

KING PHARMACEUTICALS INC

Form 10-Q

May 06, 2010

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended March 31, 2010**
- 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 No. 001-15875  
King Pharmaceuticals, Inc.**

*(Exact name of registrant as specified in its charter)*

**Tennessee**  
*(State or other jurisdiction of  
incorporation or organization)*

**54-1684963**  
*(I.R.S. Employer  
Identification No.)*

**501 Fifth Street,  
Bristol, TN**  
*(Address of principal executive offices)*

**37620**  
*(Zip Code)*

**(423) 989-8000**

*(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  No

Indicate by check mark whether the registrant 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

Number of shares outstanding of Registrant's common stock as of May 3, 2010: 249,627,116

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**Table of Contents**

	<b>Page</b>
<b><u>PART I</u> Financial Information</b>	2
<u>Item 1.</u> Financial Statements	2
<u>Condensed Consolidated Balance Sheets</u>	2
<u>Condensed Consolidated Statements of Operations</u>	3
<u>Condensed Consolidated Statements of Changes in Shareholders' Equity and Other Comprehensive Income</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2.</u> Management's Discussion and Analysis of Financial Condition and Results of Operations	29
<u>Item 3.</u> Quantitative and Qualitative Disclosures about Market Risk	51
<u>Item 4.</u> Controls and Procedures	51
<b><u>PART II</u> Other Information</b>	52
<u>Item 1.</u> Legal Proceedings	52
<u>Item 1A.</u> Risk Factors	52
<u>Item 6.</u> Exhibits	52
<u>Signatures</u>	53
<u>EX-10.5</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****KING PHARMACEUTICALS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)****(Unaudited)**

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 471,763	\$ 545,312
Investments in debt securities	27,127	29,258
Marketable securities	1,476	2,100
Accounts receivable, net of allowance of \$3,262 and \$3,401	207,062	210,256
Inventories	188,644	182,291
Deferred income tax assets	79,196	83,675
Income taxes receivable	18,258	16,091
Prepaid expenses and other current assets	49,903	60,860
Total current assets	1,043,429	1,129,843
Property, plant and equipment, net	381,370	391,839
Intangible assets, net	755,261	794,139
Goodwill	467,613	467,613
Deferred income tax assets	256,828	264,162
Investments in debt securities	204,785	218,608
Other assets (includes restricted cash of \$15,903 and \$15,900)	59,584	56,496
Assets held for sale	5,890	5,890
Total assets	\$ 3,174,760	\$ 3,328,590

**LIABILITIES AND SHAREHOLDERS EQUITY**

Current liabilities:		
Accounts payable	\$ 89,794	\$ 86,692
Accrued expenses	244,853	320,992
Short-term debt	3,369	3,662
Current portion of long-term debt		85,550
Total current liabilities	338,016	496,896

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Long-term debt	336,978	339,016
Other liabilities	128,238	123,371
Total liabilities	803,232	959,283
Commitments and contingencies (Note 9)		
Shareholders' equity	2,371,528	2,369,307
Total liabilities and shareholders' equity	\$ 3,174,760	\$ 3,328,590

See accompanying notes.

Table of Contents**KING PHARMACEUTICALS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(Unaudited)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2009</b>
Revenues:		
Net sales	\$ 373,065	\$ 414,299
Royalty revenue	7,790	14,758
Total revenues	380,855	429,057
Operating costs and expenses:		
Cost of revenues, exclusive of depreciation and amortization shown below	127,054	150,939
Selling, general and administrative	140,475	138,534
Acquisition related costs		3,789
Total selling, general and administrative expense	140,475	142,323
Research and development	28,324	27,256
Depreciation and amortization	57,275	53,349
Restructuring charges (Note 13)	262	48,050
Total operating costs and expenses	353,390	421,917
Operating income	27,465	7,140
Other income (expense):		
Interest income	409	2,788
Interest expense	(8,736)	(23,103)
Loss on investments	(872)	(823)
Other, net	(203)	(2,779)
Total other expense	(9,402)	(23,917)
Income (loss) before income taxes	18,063	(16,777)
Income tax expense (benefit)	13,594	(6,055)
Net income (loss)	\$ 4,469	\$ (10,722)
Net income per common share:		

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Basic net income (loss) per common share	\$	0.02	\$	(0.04)
Diluted net income (loss) per common share	\$	0.02	\$	(0.04)

See accompanying notes.



Table of Contents**KING PHARMACEUTICALS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY  
AND OTHER COMPREHENSIVE INCOME**  
(In thousands, except share data)  
(Unaudited)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amount		(Loss)	
Balance at December 31, 2008	246,487,232	\$ 1,391,065	\$ 871,021	\$ (28,287)	\$ 2,233,799
Comprehensive income:					
Net (loss)			(10,722)		(10,722)
Net unrealized gain on marketable securities, net of taxes of \$43				70	70
Net unrealized loss on interest rate swap, net of taxes of \$202				(329)	(329)
Net unrealized loss on investments in debt securities, net of taxes of \$1,634				(2,666)	(2,666)
Foreign currency translation				(5,026)	(5,026)
Total comprehensive income					(18,673)
Stock-based award activity	1,326,589	5,413			5,413
Balance at March 31, 2009	247,813,821	\$ 1,396,478	\$ 860,299	\$ (36,238)	\$ 2,220,539
Balance at December 31, 2009	248,444,711	\$ 1,421,489	\$ 963,620	\$ (15,802)	\$ 2,369,307
Comprehensive income:					
Net income			4,469		4,469
Reclassification of unrealized losses on investments in debt securities, net of taxes of \$268				428	428
Net unrealized loss on marketable securities, net of taxes of \$240				(384)	(384)
Net unrealized gain on investments in debt securities, net of taxes of \$89				142	142
Foreign currency translation				(5,642)	(5,642)
Total comprehensive income					(987)

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Stock-based award activity	1,158,404	3,208				3,208
Balance at March 31, 2010	249,603,115	\$ 1,424,697	\$ 968,089	\$ (21,258)	\$ 2,371,528	

See accompanying notes.

**Table of Contents****KING PHARMACEUTICALS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Cash flows (used in) provided by operating activities	\$ (1,801)	\$ 11,334
Cash flows from investing activities:		
Transfers to restricted cash	(3)	(65)
Proceeds from maturities and sales of investments in debt securities	16,810	8,000
Purchases of property, plant and equipment	(7,793)	(6,892)
Proceeds from sale of property and equipment	73	
Proceeds from the sale of Kadian®	20,000	
Acquisition of Alpharma		(69,706)
Acquisition of Avinza®		(1)
Forward foreign exchange contracts		5,406
Purchases of intellectual property and product rights	(504)	(548)
Net cash provided by (used in) investing activities	28,583	(63,806)
Cash flows from financing activities:		
Proceeds from exercise of stock options	742	36
Net (payments) proceeds related to stock-based activity	(3,905)	(2,000)
Payments on debt	(92,554)	(433,249)
Debt issuance costs		(1,220)
Net cash used in financing activities	(95,717)	(436,433)
Effect of exchange rate changes on cash	(4,614)	(14,514)
Decrease in cash and cash equivalents	(73,549)	(503,419)
Cash and cash equivalents, beginning of period	545,312	940,212
Cash and cash equivalents, end of period	\$ 471,763	\$ 436,793

See accompanying notes.

Table of Contents**KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2010 and 2009****(In thousands, except share and per share data)****(Unaudited)****1. General**

The accompanying unaudited Interim Condensed Consolidated Financial Statements of King Pharmaceuticals, Inc. ( King or the Company ) were prepared by the Company in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, accordingly, do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of items of a normal recurring nature) considered necessary for a fair presentation are included. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. These unaudited Interim Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The year-end Condensed Consolidated Balance Sheet was derived from the audited Consolidated Financial Statements, but does not include all disclosures required by generally accepted accounting principles.

These unaudited Interim Condensed Consolidated Financial Statements include the accounts of King and all of its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Certain amounts from the prior Condensed Consolidated Financial Statements have been reclassified to conform to the presentation adopted in 2010.

**2. Earnings Per Share**

The basic and diluted income (loss) per common share was determined using the following share data:

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Basic net income (loss) per common share:		
Weighted average common shares	245,205,560	243,888,839
Diluted net income (loss) per common share:		
Weighted average common shares	245,205,560	243,888,839
Effect of stock options	663,897	
Effect of dilutive share awards	3,997,330	
Weighted average common shares	249,866,787	243,888,839

For the three months ended March 31, 2009, the dilutive effect of options to purchase 5,176 shares of common stock and 2,743,397 share awards were not included in the computation of diluted loss per common share because their inclusion would have reduced the loss per share.

For the three months ended March 31, 2010, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted income per common share, included options to purchase 3,192,426 shares of common stock, 102,354 restricted stock awards ( RSAs ) and 106,209 long-term performance units ( LPU s ). For the three months ended March 31, 2009, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted loss per common share, included options to purchase 6,157,030 shares of common stock, 321,528 RSAs and 153,606 LPU s. The 11/4% Convertible Senior Notes due April 1, 2026 (the Convertible Senior Notes ) could be converted into the Company s common stock in the future, subject to certain contingencies. Shares of the Company s common stock associated with this right of conversion were excluded from

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the calculations of diluted income (loss) per common share because the conversion price of the notes was greater than the average market price of the Company's common stock during the quarters ended March 31, 2009 and 2010.

**3. Fair Value Measurements**

*Cash and Cash Equivalents.* The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Company's cash and cash equivalents consisted of institutional money market funds. There were no cumulative unrealized holding gains or losses associated with these money market funds as of March 31, 2010 and December 31, 2009.

*Derivatives.* During 2009, the Company had forward foreign exchange contracts outstanding on certain non-U.S. cash balances. The forward exchange contracts were not designated as hedges. The Company recorded these contracts at fair value and changes in fair value were recognized in current earnings. All foreign exchange contracts expired during 2009.

The terms of certain credit agreements require the Company to maintain hedging agreements that fix the interest rates on 50% of the Company's total outstanding long-term debt. Accordingly, in March 2009, the Company entered into an interest rate swap agreement with an aggregate notional amount of \$112,500, which was scheduled to expire in March 2011. The interest rate swap was designated as a cash flow hedge and was being used to offset the overall variability of cash flows. For a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the period during which the hedged transaction affects earnings. As a result of the reduction of its variable rate long-term debt beginning in the third quarter of 2009, more than 50% of the Company's outstanding long-term debt is at fixed rates and therefore an interest rate swap is no longer required. The Company terminated the interest rate swap in the third quarter of 2009.

The following table summarizes the effect of derivative instruments on the Condensed Consolidated Statements of Operations for the three months ended March 31, 2009:

	<b>Gain or (Loss) in Other Comprehensive Income on Derivative (Effective Portion)</b>	<b>Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)</b>	<b>Gain or (Loss) Recorded in Income (Ineffective Portion)</b>
Derivatives in Cash Flow Hedging Relationships			
Interest rate swap	\$ (531)	\$	\$
		<b>Gain or (Loss) Recognized in Income on Derivative</b>	

<b>Derivatives not Designated as Hedging Instruments</b>	<b>Location</b>	<b>Amount</b>
Foreign currency contracts	Other income (expense)	\$ 3,545

*Marketable Securities.* As of March 31, 2010 and December 31, 2009, the Company's investment in marketable securities consisted solely of Palatin Technologies, Inc. common stock with a cost basis of \$511. The cumulative unrealized holding gain in this investment was \$965 and \$1,589, respectively, as of March 31, 2010 and December 31, 2009.

*Investments in Debt Securities.* The Company undertook investments in auction rate securities prior to the end of the first quarter of 2008. Tax-exempt auction rate securities are long-term variable rate bonds tied to short-term interest rates that are intended to reset through an auction process generally every seven, 28 or 35 days. On February 11, 2008, the Company began to experience auction failures with respect to its investments in auction rate securities. In the event of an auction failure, the interest rate on the security is reset according to the contractual terms in the underlying indenture. The Company will not be able to liquidate these securities until a successful auction occurs, the issuer calls or restructures the underlying security, the underlying security matures or it is purchased by a buyer outside the auction process.

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company classified auction rate securities as available-for-sale at the time of purchase. Temporary gains or losses are included in accumulated other comprehensive income (loss). Other-than-temporary credit losses are included in Loss on investments in the Condensed Consolidated Statements of Operations. Non-credit related other-than-temporary losses are recorded in accumulated other comprehensive income (loss), as the Company has no intent to sell the securities and believes that it is more likely than not that it will not be required to sell the securities prior to recovery.

As of March 31, 2010 and December 31, 2009, the par value of the Company's investments in debt securities was \$264,075 and \$281,525, respectively, and consisted solely of tax-exempt auction rate securities associated with municipal bonds and student loans. The Company has not invested in any mortgage-backed securities or any securities backed by corporate debt obligations. The Company's investment policy requires it to maintain an investment portfolio with a high credit quality. Accordingly, the Company's investments in debt securities were limited to issues which were rated AA or higher at the time of purchase.

Excluding the municipal bond discussed below, as of March 31, 2010, there were cumulative unrealized holding losses of \$25,458 recorded in accumulated other comprehensive income (loss) on the Condensed Consolidated Balance Sheet associated with investments in debt securities with a par value of \$223,025, which were classified as available for sale. All of these investments in debt securities have been in continuous unrealized loss positions for greater than twelve months. As of March 31, 2010, the Company believed the decline associated with the underlying securities was temporary and it was probable that the par amount of these auction rate securities would be collectible under their contractual terms.

As of April 1, 2009, the Company adopted a new statement of the Financial Accounting Standards Board ( FASB ) that provides guidance in determining whether impairments in debt securities are other-than-temporary, and modifies the presentation and disclosures surrounding such instruments. During the fourth quarter of 2008, the Company recognized unrealized losses of \$6,832 in other (expense) income for a municipal bond with a par value of \$15,000 for which the holding losses were determined to be other-than-temporary. The Company determined that \$1,042 (or \$646 net-of-tax) of this previously recognized loss was non-credit related. Upon the adoption of this statement, the Company was required to reclassify this non-credit related loss from retained earnings to accumulated other comprehensive income (loss). As of March 31, 2010, there were cumulative unrealized holding gains of \$1,758 associated with this security recorded in accumulated other comprehensive income (loss) on the Condensed Consolidated Balance Sheet. During 2009 and 2010, no other-than-temporary impairment losses associated with available for sale investments in debt securities were recognized.

During the first quarter of 2010, the Company sold certain auction rate securities associated with student loans with a par value of \$8,000 for \$7,360 to the issuer and realized a loss of \$640 in the Condensed Consolidated Statement of Operations. The Company has not sold any other investments in debt securities below par value during the periods presented in the accompanying Condensed Consolidated Statements of Operations.

During the fourth quarter of 2008, the Company accepted an offer from UBS Financial Services, Inc. ( UBS ) providing the Company the right to sell to UBS at par value certain auction rate securities during the period from June 30, 2010 to July 2, 2012 (the right ). At March 31, 2010 and December 31, 2009, the Company held auction rate securities related to this offer with a par value of \$26,050 and \$32,500, respectively. The Company has elected the fair value option to account for this right. As a result, gains and losses associated with this right are recorded in Other income (expense) in the Condensed Consolidated Statements of Operations. The value of the right to sell certain auction rate



securities to UBS was estimated considering the present value of future cash flows, the fair value of the auction rate security and counterparty risk. As of March 31, 2010 and December 31, 2009, the fair value of the right to sell the auction rate securities to UBS at par was \$2,425 and \$3,226, respectively. With respect to this right, the Company recognized an unrealized loss of \$801 during the first quarter of 2010 and \$565 during the first quarter of 2009, in Other income (expense) in the accompanying Condensed Consolidated Statements of Operations.

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In addition, during the fourth quarter of 2008, the Company reclassified the auction rate securities that are included in this right from available-for-sale securities to trading securities. As of March 31, 2010 and December 31, 2009, the fair value of the investments in debt securities classified as trading was \$23,377 and \$29,258, respectively. During the first quarter of 2010 and 2009, the Company recognized unrealized gains of \$569 and unrealized losses of \$258, respectively, in Other income (expense) in the accompanying Condensed Consolidated Statements of Operations.

As of March 31, 2010, the Company has classified \$27,127 of auction rate securities as current assets and \$204,785 as long-term assets.

The following tables summarize the Company's assets which are measured at fair value on a recurring basis:

Description	Total Fair Value at 3/31/2010	Fair Value Measurements at March 31, 2010 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money Market Funds	\$ 446,394	\$ 446,394	\$	\$
U.S. Government Securities	4,138	4,138		
Marketable Securities	1,476	1,476		
Investments in Debt Securities	231,912		3,750	228,162
Right to Sell Debt Securities	2,425			2,425
Total Assets	\$ 686,345	\$ 452,008	\$ 3,750	\$ 230,587

Description	Total Fair Value at 12/31/2009	Fair Value Measurements at December 31, 2009		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money Market Funds	\$ 518,950	\$ 518,950	\$	\$
U.S. Government Securities	4,138	4,138		

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Marketable Securities	2,100	2,100	
Investments in Debt Securities	247,866		247,866
Right to Sell Debt Securities	3,226		3,226
Total Assets	\$ 776,280	\$ 525,188	\$ 251,092

The fair value of marketable securities within the Level 1 classification is based on the quoted price for identical securities in an active market as of the valuation date.

The fair value of investments in debt securities within the Level 2 classification is at par based on public call notices from the issuer of the security.

The fair value of investments in debt securities within the Level 3 classification is based on a trinomial discount model. This model considers the probability at the valuation date of three potential occurrences for each auction event through the maturity date of the security. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include, but are not limited to, the security's collateral, credit rating, insurance, issuer's financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each security is determined by summing the present value of the probability-weighted future principal and interest payments

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

determined by the model. As of March 31, 2010, the Company assumed a weighted average discount rate of 4.8% and expected terms which are generally less than five years. The discount rate was determined as the loss-adjusted required rate of return using public information such as spreads on near-risk free to risk free assets. The expected term is based on the Company's estimate of future liquidity as of March 31, 2010. Transfers out of Level 3 classification occur only when public call notices have been announced by the issuer prior to the date of the valuation.

