WATSON PHARMACEUTICALS INC
Form 10-Q
November 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 001-13305

WATSON PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Nevada	**95-3872914**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

Morris Corporate Center III

400 Interpace Parkway

Parsippany, New Jersey 07054

(Address of principal executive offices, including zip code)

(862) 261-7000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of the Registrant s only class of common stock as of October 19, 2012 was approximately 127,756,777.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in millions)

	September 30, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 222.0	$ 209.3
Marketable securities	12.4	14.9
Accounts receivable, net	924.8	1,165.7
Inventories, net	885.1	889.4
Prepaid expenses and other current assets	208.0	122.3
Deferred tax assets	189.2	168.1
Total current assets	2,441.5	2,569.7
Property and equipment, net	708.0	713.7
Investments and other assets	70.9	71.3
Deferred tax assets	28.8	21.7
Product rights and other intangibles, net	1,392.0	1,613.6
Goodwill	1,924.8	1,708.3
Total assets	$ 6,566.0	$ 6,698.3
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	$ 1,343.2	$ 1,535.4
Income taxes payable	5.4	106.7
Short-term debt and current portion of long-term debt	196.8	184.5
Deferred revenue	9.7	12.8
Deferred tax liabilities	0.5	0.1
Total current liabilities	1,555.6	1,839.5
Long-term debt	1,023.8	848.5
Deferred revenue	12.3	17.0
Other long-term liabilities	37.5	72.7
Other taxes payable	62.0	79.0
Deferred tax liabilities	184.9	279.1
Total liabilities	2,876.1	3,135.8
Commitments and contingencies		
Equity:		
Preferred stock		
Common stock	0.5	0.4
Additional paid-in capital	1,939.8	1,881.0
Retained earnings	2,154.7	2,085.4
Accumulated other comprehensive loss	(62.3)	(76.5)
Treasury stock, at cost	(342.1)	(326.7)

Total stockholders equity	3,690.6	3,563.6
Noncontrolling interest	(0.7)	(1.1)
Total equity	3,689.9	3,562.5
Total liabilities and equity	$ 6,566.0	$ 6,698.3

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; in millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenues	$ 1,285.2	$ 1,081.6	$ 4,164.7	$ 3,039.8
Operating expenses:				
Cost of sales (excludes amortization, presented below)	724.1	603.2	2,382.4	1,672.2
Research and development	112.5	73.4	280.7	228.2
Selling and marketing	114.7	104.4	350.7	292.0
General and administrative	110.1	85.2	396.3	249.9
Amortization	95.2	71.8	332.9	203.0
Loss on asset sales and impairments, net	39.6	3.8	119.6	25.6
Total operating expenses	1,196.2	941.8	3,862.6	2,670.9
Operating income	89.0	139.8	302.1	368.9
Non-operating income (expense):				
Interest income	0.4	0.3	1.3	1.6
Interest expense	(19.4)	(24.4)	(62.1)	(69.1)
Other income (expense), net	41.7	2.9	(113.4)	(1.1)
Total other income (expense), net	22.7	(21.2)	(174.2)	(68.6)
Income before income taxes and noncontrolling interests	111.7	118.6	127.9	300.3
Provision for income taxes	35.0	50.9	58.6	135.4
Net income	76.7	67.7	69.3	164.9
Loss attributable to noncontrolling interest		0.4		1.2
Net income attributable to common shareholders	$ 76.7	$ 68.1	$ 69.3	$ 166.1
Earnings per share attributable to common shareholders:				
Basic	$ 0.61	$ 0.55	$ 0.55	$ 1.34
Diluted	$ 0.60	$ 0.54	$ 0.54	$ 1.31
Weighted average shares outstanding:				
Basic	126.0	124.9	125.7	124.4
Diluted	128.0	126.9	127.6	126.4

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited; in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$ 76.7	$ 67.7	$ 69.3	$ 164.9
Other comprehensive income (loss):				
Foreign currency translation gains (losses)	35.8	(74.5)	14.2	(29.9)
Unrealized gains (losses) on securities, net of tax		0.2		(8.5)
Reclassification for (gains) losses included in net income, net of tax				(0.5)
Total other comprehensive income (loss), net of tax	35.8	(74.3)	14.2	(38.9)
Comprehensive income (loss)	112.5	(6.6)	83.5	126.0
Comprehensive loss attributable to noncontrolling interest		0.4		1.2
Comprehensive income (loss) attributable to common shareholders	$ 112.5	$ (6.2)	$ 83.5	$ 127.2

