources
Dr. Gerard Van Odijk	48	2006	Group Vice President Europe, and President and CEO Teva Pharmaceuticals Europe B.V.
Eli Shohet	49	1999	Chief Integration Officer (Ivax) and Vice President CEE
Bruria Sofrin	51	2004	Corporate Vice President Human Resources
Dan S. Suesskind	62	1978	Chief Financial Officer
Dr. Ben-Zion Weiner	61	1986	Chief R&D Officer
Jacob Winter	55	1991	Group Vice President Global Generic Resources
Aharon Yaari	54	2002	Group Vice President Global API Division
Yehuda Arad	59	2003	Vice President Safety and Environment
Dr. Shmuel Ben-Zvi	46	2004	Vice President Planning, Economics & IT
Doron Blachar	38	2005	Vice President Finance
Rodney Kasan	64	1999	Vice President and Chief Technology Officer
William S. Marth	51	2005	President & CEO Teva Pharmaceuticals USA, Inc.
Michael Netz	44	2002	Vice President Global Products Division
Dr. Shosh Neumann	50	2006	Vice President Product Portfolio Management
Christopher Pelloni	55	2002	Vice President Global Generic R&D
Dr. Irit Pinchasi	54	2002	Vice President Global Innovative R&D
Dr. David Reisman	59	1999	Vice President Israel Pharmaceutical Operations
Dr. Aharon Schwartz	64	1985	Vice President Strategic Business Planning and New Ventures
Judith Vardi	47	2006	Vice President Israel Pharmaceutical Sales
Ron Grupel	55	1993	Internal Auditor
Uzi Karniel	63	1979	General Counsel and Corporate Secretary

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Directors

Name	Age	Director Since	Term Ends
Eli Hurvitz Chairman (l)(2)	73	1968	2008
Dr. Phillip Frost Vice Chairman	69	2006	2006
Ruth Cheshin (2)	69	1989	2008
Abraham E. Cohen	68	1992	2007
Leslie Dan	76	2001	2007
Prof. Meir Heth	73	1977	2007
Prof. Moshe Many	77	1987	2007
Dr. Leora (Rubin) Meridor (3)	58	2002	2008
Dr. Max Reis	78	2001	2006
Carlo Salvi	69	2004	2006
Prof. Michael Sela	82	1987	2008
Dov Shafir	74	1969	2007
Prof. Gabriela Shalev (3)	64	2003	2006
David Shamir	45	2004	2006
Harold Snyder	83	1996	2008

(1) Eli Hurvitz is the father of Chaim Hurvitz, Teva s Group Vice President International.
(2) Ruth Cheshin and Eli Hurvitz are sister and brother-in-law.
(3) Statutory independent director elected in accordance with the Israeli Companies Law.

Executive Officers

Israel Makov has been the President and Chief Executive Officer of Teva since April 2002. Previously he served as Teva s Chief Operating Officer from January 1, 2001, Executive Vice President from 1999 and Vice President for Business Development from 1995 1999. Prior to joining Teva, Mr. Makov was Chief Executive Officer of Gottex from 1993 1995, Chief Executive Officer of Yachin Hakal Ltd. from 1991 1993 and Chairman of Axiom Ltd. from 1987 1991. Mr. Makov has also been a director of Bank Hapoalim Ltd. from October 2002 until February 2006, a director of Ramot at Tel Aviv University Ltd. from 2001 until January 2006, and one of the founders and a director of the INNI Israel National Nanotechnology Initiative since 2003. He received his B.Sc. in Agriculture from the Hebrew University in 1963 and his M.Sc. in Economics from the Hebrew University in 1965.

George S. Barrett has served as Group Vice President North America and Chief Executive Officer of Teva North America since January 2005. In January 2006, Mr. Barrett joined the newly created Office of the CEO. In this capacity, Mr. Barrett oversees Teva s Global Market Management, including strategies for positioning Teva in key markets, within evolving national healthcare systems. Mr. Barrett previously was President and Chief Executive Officer of Teva USA from March 1999 to December 2004. Prior to his joining Teva in 1999, Mr. Barrett was President and Chief Executive Officer of Diad Research, a technology start-up based at the Johns Hopkins School of Medicine. Mr. Barrett was President of Barre National, a subsidiary of Alpharma Inc., from 1991 to 1994 and President of Alpharma s U.S. pharmaceutical group from 1994 to 1997. From 1981 to 1991, Mr. Barrett served in various positions with NMC Laboratories, serving as President from 1988 through its acquisition by Alpharma Inc. Mr. Barrett serves as a Board member and as a past Chairman for the Generic Pharmaceutical Industry Association (GPhA) and is also a Director of The American Foundation for Pharmaceutical Education (APFE) and The University of Maryland School of Pharmacy. Mr. Barrett received his Bachelor s Degree from Brown University in 1977 and his M.B.A. from New York University in 1988.

Amir Elstein serves as Teva s Group Vice President Specialties Product Management since January 2006. In January 2006, Mr. Elstein joined the newly created Office of the CEO and assumed responsibility for overseeing the generics global supply chain. Mr. Elstein served as Teva s Group Vice President Biogenerics

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from January 2005 to January 2006 and as a director of Teva from 1995 to 2004. He was the General Manager of Intel Electronics Ltd., Jerusalem from 1998 to 2004. He received his B.Sc. in Physics and Mathematics from the Hebrew University in 1980 and his M.Sc. in the Solid State Physics Department of Applied Physics from the Hebrew University in 1982. In 1992, he received his diploma of Senior Business Management from the Hebrew University.

Chaim Hurvitz has served as Group Vice President International since April 2002. He served as Vice President Israeli Pharmaceutical Sales from May 1999 until April 2002 and was the President & CEO of Teva Pharmaceuticals Europe, B.V. and Vice President European Pharmaceutical Sales from 1995 to 1999. From 1993 to 1994, he served as the General Manager of Teva s European Office in The Netherlands and from 1990 to 1993 as the head of the pharmaceutical and OTC departments of Abic Ltd., a Teva subsidiary. He received his B.A. in Political Science and Economics from Tel Aviv University in 1985.

Dr. Itzhak Krinsky joined Teva as Corporate Vice President for Business Development in May 2005. Prior to joining Teva, Dr. Krinsky was a managing director with The Silverfern Group, Inc. from January 2003 until February 2005 and until joining Teva a managing director with Trenwith Securities, LLC, both investment banking boutiques in New York City. From July 2001 until December 2002, Dr. Krinsky was a managing director of I. Krinsky, Financial & Investment Consulting in New York City and from January 1998 until May 2001 a senior strategist with the Investment Banking Research and Strategy Group of Bankers Trust (the predecessor of Deutsche Bank Securities) and later a managing director in the Acquisition and Corporate Advisory Group of Deutsche Bank Securities in New York City. Dr. Krinsky s academic career includes a position as Professor of Finance & Business Economics, Michael G. DeGroote School of Business, McMaster University, Canada and as a visiting professor in Institute for International Studies and Training of Japan, Kamiide, Japan, Nankai University, Tianjin The Peoples Republic of China and the Leonard N. Stern School of Business at New York University as well as extensive publications in leading academic journals. Dr. Krinsky is currently a member of the boards of Can-fite Biopharma Ltd. and Advanced Vision Technology (A.V.T.) Ltd. He received his B.A and M.A in economics from Tel Aviv University in 1976 and 1978, respectively, and his Ph.D. in economics from McMaster University in 1983.

Moshe Manor has been Group Vice President Global Innovative Resources since January 2006. Mr. Manor served as Vice President Global Products Division from 2002 until January 2006. Previously, he served as Vice President of Strategic Product Planning from 2000 to 2002 and as Vice President Israel Pharmaceutical Sales from 1995 to 2000. He served as the General Manager of Teva-labeled products in Israel from 1993 to 1994 and as the Marketing Director of the Israeli Pharmaceutical Division from 1989 to 1993. He received his B.A. in Economics from the Hebrew University in 1982 and his M.B.A. from Tel Aviv University in 1985.

Dr. Gerard WM Van Odijk joined Teva as Group Vice President Europe and President and CEO of Teva Pharmaceutical Europe B.V. in January 2006. Over the last 18 years, he held a variety of senior positions in Europe at Glaxo, GlaxoWellcome and GlaxoSmithKline and served in commercial and General Management positions in France, the United Kingdom and The Netherlands. Prior to joining Teva, Dr. Van Odijk was Senior Vice President and Area Director GlaxoSmithKline Northern Europe. He received his MD from the State University of Utrecht in 1987.

Eli Shohet has been with Teva since 1986. In January 2006, Mr. Shohet joined the newly created Office of the CEO and assumed the role of Chief Integration Officer (Ivax). Mr. Shohet is Vice President of the newly created Central & Eastern Europe Region (CEE), which is a part of the International Cluster. From 1999 until 2006, he served as Vice President of Business Development. He previously served as Chief Economist and assistant to Teva s CEO from 1989 to 1993, president of Plantex USA from 1993 to 1996 and director of Business Development for Teva s API division from 1996 to 1999. He received his B.A. in Economics from Bar-Ilan University in 1986.

Bruria Sofrin joined Teva in August 2004 as Corporate Vice President Human Resources. Ms. Sofrin previously held several senior positions as HR Director from 1984 to 2004 at Hewlett-Packard (HP) in Israel and

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Europe, before which she served for three years in the role of Director of Human Resources at National Semiconductor in Israel. Ms. Sofrin received her B.A. in Psychology and studied for her M.A. in Social and Industrial Psychology at Bar Ilan University in Israel.

Dan S. Suesskind has been with Teva since 1976 and has been Chief Financial Officer since 1978. From 1970 until 1976, he was a consultant and securities analyst with International Consultants Ltd. He served as a director of Teva until 2001. Mr. Suesskind was a director of Lanoptics Ltd. until 1998, a director of ESC Medical Systems Ltd. until 1999 and a director of First International Bank until 2003. He is currently a member of the Board of Migdal Insurance Company Ltd., Ness Technologies Inc. and Syneron Medical Ltd., and a member of the Investment Advisory Committee of the Jerusalem Foundation and the Board of Trustees of the Hebrew University. Mr. Suesskind is one of the founders and a member of the steering committee of the Israeli Forum of Chief Financial Officers. He received his B.A. in Economics and Political Science from the Hebrew University in 1965 and an M.B.A. from the University of Massachusetts in 1969.

Dr. Ben-Zion Weiner has been with Teva since 1975. In January 2006, Dr. Weiner joined the newly created Office of the CEO and assumed the role of Chief R&D Officer. Dr. Weiner served as Group Vice President Global Products from April 2002 until January 2006. Previously, he served as Vice President Research & Development from 1986 to 2002. Dr. Weiner serves as a director of XTL Biopharmaceuticals Ltd. In 1975, he received a Ph.D. in Chemistry from the Hebrew University, where he also earned B.Sc. and M.Sc. degrees. He did post-doctorate research at Schering-Plough Corporation in the United States.

Jacob Winter has been with Teva since 1986 and serves as Group Vice President Global Generic Resources since January 2006. From March 1999 until January 2006, he served as Vice President Global Pharmaceutical Operations. Previously, he served as Vice President/Manager of the Israeli Pharmaceutical Operations Division from 1991 through 1998. He served as the Manager of Teva s Jerusalem pharmaceutical plants from 1986 through 1991. He received his B.Sc. in Industrial Engineering and Management from Tel Aviv University in 1976.

Aharon (Arik) Yaari has served as Group Vice President Global API division since January 2006. Mr. Yaari served as Vice President Global API Division from 2002 until January 2006. Mr. Yaari joined Teva in 1981 and among his various assignments at Teva he served as Vice President Marketing and Sales of Teva API Division from 1999 to 2002 and President of Plantex USA from 1996 to 1999. He received (Cum Laude) his B.A. and M.A. in Economics from the Hebrew University in 1981 and 1988, respectively.

Yehuda Arad has served as Teva s Vice President Safety and Environment since January 2003. Before joining Teva, Mr. Arad was Senior Vice President of Rotem Amfert Negev Ltd. from January 2001 through December 2002 and Technical Vice President Dead Sea Bromine Group from January 1995 through December 2001. He received his B.Sc. in Mechanical Engineering from Polytechnic Institute of New York in 1979 and his M.B.A. from Ben Gurion University in 1998.

Dr. Shmuel (Muli) Ben-Zvi has been Teva s Vice President Planning, Economics & IT since October 2004. Prior to joining Teva, Dr. Ben-Zvi was the Financial Advisor to the Chief of Staff and the Head of the Israel Ministry of Defense Budget Department from 2000 until 2004, and prior to 2000 held several senior positions in the Ministry of Defense Budget Department. In 1986, Dr. Ben-Zvi received a Ph.D in Economics from Tel Aviv University, where he also received his M.A degree in 1982 and B.A. degree in 1981. Dr. Ben-Zvi did post-doctorate work at Massachusetts Institute of Technology.

Doron Blachar has been Teva s Vice President Finance Division since February 2005. Mr. Blachar previously held several senior financial positions in Amdocs Limited from 1998 2005, the last as Vice President Finance. He was responsible for the Amdocs financial organization and was involved in Amdocs convertible offering, merger and acquisition activities and various other financial operations. Mr. Blachar is a Certified Public Accountant (Isr). He received his B.A. in accounting and economics in 1992 and his M.B.A. in 1996 from Tel Aviv University.

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Rodney Kasan has been with Teva since 1980. He has served as Vice President and Chief Technology Officer since 1999. Prior to that he served as Vice President Global Product Development Generic Pharmaceuticals. He served as Head of Pharmaceutical Research and Development until 1995 and subsequently as Director of Pharmaceutical Research and Development for the Operations Division. He received his degree in Pharmacy from the College for Advanced Technical Education (now part of Pretoria University), Pretoria, South Africa in 1966.

William S. Marth has been President and Chief Executive Officer of Teva USA since January 2005. He previously served as Executive Vice President of Teva USA from January 2002 to January 2005. From July 1999 to January 2002, he served as Vice President of Sales and Marketing for Teva USA. Prior to joining Teva USA, he served in various positions with the Apothecon division of Bristol-Myers Squibb. Mr. Marth received his B.Sc. in Pharmacy from the University of Illinois in 1977 and his M.B.A. in 1989 from the Keller Graduate School of Management in Chicago, Illinois.

Michael Netz has been with Teva since 1989 and has been Vice President Global Products Division since January 2006. Prior to that, he served as Vice President Israel Pharmaceutical Sales from 2002 until January 2006, as General Manager of the Teva-Abic Pharma Israeli Division from 1998 to 2002 and Branded Generic Business Unit Manager in Israel from 1993 to 1998. He received his B.A. in Economics and Business Administration in 1989 and his M.B.A. in Marketing and International Management in 1993 from the Tel Aviv University.

Dr. Shosh Neumann has been with Teva since March 1988. Dr. Neumann has served as Vice President Product Portfolio Management since January 2006. Previously, she was executive director of Israel Generic Research & Development from July 2000 to January 2006, served in various management positions in Quality Assurance from 1995 to 2000 and as manager in R&D from 1988 to 1995. Dr. Neumann received her Ph.D. in Chemistry from the Hebrew University in 1985, where she also earned her B.Sc. degree in 1978 and M.Sc. degree in 1981.

Christopher Pelloni has been with Teva since November 1997. He is currently Vice President of Global Generic Research and Development (GR&D). Previously, he was Vice President of GR&D for Teva USA from June 2000 to May 2002 and Senior Director of Pharmaceutical GR&D from November 1997 to June 2000. Prior to that, he served in various management positions with Geneva Pharmaceuticals Inc. during 28 years of service. He received a B.S. in Business Administration in 1986 and an M.B.A. in 1989 from Regis College (now Regis University) in Denver, Colorado.

Dr. Irit Pinchasi has been with Teva since 1986, serving in different positions within the Global Innovative R&D Division, and has served as Vice President for the Global Innovative R&D Division since May 2002. Dr. Pinchasi received her Ph.D. in Neurobiochemistry from Tel Aviv University in 1984, where she also earned her B.Sc. degree in 1974 and M.Sc. degree in 1976. She did her post-doctorate research at the Weizmann Institute of Science, Rehovot, Israel.

Dr. David Reisman has been with Teva since 1980. Since 1999, he has served as Vice President Israel Pharmaceutical Operations. From 1996 to 1999, he served as quality assurance director of the API Division. He received his Ph.D. in Chemistry from Bar Ilan University in 1985.

Dr. Aharon Schwartz has been with Teva since 1975 and has served as Vice President Strategic Business Planning and New Ventures since April 2002. He previously served as Vice President Global Products Division since 1999 and Vice President of the Copaxone® Division from 1995 1999. From 1993 to 1995, he served as Vice President Business Development/Export Division and served as head of the Pharmaceutical Division from 1989 to 1993. He received his Ph.D. in Chemistry from the Weizmann Institute in 1975.

Judith Vardi has been with Teva since 1985. Ms. Vardi serves as Vice President Israel Pharmaceutical Sales since January 2006. She served as the General Manager for the Prescription Medicines and Health Fund

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Division in Teva Israel from November 2002 to 2005. From 1994 to 2002, Ms. Vardi held various positions within the Global Products Division, and, from 1990 to 1994, she served as the General Manager of Farmaquim Ltd., a subsidiary of Teva in Latin America. She received her B.A. in Statistics and M.B.A. from Tel Aviv University in 1983 and 1987, respectively.

Ron Grupel has been the Internal Auditor of Teva since 1993. He received his B.A. in Economics and Accounting in 1975 and his M.B.A. in 1979 from Tel Aviv University.

Uzi Karniel has served as the General Counsel since 1971 and as Corporate Secretary since 1978. He received his L.L.B. from the Hebrew University in 1969. He is a member of the Executive Committee of the Israeli Association of Publicly Traded Companies.

Directors

Eli Hurvitz has served as Chairman of the Board of Teva since April 2002. Eli Hurvitz has been determined by the Board to be a financial and accounting expert under Israeli law. Previously, he served as Teva s President and Chief Executive Officer for over 25 years and has been employed at Teva for over forty years. He serves as Chairman of the Board of The Israel Democracy Institute (IDI), Chairman of the Board of NeuroSurvival Technologies Ltd. (a private company) and a director of Vishay Intertechnology. He served as Chairman of the Israel Export Institute from 1974 through 1977 and as the President of the Israel Manufacturers Association from 1981 through 1986. He served as Chairman of the Board of Bank Leumi Ltd. (1986 1987). He was a director of Koor Industries Ltd. from 1997 through 2004 and a member of the Belfer Center for Science and International Affairs at John F. Kennedy School of Government at Harvard University from 2002 through 2005. He received his B.A. in Economics and Business Administration from the Hebrew University in 1957.

Dr. Phillip Frost has served as Vice Chairman of the Board of Teva since the completion of the Ivax acquisition in January 2006 and as Chief Executive Officer of Ivax since 1987. He previously served as Chairman of the Board of Ivax from 1987 until January 2006 and as President of Ivax from 1991 until 1995. Dr. Frost is Chairman of the Board of Directors of Ivax Diagnostics, Inc. (diagnostic reagent kits), a public company that is 72% owned by Ivax. He is a director of Northrop Grumman Corporation (aerospace), Continucare Corporation (healthcare), Cellular Technical Services Company, Inc. (cellular services) and Ladenburg Thalmann Financial Services Inc. (securities brokerage). He is a life member, and former Chairman, of the Board of Trustees of the University of Miami, co-Vice Chairman of the Board of Governors of the American Stock Exchange, and a member of the Board of Trustees of The Scripps Research Institute. Dr. Frost received a B.A. in French literature from the University of Pennsylvania in 1957 and an M.D. from the Albert Einstein College of Medicine in 1961.

Ruth Cheshin is the President of the Jerusalem Foundation, a multi-national organization which raises funds around the world for the creation of social, educational and cultural projects for all the citizens of Jerusalem. Ms. Cheshin is also an active member in many of the city s most important boards.

Abraham E. Cohen served as Senior Vice President of Merck & Co. and from 1977 to 1988 as President of the Merck Sharp & Dohme International Division. Since his retirement in January 1992, Mr. Cohen has been active as an international business consultant. He is presently a director of Akzo Novel NV., Chugai Pharmaceutical Co. U.S.A., Neurobiological Technologies, Inc. and Vasomedical, Inc.

Leslie Dan is the Chairman of Novopharm, which he founded and managed until its acquisition by Teva in 2000. Mr. Dan serves on several hospital boards in Canada and is a director of Draxis Pharmaceutical Company and Chairman of Viventia Biotech. He is a pharmacist with over 50 years of business experience in the pharmaceutical industry. Mr. Dan received three honorary doctorates and numerous other awards for his charitable contributions, including the CAN-MAP organization that he founded. He holds an M.B.A. from the University of Toronto.

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Prof. Meir Heth has served on Teva s Board since 1977 and as Chairman of the Board from 1994 to 2002. During his service at Teva, Prof. Heth served as Chairman of the Executive Committee for an extended period. Prof. Heth was designated as the financial expert on Teva s audit committee, for the purposes of SEC regulations and as financial and accounting expert under Israeli law. Prof. Heth has served as Chairman of the Board of Bank Leumi Ltd. and as Chairman of Bank Leumi Trust Company of New York from 1987 to 1988. From 1978 to 1986, Prof. Heth was Chairman of the Tel Aviv Stock Exchange. Prof. Heth served at The Bank of Israel beginning in 1962 in various positions, including Senior Economist from 1962-1968, Supervisor of Banks from 1969 to 1975 and Senior Advisor to the Governor from 1975 to 1977. Prof. Heth is a Professor at the Law School of the College of Management and serves as Chairman of Psagot-Ofek Investment House Ltd. and as a director of Nilit Ltd.

Prof. Moshe Many, M.D., Ph.D. has served as president of the Ashqelon Academic College since January 2002. He previously served as the President of the Tisom International School of Management. He is a former President of the Tel Aviv University, the former Medical Director of the Ramat Marpeh Hospital and the former Deputy Chairman of Maccabi Health Care Fund. He has been a Department Head at Tel Hashomer Hospital since 1976. He has served as a director at Elbit Medical Imaging since 1997 and at Israel Laser Industries from 1994 to 1998. He received his M.D. degree from Geneva University in 1952 and his Ph.D. in Surgery from Tufts University in 1969.

Dr. Leora (Rubin) Meridor has been a director of Teva since December 2002. Dr. Meridor was determined by the Board as a financial and accounting expert under Israeli law. Dr. Meridor is a business and financial consultant. She served as the Chairman of the Board of Bezeq International Ltd. and Walla Communications Ltd. from 2001 to 2005. She served as Chairman of the Board of Hapoalim Capital Markets between 2001-2004. From 1996 to 2000, Dr. Meridor served as Senior Vice President and Head of the Credit and Risk Management Division of the First International Bank of Israel. Between 1983 and 1996, Dr. Meridor held various positions in the Bank of Israel, the last of which was Head of the Research Department. Dr. Meridor has held various teaching positions with the Hebrew University and holds a Bachelor s degree in mathematics and physics, a Master s degree in Mathematics and a Ph.D. in Economics from the Hebrew University, Jerusalem. She serves on several boards of directors (NICE Systems Ltd., Gilat Satellite Networks Ltd., Isrotel Ltd., GEJ Yizum Ltd. and Weizmann Institute of Science) and qualifies as a statutory independent director under Israeli law.

Dr. Max Reis is Chairman of Degem Systems Ltd. and serves on the boards of Oridion Medical Ltd., Yachin Hakal Ltd. and Gaon Holdings. From 1971 until 1986, he was Chairman or Managing Director of half a dozen companies in the Israel Chemicals Group. From 1986 until 1990, he served as President of Technion Israel Institute of Technology. From 1992 until 1999, he was Chairman of the Audit Committee of the board of directors of the Union Bank of Israel. Dr. Reis has a Ph.D. in Chemical Engineering from the Imperial College, London and attended the Advanced Management Program of the Harvard Business School.

Carlo Salvi commenced his service on the Board of Teva upon completion of the acquisition by Teva of Sicor in January 2004. Previously, Mr. Salvi served as Vice Chairman of Sicor from August 2001. Mr. Salvi was Sicor s President and Chief Executive Officer from August 1998 to September 2001. In addition, Mr. Salvi served as a director of Sicor since February 1997 and was Chairman of the Board of Sicor S.p.A. from February 1997 to June 1999. Prior to the merger of Gensia Inc. and Rakepoll Holdings in 1997, Mr. Salvi was a consultant to Alco Chemicals Ltd. from 1995 to 1997 and served as General Manager of Alco from 1986 to 1995.

