HUNT J B TRANSPORT SERVICES INC
Form 424B2
March 05, 2014

Filed Pursuant to Rule 424(b)(2)

Registration No. 333-194163

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Amount to be Registered**	**Maximum Aggregate Offering Price**	**Amount of Registration Fee(1)**
2.400% Senior Notes due 2019	$250,000,000	$250,000,000	$32,200.00
3.850% Senior Notes due 2024	$250,000,000	$250,000,000	$32,200.00
Guarantees of Senior Notes	(2)	(2)	(2)

(1) Calculated in accordance with Rule 457(r) under the Securities Act of 1933, as amended.

(2) In accordance with Rule 457(n) under the Securities Act of 1933, as amended, no separate fee is payable with respect to guarantees of the Senior Notes being registered.

Prospectus Supplement to Prospectus dated February 27, 2014

J.B. Hunt Transport Services, Inc.

$250,000,000
2.400%
Senior Notes
due 2019
$250,000,000
3.850%
Senior Notes
due 2024
Guaranteed by

J.B. Hunt Transport, Inc.

We are offering $250,000,000 aggregate principal amount of 2.400% Senior Notes due 2019 (the “2019 notes”) and $250,000,000 aggregate principal amount of 3.850% Senior Notes due 2024 (the “2024 notes” and, together with the 2019 notes, the “notes”). We will pay interest on the 2019 notes semiannually in arrears on March 15 and September 15 of each year, beginning September 15, 2014. We will pay interest on the 2024 notes semiannually in arrears on March 15 and September 15 of each year, beginning September 15, 2014. The 2019 notes will mature on March 15, 2019 and the 2024 notes will mature on March 15, 2024. However, we may redeem, at our option, at any time and from time to time prior to maturity, the 2019 notes and, prior to December 15, 2023 (the date that is three months prior to the maturity date of the 2024 notes), the 2024 notes, in whole or in part as to the particular series of notes, at the redemption price described under “Description of Notes—Optional Redemption.” On and after December 15, 2023 (the date that is three months prior to the maturity date of the 2024 notes), we may redeem, at our option, at any time and from time to time prior to maturity, the 2024 notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the 2024 notes to be redeemed plus unpaid interest, if any, accrued to the date of redemption. Upon a Change of Control Triggering Event, you will have the right to require us to repurchase all or a portion of your notes at a repurchase price equal to 101% of the principal amount of the notes to be repurchased plus unpaid interest, if any, accrued to the repurchase date unless we have exercised our option to redeem your notes in whole. See “Description of Notes—Change of Control Triggering Event.”

The notes will be senior unsecured obligations of J.B. Hunt Transport Services, Inc. and will rank equally with all of its other existing and future senior unsecured indebtedness. The notes will initially be fully and unconditionally guaranteed on a senior unsecured basis by our wholly-owned subsidiary, J.B. Hunt Transport, Inc. The notes will also be fully and unconditionally guaranteed on a senior unsecured basis by any other subsidiary of ours that in the future becomes a borrower or a guarantor under our revolving credit agreement. The notes will be denominated in U.S. dollars and issued only in minimum denominations of $2,000 and integral multiples of $1,000.

Investing in the notes involves risks. See “Risk Factors” beginning on page S-8 of this prospectus supplement.

	Price to Public(1)	Underwriting Discounts and Commissions	Proceeds to JBHT
Per 2019 note	99.957%	0.600%	99.357%
Per 2024 note	99.900%	0.650%	99.250%
Total	$499,642,500	$3,125,000	$496,517,500

(1) Plus accrued interest from March 6, 2014, if settlement occurs after such date.

Neither the Securities and Exchange Commission nor any state or other securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the notes in book-entry only form through the facilities of The Depository Trust Company and its direct and indirect participants, including Euroclear Bank S.A./N.V. and Clearstream Banking, société anonyme, on or about March 6, 2014.

Joint Book-Running Managers

J.P. Morgan Goldman, Sachs & Co. Morgan Stanley

Co-Managers

SunTrust Robinson Humphrey **US Bancorp**

Prospectus Supplement dated March 3, 2014

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Prospectus Supplement

Prospectus

You should rely only on the information contained in or incorporated by reference in this prospectus supplement, the accompanying prospectus or any free writing prospectus filed by us with the Securities and Exchange Commission, or the SEC. We have not authorized anyone to provide you with any different or additional information, and if anyone provides you such information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should not assume that the information contained in this prospectus supplement, the accompanying prospectus or any such free writing prospectus is accurate as of any date other than the date on the front of such document. Any information incorporated by reference in this prospectus supplement, the accompanying prospectus or any

such free writing prospectus is accurate only as of the date of the document incorporated by reference. Our business, financial condition, liquidity, results of operations and prospects may have changed since those dates.

ABOUT THIS PROSPECTUS SUPPLEMENT

This prospectus supplement and the accompanying prospectus are part of a registration statement that we filed with the SEC, utilizing a "shelf" registration process. In this prospectus supplement, we provide you with specific information about the notes that we are selling in this offering and about the offering itself. Both this prospectus supplement and the accompanying prospectus include or incorporate by reference important information about us and other information you should know before making a decision to invest in our notes. This prospectus supplement also adds, updates and changes information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. To the extent that any information in this prospectus supplement or any information incorporated in this prospectus supplement and the accompanying prospectus by reference is inconsistent with the information in the accompanying prospectus or information previously incorporated in this prospectus supplement and the accompanying prospectus by reference, the information in the accompanying prospectus or such previously incorporated information is deemed modified or superseded by the related information in this prospectus supplement or the information incorporated in this prospectus supplement and the accompanying prospectus by reference, as the case may be. You should read both this prospectus supplement and the accompanying prospectus, any free writing prospectus we are required to file with the SEC as well as additional information described in the accompanying prospectus under "Incorporation of Certain Documents by Reference" before investing in our notes.

References in this prospectus supplement to "JBHT," "the company," "the issuer," "we," "us" and "our" refer to J.B. Hunt Transport Services, Inc. and its subsidiaries, unless otherwise specified or unless the context otherwise requires. References to "Transport" and "the initial guarantor" refer to J.B. Hunt Transport, Inc., a wholly-owned subsidiary of JBHT.

References in this prospectus supplement to "$," "dollars" and "U.S. dollars" are to United States dollars, and all financial data included or incorporated by reference in this prospectus supplement have been presented in accordance with accounting principles generally accepted in the United States of America.

FORWARD-LOOKING STATEMENTS

This prospectus supplement and the accompanying prospectus, including documents which are incorporated by reference, contain statements that may be considered to be "forward-looking statements." Such statements relate to our predictions concerning future events or operations and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are inherently uncertain, subject to risks, and should be viewed with caution. These statements are based on our belief or interpretation of information currently available. Prospective investors are cautioned that actual results and future events may differ materially from these forward-looking statements as a result of many factors. Some of the factors and events that are not within our control and that could have a material impact on future results include: general economic and business conditions, competition and competitive rate fluctuations, cost and availability of diesel fuel, ability to attract and retain qualified drivers and delivery personnel, a loss of one or more major customers, interference with or termination of our relationships with certain railroads, insurance costs and availability, claims expense, retention of key employees, accidents, terrorist attacks or actions, acts of war, adverse weather conditions, disruption or failure of information systems, new or different environmental or other laws and regulations, adverse legal conditions, increased costs for new revenue equipment or decreases in the value of used equipment, the ability of revenue equipment manufacturers to perform in accordance with agreements for guaranteed equipment trade-in values, and audits or tax assessments of various federal, state or local taxing authorities. Additionally, our business is somewhat seasonal with slightly higher freight volumes typically experienced during August through early November in our full-load transportation business.

You should understand that many important factors, in addition to those listed above, could impact us operationally and financially. Our results may fluctuate as a result of these and other risk factors or events as described in our filings with the SEC. Some important factors that could cause our future results to differ from estimates or projections contained in the forward-looking statements are described under “Risk Factors” in our most recent Annual Report on Form 10-K, as may be updated in other reports we subsequently file with the SEC. Except as required by applicable law, we assume no obligation to update any forward-looking statement to the extent we become aware that it will not be achieved for any reason.

SUMMARY

This summary highlights information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. This summary may not contain all of the information that may be important to you. You should read this entire prospectus supplement and the accompanying prospectus and the information incorporated by reference carefully before making a decision to invest in our notes.

The Company

We are one of the largest surface transportation and delivery service companies in North America. J.B. Hunt Transport Services, Inc. is a publicly held holding company that, together with our principal operating subsidiary, J.B. Hunt Transport, Inc., and other wholly owned subsidiaries, provides a wide range of transportation services to a diverse group of customers throughout the continental United States, Canada and Mexico. We were incorporated in Arkansas on August 10, 1961, and have been a publicly held company since our initial public offering in 1983.

Our service offerings include transportation of full truckload containerized freight, which we directly transport utilizing our company-controlled revenue equipment and company drivers or independent contractors. We have arrangements with most of the major North American rail carriers to transport freight in containers and trailers. We also provide customized freight movement, revenue equipment, labor, systems and delivery services that are tailored to meet individual customers' requirements and typically involve longer-term contracts. As of December 31, 2013, we had 18,467 employees.

Our principal executive offices are located at 615 J.B. Hunt Corporate Drive, Lowell, Arkansas 72745-0130 and our telephone number is (479) 820-0000.

Transport was incorporated in Georgia on November 6, 1969. Its principal executive offices are located at 615 J.B. Hunt Corporate Drive, Lowell, Arkansas 72745-0130 and its telephone number is (479) 820-0000.

The Offering

The following summary contains basic information about the notes and is not intended to be complete. It does not contain all the information that is important to you. For a more detailed description of the terms of the notes, see "Description of Notes" in this prospectus supplement and "Description of Debt Securities" in the accompanying prospectus.

Issuer	J.B. Hunt Transport Services, Inc.
Notes offered	$250,000,000 aggregate principal amount of 2.400% Senior Notes due 2019 (the "2019 notes") and $250,000,000 aggregate principal amount of 3.850% Senior Notes due 2024 (the "2024 notes").
Maturity	Unless redeemed or repurchased by us, the 2019 notes will mature on March 15, 2019 and the 2024 notes will mature on March 15, 2024.
Interest rates	The 2019 notes will bear interest at 2.400% per year and the 2024 notes will bear interest at 3.850% per year.
Interest payment dates	We will pay interest on the 2019 notes semiannually in arrears on March 15 and September 15 of each year, beginning September 15, 2014. We will pay interest on the 2024 notes semiannually in arrears on March 15 and September 15 of each year, beginning September 15, 2014.
Guarantees	All payments with respect to the notes, including principal, premium, if any, and interest, will initially be fully and unconditionally guaranteed on a senior unsecured basis by J.B. Hunt Transport, Inc. The notes will also be fully and unconditionally guaranteed on a senior unsecured basis by any other subsidiary of ours that in the future becomes a borrower or a guarantor under our revolving credit agreement. If any guarantor of the notes, whether the initial guarantor or an additional guarantor, is no longer a borrower or a guarantor under our revolving credit agreement, then such guarantor shall automatically be released from its guarantee of the notes. See "Description of Notes—Guarantees" in this prospectus supplement.
Ranking	The notes and the guarantees, as applicable, will be:

unsecured and will rank equally with all existing and future senior unsecured debt of ours, in the case of the notes, and the initial guarantor and any additional guarantor, in the case of the guarantees;

effectively subordinated to all existing and future secured debt of ours, in the case of the notes, and the initial guarantor and any additional guarantor, in the case of the guarantees, to the extent of the value of the assets securing such debt; and

structurally subordinated to all existing and future debt and other liabilities, including trade payables, and preferred equity of our non-guarantor subsidiaries (including subsidiaries of the initial guarantor and of any future additional guarantors).

	As of December 31, 2013, we and the initial guarantor had secured debt outstanding of approximately $4.7 million and our non-guarantor subsidiaries had no outstanding debt or preferred equity.
Optional redemption	We may redeem, at our option, at any time and from time to time prior to maturity, the 2019 notes and, prior to December 15, 2023 (the date that is three months prior to the maturity date of the 2024 notes), the 2024 notes, in whole or in part as to the particular series of notes, at the redemption price described under “Description of Notes—Optional Redemption.” On and after December 15, 2023 (the date that is three months prior to the maturity date of the 2024 notes), we may redeem, at our option, at any time and from time to time prior to maturity, the 2024 notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the 2024 notes to be redeemed plus unpaid interest, if any, accrued to the date of redemption. See “Description of Notes—Optional Redemption.”
Change of control triggering event	Upon a Change of Control Triggering Event (as defined under “Description of Notes—Change of Control Triggering Event”), unless we have exercised our option to redeem your notes in whole, you will have the right to require us to repurchase all or a portion of your notes at a repurchase price equal to 101% of the principal amount of the notes to be repurchased plus unpaid interest, if any, accrued to the repurchase date, as described under “Description of Notes—Change of Control Triggering Event.”
Covenants	The indenture contains covenants for the benefit of noteholders. These covenants restrict our ability, with certain important exceptions, to:

incur debt secured by liens;

engage in sale/leaseback transactions; or merge or consolidate with, or transfer all or substantially all of our assets to, another entity.

Form and denomination	The notes will be issued only in fully registered form without coupons, in denominations of $2,000 and integral multiples of $1,000 in excess thereof.
	We anticipate that we will receive approximately $495.6 million in net proceeds from the sale of the notes, after deducting underwriting discounts and commissions and other estimated expenses of this offering.
Use of proceeds	Approximately $460 million of the net proceeds from the sale of the notes will be used to repay certain of our outstanding indebtedness, including the repayment in full of our $150 million variable interest rate term loan, $100 million of our outstanding 6.08% Senior Notes and approximately $208.7 million of long term debt outstanding under our revolving credit agreement. The balance of the proceeds of this offering will be used for general corporate purposes including capital expenditures, additions to working capital, and the repurchase of shares of our outstanding common stock.
Further issuances	The 2019 notes and the 2024 notes will each constitute a series of our debt securities issued under the indenture. We may issue and sell additional debt securities of either series ranking equally and ratably with the notes of such series in all respects, so that such additional debt securities shall be consolidated and form a single series with the notes of the applicable series for all purposes, including voting.
Risk factors	See “Risk Factors” and other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus for a discussion of factors you should consider carefully before making a decision to invest in the notes.

RISK FACTORS

An investment in the notes involves risks. You should carefully consider the following factors as well as other information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus before deciding to invest in the notes, including the factors listed under "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013 which is incorporated by reference in this prospectus supplement and the accompanying prospectus.

Risks Relating to the Notes

Claims of holders of the notes will be structurally subordinated to claims of creditors and any preferred equity holders of our non-guarantor subsidiaries and effectively subordinated to claims of secured creditors.

The notes will be guaranteed by the initial guarantor and not by any other current or future subsidiary of ours unless such subsidiary becomes a borrower or guarantor under our revolving credit agreement. Furthermore, under certain circumstances, a guarantor, whether the initial guarantor or an additional guarantor, shall automatically be released from its guarantee of the notes. See "Description of Notes—Guarantees." Claims of holders of the notes will be structurally subordinated to the claims of creditors, including trade creditors, and any preferred equity holders of our non-guarantor subsidiaries (including subsidiaries of the initial guarantor and of any future additional guarantors). All liabilities and preferred equity of our non-guarantor subsidiaries will have to be satisfied before any of the assets of such subsidiaries would be available for distribution, upon a bankruptcy, liquidation or reorganization, to us or, if applicable, a guarantor of the notes. Other than to the limited extent contemplated under "Description of Notes—Covenants" and in the accompanying prospectus under "Description of Debt Securities—Covenants—Restrictions on secured debt," the notes will not be secured by any of our assets or the assets of any of our subsidiaries (including the initial guarantor) and, as such, will be effectively subordinated to any secured debt that we or any of our subsidiaries (including the initial guarantor) may have now or may incur in the future to the extent of the value of the assets securing that debt.

We are a holding company and our ability to make payments on the notes depends on our ability to receive dividends or other distributions from our subsidiaries.

Our operations are conducted through direct and indirect subsidiaries. As a holding company, we own no significant assets other than our equity in our subsidiaries, and our ability to meet our obligations, including with respect to the notes, will be dependent on dividends and other distributions or payments from our subsidiaries. The ability of our subsidiaries to pay dividends or make distributions or other payments to us depends upon the availability of cash flow from operations and proceeds from the sale of assets and/or other capital-raising activities. We cannot be certain of the future availability of such distributions and the lack of any such distributions may adversely affect our ability to pay the principal of, and premium, if any, and interest on, the notes. In addition, dividends or other distributions from our subsidiaries to us may be subject to contractual and other restrictions and are subject to other business considerations.

The indenture does not restrict the amount of additional debt that we or our subsidiaries may incur.

The indenture does not place any limitation on the amount of debt that we or our subsidiaries may incur in the future. The incurrence of any such additional debt may have important consequences for you as a holder of the notes, including making it more difficult to satisfy our obligations with respect to the notes or the obligations of the initial guarantor or any additional guarantor with respect to its guarantee, a loss in the trading value of your notes, if any, and a risk that the credit rating of the notes is lowered, placed on negative outlook or withdrawn.

Federal and state fraudulent transfer laws may permit a court to void any guarantee and, if that occurs, you may not receive any payments on such guarantee.

The issuance of guarantees by the initial guarantor (and any additional guarantor) may be subject to review under federal and state fraudulent transfer and conveyance statutes if a bankruptcy, liquidation or reorganization case or a lawsuit, including under circumstances in which bankruptcy is not involved, were commenced at some future date by the initial guarantor (or any additional guarantor) or on behalf of the unpaid creditors of the initial guarantor (or additional guarantor). While the relevant laws may vary from state to state, under such laws a guarantee will generally be a fraudulent conveyance or transfer if (i) the transfer was made with the intent of hindering, delaying or defrauding creditors or (ii) the guarantor received less than reasonably equivalent value or fair consideration in return for issuing such guarantee, and, in the case of (ii) only, one of the following is also true:

- such guarantor was insolvent or rendered insolvent by reason of issuing such guarantee;
- payment of the consideration left such guarantor with an unreasonably small amount of capital to carry on its business; or
- such guarantor intended to, or believed that it would, incur debts beyond its ability to pay as they mature.

If a court were to find that the issuance of a guarantee by the initial guarantor (or an additional guarantor) was a fraudulent conveyance or transfer, the court could void the payment obligations under such guarantee or subordinate such guarantee to presently existing and future debt of the initial guarantor (or such additional guarantor, as the case may be) or require the holders of the notes to repay any amounts received with respect to such guarantee. In the event of a finding that a fraudulent conveyance or transfer occurred, you may not receive any payment on the notes in respect of such guarantee.

The measures of insolvency for purposes of fraudulent conveyance laws vary depending upon the law of the jurisdiction that is being applied. Generally, an entity would be considered insolvent if, at the time it incurred indebtedness:

- the sum of its debts, including contingent liabilities, was greater than the fair saleable value of all of its assets;
- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts and liabilities, including contingent liabilities, as they become absolute and mature; or

it could not pay its debts as they become due.

We cannot be certain as to the standards a court would use to determine whether reasonably equivalent value or fair consideration was received or whether or not the initial guarantor (or any additional guarantor) was solvent at the relevant time, or regardless of the standard used, that the issuance of a guarantee by it would not be voided or subordinated to other debt of the initial guarantor (or additional guarantor, as the case may be).

The initial guarantor is a borrower under, and not a guarantor of, our revolving credit agreement. Accordingly, obligations to lenders under that agreement by the initial guarantor as borrower under that agreement would not necessarily be subject to the potential for claims discussed above that would seek to avoid or subordinate obligations of a guarantor. However, obligations by the initial guarantor to holders of the notes pursuant to its guarantees of the notes could be subject to such claims, including claims by the lenders under the credit agreement or holders of any other indebtedness of the initial guarantor.

The terms of the indenture and the notes provide only limited protection against significant events that could negatively impact the value of your notes.

As described under “Description of Notes—Change of Control Triggering Event,” upon the occurrence of a Change of Control Triggering Event with respect to the notes, holders are entitled to require us to repurchase all or a portion of their notes at 101% of their principal amount plus unpaid interest, if any, accrued to the repurchase date unless we have exercised our option to redeem your notes in whole. The definition of the term “Change of Control Triggering Event” is limited and does not cover a variety of transactions (such as acquisitions by us or recapitalizations) that could negatively impact the value of your notes. As such, if we enter into a significant corporate transaction that negatively impacts the value of your notes, but which does not constitute a Change of Control Triggering Event, you would not have any rights to require us to repurchase the notes prior to their maturity or to otherwise seek any remedies.

You should also be aware that neither the indenture nor the notes:

- require us to maintain any financial ratios or specific levels of net worth, revenues, income, cash flow or liquidity;
- limit our ability or the ability of the initial guarantor (or any additional guarantor) to incur indebtedness or other obligations that are equal in right of payment to the notes or its guarantee, as the case may be;
- limit the ability of our non-guarantor subsidiaries (including subsidiaries of the initial guarantor and of any future additional guarantors) to incur debt, other liabilities or preferred equity that would rank senior to our equity interests or, if applicable, the equity interests of the initial guarantor and any future additional guarantors in those subsidiaries and therefore be structurally senior to the notes with respect to the assets of those subsidiaries;
- restrict our ability to repurchase or prepay any other of our equity or debt securities or other indebtedness; or
- restrict our ability to make investments or to repurchase, or pay dividends or make other payments in respect of, our common stock or other securities ranking junior to the notes.

As a result of the foregoing, when evaluating an investment in the notes, you should be aware that neither the indenture nor the notes restrict our ability to engage in, or to otherwise be a party to, a variety of corporate transactions, circumstances and events that could have a negative impact on the value of your notes.

We may not be able to repurchase the notes upon a Change of Control Triggering Event.

We will be required to make an offer to each holder of notes to purchase all or any part of such holder's notes at a price equal to 101% of their principal amount plus unpaid interest, if any, to the repurchase date upon a Change of Control Triggering Event unless we have exercised our option to redeem your notes in whole. If we experience a Change of Control Triggering Event, there can be no assurance that we would have sufficient financial resources available to satisfy our obligations to repurchase your notes. Our failure to purchase the notes in connection with a Change of Control would result in a default under the indenture, which could have material adverse consequences for us and the holders of the notes and would cause cross-defaults under certain of our other agreements, including our revolving credit agreement. See "Description of Notes—Change of Control Triggering Event."

There is currently no market for the notes. We cannot assure you that an active trading market will develop, continue or be liquid.

Each series of the notes is a new issue of securities as to which there is currently no market. We do not intend to apply for listing of the notes on any national securities exchange or for quotation of the notes on any automated dealer quotation system. We have been advised by the underwriters that they presently intend to make a market in the notes. However, they are under no obligation to do so and may discontinue any market-making activities at any time without notice to, or the consent of, noteholders. We cannot assure you that an active market for the notes will develop or, if it develops, will continue or be liquid. If an active trading market for the notes does not develop or continue, the market price and liquidity of the notes will be negatively affected. See “Underwriting.”

Changes in credit ratings issued by nationally recognized statistical rating organizations could adversely affect our cost of financing and the market price of our securities.

Credit rating agencies rate our debt securities, including the notes, on factors that include our financial condition, liquidity and results of operations, our business and prospects and their view of the general outlook for the economy generally and our industry specifically. Actions taken by the rating agencies can include maintaining, upgrading, downgrading or withdrawing the current rating of our debt securities or placing us on negative outlook for possible future downgrading. Downgrading or withdrawal of the credit rating of our debt securities or placing us on negative outlook for possible future downgrading would likely increase our cost of financing, limit our access to the capital markets and have a negative effect on the value of your notes.

USE OF PROCEEDS

We expect to receive approximately $495.6 million in net proceeds from the sale of the notes, after deducting underwriting discounts and commissions and other estimated expenses of this offering. Approximately $460 million of the net proceeds from the sale of the notes will be used to repay certain of our outstanding indebtedness, including the repayment in full of our $150 million variable interest rate term loan, $100 million of our outstanding 6.08% Senior Notes due July 26, 2014, and approximately $208.7 million of long term debt outstanding under our revolving credit agreement. Each of the variable interest rate term loan and revolving credit agreement bears interest based on the Prime Rate, the Federal Funds Rate, or LIBOR, depending upon the specific type of borrowing, plus an applicable margin based on our credit rating and other fees. The variable interest rate term loan matures on March 29, 2014, and at December 31, 2013, the interest rate on this facility was 1.17%. The revolving credit agreement matures on August 12, 2016, and at December 31, 2013, the interest rate on this facility was 1.12%. The balance of the proceeds of this offering will be used for general corporate purposes including capital expenditures, additions to working capital, and the repurchase of shares of our outstanding common stock.

CAPITALIZATION

The following table shows our cash and cash equivalents and our consolidated historical capitalization as of December 31, 2013 (i) on an actual cash basis and (ii) on an as-adjusted basis to give effect to the use of proceeds from the sale of the notes as described in “Use of Proceeds” above.

	December 31, 2013	
	Actual	**Adjusted**
	(in thousands)	
Cash	$5,831	$42,689
Current portion of long-term debt	250,000	—
Long-term debt	458,417	749,717
Stockholders’ equity:		
Preferred stock, $100 par value. 10 million shares authorized; none outstanding	—	—
Common stock, $0.01 par value. 1 billion shares authorized; 167,099,432 shares issued and 117,241,438 shares outstanding	1,671	1,671
Additional paid-in capital	226,595	226,595
Retained earnings	2,274,784	2,274,784
Treasury stock, at cost (49,857,994 shares)	(1,490,598)	(1,490,598)
Total stockholders’ equity	1,012,452	1,012,452
Total capitalization	$1,720,869	$ 1,762,169

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our historical ratios of earnings to fixed charges for the periods indicated.

	Year Ended December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
Ratio of earnings to fixed charges	18.17x	16.56x	12.98x	10.55x	7.94x

For purpose of calculating our ratios of earnings to fixed charges, earnings represent earnings from continuing operations before income taxes, excluding fixed charges. Fixed charges represent interest expense, amortization of costs related to indebtedness, and that portion of rental expense estimated to be the equivalent of interest. This information should be read in conjunction with the consolidated financial statements and the accompanying notes incorporated by reference in this prospectus supplement and the accompanying prospectus.

SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

The following table presents our selected historical financial data that have been derived from, and are qualified in their entirety by reference to, our audited historical consolidated financial statements and related notes. The information set forth in the following table is only a summary and should be read in conjunction with our audited historical consolidated financial statements and related notes, as well as the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2013, which are incorporated by reference in this prospectus supplement and the accompanying prospectus.

	December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
	(in millions, except per share data and working capital ratios)				
Earnings data (for the period ended):					
Operating revenues	$5,585	$5,055	$4,527	$3,793	$3,203
Operating income	577	530	444	348	248
Net earnings	342	310	257	200	136
Diluted earnings per share	2.87	2.59	2.11	1.56	1.05

Dividends per share	0.45	0.71	0.52	0.48	0.44
Balance sheet data (at end of period):					
Total assets	$2,819	$2,465	$2,267	$1,962	$1,857
Current portion of long-term debt	250	100	50	200	–
Total debt	708	685	749	654	565
Stockholders' equity	1,012	792	568	573	644
Working capital ratio	0.95	1.10	1.17	0.91	1.46

DESCRIPTION OF NOTES

The 2019 notes and the 2024 notes will each constitute a separate series of debt securities to be issued under the base indenture, dated as of September 20, 2010, among us, the initial guarantor and U.S. Bank National Association, as trustee. When we refer to the "indenture" in the following description, we are referring to the indenture as amended or supplemented.

The following description is only a summary of the material provisions of the notes, the guarantees and the indenture. You should read these documents in their entirety because they, and not this description, define your rights as holders of the notes. Unless the context requires otherwise, all references to "we", "us," "our" and "J.B. Hunt" in this section refer solely to J.B. Hunt Transport Services, Inc. and not to our subsidiaries.

The following description of the particular terms of each series of the notes and the guarantees offered hereby supplements the general description of debt securities and guarantees set forth in the accompanying prospectus.

General

The 2019 notes will be issued in an initial aggregate principal amount of $250,000,000 and the 2024 notes will be issued in an initial aggregate principal amount of $250,000,000. Unless redeemed or repurchased under the circumstances described below under "—Optional Redemption" or "—Change of Control Triggering Event," the 2019 notes will mature on March 15, 2019 and the 2024 notes will mature on March 15, 2024. The notes will be issued only in fully registered form without coupons in minimum denominations of $2,000 and integral multiples of $1,000 in excess thereof. The notes will not be entitled to any sinking fund. The notes will initially be fully and unconditionally guaranteed on a senior unsecured basis by J.B. Hunt Transport, Inc.

Interest on the 2019 notes will accrue at 2.400% per annum and interest on the 2024 notes will accrue at 3.850% per annum, in each case, from March 6, 2014, or from the most recent date to which interest has been paid or provided for. Interest on the 2019 notes will be payable semi-annually in arrears on March 15 and September 15 of each year, beginning on September 15, 2014, and interest on the 2024 notes will be payable semi-annually in arrears on March 15 and September 15 of each year, beginning on September 15, 2014, in each case to the persons in whose names the applicable notes are registered in the security register at the close of business on the March 1 or September 1 (whether or not a business day) immediately preceding the relevant interest payment date. Interest will be computed on the notes on the basis of a 360-day year of twelve 30-day months.

