

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
CONSOLIDATED FINANCIAL STATEMENTS
For the Year Ended December 31, 2002

TABLE OF CONTENTS

	<u>Page</u>
REPORT OF INDEPENDENT AUDITORS	F-2
CONSOLIDATED FINANCIAL STATEMENTS:	
Statements of income	F-3
Balance sheets	F-4
Statements of changes in shareholders' equity	F-5
Statements of cash flows	F-6 – F-7
Notes to financial statements	F-8 – F-43
REPORTS OF INDEPENDENT AUDITORS WITH RESPECT TO SUBSIDIARIES ..	F-44 – F-45

The amounts are stated in U.S. dollars (\$) in millions.

REPORT OF INDEPENDENT AUDITORS

To the shareholders of
TEVA PHARMACEUTICAL INDUSTRIES LIMITED

We have audited the consolidated balance sheets of Teva Pharmaceutical Industries Limited (the "Company") and its subsidiaries as of December 31, 2002 and 2001 and the consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain subsidiaries whose sales included in consolidation constitute approximately 16% of total consolidated sales for the year ended December 31, 2000. The financial statements of those subsidiaries were audited by other independent auditors, whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those subsidiaries, is based on the reports of the other independent auditors.

We conducted our audits in accordance with auditing standards generally accepted in Israel and in the United States, including those prescribed by the Israeli Auditors (Mode of Performance) Regulations, 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Company's Board of Directors and management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other independent auditors provide a reasonable basis for our opinion.

In our opinion, based upon our audits and the reports of the other independent auditors, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2002 and 2001, and the consolidated results of their operations, changes in shareholders' equity and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

As discussed in note 1g, effective January 1, 2002, the Company changed its method of accounting for goodwill and other indefinite life intangible assets, to conform with FASB Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets".

/s/ KESSELMAN & KESSELMAN

Kesselman & Kesselman
Certified Public Accountants (Isr.)

Tel-Aviv, Israel
February 17, 2003

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
CONSOLIDATED STATEMENTS OF INCOME

	<u>Year Ended December 31</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(U.S. dollars in millions, except earnings per ADR)		
Net sales	\$2,518.6	\$2,077.4	\$1,749.9
Cost of sales	<u>1,423.2</u>	<u>1,230.1</u>	<u>1,058.0</u>
Gross profit	1,095.4	847.3	691.9
Research and development expenses:			
Total expenses	192.6	168.6	132.3
Less — participations and grants	<u>27.6</u>	<u>61.4</u>	<u>27.7</u>
	165.0	107.2	104.6
Selling, general and administrative expenses	406.4	358.1	301.0
Restructuring expenses		15.7	
Acquisition of research and development in process			<u>35.7</u>
Operating income	524.0	366.3	250.6
Financial expenses — net	<u>24.6</u>	<u>26.0</u>	<u>42.2</u>
Income before income taxes	499.4	340.3	208.4
Income taxes	<u>84.8</u>	<u>63.6</u>	<u>59.6</u>
	414.6	276.7	148.8
Share in profits (losses) of associated companies — net	(2.7)	0.8	0.4
Minority interests in losses (profits) of subsidiaries — net	<u>(1.6)</u>	<u>0.7</u>	<u>(0.8)</u>
Net income	<u>\$ 410.3</u>	<u>\$ 278.2</u>	<u>\$ 148.4</u>
Earnings per ADR:			
Basic	<u>\$ 1.55</u>	<u>\$ 1.05</u>	<u>\$ 0.58</u>
Diluted	<u>\$ 1.52</u>	<u>\$ 1.02</u>	<u>\$ 0.57</u>
Weighted average number of ADRs (in millions):			
Basic	<u>264.5</u>	<u>264.5</u>	<u>257.9</u>
Diluted	<u>280.8</u>	<u>280.9</u>	<u>263.7</u>

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
CONSOLIDATED BALANCE SHEETS

	December 31	
	2002	2001
	(U.S. dollars in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 809.9	\$ 768.9
Short-term investments	235.7	21.2
Accounts receivable:		
Trade	855.8	651.2
Other	218.9	166.4
Inventories	781.1	570.2
Total current assets	2,901.4	2,177.9
Investments and other assets	313.5	141.9
Property, plant and equipment, net	675.4	554.2
Intangible assets and debt issuance costs, net	176.2	120.1
Goodwill	560.3	466.1
Total assets	<u>\$4,626.8</u>	<u>\$3,460.2</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term credit	\$ 176.1	\$ 206.5
Accounts payable and accruals	785.7	531.6
Convertible senior debentures	562.4	
Total current liabilities	1,524.2	738.1
Long-term liabilities:		
Deferred income taxes	43.7	39.0
Employee related obligations	63.2	53.3
Loans and other liabilities	351.4	334.9
Convertible senior debentures	810.0	912.0
Total long-term liabilities	1,268.3	1,339.2
Commitments and contingencies, see note 8		
Total liabilities	2,792.5	2,077.3
Minority interests	4.9	2.2
Shareholders' equity:		
Ordinary shares of NIS 0.10 par value; December 31, 2002 and 2001: authorized — 999.6 million and 499.6 million, respectively; issued and outstanding — 263.2 million and 256.2 million, respectively	33.9	31.0
Additional paid-in capital	481.5	480.6
Deferred compensation	(0.1)	(0.2)
Retained earnings	1,345.7	970.4
Accumulated other comprehensive income (loss)	17.3	(58.5)
Cost of Company shares held by subsidiaries — December 31, 2002 and 2001 — 4.6 million and 4.5 million ordinary shares, respectively	(48.9)	(42.6)
Total shareholders' equity	1,829.4	1,380.7
Total liabilities and shareholders' equity	<u>\$4,626.8</u>	<u>\$3,460.2</u>

/s/ E. HURVITZ

E. Hurvitz
Chairman of the Board

/s/ I. MAKOV

I. Makov
President and Chief Executive Officer

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Ordinary shares		Additional paid-in capital	Deferred compensation (U.S. dollars in millions)		Retained earnings	Accumulated other comprehensive income (loss)	Cost of Company shares held by subsidiaries	Total
	Number of shares (in millions)	Par value		(U.S. dollars in millions)	(U.S. dollars in millions)				
Balance at January 1, 2000	250.1	\$31.0	\$163.6	\$ (1.4)	\$ 608.9	\$ (29.2)	\$ (25.6)	\$ 747.3	
Changes during 2000:					148.4				
Net income								148.4	
Differences from translation of non-dollar currency financial statements of subsidiaries and associated companies						(22.6)		(22.6)	
Unrealized holding losses on available-for-sale securities — net						(0.8)		(0.8)	
Total comprehensive income								125.0	
Deferred compensation related to employee stock option plans			0.1	(0.1)				0.8	
Amortization of deferred compensation related to employee stock option plans				0.8				9.3	
Exercise of options by employees	1.3	*	9.3		(29.0)			(29.0)	
Dividends								0.6	
Exercise of warrants	0.3	*	0.6					73.6	
Shares issued in connection with the acquisition of Novopharm (note 2a)	4.2	*	73.6					226.4	
Special shares that are exchangeable into 12.8 million ordinary shares issued in connection with the acquisition of Novopharm (note 2a)			226.4				(5.4)	226.4	
Cost of acquisition of Company shares, net of proceeds from sale			2.7				(31.0)	(2.7)	
Balance at December 31, 2000	<u>255.9</u>	<u>31.0</u>	<u>476.3</u>	<u>(0.7)</u>	<u>728.3</u>	<u>(52.6)</u>	<u>(31.0)</u>	<u>1,151.3</u>	
Changes during 2001:					278.2			278.2	
Net income								278.2	
Differences from translation of non-dollar currency financial statements of subsidiaries and associated companies						(6.4)		(6.4)	
Unrealized holding gains on available-for-sale securities — net						0.5		0.5	
Total comprehensive income								272.3	
Deferred compensation related to employee stock option plans			0.3	(0.3)				0.8	
Amortization of deferred compensation related to employee stock option plans				0.8				3.9	
Exercise of options by employees	0.3	*	3.9		(36.1)			(36.1)	
Dividends								3.9	
Cost of acquisition of Company shares, net of proceeds from sale			0.1				(11.6)	(11.5)	
Balance at December 31, 2001	<u>256.2</u>	<u>31.0</u>	<u>480.6</u>	<u>(0.2)</u>	<u>970.4</u>	<u>(58.5)</u>	<u>(42.6)</u>	<u>1,380.7</u>	
Changes during 2002:					410.3			410.3	
Net income								410.3	
Differences from translation of non-dollar currency financial statements of subsidiaries and associated companies						85.6		85.6	
Unrealized holding losses on available-for-sale securities — net						(9.8)		(9.8)	
Total comprehensive income								486.1	
Amortization of deferred compensation related to employee stock option plans				0.1				0.1	
Exercise of options by employees	0.5	*	5.8		(35.0)			5.8	
Dividends								(35.0)	
Ordinary shares issued in exchange for special shares (note 2a)	6.5	*	*						
Distribution of stock dividend		2.9	(2.9)						
Cost of acquisition of Company shares, net of proceeds from sale			(2.0)						
Balance at December 31, 2002	<u>263.2</u>	<u>\$33.9</u>	<u>\$481.5</u>	<u>\$(0.1)</u>	<u>\$1,345.7</u>	<u>\$ 17.3</u>	<u>\$(6.3)</u>	<u>\$(8.3)</u>	

* Represents an amount of less than \$ 0.1 million.

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31		
	2002	2001	2000
	(U.S. dollars in millions)		
Cash flows from operating activities:			
Net income	\$ 410.3	\$ 278.2	\$ 148.4
Adjustments to reconcile net income to net cash provided by operating activities:			
Income and expenses not involving cash flows* ⁽¹⁾	84.5	132.2	131.4
Changes in certain assets and liabilities* ⁽¹⁾	<u>(141.1)</u>	<u>(137.2)</u>	<u>(114.2)</u>
Net cash provided by operating activities*⁽²⁾	<u>353.7</u>	<u>273.2</u>	<u>165.6</u>
Cash flows used in investing activities:			
Purchase of property, plant and equipment	(160.4)	(114.8)	(89.4)
Investment grants relating to property, plant and equipment			1.9
Acquisition of subsidiaries* ⁽³⁾	(156.3)		(8.0)
Acquisition of intangible assets	(25.2)	(19.3)	(22.5)
Proceeds from sale of property, plant and equipment	24.3	5.1	26.2
Proceeds from sale of long term investments	4.0		
Acquisition of long-term investments and other assets	(202.4)	(45.0)	(5.7)
Net decrease (increase) of short-term investments	<u>(148.9)</u>	<u>(16.6)</u>	<u>13.2</u>
Net cash used in investing activities	<u>(664.9)</u>	<u>(190.6)</u>	<u>(84.3)</u>
Cash flows from financing activities:			
Proceeds from exercise of options by employees	8.5	5.2	12.1
Cost of acquisition of Company shares, net of proceeds from sale	(6.3)	(11.6)	(5.4)
Proceeds from exercise of warrants			0.6
Proceeds from issuance of convertible senior debentures, net of issuance costs (2002 — \$10.8 million; 2001 — \$7.7 million; 2000 — \$12.6 million)	439.2	352.3	537.4
Long-term loans and other long-term liabilities received		82.4	136.2
Discharge of long-term loans and other long-term liabilities	(3.9)	(64.2)	(309.6)
Net decrease in short-term credit	(53.4)	(64.7)	(78.0)
Dividends paid	<u>(46.6)</u>	<u>(32.8)</u>	<u>(27.6)</u>
Net cash provided by financing activities	<u>337.5</u>	<u>266.6</u>	<u>265.7</u>
Translation differences on cash balances of certain subsidiaries	<u>14.7</u>	<u>(0.9)</u>	<u>(3.6)</u>
Net increase in cash and cash equivalents	41.0	348.3	343.4
Balance of cash and cash equivalents at beginning of year	<u>768.9</u>	<u>420.6</u>	<u>77.2</u>
Balance of cash and cash equivalents at end of year	<u>\$ 809.9</u>	<u>\$ 768.9</u>	<u>\$ 420.6</u>

* See details on page F-7.

