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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 20-F**

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(Mark One)

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

OR

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

For the fiscal year ended March 31, 2018

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

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

Date of event requiring this shell company report \_\_\_\_\_

Commission file number 001-35463

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**TARO PHARMACEUTICAL INDUSTRIES LTD.**

(Exact name of Registrant as specified in its charter)

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N/A

(Translation of Registrant's name into English)

Israel

(Jurisdiction of incorporation or organization)

14 Hakitor Street, Haifa Bay 2624761, Israel

(Address of principal executive offices)

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**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
Ordinary Shares, NIS 0.0001 nominal (par) value per share	New York Stock Exchange

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

**None**  
(Title of Class)

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

**None**  
(Title of Class)

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

**39,427,515 Ordinary Shares, NIS 0.0001 nominal (par) value per share, and 2,600 Founders' Shares NIS 0.00001 nominal (par) value per share outstanding as of March 31, 2018**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ 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

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 ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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

Large accelerated filer: ☒ Accelerated filer: ☐ Non-accelerated filer: ☐ Emerging growth company ☐

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act: ☐

† The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

U.S. GAAP ☒ International Financial Reporting Standards as issued by the International Accounting Standards Board ☐ Other ☐

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. ☐ Item 17 ☐ Item 18

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

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## INTRODUCTION

We, among other business activities, develop, manufacture and market prescription (“Rx”) and over-the-counter (“OTC”) pharmaceutical products, primarily in the United States (the “U.S.”), Canada and Israel. We also develop and manufacture active pharmaceutical ingredients (“APIs”), primarily for use in our finished dosage form products. We were incorporated in 1959 under the laws of the State of Israel. In 1961, we completed the initial public offering of our ordinary shares in the United States. Our ordinary shares have been listed on the New York Stock Exchange (the “NYSE”) under the symbol “TARO,” since March 22, 2012.

As used in this Annual Report on Form 20-F for the fiscal year ended March 31, 2018 (the “2018 Annual Report”), the terms “we,” “us,” “our,” “Taro” and the “Company” mean Taro Pharmaceutical Industries Ltd. (“Taro Israel”) and its subsidiaries, unless otherwise indicated.

This 2018 Annual Report is being filed in respect of the fiscal year ended March 31, 2018, and contains the audited consolidated financial statements for the year then ended.

## FORWARD-LOOKING STATEMENTS

Except for the historical information contained in this 2018 Annual Report, the statements contained herein, in particular with respect to our business, financial condition and results of operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in “Item 3D—Risk Factors” and elsewhere in this 2018 Annual Report. We urge you to consider that statements which use the terms “*believe*,” “*expect*,” “*plan*,” “*intend*,” “*estimate*,” “*anticipate*,” “*should*,” “*will*,” “*may*,” “*hope*” and similar expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## PRESENTATION OF FINANCIAL INFORMATION

Our consolidated financial statements appearing in this 2018 Annual Report are reported in U.S. dollars in thousands, unless otherwise indicated, and are prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”). Totals presented in this 2018 Annual Report may not total correctly due to rounding of numbers.

All references in this 2018 Annual Report to “dollars,” or “\$,” are to U.S. dollars, all references in this Annual Report to “NIS” are to New Israeli Shekel, and all references in this Annual Report to “CAD” are to Canadian dollars. The published (1) representative exchange rate between the NIS and the dollar for March 31, 2018 was NIS 3.51 per \$1.00. The published (2) representative exchange rate between the CAD and the dollar for March 31, 2018 was CAD 1.29 CAD per \$1.00. No representation is made that the NIS amounts or CAD amounts could have been, or could be, converted into dollars at rates specified herein or any other rate.

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- (1) As published by The Bank of Israel.  
(2) As published by Bloomberg L.P.

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**PART I**

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**
**A. SELECTED FINANCIAL DATA**

We have derived the following selected consolidated financial data for the years ended March 31, 2018, 2017 and 2016, and as of March 31, 2018 and March 31, 2017, from our audited consolidated financial statements set forth elsewhere in this 2018 Annual Report, which have been prepared in accordance with U.S. GAAP. We have derived the consolidated selected financial data for the years ended March 31, 2015 and 2014, from our audited consolidated financial statements not included in this Annual Report. You should read the selected consolidated financial data together with “*Item 5—Operating and Financial Review and Prospects*” and our consolidated financial statements, related notes and other financial information included elsewhere in this 2018 Annual Report.

	Year Ended March 31,				
	2018	2017	2016	2015	2014
	U.S. dollars and shares in thousands (except per share data)				
Consolidated Statements of Operations Data:					
Sales, net	\$ 661,913	\$ 879,387	\$ 950,751	\$ 862,944	\$ 759,285
Cost of sales	198,405	207,860	169,743	186,359	179,279
Impairment	—	276	2,042	—	—
Gross profit	463,508	671,251	778,966	676,585	580,006
Operating expenses:					
Research and development	70,418	70,644	71,160	65,510	55,430
Selling, marketing, general and administrative	88,196	85,656	92,365	87,644	91,733
Settlements and loss contingencies	1,884	—	973	(4,200)	2,590
	160,498	156,300	164,498	148,954	149,753
Operating income	303,010	514,951	614,468	527,631	430,253
Financial expenses (income), net	12,531	(34,636)	(19,672)	(51,311)	(12,285)
Other gain, net	1,889	11,211	2,680	2,738	1,369
Income before income taxes	292,368	560,798	636,820	581,680	443,907
Tax expense	81,954	103,780	95,313	96,059	82,729
Income from continuing operations	210,414	457,018	541,507	485,621	361,178
Net loss from discontinued operations attributable to Taro	(335)	(352)	(236)	(787)	(319)
Net income	210,079	456,666	541,271	484,834	360,859
Net (loss) income attributable to non-controlling interest	(1,071)	310	339	577	472
Net income attributable to Taro	\$ 211,150	\$ 456,356	\$ 540,932	\$ 484,257	\$ 360,387
Net income from continuing operations attributable to Taro	\$ 211,485	\$ 456,708	\$ 541,168	\$ 485,044	\$ 360,706
Net loss from discontinued operations attributable to Taro	(335)	(352)	(236)	(787)	(319)
Net income attributable to Taro	\$ 211,150	\$ 456,356	\$ 540,932	\$ 484,257	\$ 360,387
Net income per ordinary share from continuing operations attributable to Taro:					
Basic and Diluted	\$ 5.27	\$ 11.06	\$ 12.63	\$ 11.32	\$ 8.15
Net loss per ordinary share from discontinued operations attributable to Taro:					
Basic and Diluted	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)
Net income per ordinary share attributable to Taro:					
Basic and Diluted	\$ 5.26	\$ 11.05	\$ 12.62	\$ 11.31	\$ 8.14
Weighted-average number of ordinary shares used to compute net income per share:					
Basic	40,155	41,301	42,832	42,834	44,276
Diluted	40,155	41,301	42,832	42,834	44,279

	As of March 31,				
	2018	2017	2016	2015	2014
	(U.S. dollars in thousands)				
Consolidated Balance Sheet Data:					
Working capital	\$ 1,680,879	\$ 1,789,187	\$ 1,632,133	\$ 1,203,802	\$ 797,967
Property, plant and equipment, net	\$ 193,727	\$ 180,085	\$ 159,459	\$ 153,045	\$ 151,416
Total assets	\$ 2,433,210	\$ 2,289,753	\$ 2,188,033	\$ 1,737,745	\$ 1,284,376
Short-term debt, including current maturities of long-term debt	\$ —	\$ —	\$ —	\$ 912	\$ 11,974
Long-term debt, net of current maturities	\$ —	\$ —	\$ —	\$ 4,976	\$ 5,888
Shareholders' equity	\$ 2,210,399	\$ 2,073,806	\$ 1,937,144	\$ 1,417,383	\$ 1,020,593

## Dividends

We have never paid cash dividends and we do not anticipate paying any cash dividends in the foreseeable future. Our dividend policy is set forth below in “Item 8.A – Consolidated Statements and Other Financial Information.”

## B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

## C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

## D. RISK FACTORS

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

### Risks Relating to Our Industry

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

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

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

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



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

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

- filing new patents or extensions of existing patents on products whose original patent protection is about to expire, which could extend patent protection for the product and delay launch of generic equivalents;
- developing patented controlled-release products or other product improvements;
- developing and marketing branded products as Rx and OTC products;
- pursuing pediatric exclusivity for brand-name products;
- submitting citizen petitions to request that the Commissioner of the U.S. Food and Drug Administration (“FDA”) take administrative action with respect to an abbreviated new drug application (“ANDA”) approval;
- attaching special patent extension amendments to unrelated federal legislation;
- engaging in state-by-state initiatives to enact legislation that restricts the substitution of some brand-name drugs with generic drugs;
- making arrangements with managed care companies and insurers to reduce the economic incentives to purchase generic pharmaceuticals;
- introducing authorized generics or their own generic equivalents to the marketplace; and
- setting the price of brand-name drugs at or below the price of generic equivalents.

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

***We may experience declines in the sales volume and prices of our products as the result of the continuing trend of consolidation of certain customer groups, such as the wholesale drug distribution and retail pharmacy industries, as well as the emergence of large buying groups.***

We make a significant portion of our sales to a relatively small number of wholesalers, retail drug chains, food chains and mass merchandisers. If demand decreases significantly, our profitability could be negatively impacted. Also, these customers constitute an essential part of the distribution chain for generic pharmaceutical products and continue to undergo significant consolidation. This consolidation may result in these groups gaining additional purchasing leverage and consequently increasing product pricing pressures facing us. In addition, the emergence of large buying groups representing independent retail pharmacies and the prevalence and influence of managed care organizations and similar institutions, potentially enables those groups to negotiate price discounts on our products.

Our net sales and quarterly growth comparisons may also be affected by fluctuations in the buying patterns of retail chains, major distributors and other trade buyers, whether resulting from seasonality, pricing, wholesaler buying decisions or other factors. In addition, since such a significant portion of our U.S. revenue is derived from relatively few customers, any financial difficulties experienced by a single customer, or any delay in receiving payments from a single customer could have a material adverse effect on our business, financial position and results of operations, and could cause the market value of our ordinary shares to decline.

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

The markets in which we compete and intend to compete continue to undergo rapid and significant technological change. Our competitors may succeed in developing products and technologies that are more effective or less costly than any that we are developing, or that would render our products obsolete and non-competitive.

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

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

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

***Reductions in pharmaceutical pricing may adversely affect our business.***

Pharmaceutical pricing, through the current administration, political, social, and other pressure, has been subjected to increased scrutiny. Our pricing and profitability may be affected, which may have a material adverse effect on our business, financial condition and results of operation.

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

Our future profitability depends, in part, upon our ability to continue monitoring our inventory levels in the distribution channel. We obtain reports of the amount of our products held in inventory by our wholesaler customers. We use these reports as part of our process for monitoring inventory levels in our distribution channel and our exposure to product returns. If we lose access to these reports, we may not be able to adequately monitor our inventory levels in the distribution channel. The loss of our visibility into the distribution channel could cause inventory levels to build, exceeding market demand and resulting in us incurring significant and unanticipated expenditures to reimburse these wholesaler customers for product returns, which could materially affect our profitability and cash flows in an adverse manner.

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

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

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

***Our revenue and profits from individual generic pharmaceutical products typically decline as our competitors introduce their own generic equivalents.***

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

***We may be unable to take advantage of the increasing number of high-value biosimilar opportunities.***

Biosimilar products are expected to make up an increasing proportion of the high-value generic opportunities in upcoming years. The development, manufacture and commercialization of biosimilar products require specialized expertise and are very costly and subject to complex regulation, which is still evolving. We will require significant investments and collaborations with third parties to take advantage of these opportunities. We cannot assure you that any future investments and collaborations regarding biosimilar products will be successful.

**Risks Relating to Regulatory Matters**

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

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

If our product candidates receive FDA approval, the labeling claims and marketing statements that we can make for our products are limited by statutes and regulations and, with respect to our generic drugs, by the claims approved by the FDA for the brand-name product. In addition, if the FDA and/or a foreign regulatory authority approves any of our products, the labeling, packaging, adverse event reporting, storage conditions, advertising and promotion for the product will be subject to extensive and ongoing regulatory requirements. Further, as a manufacturer of pharmaceutical products distributed in the United States, we must also continue to comply with cGMP regulations, which include requirements related to production processes, quality control and quality assurance and recordkeeping. Products that we manufacture and distribute in foreign jurisdictions may be regulated under comparable laws and regulations in those jurisdictions. The facilities of Taro Pharmaceuticals U.S.A., Inc. (“Taro U.S.A.”), our manufacturing facilities and procedures and those of our suppliers are subject to periodic inspection by the FDA and foreign regulatory agencies. Any material deviations from cGMPs or other applicable standards identified during such inspections may result in enforcement actions, including delaying or preventing new product approvals, a delay or suspension in manufacturing operations, warning or untitled letters, consent decrees or civil or criminal penalties. Taro shares common ownership with Ranbaxy Inc. through acquisitions made by Sun. In 2012, Ranbaxy Inc. entered into a Consent Decree of Permanent Injunction with the FDA which decree gives the FDA authority to impose its terms and obligations on any “subsidiary” or “affiliate” of Ranbaxy Inc. Also, if such deviations occurred, it is unclear if the FDA could extend the existing Consent Decree of Permanent Injunction, applicable to Ranbaxy Inc. to a facility owned or operated by Taro in light of the companies' common ownership by Sun. Further, discovery of previously unknown problems with a product or manufacturer may result in restrictions or sanctions with respect to the product, including withdrawal of the product from the market.

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

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

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

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

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

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

Under the terms of the Hatch-Waxman Act, a generic applicant must make certain certifications with respect to the patent status of the listed drug that it references in its ANDA. 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 Paragraph IV certification. The Hatch-Waxman Act provides for a potential 180-day period of generic exclusivity for the first company that submits an ANDA with a Paragraph IV certification and that also lawfully maintains such certification. Such exclusivity prevents the approval for 180 days of a subsequently submitted ANDA containing a Paragraph IV certification. The Medicare Act modified certain provisions of the Hatch-Waxman Act. Under the Medicare Act, final ANDA approval for a product subject to Paragraph IV patent litigation may be obtained upon the earlier of a favorable district court decision or 30 months from receipt of notification to the patent holder of the Paragraph IV filing, provided there are no other issues preventing the FDA from granting final approval. Exclusivity rights for the first Paragraph IV filer may be forfeited pursuant to the Medicare Act under specified circumstances including, for example, if tentative approval is not timely obtained. Some of the changes made by the Medicare Act apply to ANDAs where the first certification was filed after the enactment of the Medicare Act; other earlier submitted ANDAs are generally governed by the previous version of the law.

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

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

***Healthcare reform may have an impact on all segments of the healthcare industry.***

In March 2010, the U.S. government enacted the Patient Protection and Affordable Care Act, as amended by the Health Care Education and Reconciliation Act of 2010 (collectively, “PPACA”), which represented the most comprehensive overhaul of both the public and private healthcare systems ever enacted in the United States.

The PPACA imposes on manufacturers a variety of additional rebates, discounts, fees, taxes and reporting and regulatory requirements. Changes to the healthcare system enacted as part of healthcare reform in the United States, as well as the increased purchasing power of entities that negotiate on behalf of Medicare, Medicaid, and private sector beneficiaries, may result in increased pricing pressure by influencing, for instance, the reimbursement policies of third-party payors. We cannot predict which additional measures may be adopted or the impact of current and additional measures on the marketing, pricing and demand for our products.

We face uncertainties due to federal legislative and administrative efforts to repeal, substantially modify or invalidate some or all of the provisions of the PPACA. Despite the recent failure of the Senate's attempts to repeal various combinations of such PPACA provisions, these and similar actions by the current administration are widely expected to lead to fewer Americans having comprehensive PPACA compliant health insurance, even in the absence of a legislative repeal. There is no assurance that any future replacement, modification or repeal of the PPACA will not adversely affect our business and financial results, and we cannot predict how future federal or state legislative or administrative changes relating to healthcare reform will affect our business.

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

Our ability to market our products depends, in part, on prices and reimbursement levels for them and related treatment established by federal and state government healthcare programs, private health insurers and other third party payor organizations, including health maintenance organizations and managed care organizations. Reimbursement may not be available for some of our products and, even if granted, may not be maintained. Limits placed on our prices or reimbursement could make it more difficult for people to buy our products and reduce, or possibly eliminate, the demand for our products. In the event that any federal, state or other governmental authority enacts any additional legislation or adopts any additional regulations or policies that affect third-party coverage, price levels or reimbursement, demand for our products may be reduced with a consequent adverse effect, which may be material, on our sales and profitability.

In addition, the purchase of our products could be significantly influenced by the following factors, among others:

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

The PPACA is a sweeping measure intended to expand healthcare coverage in the U.S., primarily through the establishment of an exchange to facilitate the purchase of health insurance, premium and cost-sharing subsidies for certain low-income individuals, the imposition of health insurance mandates on employers and individuals and expansion of the Medicaid program. Among other things, the PPACA contained provisions that changed payment levels for pharmaceuticals under Medicaid and increased pharmaceutical rebates under the Medicaid Drug Rebate Program. Effective October 1, 2010, the law changed the formula for calculating federal upper limits ("FULs"), which are a type of cap on the amount a state Medicaid program can reimburse pharmacies for multiple source drugs (drugs for which there are at least three therapeutically equivalent versions on the market). The FULs are calculated based on the weighted-average of the average manufacturer prices ("AMPs") of the equivalent drugs on the market. In addition, the law changed the preexisting definition of AMP so that it is based only on direct sales to retail community pharmacies and sales to wholesalers for drugs distributed to retail community pharmacies. The Centers for Medicare & Medicaid Services ("CMS") issued final regulations regarding the FUL and the calculation of AMP and rebates under the Medicaid Drug Rebate Program. These regulations were effective as of April 1, 2016. Even though the weighted-average does not disclose our AMP, the release of such FULs to the public and our customers may affect our pricing.

In addition, in its final regulations for the Medicaid Drug Rebate Program, CMS required state Medicaid programs, beginning April 1, 2017, to base their reimbursement rates for brand drugs and other drugs not subject to a FUL on pharmacies' actual acquisition costs, rather than using the current methodologies based on published benchmarks such as average wholesale price ("AWP") or wholesaler acquisition cost. We do not yet know the full impact of the new Medicaid reimbursement rates on our pharmacy customers.

Effective January 1, 2010, the PPACA also increased the minimum Medicaid rebate rate from 15.1% to 23.1% of AMP for most drugs approved under a new drug application ("NDA"), including authorized generics. The PPACA also increased the Medicaid rebate from 11% to 13% of AMP for most drugs approved under an ANDA. Further, the volume of rebated drugs has been expanded to include drugs dispensed to beneficiaries in Medicaid managed care organizations. In addition, an alternative, higher rebate may be imposed on drugs that are line extensions of previously approved oral dosage form drugs. CMS's final regulations also expanded the Medicaid Drug Rebate Program such that manufacturers will be required to pay rebates to Puerto Rico and the U.S. Territories (the U.S. Virgin Islands, Guam, the Northern Mariana Islands and American Samoa), effective April 1, 2020. These measures have increased or will increase our cost of selling to the Medicaid market.

Furthermore, as a result of legislative changes in the Bipartisan Budget Act of 2015 ("BBA"), effective for the first calendar quarter of 2017, generic drugs are subject to an additional rebate if the AMP for a given quarter exceeds an inflation-adjusted baseline AMP. This price increase penalty previously applied only to innovator drugs.

The full effects of the PPACA and the BBA on Medicaid payments and on our Medicaid rebates cannot be known at this time, in part because not all of these provisions have been implemented yet, but they may have an adverse impact on our results of operations. In addition, recently, the current administration has made statements that it supports repeal of all or portions of the PPACA, and Congress recently enacted new legislation that repealed key portions of the PPACA. There is uncertainty with respect to the impact these changes, if any, may have, and any changes likely will take time to unfold. Any additional federal healthcare reform measures adopted in the future could limit the amounts that federal and state governments will pay for healthcare products and services, and in turn could significantly reduce the projected value of certain development projects and reduce our profitability.

***Our relationships with customers and third-party payors are subject to applicable anti-kickback, fraud and abuse and other healthcare laws and regulations, which could expose us to criminal sanctions, civil penalties, contractual damages, reputational harm and diminished profits and future earnings.***

Healthcare providers, physicians and third-party payors play a primary role in the recommendation and prescription of any products we market. Our arrangements with third-party payors, prescribers, and customers may expose us to broadly applicable fraud and abuse and other healthcare laws and regulations that may constrain the business or financial arrangements and relationships through which we market, sell and distribute any products for which we obtain marketing approval. Restrictions under applicable federal and state healthcare laws and regulations include the following:

- the federal healthcare program anti-kickback statute prohibits persons from, among other things, knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in cash or in kind, to induce, or in return for, either the referral of an individual for, or the purchase, order or recommendation of, any good or service, for which payment may be made under a federal healthcare program such as Medicare and Medicaid;
- the federal False Claims Act imposes criminal and civil penalties, including civil whistleblower or *qui tam* actions, against individuals or entities for knowingly presenting, or causing to be presented, to the federal government, claims for payment that are false or fraudulent or making a false statement to avoid, decrease or conceal an obligation to pay money to the federal government;
- the federal Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) imposes criminal and civil liability for executing a scheme to defraud any healthcare benefit program or making false statements relating to healthcare matters;
- HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act and its implementing regulations, also imposes obligations, including mandatory contractual terms, with respect to safeguarding the privacy, security and transmission of individually identifiable health information;
- federal law requires applicable manufacturers of covered drugs to report payments and other transfers of value to physicians and teaching hospitals on an annual basis, which includes data collection and reporting obligations. The information is made publicly available on a searchable website; and
- analogous state and foreign laws and regulations, such as state anti-kickback and false claims laws, may apply to sales or marketing arrangements and claims involving healthcare items or services reimbursed by non-governmental third-party payors, including private insurers.

Some state laws require pharmaceutical companies to comply with the pharmaceutical industry’s voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government and require drug manufacturers to report information related to payments and other transfers of value to healthcare providers or marketing expenditures. Still other states require the reporting of certain pricing information, including information pertaining to and justification of the price increases greater than a specified threshold, or prohibit prescription drug price gouging. State and foreign laws also govern the privacy and security of health information in some circumstances, many of which differ from each other in significant ways and often are not preempted by HIPAA, thus complicating compliance efforts.

Efforts to ensure that our business arrangements with third parties comply with applicable healthcare laws and regulations involve substantial costs. It is possible that governmental authorities will conclude that our business practices may not comply with current or future statutes, regulations or case law involving applicable fraud and abuse or other healthcare laws and regulations. If our operations are found to be in violation of any of these laws or any other governmental regulations that may apply to us, we may be subject to significant civil, criminal and administrative penalties, damages, fines, imprisonment, exclusion of products from government funded healthcare programs, such as Medicare and Medicaid, and the curtailment or restructuring of our operations. If any of the physicians or other healthcare providers or entities with whom we expect to do business is found to be not in compliance with applicable laws, they may be subject to criminal, civil or administrative sanctions, including exclusions from government funded healthcare programs.

***Any failure to comply with the complex reporting and payment obligations under the Medicare and Medicaid programs may result in further litigation or sanctions, in addition to the lawsuits.***

The U.S. laws and regulations regarding Medicare and/or Medicaid reimbursement and rebates and other governmental programs are complex. Some of the applicable laws may impose liability even in the absence of specific intent to defraud. The subjective decisions and complex methodologies used in calculating prices that are reportable under these programs are subject to review and challenge, and it is possible that such reviews could result in material changes. A number of state attorneys general and others have filed lawsuits alleging that pharmaceutical companies reported inflated AWP, leading to excessive payments by Medicare and/or Medicaid for prescription drugs. Additional actions are possible. These actions, if successful, could adversely affect us and may have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

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

***Product recalls could harm our business.***

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

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

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

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

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

The pharmaceutical industry is also subject to extensive environmental regulation. We therefore face the risk of incurring liability for damages or the costs of remedying environmental harms because of the chemical ingredients contained in our products and the processes involved with their manufacture. For example, we could be held liable for costs to investigate or remediate contamination resulting from the presence or release of hazardous materials at or from any of our properties or the disposal of any such materials at third party sites. Although we have never incurred any such liability in any material amount, we may be subject to liability in the future. We may also be required to increase expenditures to address environmental issues and to comply with applicable regulations. If we fail to comply with environmental regulations or the conditions of our operating licenses, the licenses could be revoked and we could be subject to criminal sanctions and substantial liability. We could also be required to suspend or modify our manufacturing operations.

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

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

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

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

## **Risks Relating to Our Company and Our Operations**

***Sun Pharmaceutical Industries Ltd., and its affiliates, currently controls 83.2% of the voting power in our Company.***

Our Chairman, Dilip Shanghvi and members of his immediate family (one of whom is a member of our board of directors) currently control, through their beneficial ownership of 74.8% of our outstanding ordinary shares and 100% of our founders' shares through Sun Pharmaceutical Industries Ltd. (Reuters: SUN.BO, Bloomberg: SUNP IN, NSE: SUNPHARMA, BSE: 524715) ("Sun Pharma" and its affiliates, "Sun"), 83.2% of the voting power in our Company, as of March 31, 2018. Dilip Shanghvi, along with entities controlled by him and members of his family, control 54.4% of Sun Pharma as of March 31, 2018. Sun is able to control the outcome of shareholder votes requiring a majority of the votes.

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

The share capital of Taro U.S.A. is divided into two classes. Taro Israel owns 96.9% of the shares that have economic rights and 50% of the shares that have voting rights in Taro U.S.A. Taro Development Corporation ("TDC") owns 3.1% of the shares that have economic rights and 50% of the shares that have voting rights in Taro U.S.A. Sun owns all of the outstanding voting shares of TDC and thereby controls TDC. Although TDC has agreed to vote all of its shares in Taro U.S.A. for the election to its board of directors of such persons as Taro Israel may designate, TDC may terminate the agreement upon one year written notice. In the event that TDC were to cease voting its shares in Taro U.S.A. for our designees, or otherwise, in accordance with Taro Israel's preference, TDC could prevent Taro Israel from electing a majority of the board of directors of Taro U.S.A., effectively block actions that require approval of a majority of the voting power in Taro U.S.A. and potentially preclude the Company from consolidating Taro U.S.A. into the Company's financial statements. Taro U.S.A. accounted for 81%, 88% and 90% of the Company's consolidated revenue for the years ended March 31, 2018, 2017 and 2016, respectively.

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

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



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

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

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

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

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

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

- any products under development, if and when fully developed and tested, will not perform in accordance with our expectations;
- any generic product under development will, when tested, not be bioequivalent to its brand-name counterpart;
- necessary regulatory approvals will not be obtained in a timely manner, if at all;
- any new product cannot be successfully and profitably produced and marketed;
- quality control problems may adversely impact our reputation for high quality production;
- other companies may launch their version of generic products, either prior to or following the launch of our newly approved generic version of the same product;
- brand-name companies may launch their products, either themselves or through third-parties, in the form of authorized generic products which can reduce sales, prices and profitability of our newly approved generic products;
- generic companies may launch generic versions of our brand-name drugs; or
- our products may not be priced at levels acceptable to our customers.

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

While the majority of our products are either synthesized by us or are derived from multiple source materials, some raw materials and certain products are currently obtained from single domestic or foreign suppliers. Most of these materials are subject to regulatory inspections and if found to be non-compliant we could be prevented from obtaining them. Although we have not experienced significant difficulty in obtaining raw materials to date, material supply interruptions may occur in the future and we may have to obtain substitute raw materials or products. For most raw materials we do not have any long-term supply agreements and therefore we are subject to the risk that our suppliers of raw materials may not continue to supply to us on satisfactory terms or at all.

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

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

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

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

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

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

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

In addition, although a newly developed product may be successfully manufactured in a laboratory setting, difficulties may be encountered in scaling up for manufacture in commercially-sized batches. For this reason and others, in the pharmaceutical industry only a small minority of all new proprietary research and development programs ultimately result in commercially successful drugs.

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

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

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

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

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

***We may not be able to successfully identify, consummate and integrate licensing deals or future acquisitions.***

We have in the past, and may in the future, pursue licensing deals (both in-license and out-license deals) or acquisitions of product lines and/or companies and seek to integrate them into our operations. Licensing deals and acquisitions of additional product lines and companies involve risks that could adversely affect our future results of operations. Any one or more of the following examples may apply:

- we may encounter issues with intellectual property, manufacturing or financial complications with in-license or out-license deals;
- we may not be able to identify suitable licensing deals, acquisition targets or acquire companies on favorable terms;
- we compete with other companies that may have stronger financial positions and are therefore better able to acquire licenses, product lines and companies. We believe that this competition will increase and may result in decreased availability or increased prices for suitable licenses or acquisition targets;
- we may not be able to obtain the necessary financing, on favorable terms or at all, to finance any of our potential license deals or acquisitions;
- we may not be able to obtain the necessary regulatory approvals, including the approval of antitrust regulatory bodies, in any of the countries in which we may seek to consummate potential licenses or acquisitions;
- we may ultimately fail to complete a licensing deal or an acquisition after we announce that we plan to license a product or acquire a product line or a company;
- we may fail to license products or integrate our acquisitions successfully in accordance with our business strategy;
- we may choose to license a product or acquire a business that is not profitable, either at the time of the license or acquisition or thereafter;
- licensing deals or acquisitions may require significant management resources and divert attention away from our daily operations, resulting in the loss of key customers and personnel, and expose us to unanticipated liabilities;
- we may not be able to retain the skilled employees and experienced management that may be necessary to maximize an in-license's profitability or operate businesses we acquire, and if we cannot retain such personnel, we may not be able to locate and hire new skilled employees and experienced management to replace them; and
- we may license a product or purchase a company that has contingent liabilities that include, among others, known or unknown intellectual property or product liability claims.

***Our tax liabilities could be larger than anticipated.***

We are subject to tax in many jurisdictions, and significant judgment is required in determining our provision for income taxes. Likewise, we are subject to audit by tax authorities in many jurisdictions. In such audits, our interpretation of tax legislation might be challenged and tax authorities in various jurisdictions may disagree with, and subsequently challenge, the amount of profits taxed in such jurisdictions under our intercompany agreements. Although we believe our estimates are reasonable, the ultimate outcome of such audits and related litigation could be different from our provision for taxes and might have a material adverse effect on our consolidated financial statements.

On December 22, 2017, the United States enacted the Tax Cuts and Jobs Act (the "Tax Act"), which among other provisions, reduced the U.S. corporate tax rate from 35% to 21%, effective January 1, 2018. Fiscal year filers, such as Taro USA, recognize a partial reduction in the U.S. corporate tax rate for their year ending after January 1, 2018 and thereafter recognize the full reduction in the U.S. corporate tax rate. For the year ended March 31, 2018 Taro USA is subject to a 31.5% federal tax rate and for subsequent years Taro USA is subject to a 21% federal tax rate. Taro USA re-measured its deferred tax assets and liabilities, based on the 21% rate. The estimated tax cost recorded related to the re-measurement of the deferred tax balance was \$38.0 million.

The Tax Act changed the manner in which companies may utilize losses carried forward. For losses in tax years ending after December 31, 2017 losses may carry forward an unlimited number of years, however losses may only offset 80% of the federal taxable income in each future year. Taro USA generated an estimated \$22.6 million loss during the year ended March 31, 2018 and this estimated loss is subject to the above changes. The Tax Act created a variety of other taxes and incentives; however, the Company currently believes these other provisions have limited or no impact on Taro USA. We are still in the process of evaluating the impact on future years.

***We are in the process of enhancing and further developing our global enterprise resource planning systems and associated business applications, which could result in business interruptions if we encounter difficulties.***

We are enhancing and further developing our global enterprise resource planning (“ERP”), quality control laboratory operations systems and other business critical information technology (“IT”) infrastructure systems and associated applications to provide more operating efficiencies and effective management of our business and financial operations. Such changes to ERP systems and related software, quality control systems, and other IT infrastructure carry risks such as cost overruns, project delays and business interruptions and delays. If we experience a material business interruption as a result of our ERP enhancements, it could have a material adverse effect on our business, financial position, and results of operations and/or cash flow.

***We are increasingly dependent on information technology and our systems and infrastructure face certain risks, including cybersecurity and data leakage risks.***

We are increasingly dependent on sophisticated information technology systems and infrastructure to operate our business. In the ordinary course of business, we collect, store and transmit large amounts of confidential information, trade secrets, intellectual property, proprietary business information, and employee personal information, and it is critical that we do so in a secure manner to maintain the confidentiality and integrity of such confidential information. We have contracted with third party vendors to enhance our operations and, as part of our service arrangements with Sun as described in greater detail under “Item 7B —Related Party Transactions—Related Party Transactions—Arrangements with Sun.” We also have outsourced elements of our operations to Sun, including significant elements of our information technology infrastructure. The size and complexity of our information technology systems, and those with whom we contract, make such systems potentially vulnerable to service interruptions, security breaches from inadvertent or intentional actions by employees, partners or vendors, or from attacks by malicious third parties. Any significant disruptions to our information technology systems, including breaches of information security or cybersecurity, or failure to integrate new and existing information technology systems could adversely affect our business, financial condition or results of operations. While we exercise care in selecting vendors that maintain adequate information security controls and monitor our relationships with our vendors, we and our vendors or Sun, could be susceptible to third party attacks on our information security systems, which attacks are of ever increasing levels of sophistication and are made by groups and individuals with a wide range of motives and expertise, including state and quasi-state actors, criminal groups, “hackers” and others. Although the aggregate impact on our operations and financial condition has not been material to date, we have been the target of events of this nature and expect them to continue as cybersecurity threats have been rapidly evolving in sophistication and becoming more prevalent in the industry.

Maintaining the secrecy of our confidential information, trade secrets, intellectual property, proprietary business information, and employee personal information is important to our competitive business position. However, such information can be difficult to protect. While we have taken steps to protect such information and invested heavily in information technology, there can be no assurance that our efforts will prevent service interruptions or security breaches in our systems or the unauthorized or inadvertent wrongful use or disclosure of data that could adversely affect our business operations or result in the loss, dissemination, or misuse of critical or sensitive information. A breach of our security measures or the accidental loss, inadvertent disclosure, unapproved dissemination, misappropriation or misuse of our data, whether as a result of theft, hacking, fraud, trickery or other forms of deception, or for any other cause, could enable others to produce competing products, use our data to gain an advantage, and/or adversely affect our business position. Further, any such interruption, security breach, loss or disclosure of confidential information, could result in financial, legal, business, and reputational harm to us and could have a material adverse effect on our business, financial condition, results of operations, cash flows, and/or share price.

***Social media presents potential internal and external harm for our company.***

The internal unauthorized, inappropriate or illicit use of social media could cause reputational harm to our business and/or create adverse consequences, including the inadvertent release of non-public information or personally identifiable information. Externally, our brand and reputation could suffer harm in the event of negative comments or altered information being disseminated through social media. If we were to suffer reputational or brand harm or adverse consequences through social media, it may have a material adverse effect on our business, financial condition and results of operations.

## **Risks Relating to Our Intellectual Property**

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

Our success depends, in large part, on our ability to protect our current and future technologies and products and to defend our intellectual property rights. If we fail to protect our intellectual property adequately, competitors may manufacture and market products similar to ours. Numerous patents covering our technologies have been issued to us, and we have filed, and expect to continue to file, patent applications seeking to protect newly developed technologies and products in various countries, including the United States. Some patent applications in the United States are maintained in secrecy until the patent is issued. Because the

publication of discoveries tends to follow their actual discovery by many months, we may not be the first to invent, or file patent applications on any of our discoveries. Patents may not be issued with respect to any of our patent applications and existing or future patents issued to or licensed by us may not provide competitive advantages for our products. Many provisions of the America Invents Act went into effect March 16, 2013, and may change or otherwise affect our ability to protect our intellectual property. Patents that are issued may be challenged, invalidated or circumvented by our competitors. Furthermore, our patent rights may not prevent our competitors from developing, using or commercializing products that are similar or functionally equivalent to our products. Where trade secrets are our sole protection, we may not be able to prevent third-parties from marketing generic equivalents to our products, reducing prices in the marketplace and reducing our profitability.

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

***Third-parties may claim that we infringe on their proprietary rights and may prevent us from manufacturing and selling such products, or may challenge our own proprietary rights.***

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

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

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

From time to time, we seek to market patented products before the related patents expire. In order to do so in the United States, we must challenge the patent under the procedures set forth in the Hatch-Waxman Act. In the United States, in order to obtain a final approval for a generic product prior to expiration of certain of the innovator's patents, we must, under the terms of the Hatch-Waxman Act, as amended by the Medicare Act, notify the patent holder as well as the owner of an NDA, that we believe that the patents listed in the Approved Drug Products with Therapeutic Equivalence Evaluations contained on the FDA website (the "Orange Book") for the new drug are invalid, unenforceable or not infringed by our product. To the extent that we engage in patent challenge procedures, we are involved and expect to be involved in patent litigation regarding the validity, enforceability or infringement of the originator's patent. In addition, when seeking regulatory approval for some of our products, we are required to certify to the FDA and its equivalents in foreign countries, that such products do not infringe upon third-party patent rights, or that those patents are invalid or unenforceable. Filing a certification against a patent gives the patent holder the right to bring a patent infringement lawsuit against us. Any lawsuit in the United States would delay regulatory approval by the FDA until the earlier of the resolution of such claim or 30 months from the patent holder's receipt of notice of certification.

A third party might challenge any of our patent rights. If successful, such a challenge could result in a loss of market exclusivity with respect to one or more of our products.

In addition, it is not required that pharmaceutical patents be listed with the FDA or other regulatory authorities. For example, patents relating to antibiotics might not be listed in the Orange Book. Any launch of a pharmaceutical product by us that may infringe a patent, whether listed or not, may involve us in litigation.

Patent challenges are complex, costly and can take a significant amount of time to complete. A claim of infringement and the resulting delay could result in substantial expenses and even prevent us from manufacturing and selling products and, in certain circumstances, such litigation may result in significant damages which could have a material adverse effect on our results of operations and financial condition.

Our launch of a product prior to a final court decision, settlement with the patent owner or the expiration of a patent held by a third-party may result in substantial damages to us. Depending upon the circumstances, a court may award the patent holder damages up to three times the patent holder's loss of profit or other actual damages, and not less than a reasonable royalty. If we are found to infringe a patent held by a third-party and become subject to significant damages, these damages could have a material adverse effect on our results of operations and financial condition.

### **Risks Relating to Our Compliance with the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")**

***We have, in the past, and could in the future, fail to maintain effective internal controls in accordance with Section 404 of Sarbanes-Oxley.***

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

We have in the past, and may, in the future, identify material weaknesses in our internal controls that evidence that we fail to maintain effective internal controls in accordance with Section 404 of Sarbanes-Oxley. As of March 31, 2018, we did not identify any material weaknesses in internal controls. Failure to maintain adequate internal controls could negatively affect shareholder and customer confidence.

***Material weaknesses in our disclosure controls and procedures could negatively affect shareholder and customer confidence.***

Under Sarbanes-Oxley, we are required to assess the effectiveness of our disclosure controls and procedures on an annual basis. If we were to conclude that our disclosure controls and procedures were ineffective, shareholder and customer confidence could be negatively affected, which could have a material adverse impact on the market price of our ordinary shares.

### **Risks Relating to Investment in Our Ordinary Shares**

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

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

- actual or anticipated variations in our quarterly operating results or those of our competitors;
- announcements by us or our competitors of new or enhanced products;
- market conditions or trends in the pharmaceutical industry;
- developments or disputes concerning proprietary rights;
- failure by us to develop new products;
- introduction of technologies or product enhancements by others that reduce the need for our products;
- general economic and political conditions;
- departures of key personnel;
- changes in the market valuations of our competitors;
- regulatory considerations; and
- the other risk factors listed in this section of this 2018 Annual Report.

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

In order to reduce our risk of being classified as a “Controlled Foreign Corporation” under the United States Internal Revenue Code of 1986, as amended (the “Code”), we amended our Articles of Association in 1999 to provide that no owner of any of our ordinary shares is entitled to any voting right of any nature whatsoever with respect to such ordinary shares if (a) the ownership or voting power of such ordinary shares was acquired, either directly or indirectly, by the owner after October 21, 1999, and (b) the ownership would result in our being classified as a Controlled Foreign Corporation. This provision has the practical effect of prohibiting each citizen or resident of the United States who acquired or acquires our ordinary shares after October 21, 1999, from exercising more than 9.9% of the voting power in our Company, with respect to such ordinary shares, regardless of how many shares the shareholder owns. The provision may therefore discourage United States persons from seeking to acquire, or from accumulating, 15% or more of our ordinary shares (which, due to the voting power of the founders’ shares, would represent 10% or more of the voting power of our Company). As of March 31, 2018, no citizen or resident of the United States held an amount of ordinary shares that would represent 10% or more of the voting power of our Company.

## **Risks Relating to Our International Operations**

***We face risks related to foreign currency exchange rates.***

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

***Current and changing economic conditions may adversely affect our industry, business, partners and suppliers, financial position, results of operations and/or cash flow.***

The global economy continues to experience significant volatility, and the economic environment may continue to be, or become, less favorable than that of past years. Among other matters, the continued risk of a debt default by one or more European countries, related financial restructuring efforts in Europe, and/or evolving deficit and spending reduction programs instituted by the U.S. and other governments could negatively impact the global economy and/or the pharmaceutical industry. This has led, and/or could lead, to reduced consumer and customer spending and/or reduced or eliminated governmental or third party payor coverage or reimbursement in the foreseeable future, and this may include spending on healthcare, including but not limited to pharmaceutical products. While generic drugs present an alternative to higher-priced branded products, our sales could be negatively impacted if patients forego obtaining healthcare, patients and customers reduce spending or purchases, and/or if governments and/or third-party payors reduce or eliminate coverage or reimbursement amounts for pharmaceuticals and/or impose price or other controls adversely impacting the price or availability of pharmaceuticals. In addition, reduced consumer and customer spending, and/or reduced government and/or third party payor coverage or reimbursement, and/or new government controls, may drive us and our competitors to decrease prices and/or may reduce the ability of customers to pay and/or may result in reduced demand for our products. The occurrence of any of these risks could have a material adverse effect on our industry, business, financial position, results of operations and/or cash flow.

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

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

## **Risks Relating to Key Employees**

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

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

## **Risks Relating to Our Location in Israel**

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

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

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

Many male Israeli citizens, including our employees, are subject to compulsory annual reserve military service until they reach the age of 45 (or older, for citizens who hold certain positions in the Israeli armed forces reserves) and, in the event of a military conflict, may be called to active duty. In response to increases in terrorist activity, there have been periods of significant call-ups of military reservists, and some of our Israeli employees have been called up in connection with armed conflicts. It is possible that there will be similar large-scale military reserve duty call-ups in the future. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of our other employees due to obligatory military service requirement. Any disruption in our operations could harm our business.

***We may be affected by fluctuations in the NIS relative to the U.S. Dollar.***

A substantial portion of our expenses in Israel, primarily labor and occupancy expenses, are incurred in NIS. As a result, the cost of our operations in Israel, as measured in U.S. dollars, is subject to the risk of exchange rate fluctuations between the U.S. dollar and the NIS. During the year-ended March 31, 2018, the value of the NIS increased 3.3% with respect to the U.S. dollar. That change had a negative impact on our results of operations. If the NIS were to once again depreciate relative to the U.S. dollar, it would positively affect our U.S. dollar-measured results of operations. If the NIS were to appreciate ever further relative to the U.S. dollar, that would negatively affect our U.S. dollar-measured results of operations.

***Our operations may be affected by negative labor conditions in Israel.***

Strikes and work-stoppages occur relatively frequently in Israel. If Israeli trade unions threaten strikes or work-stoppages and such strikes or work-stoppages occur, those may, if prolonged, have a material adverse effect on the Israeli economy and on our business, including our ability to deliver products to our customers and to receive raw materials from our suppliers in a timely manner.

***Government pricing or price control policies can materially impede our profitability or ability to set prices for our products.***

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



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

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

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

Provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult a merger or acquisition. The Israeli Companies Law, 5759 - 1999 (the “Israeli Companies Law”) and the regulations promulgated thereunder, generally require that a merger be approved by a company’s board of directors and by a shareholder vote at a shareholders’ meeting that has been called on at least 35 days’ advance notice by each of the merger parties. Under our Articles of Association, the required shareholder vote is a supermajority of at least 75% of the shares voting in person or by proxy on the matter. Any creditor of a merger party may seek a court order blocking a merger if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of any party to the merger. Moreover, a merger may not be completed until at least 50 days have passed from the time that a merger proposal has been delivered to the Israeli Registrar of Companies and at least 30 days have passed from the time each merging company received shareholder approval. In addition, a majority of each class of securities of the target company must approve a merger. Moreover, a tender offer for all of a company’s issued and outstanding shares can only be completed if the acquirer receives sufficient responses such that the acquirer will hold at least 95% of the issued share capital upon consummation of the shareholders’ tenders. Completion of the tender offer also requires approval of a majority of shareholders who do not have a personal interest in the tender offer, unless, following consummation of the tender offer, the acquirer would hold at least 98% of the company’s outstanding shares. Furthermore, the shareholders, including those who indicated their acceptance of the tender offer, may, at any time within six months following the completion of the tender offer, petition an Israeli court to alter the consideration for the acquisition, unless the acquirer stipulated in its tender offer that a shareholder that accepts the offer may not seek such appraisal rights.