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in millions)

	Nine Months Ended September 30,	
	2012	**2011**
Cash Flows From Operating Activities:		
Net income	$ 69.3	$ 164.9
Reconciliation to net cash provided by operating activities:		
Depreciation	60.7	70.4
Amortization	333.0	203.0
Provision for inventory reserve	37.1	38.3
Share-based compensation	34.6	25.6
Deferred income tax benefit	(124.1)	(51.2)
Losses on equity method investments	0.2	5.7
(Gain)/loss on sale of securities		(0.8)
Loss on asset sales and impairment, net	141.0	25.6
Loss on foreign exchange derivatives	90.0	
Amortization of deferred financing costs	24.3	
Increase in allowance for doubtful accounts	2.4	
Accretion of preferred stock and contingent consideration obligations	20.3	35.9
Contingent consideration fair value adjustment	(21.3)	
Excess tax benefit from stock-based compensation	(12.6)	(13.7)
Other, net	2.5	(0.1)
Changes in assets and liabilities (net of effects of acquisitions):		
Accounts receivable, net	265.0	(121.0)
Inventories	(4.3)	(61.2)
Prepaid expenses and other current assets	(19.9)	21.4
Accounts payable and accrued expenses	(303.0)	98.5
Deferred revenue	(7.7)	(7.1)
Income and other taxes payable	(143.6)	(15.4)
Other assets and liabilities	2.1	(8.6)
Total adjustments	376.7	245.3
Net cash provided by operating activities	446.0	410.2
Cash Flows From Investing Activities:		
Additions to property and equipment	(93.3)	(87.9)
Additions to product rights and other intangibles	(5.9)	(17.7)
Proceeds from sales of property and equipment	7.7	6.4
Proceeds from sales of marketable securities and other investments	8.8	3.9
Additions to investments	(5.3)	(2.6)
Acquisition of business, net of cash acquired	(383.5)	(571.6)
Other investing activities, net		0.6
Net cash used in investing activities	(471.5)	(668.9)
Cash Flows From Financing Activities:		
Proceeds from borrowings on credit facility	375.0	400.0

Debt issuance costs	(34.1)	
Principal payments on debt	(201.7)	(303.8)
Proceeds from stock plans	17.1	53.6
Payment of contingent consideration	(107.2)	(4.5)
Repurchase of common stock	(15.4)	(13.6)
Acquisition of noncontrolling interest	(4.5)	(5.5)
Excess tax benefit from stock-based compensation	12.6	13.7
Net cash provided by financing activities	41.8	139.9
Effect of currency exchange rate changes on cash and cash equivalents	(3.6)	(0.7)
Net increase (decrease) in cash and cash equivalents	12.7	(119.5)
Cash and cash equivalents at beginning of period	209.3	282.8
Cash and cash equivalents at end of period	$ 222.0	$ 163.3

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 GENERAL

Watson Pharmaceuticals, Inc. (Watson, Company, or We) is engaged in the development, manufacturing, marketing, sale and distribution of generic and brand pharmaceutical products. Watson is also developing biosimilar products. Additionally, we distribute generic and certain select brand pharmaceutical products manufactured by third parties through our Anda Distribution business. Watson operates manufacturing, distribution, research and development (R&D) and administrative facilities in many of the world s established and growing international markets, including the U.S., Europe, Canada, Malta, India, Southeast Asia and Brazil.

The accompanying condensed consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2011. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been condensed or omitted from the accompanying condensed consolidated financial statements. The accompanying year end condensed consolidated balance sheet was derived from the audited financial statements. The accompanying interim financial statements are unaudited, but reflect all adjustments which are, in the opinion of management, necessary for a fair statement of Watson s consolidated financial position, results of operations and cash flows for the periods presented. Unless otherwise noted, all such adjustments are of a normal, recurring nature. The Company s results of operations and cash flows for the interim periods are not necessarily indicative of the results of operations and cash flows that it may achieve in future periods.