Prof. Michael Sela is Institute Professor of Immunology at the Weizmann Institute of Science where he was the President from 1975 through 1985 and served as a Deputy Chairman of the Board of Governors of the Weizmann Institute of Science from 1985 through 2004. He received his Ph.D. degree in Biochemistry from the Hebrew University in 1954. He is the recipient of nine honorary doctorate degrees from institutions in the United States, France, Mexico and Israel. He is a member of 15 Academies of Science in various countries, including the U.S. National Academy of Sciences.

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Dov Shafir, Colonel (retired) of the Israel Defense Forces, served as chairman of the Executive Committee of Teva s board of directors from 1992 until 2002 and presently serves as a director of Ofer Technologies Ltd. and Am-Shav - Initiative and Technological Applications Ltd.

Prof. Gabriela Shalev has been a member of the Faculty of Law of the Hebrew University since 1964, where from 1986 she held the position of Professor of Contract Law. Having retired from the Hebrew University in 2002, she is currently President and Rector of Ono Academic College. Over the years she has been a visiting professor in many law schools in Europe and the U.S. Prof. Shalev was a member of the Board of Directors and chairperson of the audit committee of Bank Hapoalim Ltd., Israel s largest commercial bank, from 1990 until 1996. From 1995 until 2005, she was a member of the Board of Directors and chairperson of the audit committee of the Israel Electric Company. Currently she is also a director of Koor Industries Ltd. and Osem Investments Ltd., as well as a member of various committees serving non-profit organizations. Prof. Shalev qualifies as a statutory independent director under Israeli law and was determined by the Board to have professional competence under Israeli law.

David Shamir has served as the General Manager of Texas Instruments Israel Ltd. since 2001. From 1986 to 2001, he served in several R&D and management positions in Motorola Semiconductor Israel Ltd. He received his B.Sc. in Computer Engineering from the Technion, Israel Institute of Technology in 1986.

Harold Snyder, now retired, was Senior Vice President of Teva USA and the former President of Biocraft Laboratories, Inc. Mr. Snyder founded Biocraft Laboratories in 1964. He had previously served as President of Stoneham Laboratories Inc. He received his B.S. in Science from New York University in 1948 and his M.A. in Natural Science from Columbia University in 1950.

Compensation

The aggregate direct compensation paid or accrued on behalf of all directors and executive officers as a group during 2005 was $14,543,029. This amount includes fees of $772,000 for non-employee directors and amounts set aside or accrued to provide pension, retirement or similar benefits of $171,000. This amount does not include $134,312,978 from the exercise of previously granted stock options. In addition, directors are reimbursed for expenses incurred as part of their service as directors. None of the non-employee directors have agreements with Teva that provide for benefits upon termination of service.

Teva has adopted a number of stock option or stock incentive programs covering either ordinary shares or ADRs. Following the approval of Teva s 2005 Omnibus Long-Term Share Incentive Plan by Teva s shareholders in July 2005, the compensation committee authorized, in December 2005, the granting of options to purchase an aggregate of 1,014,799 ordinary shares or ADRs to Teva s executive officers, at an average exercise price of $42.64 per share or ADR and an average expiration date in 2012, as well as 260,067 restricted share unit awards.

As of December 31, 2005, options for an aggregate of 30,741,776 shares, with an average exercise price of $21.27 per share, are outstanding under Teva s stock option and incentive programs, with options for an aggregate of approximately 45.4 million shares available for future grant. For further information regarding outstanding Teva options, see Note 9 to the Notes to Consolidated Financial Statements.

Board Practices

Teva s board of directors is comprised of 15 persons, of whom ten have been determined to be independent within the meaning of applicable Nasdaq regulations. The Board includes two independent directors mandated under Israeli law and subject to additional criteria to help ensure their independence. See Statutory Independent Directors below. The terms of the directors are set forth in the table above.

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All directors are entitled to review and retain copies of Teva s documentation and examine Teva s assets, as required to perform their duties as directors and to receive assistance, in special cases, from outside experts at the expense of Teva (subject to approval by the Board or by court).

Board Practices and Procedures. Teva s Board members are generally elected for terms of three years. Teva believes that this system of multi-year terms allows Teva s directors to acquire and provide Teva with the benefit of a high level of expertise with respect to its complex business.

Board Meetings. Meetings of the board of directors are generally held every 4-6 weeks throughout the year, with additional special meetings scheduled when required. The Board held seventeen meetings in 2005.

Executive Sessions of the Board. The independent members of the Board met in executive session (without management or non-independent directors participation) one time during 2005. They will continue to meet in executive session on a regular basis.

Directors Service Contracts. Teva does not have any contracts with any of its non-executive directors that would provide for benefits upon termination of employment.

Home Country Practice. Teva is in compliance with corporate governance standards as currently applicable to Teva under Israeli, U.S., SEC and Nasdaq laws and regulations.

As further described below, Teva has adopted an audit committee charter formalizing its procedures and duties and also has adopted a nominating procedure, each pursuant to applicable laws and regulations.

Communications with the Board. Shareholders or other interested parties can contact any director or committee of the Board by writing to them care of Teva Pharmaceutical Industries Limited, 5 Basel Street, Petach Tikva, Israel, Attn: Corporate Secretary or Internal Auditor. Comments or complaints relating to Teva s accounting, internal controls or auditing matters will also be referred to members of the audit committee as well as other bodies of the Company. The Board has adopted a global whistleblower policy, which provides employees and others with an anonymous means of communicating with the audit committee.

Statutory Independent Directors/Financial Expertise

Under Israeli law, publicly held Israeli companies such as Teva are required to appoint two statutory independent directors, who must also serve on the audit committee. All other Board committees must include at least one such statutory independent director. Such statutory independent directors are appointed at the general meetings by the holders of a majority of Teva s ordinary shares and must meet certain non-affiliation criteria all as provided under Israeli law. A statutory independent director is appointed for an initial term of three consecutive years, and may be reappointed for one additional three-year term. Regulations promulgated under Israeli law set the minimum and maximum compensation that may be paid to statutory independent directors. Prof. Gabriela Shalev and Dr. Leora Meridor currently serve in this capacity.

Israeli law further requires that at least one statutory independent director have financial and accounting expertise, and that the other statutory independent director have professional competence, as determined by the company s board of directors. Under recently enacted regulations, a director having financial and accounting expertise is a person who, due to his or her education, experience and talents is highly skilled in respect of, and understands, business and accounting matters and financial reports, in a manner that enables him or her to deeply understand the company s financial statements and to arouse discussion in respect of the manner in which the financial data is presented. Under the regulations, a director having professional competence is a person who has an academic degree in either economics, business administration, accounting, law or public administration or an academic degree in an area relevant to the company s business, or has at least five years experience in a senior position in the business management of a corporation with a substantial scope of business, in a senior position in the public service or in the field of the company s business.

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Dr. Leora Meridor was determined by the board of directors to be a financial and accounting expert under Israeli law, and Prof. Gabriela Shalev was determined by the Board to have professional competence.

The board of directors has also adopted a policy to require at least two directors who are financial and accounting experts under Israeli law, in addition to the statutory independent director. Accordingly, Prof. Meir Heth and Eli Hurvitz were determined by the board of directors to be financial and accounting experts.

Committees of the Board

Teva s Articles of Association provide that the board of directors may delegate its powers to one or more committees of the Board as it deems appropriate to the extent such delegation is permitted under the Israeli Companies Law. Each committee must include at least one independent director. The Board has appointed audit, compensation, nominating, finance, science and technology and community affairs committees.

Audit Committee

The Israeli Companies Law mandates the appointment of an audit committee comprised of at least three directors. The audit committee must include both statutory independent directors and may not include certain members of the Board. Under the Israeli Companies Law, the audit committee is responsible for overseeing the business management practices of the Company in consultation with the Company s internal auditor and independent auditors, making recommendations to the Board to improve such practices and approving transactions with affiliates, as described below under Item 10 Additional Information Memorandum and Articles of Association Directors Powers.

In accordance with the Sarbanes-Oxley Act and Nasdaq requirements, Teva s audit committee is directly responsible for the appointment, compensation and oversight of Teva s independent auditors. In addition, the audit committee is responsible for assisting the Board in monitoring Teva s financial statements, the effectiveness of its internal controls and its compliance with legal and regulatory requirements. Teva s audit committee charter sets forth the scope of the committee s responsibilities, including: its structure, processes and membership requirements; the committee s purpose; and its specific responsibilities and authority with respect to registered public accounting firms, complaints relating to accounting, internal accounting controls or auditing matters, authority to engage advisors, and funding as determined by the audit committee.

The current members of Teva s audit committee are Dov Shafir (Chairman), Prof. Gabriela Shalev, Dr. Leora Meridor, Dr. Max Reis, Prof. Moshe Many and Prof. Meir Heth, all of whom have been determined to be independent as defined by the applicable Nasdaq rules and those of the SEC. During 2005, the audit committee held nine meetings.

The Board has determined that Prof. Meir Heth is an audit committee financial expert as defined by applicable SEC regulations. See Item 16A: Audit Committee Financial Expert below.

Compensation Committee

The compensation committee is responsible for determining, or recommending for determination, the compensation of Teva s executive and other officers (including certain responsibilities in connection with the granting of stock options and other equity awards to Teva s officers, directors and employees under its Omnibus Long-Term Share Incentive Plan of 2005) and making proposals to the Board with respect to the terms of employment of such individuals. The current members of Teva s compensation committee are Prof. Meir Heth (Chairman), Harold Snyder, Dov Shafir, Abraham Cohen and Prof. Gabriela Shalev or, in her absence, Dr. Leora Meridor, all of whom have been determined to be independent as defined by the applicable Nasdaq rules and those of the SEC. During 2005, the compensation committee held 17 meetings.

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Nominating Committee

The role of the nominating committee is to recommend, to the Company s board of directors, the slate of director nominees for election to the board of directors and to identify and recommend candidates, subject to the approval of the board of directors, to fill vacancies occurring between annual shareholder meetings. Before recommending an incumbent, replacement or additional director, the committee reviews his or her qualifications, including capability, availability to serve, conflicts of interest and other relevant factors. Members of the nominating committee are Prof. Meir Heth (Chairman), Prof. Moshe Many, Dov Shafir, Abraham E. Cohen and Dr. Leora Meridor or, in her absence, Prof. Gabriela Shalev. The committee held three meetings in 2005.

Finance Committee

The finance committee is responsible for overseeing Teva s financial strategies and policies, risk management and financial controls and reporting, as well as a variety of other financial-related matters. The current members of the committee are Eli Hurvitz (Chairman), Dr. Leora Meridor, Prof. Gabriela Shalev, Carlo Salvi and Prof. Meir Heth. The committee held four meetings in 2005.

Science and Technology Committee

The science and technology committee is primarily engaged in the review and analysis of the annual budgets and plans of the innovative and generic R&D divisions, the review of new technologies and major projects, and the review of Teva s relationship with the scientific community. The current members of the committee are Prof. Moshe Many (Chairman), Eli Hurvitz, Prof. Gabriela Shalev or, in her absence, Dr. Leora Meridor, Prof. Michael Sela, Dr. Max Reis, Dov Shafir, Abraham E. Cohen and Harold Snyder. The committee held one meeting in 2005.

Community Affairs Committee

The community affairs committee is primarily engaged in the review and oversight of Teva s involvement in the community, public policy issues affecting Teva and the Company s relationships with medical, educational and cultural institutions, including charitable donations. The current members of the committee are Eli Hurvitz (Chairman), Ruth Cheshin, Prof. Gabriela Shalev, Prof. Meir Heth, Dov Shafir, Leslie Dan and Prof. Michael Sela. The committee held two meetings in 2005.

Employees

As of December 31, 2005, Teva employed approximately 14,700 full-time-equivalent employees. Teva considers its labor relations with its employees around the world to be good.

	December 31,		
Geographic Area	**2005**	**2004**	**2003**
Israel	4,314	3,842	3,430
Europe	4,908	4,833	4,129
North America (including Mexico)	4,917	4,697	2,940
Other countries	559	441	461
Total	14,698	13,813	10,960

Grouped by function, approximately 55% of Teva s employees work in pharmaceutical production, 19% in sales and marketing, 12% in research and development and 14% in the general and administrative function. In addition to the above numbers, as of December 31, 2005, Ivax employed approximately 11,300 employees worldwide.

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Share Ownership

As of February 15, 2006, all the directors and executive officers as a group beneficially held 54,266,883 ordinary shares (representing approximately 7% of Teva s outstanding shares as of such date). This figure includes 10,036,818 shares beneficially owned by Eli Hurvitz, representing approximately 1.3% of Teva s outstanding shares, and 10,631,421 shares beneficially owned by Harold Snyder, representing approximately 1.3% of Teva s outstanding shares. Such persons are the only directors or officers who hold 1% or more of Teva s outstanding shares as of December 31, 2005. In addition, as a result of the Ivax acquisition, Dr. Phillip Frost beneficially owned, as of February 15, 2006, 20,767,229 shares, representing approximately 2.7% of Teva s outstanding shares as of such date.

ITEM 7: MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

According to a Schedule 13G filed on February 14, 2006, Axa Financial Inc. beneficially owns 51,601,750 ADRs of Teva, which as of such date represented approximately 6.6% of Teva s outstanding shares. To the best knowledge of Teva, as of February 15, 2006, no other shareholder beneficially owns 5% or more of Teva s ordinary shares. All holders of Teva ordinary shares have one vote per share.

In connection with the Novopharm acquisition in 2000, Teva entered into a registration rights agreement with Dan Family Holdings Ltd. (now Clairmark Investments Ltd.), an affiliate of Mr. Leslie Dan, a director of Teva. Under the agreement, Clairmark and certain affiliates of Mr. Dan and his children have the right to request that Teva file a registration statement under the Securities Act (on up to an aggregate of three occasions) covering the sale of certain Teva ordinary shares or ADRs beneficially owned by such persons. In addition, under the agreement, if Teva proposes to register any of its ordinary shares or ADRs, whether or not for sale for its own account, Clairmark and such affiliates of Mr. Dan and his children may require Teva to include all or a portion of such shares or ADRs in the registration and any related underwriting. As a result of various transactions during 2003, 2004 and 2005, Teva believes that the registration rights now apply to up to approximately 11.475 million ordinary shares beneficially owned by such persons. In general, all fees and expenses of such registration (other than underwriting discounts and selling commissions) will be paid by Teva.

In connection with the Sicor acquisition, Teva filed a registration statement covering the resales of Teva ADRs received by Carlo Salvi, a director of Teva and the former vice chairman and a major shareholder of Sicor, who may be deemed an affiliate of Sicor under Rule 145 under the Securities Act. Similarly, in connection with the Ivax acquisition, Teva filed a registration statement covering the resales of Teva ADRs received by Dr. Philip Frost, vice chairman of Teva and the former Chairman of the Board and Chief Executive Officer of Ivax, who may be deemed an affiliate of Ivax under Rule 145 under the Securities Act.

In September 2003, Teva purchased units issued by Viventia Biotech Inc., a publicly traded Canadian biotech company, for CDN $2.8 million. Leslie Dan, a director of Teva, is a major shareholder and chairman of the board of Viventia. In December 2005, Viventia completed a going-private transaction that resulted in Viventia becoming wholly owned by Mr. Dan and members of his family. As part of the going-private transaction, Teva s units in Viventia were purchased for an aggregate of approximately CND $4.2 million in cash.

In July 2005, Teva s board of directors approved a License Agreement with Yeda Research & Development Company Ltd. and a related Agreement with Immodar Ltd., a Jerusalem-based start-up company that owned certain rights to Copaxone® in respect of Graft-vs-Host disease. Prof. Michael Sela, a director of Teva, is a shareholder in Immodar. Under the agreements, Teva received an exclusive worldwide license to commercialize Copaxone® for the Graft-vs-Host indication and Teva has undertaken to pay certain royalties, milestone payments and sublicense fees to Yeda and Immodar in respect thereof.

In September 2005, Teva s board of directors approved a Memorandum of Agreement and Share Purchase Agreement with Neurosurvival Technologies Ltd. (NST), a pharmaceutical development company. Under the agreements, Teva agreed to invest $2 million in NST in exchange for NST ordinary shares and to fund the

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co-development by Teva and NST of certain products for up to $9 million in consideration for certain rights granted to Teva by NST. Eli Hurvitz, Teva s Chairman of the Board, serves as the Chairman of the NST board and holds certain equity interests in NST.

In December 2005, Novopharm settled rent arrangements with respect to its facility in Stouffville, Ontario, Canada, which it leases from a corporation in which Mr. Dan has an interest. The annual rent payable by Novopharm for the period from October 1, 2005 to September 30, 2008 is approximately CND $600,000, which amount was determined by Novopharm to not exceed the fair market rent payable for the facility following advice from an independent appraiser. Rent is for the final five year period of the lease commencing October 1, 2008 is to be based upon the fair market rent as at that time, subject to a minimum of CND $7.00 per square foot.

As of December 31, 2005, there were approximately 1,499 record holders of ADRs, whose holdings represented approximately 78% of the total outstanding ordinary shares, substantially all of which record holders were in the United States.

ITEM 8: FINANCIAL INFORMATION

8.A Consolidated Statements and Other Financial Information

8.A.1 See Item 18.

8.A.2 See Item 18.

8.A.3 See Report of Independent Registered Public Accounting Firm, page F-2.

8.A.4 We have complied with this requirement.

8.A.5 Not applicable.

8.A.6 Not applicable.

8.A.7 Legal Proceedings

Teva is subject to various litigation and other legal proceedings. For a discussion of these matters, see Contingent Liabilities included in Note 8 to Teva s consolidated financial statements included in this report. In addition, during 2005, Teva settled various litigations, as described under Item 4 Information on the Company Pharmaceutical Products Generic Products Recent Litigation Settlements.

8.A.8 Dividend Policy See Item 3, Key Information Dividends.

8.B Significant Changes See Note 2 to Teva s consolidated financial statements included in this report regarding the Ivax acquisition and Notes 6 and 7 to such financial statements regarding the issuance of senior notes and convertible senior debentures.

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ITEM 9: THE OFFER AND LISTING

ADRs

In each of February 2000, December 2002 and June 2004, Teva effected a 2-for-1 stock split. Each holder of an ordinary share, or an ADR, as the case may be, was issued another share. All figures in this annual report have been adjusted to reflect the stock splits.

Teva s ADRs have been traded in the United States since 1982 and were admitted to trading on the Nasdaq National Market in October 1987. The ADRs are quoted under the symbol TEVA. The Bank of New York serves as Depositary for the ADRs. In November 2002, Teva was added to the NASDAQ 100 Index. Each ADR represents one ordinary share.

The following table sets forth information regarding the high and low prices of the ADR on Nasdaq for the periods specified in U.S. dollars.

Period	High	Low
Last six months:		
March 2006 (until March 15)	43.75	40.10
February 2006	43.83	39.65
January 2006	44.71	40.21
December 2005	45.91	40.84
November 2005	42.50	37.93
October 2005	39.30	33.50
September 2005	34.26	32.49
Last eight quarters:		
Q4 2005	45.91	33.50
Q3 2005	34.26	29.50
Q2 2005	34.25	30.00
Q1 2005	32.17	26.78
Q4 2004	30.18	22.82
Q3 2004	34.13	23.97
Q2 2004	34.66	30.10
Q1 2004	33.68	28.50
Last five years:		
2005	45.91	26.78
2004	34.66	22.82
2003	31.17	17.25
2002	20.08	12.92
2001	18.58	12.12

On March 15, 2006, the last reported sale price for the ADRs on Nasdaq was $41.59. The American Stock Exchange, the Chicago Options Exchange and the Pacific Stock Exchange quote options on Teva s ADRs under the symbol TEVA.

Teva s ADRs are also traded on SEAQ International in London and on the exchanges in Frankfurt and Berlin.

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Ordinary Shares

Teva s ordinary shares have been listed on the Tel Aviv Stock Exchange since 1951. The table below sets forth in U.S. dollars the high and low last reported sale prices of the ordinary shares on the Tel Aviv Stock Exchange during the periods as reported by such Exchange (restated to reflect the stock splits). The translation into U.S. dollars is based on the daily representative rate of exchange published by the Bank of Israel then in effect.

Period	High	Low
Last six months:		
March 2006 (through March 15)	43.41	40.69
February 2006	43.44	39.87
January 2006	44.67	41.08
December 2005	44.88	40.82
November 2005	42.19	37.83
October 2005	38.44	33.44
September 2005	34.16	32.60
Last eight quarters:		
Q4 2005	44.88	33.44
Q3 2005	34.16	29.39
Q2 2005	34.08	29.90
Q1 2005	31.49	26.61
Q4 2004	29.85	23.56
Q3 2004	34.00	25.65
Q2 2004	34.86	30.74
Q1 2004	33.88	28.72
Last five years:		
2005	44.88	26.61
2004	34.86	23.56
2003	30.90	17.32
2002	19.95	13.09
2001	18.27	12.77

On March 15, 2006, the last reported sale price of the ordinary shares on the Tel Aviv Stock Exchange was $41.36.

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ITEM 10: ADDITIONAL INFORMATION

Memorandum and Articles of Association

Register

Teva s registration number at the Israeli registrar of companies is 52-001395-4.

Directors Powers

The Israeli Companies Law, 1999 (the Companies Law) requires approval by both the audit committee and the board of directors of, among other things, the following actions or transactions, all subject to the requirement that such transactions are not adverse to the interests of the company:

- proposed transactions between a company and its office holders , and proposed transactions between a company and a third party in which an office holder (as such term is defined in the Companies Law) has a personal interest (as such term is defined in the Companies Law), that are outside the ordinary course of the company s business, that are not in accordance with market conditions or that may materially influence the earnings, assets or liabilities of the company;

- material actions that may otherwise be deemed to constitute a breach of fiduciary duty of any office holder of the company, that are done in good faith; and

- the grant of indemnification, insurance and exemptions to office holders who are not directors, or the undertaking to indemnify an office holder who is not a director.

Under the Companies Law, certain other transactions (listed in Section 270 of the Companies Law) that require approval by the board of directors and the audit committee may also require shareholder approval (including, in certain cases, a specified percentage of disinterested shareholders).

Approvals of the terms of service of directors, including the grant of exemption, insurance, an undertaking to indemnify or indemnification under a permit to indemnify as well as the company s contracts with its directors on conditions of employment in other assignments, require approval by the audit committee, board of directors and the shareholders.

A director with an interest in any of the above transactions may not be present and may not vote at the board of directors and audit committee s meetings at which such transaction is approved (except under certain circumstances detailed in Section 278(b) of the Companies Law). In cases where the approval of the audit committee is required, the audit committee may only approve such transactions if two statutory independent directors are members of the committee and at least one of them is present at the meeting at which the transaction is approved.

The Companies Law requires that an office holder promptly disclose any personal interest that he may have, and every substantive fact or document, in connection with any existing or proposed transaction by the company and codifies the duty of care and fiduciary duties that an office holder owes to the company.

Neither Teva s Memorandum or Articles of Association, nor the laws of the State of Israel, mandate retirement or non-retirement of directors at a certain age, or share ownership for a director s qualification.

The board of directors of Teva has adopted a policy that at least two directors of the Company, in addition to the one statutory independent director required under Israeli law, shall have financial and accounting expertise as determined by the Board, under Israeli law.

Description of Teva Ordinary Shares

The par value of Teva s ordinary shares is NIS 0.10 per share, and all issued and outstanding ordinary shares are fully paid and non-assessable. Holders of paid-up ordinary shares are entitled to participate equally in the payment of dividends and other distributions and, in the event of liquidation, in all distributions after the discharge of liabilities to creditors.

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Teva s board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year out of profits available for dividends after statutory appropriation to capital reserves. Declaration of a final dividend (not exceeding the amount proposed by the Board) requires shareholder approval through the adoption of an ordinary resolution. Dividends are declared in NIS. All ordinary shares represented by the ADRs will be issued in registered form only. Ordinary shares do not entitle their holders to preemptive rights.

Voting is on the basis of one vote per share. An ordinary resolution (for example, resolutions for the approval of final dividends and the appointment of auditors) requires the affirmative vote of a majority of the shares voting in person or by proxy. Certain resolutions (for example, resolutions amending the Articles of Association) require the affirmative vote of at least 75% of the shares voting in person or by proxy, and certain amendments of the Articles of Association require the affirmative vote of at least 85% of the shares voting in person or by proxy, unless a lower percentage shall have been established by the board of directors, approved by three-quarters of those directors voting, at a meeting of the board of directors which shall have taken place prior to that general meeting.

Meetings of Shareholders

Under the Companies Law and Teva s Articles of Association, Teva is required to hold an annual meeting every year no later than fifteen months after the previous annual meeting. In addition, Teva is required to hold a special meeting:

- at the direction of the board of directors;
- if so requested by two directors or one-fourth of the serving directors; or
- upon the request of one or more shareholders who have at least 5% of the voting rights.

