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# Taro Pharmaceuticals

**Sector: Pharmaceuticals**

**Neutral**

**Pre-Reporting Note**

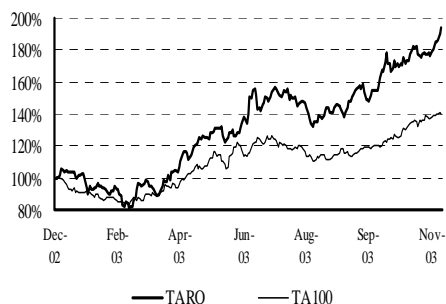
15 FEBRUARY 2004

## Stock Data

|                              |             |
|------------------------------|-------------|
| NASDAQ                       | TARO        |
| Bloomberg                    | TARO.IT     |
| Reuters                      | TARO.TA     |
| Price (\$)                   | 66.4        |
| Shares O/S (m)               | 28.9        |
| Market Cap (\$,m)            | 1,851       |
| Free Float (%)               | 66.0        |
| 12 Mo. Range (\$)            | 30.1 – 72.1 |
| 12 Mo. Average Volume (\$,m) | 4.5         |

| Model Changes    | Previous | Current |
|------------------|----------|---------|
| Rating           | Neutral  | Neutral |
| Price Tag (\$)   | ---      | ---     |
| FY03E EPS (\$)   | 2.07     | 2.07    |
| FY04E EPS (\$)   | 2.79     | 2.79    |
| FY03E Rev (\$,m) | 310.5    | 310.5   |
| FY04E Rev (\$,m) | 378.8    | 378.8   |
| CAGR (%)         | 22.0     | 22.0    |

## TARO Versus Ta100 Relative Strength



## 4Q03: Revenues to Jump 35.0% YoY; Net Income 30.0% YoY

- Taro is scheduled to release its 4Q03 and FY03 results on Tuesday, February 17, before trading (US). We expect the numbers to continue demonstrating top to bottom growth, albeit at a more moderate pace than we have seen in recent quarters.
- 4Q03 revenues should jump 35.0% YoY (\$83.6 million). FY03 top line numbers should reach \$310.5 million.
- Taro launched just one product in 4Q03 -Betamethasone Dipropionate, the generic version of Schering's Diprolene®, in both cream and gel versions. We believe that prices will experience only a marginal 35% decline (vs. an average of 70% in full generic competition). We model revenues to reach \$6.0 million for Taro and net margins to reach 33%. However, we stress that impact on 4Q03 and FY03 will be marginal.
- The 2Q03 launch of the ElixSure™, an OTC cough and cold products based on the Company's patented NonSpil™ liquid drug delivery system, is set to erode EBIT margins due to the high marketing and penetration costs of the new technology. 4Q03 EBIT is set to reach \$20.6 million (EBIT margins of 24.7%) vs.\$15.5 million in 3Q02 (25.1% margins).
- Net income this quarter is projected to reach \$16.87 million, representing an EPS of \$0.56, 1 cent above market consensus. FY03 EPS is set to reach \$2.07 (net income of \$61.3 million, 37.7% growth YoY).

## Summary Earning Estimates

| Year-end Dec (\$,m) | 2001 | 2002 | 2003E | 2004E | 2005E | 2006E |
|---------------------|------|------|-------|-------|-------|-------|
| Sales               | 150  | 211  | 310   | 379   | 462   | 563   |
| EBIT                | 33   | 53   | 76    | 104   | 126   | 154   |
| EBITDA              | 24   | 63   | 95    | 142   | 173   | 212   |
| Net income          | 26   | 65   | 61    | 83    | 101   | 123   |
| EPS                 | 1.98 | 1.52 | 2.07  | 2.79  | 3.41  | 4.20  |
| FCF                 | 16   | 21   | 44    | 46    | 48    | 51    |