Acquisition of Actavis Group

On April 25, 2012, we entered into an agreement to acquire Actavis Group for a cash payment of 4.15 billion payable at closing, as adjusted based upon among other things, the net working capital of Actavis, assumption of a maximum of 100.0 million in revolver debt, which is to be repaid at closing, and potential contingent consideration payable in the form of up to 5.5 million newly issued shares of Watson common stock or, under certain circumstances, in cash. The agreement has been approved by the Board of Directors of Watson. Actavis is a privately held generic pharmaceutical company specializing in the development, manufacture and sale of generic pharmaceuticals. Watson consummated the transaction on October 31, 2012. For additional information on the Actavis acquisition, refer to Note 2 Acquisitions and Divestitures and Note 12 Subsequent Events.

Acquisition of Ascent Pharmahealth Ltd.

On January 24, 2012, we completed the acquisition of Ascent Pharmahealth Ltd., (Ascent) the Australian and Southeast Asian generic pharmaceutical business of Strides Arcolab Ltd. for AU$376.6 million, or U.S dollar equivalency of $392.6 million, including working capital adjustments. The transaction was funded using cash on hand and borrowings from the Company s Revolving Credit Facility. As a result of the acquisition, Watson enhances its commercial presence in Australia and gains a selling and marketing capability in Southeast Asia through Ascent s line of generic and over-the-counter products. For additional information on the Ascent acquisition, refer to Note 2 Acquisitions and Divestitures.

Biosimilars Collaborations

On December 19, 2011, we entered into a collaboration agreement with Amgen, Inc. to develop and commercialize, on a worldwide basis, several oncology antibody biosimilar medicines. Under the terms of the

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agreement, Amgen will assume primary responsibility for developing, manufacturing and initially commercializing the oncology antibody products. Watson will contribute up to $400.0 million in co-development costs over the course of development, including the provision of development support, and will share product development risks. In addition, we will contribute our significant expertise in the commercialization and marketing of products in highly competitive specialty and generic markets, including helping effectively manage the lifecycle of the biosimilar products. The collaboration products are expected to be sold under a joint Amgen/Watson label. We will initially receive royalties and sales milestones from product revenues. The collaboration will not pursue biosimilars of Amgen s proprietary products.

On July 13, 2012, the Company entered into a global license agreement with Synthon, obtaining an exclusive license to its trastuzumab molecule, which is being developed as a biosimilar to Herceptin®. Watson subsequently contributed the product to the Company s biosimilar collaboration with Amgen. Under the terms of the Synthon agreement, Amgen and Watson will assume all responsibility for worldwide development and commercialization of biosimilar trastuzumab, including Phase III clinical trials and global manufacturing. The agreement entitles Synthon to an initial payment and the opportunity to receive a milestone payment and royalties on net sales. Synthon will also receive compensation for transitional support activities provided under the agreement.

Acquisition of Specifar Pharmaceuticals

On May 25, 2011, we completed the acquisition of Specifar Commercial Industrial Pharmaceutical, Chemical and Construction Exploitations Societe Anonyme (ABEE) (Specifar), a privately-held multinational generic pharmaceutical company for 400.0 million, or U.S dollar equivalency of $561.7 million, subject to a net working capital adjustment. As a result of the acquisition, we enhanced our commercial presence in key European markets through Specifar s portfolio of approved products. The transaction also gave Watson a strong branded-generic commercial presence in the Greek pharmaceutical market.

Under the terms of the acquisition agreement, Specifar s former owners could receive additional consideration based upon future profits of esomeprazole tablets during its first five years of sales, up to a maximum of 40.0 million. Watson funded the transaction using cash on hand and borrowings from its Revolving Credit Facility.

During the three months ended September 30, 2012, the Company recorded an impairment loss of $40.3 million related to a manufacturing facility located in Greece that was acquired as part of the Specifar acquisition. The impairment for the Greece facility was due to a change in the intended use of the facility as a result of the Company s decision during the third quarter of 2012 to discontinue further construction as a result of the planned acquisition of the Actavis Group.