If the board of directors receives a demand to convene a special meeting, it must publicly announce the scheduling of the meeting within 21 days after the demand was delivered. The meeting must then be held no later than 35 days after the notice was made public.

The agenda at an annual meeting is determined by the board of directors. The agenda must also include proposals for which the convening of a special meeting was demanded, as well as any proposal requested by one or more shareholders who hold no less than 1% of the voting rights, as long as the proposal is one suitable for discussion at an annual meeting.

A notice of an annual meeting must be made public and delivered to every shareholder registered in the shareholders register at least 30 days before the meeting is convened. The shareholders entitled to participate and vote at the meeting are the shareholders as of the record date set in the decision to convene the meeting, provided that the record date is not more than 40 days, and not less than 28, before the date of the meeting, provided that notice of the general meeting was published prior to the record date.

Under the Companies Law, a shareholder who intends to vote at a meeting must demonstrate that he owns shares in accordance with certain regulations. Under these regulations, a shareholder whose shares are registered with a member of the Tel Aviv Stock Exchange must provide Teva with an authorization from such member regarding his ownership as of the record date.

Right of Non-Israeli Shareholders to Vote

Neither the Memorandum of Association, the Articles of Association, nor the laws of the State of Israel restrict in any way the ownership or voting of Teva s ordinary shares by nonresidents or persons who are not citizens of Israel, except with respect to citizens or residents of countries that are in a state of war with Israel.

Change of Control

Subject to certain exceptions, the Companies Law provides that a merger requires approval both by the board of directors and by the shareholders of each of the merging companies. In approving a merger, the board of

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directors must determine that there is no reasonable expectation that, as a result of the merger, the merged company will not be able to meet its obligations to its creditors. Creditors may also seek a court order to enjoin or delay the merger if there is an expectation that the merged company will not be able to meet its obligations to its creditors. A court may also issue other instructions for the protection of the creditors rights in connection with a merger.

Under the Companies Law, an acquisition of shares in a public company must be made by means of a purchase offer to all stockholders if, as a result of the acquisition, the purchaser would become a 25% stockholder of the company. This rule does not apply if there is already another 25% stockholder of the company, nor does it apply to a purchase of shares by way of a private offering in certain circumstances provided under the Companies Law.

Foreign Exchange Regulations

Nonresidents of Israel who purchase ADRs with U.S. dollars or other non-Israeli currency will be able to receive dividends, if any, and any amounts payable upon the dissolution, liquidation or winding up of the affairs of Teva, at the rate of exchange prevailing at the time of conversion. Dividends to non-Israeli residents are subject to withholding. See Israel Taxation Withholding Taxes on Dividends Distributed by Teva to Non-Israeli Residents below.

U.S. Federal Income Tax Considerations

The following is a summary of material U.S. federal income tax consequences to U.S. Holders of ADRs who hold such securities as capital assets. For purposes of this summary, a U.S. Holder means a beneficial owner of an ADR that is for U.S. federal income tax purposes:

- a citizen or resident of the United States;
- a corporation (or another entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States or any political subdivision thereof;
- an estate, the income of which is subject to U.S. federal income tax regardless of its source; or
- a trust, if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or, if the trust was in existence on August 20, 1996, and has elected to continue to be treated as a U.S. person.

If an entity that is classified as a partnership for U.S. federal tax purposes holds ADRs, the U.S. federal income tax treatment of its partners will generally depend upon the status of the partners and the activities of the partnership. Entities that are classified as partnerships for U.S. federal tax purposes and persons holding ADRs through such entities should consult their tax advisors.

This summary is based on the U.S. Internal Revenue Code of 1986, as amended (the Code), existing final, temporary and proposed regulations thereunder, judicial decisions and published positions of the Internal Revenue Service, and the Convention Between the Government of the United Sates of America and the Government of Israel with Respect to Taxes on Income (the Treaty), all as of the date of this annual report and all of which are subject to change (including changes in interpretation), possibly with retroactive effect. It is also based in part on representations by the Depositary and assumes that each obligation under the Deposit Agreement and any related agreement will be performed in accordance with its terms.

This summary does not purport to be a complete analysis of all potential tax consequences of owning ADRs. In particular, this discussion does not take into account the specific circumstances of any particular investor (such as tax-exempt entities, certain insurance companies, broker-dealers, investors subject to the alternative minimum

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tax, investors that actually or constructively own 10% or more of Teva s voting securities, investors that hold ordinary shares or ADRs as part of a straddle or hedging or conversion transaction, traders in securities that elect to mark to market, banks or other financial institutions, partnerships or other entities classified as partnerships for U.S. federal income tax purposes or investors whose functional currency is not the U.S. dollar), some of which may be subject to special rules. Investors are advised to consult their tax advisors with respect to the tax consequences of the ownership of ADRs, including the consequences under applicable state and local law and federal estate tax law, and the application of foreign laws or the effect of nonresident status on U.S. taxation.

U.S. Holders of ADRs will be treated as owners of the ordinary shares underlying their ADRs. Accordingly, deposits and withdrawals of ordinary shares in exchange for ADRs will not be taxable events for U.S. federal income tax purposes.

The U.S. Treasury has expressed concerns that parties to whom ADRs are released may be taking actions that are inconsistent with the claiming of foreign tax credits for U.S. Holders of ADRs. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate U.S. Holders. Accordingly, the analysis of the availability of foreign tax credits and the reduced tax rate for dividends received by certain non-corporate U.S. Holders, described below, could be affected by actions taken by parties to whom the ADRs are released.

Taxation of Distributions

The amount of any distribution paid to a U.S. Holder, including any Israeli taxes withheld from the amount of such distribution, will be subject to U.S. federal income taxation as ordinary income from sources outside the United States to the extent paid out of current or accumulated earnings and profits, as determined for U.S. federal income tax purposes. Subject to applicable limitations, dividends paid to non-corporate U.S. Holders with respect to taxable years beginning on or before December 31, 2008 are generally subject to tax at a maximum rate of 15%. The amount of any distribution of property other than cash will be the property s fair market value on the date of the distribution. To the extent that an amount received by a U.S. Holder exceeds that U.S. Holder s allocable share of current and accumulated earnings and profits, such excess will be applied first to reduce that U.S. Holder s tax basis in the shares and then, to the extent the distribution exceeds that U.S. Holder s tax basis, will be treated as capital gain. Any dividend received will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from other U.S. corporations.

Dividends paid in Israeli NIS will be included in a U.S. Holder s income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of the U.S. Holder s (or, in the case of ADRs, the depositary s) receipt of the dividend, regardless of whether the payment is in fact converted into U.S. dollars. If the dividend is converted into U.S. dollars on the date of receipt, a U.S. Holder should generally not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. Holder may have foreign currency gain or loss, which will be treated as income from sources within the United States, if he or she does not convert the amount of such dividend into U.S. dollars on the date of receipt. The amount of any distribution of property other than cash will be the property s fair market value on the date of the distribution.

Subject to applicable limitations that may vary depending on a U.S. Holder s circumstances, Israeli taxes withheld from dividends on Teva ADRs at the rate provided by the Treaty will be creditable against a U.S. Holder s U.S. federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex, and, therefore, you should consult your own tax advisor regarding the availability of foreign tax credits in your particular circumstances. Instead of claiming a credit, a U.S. Holder may elect to deduct such otherwise creditable Israeli taxes in computing taxable income, subject to generally applicable limitations.

Taxation of the Disposition of ADRs

Upon the sale or exchange of ADRs, a U.S. Holder will generally recognize capital gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized and the U.S.

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Holder s tax basis determined in U.S. dollars in the ADRs. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes. In general, the capital gain of a non-corporate U.S. Holder is subject to tax at ordinary rates for ADRs held for one year or less and at the long-term capital gains rate (currently 15%) for ADRs held for more than one year. A U.S. Holder s ability to deduct capital losses is subject to limitations.

The surrender of ADRs in exchange for ordinary shares, or vice versa, will not be a taxable event for U.S. federal income tax purposes, and U.S. Holders will not recognize any gain or loss upon such an exchange.

U.S. Information Reporting and Backup Withholding

A U.S. Holder generally will be subject to information reporting with respect to dividends paid on, or proceeds from the sale or other disposition of, an ADR unless the U.S. Holder is a corporation or comes within another category of exempt recipients. If it is not exempt, a U.S. Holder may also be subject to backup withholding with respect to dividends or proceeds from the sale or disposition of an ADR unless a taxpayer identification number is provided and the other applicable requirements of the backup withholding rules are complied with. Any amount withheld under these rules will be creditable against the U.S. Holder s U.S. federal income tax liability or refundable to the extent that it exceeds such liability, provided that the required information is timely furnished to the Internal Revenue Service.

U.S. Holders should review the summary below under Israeli Taxation for a discussion of the Israeli taxes which may be applicable to them.

Israeli Taxation

Corporate Tax Rate

The regular corporate tax rate in Israel was 34% in 2005. This rate is currently scheduled to decrease as follows: in 2006-31%, 2007-29%, 2008-27%, 2009-26% and 2010 and onward-25%. However, Teva s effective consolidated tax rates (before deduction of certain charges) for the years ended December 31, 2003, 2004 and 2005 were 20.8%, 21.7% and 18% respectively, since a major portion of Teva s income is derived from Approved Enterprises (as discussed below) and from operations outside of Israel, where Teva has enjoyed lower tax rates.

Law for the Encouragement of Industry (Taxes), 1969 (the Industry Encouragement Law)

Teva and certain of its Israeli subsidiaries currently qualify as Industrial Companies pursuant to the Industry Encouragement Law. As such, Teva and these subsidiaries qualify for certain tax benefits, including amortization of the purchase price of a good-faith acquisition of a patent or of certain other intangible property rights at the rate of 12.5% per annum and the right to file consolidated tax returns. Currently, Teva files consolidated tax returns together with certain Israeli subsidiaries. The tax laws and regulations dealing with the adjustment of taxable income for local inflation provide that industrial enterprises such as those of Teva and its subsidiaries which qualify as Industrial Companies can claim special rates of depreciation of up to 40% on a straight line basis for industrial equipment. In addition, new regulations generally allow industrial equipment purchased during the period from July 1, 2005 until September 30, 2006 to be depreciated over a period of two tax years.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any government authority. Teva cannot assure you that Teva or any of its Israeli subsidiaries that presently qualify as Industrial Companies will continue to qualify as such in the future, or that the benefits will be granted in the future.

Law for the Encouragement of Capital Investments, 1959 (the Investment Law)

Industrial projects of Teva and certain of its Israeli subsidiaries are eligible to be granted Approved Enterprise status under the Investment Law.

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The Investment Law empowers the Israeli Investment Center to grant Approved Enterprise status to capital investments in production facilities that meet certain relevant criteria. In general, such capital investments will receive Approved Enterprise status if the enterprise is expected to contribute to the development of the productive capacity of the economy, absorption of immigrants, creation of employment opportunities, or improvement in the balance of payments.

The tax benefits derived from any such Approved Enterprise relate only to taxable profits attributable to the specific program of investment to which the status was granted. In the event that Teva and its subsidiaries that have been granted Approved Enterprise status are operating under more than one approval, or in the event that their capital investments are only partly approved (which we refer to as a mixed enterprise), their effective corporate tax rate will be the result of a weighted combination of the various rates applicable.

Most of Teva s projects in Israel were granted Approved Enterprise status. For the vast majority of such Approved Enterprises, the companies elected to apply for alternative tax benefits the waiver of government grants in return for tax exemptions on undistributed income. Upon distribution of such exempt income, the distributing company will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise s income. Such tax exemption on undistributed income applies for a limited period of between two to ten years, depending upon the location of the enterprise. During the remainder of the benefits period (generally until the expiration of ten years), a corporate tax rate not exceeding 25% will apply (rather than the usual rate which was 34% in 2005, gradually scheduled to be reduced to 25% in 2010).

Teva is a foreign investors company, or FIC, as defined by the Investment Law, and is entitled to further reductions in the tax rate normally applicable to Approved Enterprises. Due to the fact that its current level of foreign ownership is more than 49%, its Approved Enterprise income is taxable at a tax rate not exceeding 20% for a 10 year period. Teva cannot assure you that it will continue to qualify as a FIC in the future, or that the benefits described herein, will be granted in the future.

Dividends paid by a company owning an Approved Enterprise, the source of which dividends is income derived from the Approved Enterprise, accrued during the benefits period, are generally taxed at a rate of 15% (which is withheld and paid by the company paying the dividend) if such dividends are paid during the benefits period or at any time up to 12 years thereafter. The 12-year limitation does not apply to a FIC.

In April 2005, a major amendment to the Investment Law came into effect, which is intended to provide expanded tax benefits to local and foreign investors and to simplify the bureaucratic process relating to the approval of investments that qualify under the Investment Law. Under the amendment, certain minimum qualifying investment requirements, time restrictions in which the investment is made and other conditions were established for new approved enterprises or expansions. Moreover, with a view to simplifying the bureaucratic process, the amendment provides that in the event that an investment project meets all of the eligibility criteria under one of the Alternative Tracks (Standard Alternative Track, Ireland Track or Strategic Investment Track), as discussed further below, a project will automatically qualify for Approved Enterprise taxation benefits under the Investment Law with no need for prior approval from the Investment Center.

The amendment generally does not apply retroactively to investment programs having an Approved Enterprise approval certificate from the Investment Center issued prior to December 31, 2004 (even when investments under these programs are made after January 1, 2005). The amendment will only apply to a new Approved Enterprise and to an Approved Enterprise expansion for which the first year of benefits is 2004 or any year thereafter.

The Amendment provides two additional tracks The Ireland Track and The Strategic Investment Track in addition to those previously available. The Ireland Track generally enables companies that have an Approved Enterprise at a certain location in the country to distribute dividends while maintaining a low company and dividend tax burden. Upon election, the Ireland Track generally provides that during the 10-year benefit

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period the Approved Enterprise income will be subject to a corporate tax rate of 11.5% and a tax rate of 4% on dividends distributed from such income to foreign investors. Effectively, in the case of foreign shareholders, the aggregate corporate tax and withholding tax burden will be 15%. With respect to Israeli shareholders, the regular 15% rate still applies to dividend distributions, and therefore there would be an aggregate corporate tax and dividend liability of 24.78%.

The Strategic Investment Track applies to companies that have an Approved Enterprise in a certain location in the country, which enterprise has (i) investments of at least NIS 600 million or NIS 900 million (approximately $128 or $191 million) depending on the location in the country; and (ii) annual revenues (measured for the company s consolidated group) for the tax year prior to the year the new investment begins (or the annual average for the three years prior to the year of investment) of at least NIS 13 billion or NIS 20 billion (approximately $2.77 billion or $4.25 billion). Income accrued under this track during the benefits period will be exempt from a corporate tax liability. In addition, dividends distributed from such income will also be exempt from Israeli tax. The Israeli government, in certain cases, may reduce these minimum requirements if it determines that the investments will result in material contributions to the Israeli economy.

Unless extended, benefits under the Investment Law are granted to enterprises seeking such status for the period until December 31, 2007.

Taxation of Non-Israeli Subsidiaries

Non-Israeli subsidiaries are generally taxed based upon tax laws applicable in their countries of residence. In accordance with the provisions of Israeli-controlled foreign corporation rules, certain income of a non-Israeli subsidiary, if the subsidiary s primary source of income is passive income (such as interest, dividends, royalties, rental income or income from capital gains), may be deemed distributed as a dividend to the Israeli parent company and consequently is subject to Israeli taxation. An Israeli company that is subject to Israeli taxes on such deemed dividend income of its non-Israeli subsidiaries may generally receive a credit for non-Israeli income taxes paid by the subsidiary in its country of residence or are to be withheld from the actual dividend distributions.

Withholding Taxes on Dividends Distributed by Teva to Non-Israeli Residents

Dividends distributed by an Israeli company to non-Israeli residents are generally subject to a 20% tax to be withheld at source (generally 15% in the case of dividends distributed from taxable income attributable to an Approved Enterprise), unless a lower rate is provided in a treaty between Israel and the shareholder s country of residence.

Under the U.S.-Israel tax treaty, the maximum Israeli tax and withholding tax on dividends paid to a holder of ordinary shares or ADRs who is a resident of the United States is generally 25%, but is reduced to 12.5% if the dividends are paid to a corporation that holds in excess of 10% of the voting rights of Teva during Teva s taxable year preceding the distribution of the dividend and the portion of Teva s taxable year in which the dividend was distributed. Dividends of an Israeli company derived from the income of an Approved Enterprise will still be subject to a 15% dividend withholding tax; provided that if the dividend is attributable partly to income derived from an Approved Enterprise, and partly to other sources of income, the withholding rate will be a blended rate reflecting the relative portions of the two types of income. The withheld tax is the final tax in Israel on dividends paid to non-residents who do not conduct a business in Israel. The rate of tax withheld on Teva s dividends for the fourth quarter of 2005 was 16%.

A non-resident of Israel who has interest or dividend income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

Capital Gains and Income Taxes Applicable to Non-Israeli Shareholders

Israeli law generally imposes a capital gains tax on the sale of securities and any other capital asset.

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Gains on the sale of ordinary shares traded on a recognized stock exchange (including the Tel Aviv Stock Exchange and NASDAQ) by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax. Notwithstanding the foregoing, dealers in securities in Israel are taxed at regular tax rates applicable to business income.

In addition, the U.S.-Israeli Tax Treaty exempts U.S. residents who hold an interest of less than 10% in an Israeli company, including Teva, and who did not hold an interest of 10% or more in the company at any time during the 12 months prior to a sale of their shares from Israeli capital gains tax in connection with such sale. Certain other tax treaties to which Israel is a party also grant exemptions from Israeli capital gains taxes.

Documents On Display

Teva files annual and special reports and other information with the SEC. You may inspect and copy such material at the public reference facilities maintained by the SEC, 100 F Street, N.E., Washington, D.C. 20549. You may also obtain copies of such material from the SEC at prescribed rates by writing to the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

The SEC maintains an Internet website at http://www.sec.gov that contains reports, proxy statements, information statements and other material that are filed through the SEC s Electronic Data Gathering, Analysis and Retrieval (EDGAR) system. Teva began filing through the EDGAR system beginning on October 31, 2002.

Teva s ADRs are quoted on the Nasdaq National Market.

Information about Teva is also available on its website at http://www.tevapharm.com. Such information on its website is not part of this annual report.

ITEM 11: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

Teva takes various measures to compensate for the effects of both fluctuations in exchange rates and interest rates. These measures include traditional currency hedging transactions as well as attempts to maintain a balance between monetary assets and liabilities in each of Teva s principal operating currencies, the U.S. dollar, the NIS, the Euro, the Canadian dollar (CAD), the British pound (GBP) and the Hungarian Forint (HUF). The costs and benefits of such measures are not allocated to specific income statement line items, but are concentrated to a large extent under the caption financial expenses net .

Teva can borrow funds in NIS, U.S. dollars or any other major currency. Given that Teva s functional currency is the U.S. dollar, Teva would logically prefer to borrow in U.S. dollars. Teva takes advantage of having a surplus of NIS liabilities and purchases NIS-denominated assets and thereby is able to set-off its currency exposure, enhancing interest yields. Teva uses financial instruments and derivatives in order to limit its exposure to risks deriving from changes in exchange rates and interest rates. The use of such instruments does not expose Teva to additional exchange rate or interest rate risks because the derivatives are held to hedge corresponding assets owned by Teva. No derivative instruments are entered into for trading purposes.

Teva s derivative transactions during 2005 were executed through Israeli banks and foreign banks, including Hungarian banks. In the opinion of Teva s management, the credit risk of these banks is de minimis.

Exchange Rate Risk Management

Teva s functional currency and that of most of its consolidated subsidiaries is the U.S. dollar, with the exception of its European and Canadian subsidiaries, where the functional currency is the local currency in each country.

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Accordingly, in Teva s subsidiaries in which the functional currency is the U.S. dollar, Teva covers itself against exposure deriving from the gap between current assets and current liabilities in each currency other than the U.S. dollar (balance sheet exposure). The majority of the balance sheet exposure in such subsidiaries is in European currencies and NIS. In Teva s European subsidiaries, protection is taken against the gap between current assets and current liabilities in currencies other than the functional local currency (generally against the U.S. dollar and other European currencies). Teva strives to limit its exposure through natural hedging, i.e., attempting to have similar levels of assets and liabilities in any one currency. Thus, for example, borrowings for acquisitions and borrowings for activities of acquired companies are generally taken in the functional currency of such companies. The rest of the exposure, which is not set off naturally, is substantially covered by the use of derivative instruments. To the extent possible or desirable, this is done on a consolidated basis.

In certain cases, Teva protects itself against exposure from a specific transaction for example, the acquisition of a company or a large investment in assets which is done in a currency other than the functional currency. To a large extent, in addition to forwards, Teva uses the cylinder strategy (purchasing calls/puts on the U.S. dollar, usually together with writing put options/call on the U.S. dollar at a lower exchange rate). In order to reduce costs Teva uses also knock-in strategies together with writing put options. Teva usually limits the hedging transactions to three-month terms.

Although Teva has adopted FAS 133, it has generally elected not to follow the designation and documentation processes required to qualify for the hedge accounting method under FAS 133. Accordingly, exchange rate fluctuations impact each and every line-item separately, including sales, cost-of-goods, SG&A and R&D, whereas the results of transactions to hedge the exposure relating to these line items are recorded under the financial expenses line item. Accordingly, financial expenses may fluctuate significantly from quarter to quarter. In addition, using the cylinder strategy may also have the same impact on the financial expenses line item.

The table below details the balance sheet exposure, by currency and geography, as at December 31, 2005 (at fair value). All data in the table has been converted for convenience into U.S. dollar equivalents.

	U.S. Dollar	Euro	English Pound	Canadian Dollar	New Israeli Shekel	Other	Total
			(U.S. dollars in millions)				
Israel		86	8	(8)	(6)	(3)	111
European Union	32						32
Canada	(36)						36
Hungary	405	87	31	1		(1)	525
England		8					8
Total exposure	473	181	39	9	6	4	712

Explanatory note: Total exposure is the summation of the absolute value figures.

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Net exposure:

	EUR/USD	GBP/USD	CAD/USD	NIS/USD
	(U.S. dollars in millions)			
Net exposure	54	8	(28)	(6)

The set-off does not include exposure against the HUF.

The table below details (in millions) the hedging acquired in derivative instruments in order to limit the exposure to exchange rate fluctuations. The data is as at December 31, 2005 and is presented in U.S. dollar equivalent terms.

		Hedging Value		Fair Value		2005 Weighted Average Settlement
Currency	**Cross Currency**	**2005**	**2004**	**2005**	**2004**	**Prices/Strike Prices**
		(U.S. dollars in millions)				
Forward:						
Euro	HUF	79	79	1.5	4	261.8
GBP	HUF	36	52	0.5	5	372.0
USD	HUF	335	135	-14	33	205.9
Canadian Dollar	HUF	0	1	0	0	0
GBP	USD	10	11	0	-0.5	1.72
Euro	USD	13	5	0	4	1.19
Canadian Dollar	USD	15	25	-0.5	0.5	1.19
New Israeli Shekel	USD	6	0	0	0	4.58
Options:						
New Israeli Shekel	USD	16	20	0	0.5	4.60
Canadian Dollar	USD	20	47	0	0.5	1.17
Euro	USD	51	126	0.5	0.5	1.18
GBP	USD	22	15	0.5	0	1.75
USD	HUF	69	36	1	4	205.9
Euro	HUF	8	7	0.5	0.5	260.7
GBP	HUF	5	2	0	0	372.0
Total		685	561	-10	52	

Explanatory notes:

1. An option s value reflects its fair value disregarding the notional amount represented by such an option.
2. In addition to the above, Teva protects some of its operational exposure for the next 12 months.

Interest Rate Risk Management

In anticipation of the Ivax acquisition, Teva entered into forward interest rate swap transactions to fix the interest rates for 10 and 30 years on $500 million and $250 million, respectively. The swap transactions were terminated in January 2006.

In November 2005, Teva fully drew down its $350 million multicurrency term loan facility, which was established in September 2005 with a syndicate of banks. This loan, which bears a floating interest rate, is divided into a 3-year tranche and a 5-year tranche of $175 million each. The syndicate participants comprise 21 banks based in Israel, Europe, the United States and China, each of which committed to lending between $10 million and $25 million. The funds were used to finance working capital needs of several European subsidiaries of Teva.

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In connection with the Sicor acquisition in January 2004, a Teva finance subsidiary issued an aggregate of $460 million of 0.50% Series A Convertible Senior Debentures due 2024 and $634.45 million of 0.25% Series B Convertible Senior Debentures due 2024.