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
DETAILS TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31		
	2002	2001	2000
	(U.S. dollars in millions)		
(1) Adjustments to reconcile net income to net cash provided by operating activities:			
Income and expenses not involving cash flows:			
Depreciation and amortization	\$ 96.8	\$ 109.1	\$ 95.0
Deferred income taxes — net	(31.7)	(0.9)	(3.3)
Restructuring expenses		14.2	
Acquisition of research and development in process			34.4
Increase in employee related obligations	6.0	8.2	7.0
Amortization of deferred compensation related to employee stock option plans	0.1	0.8	0.8
Capital gains	(7.5)	(1.3)	(0.4)
Share in losses (profits) of associated companies — net	2.7	(0.8)	(0.4)
Minority interests	1.6	(0.7)	0.8
Other items — net	16.5	3.6	(2.5)
	<u>\$ 84.5</u>	<u>\$ 132.2</u>	<u>\$ 131.4</u>
Changes in certain assets and liabilities:			
Increase in accounts receivable	\$(101.8)	\$(147.4)	\$(115.5)
Increase in inventories	(149.1)	(73.4)	(56.2)
Increase in accounts payable and accruals	109.8	83.6	57.5
	<u>\$(141.1)</u>	<u>\$(137.2)</u>	<u>\$(114.2)</u>
(2) Supplemental disclosure of cash flow information:			
Interest paid	<u>\$ 25.1</u>	<u>\$ 36.6</u>	<u>\$ 47.3</u>
Income taxes paid	<u>\$ 54.2</u>	<u>\$ 89.4</u>	<u>\$ 36.5</u>
(3) Acquisition of subsidiaries (in 2002 and 2000):			
Assets and liabilities of the subsidiaries upon acquisition:			
Working capital (excluding cash and cash equivalents)	\$ 18.7		\$(100.5)
Long-lived assets other than goodwill	60.0		157.7
Long-term liabilities	(36.1)		(112.6)
Minority interests in subsidiary at date of acquisition			0.1
Research and development in process			34.4
Goodwill arising on acquisition	80.1		255.3
Cost of investment in shares	122.7		234.4
Acquisition of shareholders loan	33.6		
Issuance of special shares exchangeable into ordinary shares of the Company (note 2a)			(226.4)
Cash paid — net	<u>\$ 156.3</u>		<u>\$ 8.0</u>

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Significant Accounting Policies

a. General:

Operations

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

Functional currency

The currency of the primary economic environment in which the operations of the Company and its subsidiaries in Israel and in the United States are conducted is the U.S. dollar (“dollar” or “\$”), this in view of the overall trend of increasing dollar sales of the Company. Operating expenses (including purchase of materials) incurred in non-Israeli currencies, mainly the dollar, constitute over 50% of the total operating expenses of each of those companies. Most purchases of materials are also made in non-Israeli currencies (mainly the dollar). Thus, the functional currency of these companies is the dollar.

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

Accounting principles

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

Use of estimates in the preparation of financial statements

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

b. Principles of consolidation:

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 1 — Significant Accounting Policies (continued)

c. Inventories:

These are valued at the lower of cost or market. Cost is determined as follows:

Raw and packaging materials and purchased products — mainly on the “first-in, first-out” basis. Finished products and products in process: raw material and packaging component — mainly on the “first-in, first-out” basis; labor and overhead — on the average basis over the production period.

d. Investee companies:

These investments are included among investments and other assets. Companies controlled to the extent of 20% or more, which are not subsidiaries (“associated companies”), are accounted for by the equity method. Other non-marketable investments are carried at cost.

e. Marketable securities:

Held-to-maturity securities consist of debt securities, which are carried at amortized cost. At December 31, 2002 and 2001, the carrying value of these securities — which approximated their fair value — amounting to \$709.8 million and \$20.9 million, respectively, was included among cash and cash equivalents — \$371.5 million (2001 — \$20.9 million); short-term investments — \$223.9 million; and investments and other assets — \$114.4 million. These debt securities mature as follows: 2003 — \$595.4 million; and 2004 to 2006 — \$114.4 million.

Other marketable securities consist of equity investments classified as available-for-sale securities and presented in investments and other assets. Marketable securities are carried at market value with unrealized gains and losses, net of taxes, reported as a separate component of accumulated other comprehensive income (loss). The fair market value, cost and gross unrealized holding losses of such securities at December 31, 2002 were \$22.5 million, \$31.5 million and \$9.0 million, respectively; December 31, 2001 — \$15.2 million, \$16.0 million and \$0.8 million, respectively. In 2002, it was determined that the impairment in value of one the investments was other than temporary. Consequently, the accumulated unrealized loss in the amount of \$3.4 million relating to such investment, was charged to financial expenses.

f. Property, plant and equipment:

Property, plant and equipment are carried at cost, after deduction of the related investment grants (\$11.5 million at December 31, 2002 and 2001). Equipment leased under capital leases is classified as the Group’s assets and included at the present value of lease payments as determined by the lease agreement.

Interest expenses in respect of loans and credit applied to finance the construction or acquisition of property, plant and equipment, incurred until the assets are ready for their intended use, are charged to cost of such assets. Interest capitalized for each of the years ended December 31, 2002, 2001 and 2000 was less than \$1 million.

Depreciation is computed using the straight-line method over the estimated useful life of the assets: buildings — mainly 25 years; machinery and equipment — 8-12 years; motor vehicles, computer equipment, furniture and other assets — mainly 7 years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the related asset.

g. Goodwill, intangible assets and debt issuance costs:

Goodwill reflects the excess of the purchase price of subsidiaries acquired over the fair value of net assets acquired. In conjunction with the adoption of FAS 141, “Business Combinations”, the Company reclassified an intangible asset relating to assembled work force with a carrying value of \$3.8 million net of

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 1 — Significant Accounting Policies (continued)

income taxes to goodwill. As from January 1, 2002, pursuant to FAS 142, “Goodwill and Other Intangible Assets”, goodwill is no longer amortized but rather tested for impairment at least annually. Prior to the adoption of FAS 142, goodwill was amortized in equal annual installments, mainly over a period of 30 years. As of January 1, 2002, the Company has completed the transitional impairment review of Goodwill, as required by FAS 142: the various reporting units, for which separately identifiable cash flow information is available, were identified and the fair values of such reporting units were determined using expected future discounted cash flows. Consequently, the Company has determined that there is no indication of impairment with respect to Goodwill as of January 1, 2002. The Company has selected December 31st as the date on which it will perform its annual goodwill impairment test. As of December 31, 2002, no impairment was required.

Intangible assets consist mainly of marketing and other rights relating to products in respect of which an approval for marketing was received from the US Food and Drug Administration (“FDA”) or the equivalent agencies in other countries. In 2002, in accordance with FAS 142, a review was performed of the remaining estimated useful lives for all recorded intangible assets. As a result of this review, an intangible asset with a carrying value of \$29.6 million, relating to tradename, was determined to have an indefinite life. Accordingly, as from January 1, 2002, this intangible asset is no longer amortized, but rather tested for impairment at least annually. Other intangible assets are amortized using the straight-line method over their estimated period of useful life, as follows: marketing and product rights — mainly 12 years; other intangible assets — mainly 5-14 years. The Company has selected December 31st as the date on which it will perform its annual impairment test for the indefinite life intangible asset. As of December 31, 2002, no impairment was required.

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

h. Impairment in value of long-lived assets:

On January 1, 2002, the Company adopted FAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. FAS 144 requires that long-lived assets, to be held and used by an entity, be reviewed for impairment and, if necessary, written down to the estimated fair values, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through undiscounted future cash flows. The adoption of FAS 144 did not have a material effect on the financial position and results of operations of the Company.

i. Deferred income taxes:

Deferred taxes are determined utilizing the asset and liability method based on the estimated future tax effects of differences between the financial accounting and tax bases of assets and liabilities under the applicable tax laws. Deferred income tax provisions and benefits are based on the changes in the deferred tax asset or tax liability from period to period. Valuation 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 the Company’s intention to hold these investments, not to realize them.

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

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 1 — Significant Accounting Policies (continued)

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

j. Company shares held by subsidiaries:

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

k. Revenue recognition:

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

l. Research and development expenses:

Research and development expenses are charged to income as incurred. Participations and grants in respect of research and development expenses are recognized as a reduction of research and development expenses as the related costs are incurred, or as the related milestone is met.

m. Shipping and handling costs:

Shipping and handling costs, which amounted to \$35.9 million, \$23.4 million and \$19.3 million for the years ended December 31, 2002, 2001 and 2000, respectively, are included in Selling, general and administrative expenses.

n. Advertising expenses:

Advertising expenses are charged to income as incurred. Advertising expenses for the years ended December 31, 2002, 2001 and 2000 were \$28.7 million, \$21.4 million and \$10.1 million, respectively.

o. Concentration of credit risks — allowance for doubtful accounts:

Most of the Group's cash and cash equivalents and short-term investments as of December 31, 2002 and 2001 were deposited with Israeli, U.S. and European banks. The Company is of the opinion that the credit risk in respect of these balances is remote.

Most of the Group's sales are made in North America, Europe and Israel, to a large number of customers. The sales to each of certain two customers constitute approximately 9% of total consolidated sales in the year ended December 31, 2002 (2001 — 8% to each of certain two customers and 2000 — 6% to each of certain three customers).

In general, the exposure to the concentration of credit risks relating to trade receivables is limited, due to the relatively large number of customers and their wide geographic distribution. The Group performs ongoing credit evaluations of its customers for the purpose of determining the appropriate allowance for doubtful accounts and generally does not require collateral. An appropriate allowance for doubtful accounts is included in the accounts. The allowance in respect of trade receivables amounts to \$30.4 million and \$15.6 million at December 31, 2002 and 2001, respectively, and has been determined for specific debts doubtful of collection.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 1 — Significant Accounting Policies (continued)

p. Derivatives:

The Company carries out transactions involving foreign exchange derivative financial instruments (mainly forward exchange contracts and written and purchased currency options). The transactions are designed to hedge the cash flows resulting from existing assets and liabilities and transactions expected to be entered into over the next twelve months, in currencies other than the functional currency. However, except for one interest rate swap transaction, these contracts do not qualify for hedge accounting under FAS 133, “Accounting for Derivative Instruments and Hedging Activities”.

In 2002, the Company entered into an interest rate swap transaction in respect of a portion of a series of debentures issued in a private placement in 1998. This derivative qualifies as a fair value hedge under FAS 133, and is recognized on the balance sheet at its fair value. The carrying amount of the hedged liability is adjusted for the entire changes in the fair value of the derivative. All other derivatives are recognized on the balance sheet at their fair value, with changes in the fair value carried to the statements of income and included in financial expenses — net.

q. Cash and cash equivalents:

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

r. Earnings per American Depository Receipt (“ADR”):

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

In computing diluted earnings per ADR, basic earnings per ADR are adjusted to take into account the potential dilution that could occur upon: (1) the conversion of the convertible senior debentures due 2005, using the if-converted method, by adding to net income interest expense on these debentures and issuance costs, net of tax benefits, and by adding the weighted average number of shares issued upon assumed conversion of these debentures (no account was taken of the potential dilution that could occur upon the conversion of the convertible senior debentures due 2021 and 2022, since as at December 31, 2002 and 2001, the conditions necessary for conversion of these debentures have not been satisfied); and (2) the exercise of options granted under employee stock option plans, using the treasury stock method.

Basic and diluted earnings per ADR are computed after giving retroactive effect to distribution of 100% stock dividend in December 2002 (see note 9a).

s. Stock based compensation:

The Company accounts for its employee stock option plans using the intrinsic value based method of accounting prescribed by APB 25 and related interpretations. Accordingly, the compensation cost relating to stock options is charged on the date of grant of such options, to shareholders’ equity, under deferred compensation, and is thereafter amortized by the straight-line method and charged against income over the expected service period of the related employees.

FAS 123, “Accounting for Stock-Based Compensation”, established a fair value based method of accounting for employee stock options or similar equity instruments, and encourages adoption of such method for stock compensation plans. However, it also allows companies to continue to account for those plans using the accounting treatment prescribed by APB 25. FAS 148 amends FAS 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 1 — Significant Accounting Policies (continued)

such plans. The Company has elected to continue accounting for employee stock option plans according to APB 25, and has accordingly complied with the disclosure requirements set forth in FAS 123, as amended by FAS 148, for companies electing to apply APB 25.