## Key Valuation Ratios

| Year-end Dec       | 2001 | 2002 | 2003E | 2004E | 2005E | 2006E |
|--------------------|------|------|-------|-------|-------|-------|
| P/E (ENS, x)       | 67.9 | 43.8 | 32.1  | 23.8  | 19.5  | 16.0  |
| PEG (x)            | 3.1  | 2.0  | 1.5   | 1.1   | 0.90  | 0.69  |
| FCF Yield (%)      | 0.8  | 1.0  | 2.2   | 2.3   | 2.5   | 2.7   |
| FCF/Share (\$)     | 0.5  | 0.7  | 1.5   | 1.5   | 1.6   | 1.7   |
| EV/EBITDA (ENS, x) | ---  | 28.0 | 19.4  | 13.5  | 11.6  | 9.9   |
| EV/Sales (x)       | 25.0 | 7.6  | 6.3   | 4.1   | 3.1   | 2.8   |
| ROE (%)            | 31.1 | 18.1 | 20.8  | 17.0  | 18.1  | 18.9  |
| ROCE (%)           | 5.7  | 6.6  | 5.5   | 6.1   | 6.8   | 7.2   |

|                            | 2002a     | 2001a     | 1Q02a     | 2Q02a     | 3Q02a     | 4Q02a     | 2002a     | 1Q03a     | 2Q03a     | 3Q03a     | 4Q03a     | 2003a     |
|----------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Revenues                   | 103,797   | 150,134   | 44,539    | 49,584    | 55,482    | 61,976    | 211,581   | 68,968    | 74,753    | 83,115    | 83,668    | 310,504   |
| Cost of sales              | 41,206    | 54,736    | 15,699    | 18,775    | 21,559    | 23,435    | 79,468    | 24,588    | 24,746    | 26,559    | 27,610    | 103,503   |
| Gross Profit               | 62,591    | 95,398    | 28,840    | 30,809    | 33,923    | 38,541    | 132,113   | 44,380    | 50,007    | 56,556    | 56,057    | 207,000   |
| R&D Expenses               | 14,593    | 19,633    | 5,351     | 6,247     | 6,782     | 7,993     | 26,373    | 8,722     | 9,594     | 11,221    | 10,772    | 40,309    |
| SG&A                       | 31,902    | 42,990    | 11,745    | 12,647    | 13,067    | 15,022    | 52,481    | 17,541    | 22,403    | 25,677    | 24,650    | 90,271    |
| total operating expenses   | 46,495    | 62,623    | 17,096    | 18,894    | 19,849    | 23,015    | 78,854    | 26,263    | 31,997    | 36,898    | 35,422    | 130,580   |
| Operating Profit           | 16,096    | 32,775    | 11,744    | 11,915    | 14,074    | 15,526    | 53,259    | 18,117    | 18,010    | 19,658    | 20,635    | 76,420    |
| Financial Expenses         | 3,855     | 2,594     | -59       | 155       | 283       | -217      | 162       | 271       | 321       | 585       | 591       | 1,768     |
| Other Income               | 344       | 272       | -         | -3        | 34        | 47        | 78        | 8         | -         | -         | -         | 8         |
| Income Before Taxes        | 12,585    | 30,453    | 11,803    | 11,757    | 13,825    | 15,790    | 53,175    | 17,854    | 17,689    | 19,073    | 20,044    | 74,660    |
| Effective Tax Rate         | 20.2%     | 14.4%     | 15.9%     | 13.1%     | 16.3%     | 17.4%     | 15.8%     | 20.9%     | 15.6%     | 17.1%     | 16.0%     | 17.3%     |
| Taxes                      | 2,538     | 4,378     | 1,872     | 1,542     | 2,252     | 2,740     | 8,406     | 3,735     | 2,757     | 3,253     | 3,207     | 12,952    |
| Income After Taxes         | 10,047    | 26,075    | 9,931     | 10,215    | 11,573    | 13,050    | 44,769    | 14,119    | 14,932    | 15,820    | 16,837    | 61,708    |
| Minority Interests         | -20       | -81       | -56       | -23       | -10       | -125      | -214      | -130      | -114      | -84       | -50       | -378      |