During August 2004, Teva called the $360 million of 0.75% Senior Convertible Debentures for redemption, following which practically all such debentures were converted into Teva shares. As of December 31, 2005, the outstanding debt balances (the original amount net of debentures converted into shares) included $245 million out of the $450 million of 0.375% Senior Convertible Debentures, as well as the above-mentioned two series of convertible debentures issued in 2004.

In addition to the debentures, Teva s fixed interest-bearing debt also included $110 million of senior notes privately issued in 1998 to U.S. institutional investors in three series: $20 million due 2005 (which was repaid in 2005), $75 million due 2008 and $15 million due 2018. The blended fixed interest rate of the senior notes is approximately 6.9% per annum.

During 2002, Teva entered into a number of swap agreements with respect to the above-mentioned series of $75 million principal amount of senior notes due 2008. As a result of these agreements, Teva is currently paying an effective interest rate of LIBOR plus 0.9% on $30 million of these notes and a fixed rate of 4.5% on the remaining $45 million of these notes, as compared to the original blended 6.9% fixed rate.

The remaining debt consists of bank loans at floating interest rates. In currencies other than NIS, these borrowings are usually linked to the relevant LIBOR plus a spread of 0.2% 0.7%. Part of Teva s Canadian subsidiary debt is at floating rate based on the Canadian bankers acceptance rate of +0.65%.

Teva s cash is invested in the United States, Europe and Israel, primarily in short-term investments. In anticipation of the cash needs required for the Ivax acquisition, the average maturity of the portfolio, as of December 31, 2005, was shortened to May 2006, with average credit quality of AA+ and a minimum credit quality of BBB.

Teva s liabilities, the average interest they bear and their repayment schedule by currencies as at December 31, 2005 are set forth in the table below in U.S. dollar equivalent terms.

Currency	Total Amount	Interest Rate	2006	2007	2008	2009	2010	2011 & thereafter
					(U.S. dollars in millions)			
Fixed interest Debentures:								
U.S. Dollar	1,403.9	0.3% - 7.2%		244.5	525.0		619.4	15.0
Floating Rates:								
U.S. Dollar	44.7	4.9%	36.5	1.6	2.2	0.6		3.8
Euro	424.5	3.0%	139.4	2.2	179.9	1.6	101.4	
English Pound	99.1	5.2%	23.0	0.5	0.1	0.2	75.3	
Canadian Dollar	174.9	3.9%	174.9					
NIS	1.7	4.8%	1.7					
Total:	2,148.8		375.5	248.8	707.2	2.4	796.1	18.8

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PART II

ITEM 15: CONTROLS AND PROCEDURES

(a) *Disclosure Controls and Procedures.* Teva s chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this annual report, have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that the information required in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms, and such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Report of Teva Management on Internal Control Over Financial Reporting.* Teva s board of directors and management are responsible for establishing and maintaining adequate internal control over financial reporting. Teva s internal control system was designed to provide reasonable assurance to Teva s management and board of directors regarding the reliability of financial reporting and the preparation and fair presentation of its published consolidated financial statements.

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

Teva s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria established in *Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Based on our assessment, management has concluded that, as of December 31, 2005, Teva s internal control over financial reporting is effective based on those criteria.

Management s assessment of the effectiveness of Teva s internal control over financial reporting as of December 31, 2005 has been audited by Kesselman & Kesselman, an independent registered public accounting firm in Israel and a member of PricewaterhouseCoopers International Limited (PwC), as stated in their report which is included under Item 18 on page F-2.

(c) *Attestation Report of the Registered Public Accounting Firm.* See report of PwC included under Item 18 on page F-2.

(d) *Changes in Internal Controls over Financial Reporting.* There were no changes to our internal control over financial reporting that occurred during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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ITEM 16: [RESERVED]

ITEM 16A: AUDIT COMMITTEE FINANCIAL EXPERT

Teva s board of directors has determined that Prof. Meir Heth, a member of its audit committee, is an audit committee financial expert, as defined by applicable SEC regulations, and is independent in accordance with applicable SEC and Nasdaq regulations.

ITEM 16B: CODE OF ETHICS

Teva has adopted a code of business conduct applicable to its executive officers, directors and all other employees. A copy of the code is available to every Teva employee on its intranet site, upon request to its human resources department, to investors by contacting Teva s investor relations department and to others through the legal department or the internal auditor. Any waivers of this code for executive officers or directors will be disclosed through the filing of a Form 6-K. As referred to above, the board of directors has approved a whistleblower policy which functions in coordination with Teva s code of business conduct and provides an anonymous means for employees and others to communicate with various bodies of Teva, including the audit committee of its board of directors.

ITEM 16C: PRINCIPAL ACCOUNTANT FEES AND SERVICES

Policy on Pre-Approval of Audit and Non-Audit Services of Independent Auditors

Teva s audit committee is responsible for the oversight of its independent auditors work. The audit committee s policy is to pre-approve all audit and non-audit services provided by PwC and other members of PricewaterhouseCoopers International Limited. These services may include audit services, audit-related services, tax services and other services, as further described below. The audit committee sets forth the basis for its pre-approval in detail, listing the particular services or categories of services which are pre-approved, and setting forth a specific budget for such services. Additional services may be pre-approved by the audit committee on an individual basis. Once services have been pre-approved, PwC and management then report to the audit committee on a periodic basis regarding the extent of services actually provided in accordance with the applicable pre-approval, and regarding the fees for the services performed.

Principal Accountant Fees and Services

Teva paid the following fees for professional services rendered by PwC and other members of PricewaterhouseCoopers International Limited, for the years ended December 31:

	2005	2004
	(U.S. $ in thousands)	
Audit Fees	6,716	3,816
Audit-Related Fees	982	808
Tax Fees	4,799	5,133
All Other Fees	3	25
Total	12,500	9,782

The audit fees for the year ended December 31, 2005 were for professional services rendered for the integrated audit of Teva s annual consolidated financial statements and its internal control over financial reporting as of December 31, 2005, review of consolidated quarterly financial statements, statutory audits of Teva and its subsidiaries, issuance of comfort letters, consents and assistance with review of documents filed with the SEC. The audit fees for the year ended December 31, 2004 were for professional services rendered for the audit of Teva s annual consolidated financial statements, review of consolidated quarterly financial statements, statutory audits of Teva and its subsidiaries, issuance of comfort letters, consents and assistance with review of documents filed with the SEC.

The audit-related fees as of the years ended December 31, 2005 and 2004, respectively, were for assurance and related services related to due diligence related to mergers and acquisitions, accounting consultations and audits in connection with acquisitions, employee benefit plan audits, internal control reviews, attest services that are not required by statute or regulation and consultations concerning financial accounting and reporting standards.

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Tax fees as of the years ended December 31, 2005 and 2004, respectively, were for services related to tax compliance, including the preparation of tax returns and claims for refund, and tax planning and tax advice, including assistance with tax audits and appeals, advice related to mergers and acquisitions, tax services for employee benefit plans and assistance with respect to requests for rulings from tax authorities.

All other fees for the years ended December 31, 2005 and 2004 were for general guidance related to accounting issues and the purchase of accounting software and human resources benchmarking software.

ITEM 16E: PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

As further described below, during 2005, Teva spent $379 million to repurchase 12.7 million of its shares. This purchase had the result of decreasing total outstanding shares on a fully diluted basis at December 31, 2005 by 10.4 million shares.

Set forth below is a summary of the shares and convertible debentures repurchased by Teva during 2005 and the approximate dollar value of securities that may yet be purchased under its repurchase plan:

Teva Shares/ADRs

	Total number of shares purchased(1)	Average price paid per share (U.S. dollars)	Total number of shares purchased as part of publicly announced plans or programs	Approximate U.S. dollar value of securities that may yet be purchased under the plans or programs(2) (in millions)
January 2005	2,896,500	28.17	9,460,947	313
February 2005	2,742,070	28.56	12,203,017	235
March 2005	2,964,590	30.29	15,167,607	145
April 2005	3,479,077	31.86	18,646,684	34.5
May 2005	452,500	31.06	19,099,184	20.5
June 2005	126,850	32.25	19,226,034	16
Total	12,661,587	29.91	19,226,034	

(1) No securities were repurchased by Teva in 2005 except in the months listed.

(2) Amount available for repurchase under Teva s repurchase plan pursuant to authorization by Teva s board of directors in September 2004 to repurchase Teva securities in an amount valued at up to $300 million, which amount was increased to $600 million in December 2004. Amounts available for repurchase may be used to purchase ADRs or convertible debentures.

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PART III

ITEM 18: FINANCIAL STATEMENTS

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ITEM 19: EXHIBITS

1.1	Memorandum of Association (1)(2)
1.2	Restated Articles of Association (1)(3)
1.3	Amended Articles of Association (1)(4)
2.1	Amended and Restated Deposit Agreement, dated October 18, 2005, among Teva Pharmaceutical Industries Limited, The Bank of New York, as depositary, and the holders from time to time of ADRs (5)
2.2	Form of American Depositary Receipt (5)
2.3	Indenture, dated as of November 18, 2002, by and among Teva Pharmaceutical Finance B.V., Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (3)
2.4	Form of Global Debentures (included in Exhibit 2.3)
2.5	Indenture, dated as of January 27, 2004, by and among Teva Pharmaceutical Finance II, LLC, Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (6)
2.6	First Supplemental Senior Indenture, dated as of January 27, 2004, by and among Teva Pharmaceutical Finance II, LLC, Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (7)
2.7	Form of Global Debentures (included in Exhibit 2.6)
2.8	Senior Indenture, dated as of January 31, 2006, by and among Teva Pharmaceutical Finance Company LLC, Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (8)
2.9	First Supplemental Senior Indenture, dated as of January 31, 2006, by and among Teva Pharmaceutical Finance Company LLC, Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (8)
2.10	Second Supplemental Senior Indenture, dated as of January 31, 2006, by and among Teva Pharmaceutical Finance Company LLC, Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (8)
2.11	Form of Global Debentures (included in Exhibits 2.9 and 2.10)
2.12	Senior Indenture, dated as of January 31, 2006, by and among Teva Pharmaceutical Finance Company B.V., Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (8)
2.13	First Supplemental Senior Indenture, dated as of January 31, 2006, by and among Teva Pharmaceutical Finance Company B.V., Teva Pharmaceutical Industries Limited and The Bank of New York, as Trustee (8)
2.14	Form of Global Debentures (included in Exhibit 2.13)
2.15	Indenture, dated as of May 4, 2001, by and between Ivax Corporation and U.S. Bank Trust National Association, as Trustee (9)
2.16	First Supplemental Indenture, dated as of January 26, 2006, by and among Ivax Corporation, Teva Pharmaceutcal Industries Limited and U.S. Bank National Association, formerly U.S. Bank Trust National Association, as Trustee
2.17	Second Supplemental Indenture, dated as of January 26, 2006, by and among Ivax Corporation, Teva Pharmaceutcal Industries Limited, Ivory Acquisition Sub II, Inc. and U.S. Bank National Association, formerly U.S. Bank Trust National Association, as Trustee
2.18	Form of Global Debentures (included in Exhibit 2.17)

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2.19	Other long-term debt instruments: The registrant hereby undertakes to provide the Securities and Exchange Commission with copies upon request.
4.1	Purchase Agreement, dated February 1, 2000, among Dan Family Holdings Ltd., Almad Investments Limited, 1377077 Ontario Inc. and Teva Pharmaceutical Industries Ltd. and related exhibits, relating to the acquisition of Novopharm Limited (10)
4.2	Amending and Indemnity Agreement, dated as of April 4, 2000, among Dan Family Holdings Ltd., Almad Investments Limited, 1377077 Ontario Inc., Teva Pharmaceutical Industries Ltd., Novopharm Limited and Leslie L. Dan and related exhibits, relating to the acquisition of Novopharm Limited (11)
4.3	Agreement and Plan of Merger, dated as of July 25, 2005, by and among Teva Pharmaceutical Industries Limited, Ivax Corporation, Ivory Acquisition Sub, Inc. and Ivory Acquisition Sub II, Inc. (12)
8	Subsidiaries of the registrant
10.1	Consent of Kesselman & Kesselman
10.2	Consent of Ernst & Young LLP
12(i)	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12(ii)	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

1) English translation or summary from Hebrew original, which is the official version.
2) Incorporated by reference to Exhibit 3.1 to Teva s Registration Statement on Form F-1 (Reg. No. 33-15736).
3) Incorporated by reference to Teva s Registration Statement on Form F-3 (Reg. No. 333-102259).
4) Incorporated by reference to Teva s Registration Statement on Form F-4 (Reg. No. 333-128095).
5) Incorporated by reference to Teva s Registration Statement on Form F-6 (Reg. No. 333-116672).
6) Incorporated by reference to Teva s Registration Statement on Form F-3 (Reg. No. 333-111144).
7) Incorporated by reference to Exhibit 4.2 to Teva s Form 6-K filed on January 27, 2004.
8) Incorporated by reference to Teva s Form 6-K filed on January 31, 2006.
9) Incorporated by reference to Exhibit 4.5 to the Registration Statement on Form S-3 (Reg. No. 333-66310) of Ivax Corporation.
10) Incorporated by reference to Exhibit 10.5(i) to Teva s Annual Report on Form 20-F for the year ended December 31, 1999.
11) Incorporated by reference to Exhibit 10.5(ii) to Teva s Annual Report on Form 20-F for the year ended December 31, 1999.
12) Incorporated by reference to Annex A included in Teva s Registration Statement on Form F-4 (Reg. No. 333-128095).

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED

By: /s/ DAN S. SUESSKIND
Name: **Dan S. Suesskind**
Title: **Chief Financial Officer**

Date: March 17, 2006

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of

TEVA PHARMACEUTICAL INDUSTRIES LIMITED

We have completed an integrated audit of the 2005 consolidated financial statements of Teva Pharmaceutical Industries Limited and of its internal control over financial reporting as of December 31, 2005 and audits of its 2004 and 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

We have audited the consolidated balance sheets of Teva Pharmaceutical Industries Limited and its subsidiaries as of December 31, 2005 and 2004 and the related consolidated statements of income, changes in shareholders equity, comprehensive income and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company s Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of Teva Pharmaceutical Industries Limited and its subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations, changes in shareholders equity, comprehensive income and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in *Report of Teva Management on Internal Control Over Financial Reporting* appearing under item 15, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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

Tel-Aviv, Israel
March 17, 2006

/s/ Kesselman & Kesselman
Certified Public Accountants (Isr.)
A member of
PricewaterhouseCoopers International Limited

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31,		
	2005	2004	2003
	(U.S. dollars in millions, except earnings per ADR)		
Net sales	$ 5,250.4	$ 4,798.9	$ 3,276.4
Cost of sales	2,769.8	2,559.6	1,757.5
Gross profit	2,480.6	2,239.3	1,518.9
Research and development expenses:			
Total expenses	383.1	356.1	243.4
Less participations and grants	14.2	17.7	29.9
	368.9	338.4	213.5
Selling, general and administrative expenses	798.8	696.5	520.6
Acquisition of research and development in process		596.6	
Income from GlaxoSmithKline litigation settlement			100.0
Impairment of product rights		30.0	
Restructuring expenses			7.4
Operating income	1,312.9	577.8	877.4
Financial income (expenses) net	(4.3)	25.9	(5.0)
Income before income taxes	1,308.6	603.7	872.4
Income taxes	236.2	267.2	181.5
	1,072.4	336.5	690.9
Share in profits (losses) of associated companies net	1.7	(1.2)	1.5
Minority interests in profits of subsidiaries net	(1.8)	(3.5)	(1.4)
Net income	$ 1,072.3	$ 331.8	$ 691.0
Earnings per ADR:			
Basic	$ 1.73	$ 0.54	$ 1.29
Diluted	$ 1.59	$ 0.50	$ 1.16
Weighted average number of ADRs (in millions):			
Basic	618.4	612.7	536.8
Diluted	680.8	688.0	608.8

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2005	2004
	(U.S. dollars in millions)	
Assets		
Current assets:		
Cash and cash equivalents	$ 1,275.6	$ 784.1
Short-term investments	935.5	256.8
Accounts receivable:		
Trade	1,768.7	1,475.9
Other	411.3	398.4
Inventories	1,114.2	1,286.3
Total current assets	5,505.3	4,201.5
Investments and other assets	410.6	863.2
Property, plant and equipment, net	1,360.9	1,278.2
Intangible assets and debt issuance costs, net	648.6	716.7
Goodwill	2,462.0	2,572.4
Total assets	$ 10,387.4	$ 9,632.0
Liabilities and shareholders equity		
Current liabilities:		
Short-term credit	$ 375.5	$ 560.4
Accounts payable and accruals	1,884.6	1,643.5
Total current liabilities	2,260.1	2,203.9
Long-term liabilities:		
Deferred income taxes	219.3	212.3
Employee related obligations	84.4	87.6
Loans and other liabilities	459.4	215.0
Convertible Senior Debentures	1,313.9	1,513.4
Total long-term liabilities	2,077.0	2,028.3
Commitments and contingencies, see note 8		
Total liabilities	4,337.1	4,232.2
Minority interests	8.0	10.9
Shareholders equity:		
Ordinary shares of NIS 0.10 par value; December 31, 2005 and 2004: authorized 1,500.0 million shares and 999.6 million shares, respectively; issued and outstanding 646.7 million shares and 626.8 million shares, respectively	42.6	42.1
Additional paid-in capital	3,389.8	3,035.0
Deferred compensation	(0.2)	*
Retained earnings	3,081.6	2,171.4
Accumulated other comprehensive income	145.6	377.8
	(617.1)	(237.4)

Cost of Company shares held by subsidiaries	December 31, 2005 and 2004	28.1 million and 15.4 million ordinary shares, respectively	
Total shareholders equity		6,042.3	5,388.9
Total liabilities and shareholders equity		$ 10,387.4	$ 9,632.0

*Represents an amount of less then $0.1 million.

/s/ ELI HURVITZ
E. Hurvitz

Chairman of the Board

/s/ ISRAEL MAKOV
I. Makov

President and Chief Executive Officer

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

	Ordinary shares Number of shares (in millions)	Par value	Additional Paid-in capital	Deferred Compensation	Retained earnings	Accumulated other comprehensive income	Cost of Company shares held by subsidiaries	Total
				(U.S. dollars in millions)				
Balance at January 1, 2003	526.4	$ 33.9	$ 481.5	$ (0.1)	$ 1,345.7	$ 17.3	$ (48.9)	$ 1,829.4
Changes during 2003:								
Net income					691.0			691.0
Other comprehensive income						166.7		166.7
Total comprehensive income								857.7
Deferred compensation related to employee stock option plans			0.6	(0.6)				
Amortization of deferred compensation related to employee stock option plans				0.7				0.7
Exercise of options by employees	3.2	*	33.6					33.6
Tax benefit arising on exercise of stock options			10.6					10.6
Dividends					(76.4)			(76.4)
Conversion of Convertible Senior Debentures and related tax effect	25.8	0.4	637.0					637.4
Cost of acquisition of Company shares, net of proceeds from sale			(4.0)				0.4	(3.6)
Balance at December 31, 2003	555.4	34.3	1,159.3	*	1,960.3	184.0	(48.5)	3,289.4
Changes during 2004:								
Net income					331.8			331.8
Other comprehensive income						193.8		193.8
Total comprehensive income								525.6
Stock split		6.8	(6.8)					
Issuance of shares, stock options and warrants on acquisition of Sicor	46.7	0.5	1,410.9					1,411.4
Ordinary shares issued in exchange for special shares	0.1	*	*					*
Amortization of deferred compensation related to employee stock option plans				*				*
Exercise of options by employees	7.9	0.1	126.9					127.0
Tax benefit arising on exercise of stock options			35.2					35.2
Dividends					(120.7)			(120.7)
Conversion of Convertible Senior Debentures	16.7	0.4	358.0					358.4
Cost of acquisition of Company shares, net of proceeds from sale			(48.5)				(188.9)	(237.4)
Balance at December 31, 2004	626.8	42.1	3,035.0	*	2,171.4	377.8	(237.4)	5,388.9
Changes during 2005:								
Net income					1,072.3			1,072.3
Other comprehensive loss						(232.2)		(232.2)
Total comprehensive income								840.1
Ordinary shares issued in exchange for special shares	0.8	*	*					
Deferred compensation related to employee stock option plans			0.4	(0.4)				
Amortization of deferred compensation related to employee stock option plans				0.2				0.2
Exercise of options by employees	9.8	0.3	186.0					186.3

Tax benefit arising on exercise of stock options			24.5					24.5
Dividends					(162.1)			(162.1)
Conversion of Convertible Senior Debentures and related tax effect	9.3	0.2	195.9					196.1
Cost of acquisition of Company shares, net of proceeds from sale			(52.0)				(379.7)	(431.7)
Balance at December 31, 2005	646.7	$ 42.6	$ 3,389.8	$ (0.2)	$ 3,081.6	$ 145.6	$ (617.1)	$ 6,042.3

* Represents an amount less than $0.1 million.

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year ended December 31,		
	2005	2004	2003
	(U.S. dollars in millions)		
Net income	$ 1,072.3	$ 331.8	$ 691.0
Other comprehensive income (loss):			
Changes in net unrealized gain (loss):			
Differences from translation of non-dollar currency financial statements of subsidiaries and associated companies	(221.0)	190.5	149.4
Unrealized holding gains (losses) on available-for-sale securities net	(12.6)	10.6	15.8
Gain in respect of derivative instruments designated as a cash flow hedge		0.5	1.7
Minimum liability with respect to defined benefit plans	2.9	(3.6)	
Income tax effect:			
Differences from translation of non-dollar currency financial statements of subsidiaries and associated companies	1.2	(0.9)	
Unrealized holding gains (losses) on available-for-sale securities	(1.1)	(2.2)	(0.2)
Minimum liability with respect to defined benefit plans	(1.1)	1.1	
Changes in net unrealized gain (loss), net of tax	(231.7)	196.0	166.7
Reclassification adjustment included in net income:			
Unrealized holding gains on available-for-sale securities	(0.6)		
Gain in respect of derivative instruments designated as a cash flow hedge		(2.2)	
Income tax effect -reclassification adjustment on available-for-sale securities	0.1		
Net reclassification adjustment in net income, net of tax	(0.5)	(2.2)	
Other comprehensive income, net of tax, for the year	(232.2)	193.8	166.7
Total comprehensive income	$ 840.1	$ 525.6	$ 857.7
Accumulated other comprehensive income:			
Balance at beginning of year	$ 377.8	$ 184.0	$ 17.3
Other comprehensive income (loss), net of tax, for the year	(232.2)	193.8	166.7
Balance at end of year	$ 145.6	$ 377.8	$ 184.0

	Year ended December 31,	
	2005	2004
	(U.S. dollars in millions)	
Components of other comprehensive income:		
Differences from translation of non-dollar currency financial statements of subsidiaries and associated companies, net of tax	$ 146.4	$ 366.2
Unrealized holding gains (losses) on available-for-sale securities, net of tax	(0.1)	14.1
Minimum liability with respect to defined benefit plans, net of tax	(0.7)	(2.5)

	$ 145.6	$ 377.8

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2005	2004	2003
	(U.S. dollars in millions)		
Cash flows from operating activities:			
Net income	$ 1,072.3	$ 331.8	$ 691.0
Adjustments to reconcile net income to net cash provided by operating activities:			
Income and expenses not involving cash flows*(1)	208.7	884.2	25.5
Changes in certain assets and liabilities*(1)	89.0	29.6	(89.9)
Net cash provided by operating activities*	1,370.0	1,245.6	626.6
Cash flows from investing activities:			
Purchase of property, plant and equipment	(310.1)	(311.0)	(207.5)
Acquisition of subsidiaries and adjustment to purchase price of subsidiary*(2)	(10.9)	(1,961.3)	(8.4)
Acquisition of intangible assets	(23.5)	(24.3)	(18.6)
Proceeds from sale of property, plant and equipment	3.3	3.7	2.1
Proceeds from sale of long term investments	421.5	194.1	127.7
Acquisition of long-term investments and other assets	(424.7)	(536.1)	(472.5)
Purchase of minority interest	(2.9)		
Net decrease (increase) in short-term investments	(189.2)	242.0	142.1
Sale of subsidiary (3b)	(1.3)		
Net cash used in investing activities	(537.8)	(2,392.9)	(435.1)
Cash flows from financing activities:			
Proceeds from exercise of options by employees	134.3	78.7	35.0
Cost of acquisition of Company shares, net of proceeds from sale	(379.7)	(188.9)	0.4
Proceeds from issuance of Convertible Senior Debentures, net of issuance costs of $18.4 million		1,076.1	
Repurchase of Convertible Senior Debentures		(25.0)	
Proceeds from long-term loans and other long-term liabilities received	359.2	9.8	1.0
Discharge of long-term loans and other long-term liabilities	(157.2)	(11.5)	(4.1)
Net increase (decrease) in short-term credit	(105.6)	33.9	73.6
Dividends paid	(162.1)	(120.7)	(76.3)
Other	(1.6)		
Net cash provided by (used in) financing activities	(312.7)	852.4	29.6
Translation differences on cash balances of certain subsidiaries	(28.0)	21.7	26.3
Net increase (decrease) in cash and cash equivalents	491.5	(273.2)	247.4
Balance of cash and cash equivalents at beginning of year	784.1	1,057.3	809.9
Balance of cash and cash equivalents at end of year	$ 1,275.6	$ 784.1	$ 1,057.3

* See details on page F-9.