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

Finally, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than do United States tax laws. The provisions of Israeli corporate and tax law and the uncertainties surrounding such laws may have the effect of delaying, preventing or making more difficult a merger or acquisition. This could prevent a change of control of the Company and depress the market price of our ordinary shares, which otherwise might rise as a result of such a change of control. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of a number of conditions, including a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are subject to certain restrictions. With respect to other share swap transactions, the tax deferral is limited in time, and when this time expires, the tax becomes payable even if no disposition of the shares has occurred.

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

We are incorporated in Israel. The majority of our executive officers and directors are non-residents of the United States and a substantial portion of our assets and the assets of such persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any of those persons or to effect service of process upon those persons. It may also be difficult to enforce civil liabilities under United States federal securities laws in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum in which such a claim should be brought. Even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the applicable U.S. law must be proved as a factual matter, which can be a time-consuming and costly process. Also, certain matters of procedure will be governed by Israeli law.

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

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

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

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

#### **Risks Relating to Our Location in Canada**

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

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

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

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

***We may be adversely affected if the rate of inflation in Canada exceeds the rate of devaluation of the CAD against the U.S. dollar.***

A substantial portion of our expenses, primarily labor, raw materials, occupancy, marketing and research and development expenses in Canada, are incurred in CAD. As a result, the cost of our operations in Canada, as measured in U.S. dollars, is subject to the risk of exchange rate fluctuations among the U.S. dollar and the CAD. During the year-ended March 31, 2018, the value of the CAD increased 3.0% with respect to the U.S. dollar. While that change had a negative impact on our results of operations, if the CAD were to depreciate relative to the U.S. dollar, it would positively affect our U.S. dollar-measured results of operations. If the CAD were to appreciate ever further relative to the U.S. dollar, it would negatively affect our U.S. dollar-measured results of operations.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. HISTORY AND DEVELOPMENT OF THE COMPANY**

The legal and commercial name of our company is Taro Pharmaceutical Industries Ltd. We were incorporated under the laws of the State of Israel in 1959 under the name Taro-Vit Chemical Industries Ltd. In 1984, we changed our name to Taro Vit Industries Ltd. and in 1994 we changed our name to Taro Pharmaceutical Industries Ltd., which was the name of a subsidiary of Taro Vit Industries Ltd. incorporated under the laws of the State of Israel in 1950.

In 1961, we completed the initial public offering of our ordinary shares. In that year, we also acquired 97% of the outstanding stock of an Israeli corporation, then known as Taro Pharmaceutical Industries Ltd. (“TPIL”). In 1981, we sold 37% of our interest in TPIL. In 1993, after acquiring all of the outstanding shares of TPIL, we merged TPIL into our company. In July 2001, we completed a stock split by distributing one ordinary share for each ordinary share then outstanding and one ordinary share for every ten founders’ shares then outstanding. In October 2001, we sold 3,950,000 of our ordinary shares, and shareholders sold 1,800,000 of our ordinary shares, in a public offering. In 2007, we sold 6,787,500 of our ordinary shares to Sun. In September 2010, the Levitt and Moros families and Sun Pharma reached an agreement to transfer their interest in Taro to Sun in accordance with an option agreement entered into by the parties in May 2007. Since March 22, 2012, our ordinary shares have been traded on the NYSE under the symbol “TARO.”

On December 23, 2013, the Company completed a modified “Dutch auction” tender offer through which the Company repurchased 1,959,514 ordinary shares at a price of \$97.50 per share.

On March 15, 2016, the Company announced that its Board of Directors approved a \$250 million share repurchase of ordinary shares, which was completed on August 18, 2016. Under the program, the Company bought back 1,801,099 of its ordinary shares in open market transactions, in accordance with a 10b5-1 program, at an average price of \$138.80 per share.

On November 23, 2016, the Company announced that its Board of Directors authorized a new \$250 million share repurchase of ordinary shares. Repurchases may be made from time to time at the Company’s discretion, based on ongoing assessments of the capital needs of the business, the market price of its stock, and general market conditions. No time period was set for the repurchase program, and any such program may be suspended or discontinued at any time. The repurchase authorization enables the Company to purchase its ordinary shares from time to time through open market purchases, negotiated transactions or other means, including 10b5-1 trading plans in accordance with applicable securities laws or other restrictions. On November 7, 2017, the Board extended the share repurchase program for one year. During the year ended March 31, 2018, the Company repurchased 1,085,694 shares through the current program at an average price of \$102.52. Through May 31, 2018, in total under the authorization, the Company has repurchased 1,806,984 shares at an average price of \$102.86, leaving \$64.1 million remaining under the current board authorization.

Our registered office is located at 14 Hakitor Street, Haifa Bay 2624761, Israel. Our telephone number at that address is +972-4-847-5700. Our agent for service of process in the United States is Taro Pharmaceuticals U.S.A., Inc., 3 Skyline Drive, Hawthorne, NY 10532. Our telephone number at that address is +1-914-345-9000.

## **Capital Expenditures**

During the years ended March 31, 2018, 2017 and 2016, our capital expenditures were \$26.9 million, \$35.8 million and \$19.0 million, respectively. The focus of our capital expenditure program has been the expansion and upgrade of our manufacturing facilities, laboratories, and information technology systems in order to enable us to increase operational efficiencies, remain in compliance with cGMP, accommodate anticipated increased demand for our products and maintain a competitive position in the marketplace.

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

- the acquisition of additional production and packaging equipment;
- expanding and upgrading our research and development laboratories in Israel and Canada; and
- the upgrade of our information technology and serialization systems, in addition to general improvements to our facilities.

*For a detailed presentation of our property, plant and equipment, see Note 7 to our consolidated financial statements included elsewhere in this 2018 Annual Report. Also see Item 4.D.—“Property, Plant and Equipment.”*

## **B. BUSINESS OVERVIEW**

We are a multinational, science-based pharmaceutical company. We develop, manufacture and market Rx and OTC pharmaceutical products primarily in the United States, Canada and Israel. Our primary focus includes semi-solids formulations, such as creams and ointments and other dosage forms such as liquids, capsules and tablets, in the dermatological and topical, cardiovascular, neuropsychiatric and anti-inflammatory therapeutic categories.

We operate principally through three entities: Taro Israel, and two of its subsidiaries (including indirect), Taro Pharmaceuticals Inc. (“Taro Canada”) and Taro U.S.A. The principal activities and primary product lines of these subsidiaries may be summarized as follows:

Entity	Principal Activities	Primary Product Lines
Taro Israel	<ul style="list-style-type: none"> <li>• Manufactures more than 100 finished dosage form pharmaceutical products for sale in Israel and for export</li> <li>• Produces APIs used in the manufacture of finished dosage form pharmaceutical products</li> <li>• Markets and distributes both proprietary and generic products in the local Israeli market</li> <li>• Performs research and development</li> </ul>	<ul style="list-style-type: none"> <li>• Dermatology: Rx and OTC semi-solid and liquid products (creams, ointments, lotions and gels)</li> <li>• Cardiology and Neurology: Prescription oral dosage products</li> <li>• Oral analgesics, Rx and OTC</li> <li>• Oral Central Nervous System (CNS) - Rx</li> <li>• OTC nasal sprays</li> <li>• Allergy (Antihistamine): OTC oral dosage products</li> </ul>
Taro Canada	<ul style="list-style-type: none"> <li>• Manufactures more than 200 finished dosage form pharmaceutical products for sale in Canada and for export</li> <li>• Markets and distributes both proprietary and generic products in the Canadian market</li> <li>• Performs research and development</li> </ul>	<ul style="list-style-type: none"> <li>• Dermatology: Rx and OTC semi-solid products (creams, ointments and gels) and liquids</li> <li>• Allergy (Antihistamine): OTC oral dosage products</li> </ul>
Taro U.S.A.	<ul style="list-style-type: none"> <li>• Markets and distributes both proprietary and generic products in the U.S. market</li> <li>• Performs regulatory, post marketing and clinical activities</li> </ul>	<ul style="list-style-type: none"> <li>• Dermatology: Rx and OTC semi-solid products (creams, ointments and gels) and liquids</li> <li>• Cardiology and Neurology: Rx oral dosage products</li> <li>• Other Rx and OTC products</li> </ul>

As of March 31, 2018, 28 (excluding tentative approvals) of our ANDAs are being reviewed by the FDA. During the fiscal year ended March 31, 2018, we filed 7 ANDAs with the FDA. In addition, there are numerous products for which either development or internal regulatory work is in process. The applications pending before the FDA are at various stages in the review process, and there can be no assurance that we will be able to successfully complete any remaining testing or that, upon completion of such testing, approvals will be granted. In addition, there can be no assurance that the FDA will not grant approvals for competing products submitted by our competitors, prior to, simultaneous with or after granting approval to us.

## The Generic Pharmaceutical Industry

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

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

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

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

## Products

We currently market more than 200 pharmaceutical products in over 25 countries. The following table represents some of our key product groups and the major markets in which they are sold:

Generic Name	Dosage Form	Brand Name(1)	Therapeutic Category	Major Markets	Rx/OTC/Cosmetic
Acetaminophen	rectal suppository	Feverall®	Antipyretic	U.S.	OTC
Acetaminophen, Codeine and Caffeine	tablets	Rokacet®(2)	Analgesic	Israel	Rx/OTC
Acetazolamide	tablets	Diamox®	Carbonic anhydrase inhibitor	U.S., Israel	Rx
Acitretin	capsules	Soriatane®	Dermatologics	Canada	Rx
Acyclovir	ointment	Zovirax®	Dermatologics and topicals	U.S.	Rx
Adapalene	gel	Differin®	Dermatologics and topicals	U.S.	Rx
Adapalene & Benzoyl Peroxide	gel	Epiduo®	Dermatologics and topicals	U.S.	Rx
Alclometasone Dipropionate	cream, ointment	Aclovate®	Dermatologics and topicals	U.S.	Rx
Alnase	solution	Pyrimamine®	Allergy	Israel	OTC
Amcinonide	cream	Cyclocort®	Dermatologics and topicals	Canada	Rx
Amiodarone Hydrochloride	tablets	Cordarone®	Cardiovascular	U.S.	Rx
Ammonium Lactate	cream, lotion	Lac-Hydrin®	Dermatologics and topicals	U.S., Canada	Rx/OTC
Anastrozole	tablets	Arimidex®	Nonsteroidal aromatase inhibitor	Canada	Rx
Augmented Betamethasone Dipropionate	cream, lotion, gel	Diprolene AF®	Dermatologics and topicals	U.S.	Rx
Bacitracin	ointment	Baciquent®	Dermatologics and topicals	U.S.	OTC
Benzoyl Peroxide & Clindamycin Phosphate	gel	Duac®	Dermatologics and topicals	U.S.	Rx
Benzoyl Peroxide/Clindamycin	gel kit	Benzaclin®	Dermatologics and topicals	Canada	Rx
Betamethasone Dipropionate	cream	Diprosone®	Dermatologics and topicals	U.S., Canada	Rx
Betamethasone Valerate	cream, topical foam	Valisone®	Dermatologics and topicals	U.S., Canada	Rx
Brexin	tablets		Anti-Inflammatory & Analgesic	Israel	Rx
Brompheniramine Maleate, Pseudoephedrine Hydrochloride, Dextromethorphan Hydrobromide	syrup	Bromfed-DM®	Allergy	U.S.	Rx
Butamine	solution for infusion	Dobutrex®	Cardiovascular	Israel	Rx
Butenafine Hydrochloride	cream	Lotrimin Ultra®	Dermatologics and topicals	U.S.	OTC
Calcimore	chewable tablets	Calcimore®	Gastrointestinal	Israel	Rx
Calcipotriene	ointment	Dovonex®	Dermatologics and topicals	U.S.	Rx
Capecitabine	tablets	Xeloda®	Antineoplastics	Canada	Rx
Carbamazepine	tablets, controlled release tablets, chewable tablets, oral suspension	Tegretol®	Anticonvulsant	U.S., Israel, Canada	Rx
Cetirizine Hydrochloride	solution	Zyrtec®	Allergy	U.S.	Rx/OTC
Ciclopirox	shampoo	Penlac®	Dermatologics and topicals / Antifungal	U.S., Canada	Rx
Ciclopirox Olamine	cream, topical solution	Loprox®	Dermatologics and topicals / Antifungal	U.S.	Rx
Clarithromycin	suspension	Biaxin®	Antibiotic	Canada	Rx
Clindamycin Phosphate	topical solution	Cleocin T®	Dermatologics and topicals	U.S., Canada	Rx
Clindamycin/Benzoyl Peroxide	gel	Clindoxyl®	Dermatologics and topicals	Canada	Rx

Clobetasol Propionate	cream, ointment, gel, topical solution, lotion	Temovate® , Clobex®	Dermatologics and topicals	U.S., Canada	Rx
Clomipramine Hydrochloride	capsule	Anafranil®	Neuropsychiatric	U.S.	Rx
Clorazepate Dipotassium	tablets	Tranxene®	Neuropsychiatric	U.S.	Rx
Clotrimazole and Betamethasone Dipropionate	cream, lotion	Lotrisone®	Dermatologics and topicals / Antifungal	U.S., Israel	Rx
Clotrimazole	cream, topical solution, vaginal cream	Lotrimin® Gyne-Lotrimin®	Dermatologics and topicals / Antifungal	U.S., Canada	Rx/OTC
Clotrimazole/Fluconazole	cream/capsule	CanesOral®	Dermatologics and topicals/antifungal	Canada	OTC
Curatane	capsule	Accutane®	Dermatologics and topicals	Israel	Rx
Dapsone	gel	Aczone®	Dermatologics and topicals	U.S.	Rx
Deferasirox	dispersible tablets	Exjade®	Iron chelating agent	Canada	Rx
Dermacombin	cream	Dermacombin®	Dermatologics and topicals / Antifungal	Israel	Rx
Desonide	cream, ointment, lotion	Tridesilon® , Des-Owen®	Dermatologics and topicals	U.S.	Rx
Desoximetasone	cream, ointment, gel, spray	Topicort®(2)	Dermatologics and topicals	U.S.	Rx
Diclofenac Sodium	solution, gel	Pennsaid®, Solaraze®	Dermatologics and topicals	U.S., Canada	Rx
Diflorasone Diacetate	cream, ointment	Psorcon®	Dermatologics and topicals	U.S.	Rx
Diphenhydramine	cream	Benadryl®	Dermatologics and topicals	U.S.	OTC
Diprolol	emulsion for injection or infusion	Diprivan®	Sedative/hypnotic	Israel	Rx
Docusate Sodium	gel capsules	Soflax® Colace®	Gastrointestinal	Canada	OTC
Dorzolomid + Timolol	drops	Cosopt®	Intraocular pressure	Israel	Rx
Double Antibiotic	ointment	Polysporin®	Dermatologics and topicals	Canada	OTC
Econazole Nitrate	cream	Spectazole®	Dermatologics and topicals / Antifungal	U.S.	Rx
Enalapril Maleate	tablets	Vasotec®	Cardiovascular	U.S.	Rx
Enalapril Maleate / Hydrochlorothiazide	tablets	Vaseretic®	Cardiovascular	U.S.	Rx
Entumin	tablets	Entumin®	Neuropsychiatric	Israel	Rx
Estelle	tablets	Androcur®	Endocrine	Israel	Rx
Etodolac	tablets, capsules, extended release tablets	Etopan®(2) Lodine®	Anti-Inflammatory & Analgesic	U.S., Israel	Rx
Felbamate	tablets, suspension	Felbatol®	Anticonvulsant	U.S.	Rx
Fluocinolone Acetonide	solution, oil	Synalar®, Derma-Smooth®	Dermatologics and topicals	U.S.	Rx
Fluocinonide	cream, ointment, gel, topical solution	Lidex®, Vanos®	Dermatologics and topicals	U.S., Canada	Rx
Fluorouracil	topical solution, cream	Efudex®	Topical Anti-neoplastic	U.S.	Rx
Flurandrenolide	cream, lotion	Cordran®	Dermatologics and topicals	U.S.	Rx
Hydrocortisone 1% and Acetic Acid 2%	solution	Vosol HC Otic®	Antibacterial	U.S.	Rx
Hydrocortisone Butyrate	cream, ointment, topical solution	Locoid®	Dermatologics and topicals	U.S.	Rx
Hydrocortisone Valerate	cream, ointment	Westcort®	Dermatologics and topicals	U.S., Canada	Rx
Hydrocortisone	cream, ointment	Cortizone 10®, Hytone®	Dermatologics and topicals	U.S., Canada	Rx/OTC
Imiquimod	cream	Aldara®	Dermatological and topical	U.S.	Rx

Jungborn	granules	Jungborn®	Laxative	Israel	OTC
Ketoconazole	tablets, cream	Nizoral®	Dermatologics and topicals / Antifungal	U.S., Canada	Rx
Lamotrigine	tablets	Lamictal®	Anticonvulsant	U.S.	Rx
Levocetirizine Dihydrochloride	solution	Xyzal®	Allergy	U.S.	Rx
Lidocaine	ointment	Xylocaine™	Dermatologics and topicals	U.S.	Rx
Lidocaine / Tetracaine	gel	Pliaglis®	Dermatologics and topicals	U.S.	Rx
Loratadine	solution	Claritin®	Allergy	U.S., Canada	OTC
Lozapine	tablets	Clozaril®	Neuropsychiatric	Israel	Rx
Macrocols, Potassium chloride, Sodium Bicarbonate, Sodium chloride	powder for solution	Meroken™(2)	Laxative	Israel	Rx
Malathion	lotion	Ovide®(2)	Dermatologics and topicals	U.S.	Rx
Mercaptizol	tablets	Tapazole®	Endocrine	Israel	Rx
Metronidazole	gel	MetroGel®	Dermatologics and topicals	U.S.	Rx
Miconazole Nitrate	vaginal cream, cream	Monistat® 3 Monistat® 7 Micatin®	Dermatologics and topicals / Antifungal	U.S., Canada	OTC
Mometasone Furoate	lotion, cream	Elocon®	Dermatologics and topicals	Canada	Rx
Mupirocin	ointment	Bactroban®	Dermatologics and topicals	U.S., Canada	Rx
Naftifine HCL	cream	Naftin®	Dermatologics and topicals / Antifungal	U.S.	Rx
Nexium	tablets	Nexium®	Gastrointestinal	Israel	Rx
Normalax	powder	Miralax®	Gastrointestinal	Israel	OTC
Nortriptyline	capsule	Pamelor®	Neuropsychiatric	U.S.	Rx
Nystatin	cream	Mycostatin®	Antifungal Oral and topical	U.S., Israel, Canada	Rx/OTC
Nystatin/Triamcinolone	cream, ointment	Mycogen® II, Mycolog® II, Myconel®	Dermatologics and topicals / Antifungal	U.S.	Rx
Nystatin/Triamcinolone/Neomycin/Gramicidin	cream, ointment	Kenacomb®	Dermatologics and topicals / Antifungal/antibiotic	Canada	Rx
Ondansetron	solution	Zofran®	Antiemetic	U.S.	Rx
Oracort E	paste	Xylocaine and lignocaine®	Dermatologics and topicals	Israel	Rx
Otomycin	drops	Otomycin®	Antibacterial	Israel	Rx
Oxacatin	syrup	Oxacatin®	Cough & Cold	Israel	Rx
Oxaliplatin	injectable	Eloxatin®	Antineoplastics	Canada	Rx
Oxiconazole Nitrate	cream	Oxistat®	Dermatologics and topicals / Antifungal	U.S.	Rx
Partane	tablets	Benzhexol and trihex®	CNS	Israel	Rx
Pemetrexed Disodium	injectable	Alimta®	Antineoplastics	Canada	Rx
Percocet	tablets	Percocet®	Narcotics	Israel	Rx
Perphenan	tablets	Perphenan®	Neuropsychiatric	Israel	Rx
Phenytoin Sodium	extended release capsules, chewable tablets, suspension	Dilantin®	Anticonvulsant	U.S., Canada	Rx
Pregabalin	tablets	Lyrica®	Neuropathic pain	Israel	Rx
Profex	tablets	Rythmol SR®	Cardiovascular	Israel	Rx
Promethazine	rectal suppository	Phenergan®	Allergy & Antiemetic	U.S.	Rx
Promnix	modified release capsules	Alna ® / Flomax ®	Endocrine	Israel	Rx
Ridazin	tablets	Melleril®	Neuropsychiatric	Israel	Rx
Sebosel	suspension	Sebosel®	Dermatologics and topicals	Israel	OTC
Sevelamer	tablets	Renvela®	Control of Hyper phosphataemia	Israel	Rx
Sterocort	tablets	Sterocort®	Corticosteroid	Israel	Rx
Sumatriptan Succinate	injectable	Imitrex®	CNS	Canada	Rx
Taro Base	cream	Glaxal® base	Dermatologics and topicals	Canada	OTC
Taro Gel	gel	K-Y® gel	Dermatologics and topicals/lubricant	Canada	OTC



Tarodent	solution	Tarodent®	Anti-infectives for local oral	Israel	OTC
Tazarotene	cream	Tazorac®	Dermatologics and topicals	U.S.	Rx
Temozolomide	capsules	Temodal®	Antineoplastics	Canada	Rx
Terbinafine Hydrochloride	cream	Lamisil®	Dermatologics and topicals / Antifungal	U.S.	OTC
Terconazole	vaginal cream	Terazol®	Dermatologics and topicals / Antifungal	U.S., Canada	Rx
Testosterone Undecanoate	gel capsules	Andriol®	Endocrine	Canada	Rx
Tolnaftate	cream	Tinactin®	Dermatologics and topicals / Antifungal	U.S., Canada	OTC
Tramadol Hydrochloride	extended release tablets	Tridural®	Analgesic	Canada	Rx
Triamcinolone Acetonide	cream, ointment, dental paste	Kenalog®	Dermatologics and topicals	U.S., Canada, Israel	Rx
Triple Antibiotic	ointment	Neosporin®	Dermatologics and topicals	U.S., Canada	OTC
Warfarin Sodium	tablets	Coumadin®	Cardiovascular	U.S., Israel, Canada	Rx
Zindaclin	gel	Zindaclyn®	Dermatologics and topicals	Israel	Rx
Zoledronic acid	injectable	Aclasta® Zometa®	Bone metabolism regulator	Canada	Rx
N/A	shampoo & spray	Pilexil®	Cosmetic	Israel	Cosmetic
N/A	toothpaste & mouthwash	Lacer®	Cosmetic	Israel	Cosmetic

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

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

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

## Sales and Marketing

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

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

	Year ended March 31,					
	2018		2017		2016	
	Sales (in thousands)	% of total sales	Sales (in thousands)	% of total sales	Sales (in thousands)	% of total sales
United States	\$ 549,174	83%	\$ 785,319	89%	\$ 865,224	91%
Canada	67,226	10%	57,621	7%	56,605	6%
Israel	38,223	6%	29,200	3%	22,963	2%
Other	7,290	1%	7,247	1%	5,959	1%
Total	\$ 661,913	100%	\$ 879,387	100%	\$ 950,751	100%

In the year ended March 31, 2018, revenue in the United States accounted for 83% of total consolidated net sales. In addition to marketing Rx drugs, we market our generic OTC products primarily as store brands under its customers' labels to wholesalers, drug chains, food chains and mass merchandisers. During the year ended March 31, 2018, we sold to approximately 130 customers in the United States. The following table represents sales to our three largest customers as a percent of consolidated net sales:

Customer	Year ended March 31,		
	2018	2017	2016
Customer A	15.3%	14.2%	14.1%
Customer B	11.5%	10.3%	14.0%
Customer C	11.4%	19.3%	20.0%

The following table sets forth the percentage of consolidated net sales by each type of customer in the United States in the year ended March 31, 2018:

Customer Type	Percentage of Consolidated Sales
Drug wholesalers and store chains	48%
Mass merchandisers, food and retail chains	16%
Managed care organizations	9%
Generic drug distributors	6%
Other	4%

In the year ended March 31, 2018, sales in Canada accounted for 10% of our total consolidated net sales and Taro Canada sold to approximately 45 customers.

The PMPRB monitors and controls prices of patented drug products marketed in Canada by persons holding, or licensed under, one or more patents. The existence of one or more patents relating to a drug product triggers a governmental price control regime that significantly affects the Canadian pharmaceutical industry's ability to set pricing. Furthermore, in each province of Canada there is a drug benefit formulary. A formulary lists the drugs for which a provincial government will reimburse qualifying persons and the prices at which the government will reimburse such persons. Provincial governments generally will reimburse the lowest available price of the generic equivalents of any drug listed on the formulary list of a province. Consequently, provincial formulary regimes tend to encourage the sale of lower-priced versions of pharmaceutical products.

The following table sets forth the percentage of consolidated net sales by each type of customer in Canada in the year ended March 31, 2018:

Customer Type	Percentage of Consolidated Sales
Drug wholesalers	7%
Drug chains, independent pharmacies and others	3%

In the year ended March 31, 2018, sales in Israel accounted for 6% of our total consolidated net sales. The marketing, sales and distribution of Rx pharmaceuticals and OTC products in Israel is closely monitored by the Israeli government. The market for these products is dominated by institutions that are similar to health maintenance organizations in the United States, as well as private pharmacies. Most of our marketing efforts in Israel focus on selling directly to these groups.

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

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

The following table sets forth the percentage of consolidated net sales by each type of customer in Israel and other international markets in the year ended March 31, 2018:

Customer Type	Percentage of Consolidated Sales
Institutional	2%
Private	4%
Other international	1%

We have expanded the production capacity of our Israeli and Canadian operations to meet anticipated greater demand for our products in future years. As discussed below under “*Industry Practice Relating to Working Capital Items*,” future demand for our products may not increase at a rate we previously anticipated. In addition, we utilize contract manufacturers for certain products to satisfy customer demand in a timely manner. As a result, in each of the years ended March 31, 2018, 2017 and 2016, backorders represented less than 5% of our consolidated net sales.

## Competition and Pricing

The pharmaceutical industry is intensely competitive. We compete with the original manufacturers of the brand-name equivalents of our generic products, other generic drug manufacturers (including brand-name companies that also manufacture generic drugs or license their products to other generic drug manufacturers) and manufacturers of new drugs that may compete with our generic drugs. Many of our competitors have greater financial, production and research and development resources, substantially larger sales and marketing organizations, and substantially greater name recognition than we have. In the recent past, the barriers to entry for new entrants to the generic industry have significantly reduced, thus resulting in a larger competitive field. At the same time, the customer base for the generic manufacturers has seen significant consolidation at the purchasing level, resulting in increased purchasing power for the customer. This dual effect of increased competition and increased purchasing power has resulted in a downward trend for prices for our generic products.

Additionally, brand-name drug companies have historically attempted to prevent generic drug manufacturers from producing certain products and to prevent competing generic drug products from being accepted as equivalent to their brand-name products. We expect such efforts to continue in the future. Also, some brand-name competitors, in an attempt to participate in the generic drug sales of their branded products, have introduced generic equivalents of their own branded products, both prior and subsequent to the expiration of their patents or FDA exclusivity periods for such drugs. These competitors have also introduced authorized generics or generic equivalents of brand-name drug products. Our brand-name drug competitors are increasingly selling their branded products through controlled distribution channels, further limiting our access and increasing competitive intensity with those generic manufacturers.

Competitive factors in the major markets in which we participate can be summarized as follows:

### *North America*

The U.S. pharmaceutical market is undergoing, and is expected to continue to undergo, rapid and significant market and technological changes and we expect competition to intensify as these market and scientific advances are made. We intend to effectively compete in this marketplace by focusing on a niche product development strategy highlighted by differentiated technologies and dedicated focus on therapeutic areas which play to our strengths.

In the United States, we compete with branded pharmaceutical manufacturers such as Bristol-Myers Squibb Company, Celgene Corporation, GlaxoSmithKline Inc., Merck & Co., Inc., Novartis AG, Pfizer Inc., Valeant Pharmaceuticals International, Inc. and Galderma Laboratories, LP., as well as with generic companies such as Teva Pharmaceuticals U.S.A., Mylan Inc., Perrigo Company PLC, Glenmark Generics, Inc., USA and Sandoz Pharmaceuticals (the generics subsidiary of Novartis). Many of these companies have more resources, market and name recognition and better access to customers than we have. Therefore, there can be no assurance that we can compete successfully with them.

A significant portion of our sales are made to a relatively small number of wholesalers, retail drug chains, food chains and mass merchandisers, which continue to undergo significant consolidation. We face increasing product pricing pressures as a result of this consolidation as well as the emergence of large buying groups who are able to negotiate price discounts on our products.

There can be no guarantee that Taro will not continue to experience challenges during the current year in comparison to prior years, especially for our generic drug division, due to price erosion from our customers increased focus on lower pricing, customer consolidation and increased competition in specific product segments due to new entrants in our markets. These challenges could have a material impact on our business, cash flows, and results of operations or result in impairment charges, and the market value of our share price may decline.

#### *Canada*

In Canada, our competition includes Merck Canada Inc., Pfizer Canada Inc., Janssen Inc., Novartis Pharmaceuticals Canada Inc., GlaxoSmithKline Inc., Valeant Canada, AstraZeneca Canada, Johnson & Johnson Inc., Bayer Inc. and Bristol-Myers Squibb Canada. We also compete with other manufacturers of generic products, such as Apotex Inc., Teva Canada Limited, Mylan Pharmaceuticals ULC, Sandoz Canada Incorporated and Pharmascience Inc.

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

#### *Israel*

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

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

### **Manufacturing and Raw Materials**

We currently manufacture finished pharmaceutical products at our government approved facilities in Canada and Israel and APIs in our Israel facility.

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

We synthesize the APIs used in some of our key products, including our warfarin sodium tablets, carbamazepine products, etodolac tablets, terbinafine cream, imiquimod cream, fluocinonide cream, naftifine cream, oxiconazole nitrate cream, lamotrigine tablets, clorazepate dipotassium tablets, cetirizine oral solution and desoximetasone spray. We plan to continue the strategic selection of APIs for synthesis in order to maximize the advantages from this scientific and manufacturing capability.

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

## Industry Practices Relating to Working Capital Items

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

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

## Government Regulation

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

In the United States, the Federal Food, Drug, and Cosmetic Act (the “FDC Act”) and other federal and state statutes and regulations, govern, among other things, the research, development, testing, manufacture, storage, recordkeeping, approval, labeling, promotion and marketing, distribution, post-approval monitoring and reporting, sampling, and import and export of pharmaceutical products. Failure to comply with applicable U.S. requirements may subject a company to a variety of administrative or judicial sanctions, such as FDA refusal to approve pending new drug applications (“NDAs”), warning or untitled letters, product recalls, product seizures, total or partial suspension of production or distribution, injunctions, fines, civil penalties, and criminal prosecution. In Canada, Israel and other jurisdictions, the manufacture and sale of pharmaceutical products are regulated in a similar manner. Legal requirements generally prohibit the handling, manufacture, marketing and importation of any pharmaceutical product unless it is properly registered in accordance with applicable law. In addition, approval is required before any new drug or a generic equivalent to a previously approved drug can be marketed. Furthermore, each country requires successful inspections or approval of manufacturing facilities, including adherence to cGMPs during the production and storage of pharmaceutical components, including, but not limited to, raw materials and finished products. As a result, we have had periodic inspections of our facilities and records.

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

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

In the United States, any drug that is not generally recognized as safe and effective by qualified experts for its intended use is deemed to be a new drug, which generally requires FDA approval. Approval is obtained, either by the submission of an ANDA or an NDA. If the new drug is a new dosage form, a strength not previously approved, a new indication or an indication for which the ANDA procedure is not available, an NDA is required. Pharmaceutical product development for a new product or certain changes to an approved product in the United States typically involves preclinical laboratory and animal tests, the submission to the FDA of an investigational new drug application (“IND”), which must become effective before clinical testing may commence, and adequate and well-controlled clinical trials to establish the safety and effectiveness of the drug for each indication for which FDA approval is sought. Satisfaction of FDA approval to market requirements typically takes many years and the actual time required may vary substantially based upon the type, complexity, and novelty of the product or disease.

Preclinical tests include laboratory evaluation of product chemistry, formulation, and toxicity, as well as animal trials to assess the characteristics and potential safety and efficacy of the product. The conduct of the preclinical tests must comply with federal regulations and requirements, including good laboratory practices. The results of preclinical testing are submitted to the FDA as part of an IND along with other information, including information about product chemistry, manufacturing and controls, and a proposed clinical trial protocol. Long-term preclinical tests, such as animal tests of reproductive toxicity and carcinogenicity, may continue after the IND is submitted.

A 30-day waiting period after the submission of each IND is required prior to the commencement of clinical testing in humans. If the FDA has neither commented on nor questioned the IND within this 30-day period, the clinical trial proposed in the IND may begin.

Clinical trials involve the administration of the investigational new drug to healthy volunteers or patients under the supervision of a qualified investigator. Clinical trials must be conducted: (i) in compliance with federal regulations; (ii) in compliance with good clinical practice (“GCP”), an international standard meant to protect the rights and health of patients and to define the roles of clinical trial sponsors, administrators, and monitors; as well as (iii) under protocols detailing the objectives of the trial, the parameters to be used in monitoring safety, and the effectiveness criteria to be evaluated. Each protocol involving testing on U.S. patients and subsequent protocol amendments must be submitted to the FDA as part of the IND.

The FDA may order the temporary, or permanent, discontinuation of a clinical trial at any time, or impose other sanctions, if it believes that the clinical trial either is not being conducted in accordance with FDA requirements or presents an unacceptable risk to the clinical trial patients. The study protocol and informed consent information for patients in clinical trials must also be submitted to an institutional review board (“IRB”), for approval. An IRB may also require the clinical trial at the site to be halted, either temporarily or permanently, for failure to comply with the IRB’s requirements, or may impose other conditions.

We generally receive approval for generic products by submitting an ANDA to the FDA. An ANDA provides for marketing of a drug product that contains the same active ingredient and has the same route of administration, dosage form, and strength as a previously approved drug (also known as the reference listed drug) and has been shown to be bioequivalent to the reference listed drug. Other than the requirement for bioequivalence testing, ANDA applicants are not required to conduct, or submit results of, pre-clinical tests to prove the safety or effectiveness of their drug product. Bioavailability is generally determined by the rate and extent of absorption and levels of concentration of a drug product in the blood stream needed to produce a therapeutic effect. Bioequivalence compares the bioavailability of one drug product with another and, when established, indicates that the rate of absorption and levels of concentration of a generic drug in the body or on the skin are substantially equivalent to the previously approved brand-name reference listed drug. ANDA approvals are granted after the review by the FDA of detailed information submitted as part of the ANDA regarding the pharmaceutical ingredients, drug production methods, quality control, labeling, and demonstration that the product is bioequivalent to the brand-name reference listed drug. Demonstrating bioequivalence generally requires data demonstrating that the generic formula results in a product whose rate and extent of absorption are within an acceptable range of the results achieved by the brand-name reference listed drug. In some instances, bioequivalence can be established by demonstrating that the therapeutic effect of the generic product falls within an acceptable range of the therapeutic effects achieved by the brand-name reference listed drug. Generic drug user fees pursuant to the Generic Drug User Fee Amendments must be paid to FDA upon submission of each ANDA and Drug Master Files as well as for any manufacturing facilities. In addition, an applicant under an approved ANDA is subject to an annual program fee based on the number of ANDAs held.

Products resulting from our proprietary drug program may require us to submit an NDA to the FDA. An NDA must include the results of all preclinical, clinical, and other testing and a compilation of data relating to the product’s pharmacology, chemistry, manufacture, and controls. The clinical studies required prior to the NDA submission are both costly and time consuming, and often take five to seven years or longer, depending, among other factors, on the nature of the chemical ingredients involved and the indication for which the approval is sought. The cost of preparing and submitting an NDA is also substantial. The submission of most NDAs is additionally subject to a substantial application user fee, and the applicant under an approved NDA is also subject to an annual program fee for each prescription drug product pursuant to the Prescription Drug User Fee Act. The FDA has 60 days from its receipt of an NDA to determine whether the application will be accepted for filing based on the agency’s threshold determination that it is sufficiently complete to permit substantive review. Once the submission is accepted for filing, the FDA begins an in-depth review. The FDA has agreed to certain performance goals in the review of NDAs. A majority of such applications for standard review drug products are reviewed within 10 to 12 months; most applications for priority review drugs are reviewed in six to eight months. Priority review can be applied to drugs that the FDA determines offer major advances in treatment, or provide a treatment where no adequate therapy exists. For biologics, priority review is further limited only for drugs intended to treat a serious or life-threatening disease relative to the currently approved products. The review process for both standard and priority review may be extended by FDA for three additional months to consider certain late-submitted information, or information intended to clarify information already provided in the submission.

The FDA may also refer applications for novel drug products, or drug products that present difficult questions of safety or efficacy, to an advisory committee—typically a panel that includes clinicians and other experts—for review, evaluation, and a recommendation as to whether the application should be approved. The FDA is not bound by the recommendation of an advisory committee, but it generally follows such recommendations. Before approving an NDA, the FDA will typically inspect one or more clinical sites to assure compliance with GCP. Additionally, the FDA will inspect the facility or the facilities at which the drug is manufactured. The FDA will not approve the product unless compliance with cGMP is satisfactory and the NDA contains data that provide substantial evidence that the drug is safe and effective in the indication studied.

Among the requirements for drug approval by the FDA is that manufacturing procedures and operations conform to cGMP. The cGMP regulations must be followed at all times during the manufacture of pharmaceutical products. During the review of an NDA or ANDA, the FDA will inspect the facility or the facilities at which the drug is manufactured. The FDA will not approve the product unless compliance with cGMP is satisfactory. In addition, quality-control, drug manufacture, packaging, and labeling procedures must continue to conform to cGMPs after approval. Drug manufacturers and certain of their subcontractors are required to register their establishments with the FDA and certain state agencies. Registration with the FDA subjects entities to periodic unannounced inspections by the FDA, during which the agency inspects manufacturing facilities to assess compliance with cGMPs. Accordingly, manufacturers must continue to expend time, money, and effort in the areas of production and quality-control to maintain compliance with cGMPs. If the FDA believes a company is not in compliance with cGMP, certain sanctions may be imposed, including: (i) withholding new drug approvals as well as approvals for supplemental changes to existing applications; (ii) preventing the receipt of necessary licenses to export products; (iii) preventing the importation of certain products into the United States; (iv) classifying the company as an unacceptable supplier and thereby disqualifying the company from selling products to federal agencies; and (v) pursuing a consent decree or court action that limits company operations and/or imposes monetary fines.

After the FDA evaluates the NDA and the manufacturing facilities, it issues either an approval letter or a complete response letter. A complete response letter generally outlines the deficiencies in the submission and may require substantial additional testing, or information, in order for the FDA to reconsider the application. If, or when, those deficiencies have been addressed to the FDA's satisfaction, the FDA will issue an approval letter. An approval letter authorizes commercial marketing of the drug with specific prescribing information for specific indications.

Changes to some of the conditions established in an approved application, including changes in indications, labeling, or manufacturing processes or facilities, require submission and FDA approval of a new NDA or NDA supplement before the change can be implemented. An NDA supplement for a new indication typically requires clinical data similar to that in the original application, and the FDA uses the same procedures and actions in reviewing NDA supplements as it does in reviewing NDAs.

As a condition of ANDA or NDA approval, the FDA may require a risk evaluation and mitigation strategy ("REMS"), to help ensure that the benefits of the drug outweigh the potential risks. REMS can include medication guides, communication plans for healthcare professionals, and elements to assure safe use ("ETASU"). ETASU can include, but are not limited to, special training or certification for prescribing or dispensing, dispensing only under certain circumstances, special monitoring, and the use of patient registries. The requirement for a REMS can materially affect the potential market and profitability of the drug. Moreover, product approval may require substantial post-approval testing and surveillance to monitor the drug's safety or efficacy. Once granted, product approvals may be withdrawn if compliance with regulatory standards is not maintained or problems are identified following initial marketing.

In addition, because we market a controlled substance in the United States and other controlled substances in Canada and Israel, we must meet the requirements of the federal Controlled Substances Act and relevant state laws and regulations in the United States as well as equivalent laws in Canada and Israel. These regulations include stringent requirements for registration, manufacturing controls, receipt and handling procedures, recordkeeping and reporting and security to ensure accountability and prevent diversion of, or the unauthorized access to, the controlled substances in each stage of the production, storage and distribution process. The DEA inspects manufacturers, distributors, importers, and exporters to review compliance with the Controlled Substances Act and DEA regulations including security, record keeping and reporting prior to issuing a controlled substance registration. The specific security requirements vary by the type of business activity and the schedule and quantity of controlled substances handled by the registrant. Once registered, manufacturing, distribution, exporting or importing facilities must maintain records documenting the manufacture, receipt, distribution, import, or export of all controlled substances. Manufacturers are required to obtain quotas for certain Schedule I and II controlled substances. Also, manufacturers and distributors must submit periodic reports to the DEA on the distribution of Schedule I and II controlled substances, Schedule III narcotic substances, and other designated substances. All DEA registrants must report any controlled substance thefts or significant losses, and must obtain authorization to destroy or dispose of controlled substances. In addition to maintaining an importer and/or exporter registration, importers and exporters of controlled substances must obtain a permit for every import or export of a Schedule I or II substance and a narcotic substance in Schedule III, IV and V. For all other drugs in Schedule III, IV and V, importers and exporters must submit an import or export declaration. Failure to maintain the appropriate registrations or to obtain sufficient quota or approval for imports and exports could have a material adverse effect on our business. Failure to maintain compliance with applicable requirements, particularly as manifested in the loss or diversion of controlled substances, can result in enforcement action that could have a material adverse effect on our business, operations and financial condition. The DEA may seek civil penalties, refuse to renew necessary registrations, or initiate proceedings to revoke those registrations. In certain circumstances, violations could lead to criminal prosecution.

In May 1992, the Generic Drug Enforcement Act of 1992 (the “Generic Act”) was enacted. The Generic Act, a result of legislative hearings and investigations into the generic drug approval process, allows the FDA to impose debarment and other penalties on individuals and companies that commit certain illegal acts relating to the generic drug approval process. In some situations, the Generic Act requires the FDA not to accept or review, for a period of time, ANDAs from a company or an individual that has committed certain violations. It also provides for temporary denial of approval of applications during the investigation of certain violations that could lead to debarment and also, in more limited circumstances, provides for the suspension of the marketing of approved drugs by the affected company.

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

Any distribution of prescription drug products and pharmaceutical samples must comply with the U.S. Prescription Drug Marketing Act (“PDMA”), a part of the FDC Act. In addition, Title II of the Federal Drug Quality and Security Act of 2013, known as the Drug Supply Chain Security Act (“DSCSA”), has imposed new “track and trace” requirements on the distribution of prescription drug products by manufacturers, distributors, and other entities in the drug supply chain. These requirements are being phased in over a ten-year period. The DSCSA ultimately will require product identifiers (i.e., serialization) on prescription drug products in order to establish an electronic interoperable prescription product system to identify and trace certain prescription drugs distributed in the United States. These requirements will result in increased expenses and may create additional administrative encumbrances. Failing to comply with these requirements could result in penalties or fines.

Several types of state and federal laws have been applied to prohibit or restrict certain marketing practices in the pharmaceutical industry. These laws include anti-kickback statutes and false claims statutes. The federal healthcare program anti-kickback statute prohibits, among other things, knowingly and willfully offering, paying, soliciting or receiving remuneration to induce, or in return for, purchasing, leasing, ordering or arranging for the purchase, lease or order of any healthcare item or service reimbursable under Medicare, Medicaid, or other federally financed healthcare programs. The PPACA, enacted in March 2010, amended the intent element of the federal anti-kickback statute so that a person or entity no longer needs to have actual knowledge of the statute or specific intent to violate it. This statute has been interpreted to apply to arrangements between pharmaceutical manufacturers on the one hand and prescribers, purchasers, and formulary managers on the other. Violations of the anti-kickback statute are punishable by imprisonment, criminal fines, civil monetary penalties, and/or exclusion from participation in federal healthcare programs. Although there are a number of statutory exemptions and regulatory safe harbors protecting certain common activities from prosecution or other regulatory sanctions, the exemptions and safe harbors are drawn narrowly, and practices that involve remuneration intended to induce prescribing, purchases, or recommendations may be subject to scrutiny if they do not qualify for an exemption or safe harbor.

The Federal False Claims Act prohibits any person from knowingly presenting, or causing to be presented, a false claim for payment to the federal government, or knowingly making, or causing to be made, a false statement material to a false claim. This includes claims made to programs where the federal government reimburses, such as Medicaid, as well as programs where the federal government is a direct purchaser, such as when it purchases off the Federal Supply Schedule. Numerous pharmaceutical companies have been sued under this law for allegedly inflating drug prices they report to pricing services, which in turn were used by the government to set Medicare and Medicaid reimbursement rates. In addition, certain marketing practices, including off-label promotion, may also violate the Federal False Claims Act. Additionally, the PPACA amended the federal anti-kickback statute such that a violation of that statute can also serve as a basis for liability under the Federal False Claims Act. The majority of states also have statutes or regulations similar to the federal anti-kickback law and the Federal False Claims Act, which apply to items and services reimbursed under Medicaid and other state programs, or, in several states, apply regardless of the payor.