Global Generics Business Development

Watson has entered into exclusive agreements with Ortho-McNeil-Janssen Pharmaceuticals, Inc. (OMJPI) and Pfizer, Inc. (Pfizer) to market the authorized generic version of Concerta® (methylphenidate ER) and Lipitor® (atorvastatin), respectively. Under the terms of the agreements, OMJPI and Pfizer supply Watson with product. Watson launched its authorized generic of Concerta® and Lipitor® on May 1, 2011 and November 30, 2011, respectively.

Under the terms of its agreements, Watson pays a royalty to OMJPI based on the gross profit of product revenues as defined in the agreements. During the third quarter of 2012, the royalty payable to OMJPI was approximately 50% of sales which includes the cost of the product supplied by OMJPI. Our royalty payable on sales of methylphenidate ER will decline if a third party competitor launches a competing bioequivalent product.

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Under the terms of its agreement with Pfizer, Watson is obligated to make additional payments to Pfizer to the extent that a percentage of net sales exceed the aggregate supply price for authorized generic of Lipitor®. In addition, Pfizer is obligated to make payments to Watson to the extent that the aggregate supply price for the authorized generic of Lipitor® is in excess of a certain percentage of sales.

The agreements with OMJPI and Pfizer expire on December 31, 2014 and November 30, 2016, respectively, and are subject to normal and customary early termination provisions.

In accordance with the acquisition agreement of the Arrow Group on December 2, 2009, the Arrow Group selling shareholders have the right to receive certain contingent payments based on the after-tax gross profits, as defined by the agreement, on sales of atorvastatin within the U.S. (the Territory) from product launch date up to and including May 31, 2013 (the Contingent Payment Period). The determination of contingent payment amounts is dependent upon the existence of generic competition within the Territory and after-tax gross profits earned, as defined in the acquisition agreement. Prior to the launch of a competing generic product in the Territory during the Contingent Payment Period, payment of contingent consideration is calculated as 50% of the after-tax gross profits, as defined in the acquisition agreement. Upon launch of a competing product to atorvastatin in the Territory during the Contingent Payment Period, the contingent consideration is calculated as either 85% of the after-tax gross profits or 15% of the after-tax gross profits, as defined in the acquisition agreement, with total contingent payments being limited to $250.0 million during the Contingent Payment Period.

Watson Laboratories, Inc. has entered into an agreement with Endo Pharmaceuticals Inc. and Teikoku Seiyaku Co., Ltd to settle all outstanding patent litigation related to Watson's generic version of Lidoderm®. The agreement allows Watson to launch its lidocaine topical patch 5% product on September 15, 2013. The license will be exclusive as to an authorized generic version of Lidoderm® until the earliest of a third party generic launch or seven and one half months after Watson's launch of its generic product. Endo will receive approximately 25% of the gross profit generated on Watson's sales of its generic version of Lidoderm® during Watson's period of exclusivity. On August 23, 2012, the U.S. Food and Drug Administration (FDA) granted final approval of Watson s generic version of Lidoderm®.

Additionally, under the terms of the agreement, Watson will receive and distribute branded Lidoderm® product from Endo each month during the first eight months of 2013 valued up to approximately $96 million. Watson's availability of brand product would cease upon the launch of any generic version of Lidoderm®. The receipt of the branded product will be recorded at the time all contingencies related to Watson s ability to receive and distribute such inventory are resolved.

Preferred and Common Stock

As of September 30, 2012 and December 31, 2011, there were 2.5 million shares of no par value per share preferred stock authorized. The Board has the authority to fix the rights, preferences, privileges and restrictions, including but not limited to, dividend rates, conversion and voting rights, terms and prices of redemptions and liquidation preferences without vote or action by the stockholders. On December 2, 2009, the Company issued 200,000 shares of Mandatorily Redeemable Preferred Stock. The Mandatorily Redeemable Preferred Stock is redeemable in cash on December 2, 2012, and is accordingly included within short-term debt in the consolidated balance sheet at September 30, 2012 and December 31, 2011. Refer to Note 6 Debt for additional discussion.

As of September 30, 2012 and December 31, 2011, there were 500.0 million shares of $0.0033 par value per share common stock authorized, 138.0 million and 137.1 million shares issued and 127.8 million and 127.2 million outstanding, respectively. Of the issued shares, 10.2 million shares and 10.0 million shares were held as treasury shares as of September 30, 2012 and December 31, 2011, respectively.