If any interest payment date, the maturity date or any earlier date of redemption or repurchase falls on a day that is not a business day, then the related payment will be made on the next succeeding business day without any interest or other payment in respect of the delay. The term "business day" means any day other than a Saturday, Sunday or other day on which banking institutions in The City of New York are authorized or obligated by law, regulation or executive order to close.

The indenture does not limit the amount of notes of either series that we may issue. We may from time to time, without notice to, or the consent of, the holders of the notes of either series, issue and sell additional debt securities ranking equally and ratably with the notes of such series in all respects (other than the issue price, the issue date and the payment of interest accruing prior to the issue date), *provided* that such debt securities are fungible with the previously issued notes of such series for U.S. federal income tax purposes. Any such additional debt securities shall be consolidated and form a single series with the notes of the applicable series for all purposes, including voting.

Ranking

The notes will be:

- unsecured and will rank equally with all existing and future senior unsecured debt of ours;
- effectively subordinated to all existing and future secured debt of ours to the extent of the value of the assets securing such debt; and
- structurally subordinated to all existing and future debt and other liabilities, including trade payables, and preferred equity of our non-guarantor subsidiaries (including subsidiaries of the initial guarantor and of any future additional guarantors).

As of December 31, 2013, we and the initial guarantor had secured debt outstanding of approximately $4.7 million and our non-guarantor subsidiaries had no outstanding debt or preferred equity.

The indenture does not limit our ability to incur indebtedness or other obligations that are equal in right of payment to the notes or the ability of our non-guarantor subsidiaries to incur debt, other liabilities or preferred equity that would rank senior to our equity interests or, if applicable, the equity interests of the initial guarantor and of any future additional guarantors in those subsidiaries and therefore be structurally senior to the notes with respect to the assets of those subsidiaries.

Guarantees

The notes will initially be fully and unconditionally guaranteed by our wholly owned subsidiary, J.B. Hunt Transport, Inc. (the “initial guarantor”). The notes will also be guaranteed in the future, by any subsidiary that becomes a borrower or guarantor of obligations under our revolving credit agreement (each, an “additional guarantor” and, together with the initial guarantor, the “guarantors”) but will not be guaranteed by any other current or future subsidiary of ours unless such subsidiary becomes a borrower or guarantor under our revolving credit agreement. If at any time while the notes are outstanding there are two or more guarantors of the notes, such guarantors will guarantee the notes on a joint and several basis.

The guarantees will be:

unsecured and will rank equally with all existing and future senior unsecured debt of the initial guarantor and any additional guarantor;

effectively subordinated to all existing and future secured debt of the initial guarantor and any additional guarantor to the extent of the value of the assets securing such debt; and

structurally subordinated to all existing and future debt and other liabilities, including trade payables, and preferred equity of our non-guarantor subsidiaries, including subsidiaries of the initial guarantor and of any additional guarantors.

As of December 31, 2013, the initial guarantor had secured debt outstanding of approximately $4.7 million and subsidiaries of the initial guarantor had no outstanding debt or preferred equity.

The indenture does not limit the ability of the initial guarantor (or any additional guarantor) to incur indebtedness or other obligations that are equal in right of payment to its guarantee or the ability of any subsidiary of the initial guarantor (or any additional guarantor) to incur debt, other liabilities or preferred equity that would rank senior to the equity interests of the initial guarantor (or such additional guarantor, as the case may be) in such subsidiary and therefore be structurally senior to the guarantee of the initial guarantor (or such additional guarantor, as the case may be) with respect to the assets of such subsidiary.

The obligations of the initial guarantor and any additional guarantors will be limited as necessary to prevent the guarantees from constituting a fraudulent conveyance under applicable law. If a guarantee is rendered voidable, it could be subordinated by a court to all other indebtedness (including other guarantees and contingent liabilities) of the applicable guarantor, and, depending on the amount of such indebtedness, such guarantor's liability on its guarantee could be reduced to zero. See "Risk Factors—Federal and state fraudulent transfer laws may permit a court to void any guarantee and, if that occurs, you may not receive any payments on such guarantee."

Each applicable guarantor of the notes, whether the initial guarantor or an additional guarantor, will automatically be released from its guarantee of the notes when such guarantor is not a borrower or guarantor under our revolving credit agreement or any refinancing or replacement thereof and is released or discharged from each guarantee of such guarantor with respect to borrowings under the revolving credit agreement, except discharges or releases by or as a result of payment under any such guarantee.

Optional Redemption

We may, at our option, at any time and from time to time, redeem the notes of either series, in whole or in part as to the particular series of notes, on not less than 30 nor more than 60 days' prior written notice mailed to the holders of the notes.

Each of the 2019 notes and, prior to December 15, 2023 (the date that is three months prior to the maturity date of the 2024 notes), the 2024 notes will be redeemable at a redemption price equal to the greater of

(1) 100% of the principal amount of the notes to be redeemed or

(2) the sum of the present values of the remaining scheduled payments of principal of and interest on the notes to be redeemed that would be due after the related redemption date but for such redemption (exclusive of unpaid interest, if any, accrued to such redemption date) discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus 15 basis points, in the case of the 2019 notes, and at the Treasury Rate plus 20 basis points, in the case of the 2024 notes,

plus unpaid interest, if any, accrued to such redemption date, subject to the rights of holders of notes on a record date to receive interest due on the related interest payment date. On or after December 15, 2023 (the date that is three months prior to the maturity date of the 2024 notes), the 2024 notes will be redeemable at a redemption price equal to 100% of the principal amount of the 2024 notes to be redeemed plus unpaid interest, if any, accrued to the redemption date.

"*Treasury Rate*" means, with respect to any redemption date, the rate per annum equal to the semi-annual equivalent yield to maturity (computed as of the second business day immediately preceding such redemption date) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

"*Comparable Treasury Issue*" means the United States Treasury security selected by an Independent Investment Banker that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the notes to be redeemed.

"*Independent Investment Banker*" means one of the Reference Treasury Dealers appointed by us.

"*Comparable Treasury Price*" means, with respect to any redemption date, (1) the average of the Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest of such Reference Treasury Dealer Quotations, or (2) if the trustee obtains fewer than five such Reference Treasury Dealer Quotations, the average of all Reference Treasury Dealer Quotations obtained.

"*Reference Treasury Dealer*" means each of J.P. Morgan Securities LLC, Goldman, Sachs & Co. and Morgan Stanley & Co. LLC or their respective affiliates which are Primary Treasury Dealers (as defined below) and two other nationally recognized investment banking firms that are Primary Treasury Dealers specified from time to time by us, except that if any of the foregoing ceases to be a primary U.S. government securities dealer in The City of New York (a "Primary Treasury Dealer"), we are required to designate as a substitute another nationally recognized investment banking firm, or an affiliate thereof, that is a Primary Treasury Dealer.

"*Reference Treasury Dealer Quotations*" means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the trustee, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the trustee by such Reference Treasury Dealer as of 3:30 p.m., New York City time, on the third business day preceding such redemption date.

On and after any redemption date, interest will cease to accrue on the notes called for redemption. Prior to any redemption date, we are required to deposit with a paying agent money sufficient to pay the redemption price of the notes to be redeemed on such date. If we are redeeming less than all the notes of a series, the trustee must select the notes of such series to be redeemed by such method as the trustee deems fair and appropriate in accordance with methods generally used at the time of selection by fiduciaries in similar circumstances.

Change of Control Triggering Event

Upon the occurrence of a Change of Control Triggering Event, unless we have exercised our option to redeem the particular series of notes in whole as described under "—Optional Redemption," each holder of notes will have the right to require us to repurchase all or a portion of such holder's notes pursuant to the offer described below (the "Change of Control Offer") at a repurchase price equal to 101% of the principal amount thereof plus unpaid interest, if any, accrued to the repurchase date (the "Change of Control Repurchase Price"), subject to the rights of holders of notes on a record date to receive interest due on the related interest payment date.

Within 30 days following the occurrence of the Change of Control Triggering Event, or, at our option, prior to any Change of Control but after the public announcement of the pending Change of Control, we will be required to send, by first class mail, a written notice to each holder of notes, with a copy to the trustee, which notice will govern the terms of the Change of Control Offer. Such notice will state, among other things, the repurchase date, which must be no earlier than 30 days nor later than 60 days from the date such notice is mailed, other than as may be required by law (the "Change of Control Repurchase Date"). The notice, if mailed prior to the date of consummation of the Change of Control, will state that the Change of Control Offer is conditioned on the Change of Control being consummated on or prior to the Change of Control Repurchase Date.

On the Change of Control Repurchase Date, we will, to the extent lawful:

accept or cause a third party to accept for repurchase all notes or portions of notes properly tendered pursuant to the Change of Control Offer;

deposit or cause a third party to deposit with the paying agent an amount equal to the Change of Control Repurchase Price in respect of all notes or portions of notes properly tendered; and

deliver or cause to be delivered to the trustee the notes properly accepted together with an officers' certificate stating the aggregate principal amount of notes or portions of notes being repurchased and that all conditions precedent to the Change of Control Offer and to the repurchase by us of notes pursuant to the Change of Control Offer have been complied with.

We will not be required to make a Change of Control Offer with respect to the notes if a third party makes such an offer in the manner, at the times and otherwise in compliance with the requirements for such an offer made by us and such third party purchases all the notes properly tendered and not withdrawn under its offer.

We will comply in all material respects with the requirements of Rule 14e-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and any other securities laws and regulations thereunder to the extent those securities laws and regulations are applicable in connection with the repurchase of the notes as a result of a Change of Control Triggering Event. To the extent that the provisions of any such securities laws or regulations conflict with the Change of Control Offer provisions of the notes, we will comply with those securities laws and regulations and will not be deemed to have breached our obligations under the Change of Control Offer provisions of the notes by virtue of any such conflict.

For purposes of the foregoing discussion of a Change of Control Offer, the following definitions are applicable:

"Change of Control" means the occurrence of any of the following after the date of the prospectus supplement:

(1) the direct or indirect sale, lease, transfer, conveyance or other disposition (other than by way of merger or consolidation), in one or a series of related transactions, of all or substantially all of the assets of J.B. Hunt and its subsidiaries taken as a whole to any "person" or "group" (as those terms are used in Section 13(d)(3) of the Exchange Act) other than to J.B. Hunt or one of its subsidiaries;

(2) the consummation of any transaction (including, without limitation, any merger or consolidation) the result of which is that any "person" or "group" (as those terms are used in Section 13(d)(3) of the Exchange Act) becomes the "beneficial owner" (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, of our Voting Stock representing more than 50% of the voting power of our outstanding Voting Stock;

(3) we consolidate with, or merge with or into, any person (as that term is used in Section 13(d)(3) of the Exchange Act), or any person consolidates with, or merges with or into, us, in any such event pursuant to a transaction in which any of our outstanding Voting Stock or Voting Stock of such other person is converted into or exchanged for cash, securities or other property, other than any such transaction where our Voting Stock outstanding immediately prior to such transaction constitutes, or is converted into or exchanged for, Voting Stock representing more than 50% of the voting power of the Voting Stock of the surviving person immediately after giving effect to such transaction;

(4) the first day on which a majority of the members of our board of directors are not Continuing Directors; or

(5) the adoption of a plan relating to our liquidation, dissolution or winding up.

"*Change of Control Triggering Event*" means the notes cease to be rated Investment Grade by each of the Rating Agencies on any date during the period (the "Trigger Period") commencing 60 days prior to the first public announcement by us of any Change of Control (or pending Change of Control) and ending 60 days following consummation of such Change of Control (which Trigger Period will be extended following consummation of a Change of Control for so long as any Rating Agency has publicly announced that it is considering a possible ratings change). If a Rating Agency is not providing a rating for the notes at the commencement of any Trigger Period, the notes will be deemed to have ceased to be rated Investment Grade by such Rating Agency during that Trigger Period.

Notwithstanding the foregoing, no Change of Control Triggering Event will be deemed to have occurred in connection with any particular Change of Control unless and until such Change of Control has actually been consummated.

"Continuing Directors" means, as of any date of determination, any member of our board of directors who (1) was a member of our board of directors on the date of the prospectus supplement; or (2) was nominated for election or elected to our board of directors with the approval of a majority of the Continuing Directors who were members of our board of directors at the time of such nomination or election (either by a specific vote or by approval of our proxy statement in which such member was named as a nominee for election as a director, without objection to such nomination).

"*Investment Grade*" means a rating of Baa3 or better by Moody's (or its equivalent under any successor rating category of Moody's) and a rating of BBB- or better by S&P (or its equivalent under any successor rating category of S&P), and the equivalent investment grade credit rating from any replacement rating agency or rating agencies selected by us under the circumstances permitting us to select a replacement agency and in the manner for selecting a replacement agency, in each case as set forth in the definition of "Rating Agency."

"*Moody's*" means Moody's Investors Service, Inc., a subsidiary of Moody's Corporation, and its successors.

"*Rating Agency*" means each of Moody's and S&P; *provided*, that if either Moody's or S&P ceases to provide rating services to issuers or investors, we may appoint another "nationally recognized statistical rating organization" within the meaning of Rule 15c3-1(c)(2)(vi)(F) under the Exchange Act as a replacement for such Rating Agency, *provided* that we shall give written notice of such appointment to the trustee.

"*S&P*" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., and its successors.

"*Voting Stock*" of any specified person (as that term is used in Section 13(d) of the Exchange Act) as of any date means the capital stock of such person that, at such date, is entitled to vote generally in the election of the board of directors of such person.

The definition of Change of Control includes a phrase relating to the direct or indirect sale, lease, transfer, conveyance or other disposition of "all or substantially all" of the assets of J.B. Hunt and its subsidiaries taken as a whole. Although there is a limited body of case law interpreting the phrase "substantially all," there is no precise, established definition of the phrase under applicable law. Accordingly, the applicability of the requirement that we offer to repurchase the notes as a result of a sale, lease, transfer, conveyance or other disposition of less than all of the assets of J.B. Hunt and its subsidiaries taken as a whole to another person or group may be uncertain.

Covenants

The indenture contains certain covenants, including covenants that restrict our ability, and our ability to permit our subsidiaries, to create or incur debt secured by liens and to engage in certain sale and leaseback transactions. See "Description of Debt Securities—Covenants—Restrictions on secured debt" and "Description of Debt Securities—Covenants—Restrictions on sale and leaseback transactions" in the accompanying prospectus.

The provisions of the indenture described under "Description of Debt Securities—Discharge, defeasance, and covenant defeasance—Defeasance and covenant defeasance will be applicable to the notes.

Events of Default

The events of default with respect to the notes are described in the accompanying prospectus under "Description of Debt Securities—Events of default."

Book-Entry

We will issue the notes only in book-entry form — *i.e.*, as global notes registered in the name of The Depository Trust Company, New York, New York, or its nominee. The sale of the notes will settle in immediately available funds through DTC. You will not be permitted to withdraw the notes from DTC except in the limited situations described in the accompanying prospectus under "Description of Debt Securities—Book-entry debt securities."

Investors may hold interests in a global note through organizations that participate, directly or indirectly, in the DTC system. See "Description of Debt Securities—Book entry debt securities" in the accompanying prospectus for additional information about indirect ownership of interests in the notes.

Trustee

U.S. Bank National Association is the trustee under the indenture. Initially, the trustee will also act as the paying agent, registrar and custodian for the notes. In the ordinary course of their businesses, affiliates of the trustee have engaged in commercial banking transactions with us, and may in the future engage in commercial banking and other transactions with us.

CERTAIN MATERIAL UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following is a summary of certain of the material United States ("U.S.") federal income tax consequences of the acquisition, ownership and disposition of the notes. Unless otherwise stated, this summary deals only with initial holders that purchase notes in this offering at the price shown on the cover of this prospectus supplement. This summary also only addresses holders who hold notes as capital assets.

As used herein, "U.S. holders" are any beneficial owners of the notes, that are, for U.S. federal income tax purposes:

(i) citizens or residents of the U.S.,

(ii) corporations (or other entities treated as corporations for U.S. federal income tax purposes) created or organized in, or under the laws of, the U.S., or of any State (or the District of Columbia),

(iii) estates if the income of such estate is subject to U.S. federal income taxation regardless of the source of such income, or

(iv) trusts if (a) a court within the U.S. is able to exercise primary supervision over the administration of the trust and one or more U.S. fiduciaries have the authority to control all substantial decisions of the trust or (b) the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person.

As used herein, "non-U.S. holders" are beneficial owners of the notes, other than partnerships, that are not U.S. holders.

If a partnership (or any entity treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of the notes, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Partnerships and partners in such partnerships should consult their tax advisors about the U.S. federal income tax consequences of acquiring, owning and disposing of the notes.

This summary does not describe all of the U.S. federal income tax consequences that may be relevant to a holder in light of such holder's particular circumstances. Special rules apply, for example, to:

- some financial institutions;
- insurance companies;
- tax-exempt investors;
- brokers or dealers in securities or currencies;
- persons holding securities as part of a hedge, straddle, "synthetic security" or other integrated transaction;
- U.S. holders whose functional currency is not the U.S. dollar;

U.S. expatriates;

foreign corporations that are classified as "passive foreign investment companies" or "controlled foreign corporations" for U.S. federal income tax purposes; or

persons subject to the alternative minimum tax.

This discussion does not address the tax consequences to non-U.S. holders that are subject to U.S. federal income tax on a net basis on income realized with respect to the notes because such income is effectively connected with the conduct of a U.S. trade or business. Such holders are generally taxed in a manner similar to U.S. holders; however, certain special rules apply. Further, this discussion does not include any description of any federal estate or gift tax consequences or the tax laws of any state, local government or foreign government that may be applicable to the notes.

This summary is based on the Internal Revenue Code of 1986, as amended (the "Code"), the Treasury Regulations promulgated thereunder and administrative and judicial interpretations thereof, all as of the date hereof, and all of which are subject to change or differing interpretations, possibly on a retroactive basis.

You should consult with your own tax advisor regarding the application of U.S. federal tax laws to your particular situation with respect to the acquisition, ownership and disposition of the notes, as well as any tax consequences arising under the laws of any state, local or foreign taxing authority.

Taxation of U.S. Holders

In certain circumstances, the timing and amount of payments otherwise due on the notes may differ from the scheduled payments on the notes (e.g., see "*Description of Notes—Optional Redemption*" and "*Description of Notes—Change of Control Triggering Event*"). Because we are obligated to make such payments under certain circumstances, the notes may be subject to special rules under the Treasury Regulations that are applicable to debt instruments that provide for one or more contingent payments. If the notes were deemed to be contingent payment debt instruments, a U.S. holder might be required to accrue income on the U.S. holder's notes in excess of stated interest, and would be required to treat as ordinary income, rather than capital gain, any gain realized on the taxable disposition of the notes. Under the Treasury Regulations, however, the special rules applicable to contingent payment debt instruments will not apply if, as of the issue date, the contingencies are either "remote" or "incidental." We intend to take the position (and this discussion assumes) that such payments are remote or incidental contingencies.

Our determination that such payments are remote or incidental contingencies for these purposes is binding on each holder, unless such holder discloses in the proper manner to the Internal Revenue Service (“IRS”) that it is taking a different position. Our determination is not, however, binding on the IRS, and, if the IRS were to challenge this determination, the tax consequences to a holder could differ materially and adversely from those discussed herein. The remainder of this discussion assumes that the notes are not subject to the rules applicable to contingent payment debt instruments.

Interest income. Payments of stated interest on the notes will be taxable to a U.S. holder as ordinary interest income at the time such payments are accrued or received in accordance with the U.S. holder’s regular method of tax accounting for U.S. federal income tax purposes.

Amortizable bond premium. A U.S. holder who purchases a note for an amount greater than its principal amount will be treated as acquiring the note with amortizable bond premium. For this purpose, the purchase price of a note will not include amounts paid in respect of pre-issuance accrued interest. If a U.S. holder acquires a note with amortizable bond premium, the U.S. holder may elect to amortize the premium, under a constant yield method, over the term of the note, which will reduce the amount of interest income required to be included in the U.S. holder’s gross income. An election to amortize bond premium applies to all taxable debt instruments then owned by the U.S. holder and may be revoked only with the consent of the IRS.

Original Issue Discount. If the state redemption price at maturity of a note exceeds the issue price of such note by more than a *de minimis* amount (as explained below), such note will be deemed to have original issue discount ("OID"). The "issue price" of a note will be the first price at which a substantial amount of the notes are sold to the public (i.e., excluding sales to any agent, wholesaler or similar persons) and the "stated redemption price at maturity" of a note is its principal amount. However, a note will not be deemed to have OID if its stated redemption price at maturity exceeds its issue price by less than a *de minimis* amount equal to one-fourth of one percent (0.25%) of its stated redemption price at maturity, multiplied by the number of full years to its maturity. If a note meets this *de minimis* exception, a U.S. holder of that note is generally required to include the *de minimis* OID amount in income (as capital gain), as principal payments are made on the note, unless the U.S. holder elects to apply the constant yield method which otherwise applies to an instrument with more than *de minimis* OID. If the OID on a note is more than *de minimis*, a U.S. holder will be required to include the OID in income for U.S. federal income tax purposes as it accrues, in accordance with a constant yield method based on interest compounding and in advance of the cash payments attributable to the income. Since the issue price of the notes is expected to be at par or within the *de minimis* exception, it is expected, and the rest of this disclosure assumes, that the notes should not be considered to have OID.

Sale, exchange, redemption or retirement of notes. Upon the sale, exchange, redemption, retirement or other taxable disposition of a note, a U.S. holder will generally recognize taxable gain or loss equal to the difference, if any, between (i) the sum of the cash plus the fair market value of all other property received on the disposition and (ii) the U.S. holder's adjusted tax basis in such note. A U.S. holder's adjusted tax basis in the note generally will be the initial purchase price paid therefor, increased by any *de minimis* OID previously included in income under the election described above, and reduced by any bond premium amortized by the U.S. holder. For these purposes, the amount realized on the disposition of the note does not include any amount attributable to accrued but unpaid interest. Amounts attributable to accrued but unpaid interest are treated as interest as described under "– *Interest Income*" above.

Gain or loss recognized on the sale, exchange, redemption, retirement or other disposition of a note will generally be capital gain or loss and will be long-term capital gain or loss if, at the time of the disposition, the note has been held for more than one (1) year. Long-term capital gains of non-corporate U.S. holders are eligible for reduced rates of taxation. For corporate U.S. holders, all capital gains are currently subject to U.S. federal income tax at the same rate as ordinary income. The deductibility of any capital losses is subject to certain limitations.

Information reporting and backup withholding. In general, information reporting requirements will apply to payments of principal and interest on the notes and payments of the proceeds of the sale, exchange, redemption, retirement or other disposition of the notes. Backup withholding may apply to such payments if the U.S. holder fails to comply with certain identification requirements or otherwise fails to establish an exemption from backup withholding. Backup withholding is currently imposed at a rate of 28%. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a U.S. holder will be allowed as a credit against such holder's U.S. federal income tax liability and may entitle the U.S. holder to a refund, provided that the U.S. holder timely provides the required information to the IRS.

Taxation of Non-U.S. Holders

Non-U.S. holders should consult with their own tax advisors to determine the effect of U.S. federal, state and local and foreign tax laws, as well as income tax treaties, with regard to an investment in the notes, including any reporting requirements.

Interest income. Subject to the discussion below concerning backup withholding, interest paid on a note to a non-U.S. holder that is not engaged in a trade or business in the U.S. generally will not be subject to U.S. federal income or withholding tax provided that:

(i) the non-U.S. holder does not actually or constructively own 10% or more of the total combined voting power of all classes of our stock entitled to vote;

(ii) the non-U.S. holder is not a controlled foreign corporation that is related to us actually or constructively through stock ownership;

(iii) the non-U.S. holder is not a bank which acquired the note in consideration for an extension of credit made pursuant to a loan agreement entered into in the ordinary course of business; and

(iv) either (a) the non-U.S. holder certifies to the payor or the payor's agent, under penalties of perjury, that it is not a U.S. person and provides its name, address, and certain other information on a properly executed IRS Form W-8BEN (or a suitable substitute form) or (b) a securities clearing organization, bank or other financial institution that holds customer securities in the ordinary course of its trade or business and holds the notes in such capacity, certifies to the payor or the payor's agent, under penalties of perjury, that such a statement has been received from the beneficial owner by it or by a financial institution between it and the beneficial owner and, when required, furnishes the payor or the payor's agent with a copy thereof. (The applicable Treasury Regulations also provide alternative methods for satisfying the certification requirements of this clause (iv).)

Interest paid to a non-U.S. holder not satisfying the conditions described above will be subject to U.S. withholding tax at a rate of 30%, unless an income tax treaty applies to reduce or eliminate withholding and the non-U.S. holder provides us with a properly executed IRS Form W-8BEN (or suitable substitute form) claiming the exemption or reduction in withholding.

If a non-U.S. holder holds the note through certain foreign intermediaries or partnerships, such non-U.S. holder and the foreign intermediary or partnership may be required to satisfy certification requirements under applicable Treasury Regulations.

Except to the extent that an applicable income tax treaty otherwise provides, a non-U.S. holder generally will be taxed with respect to interest in the same manner as a U.S. holder if such income is effectively connected with a U.S. trade or business of the non-U.S. holder. Effectively connected income received or accrued by a corporate non-U.S. holder may also, under certain circumstances, be subject to an additional "branch profits" tax at a 30% rate (or, if applicable, at a lower tax rate specified by an applicable income tax treaty). Even though such effectively connected income is subject to income tax, and may be subject to the branch profits tax, it is not subject to withholding tax if the non-U.S. holder delivers a properly executed IRS Form W-8ECI (or successor form) to the payor or the payor's agent.

Sale, exchange, redemption or retirement of notes. Subject to the discussion below concerning backup withholding, a non-U.S. holder generally will not be subject to U.S. federal income tax on any gain realized on the sale, exchange, redemption, retirement or other disposition of a note unless (i) the gain is effectively connected with a U.S. trade or business of the non-U.S. holder, (ii) in the case of a non-U.S. holder who is an individual, such non-U.S. holder is present in the U.S. for a period or periods aggregating 183 days or more during the taxable year of the disposition and certain other conditions are met, or (iii) the gain represents accrued but unpaid interest not previously included in income, in which case the rules regarding interest income would apply.

Except to the extent that an applicable income tax treaty otherwise provides, if an individual non-U.S. holder falls under clause (i) above, such individual generally will be taxed on the net gain derived from a sale in the same manner as a U.S. holder. If an individual non-U.S. holder falls under clause (ii) above, such individual generally will be subject to a 30% tax on the gain derived from a sale, which may be offset by certain U.S.-related capital losses (notwithstanding the fact that such individual is not considered a resident of the U.S.). Individual non-U.S. holders who have spent (or expect to spend) 183 days or more in the U.S. in the taxable year in which they contemplate a disposition of notes are urged to consult their tax advisors as to the tax consequences of such sale. If a non-U.S. holder that is a foreign corporation falls under clause (i), it generally will be taxed on the net gain derived from a sale in the same manner as a U.S. holder and, in addition, may be subject to the branch profits tax on such effectively connected income at a 30% rate (or such lower rate as may be specified by an applicable income tax treaty).

Information reporting and backup withholding. Generally, we must report annually to the IRS and to each non-U.S. holder the amount of interest paid to such non-U.S. holder and the tax withheld with respect to those payments (if any). Copies of the information returns reporting such amounts and any withholding may also be made available to the tax authorities in the country in which the non-U.S. holder resides under the provisions of an applicable income tax treaty. U.S. backup withholding will not apply to payments on the notes to a non-U.S. holder if the requirements described in clause (iv) of "—*Interest income*" above are satisfied with respect to the non-U.S. holder, unless the payor has actual knowledge or reason to know that the holder is a U.S. person.

Information reporting requirements and backup withholding will not apply to any payment of the proceeds of a sale of notes effected outside the U.S. by a foreign office of a “broker” as defined in applicable Treasury Regulations (absent actual knowledge or reason to know that the payee is a U.S. person), unless such broker (i) is a U.S. person as defined in the Code, (ii) is a foreign person that derives 50% or more of its gross income for certain periods from the conduct of a trade or business in the U.S., (iii) is a controlled foreign corporation for U.S. federal income tax purposes or (iv) is a foreign partnership with certain connections to the U.S. Payment of the proceeds of any such sale effected outside the U.S. by a foreign office of any broker that is described in the preceding sentence may be subject to information reporting unless such broker has documentary evidence in its records that the beneficial owner is a non-U.S. holder and certain other conditions are met, or the beneficial owner otherwise establishes an exemption. Payment of the proceeds of any such sale to or through the U.S. office of a broker is subject to information reporting and backup withholding requirements unless the beneficial owner satisfies the requirements described in clause (iv) of “*—Interest Income and Original Issue Discount*” above and certain other conditions are met, or the beneficial owner otherwise establishes an exemption.