The following table provides a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	<b>2010</b>	<b>2009</b>
Beginning balance, January 1	\$ 251,092	\$ 361,913
Total gains or losses (realized/unrealized)		
Included in earnings	(872)	(823)
Included in other comprehensive income (loss)	927	(4,300)
Settlements	(16,810)	(8,000)
Transfers in and/or out of Level 3	(3,750)	1,700
Ending balance, March 31	\$ 230,587	\$ 350,490

**4. Inventories**

Inventories consist of the following:

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Raw materials	\$ 70,664	\$ 62,054
Work-in-process	37,267	29,979
Finished goods (including \$2,590 and \$3,908 of sample inventory, respectively)	121,012	126,705
	228,943	218,738
Inventory valuation allowance	(40,299)	(36,447)
Total inventories	\$ 188,644	\$ 182,291

**5. Property, Plant and Equipment**

During the first quarter of 2009, the Company classified as held for sale a pharmaceutical facility which was acquired as a result of the acquisition of Alpharma Inc., now Alpharma LLC ( Alpharma ). The facility is recorded at estimated fair value less cost to sell. The Company finalized its determination of fair value of this asset in the first quarter of

2009, reduced the value by \$3,600 and adjusted goodwill accordingly. During the fourth quarter of 2009, the Company further reduced the fair value of this asset based on management's estimate of current market conditions and incurred an asset impairment charge of \$2,010.

The net book value of some of the Company's manufacturing facilities currently exceeds fair market value. Management currently believes that the long-term assets associated with these facilities are not impaired based on estimated undiscounted future cash flows. However, if the Company were to approve a plan to sell or close any of the facilities for which the carrying value exceeds fair market value, the Company would have to write off a portion of the assets or reduce the estimated useful life of the assets which would accelerate depreciation.

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****6. Acquisitions, Dispositions, Co-Promotions and Alliances**

On December 29, 2008, the Company completed its acquisition of Alpharma. In connection with the acquisition of Alpharma, the Company and Alpharma executed a consent order (the Consent Order) with the U.S. Federal Trade Commission (FTC). The Consent Order required the Company to divest the assets related to Alpharma's branded oral long-acting opioid analgesic drug Kadian® to Actavis Elizabeth, L.L.C. (Actavis LLC). In accordance with the Consent Order, effective upon the acquisition of Alpharma, on December 29, 2008, the Company divested the Kadian® product to Actavis LLC. Actavis LLC is entitled to sell Kadian® as a branded or generic product. Prior to the divestiture, Actavis LLC supplied Kadian® to Alpharma.

Actavis LLC will pay a purchase price of up to an aggregate of \$127,500 in cash based on the achievement of certain Kadian® quarterly gross profit-related milestones for the period beginning January 1, 2009 and ending June 30, 2010. The maximum purchase price payment associated with each calendar quarter is as follows:

	<b>Maximum Purchase Price Payment</b>
First Quarter 2009	\$ 30,000
Second Quarter 2009	\$ 25,000
Third Quarter 2009	\$ 25,000
Fourth Quarter 2009	\$ 20,000
First Quarter 2010	\$ 20,000
Second Quarter 2010	\$ 7,500

None of the quarterly payments above, when combined with all prior payments made by Actavis LLC, will exceed the aggregate amount of gross profits from the sale of Kadian® in the United States by Actavis LLC and its affiliates for the period beginning on January 1, 2009 and ending on the last day of such calendar quarter. Any quarterly purchase price payment that is not paid by Actavis LLC due to the application of such provision will be carried forward to the next calendar quarter, increasing the maximum quarterly payment in the subsequent quarter. However, the cumulative purchase price payable by Actavis LLC will not exceed the lesser of (a) \$127,500 and (b) the gross profits from the sale of Kadian® in the United States by Actavis LLC and its affiliates for the period from January 1, 2009 through June 30, 2010. The Company recorded a receivable of \$115,000 at the time of the divestiture, reflecting the present value of the estimated future purchase price payments from Actavis LLC. There was no gain or loss recorded as a result of the divestiture. In accordance with the agreement, quarterly payments are received one quarter in arrears. During the first quarter of 2010, the Company received \$20,000 from Actavis LLC related to gross profit from sales during the fourth quarter of 2009.

**7. Intangible Assets and Goodwill**

Intangible assets consist primarily of patents, licenses, trademarks and product rights. A summary of the gross carrying amount and accumulated amortization is as follows:

**March 31, 2010****December 31, 2009**

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
Branded prescription pharmaceuticals	\$ 1,265,929	\$ 801,177	\$ 1,264,250	\$ 764,327
Animal Health	169,923	12,041	170,000	9,633
Meridian Auto-Injector	184,206	51,789	183,249	49,621
Royalties and other	3,731	3,521	3,731	3,510
Total intangible assets	\$ 1,623,789	\$ 868,528	\$ 1,621,230	\$ 827,091

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Amortization expense for the three months ended March 31, 2010 and 2009 was \$41,437 and \$38,178, respectively.

In January 2009, the U.S. District Court for the Eastern District of New York issued an order ruling invalid two Skelaxin® patents. In June 2009, the Court entered judgment against the Company. The Company has appealed and intends to vigorously defend its interests. Generic versions of Skelaxin® entered the market early in the second quarter of 2010. The Company's sales of Skelaxin® will decline significantly as a result of generic competition. The Company believes that the intangible assets associated with Skelaxin® are not currently impaired based on estimated undiscounted cash flows associated with these assets. However, as a result of the January 2009 order described above, the Company reduced the estimated remaining useful life of the intangible assets of Skelaxin® during the first quarter of 2009. As of March 31, 2010, the net intangible assets associated with Skelaxin® totaled approximately \$19,979. For additional information regarding Skelaxin® litigation, please see Note 9.

Goodwill at March 31, 2010 and December 31, 2009 is as follows:

	<b>Branded Segment</b>	<b>Animal Health Segment</b>	<b>Meridian Segment</b>	<b>Total</b>
Goodwill at December 31, 2009	\$ 267,024	\$ 92,179	\$ 108,410	\$ 467,613
Goodwill at March 31, 2010	\$ 267,024	\$ 92,179	\$ 108,410	\$ 467,613

**8. Long-Term Debt**

Long-term debt consists of the following:

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Convertible senior notes	\$ 336,978	\$ 332,305
Senior secured revolving credit facility		92,261
Total long-term debt	336,978	424,566
Less current portion		85,550
Long-term portion	\$ 336,978	\$ 339,016

**Convertible Senior Notes**

At March 31, 2010, the Company has \$400,000 of Convertible Senior Notes outstanding. The liability and equity components of the Convertible Senior Notes have been separately accounted for in a manner that reflects the



Company's nonconvertible debt borrowing rate at the date of issuance. The debt component is being amortized through March 31, 2013.

A summary of the gross carrying amount, unamortized debt cost and the net carrying amount of the liability component is as follows:

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Gross carrying amount	\$ 400,000	\$ 400,000
Unamortized debt cost	63,022	67,695
Net carrying amount	\$ 336,978	\$ 332,305

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Senior Secured Revolving Credit Facility***

During the first quarter of 2010, the Company made payments of \$92,261 on the Senior Secured Revolving Credit Facility ( Revolving Credit Facility ), which represented full payment of all outstanding borrowings under the Revolving Credit Facility.

During the first quarter of 2009, the Company made payments of \$32,093 on the Revolving Credit Facility.

Under its terms, the availability for borrowing under the Revolving Credit Facility was reduced to \$150,000 as of April 30, 2010. The remaining undrawn commitment amount under the Revolving Credit Facility totals approximately \$146,891 after giving effect to outstanding letters of credit totaling \$3,109.

In connection with borrowings under the facility, the Company incurred a total of approximately \$22,219 of deferred financing costs that are being amortized ratably through the maturity date.

***Senior Secured Term Facility***

During the first quarter of 2009, the Company made payments of \$15,930 on its Senior Secured Term Facility. During the fourth quarter of 2009, the Company completed its repayment obligations under the facility.

***Alpharma Convertible Senior Notes***

At the time of the acquisition of Alpharma by the Company, Alpharma had \$300,000 of Convertible Senior Notes outstanding ( Alpharma Notes ). The Alpharma Notes were convertible into shares of Alpharma's Class A common stock at an initial conversion rate of 30.6725 Alpharma common shares per \$1,000 principal amount. The conversion rate of the Alpharma Notes was subject to adjustment upon the direct or indirect sale of all or substantially all of Alpharma's assets or more than 50% of the outstanding shares of the Alpharma common stock to a third party (a Fundamental Change ). In the event of a Fundamental Change, the Alpharma Notes included a make-whole provision that adjusted the conversion rate by a predetermined number of additional shares of Alpharma's common stock based on (1) the effective date of the Fundamental Change; and (2) Alpharma's common stock market price as of the effective date. The acquisition of Alpharma by the Company was a Fundamental Change. As a result, any Alpharma Notes converted in connection with the acquisition of Alpharma were entitled to be converted at an increased rate equal to the value of 34.7053 Alpharma common shares, at the acquisition price of \$37 per share, per \$1,000 principal amount of Alpharma Notes, at a date no later than 35 trading days after the occurrence of the Fundamental Change. During the first quarter of 2009, the Company paid \$385,227 to redeem the Alpharma Convertible Senior Notes.

**9. Commitments and Contingencies**

***Intellectual Property Matters***

***Skelaxin®***

Eon Labs, Inc. ( Eon Labs ), CorePharma, LLC ( CorePharma ) and Mutual Pharmaceutical Company, Inc. ( Mutual ) each filed an Abbreviated New Drug Application ( ANDA ) with the U.S. Food and Drug Administration ( FDA ) seeking permission to market a generic version of Skelaxin® 400 mg tablets. Additionally, Eon Labs' ANDA seeks

permission to market a generic version of Skelaxin® 800 mg tablets. United States Patent Nos. 6,407,128 (the 128 patent ) and 6,683,102 (the 102 patent ), two method-of-use patents relating to Skelaxin listed in the FDA's Orange Book and do not expire until December 3, 2021. Eon Labs and CorePharma each filed Paragraph IV certifications against the 128 and 102 patents alleging non-infringement, invalidity and unenforceability of those patents. Mutual has filed a Paragraph IV certification against the 102 patent alleging non-infringement and invalidity of that patent. A patent infringement suit was filed against Eon Labs on January 2, 2003 in the U.S. District Court for the Eastern District of New York; against CorePharma on March 7, 2003 in the U.S. District Court for the District of New Jersey (subsequently transferred to the U.S. District Court for the Eastern District of

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

New York); and against Mutual on March 12, 2004 in the U.S. District Court for the Eastern District of Pennsylvania, concerning their proposed 400 mg products. Additionally, the Company filed a separate suit against Eon Labs on December 17, 2004 in the U.S. District Court for the Eastern District of New York, concerning its proposed generic version of the 800 mg Skelaxin® product. On May 17, 2006, the U.S. District Court for the Eastern District of Pennsylvania placed the Mutual case on the Civil Suspense Calendar pending the outcome of the FDA activity described below. On June 16, 2006, the U.S. District Court for the Eastern District of New York consolidated the Eon Labs cases with the CorePharma case. In January 2008, the Company entered into an agreement with CorePharma providing it with, among other things, the right to launch an authorized generic version of Skelaxin® pursuant to a license in December 2012 or earlier under certain conditions. On January 8, 2008, the Company and CorePharma submitted a joint stipulation of dismissal without prejudice. On January 15, 2008, the Court entered an order dismissing the case without prejudice.

The Company believes that CorePharma began shipping a generic form of Skelaxin® in early April 2010. On April 13, 2010, the Company brought suit against CorePharma in the U.S. District Court for New Jersey asserting certain of the Company's rights under the January 2008 agreement. The parties appeared at a District Court hearing on April 14, 2010, at which the Company sought, and was denied, a temporary restraining order (TRO) against CorePharma to prevent further sales of generic product. On April 21 and April 30, 2010, the Court held hearings and the parties await the Court's decision as to whether a preliminary injunction is to be issued.

Pursuant to the Hatch-Waxman Act, the filing of the suits against Eon Labs provided the Company with an automatic stay of FDA approval of Eon Labs' ANDA for its proposed 400 mg and 800 mg products for 30 months (unless the patents are held invalid, unenforceable or not infringed) from no earlier than November 18, 2002 and November 3, 2004, respectively. The 30-month stay of FDA approval for Eon Labs' ANDA for its proposed 400 mg product expired in May 2005 and Eon Labs subsequently withdrew its 400 mg ANDA in September 2006. The 30-month stay of FDA approval for Eon Labs' 800 mg product was tolled by the Court from January 10, 2005 to April 30, 2007, and the stay expired in early August 2009. On April 30, 2007, Eon Labs' 400 mg case was dismissed without prejudice, although Eon Labs' claim for fees and expenses was severed and consolidated with Eon Labs' 800 mg case. On August 27, 2007, Eon Labs served a motion for summary judgment on the issue of infringement. The Court granted the Company discovery for purposes of responding to Eon's motion until March 14, 2008 and set a briefing schedule. On March 7, 2008, the Company filed a letter with the Court regarding Eon Labs' inability to adhere to the discovery schedule and the Court took Eon Labs' motion for summary judgment on the issue of infringement off the calendar. Subsequently, Eon Labs filed an amended motion for summary judgment on the issue of infringement on April 4, 2008. Eon Labs also filed a motion for summary judgment on the issue of validity on April 16, 2008. On May 8, 2008, Eon Labs filed amended pleadings. On May 22, 2008, the Company moved to dismiss certain defenses and counterclaims. On June 6, 2008, the Company responded to Eon Labs' motion for summary judgment on the issue of validity. On January 20, 2009, the Court issued an order ruling invalid the 128 and 102 patents. The order was issued without the benefit of a hearing in response to Eon Labs' motion for summary judgment. The order also allowed Eon Labs to pursue its claim for exceptional case, and on March 31, 2009, Eon Labs filed its motion for this purpose, which was opposed by the Company and Elan Pharmaceuticals, Inc. (Elan). Eon Labs has replied and the motion remains pending before the Court. On May 20, 2009, Eon Labs asked for entry of final judgment, and on June 4, 2009, the Court granted this request. On July 1, 2009, the Company filed a notice of appeal to the Court of Appeals for the Federal Circuit of the Court's entry of judgment. On July 2, 2009, Elan did the same. The appeals were docketed by the Federal Circuit on July 10, 2009. In late July 2009, the companies moved to dismiss the appeals for lack of jurisdiction. On September 30, 2009, the Federal Circuit denied the motions to dismiss. The Company and Elan filed opening briefs on November 23, 2009. Eon filed its opposition brief on January 19, 2010. The Company and Elan filed reply briefs on

February 19, 2010. The Federal Circuit set oral argument for the appeal for May 7, 2010. The Company intends to vigorously defend its interests.

On December 5, 2008, the Company, along with co-plaintiff Pharmaceutical IP Holding, Inc. ( PIH ) initiated suit in the U.S. District Court of New Jersey against Sandoz for infringement of U.S. Patent No. 7,122,566 (the 566 patent ). The 566 patent is a method-of-use patent relating to Skelaxin<sup>®</sup> listed in the FDA's Orange Book; it

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

expires on February 6, 2026. The 566 patent is owned by PIH and licensed to the Company. The Company and PIH sued Sandoz, alleging that Eon Labs' submission of its ANDA seeking approval to sell a generic version of a 800 mg Skelaxin® tablet prior to the expiration of the 566 patent constitutes infringement of the patent. Sandoz, which acquired Eon Labs, is the named owner of Eon Labs' ANDA and filed a Paragraph IV certification challenging the validity and alleging non-infringement of the 566 patent. On January 13, 2009, Sandoz answered the complaint and filed counterclaims of invalidity and non-infringement. The Company filed a reply on February 5, 2009. The parties are currently conducting fact discovery.

On March 31, 2010, Sandoz received approval from the FDA to commercialize a generic product containing metaxalone. On April 1, 2010, the Company sought, and the United States District Court of New Jersey granted, a TRO enjoining Sandoz from engaging in the use, offer to sell, or sale within the United States its generic metaxalone product. On April 9, 2010, the TRO was vacated. On April 14 and May 5, 2010, the District Court heard the Company's arguments in support of a preliminary injunction against Sandoz. The trial date for the patent litigation against Sandoz is set for July 6, 2010.

On March 9, 2004, the Company received a copy of a letter from the FDA to all ANDA applicants for Skelaxin® stating that the use listed in the FDA's Orange Book for the 128 patent may be deleted from the ANDA applicants' product labeling. The Company believes that this decision is arbitrary, capricious and inconsistent with the FDA's previous position on this issue. The Company filed a Citizen Petition on March 18, 2004 (supplemented on April 15, 2004 and on July 21, 2004), requesting the FDA to rescind that letter, require generic applicants to submit Paragraph IV certifications for the 128 patent and prohibit the removal of information corresponding to the use listed in the Orange Book. The Company concurrently filed a petition for stay of action requesting the FDA to stay approval of any generic Skelaxin® products until the FDA has fully evaluated the Company's Citizen Petition.

On March 12, 2004, the FDA sent a letter to the Company explaining that the Company's proposed labeling revision for Skelaxin®, which includes references to additional clinical studies relating to food, age and gender effects, was approvable and only required certain formatting changes. On April 5, 2004, the Company submitted amended labeling text that incorporated those changes. On April 5, 2004, Mutual filed a petition for stay of action requesting the FDA to stay approval of the Company's proposed labeling revision until the FDA has fully evaluated and ruled upon the Company's Citizen Petition, as well as all comments submitted in response to that petition. The Company, CorePharma and Mutual filed responses and supplements to their pending Citizen Petitions and responses. On December 8, 2005, Mutual filed another supplement with the FDA in which it withdrew its prior petition for stay, supplement and opposition to the Company's Citizen Petition. On November 24, 2006, the FDA approved the revision to the Skelaxin® labeling. On February 13, 2007, the Company filed another supplement to the Company's Citizen Petition to reflect FDA approval of the revision to the Skelaxin® labeling. On May 2, 2007, Mutual filed comments in connection with the Company's supplemental submission. These issues are pending. On July 27, 2007 and January 24, 2008, Mutual filed two other Citizen Petitions in which it seeks a determination that Skelaxin® labeling should be revised to reflect the data provided in its earlier submissions. These petitions were denied on July 18, 2008.

Net sales of Skelaxin® were \$400,998 in 2009 and \$90,917 in the first quarter of 2010. As of March 31, 2010, the Company had net intangible assets related to Skelaxin® of \$19,979. Generic versions of Skelaxin® entered the market early in the second quarter of 2010. The net sales of Skelaxin® will decline significantly as a result of generic competition, which will materially adversely affect the results of operations and cash flows, unless the Company is successful in its legal actions to remove generic competitors from the market. According to IMS America, Ltd. weekly prescription data, for the week ending April 23, 2010, generic competitors have garnered just over 80% of the

prescriptions in the metaxalone market. For information regarding the Skelaxin® intangible assets, please see Note 7.