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

	<u>Year Ended December 31</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(In millions, except earnings per ADR)		
Net income, as reported	\$410.3	\$278.2	\$148.4
Add: amortization of deferred compensation related to employee stock option plans, included in consolidated statements of income, net of related tax effect	0.1	0.6	0.6
Deduct: amortization of deferred compensation, at fair value, net of related tax effect	<u>58.6</u>	<u>28.5</u>	<u>13.2</u>
Pro forma net income	<u>\$351.8</u>	<u>\$250.3</u>	<u>\$135.8</u>
Earnings per ADR:			
Basic — as reported	<u>\$ 1.55</u>	<u>\$ 1.05</u>	<u>\$ 0.58</u>
Basic — pro forma	<u>\$ 1.33</u>	<u>\$ 0.95</u>	<u>\$ 0.53</u>
Diluted — as reported	<u>\$ 1.52</u>	<u>\$ 1.02</u>	<u>\$ 0.57</u>
Diluted — pro forma	<u>\$ 1.30</u>	<u>\$ 0.92</u>	<u>\$ 0.52</u>

t. Comprehensive income:

Comprehensive income, presented in shareholders' equity, includes, in addition to net income:

- (i) translation gains and losses of non-dollar currency financial statements of subsidiaries and associated companies (accumulated balance at December 31, 2002 — gain of \$27.4 million; 2001 — loss of \$58.2 million); and (ii) unrealized holding losses on available-for-sale securities, net of tax (accumulated balance at December 31, 2002 — \$10.1 million; 2001 — \$0.3 million).

u. Recently issued accounting pronouncements:

1) FAS 143

In August 2001, the FASB issued FAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets". FAS 143 addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs, including, but not limited to, clean-up costs, etc. FAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company does not expect the adoption of FAS 143 to have a material effect on its consolidated financial statements.

2) FAS 146

In June 2002, the FASB issued FAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". FAS 146 requires that a liability for costs associated with an exit or disposal activity be recognized, at fair value, when the liability is incurred. Previously, a liability

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 1 — Significant Accounting Policies (continued)

for an exit cost was recognized at the date of the commitment to an exit plan. FAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

3) FIN 45

In November 2002, the FASB issued FIN No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others”. FIN 45 requires the guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing such guarantee and to provide certain disclosures. The recognition provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Company does not expect the adoption of FIN 45 to have a material effect on its consolidated financial statements.

4) FIN 46

In January 2003, the FASB issued FIN No. 46, “Consolidation of Variable Interest Entities”. FIN 46 classifies entities into two groups: (1) those for which voting interests are used to determine consolidation; and (2) those for which other interests (variable interests) are used to determine consolidation. FIN 46 deals with the identification of Variable Interest Entities (“VIE”) and the business enterprise which should include the assets, liabilities, non-controlling interests, and results of activities of a VIE in its consolidated financial statements. FIN 46 would become effective during 2003. At this stage, the Company is evaluating the effect of this pronouncement on its consolidated financial statements.

v. Reclassifications:

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

Note 2 — Certain Transactions

a. Acquisitions:

2002 acquisitions

In June 2002, the Company acquired full control and ownership of Honeywell Pharmaceutical Fine Chemicals S.r.l., an Italian manufacturer of active pharmaceutical ingredients (later renamed Teva Pharmaceutical Fine Chemicals S.r.l. — “TPFC”). The acquisition was made in order to broaden Teva’s API product line, which provides strategic depth to its generic business.

In June 2002, the Company also acquired full control and ownership of Bayer Classics S.A., a French generic pharmaceutical company (later renamed Teva Classics S.A. — “Teva Classics”), as well as a shareholders’ loan of \$34 million granted to the acquired company by the vendor. The acquisition was made in order to expand Teva’s presence in the fast growing emerging generic pharmaceutical market in France.

Total consideration paid for the two acquisitions (including the shareholder’s loan mentioned above and acquisition costs) was \$168 million in cash.

The Company accounted for these acquisitions by the purchase method. The results of operations of TPFC and Teva Classics have been included in the consolidated financial statements of Teva commencing

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 2 — Certain Transactions (continued)

the third quarter of 2002. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

	<u>U.S. \$ in millions</u>
Current assets	\$ 69.5
Property, plant, and equipment	35.8
Intangible assets	21.3
Other long lived assets	2.9
Goodwill	<u>80.1</u>
Total assets acquired	<u>209.6</u>
Current liabilities	39.1
Long-term liabilities	<u>36.1</u>
Total liabilities assumed	<u>75.2</u>
Net assets acquired	<u>\$134.4</u>

The intangible assets acquired include product rights of \$13.6 million and customer lists of \$7.7 million, with a weighted-average useful life of 6 years. No in-process research and development was identified.

Hereafter are certain unaudited pro forma combined statements of income data for the years ended December 31, 2002 and 2001, as if the acquisition of TPFC and Teva Classics occurred on January 1, 2002 and 2001, respectively, after giving effect to purchase accounting adjustments, including amortization of certain identifiable intangible assets, the elimination of intercompany transactions and profits not yet realized outside the Group.

The pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisitions taken place at the beginning of 2002 and 2001, respectively, nor is it necessarily indicative of future results.

	<u>Year Ended December 31</u>	
	<u>2002</u>	<u>2001</u>
	(U.S. \$ in millions) (Except earning per ADR) (Unaudited)	
Net sales	<u>\$2,546.8</u>	<u>\$2,133.8</u>
Net income	<u>\$ 412.1</u>	<u>\$ 279.2</u>
Earnings per ADR:		
Basic	<u>\$ 1.56</u>	<u>\$ 1.06</u>
Diluted	<u>\$ 1.53</u>	<u>\$ 1.02</u>

2000 acquisition

In 2000, Teva acquired full control and ownership of Novopharm Ltd. (“Novopharm”), a Canadian-based generic company, as well as a shareholders’ loan of approximately \$74 million granted to Novopharm by the vendor, and other rights of the vendor. In consideration, the vendor was issued 4.2 million ordinary shares of Teva and 12.8 million special shares that are exchangeable into ordinary

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 2 — Certain Transactions (continued)

shares of the Company at his discretion at a one-to-one ratio. The ordinary shares and the special shares — with a total value determined to be \$300 million — entitled the holders, assuming full conversion, to approximately 6.2% of the Company's issued and outstanding share capital at the date of issuance. In addition, in 2000, Teva acquired shares in a subsidiary of Novopharm the latter did not already own for a total amount of \$12 million.

An amount of \$34.4 million out of the cost of acquisition was attributed to in-process research and development. This amount was expensed upon acquisition, in accordance with generally accepted accounting principles. Goodwill, representing the excess of cost of acquisition over the fair value of net assets on acquisition date, not attributable to in-process research and development, after adjustments in 2001 and 2002, amounted to \$257 million.

Additional purchase liabilities recorded included \$10.5 million for severance pay and related costs associated with the shut-down and consolidation of certain acquired facilities, which was completed in 2002. At December 31, 2002, none of the purchase liabilities in respect of the above were outstanding.

b. Cooperation agreements:

1) *With Impax*

In June 2001, a subsidiary entered into an agreement with Impax Laboratories, Inc. ("Impax") under which Teva was granted exclusive U.S. marketing rights and an option to acquire exclusive marketing rights for certain Impax products in the rest of North America, South America, the European Union and Israel. Under the agreement, Teva granted Impax a \$22 million loan bearing 8% annual interest, and payable — principal and accrued interest — in 2004 in cash or in Impax stock, unless previously forgiven. Pursuant to the agreement, portions of the loan (principal and accrued interest) are to be forgiven upon the achievement by Impax of certain milestones. If not forgiven, Teva may elect to have repayment of the loan made in part in terms of a non-exclusive right to market certain products.

In addition, Teva invested \$15 million in Impax common stock. This investment is treated as an "available-for-sale" investment and included, together with the loan mentioned above, under investments and other assets.

In 2002, Teva exercised the option to acquire exclusive marketing rights for additional Impax products in Canada. In addition, Impax achieved a milestone as defined in the agreement, which resulted in the forgiveness of the accrued interest balance in the amount of \$2.4 million. This amount is reflected in intangible assets and is to be amortized over the estimated economic life of the marketing rights.

2) *With Aventis*

a) Under agreements entered into by Teva and Aventis Pharmaceuticals, Inc. ("Aventis"), sale and distribution of Copaxone[®], an innovative product of the Company for the treatment of multiple sclerosis, in North America is being carried out by Aventis. As from January 1, 2001, marketing of Copaxone[®] in the U.S. and Canada is done by indirect wholly-owned entities of the Company, operating under the name "Teva Neuroscience".

Aventis also participates in certain research and development expenses of Teva relating to the development of the oral version of Copaxone[®] and to a new indication for injectible Copaxone[®] (collectively referred to as the "Studies"). Such participation will not exceed maximum amounts stipulated in the agreement. Upon receipt of approval from the U.S. Food and Drug Administration relating to either one of the Studies, the related amount of participation is to be refunded to Aventis.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 2 — Certain Transactions (continued)

b) Under separate agreements between the Company and the German parent company of Aventis, Aventis distributes and sells Copaxone® in Europe and certain other countries. In the core European countries, Copaxone® is jointly marketed by Teva and Aventis. In addition, under certain conditions, Teva has reserved the right to reacquire the marketing and distribution rights in Europe to the injectible formulation of Copaxone® for consideration to be computed based on a certain formula, as stipulated in the agreement.

In 2001 and 2000, amounts of \$10 million and \$5 million, respectively, were paid by Aventis. Such amount, less the portion due to the relevant research institute, were deducted from research and development expenses under grants and participations.

3) *With Lundbeck*

a) In 1999, the Company entered into a cooperation agreement with a Danish company, H. Lundbeck A/S (“Lundbeck”), for the joint global development and for the marketing, mainly in Europe, of two innovative products of the Company for the treatment of Parkinson’s disease. The exclusive marketing rights for the rest of the world will remain in the hands of the Company.

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

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

4) *With BTG*

Pursuant to an agreement entered into in 1999, between Teva and Bio Technology General Corp. (“BTG”) Teva is to make payments of up to \$20 million to BTG relating to certain biotech products. Through December 31, 2002 an amount of \$12.5 million was paid, of which \$10 million relates to certain marketing and distribution rights which are expected to become effective no later than 2004 and is included among intangible assets. The remaining amount of \$2.5 million represents participation in research and development expenses of BTG relating to certain products in development and was recorded as research and development expenses in the year ended December 31, 2000. The balance is to be paid on fulfillment of certain conditions, as per the agreement.

5) *With other parties*

In 2002, Teva entered into agreements with two companies pursuant to which it is to participate in the funding of research and development conducted by these companies in a total amount of \$20 million, payable upon achievement of certain milestones. In consideration, Teva would be granted certain exclusive marketing rights with respect to the products to be developed. Through December 31, 2002, an amount of \$4.3 million, representing participation in

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 2 — Certain Transactions (continued)

development expenses of these companies, relating to certain products under research and development, was paid by Teva and expensed in the accounts.

In 2001, Teva entered into agreements with two other companies pursuant to which it is to participate in the funding of research and development conducted by these companies in a total amount of \$20 million, payable upon achievement of certain milestones. In consideration, Teva would be granted certain exclusive worldwide rights with respect to the products to be developed. In addition, Teva acquired shares in these companies for a total amount of approximately \$10 million which are carried at cost and included under investments and other assets.

Note 3 — Property, Plant and Equipment

Property, plant and equipment, net, consisted of the following:

	December 31	
	2002	2001
	(U.S. \$ in millions)	
Land	\$ 55.7	\$ 50.3
Buildings	282.3	272.5
Machinery and equipment	645.5	548.0
Motor vehicles, computer equipment, furniture and other assets	182.8	151.5
Payments on account	<u>42.0</u>	<u>12.1</u>
	1,208.3	1,034.4
Less — accumulated depreciation and amortization	<u>(532.9)</u>	<u>(480.2)</u>
	<u>\$ 675.4</u>	<u>\$ 554.2</u>

Depreciation and amortization expense was \$76.5 million, \$71.5 million and \$68.0 million in the years ended December 31, 2002, 2001 and 2000, respectively. In the year ended December 31, 2001 an additional impairment charge of \$9.7 million was made in connection with the Group's restructuring plans.

Land includes leasehold land, the rights to which extend over original periods of 49 years ending in the years 2007-2043, with an option for an additional period of 49 years.