| Net Income                 | 10,027    | 25,994    | 9,875     | 10,192    | 11,563    | 12,925    | 44,555    | 13,989    | 14,818    | 15,736    | 16,787    | 61,330    |
| Earning Per Share          | 0.75      | 0.98      | 0.34      | 0.35      | 0.39      | 0.44      | 1.52      | 0.47      | 0.50      | 0.53      | 0.56      | 2.07      |
| <b>Margins</b>             |           |           |           |           |           |           |           |           |           |           |           |           |
| Gross Margins              | 60.3%     | 63.5%     | 64.8%     | 62.1%     | 61.1%     | 62.2%     | 62.4%     | 64.3%     | 66.9%     | 68.0%     | 67.0%     | 66.7%     |
| Operating Margins          | 15.5%     | 21.8%     | 26.4%     | 24.0%     | 25.4%     | 25.1%     | 25.2%     | 26.3%     | 24.1%     | 23.7%     | 24.7%     | 24.6%     |
| EBITDA Margins             |           | 15.8%     | 30.9%     | 28.6%     | 30.2%     | 30.1%     | 29.9%     | 32.1%     | 29.9%     | 29.5%     | 31.0%     | 30.6%     |
| Net Margins                | 9.7%      | 17.3%     | 22.2%     | 20.6%     | 20.8%     | 20.9%     | 21.1%     | 20.3%     | 19.8%     | 18.9%     | 20.1%     | 19.8%     |
| <b>YoY Growth</b>          |           |           |           |           |           |           |           |           |           |           |           |           |
| Sales Growth               | -25.3%    | 44.6%     | 57.0%     | 36.4%     | 34.0%     | 40.8%     | 40.9%     | 54.8%     | 50.8%     | 49.8%     | 35.0%     | 46.8%     |
| Gross Income Growth        | 65.6%     | 52.4%     | 26.6%     | 62.9%     | 58.1%     | 58.0%     | 38.5%     | 53.9%     | 62.3%     | 66.7%     | 45.4%     | 56.7%     |
| Operating Income growth    | 48.9%     | 103.6%    | 32.8%     | 128.5%    | 120.3%    | 116.6%    | 62.5%     | 54.3%     | 51.2%     | 39.7%     | 32.9%     | 43.5%     |
| Net Income Growth          | 81.0%     | 159.2%    | 70.1%     | 192.2%    | 161.0%    | 179.6%    | 71.4%     | 41.7%     | 45.4%     | 36.1%     | 29.9%     | 37.7%     |
| <b>Percentage Analysis</b> |           |           |           |           |           |           |           |           |           |           |           |           |
| Revenues                   | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    | 100.0%    |
| Cost of sales              | 39.7%     | 36.5%     | 35.2%     | 37.9%     | 38.9%     | 37.8%     | 37.6%     | 35.7%     | 33.1%     | 32.0%     | 33.0%     | 33.3%     |
| Gross Profit               | 60.3%     | 63.5%     | 64.8%     | 62.1%     | 61.1%     | 62.2%     | 62.4%     | 64.3%     | 66.9%     | 68.0%     | 67.0%     | 66.7%     |
| R&D Expenses               | 14.1%     | 13.1%     | 12.0%     | 12.6%     | 12.2%     | 12.9%     | 12.5%     | 12.6%     | 12.8%     | 13.5%     | 12.9%     | 13.0%     |
| SG&A                       | 30.7%     | 28.6%     | 26.4%     | 25.5%     | 23.6%     | 24.2%     | 24.8%     | 25.4%     | 30.0%     | 30.9%     | 29.5%     | 29.1%     |
| total operating expenses   | 44.8%     | 41.7%     | 38.4%     | 38.1%     | 35.8%     | 37.1%     | 37.3%     | 38.1%     | 42.8%     | 44.4%     | 42.3%     | 42.1%     |
| Operating Profit           | 15.5%     | 21.8%     | 26.4%     | 24.0%     | 25.4%     | 25.1%     | 25.2%     | 26.3%     | 24.1%     | 23.7%     | 24.7%     | 24.6%     |
| Financial Expenses         | 3.7%      | 1.7%      | -0.1%     | 0.3%      | 0.5%      | -0.4%     | 0.1%      | 0.4%      | 0.4%      | 0.7%      | 0.7%      | 0.6%      |