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Avinza*<sup>®</sup>

Actavis, Inc. ( Actavis ) filed an ANDA with the FDA seeking permission to market generic versions of Avinza<sup>®</sup> at the 30 mg, 45 mg, 60 mg and 120 mg dosages. U.S. Patent No. 6,066,339 (the 339 patent ) is a formulation patent relating to Avinza<sup>®</sup> that is listed in the Orange Book and expires on November 25, 2017. Actavis filed a Paragraph IV certification challenging the validity and alleging non-infringement of the 339 patent, and the Company and Elan Pharma International LTD ( EPI ), the owner of the 339 patent, filed suit on October 18, 2007 in the U.S. District Court for the District of New Jersey to defend the rights under the patent. Pursuant to the Hatch-Waxman Act, the filing of the lawsuit against Actavis provided the Company with an automatic stay of FDA approval of Actavis ANDA for up to 30 months (unless the patent is held invalid, unenforceable or not infringed) from no earlier than September 4, 2007. On November 18, 2007, Actavis answered the complaint and filed counterclaims of non-infringement and invalidity. The Company and EPI filed a reply on December 7, 2007. The initial scheduling conference was held on March 11, 2008. Fact discovery is largely complete and the parties continue to await a hearing date for claim construction.

In November 2009, Actavis sent the Company and EPI a second Paragraph IV certification adding the 75 mg and 90 mg dosages. The Company and EPI initiated another suit against Actavis in New Jersey on December 15, 2009. On January 12, 2010, Actavis answered the complaint and filed counterclaims of non-infringement and invalidity. On February 23, 2010, this case was consolidated with the earlier-initiated suit.

Sandoz filed an ANDA with the FDA seeking permission to market generic versions of Avinza at the 30 mg and 120 mg dosages and provided the Company with a Paragraph IV certification challenging the validity and alleging non-infringement of the 339 patent. The Company and EPI filed suit on July 21, 2009 in the U.S. District Court for the District of New Jersey to defend the rights under the patent. Pursuant to the Hatch-Waxman Act, the filing of the lawsuit against Sandoz provided the Company with an automatic stay of FDA approval of Sandoz s ANDA for up to 30 months (unless the patent is held invalid, unenforceable or not infringed) from no earlier than June 11, 2009. Sandoz subsequently sent the Company and EPI a second Paragraph IV certification adding the 45 mg, 60 mg, 75 mg and 90 mg dosages. The Company and EPI initiated another suit against Sandoz in New Jersey on September 1, 2009. On October 2, 2009, Sandoz answered the complaints and filed counterclaims of non-infringement and invalidity. The Company and EPI filed a reply on October 22, 2009. The two cases were consolidated on January 4, 2010. The parties are in the midst of fact discovery.

The Company intends to vigorously defend its rights under the 339 patent. Net sales of Avinza<sup>®</sup> were \$131,148 in 2009 and \$23,196 in the first quarter of 2010. As of March 31, 2010, the Company had net intangible assets related to Avinza<sup>®</sup> of \$207,761. If a generic form of Avinza<sup>®</sup> enters the market or if the Company s current estimates regarding future cash flows adversely change, the Company may have to write off a portion or all of these intangible assets, and the Company s business, financial condition, results of operations and cash flows could be otherwise materially adversely affected.

*EpiPen*<sup>®</sup>

On November 11, 2008, the Company was granted U.S. Patent 7,449,012 (the 012 patent ) covering the next generation autoinjector ( NGA ) for use with epinephrine to be sold under the EpiPen<sup>®</sup> brand name. The 012 patent expires September 11, 2025. The 012 patent was listed in FDA s Orange Book on July 17, 2009 under the EpiPen NDA. On July 21, 2009, the Company received a Paragraph IV certification from Teva Pharmaceutical Industries Ltd.



( Teva ) giving notice that it had filed an ANDA to commercialize an epinephrine injectable product and challenging the validity and alleging non-infringement of the 012 patent. On August 28, 2009, the Company filed suit against Teva in the U.S. District Court for the District of Delaware to defend its rights under the 012 patent. On October 21, 2009, Teva filed its answer asserting non-infringement and invalidity of the 012 patent.

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Embeda*<sup>®</sup>

On November 17, 2008, Alpharma filed a declaratory judgment action against Purdue Pharma L.P. (Purdue) in the U.S. District Court for the Western District of Virginia, seeking an order declaring that nine of Purdue's patents are invalid and/or would not be infringed by the commercialization of Embeda<sup>®</sup>. The complaint was served on March 12, 2009, and on April 22, 2009 Purdue filed a motion requesting that the court dismiss the action for lack of subject matter jurisdiction or, alternatively, to transfer the action to the District of Connecticut. On July 9, 2009, the court denied Purdue's motion to dismiss or transfer. On August 6, 2009, Purdue filed its answer and counterclaims, and filed a motion for an order certifying the court's July 9 order for immediate appeal. On August 26, 2009, the court denied Purdue's motion to certify for immediate appeal and issued an order scheduling certain discovery and hearing dates. On December 4, 2009, the Company was added as a plaintiff to the lawsuit. On December 23, 2009, Purdue delivered an unconditional and irrevocable covenant not to sue the Company (or any of its affiliates, subsidiaries, parents, divisions, successors and assigns) for infringement of eight of the nine patents in the suit. On that day, the parties also filed a Stipulation with the Court to dismiss the lawsuit with prejudice with respect to these eight patents. The only patent remaining in the case was U.S. Patent No. 6,696,088 (the 088 patent). On February 4, 2010, after extensive briefing, the court held a claim construction hearing on the 088 patent and is expected to issue its claim construction ruling soon.

On February 9, 2010, the United States Patent & Trademark Office issued U.S. Patent No. 7,658,939 (the 939 patent) to Purdue. The 939 patent is a continuation of the 088 patent. On the same day, Purdue filed a patent infringement action against the Company in the U.S. District Court for the District of New Jersey, alleging infringement of the 939 patent by the commercialization of Embeda<sup>®</sup>. On February 10, 2010, the Company filed a motion in the U.S. District Court for the Western District of Virginia seeking leave to amend its complaint to add declaratory judgment counts of non-infringement and invalidity against the 939 patent.

On March 19, 2010, the Court in the Western District of Virginia granted the Company's motion for leave to amend its complaint adding the 939 patent to the existing litigation. A trial date has been set for August 18, 2010, for both the 088 and the 939 patents. On April 2, 2010, Purdue's action brought in the District of New Jersey was dismissed.

***Average Wholesale Price Litigation***

In August 2004, the Company and Monarch Pharmaceuticals, Inc. (Monarch), a wholly-owned subsidiary of the Company, were named as defendants along with 44 other pharmaceutical manufacturers in an action brought by the City of New York (NYC) in Federal court in the State of New York. NYC claims that the defendants fraudulently inflated their average wholesale prices (AWP) and fraudulently failed to accurately report their best prices and their average manufacturer's prices and failed to pay proper rebates pursuant to federal law. Additional claims allege violations of federal and New York statutes, fraud and unjust enrichment. For the period from 1992 to the present, NYC is requesting money damages, civil penalties, declaratory and injunctive relief, restitution, disgorgement of profits and treble and punitive damages. The U.S. District Court for the District of Massachusetts has been established as the multidistrict litigation court for the case, *In re: Pharmaceutical Industry Average Wholesale Pricing Litigation* (the MDL Court).

Since the filing of the NYC case, 48 New York counties have filed lawsuits against the pharmaceutical industry, including the Company and Monarch. The allegations in all of these cases are virtually the same as the allegations in the NYC case. All of these lawsuits are currently pending in the MDL Court, except for the Erie, Oswego and

Schenectady County cases, which were removed in October 2006 and remanded to the state of New York Supreme Court in Erie County, New York state court in September 2007. Motions to dismiss were granted in part and denied in part for all defendants in all NYC and county cases pending in the MDL Court. The Erie motion to dismiss was granted in part and denied in part by the state court before removal. Motions to dismiss were filed in October 2007 in the Oswego and Schenectady cases, and these cases were subsequently transferred to Erie County for coordination with the Erie County case. A hearing on these motions to dismiss occurred on March 15, 2010 and the Court has taken the motions under advisement. It is not anticipated that any trials involving the Company will be

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

set in any of these cases in 2010. On January 27, 2010, the MDL Court granted partial summary judgment for the plaintiffs in a case involving other pharmaceutical company defendants.

In January 2005, the State of Alabama filed a lawsuit in the Circuit Court for Montgomery County, Alabama against 79 defendants, including the Company and Monarch. The four causes of action center on the allegation that all defendants fraudulently inflated the AWP of their products. A motion to dismiss was filed and denied by the Court, but the Court required an amended complaint to be filed. The Company filed an answer and counterclaim for return of rebates overpaid to the state. Alabama filed a motion to dismiss the counterclaim, which was granted. The Company appealed the dismissal. The Alabama Supreme Court affirmed the dismissal. In a separate appeal of a motion to sever denied by the trial court, the Alabama Supreme Court severed all defendants into single-defendant cases. Trials against AstraZeneca International, Novartis Pharmaceuticals, SmithKline Beecham Corporation and Sandoz resulted in verdicts for the State. These defendants appealed their verdicts. On October 16, 2009, the Alabama Supreme Court reversed all of the verdicts against AstraZeneca, Novartis and SmithKline Beecham and rendered judgment in favor of these companies. Alabama filed a petition to rehear in the Alabama Supreme Court, which was denied in January 2010. A trial against Watson Pharmaceuticals, Inc. in June 2009 resulted in a deadlocked jury. In April 2009, the Court established various trial dates for all defendants. The Company is scheduled for trial in January 2011 but other scheduled cases have been continued or reset for later dates following the Supreme Court decision.

In October 2005, the State of Mississippi filed a lawsuit in the Chancery Court of Rankin County, Mississippi against the Company, Monarch and 84 other defendants, alleging fourteen causes of action. Many of those causes of action allege that all defendants fraudulently inflated the AWPs and wholesale acquisition costs of their products. A motion to dismiss the criminal statute counts and a motion for more definite statement were granted. Mississippi filed an amended complaint dismissing the Company and Monarch from the lawsuit without prejudice. These claims could be refiled.

Over half of the states have filed similar lawsuits but the Company has not been named in any other case except Iowa's, which was instituted in October 2007. The Company filed a motion to dismiss the Iowa complaint. On February 20, 2008, the Iowa case was transferred to the MDL Court. The relief sought in all of these cases is similar to the relief sought in the NYC lawsuit. The MDL Court granted in part and denied in part the Company's motion to dismiss, and the Company has filed its answer. Discovery is proceeding in these cases. The Company intends to defend all of the AWP lawsuits vigorously, but is currently unable to predict the outcome or reasonably estimate the range of potential loss.

See also AWP Litigation under the section Alpha Matters below.

***Fen-Phen Litigation***

Many distributors, marketers and manufacturers of anorexigenic drugs have been subject to claims relating to the use of these drugs. Generally, the lawsuits allege that the defendants (1) misled users of the products with respect to the dangers associated with them, (2) failed to adequately test the products and (3) knew or should have known about the negative effects of the drugs, and should have informed the public about the risks of such negative effects. Claims include product liability, breach of warranty, misrepresentation and negligence. The actions have been filed in various state and federal jurisdictions throughout the United States. A multidistrict litigation court has been established in the U.S. District Court for the Eastern District of Pennsylvania, *In re Fen-Phen Litigation*. The plaintiffs seek, among other things, compensatory and punitive damages and/or court-supervised medical monitoring of persons who have

ingested these products.

The Company's wholly-owned subsidiary, King Research and Development, is a defendant in approximately 8 multi-plaintiff (approximately 26 plaintiffs) lawsuits involving the manufacture and sale of dexfenfluramine, fenfluramine and phentermine. These lawsuits have been filed in various jurisdictions throughout the United States and in each of these lawsuits King Research and Development, as the successor to Jones Pharma Incorporated ( Jones ), is one of many defendants, including manufacturers and other distributors of these drugs. Although Jones

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

did not at any time manufacture dexfenfluramine, fenfluramine or phentermine, Jones was a distributor of a generic phentermine product and, after its acquisition of Abana Pharmaceuticals, was a distributor of Obenix<sup>®</sup>, Abana's branded phentermine product. The manufacturer of the phentermine purchased by Jones filed for bankruptcy protection and is no longer in business. The plaintiffs in these cases, in addition to the claims described above, claim injury as a result of ingesting a combination of these weight-loss drugs and are seeking compensatory and punitive damages as well as medical care and court-supervised medical monitoring. The plaintiffs claim liability based on a variety of theories, including, but not limited to, product liability, strict liability, negligence, breach of warranty, fraud and misrepresentation.

King Research and Development denies any liability incident to Jones' distribution and sale of Obenix<sup>®</sup> or Jones' generic phentermine product. King Research and Development's insurance carriers are currently defending King Research and Development in these lawsuits. The manufacturers of fenfluramine and dexfenfluramine have settled many of these cases. As a result of these settlements, King Research and Development has routinely received voluntary dismissals without the payment of settlement proceeds. In the event that King Research and Development's insurance coverage is inadequate to satisfy any resulting liability, King Research and Development will have to assume defense of these lawsuits and be responsible for the damages, if any, that are awarded against it.

While the Company cannot predict the outcome of these lawsuits, management believes that the claims against King Research and Development are without merit and intends to vigorously pursue all defenses available. The Company is unable to disclose an aggregate dollar amount of damages claimed because many of these complaints are multi-party suits and do not state specific damage amounts. Rather, these claims typically state damages as may be determined by the court or similar language and state no specific amount of damages against King Research and Development. Consequently, the Company cannot reasonably estimate possible losses related to the lawsuits.

***Hormone Replacement Therapy***

Currently, the Company is named as a defendant by 22 plaintiffs in lawsuits involving the manufacture and sale of hormone replacement therapy drugs. The first of these lawsuits was filed in July 2004. Numerous other pharmaceutical companies have also been sued. The Company was sued by approximately 1,000 plaintiffs, but most of those claims were voluntarily dismissed or dismissed for lack of product identification. The remaining 22 lawsuits were filed in Alabama, Arkansas, Missouri, Pennsylvania, Ohio, Florida, Maryland, Mississippi and Minnesota. A federal multidistrict litigation court has been established in the U.S. District Court for the Eastern District of Arkansas, Western Division, *In re: Prempro Products Liability Litigation*, and all of the plaintiffs' claims have been transferred and are pending in that Court except for one lawsuit pending in Philadelphia, Pennsylvania state court. Many of these plaintiffs allege that the Company and other defendants failed to conduct adequate research and testing before the sale of the products and post-sale monitoring to establish the safety and efficacy of the long-term hormone therapy regimen and, as a result, misled consumers when marketing their products. Plaintiffs also allege negligence, strict liability, design defect, breach of implied warranty, breach of express warranty, fraud and misrepresentation. Discovery of the plaintiffs' claims against the Company has begun but is limited to document discovery. No trial has occurred in the hormone replacement therapy litigation against the Company or any other defendants except Wyeth/Pfizer/Upjohn. The trials against Pfizer/Wyeth have resulted in verdicts for and against Pfizer/Wyeth, with several verdicts against Wyeth reversed on post-trial motions. Pfizer/Wyeth lost appeals in the Eighth Circuit from an adverse jury verdict in the federal multidistrict litigation court and in the Pennsylvania Court of Appeals. Pfizer/Upjohn has lost two jury verdicts. One of these verdicts was later reversed, and the other is being appealed. The Company does not expect to have any trials set in the next year. The Company intends to defend these lawsuits

vigorously but is currently unable to predict the outcome or to reasonably estimate the range of potential loss, if any. The Company may have limited insurance for these claims. The Company would have to assume defense of the lawsuits and be responsible for damages, fees and expenses, if any, that are awarded against it or for amounts in excess of the Company's product liability coverage.

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Alpharma Matters***

The following matters relate to our Alpharma subsidiary and/or certain of its subsidiaries.

*Department of Justice Investigation*

As previously disclosed, Alpharma, acquired by the Company in December 2008, received a subpoena from the U.S. Department of Justice ( DOJ ) in February, 2007 in connection with its investigation of alleged improper sales and marketing practices related to the sale of the pain medicine Kadian®. The Company divested Alpharma's Kadian® assets to Actavis LLC simultaneously with the closing of the acquisition of Alpharma.

In September 2009, the Company reached an agreement in principle with the U.S. Attorney's Office and DOJ which would resolve this investigation. The Company recorded a reserve of \$42,500 in connection with this development in the third quarter of 2009 as an adjustment to the goodwill associated with the purchase of Alpharma. Under the terms of the agreement in principle, the Company began accruing interest on October 1, 2009 at a rate of 3.125% per annum. During the first quarter of 2010, Alpharma entered into a definitive settlement agreement and paid \$42,500 plus interest of \$615 to the DOJ, of which \$8,876 plus interest of \$128 is related to certain states.

*Chicken Litter Litigation*

Alpharma and one of its subsidiaries are two of multiple defendants that have been named in several lawsuits that allege that one of its animal health products causes chickens to produce manure that contains an arsenical compound which, when used as agricultural fertilizer by chicken farmers, degrades into inorganic arsenic and may have caused a variety of diseases in the plaintiffs (who allegedly live in close proximity to such farm fields). These lawsuits were filed beginning on December 16, 2003. Alpharma provided notice to its insurance carriers and its primary insurance carriers have responded by accepting their obligations to defend or pay Alpharma's defense costs, subject to reservation of rights to later reject coverage for these lawsuits. One of the carriers has filed a declaratory judgment action in state court in which it has sought a ruling concerning the allocation of its coverage obligations to Alpharma among the several insurance carriers and, to the extent Alpharma does not have full insurance coverage, to Alpharma. Further, this declaratory judgment action requests that the Court rule that certain of the carrier's policies provide no coverage because certain policy exclusions allegedly operate to limit its coverage obligations under said policies. The insurance carriers may take the position that some, or all, of the applicable insurance policies contain certain provisions that could limit coverage for future product liability claims arising in connection with product sold on and after December 16, 2003.

In addition to the potential for personal injury damages to the approximately 155 plaintiffs, the plaintiffs are asking for punitive damages and requesting that Alpharma be enjoined from the future sale of the product at issue. In September 2006, in the first trial, which was brought by three plaintiffs, the Circuit Court of Washington County, Arkansas, Second Division entered a jury verdict in favor of Alpharma. The plaintiffs appealed the verdict, challenging certain pretrial expert rulings; however, in May 2008, the Supreme Court of Arkansas denied plaintiffs' challenges. In its ruling, the Supreme Court of Arkansas also overturned the trial court's grant of summary judgment that had the effect of dismissing certain poultry company co-defendants from the case. The case was tried against the poultry company co-defendants in April and May 2009, resulting in a verdict for the defendants. In July 2009, the plaintiffs filed a notice of appeal of that verdict. It is expected that the appeal of the case will be heard in 2010. No additional cases have been set for trial. Subsequent cases may be tried against both the poultry companies and Alpharma together.