There are also an increasing number of state laws with requirements for manufacturers and/or marketers of pharmaceutical products. Some states require the reporting of expenses relating to the marketing and promotion of drug products and the reporting of gifts and payments to individual healthcare practitioners in these states. Other states prohibit various marketing-related activities, such as the provision of certain kinds of gifts or meals. Still other states require the reporting of certain pricing information, including information pertaining to and justification of price increases greater than a specified threshold, or prohibit prescription drug price gouging. In addition, states such as California, Connecticut, Nevada, and Massachusetts require pharmaceutical companies to implement compliance programs and/or marketing codes. Many of these laws contain ambiguities as to what is required to comply with the laws. In addition, as discussed below, a similar federal requirement requires manufacturers to track and report to the federal government certain payments made to physicians and teaching hospitals made in the previous calendar year. These laws may affect our sales, marketing and other promotional activities by imposing administrative and compliance burdens on us, and companies that do not comply with these state laws face civil penalties.



Federal law requires that a pharmaceutical manufacturer, as a condition of having its products receive federal reimbursement under Medicaid and Medicare Part B, must pay rebates to state Medicaid programs for all units of its covered outpatient drugs dispensed to Medicaid beneficiaries and paid for by a state Medicaid program under either a fee-for-service arrangement or through a managed care organization. The rebates are based on prices reported to CMS by manufacturers for their covered outpatient drugs (AMP for generic drugs, and AMP and best price for brand drugs). CMS issued final regulations regarding the calculation of AMP and rebates under the Medicaid Drug Rebate Program, effective as of April 1, 2016. The terms of participation in the Medicaid Drug Rebate Program impose an obligation to correct the prices reported in previous quarters, as may be necessary. Any such corrections could result in additional or lesser rebate liability, depending on the direction of the correction. In addition to retroactive rebates, if a manufacturer were found to have knowingly submitted false information to the government, federal law provides for civil monetary penalties for failing to provide required information, late submission of required information, and false information.

A manufacturer must also participate in a federal program known as the 340B drug pricing program in order for federal funds to be available to pay for the manufacturer's drugs under Medicaid and Medicare Part B. Under this program, the participating manufacturer agrees to charge certain safety net healthcare providers no more than an established discounted price for its covered outpatient drugs. The formula for determining the discounted price is defined by statute and is based on the AMP and the unit rebate amount as calculated under the Medicaid Drug Rebate Program, discussed above.

Federal law also requires that manufacturers report data on a quarterly basis to CMS regarding the pricing of drugs that are separately reimbursable under Medicare Part B. These are generally drugs, such as injectable products, that are administered "incident to" a physician service and are not generally self-administered, as well as certain vaccines and oral dosage form chemotherapy and immunosuppressive therapy drugs. The pricing information submitted by manufacturers is the basis for reimbursement to physicians and suppliers for drugs covered under Medicare Part B. As with the Medicaid Drug Rebate Program, federal law provides for civil monetary penalties for failing to provide required information, late submission of required information, and false information.

Manufacturers are also required to make their covered drugs, which are generally drugs approved under NDAs or biologics license applications ("BLAs"), available to authorized users of the Federal Supply Schedule ("FSS") of the General Services Administration. The law also requires manufacturers to offer discounted FSS contract pricing for purchases of their covered drugs by certain government agencies in order for federal funding to be available for reimbursement or purchase of the manufacturer's drugs under certain federal programs. The discounts are determined based on prices that are calculated and reported to the government by manufacturers. The accuracy of a manufacturer's reported prices may be audited by the government. Among the remedies available to the government for inaccuracies is recoupment of any overcharges to the government. If a manufacturer were found to have knowingly reported false prices, in addition to other penalties available to the government, the law provides for civil monetary penalties per incorrect item.

The PPACA, as well as subsequent legislation, such as the BBA, has had an impact on all segments of the health care industry. Pharmaceutical and medical device manufacturers have seen an increase in revenues by virtue of additional Americans who have access to health insurance beginning in 2014; however, the legislation imposes on manufacturers a variety of additional rebates, discounts and fees that have curtailed that increase in revenues. For example, Medicare Part D beneficiaries within the coverage gap receive a manufacturer funded, 50% point-of-sale discount (in 2017) off of negotiated prices for brand drugs (approved via an NDA or BLA). The Bipartisan Budget Act of 2018 increased the manufacturer's subsidy under the program from 50% to 70% of the negotiated price, beginning in 2019. As another example, the PPACA increased the minimum Medicaid rebate rate from 15.1% to 23.1% of AMP for most drugs approved under an NDA, and increased the Medicaid rebate from 11% to 13% of AMP for drugs approved under an ANDA. In another example, under the BBA, generic drugs approved under an ANDA are subject to an additional Medicaid rebate if the AMP for a given quarter exceeds the inflation-adjusted baseline AMP, effective for the first calendar quarter of 2017. This price increase penalty previously applied only to innovator drugs. For generic drugs, the baseline AMP will depend on when the drug was launched. For innovator drugs, the baseline AMP is the AMP for the first full quarter after launch. Also, annual fees are imposed on each manufacturer and importer of branded prescription drugs or biologics, based on the ratio of its sales reimbursed or purchased by government agencies to such sales made by all drug manufacturers during the prior year, and based on different sales dollar tiers (the highest being over \$400 million in brand sales, and the lowest being at least \$5 million in brand sales).

The PPACA also imposed reporting and regulatory requirements. For example, the "sunshine" provisions impose reporting requirements and public disclosure requirements on a drug manufacturer's payments to physicians and teaching hospitals, and on drug sample distributions. Annual reports are due in March of each year. The data reported under the "sunshine" provisions are posted in searchable form on a public website.

In addition, the legislation advances the policy of comparative clinical effectiveness research on medical treatments, services and items, including drugs and devices. Taken together, these government-adopted health care reform measures may adversely impact the pricing of healthcare products and services in the United States and the amount of reimbursement available from governmental agencies or other third-party payors. Government cost control initiatives could decrease the price that we or any current or potential collaborators could receive for any of our products and could adversely affect our profitability.

## Environmental Compliance

We believe that we are currently in compliance with all applicable environmental laws and regulations in all of the countries in which we operate.

## C. ORGANIZATIONAL STRUCTURE

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

The following is a list of our significant subsidiaries and their countries of incorporation as of March 31, 2018:

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

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

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

Sun beneficially owns 83.2% of the voting power of the Company as of March 31, 2018.

## D. PROPERTY, PLANT AND EQUIPMENT

The following is a list of our principal facilities as of March 31, 2018:

Location	Square Footage	Main Use	Own/Lease
Haifa Bay, Israel	881,000	Pharmaceutical manufacturing, production and research laboratories, administration, and chemical production (including tank farm and chemical finishing plant)	Long-term Lease/ Own(1)
Haifa Bay, Israel	31,000	Warehousing	Lease
Brampton, Canada	159,000	Pharmaceutical manufacturing, production and research laboratories, administration, distribution, and warehousing	Own
Brampton, Canada	89,000	Administration and warehousing	Lease
Hawthorne, New York	124,000	Administrative offices	Own
Cranbury, New Jersey	315,000	Distribution facility	Own

- (1) The land housing the majority of our manufacturing, production laboratories and research facilities, as described above is held by the Company under a long-term lease from the Israeli Land Authority ("ILA"). The buildings and the vast majority of the equipment on this land are owned by the Company.

From April 1, 2015 through March 31, 2018, we invested \$81.6 million in property, plant and equipment. Most of these projects have been completed and are subject to depreciation in accordance with our accounting policy of capitalizing costs that are direct and incremental to the activities required to bring the facilities to commercial production. The Ireland facility was sold in July 2017.

Our manufacturing plant, research and office facilities in Haifa Bay, Israel are located in a complex of buildings with an aggregate area of 881,000 square feet. We lease much of the land underlying these facilities from the ILA pursuant to long-term ground leases that expire between 2018 and 2060. The Company has the right to extend the lease agreement ending 2018 for an additional period of 49 years and is in the process of extending the lease agreement. For additional information, please refer to Note 2.i. and 2.j. to our consolidated financial statements included elsewhere in this 2018 Annual Report.

We have owned our main manufacturing facility in Brampton, Canada since 1992. Since then, we have purchased additional adjacent square footage and engaged in projects to develop and expand the facility to meet our growing manufacturing needs. As of March 31, 2018, we owned a total of 159,000 square feet at our main manufacturing facility. In addition to our owned space, since September 2000, Taro Canada has leased 75,000 square feet of office and warehouse space, adjacent to our main manufacturing facilities, which lease term continues to September 2020. In December 2013, Taro Canada leased an additional 14,000 square feet of warehouse space near the two other facilities, which lease term continues to December 2021. The mortgage on this building was repaid in November 2010.

A subsidiary of Taro U.S.A. has owned its 124,000 square foot building in Hawthorne, New York since February 2005. The mortgage was repaid on this building in December 2015.

A subsidiary of Taro U.S.A. owns a 315,000 square foot distribution facility in Cranbury, New Jersey. The mortgage was repaid on this facility in February 2012.

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

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

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

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

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

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

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

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

This phase, which is necessary to bring the asset to the condition required for its intended use, is handled by a multi-functional team of engineers and technologists. The direct costs are the direct labor and the material consumed during this stage of installation and validation such as bottles, ampoules and raw materials. Incremental costs, which have arisen in direct response to the additional activity, include the expenses directly attributable to any employee's time fully dedicated to the project in question. After the equipment has passed all DQ, IQ, OQ and PQ tests, it is then tested for its ability to actually manufacture the specific products that are intended to be produced on the equipment. Three consecutive successful validation batches must be produced. This process is performed jointly by the technology and the manufacturing departments. In addition, the cleaning of the equipment must be validated to assure that there is no carry-over residue to the next product to be manufactured using the equipment. Only after the validation batches that are manufactured using the new equipment pass quality control and quality assurance tests can they be released for sale, completing the validation process. No further costs are capitalized. This process is performed for all products.

During the installation process, materials from inventory are consumed. For example, in order to qualify a tablet press machine or an ampoule filling machine, we use raw materials, including APIs and excipients, to run the qualification test. As part of this test, actual tablets are manufactured and costs are incurred. These tablets may neither be distributed nor sold. These qualification procedures are part of cGMPs mandated by the FDA and its international counterparts. The amount of inventory capitalized as part of these projects is less than one percent of the total cost of the assets. We do not capitalize, as part of the asset cost, inventories that are routinely produced in commercial quantities on a repetitive basis.

#### ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

#### ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

##### A. OPERATING RESULTS

The following discussion should be read in conjunction with our consolidated financial statements and related notes for the years ended March 31, 2018, 2017 and 2016, which are included elsewhere in this 2018 Annual Report.

##### OVERVIEW

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

The pharmaceutical industry is affected by demographic and socioeconomic trends, such as aging populations and increased demand for pharmaceuticals, as well as broad economic trends, resulting in a corresponding increase in healthcare costs, effects on reimbursement pricing, and spending decisions of healthcare organizations, all of which lead to increased recognition of the importance of generics as providing access to affordable pharmaceuticals. We believe our business model is appropriately structured to take advantage of these trends.

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

	Year ended March 31,					
	2018		2017		2016	
	Sales	% of total	Sales	% of total	Sales	% of total
	(in thousands)	net sales	(in thousands)	net sales	(in thousands)	net sales
United States	\$ 549,174	83%	\$ 785,319	89%	\$ 865,224	91%
Canada	67,226	10%	57,621	7%	56,605	6%
Israel	38,223	6%	29,200	3%	22,963	2%
Other	7,290	1%	7,247	1%	5,959	1%
Total	<u>\$ 661,913</u>	<u>100%</u>	<u>\$ 879,387</u>	<u>100%</u>	<u>\$ 950,751</u>	<u>100%</u>

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

Customer	Year ended March 31,					
	2018		2017		2016	
	Sales (in millions)	% of total net sales	Sales (in millions)	% of total net sales	Sales (in millions)	% of total net sales
Customer A	\$ 101.2	15.3%	\$ 125.0	14.2%	\$ 134.0	14.1%
Customer B	\$ 76.2	11.5%	\$ 90.7	10.3%	\$ 133.6	14.0%
Customer C	\$ 75.1	11.4%	\$ 169.3	19.3%	\$ 190.4	20.0%

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

For the years ended March 31, 2018 and 2017, no product comprised 10% of our total consolidated sales. The percentage of net sales for products on a consolidated basis greater than 10% of our total consolidated sales in 2016 is:

Product	Year ended March 31,		
	2018	2017	2016
Clobetasol	*	*	10.7%

\* Less than 10%

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

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

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

Another industry practice causes us to provide our customers with limited rights to return products, receive rebates, assert chargebacks and take other deductions with respect to sales that we make to them. See *Item 5.A—"Operating Results—Critical Accounting Policies—Allowance for Sales Deductions and Product Returns."* The exercise of these rights by customers to whom we have granted them has an impact, which may be substantial, upon our working capital.

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

## CRITICAL ACCOUNTING POLICIES

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

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

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

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

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

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

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

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

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

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

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

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

### Three-year summary

The following tables summarize the activities for sales deductions and product returns for the years ended March 31, 2018, 2017 and 2016:

For the year ended March 31, 2018 (in thousands)				
	Beginning balance	Provision recorded for current period sales (1)	Credits processed/ Payments	Ending balance
<b>Accounts Receivable Reserves</b>				
Chargebacks	\$ (112,071)	\$ (1,107,353)	\$ 1,102,792	\$ (116,632)
Rebates and Other	(193,255)	(432,060)	492,094	(133,221)
<b>Total</b>	<u>\$ (305,326)</u>	<u>\$ (1,539,413)</u>	<u>\$ 1,594,886</u>	<u>\$ (249,853)</u>
<b>Current Liabilities</b>				
Returns	\$ (82,494)	\$ (49,265)	\$ 60,894	\$ (70,865)
Other (2)	(43,370)	(60,677)	63,079	(40,968)
<b>Total</b>	<u>\$ (125,864)</u>	<u>\$ (109,942)</u>	<u>\$ 123,973</u>	<u>\$ (111,833)</u>

**For the year ended March 31, 2017 (in thousands)**

	Beginning balance	Provision recorded for current period sales (1)	Credits processed/ Payments	Ending balance
<b>Accounts Receivable Reserves</b>				
Chargebacks	\$ (126,729)	\$ (1,153,406)	\$ 1,168,064	\$ (112,071)
Rebates and Other	(164,670)	(522,791)	494,206	(193,255)
<b>Total</b>	<u>\$ (291,399)</u>	<u>\$ (1,676,197)</u>	<u>\$ 1,662,270</u>	<u>\$ (305,326)</u>
<b>Current Liabilities</b>				
Returns	\$ (93,920)	\$ (41,871)	\$ 53,297	\$ (82,494)
Other (2)	(60,428)	(79,372)	96,430	(43,370)
<b>Total</b>	<u>\$ (154,348)</u>	<u>\$ (121,243)</u>	<u>\$ 149,727</u>	<u>\$ (125,864)</u>

**For the year ended March 31, 2016 (in thousands)**

	Beginning balance	Provision recorded for current period sales (1)	Credits processed/ Payments	Ending balance
<b>Accounts Receivable Reserves</b>				
Chargebacks	\$ (64,119)	\$ (1,032,248)	\$ 969,638	\$ (126,729)
Rebates and Other	(173,228)	(439,654)	448,212	(164,670)
<b>Total</b>	<u>\$ (237,347)</u>	<u>\$ (1,471,902)</u>	<u>\$ 1,417,850</u>	<u>\$ (291,399)</u>
<b>Current Liabilities</b>				
Returns	\$ (109,765)	\$ (25,228)	\$ 41,073	\$ (93,920)
Other (2)	(55,317)	(100,570)	95,459	(60,428)
<b>Total</b>	<u>\$ (165,082)</u>	<u>\$ (125,798)</u>	<u>\$ 136,532</u>	<u>\$ (154,348)</u>

- (1) Includes immaterial amounts of reversals of provisions recorded for prior years' sales.  
(2) Includes indirect rebates and amounts due to customers.

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

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

- Changes in legal or business climate that could affect an asset's value. For example, a failure to gain regulatory approval for a product or the extension of an existing patent that prevents our ability to produce a generic equivalent.
- Changes in our ability to continue using an asset. For example, restrictions imposed by the FDA could reduce our production and sales volume.
- Decreases in the pricing of our products. For example, consolidation among our wholesale and retail customers could place further downward pressure on the prices of some of our products.



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

- The timing and amount of forecasted cash flows
- Discount rates
- Tax rates
- Regulatory actions
- Amount of competition
- Manufacturing efficiencies
- The number and size of our customers

For the years ended March 31, 2018, 2017 and 2016, the Company recorded \$0, \$0, and \$2 million impairment charges, respectively, primarily related to certain intellectual property as the Company is no longer selling a certain product.

We estimate the fair value of goodwill using a two-step procedure. First, we compare the market value of our equity to the carrying value of our equity. If the carrying value exceeds the market value of our equity, we calculate the implied fair value of our goodwill by taking the excess of our market capitalization over the fair value of our assets other than goodwill and obligations. An impairment is recorded for the difference between the implied fair value and carrying value of goodwill. The implied fair value of goodwill and any potential impairment is sensitive to estimates of the fair value of other assets and liabilities. We have not recorded any impairments of goodwill for the years ended March 31, 2018, 2017 and 2016.

**Income Taxes.** We determine deferred taxes by utilizing the asset and liability method based on the estimated future tax effects of differences between the financial accounting and tax basis of assets and liabilities under the applicable tax laws. Deferred taxes are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. On an annual basis, Management determines if it is more likely than not that we will not benefit from the deferred tax assets in certain subsidiaries. For any locations where this is determined, a full valuation allowance is provided against the deferred tax assets. In future years, if it is more likely than not that we will be in a position to utilize its deferred tax asset, the valuation allowance for such assets may be modified.

**Discontinued Operations.** Under ASC Subtopic 205-20, “*Presentation of Financial Statements—Discontinued Operations*,” when a component of an entity has been disposed of or classified as held for sale, the results of its operations, including the gain or loss on the disclosed component, should be classified as discontinued operations and the assets and liabilities of such component should be classified as assets and liabilities attributed to discontinued operations; that is, provided that the operations, assets and liabilities of the component have been eliminated from the entity’s consolidated operations and the entity will no longer have any significant continuing involvement in the operations of the component.

#### ***Recent Accounting Pronouncements that were recently adopted***

In November 2015, The Financial Accounting Standards Board (the “FASB”) issued ASU No. 2015-17, “*Income Taxes (Topic 740)*.” The amended guidance requires entities to present all deferred tax assets and liabilities, along with any related valuation allowance, as non-current on the balance sheet. The guidance was effective for the Company fiscal year that began April 1, 2017, including interim periods within that year. The amendments in this update could be applied either prospectively to all deferred tax liabilities and assets, or retrospectively to all periods presented. The Company applied the guidance prospectively and prior periods were not retrospectively adjusted.

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

In January 2017, the FASB issued ASU No. 2017-04, “*Intangibles—Goodwill and Other (Topic 350)*.” The new guidance reduces the complexity of goodwill impairment tests by no longer requiring entities to determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. The guidance will be effective for the Company fiscal year beginning April 1, 2020, including interim periods within that year on a prospective basis. The Company is currently evaluating the potential effect of the adoption of ASU 2017-04 on our financial position and results of operations.

In October 2016, the FASB issued ASU No. 2016-16, “*Income Taxes (Topic 740)*.” The guidance requires that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The guidance will be effective for the Company fiscal year beginning April 1, 2018, including interim periods within that year. As a result of the intellectual property transfer from Taro North America (“TNA”) to Israel and Canada (as noted in “*Item 8—Financial Information—Legal Proceedings*”), the Company will recognize the income tax consequences of approximately \$41.4 million for deferred tax assets upon adoption of the guidance. The amendments in this update will be applied on a modified retrospective basis through a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption.

In August 2016, the FASB issued ASU No. 2016-15, “*Statement of Cash Flows (Topic 230)*.” The guidance addresses eight specific issues: debt prepayment or debt extinguishment costs, settlement of certain debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, distributions received from equity method investees, beneficial interest in securitization transactions, separately identifiable cash flows and application of predominance principle. The guidance will be effective for the Company fiscal year beginning April 1, 2018, including interim periods within that year. The adoption of ASU 2016-15 is not expected to have a material impact on our Statement of Cash Flows.

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments—Credit Losses (Topic 326)*.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The guidance will be effective for the Company fiscal year beginning April 1, 2020, including interim periods within that year. The Company is currently evaluating the potential effect of the adoption of ASU 2016-13 on our financial position and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*.” The new guidance requires that the lessee recognize the assets and liabilities that arise from leases. The guidance will be effective for the Company fiscal year beginning April 1, 2019, and interim periods within that year. The Company is currently evaluating the potential effect of the adoption of ASU 2016-02 on our financial position and results of operations.

In January 2016, the FASB issued ASU No. 2016-01, “*Financial Instruments—Overall (Subtopic 825-10)*.” The amended guidance focuses on the recognition and measurement of financial assets and liabilities. The guidance will be effective for the Company fiscal year beginning April 1, 2018, including interim periods within that year. The adoption of ASU 2016-01 is not expected to have a material impact on our financial position and results of operations.

In May 2014, the FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606), Section A—Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40)*.” The amended guidance will enhance the comparability of revenue recognition practices and will be applied to all contracts with customers. Improved disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized are requirements under the amended guidance. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017 (early adoption is permitted for the interim and annual periods beginning on or after December 15, 2016), as a result of the FASB announcing a one year deferral. Either a full retrospective method or modified retrospective method is permitted. The Company will adopt the guidance for the fiscal year beginning April 1, 2018, including interim periods within that year, and expects to use the modified retrospective method. The Company does not currently anticipate the adoption to have a material impact on our financial position or results of operations.

## RESULTS OF OPERATIONS

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

	For the year ended March 31,		
	2018	2017	2016
<b>Consolidated Statements of Operations</b>			
Sales, net	100.0%	100.0%	100.0%
Cost of sales	30.0%	23.7%	17.9%
Impairment	0.0%	*	0.2%
Gross profit	70.0%	76.3%	81.9%
<b>Operating expenses:</b>			
Research and development	10.6%	8.0%	7.5%
Selling, marketing, general and administrative	13.3%	9.7%	9.7%
Settlements and loss contingencies	0.3%	*	0.1%
Total operating expenses	24.2%	17.7%	17.3%
Operating income	45.8%	58.6%	64.6%
Financial expenses (income), net	1.9%	(3.9%)	(2.1%)
Other gain, net	0.3%	1.3%	0.3%
Income before income taxes	44.2%	63.8%	67.0%
Tax expense	12.4%	11.8%	10.0%
Income from continuing operations	31.8%	52.0%	57.0%
Net loss from discontinued operations attributable to Taro	*	*	*
<b>Net income</b>	<b>31.8%</b>	<b>52.0%</b>	<b>57.0%</b>
Net (loss) income attributable to non-controlling interest	(0.2%)	*	*
<b>Net income attributable to Taro</b>	<b>32.0%</b>	<b>52.0%</b>	<b>57.0%</b>

\* Less than 0.05%

### YEAR ENDED MARCH 31, 2018 COMPARED WITH YEAR ENDED MARCH 31, 2017

**Sales.** For the year ended March 31, 2018, sales decreased \$217.5 million, or 24.7%, compared to the same period in 2017. Sales in the United States during the year ended March 31, 2018 decreased \$236.1 million or 30.1%, compared to the same period in 2017. We continue to experience a difficult generic pricing environment, particularly in the U.S., driven by more intense competition among manufacturers, new entrants to the market, buying consortium pressures, and a higher ANDA approval rate from the FDA. There are no products in the year ended March 31, 2018 or 2017 that represent more than 10.0% of consolidated net sales. The Company actively manages its product portfolio to assess pricing relative to market dynamics. Sales in Israel and other international markets increased \$9.1 million, or 24.9%, primarily due to new launches and increased market share on certain products. Sales in Canada increased \$9.6 million, or 16.7%, compared to the year ended March 31, 2017, due to new launches and increased market share on certain products. Total Company volumes increased 5.8% as compared to 2017.

**Cost of Sales.** Cost of sales, as a percentage of net sales, increased to 30.0% in the year ended March 31, 2018, compared to 23.7% in 2017. This increase is primarily related to increased sales volumes compared to prior year, product mix, and the challenging pricing environment effecting net selling price.

**Gross Profit.** The Company's gross profit was \$463.5 million, or 70.0% of net sales, in the year ended March 31, 2018, while gross profit was \$671.3 million, or 76.3% of net sales in the same period in 2017. The decrease in 2018 was primarily the result of increased competition and the challenging pricing environment, as noted above.

**Research and Development.** Research and development ("R&D") expenses decreased \$0.2 million in the year ended March 31, 2018, compared to the previous year. The decrease in R&D expenses was primarily the result of lower clinical study expenses. As a percentage of net sales R&D expenses increased 2.6% to 10.6% in the year ended March 31, 2018, compared to the previous year.

**Selling, Marketing, General and Administrative.** In the year ended March 31, 2018, selling, marketing, general and administrative ("SMG&A") expenses increased \$2.5 million. As a percentage of net sales, SMG&A increased to 13.3% from 9.7%.

**Settlements and Loss Contingencies.** Settlements and loss contingencies expense was \$1.9 million in the year ended March 31, 2018, compared to an expense of \$0 million in 2017 primarily due to a withholding tax settlement in Israel.

**Operating Income.** In the year ended March 31, 2018, the Company had operating income of \$303.0 million compared to \$515.0 million in the same period in 2017, a decrease of \$211.9 million. Operating income, as a percentage of sales, decreased to 45.8% in the year ended March 31, 2018 from 58.6% in the same period in 2017.

**Financial Expenses (Income), Net.** Financial income, net results principally from interest income and the impact of foreign currency exchange rate fluctuations. Net financial expense was \$12.5 million in the year ended March 31, 2018, compared to an income of \$34.6 million for the year ended March 31, 2017. The change in financial expense (income), net is the result of FX expense of \$32.5 million for 2018 compared to FX income of \$20.2 million in 2017 — an unfavorable impact of \$52.6 million, principally the result of the strength of the CAD versus the U.S. dollar; slightly offset by an increase in interest and other financial income of \$5.5 million to \$19.9 million.

**Taxes.** Tax expense in the year ended March 31, 2018 was \$82.0 million, compared to \$103.8 million in the same period in 2017, a decrease of \$21.8 million. The effective tax rate increased to 28.0% from 18.5%. During the third quarter of year ended March 31, 2018, the Company recorded a \$38.0 million expense for the impact of the re-measurement of the Company's estimated net deferred tax asset, as a result of the Tax Cuts and Job Act. Excluding the impact from the one-time re-measurement, tax expense would have been \$44.0 million with an effective tax rate of 15.0%. The Company recognized \$29.5 million of tax loss carry-forwards and investment tax credits.

**Net Income attributable to Taro.** Net income decreased \$245.2 million to \$211.2 million for the year ended March 31, 2018, from \$456.4 million in the prior year, by reason of the factors noted above.

#### **YEAR ENDED MARCH 31, 2017 COMPARED WITH YEAR ENDED MARCH 31, 2016**

**Sales.** For the year ended March 31, 2017, sales decreased \$71.4 million, or 7.5%, compared to the same period in 2016. Sales in the United States during the year ended March 31, 2017 decreased \$79.9 million or 9.2%, compared to the same period in 2016. We continue to experience a difficult generic pricing environment, particularly in the U.S., driven by more intense competition among manufacturers, new entrants to the market, buying consortium pressures, and a higher ANDA approval rate from the FDA. There are no products in the year ended March 31, 2017, that represent more than 10.0% of consolidated net sales; while Clobetasol represented 10.7% in 2016. The Company actively manages its product portfolio to assess pricing relative to market dynamics. Sales in Israel and other international markets increased \$7.5 million, or 26.0%, primarily due to increased volumes on certain products. Sales in Canada increased \$1.0 million, or 1.8%, compared to the year ended March 31, 2016, due to increased market share on certain products. Total Company volumes increased 2% as compared to 2016 on the strength of our generic business.

**Cost of Sales.** Cost of sales, as a percentage of net sales, increased to 23.7% in the year ended March 31, 2017, compared to 17.9% in 2016. This increase is primarily related to increased sales volumes of 2% compared to prior year, in addition to the challenging pricing environment effecting net selling price, product mix and increased royalties.

**Gross Profit.** The Company's gross profit was \$671.3 million, or 76.3% of net sales, in the year ended March 31, 2017, while gross profit was \$779.0 million, or 81.9% of net sales in the same period in 2016. The decrease in 2017 was primarily the result of increased competition and the challenging pricing environment, as noted above.

**Research and Development.** Research and development ("R&D") expenses decreased \$0.5 million in the year ended March 31, 2017, compared to the previous year. The decrease in R&D expenses was primarily the result of lower clinical study expenses. As a percentage of net sales R&D expenses increased 0.5% to 8.0% in the year ended March 31, 2017, compared to the previous year.

**Selling, Marketing, General and Administrative.** In the year ended March 31, 2017, selling, marketing, general and administrative ("SMG&A") expenses decreased \$6.7 million primarily as a result of reduced Kevevis® spend and certain other savings. As a percentage of net sales, SMG&A remained flat at 9.7%.

**Settlements and Loss Contingencies.** Settlements and loss contingencies expense was \$0 million in the year ended March 31, 2017, compared to an expense of \$1.0 million in 2016 primarily due to the Utah AWP settlement.

**Operating Income.** In the year ended March 31, 2017, the Company had operating income of \$515.0 million compared to \$614.5 million in the same period in 2016, a decrease of \$99.5 million. This decrease is primarily attributed to the decrease in gross profit, which is partially offset by lower SMG&A expenses. Operating income, as a percentage of sales, decreased to 58.6% in the year ended March 31, 2017 from 64.6% in the same period in 2016.

**Financial Income, Net.** Financial income, net results principally from interest income and the impact of foreign currency exchange rate fluctuations. Net financial income was \$34.6 million in the year ended March 31, 2017, compared to \$19.7 million for the year ended March 31, 2016, an increase of \$15.0 million, or 76.1%. The change in financial income, net from 2016 to 2017 reflects the favorable impact of the change in foreign currency exchange rates related primarily to the cash and cash equivalents, short-term bank deposits and intercompany balances in Canada. This is principally driven by the strengthening of the U.S. dollar compared to the CAD at a slightly lower rate compared to the prior year.

**Taxes.** Tax expense in the year ended March 31, 2017 was \$103.8 million, compared to \$95.3 million in the same period in 2016, an increase of \$8.5 million. The effective tax rate increased 3.5% mainly due to the recognition of \$36.0 million of tax loss carry-forwards and investment tax credits resulting from the acquisition of Zalicus in 2016. As of March 31, 2017, we had carryforward tax losses of \$11.1 million in the United Kingdom, \$18.6 million in Canada, and \$67.2 million in Ireland.

**Net Income attributable to Taro.** Net income decreased \$84.6 million to \$456.4 million for the year ended March 31, 2017, from \$540.9 million in the prior year, by reason of the factors noted above.

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

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

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

Period ended	Rate of (Deflation) Inflation		Rate of (Appreciation) Devaluation Against U.S. Dollar		Rate of Exchange of U.S. Dollar	
	Israel (1)	Canada (2)	Israel (1)	Canada (2)	Israel (1)	Canada (2)
3/31/2016	(0.71%)	1.27%	(5.28%)	2.36%	3.77	1.30
3/31/2017	0.92%	1.56%	(3.71%)	2.31%	3.63	1.33
3/31/2018	0.20%	2.31%	(3.31%)	(3.01%)	3.51	1.29

(1) Bank of Israel.

(2) Bank of Canada for periods ended March 31, 2016 and 2017. Bloomberg L.P. for period ended March 31, 2018.

## B. LIQUIDITY AND CAPITAL RESOURCES

Cash, including short-term deposits, and short-term marketable securities, increased \$35.9 million from March 31, 2017 to \$1,422.6 million at March 31, 2018. Total shareholders' equity increased from \$2,073.8 million at March 31, 2017 to \$2,210.4 million at March 31, 2018.

On December 23, 2013, the Company completed a modified "Dutch auction" tender offer through which the Company repurchased 1,959,514 ordinary shares at a price of \$97.50 per share, for an aggregate purchase price of \$193.0 million (including fees and expenses related to the tender offer).

On March 15, 2016, the Company announced that its Board of Directors approved a \$250 million share repurchase of ordinary shares, which was completed on August 18, 2016. Under the program, the Company bought back 1,801,099 of its ordinary shares in open market transactions, in accordance with a 10b5-1 program, at an average price of \$138.80 per share.

On November 23, 2016, the Company announced that its Board of Directors authorized a new \$250 million share repurchase of ordinary shares. Repurchases may be made from time to time at the Company's discretion, based on ongoing assessments of the capital needs of the business, the market price of its stock, and general market conditions. No time period was set for the repurchase program, and any such program may be suspended or discontinued at any time. The repurchase authorization enables the Company to purchase its ordinary shares from time to time through open market purchases, negotiated transactions or other means, including 10b5-1 trading plans in accordance with applicable securities laws or other restrictions. On November 7, 2017, the Board extended the share repurchase program for one year. During the year ended March 31, 2018, the Company repurchased 1,085,694 shares through the current program at an average price of \$102.52. Through May 31, 2018, in total under the authorization, the Company has repurchased 1,806,984 shares at an average price of \$102.86, leaving \$64.1 million remaining under the current board authorization.

Net cash provided by operating activities for the year ended March 31, 2018 was \$323.7 million, compared to \$437.5 million, in the year ended March 31, 2017, a decrease of \$113.8 million. For the year ended March 31, 2018, the Company had net cash used in investing activities of \$241.6 million compared to \$117.8 million for the year ended March 31, 2017. For the year ended March 31, 2018, the Company had net cash used in financing activities of \$107.0 million compared to \$294.9 million for the year ended March 31, 2017.

The change in our liquidity for the year ended March 31, 2018 resulted from a number of factors, including:

- Net cash provided by operating activities consists primarily of net income of \$210.1 million, in addition to deferred income taxes, net of \$56.0 million, foreign exchange effect of marketable securities and bank deposits of \$25.5 million, depreciation and amortization of \$16.5 million, decrease in income tax receivable of \$10.6 million, effect of exchange differences on intercompany balances of \$9.5 million, and an increase in trade payables of \$9.0 million. This was offset by a decrease in other accounts payable and accrued expenses of \$11.8 million.
- Net cash used in investing activities consists of investment in marketable securities, net of \$770.5 million and purchase of property, plant, and equipment of \$26.9 million. This was offset by proceeds from long term deposits and other assets of \$396.3 million, and proceeds from short term bank deposits, net of \$161.0 million.
- Net cash used in financing activities consists of purchase of treasury stock for \$107.0 million in accordance with our repurchase program.

## **Debt**

As of March 31, 2018, the Company did not have any debt outstanding.

During the year ended March 31, 2018, we did not incur any additional indebtedness, including increases in our borrowing capacity under any refinancing.

## **Liquidity**

On March 31, 2018, we had total cash and cash equivalents, short-term bank deposits, and short-term marketable securities of \$1.4 billion and no indebtedness. We expect that existing cash resources and cash from operations will be sufficient to finance our foreseeable working capital requirements. None of our cash and cash equivalents is held captive by any financial covenants or government regulation. As of March 31, 2018 and 2017, we had no commitment for capital expenditures which we consider to be material to our consolidated financial position. The Company had no available and undrawn credit facilities in place at March 31, 2018.

## **Capital Expenditures**

We invested \$26.9 million in capital equipment and facilities in the year ended March 31, 2018 and \$35.8 million in the year ended March 31, 2017. These investments are principally related to our pharmaceutical and chemical manufacturing facilities, expanding and upgrading our research and development laboratories in Israel and Canada, expanding our serialization capabilities, and maintaining compliance with cGMPs. In addition to facility-related investments, we acquired certain research and development, manufacturing, and packaging equipment to increase production capacity. We also continued to upgrade our information systems infrastructure to enable more efficient production scheduling and enhanced inventory analysis. (See Note 7 to our consolidated financial statements included in this 2018 Annual Report.)

## **C. RESEARCH AND DEVELOPMENT, PATENTS, TRADEMARKS AND LICENSES**

We believe that our research and development activities have been a principal contributor to our achievements to date and that our future performance will depend, to a significant extent, upon the results of these activities.

Recruiting talented scientists is essential to the success of our research and development programs. Approximately 15% of our employees work in our worldwide research and development programs.

We currently conduct research and development in three principal areas:

- generic pharmaceuticals, where our programs have resulted in our developing and introducing a wide range of pharmaceutical products (including tablets, sachets, capsules, suspensions, solutions, syrups, sprays, foams, creams, ointments and gels) that are equivalent to numerous brand-name products whose patents and FDA exclusivity periods have expired or been challenged under the Hatch-Waxman Act;
- proprietary pharmaceuticals; and
- organic and steroid chemistry, where our programs have enabled us to synthesize the active ingredients used in many of our products.

For the years ended March 31, 2018, 2017 and 2016, we spent \$70.4 million, \$70.6 million and \$71.2 million on research and development activities. We estimate that research and development expenses were allocated 70% to generic pharmaceuticals, 20% to proprietary pharmaceuticals and delivery systems and 10% to organic and steroid chemistry for the year ended March 31, 2018.

## Pharmaceutical Products

In the year ended March 31, 2018, we received 12 ANDA approvals. As of March 31, 2018 we have 4 tentatively approved products developed/manufactured in Canada and Israel. The following table sets forth the final approvals received in the United States from the FDA from April 1, 2017 through March 31, 2018, and tentative approvals as of March 31, 2018:

### FINAL NDA/ANDA APPROVALS

	Brand Name
Betamethasone Valerate Topical Foam 0.12%	Luxiq®
Tazarotene Topical Cream 0.1%	Tazorac®
Felbamate Tablets 400mg, 600mg	Felbatol®
Felbamate Oral Suspension 600mg/5mL	Felbatol®
Ibuprofen Oral Suspension USP, 100 mg/5mL (Rx)	Ibuprofen, Actavis
Ibuprofen Oral Suspension USP, 100 mg/5 mL (OTC)	Motrin®
Dapsone Topical Gel, 5%	Aczon®
Fexofenadine HCl Oral Suspension 30mg/5mL	Allegra®
Butenafine Hydrochloride Cream, 1%	Lotrimin®
Adapalene and Benzoyl Peroxide Gel 0.1%/2.5%	Epiduo®
Clindamycin Phosphate and Benzoyl Peroxide Gel, 1.2%/5%	Duac®
Clobetasol Propionate Topical Spray 0.05%	Clobex®

### TENTATIVE ANDA APPROVALS

Adapalene and Benzoyl Peroxide Gel 0.3%/2.5%*	Epiduo Forte®
Deferiprone Tablets, 500 mg*	Deferiprox®
Clindamycin Phosphate and Benzoyl Peroxide Gel 1.2%;3.75%	Onexton®
Diclofenac Sodium Topical Solution 2%	Pennsaid®

\*Indicates tentative approval received during the year ended March 31, 2018.

As of March 31, 2018, 28 of our ANDAs, not including the tentative approvals listed above, were being reviewed by the FDA. In addition, there are multiple products for which either developmental or internal regulatory work is in process. The applications pending before the FDA are at various stages in the review process, and there can be no assurance that we will be able to successfully complete any remaining testing or that, upon completion of such testing, approvals for any of the applications currently under review at the FDA will be granted. In addition, there can be no assurance that the FDA will not grant approvals for competing products.

## Patents, Trademarks and Licenses

We have filed and received patents, and obtained licenses in the United States and other countries for a variety of products, processes, formulations, syntheses, and methods of treatment.

We do not believe that any single patent is of material importance to us in relation to our current commercial activities.

We have registered trademarks in the United States, Canada and other countries. Taro U.S.A. typically does not use trademarks in the sale and marketing of its generic multi-source non-innovator products.

From time to time, we seek to develop products for sale in various countries prior to patent expiration. In the United States, in order to obtain a final approval for a generic product prior to expiration of certain innovator's patents, we must, under the terms of the Hatch-Waxman Act, as amended by the Medicare Prescription Drug Improvement and Modernization Act of 2003, notify the patent holder as well as the owner of an NDA, that we believe that the patents listed in the Orange Book for the new drug are either invalid or not infringed by our product. To the extent that we seek to utilize this mechanism to obtain approval to sell products, we are involved and expect to be involved in patent litigation regarding the validity, enforceability or infringement of patents listed in the Orange Book, as well as other patents, for a particular product for which we have sought approval. We may also be involved in patent litigation with third parties to the extent that claims are made that our finished product, an ingredient in our product or our manufacturing process, may infringe the innovator's or third party's process patents. We may also become involved in patent litigation in other countries where we conduct business, including Israel, Canada and various countries in Europe. From time to time, we may settle such litigations and obtain licenses to the asserted patents that allow us to market our products.

#### D. TREND INFORMATION

See Item 4—"Information on the Company" and Item 5—"Operating and Financial Review and Prospects" for trend information.

#### E. OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

#### F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table describes the payment schedules of our contractual obligations as of March 31, 2018:

Type of Contractual Obligation	Payments due by period (in millions)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations	\$ 2.80	\$ 1.78	\$ 0.95	\$ 0.07	\$ —
Other Long-term liabilities (1)	3.83	0.24	1.27	0.97	1.35
Total	<u>\$ 6.63</u>	<u>\$ 2.02</u>	<u>\$ 2.22</u>	<u>\$ 1.04</u>	<u>\$ 1.35</u>

(1) Includes deferred revenue, severance commitments, and other.



**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. DIRECTORS AND SENIOR MANAGEMENT**

The following table lists our directors and executive officers as of March 31, 2018:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Dilip Shanghvi	62	Director and Chairman of the Board
Abhay Gandhi	53	Director and Vice Chairman of the Board
Sudhir Valia	61	Director
Uday Baldota	48	Director and Chief Executive Officer
Linda Benshoshan	52	Director and Chairwoman of the Audit Committee
Elli Streit	77	Director
Dov Pekelman	78	Director and Chairman of the Social Responsibility Committee
James Kedrowski	66	Director
Mariano Balaguer	45	Vice President, Chief Financial Officer and Chief Accounting Officer
Stephen Manzano, Esq.	53	Group Vice President, General Counsel, Secretary & Corporate Compliance
Avi Avramoff, Ph.D.	53	Global Vice President, Research and Development
Itamar Karsenti	46	Vice President, Head of Operations
Michele Visosky	52	Group Vice President, Human Resources
Chantal LeBlanc	55	Vice President, Global Quality
Ara Aprahamian R.Ph.	50	Vice President, Sales and Marketing
Richard Glaze	52	Vice President, Information Technology

**Certain Familial Relationships**

Mr. Sudhir Valia is a brother-in-law of Mr. Dilip Shanghvi. Mr. Dilip Shanghvi is the beneficial majority owner of Sun.

**Business Experience**

**Dilip Shanghvi** became the Chairman of the Taro Board in August 2013, after previously serving as Director and Chairman from September 2010 to April 2012. He is the founder and Managing Director of Sun Pharma and has extensive industrial experience in the pharmaceutical industry. A first generation entrepreneur, Mr. Shanghvi has won numerous awards and recognitions, including the 2017 Entrepreneur of the Year Award from AIMA (All India Management Association), the 2016 PADMA SHRI (Fourth Highest Civilian Award in the Republic of India) from the Government of India and the 2016 NDTV Business Leadership Award (Pharmaceutical), as well as various other awards including, the Forbes Entrepreneur of the Year award in 2014, Outstanding Business Leader of the Year from CNBC TV18 in 2014, the Economic Times' Business Leader of the Year Award in 2014, the JRD TATA Corporate Leadership Award AIMA (All India Association) in 2014, CNN IBN's Indian of the Year (Business) in 2012, Business India's Businessman of the Year in 2012 and Ernst and Young's World Entrepreneur of the Year in 2011. He has also been awarded the Entrepreneur of the Year, Ernst and Young in 2010, CNBC TV 18's First Generation Entrepreneur of the Year in 2007 and Entrepreneur of the Year (Healthcare and Life Sciences), Ernst and Young in 2005. Mr. Shanghvi is a Director of various companies, including Shantilal Shanghvi Foundation and is also the Chairman and Managing Director of Sun Pharma Advanced Research Company Ltd.

**Abhay Gandhi** became a Director in December 2016 and Vice Chairman of the Taro Board in February 2017. Mr. Gandhi has served as Chief Executive Officer of Sun Pharmaceutical Industries, Inc. (“Sun Pharmaceuticals”) since November 2016. Mr. Gandhi also served as Interim Chief Executive Officer of Taro from November 2017 until Mr. Uday Baldota’s assumption of these duties in August 2017. Prior to joining Sun Pharmaceuticals, Mr. Gandhi served as a Director starting in November 2014, and as the CEO – India Subcontinent, of Sun Pharmaceutical Laboratories Ltd. (“SPLL”) starting in November 2013, where he was responsible for domestic operations of the business as well as certain international markets, including sales & marketing, integration efforts, business development, portfolio management and other allied functions. Prior to that appointment, Mr. Gandhi was President – India Subcontinent of SPLL from March 2012 to November 2013, Executive Vice President – International Marketing from April 2007 to March 2012 and has served in various other positions within the Sun Pharma organization for over 20 years. Prior to joining Sun Pharma, Mr. Gandhi held positions at Boehringer Mannheim GmbH, and Nestle India Ltd. From 2013 to 2015, he was a Member of the Executive Committee of the Indian Drug Manufacturers Association (IDMA) and a Member of the Confederation of Indian Industry (CII) National Committee on Drugs and Pharmaceuticals from 2013 to 2014. Mr. Gandhi holds a Bachelor of Science and a Masters in Marketing Management from the University of Mumbai, and a Diploma in Business Management from the Institute of Chartered Financial Analysts of India (ICFAI University).