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

DETAILS TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	Year ended December 31,		
	2005	2004	2003
	(U.S. dollars in millions)		
(1) Adjustments to reconcile net income to net cash provided by operating activities:			
Income and expenses not involving cash flows:			
Depreciation, amortization and impairment	$ 242.5	$ 248.3	$ 127.7
Deferred income taxes net	(7.2)	27.1	(28.6)
Income from GlaxoSmithKline litigation settlement			(100.0)
Acquisition of research and development in process		596.6	
Restructuring expenses			7.4
Increase in employee related obligations	0.8	4.2	9.1
Compensation related to employee stock option plans	0.2	*	0.7
Capital losses (gains) net	0.4	(1.8)	0.5
Capital gain on sale of subsidiary	(3.3)		
Share in losses (profits) of associated companies net	(1.7)	1.2	(1.5)
Minority interests in profits of subsidiaries net	1.8	3.5	1.4
Capital loss (gain), exchange differences and amortization of premium on marketable securities net	(23.1)	6.2	11.2
Other items net	(1.7)	(1.1)	(2.4)
	$ 208.7	$ 884.2	$ 25.5
Changes in certain assets and liabilities:			
Increase in accounts receivable	$ (436.6)	$ (257.7)	$ (165.4)
Decrease (increase) in inventories	103.1	(84.7)	(155.6)
Increase in accounts payable and accruals	422.5	372.0	231.1
	$ 89.0	$ 29.6	$ (89.9)
(2) Acquisition of subsidiaries:			
Assets and liabilities of the subsidiaries upon acquisition:			
Working capital (excluding cash and cash equivalents)	$ 0.6	$ 254.4	$ 0.2
Long-lived assets	0.1	369.2	8.2
Research and development in-process		583.6	
Other identifiable intangible assets	12.9	506.5	
Long-term liabilities	(3.8)	(209.9)	
Goodwill arising on acquisition		1,868.9	
	9.8	3,372.7	8.4
Adjustment to purchase price of subsidiary acquired in 2004	(8.6)		
Costs related to Ivax acquisition	9.7		
Issuance of shares, stock options and warrants		1,411.4	
Cash paid net	$ 10.9	$ 1,961.3	$ 8.4

* Represents an amount of less than $0.1 million.

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

DETAILS TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)

(3) Supplemental disclosure of non-cash investing and financing activities:

a. In 2005, 2004 and 2003, $199 million, $358 million and $558 million of Convertible Senior Debentures were converted into approximately 9.3 million, 16.7 million and 25.8 million Teva ADRs, respectively. See note 7.

b. During the second quarter of 2005, Teva sold a subsidiary for a consideration of $4.4 million which is to be received subsequent to December 31, 2005.

c. On January 22, 2004, the Company completed the acquisition of Sicor Inc., for a total consideration of $3.46 billion. Teva shares, stock options and warrants with an aggregate value of $1.4 billion were issued as part of the consideration for the acquisition.

d. In April 2003, the Company signed a settlement agreement with GlaxoSmithKline Inc. (GSK) under which the Company received product rights relating to Purinethol® and recorded a non-cash income of $100 million reflecting the value of the product rights, see note 4.

	Year ended December 31,		
	2005	2004	2003
	(U.S. dollars in millions)		
(4) Supplemental disclosure of cash flow information:			
Interest paid	$ 27.4	$ 31.2	$ 34.0
Income taxes paid	$ 218.6	$ 249.0	$ 134.2

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

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES:

a. General:

Operations

Teva Pharmaceutical Industries Limited (the Company) is an Israeli corporation, which, together with its subsidiaries and associated companies (Teva or the Group), is engaged in development, production, marketing and distribution of products in two reportable operating segments, Pharmaceuticals and Active Pharmaceutical Ingredients.

Functional currency

The major part of the Group s operations is carried out by the Company and its subsidiaries in the United States and Israel. The functional currency of these entities is the U.S. dollar (dollar or $).

The functional currency of the remaining subsidiaries and associated companies, mainly European and Canadian companies, is their local currency. The financial statements of those companies are included in consolidation, based on translation into dollars in accordance with Statement of Financial Accounting Standards (FAS) 52 of the Financial Accounting Standards Board of the United States (FASB): assets and liabilities are translated at year end exchange rates, while operating results items are translated at average exchange rates during the year. Differences resulting from translation are presented in shareholders equity, under accumulated other comprehensive income (loss).

Accounting principles

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States.

Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported years. As applicable to these financial statements, the most significant estimates and assumptions relate to sales reserves and allowances, income taxes, inventories, contingencies and valuation and impairment of goodwill and other intangible assets. Actual results could differ from those estimates.

b. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. In these financial statements, subsidiaries are companies controlled to the extent of over 50%, the financial statements of which are consolidated with those of the Company. Significant intercompany transactions and balances are eliminated in consolidation; profits from intercompany sales, not yet realized outside the Group, are also eliminated.

c. Inventories:

These are valued at the lower of cost or market. Cost is determined as follows: raw and packaging materials and purchased products mainly on the moving average basis. Finished products and products in process: raw material and packaging component mainly on the moving average basis; labor and overhead on the average basis over the production period.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

d. Investee companies:

These investments are included among investments and other assets. Investments in which the Company has a significant influence, which are not subsidiaries (associated companies), are accounted for by the equity method. Other non-marketable equity investments are carried at cost.

e. Marketable securities:

Available-for-sale debt and equity securities are carried at market value with unrealized gains and losses, net of taxes, reported as a separate component of accumulated other comprehensive income (loss).

Held-to-maturity securities consist of debt securities, which are carried at amortized cost.

Debt securities formerly classified as held to maturity securities were mainly reclassified as available for sale securities, in anticipation of the financing of the Ivax acquisition subsequent to year end.

f. Property, plant and equipment:

Property, plant and equipment are carried at cost, after deduction of the related investment grants ($11 million in respect of both December 31, 2005 and 2004). Equipment leased under capital leases is classified as the Group s assets and included at the present value of lease payments as determined by the lease agreement.

Interest expenses in respect of loans and credit applied to finance the construction or acquisition of property, plant and equipment, incurred until the assets are ready for their intended use, are charged to the cost of such assets. Interest capitalized for the years ended December 31, 2005, 2004 and 2003 was $3.8 million $1.1 million and less than $1.0 million, respectively.

Depreciation is computed using the straight-line method over the estimated useful life of the assets: buildings 25-50 years; machinery and equipment 8-12 years; motor vehicles, computer equipment, furniture and other assets mainly 5-17 years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the related asset.

g. Goodwill, intangible assets and debt issuance costs:

Goodwill reflects the excess of the purchase price of subsidiaries acquired over the fair value of net assets acquired. Intangible assets consist mainly of acquired marketing and other rights relating to products in respect of which an approval for marketing was received from the U.S. Food and Drug Administration (FDA) or the equivalent agencies in other countries. Pursuant to FAS 142, Goodwill and Other Intangible Assets , goodwill and indefinite life intangible assets are not amortized but rather tested for impairment at least annually, at December 31 of each year. As of December 31, 2005, 2004 and 2003 the Company has determined that there is no impairment with respect to either goodwill or tradename, which was determined to have an indefinite life.

Definite-lived intangible assets comprising primarily product and marketing rights, are amortized mainly using the straight-line method over their estimated period of useful life 8 to 20 years.

Costs incurred in respect of issuance of debentures are deferred and amortized as a component of interest expense over the period from issuance of the debentures through the first redemption date.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

h. Impairment in value of long-lived assets and definite life intangible assets:

The Company tests long-lived assets, including definite life intangible assets for impairment, in the event an indication of impairment exists. If the sum of expected future cash flows (undiscounted and without interest charges) of the these assets is less than their carrying amount of such assets, an impairment loss would be recognized, and the assets would be written down to their estimated fair values, calculated based on expected future discounted cash flows.

i. Deferred income taxes:

Deferred taxes are determined utilizing the asset and liability method based on the estimated future tax effects of differences between the financial accounting and tax bases of assets and liabilities under the applicable tax laws. Deferred income tax provisions and benefits are based on the changes in the deferred tax asset or tax liability from period to period. Valuation allowance is provided if, based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Taxes which would apply in the event of disposal of investments in subsidiaries have not been taken into account in computing deferred taxes, as it is the Company s intention to hold these investments, not to realize them.

Teva intends to permanently reinvest the amounts of tax-exempt income generated from its current approved enterprises (see note 10) and does not intend to cause dividend distribution from such income. Therefore, no deferred taxes have been provided in respect of such tax-exempt income.

The Group might incur additional taxes if dividends are distributed out of the income of non-Israeli companies in the Group. Such additional tax liability has not been provided for in these financial statements as the Company does not expect these companies to distribute dividends in the foreseeable future.

j. Company shares held by subsidiaries:

Company shares held by subsidiaries are presented as a reduction of shareholders equity, at their cost to the subsidiaries, under cost of Company shares held by subsidiaries. Gains and losses on sale of these shares, net of related income taxes, are carried to additional paid-in capital.

k. Revenue recognition:

Revenue is recognized when title and risk of loss for the products is transferred to the customer. Provisions for estimated chargebacks, returns, customer volume rebates, discounts and shelf-stock adjustments are established concurrently with the recognition of revenue, and are deducted from net sales.

The calculation is based on historical experience and the specific terms in the individual agreements. Shelf-stock adjustments are granted to customers based on the existing inventory of a customer following decreases in the invoice or contract price of the related product. Provisions for shelf-stock adjustments are determined at the time of the price decline or at the earliest point in time when a price decline is expected and based on estimated inventory levels. Where there is a historical experience of Teva agreeing to customer returns, Teva records a reserve for estimated sales returns by applying historical experience of customer returns to the amounts invoiced and the amount of returned products to be destroyed versus products that can be placed back in inventory for resale.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

l. Research and development expenses:

Research and development expenses are charged to income as incurred. Participations and grants in respect of research and development expenses are recognized as a reduction of research and development expenses as the related costs are incurred, or as the related milestone is met. Upfront fees received in connection with cooperation agreements are deferred and recognized over the period of the applicable agreements as a reduction of research and development expenses.

In connection with a business combination, amounts assigned to tangible and intangible assets to be used in a particular research and development project that have not reached technological feasibility and have no alternative future use are charged to research and development in process expense at the acquisition date.

m. Shipping and handling costs:

Shipping and handling costs, which amounted to $81.3 million, $59.2 million and $43.8 million for the years ended December 31, 2005, 2004 and 2003, respectively, are included in selling, general and administrative expenses.

n. Advertising expenses:

Advertising expenses are charged to income as incurred. Advertising expenses for the years ended December 31, 2005, 2004 and 2003 were $38.4 million, $33.0 million and $28.9 million, respectively.

o. Concentration of credit risks allowance for doubtful accounts:

Most of the Group s cash and cash equivalents and short-term investments as of December 31, 2005 and 2004 were deposited with major U.S., European and Israeli banks. The Company is of the opinion that the credit risk in respect of these balances is remote.

Sales to major customers, in the Pharmaceutical reporting segment, as a percentage of total consolidated sales were as follows:

	Year ended December 31,		
	2005	2004	2003
Customer A	12%	10%	7%
Customer B	7%	9%	13%

In general, the exposure to the concentration of credit risks relating to trade receivables is limited, due to the relatively large number of customers and their wide geographic distribution. The Group performs ongoing credit evaluations of its customers for the purpose of determining the appropriate allowance for doubtful accounts and generally does not require collateral. An appropriate allowance for doubtful accounts is included in the accounts. The allowance in respect of trade receivables ($33.8 million and $36.3 million, at December 31, 2005 and 2004, respectively), has been determined for specific debts doubtful of collection.

p. Derivatives:

Teva carries out transactions involving foreign exchange derivative financial instruments (mainly forward exchange contracts and written and purchased currency options). The transactions are designed to hedge the cash flows resulting from existing assets and liabilities and transactions expected to be entered into over the next twelve months, in currencies other than the functional currency.

In 2005 the Company entered into an interest swap transaction in connection with funds required for financing the acquisition of Ivax. The expiry date of this transaction was February 15, 2006.

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The Ivax acquisition was completed on January 26, 2006. Upon completion of the acquisition the Company entered into an off-setting transaction effectively closing the aforementioned interest swap transaction.

This derivative does not qualify for hedge accounting under FAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended, and is recognized on the balance sheet at its fair value, with changes in the fair value carried to the statements of income and included in financial income (expenses) net.

Other than the following transaction, derivatives do not qualify for hedge accounting under FAS 133, and are recognized on the balance sheet at their fair value, with changes in the fair value carried to the statements of income and included in financial income (expenses) net.

In 2003, a wholly-owned subsidiary of the Company entered into several forward transactions in respect of forecasted sales. These transactions were designated as hedging instruments on the date that the subsidiary entered into such derivative contracts, and qualify as cash flow hedges under FAS 133. For such derivative financial instruments, the effective portions of changes in fair value of the derivative were carried to other comprehensive income under gains in respect of derivative instruments designated for cash flow hedge, net of related taxes, and were recognized in the statements of income when the hedged item affected earnings. Ineffective portions of changes in the fair value of cash flow hedges were recognized immediately in the statements of income among financial income (expenses) net.

In 2002, the Company entered into an interest rate swap transaction in respect of a portion of a series of debentures issued in a private placement in 1998. This derivative qualifies as a fair value hedge under FAS 133, and is recognized on the balance sheet at its fair value. The carrying amount of the hedged liability is adjusted for the entire changes in the fair value of the derivative.

q. Cash and cash equivalents:

The Group considers all highly liquid investments, which include short-term (up to three months) bank deposits that are not restricted as to withdrawal or use and short-term debentures, the period to maturity of which did not exceed three months at time of investment, to be cash equivalents.

r. Earnings per American Depository Receipt (ADR):

Basic earnings per ADR are computed by dividing net income by the weighted average number of ADRs/ordinary shares (including special shares exchangeable into ordinary shares) outstanding during the year, net of Company shares held by subsidiaries.

In computing diluted earnings per ADR, basic earnings per ADR are adjusted to take into account the potential dilution that could occur upon: (i) the exercise of options granted under employee stock option plans, using the treasury stock method; (ii) the conversion of Convertible Senior debentures using the if converted method, by adding to net income interest expense on the debentures and amortization of issuance costs, net of tax benefits, and by adding the weighted average number of shares issuable upon assumed conversion of debentures.

s. Comprehensive income:

Comprehensive income, presented in shareholders equity, includes, in addition to net income: (i) translation gains and losses of non-dollar currency financial statements of subsidiaries and associated companies net of related taxes; (ii) unrealized holding gains and losses on available-for-sale securities, net of related taxes; (iii) gains in respect of derivative instruments designated as a cash flow hedge, net of related taxes and (iv) minimum liability with respect to defined benefit plans, net of related taxes.

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t. Stock-based compensation:

The Company accounts for its employee stock option plans using the intrinsic value based method of accounting prescribed by APB 25, Accounting for Stock Issued to Employees and related interpretations. Accordingly, the compensation cost relating to stock options is charged on the date of grant of such options, to shareholders equity, under deferred compensation, and is thereafter amortized by the graded vesting method and charged against income over the vesting period.

FAS 123, Accounting for Stock-Based Compensation, as amended by FAS 148, established a fair value based method of accounting for employee stock options or similar equity instruments. However, it also allows companies to continue to account for those plans using the accounting treatment prescribed by APB 25. The Company has elected to account for employee stock option plans according to APB 25, and has accordingly complied with the disclosure requirements set forth in FAS 123, for companies electing to apply APB 25.

The following table illustrates the effect on net income and earnings per ADR, assuming the Company had applied the fair value recognition provisions of FAS 123 to its stock-based employee compensation:

	Year ended December 31,		
	2005	2004	2003
	(In millions, except earning per ADR)		
Net income, as reported	$ 1,072.3	$ 331.8	$ 691.0
Add: compensation related to employee stock option plans, included in consolidated statements of income net of related tax effect	0.2	*	0.5
Deduct: amortization of deferred compensation, at fair value, net of related tax effect	35.4	44.9	54.7
Pro forma net income	$ 1,037.1	$ 286.9	$ 636.8
Earnings per ADR (see note 1r):			
Basic as reported	$ 1.73	$ 0.54	$ 1.29
Basic pro forma	$ 1.68	$ 0.47	$ 1.19
Diluted as reported	$ 1.59	$ 0.50	$ 1.16
Diluted pro forma	$ 1.54	$ 0.43	$ 1.08

* Represents an amount of less than $0.1 million.

In December 2004, the FASB issued FAS 123R, Share-Based Payment , which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company s equity instruments or that may be settled by the issuance of such equity instruments. This Statement requires that employee equity awards be accounted for using the grant-date fair value based method. As applicable to Teva, this statement will be effective as of the first quarter of 2006.

This statement applies to all awards granted or modified after the statement s effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the statement s effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards grant-date fair value as previously calculated for the pro-forma disclosure under FAS

123.

In March 2005, the SEC issued Staff Accounting Bulletin 107 (SAB 107) to assist preparers by simplifying some of the implementation challenges of FAS 123R. In particular, SAB 107 provides supplemental

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implementation guidance on FAS 123R, including guidance on valuation methods, classification of compensation expense, inventory capitalization of share-based compensation cost, income statement effects, disclosures and several other issues. The Company will apply the principals of SAB 107 in conjunction with its adoption of FAS 123R

The Company expects that upon the adoption of FAS 123R, it will apply the modified prospective application transition method, as permitted by the statement. Under such transition method, upon the adoption of FAS 123R, the new standard will be implemented as from the first quarter of 2006, with no restatement of prior periods. Taking into account the transition method adopted by the Company, the Company expects that the effect of applying this statement on the Company s results of operations in 2006 as it relates to existing option plans would not be materially different from the FAS 123 pro forma effect previously reported. The balance of unamortized compensation before taxation and any adjustment for forfeitures of options at December 31, 2005 amounted to $85.4 million. The cumulative effect upon adoption is not expected to be material to the Company s financial statements and results from operations.

u. Other recently issued accounting pronouncements:

1) FAS 151

In November 2004, the FASB issued FAS 151, Inventory Costs an amendment of Accounting Research Bulletin, ARB 43, Chapter 4 . This statement amends current guidance to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. This statement requires that those items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. As applicable to Teva, this statement will be effective for inventory costs incurred after January 1, 2006 and the provisions of this statement shall be applied prospectively. The Company does not expect this statement to have a material effect on the Company s financial statements or its results of operations.

2) FAS 154

In June 2005, the FASB issued FAS 154, Accounting Changes and Error Corrections a replacement of APB No. 20 Accounting Changes and FAS No. 3 Reporting Changes in Interim Financial Statements . This statement provides guidance on the accounting and reporting of accounting changes and error corrections, and guidance in the determination of retrospective application of changes in accounting principals. As applicable to Teva, the provisions of FAS 154 are effective as for year beginning January 1, 2006.

4) FAS 155

In February 2006, the FASB issued FAS 155, accounting for certain Hybrid Financial Instruments, an amendment of FASB statements No. 133 and 140. This statement permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entity s fiscal year, provided that no interim period financial statements have bee issued for the financial year. Management is currently evaluating the impact of this statement, if any, on the Company s financial statements or its results of operations.

v. Reclassifications:

Certain comparative figures have been reclassified to conform to the current year presentation.

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NOTE 2 CERTAIN TRANSACTIONS:

a. Acquisitions:

Event subsequent to December 31, 2005 Acquisition of Ivax Corporation.

On January 26, 2006, Teva completed its acquisition of Ivax Corporation, a multinational generic pharmaceutical company with headquarters in Miami, Florida and with operations mainly in the United States, Europe and Latin America, for approximately $3.8 billion in cash and 122,915,483 ADRs, representing approximately 16.0% of the issued and outstanding share capital of Teva. For accounting purposes, the transaction was valued at $7.9 billion (including transaction costs and fair value of Ivax s stock options, determined using the Black-Scholes option pricing model) based on the aggregate of the cash consideration and the average of the closing price per ADR during the five trading day period commencing two trading days before the date of the merger agreement with Ivax.

The cash consideration of $3.8 billion was financed with Teva s own resources and short-term borrowing in the amount of $2.8 billion. These borrowings were subsequently refinanced by the issuance of Senior Notes and Convertible Senior Debentures (See Notes 6 and 7).

This acquisition, enhances Teva s position in the United States, expands its presence in Western Europe and significantly boosts Teva s reach in Latin America, Russia and other Central and Eastern European countries. The acquisition further provides Teva with an opportunity to expand the vertical integration between Teva s API business and Ivax s finished dose manufacturing operations in both existing and new regions. Ivax brings Teva new capabilities in the respiratory business, as well as enhanced innovative pipeline focused on the central nervous system and cancer, with products in various stages of clinical development. Ivax also adds to Teva s existing veterinary business through the Ivax animal health business.

Under the terms of the merger agreement, Ivax shareholders had the right to elect to receive for each Ivax share they owned either 0.8471 Teva ADRs or $26.00 in cash, subject to proration procedures designed to ensure that the purchase consideration would be settled 50% in cash and 50% in Teva ADRs. Based on the final results of the elections, the merger consideration paid to Ivax shareholders was:

Stock Elections: Ivax shareholders who validly elected to receive all stock received 0.8471 Teva ADRs for 51.90922% of their shares of Ivax common stock and $26.00 in cash for 48.09078% of their shares of Ivax common stock, or effectively on a per share basis: 0.4397 Teva ADRs and $12.50 for each share of Ivax common stock for which such election was made;

Cash Elections: Ivax shareholders who validly elected to receive all cash received $26.00 in cash for each share of Ivax common stock for which such election was made; and

Non-Elections: Ivax shareholders who did not make a valid election received $26.00 in cash for each share of Ivax common stock.

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The acquisition is to be accounted for by the purchase method. The results of operations of Ivax are to be included in the consolidated financial statements of Teva commencing February 1, 2006. The Company has not finalized the allocation of the purchase price to the net assets acquired in this acquisition. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed, with reference to Ivax s balance sheet data as of December 31, 2005:

	U.S. $ in millions (Unaudited)
Investments and other assets	$ 57.1
Property, plant and equipment, net	606.1
Identifiable intangible assets:	
Existing products	1,700.0
Research and development in-process	1,300.0
Goodwill	4,896.9
	8,560.1
Net current liabilities	134.9
Long-term liabilities	539.8
	674.7
Net assets acquired	$ 7,885.4

The amount allocated to research and development in-process represents an estimate of the fair value of purchased in-process technology for research projects that, as of the closing date of the merger, have not reached technological feasibility and have no alternative future use. The preliminary estimate of research and development in-process is subject to change and is to be finalized upon completion of an appraisal by management, with the assistance of independent appraisers. The amount allocated to research and development in process is to be charged to operating expenses in the first quarter of 2006. The amount allocated to intangible assets estimated useful life and amortization methodology are preliminary and are subject to the completion of an appraisal by management, with the assistance of independent appraisers. The Company expects to amortize existing products mainly over periods ranging from 15 to 20 years. The Company expects to finalize its restructuring plans and the quantification thereof by the end of 2006. The above table includes a preliminary estimate of the restructuring plan in its current status.

2004 acquisitions:

Acquisition of Sicor Inc.:

On January 22, 2004, Teva completed the acquisition of full control and ownership of Sicor Inc. (Sicor), a U.S. public pharmaceutical company that focuses on generic finished dosage injectable pharmaceuticals, active pharmaceutical ingredients, and generic biopharmaceuticals. This transaction was intended to establish Teva s presence in the U.S. hospital and generic injectables market, as well as provide Teva with a global platform for a generic injectables business, help expand its Central American operations, enhance its API operations and help expand its biogenerics efforts.