Backup withholding is not an additional tax. Any amounts withheld from a payment to a non-U.S. holder under the backup withholding rules will be allowed as a credit against the non-U.S. holder’s U.S. federal income tax liability and may entitle the non-U.S. holder to a refund, provided that the non-U.S. holder timely provides the required information to the IRS. Non-U.S. holders should consult their tax advisors regarding the application of information reporting and backup withholding in their particular situations, the availability of an exemption from backup withholding and the procedure for obtaining such an exemption, if available.

Medicare Tax on Investment Income

A 3.8% Medicare tax is generally imposed with respect to “net investment income” above a certain threshold of certain U.S. citizens and residents, and on the undistributed “net investment income” of certain estates and trusts. Among other things, net investment income generally includes gross income from interest on, and net gains from the disposition, of the notes, less certain deductions. Holders are urged to consult their tax advisors with respect to the tax consequences of this legislation.

The U.S. federal income tax discussion set forth above is included for general information only, is not relevant to all prospective holders, and is not tax advice. The discussion may not be applicable depending upon a holder’s particular situation. Prospective holders should consult their tax advisors with respect to the tax consequences to them of the acquisition, ownership and disposition of the notes, including the tax consequences under state, local, foreign and other tax laws and the possible effects of changes in U.S. federal income or other tax laws.

TO ENSURE COMPLIANCE WITH INTERNAL REVENUE SERVICE CIRCULAR 230, HOLDERS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF FEDERAL TAX ISSUES IN THIS PROSPECTUS

IS NOT INTENDED OR WRITTEN BY J.B. HUNT TO BE RELIED UPON, AND CANNOT BE RELIED UPON BY HOLDERS FOR THE PURPOSES OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON HOLDERS UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS AND THE NOTES ADDRESSED HEREIN; AND (C) HOLDERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

UNDERWRITING

Subject to the terms and conditions of the underwriting agreement, the underwriters named below, through their representatives J.P. Morgan Securities LLC, Goldman, Sachs & Co. and Morgan Stanley & Co. LLC, have severally agreed to purchase from us the following respective principal amounts of notes listed opposite their name below at the public offering price less the underwriting discounts and commissions set forth on the cover page of this prospectus supplement:

Underwriters	**Principal Amount of 2019 Notes**	**Principal Amount of 2024 Notes**
J.P. Morgan Securities LLC	$80,000,000	$80,000,000
Goldman, Sachs & Co.	72,500,000	72,500,000
Morgan Stanley & Co. LLC	72,500,000	72,500,000
SunTrust Robinson Humphrey, Inc.	12,500,000	12,500,000
U.S. Bancorp Investments, Inc.	12,500,000	12,500,000
Total	$250,000,000	$250,000,000

The underwriting agreement provides that the obligations of the several underwriters to purchase the notes offered hereby are subject to certain conditions precedent and that the underwriters will purchase all of the notes offered by this prospectus supplement if any of these notes are purchased.

We have been advised by the representatives of the underwriters that the underwriters propose to offer the notes to the public at the public offering price set forth on the cover page of this prospectus supplement and to dealers at a price that represents a concession not in excess of 0.350% of the principal amount of the 2019 notes and of 0.400% of the principal amount of the 2024 notes. The underwriters may allow, and these dealers may re-allow, a concession of not more than 0.250% of the principal amount of the 2019 notes and 0.250% of the principal amount of the 2024 notes to other dealers. After the initial public offering, representatives of the underwriters may change the offering price and other selling terms.

In addition, we estimate that our share of the total expenses of this offering, excluding underwriting discounts and commissions, will be approximately $960,000.

We have agreed to indemnify the underwriters against some specified types of liabilities, including liabilities under the Securities Act of 1933, as amended, and to contribute to payments the underwriters may be required to make in respect of any of these liabilities.

Each series of the notes is a new issue of securities as to which there is currently no market. We do not intend to apply for listing of the notes on any national securities exchange or for quotation of the notes on any automated dealer quotation system. We have been advised by the underwriters that they presently intend to make a market in the notes. However, they are under no obligation to do so and may discontinue any market-making activities at any time without notice to, or the consent of, noteholders. We cannot assure you that an active market for the notes will develop or, if it develops, will continue or be liquid. If an active trading market for the notes does not develop or continue, the market price and liquidity of the notes will be negatively affected.

In connection with this offering, the underwriters may purchase and sell the notes in the open market. These transactions may include short sales, purchases to cover positions created by short sales and stabilizing transactions.

Short sales involve the sale by the underwriters of a greater principal amount of notes than they are required to purchase in this offering, which creates a short position for the underwriters. The underwriters may close out any short position by purchasing notes in the open market. A short position is more likely to be created if underwriters are concerned that there may be downward pressure on the price of the notes in the open market prior to the completion of this offering.

Stabilizing transactions consist of various bids for or purchases of the notes made by the underwriters in the open market prior to the completion of this offering.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or slowing a decline in the market price of the notes. Additionally, these purchases may stabilize, maintain or otherwise affect the market price of the notes. As a result, the price of the notes may be higher than the price that might otherwise exist in the open market. These transactions may be effected in the over-the-counter market or otherwise.

We have agreed not to offer, sell, contract to sell or otherwise dispose of any securities of the company (or guaranteed by the company) or the initial guarantor (or guaranteed by the initial guarantor) that are substantially similar to the notes from the date of this prospectus supplement until 90 days after the closing of this offering without the prior written consent of each of J.P. Morgan Securities LLC, Goldman, Sachs & Co. and Morgan Stanley & Co. LLC.

Other Relationships

The underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities. Certain of the underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for the issuer, for which they received or will receive customary fees and expenses.

Affiliates of certain of the underwriters are parties to and lenders under our revolving credit agreement. This credit agreement was negotiated on an arms-length basis and contains customary terms pursuant to which the lenders receive customary fees. A portion of the net proceeds of this offering will be used to reduce our indebtedness to such lenders under our revolving credit agreement. No affiliate of any of the underwriters will receive 5% or more of the net proceeds from this offering.

In the ordinary course of their respective various business activities, the underwriters and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and such investment and securities activities may involve securities and/or instruments of ours. The underwriters and their respective affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

Selling Restrictions

Notice to Prospective Investors in the EEA

This prospectus supplement and the accompanying prospectus is not a prospectus for the purposes of the Prospectus Directive (as defined below).

In relation to each Member State of the European Economic Area (the "EEA") which has implemented the Prospectus Directive (each, a "Relevant Member State") an offer to the public of any notes which are the subject of the offering contemplated by this prospectus supplement (the "Notes") may not be made in that Relevant Member State except that an offer to the public in that Relevant Member State of any Notes may be made under the following exemptions under the Prospectus Directive, with the effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State:

(a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provisions of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive) as permitted under the Prospective Directive subject to obtaining the prior consent of the relevant underwriter or underwriters nominated by JBHT for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Notes shall result in a requirement for the publication by JBHT or any underwriter of a prospectus pursuant to Article 3 of the Prospectus Directive.

Any person making or intending to make any offer of Notes within the EEA should only do so in circumstances in which no obligation arises for us or any of the underwriters to produce a prospectus for such offer. Neither we nor the underwriters have authorized, nor do they authorize, the making of any offer of Notes through any financial intermediary, other than offers made by the underwriters which constitute the final offering of Notes contemplated in this prospectus supplement.

For the purposes of this provision and the buyer's representation below, the expression an "offer to the public" in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and any Notes to be offered so as to enable an investor to decide to purchase or subscribe any Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression "2010 PD Amending Directive" means Directive 2010/73/EU.

Each person in a Relevant Member State who receives any communication in respect of, or who acquires, any Notes will be deemed to have represented, warranted and agreed to and with JBHT and each underwriter that:

(A) it is a "qualified investor" within the meaning of the law in that Relevant Member State implementing Article 2(1)(e) of the Prospectus Directive; and

(B) in the case of any Notes acquired by it as a financial intermediary, as that term is used in Article 3(2) of the Prospectus Directive, (i) the Notes acquired by it in the offering have not been acquired on behalf of, nor have they been acquired with a view to their offer or resale to, persons in any Relevant Member State other than "qualified investors" (as defined in the Prospectus Directive), or in circumstances in which the prior consent of the representatives have been given to the offer or resale; or (ii) where Notes have been acquired by it on behalf of persons in any Relevant Member State other than qualified investors, the offer of those Notes to it is not treated under the Prospectus Directive as having been made to such persons.

Notice to Prospective Investors in the United Kingdom

Any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the "FSMA")), in connection with the issue or sale of the Notes, has only been, and will only be, communicated or caused to be communicated in circumstances in which Section 21(1) of the FSMA does not apply to JBHT or the initial guarantor.

Anything done in relation to the Notes in, from or otherwise involving the United Kingdom, has been, and may only be done, in compliance with all applicable provisions of the FSMA.

This prospectus supplement is being distributed only to, and is directed only at, and any offer subsequently made may only be directed at persons who are “qualified investors” (as defined in the Prospectus Directive) and (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the “Order”) or (ii) high net worth companies or persons to whom it may otherwise be lawfully communicated falling within Article 49(2)(a) to (d) of the Order or (iii) other persons to whom it may be lawfully communicated in accordance with the Order (all such persons together being referred to as “relevant persons”). This prospectus supplement must not be acted on or relied on in the United Kingdom by persons who are not relevant persons. In the United Kingdom, any investment or investment activity to which this prospectus supplement relates is only available to, and will be engaged in with, relevant persons.

LEGAL MATTERS

The validity of the notes and guarantees will be passed upon for us by Mitchell, Williams, Selig, Gates & Woodyard, P.L.L.C., Little Rock, Arkansas. Sidley Austin LLP, New York, New York, will act as counsel to the underwriters.

PROSPECTUS

J.B. HUNT TRANSPORT SERVICES, INC.

Debt Securities

J.B. HUNT TRANSPORT, INC.

Guarantees of Debt Securities

J.B. Hunt Transport Services, Inc. may offer and sell from time to time, in one or more offerings, debt securities at prices and on terms determined at the time of any such offering. The debt securities may be guaranteed by J.B. Hunt Transport, Inc., a wholly owned subsidiary of J.B. Hunt Transport Services, Inc. We may offer and sell debt securities to or through one or more underwriters, dealers and agents, or directly to purchasers, on a continuous or delayed basis.

Each time debt securities are sold, we will provide one or more supplements to this prospectus that will contain additional information about the specific offering and the terms of the securities being offered. The supplements may also add, update or change information contained in this prospectus. You should carefully read this prospectus and any accompanying prospectus supplement before you invest in any of our securities.

Investing in the securities involves risks. See "Risk Factors" on page 4 of this prospectus.

Neither the Securities and Exchange Commission nor any state or other securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus may not be used to sell securities unless accompanied by a prospectus supplement.

This prospectus is dated February 27, 2014

You should rely only on the information contained in or incorporated by reference in this prospectus, any accompanying prospectus supplement or any free writing prospectus filed by us with the Securities and Exchange Commission, or the SEC. We have not authorized anyone to provide you with any different or additional information, and if anyone provides you such information you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should not assume that the information contained in this prospectus, any accompanying prospectus supplement or any such free writing prospectus is accurate as of any date other than the date on the front of such document. Any information incorporated by reference in this prospectus, any accompanying prospectus supplement or any such free writing prospectus is accurate only as of the date of the document incorporated by reference. Our business, financial condition, liquidity, results of operations and prospects may have changed since those dates.

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ABOUT THIS PROSPECTUS

This prospectus is part of an automatic shelf registration statement that we filed with the SEC, as a "well-known seasoned issuer" as defined in Rule 405 under the Securities Act of 1933, as amended, or the Securities Act. By using an automatic shelf registration statement, we may, at any time and from time to time, sell debt securities, which may or may not be guaranteed, under this prospectus in one or more offerings in an unlimited amount. As allowed by the SEC rules, this prospectus does not contain all of the information included in the registration statement. For further information, we refer to the registration statement, including its exhibits. Statements contained in this prospectus about the provisions or contents of any agreement or other document are not necessarily complete. If the SEC's rules and regulations require that an agreement or document be filed as an exhibit to the registration statement, please see that agreement or document for a complete description thereof.

This prospectus provides you with a general description of the securities we may offer. Each time we use this prospectus to offer securities, we will provide you with a prospectus supplement that will describe the specific amounts, prices and terms of the debt securities being offered. The prospectus supplement may also add, update or change information contained in this prospectus. Therefore, if there is any inconsistency between the information in this prospectus and the prospectus supplement, you should rely on the information in the prospectus supplement.

To understand the terms of our securities, you should carefully read this document and the applicable prospectus supplement. Together, they provide the specific terms of the securities we are offering. You should also read the documents we have referred you to under "Where You Can Find More Information" below for information on our company, the risks we face and our financial statements. The registration statement and exhibits can be read at the SEC's website or at the SEC as described under "Where You Can Find More Information."

References in this prospectus to "JBHT Services," the "Company," "we," "us" and "our" refer to J.B. Hunt Transport Services, Inc. and its subsidiaries, unless otherwise specified or unless the context otherwise requires. References to "Transport" refer to J.B. Hunt Transport, Inc., a wholly-owned subsidiary of JBHT Services.

References herein to "$," "dollars" and "U.S. dollars" are to United States dollars. Financial data included or incorporated by reference herein have been presented in accordance with accounting principles generally accepted in the United States of America.

The phrase "this prospectus" refers to this prospectus and any applicable prospectus supplement, unless the context otherwise requires.

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WHERE YOU CAN FIND MORE INFORMATION

We are subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and, accordingly, we file annual, quarterly and current reports, proxy statements and other information with the SEC. Our SEC filings are available at the SEC's website (*http://www.sec.gov*). You may also read any document we file with the SEC at its Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may also obtain copies of the documents at prescribed rates from the Public Reference Room of the SEC. You may call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to "incorporate by reference" documents that we file with the SEC into this prospectus, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference in this prospectus is considered part of this prospectus. Any statement in this prospectus or incorporated by reference into this prospectus shall be automatically modified or superseded for purposes of this prospectus to the extent that a statement contained in a subsequently filed document that is incorporated by reference in this prospectus modifies or supersedes such prior statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

We incorporate by reference the following document that we filed with the SEC:

Annual Report on Form 10-K for the year ended December 31, 2013.

In addition, all documents and reports that we subsequently file with the SEC (other than any portion of such filings that are furnished rather than filed under applicable SEC rules) under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act from the date of this prospectus until the termination of the offering of the securities to which this prospectus relates shall be deemed to be incorporated in this prospectus by reference.

You may request a copy of any documents incorporated by reference herein at no cost by writing or telephoning us at:

J.B. Hunt Transport Services, Inc.

615 J.B. Hunt Corporate Drive

Lowell, Arkansas 72745-0130

Attention: David N. Chelette

Telephone number: 479-820-0000

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FORWARD-LOOKING STATEMENTs

This prospectus, including documents which are incorporated herein by reference, contains statements that may be considered to be "forward-looking statements." Such statements relate to our predictions concerning future events or operations and are "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements are inherently uncertain, subject to risks, and should be viewed with caution. These statements are based on our belief or interpretation of information currently available. Prospective investors are cautioned that actual results and future events may differ materially from these forward-looking statements as a result of many factors. Some of the factors and events that are not within our control and that could have a material impact on future results include: general economic and business conditions, competition and competitive rate fluctuations, cost and availability of diesel fuel, ability to attract and retain qualified drivers and delivery personnel, a loss of one or more major customers, interference with or termination of our relationships with certain railroads, insurance costs and availability, claims expense, retention of key employees, accidents, terrorist attacks or actions, acts of war, adverse weather conditions, disruption or failure of information systems, new or different environmental or other laws and regulations, adverse legal conditions, increased costs for new revenue equipment or decreases in the value of used equipment, the ability of revenue equipment manufacturers to perform in accordance with agreements for guaranteed equipment trade-in values, and audits or tax assessments of various federal, state or local taxing authorities. Additionally, our business is somewhat seasonal with slightly higher freight volumes typically experienced during August through early November in our full-load transportation business.

You should understand that many important factors, in addition to those listed above, could impact us operationally and financially. Our results may fluctuate as a result of these and other risk factors or events as described in our filings with the SEC. Some important factors that could cause our future results to differ from estimates or projections contained in the forward-looking statements are described under "Risk Factors" in our most recent Annual Report on Form 10-K, as may be updated in our subsequent Quarterly Reports on Form 10-Q and other reports we subsequently file with the SEC. Except as required by applicable law, we assume no obligation to update any forward-looking statement to the extent we become aware that it will not be achieved for any reason.

THE COMPANY

We are one of the largest surface transportation and delivery service companies in North America. J.B. Hunt Transport Services, Inc. is a publicly held holding company that, together with our principal operating subsidiary, J.B. Hunt Transport, Inc., and other wholly owned subsidiaries, provides a wide range of transportation services to a diverse group of customers throughout the continental United States, Canada and Mexico. We were incorporated in Arkansas on August 10, 1961, and have been a publicly held company since our initial public offering in 1983.

Our service offerings include transportation of full-truckload containerized freight, which we directly transport utilizing our company-controlled revenue equipment and company drivers or independent contractors. We have arrangements with most of the major North American rail carriers to transport freight in containers and trailers. We also provide customized freight movement, revenue equipment, labor, systems and delivery services that are tailored to meet individual customers' requirements and typically involve longer-term contracts. As of December 31, 2013, we had 18,467 employees.

Our principal executive offices are located at 615 J.B. Hunt Corporate Drive, Lowell, Arkansas 72745-0130 and our telephone number is (479) 820-0000.

Transport was incorporated in Georgia on November 6, 1969. Its principal executive offices are located at 615 J.B. Hunt Corporate Drive, Lowell, Arkansas 72745-0130 and its telephone number is (479) 820-0000.

RISK FACTORS

Investing in our securities involves risk. You should carefully consider the specific risks discussed or incorporated by reference in this prospectus or the applicable prospectus supplement, together with all the other information contained in the prospectus supplement or contained in or incorporated by reference in this prospectus, including, among other things, the matters discussed under "Risk Factors" included in the applicable prospectus supplement, in our most recent Annual Report on Form 10-K and in our subsequent Quarterly Reports on Form 10-Q, as well as any other risk factors we may describe in any other reports we subsequently file with the SEC.

USE OF PROCEEDS

Unless otherwise indicated in the applicable prospectus supplement, we expect to use the net proceeds from any sale of debt securities offered by this prospectus for general corporate purposes. General corporate purposes may include:

- repayment or refinancing of a portion of our existing short-term or long-term debt;
- capital expenditures;
- additional working capital; and
- the repurchase of shares of our outstanding common stock.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our historical ratios of earnings to fixed charges for the periods indicated.

	Year Ended December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
Ratio of earnings to fixed charges	18.57x	16.56x	12.98x	10.55x	7.94x

For purpose of calculating our ratios of earnings to fixed charges, earnings represent earnings from continuing operations before income taxes, excluding fixed charges. Fixed charges represent interest expense, amortization of costs related to indebtedness, and that portion of rental expense estimated to be the equivalent of interest. This information should be read in conjunction with the consolidated financial statements and the accompanying notes incorporated by reference in this prospectus.

DESCRIPTION OF DEBT SECURITIES

The debt securities will be issued in one or more series under that certain indenture dated as of September 20, 2010, by and among us, J.B. Hunt Transport, Inc., a subsidiary of ours who may guarantee the debt securities, and U.S. Bank National Association, as trustee. References herein to the “indenture” refer to such indenture, as amended or supplemented from time to time, and references to the “trustee” refer to such trustee or any other trustee for any particular series of debt securities issued under the indenture. The terms of the debt securities of any series will be those specified in or pursuant to the indenture and in the applicable debt securities of that series and those made part of the indenture by the Trust Indenture Act of 1939, as amended.

The following description of selected provisions of the indenture and the debt securities is not complete, and the description of selected terms of the debt securities of a particular series included in the applicable prospectus supplement also will not be complete. You should review the form of the indenture and the form of the applicable debt securities, which forms have been or will be filed as exhibits to the registration statement of which this prospectus is a part or as exhibits to documents which have been or will be incorporated by reference in this prospectus. To obtain a copy of the indenture or the form of the applicable debt securities, see “Where You Can Find More Information” in this prospectus. The following description of debt securities and the description of the debt securities of the particular series in the applicable prospectus supplement are qualified in their entirety by reference to all of the provisions of the indenture and the applicable debt securities, which provisions, including defined terms, are incorporated by reference in this prospectus. Capitalized terms used but not defined in this section shall have the meanings assigned to those terms in the indenture. When we refer to “J.B. Hunt,” “we”, “us,” or “our” in this section or when we otherwise refer to ourselves in this section, we mean J.B. Hunt Transport Services, Inc., excluding, unless otherwise expressly stated or the context otherwise requires, our subsidiaries.

The following description of debt securities describes general terms and provisions of the series of debt securities to which any prospectus supplement may relate. When we offer to sell the debt securities of a particular series, we will describe the specific terms of such debt securities in the applicable prospectus supplement. If any particular terms of such debt securities described in a prospectus supplement differ from any of the terms of the debt securities generally described in this prospectus, then the terms described in the applicable prospectus supplement will supersede the terms described in this prospectus.

General

The debt securities of each series will constitute our unsecured unsubordinated obligations and will rank on a parity in right of payment with all of our other existing and future unsecured and unsubordinated indebtedness. We can issue an unlimited principal amount of debt securities under the indenture. The indenture provides that debt securities of any series may be issued up to the aggregate principal amount which may be authorized from time to time by us. Please read the applicable prospectus supplement relating to the debt securities of the particular series being offered thereby for the specific terms of such debt securities, including, where applicable:

the title of the series of debt securities;

any limit on the aggregate principal amount of debt securities of the series;

the date or dates on which we will pay the principal of and premium, if any, on debt securities of the series, or the method or methods, if any, used to determine such date or dates;

the rate or rates, which may be fixed or variable, at which debt securities of the series will bear interest, if any, or the method or methods, if any, used to determine such rate or rates;

the basis used to calculate interest, if any, on the debt securities of the series if other than a 360-day year of twelve 30-day months;

the date or dates, if any, from which interest on the debt securities of the series will accrue, or the method or methods, if any, used to determine such date or dates;

the date or dates, if any, on which the interest on the debt securities of the series will be payable and the record dates for any such payment of interest;

the person to whom any interest on the debt securities of the series will be payable, if different than the person in whose name a debt security is registered at the close of business on the regular record date for that interest;

the manner in which, or the person to whom, any interest on any bearer security of the series of debt securities will be payable, if different than upon presentation and surrender of the coupons relating to the bearer security;

the terms and conditions, if any, upon which we are required to, or may, at our option, redeem debt securities of the series;

the terms and conditions, if any, upon which we will be required to repurchase debt securities of the series at the option of the holders of debt securities of the series;

the terms of any sinking fund or analogous provision;

the portion of the principal amount of the debt securities of the series which will be payable upon acceleration if other than the full principal amount;

the authorized denominations in which the series of debt securities will be issued, if other than denominations of $2,000 and any integral multiple of $1,000 in excess thereof, in the case of registered securities, or denominations of $5,000, in the case of bearer securities;

the place or places where (1) amounts due on the debt securities of the series will be payable, (2) the debt securities of the series may be surrendered for registration of transfer and exchange and, if applicable, for conversion into or exchange for other securities or property, and (3) notices or demands to or upon us in respect of the debt securities of the series or the indenture may be served, if different than the Borough of Manhattan, The City of New York;

if other than U.S. dollars, the currency or currencies in which purchases of, and payments on, the debt securities of the series must be made and the ability, if any, of us or the holders of debt securities of the series to elect for payments to be made in any other currency or currencies;

whether the amount of payments on the debt securities of the series may be determined with reference to an index, formula, or other method or methods (any of those debt securities being referred to as "Indexed Securities") and the manner used to determine those amounts;

any addition to, modification, or deletion of, any covenant or Event of Default with respect to debt securities of the series;

whether the debt securities of the series will be issuable in registered or bearer form or both and whether any debt securities of the series will be issued in temporary or permanent global form and, if so, the identity of the depositary for the global debt securities;

whether and under what circumstances we will pay Additional Amounts on the debt securities of the series to any holder who is a United States Alien in respect of any tax, assessment, or other governmental charge and, if so, whether we will have the option to redeem such debt securities rather than pay the Additional Amounts;

whether any of our subsidiaries will provide guarantees of the debt securities; and

any other terms of debt securities of the series.

As used in this prospectus and any prospectus supplement relating to the offering of debt securities, references to the principal of and premium, if any, and interest, if any, on the debt securities of a series include Additional Amounts, if any, payable on the debt securities of such series in that context.

Debt securities may be issued as original issue discount securities to be sold at a substantial discount below their principal amount. In the event of an acceleration of the maturity of any original issue discount security, the amount payable to the holder upon acceleration will be determined in the manner described in the applicable prospectus supplement. Material federal income tax and other considerations applicable to original issue discount securities will be described in the applicable prospectus supplement.

The terms of the debt securities of any series may differ from the terms of the debt securities of any other series, and the terms of particular debt securities within any series may differ from each other. Unless otherwise specified in the applicable prospectus supplement, we may, without the consent of, or notice to, the holders of the debt securities of any series, reopen an existing series of debt securities and issue additional debt securities of that series.

Other than to the extent provided with respect to the debt securities of a particular series and described in an applicable prospectus supplement, the indenture will not contain any provisions that would limit our ability to incur indebtedness or to substantially reduce or eliminate our assets, which may have an adverse effect on our ability to service our indebtedness (including the debt securities) or that would afford holders of the debt securities protection in the event of:

(1) a highly leveraged or similar transaction involving us, our management, or any affiliate of any of those parties,

(2) a change of control, or

(3) a reorganization, restructuring, merger, or similar transaction involving us that may adversely affect the holders of our debt securities.

Registration, transfer, payment, and paying agent

Unless otherwise specified in the applicable prospectus supplement, each series of debt securities will be issued in registered form only, without coupons. The indenture, however, provides that we may also issue debt securities in bearer form only, or in both registered and bearer form. Purchasers of bearer securities will be subject to certification procedures and may be affected by limitations under United States tax laws. The terms of the bearer securities of the particular series and the applicable procedures and limitations will be described in the applicable prospectus supplement.

Unless otherwise specified in the applicable prospectus supplement, registered securities will be issued in denominations of $2,000 or any integral multiple of $1,000 in excess thereof, and bearer securities will be issued in denominations of $5,000.

Unless otherwise specified in the applicable prospectus supplement, the debt securities will be payable and may be surrendered for registration of transfer or exchange and, if applicable, for conversion into or exchange for other securities or property, at an office or agency maintained by us in the Borough of Manhattan, The City of New York. However, we, at our option, may make payments of interest on any interest payment date on any registered security by check mailed to the address of the person entitled to receive that payment or by wire transfer to an account maintained by the payee with a bank located in the United States.

Any interest not punctually paid or duly provided for on any interest payment date with respect to the debt securities of any series will forthwith cease to be payable to the holders of those debt securities on the applicable regular record date and may either be paid to the persons in whose names those debt securities are registered at the close of business on a special record date for the payment of the interest not punctually paid or duly provided for to be fixed by the trustee, notice whereof shall be given to the holders of those debt securities not less than 10 days prior to the special record date, or may be paid at any time in any other lawful manner, all as completely described in the indenture.

Subject to certain limitations imposed on debt securities issued in book-entry form, the debt securities of any series will be exchangeable for other debt securities of the same series and of a like aggregate principal amount and tenor of different authorized denominations upon surrender of those debt securities at the designated place or places. In addition, subject to certain limitations imposed upon debt securities issued in book-entry form, the debt securities of any series may be surrendered for registration of transfer or exchange thereof at the designated place or places if duly endorsed or accompanied by a written instrument of transfer. No service charge shall be made for any registration of transfer or exchange, redemption or repayment of debt securities, or for any conversion or exchange of debt securities for other securities or property, but we may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with certain of those transactions.

Unless otherwise specified in the applicable prospectus supplement, we will not be required to:

- issue, register the transfer of or exchange debt securities of any series during a period beginning at the opening of business 15 days before any selection of debt securities of that series of like tenor and terms to be redeemed and ending at the close of business on the day of that selection;

- register the transfer of or exchange any registered security, or portion of any registered security, called for redemption, except the unredeemed portion of any registered security being redeemed in part; or

- issue, register the transfer of or exchange a debt security which has been surrendered for repurchase at the option of the holder, except the portion, if any, of the debt security not to be repurchased.

Book-entry debt securities

The debt securities of a series may be issued in whole or in part in the form of one or more global debt securities. Global debt securities will be deposited with, or on behalf of, a depositary identified in the applicable prospectus supplement relating thereto. Global debt securities may be issued in either registered or bearer form and in either temporary or permanent form. Unless and until it is exchanged in whole or in part for individual certificates evidencing debt securities, a global debt security may not be transferred except as a whole by the depositary to its nominee or by the nominee to the depositary or by the depositary or its nominee to a successor depositary or to a nominee of the successor depositary.