**Sudhir Valia** became a member of the Taro Board in September 2010. Mr. Valia joined Sun Pharma as a director in January 1994 and has been a full-time director since his appointment in April 1994. Mr. Valia is the recipient of the CNBC TV 18’s CFO Awards for best performing CFO in the Pharma/Healthcare sector in 2012, 2009 and 2006. He also received the “Adivasi Sevak Puraskar” award from the Government of Maharashtra in 2008-2009. Prior to joining Sun Pharma, Mr. Valia was a chartered accountant in private practice. Mr. Valia is a Director of various companies, including Shantilal Shanghvi Foundation and Sun Pharma Advanced Research Company Ltd. Mr. Valia is a qualified chartered accountant in India.

**Uday Baldota** became a member of the Taro Board in December 2016 and assumed the role of Chief Executive Officer in August 2017. He continues as a member of the global Core Management Team of Sun Pharma. Mr. Baldota was formerly Executive Vice President & Chief Financial Officer of Sun Pharma. He led their global Finance function from June 2012 and was designated as the Chief Financial Officer in August 2014. From June 2005 to May 2012, Mr. Baldota served in various leadership positions as a Vice President and later Senior Vice President reporting to the Chairman and Managing Director of Sun Pharma. Mr. Baldota’s areas of responsibility over his tenure at Sun Pharma have included accounting, M&A, business finance, tax, treasury, insurance, controllership, legal, corporate secretarial, corporate communication and internal audit. Mr. Baldota was the Vice President Purchasing of Lafarge India Limited from March 2003 to June 2005 and served as its Head of Information Technology from November 1999 to March 2003. Prior to that, Mr. Baldota served in various IT and marketing roles with Sun Pharma between May 1995 and November 1999. Mr. Baldota earned a Bachelor of Technology in Chemical Engineering from Indian Institute of Technology, Delhi, and a Masters of Business Administration from the Indian Institute of Management, Ahmedabad.

**Linda Benshoshan** became a member of the Taro Board in December 2016 and serves as the Chairwoman of the Audit Committee and is a member of the Compensation Committee. She served as a member of the board of Israel Discount Bank from November 2014 until May 2017. Mrs. Benshoshan has been a partner at FORMA Real Estate Funds since November 2016 and a board member of Energix Renewable Energies Ltd. (TASE: ENRG). Over the last five years, Mrs. Benshoshan has served in various capacities within the finance and academic sphere, including, as a member of the advisory board at ALTO Real Estate Funds; a member on the board and Chairwoman of the marketing committee at Tel-Aviv Stock Exchange Ltd; CEO of Aluminum Construction Pro Ltd; an External Director and Chairwoman of the investments committee at ‘Rom’ and ‘Agur’ Study Funds; and a member on the board of Aloni-Hetz Properties and Investments Ltd. Mrs. Benshoshan holds a B.A. in Economics and Sociology and an M.B.A. in Finance and Banking, from the Hebrew University of Jerusalem.

**Elhanan (Elli) Streit** became a member of the Taro Board in December 2016 and is a member of the Audit Committee and Compensation Committee. He has served as a member of the Board of Governors of Tel Aviv University since 2000. From August 2007 to August 2014, Mr. Streit served on the board of directors of ITGI Medical Ltd. and served on the board of directors of Medigus Ltd. from July 2007 to May 2013. He served a six year tenure from 2001 to 2007 on the board of NCR Global Ltd. (formerly Retalix Ltd), including as Chairman of the audit committee. Mr. Streit has over 30 years of experience in multinational business development, corporate finance, private equity, international trade and transfer of technologies and provides investment banking advisory services to companies primarily in the health care sector, and provides advice on capital raisings, licensing of intellectual property and strategic partnerships to established and growing companies. Notably, Mr. Streit was appointed to Managing Director of Yeda Research and Development Company Ltd., the commercial arm of the Weizmann Institute of Science, where he served nearly five years, starting in 1982. Mr. Streit earned a Bachelor of Arts degree in economics and political science from the Hebrew University of Jerusalem and a Master of Business Administration in finance and marketing from the University of Pennsylvania—the Wharton School.

**Dov Pekelman** became a member of the Taro Board and Audit Committee in August 2011, Chairman of the Special Committee in November 2011 (disbanded in February 2013), the Stock Option Committee in March 2012 (disbanded in January 2015) and the Compensation Committee in February 2013. Professor Pekelman is currently a major shareholder of Atera Networks Ltd. and a board member of Mapi Pharma, Ltd. He serves as Dean of the Business School at the Interdisciplinary Center (IDC), Herzliya, Israel, and is Chairman of the IDC Corporation, the center's economic arm. Professor Pekelman served as a senior consultant to Teva Pharmaceutical Industries Ltd. (NASDAQ: TEVA) from 1985 to 2008 and also founded and ran a leading, Israeli-based management-consulting firm, P.O.C. Ltd. Professor Pekelman served on the Board of Directors of several large industrial corporations, including Enzymotec (NASDAQ: ENZY), Koor Industries Ltd. (TASE: KOR) and served for 22 years on the Board of Directors of Makhteshim Agan Industries Ltd. (TASE: MAIN). Professor Pekelman was also a member of the advisory committee of the Bank of Israel. He holds a Ph.D. from the University of Chicago and a B.S. from the Technion, Israeli Institute of Technology. Professor Pekelman is a published author writing on various aspects of business operations.

**James Kedrowski** became a member of the Taro Board in May 2011. In addition, Mr. Kedrowski served as the Company's Interim Chief Executive Officer from October 2010 until August 2013. Mr. Kedrowski was with Chattem Chemicals, Inc., an indirect subsidiary of Sun Pharma since 1997 and served as its President. Mr. Kedrowski's prior experience includes over 20 years with Alcoa Inc., starting in sales, then purchasing roles culminating as senior purchasing agent for all chemicals, energy, and carbon. Subsequently, Mr. Kedrowski was in progressive P&L business management positions in the United States before heading to Tokyo for four years of international experience running Alcoa's Industrial Chemicals business in Asia. Mr. Kedrowski then returned to the United States as Operational Vice President for seven North American Industrial Chemicals plants.

**Mariano Balaguer** became Chief Financial Officer, Chief Accounting Officer and Finance Vice President of the Company in October 2016. Mr. Balaguer has nearly 20 years of global professional finance and management experience. Before joining Taro, Mr. Balaguer was Vice President, CFO for the Global Strategic Portfolio Division at Henry Schein, a worldwide distributor of medical, dental and veterinary supplies including vaccines, pharmaceuticals, financial services and equipment. Mr. Balaguer's prior experience includes, serving as Vice President, CFO North America for Novartis Consumer Health providing support to the U.S., Canada and Puerto Rico businesses and prior to that as VP, Global Head of Business Planning and Analysis for the Consumer Health division. Preceding Novartis until 2010, Mr. Balaguer worked in several divisions of Nestle in the U.S., Italy, France and Argentina for over 10 years with his last two years serving as Global Finance Head Performance Nutrition Division. Mr. Balaguer earned a Bachelor's Degree in Economics from the Universidad Nacional de Cuyo, Argentina and an MBA from New York University Stern School of Business.

**Stephen Manzano, Esq.** became Group Vice President, General Counsel, Secretary & Corporate Compliance in August 2014. In addition to his secretarial duties, he is responsible for the legal affairs of Taro, and leading Taro's emphasis on fulfilling its corporate compliance responsibilities. Mr. Manzano had been Interim General Counsel, Secretary and VP of Compliance since 2012 and, prior to that, VP, Corporate Affairs, Secretary and Associate General Counsel of Taro U.S.A. since September 2010, after joining Taro in September 2008 as Associate General Counsel of Taro U.S.A. Prior to joining Taro, Mr. Manzano was in private practice since 1992, which included being a partner at Kennedy Covington and beginning his legal career as an associate at Dewey Ballantine.

**Avi Avramoff, Ph.D.** joined our Company in October 2011 as Global Vice President, Research & Development. He is responsible for the Company's generic and innovative new product development, the management of the R&D Pharma and Chemistry, R&D Analytical Laboratories, Preclinical, Pharmacokinetic and Clinical Studies, Regulatory Affairs, R&D Project Management and Pharmacovigilance in all of Taros' sites. In addition, he is involved in the new product introduction process from selection to launch and Portfolio Management. He has penned various publications and abstracts in the field of pharmacy, as well as several patents and patent applications. Prior to joining our Company, Dr. Avramoff worked as Vice President, Research & Development at Dexcel Pharma.

**Itamar Karsenti** joined our Company in December 2014 and currently serves as Vice President, Head of Operations. Mr. Karsenti is the operations lead for our Israeli and Canadian manufacturing facilities. He is responsible for Pharma and API Manufacturing, Supply Chain Management, Engineering and Environmental Health and Safety (EH&S). Mr. Karsenti also provides leadership oversight on sales and marketing, human resources, IT and finance. Prior to joining Taro, Mr. Karsenti worked for Teva Pharmaceutical Industries Ltd. since 2002, where he served as Executive Director, Jerusalem OSD site manager.

**Michele Visosky** joined our Company in January 2004 in the Human Resources department. She is currently Group Vice President, Human Resources and heads the department in Canada, Israel and the United States. Ms. Visosky has over 26 years of human resources experience, the majority of which were spent in management level roles. Prior to joining Taro, Ms. Visosky worked at Micro Warehouse, Inc. and PricewaterhouseCoopers LLP, holding progressively responsible human resources positions, with the last one as Senior Vice President, Human Resources.

**Chantal LeBlanc** joined our Company in August 2014 and currently serves as Vice President, Global Quality. Ms. LeBlanc is responsible for the Quality and cGMP compliance activities at our Canada and Israel manufacturing locations as well as our operations in the United States. Ms. LeBlanc has 33 years of experience in the biotechnology and pharmaceutical industries. Prior to joining Taro, Ms. LeBlanc was the Global Quality Director of GSK Vaccines in Belgium from 2007 to 2014. Prior to GSK, Ms. LeBlanc was a Quality/Compliance expert for 10 years. Ms. LeBlanc started her career as a Quality site Director for Kempac- Polylab Inc. then Pharmascience Inc. in Montreal for a cumulative of 12 years. Ms. LeBlanc qualified as a Health Canada field inspector in 2001.

**Ara Aprahamian, R.Ph.** joined our company in March 2013 as Vice President of Sales & Marketing for the U.S. market, and he has oversight of the Sales, Pricing and Contracts, Analytics and Portfolio teams. Mr. Aprahamian has over 26 years of experience in the pharmaceutical industry. Prior to joining Taro, Mr. Aprahamian held positions with pharmaceutical manufacturers and distributors in pricing, contracts, purchasing, and operations with companies such as Actavis and AmeisourceBergen. He is a licensed Pharmacist in New York and New Jersey.

**Richard (“Rich”) Glaze** joined our company in June 2016 as Vice President, Information Technology. Mr. Glaze is responsible for overseeing the development and maintenance of a secure Information Technology environment as well as leading innovative IT programs to enable the company’s strategic business vision. He has over 25 years of global professional IT experience. Most recently, Rich served as the Vice President and Head of IT for the Critical Care Division of Mallinckrodt Pharmaceuticals Inc. (Ikaria). Prior to Mallinckrodt, he held senior IT leadership roles at Hospira, a large global generics pharmaceutical concern and at Johnson & Johnson where he held a number of IT assignments during his ten-year tenure there. Rich began his IT career in consulting and worked at Accenture, IBM, as well as Bearing Point LLP. Rich holds a Bachelor of Science degree in Engineering from Princeton University, and an MBA from New York University Stern School of Business.

## **B. COMPENSATION**

Our directors are paid NIS 148,575 per year for their service as directors and NIS 5,715 for each board and committee meeting they attend, linked to the Israeli CPI, for their service as directors. Dilip Shanghvi and Sudhir Valia earned approximately \$1.8 million and \$1.2 million per year, respectively, for their service in addition to their duties as directors. During the year ended March 31, 2018, Mr. Dov Pekelman received an annual fee of NIS 244,725 due to his role in the establishment of a Social Responsibility Committee. The compensation for our statutory external directors, as defined under Israeli law, is not in excess of the amounts set forth in the Israeli Companies Law and regulations promulgated thereunder.

We incurred an aggregate of approximately \$7.4 million in compensation expenses paid to all of our then current directors and executive officers for services rendered to us in all capacities during the year ended March 31, 2018. In addition, approximately \$0.2 million was set aside in fiscal 2018 to provide certain executive officers and directors with pension, retirement or similar benefits. During the year ended March 31, 2018, the Company’s executive officers and directors did not receive any options to purchase Taro’s ordinary shares.

As of March 31, 2018, the Company’s executive officers and directors held no options to purchase ordinary shares.

## **C. BOARD PRACTICES**

We are incorporated in Israel and, therefore, we are subject to the provisions of the Israeli Companies Law, in addition to the relevant provisions of U.S. laws.

### **Board of Directors**

Under the Israeli Companies Law, the Board sets the policy of a company and supervises the general manager (i.e., the chief executive officer) of a company in the performance of his or her role. The Board has residual powers so that it may exercise any power of the company not granted to any other body either by law or by our Articles of Association. According to our Articles of Association, as part of its powers, our Board may cause us to borrow or secure payments of any sum or sums of money for our purposes, at times and upon conditions as it thinks fit, including the grant of security interests on all or any part of our property.

Under our Articles of Association, our Board may consist of between 5 and 25 directors.

Our directors, other than our statutory external directors, are elected at annual general meetings of our shareholders, which are required to be held at least once during every calendar year and not more than 15 months after the last preceding meeting. Directors may also be appointed to fill vacancies, or may be appointed to serve as additional members of the Board, by an ordinary resolution passed at an extraordinary general meeting of our shareholders. Likewise, in the event of a vacancy, the Board is empowered to appoint a director to fill such vacancy until the next annual general meeting of shareholders. A director, other than a statutory external director, holds office until the next annual general meeting, unless such directorship is earlier vacated in accordance with the provisions of any applicable law or regulation or under our Articles of Association.

Under the Israeli Companies Law, nominations for directors may be made by any shareholder holding at least 1% of our outstanding voting power. However, any such shareholder may make such a nomination only if a written notice of such shareholder's intent to make such nomination has been given to our company. Any such notice must include certain information, the consent of the proposed director nominee(s) to serve as our director(s) if elected and a declaration signed by the nominee(s) declaring that they have the required skills and availability to carry out their duties and providing details of such skills and that there is no limitation under the Israeli Companies Law preventing their election and that all of the information that is required to be provided to us in connection with such election under the Israeli Companies Law has been provided.

We do not have any service contracts with any of our directors that would provide for benefits upon termination of employment.

Our Board currently consists of eight directors. The following members of our Board have been determined to be independent within the meaning of applicable NYSE regulations: Linda Benshoshan, Elli Streit and Dov Pekelman.

Under the Israeli Companies Law, the board of directors of a public company must hold at least one meeting every three months.

## **Statutory External Directors**

### ***Qualifications of Statutory External Directors***

Under the Israeli Companies Law, companies incorporated under the laws of the State of Israel whose shares, *inter alia*, are listed for trading on a stock exchange or have been offered to the public by a prospectus and are held by the public, are required to have at least two statutory external directors. The Israeli Companies Law provides that a person may not be elected as a statutory external director if the person is a relative of a controlling shareholder and/or the person or the person's relative (as defined below), partner, employer, anyone to whom the person is subordinate, directly or indirectly, or any entity under the person's control has, as of the date of the person's election to serve as a statutory external director, or had, during the two years preceding that date, any affiliation (as defined below) with:

- our company;
- any entity controlling our company or relative thereof as of the date of the election; or
- any entity controlled by our company or under common control with our company as of the date of the election or during the two years preceding that date.

Under the Israeli Companies Law, "relative" is defined as a spouse, brother or sister, parent, grandparent, child and a child/brother/sister/parent of such person's spouse or the spouse of any of the preceding.

The term "affiliation" includes an employment relationship, a business or professional relationship even if not maintained on a regular basis (but excluding insignificant relationships), or control of the company, and service as an office holder (as defined below).

The Israeli Companies Law defines the term "office holder" as general manager (i.e., chief executive officer), chief business manager, deputy general manager, vice general manager, any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title, and any director or manager that reports directly to the general manager.

The Israeli Companies Law provides that no person can serve as a statutory external director if the person's other positions or other business creates, or may create, a conflict of interest with the person's responsibilities as a statutory external director or may otherwise interfere with the person's ability to serve as a statutory external director, or if the person is an employee of the Israel Securities Authority or of an Israeli stock exchange. Until the lapse of two years from termination of office as statutory external director, a company, its controlling shareholder and any entity controlled by the controlling shareholder, may not grant a former statutory external director, his/her spouse or child any benefits, directly or indirectly, including engaging the former statutory external director, his/her spouse or child to serve as an office holder in the company or in any company controlled by the controlling shareholder of the company and cannot employ or receive professional services from that person for consideration, either directly or indirectly, including through a corporation controlled by such former statutory external director. The same shall apply to a relative, who is not a former statutory external director's spouse or child, for a period of one year from termination of office as statutory external director.

A person shall be qualified to serve as a statutory external director only if he or she possesses accounting and financial expertise or professional competence, as defined in the regulations promulgated under the Israeli Companies Law. At least one statutory external director must possess accounting and financial expertise.

The Israeli Companies Law also provides that a shareholders' general meeting at which the appointment of a statutory external director is to be considered will not be called unless the nominee has declared to the company that he or she complies with the qualifications for appointment as a statutory external director.

### ***Election of Statutory External Directors***

The Israeli Companies Law provides that statutory external directors must be elected by a majority vote at a shareholders' meeting, provided that either:

- the majority includes the majority of the total votes of non-controlling shareholders (as defined in the Israeli Companies Law) who do not have a personal interest in the election of the subject external director, other than a personal interest that is not derived from a relationship with a controlling shareholder in such election present at the meeting in person or by proxy (abstentions are not taken into account); or
- the total number of votes against the election of the statutory external director by the non-controlling disinterested shareholders (as described in the previous bullet point) may not exceed two percent of the aggregate voting rights in the company.

For purposes of determining a controlling shareholder, Section 1 of the Israeli Companies Law defines "control" by reference to the definition of the Israeli Securities Law, 5728-1968 (the "Securities Law"), which defines "control" as "the ability to direct the activity of a corporation, excluding an ability deriving merely from holding an office of director or another office in the corporation, and a person shall be presumed to control a corporation if he or she holds half or more of a certain type of means of control of the corporation." "Means of control" in Section 1 of the Securities Law is defined as "any one of the following: (1) the right to vote at a general meeting of a company or a corresponding body of another corporation; or (2) the right to appoint directors of the corporation or its general manager."

The definition of "personal interest" under the Israeli Companies Law is provided in *Item 10.B below*, under "*Approval of Specified Related Party Transactions Under Israeli Law and Our Articles of Association—Disclosure of Personal Interest of an Office Holder.*"

The initial term of a statutory external director is three years and may be extended for two consecutive terms of three years each, provided that either (i) his or her service for each such additional term is recommended by one or more shareholders holding at least one percent (1%) of the company's voting rights and is approved by a majority at a shareholders meeting, which majority must include either of the criteria described above with respect to his or her initial election; or (ii) his or her service for each such additional term is recommended by the board of directors and is approved by a majority at a shareholders meeting, which majority must include either of the criteria described above with respect to his or her initial election. In accordance with the regulations under the Israeli Companies Law, companies whose securities are listed on one of a number of non-Israeli stock exchanges (including the NYSE, where our ordinary shares are listed) may re-appoint an external director for additional three-year terms, in excess of the nine years described above, if the audit committee and the board of directors confirm that, due to the expertise and special contribution of the external director to the work of the board and its committees, his or her re-appointment is in the best interests of the company. The same special majority is required for election of the statutory external director for each additional three-year term (as was required for the initial term), with the additional requirement that the arguments of the board of directors and audit committee in favor of election for such additional term, and the number of terms already served by the external director, be presented to the general meeting prior to the vote.

Statutory external directors may be removed from office only by the same percentage of votes as is required for election or by a court, if the statutory external director ceases to meet the statutory qualifications for his or her appointment or if he or she violates his or her duty of loyalty to the company.

If an external directorship becomes vacant and there are fewer than two external directors on the board of directors at the time, then the board of directors is required under the Israeli Companies Law to call a shareholders' meeting immediately to appoint a replacement external director.

Each committee of a company's board of directors that is empowered to exercise one of the functions of the board of directors is required to include at least one statutory external director, except for the Audit Committee and Compensation Committee, which are required to include all of the statutory external directors.

A statutory external director is entitled to compensation determined by the board within the scope provided in regulations adopted under the Israeli Companies Law.

Linda Benshoshan and Elli Streit currently serve as statutory external directors on the Company's Board. Our Board has determined that Linda Benshoshan possesses accounting and financial expertise, whereas Elli Streit possesses professional competence, as required of our statutory external directors under the Israeli Companies Law.

### ***Exemption from Statutory External Director Requirement***

Under regulations promulgated under the Israeli Companies Law, Israeli public companies whose shares are traded on certain U.S. stock exchanges, such as the NYSE, that lack a controlling shareholder (as defined under the Israeli Companies Law) are exempt from the requirement to appoint statutory external directors. Any such company is also exempt from the Israeli Companies Law requirements related to the composition of the audit and compensation committees of the Board. Eligibility for these exemptions is conditioned on compliance with U.S. stock exchange listing rules related to majority Board independence and the composition of the audit and compensation committees of the Board, as applicable to all listed domestic U.S. companies. Because we have a controlling shareholder (Sun), we are not eligible for these new exemptions.

### **Qualifications of Directors Generally Under the Israeli Companies Law**

Under the Israeli Companies Law, the board of directors of a publicly traded company is required to make a determination as to the minimum number of directors (not merely statutory external directors) who must have accounting and financial expertise (according to the same criteria described above with respect to statutory external directors). In accordance with the Israeli Companies Law, the determination of the board should be based on, among other things, the type of the company, its size, the volume and complexity of its activities and the number of directors. Based on the foregoing considerations, our Board of Directors determined that the number of directors with accounting and financial expertise in our company shall not be less than one. As described above, currently Linda Benshoshan has been determined by the board to possess such accounting and financial expertise.

### **Unaffiliated Directors Under the Israeli Companies Law**

Under the Israeli Companies Law, the audit committee of a publicly traded company must consist of a majority of unaffiliated directors. An "unaffiliated director" is defined as a statutory external director or a director who meets the following criteria:

- he or she meets the qualifications for being appointed as a statutory external director, as approved by the audit committee, except for (i) the requirement that the director be an Israeli resident (in the case of a company such as ours whose securities have been offered outside of Israel or are listed outside of Israel) and (ii) the requirement for accounting and financial expertise or professional qualifications; and
- he or she has not served as a director of the company for a period exceeding nine consecutive years. For this purpose, a break of less than two years in the service shall not be deemed to interrupt the continuation of the service.

The Israeli Companies Law further provides that a company may also elect to impose, via the adoption of a proposed set of corporate governance rules, certain independence requirements with respect to the composition of the board of directors as a whole. Those requirements, if undertaken by a company, mandate that (i) if the company has no controlling shareholder or no shareholder that holds at least 25% of the company's voting rights, most of the members of the board must be unaffiliated directors, whereas (ii) if the company has a controlling shareholder or a shareholder that holds at least 25% of the voting rights, then at least one-third of the directors need to be unaffiliated directors. As of the date of this 2018 Annual Report, we have not elected to adopt these corporate governance rules.

### **Alternate Directors**

Pursuant to our Articles of Association and the Israeli Companies Law, any director may appoint, by written notice to us, any person who is not serving as a director, or as an alternate director, to serve as an alternate director and may also remove such alternate director. An alternate director possesses all of the rights and obligations of the appointing director except that the alternate, in his capacity as such, has no standing at any meeting if the appointing director is present. Unless the appointing director limits the time or scope of the appointment, it shall be effective for all purposes until the appointing director ceases to be a director or terminates the appointment. The appointment of an alternate director does not diminish the responsibility of the appointing director as a director. A statutory external director may not appoint an alternate except in certain circumstances provided by the Israeli Companies Law.

## Committees

Subject to the provisions of the Israeli Companies Law, our Board may delegate its powers to certain committees comprised exclusively of Board members. Pursuant to the Israeli Companies Law, any committee of the board of directors that is authorized to perform any function of the board (other than committees constituted solely as advisory committees), must include at least one statutory external director and the audit committee and compensation committee must be composed of at least three directors and include all statutory external directors. Our Board currently has three committees—an Audit Committee, a Compensation Committee and a Social Responsibility Committee.

### Audit Committee

Under the Israeli Companies Law and our Articles of Association, our Board is required to appoint an audit committee of at least three directors, a majority of whom must be unaffiliated directors, and which must include all statutory external directors (at least two), but excluding:

- the chairman of the board of directors and a director employed by our company, or by the company's controlling shareholder, directly or indirectly, or who provides services to any of the foregoing on a regular basis and a director whose main livelihood stems from the controlling shareholder; and
- a controlling shareholder or a relative of a controlling shareholder.

The chairman of the audit committee is required to be a statutory external director.

A person who is not qualified to serve as a member of the audit committee may not be present at the committee's meetings and at the time resolutions are adopted thereby, unless such person's participation is required in order to present to the committee a particular matter.

Currently, our Audit Committee consists of the following directors: Linda Benshoshan, Elli Streit, and Dov Pekelman, all of whom have been determined by our Board to be independent as defined by the applicable rules of the NYSE and the SEC. Linda Benshoshan and Elli Streit are statutory external directors. Linda Benshoshan is the chairwoman of our Audit Committee.

Under the Israeli Companies Law and our Audit Committee charter, our Audit Committee is responsible for (i) determining whether there are delinquencies in the business management practices of the company, including, in consultation with the company's internal auditor or the independent auditor, making recommendations to the Board to improve such practices, (ii) determining whether to approve certain related party transactions or transactions in which an office holder has a personal interest, (iii) determining standards and policies for determining whether a transaction with a controlling shareholder or a transaction in which a controlling shareholder has a personal interest is deemed negligible or not and the approval requirements (including, potentially, the approval of the audit committee) for transactions that are not negligible including the types of transactions that are not negligible; (iv) where the Board approves the working plan of the internal auditor, examining such working plan before its submission to the Board and proposing amendments thereto, (v) examining the company's internal controls and internal auditor's performance, including whether the internal auditor has sufficient resources and tools to dispose of his responsibilities (taking into consideration the company's special needs and size), (vi) examining the scope of the company's auditor's work and compensation and submit its recommendation with respect thereto to the corporate organ considering the appointment thereof (either the Board or the general meeting of shareholders) and (vii) determining procedures with respect to the treatment of company employees' complaints as to the management of the company's business and the protection to be provided to such employees. Our Audit Committee also approves our financial statements in its role as a committee of the Board. Our Audit Committee may not approve an action or a related party transaction, or take any other action required under the Israeli Companies Law, unless at the time of approval a majority of the committee's members are present, a majority of whom consists of unaffiliated directors including at least one statutory external director.

In accordance with Sarbanes-Oxley requirements and our Audit Committee charter, our Audit Committee is directly responsible for the appointment, compensation and oversight of our independent auditors. In addition, the Audit Committee is also responsible for, among other things, assisting the Board in reviewing, and recommending actions to the Board with respect to, our financial statements, the effectiveness of our internal controls and our compliance with legal and regulatory requirements.

The Audit Committee has reviewed and discussed with our Management our audited consolidated financial statements as of and for the year ended March 31, 2018. The Audit Committee has also discussed with our independent registered public accounting firm the matters required to be discussed by Auditing Standards No. 1310, "*Communications with Audit Committees*," issued by the Public Company Accounting Oversight Board. Based on the reviews and discussions referred to above, the Audit Committee has recommended to the Board that the audited consolidated financial statements referred to above be included in this 2018 Annual Report.



### ***Approval of Interested Party Transactions***

Under the Israeli Companies Law, the approval of the Audit Committee (or, for transactions involving compensatory matters, the approval of the Compensation Committee) is required to effect certain actions and transactions with office holders, controlling shareholders and entities in which they have a personal interest. Such interested party transactions (including matters described in the following paragraph) require the approval of the Audit Committee (or the Compensation Committee, if involving a compensatory matter), the Board and in certain cases, the shareholders. Such shareholders' approval, in certain cases, also requires a special voting majority. See *"Approval of Specified Related Party Transactions under Israeli Law and Our Articles of Association—Disclosure of Personal Interests of a Controlling Shareholder"* in Item 10.B below.

### ***Internal Auditor***

Under the Israeli Companies Law, the board of directors of a public company is required to appoint an internal auditor proposed by the Audit Committee. The internal auditor may not be an interested party (i.e., a holder of 5% or more of the voting rights in the company or of the issued share capital), the chief executive officer of the company or any of its directors, or a person who has the authority to appoint the company's chief executive officer or any of its directors, or a relative of an office holder or of an interested party, nor may the internal auditor be our external independent auditors or their representatives. The Audit Committee is required to oversee the activities and to assess the performance of the internal auditor, as well as to review the internal auditor's work plan. The role of the internal auditor is to examine, among other things, whether our actions comply with the law and orderly business procedure. Ms. Rita Gerson is the internal auditor of the Company. The internal auditor has the right to demand that the chairman of the Audit Committee convene an Audit Committee meeting and the internal auditor may participate in all Audit Committee meetings.

### ***Compensation Committee***

On February 4, 2013, the Company established a Compensation Committee to comply with the requirements of Amendment No. 20 to the Israeli Companies Law ("Amendment 20"), which was effective as of December 2012. Currently our Compensation Committee consists of the following directors: Linda Benshoshan (who serves as chairwoman of the committee), Elli Streit, and Dov Pekelman, each of whom has been determined by our Board to be independent as defined by the applicable rules of the NYSE and the SEC, and all of our statutory external directors are members of the Compensation Committee.

Amendment 20 also required us to adopt a compensation policy regarding the terms of office and employment of office holders, including compensation, equity awards, severance and other benefits, and exemption from liability and indemnification. For a company such as ours that is not a new public company, the Israeli Companies Law (based on Amendment 20) requires that we adopt a new compensation policy, or renew our existing compensation policy, at least once every three years, via the approval of our Compensation Committee, Board and shareholders (including a special majority of our non-controlling, disinterested shareholders). Under the Israeli Companies Law, the Board may adopt the compensation policy even if it is not approved by the shareholders, provided that following non-approval of such policy by the shareholders, the Compensation Committee and the Board revisit the matter and determine that the adoption of the compensation policy is beneficial to the company. Our initial compensation policy was approved by our Board, upon the recommendations of our Compensation Committee, and was approved by our shareholders on September 12, 2013, and ratified and approved again on March 27, 2014. In December 2016, following its approval by our Compensation Committee and Board, our renewed compensation policy was approved by a majority of our shareholders, but not by the requisite special majority of the non-controlling, disinterested shareholders. As permitted under the foregoing provision of the Israeli Companies Law, our Compensation Committee and Board reconsidered the renewed compensation policy, determined that its adoption was beneficial to our Company based on several factors, and adopted it on February 9, 2017. Despite that approval, we have committed to reviewing our renewed compensation policy in light of the feedback that we received from our shareholders and shareholder advocacy organizations, and intend to bring an amended version for shareholder vote at our 2018 annual shareholder meeting.

The compensation policy serves as the basis for setting the employment and compensation terms of our officers. The compensation policy also relates to certain other factors, including advancement of our objectives, our work schedule and long-term strategy, and creation of appropriate incentives for executives. The policy also takes into account our risk management, size and the nature of our operations. The compensation policy also considers the following factors:

- the knowledge, skills, expertise and accomplishments of the relevant director or executive;
- the director's or executive's roles and responsibilities and prior compensation agreements with him or her;
- the relationship between the terms offered and the average compensation of the other employees of our company, including any persons employed through manpower companies;
- the impact of disparities in salary upon work relationships at our company;

- the possibility of reducing variable compensation at the discretion of the board of directors, and the possibility of setting a limit on the exercise value of non-cash variable compensation; and
- as to severance compensation, the period of service of the director or executive, the terms of his or her compensation during such service period, our company's performance during their period of service, the person's contribution towards our company's achievement of its goals and the maximization of its profits, and the circumstances under which the person is leaving our company.

The compensation policy also addresses the following principles:

- the link between variable compensation and long-term performance and measurable criteria;
- the relationship between variable and fixed compensation, and a cap on the value of variable compensation;
- the conditions under which a director or executive would be required to repay compensation paid to him or her if it was later shown that the data upon which such compensation was based was inaccurate and was required to be restated in our financial statements; and
- the minimum holding or vesting period for variable, long-term compensation.

The compensation policy also considers appropriate incentives from a long-term perspective and maximum limits for severance compensation.

Our Compensation Committee is responsible for recommending the compensation policy to our Board for its approval (and subsequent approval by our shareholders) and is charged with duties related to the compensation policy and to the compensation of our office holders as well as functions related to approval of the terms of engagement of office holders, including:

- recommending whether our compensation policy should continue in effect, if the then-current policy has a term of greater than three years (approval of either a new compensation policy or the continuation of an existing compensation policy must in any case occur every three years for a company such as ours);
- recommending to our Board periodic updates to the compensation policy;
- assessing implementation of the compensation policy; and
- determining whether the compensation terms of our Chief Executive Officer need not be brought to approval of the shareholders (under special circumstances).

Under Amendment 20, the terms of employment office holders require the approval of the Compensation Committee and the Board (assuming that they are consistent with the then-effective compensation policy). The terms of employment of directors and the chief executive officer (or any other office holder whose compensation deviates from the then-effective compensation policy, as described below) must also be approved by shareholders.

Changes to existing terms of employment of office holders (other than directors) can be made with the approval of the Compensation Committee only, if the committee determines that the change is not substantially different from the existing terms.

Under certain circumstances, the Compensation Committee and the Board may approve an arrangement that deviates from the compensation policy, provided that such arrangement is approved by the special majority of the company's shareholders mentioned above, or, in certain cases, even if that shareholder approval is not achieved.

### **Social Responsibility Committee**

On February 9, 2017, the Board established a Social Responsibility Committee to assist the Company in overseeing its corporate social responsibility activities at its sites worldwide. These activities may include community outreach programs, philanthropy, employee volunteer activities, academic relations and patient assistance. Dov Pekelman is the chairman of our Social Responsibility Committee.

## Nominating Committee

Our Board does not currently have a nominating committee, as director nominations are made in accordance with the terms of our articles, as described in “*Board of Directors*” above. We rely upon the exemption available to foreign private issuers under the Listed Company Manual of the NYSE from the NYSE listing requirements related to creation of a nominating committee. Also see Item 16.G “Corporate Governance” below.

## D. EMPLOYEES

The following table sets forth the number of full-time equivalents as of March 31, 2018\*:

	United States	Canada	Israel	Total
Sales and Marketing	173	37	32	242
Administration	74	35	45	154
Research and Development	15	75	129	219
Production and Quality Control	—	377	498	875
<b>Total</b>	<b>262</b>	<b>524</b>	<b>704</b>	<b>1,490</b>

The following table sets forth the number of full-time equivalents as of March 31, 2017\*:

	United States	Canada	Israel	Total
Sales and Marketing	134	38	33	205
Administration	64	34	41	139
Research and Development	15	72	139	226
Production and Quality Control	—	350	493	843
<b>Total</b>	<b>213</b>	<b>494</b>	<b>706</b>	<b>1,413</b>

The following table sets forth the number of full-time equivalents as of March 31, 2016\*:

	United States	Canada	Israel	Total
Sales and Marketing	137	36	35	208
Administration	61	33	42	136
Research and Development	13	65	129	207
Production and Quality Control	—	353	504	857
<b>Total</b>	<b>211</b>	<b>487</b>	<b>709</b>	<b>1,407</b>

\* In the United States, distribution employees are included in the Sales and Marketing category.

In general, we believe that our relationship with our employees is satisfactory. Since we are members of the Manufacturers Association, certain general collective agreements apply to us. These agreements concern principally the length of the workday, minimum daily wages for professional workers, insurance for work-related accidents, procedures for dismissing employees, pension payments, and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the required minimums.

The Board approved a new collective bargaining agreement dated January 5, 2017, (the “Collective Bargaining Agreement”) that amends and extends the collective bargaining agreement dated as of April 6, 2011 among Taro Israel, the Histadrut Trade Union and Taro’s Israel’s Employees Committee on behalf of Taro’s Israeli employees. The Collective Bargaining Agreement has a term of three years and automatically renews for one-year periods unless notice is provided by a party three months prior to the end of a term. The Collective Bargaining Agreement memorializes current employee-employer relations practices of Taro as well as additional rights relating to job security, compensation and other benefits. Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment in certain other circumstances. Under Section 14 of the Severance Pay Law (“Section 14”), in the event of termination of the employer-employee relationship, all payments made to pension funds or any other similar funds serve as severance pay and the Company is not obliged to pay the employee any other severance pay. Since 2011, the Company’s obligations to the employees’ pension plan have been governed by the Collective Bargaining Agreement, including our severance obligations and the provision rates to the various provident funds. We are complying with these obligations. We fund our

ongoing severance obligations by contributing a sum equal to 8.3% of the employee's wages to funds known as Pension Funds or Managers' Insurance. These funds provide different combinations of savings plan, life insurance and severance pay benefits to our employees, and each employee, according to the fund chosen by them, receives a pension or a lump sum payment upon retirement and severance pay, if the employee is legally entitled to it, upon termination of employment. In addition to the severance pay, each employee contributes an amount equal to 5.75% - 7.0% of their salary towards their pension plan. The Company contributes an additional sum between 6.25% - 7.5% of the employee's salary. Beginning in July 2016, the minimum numbers increased according to Israeli law. Since January 2017, employees contribute at least 6% of their salary toward their pension plan, and the Company contributes an additional sum of at least 6.5% of the employee's salary. Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute (an agency similar to the United States Social Security Administration), which include payments for national health insurance. The payments to the National Insurance Institute are approximately 19.5% of an employee's wages (up to a specified amount), of which the employee contributes approximately 12.0% and we contribute approximately 7.5%.

## E. SHARE OWNERSHIP

The following table sets forth certain information regarding the ownership of our ordinary shares by our directors and executive officers as of March 31, 2018. The percentage of ownership is based on ordinary shares outstanding as of March 31, 2018. None of the ordinary shares owned by any of our directors and executive officers has voting rights different from those possessed by other holders of our ordinary shares.

Name	Number of Ordinary Shares	Percentage of Outstanding Ordinary Shares
Dilip Shanghvi (1)	—	0.00%
Abhay Gandhi	—	0.00%
Sudhir Valia (2)	—	0.00%
Uday Baldota	—	0.00%
Linda Benshoshan	—	0.00%
Elli Streit	—	0.00%
Dov Pekelman	—	0.00%
James Kedrowski	—	0.00%
Mariano Balaguer	—	0.00%
Stephen Manzano, Esq.	—	0.00%
Avi Avramoff, Ph.D.	—	0.00%
Itamar Karsenti	—	0.00%
Michele Visosky	*	*
Chantal LeBlanc	—	0.00%
Ara Aprahamian R.Ph.	—	0.00%
Richard Glaze	—	0.00%
Total for all directors and officers (16 persons) listed above, as a group	*	*

\* Less than 1%

(1) Dilip Shanghvi, as the Managing Director of Sun Pharma's board of directors and along with entities controlled by him and members of his family, control 54.4% of Sun Pharma. As of March 31, 2018, Sun Pharma and its affiliates owned 74.8% of Taro's outstanding ordinary shares.

(2) Sudhir Valia is also a director of Sun Pharma. As of March 31, 2018, Sun Pharma and its affiliates owned 74.8% of Taro's outstanding ordinary shares.

The following table sets forth certain information regarding the ownership of our founders' shares as of March 31, 2018. The percentage of ownership is based on 2,600 founders' shares outstanding as of March 31, 2018.

Name	Number of Founders' Shares	Percentage of Outstanding Founders' Shares
Alkaloida Chemical Company Exclusive Group Ltd. (1)	2,600	100.00%

(1) Alkaloida Chemical Company Exclusive Group Ltd. (“Alkaloida”), a subsidiary of Sun, owns all 2,600 of our outstanding founders’ shares and is entitled to exercise one-third of the total voting power in our company regardless of the number of ordinary shares then outstanding. As a result of the control that may be deemed to be held by Alkaloida, each of Dilip Shanghvi and Sudhir Valia may be deemed to beneficially own the founders’ shares held by Alkaloida. Each of Mr. Shanghvi and Mr. Valia disclaims beneficial ownership of such shares, except to the extent of his pecuniary interest therein.

As of March 31, 2018, the directors and executive officers listed above held no options to purchase our ordinary shares.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. MAJOR SHAREHOLDERS

#### Ordinary Shares

The following table sets forth certain information as of March 31, 2018, with respect to the ownership of our ordinary shares by all persons who are known to us to beneficially own 5% or more of our outstanding ordinary shares. Beneficial ownership is determined in accordance with rules of the SEC and generally includes voting and investment power with respect to our ordinary shares, as well as the right to receive the economic benefit of ownership of such shares. The holder of the ordinary shares listed in the below table does not have voting rights with respect to such shares that are different from those possessed by other holders of our ordinary shares. Percentage ownership is based on 39,427,515 ordinary shares outstanding as of March 31, 2018.

<u>Name</u>	<u>Ordinary Shares Beneficially Owned</u>	<u>Percent of Ordinary Shares Outstanding</u>
Sun	29,497,813 (1)	74.8%

(1) As reported on the Schedule 13D/A filed by Sun on November 27, 2013.

During the year ended March 31, 2014, the percent of ordinary shares owned by Sun increased from 65.9% to 68.9% due to our repurchase of 1,959,514 ordinary shares in December 2013. During each of the years ended March 31, 2015 and 2016, there was no significant change in Sun’s ownership of our ordinary shares. During the year ended March 31, 2017, the percentage of ordinary shares owned by Sun increased to 72.8% due to the repurchase of 2,252,725 shares during the year. During the year ended March 31, 2018, the percentage of ordinary shares owned by Sun increased to 74.8% due to the repurchase of 1,085,694 shares during the year. As of May 31, 2018, Sun’s ownership percentage increased an additional 0.4% to 75.2%, due to our continued repurchase of additional ordinary shares.

#### Founders’ Shares

At the formation of our Company in 1959, two classes of shares were created, founders’ shares and ordinary shares. One-third of the voting power of all of our voting shares is allocated to the founders’ shares. Alkaloida, which is a subsidiary of Sun Pharma, owns all of the 2,600 outstanding founders’ shares.

#### Voting Power

As of March 31, 2018, Sun controlled 83.2% of the voting power in our Company by reason of its (i) beneficial ownership of an aggregate of 74.8% of our ordinary shares and (ii) ownership of the founders’ shares. As of May 31, 2018, Sun controlled 83.5% of the voting power in our Company due to the additional ordinary shares repurchased by the Company.

### B. RELATED PARTY TRANSACTIONS

In addition to Sun controlling 83.2% of the voting power in our Company as of March 31, 2018, Taro has substantial relationships with Sun. Certain Taro Board members are also members of various Sun entities board of directors, including our Chairman, Dilip Shanghvi, who is also Managing Director of Sun Pharma’s board of directors. In addition, certain Taro officers and executives are also executives of Sun.

## Arrangements with Sun

Since 2013, in the ordinary course of business, Taro has entered into various commercial transactions, including product distribution and logistics, manufacturing and service agreements, with Sun. The Company reviews each of these transactions and believes that the terms of these transactions are comparable to those offered by or that could be obtained from unrelated third parties. Pursuant to Israeli requirements, all material transactions were presented to the Audit Committee, which determined that each such transaction was not considered extraordinary, as defined in the Israeli Companies Law and therefore did not require shareholder approval. The Audit Committee further determined the approval requirements for the different types of transactions.

In June 2017, Sun and Taro affiliates renewed a services arrangement (the “Services Agreement”) that allows the companies to share the services of certain employees of the respective companies involved in certain North American management and operations functions in North America and Israel in the following areas: Human Resources, Information Technology, Legal (including intellectual property matters), OTC, Management, Procurement, and certain aspects of Commercial and Customer Service, Finance (Accounts Receivable, Accounts Payable, Government Pricing, Gross-to-Net and Tax Compliance), Regulatory Affairs (state licensing only in U.S.), Supply Chain and Operations (management services only) (each a “Service Area”).

The companies are required to maintain records (the “Service Reports”) of the costs associated with the provision of the services under the Services Agreement, and allocate such costs between companies, based upon the approved allocation methodologies for each Service Area. The Services Agreement requires our Audit Committee to review the Service Reports on a semi-annual basis and the Services Agreement as a whole, on an annual basis to determine its efficacy and whether it is in the Company’s best interests.

Each of the employees providing services under the Services Agreement is required to sign a written acknowledgment of his/her receipt of and agreement to be bound by (a) the confidentiality and non-disclosure agreement between Sun and Taro, and (b) guidelines for consideration in the performance of such services, including the identification of potential conflicts of interest.

