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Taro Pharmaceutical

Nearing a Bottom?

NEUTRAL

Reason for Report: Company Update

Volatility Risk:
HIGH**Company****TARO; \$21.34; C-2-9**

EPS (Dec): 2004A \$0.37; 2005E \$1.04; 2006E \$1.38

P/E (Dec): 2004A 57.7x; 2005E 20.5x; 2006E 15.5x

GAAP EPS (Dec): 2004A NA; 2005E NA; 2006E NA

GAAP P/E (Dec): 2004A NM; 2005E NM; 2006E NM

- Taro shares have been especially weak recently, and we are not aware of any fundamental reasons that would explain this weakness. If Taro's 3Q results, to be reported on November 9th, are not significantly below expectations, we believe the stock's performance could improve. We are maintaining our Neutral rating, as it is still difficult to predict the timing and magnitude of the sales, margin, and EPS improvements that we would like to see in order to justify a Buy rating.
- **Valuation suggests that growth from current EPS run rate will be limited.** Taro reported 2Q EPS of \$0.22, which equates to \$0.88 on an annualized basis. Trading at \$21.34, the stock is trading at 24x current annualized EPS. On our 2006 estimate of \$1.38 (consensus is \$1.69), the stock is trading at roughly 15x, well below the group average of 21x. Over the past five years or so, Taro's average forward P/E has been 21-22x. Taro's relatively low P/E indicates to us that investors expect estimates to come down and/or that sales and EPS growth will be below average.
- **Approvals are the name of the game.** As with any generic company, launches are needed to offset the erosion of the "base" business. While we have no idea when each of Taro's 25 ANDAs (generic applications) will be approved, it is reasonable to assume based on historical FDA timelines that there could be several approvals over the coming quarters. Predicting the sales and profit contribution of those products is another story, but we believe our model is based on reasonable assumptions.
- **We don't read into later reporting date.** While Taro's November 9th reporting date appears to be late relative to Taro's historical pattern, we do not believe there is anything "sinister" about the timing of the date. We are not aware of any changes in the closing/reporting process for Taro in this particular quarter.

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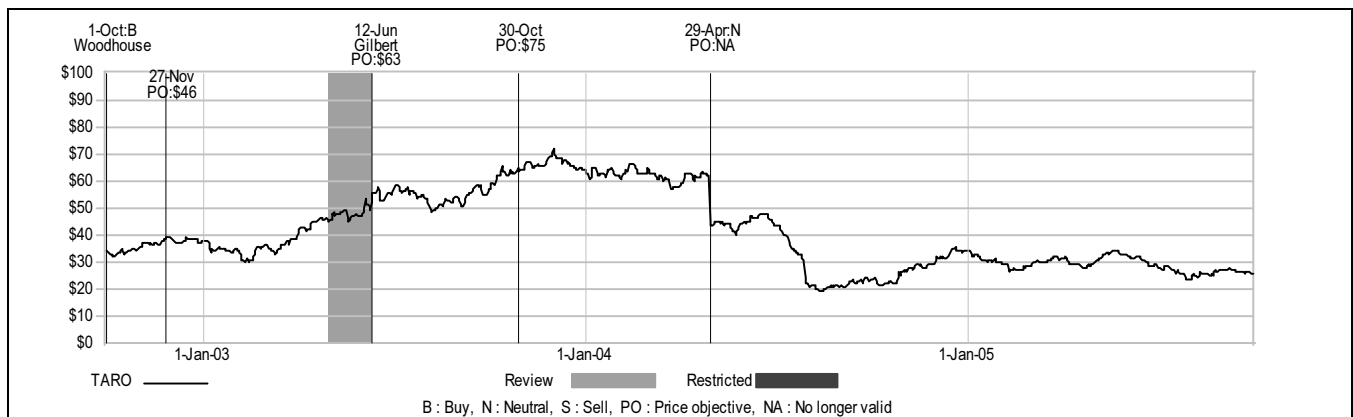
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Analyst Certification

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Important Disclosures

TARO Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of September 30, 2005.

Investment Rating Distribution: Health Care Group (as of 30 September 2005)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	99	48.77%	Buy	31	31.31%
Neutral	89	43.84%	Neutral	24	26.97%
Sell	15	7.39%	Sell	1	6.67%

Investment Rating Distribution: Global Group (as of 30 September 2005)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1076	40.21%	Buy	350	32.53%
Neutral	1399	52.28%	Neutral	412	29.45%
Sell	201	7.51%	Sell	36	17.91%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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