We anticipate that global debt securities will be deposited with, or on behalf of, The Depository Trust Company, or DTC, New York, New York, and that global debt securities will be registered in the name of DTC's nominee, Cede & Co. We also anticipate that the following provisions will apply to the depository arrangements with respect to global debt securities. Additional or differing terms of the depository arrangements will be described in the applicable prospectus supplement.

DTC has advised us that it is:

- a limited-purpose trust company organized under the New York Banking Law;

- a "banking organization" within the meaning of the New York Banking Law;

a member of the Federal Reserve System;

a "clearing corporation" within the meaning of the New York Uniform Commercial Code; and

a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act.

DTC holds securities that its participants deposit with DTC. DTC also facilitates the settlement among its participants of securities transactions, including transfers and pledges, in deposited securities through electronic computerized book-entry changes in participants' accounts, which eliminates the need for physical movement of securities certificates. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations, and other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others, sometimes referred to in this prospectus as indirect participants, that clear transactions through or maintain a custodial relationship with a direct participant either directly or indirectly. Indirect participants include securities brokers and dealers, banks and trust companies. The rules applicable to DTC and its participants are on file with the SEC.

Purchases of debt securities within the DTC system must be made by or through direct participants, which will receive a credit for the debt securities on DTC's records. The ownership interest of the actual purchaser or beneficial owner of a debt security is, in turn, recorded on the direct and indirect participants' records. Beneficial owners will not receive written confirmation from DTC of their purchases, but beneficial owners are expected to receive written confirmations providing details of the transactions, as well as periodic statements of their holdings, from the direct or indirect participants through which they purchased the debt securities. Transfers of ownership interests in debt securities are to be accomplished by entries made on the books of participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in the debt securities except in the limited circumstances described below.

To facilitate subsequent transfers, all debt securities deposited by participants with DTC will be registered in the name of DTC's nominee, Cede & Co. The deposit of debt securities with DTC and their registration in the name of Cede & Co. will not change the beneficial ownership of the debt securities. DTC has no knowledge of the actual beneficial owners of the debt securities. DTC's records reflect only the identity of the direct participants to whose accounts the debt securities are credited. Those participants may or may not be the beneficial owners. The participants are responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to direct participants, by direct participants to indirect participants and by direct and indirect participants to beneficial owners will be governed by arrangements among them, subject to any legal requirements in effect from time to time.

Redemption notices shall be sent to DTC or its nominee. If less than all of the debt securities of a series are being redeemed, DTC will reduce the amount of the interest of direct participants in the debt securities in accordance with its procedures.

A beneficial owner of debt securities shall give notice to elect to have its debt securities repurchased or tendered, through its participant to the trustee and shall effect delivery of such debt securities by causing the direct participant to transfer the participant's interest in such debt securities, on DTC's records, to the trustee. The requirement for physical delivery of debt securities in connection with a repurchase or tender will be deemed satisfied when the ownership rights in such debt securities are transferred by direct participants on DTC's records and followed by a book-entry credit of such debt securities to the trustee's DTC account.

In any case where a vote may be required with respect to the debt securities of any series, neither DTC nor Cede & Co. will give consents for or vote such global debt securities. Under its usual procedures, DTC will mail an omnibus proxy to us as soon as possible after the record date. The omnibus proxy assigns the consenting or voting rights of Cede & Co. to those direct participants to whose accounts the debt securities are credited on the record date identified in a listing attached to the omnibus proxy.

Principal of and premium, if any, and interest, if any, on the global debt securities will be paid to Cede & Co., as nominee of DTC. DTC's practice is to credit direct participants' accounts on the relevant payment date unless DTC has reason to believe that it will not receive payments on the payment date. Payments by direct and indirect participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the account of customers in bearer form or registered in "street name." Those payments will be the responsibility of participants and not of DTC or us, subject to any legal requirements in effect from time to time. Payment of principal, premium, if any, and interest, if any, to Cede & Co. is our responsibility, disbursement of payments to direct participants is the responsibility of DTC, and disbursement of payments to the beneficial owners is the responsibility of direct and indirect participants.

Except as described in this prospectus, owners of beneficial interests in a global debt security will not be entitled to have debt securities registered in their names and will not receive physical delivery of debt securities. Accordingly, each beneficial owner must rely on the procedures of DTC to exercise any rights under the debt securities and the indenture.

The laws of some jurisdictions may require that some purchasers of securities take physical delivery of securities in definitive form. These laws may impair the ability to transfer or pledge beneficial interests in global debt securities.

DTC is under no obligation to provide its services as depositary for the debt securities of any series and may discontinue providing its services at any time. Neither we nor the trustee will have any responsibility for the performance by DTC or its participants or indirect participants under the rules and procedures governing DTC. As noted above, owners of beneficial interests in a global debt security will not receive certificates representing their interests. However, if

DTC notifies us that it is unwilling or unable to continue as a depositary for the global debt securities of any series or if DTC ceases to be a clearing agency registered under the Exchange Act and a successor depositary is not appointed by us within 90 days of the notification or of our becoming aware of DTC's ceasing to be so registered, as the case may be,

we determine, in our sole discretion, not to have the debt securities of any series represented by one or more global debt securities, or

an Event of Default under the indenture has occurred and is continuing with respect to the debt securities of any series,

we will prepare and deliver certificates for the debt securities of that series in exchange for beneficial interests in the global debt securities. Any beneficial interest in a global debt security that is exchangeable under the circumstances described in the preceding sentence will be exchangeable for debt securities in definitive certificated form registered in the names that the depositary shall direct. It is expected that these directions will be based upon directions received by the depositary from its participants with respect to ownership of beneficial interests in the global debt securities.

We obtained the information in this section and elsewhere in this prospectus concerning DTC and DTC's book-entry system from sources that we believe to be reliable, but neither we nor any applicable underwriters, agents or dealers take any responsibility for the accuracy of this information.

Outstanding debt securities

In determining whether the holders of the requisite principal amount of outstanding debt securities have given any request, demand, authorization, direction, notice, consent, or waiver under the indenture:

the principal amount of an original issue discount security that shall be deemed to be outstanding for these purposes shall be that portion of the principal amount of the original issue discount security that would be due and payable upon acceleration of the original issue discount security as of the date of the determination, the principal amount of any Indexed Security that shall be deemed to be outstanding for these purposes shall be the principal amount of the Indexed Security determined on the date of its original issuance,

the principal amount of a debt security denominated in a foreign currency shall be the U.S. dollar equivalent, determined on the date of its original issuance, of the principal amount of the debt security, and

a debt security owned by us or any obligor on the debt security or any affiliate of ours or such other obligor shall be deemed not to be outstanding.

Redemption and repurchase

The debt securities of any series may be redeemable at our option or may be subject to mandatory redemption by us as required by a sinking fund or otherwise. In addition, the debt securities of any series may be subject to repurchase by us at the option of the holders. The applicable prospectus supplement will describe the terms and conditions regarding any optional or mandatory redemption or option to repurchase the debt securities of the related series.

Conversion and exchange

The terms and conditions, if any, on which debt securities of any series are convertible into or exchangeable for shares of our common stock or other securities or property will be set forth in the applicable prospectus supplement.

Subsidiary guarantees

If specified in the applicable prospectus supplement, one or more of our subsidiaries (our “subsidiary guarantors”) will guarantee the debt securities of a series, including, if applicable, any subsidiaries that are added as subsidiary guarantors with respect to the debt securities of that series after the date of original issue.

Covenants

Merger, Consolidation, and Transfer of Assets

The indenture provides that we will not, in any transaction or series of related transactions, consolidate or merge with or into any other person or sell, lease, assign, transfer, or otherwise convey all or substantially all of our assets to any other person unless:

- either (1) we shall be the continuing person (in the case of a merger) or (2) the successor person (if other than us) formed by or resulting from the consolidation or merger or to which such assets shall have been sold, leased, assigned, transferred, or otherwise conveyed is a corporation organized and existing under the laws of the United States of America, any state thereof or the District of Columbia and shall expressly assume the due and punctual payment of the principal of, premium, if any, and interest, if any, on all the debt securities outstanding under the indenture and the due and punctual performance of all of our other obligations under the indenture and the debt securities outstanding thereunder, including any applicable conversion or exchange rights of holders;

immediately after giving effect to such transaction or transactions, no Event of Default under the indenture, and no event which, after notice or lapse of time or both would become an Event of Default under the indenture, shall have occurred and be continuing; and

the trustee shall have received an officer's certificate and opinion of counsel to the effect that all conditions precedent have been satisfied.

Upon any consolidation by us with, or our merger into, any other person or any sale, assignment, transfer, lease, or conveyance of all or substantially all of our assets to any person in accordance with the provisions of the indenture described above, the successor person formed by the consolidation or into which we are merged or to which the sale, assignment, transfer, lease, or other conveyance is made shall succeed to, and be substituted for, us and may exercise every right and power of ours under the indenture with the same effect as if such successor person had been named as us therein; and thereafter, except in the case of a lease, the predecessor person shall be released from all obligations and covenants under the indenture and the debt securities issued under that indenture.

Limitations on Liens

The indenture limits the amount of liens that we or our subsidiaries may incur or otherwise create, in order to secure indebtedness for borrowed money, upon any Principal Facility or any shares of capital stock that any of our subsidiaries owning any Principal Facility has issued to us or any of our subsidiaries. If we or any of our subsidiaries incur such liens, then we will secure the debt securities and, in the case of liens upon any Principal Facility owned or leased by any guarantor of the debt securities, then such guarantor will secure the guarantee of the debt securities to the same extent and in the same proportion as the debt that is secured by such liens. This covenant does not apply, however, to any of the following:

liens existing on the date of the indenture;

liens on property or shares of capital stock existing at the time we or any of our subsidiaries acquire such property or shares of stock (including acquisition through merger, share exchange or consolidation) or securing the payment of all or part of the purchase price, construction or improvement thereof incurred prior to, at the time of, or within 180 days after the later of the acquisition, completion of construction or improvement or commencement of full operation of such property for the purpose of financing all or a portion of such purchase or construction or improvement; or

liens for the sole purpose of extending, renewing or replacing in whole or in part the indebtedness secured by any lien referred to in the foregoing two bullet points or in this bullet point; provided, however, that the principal amount of indebtedness secured thereby shall not exceed the principal amount of indebtedness so secured at the time of such extension, renewal or replacement, and that such extension, renewal or replacement shall be limited to all or a part of the property that secured the lien so extended, renewed or replaced (plus improvements on such property).

Notwithstanding the foregoing, we and/or any of our subsidiaries may create, assume or incur liens that would otherwise be subject to the restriction described above, without securing debt securities issued under the indenture equally and ratably, if the aggregate principal amount of all outstanding indebtedness secured by the liens plus the aggregate value of Sale and Leaseback Transactions does not at the time exceed 15% of Consolidated Net Tangible Assets.

"Consolidated Net Tangible Assets" means the excess over current liabilities of all assets appearing on our most recent quarterly or annual consolidated balance sheet, less (a) goodwill and other intangible assets and (b) the minority interests of others in subsidiaries.

"Principal Facility" means any facility, together with the land upon which it is erected and fixtures comprising a part thereof, used primarily for distribution or warehousing and located in the United States, owned or leased pursuant to a capital lease by us or any subsidiary, that has a gross book value (without deduction of any depreciation reserve) on the date as of which the determination is being made exceeding 2% of Consolidated Capitalization.

"Consolidated Capitalization" means the total of all the assets appearing on our most recent quarterly or annual consolidated balance sheet, less (a) current liabilities, including liabilities for indebtedness maturing more than 12 months from the date of the original creation thereof, but maturing within 12 months from the date of such consolidated balance sheet, and (b) deferred income tax liabilities appearing on such consolidated balance sheet.

Sale and Leaseback Transactions

A Sale and Leaseback Transaction by us or any of our subsidiaries of any Principal Facility is prohibited unless, within 180 days of the effective date of the arrangement, an amount equal to the greater of the net proceeds of the sale of the property leased pursuant to the Sale and Leaseback Transaction or the fair value of the property at the time of entering into the Sale and Leaseback Transaction as determined by our board of directors ("value") is applied by us to the retirement of non-subordinated indebtedness for money borrowed with more than one year stated maturity from its date of creation, including our debt securities, except that such sales and leasebacks are permitted to the extent that the "value" thereof plus the other secured debt referred to in the second full paragraph above in the subsection entitled "—Limitations on Liens" does not at the time exceed 15% of our Consolidated Net Tangible Assets.

A "Sale and Leaseback Transaction" means the sale or transfer of a Principal Facility now owned or hereafter acquired with the intention of taking back a lease of the property, except a lease for a temporary period of less than three years, including renewals, with the intent that the use by us or any subsidiary will be discontinued on or before the expiration of such period.

Provision of Financial Information

We will be required to file with the trustee, within 15 days after we are required to file the same with the SEC, copies of the annual and other reports which we are required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act. If we are not so required to file such reports to the SEC under said Sections, then we will be required to file with the trustee and the SEC, in accordance with the rules and regulations prescribed by the SEC, such of the supplementary and periodic reports which may be required pursuant to Section 13 of the Exchange Act in respect of a security listed and registered on a national securities exchange as may be prescribed in such rules and regulations. Any documents filed by us with the SEC via the SEC’s EDGAR system will be deemed filed with the trustee as of the time such documents are filed via the SEC’s EDGAR system.

Other

Any other covenants applicable to the debt securities of any series will be specified in the applicable prospectus supplement.

Events of default

Unless otherwise specified in the applicable prospectus supplement, an Event of Default with respect to the debt securities of any series is defined in the indenture as being:

(1) default for 30 days in payment of any interest on, or any Additional Amounts payable in respect of any interest on, any debt security of that series;

(2) default in payment of any principal of or premium, if any, on, or any Additional Amounts payable in respect of any principal of or premium, if any, on, any debt security of that series when due, whether at maturity, upon redemption, upon repurchase at the option of the holder or otherwise;

(3) default in the deposit of any sinking fund payment or payment under any analogous provision when due with respect to any debt security of that series;

(4) default by us in the delivery of any shares of common stock, together with cash instead of fractional shares, or any other securities or property when required to be delivered upon conversion of any convertible debt security of that series or upon the exchange of any exchangeable debt security of that series, and continuance of such default for a period of 10 business days;

(5) the cessation of a guarantee of any debt security of that series to be in full force and effect, other than in accordance with the terms of the indenture, or the denial by a subsidiary guarantor of its liability under its guarantee;

(6) default by us in the performance, or breach, of any covenant or warranty in the indenture or any debt security of that series not covered elsewhere in this section, other than a covenant or warranty included in the indenture solely for the benefit of a series of debt securities other than that series, which shall not have been remedied for a period of 60 days after notice by the trustee or the holders of at least 25% in aggregate principal amount of the debt securities of that series then outstanding;

(7) our failure or the failure of any subsidiary of ours that is a significant subsidiary within the meaning of Rule 1-02 of Regulation S-X promulgated by the SEC (a "Significant Subsidiary") to pay when due, either at maturity, upon redemption, upon exercise of a repurchase right, upon acceleration or otherwise, any indebtedness for money borrowed by us or any such Significant Subsidiary in excess of $50 million principal amount under any bond, debenture, note or other evidence of indebtedness unless such indebtedness (other than indebtedness due upon acceleration) is discharged, or the default in respect of such other indebtedness is waived, cured, rescinded, or annulled, within 30 days after written notice by the trustee or the holders of at least 25% in aggregate principal

amount of the debt securities of such series then outstanding;

(8) the rendering of a final judgment or judgments (not subject to appeal and not covered by insurance) against us or any of our subsidiaries in excess of $15 million which remains unstayed, unpaid, undischarged, or unbonded for 60 days;

(9) specified events of bankruptcy, insolvency, or reorganization with respect to us or any Significant Subsidiary of ours; or

(10) any other Event of Default established for the debt securities of that series.

No Event of Default with respect to any particular series of debt securities necessarily constitutes an Event of Default with respect to any other series of debt securities. The trustee is required to give notice to holders of the debt securities of any series within 90 days of a default relating to such debt securities; *provided, however*, that the trustee may withhold such notice except a default in payment of principal, premium, if any, interest, if any, Additional Amounts, if any, or sinking fund payments, if any, in respect of such debt securities or a default or in the delivery of securities or property upon conversion or exchange of such debt securities in accordance with their terms, if the trustee, in good faith, determines it in the best interest of such holders to do so.

If an Event of Default specified in clause (9) above occurs with respect to us and is continuing, then the principal of all the debt securities and interest, if any, thereon shall automatically become immediately due and payable. If any other Event of Default with respect to the debt securities of any series occurs and is continuing, either the trustee or the holders of at least 25% in aggregate principal amount of the debt securities of that series then outstanding may declare the principal of, or if debt securities of that series are original issue discount securities, such lesser amount as may be specified in the terms of that series of debt securities, and interest, if any, thereon to be due and payable immediately. However, upon specified conditions, the holders of a majority in aggregate principal amount of the debt securities of that series then outstanding may rescind and annul any such acceleration and its consequences.

The indenture provides that no holders of debt securities of any series may institute any proceedings, judicial or otherwise, with respect to the indenture, or for the appointment of a receiver or trustee, or for any remedy thereunder, except in the case of failure of the trustee, for 60 days, to act after it has received a written request to institute proceedings in respect of an Event of Default from the holders of at least 25% in aggregate principal amount of the outstanding debt securities of that series, as well as an offer of indemnity reasonably satisfactory to it, and no inconsistent direction has been given to the trustee during such 60 day period by the holders of a majority in aggregate principal amount of the debt securities of that series. Notwithstanding any other provision of the indenture, the holder of a debt security will have the right, which is absolute and unconditional, to receive payment of the principal of and premium, if any, and interest, if any, and any Additional Amounts on that debt security on the respective due dates for those payments and, in the case of any debt security which is convertible into or exchangeable for other securities or property, to convert or exchange, as the case may be, that debt security in accordance with its terms, and to institute suit for the enforcement of those payments and any right to effect such conversion or exchange, and this right shall not be impaired without the consent of such holder.

Subject to the provisions of the Trust Indenture Act requiring the trustee, during the continuance of an Event of Default under the indenture, to act with the requisite standard of care, the trustee is under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any of the holders of debt securities of any series unless those holders have offered the trustee reasonable indemnity. The holders of a majority in aggregate principal amount of the outstanding debt securities of any series will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee, or of exercising any trust or power conferred upon the trustee.

Within 120 days after the close of each fiscal year, we and any subsidiary guarantors must deliver to the trustee an officers' certificate stating whether or not each certifying officer has knowledge of any default under the indenture and, if so, specifying each such default and the nature and status thereof.

Modification, waivers, and meetings

The indenture permits us, the subsidiary guarantor or guarantors, if applicable, and the trustee, with the consent of the holders of a majority in aggregate principal amount of the outstanding debt securities of each series issued under the indenture and affected by a modification or amendment (voting as separate classes), to modify or amend any of the provisions of the indenture or of the debt securities of the applicable series or the rights of the holders of the debt securities of the applicable series under the indenture. However, no modification or amendment shall, among other things,

change the stated maturity of the principal of, or premium, if any, or any installment of interest, if any, on or any Additional Amounts, if any, with respect to any debt securities, or

reduce the principal of or any premium on any debt securities or reduce the rate (or modify the calculation of such rate) of interest on or the redemption or repurchase price of any debt securities, or any Additional Amounts with respect to any debt securities, or change our obligation to pay Additional Amounts, or

reduce the amount of principal of any original issue discount securities that would be due and payable upon acceleration of the maturity of any debt security, or

adversely affect any right of repurchase at the option of any holder, or

release any subsidiary guarantor from any of its obligations under its guarantee or the indenture other than in accordance with the terms of the indenture, or

change any place where or the currency in which any debt securities are payable, or

adversely affect the right, if any, of holders to convert or exchange any debt securities for other securities or property in accordance with their terms, or

impair the holder’s right to institute suit to enforce the payment of any debt securities on or after their stated maturity or the right to convert or exchange any debt securities in accordance with their terms, or

reduce the percentage of the outstanding debt securities of any series whose holders must consent to any modification or amendment or any waiver of compliance with specific provisions of such indenture or specified defaults under the indenture and their consequences, or

- reduce the requirements for a quorum or voting at a meeting of holders of the applicable debt securities,

without, in each case, obtaining the consent of the holder of each outstanding debt security affected by the modification or amendment.

The indenture also contains provisions permitting us and the trustee, without the consent of the holders of any debt securities, to modify or amend the indenture, among other things:

- to add to the Events of Default or our covenants or the covenants of any applicable subsidiary guarantor in a manner that benefits the holders of all or any series of debt securities issued under the indenture;

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to add or release a subsidiary guarantor as required or permitted by the indenture;

to add to or change any provisions of the indenture to facilitate the issuance of bearer securities;

to establish the form or terms of debt securities of any series and any related coupons;

to cure any ambiguity or correct or supplement any provision in such indenture which may be defective or inconsistent with other provisions in the indenture, or to make any other provisions with respect to matters or questions arising under the indenture, in each case which shall not adversely affect the interests of the holders of any series of debt securities;

to amend or supplement any provision contained in the indenture, provided that the amendment or supplement does not apply to any outstanding debt securities issued before the date of the amendment or supplement and entitled to the benefits of that provision; or

to conform the terms of the indenture or the debt securities to the description thereof contained in any prospectus or other offering document or memorandum relating to the offer and sale of those debt securities.

The holders of a majority in aggregate principal amount of the outstanding debt securities of any series may waive our compliance with some of the restrictive provisions of the indenture, which may include covenants, if any, which are specified in the applicable prospectus supplement. The holders of a majority in aggregate principal amount of the outstanding debt securities of any series may, on behalf of all holders of debt securities of that series, waive any past default under the indenture with respect to the debt securities of that series and its consequences, except a default (i) in the payment of the principal of, or premium, if any, or interest, if any, on the debt securities of that series, (ii) in the delivery of securities or property upon the conversion or exchange of any debt securities of that series in accordance with their terms, or (iii) in respect of a covenant or provision which cannot be modified or amended without the consent of the holder of each outstanding debt security of the affected series.

The indenture contains provisions for convening meetings of the holders of a series of debt securities. A meeting may be called at any time by the trustee, and also, upon our request, or the request of holders of at least 10% in aggregate principal amount of the outstanding debt securities of a series. Notice of a meeting must be given in accordance with the provisions of the indenture. Except for any consent which must be given by the holder of each outstanding debt security affected in the manner described above, any resolution presented at a meeting or adjourned meeting duly reconvened at which a quorum, as described below, is present may be adopted by the affirmative vote of the holders of a majority in aggregate principal amount of the outstanding debt securities of that series. However, any resolution with respect to any request, demand, authorization, direction, notice, consent, waiver, or other action which may be made, given or taken by the holders of a specified percentage, other than a majority, in aggregate principal amount of the outstanding debt securities of a series may be adopted at a meeting or adjourned meeting duly reconvened at which a quorum is present by the affirmative vote of the holders of that specified percentage in aggregate principal amount of the outstanding debt securities of that series. Any resolution passed or decision taken at any meeting of holders of debt securities of any series duly held in accordance with the indenture will be binding on all holders of debt securities of that series and the related coupons, if any. The quorum at any meeting called to adopt a resolution, and at any reconvened meeting, will be persons holding or representing a majority in aggregate principal amount of the outstanding debt securities of a series, subject to exceptions; provided, however, that if any action is to be taken at that meeting with respect to a consent or waiver which may be given by the holders of a supermajority in aggregate principal amount of the outstanding debt securities of a series, the persons holding or representing that specified supermajority percentage in aggregate principal amount of the outstanding debt securities of that series will constitute a quorum.

Discharge, defeasance, and covenant defeasance

Satisfaction and Discharge

Upon our direction, the indenture shall cease to be of further effect with respect to the debt securities of any series specified by us, subject to the survival of specified provisions of the indenture, including our obligation to repurchase such debt securities at the option of the holders thereof or to convert or exchange such debt securities into other securities or property in accordance with their terms, if applicable, and our obligation to pay Additional Amounts in respect of such debt securities to the extent described below, when:

either

(A) all outstanding debt securities of that series and, in the case of bearer securities, all related coupons have been delivered to the trustee for cancellation, subject to exceptions, or

(B) all debt securities of that series and, if applicable, any related coupons have become due and payable or will become due and payable at their maturity within one year or are to be called for redemption within one year, and we have deposited with the trustee, in trust, funds in the currency in which the debt securities of that series are payable in an amount sufficient to pay the entire indebtedness on the debt securities of that series and, if applicable, related coupons, including the principal thereof and, premium, if any, and interest, if any, thereon, and, to the extent that (x) the debt securities of that series provide for the payment of Additional Amounts and (y) the amount of any Additional Amounts which are or will be payable is at the time of deposit reasonably determinable by us, in the exercise of our sole discretion, those Additional Amounts, to the date of such deposit, if the debt securities of that series have become due and payable, or to the maturity or redemption date of the debt securities of that series, as the case may be;

we have paid all other sums payable under the indenture with respect to the debt securities of that series; and

the trustee has received an officers' certificate and an opinion of counsel to the effect that all conditions precedent to the satisfaction and discharge of the indenture have been satisfied.

If the debt securities of any series provide for the payment of Additional Amounts, we will remain obligated, following the deposit described above, to pay Additional Amounts on those debt securities to the extent that they exceed the amount deposited in respect of those Additional Amounts as described above.

Defeasance and Covenant Defeasance

Unless otherwise specified in the applicable prospectus supplement, we may elect with respect to the debt securities of the particular series either:

to defease and discharge ourselves and, if applicable, any subsidiary guarantor, from any and all obligations with respect to those debt securities ("full defeasance"), except for, among other things:

(1) the obligation to pay Additional Amounts, if any, upon the occurrence of specified events of taxation, assessment, or governmental charge with respect to payments on those debt securities to the extent that those Additional Amounts exceed the amount deposited in respect of those amounts as provided below,

(2) the obligations to register the transfer or exchange of those debt securities,

(3) the obligation to replace temporary or mutilated, destroyed, lost, or stolen debt securities,

(4) the obligation to maintain an office or agency in respect of those debt securities,

(5) the obligation to hold moneys for payment in respect of those debt securities in trust, and

(6) the obligation, if applicable, to repurchase those debt securities at the option of the holders thereof or to exchange or convert those debt securities into other securities or property in accordance with their terms, or

to be released from our obligations with respect to those debt securities under the specified covenants in the indenture described under "—Covenants—Limitation on Liens" and "—Covenants—Limitation on Sale and Leaseback Transactions" a applicable, other covenants as may be specified in the applicable prospectus supplement, and any omission to comply with those obligations shall not constitute a default or an Event of Default with respect to those debt securities ("covenant defeasance"),

in either case upon the irrevocable deposit with the trustee, or other qualifying trustee, in trust for that purpose, of an amount in the currency in which those debt securities are payable at maturity or, if applicable, upon redemption, and/or government obligations which through the payment of principal and interest in accordance with their terms will provide money, in an amount sufficient to pay the principal of and any premium and any interest on, and, to the extent that (x) those debt securities provide for the payment of Additional Amounts and (y) the amount of the Additional Amounts which are or will be payable is at the time of deposit reasonably determinable by us, in the exercise of our sole discretion, the Additional Amounts with respect to, those debt securities, and any mandatory sinking fund or analogous payments on those debt securities, on the due dates for those payments, whether at maturity, upon redemption, upon repayment at the option of the holder or otherwise.

The full defeasance or covenant defeasance described above shall only be effective if, among other things:

it shall not result in a breach or violation of, or constitute a default under, the indenture or any other material agreement or instrument to which we are a party or are bound;

in the case of full defeasance, we shall have delivered to the trustee an opinion of independent counsel reasonably acceptable to the trustee confirming that:

(A) we have received from, or there has been published by, the Internal Revenue Service a ruling, or

(B) since the date of the indenture, there has been a change in applicable federal income tax law, in either case to the effect that, and based on this ruling or change the opinion of counsel shall confirm that, the holders of the debt securities of the applicable series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the full defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if the defeasance had not occurred;

in the case of covenant defeasance, we shall have delivered to the trustee an opinion of independent counsel reasonably acceptable to the trustee to the effect that the holders of the debt securities of the applicable series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the covenant defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if the covenant defeasance had not occurred;

if the cash and government obligations deposited are sufficient to pay the outstanding debt securities of the applicable series on a particular redemption date, we shall have given the trustee irrevocable instructions to redeem those debt securities on that date;

no Event of Default or default which with notice or lapse of time or both would become an Event of Default with respect to debt securities of the applicable series shall have occurred and be continuing on the date of the deposit into trust; and, solely in the case of full defeasance, no Event of Default arising from specified events of bankruptcy, insolvency, or reorganization with respect to us or any Significant Subsidiary of ours or default which with notice or lapse of time or both would become such an Event of Default shall have occurred and be continuing during the period ending on the 91st day after the date of the deposit into trust; and

we shall have delivered to the trustee an officers' certificate and legal opinion to the effect that all conditions precedent to the full defeasance or covenant defeasance, as the case may be, have been satisfied.