Note 4 — Goodwill, Intangible Assets and Debt Issuance Costs

a. Goodwill:

The changes in the carrying amount of goodwill for the year ended December 31, 2002, are as follows:

	Pharmaceuticals	A.P.I	Total
	(U.S. \$ in millions)		
Balance as of January 1, 2002	\$459.2	\$ 6.9	\$466.1
Goodwill acquired during the year	61.6	18.5	80.1
Translation differences	21.4	0.3	21.7
Other adjustments	<u>(7.6)</u>	<u>—</u>	<u>(7.6)</u>
Balance as of December 31, 2002	<u>\$534.6</u>	<u>\$25.7</u>	<u>\$560.3</u>

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 4 — Goodwill, Intangible Assets and Debt Issuance Costs (continued)

b. Intangible assets and debt issuance costs:

1) Intangible assets and debt issuance costs, net, consisted of the following:

	Original amount	Accumulated amortization	Amortized balance	
			December 31,	
			2002	2001
			(U.S. \$ in millions)	
Intangible assets (mainly — product rights)	\$177.3	\$48.7	\$128.6	\$ 73.4
Tradename	29.8		29.8	29.6
Debt issuance costs	32.4	14.6	17.8	17.1
	<u>\$239.5</u>	<u>\$63.3</u>	<u>\$176.2</u>	<u>\$120.1</u>

2) Amortization of intangible assets amounted to \$21.4 million; \$16.2 million and \$10.8 million in the years ended December 31, 2002, 2001 and 2000, respectively. As of December 31, 2002, the estimated aggregate amortization of intangible assets for the years 2003 to 2007 is as follows: 2003 — \$22 million; 2004 — \$22 million; 2005 — \$19 million; 2006 — \$17 million and 2007 — \$12 million.

3) Amortization of debt issuance costs amounted to \$10.0 million, \$3.7 million and \$0.7 million in the years ended December 31, 2002, 2001 and 2000, respectively, and included among financial expenses — net.

c. The effect of FAS 142 adoption:

The following table summarizes the Company's reported results adjusted to eliminate the effect of amortization of goodwill and of tradename, as of January 1, 2000:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions, except earnings per ADR) (Unaudited)		
Net income — as reported	\$410.3	\$278.2	\$148.4
Add, amortization of goodwill and tradename, net of taxes, charged through 2001		18.5	16.0
As adjusted	<u>\$410.3</u>	<u>\$296.7</u>	<u>\$164.4</u>
Earnings per ADR — basic, as reported	\$ 1.55	\$ 1.05	\$ 0.58
Add — amortization of goodwill and tradename, net of taxes, charged through 2001		0.07	0.06
As adjusted	<u>\$ 1.55</u>	<u>\$ 1.12</u>	<u>\$ 0.64</u>
Earnings per ADR — diluted, As reported	\$ 1.52	\$ 1.02	\$ 0.57
Add, amortization of goodwill and tradename, net of taxes, charged through 2001		0.07	0.06
As adjusted	<u>\$ 1.52</u>	<u>\$ 1.09</u>	<u>\$ 0.63</u>

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 5 — Employee Related Obligations

a. Employee related obligations consisted of the following:

	December 31	
	2002	2001
	(U.S.\$ in millions)	
Accrued severance pay	\$49.4	\$42.9
Obligation in respect of defined benefit plans	13.8	10.4
	\$63.2	\$53.3

Costs of severance pay and defined contribution plans charged to income in the years ended December 31, 2002, 2001 and 2000 was \$22.2 million, \$16.9 million (excluding \$2.3 million in respect of restructuring) and \$15.9 million, respectively. Pension costs under the defined benefit plans in those years amounted to \$3.7 million, \$2.8 million and \$2.7 million, respectively.

The main terms of the different arrangements with employees are described in b. below. Further details relating to defined benefit plans are presented in c. below.

b. Terms of arrangements:

1) In Israel

Israeli law generally requires payment of severance pay upon dismissal of an employee or upon termination of employment in certain other circumstances. The following principal plans relate to the Group's employees in Israel:

- a) Pension plans for the majority of the Group's employees: under collective labor agreements, these external pension plans provide 72% of the severance pay liability. The pension and severance pay liabilities covered by these plans are not reflected in the financial statements as the pension and severance pay risks have been irrevocably transferred to the pension funds.
- b) Insurance policies for employees in managerial positions: the policies provide coverage for severance pay and pension liabilities of managerial personnel.
- c) Severance pay liabilities not covered above are fully provided for in the financial statements on an undiscounted basis, based upon the number of years of service and the latest monthly salary of the Group's employees in Israel.

2) Non-Israeli subsidiaries

The majority of the employees in the European subsidiaries are entitled to a retirement grant when they leave the subsidiaries. In the consolidated financial statements, an accrual of the Company's liability is made, based on the length of service and remuneration of each employee at the balance sheet date. Other employees in Europe are entitled to pension according to a defined benefits scheme providing benefits based on final pensionable pay or according to a hybrid pension scheme that provides retirement benefits on a defined benefit and a defined contribution basis. Professionally qualified independent actuaries value these schemes, the rates of contribution payable are being determined by the actuaries. Pension costs for the defined benefit section of the scheme are accounted for on the basis of charging the expected cost of providing pensions over the period during which the subsidiaries benefit from the employees' services.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 5 — Employee Related Obligations (continued)

The North American subsidiaries provide various defined contribution plans for the benefit of their employees. Under these plans, contributions are based on specified percentages of pay. Additionally, a multi-employer plan is maintained in accordance with various union agreements.

c. Certain details relating to defined benefit plans:

1) The consolidated components of net periodic benefit costs are as follows:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
Service cost	\$ 3.5	\$ 2.5	\$ 2.4
Interest cost	2.7	2.3	2.3
Expected return on plan assets	(2.0)	(2.0)	(2.0)
Recognized net actuarial loss	(0.5)	*	*
Employers' pension cost	<u>\$ 3.7</u>	<u>\$ 2.8</u>	<u>\$ 2.7</u>

* Represents an amount of less than \$ 0.1 million.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 5 — Employee Related Obligations (continued)

2) The consolidated components of the projected benefit obligation and plan assets are as follows:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
	(U.S. \$ in millions)	
Change in benefit obligation:		
Projected benefit obligation at beginning of year	\$ 40.1	\$ 37.8
Service cost	3.5	2.5
Interest cost	2.7	2.3
Plan participants' contribution	0.2	0.7
Benefits paid	(0.5)	(0.7)
Actuarial loss (gain)	8.9	(1.4)
Acquisitions	2.7	
Exchange rate differences	<u>7.2</u>	<u>(1.1)</u>
Benefit obligation at end of year	<u>64.8</u>	<u>40.1</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	29.4	30.6
Actual return on plan assets	(2.0)	(2.2)
Employer contribution	5.5	2.1
Plan participants' contribution	0.2	0.7
Benefits paid	(0.5)	(0.6)
Exchange rate differences	<u>5.0</u>	<u>(1.2)</u>
Fair value of plan assets at end of year	<u>37.6</u>	<u>29.4</u>
Reconciliation of funded status:		
Unfunded obligation	27.2	10.7
Unrecognized net actuarial loss	<u>(13.4)</u>	<u>(0.3)</u>
Net obligation, as reported	<u>\$ 13.8</u>	<u>\$ 10.4</u>
	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
Weighted average assumptions:		
Discount rate	6.1%	6.3%
Expected return on plan assets	6.4%	6.5%
Rate of compensation increase	3.3%	3.4%
Pension increase	1.8%	1.9%

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 6 — Long-Term Loans and Other Long-Term Liabilities

a. Long-term loans and other long-term liabilities consisted of the following:

	Interest rate as of December 31, 2002 (%)	December 31 2002 2001 (U.S. \$ in millions)	
Loans from banks(1) (4)	3.3 – 4.5	\$220.1	\$209.8
Debentures — in dollars:(2) (4)			
Principal amount	6.9	110.0	110.0
Fair value hedge adjustments		9.2	
Other(3)		16.2	18.8
		355.5	338.6
Less — current portion		(4.1)	(3.7)
		<u>\$351.4</u>	<u>\$334.9</u>

(1) The balance as of December 31, 2002 is composed of: (1) a loan in the amount of \$142.1 million due 2005 and bearing interest determined on the basis of Euro LIBOR (mainly) and Great Britain Pound LIBOR; and (2) a loan in the amount of \$78.0 million due 2006 and bearing interest determined on the basis of the Canadian dollar LIBOR.

(2) The balance as of December 31, 2002 and 2001 is composed of debentures, which were issued in 1998 in a private placement to institutional investors in the United States for periods of 7, 10 and 20 years at a fixed annual interest rate, the weighted average of which is 6.9%. In 2002, the Company entered into two interest rate swap transactions with respect to portions of these debentures (see note 11d), effectively changing the weighted annual interest rate on the debentures at December 31, 2002 from 6.9% to 4.6%. Only the first interest swap transaction qualifies for hedge accounting under FAS 133, resulting in an increase of \$9.2 million (identical to the fair value of the related derivative) in the carrying value of the portion of the debentures it hedges, to adjust it to the fair value of such portion based on the risk being hedged.

(3) Mainly Missouri Economic Development bonds bearing interest at a variable or fixed rate determined according to a certain formula (2.0% at December 31, 2002), maturing serially through September 2004. The Bond is secured by a letter of credit, which provides for a mortgage on the Mexico, Missouri facility.

(4) Certain loan agreements and debentures contain restrictive covenants, mainly the requirement to maintain certain financial ratios.

b. As of December 31, 2002, the required annual principal payments of long-term debt, starting from the year 2004, are as follows: 2004 — \$8.1 million; 2005 — \$162.5 million; 2006 — \$78.0 million; 2007 — \$0.6 million; 2008 and thereafter — \$93.0 million. The above does not include the three series of convertible senior debentures described in note 7.

c. The Company and certain subsidiaries entered into negative pledge agreements with certain banks and institutional investors. Under the agreements, the Company and the said subsidiaries have undertaken not to register floating charges on assets in favor of any third parties without the prior consent of the banks, to maintain certain financial ratios and to fulfill other restrictions, as stipulated by the agreements.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 7 — Convertible Senior Debentures

a. In November 2002, Teva Pharmaceutical Finance B.V. (“Teva Finance B.V.”), an indirect wholly-owned subsidiary of the Company, sold an aggregate principal amount of \$450 million of its 0.375% Convertible Senior Debentures due 2022. Interest is payable on a semi-annual basis. Payment of all principal, interest, premium and additional amounts (as defined), if any, payable on the debenture is unconditionally guaranteed by the Company.

Unless previously redeemed or repurchased, holders of the debentures may convert them into ADRs, each of which represents one ordinary share of the Company, under certain circumstances set forth in the offering memorandum, at a conversion price of \$42.8989 per ADR, (upon a full conversion 10,489,779 ordinary shares are issuable), subject to adjustments in certain circumstances. On or after November 18, 2007, Teva Finance B.V. may redeem some or all of the debentures at the principal amount of such debentures, plus accrued and unpaid interest. On certain dates set forth in the offering memorandum, each holder may require Teva Finance B.V. to repurchase some or all of the holders’ debentures at the principal amount of such debentures, plus accrued and unpaid interest. With respect to the earliest of such dates — November 18, 2007 — or upon a change in control or a termination of trading of Teva ADRs, if repurchase of debentures is requested Teva Finance B.V. can elect to pay the repurchase price in cash or in Teva ADRs (the number of Teva ADRs to be computed as set forth in the offering memorandum), or any combination thereof.

b. In August 2001, Teva Pharmaceutical Finance N.V. (“Teva Finance N.V.”), an indirect wholly-owned subsidiary of the Company, sold an aggregate principal amount of \$360 million of its 0.75% Convertible Senior Debentures due 2021. Interest is payable on a semi-annual basis. Payment of all principal, interest, premium and additional amounts (as defined), if any, payable on the debenture is unconditionally guaranteed by the Company.

Unless previously redeemed or repurchased, holders of the debentures may convert them into ADRs, each of which represents one ordinary share of the Company, under certain circumstances set forth in the offering memorandum, at a conversion price of \$42.912 per ADR, (upon a full conversion 8,389,262 ordinary shares are issuable), subject to adjustments in certain circumstances. On or after August 20, 2004, Teva Finance N.V. may redeem some or all of the debentures at the principal amount of such debentures, plus accrued and unpaid interest. On certain dates set forth in the offering memorandum, each holder may require Teva Finance N.V. to repurchase some or all of the holders’ debentures, at the principal amount of such debentures plus accrued and unpaid interest. With respect to the earliest of such dates — August 20, 2004 — or upon a change in control or a termination of trading of Teva ADRs, if repurchase of debentures is requested Teva Finance N.V. can elect to pay the repurchase price in cash or in Teva ADRs (the number of Teva ADRs to be computed as set forth in the offering memorandum), or any combination thereof.

c. In October 2000, Teva Pharmaceutical Finance, LLC (“Teva Finance LLC”), an indirect wholly-owned subsidiary of the Company, sold an aggregate principal amount of \$550 million of its 1.50% Convertible Senior Debentures due 2005. Interest is payable on a semi-annual basis. Payment of all principal, interest, premium and additional amounts (as defined), if any, payable on the debenture is unconditionally guaranteed by the Company.