While the Company can give no assurance of the outcome of any future trial in this litigation, it believes that it will be able to continue to present credible scientific evidence that its product is not the cause of any injuries the plaintiffs may have suffered. There is also the possibility of an adverse customer reaction to the allegations in these lawsuits, as well as additional lawsuits in other jurisdictions where the product has been sold. Worldwide sales of this product were approximately \$23,606 in 2009 and \$7,176 in the first quarter of 2010.

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*AWP Litigation*

Alpharma, and in certain instances one of its subsidiaries, are defendants in connection with various elements of the litigation described above under the heading *Average Wholesale Price Litigation*, primarily related to sale of Kad<sup>an</sup> capsules. At present, Alpharma is involved in proceedings in the following courts:

Superior Court for the State of Alaska, Third Judicial District of Anchorage;

Second Judicial Court in and for Leon County, Florida;

Circuit Court of Cook County, Illinois, County Department, Chancery Division; and

Court of Common Pleas, for the Fifth Judicial District, State of South Carolina, County of Richland.

In addition, Alpharma's New York and Iowa cases are pending in the MDL Court discussed above. Mississippi and Texas cases against Alpharma were dismissed without prejudice. The Company expects the Florida case will be dismissed voluntarily.

These lawsuits vary with respect to the particular causes of action and relief sought. The relief sought in these lawsuits includes statutory causes of action including civil penalties and treble damages, common law causes of action, declaratory and injunctive relief, and punitive damages, including, in certain lawsuits, disgorgement of profits. The Company believes it has meritorious defenses and intends to vigorously defend its positions in these lawsuits. Numerous other pharmaceutical companies are defendants in similar lawsuits.

***Environmental Matters***

In 2006, the Company contacted the U.S. Environmental Protection Agency (EPA) to report past deviations from the requirements of the state conditional major air emissions operating permit relating to the Company's operation of certain pollution control equipment at its Bristol, Tennessee facility. In May 2009, the Company received an information request from EPA pursuant to section 114 of the Clean Air Act regarding the Company's historic air emissions and its operation of certain pollution control equipment (Information Request). In June 2009, the Company provided EPA with its initial response to the Information Request. The Company has subsequently provided additional information to, and met with, EPA and the Tennessee Department of Environment and Conservation. At this time, the Company cannot predict or determine the outcome of this matter or reasonably estimate the amount or range of amounts of fines or penalties, if any, that might result from an adverse outcome.

**10. Accounting Developments**

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment requires greater transparency and additional disclosures for transfers of financial assets and the entity's continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, this amendment eliminates the concept of a qualifying special-purpose entity (QSPE). This amendment is effective for financial statements issued for fiscal years beginning after November 15, 2009. The Company's adoption of this amendment did not have a material effect on its financial statements.

In June 2009, the FASB also issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities ( VIEs ). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this amendment. This amendment requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. The amendment also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, the amendment requires enhanced disclosures about an enterprise s involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise s financial statements. Finally, an enterprise will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This amendment is effective for financial statements issued for fiscal

**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

years beginning after November 15, 2009. The Company's adoption of this amendment did not have a material effect on its financial statements.

**11. Income Taxes**

During the first quarter of 2010, the Company's effective income tax rate was 75.3%. This rate varied from the statutory rate of 35% due primarily to losses on foreign subsidiaries with no tax benefit, stock compensation and state taxes.

During the first quarter of 2009, the Company's effective income tax was a benefit of 36.1%. This rate is greater than the statutory rate of 35% due primarily to benefits from research credits, tax-exempt interest income and domestic manufacturing deductions, which benefits were partially offset by state taxes.

**12. Segment Information**

The Company's business is classified into four reportable segments: branded prescription pharmaceuticals, animal health, Meridian Auto-Injector, and royalties and other. The branded prescription pharmaceuticals segment includes a variety of branded prescription products that are separately categorized into neuroscience, hospital and legacy products. These branded prescription products are aggregated because of the similarity in regulatory environment, manufacturing processes, methods of distribution and types of customer. The animal health business is a global leader in the development, registration, manufacture and marketing of medicated feed additives and water soluble therapeutics primarily for poultry, cattle and swine. Meridian Auto-Injector products are sold to both commercial and government markets. The principal source of revenues in the commercial market is the EpiPen® product, an epinephrine filled auto-injector which is primarily prescribed for the treatment of severe allergic reactions and which is primarily marketed, distributed and sold by Dey, L.P. Government revenues in the Meridian Auto-Injector segment are principally derived from the sale of nerve agent antidotes and other emergency medicine auto-injector products marketed to the U.S. Department of Defense and other federal, state and local agencies, particularly those involved in homeland security, as well as to approved foreign governments. Royalties and other primarily include revenues the Company derives from pharmaceutical products after the Company has transferred the manufacturing or marketing rights to third parties in exchange for licensing fees or royalty payments.

The Company primarily evaluates its segments based on segment profit. Reportable segments were separately identified based on revenues and segment profit. Segment profits are defined as operating income (loss) before other expenses such as depreciation, amortization, restructuring charges and expenses associated with the acquisition of Alharma. Additionally, segment profits do not include general corporate expenses, which are included in the Corporate line in the table below. Prior year results have been conformed to the current presentation.

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following represents selected information for the Company's reportable segments for the periods indicated.

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Total revenues:		
Branded prescription pharmaceuticals	\$ 241,541	\$ 277,704
Animal Health	81,314	79,835
Meridian Auto-Injector	49,827	56,607
Royalties and other	8,644	16,147
Eliminations	(471)	(1,236)
Total revenues	\$ 380,855	\$ 429,057
Segment profit:		
Branded prescription pharmaceuticals(1)	\$ 63,177	\$ 105,317
Animal Health(1)	17,463	33
Meridian Auto-Injector	23,841	26,885
Royalties and other	7,369	13,218
Corporate Costs	(26,848)	(33,125)
Acquisition related costs		(3,789)
Depreciation and amortization	(57,275)	(53,349)
Restructuring charges	(262)	(48,050)
Other income (expense)	(9,402)	(23,917)
Income (loss) before tax	\$ 18,063	\$ (16,777)

(1) The segment profit for branded prescription pharmaceuticals and Animal Health for the first quarter of 2009 includes additional costs of \$1,015 and \$20,509, respectively, related to the mark up of inventory upon acquisition of AlphaPharma, which the Company recognized as the related inventory was sold.

The following represents branded pharmaceutical revenues by the Company's target markets:

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Total revenues:		
Neuroscience	\$ 155,697	\$ 157,101
Hospital	39,955	51,959

Legacy:		
Cardiovascular/metabolic	28,150	44,968
Other	17,739	23,676
Consolidated branded prescription pharmaceutical revenues	\$ 241,541	\$ 277,704

### 13. Restructuring Activities

#### *First Quarter of 2009 Action*

On January 20, 2009, the U.S. District Court for the Eastern District of New York issued an order ruling invalid two patents relating to the Company's product Skelaxin<sup>®</sup>. In June 2009, the Court entered judgment against the Company. The Company has appealed the judgment, and intends to vigorously defend its interests. Generic versions of Skelaxin<sup>®</sup> entered the market early in the second quarter of 2010. The Company's sales of Skelaxin<sup>®</sup> will decline significantly as a result of generic competition. For additional information regarding Skelaxin<sup>®</sup> litigation, please see Note 9.

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Following the decision of the District Court, the Company's senior management team conducted an extensive examination of the Company and developed a restructuring initiative. Based on an analysis of the Company's strategic needs, this initiative included a reduction in sales, marketing and other personnel; leveraging of staff; expense reductions and additional controls over spending; and reorganization of sales teams.

The Company incurred restructuring charges of approximately \$50,000 associated with this restructuring plan related to severance pay and other employee termination expenses. Almost all of the restructuring charges were cash expenditures and were substantially paid in the second quarter of 2009. The remaining severance pay and other employee termination costs are expected to be fully paid by the second quarter of 2010.

The restructuring charges include employee termination costs associated with a workforce reduction of approximately 520 employees, including approximately 380 members of our sales force.

***Fourth Quarter of 2008 Action***

As part of the acquisition of Alpharma, management developed a restructuring plan to eliminate redundancies in operations created by the acquisition. This plan includes a reduction in personnel, staff leverage, reductions in duplicate expenses and a realignment of research and development priorities.

The Company has estimated total costs of \$71,106 associated with this restructuring plan, \$64,516 of which was included in the liabilities assumed in the purchase price of Alpharma. The restructuring plan includes employee termination costs associated with a workforce reduction of 250 employees. The restructuring plan also includes contract termination costs of \$16,652 as a result of the acquisition. All employee termination costs are expected to be paid by the end of 2012. All contract termination costs are expected to be paid by the end of 2018.

***Third Quarter of 2006 Action***

During 2006, the Company decided to streamline its manufacturing activities in order to improve operating efficiency and reduce costs, including the decision to transfer the production of Levoxy<sup>1</sup>® from its St. Petersburg, Florida facility to its Bristol, Tennessee facility, which the Company expects to complete in 2010. As a result of these steps, the Company incurred restructuring charges totaling approximately \$16,500, of which approximately \$12,000 are associated with accelerated depreciation and approximately \$4,500 are associated with employee termination costs. The employee termination costs are expected to be fully paid in the third quarter of 2010.

A summary of the types of costs accrued and incurred are summarized below:

	<b>Accrued Balance at December 31, 2009</b>	<b>Income Statement Impact</b>	<b>Cash Payments</b>	<b>Non-Cash Costs</b>	<b>Accrued Balance at March 31, 2010</b>
<b>Third quarter of 2009 action</b>					
Employee separation payments	\$ 1,080	\$ 51	\$ 996	\$	\$ 135
<b>First quarter of 2009 action</b>					

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Employee separation payments	314	18	283		49
Accelerated depreciation(1)		(45)		(45)	
<b>Fourth quarter of 2008 action</b>					
Employee separation payments	16,177	(95)	5,448	(353)	10,987
Contract termination	9,193	459	724	(252)	9,180
Other	182	(182)			
<b>Third quarter of 2006 action</b>					
Employee separation payments	1,185	11	15	11	1,170
	\$ 28,131	\$ 217	\$ 7,466	\$ (639)	\$ 21,521

(1) Included in depreciation and amortization on the Condensed Consolidated Statements of Operations.

The restructuring charges in 2010 relate primarily to the branded prescription pharmaceutical segment.



**Table of Contents**

**KING PHARMACEUTICALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**14. Stock-Based Compensation**

During the first quarter of 2010, the Company granted to certain employees 650,370 RSAs, 452,530 LPUs with a one-year performance cycle, 193,930 LPUs with a three-year performance cycle, 16,550 restricted stock units ( RSUs ), and 1,770,260 nonqualified stock options under its Incentive Plan.

The RSAs are grants of shares of common stock restricted from sale or transfer for three years from grant date.

The LPUs are rights to receive common stock of the Company in which the number of shares ultimately received depends on the Company s performance over time. LPUs with a one-year performance cycle, followed by a two-year restriction period, will be earned based on 2010 operating targets. LPUs with a three-year performance cycle will be earned based on market-related performance targets over the years 2010 through 2012. At the end of the applicable performance period, the number of shares of common stock awarded is either 0% or between 50% and 200% of a target number. The final performance percentage on which the number of shares of common stock issued is based, considering performance metrics established for the performance period, will be determined by the Company s Board of Directors or a committee of the Board at its sole discretion.

RSUs represent the right to receive a share of common stock at the expiration of a restriction period, generally three years from grant, but may be restricted over other designated periods as determined by the Company s Board of Directors or a committee of the Board. The RSUs granted to non-employee directors under the current Compensation Policy for Non-Employee Directors have a restriction period that generally ends one year after the date of the grant, unless a deferral election is made in advance.

The nonqualified stock options were granted at option prices equal to the fair market value of the common stock at the date of grant and vest approximately in one-third increments on each of the first three anniversaries of the grant date.

**15. Guarantor Financial Statements**

Each of the Company s U.S. subsidiaries (the Guarantor Subsidiaries ) guaranteed on a full, unconditional and joint and several basis the Company s performance under the \$400,000 aggregate principal amount of the Convertible Senior Notes.

There are no restrictions under the Company s current financing arrangements on the ability of the Guarantor Subsidiaries to distribute funds to the Company in the form of cash dividends, loans or advances. The following combined financial data provides information regarding the financial position, results of operations and cash flows of the Guarantor Subsidiaries for the \$400,000 aggregate principal amount of the Convertible Senior Notes (condensed consolidating financial data). Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that such information would not be material to the holders of the debt.

Table of Contents**KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****GUARANTOR SUBSIDIARIES****CONDENSED CONSOLIDATING BALANCE SHEETS****(In thousands)****(Unaudited)**

King	March 31, 2010			King Consolidated	King	December 31, 2009			
	Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminating Entries			Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminating Entries	
<b>ASSETS</b>									
\$ 201,115	\$ 36,836	\$ 233,812	\$	\$ 471,763	\$ 277,603	\$ 30,779	\$ 236,930	\$	
27,127				27,127	29,258				
1,476				1,476	2,100				
2,509	170,560	33,993		207,062	2,467	174,713	33,076		
42,451	114,626	33,956	(2,389)	188,644	43,834	111,242	28,642		
29,735	49,207	254		79,196	30,828	52,597	250		
19,369	(579)	(532)		18,258	17,983	(1,865)	(27)		
14,608	33,809	1,486		49,903	14,972	44,384	1,504		
338,390	404,459	302,969	(2,389)	1,043,429	419,045	411,850	300,375		
144,303	228,387	8,680		381,370	148,399	234,233	9,207		
	721,270	33,991		755,261		759,583	34,556		
	467,613			467,613		467,613			
(30,929)	287,155	602		256,828	(26,551)	290,104	609		
204,785				204,785	218,608				
36,481	22,763	340		59,584	32,368	23,795	333		
	5,890			5,890		5,890			
3,026,310	908,086	(109)	(3,934,287)		3,027,491	938,020	(88)	(3,960,000)	
\$ 3,719,340	\$ 3,045,623	\$ 346,473	\$ (3,936,676)	\$ 3,174,760	\$ 3,819,360	\$ 3,131,088	\$ 344,992	\$ (3,960,000)	

**LIABILITIES AND SHAREHOLDERS EQUITY**

\$	33,444	\$	50,315	\$	6,035	\$		\$	89,794	\$	27,377	\$	53,966	\$	5,349	\$	
	18,631		216,702		9,520				244,853		31,541		279,662		9,789		
					3,369				3,369						3,662		
											85,550						
	52,075		267,017		18,924				338,016		144,468		333,628		18,800		
	336,978								336,978		339,016						
	66,601		47,499		14,138				128,238		59,884		48,579		14,908		
	892,158		(927,927)		35,769						906,685		(932,193)		25,508		
	1,347,812		(613,411)		68,831				803,232		1,450,053		(549,986)		59,216		
	2,371,528		3,659,034		277,642		(3,936,676)		2,371,528		2,369,307		3,681,074		285,776	(3,96	
\$	3,719,340	\$	3,045,623	\$	346,473	\$	(3,936,676)	\$	3,174,760	\$	3,819,360	\$	3,131,088	\$	344,992	\$	(3,96

**Table of Contents****KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****GUARANTOR SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF INCOME****(In thousands)****(Unaudited)**

	<b>Three Months Ended March 31, 2010</b>					<b>Three Months Ended March 31, 2009</b>			
	<b>King</b>	<b>Guarantor Subsidiaries</b>	<b>Non Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>King Consolidated</b>	<b>King</b>	<b>Guarantor Subsidiaries</b>	<b>Non Guarantor Subsidiaries</b>	<b>Eliminations</b>
Revenue	\$ 92,938	\$ 356,794	\$ 37,442	\$ (114,109)	\$ 373,065	\$ 95,149	\$ 397,356	\$ 30,477	\$ (108,683)
		7,790			7,790		14,758		
Costs	92,938	364,584	37,442	(114,109)	380,855	95,149	412,114	30,477	(108,683)
Depreciation and amortization	19,737	197,575	22,044	(112,302)	127,054	26,930	209,395	23,101	(108,487)
Research and development	49,764	82,838	7,873		140,475	59,419	76,219	6,685	
Goodwill impairment	2,184	24,714	1,426		28,324	1,609	24,327	1,320	
Other charges	6,174	50,200	901		57,275	4,857	47,946	546	
	2	260			262	13,504	34,546		
Operating costs	77,861	355,587	32,244	(112,302)	353,390	106,319	392,433	31,652	(108,487)
Income	15,077	8,997	5,198	(1,807)	27,465	(11,170)	19,681	(1,175)	(196)
Other income	279	50	80		409	1,449	267	1,072	
Provision for doubtful accounts	(7,701)	(988)	(47)		(8,736)	(22,066)	(961)	(76)	
Other adjustments	(872)				(872)	(823)			
	93	137	(433)		(203)	(441)	(99)	(2,239)	
Other income	4,461	2,760	(20)	(7,201)		12,618	7,810	(20)	(20,408)
Interest income	(2,093)	7,557	(5,464)			(1,391)	3,748	(2,357)	

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expense)	(5,833)	9,516	(5,884)	(7,201)	(9,402)	(10,654)	10,765	(3,620)	(20,408)
before	9,244	18,513	(686)	(9,008)	18,063	(21,824)	30,446	(4,795)	(20,604)
expense	4,775	7,871	948		13,594	(11,102)	5,984	(937)	
loss)	\$ 4,469	\$ 10,642	\$ (1,634)	\$ (9,008)	\$ 4,469	\$ (10,722)	\$ 24,462	\$ (3,858)	\$ (20,604)