In the event we effect covenant defeasance with respect to debt securities of any series and those debt securities are declared due and payable because of the occurrence of any Event of Default other than an Event of Default with respect to the covenants as to which covenant defeasance has been effected, which covenants would no longer be applicable to the debt securities of that series after covenant defeasance, the amount of monies and/or government obligations deposited with the trustee to effect covenant defeasance may not be sufficient to pay amounts due on the debt securities of that series at the time of any acceleration resulting from that Event of Default. However, we would remain liable to make payment of those amounts due at the time of acceleration.

The applicable prospectus supplement may further describe the provisions, if any, permitting or restricting full defeasance or covenant defeasance with respect to the debt securities of a particular series.

Governing law

The indenture, the debt securities and the guarantees will be governed by, and construed in accordance with, the laws of the State of New York.

PLAN OF DISTRIBUTION

We may sell our debt securities offered by this prospectus:

- through agents;
- to or through underwriters;
- through dealers;
- directly by us to other purchasers; or
- through a combination of any such methods of sale.

Any underwriters or agents will be identified and their discounts, commissions and other items constituting underwriters' compensation will be described in the applicable prospectus supplement.

We (directly or through agents) may sell, and the underwriters may resell, the debt securities in one or more transactions, including negotiated transactions, at a fixed public offering price or prices, which may be changed, at market prices prevailing at the time of sale, at prices related to prevailing market prices or at negotiated prices.

In connection with the sale of our debt securities, the underwriters or agents may receive compensation from us or from purchasers of the debt securities for whom they may act as agents. The underwriters may sell debt securities to or through dealers, who may also receive compensation from purchasers of the debt securities for whom they may act as agents. Compensation may be in the form of discounts, concessions or commissions. Underwriters, dealers and agents that participate in the distribution of the debt securities may be underwriters as defined in the Securities Act, and any discounts or commissions received by them from us and any profit on the resale of the debt securities by them may be treated as underwriting discounts and commissions under the Securities Act.

We may indemnify the underwriters and agents against certain civil liabilities, including liabilities under the Securities Act, or contribute to payments they may be required to make in respect of such liabilities.

Underwriters, dealers and agents may engage in transactions with, or perform services for, us or our affiliates in the ordinary course of their businesses.

If so indicated in the prospectus supplement relating to a particular offering of debt securities, we will authorize underwriters, dealers or agents to solicit offers by certain institutions to purchase the debt securities from us under delayed delivery contracts providing for payment and delivery at a future date. These contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of these contracts.

LEGAL MATTERS

In connection with particular offerings of debt securities, and if stated in the applicable prospectus supplements, the validity of the debt securities and certain other matters will be passed upon for us by Mitchell, Williams, Selig, Gates & Woodyard, P.L.L.C., Little Rock, Arkansas. Sidley Austin LLP, New York, New York, will act as counsel for any underwriters, dealers or agents named in the applicable prospectus supplement.

EXPERTS

The consolidated financial statements of J.B. Hunt Transport Services, Inc. appearing in J.B. Hunt Transport Services, Inc.'s Annual Report (Form 10-K) for the year ended December 31, 2013, including the schedule appearing therein, and the effectiveness of J.B. Hunt Transport Services, Inc.'s internal control over financial reporting as of December 31, 2013, have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their reports thereon included therein, and incorporated herein by reference. Such financial statements are, and audited financial statements to be included in subsequently filed documents will be, incorporated herein in reliance upon the reports of Ernst & Young LLP pertaining to such financial statements and the effectiveness of our internal control over financial reporting as of the respective dates (to the extent covered by consents filed with the Securities and Exchange Commission) given on the authority of such firm as experts in accounting and auditing.

J.B. Hunt Transport Services, Inc.

$250,000,000
2.400%
Senior Notes
due 2019
$250,000,000
3.850%
Senior Notes
due 2024

Guaranteed by

J.B. Hunt Transport, Inc.

PROSPECTUS SUPPLEMENT

Joint Book-Running Managers

J.P. Morgan

Goldman, Sachs & Co.

Morgan Stanley

Co-Managers

SunTrust Robinson Humphrey

US Bancorp

TARO PHARMACEUTICAL INDUSTRIES LTD.

Notes to consolidated financial statements
U.S. dollars in thousands (except share and per share data)

NOTE 1: — GENERAL

a. Taro Pharmaceutical Industries Ltd. (the “Company” or “Taro”) is an Israeli corporation, which operates in Israel and elsewhere through its Israeli, North American, and European subsidiaries (the “Group”). The principal business activities of the Group are the production, research, development and marketing of pharmaceutical products. The Company’s ordinary shares are quoted on the Pink Sheets Electronic Quotation Service (“Pink Sheets”) under the symbol TAROF. As used herein, the terms "we," "us," "our," “Taro” and the "Company" mean Taro Pharmaceutical Industries Ltd. and its subsidiaries, unless otherwise indicated.

The activities of the Group in North America are performed by Taro Pharmaceuticals Inc., Taro Pharmaceuticals North America, Inc. and Taro Pharmaceuticals U.S.A., Inc. (“Taro U.S.A.”). Taro Research Institute Ltd. in Israel provides research and development services to the Group. Taro International Ltd. in Israel, Taro Pharmaceuticals Ireland Ltd. and Taro Pharmaceuticals Europe B.V. are engaged in the pharmaceutical activities of the Group outside North America.

The Group manufactures generic and proprietary drug products in facilities located in Israel, Ireland, and Canada, and manufactures bulk active pharmaceutical ingredients in its facilities located in Israel. The Group’s research facilities are located in Israel and Canada. The majority of the Group’s sales are in North America.

In North America, the Company sells and distributes its products principally to drug industry wholesalers, drug store chains and mass merchandisers. In Israel, the Group sells and distributes its products principally to healthcare institutions and private pharmacies.

In the generic pharmaceutical industry, selling prices and related profit margins tend to decrease as products mature due to increased competition from other generic pharmaceutical manufacturers as they gain approval from the U.S. Food and Drug Administration (the "FDA"), the Canadian Health Products and Food Branch Inspectorate, and the Israeli and other Ministries of Health ("Government Agencies") to manufacture equivalent products. The Group's future operating results are dependent on, among other things, its ability to introduce new products and maintain its approvals to market existing drugs.

While non-compliance with Government Agencies' regulations can result in refusal to allow entry, seizure, fines or injunctive actions to prevent the sale of products, no such actions against the Group or its products have ever occurred. The Group believes that it is in material compliance with all Government Agencies' regulations. In February 2009, our Canadian manufacturing facility received a warning letter from the FDA (the "Warning Letter") expressing concern identified during a July 2008 inspection about certain quality control systems, including failure to complete investigations of quality issues in a timely manner. The Company responded to the Warning Letter on March 17, 2009, submitted and discussed a full compliance work plan with the FDA, provided periodic written updates to the FDA and committed to working with the FDA to resolve all issues. The Company has corrected the specific observations cited during the July 2008 inspection and in the Warning Letter, and, to ensure its products meet all requirements, has improved its ability to adhere to current good manufacturing practices ("cGMPs") by adding additional qualified personnel, engaging outside experts and adding new procedures to resolve any systemic issues and prevent recurrence. The observations cited in the Warning Letter do not relate to any of the Company's other facilities. Until remedial action is complete and the FDA has confirmed compliance with cGMPs, new applications listing the Canadian facility as a manufacturing location of finished dosage forms may not be approved. However, one new product made at the Company's Canadian facility was approved by the FDA in May 2009 after the issuance of the Warning Letter. Other Federal agencies take the Warning Letter into account when considering the awards of contracts and in some cases may have the right to terminate any agreement they have with us or remove products from their pricing schedule as one agency has done. A formal cGMP re-inspection was conducted by the FDA in February 2011 to evaluate the effectiveness of corrective actions undertaken by Taro. The FDA informed the Company on April 19, 2011 that the site has an acceptable regulatory status. Therefore, the issues noted in the February 5, 2009 warning letter are considered to be resolved. This has not had a material impact on the Company's financial condition.

TARO PHARMACEUTICAL INDUSTRIES LTD.

Notes to consolidated financial statements
U.S. dollars in thousands (except share and per share data)

While the majority of the Company's products are either synthesized by the Company itself or are derived from multiple source materials, some raw materials and certain products are currently obtained from single domestic or foreign suppliers. The Company does not believe that any interruption of supply from a single supplier would have a material adverse effect on the Company's results of operations and financial position. To date, the Group has not experienced difficulties in obtaining raw materials.

b. The Company successfully addressed its past liquidity issues by implementing initiatives to improve revenues and cash collections. During 2006, our cash flows were negatively impacted by operating losses, capital expenditures and a reduction in wholesaler inventory. During the year ended December 31, 2007, the Company's cash on hand increased by $29,047 from $16,140 to $45,187 primarily due to $56,499 of equity issuances, net of issuance costs, and $10,151 of long-lived asset sales offset by $32,761 of debt repayments and $5,982 of capital investments. During the quarter ended March 31, 2010, consolidated cash on hand increased to approximately $125,500, primarily due to higher operating cash flows from increased sales volumes and cash management activities. During the quarter ended March 31, 2010, debt decreased to $160,500, primarily due to scheduled principal payments. As of March 31, 2010, $100,200 of the Company's total debt is callable on-demand due to covenant violations. Consolidated cash at March 31, 2010 exceeds callable debt by approximately $25,300. In addition, the Company is current with all of its debt service payments. As a result of the Company's cash position at March 31, 2010 and the expected cash flows from operations, the Company has the ability to continue as a going concern for the foreseeable future.

c. On May 18, 2007, the Company, Alkaloida Chemical Company Exclusive Group Ltd. ("Alkaloida"), a subsidiary of Sun Pharmaceutical Industries Ltd. (together with its affiliates "Sun") (Reuters: SUN.BO, Bloomberg: SUNP IN, NSE: SUNPHARMA, BSE: 524715) and Aditya Acquisition Company Ltd. ("Aditya") entered into a merger agreement (the "Merger Agreement"). In addition, Taro entered into a Share Purchase Agreement with Alkaloida, pursuant to which Taro issued Alkaloida 6,787,500 ordinary shares at $6.00 per share, for a total of $40,725 (the "Share Purchase Agreement"). Under the terms of the Share Purchase Agreement, Sun also received a three-year warrant to purchase additional ordinary shares at $6.00 per share. On August 2, 2007, Sun exercised a portion of its warrant in favor of Alkaloida, as assignee, and purchased 3,000,000 additional shares at an exercise price of $6.00 per share, or $18,000. This additional investment, together with its original purchase of Taro's newly issued shares, brought Sun's investment in Taro to $58,725. Taro paid $2,436 in stock issuance costs and therefore retained $56,289 of the proceeds. The net proceeds were recorded within shareholders' equity on the consolidated balance sheet in accordance with FASB ASC Subtopic 815-40, "Derivatives and Hedging - Contracts in Entity's Own Equity", as the Company did not meet the criteria of a derivative under FASB ASC Section 815-40-30, "Derivatives and Hedging - Contracts in Entity's Own Equity – Initial Measurement".

On May 28, 2008, the Company terminated the Merger Agreement. On the same day, the Company and its directors, other than the members of the Levitt and Moros families (the "Independent Directors"), brought a lawsuit against Sun and its affiliates in the Tel-Aviv District Court (the "District Court") seeking a declaratory judgment that, under the Israeli Companies Law, a "Special Tender Offer" was required. On June 25, 2008, Sun gave notice that it was exercising its option under the May 18, 2007 option agreement entered into by Sun, with Dr. Barrie Levitt, Dr. Daniel Moros, Ms. Tal Levitt, Dr. Jacob Levitt and Taro Development Corporation ("TDC") (the "Option Agreement"). Pursuant to the Option Agreement, Sun was granted the option to acquire certain ordinary shares owned by Dr. Barrie Levitt, Dr. Moros, Ms. Levitt, and TDC for $7.75 per share, as well as all of the founders' shares, which represented one third of the voting power of all of the Company's shares, for no consideration (the "Options"). A condition to the exercise of the Options required Sun to commence a tender offer to purchase any and all ordinary shares owned by all other shareholders for $7.75 per share. According to the terms of the Option Agreement, the transactions contemplated would be consummated contemporaneously with the expiration of the tender offer.

TARO PHARMACEUTICAL INDUSTRIES LTD.

Notes to consolidated financial statements
U.S. dollars in thousands (except share and per share data)

On June 30, 2008, Sun commenced a regular tender offer for any and all ordinary shares at a price of $7.75 per share (the “Sun Offer”). On August 26, 2008, the District Court ruled that Sun was not required to comply with the Special Tender Offer rules. On August 28, 2008, the Company and its Independent Directors filed an appeal to the Supreme Court of the State of Israel (the “Israeli Supreme Court”) and requested a temporary injunction to prevent Sun from acquiring additional ordinary shares which would result in its voting power being more than 45% of the Company’s voting power during the pendency of the appeal. On September 1, 2008, the Israeli Supreme Court granted the temporary injunction.

On September 7, 2010, the Supreme Court denied the Company’s appeal and ordered the revocation of the temporary injunction which had prohibited the closing of the Sun Offer.

On the same day, Sun announced the decision of the Israeli Supreme Court and the expiration date of the Sun Offer (the “Announcement Date”) as the fifth business day following the Announcement Date which was 12:00 midnight, New York City time, on Tuesday, September 14, 2010.

On September 21, 2010, the Company announced that the controlling shareholders of the Company, the Levitt and Moros families (together with their affiliated entities, the “Levitt/Moros Shareholders”), executed a letter agreement (the “Letter Agreement”) on September 20, 2010 with Sun. Pursuant to the Letter Agreement, the Levitt/Moros Shareholders transferred certain beneficial interests in the Company, including the beneficial ownership of the founders’ shares of Taro, to Sun in accordance with the Option Agreement.

Concurrent with the execution of the Letter Agreement, Sun and the members of Taro’s Board of Directors (the “Board”), including the Levitt/Moros Shareholders, entered into a settlement agreement and release, pursuant to which Sun and the incumbent members of Taro’s Board agreed, among other things, to release each other from, and covenanted not to sue, based on certain claims related generally to the acquisition of Taro by Sun and litigation arising therefrom.

Also, on September 20, 2010, Taro’s Board passed a resolution appointing Dilip Shanghvi, Sudhir Valia, Aalok Shanghvi, Hasmukh Shah and Ilan Leviteh as members of the Board, and the incumbent members of Taro’s Board submitted their resignations as directors and officers of the Company and its subsidiaries, as applicable. At a subsequent Board meeting, Mr. Dilip Shanghvi was elected Chairman of Taro’s Board.

In addition to the foregoing, the Company issued a letter dated September 20, 2010, to Sun and Alkaloida acknowledging the valid exercise by Alkaloida of a certain Warrant No. 2 issued August 1, 2007, for the purchase of 3,787,500 ordinary shares of Taro for an aggregate price of $22,725. With the exercise of Warrant No. 2, as well as the completion of the acquisition of the shares from the Levitt/Moros Shareholders and the acquisition of the shares from Templeton Asset Management Ltd. (“Templeton”) on November 1, 2010, Sun increased its ownership of Taro's ordinary shares to 64.8% and, with Taro's founders' shares, its voting rights to 76.5%.

On January 18, 2011, Alkaloida acquired 712,500 ordinary shares of Taro pursuant to a certain Warrant No. 2 dated August 1, 2007 issued by the Company to Sun Pharma (the "Warrant"). Additionally, Alkaloida acquired 712,500 ordinary shares of the Company available pursuant to a certain Share Purchase Agreement dated May 18, 2007 between Alkaloida and the Company (the "SPA"). As a result of the exercise of the Warrant and the purchase of shares by Alkaloida pursuant to the SPA, the Company's issued and outstanding ordinary shares are 44,505,457 and

Sun Pharma owns, or controls, 29,497,933, or 66.3%, of the Company's ordinary shares, and with the Company's founders' shares, 77.3% of the vote attributable to the share equity of the Company.

TARO PHARMACEUTICAL INDUSTRIES LTD.

Notes to consolidated financial statements
U.S. dollars in thousands (except share and per share data)

d. In July 2004, Taro U.S.A. entered into a license agreement with Medicis Pharmaceutical Corporation (“Medicis”) for four product lines used in the treatment of skin disorders, including the Lustra® product line and two previously unmarketed products in the United States, Canada and Puerto Rico. The entire purchase price of $35,565 was treated as a product rights purchase and therefore, was recorded on the balance sheet under the line item “other intangible assets and deferred charges, net.” The Company allocated $23,165 for the Lustra® product family. Lustra® and Lustra-AF® were marketed by Medicis for a number of years. One of the previously unmarketed products, from the Lustra® product family, was subsequently launched by Taro under the name Lustra-Ultra™. Taro allocated $12,400 for the second previously unmarketed product, which was subsequently launched by Taro under the name U-Kera™. During 2006, the Company recorded an impairment charge of $10,023, to write off the remaining carrying value of the U-Kera™ intangible asset and recorded an impairment charge of $13,236 to reduce the carrying value of the Lustra® intangible asset to $6,298. These charges were the result of competitive market pressures and were recorded in cost of sales. The impairments were determined by conducting valuation studies and employing a discounted cash flow analysis. The remaining carrying value is being amortized to cost of sales over the weighted-average life of the product rights. See Note 2.k.

As part of the agreement, the Company received $20,000 from Medicis, which the Company estimated was its returns exposure for these products, and with which the Company established a reserve. This return reserve is presented together with the reserve for returns in current liabilities. The Company also agreed to accept expired returned goods in the future, even though the product returned may not have been sold by Taro. The reserve was established anticipating that customers will deduct, from their cash payments to the Company, the price that they originally paid to Medicis for the goods being returned. This reserve is being utilized for the return exposure related to the acquired products. During 2006, $8,300 of the reserve was recorded as income based on a determination that the reserve exceeded the requirements for such returns as a result of the near-term expiration of the customer right of return.

e. In March 2005, the Company, through its subsidiaries, entered into multi-year agreements with Alterna-TCHP, LLC (“Alterna”) to license the Company’s over-the-counter ElixSure® and Kerasal® products in North America.

The terms of the agreements include, among other things, the license of rights to distribute ElixSure® and Kerasal® products and an option to acquire the ownership rights for additional consideration, multi-year manufacturing and supply arrangements and the sale of ElixSure® inventory on-hand at the outset of the arrangement. At the time of signing the agreements, the Company received $10,000 and there were to be additional payments due over the term of the agreements. In addition, the Company receives payments from Alterna for ongoing manufacturing and supply of the products during the agreement term.

The Company accounted for this transaction in accordance with EITF Issue No.00-21, “Revenue Arrangement with Multiple Deliverable” ("EITF 00-21”). The Company has concluded that the entire arrangement should be considered as one unit of accounting mainly because the Company could not establish fair value for all undelivered elements in the transaction. Accordingly, the total up front consideration is being recognized as revenue over the three-year term of the arrangement. Revenue recognition is limited to cash received. In addition, the Company recorded deferred inventory cost in the amount of $2,037 related to the costs of ElixSure® products that were sold to Alterna at the outset of the agreement. The cost is amortized over the three-year term of the manufacturing and supply services under the agreements.

In June 2006, the Company and Alterna signed an amendment to the above agreements. Pursuant to the terms of the amendment Alterna exercised its option to purchase the full rights to the Kerasal® products and settled all outstanding balances with the Company for products shipped under the manufacturing and supply arrangement in consideration for a cash payment of $12,000. According to the amendment, the Company will continue to manufacture and supply the products to Alterna. Consistent with its original accounting treatment, the Company has concluded that all of the deliverables under the amendment should be considered as one unit of accounting, therefore the consideration is being amortized over the remaining term of the agreement. As of December 31, 2007, the current and non-current portions of deferred revenue related to this agreement were $1,176 and $0, respectively, which were recorded in other current liabilities and other long-term liabilities, respectively. As of December 31, 2006, the current and non-current portions of deferred revenue related to this agreement were $7,055 and $1,176, respectively, which were recorded in other current liabilities and other long-term liabilities, respectively. Subsequently, Alterna discontinued purchasing the ElixSure® products. However, Alterna has continued to purchase Kerasal® in limited quantities.

The Company determined that Alterna is a Variable Interest Entity ("VIE") in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46 (Revised December 2003), "Consolidation of Variable Interest Entities." However, the Company has concluded that it is not the primary beneficiary of the VIE, therefore Alterna has not been consolidated into the Company's results of operations. The Company concluded that the amendment to the agreements in June 2006 should not change this conclusion, primarily since the Company does not have exposure to losses from its involvement with Alterna.

f. The Company, through its Irish subsidiary, owns a pharmaceutical manufacturing and research facility in Ireland, designed primarily for the manufacture of sterile products. As a result of the delay in receiving regulatory approval for the manufacture of new products, the inability to pursue the launch of certain approved products, and further financial constraints during 2006 which significantly reduced the level of additional investment in the Irish facility, the Company recorded an impairment charge related to its Irish facility during 2006.

The Company used the market approach in determining the fair value of the group of assets. The Company recorded an impairment charge, in operating expenses, aggregating $27,023, resulting in a remaining book value of approximately $14,900. In addition, the Company recorded approximately $900 of loss on purchase commitments of $3,945 due to the decline in value of additional equipment that the Company committed to purchase at December 31, 2006. Subsequent to the balance sheet date, in November 2009, the Company's Irish subsidiary sold pieces of that equipment for $1,485 net of transaction costs.

During 2010, the Company announced the closure of the manufacturing facility in Ireland. The Company expects to dispose of the facility by selling it as soon as practical. The Company is currently analyzing the impact of that event on subsequent years' financial statements and any possible additional impairment that may be required in future years.

NOTE 2: — SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared according to United States generally accepted accounting principles ("U.S. GAAP").

a. Use of estimates:

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company's most critical estimates are used in its determination of its sales incentives reserves. See Note 4 for details.

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b. Financial statements in U.S. dollars:

A majority of the revenue of the Company and certain of its subsidiaries (exclusive of its Canadian, Irish, and U.K. subsidiaries – see below) is generated in U.S. dollars ("dollars"). In addition, a substantial portion of the costs of the Company and these subsidiaries is incurred in dollars. The Company's management believes that the dollar is the primary currency of the economic environment in which the Company and these subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar, requiring re-measurement from the local currency into the dollar for each of these entities. All exchange gains and losses resulting from the re-measurement are reflected in the statement of operations as financial income or expenses, as appropriate.

The functional currency of the Company's Canadian, Irish, and U.K. subsidiaries are the Canadian Dollar, the Euro, and the British Pound, respectively.

Accordingly, the financial statements of the Canadian, Irish and the U.K. subsidiaries have been translated into dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Amounts recorded in the statements of operations have been translated using the average exchange rate prevailing during the year. The resulting translation adjustments are reported as a component of shareholders' equity under accumulated other comprehensive income (loss).

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Inter-company transactions and balances have been eliminated in consolidation. A private corporation, TDC, owns 50% of the shares that have voting rights in Taro U.S.A., with the Company owning the other 50%. In 1993, TDC signed an agreement with the Company to assign its voting rights in Taro U.S.A. in all elections of directors of Taro U.S.A. as the Company may designate. TDC may terminate the agreement upon one year written notice. As of December 31, 2007, no such notice of termination has been provided. TDC is a minority shareholder in the Company by way of owning 3.1% of Taro U.S.A. shares that have economic rights. Since losses applicable to TDC exceed its interest in Taro U.S.A. equity, such excess and any further losses applicable to TDC are charged against the Company as TDC has no obligation to fund such losses.

d. Cash and cash equivalents:

Cash equivalents are short-term, highly-liquid investments that are readily convertible into cash with original maturities of three months or less at the date acquired.

e. Marketable securities:

Marketable securities are comprised primarily of shares of stock in other publicly-traded companies and auction rate securities. These marketable securities covered by Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities," were designated as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity.

f. Allowance for doubtful accounts:

The allowance for doubtful accounts is calculated primarily with respect to specific balances, which, in the opinion of the Company's management, are doubtful of collection. The allowance, in the opinion of the Company's management, is sufficient to cover probable uncollectible balances. See Note 3.

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g. Inventories:

Inventories are stated at the lower of cost or net realizable value. Inventory reserves are provided to cover risks arising from slow-moving items, short-dated inventory, excess inventory or obsolescence. Changes in these provisions are charged to cost of goods sold. Cost is determined as follows:

Raw and packaging materials – average cost basis.

Finished goods and work in progress – average production costs including materials, labor and direct and indirect manufacturing expenses.

Purchased products for commercial purposes – average cost basis.

The amounts of inventory reserves recorded as cost of sales were $2,403, $4,859, and $1,839, for the years ended December 31, 2007, 2006 and 2005, respectively.

h. Property, plant and equipment:

1. Property, plant and equipment are stated at cost, net of accumulated depreciation. Payroll and other costs that are direct incremental costs necessary to bring an asset to the condition of its intended use incurred during the construction and validation period of property, plant and equipment are capitalized to the cost of such assets.

2. Interest costs are capitalized in accordance with SFAS No. 34, "Capitalization of Interest Cost".

3. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets, from the date the assets are ready for their intended use, at the following annual rates:

	%
Buildings	2.5 - 10
Machinery and equipment	5 - 20 (mainly 10)
Motor vehicles	15 - 20
Furniture, fixtures, office equipment and computer equipment	6 - 33 (mainly 20)

Leasehold improvements are depreciated by the straight-line method over the shorter of their useful lives or the terms of the leases (generally 5-10 years).

4. The Group accounts for costs of computer software developed or obtained for internal use in accordance with Statement of Position ("SOP") No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," ("SOP No. 98-1"). SOP No. 98-1 requires the capitalization of certain costs incurred in connection with developing or obtaining internal use software during the application development stage. During the years 2007 and

2006, the Group capitalized $56 and $49 of software costs, respectively. Software costs are amortized by the straight-line method over their estimated useful life of three years.

5. On February 7, 2007, the Company, in an effort to improve liquidity, sold a car park adjacent to its Irish facility for $4,050, net of transaction costs and recorded in 2007 a pre-tax gain on this transaction of $3,721. This asset was included in property plant and equipment at December 31, 2006, as the criteria to classify this land as available-for-sale were met after the balance sheet date.

i. Lease of land from Israel Land Administration:

The Company leases land from the Israel Land Administration ("ILA"), which is accounted for pursuant to SFAS 13, as amended by SFAS 98. Taro leases several parcels from the ILA. The lease period of the industrial parcel ends between 2010 and 2058. The Company has the right to extend each of the lease agreements for an additional period of 49 years. The ILA lease agreements are standard agreements covering substantial portions of the land of Israel. The standard agreements call for a Lease Period of 49 years, with an option for one additional Lease Period (i.e., total of 98 years). The ownership over the land is not transferred at the end of the lease period and there is no option to buy the land at the end of such period. The expectation, based on practice and accumulated experience is that the renewal price would be substantially below fair market value. Since such leases do not qualify as a capital lease, they are being accounted for as operating leases. The prepaid lease amount is included in long-term receivables and other assets and amortized over the term of the lease.

j. Goodwill:

The Company follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Goodwill is not amortized, but rather is subject to an annual impairment test (or more frequently if impairment indicators arise).

SFAS 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment; while the second phase (if necessary) measures impairment.

In the first phase of impairment testing, goodwill attributable to one reporting unit is tested for impairment by comparing the fair value of the reporting unit with the carrying value of the reporting unit. When the carrying value exceeds the fair value, the second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

The Company operates in one operating segment, and this segment comprises its only reporting unit. Fair value of the reporting unit is determined using market capitalization. The Company performs its annual impairment test during the fourth fiscal quarter of each year. As of December 31, 2007 and 2006, no impairment loss had been identified.

k. Impairment of long-lived assets, intangible assets and deferred charges:

Intangible assets and deferred charges:

Acquired intangible assets and product rights to be held and used are not considered to have an indefinite useful life and are amortized over their useful life of a weighted-average amortization period of 14 years using a straight-line method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS 142.

Debt issuance costs in respect to long-term loans from institutional investors and bondholders are deferred and amortized under the effective interest method over the term of the loans from institutional investors and bondholders.

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Impairment of long-lived assets:

The Group's long-lived assets, excluding goodwill, are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," ("SFAS 144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment exists when the carrying amount of the asset exceeds the aggregate future undiscounted cash flows expected to be generated by the asset. The impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the asset. In the year ended December 31, 2006, the Company recorded, in operating expenses, a $27,923 impairment loss primarily related to the fixed assets in its Irish facility. In the year ended December 31, 2006, the Company also recorded impairment charges of $25,862 in cost of sales, which is mainly comprised of a $23,259 impairment loss, primarily for its product rights for Lustra® and U-Kera and a $2,531 impairment loss related to one of its warehouses and certain equipment in Canada. No impairment loss was recorded on these assets in the year ended December 31, 2007. See also Notes 1.d and 1.e.

l. Treasury shares:

The Company repurchases its ordinary shares from time to time on the open market and holds such shares as treasury stock. The Company presents the cost to repurchase treasury stock as a reduction of shareholders' equity.

From time to time the Company reissues treasury shares under the stock purchase plan, upon exercise of options and upon vesting of restricted stock units. When treasury stock is reissued, the Company accounts for the re-issuance in accordance with Accounting Principles Board Opinion ("APB") No. 6, "Status of Accounting Research Bulletins" and charges the excess of the purchase cost, including related stock-based compensation expenses, over the re-issuance price (loss) to retained earnings. The purchase cost is calculated based on the specific identification method.