Unless previously redeemed or repurchased, holders of the debentures may convert them into ADRs, each of which represents one ordinary share of the Company, at a conversion price of \$43.1157 per ADR, (upon a full conversion 12,756,374 ordinary shares are issuable), subject to adjustments in certain circumstances. On or after October 15, 2003, Teva Finance LLC may redeem some or all of the debentures at the redemption prices set forth in the offering memorandum. On October 15, 2003 or upon a change of control or termination of trading of Teva ADRs each holder may require Teva Finance LLC to

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 7 — Convertible Senior Debentures (continued)

repurchase some or all of the holders' debentures at a redemption price set forth in the offering memorandum. If such requirement is made, Teva Finance LLC can elect to pay the repurchase price in cash or in Teva ADRs (the number of Teva ADRs to be computed as set forth in the offering memorandum), or any combination thereof. Since the issuance of these debentures Teva has accreted the additional amounts payable upon the holders' requiring repurchase of the debentures on October 15, 2003. Such amounts have been charged to interest expenses and at December 31, 2002 amounted to \$12.4 million. As the holders of the debentures are entitled to require redemption in 2003, the debentures, as well as the additional amounts accreted as described above, are included among current liabilities.

Note 8 — Commitments and Contingencies

a. Commitments:

1) Operating leases

As of December 31, 2002, minimum future rentals under operating leases of buildings, machinery and equipment for periods in excess of one year were as follows: 2003 — \$13.1 million; 2004 — \$11.6 million; 2005 — \$8.5 million; 2006 — \$6.8 million; 2007 and thereafter — \$16.8 million.

The lease fees for each of the years ended December 31, 2002, 2001 and 2000 were \$13.9 million, \$13.4 million and \$10.9 million, respectively, of which \$2.7 million, \$2.8 million and \$2.1 million to a related party in the years ended December 31, 2002, 2001 and 2000, respectively.

2) Royalty commitments

a) The Company 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.

b) The Company has also undertaken to pay royalties to the Government of Israel, at the rates of 2.0% – 3.5% of sales relating to 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 dollar terms (in respect of research grants commencing 1999 — with the addition of dollar LIBOR interest). The maximum amount of the contingent liability in respect of royalties to the Government at December 31, 2002 amounts to \$34.4 million.

c) Royalty expense included in cost of sales for the years ended December 31, 2002, 2001, and 2000 was \$66.3 million, \$55.2 million, and \$35.1 million, respectively.

b. Contingent liabilities:

1) Teva from time to time seeks to develop generic products for sale prior to patent expiration in various territories. In the United States, to obtain generic approval for a product prior to the expiration of the originator patent, Teva must challenge the patent under the procedures set forth in the Waxman-Hatch Act of 1984. To the extent that it seeks to utilize such patent challenge procedures, Teva is involved and expects to be involved in patent litigation regarding the validity or infringement of the originator's patent. Additionally, Teva may be involved in patent litigation involving the extent to which alternate manufacturing process techniques may infringe on originator or

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 8 — Commitments and Contingencies (continued)

third party process patents. No provision has been included in the accounts in respect of pending matters at December 31, 2002.

2) Teva and its subsidiaries are from time to time subject to claims arising in the ordinary course of their business, including product liability claims. Teva believes that it has meritorious defenses to such claims and legal proceedings, pending as of December 31, 2002, and that, in any event, it has adequate product liability insurance to cover material damages related to product liability claims, pending as of December 31, 2002.

3) Teva's business inherently exposes it to potential product liability claims. From time to time, the pharmaceutical industry has experienced difficulty in obtaining product liability insurance coverage for certain products or coverage in the desired amounts or with the desired deductibles. As a result, Teva sell and may continue to sell, pharmaceutical products that are not covered by insurance and may also be subject to product liability claims that are not covered by insurance or that exceed Teva's policy limits.

4) In August 2001, Teva Pharmaceuticals USA ("Teva USA") won a judgment in a patent infringement action in the U.S. Federal District Court in Boston, Massachusetts, brought against it by SmithKline Beecham Corp. and Beecham Group Plc (together, "Beecham") regarding the U.S. patent covering nabumetone, the active ingredient in Relafen®. The court ruled in Teva USA's favor. Following the district court's decision, Teva USA launched its nabumetone product. As the first applicant to challenge the listed patent for this drug, Teva USA had enjoyed a statutory 180-day period of generic marketing exclusivity. In August 2002, the United States Court of Appeals for the Federal Circuit affirmed the district court's judgment that Beecham's patent was invalid, and did not disturb the district court's judgment that Beecham's patent was unenforceable due to inequitable conduct. On January 14, 2003, Beecham's time to file a petition of certiorari with the U.S. Supreme Court lapsed.

5) Teva USA is a manufacturer of Adipex-P brand phentermine hydrochloride, and has been sued in both class actions and individual lawsuits relating to the alleged negative health effect of phentermine and fenfluramine. While neither drug had been indicated or approved for combination use by the FDA, physicians sometimes prescribed the two together in a combination treatment for weight control known as "fen-phen". Plaintiffs have filed lawsuits from August 1997 to the present in a variety of state and federal jurisdictions seeking monetary damages in unspecified amounts. The federal actions have been consolidated for pretrial purposes to the United States District Court for the Eastern District of Pennsylvania in a multidistrict litigation proceeding. Based upon the advice of counsel, Teva believes that it has adequate insurance to cover these claims and that the outcome of the remaining litigation in which Teva USA is involved will not have a material adverse effect on Teva's financial position. No provision for this matter has been included in the accounts.

6) Teva's Hungarian subsidiary, Biogal Pharmaceutical Works Ltd., was sued in July 1999 in the County Court of Debrecen, Hungary by a Hungarian institute (Gyógyszerkutató Intézet Kft) for additional royalties arising out of a series of contracts for the development of a pharmaceutical active ingredient. Although the plaintiff has not made any claims for a specific amount, the court, in an interim decision, ordered Biogal to submit an accounting on the contested terms. Biogal has appealed the decision and, based on the advice of counsel, expects to prevail. No provision for this matter has been included in the accounts.

7) On January 13, 2002, a claim was filed in the Tel Aviv District Court by Paka Industries Ltd. against Teva, Teva Assets Ltd., an Israeli subsidiary of Teva, and a senior officer and a former senior officer of Teva Assets, in the amount of approximately \$17 million. The claim relates to a 1998

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 8 — Commitments and Contingencies (continued)

agreement between Paka and Teva Assets, under which Teva Assets sold off the assets (excluding real property) of its plant to the plaintiff. Paka claims to have been deceived and consequently lost the entire investment in the acquired plant. Teva, based on the advice of counsel, believes that its chances of prevailing are good. Accordingly, no provision for this matter has been included in the accounts.

8) In August 2000, a claim was filed in the Tel Aviv District Court, and is now pending against Teva, with respect to damages caused to the plaintiff as a result of the use of a product containing the ingredient diethylstilbestrol (“DES”). In May and November 2001, 69 plaintiffs filed an additional claim against Teva, in the District Court of Jerusalem, for damages caused by the use of two products containing DES. In July 2002, the plaintiffs amended their claim to include the Clalit Health Services (previously called General Health Fund) as a further defendant (in addition to the Ministry of Health). In December 2002, 9 women requested the District Court of Jerusalem to join the claim as plaintiffs, while 4 plaintiffs requested to withdraw from the proceedings. The court has not yet ruled on this matter. The aggregated amount of the two claims is approximately \$10 million, not including general damages. Teva is vigorously defending itself against these claims. Because the above claims are still in their early stages, no determination can be made of the likelihood of prevailing in the actions; however, based on the advice of counsel, Teva believes it has meritorious defenses. No provision for this matter has been included in the accounts.

9) On April 5, 2001, a claim was filed against Teva in the Tel Aviv District Court with respect to the use of a pharmaceutical product known as “Chorigon Ampoules 5000 Units”. The plaintiffs allege that they were administered with allegedly defective ampoules of the product during the course of an in vitro fertilization treatment, resulting in the failure of the treatment and causing financial damages and mental anguish. The plaintiffs filed a petition to certify the claim as a class action. The plaintiffs have since filed a reply to Teva’s response. Because the claim is still in its early stage, Teva’s counsel is unable to express an opinion as to the merits of the claim. Nevertheless, based on information to date, Teva believes that this matter will not have a material adverse effect on its results of operations and financial condition and that provision for this matter in the accounts is not required.

10) Teva USA, along with Elan Corporation, Elan Pharma Ltd. (collectively — “Elan”) and Biovail Corporation International (“Biovail”), were defendants in a patent litigation brought by Bayer AG and Bayer Corporation (collectively — “Bayer”) on May 8, 2000 in the District of Delaware. On July 17, 2000, the court transferred the case to the Northern District of Georgia. Bayer had alleged that Elan’s Nifedipine Extended Release Tablets CC, 30 mg, which is marketed by Teva USA, infringed a Bayer patent. On August 16, 2002, Teva USA was dismissed from the case pursuant to a settlement agreement under which Teva USA did not pay any damages or provide any other consideration.

11) Teva USA, along with Biovail, are defendants in two related patent litigations brought by Bayer AG, Bayer Corporation and, in one of the cases, Pfizer Inc. Both cases involve allegations against Teva USA of infringement of the same patent that had been at issue in the above discussed Georgia case and both cases are currently pending in the U.S. District Court for the District of Puerto Rico. The first case was commenced on February 16, 2001 by Bayer AG and Pfizer against Teva USA and Biovail for patent infringement relating to the sale of Biovail’s Nifedipine Extended Release Tablets XL, 60 mg, which are marketed in the United States by Teva USA. The second case was commenced on February 20, 2001 by Bayer Corporation against Biovail and Teva USA for patent infringement relating to the sale of Biovail’s Nifedipine Extended Release Tablets CC, 60 mg, which are also marketed in the United States by Teva USA. The plaintiffs in each of the two cases are seeking enhanced damages and attorneys’ fees in unspecified amounts, preliminary and permanent

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 8 — Commitments and Contingencies (continued)

injunctions, and a recall of the products at issue. Each of these cases is in the pre-trial phase and no provision for these matters has been included in the accounts.

12) Teva USA is a named defendant, along with Biovail Corp. and Elan Corporation, plc, in two civil actions currently pending in the federal district courts in the District of Columbia and New York City. The Company is also named as a defendant in the case pending in New York City. The cases allege generally that arrangements between Biovail and Elan Corporation, plc relating to sales of Nifedipine Extended Release Tablets CC, in connection with which Teva USA acted as a distributor for Biovail, were unlawful under the federal antitrust laws. The challenged arrangements were previously the subject of a consent decree entered into by the U.S. Federal Trade Commission with Biovail and Elan Corporation, plc, to which the Company and Teva USA were not parties. The cases seek injunctive relief, unspecified monetary damages, attorneys fees, and costs. Each of the cases is brought on behalf of an alleged class of persons that purchased Nifedipine Extended Release Tablets CC made by Elan Corporation, plc or Biovail and sold in the United States by Teva USA. A motion is currently pending before the federal Judicial Panel on Multidistrict Litigation seeking consolidation of these cases with four other cases pending in the District of Columbia and two other cases pending in the Southern District of New York; the Company and Teva USA are not parties in those other cases. Teva USA and the Company (to the extent they remain a defendant in any of these cases) intend to defend vigorously against these claims. These cases are in a very preliminary stage, so it is not possible to assess the likelihood of an unfavorable outcome or the magnitude of any potential loss. No provision for these matters has been included in the accounts.

13) In May 2002, Teva USA won a judgment in the U.S. District Court in Norfolk, Virginia in a declaratory judgment action it brought against GlaxoSmithKline (“GSK”) regarding seven U.S. patents related to potassium clavulanate, an active ingredient in Augmentin® (or, “amoxiclav”). The court ruled that all seven patents were invalid based on double patenting. GSK has appealed the judgment and oral argument is scheduled for March 5, 2003 on the appeal. Annual sales of the branded product in the U.S. were estimated to be in excess of \$1 billion. Following the district court decision, and subsequent FDA approval, Teva USA launched its amoxiclav product, which contains potassium clavulanate. Although Teva believes that the findings of fact and legal conclusions of the district court are well founded and that the decision will be upheld, were GSK to be successful in its appeal, Teva USA could be required to pay damages to GSK related to the sales of Teva USA’s amoxiclav products and enjoined from selling its amoxiclav products. No provision for these matters has been included in the accounts.