Table of Contents**KING PHARMACEUTICALS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****GUARANTOR SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	<b>Three Months Ended March 31, 2010</b>				<b>Three Months Ended March 31, 2009</b>			
	<b>King</b>	<b>Guarantor Subsidiaries</b>	<b>Non Guarantor Subsidiaries</b>	<b>King Consolidated</b>	<b>King</b>	<b>Guarantor Subsidiaries</b>	<b>Non Guarantor Subsidiaries</b>	<b>King Consolidated</b>
Cash flows provided by (used in) operating activities	\$ 18,877	\$ (12,301)	\$ (8,377)	\$ (1,801)	\$ (22,649)	\$ 49,858	\$ (15,875)	\$ 11,334
Cash flows from investing activities:								
Transfers to restricted cash	(3)			(3)	(38)	(27)		(65)
Proceeds from maturities and sales of investments in debt securities	16,810			16,810	8,000			8,000
Purchases of property, plant and equipment	(4,344)	(3,361)	(88)	(7,793)	(4,681)	(2,099)	(112)	(6,892)
Proceeds from the sale of Kadian®		20,000		20,000				
Proceeds from sale of property and equipment		73		73				
Acquisition of Alpharma					(13,104)	(56,602)		(69,706)
Acquisition of Avinza®					(1)			(1)
Forward foreign							5,406	5,406

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exchange contracts								
Purchases of intellectual property and product rights		(504)		(504)		(548)		(548)
Net cash provided by (used in) investing activities	12,463	16,208	(88)	28,583	(9,824)	(59,276)	5,294	(63,806)
Cash flows from financing activities:								
Proceeds from exercise of stock options	742			742	36			36
Net (payments) proceeds related to stock-based award activity	(3,905)			(3,905)	(2,000)			(2,000)
Payments on debt	(92,261)		(293)	(92,554)	(48,022)	(385,227)		(433,249)
Debt issuance costs					(1,220)			(1,220)
Intercompany	(12,404)	2,150	10,254		(119,091)	116,338	2,753	
Net cash (used in) provided by financing activities	(107,828)	2,150	9,961	(95,717)	(170,297)	(268,889)	2,753	(436,433)
Effect of exchange rate changes on cash			(4,614)	(4,614)			(14,514)	(14,514)
(Decrease) increase in cash and cash equivalents	(76,488)	6,057	(3,118)	(73,549)	(202,770)	(278,307)	(22,342)	(503,419)
Cash and cash equivalents, beginning of period	277,603	30,779	236,930	545,312	401,657	289,996	248,559	940,212

Cash and cash  
equivalents,

end of period    \$   201,115    \$   36,836    \$   233,812    \$   471,763    \$   198,887    \$   11,689    \$   226,217    \$   436,793



**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion contains certain forward-looking statements that reflect management's current views of future events and operations. This discussion should be read in conjunction with the following: (a) our audited consolidated financial statements and related notes which are included in our Annual Report on Form 10-K for the year ended December 31, 2009; and (b) our unaudited condensed consolidated financial statements and related notes which are included in this Quarterly Report on Form 10-Q. Please see the sections entitled Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009, and Risk Factors and A Warning About Forward-Looking Statements in this Quarterly Report on Form 10-Q for a discussion of the uncertainties, risks and assumptions associated with these statements.*

**I. OVERVIEW**

***Our Business***

We are a vertically integrated pharmaceutical company that performs basic research and develops, manufactures, markets and sells branded prescription pharmaceutical products and animal health products. By vertically integrated, we mean that we have the following capabilities:

research and development

manufacturing

packaging

quality control and assurance

distribution

sales and marketing

business development

regulatory management

Branded prescription pharmaceutical products are innovative products sold under a brand name that have, or previously had, some degree of market exclusivity. Our branded prescription pharmaceuticals include neuroscience products (primarily pain medicines), hospital products, and legacy brands, all of which are for use in humans. Our auto-injector business manufactures acute care medicines for use in humans that are delivered using an auto-injector. Our animal health business is focused on medicated feed additives ( MFAs ) and water-soluble therapeutics primarily for poultry, cattle, and swine.

Our corporate strategy is focused on specialty markets, particularly specialty-driven branded prescription pharmaceutical markets. We believe our target markets have significant potential, and our organization is aligned to focus on these markets. Our growth in specialty markets is achieved through both acquisitions and organic growth. Our strategy focuses on growth through the acquisition of novel branded prescription pharmaceutical products and technologies that we believe complement the commercial footprint we have established in the neuroscience and hospital markets. We strive to be a leader in developing and commercializing innovative, clinically-differentiated therapies and technologies in these target, specialty-driven markets. We may also seek company acquisitions that add

commercialized products or products in development, technologies or sales and marketing capabilities to our existing platforms or that otherwise complement our operations. We also have a commitment to research and development and advancing the products and technologies in our development pipeline.

We work to achieve organic growth by maximizing the potential of our currently marketed products through sales and marketing and product life-cycle management. By product life-cycle management, we mean the extension of the economic life of products, including seeking and obtaining necessary governmental approvals, by securing from the U.S. Food and Drug Administration ( FDA ) additional approved uses for our products, developing and producing different strengths, producing different package sizes, developing new dosage forms, and developing new product formulations.

We market our branded prescription pharmaceutical products, primarily through a dedicated sales force, to general/family practitioners, internal medicine physicians, neurologists, pain specialists, surgeons and hospitals across the United States and in Puerto Rico.

Through a team of internal sales professionals, our auto-injector business markets a portfolio of acute care auto-injector products to the pre-hospital emergency services market, which includes U.S. federal, state and local governments, public health services, emergency medical personnel and first responders and approved foreign governments.

## **Table of Contents**

Our animal health products of our wholly-owned subsidiary Alpharma, LLC ( Alpharma ) are marketed through a staff of trained sales and technical service and marketing employees, many of whom are veterinarians and nutritionists. Sales offices are located in the U.S., Europe, Canada, Mexico, South America and Asia. Elsewhere, our animal health products are sold primarily through the use of distributors and other third-party sales companies.

## **Recent Developments**

### *Acurox<sup>®</sup> Tablets*

Acurox<sup>®</sup> Tablets, a patented, orally administered, immediate release tablet containing oxycodone HCl as its sole active analgesic ingredient, has a proposed indication for the relief of moderate to severe pain. Acurox<sup>®</sup> uses Acura Pharmaceuticals Inc.'s ( Acura ) patented Aversion<sup>®</sup> Technology, which is designed to deter misuse and abuse by intentional swallowing of excess quantities of tablets, intravenous injection of dissolved tablets and nasal snorting of crushed tablets. Attempts to extract oxycodone from an Acurox<sup>®</sup> Tablet by dissolving it in liquid result in the formation of a viscous gel which is intended to limit the ability to inject the drug intravenously. Crushing an Acurox<sup>®</sup> Tablet for the purposes of nasal snorting releases an ingredient that is intended to cause nasal irritation and thereby discourage this method of misuse and abuse. Swallowing excessive numbers of Acurox<sup>®</sup> Tablets releases niacin in quantities that are intended to cause unpleasant and undesirable side effects.

On June 30, 2009, the FDA issued a Complete Response Letter regarding the New Drug Application ( NDA ) for Acurox<sup>®</sup> Tablets. The Complete Response Letter raises issues regarding the potential abuse deterrent benefits of Acurox<sup>®</sup>. In early September 2009, we and Acura met with the FDA to discuss the Complete Response Letter. The FDA, Acura and we agreed to submit the NDA to an FDA advisory committee to consider the evidence to support the potential abuse deterrent effects of Acurox<sup>®</sup> Tablets when compared to other currently marketed short-acting oxycodone opioid products. On April 22, 2010, the FDA held an advisory committee meeting to review the NDA related to Acurox<sup>®</sup>. The advisory committee voted that they did not have sufficient evidence to support the approval of the NDA for Acurox<sup>®</sup> Tablets for the treatment of moderate to severe pain. The addition of niacin to Acurox<sup>®</sup> was central to the deliberations. The advisory committee did not believe that the benefits of niacin outweighed the potential risks for a broad treatment population. The FDA is not bound by the advisory committee's recommendation, but may take its advice into consideration when evaluating the NDA for Acurox<sup>®</sup> Tablets.

### *Acurox<sup>®</sup> Tablets (without niacin)*

Acura and King plan to develop and submit an NDA for Acurox<sup>®</sup> (oxycodone HCl) Tablets (without niacin) intended to relieve moderate to severe pain and introduce limits and impediments to potential abuse via nasal snorting of crushed tablets and intravenous injection of dissolved tablets. At the April 22, 2010 advisory committee meeting, the FDA cited no concerns with the snorting and intravenous abuse limiting features of the current Acurox<sup>®</sup> Tablets formulation. The Companies expect to submit an NDA for Acurox<sup>®</sup> Tablets (without niacin) in early 2011.

Acura and King also plan to develop and submit NDAs for two additional immediate release opioid analgesic products utilizing Acura's proprietary Aversion<sup>®</sup> Technology; Vycavert<sup>®</sup> (hydrocodone bitartrate/acetaminophen) Tablets and Acuracet<sup>®</sup> (oxycodone HCl/acetaminophen) Tablets. Like Acurox<sup>®</sup> Tablets (without niacin) these additional product candidates are patent protected compositions comprising a mixture of active and inactive ingredients intended to relieve pain and introduce limits and impediments to nasal and intravenous abuse.

### *Department of Justice Investigation*

As previously disclosed, Alpharma, acquired by us in December 2008, received a subpoena from the Department of Justice ( DOJ ) in February 2007 in connection with its investigation of alleged improper sales and marketing practices

related to the sale of the pain medicine Kadian®. We divested Alparma's Kadian® assets to Actavis LLC simultaneously with the closing of the acquisition of Alparma.

In September 2009, we reached an agreement in principle with the U.S. Attorney's Office and DOJ which would resolve this investigation. We recorded a reserve of \$42.5 million in connection with this development in the third quarter of 2009 as an adjustment to the goodwill associated with the purchase of Alparma. During the first quarter of 2010, Alparma entered into a definitive settlement agreement and paid \$42.5 million plus interest of \$0.6 million to DOJ, of which \$8.9 million plus interest of \$0.1 million is related to certain states.

**Table of Contents***Skelaxin®*

On January 20, 2009, the U.S. District Court for the Eastern District of New York issued an order ruling invalid two patents related to Skelaxin®. In June 2009, the Court entered judgment against King. We have appealed the judgment and plan to vigorously defend our interests. Generic versions of Skelaxin® entered the market early in the second quarter of 2010, one of which is a generic product sold by CorePharma, LLC ( CorePharma ). Net sales of Skelaxin® will decline significantly as a result of generic competition. According to IMS America, Ltd. ( IMS ) weekly prescription data, for the week ending April 23, 2010, generic competitors have garnered just over 80% of the prescriptions in the metaxalone market. In January 2008, we entered into an agreement with CorePharma, granting CorePharma a license to launch an authorized generic version of Skelaxin® in December 2012, or earlier under certain conditions.

For additional information on the Skelaxin® litigation, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements.

*Patient Protection and Affordable Care Act*

On March 23, 2010, the Patient Protection and Affordable Care Act ( PPACA ) was signed into law. We expect that the new legislation will increase Medicaid rebates paid by us in the future, primarily due to an increase in Medicaid rebate rates, changes to the calculation of Medicaid rebates for new formulations of existing products, and an expansion of Medicaid rebates to products supplied to enrollees of Medicaid managed care organizations. While the increase in Medicaid rebate rates and the changes to the calculation of Medicaid rebates for new formulations of existing products were effective on January 1, 2010 and are therefore reflected in the first quarter 2010 provision for rebates, the expansion of the Medicaid program to enrollees of Medicaid managed care organizations was not effective until March 23, 2010. Therefore, we anticipate an additional increase in Medicaid rebates in the second quarter of 2010. For the full year of 2010, we expect Medicaid rebates to increase by approximately \$15.0 million as a result of the PPACA.

In addition, the PPACA will impose an annual fee on pharmaceutical manufacturers beginning in 2011. The fee will be payable no later than September 30 of each applicable year and will be allocated to pharmaceutical manufacturers based on relative market share.

**II. RESULTS OF OPERATIONS***Three Months Ended March 31, 2010 and 2009***Revenues**

The following table summarizes total revenues by operating segment:

	<b>For the Three Months Ended March 31,</b>		<b>Change</b>	
	<b>2010</b>	<b>2009</b>	<b>2010 vs. 2009</b>	
	<b>(In thousands)</b>		<b>\$</b>	<b>%</b>
Total Revenues				
Branded prescription pharmaceuticals	\$ 241,541	\$ 277,704	\$ (36,163)	(13.0)%
Animal Health	81,314	79,835	1,479	1.9

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Meridian Auto-Injector	49,827	56,607	(6,780)	(12.0)
Royalties and other	8,173	14,911	(6,738)	(45.2)
Total revenues	\$ 380,855	\$ 429,057	\$ (48,202)	(11.2)%

**Table of Contents**

The following table summarizes our deductions from gross revenues:

	<b>For the Three Months Ended March 31, 2010                      2009 (In thousands)</b>	
Gross Revenues	\$ 470,145	\$ 507,044
Commercial Rebates	15,929	15,459
Medicare Part D Rebates	3,765	2,539
Medicaid Rebates	10,940	11,623
Chargebacks	28,222	28,176
Returns	10,757	2,883
Trade Discounts/Other	19,677	17,307
Net Revenues	\$ 380,855	\$ 429,057

Gross revenues decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to market competition with several key products in the branded prescription pharmaceuticals segment discussed below, and decreases in revenues of the Meridian Auto-Injector and Royalties and other segments.

Based on inventory data provided to us by our customers, we believe that wholesale inventory levels of Skelaxin®, Thrombin-JMI®, Flector® Patch, Avinza®, Embeda® and Levoxyl® are at or below normalized levels as of March 31, 2010. We estimate that wholesale and retail inventories of our products as of March 31, 2010 represent gross revenues of approximately \$120.0 million to \$130.0 million.

The following tables provide the activity and ending balances for our significant deductions from gross revenues:

***Accrual for Rebates, including Administrative Fees (in thousands):***

	<b>2010</b>	<b>2009</b>
Balance at January 1, net of prepaid amounts	\$ 44,439	\$ 58,129
Current provision related to sales made in current period	30,431	28,512
Current provision related to sales made in prior periods	203	1,109
Alpharma acquisition	(124)	1,772
Rebates paid	(29,580)	(34,482)
Balance at March 31, net of prepaid amounts	\$ 45,369	\$ 55,040

Rebates include commercial rebates and Medicaid and Medicare rebates.

***Accrual for Returns (in thousands):***

	<b>2010</b>	<b>2009</b>
Balance at January 1	\$ 30,345	\$ 33,471
Current provision	10,757	2,883
Actual returns	(9,729)	(4,646)
Ending balance at March 31	\$ 31,373	\$ 31,708



**Table of Contents****Accrual for Chargebacks (in thousands):**

	<b>2010</b>	<b>2009</b>
Balance at January 1	\$ 10,593	\$ 9,965
Current provision	28,222	28,176
Actual chargebacks	(28,589)	(27,244)
Ending balance at March 31	\$ 10,226	\$ 10,897

**Branded Prescription Pharmaceuticals**

	<b>For the Three Months Ended March 31,</b>		<b>Change 2010 vs. 2009</b>	
	<b>2010</b>	<b>2009</b>	<b>\$</b>	<b>%</b>
	<b>(In thousands)</b>			
Branded prescription pharmaceuticals revenue:				
<i>Skelaxin</i> <sup>®</sup>	\$ 90,917	\$ 100,599	\$ (9,682)	(9.6)%
<i>Thrombin-JMI</i> <sup>®</sup>	36,932	47,339	(10,407)	(22.0)
<i>Flector</i> <sup>®</sup> Patch	33,532	16,776	16,756	99.9
<i>Avinza</i> <sup>®</sup>	23,196	38,980	(15,784)	(40.5)
<i>Embeda</i> <sup>®</sup>	9,075		9,075	
<i>Levoxyl</i> <sup>®</sup>	15,355	19,572	(4,217)	(21.5)
<i>Other</i>	32,534	54,438	(21,904)	(40.2)
Total revenue	\$ 241,541	\$ 277,704	\$ (36,163)	(13.0)%

***Skelaxin*<sup>®</sup>**

Net sales of Skelaxin<sup>®</sup> decreased in the first quarter of 2010 from the first quarter of 2009 primarily due to a decrease in prescriptions, partially offset by price increases taken in the second quarter of 2009 and the first quarter of 2010. Total prescriptions for Skelaxin<sup>®</sup> decreased approximately 24.9% in the first quarter of 2010 from the first quarter of 2009 according to IMS monthly prescription data primarily due to a decrease in promotional efforts. Following the January 2009 court order, we completed a restructuring initiative that reduced our promotional efforts with respect to Skelaxin<sup>®</sup>. For additional information regarding the restructuring initiative, please see Skelaxin<sup>®</sup> within the Liquidity and Capital Resources section below. As a result of generic competition, we expect net sales of Skelaxin<sup>®</sup> will decrease significantly in the last three quarters of 2010.

***Thrombin-JMI*<sup>®</sup>**

Net sales of Thrombin-JMI<sup>®</sup> decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to market competition. The first competing product entered the market in the fourth quarter of 2007 and another entered the market in the first quarter of 2008. We expect net sales of our Thrombin-JMI<sup>®</sup> product to decrease in 2010 as a result of competition.

*Flector® Patch*

Net sales of Flector® Patch increased in the first quarter of 2010 from the first quarter of 2009 primarily due to a significant reduction in wholesale inventory levels in the first quarter of 2009, and price increases taken in the second quarter of 2009 and the first quarter of 2010, partially offset by a decrease in prescriptions. Flector® Patch was part of the acquisition of Alpharma at the end of December 2008. At the time of acquisition, the wholesale inventory level of Flector® Patch exceeded our normal levels. During the first quarter of 2009, we reduced these inventories to a level consistent with our other promoted products. As a result, net sales of Flector® Patch were lower than prescription demand in the first quarter of 2009. Alpharma began selling the Flector® Patch in January 2008. Total prescriptions for Flector® Patch decreased approximately 3.3% in the first quarter of 2010 compared to the first quarter of 2009 according to IMS monthly prescription data.

**Table of Contents**

*Avinza*<sup>®</sup>

Net sales of Avinza<sup>®</sup> decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to a decrease in prescriptions and an increase in wholesale inventory levels in the first quarter of 2009, partially offset by a price increase taken in the fourth quarter of 2009. Total prescriptions for Avinza<sup>®</sup> decreased approximately 26.8% in the first quarter of 2010 compared to the first quarter of 2009 according to IMS monthly prescription data. We expect net sales of Avinza<sup>®</sup> to decrease in 2010 compared to 2009.

For a discussion regarding the risk of potential generic competition for Avinza<sup>®</sup>, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements.