Under the terms of the merger agreement, each share of Sicor common stock was exchanged for $16.50 in cash and 0.3812 Teva ADRs representing a total consideration of $27.52 per share, calculated based upon the aggregate of the cash consideration and the average of the closing prices per ADR for the period commencing two days before, and ending two days after, the announcement of the merger agreement. The total consideration for the acquisition was $3.46 billion (including transaction costs and the fair value of 4.3 million of Teva s vested stock options granted in exchange of Sicor s vested stock options, determined using the Black-Scholes option pricing model). The cash consideration

of $2,019 million was financed out of Teva s own resources, and from

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short-term borrowings in the amount of $1,130 million, which were subsequently refinanced by the issuance of Convertible Senior Debentures (see note 7). A total of 46,657,668 ADRs were issued as part of the Sicor acquisition; these shares amounted to 7.7% of Teva s issued and outstanding share capital shortly after the allotment. The acquisition has been accounted for by the purchase method.

The results of operations of Sicor have been included in the consolidated financial statements of Teva commencing January 22, 2004 (the closing date of the acquisition). The consideration for the acquisition was attributed to net assets on the basis of fair value of assets acquired and liabilities assumed. The following table summarizes the fair values of the assets acquired and liabilities assumed, with reference to Sicor s balance sheet data as of January 22, 2004:

	U.S. $ in millions
Current assets	$ 641.9
Investments and other assets	142.7
Property, plant and equipment, net	222.2
Identifiable intangible assets:	
Existing products	473.5
Research and development in-process	583.6
Other	33.0
Goodwill	1,780.6
Total assets acquired	3,877.5
Current liabilities	211.5
Long-term liabilities	208.9
Total liabilities assumed	420.4
Net assets acquired	$ 3,457.1

Based upon an appraisal, performed by management with the assistance of independent appraisers, an amount of $583.6 million of the purchase price was allocated to the estimated fair value of purchased research and development in process, which, as of the closing date of the merger, had not reached technological feasibility and had no alternative future use, and, in accordance with generally accepted accounting principles, was charged to operating expenses upon acquisition. In-process R&D related to 32 injectable products having a range of values of between $1 million and $68 million, with an average value of approximately $18.2 million per product, and includes two products each with a value marginally above 10% of the total value. The amount allocated to research and development in process was valued using a variation of the income approach known as the Multi-Period Excess Earnings Approach . This method utilized a forecast of expected cash inflows (including adjustments, as appropriate, for regulatory and commercial risks), cash outflows and contributory charges for economic returns on tangible and intangible assets employed. The net cash inflows were discounted to present value, using discount rates, which take into account, for each individual project, the stage of completion and the risks surrounding the successful development and commercialization. Material net cash inflows are forecasted to commence in the year 2006. A probability of success factor was used to reflect inherent technological and regulatory risks. The discount rate, as applicable to substantially all of the projects, was 14%. The status of development, stage of completion, assumptions, nature and timing of remaining efforts for completion, risks and uncertainties, and other key factors may vary among the individual projects. Out of 32 products mentioned above, 6 have been approved for marketing through December 31, 2005.

An amount of $506.5 million of the purchase price was allocated to other identifiable intangible assets (of which $473.5 million relates to existing products), which were valued by management, with the assistance of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

independent appraisers, using the Multi-Period Excess Earnings Approach described above. The Company expects to amortize existing products over periods of 12 and 20 years. Additional purchase liabilities recorded included $23.3 million, mainly related to severance pay and termination of certain agreements. The excess of cost of acquisition over the fair value of net tangible and intangible assets on the acquisition date, not attributed to acquired in-process research and development, amounted to $1.78 billion, and was allocated to goodwill.

Hereafter are certain pro forma combined statement of income data for the years ended December 31, 2004 and 2003, as if the acquisition of Sicor had occurred on January 1, 2004 and 2003, respectively, after giving effect to: (a) purchase accounting adjustments, including amortization of identifiable intangible assets; and (b) estimated additional interest expense due to: (i) issuance of Convertible Senior Debentures in connection with the acquisition; and (ii) add back of interest income on Teva s cash and cash equivalents and marketable securities used as cash consideration in the acquisition, but excluding non-recurring expenses directly attributable to the acquisition, representing acquired research and development in process in the amount of $583.6 million. The pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisition taken place at the beginning of 2004 and 2003, respectively, nor is it necessarily indicative of future results.

	Year Ended December 31,	
	2004	2003
	(U.S. $ in millions, except earnings per ADR) (Unaudited)	
Net sales	$ 4,816.2	$ 3,831.5
Net income	$ 913.0	$ 742.1
Earnings per ADR:		
Basic	$ 1.48	$ 1.27
Diluted	$ 1.34	$ 1.11

Acquisition of Dorom Srl.:

In December 2004, the Company acquired full control and ownership of Dorom Srl. (Dorom), one of the largest suppliers of generic pharmaceuticals in the Italian retail market, for a net consideration of $84.8 million comprising of a total consideration of $93.4 in 2004 less a refund of $8.6 million received in 2005.

The Company accounted for this acquisition by the purchase method. The results of operations of Dorom have been included in the consolidated financial statements of Teva commencing December 1, 2004.

Approximately $71 million of the purchase price allocation was attributed to goodwill.

Acquisition of units in Viventia Biotech

In September 2003, Teva purchased units issued by Viventia Biotech Inc., a publicly traded Canadian biotech company, for CDN $2.8 million. Leslie Dan, a director of Teva, is a major shareholder and chairman of the board of Viventia. In December 2005, Viventia completed a going-private transaction that resulted in Viventia becoming wholly owned by Mr. Dan and members of his family. As part of the going-private transaction, Teva s units in Viventia were purchased for an aggregate of approximately CND $4.2 million in cash.

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b. Cooperation agreements:

The Company has entered into alliances and other arrangements with third parties to acquire rights to products it does not have and to otherwise share development cost or litigation risks. The Company s most significant agreements of this nature are summarized below.

1) With Sanofi-Aventis:

a) Under agreements entered into by Teva and Sanofi-Aventis, sale and distribution, in North America, Europe and certain other countries, of Copaxone®, an innovative product of the Company for the treatment of multiple sclerosis, is being carried out by Sanofi-Aventis. Marketing of Copaxone® in the U.S. and Canada is done by Teva under the name Teva Neuroscience . In the core European countries, Copaxone® is jointly marketed by Teva and Sanofi-Aventis. The agreement with Sanofi-Aventis in the U.S. terminates in March 2008, at which point Teva expects to take over U.S. distribution responsibilities for Copaxone® in exchange for payment by Teva of previously agreed-upon consideration to Sanofi-Aventis. In Europe, Teva expects to take over distribution responsibilities for Copaxone® when the agreement with Sanofi-Aventis terminates in February 2012, at which time Sanofi-Aventis will be entitled to pre-agreed residual payments.

Sanofi-Aventis also participated in certain research and development expenses of Teva relating to the development of the oral version of Copaxone® and to a new indication for injectable Copaxone® (collectively referred to as the Studies). Upon receipt of approval from the FDA relating to either one of the Studies, the related amount of participation is to be refunded to Aventis.

b) Teva has reserved the right to reacquire, under certain conditions, the marketing and distribution rights in Europe to the injectable formulation of Copaxone® for consideration to be computed based on a certain formula, as stipulated in the agreement.

2) With Lundbeck:

a) The Company entered into a cooperation agreement with H. Lundbeck A/S (Lundbeck), for the joint global development and for the marketing, mainly in Europe, of two innovative products of the Company for the treatment of Parkinson s disease.

Under the agreement, commencing in 1999, Lundbeck participated in the research and development expenses of Teva at varying rates, subject to maximum amounts stipulated in the agreement.

Lundbeck will also distribute Azilect in Europe and certain other countries. Teva and Lundbeck will jointly market Azilect in the core European countries.

b) Teva and Lundbeck have entered into an additional cooperation agreement, for the global development and for the marketing, mainly in Europe, of the oral version of Copaxone®. Under the agreement, Lundbeck was to fund the research and development of the product performed by Teva, up to a maximum amount stipulated in the agreement. Other provisions of the agreement relate to the additional funding by Lundbeck of certain other development, pre-marketing and marketing activities relating to the product. Such additional funding is to be made under certain conditions and up to a maximum amount, as stipulated in the agreement.

3) With Eisai:

In May 2003, the Company entered into a cooperation agreement with Eisai Co. Ltd. and Eisai Inc. (together Eisai), for the global co-development and for co-promotion of rasagiline for several indications in the U.S market. Teva and Eisai initially aim to develop rasagiline for Alzheimer disease and will also

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

co-promote rasagiline once approved by the FDA, in the U.S. for Parkinson s disease. Other provisions of the agreement relate to additional funding by Eisai of certain development activities relating to the products. Such additional funding is being made under certain conditions up to a maximum amount, as stipulated in the agreement. In 2004, a phase II clinical study of potential uses of rasagaline in the treatment of Alzheimer s disease was initiated.

4) With Alpharma:

In April 2004, Teva entered into an exclusivity sharing agreement with Alpharma Inc. pertaining to the distribution of gabapentin, the generic version of Neurontin®, tablets and capsules. Alpharma held statutory exclusivity for these generic products. Under the terms of the agreement, Alpharma permitted Teva to launch its generic version of Neurontin® in the U.S. within Alpharma s exclusivity period in exchange for royalties on sales. In addition, the parties have agreed to certain risk sharing arrangements relating to patent litigation risks regarding the products. Teva s capsules and tablets were launched in October and December 2004, respectively. On August 23, 2005, the District Court granted Teva and Alpharma s motion for summary judgment of noninfringement. This summary judgment remains subject to appeal.

5) With Active Biotech AB:

Effective August 2004, the Company entered into an agreement with Active Biotech AB (Active Biotech), a Swedish publicly traded company, to develop and commercialize a certain Active Biotech product, which has the potential to be an orally available disease modifying treatment of multiple sclerosis.

Under the terms of the agreement, the Company acquired the exclusive rights to develop, register, manufacture and commercialize the product worldwide, with the exception of the Nordic and Baltic countries. In the third quarter of 2004 the Company made an upfront payment of $5 million, included in research and development expenses, and is to make additional payments up to a maximum amount of $87 million upon the achievement of certain milestones, as stipulated in the agreement.

6) With Barr Pharmaceuticals:

In June 2005, Teva entered into a strategic alliance arrangement with Barr Pharmaceuticals, Inc. for the marketing rights in the U.S. for the generic version of Allegra® (fexofenadine) tablets. Under the agreement, Barr enabled Teva to launch its own product, with the parties sharing in profits. The percentage of profit share to Barr is dependent on multiple factors including the number of competitors and resolution of related patent litigation with Sanofi- Aventis. The parties have agreed to share in the patent litigation risks on a proportionate basis to that of the profit split arrangement. The generic version of Allegra® was launched in September 2005.

7) With Neurosurvival Technologies Ltd.

In September 2005, Teva s board of directors approved a Memorandum of Agreement and Share Purchase Agreement with Neurosurvival Technologies Ltd. (NST), a pharmaceutical development company. Under the agreements, Teva agreed to invest $2 million in NST in exchange for NST ordinary shares and to fund the co-development by Teva and NST of certain products for up to $9 million in consideration for certain rights granted to Teva by NST. Eli Hurvitz, Teva s Chairman of the Board, serves as the Chairman of the NST board and holds certain equity interests in NST.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 PROPERTY, PLANT AND EQUIPMENT:

Property, plant and equipment, net, consisted of the following:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Land	$ 83.5	$ 75.0
Buildings	579.5	508.6
Machinery and equipment	1,106.6	1,014.1
Motor vehicles, computer equipment, furniture and other assets	379.8	353.2
Payments on account	89.0	91.8
	2,238.4	2,042.7
Less accumulated depreciation and amortization	(877.5)	(764.5)
	$ 1,360.9	$ 1,278.2

Depreciation and amortization expense was $157.6 million, $138.8 million and $93.3 million in the years ended December 31, 2005, 2004 and 2003, respectively. In the year ended December 31, 2003, impairment charges of $7.4 million were made in connection with the Group s restructuring plans.

Land includes leasehold rights in Israel which extend over original periods of 49 years ending in the years 2008-2052, with an option for an additional period of 49 years.

NOTE 4 GOODWILL, INTANGIBLE ASSETS AND DEBT ISSUANCE COSTS:

a. Goodwill:

The changes in the carrying amount of goodwill for the years ended December 31, 2005 and 2004 are as follows:

	Pharmaceuticals	API	Total
		(U.S. $ in millions)	
Balance as of January 1, 2004	$ 621.7	$ 25.8	$ 647.5
Changes during 2004:			
Goodwill acquired during the year	1,442.6	426.3	1,868.9
Translation differences	36.3	21.0	57.3
Other adjustments	(1.3)		(1.3)
Balance as of December 31, 2004	2,099.3	473.1	2,572.4
Changes during 2005:			
Reduction of goodwill mainly in respect of pre-acquisition losses and purchase price adjustments	(51.6)		(51.6)
Goodwill acquired during the year	1.7		1.7
Translation differences	(25.0)	(35.5)	(60.5)

Balance as of December 31, 2005	$ 2,024.4	$ 437.6	$ 2,462.0

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

b. Intangible assets and debt issuance costs:

1) Intangible assets and debt issuance costs, net, consisted of the following:

	Original amount		Accumulated amortization December 31,		Amortized balance	
	2005	2004	2005	2004	2005	2004
	(U.S. $ in millions)					
Intangible assets (mainly product rights)	$ 806.4	$ 808.8	$ 212.3	$ 152.7	$ 594.1	$ 656.1
Tradename	40.5	39.1			40.5	39.1
Debt issuance costs	28.7	38.5	14.7	17.0	14.0	21.5
	$ 875.6	$ 886.4	$ 227.0	$ 169.7	$ 648.6	$ 716.7

2) Amortization of intangible assets amounted to $68.1 million; $80.4 million and $44.6 million in the years ended December 31, 2005, 2004 and 2003, respectively. As of December 31, 2005, the estimated aggregate amortization of intangible assets for the years 2006 to 2010, is as follows: 2006 $73.1 million; 2007 $74.7 million; 2008 $64.8 million; 2009 $62.0 million and 2010 $57.6 million.

3) Amortization of debt issuance costs amounted to $5.7 million, $7.5 million and $7.4 million in the years ended December 31, 2005, 2004 and 2003, respectively, and is included among financial income (expenses) net.

4) Product rights received in connection with GlaxoSmithKline litigation settlement:

Pursuant to a litigation settlement agreement with GSK, on April 30, 2003 the Company received product rights relating to Purinethol®, a pharmaceutical product, for the United States, Puerto Rico and Canada, and reported a gain of $100 million reflecting the value of such rights, as determined by the Company, with the assistance of an independent appraiser.

In the first quarter of 2004, as a result of a generic competition to Purinethol® entering the market, an impairment charge of $30 million was recorded.

NOTE 5 EMPLOYEE RELATED OBLIGATIONS:

a. Employee related obligations consisted of the following:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Accrued severance pay	$ 73.4	$ 70.7
Obligation in respect of defined benefit plans	11.0	16.9
	$ 84.4	$ 87.6

As of December 31, 2005 and 2004, the Group had $69.9 million and $56.7 million, respectively, deposited in funds managed by major Israeli banks and Israeli insurance companies which are earmarked by management to cover severance pay liability in respect of Israeli employees.

Such deposits are not considered to be plan assets and are therefore included in investments and other assets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Costs of severance pay and defined contribution plans charged to income in the years ended December 31, 2005, 2004 and 2003 were $23.7 million, $27.4 million and $20.6 million, respectively. Pension costs under the defined benefit plans in those years amounted to $6.6 million, $6.3 million and $6.1 million, respectively.

The Company expects to contribute approximately $37.4 million in 2006, to the pension funds and insurance companies in respect of its severance and pension pay obligations, of which $13.7 million relates to its Israeli employees.

The main terms of the different arrangements with employees are described in b. below. Further details relating to defined benefit plans are presented in c. below.

b. Terms of arrangements:

1) In Israel

Israeli law generally requires payment of severance pay upon dismissal of an employee or upon termination of employment in certain other circumstances. The following principal plans relate to the Group s employees in Israel:

a) Pension plans for the majority of the employees: under collective labor agreements, these external pension plans provide 72% of the pension liability; these plans also provide coverage for severance pay liabilities of the relevant employees. The pension liabilities covered by these plans are not reflected in the financial statements as the pension risks have been irrevocably transferred to the pension funds.

b) Insurance policies for employees in managerial positions: the policies provide coverage for severance pay and pension liabilities of managerial personnel.

c) Severance pay liabilities not covered by the pension plans and insurance policies mentioned above are fully provided for in the financial statements on an undiscounted basis, based upon the number of years of service and the latest monthly salary of the Group s employees in Israel.

2) Non-Israeli subsidiaries

The majority of the employees in the European subsidiaries are entitled to a retirement grant when they leave the subsidiaries. In the consolidated financial statements, an accrual of the liability of the subsidiaries is made, based on the length of service and remuneration of each employee at the balance sheet date. Other employees in Europe are entitled to a pension according to a defined benefit scheme providing benefits based on final or average pensionable pay or according to a hybrid pension scheme that provides retirement benefits on a defined benefit and a defined contribution basis. Professionally qualified independent actuaries value these schemes, the rates of contribution payable being determined by the actuaries. Pension costs for the defined benefit section of the scheme are accounted for on the basis of charging the expected cost of providing pensions over the period during which the subsidiaries benefit from the employees services. The Company uses December 31 as the measurement date for the majority of its defined benefit plans. The North American subsidiaries provide various defined contribution plans for the benefit of their employees. Under these plans, contributions are based on specified percentages of pay. Additionally, a multi-employer plan is maintained in accordance with various union agreements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

c. Details relating to defined benefit plans of certain European subsidiaries:

1) The consolidated components of net periodic benefit costs are as follows:

	Year ended December 31,		
	2005	2004	2003
	(U.S. $ in millions)		
Service cost	$ 4.7	$ 4.1	$ 4.1
Interest cost	5.0	4.7	3.8
Expected return on plan assets	(4.3)	(3.4)	(2.5)
Recognized net actuarial loss	1.5	1.3	0.7
Amortization of prior service cost	(0.3)	(0.4)	
Employers pension cost	$ 6.6	$ 6.3	$ 6.1

2) The consolidated components of the projected benefit obligation and plan assets are as follows:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Benefit obligation:		
Projected benefit obligation at beginning of year	$ 109.6	$ 84.9
Changes during the year:		
Service cost	4.7	4.1
Interest cost	5.0	4.7
Plan participants contribution	1.8	1.6
Benefits paid	(2.1)	(1.5)
Actuarial loss	7.0	7.1
Prior service cost	(1.3)	1.6
Exchange rate differences	(14.7)	7.6
Curtailment	0.8	(0.5)
Other	0.5	
Projected benefit obligation at end of year	111.3	109.6

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	December 31, 2005	2004
	(U.S. $ in millions)	
Plan assets:		
Fair value of plan assets at beginning of year	70.6	52.7
Changes during the year:		
Actual return on plan assets	9.9	5.4
Employer contribution	8.1	7.2
Plan participants contribution	1.8	1.6
Benefits paid	(1.8)	(1.4)
Exchange rate differences	(10.0)	5.1
Fair value of plan assets at end of year	78.6	70.6
Reconciliation of funded status:		
Unfunded obligation, at end of year	32.7	39.0
Unrecognized net actuarial loss	(27.7)	(31.0)
Unrealized prior service cost	5.3	5.3
Net amount recognized	$ 10.3	$ 13.3
Amounts recognized in the balance sheet comprised of:		
Obligation with respect to defined benefit plans	$ 11.0	$ 16.9
Accumulated other comprehensive loss	(0.7)	(3.6)
Net amount recognized	$ 10.3	$ 13.3
Accumulated benefit obligation	$ 89.3	$ 88.6

	December 31, 2005	2004	2003
Weighted average assumptions:			
Discount rate	4.8%	4.9%	5.6%
Expected return on plan assets	5.7%	6.2%	6.2%
Rate of compensation increase	3.1%	3.0%	3.5%
Pension increase	2.3%	2.3%	2.0%

The discount rate is mainly derived from effective market interest rates at December 31, 2005 of high quality fixed income corporate bonds with duration of the pension benefits, of approximately 20 years.

3) The Company s pension plan weighted-average asset allocations at December 31, 2005, and 2004, by asset category are as follows:

	Plan Assets at December 31, 2005	2004
Equity securities	44.6%	44.7%
Debt securities	52.0%	53.5%

Other	3.4%	1.8%
Total	100.0%	100.0%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

d. The Company expects to pay the following future benefits to its employees: $5.0 million in 2006; $9.5 million in 2007; $4.6 million in 2008; $6.8 million in 2009; $6.8 million in 2010 and $37.6 million in 2011-2015. These amounts, as they relate to the Israeli subsidiaries, were determined based on the employees current salary rates and the number of service years that will be accumulated upon their retirement date. These amounts do not include amounts that might be paid to employees who will cease working with the Company before their normal retirement age.

NOTE 6 LONG-TERM LOANS AND OTHER LONG-TERM LIABILITIES:

a. Long-term loans and other long-term liabilities consisted of the following:

	Interest rate as of December 31, 2005	December 31,	
		2005	2004
	%	(U.S. $ in millions)	
Loans, mainly from banks (1)(3)	3 to 5.2	$ 477.6	$ 270.6
Debentures (2)(3)	6.9	92.2	114.8
		569.8	385.4
Less current portion (included under short-term credit)		(110.4)	(170.4)
		$ 459.4	$ 215.0

(1) The balance as of December 31, 2005 is mainly composed of a syndicated loan in the amount of $354 million of which $177 million is due in each of the years 2008 and 2010, and bearing interest determined on the basis of Euro LIBOR (mainly) and Great Britain Pound LIBOR.

(2) The balance as of December 31, 2005 and 2004 is composed of debentures with a principal amount of $90 million and $110 million, respectively, which were issued in 1998 in a private placement to institutional investors in the United States for periods of 7, 10 and 20 years at a fixed annual interest rate, the weighted average of which is 6.9%. In 2002, the Company entered into two interest rate swap transactions with respect to portions of these debentures (see note 11e), effectively changing the weighted annual interest rate on the debentures from 6.9% to 4.7%. Only one interest swap transaction qualifies for hedge accounting under FAS 133, resulting at December 31, 2005 and 2004 in an increase of $2.2 million and $4.8 million, respectively (identical to the fair value of the related derivative at the end of each year), in the carrying value of the portion of the debentures it hedges, to adjust it to the fair value of such portion based on the risk being hedged.

(3) Certain loan agreements and debentures contain restrictive covenants, mainly the requirement to maintain certain financial ratios. As of December 31, 2005, the Company met all financial covenants.

b. As of December 31, 2005, the required annual principal payments of long-term debt, starting from the year 2007, are as follows: 2007 $4.3 million; 2008 $257.2 million; 2009 $2.4 million; 2010 $176.7 million; 2011 and thereafter $18.8 million. The above does not include the Convertible Senior Debentures described in note 7.

c. The Company and certain subsidiaries entered into negative pledge agreements with certain banks and institutional investors. Under the agreements, the Company and the said subsidiaries have undertaken not to register floating charges on assets in favor of any third parties without the prior consent of the banks, to maintain certain financial ratios and to fulfill other restrictions, as stipulated by the agreements.

d. Event subsequent to December 31, 2005:

Subsequent to the Ivax acquisition, a Teva finance subsidiary issued an aggregate of $1 billion principal amount of 6.15% Senior Notes due 2036 and $500 million principal amount of 5.55% Senior Notes due 2016.

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NOTE 7 CONVERTIBLE SENIOR DEBENTURES:

As detailed below, over the last several years, indirect wholly-owned subsidiaries of the Company issued Convertible Senior Debentures unconditionally guaranteed by the Company as to payment of all principal, interest, premium and additional amounts (as defined), if any. Interest on each of the debentures is payable on a semi-annual basis. Unless previously redeemed or repurchased, under certain circumstances set forth in the relating Offering Memorandum or Prospectus Supplement (offering document), holders of the debentures may convert them into ADRs, each of which represents one ordinary share of the Company, at the conversion prices detailed below. As from a certain date applicable to each series as detailed in the table below, Teva may redeem some or all of the debentures. On certain dates, which are also detailed below, holders of the debentures may require Teva to repurchase some or all of the debentures they hold; with respect to the earliest of such dates in the case of each series, or upon the occurrence of certain events specified in the relating offering document, if repurchase of debentures is requested, Teva can elect to pay the repurchase price in cash or in Teva ADRs (as set forth in the relating offering document), or any combination thereof. Convertible Senior Debentures issued subsequent to December 31, 2005 have no contingent feature and are convertible at any time. The 0.25% Convertible Senior Debentures due 2026 include a net share settlement feature according to which principal will be paid in cash and in the case of conversion, only the residual conversion value above the principal will be paid in Teva s shares.