In April 2017, the Board of Directors approved for Taro to negotiate an agreement with Sun whereby Taro's U.S. branded products team will advertise and promote a combined portfolio of Taro and Sun corticosteroid products. The agreement between Taro U.S.A., and Sun went into effect on May 1, 2017. Under this agreement, Sun sells its products to customers and pays Taro a percentage of the net sales for Taro's promotional services.

In May 2018, Taro Canada signed an agreement with Sun’s affiliate Ranbaxy Pharmaceuticals Canada Inc., whereby Taro Canada will act as the exclusive distributor for a portfolio of Sun and Ranbaxy products in Canada. Under this agreement, Sun and Ranbaxy will pay Taro Canada a sales and distribution commission.

## C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

The financial statements required by this item are found at the end of this 2018 Annual Report, beginning on page F-1.

### Other Financial Information

We manufacture pharmaceutical products in our facilities in Israel and Canada. A substantial amount of these products are exported, both to our affiliates and non-affiliates. For a breakdown of our sales by geographic market for the past three years, see “*Item 4B—Business Overview—Sales and Marketing.*”

### Legal Proceedings

From time to time, we are a party to routine litigation incidental to our business, including patent litigation resulting from our use of the patent challenge procedures set forth in the Hatch Waxman Act, product liability litigations, and employment litigations, none of which, individually or in the aggregate, are expected to have a material effect on our financial position or profitability. Other litigation, as disclosed herein, may have a material adverse effect on our financial position or profitability.

On May 10, 2018, Taro U.S.A. received a Civil Investigative Demand from the United States Department of Justice pursuant to the False Claims Act seeking information relating to corporate and employee records, generic pharmaceutical products and pricing,

communications and/or agreements with competitors and others regarding the sale of generic pharmaceutical products, and certain other related matters. Taro U.S.A. is in the process of reviewing and responding to the Civil Investigative Demand.

On September 8, 2016, Taro U.S.A. received a grand jury subpoena from the United States Department of Justice, Antitrust Division, seeking documents relating to corporate and employee records, generic pharmaceutical products and pricing, communications with competitors and others regarding the sale of generic pharmaceutical products, and certain other related matters. Taro U.S.A. is in the process of responding to the grand jury subpoena. Certain current and former officers and employees in Taro U.S.A.'s commercial team have also received related subpoenas.

The Company and Taro U.S.A. have been named as defendants in numerous putative class action lawsuits and an additional lawsuit brought by purchasers and payors of several generic pharmaceutical products, including Clobetasol, Clomipramine, Desonide, Econazole, and Fluocinonide. The lawsuits allege that the Company and/or Taro U.S.A. have conspired with competitors to fix prices, rig bids, or allocate customers as to these products, and also allege an industry-wide conspiracy as to all generic pharmaceutical products. Each of these cases has been transferred to the United States District Court for the Eastern District of Pennsylvania for coordinated proceedings under the caption In re: Generic Drug Pricing Antitrust Litigation, MDL No. 2724.

The Company and two of its former officers were named as defendants in a putative shareholder class action entitled *Speakes v. Taro Pharmaceutical Industries, Ltd.*, No. 16-CV-08318, filed October 25, 2016, which is now pending in the United States District Court for the Southern District of New York. The current version of the complaint, filed on June 19, 2017, asserts claims under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") against all defendants and Section 20(a) of the Exchange Act against the individual defendants. It generally alleges that the defendants made material misstatements and omissions in connection with an alleged conspiracy to fix drug prices. The Company filed a motion to dismiss on October 11, 2017. The lead plaintiff (the City of Atlanta Firefighters' Pension Fund) filed its opposition to the motion to dismiss on December 11, 2017. The Company filed its reply to this opposition on January 10, 2018. The motion to dismiss is pending.

In February 2017, after consulting with its tax advisors, the Company filed an appeal pursuant to Section 153 of the Income Tax Ordinance (New Version), 1961 in the Haifa District Court. The appeal challenged the Israel Tax Authority's ("ITA") tax assessment for the period of January 1, 2010 through March 31, 2014 in the amount of \$40.8 million (before interest, linkage and penalties), and denial of an unutilized capital loss in an amount of \$74.6 million that had been claimed by the Company.

In March 2018, the Company reached a settlement with the ITA, under which the Company is obligated to pay a reduced tax assessment of \$15.0 million, and the Company was permitted to record the unutilized capital loss, transfer intellectual property from TNA to Taro Israel and Taro Canada and reorganize assets held by our subsidiaries without triggering an Israeli tax event (the "Settlement"). The Settlement settled all tax disputes between the parties for the tax years 2010 through 2014 as well as related tax issues with respect to the tax years 2015 through 2016, which years were not subject to the disputes.

#### **Dividend Policy**

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

#### **B. SIGNIFICANT CHANGES**

Subsequent to March 31, 2018, the Company received final approvals from the FDA for two additional ANDAs:

Benzoyl Peroxide; Clindamycin Phosphate Topical Gel 5%; 1% in May 2018 and Clindamycin Phosphate and Benzoyl Peroxide Gel, 1.2%/3.75% in June 2018.

**ITEM 9. THE OFFER AND LISTING****A. OFFER AND LISTING DETAILS**

Our ordinary shares are listed on the NYSE as of March 22, 2012, under the symbol “TARO.” The following table sets forth the high and low closing sale prices of our ordinary shares as quoted on the NYSE during the last five fiscal years as of the end of the reporting period of this 2018 Annual Report:

<b>Year ended</b>	<b>High</b>	<b>Low</b>
3/31/2014	\$ 121.32	\$ 54.03
3/31/2015	\$ 171.77	\$ 103.80
3/31/2016	\$ 156.98	\$ 129.09
3/31/2017	\$ 150.10	\$ 93.68
3/31/2018	\$ 126.38	\$ 95.91

The following table sets forth the high and low closing sale prices of our ordinary shares as quoted on the NYSE, during each fiscal quarter of the most recent two fiscal years, as of the end of the respective reporting period of this 2018 Annual Report, and any subsequent period:

	<b>High</b>	<b>Low</b>
<b>Year end March 31, 2017</b>		
First Quarter	\$ 150.10	\$ 130.08
Second Quarter	\$ 146.01	\$ 110.51
Third Quarter	\$ 111.00	\$ 93.68
Fourth Quarter	\$ 123.39	\$ 100.00
<b>Year end March 31, 2018</b>		
First Quarter	\$ 118.28	\$ 103.88
Second Quarter	\$ 116.29	\$ 97.26
Third Quarter	\$ 126.38	\$ 104.50
Fourth Quarter	\$ 107.26	\$ 95.91

The following table sets forth the high and low closing sale prices of our ordinary shares as quoted on the NYSE during the last six months:

	<b>High</b>	<b>Low</b>
December 2017	\$ 106.99	\$ 104.50
January 2018	\$ 107.26	\$ 101.69
February 2018	\$ 102.66	\$ 95.91
March 2018	\$ 102.02	\$ 97.11
April 2018	\$ 102.44	\$ 97.62
May 2018	\$ 118.97	\$ 103.42

**B. PLAN OF DISTRIBUTION**

Not applicable.

**C. MARKETS**

Our ordinary shares have been listed on the NYSE under the symbol “TARO” since March 22, 2012. Our ordinary shares are not offered, listed or traded on any other exchange or regulated market.

**D. SELLING SHAREHOLDERS**

Not applicable.



## **E. DILUTION**

Not applicable.

## **F. EXPENSES OF THE ISSUE**

Not applicable.

## **ITEM 10. ADDITIONAL INFORMATION**

### **A. SHARE CAPITAL**

Not applicable.

### **B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

Our registration number at the Israeli Registrar of Companies is 52-002290-6.

#### **Objects and Purposes**

Our Memorandum of Association provides that our main objects and purposes include any business connected with the developing, manufacturing, processing, supplying, marketing and distributing of Rx, OTC medical and other health care products.

In February 2000, the Israeli Companies Ordinance (New Version—1983) was replaced with the Israeli Companies Law. Because our Articles of Association were adopted before the enactment of the Israeli Companies Law, they are not always consistent with the provisions of the new law. In all instances in which the Israeli Companies Law changes or amends provisions in the Companies Ordinance, and, as a result, our Articles of Association are not consistent with the Israeli Companies Law, the provisions of the Israeli Companies Law apply unless specifically stated otherwise in the Israeli Companies Law.

#### **Approval of Specified Related Party Transactions Under Israeli Law and Our Articles of Association**

The Israeli Companies Law requires the approval of the audit committee, the board of directors and, in certain cases, the approval of the shareholders in that sequence, in order to effect specified related parties transactions, other than compensatory arrangements, for which the approval of the compensation committee, board of directors and, in certain cases, the shareholders is required.

Pursuant to the provisions of the Israeli Companies Law, our Audit Committee has (i) preapproved criteria for the classification of transactions with related parties as extraordinary or ordinary transactions, (ii) with respect to those classified as ordinary transactions, determined whether they are negligible or non-negligible, as defined in the Israel Companies Law, and (iii) determined the approval requirements for transactions that are not negligible. According to the Company's policy, if a transaction is deemed an ordinary transaction as per the preapproved criteria, the transaction will only require approval by our Board; if, however, a transaction is not covered by the preapproved criteria, it has to be first brought before the Audit Committee for its determination. Under the Israeli Companies Law, an "extraordinary transaction" is generally a transaction other than in the ordinary course of business, other than according to prevailing market terms, or that is likely to have a material impact on a company's profitability, assets or liabilities.

#### ***Fiduciary Duties of Office Holders***

The Israeli Companies Law imposes fiduciary duties that "office holders" (as defined in the Israeli Companies Law and described above in this 2018 Annual Report) owe to a company. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires an office holder to act with the level of care that a reasonable office holder in the same position would have acted with under the same circumstances. The duty of care includes a duty to use reasonable means to obtain:

- information on the advisability of a given action brought for the office holder's approval or performed by the office holder by virtue of his or her position; and
- all other information of importance with respect to these actions.

The duty of loyalty generally requires an office holder to act in good faith and for the benefit of the company, and this includes a duty to:

- refrain from any conflict of interest between the performance of his or her duties to the company and his or her other positions or personal affairs;
- refrain from any activity that is competitive with the company;
- refrain from exploiting any business opportunity of a company to receive personal gain for himself, herself or others; and
- disclose to the company any information or documents relating to the company's affairs that the office holder has received as a result of his or her position in the company.

### ***Compensation of Office Holders***

Under the Israeli Companies Law, arrangements as to compensation of a public company's office holders who are directors or the chief executive officer require the approval of the compensation committee, the board of directors and the shareholders, in that order, except where the regulations adopted under the Israeli Companies Law provide for certain easements from those requirements. Arrangements as to compensation of a public company's office holders who are not directors or the chief executive officer generally (assuming that the arrangement conforms to the then-effective compensation policy) require the approval of the compensation committee and the board of directors in that order as detailed above in *Item 6.C.—“Board Practices—Audit Committee—Approval of Interested Party Transactions.”*

### ***Disclosure of Personal Interest of an Office Holder***

The Company's Articles of Association provide that a director must disclose his or her interest in a contract or arrangement at the meeting of the Board of Directors at which such contract or arrangement is first taken into consideration. The Israeli Companies Law requires that an office holder (including a director) or a controlling shareholder who is aware that he or she has a personal interest in connection with any existing or proposed transaction by the company, promptly disclose to the company the nature of any personal interest that he or she may have, including all related material information or documents known to him or her. “Personal Interest,” as defined by the Israeli Companies Law, includes an interest of any person in an act or transaction of the company, including interest of his or her relative or of a corporate body in which such person or his or her relative is either a holder of 5% or more of the corporate body shares or voting power, is a director or the chief executive officer (referred to as a “general manager” under the Israeli Companies Law), or is entitled to appoint at least one director or the general manager and including the personal interest of a person voting by a proxy granted to him or her by another person, even if the person so granting the proxy does not have a personal interest in the transaction. In addition, the vote of a person who was granted a proxy from the shareholder who has a personal interest shall be deemed the vote of a shareholder having a personal interest, even if proxy holder has discretion on how to vote. An interest stemming merely from ownership of shares in the company is not deemed a Personal Interest. In the case of a non-extraordinary transaction, the office holder's duty to disclose does not apply to a personal interest of the office holder's relative.

Under the Israeli Companies Law, the office holder must disclose his personal interest without delay and no later than the first meeting of the company's board that discusses the particular transaction. Once disclosure is made in compliance with the above disclosure requirement, the board of directors may approve the transaction between the company and an office holder or a third party in which an office holder has a personal interest, unless the company's articles of association provide otherwise. A transaction that is adverse to the company's interest or that is not performed by the officer holder in good faith may not be approved. Approval first by the company's audit committee and subsequently by the board of directors is required for an extraordinary transaction with an office holder. If the transaction concerns compensation, exemption, indemnification or insurance of an office holder, then it must first be approved by the company's compensation committee and then by the board of directors, and, under certain circumstances (for directors, the chief executive officer, and any executive officer whose compensation terms do not conform to the then-existing compensation policy), by the shareholders of the company, in that order. Compensation of an individual office holder, including the chief executive officer (but excluding a director), that does not conform to the company's compensation policy may be adopted under special circumstances despite failure to obtain shareholder approval if, following the relevant shareholder vote, the compensation committee followed by the board once again approves the compensation, based on renewed and specific analysis of relevant factors.

A director who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee (other than a non-extraordinary transaction) or the compensation committee may not be present at this meeting, unless the chairman of the audit committee, compensation committee or the board of directors determined that the participation of such director is required in order to present the transaction. A director who has a personal interest in a matter that is considered at a meeting of the board of directors, the audit committee or compensation committee may not vote on this matter, unless a majority of the members of the board of directors or such committee, as the case may be, has a personal interest in the matter, in which case shareholder approval is also required.

### ***Disclosure of Personal Interests of a Controlling Shareholder***

Under the Israeli Companies Law, the disclosure requirements that apply to an office holder also apply to a controlling shareholder of a public company. For these purposes, a controlling shareholder is a shareholder who has the ability to direct the activities of a company (other than solely from his or her position on the board of directors or any other position with the company), including a shareholder who holds 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights. For purposes of attribution, the Israeli Companies Law provides that if two or more persons, holding voting rights in the company, each have a personal interest in the approval of the same transaction, such persons will be deemed to be one holder.

Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, including a private offering in which the controlling shareholder has a personal interest, and the engagement of a controlling shareholder or his or her relative with a public company, as an office holder or employee, require the approval of the audit committee, the board of directors and the shareholders of the company, in that order. The compensation, indemnification of, or insurance covering a controlling shareholder or his or her relative with a public company requires the approval of the compensation committee, the board of directors and the shareholders, in that order (subject to certain leniencies with respect to the approval of directors and officers liability insurance, for which shareholder approval may not be required under certain circumstances).

The shareholder approval must, in each case be by a majority of the votes cast at the meeting, whether in person or by proxy, provided that:

- the majority includes at least the majority of the total votes of the non-controlling shareholders who lack a personal interest in approval of the transaction or compensation (as applicable), or anyone voting on their behalf present at the meeting in person or by proxy; or
- the total number of votes of the non-controlling, disinterested shareholders that are voted against the transaction does not exceed two percent (2%) of the voting rights in the company.

To the extent that any such transaction with a controlling shareholder is for a period extending beyond three years, approval is required once every three years, unless the audit committee determines that the duration of the transaction is reasonable given the circumstances related thereto.

All transactions (other than compensatory transactions, which are subject to approval by the compensation committee) with a controlling shareholder, or in which a controlling shareholder has a personal interest, regardless of whether such transactions are extraordinary, are subject to the oversight of the audit committee. The audit committee is required to establish procedures for a competitive process to be used by the company prior to entering into any such transaction, or other procedures where appropriate.

### ***Director Qualifications***

Our Articles of Association do not require directors to hold shares in the Company. According to the Articles, the number of directors of the Company should be not less than five or more than twenty-five. Under the Israeli Companies Law, we must have at least two statutory external directors on the Board of Directors. See *Item 6.C.—“Board Practices—Statutory External Directors—Qualifications of Statutory External Directors.”*

### ***Voting, Rights Attached to Shares, Shareholders’ Meetings and Resolutions***

Our directors, other than our statutory external directors, are elected at annual general meetings of our shareholders. A director holds office until the next annual general meeting, unless he or she resigns or is earlier removed from office by an ordinary resolution passed at an extraordinary general meeting of our shareholders.

Our share capital is divided into founders’ shares and ordinary shares. Holders of each paid-up share 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. All ordinary shares together entitle their holders to two-thirds of the voting power of our Company. All founders’ shares together entitle their holders to one-third of the voting power of our Company. Under our Articles of Association, an increase to the share capital, creation of preferred shares or shares with special rights, consolidation or division of share capital, cancellation of shares and reduction in share capital, require a special resolution of the shareholders, i.e. an affirmative vote of 75% of the voting power voting in person or by proxy. The rights attached to any class of shares may be modified with the consent in writing of the holders of three-fourths of the issued shares of that class or by way of a special resolution of the shareholders.

Under our Articles of Association, dividends on our ordinary shares may be paid out of profits and other surplus, as defined in the Israeli Companies Law or as otherwise approved by a court of law, provided that there is no reasonable concern that the dividend will prevent us from satisfying our existing and foreseeable obligations as they become due.

Under the Israeli Companies Law and our Articles of Association, an ordinary resolution of the shareholders (for example, with respect to the appointment of auditors) requires the affirmative vote of a majority of the voting power voting in person or by proxy, whereas a special resolution (for example, a resolution amending the Articles of Association or authorizing changes in capitalization or in the rights attached to a class of shares) requires the affirmative vote of at least 75% of the voting power voting in person or by proxy. Rights pertaining to a particular class of shares require the vote of 75% of such class of shares in order to change such rights in addition to the approval of 75% of the voting power of the shareholders voting in person, or by proxy, on such resolution. The quorum required for a meeting of shareholders consists of at least three shareholders present, in person or by proxy, who hold or represent between them at least one-third of the outstanding voting power unless otherwise required by applicable rules. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the board of directors may designate. If at such reconvened meeting the required quorum is not present, any two shareholders present in person, or by proxy, shall constitute a quorum.

### ***Shareholder Meetings***

Under our Articles of Association, a general meeting of the shareholders must be held at least once in every calendar year, but not more than 15 months after the last preceding meeting. All general meetings must be held in Israel. The Board of Directors may call an extraordinary general meeting of the shareholders at any time. The Board shall convene an extraordinary general meeting of the shareholders, at the request of (i) any two of our directors or one-quarter of the members of our board of directors or (ii) one or more shareholders holding, in the aggregate, either (a) 5% or more of our outstanding issued shares and 1% of our outstanding voting power or (b) 5% or more of our outstanding voting power, provided that the request complies with the requirements provided by the Articles of Association, including but not limited to statement of the object of the meeting. Any shareholder may appoint by power of attorney a person to act as his representative at a meeting. The original instrument appointing a representative or a notarized copy must be deposited at the principal office of the Company at least 48 hours before the meeting.

The Israeli Companies Law requires that notice of any annual general meeting or extraordinary general meeting be provided to shareholders at least 21 days prior to the meeting and if the agenda of the meeting includes, among other matters, the appointment or removal of directors, the approval of transactions with office holders or interested or related parties, approval of the company's general manager to serve as the chairman of its board of directors or an approval of a merger, notice must be provided at least 35 days prior to the meeting.

The Israeli Companies Law allows one or more of our shareholders holding at least 1% of the voting power of a company to request the inclusion of an additional agenda item for an upcoming shareholders meeting, assuming that it is appropriate for debate and action at a shareholders meeting. Under related regulations, such a shareholder request must be submitted within three days or, for certain requested agenda items, seven days following our publication of notice of the meeting. If the requested agenda item includes the appointment of director(s), the requesting shareholder must comply with particular procedural and documentary requirements. If our board of directors determines that the requested agenda item is appropriate for consideration by our shareholders, we must publish an updated notice that includes such item within seven days following the deadline for submission of agenda items by our shareholders. The publication of the updated notice of the shareholders meeting does not impact the record date for the meeting. In lieu of this process, we may opt to provide pre-notice of our shareholders meeting at least 21 days prior to publishing official notice of the meeting. In that case, our 1% shareholders are given a 14-day period in which to submit proposed agenda items, after which we must publish notice of the meeting that includes any accepted shareholder proposals.

Under the Israeli Companies Law, shareholders are not permitted to take action by way of written consent in lieu of a meeting.

### ***Restriction on Voting***

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

## Duties of Shareholders

Under the Israeli Companies Law, each and every shareholder has a duty to act in good faith and in an acceptable manner in exercising his, her or its rights and fulfilling his, her, or its obligations towards the company and other shareholders and to refrain from abusing his, her or its power, such as in voting in the general meeting of shareholders and/or in a meeting of a different class of shares, on the following matters:

- any amendment to the articles of association;
- an increase of the authorized share capital;
- a merger; or
- the approval of actions of office holders in breach of their duty of loyalty and of interested party transactions.

In addition, each and every shareholder has the general duty to refrain from depriving other shareholders of their rights.

Furthermore, a duty to act in fairness towards the company applies to any controlling shareholder, any shareholder who knows that he possesses the power to determine the outcome of a shareholder vote and any shareholder that, pursuant to the provisions of the Articles of Association, has the power to appoint or to prevent the appointment of an office holder in the company or any other power in regard to the company. The Israeli Companies Law does not describe the substance of this duty to act in fairness.

These various shareholder duties may restrict the ability of a shareholder to act in what the shareholder perceives to be his, her or its own best interests.

## Transfer of Shares

Fully paid ordinary shares are issued in registered form and may be freely transferred under our Articles of Association unless the transfer is restricted or prohibited by another instrument (or by any other limitation described herein).

## Mergers and Acquisitions under Israeli Law

The Israeli Companies Law and the regulations promulgated thereunder include provisions that allow a merger transaction, in general, and require that each company that is a party to a merger has the transaction approved by its board of directors and a vote of the majority of the voting power of its shares at a shareholders' meeting called on at least 35 days' prior notice by each of the merger parties. Under the Articles of Association, the required shareholder vote is a supermajority of at least 75% of the shares voting in person or by proxy on the matter. A court may determine that a company duly approved a merger, in certain cases, upon the request of shareholders holding 25% or more of the voting power in the company. A court may not approve a merger unless it is convinced that the merger offer is fair and reasonable, in light of the valuation of the merging companies and the consideration which has been offered to the shareholders. Upon the request of a creditor of either party of the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that as a result of the merger the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be completed unless at least 30 days have passed from the time that the shareholders of each company have approved the merger and 50 days have passed from the time that a merger proposal has been delivered to the Israeli Registrar of Companies.

In general, the Israeli Companies Law also provides that an acquisition of shares of a public company is to be made by means of a special tender offer if, as a result of the acquisition, the purchaser would become a holder of 25% or more of the voting rights in the company if there is no existing holder of 25% or more of the voting rights in the company. If there is no existing holder of more than 45% of the voting rights in the company, in general, the Israeli Companies Law provides that an acquisition of shares of a public company is to be made by means of a special tender offer if as a result of the acquisition the purchaser would become a holder of more than 45% of the voting rights in the company.

These requirements do not apply if, in general, the acquisition (1) was made in a private placement that received shareholders' approval (confirming that the purchaser would become a holder of 25% or greater than 45%, of the voting power in the company, unless there is already a holder of 25% or more or more than 45% of the voting power in the company), (2) was from a holder of 25% or more, of the voting power in the company which resulted in the acquirer becoming a holder of 25% or more of the voting power in the company, or (3) was from a holder of greater than 45% of the voting power in the company which resulted in the acquirer becoming a holder of greater than 45% of the voting power in the company. The tender offer must be extended to all shareholders, but the offeror is not required to purchase more than 5% of the company's outstanding shares, regardless of how many shares are tendered by shareholders. The tender offer may be consummated only if (i) at least 5% of the company's outstanding shares will be acquired by the offeror and (ii) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

If as a result of any acquisition of shares, the acquirer will hold more than 90% of the company's issued and outstanding share capital or of a class of shares or more than 90% of the voting power of the company, the acquisition may not be made other than through a tender offer to acquire all of the shares or all of the shares of such class. If the shares represented by the shareholders who did not tender their shares in the tender offer constitute less than 5% of the issued and outstanding share capital of the company or of a class of shares (or voting power thereof), and a majority of the shareholders offered such tender who do not have a personal interest in receipt of such tender accepted such tender (which condition shall not apply if, following consummation of the tender offer, the acquirer holds at least 98% of all of the company's outstanding shares or voting rights), all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. If the dissenting shareholders hold 5% or more of the issued and outstanding share capital (or voting power) of the company or of a class of shares, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer to the extent that following such acquisition the acquirer would then own over 90% of the company's issued and outstanding share capital or of a class of shares. Shareholders may petition the court to alter the consideration for the acquisition to reflect a fair value. Such petition may be submitted within six months from the date the tender offer has been accepted. However, the acquirer may provide in the tender offer documents that a shareholder that accepts the offer may not seek such a court appraisal.

Israeli tax law may treat stock-for-stock acquisitions between an Israeli company and a foreign company less favorably than does United States tax law. For example, unless the stock-for-stock transaction is considered a tax-deferred merger which relates to a transfer of at least 80% of the shares in the transferred company, Israeli tax law subjects a shareholder who exchanges his ordinary shares for shares in another corporation (which is listed for trading on a stock exchange) to taxation on half the shareholder's shares two years following the exchange and on the balance four years thereafter even if the shareholder has not yet sold the new shares.

## **Indemnification and Insurance of Office Holders**

### ***Insurance of Office Holders***

Subject to the provisions of the Israeli Companies Law, our Articles of Association provide that we may enter into an insurance contract that would provide coverage in respect of liability imposed on any of our office holders with respect to an act performed in the capacity of an office holder for:

- a breach of the office holder's duty of care to the company or to another person, to the extent such a breach arises out of the negligent conduct of the officer holder;
- a breach of the office holder's duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that his or her act would not prejudice the good of the company; or
- a financial liability imposed upon him or her in favor of another person.

We have obtained liability insurance covering our officers and directors.

### ***Indemnification of Office Holders***

Subject to the provisions of the Israeli Companies Law, our Articles of Association provide that we may indemnify any of our office holders, in advance and retroactively, against the following liabilities imposed or expenses incurred on the office holder with respect to an act performed in the capacity of an office holder:

- a monetary obligation imposed on him or her in favor of another person by a court judgment, including a compromise judgment or an arbitrator's award approved by the court;
- reasonable litigation expenses, including attorneys' fees, expended by the office holder due to an investigation or a proceeding instituted against him or her by an authority competent to administer such an investigation or proceeding that was either finalized without the filing of an indictment (as defined in the Israeli Companies Law) against him or her and "without any monetary obligation imposed in lieu of criminal proceedings" (as defined in the Israeli Companies Law) or finalized "without the filing of an indictment" against him or her with a "monetary obligation imposed in lieu of criminal proceedings" relating to an offense that does not require proof of criminal intent; and
- reasonable litigation expenses, including attorneys' fees, expended by the office holder or charged to him or her by a court in connection with proceedings we institute against him or her or that are instituted on our behalf or by another person or a criminal charge from which he or she is acquitted, or a criminal charge in which he or she is convicted of an offense that does not require proof of criminal intent.

Under the Israeli Companies Law, indemnification in advance in respect to monetary liabilities to third parties are limited to those events which, in the opinion of the board of directors, are to be expected in light of the company's actual activities when the indemnification is granted and to a sum or a standard which the board of directors determines that are reasonable in the circumstances.

### ***Exemption of Office Holders***

The Israeli Companies Law provides that a company may exempt an office holder in advance from liability for damages flowing from breach of his duty of care to the company, but only if a provision authorizing such exemption is included in its articles of association. Our Articles of Association include such a provision. The company may not exempt in advance a director from liability arising out of a prohibited dividend or distribution to shareholders.

### ***Limitations on Exemption, Insurance and Indemnification***

The Israeli Companies Law provides that a company may not exempt or indemnify an office holder for, or enter into an insurance contract that would provide coverage for any monetary liability incurred as a result of, any of the following:

- a breach by the office holder of his or her duty of loyalty unless, with respect to indemnification and insurance coverage, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the good of the company;
- a breach by the office holder of his or her duty of care which was committed intentionally or recklessly, except when it was committed solely by negligence;
- any act or omission done with the intent to derive an illegal personal benefit; or
- any civil fine, monetary sanction or forfeiture imposed against the office holder.

In addition, under the Israeli Companies Law, exemption, indemnification, and procurement of insurance coverage (except where the regulations provide for certain easements from such requirements with respect to insurance) for office holders must be approved by the compensation committee and board of directors of a company and, if the beneficiary is a director or the chief executive officer (or a controlling shareholder and his or her relative), by the shareholders, in that order.

Following approval by the Audit Committee and Board of Directors and, in the case of directors, approval by our shareholders, we entered into exemption and indemnification agreements with our directors and certain officers.

## **C. MATERIAL CONTRACTS**

During the two years preceding the date of this 2018 Annual Report, neither we nor any of our affiliates and subsidiaries entered into any material contracts, other than contracts entered into in the ordinary course of business.

In December 2016, the Company announced the sale of U.S. rights to Keveyis® (dichlorphenamide) to Strongbridge Biopharma plc ("Strongbridge"). Keveyis® was approved by the U.S. FDA in August 2015 to treat primary hyperkalemic and hypokalemic periodic paralysis, a group of rare hereditary disorders that cause episodes of muscle weakness or paralysis. Keveyis® has orphan designation status through August 2022. In accordance with the terms of the purchase agreement, Strongbridge paid Taro a total of \$8.5 million through upfront payments; Taro is also eligible to receive additional future payments upon the achievement of certain sales unit milestones. Taro has agreed to continue to manufacture Keveyis® for Strongbridge, under an exclusive supply agreement at least for the period of Keveyis® orphan exclusivity, subject to certain commercial terms and conditions, including minimum supply purchases.

In April 2017, the Company entered into a development and commercialization license agreement with Crescita Therapeutics Inc. ("Crescita"), under which, Crescita has granted Taro an exclusive license to the rights to sell and distribute Pliaglis® in the U.S. market and for a second-generation enhanced version with patent pending.

## **D. EXCHANGE CONTROLS**

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares.

Dividends, if any, paid to our ordinary shareholders, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriated dollars at the rate of exchange prevailing at the time of conversion. Payments of dividends may be subject to withholding taxes.

## E. TAXATION

### General

The following is a brief summary of the material, current income tax aspects applicable to companies in Israel with reference to its effect on us. The following also contains a discussion of material Israeli and United States tax consequences to our shareholders and Israeli government programs benefiting us. We cannot assure you that the tax authorities, the courts or any other judicial or administrative authority will accept the views expressed in the discussion in question. This summary is based on the laws and regulations in effect as of the date hereof. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations. **Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.**

### Israeli Tax Considerations and Government Programs

#### *General Corporate Tax Structure*

Generally, Israeli companies are subject to corporate tax on their taxable income. As of 2018, the corporate tax rate is 23.0% (in 2017, 2016 and 2015 the corporate tax rate was 24.0%, 25.0% and 26.5%, respectively). However, the effective tax rate payable by a company that derives income from an Approved Enterprise, a Benefited Enterprise, a Preferred Enterprise or a Preferred Technological Enterprise, as discussed below, may be considerably less. In general, Israeli companies are subject to regular corporate tax rate for their capital gain.

#### *Tax Benefits under the Law for the Encouragement of Capital Investments, 1959*

The Law for the Encouragement of Capital Investments, 5719-1959 (the “Investment Law”), provides certain incentives for productive activity, as under the regimes stipulated in the Investment Law. Generally, an investment program that is implemented in accordance with the provisions of the Investment Law, referred to as an Approved Enterprise, a Benefited Enterprise, a Preferred Enterprise or a Preferred Technological Enterprise, is entitled to benefits as discussed below. These benefits may include cash grants from the Israeli government and tax benefits, based upon, among other things, the location of the facility within Israel or the election of the grantee. In order to qualify for these incentives, an Approved Enterprise a Benefited Enterprise, a Preferred Enterprise, or a Preferred Technological Enterprise is required to comply with the requirements of the Investment Law. Various production and development facilities of our companies in Israel have been granted “Approved Enterprise” and “Benefited Enterprise” status, which provides certain benefits, including tax exemptions and reduced tax rates for a defined period.

The Investment Law was significantly amended as of April 1, 2005 (the “2005 Amendment”), as of January 1, 2011 (the “2011 Amendment”), and as of January 1, 2017 (the “2017 Amendment”). Pursuant to the 2005 Amendment, tax benefits granted in accordance with the provisions of the Investment Law prior to its revision by the 2005 Amendment remained in force, but any benefits granted subsequently were subject to the provisions of the 2005 Amendment. Similarly, the 2011 Amendment introduced new benefits instead of the benefits granted in accordance with the provisions of the Investment Law in effect prior to the 2011 Amendment. However, companies entitled to benefits under the Investment Law in effect up to January 1, 2011, were entitled to choose to continue to enjoy such benefits, provided that certain conditions are met, or elect instead irrevocably, to forego such benefits and elect the benefits of the 2011 Amendment. The 2017 Amendment introduced new benefits for Technological Enterprises, alongside the existing tax benefits.

The following discussion is a summary of the Investment Law prior to the 2005 Amendment and 2011 Amendment as well as the relevant changes contained in such amendments and in the new legislation.



### ***Tax Benefits Before the 2005 Amendment***

An investment program that is implemented in accordance with the provisions of the Investment Law prior to the 2005 Amendment, generally referred to as an “Approved Enterprise”, is entitled to certain benefits. These benefits may include cash grants from the Israeli government and tax benefits, based upon, among other things, the location of the facility within Israel in which the investment is made or the election of the grantee. A company that wished to receive benefits had to receive an approval from the Israeli Authority for Investments and Development of the Industry and Economy (formerly the Ministry of Industry, Trade and Labor) (the “Investment Center”), in order to obtain such Approved Enterprise status. Each certificate of approval for an Approved Enterprise relates to a specific investment program, delineated both by the financial scope of the investment, including sources of funds, and by the physical characteristics of the facility or other assets. The tax benefits available under any certificate of approval relate only to taxable income attributable to the specific program and are contingent upon meeting the criteria set forth in the certificate of approval. Income derived from activity that is not integral to the activity of the Approved Enterprise will not enjoy tax benefits.

A company owning an Approved Enterprise may elect to forego certain government cash grants extended to an Approved Enterprises in return for an alternative package of tax benefits (the “Alternative Benefits Program”). Under the Alternative Benefits Program, a company’s undistributed income derived from an Approved Enterprise is exempt from corporate tax for a period of between two and ten years (the “Exemption Period”), beginning on the first year in which the company derives taxable income under the program after the commencement of production, depending on the geographic location of the Approved Enterprise in Israel. After the Exemption Period, the company will be eligible for the reduced tax rates of 10% - 25% for the remainder of the benefits period, depending on the level of foreign investment in the company in each year. These tax benefits are granted for a limited period not exceeding seven years, or ten years for a company whose foreign investment level exceeds 25%, from the first year in which the Approved Enterprise has taxable income, after the year in which production commenced (as determined by the Investment Center). However, the benefits period may in no event exceed the lesser of 12 years from the year in which the enterprise commences its operations (as determined by the Investment Center) or 14 years from the year of receipt of Approved Enterprise status, whichever ends earlier. If a company has more than one Approved Enterprise program or if only a portion of its capital investments are approved, the company’s effective tax rate reflects the weighted-average of the applicable rates. The tax benefits available under any certificate of approval relate only to taxable income attributable to the specific program and are contingent upon meeting the criteria set out in the certificate of approval.

The tax benefits under the Investment Law also apply to a company’s income that is generated from (i) the grant of a right of use with respect to know-how developed by the Approved Enterprise, (ii) income generated from royalties and (iii) income derived from a service which is ancillary to such right of use or royalties, provided that such income is attributable to the Approved Enterprise’s ordinary course of business. The tax benefits under the Investment Law may generally not be available with respect to income derived from products manufactured outside of Israel (subject to certain de-minimis thresholds, and attribution formulas).

A company that has an Approved Enterprise program is eligible for further tax benefits if it qualifies as a Foreign Investors’ Company (“FIC”). A FIC that is eligible for benefits is essentially a company with a level of foreign investment, as defined in the Investment Law, of more than 25%. The level of foreign investment is measured as the percentage of rights in the company (in terms of shares, rights to profits, voting and appointment of directors), and of combined share and loan capital, that are owned, directly or indirectly, by persons who are not residents of Israel. The determination as to whether or not a company qualifies as an FIC is made on an annual basis. A FIC that has an Approved Enterprise program will be eligible for an extension of the period during which it is entitled to tax benefits under its Approved Enterprise status (so that the benefit periods may be up to ten years) and for further tax benefits if the level of foreign investment is 49% or more. If a company that has an Approved Enterprise program is a wholly-owned subsidiary of another company, then the percentage of foreign investments is determined based on the percentage of foreign investment in the parent company.

The following table sets forth the corporate tax rates and related levels of foreign investments with respect to a FIC that has an Approved Enterprise program.

<b>Percentage of non-Israeli ownership</b>	<b>Corporate Tax Rate</b>
49% or more but less than 74%	20%
74% or more but less than 90%	15%
90% or more	10%

Dividends paid out of income attributed to an Approved Enterprise (or out of dividends received from a company whose income is attributed to an Approved Enterprise) are generally subject to withholding tax at source at the rate of 15%, or at the lower rate under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA). This withholding tax is deducted at source by the company. The 15% tax rate is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. After such period, the withholding tax is applied at a rate of up to 30%, or at

the lower rate under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA). In the case of a FIC, the 12-year limitation on reduced withholding tax on dividends does not apply. Under the Investment Law, a company that has elected the Alternative Benefits Program is not obligated to distribute retained profits, and may generally decide from which year's profits to declare dividends. In addition, a company that pays a dividend out of tax-exempt income attributed to its Approved Enterprise will be subject to tax in respect of the amount of the dividend distributed (grossed up to reflect the pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate that would have otherwise been applicable. This rate generally ranges from 10% to 25%, depending on the level of foreign investment in the company in each year, as explained above. We have elected to use the Alternative Benefits Program, but currently intend to reinvest any income derived from our Approved Enterprise program and not to distribute such income as a dividend.

The Investment Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an Approved Enterprise during the first five years in which the equipment is used. This benefit is an incentive granted by the Israeli government regardless of whether an Alternative Benefits Program is elected.

The benefits available to an Approved Enterprise are subject to the fulfillment of the conditions stipulated in the Investment Law and its regulations published thereunder and criteria in the specific certificate of approval with respect thereto, as described above. In the event of failure to comply with these conditions, the company is required to refund the amount of tax benefits, adjusted to the Israel consumer price index and interest, or other monetary penalty.

#### ***Tax Benefits Subsequent to the 2005 Amendment***

The 2005 Amendment applies to new investment programs commencing in 2004 and thereafter, but does not apply to investment programs approved prior to April 1, 2005. The 2005 Amendment provides that terms and benefits included in any certificate of approval that was granted before the date on which the 2005 Amendment entered into effect (April 1, 2005) will remain subject to the provisions of the Investment Law as in effect on the date of such approval. Pursuant to the 2005 Amendment, the Investment Center will continue to grant Approved Enterprise status to qualifying investments. The 2005 Amendment, however, limits the scope of enterprises that may be approved by the Investment Center by setting criteria for the approval of a facility as an Approved Enterprise.

The 2005 Amendment provides that a certificate of approval from the Investment Center is required only for Approved Enterprises that receive cash grants. As a result, a company is no longer required to obtain the advance approval of the Investment Center in order to receive the tax benefits previously available under the Alternative Benefits Program. Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set forth in the 2005 Amendment (a "Benefited Enterprise"). A company that has a Benefited Enterprise may, at its discretion, approach the ITA for a pre-ruling confirming that it is in compliance with the provisions of the Capital Investment Law.

Tax benefits are available under the 2005 Amendment for production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export (and subject to certain conditions stipulated under law). In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment in fixed assets in the Benefited Enterprise that meets all the conditions set forth in the amendment for tax benefits and that exceeds a minimum investment amount specified in the Investment Law. Such investment entitles a company to receive a Benefited Enterprise status with respect to the investment, and may be made over a period of no more than three years from the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise (the "Year of Election"). Where a company requests to have the tax benefits apply to an expansion of existing facilities, then only the expansion will be considered a Benefited Enterprise and the company's effective tax rate will be the result of a weighted-average of the applicable rates.

The benefits period is subject to a limitation of 7 to 10 years from the Commencement Year (the "Commencement Year" being defined as the later of: (i) the first tax year in which the company derives income for tax purposes from the Benefited Enterprise or (ii) the Year of Election) provided that 12 years have not elapsed from the first day of the Year of Election. The tax benefits granted to a Benefited Enterprise depend on, among other things, the geographic location in Israel of the Benefited Enterprise, according to one of the following new tax routes, which may be applicable to a company:

- Similar to the Alternative Benefits Program, exemption from corporate tax on undistributed income for a period of 2 to 10 years, depending on the geographic location of the Benefited Enterprise in Israel, and a reduced corporate tax rate of 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in a company in each year. The benefits period is limited to 12 or 14 years from the year the company requested to have the tax benefits apply, depending on the location of the company. A company qualifying for tax benefits under the 2005 Amendment which pays a dividend out of income attributed to its Benefited Enterprise during the tax Exemption Period, will be subject to corporate tax in respect of the amount of the dividend distributed (grossed-up to reflect the pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate which would have otherwise been applicable.

Dividends paid out of income attributed to a Benefited Enterprise (or out of dividends received from a company whose income is attributed to a Benefited Enterprise) are generally subject to withholding tax at source at a rate of 15%, or at a lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA). The reduced rate of 15% is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. After this period, the withholding tax is applied at a rate of up to 30%, or at a lower rate under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA). In the case of a FIC, the 12-year limitation on reduced withholding tax on dividends does not apply.

- A special tax route, which enables companies owning facilities in certain geographical locations in Israel to pay corporate tax at the rate of 11.5% on income of the Benefited Enterprise. The benefits period is 10 years. Upon payment of dividends, the company is required to withhold tax at source at a rate of 15% for Israeli residents and at a rate of 4% for foreign residents.

The Investment Law also provides that a Benefited Enterprise is entitled to accelerated depreciation on its property and equipment that are productive assets as defined by the 2005 Amendment.

The benefits available to a Benefited Enterprise are subject to the fulfillment of conditions stipulated in the Investment Law and its regulations. If a company does not meet these conditions, then it would be required to refund the amount of tax benefits, adjusted to the Israeli consumer price index and interest, or other monetary penalty.

Our facilities in Israel have received Approved Enterprise status which entitles us to receive certain tax benefits. We currently have three active plans, two Approved Enterprises under the Alternative Benefits Program (Plan 3-4 and Plan 5) and one Benefited Enterprise (Plan 6), granting us a package of benefits, subject to compliance with applicable requirements. Under Plan 3-4 (benefit period starting 2003), we were entitled to an exemption from corporate income tax on undistributed profits for a period of two years following implementation of the plan and to a reduced tax rate of between 10% and 25% (depending on the level of foreign investment) for an additional 13 years thereafter. Under Plan 5 (benefit period starting 2007), we were entitled to an exemption from corporate income tax on undistributed profits for a period of two years following implementation of such plan and to a reduced tax rate of 10% to 25% (depending on the level of foreign investment) for eight additional years thereafter. We filed a request for an additional five years of reduced tax rates for such plan. Approval is still pending. Under Plan 6 (benefit period starting 2010), we were entitled to an exemption from corporate income tax on undistributed profits for a period of two years and a reduced tax rate of 10% to 25% (depending on the level of foreign investment) for eight additional years thereafter.

All of these programs are subject to the time limits imposed by the Investment Law and based upon the level of foreign ownership in the company in each tax year. To retain the most favorable rates we must maintain a foreign shareholders' level of at least 90%. We believe that we currently exceed this level but there can be no assurance that we will be able to reach or maintain this level of foreign ownership for each subsequent year.

#### ***Tax benefits under the 2011 Amendment and 2017 Amendment***

The 2011 Amendment cancelled the availability of the benefits granted in accordance with the provisions of the Investment Law prior to 2011 and, instead, introduced new benefits for income generated by a "Preferred Company" through its Preferred Enterprise (as such terms are defined in the Investment Law) as of January 1, 2011. A Preferred Company is defined as either (i) a company incorporated in Israel which is not wholly-owned by a governmental entity or (ii) a limited partnership that (a) was registered under the Israeli Partnerships Ordinance and (b) all of its limited partners are companies incorporated in Israel, but not all of them are governmental entities; which has, among other things, Preferred Enterprise status and is controlled and managed from Israel. Pursuant to the 2011 Amendment, a Preferred Company is entitled to a reduced corporate tax rate of 15% with respect to its preferred income attributed to its Preferred Enterprise in 2011-2012, unless the Preferred Enterprise is located in a specified development zone, in which case the rate will be 10%. These corporate tax rates were reduced to 12.5% and 7%, respectively, in 2013 and increased to 16% and 9%, respectively, in 2014 until 2016. Pursuant to the 2017 Amendment, in 2017 and thereafter, the corporate tax rate for a Preferred Enterprise which is located in a specified development zone was decreased to 7.5% while the reduced corporate tax rate for other development zones remains 16%. Income derived by a Preferred Company from a "Special Preferred Enterprise" (as that term is defined in the Investment Law) would be entitled, during a benefits period of 10 years, to further reduced tax rates of 8%, or to 5%, if the Special Preferred Enterprise is located in a specified development zone. As of January 1, 2017, the definition for 'Special Preferred Enterprise' includes less stringent conditions.