*Embeda*<sup>®</sup>

In August 2009, the FDA approved Embeda<sup>®</sup> (morphine sulfate and naltrexone hydrochloride) Extended Release Capsules, a long-acting Schedule II opioid analgesic for the management of moderate to severe pain when a continuous, around-the-clock opioid analgesic is needed for an extended period of time. We began selling Embeda<sup>®</sup> in late September 2009, and we anticipate net sales of Embeda<sup>®</sup> will increase significantly in 2010. During the first quarter of 2010, we received approval of two patents on the product and listed these in the FDA's Orange Book. These patents expire in June 2027.

On October 8, 2009, we received a warning letter from the FDA, Division of Drug Marketing, Advertising, and Communications (DDMAC) regarding certain materials used to announce the commercial launch of Embeda<sup>®</sup>. The letter indicated these materials were false or misleading because they omitted and minimized the risks associated with the use of Embeda<sup>®</sup>, failed to present the limitations to its approved indication, and presented misleading claims. We ceased the dissemination of these materials and took steps to conform other materials we currently utilize with Embeda<sup>®</sup> to the guidance set forth in the warning letter. On October 16, 2009, we responded to the warning letter, providing DDMAC with a list of materials that were discontinued and a comprehensive plan of action to appropriately disseminate corrective messages to those that received the original materials. We met with members of the FDA on December 22, 2009 to discuss the warning letter. On March 26, 2010, we issued a corrective press release to address the issues raised in the warning letter and DDMAC closed the case.

During January 2010, we submitted to DDMAC for pre-approval proposed revised marketing materials for Embeda<sup>®</sup>.

*Levoxl*<sup>®</sup>

Net sales of Levoxl<sup>®</sup> decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to increases in wholesale inventory levels in 2009 and a decrease in prescriptions. Total prescriptions for Levoxl<sup>®</sup> decreased approximately 9.8% in the first quarter of 2010 compared to the first quarter of 2009 according to IMS monthly prescription data. We anticipate net sales for this product will decline in 2010 due to decreasing prescriptions.

*Other*

Our other branded prescription pharmaceutical products are not promoted through our sales force and prescriptions for many of our products included in this category are declining. Net sales of other branded pharmaceutical products were lower in the first quarter of 2010 compared to the first quarter of 2009 primarily due to lower net sales of Cytomel<sup>®</sup> and a decrease in prescriptions.

In April 2009, a third party entered the market with a generic substitute for Cytomel<sup>®</sup>. As a result of the entry of generic competition, net sales of Cytomel<sup>®</sup> declined in the first quarter of 2010 and we expect net sales of Cytomel<sup>®</sup>

to continue to decline in the future. Net sales of Cytomel® were \$5.3 million in the first quarter of 2010 and were \$13.9 million in the first quarter of 2009.

As a result of generic competition for Cytomel® and declining demand for many other products included in this category, we anticipate net sales of other branded prescription pharmaceutical products will continue to decline in 2010.

***Animal Health***

Revenues of the Animal Health segment were consistent in the first quarter of 2010 compared to the first quarter of 2009.

**Table of Contents*****Meridian Auto-Injector***

Revenues from our Meridian Auto-Injector segment decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to lower unit sales of products sold to government entities.

Revenues from the Meridian Auto-Injector segment fluctuate based on the buying patterns of Dey, L.P. and government customers. With respect to auto-injector products sold to government entities, demand for these products is affected by the cyclical nature of procurements as well as response to domestic and international events. Demand for EpiPen® is seasonal as a result of its use in the emergency treatment of allergic reactions for both insect stings or bites, more of which occur in the warmer months, and food allergies, for which demand increases in the months preceding the start of a new school year. Most of our EpiPen® sales are based on our supply agreement with Dey, L.P., which markets, distributes and sells the product worldwide, except for Canada where it is marketed, distributed and sold by us. Total prescriptions for EpiPen® in the United States increased approximately 6.5% in the first quarter of 2010 compared to the first quarter of 2009 according to IMS monthly prescription data.

***Royalties and other***

Revenues from royalties are derived primarily from payments we receive based on sales of Adenoscan®. We are not responsible for the marketing of this product.

On April 10, 2008, CV Therapeutics, Inc. and Astellas Pharma US, Inc. ( Astellas US ) announced that the FDA approved regadenoson injection, an A2A adenosine receptor agonist product that competes with Adenoscan®. Regadenoson has been commercialized by Astellas US. Astellas US is also responsible for the marketing and sale of Adenoscan® pursuant to agreements we have with Astellas US. With the commercial launch of regadenoson, sales of Adenoscan and our royalty revenue have declined and may continue to decline. However, our agreements with Astellas US provide for minimum royalty revenue payments to us of \$40.0 million per year for three years (beginning June 1, 2008 and ending May 31, 2011). Therefore, we will continue to receive royalties on the sale of Adenoscan® through expiration of the patents covering the product, although the minimum guaranteed portion of the royalty payments would terminate upon certain events, including a finding of invalidity or unenforceability of the patents related to Adenoscan®.

In October 2007, we entered into an agreement with Astellas US and a subsidiary of Teva Pharmaceutical Industries Ltd. providing Teva with the right to launch a generic version of Adenoscan® pursuant to a license in September 2012 or earlier under certain conditions.

**Operating Costs and Expenses**

	<b>For the Three Months</b>		<b>Change</b>	
	<b>Ended March 31,</b>		<b>2010 vs. 2009</b>	
	<b>2010</b>	<b>2009</b>	<b>\$</b>	<b>%</b>
	<b>(In thousands)</b>			
Cost of revenues, exclusive of depreciation and amortization	\$ 127,054	\$ 150,939	\$ (23,885)	(15.8)%
Selling, general and administrative	140,475	142,323	(1,848)	(1.3)
Research and development	28,324	27,256	1,068	3.9
Depreciation and amortization	57,275	53,349	3,926	7.4
Restructuring charges	262	48,050	(47,788)	(99.5)

Total operating costs and expenses	\$ 353,390	\$ 421,917	\$ (68,527)	(16.2)%
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***Cost of Revenues***

Cost of revenues decreased in the first quarter of 2010 versus the first quarter of 2009 primarily due to the decrease of a special item related to the acquisition of Alpharma, as described below, partially offset by costs associated with the addition of Embeda<sup>®</sup>, which we began selling in late September 2009, and an increase in the Skelaxin<sup>®</sup> royalty rate.

**Table of Contents**

The royalty rate on Skelaxin<sup>®</sup> increased in the second quarter of 2009 due to the achievement of certain regulatory milestones under our agreement with Mutual. For additional information on the Mutual agreement, please see Other within the Liquidity and Capital Resources section below.

Special items are those particular material income or expense items that our management believes are not related to our ongoing, underlying business, are not recurring, or are not generally predictable. These items include, but are not limited to, merger and restructuring expenses; non-capitalized expenses associated with acquisitions, such as in-process research and development charges and inventory valuation adjustment charges; charges resulting from the early extinguishments of debt; asset impairment charges; expenses of drug recalls; and gains and losses resulting from the divestiture of assets. We believe the identification of special items enhances an analysis of our ongoing, underlying business and an analysis of our financial results when comparing those results to that of a previous or subsequent like period. However, it should be noted that the determination of whether to classify an item as a special item involves judgments by us.

At the time of the acquisition of Alharma, we valued the inventory that was acquired based on the accounting requirements for business combinations. As a result, we increased the carrying value of the Flector<sup>®</sup> Patch and Animal Health inventory by approximately \$42.1 million. During the first quarter of 2009, the cost of revenues reflects a charge of \$21.5 million related to the sale of this marked up inventory.

***Selling, General and Administrative Expenses***

	<b>For the Three Months</b>		<b>Change</b>	
	<b>Ended March 31,</b>		<b>2010 vs. 2009</b>	
	<b>2010</b>	<b>2009</b>	<b>\$</b>	<b>%</b>
	<b>(In thousands)</b>			
Selling, general and administrative	\$ 140,475	\$ 138,534	\$ 1,941	1.4%
Acquisition related costs		3,789	(3,789)	(100.0)
Total selling, general and administrative	\$ 140,475	\$ 142,323	\$ (1,848)	(1.3)%

As a percentage of total revenues, total selling, general, and administrative expenses were 36.9% and 33.2% in the first quarter of 2010 and the first quarter of 2009, respectively.

Total selling, general and administrative expenses decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to a decrease in expenses resulting from the integration of Alharma, a restructuring initiative related to Skelaxin<sup>®</sup>, and a reduction in special charges, partially offset by an increase in marketing due to the launch of Embeda<sup>®</sup>.

Alharma was purchased on December 29, 2008. The integration of Alharma was substantially completed by the end of the first quarter of 2009. During the first quarter of 2009, therefore, selling, general and administrative costs included costs associated with Alharma corporate and pharmaceutical management division employees and related activities.

Following the January 2009 court order ruling invalid two patents relating to Skelaxin<sup>®</sup>, our senior management team conducted an extensive examination of our company and implemented a restructuring initiative. The initiative included, based on an analysis of our strategic needs: a reduction in sales, marketing and other personnel; leveraging

of staff; expense reductions and additional controls over spending; and reorganization of sales teams.

We incurred a special charge in the first quarter of 2010 of \$1.7 million related to a litigation settlement offer and a special charge of \$3.8 million in the first quarter of 2009 for costs related to the acquisition and integration of Alharma.

***Research and Development Expense***

Research and development represents expense associated with the ongoing development of investigational drugs and product life-cycle management projects in our research and development pipeline. These expenses increased due to the timing of costs incurred on our current research and development projects. For a discussion regarding recent research and development activities, please see [Recent Developments](#) above.



**Table of Contents*****Depreciation and Amortization Expense***

Depreciation and amortization expense increased in the first quarter of 2010 from the first quarter of 2009 primarily due to an increase in amortization expense associated with Skelaxin®.

Depreciation and amortization expense in the first quarter of 2009 includes special items of \$1.0 million due to accelerated depreciation on certain assets.

In addition, certain generic companies have challenged the patent covering Avinza®. For additional information, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements. If a generic version of Avinza® enters the market or if our current estimates regarding future cash flows adversely change, we may have to write off a portion or all of the intangible assets associated with this product.

***Other Operating Expenses***

We incurred restructuring charges of \$48.1 million in 2009 primarily due to our restructuring initiative related to Skelaxin®. For additional information on the first quarter 2009 restructuring event, please see Note 13, Restructuring Activities, in Part I, Item 1, Financial Statements.

**Non-Operating Items**

	<b>For the Three Months Ended March 31, 2010                  2009 (In thousands)</b>	
Interest income	\$ 409	\$ 2,788
Interest expense	(8,736)	(23,103)
Loss on investment	(872)	(823)
Other, net	(203)	(2,779)
Total other income	(9,402)	(23,917)
Income tax expense (benefit)	13,594	(6,055)

***Interest Income***

Interest income decreased during the first quarter of 2010 compared to the first quarter of 2009 primarily due to a lower average balance of cash, cash equivalents and investments in debt securities in the first quarter of 2010 compared to the first quarter of 2009, and a decrease in interest rates. Cash and cash equivalents decreased in the first quarter of 2009 due to the payment of the Alpharma Convertible Senior Notes. In addition, redemptions of our auction rate securities of approximately \$145.9 million during 2009 and the first quarter of 2010 were used to reduce long-term debt.

***Interest Expense***

Interest expense decreased in the first quarter of 2010 compared to the first quarter of 2009 primarily due to a decrease in borrowings. Our December 29, 2008 acquisition of Alpharma was funded with available cash on hand, borrowings of \$425.0 million under the Senior Secured Revolving Credit Facility, and borrowings of \$200.0 million under a

Senior Secured Term Facility. We made payments of \$918.0 million related to long-term debt during 2009, which consisted of \$200.0 million related to the Senior Secured Term Facility, \$332.7 million related to the Senior Secured Revolving Credit Facility, and \$385.2 million related to the Alparma Convertible Senior Notes. In addition, during the first quarter of 2010, the remaining outstanding borrowings of \$92.3 million under the Senior Secured Revolving Credit Facility were paid in full.

Special items affecting other income (expense) included the following:

The liability and equity components of the \$400,000 11/4% Convertible Senior Notes due April 1, 2026 (the Convertible Senior Notes ) have been separately accounted for in a manner that reflects our nonconvertible debt borrowing rate at the date of issuance. The debt component is being amortized through March 31, 2013,

## **Table of Contents**

which is reflected as an increase in interest expense. Interest expense in the first quarter of 2010 and 2009 reflects non-cash interest of \$4.7 million and \$4.4 million, respectively, due to the accretion of the debt component of the Convertible Senior Notes.

A loss of \$0.9 million and \$0.8 million in the first quarter of 2010 and 2009, respectively, related to our investments in debt securities.

### ***Income Tax Expense***

During the first quarter of 2010, our effective income tax rate was 75.3%. This rate varied from the statutory rate of 35% due primarily to losses on foreign subsidiaries with no tax benefit, stock compensation and state taxes.

During the first quarter of 2009, our effective income tax rate was a benefit of 36.1%. This rate is greater than the statutory rate of 35% due primarily to benefits from research credits, tax-exempt interest income and domestic manufacturing deductions, which benefits were partially offset by state taxes.

### **Liquidity and Capital Resources**

#### ***General***

We believe that existing balances of cash, cash equivalents, cash generated from operations and our existing revolving credit facility are sufficient to finance our current operations and working capital requirements on both a short-term and long-term basis. However, we cannot predict the amount or timing of our need for additional funds. We cannot provide assurance that funds will be available to us when needed on favorable terms, or at all.

We plan to enter into a new \$500.0 million five-year Senior Secured Revolving Credit Facility in the second quarter of 2010 and terminate the existing \$475.0 million Senior Secured Revolving Credit Facility entered into April 19, 2007 and amended December 5, 2008. In connection with the acquisition of Alpharma on December 29, 2008, we borrowed \$425.0 million in principal under the Senior Secured Revolving Credit Facility which was fully paid by the end of the first quarter of 2010. The existing Senior Secured Revolving Credit Facility allows for borrowings of up to \$150.0 million, as the commitment under this facility was reduced, in accordance with the terms of the facility, as we paid down the borrowings related to the Alpharma acquisition.

#### ***Investments in Debt Securities***

As of March 31, 2010, our investments in debt securities consisted solely of tax-exempt auction rate securities and did not include any mortgage-backed securities or any securities backed by corporate debt obligations. The tax-exempt auction rate securities that we hold are long-term variable rate bonds tied to short-term interest rates that are intended to reset through an auction process generally every seven, 28 or 35 days. Our investment policy requires us to maintain an investment portfolio with a high credit quality. Accordingly, our investments in debt securities were limited to issues which were rated AA or higher at the time of purchase.

In the event that we attempt to liquidate a portion of our holdings through an auction and are unable to do so, we term it an auction failure. On February 11, 2008, we began to experience auction failures. As of March 31, 2010, all our investments in auction rate securities, with a total par value of \$264.1 million, have experienced multiple failed auctions. In the event of an auction failure, the interest rate on the security is reset according to the contractual terms in the underlying indenture. As of May 3, 2010, we have received all scheduled interest payments associated with these securities.

We will be unable to liquidate these securities until a successful auction occurs, the issuer calls or restructures the underlying security, the underlying security matures or is purchased by a buyer outside the auction process. Based on the frequency of auction failures and the lack of market activity, current market prices are not available for determining the fair value of these investments. As a result, we have measured \$260.3 million in par value of our investments in debt securities and the UBS put right discussed below, or 36.8% of the assets that we have measured at fair value, using unobservable inputs, which are classified as Level 3 measurements. For additional information regarding this, please see Note 3, Fair Value Measurements, in Part I, Item 1, Financial Statements.

**Table of Contents**

As of March 31, 2010, there were cumulative unrealized holding losses of \$25.5 million recorded in accumulated other comprehensive income (loss) on the Condensed Consolidated Balance Sheet associated with investments in debt securities with a par value of \$223.0 million classified as available for sale. All of these investments in debt securities have been in continuous unrealized loss positions for greater than twelve months. As of March 31, 2010, we believed the decline was temporary and it was probable that the par amount of these auction rate securities would be collectible under their contractual terms.

During the first quarter of 2010, we sold certain auction rate securities associated with student loans with a par value of \$8.0 million for \$7.4 million to the issuer and realized a loss of \$0.6 million in the Condensed Consolidated Statements of Operations. We have not sold any other investments in debt securities below par value during the periods presented in the accompanying Condensed Consolidated Statements of Operations.

During the fourth quarter of 2008, we accepted an offer from UBS Financial Services, Inc. ( UBS ) providing us the right to sell to UBS at par value certain auction rate securities during the period from June 30, 2010 to July 2, 2012 (the right ). At March 31, 2010 and December 31, 2009 we held auction rate securities related to this offer with a par value of \$26.1 million and \$32.5 million, respectively. We have elected the fair value option to account for this right. As a result, gains and losses associated with this right are recorded in other income (expense) in the Condensed Consolidated Statements of Operations. The value of the right to sell certain auction rate securities to UBS was estimated considering the present value of future cash flows, the fair value of the auction rate security and counterparty risk. As of March 31, 2010 and December 31, 2009, the fair value of the right to sell the auction rate securities to UBS at par was \$2.4 million and \$3.2 million, respectively. With respect to this right, we recognized an unrealized loss of \$0.8 million during the first quarter of 2010 and an unrealized loss of \$0.6 million during the first quarter of 2009 in other income (expense) in the Condensed Consolidated Statements of Operations.

In addition, during the fourth quarter of 2008, we reclassified the auction rate securities that are included in this right from available-for-sale securities to trading securities. As of March 31, 2010 and December 31, 2009, the fair value of the investments in debt securities classified as trading was \$23.4 million and \$29.3 million, respectively. During the first quarter of 2010 and the first quarter of 2009, we recognized unrealized gains of \$0.6 million and unrealized losses of \$0.3 million, respectively, in other income (expense) in the Condensed Consolidated Statements of Operations.

As of March 31, 2010, we had unrealized holding gains of \$1.8 million associated with a security that was previously impaired, as it was determined that the losses in previous periods were other-than-temporary.

As of March 31, 2010, we had approximately \$264.1 million, in par value, invested in tax-exempt auction rate securities which consisted of \$150.5 million associated with student loans backed by the Federal Family Education Loan Program (FFELP), \$87.6 million associated with municipal bonds in which performance is supported by bond insurers and \$26.0 million associated with student loans collateralized by loan pools which equal at least 200% of the bond issue.

As of March 31, 2010, we classified \$27.1 million of auction rate securities as current assets and \$204.8 million as long-term assets.