The main terms of these debentures are summarized in the following table:

Month Issued	Issuer	Footnote	Annual interest rate %	Principal amount (U.S. $ in millions)	Year due	Conversion price $	Number of Teva ordinary shares issuable upon full conversion	Earliest date of (i) redemption at issuer s option; and (ii) repurchase at holder s option
October 2000	Teva Pharmaceutical Finance, LLC	(1)	1.50	$ 550	2005	21.55785	Converted during 2003	
August 2001	Teva Pharmaceutical Finance, N.V.	(1)	0.75	$ 360	2021	21.456	Converted during 2004	
November 2002	Teva Pharmaceutical Finance, B.V.	(2)	0.375	$ 450	2022	21.44945	20,979,558	November 18, 2007
January 2004	Teva Pharmaceutical Finance II, LLC							
	Series A	(2)	0.50	$ 460	2024	37.90	12,137,204	August 1, 2008

	Series B	(2)	0.25	$	634	2024	35.255	17,996,028	February 1, 2010
Debentures issued subsequent to December 31, 2005:									
January 2006	Teva Pharmaceutical Finance Company B.V.		1.75	$	818	2026	51.26	15,948,108	February 1, 2011
	Teva Pharmaceutical Finance Company, LLC		0.25	$	575	2026	47.16	12,192,536	February 1, 2008

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(1) In accordance with the conditions set forth in the applicable offering document, on September 25, 2003 and on August 1, 2004, Teva Pharmaceutical Finance LLC and Teva Pharmaceutical Finance, N.V., respectively, called for the redemption of the debentures each issued. In each case, substantially all of the outstanding debentures were converted into a total of 41,598,476 ADRs of the Company.

(2) Holders of the debenture series issued in 2002 and 2004, may convert the debentures into Teva ADRs under certain conditions detailed in the relating offering document; inter alia, holders of these series of debentures may surrender debentures for conversion into Teva ADRs during any conversion period (as defined) if the trading price of Teva s ADRs were more than 120% and 130%, respectively, of the conversion price for twenty trading days within the first thirty trading days of each quarter (price threshold condition).

The price threshold condition for the series of debentures issued in 2002 was met as of the third quarter of 2003 (and through December 31, 2005, 2004 and 2003). In 2005, 2004 and 2003, an amount of $199.5 million, $5.9 million and $0.1 million, respectively, of these debentures were converted into 9,581,082 ADRs of the Company. In 2004, Teva repurchased $25 million principal amount of Convertible Senior Debentures issued in 2004.

The number of Teva ordinary shares issuable upon full conversion is subject to adjustments in certain circumstances, as detailed in the related offering document.

The balance of the principal amount and accrued interest is as follows:

Month issued		December 31, 2005	2004
		(U.S. $ in millions)	
November 2002	Principal*	$ 244.5	$ 444.0
	Accrued interest	0.1	0.2
January 2004	Principal	$ 1,069.4	$ 1,069.4
	Accrued interest	1.6	1.6
	Total	$ 1,315.6	$ 1,515.2

* Subsequent to December 31, 2005, an amount of $115.5 million of these debentures were converted into Teva ADRs.

The Convertible Senior Debentures, including accrued interest, are reflected in the balance sheets among:

	December 31, 2005	2004
	(U.S. $ in millions)	
Current liabilities	$ 1.7	$ 1.8
Long-term liabilities	1,313.9	1,513.4
	$ 1,315.6	$ 1,515.2

NOTE 8 COMMITMENTS AND CONTINGENCIES:

a. Commitments:

1) Operating leases:

As of December 31, 2005, minimum future rentals under operating leases of buildings, machinery and equipment for periods in excess of one year were as follows: 2006 $22.3 million; 2007 $17.1 million; 2008 $14.2 million; 2009 $12.3 million; 2010 $11.1 million; 2011 and thereafter $16.6 million.

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The lease fees expensed in each of the years ended December 31, 2005, 2004 and 2003 were $20.4 million, $20.2 million and $15.6 million, respectively, of which $2.7 million, $2.4 million and $3.1 million, respectively, were to a related party.

2) Royalty commitments:

a) The Company is committed to pay royalties to owners of know-how, partners in alliances and other certain arrangements and to parties that financed research and development, at rates ranging mainly from 0.5% to 10% of sales of certain products, as defined in the agreements. In some cases, the royalty period is not defined; in other cases, royalties will be paid over various periods, not exceeding 20 years, commencing on the date of the first royalty payment.

The Company has also undertaken to pay royalties to the Government of Israel, at the rates of 2.0% 3.5% of sales relating to certain products the development of which was funded by the Office of the Chief Scientist. The royalties due to the Government are linked to the amount of participation, in dollar terms (in respect of research grants commencing 1999 with the addition of dollar LIBOR interest). At the time the grants were received, successful development of the related projects was not assured. In the case of failure of a project that was partly financed as above, the Company is not obligated to pay any such royalties. The maximum amount of the contingent liability in respect of royalties to the Government as of December 31, 2005 amounts to $39.5 million.

b) Royalty expense included in cost of sales for the years ended December 31, 2005, 2004, and 2003 was $119.5 million, $169.9 million, and $93.0 million, respectively.

3) Other commitments

Teva has agreed to invest in venture capital funds in Israel and to participate in the funding of research and development conducted by other companies. As of December 31, 2005, Teva s remaining commitment is $23.4 million.

b. Contingent liabilities:

General

From time to time, Teva and its subsidiaries are subject to claims (including product liability claims) arising in the ordinary course of their business. In addition, as described below, in large part as a result of patent challenge procedures under applicable law, Teva is frequently subject to patent litigation. Teva believes it has meritorious defenses to the actions to which it is a party and expects to pursue vigorously the defense of each of the ongoing actions described below. Based upon the status of these cases, the advice of counsel, management s assessment of such cases and potential exposure involved relative to insurance coverage, except as otherwise noted below, no provision has been made in Teva s financial statement for any of the matters described below. Teva believes that none of the proceedings described below will have a material adverse effect on its financial condition; however, if one or more of such proceedings were to result in judgments against Teva, such judgments could be material to its results of operations in a given period.

From time to time Teva seeks to develop generic products for sale prior to patent expiration in various territories. In the United States, to obtain approval for most generic products prior to the expiration of the originator s patent(s), Teva must challenge the patent(s) under the procedures set forth in the Hatch-Waxman Act of 1984, as amended by the Medicare Prescription Drug Improvement and Modernization Act of 2003. To the extent that it seeks to utilize such patent challenge procedures, Teva is and expects to be involved in patent litigation regarding the validity, enforceability or infringement of the originator s patent(s). Additionally, Teva

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may be involved in patent litigation involving the extent to which alternate manufacturing process techniques may infringe originator or third party process patents. Additionally, depending upon a complex analysis of a variety of legal and commercial factors, Teva may, in certain circumstances, elect to market a generic product even though litigation is still pending. This could be before any court decision is rendered or while an appeal of a lower court decision is pending. To the extent Teva elects to proceed in this manner, it could face substantial liability for patent infringement if the final court decision is adverse to Teva. Although the underlying generic industry legislation is different in Europe, Canada and Israel, from time to time Teva is also involved in similar patent litigation regarding corresponding patents in these jurisdictions. Except as described below, Teva does not have a reasonable basis to estimate the loss, or range of loss, that is reasonably possible with respect to such patent infringement cases. However, if Teva were to be required to pay damages in any such case, courts would generally calculate the amount of any such damages based on a reasonable royalty or lost profits of the patentee. If damages were determined based on lost profits, the amount would be related to the sales of the branded product. In addition, the launch of an authorized generic and other generic competition may be relevant to the damages estimation.

Teva s business inherently exposes it to potential product liability claims. Teva believes that it maintains product liability insurance coverage in amounts and with provisions that are reasonable and prudent in light of its business and related risks. However, Teva sells, and will continue to sell, pharmaceutical products that are not covered by insurance and accordingly may be subject to claims that are not covered by insurance as well as claims that exceed its policy limits. In addition, product liability coverage for pharmaceutical companies is becoming more expensive and increasingly difficult to obtain. As a result, Teva may not be able to obtain the type and amount of coverage it desires.

In connection with third party agreements, Teva may under certain circumstances be required to indemnify, in unspecified amounts, the parties to such agreements against third party claims relating to: (i) intellectual property infringement or (ii) product liability. Except as set forth in this Note 8, as of December 31, 2005, Teva is not aware of any material pending claim for indemnification.

Product Liability Matters

Teva is a manufacturer of Adipex-P brand phentermine hydrochloride, and has been sued in both class actions and individual lawsuits relating to the alleged negative health effect of phentermine and fenfluramine. While neither drug had been indicated or approved for combination use by the FDA, physicians sometimes prescribed the two together in a combination treatment for weight control known as fen-phen. Plaintiffs have filed lawsuits from August 1997 to the present in a variety of state and federal jurisdictions seeking monetary damages in unspecified amounts. The federal actions have been consolidated for pretrial purposes in the United States District Court for the Eastern District of Pennsylvania in a multidistrict litigation proceeding.

On April 5, 2001, a claim was filed against Teva in the Tel Aviv District Court with respect to the use of a pharmaceutical product known as Chorigon Ampoules 5000 Units. The plaintiffs claim that they were administered with allegedly defective ampoules of the product during the course of an in vitro fertilization treatment, resulting in the failure of the treatment and causing financial damages and mental anguish. The plaintiffs have filed a petition to certify the claim as a class action, which has not yet been decided.

Intellectual Property Proceedings

On September 14, 2001, Purdue Pharma L.P. (Purdue) filed an action in the United States District Court for the Southern District of New York, alleging that the filing of Teva s ANDA for 80 mg oxycodone hydrochloride extended-release tablets, AB-rated to OxyContin®, infringed three patents owned by Purdue.

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Subsequently on April 3, 2003, Purdue sued Teva on its 10, 20 and 40 mg oxycodone products. On January 5, 2004, those three patents were held unenforceable due to inequitable conduct in a related case, Purdue Pharma L.P. v. Endo Pharmaceuticals Inc., pending before the same judge as in Teva s case. On March 31, 2004, Teva commenced sales of its 80 mg oxycodone product and on December 6, 2005, Teva commenced sales of its 10, 20, and 40 mg oxycodone products. On February 1, 2006, the United States Court of Appeals for the Federal Circuit vacated the inequitable conduct finding and remanded the case to the District Court for further proceedings, including reconsideration of the inequitable conduct finding based on certain parameters. The 2003 annual sales of the 80 mg branded product in the U.S. were estimated to be approximately $707 million and the annual sales of the 10, 20, and 40 mg branded products prior to Endo s launch in May 2005 was estimated to be approximately $1.3 billion. Were Purdue to be successful on its allegations of patent infringement, Teva could ultimately be required to pay damages related to the sales of its oxycodone hydrochloride extended-release tablets and be enjoined from selling this product.

On September 12, 2002, Teva obtained summary judgment from the U.S. District Court for the Northern District of Illinois regarding a U.S. patent on a combination of hydrocodone bitartrate and ibuprofen. The District Court ruled that the U.S. patent was invalid as obvious. Subsequently, on May 19, 2004, the Court of Appeals for the Federal Circuit reversed, mainly on procedural grounds, the District Court s ruling, remanding the case for further proceedings on the issues of infringementvalidity and unenforceability. The patent was asserted by Knoll Pharmaceutical Company, now a subsidiary of Abbott Laboratories, which markets the combination as Vicoprofen®. Teva had launched its product, hydrocodone bitartrate andibuprofen tablets, 7.5mg/200mg, in April 2003. Annual sales in 2002 of the branded product in the U.S. were estimated to be approximately $108 million. On September 9, 2005, the case was dismissed with prejudice pursuant to a settlement among the parties.

In September 2002, Sicor launched an idarubicin hydrochloride injection product. On July 8, 2004, Pharmacia filed a complaint in the U.S. District Court for the District of Delaware against Sicor, alleging that its idarubicin hydrochloride injection product infringes a Pharmacia formulation patent. Trial is scheduled for November 20, 2006. Annual sales of the branded product in the U.S. prior to Sicor s launch were estimated to be $40 million. Were Pharmacia ultimately to be successful on its allegation of patent infringement, Sicor could be required to pay damages and be enjoined from selling that product until the patent expires in August 2007.

In May 2003, Teva commenced sales of its 7.5 mg and 15 mg moexipril hydrochloride tablets, which are AB-rated to Schwarz Pharma s Univasc® tablets. Teva had previously obtained summary judgment of non-infringement as to the one patent, but that decision was later vacated on appeal. Following the filing of Schwarz Pharma s motion for a preliminary injunction, on September 12, 2004, Teva entered into an agreement with Schwarz whereby Teva agreed to suspend all manufacturing and selling of its moexipril hydrochloride tablets pending the outcome of litigation between the two companies in the District Court or a court order. On August 11, 2005, following a reversal and remand by the United States Court of Appeals for the Federal Circuit in the related patent dispute regarding Teva s quinapril hydrochloride products, the United States District Court for the District of New Jersey vacated certain of its prior summary judgment rulings against Teva. No trial date has been scheduled. Were Schwarz Pharma ultimately to be successful on its allegation of patent infringement, Teva could be required to pay damages. The patent at issue expires in February 2007 and may be eligible for an additional 6-month pediatric exclusivity. An appropriate provision for this matter has been included in the accounts.

In October 2004, Alpharma and Teva launched their 100 mg and 400 mg gabapentin capsule products and, in December 2004, Alpharma and Teva lauched their 600 mg and 800 mg gabapentin tablet products. Gabapentin capsules and tablets are the AB-rated generic versions of Pfizer s anticonvulsant Neurontin® capsules and tablets, which had annual sales of approximately $2.7 billion for the twelve months ended September 2004. On August 23, 2005, the United States District Court for the District of New Jersey granted summary judgment in

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favor of Teva and Alpharma. Pfizer s time to appeal has not expired. Were Pfizer ultimately to be successful on its allegation of patent infringement, Teva could be required to pay damages and be enjoined from selling that product. Pursuant to the terms of the agreement with Alpharma, were Pfizer to be successful on its allegation of patent infringement against Alpharma, Teva may also be required to pay damages related to a portion of the sales of Alpharma s gabapentin products.

In September and November 2004, Teva commenced sales of Impax Laboratories 20 and 10 mg omeprazole delayed release capsules, respectively, which are AB-rated to AstraZeneca s Prilosec® capsules. Prilosec® had sales for the 10 mg capsule of $30 million and 20 mg capsule sales of approximately $532 million, both for the twelve months ended June 2004. As provided for in a strategic alliance agreement between Impax and Teva, the parties agreed to certain risk-sharing arrangements relating to the omeprazole launch. AstraZeneca previously commenced a patent infringement litigation against Impax relating to its omeprazole capsules and also sued Teva following its launch of the omeprazole capsules. Were AstraZeneca ultimately to be successful on its allegation of patent infringement, Teva and Impax could be required to pay damages related to a portion of the sales of Impax s omeprazole capsules and be enjoined from selling that product.

In June 2005, Teva commenced sales of its 250 mg and 500 mg clarithromycin tablets, which are AB-rated to Abbott Laboratories Biaxin® tablets. Biaxin® had sales of about $200 million for the twelve months ended March 2005. Teva is currently involved in litigation in the United States District Court for the Northern District of Illinois, in which Abbott has asserted that Teva s clarithromycin product infringes Abbott s patents. Were Abbott ultimately to be successful on its allegation of patent infringement, Teva could be required to pay damages and be enjoined from selling the product.

In September 2005, pursuant to an agreement with Barr Pharmaceuticals, Inc., Teva launched its fexofenadine hydrochloride 30 mg, 60 mg and 180 mg tablet products, which are AB-rated to Aventis Pharmaceuticals Allegra® tablets. Allegra® tablets had annual sales of approximately $1.4 billion, based on the IMS data for the twelve months ended June 2005. Aventis has brought patent infringement actions against Teva and its API supplier in the United States District Court for the District of New Jersey. There are three formulation patents, three use patents, and two API patents at issue in the litigation and Teva has obtained summary judgment as to each of the formulation patents. On January 27, 2006, the Court denied Aventis motion for a preliminary injunction against Teva and its API supplier on the three use patents, finding those patents likely to be invalid, and one of the API patents, finding that patent likely to be not infringed. A trial has not been scheduled. Aventis has also brought patent infringement litigation against Teva in Tel Aviv. Were Aventis ultimately to be successful on its allegation of patent infringement, Teva and Barr could be required to pay damages related to a portion of the sales of Teva s fexofenadine tablets and be enjoined from selling those products.

In November 2005, Teva launched its azithromycin monohydrate 250 mg, 500 mg and 600 mg tablet products that are the AB-rated version of Pfizer Inc. s Zithromax® tablets. Zithromax tablets had annual sales of approximately $1.6 billion, based on IMS data for the month ended September 2005. Teva and Pfizer have been involved in patent litigation in the United States District Court for the Southern District of New York regarding Pfizer s azithromycin dihydrate patent. On February 9, 2006, Pfizer granted Teva a covenant not to sue with respect to the azithromycin dihydrate patent. Pfizer had previously granted Teva a covenant not to sue with respect to a food effect patent that was also the subject of litigation in the same Court. On February 8, 2006, Pfizer filed a complaint against Teva in the US District Court for the District of Delaware, alleging infringement of Pfizer s azithromycin sesquihydrate polymorph patent. Also, on February 8, 2006, Pfizer filed a Citizens Petition with the FDA, requesting that the FDA revoke Teva s approval for this product on the basis that Teva s labeling failed to disclose the alleged presence of the sesquihydrate. Were Pfizer ultimately to be successful on its allegations, Teva could be required to pay damages and be enjoined from selling its azithromycin products.

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Commercial Matters

On April 21, 2004, Rhodes Technologies and Napp Technologies (Rhodes/Napp) filed a complaint in Massachusetts Superior Court, seeking an equal share of the value to Teva of the settlement of certain claims between GlaxoSmithKline and Teva relating to Teva s nabumetone products. The allegations are based upon the termination of a nabumetone API supply agreement between Teva and Rhodes/Napp. Teva originally assessed the value of the product rights received in connection with the settlement at $100 million and subsequently revised the value to $70 million based on certain impairment factors not related to this action.

Environmental Matters

In May 2004, the Israeli Ministry of the Environment imposed additional conditions on business licenses of certain manufacturing plants operated in Ramat Hovav, Israel, including Teva s API plant. These additional conditions, some of which were effective immediately and some of which will take effect commencing June 2006, deal primarily with the treatment and quality of waste discharged. Teva and other companies that operate chemical and pharmaceutical plants in Ramat Hovav have appealed to the relevant court against the imposition of such additional conditions. On March 3, 2005, the parties agreed to transfer the matter to mediation which is still ongoing as of March 2006. In the event that the mediation process does not succeed and such additional conditions are not revoked by the court, Teva may have to incur additional costs or capital expenditures in order to comply with the additional conditions and/or find alternative production sites or third-party sources for certain API chemicals produced at the plant.

Competition, Pricing and Regulatory Matters

Teva USA is a defendant, along with Biovail Corp. and Elan Corporation, plc, in several civil actions currently pending in the federal district court in the District of Columbia. The cases allege generally that arrangements between Biovail and Elan relating to sales of nifedipine cc extended release tablets, in connection with which Teva U.S.A acted as a distributor for Biovail, were unlawful under the federal antitrust laws. The challenged arrangements were previously the subject of a consent decree entered into by the U.S. Federal Trade Commission with Biovail and Elan, to which Teva U.S.A was not a party. The cases seek unspecified monetary damages, attorneys fees and costs. Four of the cases were brought on behalf of alleged classes of persons who allegedly purchased nifedipine cc extended release tablets made by Elan or Biovail in the United States directly from Teva USA; two of the cases were brought individually by alleged direct purchasers. Teva and Teva U.S.A are also defendants, along with Biovail and Elan in a case pending in state court in San Joaquin County, California that was brought on behalf of an alleged class of persons that indirectly purchased nifedipine cc extended release tablets made by Elan or Biovail and sold in the United States by Teva USA.

On February 25, 2003, two motions requesting permission to institute a class action were filed on behalf of all Quebec citizens in the Superior Court for the Province of Quebec against all major Canadian generic drug manufacturers, including Novopharm. The claimants seek damages based on alleged marketing practices of generic drug manufacturers in the Province of Quebec. On January 17, 2006, the Court denied the motions to authorize the class and dismissed the matters. The claimants have filed an appeal.

Sicor is a defendant in several putative private class action complaints on behalf of Medicare and Medicaid patients nationwide who received oncology drugs as well as several actions filed by state attorneys general and one by the federal government alleging that the respective patients and the state and federal health care programs paid fraudulently inflated Average Wholesale Prices for their medicines. The litigation has been largely consolidated in federal court in Boston. Sicor is one of many defendants in each of these cases including many of the largest generic and brand name drug manufacturers alleging the same claims of fraud. In early 2004, the court

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dismissed all but one count in the complaint and discovery ensued for all parties. Sicor continues to pursue its defenses vigorously. Teva U.S.A has also been named in some related matters, which are still at a preliminary stage. An appropriate provision for certain of these matters has been included in the accounts.

NOTE 9 SHAREHOLDERS EQUITY:

a. Share capital:

As of December 31, 2005, there were 646.7 million ordinary shares issued and outstanding (December 31, 2004 626.8 million). These shares are traded on the Tel-Aviv Stock Exchange (TASE) and, in the form of ADRs, each of which represents one ordinary share, on the Nasdaq National Market in the United States. In addition, as at December 31, 2005 and 2004, there were 11.6 million and 12.4 million, respectively, of outstanding special shares, issued by a subsidiary, that are exchangeable any time at the discretion of their holder into ordinary shares of the Company at a 1:1 ratio.

During the years ended December 31, 2005 and 2004 Teva spent $379 million and $188 million respectively to repurchase 12.7 million and 6.9 million respectively of its shares pursuant to a repurchase plan authorized by Teva s board of directors in September 2004.

Ordinary shares net of Company shares held by subsidiaries at December 31, 2005 and 2004 amounted to 618.6 million and 611.4 million respectively.

In addition to ordinary shares held by subsidiaries of the Company, as disclosed on the face of the balance sheet, the Company issued to a certain subsidiary a total of 5.6 million ordinary and ordinary A shares, which do not confer on their holder voting rights or rights to appoint directors (other rights are identical to those of the ordinary shares) and are not listed for trading.

Subsequent to December 2005 122.9 million shares were issued in connection with the acquisition of Ivax (see note 2a subsequent events)

In January 2004, 46.7 million shares were issued in connection with the acquisition of Sicor (see note 2a).

b. Registered offerings:

In December 2003, the Company and its finance subsidiaries filed a shelf registration statement with the U.S. Securities and Exchange Commission. Under this shelf registration statement, the Company or one or more of its indirect wholly owned subsidiaries may, from time to time, sell ADRs, debt securities and/or any other securities described in the registration statement in one or more offerings up to a total dollar amount of $2,000 million. On January 22, 2004, a Teva finance subsidiary issued Convertible Senior Debentures in an aggregate amount of $1,094 million under this shelf registration statement (see note 7).

In December 2005, the Company and its finance subsidiaries filed a shelf registration statement with the U.S. Securities and Exchange Commission. Under this shelf registration statement, the Company or one or more of its indirect wholly owned subsidiaries may, from time to time, sell ADRs, debt securities and/or any other securities described in the registration statement in one or more offerings. Subsequent to December 31, 2005, two Teva finance subsidiaries issued Convertible Senior Debentures in an aggregate amount of $1,393 million under this shelf registration statement (see note 7).

c. Employee stock option plans:

In 1999, the Company s Board of Directors approved an option plan for employees of the Group, under which senior employees in Israel, Europe and the United States could be granted options to purchase up to

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8 million ordinary shares of the Company. Any option not exercised by the end of the exercise period will expire, unless the exercise period is extended by the Board of Directors. Through December 31, 2005, options to purchase 5.5 million ordinary shares were granted under this plan.

In August 2000, the Company s Board of Directors approved an option plan under which, over five years, employees of the Group could be granted options to purchase up to 26.2 million ordinary shares of the Company. In addition to this authorization, in March 2003, the Company s Board of Directors granted options to senior employees of Teva to purchase up to 9.0 million ordinary shares of the Company. During 2004, and further to the approval of August 2000, the Company s Board of Directors approved the granting of options to purchase 4.8 million ordinary shares of the Company, of which the Chief Executive Officer and President of the Company was granted options to purchase 0.5 million ordinary shares at the exercise price of $25.03. Through December 31, 2005, options to purchase 25.3 million ordinary shares were granted at an exercise price equal to the closing price on NASDAQ or TASE, or the average price between the high and low prices on NASDAQ, as applicable, on the day of approval of each grant.