14) In August 2002, GSK filed a complaint against Teva USA in the Pennsylvania Court of Common Pleas. Ranbaxy Pharmaceuticals, Inc. (“Ranbaxy”) is a defendant in the same case, though GSK does not allege any connection between Teva USA and Ranbaxy. The complaint alleges that Teva USA’s amoxiclav products are derived from a strain of *Streptomyces clavuligerus* stolen from GSK. The Complaint asserts causes of action for alleged trade secret misappropriation, unfair competition, and conversion. The suit seeks equitable relief and imposition of a constructive trust related to Teva USA’s amoxiclav products. The case is scheduled to be ready for trial in February 2004. Although Teva believes that the likelihood of GSK prevailing is low, if GSK’s allegations were proven true, Teva USA could be required to pay damages to GSK related to the sales of Teva USA’s amoxiclav products and enjoined from selling its amoxiclav products. No provision for these matters has been included in the accounts.

15) On August 5, 2002, Lek Pharmaceuticals d.d. (“Lek”) filed a complaint against Teva USA in the United States District Court for the District of New Jersey. Lek has accused Teva USA of misappropriating Lek’s trade secrets and proprietary information pertaining to formulations for

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 8 — Commitments and Contingencies (continued)

Teva USA's amoxiclav products. In its complaint, Lek seeks equitable relief and unspecified damages. Teva USA filed its answer on September 24, 2002, denying all allegations of wrongdoing. The parties have agreed on a discovery plan and all fact and expert discovery is scheduled to be completed by December 17, 2003. Although Teva believes that the likelihood of Lek prevailing is low, if Lek's allegations are proven true, Teva USA could be required to pay damages to Lek related to the sales of Teva USA's amoxiclav products and enjoined from selling its amoxiclav products. No provision for these matters has been included in the accounts.

16) Bayer and Bayer's marketing joint venturer GSK have been named in extensive litigation for personal injuries allegedly related to the use of the product Baycol[®], a blood lipid reducing agent, which Bayer withdrew from the market in August, 2001. Teva is the manufacturer of gemfibrozil, the generic version of Lopid[®], another blood lipid reducing drug, which was at times prescribed in combination with Baycol[®]. In five cases where there allegedly was concomitant use of Baycol[®] and gemfibrozil, Teva USA has been named as a codefendant of Bayer and GSK in the Court of Common Pleas of the Commonwealth of Pennsylvania, County of Philadelphia. The Complaints in each of these cases allege that plaintiff was injured as a result of exposure to gemfibrozil, either alone or in combination with Baycol[®]. Because these claims are still in their early stages, Teva's counsel is unable to express an opinion as to their merits. Nevertheless, based upon currently available information, Teva believes that these cases will not have a material adverse effect on its results of operations and financial condition. No provision for these matters has been included in the accounts.

Note 9 — Shareholders' Equity

a. Share capital:

As of December 31, 2002, there were 263.2 million ordinary shares issued and outstanding, (December 31, 2001 — 256.2 million). These shares are traded on the Tel-Aviv Stock Exchange ("TASE") and, in the form of ADRs, each of which represents one ordinary share, on the Nasdaq National Market in the United States. In addition, as at December 31, 2002, there were 6.3 million outstanding special shares (December 31, 2001 — 12.8 million), issued by a subsidiary, that are exchangeable into ordinary shares of the Company at a 1:1 ratio, see note 2a.

In addition to ordinary shares held by subsidiaries of the Company, as disclosed on the face of the balance sheet, the Company issued to a certain subsidiary, a total of 2.8 million ordinary and ordinary "A" shares, which do not confer on their holder voting rights or rights to appoint directors (other rights are identical to those of the ordinary shares) and are not listed for trade.

b. In December 2002, the Company distributed a 100% stock dividend to all holders of ordinary shares. All shares, option and convertible senior debentures information in the consolidated financial statements has been retroactively restated to reflect the effect of this distribution as if it had occurred at the beginning of the earliest period presented.

c. Employee stock option plans:

In 1992, the Company's Board of Directors approved an employee stock option plan, under which options are to be granted without consideration to the Company's senior employees in Israel. The options may be exercised to purchase up to 5 million ordinary shares of the Company. Any options not exercised before the expiration date will expire, unless extended by the Board of Directors. Through December 31, 2002, options exercisable to purchase 4.4 million ordinary shares were granted under the plan. The plan expired in 2002 and the balance of the options not granted was cancelled.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 9 — Shareholders' Equity (continued)

During the period from 1988 through 2002, certain non-Israeli subsidiaries granted their employees options for the purchase of the Company's ADRs. Any options not exercised within the applicable exercise period will expire.

On January 6, 1997, September 3, 1998 and September 4, 2001, the Board of Directors resolved to grant the Chief Executive Officer and President of the Company, at no consideration, options exercisable in purchase of 1,000,000, 200,000 and 150,000 ordinary shares at the exercise price of \$9.88, \$9.22 and \$35.11, respectively. These resolutions were approved by shareholders' meetings.

On February 14, 2002, the Board of Directors resolved to grant, at no consideration, the following options, each exercisable in purchase of one ordinary share: (i) to the Chief Executive Officer and President of the Company, 1,400,000 options, at an exercise price of \$27.81, which was determined based on the price of the Company's share on the date the grant was approved by the shareholders' meeting; (ii) to the new Chief Executive Officer and President of the Company, at no consideration, options exercisable in purchase of 600,000 options at the exercise price of \$30.21; and (iii) to each of the chairman of the Board of Directors and the chairman of its executive committee, 60,000 options, at an exercise price of \$27.81.

In 1999, the Company's Board of Directors approved an additional option plan for employees of the Group, under which senior employees in Israel, Europe and the United States are to be granted options for up to 4 million ordinary shares of the Company, without consideration. Any option not exercised by the end of the exercise period will expire, unless the exercise period is extended by the Board of Directors. Through December 31, 2002, options exercisable to purchase 2.2 million ordinary shares were granted under this plan. The balance of the options may be granted from time to time, as determined by the Committee.

In August 2000, the Company's Board of Directors approved an option plan under which, over five years, employees of the Group will be granted options for up to 13.1 million ordinary shares of the Company, without consideration. Through December 31, 2002, the Board of Directors approved the grant of options for up to 8.1 million ordinary shares of which options to purchase 6.75 million ordinary shares were granted.

In July 2001, the Company's Board of Directors approved an option plan, under which options to purchase 1,257,000 ordinary shares of the Company were granted, at no consideration, to substantially all employees who were in the employ of the Group prior to September 1, 2000. Each such employee was granted options to purchase 200 ordinary shares without consideration, at an exercise price of \$27.77 (85% of the market value of the Company's ADR on date of grant). Certain other employees were granted options under the same plan, at no consideration, to purchase 170,000 ordinary shares of the Company, at an exercise price of \$29.60. The Company accounts for this stock option plan as a non-compensatory plan in accordance with the provisions of APB 25.

The grant of options to Israeli employees under the plans described above is to be subject to the terms stipulated by the Israeli Income Tax Ordinance. Inter alia, the Ordinance provides that the Company will be allowed to claim as an expense for tax purposes the amounts credited to the employees as a benefit, when the related tax is payable by the employee.

The vesting period of the options granted is generally 2 to 5 years from the date of grant and the rights of the ordinary shares obtained upon exercise of the options will be identical to those of the other ordinary shares of the Company. The exercise period of the options granted is mainly 5 to 8 years from the date of grant.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 9 — Shareholders' Equity (continued)

A summary of the status of the option plans as of December 31, 2002, 2001 and 2000, and changes during the years ended on those dates, is presented below (the number of options represents ordinary shares exercisable in respect thereof):

	Year Ended December 31					
	2002		2001		2000	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Balance outstanding at beginning of year . . .	12,708,480	21.70	9,181,006	16.51	6,458,212	9.32
Changes during the year:						
Granted	5,085,132	29.15	4,388,160	30.57	4,608,700	22.81
Exercised	(809,864)	9.88	(559,758)	10.43	(1,802,906)	6.95
Forfeited	<u>(87,354)</u>	27.58	<u>(300,928)</u>	15.60	<u>(83,000)</u>	14.25
Balance outstanding at end of year	<u>16,896,394</u>	24.75	<u>12,708,480</u>	21.70	<u>9,181,006</u>	16.51
Balance exercisable at end of year	<u>3,721,748</u>	15.31	<u>2,112,668</u>	10.43	<u>2,628,826</u>	10.31

The weighted average fair value of options granted during the year, estimated by using the Black & Scholes option-pricing model, was \$13.08, \$16.72 and \$11.6 for the years ended December 31, 2002, 2001 and 2000, respectively. The fair value of the options was estimated on the date of grant, based on the following weighted average assumptions: dividend yield of: 2002 — 0.6%, 2001 — 0.5% and 2000 — 0.4%; expected volatility of: 2002 — 33%, 2001 — 36% and 2000 — 37%; risk-free interest rates (in dollar terms) of: 2002 — 4%, 2001 — 5% and 2000 — 6%; and expected lives of: 2002 — 4.9 years, 2001 — 5.2 years and 2000 — 4.5 years.

The exercise price of options granted to employees is, generally, equal to the market price of the Company's ADR at the time of grant. In the years ended December 31, 2002, 2001 and 2000, 5,085,132, 3,030,960 and 4,608,700 such options were granted with fair values of \$66.5 million, \$45.4 million and \$53.5 million, respectively.

In 2001, 1,357,200 options were granted at prices below the market price of the Company's ADR at the time of grant. The fair value of such options was \$26.9 million.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 9 — Shareholders' Equity (continued)

The following table summarizes information about options outstanding at December 31, 2002:

Range of exercise prices	Number of ordinary shares issuable upon exercise of options outstanding			Number of ordinary shares issuable upon exercise of options vested	
	Balance at December 31, 2002	Weighted average remaining contractual life Years	Weighted average exercise price \$	Balance at December 31, 2002	Weighted average exercise price \$
\$ 8.20 - \$10.75	2,437,284	2.36	9.81	1,983,344	9.68
\$11.00 - \$19.00	1,996,344	4.18	12.09	718,404	12.51
\$24.00 - \$24.50	700,400	4.11	24.88		
\$27.00 - \$28.75	4,755,400	6.78	27.93	720,000	27.39
\$29.00 - \$30.50	2,865,400	6.40	30.15	300,000	30.21
\$31.00 - \$32.75	3,953,706	3.61	32.09		
\$35.00 - \$36.25	187,860	6.47	35.33		
\$ 8.20 - \$36.25	<u>16,896,394</u>	4.92	24.75	<u>3,721,748</u>	15.31

d. Retained earnings:

1) Retained earnings available for distribution as cash dividends at December 31, 2002, includes amounts, the distribution of which would attract tax of approximately \$100 million (see note 10a).

2) Dividends are declared and paid in Israeli currency ("NIS"). Dividends paid per ADR for the years ended December 31, 2002, 2001 and 2000 were \$0.13, \$0.14 and \$0.12, respectively. Subsequent to December 31, 2002, the Company declared an additional dividend of NIS 0.33 per ADR (\$0.07 per ADR as of date of declaration) in respect of the year 2002.

Note 10 — Income Taxes

a. The Company and its Israeli subsidiaries:

Tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959 (the "law")

Expansion projects of the Company and several of its Israeli subsidiaries have been granted "approved enterprise" status under the law. Income derived from these enterprises during a period of 10 years from the year in which these enterprises first realize taxable income, provided the maximum period to which it is restricted by the law has not elapsed, is entitled to certain tax benefits — tax exemption for an initial period of 2 to 10 years, having regard to the benefit route the company had chosen and the area in which the enterprises are located, and a reduced corporate tax rate for the remainder of the period. Since the Company is over 49% foreign-owned, it is entitled to reduced tax at the rate of 20%.

With respect to certain expansions of several Israeli subsidiaries, investment grants were received from the State of Israel under the terms of the law (the "government grant route"). As security for implementation of the approved projects and compliance with the conditions of the certificates of approval, floating charges have been registered on the above companies' assets in favor of the State of Israel.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 10 — Income Taxes (continued)

For certain other expansion projects, the Company and certain Israeli subsidiaries elected to apply for alternative tax benefits — waiver of grants in return for tax exemption (the “alternative tax benefits route”).

