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

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

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

Or

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

Commission File number: 0-16174

TEVA PHARMACEUTICAL INDUSTRIES LIMITED

(Exact name of Registrant as specified in its charter)

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

5 Basel Street

P.O. Box 3190

Petach Tikva 49131, Israel

(Address of principal executive offices)

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

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

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

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

each representing one Ordinary Share

(Title of Class)

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

0.25% Convertible Senior Debentures Due 2026

1.75% Convertible Senior Debentures Due 2026

5.55% Senior Notes due 2016

6.15% Senior Notes due 2036

and related Guarantees

(Title of Class)

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

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

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

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

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

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

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

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

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

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

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INTRODUCTION AND USE OF CERTAIN TERMS

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

FORWARD-LOOKING STATEMENTS

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

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

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

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

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PART I

ITEM 3: KEY INFORMATION

SELECTED FINANCIAL DATA

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

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

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

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

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Operating Data

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

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

(2) See the below reconciliation.

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

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

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

Balance Sheet Data

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

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Dividends

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

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

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

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

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RISK FACTORS

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

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

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

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

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

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

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

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filing suits for patent infringement that automatically delay FDA approval;

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

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

changing product claims and product labeling; or

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risks Associated with Our Acquisition of Ivax

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

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

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

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

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

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

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

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

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

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

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ITEM 4: INFORMATION ON THE COMPANY

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

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

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

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

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

Pharmaceutical Products

Generic Products

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

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

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

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

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

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

North America

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Europe

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

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

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

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

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

Operations in Selected European Countries

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

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

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

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

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

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

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

Israel and Other Countries

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

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

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

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

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

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

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

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

Biopharmaceutical Operations

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

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

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

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

Proprietary Products

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

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

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

Multiple Sclerosis

Copaxone®

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

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

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

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

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

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

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

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

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

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

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

Laquinimod

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

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

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

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

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

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

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

Parkinson s Disease

Azilect® (rasagiline mesylate)

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

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

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

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

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

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

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

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

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

Other Projects

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

Intellectual Property and Other Protections

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

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

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

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

Active Pharmaceutical Ingredients

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

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

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

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

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

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

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

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

Marketing and Sales

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

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

Production

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

Animal Health

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

Research and Development

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

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

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

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

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

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

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

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

Competition

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

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

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

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

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

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

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

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

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

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

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

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

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

Regulation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Miscellaneous Regulatory Matters

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

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

Pharmaceutical Production

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

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

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

Raw Materials for Pharmaceutical Production

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

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

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

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Organizational Structure

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

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

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

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

Properties and Facilities

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

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

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

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

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

Teva owns or leases various other facilities worldwide.

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

ITEM 4A: UNRESOLVED STAFF COMMENTS

None.

ITEM 5: OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Introduction

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

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

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

Highlights

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

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

Among the more significant highlights of 2005 were:

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

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

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

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

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

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

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

Ivax Acquisition

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

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

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

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

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

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

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

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

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

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

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

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

Sicor Acquisition

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

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Results of Operations

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

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

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

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

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

Sales General

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

Sales by Geographical Areas

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

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

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Sales by Business Segments

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

* Third-party sales only.

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

Pharmaceutical Sales

North America

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

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

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

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

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

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

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

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

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

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

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

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

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

Europe

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

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

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

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

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

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

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

Israel and Other Countries

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

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

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

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

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

Innovative Products

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

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

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

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

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

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

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

Active Pharmaceutical Ingredients (API) Sales

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

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

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

Other Income Statement Line Items

Gross Profit

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

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

Research and Development (R&D) Expenses

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

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

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

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

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

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

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

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

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

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

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

Selling, General and Administrative Expenses

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

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

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

Operating Income

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

Financial Income (Expenses)

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

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

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

Taxes

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

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

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

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

Net Income and Earnings per ADR

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

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

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

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

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

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

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

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

Certain One-Time (Charges)/Benefits

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

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

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

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

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

Impact of Currency Fluctuations and Inflation

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

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

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

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

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

Critical Accounting Policies

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

Revenue Recognition and Sales Reserves and Allowances

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Income Taxes

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

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

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

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

Contingencies

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

Inventories

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

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

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

Intangible assets:

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

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

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

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

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

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Marketable securities:

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

Long-lived assets:

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

Allowance for doubtful accounts

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

Recent Accounting Pronouncements

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

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

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

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

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

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

Liquidity and Capital Resources

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Research and Development, Patents and Licenses

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

Trend Information

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

Off-Balance Sheet Arrangements

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

Aggregate Contractual Obligations

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

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

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

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

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

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ITEM 6: DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

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

Executive Officers

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

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Directors

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

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

Executive Officers

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

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

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

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

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

Dr. Itzhak Krinsky joined Teva as Corporate Vice President for Business Development in May 2005. Prior to joining Teva, Dr. Krinsky was a managing director with The Silverfern Group, Inc. from January 2003 until February 2005 and until joining Teva a managing director with Trenwith Securities, LLC, both investment banking boutiques in New York City. From July 2001 until December 2002, Dr. Krinsky was a managing director of I. Krinsky, Financial & Investment Consulting in New York City and from January 1998 until May 2001 a senior strategist with the Investment Banking Research and Strategy Group of Bankers Trust (the predecessor of Deutsche Bank Securities) and later a managing director in the Acquisition and Corporate Advisory Group of Deutsche Bank Securities in New York City. Dr. Krinsky