Dividends paid out of preferred income attributed to a Preferred Enterprise or to a Special Preferred Enterprise are generally subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA allowing for a reduced tax rate). However, if such dividends are paid to an Israeli company, no tax will be withheld (although if such dividends are subsequently distributed to individuals or a non-Israeli company, withholding tax at a rate of 20%, will apply, subject to any lower rate as may be provided in an applicable tax treaty subject to the receipt in advance of a valid certificate from the ITA allowing for a reduced tax rate). In 2017 - 2019, dividends paid out of preferred income attributed to a Special Preferred Enterprise, directly to a foreign parent company, are subject to withholding tax at source at the rate of 5% (temporary provisions).

The 2011 Amendment also included transitional provisions to address companies already enjoying existing tax benefits under the Investment Law. These transitional provisions provide, among other things, that unless an irrevocable request is made to apply the provisions of the Investment Law as amended in 2011 with respect to income to be derived as of January 1, 2011: (i) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, which chose to receive grants, before the 2011 Amendment became effective, will remain subject to the provisions of the Investment Law as in effect immediately prior to the date of the 2011 Amendment, and subject to certain conditions; (ii) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise, which had participated in an Alternative Benefits Program, before the 2011 Amendment became effective will remain subject to the provisions of the Investment Law as in effect immediately prior to the date of the 2011 Amendment, provided that certain conditions are met.; and (iii) a Benefitted Enterprise can elect to continue to benefit from the benefits provided to it before the 2011 Amendment became effective, provided that certain conditions are met.

We have evaluated the likely effect of the 2011 Amendment and have currently decided not to file a request to apply the new benefits under the 2011 Amendment. We may decide in the future to make the above-mentioned election.

### ***The New Technological Enterprise Incentives Regime – Amendment 73 to the Investment Law***

The 2017 Amendment was enacted as part of the Economic Efficiency Law that was published on December 29, 2016, and is effective as of January 1, 2017. The 2017 Amendment is based on OECD guidelines recently published as part of the Base Erosion and Profit Shifting (BEPS) project and introduced the incentive regimes of "Preferred Technological Enterprise" and of "Special Preferred Technological Enterprise", as described below. These new regimes are in addition to the other existing tax incentives regimes under the Investment Law. The new incentives regime will apply to "Preferred Technological Enterprises" that meet the "Preferred Enterprise" condition and certain additional conditions, including, all of the following:

- A company's average R&D expenses in the three years prior to the current tax year must be greater than or equal to 7% of its total revenue or exceed NIS 75 million (approximately \$21 million) per year; and
- A company must also satisfy one of the following conditions: (1) at least 20% of the workforce (or at least 200 employees) are employed in R&D; (2) a venture capital investment of an amount of NIS 8 million (approximately \$2 million) was previously made in the company; or (3) growth in sales or workforce by an average of 25% over the three years preceding the tax year.

A "Special Preferred Technological Enterprise" is an enterprise that meets the "Preferred Technological Enterprises" conditions, and in addition is a part of a group of companies that have total annual consolidated revenues of at least NIS 10 billion (approximately \$2.8 billion).

A "Preferred Technological Enterprise" satisfying the required conditions will enjoy a reduced corporate tax rate of 12% on income that qualifies as "Preferred Technological Income", as defined in the Investment Law. The tax rate is further reduced to 7.5% for a Preferred Technological Enterprise located in development zone A. These corporate tax rates shall generally be limited to the portion of intellectual property developed in Israel. In addition, a Preferred Technological Enterprise will enjoy a reduced corporate tax rate of 12% on capital gain derived from the sale of certain "Benefitted Intangible Assets" (as defined in the Investment Law) to a related foreign company if the Benefitted Intangible Assets were acquired from a foreign company on or after January 1, 2017 for at least NIS 200 million, if the sale was pre-approved by the Israel Innovation Authority ("IIA"), formally known as the Office of the Chief Scientist.

A "Special Preferred Technological Enterprise" satisfying the required conditions will enjoy a further reduced corporate tax rate of 6% on "Preferred Technological Income" regardless of the company's geographic location within Israel. In addition, a Special Preferred Technological Enterprise will enjoy a reduced corporate tax rate of 6% on capital gain derived from the sale of certain "Benefitted Intangible Assets" to a related foreign company if the Benefitted Intangible Assets were either developed by an Israeli company or acquired from a foreign company on or after January 1, 2017, and the sale received prior approval from IIA. A Special Preferred Technology Enterprise that acquires Benefitted Intangible Assets from a foreign company for more than NIS 500 million will be eligible for these benefits for at least ten years, subject to certain approvals as specified in the Investment Law.

Dividends distributed by a Preferred Technological Enterprise or a Special Preferred Technological Enterprise, paid out of Preferred Technological Income, are generally subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). However, if such dividends are paid to an Israeli company, no tax is required to be withheld. If such dividends are distributed to a foreign parent company holding at least 90% of the shares of the distributing company and other conditions are met, the withholding tax rate may be reduced to 4%.

We have evaluated the likely effect of the 2017 Amendment and have currently decided not to file a request to apply the new benefits under the 2017 Amendment. We may decide in the future to make the above-mentioned election.

#### ***Tax Benefits under the Law for the Encouragement of Industry (Taxes), 1969***

The Law for the Encouragement of Industry (Taxes), 1969 (the “Industry Encouragement Law”) provides several tax benefits for Industrial Companies. Pursuant to the Industry Encouragement Law, a company qualifies as an Industrial Company if it is an Israeli resident company, and at least 90% of its income in any tax year (other than income from certain government loans), is generated from an “Industrial Enterprise” located in Israel that it owns. An Industrial Enterprise is defined as an enterprise whose major activity in a given tax year is industrial production.

Under the Industry Encouragement Law, an Industrial Company is entitled to certain corporate tax benefits, including:

- Deduction of the cost of purchase of know-how, patents and rights to use a patent or know-how used for the development or promotion of the Industrial Enterprise, over an eight-year period commencing on the year in which such rights were first exercised;
- The right to elect, under specified conditions, to file a consolidated tax return together with Israeli industrial companies controlled by it;
- Accelerated depreciation rates on equipment and buildings; and
- A straight-line deduction of expenses related to a public offering over a three-year period commencing in the year of offering.

Under some tax laws and regulations, an Industrial Enterprise may be eligible for special depreciation rates for machinery, equipment and buildings. These rates differ based on various factors, including the date the operations begin and the number of work shifts. An Industrial Company owning an Approved Enterprise may choose between these special depreciation rates and the depreciation rates available to the Approved Enterprise.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. As any unilateral tax position, we cannot assure that it will not be challenged, or that we will continue to qualify as an Industrial Company or that the benefits described above will be available to us in the future.

#### ***Grants under the Encouragement of Research, Development and Technological Innovation Law, 5744-1984***

On January 1, 2016, the Encouragement of Research, Development and Technological Innovation Law, 5744-1984 (the “Research Law”, as amended), was enacted, which amended the Encouragement of Industrial Research and Development Law, 1984. Under the Research Law development programs that meet specified criteria and are approved by the IIA are generally eligible for grants of up to 50% of the project’s expenditures, as determined by the IIA, in exchange for the payment of royalties from the sale of products developed as part of the programs under which the grants were given.

The Company received grants from the IIA. Regulations under the Research Law, as amended generally provide for the payment of royalties to the IIA of 3-6% on sales of products and services derived from a technology developed using these grants until 100% of the dollar-linked grant is repaid. Our obligation to pay these royalties is contingent on our actual sale of such products and services. In the absence of such sales, no payment of such royalties is required. Effective for grants received from the IIA under programs approved after January 1, 1999, the outstanding balance of the grants will be subject to interest at a rate equal to the 12 month LIBOR applicable to dollar deposits that is published on the first business day of each calendar year in which the program has been approved. Following the full repayment of all the outstanding liabilities in connection with such grants, including the accrued interest thereof, there is no further liability for such royalties. However, even after the repayment of such liabilities in full, we will remain subject to the limitations set forth under the Research Law, including inter alia on the sale, transfer or assignment outside of Israel of know-how developed as part of the programs under which the grants were given. Grant recipients are required to notify the IIA of events enumerated in the Research Law.

The terms of the grants under the Research Law also require that generally the manufacture of products developed as part of the programs under which the grants were given be undertaken in Israel. However, under the regulations pursuant to the Research Law, the manufacturing may be undertaken outside of Israel, assuming we receive prior approval from the IIA for the foreign manufacturing, which approval is given in special circumstances upon the fulfillment of certain conditions. If we receive that approval and manufacture outside of Israel, we may be required to pay increased royalties. The increase in royalties depends upon the extent of the manufacturing volume that is performed outside of Israel, as follows:

<b>Extent of manufacturing volume outside of Israel</b>	<b>Royalties to the Chief Scientist as a percentage of grant</b>
Less than 50%	120%
between 50% and 90%	150%
90% and more	300%

Despite the general approval requirement, a transfer outside of Israel of up to 10% of the manufacturing rights will not require the approval of the IIA, but rather a notification to the IIA, which may block such transfer within 30 days.

The know-how developed within the framework of the IIA programs may not be transferred to third parties outside Israel without the prior approval of the IIA. The approval, however, is not required for the export of any products developed using grants received from the IIA. The IIA approval to transfer know-how created, in whole or in part, in connection with an IIA-funded program to a third party outside Israel is subject to payment of a redemption fee to the IIA calculated according to a formula provided under the Research Law, which cannot exceed 6 times of the total grant amount plus interest. Upon payment of such redemption fee, the know-how and the production rights for the products supported by such funding cease to be subject to the Research Law.

In May 2017, the IIA issued new rules for licensing know-how developed with IIA funding outside of Israel (the “Licensing Rules”), which allow grant recipient to enter into licensing arrangements or grant other rights in know-how developed under IIA programs outside of Israel, subject to the prior consent of IIA and payment of license fees, calculated in accordance with the Licensing Rules. The payment of the license fees will not discharge grant recipient from the obligations to pay royalties or other payments to the IIA. The maximum amount payable to the IIA under the Licensing Rules shall not exceed 6 times the amount of the grants received plus LIBOR interest.

Transfer of know-how within Israel is subject to an undertaking of the recipient Israeli entity to comply with the provisions of the Research Law and related regulations, including the restrictions on the transfer of manufacturing rights or know-how and the obligation to pay royalties, if applicable, as further described in the Research Law and related regulations.

#### ***Tax Benefits and Grants for Research and Development***

Israeli tax law allows, under certain conditions, a deduction of research and development expenditures in the year in which they are incurred, subject to a pre-approval. The amount of such deductible expenses is reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects.

Expenditures not so approved, but otherwise qualifying for deduction, are deductible over a three-year period, from the first year that the expenditures were made. However, the amount of any government grants made available are subtracted from the amount of expenses which may be deducted.

## ***Taxation of Non-Israeli Resident Holders of our Ordinary Shares***

The following is a brief summary of the material Israeli tax consequences concerning the ownership and disposition of our ordinary shares by our shareholders. This summary does not discuss all the aspects of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of such investors include residents of Israel or traders in securities who are subject to special tax regimes not covered in this discussion. Because parts of this discussion are based on new tax legislation that has not yet been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities or the courts will accept the views expressed in this discussion. The discussion below is subject to change, including due to amendments under Israeli law or changes to the applicable judicial or administrative interpretations of Israeli law, which may have retroactive effect.

***Taxation of Non-Israeli Resident Shareholders on Receipt of Dividends.*** Non-Israeli residents (whether individuals or corporations) are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 25% or 30% (if the dividend recipient is a “Substantial Shareholder” at the time of distribution or at any time during the preceding 12-month period). Such dividends are generally subject to Israeli withholding tax at the rate of 25% so long as the shares are registered with a Nominee Company (whether the recipient is a substantial shareholder or not). A “substantial shareholder” is generally a person who alone or together with such person’s relative or another person who collaborates with such person on a permanent basis, holds, directly or indirectly, at least 10% of any of the “means of control” of the corporation. “Means of control” generally includes the right to vote, receive profits, nominate a director or an officer, receive assets upon liquidation, or order someone who holds any of the aforesaid rights how to act, and all regardless of the source of such right. However, distribution of dividends from income attributed to an Approved Enterprise or a Benefited Enterprise is subject to Israeli income tax at a rate of 15% (and 20% with respect to Preferred Enterprise or Preferred Technological Enterprise), unless a reduced tax rate is provided under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA). For example, under the Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, as amended (the “U.S.-Israel Tax Treaty”), the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a U.S. resident (for purposes of the U.S.-Israel Tax Treaty) is 25%. However, generally, the maximum rate of withholding tax on dividends, not generated by an Approved Enterprise, Benefited Enterprise, Preferred Enterprise or Preferred Technological Enterprise, that are paid to a U.S. corporation holding 10% or more of the outstanding voting rights throughout the tax year in which the dividend is distributed as well as the previous tax year, is 12.5%, provided that not more than 25% of the gross income for such preceding year consists of certain types of dividends and interest. Notwithstanding the foregoing, dividends distributed from income attributed to an Approved Enterprise or Benefited Enterprise are subject, under certain conditions, to withholding at the rate of 15%. We cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders’ tax liability. If the dividend is partly attributable to income derived from an Approved Enterprise, Benefited Enterprise or Preferred 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. U.S. residents who are subject to Israeli withholding tax on a dividend may be entitled to a credit or deduction for United States federal income tax purposes in the amount of the taxes withheld, subject to detailed rules contained in U.S. tax legislation.

A non-Israeli resident who receives dividends from which tax was duly withheld is generally exempt from the duty to file returns in Israel in respect of such income, provided that (i) such income was not derived from a business conducted in Israel by the taxpayer, and (ii) the taxpayer has no other taxable sources of income in Israel with respect to which a tax return is required to be filed and (iii) the taxpayer is not obliged to pay excess tax (as further explained below).

***Capital Gains Taxes Applicable to Non-Israeli Resident Shareholders.*** Israeli capital gain tax is imposed on the disposal of capital assets by a non-Israeli resident if such assets are either (i) located in Israel; (ii) shares or rights to shares in an Israeli company, or (iii) represent, directly or indirectly, rights to assets located in Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder’s country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is, generally, a portion of the total capital gain which is equivalent to the increase of the relevant asset’s purchase price which is attributable to the increase in the Israeli consumer price index, between the date of purchase and the date of sale (under certain circumstances, linkage to a foreign currency may be used to determine the inflationary surplus). The real gain is the excess of the total capital gain over the inflationary surplus. Real capital gain on a disposition of listed shares is generally subject to tax at the corporate tax rate of 23.0% as of 2018 (in 2017, 2016 and 2015 the corporate tax rate was 24.0%, 25.0% and 26.5%, respectively), if generated by a company, or at the rate of 25.0% (or 30.0% for Substantial Shareholder), if generated by an individual from the sale of an asset purchased on or after January 1, 2012. Individual and corporate shareholders dealing in securities in Israel are taxed at the tax rates applicable to business income (a corporate tax rate for a corporation and a marginal tax rate of up to 47% for an individual in 2018).

Notwithstanding the foregoing, shareholders that are not Israeli residents (individuals and corporations) are generally exempt from Israeli capital gains tax on any gains derived from the sale, exchange or disposition of shares listed on a non-Israeli stock exchange, provided, inter alia, that certain conditions are met. The main conditions are that (i) such gains are not derived through a permanent establishment that the non-Israeli resident maintains in Israel; (ii) the shares were purchased after being listed; and (iii) the capital gains are neither subject to section 101 of the Israeli Tax Ordinance, nor to the Israeli Income Tax Law (Inflationary Adjustments) 5745-1985. However, non-Israeli corporations will not be entitled to the foregoing exemption if Israeli residents (i) have a controlling interest of more than 25% in such non-Israeli corporation, or (ii) are the beneficiaries of or are entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly. Furthermore, such an exemption is not applicable to a person whose gains from selling or otherwise disposing of the shares are deemed to be business income.

Additionally, a sale of shares may be exempt from Israeli capital gains tax under the provisions of an applicable tax treaty (subject to the receipt in advance of a valid certificate from the ITA). For example, under the U.S.-Israel Tax Treaty, the sale, exchange (whether from merger, acquisition or similar transaction) or disposition of our ordinary shares by a shareholder who is both a U.S. resident (for purposes of that treaty) holding the ordinary shares as a capital asset and entitled to claim the benefits afforded to such resident by the U.S.-Israel Tax Treaty (called a “Treaty U.S. Resident”) is generally exempt from Israeli capital gains tax unless either (i) such Treaty U.S. Resident if an individual has been present in Israel for a period or periods aggregating to 183 days or more during the applicable taxable year; or (ii) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting rights during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions; or (iii) the capital gain arising from such sale, exchange or disposition is attributable to a permanent establishment of the Treaty U.S. Resident maintained in Israel; or; (iv) the capital gains arising from such sale, exchange or disposition is attributed to real estate located in Israel or to royalties. In any of these cases, the sale, exchange or disposition of our ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for the tax against the U.S. federal income tax imposed with respect to the sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits.

In some instances, whether or not our shareholders are liable for Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at source. Shareholders may be required to demonstrate that they are exempt from tax on their capital gain in order to avoid withholding at source at the time of sale. Specifically, in transactions involving a sale of all of the shares of an Israeli resident company, in the form of a merger or otherwise, the ITA may require from shareholders who are not liable for Israeli tax to sign declarations in forms specified by this authority or obtain a specific exemption from the ITA to confirm their status as a non-Israeli resident, and, in the absence of such declarations or exemptions, may require the purchaser of the shares to withhold taxes at source.

*Excess Tax.* Individuals who are subject to tax in Israel are also subject to an additional tax at a rate of 2% on annual income exceeding NIS 803,520 for 2016, and as of 2017, the additional tax will be at a rate of 3% on annual income exceeding NIS 640,000 (which amount is linked to the annual change in the Israeli consumer price index). Such excess tax is imposed on almost any type of income, including, but not limited to, dividends, interest and capital gain.

### ***Israeli Transfer Pricing Regulations***

On November 29, 2006, Income Tax Regulations (Determination of Market Terms) promulgated under Section 85A of the Tax Ordinance, came into effect (“TP Regulations”). Section 85A of the Tax Ordinance and the TP Regulations generally require that all cross-border transactions carried out between related parties be conducted on an arm’s length principle basis and will be taxed accordingly.

### **United States Federal Income Tax Considerations**

Subject to the limitations described in the next paragraph, the following discussion describes the material United States federal income tax consequences to a holder of our ordinary shares (a “U.S. Holder”) that is:

- a citizen or resident of the United States;
- a corporation, or other entity taxable as a corporation for United States federal income tax purposes, created or organized in the United States or under the laws of the United States, any state thereof or the District of Columbia;
- an estate, the income of which is includable in gross income for United States federal income tax purposes regardless of its source; or
- a trust, if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust or if the trust has validly elected to be treated as a United States person under applicable Treasury regulations.



In addition, certain material aspects of United States federal income tax relevant to a holder who is not a partnership and is not a U.S. Holder (a “Non-U.S. Holder”) are discussed below.

If a partnership, or other entity or arrangement treated as a partnership for United States federal income tax purposes, holds ordinary shares, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partner in a partnership that holds ordinary shares is urged to consult its own tax advisor regarding the specific tax consequences of owning and disposing of ordinary shares.

This summary is for general information purposes only. It does not purport to be a comprehensive description of all of the tax considerations that may be relevant to each person’s decision to own our ordinary shares.

This discussion is based on current provisions of the Code, current and proposed Treasury regulations promulgated thereunder, and administrative and judicial decisions as of the date hereof, all of which are subject to change, possibly on a retroactive basis. Any such change could materially affect the continued validity of this discussion and the tax consequences described herein. This discussion does not address all aspects of United States federal income taxation that may be relevant to any particular shareholder based on such shareholder’s individual circumstances. In particular, this discussion considers only U.S. Holders that will own ordinary shares as capital assets and does not address the potential application of the alternative minimum tax or United States federal income tax consequences to U.S. Holders that are subject to special treatment, including U.S. Holders that:

- are broker-dealers or insurance companies;
- are certain former citizens or long-term residents of the United States.;
- are persons subject to the alternative minimum tax;
- have elected mark-to-market accounting;
- are tax-exempt organizations;
- are financial institutions or financial services entities;
- hold ordinary shares as part of a straddle, hedge or conversion transaction with other investments;
- own directly, indirectly or by attribution at least 10% of our company (by vote or value);
- have a functional currency that is not the U.S. dollar;
- are carrying on a trade or business in Israel through a permanent establishment; or
- acquire ordinary shares as compensation.

In addition, this discussion does not address any aspect of state, local or non-United States tax laws and does not consider the possible application of United States federal gift or estate tax or the Medicare tax on net investment income.

**Each holder of ordinary shares is advised to consult such person’s own tax advisor with respect to the specific tax consequences to such person of purchasing, holding or disposing of our ordinary shares.**

## **Taxation of Ordinary Shares**

### ***Taxation of Distributions Paid On Ordinary Shares***

Subject to the discussion below under “Tax Consequences if We Are a Passive Foreign Investment Company,” a U.S. Holder will be required to include in gross income as ordinary income the amount of any distribution paid on our ordinary shares, including any Israeli taxes withheld from the amount paid, on the date the distribution is actually or constructively received to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for United States federal income tax purposes. Distributions in excess of such earnings and profits will be applied against and will reduce the U.S. Holder’s basis in the ordinary shares and, to the extent in excess of such basis, will be treated as gain from the sale or exchange of ordinary shares.

With respect to non-corporate U.S. Holders, including individual U.S. Holders, dividends may constitute “qualified dividend income” eligible to be taxed at the preferential rate applicable to long-term capital gains (currently a maximum rate of 20%), provided that (1) (a) our ordinary shares are readily tradable on an established securities market in the United States or (b) we qualify for benefits under an income tax treaty with the United States which includes an information exchange program and such treaty is determined by the United States Internal Revenue Service (“IRS”), to be satisfactory, (2) we are not a passive foreign investment company (“PFIC”) (as discussed below) for either our taxable year in which the dividend was paid or the preceding taxable year, and (3) the U.S. holders satisfy certain minimum holding period requirements. Our shares are now traded on the NYSE and we believe the requirements of 1(a), (1)(b) and (2) are met. Therefore, dividends on our shares would qualify as qualified dividend income so long as a U.S. Holder meets requirement (3).

**You should consult your tax advisor regarding the availability of the lower rate for any dividends paid with respect to our ordinary shares.**

Any dividends paid by us to a U.S. Holder on our ordinary shares will be treated as foreign source income and will generally be categorized as “passive income” for United States foreign tax credit purposes. Subject to the limitations in the Code, as modified by the U.S.-Israel Tax Treaty, a U.S. Holder may elect to claim a foreign tax credit against its United States federal income tax liability for Israeli income tax withheld from dividends received in respect of ordinary shares. U.S. Holders who do not elect to claim the foreign tax credit may instead claim a deduction for Israeli income tax withheld, but only for a year in which the U.S. Holder elects to do so with respect to all foreign income taxes. A deduction does not reduce United States tax on a dollar-for-dollar basis like a tax credit. The deduction, however, is not subject to the limitations applicable to foreign tax credits. The rules relating to the determination of the foreign tax credit are complex. Accordingly, if you are a U.S. Holder of ordinary shares you should consult your own tax advisor to determine whether and to what extent you would be entitled to the credit.

### ***Taxation of the Disposition of Ordinary Shares***

Subject to the discussion below under “Tax Consequences if We Are a Passive Foreign Investment Company,” upon the sale, exchange or other taxable disposition of our ordinary shares, a U.S. Holder will recognize a capital gain or loss in an amount equal to the difference between such U.S. Holder’s basis in the ordinary shares, which is usually the cost of such shares in U.S. dollars, and the amount realized on the disposition in U.S. dollars. Any gain or loss recognized upon the sale, exchange or other taxable disposition of the ordinary shares will be treated as long-term capital gain or loss if, at the time of the sale, exchange or other taxable disposition, the holding period of the ordinary shares exceeds one year. In the case of individual U.S. Holders, capital gains generally are subject to United States federal income tax at preferential rates if specified minimum holding periods are met. The deductibility of capital losses is subject to significant limitations. U.S. Holders should consult their own tax advisors in this regard.

In general, gain or loss recognized by a U.S. Holder on the sale, exchange or other taxable disposition of our ordinary shares will be United States source income or loss for United States foreign tax credit purposes. In certain instances, a U.S. Holder who is subject to tax in Israel on the sale of our shares and who is entitled to the benefits of the U.S.-Israel Tax Treaty may treat such gain as Israeli source income and thus could, subject to other United States foreign tax credit limitations, credit the Israeli tax on such sale against such U.S. Holder’s United States federal income tax on the gain from that sale.

### ***Tax Consequences if We Are a Passive Foreign Investment Company***

We will be a PFIC if 75% or more of our gross income in a taxable year, including the pro rata share of the gross income of any company, United States or foreign, in which we are considered to own, directly or indirectly, 25% or more of the shares by value, is passive income. Alternatively, we will be considered to be a PFIC if at least 50% of our assets in a taxable year, averaged quarterly over the year and ordinarily determined based on fair market value and including the pro rata share of the assets of any company in which we are considered to own, directly or indirectly, 25% or more of the shares by value, are held for the production of, or produce, passive income. Passive income includes, among other amounts, amounts derived by reason of the temporary investment of funds raised in our public offerings.

Based on our income, assets, and business activities, we do not believe that we are a PFIC. However, the tests for determining PFIC status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a PFIC. If we were characterized as a PFIC for any taxable year, a U.S. Holder would suffer adverse tax consequences. These consequences may include having the gains that are realized on the disposition of ordinary shares treated as ordinary income rather than capital gains and being subject to punitive interest charges with respect to certain dividends and gains and on the sale or other disposition of the ordinary shares. Furthermore, dividends paid by a PFIC are not eligible to be treated as “qualified dividend income” (as discussed above). In addition, if a U.S. Holder holds ordinary shares in any year in which we are treated as a PFIC, such U.S. Holder will be subject to additional tax form filing and reporting requirements (including additional filing requirements under recently-enacted legislation).

If we determine that we have become a PFIC, we will notify our U.S. Holders and provide them with the information necessary to comply with the “qualified electing fund” (“QEF”) rules (which can mitigate some of the adverse effects of our being a PFIC). U.S. Holders are urged to consult their tax advisors about the PFIC rules, including the consequences to them of making any elections with respect to our ordinary shares in the event that we qualify as a PFIC.

### ***Tax Consequences for Non-U.S. Holders of Ordinary Shares***

Except as described in “Information Reporting and Backup Withholding” below, a Non-U.S. Holder of ordinary shares will not be subject to United States federal income or withholding tax on the payment of dividends on, and the proceeds from the sale, exchange or other taxable disposition of our ordinary shares, unless:

- such item is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States and, in the case of a resident of a country which has a tax treaty with the United States, such item is attributable to a permanent establishment or, in the case of an individual, a fixed place of business, in the United States;
- the Non-U.S. Holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition and certain other conditions are met; or
- the Non-U.S. Holder is subject to tax pursuant to the provisions of United States tax law applicable to United States expatriates.

### ***Information Reporting and Backup Withholding***

U.S. Holders generally are subject to information reporting requirements with respect to dividends paid in the United States on, or the proceeds from the taxable disposition of, our ordinary shares, unless the U.S. Holder is an exempt recipient. U.S. Holders are also generally subject to backup withholding on dividends paid in the United States on, or the proceeds from the taxable disposition of, our ordinary shares unless the U.S. Holder provides IRS Form W-9 or otherwise establishes an exemption.

Non-U.S. Holders generally are not subject to information reporting or backup withholding with respect to dividends paid on, or upon the taxable disposition of, ordinary shares. Such holders, however, may be required to provide certification of non-U.S. status (generally on IRS Form W-8BEN) in connection with payments received in the United States or through certain U.S.-related financial intermediaries.

The amount of any backup withholding may be allowed as a credit against a U.S. or Non-U.S. Holder’s United States federal income tax liability and may entitle such holder to a refund, provided that certain required information is timely furnished to the IRS.

U.S. Holders should also be aware that additional reporting requirements apply with respect to the holding of certain foreign financial assets, including stock of foreign issuers that is not held in an account maintained by a financial institution, if the aggregate value of all such assets exceeds U.S. \$50,000. U.S. Holders should consult their own tax advisors regarding the application of these and other information reporting rules applicable to an investment in our ordinary shares based on their particular situation.

### **F. DIVIDENDS AND PAYING AGENTS**

Not applicable.

### **G. STATEMENT BY EXPERTS**

Not applicable.

### **H. DOCUMENTS ON DISPLAY**

We are subject to the informational requirements of the Exchange Act applicable to foreign private issuers and fulfill the obligation with respect to such requirements by filing reports 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.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements with the SEC as frequently or as promptly as United States companies whose securities are registered under the Exchange Act. A copy of each report submitted in accordance with applicable United States law is available for public review at our principal executive offices and on our website at [www.taro.com](http://www.taro.com). The information contained on our website does not constitute part of this 2018 Annual Report.

## I. SUBSIDIARY INFORMATION

Not applicable.

### ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, which primarily consists of interest rate and foreign exchange risk. We use derivative instruments to partially mitigate our exposure to these risks. Our objective is to reduce volatility in cash flows due to changes in interest and foreign exchange rates.

#### Foreign Exchange Rate Risk

We and Taro U.S.A. use the U.S. dollar as our reporting currency and are exposed to foreign exchange rate risk from transactions conducted in different currencies.

In 2018, 83% of our revenue was generated in U.S. dollars. However, the remainder of our sales was denominated in the local currencies of the countries in which the sales occurred. As a result, our reported profits and cash flows are exposed to changing exchange rates. If these foreign currencies weaken relative to the U.S. dollar, the earnings generated in these foreign currencies will, in effect, decrease when converted into U.S. dollars, and vice versa. Therefore, from time to time we attempt to manage exposures that arise in the normal course of business related to fluctuations in foreign currency exchange rates by entering into offsetting positions through the use of foreign exchange forward contracts.

Due to the relatively low level of non-U.S. dollar revenues, the effects of currency fluctuations on consolidated net sales and operating income were not significant in 2018.

#### *Intercompany Foreign Exchange Transactions*

Our most significant foreign exchange rate risk relates to our Canadian subsidiary's transactions with Taro U.S.A. that are denominated and settled in U.S. dollars. These transactions increase the volatility of our earnings since our Canadian subsidiary records gains or losses on foreign exchange transactions under U.S. GAAP as its functional currency is the CAD. During the year ended March 31, 2018, the Company recorded a loss of \$35.2 million compared to a gain of \$23.3 million in 2017, reflecting the unfavorable impact of the change in foreign currency exchange rates related primarily to cash and cash equivalents, short-term bank deposits and intercompany balances in Canada.

As of March 31, 2016, the Company did not have any forward contracts in place to purchase either the NIS or CAD. However, the Company settled contracts throughout the year to purchase the NIS totaling \$26.2 million and the CAD totaling \$24.9 million and recorded net gains of \$0.8 million and \$3.4 million, respectively.

In April 2016, the Company began entering into separate forward contracts to purchase the NIS and the CAD on a monthly basis at agreed upon spot rates to hedge the variability of cash flows in U.S. dollars due to changes in the respective exchange rates.

As of March 31, 2018, the forward contracts to purchase the NIS are for a total amount of \$52.3 million, at a weighted-average forward rate of 3.45 NIS per U.S. dollar, which are settled in 18 monthly settlements of \$3.3 million for eleven (11) months, \$2.0 million for six (6) months, and \$4.5 million for one (1) month. The Company recorded a net gain of \$0.1 million for the year ended March 31, 2018 for the contracts to purchase the NIS.

As of March 31, 2018, the forward contracts to purchase the CAD are for a total amount of \$53.5 million, at a weighted-average forward rate of CAD 1.28 per U.S. dollar, which are settled in 14 monthly installments of approximately \$2.8 million for six (6) months, \$4.0 million for five (5) months, and \$5.5 million for three (3) months. The Company recorded a net gain of \$2.1 million for the year ended March 31, 2018 for the contracts to purchase the CAD.

We do not account for these derivatives as a hedge and are therefore subject to earnings volatility due to fluctuations in the fair value of the forward contracts. There is no collateral for these hedges.

#### Interest Rate Risk

Under current conditions, we do not believe that our exposure to market risks will have a material impact on future earnings.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Not applicable.

**ITEM 15. CONTROLS AND PROCEDURES**

**a. *Disclosure Controls and Procedures***

Taro's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of Taro's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this 2018 Annual Report, have concluded that, as of such date, Taro's disclosure controls and procedures were effective to ensure that the information required in the reports that it files or submits 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 its Management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**b. *Report of Taro Management on Internal Control Over Financial Reporting***

Taro's Board and Management are responsible for establishing and maintaining adequate internal control over financial reporting. Taro's internal control system was designed to provide reasonable assurance to Taro's Management and Board 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.

Taro's Management assessed the effectiveness of the Company's internal control over financial reporting as of March 31, 2018. In making this assessment, it used the criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on such assessment, Management has concluded that, as of March 31, 2018, Taro's internal control over financial reporting is effective based on those criteria.

**c. *Attestation Report of the Registered Public Accounting Firm***

Taro's internal control over financial reporting as of March 31, 2018, has been audited by Ziv Haft, a BDO Member Firm ("Ziv Haft"), an independent registered public accounting firm in Israel, as stated in their report, which is included on pages F-2 and F-3 of this 2018 Annual Report.

**d. *Changes in Internal Control Over Financial Reporting***

There were no changes to Taro's internal control over financial reporting that occurred during the period covered by this 2018 Annual Report that have materially affected, or are reasonably likely to materially affect, Taro's internal control over financial reporting.

**ITEM 16. [RESERVED]**

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our Board has determined that Linda Benshoshan, the Chairwoman of the Audit Committee, is an audit committee financial expert, as defined by applicable SEC regulations, and is independent in accordance with applicable SEC and NYSE regulations. See Item 6.A for a summary of Linda Benshoshan's relevant professional experience.

**ITEM 16B. CODE OF ETHICS**

We have adopted a code of conduct applicable to our directors and all employees. We have also adopted a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer and other senior officers. A copy of the code of conduct or the code of ethics may be obtained, without charge, upon a written request addressed to: Corporate Affairs Department, Taro Pharmaceutical Industries Ltd., c/o Taro Pharmaceuticals U.S.A., Inc., 3 Skyline Drive, Hawthorne, NY 10532. The code of conduct is also available on the Company's website at [www.taro.com](http://www.taro.com). Any waivers of the code of conduct or the code of ethics for executive officers or directors will be disclosed through the filing of a Report on Form 6-K.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES****Principal Accountant Fees and Services**

We paid the following fees for professional services rendered by Ziv Haft – BDO Member Firm, for the years ended March 31, 2018 and 2017, respectively.

	Year ended March 31, 2018	Year ended March 31, 2017
	(in millions)	
Audit fees	\$ 0.71	\$ 0.69
Tax fees	0.06	0.06
Other fees	0.10	—
<b>Total</b>	<b>\$ 0.87</b>	<b>\$ 0.75</b>

The audit fees for the years ended March 31, 2018 and 2017, respectively, represent fees for professional services rendered for the audits of our annual consolidated financial statements, statutory or regulatory audits of us and our subsidiaries, consents and assistance with review of documents filed with the SEC. All services provided by the Company's independent auditors, including those set forth in the table above, were approved by the Audit Committee.

Tax fees represent fees for professional 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, tax services for employee benefit plans and assistance with respect to requests for rulings from tax authorities.

Other fees represent fees for additional professional services performed for certain legal entities.

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

Our Audit Committee is responsible for the oversight of our independent auditors' work. The Audit Committee's policy is to pre-approve all audit and non-audit services provided by our independent registered public accounting firm, Ziv Haft. 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 that 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, Ziv Haft and our 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.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not applicable.

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

On December 23, 2013, we completed a modified "Dutch" tender offer through which it repurchased 1,959,514 ordinary shares at a price of \$97.50 per share for total consideration of \$193.0 million (including fees and expenses).

On March 15, 2016, the Company announced that its Board of Directors approved a \$250 million share repurchase of ordinary shares, which was completed on August 18, 2016. Under the new program, the Company bought back 1,801,099 of its ordinary shares in open market transactions, in accordance with a 10b5-1 program, at an average price of \$138.80 per share.

On November 23, 2016, the Company announced that its Board of Directors approved a new \$250 million share repurchase of ordinary shares. Repurchases may be made from time to time at the Company's discretion, based on ongoing assessments of the capital needs of the business, the market price of its stock, and general market conditions. No time period has been set for the repurchase program, and any such program may be suspended or discontinued at any time. The repurchase authorization enables the Company to purchase its ordinary shares from time to time through open market purchases, negotiated transactions or other means, including 10b5-1 trading plans in accordance with applicable securities laws or other restrictions. On November 7, 2017, the Board extended the share repurchase program for one year. The table below presents a summary of the ordinary shares repurchased by the Company under the new authorization and classified as treasury stock, as of May 31, 2018, in accordance with a 10b5-1 program:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of the Current Program	Dollar Value of Shares that May Yet Be Purchased Under the Program (in thousands)
November 25, 2016 - November 30, 2016	68,641	\$ 105.21	68,641	
December 1, 2016 - December 31, 2016	242,821	\$ 104.87	311,462	
January 1, 2017 - January 31, 2017	156,353	\$ 103.33	467,815	
February 1, 2017 - February 28, 2017	51,150	\$ 106.02	518,965	
March 1, 2017 - March 31, 2017	—	\$ —	518,965	
April 1, 2017 - April 30, 2017	—	\$ —	518,965	
May 1, 2017 - May 31, 2017	34,193	\$ 105.58	553,158	
June 1, 2017 - June 30, 2017	45,814	\$ 106.44	598,972	
July 1, 2017 - July 31, 2017	—	\$ —	598,972	
August 1, 2017 - August 31, 2017	213,392	\$ 101.72	812,364	
September 1, 2017 - September 30, 2017	96,740	\$ 105.56	909,104	
October 1, 2017 - October 31, 2017	20,525	\$ 108.12	929,629	
November 1, 2017 - November 30, 2017	17,623	\$ 108.88	947,252	
December 1, 2017 - December 31, 2017	105,343	\$ 105.78	1,052,595	
January 1, 2018 - January 31, 2018	137,670	\$ 104.39	1,190,265	
February 1, 2018 - February 28, 2018	201,854	\$ 99.45	1,392,119	
March 1, 2018 - March 31, 2018	212,540	\$ 99.60	1,604,659	
April 1, 2018 - April 30, 2018	165,505	\$ 99.45	1,770,164	
May 1, 2018 - May 31, 2018	36,820	\$ 104.34	1,806,984	
Total	1,806,984	\$ 102.86		\$ 64,133

During the year ended March 31, 2018, the Company repurchased 1,085,694 shares through the current program at an average price of \$102.52.

#### ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

**ITEM 16G. CORPORATE GOVERNANCE**

Under the NYSE Listed Company Manual, foreign private issuers may elect to be subject to a more limited set of corporate governance requirements than U.S. domestic issuers. Despite any such election, Taro, as a foreign private issuer, must comply with four principal NYSE corporate governance rules: (1) Taro must satisfy the requirements of Exchange Act Rule 10A-3; (2) Taro’s Chief Executive Officer must promptly notify the NYSE in writing after any executive officer becomes aware of any material non-compliance with the applicable NYSE corporate governance rules; (3) Taro must provide the NYSE with annual and interim written affirmations as required under the NYSE corporate governance rules; and (4) Taro must provide a brief description of any significant differences between its corporate governance practices and those followed by U.S. companies under NYSE listing standards. The table below briefly describes the significant differences between Taro’s domestic practice and the NYSE corporate governance rules.

<b>Section</b>	<b>NYSE Corporate Governance Rule for U.S. Domestic Issuers</b>	<b>Taro’s Approach</b>
303A.01	A listed company must have a majority of independent directors.  “Controlled companies” are not required to comply with this requirement.	Taro is a controlled company because more than a majority of its voting power is controlled by Sun. As a controlled company, Taro would not be required to comply with the majority of independent directors’ requirements if it were a U.S. domestic issuer. There is not a similar requirement under Israeli practice or the Israeli Companies Law that requires Taro to have a majority of independent directors. Rather, the statutory external director provisions under the Israeli Companies Law only require Taro, as a public company, to have at least two external directors.
303A.03	The non-management directors of a listed company must meet at regularly scheduled executive sessions without management.	There is not a similar requirement under Israeli practice or the Israeli Companies Law, and non-management directors of Taro do not meet at regularly scheduled executive sessions without management.
303A.04	A listed company must have a Nominating/Corporate Governance Committee composed entirely of independent directors, with a written charter that covers certain minimum specified duties.  “Controlled companies” are not required to comply with this requirement.	Taro does not have a nominating committee. As a controlled company, Taro would not be required to comply with the nominating/corporate governance committee requirements if it were a U.S. domestic issuer. There is not a similar requirement under the Israeli Companies Law.
303A.05	A listed company must have a compensation committee composed entirely of independent directors, with a written charter that covers certain minimum specified duties.  “Controlled companies” are not required to comply with this requirement.	Taro has a compensation committee currently comprised of three directors. Under the Israeli Companies Law, which provides standards for the independence of the compensation committee, the compensation committee shall have no less than three members and all of the statutory external directors shall be members thereof.
303A.06/303A.07	A listed company must have an audit committee with a minimum of three independent directors who satisfy the independence requirements of Rule 10A-3 under the Exchange Act, with a written charter that covers certain minimum specified duties.	Taro has an Audit Committee currently comprised of three directors. Under the Israeli Companies Law, which provides standards for the Independence of the audit committee, the Audit Committee shall have no less than three members and all of the statutory external directors shall be members thereof. All of the directors that are members of the Audit Committee meet the NYSE independence requirements as well as the SEC Independence requirements that would apply to the Audit Committee members in absence of our reliance on the exemption provided by Exchange Act Rule 10A-3(c)(3).



Section	NYSE Corporate Governance Rule for U.S. Domestic Issuers	Taro's Approach
303A.07	The audit committee of a listed company must be directly responsible, to the extent permitted by law, for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review, or attest services, and each such firm must report directly to the audit committee.	Pursuant to the Israeli Companies Law, Taro's Audit Committee is responsible for determining the scope of the work of, and the compensation to be paid to, Taro's external auditors, whereas the actual appointment of the external auditors and approval of their compensation is carried out by Taro's shareholders at the annual meeting of shareholders. Furthermore, pursuant to the Israeli Companies Law, Taro's Audit Committee is responsible for supervising the work of Taro's external auditors with respect to the audit of Taro's financial statements, whereas actual final approval of the financial statements is provided by Taro's Board as a whole.
303A.08	Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exemptions set forth in the NYSE rules.	Under the Israeli Companies Law, shareholder pre-approval is not required for the adoption or material amendment of equity compensation plans. Shareholder approval is required prior to any grants under the plan to directors or the chief executive officer of Taro.
303A.09	A listed company must adopt and disclose corporate governance guidelines that cover certain minimum specified subjects.	Taro does not have formal corporate governance guidelines that address all of the matters specified in the NYSE rules. There is not a similar requirement under the Israeli Companies Law.
303A.10	A listed company must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.	<p>Taro has adopted a formal code of ethical and compliant conduct, which applies to its directors, officers and employees.</p> <p>Taro reports each year under Item 16B of its Annual Report on Form 20-F any waivers of the code of ethical conduct granted for directors and executive officers. Taro's code of ethical conduct has a scope that is similar, but not identical, to that required for a U.S. domestic company under the NYSE rules.</p> <p>Taro also has a code of ethics that applies specifically to Taro's Chief Executive Officer, Chief Financial Officer and other senior officers.</p>
303A.12	Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards.	Taro's CEO will promptly notify the NYSE in writing if any executive officer of Taro becomes aware of any material noncompliance with any applicable provisions of the NYSE corporate governance rules.

#### ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

**ITEM 17. FINANCIAL STATEMENTS**

We have responded to Item 18—“*Financial Statements*” in lieu of this item.

**ITEM 18. FINANCIAL STATEMENTS**

The financial statements required by this item are found at the end of this 2018 Annual Report, beginning on page F-1.

The Financial Statement Schedule II—Valuation and Qualifying Accounts is found on page S-1 following the financial statements.

**ITEM 19. EXHIBITS**

The exhibits filed with or incorporated into this 2018 Annual Report are listed on the index of exhibits below.