| Other Income               | 0.3%      | 0.2%      | 0.0%      | 0.0%      | 0.1%      | 0.1%      | 0.0%      | 0.0%      | 0.0%      | 0.0%      | 0.0%      | 0.0%      |
| Income Before Taxes        | 12.1%     | 20.3%     | 26.5%     | 23.7%     | 24.9%     | 25.5%     | 25.1%     | 25.9%     | 23.7%     | 22.9%     | 24.0%     | 24.0%     |
| Taxes                      | 2.4%      | 2.9%      | 4.2%      | 3.1%      | 4.1%      | 4.4%      | 4.0%      | 5.4%      | 3.7%      | 3.9%      | 3.8%      | 4.2%      |
| Income After Taxes         | 9.7%      | 17.4%     | 22.3%     | 20.6%     | 20.9%     | 21.1%     | 21.2%     | 20.5%     | 20.0%     | 19.0%     | 20.1%     | 19.9%     |
| Minority Interests         | 0.0%      | -0.1%     | -0.1%     | 0.0%      | 0.0%      | -0.2%     | -0.1%     | -0.2%     | -0.2%     | -0.1%     | -0.1%     | -0.1%     |
| Net Income                 | 9.7%      | 17.3%     | 22.2%     | 20.6%     | 20.8%     | 20.9%     | 21.1%     | 20.3%     | 19.8%     | 18.9%     | 20.1%     | 19.8%     |
| <b>Key Parameters</b>      |           |           |           |           |           |           |           |           |           |           |           |           |
| EBITDA                     | 21,933    | 23,695    | 13,782    | 14,182    | 16,735    | 18,662    | 63,361    | 22,115    | 22,359    | 24,497    | 25,913    | 94,884    |
| Enterprise Value           | 7,563,456 | 7,457,326 | 1,766,298 | 1,782,660 | 1,774,573 | 1,775,811 | 1,775,811 | 1,807,675 | 1,830,850 | 1,862,570 | 1,844,870 | 1,844,870 |
| ROE(%)                     | 21.7%     | 31.1%     | 17.3%     | 17.0%     | 18.5%     | 19.8%     | 18.1%     | 20.4%     | 20.6%     | 20.9%     | 21.2%     | 20.8%     |
| ROCE(%)                    | 2.9%      | 5.7%      | 6.9%      | 6.0%      | 6.7%      | 7.0%      | 6.6%      | 6.1%      | 5.6%      | 5.0%      | 5.4%      | 5.5%      |
| Earnings yield(%)          | 0.4%      | 1.0%      | 1.8%      | 2.0%      | 2.2%      | 2.4%      | 2.1%      | 2.6%      | 2.9%      | 3.1%      | 3.3%      | 3.0%      |
| CFPS                       | 0.04      | 0.53      | -0.02     | 0.10      | 0.33      | 0.29      | 0.69      | 0.34      | 0.35      | 0.38      | 0.40      | 1.47      |
| PER(x)                     | 241.0     | 113.3     | 55.9      | 49.7      | 44.7      | 41.6      | 48.0      | 38.0      | 34.7      | 32.2      | 30.2      | 33.5      |
| EV/sales(x)                | 40.77     | 25.78     | 8.11      | 7.73      | 7.41      | 7.08      | 7.58      | 6.75      | 6.44      | 6.14      | 5.85      | 6.30      |
| EV/EBITDA(x)               |           | 314.72    | 32.04     | 31.42     | 26.51     | 23.79     | 28.03     | 20.44     | 20.47     | 19.01     | 17.80     | 19.44     |

Note Figures are in US\$, thousands

## Ratings Key

1. **Strong Buy:** Expected to significantly outperform the relevant broader market index over the next 6-12 months. An identifiable catalyst is present to drive appreciation.
2. **Buy:** Expected to outperform the relevant broader market index over the next 12-18 months.
3. **Neutral:** Expected to perform in-line with the relevant broader market index over the next 6-12 months.
4. **Sell:** Expected to underperform the relevant broader market index over the next 6-12 months.

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