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Revenue Recognition

Revenue is generally realized or realizable and earned when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller s price to the buyer is fixed or determinable, and collectability is reasonably assured. The Company records revenue from product sales when title and risk of ownership have been transferred to the customer, which is typically upon delivery to the customer. Revenues recognized from research, development and licensing agreements (including milestone payments) are recorded on the contingency-adjusted performance model which requires deferral of revenue until such time as contract milestone requirements, as specified in the individual agreements, have been met. Under this model, revenue related to each payment is recognized over the entire contract performance period, starting with the contract s commencement, but not prior to earning and/or receiving the milestone payment (i.e., removal of any contingency). The amount of revenue recognized is based on the ratio of costs incurred to date to total estimated cost to be incurred. In certain circumstances, it may be appropriate to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. Royalty and commission revenue is recognized in accordance with the terms of their respective contractual agreements when collectability is reasonably assured and revenue can be reasonably measured.

Revenue and Provision for Sales Returns and Allowances

As customary in the pharmaceutical industry, the Company s gross product sales are subject to a variety of deductions in arriving at reported net product sales. When the Company recognizes revenue from the sale of products, an estimate of sales returns and allowances (SRA) is recorded, which reduces product sales. Accounts receivable and/or accrued expenses are also reduced and/or increased by the SRA amount. These adjustments include estimates for chargebacks, rebates, cash discounts and returns and other allowances. These provisions are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and current contract sales terms with direct and indirect customers. The estimation process used to determine our SRA provision has been applied on a consistent basis and no material adjustments have been necessary to increase or decrease our reserves for SRA as a result of a significant change in underlying estimates. The Company uses a variety of methods to assess the adequacy of our SRA reserves to ensure that our financial statements are fairly stated. This includes periodic reviews of customer inventory data, customer contract programs and product pricing trends to analyze and validate the SRA reserves.

The provision for chargebacks is our most significant sales allowance. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to the Company by our wholesale customer for a particular product and the negotiated contract price that the wholesaler s customer pays for that product. The Company s chargeback provision and related reserve varies with changes in product mix, changes in customer pricing and changes to estimated wholesaler inventories. The provision for chargebacks also takes into account an estimate of the expected wholesaler sell-through levels to indirect customers at contract prices. The Company validates the chargeback accrual quarterly through a review of the inventory reports obtained from our largest wholesale customers. This customer inventory information is used to verify the estimated liability for future chargeback claims based on historical chargeback and contract rates. These large wholesalers represent 85% - 90% of the Company s chargeback payments. The Company continually monitors current pricing trends and wholesaler inventory levels to ensure the liability for future chargebacks is fairly stated.

A number of factors impact the level of SRA as a percentage of gross accounts receivable. These factors include sales levels for our Distribution segment, which has lower levels of SRA relative to our other segments, and international sales with operations in Europe, Canada, Australasia, South America and South Africa, which generally has lower levels of SRA compared to our U.S. generic business.

Net revenues and accounts receivable balances in the Company s consolidated financial statements are presented net of SRA estimates. Certain SRA balances are included in accounts payable and accrued expenses.

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Accounts receivable are presented net of SRA balances of $523.6 million and $556.3 million at September 30, 2012 and December 31, 2011, respectively. SRA balances in accounts receivable at September 30, 2012 decreased $32.7 million compared to December 31, 2011 primarily due to lower chargeback and rebate amounts on lower U.S. sales of atorvastatin partially offset by an increase in returns and other allowances. Accounts payable and accrued expenses include $282.1 million and $250.5 million at September 30, 2012 and December 31, 2011, respectively, for certain rebates including Medicaid and other amounts due to indirect customers.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to, the Company s stockholders. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that, under GAAP, are included in comprehensive income (loss), but excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity. Watson s other comprehensive income (loss) is composed of unrealized gains (losses) on certain holdings of publicly traded equity securities, net of tax, reclassification for (gains) losses included in net income, net of tax and foreign currency translation adjustments.