Exhibit No.	Description
1.1	Memorandum of Association of Taro Pharmaceutical Industries Ltd. (1) (P)*
1.2	<a href="#">Articles of Association of Taro Pharmaceutical Industries Ltd., as amended</a> (2)
2.1	Form of ordinary share certificate (1) (P)*
4.1	Taro Pharmaceutical Industries 1999 Stock Incentive Plan (3) (P)*
4.2	<a href="#">Amendment No. 1 to Taro Pharmaceutical Industries 1999 Stock Incentive Plan</a> (4)
4.3	<a href="#">Amendment No. 2 to Taro Pharmaceutical Industries 1999 Stock Incentive Plan</a> (4)
8	<a href="#">List of Subsidiaries (See “Organizational Structure” in Item 4.C of this Form 20-F)</a>
12.1	<a href="#">Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
12.2	<a href="#">Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
13	<a href="#">Certification of the Chief Executive Officer, Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101 INS	XBRL Instance Document
101 SCH	XBRL Taxonomy Extension Schema Document
101 CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101 DEF	XBRL Taxonomy Extension Definition Linkbase Document
101 LAB	XBRL Taxonomy Extension Label Linkbase Document
101 PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Previously filed as an exhibit to our Registration Statement on Form F-4 (No. 333-63464), as amended, and incorporated herein by reference.
- (2) Previously filed as an exhibit to our Annual Report on Form 20-F for the fiscal year ended March 31, 2013, and incorporated herein by reference.
- (3) Previously filed as an exhibit to our Registration Statement on Form S-8 (No. 333-13840) and incorporated herein by reference.
- (4) Previously filed as an exhibit to our Annual Report on Form 20-F for the fiscal year ended December 31, 2005, and incorporated herein by reference.
- (5) Previously filed as an exhibit to our Annual Report on Form 20-F for the fiscal year ended December 31, 2003 and incorporated herein by reference.

\*filed herewith  
(P) Paper exhibits

**SIGNATURE**

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 2018 Annual Report on its behalf.

TARO PHARMACEUTICAL INDUSTRIES LTD.

By: /s/ Mariano Balaguer  
Mariano Balaguer  
Vice President, Chief Financial Officer and Chief  
Accounting Officer

Dated: June 21, 2018

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**Report of Independent Registered Public Accounting Firm**

Shareholders and Board of Directors of  
Taro Pharmaceutical Industries Ltd.  
Haifa, Israel

**Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of Taro Pharmaceutical Industries Ltd. (the “Company”) and subsidiaries as of March 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended March 31, 2018, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries at March 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of March 31, 2018, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated June 19, 2018 expressed an unqualified opinion thereon.

**Basis for Opinion**

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

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

We have served as the Company’s auditor since 2010.

Tel Aviv, Israel

June 19, 2018

**Report of Independent Registered Public Accounting Firm**

Shareholders and Board of Directors of  
Taro Pharmaceutical Industries Ltd.  
Haifa, Israel

**Opinion on Internal Control over Financial Reporting**

We have audited Taro Pharmaceutical Industries Ltd. Company's (the "Company's") internal control over financial reporting as of March 31, 2018, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company and subsidiaries as of March 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended March 31, 2018, and the related notes and our report dated June 19, 2018 expressed an unqualified opinion thereon.

**Basis for Opinion**

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, included in the accompanying Item 15, Controls and procedures. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

**Definition and Limitations of Internal Control over Financial Reporting**

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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

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

Tel Aviv, Israel

June 19, 2018

## CONSOLIDATED BALANCE SHEETS

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

	March 31,	
	2018	2017
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 576,611	\$ 600,399
Short-term and current maturities of long-term bank deposits	296,188	782,813
Marketable securities	549,821	3,548
Accounts receivable and other:		
Trade, net	206,455	203,924
Other receivables and prepaid expenses	122,965	266,280
Inventories	144,595	141,045
Long-term assets held for sale, net	—	1,015
TOTAL CURRENT ASSETS	1,896,635	1,999,024
LONG-TERM DEPOSITS AND MARKETABLE SECURITIES	225,639	70,685
PROPERTY, PLANT AND EQUIPMENT, NET	193,727	180,085
DEFERRED INCOME TAXES	87,257	10,324
OTHER ASSETS	29,952	29,635
TOTAL ASSETS	<u>\$ 2,433,210</u>	<u>\$ 2,289,753</u>

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

## CONSOLIDATED BALANCE SHEETS

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

	March 31,	
	2018	2017
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable:		
Trade payables	\$ 25,697	\$ 16,394
Other current liabilities	190,059	193,443
TOTAL CURRENT LIABILITIES	215,756	209,837
LONG-TERM LIABILITIES:		
Deferred income taxes	3,228	2,114
Other long-term liabilities	3,827	3,996
TOTAL LONG-TERM LIABILITIES	7,055	6,110
COMMITMENTS AND CONTINGENT LIABILITIES		
TOTAL LIABILITIES	222,811	215,947
SHAREHOLDERS' EQUITY:		
Taro shareholders' equity:		
Ordinary shares of NIS 0.0001 par value:		
Authorized at March 31, 2018 and March 31, 2017: 200,000,000 shares;		
Issued at March 31, 2018 and March 31, 2017: 45,116,262 shares		
Outstanding at March 31, 2018 and March 31, 2017:		
39,427,515 and 40,513,209 shares, respectively	679	679
Founders' shares of NIS 0.00001 par value:		
Authorized, issued and outstanding at March 31, 2018 and March 31, 2017:		
2,600 shares	1	1
Additional paid-in capital	262,445	262,445
Accumulated other comprehensive income, net of taxes	(110,285)	(148,133)
Treasury stock at March 31, 2018 and March 31, 2017: 5,688,747 and 4,603,053 shares, respectively	(610,009)	(498,675)
Accumulated earnings	2,662,327	2,451,177
Taro shareholders' equity	2,205,158	2,067,494
Non-controlling interest	5,241	6,312
TOTAL SHAREHOLDERS' EQUITY	2,210,399	2,073,806
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 2,433,210	\$ 2,289,753

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



## CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Years ended March 31,		
	2018	2017	2016
Sales, net	\$ 661,913	\$ 879,387	\$ 950,751
Cost of sales	198,405	207,860	169,743
Impairment	—	276	2,042
Gross profit	463,508	671,251	778,966
Operating expenses:			
Research and development	70,418	70,644	71,160
Selling, marketing, general and administrative	88,196	85,656	92,365
Settlements and loss contingencies	1,884	—	973
	160,498	156,300	164,498
Operating income	303,010	514,951	614,468
Financial expenses (income), net	12,531	(34,636)	(19,672)
Other gain, net	1,889	11,211	2,680
Income before income taxes	292,368	560,798	636,820
Tax expense	81,954	103,780	95,313
Income from continuing operations	210,414	457,018	541,507
Net loss from discontinued operations attributable to Taro	(335)	(352)	(236)
Net income	210,079	456,666	541,271
Net (loss) income attributable to non-controlling interest	(1,071)	310	339
Net income attributable to Taro	<u>\$ 211,150</u>	<u>\$ 456,356</u>	<u>\$ 540,932</u>
Net income from continuing operations attributable to Taro	\$ 211,485	\$ 456,708	\$ 541,168
Net loss from discontinued operations attributable to Taro	(335)	(352)	(236)
Net income attributable to Taro	<u>\$ 211,150</u>	<u>\$ 456,356</u>	<u>\$ 540,932</u>
Net income per ordinary share from continuing operations attributable to Taro:			
Basic and Diluted	<u>\$ 5.27</u>	<u>\$ 11.06</u>	<u>\$ 12.63</u>
Net loss per ordinary share from discontinued operations attributable to Taro:			
Basic and Diluted	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Net income per ordinary share attributable to Taro:			
Basic and Diluted	<u>\$ 5.26</u>	<u>\$ 11.05</u>	<u>\$ 12.62</u>
Weighted-average number of ordinary shares used to compute net income per share:			
Basic and Diluted	<u>40,155</u>	<u>41,301</u>	<u>42,832</u>

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

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

U.S. dollars in thousands

	Years ended March 31,		
	2018	2017	2016
Net income attributable to Taro	\$ 211,150	\$ 456,356	\$ 540,932
Other comprehensive loss			
Foreign currency translation adjustments	35,931	(25,038)	(12,071)
Change in unrealized gain (loss) from marketable securities	1,917	(69)	11
Total other comprehensive income (loss) attributable to Taro	37,848	(25,107)	(12,060)
Total comprehensive income attributable to Taro	<u>\$ 248,998</u>	<u>\$ 431,249</u>	<u>\$ 528,872</u>

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

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars and shares in thousands

	Taro Shareholders' Equity								
	Number of Shares	Share Capital	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Retained Earnings	Total Taro Shareholders' Equity	Non- controlling Interest	Total Shareholders' Equity
Balance at March 31, 2015	42,833	\$ 680	\$ 262,445	\$ (110,966)	\$ (194,328)	\$ 1,453,889	\$ 1,411,720	\$ 5,663	\$ 1,417,383
Repurchase of treasury stock	(67)	—	—	—	(9,450)	—	(9,450)	—	(9,450)
Comprehensive loss, net of tax	—	—	—	(12,060)	—	—	(12,060)	—	(12,060)
Net income	—	—	—	—	—	540,932	540,932	339	541,271
Balance at March 31, 2016	42,766	\$ 680	\$ 262,445	\$ (123,026)	\$ (203,778)	\$ 1,994,821	\$ 1,931,142	\$ 6,002	\$ 1,937,144
Repurchase of treasury stock	(2,253)	—	—	—	(294,897)	—	(294,897)	—	(294,897)
Comprehensive loss, net of tax	—	—	—	(25,107)	—	—	(25,107)	—	(25,107)
Net income	—	—	—	—	—	456,356	456,356	310	456,666
Balance at March 31, 2017	40,513	\$ 680	\$ 262,445	\$ (148,133)	\$ (498,675)	\$ 2,451,177	\$ 2,067,494	\$ 6,312	\$ 2,073,806
Repurchase of treasury stock	(1,085)	—	—	—	(111,334)	—	(111,334)	—	(111,334)
Comprehensive income, net of tax	—	—	—	37,848	—	—	37,848	—	37,848
Net income	—	—	—	—	—	211,150	211,150	(1,071)	210,079
Balance at March 31, 2018	39,428	\$ 680	\$ 262,445	\$ (110,285)	\$ (610,009)	\$ 2,662,327	\$ 2,205,158	\$ 5,241	\$ 2,210,399

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Years ended March 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net income	\$ 210,079	\$ 456,666	\$ 541,271
Adjustments required to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	16,496	14,829	14,848
Impairment of long-lived assets	—	276	2,042
Accrued severance pay and other long-term liabilities, net	(227)	273	(53)
Realized loss (gain) on sale of marketable securities and long-lived assets	275	(8,389)	74
Change in derivative instruments, net	(893)	1,434	(6,137)
Effect of exchange differences on intercompany balances	9,467	(6,017)	(2,268)
Foreign exchange effect of marketable securities and bank deposits	25,503	(15,157)	(5,510)
Deferred income taxes, net	56,007	73,706	(11,976)
(Increase) decrease in trade receivables, net	(2,297)	34,413	(16,386)
Decrease (increase) in other receivables, prepaid expenses and other	2,020	(4,829)	(3,518)
Increase in inventories, net	(1,978)	(3,770)	(19,013)
Decrease (increase) in income tax receivables	10,624	(70,390)	(39,340)
Increase (decrease) in trade payables	9,049	(2,290)	(679)
Decrease in other accounts payable and accrued expenses	(11,785)	(28,377)	(6,194)
Increase (decrease) in income tax payables	2,027	(4,843)	(52,033)
Income from marketable securities, net	(678)	—	—
Net cash provided by operating activities	323,689	437,535	395,128

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Years ended March 31,		
	2018	2017	2016
Cash flows from investing activities:			
Purchase of property, plant and equipment	(26,886)	(35,755)	(18,972)
Investment in other intangible assets	(2,650)	(68)	(134)
Proceeds from other assets	—	10	35,000
Proceeds from (investment in) short-term bank deposits, net	161,032	196,170	(220,102)
Proceeds from restricted bank deposits	—	—	199
Proceeds from (investment in) long-term deposits and other assets	396,281	(286,617)	(80,587)
Investment in marketable securities	(1,140,853)	(376)	(170)
Proceeds from marketable securities	370,363	350	35
Proceeds from sale of long-lived assets	1,075	8,508	—
Net cash used in investing activities	(241,638)	(117,778)	(284,731)
Cash flows from financing activities:			
Repurchase of treasury stock	(106,986)	(294,897)	(9,450)
Proceeds from long-term debt	—	—	(5,888)
Net cash used in financing activities	(106,986)	(294,897)	(15,338)
Effect of exchange rate changes on cash and cash equivalents	1,147	(1,218)	57
(Decrease) increase in cash and cash equivalents	(23,788)	23,642	95,116
Cash and cash equivalents at the beginning of the period	600,399	576,757	481,641
Cash and cash equivalents at the end of the period	<u>\$ 576,611</u>	<u>\$ 600,399</u>	<u>\$ 576,757</u>

## Supplemental disclosure of cash flow transactions:

Cash paid during the year for:			
Interest	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 85</u>
Income taxes	<u>\$ 55,051</u>	<u>\$ 99,720</u>	<u>\$ 192,964</u>
Cash received during the year for:			
Income taxes	<u>\$ 36,668</u>	<u>\$ 1,938</u>	<u>\$ —</u>
Non-cash investing transactions:			
Purchase of property, plant and equipment included in accounts payable	<u>\$ 2,281</u>	<u>\$ 692</u>	<u>\$ 1,744</u>
Non-cash financing transactions:			
Purchase of treasury stock	<u>\$ 4,348</u>	<u>\$ —</u>	<u>\$ —</u>
Purchase of Marketable Securities	<u>\$ 3,491</u>	<u>\$ —</u>	<u>\$ —</u>

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

## Notes to consolidated financial statements

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

## NOTE 1: — GENERAL

Taro Pharmaceutical Industries Ltd. (the “Company” or “Taro”) is an Israeli corporation, which operates in Israel and elsewhere through its Israeli, North American, and European subsidiaries (the “Group”). The principal business activities of the Group are the production, research, development and marketing of pharmaceutical products. As of March 22, 2012, the Company’s ordinary shares are traded on the New York Stock Exchange (the “NYSE”), under the symbol “TARO.” As used herein, the terms “we,” “us,” “our,” “Taro” and the “Company” mean Taro Pharmaceutical Industries Ltd. and its subsidiaries, unless otherwise indicated.

The activities of the Group in North America are performed by Taro Pharmaceuticals Inc. (“Taro Canada”), Taro Pharmaceuticals North America, Inc. and Taro Pharmaceuticals U.S.A., Inc. (“Taro U.S.A.”). Taro International Ltd. in Israel is engaged in the pharmaceutical activities of the Group outside North America.

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

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

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

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

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

Sun Pharmaceutical Industries Ltd. (“Sun”), the Company’s majority shareholder, owns, or controls as of March 31, 2018, 29,497,813, or 74.8%, of the Company’s ordinary shares, and with the Company’s founders’ shares, 83.2% of the vote attributable to the share equity of the Company. As of May 31, 2018, Sun owns, or controls 75.2% of the Company’s ordinary shares and controls 83.5% of the voting power in the Company due to the additional ordinary shares repurchased by the Company (as described below).

On October 1, 2015, Taro entered into a share purchase Agreement with EPIRUS Biopharmaceuticals, Inc. (“EPIRUS”) for all of the shares of Zalicus Pharmaceuticals Ltd. (“Zalicus”), including its product candidate Z944 and certain related assets, a novel, oral, T-type calcium channel modulator in development for the treatment of pain. As a result of the acquisition, Taro paid CAD \$5,000 in cash and a non-interest bearing, limited recourse promissory note in the amount of CAD \$5,000 with a maturity date of July 1, 2017. In July 2017, Taro elected not to repay the promissory note and the Z944 assets were transferred back to EPIRUS.

On March 15, 2016, the Company announced that its Board of Directors authorized a \$250,000 share repurchase of ordinary shares, which was completed on August 18, 2016. Under the program, the Company bought back 1,801,099 of its ordinary shares in open market transactions, in accordance with a 10b5-1 program, at an average price of \$138.80 per share.

On November 23, 2016, the Company announced that its Board of Directors authorized a new \$250,000 share repurchase of ordinary shares. Repurchases may be made from time to time at the Company’s discretion, based on ongoing assessments of the capital needs of the business, the market price of its stock, and general market conditions. No time period was set for the repurchase program, and any such program may be suspended or discontinued at any time. The

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)**

repurchase authorization enables the Company to purchase its ordinary shares from time to time through open market purchases, negotiated transactions or other means, including 10b5-1 trading plans in accordance with applicable securities laws or other restrictions. On November 7, 2017, the Board extended the share repurchase program for one year. During the year ended March 31, 2018, the Company repurchased 1,085,694 shares through the current program at an average price of \$102.52. Through May 31, 2018, in total under the authorization, the Company has repurchased 1,806,984 shares at an average price of \$102.86; with \$64,133 remaining.

On December 23, 2016, the Company announced the sale of U.S. rights to Keveyis® (dichlorphenamide) to Strongbridge Biopharma plc (Strongbridge). Keveyis® was approved by the U.S. FDA in August 2015 to treat primary hyperkalemic and hypokalemic periodic paralysis, a group of rare hereditary disorders that cause episodes of muscle weakness or paralysis. Keveyis® has orphan designation status through August 2022. In accordance with the terms of the purchase agreement, Strongbridge paid Taro a total of \$8,500 through upfront payments; Taro is also eligible to receive additional future payments upon the achievement of certain sales unit milestones. Taro has agreed to continue to manufacture Keveyis® for Strongbridge, under an exclusive supply agreement at least for the period of Keveyis® orphan exclusivity, subject to certain commercial terms and conditions, including minimum supply purchases.

On March 16, 2017, the Company entered into a share purchase agreement with BELLUS Health Inc. (“BELLUS”) for the sale of BELLUS’ wholly-owned subsidiary Thallion Pharmaceuticals Inc. (“Thallion”), including all the rights to the drug candidate Shigamab™. Pursuant to the agreement, Taro acquired all issued and outstanding shares of Thallion for a potential total consideration of CAD \$2,700. In addition, BELLUS will receive a portion of certain post-approval revenues related to the Shigamab™ program.

On April 21, 2017, the Company entered into a development and commercialization license agreement with Crescita Therapeutics Inc. (“Crescita”), under which, Crescita has granted Taro an exclusive license to the rights to sell and distribute Pliaglis® in the U.S. market and for a second-generation enhanced version with patent pending.

**NOTE 2: — SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements are prepared according to U.S. GAAP.

a. Use of estimates:

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

The Company’s most critical estimates are used in its determination of its sales incentives reserves, inventory reserves, income taxes, fixed assets, intangible assets, derivative instruments and contingencies.

b. Financial statements in U.S. dollars:

A majority of the revenue of the Company and certain of its subsidiaries (exclusive of its Canadian, Irish, and UK subsidiaries – see below) is generated in U.S. dollars (“dollars”). In addition, a substantial portion of the costs of the Company and these subsidiaries is incurred in dollars. Management believes that the dollar is the primary currency of the economic environment in which the Company and these subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar, requiring re-measurement from the local currency into dollars for each of these entities. All exchange gains and losses resulting from the re-measurement are reflected in the Consolidated Statements of Operations as financial income or expense, as appropriate.

The functional currency of the Company’s Canadian, Irish, and U.K. subsidiaries are the Canadian dollar (“CAD”), the Euro, and the British pound, respectively. Accordingly, the financial statements of the Canadian, Irish, and U.K. subsidiaries have been translated into dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Amounts recorded in the Consolidated Statements of Operations have been translated using the average exchange rate prevailing during the year. The resulting translation adjustments are reported as a component of shareholders’ equity under accumulated other comprehensive income.

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)****c. Principles of consolidation:**

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated in consolidation and non-controlling interest is included in shareholders' equity.

Sun, through its wholly owned subsidiary, Taro Development Corporation ("TDC") owns 3.1% of the shares that have economic rights and has 50% of the voting rights in Taro U.S.A.; with the Company owning the remaining shares and voting rights. In 1993, TDC signed an agreement with the Company to vote all of its shares in Taro U.S.A. in all elections of directors of Taro U.S.A. as the Company shall instruct. In April 2018, TDC renewed its commitment to the Company. TDC may terminate the agreement upon one year written notice and no such notice of termination has been provided. TDC is a minority shareholder in the Company by way of its ownership of Taro U.S.A. shares that have economic rights.

**d. Cash and cash equivalents:**

Cash equivalents are highly-liquid investments that are readily convertible into cash.

Short-term bank deposits:

Bank deposits with maturities of more than three months, but less than one year, are included in short-term deposits. Such deposits are stated at cost which approximates market value and are invested at an average interest rate of 1.85% and 1.36% for March 31, 2018 and 2017, respectively.

**e. Marketable securities:**

Marketable securities are comprised primarily of corporations bonds, sovereign bonds, U.S Treasuries, certificates of deposits, and commercial papers. These marketable securities were designated as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income, a separate component of shareholders' equity.

Realized gains and losses on the sale of investments are included in financial income, net and are derived using the specific identification method for determining the cost of securities.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization together with interest and dividends on securities are included in financial income, net.

The Company recognizes an impairment charge when a decline in the fair value of its investments in debt securities results in the value of the investments being below the cost basis of such securities and when such decline is judged to be other-than-temporary. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value, the potential recovery period and the Company's intent to sell, including whether it is more likely than not that the Company will be required to sell the investment before recovery of cost basis. For securities that are deemed other-than-temporarily impaired, the amount of impairment is recognized in financial income, net in the Consolidated Statements of Operations and is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income.

During the years ended March 31, 2018, 2017 and 2016, the Company did not own or sell any marketable securities previously impaired.

**f. Allowance for doubtful accounts:**

The allowance for doubtful accounts is calculated primarily with respect to specific balances, for which, in the opinion of Management, collection of such balances is doubtful. The allowance, in the opinion of Management, is sufficient to cover probable uncollectible balances.

**g. Inventories:**

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

Raw and packaging materials – weighted-average cost basis.

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



## Notes to consolidated financial statements

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

Purchased products for commercial purposes – weighted-average cost basis.

## h. Taxes:

## (1) Deferred income taxes:

Deferred income taxes are determined utilizing the “asset and liability” method based on the estimated future tax effects of temporary differences between the financial accounting and tax basis of assets and liabilities under the applicable tax laws, and on tax rates anticipated to be in effect when the deferred taxes are expected to be paid or realized. A valuation allowance is provided if, based upon the weight of available evidence, it is “more likely than not” that a portion of the deferred tax assets will not be realized. For the year ended March 31, 2017, deferred tax liabilities and assets are classified as current or non-current based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences where appropriate. For the year ended March 31, 2018, in accordance with the required updates in ASU No.2015-17 (see Note 2 bb), all deferred tax liabilities and assets are classified as non-current.

## (2) Tax contingencies:

The Company follows a two-step approach to recognizing and measuring a liability for uncertain tax positions. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. In addition, the Company classifies interest and penalties recognized in the financial statements relating to uncertain tax positions under the provision for income taxes. A liability for unrecognized tax benefits was recorded as a result of the implementation of ASC 740 amounting to \$16,810 and \$23,457 as of March 31, 2018 and 2017, respectively.

## (3) Income taxes:

Income taxes are accounted for in accordance with the use of the liability method, whereby deferred tax asset and liability account balances are determined for temporary differences between the financial reporting and tax basis of assets and liabilities, and for carryforward losses and credits. Deferred taxes are measured using tax rates and laws that will be in effect when the differences are expected to reverse. In certain cases Management determined that it was more likely than not that the Company will not benefit from the deferred tax assets in subsidiaries, and a valuation allowance was provided against the deferred tax assets carried by such subsidiaries. In future years, if it is more likely than not that the subsidiary will be in a position to utilize its deferred tax asset, the valuation allowance for such assets will be modified.

## i. Property, plant and equipment:

- (1) Property, plant and equipment is stated at cost, net of accumulated depreciation. Payroll and other costs that are direct incremental costs necessary to bring an asset to the condition of its intended use incurred during the construction and validation period of property, plant and equipment are capitalized to the cost of such assets.
- (2) Depreciation is calculated utilizing the straight-line method over the estimated useful lives of the assets, from the date the assets are ready for their intended use, at the following annual rates:

	%
Building	2.5 - 10
Machinery and equipment	5 - 10
Motor vehicles	20
Furniture, fixtures, office equipment and computer equipment	6 - 33

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

- (3) Certain costs incurred for computer software developed or obtained for internal use is required to be capitalized. As of March 31, 2018 and 2017, the Group capitalized \$4,636 and \$4,517 of software costs, respectively. Software costs are amortized using the straight-line method over their estimated useful life (generally three – five years).

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)****j. Lease of land from Israel Land Administration:**

The Company leases several parcels of land from the Israel Land Administration (“ILA”). The lease period of the industrial parcels ends between 2018 and 2060. The Company has the right to extend the lease agreement ending 2018 for an additional period of 49 years and is currently in the process of extending the lease agreement. The ILA lease agreements are standard agreements covering substantial portions of the land of Israel. The standard agreements call for a Lease Period of 49 years, with an option for one additional Lease Period (i.e., total of 98 years). A majority of the Company’s leases are in the beginning of the second 49 year period, and the remaining leases still in the first 49 year period have the option for the one additional lease period. The ownership of the land is not transferred at the end of the lease period, however, in certain conditions the lessee may purchase the land from the ILA. The expectation, based on practice and accumulated experience is that the renewal price would be substantially below fair market value. Since such leases do not qualify as a capital lease, they are being accounted for as operating leases. The prepaid lease amount is included in long-term receivables and other assets and amortized over the term of the lease.

**k. Goodwill:**

The goodwill of the Company is not amortized, but rather is subject to an annual impairment test (or more frequently if impairment indicators arise).

The Company operates in one operating segment, comprising its only reporting unit. The goodwill impairment tests are conducted in two steps. In the first step, if it is determined that the net book value of the reporting unit exceeds its fair value, the Company would then perform the second step of the impairment test. This requires the allocation of the reporting unit’s fair value of all of its assets and liabilities in a manner similar to an acquisition cost allocation, with any residual fair value being allocated to goodwill. The implied fair value of the goodwill is then compared to the carrying value to determine impairment, if any.

The Company determined the fair value using the market approach, which is based on the market capitalization by using the share price of the Company on the NYSE and an appropriate control premium. As of March 31, 2018, the market capitalization of the Company was significantly higher than the net book value, therefore there was no need to continue to step two. Taro determined the goodwill was not subject to impairment as of March 31, 2018 and 2017.

**l. Contingencies:**

The Company may be involved in various patent, product liability, consumer, commercial or environmental claims, government investigations, and other legal proceedings that arise from time to time in the ordinary course of business. Except for income tax contingencies, the Company records accruals for these types of contingencies to the extent that the Company concludes their occurrence is probable and that the related liabilities are estimable. The Company records anticipated recoveries under existing insurance contracts that are virtually certain of occurring and at the gross amount that is expected to be collected.

**m. Intangible assets and deferred charges and long-lived assets:****Intangible assets and deferred charges:**

Acquired intangible assets and product rights to be held and used are amortized over their useful life of a weighted-average amortization period of between 5 to 20 years using a straight-line method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up.

**Long-lived assets:**

The Group’s long-lived assets, excluding goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment exists when the carrying amount of the asset exceeds the aggregate future undiscounted cash flows expected to be generated by the asset. The impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the asset. During the year ended March 31, 2018, the Company did not record any impairment charge. In the year ended March 31, 2017, the Company recorded a \$276 impairment charge relating to product rights. In the year ended March 31, 2016, the Company recorded \$2,042 impairment charge primarily related to certain intellectual property as the Company is no longer selling a certain product.

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)****n. Comprehensive income:**

The comprehensive income statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders. The Company determined that its items of other comprehensive income relates to unrealized gains and losses on available for sale securities and foreign currency translation adjustments.

**o. Treasury shares:**

The Company repurchases its ordinary shares from time to time on the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity. During the years ended March 31, 2018, 2017 and 2016, the Company repurchased 1,085,694 shares, 2,252,725 shares, and 67,339 shares, respectively.

When treasury stock is reissued, the Company charges the excess of the purchase cost, including related share-based compensation expenses, over their issuance price (loss) to retained earnings. The purchase cost is calculated based on the specific identification method. The Company did not reissue treasury shares during the year ended March 31, 2018.

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

**p. Revenue recognition:**

The Company generally recognizes revenue from product sales when title and risk of loss have transferred to its customers. Those criteria generally require that (i) persuasive evidence of an arrangement exists; (ii) product delivery has occurred; (iii) the price to customers is fixed or determinable; (iv) collectability is reasonably assured, and (v) the amount of product returns, chargebacks, rebates and other sales deductions can be reasonably estimated. The Company ships products to its customers only in response to, and to the extent of, the orders that customers submit to the Company. Depending on the terms of our customer arrangements, revenue is generally recognized when the product is received by the customer ("FOB Destination Point") or at the time of shipment ("FOB Shipping Point").

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

Chargebacks result from pricing arrangements the Company has with end-user customers establishing contract prices which are lower than the wholesalers' acquisition costs or invoice prices. When these customers buy the Company's products from their wholesaler of choice, the wholesaler issues a credit memo (chargeback) to the Company for the difference between the invoice price and the end-user contract price. Chargeback reserves are estimated using current wholesaler inventory data beyond the Company's control, and historical data.

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

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

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

Reserves for returns, Medicaid and indirect rebates are included in current liabilities. All other sales deductions allowances are recorded as accounts receivable reserves. The reserve for returns is included in current liabilities as substantially all of these returns will not be realized until after the year-end accounts receivable balances are settled. Medicaid and indirect rebates are included in current liabilities because the Company does not have direct customer relationships with any of the payees.

## Notes to consolidated financial statements

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

The Company offers incentives to certain resellers and retailers through various marketing programs where the Company agrees to reimburse them for advertising costs incurred to include the Company's products. The Company accounts for these in accordance with FASB ASC Subtopic 605-50, "*Revenue Recognition – Customer Payments and Incentives*," as reductions of revenue unless the customer receives an identifiable benefit in exchange for the consideration that is sufficiently separable from the customer's purchase of the products and the fair value of the benefits can be reasonably estimated.

## q. Research and development:

Research and development expenses are charged to expense as incurred. Payments made for research and development services prior to the services being rendered are recorded as prepaid expenses on our consolidated balance sheet and expensed as provided.

## r. Royalty-bearing grants:

Royalty-bearing grants from the government of Israel through the National Technological Innovation Authority (the "Authority") (formerly operating as Office of the Chief Scientist of the Ministry of Economy of the State of Israel ) for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred. The Company did not earn any grants during the years ended March 31, 2018, 2017 and 2016.

## s. Advertising expenses:

The Group expenses advertising costs as incurred. Product samples are recorded within prepaid expense on the consolidated balance sheet and recorded within advertising expenses when provided to potential customers. Advertising expenses were \$9,913, \$10,468, and \$15,504 for the years ended March 31, 2018, 2017 and 2016, respectively.

## t. Sales and other taxes collected and remitted to governmental authorities:

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

## u. Basic and diluted net income per ordinary share attributable to Taro:

Basic net income per ordinary share is calculated based on the weighted-average number of ordinary shares outstanding during each year. Diluted net income per ordinary share is calculated based on the weighted-average number of ordinary shares outstanding during each year, plus potential dilutive ordinary shares considered outstanding during the year (except where anti-dilutive).

## v. Freight and distribution costs:

The Company's accounting policy is to classify shipping and handling costs as a part of sales and marketing expense. Freight, distribution costs, and distribution warehousing costs related to shipping and handling to customers, primarily through the use of common carriers or external distribution services amounted to \$12,170, \$11,949, and \$11,540 for the years ended March 31, 2018, 2017 and 2016.

## w. Concentrations of credit risk:

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

The Group's trade accounts receivables are mainly derived from sales to customers in the United States, Canada, Europe and Israel. At March 31, 2018, two different customers represented approximately 48.7% and 24.5% of the Company's trade accounts receivable. The Group has adopted credit policies and standards intended to mitigate inherent risk while accommodating sales growth. The Group performs ongoing credit evaluations of its customers' financial condition when deemed necessary, but does not require collateral for its customers' accounts receivable.

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)****x. Fair value of financial instruments:**

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

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

As of March 31, 2018 and 2017, the Company did not have any amounts outstanding under borrowing arrangements.

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

**y. Accounting for derivatives:**

The Company recognizes all of their derivative instruments as either assets or liabilities at fair value, in the statement of financial position. The accounting for changes (i.e., gains or losses) in the fair value of a derivative instrument depends on whether the instrument has been designated and qualifies as part of a hedging relationship and on the type of hedging relationship. For derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation. For derivatives which qualify as a fair value hedge, changes in fair value are reported with the carrying amount of the hedged asset or liability with cash flows reported on the Consolidated Statement of Cash Flows consistent with the classification of cash flows from the underlying items being hedged. For derivatives that qualify as a cash flow hedge, the effective portion of these derivatives' fair value is initially reported as a component of other comprehensive income with cash flows reported on the consolidated statement of cash flows consistent with the classification of cash flows from the underlying items being hedged. The designation is based upon the nature of the exposure being hedged. At March 31, 2018, 2017, and 2016, no derivative instruments were designated as hedging instruments.

For derivative instruments not designated as hedging instruments for accounting purposes, the gain or loss is recognized in financial income, net in the Consolidated Statement of Operations during the period of change with the cash flows reported on the Consolidated Statements of Cash Flows consistent with the classification of cash flows from the underlying items being hedged. See Note 10.

**z. Fair value measurements:**

There is a fair value hierarchy that distinguishes between assumptions based on market data obtained from independent sources (observable inputs) and those based on an entity's own assumptions (unobservable inputs). Additional disclosure about fair value measurements is also required.

**aa. Discontinued operations:**

When a component of an entity, has been disposed of or is classified as held for sale, the results of its operations, including the gain or loss on the disposed component, should be classified as discontinued operations and the assets and liabilities of such component should be classified as assets and liabilities attributed to discontinued operations; that is, provided the operations, assets and liabilities of the component have been eliminated from the Company's consolidated statements of operations and the Company will no longer have any significant continuing involvement in the operations of the component.

**bb. Impact of recently adopted accounting standards:**

In November 2015, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2015-17, "*Income Taxes (Topic 740)*." The amended guidance requires entities to present all deferred tax assets and liabilities, along with any related valuation allowance, as non-current on the balance sheet. The guidance was effective for the Company fiscal year that began April 1, 2017, including interim periods within that year. The amendments in this update could be applied either prospectively to all deferred tax liabilities and assets, or retrospectively to all periods presented. The Company applied the guidance prospectively and prior periods were not retrospectively adjusted.

## Notes to consolidated financial statements

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

Impact of recently issued accounting standards not yet adopted:

In January 2017, the FASB issued ASU No. 2017-04, “*Intangibles—Goodwill and Other (Topic 350)*.” The new guidance reduces the complexity of goodwill impairment tests by no longer requiring entities to determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. The guidance will be effective for the Company fiscal year beginning April 1, 2020, including interim periods within that year on a prospective basis. The Company is currently evaluating the potential effect of the adoption of ASU 2017-04 on our financial position and results of operations.

In October 2016, the FASB issued ASU No. 2016-16, “*Income Taxes (Topic 740)*.” The guidance requires that entities should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The guidance will be effective for the Company fiscal year beginning April 1, 2018, including interim periods within that year. As a result of the intellectual property transfer from Taro North America (TNA) to Israel and Canada (as noted in Note 15.c and Note 17.p), the Company will recognize the income tax consequences of approximately \$41,400 for deferred tax assets upon adoption of the guidance. The amendments in this update will be applied on a modified retrospective basis through a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption.

In August 2016, the FASB issued ASU No. 2016-15, “*Statement of Cash Flows (Topic 230)*.” The guidance addresses eight specific issues: debt prepayment or debt extinguishment costs; settlement of certain debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interest in securitization transactions; separately identifiable cash flows and application of predominance principle. The guidance will be effective for the Company fiscal year beginning April 1, 2018, including interim periods within that year. The adoption of ASU 2016-15 is not expected to have a material impact on our Statement of Cash Flows.

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments—Credit Losses (Topic 326)*.” The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The guidance will be effective for the Company fiscal year beginning April 1, 2020, including interim periods within that year. The Company is currently evaluating the potential effect of the adoption of ASU 2016-13 on our financial position and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*.” The new guidance requires that the lessee recognize the assets and liabilities that arise from leases. The guidance will be effective for the Company fiscal year beginning April 1, 2019, and interim periods within that year. The Company is currently evaluating the potential effect of the adoption of ASU 2016-02 on our financial position and results of operations.

In January 2016, the FASB issued ASU No. 2016-01, “*Financial Instruments—Overall (Subtopic 825-10)*.” The amended guidance focuses on the recognition and measurement of financial assets and liabilities. The guidance will be effective for the Company fiscal year beginning April 1, 2018, including interim periods within that year. The adoption of ASU 2016-01 is not expected to have a material impact on our financial position and results of operations.

In May 2014, the FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606), Section A—Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40)*.” The amended guidance will enhance the comparability of revenue recognition practices and will be applied to all contracts with customers. Improved disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized are requirements under the amended guidance. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017 (early adoption is permitted for the interim and annual periods beginning on or after December 15, 2016), as a result of the FASB announcing a one year deferral. Either a full retrospective method or modified retrospective method is permitted. The Company will adopt the guidance fiscal year beginning April 1, 2018, including interim periods within that year, and expects to use the modified retrospective method. The Company does not currently anticipate the adoption to have a material impact on our financial position or results of operations.

## Notes to consolidated financial statements

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

## NOTE 3: — MARKETABLE SECURITIES

## a. Marketable securities:

	March 31,	
	2018	2017
Short-term marketable securities	\$ 549,821	\$ 3,548
Long-term marketable securities	225,639	—
	<u>\$ 775,460</u>	<u>\$ 3,548</u>

## b. The following is a summary of both short-term and long-term marketable securities by type:

	March 31,					
	2018			2017		
	Amortized cost	Gross unrealized loss	Market value	Amortized cost	Gross unrealized loss	Market value
Marketable securities:						
Bonds	\$ 386,332	\$ (2,027)	\$ 384,305	\$ —	\$ —	\$ —
Government Securities	177,657	(555)	177,102	3,617	(69)	3,548
Commercial Paper	51,432	(1)	51,431	—	—	—
Other Securities	162,672	(50)	162,622	—	—	—
Total marketable securities	<u>\$ 778,093</u>	<u>\$ (2,633)</u>	<u>\$ 775,460</u>	<u>\$ 3,617</u>	<u>\$ (69)</u>	<u>\$ 3,548</u>

For March 31, 2018, the gross unrealized loss excludes \$4,550 of other comprehensive income relating to marketable securities for foreign exchange gain.

As of March 31, 2018 no other than temporary impairment charges were recorded.

## c. The estimated fair value of marketable securities as of March 31, 2018 and 2017, by contractual maturity, are as follows:

	March 31,			
	2018		2017	
	Amortized cost	Market Value	Amortized cost	Market Value
Available-for-sale marketable securities:				
Matures in less than five years	\$ 776,932	\$ 774,300	\$ 1,181	\$ 1,001
Matures in more than five years	1,161	1,160	2,436	2,547
	<u>\$ 778,093</u>	<u>\$ 775,460</u>	<u>\$ 3,617</u>	<u>\$ 3,548</u>

## Notes to consolidated financial statements

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

## NOTE 4: — ACCOUNTS RECEIVABLE AND OTHER

## a. Trade, net:

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

	March 31,	
	2018	2017
Trade accounts receivable, gross	\$ 456,308	\$ 509,250
Reserves for sales deductions:		
Chargebacks	(116,632)	(112,071)
Other sales deductions	(81,677)	(109,411)
Customer rebates	(51,296)	(83,472)
Allowance for doubtful accounts	(248)	(372)
Trade accounts receivable, net	<u>\$ 206,455</u>	<u>\$ 203,924</u>

## b. Other receivables and prepaid expenses:

	March 31,	
	2018	2017
Government authorities	\$ 102,008	\$ 112,301
Due from related parties	8,239	2,927
Prepaid expenses	6,252	8,824
Interest receivable	3,314	5,266
Advances to suppliers	1,455	3,410
Deferred income taxes	—	132,064
Other	1,697	1,488
	<u>\$ 122,965</u>	<u>\$ 266,280</u>

## NOTE 5: — SALES INCENTIVES

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

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

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

*Product returns:*

Consistent with industry practice, the Company generally offers its customers the right to return inventory within three to six months prior to product expiration and up to 12 months thereafter (the "return period"). Product returns are identified by their manufacturing lot number. Because the Company manufactures in bulk, lot sizes are generally large and, therefore, shipments of a particular lot may occur over a one-to-three month period. As a result, although the Company



**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)**

cannot associate a product return with the actual shipment in which such lot was included, the Company can reasonably estimate the period (in months) over which the entire lot was shipped and sold. The Company uses this information to estimate the average time period between lot shipment (and sale) and return for each product, which the Company refers to as the “return lag.” The shelf life of most of the Company’s products ranges between 18-36 months. Because returns of expired products are heavily concentrated during the return period, and given the Company’s historical data, it is able to reasonably estimate return lags for each of its products. These return lags are periodically reviewed and updated, as necessary, to reflect the Company’s best knowledge of facts and circumstances. Using sales and return data (including return lags), the Company determines a rolling average monthly return rate to estimate its returns reserve. The Company supplements this calculation with additional information including customer and product specific channel inventory levels, competitive developments, external market factors, the Company’s planned introductions of similar new products and other qualitative factors in evaluating the reasonableness of the returns reserve. The Company continuously monitors factors that could affect its estimates and revises the reserves as necessary. The Company’s estimates of expected future returns are subject to change based on unforeseen events and uncertainties.

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

*Chargebacks:*

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

*Rebates and other deductions:*

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

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

## Notes to consolidated financial statements

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

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

*Use of estimates in reserves:*

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

The following tables summarize the activities for sales deductions and product returns for the years ended March 31, 2018, 2017, and 2016:

**For the year ended March 31, 2018**

	<b>Beginning balance</b>	<b>Provision recorded for current period sales (1)</b>	<b>Credits processed/ Payments</b>	<b>Ending balance</b>
<b>Accounts Receivable Reserves</b>				
Chargebacks	\$ (112,071)	\$ (1,107,353)	\$ 1,102,792	\$ (116,632)
Rebates and Other	(193,255)	(432,060)	492,094	(133,221)
<b>Total</b>	<u>\$ (305,326)</u>	<u>\$ (1,539,413)</u>	<u>\$ 1,594,886</u>	<u>\$ (249,853)</u>
<b>Current Liabilities</b>				
Returns	\$ (82,494)	\$ (49,265)	\$ 60,894	\$ (70,865)
Other (2)	(43,370)	(60,677)	63,079	(40,968)
<b>Total</b>	<u>\$ (125,864)</u>	<u>\$ (109,942)</u>	<u>\$ 123,973</u>	<u>\$ (111,833)</u>

## Notes to consolidated financial statements

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

## For the year ended March 31, 2017

	Beginning balance	Provision recorded for current period sales (1)	Credits processed/ Payments	Ending balance
<b>Accounts Receivable Reserves</b>				
Chargebacks	\$ (126,729)	\$ (1,153,406)	\$ 1,168,064	\$ (112,071)
Rebates and Other	(164,670)	(522,791)	494,206	(193,255)
<b>Total</b>	<u>\$ (291,399)</u>	<u>\$ (1,676,197)</u>	<u>\$ 1,662,270</u>	<u>\$ (305,326)</u>
<b>Current Liabilities</b>				
Returns	\$ (93,920)	\$ (41,871)	\$ 53,297	\$ (82,494)
Other (2)	(60,428)	(79,372)	96,430	(43,370)
<b>Total</b>	<u>\$ (154,348)</u>	<u>\$ (121,243)</u>	<u>\$ 149,727</u>	<u>\$ (125,864)</u>

## For the year ended March 31, 2016

	Beginning balance	Provision recorded for current period sales (1)	Credits processed/ Payments	Ending balance
<b>Accounts Receivable Reserves</b>				
Chargebacks	\$ (64,119)	\$ (1,032,248)	\$ 969,638	\$ (126,729)
Rebates and Other	(173,228)	(439,654)	448,212	(164,670)
<b>Total</b>	<u>\$ (237,347)</u>	<u>\$ (1,471,902)</u>	<u>\$ 1,417,850</u>	<u>\$ (291,399)</u>
<b>Current Liabilities</b>				
Returns	\$ (109,765)	\$ (25,228)	\$ 41,073	\$ (93,920)
Other (2)	(55,317)	(100,570)	95,459	(60,428)
<b>Total</b>	<u>\$ (165,082)</u>	<u>\$ (125,798)</u>	<u>\$ 136,532</u>	<u>\$ (154,348)</u>

(1) Includes immaterial amounts of reversals of provisions recorded for prior years' sales.

(2) Includes Medicaid, indirect rebates, and amounts due to customers.

## NOTE 6: — INVENTORIES

	March 31,	
	2018	2017
Finished goods	\$ 57,038	\$ 56,652
Raw and packaging materials	56,199	53,436
Work in progress	26,856	27,200
Other	4,502	3,757
	<u>\$ 144,595</u>	<u>\$ 141,045</u>

As of March 31, 2018 and 2017, reserves recorded against inventories for slow-moving, short-dated, excess and obsolete inventory totaled \$24,915 and \$24,482, respectively.

As of March 31, 2018 and 2017, there were no pledges of inventory.