***Skelaxin***<sup>®</sup>

As previously disclosed, we are involved in multiple legal proceedings over patents relating to our product Skelaxin<sup>®</sup>. In January 2009, the U.S. District Court for the Eastern District of New York issued an order ruling invalid two of these patents. In June 2009, the Court entered judgment against us. We have appealed the judgment and intend to vigorously defend our interests. Generic versions of Skelaxin<sup>®</sup> entered the market early in the second quarter of 2010. Net sales of Skelaxin<sup>®</sup> will decline significantly as a result of generic competition. For additional information

regarding Skelaxin® litigation, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements .

Following the decision of the District Court in January 2009, we conducted an extensive examination of the company and developed a restructuring initiative. Based on an analysis of our strategic needs, this initiative included: a reduction in branded prescription pharmaceutical sales, marketing and other personnel; leveraging of staff; expense reductions and additional controls over spending; and reorganization of sales teams.

**Table of Contents**

We incurred total restructuring costs of approximately \$50.0 million, almost all of which was paid during the second quarter of 2009. These costs relate to severance pay and other employee termination expenses. For additional information, please see Note 13, *Restructuring Activities* in Part I, Item 1, *Financial Statements*.

***Kadian***<sup>®</sup>

In connection with the acquisition of Alparma, we and Alparma executed a consent order (the *Consent Order*) with the U.S. Federal Trade Commission. The *Consent Order* required us to divest the assets related to Alparma's branded oral long-acting opioid analgesic drug *Kadian*<sup>®</sup> to Actavis Elizabeth, L.L.C., ( *Actavis LLC* ). In accordance with the *Consent Order*, effective upon the acquisition of Alparma, on December 29, 2008, we divested the *Kadian*<sup>®</sup> product to Actavis LLC. Actavis LLC is entitled to sell *Kadian*<sup>®</sup> as a branded or generic product. Prior to this divestiture, Actavis LLC supplied *Kadian*<sup>®</sup> to Alparma.

Actavis LLC will pay a purchase price of up to an aggregate of \$127.5 million in cash based on the achievement of certain *Kadian*<sup>®</sup> quarterly gross profit-related milestones for the period beginning January 1, 2009 and ending June 30, 2010. The maximum purchase price payment associated with each calendar quarter is as follows:

	<b>Maximum Purchase Price Payment</b>
First Quarter 2009	\$30.0 million
Second Quarter 2009	25.0 million
Third Quarter 2009	25.0 million
Fourth Quarter 2009	20.0 million
First Quarter 2010	20.0 million
Second Quarter 2010	7.5 million

None of the quarterly payments above, when combined with all prior payments made by Actavis LLC, can exceed the aggregate amount of gross profits from the sale of *Kadian*<sup>®</sup> in the United States by Actavis LLC and its affiliates for the period beginning on January 1, 2009 and ending on the last day of such calendar quarter. Any quarterly purchase price payment that is not paid by Actavis LLC due to the application of such provision will be carried forward to the next calendar quarter, increasing the maximum quarterly payment in the subsequent quarter. However, the cumulative purchase price payable by Actavis LLC will not exceed the lesser of (a) \$127.5 million and (b) the gross profits from the sale of *Kadian*<sup>®</sup>, as determined by the agreement, in the United States by Actavis LLC and its affiliates for the period from January 1, 2009 through June 30, 2010. At the time of the divestiture, we recorded a receivable of \$115.0 million reflecting the present value of the estimated future purchase price payments from Actavis LLC. There was no gain or loss recorded as a result of the divestiture. In accordance with the agreement, quarterly payments are received one quarter in arrears. During the first quarter of 2010, we received \$20.0 million from Actavis LLC related to gross profit from sales during the fourth quarter of 2009.

***Alparma***

As part of the integration of Alparma, management developed a restructuring initiative to eliminate redundancies in operations created by the acquisition. This initiative included, based on an analysis of our strategic needs: a reduction in sales, marketing and other personnel; leveraging of staff; expense reductions and additional controls over spending; and reorganization of sales teams.

We estimated total costs of approximately \$71.1 million associated with this restructuring plan, almost all of which are cash-related costs. All employee termination costs are expected to be paid by the second quarter of 2012. All contract termination costs are expected to be paid by the end of 2018. For additional information, please see Note 13, Restructuring Activities, in Part I, Item 1, Financial Statements.

During the first quarter of 2009, we paid \$385.2 million to redeem the Convertible Senior Notes of Alharma outstanding at the time of the acquisition and at December 31, 2008. For additional information, please see Alharma Convertible Senior Notes in Note 8, Long-Term Debt in Part I, Item 1, Financial Statements.



**Table of Contents**

***Senior Secured Revolving Credit Facility***

On April 19, 2007, we entered into a new \$475.0 million five-year Senior Secured Revolving Credit Facility ( Revolving Credit Facility ), as amended on December 5, 2008. The Revolving Credit Facility matures in April 2012 or in September 2011 if the Convertible Senior Notes have not been refinanced.

In connection with the acquisition of Alpharma on December 29, 2008, we borrowed \$425.0 million in principal amount under the Revolving Credit Facility.

During 2009 and the first quarter of 2010, we made payments of \$332.7 million and \$92.3 million, respectively, on the Revolving Credit Facility, \$203.2 million in excess of the required amounts, which represented full payment of all borrowings under the Revolving Credit Facility. The average interest rate on borrowings under the Revolving Credit Facility was 5.3% in the first quarter of 2010. The availability under the Revolving Credit Facility was \$150.0 million as of April 30, 2010. As of April 30, 2010, the remaining undrawn commitment amount under the Revolving Credit Facility totals approximately \$146.9 million after giving effect to outstanding letters of credit totaling approximately \$3.1 million.

If we should undertake future borrowings under the Revolving Credit Facility, we would be required to make annual prepayments equal to 50% of our annual excess cash flows, which could be reduced to 25% under certain conditions. In addition, we would be required to make prepayments upon the occurrence of certain events, such as an asset sale, the issuance of debt or equity or the liquidation of auction rate securities.

We have the right to prepay, without penalty (other than customary breakage costs), any borrowing under the Revolving Credit Facility.

For additional discussion regarding the Revolving Credit Facility, please see Senior Secured Revolving Credit Facility within the Certain Indebtedness and Other Matters section below.

***CorePharma, LLC***

In June 2008, we entered into a Product Development Agreement with CorePharma to collaborate in the development of new formulations of metaxalone that we currently market under the brand name Skelaxin®. Under the agreement, we and CorePharma granted each other non-exclusive cross-licenses to certain pre-existing intellectual property. Any intellectual property created as a result of the agreement will belong to us and we will grant CorePharma a non-exclusive, royalty-free license to use this newly created intellectual property with any product not containing metaxalone. In the second quarter of 2008, we made a non-refundable cash payment of \$2.5 million to CorePharma. Under the terms of the agreement, we will reimburse CorePharma for the cost to complete the development activities incurred under the agreement, subject to a cap. In addition, we could be required to make milestone payments based on the achievement and success of specified development activities and the achievement of specified net sales thresholds of such formulations, as well as royalty payments based on net sales.

***Acura Pharmaceuticals, Inc.***

In October 2007, we entered into a License, Development and Commercialization Agreement with Acura to develop and commercialize certain opioid analgesic products utilizing Acura's Aversio® Technology in the United States, Canada and Mexico. The agreement provides us with an exclusive license for Acurox® Tablets and another opioid product utilizing Acura's Aversio® Technology. In addition, the agreement provides us with an option to license all future opioid analgesic products developed utilizing Acura's Aversio® Technology. In May 2008 and December 2008, we exercised our options for third and fourth immediate-release opioid products under the agreement. In

connection with the exercise of the options, we paid non-refundable option exercise fees to Acura of \$3.0 million for each option.

Under the terms of the agreement, we made a non-refundable cash payment of \$30.0 million to Acura in December 2007. In addition, we will reimburse Acura for all research and development expenses incurred beginning from September 19, 2007 for Acurox<sup>®</sup> Tablets and all research and development expenses related to future products after the exercise of our option to an exclusive license for each future product. We may make additional non-refundable cash milestone payments to Acura based on the successful achievement of certain

## **Table of Contents**

clinical and regulatory milestones for Acurox<sup>®</sup> Tablets and for each other product developed under the agreement. In June 2008, we made a milestone payment of \$5.0 million associated with positive top-line results from the Phase III clinical trial evaluating Acurox<sup>®</sup> Tablets. We will also make an additional \$50.0 million non-refundable cash milestone payment to Acura in the first year that the aggregate net sales of all products developed under the agreement exceeds \$750.0 million. In addition, we will make royalty payments to Acura ranging from 5% to 25% based on the level of combined annual net sales of all products developed under the agreement.

### ***Avinza<sup>®</sup>***

In September 2006, we entered into a definitive asset purchase agreement and related agreements with Ligand to acquire rights to Avinza<sup>®</sup> (morphine sulfate long-acting). Avinza<sup>®</sup> is a long-acting formulation of morphine and is indicated as a once-daily treatment for moderate to severe pain in patients who require continuous opioid therapy for an extended period of time.

As part of the transaction, we have agreed to pay Ligand an ongoing royalty through November 2017 and assume payment of Ligand's royalty obligations to third parties. We paid Ligand a royalty of 15% of net sales of Avinza<sup>®</sup> until October 2008. Subsequent royalty payments to Ligand are based upon calendar year net sales of Avinza<sup>®</sup> as follows:

If calendar year net sales are less than \$200.0 million, the royalty payment will be 5% of all net sales.

If calendar year net sales are greater than \$200.0 million, then the royalty payment will be 10% of all net sales up to \$250.0 million, plus 15% of net sales greater than \$250.0 million.

### ***Patient Protection and Affordable Care Act***

On March 23, 2010, the Patient Protection and Affordable Care Act ( PPACA ) was signed into law. We expect that the new legislation will increase Medicaid rebates paid by us in the future, primarily due to an increase in Medicaid rebate rates, changes to the calculation of Medicaid rebates for new formulations of existing products, and an expansion of Medicaid rebates to products supplied to enrollees of Medicaid managed care organizations. We anticipate higher Medicaid rebates in future periods. For the full year of 2010, we expect rebates to increase by approximately \$15.0 million as a result of the PPACA.

In addition, the PPACA will impose an annual fee on pharmaceutical manufacturers beginning in 2011. The fee will be payable no later than September 30 of each applicable year and will be allocated to pharmaceutical manufacturers based on relative market share.

### ***Other***

In March 2006, we acquired the exclusive right to market, distribute and sell EpiPen<sup>®</sup> throughout Canada and certain other assets from AllereX Laboratory LTD ( AllereX ). Under the terms of the agreements, the initial purchase price was approximately \$23.9 million, plus acquisition costs of approximately \$0.7 million. As an additional component of the purchase price, we pay AllereX an earn-out equal to a percentage of future sales of EpiPen<sup>®</sup> in Canada over a fixed period of time. As these additional payments accrue, we increase intangible assets by the amount of the accrual. As of March 31, 2010, we have incurred a total of \$12.7 million for these earn-out payments. The aggregate amount of these payments will not exceed \$13.2 million.

In December 2005, we entered into a cross-license agreement with Mutual related to Skelaxin<sup>®</sup>. Under the terms of the agreement, each of the parties has granted the other a worldwide license to certain intellectual property, including patent rights and know-how, relating to metaxalone. As of January 1, 2006, we began paying royalties to Mutual on

net sales of products containing metaxalone. This royalty increased in the fourth quarter of 2006 and the second quarter of 2009 due to the achievement of certain milestones. The royalty percentage we pay to Mutual is currently in the low-double-digit and could potentially increase by an additional 10% depending on the achievement of certain regulatory and commercial milestones in the future. In the event certain specified net sales levels are not achieved, the royalty could be reduced to a lower double-digit or single-digit rate. No increases in the royalty rate are presently anticipated. The royalty we pay to Mutual is in addition to the royalty we pay to Elan Corporation, plc on our current formulation of metaxalone, Skelaxin<sup>®</sup>.

**Table of Contents**

During the fourth quarter of 2005, we entered into a strategic alliance with Pain Therapeutics to develop and commercialize Remoxy® and other opioid painkillers. Under the strategic alliance, we made an upfront cash payment of \$150.0 million in December 2005 and made a milestone payment of \$5.0 million in July 2006 to Pain Therapeutics. In August 2008, we made milestone payments totaling \$20.0 million. In addition, we may pay additional milestone payments of up to \$125.0 million in cash based on the successful clinical and regulatory development of Remoxy® and other opioid products. This amount includes \$15.0 million upon FDA approval of Remoxy®. In March 2009, we exercised rights under our Collaboration Agreement with Pain Therapeutics and assumed sole control and responsibility for the development of Remoxy®. This includes all communications with the FDA regarding Remoxy® and ownership of the Remoxy® NDA. We are responsible for research and development expenses related to this alliance subject to certain limitations set forth in the agreement. After regulatory approval and commercialization of Remoxy® or other products developed through this alliance, we will pay a royalty of 15% of the cumulative net sales up to \$1.0 billion and 20% of the cumulative net sales over \$1.0 billion.

**Patent Challenges**

Certain generic companies have challenged patents on Skelaxin®, Avinza® and EpiPen®. For additional information, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements. Generic versions of Skelaxin® entered the market early in the second quarter of 2010. Net sales of Skelaxin® will decline significantly as a result of generic competition, which will materially adversely affect the results of operations and cash flows. If a generic version of Avinza® or EpiPen® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected.

**Cash Flows****Operating Activities**

	<b>For the Three Months Ended March 31, 2010                      2009 (In thousands)</b>	
Net cash (used in) provided by operating activities	\$ (1,801)	\$ 11,334

Our net cash from operations was lower in the first quarter of 2010 than in the first quarter of 2009 primarily due to a decrease in net sales of several key branded prescription pharmaceutical products and payment of \$42.5 million to the DOJ. Please see the section above entitled Results of Operations for a discussion of net sales.

During the first quarter of 2010, we made a payment of \$42.5 million, plus interest of \$0.6 million, to the DOJ. For additional information related to the DOJ settlement, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements.

In addition, we made cash payments related to the Skelaxin® and Alpharma restructuring actions during the first quarter of 2009 and the first quarter of 2010 which reduced operating cash flows. For information regarding the restructuring actions, please see Note 13, Restructuring Activities in Part I, Item 1, Financial Statements.

**Table of Contents**

The following table summarizes the changes in operating assets and liabilities and deferred taxes for the three months ended March 31, 2010 and 2009:

	<b>For the Three Months Ended March 31, 2010                      2009 (In thousands)</b>	
Accounts receivable, net of allowance	\$ 1,866	\$ 16,726
Inventories	(7,663)	(20,345)
Prepaid expenses and other current assets	(9,873)	1,437
Accounts payable	5,469	(45,471)
Accrued expenses and other liabilities	(70,725)	(18,853)
Income taxes payable	(905)	(9,552)
Deferred revenue	(1,170)	(1,170)
Other assets	(4,614)	988
Deferred taxes	11,650	(5,135)
 Total changes from operating assets and liabilities and deferred taxes	 \$ (75,965)	 \$ (81,375)

**Investing Activities**

	<b>For the Three Months Ended March 31, 2010                      2009 (In thousands)</b>	
Net cash provided by (used in) investing activities	\$ 28,583	\$ (63,806)

Our cash flows from investing activities for the first quarter of 2010 were primarily due to net sales of our investments in debt securities of \$16.8 million, and proceeds related to the sale of Kadian® of \$20.0 million, partially offset by capital expenditures of \$7.8 million. Our cash flows from investing activities for the first quarter of 2009 were primarily due to payments associated with Alharma employee stock-based awards in connection with our acquisition of Alharma.

We anticipate capital expenditures, including capital lease obligations, for the year ending December 31, 2010 of approximately \$40.0 million to \$50.0 million, which will be funded with cash from operations. The principal capital expenditures are anticipated to include costs associated with the preparation of our facilities to manufacture new products as they emerge from our research and development pipeline.

**Financing Activities**

	<b>For the Three Months Ended March 31, 2010                      2009</b>	
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**(In thousands)**

Net cash used in financing activities	\$ (95,717)	\$ (436,433)
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Our cash flows from financing activities for the first quarter of 2010 and the first quarter of 2009 are primarily related to payments on long-term debt. During the first quarter of 2010, we made payments of \$92.3 million on the Revolving Credit Facility, which represented full payment of all outstanding borrowings. During the first quarter of 2009, we paid \$385.2 million to redeem the Alharma Convertible Senior Notes. In addition, we paid \$32.1 million on the Senior Secured Revolving Credit Facility and \$15.9 million on the Senior Secured Term Facility.

***Certain Indebtedness and Other Matters******Convertible Senior Notes***

The Convertible Senior Notes, issued in 2006, are unsecured obligations and are guaranteed by each of our domestic subsidiaries on a joint and several basis. The Convertible Senior Notes accrue interest at an initial rate of 11/4%. Beginning with the six-month interest period that commences on April 1, 2013, we will pay additional

**Table of Contents**

interest during any six-month interest period if the average trading price of the Convertible Senior Notes during the five consecutive trading days ending on the second trading day immediately preceding the first day of such six-month period equals 120% or more of the principal amount of the Convertible Senior Notes. Interest is payable on April 1 and October 1 of each year.

On or after April 5, 2013, we may redeem for cash some or all of the Convertible Senior Notes at any time at a price equal to 100% of the principal amount of the Convertible Senior Notes to be redeemed, plus any accrued and unpaid interest, and liquidated damages, if any, up to but excluding the date fixed for redemption. Holders may require us to purchase for cash some or all of their Convertible Senior Notes on April 1, 2013, April 1, 2016 and April 1, 2021, or upon the occurrence of a fundamental change, at 100% of the principal amount of the Convertible Senior Notes to be purchased, plus any accrued and unpaid interest, and liquidated damages, if any, up to but excluding the purchase date.

***Senior Secured Revolving Credit Facility***

On April 19, 2007, we entered into a new \$475.0 million five-year Revolving Credit Facility, as amended on December 5, 2008. The Revolving Credit Facility matures in April 2012 or in September 2011 if the Convertible Senior Notes have not been refinanced.

In connection with our acquisition of Alpharma on December 29, 2008, we borrowed \$425.0 million in principal. As of December 31, 2009, \$92.3 million was outstanding under the Revolving Credit Facility. During the first quarter of 2010, all borrowings under the Revolving Credit Facility were fully paid. As of March 31, 2010, there were no outstanding borrowings under the Revolving Credit Facility and letters of credit totaled \$3.1 million.

In connection with the borrowings, we incurred approximately \$22.2 million of deferred financing costs that are being amortized ratably from the date of the borrowing through the maturity date.