Goodwill and Intangible Assets with Indefinite-Lives

During the second quarter of 2012, the Company performed its annual impairment assessment of goodwill, acquired in-process research and development (IPR&D) intangibles and trade name intangible assets with indefinite-lives. The Company determined there was no impairment associated with goodwill or trade name intangibles. However, the Company recorded a $101.0 million impairment charge related to certain IPR&D assets acquired as part of the Specifar acquisition. The impairment was related to delays in expected launch dates, and other competitive factors that resulted in lower forecasted pricing and additional projected manufacturing costs. These events in the second quarter led us to revise the estimated fair value of these IPR&D assets compared to the carrying values.

Earnings Per Share (EPS)

Basic EPS is computed by dividing net income by the weighted average common shares outstanding during a period. Diluted EPS is based on the treasury stock method and includes the effect from potential issuance of common stock, such as shares issuable pursuant to the exercise of stock options, assuming the exercise of all in-the-money stock options and restricted stock units. Common share equivalents have been excluded where their inclusion would be anti-dilutive.

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A reconciliation of the numerators and denominators of basic and diluted EPS consisted of the following (in millions, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
EPS - basic				
Net income attributable to common shareholders	$ 76.7	$ 68.1	$ 69.3	$ 166.1
Basic weighted average common shares outstanding	126.0	124.9	125.7	124.4
EPS - basic	$ 0.61	$ 0.55	$ 0.55	$ 1.34
EPS - diluted				
Net income attributable to common shareholders	$ 76.7	$ 68.1	$ 69.3	$ 166.1
Basic weighted average common shares outstanding	126.0	124.9	125.7	124.4
Effect of dilutive securities:				
Dilutive stock awards	2.0	2.0	2.0	2.0
Diluted weighted average common shares outstanding	128.0	126.9	127.6	126.4
EPS - diluted	$ 0.60	$ 0.54	$ 0.54	$ 1.31

Awards to purchase 0.1 million and 0.2 million common shares for the three month and nine month periods ended September 30, 2011were outstanding but were not included in the computation of diluted earnings per share because the options were anti-dilutive.

Share-Based Compensation

The Company recognizes compensation expense for all share-based compensation awards made to employees and directors based on estimated fair values. Share-based compensation expense recognized during a period is based on the value of the portion of share-based awards that are expected to vest with employees. Accordingly, the recognition of share-based compensation expense has been reduced for estimated future forfeitures. These estimates will be revised in future periods if actual forfeitures differ from the estimates. Changes in forfeiture estimates impact compensation expense in the period in which the change in estimate occurs.

As of September 30, 2012, the Company had $54.0 million of total unrecognized compensation expense, net of estimated forfeitures, which will be recognized over the remaining weighted average period of 1.6 years. During the nine months ended September 30, 2012, the Company issued approximately 890,368 restricted stock grants and performance awards with an aggregate intrinsic value of $57.0 million. Certain restricted stock units are performance-based awards issued at a target number, subject to adjustments up or down based upon achievement of certain financial targets. No stock option grants were issued during the nine months ended September 30, 2012.

Recent Accounting Pronouncements

In July 2012, the FASB issued new guidance that changed the indefinite-lived intangible assets impairment guidance. The revised standard provides entities an option to assess qualitative factors to determine whether

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performing a quantitative test necessary. If an entity believes, as a result of its qualitative test that it is more likely than not that an indefinite-lived intangible asset s fair value is less than its carrying amount, then the quantitative test would need to be performed. Otherwise no further testing is required. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. The new guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company completed its most recent indefinite-lived intangible assets impairment test during the second quarter of 2012 and recognized an impairment loss associated with in-process research and development, for additional information refer to Note 5 Goodwill and Intangible Assets. The adoption of this new guidance did not have any impact on the Company s consolidated financial statements.

In September 2011, the FASB issued a revised standard changing the goodwill impairment guidance. The revised standard provides entities with the option to first assess qualitative factors to determine whether performing the two-step goodwill impairment test is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the two-step quantitative impairment test will be required. Otherwise, no further testing will be required. Entities can choose to perform the qualitative assessment on none, some, or all of its reporting units. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company completed its most recent annual goodwill impairment test during the second quarter 2012 by applying the two-step test and determined that there was no impairment associated with goodwill. The adoption of this new guidance did not have any impact on the Company s consolidated financial statements.