## Notes to consolidated financial statements

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

## NOTE 7: — PROPERTY, PLANT AND EQUIPMENT

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

	March 31,	
	2018	2017
Cost:		
Land	\$ 7,681	\$ 7,633
Buildings	171,735	158,510
Leasehold improvements	2,307	2,273
Machinery and equipment	191,619	181,176
Computer equipment	39,108	34,271
Motor vehicles	218	215
Furniture, fixtures and office equipment	14,870	14,052
	<u>427,538</u>	<u>398,130</u>
Accumulated depreciation and impairment charges:		
Buildings	\$ 65,120	\$ 59,011
Leasehold improvements	1,597	1,436
Machinery and equipment	129,104	121,717
Computer equipment	29,338	28,105
Motor vehicles	217	199
Furniture, fixtures and office equipment	8,435	7,577
	<u>233,811</u>	<u>218,045</u>
Depreciated cost	<u>\$ 193,727</u>	<u>\$ 180,085</u>

- b. Depreciation expenses were \$14,727, \$12,645, and \$11,901 for the years ended March 31, 2018, 2017 and 2016, respectively. For related impairment charges, see Note 2.m.
- c. Cost of property, plant and equipment includes capitalized interest expense, capitalized direct incremental costs (such as payroll and related expenses) and other internal costs incurred in order to bring the assets to their intended use in the amount of \$15,333 and \$16,234 as of March 31, 2018 and 2017. There were no additional capitalized interest and other costs as of March 31, 2018 and 2017.
- d. Cost of computer equipment includes capitalized development costs of computer software developed for internal use in the amount of \$4,636 and \$4,517 as of March 31, 2018 and 2017, respectively.
- e. As for pledges – see Note 14.
- f. Asset disposals were \$578 and \$10,799 for the years ended March 31, 2018 and 2017, respectively, mainly relating to the write-offs of fully depreciated production equipment.

## Notes to consolidated financial statements

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

## NOTE 8: — INTANGIBLE ASSETS AND DEFERRED COSTS

## a. Composition:

	March 31,	
	2018	2017
Cost:		
Product and distribution rights	\$ 79,921	\$ 77,224
Other deferred costs	—	186
	<u>79,921</u>	<u>77,410</u>
Accumulated amortization and impairment charges:		
Product and distribution rights	72,829	71,157
Impairment	—	139
Other deferred costs	—	186
	<u>72,829</u>	<u>71,482</u>
	<u>\$ 7,092</u>	<u>\$ 5,928</u>

- b. Amortization expenses related to product and distribution rights were \$1,769, \$2,184 and \$2,947 for the years ended March 31, 2018, 2017 and 2016, respectively.
- c. As of March 31, 2018, the estimated amortization expense of product and distribution rights for 2019 to 2023 is as follows: 2019—\$885; 2020—\$874; 2021—\$850; 2022—\$848; 2023—\$795.
- d. The weighted-average amortization period for product rights is approximately 10 years.
- e. During the year ended March 31, 2018, the Company did not record any impairment charge. During the year ended March 31, 2017, the Company recorded a \$276 impairment charge primarily related to product rights.

## NOTE 9: —OTHER ASSETS

	March 31,	
	2018	2017
Prepayment of land leased from ILA (1)	\$ 13,709	\$ 13,939
Goodwill	7,201	7,192
Intangible assets and deferred costs, net (2)	7,092	5,928
Severance pay fund (3)	1,657	2,118
Other	293	458
	<u>\$ 29,952</u>	<u>\$ 29,635</u>

- (1) The ILA lease agreements are standard agreements covering substantial portions of the land of Israel. The standard agreements call for a Lease Period of 49 years, with an option for one additional Lease Period (i.e., total of 98 years). A majority of the Company's leases are in the beginning of the second 49 year period, and the remaining leases still in the first 49 year period have the option for the one additional lease period. This amount was prepaid. See Note 2.j.
- (2) See Note 8.
- (3) Under Israeli law, the Company is required to make severance or pension payments to dismissed employees and to employees terminating employment under certain other circumstances. Deposits are made with a pension fund or other insurance plans to secure pension and severance rights for the employees in Israel. These amounts represent the balance of the deposits in those funds (including profits) that will be used to cover the Company's severance obligations. See Note 12.b.

## Notes to consolidated financial statements

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

The Company's non-Israeli subsidiaries maintain defined contribution retirement savings plans covering substantially all of their employees. Under the plans, contributions are based on specific percentages of pay and are subject to statutory limits. The subsidiaries' matching contribution to the plan was \$1,195, \$1,080 and \$958 for the years ended March 31, 2018, 2017 and 2016, respectively.

	Years ended March 31,		
	2018	2017	2016
Pension, retirement savings and severance expenses	\$ 6,058	\$ 5,751	\$ 5,217

**NOTE 10: — DERIVATIVE INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**

The Company's operations are exposed to market risks from changes in interest rates and currency exchange rates. Exposure to these risks is managed through normal operating and financing activities and, when appropriate, through derivative instruments.

## a. Interest rates:

The Company manages its risk to fluctuating interest rates by using interest rate swaps to convert its floating rate debt into fixed rate obligations. These interest rate swaps were not designated as hedges for accounting purposes and changes in the fair value of these instruments are reflected in earnings. There are no interest rate swaps in place for the years ended March 31, 2018, 2017, and 2016.

In September 2005, the Company entered into a mortgage agreement for its New York facility and concurrently entered into an interest rate swap with the intention to mitigate the variable mortgage interest rate risk by effectively establishing the mortgage rate at a fixed rate of 6.16%. In December 2015, the Company repaid the full outstanding balance of the mortgage and interest rate swap. The Company recorded a net loss of \$0, \$0 and (\$6) within financial income, net for the years ended March 31, 2018, 2017 and 2016, respectively. These amounts include a realized gain of \$0, \$0, and \$180 for the years ended March 31, 2018, 2017, and 2016, respectively.

## b. Currency exchange rates:

The Company manages its exposure to debt obligations denominated in currencies other than its functional currency by opportunistically using cross-currency swaps to convert its foreign currency debt payments into its functional currency.

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

Period ended	Rate of Inflation		Rate of Devaluation (Appreciation) Against U.S. Dollar		Rate of Exchange of U.S. Dollar	
	Israel (1)	Canada (2)	Israel (1)	Canada (2)	Israel (1)	Canada (2)
3/31/2017	0.92%	1.56%	(3.71%)	2.31%	3.63	1.33
3/31/2018	0.20%	2.31%	(3.31%)	(3.01%)	3.51	1.29

(1) Per Bank of Israel

(2) Per Bloomberg L.P. for period ended March 31, 2018. Per Bank of Canada for period ended March 31, 2017.

## Notes to consolidated financial statements

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

In October 2011, the Company began entering into separate forward contracts to offset the variability of our cash flows in U.S. dollars due to changes in the NIS and the CAD. In April 2016, the Company began entering into separate forward contracts to purchase the NIS and the CAD on a monthly basis at agreed upon spot rates to hedge the variability of cash flows in U.S. dollars due to changes in the respective exchange rates. At March 31, 2018, the forward contracts to purchase the NIS are for a total amount of \$52,250, at a weighted-average forward rate of 3.45 NIS per U.S. dollar, which are settled in 18 monthly settlements of \$3,250 for eleven (11) months, \$2,000 for six (6) months, and \$4,500 for one (1) month. The Company recorded a net gain of \$97, \$618 and \$813 for the years ended March 31, 2018, 2017 and 2016, respectively, for the contracts to purchase the NIS.

The forward contracts to purchase the CAD are for a total amount of \$53,490, at a weighted-average forward rate of CAD 1.28 per U.S. dollar, which are settled in 14 monthly installments of approximately \$2,786 for six (6) months, \$4,043 for five (5) months, and \$5,519 for three (3) months. The Company recorded a net gain (loss) of \$2,068, (\$3,236) and \$3,413, for the years ended March 31, 2018, 2017 and 2016, respectively, for the contracts to purchase the CAD.

There is no collateral for these hedges.

**NOTE 11: — FAIR VALUE MEASUREMENTS**

FASB ASC Topic 820 defines fair value as the price that would be received for an asset or paid to transfer a liability, from a selling party's perspective, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets and liabilities. Active market means a market in which transactions for assets or liabilities occur with "sufficient frequency" and volume to provide pricing information on an ongoing unadjusted basis.

Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company's Level 2 assets primarily include derivative instruments. The Level 2 asset values are determined using valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and consider counterparty credit risk in the assessment of fair value.

Level 3: Significant unobservable inputs that are not corroborated by market data. The Company has no Level 3 assets or liabilities.

The fair value of the Company's financial assets measured at fair value on a recurring basis as of March 31, 2018 and 2017 were as follows:

	March 31, 2018		March 31, 2017	
	Quoted Market Prices of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Quoted Market Prices of Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<b>Assets</b>				
Short-term marketable securities *	\$ 549,821	\$ —	\$ 3,548	\$ —
Long-term marketable securities *	225,639	—	—	—
Forward contracts	—	411	—	724
	<u>\$ 775,460</u>	<u>\$ 411</u>	<u>\$ 3,548</u>	<u>\$ 724</u>
<b>Liabilities</b>				
Forward contracts	\$ —	\$ (888)	\$ —	\$ (2,110)
	<u>\$ —</u>	<u>\$ (888)</u>	<u>\$ —</u>	<u>\$ (2,110)</u>

\*Refer to Note 3 for additional details on marketable securities.

## Notes to consolidated financial statements

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

## NOTE 12: — OTHER LIABILITIES

## a. Other current liabilities:

	March 31,	
	2018	2017
Returns reserve	\$ 70,865	\$ 82,494
Medicaid and indirect rebates	36,638	36,884
Accrued income taxes	20,619	18,591
Employees and payroll accruals	19,123	18,577
Accrued expenses	17,952	14,609
Due to customers	4,330	6,486
Legal and audit fees	2,723	1,644
Suppliers of property, plant and equipment	2,281	687
Settlements and loss contingencies	1,736	—
Royalties	1,707	4,065
Derivative instruments	591	2,110
Other	11,494	7,296
	<u>\$ 190,059</u>	<u>\$ 193,443</u>

## b. Other long-term liabilities:

	March 31,	
	2018	2017
Deferred revenue	\$ 1,858	\$ 1,630
Accrued severance pay	1,672	2,360
Other	297	6
	<u>\$ 3,827</u>	<u>\$ 3,996</u>

## NOTE 13: — LONG-TERM DEBT

As of March 31, 2018 and March 31, 2017, the Company does not have any long-term debt.

## NOTE 14: — LIABILITIES COLLATERALIZED BY PLEDGES

As of March 31, 2018 and March 31, 2017, the Company does not have any liabilities collateralized by pledges of assets.

## NOTE 15: — COMMITMENTS AND CONTINGENT LIABILITIES

- a. Companies of the Group have leased offices, warehouse space and equipment under operating leases for periods through 2022. The minimum annual rental payments, under non-cancelable lease agreements, are as follows:

	March 31, 2018	
3/31/2019	\$	1,778
3/31/2020		697
3/31/2021		255
3/31/2022		70
	<u>\$</u>	<u>2,800</u>



**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)**

Total rent expenses were \$2,966, \$2,335 and \$2,442 for the years ended March 31, 2018, 2017 and 2016, respectively.

b. **Royalty commitments:**

The Company is committed to pay royalties at the rate of 3.0% to 3.5% to the government of Israel through the Authority on proceeds from sales of products in which the government participates in the research and development by way of grants. The obligation to pay these royalties is contingent on actual sales of the products and, in the absence of such sales, no payment is required. The commitment is on a product by product basis, in an amount not exceeding the total of the grants received by the Company, including interest accrued thereon, and is linked to the U.S. dollar. Grants are subject to interest at a rate of LIBOR (cost of borrowing funds in U.S. dollars). As of March 31, 2018 and 2017, the aggregate contingent liability to the Authority was \$12,513 and \$12,221, respectively.

Royalty payments to the Authority were \$100, \$112 and \$86 for the years ended March 31, 2018, 2017 and 2016, respectively.

c. **Legal proceedings:**

From time to time, we are a party to routine litigation incidental to our business, including patent litigation resulting from our use of the patent challenge procedures set forth in the Hatch Waxman Act, product liability litigations, and employment litigations, none of which, individually or in the aggregate, are expected to have a material effect on our financial position or profitability. Other litigation, as disclosed herein, may have a material adverse effect on our financial position or profitability. The Company records a provision in its financial statements to the extent that it concludes that a contingent liability is probable and the amount thereof is estimable. Because litigation outcomes and contingencies are unpredictable, and because excessive verdicts can occur, these assessments involve complex judgments about future events and can rely heavily on estimates and assumptions.

1. *Legal actions commenced by the Company:*

Company's lawsuit related to tax assessment:

In February 2017, after consulting with its tax advisors, the Company filed an appeal pursuant to Section 153 of the Income Tax Ordinance (New Version), 1961 in the Haifa District Court. The appeal challenged the Israel Tax Authority's ("ITA") tax assessment for the period of January 1, 2010 through March 31, 2014 in the amount of \$40,782 (before interest, linkage and penalties), and denial of an unutilized capital loss in an amount of \$74,551 that had been claimed by the Company.

In March 2018, the Company reached a settlement with the ITA, under which the Company is obligated to pay a reduced tax assessment of \$15,000, and the Company was permitted to record the unutilized capital loss, transfer intellectual property from TNA to Taro Israel and Taro Canada and reorganize assets held by our subsidiaries without triggering an Israeli tax event (the "Settlement"). The Settlement settled all tax disputes between the parties for the tax years 2010 through 2014 as well as related tax issues with respect to the tax years 2015 through 2016, which years were not subject to the disputes.

2. *Other Legal Actions:*

On May 10, 2018, Taro U.S.A. received a Civil Investigative Demand from the United States Department of Justice pursuant to the False Claims Act seeking information relating to corporate and employee records, generic pharmaceutical products and pricing, communications and/or agreements with competitors and others regarding the sale of generic pharmaceutical products, and certain other related matters. Taro U.S.A. is in the process of reviewing and responding to the Civil Investigative Demand.

On September 8, 2016, Taro U.S.A. received a grand jury subpoena from the United States Department of Justice, Antitrust Division, seeking documents relating to corporate and employee records, generic pharmaceutical products and pricing, communications with competitors and others regarding the sale of generic pharmaceutical products, and

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)**

certain other related matters. Taro U.S.A. is in the process of responding to the grand jury subpoena. Certain current and former officers and employees of Taro U.S.A.'s commercial team have also received related subpoenas.

The Company and Taro U.S.A. have been named as defendants in numerous putative class action lawsuits and an additional lawsuit brought by purchasers and payors of several generic pharmaceutical products, including Clobetasol, Clomipramine, Desonide, Econazole, and Fluocinonide. The lawsuits allege that the Company and/or Taro U.S.A. have conspired with competitors to fix prices, rig bids, or allocate customers as to these products, and also allege an industry-wide conspiracy as to all generic pharmaceutical products. Each of these cases has been transferred to the United States District Court for the Eastern District of Pennsylvania for coordinated proceedings under the caption In re: Generic Drug Pricing Antitrust Litigation, MDL No. 2724.

The Company and two of its former officers were named as defendants in a putative shareholder class action entitled *Speakes v. Taro Pharmaceutical Industries, Ltd.*, No. 16-CV-08318, filed October 25, 2016, which is now pending in the United States District Court for the Southern District of New York. The current version of the complaint, filed on June 19, 2017, asserts claims under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") against all defendants and Section 20(a) of the Exchange Act against the individual defendants. It generally alleges that the defendants made material misstatements and omissions in connection with an alleged conspiracy to fix drug prices. The Company filed a motion to dismiss on October 11, 2017. The lead plaintiff (the City of Atlanta Firefighters' Pension Fund) filed its opposition to the motion to dismiss on December 11, 2017. The Company filed its reply to this opposition on January 10, 2018. The motion to dismiss is pending.

d. Other:

Payments to pharmacies for Medicaid-covered outpatient prescription drugs are set by the states. For many multiple source drugs with respect to which FDA has rated at least three drugs as therapeutically equivalent, the amount that states may reimburse pharmacies in the aggregate is subject to a Federal upper limit (FUL) ceiling price. Health care reform legislation enacted in March 2010 changed the methodology by which the Centers for Medicare & Medicaid Services (CMS) calculates the FULs so that the FUL is based on no less than 175 percent of the weighted-average of the monthly average manufacturer prices (AMPs) reported to the government by manufacturers of each of the therapeutically equivalent multiple source drugs. Effective October 1, 2010, the legislation also changed the definition of AMP to include sales to the Retail Class of Trade only. In addition, under the Medicaid Drug Rebate Program, manufacturers are required, as a condition of Federal payment for their drugs under Medicaid and Medicare Part B programs, to pay rebates to state Medicaid programs on drugs dispensed to Medicaid beneficiaries in the state. The amount of the rebate is calculated as a percentage of AMP and for innovator drugs the best price of the drug. Both innovator and non-innovator drugs are now subject to a potential inflation penalty as part of the rebate calculation.

Before implementation of the new FUL methodology on April 1, 2016, CMS used average wholesale price ("AWP") or Wholesale Acquisition Cost ("WAC") in the calculation of FULs. States have also historically used AWP or WAC in setting Medicaid reimbursement rates for drugs. Effective April 1, 2017, states are now required to use actual acquisition cost as the basis of reimbursement. Many of the legislative changes noted above stemmed from civil lawsuits being brought by states against pharmaceutical manufacturers in which allegations that the defendants overstated AWP or WACs, which were used by state agencies to calculate drug reimbursements to healthcare providers.

The Board approved a new collective bargaining agreement dated January 5, 2017, (the "Collective Bargaining Agreement") that amends and extends the collective bargaining agreement dated as of April 6, 2011, among Taro Israel, the Histadrut Trade Union and Taro Israel's Employees Committee on behalf of Taro's Israeli employees. The Collective Bargaining Agreement has a term of three years and automatically renews for one-year periods unless notice is provided by a party three months prior to the end of a term. The Collective Bargaining Agreement memorializes current employee-employer relations practices of Taro as well as additional rights relating to job security, compensation and other benefits.

**NOTE 16: — SHAREHOLDERS' EQUITY**

a. Pertinent rights and privileges of ordinary shares:

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

## Notes to consolidated financial statements

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

## b. Founders' shares:

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

## c. Stock option plans:

The Company's 1999 Stock Incentive Plan ("1999 plan") provided for the issuance of incentive stock options, non-qualified stock options, or stock appreciation rights to key employees and associates of the Group.

The options were substantially granted with an exercise price equal to 100% of the fair market value of the stock on the date of grant and the aggregate amount of the options granted could not exceed 2,100,000 and none of the options granted included stock appreciation rights. The options were granted to employees and associates, had a four to five-year graded vesting term and expired 10 years after the date of the grant. Each option entitled its holder the right to purchase one ordinary share of NIS 0.0001 par value (subject to adjustments). The Company issued new shares to employees exercising their stock options. As of March 31, 2018, 2017, and 2016, no options were outstanding. No further options in respect of the 1999 plan are available for future grants. There were no options exercised in the years ended March 31, 2018, 2017 and 2016, respectively.

## d. Net income per share:

	Year ended March 31, 2018			Year ended March 31, 2017			Year ended March 31, 2016		
	Net income attributable to Taro	Shares	Per Share	Net income attributable to Taro	Shares	Per Share	Net income attributable to Taro	Shares	Per Share
	(numerator)	(denominator)	Amount	(numerator)	(denominator)	Amount	(numerator)	(denominator)	Amount
Basic EPS	\$ 211,150	40,155,087	\$ 5.26	\$ 456,356	41,300,797	\$ 11.05	\$ 540,932	42,832,241	\$ 12.62
Diluted EPS	\$ 211,150	40,155,087	\$ 5.26	\$ 456,356	41,300,797	\$ 11.05	\$ 540,932	42,832,241	\$ 12.62

## e. As of March 31, 2018, the accumulated other comprehensive income comprised of loss from foreign currency translation adjustments of \$112,327 and unrealized gain from available for sale securities of \$2,042. As of March 31, 2017, the accumulated other comprehensive income comprised of loss from foreign currency translation adjustments of \$148,258 and unrealized gain from available for sale securities of \$125.

## NOTE 17: — INCOME TAXES

## a. Corporate income tax rate in Israel:

Taxable income of Israeli companies is subject to income tax at the rate of 24.0%, 25.0% and 26.5% for the years ended March 31, 2018, 2017 and 2016, respectively.

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

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

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

Various production and development facilities of the Company have been granted "Approved Enterprise" and "Benefited Enterprise" status, which provides certain benefits, including tax exemptions and reduced tax rates for a defined period. The benefits available to an Approved Enterprise and Benefited Enterprise relate only to taxable income attributable to the specific investment program and are conditioned upon terms stipulated in the Investments Law and the related regulations and the criteria set forth in the applicable certificate of approval (for an Approved Enterprise). If the Company does not fulfill these conditions, in whole or in part, the benefits can be cancelled and the Company may be required to pay additional tax to refund the benefits, in an amount linked to the Israeli consumer price index plus interest.

The Company qualifies as a foreign investors' company, or FIC. FICs are entitled to further reductions in the tax rate normally applicable to Approved or Benefited Enterprises, depending on the level of foreign ownership. The tax rate ranges between 10% (when foreign ownership is 90% or more) to 25% (when the foreign ownership is below 49%).

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)**

The Company has three active plans, two Approved Enterprises under the Alternative Benefits Program (Plan 3-4 and Plan 5) and one Benefited Enterprise (Plan 6), granting us a package of benefits, subject to compliance with applicable requirements. Under Plan 3-4 (benefit period starting 2003), the Company was entitled to an exemption from corporate income tax on undistributed profits for a period of two years following implementation of the plan and to a reduced tax rate of between 10% and 25% (depending on the level of foreign investment) for an additional 13 years thereafter. Under Plan 5 (benefit period starting 2007), the Company was entitled to an exemption from corporate income tax on undistributed profits for a period of two years following implementation of such plan and to a reduced tax rate of 10% to 25% (depending on the level of foreign investment) for eight additional years thereafter. We filed a request for an additional five years of reduced tax rates for such plan. Approval is still pending. Under Plan 6 (benefit period starting 2010), the Company was entitled to an exemption from corporate income tax on undistributed profits for a period of two years and a reduced tax rate of 10% to 25% (depending on the level of foreign investment) for eight additional years thereafter.

The entitlement to these benefits is conditional upon the Company fulfilling the requirements of the Investments Law, regulations published thereunder and the certificate of approval for the specific investments in the case of Approved Enterprises. In the event of failure to comply with these requirements, the benefits may be reduced or canceled and the Company may be required to refund the amount of the benefits it received, in whole or in part, including linkage and interest. As of March 31, 2018, Management believes that the Company complied with all of the aforementioned requirements.

If the Company pays a dividend, the source of which is income derived from the Approved and/or Benefited Enterprises during the tax exempt period, the Company will be subject to corporate tax at the rate ordinarily applicable to the Approved/Benefited Enterprise from which it was exempt, on the gross amount of such dividend.

The Company has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved and/or Benefited Enterprises.

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

For the years ended March 31, 2018 and 2017, income not eligible for Approved and/or Benefited Enterprise benefits is taxed at the regular corporate income tax rate.

d. **The New Incentives Regime—Amendment 68 to the Investment Law**

Under Amendment 68 to the Investment Law ("Amendment 68"), upon an irrevocable election made by a company, a uniform corporate tax rate will apply to all qualifying industrial income of such company (an "Industrial Company"), as opposed to the previous law's incentives, which were limited to income from Approved/Benefited Enterprises during the benefits period. Under the law, when the election is made, the uniform tax rate for 2014 and onwards will be 9% in areas in Israel designated as Development Zone A (decreased to 7.5% as of January 1, 2017) and 16% elsewhere in Israel. The decrease of the uniform tax rate to 7.5% will be effective for the Company's reporting periods starting April 1, 2017. The profits of these Industrial Companies will be freely distributable as dividends, subject to withholding tax of 20% or lower, under an applicable tax treaty. Certain "Special Preferred Enterprise" that meet more stringent criteria (significant investment, R&D or employment thresholds), and will enjoy further reduced tax rates of 5% in Zone A and 8% elsewhere. In order to be classified as a "Special Preferred Enterprise," the approval of three governmental authorities in Israel is required. We did not elect to apply for Amendment 68 in tax year 2017 or 2016.

e. **The New Technological Enterprise Incentives Regime – 2017 Amendment to the Investment Law**

Amendment 73 to the Investment Law ("the 2017 Amendment"), which came into effect as of January 1, 2017 is based on the "Nexus Principles", according to the OECD guidelines recently published as part of the Base Erosion and Profit Shifting (BEPS) project.

The new incentives regime will apply to "Preferred Technological Enterprises" that meet certain conditions, including all of the following:

1. A company's average R&D expenses in the three years prior to the current tax year must be greater than or equal to 7% of its total revenue or exceed NIS 75 million (approximately \$21,000) per year;

## Notes to consolidated financial statements

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

2. A company must also satisfy one of the following conditions:

- at least 20% of the workforce (or at least 200 employees) are employed in R&D;
- a venture capital investment of an amount approximately equivalent to at least \$2,000 was previously made in the company; or
- growth in sales or workforce by an average of 25% over the three years preceding the tax year

A "Special Preferred Technological Enterprise" is an enterprise that meets conditions 1 and 2 above, and in addition is a part of a group of companies that have total annual consolidated revenues above NIS 10 billion (approximately \$2,800,000).

Preferred Technological Enterprises will be subject to a corporate tax rate of 7.5% for operations in Development Zone A or 12% for operations outside of Development Zone A with respect to the portion of their income derived from certain types of proprietary IP as defined within the Investment Law and which were generally developed in Israel, while Special Preferred Technological Enterprises will be subject to 6% with respect to income related to such IP. The withholding tax on dividends from these enterprises will be 4% for dividends paid to a foreign parent company holding at least 90% of the shares of the distributing company. For other dividend distributions, the withholding tax rate shall be 20% (or a lower rate under a tax treaty, if applicable).

We have evaluated the likely effect of the 2017 Amendment and have currently decided not to file a request to apply the new benefits under the 2017 Amendment. We may decide in the future to make the above-mentioned election.

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

With respect to the Israeli entity, commencing in taxable year 2003, the Company elected to measure its taxable income and file its tax returns in U.S. dollars in keeping with Israeli Income Tax Regulations, 1986 (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income). Such an election was binding to the Company for three years. Accordingly, commencing taxable year 2003, results for tax purposes are measured in U.S. Dollar terms. After the initial three-year term, the Company must make the election on an annual basis. Through taxable year 2017, the Company has consistently elected, for tax purposes, to measure its earnings in U.S. dollars.

g. Income from continuing and discontinued operations before income taxes is comprised of the following:

	Year ended March 31,		
	2018	2017	2016
Domestic (Israel)	\$ 91,485	\$ 123,707	\$ 290,946
Foreign (North America, the Cayman Islands, Ireland and the U.K.)	200,548	436,739	345,638
Income from continuing and discontinued operations before taxes	<u>\$ 292,033</u>	<u>\$ 560,446</u>	<u>\$ 636,584</u>

h. Taxes on income are comprised of the following:

	Year ended March 31,		
	2018	2017	2016
Current taxes	\$ 27,687	\$ 25,396	\$ 66,785
Prior years' (benefits) taxes	(1,830)	(2,444)	2,540
Deferred income taxes	56,097	80,828	25,988
	<u>\$ 81,954</u>	<u>\$ 103,780</u>	<u>\$ 95,313</u>
Domestic (Israel)	\$ 17,373	\$ 26,175	\$ 34,254
Foreign (North America, the Cayman Islands, Ireland and the U.K.)	64,581	77,605	61,059
	<u>\$ 81,954</u>	<u>\$ 103,780</u>	<u>\$ 95,313</u>

## Notes to consolidated financial statements

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

Included within current and deferred income tax expense are benefits relating to research and development tax credits at Taro Canada of \$1,091, \$955 and \$884 for the years ended March 31, 2018, 2017 and 2016, respectively. Taro Canada uses the “flow-through” method and therefore records the benefits in earnings in the period the tax credits are utilized.

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act (the “Tax Act”), which among other provisions, reduced the U.S. corporate tax rate from 35% to 21%, effective January 1, 2018. Fiscal year filers, such as Taro USA, recognize a partial reduction in the U.S. corporate tax rate for their year ending after January 1, 2018 and thereafter recognize the full reduction in the U.S. corporate tax rate. For the year ending March 31, 2018 Taro USA is subject to a 31.5% federal tax rate and for subsequent years Taro USA is subject to a 21% federal tax rate. Taro USA re-measured its deferred tax assets and liabilities, based on the 21% rate. The estimated tax cost recorded related to the re-measurement of the deferred tax balance was \$38,000.

The Tax Act changed the manner in which companies may utilize losses carried forward. For losses in tax years ending after December 31, 2017 losses may carry forward an unlimited number of years, however losses may only offset 80% of the federal taxable income in each future year. Taro USA generated an estimated \$22,596 loss during the year ended March 31, 2018 and this estimated loss is subject to the above changes. The Tax Act created a variety of other taxes and incentives; however, the Company currently believes these other provisions have limited or no impact on Taro USA. We are still in the process of evaluating the impact on future years.

As a result of the Zalicus acquisition and subsequent amalgamation of Zalicus with Taro Canada, Taro Canada recognized approximately \$36,000 of tax loss carryforwards and investment tax credits in the year ended March 31, 2016.

As a result of the Thallion Pharmaceuticals Ltd. acquisition in March 2017 and subsequent amalgamation of Thallion with Taro Canada, Taro Canada recognized approximately \$29,500 of tax loss carryforwards and investment tax credits in the year ended March 31, 2018.

Included within current and deferred income tax expense are benefits relating to state tax credits at Taro U.S.A. of \$79 for the year ended March 31, 2016.

- i. Reconciliation of the statutory tax rate of the parent company in Israel to the effective consolidated tax rate:

	Year ended March 31,		
	2018	2017	2016
Statutory tax rate (in Israel)	24.0%	25.0%	26.5%
(Decrease) increase in effective tax rate due to:			
Tax benefits from reduced tax rates under benefit programs and other	(7.8%)	(5.2%)	(6.0%)
Utilization of net operating losses	(2.5%)	—	(5.0%)
Different tax rates applicable to non-Israeli subsidiaries	(2.3%)	(1.5%)	(2.5%)
Uncertain tax positions, net	(3.3%)	0.7%	1.5%
Taxes from prior years	5.7%	(0.5%)	0.5%
Change in Federal corporate income tax rate	14.2%	—	—
Effective consolidated tax rate	<u>28.0%</u>	<u>18.5%</u>	<u>15.0%</u>

## Notes to consolidated financial statements

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

- j. Current taxes are calculated at the following rates:

	Year ended March 31,		
	2018	2017	2016
On Israeli operations (not including "Approved Enterprise")	24.0%	25.0%	26.5%
On U.S. operations *	31.7%	35.2%	35.2%
On Canadian operations *	25.0%	25.0%	25.0%
On U.K. operations *	20.0%	20.0%	20.0%
On Ireland operations *	12.5%	12.5%	12.5%

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

- k. Deferred income taxes:

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

	March 31,	
	2018	2017
Deferred tax assets:		
Operating carryforward loss	\$ 4,745	\$ 18,143
Capital carryforward loss	17,219	—
Deferred revenue	19,245	22,137
Property, plant, and equipment	—	789
Accrued expenses	50,704	86,760
Bad debt allowance	46	112
Amortization and impairment	6,207	4,435
Other, net	6,310	21,419
Total deferred tax assets	104,476	153,795
Valuation allowance for deferred tax assets	(17,219)	(11,407)
Net deferred tax assets	87,257	142,388
Deferred tax liabilities:		
Property, plant, and equipment	(2,873)	(2,086)
Other, net	(355)	(316)
Total deferred tax liabilities	(3,228)	(2,402)
Net deferred tax assets	\$ 84,029	\$ 139,986
Domestic	\$ 13,004	\$ 11,152
Foreign	71,025	128,834
	\$ 84,029	\$ 139,986

The deferred income taxes are presented on the consolidated balance sheets as follows:

	March 31,	
	2018	2017
Among current assets ("other receivables and prepaid expenses")	\$ —	\$ 132,064
Among non-current assets	87,257	10,324
Among short-term liabilities	—	(288)
Among long-term liabilities	(3,228)	(2,114)
	\$ 84,029	\$ 139,986

## Notes to consolidated financial statements

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

The Company changed its method of deducting certain customer rebates and allowances in the U.S. for the March 31, 2017 annual tax filing. As a result of this change, the Company converted \$49,374 of its deferred tax asset to tax receivable, which is reflected in the March 31, 2017 balances.

## l. Carryforward tax losses:

1. *The Company:*

As of March 31, 2018, the Company has \$74,864 carryforward capital losses. Please refer to Note 15.c. and Note 17.p. for additional information relating to Israel's carryforward capital losses.

2. *Canadian subsidiary:*

As of March 31, 2018, this subsidiary has no carryforward losses.

3. *U.K. subsidiary:*

As of March 31, 2018, this subsidiary has no carryforward losses and is in the process of liquidation.

4. *Irish subsidiary:*

As of March 31, 2018, this subsidiary has no carryforward losses and was dissolved as of January 2018.

5. *U.S. subsidiary:*

As of March 31, 2018, this subsidiary has carryforward losses of \$22,596.

6. *Hungarian subsidiary:*

As of March 31, 2018, this subsidiary has no carryforward losses and was dissolved as of February 2017.

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

n. At March 31, 2018, deferred income taxes were not provided for on a cumulative total of \$1,347,997 of the undistributed earnings of Taro Canada, which are not taxable provided earnings remain undistributed. Taro Canada intends to invest these earnings indefinitely in its operations.

o. Foreign withholding taxes have been accrued as necessary by the Company and its subsidiaries.

## p. Tax assessments:

The Company completed its tax assessments with the Israeli tax authorities for years through 2014. In February 2017, after consulting with its tax advisors, the Company filed an appeal pursuant to Section 153 of the Income Tax Ordinance (New Version), 1961 in the Haifa District Court. The appeal challenged the Israel Tax Authority's ("ITA") tax assessment for the period of January 1, 2010 through March 31, 2014 in the amount of \$40,782 (before interest, linkage and penalties), and denial of an unutilized capital loss in an amount of \$74,551 that had been claimed by the Company.

In March 2018, the Company reached a settlement with the ITA, under which the Company is obligated to pay a reduced tax assessment of \$15,000, and the Company was permitted to record the unutilized capital loss, transfer intellectual property from TNA to Taro Israel and Taro Canada and reorganize assets held by our subsidiaries without triggering an Israeli tax event (the "Settlement"). The Settlement settled all tax disputes between the parties for the tax years 2010 through 2014 as well as related tax issues with respect to the tax years 2015 through 2016, which years were not subject to the controversy.

Taro U.S.A. completed its tax assessments with the U.S. tax authorities for the years through March 31, 2014. The Company is currently under examination by the U.S. tax authorities for the year ended March 31, 2015. The Company may be subject to examination by the U.S. tax authorities for the years ended March 31, 2016 and onward. The Company believes that its tax provision is adequate to satisfy any assessments resulting from examination related to these years.

Taro Canada completed its tax assessments with the Canadian tax authorities for the years through 2011. The Company's tax provision was materially adequate to satisfy these assessments. The Company is under examination by the Canada tax authorities for the year ended March 31, 2015 and the short period ended October 4, 2015. Taro Canada remains subject



## Notes to consolidated financial statements

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

to examination by the Canadian tax authorities for years after October 4, 2015 according to the statute of limitations. The Company believes that its tax provision is adequate to satisfy any assessments resulting from examinations related to these years.

## q. Uncertain tax positions:

The Company adopted FASB ASC Section 740-10-25, “*Income Taxes-Overall-Recognition*,” effective January 1, 2007, which prescribes a model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return (see Note 2.h).

	Year ended March 31,		
	2018	2017	2016
Unrecognized tax exposure at beginning of year	\$ 23,457	\$ 22,093	\$ 8,966
Increases as a result of positions taken in prior period	—	750	6
Decreases as a result of positions taken in prior period	(15,506)	(4,794)	4,393
Increases as a result of positions taken in current period	8,859	5,408	8,728
Unrecognized tax exposure at end of year	<u>\$ 16,810</u>	<u>\$ 23,457</u>	<u>\$ 22,093</u>

The total amount of interest and penalties recognized on the consolidated statement of operations for the years ended March 31, 2018, 2017 and 2016, were \$0, \$1,379, and \$759, respectively. The total amount of interest and penalties recognized on the consolidated balance sheets at March 31, 2018 and 2017 were \$0 and \$2,674, respectively.

The total amount of unrecognized tax benefits, which would impact the effective tax rate if recognized, was \$16,810 and \$23,457 at March 31, 2018 and 2017, respectively.

## NOTE 18: — SELECTED STATEMENTS OF INCOME DATA

	Year ended March 31,		
	2018	2017	2016
Sales, net	\$ 661,913	\$ 879,387	\$ 950,751
Selling, marketing, general and administrative expenses:			
Selling and marketing	\$ 33,724	\$ 40,813	\$ 43,574
Advertising	9,913	10,468	15,504
General and administrative *	44,559	34,375	33,287
Settlements and loss contingencies	1,884	—	973
	<u>\$ 90,080</u>	<u>\$ 85,656</u>	<u>\$ 93,338</u>
* Including provision for doubtful accounts	<u>\$ (124)</u>	<u>\$ 218</u>	<u>\$ (5)</u>
Financial expenses (income):			
Interest and exchange differences on long-term liabilities	\$ 304	\$ 131	\$ 473
Income in respect of deposits	(20,238)	(14,599)	(13,077)
Foreign currency transaction gains	32,465	(20,168)	(7,068)
	<u>\$ 12,531</u>	<u>\$ (34,636)</u>	<u>\$ (19,672)</u>

## Notes to consolidated financial statements

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

## NOTE 19: — SEGMENT INFORMATION

## a. Geographic Area Information:

The Group operates in one industry segment, which produces, researches, develops and markets pharmaceutical products. Management organizes the Company's operations based on geographic segments, which are presented below in accordance with FASB ASC Paragraph 280-10-50-1, "Segment Reporting – Overall – Disclosure – Operating Segments."

	Israel	Canada*	U.S.A.	Other	Consolidated
Year ended March 31, 2018 and as of					
March 31, 2018:					
Sales to unaffiliated customers **	\$ 38,223	\$ 67,226	\$ 549,174	\$ 7,290	\$ 661,913
Long-lived assets ***	\$ 114,145	\$ 56,629	\$ 37,246	\$ —	\$ 208,020
Year ended March 31, 2017 and as of					
March 31, 2017:					
Sales to unaffiliated customers **	\$ 29,200	\$ 57,621	\$ 785,319	\$ 7,247	\$ 879,387
Long-lived assets ***	\$ 101,111	\$ 55,154	\$ 36,940	\$ —	\$ 193,205
Year ended March 31, 2016 and as of					
March 31, 2016:					
Sales to unaffiliated customers **	\$ 22,963	\$ 56,605	\$ 865,224	\$ 5,959	\$ 950,751
Long-lived assets ***	\$ 92,284	\$ 49,936	\$ 32,771	\$ —	\$ 174,991

\* Includes operations in both Canada and Cayman Islands.

\*\* Based on customer's location.

\*\*\* Includes property, plant and equipment, net; goodwill and intangible assets, net.

- b. For the year ended March 31, 2018, the Company had net sales to three different U.S. customers of 15.3%, 11.5%, and 11.4% of consolidated net sales. For the year ended March 31, 2017, the Company had net sales to three different customers of 19.3%, 14.2%, and 10.3% of consolidated net sales. For the year ended March 31, 2016, the Company had net sales to three different customers of 20.0%, 14.1% and 14.0% of consolidated net sales.

- c. Sales by therapeutic category, as a percentage of total net sales for the years ended March 31, 2018, 2017 and 2016, were as follows:

Category	Year ended March 31,		
	2018	2017	2016
Dermatological and topical	65%	64%	66%
Neuropsychiatric	17%	18%	20%
Cardiovascular	6%	6%	8%
Anti-inflammatory	4%	8%	3%
Other	8%	4%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## Notes to consolidated financial statements

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

**NOTE 20: — DISCONTINUED OPERATIONS**

- a. During 2010, the Company's Management decided to sell its Irish facility, which was sold in July 2017 for \$946. The results of operations of the Irish facility have been classified as discontinued operations in the Consolidated Statements of Operations. The subsidiary was dissolved as of January 2018.
- b. The following is the detail of discontinued operations:

	Year ended March 31,		
	2018	2017	2016
Sales, net	\$ —	\$ —	\$ —
Cost of sales	(103)	(172)	(178)
Gross loss	(103)	(172)	(178)
Operating expenses:			
Research and development	(30)	—	(18)
Selling, marketing, general and administrative	(169)	(142)	(141)
Operating loss	(302)	(314)	(337)
Financial (expenses) income, net	113	(67)	65
Other income, net	(146)	29	36
Loss before income taxes	(335)	(352)	(236)
Net loss from discontinued operations	<u>\$ (335)</u>	<u>\$ (352)</u>	<u>\$ (236)</u>

**NOTE 21: — RELATED PARTY TRANSACTIONS**

In addition to Sun controlling 83.2% of the voting power in the Company as of March 31, 2018, the Company has substantial relationships with Sun. Certain Taro Board members are also members of various Sun entities board of directors, including Taro's Chairman, Dilip Shanghvi who is also Managing Director of Sun Pharma's board of directors. In addition, certain Taro officers and executives are also executives of Sun.

**Arrangements with Sun**

Since 2013, in the ordinary course of business, Taro has entered into various commercial transactions, including product distribution and logistics, manufacturing and service agreements, with Sun. The Company reviews each of these transactions and believes that the terms of these transactions are comparable to those offered by or that could be obtained from unrelated third parties. Pursuant to Israeli requirements, all material transactions were presented to the Audit Committee, which determined that each such transaction was not considered extraordinary, as defined in the Israeli Companies Law and therefore did not require shareholder approval. The Audit Committee further determined the approval requirements for the different types of transactions.

In June 2017, Sun and Taro affiliates renewed a services arrangement (the "Services Agreement") that allows the companies to share the services of certain employees of the respective companies involved in certain North American management and operations functions in North America and Israel in the following areas: Human Resources, Information Technology, Legal (including intellectual property matters), OTC, Management, Procurement, and certain aspects of Commercial and Customer Service, Finance (Accounts Receivable, Accounts Payable, Government Pricing, Gross-to-Net and Tax Compliance), Regulatory Affairs (state licensing only in U.S.), Supply Chain and Operations (management services only).

The companies are required to maintain records (the "Service Reports") of the costs associated with the provision of the services under the Services Agreement, and allocate such costs between the companies, based upon the approved allocation methodologies for each Service Area. The Services Agreement requires our Audit Committee to review the Service Reports on a semi-annual basis and, the Services Agreement as a whole, on an annual basis to determine its efficacy and whether it is in the Company's best interests.

**Notes to consolidated financial statements****U.S. dollars in thousands (except share and per share data)**

Each of the employees providing services under the Services Agreement is required to sign a written acknowledgment of his/her receipt of, and agreement, to be bound by (a) the confidentiality and non-disclosure agreement between Sun and Taro, and (b) guidelines for consideration in the performance of such services, including the identification of potential conflicts of interest.

In April 2017, the Board of Directors approved for Taro to negotiate an agreement with Sun whereby Taro's U.S. branded products team will advertise and promote a combined portfolio of Taro and Sun corticosteroid products. The agreement between Taro U.S.A., and Sun went into effect on May 1, 2017. Under this agreement, Sun sells its products to customers and pays Taro a percentage of the net sales for Taro's promotional services.

In May 2018, Taro Canada signed an agreement with Sun's affiliate Ranbaxy Pharmaceuticals Canada Inc., whereby Taro Canada will act as the exclusive distributor for a portfolio of Sun and Ranbaxy products in Canada. Under this agreement, Sun and Ranbaxy will pay Taro Canada a sales and distribution commission.

**NOTE 22: — SUBSEQUENT EVENTS**

Subsequent to March 31, 2018, the Company received final approvals from the FDA for two additional ANDAs: Benzoyl Peroxide; Clindamycin Phosphate Topical Gel 5%; 1% in May 2018 and Clindamycin Phosphate and Benzoyl Peroxide Gel, 1.2%/3.75% in June 2018.

**End of consolidated financial statements**

**SCHEDULE II: — VALUATION AND QUALIFYING ACCOUNTS**

Schedules have been omitted as the required information is provided elsewhere in these financial statements.

**CERTIFICATION**

I, Uday Baldota, certify that:

1. I have reviewed this annual report on Form 20-F of Taro Pharmaceutical Industries Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared.
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: June 21, 2018

/s/ Uday Baldota

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Name: Uday Baldota  
 Title: Chief Executive Officer and Director

**CERTIFICATION**

I, Mariano Balaguer, certify that:

1. I have reviewed this annual report on Form 20-F of Taro Pharmaceutical Industries Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared.
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: June 21, 2018

/s/ Mariano Balaguer

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Name: Mariano Balaguer  
 Title: Vice President, Chief Financial Officer and Chief Accounting Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT 2002**

In connection with the Annual Report of Taro Pharmaceutical Industries Ltd. (the “Company”) on Form 20-F for the period ended March 31, 2018 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we, Uday Baldota, Chief Executive Officer and Director of the Company, and Mariano Balaguer, Vice President, Chief Financial Officer and Chief Accounting Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 21, 2018

By: /s/ Uday Baldota

Uday Baldota

Chief Executive Officer and Director

By: /s/ Mariano Balaguer

Mariano Balaguer

Group Vice President, Chief Financial Officer and Chief Accounting Officer