All options authorized but not granted by the Board of Directors under the Plans described in the immediately preceding paragraphs have expired and are of no further effect except for approximately 0.1 million options which remain available for future grants.

In connection with Teva s 100 year anniversary celebration, in July 2001, the Company s Board of Directors approved an option plan, under which options to purchase 2.5 million ordinary shares of the Company were granted to substantially all employees who were in the employ of the Group prior to September 1, 2000. Each such employee was granted options to purchase 400 ordinary shares at an exercise price of $13.89 (85% of the market value of the Company s ADR on date of grant). Certain other employees were granted options under the same plan to purchase 0.3 million ordinary shares of the Company, at an exercise price of $14.80. The Company accounts for this stock option plan as a non-compensatory plan in accordance with the provisions of APB 25.

On September 4, 2001, the Board of Directors resolved to grant to the former Chief Executive Officer and President of the Company options to purchase 0.3 million ordinary shares at the exercise price of $17.55. On February 14, 2002, the Board of Directors resolved to grant the following options: (i) to the former Chief Executive Officer and President of the Company, options to purchase 2.8 million ordinary shares, at an exercise price of $13.91, which was determined based on the price of the Company s share on the date the grant was approved by the shareholders meeting; (ii) to the Chief Executive Officer and President of the Company options to purchase 1.2 million ordinary shares at the exercise price of $15.11; and (iii) to each of the former chairman of the Board of Directors and the chairman of its Executive Committee at that time, options to purchase 0.1 million ordinary shares, at an exercise price of $13.91.

On July 27, 2005 the Shareholders approved the Teva s 2005 Omnibus Long-Term Share Incentive Plan, under which 50 million equivalent option units which include both options exercisable into Ordinary Shares (or ADSs representing Ordinary Shares) and restrictive stock units (RSUs) were approved for granting. As of December 2005, the Compensation Committee of the Board had approved equivalent options of up to 4,610,628 for allotment to officers and employees of the Company at an average exercise price of $42.64 per option with an expiration date in 2012. RSUs are allocated for no consideration.

Options and RSUs were allocated in a ratio of 1 RSU being equivalent to 3 options. Out of the total 4,368,553 equivalent options granted, 274,351 RSU s were granted (equivalent to 823,053 options) with the balance of 3,545,500 being options.

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The 274,351 RSUs granted with a weighted average fair value of $42.56 at the date of grant have a similar vesting period and remaining contractual life as the options granted in the Omnibus plan.

The grant of options to Israeli employees under the plans described above is to be subject to the terms stipulated by the Israeli Income Tax Ordinance (the Ordinance). Inter alia, the Ordinance provides that the Company will be allowed to claim as an expense for tax purposes the amounts credited to the employees as a benefit, when the related tax is payable by the employee.

The vesting period of the options granted is generally 2 to 4 years from the date of grant and the rights of the ordinary shares obtained upon exercise of the options will be identical to those of the other ordinary shares of the Company. The exercise period of the options granted is mainly 5 to 7 years from the date of grant.

A summary of the status of the option plans as of December 31, 2005, 2004 and 2003, and changes during the years ended on those dates, is presented below (the number of options represents ordinary shares exercisable in respect thereof):

	Year ended December 31,					
	2005		2004		2003	
	Number	Weighted average exercise price $	Number	Weighted average exercise price $	Number	Weighted average exercise price $
Balance outstanding at beginning of year	37,339,657	17.16	36,358,880	14.34	33,792,788	12.38
Changes during the year:						
Granted**	3,657,008	42.30	8,980,699	22.50	6,980,576	21.56
Exercised	(9,997,077)	13.63	(7,704,848)	10.08	(3,954,740)	8.91
Forfeited	(257,812)	20.24	(295,074)	16.81	(459,744)	14.96
Balance outstanding at end of year	30,741,776	21.27	37,339,657	17.16	36,358,880	14.34
Balance exercisable at end of year	16,503,513	14.71	16,644,140	12.70	11,731,036	10.25

In 2004, options granted include approximately 4.3 million vested stock options issued in connection with the acquisition of Sicor, see note 2a.

** Virtually all granted at market value

The weighted average fair value of options granted during the year, estimated by using the Black & Scholes option-pricing model, was $14.3, $11.0 and $9.7 for the years ended December 31, 2005, 2004 and 2003, respectively. The fair value of the options was estimated on the date of grant, based on the following weighted average assumptions: dividend yield of: 2005 0.6%, 2004 0.7% and 2003 0.7%; expected volatility of: 2005 32%, 2004 37% and 2003 40%; risk-free interest rates (in dollar terms) of: 2005 4.3%, 2004 3.6% and 2003 3.3%; and expected lives of: 2005 5 years, 2004 5 years and 2003 7 years.

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The following table summarizes information about options outstanding at December 31, 2005:

Number of ordinary shares issuable upon exercise of options outstanding					Number of ordinary shares issuable upon exercise of options vested	
Range of exercise prices		Balance at December 31, 2005	Weighted average remaining contractual life Years	Weighted average exercise price $	Balance at December 31, 2005	Weighted average exercise price $
$ 4.60	$ 6.90	1,493,456	0.99	5.63	1,493,456	5.63
$ 9.85	$14.38	7,898,255	3.58	13.92	7,497,055	13.92
$14.50	$15.25	4,390,800	3.35	15.09	2,975,800	15.08
$15.50	$18.25	2,456,236	1.52	16.35	2,438,736	16.34
$20.00	$21.00	4,193,716	4.23	20.20	1,397,905	20.20
$24.00	$28.35	3,026,681	4.83	24.84	700,561	24.37
$28.50	$33.50	3,737,124	5.59	31.67		
$35.55	$43.00	3,545,508	6.93	42.64		
		30,741,776	4.10	21.27	16,503,513	14.71

d. Retained earnings:

1) Retained earnings available for distribution as cash dividends at December 31, 2005, includes amounts, the distribution of which would attract tax of approximately $241 million (see note 10a).

2) Dividends are declared and paid in Israeli currency (NIS). Dividends paid per ADR in the years ended December 31, 2005, 2004 and 2003 were $0.27, $0.20 and $0.15, respectively. Subsequent to December 31, 2005, the Company declared an additional dividend of 0.34 NIS per ADR ($0.07 per ADR as of date of declaration) in respect of the fourth quarter of 2005.

NOTE 10 INCOME TAXES:

a. The Company and its Israeli subsidiaries:

Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (the law)

Various industrial projects of the Company and several of its Israeli subsidiaries have been granted approved enterprise status under the law. Income derived from these enterprises during a period of 10 years from the year in which these enterprises first realize taxable income, provided the maximum benefit period as determined by the law has not elapsed, is entitled to a tax exemption for undistributed profits for an initial period of 2 to 10 years, having regard to the benefit route the company had chosen and the area in which the enterprises are located, and a reduced corporate tax rate for the remainder of the period. Since the Company is over 49% non-Israeli-owned, the applicable tax rate would not exceed 20%.

In April 2005, a major amendment to the Investment Law came into effect, which is intended to provide expanded tax benefits to local and foreign investors and to simplify the bureaucratic process relating to the approval of investments qualified under the Investment Law.

Under the aforesaid amendment, certain minimum qualifying investment requirements, time restrictions in which the investment is made, and other conditions had been set for new approved enterprises or expansions. Moreover, with a view to simplifying the process relating to the approval of investments, the amendment provides that in the event that an investment project meets all of the eligibility criteria under one of the

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Alternative Tracks (Standard Alternative Track, Ireland Track or Strategic Investment Track), as discussed below, a project will automatically qualify for the approved enterprise taxation benefits under the Investment Law with no need for prior approval from the Investment Center.

The amendment generally does not retroactively apply to investment programs having an approved enterprise approval certificate from the Investment Center issued prior to December 31, 2004 (even when investments under these programs are conducted after January 1, 2005). Consequently, the amendment should not impact an existing approved enterprise that received an approval certificate. The new amendment will only apply for a new approved enterprise and for a new approved enterprise expansion for which the first year of benefits may be as early as 2004.

Under the Amendment, the alternative tax benefits discussed above, which were already in effect prior to the Amendment, continue to be available, together with two new tracks: The Ireland Track and The Strategic Investment Track .

With respect to certain expansions of several Israeli subsidiaries, investment grants were received from the State of Israel under the terms of the law (the government grant route). As security for implementation of the approved projects and compliance with the conditions of the certificates of approval, floating charges have been registered on the above companies assets in favor of the State of Israel.

For certain other expansion projects, the Company and certain Israeli subsidiaries elected to apply for alternative tax benefits waiver of grants in return for tax exemption (the alternative tax benefits route).

The periods of tax benefits in respect of approved enterprises entitled to the said benefits commenced in 1997 2005. Final approvals in respect of certain expansion programs have not yet been received. In the event of the distribution of dividends from the said tax-exempt income (either under the government grants route or under the alternative tax benefits route), the amount distributed will be subject to the tax rate it was exempted from (see also note 1i).

The law also allows accelerated depreciation for tax purposes on buildings, machinery and equipment used by the approved enterprise during five tax years commencing in the first year of operation of each asset.

The entitlement to the above benefits is conditional upon the companies fulfilling the conditions stipulated by the law, regulations published thereunder and the certificates of approval for the specific investments in approved enterprises. In the event of failure to comply with these conditions, the benefits may be cancelled and the companies may be required to refund any amount of the benefit received, in whole or in part, with the addition of interest and linked to the Israeli consumer price index (the Israeli CPI).

Measurement of results for tax purposes

Results for tax purposes are measured on a real basis adjusted for the increase in the Israeli CPI. As explained in note 1a, the financial statements are presented in dollars. The difference between the change in the Israeli CPI and the NIS-dollar exchange rate both on annual and cumulative basis causes a difference between taxable income and income reflected in these financial statements.

Paragraph 9 (f) of FAS 109, Accounting for Income Taxes , prohibits the recognition of deferred tax liabilities or assets that arise from differences between the financial reporting and tax basis of assets and liabilities that are remeasured from the local currency into dollars using historical exchange rates, and that result from changes in exchange rates or indexing for tax purposes. Consequently, the above-mentioned differences were not reflected in the computation of deferred tax assets and liabilities.

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Tax benefits under the Israeli Law for the Encouragement of Industry (Taxes), 1969

The Company and certain of its Israeli subsidiaries currently qualify as industrial companies under the above law. In accordance with this law such companies are entitled to certain benefits including accelerated depreciation on industrial buildings and equipment, a deduction of 12.5% per year of the purchase price of a good-faith acquisition of patent and certain other intangible property rights and the right to file consolidated tax returns. In addition, new regulations generally allow industrial equipment purchased during the period of July 1, 2005 until September 30, 2006 to be depreciated over a period of two tax years.

Currently, the Company files consolidated tax returns together with certain of its Israeli subsidiaries.

Tax rates in Israel applicable to income from other sources

Income not eligible for approved enterprise benefits, mentioned above, is taxed at a regular rate. The regular corporate tax rate in Israel in 2005 is 34%. In August 2005, an amendment to the Income Tax Ordinance was enacted whereby the corporate tax rate is to be gradually reduced as follows: in 2006 31%, in 2007 29%, in 2008 27%, in 2009 26% and in 2010 and onward 25%. Deferred income taxes balances have been adjusted accordingly; the effect of such adjustment was not material.

b. Non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their country of residence.

c. Deferred income taxes:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Short-term deferred tax assets (liabilities) net:		
Inventory related	$ 7.8	$ (2.4)
Sales allowance reserve	14.7	9.3
Provisions for employee related obligations	11.3	12.2
Unrealized profit from intercompany sales	53.9	58.8
Carryforward losses and deductions	6.3	2.4
Other	13.2	11.2
	107.2	91.5
Valuation allowance in respect of carryforward losses and deductions that may not be utilized	(17.7)	(9.3)
	89.5	82.2
Long-term deferred tax assets (liabilities) net:		
Property, plant and equipment and intangible assets	(210.8)	(224.4)
Provisions for employee related obligations	5.6	7.8
Carryforward losses and deductions*	86.5	154.2
Other	10.9	5.1
	(107.8)	(57.3)
Valuation allowance in respect of carryforward losses and deductions that may not be utilized	(34.6)	(92.6)

	(142.4)	(149.9)
	$ (52.9)	$ (67.7)

* This amount represents the tax effect of carryforward losses and deductions and expires as follows: 2007 - 2008 $4.8 million; 2009 - 2020 $24.4 million. The remaining balance $57.3 million can be utilized with no expiration date.

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The deferred income taxes are reflected in the balance sheets among:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Current assets	$ 95.4	$ 91.1
Current liabilities	(5.9)	(8.9)
Investments and other assets	76.9	62.4
Long-term liabilities	(219.3)	(212.3)
	$ (52.9)	$ (67.7)

d. Income before income taxes is composed of the following:

	Year ended December 31,		
	2005	2004	2003
	(U.S. $ in millions)		
The Company and its Israeli subsidiaries	$ 748.6	$ 463.8	$ 432.8
Non-Israeli subsidiaries	560.0	139.9	439.6
	$ 1,308.6	$ 603.7	$ 872.4

e. The provision for income taxes included the following components:

	Year ended December 31,		
	2005	2004	2003
	(U.S. $ in millions)		
Current:			
In Israel	$ 126.1	$ 104.2	$ 88.2
Outside Israel	117.3	135.9	121.9
	243.4	240.1	210.1
Deferred:			
In Israel	10.2	(10.0)	(11.3)
Outside Israel	(17.4)	37.1	(17.3)
	(7.2)	27.1	(28.6)
	$ 236.2	$ 267.2	$ 181.5

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A reconciliation of the theoretical tax expense, assuming all income is taxed at the regular rate applicable to income of companies in Israel 34%, 35% and 36% for the years ended December 31, 2005, 2004 and 2003, respectively -and the actual tax expense, is as follows:

	Year ended December 31,		
	2005	2004	2003
	(U.S. $ in millions)		
Income before taxes on income, per consolidated statements of income	$ 1,308.6	$ 603.7	$ 872.4
Theoretical tax expense	$ 444.9	$ 211.3	$ 314.1
Decrease in tax arising from different statutory tax rates applicable to non-Israeli subsidiaries	(98.4)	(76.2)	(50.9)
	346.5	135.1	263.2
Tax benefits arising from reduced tax rates under benefit programs	(133.3)	(107.8)	(109.1)
	213.2	27.3	154.1
Increase (decrease) in taxes resulting from permanent differences:			
Tax exempt income	(3.2)	(3.6)	(1.0)
Disallowable deductions	3.6	209.1*	9.7
Difference between income reported for tax purposes and income for financial reporting purposes net	0.5	(5.2)	(5.0)
Other net	22.1	39.6	23.7
Income taxes in the consolidated statements of income	$ 236.2	$ 267.2	$ 181.5

* Includes amounts attributable to acquisition of research and development in process and impairment of product rights

f. Tax assessments:

The Company has received final tax assessments through tax year 2001. The subsidiaries have received final tax assessments through tax years 1991-2004.

NOTE 11 ADDITIONAL FINANCIAL STATEMENT INFORMATION:

a. Inventories:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Raw and packaging materials	$ 290.8	$ 326.3
Products in process	149.3	169.1
Finished products	517.5	619.6
Purchased products	118.6	133.4
	1,076.2	1,248.4
Materials in transit and payments on account	38.0	37.9

	$ 1,114.2	$ 1,286.3

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

b. Marketable securities:

1) Available-for-sale securities:

At December 31, 2005 and 2004 the fair market value, cost and gross unrealized holding gains and losses of such securities were as follows:

	Fair market value	Cost	Gross unrealized holding gains	Gross unrealized holding losses
			(U.S. $ in millions)	
December 31, 2005				
Debt securities**	$ 1,040.1	$ 1,042.9	$ 0.7	$ 3.5
Equity securities	52.6	44.7	13.8	5.9
	$ 1,092.7	$ 1,087.6	$ 14.5	$ 9.4
December 31, 2004				
Debt securities**	$ 408.1	$ 412.0	$ 1.4	$ 5.3
Equity securities	95.9	75.9*	21.4	1.4
	$ 504.0	$ 487.9	$ 22.8	$ 6.7

* Including an amount of $2.8 million at December 31, 2004, invested in an entity which is controlled by a related party. This investment was realized during 2005, with a realized gain of $1.4 million recognized in the statement of income.

** Debt securities are reflected at amortized cost.

2) Held-to-maturity securities*:

At December 31, 2005 and 2004 the amortized cost basis, aggregate fair value and unrealized holding gains and losses by major types of debt security were as follows:

	Amortized cost	Aggregate fair value	Unrealized gains	Unrealized losses
		(U.S. $ in millions)		
December 31, 2005:				
Corporate	$ 0.2	$ 0.2	$	$
December 31, 2004:				
Government	$ 242.6	$ 243.8	$ 1.3	$ 0.1
Corporate	324.0	324.9	1.0	0.1
	$ 566.6	$ 568.7	$ 2.3	$ 0.2

In connection with the acquisition of Ivax in 2006, Teva reclassified the major portion of held to maturity securities to available for sale securities at December 31, 2005.

In connection with the acquisition of Sicor, in 2003 and 2004 Teva sold $490.7 million of its held to maturity securities.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3) The marketable securities are presented in the balance sheets as follows:

	December 31, 2005	2004
	(U.S. $ in millions)	
Among current assets:		
Cash and cash equivalents:		
Available-for-sale securities	$ 29.0	$ 86.9
Held-to-maturity securities		92.7
Short-term investments:		
Available-for-sale securities	935.3	89.1
Held-to-maturity securities	0.2	161.8
	964.5	430.5
Among investments and other assets:		
Available-for-sale securities	128.4	328.0
Held-to-maturity securities		312.1
	128.4	640.1
	$ 1,092.9	$ 1,070.6

Debt securities, presented amongst investments and other assets, mature as follows:

	Available for sale (U.S. $ in millions)
2007	$ 6.3
2008	5.1
2009	4.1
2010	17.2
2011 and thereafter	43.1
	$ 75.8

c. Short-term credit:

Short-term credit was obtained mainly from banks at a weighted average interest rate of 3.4% and 2.9% at December 31, 2005 and 2004 respectively.

As of December 31, 2005, the Group had about $465.4 million available under unused lines of credit.

d. Accounts payable and accruals:

	December 31,	
	2005	2004
	(U.S. $ in millions)	
Trade accounts payable	$ 359.7	$ 358.7
Sales reserves and allowances	732.9	590.9
Income taxes payable	199.8	190.6
Employees and employee related obligations	129.6	120.9
Other	462.6	382.4
	$ 1,884.6	$ 1,643.5

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e. Financial instruments and risk management:

1) Foreign exchange risk management

The Group enters into forward exchange contracts in non-functional currencies and purchases and writes non-functional currency options in order to hedge cash flows (mainly in dollars) resulting from existing assets and liabilities as well as anticipated transactions for the next twelve months which are probable, in currencies other than the functional currency. In addition, the Group takes steps to reduce exposure by using natural hedging. The Company also acts to offset risks in opposite directions among the companies in the Group. The currency hedged items are usually denominated in the following currencies: European (mainly the Euro and Hungarian Forint), Israeli (NIS) and Canadian Dollars (CAD $). The writing of options is part of a comprehensive currency hedging strategy.

These transactions are for periods of less than one year. As the counterparties to the derivatives are major banks, the Company considers the inherent credit risks to be remote.

2) Interest rate swaps

In November 2005, the Company entered into an interest rate swap transaction in connection with funds required for financing the Ivax acquisition. The purpose of the transaction was to fix the interest rate for the 10 and 30 year financing of $500 million and $250 million respectively. Upon completion of the Ivax acquisition the Company entered into an off-setting transaction effectively closing the aforementioned interest swap transaction. This derivative does not qualify for hedge accounting under FAS 133, and is recognized on the balance sheet at its fair value, with changes in the fair value carried to the statements of income and included in financial expenses net.

During 2002, the Company entered into two interest rate swap agreements with respect to the portion of the senior notes due 2008 issued in a private placement during 1998 (see note 6a). As a result of these agreements, Teva is currently paying an effective interest rate of LIBOR plus 1% on $30 million of these notes and a fixed rate of 4.5% on the remaining $45 million of these notes, as compared to the original 6.9% fixed rate. While the cash flows of interest payable and receivable under the two interest rate swap transactions are to take place on the same dates through the remaining life of these transactions, under FAS 133, only one interest rate swap transaction qualifies for hedge accounting and is accounted for as such, as more fully explained in note 6a.

3) Fair value of financial instruments:

The financial instruments of the Group consist mainly of cash and cash equivalents, marketable securities, current and non-current receivables, short-term credit, accounts payable and accruals, long-term loans and other long-term liabilities, convertible senior debentures and derivatives.

The fair value of the financial instruments included in working capital and non-current receivables of the Group is usually identical or close to their carrying value. The fair value of long-term bank loans also approximates their carrying value, since they bear interest at rates close to the prevailing market rates. The fair value of the Convertible Senior Debentures and long-term debentures, based on quoted market values and prevailing market rates, amounted to $1,866.4 million at December 31, 2005 (December 31, 2004 $1,796.2 million).

The fair values and the carrying amounts of derivatives are assets of $7.6 million and liabilities of $42.0 million at December 31, 2005, and assets of $50.5 million and liabilities of $5.1 million at December 31, 2004. The fair value of derivatives generally reflects the estimated amounts that Teva would receive or pay to terminate the contracts at the reporting dates.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

f. Information on operating segments

Operating segments:

1) General:

While financial reports to Teva s chief executive officer (its chief operating decision maker) evolve over time as Teva s business develops, currently the chief operating decision maker reviews financial information on the following main disaggregated components of Teva s business, on a quarterly basis:

a) Pharmaceutical business: sales, detailed by countries and major products; operating income data, detailed by: (i) generic pharmaceutical products, by geographic regions, as described below; (ii) global non-generic products, primarily Copaxone®; (iii) manufacturing and production of certain locations; and (iv) research and development. Teva s pharmaceutical business operates in three main regions (clusters): North America, Europe and International (which represents areas outside of North America and Europe). Each cluster is managed by an executive who reports directly to the chief executive officer.

b) Active Pharmaceutical Ingredients (API) business operating income data.

c) Veterinary business operating income data.

d) Administration corporate expenses.

The Group s reportable segments are strategic businesses differentiated by the nature of their products and customers. The segments are managed separately due to the differences in production technologies and marketing methods. Accordingly, Teva provides information regarding its Pharmaceutical segment and its API segment, which comprise discrete strategic businesses. The Pharmaceutical segment is engaged in the development, production, marketing and distribution of drugs in various dosages and forms, in most areas of medicinal treatment and disposable hospital supplies. The API segment is engaged in the development, production, marketing and distribution of API for the pharmaceutical industry including the Group s pharmaceutical segment.

2) Information on revenues, profits and assets of the reportable operating segments:

a) Measurement of revenues, profits and assets of the operating segments:

The measurement of revenues and assets of the reportable operating segments is based on the same accounting principles applied in these financial statements.

Segment profits reflect the income from operations of the segment and do not include net financial income or expense, minority interest, income tax expenses and share in profits (losses) of associated companies, since those items are not allocated to the segments.

Sales of the API segment to the pharmaceutical segment are recorded at the market prices of sales of similar products to non-related customers.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

b) Financial data relating to reportable operating segments:

	Pharmaceuticals	API	Other	Total
		(U.S. $ in millions)		
Year ended December 31, 2005:				
Net sales*:				
To unaffiliated customers	$ 4,702.7	$ 524.1	$ 23.6	$ 5,250.4
Intersegment	0.1	542.5	1.3	543.9
Total net sales	$ 4,702.8	$ 1,066.6	$ 24.9	$ 5,794.3
Operating income	$ 981.1	$ 435.3	$ 1.9	$ 1,418.3
Assets (at end of year)	$ 4,069.7	$ 881.4	$ 32.9	$ 4,984.0
Goodwill (at end of year)	$ 2,024.4	$ 437.6		$ 2,462.0
Expenditures for segment assets	$ 218.5	$ 98.8	$ 1.5	$ 318.8
Depreciation and amortization	$ 176.0	$ 61.7	$ 1.0	$ 238.7
Year ended December 31, 2004:				
Net sales*:				
To unaffiliated customers	$ 4,275.6	$ 500.9	$ 22.4	$ 4,798.9
Intersegment		438.9	1.6	440.5
Total net sales	$ 4,275.6	$ 939.8	$ 24.0	$ 5,239.4
Operating income**	$ 307.2	$ 370.2	$ 1.9	$ 679.3
Assets (at end of year)	$ 3,873.9	$ 941.2	$ 32.0	$ 4,847.1
Goodwill (at end of year)	$ 2,099.3	$ 473.1		$ 2,572.4
Expenditures for segment assets	$ 205.9	$		