In cases where the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

m. Revenue recognition:

The Company recognizes revenue from product sales when title and risk of loss have transferred to its customers and when the criteria in Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" ("SAB 104"), and SFAS No. 48, "Revenue Recognition When Right of Return Exists" ("SFAS 48"), have been satisfied. Those criteria generally require that (i) persuasive evidence of an arrangement exists; (ii) product delivery has occurred; (iii) the price to customers is fixed or determinable; (iv) collectability is reasonably assured, and (v) the amount of product returns, chargebacks, rebates and other sales deductions can be reasonably estimated. The Company ships products to its customers only in response to, and to the extent of, the orders that customers submit to the Company. Depending on the terms of our customer arrangements, revenue is recognized when the product is received by the customer ("FOB Destination Point") or at the time of shipment ("FOB Shipping Point").

When the Company recognizes and records revenue from the sale of its pharmaceutical products, the Company, in the same financial reporting period, records an estimate of various future deductions related to the sale. This has the effect of reducing the amount of reported product sales. These deductions include the Company's estimates, which may require significant judgment, of chargebacks, product returns, rebates, cash discounts and other sales deductions.

Chargebacks result from pricing arrangements the Company has with end-user customers establishing contract prices which are lower than the wholesalers' acquisition costs or invoice prices. When these customers buy the Company's products from their wholesaler of choice, the wholesaler issues a credit memo (chargeback) to the Company for the difference between the invoice price and the end-user contract price. Chargeback reserves are estimated using current wholesaler inventory data beyond the Company's control, and historical data. Due to the passage of time from the balance sheet date to the issuance of these financial statements, the Company has considered actual wholesaler returns and reverse chargebacks received in estimating its chargeback reserve.

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Product returns result from agreements allowing the Company's customers to return unsold inventory that is expired or close to expiration. Product return reserves are calculated using the average lag period between sales and product expiry, historical product returns experience, and specific return exposures to estimate the potential obligation for returns of inventory in the distribution channel.

Rebates result from contractual agreements with the Company's customers and are earned based on the Company's direct sales to customers or the Company's customers' sales to third parties. Rebate reserves from the Company's direct sales to customers and the Company's customers' sales to third parties are estimated using historical and contractual data.

The Company generally offers discounts to its customers for payments within a certain period of time. Cash discount reserves are calculated by multiplying the specified discount percentage by the outstanding receivable at the end of each period.

Reserves for returns, Medicaid and indirect rebates are included in current liabilities. All other sales deductions allowances are recorded as accounts receivable reserves. The reserve for returns is included in current liabilities as substantially all of these returns will not be realized until after the year-end accounts receivable balances are settled. Medicaid and indirect rebates are included in current liabilities because the Company does not have direct customer relationships with any of the payees. See Notes 4 and 11 for more details.

The Company offers incentives to certain resellers and retailers through various marketing programs where the Company agrees to reimburse them for advertising costs incurred to include the Company's products and accounts for these in accordance with EITF Issue No. 01-09 "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of Vendor's Product)", as reductions of revenue unless the customer service receives an identifiable benefit in exchange for the consideration that is sufficiently separable from the customer's purchase of the products and the fair value of the benefits can be reasonably estimated.

With respect to revenue recognition policies in the Alterna transaction, see also Note 1.e.

n. Research and development:

Research and development expenses, net of grants received, are charged to expenses as incurred.

o. Royalty-bearing grants:

Royalty-bearing grants from the government of Israel through the Office of the Chief Scientist for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred. The Company earned grants in the amounts of ($309), $430 and $559 during 2007, 2006 and 2005, respectively. Such grants are included as deductions from research and development costs.

p. Advertising expenses:

The Group expenses advertising costs as incurred. Product samples are recorded within prepaid expense on the consolidated balance sheet and recorded within advertising expenses when provided to potential customers. Advertising expenses were approximately $6,473, $11,741, and $20,836 for the years ended December 31, 2007, 2006 and 2005, respectively.

q. Income taxes:

Income taxes are accounted for in accordance with SFAS No. 109, “Accounting for Income Taxes” (“SFAS 109”). SFAS 109, prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined for temporary differences between the financial reporting and tax basis of assets and liabilities, and for carryforward losses and credits. Deferred taxes are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. As of each balance sheet date, management determined that it was more likely than not that the Company will not benefit from the deferred tax asset in the U.S., Ireland and certain other subsidiaries. Therefore, for these locations a full valuation allowance was provided against deferred tax assets. In future years, if it is more likely than not that the Company will be in a position to utilize its deferred tax asset, the valuation allowance for such assets may be modified.

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Effective January 1, 2007, the Company adopted FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FAS 109" ("FIN 48"), which was issued in June 2006. FIN 48 clarifies the accounting for uncertainty in income taxes, and prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company's accounting policy, pursuant to the adoption of FIN 48, is to classify interest and penalties recognized in the financial statements relating to uncertain tax positions as income tax expense. See Note 16. The following table presents the impact at January 1, 2007 on the consolidated balance sheet as a result of implementing FIN 48:

Increase to short-term accrued taxes	$ 1,178
Decrease to valuation allowance	$ 6,220
Decrease to deferred tax assets	$ 6,220
Increase to accumulated deficit	$ 1,178

r. Sales and other taxes collected and remitted to governmental authorities:

The Company collects various taxes from customers and remits them to governmental authorities. These taxes are recorded on a net basis and therefore do not impact the statement of operations.

s. Basic and diluted net income (loss) per share:

Basic net income (loss) per share is calculated based on the weighted-average number of ordinary shares outstanding during each year. Diluted net income (loss) per share is calculated based on the weighted-average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year (except where anti-dilutive), in accordance with SFAS No. 128, "Earnings per Share."

The total weighted-average number of options excluded from the calculations of diluted net earnings per share, as a result of their anti-dilutive effect, was 1,126,528, 1,578,387, and 1,504,479 for the years ended December 31, 2007, 2006 and 2005, respectively.

t. Freight and distribution costs:

In accordance with EITF 00-10, "Accounting for Shipping and Handling Fees and Costs," the Company's accounting policy is to classify shipping and handling costs as a part of sales and marketing expense. Freight and distribution costs and distribution warehousing costs related to shipping and handling to customers, primarily through the use of common carriers or external distribution services amounted to $9,436, $9,090, and $9,454 for the years ended December 31, 2007, 2006 and 2005, respectively.

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u. Accounting for stock-based compensation:

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), “Share-Based Payment” (“SFAS No. 123(R)”), which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. SFAS No. 123(R) supersedes APB No. 25, “Accounting for Stock Issued to Employees” (“APB No. 25”), for periods beginning in fiscal year 2006. In March 2005, the Securities and Exchange Commission (“SEC”) issued SAB No. 107 (“SAB 107”) relating to SFAS No. 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). SFAS No. 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company’s consolidated income statement.

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard starting from January 1, 2006, the first day of the Company’s fiscal year 2006. Under that transition method, compensation cost recognized in the year ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated. The Company selected the Black-Scholes option pricing model as the most appropriate fair value method for its stock option awards and values restricted stock based on the market value of the underlying shares at the date of grant.

The Company recognizes compensation expense for the value of its awards granted subsequent to January 1, 2006, based on the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures. For awards granted prior to January 1, 2006, the Company recognizes compensation expense based on the straight line-method over the requisite service period of each of the awards. Forfeitures were previously accounted for as they occurred, but have been estimated with the adoption of SFAS No. 123(R) for those awards not yet vested. Upon the adoption of SFAS No. 123(R) the expected life of the option is estimated using the “simplified” method as provided in SAB 107. Under this method, the expected life equals arithmetic average of the vesting term and the original contractual term of the option.

Prior to 2006, the Company elected to follow APB No. 25 and FASB Interpretation No. 44 “Accounting for Certain Transactions Involving Stock Compensation” (“FIN 44”), in accounting for its employees’ stock options plans. According to APB No. 25, compensation expense is measured under the intrinsic value method, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price of the option at the grant date of the award.

Prior to the adoption of SFAS No.123(R), pro-forma information regarding the Company’s net income and net earnings per share is required by SFAS No.123(R) and has been determined as if the Company had accounted for its employee stock option plans under the fair value method prescribed by SFAS No.123(R).

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company's operating income, income before income taxes, and net income for year ended December 31, 2006, were $599 lower than if the Company had continued to account for stock-based compensation under APB No. 25. Basic and diluted net loss per share for year ended December 31, 2006, were $0.02 lower than if the Company had continued to account for stock-based compensation under APB No. 25.

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Stock Options: The fair value of options granted under the Stock Incentive Plan in 2007, 2006 and 2005 is amortized over their vesting period on a straight-line basis and estimated at the date of grant using a Black-Scholes options pricing model with the following weighted-average assumptions:

	2007	2006	2005
Dividend yield	0 %	0 %	0 %
Expected volatility	53.1 %	58.5 %	60.0 %
Risk-free interest rate	4.7 %	4.4 %	4.2 %
Expected life of up to	6.9 years	6.9 years	6.9 years

The risk-free interest rate is based upon the yields of U.S. Treasury bills with maturity terms similar to those of the expected lives of the options at the time of grant. The expected volatility is based upon daily movements in the Company's stock price.

Employee Stock Purchase Plan: The fair value of the incentive rewards granted under the Company's 2000 Employee Stock Purchase Plan, in 2006, is amortized over their vesting period on a straight-line basis and estimated at the date of the grant using a Black-Scholes options pricing model with the following weighted assumptions: 0% dividend yield, 72.7% volatility, 3.7% risk free weighted-average interest rate and expected life of six months.

Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The following table illustrates the effect on net loss and net loss per share for the year ended December 31, 2005, assuming that the Company had applied the fair value recognition provision of SFAS 123(R) on its stock-based employee compensation:

		December 31, 2005
Net income - as reported	$	84
Add – stock-based compensation expense recorded in reported net income		382
Less - total stock-based compensation expenses under fair value method		14,608
Net (loss) - pro-forma	$	(14,142)
Earnings per share:		
Basic and diluted net income per ordinary share - as reported(*)	$	0.00
Basic and diluted net (loss) per ordinary share - pro-forma	$	(0.48)

(*) Amount is less than $0.01.

The Company applies SFAS No. 123(R) and EITF No. 96-18 “Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services”; with respect to options issued to non-employees. SFAS No. 123(R) requires the use of option valuation models to measure the fair value of the options granted. Compensation expensed to non-employees was not material.

v. Concentrations of credit risk:

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, restricted short-term bank deposits and trade receivables. Cash and cash equivalents and restricted short-term bank deposits are invested in major banks in Israel, the United States, Canada and the Cayman Islands. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Group’s cash and cash equivalents and restricted short-term bank deposits are financially sound and that low credit risk therefore exists with respect to these financial instruments. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk.

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The Group's trade accounts receivables are mainly derived from sales to customers in the United States, Canada, Europe and Israel. At December 31, 2007, three different wholesale customers in the United States represented approximately 16.0%, 14.7% and 12.2% of the trade accounts receivable, net. The Group has adopted credit policies and standards intended to mitigate inherent risk while accommodating sales growth. The Group performs ongoing credit evaluations of its customers' financial condition when deemed necessary, but does not generally require collateral for its customers' accounts receivable.

w. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, restricted short-term bank deposits, trade and other receivables and trade and other payables approximate their fair value, due to the short-term maturities of these instruments.

The carrying amount of long-term bank deposits approximates their fair value because such deposits bear market interest rates.

The carrying amounts of the Group's borrowing arrangements under its short-term and long-term debt agreements approximate their fair value since the loans bear interest at rates that approximate the Group's incremental borrowing rates for similar types of borrowing arrangements.

The fair value of currency and interest rate contracts is determined by discounting to the present all future cash flows of the currencies to be exchanged at interest rates prevailing in the market for the period the currency exchanges are due and expressing the results in U.S. dollars at the current spot foreign currency exchange rate.

x. Accounting for derivatives:

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes (i.e., gains or losses) in the fair value of a derivative instrument depends on whether the instrument has been designated and qualifies as part of a hedging relationship and on the type of hedging relationship. For derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation. The designation is based upon the nature of the exposure being hedged. At December 31, 2007 and 2006, no derivative instruments were designated as hedging instruments.

For derivative instruments not designated as hedging instruments, the gain or loss is recognized in financial income/expense in current earnings during the period of change. For additional information see Note 9.

y. Impact of recently issued accounting standards:

In September 2006, the FASB issued SFAS No. 157, ''Fair Value Measurements,'' ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of SFAS 157 will not have a material impact on the Company's consolidated financial position and results of operations.

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In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS 159"). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for the Company as of the beginning of the first fiscal year that begins after November 15, 2007. The Company believes that the adoption of SFAS 159 will not have a material impact on the Company's consolidated financial statements.

In June 2007, the FASB ratified EITF Issue 07-3, "Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development Activities" ("EITF 07-3"). EITF 07-3 provides guidance on the capitalization of non-refundable advance payments for goods and services to be used in future research and development activities, until such goods have been delivered or the related services have been performed. This issue will be effective for the Company for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. The Company believes that the adoption of EITF 07-3 will not have a material impact on the Company's consolidated financial statements.

In November 2007, EITF issued EITF Issue No. 07-1, "Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property" ("EITF 07-1"). Companies may enter into arrangements with other companies to jointly develop, manufacture, distribute, and market a product. The consensus requires collaborators in such an arrangement to present the result of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. EITF 07-1 is effective for collaborative arrangements in place at the beginning of the annual period beginning after December 15, 2008. The adoption of EITF 07-1 will not have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) "Business Combinations" ("SFAS 141R"). SFAS 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Key changes include: acquired in-process research and development will no longer be expensed on acquisition, but capitalized and amortized over its useful life; fair value will be based on market participant assumptions; acquisition costs will generally be expensed as incurred; and restructuring costs will generally be expensed in periods after the acquisition date. Early adoption is not permitted. This statement will be effective for us as of the year beginning January 1, 2009. The impact of the adoption of SFAS 141R on the Company's consolidated financial statements would depend on the nature, terms and magnitude of acquisitions it may consummate in the future.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51," ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards for non-controlling interests in a subsidiary and deconsolidation of a subsidiary. Early adoption is not permitted. These statements will be effective for us as of the year beginning January 1, 2009. The Company believes that the adoption of SFAS 160 will not have a material impact on the Company's consolidated financial statements.

In December 2007, the SEC issued SAB No. 110 ("SAB 110") relating to the use of a "simplified" method in developing an estimate of the expected term of "plain vanilla" share options. SAB 107 previously allowed the use of the simplified method until December 31, 2007. SAB 110 allows, under certain circumstances, the continuation of the use of the simplified method beyond December 31, 2007. Effective January 1, 2008, the Company believes that the adoption of SAB 110 will not have a material impact on its consolidated financial statements.

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In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" ("FAS 157-1") and FSP No. FAS 157-2, "Effective Date of FASB Statement No. 157". Collectively, the Staff Positions defer the effective date of Statement 157 to fiscal years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of Statement 157. The Company believes that the adoption of FAS 157-1 will not have a material impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161") an amendment to FASB No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not expect the adoption of SFAS 161 to have a material impact on its financial position, results of operations or cash flows.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur between the balance sheet date and the date financial statements are issued or are available to be issued. This statement is effective for interim or annual periods ending after June 15, 2009. The adoption of SFAS 165 will not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46 (R)" ("SFAS 167"), which amends existing accounting rules for consolidation of variable interest entities. Under SFAS 167, the primary beneficiary of a variable interest entity is determined by a qualitative rather than a quantitative test previously required under FIN 46 (R). In addition, SFAS 167 requires an ongoing assessment of whether an entity is a primary beneficiary of a variable interest entity, and additional disclosure. SFAS 167 is effective at the beginning of the first annual reporting period that begins after November 15, 2009. SFAS 167 will not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162" ("SFAS 168"). With this statement, the FASB Accounting Standards Codification ("Codification") becomes the single source of GAAP recognized by FASB in the United States. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of this standard will not affect our results of operations or our financial position. However, because the Codification replaces any existing GAAP standards, it will affect the way we reference US GAAP within our financial statements.

In October 2009, the FASB issued Accounting Standard Update ("ASU") No. 2009-13, "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13"). ASU 2009-13 revises the current model for recording revenue from multiple element arrangements and expands disclosure requirements. This standard requires entities to allocate revenue in an arrangement at inception using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendments eliminate the residual method of revenue allocation and require revenue to be allocated using the relative selling price method. ASU 2009-13 will be effective for arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company does not expect adoption of ASU 2009-13 to have a material impact on the results of operations or financial condition.

In December 2010, the FASB issued ASU No. 2010-27, "Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers (a consensus of the FASB Emerging Issues Task Force)." This standard addresses how fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act should be recognized and classified in the income statements of pharmaceutical manufacturers. Under the proposal, the annual fee would be recognized as a liability for the total amount and a corresponding deferred cost over the calendar year. This is a liability and presented as an operating expense. This ASU is effective for calendar years beginning after December 31, 2010. Since the fees are anticipated to be less than 0.2% of net sales, the Company does not expect the provisions of ASU 2010-27 to have a material effect on its financial statements.

In December 2010, the FASB also issued ASU No. 2010-28, "Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)." Under this standard, if the carrying amount of a reporting unit is zero or negative, an entity must assess whether it is more likely than not that goodwill impairment exists. To make that determination, an entity should consider whether there are adverse qualitative factors that could impact the amount of goodwill, including those listed in ASC 350-20-35-30. As a result of the new guidance, an entity can no longer assert that a reporting unit is not required to perform the second step of the goodwill impairment test because the carrying amount of the reporting unit is zero or negative, despite the existence of qualitative factors that indicate goodwill is more likely than not impaired. The equity or enterprise valuation premise can be used to determine the carrying amount of a reporting unit. ASU 2010-28 is effective for public entities for fiscal years, and for interim periods within those years, beginning after December 15, 2010, with early adoption prohibited. The Company's goodwill test does not currently have a zero or negative carrying amount where this standard would apply.

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NOTE 3: — ACCOUNTS RECEIVABLE

a. Trade, net:

The following tables summarize the impact of accounts receivable reserves and allowance for doubtful accounts on the gross trade accounts receivable balances at each balance sheet date:

	December 31, 2007	December 31, 2006
Trade accounts receivable, gross	$ 117,557	$ 118,459
Reserves for sales deductions:		
Chargebacks	(18,525)	(40,211)
Customer rebates	(12,421)	(19,628)
Other sales deductions	(15,853)	(17,005)
Allowance for doubtful accounts	(741)	(2,159)
Trade accounts receivable, net	$ 70,017	$ 39,456

b. Other receivables, prepaid expenses and other:

	December 31, 2007	December 31, 2006
Prepaid expenses	$ 5,804	$ 7,560
Deferred income taxes	3,221	4,735
Government authorities	3,207	1,433
Advanced to suppliers	551	843
Derivative instruments	12,953	497
Office of the Chief Scientist	269	279
Employees	17	21
Other	238	325
	$ 26,260	$ 15,693

NOTE 4: — SALES INCENTIVES

When the Company recognizes and records revenue from the sale of its pharmaceutical products, it records an estimate in the same financial reporting period for product returns, chargebacks, rebates and other sales deductions, which are reflected as reductions of the related gross revenue. Beginning in 2006, the Company regularly monitors customer inventory information at its three largest wholesale customers to assess whether any excess product inventory levels may exist. The Company reviews this information together with historical product and customer experience, third-party prescription data, industry and regulatory changes and other relevant information and revises its estimates as necessary.

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

The Company considers any information available subsequent to the balance sheet date, but before the issuance of the financial statements, that provides additional evidence with respect to conditions existing at the balance sheet date and adjusts the reserves accordingly.

Product returns:

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

The Company's product returns reserve at December 31, 2007 and related statement of operations impact for the year ended December 31, 2007, also considered actual product returns experienced subsequent to December 31, 2007 to validate the product returns reserve estimate based on the methodology described above.

Beginning in 2006, the Company monitors the levels of inventory in its distribution channels to assess the adequacy of the product returns reserve and to identify potential excess inventory on hand that could have an impact on its revenue recognition. The Company does not ship products to its wholesalers when it appears they have an excess of inventory on hand, based on demand and other relevant factors, for that particular product. Additionally, as a general practice, the Company does not ship products that have less than 12 months until expiration (i.e., "short-dated sales").

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Chargebacks:

The Company has arrangements with certain customers that allow them to buy its products directly from its wholesalers at specific prices. Typically these price arrangements are lower than the wholesalers' acquisition costs or invoice prices. In exchange for servicing these third party contracts, the Company's wholesalers can submit a "chargeback" claim to the Company for the difference between the price sold to the third party and the price at which they purchased the product from us. The Company generally pays chargebacks on generic products, whereas branded proprietary products are typically not eligible for chargeback claims. The Company considers many factors in establishing its chargeback reserves including inventory information from its largest wholesale customers (beginning in 2006) and the completeness of their reports, estimates of Taro inventory held by smaller wholesalers and distributors, processing time lags, contract and non-contract sales trends, average historical contract pricing, actual price changes, actual chargeback claims received from the wholesalers, Taro sales to the wholesalers and other relevant factors. The Company's chargeback provision and related reserve varies with changes in product mix, changes in pricing, and changes in estimated wholesaler inventory. The Company reviews the methodology utilized in estimating the reserve for chargebacks in connection with analyzing its product returns reserve each quarter and makes revisions as considered necessary to reasonably estimate its potential future obligation. Due to the passage of time from the balance sheet date to the issuance of these financial statements, the Company has considered actual wholesaler returns and reverse chargebacks received in estimating its chargeback reserve.

Rebates and other deductions:

The Company offers its customers various rebates and other deductions based primarily on their volume of purchases of its products. Chain wholesaler rebates are rebates that certain chain customers claim for the difference in price between what the chain customer paid a wholesaler for a product purchase and what the chain customer would have paid if such customer had purchased the same product directly from the Company. Cash discounts, which are offered to the Company's customers, are generally 2% of the gross sales price, and provide the Company's customers an incentive for paying within invoice terms (30 to 90 days). Medicaid rebates are earned by states based on the amount of the Company's products dispensed under the Medicaid plan. Billbacks are special promotions or discounts provided over a specific time period to a defined customer base and for a defined product group. Distribution allowances are a fixed percentage of gross purchases for inventory shipped to a national distribution facility that the Company pays to its top wholesalers on a monthly basis. Administration fees are paid to certain wholesalers, buying groups, and other customers for stocking the Company's products and managing contracts and servicing other customers. Shelf stock adjustments, which are customary in the generic pharmaceutical industry, are based on customers' existing levels of inventory and the decrease in the market price of the related product. When market prices for the Company's products decline, the Company may, depending on its contractual arrangements, elect to provide shelf-stock adjustments and thereby allow its customers with existing inventories to compete at the lower product price. The Company uses these shelf-stock adjustments to support its market position and to promote customer loyalty.

The Company establishes reserves for rebates and these other various sales deductions based on contractual terms and customer purchasing activity, tracking and analysis of rebate programs, processing time lags, the level of inventory in the distribution channel and other relevant information. Based on the Company's historical experience, substantially all claims for rebates and other sales deductions are received within 24 months. Therefore, at December 31, 2007 and for the year ended December 31, 2007, the Company considered subsequent actual claims submitted by its customers in determining the Company's reserves and related statements of operations impact for rebates and other sales deductions.

As discussed above, Taro believes it has the experience and information that it believes are necessary to reasonably estimate the amounts of reserves for its sales incentives programs. Several of the assumptions used by the Company for certain estimates are based on information received from third parties, such as wholesale customer inventory levels, market data, and other factors beyond Taro's control. The most critical estimates in determining these reserves, and the ones therefore that would have the largest impact if these estimates were not accurate, are related to contract sales volumes, average contract pricing, customer inventories and return volumes. Taro regularly reviews the information related to these estimates and adjusts its reserves accordingly, if and when actual experience differs from previous estimates.

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Use of estimates in reserves:

The Company believes that its reserves, allowances and accruals for items that are deducted from gross revenue are reasonable and appropriate based on current facts and circumstances. Changes in actual experience or changes in other qualitative factors could cause the Company's allowances and accruals to fluctuate, particularly with newly launched or acquired products. The Company regularly reviews the rates and amounts in its reserve estimates. If future estimated rates and amounts are significantly greater than those reflected in the Company's recorded reserves, the resulting adjustments to those reserves would decrease the Company's reported net revenue; conversely, if actual product returns, rebates and chargebacks are significantly less than those reflected in the Company's recorded reserves, the resulting adjustments to those reserves would increase the Company's reported net revenue. If the Company were to change its assumptions and estimates, its reserves would change, which would impact the net revenue that the Company reports. The Company regularly reviews the information related to these estimates and adjusts its reserves accordingly, if and when actual experience differs from previous estimates.

The following table summarizes the activities for sales deductions and product returns for the year ended December 31, 2007:

	Beginning balance	Provision recorded for current period sales	Credits processed / Payments	Ending balance
Accounts Receivable Reserves				
Chargebacks	$ (40,211)	$ (170,447)	$ 192,133	$ (18,525)
Rebates and Other	(38,792)	(63,005)	72,782	(29,015)
Total	$ (79,003)	$ (233,452)	$ 264,915	$ (47,540)
Current Liabilities				
Returns	$ (34,144)	$ (9,243)	$ 18,286	$ (25,101)
Others (1)	$ (23,271)	$ (14,498)	$ 27,213	$ (10,556)
Total	$ (57,415)	$ (23,741)	$ 45,499	$ (35,657)

(1) Includes indirect rebates.

NOTE 5: — INVENTORIES

	December 31, 2007	December 31, 2006
Raw and packaging materials	$ 21,292	$ 15,483
Finished goods	23,806	26,375
Work in progress	17,162	11,892
Purchased products for commercial purposes and other	4,697	3,012
	$ 66,957	$ 56,762

As of December 31, 2007 and 2006, reserves recorded against inventories for slow-moving, short-dated, excess and obsolete inventory totaled $12,435 and $14,287, respectively.

As for pledges, see Note 13.

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NOTE 6: — PROPERTY, PLANT AND EQUIPMENT

a. Composition of assets grouped by major classifications are as follows:

	December 31,	
	2007	2006
Cost:		
Land	$ 12,840	$ 12,500
Buildings	163,755	157,550
Leasehold improvements	3,263	3,060
Machinery and equipment	151,878	141,583
Computer equipment	30,901	29,478
Motor vehicles	281	281
Furniture, fixtures and office equipment	8,854	8,236
Advances for property and equipment	290	92
	372,062	352,780
Accumulated depreciation and impairment charges:		
Buildings	42,503	35,475
Leasehold improvements	2,733	2,439
Machinery and equipment	81,417	67,065
Computer equipment	27,543	23,051
Motor vehicles	272	236
Furniture, fixtures and office equipment	5,665	4,761
	160,133	133,027
Depreciated cost	$ 211,929	$ 219,753

Depreciation expenses were $19,874, $20,098 and $18,910, for the years ended December 31, 2007, 2006 and 2005, respectively. For related impairment charges, see Note 2.k.

b. Cost of property, plant and equipment includes capitalized interest expenses, capitalized direct incremental costs such as payroll and related expenses and other internal costs incurred in order to bring the assets to their intended use in the amount of $13,147 and $15,941 as of December 31, 2007 and 2006, respectively. Capitalized interest and other costs were $56, $8,670, and $12,199 for the years ended December 31, 2007, 2006 and 2005, respectively.

c. Cost of computer equipment includes capitalized development costs of computer software developed for internal use in the amount of $4,416 and $4,158 as of December 31, 2007 and 2006, respectively.

d. As for pledges – see Note 13.

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NOTE 7: —INTANGIBLE ASSETS AND DEFERRED COSTS

a. Composition:

	December 31, 2007	December 31, 2006
Cost:		
Product rights	$ 68,852	$ 68,245
Deferred charges in respect of loans and bonds from institutional investors	1,246	1,216
Other deferred cost	1,541	1,541
	71,639	71,002
Accumulated amortization and impairment charges:		
Product rights	42,689	39,602
Deferred charges in respect of loans and bonds from institutional investors	1,144	1,031
Other deferred cost	1,438	1,306
	45,271	41,939
Amortized cost	$ 26,368	$ 29,063

b. Amortization expenses related to product rights were $2,740, $5,014, and $5,101, for the years ended December 31, 2007, 2006 and 2005, respectively.

c. As of December 31, 2007, the estimated amortization expense of product rights for 2008 to 2012 is as follows: 2008 - $2,805; 2009 - $2,932; 2010 - $2,789; 2011 - $2,680; and 2012 - $2,518.

d. The weighted-average amortization period for product rights is 14 years.

NOTE 8: — LONG-TERM RECEIVABLES AND OTHER ASSETS

	December 31, 2007	December 31, 2006
Prepayment of land leased from Israel Land Administration (1)	$ 15,065	$ 15,292
Receivable related to class action lawsuit	7,000	7,000
Derivative instruments (2)	659	5,743
Severance pay fund (3)	3,649	2,755
Long-term deposit	84	-
Other	119	753
	$ 26,576	$ 31,543

(1) The land is leased for a period of 49 years and is subject to renewal. This amount was prepaid. For more details see Note 2.i.