The periods of tax benefits in respect of approved enterprises entitled to the said benefits commenced in 1993 — 2002. Final approvals in respect of certain expansion programs have not yet been received. In the event of the distribution of dividends from the said tax-exempt income (either under the government grants route or under the alternative tax benefits route), the amount distributed will be subject to a 20% tax (see also note 1i).

The law also allows accelerated depreciation on buildings, machinery and equipment used by the “approved enterprise” during five tax years commencing in the first year of operation of each asset.

The entitlement to the above benefits is conditional upon the companies’ fulfilling the conditions stipulated by the law, regulations published thereunder and the certificates of approval for the specific investments in approved enterprises. In the event of failure to comply with these conditions, the benefits may be cancelled and the companies may be required to refund the amount of the benefits, in whole or in part, with the addition of interest and linkage differences to the Israeli consumer price index (the “Israeli CPI”).

Measurement of results for tax purposes

Results for tax purposes are measured on a real basis — adjusted for the increase in the Israeli CPI. As explained in note 1a, the financial statements are presented in dollars. The difference between the change in the Israeli CPI and the NIS-dollar exchange rate — both on annual and cumulative bases — causes a difference between taxable income and income reflected in these financial statements.

Paragraph 9(f) of FAS 109, “Accounting for Income Taxes”, prohibits the recognition of deferred tax liabilities or assets that arise from differences between the financial reporting and tax bases of assets and liabilities that are measured from the local currency into dollars using historical exchange rates, and that result from changes in exchange rates or indexing for tax purposes. Consequently, the abovementioned differences were not reflected in the computation of deferred tax assets and liabilities.

Tax benefits under the Israeli Law for the Encouragement of Industry (Taxes), 1969

The Company and certain of its Israeli subsidiaries currently qualify as “industrial companies” under the above law. In accordance with this law such companies are entitled to certain benefits including accelerated depreciation on industrial buildings and equipment, a deduction of 12.5% per year of the purchase price of a good-faith acquisition of patent and certain other intangible property rights and the right to file consolidated tax returns.

Currently, the Company files consolidated tax returns together with certain of its Israeli subsidiaries.

Tax rates in Israel applicable to income from other sources

Income not eligible for “approved enterprise” benefits, mentioned above, is taxed at the regular rate of 36%.

Recent Israeli Tax Reform Legislation

In July 2002, the Israeli parliament approved a law enacting extensive changes to Israel’s tax law generally effective January 1, 2003 (the “Tax Reform Legislation”). Among the key provisions of the tax

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 10 — Income Taxes (continued)

Reform Legislation as applicable to Teva is the introduction of the “controlled foreign corporation” concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary’s primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid by the subsidiary in its country of residence.

b. Non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their country of residence.

c. Deferred income taxes:

	December 31	
	2002	2001
	(U.S. \$ in millions)	
Short-term deferred tax assets (liabilities) — net:		
Inventory reserve	\$ 1.4	\$ (0.8)
Sales allowance reserve	0.4	0.6
Provisions for employee related obligations.....	3.0	4.5
Unrealized income from intercompany sales	33.6	11.6
Loss carryforward	2.9	2.8
Other	3.7	2.0
	45.0	20.7
Long-term deferred tax assets (liabilities) — net:		
Property, plant and equipment and intangible assets	(51.1)	(53.4)
Provisions for employee related obligations.....	1.6	1.6
Carryforward losses and deductions*	121.7	70.4
Other	1.0	(2.0)
	73.2	16.6
Valuation allowance — in respect of carryforward losses and deductions that may not be utilized	(65.1)	(33.0)
	\$ 53.1	\$ 4.3

* This amount represents the tax effect of carryforward losses and deductions and expires as follows: 2004-2006 — \$27.4 million; 2007-2012 — \$26.7 million. The remaining balance — \$67.6 million — can be utilized with no expiration date.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 10 — Income Taxes (continued)

The deferred income taxes are reflected in the balance sheets among:

	December 31	
	2002	2001
	(U.S. \$ in millions)	
Current assets	\$ 48.2	\$ 27.4
Current liabilities	(3.2)	(6.7)
Investments and other assets	51.8	22.6
Long-term liabilities	<u>(43.7)</u>	<u>(39.0)</u>
	<u>\$ 53.1</u>	<u>\$ 4.3</u>

d. Income before income taxes is composed of the following:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
The Company and its Israeli subsidiaries	\$282.0	\$205.5	\$ 82.2
Non-Israeli subsidiaries	<u>217.4</u>	<u>134.8</u>	<u>126.2</u>
	<u>\$499.4</u>	<u>\$340.3</u>	<u>\$208.4</u>

e. The provision for income taxes included the following components:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
Current:			
In Israel	\$ 65.2	\$37.8	\$18.3
Outside Israel	<u>51.3</u>	<u>26.7</u>	<u>44.6</u>
	<u>116.5</u>	<u>64.5</u>	<u>62.9</u>
Deferred:			
In Israel	(19.3)	(1.9)	1.5
Outside Israel	<u>(12.4)</u>	<u>1.0</u>	<u>(4.8)</u>
	<u>(31.7)</u>	<u>(0.9)</u>	<u>(3.3)</u>
	<u>\$ 84.8</u>	<u>\$63.6</u>	<u>\$59.6</u>

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 10 — Income Taxes (continued)

A reconciliation of the theoretical tax expense, assuming all income is taxed at the regular rate applicable to income of companies in Israel (36%) and the actual tax expense, is as follows:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
Income before taxes on income, per consolidated statements of income	\$499.4	\$340.3	\$208.4
Theoretical tax expense	\$179.8	\$122.5	\$ 75.0
Decrease in tax arising from different statutory tax rates applicable to non-Israeli subsidiaries.....	(30.1)	(27.0)	(17.4)
	149.7	95.5	57.6
Tax benefits arising from reduced tax rates under benefit programs	(81.5)	(53.0)	(18.4)
	68.2	42.5	39.2
Increase (decrease) in taxes resulting from permanent differences:			
Tax exempt income	(1.9)	(3.5)	(1.2)
Disallowable deductions (in 2000 — mainly in respect of acquisition of research and development in process)	4.1	13.5	17.8
Difference between income reported for tax purposes and income for financial reporting purposes — net	7.5	(1.7)	2.4
Other — net	6.9	12.8	1.4
Income taxes in the consolidated statements of income.....	\$ 84.8	\$ 63.6	\$ 59.6

f. Tax assessments:

The Company has received final tax assessments through tax year 1997. The subsidiaries have received final tax assessments through tax years 1991-2001.

Note 11 — Additional Financial Statement Information

a. Inventories:

	December 31	
	2002	2001
	(U.S. \$ in millions)	
Raw and packaging materials	\$210.8	\$137.6
Products in process	133.4	117.4
Finished products	370.4	272.8
Purchased products	60.1	32.5
	774.7	560.3
Materials in transit and payments on account	6.4	9.9
	\$781.1	\$570.2

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

b. Short-term credit:

Short-term credit was obtained mainly from banks at a weighted average interest rate of 4.36%.

As of December 31, 2002, the Group had \$408 million available under unused lines of credit.

c. Accounts payable and accruals:

	December 31	
	2002	2001
	(U.S. \$ in millions)	
Trade accounts payable	\$251.5	\$189.1
Sales reserves and allowances	172.6	137.2
Income taxes payable	141.0	24.4
Employees and employee related obligations	63.7	50.6
Other	156.9	130.3
	\$785.7	\$531.6

d. Financial instruments and risks management:

1) Foreign exchange risk management

The Group enters into forward exchange contracts in foreign currencies and purchases and writes foreign currency options in order to hedge cash flows (mainly in dollars) resulting from existing assets and liabilities as well as anticipated transactions for the current year which are probable, in currencies other than the functional currency. In addition, the Group takes steps to reduce exposure by using “natural” hedging. The Company also acts to offset risks in opposite directions among the companies in the Group. The currency hedged items are usually denominated in the following currencies: European (mainly — the Euro and Hungarian Forint), Israeli (NIS) and Canadian Dollars (CAD\$). The writing of options is part of a comprehensive currency hedging strategy. These transactions do not qualify for hedge accounting under FAS 133.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

The notional amounts of foreign currency derivatives are as follows:

	<u>December 31</u>	
	<u>2002</u>	<u>2001</u>
	(U.S. \$ in millions)	
Currency options purchased for conversion of:		
EURO into Dollars	38.0	18.0
NIS into Dollars	15.0	25.0
CAD\$ into Dollars	8.0	6.0
Hungarian Forints (HUF) into Dollars	22.0	
HUF into EUR	9.0	
HUF into Great Britain Pounds (GBP)	1.6	
Currency options written for conversion of:		
EURO into Dollars	37.0	18.0
NIS into Dollars	30.0	25.0
CAD\$ into dollars	8.0	6.0
HUF into dollars	22.0	
HUF into EUR	9.0	
HUF into GBP	1.6	
Forward exchange contracts for conversion of:		
Dollars into HUF	120.2	49.0
GBP into HUF	10.2	6.0
EURO into HUF	28.9	22.0
CAD\$ into HUF	1.3	
NIS into Dollars	5.0	
CAD into Dollars	2.0	

These transactions are for periods of less than one year. As the counter parties to the derivatives are banks, the Company considers the inherent credit risks to be remote.

2) Interest rate swaps

During 2002, the Company entered into two interest rate swap agreements with respect to a portion of the debentures issued in a private placement during 1998 (see note 6a).

In March 2002, the Company entered into a 6.5 year \$75 million notional amount interest rate swap agreement, the effect of which is that, for the applicable notional amount, the Company pays interest at the rate of LIBOR +0.65% (2.1% at December 31, 2002) and receives interest at the rate of 6.9%.

In September 2002, the Company entered into a 6 year \$45 million notional amount interest rate swap agreement, the effect of which is that, for the applicable notional amount, the Company pays interest at the rate of 4.5% and receives interest at the rate of LIBOR +0.65%.

While the cash flows of interest payable and receivable under the two interest rate swap transactions are to take place on the same dates through the remaining life of these transactions, under FAS 133, only the first interest rate swap transaction qualifies for hedge accounting and is accounted for as such, as more fully explained in note 6a.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

3) Fair value of financial instruments

The financial instruments of the Group consist mainly of cash and cash equivalents, marketable securities, current and non-current receivables, short-term credit, accounts payable and accruals, long-term loans and other long-term liabilities, convertible senior debentures and derivatives.

The fair value of the financial instruments included in working capital and non-current receivables of the Group is usually identical or close to their carrying value. The fair value of long-term bank loans also approximates their carrying value, since they bear interest at rates close to the prevailing market rates. The fair value of the convertible senior debentures and long-term debentures, based on quoted market values and prevailing market rates, amounted to \$1,584 million.

The fair value and the carrying amounts of derivatives at December 31, 2002, is an asset of \$ 26.6 million (December 31, 2001 — \$1.3 million). The fair value of derivatives generally reflects the estimated amounts that Teva would receive or pay to terminate the contracts at the reporting dates.

e. Information on operating segments:

Operating segments

1) General

The Group's reportable segments are strategic businesses differentiated by the nature of their products and customers. The segments are managed separately due to the differences in production technologies and marketing methods and can be described as follows:

Pharmaceutical segment — development, production, marketing and distribution of medicines in various dosages and forms, in most areas of medicinal treatment and disposable hospital supplies.

Active Pharmaceutical
Ingredients

("A.P.I.") segment — development, production, marketing and distribution of A.P.I. for the pharmaceutical industry including the Group's pharmaceutical segment.

2) Information on revenues and assets of the reportable operating segments

a) Measurement of revenues and assets of the operating segments:

The measurement of revenues and assets of the reportable operating segments is based on the same accounting principles applied in these financial statements.

Segment profits reflect the income from operations of the segment and do not include net interest income or expense, minority interest and income tax expenses, since those items are not allocated to the segments.