NOTE 2 ACQUISITIONS AND DIVESTITURES

Business acquisitions after 2008 have been accounted for under the acquisition method. Business acquisitions occurring during 2012 were as follows:

Acquisition of Actavis Group

On April 25, 2012, the Company entered into a Sale and Purchase Agreement (the Purchase Agreement) with Actavis Acquisition Debt S.à r.l., a company incorporated in Luxembourg (the Vendor), Nitrogen DS Limited, a company incorporated in the British Virgin Islands, Landsbanki Islands hf., a company incorporated in Iceland, ALMC Eignarhaldsfélag ehf., a company incorporated in Iceland, ALMC hf., a company incorporated in Iceland, Argon Management S.à r.l., a company incorporated in Luxembourg, the Managers party thereto, Deutsche Bank AG, London Branch, a branch of a company incorporated under the laws of the Federal Republic of Germany. Actavis is a privately held generic pharmaceutical company specializing in the development, manufacture and sale of generic pharmaceuticals. The acquisition was subject to customary conditions, including review by the U.S. Federal Trade Commission (FTC) under the provisions of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act), as well as approvals outside of the United States. The Purchase Agreement was approved by the Board of Directors of Watson and was consummated on October 31, 2012.

Pursuant to the Purchase Agreement, Watson acquired (i) the entire issued share capital of Actavis, Inc., a Delaware corporation, Actavis Pharma Holding 4 ehf., a company incorporated in Iceland, and Actavis S.à r.l., a company incorporated in Luxembourg (collectively Actavis) and (ii) all the rights of the Vendor in certain indebtedness of Actavis, in exchange for the following consideration:

A cash payment of 4.15 billion, as adjusted based upon among other things, the net working capital of Actavis;

Assumption of a maximum of 100.0 million in revolver debt of the Vendor, and,

The potential right to receive contingent consideration payable in the form of up to 5.5 million newly issued shares of Watson common stock or, under certain circumstances, in cash, based on Actavis financial performance in 2012 as described in the Purchase Agreement. The shares issued, if any, would be issued in 2013.

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The Company funded the cash portion of the transaction through a combination of term loan borrowings pursuant to an agreement with a syndicate of lenders dated June 22, 2012 and senior unsecured notes, which the Company issued on October 2, 2012. For additional information, refer to Note 6 Debt and Note 12 Subsequent Events.

Acquisition Related Expenses

Included in general and administrative expenses for the three and nine months ended September 30, 2012 are costs totaling $13.9 million and $51.5 million, respectively for acquisition and integration costs including advisory, legal, regulatory and severance charges incurred in connection with the acquisition of the Actavis Group.

Acquisition of Ascent Pharmahealth Ltd.

On January 24, 2012, Watson acquired all of the outstanding equity of Ascent for AU$376.6, or U.S dollar equivalency of $392.6 million, including certain working capital adjustments. The transaction was funded using cash on hand and borrowings from the Company s Revolving Credit Facility. Through the acquisition, Watson enhances its commercial presence in Australia and gains selling and marketing capabilities in Southeast Asia. In Australia, Ascent markets generic, brands, over-the-counter (OTC) and dermatology and skin care products. In Southeast Asia, Ascent markets generic and OTC products. Ascent s Southeast Asian business includes commercial operations in Singapore, Malaysia, Hong Kong, Vietnam and Thailand. Ascent operates a manufacturing facility in Singapore for generic products in Southeast Asian markets. Ascent s results are included in the Global Generics segment as of the acquisition date.

Recognition and Measurement of Assets Acquired and Liabilities Assumed at Fair Value

The transaction has been accounted for using the acquisition method of accounting. This method requires, among other things, that assets acquired and liabilities assumed in a business purchase combination be recognized at their fair values as of the acquisition date and that in-process research and development (IPR&D) be recorded at fair value on the balance sheet regardless of the likelihood of success of the related product or technology.

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The following table summarizes the final fair values of the tangible and identifiable intangible assets acquired and liabilities assumed at acquisition date (in millions):

	Amount
Cash and cash equivalents	$ 9.1
Accounts receivable	29.7
Inventories	27.2
Other current assets	3.3
Property, plant & equipment	4.4
Intangible assets	192.6
Goodwill	214.3
Current liabilties	(35.7)
Long-term deferred tax and other tax liabilities	(51.8)
Other long term liabilities	(0.4)
Long-term debt	(0.1)
Net assets acquired	$ 392.6