(2) See Note 9.

(3)

Under Israeli law, the Company and its Israeli subsidiaries are required to make severance or pension payments to dismissed employees and to employees terminating employment under certain other circumstances. Deposits are made with a pension fund or other insurance plans to secure pension and severance rights for the employees in Israel. These amounts represent the balance of the deposits in those funds (including profits) that will be used to cover the Company’s severance obligations. See Note 11.b.

The Company’s non-Israeli subsidiaries maintain defined contribution retirement savings plans covering substantially all of their employees. Under the plans, contributions are based on specific percentages of pay and are subject to statutory limits. The subsidiaries’ matching contribution to the plan was approximately $910, $913 and $956 for the years-ended December 31, 2007, 2006 and 2005, respectively.

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	December 31,		
	2007	2006	2005
Pension, retirement savings and severance expenses	$ 3,902	$ 4,763	$ 3,688

NOTE 9: — DERIVATIVE INSTRUMENTS

The Company's operations are exposed to market risks from changes in interest rates and currency exchange rates. Exposure to these risks is managed through normal operating and financing activities and, when appropriate, through derivative instruments.

a. Interest rates:

The Company manages its risk to fluctuating interest rates by opportunistically using interest rate swaps to convert its floating rate debt into fixed rate obligations. These interest rates swaps are not designated as hedges and changes in the fair value of these instruments are reflected in earnings. The Company's interest rate swaps are as follows.

In June 2005, the Company entered into a mortgage agreement for its New Jersey facility. Subsequently, in September 2005, the Company entered into an interest rate swap to mitigate variable mortgage interest rate risk by effectively establishing the mortgage rate at a fixed rate of 4.66%. At December 31, 2007, the fair market value of the swap was a $154 liability, and was recorded in other long-term liabilities on the consolidated balance sheet. At December 31, 2006, the fair market value of the swap was a $137 asset, and was recorded in long-term receivables and other assets on the consolidated balance sheet. The Company recorded an unrealized (loss) gain of ($291), $111 and $26 within financial expenses, net for the years ended December 31, 2007, 2006 and 2005, respectively. This swap matured on November 28, 2008. See Note 12.a.6.

In September 2005, the Company also entered into a mortgage agreement for its New York facility and concurrently entered into an interest rate swap with the intention to mitigate the variable mortgage interest rate risk by effectively establishing the mortgage rate at a fixed rate of 6.16%. At December 31, 2007, the fair market value was a $269 liability, and was recorded in other long-term liabilities on the consolidated balance sheet. At December 31, 2006, the fair market value was a $177 asset, and was recorded in long-term receivables and other assets on the consolidated balance sheet. The Company recorded an unrealized (loss) gain of ($446), $207, and ($30) within financial expenses, net, for the years ended December 31, 2007, 2006 and 2005, respectively. See Note 12.a.6.

b. Currency exchange rates:

The Company manages its exposure to debt obligations denominated in currencies other than its functional currency by opportunistically using cross-currency swaps to convert its foreign currency debt payments into its functional currency. These cross-currency swaps are not designated as hedges and changes in fair value of these derivatives are reflected in earnings.

From July 1999 to November 2000, the Company issued approximately $24 million of CPI + 8.25% bonds denominated in NIS with terms of 10 years. At the same time, the Company entered into 9-10 year cross currency swaps in which the Company receives CPI plus 6% to 8.25% in NIS and pays LIBOR plus 0.6% to 3.3% in USD based on the outstanding amount of the bonds. At December 31, 2007, the fair market value of these swaps was a $1,169 asset and was recorded in other receivables, prepaid expenses and other ($510 short-term portion) and long-term receivables and other assets ($659 long-term portion). At December 31, 2006, the fair market value of these swaps was a $716 asset and was recorded in other receivables, prepaid expenses and other ($212 short-term portion) and long-term receivables and other assets ($504 long-term portion). For the years ended December 31, 2007, 2006, and 2005, net gains (losses) of approximately $883, $628 and ($972) were recorded within financial expenses, net for these swaps.

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In November 2003, the Company entered into loan agreements to borrow, in Israel, NIS 210.8 million for an eleven-year term at an annual interest rate of 5.8%. At the same time the Company entered into a USD/NIS, 5-year, CPI-adjusted currency swap in which it will receive at the end of the period the NIS amount linked to the CPI plus interest equal to 5.8% of the outstanding NIS balance, and will pay $47,190 USD plus a fixed rate of 5.9%. At December 31, 2007, the fair market value of this swap was a $12,271 asset and was recorded in other receivables, prepaid expenses and other. At December 31, 2006 the fair market value of this swap was a $5,147 asset, and was recorded in other receivables and prepaid expenses ($222 short-term portion) and long-term receivables and other assets ($4,925 long-term portion) on the consolidated balance sheet. The Company recorded net gains of $7,597, $4,101 and $749 within financial expenses, net for the years ended December 31, 2007, 2006 and 2005, respectively. This swap matured on November 28, 2008 and was replaced on the maturity date by a USD/NIS, CPI-adjusted, 6-year currency swap.

NOTE 10: — SHORT-TERM BANK CREDIT AND SHORT-TERM LOANS

Classified by currency, linkage terms and interest rates, the credit and loans are as follows:

	Weighted - average interest rate December 31, 2007		Amount December 31, 2007	2006
	2007	2006	2007	2006
Short-term bank credit and short-term loans:				
In, or linked to, U.S. dollars (1) (2) (3) (4)	6.92 %	6.92 %	$ 80,841	$ 91,304
In NIS (5)	7.07 %	7.55 %	10,759	11,002
In Canadian dollars (6) (7)	6.97 %	6.45 %	17,392	17,020
			108,992	119,326
Reclass from long-term debt, included in the above amounts (8)			35,181	42,783
Total utilized credit lines and short-term loans			$ 73,811	$ 76,543
Total authorized credit lines and short-term loans			$ 76,042	$ 78,765
Unutilized credit lines			$ 2,231	$ 2,222
Weighted-average interest rates at the end of the year for all loans	6.94 %	6.91 %		

(1) This amount includes approximately $28,100 of outstanding debt under a $40,000 Taro U.S.A. credit facility at December 31, 2007 and 2006, respectively. This credit facility bears interest at a rate of LIBOR plus 2.75% and is secured by a first lien on Taro U.S.A.'s accounts receivable, inventory and all products and proceeds thereof. Additional borrowings are currently not available under this facility due to covenant defaults. Subsequent to the balance sheet date, the Company amended this credit agreement to extend the maturity date to October 5, 2010.

(2) This amount includes approximately $9,750 and $10,000 of outstanding debt under a $10,000 Taro U.S.A. credit facility at December 31, 2007 and 2006, respectively. The Company entered into a letter agreement with this financial institution as described in Note 12.a.3.

(3) This amount includes approximately $23,800 and $29,327 of outstanding debt under the Company's credit facilities in Israel at December 31, 2007 and 2006, respectively.

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(4) This amount includes approximately $19,191 and $23,877 of long-term debt reclassified as short-term due to covenant defaults at December 31, 2007 and 2006, respectively.

(5) This amount represents outstanding debt under the Company’s credit facilities of $6,193 and $4,389 and a reclassification from long-term debt of $4,566 and $6,613 in Israel at December 31, 2007 and 2006, respectively.

(6) This amount includes approximately $5,967 and $4,728 of outstanding debt at December 31, 2007 and 2006, respectively, under a demand revolving line of credit to Taro Pharmaceuticals Inc, the Company’s indirect Canadian subsidiary. The amount available under this line of credit was $8,070 and $6,865 at December 31, 2007 and 2006, respectively. This facility is secured by a general security agreement over the Canadian subsidiary’s assets other than real property and certain other capital assets. In addition, the agreement provides the lending institution a second lien on real property and other capital assets in Canada, and the United States.

(7) This amount includes approximately $11,424 and $12,292 of long-term debt reclassified as short-term due to covenant defaults at December 31, 2007 and 2006, respectively.

(8) These amounts represent long-term debt classified as short-term debt due to covenant defaults described in Notes 12.a.1, 12.a.3, 12.a.4 and 12.a.6.

NOTE 11: — OTHER LIABILITIES

a. Other current liabilities:

	December 31, 2007	December 31, 2006
Returns reserve	$ 25,101	$ 34,144
Due to customers (1)	1,626	16,327
Employees and payroll accruals	11,432	7,382
Deferred revenue	1,176	7,055
Medicaid and indirect rebates	5,038	6,944
Accrued income taxes	9,443	6,163
Payable to Medicis	-	5,100
Legal and audit fees	2,166	4,429
Accrued expenses	7,600	4,183
Interest payable	1,726	2,072
Other	6,895	3,584
	$ 72,203	$ 97,383

(1) Amount due to customers in excess of their outstanding balance as a result of chargebacks, rebates and other deductions:

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b. Other long-term liabilities:

	December 31, 2007	December 31, 2006
Class action lawsuit	$ 10,000	$ 10,000
Accrued severance pay	4,642	3,645
Deferred revenue	-	1,176
Grant from Irish government	233	538
Other	424	76
	$ 15,299	$ 15,435

NOTE 12: — LONG-TERM DEBT

a. Composed as follows:

	December 31, 2007	December 31, 2006
Loans from institutional investors and bonds (1)	$ 8,313	$ 10,296
Loans from institutional investors and bonds (2)	97,040	102,393
Banks (3)	1,577	5,333
Term loan from Canadian bank (4)	14,451	19,308
Mortgage for U.S. distribution facility (5) (6)	10,450	12,650
Mortgage for U.S. office facility (6)	11,059	11,608
	142,890	161,588
Less: current maturities	31,348	28,428
Less: long-term debt reclassified as short-term loans (1, 3, 4, 6)	35,181	42,783
	$ 76,361	$ 90,377

1. In 1999 and 2000, the Company entered into a series of debenture and loan agreements in Israel, secured by a floating charge on substantially all of its property, assets and rights. The debentures were issued in separate tranches during 1999 and 2000 for a term of 10 years, with the last tranche maturing in November 2010; most of the loan balance at December 31, 2007 and 2006 was linked to Israeli CPI plus 8.25%. Under the debentures, Taro provided certain undertakings that, among other things, as long as the loan is outstanding, (i) the ratio between long-term liabilities and shareholders' equity shall not exceed two and the current ratio (defined as current assets divided by current liabilities) shall not be less than one and (ii) the ratio of current assets and liabilities shall not exceed one. Such ratios are based on the Company's audited financial statements. As of December 31, 2007 and 2006, the Company was current with its payment obligations but not in compliance with other covenants. Since the Company was not in compliance with certain covenants as described above and since according to the provisions of the agreements, the lenders have the right to accelerate the obligations after notice and opportunity to cure, the Company has reclassified the long-term portion of its long-term debt to these lenders in the amount of $5,032 and $7,404, to short-term loans at December 31, 2007 and 2006, respectively.

2. In 2003, the Company entered into two series of loan agreements, subsequently amended, with multiple lenders in Israel. Approximately half of the amount of the loans was issued in U.S. dollars at an interest rate of 6.0 – 6.1%,

maturing in 2010. The other half of the loans were issued in NIS at a rate of Israeli CPI plus 5.8%, maturing in 2014. The debentures, provided certain undertakings, including (i) not to encumber any of its assets, unless to secure indebtedness, as defined in such agreements, which in the aggregate does not exceed $20,000, or unless to encumber newly acquired assets to secure financing provided to acquire such assets, and (ii) not to incur any additional indebtedness as long as the ratio of EBITDA to total net interest expense and current principal payable on long-term indebtedness is less than 2:1. The test is based on the Company's audited financial statements, and is performed on April 1 of each year with respect to the prior calendar year. Since the Company was not in compliance with the above described covenants, no additional indebtedness has been incurred by the Company. Although additional borrowing by the Company is restricted, the lenders do not have the right to accelerate their obligations and, thus, these loans have not been reclassified as short-term debt.

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3. In 2004, in connection with the long and short-term loans provided by four banks, the Company provided each such bank with undertakings including provisions that it would: (i) not pledge any of its current or future assets without the prior written consent of such bank, provided that Taro is allowed to pledge any newly acquired assets to secure financing provided to acquire such assets and to pledge any fixed assets up to an aggregate of $20,000, which includes the pledges in favor of the lenders under the 1999 and 2000 debenture and loan agreements; (ii) not sell or transfer any of the current or future assets of the Company (excluding current assets) without the prior written consent of such lender, provided that the Company is allowed to sell any asset without consent of such lender if the sale proceeds do not exceed 5% of the total assets (based on the audited financial statements) less the current assets and goodwill (based on the audited financial statements); (iii) comply with certain financial covenants, one of which requires that the Company's operating income will exceed 12% of sales, and another which requires that the Company maintain a ratio of debt to EBITDA not to exceed 3.5 over a rolling three-year average, and (iv) comply with certain financial reporting requirements. Excluding the mortgage relating to the distribution facility in New Jersey that is described in (6) below, the loans covered by the foregoing covenants and negative pledge undertakings matured in 2008 and bore interest ranging from LIBOR plus 0.9% to LIBOR plus 2%. As of December 31, 2007, the Company was current with its payment obligations but was not in compliance with the covenants. Since the Company was not in compliance with certain covenants as described above and otherwise set forth in the original loan agreements with these banks, and since according to the agreements, the banks have the right to accelerate their obligations, the Company has reclassified the long-term portion of its long-term debt to these banks. As of December 31, 2006, the Company reclassified long-term loans in the amount of $1,577 as short-term loans. No amounts were reclassified as short-term loans at December 31, 2007.

4. During 2004, Taro Pharmaceuticals Inc., the Company's indirect Canadian subsidiary, refinanced its mortgage payable and its plant expansion term loans with a new term loan. The new term loan is collateralized by a first lien on the Canadian subsidiary's land, buildings and certain manufacturing equipment, a lien covering all other assets, subject to prior liens indicated in Note 10 above, and a subordinated lien on the buildings and land securing the mortgage loans described in (6) below, as well as certain equipment of Taro U.S.A. Taro U.S.A. and two of its subsidiaries have provided guarantees to the lender for the full amount of the loan. The Canadian subsidiary provided undertakings in the relevant loan documentation that include certain (i) financial covenants, requiring the Canadian subsidiary to maintain a maximum ratio of debt to tangible net worth of 1.60:1 and a ratio of current assets to current liabilities of 1.5:1 or more and (ii) financial reporting covenants relating to the Company and certain subsidiaries, including the Canadian subsidiary. Since the Canadian subsidiary was not in compliance with certain covenants as described above, and in accordance with the agreement, the bank has the right to accelerate its obligation. The Company has reclassified the long-term portion of its long-term debt to this bank in the amount of $11,424 and $12,293, as short-term loans at December 31, 2007 and 2006, respectively.

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5. On January 8, 2004, the Company's U.S. subsidiary expanded its distribution capacity with the purchase of a 315,000 square foot distribution center on 25 acres of land in South Brunswick, New Jersey. Taro acquired the facility for $18,433, of which, $13,200 was financed by a mortgage. This facility is subject to depreciation on a straight-line basis over a 40 year period.

6. In 2005, Taro U.S.A. and two of its subsidiaries entered into obligations, secured by mortgages on the Company's U.S. headquarters facility located in New York and distribution facility located in New Jersey. The Company guaranteed these obligations. The Canadian bank described in (4) above has a subordinated security position in the facilities which are the subject of the mortgages. The mortgage on the New York facility was $11,059 and $11,608, as of December 31, 2007 and 2006, respectively, was for an original term of 15 years, bears interest at the rate of LIBOR plus 1.25%, and has a graduating debt service coverage ratio covenant of 1.90, which the Company failed to meet. The interest rate of this mortgage is effectively fixed at 6.16%, as the Company has an interest rate swap in place which is concurrent with the 15-year term of the mortgage. The mortgage on the New Jersey facility, as described in (5) above, was $10,450 and $12,650, as of December 31, 2007 and December 31, 2006, was for an original term of seven years, bearing interest at the rate of LIBOR plus 1.85% and has certain financial and reporting covenants. The interest rate of the mortgage was effectively fixed at 4.66%, as the Company had an interest rate swap in place through November 28, 2008. The mortgage holder is one of the banks with which the Company entered into a letter agreement, with similar covenants, as described in (3) above. On November 28, 2008, the principal amount of this mortgage was increased from $4,743 to $12,992, and the interest rate swap was terminated. Since the Company, with respect to each such mortgage, was not in compliance with certain financial and other covenants and because each lender has the right to accelerate its obligations, the Company has reclassified the long-term portion of each mortgage, in the amount of $18,725 and $21,509, respectively, as short-term loans at December 31, 2007 and 2006, respectively.

As discussed above, part of the undertakings also include financial reporting obligations that have not been met as a result of the delayed filing of the Company's Annual Reports on Form 20-F for the years 2007, 2008 and 2009. The Company is also not in compliance with certain financial, reporting, and administrative covenants. Additionally, most of the Company's debt instruments have cross-default provisions that provide for acceleration of payments in the event of failure to meet payment obligations or a breach or default of covenants included in other agreements. As a result, even though the Company has been current in its payment obligations, the loans, except the one described in Note 12a.2 above, are callable by the lenders until the Company is in compliance with its Form 20-F filing requirements as well as with all covenants. In addition, the covenants and undertakings described above restrict the Company's ability to incur additional debt.

As a result of the foregoing, various creditors have the right to elect to accelerate their indebtedness and pursue remedial action, including proceeding against collateral that has been granted to them. The financial statements presented herein do not reflect any adjustments for the impact of any such acceleration or remedial action if they were to be taken.

b. Classified by currency, linkage terms and interest rates, the total amount of the liabilities (including current maturities and the reclassified short-term portion) is as follows:

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	Weighted Average Interest Rate		Amount	
	December 31,		December 31,	
	2007	2006	2007	2006
In, or linked to, U.S. dollars	6.08%	5.98%	$ 62,882	$ 81,643
In Canadian dollars	7.09%	6.33%	14,451	19,308
In Israeli currency – linked to CPI	6.08%	6.17%	65,557	60,637
			$ 142,890	$ 161,588

Not included in the CPI-linked loans, are loans in the amount of $47,682 and $62,417 as of December 31, 2007 and 2006, respectively, which are subject to variable interest rates primarily linked to the LIBOR or the Canadian Bankers' Rate. The remaining balance of the Company's outstanding debt is subject to fixed interest rates.

c. The debt matures as follows:

	December 31, 2007
2008	$ 31,348
2009	29,809
2010	28,383
2011	14,648
2012	13,462
Thereafter	25,240
	$ 142,890

As of the date of these financial statements, the Company has met all of its scheduled debt obligations.

For collateral, see Note 13.

NOTE 13: — LIABILITIES COLLATERALIZED BY PLEDGES

Balance of liabilities collateralized by pledges is as follows:

	December 31,	
	2007	2006
Short-term bank credit and short-term loans (1)	$ 34,067	$ 32,841
Long-term debt (including current maturities) (2)	$ 44,274	$ 53,862

(1) Short-term bank credits and short-term loans primarily include $28,100 of debt secured by accounts receivable, inventory and all products and proceeds thereof of Taro U.S.A. at December 31, 2007 and 2006.

(2) Long-term debt primarily includes mortgages secured by facilities in the U.S.A. and Canada.

For further discussion of collateralized assets see Notes 10 and 12.

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NOTE 14: — COMMITMENTS AND CONTINGENT LIABILITIES

a. Companies of the Group have leased offices, warehouse space and equipment under operating leases for periods through 2012. The minimum annual rental payments, under non-cancelable lease agreements, are as follows:

	December 31, 2007
2008	$ 2,183
2009	1,471
2010	975
2011	75
2012 and thereafter	39
	$ 4,743

Total rent expenses were $3,562, $2,935 and $3,395 for the years ended December 31, 2007, 2006 and 2005, respectively.

b. Royalty commitments:

The Company is committed to pay royalties at the rate of 3% to 5% to the government of Israel through the Office of the Chief Scientist (“OCS”) on proceeds from sales of products in which the government participates in the research and development by way of grants. The obligation to pay these royalties is contingent on actual sales of the products and, in the absence of such sales, no payment is required. The commitment is on a product by product basis, in an amount not exceeding the total of the grants received by the Company, including interest accrued thereon, and is linked to the U.S. dollar. Commencing in 1999, grants are subject to interest at a rate of LIBOR (cost of borrowing funds in U.S. dollars). As of December 31, 2007 and December 31, 2006, the aggregate contingent liability to the OCS was approximately $12,382 and $11,600, respectively.

Royalty payments (refunds) to the OCS were ($309), $340 and $325 for the years ended December 31, 2007, 2006 and 2005, respectively.

c. Legal proceedings:

From time to time the Company is subject to litigation arising in the ordinary course of business. Except for the accruals with respect to the Zwickel case (see Note 14.c.4.iii) and the Israeli taxation cases (see Note 14.c.3), no accruals for any lawsuits, to which the Company is party, are required in the financial statements. Additionally, the Company is party to certain lawsuits disclosed herein, whose outcome the Company does not believe will have a material adverse effect on its consolidated financial statements.

1. Legal actions commenced by the Company:

i. Company’s lawsuit related to Special Tender Offer:

For a detailed description of the Company's lawsuit related to the Sun Offer, see Note 1.c.

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ii. Company's lawsuit related to Sun's failure to disclose information in the Sun Offer:

On September 29, 2009, the Company filed a lawsuit against Sun and certain of its affiliates in the United States District Court for the Southern District of New York alleging among other things, failure to disclose material information in the Sun Offer. On October 1, 2010, the Court entered a So-ordered Stipulation of Dismissal without prejudice and dismissed all pending motions as moot.

iii. Company's lawsuit related to Ireland:

On June 15, 2008, the Company brought a lawsuit in the District Court seeking a declaratory ruling and permanent injunction against Sun from taking actions to hinder the Company's efforts to sell its Irish operations. This case is pending before the District Court.

iv. Company's lawsuit related to Ovide® (malathion) lotion:

On July 27, 2009, the Company filed a lawsuit against Synerx Pharma, LLC, DPT Laboratories, Ltd. and Karalex Pharma, LLC (a subsidiary of Eagle Pharmaceuticals, Inc.) in the United States District Court for New Jersey for infringement of its United States Patent No. 7,560,445 covering its Ovide® (malathion) Lotion, 0.5%. This matter was dismissed in early 2011 with no material impact on the Company's financial position.

2. Legal actions by certain shareholders:

i. Templeton's lawsuits related to proposed Merger Agreement:

Between May and August 2007, Templeton filed three motions which were all dismissed by the District Court related to the Share Purchase and Merger Agreements. One decision was appealed but then subsequently dismissed on November 15, 2010.

ii. Sun's lawsuit related to the termination of the Merger Agreement and enforcement of the Option Agreement:

On June 25, 2008, Sun filed a lawsuit in New York State Court against, among others, the Company and all of its directors, related to the Merger Agreement and the Option Agreement. On September 29, 2010, Sun discontinued this action against all defendants.

iii. Sun's lawsuit related to the issuance of audited financial statements:

On May 14, 2009, Sun and Alkaloida brought a lawsuit against the Company and its directors at the time in the District Court related to the issuance of audited financial statements for the years 2006 and thereafter. Upon Sun and Alkaloida's motion, the Court dismissed all claims on October 10, 2010.

iv. Sun's litigation relating to the Company's engagement of Guggenheim Securities, LLC ("Guggenheim"):

On July 27, 2010, certain affiliates of Sun that hold shares in the Company filed an originating motion against the Company with the Haifa District Court requesting a declaratory ruling related to the Company's engagement of

Guggenheim. Upon Sun's affiliates' motion, the Court dismissed all claims on October 10, 2010.

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3. Litigations related to Israeli taxation:

i. The Company has challenged a tax assessment by the Israel Income Tax Authority ("ITA") on certain options granted in 1992 to certain officers of Taro U.S.A. The ITA claimed that taxes should have been withheld by the Company and assessed a payment of approximately $34,000 nominal amount of tax and approximately $19,000 in interest and other charges to be paid by Taro. In January 2008, the Company filed an appeal against the assessment with the Haifa District Court. In addition, applications for the conduct of Mutual Agreement Proceedings ("MAP") pursuant to the Israel-United States tax treaty with respect to this matter have been filed both with the Israel Tax Authority and the U.S. Internal Revenue Service. MAP proceedings are intended to resolve matters of double taxation; the Company itself is not a party to those MAP proceedings. Based on the opinion of counsel, the Company believes that no Israeli tax liability or withholding obligation arose as a result of the option exercise because both under Israeli tax law and under the Israel/U.S. Tax Treaty, no Israeli tax can be imposed on the employment or service income (including compensatory option gains) of United States residents derived from employment or services performed in the United States.

ii. On December 31, 2009, the Company and the ITA reached an agreement related to a tax assessment for the Company's taxes for the years 2002 and 2003. The Company is fully reserved for the amounts agreed to with the ITA and believes that an unfavorable result is more likely than not. See Note 16 for further details.

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4. Other Legal Actions:

i. On November 10, 2004, the Company was sued in the Superior Court of New Jersey in Atlantic County along with other defendants in a purported class action lawsuit for alleged personal injuries related to defendants' sale of amiodarone. On June 9, 2010, the class action case was dismissed with prejudice, with a window of 150 days for individual claimants to file lawsuits. Only one suit was commenced against the Company. In early 2011, an agreement to resolve this matter was reached which will have no material impact on the Company's financial position.

ii. A group of former Israeli soldiers have filed three lawsuits for personal injury against the Municipality of Haifa, The Israel Oil Refineries Ltd., The Haifa Town Union Sewage and Haifa Chemicals Ltd. alleging that they contracted serious illnesses as result of their military service which included diving in the Kishon River near Haifa Bay. In 2005, the Company and over 40 municipalities, governmental entities (including the State of Israel), cooperative villages (kibbutzim) and other companies, were named as third party defendants in these lawsuits. The hearing of the lawsuits was consolidated with the hearing of another lawsuit filed by a group of fishermen also claiming to suffer from serious illnesses as a result of their activities in the Kishon River. The proceedings are currently in different stages, during which the parties present the evidence in the cases to the court.

iii. On April 28, 2008, the Company agreed to pay $10,000, of which $7,000 will be provided by its insurance company, as part of a settlement with plaintiffs in a class action suit, Zwickel v. Taro Pharmaceutical Industries Ltd., 04-CV-5969 (S.D.N.Y.). The legal proceedings were initially filed in 2004, and a consolidated amended complaint was filed in 2007, against the Company and certain of its current and former officers and directors alleging claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The settlement amount of $10,000 owed by the Company was accrued as part of other long-term liabilities in the 2006 consolidated balance sheet. The receivable from the insurance company was recorded as part of long-term receivables and other assets in the 2007 and 2006 consolidated balance sheets. On October 26, 2009, the Company fulfilled its obligation as per the terms of the settlement agreement and the Company's insurer paid its respective settlement amount as well.

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d. In 2003, the Company and its Irish subsidiary entered into an agreement with a government agency in Ireland to receive grants for the development and provision of employment for a manufacturing facility in Ireland. The obligation to repay these grants terminated in 2008 and 2009, subject to the continued operation and control by the Company's Irish subsidiary. The grants, or portions thereof, may be revoked if jobs related to the grants remain vacant for a period in excess of six calendar months. As of December 31, 2007 and 2006, the balance of grants received was $233 and $538, respectively, and is included in other long-term liabilities. Subsequent to the balance sheet date, the Company fulfilled all of its obligations under the terms of the grant agreement and earned the full benefit of the grant. This grant was amortized as earned by the Company.

e. Subsequent to the balance sheet date, in November 2009, the Company's Irish subsidiary sold a vial filling line for $1,485, net of transaction costs. For further details see Note 1.f.

NOTE 15: — SHAREHOLDERS' EQUITY

a. Pertinent rights and privileges of ordinary shares:

1. 100% of the rights to profits are allocated to the ordinary shares.

2. 100% of the dissolution rights are allocated to the ordinary shares.

3. Two-thirds of the voting power of the Company's shares is allocated to the ordinary shares.

b. Founders' Shares:

One-third of the voting power of all of the Company's shares is allocated to the founders' shares.

c. Stock option plans:

1. The Company's 1991 Stock Incentive Plan provided for the issuance of incentive stock options, non-qualified stock options, and stock appreciation rights to key employees and associates of the Group.

The options were granted with an exercise price equal to 100% of the fair market value of the stock on the date of grant. As of December 31, 2007, none of the options granted include stock appreciation rights. The options are granted to employees and associates, have a four-year graded vesting term and generally expire ten years after the date of the grant. Each option entitles its holder the right to purchase one ordinary share. As of December 31, 2007 and 2006, an aggregate of 82,575 and 124,649 options in respect of the 1991 plan were outstanding, respectively, and no further options in respect of the 1991 plan are available for future grants. The Company issues new shares to employees and associates exercising their stock options.