Sales of the A.P.I. segment to the pharmaceutical segment are recorded at the market prices of sales of similar products to non-related customers.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

b) Financial data relating to reportable operating segments:

	<u>Pharmaceuticals</u>	<u>A.P.I.</u>	<u>Other</u>	<u>Total</u>
	(U.S. \$ in millions)			
Year ended December 31, 2002:				
Net sales:				
To unaffiliated customers	\$2,240.2	\$259.3	\$19.1	\$2,518.6
Intersegment	<u>0.2</u>	<u>205.5</u>	<u>0.9</u>	<u>206.6</u>
Total net sales	<u>\$2,240.4</u>	<u>\$464.8</u>	<u>\$20.0</u>	<u>\$2,725.2</u>
Operating income	<u>\$ 426.5</u>	<u>\$194.4</u>	<u>\$ 1.6</u>	<u>\$ 622.5</u>
Assets (at end of year)	<u>\$1,986.4</u>	<u>\$497.2</u>	<u>\$28.4</u>	<u>\$2,512.0</u>
Goodwill (at end of year)	<u>\$ 534.6</u>	<u>\$ 25.7</u>	<u> </u>	<u>\$ 560.3</u>
Expenditures for segment assets	<u>\$ 98.5</u>	<u>\$ 50.5</u>	<u>\$ 5.0</u>	<u>\$ 154.0</u>
Depreciation and amortization	<u>\$ 69.3</u>	<u>\$ 26.4</u>	<u>\$ 1.9</u>	<u>\$ 97.6</u>
Year ended December 31, 2001:				
Net sales:				
To unaffiliated customers	\$1,838.0	\$219.2	\$20.2	\$2,077.4
Intersegment	<u>0.2</u>	<u>150.1</u>	<u>1.0</u>	<u>151.3</u>
Total net sales	<u>\$1,838.2</u>	<u>\$369.3</u>	<u>\$21.2</u>	<u>\$2,228.7</u>
Operating income	<u>\$ 296.9</u>	<u>\$130.9</u>	<u>\$ 2.0</u>	<u>\$ 429.8</u>
Assets (at end of year)	<u>\$1,481.4</u>	<u>\$352.7</u>	<u>\$24.4</u>	<u>\$1,858.5</u>
Goodwill (at end of year)	<u>\$ 459.2</u>	<u>\$ 6.9</u>	<u> </u>	<u>\$ 466.1</u>
Expenditures for segment assets	<u>\$ 75.8</u>	<u>\$ 30.2</u>	<u>\$ 1.4</u>	<u>\$ 107.4</u>
Depreciation and amortization	<u>\$ 78.2</u>	<u>\$ 23.5</u>	<u>\$ 0.7</u>	<u>\$ 102.4</u>
Year ended December 31, 2000:				
Net sales:				
To unaffiliated customers	\$1,548.3	\$180.6	\$21.0	\$1,749.9
Intersegment	<u>0.4</u>	<u>134.6</u>	<u>0.7</u>	<u>135.7</u>
Total net sales	<u>\$1,548.7</u>	<u>\$315.2</u>	<u>\$21.7</u>	<u>\$1,885.6</u>
Operating income	<u>\$ 222.9</u>	<u>\$100.7</u>	<u>\$ 3.2</u>	<u>\$ 326.8</u>
Assets (at end of year)	<u>\$1,343.3</u>	<u>\$316.5</u>	<u>\$21.5</u>	<u>\$1,681.3</u>
Goodwill (at end of year)	<u>\$ 474.3</u>	<u>\$ 7.7</u>	<u> </u>	<u>\$ 482.0</u>
Expenditures for segment assets	<u>\$ 44.0</u>	<u>\$ 33.9</u>	<u>\$ 0.8</u>	<u>\$ 78.7</u>
Depreciation and amortization	<u>\$ 61.8</u>	<u>\$ 20.6</u>	<u>\$ 0.5</u>	<u>\$ 82.9</u>

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

c) Following is a reconciliation of the net sales, operating income and assets of the reportable segments to the data included in the consolidated financial statements:

	<u>Year Ended December 31</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(U.S. \$ in millions)		
Net sales:			
Total sales of reportable segments	\$2,705.2	\$2,207.5	\$1,863.9
Other sales	20.0	21.2	21.7
Elimination of intersegment sales	<u>(206.6)</u>	<u>(151.3)</u>	<u>(135.7)</u>
Total consolidated net sales	<u>\$2,518.6</u>	<u>\$2,077.4</u>	<u>\$1,749.9</u>
Operating income:			
Total operating income of reportable segments	\$ 620.9	\$ 427.8	\$ 323.6
Other	1.6	2.0	3.2
Amounts not allocated to segments:			
Restructuring expenses		(15.7)	
Acquisition of research and development in process			(35.7)
Profits not yet realized	(48.5)	(7.6)	(5.9)
General and administrative expenses	(39.8)	(38.8)	(37.2)
Other expenses	(10.2)	(1.4)	2.6
Financial expenses — net	<u>(24.6)</u>	<u>(26.0)</u>	<u>(42.2)</u>
Consolidated income before income taxes	<u>\$ 499.4</u>	<u>\$ 340.3</u>	<u>\$ 208.4</u>
Assets (at end of year):			
Total assets of reportable segments	\$2,483.6	\$1,834.1	\$1,659.8
Total goodwill of reportable segments	560.3	466.1	482.0
Other assets	28.4	24.4	21.5
Elimination of intersegment balances	(13.7)	(13.4)	(14.0)
Elimination of unrealized income from inventories	(50.4)	(3.0)	(5.0)
Assets not allocated to segments:			
Current assets	1,264.5	956.5	561.7
Investments and other assets	313.5	141.9	100.1
Property, plant and equipment, net	22.8	36.5	36.5
Debt issuance costs	<u>17.8</u>	<u>17.1</u>	<u>13.1</u>
Consolidated assets (at end of year)	<u>\$4,626.8</u>	<u>\$3,460.2</u>	<u>\$2,855.7</u>

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

3) Geographical information

Net sales by geographical areas:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
Israel	\$ 231.9	\$ 241.4	\$ 244.6
United States	1,473.1	1,129.6	882.6
Europe	599.7	456.9	398.9
Other	<u>213.9</u>	<u>249.5</u>	<u>223.8</u>
	<u>\$2,518.6</u>	<u>\$2,077.4</u>	<u>\$1,749.9</u>

The geographical sales information is classified by the geographical location of the customers.

Property, plant and equipment — by geographical location:

	December 31	
	2002	2001
	(U.S. \$ in millions)	
Israel	\$311.6	\$290.0
United States	119.2	103.9
Hungary	90.7	65.0
Europe, excluding Hungary	114.6	58.7
Canada	36.8	34.3
Other	<u>2.5</u>	<u>2.3</u>
	<u>\$675.4</u>	<u>\$554.2</u>

f. Restructuring expenses:

The consolidated statement of income for the year ended December 31, 2001 includes restructuring expenses in a total amount of \$15.7 million, including an impairment charge of \$9.7 million relating to property, plant and equipment. The remaining balance relates mainly to the closure of plants of the Group and the moving of pharmaceutical production lines between locations, according to exit plans, which commenced in the fourth quarter of 2001. As a result of the structural changes, the Group expects to terminate the employment of 198 employees (mainly management, production and sales personnel), at a total cost of \$2.3 million. Through December 31, 2002, the employment of 76 employees has been terminated at a cost of \$1.1 million; other restructuring expenses paid through December 31, 2002, amounted to \$2.5 million. Management expects to complete the restructuring plan during 2003.

g. Acquisition of research and development in process:

The amounts charged to income in the year ended December 31, 2000 relate mainly to in-process research and development, identified at the time of acquisition of Novopharm — see note 2a.

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 11 — Additional Financial Statement Information (continued)

h. Financial expenses — net:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
Interest expense	\$ 54.5	\$ 46.9	\$ 53.0
Interest income	(17.8)	(20.7)	(10.3)
Exchange differences — net	(12.6)	1.4	3.3
Loss (income) from securities	0.5	(1.6)	(3.8)
	\$ 24.6	\$ 26.0	\$ 42.2

i. Earnings per ADR:

The net income and the weighted average number of ADRs used in computation of basic and diluted earnings per ADR for the years ended December 31, 2002, 2001 and 2000 are as follows:

	Year Ended December 31		
	2002	2001	2000
	(U.S. \$ in millions)		
Net income	\$410.3	\$278.2	\$148.4
Interest expense on convertible senior debentures due 2005, and issuance costs, net of tax benefit	16.4	8.4	1.4
Net income used for the computation of diluted earnings per ADR	\$426.7	\$286.6	\$149.8
Weighted average number of ADRs used in the computation of basic earnings per ADR	264.5	264.5	257.9
Add:			
Additional shares from the assumed exercise of employee stock options	3.5	3.6	2.9
Weighted average number of additional shares issued upon the assumed conversion of the convertible senior debentures due 2005	12.8	12.8	2.9
Weighted average number of ADRs used in the computation of diluted earnings per ADR	280.8	280.9	263.7

For the sake of clarity, the following table details the number of ordinary shares and special shares less ordinary shares held by subsidiaries as of each balance sheet date.

	December 31	
	2002	2001
	(Number of shares, in millions)	
Ordinary shares — issued and outstanding	263.2	256.2
Special shares — see note 2a	6.3	12.8
	269.5	269.0
Ordinary shares, held by subsidiaries	(4.6)	(4.5)
	264.9	264.5

INDEPENDENT AUDITORS' REPORT

To the shareholders of Biogal Pharmaceutical Co. Ltd.:

We have audited the statements of income and comprehensive income, shareholders' equity, and cash flows for the year ended December 31, 2000 of Biogal Pharmaceutical Co. Ltd. (a company incorporated in Hungary). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of operations of Biogal Pharmaceutical Co. Ltd. and its cash flows for the year ended December 31, 2000, in conformity with generally accepted accounting principles in the United States of America.

/s/ KPMG HUNGÁRIA KFT.

Budapest, Hungary
January 22, 2001



Ehrenkrantz
Sterling & Co. L.L.C.

Certified Public Accountants and Consultants

6 Regent Street, Livingston, New Jersey 07039 (973) 994-7777 Fax: (973) 994-3444

E-mail: success@es-cpa.com Web: www.es-cpa.com

INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Shareholders
Plantex-U.S.A., Inc.
Englewood Cliffs, New Jersey

We have audited the accompanying balance sheet of Plantex-U.S.A., Inc., as of December 31, 2000 and the related statements of income and comprehensive income, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Plantex-U.S.A., Inc. as of December 31, 2000 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ EHRENKRANTZ STERLING & CO. L.L.C.
Certified Public Accountants
January 17, 2001

**REPORT OF INDEPENDENT ACCOUNTANTS ON
FINANCIAL STATEMENT SCHEDULE**

To the Board of Directors of
Teva Pharmaceutical Industries Limited

Our audits of the consolidated financial statements referred to in our report dated February 17, 2003 appearing in the 2002 Annual Report to the Shareholders of Teva Pharmaceutical Industries Limited also included an audit of Financial Statement Schedule II — Valuation and Qualifying Accounts — listed in Item 18 of this Form 20-F. In our opinion, the schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ KESSELMAN & KESSELMAN
Kesselman & Kesselman
Certified Public Accountants (Isr.)

Tel-Aviv, Israel
February 17, 2003

TEVA PHARMACEUTICAL INDUSTRIES LIMITED
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
Three Years Ended December 31, 2002
(U.S. \$ in millions)

<u>Column A</u>	<u>Column B</u>	<u>Column C</u>		<u>Column D</u>	<u>Column E</u>
	<u>Balance at beginning of period</u>	<u>Charged to costs and expenses</u>	<u>Charged to other accounts</u>	<u>Deductions</u>	<u>Balance at end of period</u>
Allowance for doubtful accounts:					
Year ended December 31, 2002	<u>\$15.6</u>	<u>\$12.3</u>	<u>\$ 4.2</u>	<u>\$(1.8)</u>	<u>\$30.3</u>
Year ended December 31, 2001	<u>\$ 9.5</u>	<u>\$13.7</u>	<u>\$ 0.1</u>	<u>\$(7.7)</u>	<u>\$15.6</u>
Year ended December 31, 2000	<u>\$10.2</u>	<u>\$ 1.1</u>	<u>\$ 4.4</u>	<u>\$(6.2)</u>	<u>\$ 9.5</u>
Allowance in respect of carryforward tax losses:					
Year ended December 31, 2002	<u>\$33.0</u>	<u>\$ 9.6</u>	<u>\$23.9</u>	<u>\$(1.4)</u>	<u>\$65.1</u>
Year ended December 31, 2001	<u>\$39.5</u>	<u>\$(4.6)</u>	<u>\$(1.9)</u>		<u>\$33.0</u>
Year ended December 31, 2000	<u>\$13.1</u>	<u>\$15.5</u>	<u>\$10.9</u>		<u>\$39.5</u>