As discussed above, we have repaid our borrowings under the Revolving Credit Facility. Should we undertake future borrowings we would have the right, without penalty (other than customary breakage costs), to prepay any borrowing under the Revolving Credit Facility and, subject to certain conditions, we could be required to make mandatory prepayments. For additional discussion regarding the Revolving Credit Facility, please see *Liquidity and Capital Resources* *Senior Secured Revolving Credit Facility* above.

Our borrowings under the Revolving Credit Facility bear interest at annual rates that, at our option, will be either:

a base rate generally defined as the sum of (i) the greater of (a) the prime rate of Credit Suisse and (b) the federal funds effective rate plus 0.5% and (ii) 4.0%; or

an adjusted rate generally defined as the sum of (i) the product of (a) LIBOR (by reference to the British Banking Association Interest Settlement Rates) and (b) a fraction, the numerator of which is one and the denominator of which is the number one minus certain maximum statutory reserves for Eurocurrency liabilities and (ii) 5.0%.

Interest on our borrowings is payable quarterly, in arrears, for base rate loans and at the end of each interest rate period (but not less often than quarterly) for LIBO rate loans. We are required to pay an unused commitment fee on the difference between committed amounts and amounts actually borrowed under the Revolving Credit Facility equal to 0.5% per annum. We are required to pay a letter of credit participation fee based upon the aggregate face amount of outstanding letters of credit equal to 5.0% per annum.



The Revolving Credit Facility requires us to meet certain financial tests, including, without limitation:

maintenance of maximum funded debt to consolidated EBITDA ratios that range from 1.50:1 to 3.25:1 (depending on dates and the occurrence of certain events relating to certain patents); and

maintenance of minimum consolidated EBITDA to interest expense ratios that range from 3.75:1 to 4.00:1 (depending on dates and the occurrence of certain events relating to certain patents).

As of March 31, 2010, we were in compliance with these covenants.

## **Table of Contents**

In addition, the Revolving Credit Facility contains certain covenants that, among other things, restrict additional indebtedness, liens and encumbrances, sale and leaseback transactions, loans and investments, acquisitions, dividends and other restricted payments, transactions with affiliates, asset dispositions, mergers and consolidations, prepayments, redemptions and repurchases of other indebtedness, capital expenditures and other matters customarily restricted in such agreements. The Revolving Credit Facility contains customary events of default, including, without limitation, payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to certain other material indebtedness in excess of specified amounts, certain events of bankruptcy and insolvency, certain ERISA events, judgments in excess of specified amounts, certain impairments to the guarantees, and change in control.

The Revolving Credit Facility requires us to pledge as collateral substantially all of our assets, including 100% of the equity of our U.S. subsidiaries and 65% of the equity of any material foreign subsidiaries. Our obligations under this facility are unconditionally guaranteed on a senior basis by all of our U.S. subsidiaries.

The Revolving Credit Facility requires us to maintain hedging agreements that will fix the interest rates on 50% of our outstanding long-term debt for a period of not less than two years.

### ***Impact of Inflation***

We have experienced only moderate raw material and labor price increases in recent years. In general, the price increases we have passed along to our customers have offset inflationary pressures.

### ***Recently Issued Accounting Standards***

For information regarding recently issued accounting standards, please see Note 10, Accounting Developments, in Part I, Item 1, Financial Statements.

### ***Critical Accounting Policies and Estimates***

We have chosen accounting policies that we believe are appropriate to accurately and fairly report our operating results and financial position, and apply those accounting policies in a consistent manner.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Significant estimates for which it is reasonably possible that a material change in estimate could occur in the near term include forecasted future cash flows used in testing for impairments of intangible and tangible assets and loss accruals for excess inventory and fixed purchase commitments under our supply contracts. Forecasted future cash flows in particular require considerable judgment and are subject to inherent imprecision. In the case of impairment testing, changes in estimates of future cash flows could result in a material impairment charge and, whether they result in an immediate impairment charge, could result prospectively in a reduction in the estimated remaining useful life of tangible or intangible assets, which could be material to the financial statements.

Other significant estimates include accruals for Medicaid, Medicare, and other rebates, returns and chargebacks, allowances for doubtful accounts, the fair value of our investments in debt securities, and estimates used in applying the revenue recognition policy.

We are subject to risks and uncertainties that may cause actual results to differ from the related estimates, and our estimates may change from time to time in response to actual developments and new information.

The significant accounting estimates that we believe are important to aid in fully understanding our reported financial results include the following:

*Intangible assets, goodwill, and other long-lived assets.* When we acquire product rights in conjunction with either business or asset acquisitions, we allocate an appropriate portion of the purchase price to intangible assets, goodwill and other long-lived assets. The purchase price is allocated to products, acquired

**Table of Contents**

research and development, if any, and other intangibles using the assistance of valuation consultants. We estimate the useful lives of the assets by factoring in the characteristics of the products such as: patent protection, competition by products prescribed for similar indications, estimated future introductions of competing products, and other issues. The factors that drive the estimate of the life of the asset are inherently uncertain. We use a straight-line method of amortization for our intangible assets.

We review our property, plant and equipment and intangible assets for possible impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. We review our goodwill for possible impairment annually, during the first quarter, or whenever events or circumstances indicate that the carrying amount may not be recoverable. In any event, we evaluate the remaining useful lives of our intangible assets each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. This evaluation is performed through our quarterly evaluation of intangibles for impairment. We review our intangible assets for possible impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating goodwill for impairment, we estimate the fair value of our individual business reporting units on a discounted cash flow basis. Assumptions and estimates used in the evaluation of impairment may affect the carrying value of long-lived assets, which could result in impairment charges in future periods. Such assumptions include projections of future cash flows and, in some cases, the current fair value of the asset. In addition, our depreciation and amortization policies reflect judgments on the estimated useful lives of assets.

We may incur impairment charges in the future if prescriptions for, or sales of, our products are less than current expectations and result in a reduction of our estimated undiscounted future cash flows. This may be caused by many factors, including competition from generic substitutes, significant delays in the manufacture or supply of materials, the publication of negative results of studies or clinical trials, new legislation or regulatory proposals.

The gross carrying amount and accumulated amortization as of March 31, 2010 are as follows:

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization (In thousands)</b>	<b>Net Book Value</b>
<b><i>Branded Prescription Pharmaceuticals</i></b>			
Avinza®	\$ 290,133	\$ 82,372	\$ 207,761
Skelaxin®	288,049	268,070	19,979
Sonata®	61,961	61,961	
Flector® Patch	130,000	14,773	115,227
Neuroscience	770,143	427,176	342,967
Synercid®	70,959	49,330	21,629
Other hospital	8,442	6,808	1,634
Hospital	79,401	56,138	23,263
Bicillin®	92,350	35,897	56,453
Other legacy products	324,035	281,966	42,069
Legacy products	416,385	317,863	98,522

Total Branded	1,265,929	801,177	464,752
<i>Animal Health</i>	169,923	12,041	157,882
<i>Meridian Auto-Injector</i>	184,206	51,789	132,417
<i>Royalties and other</i>	3,731	3,521	210
Total intangible assets	\$ 1,623,789	\$ 868,528	\$ 755,261

**Table of Contents**

The amounts for impairments and amortization expense for the three months ended March 31, 2010 and 2009 are as follows:

	<b>Three Months Ended March 31, 2010</b>		<b>Three Months Ended March 31, 2009</b>	
	<b>Impairments</b>	<b>Amortization Expense</b>	<b>Impairments</b>	<b>Amortization Expense</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
<b><i>Branded Prescription Pharmaceuticals</i></b>				
Avinza®	\$	\$ 6,775	\$	\$ 6,638
Skelaxin®		23,247		20,041
Flector® Patch		2,955		2,955
Neuroscience		32,977		29,634
Synercid®		1,442		1,484
Other hospital		76		76
Hospital		1,518		1,560
Bicillin®		925		925
Other legacy products		1,430		1,430
Legacy products		2,355		2,355
Total Branded		36,850		33,549
<b><i>Animal Health</i></b>		2,408		2,408
<b><i>Meridian Auto-Injector</i></b>		2,168		2,035
<b><i>Royalties and other</i></b>		11		186
Total	\$	\$ 41,437	\$	\$ 38,178

The remaining patent amortization period compared to the remaining amortization period for trademarks and product rights associated with significant products is as follows:

	<b>Remaining Life at March 31, 2010</b>
Skelaxin®	3 months
Avinza®	7 years 8 months
Synercid®	3 years 9 months
Bicillin®	15 years 3 months
Flector® Patch	9 years 9 months

*Inventories.* Our inventories are valued at the lower of cost or market value. We evaluate our entire inventory for short-dated or slow-moving product and inventory commitments under supply agreements based on projections of future demand and market conditions. For those units in inventory that are so identified, we estimate their market value or net sales value based on current realization trends. If the projected net realizable value is less than cost, on a product basis, we make a provision to reflect the lower value of that inventory. This methodology recognizes projected inventory losses at the time such losses are evident rather than at the time goods are actually sold. We maintain supply agreements with some of our vendors which contain minimum purchase requirements. We estimate future inventory requirements based on current facts and trends. Should our minimum purchase requirements under supply agreements, or if our estimated future inventory requirements exceed actual inventory quantities that we will be able to sell to our customers, we record a charge in costs of revenues.

*Accruals for rebates, returns and chargebacks.* We establish accruals for returns, chargebacks, Medicaid, Medicare and commercial rebates in the same period we recognize the related sales. The accruals reduce revenues and are included in accrued expenses. At the time a rebate or chargeback payment is made or a product return is received, which occurs with a delay after the related sale, we record a reduction to accrued expenses and, at the end of each quarter, adjust accrued expenses for differences between estimated and actual payments. Due to estimates and assumptions inherent in determining the amount of returns, chargebacks and rebates, the actual amount of product returns and claims for chargebacks and rebates may be different from our estimates.

**Table of Contents**

Our product returns accrual is primarily based on estimates of future product returns over the period during which customers have a right of return which is in turn based in part on estimates of the remaining shelf life of our products when sold to customers. Future product returns are estimated primarily on historical sales and return rates. We also consider the level of inventory of our products in the distribution channel. We base our estimate of our Medicaid rebate, Medicare rebate and commercial rebate accruals on estimates of usage by rebate-eligible customers, estimates of the level of inventory of our products in the distribution channel that remain potentially subject to those rebates, and the terms of our commercial and regulatory rebate obligations. We base our estimate of our chargeback accrual on our estimates of the level of inventory of our products in the distribution channel that remain subject to chargebacks, and specific contractual and historical chargeback rates. The estimate of the level of our products in the distribution channel is based primarily on data provided by our three key wholesalers under inventory management agreements.

Our accruals for returns, chargebacks and rebates are adjusted as appropriate for specific known developments that may result in a change in our product returns or our rebate and chargeback obligations. In the case of product returns, we monitor demand levels for our products and the effects of the introduction of competing products and other factors on this demand. When we identify decreases in demand for products or experience higher than historical rates of returns caused by unexpected discrete events, we further analyze these products for potential additional supplemental reserves.

*Investments in debt securities.* Prior to the end of the first quarter of 2008, we undertook investments in debt securities. Tax-exempt auction rate securities are long-term variable rate bonds tied to short-term interest rates that are reset through an auction process generally every seven, 28 or 35 days. On February 11, 2008, we began to experience auction failures with respect to our investments in auction rate securities. All of our investments in auction rate securities have experienced multiple failed auctions. We will not be able to liquidate these securities until a successful auction occurs, the issuer calls or restructures the underlying security, the underlying security matures or it is purchased by a buyer outside the auction process. Based on the frequency of auction failures and the lack of market activity, current market prices are not available for determining the fair value of these investments. As a result, we measure these investments using unobservable inputs.

The fair value of investments in debt securities is based on a trinomial discount model. This model considers the probability at the valuation date of three potential occurrences for each auction event through the maturity date of the security. The three potential outcomes for each auction are (i) successful auction/early redemption, (ii) failed auction and (iii) issuer default. Inputs in determining the probabilities of the potential outcomes include, but are not limited to, the security's collateral, credit rating, insurance, issuer's financial standing, contractual restrictions on disposition and the liquidity in the market. The fair value of each security is determined by summing the present value of the probability-weighted future principal and interest payments determined by the model. The discount rate is determined as the loss-adjusted required rate of return using public information such as spreads or near-risk free to risk free assets. The expected term is based on our estimate of future liquidity as of the balance sheet date.

*Revenue recognition.* Revenue is recognized when title and risk of loss are transferred to customers, collection of sales is reasonably assured, and we have no further performance obligations. This is generally at the time products are received by the customer. Accruals for estimated returns, rebates and chargebacks, determined based on historical experience, reduce revenues at the time of sale and are included in accrued expenses. Medicaid and certain other governmental pricing programs involve particularly difficult interpretations of relevant statutes and regulatory guidance, which are complex and, in certain respects, ambiguous. Moreover, prevailing interpretations of these statutes and guidance can change over time. We launched Embeda® in late September 2009. We have recognized revenue on Embeda® in a manner consistent with our other products, as described above, which is generally at the time the product is received by the customer. We believe Embeda® has similar characteristics of certain of our other pharmaceutical products such that we can reliably estimate



expected returns of the product. Royalty revenue is recognized based on a percentage of sales (namely, contractually agreed-upon royalty rates) reported by third parties.

**Table of Contents**

**A WARNING ABOUT FORWARD-LOOKING STATEMENTS**

This report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to analyses and other information which are based on forecasts of future results and estimates of amounts that are not yet determinable. These statements also relate to our future prospects, developments and business strategies.

These forward-looking statements are identified by their use of terms and phrases, such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will and other similar terms and phrases, including assumptions. These statements are contained in the Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations sections, as well as other sections of this report. You should not unduly rely on our forward-looking statements.

Forward-looking statements in this report include, but are not limited to, those regarding:

expectations regarding the outcome of various pending legal proceedings including the Skelaxin<sup>®</sup>, Avinza<sup>®</sup> and EpiPen<sup>®</sup> patent challenges, litigation, and other legal proceedings described in this report;

expectations regarding the enforceability and effectiveness of product-related patents, including, in particular, patents related to Skelaxin<sup>®</sup>, Avinza<sup>®</sup>, EpiPen<sup>®</sup> and Adenoscan<sup>®</sup>;

the potential of, including anticipated net sales and prescription trends for, our branded prescription pharmaceutical products, particularly Skelaxin<sup>®</sup>, Avinza<sup>®</sup>, Thrombin-JMI<sup>®</sup>, Flector<sup>®</sup> Patch, Embeda<sup>®</sup>, Levoxy<sup>®</sup> and Cytome<sup>®</sup>;

expected trends and projections with respect to particular products, reportable segment and income and expense line items;

the adequacy of our liquidity and capital resources and our ability to enter into borrowing arrangements in the future;

anticipated capital expenditures;

the development, approval and successful commercialization of Remoxy<sup>®</sup>, Acurox<sup>®</sup> Tablets, CorVue<sup>™</sup> and other products;

the cost of and the successful execution of our growth and restructuring strategies;

anticipated developments and expansions of our business;

our plans for the manufacture of some of our products, including products manufactured by third parties;

the potential costs, outcomes and timing of research, clinical trials and other development activities involving pharmaceutical products, including, but not limited to, the timing or outcomes of regulatory processes or the magnitude and timing of potential payments to third parties in connection with development activities;

the development of product line extensions;

the expected timing of the initial marketing of certain products;

products developed, acquired or in-licensed that may be commercialized;

our intent, beliefs or current expectations, primarily with respect to our future operating performance;

expectations regarding sales growth, gross margins, manufacturing productivity, capital expenditures and effective tax rates;

expectations regarding our financial condition and liquidity as well as future cash flows and earnings; and

expectations regarding our ability to liquidate our holdings of auction rate securities and the temporary nature of unrealized losses recorded in connection with some of those securities.

**Table of Contents**

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from those contemplated by our forward-looking statements. These known and unknown risks, uncertainties and other factors are described in detail in the Risk Factors section and in other sections of this report.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

We are exposed to market risk for changes in the market values of some of our investments ( Investment Risk ), the effect of interest rate changes ( Interest Rate Risk ) and the effect of changes in foreign currency exchange rates ( Foreign Currency Exchange Rate Risk ). At March 31, 2010, we held derivative financial instruments associated with the Convertible Senior Notes. There have been no material changes in our exposure to these items since our disclosure under Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2009, except that we fully repaid all borrowings under the Revolving Credit Facility in the first quarter of 2010, which carried a variable rate of interest.

**Item 4. *Controls and Procedures***

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act )). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to reasonably ensure that information required to be disclosed and filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified, and that management will be timely alerted to material information required to be included in our periodic reports filed with the SEC.

There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

The information required by this Item is incorporated by reference to Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements.

**Item 1A. Risk Factors**

We have disclosed a number of material risks under Item 1A of our annual report on Form 10-K for the year ended December 31, 2009, which we filed with the Securities and Exchange Commission on February 26, 2010. Please also see the additional risk factor below.

*Net sales of Skelaxin® will decline significantly as the result of competition from generic products.*

In January 2009, the U.S. District Court for the Eastern District of New York issued an order ruling invalid two Skelaxin® patents. In June 2009, the Court entered judgment against the Company. The Company has appealed and intends to vigorously defend its interests. Generic versions of Skelaxin® entered the market early in the second quarter of 2010. The Company's net sales of Skelaxin® will decline significantly as a result of this generic competition.

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
10.1*(1)	Form of Option Certificate and Nonstatutory Stock Option Agreement
10.2*(1)	Form of Restricted Stock Certificate and Restricted Stock Grant Agreement
10.3*(1)	Form of Long-Term Performance Unit Award Agreement One-Year Performance Cycle
10.4*(1)	Form of Long-Term Performance Unit Award Agreement Three-Year Performance Cycle
10.5	Settlement Agreement, dated as of March 16, 2010, by and among the U.S. Department of Justice on behalf of the Office of Inspector General of the Department of Health and Human Services; the TRICARE Management Activity; the U.S. Office of Personnel Management; Alpharma Inc.; Alpharma Pharmaceuticals LLC; Debra Parks; and King Pharmaceuticals, Inc., as guarantor.
31.1	Certificate of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certificate of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certificate of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certificate of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Denotes management contract or compensatory plan or arrangement.

(1) Incorporated by reference to King's Current Report on Form 8-K, dated March 23, 2010.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KING PHARMACEUTICALS, INC.

By: /s/ Brian A. Markison  
Brian A. Markison  
*President and Chief Executive Officer*

Date: May 5, 2010

By: /s/ Joseph Squicciarino  
Joseph Squicciarino  
*Chief Financial Officer*

Date: May 5, 2010