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2. The Company’s 1999 Stock Incentive Plan (“1999 plan”) provides for the issuance of incentive stock options, non-qualified stock options, and stock appreciation rights to key employees and associates of the Group.

The options are substantially granted with an exercise price equal to 100% of the fair market value of the stock on the date of grant and the aggregate amount of the options granted may not exceed 2,100,000. As of December 31, 2007, none of the options granted include stock appreciation rights. The options are granted to employees and associates, have a four to five-year graded vesting term and generally expire ten years after the date of the grant. Each option entitles its holder the right to purchase one ordinary share of NIS 0.0001 par value (subject to adjustments). As of December 31, 2007 and 2006, an aggregate of 1,132,130 and 1,268,480 options in respect of the 1999 plan were outstanding, respectively, and, as of March 10, 2009, no further options in respect of the 1999 plan are available for future grants. The Company issues new shares to employees and directors exercising their stock options.

3. During December 2005, the Company accelerated the vesting period of 1,052,030 options outstanding with a weighted-average exercise price of $35.23, which was higher than the market price at the time of the acceleration, and with remaining vesting periods prior to acceleration from one to five-years. The decision to accelerate the vesting of those options was based primarily upon the issuance of SFAS 123(R) which required the Company to record compensation expense for all unvested stock options effective January 1, 2006. The Company believes that the acceleration of vesting of those options will enable the Company to avoid recognizing stock-based compensation expenses associated with these options in future periods. An additional reason for the acceleration of the vesting period was to make the options more attractive to the recipients.

4. A summary of the Company’s stock option activity (except options to non-employees) and related information for the year ended December 31, 2007 is as follows:

	Number of options	Exercise price $	Weighted-average exercise price $	Weighted-average remaining contractual terms (in years)	Aggregate intrinsic value
Outstanding at December 31, 2006	1,387,129	$2.38 - $69.26	$ 25.20		
Exercised	(41,400)	$2.44 - $4.63	$ 3.10		
Forfeited	(206,024)	$2.38 - $69.26	$ 28.36		
Granted	75,000	$6.23 - $10.13	$ 6.75		
Outstanding at December 31, 2007	1,214,705	$2.38 - $69.26	$ 24.31	5.66	$ 586
Exercisable at December 31, 2007	863,455		$ 26.83	4.74	$ 491
Vested and expected to vest at December 31, 2007	897,519		$ 25.15	5.40	$ 417

Total intrinsic value of options exercised for the year ended December 31, 2007 and December 31, 2006 was approximately $161 and $250, respectively.

As of December 31, 2007, there was $902 of unrecognized compensation costs related to share-based compensation arrangements granted under the Company's stock option plan. The unrecognized cost is expected to be recognized over a weighted-average period of 6.72 years for the year ended December 31, 2007. For the years ended December 31, 2007, 2006 and 2005 the Company recognized $284, $599, and $382, respectively, in stock-based compensation expense.

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The number of options exercisable as of December 31, 2007, 2006 and 2005 are 863,455, 1,037,379, and 1,421,183, respectively. The weighted-average exercise prices for the options exercisable as of December 31, 2007, 2006 and 2005 are $26.83, $26.04, and $28.13, respectively.

The stock options outstanding and exercisable as of December 31, 2007 have been classified into ranges of exercise prices as follows:

	Options outstanding			Options exercisable	
Range of exercise price	Outstanding as of December 31, 2007	Weighted-average remaining contractual life (in years)	Weighted-average exercise price $	Exercisable as of December 31, 2007	Weighted-average exercise price $
$2.38 – $10.00	182,325	4.33	$ 4.48	117,325	$ 3.52
$10.01 – $20.00	345,150	6.03	$ 13.40	141,100	$ 12.56
$20.01 – $30.00	241,900	6.42	$ 24.68	216,700	$ 24.66
$30.01 – $40.00	304,980	5.35	$ 33.60	268,980	$ 33.55
$40.01 – $69.26	140,350	5.92	$ 56.50	119,350	$ 55.42
	1,214,705	5.67	$ 24.36	863,455	$ 26.83

5. The weighted-average price and fair values for options granted were:

	Granted below market price Year ended December 31,			Granted equal to market price Year ended December 31,		
	2007	2006	2005	2007	2006	2005
Weighted-average exercise price	$ 0.00	$ 0.00	$ 33.37	$ 6.75	$ 14.03	$ 28.38
Weighted-average fair value on the date of grant	$ 0.00	$ 0.00	$ 19.61	$ 4.00	$ 8.64	$ 17.63

6. There was no activity related to non-employees stock options as of December 31, 2007 and 2006.

d. Dividends:

The Company may declare and pay dividends out of retained earnings (as for restrictions on dividend distribution, see Note 16.d).

e. Net income (loss) per share:

	Year ended December 31, 2007			Year ended December 31, 2006			Year ended December 31, 2005		
	Net income (numerator)	Shares (denominator)	Per Share Amount	Net (loss) (numerator)	Shares (denominator)	Per Share Amount	Net income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS:	$ 34,336	34,724,702	$ 0.99	$ (82,679)	29,347,202	$ (2.82)	$ 84	29,250,398	$ 0.00
Effect of dilutive securities:									
Stock options	-	78,496	-	-	-	-	-	339,899	-
Sun Stock Warrants		411,439							
Diluted EPS:	$ 34,336	35,214,637	$ 0.98	$ (82,679)	29,347,202	$ (2.82)	$ 84	29,590,297	$ 0.00

f. 2000 Employee Stock Purchase Plan:

In May 2000, the Company's Board of Directors ("Board") approved and implemented the 2000 Employee Stock Purchase Plan ("2000 Plan"), which was approved at an extraordinary general meeting of shareholders held on May 2, 2001. The purpose of the 2000 Plan is to provide employees of the Company and those of its subsidiaries, designated by the Board, an opportunity to purchase ordinary shares. The maximum number of shares issuable under the 2000 Plan is 500,000 ordinary shares, subject to adjustment.

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Under the terms of the 2000 Plan, participating employees accrue funds in an account through payroll deductions during six month offering periods. Eligible employees can have up to 10% of their earnings withheld, up to a maximum of $25,000 annually. The funds in this account are applied at the end of such offering periods to purchase ordinary shares at a 15% discount from the closing price of the ordinary shares on (i) the first business day of the offering period or (ii) the last business day of the offering period, whichever closing price is lower. As of December 31, 2007 and December 31, 2006, participating employees purchased an aggregate of $7,139 and 211,134 of newly issued ordinary shares, respectively, at weighted-average exercise prices of $7.72 and $23.12, respectively.

The amounts of consideration received from participating employees for the years ended December 31, 2007, 2006 and 2005 were $55, $598, and $1,422, respectively.

In August 2006, the Company extended, by six months, the term of the March 2006 grant under the 2000 Plan. Subsequent to the balance sheet date, the Company decided to suspend the 2000 Plan until it was in compliance with SEC regulations to issue shares and allowed employees to withdraw funds owed to them by the plan. The effect of the above modification was immaterial to the 2006 Company's consolidated financial statements. In accordance with SFAS No. 123(R), the 2000 Plan is compensatory, and as such, results in recognition of compensation costs. For the years ended December 31, 2007 and December 31, 2006, the Company recognized $10 and $295, respectively, of compensation expenses in connection with the 2000 Plan.

NOTE 16: — INCOME TAXES

a. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985 of Israel:

With respect to the Israeli entity, commencing in taxable year 2003, the Company has elected to measure its taxable income and file its tax return under the Israeli Income Tax Regulations, 1986 (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income). Such an elective obligates the Company for three years. Accordingly, commencing taxable year 2003, results for tax purposes are measured in terms of earnings in U.S. dollars. After the initial three-year term, the Company has to make the election on an annual basis. Through taxable year 2009, the Company has consistently elected, for tax purposes, to measure its earnings in U.S. dollars.

b. Tax rates applicable to the income of the Israeli companies in the Group:

1. Generally, Israeli companies are subject to "corporate tax" on their taxable income. On July 25, 2005, the Knesset (Israeli Parliament) approved the Law of the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2005 - 34%, in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. However, the effective tax rate payable by a company that derives income from an Approved Enterprise, as discussed below, may be considerably less.

2. On July 25, 2009, the Knesset approved new legislation which provides for lower tax rates in the years 2011-2016. According to the new legislation, the corporate tax rate is to be gradually reduced over the years 2010-2016. The top income tax rate will decrease from 25% in 2010 to 18% in 2016.

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3. Pursuant to another amendment to the Income Tax Ordinance, which became effective in 2003, capital gains are taxed at a reduced rate of 25% from January 1, 2003, instead of the regular corporate tax rate at which such gains were taxed until the aforementioned date. This amendment stipulates that with regard to the sale of assets acquired prior to January 1, 2003, the reduced tax rate will be applicable only for the gain allocated to capital gains earned after the implementation of the amendment, which will be calculated as prescribed by the amendment.

c. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969:

The Company is an "industrial company" as defined by this law and, as such, is entitled to certain income tax benefits, mainly accelerated depreciation in respect of machinery and equipment (as prescribed by regulations published under the Inflationary Adjustments Law) and the right to claim public issuance expenses, amortization of patents and other intangible property rights as deductions for tax purposes.

d. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

The Company's production facilities in Israel have been granted an "Approved Enterprise" status under the Law. The main benefits arising from such status are tax exempt income for a period of two to four years and reduction in tax rates on income derived from Approved Enterprises for the remaining benefit period. The Company is also a "foreign investors' company", as defined by the Law and, as such, is entitled to a 10 or 15 year period of benefits, based on the level of investment, and to a reduction in tax rates to 10% to 25% (based on the percentage of foreign ownership in each tax year) and to accelerated depreciation in respect of machinery and equipment.

The period of tax benefits, described above, is subject to a limit of 12 years from commencement of production or 14 years from the date of receiving the Approved Enterprise status, whichever occurs earlier.

The Company has four "Approved Enterprise" plans. Under the approved plans, the undistributed income derived from the Approved Enterprise will be exempt from corporate tax for a period of two to four years, and the Company will be eligible for a reduced tax rate of between 10% and 25% for an additional six to eight years. Notwithstanding the foregoing, the Company's undistributed income will be eligible for a reduced tax rate for an additional five years. Under the fourth plan, which was filed in January 2010, and is pending approval, the undistributed income will be exempt from corporate tax for a period of two years following implementation of the plan and the Company will be eligible for a reduced tax rate of between 10% and 25% (based on the percentage of foreign ownership in each tax year) for an additional eight years thereafter. The Company expects to receive approval for this plan.

The entitlement to these benefits is conditional upon the Company fulfilling the requirements of the Law, regulations published thereunder and the instruments of approval for the specific investments in Approved Enterprises. In the event of failure to comply with these requirements, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2007, management believes that the Company is meeting all of the aforementioned requirements.

The income subject to reduced tax rates, attributable to the Approved Enterprises, cannot be distributed to shareholders without subjecting the Company to additional taxes. The Company has decided not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved Enterprises.

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If the retained income subject to reduced tax rates is distributed, it will be taxed at the corporate tax rate applicable to such profits as if the Company had not chosen the alternative tax benefits (currently 10%).

If the Company pays a dividend out of income derived from the Approved Enterprises during the tax exemption period, the Company will be subject to corporate tax in the year the dividend is distributed in respect of the gross amount of dividend distributed, at the rate that would have been applicable had the Company not elected the Alternative Route (10% to 25%, depending on the level of foreign investment in the company, as explained below).

For 2007, income not eligible for Approved Enterprise benefits mentioned above is taxed at the regular rate of 29%. See Note 16.b.

On April 1, 2005, an amendment to the Investment Law came into effect (‘‘the Amendment’’) and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a Benefited Enterprise, such as provisions generally requiring that at least 25% of the Benefited Enterprise’s income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Amendment provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore, the Company’s existing Approved Enterprises will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the new law, will subject the Company to taxes upon distribution or liquidation and the Company may be required to record deferred tax liability with respect to such tax-exempt income. As of December 31, 2007, the Company did not generate income under the provisions of the new law. The amendment also added section 85a which gives the Minister of Finance the authority to legislate regulation which determines the price in international transactions between related parties (known as transfer pricing issue).

e. On July 24, 2002, Amendment 132 to the Israeli Income Tax Ordinance (“the Ordinance Amendment”) was approved by the Israeli Parliament and came into effect on January 1, 2003. The principal objectives of the Ordinance Amendment were to broaden the categories of taxable income and to reduce the tax rates imposed on employees’ income.

The material consequences of the Ordinance Amendment applicable to the Company include, among other things, imposing a tax on all income of Israeli residents, individuals and corporations, regardless of the territorial source of income, certain modifications in the qualified taxation tracks of employee stock options and 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. Since the Company benefits from lower tax rates of an “Approved Enterprise,” such credits are immaterial to its results of operations.

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f. Income (loss) before income taxes comprises of the following:

	Year ended December 31, 2007	2006	2005
Domestic (Israel)	$ 20,728	$ (17,098)	$ 22,729
Foreign (North America, the Cayman Islands, Ireland and the U.K.)	19,820	(64,709)	(21,168)
	$ 40,548	$ (81,807)	$ 1,561

g. Taxes on income comprise of the following:

	Year ended December 31, 2007	2006	2005
Current taxes	$ 4,015	$ 4,103	$ 2,361
Deferred income taxes	2,197	(3,231)	(884)
	$ 6,212	$ 872	$ 1,477
Domestic	$ 3,049	$ 1,470	$ 1,240
Foreign	3,163	(598)	237
	$ 6,212	$ 872	$ 1,477

Included within current and deferred income tax expense are benefits relating to investment tax credits at Taro Canada of $1,075 for the year ended December 31, 2007. Taro Canada uses the “flow-through” method and therefore records the benefits in earnings in the period the tax credits are utilized.

h. Reconciliation of the theoretical tax expenses to the actual tax expenses:

A reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to income of the Group and the actual tax expense is as follows:

	Year ended December 31, 2007	2006	2005
Income (loss) before income taxes	$ 40,548	$ (81,807)	$ 1,561
Statutory tax rate	29%	31%	34%
Theoretical tax (credits)	$ 11,759	$ (25,360)	$ 531
Deferred tax in respect of losses for which valuation allowance was provided	2,462	24,923	2,287
(Benefit) tax in respect to prior years	(601)	303	-
Tax in respect to advanced years	-	-	317
“Approved Enterprise” (benefit) expense (1)	(4,353)	1,874	(3,263)
Effect of different tax rates in other countries	768	4,517	753

Non-deductible expenses	3,480	4,800	2,477
Canadian tax benefits in respect of research and development expenses	(865)	(1,332)	(1,427)
Utilization of net operating losses	(6,452)	(29)	(5,592)
Deferred tax asset on temporary differences for which a valuation allowance was provided	(907)	(7,670)	5,439
Other	921	(1,154)	(45)
Income taxes in the Statements of Operations	$ 6,212	$ 872	$ 1,477

(1) Per share tax benefit (expense) resulting from the income exemption:

	Year ended December 31, 2007	2006	2005
Basic	$ 0.13	$ (0.06)	$ 0.11
Diluted	$ 0.12	$ (0.06)	$ 0.11

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i. Current taxes are calculated at the following rates:

	Year ended December 31, 2007	2006	2005
On Israeli operations (not including "Approved Enterprise")	29.0 %	31.0 %	34.0 %
On U.S. operations *	34.0 %	35.0 %	34.0 %
On Canadian operations *	34.1 %	34.1 %	33.8 %
On U.K. operations *	30.0 %	35.0 %	35.0 %

* The U.S., U.K., Irish and Canadian subsidiaries are taxed on the basis of the tax laws prevailing in their countries of residence. The Canadian subsidiary qualifies for research and development tax credits, thereby reducing its effective tax rate.

j. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes and carryforward losses.

	December 31, 2007	2006
Deferred tax assets:		
Net operating loss carryforward	$ 64,424	$ 70,627
Deferred revenue	1,933	2,818
Property, plant, and equipment	2,581	2,537
Accrued expenses	21,474	18,423
Bad debt allowance	193	775
Amortization and impairment	9,493	10,078
Other, net	5,926	9,076
Total deferred tax assets	106,024	114,334
Valuation allowance for deferred tax assets	(100,031)	(105,896)
Net deferred tax assets	5,993	8,438
Deferred tax liabilities:		
Property, plant, and equipment	(4,394)	(4,490)
Amortization	(84)	(81)
Other, net	(1,532)	(1,450)
Total deferred tax liabilities	(6,010)	(6,021)
Net deferred tax (liabilities) assets	$ (17)	$ 2,417
Domestic	$ 1,871	$ 2,456
Foreign	(1,888)	(39)
	$ (17)	$ 2,417

The deferred income taxes are presented in the balance sheet as follows:

	December 31, 2007	December 31, 2006
Among current assets ("other receivables, prepaid expenses and other")	$ 3,221	$ 4,735
Long-term deferred income tax assets	2,772	3,703
Among short-term liabilities	(424)	(505)
Among long-term liabilities	(5,586)	(5,516)
	$ (17)	$ 2,417

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k. Carryforward tax losses:

1. The Company:

As of December 31, 2007, the Israeli company has carryforward tax losses in the amount of $268.

2. Canadian subsidiary:

As of December 31, 2007, this subsidiary has no carryforward tax losses.

3. U.K. subsidiary:

As of December 31, 2007, this subsidiary has carryforward tax losses in the amount of $10,980, which may be carried forward and offset against taxable income for an indefinite period in the future. As discussed in Note 2.q, there is a full valuation allowance provided against these losses.

4. Irish subsidiary:

As of December 31, 2007, this subsidiary has carryforward tax losses of $28,666. Taro Ireland commenced trade in 2006 and therefore has satisfied any expiration deadlines. As discussed in Note 2.q., a full valuation allowance is provided against these losses.

5. U.S. subsidiary:

As of December 31, 2007, this subsidiary has carryforward tax losses in the amount of $164,287 resulting from prior years U.S. operating losses and the exercise of stock options in 2001 by selling shareholders in a public offering of the Company's shares. These losses can be carried forward against taxable income for 20 years from the year in which the losses were incurred, resulting in expiration dates of 2021 through 2026. As discussed in Note 2.q., a full valuation allowance is provided against these losses as it was determined then that it was not more likely than not that the Company would be in a position to utilize such losses in the future. However, in 2008, the Company utilized approximately $26.4 million of such losses on its tax returns and estimates that it will utilize a similar amount on its 2009 tax returns.

l. The Company's Board of Directors has determined that its U.S. subsidiary will not pay any dividend as long as such payment will result in any tax expense for the Company.

m. Deferred taxes for income taxes were not provided for on a cumulative total of $81,748 of the undistributed earnings of Taro Canada, which are not taxable provided earnings remain undistributed. Taro Canada intends to invest these earnings indefinitely in its operations.

n. Foreign withholding taxes have been accrued as necessary by the Company and its subsidiaries.

o. Tax assessments:

The Company completed its tax assessments with the Israeli tax authorities for years through 2003. The Company's tax provision was adequate to satisfy these assessments. The Company remains subject to examination by the Israeli tax authorities for years 2004 and onward. The Company believes that its tax provision is adequate to satisfy any assessments resulting from examinations related to these years.

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The Company's U.S. subsidiary has been examined by U.S. tax authorities through 2001. Due to its net operating loss carryforward, the U.S. subsidiary remains subject to examination by the U.S. tax authorities for years 2002 and onward. However, so long as these net operating losses are available, the Company believes its U.S. subsidiary will not have any tax assessments.

The Company completed its tax assessments for domestic issues with the Canadian tax authorities for the years through 2001, and for international tax considerations for years through 1998. The Company’s tax provision was adequate to satisfy these assessments. The Company remains subject to examination by the Canadian tax authorities for domestic issues for years 2004 and onward and for international issues for year 1998 and onward. The Company believes that its tax provision is adequate to satisfy any assessments resulting from examinations related to these years.

p. Uncertain tax positions:

The Company adopted FIN 48 effective January 1, 2007, which prescribes a model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. For additional information, see Note 2 q.

		December 31, 2007
Unrecognized tax benefits at January 1, 2007	$	12,023
Increases as a result of positions taken in prior periods		408
Increases as a result of positions taken in current period		2,168
Unrecognized tax benefits at December 31, 2007	$	14,599

The total amount of interest and penalties recognized on the consolidated statement of operations for the year ended December 31, 2007 and consolidated balance sheet at December 31, 2007 are $234 and $812, respectively.

The total amount of unrecognized tax benefits, which would impact the effective tax rate if recognized, was $7,145 at December 31, 2007.

Taro Canada and the Israeli company have the 2004 and 2005 tax years currently under examination. No tax years for Taro U.S.A. are currently under examination by IRS.

The Company, to the best of its knowledge, does not believe any of its uncertain tax positions are reasonably likely to significantly increase or decrease within the next 12 months.

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NOTE 17: — SELECTED STATEMENTS OF INCOME DATA

	Year Ended December 31, 2007	2006	2005
Sales by location of customers:			
Israel	$ 17,362	$ 14,942	$ 15,243
Canada	34,913	37,266	26,420
U.S.A.	258,519	192,785	243,416
Other	8,760	7,276	3,544
	$ 319,554	$ 252,269	$ 288,623
Research and development expenses, net:			
Total expenses	$ 29,508	$ 36,703	$ 46,273
Less — grants and participations	(309)	430	559
	$ 29,817	$ 36,273	$ 45,714
Selling, marketing, general and administrative expenses:			
Selling and marketing	$ 32,257	$ 34,862	$ 36,258
Advertising	6,473	11,741	20,836
General and administrative *	58,544	62,445	53,654
	$ 97,274	$ 109,048	$ 110,748
* Including provision for doubtful accounts	$ (23)	$ 1,030	$ 1,201
Financial expenses:			
Interest and exchange differences on long-term liabilities	$ 9,313	$ 8,749	$ 6,498
Income in respect of deposits	(1,162)	(2,232)	(2,200)
Expenses in respect of short-term credit	6,339	5,325	3,214
Foreign currency transaction losses (gains)	8,326	(388)	473
	$ 22,816	$ 11,454	$ 7,985
Interest capitalized in cost of property, plant, and equipment	$ -	$ 2,952	$ 4,455

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NOTE 18: — SEGMENT INFORMATION

a. Geographic Area Information:

The Group operates in one industry segment, which produces, researches, develops and markets pharmaceutical products. Management organizes the Company's operations based on geographic segments, which are presented below in accordance with SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information".

	Israel	Canada*)	U.S.A.	Other	Consolidated
Year ended December 31, 2007 and as of December 31, 2007:					
Sales to unaffiliated customers **	$ 17,362	$ 34,913	$ 258,519	$ 8,760	$ 319,554
Long-lived assets ***	$ 117,339	$ 62,757	$ 46,860	$ 18,628	$ 245,584
Year ended December 31, 2006 and as of December 31, 2006:					
Sales to unaffiliated customers **	$ 14,942	$ 37,266	$ 192,785	$ 7,276	$ 252,269
Long-lived assets ***	$ 126,531	$ 62,725	$ 51,385	$ 15,406	$ 256,047
Year ended December 31, 2005 and as of December 31, 2005:					
Sales to unaffiliated customers**	$ 15,243	$ 26,420	$ 243,416	$ 3,544	$ 288,623
Long-lived assets ***	$ 128,490	$ 70,653	$ 82,785	$ 30,516	$ 312,444

* Includes operations in both Canada and Cayman Islands.

** Based on customer's location.

*** Includes Property, Plant and Equipment, net, Goodwill and Intangible Assets, Net.

b. For the year ended December 31, 2007, the Company had net sales to two different customers of 15.8% and 10.1% of consolidated net sales. For the years ended December 31, 2006, and 2005, the Company had net sales to a different single customer of 12.0%, and 22.7% of consolidated net sales, respectively.

c. Sales by therapeutic category, as a percentage of total sales for the years ended December 31, 2007, 2006 and 2005:

Category	Year ended December 31, 2007	2006	2005
		%	
Dermatological and topical	67	67	71
Cardiovascular	12	13	12
Anti-inflammatory	7	7	8
Neuropsychiatric	9	7	5
Other	5	6	4
Total	100	100	100

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NOTE 19: — SUBSEQUENT EVENTS

a. Licensing Agreements:

1. In June 2009, Taro and Quinnova Pharmaceuticals, Inc. ("Quinnova") entered into an agreement to co-promote "Neosalus" and "Cleanse & Treat" (the "Co-Promote Products") in the United States. Until the expiration of the agreement in September 2010, Taro's branded division, TaroPharma®, and Quinnova were engaged in the coordinated marketing of the Co-Promote Products. This agreement has been terminated upon mutual agreement of the parties.

2. In May 2010, Taro and Quinnova entered into an agreement to co-promote Taro's Topicort and desoximetasone products. Under the terms of the arrangement, Taro manufactures and Quinnova distributes the products. The parties mutually agreed to terminate the agreement in January 2011.

3. In May 2010, Taro and Glenmark Generics Inc., USA, a wholly owned subsidiary of Glenmark Generics Ltd Limited, India ("Glenmark"), entered into an exclusive license and supply agreement for a branded product. Glenmark Generics Inc., USA will manufacture the product and Taro will distribute the product to customers. Taro paid an up-front payment for distribution rights and will pay an additional amount upon the first shipment to customers. Taro will also pay royalties based on the amounts of sales to its customers.

b. Major Shareholder Transactions:

For a detailed description of major shareholder transactions, see Note 1.c.

c. Other:

Payments to pharmacies for Medicaid-covered outpatient prescription drugs are set by the states. For multiple source drugs, Federal reimbursements to states for the Federal share of those payments are subject to a Federal upper limit (FUL) ceiling. Health care reform legislation enacted in March 2010 changed the methodology by which the Centers for Medicare & Medicaid Services (CMS) calculates the FULs so that the methodology will, effective October 1, 2010, be based on the weighted average of the average manufacturer prices (AMPs) reported to the government by manufacturers of each of the therapeutically equivalent multiple source drugs. The legislation also, effective October 1, 2010, changes the definition of AMP to exclude sales to certain customer classes that are currently included. These changes may have the effect of reducing the Medicaid reimbursement rates for certain medications that the Company currently sells. In addition, under the Medicaid Drug Rebate Program, manufacturers are required, as a condition of Federal payment for their drugs under Medicaid, to pay rebates to state Medicaid programs on drugs dispensed to Medicaid beneficiaries in the state. The amount of the rebate is based on the AMP of the drug. Besides changing the definition of AMP, the health care reform legislation increased the minimum Medicaid Rebate, effective January 1, 2010. These changes may increase the Medicaid rebates the Company has to pay for certain medications that the Company currently sells.

d. On March 7, 2011, the Company was sued by The Blackstone Group L.P. ("Blackstone") in the Supreme Court of the State of New York, County of New York. The lawsuit alleges breach of contract relating to fees under an agreement whereby Blackstone would provide certain financial advisory services to the Company. Blackstone seeks approximately $6,300 in fees and expenses. The proceedings are in the very early stages and the Company denies liability in the matter.

e. On April 28, 2011, the Company filed a lawsuit against Suven Life Sciences Ltd. ("Suven") in the United States District Court for New Jersey for infringement of its United States Patent No. 7,560,445 covering its Ovide® (malathion) Lotion, 0.5%. The suit alleges that Suven's abbreviated new drug application seeking approval from the U.S. Food and Drug Administration to sell its own malathion lotion infringes Taro's patent.

f. On April 29, 2011, the Board ratified a collective bargaining agreement dated as of April 6, 2011 (the "Agreement") among Taro, the Histadrut Trade Union and Taro's Employees Committee on behalf of Taro's Israeli employees. The Agreement has a term of five years and automatically renews for two-year periods unless notice is provided by either side prior to the end of a term. The Agreement memorializes current employee-employer relations practices of Taro as well as additional rights relating to job security, compensation and other benefits. Additionally, the Agreement, inter alia, provides for a one-time payment of $1,500 (payable in NIS) to be divided among Taro's Israeli employees as of the date of the Agreement. This amount has been accrued as of December 31, 2010.

g. In 2008, the Company entered into severance agreements tied to change in control, with certain executives whereby each executive would receive salary and benefits for a period of time if terminated after a change in control. In November 2010 and April 2011, the Company terminated employment of certain of these executives.

h. Stock options:

Between 2008 and May 25, 2011 a total of 39,000 stock options were granted to the Company's directors and all currently remain unexercised.

End of consolidated financial statements

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U.S. dollars in thousands

SCHEDULE II: — VALUATION AND QUALIFYING ACCOUNTS

Allowance for Inventory Obsolescence

Year	Balance at beginning of period	Additions — Charged to costs and expenses	Foreign currency translation adjustments	Deductions — Write-offs of Inventory	Balance at end of period
2007	$ 14,287	$ 2,403	$ 574	$ (4,829)	$ 12,435
2006	18,712	4,859	82	(9,366)	14,287
2005	26,927	1,839	247	(10,301)	18,712

Allowance for Doubtful Accounts

Year	Balance at beginning of period	Additions — Charged to costs and expenses	Deductions — Write-offs	Balance at end of period
2007	$ 2,159	$ (23)	$ (1,395)	$ 741
2006	1,778	1,030	(649)	2,159
2005	4,421	1,201	(3,844)	1,778